

Effects of the Spatial Sorting of Human Capital on Economic Activity and Welfare

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Abstract

The paper analyzes effects of the spatial sorting of human capital on economic activities and welfare. For this purpose, I build a two-region general equilibrium overlapping generations model, in which heterogeneous individuals are spatially sorted according to their productivity. The model is calibrated to match some Japanese facts. A counterfactual simulation shows that the existence of sorting applied to all individuals leads to greater efficiency compared with the economy without it. The associated aggregate welfare gain is tremendous, but at the cost of welfare of relatively productive individuals. It is also shown that a productivity improvement biased toward the skill-intensive sector results in welfare gain of all individuals and that the effect on welfare gain of relatively productive individuals is again weakened by sorting applied to migrants. Besides the welfare analysis, the paper identifies mismatch between workers and firms as the key source of observed seemingly irrational bidirectional migration flows.