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## PUBLIC LECTURE

- December 16, 2009, 2pm
- HSII (lecture room II, groundfloor)  
Institut für Höhere Studien  
Stumpergasse 56, 1060 Wien

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### **“Product Heterogeneity, Within-Industry Trade Patterns, and the Home Bias of Consumption”**

#### **ABSTRACT**

Starting with Krugman (1980), much literature has analyzed how trade liberalization affects the economy based on the notion that trade is motivated by consumer's love of variety. In this paper, I first document that in the European car industry, differences in the type of cars that various nations produce and consume are an important factor for explaining the patterns of within-European trade. Second, I document that such across-country differences in the type of cars that people value are associated with a strong home market effect and have reduced trade flows by up to 12% during the 1970s, but much less today since the industry has adapted to the need structure of the common market. To rationalize these patterns, I augment the love-of-variety preferences by the determinants of demand for heterogeneous products. The model features products with heterogeneous attributes and consumers with heterogeneous tastes for attributes. Allowing for international trade, the model predicts a within-industry home market effect, i.e., that high domestic demand for an attribute leads to entry of firms producing a fitting output and, consequently, net exports of such products. Second, the model predicts that consumption is home-biased immediately after liberalization since each industry is optimized for the preferences of domestic consumers and its output does not match well with export market preferences. Third, in the long run, countries specialize further and the within-industry home market effect intensifies. Intriguingly, as long as it is incomplete, specialization implies that the consumption home bias disappears completely and also, that the gains from trade occur to all consumers in the same proportion irrespective of the composition of imports.