

# Problem Set 4: Movements of labor and capital between countries

1. Assume that Portugal receives an inflow of FDI. Suppose two factors (labor and capital) are used in the production in two industries (shoes and cars). Further assume that cars are capital intensive relative to shoes. Use the HO model to answer the following questions.

a) What happens to the equilibrium output of each good?

b) How does the wage change in terms of shoes and cars?

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1. Assume that Portugal receives an inflow of FDI. Suppose two factors (labor and capital) are used in the production in two industries (shoes and cars). Further assume that cars are capital intensive relative to food. Use the HO model to answer the following questions.

a) What happens to the equilibrium output of each good?

Output of cars increases, while the output of shoes falls.

b) How does the wage change in terms of shoes and cars?

Since Portugal is a small open economy and takes international prices as given, nominal and real wages do not change with FDI.

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2. Consider the HO model for a country producing two products (digital cameras and shirts) using capital and labor.
  - a) Which good would you expect to be capital intensive? Which good would you expect to be labor intensive?
  - b) Suppose that foreign owners of domestic capital decide to decrease their investment. Does output in each industry increase, decrease, or stay the same? Do wages increase, decrease, or stay the same in each industry?
  - c) Suppose now that there is an influx of refugees. Does output in each industry increase, decrease, or stay the same? Do wages increase, decrease, or stay the same in each industry?

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2. Consider the HO model for a country producing two products (digital cameras and shirts) using capital and labor.

a) Which good would you expect to be capital intensive? Which good would you expect to be labor intensive?

Digital cameras would be expected to be capital intensive, shirts would be expected to be labor intensive.

b) Suppose that foreign owners of domestic capital decide to decrease their investment. Does output in each industry increase, decrease, or stay the same? Do wages increase, decrease, or stay the same in each industry?

Assuming that the country is a small open economy. Output of digital cameras would fall, output of shirts would increase. Wages would stay unchanged.

c) Suppose now that there is an influx of refugees. Does output in each industry increase, decrease, or stay the same? Do wages increase, decrease, or stay the same in each industry?

Assuming that the country is a small open economy. Output of shirts would increase, output of digital cameras would fall. Wages would stay unchanged.

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3. For some low-income countries, remittances account for a larger source of income than foreign aid. Should these countries have policies to encourage emigration? Explain.

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Remittances are an important source of income for some low-income countries. So encouraging emigration would likely increase such income.

But emigration might also have adverse effects:

- Brain drain (although remittances might help increase education of those that stay)
- Labor scarcity
- Non-economic costs

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Competition for FDI takes place both between developed and developing countries.



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5. Which policy options do countries have to promote inward FDI flows? Which are more likely to be effective? Explain.

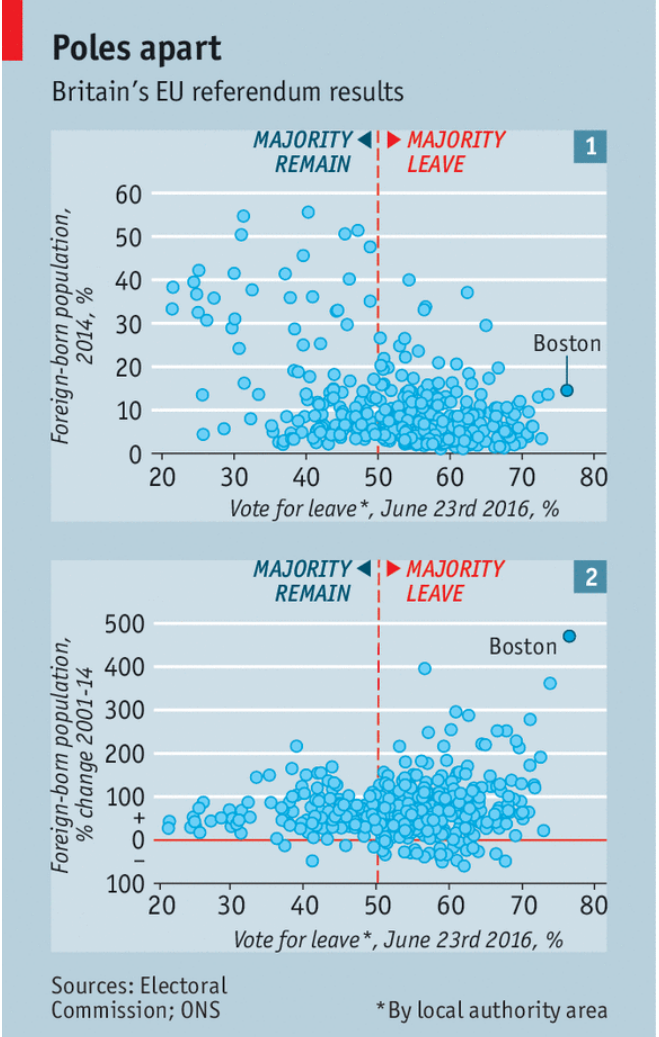
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5. Which policy options do countries have to promote inward FDI flows? Which are more likely to be effective? Explain.

- Stable macro and institutional environment
- High-quality education
- Low taxes on capital
- Investment promotion agencies
- Rapid and fair justice system, low corruption

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6. Consider the figure below. How can you rationalize the evidence presented there? Does economic theory and empirical evidence support negative attitudes towards immigration in some high-income countries? Explain.



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6. Consider the figure below. How can you rationalize the evidence presented there? Does economic theory and empirical evidence support negative attitudes towards immigration in some high-income countries? Explain.

- Some limited evidence of negative wage effects on wages of native unskilled workers
- Seems insufficient to drive attitudes overall, but may be more important in some locations
- Immigration also has several positive impacts
- Non-economic factors may play an important role in driving perceptions