CROSS-BORDER FLOWS: LABOR, CAPITAL AND FINANCE

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August, 2000

Introduction

The world economy nowadays experiences an unprecedented openness. The fading of borders between independent economic systems - local, state, national and supernational - allows capital, firms, and labor to move more freely around the globe, so as to better exploit differences in opportunities (employment, savings, investments, etc.) arising from ever-changing technological and economic environments, as well as in fiscal and monetary stances.

Globalization is not an entirely new phenomenon. The world economy experienced such a process about a century ago, until it was disrupted by the eruption of the first and second world wars. Nevertheless, the current trend of economic integration is historically unprecedented. We support Bordo, Eichengreen and Irwin (1999) who conclude that "our world is different: Commercial and financial integration before World War I was more limited." A century ago, trade in goods was impeded by transport costs and imperfect information. Also, services that were then considered largely nontradable, are now a growing component of the volume of trade. Intra-industry trade, especially among multinationals, is flourishing. Financial integration is deeper and broader than before, as financial flows spread into more and more activities and sectors.

An exception to the higher degree of international integration nowadays, as compared to a century ago, is, however, the flow of labor. Hatton and Williamson (1992) provide the following historical perspective:[1] "In the century following 1820, an estimated 60 million Europeans set sail for labor-scarce New World destinations." In fact, net migration contributed a significant share of the total growth of the white population in the United States

[1] See also Hatton and Williamson (1998).

in the nineteenth and early twentieth centuries.[2]

The development of new national institutions (e.g., national insurance) and international bodies (e.g., the European Central Bank, the International Monetary Fund, the World Trade Organization, to name a few) raises new subtle issues that are intertwined with globalization. As put succinctly by Bordo, Eichengreen and Irwin: "Does the growth of global markets pose a threat to distinctive national social systems? Does a world characterized by high levels of trade and large international capital flows jeopardize social cohesion and economic and financial stability and therefore requires the strengthening of national safety nets...? And failing this, will governments retreat toward financial autarchy and succumb to populist pressures for trade protectionism?" Furthermore, the "new economy" is a fertile ground for the international mobility of technology. Indeed, studying international "spillover" effects of research and development, Helpman (1999) concludes that "... there exist significant, cross-country links that are driven by foreign trade and investment."

This book attempts to address many of these issues analytically, while providing some empirical analysis of analytical issues as well.

In Part I we first develop the traditional arguments for free welfare-enhancing flows of goods, labor, and capital. It serves as a review of traditional trade literature on the substitutability and complementarity between trade in goods, labor mobility and capital flows. We use this background as a departure point for succeeding analyses of nontraditional benefits and pitfalls of these flows in the presence of social and political institutions which impose a set of constraints on globalization, such as safety nets, representative democra-

[2] For instance, net migration accounted for between 32 and 43 percent of the total increase in the white population during 1880-1910.

cies, financial intermediaries, etc.; and imperfect information, such as between foreign and domestic savers/investors, which impedes on international interactions.

Part II deals with labor flows. The economic theory of migration, and in particular the analysis of the implications of the welfare state for the causes and consequences of migration, is systematically developed in this part.

Part III considers capital and financial flows and addresses a number of issues related to open capital markets. In addition to serving as a review of the globalization of capital markets, and the desirability (or costliness) of regulating capital flows, this part also analyzes the magnitude and composition of capital flows when there are imperfect-information distortions. The various chapters in this part deal systematically with financial intermediation, debt, equity and FDI flows.