CHAPTER 7

INTERNATIONAL FACTOR MOVEMENTS

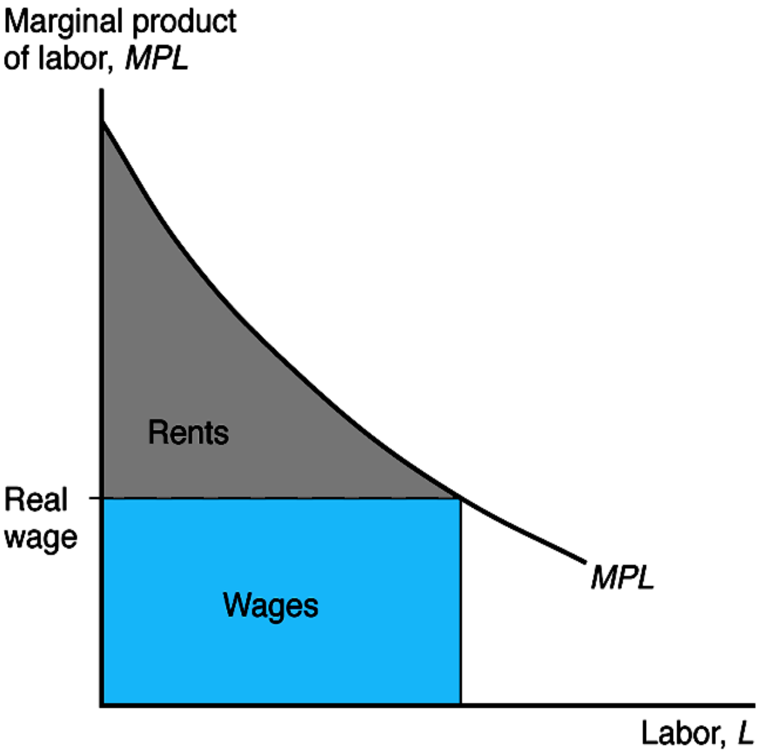
by Richard Baldwin,
Graduate Institute of International Studies, Geneva

International Factor Movements

- Deep economics of factor movements are very similar to HO model; viz. factor content approach.
- Politics is very different
- Labour and Capital are two main ones.
- Start with labour migration.

International Labour Migration

- Krugman works with a very simple model:
  - 1 good in the world, 2 nations and 2 factors (T and L).
- In Auky (no trade in goods or factors), we have the usual division of output between T & L.
- NB: since there is only one good:
  - we can normalise its price to 1, so MPL=VMPL
  - and the nominal wage = real wage.

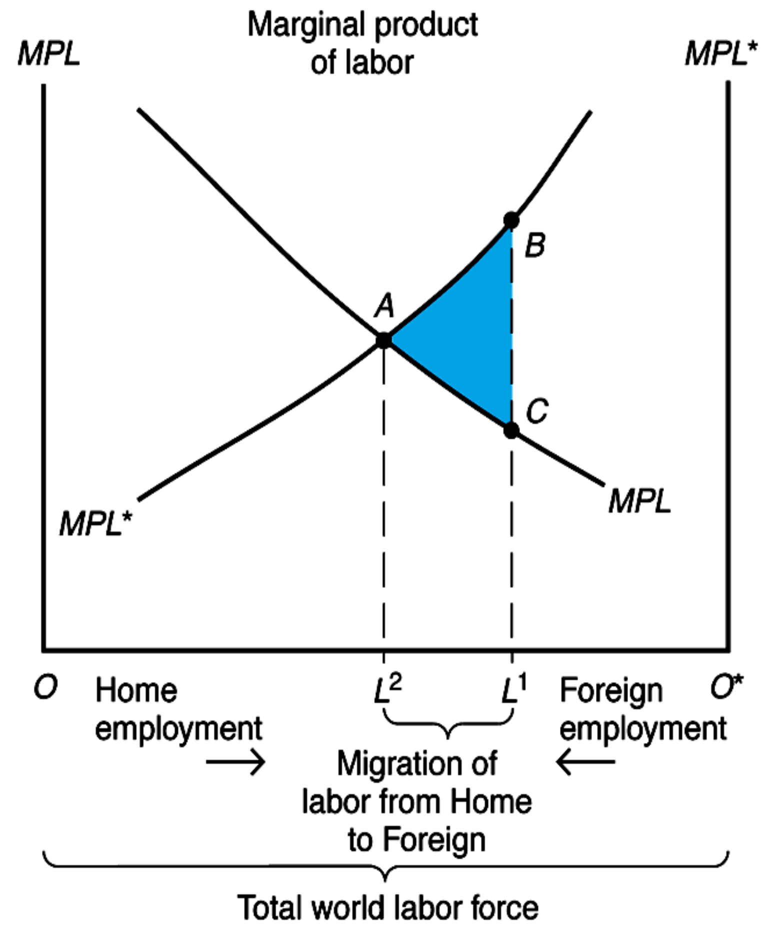


International Labour Migration

- Now move from auky in gds & factors to perfect labour migration but no T migration.
- We can use a beaker-like diagram to study the outcome.
- Foreign starts with a higher T/L endowment, so its real wage is higher in auky.

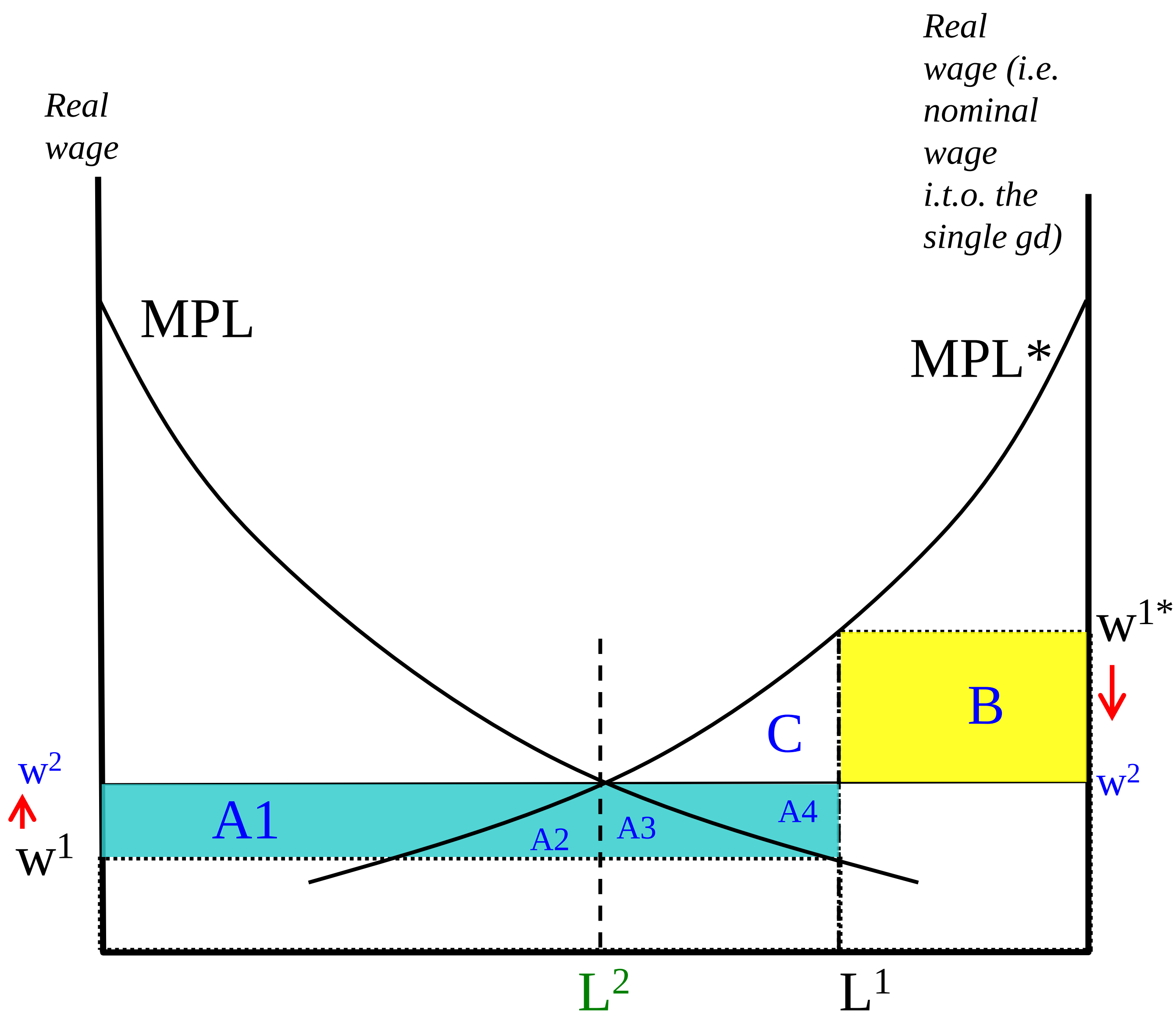
International Labour Migration

- Free migration results in Home-to-Foreign migration.
  - Real wage in Home rises, in Foreign falls.
  - Total output of world economy rises by gap between MPL Home vs foreign.
    - Usual marginal reasoning.
- Closer look at the gains & pains of migration …



International Labour Migration

- Real wage in For. ↓, so For. L loses B.
- Real wage in Hom. ↑, so Hom. L wins A1+A2+A3+A4.
- For. T gains B+C.
- Hom.T loses A1+A2+A3
- The GFT go to For.T (C) and Home L (A4).



International Labour Migration

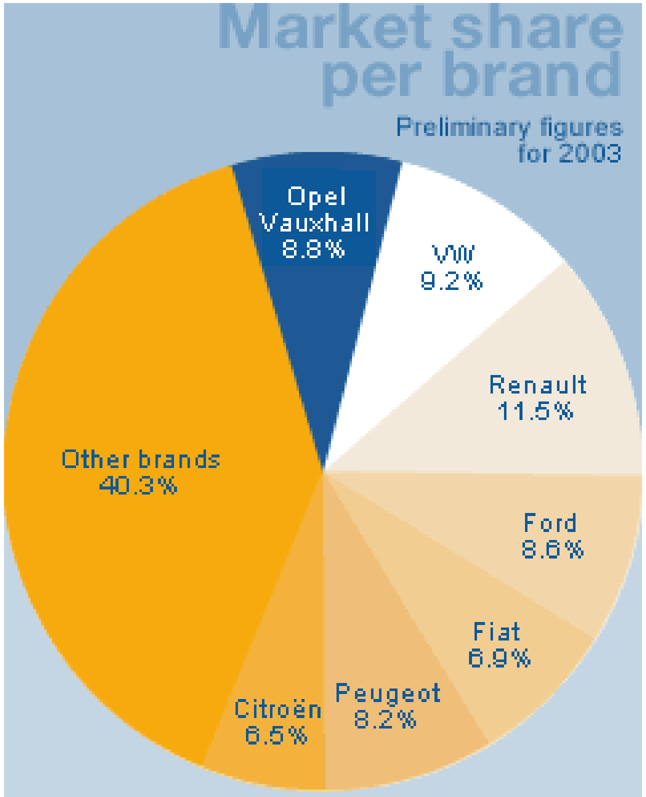
- Here we see a natural tension between T & L in the labour scarce country.
- Labour wants to keep itself scarce (high priced), and T wants cheaper labour.
- There is also a conflict in the out-migration nation, but this rarely arises since few nations place restrictions on out-migration of workers.
  - Gov't in out-migration nations often tax the remitted earnings and so benefit budgetary from migration.

International capital movements

- Ignore section on ‘international borrowing & lending’, or skim; this is not an important trade topic but is critical in the field of international macro economics (i.e. if you were going to work for the BIS or IMF).
- Foreign direct investment (FDI) & Multinational Corporations (MNCs)
  - Important role in trade.
  - In US, about half of imports involve sales between related firms (i.e. the foreign-based exporting firm is related the US-based importing firm).
  - MNCs play large role in politics of globalisation.
  - Frequent users/targets of WTO law.

MNC theory

- Krugman is very lite on the theory of MNCs.
- Basic logic can be seen by questioning the example of US auto firms producing in Europe.
- Opel is owned by US firm GM and sells many cars in Europe.



MNC theory: the 2 questions

- Why doesn't GM make the cars in the US and ship them to Europe?
  - Trade costs, broadly interpreted.
- So, there is a reason to make these goods in Europe instead of the US, but why is Opel owned by an American company instead of a European company?
- Theory of MNCs focuses on 2 questions:
  - Why are production facilities located in many nations?
    - This is the 'Multinational' part of MNC.
  - Why are these production facilities owned by a single firm?
    - This is the 'Corporation' part of MNC.

The 2 questions: answers

- Why are production facilities located in many nations?
  - This is answered by any of the many trade theories we have; note that transport costs are an important consideration, especially when nations have similar c.a. (i.e. the costs of production are not very different, so there is little cost-incentive to concentrate production in one place).
- Why are these production facilities owned by a single firm?
  - This is answered by 'theory of the firm'. One of the most common is that the corporation has some firm-specific knowledge that it does not want to license or sell to others.
  - FDI allows the firm to exploit its knowledge without losing control of that knowledge.

MNCs, advantages approach & gains from investment

- The fact that an MNC finds it advantageous to produce in another nation and to own that facility suggests that the MNC has certain advantages over host-nation firms.
  - Typically know-how of some sort.
- This suggests that MNCs bring with them something positive for host nation.
  - Basic belief that MNCs are good.
  - Contrasts with 1970s view that they were bad.
- Nevertheless, host nation gov'ts should be aware that MNC and national interests are not always aligned and MNCs are not operating in a perfectly competitive environment.

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