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ADDITIONAL SOURCE OF GAINS FROM TRADE: THE RESPONSE OF THE LABOR MARKET TO A DECLINE IN TARIFFS

Abstract:

A standard model of international trade has a setting with constant labor supply. However, this model introduces a consumption-leisure choice into a traditional model of international economics. Therefore, this paper focuses on the response of labor to changes in tariffs. Moreover, I show that there exists a positive optimal tariff rate which maximizes welfare in a setting with endogenous labor and compare this result quantitatively with the standard models using constant labor supply. This paper also focuses on the welfare implications of a decline in trade barriers (in terms of tariffs). I utilize a version of computational general equilibrium model of international trade (based on Armington assumption) where countries are potentially asymmetric in terms of labor endowment, productivity, etc.

Eaton and Kortum (2002) derive a simple formula which shows the gains from trade and this formula is generalized by Arkolakis, Costinot, and Rodriguez-Clare (2012) in the case of iceberg costs and exogenously fixed labor supply. I generalize this formula in Armington setup with tariffs and endogenous labor supply and highlight the importance of both revenue generating tariffs and consumption-leisure choice.

Keywords:

Endogenous Labor Supply, Optimal Tariff, Computational General Equilibrium, Welfare

JEL Classification: F10, F11, F16