The revealed cost competitiveness of changing trade patterns: A country-sector exercise

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Abstract

In new trade models with heterogenous firms, trade liberalization between high-cost and low-cost countries is expected, all the rest equal, to increase cost competitiveness (i.e., to decrease real marginal costs) relatively more in the former. We report evidence in favour of this prediction for a sample of countries, accounting for about 85% of world trade, from the 1980s to the 2000s. The estimation of the country-sector changes in cost competitiveness (relative to the UK) hinges on taking advantage of the observability of international trade patterns to reveal information on cross-country differences in marginal costs, hence '*revealed*' cost competitiveness.

Keywords: Firm Selection, Gravity Equation, Import Competition
J.E.L. Classification: F12 F14 F15 O47

1 Introduction

A significant reshuffle of international trade flows is currently underway. At the aggregate level, the share of world trade involving developing and emerging countries as exporters increased between 1980 and 2011 from 34% to 47%; as importers, the share rose from 29% to 42% (WTO, 2013). At the firm level, a number of studies document considerable resource and market share reallocations from less to more productive firms (beginning with Pavcnik, 2002). Compared to traditional trade theories, trade models with heterogeneous firms (Bernard *et al.*, 2003; Melitz, 2003; Melitz and Ottaviano, 2008; Chaney, 2008) have an increased ability to explain these trends by 'slicing up' the within-country effects of international competition: increasing competition fosters the survival of firms able to produce at lower marginal costs at the expense of the less productive firms (i.e., the *firm-selection* effect). To the extent that trade integration makes competition fiercer, decreasing trade barriers contribute to this process by lowering the marginal cost level above which firms cannot survive (i.e. *cost cutoff*): firms producing at too high a marginal cost are forced to leave the market, and their market

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