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MIGRATION POLICY AND THE GENEROSITY OF THE WELFARE STATE IN EUROPE

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Immigration and the welfare state debate

Public debate on immigration has increasingly focused on the welfare state amid fears that immigrants are a fiscal drain. Particularly there have been increasing concerns that welfare-state generosity works as a social magnet to immigrants. Over the last 20 years, Europe has attracted a substantial number of immigrants (26 million) compared with the US (23 million), Australia (1.6 million) and Japan (0.5 million); (Boeri 2010). Europe also devotes a larger fraction of GDP to social expenditure relative to other immigration countries. Indeed, the Table shows that the average aggregate social spending as a percent of GDP for Europe, between 1980–95, was around 21 percent compared to around 18 percent in the US, 17 percent in Canada and 13 percent in Australia. At the same time Europe, on average, attracts more unskilled immigrants relative to the US, Canada and Australia, which have a relatively high skill composition of immigrants.

At first glance this suggests that countries that have generous welfare systems also have relatively more unskilled immigrants, i.e., welfare state generosity acts as a magnet for unskilled migrants. However, the skill composition of immigrants depends on many factors, and in particular on the policy regime – namely whether migration is free or restricted. In other words, the generosity of the welfare state may affect the skill composition of immigrants differently, depending on which immigration policy is adopted. The generosity of the welfare state, that is total govern-

ment spending on social insurance, welfare benefits, social investment and public services, determines the self-selection of potential migrants (supply-side mechanism) and the immigration policy in the destination country (demand-side mechanism).

Previous evidence on the welfare state and immigration

Welfare migration has received considerable attention in the literature, however, with mixed results. Several studies have examined whether welfare-state generosity acts as a magnet for migrants (see Brueckner 2000) for a detailed review. A few studies, focusing on the US, show that high-benefit states have more welfare-recipient migrants than low-benefit regions. For exam-

Table

Immigration and aggregate social spending

Country of immigration	Unskilled as % of total immigration in 2000 ^{a)}	Highly skilled as % of total immigration in 2000	Social expenditure as % GDP: average 1980–95
Austria	47.5	12.7	24.10
Belgium	65.7	18.3	25.18
Denmark	44.8	17.3	25.51
Finland	48.7	23.8	23.96
France	74.6	16.4	25.03
Germany	65.9	21.8	23.28
Greece	44.5	15	15.01
Ireland	13.6	41.1	17.14
Italy	52.9	15.4	19.66
Luxembourg	44.6	21.7	20.18
Netherlands	50.2	22.0	24.88
Norway	22	28.7	20.05
Portugal	59.7	18.6	12.25
Spain	28.7	18.5	18.67
Sweden	34.1	25.7	29.73
Switzerland	54.9	18.6	14.85
UK	34.1	34.9	18.16
Average Europe	46.26	21.8	21.04
Australia	35.3	40.3	12.93
Canada	29.6	58.8	16.91
US	37.9	42.7	17.50
Average AUS, CAN and US	34.27	47.27	15.78

Sources: Docquier, Frederic and Abdeslam Marfouk (2006); OECD, Social Expenditure Database (SOCX).

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ple, Borjas (1999) found that low-skilled migrants are much more heavily clustered in high-benefit states, in comparison to other migrants or natives. On the other hand, Levine and Zimmerman (1999) found no support for the welfare magnet hypothesis in their analysis of moves within the US.

As for OECD countries, again the findings are inconclusive. Pedersen et al. (2008) found only weak and negative results for the welfare generosity on migration flows to 27 OECD countries. However, Peridy (2006) studied migration rates in 18 OECD host countries from 67 source countries and found that the host-source ratio of welfare-state benefits has a significant positive effect on migration. Docquier et al. (2006) studied the determinants of migration stocks in the OECD countries in the year 2000, with migrants from 184 countries, classified according to three education levels. They found that social welfare programs encourage the migration of both skilled and unskilled workers. However, the unskilled are motivated by social expenditure much more than the skilled migrants.

There is little research on the issue of welfare magnets and selectivity of migrants for the European countries. Geis et al. (2008) found mixed effects for welfare generosity on choosing France, Germany, the UK and the US as a country for migration. De Giorgi and Pellizzari (2009) explored the issue of welfare migration across the countries of the pre-en-large-ment European Union and found a significant but small effect of the generosity of welfare on migration decisions, though the effect is stronger for unskilled workers.

One potential reason for the mixed results is that none of those studies control for the migration regime: whether immigration is free or restricted.

The effect of migration regime on the skill composition of immigrants

In a free-migration regime, a typical welfare state with relatively abundant capital and high total factor productivity (implying relatively high wages for all skill levels) attracts both unskilled and skilled migrants. On the other hand, the generosity of the welfare state attracts unskilled (poor) migrants, as they expect to gain more from the benefits of the welfare state than what they expect to pay in taxes for these benefits: that is, they are net beneficiaries of the gen-

erous welfare state. In contrast, potential skilled (rich) migrants are deterred by the generosity of the welfare state. Thus the generosity of the welfare state shifts the migrant skill composition towards the unskilled.

In the restricted-migration regime, these same considerations lead host-country voters to open the door wide to skilled migration and slam the door shut on unskilled migration. Voters are motivated by two considerations: how migration affects their wages, and how it bears on the finances of the welfare state. Typically, unskilled migration depresses the unskilled wage and boosts the skilled wage. The opposite occurs with skilled migration. The effect of migration on the finances of the welfare state is common to all voters of all skills, because skilled migrants are net contributors to the welfare state, whereas unskilled migrants are net beneficiaries. From a public finance point of view, native-born voters of all skills would therefore opt for the skilled to come and for the unskilled to stay away to mitigate the fiscal burden.¹ Hence, there is a need to consider the migration regime when examining the effect of the generosity of the welfare state on migration.

The EU as a case study

The European Union (EU-15) was host to some 20.1 million foreign nationals in 2000–01. Of these, around 6 million people were EU-15 citizens living in another EU-15 member state, i.e. benefitted from free mobility, and some 14.3 million were third-country nationals (around 3.8 percent of the total population of EU 15) who fell in the restrictive immigration regime. The largest group of third-country nationals residing in the EU are citizens of Turkey (2.6 million), followed by Morocco (1.4 million); (OECD 2004). Thus, the European Union countries have been facing intensive immigration pressure. In the meantime, EU countries possess generous welfare systems, though the generosity vary substantially from one European state to another.

We have utilize free-movement within pre-enlarge-ment EU-14 (old core) plus Norway and Switzerland² to examine the free migration regime and compare that to immigration into the EU from two other source-country groups to capture the immigration-restricted regime. We test how the generosity of the

¹ See Razin, A., E. Sadka, and B. Suwankiri, (2011).

² Norway and Switzerland enjoy bilateral agreements with the EU, ensuring free labor mobility.

welfare state affects the skill composition of the immigrants across policy regimes distinguishing between immigration from developed versus developing source countries. We control for the educational quality of immigrants by standardizing cross-country education quality differences using the Hanushek-Woessmann (2009) cognitive skills measure. Since immigrants with the same years of schooling may be treated equally in a points system – although in reality they may vary in their labor market productivity, causing different fiscal burdens – this may introduce a bias in estimates, in particular for LDC source countries. If, on the one hand, immigration policies favor immigrants with higher educational attainment and there is no control for the quality of education, this will overestimate the effect of skill composition for LDC source countries. If, on the other hand, highly educated immigrants are of poor quality, then their productivity will not be that different from the poorly skilled, and they will behave similarly by being net recipients rather than contributors to the welfare state, resulting in an underestimate of the effect of welfare generosity on the skill composition. Thus not controlling for educational quality is problematic since *a priori* it is unknown which way the results would be biased.

Another potential problem is that of endogeneity, i.e. reverse causation between immigration and welfare state generosity. Although we are interested in how the generosity of the welfare state affects immigration and its composition, we know that the relationship can also work in the opposite direction. Immigration might affect the generosity of the welfare state, in particular the level of benefits in the host country, because immigrants can influence the level of benefits. For example, more immigration may lead to lower levels of social spending per capita if migrants are more likely to become unemployed or if migrants come with large dependent families. Thus, we also consider reverse causality in our estimations.

Finally, given that welfare considerations may be one aspect affecting the skill composition of immigrants, we control for the differential returns to skills in both the source and the host country. The higher the returns to skills in the host and the lower the returns to skills in the source country, the more positive is the effect on the skill composition of immigrants (Borjas 1987). In addition, to capture recent immigration policies, we take into account family re-unification schemes, using past immigration stocks, and the number of refugees and asylum seekers admit-

ted, both of which are likely to impact adversely on the skill composition of immigrants. Hence the estimation controls for a battery of other push and pull factors.

The generosity of the welfare state: a social magnet or a fiscal burden?

We have found evidence that the generosity of the welfare state adversely affects the skill-composition of migrants under free-migration (social magnet hypothesis), but it exerts a more positive effect under a policy-controlled migration regime (fiscal burden hypothesis), even after controlling for the differential returns in skills in source and host countries. Interestingly, these results hold for both developed and developing countries, but the effect at first seems to be larger for developed countries. However, once we adjust for educational quality, the effect of welfare-state generosity on skill composition increases for immigration from developing countries and converges to that experienced by immigration from developed countries.

Policy implications

To sum up, our findings suggest that immigration regimes affect the skill composition of migrants. When migration is free as in the case of mobility within the EU, the generosity of the welfare state attracts unskilled immigrants, whilst when migration is restricted and is demand driven by the host country and its voters, immigration tends to be more skilled. One potential implication of those findings is that it provides justification for reasonable restrictions on access to welfare benefits, i.e. being conditional on the payment of contributions, imposed by countries such as the UK for EU migrants who benefit from free mobility.

Another important implication of our finding that under free-migration the generosity of the welfare state acts as a magnet for the unskilled suggests that harmonizing the minimum welfare provision within the EU may be an option to reduce the negative effect of the welfare state on the skill composition of EU immigrants under free-migration.

As for restrictive migration, it is clear from our analysis that immigration policies favoring highly skilled migrants need to take into account educational quality. If immigration countries aim to attract the highly

skilled, then using educational levels as a signal for skill is not sufficient. In other words, a selective immigration scheme based solely on years of education will not be as effective in identifying the highly skilled as a points-based system where ability (language ability and labor market experience) is considered.

Fiscal competition in the EU in the presence of migration

In view of the evidence for the magnet effect within the EU, there is a concern for tax competition among EU members to attract productive migrants. Razin and Sadka (2011) have developed a fiscal competition model which can shed some light on this phenomenon. In their model a group of countries, such as the EU, face upward sloping supplies of skilled and unskilled migrants. The migrants select the host country of residence through both wage and benefit generosity channels. Labor and capital income taxes as well as social benefits are determined in a political economy setup by the majority of the native born voters. Due to a fiscal externality, whereby a voter of a EU type economy does not internalize the fiscal burden his decisions impose on all other countries, there is a disparity between the uncoordinated and coordinated equilibria. Taxes and welfare state generosity are higher in the uncoordinated equilibrium compared with their levels under the coordinated equilibrium. This implies that there is a need for coordination within the EU on both immigration policies and welfare benefit policies.

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