# The impact of labor market frictions on industrial agglomeration

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**Abstract**

This paper analyzes the effect of labor market conditions on the configuration of industrial firms in an 'new economic geography' framework with search and matching frictions. The model economy consists of two countries, two sectors, and two factors of production. The agricultural sector is characterized by perfect competition and zero trade costs. The industrial sector is subject to imperfect competition and positive trade costs. Only industrial firms can move between countries and their distribution is analyzed. We examine two types of frictions: one is that there are labor market frictions in only the agricultural sector, and the other is that there are such frictions in both sectors. It is shown that in both cases the country that has the same amount of factors but has relatively less frictions in the industrial sector than the other country hosts a more than proportional share of industrial firms. It is also found that in both cases the country that has a fewer amount of factors but has relatively less frictions in the industrial sector than the other country loses its firms when trade costs are high. However, when trade costs are sufficiently low, the country achieves agglomeration by utilizing the advantage of its healthiness of the labor market. Our results suggest that, in the world today where transportation costs and trade impediments are becoming significantly low, labor market conditions rather than market size determine industrial agglomeration.

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