

**PARETO INFERIOR TRADE AND OPTIMAL COMPENSATION**  
**IN A MODEL INCORPORATING OVERLAPPING GENERATIONS**

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**Abstract**

This paper considers the welfare impact of the introduction of trade on a two-factor, two-good, small trading nation in which the population is composed of overlapping, life-cycle maximizing generations. It is shown that free trade without compensation can be Pareto inferior to autarky for this country. While it is possible to find a lump-sum compensatory transfer scheme to restore the gainfulness of trade, the optimal transfer scheme is not necessarily Pareto superior to autarky.

Key words: Trade, Overlapping generations, Compensation, Pareto inferior

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