

The International Allocation of Labour

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1. Introduction

Traditional international economics has very little to say about how workers should be distributed around the globe. Instead, it has discussed at some length where different goods should be produced. Also, more recently, how capital should be allowed to move across borders. But traditional international economics has regarded each nation's labour supply as somehow fixed.

Yet international migration is a persistent phenomenon. The conference organizers mentioned migration from the East and from across the Mediterranean Sea. There was the recent summit meeting of the European Union in Tampere, Finland, intended to discuss the creation of a common judicial area, including harmonized immigration policies, now seen to be an urgent need because of, on the one hand, the Schengen agreement on free mobility, and on the other hand, the perceived pressure of migration into the EU. As for the United States, where I now reside, the demographic history is one in which immigration has always been the major source of an increasing population.

This trend is expected to continue, especially in California. It may be worth remarking that Stanford University now claims that somewhat less than 50% of its undergraduates are of European descent. Among our post graduate students, a minority are American born. In the Economics Department, a majority of my colleagues are American born, but the gap is narrowing quite fast. Elsewhere, Israel since 1990 has welcomed something like 700,000 immigrants from the former Soviet Union — adding about 20% to its previous population. For the same proportional effect, Italy would need to absorb over 10 million immigrants; the EU would need to absorb at least the present population of Italy.

Describing current or past migration patterns is not my comparative advantage, however. Instead, I would like to reflect on some policy issues raised by migration. Specifically, let me draw your attention to the contrasting attitudes that economists, politicians, and many ordinary people display toward trade and capital flows on the one hand, and toward migration on the other hand. In particular, there is a general favourable attitude toward free trade and free capital movements, at least subject to the rules negotiated through various General Agreements on Tariffs and Trade (GATT), now administered through the World Trade Organization (WTO). There is also an increasing number of free trade areas. Some economists do object to the latter, but only because

they worry that freeing trade among a restricted group of countries such as the European Economic Area or North American Free Trade Area (NAFTA) may come at the expense of trade with the rest of the world. That is, trade is created within the area, but diverted from other countries. And free capital movements are also seen as being generally favourable — at least as long as they take the form of long-term real investment instead of short-term financial speculation or, even worse, capital flight out of countries whose currencies are expected to depreciate.

Migration, however, is often viewed with disfavour, sometimes extreme. Especially so-called “economic” migrants seeking their fortune across an international border. My talk will be about such economic migration, rather than about refugees seeking escape from oppressive political regimes, from human rights abuses, racial discrimination, or other forms of non-economic harassment that remain all too common to this day.

Actually, the contrast in attitude we most usually see is not really between flows of goods on the one hand and flows of labour on the other. Rather, the contrast is between flows of labour within nations and international flows. After all, even the worst bigots in each nation seem not to oppose mobility *within* the nation they happen to inhabit. The economic system of the Soviet Union was criticized for many reasons, including the barriers that were placed to prevent all except a privileged minority from moving around freely. In the 1960s and 1970s, a frequent concern of British economists was the obstacle to labour mobility due to rigidities in the rental housing market, nearly all controlled by local government, often with long waiting lists for people moving into the area. And, of course, one concern within the Euro-11 area of the European Union is whether labour mobility within the Union will be enough to offset regional macroeconomic shocks now that exchange rates or even interest rates have been removed as policy instruments. Of course, the European Union — and in fact the European Economic Area as a whole — is an unusual example of a multinational grouping where the right to migrate within the area is recognized, at least officially. Some of us have noted that, despite migration being allowed in principle, there are often obstacles to those who wish to transfer professional qualifications. But some such obstacles can arise even within one nation — between different German *Länder*, for instance.

2. Comparative Advantage and Factor Price Equalization

How has traditional international economics managed to neglect the important phenomenon of migration? Well, actually, it was not entirely missed. A few pioneers have had interesting things to say about migration, especially recently. On the whole, however, international economists have tended to concentrate until recently on flows of goods and capital between nations with fixed populations. Nations are supposed to concentrate their factors of production in industries where

they have a “comparative advantage” — i.e., the ratio of the cost of production to the costs in other industries is lower than the corresponding ratio in other countries. But factors of production are usually treated as fixed — even capital, in the short run.

Some more thoughtful international economists have an interesting argument to defend their neglect of migration. There is a tradition of considering a special class of models which describe each nation’s industrial structure and production possibilities. In these models, there are what economists call “constant returns to scale”, in the sense that when all inputs increase in the same proportion, the output of each industry expands in proportion to the scale of the inputs. Then, under the usual economists’ hypothesis that producers maximize their profits, each output price is equal to the cost of producing one unit of output. Otherwise, if price is lower, any output would be produced at a loss, whereas if price is higher, producers can make an arbitrarily large profit by expanding the scale of their industry indefinitely. Now, the crucial point of such models, with prices equal to unit costs, is the following. In the first place, free international trade of final products will equalize relative prices of these products in different countries (ignoring transport costs, as in commonly done). Then, provided that all countries have access to the same technology, and there are no more factors of production than traded goods, it may happen that there is a unique collection of factor prices with the property that the equalized product price ratios are equal to the ratios of unit costs at those factor prices. If so, equilibrium with free trade requires the ratios of factor prices in each country to be the same, just as the ratios of output prices must be. Furthermore, after adjusting for exchange rates, both output prices and factor prices must be the same in every country. This property is called **factor price equalization**.

What has this to do with migration? Well, if labour is a factor of production, factor price equalization implies that labour earns the same real wage in every country. Or, if there are many different types of labour, each type of labour has the same real wage. So workers who will only migrate to countries where they can earn a higher real wage lose any reason to migrate. In other words, migration becomes economically irrelevant when factor price equalization holds. Provided, that is, workers do not want to move for other reasons like better climate, religious or other kinds of freedom, etc.

Frankly, the argument that trade equalizes factor prices, though theoretically correct under special assumptions, seems not too persuasive in practice. For one thing, particular inputs like farmland of different kinds may well be specific to countries. Mexican farm workers really can be more productive on California farmland, it seems, because of the climate and perhaps the quality of the soil.

In fact, migration seems a more effective equalizer of factor prices than trade alone is ever

likely to be. After all, following the collapse of the Berlin Wall in 1989, it was rather easy to see that real wages were likely to rise faster in East Germany than elsewhere in Eastern Europe because the East Germans had the right to migrate to the West. To a large extent, this is because West German politicians saw the need to build a newly united nation by strengthening the infrastructure in the East. Also because private German firms expanded eastwards. But the East Germans' right to migrate westwards seems to me another potential force which should not be ignored. Politicians knew they could not keep East Germans out of the West except by offering them sufficient positive incentives to remain in the east.

This example shows that, whether or not immigration is officially allowed, measures like investment and foreign aid which improve the living standards of potential migrants can be rather effective in persuading them to stay at home. In other words, flows of capital and of international aid can substitute for flows of labour. Really, this is the most humane and possibly the only effective way of removing economic pressures to migrate. But, turning this argument around, those with the freedom to migrate may be the most likely to benefit from capital flows, especially when those flows are arranged or supported by public authorities anxious not to receive too many immigrants from economically depressed areas abroad.

3. Potential Gains from Economic Liberalization

It seems fair to conclude that trade alone will not equalize factor prices. And even if it did, people might still want to migrate for reasons other than seeking the highest real wage. Why then should we stand in the way of voluntary migration, even by the generally reviled "economic migrants"?

A common objection to relaxing controls on immigration is the claim that immigrants reduce job opportunities for native workers. Nor is this claim always empty. Allowing immigrants to take up positions in, say, the clothing industry may well reduce real wages for natives, or lead to job losses for them. The harm suffered by such workers should not be ignored. But these workers will suffer just as much harm, it would seem, if existing domestic producers are driven out of business by cheaply produced imports as a result of free trade agreements.

This simple example highlights the need to see what may be the reasons to distinguish free migration from free trade.

Generally, moves toward free trade and relaxation of immigration controls are examples of economic liberalization. Other prominent examples include measures to enhance competition in monopolized industries, or some kinds of tax reform. I propose that we remind ourselves what is the reasoning behind most economists' advocacy of such reforms in general. Then we can consider

whether these are valid reasons to treat migration — especially international migration — differently.

Early arguments in favour of free trade and other kinds of economic liberalization relied on being able to demonstrate that anybody who was hurt by a liberalizing reform could be compensated by transfers from those who would gain. Moreover, the transfers required would leave some surplus which could be distributed among the whole population in a way that leaves everybody better off. Thus, one has a “potential gain” for everybody from the reform, which could be made into an actual gain by suitable complementary policies that go along with the reform.

Such potential gains sparked enormous debate among economists. Many argued that it is irrelevant whether they were accompanied by compensation for potential losers. Myself, I find this ethically dubious. If a liberalizing reform benefits some people but harms others, we really should consider carefully who gains, who loses, whether the losers are more or less deserving than the gainers, and what can be done to reduce the losses of deserving losers.

What many economists overlooked, however, at least until recently, is the problem of identifying those who really do lose from a liberalizing reform, and of estimating how much compensation they are likely to need. After all, suppose we realize that some industry will become uncompetitive after the reform, so that its workers, who may have specific skills which cannot easily be used in other industries, are likely to join the ranks of the long-term unemployed. Their only fault was that they failed to see the liberalizing reform coming, or to understand that their industry was going to be badly hit. They seem deserving losers. How much compensation do they need?

The difficulty is that claims for compensation can easily become exaggerated. Some workers may indeed be forced to give up life-time jobs, with almost no opportunities for re-employment, and need full compensation for the earnings they could reasonably have expected from the rest of their career. Others, however, have time to acquire new skills and find new jobs, provided they can be suitably motivated. They need less compensation; indeed, limiting their compensation may even encourage a beneficial adjustment to a new career. Still others may not even have joined the industry yet, but were planning to do so. Perhaps this industry is the major employer in the town where they are still growing up, so if it is closed, they will be forced to relocate at some expense and inconvenience. Obviously, all these considerations show how hard it is to know who should be compensated and how much.

With these difficulties in mind, more recent work on the gains from liberalization has looked elsewhere for a way to reduce or eliminate economic losses. Instead of direct compensation, one tries to adjust the tax system in ways that preserve people’s real incomes

whatever they choose to do. This is certainly complex, and requires sensitive fine tuning of local as well as national taxes to the circumstances created by the liberalizing reform. Yet various forms of trade adjustment assistance and schemes to re-train workers really do get set up in some cases. Rigid rules enforcing tax harmonization, by the way, are a distinctly unhelpful obstacle to policies of this kind.

What emerges from this analysis is a rather broad general principle. Typically, a well designed liberalizing reform promotes a more efficient allocation of economic resources, enabling larger outputs of desirable goods and services to be produced with the same or less expenditure of effort, the same or less use of capital and exhaustible resources, etc. By itself, this increased efficiency does not ensure that everybody is better off. But it should help to generate more tax revenue, or more profit for private producers which could be taxed in ways that allow other policies to distribute the efficiency gains as widely as possible — in particular, such policies should be able to mitigate the harm to deserving losers, even if such harm cannot quite be eliminated altogether. The task of the economist and of policy makers should be to identify not only liberalizing reforms, but the accompanying re-distributive policies without which any liberalizing reform may well be ethically and even politically unacceptable.

In some cases, moreover, economists should be ready to admit that not all liberalizing reforms are beneficial, even potentially when combined with suitable policies that reduce the harm to deserving losers. Sometimes, such compensatory policies will be impossible. Sometimes, liberalization concerns markets in commodities like addictive drugs where many people think controls should remain in place, and almost everybody agrees that the very young need protection. Less dramatically, one might begin to build a limited case for protecting some of Europe's farmers based on the need for food security in times of crisis.

Also, even if there are potential gains to some kinds of economic liberalization, it may easily happen that other political institutions create insurmountable obstacles preventing those potential gains being distributed in an ethically acceptable fashion that avoids treating losers unduly harshly. For example, there may be no unemployment insurance at all for those working in industries that cease to be competitive. In such cases, it would seem wise to refrain from liberalization until these other institutions can be adapted.

4. Congestion Externalities

In the last section, I tried to remind you of the reasoning behind most economists' eagerness to recommend liberalizing reforms of various kinds. I also tried to be more careful than I see most economists being when they argue for free trade in particular. You may rightly think that

we have strayed rather far from the topic of migration — especially international migration. Yet really it seems that allowing such migration is merely one kind of liberalizing reform. Allowing workers to locate where they can earn higher real wages because they are more productive surely enhances the efficiency of the international allocation of labour. Accompanying freer migration with good policies to distribute the resulting gains could allow us all to benefit. If the same efficiency gains resulted from transfers of capital or from regional migration of labour within one country, few would object. Also, even if people want to move to countries where the real wage is no higher, but where the lifestyle appeals to them better, what is wrong with that? We let people live in a town or in the countryside depending on personal preferences; why not let them choose the country in which they would like to live?

I have already mentioned the job loss objection to immigration. More recently, especially in California, the objection has been to the cost of providing public services to “illegal” immigrants. Mind you, since the U.S.A. in general and California in particular is far from a European welfare state, these public services are rather restricted — mostly, the expense is for educating immigrants’ children, and for providing some emergency health care. Those of us who pay taxes in California seem to get quite reasonable value for these rather limited expenditures. Nevertheless, especially where the burden on the state created by each immigrant is much larger, this increased public expenditure does seem to be a legitimate source of concern — at least at first. So we should re-examine the argument for liberalized immigration when more public facilities may have to be provided.

Communities with expanding populations face congested public schools, health services, and other public facilities. Public services will deteriorate in quality unless there are more teachers, nurses, classroom, medical clinics, etc. This expansion will need public funding, some of which may come from central government, but much of which will have to be financed locally or regionally. Tax revenues must rise. Fortunately, the number of taxpayers is increasing. The tax base may also be expanding, if property prices rise as there is more demand for living space.

When migration takes place between regions within one nation, such congestion seems to raise only relatively minor concerns. People expect to pay more to move to economically successful regions where these job prospects are higher. Older retired people may choose to move out where housing is less expensive and the pace of life seems gentle. All inhabitants pay taxes which depend on what they consume and what property they own, not on where they were born. Here in Northern Italy, I know there has been some rather loose and irresponsible talk of declaring independence from Rome, but not — so far as I know — of sending back the many people who have moved in from elsewhere in Italy, or even from elsewhere in the European Union.

Indeed, congestion in public facilities, and the increased expenditure needed to mitigate it, are caused by *all* residents in a community — not just by immigrants. And the same is true in the nation as a whole. A desirable international allocation of labour, even with congestion effects, has people living where they most want to, taking account of earnings opportunities, as well as local amenities, climate, language, lifestyle, personal preferences, and the taxes they must pay for local and national facilities. Gender, race, or national origin are largely irrelevant, unless people care about what their neighbours look like, how they sound, or where they come from. And if they do care, should they? And should such preferences — and prejudices — be allowed to limit the economic gains from liberalized economic migration, both national and international?

In the previous section, I concluded by pointing out that there are cases where economic liberalization would be undesirable. The same, of course, is true of expanded economic migration — seen as one particular kind of liberalizing reform. Indeed, there may be more problems with some kinds of migration than with other forms of liberalization. But I see few reasons a priori why this should be so. Indeed, as for any liberalizing reform, really one needs to examine carefully who benefits, who loses, how large are the gains and the losses for different groups in the world population, whether deserving losers can have their losses reduced to acceptable levels, and finally, whether the benefits really do outweigh the costs. In other words, a careful empirical analysis is required, not only of the liberalizing reform, but of other policy measures which can be used to make its distributional implications acceptable. In this regard, economic migration is no different from trade.

5. Problem Migrants

If these arguments are anything like correct, it seems likely that there may be much to gain from free migration, and little to lose — as long as we restrict ourselves to economic migration and to economic concerns. By and large, migration seems a natural way to improve the allocation of labour, just as trade generally improves the allocation of goods, and freer capital flows may improve the allocation of investment. There are added benefits if people manage to live where they prefer. Also, for much of the developed world, attracting more young migrant workers could help relieve the burden faced by native youngsters in supporting the increasing proportion of elderly retired people.

Let me readily admit that the economic migration I am discussing covers only a minority of the immigrants, especially a minority of those who create most of the problems discussed in the press. I have been thinking of migrants who like myself, had arranged a job and a visa or work permit even before taking a plane to Australia (my first position abroad), California, Israel, Japan,

wherever. Or of those who, even though they may violate immigration laws, do so in ways that escape the attention of public authorities because they soon find jobs, they require no public assistance beyond that readily afforded to other residents and tax payers, and they pay their taxes just like everybody else. The same category also includes those who may not succeed in their new country of residence because they came to look for a job they could not find, but they gave up the search and returned home at their own expense before the public authorities had any reason to notice them. It even includes those who would have succeeded in their new life plans if they had not been caught violating immigration laws, but once they have been caught, are sent to detention centers or hostels where they may languish long at public expense before their ultimate fate is decided. All these are migrants who would create no special problems if left alone to live like any native resident.

Which still leaves many desperate people seeking better opportunities abroad, but with little idea of how they will actually be able to support themselves. These are the problem immigrants whose skills are few or in little demand, and who lack family contacts abroad which could provide them opportunities and contacts for jobs, as well as shelter and food while looking for suitable employment.

It is worth remarking that many countries now have immigration policies that seem destined to create large numbers of problem immigrants. Economic migrants who could arrange jobs even before leaving their homeland face heavy bureaucracy at least, or outright exclusion. Family members receive preference, which is fine in principle if those family members really do provide enough support to prevent the immigrant needing public assistance, but in practice taxpayers often are required to offer undue help. Tight border controls help select as migrants the most desperate and those whose only contacts are with criminal gangs who arrange clandestine transport for illegal immigrants. Often, such gangs also leave the migrant with no financial resources at all to cover the period until at least a menial job can be found. Sometimes the migrant is left with no alternative to joining a criminal organization.

Indeed, it may turn out that this need to break the law is most relevant economic distinction between the officially approved migrant from, say, Sicily or Portugal; and the officially prohibited migrant from, say, Tunisia or Albania. Language skills may be another distinction, but are often not so important for the migrant's first job. What does matter is that the person from Sicily or Portugal probably arrives with some savings while they search for a better job; the person from Tunisian or Albania is quite likely to have had any cash reserves stolen, even if there were any after paying for the illegal voyage to southern Italy.

This is not an argument against all forms of immigration control that could keep out

problem immigrants. Rather, it suggests rethinking the design of such controls, emphasizing the likely burden on the state. And also facing much more honestly the awkward question why migrants from Sicily or Portugal, even if they become homeless and unemployed in Milan, deserve so much better treatment than migrants from Tunisia or Albania, even those whose only contact with the public authorities comes when they happen to be caught without the documents the law requires them to have.

6. Politics, Culture and Society

Not everything that matters can be analysed using narrow economics, however. If there are few legitimate economic objections to economic migration, might there be non-economic objections? Of course, discussing non-economic considerations falls outside my area of comparative advantage, and what I have to say should be discounted accordingly.

Let me start with politics, which is certainly affected by migration. The clear hostility to Spanish-speaking migrants displayed by Pete Wilson, the previous governor of California, motivated many who had recently become citizens to register as voters and become politically active. This helped to ensure victories for the Democratic Party in many California elections. Many other politicians may fear a similar loss of control if more immigrants are allowed to enter and then to vote. This helps to explain why politicians may be averse to migrants, and not only to immigrants from foreign nations. It does not offer the rest of us any reason to object to immigration, however, unless one feels the whole political process may be undermined by significant numbers of new voters (as some Israelis may be feeling).

A rather better reason for politicians to be averse to immigration is a worry that some extremists are going to be provoked into violent behaviour. Here there does seem to be a clear distinction between trade and migration. When French farmers blockade and then destroy lorry loads of Spanish tomatoes, this is highly unpleasant, but rarely life-threatening. When German skinheads burn down immigrant hostels, sometimes with immigrants still inside, this is much more serious. However, facing down the extremists is going to be necessary in the end. And finding better ways of assimilating refugees than Germany seems to be doing might also be wise.

Significant numbers of immigrants from abroad, or even from remote regions of the same country, can also affect local culture and society. Sometimes this is for the better. England has gained much from the many immigrants who have arrived since about 1950 — even some quite good restaurants, quite apart from bus and train drivers, factory workers, shopkeepers, doctors and nurses, some entrepreneurs, even the odd member of the House of Lords. But many parts of the world have filthy and crime-ridden ghettos full of alienated children of recent immigrants. One

also sees numerous obvious immigrants who eke out a living on the margins of the economy by activities such as washing car windscreens, or occupying the street to sell items without — one suspects — bothering to pay taxes, let alone rent. Nor are all allegations that immigrants practise petty crime or deal in illegal drugs entirely unfounded.

The important thing to remember here is the argument that immigrants should be treated exactly as natives — subjected to taxes and local regulations, prosecuted for crimes, etc. The one difference is that when a native would have a prison sentence imposed, an immigrant might well be subject to deportation.

One complication is compulsory military service. Drafting immigrants with suspect loyalties into the armed forces might pose problems. But isn't it time to consign military conscription for anybody to the dustbin of history, along with other forms of slavery?

7. Conclusions

All this must seem a rather strong plea to allow economic migration between as well as within nations. If so, it is because, in trying to remain open-minded, I have heard few good arguments against — at least if much freer migration is accompanied with other policies whose effect includes having migrants themselves bear the cost of the housing and public amenities they need. I have to admit that my own favourable experiences as a migrant and in dealing with other migrants in many different countries may have coloured my judgement. But if there are good arguments for blanket restrictions on economic migration, or for treating international movements of labour differently from those of goods or capital — especially good economic arguments — I have yet to hear them, though I am still listening.

This is not to deny that some immigrants — even economic ones — may place unusual burdens on other inhabitants of their new places of residence. It is reasonable to expect foreign immigrants to pay for language training, and the additional cost of serving those who never become fluent in the local language. Immigrants should expect to abide by local laws and customs. If religious fundamentalists find life in a secular state intolerable, they should be encouraged nevertheless to respect other peoples' freedom, or move elsewhere. Secular immigrants who would dislike abiding by the restrictive laws of a religious state can also vote with their feet. Everybody, especially immigrants, should be tolerant, perhaps even of local intolerance.

I shall conclude with the words of a bumper sticker I saw some years ago on the back of a Volkswagen Beetle in Bonn:

“Wir sind alle Ausländer fast überall”

— i.e., “We are all foreigners almost everywhere.”