

BUSN 33946 & ECON 35101  
International Macroeconomics and Trade  
Jonathan Dingel  
Autumn 2021, Week 9



The University of Chicago Booth School of Business

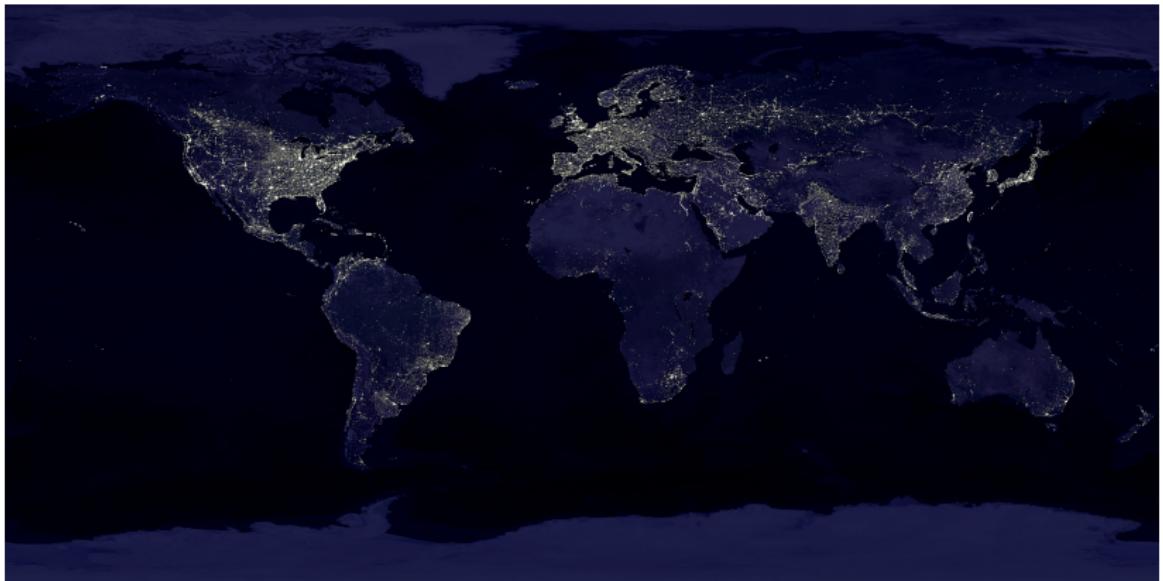


Image from [NOAA](#)

(Defense Meteorological Program Operational Linescan System)

Donaldson & Storeygard, “[The View from Above: Applications of Satellite Data in Economics](#)”, *JEP*, 2016

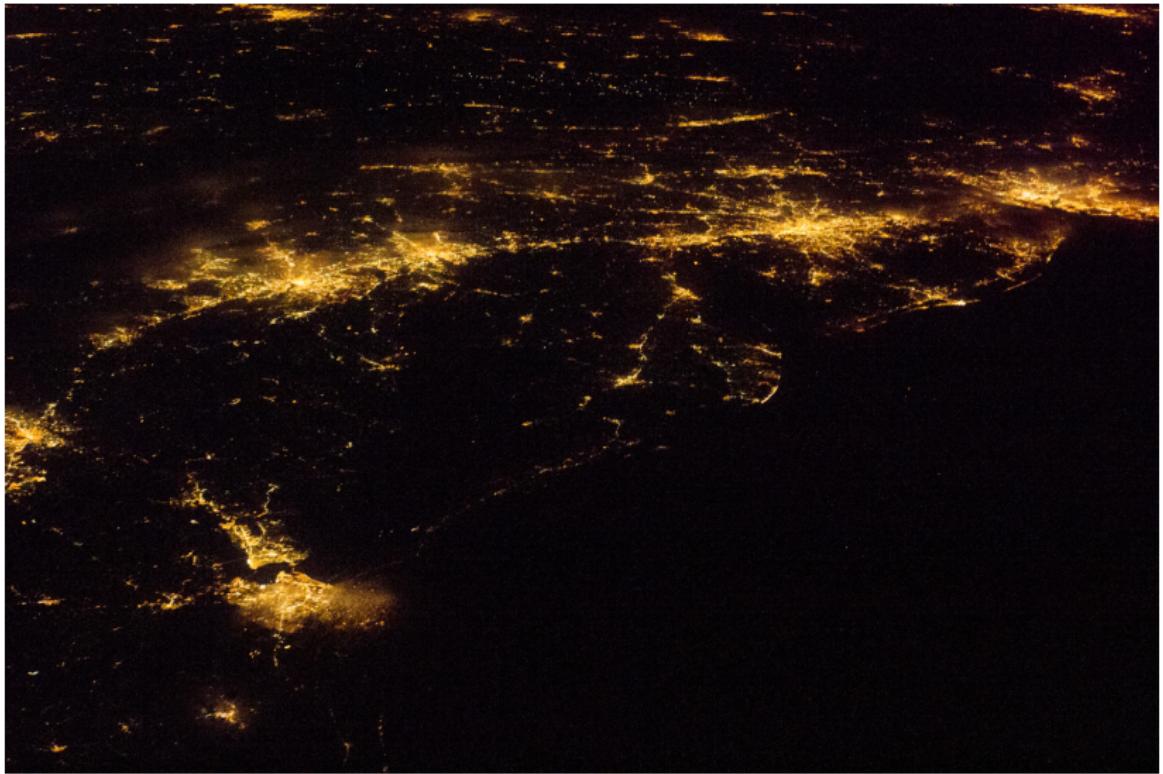
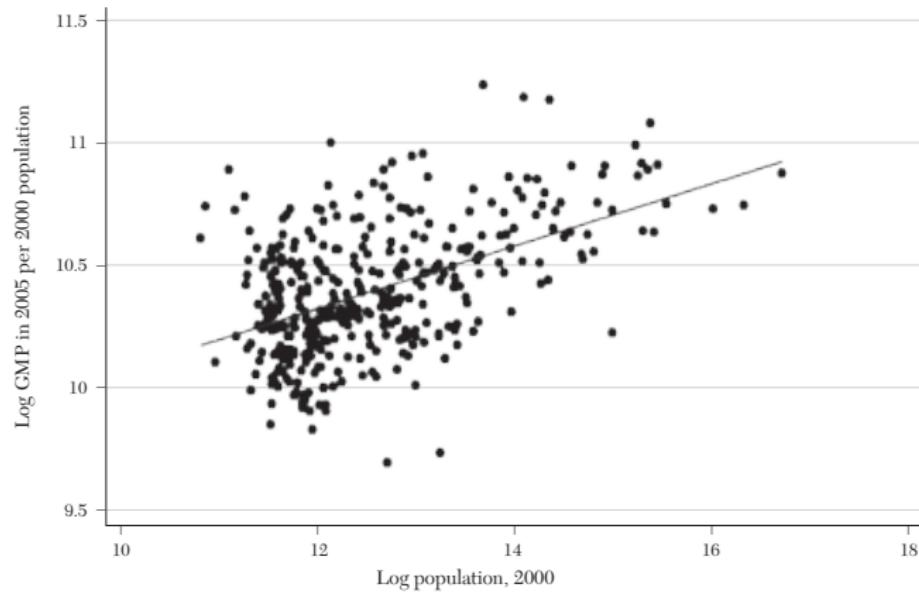


Image from [NASA](#)

# Today: Agglomeration economies

Gross metropolitan product per capita rises with metro population:



Lucas (1988) on local external economies:

*What can people be paying Manhattan or downtown Chicago rents for, if not being near other people?*

# Today's agenda

- ▶ Spatial equilibrium
- ▶ Henderson (1974)
- ▶ Ahlfeldt, Redding, Sturm, and Wolf (2015)
- ▶ Dingel and Tintelnot (2021)

# Spatial equilibrium

Fundamentally, spatial equilibrium is a no-arbitrage condition.

Glaeser and Gottlieb (*JEL* 2009):

*The high mobility of labor leads urban economists to assume a spatial equilibrium, where elevated New York incomes do not imply that New Yorkers are better off. Instead, welfare levels are equalized across space and high incomes are offset by negative urban attributes such as high prices or low amenities.*

- ▶ The benchmark model of spatial equilibrium is dubbed the “Rosen-Roback” model, due to the theory of equalizing differences (Sherwin Rosen 1974) applied to cities for both workers and firms (Jennifer Roback 1982)
- ▶ I borrow my exposition of Rosen-Roback model from [Owen Zidar's slides](#)

# Rosen-Roback framework

## Goals

- ▶ How does change in amenity  $s$  alter local prices (wages, rents)?
- ▶ Infer the value of amenities

## Markets

- ▶ Labor: price  $w$ , quantity  $N$
- ▶ Land: price  $r$ , quantity  $L = L^w + L^p$  for workers and production
- ▶ Goods: price  $p = 1$ , quantity  $X$

## Agents

- ▶ Workers (homogenous, perfectly mobile)
- ▶ Firm (perfectly competitive, CRS)

## Indifference conditions

- ▶ Workers have same indirect utility in all locations
- ▶ Firm has zero profit (i.e., unit costs equal 1)

## Workers: Preferences and budget constraint

Utility is  $u(x, l^c, s)$

- ▶  $x$  is consumption of private good
- ▶  $l^c$  is consumption of land
- ▶  $s$  is amenity

Budget constraint is  $x + rl^c - w - I = 0$

- ▶  $I$  is non-labor income that is independent of location (e.g., share of national land portfolio)
- ▶  $w$  is labor income (note: no hours margin).

Indirect utility is given

$$V(w, r, s) = \max_{x, l^c} u(x, l^c, s) \text{ s.t. } x + rl^c - w - I = 0$$

Let  $\lambda = \lambda(w, r, s)$  be the marginal utility of a dollar of income, then

$$\begin{aligned} V_w &= \lambda > 0 & V_r &= -\lambda l^c < 0 \\ && \Rightarrow V_r &= -V_w l^c \end{aligned}$$

## Example: Cobb-Douglas preferences

Utility is Cobb Douglas over goods and land with an amenity shifter:

$$u(x, l^c, s) = s^{\theta_W} x^\gamma (l^c)^{1-\gamma}$$

- ▶ Then  $x = \gamma \left( \frac{w+I}{1} \right)$  and  $l^c = (1 - \gamma) \left( \frac{w+I}{r} \right)$
- ▶ Let  $\Gamma \equiv \gamma^\gamma (1 - \gamma)^{(1-\gamma)}$  so that indirect utility is

$$V(w, r, s) = \underbrace{\Gamma}_{\text{constant amenities}} \underbrace{s^{\theta_W}}_{\text{amenities}} \underbrace{1^{-\gamma} r^{-(1-\gamma)}}_{\text{prices}} \underbrace{(w + I)}_{\text{income}}$$

- ▶ MU of income is  $\lambda(w, r, s)$

$$V_w = \lambda = \Gamma s^{\theta_W} r^{-(1-\gamma)}$$

$$V_r = -\lambda l^c = -\Gamma s^{\theta_W} r^{-(1-\gamma)} (1 - \gamma) \underbrace{\left( \frac{w + I}{r} \right)}_{l^c}$$

$$\Rightarrow V_r = -V_w l^c$$

## Firms: Unit cost function

CRS production with cost function  $C(X, w, r, s)$

- ▶  $X$  is output
- ▶ Unit cost  $c(w, r, s) = \frac{C(X, w, r, s)}{X}$
- ▶  $L^p$  is total amount of land used by firms
- ▶  $N$  is total employment

From Sheppard's Lemma, we have

$$c_w = N/X > 0$$

$$c_r = L^p/X > 0$$

## Example: Cobb-Douglas production

Suppose the production function is

$$X = f(N, L^p) = s^{\theta_F} N^\alpha L^{1-\alpha}$$

Let  $\mathcal{A} \equiv \alpha^{-\alpha}(1 - \alpha)^{-(1-\alpha)}$ . Then the cost function is:

$$C(X, w, r, s) = X(s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A} \Rightarrow$$

$$c(w, r, s) = (s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A}$$

Then

$$C_w(X, w, r, s) = \alpha \frac{(X(s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A})}{w} = N$$

$$C_r(X, w, r, s) = (1 - \alpha) \frac{(X(s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A})}{r} = L^p$$

Dividing both sides by  $X$  gives:

$$c_w = N/X > 0$$

$$c_r = L^p/X > 0$$

# Model recap

Workers parameters:  $s, \theta_W, \gamma, I$

- ▶  $s$  is level of amenities
- ▶  $\theta_W$  governs importance of amenities for utility
- ▶  $\gamma$  governs importance of goods for utility
- ▶  $1 - \gamma$  governs importance of land for utility
- ▶  $I$  is non-labor income

Firm Parameters:  $s, \theta_F, \alpha$

- ▶  $s$  is level of amenities
- ▶  $\theta_F$  governs importance of amenities for productivity
- ▶  $\alpha$  is output elasticity of labor
- ▶  $1 - \alpha$  is output elasticity of land

Endogenous outcomes:

- ▶ Labor: price  $w$ , quantity  $N$
- ▶ Land: price  $r$ , quantities  $L^w, L^p$  for workers and production
- ▶ Goods: price  $p = 1$ , quantity  $X$

## Equilibrium concept: Two key indifference conditions

In equilibrium, workers and firms are indifferent across cities with different levels of  $s$  and endogenously varying wages  $w(s)$  and rents  $r(s)$ :

$$c(w(s), r(s), s) = 1 \quad (1)$$

$$V(w(s), r(s), s) = V^0 \quad (2)$$

where  $V^0$  is the equilibrium level of indirect utility.

Specifically, in our example:

*Given  $s, \theta_W, \theta_F, \gamma, I, \alpha$ , equilibrium is defined by local prices and quantities  $\{w, r, N, L^w, L^p, X\}$  such that (1) and (2) hold and land markets clear.*

N.B. We will mainly be focusing on prices:  $w(s)$  and  $r(s)$ .

# Solving for effect of amenity changes on prices

- ▶ Differentiate (1) and (2) with respect to  $s$  and rearrange, we have:

$$\begin{bmatrix} c_w & c_r \\ V_w & V_r \end{bmatrix} \begin{bmatrix} w'(s) \\ r'(s) \end{bmatrix} = \begin{bmatrix} -c_s \\ -V_s \end{bmatrix}$$

- ▶ Solving for  $w'(s), r'(s)$ , we have

$$w'(s) = \frac{V_r c_s - c_r V_s}{c_r V_w - c_w V_r}$$

$$r'(s) = \frac{V_s c_w - c_s V_w}{c_r V_w - c_w V_r}$$

- ▶ Note we can rewrite

$$c_r V_w - c_w V_r = \lambda L^p / X + \lambda l^c N / X = \lambda L / X = V_w L / X$$

## Aside: example values for matrix elements

$$c_w = \alpha \frac{(s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A}}{w}$$

$$c_r = (1 - \alpha) \frac{(s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A}}{r}$$

$$c_s = \theta_F \frac{(s^{\theta_F})^{-1} w^\alpha r^{1-\alpha} \mathcal{A}}{s}$$

$$V_w = s^{\theta_W} 1^{-\gamma} r^{-(1-\gamma)} \Gamma$$

$$V_r = -s^{\theta_W} 1^{-\gamma} r^{-(1-\gamma)} \Gamma(1 - \gamma) \left( \frac{w + I}{r} \right)$$

$$V_s = \theta_W \frac{(s^{\theta_W} 1^{-\gamma} r^{-(1-\gamma)} \Gamma(w + I))}{s}$$

# Effect of amenity changes on prices

- ▶ Price changes

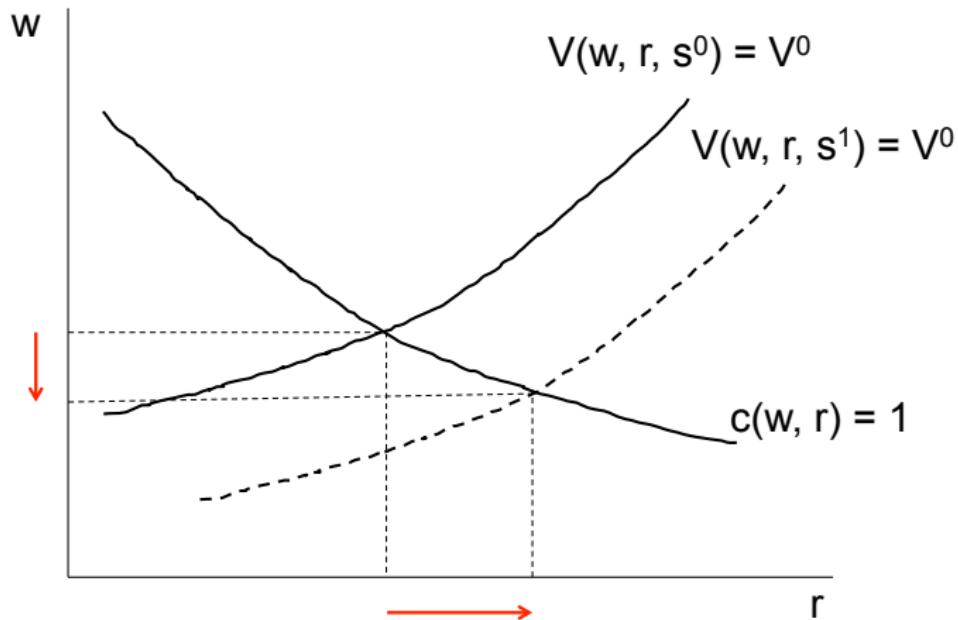
$$w'(s) = \frac{(V_r c_s - c_r V_s)X}{\lambda L}$$
$$r'(s) = \frac{(V_s c_w - c_s V_w)X}{\lambda L}$$

- ▶ Special cases of interest:

1. Amenity only valued by consumers:  $\theta_F = 0 \Rightarrow c_s = 0$
2. Amenity only has productivity effect:  $\theta_W = 0 \Rightarrow V_s = 0$
3. Firms use no land  $1 - \gamma = 0$  and amenity is non-productive  
 $\theta_F = 0$ :  $c(w(s)) = 1$ ,  $c_r = c_s = 0$

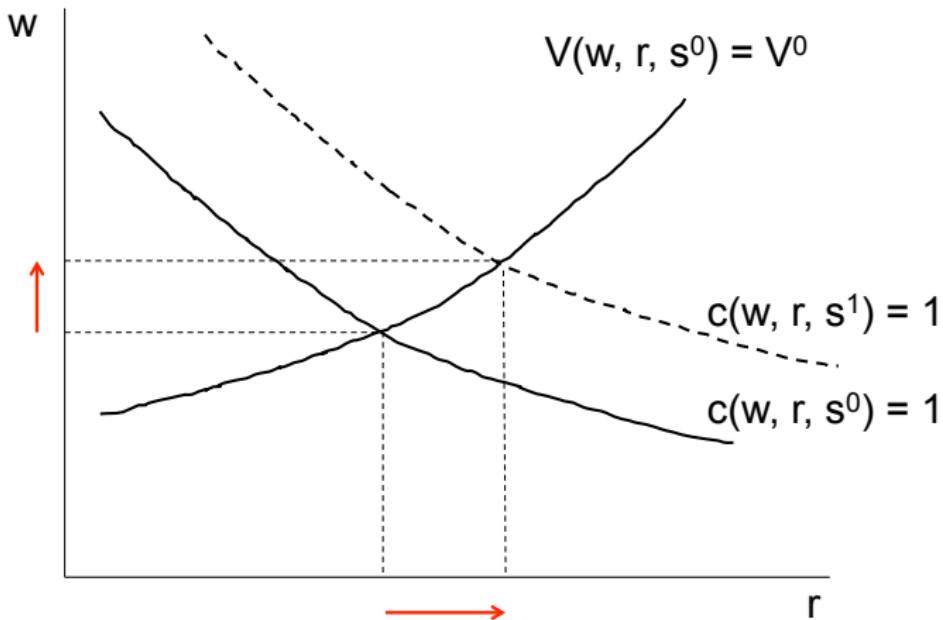
# 1. Amenity only valued by consumers: $\theta_F = 0 \Rightarrow c_s = 0$

- ▶ When  $c_s = 0$ , higher  $s \Rightarrow$  higher  $r$ , lower  $w$
- ▶ Workers are willing to pay more in land rents and receive less in wages to have access to higher levels of amenities



## 2. Amenity only valued by firms: $\theta_W = 0 \Rightarrow V_s = 0$

- ▶ When  $V_s = 0$ , higher  $s \Rightarrow$  higher  $r$  and higher  $w$
- ▶ Firms are willing to pay more in land rents and wages to access higher productivity due to amenities



### 3. Firms don't use land nor value amenity

- ▶ Firms don't use land ( $\alpha = 1$ ) nor value amenity ( $\theta_F = 0$ )
- ▶ Only production input is labor and firms are indifferent across locations, so wages must be the same across cities:  $c(w(s)) = 1$
- ▶ Since  $c_r = c_s = 0$ ,

$$w'(s) = 0$$

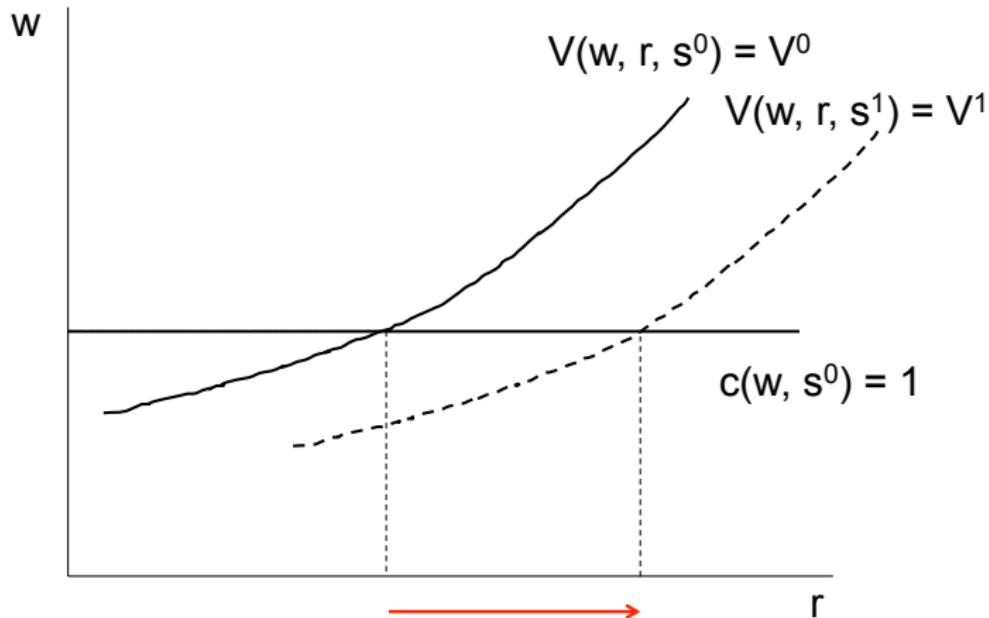
$$r'(s) = \frac{V_s c_w}{-c_w V_r} = \frac{V_s}{l^c V_w}, \text{ since } V_r = -l^c V_w$$

- ▶ So the rise in total cost of land for a worker living in a city with higher  $s$  is

$$l^c r'(s) = \frac{V_s}{V_w}$$

### 3. Firms don't use land nor value amenity

- ▶  $\frac{V_s}{V_w}$  = marginal WTP for a change in  $s$  so the marginal value of a change in the amenity is “fully capitalized” in rents



$\frac{V_s}{V_w} = \theta_W \frac{(w+I)}{s}$  is increasing in income, decreasing in level of amenities

# Evidence of agglomeration economies

People are concentrated. Are industries concentrated? Yes.

- ▶ Ellison and Glaeser (1997) “dartboard approach” to address internal vs external economies
- ▶ Duranton and Overman (2005) for continuous space

Identify agglomeration channels empirically

- ▶ Estimate directly (faces peer-effects problem)
- ▶ Infer from observed spatial equilibrium
- ▶ Test for multiple equilibria

References to know

- ▶ [Greenstone, Hornbeck, Moretti \(2010\)](#) use “million-dollar plants” to estimate agglomeration economies (cf [Patrick 2016](#))
- ▶ Combes and Gobillon - “[The Empirics of Agglomeration Economies](#)” (*Handbook* 2015)
- ▶ Lin and Rauch - “[What future for history dependence in spatial economics?](#)”

# Bleakley and Lin - Portage and Path Dependence

Table 1: Proximity to Historical Portage Site and Contemporary Population Density

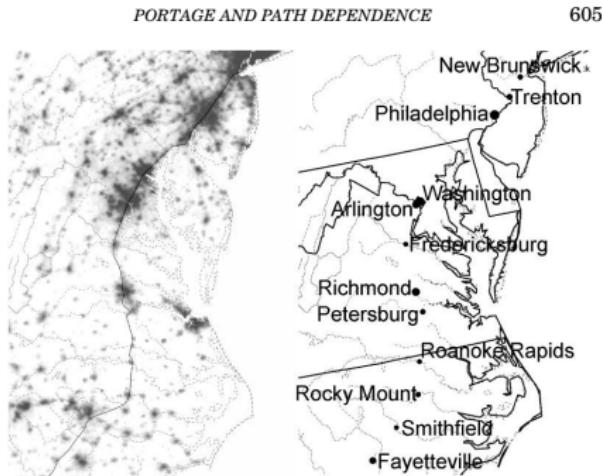


FIGURE IV

Fall-Line Cities from North Carolina to New Jersey

The map in the left panel shows the contemporary distribution of economic activity across the southeastern United States measured by the 2003 nighttime lights layer from NationalAtlas.gov. The nighttime lights are used to present a nearly continuous measure of present-day economic activity at a high spatial frequency. The fall line (solid) is digitized from *Physical Divisions of the United States*, produced by the U.S. Geological Survey. Major rivers (dashed gray) are from NationalAtlas.gov, based on data produced by the U.S. Geological Survey. Contemporary fall-line cities are labeled in the right panel.

	(1) Basic	(2) Other spatial controls	(3) State fixed effects Distance from various features
Specifications:			
Explanatory variables:			
<i>Panel A: Census Tracts, 2000, N = 21452</i>			
Dummy for proximity to portage site	1.113 (0.340)***	1.009 (0.321)***	1.118 (0.243)***
Distance to portage site, natural logs	-0.617 (0.134)***	-0.653 (0.128)***	-0.721 (0.118)***
<i>Panel B: Nighttime Lights, 1996–97, N = 65000</i>			
Dummy for proximity to portage site	0.504 (0.144)***	0.445 (0.127)***	0.490 (0.161)***
Distance to portage site, natural logs	-0.188 (0.065)***	-0.159 (0.065)**	-0.151 (0.090)

TABLE II  
UPSTREAM WATERSHED AND CONTEMPORARY POPULATION DENSITY

	(1) Basic	(2) Other spatial controls	(3) State fixed effects Distance from various features	(4) Water power	(5)
Specifications:					
Explanatory variables:					
<i>Panel A: Census Tracts, 2000, N = 21452</i>					
Portage site times upstream watershed	0.467 (0.175)**	0.467 (0.164)***	0.500 (0.114)***	0.496 (0.173)***	0.452 (0.177)**
Binary indicator for portage site	1.096 (0.348)***	1.000 (0.326)***	1.111 (0.219)***	1.099 (0.350)***	1.056 (0.364)***
Portage site times horsepower/100k				-1.812 (1.235)	
Portage site times I(horsepower > 2000)					0.110 (0.311)

# Davis & Weinstein: “Bones, Bombs, and Breakpoints”

Bombs: Does a temporary shock have permanent effects? After the Allied bombing in WWII, most cities returned to their relative position in the distribution of city sizes within about 15 years

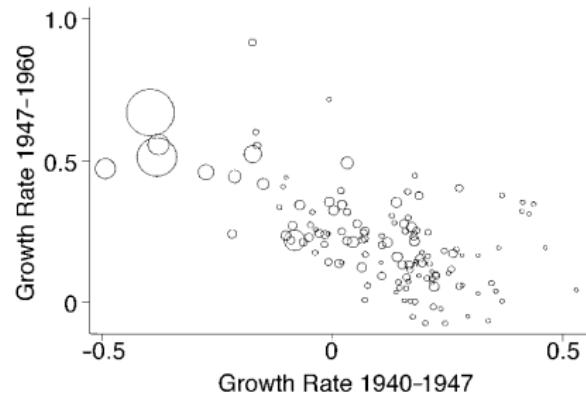


FIGURE 1. EFFECTS OF BOMBING ON CITIES WITH MORE THAN 30,000 INHABITANTS

*Note:* The figure presents data for cities with positive casualty rates only.

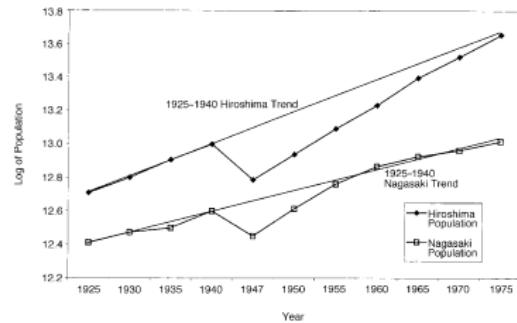


FIGURE 2. POPULATION GROWTH

Also, Miguel and Roland (*JDE* 2011): “even the most intense bombing in human history did not generate local poverty traps in Vietnam”

## (Homogeneous) agglomeration: Henderson (1974)

“The Sizes and Types of Cities” addresses basic, fundamental questions about a system of cities in general equilibrium

- ▶ Why do cities exist?
- ▶ Are cities too large or too small?
- ▶ Why do cities of different sizes exist?

## (Homogeneous) agglomeration: Henderson (1974)

“The Sizes and Types of Cities” addresses basic, fundamental questions about a system of cities in general equilibrium

- ▶ Why do cities exist? “because there are technological economies of scale in production or consumption”
- ▶ Are cities too large or too small? a stability argument says that cities tend to be too large
- ▶ Why do cities of different sizes exist? “because cities of different types specialize in the production of different traded goods”

## Henderson (1974) environment

- ▶ Factors: land  $L$ , labor  $N$ , capital  $K$
- ▶ Tradables production (external economies a la Chipman)

$$X_1^{1-\rho_1} = L_1^{\alpha_1} K_1^{\beta_1} N_1^{\gamma_1} \quad \alpha_1 + \beta_1 + \gamma_1 = 1, \rho_1 \in (0, 1)$$

- ▶ Housing production

$$X_3 = L_3^{\alpha_3} K_3^{\beta_3} N_3^{\gamma_3} \quad \alpha_3 + \beta_3 + \gamma_3 = 1,$$

- ▶ Land sites produced by labor

$$L = N_0^{1/(1-z)} \quad z < 0, z'(N) < 0$$

- ▶ Clear factor markets with prices  $p_N, p_K, p_L$

$$N_0 + N_1 + N_3 = N, \quad K_1 + K_3 = K, \quad L_1 + L_3 = L$$

- ▶ Cobb-Douglas preferences ( $U = x_1^a x_2^b x_3^c$ ) with income  $y$ , import of good 2, and prices  $q$  deliver indirect utility

$$U \propto y q_1^{-a} q_2^{-b} q_3^{-c}$$

# Capitalists and workers

Different (stark) assumptions about capital ownership:

- ▶ each laborer owns equal capital stock (Assumption A)
- ▶ capital owners live outside of cities (Assumption B)

Utility components for labor income and capital income

$$U_N \propto p_N q_1^{-a} q_2^{-b} q_3^{-c}$$
$$U_K \propto \bar{p}_K \frac{\bar{K}}{\bar{N}} q_1^{-a} q_2^{-b} q_3^{-c}$$

Solving for optimal and equilibrium city sizes

- ▶ Optimum: maximize  $U_N + U_K$ , given the determination of  $U_N$ ,  $U_K$ , and  $p_K$  through simultaneous location and investment of labor and capital in cities in the economy
- ▶ Equilibrium: atomistic choices of capital owners, firms, and laborers

# Utility and factor prices

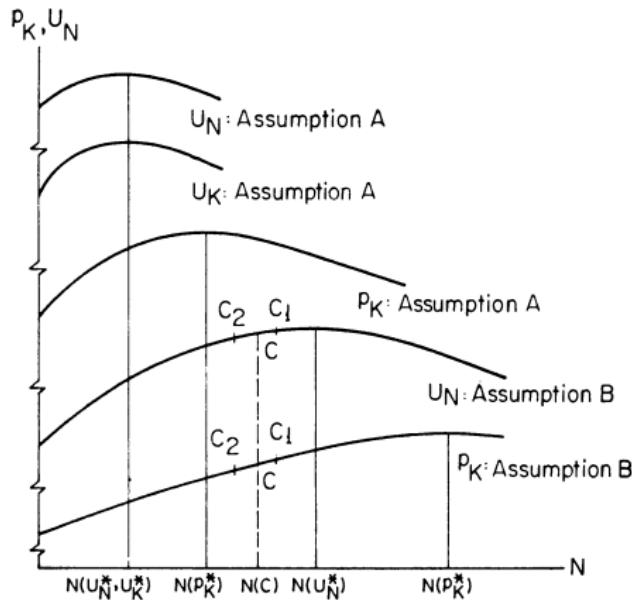


FIGURE 1. UTILITY AND CAPITAL RENTAL PATHS UNDER ASSUMPTIONS A AND B

- ▶  $\alpha_1 > \rho_1$  (site intensity vs IRS) is sufficient for both  $p_K$  and  $U_N$  to exhibit interior maxima
- ▶  $p_K$  curve has peak to right of  $U_N$  and  $U_K$  peak because  $U_K$  is  $p_K$  deflated by  $q_3^{-c}$
- ▶ Assumption B curves peak to right of Assumption A curves because capitalist income doesn't bid up housing prices
- ▶ Why isn't "two identical cities at point C" stable?

# Optimal city size

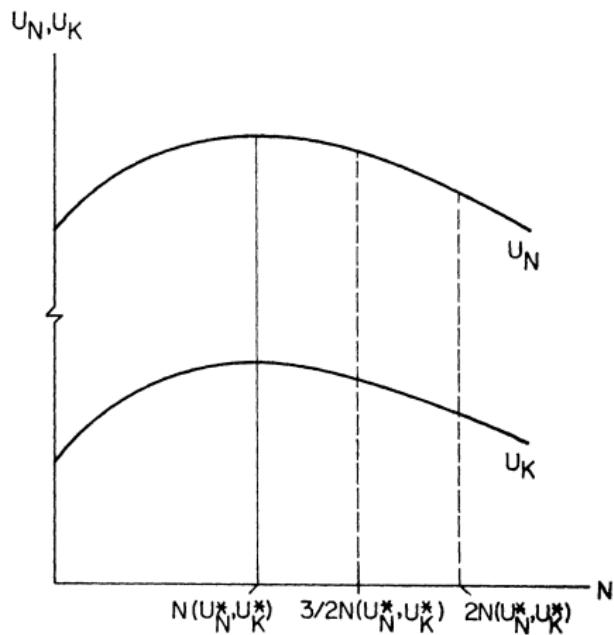
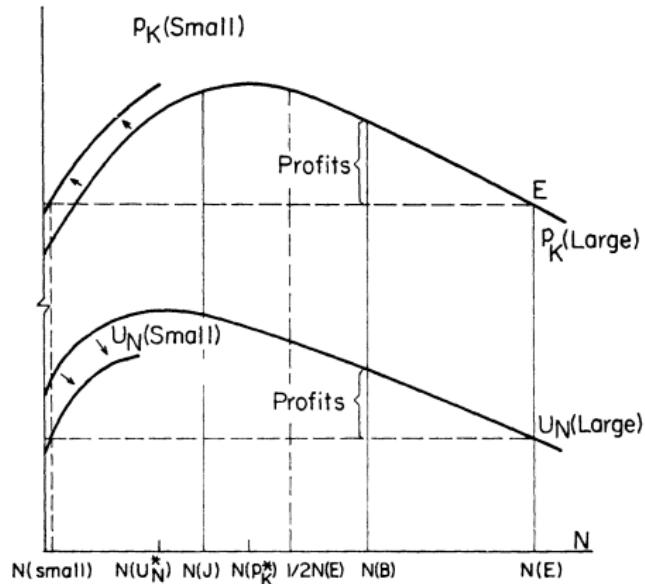


FIGURE 2. OPTIMUM CITY SIZE: ASSUMPTION A

- ▶ For Assumption A, maximize the vertical sum of  $U_N$  and  $U_K$
- ▶ Planner has total population  $N$  and faces integer constraint
- ▶ Start second city when  $N$  is twice  $N(U_N^*, U_K^*)$   
(Starting second city earlier is not a stable optimum)
- ▶ Figure 3 is more complicated due to Assumption B and the worker vs capitalist disagreement on optimal city size

# Equilibrium city size

$P_K, U_N$



- ▶ Why is  $N(\text{small})$  a bit of a fudge?
- ▶ Atomistic equilibrium with particular dynamics is at  $N(E)$ , way past both peaks
- ▶ City corporation attains optimal city sizes under Assumption B
- ▶ City corporation achieves  $N(J)$  under Assumption A

FIGURE 4. EQUILIBRIUM CITY SIZE

BDRN (2014): “there is a coordination failure in city formation so that any population size between optimal city size and grossly oversized cities – leaving their residents with zero consumption – can occur in equilibrium.”

## Henderson (1974) on heterogeneous cities

- ▶ “Our second type of city specializes in the production of another type of traded good, say,  $X_2$ .”
- ▶ “Different types of cities differ in size because production parameters, in particular  $\alpha_i$  and  $\rho_i$ , differ between the traded goods of each type of city.”
- ▶ “Although utility levels will be equalized between cities, wage rates and housing prices will vary with city type and size.”

# Ahlfeldt, Redding, Sturm, Wolf (Ecma, 2015)

ARSW is often referred to as “the Berlin Wall paper”:

- ▶ Develop a quantitative model of the city to identify intra-city agglomeration and dispersion forces
- ▶ Estimate model using data for thousands of city blocks in Berlin on land prices, workplace employment, and employment by residential location in 1936, 1986 and 2006
- ▶ Use the division of Berlin in the aftermath of the Second World War and its reunification in 1989 as a source of exogenous variation in the surrounding concentration of economic activity

Won the [2018 Frisch Medal](#) for best applied paper in *Econometrica*:  
“The paper provides an outstanding example of how to credibly and transparently use a quasi-experimental approach to structurally estimate model parameters that can serve as critical inputs for counterfactual policy analyses.” (cf [Haile](#))

Thanks to Felix for sharing TeX of the following slides.

# Dividing Berlin

- ▶ A protocol signed during the Second World War organized Germany into American, British, French, and Soviet occupation zones
- ▶ Although 200km inside the Soviet zone, Berlin was to be jointly occupied and organized into four occupation red:
  - ▶ Boundaries followed pre-war district boundaries, with the same East-West orientation as the occupation zones, and created sectors of roughly equal pre-war population (prior to French sector which was created from part of the British sector)
  - ▶ Protocol envisioned a joint city administration (“Kommandatura”)
- ▶ Following the onset of the Cold War
  - ▶ East and West Germany founded as separate states and separate city governments created in East and West Berlin in 1949
  - ▶ The adoption of Soviet-style policies of command and control in East Berlin limited economic interactions with West Berlin
  - ▶ To stop civilians leaving for West Germany, the East German authorities constructed the Berlin Wall in 1961

## ARSW model: Overview

- ▶ The city consists of a set of discrete blocks indexed by  $i$
- ▶ Single, freely traded (numeraire) final good
- ▶ Floor space can be used for residential or commercial use
- ▶ Firms choose a block of production and inputs of labor and floor space
- ▶ Workers choose block of residence, block of employment, and consumption of the final good
- ▶ Reservation level of utility ( $\bar{U}$ ) for living outside the city

Individuals who choose Berlin and realize utility below the city-wide average cannot leave.

## ARSW model: Workers

- ▶ Utility for worker  $\omega$  residing in block  $i$  and working in block  $j$ :

$$U_{ij\omega} = \frac{B_i z_{ij\omega}}{d_{ij}} \left( \frac{c_{ij}}{\beta} \right)^\beta \left( \frac{\ell_{ij}}{1-\beta} \right)^{1-\beta}, \quad 0 < \beta < 1,$$

- ▶ Consumption of the final good ( $c_{ij}$ ), numeraire ( $p_i = 1$ )
- ▶ Residential floor space ( $\ell_{ij}$ ), price  $Q_i$
- ▶ Residential amenity  $B_i$
- ▶ Commuting costs  $d_{ij}$
- ▶ Idiosyncratic shock  $z_{ij\omega}$
- ▶ Wage  $w_j$
- ▶ Indirect utility

$$U_{ij\omega} = \frac{z_{ij\omega} B_i w_j Q_i^{\beta-1}}{d_{ij}},$$

- ▶ The idiosyncratic shock to worker productivity is drawn from a Fréchet distribution:

$$F(z_{ij\omega}) = e^{-T_i E_j z_{ij\omega}^{-\epsilon}}, \quad T_i, E_j > 0, \quad \epsilon > 1,$$

## ARSW model: Commuting decisions

- ▶ Probability worker chooses to live in  $i$  and work in  $j$  is

$$\pi_{ij} = \frac{T_i E_j \left( d_{ij} Q_i^{1-\beta} \right)^{-\epsilon} (B_i w_j)^\epsilon}{\sum_{r=1}^S \sum_{s=1}^S T_r E_s \left( d_{rs} Q_r^{1-\beta} \right)^{-\epsilon} (B_r w_s)^\epsilon} \equiv \frac{\Phi_{ij}}{\Phi}.$$

- ▶ Residential and workplace choice probabilities

$$\pi_{Ri} = \sum_{j=1}^S \pi_{ij} = \frac{\sum_{j=1}^S \Phi_{ij}}{\Phi}, \quad \pi_{Mj} = \sum_{i=1}^S \pi_{ij} = \frac{\sum_{i=1}^S \Phi_{ij}}{\Phi}.$$

- ▶ Conditional on living in block  $i$ , the probability that a worker commutes to block  $j$  follows a gravity equation:

$$\pi_{ij|i} = \frac{E_j (w_j/d_{ij})^\epsilon}{\sum_{s=1}^S E_s (w_s/d_{is})^\epsilon},$$

## ARSW model: Commuting

- ▶ Employment in block  $j$  equals the sum across all blocks  $i$  of people living in residence times the probability of commuting from  $i$  to  $j$ :

$$H_{Mj} = \sum_{i=1}^S \frac{E_j (w_j/d_{ij})^\epsilon}{\sum_{s=1}^S E_s (w_s/d_{is})^\epsilon} H_{Ri}, \quad d_{ij} = e^{\kappa \tau_{ij}}.$$

- ▶ This equation be useful to determine equilibrium wages.

## ARSW model: Consumers

- ▶ Consumers decide before idiosyncratic shocks  $z_{ij\omega}$  are realized whether to move to the city or not.
- ▶ Population mobility implies that expected utility equals reservation utility level:

$$\mathbb{E}[U] = \gamma \left[ \sum_{r=1}^S \sum_{s=1}^S T_r E_s \left( d_{rs} Q_r^{1-\beta} \right)^{-\epsilon} (B_r w_s)^\epsilon \right]^{1/\epsilon} = \bar{U},$$

- ▶ Residential amenities are influenced by both fundamentals ( $b_i$ ) and spillovers ( $\Omega_i$ )

$$B_i = b_i \Omega_i^\eta, \quad \Omega_i \equiv \left[ \sum_{s=1}^S e^{-\rho \tau_{is}} \left( \frac{H_{Rs}}{K_s} \right) \right].$$

## ARSW model: Production

- ▶ A single final good (numeraire) is produced under conditions of perfect competition, constant returns to scale and zero trade costs with a larger economy:

$$y_j = A_j (H_{Mj})^\alpha (L_{Mj})^{1-\alpha}, \quad 0 < \alpha < 1,$$

- ▶  $H_{Mj}$  is workplace employment
- ▶  $L_{Mj}$  is measure of floor space used commercially
- ▶ Productivity ( $A_j$ ) depends on fundamentals ( $a_j$ ) and spillovers ( $\Upsilon_j$ ):

$$A_j = a_j \Upsilon_j^\lambda, \quad \Upsilon_j \equiv \left[ \sum_{s=1}^S e^{-\delta \tau_{is}} \left( \frac{H_{Ms}}{K_s} \right) \right],$$

- ▶  $\delta$  is the rate of decay of spillovers
- ▶  $\lambda$  captures the relative importance of spillovers

## ARSW model: Land prices

- ▶ The share of floor space used commercially:

$$\theta_i = 1 \quad \text{if} \quad q_i > \xi_i Q_i,$$

$$\theta_i \in [0, 1] \quad \text{if} \quad q_i = \xi_i Q_i,$$

$$\theta_i = 0 \quad \text{if} \quad q_i < \xi_i Q_i.$$

- ▶  $\xi_i \geq 1$  represents 1 plus the tax equivalent of land use regulations
- ▶ Assume observed land price is maximum of commercial and residential price:  $Q_i = \max\{q_i, \theta_i Q_i\}$

## ARSW model: Production

- ▶ Firms choose a block of production, effective employment and commercial land use to maximize profits taking as given goods and factor prices, productivity and the locations of other firms/workers
- ▶ Zero profits imply for the price of commercial land  $q_j$ :

$$q_j = (1 - \alpha) \left( \frac{\alpha}{w_j} \right)^{\frac{\alpha}{1-\alpha}} A_j^{\frac{1}{1-\alpha}}.$$

## ARSW model: Land Market Clearing

- ▶ Utility max implies demand for residential floor space:

$$(1 - \theta_i)L_i = \frac{(1 - \beta)\mathbb{E}(w | i)}{Q_i} H_{Ri}.$$

- ▶ Profit max implies demand for commercial floor space:

$$\theta_i L_i = H_{Mi} \left( \frac{(1 - \alpha)A_i}{q_i} \right)^{\frac{1}{\alpha}}.$$

- ▶ Floor space  $L$  supplied by a competitive construction sector using geographic land  $K$  and capital  $M$  as inputs

$$L_i = \varphi_i K_i^{1-\mu}, \quad \varphi_i = M_i^\mu,$$

- ▶ Density of development ( $\varphi_i$ ) from land market clearing:

$$\varphi_i = \frac{L_i}{K_i^{1-\mu}} = \frac{(1 - \theta_i)L_i + \theta_i L_i}{K_i^{1-\mu}}$$

## Equilibrium with exogenous loc. charact.

- ▶ **Proposition 1:** Given the model's parameters  $[\alpha, \beta, \mu, \epsilon, \kappa]$ , the reservation utility  $\bar{U}$ , and vectors of exogenous location characteristics  $[T, E, A, B, \phi, K, \xi, \tau]$ , there exists a unique general equilibrium vector  $[\pi_M, \pi_R, H, Q, q, w, \theta]$ , where  $H$  denotes total city population.
- ▶ These seven components are determined by the system of seven equations: commercial land market clearing, residential land market clearing, zero profits, no arbitrage between alternative uses of land, residential choice probability  $\pi_{Ri}$ , workplace choice probability  $\pi_{Mi}$ , and indifference with reservation utility.

## Overview of remainder of paper

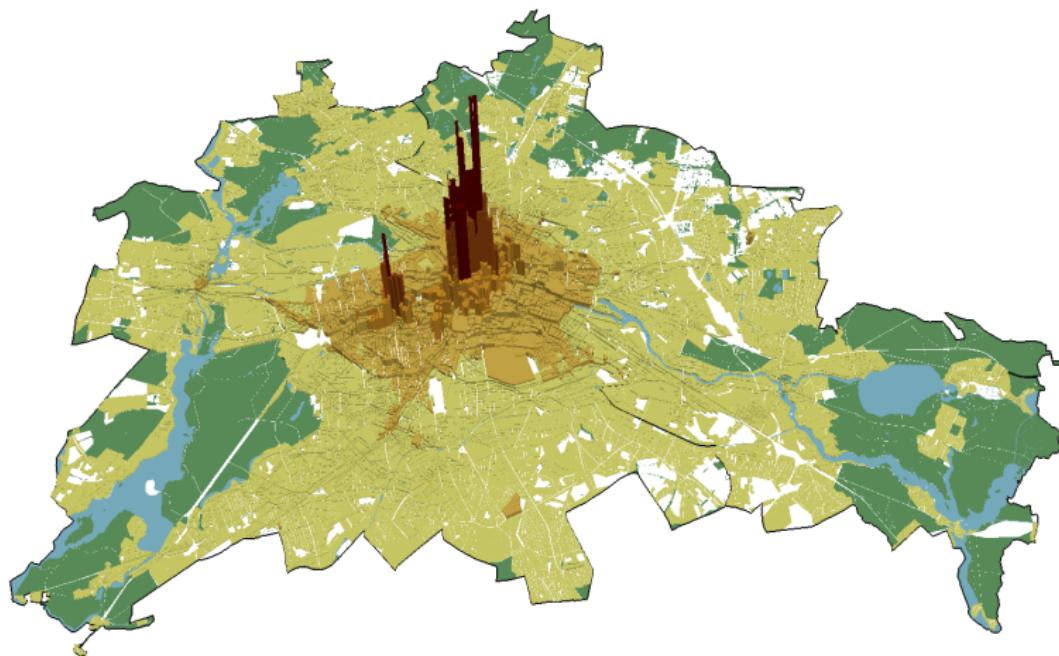
- ▶ Relate land prices to distance to pre-war CBD
- ▶ Estimate the model without any agglomeration effects. In counterfactuals, this model “is unable to account quantitatively for the observed impact of division and reunification on the pattern of economic activity within West Berlin.”
- ▶ Next the authors present a reduced-form empirical exercise on land price and population changes
- ▶ Then the authors estimate simple version of the model without agglomeration effects. They show that when doing counterfactuals (i.e. establishing / removing a wall, with its effects on where you can live, work) the counterfactual predictions are different from the data
- ▶ Estimate model with local production and residential amenity externalities. These are interesting in their own right and improve model fit (they also create possibility of multiple equilibria, which must be handled carefully)

# Data

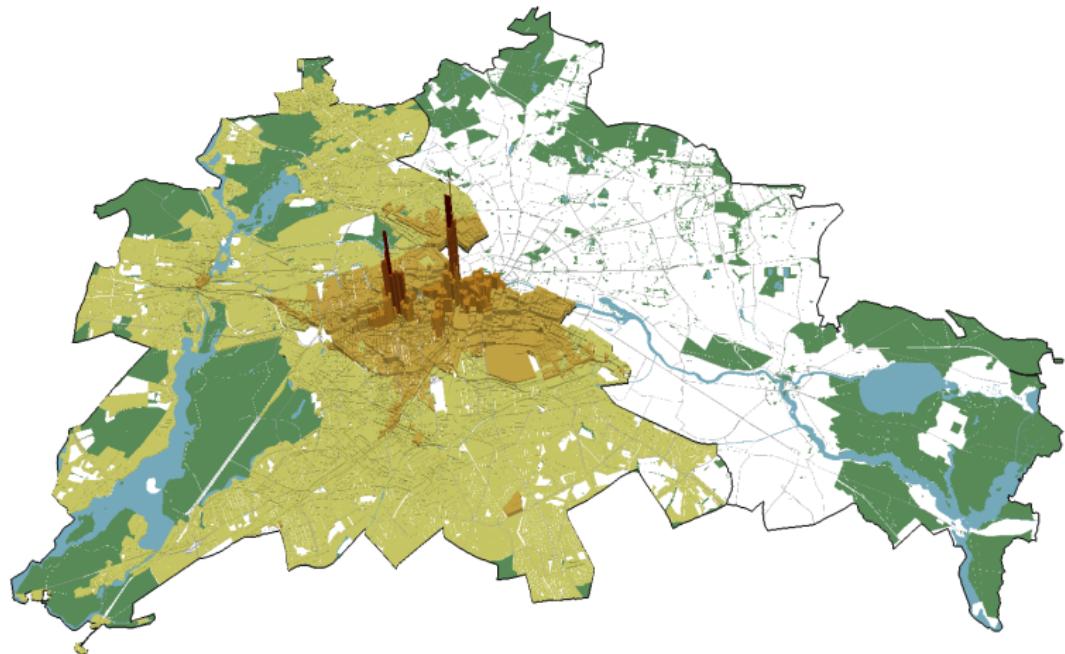
- ▶ Data on land prices, workplace employment, residence employment and bilateral travel times
- ▶ Data for Greater Berlin in 1936 and 2006
- ▶ Data for West Berlin in 1986
- ▶ Data at the following levels of spatial aggregation:
  - Pre-war districts (“Bezirke”), 20 in Greater Berlin, 12 in West Berlin
  - Statistical areas (“Gebiete”), around 90 in West Berlin
  - Statistical blocks, around 9,000 in West Berlin
- ▶ Land prices: official assessed land value of a representative undeveloped property or the fair market value of a developed property if it were not developed
- ▶ Geographical Information Systems (GIS) data on land area, land use, building density, proximity to U-Bahn (underground) and S-Bahn (suburban) stations, schools, parks, lakes, canals and rivers, Second World War destruction, location of government buildings and urban regeneration programs<sup>44</sup>

# Land prices in Berlin in 1936

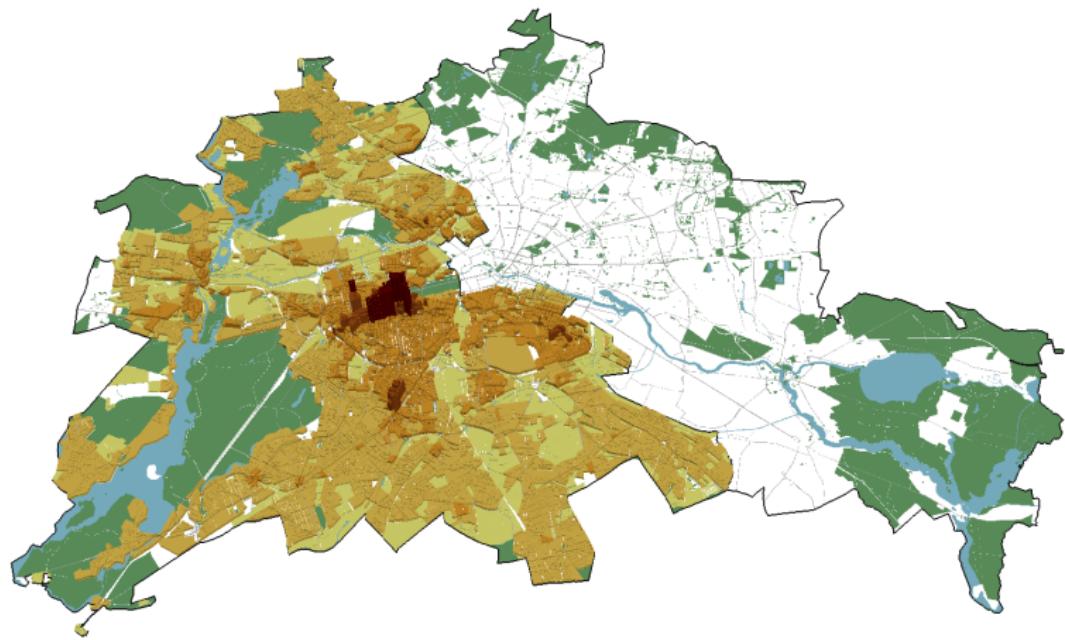
Land prices are normalized to have a mean of 1 in each year.



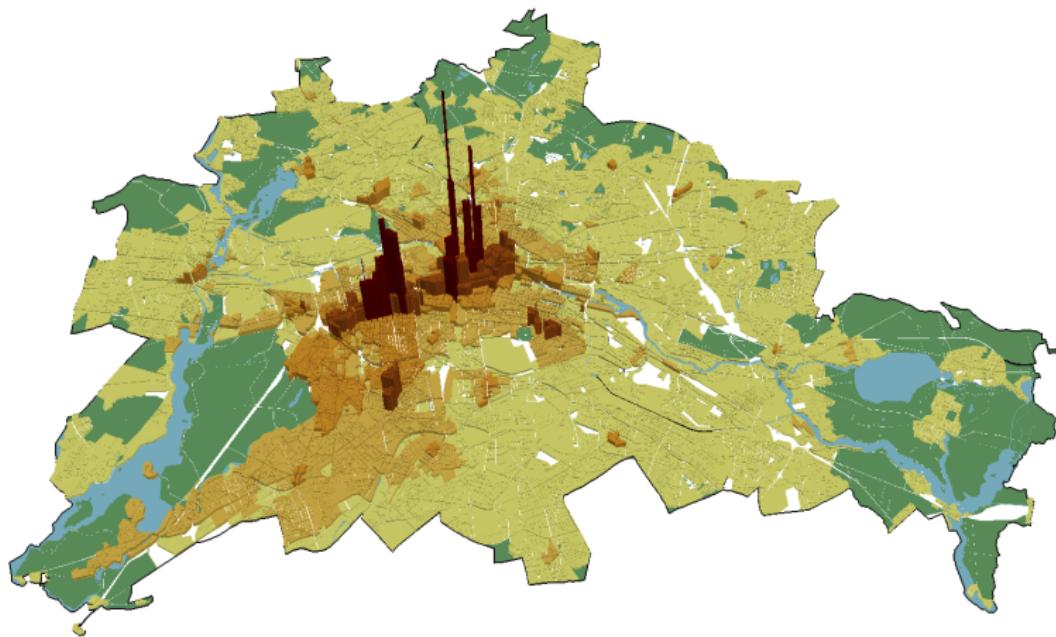
# Land prices in West Berlin in 1936



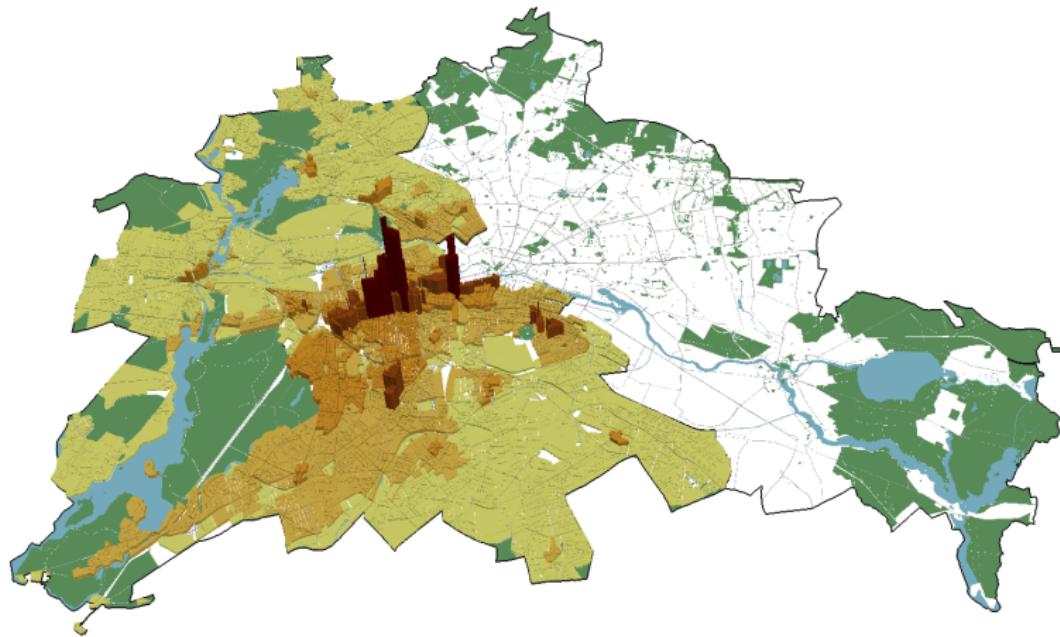
# Land prices in West Berlin in 1986



# Land prices in Berlin in 2006



# Land prices in West Berlin in 2006



## Diff-in-diffs specification

- ▶ Estimate difference in difference specification for division and reunification separately (for areas in West Berlin):

$$\Delta \ln Q_i = \psi + \sum_{k=1}^K \mathbf{1}_{ik} \beta_k + \ln X_i \zeta + \chi_i,$$

- ▶  $\mathbf{1}_{ik}$  is a  $(0, 1)$  dummy which equals one if block  $i$  lies within distance grid cell  $k$  from the pre-war CBD and zero otherwise
- ▶ Observable block characteristics ( $X_i$ ): Land area, land use, distance to nearest U-Bahn station, S-Bahn station, school, lake, river or canal, and park, war destruction, government buildings and urban regeneration programs

# Division and Pre-War CBD



# Diff-in-diffs West Berlin 1936-86

	(1) Δ ln Q	(2) Δ ln Q	(3) Δ ln Q	(4) Δ ln Q	(5) Δ ln Q	(6) Δ ln EmpR	(7) Δ ln EmpR	(8) Δ ln EmpW	(9) Δ ln EmpW
CBD 1	-0.800*** (0.071)	-0.567*** (0.071)	-0.524*** (0.071)	-0.503*** (0.071)	-0.565*** (0.077)	-1.332*** (0.383)	-0.975*** (0.311)	-0.691* (0.408)	-0.639* (0.338)
CBD 2	-0.655*** (0.042)	-0.422*** (0.047)	-0.392*** (0.046)	-0.360*** (0.046)	-0.400*** (0.043)	-0.715** (0.050)	-0.361 (0.299)	-1.253*** (0.280)	-1.367*** (0.293)
CBD 3	-0.543*** (0.034)	-0.306*** (0.039)	-0.294*** (0.037)	-0.258*** (0.032)	-0.247*** (0.034)	-0.911*** (0.239)	-0.460** (0.206)	-0.341 (0.241)	-0.471** (0.190)
CBD 4	-0.436*** (0.022)	-0.207*** (0.033)	-0.193*** (0.033)	-0.166*** (0.030)	-0.176*** (0.026)	-0.356** (0.145)	-0.259 (0.159)	-0.512*** (0.199)	-0.521*** (0.169)
CBD 5	-0.353*** (0.016)	-0.139*** (0.024)	-0.123*** (0.024)	-0.098*** (0.023)	-0.100*** (0.020)	-0.301*** (0.110)	-0.143 (0.113)	-0.436*** (0.151)	-0.340*** (0.124)
CBD 6	-0.291*** (0.018)	-0.125*** (0.019)	-0.094*** (0.017)	-0.077*** (0.016)	-0.090*** (0.016)	-0.360*** (0.100)	-0.135 (0.089)	-0.280** (0.130)	-0.142 (0.116)
Inner Boundary 1-6		Yes							
Outer Boundary 1-6		Yes							
Kudamm 1-6			Yes						
Block Characteristics				Yes	Yes	Yes	Yes	Yes	Yes
District Fixed Effects	Yes								
Observations	6260	6260	6260	6260	6260	5978	5978	2844	2844
R-squared	0.26	0.51	0.63	0.65	0.71	0.19	0.43	0.12	0.33

Note: Q denotes the price of floor space. EmpR denotes employment by residence. EmpW denotes employment by workplace. CBD1-CBD6 are six 500m distance grid cells from the pre-war CBD. Inner Boundary 1-6 are six 500m grid cells for distance to the Inner Boundary between East and West Berlin. Outer Boundary 1-6 are six 500m grid cells for distance to the outer boundary between West Berlin and East Germany. Kudamm 1-6 are six 500m grid cells for distance to Breitscheid Platz on the Kurfürstendamm. The coefficients on the other distance grid cells are reported in Table A2 of the web appendix. Block characteristics include the logarithm of distance to schools, parks and water, the land area of the block, the share of the block's built-up area destroyed during the Second World War, indicators for residential, commercial and industrial land use, and indicators for whether a block includes a government building and urban regeneration policies post-reunification. Heteroscedasticity and Autocorrelation Consistent (HAC) standard errors in parentheses (Conley 1999). \* significant at 10%, \*\* significant at 5%, \*\*\* significant at 1%.

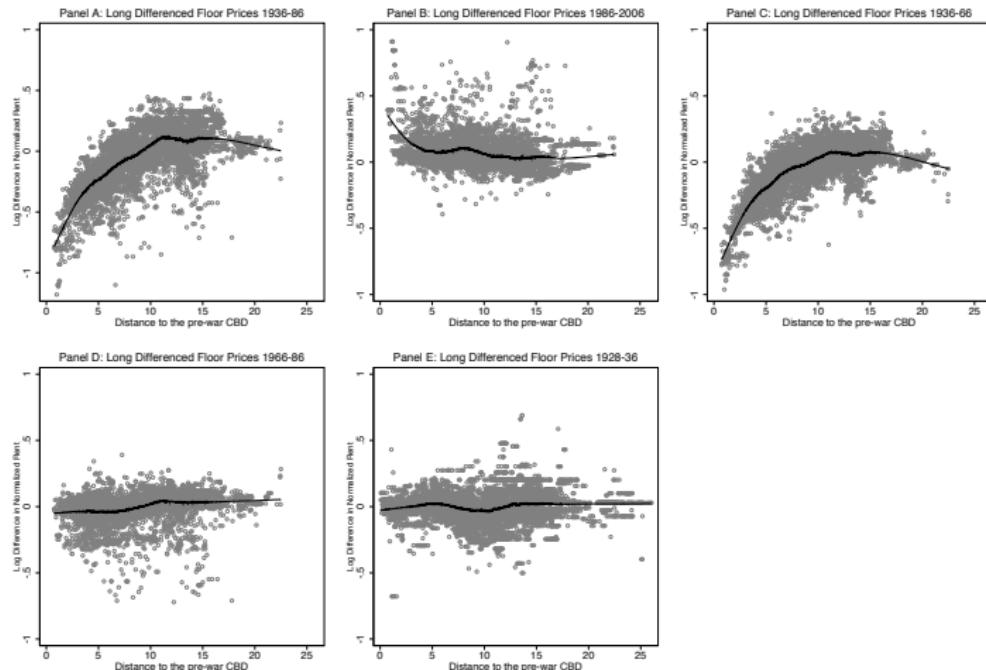
# Diff-in-diffs West Berlin 1986-2006

	(1) $\Delta \ln Q$	(2) $\Delta \ln Q$	(3) $\Delta \ln Q$	(4) $\Delta \ln Q$	(5) $\Delta \ln Q$	(6) $\Delta \ln \text{EmpR}$	(7) $\Delta \ln \text{EmpR}$	(8) $\Delta \ln \text{EmpW}$	(9) $\Delta \ln \text{EmpW}$
CBD 1	0.398*** (0.105)	0.408*** (0.090)	0.368*** (0.083)	0.369*** (0.081)	0.281*** (0.088)	1.079*** (0.307)	1.025*** (0.297)	1.574*** (0.479)	1.249** (0.517)
CBD 2	0.290*** (0.111)	0.289*** (0.096)	0.257*** (0.090)	0.258*** (0.088)	0.191** (0.087)	0.589* (0.315)	0.538* (0.299)	0.684** (0.326)	0.457 (0.334)
CBD 3	0.122*** (0.037)	0.120*** (0.033)	0.110*** (0.032)	0.115*** (0.032)	0.063** (0.028)	0.340* (0.180)	0.305* (0.158)	0.326 (0.216)	0.158 (0.239)
CBD 4	0.033*** (0.013)	0.031 (0.023)	0.030 (0.022)	0.034 (0.021)	0.017 (0.020)	0.110 (0.068)	0.034 (0.066)	0.336** (0.161)	0.261 (0.185)
CBD 5	0.025*** (0.010)	0.018 (0.015)	0.020 (0.014)	0.020 (0.014)	0.015 (0.013)	-0.012 (0.056)	-0.056 (0.057)	0.114 (0.118)	0.066 (0.131)
CBD 6	0.019** (0.009)	-0.000 (0.009)	-0.000 (0.012)	-0.003 (0.012)	0.005 (0.011)	0.060 (0.039)	0.053 (0.041)	0.049 (0.095)	0.110 (0.098)
Inner Boundary 1-6		Yes	Yes	Yes		Yes		Yes	
Outer Boundary 1-6		Yes	Yes	Yes		Yes		Yes	
Kudamm 1-6			Yes	Yes		Yes		Yes	
Block Characteristics				Yes		Yes		Yes	
District Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	7050	7050	7050	7050	7050	6718	6718	5602	5602
R-squared	0.08	0.32	0.34	0.35	0.43	0.04	0.07	0.03	0.06

Note: Q denotes the price of floor space. EmpR denotes employment by residence. EmpW denotes employment by workplace. CBD1-CBD6 are six 500m distance grid cells for distance from the pre-war CBD. Inner Boundary 1-6 are six 500m grid cells for distance to the Inner Boundary between East and West Berlin. Outer Boundary 1-6 are six 500m grid cells for distance to the outer boundary between West Berlin and East Germany. Kudamm 1-6 are six 500m grid cells for distance to Breitscheid Platz or the Kurfürstendamm. The coefficients on the other distance grid cells are reported in Table A4 of the web appendix. Block characteristics include the logarithm of distance to schools, parks and water, the land area of the block, the share of the block's built-up area destroyed during the Second World War, indicators for residential, commercial and industrial land use, and indicators for whether a block includes a government building and urban regeneration policies post-reunification. Heteroscedasticity and Autocorrelation Consistent (HAC) standard errors in parentheses (Conley 1999).\* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%.

# Land prices over time

Placebo test: Land price change from 1928 to 1936. Of the change from 1936 - 1986, most of the effect is already in place by 1966.



Note: Log floor prices are normalized to have a mean of zero in each year before taking the long difference. Solid lines are fitted values from locally-weighted linear least squares regressions.

# Gravity regression for commuting

Gravity equation for commuting from residence  $i$  to workplace  $j$ :

$$\ln \pi_{ij} = -\nu \tau_{ij} + \vartheta_i + \varsigma_j + e_{ij},$$

where  $\tau_{ij}$  is transit minutes,  $\nu = \epsilon \kappa$ , and  $\vartheta_i$  and  $\varsigma_j$  are fixed effects

	(1) In Bilateral Commuting Probability 2008	(2) In Bilateral Commuting Probability 2008	(3) In Bilateral Commuting Probability 2008	(4) In Bilateral Commuting Probability 2008
Travel Time ( $-\kappa \epsilon$ )	-0.0697*** (0.0056)	-0.0702*** (0.0034)	-0.0771*** (0.0025)	-0.0706*** (0.0026)
Estimation	OLS	OLS	Poisson PML	Gamma PML
More than 10 Commuters		Yes	Yes	Yes
Fixed Effects	Yes	Yes	Yes	Yes
Observations	144	122	122	122
R-squared	0.8261	0.9059	-	-

Note: Gravity equation estimates based on representative micro survey data on commuting for Greater Berlin for 2008. Observations are bilateral pairs of 12 workplace and residence districts (post 2001 Bezirke boundaries). Travel time is measured in minutes. Fixed effects are workplace district fixed effects and residence district fixed effects. The specifications labelled more than 10 commuters restrict attention to bilateral pairs with 10 or more commuters. Poisson PML is Poisson Pseudo Maximum Likelihood estimator. Gamma PML is Gamma Pseudo Maximum Likelihood Estimator. Standard errors in parentheses are heteroscedasticity robust. \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%.

## Backing out amenities and productivities

- ▶ Using estimated  $\nu$ , and data on residence and workplace employment, one can solve for transformed wages  $\omega_j = w_j^\epsilon$  from commuting equation (summed over origins)
- ▶ Recover overall productivity  $A_j$  from zero-profit equation:

$$\ln \left( \frac{A_{it}}{\bar{A}_t} \right) = (1 - \alpha) \ln \left( \frac{\mathbb{Q}_{it}}{\bar{\mathbb{Q}}_t} \right) + \frac{\alpha}{\epsilon} \ln \left( \frac{\omega_{it}}{\bar{\omega}_t} \right)$$

where  $\bar{A}_t = \exp \left( 1/S \sum_{s=1}^S \ln A_{st} \right)$  (geometric mean)

- ▶ High floor prices and wages require high final good productivity for zero profits to be satisfied

## Backing out amenities and productivities

- ▶ Recover amenities  $B_i$  from residential choice probabilities:

$$\ln \left( \frac{B_{it}}{\bar{B}_t} \right) = \frac{1}{\epsilon} \ln \left( \frac{H_{Rit}}{\bar{H}_{Rt}} \right) + (1 - \beta) \ln \left( \frac{\bar{Q}_{it}}{\bar{Q}_t} \right) + \frac{1}{\epsilon} \ln \left( \frac{W_{it}}{\bar{W}_t} \right)$$

where  $W_{it} = \sum_{s=1}^S \omega_{st} / e^{\nu \tau_{ist}}$  and variables with an upper bar denote that variable's geometric mean.

- ▶ High floor prices and high residence employment must be explained either by high wage commuting access or high amenities.
- ▶ (So far not making assumptions about the relative importance of production and residential externalities versus fundamentals)

## Backing out amenities and productivities

- ▶ Fix other parameters ( $\alpha$ , ...) to values from the literature.
- ▶ Estimate  $\epsilon$  from dispersion of log adjusted wages backed out in the model and log wages in the data for a selected year.
- ▶ Next table shows in columns 1-4 how the amenities and productivities changed over time.
- ▶ Also, simulate the impact of the division on West Berlin, holding productivity, amenities constant at their 1936 values. Column 5 shows that the models prediction are off from the diff and diff results (-.4 versus -.8 log points) Similarly for column 6 (re-unification; 0 versus -.4 log points).

# Changes in Amenities and Productivity

TABLE IV  
PRODUCTIVITY, AMENITIES, AND COUNTERFACTUAL FLOOR PRICES<sup>a</sup>

	(1) $\Delta \ln A$ 1936–1986	(2) $\Delta \ln B$ 1936–1986	(3) $\Delta \ln A$ 1986–2006	(4) $\Delta \ln B$ 1986–2006	(5) $\Delta \ln QC$ 1936–1986	(6) $\Delta \ln QC$ 1986–2006
CBD 1	−0.207*** (0.049)	−0.347*** (0.070)	0.261*** (0.073)	0.203*** (0.054)	−0.408*** (0.038)	−0.010 (0.020)
CBD 2	−0.260*** (0.032)	−0.242*** (0.053)	0.144** (0.056)	0.109* (0.058)	−0.348*** (0.017)	0.079** (0.036)
CBD 3	−0.138*** (0.021)	−0.262*** (0.037)	0.077*** (0.024)	0.059** (0.026)	−0.353*** (0.022)	0.036 (0.031)
CBD 4	−0.131*** (0.016)	−0.154*** (0.023)	0.057*** (0.015)	0.010 (0.008)	−0.378*** (0.021)	0.093*** (0.026)
CBD 5	−0.095*** (0.014)	−0.126*** (0.013)	0.028** (0.013)	−0.014* (0.007)	−0.380*** (0.022)	0.115*** (0.033)
CBD 6	−0.061*** (0.015)	−0.117*** (0.015)	0.023** (0.010)	0.001 (0.005)	−0.354*** (0.018)	0.066*** (0.023)
Counterfactuals					Yes	Yes
Agglomeration Effects					No	No
Observations	2,844	5,978	5,602	6,718	6,260	7,050
R <sup>2</sup>	0.09	0.06	0.02	0.03	0.07	0.03

## Estimation of structural model

- ▶ Next, use exogenous variation from Berlin's division and reunification to estimate model parameters including the agglomeration forces.
- ▶ From the previous equations and definitions:

$$\Delta \ln \left( \frac{a_{it}}{\bar{a}_t} \right) = (1 - \alpha) \Delta \ln \left( \frac{\mathbb{Q}_{it}}{\bar{\mathbb{Q}}_t} \right) + \frac{\alpha}{\epsilon} \Delta \ln \left( \frac{\omega_{it}}{\bar{\omega}_t} \right) - \lambda \Delta \ln \left( \frac{\Upsilon_{it}}{\bar{\Upsilon}_t} \right)$$

$$\Delta \ln \left( \frac{b_{it}}{\bar{b}_t} \right) = \frac{1}{\epsilon} \Delta \ln \left( \frac{H_{Rit}}{\bar{H}_{Rt}} \right) + (1 - \beta) \Delta \ln \left( \frac{\mathbb{Q}_{it}}{\bar{\mathbb{Q}}_t} \right)$$

$$+ \frac{1}{\epsilon} \Delta \ln \left( \frac{W_{it}}{\bar{W}_t} \right) - \eta \Delta \ln \left( \frac{\Omega_{it}}{\bar{\Omega}_t} \right)$$

- ▶ Production externalities  $\Upsilon_{it}$  depend on travel-time weighted sum of observed workplace employment densities
- ▶ Residential externalities  $\Omega_{it}$  depend on travel-time weighted sum of observed residence employment densities
- ▶ Adjusted fundamentals relative to geometric mean are structural residuals

# Parameters

Assumed Parameter		Source	Value
Residential land	$1 - \beta$	Davis & Ortalo-Magne (2011)	0.25
Commercial land	$1 - \alpha$	Valentinyi-Herrendorf (2008)	0.20
Fréchet Scale	$T$	(normalization)	1
Expected Utility	$\bar{u}$	(normalization)	1000

Estimated Parameter	
Production externalities elasticity	$\lambda$
Production externalities decay	$\delta$
Residential externalities elasticity	$\eta$
Residential externalities decay	$\rho$
Commuting semi-elasticity	$\nu = \epsilon\kappa$
Commuting heterogeneity	$\epsilon$

## Moment Conditions

- ▶ Changes in adjusted fundamentals uncorrelated with exogenous change in surrounding economic activity from division/reunification

$$\mathbb{E} [\mathbb{I}_k \times \Delta \ln (a_{it}/\bar{a}_t)] = 0, \quad k \in \{1, \dots, K_{\mathbb{I}}\},$$

$$\mathbb{E} [\mathbb{I}_k \times \Delta \ln (b_{it}/\bar{b}_t)] = 0, \quad k \in \{1, \dots, K_{\mathbb{I}}\}.$$

where  $\mathbb{I}_k$  are indicators for distance grid cells from pre-war CBD

- ▶ Other moments are fraction of workers that commute less than 30 minutes and wage dispersion

$$\mathbb{E} \left[ \vartheta H_{Mj} - \sum_{i \in \aleph_j}^S \frac{\omega_j / e^{\nu \tau_{ij}}}{\sum_{s=1}^S \omega_s / e^{\nu \tau_{is}}} H_{Ri} \right] = 0,$$

$$\mathbb{E} \left[ (1/\epsilon)^2 \ln (\omega_j)^2 - \sigma_{\ln w_i}^2 \right] = 0,$$

# Estimated Parameters

TABLE V  
GENERALIZED METHOD OF MOMENTS (GMM) ESTIMATION RESULTS<sup>a</sup>

	(1)	(2)	(3)
	Division	Reunification	Division and Reunification
	Efficient	Efficient	Efficient
	GMM	GMM	GMM
Commuting Travel Time Elasticity ( $\kappa\epsilon$ )	0.0951*** (0.0016)	0.1011*** (0.0016)	0.0987*** (0.0016)
Commuting Heterogeneity ( $\varepsilon$ )	6.6190*** (0.0939)	6.7620*** (0.1005)	6.6941*** (0.0934)
Productivity Elasticity ( $\lambda$ )	0.0793*** (0.0064)	0.0496*** (0.0079)	0.0710*** (0.0054)
Productivity Decay ( $\delta$ )	0.3585*** (0.1030)	0.9246*** (0.3525)	0.3617*** (0.0782)
Residential Elasticity ( $\eta$ )	0.1548*** (0.0092)	0.0757** (0.0313)	0.1553*** (0.0083)
Residential Decay ( $\rho$ )	0.9094*** (0.2968)	0.5531 (0.3979)	0.7595*** (0.1741)

# Localized Externalities

TABLE VI  
EXTERNALITIES AND COMMUTING COSTS<sup>a</sup>

	(1) Production Externalities $(1 \times e^{-\delta\tau})$	(2) Residential Externalities $(1 \times e^{-\rho\tau})$	(3) Utility After Commuting $(1 \times e^{-\kappa\tau})$
0 minutes	1.000	1.000	1.000
1 minute	0.696	0.468	0.985
2 minutes	0.485	0.219	0.971
3 minutes	0.338	0.102	0.957
5 minutes	0.164	0.022	0.929
7 minutes	0.079	0.005	0.902
10 minutes	0.027	0.001	0.863
15 minutes	0.004	0.000	0.802
20 minutes	0.001	0.000	0.745
30 minutes	0.000	0.000	0.642

# Counterfactuals

TABLE VII  
COUNTERFACTUALS<sup>a</sup>

	(1) $\Delta \ln QC$ 1936–1986	(2) $\Delta \ln QC$ 1936–1986	(3) $\Delta \ln QC$ 1936–1986	(4) $\Delta \ln QC$ 1936–1986	(5) $\Delta \ln QC$ 1986–2006	(6) $\Delta \ln QC$ 1986–2006	(7) $\Delta \ln QC$ 1986–2006
CBD 1	-0.836*** (0.052)	-0.613*** (0.032)	-0.467*** (0.060)	-0.821*** (0.051)	0.363*** (0.041)	1.160*** (0.052)	0.392*** (0.043)
CBD 2	-0.560*** (0.034)	-0.397*** (0.025)	-0.364*** (0.019)	-0.624*** (0.029)	0.239*** (0.028)	0.779*** (0.044)	0.244*** (0.027)
CBD 3	-0.455*** (0.036)	-0.312*** (0.030)	-0.336*** (0.030)	-0.530*** (0.036)	0.163*** (0.031)	0.594*** (0.045)	0.179*** (0.031)
CBD 4	-0.423*** (0.026)	-0.284*** (0.019)	-0.340*** (0.022)	-0.517*** (0.031)	0.140*** (0.021)	0.445*** (0.042)	0.143*** (0.021)
CBD 5	-0.418*** (0.032)	-0.265*** (0.022)	-0.351*** (0.027)	-0.512*** (0.039)	0.177*** (0.032)	0.403*** (0.038)	0.180*** (0.032)
CBD 6	-0.349*** (0.025)	-0.222*** (0.016)	-0.304*** (0.022)	-0.430*** (0.029)	0.100*** (0.024)	0.334*** (0.034)	0.103*** (0.023)
Counterfactuals	Yes						
Agglomeration Effects	Yes						
Observations	6,260	6,260	6,260	6,260	7,050	6,260	7,050
R <sup>2</sup>	0.11	0.13	0.07	0.13	0.12	0.24	0.13

## How these models work: Normative properties

Davis, Gregory (2021) - “[Place-Based Redistribution in Simple Location-Choice Models](#)”

- ▶ [Fajgelbaum and Gaubert \(2020\)](#) and subsequent papers prescribe fiscal transfers (trade deficits) to high-MU-of-tradables places (cf [Glaeser and Gottlieb 2008](#))
- ▶ Idiosyncratic errors terms are uninsured and affect location choices, the level of utility, and marginal utility
- ▶ Frechet vs Weibull: marginal utilities can differ even when allocations and elasticities for marginal households coincide, thus making the planning problems differ even when positive predictions coincide
- ▶ I conjecture that if you write GEV errors, the model is underidentified without further functional form choices
- ▶ I am skeptical that their proposed computational approach to planning problem will scale to empirical applications

## How these models work: Positive properties

Thisse, Turner, Ushchev (2021) contrast quantitative spatial models and canonical urban model

- ▶ QSM features cross-hauling of homogeneous labor, canonical model does not
- ▶ Canonical model: Commuting costs are a centralizing force when employment is concentrated (e.g., the monocentric case)
- ▶ QSM: commuting costs are a centralizing force even when net labor flows are zero

Dingel, Tintelnot (2021) - “Spatial Economics for Granular Settings”

- ▶ Go to presentation slide deck

## Next week

Next week, we introduce heterogeneous agents and activities:  
spatial sorting of skills and sectors