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Immigrants Still Assimilate, But Earn Less Than Natives

Many people believe that immigrants to the United States assimilate into the economy relatively quickly. In other words, immigrants' wages tend to rise after they arrive in the United States. In **The Assimilation of Immigrants in the U.S. Labor Market** (*NBER Working Paper No. 3573*), NBER economists **Robert LaLonde** and **Robert Topel** show that the earning capacity of typical new immigrants, holding experience and education constant, rises by over 20 percent in their first ten years of working in the United States.

Still, NBER Research Associate **George Borjas** shows in a related study that immigrant earnings have dropped over time relative to earnings of U.S. natives. In **National Origin and the Skills of Immigrants in the Postwar Period** (*NBER Working Paper No. 3575*), Borjas notes that in 1940 the wage rate of recent immigrants was only 3 percent lower than that of natives, but by 1960 the wage differential had increased to 13 percent, by 1970 to 16 percent, and by 1980 to 30 percent.

These findings can be reconciled by the fact that immigrants' countries of origin have changed dramatically in the last 40 years. According to LaLonde and Topel, two-thirds of all immigrants during the 1950s came from Europe, Canada, and Australia. By contrast, only 6 percent came from South or East Asia, 14 percent from Mexico, and 8 percent from Latin America and the Caribbean. But in the 1970s, 18 percent of U.S. immigrants came from Europe, Canada, and Australia, versus 23 percent from South or East Asia, 27 percent from Mexico, and 18 percent from Latin America and the Caribbean.

The country of origin matters, in part because it is related to immigrants' years of schooling, which in turn has a strong effect on earnings. Immigrants from Mexico, Borjas notes, had six fewer years of education than U.S. natives, while immigrants from France and the Netherlands had three more years of schooling. LaLonde and Topel report similar evidence, noting that immigrants from Europe, Canada, and Australia typically have about five more years of schooling than Mexican immigrants.

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Another factor that explains the relatively low wages of recent immigrants to the United States, LaLonde and Topel note, is that in the 1970s, wages for unskilled labor fell relative to wages for skilled labor. Because such a large fraction of recent immigrants are unskilled workers from Mexico, their earnings reflect this economywide decline in unskilled wages, rather than any failure to assimilate. This drop in unskilled wages may have reduced the wages of new immigrants relative to the wages of natives by as much as 8 percent.

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Foreign Direct Investment and Trade

The recent increase in the flow of foreign direct investment into the United States has raised concerns about the effect of these investments on U.S. trade. Do foreign investments tend to increase imports by serving as a conduit for foreign products? Does production in the United States by foreign-owned firms actually displace imports, or do the foreign firms expand U.S. exports by selling their products in markets outside the United States?

A new study by NBER Research Associate **Robert Lipsey** reports that the share of foreign-owned manufacturers in U.S. trade grew from almost nothing in the 1960s to about 7-8 percent of trade by the 1980s. In **Foreign Direct Investment in the United States and U.S. Trade** (NBER Working Paper No. 3623), Lipsey calculates that the average foreign-owned manufacturing firm exports about 8 percent of its sales, and imports raw material and components used in production and finished goods equal to about 11 percent of sales. By contrast, U.S. manufacturing firms that owned affiliates abroad exported 11 percent of their U.S. production in 1988, and had imports equal to 6.5 percent of sales. U.S.-owned firms have a greater propensity to export and a lower propensity to import than Japanese firms do, whether in the same industry or in manufacturing as a whole, he finds.

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Lipsey observes no particular trend in export or import ratios for foreign-owned firms, but finds that those ratios fluctuate much more than the export or import ratios of their U.S.-owned counterparts. Foreign-owned firms also appear to be more sensitive to changes in exchange rates than U.S.-owned firms are. When the dollar rises, the foreign-owned firms shift their sales from export markets to U.S. markets and increase the share of imports in their sales. When the dollar falls in value, the process is reversed.

Investor Perceptions of Stock Markets

Despite the removal of many governmental obstacles and the dramatic increase in international capital flows during the 1980s, most investors keep their money at home, according to a study by NBER Research Associates **Kenneth French** and **James Poterba**. They estimate that in December 1989 the share of domestic stocks in investors' equity portfolios was more than 98 percent in Japan; almost 94 percent in the United States; and 82 percent in the United Kingdom.

In **Investor Diversification and International Equity Markets** (NBER Working Paper No. 3609), French and Poterba point out that there are explicit limits on foreign investing for some institutional investors in Japan, France, and other countries, but these limits are far above the share of foreign assets in the portfolios of investors in those countries. They also find that higher transactions costs and less favorable tax treatment for foreign-source income are not sufficient to explain differences in portfolios across countries. The two authors conclude that the differences in stock holdings must be based on investor perceptions of likely returns.

Considering differences in portfolios in the United States, the United Kingdom, and Japan in December 1989, and making plausible assumptions about investors' risk aversion, French and Poterba calculate that U.S. investors believed that the expected return on U.S. stocks would be 250 basis points above the return on Japanese stocks. In contrast, Japanese investors thought that Japanese stocks would outperform U.S. stocks by 350 basis points.

In **Speculative Behavior in the Stock Markets: Evidence from the United States and Japan** (NBER Working Paper No. 3613), **Robert Shiller**, **Fumiko Kon-Ya**, and **Yoshiro Tsutsui** report on survey data on just such expectations. They find that U.S. investors are much more optimistic about the U.S. stock market than the Japanese stock market. In mid-1990, U.S. investors expected the Dow Jones Industrial Average to rise by 1.6 percent over the next year, and the Nikkei index to decline by 8.8 percent. Japanese investors, on the other hand, expected the Dow Jones to rise by 4.3 percent and the Nikkei to rise by 8.2 percent. About 74 percent of U.S. investors but only 27 percent of the Japanese investors surveyed in July 1989 thought that Japanese stocks were overpriced.

Japanese investors also were more optimistic than U.S. investors about U.S. stock prices between 1989 and 1990. In July 1989, 19 percent of the U.S. investors but none of the Japanese thought that U.S. stock prices were too high. In January 1990, the

comparable figures were 38 percent for the Americans but only 1 percent for the Japanese. By July 1990, 39 percent of the Americans and 11 percent of the Japanese were pessimistic.

For their study, Shiller and his coauthors surveyed *institutional* investors in the United States and Japan in July 1989. They asked whether stock prices in both countries were too low, too high, or about right "when compared with measures of true fundamental value or sensible investment value."

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Shiller, Kon-Ya, and Tsutsui learned that a substantial fraction of investors in both countries advised their clients to continue investing in stocks for the time being, even though they expected "a substantial drop in stock prices ultimately." In July 1989, 34 percent of U.S. investors and 39 percent of Japanese investors held this opinion about the stock markets of their own countries. By the following July, these numbers had dropped to 11 percent and 7 percent, respectively.

The authors note that these survey responses are not likely to be the result of imperfect information in both countries: "Information about the entire stock market is hard to keep secret; any aggregate data available to the Japanese institutional investment community tend to be available to the U.S. community as well." Finally, Shiller and his coauthors conclude that traditional notions of a "speculative bubble" are consistent with the behavior of the investors who continued to place their money in stocks even though they expected that prices ultimately would fall.

The Effect of Tax Policy on Business Investment

The Tax Reform Act of 1986 (TRA86) eliminated the investment tax credit and certain other mea-

asures designed to encourage business investment. As a consequence, many economists predicted that business investment, especially new investment in equipment, would fall after TRA86 took effect. Instead, nonresidential fixed investment dipped only slightly from 12.5 percent of GNP in 1985 to 11.9 percent of GNP in 1987-9, and investment in equipment as a share of GNP actually *rose* from 8.4 percent to 9 percent from 1985 to 1987-9.

At first glance, it seems that predictions of TRA86's effect were wrong. But a new NBER study by **Alan Auerbach** and **Kevin Hassett** suggests that "the equipment boom since 1986 appears to be a continuation of a long-term shift in investment from structures to equipment that swamps the incentives of the 1986 Act." Nonetheless, they find that investment in equipment would have been significantly higher if TRA86 had not reduced tax incentives for business investment.

In **Recent U.S. Behavior and the Tax Reform Act of 1986: A Disaggregate View** (*NBER Working Paper No. 3626*), Auerbach and Hassett note that the structure of business investment has shifted substantially since the 1950s. For instance, in 1953 the U.S. agricultural sector and the FIRE (finance, insurance, real estate, and services) sector each accounted for about 12-13 percent of total investments in equipment. In 1989, agriculture's share of total investment in equipment had shrunk to 2.7 percent, while FIRE's share had grown to over 41 percent. Partly as a result of this shift in the structure of the U.S. economy, equipment went from 55 percent of total investment in 1953 to 76 percent in 1989. Much of that growth was attributable to computers: they rose from less than 1 percent of total nonresidential fixed investment in 1953 to 25 percent in 1989.

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To isolate the effect of TRA86 on business investment, Auerbach and Hassett estimate what investment would have been in 1987-9 if TRA86 had not been in effect. Their predictions are based on investment by asset and industry for 1953-85, and take into account such factors as each industry's investment-capital ratio, the price of capital goods, the cash flow to the industry, the real interest rate, and the price of oil. They find that the cross-industry pattern of investment in equipment is consistent with the predicted effects of the tax reform.

Recent NBER Book

Immigration, Trade, and the Labor Market

Immigration, Trade, and the Labor Market, edited by John M. Abowd and Richard B. Freeman, is available from the University of Chicago Press for \$49.95. This NBER Project Report focuses on the growing internationalization of the American labor market that began in the 1970s and 1980s.

Among the interesting findings of this project are: 1) Immigration into an area does not discernibly reduce the wages and employment of low-skilled native workers in that area. But increased imports reduce the pay and employment of workers in competing domestic industries. 2) There are far fewer illegal

immigrants in the United States than has been reported in the media. Further, the immigrant share of labor force growth has been relatively moderate over the last 20 years or so because of increased entry into the labor market by natives.

Abowd is a research associate in, and Freeman is director of, the NBER's Program in Labor Studies. Abowd is also a professor of labor economics and management at Cornell University. Freeman is a professor of economics at Harvard University.

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