



Introduction by

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Minister Wiesheu,
excellencies, ladies and gentlemen,

Speaking on behalf of the Ifo Institute for Economic Research at the University of Munich, I also welcome all of you, hoping that we will have a stimulating conference on a topic that is of great importance for Europe. I thank the BMW Foundation Herbert Quandt and its chairman, Kai Schellhorn, as well as all our sponsors for their help and cooperation.

This year's Munich Economic Summit parallels the meeting of the European Council in Brussels where the new EU constitution is to be agreed by the representatives of 25 EU countries. We will have to see whether all parliaments will ratify the constitution and, in particular, which result the British referendum will yield.

Having a constitution is a matter of urgent necessity for Europe. I very much hope it will help to speed up European integration and to move us closer to my childhood dream of a United States of Europe. Even today I am deeply convinced that this is where Europe should go, but I also hope that a United States of Europe will be a liberal Europe. Unfortunately, I see more and more signs that my dreams will not come true. There may neither be a United States of Europe nor may the Europe that will come be similar to the one of which I have dreamt.

The new constitution does not define the United States of Europe. There is still a long way to such a union. But the constitution does give direction. Some people say that the constitution does not imply anything new in addition to what has already been laid down in previous EU treaties, including the Treaty of Maastricht. I do not share this view. If it were right, we would not need a constitution. Even though there

are no radical changes, the constitution has the important function of ennobling some of the European rules and regulations, making them superior to others. The constitution narrows the scope of interpretation in cases where the existing rules are vague, and it ranks the rules that are potentially conflicting.

Important examples of what I mean are articles I-4, I-8 and II 34 that define the basic rights of EU citizens. I cite from these articles:

- ... any discrimination on grounds of nationality shall be prohibited ...
- ... every national of a Member State shall be a citizen of the Union ...
- ... Citizens of the Union shall have the right to move and reside freely within the territory of the Member States ...
- ... the Union recognises and respects the entitlement to social security benefits and social services ...
- ... Everyone residing and moving legally within the European Union is entitled to social security benefits and social advantages ...
- ... the Union recognises and respects the right to social and housing assistance so as to ensure a decent existence for all those who lack sufficient resources ...

These articles will greatly affect the future of Europe. The non-discrimination clause together with the explicit social inclusion rights and the right of free residence will reinforce the evolution towards a Social Union of Europe that, according to experts in EU law, has already started in the past due to various EU directives and decisions of the European Court of Justice.

For many, Social Union is the next logical step after Economic Union and Monetary Union. From a German perspective, however, I hesitate to follow this logic, as the social union of Germany has not been a success. The social union has meant that the German welfare state created excessively high replacement incomes in east Germany like social

assistance, unemployment benefits and early retirement benefits that have pushed up the wage scale. The welfare state's replacement incomes are minimum wages. If these minimum wages exceed labour productivity, the result is unemployment. East Germany has been suffering from mass unemployment which is intensifying year by year, and there has been no convergence of the two parts of the country since 1997. In fact, the gap between east and west Germany has been widening. I attribute the economic failure of German unification primarily to the social union which has made the welfare state into a competitor of private business in the labour market. Private business is losing the contest. Since the competitor has to be paid for with west German taxes, even the west German economy has been suffering from this development.

If Europe establishes a social union of the German kind with harmonised replacement incomes throughout the continent, there will be twenty regions like east Germany in Europe. No one can afford that.

Thus, the social union for which the constitution paves the way, can only be one with non-harmonised welfare benefits whose size is determined by each individual country. However, as the theory of fiscal competition has demonstrated very clearly, it is not possible to maintain the European welfare state when there is free migration, full social inclusion as defined by the Constitution and separate policy decisions of individual states. The reason is that welfare states are magnets that attract poor people who receive more resources from the state than they pay in terms of taxes and social security contributions. By attracting the needy, the welfare state will not be able to keep its expenses under control. Thus there will be a kind of competition of deterrence among the welfare states where each state scales down its benefits so as not to become the target of poverty migration. With all countries behaving in a similar way, the welfare state will erode and shrink far below its efficient size, whatever that is.

Europe will become more like the United States of America in this respect. Remember New York City. John Lindsay, the mayor of the city of New York had implemented a generous welfare program in the sixties in order to get the poor off the streets and help calm down social unrest. However, as a result of his policy, New York attracted the needy from all over the United States and the city was almost driven into bankruptcy. In 1975, the programme had to be aban-

doned because the banks were no longer willing to extend credit to the city. The Washington D.C. welfare program suffered a similar fate.

I do not want to be misunderstood if I point to these problems. I am not arguing that migration is a danger and that we should impose constraints on migration flows. Migration as such is a good thing for Europe. To the extent that migration is driven by wage differences, it improves the allocation of labour in Europe, because wage differences reflect productivity differences. It is good that people migrate from low productivity to high productivity countries, because this will generate additional GDP growth for Europe. In particular, mass migration from eastern Europe to western Europe is necessary to efficiently allocate the available labour force to the various countries during the transition phase until the eastern countries will have caught up with the west. There is nothing wrong with migration as such.

Neither am I saying that the forces of systems competition will necessarily imply large migration flows. In a symmetrical world of similarly advanced countries with perfect labour mobility, there would be no visible migration, but nevertheless the forces of systems competition would be eroding the welfare states.

What I am saying, however, is that, from the point of view of the theory of fiscal competition, it is hardly possible to construct Europe along the lines prescribed by the draft constitution. Free migration, full social inclusion and the maintenance of the European welfare state are three goals that simply cannot coexist. One of these goals has to be sacrificed.

EU politicians are not following this logic. They tend to downplay the problems, arguing that we are far away from inclusion rights that would trigger the erosion of the welfare state. The truth of the matter is, however, that we are already in the middle of welfare state erosion in Europe. For me, Agenda 2010 is only one step among many that are coming. Competitive forces take decades to take effect, but they are strong and persistent.

It is true that such erosion should be welcomed to some extent. Maybe eastern enlargement and the migration flows resulting from it will be the Trojan Horse for Europe through which the fighters against an exaggerated welfare state will enter, as Michael Burda once argued. However, I would rather prefer

a planned reform of the welfare state, as the forces through which the erosion is to work are not overly convincing.

There are three kinds of forces that must be distinguished.

First, there is direct migration of employed people into the welfare state. This migration is one of the fundamental rights of the EU, and in fact the EU has experienced massive labour migration of this kind over the last thirty years. Migration of workers has been a direct migration into the welfare state because the migrants have less than average productivity, earn less than average wages and are therefore beneficiaries of the redistributive activities of the welfare state. They pay taxes and contributions but receive more public resources from the state than they paid for. According to a study by the Ifo Institute, in 1997 the average migrant, who had been in the country for less than ten years, received a gift of about €2,400 per year. This average migrant includes the people in the workforce, their non-working relatives and just everybody who happened to live in Germany. The sum is enormous. For a family of five it amounts to €118,000 over ten years. People, who stay longer, receive less from the state because their productivity and wages are higher, but only those who stay in Germany for more than 25 years are net contributors to the government budget. Unfortunately, however, there are not so many of them, since 80 percent of the immigrants had died or had left the country 25 years after entry.

The second erosive force is indirect migration into the welfare state by crowding out nationals from their jobs. This kind of migration has been the reality in Germany for three decades at least. From 1970 to 2002 there was net immigration into Germany of seven and a half million people. Of these about 3.1 million found official employment. The increase in unemployment among nationals over that same period of time happened to be nearly the same, namely 3.2 million.

Germany has been unable to provide the immigrants with additional jobs. Because of wage rigidity at the lower end of the income scale, which itself has been caused by the replacement incomes paid by the welfare state, immigration was unable to stimulate the creation of additional jobs. There would have been more jobs only if politics had accepted declining wages, because only declining wages induce employ-

ers to create more jobs. Because of wage rigidity, there was indirect migration into unemployment. The immigrants took the jobs, and instead of entering low wage competition that could have resulted in declining wages and additional jobs, the nationals preferred to sit down in the easy chairs offered by the welfare state.

Indirect immigration into unemployment has also been indirect immigration into the welfare state. The benefits of the welfare state have kept wages high. That attracted excessive immigration. And the increasing unemployment among the domestic population incurred substantial budgetary costs for the state.

The third kind of welfare migration has been the least important, but things may change. It is the migration of non-employed (inactive) people, including students, pensioners and others. This type of welfare migration has not been quantitatively important in the past, since non-working foreigners who applied for welfare could be denied the right of residence. Under current German law, they can be sent back to their home countries.

Things have indeed changed, as on May 1st of this year the new Directive on Free Movement became European law. That directive has to be implemented into national law by May 2006. It gives an immigrant the right of residence for up to five years if he or she can show sufficient resources so as to make it unnecessary to apply for social aid for the planned period of residence and if the immigrant has health insurance coverage.

There are two points where the directive differs from current German law and where German law and the law of a number of other countries will therefore have to be changed.

First, the immigrant will have the permanent right of residence after five years, even if he has no resources to live on. He will then be fully entitled to all the social benefits that are granted to nationals. An immigrant family with two children planning to stay in Germany for fifteen years will therefore be entitled to ten years of social benefits, which under current conditions would amount to more than €180,000, undiscounted.

Second, it is impossible for the host state to shorten the time of residence to less than the period granted

upon entry if the immigrant becomes needy and claims social aid, unless the claim is unreasonable. However, it is the government's responsibility to prove that the claim is unreasonable.

These two changes are substantial, but they have passed without any notice being taken in the European public debate. They imply that the door of the welfare state has been opened further. There is not only the direct immigration of working people into the welfare state and the indirect immigration of working people insofar as they push domestic residents into unemployment. There is now also the possibility of a direct migration of non-employed people into the welfare state.

All in all, this means that Europe will be subjected to the destructive forces of deterrence competition among its welfare states that I described above. I therefore expect a gradual erosion over the next few decades. And I also expect tendencies to harmonise minimum standards for social benefits in Europe with the consequences for wage equalisation and increasing unemployment that I described.

Neither of these expectations is pleasant. Both raise doubts about the wisdom behind the new draft constitution and the paragraphs I cited. The fathers and mothers of the constitution certainly wanted to preserve the social framework of European society, but I am afraid that they might contribute to its destruction instead.

As I said, the welfare state, social inclusion and free migration are three goals that are incompatible. One has to be sacrificed.

If we do nothing, the European welfare state is likely to erode. If we want to preserve the welfare state, we will have to sacrifice either free migration or the inclusion principle. As a ban on free migration of the type Germany has enacted for the countries of eastern Europe is detrimental to European growth, I would opt for a limitation of the inclusion principle.

The principle of selectively delayed immigration, as suggested by the Council of Advisors to the German Ministry of Finance and the Ifo Institute, is one useful kind of limitation. The principle says that immigrants pay taxes and social security contributions and in turn receive all contribution-financed benefits and have free access to the public infrastructure. However, certain tax-financed social benefits such as

social aid and subsidised housing will not be granted for a transition period. In fact, Ireland and Great Britain have recently adopted a variant of this principle.

I would apply the principle of delayed integration to employed people, and in addition I would apply a home-country principle to non-employed people. Everyone can freely migrate, but if he does not work in the host country, the home country remains responsible for welfare benefits. With these provisions, Europe would be liberal and social at the same time, as the erosive forces of systems competition would effectively be banned.

This is my personal view on the matter, and I am sure that not all of you will share it. There is ample time during this conference to discuss the issues and exchange diverging views.

We have three main sessions that will touch upon this and other topics:

The first session deals with the problem of deterrence competition among the welfare states as such. The second will address the question of whether migration constraints could be the right means to prevent welfare erosion. The third will address the problem of migration into unemployment as described above, and thus the problem of indirect migration into the welfare state.

We have competent academic speakers to clarify the issues, and we have first-rate politicians and business leaders to comment from their perspectives. And then we have you, dear guests. We expect all of you to participate actively in the debates, and I am confident that there will be plenty of time for plenary discussions.

Thank you very much for your attention.

Appendix

New Legal Framework for Immigration into the Welfare State

Selected articles taken from the Directive 2004/38/EG of 29 April 2004 published in the Official Journal of the European Union No. L 158 on 30 April 2004

Text of the Directive:	Comments:
A. Right of residence for up to three months	
<p>Article 6 (1): “Union citizens shall have the right of residence on the territory of another Member State for a period of up to three months without any conditions or any formalities other than the requirement to hold a valid identity card or passport.”</p>	<p>During this initial period, entitlement to social assistance in the host country can be excluded in some cases by national law. This follows from the considerations laid down in the preamble of the Directive:</p>
<p>Preamble, No. (21): “However, it should be left to the host Member State to decide whether it will grant social assistance during the first three months of residence, or for a longer period in the case of job-seekers, to Union citizens other than those who are workers or self-employed persons or who retain that status or their family members, or maintenance assistance for studies, including vocational training, prior to acquisition of the right of permanent residence, to these same persons.”</p>	<p>Exclusion is possible only in the case of individuals who are inactive or self-employed persons. The specific rule by which they can be excluded from receiving social assistance (only!) during the first three months of their stay reads as follows:</p>
<p>Article 24 (2): “By way of derogation from paragraph 1, the host Member State shall not be obliged to confer entitlement to social assistance during the first three months of residence or, where appropriate, the longer period provided for in Article 14 (4) (b) [i. e., job-seekers], nor shall it be obliged, prior to acquisition of the right of permanent residence, to grant maintenance aid for studies, including vocational training, consisting in student grants or student loans to persons other than workers, self-employed persons, persons who retain such status and members of their families.”</p>	<p>With respect to the category of persons and the period of time defined here, there is no “equal treatment” with nationals that is otherwise required by Article 24.</p>
<p>Article 14 (1): “Union citizens and their family members shall have the right of residence provided for in Article 6 [for up to three months], as long as they do not become an unreasonable burden on the social assistance system of the host Member State.”</p>	<p>Nevertheless, even during this initial period of residence expulsion is possible only if individuals become an “unreasonable” burden on the host country’s social assistance system, not a burden as such (see below).</p>
B. Conditions for a right of residence for more than three months	
<p>Article 7 (1): “All Union citizens shall have the right of residence on the territory of another Member State for a period of longer than three months if they: (a) are workers or self-employed persons in the host Member State; or</p>	<p>Rules regarding longer stays are clearly more important. Employed persons have a right of residence subject to no further conditions. For other individuals, the right of residence is subject to a proof of having “sufficient resources” and comprehensive sickness insurance cover, as in the</p>

<p>(b) have sufficient resources for themselves and their family members not to become a burden on the social assistance system of the host Member State during their period of residence and have comprehensive sickness insurance cover in the host Member State; (...)"</p>	<p>pre-existing law. Closer examination reveals, however, that these conditions have now been weakened.</p>
<p>Article 8 (1): "Without prejudice to Article 5 (5), for periods of residence longer than three months, the host Member State may require Union citizens to register with the relevant authorities." Article 8 (4): "Member States may not lay down a fixed amount which they regard as 'sufficient resources', but they must take into account the personal situation of the person concerned. In all cases this amount shall not be higher than the threshold below which nationals of the host Member State become eligible for social assistance, or, where this criterion is not applicable, higher than the minimum social security pension paid by the host Member State."</p>	<p>After three months, individuals can be required to register and give proof that they satisfy the relevant conditions (cf. Article 8 (3)). However, the term "sufficient resources" shall not defined as a fixed amount in national law. Furthermore, no criteria are being given for how to determine the relevant amount of resources taking into account the "personal situation of the person concerned". Clearly, any specific requirement would have to be made transparent before, and eventually accepted by, the ECJ.</p>
<p>Preamble, No. (31): "This Directive respects the fundamental rights and freedoms and observes the principles recognised in particular by the Charter of Fundamental Rights of the European Union. In accordance with the prohibition of discrimination contained in the Charter, Member States should implement this Directive without discrimination between the beneficiaries of this Directive on grounds such as sex, race, colour, ethnic or social origin, genetic characteristics, language, religion or beliefs, political or other opinion, membership of an ethnic minority, property, birth, disability, age or sexual orientation."</p>	<p>There may be yet another restriction: It is unclear how absence of discrimination with respect to property, a fundamental commitment stated in the preamble of the Directive, could interfere with a personalised definition of sufficient resources. An extreme implication could be that denying individuals with few resources the right of residence is effectively impossible. In any case, there is a conflict here implying that the amount of resources required for a given individual may have to be set substantially below the social assistance threshold.</p>
<p>Article 14 (2): "Union citizens and their family members shall have the right of residence provided for in Articles 7, 12 and 13 as long as they meet the conditions set out therein. In specific cases where there is a reasonable doubt as to whether a Union citizen or his/her family members satisfies the conditions set out in Articles 7, 12 and 13, Member States may verify if these conditions are fulfilled. This verification shall not be carried out systematically." Article 14 (3): "An expulsion measure shall not be the automatic consequence of a Union citizen's or his or her family member's recourse to the social assistance system of the host Member State."</p>	<p>The condition of having sufficient resources is relevant during a period of residence of up to five years. Verifying whether it is met is possible if there is "reasonable" doubt, but there shall be no systematic checks. In principle, EU citizens are given access to the host country's social assistance system from the very beginning, even though this entitlement is temporarily suspended through the condition of holding sufficient resources (cf. Article 24 (1) below). If resources are being run down faster than expected, claiming social assistance benefits is not in itself a legitimate reason for expulsion (as with Article 6).</p>
<p>Preamble, No. (16): "As long as the beneficiaries of the right of residence do not become an unreasonable burden on the social assistance system of the host Member State they should not be expelled. (...)"</p>	<p>This is again evident from the Preamble: Expulsion of individuals claiming social assistance benefits is the exception rather than the rule, restricted to the case where paying benefits is an</p>

	<p>“unreasonable burden”. Claims that are reasonable are justified. There are no criteria for what would be unreasonable. In the case of a dispute, the host country would have to prove that specific claims are unreasonable.</p> <p>In the future, Article II (34) of the EU Constitution would have to be taken into consideration stating that non-employed persons are entitled to full inclusion in their host country’s social protection system.</p> <p>Expulsion is in no case possible in the following two cases C and D:</p>
C. Special regulations regarding employed persons	
<p>Article 14 (4):</p> <p>“By way of derogation from paragraphs 1 and 2 and without prejudice to the provisions of Chapter VI, an expulsion measure may in no case be adopted against Union citizens or their family members if:</p> <p>(a) the Union citizens are workers or self-employed persons, or</p> <p>(b) the Union citizens entered the territory of the host Member State in order to seek employment. (...)”</p>	<p>First, expulsion is ruled out if individuals have the status of employed persons,</p> <p>also in the case where they are seeking employment (not necessarily being entitled to social assistance benefits in this sub-case, cf. Article 24 (2) above).</p>
<p>Article 7 (3):</p> <p>“For the purposes of paragraph 1 (a), a Union citizen who is no longer a worker or self-employed person shall retain the status of worker or self-employed person in the following circumstances:</p> <p>(a) he/she is temporarily unable to work as the result of an illness or accident;</p> <p>(b) he/she is in duly recorded involuntary unemployment after having been employed for more than one year and has registered as a job-seeker with the relevant employment office;</p> <p>(c) he/she is in duly recorded involuntary unemployment after completing a fixed-term employment contract of less than a year or after having become involuntarily unemployed during the first twelve months and has registered as a job-seeker with the relevant employment office. In this case, the status of worker shall be retained for no less than six months;</p> <p>(d) he/she embarks on vocational training. Unless he/she is involuntarily unemployed, the retention of the status of worker shall require the training to be related to the previous employment.”</p>	<p>What also matters in this context are the rules by which the status of an employed person can be retained for an extended period of time.</p> <p>In particular, the fact that after one year in employment the status of an employed person is retained, effectively implies a right of permanent residence even in the absence of sufficient resources. The only restriction is that individuals have to register as unemployed (and may thus be required to accept a new job that is offered).</p>
D. Right of permanent residence	
<p>Article 16 (1):</p> <p>“Union citizens who have resided legally for a continuous period of five years in the host Member State shall have the right of permanent residence there. This right shall not be subject to the conditions provided for in Chapter III [i.e., Articles 6–15, among these the existence of sufficient resources and comprehensive sickness insurance cover].”</p>	<p>Second, expulsion is ruled out if individuals have acquired a right of permanent residence. Formally, this right is granted after a maximum of five years of legal residence without interruptions of more than six months per year. (Only in the case of absence of two or more years in continuity is the right lost).</p>

	After five years, a right of permanent residence is also given to persons who are not employed. It is granted without any further conditions, even if these individuals do not have sufficient resources or comprehensive sickness insurance cover.
<p>Article 17 (1):</p> <p>“By way of derogation from Article 16, the right of permanent residence in the host Member State shall be enjoyed before completion of a continuous period of five years of residence by:</p> <p>(a) workers or self-employed persons who, at the time they stop working, have reached the age laid down by the law of that Member State for entitlement to an old age pension or workers who cease paid employment to take early retirement, provided that they have been working in that Member State for at least the preceding twelve months and have resided there continuously for more than three years. If the law of the host Member State does not grant the right to an old age pension to certain categories of self-employed persons, the age condition shall be deemed to have been met once the person concerned has reached the age of 60;</p> <p>(b) workers or self-employed persons who have resided continuously in the host Member State for more than two years and stop working there as a result of permanent incapacity to work. If such incapacity is the result of an accident at work or an occupational disease entitling the person concerned to a benefit payable in full or in part by an institution in the host Member State, no condition shall be imposed as to length of residence;</p> <p>(...)”</p>	<p>Employed persons who entered the host country before reaching the statutory retirement age have a right of permanent residence, and are thus entitled to receive social assistance benefits, as soon as they reach this age threshold. A minimum period of stay before this entitlement becomes effective is specified only for the case of early retirement (three years of residence, at least twelve months in employment).</p> <p>In cases of incapacity to work, the right of permanent residence is also granted after fewer than five years of stay (in principle, after two years; without any time limit if incapacity to work is a consequence of work injury or occupational disease giving rise to a related benefit entitlement in the host country).</p>
<p>Article 24 (1):</p> <p>“Subject to such specific provisions as are expressly provided for in the Treaty and secondary law, all Union citizens residing on the basis of this Directive in the territory of the host Member State shall enjoy equal treatment with the nationals of that Member State within the scope of the Treaty. The benefit of this right shall be extended to family members who are not nationals of a Member State and who have the right of residence or permanent residence.”</p>	After a maximum of five years, Union citizens are thus entitled to claiming all kinds of benefits that the Welfare State offers its nationals.

Excerpt by Ifo Institute, Munich.