Asset bubble, growth and endogenous labor supply

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Abstract:

Bubbles are often associated with an increase in growth and labor. Their collapse is often accompanied by a reduction in working hours and a recession of economic growth. Taking into account this empirical evidence, we examine the interaction between asset bubbles, labor supply and economic growth. We consider an overlapping generations with elastic labor model in which we intro- duce productive public spending and lump-sum transfers. The latter two are financed by tax burden on capital and labor incomes. First, we find that asset bubbles can (cannot) emerge when the labor supply is higher (lower) than its value in the equilibrium without bubble. Second, we show that labor supply is promoted by bubbles. The growth rate is also boosted by bubbles when the positive effect of labor supply occurred thanks to bubble (crowding-in effect) dominates the negative effect of bubbles (crowding-out effect). We explore a transitional dynamics of bubble, employment and growth following the bubble bursting caused by changes in fiscal policy.

Keywords: Bubble, endogenous labor, endogenous growth, crowding-in effect, fiscal policy.

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