Immigration Following EU Eastern Enlargement

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In the negotiations for EU enlargement, the delicate matter of the free movement of labour is on the agenda this year. As with past enlargements, fears are prevalent within EU member states that massive east-west migration will occur if the free movement of labour is granted swiftly to the accession countries. The huge gap in standards of living, the migration pressure that has built up, and the critical situation in western European labour markets are the problems that must be dealt with. Several estimates of the migration potential after EU enlargement, as it affects Germany or western Europe as a whole, have already been made. (See, for example, Bauer and Zimmermann 1999, European Integration Consortium 2000, or Sinn et al. 2001). Public attention has focused on the projected migration volumes, which for Germany are estimated at between two and six million people over a fifteen year period. In the final analysis, the problem is not the numbers involved, which are very difficult to forecast, but existing economic and legal factors that affect migration.

Special features of migration in Europe

Conventional economic migration theory is based on the experience of countries with a tradition of immigration such as the United States, Canada, Australia or New Zealand, but European migration follows a different pattern. In the above countries, immigration is usually permanent, but within Europe a large portion of migrants can be seen as "commuters". They differ only in the frequency of their trips home, which in some cases can be daily or weekly but normally at least several times a year. Most migrants only work for several years in the host country and then return to their home countries, at the latest for retirement. Studies of a migrant cohort in Germany show that after ten years only 40% still live in Germany and after 25 years only 30%. The remainder has either returned or is deceased.

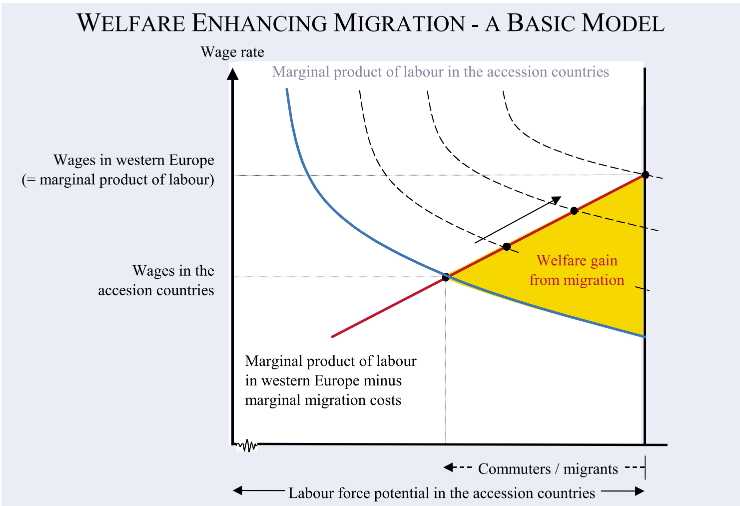
Another special feature of migration within Europe lies in the differing regulations with regard to the migrants' countries of origin. Whereas migration from non-EU countries is strictly controlled and limited, workers and their families within the EU enjoy, in principle, free movement across borders. Migration within the EU cannot be directly controlled but depends solely on individual migration incentives like the relative income situation, the state of the labour market, statutory regulations as well as migration costs.

Advantages of the free movement of labour

From an economic point of view, good arguments exist for the free movement of labour. With flexible labour markets, free mobility ensures an efficient distribution of labour in all countries of an enlarged EU and increases GDP in the Union. The self-regulation of the labour market continuously and optimally adjusts the stock of migrants to the state of economic development in the new member states.

Figure 1 shows that voluntary migration takes place precisely to the degree that is advantageous for both potential migrants and for the economies involved. This fundamental correspondence

Figure 1



Source: Sinn et al. (2001).

between an individual and a social optimum arises in a basic model which, for the purpose of simplification, abstracts from all kinds of government intervention.

Individual migration decisions are based primarily on wage differentials between the home and host countries, adjusted for the cost of travel and other disadvantages that arise from living and working in a foreign environment. Those whose wage advantage is greater than the migration costs will migrate, those for whom this is not the case will stay at home. Insofar as the wage differential adequately reflects the productivity lead of the host country over the home country, free migration leads to the best possible distribution of labour in the countries involved, in the sense that the joint GDP minus the migration costs is maximised. If there are additional pecuniary migration incentives, people will come who contribute less to value added than is necessary to compensate for the loss in value added of the home country and the migration costs. If administrative migration hurdles are established, people will stay at home who would, in the host country, create more value added than necessary to compensate for the migration costs and the loss of value added in the home country.

To the extent that labour productivity and wages in Central and Eastern Europe (CEE) increase with progressing transformation and EU integration, the incentive to work in western Europe will weaken over time and the number of persons for whom wage differences exceed the costs of commuting and living abroad will also decline. For this reason, more and more people will return to their home countries.

The conclusion to be drawn from these preliminary considerations is that labour mobility is an important element of an optimal strategy for system transformation and EU integration of the CEE countries, from which Germany and the other EU countries can also profit (Sinn 2000). This basic tenet must be kept in mind in the following sections when possible problems associated with the granting of unrestricted movement of labour in the EU are discussed.

Potential migration

In a study for the Federal Ministry of Labour, the Ifo Institute estimated the migration volume that Germany might expect after EU enlargement, if full mobility is granted immediately (Sinn et al. 2001, Chapter 1). The estimates were made for the five largest accession countries (Poland, Romania, the Slovak and Czech Republics, and Hungary). The forecast was based on past experience with migration that took place between 1974 and 1997 from Italy, Greece, Portugal and Spain after southern EU enlargement, and from Turkey.

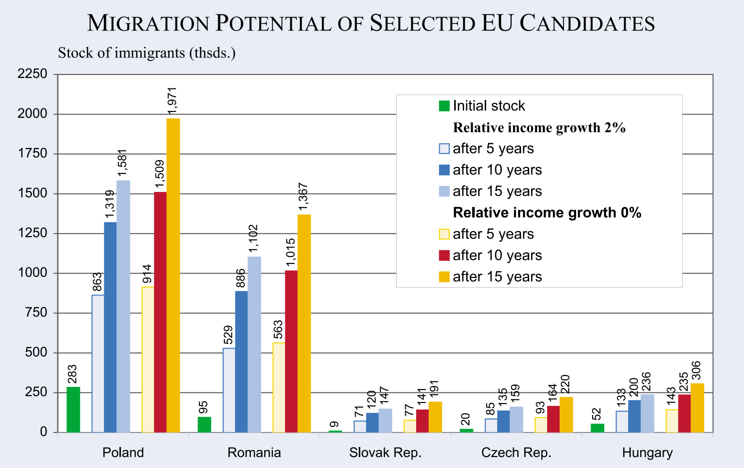
The estimation was based on a panel analysis looking at the determinants of previous migrations both in a cross-section analysis and in longitudinal perspective. The determinants include the following variables:

- *Income gap at purchasing power parity* (measured in terms of the ratio of per capita GDP in the home country to per capital GDP in Germany);
- *State of the labour market* in Germany (represented by an "output gap", see Flaig 2000);
- *Network effects* (measured by the stock of immigrants in the preceding period);
- Dummy variables for *EU membership* and, independently, for the *full mobility of labour.*

A special feature of the approach is the primary determination of the expected stock of immigrants living in Germany, while annual migration flows result from lagged adjustments to the determined stocks. Thus, it takes into account the main difference between the Iberian migrations and the migrations from eastern Europe: Behind the Iron Curtain considerable migration pressure built up which still has not weakened owing to the tightening of immigration restrictions in the EU; migration during the period of the Iberian dictatorships, however, was unrestricted. This simple fact helps explain why the 2% to 3% of the population that migrated during the southern EU expansion cannot be applied one-to-one to forecast eastern European migration (see *Handelsblatt* of 24 April 2001). Such a rule of thumb approach is also meaningless because the gap in real income (at purchasing power parities) between the EU and the Iberian countries was only 30% in 1974 whereas today it is 60% with regard to the five largest eastern European countries (55% excluding Romania).

Figure 2 presents an overview of Ifo's estimates of eastern European potential migration to Germany. The projections consider two scenarios in which

Figure 2



Source: Sinn et al. (2001).

the income gap to Germany either gradually declines (relative income growth of 2%) or remains constant (relative income growth of 0%). The figure shows the projected stock of foreigners of different nationalities living in Germany five, ten, and fifteen years after EU enlargement with immediate full mobility. After fifteen years these stocks will increase from a current 500,000 persons to an estimated 3.2 to 4 million persons. This corresponds to a migrant ratio of about 4% to 5% of the home country populations.

In addition, potential annual net immigration was estimated with an otherwise strictly analogous model. It yields the result that, in the first five years after EU enlargement, an annual inflow of about 200,000 to 250,000 migrants from the five countries can be expected, followed by a gradual decline in annual numbers. However, estimates of the distribution of the projected stock effect over the individual years are less reliable than estimates of the stock effect itself. Actual migration will deviate from these potentials partly because transition periods for the granting of full mobility are being considered and because the precise dates of EU accession are not known. Also, in the final analysis, all forecasts are hypothetical, an aspect often overlooked in the public discussion.

In the meantime, Romania is not expected to be among the first to be granted EU membership, partly because of the migration potential. On the basis of the recommendation of the European Commission, announced after the release of the Ifo study on 8 November 2000, up to eight countries will be included in the first wave of EU membership: Estonia, Latvia, Lithuania, Poland, Slovakia, Slovenia, Czech Republic and Hungary. Data is currently not available to make explicit forecasts for these countries. However, an initial estimate is indeed possible since the countries not explicitly included only comprise 15% of the population of the eight countries. Disregarding the results for Romania, on the basis of our forecast method, a total of between 3.4% and 4.3% of the population of the acceding countries will immigrate to Germany during the first 15 years of EU membership if full mobility is granted. If we multiply this by the population of the eight accession candidates, the result is a longer-term migration potential of 2.5 million to 3.3 million people. It is not exactly clear how these numbers will be distributed over a 15-year period, nor is it clear how they would be reduced in the case of political restrictions.

A comparison with the DIW estimate

The Ifo forecast of the migration potential is higher than that forecasted by the German Institute for Economic Research (DIW) (European Integration Consortium 2000). The DIW results see migration to Germany within a fifteen year period at between 1.8% and 2.4% of the population of the sending countries, and this forecast also includes Bulgaria and Romania. How can the differences in the two forecasts be explained?

The DIW forecast and the Ifo forecast use similar data. In actual fact, an exchange of data between the two institutes showed that the results are mutually replicable. The inclusion of Bulgaria in the DIW study also does not explain the difference. The difference can only be explained by the methodology used in compiling and interpreting the data and, in particular, by the different ways of dealing with the cross-country and longitudinal information (variation across countries vs. variation over time) that is contained in the data.

In contrast to the Ifo Institute, DIW used a fixed-effects estimator which effectively eliminated nearly all of the cross-country information when the coefficients for the forecast were calculated. The remaining time series information produced much lower coefficients for the influence of international differences on migration. The influence of international income differences on the projected migration flows was faded out of the picture (Flaig 2001).

The DIW approach would be more convincing if the matter were one of predicting how an initial migration level shrinks with the passage of time when income in the accession country increases. The result would be that the shrinkage is only small and migration over a period of 15 years is large. But this is not the question.

The more important issue is determining the migration volume that can be expected from the individual countries after EU membership and granting of full mobility, and this is a question of the anticipated cross-country effects. The DIW attempts to estimate the cross-country effects solely with coefficients gained from the time-series information. This is a methodological error. If indeed any data could be suppressed in forecasting the cross-country effects it would be the time-series data but not the cross-country data themselves.

We can only speculate as to the economic reasons for why the cross-country data generate much lower coefficients than the time series data. A plausible hypothesis relates to the old distinction between longer term and cyclical (or permanent and transitory) effects. Annual time series data mostly reflect the cyclical effects, and these effects are small since people rightly consider them to be temporary. If, for example, a cyclical high and low of Spanish income only led to slight changes in migration behaviour, since the Spanish knew that the income changes were only transitory, then the result is, to be sure, a lower estimated coefficient in the DIW method. However, it does not follow that the income gap between Poland and Germany after Poland joins the EU will induce only moderate migration flows. But it is precisely this conclusion that the DIW method produces, since the low coefficient that is gained by observing the cyclical fluctuations in incomes is used for estimating migration from Poland.

Immigration from Poland depends on the anticipated longer-term income gap vis-à-vis Germany. Longer-term differences, however, are especially evident in the cross-country data since people regard the differences from country to country as more permanent than the differences between boom and recession. In the estimation of the Ifo Institute the size of the coefficient used in the forecast is fully determined by the differences between the countries, but in the DIW forecast these differences play only a minor role, apart from an indirect effect that influences country-specific constants.[1]

The true problems of migration

In the public discussion, estimates of potential migration are frequently regarded as threatening, or – if low numbers are forecast – are received with relief. Forecasts of high migration numbers are suspected of supporting the political right whereas low numbers have the smack of conformity with positions of the left. Independent research, however, does not follow a political agenda. If an econometric estimate produces high migration numbers, this by no means implies that migration is regarded as "too high".

As long as migration is only induced by the international wage and productivity differences, and if the labour markets of the host countries are sufficiently flexible and receptive, the total welfare effects of migration are positive. To be sure, redistribution is touched off within the country of immigration since at least in some labour market segments the competition for jobs increases, putting downward pressure on wages. But capital income, rents and wages for complementary types of work increase (Sinn 1992; Borjas 1995). On balance, the inhabitants of the host country always gain, and the gains can theoretically be passed on to all affected.

However, if the conditions on which these welfare gains depend are examined more closely, two problem areas become evident:

- Firstly, the German and Continental European labour markets are not very flexible for a num-

[1] As an illustration, note that according to the DIW approach the long-term rate of immigration to be expected from eastern Europe to Germany is only around 2% of the domestic population. This is lower than the current stock of immigrants from Greece (3.5%) or Turkey (3.4% or, if corrected for naturalisations, 3.7%). The latter example is particularly telling since the estimates for the accession countries relate to a situation of unrestricted labour mobility, while there is no free movement for potential migrants from Turkey.

ber of reasons, and their ability to adjust could be overtaxed by large-scale immigration.

- Secondly, the redistribution measures of western European social welfare states, with their tax-financed social benefits and their extensive supply of public goods, artificially increase the incentives to migrate.

Inflexible labour markets

Western European labour markets are still suffering from high unemployment. Especially in the case of relatively rapid immigration of a large number of additional workers, there is the risk that these workers will partially only crowd out some of the presently employed as a result of the low flexibility of wages. The reduced GDP of the home countries is then not offset by increased value added in the host country, and the migration costs that occur are economically wasted. In addition, domestic workers who lose their jobs, have – because of claims to unemployment benefits – little incentive to return to employment and to contribute to a clearing of the labour market at lower wages.

The key to solving this problem lies in the host countries. The general, and by no means new, recommendation is that the labour markets' ability to adjust must be enhanced (see OECD 1994; European Commission 1998; Sinn et al. 2001, Chapter 2.6). First, a precise analysis of the actual causes of labour market inflexibility is required, the usual suspects being: systems of collective bargaining, labour market regulation, and/or unfavourable incentives of the social-welfare system. Consequently, the agenda for reform would include more decentralised wage agreements, changes in dismissal protection laws and other labour market institutions as well as a reform of unemployment and welfare benefits which should be geared more to a welfare-to-work idea than to rewarding non-employment. In any case, efforts are needed, prior to EU enlargement, to make the labour markets more flexible.

If the remaining time for this is not sufficient, and provided that the risk of job displacement of domestic workers were the only problem involved in granting free movement of labour, a transition phase with temporary constraints on the migration volume would be the only alternative. However, such a dirigiste approach would only be a second-best solution compared to swift reform of the labour market and the immediate granting of free labour mobility.

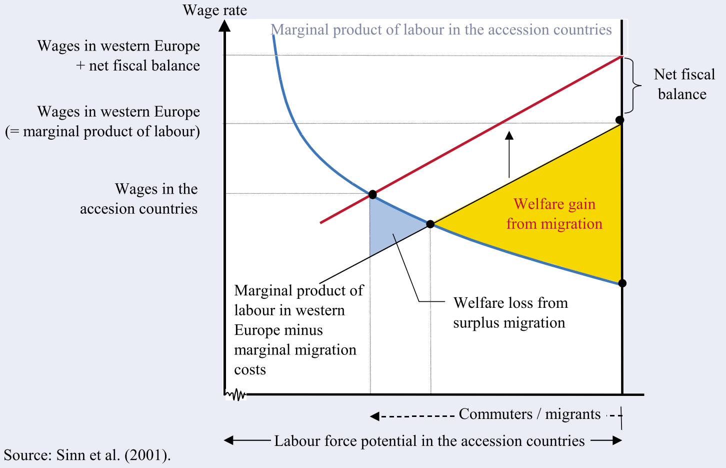
Migration incentives from public redistribution

In the second problem area – the artificial migration incentives given by the redistributing social-welfare state – things are more complicated. Figure 3 shows that the volume of migration is too high from an economic point of view when migrants profit from the redistribution that is practised in the host country. Here, the migrants' "fiscal balance" must be examined, i.e. the sum of social benefits received and the equivalent of all state-provided or financed infrastructure goods minus all financial contributions in the form of taxes and social insurance charges. If this fiscal balance is positive, the effective wage of the migrants exceeds the labour costs and the individual gain from migration is higher than the gain for the economy. Corrected for the migration costs, the additional migrants that would be attracted in comparison to the optimum amount create a lower GDP in the host country than they would have in their home country. A marginal welfare loss is the result.

In practice, the problem is usually such that migrants initially work in low-skilled jobs. They earn below-average incomes for a number of years until they have assimilated and reached the average wage. Since migrants pay relatively low taxes

Figure 3

DISTORTED MIGRATION INCENTIVES FROM PUBLIC REDISTRIBUTION



Source: Sinn et al. (2001).

during this phase but participate in full measure in the tax-financed state spending, they profit from the redistribution of resources from the wealthy to the poor that characterises the tax and transfer systems in western European states.

In the short term this leads to an excessive and, above all, distorted migration volume. Since the artificial element of economic migration incentives is the stronger the lower the migrant's market wage, it is precisely the less qualified who are more strongly attracted. Conversely, the natural, wage-inherent migration incentives for the highly qualified are reduced since they earn above-average incomes and must therefore give the state more in the form of taxes and contributions than they get back in the form of public goods and other services.

In the long term, with large migration flows, considerable fiscal burdens can result which encourage the host country to dismantle its social welfare system so as not to become the target of further migration flows. The danger of an erosion of the western European social welfare state, even threatening redistribution measures that are at the heart of government responsibility, cannot be dismissed.[2]

The magnitude of the problem can be assessed by drawing up a "fiscal balance" of previous migration to Germany, which for persons with a relatively short stay clearly shows a migration premium in addition to the wage differential. The results of a detailed calculation for all major categories of the German tax and transfer system are shown in the table below. The figures are based on data from the Socio-Economic Panel as well as calculations of the Ifo Institute (Sinn et al. 2001, Chapter 4). They show present values for social insurance contributions and benefits, tax payments and tax-financed transfers as well as other state transfers.

During the first ten years immigrants in Germany enjoy an average net fiscal advantage of ca. Euro 2,300 a year. As expected, this benefit declines as the stay lengthens. Whoever lives twenty-five years or longer in Germany pays the state Euro 850 more per year than he receives in benefits. These results show that, from the standpoint of the immigrant who stays a short time, which is typical for European migration, the fiscal net balance is indeed positive, as was assumed in Figure 3. The results confirm (for the past) that, even with the numerous special regulations for foreigners qualifying for social benefits, there is an artificially enhanced incentive to immigrate to Germany and an incentive for the German government to reduce the generosity of its welfare system.

Direct Fiscal Impact of Immigration[a)b)]
– West Germany 1997 –

	Length of stay			Total
	0–10	10–25	25+	
	– in € p.a –			
Revenues				
Health insurance	929	1.144	1.939	1.418
Pension insurance	2.072	2.419	3.236	2.705
Nursing care insurance	129	159	240	188
Unemployment ins.	358	558	712	592
Taxes	3.090	3.091	4.953	3.874
Total revenue	6.578	7.370	11.081	8.776
Expenditures				
Health insurance	1.519	1.187	1.890	1.543
Pension insurance[c)]	696	813	1.088	909
Nursing care insurance[c)]	34	42	64	50
Unemployment ins.	231	341	1.231	692
Tax-financed transfers and benefits[d)]	6.466	6.319	5.953	6.308
Total expenditures	8.947	8.702	10.226	9.502
Balance				
Health insurance	-590	-43	49	-125
Pensions insurance	1.376	1.606	2.148	1.796
Nursing care ins.	95	117	176	138
Unemployment ins.	127	217	-519	-100
Tax-financed transfers & benefits	-3.376	-3.227	-1.001	-2.434
Total balance	-2.368	-1.331	854	-726

a) Numbers in this table only reflect the relative position of a migrant who was living in west Germany in 1997. A direct transference to the expected migrants from central and eastern Europe is not possible since the structure of future migrant cohorts is likely to be different from the migration stock of 1997.
b) Migrants in Germany are persons with non-German nationality, persons whose mother is of non-German nationality, and persons who have been naturalised in Germany; it does not include ethnic Germans who have immigrated from eastern Europe and Russia.
c) Present value of future benefit entitlements (implicit public debt)
d) Transfers to private households and average costs of the provision of public goods.

Source: Sinn et al. (2001).

[2] It is irrelevant whether government-organised redistribution is understood here as the expression of special redistributive preferences over which there is public consensus or whether they are interpreted as the result of a general efficiency-enhancing insurance of risks with regard to life-time income, insurance that cannot (or not completely) be offered by the market (Sinn 1995; 1996).

The solution: Selectively delayed integration into the social welfare system

The traditional western European-style welfare state is incompatible with the free mobility of labour and immediate inclusion of immigrants in the host country's welfare programmes. Since each state will attempt to discourage net recipients of state transfers and to attract net contributors, the foundations of the welfare state are eroded. Competition among social-welfare states is a dumping competition, which, if it is allowed to take place, will lead to the loss of the social achievements of western Europe.

The American example shows the dangers quite clearly. In the United States, freedom and inclusion are guaranteed and government is strongly decentralised. As a result, social-welfare structures along European lines have not been able to develop. In the early 1970s, the generous social benefits granted in New York City proved to be a welfare magnet to the low-skilled and, after the city nearly went bankrupt in 1974, had to be scaled back. A similar phenomenon occurred in California in the 1990s.

In order to protect the welfare state from the erosive forces of competition among countries, either the free movement of labour or inclusion must be restricted.[3] The Ifo Institute considers the free movement of labour to be the more important legal principle and hence recommends a moderate, temporary weakening of the inclusion principle.

To prevent artificial migration incentives and a competition of deterrence measures, the net fiscal balance of immigrants that stay for short periods of time must be equalised. This does not impede the long-term integration of the immigrants and it does not imply the full exclusion of the immigrants from the tax and transfer system of the host country. Such a radical step cannot be considered for the simple fact that most of the infrastructure provided by the state is freely accessible and because the association agreements between the EU and the accession candidates call for an inclusion in the *contribution-financed* benefits of the welfare state. A possible and sufficient way to equalise the fiscal balance is to delay the granting of selected *tax-financed* social benefits. This includes supplemental social assistance, housing benefits, and qualification for public housing. Another possibility is prohibiting the "export" of family benefits to children living in the home country. This has been suggested by Sinn et al. (2001), and, similarly, by the Scientific Council to the German Ministry of Finance (2001).

The key to solutions of this nature, however, lies at the European level. Current law on the free movement of EU labour is supplemented by co-ordinating EU social law, whose overarching principle is the non-discrimination of migrants vis-à-vis the native-born population. In EU law and subsequent court rulings, this principle has always been interpreted such that – with some differentiation with regard to the tax and contribution-financed systems – the regulations of the country of employment primarily determine the social rights of migrants and commuters, including an "export" provision for some social benefits for dependants still living in the home country. Fears of increased migration in the case of previous EU enlargements were dealt with by introducing transitional regulations that restricted the overarching right of free movement. Whoever wanted to migrate received the full status of an EU migrant employee, but many who wanted to migrate were not allowed to enter. They were faced with a maximum of discrimination.

There are no precedents in European law for selectively delayed integration of migrants from the accession countries into the western European social systems but there are also no insurmountable barriers. In the current accession negotiations, this idea has not yet been discussed. There are good reasons for considering this approach, however, also with regard to the traditions and intentions of European integration. Past transitional regulations, which permitted temporary quotas for migrants from acceding countries, are too strong a limitation of the freedom of movement guaranteed by the Treaty of Rome and also mean foregoing possible integration gains. The alternative proposed here will lead to a considerably weaker limitation of personal civil rights. Anyone who wants to is free to come but receives no hand-outs. This will permit a more rapid transition to the completely free movement of labour and will result in

[3] Harmonisation of social benefits in Europe is not possible at the moment because of the considerable income differentials. Harmonised social benefits, which seem appropriate for the richer European countries, would implement high minimum wages in the weaker countries whose consequence would be mass unemployment. This would create many Mezzogiorni in Europe. See Sinn and Westermann (2000).

an efficient self-selection of potential migrants, which is necessary to achieve maximum welfare gains. Dirigiste solutions to the migration problem are not needed in Europe.

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