

Problem Set 5: Trade with monopolistic competition and increasing returns to scale

1. Consider two identical countries. Beer manufacturers in each country compete under monopolistic competition.
 - a) Suppose the two countries engage in trade. Determine the impact of free trade on consumers in each country
 - b) How does free trade affect domestic producers in each country?
2. Why is trade greater between two large trading partners?
3. In the context of the monopolistic competition trade model, could trade cause adjustment costs to workers? Explain why, or why not?