The Impact of Labor Market Frictions on Industrial Agglomeration

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Abstract

This paper develops a two-country model of trade and geography characterized by the homogeneous traditional sector with diminishing returns and the differentiated modern sector subject to increasing returns. When international trade is perfectly free, the country with a larger amount of factor endowments ends up with shrinking its modern sector. When trade liberalization proceeds continuously, it may be possible that the large country first expands, then shrinks its modern sector.