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Local-Global Competition Under Home Bias Effect in Consumer Preferences

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According to a number of empirical studies, consumer preferences are often biased toward domestic products, leading to changes in market structure and trade flows. Holger C. Wolf (2000) exploring trade in the US indicates that intranational trade is much larger than would be expected based on a gravity specification, and this is not explained only by national trade barriers. Martínez-San Román V., Mateo Mantecón I., Sainz-González R (2017) show that although Wolf's estimates on the magnitude of home bias were somewhat overstated, the bias effect increased significantly from 2002 to 2012. Home bias occurs when states trade more with themselves than with other states, despite the absence of formal trade barriers between states.

Mitchell Morey (2016) shows that attempts to explain the effect of home bias through location advantage, purchasing habits, or safety factors do not provide a convincing answer to the question of the cause of home bias. As a counterexample, data on rice sales using the auction mechanism show that buyers are willing to pay more for locally produced rice in the absence of any additional information. The disproportionate consumption of domestic goods provides evidence in favor of models that take into account the effect of home bias, whereas neoclassical models predict more trade than we observe in reality (the phenomenon of "missing trade").

Hence, there is a need to consider differences in consumer preferences for local and foreign brands. In our model, this is expressed as additional costs for buyers when purchasing a foreign brand (this is the classic approach and corresponds to the model of Neven, Norman, and Thisse, 1991). Furthermore, the preferences of different buyers are biased differently, according to some distribution function, that is more home-biased consumers bear more acquisition costs.

In addition, buyers are heterogeneous in their preferences for different varieties of a homogeneous product. Differentiation in preferences, in turn, leads to market fragmentation and the emergence of the combined type of competition: more aggressive localized competition (à la Hotelling 1929, Kaldor 1935) with domestic companies and global competition with all firms on the market (à la Chamberlin 1933, Chen-Riordan 2007). A prime example is international trade, where different countries represent different market fragments, in which firms compete with both their local and distant competitors.

Modification of the model assumes the heterogeneity of the firms in productivity. That is, different firms have different production costs and, thus, different behavior. In market equilibrium, we seek conditions for the efficient distribution of firms across price segments, which means that more productive firms produce more good (in accordance with the model of Kokovin S., et al. 2024, where more productive firms choose more populated niches) . That is, we distribute firms by prices according to the efficient distribution, and then find for each firm the required demand value that guarantees the impossibility of profitable deviation (the idea is very similar to screening models, where more productive agents get information rents, that is extra profit, for following their type).

Thus, the equilibrium price distribution and, accordingly, public welfare are determined by the complex structure of consumer preferences, heterogeneity of firms, and spatial characteristics of the market. From an applied point of view, the key results of the work are elements of comparative statics, that is, we analyze how changes in market structure affect the prices and public welfare,

and how does the behavior of firms depend on the distribution of production costs. In addition, we calculate the amount of lost trade due to the home bias effect and show how firm heterogeneity affects consumer and public welfare.

The theoretical interest of the work lies in its contribution to the theory of spatial (local) and monopolistic (global) competition, as well as in proposing a new approach to modeling international trade under the variability of three dimensions: consumer diversity, firm heterogeneity, and variation in spatial characteristics.

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