

INVESTMENT UPDATE

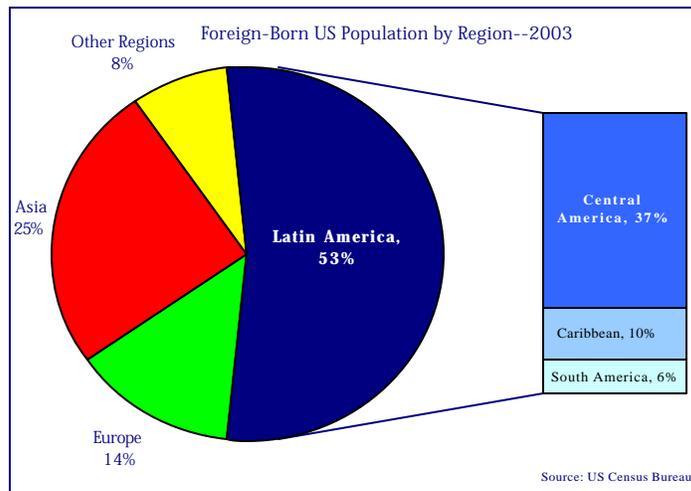
The topic of US immigration has pushed a lot of hot buttons lately, landing on the front pages of newspapers, debated in the halls of Congress, spurring protests and marches among the Latino population, and providing plenty of fodder for water-cooler conversations. While we wouldn't dream of taking a stand one way or the other on how to legislate immigration policy, we are, as long-term bond investors, very interested in how policy may impact the future demographics of the US.

The fact of the matter is that the US economy benefits from immigrants in some important respects, mainly from the immigrant population's higher fertility rate. Among developed countries, the US is the only country where the average woman gives birth to more than two children (2.1, to be exact) in her lifetime. The overall fertility rate in Europe is 1.4, ranging from a high of 1.9 in France to 1.3 in Spain, Italy and Germany, and only 1.2 in Poland. Likewise, the fertility rate in Japan is very low at 1.3 and even lower in South Korea (1.2) and Hong Kong (0.9). As we all know (when excluding the effects of immigration/emigration), a country must have a fertility rate slightly above 2.0 in order for its population to grow—any less and the average woman (and her male counterpart) die without corresponding replacements.

Policy-makers in countries with low birthrates are facing serious social and fiscal policy problems: As a country's population ages, the ratio of active to retired workers declines. If trends continue (as many predict they will) many of the industrialized countries' retirement plans, both public and private, will not have the funding necessary to support their very large retired population. Even here in the US, with our relatively high birthrate, we are looking at a Social Security System that will, without making some sort of mid-course correction, begin to pay out more than it takes in within the next twelve years.

What does a rising immigrant population mean to the United States? First we need to know the composition of our immigrant population.

According to the March 2003 US Census Bureau survey (which does not include undocumented aliens), the US includes 33.5 million people who were born in a foreign country, representing just less than 12% of the US population. As the pie chart on this page shows, more than half come from Latin America and one quarter from Asia. Almost 60% of the foreign-born population resides in the Western and Northeastern regions of the US, compared to approximately 40% of the native population. Foreign-born residents (especially those from Latin America) are younger, less educated, have larger families, and are more prone to poverty and unemployment.



The Pew Hispanic Center is currently attempting to account for the "unauthorized" immigrant population in the US (those who overstayed their visas or those the government categorizes as "entries without inspection"). The 2005 Pew survey estimates that of the approximately 11.1 million unauthorized aliens in the US (5.4 million adult males, 3.9 million adult females and 1.8 million children), 7.2 million were in the US labor force in 2005. While this amounts to just 5% of the

total US labor force, they estimate that these unauthorized workers make up 25% of both US construction laborers and grounds workers, 24% of farm workers, 22% of the maids and painters, and 20% of cooks and packers. These unauthorized workers are overwhelmingly from Latin America, with an estimated 56% from Mexico and 22% from other Latin American countries.

Immigration growth (for both legal and illegal entrants) has not been linear over the recent past, growing rapidly throughout the mid-1990's and peaking at the end of the last decade with an annual inflow of over 1.5 million in 1999-2000. After falling to 1.1 million per year in 2002-03, the numbers appear to be on their way back up. Importantly, the share of unauthorized immigrants has been growing over the last fifteen years. The growth in "illegal aliens," along with the high degree of participation in the work force (Pew estimates that 94% of unauthorized male immigrants are employed) has led to protests (especially from US labor groups) that wages for unskilled workers have dropped as these unauthorized immigrants have taken these jobs for very low pay. Recent Pew studies confirm the trend of immigrants moving away from



high-immigrant population states such as California and New York into more rural states such as Iowa and North Carolina. This has served to draw attention to the influx of immigrants to a wider slice of the US population, who might have previously viewed immigrant-driven wage pressure as a “big city” phenomenon.

Yet the degree to which wages have been reduced is difficult to calculate, and varies (apparently on who is funding the study). Harvard Professor George Borjas, in a 2004 study published by the labor-friendly *Center for Immigration Studies*, estimated that earnings for the average native-born US worker were approximately 4% lower (and more than 7% lower for those with less than a high school education) than they otherwise would have been due to the influx of immigrant workers who came to the US between 1980-2000; he found the impact on native-born black and Hispanic workers to be even more profound.

There are other researchers who believe that these lower wages, despite the pressure they put on the most poorly educated members of the native population, have a neutral or even a beneficial impact on the overall economy. Perhaps the best known of these are Alan Krueger of Princeton and David Card of UC-Berkeley, whose work shows that lower wages have led to increased capital formation, as a more stable cost structure (wages being a primary component of costs) boosts confidence and business investment, leading to healthier long-term economic growth. Card found no increase in the income gap (as would be expected) between high-school grads and drop-outs since 1980, despite the rapid growth in the immigrant population. In addition, he noted, these immigrant workers, both documented and undocumented, are consumers and add to aggregate demand for US goods and services.

In addition to their higher fertility rate, the most powerful demographic characteristic in support of immigration comes from the favorable age distribution of those who come to the US compared to the native population. The top chart on this page shows how the native-born population compares to the

immigrant population, based on a US Census study from 2003. The most obvious difference is the relative paucity of people in the immigrant population under the age of 15—only 6% compared to more than 23% of the native population. All told, more than 80% of the foreign-born population is in the 18-64 age group (compared to 60% for natives) and 45% (compared to only 27%) of the immigrant population is in the economically-important 25 to 44 year old segment.

The immigrant population is a powerful employment engine that propels a measurable chunk of the US economy. What’s more, the Hispanic and Asian segments of the US population are expected to continue to grow much more rapidly than the white population, both from continued immigration as well as

higher birth rates. According to the Census Bureau, the non-Hispanic white population, which represented more than 75% of the country’s population in 1990, will constitute only 52.5% by 2050. The combination of immigration and high fertility will allow the US population age distribution to remain fairly stable in the decades ahead (see the lower chart). The average age of a resident in the US is expected to increase only from 35.8 to 39.1 over the next 45 years, while the average of the other G-8 countries will extend by more than eight years. Where the US will have barely 20% of its population over the

age of 65, the other G-8’s will have an average of almost 30% past the age of retirement in the year 2050. During this same period, the US population is expected to grow from 295 million to 420 million, while theirs are expected to *shrink*, collectively, from 564 million to 499 million.

As investors, we view the world differently than policy-makers; it’s relatively easy to see the economic benefits of a vibrant immigration population. Elected leaders and their agencies will need the wisdom of King Solomon to balance the positive demographic characteristics of the immigrant population with the potential disruptions of assimilating them into our great melting pot. These are critical decisions that have no simple solutions, and will likely need to evolve as the population changes with time.

