

**FDI, Skill-Specific Unemployment, and Institutional Spillover Effects (MS#664).  
RESPONSE TO REFEREE 2**

Thank you very much for the numerous excellent suggestions, which helped a lot to improve the paper. The introduction is completely rewritten and major parts of the paper are also new. The focus of the paper shifted away from foreign direct investment towards the effects of institutional reforms on global competitiveness. That is also the reason why the title changed to "Skill-biased labor market reforms and international competitiveness".

One of the main concern was the empirical relevancy of skill-specific labor market institutions. Following the lines proposed by the invited reader, more examples for labor market institutions that can have skill-specific effects on workers are briefly discussed in the text. I also improved the search and matching framework by distinguishing between the flow value of being unemployed and unemployment benefits in line with Pissarides (2000). The German labor market reform (Hartz IV) for instance affected all workers' replacement rate and was thus not skill-specific. Nevertheless, a reduction in unemployment benefits may have different effects on different type of workers through their relative importance. High-killed may be less concerned about job losses compared to low skilled, which may also result in skill-biased effects of institutions even through they are not skill-specific.

Proposition 6 and 7 are now proposition 2 and 3. The point raised about incompleteness of both proofs is valid. A new discussion tries to bridge the gap between wages and intermediate good prices.

I followed your suggestions and dropped all propositions other than 5, 6, and 7. Proposition 5 is now a lemma.

The following points were also fixed:

1. The structure of the paper has changed. The new version contains only four sections: introduction, benchmark model, comparative statics, and conclusion.
2. Proposition 4 does not exist anymore.
3. Iranzo et al. (2008, Journal of Labor Economics) show that production and non-production workers are compliments (between group), which supports the choice of Leontief. I added a short discussion in the paper. Moreover, I also extended the discussion of skill-biased effects on wages in both skill-groups.
4. The discussion about the linearity assumption of vacancy posting costs is indeed important. One could also assume that firms pay vacancy posting costs in terms of the numéraire so that vacancy posting costs remain constant. The main results would not change.

5. The detailed solution of the labor market clearing condition moved into the appendix.
6. The last sentence in footnote 6 was misleading! I corrected it.
7. I also extended the discussion about uniqueness of the equilibrium along the lines proposed in your report.
8. I agree that the labor market clearing conditions would be easier to understand if the cutoff is visible in the equations. However, we do not know ex-ante without introducing assumptions about the comparative advantage of each country. This is done later in the comparative static exercise. I moved the discussion about the cutoff industry instead closer to the labor market clearing conditions so that the intuition behind the upper and lower bounds is easier to follow.

I hope you like the revision.

Best regards,

Hans-Joerg Schmerer

## References

- [1] IRANZO, S., F. SCHIVARDI, AND E.TOSETTI (2008), "Skill Dispersion and Firm Productivity: An Analysis with Employer-Employee Matched Data," *Journal of Labor Economics* **26**: p. 247-285.