Abstract

This paper presents a model aim to reconcile the discrepancy between the theoretical and empirical depiction of the productivity distribution. The Melitz (2003) while being able to reflect on the asymmetric selection of heterogeneous firms in trade, the model strictly truncate the least productive firms leaving the productivity distribution with a distinctive cut-off threshold at the lower end. This contradicts the empirical findings (Mayer and Ottaviano, 2007). The model in this paper proposed that firms are not only heterogeneous in terms of productivity but also in terms of fixed cost. In other words, viability selection in our model is based on firms' efficiency (TFP). This model successfully depicts the productivity distributions of active firms in the market that resemble the empirical findings, for which a great range of productivity distribution of exporters and domestic firms overlap. In addition, we show that only when the fixed exporting cost is *no less* than proportionate to the domestic fixed cost will the ultimate free trade scenario ensures that the weighted productivity in trade be greater than the weighted productivity in autarky. Lastly, trade liberation is always welfare improving, mainly due to the increasing product varieties.