

ABSTRACT

The seminal Brander and Spencer (1985) model and those used in most of the other studies in the literature on strategic trade policy, barring a few (e.g. Gruenspecht, 1988; Bagwel, 1991), dealt with homogenous products. However, existence of product differentiation increases the super-normal profit in the system thereby raising the incentives to the governments to intervene in market. This calls for further study of strategic trade policies in such set up. The three core chapters (chapters 3, 4 & 5) of the present thesis, therefore, are set up in a differentiated product duopoly.

Chapter 3 deals with vertically differentiated products with technological asymmetry and covered market (the products being essential commodities). We analyse strategic trade policies of two exporting countries, called the developed and the developing country respectively and also of the consuming {or, the third) country. While the optimal unilateral intervention policies of the exporting countries are similar to the existing results, the importing country's optimal intervention policy is shown to depend on a parameter symbolising the comparative positions of the firms in respect of their technological levels and product qualities. In the equilibrium of the governments' game of intervention, while it is always optimal for the developing country to intervene, it is shown that only one of the remaining two countries should intervene in the market.

Chapter 4 addresses the question of leapfrogging in quality through R&D by a low quality firm that produces lower quality good compared to its rival. We consider here a covered market scenario with technological symmetry and unilateral intervention by the government of the low quality firm. Export subsidy policy is found not to be optimal when the ex-post quality gap of the two products is low. But an R&D tax is shown to be optimal if the firm's R&D effort is at an inefficiently high level.

In chapter 5, we consider an uncovered market scenario. Here we find that the incentive for product innovation is not as clear as that of process innovation. In this chapter, where the low quality firm undertakes R&D for process innovation, we are able to show that existence of vertical product differentiation could lead to reversal of some of the existing results in the literature.