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Economic geography and the distribution of profits

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Abstract

In modern economies, the amount of profits distributed to shareholders is far from being negligible. We show that the way they are distributed among agents matters for the space-economy. For example, the existence of mobile rentiers is sufficient to make the symmetric configuration unstable for all transport cost values and to allow for the partial agglomeration of firms. Obviously, to account for profits and for their distribution, the assumption of free entry must be abandoned. So doing, we ignore fixed costs and show that it is the combination of imperfect competition and firms' indivisibility that matters for the formation of agglomeration in economic geography.
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1. Introduction

Economic geography models show that mobile activities are agglomerated (respectively dispersed) when transport costs are sufficiently low (respectively high); however, when the

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output of the mobile sector is very differentiated or the share of this sector is large, a region acts as a "black hole" in that agglomeration prevails for all transport costs values (Krugman [11], Fujita et al. [5], Neary [14]). These results are established for a highly simplified economic environment. First, the free-entry zero-profit condition associated with monopolistic competition implies that wages are the unique source of individual incomes. Such an assumption clashes with the importance of profits that account for about 15% of the GDP of many developed countries (Sørensen [17]). It also amounts to assuming that the number of entrepreneurs within the economy is sufficiently large for all profits opportunities to be exhausted in all regions, as if entrepreneurship were not a scarce resource. Second, economic geography assumes that the only actors who shape the space-economy are the immobile "farmers" and the mobile "workers." Once firms make positive profits, it is our contention that *firms' owners must be taken into account in the study of the location and trade process, thus implying that the ownership structure of firms may affect significantly the spatial pattern of production and consumption*. Indeed, when choosing a location for themselves, firms' owners affect the size of demand within each region and, therefore, the location of firms and workers.

Exploring the impact of firms' ownership on the space-economy within an otherwise standard model of economic geography is therefore the objective of this paper. To this end, we change the canonical model of economic geography in two respects. In the first place, we retain Chamberlin's [4] idea of a "large group" in which *the number of firms is large but fixed* (there is no entry and exit).[1] Using a fixed number of firms is fairly common in economics. For example, it is central to the Arrow–Debreu model used in general equilibrium theory (Arrow and Hahn [2]). The number of firms may also be fixed for various reasons. First, entrepreneurship may be a scarce resource that limits the proliferation of firms. Second, the number of possible varieties that firms may supply may be bounded because of legal or technological reasons. Last, as argued in industrial organization, entry barriers may be built by firms to preserve their supranormal profits.

In the second place, we consider several types of agents: *farmers* and *workers*, as in all economic geography models, but also *entrepreneurs* and *rentiers*. Regional wages are determined on competitive labor markets and market power endows firms with a positive mark-up, thereby a positive profit can be distributed. Although we provide the analytical description of any ownership combination involving the above-mentioned agents, we find it convenient to focus on a taxonomy of *five* particular, but relevant, ownership structures. In the first one, entrepreneurs are firms' owners—hence their earnings are equal to their firm's profits—and they must reside where their firm is established. Second, we allow for the firms' owners to be rentiers who choose to reside wherever they want in the economy. In the third scenario, firms' owners live abroad, in which case profits are not recycled within the economy.[2] In the fourth one, profits go to farmers who stand for immobile shareholders. Finally, profits are distributed to workers, and these earnings supplement their wages. In this case, workers' welfare depends on their real wage but also on the nominal profits made in each region.

[1] See Vives [19] for a similar assumption in a different context.

[2] This is also a classical assumption in the literature on foreign direct investment; see, e.g., Haufler and Wooton [8].

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