

Timing of Market Openings and Income Distribution

Tatsuya Asami *

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Abstract

This study analyzes the dynamic effect of trade liberalization on the income distribution and the short- and long-run equilibria in a simple one-period model with intertemporal transfers. Existing related studies have discussed this issue for closed or small open economies by assuming initial differences in the wealth distribution. This study departs from previous studies by assuming heterogeneity in skills acquisition and an imperfect credit market. We show that the impact of market openness on income inequality depends on the model economy's stage of development. That is, the extent of income inequality increases as the market opens only when the economy is less developed. Furthermore, differences in development stages (i.e., differences in market opening timing) may result in different steady states. This study illustrates the possibility that an early market opening in the case of a less-developed economy may lead to a poverty trap.

Keywords: income distribution, market opening, dynamics, skill acquisition

*Graduate School of Economics, Kobe University, Rokkodai-cho 2-1, Nada-ku, Kobe 657-8501, Japan.
Email: azutotatsu@gmail.com