

Trade Theory, Trade Policy, and Cross-Border Integration

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Introduction

In a 1992 article, economist Paul Krugman asked whether the new trade theory required a new trade policy. He concluded that it did not, arguing that since existing trade policies were unrelated to long-established trade theories¹, it was difficult to see why such policies needed to accommodate new theoretical insights. In his view, "GATT-think [is] a simple set of principles that is entirely consistent, explains most of what goes on in the negotiations, but makes no sense in economic terms."² Krugman's point was clever but also misleading because it did not fully appreciate either the nature or the genius of the international trade regime, or the challenges it needed to address in the

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¹ Theories first developed by, *inter alia*, Adam Smith and David Ricardo (specialization and comparative advantage) and refined over the years by economists like Eli Heckscher, Bertil Ohlin, and Paul Samuelson (the factor proportions theory) and Ray Vernon (the product cycle theory), and now supplemented by theories to take account of imperfect competition, increasing returns to scale, and other factors.

² "Does the New Trade Theory Require a New Trade Policy?" *The World Economy* 15:4 (July 1992), p. 429. See Douglas Irwin, *Against the Tide: An Intellectual History of Free Trade* (Princeton: Princeton University Press, 1996) for a full discussion of the development of trade theories and the broad commitment of economists to the doctrine of free trade.