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Immigration and the welfare state
Introducing four papers

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Abstract:

Immigration from a LDC to a DC is potentially advantageous for both immigrants and the natives and hence for the world. However, the conditions for the potential to be fully realized are strict. Welfare states normally have a refugee orientation that promotes adverse selection of immigrants, and an institutional setup that gives small incentives to work. In such cases the welfare gain is still large for the immigrant; but it changes to become negative for the natives. Aspects of these mechanisms are discussed in the four papers included.

Keywords: Immigration, welfare state

Jel: F22, J41, J70, O15

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One of the most controversial issues on the political agenda all over the rich DC world is the pressure of immigration from the poor LDC world. It involves a tangle of complex problems, rising issues that are both humanitarian and economic. This introduction summarizes four papers dealing with economic aspects of the tangle: Blume and Verner (2006), Borooah and Mangan (2006), Nannestad (2006), Wadensjö (2006). The papers will be organized by a simple framework, presented in Chand and Paldam (2006),[2] which allows the calculation of gains and losses of the parties involved: the immigrant and the natives.[3]

The first observation is that the immigration of people from LDCs to DCs is a potential advantage for both parties. When the immigrant is accepted in DC at time $t = 0$, he ideally shifts from a low LDC wage (w_L) to a high DC wage (w). The DC natives gain the excess production (z) of the immigrant over his wage. Both potentials are substantial. They are also easy to calculate:

The potential gain for the immigrant is $PV_0^{\infty}(w - w_L)$, the present value of the wage difference from $t = 0$. It is the discounted area between the two wage-curves on Figure 1. For typical values of the variables this comes to about $ 1 million. The potential gain for the natives is $zPV_0^{\infty}(w)$, i.e. z times the present value of the DC wage.[4] If we take $z \approx 0.25$ the typical potential gain of the natives is in the order of $ 0.3 million. Both potential gains are positive giving a net welfare gain to the world of $ 1.3 million.

For the potential to be realized two aspects are crucial: (1) The selection of immigrants and (2) the package of institution encountered be the immigrants, when they are permitted to enter. In both respects countries differs widely.

Borooah and Mangan (2006) looks at the immigration country Australia where the institutions are made to generate the full potential. Essentially Australia selects skilled immigration, which can easily fill vacant jobs. Everybody else is kept out. It is demonstrated that the policy works as intended.

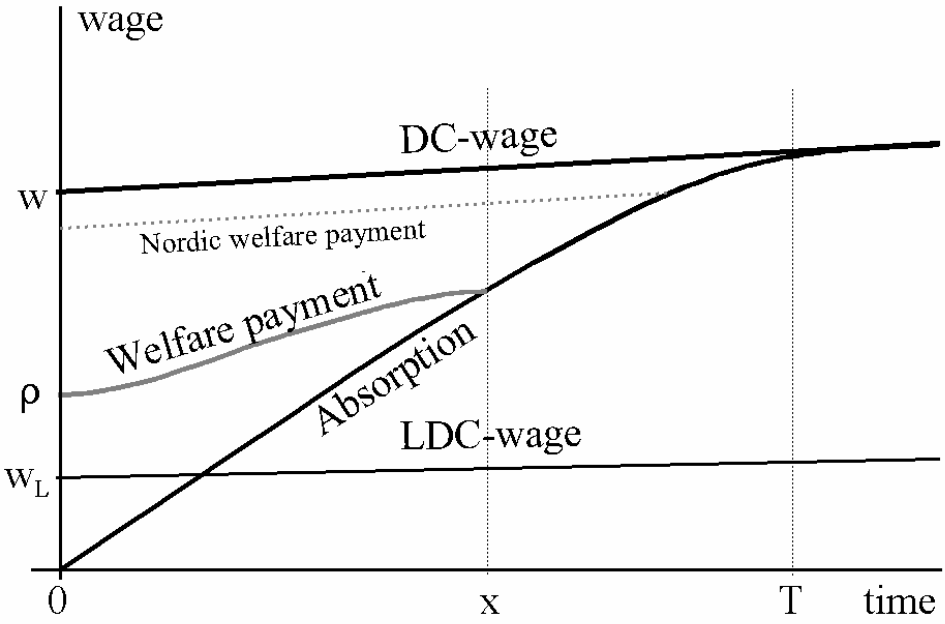
In Western Europe – and notable in the welfare states – immigrants are not selected for economic, but for humanitarian reasons, see Hatton and Williamson (2006). Four groups enter: (1) Refugees, who convince the appropriate bureaucrats in either UN or the recipient country that they have a "*well founded fear of prosecution*." (2) Family of accepted immi-

2. The reader may find that the calculations made are presented in a rather cavalier fashion. However, Chand and Paldam (2006) gives all assumptions and calculations.
3. The third part, i.e. the LDC, is disregarded. This may be justified in two ways: (i) the LDC may be a labor surplus economy, and (ii) the loss may be offset by remittances.
4. As the DC has restrictions on immigration the product of the marginal immigrant is larger than his wage, and it is still larger for the average immigrant.

grants, who are granted "*family reunion.*" (3) Some others, who manage to seep through the barriers and become accepted after some time. (4) Skilled persons, who are applied for by firms needing their labor.[5] In addition to the selection of the recipient country there is also an element of choice on the immigrant side. If he has high labor market value, he may want to go to countries where he knows the language and can get a job quickly. If he has low labor market value he may prefer countries where social support is high. So the selection process works both on the supply and demand side, to provide the welfare countries with immigrants which are relatively difficult to absorb in the labor markets.

In addition to the adverse selection the institutions of the welfare state negatively affect absorption, as will be discussed. Nannestad (2006) surveys attempts to analyze both effects. These institutions were developed for natives in a closed labor market well before substantial immigration started. When these institutions are applied to the new situation they have the effects shown on Figures 1 to 3.

Figure 1. The economics of one immigrant from a low wage to a high wage country



The analysis starts on Figure 1. It has two wage rates, the high DC wage, *w*, and the low LDC wage, w_L. Two additional curves – *absorption* and *welfare payment* are added:

5. The dominance of the other three categories normally makes it quite difficult for skilled people to be granted entry. They are parallel to the Australian case.

A*bsorption* shows that immigrants, who are not selected for economic reasons, need time to be absorbed in the labor market. Till then they have a higher unemployment rate than natives. On the figure the labor market starts at zero (for $t = 0$) and reaches w at $t = T$. The paper by Blume and Verner (2006) estimates part of the absorption curve by looking at the duration of welfare payments to immigrants in Denmark. Even when the data are not long enough to show the full curve it is obvious that full absorption takes several generations. The calculations in Chand and Paldam put $T = 40$ to 60 as the typical orders of magnitudes in Nordic countries. This is amazingly high numbers, having a strong influence on the results.

The w*elfare payment* curve shows the excess transfers to immigrants before they are absorbed. The solid gray line gives the standard case of a low minimum rate, and an insurance element, where the support rate goes up as the immigrant earns up insurance coverage, as shown. The more generous welfare payments in the Nordic welfare states are also shown.

Figure 2. The gain of the immigrant

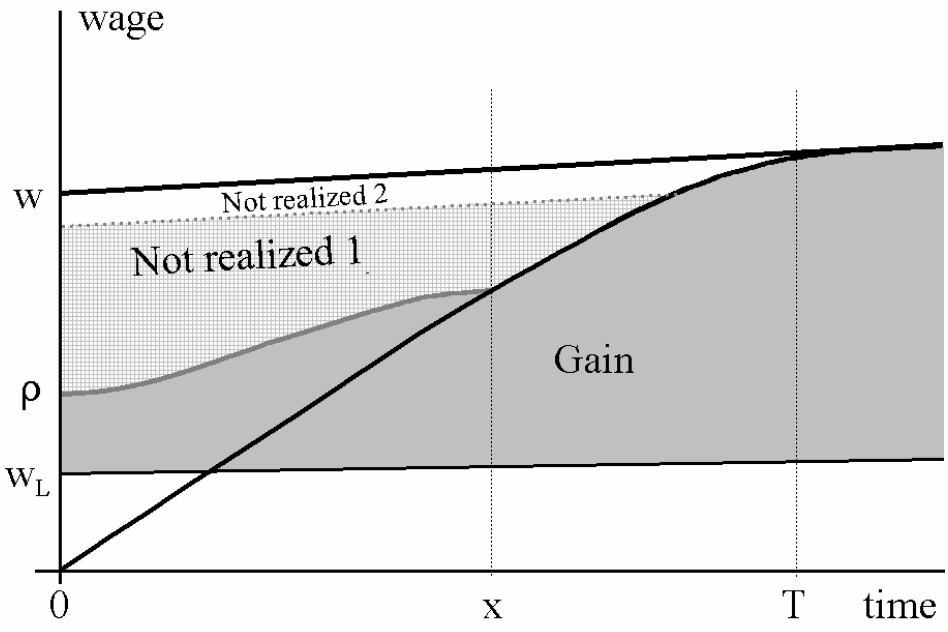


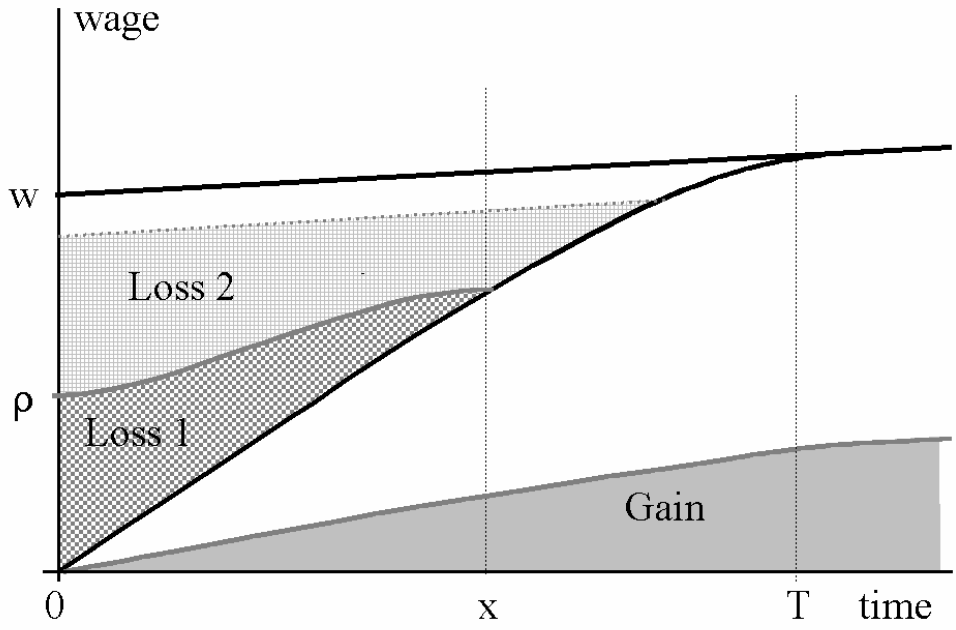
Figure 2 shows the resulting gain to the immigrant. Two cases are shown. The typical case is depicted in darker gray. The immigrant here looses about 1/3 of the potential gain. However, in the Nordic case social payments are so generous that the checkered area is added to the gain of the immigrant.

Thus in the Nordic case the immigrant looses very little of the potential gain, even if he has a long absorption time. One may even argue that the reason why absorption is so slow

in the Nordic countries is precisely that the economic incentive to work is so small, but there is probably also some discrimination.

In the Nordic countries app. 50% of GDP is collected in taxes and about half is paid back in the form of transfer payments. As both taxes and transfers depend on income, the net marginal effect of an income increase (employment rise) is by necessity small. The immigrants are likely to be in the low income brackets where the net gain from working is especially small. Many cases have been reported where it was even negative. Rules are often adjusted to keep the marginal gains from working positive, but welfare states have many complex rules that interact in puzzling ways. Also, the economy has a (small) gray sector that evades taxation. Even if there is a risk of detection and grey wages are low wages it may still be better than working, especially for immigrants who – with some justification – can claim that they fail to understand the rules, and that they are being discriminated against.

Figure 3. The gain/loss of the natives



Finally Figure 3 shows what happens to the gain of the natives. The excess production of the immigrant is proportional to the wage he receives, and hence it is the area under a downscaled version of the absorption curve as shown. However, the natives have to provide the (excess) welfare payment: This gives the loss shown. As the gain is well into the future and the loss is biggest at the start, the net gain easily vanishes when the areas are discounted.

In the Nordic case the loss is the sum of the two losses shown. It is larger then the gain, in most studies cited by Nannestad (2006), resulting in a considerable cost of immigration. The effects for public spending in Denmark have been calculated in a series of studies from the Rockwool Foundation. An offspring of that study is Wadensjö (2006) giving the main results and analyzing how net loss due to immigration is distributed between the levels of government. It is demonstrated that the costs are mainly passed on from the central government level – where the decisions as regards immigration are made – to the municipalities.

All the areas shown on Figures 2 and 3 are surprisingly easy to assess, though they can be infinitely refined, by adding secondary effects. The secondary effects are typically small and go in both directions so it appears that the primary effects shown on the figures are rather robust. Table 1 gives some basic assessments.

Table 2. Alternative Cases: Stylized calculations

In million US $	Potential	Australia-like	USA-like	Nordic-like
Immigrant NPV_I	1.00	1.00	0.85	0.70
Natives NPV_{DC}	0.30	0.25	0.10	-0.20
World NPV	1.3	1.25	0.95	0.50

Note: Based on Chand and Paldam (2004), and Borooah and Megan (2006)

The results in Table 1 show large differences in the welfare gain from immigration due to differences in institutions. Immigration is a field where institutions are crucial. Obviously the Nordic welfare state has a large problem as regards immigration. A problem that leads to two basic choices: Changing the welfare state or building walls to keep out immigrants. Till now the popularity of the welfare state has caused a gradual move towards the second "solution," in all welfare states.

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