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Putting the Immigration Debate into Context

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While hundreds of thousands of pro-immigration protesters march peacefully through the streets of Los Angeles and other southwestern cities, the U.S. Congress debates conflicting bills intended to help the country get a grip on illegal immigration. The Senate bill would attempt to legalize many of these illegal workers, while the House bill would turn them into felons.

The proponents of tough measures against illegal immigrants hope to stem the tide by doubling the number of border patrol agents (after already doubling them over the last decade), building a double wall across much of the southern U.S. border, and criminalizing anyone who assists an illegal immigrant.

These get-tough measures will fail, and the reason is simple: They are a form of prohibition, and prohibition always fails because it ignores the economic incentives to violate the legal ban. The only effective solution to the problem of illegal immigration is to increase Mexico's wealth, which can best be done by coupling economic reform in Mexico with a North American common market. A common market with Mexico is a radical proposal, certain to face knee-jerk rejection from many; but, history shows the repeated failures of prohibition and the vital success of common markets.

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The Failure of Prohibition Policies

The most famous example of prohibition in the United States is the Eighteenth Amendment's prohibition of the production and consumption of intoxicating liquors. As is well known, this amendment is the only amendment to ever have been explicitly repealed; but, while it was in operation, liquor was not difficult to obtain. Likewise, the war on drugs, our contemporary prohibition battle, has failed to significantly reduce, much less eliminate, illegal drug use. Advocates of prohibitions always mistakenly believe that simple command-and-control policies will shape behavior into the desired patterns. They never foresee the real incentives that are created, because they do not grasp the simple economic concept of cost-benefit analysis.

The analysis is deceptively simple: If an individual calculates the benefits of violating the law as greater than the cost of violating, multiplied by the *probability* of incurring that cost, then their subjective expected value of violating the law is positive.[1] In the case of prohibition of liquor and drugs, many people like their intoxicants enough to endure fairly serious risks.

But command-and-control policies *do* shape behavior, just not in the ways advocates expect. One of the predictable effects of prohibition is the creation of a black market. Because demand for the prohibited good remains while the legal means of securing it disappears, an economic vacuum is created, and the market abhors a vacuum as much as nature does. Reduced supply and steady demand result in an increase in prices. Higher prices mean higher profits, and higher profits lure entrepreneurs into the market. In this case, the higher profits must also be enough to compensate the black-market entrepreneur for the risk they must bear. But there has never been a shortage of people willing to take those risks, usually because better economic opportunities are not open to them. The gangs who supplied alcohol during the roaring twenties were predominantly Irish and Italian, two groups that had not yet fully assimilated, so that operating in the black market was the best economic opportunity open to them. The current black-market entrepreneurs in the drug trade are predominantly inner-city African Americans. Given that the real unemployment rate for young urban black men is estimated conservatively at more than 25 percent, it is not surprising that the risks of the drug trade are outweighed by the prospect of real economic gain.

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Prohibition of illegal immigration follows the very same pattern. The benefits to Latino immigrants are greater than the risks they face, so they continue to find ways to cross the border despite all U.S. efforts. In addition, black markets in both border-crossing guides and forged documents have emerged, as men with little economic opportunity in the legal economy recognize the value of filling demand in the extra-legal markets.

The Costs and Benefits to Illegal Immigrants

Only when we compare the current benefits and costs to illegal immigrants do we recognize the futility of the proposed immigration reforms.

First, the benefits are greater than most Americans realize. While everyone knows that Latino immigrants come to the United States because the economic opportunity is greater, few recognize how much is at stake. In 2005, Latin American and Caribbean workers in the United States, Europe, and Japan sent home $53.6 billion dollars in remittances.[2] That is not just a lot of money — it is more than direct foreign investment (investment by foreign companies) and foreign aid to those countries combined. In other words, the greatest external boost to Latin American economies is not investment by U.S. and European firms, but the money sent back home by immigrant labor.

Of that total, $20 billion went just to Mexico, where 40 percent of the population lives below the poverty line (compared to 12 percent in the United States).[3] Since nearly all Mexican migrant labor comes to the United States, the vast majority of that money came from workers in the United States. Mexico's gross domestic product (GDP) is roughly $1 trillion,[4] so $20 billion is about 2 percent of the GDP (the Inter-American Development Bank's estimate is slightly higher, at 2.46 percent).[5] That may not sound like much, but consider some comparisons. With a GDP of $12.4 trillion, 2 percent of the U.S. economy would be $248 billion dollars. That is greater than the market capitalization value of Wal-Mart. Although the two measures are not directly comparable, if the economic impact of Wal-Mart in the U.S. is considered, some sense of the value of remittances in Mexico can be gained.

Next, consider the cost side of the equation. Many in Congress propose to get tough, by making illegal immigration a felony crime. But in 2004 alone, more than four hundred people died trying to cross the border. If people are desperate enough to face the risk of death, is the risk of felony status really going to be a deterrent? Unless we are willing to pay the cost of imprisoning all these unlawfully present Mexican nationals, we will simply transport them back across the border, as can already happen. They would forfeit the possibility of ever entering the United States legally, but that is not a pressing real-at-the-moment cost to someone hoping to feed their family.

Congressional leaders also propose building a higher and longer fence along the U.S. border. But this merely creates a marginal increase in the cost of illegal border crossing, and is an insufficient deterrent. Consider the Berlin Wall. Escapees knew the entire wall was patrolled and they could be shot on sight, yet innumerable freedom-seekers took the risk anyway. The U.S. border wall will not be perpetually patrolled along its entire length (even with the proposed increases in the border patrol), and U.S. border guards will not be authorized to shoot on sight. That means an improved wall will merely be a technical obstacle for the black-market border guides. Already they have dug multiple tunnels along the existing fence, and the same will, most definitely, continue to happen along whatever length of fence is created. It may be technologically possible to build an impassable fence, for example, 2,000 miles in length, set in the ground to a depth great enough to prohibit tunnels, high enough and smooth enough to make scaling it impossible, and perpetually guarded at each segment, but it would be cost-prohibitive. In short, a better wall will only raise the costs of immigration, but not enough to offset immigrants' potential gains.

The proposals to criminalize employers who hire illegal immigrants will also fail, for two reasons. First, southwestern agriculture is dependent on migrant labor. The time window for harvesting crops is brief, and farm operators need to get a temporary workforce in place quickly. Proving legality for every worker will be time and cost-prohibitive. If the government does pass and enforce such measures, the political response from southwestern farm operators will be swift and loud, and southwestern legislators will find ways to pass legislation undermining the policy in order to protect their constituents.

Second, such a policy will only increase the price of falsified documents, creating an ever more lucrative black market in fake documents. Again, the cost to illegal immigrants will rise, but probably not enough to offset their expected gains from coming here.

We must also factor in other costs to immigrants, such as finding places to stay and adjusting to an unfamiliar world. But, with the recent increases in the number of legal Mexican immigrants, these costs are dramatically reduced, as potential illegal immigrants can expect to receive housing and job-finding assistance from relatives and friends. As economist Janet Landa of York University has shown, these types of social networks dramatically reduce transaction costs for those within those networks.[6] When this ever-diminishing cost is weighed against Congress's efforts to increase the costs, it becomes even more apparent that the proposed reforms are simply costly symbolic politics, rather than substantive and effective policies.

In brief, without resort to massive police-state tactics, we cannot stem the tide of illegal immigration through prohibitionist policies. And, in a democratic republic, police state tactics are unacceptable. But, there is a solution, albeit a radical one. Like most solutions, it ultimately comes from inside, rather than outside. It requires recognition that the solution lies within Mexico, and that the United States can help Mexico achieve it.

The Mexican Problem

The immediate problem is that Mexico is dramatically underdeveloped compared to the United States. But the more fundamental problem is the cause of that underdevelopment, a cause common to all of Latin America – a lack of property rights.

Hernando de Soto, president of the Institute for Liberty and Democracy in Peru, has convincingly shown that the critical difference between the developed and undeveloped worlds is access to property rights for the average citizen. In the United States, everyone, whether poor or rich, has access to property rights. In fact, U.S. laws, such as deduction of mortgage interest from federal income taxes, actively promote property ownership for all economic classes. This allows people legal title to their assets, which makes it possible to use them as income-producing capital. A house can be mortgaged to provide start-up money for a business, rented out to others without fear of losing control of the property, or sold for profit. Because it is legally incorporated, a startup business can convince others to invest their money in it through loans or purchase of stock. Property rights, by creating capital, create wealth.

Most underdeveloped countries do not lack property rights laws, but only the elites have access to them. The poor, while possessing assets that are of greater value than their countries' stock markets, usually do not have legal title to those assets.[7] This means they cannot capitalize on those assets. They cannot use them to get loans because no bank will loan money on property that is not secured by a title, they cannot sell them to someone else at top dollar because their claim of possession is legally tenuous, and they cannot sell stock shares because it is nearly impossible to legally incorporate a business.

In Mexico, more than 30 percent of the workforce works in the extralegal sector of the economy, accounting for a roughly equivalent proportion of the country's GDP. In Mexico City alone, there are over 350,000 extralegal businesses.[8] While the owners of these businesses are working hard to improve their economic condition, their extralegal status forces them to remain small and unnoticed, while wasting money on bribes to officials just to stay in business. If they do try to become legal, they risk drawing the government's attention and being shut down.

This also means a tremendous loss for the Mexican government, as resources are wasted in trying to control these businesses while the government receives nothing from them in taxes. As de Soto shows, these businesses *want* to be legal, but are not able to become so. People *want* to gain legal titles to the land underlying their homes, but the government refuses to grant them. All of these work to keep the Mexican economy undercapitalized and underproductive.

The Solution: A Common Market

The United States has only three times the population of Mexico, but its economy, at $12.4 trillion, is twelve times larger. While U.S. GDP per capita is $42,000, Mexico's is only a quarter of that at $10,000. If that could be improved so that Mexicans had a standard of living that was even close to that of Americans, the necessity of Mexican laborers to migrate to the United States would disappear. So how can Mexico develop? By instituting property rights for everyone and by joining a common market with the United States.

A common market would be substantively different than the North America Free Trade Agreement (NAFTA). NAFTA is not even a true free trade agreement, as some tariffs and quotas still remain. But, in a common market, all factors of production can travel without restriction to where they are needed. The larger the common market, the lower the costs of doing business and the greater the overall economic development, all other things being equal. It may be hard for Americans to recognize that a common market with Mexico would be beneficial to the United States, but it is nonetheless true. After all, the United States is itself one of the largest common markets in the world.

We are not accustomed to thinking of the United States as a common market, but that was one of the major achievements of the U.S. Constitution. Between the end of the Revolution and the drafting of the Constitution, states were enacting numerous trade barriers against each other, to the detriment of the economies of all of them. The Constitution's Interstate Commerce Clause deprived the states of the authority to erect trade barriers, creating a comprehensive free trade zone among the states. Notably, U.S. states are more economically distinct and specialized than are the countries of the European Union.[9] Thus, there is considerable trade between the states as they specialize. Instead of each state trying to have its own steel or movie industries, those sectors are geographically clustered in a way that reduces their production costs. While it is common to think of the United States as trading with Japan — our movies for their cars, for example — we forget that, in the same way, California trades movies for cars with Michigan. (Of course it is not actually "Japan" or "California" that trades, but in each case the trade is between individual firms and consumers.)

Just as this internal common market has enriched the United States, bringing Mexico into the common market would enrich Mexico, by allowing their citizens to find jobs closer to home. However the agreement would have to be dependent on Mexico instituting a process to make property rights accessible to all Mexican citizens, in the same way that all U.S. citizens have legal title to their own assets. The United States can help Mexico in this area by providing a model for how to create a full set of rights to property.

Criticism: Drain on the U.S. Economy

Of course this proposal will be subject to criticism, so it is worthwhile to anticipate two of the most probable and potent criticisms — first, that this proposal would harm the U.S. economy and second, that it would create greater national security risks.

Many people will assume that a common market with Mexico would be a massive drain on the American economy. This criticism cannot be taken lightly, as there would certainly be significant economic disruptions, although their exact form is difficult to predict.[10] But, there is little reason to expect long-term harm to the U.S. economy.

Nearly two centuries ago, David Ricardo provided the strongest argument for unrestricted free trade with the theory of comparative advantage. This theory, reflected in history, suggests in part that wealthy countries can prosper even through trade with poor countries. Consider the United States again. Mississippi has the country's lowest Gross State Product (GSP) per capita, at around $25,000. Delaware's GSP, the second highest in the country, is more than double, at $60,000.[11] Does anyone really believe that Delaware has been harmed by being in a common market and having unrestricted trade with Mississippi?

We can also look at the experience we have already had with Mexico under the NAFTA treaty. In 1992, while the treaty was being negotiated, presidential aspirant Ross Perot predicted a "giant sucking sound" as American jobs flowed south. More than a decade later, even following a sharp recession caused by the bursting of the tech stocks bubble, the U.S. unemployment rate is still at near record lows, coming in at under 5 percent in early 2006. While many claim that the United States is retaining only low-wage jobs, real income has continued to increase over the past decade.[12]

In sum, there is no evidence of real harm from trade with poorer countries. On the contrary, the resulting lower prices allow Americans to increase their standard of living by being able to purchase more goods, and the reduced business costs allow U.S. firms to invest in higher-value enterprises, boosting overall economic growth.

If Mexico develops economically, it is good news for the United States. Contrary to the predictions of some, Mexico can develop, and quickly. Less than two generations ago, South Korea was recovering from civil war and was an impoverished agrarian-based economy. Today it's GDP per capita is $20,400, twice that of Mexico, just behind Spain's and slightly ahead of Portugal.[13] With property rights reform and full access to the U.S. market Mexico too could be transformed within a generation.

Criticism: National Security

Another serious criticism concerns national security. A common market would require borders that are more open than they are at present, and many will fear that opening the borders would make it easier for terrorists to enter the country. Although terrorism remains one of the least likely causes of death for a U.S. citizen, in a post-9/11 world it is a political issue that cannot be ignored. In fact, Senate Majority Leader Bill Frist has claimed national security as the primary reason immigration reform is needed: "America needs secure borders. Right now, we don't have them. Every day thousands of people violate our frontiers. We don't know their identities and, quite often, we can't stop them."[14]

Senator Frist is probably sincere in his belief that national security is at stake, but the proposed reforms would do nothing to further national security, because as explained previously, they would do nothing to stem the flow of illegal border crossings.

The best way to improve national security vis-à-vis immigration is to direct the majority of immigrants to official border crossings where their identities can be verified. Opening up the border so that crossing is legal would have this effect. Consider the U.S.-Canada border. Because it is legal and relatively simple to cross, almost no one takes the extra risk of crossing illegally, and nearly everyone goes through a government checkpoint. The same effect would occur on the U.S.-Mexican border. Because they could cross legally at official border crossings, immigrants would avoid the risk of crossing illegally outside those checkpoints.

Potential terrorists attempting to sneak into the United States across the Mexican border would have to choose between going through a checkpoint, exposing themselves to potential capture, or crossing illegally outside the checkpoint. Right now the border patrol is unable to apprehend and detain all of the people crossing the border illegally because there are simply so many of them. The United States has doubled its border patrol in the last decade, during which time the number of illegal immigrants has increased. There is little reason to expect that doubling it again will have a substantial effect, because they will still be massively outnumbered. But if the number of illegal crossers was reduced to nearly zero because they could freely go through proper border crossings, then the very few people who did sneak across, including potential terrorists, would face a far greater likelihood of being apprehended.

Conclusion

Both government officials and politically aware citizens typically think in terms of command-and-control policies, or prohibitions, instead of focusing on the incentives lawbreakers are responding to. But it is foolishly simplistic to assume that instituting a rule and a punishment will create a strong enough incentive to obey. More than one person per day died trying to cross the border last year. Given the number that crossed, the probability of dying is low, yet the cost is higher than anything the U.S. government is proposing to impose.

When we take time to think about the incentives these immigrants are responding to, we can begin to understand the futile nature of the proposed immigration reforms. What is needed is a wholesale change in our approach in an effort to radically change the incentives. A booming Mexican economy would create incentives for individuals to look for work nearer to home, leading to an end to the problem of illegal immigration from Mexico. The United States can make that happen, by inviting Mexico into a common market, with the proviso that they open up property ownership to all citizens.

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1 The cost-benefit approach to criminal behavior was pioneered by Gary Becker. See his "Crime and Punishment: An Economic Approach." *Journal of Political Economy* 78 (March/April 1968: 169-217. A popular discussion of these ideas is found in Todd Buchholz, *New Ideas from Dead Economists* (Plume Books: 1989): 197-199.

2 Inter-American Development Bank. "Remittances 2005: Promoting Financial Democracy." 2006. http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=697487.

3 Ibid.

4 As based on Purchasing Power Parity, the best measure. At official exchange rates it is only $700 billion. Central Intelligence Agency. *The World Factbook*. http://www.cia.gov/cia/publications/factbook/geos/mx.html.

5 The Inter-American Development Bank. "Remittances and Development: The Case of Mexico." 2005. http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=561166

6 Janet T. Landa, "A Theory of the Ethnically Homogenous Middleman Group: An Institutional Alternative to Contract Law." *The Journal of Legal Studies* vol. X (June 1981): 349-362.

7 See Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. (Basic Books, 2000).

8 Ibid.

9 Tyler Cowen, *Creative Destruction: How Globalization is Changing the World's Cultures*. (Princeton: University Press, 2000): 87.

10 Of course there is also economic disruption and harm caused by protecting U.S. jobs. Serious analyses of the Bush steel tariffs conclude that more jobs were lost in the steel consumption industries than were saved in the steel production ones, creating a net economic loss.

11 The Nelson A. Rockefeller Institute of Government Fiscal Studies Program. http://rfs.rockinst.org/ffdetail/1279

12 Department of Labor, Bureau of Labor Statistics.

13 Central Intelligence Agency. *The World Factbook*. http://www.cia.gov/cia/publications/factbook/geos/mx.html.

14 Bill Frist. "Securing America's Borders: It's a National Security Issue." *National Review* (March 17, 2006), http://www.nationalreview.com/comment/frist200603170116.asp

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