

Economic Watch

US

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Economic Analysis

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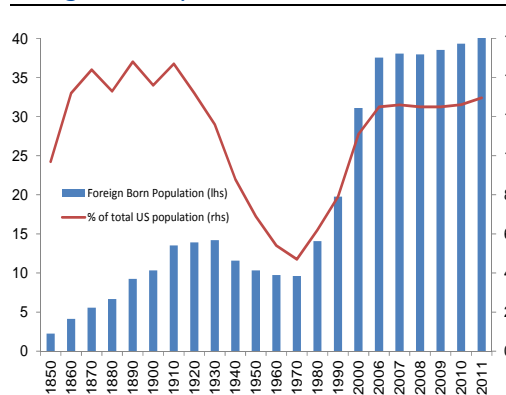
Structural Series: Immigration Reform Enhancing Growth through Immigration Policy: An Update

- The U.S. will continue to be a magnet for immigrants as long as returns on human capital continue to be higher than in other countries
- Immigration policies should facilitate the retention of high-skilled individuals with the potential to increase the productivity of the native labor force
- A path for the legalization of unauthorized immigrants is beneficial in a variety of ways, including fiscal revenues and a more efficient allocation of resources

Everywhere immigrants have enriched and strengthened the fabric of American life. -John F. Kennedy

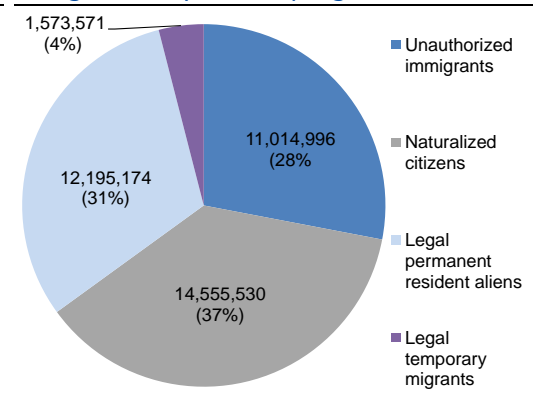
Immigration has been a key part of history in the United States, contributing to the country's reputation as the "melting pot" of cultures. However, there is ample consensus that the immigration system no longer responds to the country's economic and security needs. Immigration reform has been on the table for many years and strong differences in Congress have resulted in several failed attempts. In the meantime, concerns about border security increase, native workers complain about immigrants taking their jobs, farmers struggle to get seasonal visas for their workers, and universities cannot obtain visas for international students. Businesses continue to hire, and in some cases, exploit undocumented workers. State governments complain about the fiscal burden of illegal immigration, while foreign-born science and engineering graduates leave the U.S. due to increasing bureaucratic obstacles to obtain a green card.

Chart 1
Foreign Born Population in the U.S.(Mn)



Source: U.S. Census Bureau & BBVA Research

Chart 2
Foreign Born Population by Legal Status



Source: Pew Hispanic Center & BBVA Research

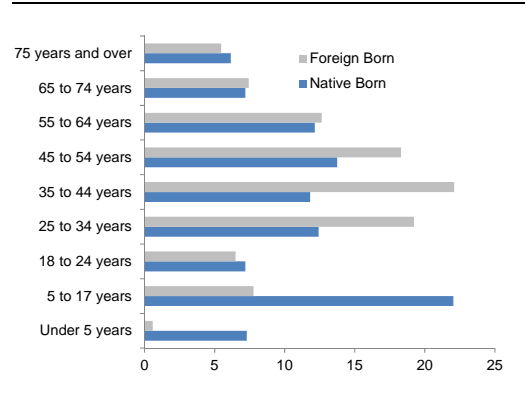
Recently, several state governments have attempted to reduce illegal immigration by enacting their own, and usually tougher, immigration laws. In the most extreme cases, these laws affect almost every aspect of the life of an undocumented immigrant (access to education, housing, healthcare, etc.), and generate severe disruptions in the labor market, with businesses losing their workforce. Although, the most controversial aspect of the immigration debate has to do with illegal immigration and the 11 million undocumented individuals already living in the US, another important issue deals with legal immigration and the inability of the system to retain talent. Determining the impact of immigration on the overall economy is crucial to create more effective immigration policies in the United States.

Immigration and the Economy

Existing literature regarding the impact of immigration on the U.S. economy does not present a clear and definitive picture about the positive effects of immigration, although it is generally understood that there is great potential for benefits. Anti-immigration rhetoric holds that immigrants steal employment opportunities available for locals. However, research has shown that an increase in immigration may actually increase the number of jobs available to native-born workers.

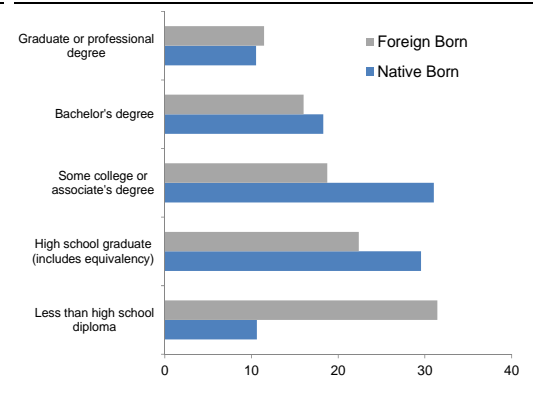
Furthermore, immigrants can contribute to economic growth and boost activity in other ways, including low prices of goods and services as well as increased consumption and innovation. No conclusive evidence exists to suggest that immigrants are perfect substitutes for native-born workers and it could be argued that they are unlikely to be in the same job market as a result of differences in education, work experience, and location.

Chart 3
Age Distribution in the U.S. (%)



Source: U.S. Census Bureau & BBVA Research

Chart 4
Educational Attainment in the U.S. (%)

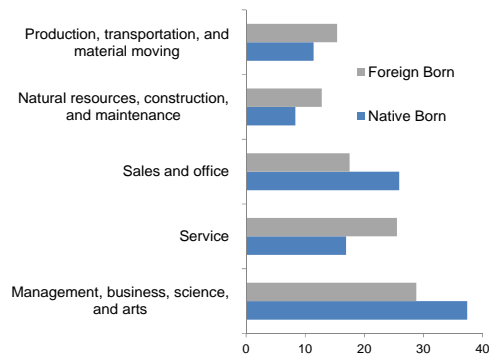


Source: U.S. Census Bureau & BBVA Research

For the sake of simplicity we define an immigrant as a resident of the United States that was born outside the country. Therefore, naturalized citizens, lawful permanent residents, refugees, undocumented individuals and temporary residents (workers and students) fit in this definition. Data from the 2010 Census shows that 14.7% of the U.S. population (39.4 million residents) was born in another country. Since the immigration system abolished quotas based on nationality, developing countries have been the largest expellers of immigrants to the United States. Approximately 53% (20.9 million) of foreign-born residents come from Latin America, mainly from Mexico, and another 30% come from Asia. Two differences between the foreign- and the native-born population are worth emphasizing. First, the foreign-born population has a larger share of people between 25 and 54 years old than the native born population (Chart 3). Second, the foreign-born population has, on average, a lower educational attainment than the native-born. However, the proportion of foreign-born individuals with graduate degrees slightly exceeds that of the native population (Chart 4). The foreign-born represent 19% of the total civilian labor force, and around two-thirds of them are employed in low value-added and labor-intensive industries (Chart

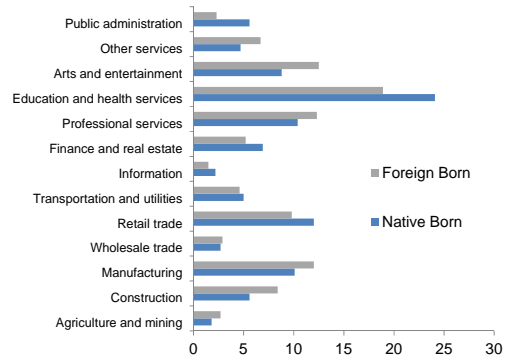
5). By industry, the share of foreign-born workforce relative to the native labor force is higher for construction, manufacturing, wholesale trade, agriculture, leisure and hospitality, and professional and business services (Chart 6). BBVA Research estimates that foreign born-population contributed to 15% of real Gross Domestic Product in 2010. This estimation is in line with a 10% contribution estimated by the Center for Immigration Studies. These results are also consistent with research conducted by the Fiscal Policy Institute showing that immigrants contribute to economic output in proportion to their share of the population.

Chart 5
Civilian Employed Population by Occupation (%)



Source: U.S. Census Bureau & BBVA Research

Chart 6
Civilian Employed Population by Industry (%)

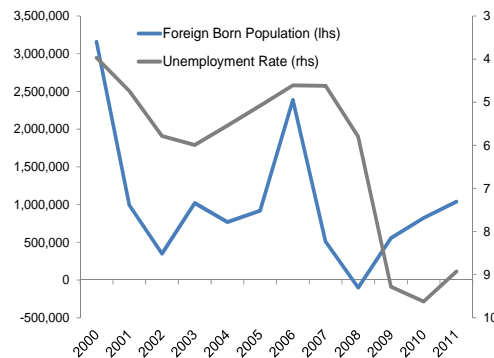


Source: U.S. Census Bureau & BBVA Research

Economic prosperity is the most important driver of immigration to the US. There is a positive correlation between the business cycle and immigration. In other words, the better the economy is doing, the larger the flow of new immigrants and vice versa. Immigration also has a structural component. Labor-shortages in agriculture, construction, and low value-added manufacturing and services are due to structural factors such as a higher educational attainment of the native-born population and the wage gap between the U.S. and traditional immigration expellers such as Mexico and Central America where public policy has failed to reduce poverty. As the share of native-born population with more than a high-school diploma continues to increase, there will be fewer people willing to do jobs that require a minimum level of skills. Therefore, new immigrants will tend to occupy these jobs.

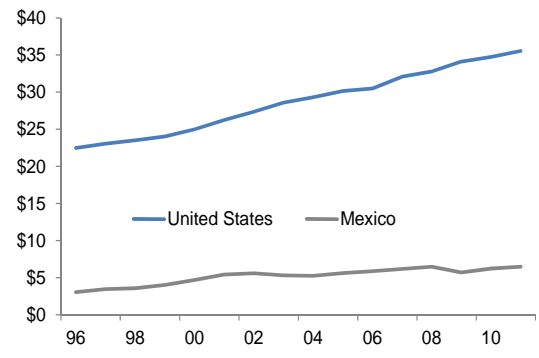
Structural factors are not only limited to low value-added industries. In fact, the high-tech industry is a typical example where the shortage of native-born science graduates has to be fulfilled with foreign workers who for the most part attended graduate school in the US. Regardless of their legal status and their educational level, immigrants are attracted by the returns to human capital, and since U.S. industries are more capital intensive relative to other countries, immigrants can earn up to several times more than what they would earn in their countries of origin. When they come to the U.S. they become more productive relative to workers with similar skills in their home countries.

Chart 7
Immigrant Inflows & Unemployment Rate (%)



Source: U.S. Census Bureau, BLS, & BBVA Research

Chart 8
Wage Gap Between U.S. and Mexico (Hourly \$US)



Source: BLS & BBVA Research

The economic impact of low-skilled immigration

Much of the debate regarding illegal immigration stems from employment concerns. Economic theory implies that immigration should create competition in the workforce, lowering the wages of competing workers and increasing the wages of complementary workers. Compared to the overall population, immigrants are more likely to be of working age and therefore tend to have a higher share in the workforce, particularly at the low-skill level. Given the flexibility of the labor market in the U.S., many assume that more workers would lose their jobs as a result of an influx of cheap immigrant labor. However, Peri (2009) suggests that the U.S. economy absorbs immigrants, adding to total employment rather than “crowding-out” employment and hours of native-born workers. In addition, the Immigration Policy Center suggests that immigration does not directly cause high unemployment (Chart 7). In fact, immigrants comprise, on average, 4.6% of the population in countries with the lowest unemployment rates (less than 4.8%) but only 3.1% of the population in countries with the highest unemployment (more than 13.4%). Peri’s (2009) findings also suggest that immigration actually increases total factor productivity and efficiency, particularly among less-educated workers. Immigrants tend to promote efficient task specialization and competition, helping to better allocate laborers to more manual-intensive jobs while native-born workers move to communication-intensive tasks in which they have the competitive advantage. Wages are affected as well, particularly given that the wage gap between the U.S. and immigrant-origin countries is so extreme (Chart 8). Data from 1990-2007 show that a 1% increase in immigrant-induced employment resulted in a 0.6%-0.9% increase in income per worker. A study from the Economic Policy Institute suggests that between 1994 and 2007, immigration led to a 0.4% wage increase among native-born workers and a 0.3% increase among those with less than a high school diploma.

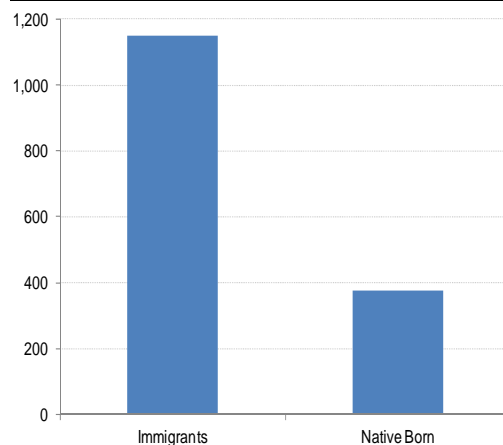
Other studies dispute these findings and point to adverse effects of low-skilled immigration, which tends to redistribute income via the labor market and public finances. In the labor market, research has shown that legal immigration can negatively impact native-born workers who are direct substitutes for immigrants. Borjas (2003) shows that the immigrants flux between 1980 and 2000 reduced the wage of the average native worker by 3.2%. The reduction is larger for low-skilled workers such as high school dropouts (8.9%). In regards to public finances, low-skilled immigrants are considered more likely to utilize public assistance and entitlement programs offered by the government. Less-educated immigrants have a lower earning potential and in turn contribute less to overall tax revenues, potentially creating a net burden on taxpayers. For instance, Borjas (2009) calculated that in the city of Los Angeles, 33.2% of immigrant households

received government assistance in the form of cash, food stamps, or Medicaid, compared with only 12.7% of native households. Other studies highlight the effect of increased immigration on native migration. They argue that when immigrants move to the U.S., native-born workers often feel threatened by their presence and opt to move to other areas, taking labor and capital with them. Borjas (2005) has shown that for every 10 new immigrants in a particular metropolitan area, three to six native-born workers decide to move elsewhere (Borjas, 2005). Increasing native migration ultimately leads to declining growth rates of the native workforce in regions with higher immigration rates, but it may reduce the negative impact of immigration on wages among those who do leave.

The impact of high-skilled immigration

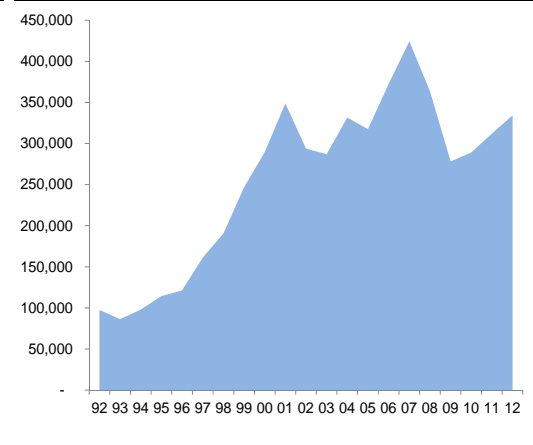
Immigrants living legally in the U.S. can be a significant resource, as research has shown that they can contribute to economic growth via innovation and entrepreneurship. Throughout the past decade, high-skilled immigrants have been responsible for creating new businesses and developing intellectual property that has spurred growth and boosted economic activity. According to the National Venture Capital Association, 25% of high-tech startups in the U.S. are founded or co-founded by an immigrant. Tech-giants such as Google, Yahoo and Intel were founded by immigrants. In addition, approximately 26% of U.S.-based Nobel Prize recipients between 1990 and 2000 were immigrants. Data from the World Intellectual Property Organization shows that immigrant patents have increased significantly over time, from 7.3% in 1998 to 24.2% in 2006, and immigrant-issued patents far outweigh that for the native born graduates (Chart 9). Although the benefits from high-skilled immigration to the U.S. are extensive, findings from Borjas (2006) suggest that a 10% increase in doctorate-level employees due to immigration led to a 3-4% decline in wages among competing workers. Yet, it is in the best interest of the United States to retain foreign nationals with higher degrees in science and engineering as they keep innovation and businesses in the country, necessary to increase productivity and create jobs. However, to reside permanently in the United States, a foreign professional should receive a permanent residence (green card) from the government. Otherwise they could opt for H1B and L1 temporary visas. Every fiscal year, the government allows 140,000 employment-based green cards, including spouses and children. This number is insufficient and lead to waiting times that range between 6 to 12 years in some categories. Further delays arise from the per country limit of employed-based immigrants that has a stronger impact on Chinese and Indian citizens. Despite the foreseeable benefits of retaining these foreign-born graduates, the number of H1B visas issued has trended downward in recent years (Chart 10).

Chart 9
Patents Per 10,000 Post-College Grads



Source: Hamilton Project & BBVA Research

Chart 10
H1B Visas (YoY % Change)



Source: U.S. State Department & BBVA Research

Illegal immigration

Substantial demand for low-skilled workers coupled with an outdated and inefficient immigration policy has unintentionally allowed for millions of illegal immigrants to enter the country. Failure to deal with this issue in a timely and efficient manner has resulted in a snowball effect that has made it difficult for politicians to compromise on a solution. Data from the Department of Homeland Security shows that the unauthorized immigrant population in the United States was 10.8 million as of January 2010. This is 8% less than the 11.8 million peak in 2007. Arguably, the number of unauthorized immigrants declined due to the recession. To reduce the flow of illegal immigration, the government has invested significant resources to enhance border security and increase the number of deportations and sanctions to business that hire undocumented workers.

Massive deportations would be damaging to the economy and would allocate funds away from more important sectors like education and infrastructure. A study by the Center for American Progress estimates that it would cost no less than \$200 billion over 5 years to deport 10 million illegal immigrants, money that the U.S. does not have to spend. The Perryman Group furthers this argument and suggests that deportation would result in a loss of 2.8 million jobs and approximately \$245 billion in lost GDP, outweighing the fiscal cost of illegal immigration estimated at \$113 billion by the Federation for American Immigration Reform. Overall, the Immigration Policy Center estimates that authorizing illegal immigrants to work in the U.S. would support 750,000-900,000 new jobs, increase tax revenues by \$4.5-5.4 billion, and add at least \$1.5 trillion in GDP over a 10 year period. The CBO (2007) estimated that establishing a path for the legalization of undocumented immigrants will increase federal revenues by \$48 billion, while the cost incurred in providing services would be \$23 billion. This leads a surplus of \$25 billion in government revenues. The CBO (2010) has estimated that approving the DREAM Act (which would provide legal status to educated young people who were brought to the country when they were children), would reduce the fiscal deficit by \$2.2 billion between 2011 and 2015. In 2006, CBO estimated that comprehensive immigration reform could add 0.8 percentage points to GDP between 2012 and 2016.

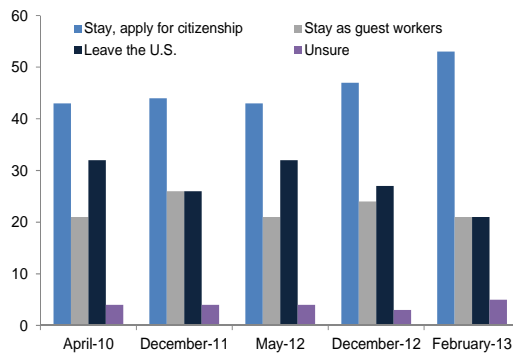
One option to reduce illegal immigration is to establish a more generous temporary visa program. Currently, the only options available are the H-2A and H-2B visas which are primarily used for short-term seasonal jobs. For employers, the process of getting these visas is costly with plenty of bureaucratic obstacles. In addition, there are no visas for low-skilled workers required in non-seasonal services. This explains why employers end up hiring (intentionally or unintentionally) undocumented workers. Expanding the number of H-2A and H-2B visas and creating special visas for low-skilled workers would presumably reduce illegal immigration. In addition, certain categories of low-skilled workers, particularly those who are employed in non-seasonal jobs, should have the option to apply for a green card. This will reduce the cost of new hiring or visa renewals.

Immigration Reform in Washington

Both the Bush and Obama Administrations made immigration reform a priority, focusing on improving border security, enhancing economic competitiveness, and enforcing accountability for people who are living in the country illegally as well as businesses that hire and/or exploit these people. President Obama's blueprint addresses the main challenges of the immigration system and its approval would be the largest change in immigration policy since the 1980s. However, the current climate of economic uncertainty and still-high unemployment reduces the chances of getting the proposal approved. Very often, the immigration debate is mixed with other issues like drug trafficking, terrorism, assimilation and prejudices about history, language and culture. Exaggerating the importance of these topics polarizes the debate even more and lowers the probability of reaching an agreement based on economic rationale. Nonetheless, as the economy continues to improve, anti-immigration feelings will tend to diminish, and politicians will be more willing to make concessions and avoid extreme positions. In fact, recent polls show a more favorable opinion towards immigration compared to the previous three years. (Charts 11 and 12).

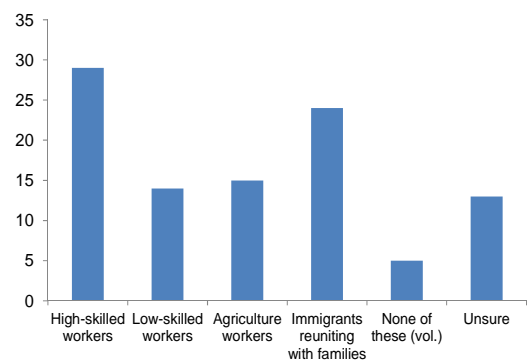
The increasing importance of the Latino vote is another factor that could accelerate reform. In 2012, Hispanics overwhelmingly favored president Obama's re-election. This was due in large part to the President's support of immigration reform -which would have a significant impact in the Hispanic community- and an executive order that granted working permits to young undocumented immigrants who were brought to the U.S. as children (an incomplete version of the DREAM Act). In light of demographic trends that point to a sustained increase in Hispanics' share of total population, the Republican Party is expected to intensify its efforts to attract Hispanic voters by abandoning anti-immigration rhetoric and embracing comprehensive immigration reform. This improves the chances of reaching a bipartisan solution in the short-run.

Chart 11
Opinion on Illegal Immigrants in the U.S.(%)



"Which comes closest to your view about illegal immigrants who are currently working in the U.S.? They should be allowed to stay in their jobs and to eventually apply for U.S. citizenship. OR, They should be allowed to stay in their jobs only as temporary guest workers, but not to apply for U.S. citizenship. OR, They should be required to leave their jobs and leave the U.S." Source: CBS News Poll.

Chart 12
Opinion on Increasing the Number of Visas (%)



"Which of the following groups should get top priority if Congress decides to grant more work visas to immigrants? High-skilled workers, such as engineers. Low-skilled workers, such as construction and hotel employees. Agriculture workers. Immigrants who are reuniting with their families." Options rotated. Source: Bloomberg National Poll.

Bottom Line

The primary driver of immigration is economic prosperity, and the U.S. will continue to be a magnet for foreign individuals as long as returns on human capital continue to be higher relative to other countries. This is why the vast majority of immigrants, both legal and illegal, are still coming from developing countries, where returns on human capital are lower than in the U.S. This trend is likely to weaken over time if competing countries continue to grow at rapid rates and are able to catch up with the U.S. in terms of compensations and job opportunities, which could reduce America's competitive advantage in attracting immigrants of all skills. From an economic perspective, immigration reform should strive for a system that accelerates GDP growth in the long-run. This requires immigration policies that facilitate the retention of foreign talent and entrepreneurship that have the potential to increase the productivity of the native labor force. It also requires policies that facilitate the hiring of low-skilled workers for those jobs that natives are no longer willing to undertake. This can be achieved through a more generous and expedited temporary-visa system that will prevent workers from staying illegally in the country. However, certain categories of low-skilled workers, like those related to non-seasonal jobs, should have the opportunity to apply for a green card in order to reduce the costs associated with hiring new workers. Regarding illegal immigration, massive deportation creates a huge fiscal burden and disrupts the supply of labor in industries that rely heavily on low labor costs. Opening a path for the legalization of 11 million undocumented individuals currently living in the country is likely to increase tax revenues, improve security, and spread the fiscal burden of social entitlements among a larger pool of young workers.

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