Abstract

This study examines the firms' market behavior and the effect of spillovers on the Southern tariff decision in a North-South mixed duopoly model where a low−cost Northern firm competes with a high−cost Southern partially privatized firm in the Southern market. The Northern firm serves the Southern market through either exports or foreign direct investment (FDI). Only when the tariff level is sufficiently low or the spillover effect is sufficiently strong can induce the Northern firm to choose export to the Southern market. As a result, the South can obtain a higher level of social welfare from FDI of the Northern firm in most cases; the Southern government's tariff decision is limited by location choice of the Northern firm and, in some instances, it cannot maximize its social welfare by setting an optimal tariff; tariff decision of the Southern government is highly concerned with tariff revenue.