TITLE: UNCERTAINTY IN VERTICALLY LINKED INDUTRIES: A NEW ECONOMIC GEOGRAPHY MODEL

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ABSTRACT:

An important issue in the New Economic Geography literature is to assess the nature of the relationship between the level of integration and the degree of agglomeration: once the agglomeration of industrial activities has occurred, do industries tend to redisperse or not with the pursuit of the integration process? In this paper, we investigate this issue in a two-regions model which extends the Venables (1996) by accounting for uncertainty in interregional input-output linkages and associated coordination costs. The need of coordination between upstream and downstream industries has two main sources: i) first, the geographical distance between intermediate and final producers; ii) second, the complexity of the production process captured by the number of intermediate goods used in final production. In this framework, we reach two main results. First, the presence of coordination costs makes agglomeration more likely. Second, re-dispersion does not occur despite wage differentials unless the level of coordination cost falls below a critical value. This result is supported by the European Manufacturing Survey (2006). This study suggests that outsourcing, led by wage differential, can be counteracted by a high level of coordination cost, enhancing the agglomeration of economic activities.