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New Goods, Old Theory, and the Welfare Costs of Trade Restrictions

Paul Romer

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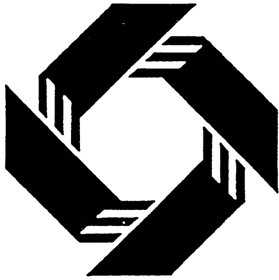

IPR 63

New Goods, Old Theory, and the Welfare Costs of Trade Restrictions

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and

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August 1993

The typical economic model implicitly assumes that the set of goods in an economy never changes. As a result, the predicted efficiency loss from a tariff is small, on the order of the square of the tariff rate. If we loosen this assumption and assume that international trade can bring new goods into an economy, the fraction of national income lost when a tariff is imposed can be much larger, as much as two times the tariff rate. Much of this paper is devoted to explaining why this seemingly small change in the assumptions of a model can have such important positive and normative implications. The paper also asks why the implications of new goods have not been more extensively explored, especially given that the basic economic issues were identified 150 years ago. The mathematical difficulty of modeling new goods has no doubt been part of the problem. An equally, if not more important stumbling block has been the deep philosophical resistance that humans fell toward the unavoidable logic consequence of assuming that genuinely new things can happen and could have happened at every date in the past. We are forced to admit that the world as we know it is the result of a long string of change outcomes.

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