

Exercise 6

Problem 1: Consider the spatial version of the Dixit-Stiglitz Model as presented in chapters 4 and 5 of Fujita, Krugman, Venables (1999).

- a) Derive the equations that characterise the *price index effect* and the *home market effect*. Explain what these effects imply for agglomeration.
- b) Derive the eight equations that determine the equilibrium in the two-region version of the model. Explain, using graphs, under which conditions manufacturing industry will be concentrated in one region, and when it will be equally divided across regions.