

# WEEKLY ECONOMIC COMMENTARY

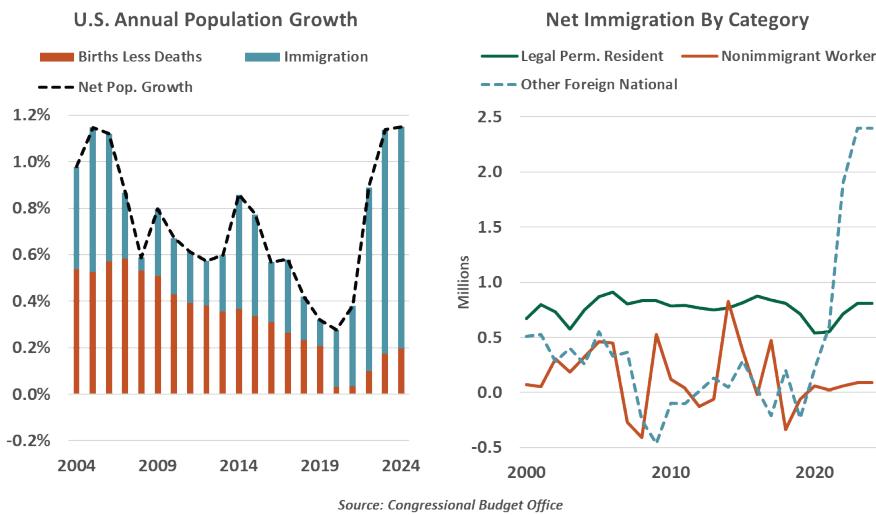
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Among the liveliest elements of our work are question-and-answer segments when we present to clients. We never know what will come up. The thorniest question I have received of late was, "What do you think of the immigration problem?"

This query comes both from those who perceive that the U.S. has allowed in too many immigrants and others who think we need more newcomers to address a shortage of workers. Answering is also complicated by the challenge in assessing just how many new entrants have arrived. Recent work on this latter front has placed the immigration debate front and center.

Immigration has always been a contentious but fundamental component of the dynamic U.S. labor market. The American economy wouldn't be the world leader without immigrants, but the continual inflow of migrants at the southern border has raised questions over whether the current state is helpful or harmful to growth and inflation. That is what we will focus on, preferring to leave policy questions to politicians.



Estimates of the population change due to activity at the southern border are wide ranging, but uniformly upward. Pre-COVID, the nation could expect about 900,000 working immigrants per year. Among official approximations, the Congressional Budget Office (CBO) has published the highest estimate of 3.3 million arrivals in 2023. The CBO's inclusion of the "other foreign nationals" arriving in the busy second half of 2023 gives credibility to their estimate.

Most recent arrivals are attempting to stay in the country through processes that sidestep conventional visa eligibility. Parole and asylum statuses grant safe haven but leave the

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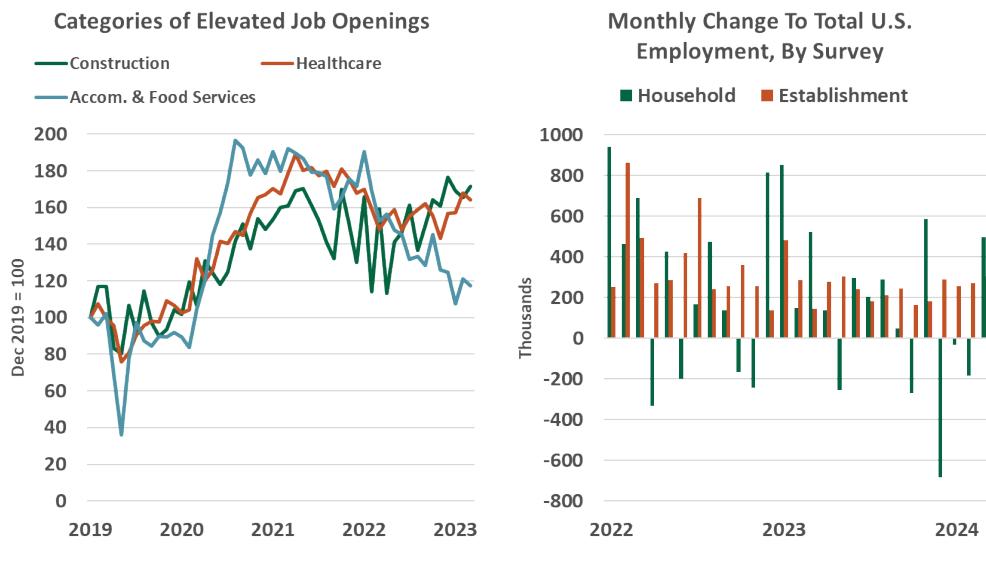
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migrants in a state of legal limbo. The immigration court backlog stands at over 3.4 million cases; the asylum process takes five years from filing to reach a decision.

However, roughly six months after starting these processes, migrants can gain work authorization. About half of asylum claims are denied, but that still grants many productive years in the United States.

The recent wave of immigration has some positive aspects for the U.S. economy. A nation's potential output is the product of its working-age population and the output of those workers. More workers means more productive activity, and the children accompanying them will support the labor force as they mature. And in a consumption-led economy like the U.S., more people means more demand for goods and services.

More newcomers will help to close shortages in the labor market. Past generations of immigrants had high rates of employment, filling jobs at the low end of the wage scale. More hiring of lower-paid workers can help to limit wage-driven inflation. As the new workers acclimate, their productivity rises, allowing for non-inflationary wage gains. Recent hiring has been strongest in the hospitality and healthcare sectors, common first jobs for new immigrants and areas where additional hands have been needed.



**The surge in immigration explains some recent oddities in the employment data.**

The migrant flow also helps to explain some of the curiosities of employment data in the past year. The payroll (or establishment) survey has shown extranormal increases over the past year; but the household survey has reflected declining employment and labor force participation. We can now see that immigration grew the population faster than employers were hiring. New entrants taking payroll jobs were reflected immediately in the establishment survey, giving greater confidence in the signal from that figure. The unemployment rate may rise further as the population grows, but it will not be the same signal of economic distress that it was in past cycles.

Upon arrival, migrants need basic necessities like food, clothing, shelter and education. Demand for these goods and services will rise, and prices may follow. Added demand for housing comes at an inopportune time. The costs are not borne evenly, as border regions and sanctuary cities stretch their budgets to bring newcomers into their local education and social support systems.

Immigration will figure prominently in the 2024 election. Recent policy swings have been entirely through executive action. A change in leadership could abruptly end all accommodative programs and halt the migrant flow; continual strain on local resources could prompt action even before the election. The flow may naturally dwindle as those most motivated to migrate have made their moves, but such an inflection is difficult to predict. Canada offers a cautionary tale: its permissive immigration stance led to greater population growth than had been estimated, requiring changes to some of its policies. We expect those who have arrived in the U.S. will stay, as a mass expulsion of those who followed immigration protocols would be an economic shock with little precedent.

The question of the “immigration problem” is far from resolved. The more we dig into the research, the more questions arise. We can be certain that the flow of immigrants is having a profound impact on the economy today, and will place the issue at the forefront of electoral debates. Long-run benefits of immigration must be balanced against immediate resource constraints. The conversations can be tense, and the solutions difficult, but arriving at a cohesive policy response is essential.

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**Migrant flows are difficult to measure, but impossible to ignore.**

## Parched

I live in the city of Bangalore, in India. Bangalore was once known as a city of lakes, home to hundreds of reservoirs constructed to store water, sustain fish and support agriculture.

Today, the city faces an acute water shortage. About half of the city gets its drinking water through piped supply. The other half relies on groundwater, which has been depleted by unplanned and uncontrolled urbanization.

Bangalore is just one example of a developing global water crisis. Cities across the world are becoming increasingly thirsty as the demand for water grows and supply dwindles. Parts of Spain are experiencing the worst drought in recorded history. Water scarcity forced the U.S. to limit water releases in its western states. Unprecedented water shortages have afflicted Mexico City. Cape Town is planning for “day zero,” a point at which the city’s taps would run dry.

Two-thirds of the world’s largest rivers are no longer free-flowing. Since 1970, the world has lost over one-third of its remaining wetlands. The Rio Grande/Rio Bravo, the water supply for over 6 million Americans and 10 million Mexicans, is drying up rapidly.

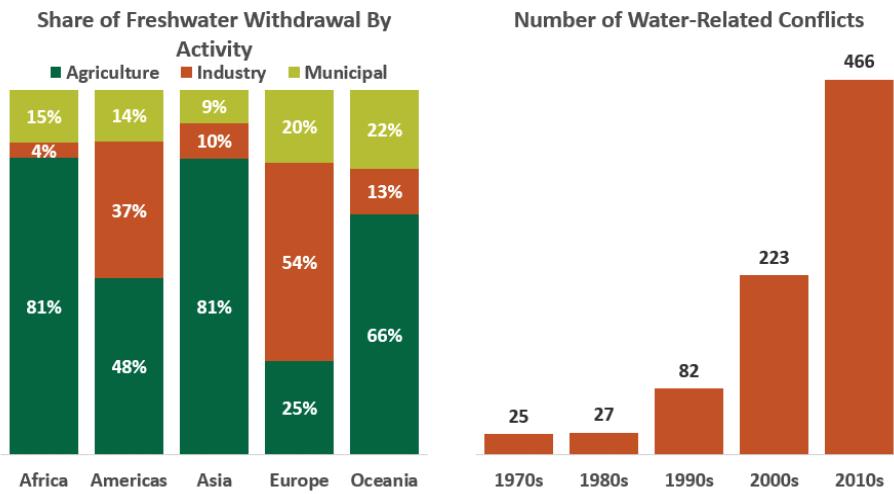
Climate change, along with growing populations and the transition to clean energy, will only intensify water stress. Morgan Stanley estimates global water demand will be 40% greater than supplies of fresh water by 2030. India is the most stretched, with about one-fifth of the global population but only 4% of the world’s fresh water. Saudi Arabia and South Africa are the major countries from the Group of 20 nations facing extreme water deficits. Cooler regions are not immune: London faces “serious shortages” by 2040, according to the Greater London Authority.

Increasing water shortages are a particular threat to the most vulnerable sections of society. Over 2 billion people around the globe lack access to clean drinking water. Millions of people have to walk miles every day to just get a single bucket of water. Around 3.6 billion people are living without access to proper sanitation.

Water scarcity will hinder economic growth. Data from Aqueduct shows close to one-third of global gross domestic product, equivalent to \$70 trillion, will be exposed to high water stress by 2050. Agriculture accounts for 70% of global water withdrawals. By 2050, the world will need to raise food output by almost 60% to feed the projected global population of 9.8 billion. Receding water levels in Europe in 2022 caused disruptions to shipping and nuclear output. A lack of water to cool

powerplants in India between 2017 and 2021 led to 8.2 terawatt-hours in lost electricity output, enough to have powered 1.5 million households for five years.

The need for critical resources such as oil and land have often led to serious conflicts throughout history. Today, water stands to be a source of conflict and civil unrest in many parts of the world.



Sources: FAO, Morgan Stanley, Eurasia

**Water shortages will hinder global economic growth.**

Water is linked to nearly every Sustainable Development Goal (SDG). Yet this critical issue is frequently overlooked. The United Nations Water Conference in March 2023 was the first meeting in 50 years on the subject. But discussion of this most vital of resources was virtually absent from the SDGs Summit agenda held a few months later. Treating it as a temporary crisis will not help address the long-term challenge.

Benjamin Franklin once said: "When the well is dry, we know the worth of water." We are learning and living that adage more and more each year.

## The Science Of Being Human

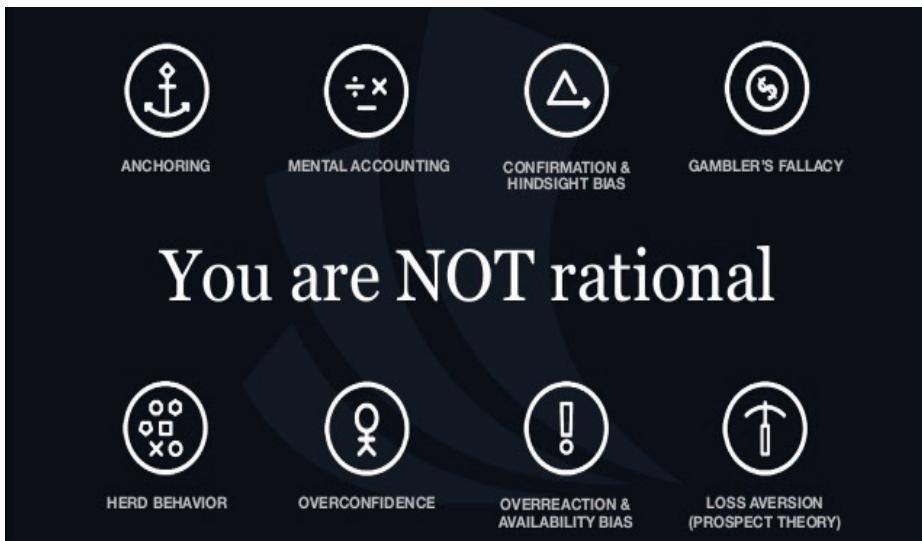
As an undergraduate, I was taught that people behave rationally and process information well. I recall being curious about these suppositions, having witnessed plenty of less-than-intelligent behavior (some of it my own). But these assumptions were used as the basis for models of how markets work.

As the years went by, evidence of irrationality accumulated. I felt as if the economic foundations I was taught were cracking. Fortunately, a group of psychologists invited themselves into our discipline to bind up our understandings.

Among them was Daniel Kahneman, who died last week. Kahneman was a godfather of behavioral economics, which proved that people are irrational...but in very predictable ways. His life's work earned him the 2002 Nobel Prize in Economics, the first awarded to someone who had never taken an economics class.

Through easy-to-follow experiments, Kahneman and his collaborator Amos Tversky explored the boundaries of our rationality. They identified a series of flaws, or biases, that separate human beings from classical economic ideals:

- We are overly influenced by things we have experienced recently, and prone to give more credence to news that confirms what we already think.
- We do not assess gains and losses using strict calculus. Our sense of risk is very different from mathematical probabilities.
- When confronted with a complicated problem, we try to solve it by considering a simpler problem that is similar. The mapping is often imperfect, leading to bad decisions.



**A grounding in behavioral economics is essential to understanding people and markets.**

These examples of our innate humanness are interesting, but usually harmless. In other situations, though, the boundaries of our rationality can be much more costly. Kahneman's work has helped to steer people to make better decisions more often.

I encourage my colleagues to include books on behavioral economics on their reading lists. A good entry point is "[The Undoing Project](#)," Michael Lewis' profile of Kahneman and Tversky. "Misbehaving," by Kahneman's collaborator Richard Thaler, takes things to the next level. (My review of that book can be found [here](#).) And for the harder core, Kahneman's "[Thinking Fast and Slow](#)" goes deeper into the depths of the human mind.

Daniel Kahneman will be missed. But his ideas will forever be with us.

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