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Article

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How does international trade affect household welfare?

Households can benefit from international trade as it lowers the prices of consumer goods

Keywords: international trade, household welfare, consumption, wages

ELEVATOR PITCH

Imported products tend to have lower prices than locally produced ones for a variety of reasons, including lower labor costs and better technology in the exporting country. The reduced prices may lead to wage losses for individuals who work in the production of a local version of the imported item. On the other hand, lower prices may be beneficial to households if the cheaper product is in their consumption basket. These welfare gains through consumption, on average, are found to be larger in magnitude than the wage effect for some developing countries.

KEY FINDINGS

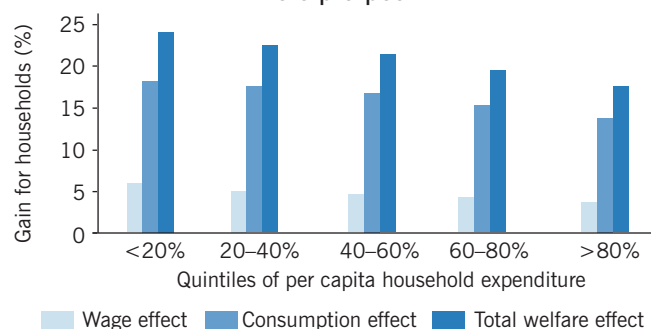
Pros

- ➕ International trade tends to reduce the prices of consumption goods, creating welfare gains for consumers in importing countries.
- ➕ Welfare gains through reduced costs of consumption may be larger than gains or losses through income changes.
- ➕ In developing countries, the welfare effect of unilateral trade liberalization through consumption tends to be pro-poor.
- ➕ Welfare gains from trade are larger for households that live in urban areas and that are closer to national borders.
- ➕ Households that participate in the production of exported products may experience further welfare gains in addition to gains through cheaper consumption goods.

Cons

- ➖ Earnings may be reduced depending on an individual's skill level and the impacted industry's level of exposure to international trade.
- ➖ Income effects can be pro-rich if agricultural wages decline due to trade liberalization.
- ➖ Welfare gains through consumption are expected to be pro-poor only if the cheaper imports are relatively important in poor households' budgets.
- ➖ Welfare gains through consumption may be smaller for households that are isolated from price effects due to low competition in their region.
- ➖ Households with skilled labor may experience smaller welfare gains in developing countries.

Household welfare effects of Indian trade liberalization were pro-poor



Source: Author's own estimations based on [1].

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AUTHOR'S MAIN MESSAGE

International trade is known to reduce real wages in certain sectors, leading to a loss of wage income for a segment of the population. However, cheaper imports can also reduce domestic consumer prices, and the magnitude of this impact may be larger than any potential effect occurring through wages. Research on some developing countries suggests that most households experience net gains in welfare and that the distributional effects are progressive. Policymakers should, therefore, consider the impacts on consumer prices when evaluating how trade affects households in their roles as both consumers and producers.