

The New Immigration and the New US economy

Richard B. Freeman
Harvard University and NBER
April 25, 2006

Statement before the Senate Judiciary Committee

I have organized my comments around eight points.

1) Immigration is part of globalization. It is intimately connected to increased trade, free mobility of capital, and transmission of knowledge across national lines. Ideally, immigration and these other flows allow the US and the world to make better use of available resources and to raise national and world output. A worker who comes to the US increases the American labor supply, which means the country can produce more. If that worker does not immigrate, he or she may make the same or similar good in their native country and export that good to the US. Or a US or other multinational may invest in that worker's country to produce the good. In other situations, the immigrant may bring capital, particularly human capital, with them, so that both capital and labor move together. The message for thinking about immigration in the global economy is: view immigration as related to trade and capital flows; policies that affect trade and capital will alter immigration and conversely.

2) Immigration is the least developed part of globalization.. Immigrants make up about 3 percent of the global workforce; whereas international trade's share of world output is around 13 percent; and foreign equities in investors' equity portfolio are on the order of 15 percent, as of the early 2000s. Consistent with this, the range of pay for workers with nominally similar skills is far greater than the range of prices for goods around the world or the returns to capital: The ratios of wages in the same occupation in high paying countries relative to low paying countries are on the order of ten to one measured in exchange rates and are on the order of four to five to one measured in purchasing power parity prices. The comparable ratio for prices of Big Macs is less than 2 to 1 and the comparable ratio for the cost of capital is 1.4 to 1. Thus, there is a huge incentive for workers to immigrate from developing countries to developed countries. Given this gap in incomes, the incentive to immigrate will remain huge for the next 40-50 years at least.

3) In the simplest economic model of globalization, the flow of people, goods, and capital are substitute ways to raise production and economic well-being. During the NAFTA debate, the Clinton Administration argued that the treaty would reduce illegal Mexican immigration to the US on the notion that increased trade with Mexico would create more jobs there and lower the incentive to migrate to the US. This turned out to be incorrect. The US attracts capital flows and unskilled immigrants and skilled immigrants while running a huge trade deficit. One reason is that the US has a technological edge and a business climate edge over most other countries, particularly poor countries.

4) Economic analysis predicts that immigrants reduce earnings of substitute factors and raise the earnings of complementary factors, where complements include capital and other types of native-born labor. The gains to native complements exceed the losses to native substitutes, so that immigration - like trade and capital flows - are a net boon for the economy. Most immigration studies estimate the adverse effect of immigrants on native earnings or employment, but the logic of the analysis establishes a direct link between the losses to native substitutes and the larger gains to native complements. Studies that

compare wages/employment in cities with lots of immigrants with wages/employment in cities with few immigrants find little adverse effect of immigration on native workers. But this also means that there is little native gain from immigration (save when immigrants do things that no native can or will do at any reasonable wage). Studies that compare wages/employment among groups over time find that immigrants depress the wages/employment of natives, with a larger impact among more highly educated workers. Even so, the gains and losses to natives from immigration are dwarfed by the gains that immigrants themselves make. An unskilled Mexican can earn 6 to 8 times as much in the US as in rural Mexico. The main beneficiaries from immigration to the US are immigrants; this is why so many are willing to enter illegally when they can - from Mexico or Central America or the Caribbean.

5) The huge difference in the earnings of low skilled immigrants, in particular, in their native land and in the US creates a powerful economic force for continued immigrant flows and makes it very difficult to control the US borders. At the same time, however, it suggests that many current illegal immigrants or potential immigrants would be willing to pay for legal status in the country. To change immigration flows from illegal to legal and to control the flows requires redistributing some of the huge gains to immigrants to natives.

6) At the other end of the skill distribution, the US relies extensively on highly skilled immigrants to maintain our comparative advantage in science and technology. The United States imports science and engineering specialists, who help the country maintain its position at the technological frontier. During the 1990s boom, the United States greatly increased the proportion of foreign-born workers among scientists and engineers. In 2000 over half of the country's Ph.D. scientists and engineers were born overseas! Sixty percent of the growth of S&E workers over this decade came from the foreign born. Without this flow of immigrants, US labs, including government labs such as those of NIH, would have to cut their workload in half. Highly skilled immigrants add to the ability of our economy to maintain predominance in high-tech industries with good jobs and growth potential. The desire of highly educated immigrants to come to the US is a major competitive advantage to the US.

7) But having a huge flow of highly skilled immigrants invariably reduces the incentives for American students to go on in science and engineering. The 1990s increase in science and engineering employment occurred without great increases in pay for these workers, in part because of the large supply of foreign born specialists desirous of coming to the US. Without gains in earnings and quality of work life, many outstanding American students, particularly men, shunned science and engineering in favor of business, law, and other disciplines. This does not however mean that the US must limit foreign flows to attract more Americans into these fields. It can attract more Americans with more and increased graduate fellowships and undergraduate scholarships. To maintain the US as the lead scientific and technological country, the US should develop policies to attract more able students from our native born population without seeking to reduce immigrant flows.

8) Multinational firms today source highly skilled labor globally. They seek the best workers they can get regardless of country of origin. As the number of university graduates is increasing throughout the world, the competition facing educated American workers has risen. Is it better for native born and resident Americans to compete with educated foreigners from developing countries who come as immigrants in the US, where wages and working conditions are reasonably high, or to compete with them when they are working overseas, where wages and working conditions are generally lower? Is it better to have US firms offshore jobs or bring in more immigrants? While there is no definitive analysis of

these questions, my guess is that it is better to have the top foreign talent in the US; and to do what we can to get them to become citizens and remain here than to have them compete with US workers from lower wage settings overseas. Because trade and capital and immigration flows are intimately connected, however, there are some economic factors operating in the other direction.

In sum, we should think about the economics of immigration in two parts. Taking unskilled and often illegal immigration first, the main beneficiaries of low skill immigration are the immigrants, who have a huge economic incentive to come to the US when they can. The vast improvement they can make in their lives and the lives of their children by coming to our country speaks well for our society, even if few of those benefits accrue to current citizens and residents. With respect to the highly educated immigrants, they add to the country's strength in the sectors that we need to prosper in the global economy. We should compete actively in the global market for the top students and workers in science and engineering and other technical fields, but also provide incentives for more Americans to enter these fields.