

BEYOND PARANOIA: THE ECONOMICS OF NON-EU IMMIGRATION

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The refugee crisis has received extensive attention this year. In this essay, Kilian Mueller examines some of the common claims about the economic impacts of immigration using a number of theoretical frameworks and previous empirical findings. He follows this theoretical analysis with a discussion of the likely effects of the refugee crisis on Europe going forward.

Introduction

In light of the current refugee crisis the impact of non-EU migration on the European economy has received extensive media attention, with the potential economic outcomes often misinterpreted or misused for cheap populist propaganda. This essay will elaborate on the economic effects of non-EU immigration using a number of different theoretical models and empirical evidence. The second part of the essay will examine the specific economic effects which are expected to follow the recent migration crisis as well as the impact on the European political landscape. The essay will conclude with a summary and an answer, based on the key findings, to the question of whether or not non-EU immigration has to be considered the major threat currently facing the EU.

Immigration, Wages and Unemployment

The common belief in the European Union, that immigration depresses native wages, is only true in the most simplistic neoclassical analytical framework. Under the assumption that wages are determined by competitive forces and labour is homogeneous, the laws of supply and demand imply a rightward shift of labour supply caused by immigration will, ceteris paribus, lead to a lower equilibrium wage.

However, this appears to be wrong under a more realistic theoretical modelling. Firstly, labour is certainly not homogeneous, which means that immigrants can be seen as substitutes or complements to native labour, depending on the immigrant's skills and level of education. Moreover, immigrant labour can be a substitute to some native groups, but a complement to others. If immigrants show a high level of substitutability for native workers the demand for native labour decreases, resulting in lower wages. However, immigrants acting as complements for native workers will trigger a higher demand for native

workers the demand for native labour decreases, resulting in lower wages. However, immigrants acting as complements for native workers will trigger a higher demand for native labour and therefore higher wages (Borjas, 1989). Secondly, in the European Union, wages are to a large extent determined by the structure of the national labour market, particularly minimum wages and tariffs negotiated by unions and therefore the effect of immigrants willing to work for less than the prevailing market wage is restricted (Schmidt, Stilz and Zimmermann, 1994). Thirdly, immigrants themselves create an additional demand for goods and services produced by natives, leading to a rightward shift of demand for native labour and consequently to higher wages for native workers (Zimmermann, 1995).

Empirical findings from Ottaviano and Peri (2011) on the impacts of immigration on the US labour market support this theoretical argument. The key findings of their regression analysis over a period of 16 years suggest a significant negative effect of immigration on the wages of immigrants (-6.7 per cent) where labour has a highly substitutable character, and a small positive effect on the wages of native workers (+0.6 to 1.7 per cent) where immigrant labour has a complementary character.

To conclude this first argument, it should be emphasized that the impact of immigration on native wages depends on the substitutability of native workers and on the interactions between domestic and immigrant labour. Indeed an increase in low skilled immigration which serves as a complement to high skilled native labour is very likely to raise the domestic market wage.

The aforementioned framework with flexible wages cannot account for displacement of native workers by immigrants since at an equilibrium wage unemployment does not exist. Therefore I want to introduce a new labour supply, one determined by a wage negotiated by workers unions and set above equilibrium wage. An increase of substitutable immigrant workers in this framework leads to a drop in wages and a decrease in domestic employment. However, if the relation between union-set labour supply and individual labour supply is proportionate, an increase in immigration does not affect domestic unemployment, but it may certainly increase the total employment in the economy (Baldwin and Wyplosz, 2015). In addition to this, under this framework, immigrants serving as complements to certain native sectors are very likely to even reduce native unemployment (Zimmerman, 1995).

Empirical evidence from Longhi and colleagues (2006) supports this theoretical argument. They used a meta data analysis of 165 estimates of the impact of immigration on native unemployment from 9 different OECD countries, concluding that a 1 per cent increase in immigration amounts to an average decrease of 0.024 per cent in native employment, a negligible effect. In addition Jean and Jiménez (2011) found no significant long-run impact of immigration on native unemployment in their study of eighteen OECD

countries over a period of 19 years. In conclusion, the effect of immigration on native unemployment is unlikely to be significant in either direction and is highly dependant on the modelling choices, in fact it seems that under more realistic models immigration is likely to increase total employment.

Immigration and European Efficiency

The last prejudice I want to examine is that immigrants are a net drag on the domestic economy, in particular on its efficiency, growth and social welfare. First of all, using the simple analytical framework of homogenous labour and competitive wages from my first argument, immigration can lead to a sectorial drop in wages and an expansion of total employment. The result is a net income gain for the economy, held by capital owners (Baldwin and Wyplosz, 2015; Hanson, 2009). This has to be followed by a redistribution of national income to realize an increase in overall social welfare and to achieve Pareto efficiency (Zimmermann, 1995). In a broader interpretation, additional national income can be created by immigrants through the aforementioned complementary immigration and positive spillover effects, realized by immigrants acting as market participants and consumers.

Secondly, migration within the EU is important for an efficient allocation between labour and capital (Baldwin and Wyplosz, 2015). Non-EU Immigrants can serve as 'a flexible reserve to compensate the low mobility of natives' (Zimmermann, 1995:53) and increase the efficiency in the European labour and capital market.

Thirdly, non-EU migration can be an important counteracting force for expected demographic change within the European Union. Low fertility rates and a higher life expectancy have led to an aging population and a decline in population growth in the European Union. Non-EU migrants tend to show higher fertility rates than natives and constitute a disproportionately high share of Europe's working age population between 25 and 64 (Cuaresma et al., 2015). As a counteracting force for the demographic change, immigration promotes human capital accumulation with positive effects on economic growth. Immigration also increases the tax base, spreading the tax burden with positive effects on social welfare and the intergenerational contract (Hanson, 2009; Cuaresma et al., 2015).

To conclude the theoretical point, non-EU migration is by no means a net drag on the European economy, but rather could be viewed as a means of increasing economic efficiency and adding to the accumulation of human capital to promote economic growth and increase social welfare.

Reality of Current Migrant Crisis

As of mid-2015, the civil war in Syria and uncertain political conditions in the Middle

East and North Africa had forced an estimated 15.5 million people to leave their home country as refugees. Out of those, 3.5 million fled to Europe to seek asylum within the European borders (UNHCR, 2016). This massive inflow of refugees has added a new dimension to the economic and also political impacts of non-EU migration.

Economically, the OECD Economic Outlook (2015) estimates that additional public spending for newly arrived refugees as well as public long-term support for asylum seekers in 2016 and 2017 will boost aggregate demand in the European Union by 0.1 TO 0.2 per cent of GDP and therefore will likely increase national income and social welfare. The aforementioned labour market effects will probably build up gradually since labour market integration of current refugees takes a certain amount of time. By the end of 2016, refugees will make up less than 0.4 per cent of the EEAs total labour force (OECD Economic Outlook, 2015).

Kai Arzheimer (2008) developed a regression model, using data from the European Social Survey Project in 2003 to analyse the motivations of extreme right voters in Europe. His key findings suggest that anti-immigrant sentiments, especially beliefs regarding their negative impact on the labour market and on the economy in general are some of the main motivations for European voters in voting for extreme right parties (Arzheimer, 2008).

In the light of the extraordinary increase in recent non-EU migration, the latest regional election outcomes in France and involvement in government of populist right wing parties in Poland, Hungary, Switzerland and Finland reveals a dramatic rightward shift on Europe's political landscape, fuelled by a fear of immigrants that seems to be economically irrational (The Economist, 2015). Besides their negative views of immigrants, Europe's far right parties either push for regional autonomy (Belgium's Vlaams Belang and Italy's Northern League) within the EU or they completely reject EU membership (UKIP, Finns Party, Front National). They all have one thing in common: a pronounced euroscepticism combined with strong claims for national sovereignty, which is endangering the European Union and the process of European integration which lies at its core (The Economist, 2014).

Conclusion

In conclusion, I want to stress the three main findings of this essay. First of all, as discussed extensively in the first part, the labour market impacts of immigration are ambiguous and very likely to be positive, but also very dependant on the modelling choices. Moreover, the impacts on the overall economy are most likely stimulating. Both points can be proven through conclusive theoretical reasoning and empirical findings. Secondly, even though Europe is facing an extraordinary increase in non-EU migration the effect of those migrants on the European economy has to be seen as a chance for increased prosperity rath-

er than a threat, at least from an economic point of view. Finally, on the political level, Europe is experiencing a rise of right wing populism, which is very likely being fuelled, at least in part, by ill-informed prejudice against immigrants. This failure in public relations, or more precisely the established parties' failure to communicate the economic opportunities of immigration is leading to a return to nationalism and euroscepticism, which this essay argues is endangering the future of the European integration process and therefore has to be seen as the biggest threat to the European Project that has arisen in recent years.

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