

Referee 2 Comments:

Using time-series data, the paper investigates the effect of U.S. immigration policy on FDI inflows to the country. The key hypotheses that have been tested are (i) liberal U.S. immigration policy increases FDI (direct effect); and (ii) greater immigration increases FDI via its effect on labor costs. While the hypotheses are suggestive and merit serious consideration, there are serious shortcomings that need to be addressed before the paper is ready for publication.

My Response:

Thank you for your insightful comments. I address your concerns and comments by outlining the questions in order. I hope this letter sufficiently addresses your concerns. I welcome the opportunity to speak more with you about this article if any questions remain.

1. It is not clear why the number of refugees admitted to the country has been used as the proxy measure to capture the effect of immigration reform on FDI. Given that the majority of FDI inflows are in high-skilled sectors that require relatively skilled workers, the number of refugees admitted is not an appropriate measure to capture the effect of immigration policy on FDI, and any association between the variables cannot be viewed as the causal effect of policy on FDI. The authors should instead use data on skilled workers (e.g. a number of H1B visas issued, or lawful permanent resident population (e.g. Kerr (2019))).

Reference:

William R. Kerr (2019), "The Gift of Global Talent",
https://conference.nber.org/conf_papers/f119265.pdf

My Response:

I appreciate your suggestion on this point. My point is that it is hard to make the argument that foreign firms are more likely to be attracted to regions with high-skilled workers because growing foreign firms are in high-skilled and knowledge-based industries. Although growing foreign investors have allocated factors toward more skill-intensive firms in the U.S., the manufacturing sector has been the largest recipient of all FDI in the U.S. during the past 20 years (Jackson, 2017). It is also important to note that the measure of FDI in this paper is the aggregate amounts of FDI inflow in the U.S. regardless of type of industries. What we need to focus on the linkage between immigration policy and FDI is potential benefits of large immigration population (both skilled and unskilled immigrants) that would be a critical source of labor supply and consumption.

Indeed, many studies in FDI suggest that foreign firms are more likely to invest in countries with relatively high shares of unskilled labor due to lower wages (e.g., Carr et al., 2001; Blonigen and Piger, 2014). Some studies also point out not only that, on average, FDI does not generally stem from high-skilled sectors, but that even major firms tend to avoid places with highly skilled workers strategically due to the concern about knowledge leakage (Chung and Alcacer, 2002; Shaver and Flyer, 2000).

Also, we wouldn't be able to assert that refugees are a potential source of increasing low-skilled workforces; many of them are high-skilled refugees who can apply their skills productively. Also, refugees are investment in human capital and have a positive impact that stabilizes the existing labor market in the host countries. It is argued that increasing refugee migration would

reallocate native workers to more productive and skill-demanding sectors, as those refugees take over low-skilled tasks (Andersson et al., 2019; Ottaviano and Peri, 2012).

Furthermore, it is important to note that at least the changing quota of refugees to be admitted in the U.S. mirrors the overall pattern of the U.S. immigration policy. My research does not classify a different impact of skilled immigrants versus unskilled immigrants on FDI inflow. However, as you pointed out, in the revised version, I included the number of lawful permanent residents, which is another alternative measure of the changing immigration policy. The reason I did not use the number of H-1B visas is because the reliable data of H-1B visa is only available from 2004 that USCIS began to provide proper reports. There is the annual limit to issue an H-1B visa, which is often called a quota or a cap, although institutions of higher education, nonprofit organizations, and research organizations are not subjected to H-1B annual quotas. Also, there have been no changes to the H-1B quotas since 2004 (65,000 plus additional 20,000 for higher degrees from U.S. universities). As you see the below tables, the results remain substantively unchanged even when I use the lawful permanent resident population as the alternative measure of the U.S. immigration policy.

Table. The Impact of Immigration Policy on FDI

Variables	Number of lawful permanent resident per capita
FDI_{t-1}	-0.676*** (0.298)
Δ Immigration policy $_t$	1.779*** (0.653)
Immigration policy $_{t-1}$	1.307* (0.883)
Δ Labor cost $_t$	0.027 (0.043)
Labor cost $_{t-1}$	-0.060*** (0.014)

Table. The Impact of Immigration Policy on Labor Costs

Variables	Number of lawful permanent resident per capita
Labor cost $_{t-1}$	-0.125** (0.067)
Δ Immigration policy $_t$	-6.280** (3.237)
Immigration policy $_{t-1}$	3.361 (4.330)

References:

Andersson, L. F., Eriksson, R., and Scocco, S. (2019). Refugee immigration and the growth of low-wage work in the EU 15. *Comparative Migration Studies*, 7(39), 1-19.

Blonigen, B. A., and Piger, J. (2014). Determinants of foreign direct investment. *Canadian Journal of Economics*, 47(3), 775-812.

Carr, D., Markusen, J. R., and Maskus, K. E. (2001). Estimating the knowledge-capital model of the multinational enterprise. *American Economic Review*, 91, 603-708.

- Chung, W., and Alcacer, J. (2002). Knowledge seeking and location choice of foreign direct investment in the United States. *Management Science*, 48, 1534–1554.
- Jackson, J. K. (2017). Foreign direct investment in the United States: An economic analysis. Congressional Research Service Report.
- Ottaviano, G., and Peri, G. (2012). Rethinking the effect of immigration on wages. *Journal of the European Economic Association*, 10(1), 152-197.
- Shaver, J. M., and Flyer, F. (2000). Agglomeration economies, firm heterogeneity, and foreign direct investment in the United States. *Strategic Management Journal*, 21, 1175–1193.

2. While the majority of the skilled immigrants in recent years have been from China and India, the major sources of FDI inflow to the US are from countries in Western Europe and Australia. How does the study reconcile its hypothesis to this stylized fact?

My Response:

This study focuses on the effect of changing immigration policy on the aggregate amounts of FDI inflows in the U.S. Regardless of where multinational corporations come from, it is important to note that firms are rational actors who pursue profit maximization (Shin, 2018). In this sense, firms from Western Europe and Australia, which account for almost 70% of all foreign-owned the real annual book value of the gross property, plant, and equipment, are less likely to make their investment decision based on immigrants’ countries of origin (e.g., China and India). Based on your question, I think that future research may explore how differently immigration populations from specific countries influenced by the U.S. immigration policy affect FDI from different countries by specifying source county of ultimate beneficial owner. However, this is not the major concern of this research; what this research suggests is that rational firms are more likely to invest their physical and financial resources in the U.S. when it liberates immigration policy. Rational firms are interested in all potential immigrants who are expected to provide competitive workforces in the U.S. market.

Reference

- Shin, G. (2018). Corporate tax policy and multinational corporations in the American states: Exploring the intervening effect of local fiscal decentralization. *Journal of Urban Affairs*, 40(5), 679-704.

3. There is a large literature on the role of ethnic networks in promoting trade. In that case, ethnic networks can substitute FDI for greater bilateral trade. The authors should discuss the complementarity between FDI and trade that has been assumed in establishing their hypothesis.

My Response:

Thank you for bringing up a very good point here. As you pointed out, both static and dynamic neoclassical models in macroeconomics suggest that more liberal international migration can allocate an efficient global workforce by increasing international integration of markets driven by migrant networks (Combes et al., 2005; Klein and Ventura, 2007; Rauch and Trindade, 2002). For example, ethnic networks are positively associated with the volume of international trade not only because an increase in migrant population increases the demand for their home-country products, but also because migrants reduce the information as well as contracting costs (i.e., trade costs) by providing their indigenous knowledge and information related to their home countries (Combes et al., 2005; Gould, 1994). Such the positive effect of socioeconomic enrichment of immigration networks, however, is not limited to bilateral trade. Since trade itself

is substantiated exclusively by transactions between firms across countries, we can expect that FDI is naturally influenced by the networked ethnic activity (Bernard and Moxnes, 2018).

Like the effect of ethnic networks on international trade, larger ethnic networks create potential source of consumption. Immigration networks have a substantial impact on FDI inflows not only by creating the cultural diversity and socioeconomic enrichment in the host countries, but also by increasing social capital and innovation through interpersonal ties that connect their ethnic group (Gheasi and Nijkamp, 2017). Large immigrant networks lower the risk of foreign investment through increased information flows within the market (Foad, 2012). Consequently, one country's FDI would increase in the countries where the immigrants from the same investing country reside due to the increased expected return to foreign firms by accessing immigrants' experience, information, and social capital.

References:

- Bernard, A. B., and Moxnes, A. (2018). Networks and trade. *Annual Review of Economics*, 10, 65-85.
- Combes, P. P., Lafourcade, M., and Mayer, T. (2005). The trade-creating effects of business and social networks: evidence from France. *Journal of International Economics*, 66(1), 1-29.
- Gheasi, M., and Nijkamp, P. (2017). A brief overview of international migration motives and impact, with specific reference to FDI. *Economies*, 5(31), 1-11.
- Gould, D. M. (1994). Immigrant links to home country: Empirical implications for U.S. bilateral trade flows. *Review of Economics and Statistics*, 76(2), 302-316.
- Klein, P., and Ventura, G. J. (2007). TFP differences and the aggregate effects of labor mobility in the long run. *The B.E. Journal of Macroeconomics*, 7(1), 1-38.
- Rauch, J. E., and Trindade, V. (2002). Ethnic Chinese networks in international trade. *Review of Economics and Statistics*, 84(1), 116-130.

4. The discussion in the section on “Immigration policy of the Federal Government and FDI inflows” can be shortened.

My Response:

Thank you for your suggestion. First, I tried to shorten the section by revising redundant sentences and combining similar arguments or findings by literature. Second, I removed a half-page paragraph with Figure 2 that gives some examples of expansive and restrictive immigration laws because that paragraph and the figure are not related to the discussion that explains the linkage between immigration policy and FDI.