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POLICY COMPETITION AND AGGLOMERATION: A LOCAL GOVERNMENT VIEW

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ABSTRACT: This paper presents a model of local government policy competition in an New Economic Geography-setting. To maximize welfare, local governments can subsidize a mobile factor or provide public goods. In the local perspective, firms' vertical linkages promote colocation and policy (subsidy) setting is simultaneous, giving rise to mixed profiles. Agglomeration benefits lead larger regions to set higher subsidies, preventing a race to the top. We show the results numerically as well as in an analytical case. In contrast to related literature, policy harmonization can be welfare-improving, mainly due simultaneous policy-setting with a (local) utilitarian objective.

JEL Codes: R38, R50, R53, F12

Keywords: Spatial general equilibrium, local policy competition.

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