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A MORE PEOPLE-ORIENTED GLOBALIZATION FOR THE 21ST CENTURY

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Introduction

Economists have long expounded upon the mutually beneficial gains that can be enjoyed among economies that open their borders to international trade in goods and services. For similar reasons economists have also emphasized the advantages of enhancing the freer flow of the inputs that are used in the production of goods and services, most notably capital investment assets. However, there is an important factor of production that has received far less attention in the arena of international economics and globalization, namely labor. As we will argue here, greater openness to international labor markets can potentially provide for a new era of globalization that turns out to be more people-oriented, and provides an opportunity to alleviate a number of difficulties that have been associated with globalization to date.

The relatively meager attention devoted to the study of international labor flows is not for lack of recognition of the importance of labor and the likely enormous gains that could be enjoyed from an international political environment that better fosters the flow of labor input across international borders. For example, in a recent essay on the subject of feasible globalizations, Harvard economist Dani Rodrick (2002) argues that even small temporary work visa schemes amounting to no more than 3% of wealthy country work forces could easily result in gains worth \$200 billion per year for developing economies alone, and as we discuss below, this accounts for only one channel of the most obvious and immediate gains.

Rather, the greater attention paid to international openness to trade in goods and services and capital investment assets stems for the most part simply from historical precedence. The starting point in much of traditional international economic analysis considers the return to trade in outputs and capital inputs while treating labor as internationally immobile - perhaps for good reason. It is difficult enough to persuade governments to foster greater openness to trade in outputs and capital inputs even when these are in the interest of overall national welfare if there are specific industries and sectors of the economy that resist. The political economy of increased openness to labor markets can be fraught with even greater difficulties, particularly when domestic labor markets are

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fairly rigid. For example, if not properly managed, a system of enhanced international labor mobility has the potential to increase unemployment pressure in some sectors at the same time that it alleviates pressure in other sectors. We discuss in further detail below some of the practical difficulties and obstacles to greater international labor mobility.

Notwithstanding the difficulties, the global benefits that can be obtained from creating a social, economic, and political environment in which increased labor flows across borders are made possible are potentially staggering in breadth and magnitude. Aside from the most obvious gains that come from the increased efficiency of allowing labor to flow to where it can be most productive, there a number of other important considerations. For example, enhanced international labor migration can also provide relief for the serious solvency issues that many developed economies with falling birth rates anticipate for their social retirement and social welfare programs over the next decades. Perhaps most importantly, the long run growth implications of enhanced openness to labor flows is potentially very different from that of capital flows or trade in goods and services. Under ideal situations, all of these tend to enhance growth prospects for the countries involved. But what is potentially distinct about openness to labor flows is that it creates prospects for growth such that, not only do all countries grow faster, but also the incomes in the poorest countries are able to catch up with those of the wealthiest countries.

In this sense globalization that includes increased openness to labor mobility is potentially associated with a much wider dispersion of the gains from international economic exchanges. In an era of potential backlash against globalization, this may be essential in determining whether the process of globalization will succeed in enhancing the welfare of economies around the world. In what follows we elaborate briefly on these ideas.

Potential Benefits from Enhancing Labor Flows Internationally

From an economic point of view there are numerous benefits that can be obtained from creating a social, economic, and political environment in which increased labor flows across borders are made possible. Some of the most significant of these are outlined in what follows.

Traditional static gains from increased efficiency

As we have already mentioned, the traditional efficiency gains alone are likely to be enormous if countries allow for greater international labor mobility. These gains stem from the fact that if workers are allowed to move from areas where they are less productive to areas where they are more productive, the efficiency of production increases in both the location they have left as well as the location where they have arrived. The economic principle is simple, and is the same one that motivates gains from other forms of trade. For example, if labor of a certain type is abundant in one part of the world but scarce in another part of the world, then a more productive allocation will be accomplished if workers flow from the area where they are abundant to the area where they are scarce. They are naturally inclined to do so since their wages will be higher in the area where they are initially scarcer. The mechanism is completely analogous to the way in which capital assets should flow to areas of the world where the risk-adjusted rate of return is highest.

To get a sense of the magnitude of the likely gains obtained from trade, economists compare the inflation-adjusted price differentials across countries. When comparing real, inflation-adjusted wages for various types of workers in different countries, it is clear that the differentials are far larger than the corresponding differentials between the real, inflation-adjusted prices of goods and services, or the risk-adjusted real rates of return on capital. This is why studies such as Rodrick (2002) estimate that the gains from increased openness to trade in goods and services and trade in capital assets pale in comparison to the potential gains that could be obtained from more open labor markets internationally.

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Dynamic gains from increased international labor mobility; “Catching up” growth rather than divergent growth

Another very important consequence of greater international labor mobility is the impact on how economies grow over time, and whether growth rates of the poorest countries will be fast enough for their per capita incomes to eventually catch up with wealthier economies. For example, over the past several decades, it has been the case that almost all countries of the world have experienced growth in per capita incomes. Openness to international trade in goods and services and capital assets has no doubt facilitated this in part. However, it has generally not been the case that the poorer countries have been able to grow fast enough to catch up with the wealthier countries, and in many cases the differences in standards of living have actually become greater.

Increased international labor mobility has the potential to permit growth to occur in a way that allows poorer countries to grow fast enough to catch up with the incomes of wealthier countries. The key insight for this comes once one recognizes that imbedded in labor are the skills, experience and education that economists refer to as human capital and the idea that these features tend to produce positive spillover effects known as externalities. This is an aspect of economic growth that the Nobel Prize-winning economist Robert Lucas, from the University of Chicago, emphasized in his seminal work, Lucas (1988, 1990), on the underlying reasons for economic growth. As Razin and Yuen (1995, 1997) demonstrated in a subsequent series of theory papers, there is also good reason to believe that under these conditions, capital mobility will tend to induce growth rates to equalize in the long run, but only labor mobility that allows workers to move to where they are most productive can induce per capita incomes to catch up in the long run.

An interesting casual observation is to compare the historical experiences of the states of the U.S., the countries of Western Europe and the provinces of China as each of these regions of the world has developed. Taken as a group, the states of the U.S. can be viewed as individual economies that are highly integrated. Trade of goods and services across individual states of the U.S. is almost completely unrestricted, and the flow of capital and labor is likewise almost completely mobile

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among states of the U.S. While some states have higher per capita incomes than others do, historically the poorest states have never been able to lag that far behind the wealthiest states and the differences between states have tended to diminish over time rather than grow wider. Few economists would argue that growth in high per capita income states such as Connecticut has been restrained by the fact that labor is free to flow from traditional lower per capital income states such as Maine, and conversely, few would argue that the growth in Maine is hampered by the fact that labor is free to flow between Maine and Connecticut. Rather, both states enjoy faster rates of growth, and the extent to which their per capita incomes can differ is greatly limited by the fact that labor is free to flow among states of the U.S.

China offers a unique and interesting example of a fast growing economy at the other end of the spectrum. Since the economic reforms of the late 1970's, China's economy has increasingly opened its economic markets to trade with the rest of the world. It has also greatly liberalized its capital markets and has engaged in dramatic reforms over the last few decades to become a market oriented economy. However, what is unusual about China in this context is that until recently China had in place a system that greatly restricted the movement of labor across many of its provincial borders. This has had an important consequence for China. Although many of the provinces have enjoyed rapid growth rates during this period, regional incomes diverged such that difference between the highest income and lowest income provinces has continued to grow wider. These regional differences in income levels have been a significant source of tension for China, and only in the last few years as restrictions on labor mobility have been lifted has the regional divergence started to reverse itself so that the poorer provinces are now growing at a fast enough rate to begin catching up with the wealthier provinces.

Finally, the countries of Western Europe offer an interesting intermediate case. Nominally, labor has been free to migrate across national borders in Europe. However, in practice labor mobility is substantially restricted relative to the U.S., due in large part to the fact that pension plans and other national entitlements are not easily transferable across the countries of Europe as they are across the states of the U.S. The lesser degree of labor mobility may help to explain in part why the differences

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between the poorest and wealthiest regions of Europe are large and persistent as compared to the differences between the poorest and wealthiest states of the U.S.

Needless to say, greater language and cultural differences among the regions of Europe and of China as compared to the U.S. also play a role in reducing labor mobility and the degree of labor mobility on a global scale is never likely to approach that of the U.S. But the important point is that increasing the degree of mobility across national economic boundaries is likely to enhance the extent to which countries are able to grow fast enough to catch up to the standard of living of the wealthiest countries without restricting the growth of the wealthy countries. In an era when many individuals in developing countries perceive globalization as a process that generates very unevenly distributed gains, a globalization that naturally tends towards very broadly shared gains may be politically imperative.

Demographic benefits; a practical solution to solvency problems for social welfare and pension programs and other issues.

Many developed countries of the West, including notably the United States and the major economies of Europe, have encountered serious funding issues for social welfare and pension plans. These countries have experienced increased life expectancies coupled with rapidly declining birth rates as increases in wealth have on average led to fewer children per household. This has caused the demographic profiles in these countries to become increasingly skewed toward a greater percentage of retired persons relative to working age persons. For “pay as you go” public welfare and pension plans such as the Medicare and Social Security program in the United States, there is a danger that the programs will become insolvent sometime in the next few decades if the system is not changed.

One solution is to require the shrinking fraction of the population that is working to pay in at an increasingly higher rate to support the growing fraction of the population that is retired. Another obvious possibility is to alter the demographic profile by allowing a larger number of working age immigrants. Since immigrants tend to be motivated by employment opportunities, they tend to be

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disproportionately younger than the general population. Consequently, in addition to the usual static and dynamic gains that both developed and developing economies would enjoy, enhanced labor mobility across borders also has the potential to reap immediate demographic benefits for developed economies.

There are numerous other potential benefits that could derive from increased international openness to labor flows either in the form of permanent immigration or temporary guest workers. For example, in the U.S. there has been much recent discussion of concerns about “outsourcing” jobs. From an aggregate perspective, outsourcing jobs should improve factor allocation in the same way that labor migration will, and thus may not be of concern at least from an aggregate perspective. On the other hand, if workers embody the ideas, experiences and skills associated with human capital, then as we discussed previously, there is the possibility that high skill workers may produce positive externalities that would only be enjoyed in the location where the work occurs. In this case, “in-sourcing” the same jobs via a guest worker program or other forms of international labor mobility will provide an alternative to outsourcing that allows the domestic economy to benefit from the human capital externalities.

Finally, it is worth noting that the development of a broader program for enhanced labor mobility should also decrease the pressure on illegal immigration and the potential problems that illegal immigration produces. By increasing legal labor flows, developed economies will be able to exercise greater control over the rate of inflow and the mix of skilled and unskilled workers.

Potential Difficulties Associated with Enhancing Labor Flows across Borders

The opportunities that a move toward greater international mobility can bring are far reaching and hold out the hope for higher standards of living worldwide. However, at the same time, any substantial move in this direction would represent a fairly dramatic change to the global economy. Needless to say, these changes are also fraught with potential difficulties if not managed properly. In what follows, we highlight a few of these difficulties.

Labor market pressures in developed economies.

It is not unusual for economists to emphasize the fact that in aggregate an economy will be better off pursuing a particular policy without adequately addressing the fact that the changes from the policy will nonetheless likely make some individuals worse off. The usual argument is that the amount by which some individuals are made worse off is small in comparison to how much others are made better off, so that it should be possible to more than compensate the individuals who are harmed. However, in practice this is often difficult to accomplish politically, and it is important to take care to facilitate policy changes in a way that minimizes the need for this.

In the case of increased labor flows across borders, there is the potential for increased pressure in the domestic labor markets of developed economies as the markets adjust to the influx of new labor. If not properly managed, a rapid influx of labor can easily result in increased unemployment pressure in corresponding domestic labor markets. Over time, the skill mix in the labor market tends to adjust to demand, but it is important to recognize that this is a lengthy process. Therefore, a carefully managed system will need to make sure to control the rate of inflow and the mix of skilled and unskilled workers for various sectors of the economy by indexing these to measures of labor market pressure, such as the unemployment rate or the wage rate. Over time, the dynamic gains from a faster growing economy can be expected to lead to higher wages across virtually all segments of the labor market. However, needless to say, in the short run it is important for countries to use their customs and immigration services to manage the inflow carefully in order to avoid political disasters.

Security concerns

In the post 9/11 era, national security concerns have become pervasive in virtually any debate about greater international openness. At first glance, the idea of greater international openness to labor flows appears directly to contradict the trend toward increased security screening. However, this

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need not be the case. In fact, it is perfectly reasonable to anticipate that a system involving greater legal migration and correspondingly diminished clandestine infrastructure that supports illegal immigration should provide a better opportunity to monitor and regulate movements across borders.

There is a broad recognition that the international community is currently in a critical transition phase. Countries may respond to perceived security threats by reversing decades of increasingly open international economic exchanges. More optimistically, they may respond with recognition of the importance of further coordination and international openness. Legal exchanges of labor across international borders may be viewed as a potentially valuable way to enhance the global connectivity among countries in a positive and stabilizing form.

A Marshall Plan for the 21st Century?

The post-war Marshall Plan, developed under the intellectual leadership of William Clayton, is widely heralded as one of the most successful international economic programs initiated by the United States. Following the ravages of World War II, the economies of Europe had been depleted of private and public capital. The Marshall Plan induced a huge transfer of capital investment from the U.S. to Europe which allowed for the rapid rebuilding of the European economies. This allowed for a transition from dire poverty immediately following WWII, to unprecedented growth and prosperity among European economies. Both Europe and the U.S. benefited enormously from the fruits of the program.

Using the Marshall Plan as their model, many economists felt they had a clear vision of what had to happen in order to encourage a similarly rapid growth and prosperity for the rest of the developing world. By opening up capital markets globally, the hope was that capital investment would flow from countries where it was abundant, such as the U.S. and other developed economies, to countries where it was in greatest demand, namely the developing countries, just as it had for Europe in the post-war era. The great frustration among international economists and development experts is that this simply has not happened, despite the fact that many economies have been liberalized and capital

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markets have been opened to a greater extent than ever before.

Individuals in developed economies are for the most part not clamoring to send their investment to less developed economies. In many cases, capital has even flowed in the reverse direction, from the less developed countries into the wealthiest countries. To individual investors, the reasons are often obvious. Economists have nevertheless felt the need to write at length on the differences between post-war Europe and more recently developing economies, and the reasons why simply opening capital markets has not succeeded in directing investments toward-capital scarce regions of the world. Needless to say, there are a myriad of reasons and explanations put forth. But an overall consensus appears to be forming around the rather common sense idea that unlike Europe in the post-war era, the key point is that many developing economies do not have the well established legal institutions and market infrastructure that serve to ensure the safe and productive return on capital.

Put simply, capital investment is risky when ownership of the returns cannot be guaranteed and the productivity is not high enough to compensate the associated risk level. This is one important reason why capital tends to flow into wealthy economies, despite the fact that it is already abundant in wealthy economies and would otherwise enjoy a much higher return in regions of the world where it is scarce. Fundamentally this explains why in practice labor tends to want to move to the location where capital is abundant much more readily than capital wants to move to the locations where labor is abundant.

In this way, a new Marshall Plan for the 21st century might be thought of as building on the successes of the first Marshall Plan. The Marshall Plan of the post war era was successful in opening the door for capital to be transferred from regions of the world where it was abundant to regions of the world where it was scarce, and which were equipped to receive it. A Marshall Plan for the 21st century might be thought of as continuing the process of encouraging international factor flows by promoting the openness to the corresponding reverse flows of labor, whether through permanent immigration or temporary guest worker programs.

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On net, one should expect a flow of relatively lesser skilled workers from less developed to more developed countries, and the reverse flow of higher skilled, educated workers from developed countries to developing countries. To a large extent, one already sees this process in place in the United States. Large numbers of relatively low skilled workers migrate to the U.S. each year and help increase productivity in the U.S. and, at the same time, raise the marginal productivity and thus the incomes of the smaller number of workers that remain in the migrant's home country. Concurrent with this, the United States has developed an extremely effective system of higher education, which trains graduate students from all over the world in the sciences, business, medicine, and engineering. Many of these highly skilled workers then choose to return to their home countries. The United States has a well-established and much admired history of accepting low skilled workers from around the world and sending domestically trained, high skilled workers to the rest of the world. Promoting this process of greater international openness to labor among developed and developing economies is something that the United States can speak to with experience and authority, and it is something for which the world can look to the United States for leadership.

In many parts of the world today, American-led efforts toward greater globalization convey images of American fast food franchises at every corner, and the gradual erosion of local cultures to a global American culture. In an era of growing backlash against these images of globalization associated with international capital investments, it may become imperative for the U.S. and other developed economies to signal a commitment to a richer, more people oriented form of globalization that recognizes the gains from the international exchange among individuals, and not just capital. A globalization that promotes openness to labor mobility is a globalization that also accepts the flow of cultures and ideas *into* developed economies, something for which the United States, and in particular cities such as New York, Los Angeles, Chicago, Houston and Miami are often admired. Promoting this image of globalization may be imperative if we wish to avoid a growing backlash against international openness.

Just as the Marshall Plan called for the U.S. public to accept the promises and the risks of a large ambitious investment, U.S. leadership in the movement toward a new openness to international labor

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movements will require public and private investment. Although as individual nations, the U.S. and other developed economies stand to gain substantially from increased openness in labor markets, there must be recognition that the adjustment process toward such a new globalization requires substantial commitment and investment on the part of developed economies. Just as the liberalization and internationalization of the U.S. economy to trade and capital markets in the late 1970's saw a restructuring of labor markets to higher skill sectors, openness to labor markets will continue this trend toward greater need for highly educated and skilled workers. Domestically, adjustment in this direction requires a commitment to educating and retooling workers for higher skilled professions as the demand for these jobs will rise dramatically in response to the likely inflow of lesser skilled workers. Clearly one important form of public and private investment that this calls for is in the education sectors of developed economies in order to facilitate the process of absorbing low skilled workers into developed economies and educating high skilled workers for developing economies.

The post-war Marshall Plan was successful in promoting the flow of physical investment capital. In the language of economists, one can think of a Marshall Plan for the 21st century as a plan for the promotion of openness to international labor, and most importantly the human capital, or education, which is embodied in labor. In short, one might think of an appropriate Marshall Plan for the 21st century in terms of labor and human capital rather than physical capital.

Prospects for Academic Research

It is easy to envision grand ideas for improving world standards of living. However, before societies are willing to move in new directions and undertake large, risky new plans, it is important to investigate more fully the implications and consequences of these changes, and this is what professional and academic economists can hope to contribute.

A plan for promoting greater openness to international labor flows, leads to a number of important economics questions that need to be investigated more thoroughly. For example, just how large are

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the traditional efficiency gains that come from modest increases in international labor flows? There are only a few existing studies, and most of them are only very rough estimates. If greater openness to labor markets is taken seriously, then one needs to have more detailed estimates of the likely gains under various scenarios for typical developed and developing countries that choose to participate.

Also, can greater openness to international labor flows foster a different type of globalization in which the gains are widely distributed and poorer countries are able to raise their standards of living fast enough to catch up with higher income countries? Theory has been developed to indicate that this may be a possibility. Casual observation reinforces our hope that this may be the case. However, there is to date no rigorous empirical evidence to support or refute this. From a global perspective, this is likely to be one of the most important issues for rapidly raising standards of living.

Correspondingly, on the domestic front for developed economies, how sensitive are domestic wages and unemployment to increased labor inflows? At what rate can international labor markets be opened without causing too much of an adverse effect on domestic markets? What is the optimal mix of skilled and unskilled workers? Are labor flows in the form of permanent immigration or temporary guest workers more desirable? How large a labor inflow would it take to reverse the decline in social pension and social welfare funds in developed economies?

These are just a few of the many diverse issues that are raised when one begins to think seriously about promoting greater international openness to labor and the human capital that it embodies. My own research will focus initially on the question of whether increased openness to international labor flows can foster a type of globalization in which countries can rapidly catch up in terms of standards of living, as previously described, since this is likely to be one of the most central questions from a global perspective.

Needless to say, the fact that economists study these questions does not ensure that such changes will be promoted or implemented. On the other hand, without further study, ideas are unlikely to be

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taken seriously. One of the most effective contributions that economists can make for the world of policy is to study the feasibility and the consequences of these broad ideas. The Baker Institute provides an opportunity to foster this valuable research.

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