

Quality Innovation, Firm Heterogeneity and International Trade

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Abstract

The present paper explores the link between international trade and productivity growth when firms are heterogeneous and technical progress takes the form of quality improvement of products traded. Our framework introduces a number of new and plausible features that are absent in studies which model technical progress as variety expansion. Firm entry and exit are endogenously determined due to creative destruction of products. An interesting consequence of this feature is that a given industry can be open or closed to trade, depending on random productivity levels. In this framework, we explore the effects of globalization on productivity level and growth of industries. Our results contrast with variety-based models in that trade liberalization unambiguously promotes growth.