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CROSS-BORDER INTERDEPENDENCE OF VERTICALLY RELATED INDUSTRIES AND WELFARE IMPLICATIONS

Abstract:

We examine the effects of the cross-border interdependence of vertically related industries on trade policies and welfare of related countries. With the rapid trends of globalization of value-adding chains of multinational firms, fragmentation of the production process is a wide spread phenomenon of corporate strategies. This paper demonstrate that as the cross-border interdependency of vertically related industries is deepened, protective trade policies are replaced by the pro-trade policies based on an oligopoly model where each representative firm competes over vertically interdependent products. In addition, when the market power of the upstream firm is higher, the tariffs imposed on the intermediate goods are lowered. Although welfare implications of cross-border interdependence of the vertically related industries are affected by the relative technology structures of the upstream firms and the downstream firm of competing economies, a firm with technological advantage benefits more from the deepened cross-border interdependence with increased competition due to the higher homogeneity of the final products.

Keywords:

Tariffs; Interdependence of nations; Trade in intermediate goods; Vertically related markets; Product differentiation

JEL Classification: F12, F13, L13