

2011-10-25

PRESS RELEASE

Verti-zontal differentiation in monopolistic competition

by Francesco Di Comite, Jacques-François Thisse and Hylke Vandenbussche

NBB Working Paper No 216 - Research Series

In this study, 3 UCL [Louvain University] researchers investigate how "prices and tastes" vary between countries. If a firm exports one of its products to various other European or non-European countries, to what extent is that product sold at a different price, and are the quantities sold comparable per head of population? This study is less concerned with absolute prices and quantities but focuses more on the ranking in relation to other comparable products. In other words, the researchers compare a kilo of a particular brand of chocolates in terms of price and quantity sold in relation to the price and quantity of comparable chocolates sold by other brands in other countries. The comparison consists in checking which brand of chocolates is the most expensive and which brand is the cheapest, and whether that price ranking is the same in every country where the chocolates are sold or whether it varies from one country to another. The same comparison is made for the quantities sold.

The results of the study are rather surprising. The main finding is that the price ranking is much the same regardless of the country where the goods are sold. In other words, an expensive kilo of chocolates of a particular make is often the more expensive brand in another country, while the cheapest chocolates in one country are often also the cheapest in another country. The price ranking of comparable products seems to be very stable. However, that is not true for the quantities sold. While the more expensive chocolates sell very well in some countries, that is not the case in others. Also, the cheapest chocolates are not the biggest sellers in every country. In some countries, sales of expensive chocolates are modest, while cheap chocolates are sold in large quantities, whereas in other countries it is the expensive ones that sell in large quantities and the cheaper versions that do not sell so well. The ranking in terms of quantities sold therefore seems to be highly unstable.

To understand these empirical findings, the researchers construct a theoretical model that takes many parameters into account, such as production costs, product quality, country size, consumers' income and competition on the local market. They show that the theoretical model can only make accurate predictions for the quantities sold if "variations in taste" between countries and products are also taken into account as well as the above parameters. Variations in taste are the only explanation for the large differences revealed by empirical findings in terms of the volume of sales of comparable products. The introduction of "variations in taste" between countries and products is new in relation to existing models, and increases the accuracy of the prediction, making this a highly innovative study.