

Bougheas, Spiros; Nelson, Douglas R.

**Working Paper**

## Skilled worker migration and trade: Inequality and welfare

CESifo Working Paper, No. 3282

**Provided in Cooperation with:**

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Bougheas, Spiros; Nelson, Douglas R. (2010) : Skilled worker migration and trade: Inequality and welfare, CESifo Working Paper, No. 3282, Center for Economic Studies and Ifo Institute (CESifo), Munich

This Version is available at:

<http://hdl.handle.net/10419/46380>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

Skilled Worker Migration and Trade:  
Inequality and Welfare

Spiros Bougheas  
Doug Nelson

CESIFO WORKING PAPER NO. 3282

CATEGORY 8: TRADE POLICY

DECEMBER 2010

*An electronic version of the paper may be downloaded*

- *from the SSRN website:* [www.SSRN.com](http://www.SSRN.com)
- *from the RePEc website:* [www.RePEc.org](http://www.RePEc.org)
- *from the CESifo website:* [www.CESifo-group.org/wp](http://www.CESifo-group.org/wp)

# Skilled Worker Migration and Trade: Inequality and Welfare

## Abstract

We develop a two-sector, two-country model where trade is driven by technological differences. Each country is populated by large number of heterogeneous workers distinguished by their level of skills. Given that one country has a technological advantage in the skilled intensive good when we allow for both trade and migration skilled workers migrate to that country. We analyze the consequences of this migration for both inequality and welfare for the source and the host country.

JEL-Code: F22.

Keywords: skilled labor, migration, welfare, political economy.

*Spiros Bougheas*  
*University of Nottingham*  
*Nottingham / UK*  
*spiros.bougheas@nottingham.ac.uk*

*Douglas Nelson*  
*Tulane University*  
*New Orleans / USA*  
*dnelson@tulane.edu*

September 1, 2008

We would like to thank participants at the ETSG (Warsaw, 2008) and the Bank of England-MMF-GEP Macroeconomics and International Migration Conference (London 2010) for helpful comments and suggestions. We also acknowledge financial support from the Leverhulme Trust under Programme Grant F/00/114/AM.

# 1. Introduction

For all the public concern with unskilled immigration, it is notable that a sizable share of immigration involves people that are skilled—relative to both the home and host country labor markets (Docquier & Marfouk 2006, Defoort & Rodgers 2008). While such migrations have long been a staple of the literature on the "brain drain" (e.g. Grubel & Scott 1966, Bhagwati & Rodriguez 1975, Kwok & Leland 1982, Commander, Kangasniemi & Winters 2004, Kapur & McHale 2005), the focus of research on host countries has primarily been unskilled migration (Ethier 1986). Furthermore, most of this literature has emphasized single-country analysis, not the global equilibrium of such flows. Similarly, most of this literature tends to consider economies that are closed to all global flows but migration (or small, open economies with relative prices fixed by international trade). This was a sensible research strategy in an era characterized by high trade restrictions in North-South trade, but it seems problematic in an increasingly globalized world where international trade constitutes a sizable share of world product. In addition, as long as trade and factor movements take place between countries with democratically elected governments we also need to distinguish welfare outcomes from outcomes that are politically feasible.

To address these issues, we introduce migration of skilled workers in a two-country, two-sector trade model. As in the Roy selection model (Roy 1951), workers in both countries are differentiated by skill and, in autarky or under trade (but without migration), they will sort themselves among sectors based on the sector that offers the higher income.<sup>1</sup> As in the Roy-Borjas model (Borjas 1987), when presented with the opportunity to migrate, they will choose whether or not to migrate based on comparison of incomes net of migration costs.<sup>2</sup> It is well-known that in models of the Heckscher-Ohlin-Samuelson type trade and migration are substitutes (Mundell 1957, Markusen 1983, Ethier 1996). In line with much of the recent literature on migration, we will assume that there is a technology gap between countries.<sup>3</sup> Specifically, while the two countries use the same technology in the primary sector, one country has a more efficient technology in the high-tech sector. The two countries have identical endowments of skills (human capital). In the primary sector worker productivity is independent of the level of skills. Skills however matter in the high-tech sector.

---

<sup>1</sup>Bougheas & Riezman (2007), Davidson & Matusz (2006) and Davidson, Matusz & Nelson (2006) use the same framework to analyze a host of trade issues, but not migration.

<sup>2</sup>The Roy-Borjas model has proved to be an extremely useful framework for organizing both theoretical and empirical work on migration (e.g. Chiquiar & Hanson 2005, Brucker & Defoort 2006, Belot & Hatton 2008, Grogger & Hanson 2008, Ortega & Peri 2009). It is notable that all of the papers just cited find support for positive selection.

<sup>3</sup>In his Marshall lecture, Lucas (1988, pg. 38) noted in passing that patterns of immigration seem inconsistent with patterns of capital flow in standard growth model. Davis & Weinstein (2002) and Iranzo & Peri (2009) build models of trade and migration with technological differences in which the technologically superior country not only exports the skilled labor-intensive good, but also imports skilled labor. Building on the same empirical observation, Rauch (1991) develops an alternative model with heterogeneous workers in which production requires managerial labor as well as skilled and unskilled labor, only skilled workers can be managers. Rauch's model also generates the observed patterns of mobility and trade.

After we derive the equilibrium under autarky for each country, we solve for the free trade equilibrium. Next, we do not allow trade but we permit migration. When migration is costless we arrive at a full integration equilibrium where everybody lives in the country that is technologically superior. We also derive the equilibrium when migration is costly and we find that when only skilled workers move the gap between the autarky prices widens. The intuition is that as skilled workers move away from the country that is technologically disadvantaged it increases the relative cost of producing the high tech-good and thus increases its relative price which in turn deteriorates the incomes of the producers of the primary commodity who also are the relatively poor. Migration has exactly the opposite effects on the technologically advanced country.

When we allow for both trade and migration we derive two main results. The first is that trade and migration are complements. Put differently, migration is higher under trade than under autarky. The second result is that welfare is higher when both trade and migration are allowed. More importantly, when we consider separately migrants, and the citizens of each country without including the migrants we find that migration and trade increase the welfare of each of these three groups.

Finally, we turn to the political economy implications of our model. When citizens are allowed to vote for whether or not to allow migration and on whether or not to compensate those who lose as a consequence of migration we find that the sequence of referenda in the source country and the citizenship status of migrants in the host country can both matter. There is now a sizable literature developing on the political economy of migration.<sup>4</sup> In an important early contribution, Benhabib (1996) developed a small, open, one-sector economy with heterogeneous agents (every agent possesses one unit of labor and some non-negative quantity of capital), where migration policy is decided by referendum. Grether, DeMelo & Müller (2001) drop the agent heterogeneity, but consider a small, open, 2-sector economy, with a referendum mechanism. In our analysis, we model a large, 2-sector economy with heterogeneous agents. In our 2-country world, we can follow the literature on selection, while still retaining the tractability to present a simple intuitive model permitting welfare and political economy issues.

## 2. The Model

There are two countries  $A$  and  $B$  each populated by a continuum of workers of unit measure. Each worker is endowed with one unit of indivisible labor and some level of human capital  $h$ . In both countries human capital is uniformly distributed on the interval  $[0, 1]$ . In each country there are two competitive sectors. Sector  $X$  produces a high-tech product while sector  $Y$  produces a primary commodity. The productivity of workers depends on their level of human capital and their sector of employment. Let  $z_{AX}(h)$  denote the productivity of a worker with human capital  $h$  who works in country  $A$  in sector  $X$

---

<sup>4</sup>Much of this literature deals with the way redistributive policy interacts with migration (e.g. Mazza & Van Winden 1996, Wellisch & Walsz 1998, Razin, Sadka & Swagel 2002). That is not the focus of our paper, and we will not comment on it any further. Similarly, a number of papers have used lobbying models to analyze the political economy of immigration (e.g. Facchini & Willmann 2005, Epstein & Nitzan 2006). As our paper focuses on the referendum mechanism, we will not discuss these papers either.

(other types of employment are similarly defined). All four technologies are linear in  $h$ :

$$\begin{aligned} z_{AX} &= h \\ z_{BX} &= kh; \quad k > 1 \\ z_{AY} &= z_{BY} = v; \quad 0 < v < 1; \end{aligned}$$

Both countries use the same technology to produce the primary commodity but country  $B$  has a superior technology in sector  $X$ . In addition, the marginal return to human capital is higher in the high-tech sector.

All workers have identical Cobb-Douglas preferences given by

$$U = X^\alpha Y^\beta; \quad 0 < \alpha, \beta < 1; \quad \alpha + \beta = 1$$

Given that technologies are CRS and that all markets are competitive worker incomes equal their productivities and each workers spend a fraction  $\alpha$  of her income on product  $X$ .

### 2.1. Autarky

Throughout we use good  $X$  as the numeraire and let  $p_A$  and  $p_B$  denote the autarky prices in countries  $A$  and  $B$  respectively. In what follows we are going to concentrate our analysis on country  $B$  since by setting  $k = 1$  we can obtain the corresponding solutions for country  $A$ .

Workers choose their sector of employment by comparing wages. A worker with human capital  $h$  will receive income  $kh$  if employed in sector  $X$  while the same worker will receive income  $p_B v$  if employed in sector  $Y$ . This implies that all workers with human capital higher than  $h_B \equiv \frac{p_B v}{k}$  will be employed in the high-tech sector while workers with human capital below this threshold will be employed in the primary sector. Given our specification of preferences the equilibrium autarky price is proportional to the ratio of aggregate production in sector  $X$  divided by the aggregate production in sector  $Y$ :

$$p_B = \frac{\beta \int_{h_B}^1 kh dh}{\alpha h_B v}$$

The corresponding closed form solution for the autarky price is given by:

$$p_B = \frac{k}{v} \sqrt{\frac{\beta}{2\alpha + \beta}}$$

Notice that the above solution implies that  $p_B > p_A$  which follows from the fact that country  $B$  has a superior technology for producing the high-tech product. It also follows that  $h_A = h_B$ .

—Figure 1 about here—

We illustrate the autarky equilibrium in figure 1. The horizontal axis shows the (uniform) distribution of skill from 0 to 1. The left vertical axis shows value marginal product in Y, while the right vertical axis shows value marginal product in X (the numeraire). Since both countries share the same distribution of skill, both can be shown on the same graph. Our assumptions imply that the value marginal product curve for X in country B lies above that in country A. Finally, we see both  $p_B > p_A$  and  $h_A = h_B$  (which we simply denote  $h$  in the diagram).

## 2.2. Trade

When the two economies trade country A exports the primary commodity Y and country B exports the high-tech product X. The world price  $p^T$  lies between the two autarky prices and is given by

$$p^T = \frac{\beta \int_{h_A^T}^1 h dh + \int_{h_B^T}^1 k h dh}{\alpha (h_A^T + h_B^T) v}$$

where  $h_A^T = p^T v > h_A = h_B > \frac{p^T v}{k} = h_B^T$ . The corresponding closed form solution for the world price is given by:

$$p^T = \frac{\sqrt{k}}{v} \sqrt{\frac{\beta}{2\alpha + \beta}}$$

–Figure 2 about here–

Figure 2 illustrates the equilibrium with trade. With a common world price, we see country B specializing in the production of good X, in which it has a comparative advantage, by allocating more labor to its production. Similarly for country A and good Y.

## 2.3. Migration

Suppose that the two economies do not trade but migration is allowed.

### 2.3.1. Costless Migration

Given that the two countries use the same technology to produce the primary commodity but country B has a superior technology for producing the high-tech product every worker in country A will emigrate in country B. The integration equilibrium price is equal to  $p_B$ , i.e. country B's autarky price.

### 2.3.2. Costly migration

Now suppose that migration entails a cost  $\gamma$  measured in numeraire units. We are going to assume that this cost is sufficiently high so that workers in the primary sector do not wish to emigrate.<sup>5</sup> Let  $p_A^M$  and  $p_B^M$  denote the two new autarky prices. The utility of a

<sup>5</sup>When we introduce trade these workers will not have an incentive to emigrate. Thus, by restricting their movement in the absence of trade allows for clearer comparisons between the two cases.

worker who is a citizen of country  $A$ , employed in sector  $X$  and does not emigrate is equal to  $(h)^\alpha (\frac{h}{p_A^M})^\beta = h (p_A^M)^{-\beta}$ .<sup>6</sup> If the same worker emigrates to country  $B$  her new utility will be  $(kh - \gamma)^\alpha (\frac{kh - \gamma}{p_B^M})^\beta = (kh - \gamma) (p_B^M)^{-\beta}$ . Then there exists a threshold level of human capital  $h^M = \frac{\gamma (p_B^M)^{-\beta}}{k (p_B^M)^{-\beta} - (p_A^M)^{-\beta}}$  such that all workers with human capital above it and who initially were citizens in country  $A$  emigrate to country  $B$ . Letting  $h_A^M$  and  $h_B^M$  denote the new threshold levels of human capital that separates those employed in sector  $X$  from those employed in sector  $Y$ , in countries  $A$  and  $B$  respectively, the new autarky prices are given by the system of equations:

$$p_A^M = \frac{\beta \int_{h_A^M}^{h^M} h dh}{\alpha h_A^M v}$$

and

$$p_B^M = \frac{\beta \int_{h^M}^1 (kh - \gamma) dh + \int_{h_B^M}^1 kh dh}{\alpha h_B^M v}$$

Notice that the two equations need to be solved simultaneously since  $h^M$  depends on both new autarky prices. This complication implies that it is not possible to derive closed-form solutions for the two prices. Nevertheless, the effect of migration is to increase the gap between the autarky prices, i.e.  $p_B^M > p_B > p_A > p_A^M$ . The intuition is that in country  $A$  the old threshold level of human capital that separates those employed in sector  $X$  from those employed in sector  $Y$  is too high, given that only high ability workers have migrated while the corresponding threshold in country  $B$  is too low.<sup>7</sup>

–Figure 3 about here–

While the principle is straightforward, our graphical apparatus gets messier here. Since all workers with human capital above  $h_M^A$  migrate from  $A$  to  $B$ , we truncate the  $A$  distribution at  $h_M^A$  and append the  $\mu$  skilled workers to the  $B$  distribution. It is easy to see that, with unchanged preferences and no international trade, the migration of workers that produce only good  $X$  results in too little  $X$  production in country  $A$  and too much in country  $B$ . This results in an increase in the relative price of  $X$  in country  $A$  and a reduction country  $B$  (i.e. a fall in  $p_A^M$  and a rise in  $p_B^M$ ) and, of course, an increase in the allocation of labor to  $X$  production in  $A$  and to  $Y$  production in  $B$ .

<sup>6</sup>All utilities have been divided by  $\alpha^\alpha \beta^\beta$ .

<sup>7</sup>Let  $\mu$  denote the proportion of migrants. Given that both populations originally were of unit measure the new population of country  $A$  is of measure  $1 - \mu$  and human capital is uniformly distributed on the interval  $[0, 1 - \mu]$ .



### 3. Migration and Trade

#### 3.1. Costless Migration

When migration is costless it is optimal that the whole production of the high-tech product takes place in country  $B$ . In the absence of trade costs, the production location of the primary product is inconsequential. In the presence of trade costs it is optimal that all workers move to country  $B$ . In either case we have full integration. The full integration equilibrium price  $p^{FI}$  is given as the solution of

$$p^{FI} = \frac{\beta}{\alpha} \frac{\int_{h^{FI}}^1 kh dh}{h^{FI} v}$$

where  $h^{FI} = \frac{p^{FI} v}{k}$ . It is clear that the equilibrium world trade price and the critical threshold are the same as those for the autarky case for country  $B$ .

#### 3.2. Costly Migration

Once again suppose that migration entails a cost  $\gamma$  measured in numeraire units. Given that when the two countries trade all workers face the same price, the only workers that move across borders are some of those workers who were citizens of country  $A$  and employed in sector  $X$  and now move to country  $B$  and are employed in the same sector. For these workers their pre-migration income was equal to  $h$  while their post-migration income is equal to  $kh - \gamma$ . This implies that there exists a threshold level of human capital  $h^* \equiv \frac{\gamma}{k-1}$  such that all workers with human capital above it and who initially were citizens in country  $A$  emigrate to country  $B$ .<sup>8</sup> Letting  $h_A^*$  and  $h_B^*$  denote the new threshold levels of human capital that separates those employed in sector  $X$  from those employed in sector  $Y$ , the new equilibrium price  $p^*$  is given by

$$p^* = \frac{\beta}{\alpha} \frac{\int_{h_A^*}^{h^*} h dh + \int_{h^*}^1 (kh - \gamma) dh + \int_{h_B^*}^1 kh dh}{(h_A^* + h_B^*) v}$$

The corresponding closed form solution is:

$$p^* = \frac{\sqrt{k}}{v} \sqrt{\frac{2k - \gamma}{1 + k}} \sqrt{\frac{\beta}{2\alpha + \beta}}$$

Given that  $\sqrt{k} > \sqrt{\frac{2k - \gamma}{1 + k}}$  we have  $p^B > p^*$ . In addition, the inequality  $\gamma < k - 1$  implies that  $p^* > p^T$  which in turn implies that  $h_B^* > h_B^T$  and  $h_A^* > h_A^T$ . This is because migration has allowed a more efficient allocation of resources by moving high skilled workers to country  $B$  which has a superior technology for producing the skill-intensive product  $X$ .

---

<sup>8</sup>Notice that here it is sufficient to compare incomes because the prices in the two countries are equal. Earlier we examined the case where there is no trade and therefore the prices in the two countries were different.

Comparing the threshold levels of human capital that separate those who emigrate from those who do not for the cases of migration without trade and migration with trade we get the following result

**Proposition 1** *Migration and trade are complements.*

**Proof** The proposition follows from the inequality  $p_B^M > p_A^M$  which ensures that  $h^* < h^M$ .

Figure 4 illustrates the equilibrium with trade and migration.

–**Figure 4 about here**–

There is more migration under free trade and the skilled migration to the skill abundant country supports increased comparative advantage based trade. The intuition is that, under trade, prices converge which further boosts the incomes of the migrants and thus the incentive to migrate. Of course this is not a new result. Markusen (1983) and Razin & Sadka (1994) have, within more traditional trade modes, demonstrated the complementarity between trade and migration when countries differ in technologies.

## 4. Welfare

We measure group welfare as the sum of utilities of its individual members. We are focusing on three groups: The citizens of country  $B$  (excluding migrants), the migrants and the citizens of country  $A$  excluding migrants. Below we demonstrate that migration increases the welfare of all three groups and thus global welfare.<sup>9</sup>

### 4.1. Citizens of Country B (excluding migrants)

Those workers who were employed in the primary sector during the pre-migration period and are still employed in the same sector during the post-migration period are better off in the later period. This is because migration increases the price of the primary commodity and hence their income. For exactly the same reason those workers that are employed in the high-tech sector during both periods experience a loss in utility. In addition, the inequality  $h_B^* > h_B^T$  implies that there are some workers who before migration were employed in the high-tech sector and after migration they moved to the primary sector. Among these workers some are better off and some are worse off. More specifically, there exists a threshold level of human capital,  $\tilde{h}^B$ , such that all workers with human capital below that level are better off after migration while all those workers with human capital above that level are worse off after migration.

**Lemma 1** *Migration increases the welfare of the citizens of country B.*

---

<sup>9</sup>All utilities have been divided by  $\alpha^\alpha \beta^\beta$ . In addition, by  $p$  we denote the equilibrium price  $p^*$  where for notational simplicity we have dropped the superscript when confusion can be avoided.

**Proof** The post migration utility of an agent working in sector  $X$  is equal to

$$(kh)^\alpha \left(k \frac{h}{p}\right)^\beta = kh p^{-\beta}$$

and the corresponding utility of an agent working in sector  $Y$  is equal to

$$(pv)^\alpha v^\beta = p^\alpha v$$

Then, the post-migration welfare,  $W^B$ , of the citizens of country  $B$  is given by

$$\begin{aligned} W^B &= \int_0^{\frac{pv}{k}} p^\alpha v dh + \int_{\frac{pv}{k}}^1 kp^{-\beta} dh = \\ &= \frac{p^{1+\alpha} v^2}{k} + \frac{1}{2} kp^{-\beta} - \frac{1}{2} \frac{p^{2-\beta} v^2}{k} = \\ &= \frac{1}{2} \left[ \frac{v^2}{k} p^{1+\alpha} + kp^{-(1-\alpha)} \right] \end{aligned}$$

Next consider the effect on welfare of a small change in the migration cost  $\gamma$ .

$$\text{sign} \left[ \frac{dW^B}{d\gamma} \right] = \text{sign} \left[ \left( (1+\alpha) \frac{v^2}{k} p^\alpha - \frac{(1-\alpha)k}{p^{2-\alpha}} \right) \frac{dp}{d\gamma} \right]$$

Substituting for  $p^*$  and rearranging we get

$$\text{sign} \left[ \frac{dW^B}{d\gamma} \right] = \text{sign} \left[ \left( 1 - \frac{1+k}{2k-\gamma} \right) \frac{dp}{d\gamma} \right]$$

Given that  $\gamma < k - 1$  and  $\frac{dp}{d\gamma} < 0$  a decrease in migration costs will increase welfare.

## 4.2. Migrants

**Lemma 2** *Migration increases the welfare of the migrants.*

**Proof** The pre-migration utility of a migrant is equal to

$$h(p^T)^{-\beta}$$

while the post-migration utility of a migrant is equal to

$$h(p^*)^{-\beta} k$$

Substituting for  $p^T$  and  $p^*$  we find that migration increases the welfare of migrants if and only if

$$\frac{(\sqrt{1+k})^{1-\alpha}}{(\sqrt{2k-\gamma})^{1-\alpha}} k > 1$$

As  $\gamma \rightarrow 0$  the left-hand side of the above expression approaches

$$\frac{(\sqrt{1+k})^{\frac{1-\alpha}{2}} k^{\frac{1+\alpha}{2}}}{2^{\frac{1-\alpha}{2}}}$$

The above expression is increasing in  $k$  and is equal to 1 for  $k = 1$  which, given that  $k > 1$ , completes the proof.

### 4.3. Citizens of Country A (excluding migrants)

For exactly the same reasons as those analyzed for country  $B$ , those workers who were employed in the primary sector during the pre-migration period and are still employed in the same sector during the post-migration period are better off in the later period. Once more, the inequality  $h_A^* > h_A^T$  implies that there are some workers who before migration were employed in the high-tech sector and after migration they moved to the primary sector. Among these workers some are better off and some are worse off. Again, there exists a threshold level of human capital,  $\tilde{h}^A$ , such that all workers with human capital below that level are better off after migration while all those workers with human capital above that level are worse off after migration.

**Lemma 3** *Migration increases the welfare of the citizens of country A excluding the migrants.*

**Proof** The post migration utility of an agent working in sector  $X$  is equal to

$$h^\alpha \left(\frac{h}{p}\right)^\beta = hp^{-\beta}$$

and the corresponding utility of an agent working in sector  $Y$  is equal to

$$(pv)^\alpha v^\beta = p^\alpha v$$

Then, the post-migration welfare,  $W^A$ , of the citizens of country  $A$  is given by

$$\begin{aligned} W^A &= \int_0^{pv} p^\alpha v dh + \int_{pv}^{\frac{\gamma}{k-1}} p^{-\beta} h dh = \\ &= p^{1+\alpha} v^2 + \frac{1}{2} p^{-\beta} \left(\frac{\gamma}{k-1}\right)^2 - \frac{1}{2} p^{2-\beta} v^2 = \\ &= \frac{1}{2} \left[ v^2 p^{1+\alpha} + \frac{\gamma^2}{(k-1)p^{(1-\alpha)}} \right] \end{aligned}$$

Next consider the effect on welfare of a small change in the migration cost  $\gamma$ .

$$\text{sign} \left[ \frac{dW^A}{d\gamma} \right] = \text{sign} \left[ \left\{ \left( (1+\alpha)v^2 p^\alpha - \frac{(1-\alpha)k\gamma^2}{(k-1)p^{(2-\alpha)}} \right) \frac{dp}{d\gamma} \right\} + \frac{2\gamma}{(k-1)p^{1-\alpha}} \right]$$

Notice that a change in migration costs will affect the number of migrants and the last term captures the change in welfare as a result of the change in the size of the group. We know that a decrease in migration costs will increase the number of migrants and we know that their welfare will increase. Here, we need to concentrate only on the first term. Given that  $\gamma < k-1$ ,  $\frac{\gamma^2}{k-1} < 1$  and the proof is completed by following the same steps as those used in the proof of proposition 1.

### 4.4. Global Welfare

The following proposition is a direct implication of the three lemmas.

**Proposition 2** *Migration increases global welfare.*

## 5. Political Economy

The results of the previous section suggest that migration increases welfare in both countries even when migrants (who definitely gain) are ignored. This implies that the gains of those who benefit are more than sufficient to cover the losses of those workers who are worse off as a result of migration. However, for countries with democratically elected governments where majority voting decides key policy issues people might vote against migration and even if they decide to allow it losers might not be compensated. In this section, we identify the conditions under which each of these outcomes materializes. We begin by examining the possible outcomes of a referendum on migration ignoring, for the moment, any compensation policies.

### 5.1. Referendum on Migration

Consider the voting outcome in country  $A$ . The proportion of people who would vote in favor of migration,  $\varphi_A^M$ , is equal to

$$\varphi_A^M = \tilde{h}^A + \left(1 - \frac{\gamma}{k-1}\right)$$

where the second term captures the votes of the migrants. The median voter's pre-migration utility is equal to  $\tilde{h}^A(p^T)^{-\beta}$  while the same voter's post-migration utility is  $(p^*)^\alpha v$ ; keeping in mind that in the pre-migration period is employed in sector  $X$  and then moves to sector  $Y$ . Equating the two utilities, solving for the median voter's human capital and substituting in the above equality, we get

$$\varphi_A^M = p^T v \left( \sqrt{\frac{2k-\gamma}{1+\gamma}} \right)^\alpha + \left(1 - \frac{\gamma}{k-1}\right)$$

Next consider the voting outcome in country  $B$ . The proportion of people who would vote in favor of migration,  $\varphi_B^M$ , is equal to

$$\varphi_B^M = \tilde{h}^B = \frac{\tilde{h}^A}{k}$$

The proposition below follows from the inequality  $\varphi_B^M < \varphi_A^M$  and the fact that both countries have to vote in favor of migration.

**Proposition 3** *In the absence of any compensation policy migration will take place if and only if  $\varphi_B^M > 0.5$ .*

Also, notice that a decline in migration costs increases the likelihood that the voting outcome will favor migration.

## 5.2. Referenda on Migration and Compensation

Suppose that citizens in each country have the opportunity to vote on two referenda. In one referendum, as in the previous section, they vote on whether or not to allow migration (emigration in country  $A$  and immigration in country  $B$ ). In the other referendum they vote on whether or not there will be compensation for those who experience a loss in income as a result of migration. We demonstrate that outcomes would depend on whether or not migrants are allowed to vote on the compensation referendum in the host country ( $B$ ) and on the sequence of referenda in the source country ( $A$ ).

We begin with country  $A$ . We assume that if the compensation referendum takes place first the compensation scheme can include a tax on migrants whose revenues can be used for compensating the losers. The proposition below identifies conditions such that the sequence of referenda matters.

**Proposition 4** *Suppose that  $\tilde{h}^A + 1 - \frac{\gamma}{k-1} > \frac{\gamma}{k-1} - \tilde{h}^A > \tilde{h}^A$ . Then country  $A$  will vote for compensation if and only if the migration referendum takes place first..*

**Proof** The first inequality states that the winners together with the migrants are a majority group. The second inequality states that the proportion of losers is higher than the proportion of winners. Suppose that the compensation referendum takes place first. The migrants do not have an incentive to vote for compensation given that together with the winner will vote in favor of migration. In contrast, when the migration referendum takes place first there will be an unanimous vote in favor of migration. The winners are still better off and the losers know that they can get compensation after the next referendum.

Now consider the referenda in country  $B$ .

**Proposition 5** *Suppose that  $\tilde{h}^B + 1 - \frac{\gamma}{k-1} > 1 - \tilde{h}^B > \tilde{h}^B$ . Then country  $B$  will vote for compensation if and only if migrants are not allowed to vote on the compensation referendum.*

**Proof** Clearly, if migrants are allowed to vote on the compensation referendum they would vote against compensation. The first inequality states that the winners together with the migrants are a majority group. The second inequality states that the proportion of losers is higher than the proportion of winners. Notice that if migrants were allowed to vote and given that they would vote against compensation there would be a vote against migration given that the losers (in the absence of migrant vote) are a majority group.

## 6. Conclusion

We have presented a two-country model of trade and skilled labor migration. Trade and migration are induced by differences in technologies and thus are complements. Cross-border movements of workers has significant welfare implications for both source and

host countries. In our model, where only skilled workers have an incentive to migrate those workers who are employed in skill-intensive sectors (other than the migrants) suffer welfare losses. Nevertheless, we have shown that, in both countries, the welfare gains of those workers who benefit from migration exceed (in absolute terms) the losses of those workers who suffer losses. However, we have also shown that in countries where both migration and any compensation policies are decided by majority vote, there is no guarantee that neither the losses will be compensated should migration take place nor there will be a vote in favor of migration.

This framework can be easily extended to account for unskilled worker migration by having the two countries using different technologies for the production of the primary commodity. For that matter a general version can allow for migration of both types of workers which can be either in the same or in the opposite direction.<sup>10</sup>

## 7. References

### References

- Belot, M. V. & Hatton, T. J. (2008). Immigrant selection in the OECD. Australian National University Center for Economic Policy Research, Discussion Paper 571.
- Benhabib, J. (1996). On the political economy of immigration, *European Economic Review* **40**(9): 1737–1743.
- Bhagwati, J. & Rodriguez, C. (1975). Welfare-theoretical analyses of the brain drain, *Journal of Development Economics* **2**: 195–221.
- Borjas, G. (1987). Self-selection and the earnings of immigrants, *American Economic Review* **77**(4): 531–553.
- Bougheas, S. & Riezman, R. (2007). Trade and the distribution of human capital, *Journal of International Economics* **73**: 421–433.
- Brucker, H. & Defoort, C. (2006). The (self-)selection of international migrants reconsidered: Theory and new evidence. IZA Discussion Paper, 2052.
- Chiquiar, D. & Hanson, G. (2005). International migration, self-selection, and the distribution of wages: Evidence from Mexico and the United States, *Journal of Political Economy* **113**: 239–281.
- Commander, S., Kangasniemi, M. & Winters, L. A. (2004). The brain drain: Curse or boon? a survey of the literature, in R. Baldwin & L. A. Winters (eds), *Challenges to Globalization: Analyzing the Economics*, number 809 in *Discussion Paper*, University of Chicago Press, Chicago, pp. 235–272.

---

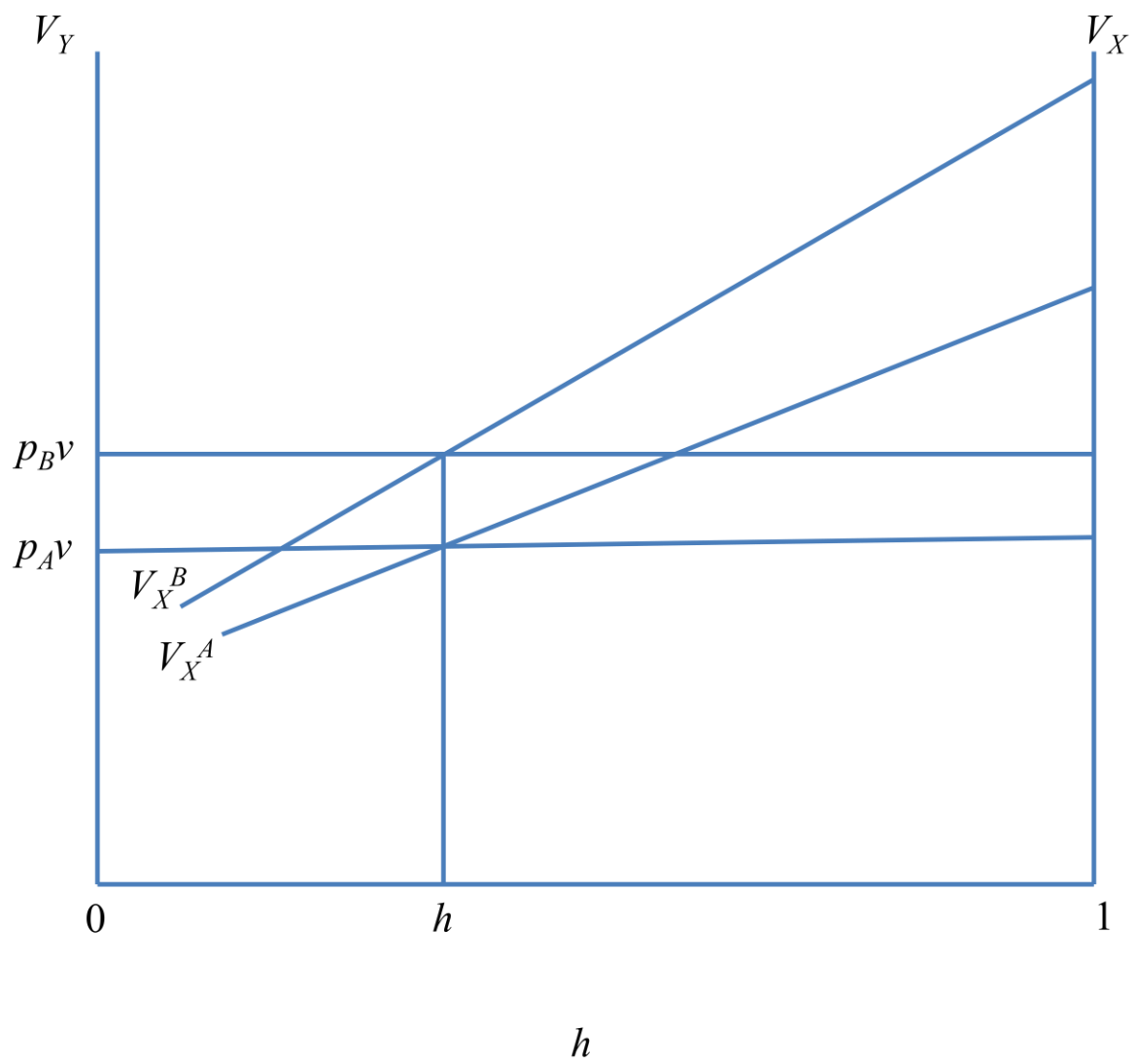
<sup>10</sup>For example, Ishikawa (1996) offers a model of trade and migration, where the two countries differ in their endowments, and where both types of workers move in the same direction.

- Davidson, C. & Matusz, S. (2006). Trade liberalization and compensation, *International Economic Review* **47**: 723–747.
- Davidson, C., Matusz, S. & Nelson, D. (2006). Can compensation save free trade?, *Journal of International Economics* **71**: 167–186.
- Davis, D. & Weinstein, D. (2002). Technological superiority and the losses from migration, NBER Working Paper, w8971.
- Defoort, C. & Rodgers, G. (2008). Long trends in international skilled migrations: Evidence from 6 major receiving countries, *Population* **63**(2): 285–318.
- Docquier, F. & Marfouk, A. (2006). International migration by educational attainment (1990-2000) - release 1.1, in Ç. Özden & M. Schiff (eds), *International Migration, Remittances and Development*, Palgrave Macmillan, New York, chapter 5.
- Epstein, G. & Nitzan, S. (2006). The struggle over migration policy, *Journal of Population Economics* **19**(4): 703–723.
- Ethier, W. (1986). International trade theory and international migration, in O. Stark & I. Sirageldin (eds), *Research in Human Capital and Development: Migration*, JAI Press, New York, pp. 27–74.
- Ethier, W. (1996). Theories about trade liberalisation and migration: Substitutes or complements?, in P. J. Lloyd & L. S. Williams (eds), *International Trade and Migration in the APEC Region*, Oxford University Press, New York, pp. 50–68.
- Facchini, G. & Willmann, G. (2005). The political economy of international factor mobility, *Journal of International Economics* **67**(1): 201–219.
- Grether, J.-M., DeMelo, J. & Müller, T. (2001). The political economy of migration in a ricardo-viner model, in S. Djajic (ed.), *International Migration: Trends, Policy, Impact*, Routledge, London, pp. 42–68.
- Grogger, J. & Hanson, G. (2008). Income maximization and the selection and sorting of international migrants, NBER Working Paper, w13821.
- Grubel, H. & Scott, A. (1966). The international flow of human capital, *American Economic Review* **56**(2): 268–274.
- Iranzo, S. & Peri, G. (2009). Migration and trade: Theory with an application to the eastern-western european integration, *Journal of International Economics* **79**(1): 1–19.
- Ishikawa, J. (1996). Scale economies in factor supplies, international trade, and migration, *Canadian Journal of Economics* **29**: 573–594.

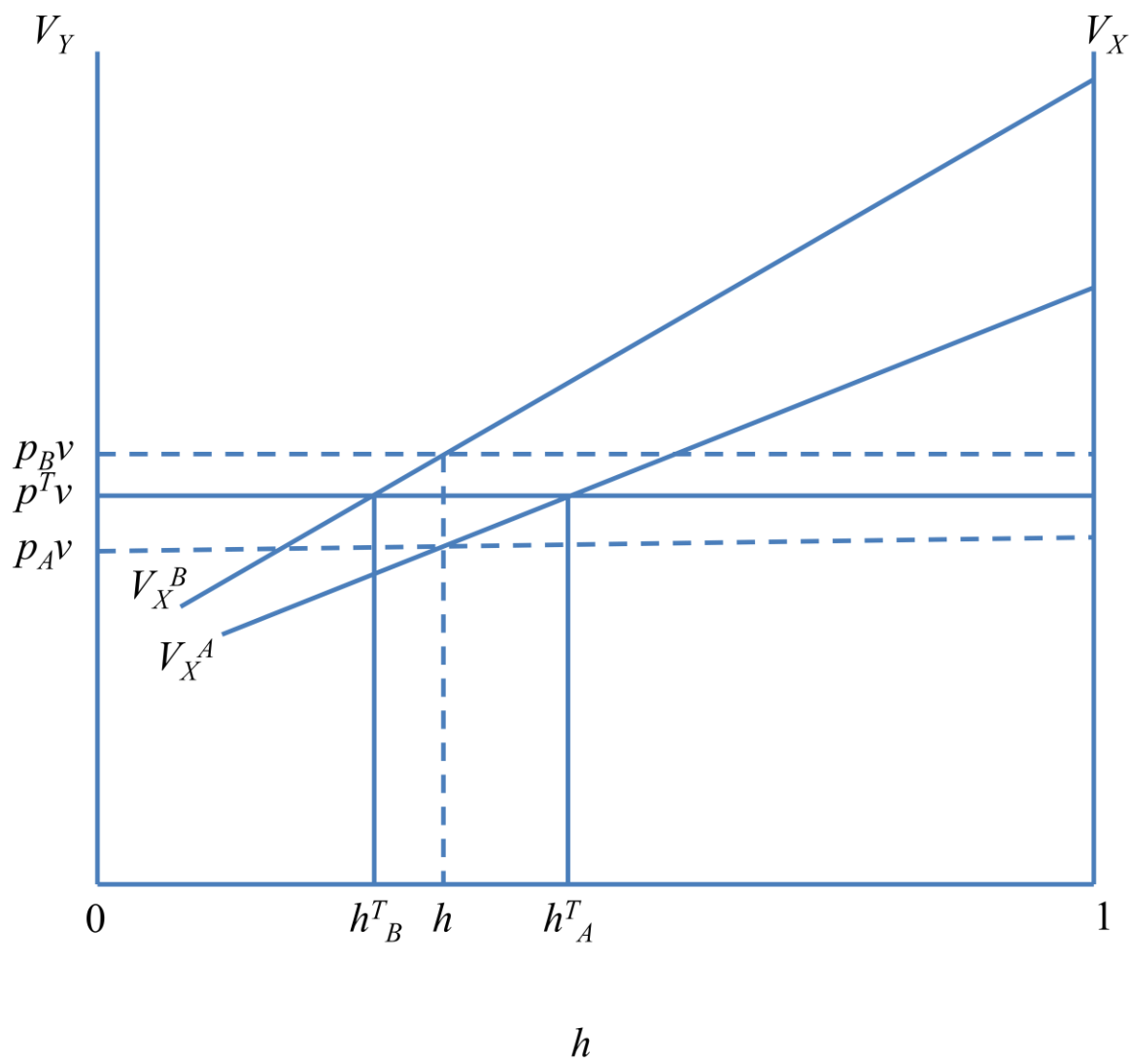


- Kapur, D. & McHale, J. (2005). *Give Us Your Best and Brightest: The Global Hunt for Talent and Its Impact on the Developing World*, Brookings Institution Press, Washington, DC.
- Kwok, V. & Leland, H. (1982). An economic model of the brain drain, *American Economic Review* **72**(1): 91–100.
- Lucas, R. (1988). On the mechanics of economic development, *Journal of Monetary Economics* **22**(1): 3–42.
- Markusen, J. (1983). Factor movements and commodity trade as complements, *Journal of International Economics* **14**: 341–356.
- Mazza, I. & Van Winden, F. (1996). A political economic analysis of labor migration and income redistribution, *Public Choice* **88**(2): 333–363.
- Mundell, R. (1957). International trade and factor mobility, *American Economic Review* **47**(3): 321–335.
- Ortega, F. & Peri, G. (2009). The causes and effects of international mobility: Evidence from OECD countries 1980-2005, NBER Working Paper, w14833.
- Rauch, J. (1991). Reconciling the pattern of trade with the pattern of migration, *American Economic Review* **81**: 775–796.
- Razin, A. & Sadka, E. (1994). International migration and international trade, in M. Rosenzweig & O. Stark (eds), *Handbook of Population and Family Economics, Vol. 1*, North-Holland Publishers, North-Holland, Amsterdam.
- Razin, A., Sadka, E. & Swagel, P. (2002). Tax burden and migration: A political-economy theory and evidence, *Journal of Public Economics* **85**(2): 167–190.
- Roy, A. (1951). Some thoughts on the distribution of earnings, *Oxford Economic Papers* **3**(2): 135–146.
- Wellisch, D. & Walsz, U. (1998). Why do rich countries prefer free trade over free migration? the role of the modern welfare state, *European Economic Review* **42**: 1595–1612.

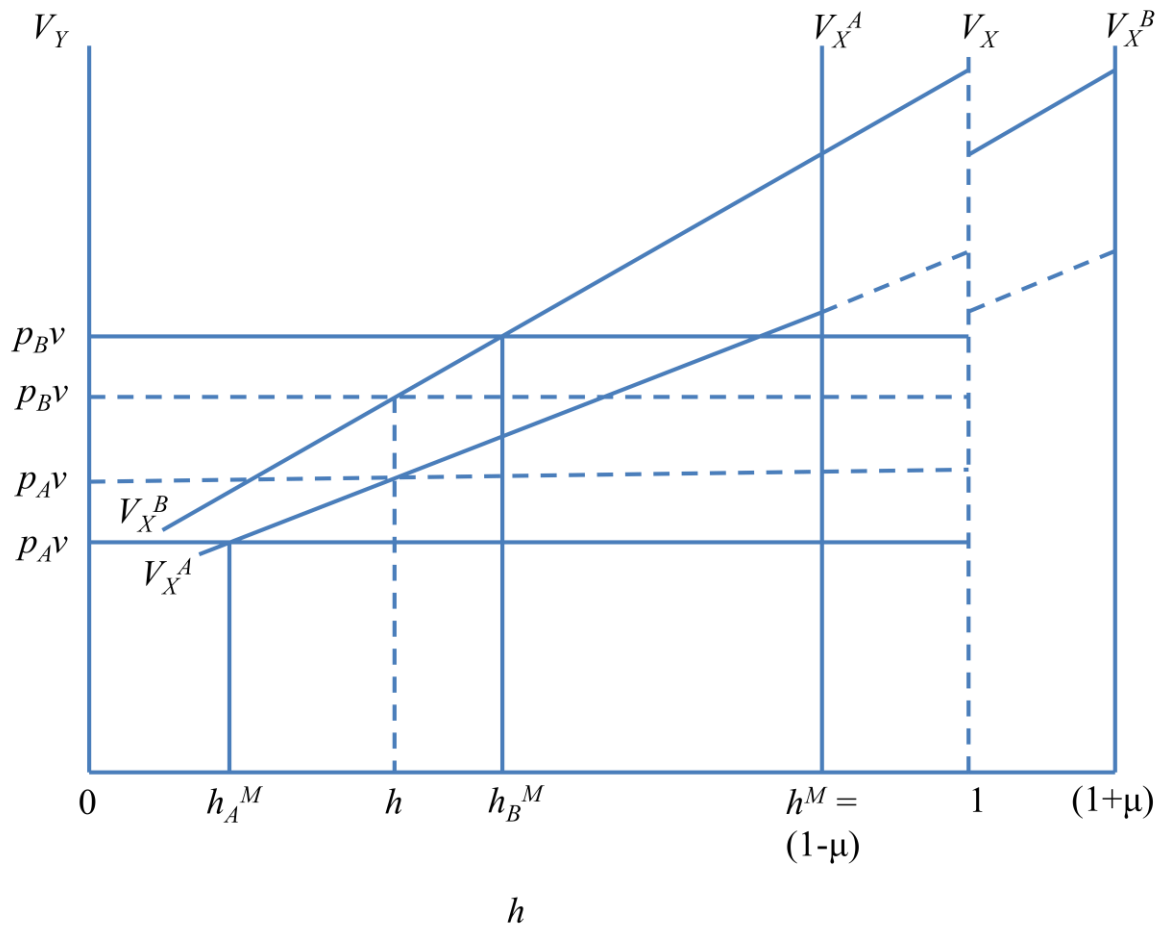
**Figure 1: Autarky**



**Figure 2:** International Trade without Migration



**Figure 3:** Migration without International Trade



**Figure 4:** International Trade and Migration

