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Price and Quality Dispersion in an Offshoring Market: Evidence from Semiconductor Production Services

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This paper studies price and quality differences across international intermediate input suppliers. We develop price measures that account for (i) differences in product characteristics, (ii) unobserved quality differences, and (iii) pure (frictional) price dispersion across suppliers. Using uniquely detailed transaction-level data from the semiconductor industry, we document large average price differences across suppliers for observationally identical products, and find that price differentials close over the product life cycle. We interpret this finding in a model where buyers face costs of switching suppliers. The theory demonstrates how to use the observed price dynamics to adjust prices for unobserved quality differences across suppliers. The results of this analysis reveal that pure price dispersion and unobserved quality differences are both important in this market. These two features make it difficult to construct constant-quality import price indexes, which generally assume away pure price dispersion. We document the resulting upward bias in standard price indexes, develop a quality-adjusted index for semiconductor fabrication, and propose a general method for bounding the true constant-quality price index.

(736 K)

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