International trade with binary demands and heterogeneous productivity

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Abstract

By a trade model between a developed country and a developing country with binary preferences and heterogeneous productivity, we find that the selecting effect is a dominant factor in determining the market structure of the whole economy. Four main results are obtained. First, we observe a price reversal that the price in the developed (high-income) country is lower than that in the developing (low-income) country. Second, we show the existence of export-only firms in the developing country when the developed country is large enough. Meanwhile, some firms in the developed country do not export even if they have the ability. Third, the home market effect in terms of wages remains true but the home market effect in terms of firm share may be reversed. Fourth, the selection effect of local production is stronger in the small country when trade costs are small. We also confirm a welfare loss from globalization may occur in the developing country when trade costs are small.

Keywords: Binary demands, Arbitrage, Export zeros, Export-only firms, Home market effect
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