Economies of Scale and International Business Cycles

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Abstract

This paper analyzes whether economies of scale are important in industrial and aggregate international business cycles when those economies arise from sloping marginal cost curves. I first provide a method to estimate the slopes of marginal cost curves and show that industry's international business cycle patterns vary systemically by the slopes. In line with these findings, I introduce sloping marginal cost curves and their variations across industries in an open economy macroeconomic model. It delivers endogenous export gains/losses and within-firm links between domestic and export markets which generate two attractive features of the model: (i) it raises model-implied cross-country aggregate GDP comovements which are close to the data, and (ii) it reproduces observed industrial international business cycle patterns. In industries with decreasing marginal costs, output, imports, and exports are all more correlated with aggregate GDP than in industries with increasing marginal costs. My results suggest that sloping marginal cost curves and their heterogeneity are informative to understand the international business cycle.

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