

<< Abstract >>

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Trade Cost Effects on Bilateral Trades: Panel SVAR Approach

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Abstract

We investigate the sources of bilateral trade movements disentangling the effects of theory-driven trade costs and output growth. We estimate a panel structural vector-autoregressive (SVAR) model using 149 bilateral trades during three eras of globalization. Main findings are as follows. First, estimated trade cost shocks permanently reduce bilateral trades while positive output shocks increase trades. Second, the relationship between trade cost and output has changed from no close link in the pre-World War I period to a significantly negative comovement in the interwar and the post-World War II periods. Third, the contribution of trade cost shocks on trade movements also shows a time-variant pattern from high to low and then to high values. Fourth, bilateral characteristics such as sharing a border, membership in an empire, a common language, and the exchange regime are important determinants of trade volatility.

Keywords: bilateral trade volatility, trade cost, gravity model, panel VAR

JEL classification: F1, F4