

# Specializing in Density: Spatial Sorting and the Pattern of Trade<sup>\*</sup>

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February 28, 2022

## Abstract

This paper documents one way that domestic economic geography affects patterns of trade by showing that a country's population distribution is an important source of comparative advantage. We develop strategies to estimate both the "population density affinity" of each industry and the "population concentration" of any geographic area. We show that both US states and countries with more concentrated ("denser") populations disproportionately export in sectors with high population density affinity. The findings are similar using an instrumental variables strategy in which we exploit variation in countries' historical city size distribution to construct instruments for modern population concentration. We rationalize these findings with a model in which national sector-specific exports emerge endogenously from the distribution of productivity and factors within countries, and show how location-level data can be aggregated to measure determinants of country-level specialization. Even conditional on aggregate endowments, our results suggest that the within-country distribution of population—in particular, the extent to which it is concentrated in dense cities—shapes comparative advantage.

**JEL codes:** F14, F16, R12, R13.

**Keywords:** International trade, comparative advantage, density, spatial sorting.

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\*We thank Daron Acemoglu, Treb Allen, David Atkin, Abhijit Banerjee, Arnaud Costinot, Dave Donaldson, Mayara Felix, Teresa Fort, Joel P. Flynn, Nathan Nunn, Ben Olken, Pierre-Luc Vautrey, and Ivan Werning for advice and comments. We are also grateful to seminar participants at MIT, Dartmouth, and the Urban Economics Association for helpful feedback.

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## 1 Introduction

Does the distribution of economic activity *within* countries affect the pattern of trade *across* countries? Most analyses of comparative advantage treat countries as unified factor markets or equilibrium “points” in the production space. However, there is mounting evidence that the *distribution* of factors within countries—and in particular, population density—is a key determinant of productivity.<sup>1</sup> The impacts of place-based policies, of urban agglomeration, and of spatial sorting, as well as their implications for domestic welfare and inequality, are the subject of substantial analysis.<sup>2</sup> Urban planners and politicians debate the role of density in shaping features of life ranging from firm location decisions to local pollution to violent crime. This paper documents that domestic heterogeneity also has a major impact on patterns of trade—differences across countries in the extent of agglomeration (or lack thereof) shape comparative advantage.

The hypothesis domestic heterogeneity could affect comparative advantage is general, and a version of it dates back to Courant and Deardorff (1992), who argue that the “lumpiness” of factor distribution can affect a country’s pattern of exports. We take it directly to data by investigating one particular but central example of domestic heterogeneity: population density and distribution. Density may boost productivity through several potential mechanisms; dense cities ease search and matching frictions in the labor and product market, attract high-skilled and talented workers, provide large and local consumption markets, and serve as hubs for high-tech investment and innovation (e.g. Duranton and Puga, 2004; Moretti, 2012). Crucially, moreover, and as we will document in detail, density bolsters productivity differentially across industries, some of which end up located at the center of large agglomerations while others end up in smaller cities or sparsely populated areas.<sup>3</sup>

This logic suggests that the extent to which a country’s population is concentrated in dense areas might affect not only its domestic productivity, but also its international specialization. If industries benefit differently from population density, holding all other country-level characteristics constant, countries with a more concentrated population distribution will have a comparative advantage in industries that benefit disproportionately from agglomeration. While a range of work has analyzed the effect of trade on domestic economic geography, this reverse relationship—the effect of patterns of urbanization on patterns of trade—has received little attention.<sup>4</sup> Using novel measures of industry-level “density affinity” and country-level “population concentration,” we show that urban density is a significant determinant of international exports.

We first present a model that illustrates how the distribution of factors of production within countries—i.e. having a concentrated versus dispersed population—affects patterns of trade. In the model, industries vary in the extent to which they benefit from the population density of the

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<sup>1</sup>For example, see Keesing and Sherk (1971), Ciccone and Hall (1996), Duranton and Puga (2004), and Moretti (2012) and more recently Davis and Dingel (2014) and Gaubert, 2018.

<sup>2</sup>See e.g. Hsieh and Moretti (2019) and Kline and Moretti (2014)

<sup>3</sup>On the impact of density on *sector-specific* productivity and role of density in determining heterogeneity across sectors in spatial sorting, see also Nakamura, 1985; Rosenthal and Strange, 2004; Faggio, Silva, and Strange, 2017.

<sup>4</sup>On the impact of trade shocks on domestic economic geography, see, for example: Autor, Dorn, and Hanson (2013), Caliendo, Dvorkin, and Parro (2015), Dix-Carneiro and Kovak (2015), Ramondo, Rodríguez-Clare, and Saborío-Rodríguez (2016), and Bakker (2018)

location in which production takes place.<sup>5</sup> Countries are composed of locations endowed with different sector-neutral productivities. Endogenously, countries with more dispersion in sector-neutral productivity exhibit higher population-weighted density (i.e. a more concentrated population) and have a comparative advantage in sectors that benefit relatively more from local agglomeration.

The theory provides three key insights. First, motivated by evidence that countries display significant domestic spatial heterogeneity in factor prices, product specialization, and relative productivity (e.g. Porter, 2003; Desmet and Rossi-Hansberg, 2013), our model formalizes the idea that the relevant units of observation for understanding comparative advantage are regions within countries where production takes place. This is different from most models of comparative advantage, which focus on aggregate country-level characteristics that are taken as given. Second, our model documents how regional variation can be aggregated to uncover country-level determinants of comparative advantage. The model formalizes our use of “population-weighted density” as the country-level summary of within-country heterogeneity in population density. Finally, the model provides theoretical justification for our main empirical framework and result: countries with higher population-weighted density have relatively lower autarky prices in sectors that benefit relatively more from agglomeration; hence, their exports exhibit a revealed comparative advantage in these sectors.

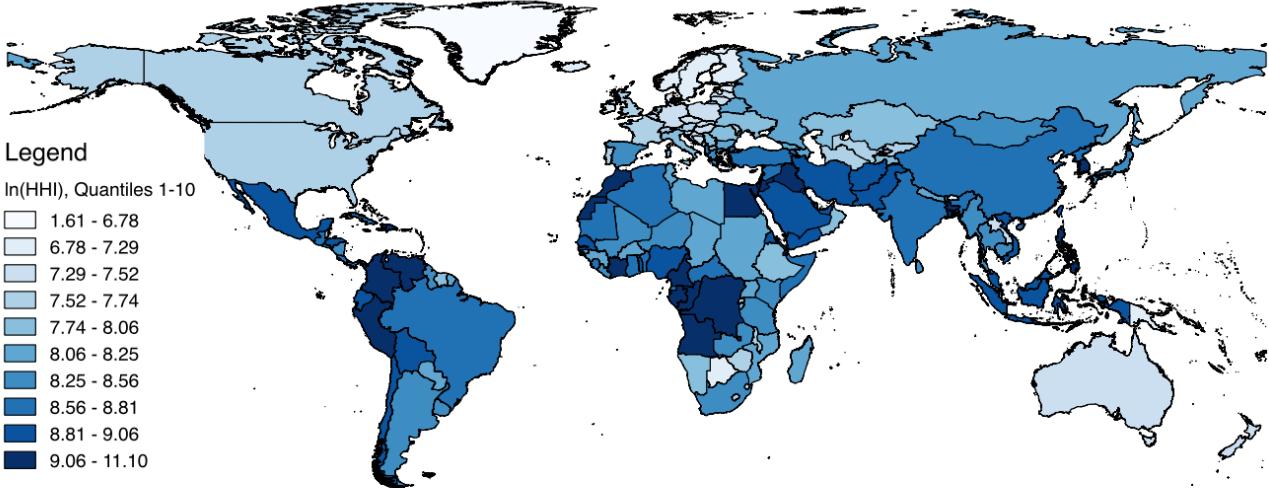
We then empirically investigate whether the distribution of population within countries is an important determinant of comparative advantage. Our empirical strategy requires two main ingredients: (i) a sector-level estimate of “density affinity,” or the extent to which production in each sector is disproportionately located in denser locations, and (ii) a country-level estimate of population concentration.

To measure industry-level density affinity, we turn to detailed business location data across US urban areas from the County Business Patterns (CBP) and non-parametrically estimate the extent to which each sector is disproportionately located in denser locations. To account for potential endogeneity in the correlation between density and industry specialization, we use subterranean geological instruments that exogenously shift local density independently from other city-level characteristics by easing vertical construction costs and constraints. This generates causal estimates of the marginal impact of population density on industry-level production. In the end, this procedure yields industry-level measures of density affinity across all 4-digit NAICS manufacturing sectors; the substantial heterogeneity in density affinity that we estimate lends credibility to the modeling assumption of significant variation in sector-specific sorting with respect to population density.

To measure population-weighted density across regions and countries, we rely on satellite-derived gridded population data from the *LandScan* database. *LandScan* incorporates comprehensive country-level census data on the distribution of population, and derives gridded population estimates using “smart interpolation,” a multi-layered, asymmetric, spatial modeling approach. These data make it possible to estimate characteristics of the geographic population *distribution* of each country. To measure population-weighted density, we sum population density across grid cells within each country, weighting each cell by its total population. This captures the experienced population density of the average person in the country and measures the concentration of population across space.

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<sup>5</sup>In the baseline model, we are agnostic about the source of this variation in agglomeration externalities.



**Figure 1: Population weighted population density across countries (deciles).** The figure is a map in which countries are color-coded based on their population-weighted density decile. Darker countries have higher population-weighted density.

Before turning to cross-country trade, we focus on the exporting patterns of US States. Using the *LandScan* data, we estimate the population-weighted density of each state, and document that denser states indeed export relatively more in “density-loving” sectors.<sup>6</sup> While this result is a preliminary test of our hypothesis, it also validates our density affinity measures as supply side determinants of sector productivity, rather than the product of path dependence or demand-side forces. Our estimates of density affinity from US data could have been driven by the fact that certain sectors are over-represented in certain US locations for historical or demand-side reasons; however, the state-level export results suggests that density-loving sectors are indeed more productive in denser regions within the US. Population concentration is a source of state-level comparative advantage.

Next, we investigate the role of density as a source of country-level comparative advantage. Country-level estimates of population weighted density are displayed in the map in Figure 1. There is substantial variation in density across countries, even within continents and income levels. For example, Finland and Sweden are two of the wealthiest and also two of the least dense countries in the world, by our measure; indeed, both countries have strong revealed comparative advantage in pulp and paper product exports, one of the least density-loving sectors.<sup>7</sup> Within sub-Saharan Africa, Botswana is among the least dense countries while the nearby Democratic Republic of Congo and Djibouti, among the world’s poorest countries, are among the densest.<sup>8</sup> Finally, the United States

<sup>6</sup>While some recent studies have attempted to estimate export data at the metropolitan level (see e.g. the database constructed by Tomer and Kane, 2014), most trade flows data are still collected at a broader level of aggregation. The lowest level of consistent and exhaustive trade reporting in the United States is the state.

<sup>7</sup>See Sweden exports in the [Atlas of Economic Complexity](#) for HS4 codes 4800-4810, NAICS code: 3221.

<sup>8</sup>Indeed, Djibouti, exhibits a strong revealed comparative advantage in semiconductors, one of the most density-loving

has mid-range population-weighted density since it has both very dense cities, as well as a relatively large share of the population living in suburbs, towns, and rural areas.

We systematically investigate the relationship between population density and comparative advantage and show that countries with higher population-weighted density have a revealed comparative advantage in density-loving sectors. This finding is robust to the inclusion of a broad range of country and industry-level controls, including the skill and capital intensity of each sector, as well as country-level income, skill endowment, specialization in agriculture, and other covariates that might bias the relationship between density and exports. The results are also similar across a range of possible parameterizations of the density affinity measure; either including or excluding observations with zero trade; and using either OLS or Poisson pseudo-maximum likelihood estimators.

To correct for potential reverse causality from trade flows to density (see Krugman and Elizondo, 1996; Ades and Glaeser, 1995), we exploit differences in states' and countries' *historical* population and city size distributions to construct instruments for modern density. Data on the global distribution of cities and their populations for historical periods were collected by Chandler (1987), and recently digitized by Reba, Reitsma, and Seto (2016). While patterns of trade might affect modern economic geography, it is unlikely that modern patterns of trade, which have evolved substantially in recent decades and particularly after the Second World War, affected the *historical* (c. 1900) distribution of cities within countries (see Irwin, 2017). Using this strategy, the estimated effect of density on trade flows from our baseline results remains very similar. In our sample of countries, we find that the impact of the within-country population distribution on patterns of trade is comparable to and if anything slightly larger in magnitude than the impact of human or physical capital.

Finally, we investigate potential channels underpinning the relationship density affinity and trade. Our goal was to capture all possible effects of population density on industry-level productivity; therefore, our baseline density affinity measure does not take a stand on any particular mechanism. However, we document a similar pattern to our baseline results when we focus instead on the research and development (R&D) intensity of each industry, consistent with evidence that dense cities facilitate and spur innovation (e.g. Duranton and Puga, 2001; Duranton and Puga, 2004; Moretti, 2012). We also document a similar pattern when we focus on the reliance of each industry on immobile natural resources, consistent with the idea that only industries that do not rely on natural resources are free to locate in cities (Ades and Glaeser, 1995). We show that the results do not seem to be driven, however, by industry-level skill or capital intensity, or reliance on service-sector inputs (as suggested by e.g. Abdel-Rahman, 1994). Finally, we find that the combination of all independent channels that we can measure do not fully explain our baseline results, suggesting that additional and unobservable industry-level forces are also captured by our baseline estimates.

This study is at the intersection of several areas of research. Our theory is most closely related to Courant and Deardorff (1992) and Courant and Deardorff (1993), who argue that patterns of trade come not only from relative factor abundance, but also from factor distribution ("lumpiness"). The idea has been explored more recently by Debaere (2004), Bernard, Robertson, and Schott (2010), and Brakman and Van Marrewijk (2013). We directly measure the "lumpiness" of population density

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sectors. See Djibouti exports in the [Atlas of Economic Complexity](#) for HS4 code: 8541, NAICS code: 3344.

from satellite data and estimate the impact of population distribution on patterns of trade.

This paper is also related to investigations of the sorting of sectors across cities (most recently Davis and Dingel, 2014; Gaubert, 2018). A range of work has argued that agglomeration benefits some sectors more than others and that there is heterogeneity in sector-specific sorting with respect to population density (Nakamura, 1985; Rosenthal and Strange, 2001; Rosenthal and Strange, 2004; Holmes and Stevens, 2004; Ellison, Glaeser, and Kerr, 2010; Faggio, Silva, and Strange, 2017). We extend existing work in this area by developing a new strategy to estimate industry-specific sorting with respect to density. This paper also relates to a large literature devoted to understanding the causes and consequences of city size distributions and Zipf’s law (e.g. Zipf, 1949; Gabaix, 1999a; Gabaix, 1999b; Ioannides and Overman, 2003; Soo, 2005). Using gridded data, we observe the full population distribution—both inside and outside administratively defined urban areas—and measure the average experienced density of each country, which differs markedly around the world, even conditional on total population and average density or urbanization.

A broad set of work studies the interplay between trade and within-country heterogeneity by highlighting the effect of international trade on within-country disparities (Autor, Dorn, and Hanson, 2013; Caliendo, Dvorkin, and Parro, 2015; Dix-Carneiro and Kovak, 2015; Ramondo, Rodríguez-Clare, and Saborío-Rodríguez, 2016; Bakker, 2018) Other studies have focused on the impact of within-country trade costs on patterns of trade (Rauch, 1991; Coşar and Fajgelbaum, 2016). A large theoretical literature on patterns of trade arising from agglomeration, initiated by Krugman (1991), has given rise to studies of the stylized interaction between agglomeration and more traditional sources of comparative advantage (Van Marrewijk et al., 1997; Ricci, 1999; Pflüger and Tabuchi, 2016).

Finally, our empirical framework builds on existing analyses of sources of comparative advantage across countries; recent studies that rely on a similar framework include Nunn (2007), Costinot (2009), Chor (2010), Bombardini, Gallipoli, and Pupato (2012), and Cingano and Pinotti (2016).

The paper is organized as follows. Section 2 provides a simple formalization of our hypothesis that comparative advantage across countries stems, in part, from the distribution of population within countries. Section 3 describes the data used in the empirical analysis. Section 4 presents our main results and Section 5 concludes.

## 2 Theoretical Framework

We present a model that illustrates how within-country heterogeneity in productivity can affect a country’s pattern of exports across industries. We emphasize how two key ingredients—productivity heterogeneity across a country’s locations and differential returns to agglomeration across industries—can produce patterns of specialization both within and across countries. The theoretical results guide our estimation of the key components of our empirical analysis.

### 2.1 Environment: the closed economy

We study an economy in which countries exhibit domestic heterogeneity across inhabited locations, or “cities.” A country is defined as a continuum of cities, indexed by  $c \in C$ , with innate productivity

$A_c$ , land area  $B_c$ , and equilibrium population  $L_c$ . The country's total population is fixed to  $\bar{L}$ ; workers are mobile across regions within a country, but not across borders. The economy consists of  $J$  tradable sectors indexed by  $j = 1, \dots, S$ , as well as a non-tradable good specific to each city, "housing" ( $H_c$ ); housing is the key force of pecuniary congestion in the model. Tradable goods can be shipped from city  $c$  to city  $d$ , by paying iceberg trade costs  $\tau_{c,d} \geq 1$ .

### 2.1.1 Workers

Workers in city  $c$  inelastically supply one unit of labor, earning wage  $w_c$ . They derive utility  $U_c$  from the consumption of housing and a basket of tradable sectors:

$$U_c(h_c, c_{j=1,\dots,J}) = \left(\frac{h_c}{\beta}\right)^\beta \left(\frac{\prod_{j=1}^S (\frac{c_j}{\alpha_j})^{\alpha_j}}{1-\beta}\right)^{1-\beta}$$

where  $h_c$  is the worker's housing and  $c_j$ , total consumption of sector  $j$ , is a CES aggregate of a continuum of varieties indexed by  $\omega$ , with elasticity  $\omega$ . The price level in each sector  $j$  is thus:  $p_j = (\int_0^1 p_j(\omega)^{1-\sigma} d\omega)^{\frac{1}{1-\sigma}}$ , and the aggregate tradable price level in the country  $P$  is  $P = \prod_{j=1}^J p_j^{\alpha_j}$ . We assume that  $\sigma > 1$ , so that within each sector, varieties  $\omega$  are substitutes. Indirect utility in city  $c$  for a worker that supplies a unit of labor is thus:  $V_c = \frac{Y_c}{P^{1-\beta} p_{hc}^\beta}$ . Since utility must be the same for a worker in all cities at some level  $V_c = \bar{U} \forall c$ , city-level income is:

$$Y_c = \bar{U} P^{1-\beta} p_{hc}^\beta \quad (2.1)$$

As is standard, income is increasing in the price of housing  $p_{hc}$ .

### 2.1.2 Housing

The supply of land in location  $c$  is fixed at  $B_c$ ; this generates the key pecuniary congestion force in the model. As in Gaubert (2018), atomistic landowners in city  $c$  own an amount  $\gamma$  of local land, and produce housing using land and tradable goods, according to the production function:<sup>9</sup>

$$H_c(\gamma) = \gamma^\xi \left(\frac{X_{hc}(\gamma)}{1-\xi}\right)^{1-\xi}$$

Equalizing supply and demand yields equilibrium housing prices in each city:<sup>10</sup>

$$p_{Hc}^{\frac{1}{\xi}} = \beta \frac{L_c Y_c}{B_c P^{\frac{\xi-1}{\xi}}} \quad (2.2)$$

All Ricardian rents accruing to local landowners are fully taxed by the city government and rebated to resident workers as lump-sum transfers  $T_c$ , as in Helpman (1998). Thus, disposable income  $Y_c$

<sup>9</sup>For simplicity, we assume that they divide spending on final goods used as inputs in housing production across the  $S$  sectors in the same manner as workers; alternatively, one could model the other input into housing production as migrant labor living at zero cost on rural land and only consuming the final good.

<sup>10</sup>The details are given in Appendix B.

of a worker in city  $c$  is proportional to wage income  $w_c$ :  $Y_c = w_c + T_c = \frac{w_c}{1-\beta\xi}$ . Using the spatial equilibrium condition (2.1), we derive an expression for city-specific wages:

$$w_c = P(1 - \beta\xi) \bar{U}^{\frac{1}{1-\beta\xi}} \beta^{\frac{\beta\xi}{1-\beta\xi}} \frac{L_c^{\frac{\beta\xi}{1-\beta\xi}}}{B_c} \propto P \times D_c^{\frac{\beta\xi}{1-\beta\xi}}$$

where  $D_c$  is the population density of city  $c$ . Consistent with a large literature in urban economics (Glaeser and Gottlieb, 2009), there is a log-linear relationship between local wages and population density.

### 2.1.3 Production

To study the impact of density on industrial geography and trade, we turn to the supply side of the economy. For simplicity, labor  $L_{jc}(\omega)$  is the only input to production. In each industry  $j$ , the output of variety  $\omega$  in city  $c$ ,  $Q_{jc}(\omega)$ , is given by:

$$Q_{jc}(\omega) = \tilde{A}_{jc} L_{jc}(\omega)$$

Each city draws a Ricardian productivity parameter in each sector,  $\tilde{A}_{jc}$ , from a Fréchet distribution. The unit cost of production for variety  $\omega$  in sector  $j$  and location  $c$  is then  $\frac{w_c}{\tilde{A}}$ . The actual productivity draw  $\tilde{A}_{cj}(\omega)$  for a variety of good  $j$  in location  $c$  has cumulative distribution function:<sup>11</sup>

$$\Pr(\tilde{A}_{cj}(\omega) \leq \tilde{A}) = F_{jc}(\tilde{A}) = \exp(-(\frac{\tilde{A}}{A_{jc}})^\theta)$$

Here we introduce the key assumption of the model, which allows us to isolate our channel of interest: the relationship between population distribution and comparative advantage. We assume that a sector's productivity in city  $c$  depends on (i) the city's exogenous sector neutral productivity term  $A_c$ , (ii) the city's equilibrium population density  $D_c$ , and (iii) the extent to which each sector benefits from local density,  $\tilde{\eta}_j$ . In particular, we let:  $A_{jc} = A_c D_c^{\tilde{\eta}_j}$ .

The sector-specific "density elasticity,"  $\tilde{\eta}_j$ , mediates the relationship between density and sector-specific productivity. Variation in  $\eta_j$  across sectors—the extent to which each sector benefits from local agglomeration—will be central to our empirical analysis, and is the key modeling assumption. The idea that industries benefit differentially from urban density has been argued in prior work (e.g. Nakamura, 1985; Rosenthal and Strange, 2004; Faggio, Silva, and Strange, 2017) and corroborated by our estimates in Section 3.<sup>12</sup>

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<sup>11</sup>We assume the distribution has shape parameter  $\theta > \sigma - 1$ , which governs the variance across varieties, is assumed constant across both locations and sectors. As is traditional in supply-driven models of specialization,  $\theta > \sigma - 1$  ensures that the CES price index for each sector is well defined.

<sup>12</sup>We remain agnostic here about the specific source of sector-specific density affinity; in section 4.5, we explore potential determinants of  $\eta_j$ .

### 2.1.4 Trade across cities

If we make the (admittedly strong) assumption that trade costs are zero within country, cost minimization by consumers in any location  $d$  then implies that the share of spending on varieties from location  $c$  in sector  $j$  must be equal for any locations  $d$  in the same country:

$$\pi_{dcj} = \pi_{cj} = \frac{p_{cj} X_{dcj}}{X_{dj}} = \frac{(A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta}}{\sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta}} \quad (2.3)$$

where  $\pi_{dcj}$  denotes spending in city  $d$  on goods in sector  $j$  produced in city  $c$ .<sup>13</sup>

### 2.1.5 Equilibrium

**Goods market clearing** In the equilibrium of the closed domestic economy, the wage bill in each sector  $j$  and city  $c$  equals total spending on goods produced in sector  $j$  in city  $c$ .<sup>14</sup> This generates the tradable goods market clearing condition:

$$w_c L_{jc} = \alpha_j \frac{(A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta}}{\sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta}} \sum_d w_d L_d \quad (2.4)$$

In the absence of within-country trade costs, the price index for good  $j$  is independent of the location where it is consumed and is proportional to:<sup>15</sup>

$$p_j \propto \left[ \sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta} \right]^{-\frac{1}{\theta}} \propto \left[ \sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j - \frac{\beta\xi}{1-\beta\xi}})^\theta \right]^{-\frac{1}{\theta}} \quad (2.5)$$

Trade balance requires that tradable spending from all locations on all goods produced in location  $c$  is equivalent to the total wage bill in location  $c$ :

$$w_c L_c = \sum_j \sum_d \pi_{dcj} \alpha_j (1 - \beta\xi) Y_d L_d = \sum_j \alpha_j \pi_{cj} \sum_d w_d L_d = \sum_d w_d L_d \sum_j \alpha_j \pi_{cj} \quad (2.6)$$

Moreover, the housing market must clear in every location, as in Equation (2.2).

**Labor market clearing** The ratio of labor allocated to sectors  $j$  and  $j'$  in each city  $c$  is given by:

$$\frac{L_{jc}}{L_{j'c}} = \frac{\alpha_j}{\alpha_{j'}} \left( \frac{p_j}{p_{j'}} \right)^\theta D_c^{\theta(\eta_j - \eta_{j'})} \quad (2.7)$$

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<sup>13</sup>This expression is derived in Appendix B and relies on standard Eaton-Kortum algebra similar to Costinot, Donaldson, and Komunjer (2011) and Michaels, Rauch, and Redding (2013). Given the unbounded nature of the Fréchet distribution, the production structure does not lead to the full specialization of cities in the production of some sectors, which would make the exposition more involved by inducing censoring at the bottom of the sector-city employment density without adding substantial insight in the model.

<sup>14</sup>Note that sector  $j$  spending coming from location  $d$  is equal to the sum of consumer spending ( $\alpha_j (1 - \beta) Y_d L_d \pi_{jc}$ ) and intermediate spending by housing producers ( $\alpha_j \beta (1 - \xi) Y_d L_d \pi_{jc}$ ), so that total spending in  $d$  on  $j$  goods produced in  $c$  is  $\alpha_j (1 - \beta\xi) Y_d L_d \pi_{jc} = \alpha_j w_d L_d \pi_{jc}$ .

<sup>15</sup>The proportionality coefficients are independent of the sector and city, since  $\theta$  is assumed constant

Total population in a city equals the sum of employment across tradable sectors:

$$\sum_j L_{jc} = L_c \quad (2.8)$$

The labor market clears for the country as a whole:

$$\sum_c L_c = \sum_c \sum_j L_{jc} = \bar{L} \quad (2.9)$$

We can now define the equilibrium of the domestic economy.

**Definition 2.1** (Equilibrium). *An equilibrium in the closed economy is defined as an allocation of labor  $L_{jc}$  across cities and sectors such that utility is equalized across sites; trade shares satisfy (2.3); labor allocations satisfy (2.7), (2.8) and (2.9); wages satisfy (2.6) and (2.4); tradable prices satisfy (2.5); and housing prices satisfy (2.2).*

## 2.2 Implications

### 2.2.1 Within-Country Specialization

We now investigate the domestic sorting of production generated by the model. Double-differencing spending shares (2.3) from any location  $d$  across two goods  $j$  and  $j'$  and locations  $c$  and  $c'$ :

$$\left( \frac{\pi_{jc}}{\pi_{j'c}} \right) / \left( \frac{\pi_{jc'}}{\pi_{j'c'}} \right) = \frac{D_c}{D_{c'}}^{\theta(\tilde{\eta}_j - \tilde{\eta}_{j'})} \quad (2.10)$$

While the absolute unit cost of production is increasing in density  $D_c$  due to the need to compensate workers with higher nominal wages, as  $D_c$  increases costs increase relatively less fast in sectors with higher  $\eta_j$ . Denser cities thus have a comparative advantage in sectors that benefit more from agglomeration.<sup>16</sup> Immediately, this implies:

**Lemma 2.1.** *The share of the labor force employed in higher  $\eta_j$  sectors is relatively larger in denser cities:*

$$\left( \frac{L_{jc}}{L_{j'c}} \right) / \left( \frac{L_{jc'}}{L_{j'c'}} \right) = \left( \frac{w_c L_{jc}}{w_{c'} L_{j'c}} \right) / \left( \frac{w_{c'} L_{jc'}}{w_c L_{j'c'}} \right) = \left( \frac{\pi_{jc}}{\pi_{j'c}} \right) / \left( \frac{\pi_{jc'}}{\pi_{j'c'}} \right) = \frac{D_c}{D_{c'}}^{\theta(\tilde{\eta}_j - \tilde{\eta}_{j'})} \quad (2.11)$$

We use Equation (2.11) in our empirical analysis to estimate the  $\eta_j$  for each sector (see Section 3.3).

### 2.2.2 Cross-Country Specialization

The following proposition clarifies the implications of the model for country-by-sector level prices in autarky:

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<sup>16</sup>Introducing decreasing returns at the establishment level, for example related to the use of a fixed factor in production such as management skill or land, would make these cross-cities, within-country comparative advantage results hold in terms of the number of establishments as well, consistent with our empirical results in section 4.

**Proposition 2.1.** *The relative price level of two sectors  $j$  and  $j'$  in the Home country in autarky is:*

$$\log\left(\frac{p_j}{p_{j'}}\right) = (\eta_{j'} - \eta_j) \sum_c \omega_{jj',c} \ln(D_c) \quad (2.12)$$

where  $\omega_{jj',c}$  are bilateral Sato-Vartia weights (Sato, 1976; Vartia, 1976) across any two goods  $j$  and  $j'$  in city  $c$ , computed from the export shares:

$$\omega_{jj',c} = \left( \frac{\pi_{cj} - \pi_{cj'}}{\log(\pi_{cj}) - \log(\pi_{cj'})} \right) / \left( \sum_d \frac{\pi_{dj} - \pi_{dj'}}{\log(\pi_{dj}) - \log(\pi_{dj'})} \right)$$

*Proof.* See Appendix B. □

Conditional on a fixed distribution of location-level population, the closed economy price index in sector  $j$  relative to  $j'$  is lower when  $\eta_j > \eta_{j'}$ . Stronger agglomeration forces in a sector increase productivity in all cities, and lower equilibrium prices for any distribution of density. Moreover, we have the following corollary:

**Corollary 2.1.** *Conditional on the vector of  $A_c$ 's and wages, a more dispersed distribution of  $D_c$  across places – defined as second-order stochastic dominance of the  $D_c$  distribution – lowers the price index by more for high  $\eta_j$  sectors than for lower  $\eta_{j'}$  sectors.<sup>17</sup>*

A more dispersed population implies relatively more variation in sourcing prices across producing locations for higher  $\eta_j$  sectors. Substitution across sourcing cities implies lower relative price indices for more "density-loving" sectors in countries with a more dispersed population. This sub-modularity property of price indices in  $\eta_j$  and  $D_c$  is at the core of comparative advantage of countries in our global economy.

**Comparative Advantage** To illustrate the implications of the model for patterns of exports under international trade, we aggregate trade flows at the country level. As in Ramondo, Rodríguez-Clare, and Saborío-Rodríguez (2016), we study the special case of  $N$  countries, indexed by  $i$ , each composed of a set of regions  $c \in C_i$ , trading  $S$  goods indexed by  $j$ . We continue to assume that iceberg trade costs are zero across two regions within any country; we also assume trade costs are symmetric and constant across any two regions in two different countries.

To make the results as stark as possible, we assume all countries have the same total population  $L = L_i$  and the same land area  $\int_{c \in C_i} B_c = \int_{c \in C_{i'}} B_c$ . We let  $B_c = 1$  in each city, so that we simplify the model to the case where  $L_c = D_c$ . We define  $X_{ijn}$  as exports from country  $i$  to country  $n$  in industry  $j$ ,  $\tilde{w}_{ij} = \frac{\sum_{c \in C_i} w_c L_{jc}}{\sum_{c \in C_i} L_{jc}}$  as the average wage in sector  $j$  in country  $i$ , and  $M_i$  as country  $i$ 's aggregate wage bill,  $M_i = \tilde{w}_i L_i = \sum_j w_{ij} L_{ij}$ . We can then state the following aggregation result:

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<sup>17</sup>This follows immediately from Proposition 2.1, since the log is concave and  $\theta > 0$ . As in Proposition 1 in Redding and Weinstein (2020), this results from substitutability across suppliers (note we assumed  $\theta > \sigma - 1 > 0$ ), making the price index log sub-modular in  $\eta_j$  and  $D_{c'}$ .

**Proposition 2.2.** *Exports of sector  $j$  from country  $i$  to country  $n$  satisfy the following aggregation results*

$$X_{inj} = \alpha_j M_n \frac{T_{ij} w_{ij}^{-\theta} \tau_{ni}^{-\theta}}{\sum_s T_{sj} w_{sj}^{-\theta} \tau_{ns}^{-\theta}}$$

where the country level productivity parameter is:

$$T_{ij} = \left( \sum_{c \in C_i} (A_c D_c^{\eta_j})^{\frac{\theta}{1+\theta}} \left( \frac{L_{jc}}{L_{ji}} \right)^{\frac{\theta}{1+\theta}} \right)^{1+\theta}$$

Moreover, the aggregate wage bill can be expressed as:

$$M_i = \sum_j w_{ij} L_{ij} = \sum_j \Delta_{ij} L_{ij}^{\frac{\theta}{1+\theta}} T_{ij}^{\frac{1}{1+\theta}}$$

where  $\Delta_{ij}$ , country  $i$ 's market access in sector  $j$ , solves the system of  $N \times S$  equations:

$$\Delta_{ij} = \left[ \alpha_j \frac{\sum_n M_n \tau_{in}^{-\theta}}{\sum_s \tau_{is}^{-\theta} \Delta_{sj}^{-\theta} L_{sj}^{\frac{1}{1+\theta}} T_{sj}^{\frac{1}{1+\theta}}} \right]^{\frac{1}{1+\theta}}$$

*Proof.* See Appendix B. □

Country-by-sector productivity  $T_{ij}$  is relatively higher for high  $\eta_j$  goods in countries with a more concentrated population (and thus, all else equal, for countries with more variance in sector-neutral productive amenities  $A_c$ ). Even though we all countries have the same total population, the within-country population distribution drives patterns of cross-country trade.

**Two-Country Case** To build the intuition behind this result, we focus on the the case of two countries, Home and Foreign. First, suppose that Home and Foreign have identical distributions of amenities,  $A_c$  and  $A_c^*$ . Then there will be cross-city trade both within and across countries, but there will be no apparent pattern of inter-industry trade at the country level. Next, assume the distribution of *sector-neutral* productivity across cities is *more even* in the Foreign country than at Home. By "more even", we mean that the distribution of Foreign productivity is a "utility-preserving spread," an extension of the "mean-preserving spread" concept defined as:

**Definition 2.2.**  *$G$  is a "utility-preserving spread" of  $G^*$  if in the closed economy, welfare is the same at Home and in Foreign,  $\bar{U} = \bar{U}^*$ , but the variance of  $A_c$  is higher than the variance of  $A_c^*$ .*<sup>18</sup>

This implies, from Equation (2.13), that the distribution of population at Home second-order stochastically dominates the distribution in Foreign; the Generalized Lorenz Curve of population in the Foreign economy lies strictly above the Lorenz curve at Home. By Proposition 2.1, the relative prices of higher  $\eta_j$  goods are lower in the closed Home economy than in the closed Foreign economy.

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<sup>18</sup>One can imagine an experiment with two cities,  $c_1$  and  $c_2$ , where initially  $A_{c_2} > A_{c_1}$ . Then a utility-preserving spread could involve lowering  $A_{c_1}$  by  $\epsilon$ , and increasing  $A_{c_2}$  by  $\alpha\epsilon$ , where  $\alpha$  is chosen so that  $\bar{V}_0 = \bar{V}'(\alpha)$ .

Equation (2.11) implies that the relative share of employment of high  $\eta_j$  sectors is increasing in density, so in the Home country, relatively more workers are active in high  $\eta_j$  sectors than in the Foreign country. Aggregating cross-location trade flows to the country level, the Home country will appear to specialize in goods that have a high  $\eta_j$ 's and import goods with lower  $\eta_j$ 's. Let the Generalized Lorenz Curve (GLC) of population density be the cumulative distribution function of experienced density. Then, in a two-good setting:

**Corollary 2.2.** *Suppose there are two countries,  $H$  and  $F$ , and two goods  $j$  and  $j'$  where  $\eta_j > \eta_{j'}$  and  $\alpha_j = \alpha_{j'}$ . The CDFs of location-specific amenities in  $H$  and  $F$  are  $G$  and  $G^*$ . If  $G$  is a utility-preserving spread of  $G^*$ , then the GLC of population-weighted density in  $H$  lies strictly below the Generalized Lorenz Curve of population-weighted density in  $F$ . Moreover,  $H$  is a net exporter of  $j$  and  $F$  is a net exporter of  $j'$ .*

### 2.2.3 From Theory to Measurement: Population-Weighted Density

From the equilibrium definition in Section 2.1, the population distribution can be expressed as the labor market clearing (2.9), along with a system of  $C$  equations that depend on city-level population-weighted density, city-level population weighted amenities, and a constant term:

$$L_c D_c^{\frac{\beta\xi}{1-\beta\xi}} = \sum_j \alpha_j \frac{(A_c D_c^{\tilde{\eta}_j - \frac{\beta\xi}{1-\beta\xi}})^{\theta}}{\sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_{j'} - \frac{\beta\xi}{1-\beta\xi}})^{\theta}} \sum_d L_d D_d^{\frac{\beta\xi}{1-\beta\xi}} \quad (2.13)$$

There is a unique equilibrium when the maximum sector-level density elasticity ( $\eta_{max} = \max_j \eta_j > 0$ ) is "not too large" relative to the share of land in housing production ( $\xi$ ); this makes congestion forces strong enough to offset multiple equilibria.<sup>19</sup>

At the country level a greater dispersion of  $A_c$  leads to greater equilibrium  $D_c$  dispersion. In particular, the population density distribution in an economy with more dispersed  $A_c$  is second-order stochastically dominated by the population density distribution in an economy with less dispersed  $A_c^*$  (see Appendix B), and we will observe the footprint of productivity dispersion across cities in the dispersion (or concentration) of population. In the special case where total population is held constant, which we ensure in our empirical analysis, and  $B_c$  and  $A_c$  are uncorrelated, greater dispersion in the exogenous  $A_c$ 's can be mapped directly to greater country-level "population-weighted density":

$$D_i = \int_0^{\max D_c} \frac{L_c^2}{B_c} dH(D_c)$$

which captures the local population density experienced by the average worker in the economy. While, as discussed below, there are several intuitively appealing features of using this as our county-level parameterization of population concentration, the model also indicates that it is the observable consequence of dispersion (or lack thereof) of the primitive productivity distribution. This is the

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<sup>19</sup>The proof is analogous to Redding (2016). For a sufficiently small  $\eta_{max}$ , a location's density  $D_c$  is increasing in its productive amenity  $A_c$ , since a higher  $A_c$  increases the marginal product of labor in any sector, leading to rising nominal wages, population inflows, and land prices, until utility is again equalized. Agglomeration forces, modeled as positive  $\eta_j$ 's, reinforce this phenomenon, but do not offset it if they are small enough.

measure we estimate next in Section 3, and use as our main measure of population concentration (“density”) in Section 4.1.

## 3 Measurement

### 3.1 Data Sources

**Economic Geography** Data on economic activity in the US are collected from the 2016 version of the County Business Patterns (CBP) data set. The CBP contains information on employment, establishment counts, and total payroll in each industry and Core-Based Statistical Area (CBSA). We focus on measures at the NAICS 4-digit level, which are less likely to suffer from suppression.<sup>20</sup> We compile data on a range of industry-level characteristics from the latest available year in the NBER-CES Manufacturing Industry Database, including capital intensity, the labor share, and average wages. We also include data from the American Community Survey to control for the age and gender breakdown of the workforce as well as detailed measures of the educational attainment of the workforce in each industry.

To construct instruments for local density, we also compile data on distance to subterranean bedrock for all US CBSAs. Raster data displaying the distance to bedrock of each 250m grid cell in the US, which we use to construct the instruments, are from the International Soil Reference and Information Centre (ISRIC) *SoilGrid* project.<sup>21</sup>

**Density** Spatial data on global population density are obtained from the *LandScan* Database.<sup>22</sup> These data are calculated by combining existing demographic and census data with remote sensing imagery, and are released as a raster data set composed of one square-kilometer grid cells.<sup>23</sup> The resulting population count is an ambient or average day/night population count. We use the the *LandScan* data to compute state and country-level estimates of population-weighted density. For our instrumental variables analysis, we also rely on new measures of historical population and city size distributions constructed from data sets recently introduced by Reba, Reitsma, and Seto (2016) and Fang and Jawitz (2018).

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<sup>20</sup>We verify that our results are not sensitive to imputation when using interpolation techniques to impute missing employment data in the CBP.

<sup>21</sup>See here: <https://www.isric.org/explore/soilgrids>.

<sup>22</sup>*LandScan* data can be found here: <https://landscan.ornl.gov> We use the *LandScan* data product from 2016.

<sup>23</sup>For more information, see here: <https://landscan.ornl.gov/documentation>. According to *LandScan*: ORNL's *LandScan* is the community standard for global population distribution. At approximately 1 km resolution (30 × 30 degree), *LandScan* is the finest resolution global population distribution data available and represents an ambient population (average over 24 hours). [...] The *LandScan* global population distribution models are a multi-layered, dasymetric, spatial modeling approach that is also referred to as a “smart interpolation” technique. In dasymetric mapping, a source layer is converted to a surface and an ancillary data layer is added to the surface with a weighting scheme applied to cells coinciding with identified or derived density level values in the ancillary data. [...] The modeling process uses sub-national level census counts for each country and primary geospatial input or ancillary datasets, including land cover, roads, slope, urban areas, village locations, and high resolution imagery analysis; all of which are key indicators of population distribution. [...] Within each country, the population distribution model calculates a “likelihood” coefficient for each cell and applies the coefficients to the census counts, which are employed as control totals for appropriate areas. The total population for that area is then allocated to each cell proportionally to the calculated population coefficient

**Trade** US State-level international exports from 2016 are collected from the US Census Bureau’s USATradeonline database. These data are provided at the NAICS 4-digits level, which is our primary level of analysis across industries. We focus on gross exports flows, as they are the natural counterpart of spending in our theoretical framework. Cross-country trade flows data are obtained from the UN Comtrade Database for all available exporters in 2016, at the HS4 digit level. We map HS4 industries to NAICS-4 industries using the crosswalk developed by Pierce and Schott (2012).

**Additional Data** To include additional controls in our cross-state and cross-country estimates, we compiled US state-level data on educational attainment, age composition, and worker income from the 2016 American Community Survey estimates. At the country level, we also compiled information on educational attainment, urbanization, GDP per capita, and a range of other country-level characteristics from the World Bank’s World Development Indicators and International Monetary Fund’s World Economic Outlook databases, and measures of country-level capital stocks from the Penn World Tables.

### 3.2 Estimating State and Country Level Density

For both US states and countries, we compute *population-weighted density* ( $D_i$ ) as:

$$D_i = \sum_{g \in G(i)} \left( L_g \times \frac{L_g}{\sum_{g' \in G(i)} L_{g'}} \right)$$

where  $g$  indexes grid cells and  $G(i)$  is the set of grid cells in country (or state)  $i$ .  $L_g$  is the population, according to *LandScan*, in grid cell  $i$ . Since all grid cells are the same size,  $L_g$  is also the density of grid cell  $i$ . This measure is equivalent to weighting the population density of each grid cell in a country or state by its population, and yields a measure of population density that approximates to the expected experienced density of a person in the state or country.<sup>24</sup>

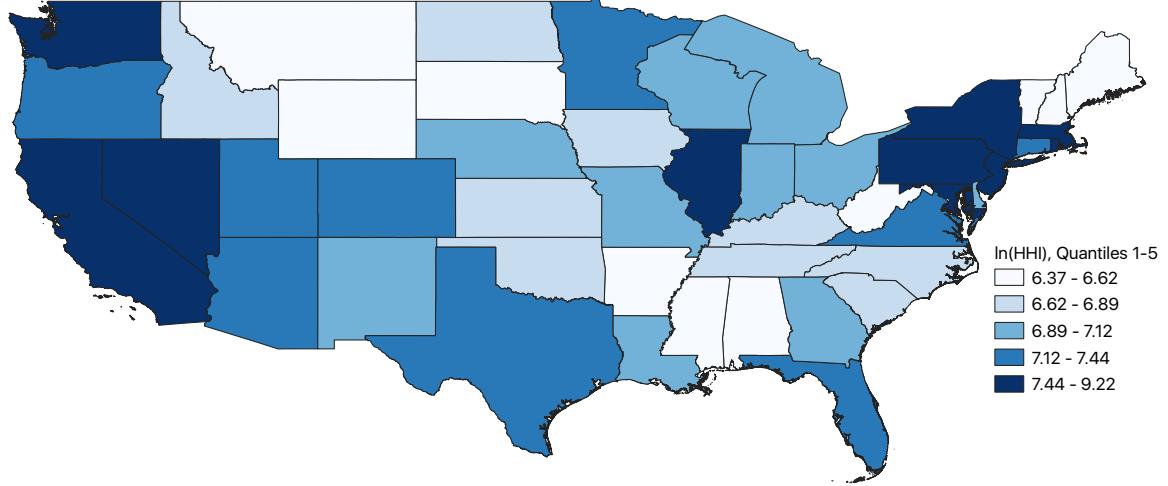
This is our key state and country-level independent variable of interest. Intuitively, this measure captures the concentration of population within a state or country. For a given total population if people are very concentrated in a few cities this measure will be large whereas if people are dispersed across many less-dense cities or suburban and rural areas,  $D_i$  will be small. Figure 2 plots the distribution of  $D_i$  across US states. While, intuitively, populous and urban states like New York and California have high measures of  $D_i$ , so do Massachusetts and Washington; large states like Texas and Florida, with their large but more sprawling cities, are in the middle of the distribution. Figure 1 (above) had displayed deciles of  $D_i$  for each country around the world. There is substantial variation in  $D_i$  across countries, both within continents and within income groups.

### 3.3 Estimating Sector-Specific Density Affinity

Using industry-by-city level data from the US County Business Patterns (CBP), we estimate the agglomeration elasticity of each tradable manufacturing sector. Because our focus is cross-country

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<sup>24</sup>See Wilson (2012) for a justification of the use of population-weighted density by the United States Census Bureau.



**Figure 2: Population weighted population density across US states.** The figure is a map in which US states are color-coded based on their population-weighted density quintile. Darker shaded states have higher population-weighted density.

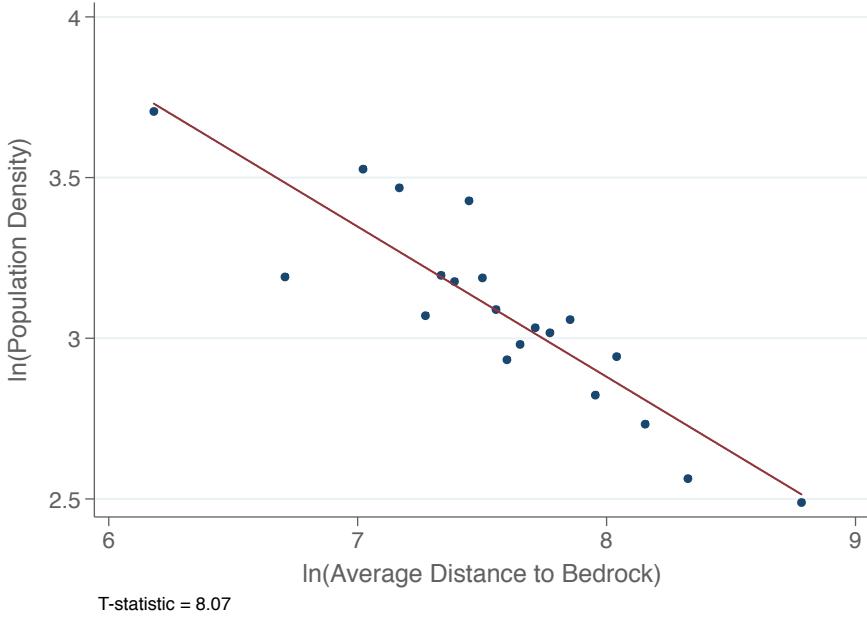
trade, and manufactured goods account for the bulk of international exports, we emphasize the existence of substantial within-manufacturing differences in density affinity.

We compute a “density-elasticity” for each industry by estimating the following empirical analog of the model’s Equation (2.11):

$$y_{cj} = \alpha_c + \gamma_j + \sum_j \eta_j \cdot (\ln D_c \cdot \mathbb{I}_j) + \epsilon_{cj} \quad (3.1)$$

where  $c$  indexes cities and  $j$  indexes sectors.  $y_{cj}$  is the (log of the) number of employees, number of establishments, or first quarter aggregate payroll in industry  $j$  and location (city)  $c$ .  $\alpha_c$  and  $\gamma_j$  are city and sector fixed-effects, respectively.  $D_c$  is population density at the level of the Core Based Statistical Area (CBSA) and  $\mathbb{I}_j$  is an indicator that equals one for sector  $j$ . The coefficients of interest are the density elasticities,  $\eta_j$ , the key source of industry-level variation in the model. These elasticities capture the extent to which each industry tends to be more or less represented in denser locations.

We first estimate Equation (3.1) using OLS and report the ten sectors with the highest and lowest density elasticities in Table 1a. Since CBSA-level density is likely correlated with a range of other city-level characteristics that might affect industry sorting, it is difficult to interpret the purely correlational estimates. To circumvent this issue, we construct an instrument for CBSA-level density in order to estimate the causal effect of a marginal change in CBSA-level density on industry-specific production. Subterranean geology affects ease of vertical construction, and hence potential population density, but is unlikely to independently affect other city-level characteristics. Our instrument is the (log of the) average distance of each CBSA to subterranean bedrock. Lower distance to bedrock in a location eases the land constraint, and can be interpreted as increasing the available share of land  $B_c$  in our theoretical framework; construction often requires a foundation in bedrock and is more



**Figure 3: Distance to Bedrock and Population Density.** The figure is a binned scatter plot. It reports the correlation between log of distance to bedrock and log of population density at the CBSA level. The t-statistic is 8.07.

difficult when bedrock is deep (e.g. Schuberth, 1968; Landau and Condit, 1999).<sup>25</sup> By exogenously shifting density, we estimate the response of industry specialization to density alone, capturing the causal effect of a marginal change in city-level density on industry-level production.

The correlation between CBSA-level density and the log of the distance to bedrock is shown in Figure 3. The correlation coefficient is highly statistically significant ( $t$ -statistic = 8.07) suggesting that, consistent with the mechanical impact of distance to bedrock on construction, CBSA-level variation in subterranean bedrock systematically shifts equilibrium population density. The necessary identification assumption is that distance to subterranean bedrock only affects industry sorting through its impact on ease of construction and hence population density.<sup>26</sup>

We then estimate  $\eta_j$  for each sector using IV-2SLS, and the interaction between industry-level indicators ( $I_j$ ) and (log of) distance to bedrock as the instruments. Industries with the highest and lowest IV estimates of  $\eta_j$  are listed in Table 1b. While many of these sectors are intuitive and commonly associated with production in dense cities, in the case of the top sectors, or production away from large cities, in the case of the bottom sectors, they also do not map clearly onto common determinants of comparative advantage. The top of our list features both industries that are skill-intensive

<sup>25</sup>Recent research has suggested the use of underlying geologic characteristics to provide exogenous sources of variation in land supply availability and estimate its economic effects (Rosenthal and Strange, 2008; Saiz, 2010; Duranton and Turner, 2018) However, existing research has focused on within-city variation in geological features to instrument for urban shape, rather than variation across metropolitan areas.

<sup>26</sup>While this assumption seems likely, we also verify that the results are similar after controlling for other ground and soil characteristics (e.g. characteristics of soil content, agricultural suitability, etc.). These estimates and their possible parameterizations are available upon request.

Table 1: The Ten Most and Least Density Elastic Industries: OLS and IV Estimates

(1)	(2)	(3)	(4)	(5)	(6)
TOP TEN			BOTTOM TEN		
Elasticity: OLS Estimate	NAICS Code	Industry Name	Elasticity: OLS Estimate	NAICS Code	Industry Name
1.841537	3222	Converted Paper Product Manufacturing	0.5473573	3117	Seafood Product Preparation and Packaging
1.708105	3345	Navigational, Measuring, Electromedical, and Control Instruments	0.5272605	3131	Fiber, Yarn, and Thread Mills
1.702192	3261	Plastics Product Manufacturing	0.5059118	3112	Grain and Oilseed Milling
1.641616	3344	Semiconductor and Other Electronic Component Manufacturing	0.4773871	3365	Railroad Rolling Stock Manufacturing
1.632981	3363	Motor Vehicle Parts Manufacturing	0.4667493	3162	Footwear Manufacturing
1.531617	3339	Other General Purpose Machinery Manufacturing	0.4558011	3361	Motor Vehicle Manufacturing
1.520556	3342	Communications Equipment Manufacturing	0.4041506	3221	Pulp, Paper, and Paperboard Mills
1.508072	3321	Forging and Stamping	0.4014953	3161	Leather and Hide Tanning and Finishing
1.493721	3255	Paint, Coating, and Adhesive Manufacturing	0.3166769	3211	Sawmills and Wood Preservation
1.487333	3353	Electrical Equipment Manufacturing	-0.0162934	3122	Tobacco Manufacturing

Notes: The density elasticity measure is estimated by OLS.

(a) OLS Estimates

(1)	(2)	(3)	(4)	(5)	(6)
TOP TEN			BOTTOM TEN		
Elasticity: IV Estimate	NAICS Code	Industry Name	Elasticity: IV Estimate	NAICS Code	Industry Name
1.524013	3117	Seafood Product Preparation and Packaging	-0.1235644	3361	Motor Vehicle Manufacturing
1.271837	3151	Apparel Knitting Mills	-0.1605782	3331	Agriculture, Construction, and Mining Machinery Manufacturing
1.226573	3342	Communications Equipment Manufacturing	-0.1798471	3112	Grain and Oilseed Milling
1.197432	3121	Beverage Manufacturing	-0.2356362	3325	Hardware Manufacturing
1.165016	3219	Other Wood Product Manufacturing	-0.2846771	3221	Pulp, Paper, and Paperboard Mills
1.147163	3132	Fabric Mills	-0.3778235	3339	Other General Purpose Machinery Manufacturing
1.011703	3371	Household and Institutional Furniture and Kitchen Cabinet Manufacturing	-0.4019563	3111	Animal Food Manufacturing
1.006027	3344	Semiconductor and Other Electronic Component Manufacturing	-0.4702834	3274	Lime and Gypsum Product Manufacturing
0.9815783	3113	Sugar and Confectionery Product Manufacturing	-0.5856257	3114	Fruit and Vegetable Preserving and Specialty Food Manufacturing
0.8887671	3211	Sawmills and Wood Preservation	-0.6302103	3346	Manufacturing and Reproducing Magnetic and Optical Media

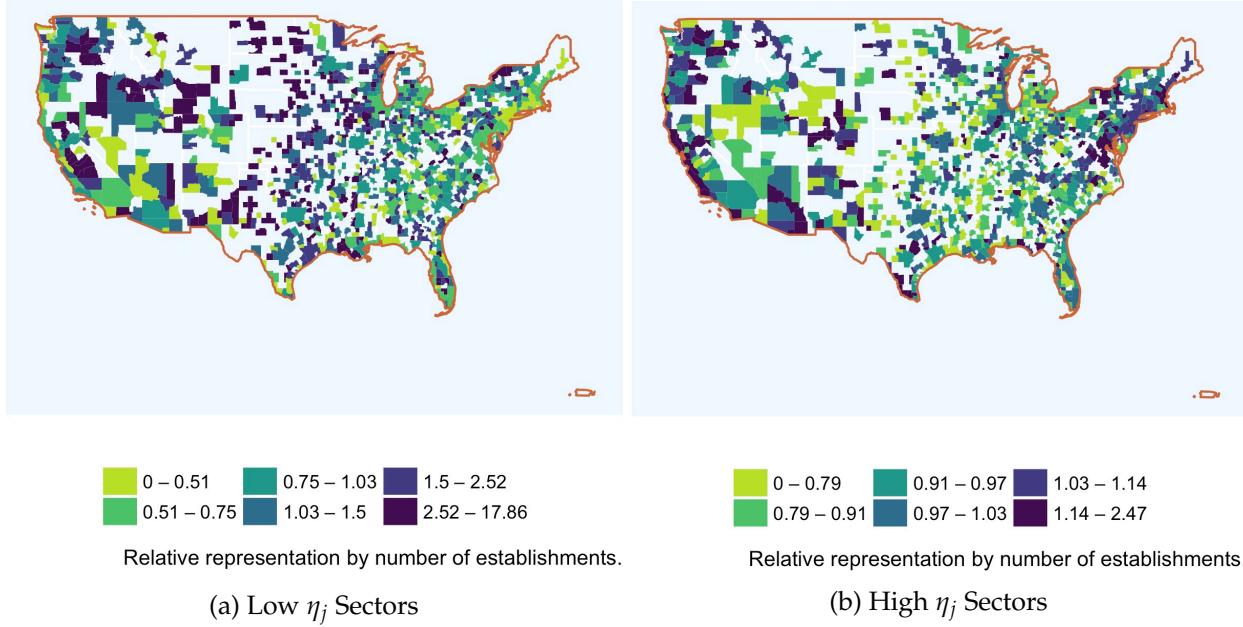
Notes: The density elasticity measure is estimated by IV-2SLS.

(b) IV Estimates

(e.g. Semiconductor and Other Electronic Component Manufacturing) and industries that are not skill-intensive (e.g. Beverage Manufacturing). The same is true for capital intensity.<sup>27</sup>

Figure 4 shows the distribution of establishments in the top and bottom ten sectors listed in Table

<sup>27</sup>Moreover, motor vehicle manufacturing, for example, the top of Nunn (2007)'s list of contract intensive industries, but are at opposite ends of our list. The same is true of Manufacturing and Reproducing Magnetic and Optical Media.



**Figure 4: Representation of Low- and High-  $\eta_j$  Sectors Across US Cities.** Both (a) and (b) are US CBSA-level maps. (a) displays the relative representation of low- $\eta_j$  sectors, the ten sectors with the lowest first principal component of our six density elasticity estimates. (b) displays the relative representation of high- $\eta_j$  sectors, the ten sectors with the highest first principal component of our six density elasticity estimates. These sectors are listed in Table 1

4b across the US. For each CBSA  $c$  and sector  $j$ , we compute:

$$\text{Representation}_{cj} = \left( \frac{\sum_{j \in T, B} \text{Establishments}_{cj}}{\sum_j \text{Establishments}_{cj}} \right) / \left( \frac{\sum_c \sum_{j \in T, B} \text{Establishments}_{cj}}{\sum_c \sum_j \text{Establishments}_{cj}} \right)$$

where  $T$  and  $B$  are the set of ten highest and lowest  $\eta_j$  sectors respectively. This normalization captures the over- or under-representation of top or bottom sectors in city  $c$  by normalizing the share of city  $c$  manufacturing establishments that belong to  $j \in T/B$  by the overall share of manufacturing establishments that belong to  $j \in T/B$  in the US.

Figure 4a shows the geographic distribution of low- $\eta_j$  sectors; they are disproportionately located in Upper Midwest and Central and Northern Plains regions (purple-shaded regions). High- $\eta_j$  sectors, displayed in Figure ??, are disproportionately located on the East and West coasts, as well as in cities in Texas and parts of the Midwest. There is significant variation within regions and states as well. Indeed, almost all states have locations in which both high and low  $\eta_j$  sectors are disproportionately produced.

Our baseline empirical results do not take a strong stance on industry-specific characteristics driving variation in the "density affinity" of manufacturing industries. Recent work has proposed industry-level variables that determine the extent to which sectors benefit from agglomeration and production in denser cities; these include education and skill requirements (Davis and Dingel, 2014) or capital intensity (Gaubert, 2018). An important distinction between most recent work and our

estimates is that we restrict attention to tradable manufacturing sectors; therefore, the fact that high-skilled services, for example, are disproportionately located in cities is outside the scope of our analysis. An alternative source of density affinity is the intensive use of differentiated local services (Abdel-Rahman and Fujita, 1990; Abdel-Rahman and Fujita, 1993; Abdel-Rahman, 1994). In this framework, density facilitates the production of non-tradable services, and hence service-reliant sectors sort into dense cities.<sup>28</sup> Another potential determinant of variation in density affinity is the extent to which each sector relies on raw materials (e.g. minerals, agriculture) as inputs. Sectors that rely on immobile natural resources might be less able to locate in cities and reap the benefits of agglomeration (Ades and Glaeser, 1995). Finally, dense cities might be particularly productive places for innovation and R&D (e.g. Duranton and Puga, 2004). If this is the case, the density affinity measure might be capturing the role of R&D in each industry's production process. We investigate the potential contribution of these mechanisms in Section 4.5.

## 4 Empirical Results: Population Distribution and the Pattern of Trade

### 4.1 Estimation Framework

We now examine the impact of within-country population distribution on patterns of trade. We investigate whether population-weighted density,  $D_i$ , is a systematic source of comparative advantage. Our main empirical estimating equation is:

$$y_{ij} = \alpha_i + \gamma_j + \beta \cdot \eta_j^{IV} \cdot \ln(D_i) + X'_{ij}\Gamma + e_{ij} \quad (4.1)$$

where  $i$  indexes states or countries and  $j$  indexes sectors. The unit of observation is a country (or state)-by-sector pair. The dependent variable is total exports in sector  $j$  from state or country  $i$ . The independent variable of interest is an interaction term between (i) IV estimates of sector-level density affinity ( $\eta_j^{IV}$ ) and (ii) log of state or country-level population weighted density ( $\ln(D_i)$ ). The density affinity of all NAICS-4 sectors were estimated using Equation (3.1) and the instrumental variables strategy outlined in Section 3.3. All specifications include sector and state or country fixed effects. We will also include a range of controls that vary at the state-by-sector or country-by-sector level ( $X'_{ij}$ ); these vary across specifications to probe the sensitivity of our estimates. Following Silva and Tenreyro (2006), we use the Poisson pseudo-maximum likelihood (PPML) estimator as our baseline specification, but show throughout that results are similar using OLS and a log-transformed dependent variable.<sup>29</sup>

The coefficient of interest is  $\beta$ . If  $\beta > 0$ , it implies that countries with greater population-weighted density have a revealed comparative advantage in “density-loving” sectors. This framework follows the regression-based index of comparative advantage summarized in French (2017), as used, among

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<sup>28</sup>Anecdotally, many large companies justify their relocation in large cities by their readily available diversity of services producers. See Bruce Nollip, [Wall Street Journal - The Experts](#), April 25, 2016: “As companies focus on their core competencies, they can benefit greatly from cities’ networks of service providers”.

<sup>29</sup>As shown by Fally (2015), the Poisson pseudo-maximum likelihood estimation method has the additional benefit of ensuring that predicted trade flows satisfy the “adding up” constraint implicit in gravity models of trade.

others, by Nunn (2007) or Bombardini, Gallipoli, and Pupato (2012). In Section 4.4 (below) we propose an instrumental variables strategy that exploits variation in historical population and city size distributions as shifters of modern population density.

## 4.2 US State-Level Estimates

The over-representation of some manufacturing sectors in dense areas in the United States might stem from either local supply or local demand conditions. Our hypothesis focuses on the supply side, by suggesting that denser cities are relatively more efficient in the production of “density-loving” industries. If this is the case, dense areas within the US should not only attract relatively more employment and production in these industries, but also export significantly more of them internationally. Moreover, while many models of international trade consider the entire US as a single “point,” different parts of the US specialize in vastly different industries (see e.g. Irwin (2017) for a long-term perspective). Thus, as a first test of our hypothesis that regions with greater population-weighted density specialize in the export of density-loving industries, we estimate Equation (4.1) at the US state level.<sup>30</sup>

These estimates are reported in Table 2. Panel A reports Poisson maximum likelihood estimates while Panel B reports OLS estimates with log of exports as the outcome variable. Across specifications, we find that the coefficient of interest is positive and statistically significant, suggesting that US states with greater population-weighted density have a comparative advantage in density-loving industries. Column 1 presents the coefficient of interest when only  $\eta_j^{IV} \times \ln(D_i)$ —the interaction between state-level population weighted density and industry-level density affinity—is included on the right hand side (along with state and industry fixed effects). The remaining specifications investigate the robustness of this baseline result to the inclusion of additional controls.

In order to investigate whether the results are driven by state-level differences in education and comparative advantage in high-skill industries, in column 2 we include a series of interactions between state-level educational attainment and sector-level skill demand. In particular, we separately interact the share of people in each state who have achieved a (i) high school degree, (ii) a bachelors degree, and (iii) a graduate degree, with the share of people employed in each sector (i) that have a high school degree or (ii) that have at least a college degree. The inclusion of these six interactions has little effect on our coefficient of interest.

In column 3, we control for a series of state-level variables interacted  $\eta_j^{IV}$  in order to investigate whether the baseline result is driven by some omitted state-level characteristic. These controls include (log of) the median household income; (log of) state-level population; the share of inhabitants with high school, bachelor, and graduate degree; and the share of young people, aged 18-30. It is possible, for example, that denser states are also just wealthier and that this drives the baseline estimate. However, the coefficient of interest remains very similar after including these controls.

In order to address the potential for omitted industry-level characteristics, in column 4 we control

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<sup>30</sup>While some recent studies have attempted to estimate export data at the metropolitan level (see e.g. the database constructed by Tomer and Kane (2014)), most trade flows data are still collected at a broader level of aggregation. The smallest level of consistent and exhaustive trade reporting in the United States is the state.

Table 2: State-Level Trade, Baseline Estimates

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Dependent Variable is Total Exports from the State-Sector							
Strategy for estimation of density affinity:		$\eta_j$ computed using industry-level employment					$\eta_j$ computed using industry-level number of establishments
$D_i \times \eta_j$	0.612*** (0.145)	0.539*** (0.117)	0.563*** (0.201)	0.437*** (0.0917)	0.538*** (0.199)	3.508*** (0.541)	3.241*** (0.660)
<i>Panel A: Outcome Variable is Total Exports (Thousands), PML Model</i>							
$D_c \times \eta_j$	0.146* (0.0734)	0.129* (0.0725)	0.142* (0.0738)	0.120* (0.0685)	0.124 (0.0793)	0.864** (0.358)	0.839** (0.363)
R-squared	0.756	0.758	0.757	0.758	0.760	0.756	0.760
Factor Intensity Controls	No	Yes	No	No	Yes	No	Yes
State Level Controls	No	No	Yes	No	Yes	No	Yes
Industry Level Controls	No	No	No	Yes	Yes	No	Yes
State FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
States	50	50	50	50	50	50	50
Observations	4,182	4,132	4,182	4,132	4,132	4,182	4,132
<i>Panel B: Outcome Variable is log(Exports), OLS Model</i>							

Notes: The unit of observation is a state-by-sector pair. The coefficient of interest is the coefficient on an interaction between state-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment in columns 1-5 and establishments in columns 6-7. Panel A reports Poisson pseudo-maximum likelihood estimates while Panel B reports OLS estimates. All specifications include state and sector fixed effects, along with other controls listed at the bottom of each column. Standard errors, clustered at the state level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively

for a series of industry-level characteristics interacted with  $\ln(D_i)$ . These covariates, computed for each manufacturing industry in the US, are the value of installed capital per worker, (log of) the average employee compensation, the share of workers with at least a college degree, the average age of employees, and the gender breakdown of employment. In column 5 we include all 17 controls mentioned thus far and again, the coefficient of interest remains very similar. It does, however, lose statistical significance in Panel B when we use an OLS regression model and log of exports as the outcome variable; this is driven by a larger standard error rather than a decline in coefficient magnitude.

In columns 6-7 we repeat the specifications from columns 1 and 5—the specifications without any controls and the specification with all controls—and construct the “density affinity” measure using industry-level establishment data rather than employment data. The number of establishments is a potentially less noisy measure of industry-level production across space than employment, and moreover is never suppressed in the CBP data. Reassuringly, in both columns 6 and 7 and in both Panels A and B, our coefficient of interest is positive and highly significant. Finally, Table A1 reports estimates from a series of additional specifications; each reported coefficient in Table A1 is estimated from a separate regression. The results are very similar if we use the versions of  $\eta_j$  estimated using OLS (instead of IV) and using city-level data on payroll, rather than employment or establishments.

Finally, all findings are very similar if we exclude state-industry pairs with zero exports (Table A2).

This first set of results demonstrates that US states that exhibit a more spatially concentrated population export relatively more in sectors whose production is concentrated in denser metropolitan areas. According to our estimates, a one-standard deviation increase in the density interaction in the fully controlled specification increases the dependent variable by 0.139 standard deviations when computed using the elasticity with respect to employment and 0.295 when computed using the elasticity with respect to establishments.

### 4.3 Country-Level Estimates

We now turn to the main results of the paper: the relationship between density and patterns of cross-country trade. Estimates of (4.1) in which the units of observation are country-industry pairs are reported in Table 3. Panel A presents Poisson pseudo-maximum likelihood estimates while Panel B reports OLS estimates. The coefficient of interest in a specification without controls is presented in column 1; it is positive and highly significant. Countries with a more concentrated population distribution have a revealed comparative advantage in density-loving sectors.

Columns 2-6 investigate the robustness of the result to the inclusion of a series of controls in order address potential concerns due to omitted variable bias. In column 2, we control for traditional determinants of comparative advantage, including capital and skill intensity (Romalis, 2004).<sup>31</sup> Since data on the country-level capital stock is only available for 90 countries, the sample size of the regression is reduced; nevertheless, the coefficient of interest is almost exactly identical.

In column 3 we control for a series of country-level characteristics interacted with the sector-level density elasticity measure,  $\eta_j^{IV}$ . These are included to account for the fact that population-weighted density is potentially related to other country-level characteristics that may affect comparative advantage. In particular, we control for (the log of) country-level total population, educational attainment, urbanization, the share of population employed in agriculture, the share of population employed in service production, (log of) per capita GDP (PPP adjusted), and a rule of law index, all interacted with  $\eta_j^{IV}$ . Again, the coefficient of interest is very similar.<sup>32</sup> Further, in Table A3 we reproduce our findings after including continent-by-industry fixed effects; this specification flexibly controls for differences in *industry-specific* productivity and trade in different parts of the world.

Next, we investigate the robustness of the result to the inclusion of sector-level controls. We control for the same industry-level controls as in Table 2, interacted with country-level measures of population-weighted density,  $D_i$ . Reassuringly, the coefficient of interest is again very similar after the inclusion of these controls.

In column 5, we include all controls mentioned thus far on the right-hand side of the regression. Due to missing covariates, the sample size is reduced to 83 countries, yet the coefficient of interest

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<sup>31</sup>In particular, we interact country-level capital stock (as drawn from the Penn World Tables) with an industry's average level of capital intensity obtained from the NBER-CES Manufacturing database. We also interact measures of educational attainment at the country level with our estimates of the skill intensity of an industry in US data computed from the share of high school and college attainment of workers in the industry in the American Community Survey data.

<sup>32</sup>Moreover, the coefficient of interest is also similar if only individual country-level controls or smaller sets of country-level controls are included on the right-hand side, but to conserve space we do not report these specifications.

Table 3: Country-Level Trade, Baseline Estimates

	(1)	(2)	(3)	(4)	(5)
Dependent Variable is Total Exports from the Country-Sector					
D <sub>i</sub> x η <sub>j</sub>	0.456*** (0.111)	0.464*** (0.110)	0.757*** (0.0849)	0.462*** (0.0710)	0.765*** (0.0731)
<i>Panel A: Outcome Variable is Total Exports (Thousands), PML Model</i>					
R-Squared	0.814	0.796	0.793	0.816	0.797
Factor Intensity Controls	No	Yes	No	No	Yes
Country Level Controls	No	No	Yes	No	Yes
Industry Level Controls	No	No	No	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Countries	134	90	107	134	83
Observations	10,464	7,241	8,542	10,332	6,674

Notes: The unit of observation is a country-by-sector pair. The coefficient of interest is the coefficient on an interaction between country-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment. Panel A reports Poisson pseudo-maximum likelihood estimates while Panel B reports OLS estimates. All specifications include country and sector fixed effects, along with other controls listed at the bottom of each column. Standard errors clustered at the country level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

remains positive and highly significant, suggesting that our findings are not driven by standard determinants of comparative advantage or other measurable country or industry level covariates. Table A5 documents that the results are not sensitive to the use of our alternative estimates of  $\eta_j$ , and are also very similar after excluding countries in the bottom 10% of the income and population distributions. The lowest income countries likely also have lower quality data and the smallest or poorest countries might have extreme values of either density or trade values. As in the case of our state-level estimates, the findings are also very similar if we include country-industry pairs with zero exports (Table A2).

Finally, we investigate the robustness of the findings to alternative potential sources of population data. While our baseline results rely on the LandScan database, other organizations, using slightly different methodologies to account for sparse data in some parts of the world, also produce gridded global population estimates. These are: the Global Human Settlement Layer, the Gridded Population of the World, and the WorldPop Project. We measure country-level population density using each of these data sets and re-estimate our baseline results after computing the independent variable of interest from each data source. These results are presented in Table A4 and our findings are very

similar across population data sources.<sup>33</sup>

These estimates indicate that the distribution of population within countries is a potentially important determinant of comparative advantage and patterns of trade. Our point estimate from column 2, when only factor endowment controls are included, implies that a one standard deviation increase in the density interaction increases the outcome variable by 0.113 standard deviations. This is slightly larger in magnitude than the coefficient on the capital interaction, which implies a standardized beta coefficient of 0.109.<sup>34</sup> In the specification with all controls included, the coefficient of interest increases and implies a beta coefficient on the density interaction of 0.276.

#### 4.4 Endogeneity

This section proposes an instrument for population-weighted density and reports instrumental variable estimates of our baseline specification. The goal of introducing an instrument is to make sure that the baseline results are not driven by reverse causality. That is, it is possible that the composition of a state or country's exports has feedback effects and shapes its economic geography; we would then find a positive coefficient on our density interaction, but it would be incorrect to interpret the relationship as evidence that density is a source of comparative advantage. To rule out the possibility that our results capture the effect of trade on economic geography, we use characteristics of a state or country's *historical* population distribution to construct instruments for the population distribution today. While characteristics of a country's historical population distribution predict its modern population distribution, it seems unlikely that modern patterns of trade, which developed largely after World War II, had a direct effect on the population distribution in 1900 (e.g. Irwin, 2017).

The ideal instrument for our purposes would be a historical measure of population weighted density, analogous to our contemporary measure. We construct such a measure for each US state using estimates of the historical US population distribution presented in Fang and Jawitz (2018). Fang and Jawitz (2018) combine historical census data with population modeling techniques to construct a spatially explicit distribution of the US population for each decade since 1790.<sup>35</sup> Using this gridded data set, we compute the population weighted density of each US state in 1900 ( $D_i^{1900}$ ).<sup>36</sup> The first stage estimating equation is thus:

$$(\eta_j^{IV} \cdot \ln(D_i)) = \xi \cdot \eta_j^{IV} \cdot \ln(D_i^{1900}) + \alpha_i + \gamma_j + X'_{ij}\Gamma + e_{ij} \quad (4.2)$$

where we hypothesize  $\xi > 0$  if the historical state-level population distribution is a strong predictor of the modern population distribution.

Our state-level IV-2SLS estimate of Equation (4.1), where the first stage estimating equation is

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<sup>33</sup>We thank Richard Delome for pointing this out to us, and rely on his version of the data sets which can be found here: [https://github.com/richarddelome/density\\_metrics/blob/master/README.md?fbclid=IwAR1KQ1KJB5FeLW45ROHXA63gfET9XT8jS7ecmaQ9h-B7LmPYuJW10DAdK98](https://github.com/richarddelome/density_metrics/blob/master/README.md?fbclid=IwAR1KQ1KJB5FeLW45ROHXA63gfET9XT8jS7ecmaQ9h-B7LmPYuJW10DAdK98).

<sup>34</sup>Reassuringly, our estimates of the magnitudes of comparative advantage due to factor endowments is very similar to Nunn (2007), who estimates a beta coefficient on an analogous capital interaction of 0.105.

<sup>35</sup>While the most advanced version of their model also uses socioeconomic characteristics of each region to predict population, we use the "Level 4" version of the model that does not take socioeconomic characteristics into account.

<sup>36</sup>We select the year 1900 for comparability with our country-level IV estimates, which have additional data constraints and are reported below.

(4.2), is presented in column 1 of Table 4. The coefficient estimate is positive, statistically significant, and similar in magnitude to the OLS estimates, suggesting that our state-level findings are not driven by reverse causality. Moreover, the first stage relationship is also strong; the Kleibergen-Paap first stage F-statistic is 25.159.

While it is possible to estimate the historical population weighted density of each US state, to our knowledge this is not possible at the country level. Therefore, in order to adapt the logic of our identification strategy to the country-level analysis, we also introduce a second set of instruments. We determined the location and population of cities around the world in 1900 using historical data collected by Chandler (1987), and recently digitized by Reba, Reitsma, and Seto (2016).<sup>37</sup> Intuitively, high  $D_i$  corresponds to having a high city population concentrated in a relatively small number of cities. For each state and country, we therefore compute the total population across all cities ( $p_i^{1900}$ ), as well as the inverse number of cities ( $c_i^{1900}$ ). We include both, as well as their interaction ( $p_i^{1900} \cdot c_i^{1900}$ ), interacted with  $\eta_j$ , as excluded instruments. We expect  $p_i^{1900} \cdot c_i^{1900} \cdot \eta_j$  to be positively correlated with  $D_i \cdot \eta_j$ , the endogenous variable, since a high value of  $p_i^{1900} \cdot c_i^{1900}$  implies that in 1900 the state had high overall city population concentrated in a small number of cities.

The first stage estimating equation using the city-level data is:

$$(\eta_j^{IV} \cdot \ln(D_i)) = \zeta \cdot c_i^{1900} \cdot \eta_j^{IV} + \xi \cdot p_i^{1900} \cdot \eta_j^{IV} + \phi \cdot p_i^{1900} \cdot c_i^{1900} \cdot \eta_j^{IV} + \alpha_i + \gamma_j + X_{ij}'\Gamma + e_{ij} \quad (4.3)$$

and we hypothesize that  $\phi > 0$ . States (and below, countries) with a high historical urban population concentrated in a small number of cities should—if the logic of the instrument is correct—have higher population-weighted density today.

State-level IV-2SLS estimates of Equation (4.1) with this second instrumentation strategy are reported in columns 2-3 of Table 4. The sample is reduced to 39 states because 11 states have no cities in the Chandler (1987) data in 1900. Nevertheless, the estimates remain positive and highly significant. Since  $p_i^{1900}$  (total urban population in 1900), one of the excluded instruments, will likely be mechanically correlated with modern population, we control for modern (log of) country population interacted with  $\eta_j$  in column 3; the coefficient of interest remains positive and significant. Finally, in columns 4-6, we repeat the results from columns 1-3 except in all cases use the version of  $\eta_j^{IV}$  estimated from data on establishments rather than data on employment; the results are very similar. Next, we turn to IV-2SLS estimates of our country-level results. Across countries, we rely exclusively on the instruments constructed from the Chandler (1987) city-level data. Although this is a limitation, it is worth noting that across US states, our instrument constructed from the Chandler (1987) data and our direct estimate of historical population weighted density are highly positively correlated; the binned partial correlation plot is reported in Figure 5.

Country-level IV-2SLS estimates of Equation (4.1) are presented in Panel A of Table 5; the first stage estimating equation is Equation 4.3 and first stage estimates are reported in Panels B. For comparison, Panel C reports OLS estimates. Our baseline country-level IV-2SLS estimate is reported in column 1 of Table 5. The coefficient estimate is positive and significant, supporting the argument

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<sup>37</sup>1900 was chosen because it is the oldest year with broad and global coverage.

Table 4: State-Level Trade, IV Estimates

	(1)	(2)	(3)	(4)	(5)	(6)
Strategy for estimation of density affinity:	Dependent Variable is Total Exports from the State-Sector					
	$\eta_j$ computed using industry-level employment			$\eta_j$ computed using industry-level number of establishments		
$D_c \times \eta_j$	0.231** (0.0878)	0.149** (0.0692)	0.288*** (0.0865)	1.098*** (0.408)	0.657* (0.381)	0.951*** (0.349)
$\ln(\text{population}) \times \eta_j$			-0.106 (0.0816)			-0.0921 (0.0738)
K-P F-Statistic	25.159	45.755	25.411	25.251	45.127	37.259
State FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
States	48	39	39	48	39	39
Observations	4,182	4,132	4,182	4,132	4,132	4,182

Notes: The unit of observation is a state-by-sector pair. The coefficient of interest is the coefficient on an interaction between state-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment in columns 1-3 and establishments in columns 4-6. All estimates report IV-2SLS estimates. In columns 1 and 3, the excluded instrument is an interaction between sector-level density affinity and state-level population weighted density computed from the US 1900 population distribution. In columns 2-3 and 5-6, the excluded instruments are the total urban population in the state in 1900, the inverse number of cities, and the interaction between the two. The Kleibergen-Paap F-statistic for each first stage regression is reported at the bottom of each column. Standard errors, clustered at the state level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

that density is a source of comparative advantage and that our baseline estimates are not driven by reverse causality. Reassuringly, and following the state-level analysis, in the first stage specification we find that  $\phi > 0$  while the direct effects of  $p_i^{1900}$  and  $c_i^{1900}$  are both negative. The IV estimate, however, is larger in magnitude than the OLS estimate. One explanation for this is that the IV estimate is capturing a particular local average treatment effect. For example, it could be the case that countries whose modern economic geography is highly correlated with economic geography in 1900 are also countries that industrialized early, and are very specialized in industries that fit their population distribution. This would generate IV estimates that are larger than OLS, since the the IV captures variation across countries whose specialization is most responsive to their population distribution.

Another possible explanation, as noted above, is that variation in the instruments is correlated with the error term in the second stage regression. Indeed, the instruments are constructed from historical population data and likely capture variation in total population and not only variation in  $D_i$ . Following the control strategy in our baseline results, in column 2 we include an interaction term between the (log of) present day population and  $\eta_j^{IV}$  as a control. The IV coefficient is smaller in magnitude in column 2 and more precisely estimated. While it remains larger than the OLS estimate, it is no longer statistically distinguishable.

Table 5: Country-Level Trade, IV Estimates

	(1)	(2)	(3)	(4)	(5)	(6)
	Dependent Variable is Total Exports from the State-Sector					
	Full Sample		Excluding Bottom 10% by Population		Excluding Bottom 10% by Income	
<i>Panel A: IV-2SLS Estimates</i>						
D <sub>i</sub> x η <sub>j</sub>	0.517** (0.236)	0.279** (0.117)	0.411** (0.196)	0.319*** (0.116)	0.404** (0.185)	0.214** (0.0894)
ln(population) x η <sub>j</sub>		-0.0895** (0.0366)		-0.0434 (0.0407)		-0.0887** (0.0346)
<i>Panel B: First Stage Estimates</i>						
(p <sub>i</sub> , 1900) x (c <sub>i</sub> , 1900) x η <sub>j</sub>	0.787** (0.344)	1.021*** (0.312)	0.797** (0.338)	1.091*** (0.345)	1.119*** (0.382)	1.153*** (0.356)
p <sub>i</sub> , 1900 x η <sub>j</sub>	-0.614*** (0.213)	-0.728*** (0.180)	-0.634*** (0.211)	-0.766*** (0.189)	-0.705*** (0.227)	-0.787*** (0.192)
c <sub>i</sub> , 1900 x η <sub>j</sub>	-8.705** (3.868)	-10.54*** (3.497)	-8.782** (3.807)	-11.36*** (3.868)	-12.43*** (4.304)	-11.83*** (3.998)
R-Squared	0.095	0.463	0.115	0.474	0.127	0.527
K-P F-Statistic	8.533	27.145	9.104	24.904	9.176	28.569
<i>Panel C: OLS Estimates</i>						
D <sub>i</sub> x η <sub>j</sub>	0.134** (0.0624)	0.196*** (0.0709)	0.169*** (0.0608)	0.181*** (0.0676)	0.129** (0.0635)	0.198*** (0.0719)
ln(population) x η <sub>j</sub>		-0.0753** (0.0334)		-0.0175 (0.0344)		-0.0861** (0.0332)
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Countries	86	86	77	77	78	78
Observations	7022	7022	6281	6281	6379	6379

Notes: The unit of observation is a country-by-year pair. Panel A reports IV-2SLS estimates, Panel B reports first stage estimates, and Panel C reports OLS estimates. The coefficient of interest is the coefficient on an interaction between country-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment. p is the log of the total urban population in 1900 and c is the inverse number of cities. All specifications include country and sector fixed effects, along with other controls listed at the bottom of each column. Sample restrictions are noted in the column header. The Kleibergen-Paap F-statistic for each first stage regression is reported at the bottom of Panel B. Standard errors clustered at the country level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

A potential concern with using the Chandler (1987) data is that data quality and coverage are likely different for different sets of countries. In particular, it is likely of lower quality for smaller and lower income countries, which might be more likely to have cities excluded from the data. To make sure this is not driving the result, in columns 3-4 and 5-6 we repeat the specifications from columns 1-2 after dropping countries in the bottom 10% of the population and income distribution respectively. Reassuringly, our estimates remain very similar. The results are also similar if we drop countries in the bottom 20 or 25% of the distribution (not reported).

Taken together, the robustness of our result to the battery of controls and specifications in the previous section, as well as the broadly similar results using these historical instruments, indicates

that density is an important and causal determinant of patterns of trade.

#### 4.5 Mechanisms: What drives density affinity?

We next turn to potential mechanisms underpinning the baseline results. While in the main specification we relied on a reduced-form measure of industry-level “density affinity,” in this section we explore which industry characteristics potentially underlie the baseline estimates. First, some recent work has highlighted the greater skill and level of human capital in cities (Davis and Dingel, 2014). It is worth noting that in the baseline specification, we were careful to control flexibly for the potential role of variation in skill or education, both across sectors and across countries. In column 1 of Table 6, we report the coefficient on the interaction between population-weighted density and the share of employment in each industry in the US with a college degree. The coefficient on this interaction is statistically insignificant; we also find no evidence that education is driving the result if we break the industry-level education measure into a larger number of discrete bins (not reported).

Another potential determinant of our density affinity measure is the extent to which each sector relies on differentiated local services. Population density might facilitate the productive provision of services and sectors that rely more on local services may therefore benefit disproportionately from density (Abdel-Rahman and Fujita, 1990; Abdel-Rahman and Fujita, 1993; Abdel-Rahman, 1994; Abdel-Rahman, 1996). Our estimates lend some support to this hypothesis. Within the United States, we find that manufacturing industries in which services comprise a large share of total intermediate inputs tend to locate in denser areas.<sup>38</sup> When we turn to the trade data, however, service reliance does not explain the export patterns of high- $\eta_j$  sectors (column 2). The coefficient on the interaction between population-weighted density and industry-level service intensity is in fact negative and far from statistically significant.

Certain industries may locate away from dense cities if they rely on immobile natural resources (e.g. Ades and Glaeser, 1995). These sectors might be less able to benefit from urban externalities and variation in natural resource dependence across industries might drive our variation in density affinity. Anecdotally, the sectors at the bottom of our “density affinity” list seem to be those that source extensively from natural resources (see Table 1). To investigate this, we compute the share of natural resource inputs for each manufacturing sector using the US input-output tables. The coefficient on the interaction term between population-weighted density and industry-level natural resource dependence is negative and significant (column 3 of Table 6), suggesting that indeed denser countries export less in sectors that rely on natural resources. This is consistent with the idea that resource-reliant sectors optimally locate away from urban centers and that dense countries hence are disproportionately productive in industries that do not rely on natural resources.

A final potential mechanism is the role of research and development (R&D) in production. Industries rely differentially on R&D expenditure and innovation in the production process. If cities facilitate innovation (e.g. Duranton and Puga, 2001; Duranton and Puga, 2004), then sectors that rely disproportionately on R&D might be especially productive in dense cities. Therefore, our baseline estimates might be capturing the role of density in facilitating R&D. To investigate this, for each

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<sup>38</sup>We compute each sector’s non-tradable input share from the Bureau of Labor Statistics input-output tables.

Table 6: Exploring Potential Mechanisms

	(1)	(2)	(3)	(4)	(5)	(6)
	Dependent Variable is Total Exports from the Country-Sector					
$\eta_j$ computed using industry-level:					Total Emp.	Number of Est.
$D_i \times \eta_j$					0.875***	2.282***
					(0.171)	(0.494)
$D_i \times (\text{Share Employment College Educated})_j$	0.996				1.989	-1.484
	(1.944)				(1.538)	(1.954)
$D_i \times (\text{Services Input Share})_j$		-0.646			-0.592	-0.444
		(0.620)			(0.443)	(0.497)
$D_i \times (\text{Nat. Resource Input Share})_j$			-1.575**		-0.599	-1.186**
			(0.652)		(0.430)	(0.559)
$D_i \times (\text{R&D per Worker})_j$				0.0844**	0.0743**	0.0705*
				(0.0378)	(0.0370)	(0.0387)
$D_i \times (\text{Share STEM Workers})_j$				1.124**	1.290**	0.804
				(0.525)	(0.527)	(0.493)
Country Level Controls	Yes	Yes	Yes	Yes	Yes	Yes
Industry Level Controls	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	8,437	8,437	8,437	8,333	8,333	8,333

Notes: The unit of observation is a country-by-sector pair. All specifications include country and sector fixed effects, along with other controls listed at the bottom of each column. Sector-level density affinity computed using the bedrock IV and city-level employment (columns 5) or city-level employment (column 6). Additional interactions included in each regression are noted on the left side of the table. Standard errors clustered at the country level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

sector we compile data on (i) R&D spending per worker and (ii) the share of employees in science, technology, engineering, and mathematical (STEM) fields from the Brookings Advanced Industries database. Again, we include an interaction term between both measures and country-level density in our baseline country-level estimating equation; the estimates are reported in column 4 of Table 6. Both interactions are positive and statistically significant, suggesting that density may play a role in facilitating R&D and that denser places specialize in the export of R&D intensive sectors.

Does the combination of these channels explain our baseline estimates? In columns 5-6, we include all variables from columns 1-4 of Table 6 on the right hand side of the regression, along with the industry-level reduced form density affinity interacted with population-weighted density. If our proposed mechanisms fully explained the baseline results, we would expect the coefficient on the density affinity variable to be zero. However, it remains positive and statistically significant, whether density-affinity is measured using US employment data (column 5) or data on establishments (column 6). Thus, we find suggestive evidence that (i) the role of cities in facilitating R&D and (ii) heterogeneity in industry-specific natural resource dependence are important channels; however, they do not fully explain our baseline results, suggesting that additional and un-observed industry charac-

teristics are also at play. Uncovering industry-level characteristics that drive sorting with respect to density strikes us as a potentially interesting area for additional exploration, and we leave a deeper exploration of the determinants of density affinity to future work.

## 5 Conclusion

This paper argues that some countries specialize in density: countries with an abundance of dense cities export relatively more in density-loving sectors. Most analysis of sources of comparative advantage in international trade have emphasized aggregate variation in country-level endowments or production technologies. Our theory and empirical results, however, suggest that even when two countries have identical factor endowments in the aggregate, they may specialize in vastly different industries because the domestic distribution of factors of production is a key determinant of comparative advantage. In particular, a key determinant of patterns of trade might lie in the spatial distribution of people within regions and countries.

We first uncover substantial heterogeneity in the density-affinity of tradable sectors, using a new strategy that exploits subterranean geology as a shifter of location-specific population density; while some sectors are disproportionately located in large cities, others are more frequently found in small cities or suburban areas. Next, we show that US states and countries with higher population-weighted density—that is, with a more concentrated population—export relatively more in sectors with high density affinity. Population density and distribution affect not only domestic productivity and inequality, but also comparative advantage and international trade.

The implications of these findings extend into the realms of policy and politics. First, this paper's results suggest that place-based policies might have systematically heterogeneous effects across industries, even to the point of affecting international specialization. By disproportionately benefiting certain places, and perhaps even altering the population distribution, policy could affect sector-level comparative advantage. Second, it is a well-known feature of politics in most countries that more or less dense places achieve different levels of political representation. In the US, for example, institutions like the Senate, the Electoral College, and even the lags in House re-districting, lead to the systematic over-representation of less dense areas. Our analysis suggests that this inherently leads to an uneven level of political representation across sectors; the resulting political inequality could have major implications for trade policy and the approach to politics that each industry pursues. This interaction between population distributions, political power, and trade is the subject of ongoing work.

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## Appendices

### A Appendix Figures and Tables

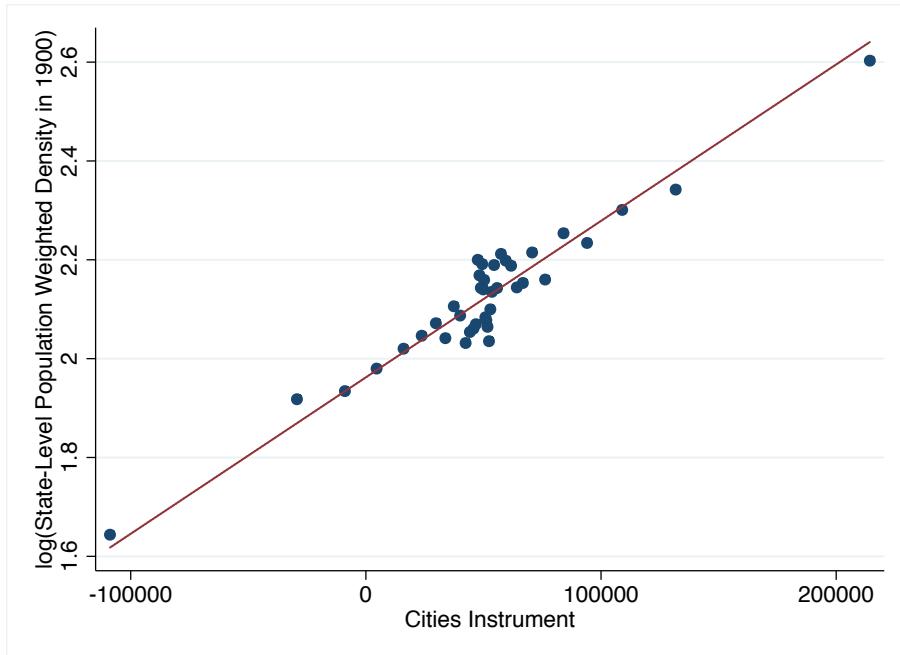


Figure 5: **Correlation Between Both US State-Level Instruments.** This figure presents the partial correlation, conditional on state and industry fixed effects, between (i) log of US state-level population weighted density in 1900, estimated from the Fang and Jawitz (2018) data set, and (ii) the interaction between total 1900 city population and the inverse number of cities, estimated from the Chandler (1987) data set.

Table A1: State-Level Trade, Alternative Specifications

	(1)	(2)
Dependent Variable is Total Exports (Thousands)		
$\eta_j$ computed using:		
Employment, IV	0.612*** (0.145)	0.538*** (0.199)
Establishments, IV	3.508*** (0.541)	3.241*** (0.660)
Payroll, IV	0.335*** (0.0753)	0.295*** (0.111)
Employment, OLS	0.788*** (0.236)	0.459*** (0.172)
Establishments, OLS	2.650*** (0.462)	1.766*** (0.401)
Payroll, OLS	0.504*** (0.169)	0.307*** (0.117)
All Controls	No	Yes
State FE	Yes	Yes
Industry FE	Yes	Yes
Observations	4,182	4,132

Notes: The unit of observation is a state-by-sector pair. Each coefficient is an estimate from a separate regression. The coefficient of interest is the coefficient on an interaction between state-level population weighted density and sector-level density affinity using the strategy listed on the left side of the table. All reported specifications are Poisson pseudo-maximum likelihood estimates and include state and sector fixed effects, along with other controls listed at the bottom of each column. Standard errors clustered at the state level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

Table A2: Main Results: Including Observations with No Exports

	(1)	(2)	(3)	(4)
	US State-Level		Country-Level	
Outcome Variable:	Exports	Exports (asinh)	Exports	Exports (asinh)
Model:	PML	OLS	PML	OLS
D <sub>i</sub> x η <sub>j</sub>	0.612*** (0.145)	0.425** (0.169)	0.456*** (0.111)	0.167** (0.0720)
State FE	Yes	Yes	-	-
Country FE	-	-	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Observations	4,250	4,250	11,122	11,122
R-squared		0.709		0.823

Notes: The unit of observation is a state-industry pair (columns 1-2) or a country-industry pair (columns 3-4). . The coefficient of interest is the coefficient on an interaction between state- or country-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment. In columns 1 and 3, the outcome variable is total exports and in columns 2 and 4, it is the inverse hyperbolic sine of total exports. Observations with zero exports are included in the estimation. Standard errors clustered at the state (columns 1-2) or country (columns 3-4) level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

Table A3: Country-Level Trade, Including Continent  $\times$  Industry Fixed Effects

	(1)	(2)	(3)	(4)	(5)
Dependent Variable is Total Exports from the Country-Sector					
D <sub>i</sub> x η <sub>j</sub>	0.412** (0.191)	0.403** (0.181)	0.486*** (0.163)	0.380*** (0.0986)	0.491*** (0.158)
<i>Panel A: Outcome Variable is Total Exports (Thousands), PML Model</i>					
R-Squared	0.837	0.820	0.821	0.837	0.822
Factor Intensity Controls	No	Yes	No	No	Yes
Country Level Controls	No	No	Yes	No	Yes
Industry Level Controls	No	No	No	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes
Industry x Continent FE	Yes	Yes	Yes	Yes	Yes
Countries	134	90	107	134	83
Observations	10,464	7,159	8,542	10,332	6,674
<i>Panel B: Outcome Variable is log(Exports), OLS Model</i>					

Notes: The unit of observation is a country-by-sector pair. The coefficient of interest is the coefficient on an interaction between country-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment. Panel A reports Poisson pseudo-maximum likelihood estimates while Panel B reports OLS estimates. All specifications include country and continent-by-sector fixed effects, along with other controls listed at the bottom of each column. Standard errors clustered at the country level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

Table A4: Main Results: Robustness to Alternative Sources of Population Data

	(1)	(2)	(3)	(4)
Gridded Population Data Set:	LandScan (Baseline)	Global Human Settlement Layer	Gridded Population of the World	Worldpop Project
D <sub>i</sub> x η <sub>j</sub>	0.456*** (0.111)	0.468*** (0.125)	0.443*** (0.0956)	0.497*** (0.102)
Country FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Countries	134	134	134	134
Observations	10,547	10,547	10,547	10,547

Notes: The unit of observation is a country-by-sector pair. The coefficient of interest is the coefficient on an interaction between country-level population weighted density and sector-level density affinity computed using the bedrock IV and city-level employment. Population weighted density is computed from a different data set in each column, and the data source is listed at the top of each column. Standard errors clustered at the country level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

Table A5: Main Results: Alternative Specifications

Sample:	(1)	(2)	(3)	(4)
	Dependent Variable is Total Exports (Thousands)			
	Full Sample	Excluding countries with pop < 1 million	Excluding bottom 10% income	
<i><math>\eta_j</math> computed using:</i>				
Employment, IV	0.456*** (0.111)	0.774*** (0.0720)	0.457*** (0.111)	0.456*** (0.111)
Establishments, IV	1.594*** (0.361)	1.836*** (0.262)	1.594*** (0.362)	1.594*** (0.361)
Payroll, IV	0.248*** (0.0640)	0.401*** (0.0408)	0.248*** (0.0640)	0.248*** (0.0640)
Employment, OLS	0.292** (0.147)	0.135 (0.0881)	0.292** (0.147)	0.292** (0.147)
Establishments, OLS	0.793** (0.329)	0.480** (0.225)	0.792** (0.329)	0.792** (0.328)
Payroll, OLS	0.224** (0.0985)	0.105* (0.0580)	0.224** (0.0987)	0.224** (0.0984)
All Controls	No	Yes	No	No
Country FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Observations	10,464	6,674	9,277	9,515

Notes: All reported coefficients are from regressions at the country-by-sector level. Each coefficient is an estimate from a separate regression. The coefficient of interest is the coefficient on an interaction between country-level population weighted density and sector-level density affinity computed using the strategy listed on the left hand side of each row. All reported specifications are Poisson pseudo-maximum likelihood estimates and include country and sector fixed effects, along with other controls listed at the bottom of each column. Sample restrictions are noted in the column header. Standard errors clustered at the country level, are reported in parentheses. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels respectively.

## B Derivations and proofs

### B.1 Housing market

Out of nominal disposable income  $Y_c$ , a worker in city  $c$  spends a constant share  $p_{hc}h_c = \beta Y_c$  on the non-tradable good produced in city  $c$ , and a constant share  $(1 - \beta)Y_c = X_c$  on the basket of tradable sectors, with sub-shares  $\alpha_j X_c = p_j c_j^c$  on each sector  $j$ . Each landowner faces a price  $p_{hc}$  for housing and a cost of  $P$  for the numeraire input. Each landowner then uses an amount  $X_{hc}(\gamma) = \gamma(1 - \xi)(\frac{p_{hc}}{P})^{\frac{1}{\xi}}$  of tradable inputs, and aggregate housing supply is:  $H^s(c) = B_c(\frac{p_{hc}}{P})^{\frac{1-\xi}{\xi}}$ . Equalizing supply and demand yields equilibrium housing prices in each city (equation 2.2):

$$p_{hc}^{\frac{1}{\xi}} = \beta \frac{L_c Y_c}{B_c P^{\frac{\xi-1}{\xi}}}$$

Landowners in a city receive proceeds from real estate sales  $\beta Y_c L_c$ , out of which they spend  $PX_{hc} = (1 - \xi)\beta Y_c L_c$  on the final good, while accruing rents  $r_c B_c = \xi \beta Y_c L_c$ .  $r_c$  is defined as the Ricardian rent per unit of land, increasing in local population density and local disposable income. Using the spatial equilibrium condition and the fact that all land rents are fully rebated to local workers, we have:

$$Y_c = \bar{U} P^{1-\beta} p_{hc}^\beta = \bar{U} P^{1-\beta} \left( \frac{\beta L_c Y_c}{B_c P^{\frac{\xi-1}{\xi}}} \right)^{\beta \xi} = \bar{U} P^{1-\beta \xi} (\beta \frac{L_c}{B_c} Y_c)^{\xi \beta}$$

and thus

$$w_c = P(1 - \beta \xi) \bar{U}^{\frac{1}{1-\beta \xi}} \beta^{\frac{\beta \xi}{1-\beta \xi}} \frac{L_c}{B_c}^{\frac{\beta \xi}{1-\beta \xi}} \propto P \times D_c^{\frac{\beta \xi}{1-\beta \xi}}$$

### B.2 Comparative advantage of cities

Cost minimization by consumers in any location  $d$  implies, in the absence of trade costs and using standard Eaton-Kortum algebra (Costinot, Donaldson, and Komunjer, 2011; Michaels, Rauch, and Redding, 2013):

$$p_{dj}(\omega) = \min \{ p_{dcj}(j); c \in C \}$$

The probability that the unit cost is less than  $p$  for variety  $\omega$  of good  $j$  produced in  $c$  is:

$$F_{jc}(p) = \mathbb{P}\left(\frac{w_c}{\tilde{z}_{jc}} < p\right) = 1 - e^{-\left(\frac{w_c}{A_c D_c^{\tilde{\eta}_j}}\right)^\theta}$$

The probability that the minimal cost for variety  $\omega$  of good  $j$  is less than  $p$  is thus:

$$F_j(p) = 1 - (\prod_{c \in C} (1 - F_{jc}(p))) = 1 - e^{-\sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta} p^\theta}$$

and the probability that location  $c$  is the lowest cost supplier for variety  $\omega$  for location  $d$  is:

$$\mathbb{P}\left(\frac{w_c}{\tilde{z}_{jc}} \leq \min \{ p_{dcj}(j); c \in C \}\right) = \frac{A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta}}{\sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta}}$$

From the Fréchet distribution assumption and the Constant Elasticity of Substitution structure on demand allocation within good  $j$ , standard algebra then implies that the share of spending on varieties from location  $c$  in sector  $j$  must be equal across all locations  $d$ .<sup>39</sup>

$$\pi_{dcj} = \pi_{cj} = \frac{p_{cj} X_{dcj}}{X_{dj}} = \frac{(A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta}}{\sum_{c'} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta}} \quad (\text{B.1})$$

where  $\pi_{dcj}$  denotes spending in city  $d$  on goods in sector  $j$  produced in city  $c$ , equation 2.3 in the model.

### B.3 Proposition 2.1

The derivation borrows from the definition of the unified price index in Redding and Weinstein (2020). Using spending shares 2.3, and the definition of the price index 2.5, we obtain:

$$\frac{\pi_{cj}}{\pi_{cj'}} = \left(\frac{P_j}{P_{j'}}\right)^\theta \frac{(A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta}}{(A_c D_c^{\tilde{\eta}_{j'}})^\theta w_c^{-\theta}}$$

Re-expressing and taking logs on both sides:

$$\frac{\log\left(\frac{P_j}{P_{j'}}\right) - (\eta_{j'} - \eta_j) \log(D_c)}{\log\left(\frac{\pi_{cj}}{\pi_{cj'}}\right)} = \frac{1}{\theta}$$

Multiplying both sides by  $\pi_{cj} - \pi_{cj'}$ , and using that in autarky  $\sum_{c \in C} \pi_{cj} = 1$ , summing over all cities  $c$  and rearranging yields the Sato-Vartia relative price:

$$\sum_{c \in C} \left( \frac{\pi_{cj} - \pi_{cj'}}{\log(\pi_{cj}) - \log(\pi_{cj'})} \right) \log\left(\frac{P_j}{P_{j'}}\right) = (\eta_{j'} - \eta_j) \sum_{c \in C} \left( \frac{\pi_{cj} - \pi_{cj'}}{\log(\pi_{cj}) - \log(\pi_{cj'})} \right) D_c$$

and, rearranging, we obtain the "Sato-Vartia" relative price expression in proposition 2.1.

### B.4 Population density dispersion

Because equilibrium density  $D_c$  is increasing in  $A_c$ , at the country level, greater dispersion of  $A_c$  therefore leads to greater equilibrium  $D_c$  dispersion, as workers reallocate from lower to higher- $A_c$ , higher- $D_c$  locations. The population density distribution in an economy with more dispersed  $A_c$  is second-order stochastically dominated by the population density distribution in an economy with less dispersed  $A_c^*$  (see B).

Formally, suppose there are two countries,  $H$  and  $F$ , and define  $H(d)$  as the share of the total

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<sup>39</sup>Given the unbounded nature of the Fréchet distribution, the production structure does not lead to the full specialization of cities in the production of some sectors, which would make the exposition more involved by inducing censoring at the bottom of the sector-city employment density, without adding substantial insight in the model, given that we do not attempt a structural estimation of the parameters

population living in cities with density below  $d$  in  $H$ , the high-amenity-dispersion economy:

$$H(d) = \frac{\sum_{c \in C} L_c \mathbb{1}(\frac{L_c}{B_c} \leq d)}{\bar{L}}$$

Let  $H^*(d)$  be its counterpart in  $F$ . Then, for any  $d$ , we have:

$$\int_0^d H(s)ds \geq \int_0^d H^*(s)ds$$

For any percentile  $p$ , there is a corresponding density threshold  $H^{-1}(p) = d$ . Let the Generalized Lorenz Curve (GLC) of population density be the function:

$$GLC(p) = \int_0^p H^{-1}(q)dq, \text{ for } p \in [0, 1]$$

Integration by parts yields:

$$GLC(p) \leq GLC^*(p) \forall p$$

The GLC of density in a country with a higher dispersion of population lies strictly below that of a country with a more concentrated distribution of population. Note that we have, by a change of variable:

$$GLC(p) = \frac{\sum_{c \in C} \frac{(L_c)^2}{B_c} \mathbb{1}(H(\frac{L_c}{B_c}) \leq p)}{\bar{L}}$$

## B.5 Proposition 2.2

We assume, as in Ramondo, Rodríguez-Clare, and Saborío-Rodríguez (2016), that iceberg trade costs are nil within a country, and symmetric (at the country-level) across any two locations in two different countries. The proof follows the structure of Ramondo, Rodríguez-Clare, and Saborío-Rodríguez (2016), extended to a case with many sectors.

We obtain a natural extension of equation 2.4 in a world of many countries, namely that for any city  $c$  in country  $i$ , the wage bill in sector  $j$  satisfies:

$$w_c L_{jc} = \alpha_j \sum_n \frac{(A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta} \tau_{in}^{-\theta}}{\sum_s \sum_{c' \in C_s} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta} \tau_{sn}^{-\theta}} \sum_{d \in C_n} w_d L_d \quad (\text{B.2})$$

We rewrite equation (B.2) as:

$$w_c = \left( \frac{(A_c D_c^{\tilde{\eta}_j})^\theta}{L_{jc}} \right)^{\frac{1}{1+\theta}} \Delta_{ij} \quad (\text{B.3})$$

where  $\Delta_{ij}$  is a country-sector level variable indexing market access in sector  $j$  and country  $i$ :

$$\Delta_{ij}^{1+\theta} = \alpha_j \sum_n \frac{\tau_{in}^{-\theta}}{\sum_s \sum_{c' \in C_s} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta} \tau_{sn}^{-\theta}} \sum_{d \in C_n} w_d L_d \quad (\text{B.4})$$

We can use the fact that:

$$\sum_{d \in C_n} w_d L_d = \sum_{d \in C_n} \sum_k w_d L_{dk}$$

and equation (B.2) to re-express  $\Delta_{ij}$ :

$$\begin{aligned} \Delta_{ij}^{1+\theta} &= \alpha_j \sum_n \frac{\tau_{in}^{-\theta} \sum_{d \in C_n} \sum_k L_{kd} \left( \left( \frac{A_d D_d^{\tilde{\eta}_k}}{L_{dk}} \right)^{\frac{1}{1+\theta}} \Delta_{nk} \right)}{\sum_s \sum_{c' \in C_s} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta} \tau_{sn}^{-\theta}} \\ \Delta_{ij}^{1+\theta} &= \alpha_j \sum_n \frac{\tau_{in}^{-\theta} \sum_k \Delta_{nk} L_{nk}^{\frac{\theta}{1+\theta}} \sum_{d \in C_n} (A_d D_d^{\tilde{\eta}_k})^{\frac{\theta}{1+\theta}} \left( \frac{L_{kd}}{L_{nk}} \right)^{\frac{\theta}{1+\theta}}}{\sum_s \tau_{sn}^{-\theta} \Delta_{sj}^{-\theta} L_{js}^{\frac{\theta}{1+\theta}} \sum_{c' \in C_s} (A_{c'} D_{c'}^{\tilde{\eta}_j})^{\frac{\theta^2}{1+\theta}} \left( \frac{L_{jc'}}{L_{js}} \right)^{\frac{\theta}{1+\theta}}} \end{aligned} \quad (\text{B.5})$$

where  $L_{nk} = \sum_{d \in C_n} L_{dk}$ . We define the following objects, that depend on the equilibrium distribution of population within a country:

$$T_{ij} = \left( \sum_{c \in C_i} (A_c D_c^{\eta_j})^{\frac{\theta}{1+\theta}} \left( \frac{L_{jc}}{L_{ji}} \right)^{\frac{\theta}{1+\theta}} \right)^{1+\theta} \quad (\text{B.6})$$

$$M_i = \sum_j \Delta_{ij} L_{ij}^{\frac{\theta}{1+\theta}} T_{ij}^{\frac{1}{1+\theta}} \quad (\text{B.7})$$

Note then that we can re-express equation (B.5) as a system of equations in  $M_n$ ,  $T_{sj}$ ,  $L_{sj}$ , and  $\Delta_{sj}$ :

$$\Delta_{ij}^{1+\theta} = \alpha_j \frac{\sum_n M_n \tau_{in}^{-\theta}}{\sum_s \tau_{is}^{-\theta} \Delta_{sj}^{-\theta} L_{sj}^{\frac{1}{1+\theta}} T_{sj}^{\frac{1}{1+\theta}}} \quad (\text{B.8})$$

We make note that  $M_i$  corresponds to the total tradable wage bill in a country:

$$\sum_{c \in C_i} w_c L_c = \sum_{c \in C_i} \sum_j w_c L_{cj} = \sum_j \Delta_{ij} L_{ij}^{\frac{\theta}{1+\theta}} T_{ij}^{\frac{1}{1+\theta}} = M_i \quad (\text{B.9})$$

We now use fact (B.9) to derive the bilateral export flows from country  $i$  to country  $n$  in sector  $j$ , by using the fact that exports of good  $j$  from any city  $c \in C_i$  to any city  $d \in C_n$  are given by:

$$x_{cdj} = \alpha_j w_d L_d \frac{(A_c D_c^{\tilde{\eta}_j})^\theta w_c^{-\theta} \tau_{in}^{-\theta}}{\sum_s \tau_{sn}^{-\theta} \sum_{c' \in C_s} (A_{c'} D_{c'}^{\tilde{\eta}_j})^\theta w_{c'}^{-\theta}}$$

Summing over cities, using (B.5), (B.7) and (B.6), yields, after rearranging:

$$X_{inj} = \sum_{c \in C_i} \sum_{d \in C_n} x_{cdj} = \alpha_j M_n \tau_{in}^{-\theta} \frac{\Delta_{ij}^{-\theta} T_{ij}^{\frac{1}{1+\theta}} L_{ij}^{\frac{\theta}{1+\theta}}}{\sum_s \Delta_{sj}^{-\theta} T_{sj}^{\frac{1}{1+\theta}} L_{sj}^{\frac{\theta}{1+\theta}}} \quad (\text{B.10})$$

We next derive the average wage in country  $i$  and sector  $j$ :

$$w_{ij} = \frac{\sum_{c \in C_i} w_c L_{cj}}{\sum_{c \in C_i} L_{cj}}$$

by using equation (B.2), again summing over all cities in country  $i$  and using the same manipulations:

$$w_{ij} = \frac{\sum_n X_{inj}}{\sum_{c \in C_i} L_{cj}} = \frac{\sum_n X_{inj}}{L_{ij}} = \alpha_j \frac{\sum_n M_n \tau_{in}^{-\theta} \Delta_{ij}^{-\theta} T_{ij}^{\frac{1}{1+\theta}} L_{ij}^{-\frac{1}{1+\theta}}}{\sum_s \Delta_{sj}^{-\theta} T_{sj}^{\frac{1}{1+\theta}} L_{sj}^{\frac{\theta}{1+\theta}}} \quad (\text{B.11})$$

and, using the system (B.8) and substituting, we obtain:

$$w_{ij} = \Delta_{ij} \left( \frac{T_{ij}}{L_{ij}} \right)^{\frac{1}{1+\theta}} \quad (\text{B.12})$$

Plugging (B.12) into equation (B.10) yields proposition 2.2.