

# Understanding Immigrant Entrepreneurs: Theoretical and Empirical Issues

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What are the benefits of immigration? What are the costs? The focus of recent debate on immigration policy has been on these two questions. Of course the answers depend upon the subsidiary question of benefits and costs to whom. Although several scholars have proffered answers to these questions — answers intended as policy recommendations — one element that often has been overlooked is entrepreneurship among immigrants, and the benefits they confer.

Although current immigration law creates a special category for entrepreneurs,<sup>1</sup> our concern is not with the big investor but with the small immigrant business owner, the vast majority of whom entered in immigrant categories for relatives or as refugees. What we know for sure is that the small immigrant business owner exists. There was an 89.3 percent increase in Asian American owned businesses between 1982 and 1987; of the firms in 1987 that were established since 1979, 80 percent were immigrant owned.<sup>2</sup> Recent census statistics show that 2.7 percent of all businesses in the United States were owned by Asian Pacific Islanders, with the largest percentage in Hawaii (51.4 percent) and the lowest in Vermont, South Dakota, and Maine (each at 0.2 percent).<sup>3</sup> In 1987 total sales and receipts generated by Asian Pacific Islander businesses were a little over \$33 billion, with an annual payroll of over \$3 billion in total and over 351,000 employees. In 1987 businesses run by Asian Pacific Islanders ranged across sectors, with per firm receipts across all sectors averaging \$93,000. The highest average receipts per firm came from "Wholesale Trade" (\$393,000). Other sectors where Asian presence is strong include "Construction" (\$38,000), "Finance, Insurance and Real Estate" (\$40,000), and "Manufacturing" (\$144,000).<sup>4</sup> Despite the availability of these Census fig-

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ures, benefits created by immigrant entrepreneurship has never been fully measured by most researchers.

The entrepreneurial diversity represented by Asian Pacific immigrant businesses is remarkable. In addition to the conventional "mom and pop" grocery stores, laundries, restaurants, and liquor stores, Asian Pacific immigrant entrepreneurs are involved in clothing manufacturing, publishing, banking, jewelry, fast foods, medical equipment designing and manufacturing, herbal extracts, entertainment, fashion designing, and of course the high-tech industry. And their businesses and headquarters are located all across the United States, in virtually every state of the union.<sup>5</sup> In downtown Flushing, Queens, New York, Asian immigrant businesses make up many of the bustling "greengrocers, butchers, bakeries, beauty parlors, restaurants and video, fish and jewelry stores, . . . [and now the area seems] light-years away from the deterioration and vacancies that characterized it in the 1970s." Korean American merchants have flourished and become "synonymous with small business in New York City."<sup>6</sup> Asian Pacific Americans own over half of all small businesses in Washington, D.C. In nearby northern Virginia, a thriving Koreatown has developed with an estimated 200 Korean American-owned businesses.<sup>7</sup> In Seattle's busy Rainier Avenue South, hundreds of Asian Pacific American-owned shops dot the street with "restaurants, dry cleaners, discount stores, export shops, and manicure shops." In the Puget Sound area, Koreans own 70 percent of the more than 500 dry cleaning businesses and 15 beauty-supply stores.<sup>8</sup> Korean American entrepreneurs who own restaurants, import shops, and professional offices have also revitalized neighborhoods in Dallas. In fact, immigrants from India, as well as Pakistan, Ethiopia, Eritrea, and Ghana have become small-business owners in Dallas.<sup>9</sup>

The principal thesis of this paper is that the existence of a sizeable number of immigrant entrepreneurs introduces important and previously overlooked factors into the theoretical and policy discussion of immigration. For purposes of this discussion, theories of immigration can be divided into two camps: (1) free market advocates who hold that the unfettered mobility of goods and people maximizes global welfare and the welfare of individual nations and (2) interventionist advocates who propose limitations on the global mobility through either strict controls or by targeted controls in order to protect against transfers of wealth across nations or within nations. The existence of immigrant entrepreneurs — as a theoretical category, previously overlooked, and as an empirical fact, understudied — provides a common ground between these two prongs of the

immigration debate. Immigrant entrepreneurs coordinate and expand markets, under the free market world view, by injecting capital into the domestic economy, although with the risk that the returns on capital may be repatriated. Immigrant entrepreneurs also can provide employment and external benefits in a way that is overlooked by the interventionist world view. If the focus is on the benefits and costs of immigration, then the role of immigrant entrepreneurs must be considered.

This paper should be read with two caveats. First, the conclusions of this paper are impartial ones; this is not an advocacy piece for a particular policy agenda. Instead, the purpose is to address one area generally overlooked in the immigration debate: the existence and impact of immigrant entrepreneurs. This piece is intended to provoke thought and discussion, and although several policy conclusions can be imagined, including providing preferences for certain entrepreneurial groups or expanding current categories for entrepreneurship, the advocacy of particular reform is not intended. Indeed, the impressive figures on Asian Pacific entrepreneurs set forth above have resulted from the current, mostly family-based, immigration system. Many connections could be made between the theory and the application, but those discussions are for future debate.

The second caveat relates to the limitation of examples presented in this paper just to Asian immigrants. The choice of this group is dictated by the purpose of this project. There is no presumption that Asian immigrants are somehow particularly more fit for entrepreneurship or are different from other immigrants. Therefore, any attempt to use this research to favor Asian immigrants would be a misuse of this paper. By focusing on the Asian sub-population of immigrants, this paper addresses several open hypotheses about immigrant entrepreneurs, such as the "protected market" hypothesis, which states that immigrant business success results in part from providing services to immigrants of the same ethnicity.<sup>10</sup> As argued below, the protected market hypothesis is not as successful at explaining the success of Asian entrepreneurs as the "capital endowment hypothesis."<sup>11</sup> This result may mitigate the role of purely ethnic or cultural factors in explaining entrepreneurial success. The next logical step is to expand the analysis to other ethnic groups and conduct cross-ethnic group comparisons, this paper's focus on Asian entrepreneurs is intended to serve as a model for future researchers rather than as a model for policy makers or advocates seeking to single out the Asian population for different treatment.

The next section places the immigrant entrepreneur in the context of various theoretical models of immigration and trade. The following section

moves from the theoretical to the empirical and focuses on actual determinants of the success of Asian entrepreneurs in the United States. The final section ties the theoretical and empirical work together as a critique of various immigration reform proposals, particularly those of Huddle and Borjas.

## **The Immigrant Entrepreneur, Free Trade, And Protectionism**

As shown by the statistics cited above and discussed below, immigrant entrepreneurs are a real phenomenon. This section of the paper, however, approaches the existence of immigrant entrepreneurs from a purely theoretical perspective. The basic question is, what does the existence of immigrant entrepreneurs imply about the various possible theoretical constructs used to explain trade and immigration. Put another way, do immigrant entrepreneurs support or destroy a particular theoretical construction? This section focuses on two principal theories: the free trade theory and the various theories that I collectively call the interventionist theory.

The economic theory of free trade is common knowledge: countries under conditions of perfect competition will trade in goods according to the principle of comparative advantage. Comparative advantage means that a country will export those goods that it can produce more cheaply in relative terms than other countries.<sup>12</sup> To take a simple example, assuming goods can be produced with a combination of human labor and physical capital, then a country that has more labor relative to capital than other countries will tend to have a comparative advantage in those goods that use more labor relative to capital, i.e., "labor intensive goods." Although several factors, such as differences in consumption patterns and tastes across countries and imperfect markets like monopolies, may cause actual trade to deviate from this theoretical prediction, the economic theory of free trade stands firmly on the principle of comparative advantage. The corollary to this theory is that comparative advantage will generate a surplus that will increase world income, that is, the sum of incomes of all countries. Because of gains from trade, free trade is said to be more efficient than an autarkic policy of national self-sufficiency and nonreliance on imports or economic aid.

The free trade theory described above is textbook material. Variants appear in many debates about trade policy. Less often emphasized is the subtle effect of free trade: factor price equalization, which theoretically de-

scribes the tendency of factor prices, including wages and returns to capital, to equalize under free trade conditions. Analytically, factor price equalization result depends on many assumptions about the underlying technology by which goods are produced. Conceptually, the principle captures an important aspect of free trade in goods: integration of disparate and isolated regions through exchange. In a world of autarky, workers in region A may be earning considerably less than those in region B.<sup>13</sup> In contrast, a world of perfect factor price equalization would result eventually in equal wages throughout each region. Similarly the returns to capital may differ widely between the regions in an autarky. One way to equalize factor payments under the free trade theory is to have interregional mobility of labor and capital; the principle of arbitrage or the law of one price would guarantee equalization of factor prices. Under the factor price equalization proposition, equality of factor returns could also result by free exchange of goods that are produced with factors of production. Put another way, factor price equalization means that trade in goods substitutes for the global mobility of factors of production.

Free trade theory taken to its limits means that it would be redundant to advocate for both free trade in goods and free migration because the former would simply be a substitute for the latter. A stronger implication is that the goal of free migration may work against goals of free trade. Free trade in goods and free migration, however, may not be redundant positions if, for instance, political factors prevented trade from being completely free. Trade, for example, could be used as a strategic weapon for geopolitical or security reasons. In such a world, where trade plays the role both of integrating markets and protecting national security, a free migration policy might be necessary to guarantee economic benefits of free markets without losing the use of free trade as a strategic weapon.

So far we have spoken very abstractly about factors of production, trade, and mobility of factors. What does this analysis have to do with immigrant entrepreneurs? The role that immigrant entrepreneurs play in the theory of free trade rests specifically on which factors of productions they embody. While immigrant entrepreneurs certainly constitute labor and their mobility is very likely in response to differences in wages, entrepreneurs also constitute capital since many bring financial capital with them to invest in the United States. Furthermore immigrant entrepreneurs embody certain skills or human capital. Explaining immigrant entrepreneurs within the context of free trade theory entails explaining first, why free trade fails to equalize differences in wage rates, returns to financial capital or returns to

human capital globally and second, how immigrant entrepreneurs substitute for the missing global market in goods.<sup>14</sup>

On the surface, encouraging immigrant entrepreneurs is arguably a strong free trade position, but a closer consideration of the free trade theory suggests certain deficiencies in explaining why immigrant entrepreneurship occurs in the first place. Would, for example, free trade theory predict that immigrant entrepreneurship should decline as markets open up? This prediction is not wholly consistent with the ethnic pattern of Asian immigrant entrepreneurs who originate from India (protectionist vis-a-vis the world), South Korea (less protectionist than India) and Southeast Asia (more recently the least protectionist of the three).<sup>15</sup> The problem with the free trade position is that it cannot wholly explain where differences in comparative advantage arise. In support of the free trade theory, we should add that for the purposes of realizing gains from trade the question of the origins of comparative advantage is irrelevant. Understanding the differences can, however, uncover previously unexplored benefits of immigrant entrepreneurs. Interventionist theories can better aid this exploration.

What we refer to as the interventionist theory actually encompasses a range of theories, including economist Paul Krugman's models of trade under increasing returns and economist George Borjas' theory of immigration and human capital.<sup>16</sup> The main theme of the interventionist theory is that differences across nations result from the existence of "external economies," benefits or costs that arise from an exchange that affects those who are not party to the exchange. For example, the existence of one or two educated individuals in an economy may not have much of an impact on output. Increasing the number, though, may result in external economies: not only does the economy benefit from the individual contributions but also from the network of educated individuals who can work together. External economies can also be negative, such as those that arise from having too many individuals taking advantage of a government entitlement program: participants beyond a certain number may increase the costs of the program above the additional direct costs of their participation.<sup>17</sup>

The presence of external economies alters the free trade theory in two ways. Free trade by itself may not be enough to generate all the potential gains from trade. The United States may need more scientists, for example. Individuals may not, however, have the full incentive to become scientists if they cannot capture the full additional benefits generated by entering the field. In this case, financial incentives or quotas may be needed to correct the problem. The question of what institution should implement these in-

centives is left to others. The initial inclination may be to designate this role to "the government," even though the question of how large a role government should play is still unsettled. Another alternative is the business sector, which may be able to exploit external economies because of size and access to financial markets. Leaving this point aside, this type of argument is what essentially buttresses government intervention programs that target the class of immigrants permitted into the country.

The concept of external economies also fills in the missing element of the free trade theory: the origins of comparative advantage. According to the interventionist view, comparative advantage arises from that combination of accident and planning which we call history.<sup>18</sup> Some regions, for instance, gain a comparative advantage in computer technology because at some point in time a critical mass of entrepreneurs came together to generate external economies in the production of computers. Other regions became well endowed in certain types of human capital because of decisions by individuals to invest in human capital and in the creation of institutions to support its development. Thus, external economies can explain the paradox within free trade theory of why countries that vary in protectionist policies, such as India and Southeast Asia, do not vary as much in immigration. While free trade theory would tend to argue that immigration substitutes for trade in goods, interventionist theory would look at factors that promote and sustain immigration from one country, such as the Vietnam War that resulted in Southeast Asian refugees entering the country or the liberal U.S. immigration policy toward India after 1965. Historical events coupled with the presence of external economies, can explain why immigration occurs from countries that are otherwise different under free trade theory.

Furthermore, not only can external economies help us understand the origins of comparative advantage, the concept is useful in explaining a trade phenomenon that would otherwise be unexplainable by free trade theory: intra-industry trade, or trade between different countries in the same commodity, such as the global automobile market. In some ways, immigrant entrepreneurs also represent a species of intra-industry trade: U.S. investors take their capital overseas to invest in business at the same time that immigrants bring their capital to the United States. To the extent that immigrant entrepreneurship is an example of intra-industry trade, it can be explained by external economies.

Just as comparative advantage had its corollary in the theory of gains from trade, so external economies has a corollary in the phenomenon of

rent seeking. As discussed above, the reason that external economies do not lead necessarily to the realization of the full gains from trade is that an individual may not be able personally to capture all additional benefits the concept of external economies provides for the economy. The existence of these additional benefits, however, creates incentives for entry into markets that have external economies. Of course these incentives also exist under free trade, but the chief difference is that under free trade all rents are dissipated. Such is not the case when there are external economies: Being the first to enter a market with external economies allows an entrepreneur to capture much of the rents, and provide incentives to keep others out of the market even though society may gain from having more entrepreneurs enter. This tension between individual and societal interests arises from the presence of external economies and rent seeking.

To fully understand tensions created by immigration, we need also to consider negative external economies. A system of government entitlement can create negative external economies since the program beneficiaries often do not bear program costs. Negative external economies can be exacerbated by fraud and corruption. These phenomena all result from rent seeking behavior. Draconian measures like Proposition 187, as well as more moderate immigration reforms, are motivated in part by the problems of negative external economies generated by entitlement programs. By defining which individuals are entitled to the programs — documented and undocumented immigrants, for instance — policy makers seek to mitigate the negative external economies. Proposals to do so, however, often ignore, or at least fail to balance, potentially positive external economies that motivate immigration.

Mainstream economic research is lacking in focused and detailed research on the phenomenon of entrepreneurship.<sup>19</sup> Consequently, immigrant entrepreneurship poses problems for both the free trade and the interventionist theories. Immigrant entrepreneurship is consistent with free trade theory but cannot be fully explained by it. Immigrant entrepreneurship potentially plays a role in interventionist theory, but it is not clear *a priori* whether external economies are a net positive or a net negative. While free market theory has no explanation, it would advocate unrestricted entry as immigration policy. Intervention theory has an explanation but it cannot provide a specific policy recommendation to either encourage or limit immigration.<sup>20</sup>

Immigrant entrepreneurship poses challenges to many elements of free trade and interventionist theories of trade and migration. An empirical analy-



sis of the role of immigrant entrepreneurs, presented in the next section, outlines further challenges.

## **The Effects Of Immigrant Entrepreneurs On Labor Markets, Fiscal Finance, And Regional Economies**

Some empirical information can be presented on the economic effects of immigrant entrepreneurs but the topic is open for future research. The purpose of this section is not to offer a complete empirical analysis. This section has two goals. The first is to demonstrate that empirical findings that appear to be robust provide even more challenges to the theoretical positions described in the previous section and to any related policy prescriptions. The second is to highlight impediments, both theoretical and empirical, to the pursuit of empirical research on immigrant entrepreneurship and to provide some skepticism about various empirical claims made in the media. Although the focus is on immigrant entrepreneurship, immigration is addressed broadly. Implications for immigrant entrepreneurship are developed in each subsequent section.

### **Immigrant Entrepreneurs and Labor Markets**

The free trade theory has a definite prediction about effects of immigrants on domestic wages and employment: Immigration will increase the supply of domestic workers, thereby lowering wages and raising employment. The prediction of interventionist theorists, on the other hand, is not so clear. Although many interventionist theorists would accept the basic free trade supply-and-demand model, they would consider other factors as well. For example, interventionists who emphasize positive externalities associated with immigrants would emphasize higher skill level of immigrants, which according to this view, may increase wages in the long run by improving the quality of the workforce. In addition, highly skilled immigrant workers may not substitute for domestic workers so that job competition may be minimal. Some may even predict a positive effect on employment because skilled workers and unskilled workers may actually complement the native force.<sup>21</sup> In contrast, interventionist theorists focusing on negative externalities generated by immigrants would predict that employment may worsen with immigration because of increased public assistance utilization by immigrants and by domestic workers who now face competition in labor markets and lower wages.

Empirical findings support both theories. The fundamental problem with assessing the effects of immigrants on labor markets is isolating immi-

gration from other variables, such as macroeconomic trends and regional effects. In 1980, the influx of Mariel Cubans into Miami provided economist David Card with a subject for study.<sup>22</sup> The arrival was an external change in the economic environment of Miami, which allowed Professor Card to isolate the effects of migration from other changes. Interestingly he found that the increase in migration had no effect on unemployment rates or wages of low-skilled native workers. While the earnings dropped for Latinos in the early 1980s, earnings for African Americans remained constant up to 1981, dropped from 1982-83, and then rose in 1984. Professor Card attributed the phenomena to the ability of Miami's strong textile and clothing industries to absorb unskilled workers.

Professor Card's results are consistent with those reported in a recent study from the Alexis de Tocqueville Institution.<sup>23</sup> That study looked at the correlation between state level unemployment and immigration and found a negative correlation. The implication is that serious causation problems arise in interpreting the data. While Professor Card was able to treat the arrival of Cubans into Miami as an external event and could thus interpret resulting changes causally, authors of the de Tocqueville study, however, could not conclude that immigration reduces unemployment or that lower unemployment attracts immigration. The de Tocqueville study's finding of negative correlation is also not completely consistent with the view that immigration tends to increase unemployment either. A more complete study and analysis must include the relationships between local wages and immigration.

Several principal lessons can be drawn from studies of the impact of immigration on labor markets. First, the effect of immigration on labor markets varies regionally.<sup>24</sup> One pattern is that immigrants occupy a niche in the low wage, unskilled segment of the labor market. This pattern tends to create an empirical bias toward the finding that immigration lowers wages since regions with a higher proportion of immigrants will tend to have lower wages. Therefore, empirical studies of the effects of immigration on wages should be careful in separating out the sorting effect (i.e., immigrants tend to be found in the low wage sector) from the market effect (i.e., immigrants do in fact depress wages). Some studies that have attempted to disentangle these two effects have found that immigrants tend to have the largest negative effect on wages of fellow immigrants and a lesser, or sometimes even negligible, effect on the wages of young African Americans and Latinos.<sup>25</sup> One researcher concluded from an international comparison that a 10 percent increase of immigration into a country would have less than a 1 percent depressing effect on wages.<sup>26</sup>

Second, the sorting effect of immigrants into the low wage sector tends to increase wages for some minority groups by shifting them into higher paid jobs, a pattern observed in New York and Los Angeles.<sup>27</sup> This upward push on wages for some non-immigrant minority groups is strengthened by the presence of immigrant entrepreneurs who provide employment in some formerly depressed regions. Not only are external benefits generated for minority groups but they are also generated from the rejuvenation of certain industries that would otherwise be in decline without the presence of immigrant labor. Studies of the automobile parts, textile, and garment industries support this finding.<sup>28</sup>

Whether these findings support the free trade or the interventionist theory is impossible to say. The empirical findings are consistent with both the view that immigration works to integrate disparate, regional markets and the view that immigration is in response to increasing returns to scale. The presence of immigrant entrepreneurs makes the situation even more complicated. While traditional analysis of immigration focuses squarely on changes in the supply of workers, immigrant entrepreneurs potentially affect the demand and the supply of labor since immigrant entrepreneurs not only demand additional labor for their business ventures but also supply labor to other sectors. The theoretical prediction of how wages are affected is ambiguous, because immigrant entrepreneurs could potentially increase, decrease, or have no effect on wages. The effect on employment, however, is unambiguous since immigrant entrepreneurs would increase employment by expanding both the demand for, and supply of, workers.

Sociologists Ivan Light and Carolyn Rosenstein recently published the first comprehensive study of the effect of immigrant entrepreneurs on regional economies, and their findings clarify the ambiguous theoretical predictions. Looking at data on self-employment as a measure of entrepreneurship, they found that during the '70s, "[h]igh rates of immigrant self-employment neither increase[d] nor reduce[d] self-employment of native whites."<sup>29</sup> During this period the self-employment rate was also higher among the foreign born than among native born African Americans, Asians, Latinos, and whites in the metropolitan areas studied. In addition, the authors found strong regional effects on entrepreneurship across all regions of the United States, with the strongest effects being in New York, New Jersey, Pennsylvania, the East Central United States, and the South Atlantic. They also found no depressing effects on the earnings of native whites or African Americans regionally.<sup>30</sup>

Measuring effects of immigrant entrepreneurs on labor markets is complicated by the entrepreneurship's hybrid production factor: part labor, part capital. The impact can best be seen within the free trade theory. To the extent that immigrant entrepreneurs are motivated by factor price differences, *i.e.*, returns to entrepreneurship are greater domestically than overseas, free trade theorists would predict that immigrant entrepreneurs would lead to a drop in the domestic factor price in order to equalize the differences. The issue, however, is the relevant factor price. Wages do not adequately measure the underlying factor price because wages earned by entrepreneurs could be measuring the revenues generated by their business ventures. Factor price equalization does not imply that revenues would be equalized across regions, only the returns to the mobile factor. Under the free trade theory, returns to the skill owned by entrepreneurs should equalize across regions with migration. The skill would be a hybrid of returns to capital and wages not readily available.

Furthermore, immigrant entrepreneurs affect capital markets, as well as labor markets. Under the assumption that capital markets are perfectly competitive, an increase in immigrant entrepreneurs would affect both the supply of financial capital and the demand for financial capital; once again the effect on the price, in this case, the interest rate would be ambiguous. Empirical work, so far non-existent, could clarify the ambiguity.

The analysis, whether under the free trade theory or under the interventionist theory, is riddled by what economists refer to as the "missing market problem."<sup>31</sup> Often immigrant entrepreneurs are leaving one vacuum to enter another. For example, several groups migrating from the Indian sub-Continent are not leaving behind entrepreneurial opportunities, they are leaving tight labor markets. Those who do become entrepreneurs in the United States do not necessarily do so in regions that are centers for entrepreneurial activity. Immigrant entrepreneurs act not only as market participants but also as market creators and, thus, do not necessarily cause factor prices to equalize across regions. Factor prices may instead rise domestically and not change at all in the foreign country. The domestic increase rises as entrepreneurs push up the demand for labor and other production factors in previously underdeveloped regions. While this possibility is often overlooked under the free trade theory, it is consistent with the interventionist theory. Entrepreneurs who create markets generate rents for themselves and external benefits for others. This prediction is consistent with much of the empirical research discussed below.

The difficult question is how capital markets affect, and are affected by, markets created by entrepreneurs. The access to capital markets may be a critical determinant of business survivability. Timothy Bates shows that among Asian immigrant entrepreneurs in 1979, 43.1 percent borrowed from financial institutions and 37.7 percent from family.<sup>32</sup> Among the ones who borrowed from institutions, 20.4 percent also borrowed from family.<sup>33</sup> The average loan from financial institutions was greater than that from family, and the resulting debt-equity ratio was higher as well among those who borrowed from financial institutions than those who borrowed from family. He also found that initial capitalization directly affected survivability of the businesses over the eight-year period of his study.<sup>34</sup> We do not know how immigrant entrepreneurs affect capital markets. For example, do they dominate loans that might otherwise have gone to native entrepreneurs? Do immigrant entrepreneurs face the same difficulties as native-born minority groups in credit markets? Finally, do immigrant entrepreneurs raise the cost of borrowing for native entrepreneurs? The relationship between immigrant entrepreneurs and credit markets is an open and crucial area for further inquiry.<sup>35</sup>

### **Immigrant Entrepreneurs And Fiscal Finance**

Fiscal finance issues are matters of federal, state, and regional governments. Unfortunately many researchers who have commented on the impact of entrepreneurs on fiscal finance have ignored federalism issues. This section explicitly distinguishes between federal and local finance issues. Once again we begin with a discussion of the effects of immigrants in general on fiscal finance and then proceed to the special problems raised by immigrant entrepreneurs in particular.

The following fundamental concepts will facilitate analysis of the next point:

Y = gross national product

C = total consumption

S = total savings

I = total private investment

G = total government spending, including spending on entitlement and government investments

T = total federal taxes collected

X = total exports

M = total imports

The basic relationship among these concepts is as follows:  $Y = C + I + G + (X - M)$ . That is to say, in the aggregate, gross national product must be spent on consumption, private investment, government spending, and net exports. A similar relationship holds for the consumption side of the equation. Since gross national product represents the total income earned by all members of society, it must also be true that  $Y = C + S + T$ , which states that total income is consumed, saved, or paid in taxes. Combining and rearranging these equations allows us to derive the basic formula that provides a relationship among all the potential deficits in society:  $0 = (I - S) + (G - T) + (X - M)$ . This states that, in the aggregate, the budget deficit ( $G - T$ ) must be balanced by the trade surplus ( $X - M$ ) and the savings deficit ( $I - S$ ). The last equation summarizes the basic macroeconomic relationships in the economy and provides a basis for comparing various arguments concerning the effect of immigration on federal fiscal finance.

Under the free trade view, immigration substitutes for free trade. One of the effects of immigration would be to lower the amount of imports and correspondingly to raise the trade surplus ( $X - M$ ). Since all deficits must balance, the effect of increased immigration on the trade surplus must be balanced by either a decrease in the budget deficit or a decrease in the savings deficit. The premise that immigration substitutes for trade in goods, however, is suspect, as discussed above. Furthermore, which deficit is affected by immigration is largely an empirical matter. Immigration may have some counteracting effects as well, such as increasing savings or increasing taxes. Immigration may also raise the volume of exports if immigrant entrepreneurs produce and sell goods overseas or even raise the volume of imports if immigration increases the demand for goods from overseas. What matters is not the direction of the effects on these elements of the GNP, that is, whether the effects are positive or negative, but the magnitude of the effects. Isolating the role immigration plays in affecting these individual variables is difficult.

The presence of external costs and benefits makes predictions even harder. Interventionist theorists would have difficulty in isolating the effects of immigration on the GNP and its elements because, as discussed in this paper, external benefits and costs may largely be local phenomena from which extrapolating to the macro economy is complex. Given increasing returns, an immigration multiplier theoretically exists so that an increase in immigration stimulates local economies and increases gross national product. This effect is hard — if not impossible — to measure, but it contrasts with the free trade view, which implies that immigration substitutes for

trade in goods. The effect contrasts also with “zero sum” views of immigration, which would suggest immigrants crowd out many of the benefits earned by natives. To the extent, however, that interventionist theorists posit negative externalities generated by immigrants — through use of entitlement programs, for example — immigration would increase the government deficit.

Immigrant entrepreneurs introduce several interesting factors into the analysis. In contrast to the free trade view, immigrant entrepreneurs do not substitute for markets in goods; they most likely create markets regionally. The creation of previously missing markets potentially increases gross national product through the effects on regional economies in much the same way as the “immigration multiplier” described in the previous paragraph. In this way, interventionist theorists would appreciate effects of immigrant entrepreneurs in a way that free trade theorists do not. Immigrant entrepreneurs can, however, generate the immigration multiplier without generating external benefits. In the framework of national income identity equations discussed above, activities of immigrant entrepreneurs would also affect the private investment component of the savings deficit equation and may also affect the import component to the extent they repatriate many of the goods produced domestically. Once again the magnitude of these effects is hard to measure.

Because of measurement problems on the federal level, researchers have tended to study the more manageable regional effects of immigration on fiscal finance, even though this regional focus is misleading for several reasons. Foremost is the disregard of the potential national effects of immigration discussed above. These ignored effects, however, undercut the finding that immigrants are a net burden to regional economies because they contribute less to the regional economy than they take. This fact, as others have pointed out, is true for all citizens.<sup>36</sup> As a result of local economies of scale and large fixed costs of infrastructure, most citizens provide less to their local governments than they receive in local services. Focusing solely on regional effects biases studies toward a finding that immigrants are a net burden. This criticism has been correctly leveled against the study of the Los Angeles County Board of Supervisors, which concluded that immigrants imposed an annual net cost of \$808 million to the county.<sup>37</sup> This figure was determined by measuring costs imposed on various local public services — such as health, justice, and public social services — and the local tax revenue paid by immigrants. Although the study acknowledged an amount of aggregate taxes above local costs, the study also discounted

the total amount of taxes paid because most of that revenue went to the federal government. The study was arguably correct to focus on local costs and local taxes paid, but this approach overlooks the fact that much of the federal tax revenues trickle back to state coffers in the form of block grants and subsidies. Completely ignoring federal taxes paid disregards some of the benefits generated by immigrants.

A similar error is made by economist Donald Huddle in calculating net costs of immigrants through gross measures of consumption of public services. His measurements overlook the federal structure of fiscal finance and do not take into account that immigrants contribute to the fisc in many ways other than just through payment of income taxes.<sup>38</sup> Specifically, immigrants pay local property taxes and sales taxes, the latter often regressive (where the tax rate decreases as income increases) and therefore placing a heavier burden on immigrants. More subtly, Huddle's study overlooks intergenerational transfers of money, goods, and services within immigrant social groups that may often substitute for dependence on public services. Thus, measuring present welfare dependence from a projection of past use would be wrong because these transfers would result in vast differences across generations in consumption of public services. This last point is underscored by a recent study, which found that compared to the native-born population, newer immigrants are concentrated in the youthful workforce age range, during which "people contribute more to the coffers than they draw out."<sup>39</sup>

Immigrant entrepreneurs, of course, add further complications to the analysis. Economists Rebecca Clark and Jeffrey Passell criticized the Los Angeles Internal Services study for ignoring revenues and taxes generated by immigrant-owned businesses and "multiplier effects" of job creation from immigrant businesses.<sup>40</sup> Problems with measuring these factors stem from the lack of data and the lack of a good conceptual framework to balance effects on the regional versus national economy. The latter difficulty also arises because of inherent tensions in fiscal federalism between regional and national powers. The data problem has been addressed in a promising way by recent research conducted by Light and Rosenstein and is discussed in the next sub-section.

### **Immigrant Entrepreneurs and Regional Economies**

Understanding immigrant entrepreneurs, whether within the free trade view or the interventionist, entails recognizing that entrepreneurs provide a service. Much of the literature on the sociology of entrepreneurship is not



helpful in this regard because the common prediction is that entrepreneurship declines over time as market economies mature and develop. This sociological argument has an interesting parallel in economics literature, which shows that as market economies mature and develop, the importance of the managerial class grows and that of the entrepreneurial class wanes.<sup>41</sup> Light and Rosenstein challenge many of sociological and economic arguments by demonstrating that, at least in regional economies, entrepreneurship has not waned and perhaps has increased, especially with the influx of immigrants. Their causal model attempts to explain the persistence of entrepreneurship by examining factors affecting the demand and supply of entrepreneurs.<sup>42</sup>

Light and Rosenstein focus on general demand factors, that is, those that are national in scope and work across all metropolitan areas, and on specific demand factors, which are purely local. These factors are measured for the most part by dummy variables to reflect the region, population ethnicity, and industrial structure. They also include measures of mean income by region. Not too surprisingly, they found that, on the demand side, specific factors were better able to explain statistically the rate of self-employment locally.<sup>43</sup> What is somewhat frustrating about their study is that determining exactly which specific factors affect the demand for entrepreneurs is impossible because of the lack of more detailed data on the economic and social characteristics of the regions studied in the sample. Bates' study of the survivability of Asian immigrant businesses fills in one gap in the puzzle. He found that one very important survivability factor was the entrepreneur's ability to service demands outside of the particular ethnic group. Those businesses that survived and were more profitable were those that served the African American community rather than the Asian community alone.<sup>44</sup>

Light and Rosenstein's stronger results come from measuring supply factors that affect immigrant entrepreneurship. On this point, they provide very cogent findings that challenge the conclusion of much of the sociological and economic literature that entrepreneurship wanes as market economies mature. Considering such supply factors as ethnicity and sectoral composition of local economies, once again measured with dummy variables, they conclude that these supply variables are very significant in explaining the rate of self-employment locally and that the supply factors make the effects of the demand factors larger.<sup>45</sup> These findings support the conclusion that supply factors can counter any tendency for entrepreneurship to wane as markets mature.

Also frustrating is discerning exactly what is being measured. For example, Light and Rosenstein find that rates of entrepreneurship are positively related with the percentage of population that is Asian and negatively related with the percentage of population that is African American. They offer little guidance as to how to interpret this result except to say that in some way culture matters.<sup>46</sup> What is especially confounding is that this result is not completely consistent with the hypothesis that entrepreneurship results in part from discrimination in labor markets. Fortunately, part of the puzzle once again is filled in by Bates' research on Asian immigrant-owned businesses, which found that initial capitalization was a key variable in explaining survivability.<sup>47</sup> This result suggests that while discrimination in labor markets may explain entrepreneurial success, access to capital markets may be an even more important explanatory variable. Access to capital markets may, in fact, explain Light and Rosenstein's results regarding the relative self-employment rates among Asians and African Americans.<sup>48</sup>

What is perhaps most frustrating is the impossibility of extrapolating from Light and Rosenstein's findings to make inferences or further findings about the many economic factors discussed above. Their research suggests one conclusion: immigrant entrepreneurs are linked to local economies. The unknowns are how these linkages occur, how large they are, and how they filter to, and affect, the national economy. Yet their research is stimulating despite some of the frustrations and offers challenges for future research.

## Summary

The issue of immigration has created some unexpected political alignments. Progressives like the late Barbara Jordan ostensibly adopt the same position toward immigration as conservatives such as Patrick Buchanan. The rather odd constellation of political opinions reflects the varying interest groups affected by immigration.

In this paper we have neither attempted to disentangle the politics of immigration, nor to address social forces that have led to the current immigration debate. Instead we highlighted the hidden economic and social assumptions that affect how individuals, whether acting in the legislature or in the voting booth, weigh costs and benefits of immigration. The major lesson of this paper is that entrepreneurship has been an overlooked element in the immigration debate.

This conclusion summarizes why immigrant entrepreneurship matters and where future research energies should be directed. The “why” question can best be understood in the context of two proposals that have recently garnered policy attention. The first propagated by Huddle, is that immigrants are too large a drain on the public fisc and therefore should be limited. This analysis pays no attention to benefits provided by immigrant entrepreneurs. No claims are made here about the size of these benefits except to assert that the benefits are positive and should be considered before supporting policies. Similarly, the reality of immigrant entrepreneurs has implications for Borjas’ pro-immigrant policies. While Huddle seeks limits on immigration, Borjas advocates targeting policy to promote immigration of highly skilled immigrants. Borjas’ research provides much compelling evidence on the benefits provided by immigrants in terms of human capital, but his analysis overlooks the benefits of immigrant entrepreneurs. There is a strong reason to include entrepreneurship among the human capital skills targeted in promoting immigration. Recall however, that today’s entrepreneurs have entered as relatives and refugees. Immigrant entrepreneurs, then, have implications for both conservative and progressive immigration policies.

Further research is needed to flesh out the details highlighted in this paper and to answer questions concerning immigration entrepreneurs. Some issues include the following:

*Capital Markets.* How is the success of immigrant entrepreneurs affected by access to capital markets? Do immigrant entrepreneurs have easier access to capital than native minorities? To what extent do immigrant entrepreneurs rely on, or contribute to, family and social networks through transfers?

*Discrimination.* Light and Rosenstein present compelling evidence that immigrant entrepreneurship is often a response to discrimination in labor markets. The question is: why has entrepreneurship not been a successful response for other groups that have suffered from discrimination? Our null hypothesis is that access to capital markets explains the difference.

*Contributions of immigrant entrepreneurs to local taxes.* Many studies of the economic impact of immigrants have focused on crude estimates of immigrant contributions to federal taxes. Some researchers have discussed the contribution to local sales and property taxes as well. What is missing is a study of the contributions that immigrant entrepreneurs make to local taxes by creating businesses that generate sales taxes, improving property values — thus raising property taxes, and creating employment — therefore increasing income taxes.

*Externalities generated by immigrant entrepreneurs to regional economies.* Many of the case studies presented in this most current LEAP project contribute to the necessary research agenda. We need more detailed studies of this kind, however, to understand better the range of businesses to which immigrant entrepreneurs contribute. Along these lines, we need to know how these various businesses affect employment, earnings, and development of local infrastructure. Vis-a-vis the last point, we would like to know whether immigrant entrepreneurs have "agglomeration effects," that is, does the creation of immigrant entrepreneur businesses help generate other businesses and investments?

*Effects on the national economy.* Light and Rosenstein suggest that "just encouraging entrepreneurship can have a significant, cost-effective impact upon the reduction of poverty, the promotion of economic growth, job creation, and even the reduction of intergroup conflict in society."<sup>49</sup> Although proposed regional studies go a long way in answering some of these questions, the subsequent question is: how do these regional effects translate to the national economy? For example, if immigrant entrepreneurship reduces poverty and unemployment, do these benefits affect federal spending on poverty and unemployment? If so, how much? As discussed in this paper, this question is perhaps the most difficult to answer.

This research agenda should be tempered by the reality that overemphasizing the effects of immigrant entrepreneurship may be easy. In the context of the global economy, or even the national economy, movement away from entrepreneurship to managerial power militates against entrepreneurship benefits. Regional economies may, however, benefit substantially from entrepreneurship as the research discussed in this paper suggests. Nonetheless, effects should not be prejudged in either direction. What is important is that as the immigration debate moves toward a question of benefits and costs, immigrant entrepreneurship should not be overlooked.

## Notes

- <sup>1</sup> Federal immigration law creates a special category of "alien entrepreneur," defined as an alien intending to start employment-generating activity (10 jobs) in the United States with an initial capital investment of \$1 million dollars. See 8 U.S.C. 1186b.
- <sup>2</sup> Timothy Bates, "Social Resources Generated by Group Support Networks May Not Be Beneficial to Asian Immigrant-Owned Small Businesses," *Social Forces* 72 no. 3 (March 1994):671-89.
- <sup>3</sup> "Asians in America, 1990 Census," Bureau of Census, U.S. Dept. of Commerce, *Survey of Minority Owned Business Enterprises* (Washington, D.C., June 1991).
- <sup>4</sup> *Ibid.*

- 5 "Transpacific 100 Great Asian American Entrepreneurs," *Transpacific*, December 1994. Editor's note: see also the papers in this report by Edward Park and Melanie Erasmus.
- 6 Cara S. Trager, "Despite Market's Cooling, Flushing is Still Hot," 16 December 1994, *Newsday*, sec. E, p. 4; Lynette Holloway, "The Cost of Success: Superstores' Impact on Small Grocers Strains Koreans' traditional Spirit of Community," *The Dallas Morning News*, 29 January 1995, sec. A, p. 1.
- 7 Daniel Choi, *History of Korean-Americans in the Washington, D.C. Area 1883-1993* (Korean Association of Greater Washington, 1995); Lena H. Sun, "Videotape Explains Legal System to Asian Americans," *The Washington Post*, 17 December 1995, sec. B, p. 7.
- 8 Karen Ogden, "Korean Americans Find a Home in Federal Way; Community Thrives in Receptive City," *News Tribune*, 31 July 1995, sec. B, p. 1; Stanley Holmes, "Cosmetic Changes—Koreans are Moving Into a Beauty-Supply Market Once Dominated by African Americans," *The Seattle Times*, 24 September 1995, sec. F, p. 1.
- 9 Bill Marvel, "A Century of Newcomers; Immigrants from as Far Away as Milan, Moscow and Monterrey Have Helped Shape Dallas' History," *The Dallas Morning News*, 30 October 1995, sec. C, p. 1.
- 10 Timothy Bates, "Determinants of Survival and Profitability Among Asian Immigrant-Owned Small Businesses" paper presented at the Center for Economic Studies, U.S. Bureau of Census, Washington, D.C., Aug. 1993, 5-9.
- 11 *Ibid.*
- 12 For an excellent overview of trade theory, see Avinash Dixit, *Theory of International Trade* (1986).
- 13 In contrast, a world of perfect factor price equalization would result eventually in equal wages throughout the region.
- 14 *Ibid.* For another perspective that incorporates external economies see Elhanin Helpman and Paul Krugman, *Increasing Returns and The Theory of International Trade* (1985).
- 15 For a general discussion of these patterns, see Ivan Light *Ethnic Enterprises in America* (1972), Ivan Light and Edna Bonacich, *Immigrant Entrepreneurs: Koreans in Los Angeles* (1988), and Ivan Light and Carolyn Rosenstein, *Race, Ethnicity, and Entrepreneurship in Urban America* (1995).
- 16 See Paul Krugman, *Geography and International Trade* (1991) and Paul Krugman, *Peddling Prosperity* (1994). Also see George J. Borjas, "The Economic Benefits from Immigration," *Journal of Economic Perspectives* 9 (1995) 3-22.
- 17 Richard Cornes and Todd Sandler, *The Theory of Externalities, Public Goods, and Club Goods* (1986).
- 18 See Krugman, *Geography and International Trade*.
- 19 For a discussion of the paucity of research on entrepreneurship among economists, see Mark Blaug, *Economic Theory in Retrospect*, 4th ed. (1993) 458-65. Blaug discusses three theories about entrepreneurship: (1) Frank Knight's theory, which analyzed entrepreneurship as a response to business uncertainty; (2) Joseph Schumpeter's, which analyzed entrepreneurship as the basis for technical change and technological diffusion, and (3) the "Austrian School" theory that analyzed entrepreneurship as a response to arbitrage possibilities in financial and product markets. Each theory is deficient in predicting when entrepreneurship is likely to arise and when it is likely to be most successful. None of the theories helps to understand the role of the immigrant

- entrepreneur in either integrating the global market or fostering development in regional economies.
- 20 This point is made by Paul Krugman in his criticisms of policy makers who attempt to apply some of his theoretical findings to real world problems. See Krugman, *Peddling Prosperity*.
  - 21 See Borjas, "Economic Benefits."
  - 22 David Card, "The Impact of the Mariel Boatlift on the Miami Labor Market," *Industrial and Labor Relations Review*, 40 (1990) 382-93.
  - 23 Richard Vedder, Lowell Gallaway, and Stephen Moore, "Immigration and Unemployment: New Evidence," Alexis de Tocqueville Institution (March 1994).
  - 24 For a survey of these findings, see Bill Ong Hing, *To Be An American: Cultural Pluralism and the Rhetoric of Assimilation* (1996).
  - 25 Rachel M. Friedberg and Jennifer Hunt, "The Impact of Immigrants on Host Country Wages, Employment and Growth," *Journal of Economic Perspectives* 9, (1995) 23-44.
  - 26 *Ibid.*
  - 27 See Hing, *Cultural Pluralism*.
  - 28 *Ibid.*
  - 29 Light and Rosenstein, *Race, Ethnicity, and Entrepreneurship*, 193. *Ibid.*
  - 30 *Ibid.*, 98-103.
  - 31 See Dixit, *International Trade*.
  - 32 See Bates, "Social Resources," 11.
  - 33 *Ibid.*
  - 34 *Ibid.*, 34.
  - 35 For an excellent discussion of discrimination in credit markets, see Peter Swire, "The Persistent Problem of Lending Discrimination: A Law and Economics Analysis," *Texas Law Review*, 73, (1995) 787.
  - 36 See Hing, *Cultural Pluralism*.
  - 37 Los Angeles County Internal Services Department, *Impact of Undocumented Persons and Other Immigrants on Costs, Revenues, and Services in Los Angeles County* (November 6, 1992).
  - 38 Donald Huddle, "The Costs of Immigration" (July 20, 1993, manuscript).
  - 39 "New Study says Immigrants Contribute More Than They Take," *San Jose Mercury News*, December 11, 1995.
  - 40 Rebecca L. Clark and Jeffrey Passell, "How Much Do Immigrants Pay in Taxes? Evidence from Los Angeles County" (working paper, Urban Institute, August 1993).
  - 41 See Light and Rosenstein, *Race, Ethnicity, and Entrepreneurship*, 24.
  - 42 *Ibid.*
  - 43 *Ibid.*, 109-110.
  - 44 See Bates, "Determinants of Survival," 34.
  - 45 See Light and Rosenstein, *Race, Ethnicity, and Entrepreneurship*, 139.
  - 46 *Ibid.*
  - 47 See Bates, "Determinants of Survival."

<sup>48</sup> See Light and Rosenstein, *Race, Ethnicity, and Entrepreneurship*, 167, 197.

<sup>49</sup> *Ibid.*, 208.