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Effects of Legal and Unauthorized Immigration on the U.S. Social Security System

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The effect of immigration on the social insurance system is a policy issue of growing importance and it needs to be carefully analyzed and discussed by economists and policy makers. Immigration to the United States has grown rapidly for the last four decades. The foreign-born share of the U.S. population went up from 5 to 12.5 percent between 1970 and 2007 (Borjas, 2009), and the foreign born population reached approximately 40.1 million by 2009, with almost 30 percent of the foreign born entering the United States within the last decade (American Community Survey 2009). Additionally, as of March 2010 (Passel and Cohn, 2011), the number of undocumented immigrants has reached approximately 3.7 percent of the total population (with a total of 11.2 million people) and the number of legal immigrants is around 29 million (9.58 percent of the population). While research on the effects of migrants on local labor markets has attracted considerable attention, the importance of understanding the effect of immigration on public programs is only recently being recognized.

In a Pay As You Go system, increased immigration has a positive effect on the health of the public pension system, at least in the short and medium run. Most migrants who work pay their labor taxes, and given that these individuals are generally young, their taxes are used to support the benefits payments of the older generations. Moreover, undocumented immigrants, working under Individual Taxpayer Identification Numbers or sometimes fake Social Security numbers, in many cases also pay Social Security taxes but are unlikely to receive the benefits from their withholding, suggesting that at least in this dimension, undocumented immigration contributes positively to the financial health of the system.

The long run effects on the system, however, will depend on whether these immigrants are net contributors. To determine this, one needs to take into account a number of important dimensions. First of all, legal immigrants not only have the right to receive pension benefits and unemployment insurance, but also disability and health care. Second of all, undocumented immigrants pay some taxes but are in principle not eligible, becoming net contributors to the system. However, they may obtain legal status, in which case their characteristics, and comparatively lower health investments will probably make them more costly for the social insurance system. Therefore, any analysis that tries to understand the impact of immigrant workers on the overall system has to take into account the circumstances different types of immigrants face throughout their lives, as well as the use of the government programs they are entitled to.

A key aspect of our research is the tension between the decisions regarding domestic savings and remittances that immigrants make. We explicitly analyze the differential effects on the economy between resources saved in the host country versus resources sent back to the country of origin. The former foster economic growth, while the latter do not improve the economic conditions of the country even if they provide utility to the senders. If documented immigrants save more domestically, while undocumented immigrants send a higher proportion of their resources overseas, any reform might have a positive effect on economic growth via savings, but the final effect is a function of the possible increase in the social insurance expenditures linked with legalization. According to the Mexican Migration Project and the Latin American Migration Project, 65 percent of immigrants sent back remittances on a monthly basis with the average monthly remittance nearing $US404

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dollars. More importantly, 62 percent of the savings of undocumented immigrants are in the form of remittances, while only 40 percent of the savings of legal immigrants are remittances.

We present a General Equilibrium model of the key decisions of immigrants.** We analyze their situation regarding their labor supply productivity, consumption, wealth accumulation, and retirement, and we will account for the different incentive structures and eligibility rules faced by legal and undocumented immigrants regarding their retirement and their unemployment benefits. We use the equilibrium setting to account for the macroeconomic effects of immigration and changes in immigration policy, given that these effects are particularly important when studying the sustainability of social insurance programs, since changes in wages, labor productivity, and interest rates directly affect the government budget through changes in tax revenues and government debt. In the model, all immigrants work but face unemployment shocks, and choose how much to consume and save. They obtain wages and are subject to unemployment uncertainty. Wages are taxed (at potentially different rates) independently of their legal status; legal immigrants receive a public pension when they reach a certain age and will be covered by unemployment insurance if needed as well. Undocumented immigrants do not have access to Social Security benefits, but can receive unemployment insurance at a slightly lower level than natives and legal immigrants.

In the model, the two types of immigrants differ not only in terms of their saving behavior, but also regarding the usage of the social insurance system. Legal immigrants are in this case the main users, with undocumented immigrants not being able to benefit from it as much. Additionally, these two groups face different wage productivities, with legal migrants able to obtain the same wages as natives thanks to the fact that their abilities are better matched as opposed to undocumented immigrants.

This model allows us to examine a key aspect that should be part of the debate regarding immigration reform, which is the tension between the contribution to economic growth of legal and undocumented immigrants (through savings and labor productivity) versus the costs they subject the system to through the usage of social insurance programs. This trade-off is critical to successfully analyze the optimal type of reform and also to take into account which variables to consider when proposing a path to legalize undocumented immigrants. We find significant positive effects of legalization on capital stock, output, consumption levels, labor productivity, and the overall welfare of individuals. While the overall effects are small in percentage terms, given the size of our economy, the level effects are considerable.

*** We use Passel's (1999) residual approach to identify and assign status to immigrants in Current Population Survey (CPS) data, the American Community Survey (ACS), and use intensively the Mexican Migrant Survey of 2005, and the more recent Latin American Migration Project which have some ad-hoc definition of legal status.*

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