What are the Price Effects of Trade? Evidence from the U.S. and Implications for Quantitative Trade Models*

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Abstract

We estimate the impact of trade with China on U.S. consumer prices and use this evidence to discipline quantitative trade models. Using comprehensive price data from the U.S. Bureau of Labor Statistics and two complementary identification strategies from **?** and **?**, we find that trade with China had a large impact on U.S. prices. Between 2000 and 2007, a one percentage point increase in Chinese import penetration in a given industry led to a three percentage point fall in the Consumer Price Index in that industry. This effect is large but plausible; abstracting from GE effects and benchmarking our estimates against those of **?**, our results imply that increased Chinese import penetration generated benefits to U.S. consumers through lower prices equal to $101,250 per lost manufacturing job, or a cumulative 1.97% fall in the aggregate U.S. CPI between 2000 and 2007. These price effects are one order of magnitude larger than in the class of trade models nested by **?**. In contrast with these models, we find that (i) the price response of pre-existing domestic products drives the overall price effects; (ii) market concentration is a key predictor of the magnitude of the price response. Using a simple model, we show that these patterns can be explained by a fall in markups in response to increased import competition. These results indicate that the pro-competitive effects of trade have important implications for inflation and consumer welfare.

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