The Economics of International Wage Differentials and Migration

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Summary

The key question for the economics of international migration is whether observed real wage differentials across countries for workers with identical intrinsic productivity represent an economic inefficiency sustained by legal barriers to labor mobility between geographies. A simple comparison of the real wages of workers with the same level of formal schooling or performing similar occupations across countries shows massive gaps between rich and poorer countries. These gaps persist after adjusting for observed and unobserved human capital characteristics, suggesting a “place premium”—or space-specific wage differentials that are not due to intrinsic worker productivity but rather are due to a misallocation of labor. If wage gaps are not due to intrinsic worker productivity, then the incentive for workers to move to richer countries is high. The idea of a place premium is corroborated by macroeconomic evidence. National accounts data show large cross-country output per worker differences, driven by the divergence of total factor productivity. The lack of convergence in total factor productivity and corresponding spatial productivity differentials create differences in the marginal product of factors, and hence persistent gaps in the wages of equal productivity workers. These differentials can equalize with factor flows; however their persistence and large magnitude in the case of labor, suggest legal barriers to migration restricting labor flows are in fact constraining significant return on human capital, and leaving billions in unrealized gains to the world’s workers and global economy. A relaxation of these barriers would generate worker welfare gains that dwarf gold-standard poverty reduction programs.

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