Mobile Capital and the Home Market Effect

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Abstract

To study the home market effect (HME), revealing how industrial location depends on country size, earlier literature uses one-factor or immobile-labor models while more recent literature employs two-factor models with the addition of mobile capital. This paper reexamines those models and finds that the transport costs of the homogeneous good is essential in a one-factor model but not in a two-factor model. Specifically, in a one-factor model, there is a threshold value of the transport costs so that the HME is observed *if and only if* the transport costs of the homogeneous good are below this threshold. Meanwhile, in a two-factor model, the mobile capital brings the existence of the HME for *any* transport costs of the homogeneous good. In addition, in a two-factor model, firms may relocate to the smaller country when the homogeneous good markets are more integrated.

Key words: Mobile capital, Home market effect, Transport costs.

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