

# Economic Watch

US

February 1, 2012  
Economic Analysis

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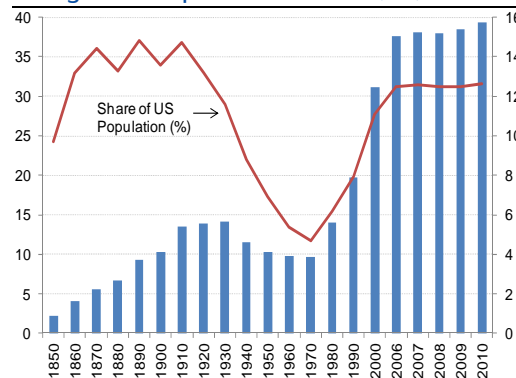
## Structural Series: Immigration Reform Enhancing Growth through Immigration Policy

- 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

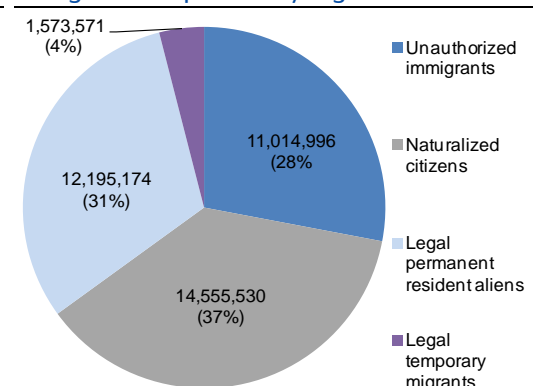
Immigration has been a key part of history in the United States, contributing to the country's reputation as the "melting pot" of cultures. President Obama characterized the immigration system as "fundamentally broken" because it no longer responds to the country's economic and security needs, and he has pledged for a deep change to the rules that affect immigration to the United States. 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

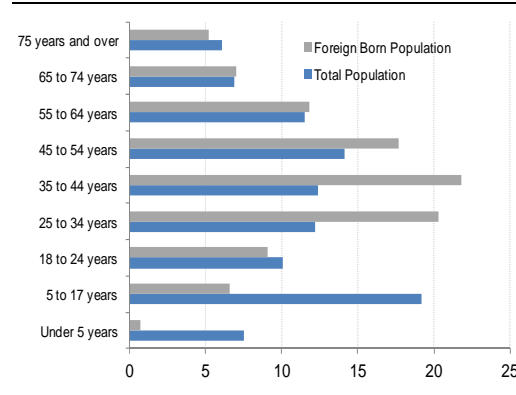
Recently, several state governments have attempted to reduce illegal immigration by enacting their own, and usually tougher, immigration laws. In the most extreme cases, these laws affect almost every aspect of the life of an undocumented immigrant (access to education, housing, healthcare, etc.), and 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, propagated by some politicians and media outlets, 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.

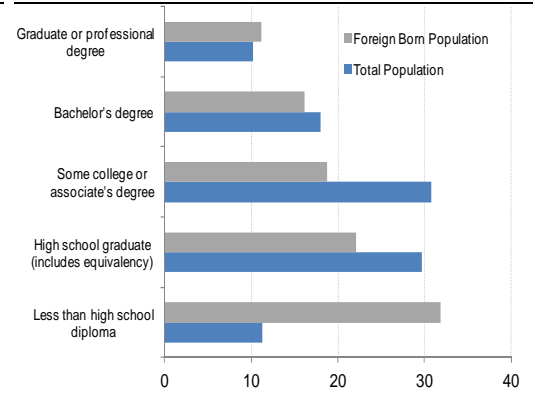
Furthermore, immigrants can contribute to economic growth and boost activity in other ways, including low prices of goods and services as well as increased consumption and innovation. No conclusive evidence exists to suggest that immigrants are perfect substitutes for native-born workers and it could 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. (%)

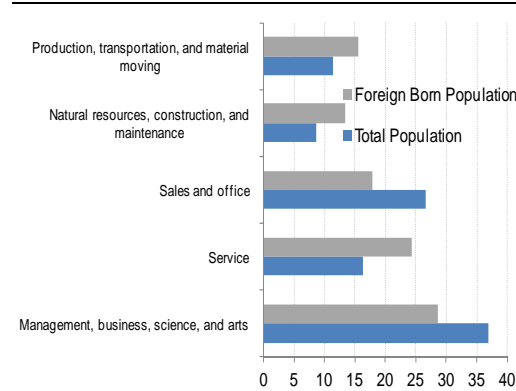


Source: U.S. Census Bureau & BBVA Research

The U.S. Census defines 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 migrants (workers and students) are considered immigrants. In this regard, 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. In fact, around 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

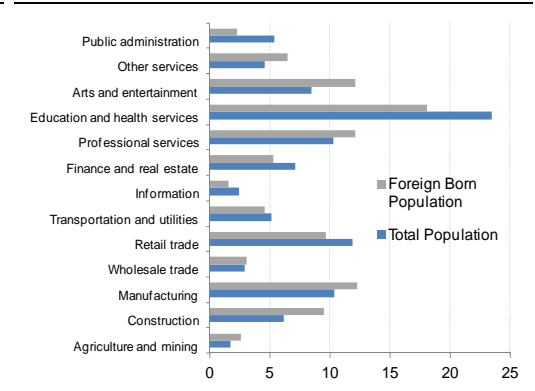
industry, the share of foreign-born workforce relative to the native labor force is higher for construction, manufacturing, wholesale trade, agriculture, leisure and hospitality, and professional and business services (Chart 6). BBVA Research estimates that foreign born-population contributed to 15% 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 (%)

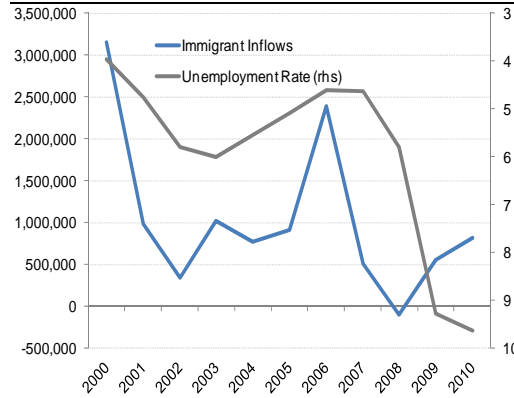


Source: U.S. Census Bureau & BBVA Research

Economic prosperity is the most important driver of immigration to the US. In fact, 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.

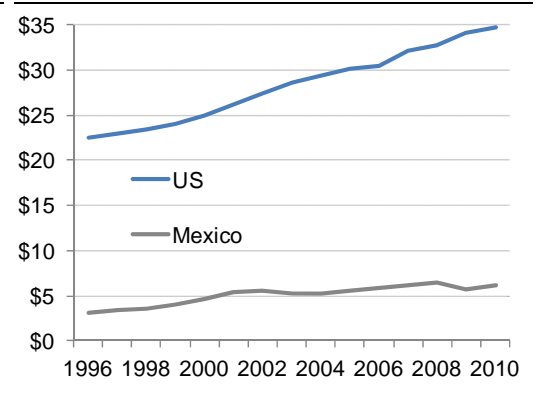
Structural factors are not only limited to low value-added industries. In fact, the high-tech industry is a typical example where the shortage of native-born science graduates has to be fulfilled with foreign workers who for the most part attended graduate school in the US. Regardless of their legal 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.

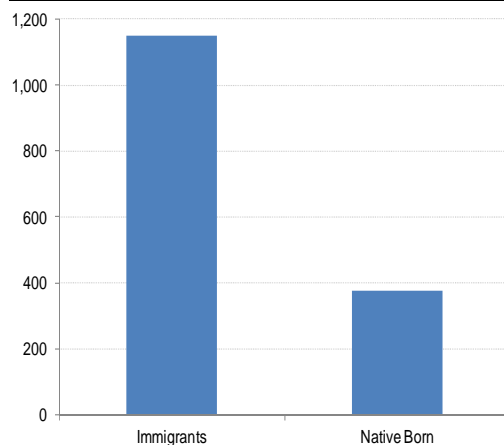
Other studies dispute these findings and point to adverse effects of low-skilled immigration, which tends to redistribute income via the labor market and public finances. In the labor market, research has shown that legal immigration can negatively impact native-born workers who are direct substitutes 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**

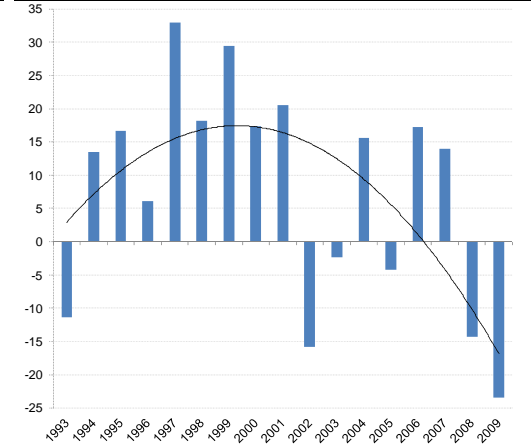
Immigrants living legally in the U.S. can be a significant resource, as research has shown that they can contribute to economic growth via innovation and entrepreneurship. Throughout the past decade, high-skilled immigrants have been responsible for creating new businesses and developing intellectual property that has spurred growth and boosted economic activity. For instance, between 1995 and 2005, 25.3% of all engineering and technology companies established in the U.S. had at least one immigrant founder, and together, this mix of companies created close to 450,000 jobs. 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. 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 most 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.

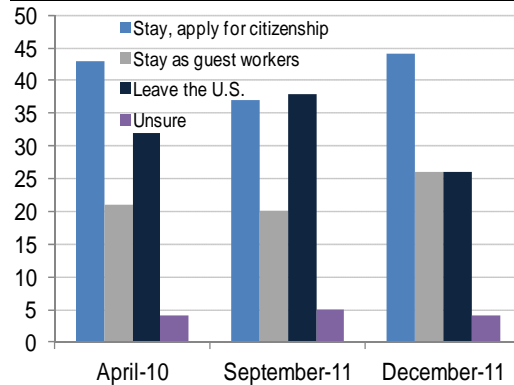
Massive deportations would be damaging to the economy and would allocate funds away from more important sectors like education and infrastructure. A study by the Center for American Progress estimates that it would cost no less than \$200 billion over 5 years to deport 10 million illegal immigrants, 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 \$1.4 billion over the next ten years.

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**

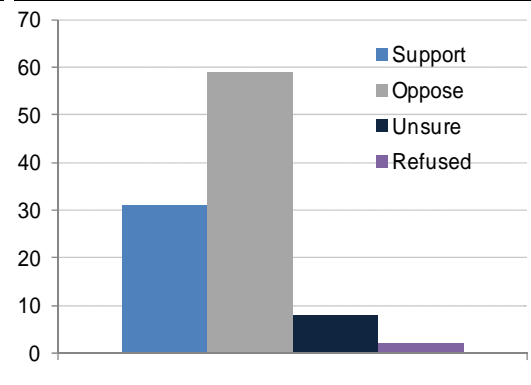
Both the Bush and Obama Administrations made immigration reform a priority, focusing on improving border security, enhancing economic competitiveness, and enforcing accountability for people who are living in the country illegally as well as businesses that hire and/or exploit these people. President 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 weakness and high unemployment reduces the chances of getting the proposal approved. Moreover, the debate has heated up as some politicians and media stir anti-immigration feelings in order to attract voters and increase ratings. 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 improves, anti-immigration feelings will tend to diminish, and politicians will be more willing to make concessions and avoid extreme positions. Recent polls show that public opinion on immigration is mixed and that it is likely to improve as the economy recovers (Charts 11 and 12). The increasing importance of the Latino vote is another factor that could accelerate reform as politicians try to appeal to this group during the upcoming presidential election.

Chart 11  
Opinion of Illegal Immigrants Working in U.S.(%)



Source: CBS News Poll & BBVA Research

Chart 12  
Opinion on Increasing Visas for High-Skilled (%)



Source: CBS News Poll & BBVA Research

### 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 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. Finally, U.S. history is a constant reminder of the advantages of putting freedom and human dignity at the forefront of immigration policy. Therefore, in a country that was built on the idea of immigration, a comprehensive reform based on these principles is necessary.

## Appendix: Immigration Throughout History

Immigration has always been a constant in U.S. history. Between 1700 and the beginning of the Revolutionary War, 450,000 immigrants came to America from countries such as Germany, Scotland and Ireland. At the end of the 1700's and early in the 1800's a large number of Irish and French fled to America escaping from the English rule and the French Revolution. By 1808, when Congress made it illegal to bring slaves, 375,000 black Africans had been imported to the United States.

The second wave of massive immigration ran from 1820-1870, when approximately 7.5 million people entered the United States, most of them from Northern and Western Europe, many of them Irish and Germans, the former pushed by a severe famine. The expansion of the railroad, the discovery of Gold in California, and lower transportation fares brought the first massive wave of immigrants from China. As the U.S. entered in recession in 1870's and the economies of Britain and Germany improved, the flow of English and German immigrants eased; however, new arrivals from Scandinavia, Canada, China, and Southern and Eastern Europe increased.

In 1875, Congress passed the first restrictive immigration law, forbidding prostitutes and convicts from entering the country. By this time, the constant flow of immigrants and the cultural differences between natives and the incomers generated concerns in the American society. Californians demanded restrictions to the immigration of Chinese workers, who were blamed for lowering wages in the region. In some cases, complaints turned into anger and violent attacks on Chinese communities.

The third wave of massive immigration occurred between 1881 and 1920. During this time, 23.5 million immigrants arrived to the U.S. ports. Although a large portion of them were still coming from traditional places such as Ireland or Germany, by 1890 the majority of them came from southern and eastern Europe. Concerns among the native-born population continued and hostility to "new immigrants" (among them Jews, Roman Catholics and Asians) increased. In 1882, Congress passed the Chinese Exclusion Act, prohibiting Chinese workers to come to the United States. Moreover, the list of unacceptable immigrants expanded beyond convicts and prostitutes to include contract labourers, "the insane", and unaccompanied children. A new law passed in 1917 required new immigrants to be literate. This law also banned immigration from the Asia Barred Zone, a designated area that included much of eastern Asia and the Pacific Islands.

The first large-scale change to the immigration system happened in 1921 when Congress established a quota system based on nationality. Under the new law, immigrants of any country could not exceed 3% of the foreign born population of that nationality already living in the United States. The Immigration Act of 1924 limited immigration from outside the Western hemisphere to 153,700 a year and assured that 126,000 came only from Northern and Western Europe.

The Great Depression significantly reduced immigration. Between 1931 and 1940, only 500,000 new immigrants arrived to the country, and many others left. World War II also brought some changes to immigration policy. The War Brides Act of 1945 allowed the admission of spouses and children of soldiers that married while abroad. In addition, since China was an ally during the war, the ban over Chinese naturalization was lifted. In 1952 the Immigration and Nationality Act established new quotas for Asian countries that had been excluded from the original system, and allowed naturalization for people of all origins.

Two provisions for refugees, enacted in 1948 and 1960, allowed for the entrance of 600,000 Europeans and Soviet citizens that lost their homes during WWII. Late in the 1950's and early in the 1960's, the U.S. received refugees from Cuba, Hungary, and China.

The second largest change to the immigration system occurred in 1965 with an amendment to the Immigration and Nationality Act that replaced quotas based on nationality by a fixed annual quota of 170,000 for the Eastern Hemisphere and 120,000 for the Western Hemisphere. Preference was given to relatives of U.S. citizens and permanent resident aliens. Wives, husbands, and children of U.S. citizens could enter without being counted in the quota. In 1978 Congress reduced the quotas for both hemispheres into a single one of 290,000.



The new law caused a dramatic change in the composition of immigration. Quickly, immigration from Europe was outpaced by immigration coming from developing countries such as Mexico, China, India, Philippines Dominican Republic, Vietnam and South Korea. Between 1960 and 1980, adverse economic conditions abroad led to acceleration in illegal immigration. Most of the undocumented immigrants were Mexicans. Immigration doubled between 1965 and 1970 and again between 1970 and 1990.

In 1986, the Immigration Reform and Control Act offered amnesty to illegal aliens that had lived continuously in the U.S. since before January 1, 1982 or had worked at least 90 days in U.S. farms between May 1985 and 1986. More 3 million illegal immigrants applied for amnesty. The amnesty had little effect on the flow of illegal immigration, which continued to increase until 2008, when the recession and tougher security at the border deterred thousands of immigrants from entering the country. In 1990, further amendments to the Immigration and Nationality Act increased legal immigration to the United States by 40%. There were no ceilings for refugees and U.S. citizens' immediate relatives. During the Clinton Administration the Commission on Immigration Reform recommended reducing legal immigration from about 800,000 people per year to approximately 550,000.

In the first half of the 2000s, more than 8 million immigrants came to the United States and almost half of them illegally. By this time, illegal immigration had become a big issue in Washington. The Bush Administration supported a proposal to resolve the status of the millions of illegal immigrants already in the U.S, encourage assimilation, improve border security, introduce a temporary guest worker program, and penalize employers for willingly hiring illegal immigrants. The proposal was rejected by Congress as the Administration failed to convince conservative members that a path for legalization was not an amnesty. Between 2007 and 2009, the number of undocumented immigrants declined from 12 to 11.1 million in large part due to the recession. By 2010, illegal immigration increased slightly to 11.2 million, reflecting better economic conditions in the U.S. In the same year, 1,042,265 migrants were granted with legal permanent residence. In his 2012 State of the Union address, President Obama emphasized the urgency of comprehensive immigration reform. His proposal is still waiting to be discussed in Congress.

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