

Cost Reduction and Economic Welfare in Service Industries

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Abstract

This paper investigates welfare effects of cost reduction in a service industry with location choice by firms. We focus on the situation where firms determine their locations in either of two regions, which have different region-specific costs. In this situation, cost reduction is favorable for all producers in the both regions, wherever it occurs. In contrast, it may be unfavorable for consumers, especially if cost reduction occurs in the region with high marginal cost and the total number of firms is sufficiently small. Finally, cost reduction is unambiguously favorable for the economy as a whole. This result implies that if cost reduction is brought by policy, it is effective for the policy to be conducted in the region with a lower cost. If the policy is conducted in the region with a higher cost, the degree of competition (i.e., the number of firms in the industry) must be cared.

Keywords: Cost reduction; Service industry; Location choice; Cournot competition

JEL classifications: F12; F13; F53

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