SMART-LERECO SEMINAR

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"Quality standard, trade and the evolution of food industry"

Abstract:

We study the impact of public quality standards on industry structure and trade when firms may be able to develop their own private standard with a higher quality than the public standard. To reach our goal, we introduce vertical differentiation in an international trade model based on monopolistic competition in which firms differ in terms of their productivity and select non cooperatively the quality of their product. Firms must incur two fixed export costs when exporting to any given destination: a generic one (i.e., setting up a distribution system) and a destination-specific one to meet the quality standard prevailing in the importing country. Variable costs are also increasing in quality. Not surprisingly, the absolute mass of firms in any given country is decreasing in the domestic standard, but contrary to popular wisdom, the relative mass (market share) of foreign firms is increasing in the domestic standard. A relatively lower (higher) wage (labour endowment) in the exporting country helps foreign firms gain market share in the domestic market. We also show that the ratio of minimum productivity required for foreign firms and for domestic firms to be active in the domestic market is increasing in trade costs, but decreasing in quality. The implication for public policy is that lowering tariffs and increasing quality standards benefit highly productive foreign firms which gain from the quality-induced exit of less productive domestic and foreign firms. Welfare is concave with respect to quality and governments have an incentive to impose standards, but some firms have an incentive to impose higher private standards.