A Simple Trade Model with Non-Homothetic Preferences and Inequality

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April 23, 2008

Abstract

This paper builds a trade model with a monopolistically competitive sector and non-homothetic preferences. It assumes the existence of two types of goods: necessities, which are homogeneous, and luxuries, which are differentiated, and analyzes the implication of income inequality on trade patterns. It is shown that when two countries are identical except for the lowest level of labor skill (average skill), the country with higher skill level will have a larger number of firms than the other country for high levels of inequality, and a smaller number of firms for low levels of inequality; Second, under certain conditions, the total number of varieties of the trading world can be smaller then the number of varieties of any single country prior to trade.

JEL classification:F12, F16, D31

Keywords: Income inequality, monopolistic competition, non-homothetic preferences

*The author would like to thank Kikuchi Toru and Noritsugu Nakanishi for constructive comments. Any errors are the responsibility of the author.

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