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Editorial: Spatial inequalities and economic growth

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Abstract: In this editorial we summarize and comment the five articles published in issue 9.3. The five articles are a selection of papers presented at the “Workshop on Inequality and Regional Growth and Cohesion” organised by the Regional Quantitative Analysis research group (AQR-IREA) of the University of Barcelona in November 2011. The first two articles, by De Dominicis and by Monastiriotis, focus on the analysis of regional growth and examine the influence of agglomeration and national development, respectively, on this. The article by Rodriguez-Pose and Ezcurra looks instead at how trade openness impacts on within-country regional disparities; while the article by Kyriacou and Roca-Sagalés examines in turn how regional disparities impact on the quality of government at the national level. Last, the article by Salotti and Sacchi examines the impact of different forms of decentralisation on income inequalities at the household level. From our perspective, these articles contribute to a better understanding of the complex link between inequality and economic growth, but they also leave several open questions that clearly stimulate future research on the topic.

Keywords: Economic growth, convergence, inequalities, regional disparities, trade, redistributive policies, fiscal decentralization

JEL Codes: R11, R15, F10, F43, H77, O11, O18.

Editorial: Spatial inequalities and economic growth

In November 2011, the Regional Quantitative Analysis research group (AQR-IREA) organized a “**Workshop on Inequality and Regional Growth and Cohesion**”. The aim of the workshop was to bring together original research papers that could cast some light on the evolution and determinants of economic and social inequality but also on its impact on regional growth and cohesion. The call for papers attracted a large number of submissions, eight of which were selected for presentation at the workshop – in addition to two keynote presentations by José Enrique Garcilazo (OECD) and Andrés Rodríguez-Pose (LSE). The papers presented and discussed in the workshop covered a range of themes, from the role of agglomeration, openness and national development to the role and effectiveness of governance structures, at the supra-national, national and sub-national levels. This thematic range reflects in a way the complexity and multi-dimensionality of issues of (spatial) inequality and (regional) growth – and, in the workshop, it allowed a constructive and thought-provoking discussion concerning not only how this complexity can be addressed in policy terms but also how it can be best conceptualised analytically and studied empirically.

The five articles published in this special issue, selected among the very good contributions across the workshop under the standard refereeing procedures of this journal, reflect this broad thematic coverage and cogitation developed in the workshop – each highlighting a distinct dimension in the overarching issue of spatial inequality and regional growth. The first three papers look at the *mechanics of growth*, each focusing at economic processes occurring at a different spatial scale: at the sub-national scale, the focus is quite naturally on the role of agglomeration and the uneven distribution of incomes within countries and regions (De Dominicis, 2014); at the national scale, the question is instead linked to processes of economic and political restructuring and the overall level of national economic development (Monastiriotis, 2014); while at the supra-national scale, attention is directed to processes of internationalisation and economic (trade) openness (Rodríguez-Pose and Ezcurra, 2014). Following, the last two papers take us back to the national and sub-national scales, this time shifting the focus towards questions concerning the *structure and effectiveness of governance* (government quality and type/extent of decentralisation). At the national scale, the most pertinent question is whether and how regional disparities may impact on governance quality and policy efficiency (Kyriacou and Roca-Sagalés, 2014); in turn, at the sub-national scale the causal link is reversed and the question examined is how different models of sub-national governance (types and degrees of decentralisation) amplify or smoothen income inequalities (Salotti and Sacchi, 2014). We review how these questions are addressed in the five papers published in this special issue, and the conclusions drawn from these, in what follows.

The first paper is by **Laura de Dominicis**, entitled “Regional inequality and growth in European regions: towards a place-based approach”. The paper looks at a sample of 188 European regions during the period 1991-2004 to analyse the impact that intra-regional income distribution has on regional growth in Europe. Drawing on the spatially-augmented Solow model of Ertur and Koch (2007), the paper sets out and examines empirically a central hypothesis, that the clustering of income in a relatively small number of locations within the

region itself may promote economic growth through benefits associated with agglomeration economies. This is an important issue that speaks directly to contemporary policy discussions concerning the scale, coverage and nature of policy interventions (place-based versus people-centred approach). If inter-personal inequalities contribute positively to regional growth, then people-centred policies may not be sufficient, or even appropriate, instruments for enhancing regional potentials and addressing disparities at wider spatial scales (across regions or nationally). In turn, more place-based approaches can be more effective, by strengthening agglomerations and the benefits deriving from them, especially in the less developed areas of a country. The results of the paper provide very useful insights with regard to this issue. When the hypothesis is tested across the full sample, the relationship between agglomeration (income concentration) and growth is not statistically significant, thus questioning the general validity of the proposed hypothesis. However, when examined specifically for the sub-sample of Objective 1 regions, strong evidence is found that, in these less developed regions, agglomeration positively impacts subsequent growth. As argued by De Dominicis, “[t]his result calls for a reflection on the adoption of regional policies in support of the development of very few and perhaps (central) locations, hoping that, the sub-regions which are not a target of policy decisions will benefit anyway, due to spillover effects.” Additionally, this result highlights the influence that the level of development (in this case, at the regional level) has on the factors underlying growth dynamics within and across regions – with spatial concentration appearing to play a more crucial role for regional growth at initial (low) levels of economic development.

The issue of the interplay between economic development and regional growth is examined more formally in the second paper, by **Vassilis Monastiriotis**, entitled “Regional growth and national development: transition in Central and Eastern Europe and the regional Kuznets curve in the East and the West”. Reflecting on the observation that the literature pays generally little attention on how regional growth (and convergence) may link to national processes of development (e.g., Tondl, 1997), the paper uses regional growth data for the period 1990-2008, contrasting the case of the CEECs to that of the ‘old’ EU member states, to investigate how different levels, or stages, of national economic development may be associated with different trajectories regarding regional growth and convergence. As a starting point for the analysis, the paper looks at the evidence concerning beta- and sigma-convergence as well as distributional polarisation and cumulative causation and finds that the data are consistent with evidence of both convergence and divergence/polarisation, as is found elsewhere in the literature (e.g., Ertur et al, 2006; Dall’erba et al, 2008). To reconcile this paradoxical finding, the paper hypothesises that processes of cumulative causation and neoclassical convergence may exist simultaneously but their relative strength may indeed be conditional on the context of national development, possibly along a non-linear path. Drawing on the tradition of the regional Kuznets curve (Williamson, 1965), whereby inequalities first rise, as economies start to grow out from initially low levels of development, and then subside, as national economies advance, the paper sketches out a hybrid model of regional growth which is then estimated on the two sub-samples of Central-Eastern and Western European regions. The obtained results provide clear evidence in support of the assertion that the convergence process – and regional growth more generally – is significantly different across different levels/stages of development, showing that the speed of convergence is not constant over time. Instead, the

intensity of convergence is found to follow a non-linear path along levels of national development, which takes however a different form in the east and the west, with the former moving monotonically towards more divergence and the latter showing a return to convergence at higher levels of national development. The author links the observed differences to the unique experience of post-communist transition and the subsequent market integration/liberalisation followed by the countries in the CEE sample, while recognising at the same time however that “we cannot exclude the possibility that this result may simply reflect that the CEECs have not yet reached the levels of national development needed to (re-)mobilise regional convergence”.

The third paper by **Andrés Rodríguez-Pose** and **Roberto Ezcurra** entitled “Trade Openness and Spatial Inequality in Emerging Countries” provides deeper insights on the role of trade liberalisation on spatial inequalities, moving also beyond the European space and examining the issue for an unbalanced panel of 22 emerging and developing countries over the period between 1990 and 2006. Taking for granted the overall long-run growth advantages of greater engagement in trade (e.g., Greenaway et al., 2002), the authors use data derived from the IMF World Economic Outlook Report, to examine empirically the link between trade openness (measured as the ratio of total trade to national GDP) and spatial inequality (measured by means of a Theil index). Although data-coverage and data-quality issues mean that the results from the empirical analysis should be treated with caution, they nevertheless show quite convincingly that the degree of trade openness is positively correlated with spatial inequality. Moreover, the spatial impact of trade is found to be greater in poorer countries, meaning that, while trade on the whole may have a beneficial effect for aggregate economic performance in the emerging world, the poorest regions in the poorest countries – the poorest of the poor – are likely to lose out from greater engagement in international trade. This result, which is also consistent with the evidence found by Monastiriotis (2014) for the case of the CEECs, holds after several robustness checks addressing the potential omission of explanatory variables, to alternative definitions of spatial inequalities or to influential observations (outliers). The empirical evidence provided in the paper raises a number of important questions which the authors propose as possible extensions for future research (for instance, what are the causal mechanisms that account for the positive link between trade and inequalities; and is this link also influenced by the actual composition of trade?) But in any case, the contribution by Rodríguez-Pose and Ezcurra clearly shows that the increase in trade exposure across the emerging world generates winners and losers and justifies supra-regional redistributive policies.

The issue of redistributive policies, albeit from a very different perspective, is picked up also in the next paper, by **Andreas Kyriacou** and **Oriol Roca-Sagalés** entitled “Regional Disparities and Government Quality: Redistributive Conflict Crowds out Good Government”. In the context of the literature that has analysed the causes and consequences of interregional redistributive conflict (Spolaore, 2008 for a review), this paper examines the link between within-country regional income differentials and (national) government quality. The central hypothesis of the paper is that regional disparities can affect the quality of government as they heighten the redistributive conflict between relatively poor and relatively wealthy regions, thus giving more salience to issues of inter-regional redistribution at the expense of policies aiming towards improvements in efficiency (removing distortions to private markets and efficiently providing

necessary public goods – following La Porta et al, 1999). As the authors put it, “regional disparities may engender redistributive conflicts which crowd-out good government”. In their empirical analysis the authors use measures of governance quality produced by the World Bank, along four categories related to “control of corruption, rule of law, regulatory quality and government effectiveness”. In turn, the extent of inequality is measured by a number of alternative indexes, including a population-weighted coefficient of variation, the Theil index, and others. The empirical analysis is based on a sample of 22 OECD countries over the period from 1996 to 2005 and the empirical model is estimated using a Feasible General Least Squares (FGLS) estimator which controls for panel heteroskedasticity and serial autocorrelation in the residuals. Although the simple analysis support the hypothesis put forward in the paper, the authors recognise the potential presence of reverse causality, as regional disparities may well be the outcome of ‘bad’ government. To address this, the authors extend their analysis using an instrumental variables technique based on a 2-stage FGLS. Given the relative temporal stability of the variables of interest (government quality, regional disparities), the authors dismiss the use of pre-determined variables (time-lags of the right-hand-side variables) and instead employ as their instrument the log-area of each country, which is exogenous to government quality (at list over the time-period under study) and has been shown, both in this dataset and in previous literature, to correlate reasonably well to the level of regional disparity. Despite this treatment for the endogeneity of regional disparities, the empirical result concerning the role of regional disparities on national government quality still holds and in fact becomes stronger, which the authors take to signal “the presence of a negative feedback effect from government quality towards regional disparities”.

The last article in this issue by **Simone Salotti** and **Agnese Sacchi** entitled “The Effects of Fiscal Decentralization on Household Income Inequality: Some Empirical Evidence” provides additional insights on the structure and effectiveness of government, specifically by examining the effects of fiscal decentralisation on income disparities. The authors investigate this issue using a sample of 23 OECD countries over the period 1971-2000 and employing a range of measures of fiscal decentralisation covering the degree of both fiscal and political autonomy of sub-national jurisdictions. The use of these measures of decentralisation complements and extends existing analyses on the topic (e.g., Tselios et al, 2012), providing additional evidence not simply about the link between decentralisation and income inequality but also about the link between the latter and different models of decentralisation (e.g., spending versus tax autonomy). The results of the empirical analysis confirm the underlying hypothesis of the paper, highlight the importance of both the nature of fiscal decentralisation – expenditure versus revenue – and the extent to which independent spending responsibility and taxing powers are actually assigned to local governments. For instance, a higher degree of autonomy and responsibility over taxes assigned to sub-national governments is associated with a more unequal distribution of income across households within a country. From a policy perspective, this suggests again, as in the papers by Rodriguez-Pose and Ezcurra (2014) and Kyriacou and Roca-Sagalés (2014), that redistributive policies are necessary to mitigate the distributional consequences of, presumably, otherwise efficiency-enhancing policies. Reflecting on this, the authors go further to suggest that some form of ‘asymmetric federalism’ could be advised as results mainly show no adverse effects of expenditure decentralisation on household income distribution. In fact, as highlighted by the authors “this seems to describe well the situation of

many developed countries characterized by the existence of some fiscal mismatch at the sub-central level, i.e. an imperfect correspondence between the degrees of revenue and expenditure decentralization”.

Summarising, we hope that the articles included in this special issue offer a stimulating set of insights and empirical evidence towards the achievement of a better understanding of the complex link between inequality and economic growth. As reflected in each of these papers, regional and intra-regional disparities are often driven by processes well beyond the responsibility and control of individual regions. Regional disparities may be enhanced by institutions of good governance (e.g., fiscal decentralisation) and efficiency-enhancing policies (e.g., trade liberalisation), while they may also be amplified by positive outcomes at different spatial scales, such as processes of agglomeration and national development. In turn, the extent of inequality may also influence the quality of good governance institutions, the effectiveness of policy and the pace of (national and regional) growth. Although it is acknowledged that the papers published in this special issue do not offer definitive and fully conclusive answers to those issues, it is hoped that the publication of these articles here will contribute not only to informing policy design in the European Union but also to strengthening and encouraging further research on the analysis of inequalities from a spatial perspective.

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