Love of Quality and Quantity

-A Non-Unit Demand Model of Trade on Vertically Differentiated Goods-

Motivations and Research Questions

Nowadays, we sometimes hear the news that well-known companies of producing high quality products go out of business. These companies are often said to exit the market because of low quality but inexpensive imports from developing countries.(the Wal-mart effect) This anecdote suggests that a vertical product cycle - high quality goods in developed countries are replaced by low quality imports from developing countries – may be happening now. However, existing theoretical models do not provide satisfactory explanation for this vertical product cycle. A typical result is that trade liberalization should result in quality upgrading in equilibrium. One reason why the vertical product cycle has not been shown by previous studies is because most of these studies assume the unit demand: each consumer buys at most one unit of a product regardless of his income. This assumption presumes that consumers love quality but not quantity and limits the favorable effect of low price on low quality goods. Alternatively, this paper presents a new non-unit demand model, where consumers love quantity as well as quality.

Main Results and Contributions

Adding consumers' love of quality into the model, this paper shows that the firm producing the high quality goods will always lose profits after trade, while the firm producing the low quality goods will gain profits if the income distribution of two countries is dissimilar enough to make room for the low-quality good’s firm to sell its products to wealthier consumers. As shown above, the contribution of this paper is to propose a new non-unit demand model that can consider consumers' love of quantity and to show that a firm producing low quality goods gains profit after trade while a firm producing high quality goods loses profit if the income gap between two countries is large enough.