

## **Labor Market Integration, Entrepreneur Sorting, and Regional Inequality**

### **Abstract**

This paper studies the impact of increased labor market integration on entrepreneurs' migration decisions and firms' performance in China over the past three decades. We build a spatial general equilibrium framework that incorporates salient features of the Chinese migration restriction system to illustrate the mechanism by which worker and firm locations respond together to heterogeneous changes in labor mobility restrictions. We compile a new dataset of prefectural-level Hukou reforms between 1995 and 2019. We then use this exogenous change in labor mobility costs, together with data on city-to-city labor migration flows and 90 million firms, to identify the effect of labor mobility restriction reduction on the regional redistribution of economic activities. We show that skill-biased relaxation of mobility restriction attracts high-skill labor and migrant entrepreneurs, at the cost of crowding out local entrepreneurs. In contrast, non-restrictive hukou relaxation spurs overall economic activities through abundant labor supply, firm agglomeration, and, more importantly, the co-movement of labor and entrepreneur.