

A Dynamic Two Country Heckscher-Ohlin Model with Non-Homothetic Preferences

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Summary. We examine the properties of a two country dynamic Heckscher-Ohlin model that allows for preferences to be non-homothetic. We show that the model has a continuum of steady state equilibria under free trade, with the initial conditions determining which equilibrium will be attained. We establish conditions under which a static Heckscher-Ohlin theorem will hold in the steady state, and also conditions for a dynamic H-O theorem to hold. If both goods are normal, each country will have a unique autarkic steady state, and all steady state equilibria are saddle points. We also consider the case in which one good is inferior, and show that this can lead to multiple autarkic steady states, violations of the static H-O theorem in the steady state. Furthermore, there may exist steady state equilibria that Pareto dominate other steady states. These steady states will be unstable if discount factors are the same in each country, although they may exhibit dynamic indeterminacy if discount factors differ.

Key words: two-country model, Heckscher-Ohlin, inferior good, multiple equilibria, indeterminacy

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