Poverty trap, dynamic gains from trade, and inferiority in consumption

Kazumichi Iwasa

KIER, Kyoto University, Yoshida-Honmachi, Sakyo-ku, Kyoto 606-8501, Japan
(e-mail: iwasa@kier.kyoto-u.ac.jp)

Summary. We extend the dynamic Heckscher-Ohlin model in Bond et al. (2009) and show that if a labor intensive good is inferior, then there may exist multiple steady states in autarky and poverty trap can arise. Also, it is shown that there is a possibility that under free trade, each country will reach a higher steady state level of welfare as a result of opening trade than in autarky. This contrasts sharply with the result in dynamic H-O models with normality in consumption: The country with a higher (lower) capital stock than the other will reach the steady state where the level of welfare is higher (lower) than that in autarky.

Key words: dynamic Heckscher-Ohlin model, poverty trap, inferior good, dynamic gains from trade

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