

Trade Costs and the Agglomeration of Production

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The object of this work is to study the evolution of trade costs and of the agglomeration of production, as well as their relationship, at the sectoral level in the EU. We check whether and how trade costs and agglomeration have changed, and if it is possible to establish a connection between the two. The analysis is developed by considering the Home Market Effect's prescription of increasing agglomeration when trade costs decrease.

We devise an original test of the sign of the joint variation between trade costs and agglomeration which exploits different bootstrap distributions. Their relationship is also analysed through a regression analysis which, differently from what is in the literature, uses agglomeration and trade-costs indicators, by so doing, we avoid any simultaneity bias.

Our analysis suggests that the net evolution of these two entities depends specifically upon the sector considered. On the whole, trade costs seem to have decreased while agglomeration shows a non-increasing trend. As for the interaction of trade costs and agglomeration, they are more likely to move in an opposite direction but results depend on the specific sector considered in this case too. Furthermore, we find evidence that trade costs contribute to explain the observed levels of agglomeration as well as its evolution.