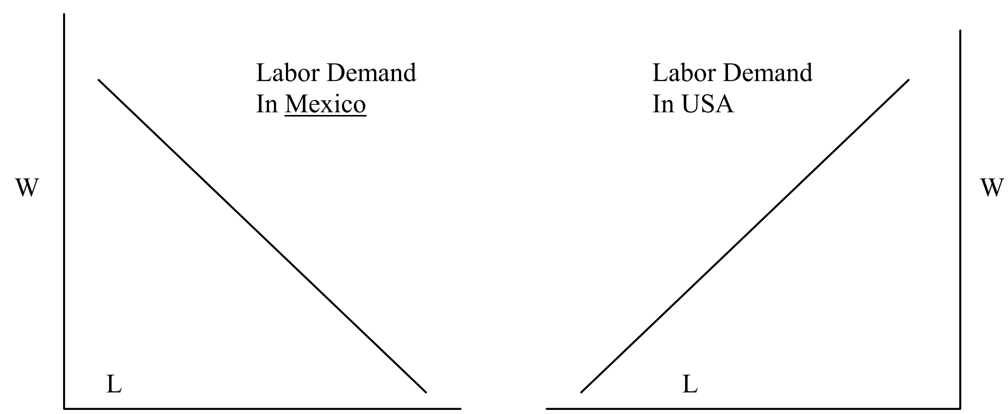
Lecture 19
Factor Movements, continued
Foreign Investment and Migration

I. Concluding Comments on direct foreign investment and outsourcing

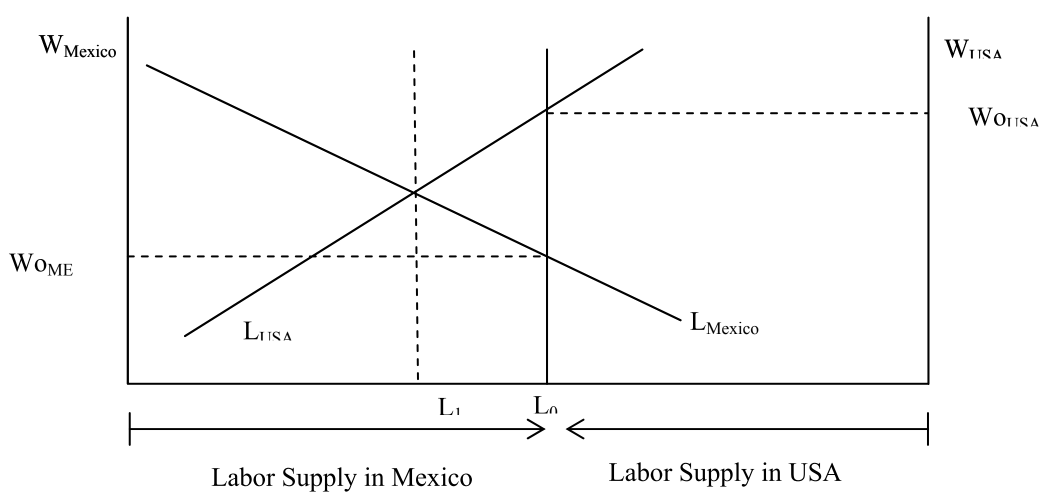
II. A Framework for examining Immigration.

Motivation: we saw that we can predict what types of goods will be successfully exported by specific countries or regions based on natural resources, labor endowments, and technological edge. An alternative way to achieve similar ends is to allow labor to move across countries. Here we present a simple model to predict the pattern of labor movement. We will then examine data on the determinants of immigration from Mexico. Finally, we will examine the impact of migration, if any, on US wages. Although we will focus on the US, this analysis could also be applied to other regions, such as Europe.

Demand for labor is like demand for any other good. We can show that the demand for labor (L) is a decreasing function of wages (w):



Let's assume that Mexico has more unskilled labor. Let's also assume that trade is not allowed. Where will wages settle? What will happen if migration occurs?



If migration is allowed, workers move from the low wage to the high wage country. The international allocation of labor moves from L0 to L1. Wages are equalized (for unskilled labor) across the two countries. If differences in wages reflect the fact that workers are less productive in Mexico, then the movement from the low productivity to the high productivity environment will mean a global increase in output.

Testing the model:

Attached is evidence showing relative wages for unskilled workers in Mexico and the US over the last 23 years. The data suggests the following:

(1) Extremely large changes in relative US-Mexican wages real wages. All of the movements are driven by large fluctuations in Mexican real wages, which are in turn driven by fluctuating prices and exchange rates, rather than nominal wage changes.

(2) Both series show a long term decline. In both the US and Mexico, real wages for production workers are falling. In Mexico, however, the trend is very erratic, making it difficult to predict labor costs in the long run.

(3) The best measure of migration available is the number of apprehensions at the border. These are indeed highly negatively correlated with the wage gap between Mexico and the US. As the gap has widened, in-migration into the US has increased. Of course, apprehensions have also increased with the amount of patrolling done at the border.

The evidence does suggest that wage differentials give rise to migration into the US of unskilled labor. In principle, this should mean that we gain a comparative advantage in producing goods which use unskilled labor, substituting the movement of labor for the movement of goods.

The second question: do US wages fall when migration rises (do Mexican wages rise?)

The surprising answer is no. Only in the Mexican border towns do we see the expected adjustment....

Bottom line: It is important to understand the factors that could motivate the movement of labor (primarily differences in wages). Although evidence suggests that these movements of labor may not affect host country wages as much as is popularly believed, there is no doubt that in-migration can help local businesses. One third of agricultural labor in California is estimated to be illegal, the other two-thirds is also migrant, but legal. In addition, rapidly growing manufacturing industries tend to use more immigrant labor. Clearly, business in the labor scarce country has an incentive to promote freer movement of labor, while interests in the labor abundant country may have an interest in restricting it.

For political reasons, labor movements are frequently limited. Some politicians in France have built their entire political careers on restricting immigration.