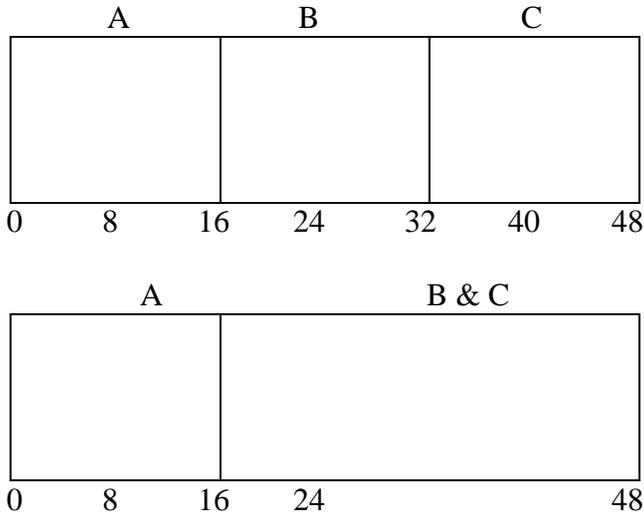


Costs and Benefits of Clusters

Costs



Firm C loses sales. Consumers from mile 40 to 48 used to travel to mile 40 to buy goods, but now they have to go all the way to mile 24, raising net cost and decreasing demand. B sales fall since it splits its original area with C and gets few sales from C's former area.

Benefits - Firms in the Cluster share intermediate input suppliers, get lower wages, better labor skill matches, and communications economies. These result in lower production costs, lower product prices, and increased sales. If the benefits exceed the costs, firms have an incentive to cluster and give up their exclusive market areas.