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**GAINS FROM TRADE AND EFFICIENCY UNDER
MONOPOLISTIC COMPETITION:
A VARIABLE ELASTICITY CASE**

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Abstract

We present a general equilibrium model of monopolistic competition with variable demand elasticities and investigate the impact of free trade on welfare and efficiency. First, contrary to the constant elasticity case, in which all gains from trade are due to increasing product diversity, our model features gains from pro-competitive effects. Second, we prove that the market outcome is not efficient because too many firms operate at an inefficiently small scale. Last, we illustrate that free trade raises efficiency by reducing the gap between the equilibrium utility and the optimal utility.

Keywords: international trade, monopolistic competition, variable elasticity, gains from trade, efficiency.

JEL Classification: D43, D51, F12.

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