

in brief...

Heterogeneous firms in international trade

Research in international trade increasingly focuses on firms and products as well as countries and industries. **Stephen Redding** reports on a recent conference to discuss the latest findings.

International trade is dominated by firms selling multiple products to multiple destinations. Research by Peter Schott (Yale School of Management) and colleagues examines the production and export decisions of these firms and how they are affected by globalisation. In his keynote presentation to the conference, he showed that much of the variation in aggregate trade between countries is accounted for by the 'extensive margins' of trade – the number of exporting firms, the number of exported products and the number of export destinations.

Trade liberalisation raises firms' productivity by inducing them to focus on their 'core competencies' in their leading products. Therefore, the reallocation of resources in response to events such as trade liberalisation may be even more important than hitherto thought insofar as it occurs within as well as across firms.

Further theory and evidence on the role of multi-product firms in understanding the volume and pattern of trade was presented by Peter Neary (University of Oxford) and colleagues and by Costas Arkolakis (Yale University) and Marc Muendler (University of California, San Diego).

Other papers presented at the conference explored the dynamics of firm exporting. Recent empirical research has found that between one third and one half of all exporters are new entrants in a typical year. These new entrants are, on average, much smaller than incumbent exporters and the majority of them exit within a year. Nonetheless, those new exporters that do survive grow rapidly and as a result account for a substantial proportion of aggregate export growth over longer time intervals.

Emanuel Ornelas (CEP) and colleagues presented theory and evidence on 'sequential exporting,' in which firms enter one export market in part to obtain information about their profitability in other export markets. Costas Arkolakis (Yale University) presented a unified model of firm selection and growth that can account for both the cross-section dispersion of firm size and the dynamics of firm growth and survival over time.

Another theme of the conference was the impact of trade liberalisation on wage inequality and unemployment. In research with Elhanan Helpman and Oleg Itskhoki, I presented a new framework for examining the distributional consequences of globalisation, which

emphasises heterogeneity across workers and firms, labour market frictions and firm selection into export markets.

Within this framework, the opening of trade increases wage inequality and unemployment in both developed and developing countries, because only the most productive firms export and these exporters pay higher wages and are more selective in their recruitment policies than non-exporters. Once the economy is open to trade, further trade liberalisation can either increase or decrease wage inequality and unemployment, depending on the initial level of trade openness.

Another dimension through which globalisation can affect wages and employment is offshoring. Guru Sethupathy (Columbia University) presented a paper in which lower offshoring costs raise profitability and wages at offshoring firms relative to those at non-offshoring firms. Perhaps surprisingly, domestic employment can rise at offshoring firms because the increase in efficiency from offshoring expands their employment and offsets the direct loss of offshored jobs. In contrast, domestic employment necessarily falls at non-offshoring firms, which lose market share and contract.

Using the Mexican Foreign Investment Law of 1993 and the peso crisis in 1994 as natural experiments that changed the marginal cost of offshoring to Mexico, the study provides empirical evidence in support of these predictions.

This article summarises the issues and papers discussed at a conference on 'Heterogeneous Firms in International Trade', jointly organised by CEP, CESifo and the Norface partnership between 14 European research councils, held in Venice in July 2009 (<http://www.cesifo-group.de/portal/page/portal/ifoHome/c-event/c2conf/30confvsi>).

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