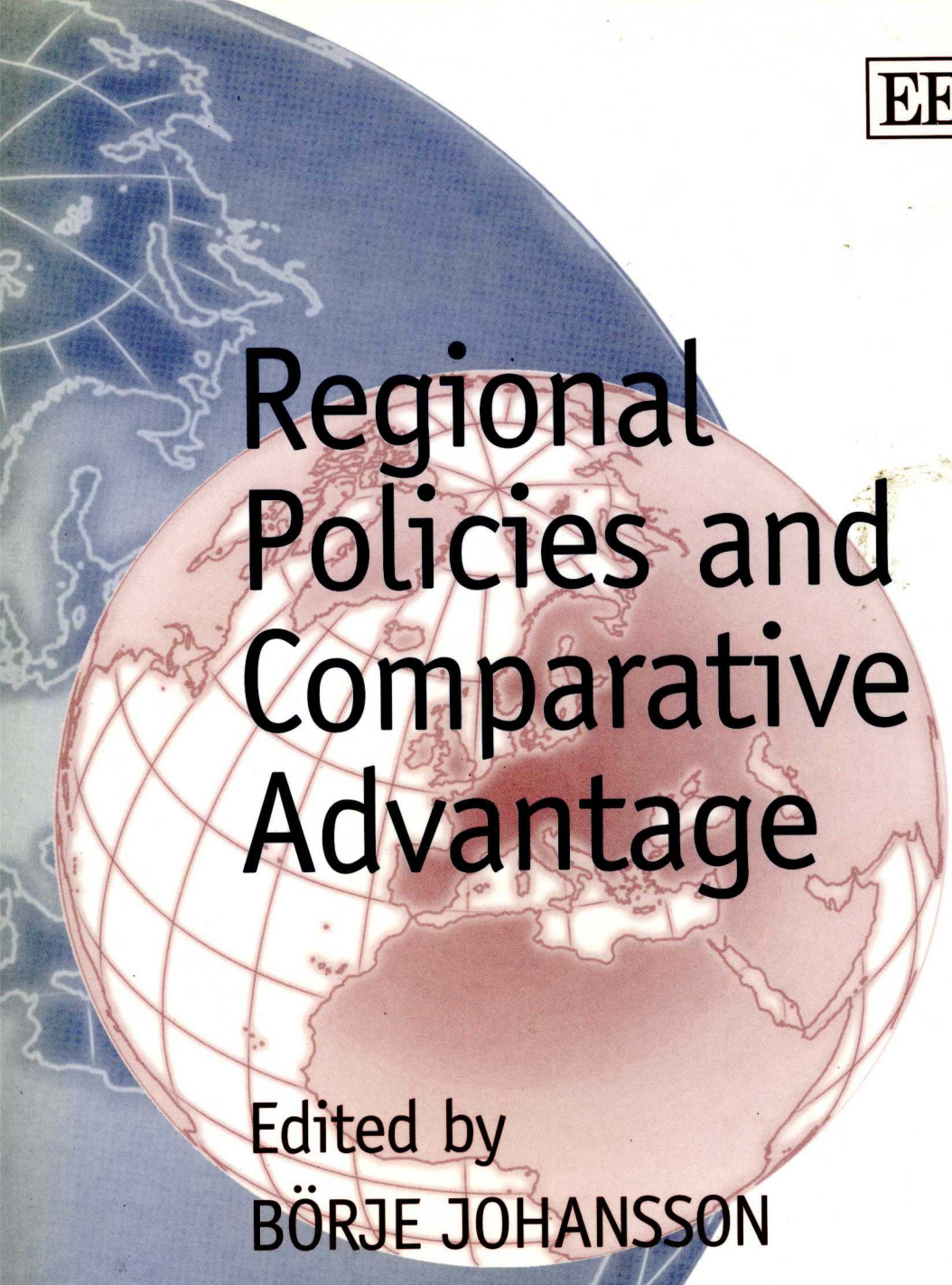

Regional Policies and Comparative Advantage

Edited by
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Preface

The contributions forming the different chapters in this book were first presented and discussed at an international workshop in June 1999 in Fiskebäckskil, Sweden. The workshop, which had the theme 'Evaluation of Regional Policies', was the second in a row of international workshops related to evaluating the effects of the application of the European Union structural funds.

The workshop was organised jointly by the Department of Economics and Business Administration, University of Trollhättan/Uddevalla, Sweden, Jönköping International Business School, Jönköping University, Sweden and the School of Public Policy, George Mason University, USA.

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1. Introduction: Regional Policy Evaluation in the New Economic Geography

Charlie Karlsson and Roger Stough

INTRODUCTION

The conceptions of economic development in modern regions have gone through a fundamental change since the beginning of the 1980s. Today, regions are increasingly looked upon as independent market places that are connected via interregional and international trade and not as administrative units embodied in a national unit. Two different but complementary theoretical frameworks explain the economic specialisation of regions. The traditional but insufficient framework assumes that the comparative advantages of regions depend upon differences in the supply of lasting resources.

The new complementary framework known as the new economic geography assumes that the dynamic interaction between geographical market potentials and rational firms in its own way creates the comparative advantage of regions. These comparative advantages take the form of localised increasing returns to scale, for example the formation of highly competitive and rapidly growing industrial clusters. In this framework the role of regions as market places and as carriers of specialisation advantages is stressed. Economic development in a country is no longer a question of national specialisation and competitive power but of regional specialisation often based on clusters and geographical competitive advantages.

The new framework puts regional policy in a new perspective. Of course, regional policy can still stimulate the development of dynamic comparative advantages through investments in lasting resources such as infrastructure capital, human capital and R&D. However, according to the modern theories of endogenous regional economic growth, regional growth comes in major part from internal conditions that can be influenced by policy and other processes. Internal conditions must be developed and implemented

with specific local and regional knowledge. The new theoretical base for regional policy also means new challenges for evaluating the effects of regional policies. Evaluation of regional policies must be given a new focus, a new time perspective and new models. This, in summary, is the message from the papers collected in this book.

The purpose of this introductory chapter is to present the new theoretical framework for regional development and, hence, regional policy. It highlights the problems faced today in regional policy evaluation and it presents the chapters included in this volume.

A STYLISED MODEL OF THE NEW ECONOMIC GEOGRAPHY

Current research on the links between regional market potentials and scale economies has produced a rich variety of models. However, most of these models have a common theme. Some common aspects for many models related to the new economic geography are illustrated below.

Increasing returns is a common theme in these models. In the simplest case externalities emerge as a consequence of market interactions involving economies of scale at the level of the individual firm. To deal with this situation it is common to use a spatial version of the Dixit–Stiglitz model of monopolistic competition that allows for multiple locations and transport costs between different locations (Dixit and Stiglitz, 1977).

These models, in their most elementary form, contain two sectors: agriculture and manufacturing. The agricultural sector is perfectly competitive and produces a single homogenous good. On the other hand it provides a large variety of differentiated goods, is characterised by increasing returns and is hence imperfectly competitive. The number of potential manufactured goods is very large.

Production and consumption takes place at a specific location in a geographic space with discrete locations. All consumers have the same preferences and a taste for variety. Each variety of the manufactured good is produced in only one location. All varieties produced at a particular location are symmetric, having the same technology and price. Economies of scale arise for different levels of variety and no economies of scope are allowed.

Agricultural and manufactured goods can be shipped between locations and may incur shipment transport costs. Total sales of a specific variety depend on income in each location, the price index in each location, transport costs and the mill price. Because of increasing returns to scale, consumers' preferences for variety and the unlimited number of potential

varieties of manufactured goods, no firm will choose to produce the same variety as another firm.

Hence, each variety is produced in only one location by a single specialised firm. This means that the number of firms is equal to the number of varieties. Here all scale effects work through changes in the variety of goods available. The number of firms in each location is related to the size of the manufacturing labour force in a location.

A location or region with a large manufacturing sector has a lower price index for manufactured goods, because a smaller proportion of this region's manufacturing consumption has to bear transport costs. The region with the larger home market has a more than proportionally larger manufacturing sector and therefore also exports manufactured goods. This phenomenon is known as the home market effect. Locations with large concentrations of manufacturing also tend to have a large demand for manufactured goods.

The basic model framework presented in this section is now expanded.

INCREASING RETURNS AND INTERNAL ECONOMIES OF SCALE

The idea of increasing returns is a basic ingredient in modelling approaches related to the new economic geography. Without increasing returns it is virtually impossible to explain the geographical concentration of firms, regional specialisation and the importance of the home market. Increasing returns is also a basic explanation for trade among regions. If the relationship between the scale of production and the average cost per produced unit is negative, scale advantages exist, which are synonymous with increasing returns to scale.

The major explanation for the existence of increasing returns is that some production factor in a firm is fixed and, hence, gives rise to a cost that is fixed and independent of whether production is small or large in a given interval. The most common explanations to the existence of fixed factors of production are indivisible resources and so called set-up costs, which consist of development, start-up, establishment, preparation and training costs. These latter costs are normally associated with labour and immaterial resources, while indivisible resources are most often associated with capital objects such as buildings, facilities, machines and material networks. Other examples of fixed factors are knowledge assets, brand names and non-material networks. A fixed production factor can be most closely compared to a catalyst, which must be present in production. As such it generates a cost – often a start-up cost – but the use of the resource is not dependent upon the volume of production or if the firm has many or few customers.