discussion of

The selection effect of international trade

by

Finicelli, Pagano, and Sbracia

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based on Eaton and Kortum 2002

productivity is a function of
  ► state of technology
  ► trade cost

international competition raises productivity
state-of-the-art technology is given for each country

productivity gains from lower trade cost
- cheaper intermediate inputs (direct effect)
- reallocation of production (selection effect)

perfect competition
- no increasing product variety (Paul Krugman)
the authors come up with a gravity-like specification:

$$X(\text{trade, production}) = f(\text{TFP, trade cost, wages})$$

TFP can be identified through a two-step estimation strategy:

1. estimate trade cost using country dummies
2. compute TFP using wage data
application to the Internal Market

Did the EU raise productivity through stimulating international competition?
EU effect in cross section

<table>
<thead>
<tr>
<th>Coefficients on EU dummy</th>
<th>1985</th>
<th>1990</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finicelli, Pagano &amp; Sbracia</td>
<td>-0.22</td>
<td>0.11</td>
<td>0.12</td>
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<tr>
<td></td>
<td>(0.13)</td>
<td>(0.12)</td>
<td>(0.17)</td>
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<tr>
<td>Eaton &amp; Kortum</td>
<td></td>
<td>0.04</td>
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<td>(0.13)</td>
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Coefficient on EU dummy is very volatile!
EU effect with panel data

estimation results using linear spline:

(For details see Chapter 3 of Straathof, Gert-Jan Linders, Arjan Lejour, and Jan Möhlmann, The Internal Market and the Dutch economy: implications for trade and economic growth, CPB Document 168.)
open issues

effect international competition on:

- innovation
- offshoring and intra-firm trade