Global Quality Competition, Offshoring and Wage Inequality

Giammario Impullitti (Cambridge University)

In the 1970s and 1980s the US position as the global technological leader was increasingly challenged by foreign competition from Japan and Europe. In those years the skill premium and residual wage inequality increased substantially in the US. This paper presents a model of innovation and international quality competition with two regions separated by a technology gap. As the lagging region closes the gap, quality-improving innovation, the skill premium, and residual inequality increase in the leading region. Off shoring production and innovation plays a key role in the link between the technology gap and inequality. The quantitative analysis exploits the variation in the geographical distribution of R&D investment in OECD STAN data to construct a measure of the inter national technology gap between the US and the rest of the world. In a calibrated version of the model, the observed reduction in the gap produces up to 1/6th of the surge in the US skill premium and up to about one half of the increase in residual inequality between 1979 and 1995.