Immigration and Its Effect on Economic Freedom: An Empirical Approach

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Many concerns regarding immigration have arisen over time. The typical worry is that immigrants will displace native workers and fail to create new demand and jobs. That concern and other economic concerns about immigrants, however, have failed to hold up when assessed empirically. But a new argument has arisen: many commentators, pundits, and respected economists have suggested that immigrants today differ critically with respect to how they think about economic policy. In particular, immigration to countries like the United States could undermine economic institutions and diminish economic growth (Collier 2013, Borjas 2015, Jones 2016).

Immigrants and Economic Freedom

This article focuses on two potential channels through which immigration could affect a country's institutions. First, there is the idea that the opinions held by immigrants are representative of the average opinions held by people in the societies that they come from and that their opinions may not be consistent with the institutions of their adopted country. Collier (2013), Borjas (2015), and Jones (2016) have made this argument with regard to immigrants

coming into the United States, but they do not present any actual direct empirical evidence supporting their specific claims about immigrants. There is a straightforward rebuttal of their argument, however. Immigrants self-select for their destination countries and they normally choose countries whose institutions they admire and wish to support. In other words, there is no good reason for researchers to assume that the opinions held by immigrants are representative of the average opinions held by people in the societies that they come from.

The second argument is that immigrants may cause the welfare state to swell in size. Milton Friedman, in an often-repeated quotation, argued that immigration and the welfare state are fundamentally incompatible, and that huge influxes of immigrants would cause the welfare state to spiral out of control. Friedman's case is actually much more ambiguous than it may appear (Nowrasteh 2015, *The Economist* 2016).[1]

Setting aside the intricacies of immigrants' lifetime impact on various welfare and entitlement programs, there is a parallel argument as to why immigrants may *reduce* the size of the welfare state (Nowrasteh 2015). Ironically, the underlying reason for this is made clear by the rhetoric of those making the former argument. There is a significant amount of academic literature on "fractionalization"— that is, formal measures of diversity along ethnic, racial, and even linguistic dimensions. Voting populations are much less willing to use governments to transfer money to other residents when there are clearly demarcated lines, such as ethnicity, that differentiate individuals within a society. This unwillingness of voters can help explain differences in the size of welfare states when comparing the United States and Europe (Alesina and Glaeser 2004), as well as differences in spending on public goods, both between nations (Easterly and Levine 1997) and among U.S. states (Alesina, Baqir, and Easterly 1999).

In sum, immigrants could import ideas contrary to those of their destination countries, or they could self-select for their desire to strengthen those institutions. They could increase per capita usage of welfare and entitlement programs, or they could change voter

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[1]For a discussion of Friedman's views on immigration, see https://openborders .info/friedman-immigration-welfare-state.

sociology in such a way that reduces the willingness to engage in social spending. These channels each present falsifiable hypotheses that should be tested empirically, rather than relying on rhetoric or armchair theorizing.

The Impact of Immigrants on Institutions

In an earlier article (Clark et al. 2015), my co-authors and I use data from the *Economic Freedom of the World* (EFW) report, published by the Fraser Institute in collaboration with the Cato Institute (Gwartney, Lawson, and Hall 2013), to analyze the impact of immigrants on institutions. The EFW index has been used extensively in the scholarly literature to study a wide array of questions with academic rigor (Hall and Lawson 2014) and has been shown to relate robustly to economic growth (De Haan, Lundstrum, and Strum 2006). The EFW index is composed of five components ("areas"):

- *Area 1*, Size of Government;
- *Area 2*, Legal System and Property Rights;
- *Area 3*, Sound Money;
- *Area 4*, Freedom to Trade Internationally; and
- *Area 5*, Regulation.

Each area combines several measures into one score, with "10" corresponding to the highest possible amount of economic freedom (e.g., high index values for Size of Government correspond to smaller governments) and "zero" corresponding to zero economic freedom.

Results

We look at the percent of the population that is foreign-born in 1990 in countries across the world, and measure its effects on EFW in 2011. We control for the value of the EFW index in 1990 when doing so and for all estimates that follow. The choice of the years 1990 and 2011 may seem arbitrary but data constraints, as well as our desire to allow the data on immigrants to have enough time to impact a country, required us to use those particular years. When we run this simple model, we find a small and positive effect of immigration on economic freedom. For each additional percentage point of immigrants in 1990, countries had 0.011 more units of EFW in 2011. That effect borders on statistical significance, meaning the model is unclear whether the effect is truly distinguishable from zero.

By controlling for the EFW index in 1990, we are controlling for many things that would impact the index in 2011. In other words, if there is some characteristic about the country in 1990 that is also present in 2011, and it has not changed all that much, the model already accounts for it. We also account for certain things by comparing the EFW index in 2011 with immigrants in 1990, instead of comparing it with immigrants in 2011. For example, if we had compared EFW in 2011 with immigrants in 2011, a higher index (i.e., more economic freedom) may have meant that it was attracting immigrants instead of more immigrants causing a higher index.

Robustness Checks

Regardless, it makes sense to add additional control variables to get a better idea of how the data behave and to determine whether or not the effect we calculated is reliable. To do this, we added two sets of controls to the model. First, we added real GDP per capita in both 1990 and 2011, since a country's level of prosperity may impact where immigrants choose to immigrate. Second, we included the *Polity IV* index in both 1990 and 2011, a measure of how strongly democratic a country is, to account for the fact that immigrants may react to political institutions as they may react to the economic institutions that underpin economic freedom. To discuss these models concisely, I will refer to the first model we ran as "Baseline," to the model with the first set of controls as "Control 1," and to the model with all five controls (EFW in 1990, RGDP in 1990 and 2011, and *Polity IV* in 1990 and 2011) as "Control 2."

In Control 1, the positive effect increases. One percentage point of more immigrants in 1990 now corresponds to 0.015 units of EFW. This time, the model can more clearly distinguish the effect from zero and it passes the conventional standard of statistical significance. In Control 2, the effect increases again to 0.028 units and it is even more clearly distinguished from zero. None of these effects are large but considering the dire warnings of negative effects feared by many, these positive effects are especially meaningful even if they are not large enough to be a large driver of increases in economic freedom across countries.

We then applied models like Baseline, Control 1, and Control 2 to other ways of thinking about immigration and economic freedom. For instance, it may be the case that immigration is fine when the immigrants come to the United States from other rich countries

(e.g., Canada or Japan), but immigrants from poorer countries may actually lower economic freedom. To account for this, we split the foreign-born populations by country into two different groups, those that come from rich OECD countries and those that come from other, generally less-developed countries. We then allowed them to impact economic freedom separately in Baseline, Control 1, and Control 2. In all three models, the population of immigrants from OECD countries has a positive effect on economic freedom, but the model could not distinguish the effects from zero so they were not statistically significant. The size of the effect also diminished when going from Baseline to Control 1 to Control 2. However, the effects of the immigrants from the poorer countries were positive, larger in magnitude, and statistically significant. In Control 2, the results were strongly significant and corresponded to 0.031 units of EFW, larger than what was found before, when lumping all immigrants together.

Instead of looking at how many immigrants there were in 1990, we also looked at the net inflow from 1990 to 2010 of immigrants as a percentage of the total population, and found that the effect is positive in Baseline, Control 1, and Control 2. However, the size of the effect is smaller than before, and Baseline and Control 1 barely achieve statistical significance. In contrast, Control 2 verifies the effect clearly, and in that model it corresponds to 0.008 units of EFW. Next, we also allowed the number of immigrants in 1990 and their subsequent inflow to impact EFW in the same model. Because the number and the change are pretty closely related, the model has problems figuring out which one is which, making it difficult to distinguish either effect from zero. However, the effects of both in Baseline, Control 1, and Control 2 are positive even if they lack significance in the statistical sense.

Finally, we included an interaction between immigrant population in 1990 and the inflow. A critic might think that a large immigrant population by itself does not have much of an impact, and a large inflow does not do much either, but a lot of both could be detrimental. We ultimately found some very weak evidence in favor of that hypothesis. When we run the model, including both the population and inflow as well as their interaction, the first two have positive effects while the latter has a negative effect. Baseline and Control 1 have difficulty distinguishing anything from zero, but Control 2 is able to distinguish the positive effect in the inflow and the negative effect from the interaction. However, the reason this evidence is

weak is because the size of the effect of the interaction term is actually much smaller than the effects of the other variables. It is unlikely that any country in the world actually experiences an effect of immigration that is, on net, negative and it can best be thought of as a "diminishing return" to economic freedom from immigrants instead of a negative breaking point.

These findings beg for an explanation so we went back and broke down EFW into its component areas. We then re-ran a model mirroring Control 2 for each area of economic freedom for immigrant population in 1990 and inflow. If we focus only on what we can confidently distinguish from zero, it appears that inflows of immigrants have a positive effect on Size of Government (Area 1), meaning that immigrants tend to incentivize smaller government. This result supports the work referenced earlier—namely, that fractionalization reduces the willingness of the voting public to spend. Perhaps surprisingly, more immigrants in 1990 have a positive effect on the legal system and property rights (Area 2) in 2011. It also may have a positive effect on Area 5, meaning it corresponds to fewer regulations, but that is a borderline result.

While we ran several different models, the underlying work here is not highly sophisticated. There are many other ways to measure the impacts of immigrants, and myriad other sets of control variables that can be implemented. But the fact is that ostensibly erudite work by scholars claiming that immigration produces large negative effects on economic freedom and the institutions of capitalism lacks any direct support from the data. I ultimately welcome alternative empirical studies using the EFW index or other measures similar to it for the purpose of assessing the effects of migration on economic freedom. One study published since ours continues down this path, finding that the ease of *emigrating* from a country improves the economic freedom of the potential country of origin as well (Hall 2016).

Conclusion

The application of relatively straightforward empirics to the question of the effects of immigration on economic freedom, in a variety of models, does not support the position that immigration has a negative effect. The net effects are positive but small. This result holds across a variety of assumptions, with the only caveat being that the

strength of the effect may diminish when very high levels of immigrants (much higher than those found in any large developed economy) are paired with very high inflows. Of the theories and mechanisms discussed at the beginning this article regarding how immigrants may impact institutions, the strongest confirmation is that immigration may act via the channel of fractionalization, reducing the willingness of voters to fund large public sectors. Contrary to the argument that immigrant ideology may hamper economic freedom, it appears immigrants support economic liberty in their new homes.

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