

Harmful Pro-Competitive Effects of Trade under Classical Monopolistic Competition

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Gains from trade is an evergreen topic. In *New Trade*, it again attracted a discussion after [1] puzzled the theorists with surprisingly low estimated gains. Moreover, even welfare loss may occur in free trade in comparison with autarky [2]. By contrast, this paper discovers harmful trade under additive VES utilities enabling autarky - but only under very high trade costs, near autarky: the first step from autarky is harmful. The setting is close to classical Krugman's trade model, it includes one diversified sector, no outside good, and unspecified additive utilities. Homogeneous firms use one production factor (labor) with same fixed and marginal cost, consumers are identical. Labor and trade are balanced. Near free trade, welfare locally increases in each country with liberalization (under realistic, decreasingly elastic utilities). More subtle and unexpected is the effect at the beginning of liberalization, near autarky. From the policy viewpoint, our "harmful trade" seems to favor protectionism, but in fact, it only suggests not to liberalize trade gradually, to jump over the initial losses towards sufficiently massive trade. See [3] for details.

References

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