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Strategic Location Choice under Dynamic Oligopolistic Competition and Spillovers

Luca Colombo* Herbert Dawid†

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Abstract

This paper investigates firms' optimal location choices explicitly accounting for the role of inwards and outwards knowledge spillovers in a dynamic Cournot oligopoly with firms that are heterogeneous in their ability to carry out cost-reducing R&D. Firms can either locate in an industrial cluster or in isolation. Technological spillovers are exchanged between the firms located in the cluster. It is shown that a technological leader has an incentive to locate in isolation only if her advantage exceeds a certain threshold, which is increasing in firms' discount rate, in industry dispersion, and in the intensity of knowledge spillovers. Scenarios are identified where although it is optimal for the technological leader to locate in isolation, from a welfare perspective it would be desirable that she locates in the cluster.

Keywords: Location Choice, Knowledge Spillovers, Technological Leadership, Markov-perfect Equilibrium

JEL-Code: L13, C73, O31, R12

1 Introduction

A rich literature has investigated a variety of factors affecting the location choices of firms, ranging from the proximity to important sales markets to the availability and costs of relevant inputs¹, from the benefits of an active market for skilled labor (see e.g. Almazan et al., 2007),

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¹In the New Economic Geography literature, transportation costs play a crucial role in shaping the level of agglomeration in the economy; see e.g. Krugman (1991), and Krugman and Venables (1995), or Fujita et al. (1999), Fujita and Thisse (2002), and Ottaviano and Thisse (2004) for comprehensive reviews on these issues.

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