Asymmetric Trade Costs and Bilateral Trade

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Abstract

The pattern of bilateral trade between rich and poor countries is asymmetric. That is poor countries import a larger share of goods from rich countries, than rich countries import from poor countries. Though this pattern suggests asymmetric costs to trade are important to account for this phenomenon, most studies assume symmetric costs to trade between countries. Building on the framework of Eaton and Kortum (2002), I derive a relationship between trade flows, relative prices, and trade costs. Since the first two objects are measurable, I recover the trade costs necessary to reconcile the pattern of trade without restrictions on the form these costs take. I show that to explain the pattern of bilateral trade, costs to trade must be asymmetric with poor countries facing systematically higher costs to export relative to rich countries. I then illustrate the quantitative importance of asymmetry by examining the model’s ability to replicate the variation in bilateral trade. Asymmetry accounts for at least 50 percent of the variation in bilateral trade, in contrast to symmetric costs such as distance which accounts for at most 15 percent.

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