

ECB FORUM 2019

Comments on:

Spatial Agglomeration and Superstar Firms: Firm-level Patterns from Europe and the U.S.

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Sintra, 19 June 2019



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Alfaro, Chen and Fadinger

- **Firm characteristics** matter as some firms are significantly more centered than others:
 - Firms, including **MNCs**, are far from equal within each industrial cluster
 - **Larger and more productive establishments are centered with more agglomeration than their smaller, less productive counterparts**
- **Region attributes** play an important role:
 - Better location fundamentals (such as human capital and R&D spending) could **weaken** the incentive to agglomerate around super large firms



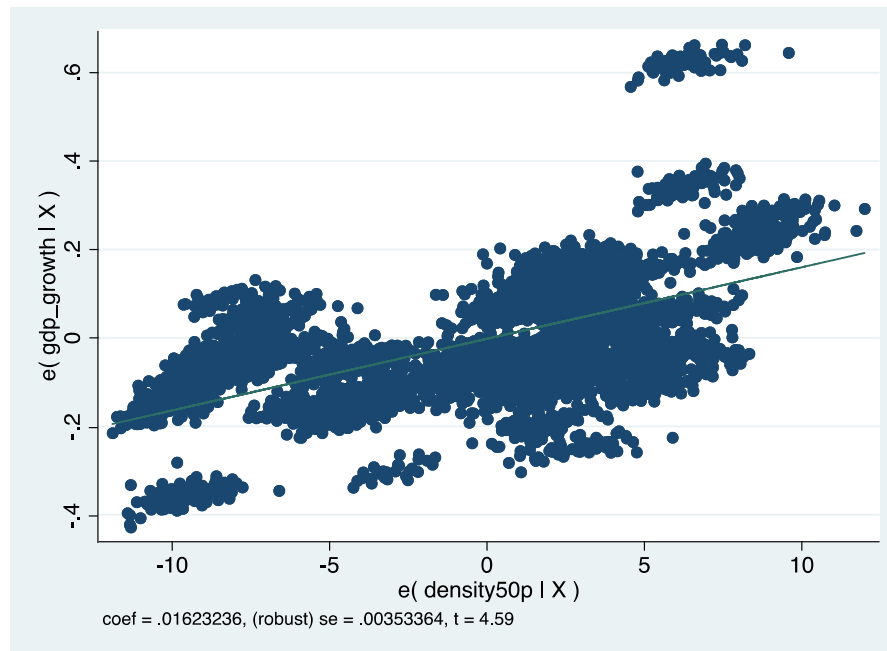
Alfaro, Chen and Fadinger (cont.)

- Dominance of **few superstar (multinational) firms** and emergence of industrial clusters often surrounding them is an important paradox of globalization
- **Agglomeration economies** can be particularly strong around superstar firms (more productive, more intensive in capital and knowledge)
- Some expected easier movement of goods, people and ideas through **economic integration** to reduce the benefits of agglomeration economies
- In contrast, we observe **growing dominance** of superstar firms, industrial clusters and cities despite reductions in transportation and communication costs and the competition implications of geographic concentration



Why should we care? Economics

Eurozone Countries: Regional GDP Growth Rates (2005-2017)



Eurozone: One-standard-deviation increase in agglomeration is associated with a 6-percentage-point increase in growth; (non euro, 3 percentage point). Source: Alfaro et al.

Why should we care? Economics (cont.)

- Breinlich, Ottaviano and Temple (2014)
- Growth and agglomeration in a **core** area could make those living in the **periphery** worse off, even in absolute terms:
 - Particular concern with **restricted mobility** of individuals or firms, and labor mobility may be especially difficult for the poor
- Even when mobility is unrestricted, it may be that **human capital** is relatively costly to acquire in poorer regions:
 - Since children cannot choose where to locate, regional disparities would contribute to differences in **life chances and inequality**



Why should we care? Economics (cont.)

- Tendency for **children** to remain in the same region as their parents:
 - Regional disparities help to explain the decline in **social mobility** seen in the US in the first part of the twentieth century
- As spatial equilibrium takes time to achieve, there could be lengthy periods for which wellbeing **differences persist**:
 - Those who leave declining regions are likely to experience significant **disruption** in their lives, relative to the residents of more prosperous regions.
 - Moreover, **life chances** may be influenced, in ways that economists have rarely analyzed

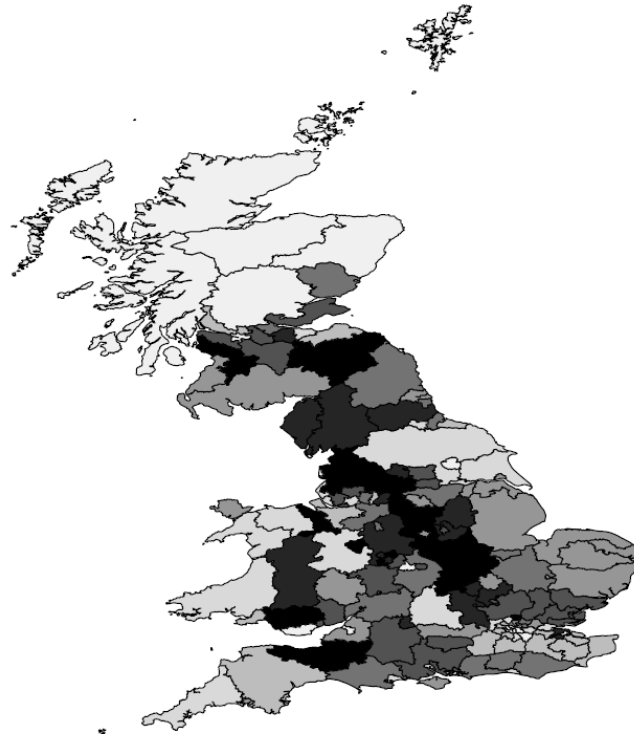


Why should we care? Politics

- Econometric analysis reveals that the **Brexit vote was a vote against regional disparities** enhanced by globalization (measured as a “**China Shock**”: imports from non-European low wage countries)
- A protest vote by those who feel their **regions** have experienced only the **costs of the current wave** of globalization:
 - Foreign competition, factory closures, persistent unemployment, stagnating purchasing power, deteriorating infrastructures and public services, rising social exclusion, brain drain, dwindling local tradition and identity, growing uncertainty about the future



The economic geography of discontent

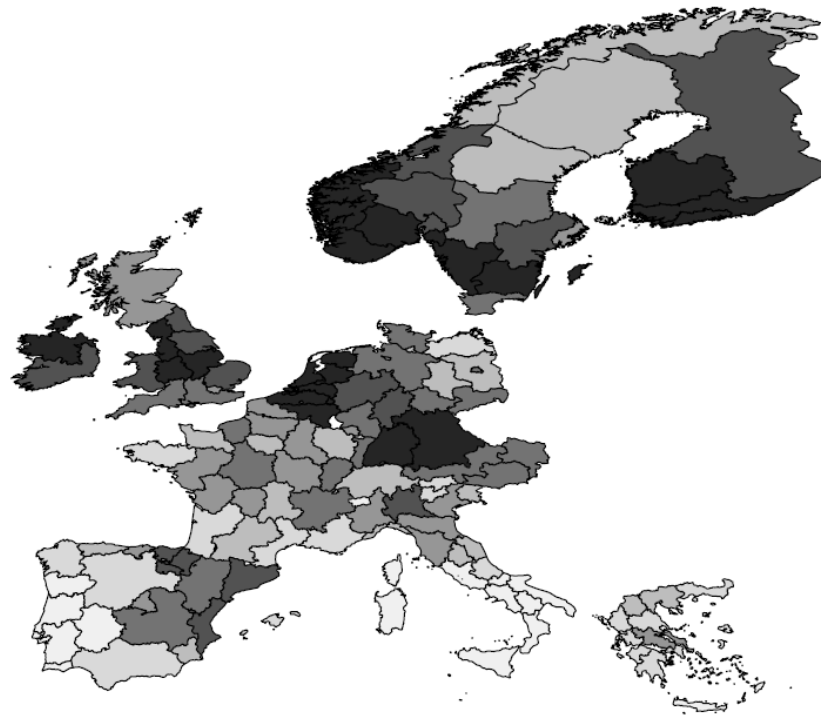


The economic geography of discontent (cont.)

- The **unequal distribution** of the costs and benefits of globalization also explains the rise of the “radical right” in continental Europe
- The areas hit harder by the “China shock” are those where electoral support grew more for the **protectionist right** and fell more for the liberal left
- Support for the liberal right and the protectionist left were largely unaffected
- As the “**reactive redistribution**” of the costs and benefits of globalization have not worked, people ask for “**preventive protection**”



The economic geography of discontent (cont.)



From the China shock to the East wind

- Regions voting more for radical right are not only those hit by the “China shock” but also those on which the **enlargement** of the EU had stronger impact
- From 2004 to 2007, the EU added **12 Eastern countries** to its 15 members
- The “**East wind**” started blowing from the new to the old members with growing **imports from European low wage countries**
- The regional effects of the “East wind” (enlargement) on electoral outcomes is **similar** to, and sometimes stronger than those of the “China shock” (globalization)

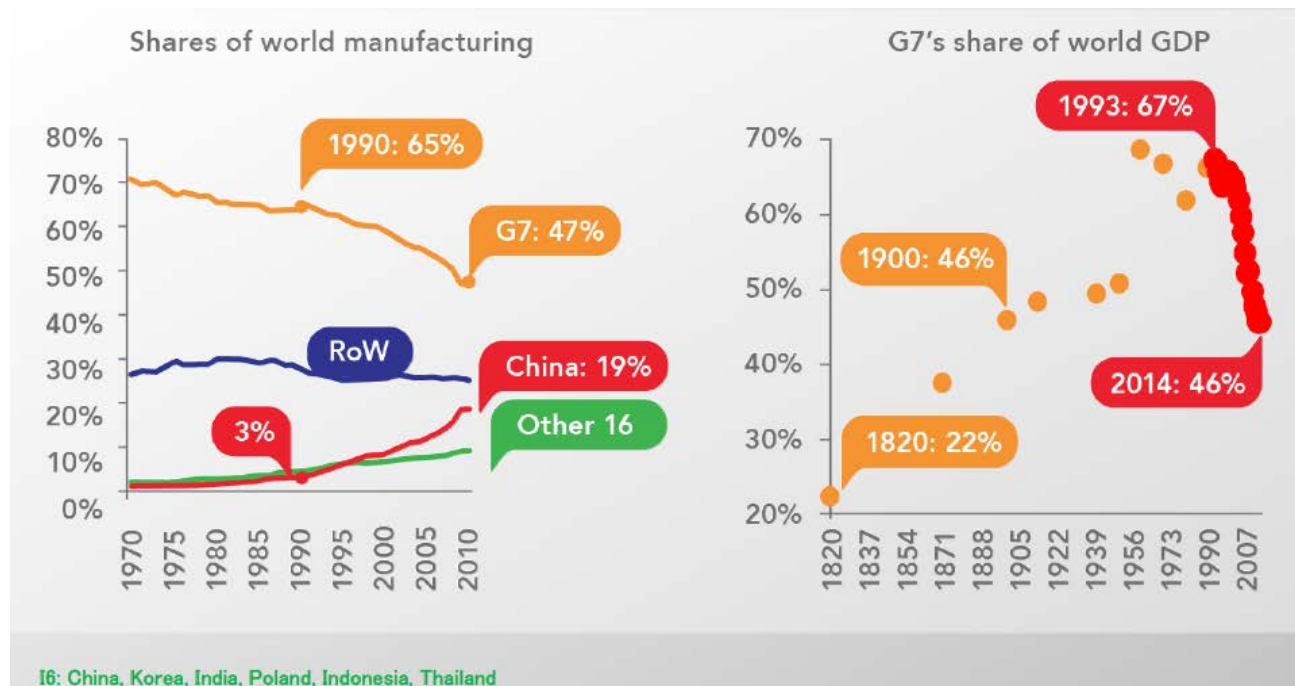


Great Convergence and Great Divergence

- In the last decades Western countries have been affected by **two secular trends**
- **Globally**, due to **offshoring and technology transfer**, manufacturing and GDP shares have shifted from G7 to a few developing countries (first of all China): this is the “**Great convergence**” (Baldwin, 2016)
- **Locally**, due to skill-biased technological change and skilled-biased globalization, the economic geography of G7 countries has become more polarized between **outward-looking dynamic growth centers and inward-looking stagnating backwaters**: this is the “**Great divergence**” (Moretti, 2012)



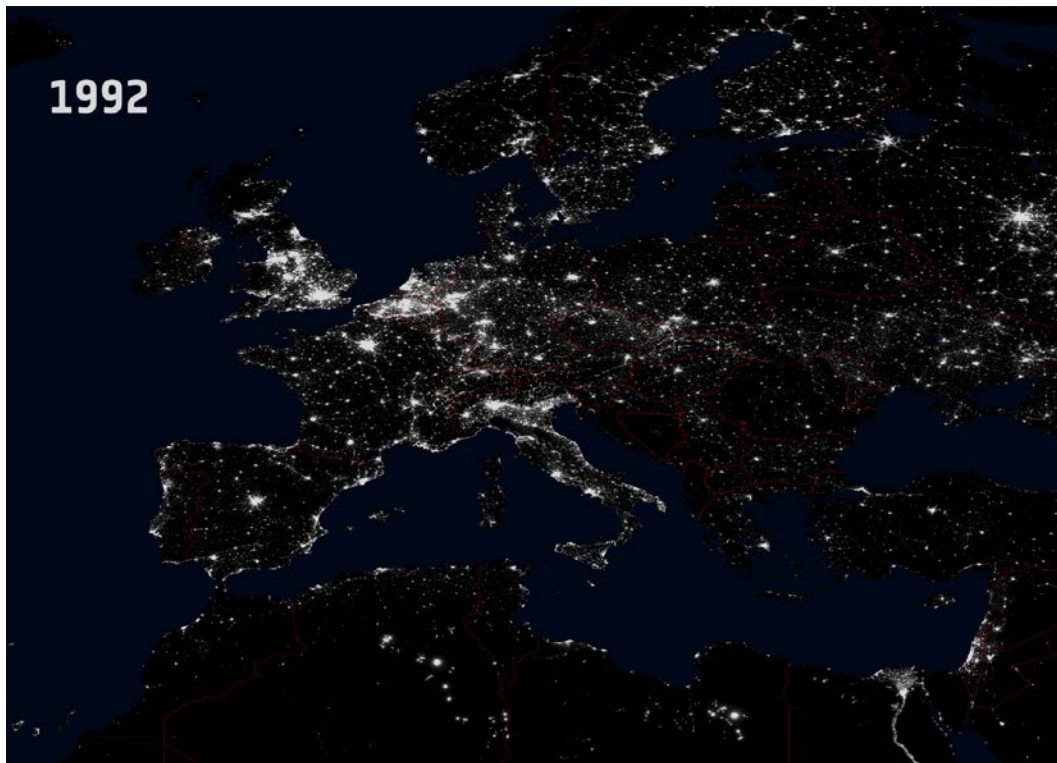
The Great Convergence



The Great Divergence: USA

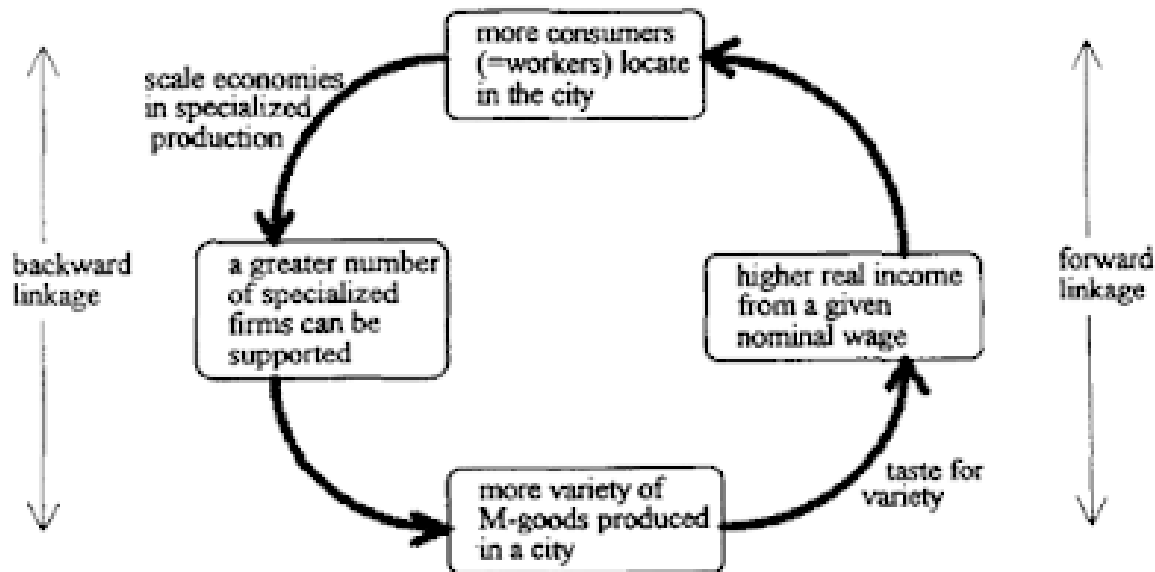


The Great Divergence: Europe



The Triumph of the New Economic Geography

M. Fujita, P. Krugman / Reg. Sci. Urban Econ. 25 (1995) 505–528



Circular causality in spatial agglomeration of firms and workers.



The Return of Protectionism

- Fajgelbaum, Goldberg, Kennedy and Khandelwal (2019)
- For decades, the US pushed for **lower global trade barriers** around the world
- These efforts were **reversed in 2018** when the US implemented tariffs on **12.6%** of its imports, raising tariffs on targeted imports from an average **2.6% to 17%**
- Trade partners **retaliated** by targeting **6.2%** of US exports, raising tariffs from average **6.6% to 23%**



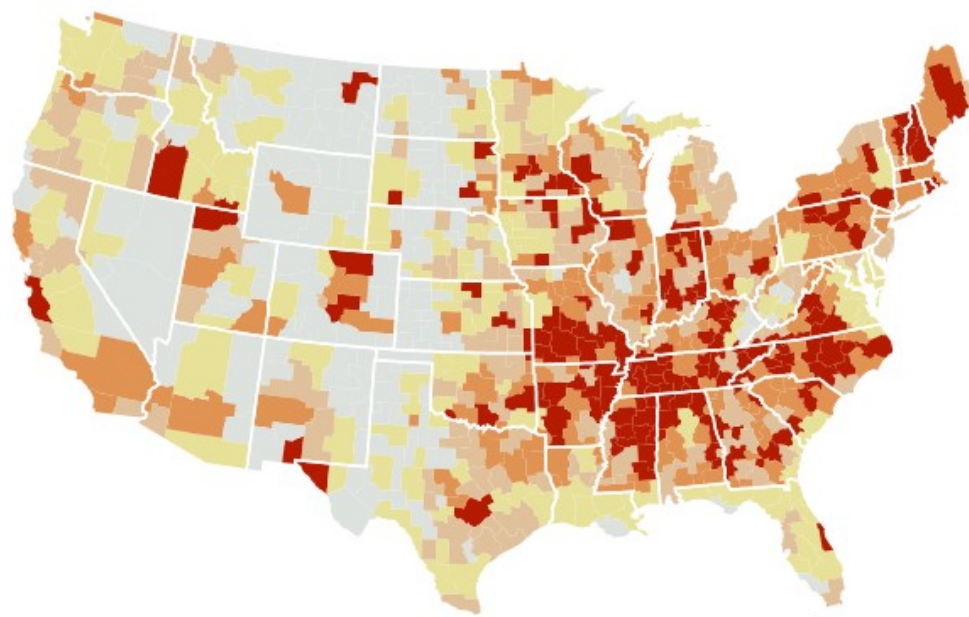
The Return of Protectionism (cont.)

- This episode is the **largest return to protectionism** by the US since the 1930 Smoot-Hawley Act and the 1971 'Nixon shock' (Irwin 1998, 2013)
- **US tariffs protected politically competitive counties, whereas retaliations targeted heavily Republican counties**
- On net, **Republican counties** are most negatively impacted by the trade war

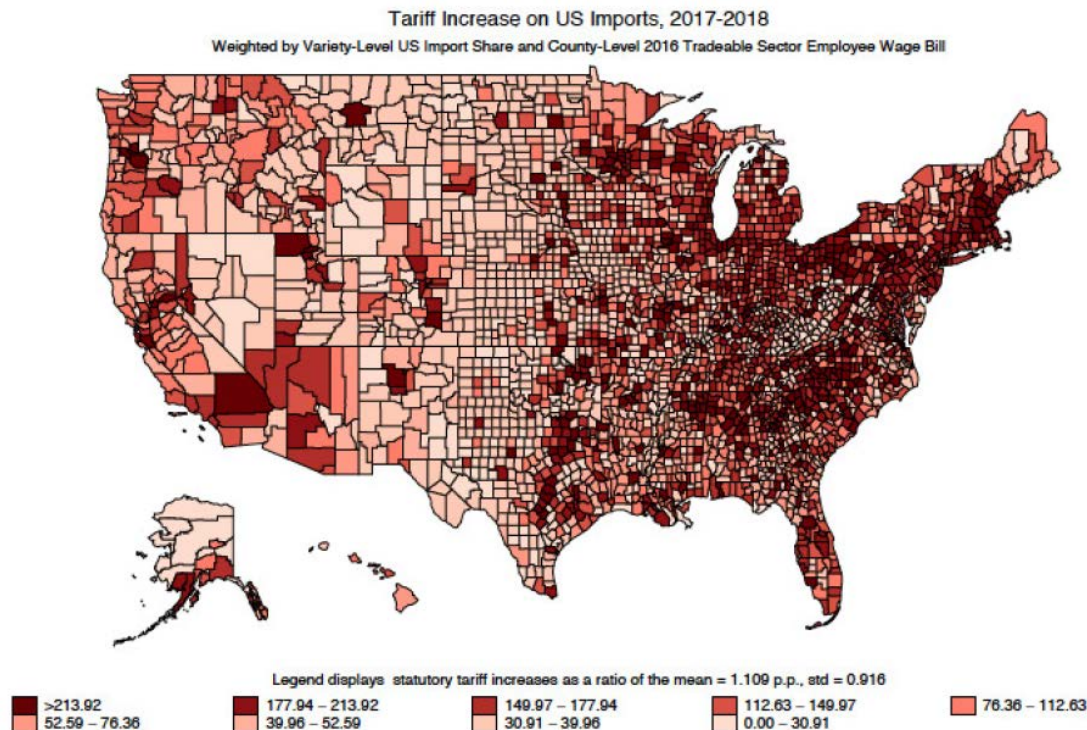


The Return of Protectionism (cont.)

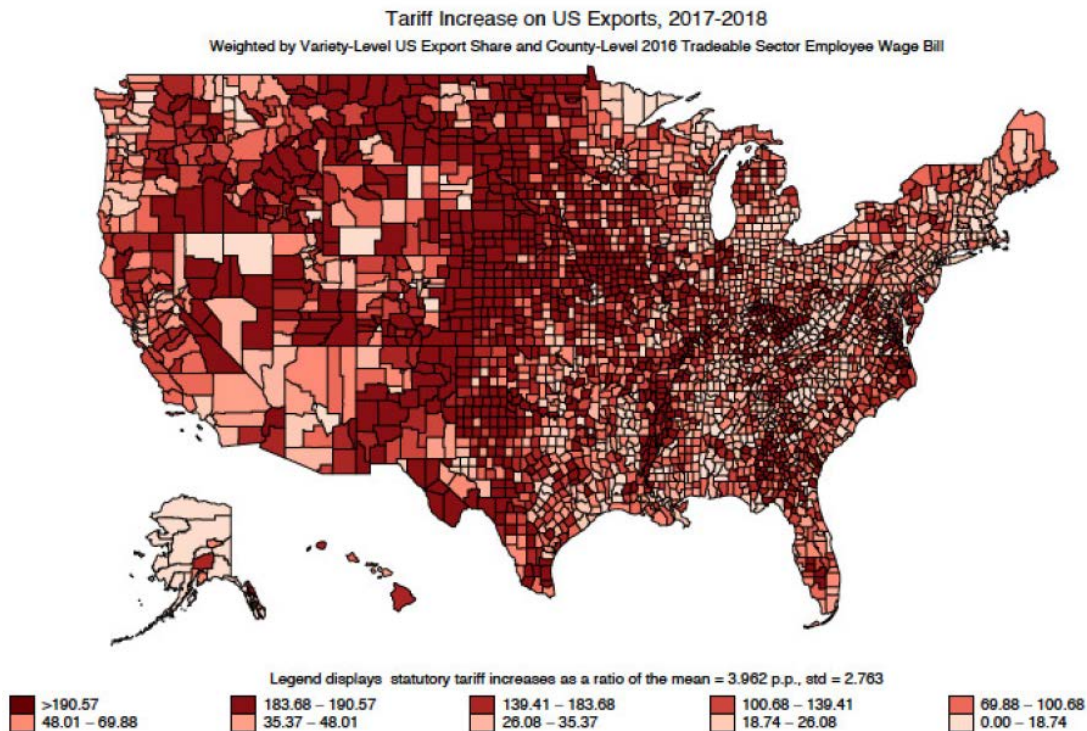
Most-affected 20% Second-highest 20% Middle 20% Second-lowest 20% Least-affected 20%



The Return of Protectionism (cont.)



The Return of Protectionism (cont.)



The Return of Protectionism (cont.)

- Fetzer and Schwarz (2019)
- **Retaliatory tariffs are politically targeted**
- Retaliation directly targeted to areas that swung to Donald Trump in the 2016 **Presidential elections**
- But **not to other Republican candidates** running for office in the same year

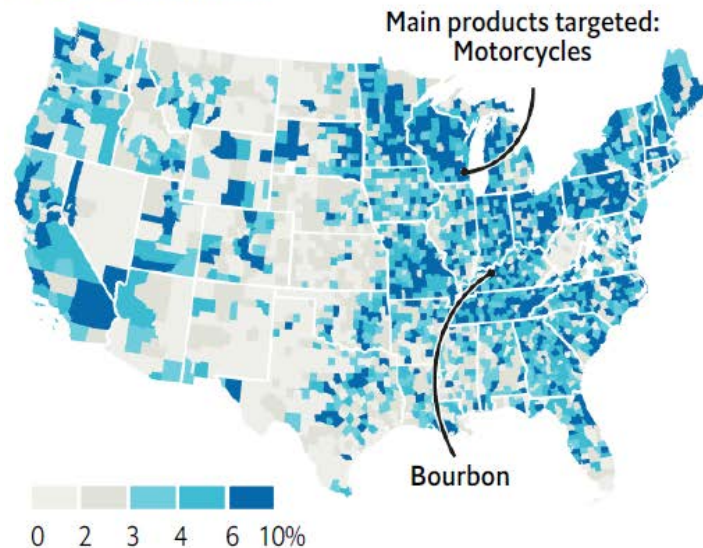


The Return of Protectionism (cont.)

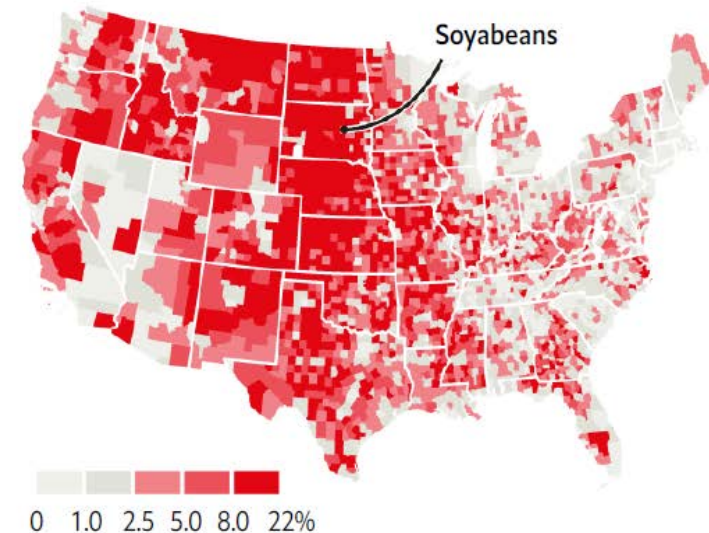
- Retaliation aimed at Trump voters: EU in Rust Belt, China in Great Plains

Share of counties' exports affected by retaliatory tariffs, %

The EU's tariffs



China's tariffs

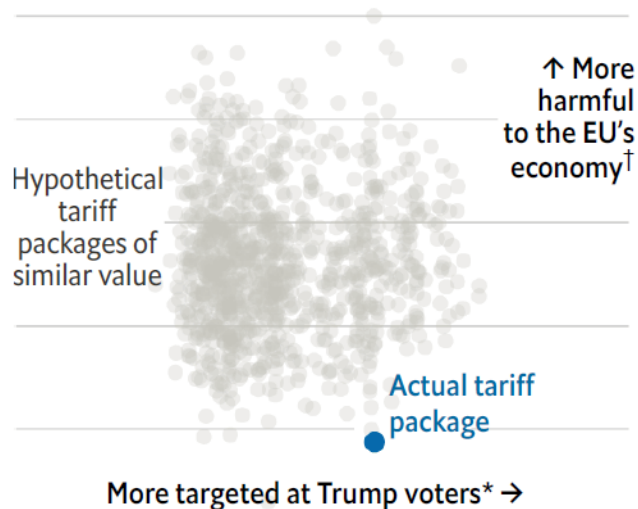


The Return of Protectionism (cont.)

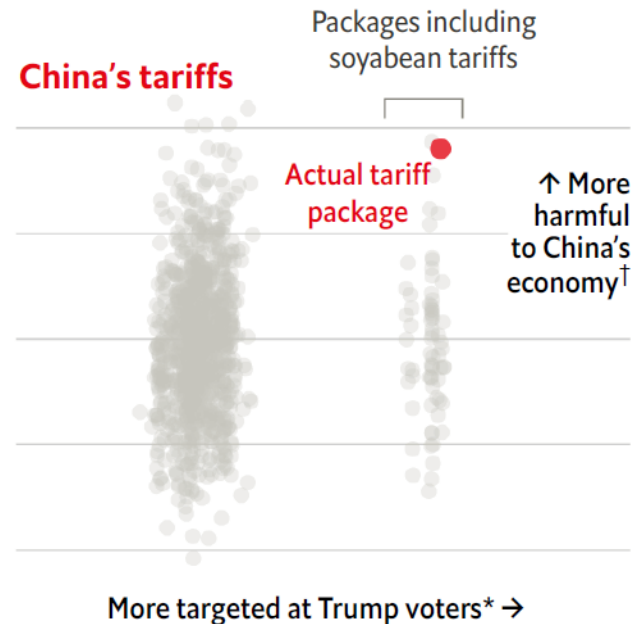
- EU minimizes self harm, China does not

Political impact and domestic economic cost of tariff packages
Actual v 1,000 simulated alternatives

The EU's tariffs



China's tariffs



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THANK YOU FOR YOUR ATTENTION

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