The ‘New’ Economic Geography: Where Are We?

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Importance is an eigenvector. Really. The search engine Google uses links among websites to rank sites by importance, through a seemingly circular process in which a site’s importance is determined by the number of links it receives from other sites, weighted by their importance. The process bears a strong formal resemblance to the process that generates geographical concentrations of economic activity in some of the models that Masahisa Fujita, Anthony Venables, and I have worked on; in both cases what emerges is the eigenvector with the largest eigenvalue. And anyone who uses Google routinely knows that the eigenvector embodies the truth: Google is almost always right about what is important.

I mention this because Google has a new service, which lets one search scholarly work the way one searches the Web; citations play the same role that links play in regular Google. When I learned about the service, I did what any academic would do, and Googled myself. And it turns out that the work I did on economic geography is, in the judgment of the eigenvector, the most important of my scholarly career. That’s good to know – especially because of the fields I have worked in, geography is my personal favorite, and the collaboration with Fujita and Venables among the most fruitful.

But where does the field stand, almost 15 years after I began working in it? Where is the ‘new’ economic geography today? For this book, I want to provide an overview of the state of empirical play.

Four propositions

The new economic geography began with simple, stylized models designed for tractability rather than realism; in Fujita, Krugman and
Venables we described our approach as depending on ‘Dixit-Stiglitz’ – a highly unrealistic but tractable model of increasing returns and imperfect competition – ‘icebergs’ – a highly unrealistic but tractable way to incorporate transportation costs – ‘evolution’ – an ad hoc but tractable way to think about dynamics – and ‘the computer’, because even with all this sacrifice of realism to tractability the models weren’t all that tractable, and numerical examples were an essential guide to theorizing. But the specifics of the models weren’t the point; what we and the many other theorists who have entered this field were really trying to do was find a way to clarify a world-view about how economic interactions over space work. That world view rested on four propositions:

1. Transportation costs, or more broadly transaction costs across distance, play a crucial role in shaping international and interregional trade. In contrast to traditional trade theory, and even traditional urban economics, we argued that distance matters.

2. The interaction of market size with increasing returns plays an important role in determining the location of production. That is, we argued that some kind of home-market effect, as opposed to localized resources or more amorphous externalities, was at least one major explanation both of differences in population density and localized specialization.

3. A cumulative process in which large markets attract production, which increases the size of markets, leads to agglomeration – and possibly to multiple equilibria. Much of the excitement surrounding the new economic geography came from its suggestion that historical accident might play a major role in shaping the location of production, and also that cities and regions might be subject to discontinuous change.

4. The same processes that shape economic geography within countries also shape international trade. We hoped, finally, to justify Ohlin’s claim that international trade theory is simply international location theory – or my version from 1990, that I was like Moliere’s character who was startled to learn that he had been speaking prose all his life; I thought I had learned that I had been doing economic geography all my years as a trade theorist.

It was an exciting and inspiring world view, but was it right? We now have quite a lot of empirical evidence. So let’s look at the propositions.