Introduction: ‘New directions in international trade theory’

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This special issue contains nine papers which were invited to a conference themed “New Directions in International Trade Theory” at the Leverhulme Centre for Research on Globalization and Economic Policy at the University of Nottingham, UK.

Bernhofen (2009) “Predicting the pattern of international trade in the neoclassical trade model: a synthesis” suggests a unifying framework for pattern of trade predictability in the neoclassical trade theory. His framework is based on the Popperian key characteristic of a scientific theory: the imposition of a restriction on possible outcomes. There are two parts to a theoretical prediction: the identification of a set of conceivable outcomes and a restriction criterion. Applying this apparatus to the neoclassical trade model reveals a remarkable coherence between the various formulations of the model and allows for an intuitive interpretation of the predictions. In addition, it highlights the intellectual continuity between Ricardo’s (1817) original formulation of comparative advantage and the modern general equilibrium formulations.

Traditionally, the trade policy reform literature has assumed that policy makers care mainly about social welfare. Motivated by the observation that recent trade negotiations have also been about guaranteeing ‘foreign market access’, the literature has recently started to investigate the effects of policy reforms on both welfare and market access. Falvey and Kreickemeier (2009) “Tariff reforms with rigid wages” extend the trade policy reform literature by incorporating unemployment. They analyze the effects of tariff reforms on welfare and market access in a competitive small open economy

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where unemployment is caused by rigid wages. The authors derive welfare increasing trade reform strategies and show that the tension between reforms that increase welfare and market access also holds in their environment.

[Leahy and Neary \(2009\)](#) “Multilateral subsidy games,” develop a strategic trade policy model that examines the rationale for multi-lateral agreements to limit investment subsidies. Their model identifies two groups of factors that affect the national desirability of investment assistance: the effects on rivals’ profits and the social welfare weights attached to domestic profitability and consumption. Their model focuses in more detail on R&D competition and spillovers under different assumptions on the mode and intensity of strategic interactions. From a global welfare perspective, national governments over-subsidize only when spillovers are low and competition is intensive. When spillovers are high, there is an incentive to under-subsidize.

[Hu et al. \(2009\)](#) “A two-country dynamic Heckscher–Ohlin model with physical and human capital accumulation” construct a growth model where long-run growth is determined by the accumulation of physical and human capital. Their key innovation is to introduce adjustment costs in the accumulation of human capital to pin down unique values of the ratio of physical to human capital. In previous work this ratio was indeterminate resulting in indeterminacies in predicting the pattern of trade. Country differences in the efficiency of educational services lead to differences in adjustment costs which gives rise to a dynamic Heckscher–Ohlin prediction.

[Bond \(2009\)](#) “Paths of efficient self-enforcing trade agreements” adds to the discussion on whether preferential trade agreements are ‘stumbling’ or ‘building blocks’ towards a multilateral trade agreement. He notices that trade agreements must be enforceable and that there are adjustment costs in forming trade agreements. He examines the set of sustainable payoffs from self-enforcing agreements in a three country model where countries face costs of forming agreements. Self enforcing transfers are allowed. Conditions are derived for a global free trade agreement to be sustainable. He also derives conditions under which a two step agreement, in which a preferential trade agreement is formed initially and the third country added later, emerges as an equilibrium. Examples are provided in which two step agreements may not be Pareto dominated by the immediate formation of a global agreement.

Traditionally, international trade theory has focused on the causes and consequences of international exchange without paying much attention to the institutional foundations that sustain international trade. [Anderson \(2009\)](#) “Does trade foster contract enforcement?” develops a model where trade can have positive and negative knock-on effects on institutional development. He focuses on contract enforcement and finds that a stimulus to trade will improve contract enforcement when the elasticity of supply of traders is high. Negative knock-on effects are possible when the elasticity is low. This model is capable of providing a possible explanation for the post-1500 divergence in institutional developments in Europe and China and also for more recent institutional developments in low-income and transition economies.

[Huang et al. \(2009\)](#) “Is GATS desirable?” ask if service trade liberalization is welfare improving under incomplete markets in an environment of inter-spatial and inter-temporal trade. They use a two-country model to show that the liberalization of trade in financial services can be welfare worsening in the presence of a tariff on spatial trade in goods. They also consider service trade liberalization with existing

free trade agreements. Since tariffs are zero within the free trade area they find that in this case, service trade liberalization is generally welfare improving.

Kowalczyk and Riezman (2009) "Free trade: What are the terms-of-trade effects?" build on the authors' prior work which has shown that global free trade can be attained if agreed side payments equal the terms-of-trade effects. This paper investigates the magnitudes of the terms of trade effects and the necessary transfer payments. In particular, they apply a computable general equilibrium model to estimate the magnitude of the terms-of-trade effects. In some cases terms-of-trade effects are small compared to efficiency gains, and transfers are not necessary for free trade. In other cases, terms-of-trade gains may account for more than 50% of a country's gains from free trade and transfers could be very large.

Jones and Marjit (2009) "Competitive trade models and real world features" argue that competitive trade theory models are quite capable of explaining real world features such as, that the number of commodities consumed locally can be much larger than the number of commodities produced for world markets and that the degree of international fragmentation of production is increasing. They extend a standard Heckscher–Ohlin model by adding specific factors and trade in middle products. Consumer goods are produced locally with middle products and labor. This results in a model in which international trade allows a transformation of a specific-factors production environment with sector-specific capital and mobile labor into a specific-factors environment with mobile capital and sector specific labor.

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