

Firm Heterogeneity, rent seeking and unemployment

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Abstract

We argue about the economic impacts of increase in government expenditure, constructing an unemployment model with rent seeking activities based on Melitz (2003). If the low productivity firms cannot obtain subsidy from the government, they have to exit the market because of their less competitiveness. For staying the market, firms positively engage in rent seeking activities. This may go down the average productivity in the economy. This indicates that increase in government expenditure is one of reasons why the developed countries have not recovered from recession for recent a or two decades.

On the other hand, if the low productivity firms can be alive in the market, they will be able to offer more jobs. Therefore, the unemployment rate may decrease and welfare increase in this economy.

Keywords: Rent-seeking, Public expenditure, unemployment

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