

Abstract

This thesis, building on existing studies on border effect, analyzes price dispersion among cities in the European region over the last twenty years (1990-2009). An extensive overview of the literature reveals that the authors completely neglect the entrepreneurial aspect of the arbitrage process, even though arbitrage is the main power behind the law of one price. Once we understand arbitrage as productive entrepreneurial activity, institutional quality should be one of determinants of arbitrage attractiveness and should, therefore, influence the price dispersion. To test this hypothesis I express the quality of institutions as one of the factors influencing total costs of arbitrage, together with population density in cities used as a proxy for competition intensity, and distance. The regression analysis proves that all three variables explain a part of observed price dispersion – the higher is the density and the better are the institutions, the lower is the predicted dispersion. This result can also be viewed as a small contribution to the emerging literature empirically testing the theory of productive and unproductive entrepreneurship. Keywords: border effect, price dispersion, price convergence, law of one price, institutional quality, entrepreneurship