*Who wins and who loses from international trade? Discuss.*

Opening to free trade happens when countries remove barriers to trade, facilitating the flow of exports and imports between the nations. Generally, economists have seen international trade as a way for countries to improve their economic welfare. Although moving from an autarky state to free trade is beneficial for the countries in the aggregate, it naturally generates winners and losers (World Trade Organization, 2008). This essay discusses the distributional effects of trade in the context of the underlying theories and reviews the traditional models, linking the theory with empirical observations. Results derived from different models are evaluated to analyse how opening up to free trade impacts countries and individual groups overall.

The Ricardian model of international trade provides a reason for countries to move from autarky to mutual trade based on the principle of comparative advantage. Once trading becomes possible, each state will specialise in the production and exports of goods in which it has a comparative advantage, meaning, these goods have a lower opportunity cost of producing compared to other countries. Under this model, both exporting and importing countries’ consumers attain higher utility by consuming more goods at lower prices. David Ricardo argued: trade is beneficial for countries when they open up to free trade, and the countries, engaging in trade, gain at least as much they do in autarky (Deardorff, 2007).

The Hecksher-Ohlin (HO) model is an economic theory that interprets the patterns of trade, based on relative factor endowments and characteristics of trading countries. The theory emphasises that countries export goods and resources of which they have in abundance, while proportionately importing those which they cannot produce as comparatively efficiently. Therefore, a capital-rich country will export capital-intensive goods and import labourintensive commodities. In contrast, a country endowed with labour will conversely export labour-intensive and import capital-intensive products. The analogous prediction of the HO model is: developed countries that have plenty of skilled workers will export skilled-intensive goods; meanwhile, developing countries with prevailing unskilled workers will export unskilled-intensive goods. Eli Hecksher and Bertil Ohlin claimed that aggregate efficiency increases with the movement to free trade because it allows countries to shift their production resources towards the goods they export and decrease the production of imported goods. Even though the removal of trade barriers is expected to improve economic efficiency and to be overall advantageous for the countries, there are winners and losers from trade due to redistributive effects between factor remunerations (Subasat, 2003).

The distributive implications of trade are explained by the Stolper-Samuelson theory (SST), which is a foundation theorem in the HO framework. It assumes, as the relative price of a capital-intensive good rises, the real return to the intensively-used capital factor in the production of that product will also increase, whereas the real return to a labour factor will decrease. In other words, the country’s abundant factor wins from an increase in the relative price of exports, but the scarce factor of production loses in absolute terms, thereby making the owner of that deficient factor worse off (Samuelson and Stolper, 1941). As predicted by Wolfgang Stolper and Paul Samuelson, the movement to free trade tends to widen the real wage inequality in advanced economies and, on the contrary, benefit the abundant low-skilled labour in developing countries because, with free trade, there is more demand for their services (Ghazali, 2009).

The uneven distribution of gains from international trade within the countries can be examined in the light of the Kaldor-Hicks potential compensation principle (Martin, 2018). According to this principle, there is a possibility to redistribute income from winners to losers in such a manner that aggregated gains from trade exceed the total losses: to make all parties at least as better off with trade as they were in autarky equilibrium. Thus, it is feasible to attain an optimal level of free trade consumption and make trade liberalisation beneficial for every involved nation. In order to correct for the distributive effects of trade, the government intervenes by implementing the compensation-redistributive scheme conventionally through lump-sum transfers. Assuming the compensation is provided with the redistribution policy, the countries experience an increase in aggregate national welfare, leaving everyone better off from engagement in free trade (Suranovic, 2010).

Although the traditional theory commonly anticipates that trade facilitation will benefit the poor by reducing the wage inequality in developing countries, the opposite effect was observed: underdeveloped countries experienced an increase in inequality when they opened themselves to free trade. This phenomenon was captured by Golberg and Pavcnik (2007) for India after its trade liberalisation policies in 1991. Economists argued that traditional theory contradicting results could have been caused by other factors, such as technological innovations, tariff schedules before and after trade intensification or the timing of trade reforms, because these factors may provide a more reasonable explanation for inequality rise in developing countries (World Trade Report, 2008).

International trade is widely viewed as beneficial to consumers as with free trade flows they gain an option to consume goods at lower prices. However, the positive effect of decreased prices on tradeable products is unequally distributed across households. The magnitude of consumer gains in the United States from Chinese imports during 2014-2015 was estimated and the following conclusion was made: poor households spend a larger proportion of their wealth on tradeable goods and services; hence they benefit from a fall in prices more than highincome households (Stumpner and Bai, 2018).

The impact of trade on employment depends on the extent to which labour markets are correlated with import competition and exporting opportunities. Therefore, domestic firms with export opportunities and competitive advantage will have a growth in revenues and will, sequentially, expand production, creating more jobs. At the same time, firms which encounter competition from cheaper imports might be forced to scale down or exit the market (Caroll and Hur, 2019). This negative effect was observed by Autor et al. (2014), who found that while low-skilled labour suffered from displacement due to import competition, high-skilled workers were significantly more mobile across industries, and were less exposed to import competition. Despite this, Feenstra and Sasahara (2018) estimated that in the period between 1995 and 2011, the growth in the United States’ exports led to the net effect of elevated labour demand after accounting for the negative impacts of intensified imports. Comparison of these two effects reveals: low-wage households may be worse off in terms of employment due to import competition, though they may also benefit from a reduction in prices on tradable goods (Caroll, Hur, 2019).

Economists have established a positive and statistically significant relationship between trade intensification and economic growth in developed and developing states. An increase in trade ratio to GDP by one percent was estimated to raise earnings per person by 1 or 2 percentage points, which is consistent with the prediction of traditional models. Notwithstanding the positive effects of the movement to free trade, no statistical significance was observed for the least developed group of states such as African countries. Were (2015) argues that the least developed countries can potentially benefit from trade integration, but they should alter their trade patters by enhancing domestic investment and attracting FDI (Were, 2015). The reduction of tariffs causes a considerable fall in international trade tax revenue, which is an important source of finance for governments in less developed countries. Consequently, for trade liberalisation to be effective and welfare-enhancing, it must be accompanied by institutional innovations and sound domestic policies, including fiscal reforms (Pupongsak, 2009).

Ultimately, both traditional literature and the empirical analysis have shown that trade indeed has redistributive consequences among individual groups. The discussed empirical results align with the theory that trade openness benefits consumers by offering them a more extensive choice of goods at lower prices. Particularly, low-income households are better offfrom the lower prices of imported tradeable goods and services. In general, the traditional HO model states that trade liberalisation is inequality reducing in underdeveloped countries with most of the low-skilled workers involved in the labour force. However, the empirical observations have shown the opposite results that can be explained by other factors not accounted for in the analysis. Also, the negative effect of intensified trade was found for lowskilled workers in developing countries due to firms facing import competition in an integrated world market. On the one hand, low-income households benefit from a reduction in prices, but, on the other hand, they may lose due to labour displacement.

Trade liberalisation reforms have shown to promote economic growth in developed and developing countries, which reconciles with the traditional theory. However, no statistically positive effect from trade openness has been observed for the least developed states. According to the compensation principle, it is feasible to attain an optimal free trade level of consumption with government intervention. This will mitigate the distributive consequences and assure that all agents engaged in the trade have an opportunity to benefit from it.

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# **Feedback comments**

This essay is on the winners and losers from trade.

There is much to like about this essay. It is clearly written and easy to read. It discusses a lot of recent literature, in a well-organised way, at a level which is appropriate to this course.

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