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September 8, 2000

Paper presented at the  
National Association for Business Economics  
Annual Meeting, September 2000

“The Economics of Illegal Migration for the Host Economy”

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Running Head: Illegal Migration

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**September 2000**

**Abstract**

**“The Economics of Illegal Migration for the Host Economy”**

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This paper analyzes theoretically the economic impact of illegal migration on the host economy. It analyzes the supply and demand for the international migration of workers in the presence of barriers to labor mobility. It shows that the often temporary nature of illegal migration (for voluntary and involuntary reasons) and efforts to avoid revealing their illegal status result in their tending to have very low levels of skills and earnings. It then analyzes the impact of this migration on the distribution of income and the income transfer system. It closes with a discussion of the political economy of illegal migration. (100 words)

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“The Economics of Illegal Migration for the Host Economy”<sup>1</sup>

Barry R. Chiswick

The worldwide growth in international migration in recent decades has been accompanied by an increase in what is variously called “irregular migration,” “undocumented migration” or “illegal migration.” That is, there has been an increase in the number of people living in the higher-income countries who have either entered the country in violation of that country’s laws or who have done something to violate a condition of a legal entry. The latter may arise from staying longer than permitted or from working in spite of a visa that prohibits or limits working, such as a tourist, student or temporary worker visa.

This increase in illegal migration has occurred in countries that have generous legal immigration programs, such as the United States which accepts nearly one million legal immigrants each year. At the other extreme, it has also occurred in island countries that have virtually no legal migration, such as Japan. There is every reason to believe that this illegal migration from the developing countries of the “South” to the high income countries of the “North” (including Australia) will intensify in the coming decades if present policies continue. This paper will explore some of the basic principles and issues related to the economics of illegal migration for the host economy. Its purpose is to stimulate further discussion and thought on these issues.

Section I explores issues having to do with the supply and demand for illegal migrant workers. It is assumed that the migration is motivated purely by economic factors, leaving refugee and asylee illegal migration for another time. Section II

considers why illegal migrants tend to be low-skilled workers. The impact of the illegal migration of low-skilled workers on the distribution of income in the host economy and the use of income transfers is considered in Section III. This section includes a discussion of the political economy of illegal migration, or why enforcement seems incomplete.

### **I. The Supply and Demand for Illegal Migration**

Consider two countries, A and B, where country A has higher real wages for workers of a given level of skill because of a more advanced technology, a greater capital stock per worker, greater human capital embodied in its workers, a greater abundance of natural resources per worker, a political/legal system more conducive to economic growth, or some other reason. Let us also assume that legal barriers prohibit the migration of workers from B to A, and that even if there were no legal barriers no migration could take place because the costs of moving are high and the wage differential between A and B is small for workers of the same level of skill. Now consider a situation in which the costs of migration and resettlement, including the information costs, decline, the wages in A increase, or those in B decrease.<sup>2</sup> The rate of return to the investment in migration has increased. If the rate of return exceeds the individual's interest cost of funds, that is, the person's discount rate, there is an economic incentive to migrate.

In a world with no legal barriers to migration, enough migration would occur until the rate of return declines to the discount rate, that is, until there would be no economic gain for the person at the margin from moving from B to A. A wage differential between A and B could persist only to the extent that the present value of the stream of wage differences equals the present value of the full cost of migration borne by the individual.

This is represented in Figure I, with a migration level of  $m_0$  and a wage differential of  $d_0$ .

With the existence of legal barriers to mobility, however, a rate of return in excess of the discount rate can persist. This is represented by the larger wage differential  $d_1$  in Figure I. This larger wage differential need not persist indefinitely, however, because in the long run the movement of other factors of production (e.g., capital and entrepreneurship) and free trade in goods could bring about “factor price equalization.” In the absence of these latter adjustments, at the margin there may be large economic rents to be had from migrating (the wage differential  $d_1-d_2$ ) even though it is against the law. Illegal labor migration is therefore a response to disequilibrium in international labor markets brought about by barriers to the unrestricted movement of factors of production, including labor.

**[Figure 1 Goes About Here]**

The supply of illegal migrants can be thought of as a rising function of the wage differential, with a greater supply forthcoming the lower is the cost of migration, the lower the probability of apprehension and the lower the penalty if apprehended. For some countries in close proximity, such as Mexico and the United States, the wage differentials are large and growing and the costs of illegal migration have fallen over time. The incentives for illegal migration have increased. The extent of illegal migration, therefore, depends, in part, on the degree of enforcement along the border and in the interior of the destination country.

This illegal flow can then be imperfectly regulated by raising and lowering the cost of illegal migration to the potential migrant by varying the extent of enforcement.

The greater the amount of resources devoted to enforcement and the greater the penalties if illegal migration is detected, the lower is the supply of illegal aliens to the destination. This enforcement can occur at the frontier (border enforcement) or in the interior.

The expected penalty from being detected can be thought of as the probability of detection and the value of the penalty if detected, including the disruption costs from deportation. If illegal migrants were risk neutral they would be just as sensitive to a 10 percent increase in the probability of being apprehended as they would be to a 10 percent increase in the penalty. If, as seems more realistic, they are risk averse, a 10 percent increase in the probability of apprehension would have a greater deterrent effect than a similar increase in the penalty. However, apprehensions without penalties, or penalties without apprehensions have no deterrent effects.<sup>3</sup>

The demand by employers for illegal alien workers arises from the difference in wages that are paid in the labor market to legal workers and the reservation wage of illegal aliens, the lowest wage needed to induce them to migrate illegally. The demand for illegal alien workers can be reduced by lowering their productivity or by raising the cost of hiring illegal alien workers. Penalties against employers who “knowingly” hire illegal aliens, referred to as “employer sanctions,” are a mechanism to reduce illegal alien employment by raising the hiring costs to employers (Chiswick, 1986, 1988a).

The obvious question that arises is: Why are there barriers to the free movement of people for employment across international boundaries?<sup>4</sup> This question becomes increasingly relevant as international barriers to the free trade in market goods and capital have been declining.<sup>5</sup> There are several reasons why nation-states limit the free movement of people.

While it is recognized that individuals have a human right to emigrate from their country of origin, it is also recognized that there is no right to immigrate into any particular country. That is, countries have the right to regulate the number and characteristics of international migrants that enter their country. Governments do this, in part, to influence the impact of migration on the host country's culture and demographic characteristics. Some countries have ideologies or mythologies that emphasize diversity or heterogeneity (such as the United States), while others have ideologies or mythologies that emphasize homogeneity (such as Japan).<sup>6</sup> Many countries, for example, the United Kingdom, Ireland, Germany and Japan, give preference to immigrants with a similar cultural, historical, or ancestral background as the dominant population of the host country. This may be done because it facilitates economic and social integration, to assist culturally close individuals, as a mechanism for preserving or maintaining the host country culture, or for broader cultural or ideological reasons, including xenophobia.

There are, however, political and economic reasons as well for nations to control who enters and for what purposes. On the political side, immigrants may change the political balance of power, and thereby implicitly or explicitly change the distribution of property rights and the distribution of income by aligning themselves with what would otherwise be a minority of the population. To oversimplify, imported goods do not vote, but "imported" people do vote, or at least have political influence.

There are also economic arguments for restrictions on immigration into high income countries (Chiswick, 1982). One issue is the "absorptive capacity" of the economy. To what extent does immigration impose externalities on the host population? Consider, for example, a situation in which immigrants add to congestion and, thereby,

impose costs on others that the immigrants themselves do not pay. These costs may be simple congestion costs (e.g., crowded streets and highways slowing down traffic), or the costs of more pollution and fewer trees, or they may involve the rising marginal cost of adding on to the increased social overhead capital needed by a larger population. These costs may outweigh the benefits from the larger labor force that pushes outward the country's production possibility frontier.<sup>7</sup>

Other economic costs may arise if immigrants, or subsets of immigrants, make use of public income transfers that raise their total income (transfers plus labor market earnings) above their level of productivity.<sup>8</sup> This is more likely to occur for low-skilled immigrants. This would tend to reduce the net income after paying taxes and receiving transfers of the native population of the immigrant receiving country.

Finally, political and economic factors are intertwined. Migrants may have positive effects on some segments of the population and negative effects on others. For example, low-skilled immigration would change the distribution of income by lowering the wages of all low-skilled workers and raising the earnings of high-skilled workers and the return to the owners of land and capital. If the gainers are diffused, but the losers are concentrated, or have political power, the latter may be more effective politically, and pressure the political process to reduce migration. If the gainers are concentrated or otherwise have political power which the losers lack, there would be political pressure to increase migration, whether legal or illegal.

## **II. The Skills of Illegal Aliens**

A general characteristic of illegal alien workers in developed economies is that they tend to be lower skilled than legal permanent immigrants and the average worker in

the destination labor market (Chiswick 1983, 1984, 1988b). In small part this is due to immigration laws. The immigration laws of many of the receiving countries give some preference to high-skilled professionals, technical workers, and managers (executives). Yet, this tilting of legal immigration in favor of the highly-skilled is too minor to account for the preponderance of the low-skilled workers in the illegal alien population.

Part of the answer is in the formality of labor markets. In highly formal labor markets that require educational credentials, occupational licenses or union membership it is that much more difficult for an illegal migrant to mask his or her illegal status. Educational credentials and occupational licenses are more common in high-skilled jobs than in low-skilled jobs. Hence, illegal migration is relatively less attractive, when comparing opportunities in the origin and destination, for workers in the origin with educational credentials and occupational licenses. For very low-skilled workers this is less of a problem.

The most important explanation, however, may have to do with the expected temporary nature of much illegal migration. Because of concerns regarding apprehension and deportation many potential illegal migrants would view their stay in the destination as being subject to involuntary interruptions. Moreover, since the probability of apprehension and the costs of deportation would increase if there are more members of the family in an illegal status, there is an incentive to leave family members in the origin. This would increase the number of trips back and forth, and decrease the likelihood of uninterrupted long-term or permanent working spells in the destination.

Investments in human capital, including destination language skills, labor market information, and on-the-job training, as well as union membership and occupational

licensing, have many elements that are country specific. Expectations of short or interrupted stays in the destination would decrease incentives for investing in destination-specific human capital, as would upward job mobility that increased the probability of being detected. Moreover, the destination specific human capital that is acquired would depreciate in value during periods back home. Furthermore, investments made in the origin before migration, or during sojourns at home, would depreciate in value while in the destination. These considerations imply that temporary migrants, whether guest workers or illegal aliens, would make fewer human capital investments specific to the destination than would otherwise comparable permanent immigrants.

There is a general complementarity between internationally transferable human capital and destination specific human capital, each enhancing the productivity of the other (Chiswick and Miller, 1999). Lower returns from destination-specific human capital will lower incentives for investment in internationally transferable skills. Hence, illegal migrants will tend to have lower levels of skill than legal permanent migrants and the native population in the destination. One implication of this analysis is that investments in destination specific skills would increase, and hence so too would their earnings, the greater the expected permanence of their stay, either because of a decline in the enforcement of immigration law or because of the receipt of an amnesty. Yet, even with an increase in their investments in human capital after an amnesty, most illegal migrants will remain relatively low-skilled workers engaged in low-wage jobs with relatively flat earnings profiles.

### **III. The Impact of Illegal Migration**

The low skill levels of illegal migrants have implications for their impact in the labor market. They compete with low-skilled native-born workers for the lower-skilled jobs and compete with low-income native-born families in the low-income housing market and for public income transfers (Chiswick 1982 and 1992, Altonji and Card 1991). The larger the stock of illegal migrants in the destination, the greater is the intensity of this competition in the labor market, the housing market and the market for public income transfers, and hence the lower the level of economic well-being among the native-born poor. It is the low-income native-born (and legal immigrant) population that pays the highest economic price from low-skilled illegal migration.

On the other hand, a greater supply of low-skilled workers, whether illegal or legal migrants, increases the wages of high-skilled workers and the return to capital (Chiswick 1982). This follows from the principle of complementary in production, that is, that a greater supply of one factor of production increases the productivity of other complementary factors.

It is often said that one of the benefits of illegal migrant workers is that they will do the jobs that native workers will not do. These are the dirty, dangerous, dull and difficult low-skilled jobs. By implication, it is “important” that these jobs be done.

The relevant question that should be asked is: “At what wage rates will native workers do these jobs?” It is to be expected that undesirable jobs, that is, jobs with less favorable non-pecuniary characteristics, will command a higher wage in the labor market than desirable jobs requiring the same level of skill. At a sufficiently large wage differential, native-born workers will be indifferent between the undesirable and the

desirable jobs. With the increase in wealth and marginal tax rates in the developed countries in the post-war period, there has also been an increase in the wage differential that would be needed to induce workers to be indifferent between undesirable and desirable jobs.

If employers have to pay the cost of attracting native-born workers to the less desirable jobs they will have an incentive to invest in making these jobs less undesirable. A cleaner, safer, more pleasant workplace would emerge. Moreover, employers will invest in substituting capital for the now more expensive labor to reduce the amount of labor employers demand for these jobs. Finally, some of these jobs will disappear from the destination labor market, either not be done at all or to be exported to other countries. The goods and services that are worth producing will be produced, even if production methods and market baskets differ due to the higher cost of low-skilled labor.<sup>9</sup>

The sectors of the economy that are particularly active in the illegal alien labor market have identifiable characteristics. These tend to be sectors employing low-skilled labor that need not have host-country skills (including knowledge of the destination country's language), that are characterized by unstable employment or in which high job turnover has low costs, that tend to be outside the formalized sectors of the economy, and that tend to be viewed as offering "undesirable" job characteristics.

Illegal migrants tend to have low skill levels, leave their family members in the origin, and return to the origin when their employment opportunities deteriorate for cyclical, seasonal or other reasons. As a result, they tend to make much less use of the broad range of government benefits, including schooling for their children and health care for family members, than lawful permanent immigrants with the same level of skill

and earnings. This raises an interesting public policy dilemma. It is clearly politically and socially undesirable to have a segment of the population living outside the law and denied the law's full protection, including the social welfare or social security benefits. A "solution" is therefore necessitated.

One extreme policy is to remove illegal migrants from the country, that is, to have widescale round-ups and deportations of illegal migrants (Chiswick 1988a). This would have a favorable effect on the low-income native-born population, but raises a whole host of civil liberties issues. There are some things that governments in liberal democracies cannot do politically, and one of these is draconian measures toward deporting illegal migrants.

Another extreme policy, at the other end of the spectrum, is to grant illegal migrants legal status through an amnesty program (Chiswick 1988a). This policy is also not without its problems. Workers whose presence was not desired in the first place find their status regularized. This does not solve the problem that, for whatever reason, their presence in the labor market was not wanted by the legal system. Moreover, it does not deter the inflow of illegal migrants after the amnesty is granted. Once an amnesty is granted it creates expectations that if the illegal migrant pressures once more become intense amnesties will be given again in the future. This lowers the cost or increases the benefits of illegal migration, encouraging additional illegal flows.

Furthermore, with legal status the former illegal migrant has new rights to income transfers, is more likely to bring dependent family members to the destination, and is less likely to return to the origin if and when employment opportunities decrease in the destination due to seasonal, cyclical or other, perhaps random, reasons. In addition, the

availability of these benefits tends to decrease the incentives for working, and hence reduces the supply of labor from the beneficiaries of amnesty. Then, the low-skilled illegal migrant worker who contributed more to the public treasury than he or she took out in benefits may become a net cost when these same low-skilled migrants are given legal status (Chiswick, 1982).

It is perhaps because the two extremes of deportation and amnesty have such undesirable implications that a middle ground “solution” of “benevolent ambiguity” is often grudgingly tolerated (Chiswick 1988a, Hillman and Weiss 1999). Under this approach there is strict enforcement of immigration law at the border, but minimal enforcement in the interior – neither massive deportations nor formal amnesties. Sanctions against employers who knowingly hire illegal aliens may exist in principle, but because of employer objections due to the enforcement burden placed on them, and, in some countries, civil liberties arguments, they are not vigorously enforced.<sup>10</sup> There is a form of de facto but not de jure amnesty for those who are established in the destination. The employment of illegal aliens is tacitly tolerated, but they receive fewer income transfers and are less likely to bring dependent family members. Hence, although they have adverse labor market effects on the wages of low-skilled natives, they are likely to contribute more to the economy than they take in the form of wages and transfer benefits – or at least contribute more than they would if they had legal status. In a static model this scenario has its own pragmatic appeal.

The “benevolent ambiguity” approach will have its appeal in diverse settings. It is the approach adopted in the United States which experiences large flows of illegal alien workers primarily from Mexico, a very low income country that has difficulty creating

employment for its expanding youth labor force and which shares a 2,000 mile long border that for geographic and political reasons is difficult to seal. Yet, similar problems, and seemingly similar solutions, are being adopted in other liberal democracies. Although the level of illegal migration flows are much smaller than in the United States, the island nations of Japan and Australia, and Canada which has relied on the US as a protective barrier, are finding that in the modern era oceans and the geographic space of other countries offer limited but not complete immunity from illegal immigration.

In a dynamic setting, however, there are problems. Incentives are created for the continued growth of an illegal alien workforce, with increasing numbers developing a permanent attachment and bringing in dependent family members. To avoid the development of a population living outside of, or on the margins of, the legal system, pressures increase for the awarding of de jure amnesty, with expanding economic, social and political rights.

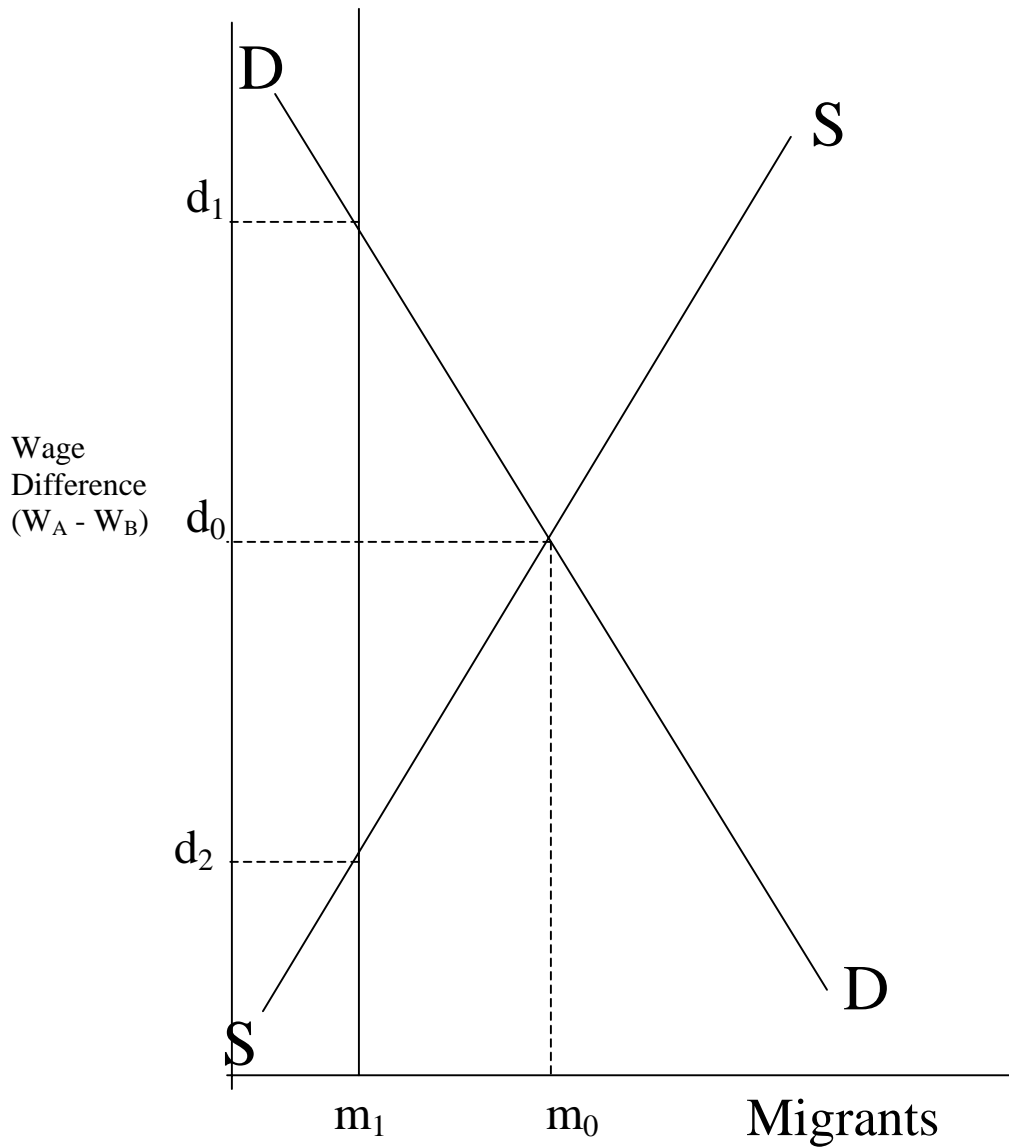
The emergence of a legal population of the same ethnic origin as streams of illegal migrants makes it more difficult to control illegal migration. First, it makes it easier for illegal migrants to mask their illegal identity. They have an enclave that makes it easier to live and work while avoiding detection. Second, as a result of kinship ties, ethnic solidarity and ethnic politics, a vigorous enforcement of immigration law at the border and in the interior becomes politically that much more difficult. The legal population becomes a political advocate for reduced enforcement and for the awarding of amnesty and economic and social benefits.

#### **IV. Conclusions**

Illegal migration flows are seductive. The low-skilled workers come providing “needed” labor services for employers unwilling or unable to offer higher wages and more attractive job opportunities to those with legal rights to work or to reduce their demand for low-skilled labor. Although initially illegal migrants seem like unsanctioned temporary or guest workers, with the passage of time their attachment increases and their use of government transfers and services also increases. They compete with low-skilled native-born workers in the labor market, the housing market and for public income transfers. It is the low-income native-born population that pays the greatest price for the presence of illegal migrants. With the passage of time measures to combat their presence become more difficult to implement, particularly if a significant legal population of the same ethnicity develops. Some processes are much easier to stop or reverse in their early stages before they have become established, and this is an important characteristic of illegal migration.

# Figure I

## Supply and Demand for Migrant Workers



- $m_0, d_0$ : Equilibrium number of migrant workers ( $m_0$ ) and wage difference ( $d_0$ )
- $m_1, d_1$ : Number of migrant workers and wage difference if migration limited to  $m_1$
- $d_2 - d_1$ : Economic rent to be had from illegal migration when legal migration limited to  $m_1$ .

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## Endnotes

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<sup>1</sup> The first draft of this paper was written while I was the John M. Olin Visiting Professor, Center for the Study of the Economy and the State, Graduate School of Business, University of Chicago. An earlier version was presented at the OECD Seminar on Preventing and Combating the Employment of Foreigners in an Irregular Situation, The Hague, April 22-23, 1999, the International Expert Meeting on Irregular Migration: Dynamics, Impact and Policy Options, Jerusalem, August 29-September 2, 1999, and the Conference on International Migration into the 21<sup>st</sup> Century, University of Western Australia, Perth, November 29 to December 4, 1999.

<sup>2</sup> The immediate costs of migration, for example, the airline or bus ticket and the time involved in this transportation mode are generally a minor part of the total cost of international migration. The greater part of the cost involves the cost of leaving familiar places and people, the cost of resettling in the new location where the language skills, labor market skills, information and networks acquired in the origin have little or no value and new investments must be undertaken. Indeed, that is why there is a tendency for international migrants to select destination countries, or locations within the destinations, that minimize these costs, other variables being the same. This results in the appearance of chain migration and the formation of immigrant/ethnic concentrations or enclaves. It is not that immigrants are any more “clanish” than natives, but they seek a mechanism for minimizing resettlement costs. These less tangible costs, along with high discount rates due to low incomes, may explain why seemingly large international and inter-regional wage differences can persist over time.

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<sup>3</sup> It has been said that the U.S. government policy of focusing on enforcement along the border with Mexico, with a virtual abandonment of interior enforcement, has the effect of increasing the number of apprehensions while imposing few penalties on those apprehended along the Mexican border. The result of this policy of apprehension with minimal penalties has been little deterrent effect. A de facto amnesty in an irregular status is granted most illegal aliens who penetrate the border and do not commit felonies or seek to leave and re-enter the United States.

<sup>4</sup> For an overview of arguments for a freer movement of people across international borders, see Ghosh (1997).

<sup>5</sup> It should be noted that barriers to international migration have decreased in some regions. The free mobility of labor among citizens of the member states within the European Union is one such example.

<sup>6</sup> For a comparison of immigration issues in the United States and Japan, see Chiswick (1998).

<sup>7</sup> On the other hand, economies of scale and immigrant contributions to the financing of collective goods (e.g., national defense) would argue for a larger immigration.

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<sup>8</sup> Throughout this paper public transfers refer to welfare, social insurance, social security, educational and medical benefits received from the government and non-profit (non-government) organizations.

<sup>9</sup> When asked recently what I would do if illegal alien gardeners disappeared from the Chicago labor market I replied that there would be a variety of responses: paying higher wages to attract similarly skilled or higher-skilled native-born workers, switch from labor intensive flower beds to less labor intensive grass lawns, plant slower growing varieties of grass, brick over part or all of the garden, prefer a house with a smaller lawn, and let the grass grow longer, among other alternatives. Thus, substitutions come in the form of using different types of labor inputs, substitution of capital for labor, use of a different technology, and substitution among consumption goods. Similar substitution possibilities exist for other market goods and services.

<sup>10</sup> Employer sanctions may be viewed as a tax on the employment of illegal aliens. One alternative is to have a low-skilled guest worker program in which a fee is levied on employers using the certified guest workers, as in the United States – Mexico Bracero program (for farm laborers) in the mid 20<sup>th</sup> century. While this approach legalizes the status of otherwise illegal aliens, their experience working in the U.S. will make it that much more difficult to get them to leave when their contract expires. Moreover, once in the U.S. they have an incentive to leave their guest worker employer to work illegally. Raising the legal minimum wage serves to make illegal alien workers that much more attractive for employers. Subsidies to forms of capital that substitute for low-skilled

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workers, thereby lowering the demand for low-skilled workers, are difficult to target and harm the economic status low-skilled native-born and legal immigrant workers.