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# Promoting Domestic Industry. Quantifying the Effects of Reducing Labor Cost and Upgrading Quality

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## Résumé

We propose a new methodology to investigate the importance of price and non-price competitiveness factors for domestic industries facing foreign competition. It relies on a structural model of bilateral industry trade flows to estimate the elasticities of the ratio of imports to consumption of domestic products (i.e. the import-domestic ratio) to a change in relative production costs (labor cost, productivity, quality cost) and product quality perceived by consumers. We apply our methodology to the EU food sector using publicly available trade and production data. The IV estimates show that both components of competitiveness are important to explain the share of expenditure on imports. Using the structural framework, we perform some counterfactual exercises simulating the effects of a unilateral shock on labor cost or product quality at the country-industry level. The results reveal that the two instruments produce very different effects from one country to another, but also across industries within a country. Additionally, the competitiveness gains are much lower for consumers than for producers.

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