1 Theory of Firm Differentials

Let there be a single market that a firm is entering that straddles two counties. Each has a different set of local policy parameters, such as taxes that affect things on the margin. Thus firms want to see on what side of the border between counties profits are larger.

Since prices, wages, and pre-tax rental rates equalize across the border, nominally

$$E(\pi_1|\tau_1) > E(\pi_2|\tau_2)$$