Productivity Growth, Industry Location Patterns and Labor Market Frictions

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January 2019

Abstract

This paper constructs a two-country model of international trade to study how labor market frictions affect industry location patterns, unemployment rates, and fully endogenous productivity growth. We show that when the larger country offers subsidies to labor search costs or reduces unemployment benefits, the domestic unemployment rate falls, causing greater industry concentration and faster productivity growth, but higher unemployment for the smaller country. When similar labor market policies are implemented in the smaller country, however, the resulting fall in domestic unemployment leads to lower industry concentration and slower productivity growth, while lowering unemployment in the larger country.

JEL Classifications: E24; J64; O41; R11
Keywords: Labor market frictions; Industry location; Imperfect knowledge spillovers; Endogenous productivity growth

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from JSPS through Grants-in-Aid for Scientific Research (A) and (C). All remaining errors are their own.