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The political economy of international factor mobility

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Abstract

We model the endogenous determination of policy towards international factor mobility. In a common agency setting, domestic interest groups bid for protection from the government and the incumbent politicians maximize a welfare function that depends both on domestic voters' welfare and contributions collected. We characterize equilibrium policies in the price space and show how the degree of complementarity among inputs determines the outcome. We establish a similar result for quotas, allowing for partial rent capturing. For the strategic environment under consideration, we also establish a general equivalence result between tariffs and quotas if capturing is complete.

Keywords: FDI; Migration; Political economy; Common agency

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1. Introduction

Economic theory suggests that the free international movement of production factors is efficient, but countries invariably use their sovereignty to restrict migration and influence the flows of foreign direct investment. Notwithstanding Lady Liberty's promise "Give me

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your tired, your poor, your huddled masses, yearning to breathe free," virtually no nation has ever adopted an "Open Door" policy towards international migration, regardless of ethnicity or national origin. Movements of capital, and in particular the flow of Foreign Direct Investment, have also been the object of government regulation. At times in the past they were severely restricted, whereas more recently they have been actively subsidized.[1]

There is substantial evidence regarding the role of pressure groups in shaping the attitude of governments towards factor mobility. Labor Unions have consistently played an important role in determining US migration policy. The enactment of the first legislative measure to systematically limit immigration from a specific country–the Chinese Exclusion Act of 1882–was the result of the efforts of the newly founded Federation of Organized Trade and Labor Unions. Similarly, the American Federation of Labor (AFL) played an important role in the introduction of the Literacy Test provision in the 1917 Immigration Act, with the explicit intent to "screen and reduce the inflow of unskilled workers in the U.S labor force" (Briggs (1998), page 125). More recently, the AFL-CIO supported measures to reduce illegal immigration, that culminated in the 1986 Immigration Reform and Control Act.

Complementarities among factors are important in understanding pressure group behavior. For instance, during a recent debate spurred by Senator Hollings' bill limiting FDI by foreign state-owned corporations, the president of the Communications Workers of America, Morton Bahr, was called to witness on the proposed takeover of Voicestream by Deutsche Telekom. In his testimony, he stresses how "In the telecommunication industry, the presence of Deutsche Telekom in our market-place could yield some substantial benefits to workers and consumers."[2] Similarly, analyzing the recent surge in immigration into the United States, Goldsborough (2000) notes that "Immigration policy today is driven by businesses that need more workers—skilled and unskilled, legal and illegal [. . .] During the annual debate on H1-B visas two years ago, Silicon Valley executives trooped before Congress, warning of a Y2K computer disaster unless the number of H1-B visas was increased."

At the same time, competition for foreign direct investment has become a global phenomenon. Both advanced and developing countries offer large financial and fiscal incentives to attract foreign corporations. Examples abound—consider the automobile sector as a particularly revealing case in point. Recent estimates[3] show that the incentives offered to attract new plants have risen from the roughly $ 4,000 per job paid by Ohio to secure a Honda plant in 1980 to the $ 168,000 per job paid by Alabama in 1993 to convince Daimler-Benz to build a factory near Tuscaloosa. Other countries hardly lag behind. Portugal, for instance, offered an even more substantial package to secure a large investment by Ford and Volkswagen in 1992 and the list could go on. We can summarize this evidence as follows: on the one hand, organized factors lobby governments for protection; on the other, complementarities between factors matter in determining the amount of protection that is granted in equilibrium.

[1] See Oman (2000).

[2] The full statement is available at http://www.com-notes.house.gov/ccchear/hearings106.nsf.

[3] See Oman (2000), page 80.