

# **Microeconomic Foundations of Clustering Behaviour in the New Economy**

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## **Abstract**

This paper presents a theoretical model explaining the clustering behaviour of firms in the New Economy (NE). A review of I-O literature reveals two views of clustering in the NE. While one view suggests clustering behaviour is more prevalent in the NE, largely because the generation and dissemination of knowledge is more conducive to firms in clusters, another view argues clustering may be less prevalent in the NE as IT has made it possible for firms to effectively communicate, and thus create and pass on knowledge, over distances. The model contributes to the literature by incorporating knowledge creation in clusters as a location specific comparative advantage with Brakman, Garretsen, Gigengack, van Marrewijk, and Wagenvoort's (1996) negative location specific external economies of scale due to congestion into Krugman's (1991) core-periphery model. Simulation results suggest that clustering is more prevalent in the New Economy. Results are useful for understanding industrial location decisions in the New Economy and for designing policy for the economic development of less favoured communities and regions.