

The benefits of openness

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Economic models fall short in assessing the effects of immigration



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In the debate on immigration, currently rumbling in the US and raging in Europe, business generally comes down on the side of greater openness.

For most employers, the merits of being able to draw from a bigger pool of labour seem self-evident.

Economists, however, would be more cautious. How you feel about immigration will depend on who you are and what you do – and on who the immigrants are, too.

Some of the most influential recent academic work on immigration has been done by George Borjas, now at the Kennedy School of Government at Harvard. His simple model of the labour market assumes a fixed demand for labour. Immigration raises the supply of labour, so real wages fall and profits rise – which must have some connection to business leaders' enthusiasm.

Although native workers then earn less, their losses are more than offset by the rise in returns to capital, so overall national income is higher. Indeed, the greater the effect of immigration on wages, the bigger is the benefit to national income.

However, calculations based on reasonably accurate figures for the extent of immigration and the sensitivity of wages in the US suggest the size of the effect may not be enormous. Prof Borjas' estimates in 1994* were that the total gains to the US from immigration were only about \$6bn (£4bn) a year – a mere 0.1 per cent of US gross domestic product – and certainly less than \$20bn.

The redistribution caused by immigration is greater than the net gain. The same assumptions for the US suggest that native workers lose about \$114bn a year owing to immigration – about 1.9 per cent of GDP – while investors gain \$120bn.

Given the social strains caused by such significant redistribution, and the fact that the net fiscal effects of immigration are unclear, all the estimates of the balance between the taxes paid by immigrants and the cost of the services they use are highly speculative. Prof Borjas' analysis suggests that, on balance, the effects on natives may be negative.

If that extremely simple model of the labour market is made more realistic, however, scepticism about immigration is tempered.

For example, if immigration increases the spread of skills and knowledge through the economy, whether because immigrants bring new ideas or simply because a larger workforce generates more connections and sparks more ideas, the benefits can be much greater.

Another refinement to the model incorporates differences in skills in the workforce. In the US, the wages of skilled workers are apparently more responsive to changes in supply than the wages of unskilled

workers. As it is the fall in wages that generates the surplus from immigration, the gains will be greater if the immigrants are skilled rather than unskilled.

Using some plausible estimates of the responsiveness of wages to labour supply, the net benefit to the US of immigration could rise to more than \$40bn a year if only skilled workers were admitted.

In practice, however, immigrants to the US tend to be less skilled than the native population. In 1998, the typical immigrant worker in the US earned 23 per cent less than the typical native worker. Immigrants in the 1980s and 1990s have been less skilled than those of previous waves.

A new paper** by Ximena Clark of the World Bank, Timothy Hatton of Essex University and Jeffrey Williamson of Harvard examines why this may have happened.

The change in the origins of immigrants into the US since the second world war has been remarkable. In the 1950s Europeans, most of them from western Europe, formed more than half the total; by the 1990s, they were down to just 5 per cent. In the 1900s they had been 92 per cent.

The proportions from developing countries have risen accordingly, with the share from the Caribbean peaking in the 1970s and that

from Asia in the 1980s. The shares of immigration from Mexico, Africa and eastern Europe continue to increase.

This has not been a deliberate act of policy. The 1965 reform of immigration law put a strong priority on family reunification, ahead of employment, as a justification for legal immigration. It was argued at the time that because the existing stock of immigrants was largely European, the flow of new immigrants would be, too. Clark, Hatton and Williamson set up a model of worldwide migration to the US to see why that argument has turned out to be so wrong. The answer seems to be that whatever a country's immigration policy may be, people will come only if they want to.

With each passing decade since the war, Europeans have grown less needy. The majority of immigrants to the US have come from the countries closest to the US, which have had the highest proportions of young people and have offered the worst economic opportunities.

One conclusion is that although the US might be better off if it accepted only skilled immigrants, cutting off unskilled immigration could cut off immigration altogether.

Several countries have changed immigration requirements in attempts to increase the supply of skilled workers but found they were not an attractive enough prospect to attract the immigrants they wanted.

As Prof Borjas says, immigration is about much more than the financial considerations: it touches on the most important questions of justice, human rights and conflicting political interests.

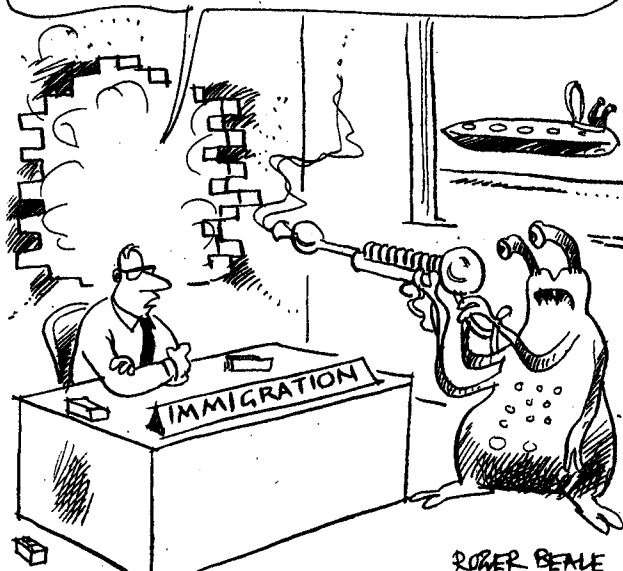
The case for open immigration will have to be made on those arguments, as well as the economics.

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* *The Economic Benefits From Immigration*; G.J. Borjas; NBER Working Paper 4955; December 1994

** *Where Do US Immigrants Come From, and Why?*; X. Clark, T.J. Hatton, J.G. Williamson; NBER Working Paper 8998; June 2002

OK. APART FROM THAT, ANY SPECIAL SKILLS THAT MIGHT SUPPORT YOUR APPLICATION?



ROGER BEALE