EEAG (2015), *The EEAG Report on the European Economy,* "Migration in the European Union: Too Much of a Good Thing?," CESifo, Munich 2015, pp. 78–96.

Migration in the European Union: Too Much of a Good Thing?

4.1 Introduction

The principle of the free movement of labour – along with capital, goods and services – is one of the central tenets of the European Union. But in recent years it has come under attack. There are proposals to restrict the ability of migrants to access welfare benefits, and limit the ability of EU citizens to move within the EU. These proposals are one aspect of a general shift in sentiment, which also encompasses immigration from outside the EU. Several member states have already tightened their entry criteria.

The British government has recently engaged in strident anti-immigration rhetoric. It has toyed with the adoption of a target for net immigration into the UK in the tens of thousands per annum, and has been considering tightening entry criteria for non-EU citizens to the UK (Lewis et al., 2012). However, its stated aims have been frustrated by its limited ability to control migration within the EU, and a large net inflow of EU citizens continues. There are plans to place more restrictions on the access of new immigrants to welfare benefits.[1] Similar noises have been coming from Austria, the Netherlands, Belgium, and Germany.

In 2008 Belgium started writing to unemployed recent immigrants from other EU states. In 2013 it intensified this programme, instructing more than 2,700 unemployed EU citizens to return to their home countries within thirty days or risk being returned, on the grounds that they had become an unreasonable burden on the welfare system.[2] Most of those written to were from Romania, Bulgaria, Italy and Spain. Over 10 percent of Belgian residents are foreign nationals. But Belgium was not violating EU rules with its programme, it was merely applying them. EU law allows a country to send back citizens from another EU member after six months if they lack the means to support themselves and to pay for health insurance. As in the UK, the Belgian government has come under pressure from far right nationalist anti-immigration parties like Vlaams Belang, which has influenced the policies of the New Flemish Alliance (the largest party in the Belgian parliament) and the moderate Flemish Liberals.

Since 2010 the French government has been conducting large-scale deportation programmes for Sinti and Roma, involving the demolition of camps in France by police forces, often following arson and other hostile acts by the local population. The programme was deemed "voluntary" as the individuals received 300 euros for accepting both deportation and a re-entry ban. In the first quarter of 2013 alone, the police destroyed around 40 Roma camps, 15 of them on the outskirts of Paris.[3]

The German government is considering capping its voluntary scheme of providing child benefits to immigrants' children not residing in Germany at the levels paid in their respective countries of residence, echoing UK government proposals to reform overseas payment of child benefit.[4] The German proposal affects people who come to work in Germany while their children stay at home with grandparents or other relatives. In December 2013, payments were made for 92,000 children outside Germany, 41,000 of which live in Poland alone, where the purchasing power of a euro

[1] In November 2014 the British Prime Minister David Cameron proposed restricting the access of EU immigrants to Britain to housing benefit and tax credits for at least four years after arrival. While such a restriction could be enforced for non-working migrants within the first five years of residence in the UK according to existing EU treaties and laws, it could not be implemented for working migrants or those seeking work, since they are guaranteed equal treatment to permanent residents under EU treaties. An alternative solution not requiring changes to EU treaties would entail restoring the insurance principle in social insurance and making eligibility for housing benefit dependent on a history of national insurance contributions. Tax credits (a tax concession to low-paid workers) would be harder to deal with. The European Commission has accused the UK of creating problems for itself by providing excessively generous non-contributory social assistance.

[2] A. Byrne (2014), "Free flow of labour stemmed as Belgium cracks down on migrants," *Financial Times,* 16 March, http://www.ft.com/cms/s/0/d736fe48-a912-11e3-bf0c-00144feab7de.html?siteedition=uk.

[3] S. Harraudeau (2013), "Roma in Frankreich: Fakten und Daten," *Arte Journal,* 17 June, http://www.arte.tv/de/roma-in-frankreich-fakten-und-daten/7556828,CmC=7552026.html.

[4] J. Vasagar and G. Parker (2014), "Germany considers capping child benefit for migrants," *Financial Times,* 27 August, http://www.ft.com/cms/s/0/48e0faec-2df4-11e4-8346-00144feabdc0.html on 23rd September 2014.

is 1.8 times that in Germany. Germany is also introducing laws to limit the rights of out-of-work migrants from other EU states to remain in the country, as well as time-limited bans on re-entry in cases of fraud (German Government, 2014).

The rhetoric has grown louder since the financial crisis of 2008–9, the European public debt and banking crises that followed, and the lingering stagnation of the EU's economy and high unemployment. The rise of right-wing nationalist and anti-immigration parties is widespread. Their growing popularity has forced mainstream politicians to shift to the right and adopt the same rhetoric. The UK Independence Party (UKIP) is forcing the Conservative-Liberal Democrat coalition government to harden its line on immigration.

Anti-migration sentiment has grown with the enlargement of EU membership to include poorer countries in Eastern Europe, widening income disparities within the Union. This has raised fears among various electorates that large numbers of low-paid workers from Bulgaria and Rumania will migrate to richer north-western states and undercut low-skilled local workers in the labour market, raising unemployment (directly and indirectly) and placing a higher burden on the welfare state. The relatively generous social security provisions of Northern Europe have been portrayed as a magnet for migrants – the "welfare magnet" – implying that migration is stimulated by the prospect of generous welfare benefits. This parallels the US where operation of the "welfare magnet" has been thoroughly documented (Borjas, 1999).

The rise of militant Islam since 9/11 – 11 September 2001 – and the belief that the West faces a growing terrorist threat is also a factor. Liberal Western European attitudes to religion, religious practices, religious symbols and aspects of dress, like the wearing of headscarves, or the acceptability of irreverence towards religion, have clashed with those of mostly Islamic, immigrant groups. The murders of the Charlie Hebdo journalists in France on 7 January 2015, by people claiming to be avenging insults to Islam, have galvanised public opinion in France and around the world, as the most direct and shocking assault on the liberal value of freedom of expression. That the killers were not recent immigrants, but French citizens deepens the horror, that Western democracies are threatened by an "enemy within", nurtured by these societies themselves. The recent "Pegida" demonstrations against Muslims in Germany that spread from Dresden, and the counter-demonstrations that followed, point to the apparently growing polarisation in Western societies. There are signs of a lack of integration of immigrants with native populations, pockets of poverty and unemployment concentrated among immigrant communities, and intermittent outbreaks of unrest and violence. France has unresolved problems with the banlieues, where disaffected populations of unemployed low-skilled immigrants from the Middle East and North Africa erupted into violence in October 2005. Sweden faces problems of discrimination against immigrants in the Stockholm hinterland and around Malmo. The Netherlands was rocked by the murder of Theo van Gogh by an Islamist in 2005 (Buruma, 2006). These experiences have raised concerns about the possibility of integration. Indeed, the very viability of a multicultural society is being called into question. Western governments' responses to the Islamist threat have themselves contributed to the alienation of immigrant groups.

Meanwhile poverty and violence in Africa and the Middle East have led to a stream of asylum-seekers and people desperate to get into Europe by any possible means. Thousands die, packed by ruthless agents into overcrowded boats, trying to sail from North Africa to Italy and Spain. The survivors of these journeys have imposed costs on the economies that have had to receive them. The issue of whether or not to rescue would-be immigrants from Africa whose boats sink in the Mediterranean poses an awkward moral dilemma for the EU and member states, particularly Italy. What quantities of resources should be devoted to this effort? Italy operated a surveillance and rescue operation, Mare Nostrum, which has now been terminated due to its cost (estimated at 9 million US dollars a month) to the Italian state. It has been succeeded by the more modest Operation Triton carried out by Frontex, the EU's border forces, at an estimated cost of around 3 million euros a month. The European authorities fear that the existence of a rescue operation encourages traffickers and agents to send migrants to sea in unseaworthy vessels, risking their lives. But pursuing a policy of not rescuing shipwrecked voyagers to discourage illegal immigration also is immoral.

Besides Africa, Italy receives many illegal immigrants from Albania. The UK is to contribute 12 million British pounds to France's costs of policing the port of Calais, where crowds of illegal immigrants, desperate to get into the UK, mob, and try to hide in or under trucks boarding cross-channel ferries. In 2013 Germany took in over 35,000 asylum-seekers who originally had entered other EU countries, although the Treaty of Dublin (1990) stipulates that the country of first entry is responsible for dealing with asylum-seekers.

It follows that there are at least four key aspects to the immigration issue. One is the migration of EU citizens, who have the right to move freely and work wherever they wish in the Union. For such individuals, migration is driven largely by their desires in response to economic and social incentives. Migration is effectively supply-driven. Individual member states are not able to restrict the movements of the citizens of the Union, except indirectly, through the design of their welfare systems or other aspects of labour markets. This is the part of immigration that has attracted a lot of media attention in recent years, as the numbers are large and EU laws restrict member states' freedom of action.

A second aspect is immigration from outside the EU of citizens of non-member states. This is largely under the control of EU member states, as they are free to limit numbers and apply any selection criteria to aspiring immigrants, including their educational level, occupation, wealth or other criteria. Non-EU citizens who have been admitted to one member state do not have the right to move freely between EU member states. EU states are free to grant access to social security benefits to whatever extent they wish. These migrants pose less of a problem for governments. Of course, the questions of how immigration policies should be designed, whether current policies are appropriate and what improvements, if any, might be made nevertheless remain.

A third aspect of immigration is the flow of illegal immigrants and asylum-seekers from Africa, the Middle East, and other parts of the world.

A fourth aspect is the movement of students taking advantage of the international market for higher education. A growing number of students from India, China, and other emerging economies are coming to European universities to study. The UK higher education system derives a substantial fraction of its income from overseas students. It is useful to consider students separately from other migrants because they most often intend to stay in the host country for the duration of their studies, and in some cases stay on briefly to obtain some post-qualification work experience after their studies.

Given the breadth of this topic, this chapter focuses on the issues surrounding the free movement of EU citizens within the EU that have attracted a great deal of attention in recent years.

4.2 European Union laws on free movement

The rights of free movement for workers go back to the early days of the European Communities. They were included in the Treaty of Paris (1951) that set up the European Coal and Steel Community, which gave freedom of movement to workers in those industries. The 1957 Treaty of Rome extended these rights to workers in the European Economic Community. They were subsequently extended to the family members and other citizens of EU member states. More recent directives have clarified the terms on which migrants can access welfare benefits.

The principle is set out in the broadest terms in Article 3, paragraph 2, of the Consolidated Version of the Treaty of the European Union[5], which states that:

> "The Union shall offer its citizens an area of freedom, security and justice without internal frontiers, in which the free movement of persons is ensured in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime."

The principle is further elaborated upon in Article 20 of the Treaty on the Functioning of the European Union[6], which establishes citizenship of the Union, and gives citizens inter alia

> "[…] the right to move and reside freely within the territory of the Member States."

Article 21 of the same treaty repeats the right of citizens' free movement. Article 45 guarantees that

> "[…] freedom of movement for workers shall be secured within the Union."

And that

> "[…] such freedom of movement shall entail the abolition of any discrimination based on nationality

[5] European Union (2012a).
[6] European Union (2012b).

between workers of the Member States as regards employment, remuneration and other conditions of work and employment."

Directive 2004/38/EC[7] amends and consolidates a number of earlier directives on the free movement of EU citizens and family members. It grants an unqualified right of residence in the territory of any member state for up to three months. All Union citizens have a right of residence for more than three months if they are workers or self-employed persons; or if they have enough resources not to become a burden on the social assistance system of the host member state and have comprehensive sickness insurance; or if they are students or family members of an EU citizen.

According to Directive 2004/38/EC, EU citizens (and non-EU family members who have lived with them) automatically acquire the unconditional right to permanent residence in another member state once they have lived there legally for five years, and are entitled to all tax-financed social benefits and other local amenities just like a native. This means that immigration into the welfare system is possible without ever participating in the official labour market, subject to the constraint that no social benefits are available for the first five years. The qualifying period is reduced to three years for workers and self-employed persons who have been resident for three years when they reach the age at which they qualify for an old-age pension, and to two years or less for persons who become permanently incapacitated and unable to work, or who have had a work-related accident.

EU citizens who were workers or self-employed continue to be regarded as such if they become temporarily unable to work because of illness or accident, are involuntarily unemployed and are looking for a job, have had a fixed term job that has come to an end, or embark on vocational training.

The directive makes clear that an EU citizen's dependency on social assistance will not automatically lead to being ordered to leave the country. Furthermore, a state may not attempt to expel an EU citizen or their family members if the citizens are workers or self-employed persons, or entered the host member state to seek employment, in which case, they may not be expelled for as long as they can show that they are continuing to seek work and have a genuine chance of finding it.

[7] European Parliament and Council of the European Union (2004).

Nevertheless, a case recently brought before the European Court of Justice has established that nationals of one member state who travel to another solely to claim benefits there may be excluded from receiving certain social benefits during the initial five-year period.[8] Thus, while the existing treaties and directives strictly limit the freedom of member states to do so, it remains possible for them to temporarily (for five years) refuse certain benefits to people who may be classified as "welfare tourists".

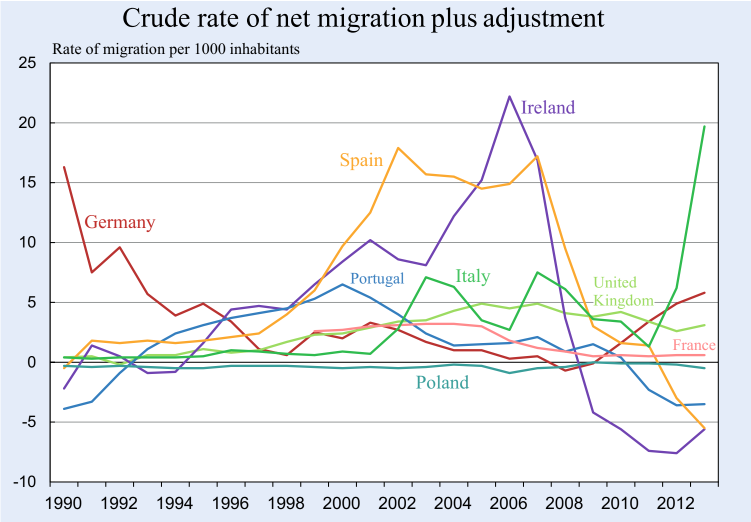
4.3 How much immigration has there been?

It is important to bear in mind the scale of the issue, and the patterns of movement that have taken place in recent years. Eurostat publishes figures for a "crude rate of net migration plus adjustment."[9] Data for selected countries is given in Figure 4.1 below. The figure shows the rapid inflow into Germany in the early 1990s following unification and the collapse of the Soviet Union, when Germany absorbed about two-thirds of Europe's East-West migration, followed by a long period of modest net immigration, rising again since 2009 to just over 0.5 percent based on provisional figures for 2013. Immigration to France, by contrast, has been low, which is perhaps unsurprising in view of the harsh measures taken by the Sarkozy government. The rate of net inflow into Spain in the boom years between 1997 and 2008 is strikingly high, as is the flow into Ireland between 1995 and 2008; again, while the Irish economy was booming. These dramatic inflows have turned negative since the financial crisis. A net outflow of workers may be making a modest contribution to lowering the rate of unemployment in these countries. Portugal shows a similar pattern. A net inflow between 1993 and 2010 has turned clearly negative. Interestingly, the data for Poland, a country

[8] In this case the persons who moved to Germany had been there for more than three months but less than five years, and so could not claim a right of permanent residence in Germany. As they were not seeking work and did not have sufficient resources to maintain themselves, they could not claim a right of residence in Germany and were not entitled to certain benefits. Court of Justice of the European Union (2014), "Economically inactive EU citizens who go to another Member State solely in order to obtain social assistance may be excluded from certain social benefits," *Press release* No 146/14, Luxembourg, 11 November, http://curia.europa.eu/jcms/upload/docs/application/pdf/2014-11/cp140146en.pdf.

[9] The "crude rate of net migration plus adjustment" is calculated by taking the actual increase in population over the period of time in question and deducting from it the estimated natural change in population, i.e., the change that would occur in the absence of migration, based on estimated fertility and mortality rates. This, in principle, gives the same answer as taking the data on immigration and subtracting the estimated emigration. For many countries the two methods give almost identical answers, but for some there are differences. However, as the direct figures on emigration are subject to wide margins of error, the "crude rate of net migration plus adjustment" figure may be the better estimate.

Figure 4.1



Source: Eurostat, last accessed on 30 October 2014.

famous for being a massive source of emigration into the rest of the EU since joining in 2004, does not show a massive net outflow. There has been a consistent small net outflow since 1990, with a small increase in the rate in around 2005–6, but the numbers look modest, compared to the inflows into Spain and Ireland. The net inflow into the UK has clearly grown since 1996, peaking at around 0.5 percent in 2005, shortly after Poland joined the EU when many Polish workers moved to the UK.

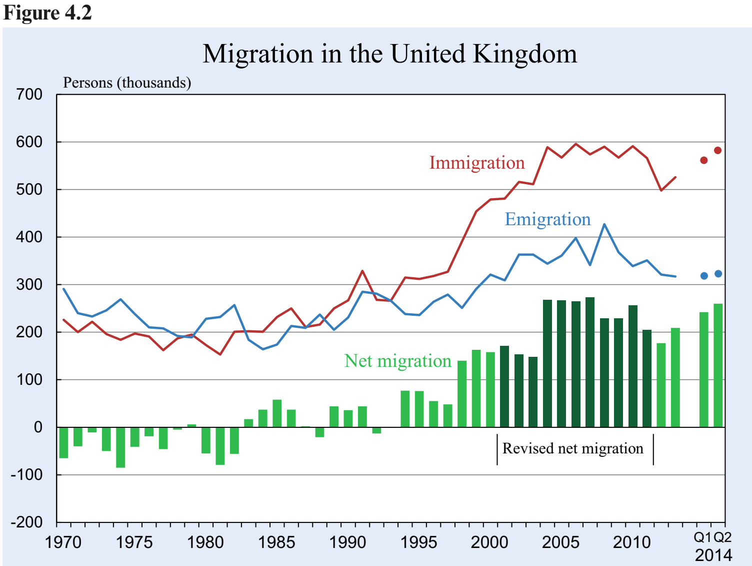
Although the intra-EU flows have been large enough to cause anxiety among electorates and politicians, it is surprising that they are not larger, in view of the huge disparities in real wage rates, and particularly in unemployment rates. The outflows from the crisis countries – Greece, Ireland, Portugal, Spain, Italy and Cyprus – were relatively modest. Obviously migrants still face considerable social and economic obstacles, despite the guarantee of free movement.

The net migration figures do not tell the whole story. Behind them, there have been a variety of developments in gross in- and outflows. In the case of the UK (Figure 4.2) both the gross outflows and inflows have grown substantially since the 1990s, and, as shown above, net migration has changed markedly. Gross flows were around 200,000 per year until the early 1990s. There was a small net outflow every year from 1970 to 1982, with the exception of 1979 when there was a net inflow. Since then gross flows have increased, with the gross inflow rising to nearly 600,000 in the early 2000s and the outflow to between 300,000 and 400,000, giving a net inflow of roughly 200,000 since 2000. A clear upward jump in the net inflow between 2004 and 2005 coincides with the accession of Poland and other new members to the EU, at which point there was a large movement of people from Poland to the UK (the UK was one of few EU member states that did not restrict these flows). Net migration to the UK was 243,000 in the year to 31 March 2014, according to provisional estimates.

In the case of Germany, on the other hand, gross flows started at a high level in 1998, but they have not grown since then, as Eurostat data in Figure 4.3 shows. Both immigration and emigration fell from around 700,000 persons in 2008 to around 300,000 in 2009. Since then emigration has continued to fall modestly, while immigration has grown sharply, reaching 600,000 in 2012.

The cumulative effect of these movements of people is that in 2011 (the most recent year for which figures are available), the foreign-born population of Germany

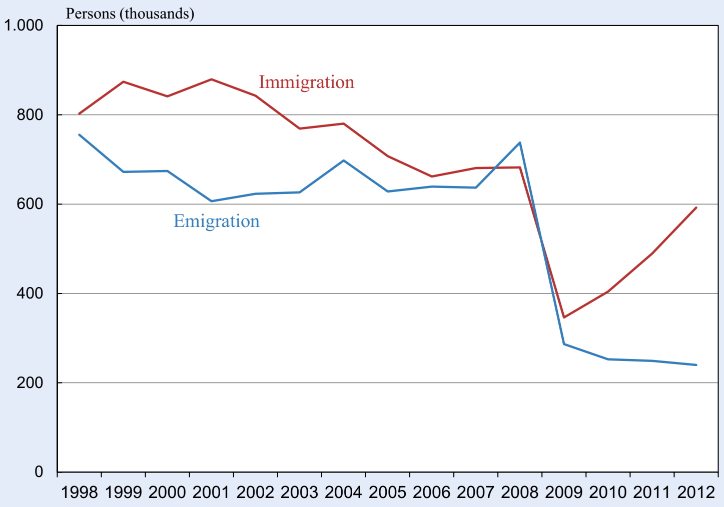
Figure 4.2



Source: UK Office for National Statistics, last accessed on 30 November 2014.

Figure 4.3

Migration in Germany



Source: Eurostat, last accessed on 25 September 2014.

was 13.1 percent of the total, compared to 12.0 percent in Britain, 11.6 percent in France and 9.0 percent in Italy.

While opposition to immigration has grown in those Northern European countries that have had sustained net inflows of people, the fact that several million of their citizens are living in other European and non-European countries is mentioned less frequently in public debates. Emigration gets far less attention than immigration, and indeed the data on emigration is far poorer.

Migration at rates recently experienced will have a substantial effect on population sizes in the decades ahead. In most cases it will partly offset a large fall in population that would occur in the absence of migration. While migrants may be younger than the native populations on average, the ageing of populations continues, with steadily rising dependency ratios. Figure 4.4 features data from Europop2013, the most recent population projections to 2080. Based on current assumptions about migration flows, fertility and mortality, the population of Germany will fall from 82 million to 50 million in the absence of migration, while it will be 65 million according to the central projection. The population of the United Kingdom, which totalled 64 million on 1 January 2013, is projected to rise to 85 million according to the central projection, but to just 65 with no migration. The population of France is forecast to rise from 66 million to 79 million according to the central projection and to 69 million without migration. The difference is not entirely accounted for by net inward migration; it also takes into account the fertility of migrants and their own projected migratory behaviour. The data underlying Figure 4.4 is featured in Table 4.A.1 in the appendix.

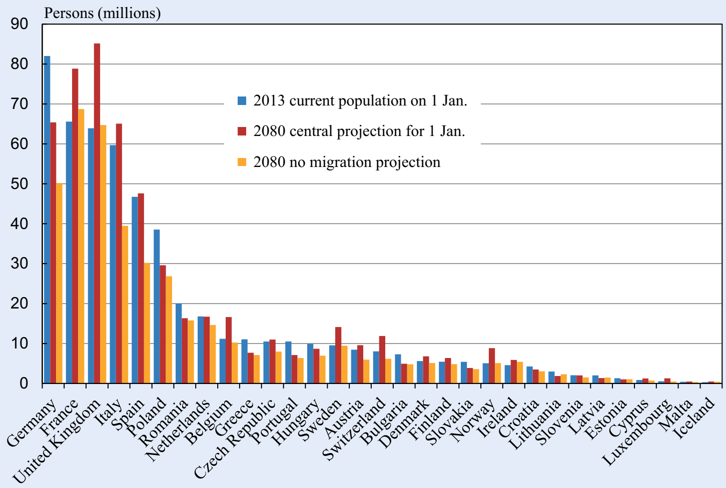
The share of people with foreign backgrounds is forecast to rise substantially between 2011 and 2061 (based on calculations of Eurostat staff; see Lanzieri, 2011), as shown by Figure 4.5.

4.4 Effects of migration

The problem with migration, like many aspects of international trade, is that it produces clear losers as well as winners. While the migrants themselves are among the winners, and some sections of the receiving economy gain (some workers, employers, shareholders, and property owners), those groups of workers who compete for jobs with migrants are losers. They suffer

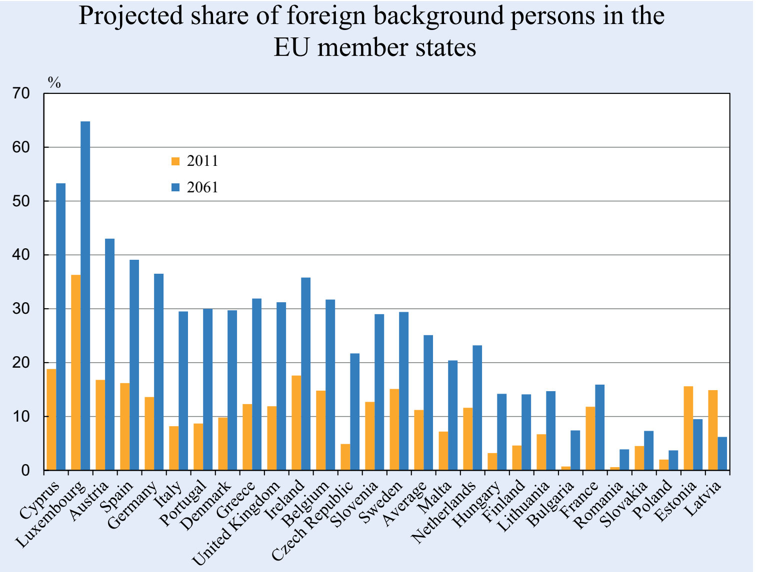
Figure 4.4

Projected population of EU member states



Source: Eurostat, Europop 2013 population projection.

Figure 4.5



Source: Lanzieri (2011), p. 18.

more unemployment and their wages are pushed down. Immigration adds to pressure on public infrastructure: public services become more congested. Housing also becomes scarcer or more expensive or both as rents and property prices are pushed up. Tax payers may stand to lose out in cases where migrants make heavier use of social welfare than the indigenous population and, despite working and paying taxes, contribute less than they receive in terms of transfers and free public goods, as members of lower-income groups in a redistributive fiscal system.

What makes migration a particularly inflammatory issue is that the losses caused by it are immediate and up-front: people can see jobs being taken by migrants, houses occupied, new shops and religious establishments appearing. The benefits – as the labour market adjusts to produce more jobs, and the supply of housing grows to meet demand – are slower to appear and less obvious. The beneficial effect of migrants lowering the dependency ratio and easing the pension problem is even less apparent.

4.4.1 Effects on employment and wages in receiving economies

In principle, an inflow of migrants will increase the supply of labour in the economy and either reduce a shortage of it (or increase a surplus), or, if wages can adjust, cause wages to fall, relative to what they would otherwise have been, while the additional workers are absorbed into employment. On the demand side of the labour market, the increase in consumption caused by migrants increases labour demand, thereby limiting its negative effects on some workers (Borjas, 2014). If labour is viewed as a single homogeneous factor of production, the fall in wages applies to all workers. At the same time, the return to capital increases. In an extreme and ideal case where there are no fixed factors of production and firms face a perfectly elastic supply of capital – because they can effectively raise funds on an international capital market, which enables them to invest and increase the economy's capital stock, causing production to expand – wages might even be restored to their pre-immigration level.[10] To the extent that capital mobility is less than perfectly elastic and fixed factors such as land play a role, only a partial restoration of wages is possible.

Immigration is likely to affect all workers in the same way when the composition of the immigrant workforce is similar to that of the host country, in terms of age, education and skills. In practice, immigrants tend to be different. Some countries have had waves of relatively low-skilled immigrants, such as Germany, France, Italy and other European countries, while others have experienced the immigration of relatively skilled workers, the United States being a case in point. Immigrants tend to be younger and more entrepreneurial than the existing workforce. European economies are increasingly restricting immigration from outside the European Union to limit overall numbers and to grant entry to workers whose skills meet shortages and serve other national objectives. Typically, this means granting entry to highly educated immigrants and excluding low-skilled workers.

In cases where immigrants are less skilled than the existing work-force, an influx of such immigrants lowers the wages of unskilled workers relative to skilled workers. This kind of immigration is likely to be resisted by low-skilled workers, who see their jobs being taken by cheap foreign labour, and supported by higher skilled workers and employers whose earn-

[10] Dustmann et al. (2008) provide a fuller analysis of these effects.

ings and profits rise because the factors of production that they offer are complements to, rather than substitutes for those offered by the immigrants. The immigration of skilled workers has the opposite effect on workers: the skill-differential narrows (relative to what it otherwise would have been). Low-skilled workers and employers stand to gain. The immigration of skilled workers may generate productivity gains or adjustments in production technology, which also benefit existing residents; or at least mitigate the negative effects of immigration (Lewis, 2012). If migration is restricted to meet skill shortages, or expands the supply of groups of workers for whom demand is rising over time and whose relative earnings are growing, it may dampen relative wage growth without causing wages to actually fall, and may not be perceived as a threat to the existing workforce. The migration of health care professionals to the UK is a case in point. Such individuals lessen a shortage of National Health Service staff and are not perceived to have depressed the earnings of doctors and nurses. This kind of immigration generally encounters little opposition.

There have been many studies of the wage and employment effects of immigration, and indeed many surveys of these studies. The following paragraphs summarise findings from a small number of them, which convey the general thrust of writing on this topic.

Dustmann et al. (2008) report on a number of studies of immigration in the UK, which find that it has very modest effects on wages and the employment of existing workers. Disentangling the effects of immigration is not straightforward statistically, and the results depend to some degree on the methods and assumptions used. Nevertheless, the broad message is clear. The authors report study-findings that immigration has no effect on the wages of young Austrians. Studies for Israel have found a positive effect on Israeli wages (although not statistically significant), while studies for Spain have found no effect. For the US, while some earlier research had found modest negative effects, more recent studies have found that immigration has a zero or positive effect on wages. In their own work on the UK, Dustmann et al. (2008) find no effect on the employment of native workers. This, however, does not prove that no effect exists, as the failure to find an effect may simply mean that the available data is not good enough to reach a conclusion.

When they break down the labour force into groups with different levels of skill (low, medium and high), Dustmann et al. (2008) find, however, that the employment of the medium skill group is reduced, while the employment of high-skill workers is increased. For existing workers with intermediate skills an increase in immigration amounting to 1 percent of the native population leads to a decrease of 1.8 percentage points in the employment rate, a decrease of 1.1 percentage points in the participation rate, and an increase of 1 percentage point in the unemployment rate. This confirms a theoretical result reached by Sinn (2005) whereby an unemployment system with benefits not immediately available to immigrants implies that immigrants drive domestic residents of the same skill group into unemployment, given that they have lower reservation wages due to their initial non-eligibility for unemployment benefits. However, these effects are offset by an increase in the employment of natives with high skills. For the latter group, a similar inflow of immigrants leads to an increase of 1.1 percentage points in employment and participation rates, and has no effect on the unemployment rate. Dustmann et al. (2008) do not find a significant effect on workers with low skills. As for the effects of immigration on wages, Dustmann et al. (2008) report that they seem to be positive rather than negative.

Further analysis by the same researchers confirms a widely-held belief about immigrant workers, namely that they tend to be more highly skilled than the native work-force, but work in less-skilled jobs than their educations and qualifications merit, particularly in the early years following migration.

A large body of research on employment and wage effects supports these conclusions. Examples include Kerr and Kerr (2011) who survey a wide range of material for many European and non-European countries. The British government itself argues that immigration has few adverse effects on the employment and earnings of UK natives (UK Government, 2014). The report concludes that

> "[…] there is relatively little evidence that migration has caused statistically significant displacement of UK natives from the labour market in periods when the economy has been strong. However, in line with some recent studies, there is evidence for some labour market displacement in recent years when the economy was in recession."

It finds that

> "[…] displacement effects are also more likely to be identified in periods when net migration volumes are high […]"

and that any effects that exist are likely to be concentrated on low-skilled natives. The report states that

> "[...] the labour market adjusts to increased net migration when economic conditions are good. But during a recession, and when net migration volumes are high as in recent years, it appears that the labour market adjusts at a slower rate and some short-term impacts are observed."

It goes on to remark that:

> "To date there has been little evidence in the literature of a statistically significant impact from EU migration on native employment outcomes [...]"

and

> "[...] where there has been a displacement effect from a particular cohort of migrants, this dissipates over time – that is, any displacement impacts from one set of new arrivals gradually decline as the labour market adjusts, as predicted by economic theory."

The latter statement seems plausible insofar as immigrants are entitled to full unemployment benefits after they have worked in the economy for some time and therefore adopt the higher reservation wages stemming from the availability of the unemployment benefits.

This summary of research may suggest that immigration within the EU has mainly displaced low-skilled native workers. Economic principles suggest that migration has the strongest negative effects on those who are the closest substitutes for immigrants, as stated above. The finding that low-skilled natives have suffered most from immigration depends on whether the immigrants in question are predominantly low-skilled. This is true of some, but not all EU countries. Evidence provided by Ottaviano and Peri (2012) suggests that the main negative effects of new immigrants may be on previous immigrants, as natives and immigrants may be imperfect substitutes even within skill groups for various reasons.

4.4.2 Effects on countries with a net outflow of migrants

Most of the excitement is generated by immigration rather than emigration, but migration has effects on the countries that migrants leave. Poland and others saw waves of emigration after joining the EU in 2004. Since 2009 there have been significant outflows from Ireland, Spain, Portugal, and Greece. There is often concern in these countries that the most able and entrepreneurial workers are leaving, resulting in a brain drain and diminishing the economy's potential for growth. In principle, emigration might be expected to reduce unemployment and raise wages (of the groups of workers who emigrate). Remittances sent back to their country of origin by emigrants are a major source of income in some developing countries. However, although we do not have data on this phenomenon for Europe, the indications suggest that it is not a major factor. The experience of Poland indicates that moderate emigration may have benign effects.

Poland has a long history as a source of emigrants. To some degree, the post 2004 exodus was business as usual. The scale of emigration was nevertheless dramatic. Between 1 May 2004 and 1 January 2008, approximately 6 percent of the population of a working age went abroad. In January 2008 there were 2,270,000 Poles abroad as "temporary migrants", 690,000 of them in the UK, 490,000 in Germany, and 200,000 in Ireland, with the rest mainly in other EU countries. Polish migrants to the UK were disproportionately highly educated, many of them from small towns and villages; while migrants to Germany were relatively less educated.

Kaczmarczyk and Okólski (2008) note that:

> "The outflow of men was more than 50 percent greater than that of women; the loss in males amounted to 4.4 percent of the population, while the loss in females was 2.2 percent. The largest loss according to age was noted in the group 25–29 years, and it stood at 9.3 percent. The other groups lost, respectively: 20–24 years – 8.8 percent; 30–44 years – 3.8 percent; 45+ years – 1.1 percent; and 15–19 years – 0.8 percent."

Young and relatively well-educated men were particularly likely to migrate, especially to countries that did not impose temporary restrictions after Poland's EU accession. Middle-aged and less highly educated men were also inclined to migrate, but they tended to move to Germany, Italy, or the Netherlands.

Before accession, Poland, like many other Central and Eastern European countries, had severe job shortages and high unemployment. The unemployment rate was roughly 20 percent in 2002. The labour market improved steadily thereafter. An improvement was already visible in 2003, and gained additional momentum after May 2004. Between the second quarter of 2004 and the first quarter of 2007 the number of unemployed persons fell from 3.1 million to 1.5 million. In 2007 the unemployment rate fell below 10 percent. The Polish economy grew vigorously after accession to the EU. There is no evidence that out-migration hindered growth. The labour market effects of outward migration per se appear to have been modest, rather in line with the evidence on effects of inward migration in the UK and Germany.

The actual emigration figures were much higher than had been anticipated in various studies financed by the EU in the years before accession. For example, Bauer and Zimmermann (1999) predicted that only 2–3 percent of the population of Eastern European countries would emigrate after EU accession over 10–15 years. Similar estimates were published by Boeri and Brücker (2001).

4.4.3 Migration and social cohesion

This is a report by the European Economic Advisory Group, and most of the analysis here is of the economic causes and effects of migration. However, much of the recent political debate surrounding migration has been propelled by its social implications, not its economic effects.

Examples of the effects of migration abound, but it is difficult to gauge the scale of the phenomena from them. People see jobs being taken by migrants and housing being sold or rented to migrants. They see changes in the shops in their local areas. They may see businesses run by immigrants, employing immigrant workers, and selling services and goods to the same immigrant communities. These businesses may appear to employ workers at less than the minimum wage, which is possible since the immigrant workers believe that they are not eligible for social security benefits if they become unemployed, and are therefore less likely to press for minimum wages to be paid. Similarly, their conditions of work may fall short of legal standards of health and safety. These practices may then undermine the pay and conditions of work of native workers in the same country, creating resentment and opposition to immigration. This kind of scenario is often reported.

At the other end of the scale, namely at the pro-migration end, employers argue that without migration, they would not be able to obtain workers of the right calibre for the job at the right price, or occasionally at any price. These employers may look for high-level skills that are in short supply, e.g. skills in electronics, information technology, and medical research, or they may look for low-level skills, e.g. in agriculture where farms look for seasonal workers to harvest crops, and other sectors where it is often claimed that the indigenous work force is not willing to do the work at reasonable wages. Speaking about the benefits of mobility, Boris Johnson, Mayor of London, pointed out in a speech that the most striking thing about Prince Albert, consort of Queen Victoria and a revered figure who brought Christmas trees and many other charming innovations to the British Isles, had one met him at the time, would have been that he was German. The superior academic performance of pupils in London schools compared with the rest of the UK is attributed to the cultural diversity of the city. It is one of the ironies of the migration debate that opposition to migration seems strongest in areas that have little migration, whereas areas with more migration are relatively relaxed about it.

Societies require some degree of mutual understanding and trust among their members to be able to function satisfactorily. The American sociologist Robert Putnam has labelled this as “social capital”. More social capital, deeper trust and understanding, enables societies to function better. This may explain why some of the small and homogeneous Scandinavian nations have performed so well economically and socially, although they lack the advantages of natural resources possessed by the United States, a more disparate nation. Collier (2013) argues that excessively rapid immigration can undermine trust across society, as a growing presence of recent immigrants with different cultures and practices to those of the native population causes the latter to retreat within itself, “hunker down” in Collier’s phrase, and not cooperate effectively with the new arrivals. Migration tends to introduce new, easily recognised persons into a society. There is a long history of societies – tribes, clans, communities, and states – identifying some group or another as outsiders, and variously giving them less favourable treatment than insiders, treating badly, or expelling them altogether. The instinct to expel outsiders, symbolically purifying the clan, is ancient and seems deep seated; even in modern societies that regard themselves as sophisticated. This accounts for the ease with which hostility to migrants, and particular groups with identifiable characteristics, can be excited, and the tendency of the popular media to use inflammatory language about them. It reflects the tendency of the native population to "hunker down" and the decline in social capital. For these reasons Collier (2013) argues in favour of limiting the pace of immigration, to give time for recently arrived migrants to become absorbed into the host society.

Despite the qualitative and anecdotal nature of the evidence, the social effects of migration exert a powerful influence. Some would even argue that economics has nothing to do with the case. Facchini and Mayda (2008) document the influence of attitudes to migrants on policy towards migration. They find that there is not a total disconnection between economic realities and social perceptions. Data for many OECD countries shows that people with more education and higher incomes, groups who are on the whole more likely to benefit from migration, have more positive attitudes towards it. Given the prevalence of hostility towards migration, they conclude that it is puzzling why countries allow as much migration as they actually do. According to their analysis, the median voter would vote against it, and if democracy worked in a simple textbook way, migration would be prohibited. They argue that, in practice, migration continues because various interest groups who benefit from it, such as business, can lobby effectively for it.

4.5 Migration and the welfare state

Politicians and economists have shown increasing concern about welfare migration, or the idea that migrants are drawn to their country not only because of wage differences, but also because of the benefits of a redistributive state.[11] Following the surge of immigration figures, various countries have hardened their stance on immigration in recent years.

[11] For scholarly debates see Auerbach and Oreopoulos (1999), Borjas (1999 and 2014), Borjas and Trejo (1991) or Sinn (2002).

As all EU countries are democracies that guarantee individual freedom, migration between EU-countries is driven by economic factors. These are predominantly differences in wages, availability of jobs, taxes and availability of public benefits, including transfer payments and freely available public goods.

If the EU countries differed only by their wages, and labour markets were flexible, migration would probably be efficient. As it can be assumed that a person migrates only when his or her annualised migration costs in the sense of pecuniary and non-pecuniary costs of staying abroad (while commuting regularly back home) are lower than the wage increase s/he can realise through migration, migration increases the aggregate EU GDP net of migration costs. In fact, the invisible hand of market forces allocates people across space such that the joint GDP net of objective and subjective migration costs is maximised.

If, however, the countries sustain redistributive tax and expenditure systems that impose a net burden on the skilled, high-wage earners and offer fiscal net benefits to the less-skilled, low-wage earners, migration is distorted, and it can no longer be assumed that the free migration decision maximises EU GDP net of migration costs. States with an above-normal redistributive system attract too few skilled people and too many unskilled. The latter is the deeper reason for the current concern about EU-internal migration in some parts of the EU with well-developed welfare benefits.

In the European Union these concerns have led to provisions that make the direct immigration into welfare states difficult. While each EU citizen has the right to live and work in every other EU state, welfare benefits without work are constrained. Thus a migrant who does not come to work as an employee or be self-employed, but prefers not to work, is not, in principle, eligible for welfare benefits for the first five years of residence. Only after five years does s/he receive a permanent right of settlement and eligibility to the same tax financed social benefits as a domestic resident. Someone who takes on dependent work, on the other hand, is immediately integrated into the fiscal system and must pay all taxes and contributions while participating in all tax and contribution financed benefits available to nationals.

It is debateable whether these provisions are sufficient or appropriate to limit welfare migration, and whether they might even act as a deterrent to useful migration. What is clear, however, is that it makes no sense to ask the blanket question of whether or not migration per se is good or bad. Instead, different judgements and possibly policy reactions are necessary for different types of incentives affecting the migration decisions. Two polar cases are non-working migrants and working migrants.

4.5.1 Non-working migrants

The fact that non-working migrants are fully integrated into the welfare state after a waiting period of five years clearly gives rise to distorted migration incentives, although these incentives are smaller than they would be in the absence of such a period. Consider, for example, a migrant aged 60 who comes with savings sufficient to finance five years of residence. This person will be fully eligible to social welfare at the age of 65, as then s/he will be unable to work and will therefore be entitled to receive a sort of pension in terms of ordinary welfare until his or her death. Given that this "pension" would in many Northern EU states be much bigger than an ordinary wage income at home, there is an incentive for inefficient welfare migration.

As a remedy, a home country principle could be introduced for non-working migrants between EU countries. The basic idea is that all EU countries must take care of their poor in a reasonable way and provide them with satisfactory social benefits. However, they should not restrict the places where these people want to consume their benefits, be it at home or any other country. The migration decision in this case would be strictly welfare enhancing. There would be no welfare migration, but everyone would enjoy the right to migrate to countries where the welfare benefits would buy him or her a higher living standard. Thus, a welfare recipient from Northern Europe could freely move to Southern, poorer countries, consuming his or her benefits there. Arguably, this idea makes the home country principle harmonise well with the EU's basic aim of securing free migration, while the current residence principle discriminates against the migration of welfare recipients from well-to-do countries, given that they would have to be satisfied with the local benefit levels.

4.5.2 Working migrants

It is extremely difficult to come to a similar judgment on the current treatment of working migrants as two basic arguments need to be considered.

The first is the fact that migrants will participate in the pay-as-you-go pension system. As no such system is actuarially fair and all systems involve redistribution from later to earlier generations, it is clear that migrants will normally make a positive net fiscal contribution for the existing population. This contribution is particularly large if immigration is of a permanent dynastic nature. As the immigrants' children will, via their own contributions to the system, take care of the funds needed to finance their parents when old, the first generation's gross contributions to the pay-go system is a net fiscal externality benefitting the resident society (Sinn, 2001). This net fiscal externality, which acts as an entry fee, could be extremely large. In Sinn's words:

> "Obviously, the pay-go system involves a substantial entrance fee for immigrant families, which is a major gain for the incumbent population."

The second concerns the fact that all modern states sustain huge redistribution machinery through the public budget. Every working migrant pays taxes and contributions in proportion to, or even progressively with, his or her income, but participates in the public goods and services that the state provides on more or less equal terms. Thus, migrants with above average skills and incomes tend to be net contributors, while those with below-average skills are net recipients of public resources.

Taking the first and the second consideration together implies that, from a fiscal perspective, high-skilled immigrants definitely benefit domestic residents. Their net pension contributions add to the net contributions in the redistributive state.

For the less-skilled strata of the immigrant population the situation is more ambiguous, as it is unclear whether their net contributions to the pension system are large enough to outweigh the net receipt of benefits from the redistributive state. The answer largely depends on the length of time that immigrants stay in a country, and particularly on whether immigration is permanent in the dynastic sense, or whether immigration is more similar to temporary commuting.

In earlier studies Sinn and Werding (2001) and Sinn et al. (2001) found that in 1997, the net fiscal costs of an immigrant resident in Germany for less than a decade, a valid assumption for most migrants, were 2,367 euros per year. However including long-term immigrants, and assuming that the children of these immigrants would contribute to the pay-go system, they found that, on average, the fiscal net cost of an average immigrant was 726 euros per year.[12]

By contrast, in their study of the fiscal effect of migration into the United Kingdom, Dustmann and Frattini (2014) have found that the fiscal effects of immigrants were positive on the whole, migrants from outside the European Economic Area being among the exceptions.[13]

The difference in these studies could stem from the fact that the UK maintains a less generous welfare system and, perhaps for that reason, attracts far better qualified immigrants than Germany. While 46 percent of immigrants to the UK have a tertiary education, only 21 percent of immigrants to Germany fall into this category, for example.[14] Another reason could be that Dustmann and Frattini (2014), in the absence of better data, have been forced to approach the problem by making a great many assumptions as to how immigrants would participate in certain public expenditure and revenue categories, while Sinn and Werding (2001) were able to base their analysis on the German Socio-Economic Panel, a micro survey from a representative sample of the population residing in Germany. Thus, for example, Dustmann and Frattini (2014) assume that immigrants and domestic residents of the same age living in the same region consume the same amount of health care and social protection, and they allow for systematic deviations between these two groups only to the extent that there are differences in age and place of residence.[15] Sinn and Werding (2001), by contrast, were able to simply count the actual use of medical and social protection among the immigrants and the domestic population without having to resort to theories or assumptions.

Another, more recent study that was also based on the German Socio-Economic Panel is that of Bonin (2014). The author comes to the conclusion that an average foreigner in the year 2012 paid 3,300 euros more in taxes than s/he received in terms of social transfers and free schooling. While this result prima facie seems to confirm Dustmann and Frattini (2014), it in fact does not, as the latter not only take the cost of schooling, but all government expenditure into account. Bonin (2014) mentions that extending his study in a similar way would change the sign of the fiscal balance he calculated, but does not provide the numbers.[16] Adjusting the Bonin calculations for the rest of government expenditure to make it compatible with Dustmann and Frattini (2014) as well as Sinn and Werding (2001) turns Bonin's number into minus 1,800 euros. Even if defence spending were taken out of this figure on the grounds that defence might come close to a pure public good, whose cost is unrelated to the size of the population, the fiscal balance still would be minus 1,450 euros per year. Interestingly enough, in a generational accounting variant of his calculations, Bonin does take all government expenditure into account and finds that in present value terms and over a full lifetime, the average migrant costs the German state 79,100 euros.[17]

An aspect that compounds the difficulties of properly calculating the potential externalities of migration for the domestic population is the existence of natural public goods like forests and lakes, or public goods that were produced a long time ago and that involve only small variable maintenance costs like railways, canals or other parts of the public infrastructure. The free access to such public goods may involve much higher negative congestion externalities for the domestic population that would legitimate a sort of membership fee for the "nation club". Just as a market-equilibrium with freely accessible private clubs and congestion externalities inside the club would not be able to function properly, a migration-equilibrium with freely accessible nation clubs also might not be efficient. Perhaps the net contributions to the pay-go system can be interpreted as such a club fee. There may be some "pure" public goods that do not suffer from congestion externalities, such as national defence, for which costs do not depend on the size of the population. For these goods, inward migration increases the number of taxpayers contributing and lowers the tax burden on each one.

Given the difficulties of properly calculating the relevant migration externalities for countries other than Germany, whose Socio-Economic Panel offers exact empirical data on at least the direct pecuniary costs and benefits accruing to migrants such as taxes, con-

[12] Sinn et al. (2001), p. 227.

[13] They summarise their findings as "[...] when considering the resident immigrant population in each year from 1995 to 2011, immigrants from the European Economic Area (EEA) have made a positive fiscal contribution[...] while Non-EEA immigrants, not dissimilar to natives, have made a negative contribution." They add that: "Notable is the strong positive contribution made by immigrants from countries that joined the EU in 2004."

[14] OECD (2014), p. 48.

[15] See Dustmann and Frattini (2014), pp. 41 and 42.

[16] See Bonin (2014), p. 56.

[17] Bonin (2014), ibidem.

tributions and social transfers, it is hard to conclude this chapter with clear policy proposals for working migrants. By and large it seems to us that the EU is on the right track by defending the four fundamental freedoms: the free movement of capital, services, goods and people.

However, concerning the non-working migrants who receive both net welfare benefits and free access to the existing public goods in the nation club, an abolition of the EU's residence system might be worth considering. After making sure that all EU countries satisfy certain minimum welfare standards, the home country principle might be advisable for non-working migrants. Such a system would not encourage welfare migration, and is compatible with the EU's right of free movement, as welfare recipients would not be constrained from choosing their country of residence by being threatened with a deprivation of their social entitlements.

4.5.3 Evidence on welfare migration

What about the actual experience of welfare migration? Does this appear to have been an important phenomenon in the past? In Switzerland, for example, there appear to have been very few actual "welfare migrants", despite the substantial political discussion of the topic.

Giulietti and Wahba (2012) distinguish between two aspects of the welfare-magnet hypothesis. One is the extent to which immigrants make more use of the welfare system than the native population. The other is the extent to which the existence of generous welfare systems influences the migration decision: whether to migrate and, if so, to which destination. Of course, these two issues are linked, but they are not exactly the same thing.

Do migrants make more use of the welfare system than the native population? The evidence is mixed. Using Swedish data for 1990 to 1996 Hansen and Lofstrom (2003) find that that after controlling for observable characteristics, immigrants use welfare more than natives, but the difference is smaller the longer they have been in Sweden. This contrasts with findings of Borjas and Trejo (1991) for the United States. Riphahn et al. (2010) found that Turkish immigrants in Germany were more prone to welfare use than natives. After controlling for a set of individual and household characteristics, however, the difference is statistically significant only for second-generation immigrants. A review of various studies by Barrett and McCarthy (2008) concludes that the evidence across countries is mixed.

On the question of whether generous welfare benefits induce greater migration, evidence is provided by De Giorgi and Pellizzari (2009), using the European Community Household Panel (ECHP) and the OECD Database on Unemployment Benefit Entitlements and Replacement Rates. Measuring welfare generosity by the net replacement rate, the ratio between the income received when not working (e.g. unemployment benefits) and the average wage, they look at immigration in the EU-15. They find that, although welfare generosity does indeed influence migration decisions, the effect is small. In a study of OECD countries, Pedersen et al. (2008) find that while social networks are an important pull factor for immigrants, welfare – measured by social expenditure in percent of GDP – does not exert a significant role. Thum (1995, 2000), on the other hand, shows that network effects strengthen the long-term effects of fiscal incentives, since via network effects today's migration depends partly on the fiscal and wage incentives of the past. Moreover, the results of Pedersen et al. (2009) might be due to immigration policies that restrict the entry of some types of workers. Examining the skill composition of immigrants, Brücker et al. (2002) find that welfare-generous countries attract low-skilled workers, whilst countries with low social spending are more likely to be a magnet for high-skilled workers, since taxes are also low in these countries. As a result, welfare generosity may induce a negative sorting of immigrants. The skill differences between emigrants from Poland to Germany and those to the UK, who tended to be more highly skilled (which is discussed above in Section 4.4.2), supports the view that welfare generosity induces a sorting of immigrants.

4.5.4 The race to the bottom

While generous public welfare may affect migration, the reverse may also be true: Migration may affect the generosity of public welfare systems. It has been feared that free migration induces a "race to the bottom" in welfare provision. Indeed, this is the result of a large body of public finance literature starting with the work of Oates (1972), Musgrave (1959) and others.[18] While the term "race" may be an overstatement, the redistributive activities of the state are curtailed by clear incentives and legal requirements to keep public budgets under control.

A telling example of this effect is the social reforms of New York's Mayor Lindsey. These reforms made New York so attractive for welfare recipients that poor people from all over the US flooded into the City to reap the benefits. The result was that New York came close to bankruptcy in the early 1970s and had to abandon the programmes.

Allowing unrestricted migration into welfare states has parallels with allowing potential purchasers of insurance to sign contracts after learning whether or not damage has occurred. Of course, the insurance market would collapse under such rules, as no insurer would be able to make profits.

These difficulties point to a fundamental incompatibility among the goals of free migration, social inclusion and sustaining a welfare state. One of these goals may have to be sacrificed or constrained in order for the others to be achievable. As, in our opinion, neither the welfare state nor the right to move freely among the EU member states should be touched, the inclusion principle, regrettably, may need to be diluted, at least in the short term. This is another argument in favour of the home country principle for non-working migrants.

4.6 Conclusions and policy recommendations

Migration has become a major issue in recent years. The enlargement of the EU, with 100 million people from poorer Eastern European countries becoming members, most recently from Bulgaria and Rumania, has put the combination of comprehensive welfare systems based on the inclusion principle and free movement of labour under considerable strain. There is anxiety among the populations of longer-established member states that large numbers of people will migrate to them, putting job prospects, pay, and conditions of work at risk. Less-skilled, lower-paid workers are particularly concerned at this prospect, as they see their jobs under threat.

Moreover, there are fears that the generous welfare state acts as a magnet that will prove particularly attractive to low-skill low-paid migrants. Some of these workers may migrate not to work, but to collect benefits; while for others the decision to migrate into low-paid jobs is incentivised by the redistributive activities of the state, which involve the implicit payment of immigration premia for the less-skilled. By the very definition of the redistributive state, the low-paid are likely to be the net beneficiaries of progressive taxation and public spending.

The public finances of host countries may therefore come under pressure. Migration will also put more pressure on housing markets, raising prices and rents, unless the production of new housing responds sufficiently. Public infrastructure like roads, railways, schools and hospitals may be more congested, at least in the short run before the supply of these goods can be adjusted, but when it is adjusted, marginal congestion costs translate into marginal pecuniary costs of the state.

These are the economic effects described in the literature on the subject. But public animosity and political rhetoric on migration may be fuelled predominantly by other factors, social and political. The lingering recession, high unemployment in many countries, and falling real incomes for low-wage workers, while the rich get richer and richer, is creating a sense of injustice. The larger inflows and outflows of migrants, in this age of greater mobility, create a greater sense of social instability, as greater numbers of new and unfamiliar people move into neighbourhoods. The lack of trust between newly-arrived migrant groups and established residents reduces social capital, and makes society work less effectively. Mainstream politicians are challenged by populist fringe parties with anti-immigration policies, and have been adapting their own policies.

It is a great irony that the EU has too little labour mobility to enable a monetary union to function satisfactorily, but has too much mobility for social harmony and for a redistributive welfare state to operate fairly and at reasonable cost. Successive British governments, which have advocated enlargement of the EU to slow down progress towards ever deeper union, may now feel they are hoist with their own petard.

The evidence on the economic effects of migration suggests that they are in fact relatively modest. Wages fall, but not by much. Unemployment increases in the short run, but labour markets adjust, unless wage ad-

[18] See for example Hettich and Winer (2004), Josselin and Marciano (2004), and Sinn (2003).

justments are hampered by minimum wages; more jobs are created; unemployment falls back to its former levels. A report issued by the British government in 2014 argued that the economic costs are modest at most. It remains true that while costs are modest, immigration redistributes incomes and creates winners and losers.

The effects on public finance are contested. German studies, based on Socio-Economic Panel accounting suggest that migrants are likely to be net beneficiaries, receiving substantially more social benefits and public goods from the welfare state than they contribute in terms of taxes and social security contributions. British studies, based on indirect econometric evidence, find modest effects in the other direction for EU citizens, and the same direction for non-EU citizens.

A factor that tilts the balance in favour of more immigration is the demographic transformation that most European countries face. All EU member states expect old-age dependency ratios to rise over the next fifty years and most will actually have shrinking populations. According to current forecasts, migration is likely to alleviate this problem, but it is important to note that migration from outside Europe is a crucial element here, since internal migration within the EU may redistribute the current EU population more efficiently around the EU, but it cannot offset the EU-wide population decline.

What lessons for public policy can be drawn from these facts? As we showed, migration would be efficient from an overall EU perspective if it were not disturbed by the migration incentives of the redistributive state. Migrants would move up to the point where the "last" migrant enjoyed a wage increase that equals his or her marginal migration cost. If wages reflected marginal productivities, as they would in a perfectly functioning market economy, this condition would ensure an allocation of people across space so as to maximise EU GDP net of migration costs. Under these circumstances, free migration would be efficient.

If the welfare state redistributes incomes, migration decisions will be distorted as low-skilled migrants receive an immigration premium, while high-skilled ones pay an immigration fee. Given that taxes and benefits differ widely across the European Union, excessive immigration of low-skilled people into the Northern European welfare states is likely.

The home country principle for non-working migrants, which keeps the responsibility for welfare payments for a couple of years with the countries of origin rather than the countries of residence, could be a solution. This principle is compatible with free migration, as the welfare recipient has the right to consume his or her benefits in any other EU country. For working migrants, however, the current rules based on inclusion principles should not be changed.

The home country principle is also beneficial insofar as it eliminates the incentive for countries attractive to welfare migrants to curtail their social expenditure, thus inducing the risk of a race to the bottom. Even if in some distant future the EU countries have become equal, such that no net migration will occur in equilibrium, the incentives summarised under the term "race to the bottom" risk would bring about an equilibrium with too little redistribution. The home country principle would eliminate such incentives.

An alternative means of eliminating the forces of systems competition would be the harmonisation of social benefits. However, for the time being such a solution would be very difficult to implement and may actually do more harm than good, given the huge differences in living standards and productivities across the EU. If a common social safety net were to be put in place today in Europe, there is the danger that large swathes of the Union would suffer intolerable levels of unemployment.

Apart from these considerations, the current magnitude of migration from East to West in the EU following the accession of Bulgaria and Rumania are likely to be temporary. They stem from a removal of a barrier to movement. This is more a stock-adjustment phenomenon, than a change in a permanent flow.

The experience of Poland suggests that a large fraction of the migrants from Bulgaria and Rumania may want to return to their home countries when job prospects and wages improve there. The likely return of many migrants in a few years is another reason why some of the current problems may be temporary. As growth returns, unemployment falls, and real wages start to rise again in the future, labour markets will absorb immigrants more effectively, and social problems will recede. Unfortunately, however, the incentives to undercut the welfare of other countries so as not to become a target for welfare migration would remain, unless the home country principle is introduced.

At the same time, there is a case for the EU doing more to speed up the economic development of new member states. The sooner incomes converge across the Union, the sooner the pressure of migration will dwindle. While convergence is a laudable goal, evidence on regions that we discuss in another chapter of this report is not very encouraging.

It is obviously not appropriate to make permanent policy changes to address a short-term issue. EU member states may wish to use the freedoms they currently have under existing EU laws to limit welfare benefits to migrants who have not established permanent right of residence. This will give the electorate the sense that natives cannot be ripped off by welfare tourists, and may stem resistance to migrants.

For the longer term, if free movement continues to lead to unacceptably high rates of net inward migration to some EU members, there are a variety of changes to social welfare systems that can be made. Apart from introducing the home country principle for welfare recipients, it might be wise to strengthen the insurance principle in welfare, and relate benefit payments more closely to contributions into the system. Under such a scheme, there are no distortions from the inclusion principle. Rights to benefits acquired in the various EU member states where a person had made contributions would be portable across the borders, as is the case with social security pensions today. Recipients would be able to take their benefits to whatever state they happened to be residing in. The cost of benefits should be borne by the states that received the contributions. Such a scheme would require a vast amount of data collection across the EU and harmonisation of social security systems, if run centrally. However, such a centralised system is not necessary if claims can be directed towards the countries where they were acquired, regardless of the country of residence.

Member states can use stiffer tests of availability for work as a means of reducing payments to welfare tourists. Of course, this may be one aspect to the "race to the bottom" that one wants to avoid.

One of many complaints about immigrants is that, because they believe that they cannot apply for unemployment benefits if they lose their jobs, they are willing to work for low pay, often below the minimum wage, and under very poor conditions of health and safety at work. In the UK few if any firms have been penalised for paying less than minimum wages, although anecdotal evidence suggests that this practice is widespread. It may be that the UK government is willing to turn a blind eye to the practice. There are two potential solutions to this problem. One option is that governments perform more rigorous tests of availability for work and enforce minimum pay laws, so that native workers are not undercut by migrants who believe they have no welfare rights.[19] The other is that minimum pay laws are abolished and wage setting is returned to market forces. The latter avoids a problem of minimum wages, which is that they risk limiting the availability of jobs for the low-skilled and turn immigration into a direct route into unemployment. However, the abolition of minimum pay laws does not address popular fears that migrants drive down already-low wages even further and undercut the employment of the existing population.

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[19] Textbook analysis predicts that minimum wage laws create unemployment among the low-skilled. But UK experience has been that a modest minimum wage has few if any negative effects on employment while raising the lowest wages in the economy. There is always a danger with minimum wage laws that the level is raised over time and their negative effects dominate.

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Table 4.A.1

Population projections for the European Union

	2013 current population on 1 Jan.	2080 central projection for 1 Jan.	2080 no migration projection
Belgium	11,161,642	16,614,305	10,254,226
Bulgaria	7,284,552	4,925,270	4,798,771
Czech Republic	10,516,125	10,998,397	7,986,243
Denmark	5,602,628	6,792,190	5,128,723
Germany[a)]	82,020,578	65,378,410	50,201,169
Estonia	1,320,174	1,029,443	1,053,324
Ireland	4,591,087	5,895,992	5,395,583
Greece	11,062,508	7,697,872	7,108,055
Spain	46,727,890	47,599,370	30,190,375
France	65,578,819	78,842,668	68,713,709
Croatia	4,262,140	3,471,568	3,022,548
Italy	59,685,227	65,059,083	39,469,771
Cyprus	865,878	1,253,155	717,636
Latvia	2,023,825	1,351,057	1,462,345
Lithuania	2,971,905	1,841,709	2,294,330
Luxembourg	537,039	1,287,296	479,224
Hungary	9,908,798	8,685,213	6,936,101
Malta	421,364	481,567	333,268
Netherlands	16,779,575	16,718,275	14,633,500
Austria	8,451,860	9,562,386	5,964,504
Poland	38,533,299	29,582,117	26,844,419
Portugal	10,487,289	7,113,878	6,367,101
Romania	20,020,074	16,338,339	15,789,732
Slovenia	2,058,821	2,006,508	1,500,376
Slovakia	5,410,836	3,868,254	3,581,459
Finland	5,426,674	6,381,733	4,829,970
Sweden	9,555,893	14,110,527	9,448,922
United Kingdom	63,896,071	85,148,887	64,710,496
Iceland	321,857	467,187	397,561
Norway	5,051,275	8,851,414	5,077,041
Switzerland	8,039,060	11,870,552	6,188,784

[a)] Until 1999 former territory of the Federal Republic of Germany.

Source: Eurostat Europop 2013 population projection.