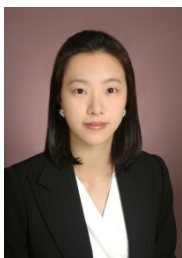# Trade Liberalization, Welfare Prediction and Political Conflicts

Soohyun (Catherine) Oh

PhD, Research Fellow, Regional Trade Agreement Team
Korea Institute for International Economic Policy

There seems to be a consensus among trade economists that trade liberalization benefits every participating country in the long run by encouraging efficient allocation of resources according to comparative advantage. However, in the real world, FTA does not occur as frequently as the prediction implies and political conflicts regarding trade liberalization still exist. One of the reasons may be that the predictions in the long run and short run are different. Although it is not easy for trade economists to predict the short-run outcome, public fear on trade liberalization mainly comes from potential short-run cost. In a democratic country, people can vote against short-run cost instead of voting for long-run gains. The welfare analysis based on the long run is not able to reflect trade preference of the

public under the majority voting rule.

Particularly, among the long-run gains that come from resource reallocation, human resource reallocation may take time and its transition process might be painful for the person directly involved; no one knows how long the transition will be. Traditional trade theory based on comparative static or steady state analysis predicts aggregate gains from trade liberalization because it ignores search matching friction in the labor market and it makes resource adjust immediately after the trade reform shock. Thus, in the traditional Heckscher-Ohlin model, welfare consequence after trade liberalization is solely determined by factor endowment. Recently trade literature with labor market friction is growing; Davidson, Martin, and Matusz investigated how the labor market friction affects comparative advantage. They found that a country with more efficient matching specializes in the sector with higher separation rate. Helpman and Itskhoki and Felbermayr, Prat, and Schmerer analyzed the relationship between trade and unemployment in the long run.

In the model we recently constructed[1], we analyzed trade preference by developing the dynamic extension of the Heckscher-Ohlin model with imperfect labor mobility. We found in the Stolper and Samuelson doctrine that the abundant factor is better off and scarce factor is worse off does not hold any longer when the intersectoral migration decision is not sufficiently sensitive to the value differentials across sectors because the paths of lifetime values of workers differ across sectors. In particular, trade preferences are determined not only by factor endowment, but also by initial sectoral allocation. A bilateral FTA can garner a broad political constituency in both countries only when each specializes in the sector it is supposed to continuously specialize in after the agreement. A country that has an excessive mass of workers in a sector that should be reduced post agreement may encounter strong objections from the majority of workers.

Although the Heckscher-Ohlin theory predicts that gains from trade between heterogeneous economies are larger, in reality, however, the FTA is more likely to be agreed between homogeneous economies, especially between developed countries, such as the European countries or the North American countries. Our study finds that this is not a failure

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[1] This research is independently done by the authors and the full version is available on each author's Web site. It does not necessarily reflect the official opinion of the KIEP and the Korean government.

of Heckscher-Ohlin but the result of self-selected political equilibrium. In spite of larger expected gains from FTA among heterogeneous countries in the long run, it may confront political conflicts in the short run depending on initial allocation that hinders FTA. Thus, researchers and policy makers need to consider various measures to mitigate short-run cost by delaying tariff reduction schedules or providing subsidies. **KIEP**