

General Equilibrium Analysis of Globalizing Capital and Labor Mobility: Its Impacts on Growth, Poverty and Inequality

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Summary

Factor availability is a common constraint both in developed and developing countries, but takes different forms. While abundance of labor and shortage of capital are stylized facts in developing countries, the opposite is typically true for developed countries. If factors were freely reallocated across the world, a country's capital and labor would be employed in sectors where they were most productive and world output would increase. All countries could benefit from the exchange of this higher level of output. While traditional trade theories have considered that the abundance of factors determines trade patterns, cross-border factor mobility also matters in the recently globalized world.

Cross-border factor movements typically take the form of foreign direct investment (FDI) and labor migration. Labor-abundant developing countries are expected to benefit from FDI as it is considered to be a supplement to domestic investment for these capital-scarce economies. Similarly, migrant workers' remittances are one of the major sources of foreign exchange earnings in many developing countries. However, in recent years, remittance inflows in some countries have declined steadily because of the real income reductions of migrants. These income losses have increased the number of returning migrants, making domestic employment less secure.

To address these issues of cross-border factor mobility, we develop both static and dynamic computable general equilibrium (CGE) models. In our first study (in Chapter 3),

we develop a static CGE model that describes competition between local firms and multinational enterprises (MNEs) in sectors hosting FDI and the distributional impacts of factor mobility among households. In the second study (in Chapter 4), we extend our static CGE model to a dynamic one by explicitly incorporating labor markets with endogenous labor supply decisions by households in response to market wages. Migration decisions by households are also endogenously determined in our model in response to a foreign wage premium.

We analyze the impacts of cross-border factor mobility in Bangladesh, which faces globalization in factor mobility. Using a static model, we examine how the benefits of an increase in FDI in the ready-made garments (RMG) sector are transmitted and shared among households with different characteristics, and the appropriate government policies to mitigate adverse distributional problems, if any, created from the increased FDI. Our simulation results demonstrate that FDI would promote both output and exports by the RMG multinationals, but would benefit household groups unevenly. We then demonstrate that human capital development programs targeting an adversely affected group of households could create more equitable gains for these households.

Our dynamic CGE analysis describes how a foreign labor market shock affecting migrants reduces household welfare by lowering wages and increasing unemployment, particularly for unskilled workers in the domestic labor market. Using counteractive policy options, we examine the impacts of FDI promotion in the RMG sector and of a human-capital development program. Based on our results, we conclude that the former policy minimizes the negative impacts of foreign labor market shocks, while a combination of both policies is more equitable.