

PRODUCT MARKET REGULATION, FIRM SELECTION, AND UNEMPLOYMENT

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Abstract

This paper analyzes the effect of Product Market Regulation (PMR) on unemployment in a search model with heterogeneous multiple-worker firms. In our setup, PMR modifies the distribution of firm productivities, thereby affecting the equilibrium rate of unemployment. We distinguish between PMR related to entry costs and PMR that generates recurrent fixed costs. We find that: (i) higher entry costs raise the rate of unemployment mainly through our novel, (ii) higher fixed costs decrease unemployment through the selection effect and increase it through the competition effect analyzed in Blanchard and Giavazzi (2003). Firm heterogeneity magnifies the impact of both types of regulatory costs. We propose econometric evidence consistent with the unemployment effects of sunk versus recurring costs. (JEL: E24, J63, L16, O00)