Optimal export policy with upstream price competition

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Abstract

We constructed a third-market model with a vertical trading structure in which input suppliers engage in the homogeneous price competition *à la* Dastidar (1995). We show that in the case of downstream Bertrand competition, a non-monotonic export policy may appear, that is, the optimal export policy can change like a *tax–subsidy–tax* as the degree of product-substitutability rises. We also show that when the number of domestic input suppliers is at an intermediate level, the conventional result in which the optimal policy is an export subsidy (tax) if downstream is Cournot (Bertrand) rivalry remains. We further discuss welfare comparisons between downstream Cournot and Bertrand cases.

Key words: Upstream price competition; Export subsidy/tax; Non-monotonic policy; Product substitutability

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