

Uncertainty, Gains from Specialization and the Welfare State

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Abstract

This paper presents a specific-factor model showing that, under technological uncertainty and risk averse agents, increasing trade integration is not always welfare increasing. The reason is that changes in the country's specialization level induced by trade integration produce both benefits and cost. Increasing specialization increases wages (efficiency gains), but, modifying the tax scheme of the Welfare State, it also increases income variance. The model identifies a trade-off, absent in the standard deterministic model, between gains from specialization and the higher cost of the Welfare State. It is shown that, depending on the parameter's configuration, it exists a specialization level beyond which aggregate expected income under free trade becomes lower than that achieved under autarky.

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