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Product diversity, taste heterogeneity, and geographic distribution of economic activities: market vs. non-market interactions[☆]

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Abstract

There are two independent strands of literature on the geographic distribution of economic activities. One is the new economic geography that emphasizes product diversity, and the other is probabilistic migration that stresses taste heterogeneity in residential location. This article incorporates these two characteristics into a single framework, and analyzes how they affect the number and stability of equilibrium geographic structures. It shows that the home market effect due to market-mediated product diversity creates an agglomeration force, whereas idiosyncratic taste differences due to non-market interactions serve as a probabilistic immobile factor and induce a dispersion force. The tension between these opposite forces, together with the decline in transportation costs, yields different patterns of agglomeration and the associated changes in interregional wage differentials.

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1. Introduction

The interregional differences in economic activities arise from myriad market and non-market interactions. This view dates back at least to Hicks [14]. In “The Theory of Wages” Hicks proposed that the persistence of regional differences in wages is due to “differences in the cost of living” and “indirect attractions of living in certain localities.”¹ Thirty years later, Sjaastad [35] divided the costs and returns of migration into “money” and “non-money” factors. The money costs are literally pecuniary ones, whereas the non-money costs are subdivided in two: “opportunity costs” related to the distance of migration and the level of unemployment in the destination, and “psychic costs” that prevent people from leaving familiar surroundings, family, and friends.² On the other hand, he defined the money returns of migration as an increment to a migrant’s real earnings stream, whereas he related the non-money returns of migration to factors such as climate, smog, and congestion.³ Furthermore, Jane Jacobs [15,16] emphasized both social and economic factors as determinants of the rise and fall of cities. In part one of [15] she focused on how neighborhood environments, such as sidewalk safety, useful and enjoyable contacts, and parks (i.e., non-market interactions) affect the residential configuration, and in part two, on the condition for urban diversity (i.e., market interactions).⁴ Jacobs’ subsequent work [16] can be considered as further elaboration of the latter perspective. In those days, the dichotomy between market and non-market interactions was dominant, and these two types of interactions were treated in a unified framework.

Since then, the effects of each type of interactions on the geographic distribution of economic activities have been independently explored in each strand of literature with solid theoretical frameworks. One is the so-called new economic geography (such as Krugman [18] and Fujita et al. [5]) that utilized the Dixit–Stiglitz model of monopolistic competition (Dixit and Stiglitz [4]). It emphasized the importance of product diversity, transportation costs, and immobile factors such as peasants and land that are jointly associated with pecuniary externalities for creating agglomeration and dispersion forces. It focused solely on interactions within markets where the prices transmit all information on the economy. In addition, it assumed that both peasants and workers have identical preferences for

¹ The “quality of life” literature, such as Rosen [32] and Roback [31], suggests that the interregional wage differentials are affected not only by land prices but also by amenities.

² Makower et al. [21–23] found that a longer distance of migration and a relatively higher unemployment rate in the destination reduce a migration rate. Mincer [26] made a distinction between personal and family migration decisions, and confirmed that family ties and a labor market attachment of women tend to deter migration.

³ Glaeser et al. [10] used regional dummies and stated that “weather and other regional characteristics have played an important role in migration and hence the growth of cities” (p. 129). Moreover, Glaeser et al. [9] found that population growth of cities has a positive relationship with amenities such as temperate climate, dryness, and proximity to the coast.

⁴ Glaeser et al. [8] tested the relationship between urban diversity and employment growth in cities and concluded that urban diversity and local competition encourage employment growth. Note, however, that their definition of “diversity” includes non-market factors such as knowledge spillovers among different industries.

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