

Immigration Policy and Economic Growth
Remarks prepared for the “Primer Foro Presidencial Internacional de
Seguridad, Democracia, y Comercio,” San Salvador, El Salvador

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October 29, 2007

Immigration policies usually contribute little to economic growth, not because immigration or emigration is unimportant, but because so many other factors are important too. Indeed, in my view, to successfully foster economic growth, policy makers must aim to do 1,000 things 1% better. Immigration policy is just one of those things, but to be sure it can be done more than 1% better than it is now.

What I propose to do this morning is the following:

- 1) To layout a framework that isolates various components of economic growth
- 2) To show where immigration and immigration policy fit into this framework
- 3) To discuss regional immigration policies designed to foster economic growth, and
- 4) To show how the effects of these policies are influenced by both US immigration and US trade policies

Determinants of Economic Growth

My framework for describing economic growth is a simple one: A nation's output is determined by the number of people working and the output per worker. Output per worker is how we define labor productivity. Growth in output therefore depends on employment growth and labor productivity growth.

A nation's employment levels depend on attitudes toward work, social insurance policies, the business cycle, and demographic trends. But, employment growth does not contribute much to increased national output (or GDP) in rapidly expanding economies. China is a good example.

Growth in labor productivity is the key determinant of economic growth. So what are some of the determinants of productivity growth? Here is a list:

- 1) Capital investment (without technological change)
- 2) Public infrastructure investments (e.g., public health and transportation)
- 3) Human capital investments (e.g., schooling and vocational training)
- 4) Creating flexible labor markets
- 5) Subcontracting/specialization (e.g., proliferation of business services)
- 6) Ease of internal migration (e.g., rural to urban population movements in developing countries and movements across industrial sectors in developed economies)
- 7) Technological change (e.g., new production techniques or improved financial markets)
- 8) Government regulation of markets
- 9) Political factors, such as stability, well defined property rights, enforcement, transparency and related institutions.

Let me illustrate the role that internal migration plays in productivity growth. In developing countries, the key role that internal migration plays in contributing to such growth is migration from rural to urban areas. In developed countries, it is movement of labor across industries. For example, in Mexico roughly 25 percent of the population lives in rural areas, but produces 5 to 10 percent of the country's GDP. Mobility out of rural areas and agriculture will increase Mexican labor productivity.

Although I realize that implication of this point constitutes a very sensitive issue in Central America, nonetheless, policies that help sustain small family farming are likely to slow growth unless they also are associated with movements from rural to more populated settings. In East Asia, one measurable determinant of economic growth has been migration from rural to urban areas. There people have been moving from regions where they are less productive to regions where they are more productive. Here in El Salvador, the percentage of the population in rural areas fell from 25% to 16% between 1995 and 2005. This movement in people likely contributed modestly to the country's labor productivity growth.

How Immigration Policy Can Contribute to Growth

Immigration policy contributes to economic growth in several ways. One way it contributes is that it allows a country to acquire highly-skilled labor rather than educating its own workers. Welcoming new immigrants is certainly the cheaper alternative. In Canada and Australia, their "point-

based” immigration policies make it relatively easy for highly-skilled foreign-born workers to enter these countries. By contrast, the US also attracts highly-skilled immigrants because, among developed countries, it has the highest returns to skills—and despite its policy to ration visas for such workers through its H1-B program. I contend that this policy rationing visa for the highly skilled has a small effect, but it does slow economic growth.

Another way immigration policy contributes is that it can improve the flexibility of labor markets by providing another source of labor to aid adjustment to changing economic circumstances. Government regulation, such as the extent of border enforcement, can restrict the flow of unskilled immigrants into countries in general, and the US in particular. But nations, such as the US, can benefit from the immigration of unskilled workers. Japan is an even better example of a nation that would benefit economically from freer immigration policies. In both countries, unskilled labor is relatively scarce. Immigration policy that facilitates the migration of, at least, some unskilled workers to developed countries is in general desirable because it fosters economic growth.

As an aside, studies of the Asian Tigers (Korea, Taiwan, Hong Kong, and Singapore) indicate that dramatic growth in capital investment coupled with political stability and improved market-based institutions were the most important contributors to the 30 years of sustained growth that these countries experienced. Human capital investments made a much smaller contribution than one might think. What role did immigration play? Korea and Singapore are at the opposite ends of the spectrum. In Korea—none; in Singapore immigration into the country appears to have contributed, at least in a modest way, to economic growth.

Of course, economies in Central America have been dramatically affected by emigration to the US. In many countries, 10% or more of the population resides in the US and here, in El Salvador, the fraction is between one-quarter and one-third. Still as President Ortega emphasized in his remarks, there are movements of labor among countries *within* Central America. What then constitutes a pro-growth immigration policy? In the absence of large differences in social welfare policies among countries in this region, policy makers should have a unified labor market and allow labor to move freely among countries. This happens to be the policy in the Nordic

countries where, in any of these countries, workers are free to search for work.

The principle here is that immigration is like voluntary trade. A transaction between an employer and a worker brings benefits to both parties. Both buyer and seller are better off. And, free trade is good both within and across borders. Immigration and emigration enable more beneficial “trades” in labor to take place.

Building Consensus for Policy Change

Before further discussing immigration policies and their consequences, it is important to acknowledge the point that all of the Presidents touched on in their remarks: that as with any policy change, not everyone gains and indeed some citizens will lose. Having said this, however, it also is important to keep in mind that maintaining the status quo also creates winners and losers. The gains associated with immigration policy changes are usually diffuse: they are modest on per capita basis and are spread out among a large segment of the population. By contrast, although the losers are usually fewer in number, their losses often can be very large.

Even though those who suffer large losses tend to be relatively little in number their opposition tends to be quite strident and, thus, threatens the establishment of pro-growth immigration policies. Therefore, in democratic societies, it is important to try to build consensus in favor of such changes. This applies not only to immigration policies, but also to many other policies that are associated with structural changes, such as those that result from trade liberalization or financial sector reform.

The lesson here is that pro-growth policies require consensus. If policy makers do not successfully build this consensus, they leave in place considerable incentives for those at risk to lose the most to oppose such policies. The consequences of not paying adequate attention to this point are seen right now in the US. During this decade, we have seen the breakdown of the consensus for free trade, alongside the continued failure to reach consensus about immigration policy. As a result, this consensus is unlikely and there will be likely little progress made toward enacting pro-growth trade and immigration policies and the status quo will remain.

Why is Immigration Good?

If immigration can be bad for some, then why do I say immigration is good? First, natives' losses are concentrated among those who compete with immigrants in the labor market. But, their losses are exactly offset by other natives who benefit from lower prices for goods and services and higher returns to capital. In addition, wages and labor-market opportunities rise modestly for workers who complement immigrant labor. An example is native born bi-lingual workers in the US. Studies indicate this group does better in local-labor markets that also have many Spanish speaking immigrants.

The source of most of the net gains from immigration for a country come from the additional "profit" that owners of capital and entrepreneurs earn from hiring immigrant labor. This amount has been calculated for the United States and it is smaller than you might guess. To arrive at the net benefit that natives received from immigration, this gain must be reduced to the extent that immigrants use social welfare benefits, schools, and medical facilities without paying for their cost through taxes. Studies of the US experience suggest that once the costs of such services are accounted for immigrants cause native-born Americans' incomes to rise by only about 1/3 of one percent of GDP, and possibly by less. The point is that this is not a large number.

As a rule of thumb, the benefits to a nation from immigration are proportional to the decline in wages experienced by natives who compete with immigrants in the labor market. I know this assertion seems strange, but without reduced wages, natives can not benefit from lower prices for goods and services or from increased returns to capital. However, such wage declines also imply that immigration affects income inequality. This is why some members of the population have good reason to oppose open immigration policies, just as they would oppose freer trade.

Emigration from Central America

In Central America, emigration has significant effects on labor markets. The analysis is the exact opposite of that of immigration on a receiving country. Emigration benefits workers in the source country with similar skills, hurts workers whose skills complement the émigrés, and lowers returns to capital. On the whole, however, these source nations lose.

However, there are other ways in which nations can benefit from emigration of its citizens, especially to a developed economy such as the US. These benefits include:

- 1) Remittances
- 2) Technology/knowledge transfers back to the source country
- 3) Alternative sources of private capital
- 4) Alternative resources for local infrastructure

To weigh the negative effects of emigration against its potential benefits requires a country-by-country analysis. In El Salvador, for example, the importance of remittances has been widely reported. Thirty percent of the population – roughly those now in the US, produce 18 percent of the country's GDP through remittances. This suggests these remittances alone might not offset the losses associated with the massive emigration during the last 25 years.

The consequences of emigration could be better or worse depending on how similar or different the émigrés are from the typical worker. The more similar they are, the less the cost of emigration to the nation (country). Here in El Salvador, the evidence I have seen suggests that, like Mexico, émigrés tend to be from the middle portion of the skill distribution. If this is correct, this suggests that emigration is less costly than it otherwise might be. The idea here is that if the skills of people who leave are relatively abundant, the cost of emigration will be less than if their skills are relatively scarce.

Whose Immigration Policy?

Although, I am here today to speak about immigration policy in Central America, US economic conditions and policies must also be part of this discussion as the US produces more than 25% of world output and gobbles up somewhat more of the world's consumption. In this part of the world, US policy (and economic conditions, e.g., the current recession in the housing market) will matter a lot and especially for emigration. In effect, US immigration and trade policies become Central American emigration policy.

Both US immigration and trade policies matter for the goals and objectives of regional policies. The effects of US immigration policy on this region are like no other region in the world. Indeed, policy makers in Central America usually are more up to date on the direction of US immigration policy than are US policy makers themselves.

But it makes little sense to talk about the effects of US immigration without also talking about US trade policy. Indeed, we think of immigration as the reverse side of the same coin as trade in goods and services. The idea is that trade in goods embodies trade in labor. A country can obtain low cost unskilled labor in two ways: either directly through immigration, or indirectly through trade with a poorer country. So, for example, the demise of the multi-fiber agreements and trade liberalization in apparel meant that apparel workers in Central America wound up competing in US markets with workers in China and Southeast Asia.

One consequence of liberalized world trade and economic development in China and India—both nations with over one billion people—is that the supply of unskilled labor is effectively limitless. Thus, the wages of such unskilled workers, no matter where they are, will remain low and may actually decline at least during our lifetime. One implication of these developments for Central America would be the continued migration of workers to non-traded sectors. Another implication is that promoting economic growth through exports produced by unskilled laborers is likely a losing strategy in this part of the world.

Sources of Future Growth in Central American Economies

Because competing in unskilled labor markets is unlikely to pay off for Central American economies, increased investments in schooling, including English language education, appear to be an essential ingredient for future economic growth. My reading of the data is that nations here are spending around 3% of GDP on education and workforce development policies. These figures likely need to move toward 5% as is the case for your three larger neighbors to the north. Such investments will foster economic opportunities in services, in non-traded goods, and possibly in a category I have heard described here as “non-traditional traded goods.” In turn, such opportunities will reduce the considerable incentives for workers to emigrate from this region to the US.

To conclude, I want to emphasize the point I made at the beginning. Successful implementation of say, sound human capital and other work force development policies—of which immigration policy is included—will help only so much and possibly not at all if they are not accompanied by other policies that promote growth. Capital investment and well-functioning capital markets are examples. Central American immigration policy—such

as the one that I believe is optimal—that includes establishing a unified labor market and free regional immigration promotes economic growth. But, its effects will be small or nil unless accompanied by a wide range of policies that promote economic growth. This is in keeping with my view that rather than doing one thing 1,000 % better, promoting successful economic growth requires policy makers to do 1,000 things 1% better.