The Missing Pieces of the Economic Debate Over Immigration Reform

Exequiel Hernandez
University of Pennsylvania

Follow this and additional works at: https://repository.upenn.edu/pennwhartonppi

Part of the American Politics Commons, Economic Policy Commons, Labor Economics Commons, Other Economics Commons, Political Economy Commons, and the Public Policy Commons

Recommended Citation
https://repository.upenn.edu/pennwhartonppi/57

This paper is posted at ScholarlyCommons. https://repository.upenn.edu/pennwhartonppi/57
For more information, please contact repository@pobox.upenn.edu.
The Missing Pieces of the Economic Debate Over Immigration Reform

Summary
To the extent that immigration reform is discussed in terms of economics, the debate tends to focus exclusively on labor issues—specifically, how immigrants affect jobs and wages for native citizens. But to understand the economic effects of immigration, and thus develop sounder policies, policymakers need to consider how immigration affects all three core components of economic growth: not just labor, but capital and innovation too.

In the Penn Wharton Public Policy Brief, “The Missing Pieces of the Economic Debate Over Immigration Reform/whr.tn/2vmKbK8>,” Professor Exequiel Hernandez discusses new research showing that immigration produces gains for the U.S. economy with respect to capital and innovation. Immigrants help to attract investment from foreign firms and significantly increase bilateral trade flows between the U.S. and their home countries. Immigrants also account for roughly a quarter of all U.S. entrepreneurs. They not only generate novel businesses and inventions, but also introduce novel ideas that U.S. citizens develop further to create new products and companies of their own.

Just as importantly, labor, capital, and innovation are all interrelated. Policies that target one growth component (such as labor) can carry unintended negative consequences for the other two, and result in undesirable economic outcomes.

Disciplines
American Politics | Economic Policy | Labor Economics | Other Economics | Political Economy | Public Policy

License
This work is licensed under a Creative Commons Attribution-Noncommercial 4.0 License

This brief is available at ScholarlyCommons: https://repository.upenn.edu/pennwhartonppi/57
Sweeping policy measures aimed at correcting the deficiencies of the U.S. immigration system have remained elusive for Congress over the last decade, despite several serious attempts at brokering compromise legislation.¹

One result of this policy limbo is the continuation of a debate that lawmakers and the national news media have now recycled several times over. Policymakers, pundits, and professors sometimes emphasize the effects of immigrants on crime and safety, while other times they argue about more qualitative ideals like human rights and fairness. Typically, however, an economic rationale for or against a particular policy will surface, even if the immigration debate at that moment is not explicitly predicated on the subject of economics. To the extent that the issue of immigration is one of economics, policymakers have focused narrowly on labor issues (i.e., jobs and wages). But to really understand the economic consequences of immigration, policymakers will need to start looking beyond its labor effects.

Lawmakers at all levels of government should think about and construct immigration policy solutions while considering all of the three core elements of economic growth—labor, capital, and innovation. These three components are interrelated and dynamic, so it is impossible to target policy changes in regards to one element without affecting the others. Further, in order to have an honest debate about how immi-

---

**SUMMARY**

- When policymakers discuss the economics of immigration, they focus on labor issues (i.e., jobs and wages). But to understand the economic effects of immigration, and thus develop sounder policies, they need to consider how immigration affects all three core components of economic growth—not just labor, but capital and innovation too.

- The consensus among economists is that, as a whole, U.S. natives benefit from immigration in the labor market. Research suggests that similar gains are true with respect to capital and innovation.

- Immigrants critically influence firms’ investment and operations decisions, significantly increase bilateral trade flows with their home countries, and account for roughly a quarter of all U.S. entrepreneurs.

- Taking the full economic growth equation into account is important, as policies targeted to one component (like labor) can have unintended consequences for the other two.

- To better understand the relationship between labor, capital, and innovation, policymakers would do well to listen closely to firms, whose leaders are uniquely positioned to explain how they rely on immigrants—and not just for their labor.
migration truly affects labor, capital, or innovation, we need to talk about the role that firms play in each of those three relationships.

Much of the general debate over immigration in the United States is isolated from the mediating role played by firms. Firms hire workers (labor), make investments (capital), and originate the vast majority of new knowledge, products, and technologies (innovation). For their part, immigrants play an outsized role in firms: they are disproportionately represented as employees in some large industries, such as technology and engineering; they drive substantial capital investments, especially from foreign firms; and they create more companies and earn more patents than the average native citizen. All of this gives firms not only the motivation but also the perspective to accurately inform immigration policy and demonstrate the myriad ways immigrants contribute to greater economic growth.

There is a lot we know about immigration’s effects on labor, and these effects have been covered extensively in many publications. Briefly, though, quantitative evidence suggests a null or very small negative effect for low skill workers, but a fairly strong positive effect for high skill workers. If any group is hurt most by low skill immigrants, it is other low skill immigrants. The consensus among economists is that, as a whole, U.S. natives gain from immigration in the labor market.

Meanwhile, we have other compelling research on how immigrants affect innovation, such as the consistent finding that they account for roughly a quarter of all U.S. entrepreneurs, but this is virtually ignored in the public discourse. Finally, we are increasingly learning more about immigration’s capital impacts. A growing body of research shows that immigrants critically influence firms’ investment and operations decisions, and they significantly increase bilateral trade flows with their home countries. The mounting body of research on innovation and the capital effects of immigration shows that, on both fronts, immigrants seem to have a positive effect on the receiving economy.

The remainder of this Issue Brief will highlight a few of the research findings related to each of the two lesser-referenced components of growth (i.e., capital and innovation), followed by a short discussion on both the importance of crafting immigration policy based on the complete economic growth equation and the necessity of firm involvement in the immigration reform process.

**IMMIGRANTS AND CAPITAL**

Rarely do foreign firms explicitly cite co-national immigrant populations as a reason for why they choose to locate new plants or offices in the U.S. where they do, but immigrant demographics in the markets they enter do inform the business decisions and investments firms make abroad. The strong presence of Japanese immigrants in the Los Angeles area in the 1950’s is why Honda elected to establish its U.S. operations there, for example. Immigrant populations also heavily influence how one of the country’s fastest growing fast food chains, Pollo Campero, a firm from Guatemala, makes decisions about opening new restaurants. After starting in California, it has expanded throughout the country, establishing new stores in neighborhoods that have a density of Hispanic immigrants. Beyond influencing firms that sell consumer products, where immigrants may simply function as a niche customer base, immigrants also influence the investment decisions of companies in

**NOTES**

1 Most notably, S. 744, introduced in the 113th Congress in 2013.
2 William R. Kerr (2008), “The Ethnic Composition of US Inventors,” Working Paper. (“The contributions of immigrants to US technology formation are staggering: while foreign-born account for just over 10% of the US working population, they represent 25% of the US science and engineering (SE) workforce and nearly 50% of those with doctorates.”)
6 Howard Chang of the University of Pennsylvania Law School explores the details of this consensus and summarizes the vast literature pertaining to immigrants’ effects on the U.S. labor market in a previous Wharton PPI brief. See Howard F. Chang (2016), “Walls or Welcome Mats?”
other sectors, such as venture capital and information technology.11

The U.S. is among the top receivers of immigration12 and foreign capital,13 in both volume and variety. Research has documented a positive relationship between immigrant clusters in a receiving country and trade or investment at the country level.14 But even though existing research focuses on country-level effects, it is firms that are the primary vehicles of foreign exchange in goods and services. It is critical for policymakers to appreciate not only the fact that immigrants in the U.S. are attracting desirable foreign capital, but how and why—and this is where firms are crucial.

Knowledge plays a central role in the international expansion of firms, and research has demonstrated that obtaining and transferring knowledge across national boundaries is a non-trivial task. While the obstacles to successful knowledge exchange may partly be solved by getting information through market transactions such as contracting with local informants, research strongly suggests that purely arm’s-length knowledge exchanges lack the richness and effectiveness of those based on more primal relationships and a “common code,” like nationality.15 As parties in transnational networks, immigrants bridge the cultural, economic, and institutional distances that inherently make new market entry challenging for firms.16 As such, they have information about specific resources or places that is particularly attractive to firms seeking to expand from the sending to the receiving location.17

If immigrants truly provide preferential access to knowledge, however, it is important to demonstrate the performance outcomes of co-locating with immigrants. Using a sample of 288 foreign investments into the United States made by 194 firms from 27 countries between 1998 and 2003 (matched with detailed state-level data on immigrants), I tracked the performance of these investments through 2011, and I discovered three key takeaways.18 First, if a foreign firm decides to locate its operations in a U.S. state, it is much more likely to choose a state that has more, rather than fewer, immigrants from its home country. For every 1 percent increase in the state population from the firm’s home country, the likelihood of the firm choosing that state increased by nearly 50 percent. Second, the presence of immigrants is a very strong predictor of the likelihood of survival or longevity of the firm’s investments, leading to a nearly 8 percent increase in the odds of survival for each 1 percent increase in the co-national immigrant population. Third, these first two effects are especially strong for firms that have some kind of knowledge-related need—for instance, first-time investors in the U.S. who do not know how to do business here, firms in a high tech industry, or those that need to transfer knowledge from their home countries into the United States. Immigrants can thus be a powerful means of attracting first-time foreign investors into the U.S., as well as firms that bring valuable intangible assets.19

Surprisingly, the effect of immigrants on both location choice and firm survival is actually stronger (i.e., more responsible for favorable outcomes) than the presence of other firms from the same industry, which offer the possibility of knowledge spillovers from native industry employees who may choose to work for a new U.S. subsidiary of a foreign firm. It is even a lot stronger than the effect of other things that policymakers, in particular, typically think of as important for firms, such as incentives for foreign investors or corporate tax rates. Put simply, immigrants are more effective at attracting foreign direct

NOTES

investment than government incentives, generally speaking. Although those who debate immigration policy may not think of immigrants as affecting foreign capital, the implication of my research is that they do.

**IMMIGRANTS AND INNOVATION**

Sari Pekkala Kerr of Wellesley College and William R. Kerr of Harvard Business School have made some discoveries that policymakers cannot simply ignore when crafting immigration policy. For example, although immigrants constitute only 15 percent of the general U.S. workforce, they account for roughly 25 percent of U.S. entrepreneurs—defined as the top three initial earners in a new business—and 31 percent of all venture capital-backed founders. In fact, “35%-40% of new firms have at least one immigrant entrepreneur connected to the firm’s creation.” Kerr and Kerr find that immigrants create smaller firms than those established by native citizens (4.4 initial employees compared to 7.0, respectively). However, “mixed founder teams,” comprising both immigrants and natives, launch firms with 16.9 workers, on average. Although immigrant-founded firms fail more often than native-founded firms, those that do succeed grow faster in terms of employees, payroll, and new establishments. Finally, the researchers find that much of the growth and success of immigrant-founded firms depend on where they decide to establish their companies, in keeping with my own results.

Research from the Kauffman Foundation echoes these findings. Kauffman researchers report that immigrants were almost twice as likely to start businesses in 2012 as native-born Americans. In terms of hard jobs numbers, “Immigrant-founded engineering and technology firms employed approximately 560,000 workers and

![Entrepreneurship Rates Among Natives and Immigrants, 2000-2016](chart)

Source: Statista

**NOTES**


16 The processes by which firms obtain knowledge about a place from co-national immigrants can be split between immigrant- and firm-initiated exchanges. The firm may directly contact co-nationals to assess the viability of the market or the availability of resources. Alternatively, immigrants may themselves contact the firm to promote activity in the host location.


generated $63 billion in sales in 2012.” And according to a report issued by the National Foundation for American Policy in 2016, “44 of 87 startups valued at more than $1 billion as of January 2016 were (co-) founded by immigrants, creating an average of 760 jobs per company in the process.” Finally, as noted previously, immigrants constitute roughly one quarter of inventors, as determined by patent filings. The results of these new businesses and inventions are new technologies, knowledge, and products that collectively foster greater economic growth.

In addition to starting novel businesses directly, immigrants play a crucial role in mediating the transfer of innovative and economically valuable ideas from foreign countries into the U.S. that benefit local workers and consumers. A recent study by Prithviraj Chouhdhury from Harvard Business School shows two important findings in this regard. First, immigrant scientists are the means by which knowledge originated in a foreign location is transferred and formally codified (e.g., patented) in the U.S. Second, once this knowledge is codified by immigrants, it is locals (i.e., Americans) that further develop that knowledge and recombine it with other ideas to generate novel technologies and products that benefit the public. Hence, immigrants not only bring new ideas, but allow natives to enhance their own innovativeness. This is a good example of how migration enhances the stock of knowledge in the receiving economy by making local labor more productive—two of the key elements of the economic growth equation.

**THE FULL EQUATION**

In this Issue Brief, I have already noted that immigrants greatly affect foreign capital investment in the U.S. and are more likely than native citizens to found a new business or invent something. These points are not as well known as the consensus finding that immigrants do not, in the aggregate, negatively affect the employment of natives. However, economic debates about immigration policy often remain mired in verifiably false rhetoric about jobs and wages, while ignoring the capital and innovation effects. Putting all three factors of the growth equation together illustrates how complex the policy issue of immigration really is from a strictly economic perspective.

It quickly becomes evident that legislating or crafting policy by targeting one growth component (like labor) to address a specific concern (like competition for low-skilled jobs) has much broader economic consequences beyond the stated goal of any legislation. For instance, an attempt to limit temporary visas at either the high (H-1B) or low (H-2A and H-2B) ends of the skills spectrum in order to boost native employment may result in less capital development from firms (foreign and/or domestic) and less innovation, as immigrants have decreased access to U.S. resources for establishing new businesses or creating new knowledge, products, and technologies—all of which would translate into more jobs. These are generalities, of course, but the linkages between labor, capital, and innovation are tight. Tinkering with only one part of the equation has multiplier effects.

Unintended consequences from policies dealing with this dynamic growth equation are unavoidable, but they need to be taken into account and mitigated before laws are passed that undermine economic growth. Failing to understand the multiplicative relationship between labor, capital, and innovation will result in failed economic policy—a truth that extends beyond the issue of immigration, of course. But to effectively meet this challenge head on, policymakers must consider how firms—the engines of economic growth—affect and are affected by immigration. And firms themselves, with their unique benefit of knowing exactly how their businesses rely upon immigrants, must become more involved in future attempts at reworking the U.S. immigration system by sharing the insights that only they have. After all, they are the ones who make choices about hiring immigrants and natives (labor), who make investments in places where immigrants live (capital), and who hire many of the immigrant workers who produce novel technologies and products (innovation).
ABOUT THE PENN WHARTON PUBLIC POLICY INITIATIVE

The Penn Wharton Public Policy Initiative (PPI) is a hub for research and education, engaging faculty and students across the University of Pennsylvania and reaching government decision-makers through independent, practical, timely, and nonpartisan policy briefs. With offices both at Penn and in Washington, DC, the Initiative provides comprehensive research, coverage, and analysis, anticipating key policy issues on the horizon.

ABOUT PENN WHARTON PUBLIC POLICY INITIATIVE ISSUE BRIEFS

Penn Wharton PPI publishes issue briefs at least once a month, tackling issues that are varied but share one common thread: they are central to the economic health of the nation and the American people. These Issue Briefs are nonpartisan, knowledge-driven documents written by Wharton and Penn faculty in their specific areas of expertise.

CONTACT THE PENN WHARTON PUBLIC POLICY INITIATIVE

At Penn
Steinberg Hall-Dietrich Hall, Room 201
Philadelphia, PA 19104-6302
+1.215.898.1197

In Washington, DC
300 New Jersey Avenue, Suite 900
Washington, DC 20001
1+202-870-2655

For additional copies, please visit the Penn Wharton PPI website at publicpolicy.wharton.upenn.edu.

Follow us on Twitter: @PennWhartonPPI

Founded in 1881 as the first collegiate business school, the Wharton School of the University of Pennsylvania is recognized globally for intellectual leadership and ongoing innovation across every major discipline of business education. With a broad global community and one of the most published business school faculties, Wharton creates economic and social value around the world.