

Migration, Trade, Capital, and Development: Substitutes, Complements, and Policies

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The postwar era is not the first experience the world has had with globalization in all its dimensions. The current episode can, however, be distinguished from its nineteenth century predecessor by its scale—a world of six billion inhabitants, massive movements of goods, services, and capital—as well as by continuously falling communication and transport costs and the instantaneous nature of information flows and stakeholder reaction possibilities. When war and interwar autarky ended in 1945, international trade was first to pick up, followed by a renewal of public capital movements, initially to Europe and subsequently to developing countries. Next came private portfolio capital and foreign direct investment (FDI), quickly dwarfing public capital flows, known as Official Development Assistance (ODA).

The economic migration of people, excluding refugees and asylum seekers, has lagged substantially behind. That's largely because barriers to the movement of people remain high—despite calls and considerable action for increased freedom of trade, capital, and associated technology mobility. This dimension of globalization tends to cause the strongest political resistance; when domestic workers are seen to be threatened by some combination of technology change, imports, and immigrants, it is invariably the last of these that generates the largest rhetorical and policy response.

Nevertheless, pressures for enhanced migration are rising, certainly in the less-developed origin (O) countries but also in some quarters of the more developed destination (D) countries. The very fact that migration has lagged substantially behind the other dimensions of globalization also makes it the largest

opportunity for additional global welfare gains—especially today, when further multilateral trade liberalization is in considerable doubt. We will, therefore, focus on migration and its interactions with the other elements of globalization as they impact development. In this context, we will find it useful to distinguish between the costs and benefits to the O and D countries while differentiating between the movement of skilled and unskilled migrants. The first section concentrates on the movement of the unskilled and its relation to the other dimensions of globalization, while the second attempts the same with respect to the skilled. The final section suggests some conclusions for policy within the same broad globalization framework.

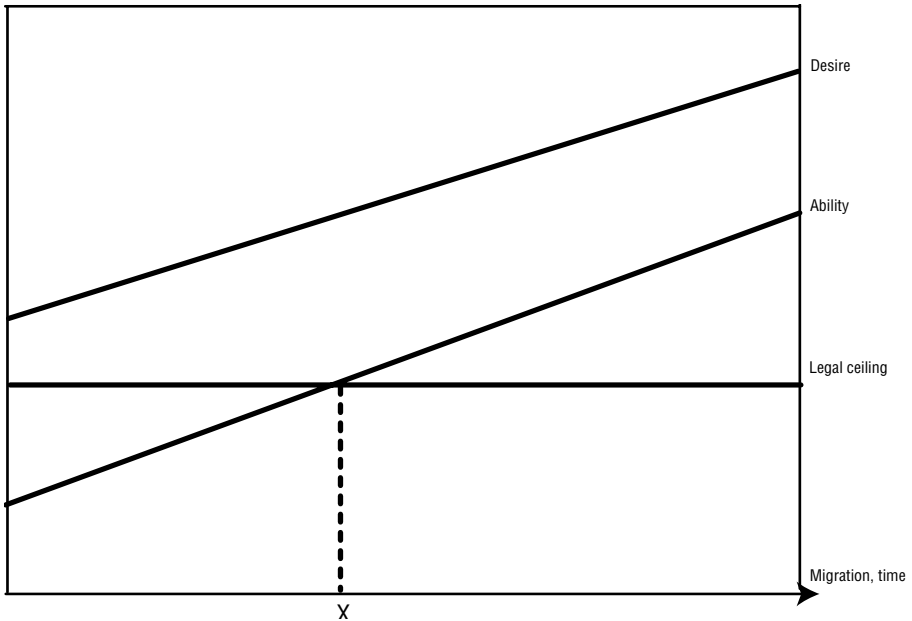
Migration of the Unskilled

The unskilled migrant represents the largest potential benefit to global welfare even as the distribution of gains between O and D countries remains controversial. The desire to migrate by the unemployed, underemployed, and those employed at very low incomes in developing countries is a function of the availability of information, geographic distance, gaps in prospective lifetime incomes, and the perceived probability of gaining employment in the D country. The ability to migrate, on the other hand, depends on some combination of family income levels, access to credit markets, government support, the extent of diaspora corridors abroad, and the level of entry barriers erected by the D countries. As indicated in Figure 1, picturing Mexico as a typical case, we can expect the desire to migrate to dominate both the private ability to do so and the D countries' barrier levels. In some O countries, such as the Philippines, the government may step in by providing both information and financial support in return for the promise of enhanced remittances, which tends to shift up both the desire and ability curves. However, to the extent that immigration barriers remain the dominant constraint (X marks the actual level of migration), there will be increasing pressure to attempt illegal entry.

The benefits of unskilled migration are clear to the O country. Given that the O country is likely to find itself in a labor surplus condition, the withdrawal of even substantial numbers of unskilled workers from meager-paying rural or, more likely, urban informal business sectors is not likely to affect output significantly. Indeed, given the probability of family subsidization of underemployed relatives, plus positive adjustments in technology as a consequence of such departures, productivity is likely to rise and poverty to decline.

The O country accrues other substantial benefits. Chief among these is the receipt of remittances, which not only substantially enhance family incomes but also have important dynamic spillover effects. Such receipts are likely to encour-

Figure 1
The Mexican Case



SOURCE: Author's calculations.

age additional entrepreneurial and investment activities by those left behind and, probably as important, innovative activities by returning migrants who have had new windows and contacts opened to them while abroad. This is especially true since the D country is likely to be a more advanced market economy. But even in relatively advanced, developing O countries such as Pakistan, which has sent temporary migrants to the Middle East, evidence from its North-West Frontier Province has shown that returned migrants make important entrepreneurial, human capital as well as financial capital contributions.

Mexico, for example, receives \$20 billion to \$25 billion in remittances annually, exceeding FDI flows (\$18 billion in 2004) and providing an estimated 20 to 30 percent of its microenterprise capital (Woodruff and Zenteno 2007). In 2000, unskilled workers in the U.S. earned roughly six times more than unskilled workers in Mexico (Freeman 2006). An individual's average annual gain by moving to the U.S. is thus estimated at \$10,000, which, over a working life, amounts to a roughly \$250,000 differential—clearly undergirding the desire to migrate, substantially above either the ability to migrate or the legal barrier put up by

the U.S. The Philippine case is not too different, except that the government has been more directly involved in supporting emigration via the provision of information and credit advances. Between 1975 and 1986, the number of Philippine contract workers moving to other parts of Asia increased from 4,200 to 76,650, and those moving to the Middle East rose from 1,552 to 262,758.¹ In 2003, remittances amounted to 10.2 percent of GDP, up from 2.7 percent in 1990.² Globally, remittances reached \$150 billion in 2004, almost three times ODA, with an estimated additional \$50 billion underreported (Maimbo and Ratha 2005). In some O countries, remittance flows have risen to 40 percent of export earnings and 20 percent of GDP. These flows have clearly helped reduce poverty rates and had an equalizing effect on the distribution of income.

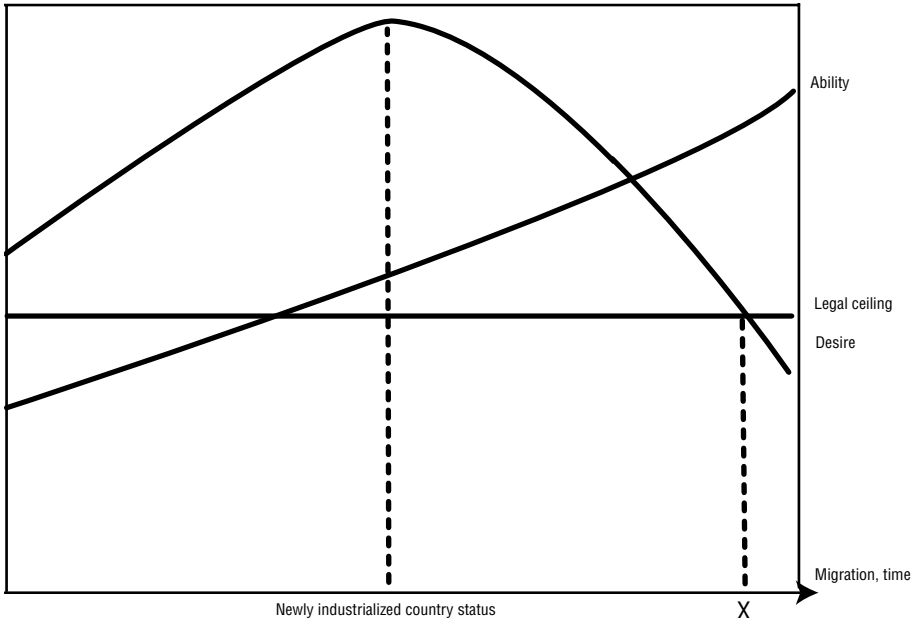
Remittances, as well as capital inflows such as ODA and private capital, substitute for unskilled labor migration. To the extent such inflows generate equitable growth, the income gaps between the O and D countries will decline and the desire to migrate will fall even as the ability rises. If after some time the country is successful in reaching East Asian newly industrialized country status, or Kuznets' (1973) epoch of "modern economic growth," the D country's import barriers will at some point, beyond X, no longer be binding (*Figure 2*).

Remittances have additional advantages in comparison with other types of capital inflows. For one, they are likely to be more dependable, fluctuating less. For another, they are likely to be countercyclical, increasing in times of economic decline or natural disasters, while other types of private capital often act cyclically. Moreover, remittances are less likely to cause Dutch disease problems, either of the narrow or the extended variety,³ because they typically are broadly dispersed and frequently end up in the hands of rural and urban-informal sector families. With respect to the traditional, narrow variety, that means remittances are less likely to cause a strengthening of the currency and a shift from exportable to nontraded goods—especially if they are used for entrepreneurial investment rather than purely consumption activities. Turning to the extended variety, which we define as the political economy consequence of capital inflows that tend to take the pressure off and permit governments to avoid reforms, remittances again are much less likely than foreign aid to be a source of reform obstruction and the object of rent-seeking and corruption.

The most important substitute for unskilled labor migration is trade, which incorporates such labor in the form of labor-intensive commodities that are sent to the D country under the radar. Unfortunately, while trade has virtually exploded in the postwar era, early liberalization efforts have recently tended to run out of steam, and neoprotectionist measures such as antidumping provisions and exemptions from preferences, targeted especially at textiles, shoes, and other labor-intensive commodities, have been on the rise.

In addition to capital and trade movements, a substitute for unskilled mi-

Figure 2
The East Asian Case



SOURCE: Author's calculations.

gration is the inflow of technology, especially if it is adaptable to the more labor-abundant environment of the O country and thus enhances the potential of keeping unskilled labor productively employed at home or embodied in exports. Indeed, I would place much more weight, whether discussing the impact of migration, trade, or capital, on such dynamic dimensions rather than on static comparative-advantage and efficiency criteria.

In summary, various other dimensions of globalization can act as substitutes for unskilled labor migration. Moreover, the economic benefits of such migration for the O country are overwhelmingly clear. On the negative side of the ledger, we can record the not-inconsiderable social costs incurred as a result of prolonged family separations as well as the risks of exploitation and ill treatment of migrants, temporary or permanent, in the D country.

Turning to the benefits and costs of unskilled migration with respect to the D country, the situation is somewhat less clear. The arrival of "cheap labor" from abroad is usually greeted by much more political flak than the arrival of "cheap goods" incorporating "cheap labor." Yet both serve the interests of dispersed D

country consumers because the former may encourage the survival, at least for a time, of relatively sick or defensive industries, while the latter directly enhances consumer welfare. The other benefit, increasingly recognized, especially in rich D countries suffering from low birthrates, is that large-scale migration by overwhelmingly young workers is necessary to help support the welfare and safety-net packages of the indigenous elderly population. We can safely assume that such pressures in the future will be even greater because of continuously falling birthrates and rising life expectancies. It is, moreover, a fact that there are jobs at the lower end of the occupational totem pole, mostly in agriculture and personal services, which D country workers are reluctant to take and which have been increasingly filled by unskilled immigrants. In this important sense, unskilled immigrants are substitutes for capital, increase labor force participation rates, and thus enhance the D country's productive capacity.

Nevertheless, resistance to the admission of unskilled migrants continues to be formidable in almost all D countries. The key objection, emanating mainly from unions and their political allies, focuses on the cost in terms of lowering indigenous unskilled worker wages, as we would expect from economic theory. Nevertheless, what empirical evidence we have casts doubt on the robustness of this effect. David Card (2001), for example, examining such national experiments as the Mariel boatlift and Algerian inflows into France, finds only relatively minor negative wage impacts on earlier migrants and virtually none on indigenous unskilled workers. All in all, from a global welfare point of view, unskilled migration from poor to rich countries seems to have large benefits for both sides; yet, it is clearly the most controversial and most restricted of all globalization flows. Here, politics and both intentional and unintentional misperceptions decidedly trump economics.

Migration of the Skilled

When we attempt to examine the costs and benefits for both the O and D countries of high-talent labor migration, the story is quite different. The benefit to the O country is still the contribution such migrants make to the volume of remittances, although the spending pattern of these somewhat more well-to-do left-behind families is likely to be somewhat different—more oriented toward additional consumption than investment. Still, on the benefit side, skilled migrants are likely to stimulate others in the O country to seek additional education in preparation for future migration, thus increasing the average level of education. Moreover, there is a good chance that such migrants will ultimately return once the home country has reached a certain level of income and opportunity. This has certainly proven to hold in the cases of Korea, Taiwan, and India, with engineers, informa-

tion technology specialists, and others leaving Silicon Valley and its equivalents, returning home—sometimes after many years—and contributing in a major way to the growth of high-tech industries in the O countries.

But there are also costs to be considered, especially in the short run, when a poor O country loses valuable human capital in which it has invested substantial educational expenditures. This perverse movement of human capital—from poor to rich countries—has occasioned much discussion and policy debate in the past, including Bhagwati's (1976) suggestion of an exit tax and equally unimplemented efforts to restrict long-term stays abroad by legal/contractual means.

While high-talent manpower is clearly needed to support the O country's development efforts, all too frequently the educational structure's yield is not suited to the needs of the contemporary economy, creating a mismatch with potentially explosive political consequences. A well-known case is the highly skilled unemployed in Sri Lanka. In such circumstances, unless the domestic educational production function can be reformed so that the output is better suited to the developing country's needs, emigration may provide the only possible escape valve. On the other hand, there are cases, including the Philippines, where it is official policy to generate skilled labor—in this instance, doctors and nurses—specifically for purposes of export and remittances. This is seen not as a cost but as a benefit to society.

In the D country, where unskilled immigrants can generally be viewed as substitutes for capital, skilled labor is likely to constitute a complement to the rich country's capital, both physical and human. While D country immigration barriers are therefore usually friendlier to skilled immigrants than to the unskilled, empirical evidence indicates that the negative impact of such arrivals on the incomes of their indigenous counterparts is likely to be larger than what we find for the unskilled.

Unless the skilled arrivals fill a particular, relatively poorly serviced, non-competitive niche or, in a dynamic context, are in a position to help generate new economic activities, they ultimately represent a greater threat to the income levels of their domestic counterparts than the unskilled do. Nevertheless, given their modest numbers and a relative absence of union opposition to their arrival, skilled immigrants are likely to meet much lower political resistance. Moreover, the recognition that they help overcome specific shortages and/or provide entrepreneurial energy and generate precious technology change, especially in the knowledge industries, is more likely to carry the day, certainly in the more dynamic D countries. In the case of the U.S., for example, it has been estimated that a 10 percent increase in the number of foreign graduate students raises patent applications by 4.7 percent, and we all know of the contribution of Chinese and Indian migrants to the science and technology explosions in Silicon Valley.

Conclusions for Policy

It should be abundantly clear that the enhanced south–north migration of both unskilled and skilled individuals would not only increase global welfare but would almost certainly benefit both the O and D countries. At present, since migration is clearly the most constrained of the various dimensions of globalization, it also offers the greatest potential for future gains. This potential emanates not only from the fact that it is a static substitute for or complement to the other elements of globalization but also because, as we have noted, it has a potentially important, dynamic catalytic impact.

International trade has exploded since 1950, rising twenty-five fold, much faster than per capita income. Even if the Doha Round cannot be resuscitated, we can expect trade to continue to grow—if at somewhat lower rates—since it is generally recognized to represent a positive sum game even if the gains are not equitably distributed, as between north and south. The arrival of foreign capital, shifting from ODA in the immediate postwar era to private flows, can also be expected to continue to expand. The same can be said of the transfer of technology, even though trade-related property rights issues do still need to be sorted out.

The most obvious policy conclusion, but also the most difficult to implement, would be for the D countries to lower their barriers to migration, especially those curbing the unskilled labor variety. When domestic producers and labor unions in the so-called sunset industries feel threatened by a combination of technology change, competitive imports, and the arrival of migrant workers, it is usually the last—more visible and threatening—that is likely to bear the brunt of restrictive actions. While politics here is usually in a good position to trump rationality—just as it is with the traditional emphasis on reciprocity in trade liberalization negotiations—nowhere else is the problem as pronounced as in the realm of international migration. The resistance is usually more modest to the flow of skilled immigrants because they can be defended as net helpful to the local economy. Even as pressures mount to accept more immigrants, whether for demographics, business interests, entrepreneurial renewal, or job characteristics, most rich D countries, including Japan and the U.S., prefer to close one eye to illegal immigration rather than lower official barriers. This holds generally in spite of the serious humanitarian and rule-of-law-related side effects. The recently passed U.S. immigration legislation, focused on penalties and border fences, can be seen as a response to this general attitude.

Multilateral negotiations to reduce migration barriers have never been tried. Given the convergence of issues relating to trade and immigration, such a function might sensibly be lodged in the World Trade Organization. With services now included in WTO negotiations, this would represent a rational extension—especially when migration is increasingly perceived as a potential benefit to both

rich and poor countries. Though there are legitimate worries about further overloading that body, this would appear to be a better option than working with the toothless International Organization for Migration—or creating yet another new look-alike institution.

A second policy option, emphasized in the 2005 report of the United Nations Global Commission on National Immigration, would be to generalize member countries' "best practice" related to guest worker arrangements. For example, it recommended multilateral consideration of a South Korean program forcing temporary migrants to deposit a proportion of their earnings in a special savings account that is forfeited if "temporary" threatens to become "permanent."

A third policy option would be the installation of a much more effective trade adjustment-assistance program in D countries so that, given the simultaneous arrival of immigrants and imports, affected domestic workers could be retrained and moved into "sunrise industries." Discussion during the WTO Hong Kong Ministerial Conference in December 2005 suggested focusing ODA more on the facilitation of trade. Such an initiative could include moving toward a global trade and migration adjustment-assistance program that is administered by the World Bank or the WTO, financed mainly by D countries' ODA contributions, and follows multilaterally negotiated rules of the game. Foreign aid spent at home in this fashion is likely to yield a higher return to D country taxpayers. Inevitably, when all is said and done, elements of globalization can lead to some job losses in the D countries. The reaction has varied from minimal state intervention in the form of a rather ineffective adjustment-assistance program, plus a rather flexible labor market, in the U.S. to substantial public purse support combined with strict government controls over the labor market in France. Perhaps the best model may be found in Denmark, which combines a generous public safety net with a relatively flexible labor market. But since all, especially emerging, countries will not have the same budgetary capacity, assistance from outside may be warranted. Even in the absence of major changes in the international rules of the game, O countries can provide systematic information and even financial support to potential migrants, both temporary and permanent, as in the case of the Philippines. Improving credit access may serve to reduce the demand and simultaneously enhance the ability of unskilled would-be migrants to move—thus reducing the potentially explosive gap previously referred to.

One way to be helpful in this regard is by facilitating the flow of remittances, which can make important financial as well as entrepreneurial contributions to the O countries' development while incurring much smaller risks than other capital flows with respect to either the narrow or broad definition of Dutch disease. Given the rapidly increasing realization of remittances' importance to both parties, special efforts should be made to reduce exorbitantly high remittance transfer fees in the D countries.

But, ultimately, the only reliable way to reduce expected lifetime income gaps between individuals in the O and D countries is to enhance participatory, or labor-absorbing, development in the former. With Mexican immigrants to the U.S. benefiting to the extent of approximately \$250,000, a reduction of such huge expected income gaps for an individual Mexican and, as important, for his or her children, undoubtedly is required. And that, in turn, requires successful development in the O country—mainly a domestic affair but one that can be assisted from the outside. How to do this effectively extends beyond the scope of this paper.⁴

Notes

¹ Philippine Overseas Employment Administration, www.poea.gov.ph/default.htm.

² International Organization for Migration, www.iom.int/jahia/jsp/index.jsp.

³ In general, the term Dutch disease refers to the case where a sudden appreciation of a country's currency renders the (tradable) manufacturing sector less competitive and leads to a decline in manufacturing output and employment (de-industrialization). This phenomenon was first observed in the Netherlands in the 1970s, where the discovery of a major natural gas field caused a sudden and strong appreciation of the Dutch exchange rate and subsequent decline in manufacturing activity.

⁴ See, however, Ranis (forthcoming).

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