Predicting the economic costs and benefits of trade liberalisation for developing countries with applied general equilibrium models? AN INTRODUCTORY APPRAISAL OF THE LAKATOSIAN HARD CORE ASSUMPTIONS OF THE NEO-WALRASIAN GENERAL EQUILIBRIUM FRAMEWORK

In this master's thesis I appraise the methodology, hard core assumptions and certain auxiliary hypothesis of this framework. I critically discuss the consistency of the hard core assumptions made and the realism of these assumptions as opposed to competing explanations of economic reality. In this discussion I will attempt to give a picture of what kind of an economic world is being discussed according to the standard hard core assumptions. I will also give an account of how the arising issues are depicted in the Global Trade Analysis Project (GTAP), which is based on the neo-Walrasian GE framework, and generally assess whether these frameworks are able to account for the costs and benefits of trade liberalization in developing countries.

I conclude that the neo-Walrasian general equilibrium framework is not yet adequate enough to function as a framework for applied general equilibrium models especially when estimating the gains and losses of trade for developing countries. The analysis of the GTAP framework additionally fits this conclusion as even stronger assumptions about economic reality need to be made in order to apply the neo-Walrasian general equilibrium framework for analyzing real world economic issues.

The principal problem in the neo-Walrasian general equilibrium framework is the assumption that economies should be analyzed with respect to general equilibrium states. Among the many issues arising here, not adequate enough reasons have been given to avoid the problems of hysteresis and path dependence. There can be a variety of different and unpredictable equilibrium states that will result just due to these problems. The neo-Walrasian GE framework is also unable to account for the dynamic effects that income redistribution has on agents’ preferences and the resulting outcomes for production and consumption. The framework cannot assess the effects of oligopoly without making stronger more unrealistic assumptions and additionally requiring high amounts of data. The standard trade models do not assess the environmental impacts of trade, which analytically challenge the stability of equilibrium and lead to neglecting the potentially hazardous effects of local and global environmental impacts. Finally the maximization assumptions for both supply and demand have been criticized from various angles. The upshot is that the assumptions based on maximization behaviour cannot adequately describe how consumers make choices and achieve welfare, while the factor pricing theory for production cannot be an adequate description of how firms maximize profits. These results are based on summarizing various sources and come with some qualifications.