Consumer-benefiting transport cost: The role of product innovation in a vertical structure

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Abstract

We analyze the effects of transport cost on firm's product R&D and consumers benefit. In a two-country two-way trade model in which firms pay a transport cost to export, each country's firm uses its domestic input, and decides whether to invest or not to promote a degree of differentiation of its product. When the investment cost is low, equilibrium depends on the transport cost. Whilst the investment (non-investment) is dominant strategy if the transport cost is low (high), the multiple equilibria of investment and non-investment appears if the transport cost is intermediate size. We show that positive transport costs can *maximize* consumer's surplus. Even if the degree of product-differentiation due to the R&D is low, our results basically hold.

Key words: Transport cost; Consumer's surplus; Product R&D; Two-way trade

JEL classification: L13; F12; O31

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