SOME REFLECTIONS ON IMMIGRANTS' FISCAL IMPACT

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Abstract

The influx of immigrants in developed countries has increased in recent decades. This, together with rapid population aging have stimulated public interest on immigration issues.

Thus, some authors have argued that immigration could serve as a remedy for age-related fiscal pressures. However, often, immigrants are considered to be a public burden. The studies realised have shown that immigration may have strong quantitative implications for fiscal policy of the host country.

The paper makes a brief analysis of the fiscal impact of immigrants with diverse skills in host countries. Are given tax effects that occurred immigrants from countries joined the European Union in 2004 the United Kingdom.

Keywords: migration, fiscal pressure, the structure of migration flows
Clasificare JEL: G28, H30, J21, J39

Migration is one of the more controversial issues in the current debate on economic and social policies in many countries of destination. On hand migration is blamed in some quarters for unemployment and increasing inequality in the host countries. On the other hand it is hoped that international migration can at least alleviate the burden of the rapidly aging population in some host societies.

In an article in Financial Times (July 12th, 2004), Hans-Werner Sinn show that recent and future enlargements, the European Union could face a rise in welfare migration: "…*there will be more migration in Europe, but it will be 'bad' migration as well as 'good'. 'Good' migration is driven by wage and productivity difference. 'Bad' migration is driven by the generosity of the welfare state*".

Indeed, it was demonstrated elsewhere that the generosity of the welfare state, as by itself, drives out high-skill migration and drives in low-skill migration (Razin and Sadka 2001).

Europe, both “old" and “new", are facing with a severe aging problem. This shakes the financial soundness of the welfare state, especially its old-age security and medical health components, because there are fewer workers asked to support increasing numbers of retirees. As put metaphorically by the Economist (March 15th, 2003, p.80): “*...the fiscal burden on the diminishing number of worker-bees will rise as more people turn into pensioner drones*".

The enlargement of the European Union towards the east will open up new markets. It will facilitate the flow of goods and factors in both directions. In particular, it will allow labour to migrate to the west where wages are much higher and where the welfare states are more comprehensive. It is this latter aspect that sparks the most intensive discussion about the economic consequences of EU enlargement.

The increase of the labour supply in the Western Europe will put pressure on the wages and intensify the already difficult distributional conflict between capital and labour. Moreover, the migratory pressure may trigger fiscal competition.

As the inflow of workers will be largely low-skilled labour, the immigrants are likely to become net recipients of the comprehensive welfare states in Western Europe. Each potential receiver country will lower its level of social transfer to reduce the inflow of migrants. By doing so each country inflicts an externality on other EU member states as migrants will choose alternative receiver countries.

Labour outflows can clearly provide relief from unemployment and poverty. For example, work abroad, particularly in the Russian Federation, has been one of the means of subsistence and an important coping mechanism for many families in the Central Asia and the South Caucasus.

In today’s context, emigration usually involves a small percentage of the country’s work force – to small to make a substantial dent into unemployment, especially if the structural problems remain unresolved.

The most direct link between migration and development in countries of origin is through remittances – the funds migrants send home. The Report for 2008 on the level of remittances in the global economy have made by World Bank present the situation of the cash flow and the level of remittances in national economies whose gross domestic product is largely dependent on them.

The total value of official remittances flowing to developing countries in 2007 is estimated to be over USD 281 billion. Many estimate that remittances sent through informal channels would double the figure.

Skill migration or “brain drain”, in particular, has come under strong criticism on the grounds that it can have a cumulative negative effect on fragile economies.

The issue can also be seen as one of “brain overflow”. Viewed from this perspective, emigration reduces the supply-demand gap for skilled workers in developing countries and ensures optimal allocation of unused human resources.

Clearly, however, when there is a skill shortage or when skills are difficult to replace, the cost is high for the sending country. This is the case for example in Africa which as a region may have lost one-third of its highly skilled personnel in recent decades. The problem has been less serious in Asia and Latin America.

Immigration can be a rich resource for a country facing labour shortage.

When the labour market is tight in the destination country, the economy gains from new labour inflows but the effects could be uneven on different groups of population.

If most immigrants are low skilled workers, employers of low wage labour and consumers of labour intensive products would benefit. But the flows could depress wages and other benefits at the lower end of the host country’s work force.

For a receiving country that already faces unemployment, as in Western Europe today, immigration implies additional supply side pressure in the labour market. But low skilled immigrants do not necessarily compete with local workers for the same jobs.

This is because labour markets in the receiving countries are often segmented and local workers may wish to avoid certain menial jobs. In any case, immigration does not cause unemployment, the basic reasons lie elsewhere.

Immigration of skilled workers implies savings of the destination country’s opportunity cost for increasing its human capital. These costs could be considerable in most cases. An estimate made in 1972 for the United States Congress showed that the opportunity cost saved by the United States through inflows of skilled workers amounted to USD 1,718 million for five years; the developing countries may have lost USD 646 million in 1971-1972.

The fiscal impact of immigration can be evaluated with static or dynamic analyses (Rowthorn (2008)). Static analyses compute, for a given year, the net fiscal contribution of a cross section of immigrants as the difference between the amount of taxes paid in and the government transfers received.

Static analyses are instead more backward looking, but allow a precise quantification of the fiscal costs and benefits of a particular immigrant population.

Dynamic studies (e.g. Storesletten, 2000) instead compute the net present value of the lifetime net fiscal contribution of immigrants, and (in some cases) those of their descendants.

Dynamic analyses have the distinct advantage of providing a forward looking picture of the fiscal consequences of emigration, but this comes at the expense of strong assumptions about immigrants' future behaviour and future fiscal policies.

With fiscal competition, each of the immigration countries determines its level of social transfers independently.

However, as the network effect creates a positive link between current and future immigration, each immigration country takes into account that more immigration today will worsen a country's fiscal stance in the future.

The analysis provided in Dustmann, Frattini and Halls (2009) adopts a static approach and evaluates the annual net fiscal effect immigrants from A8 countries had on the UK since enlargement in 2004. It also assesses the degree to which A8 immigrants obtain benefits, or rely on social housing, in comparison to UK native born.

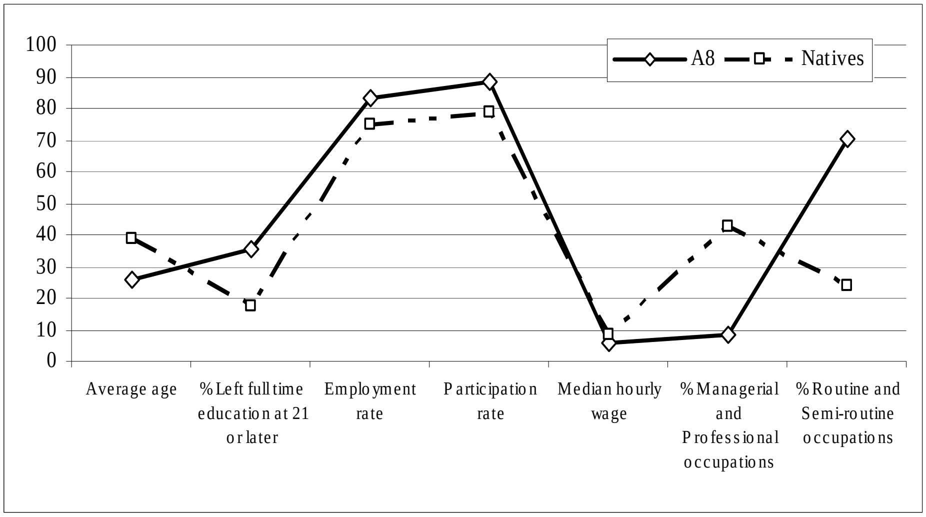
The analysis is based on data from the UK Labour Force Survey and publications by HM Treasury, the Office for National Statistics, and several other Government Departments. It is the first study to assess the fiscal impact of A8 immigration to the UK. Previous work considered the fiscal impact of overall migration for earlier years (Gott and Johnston (2002) came to the conclusion that immigrants were making a net fiscal contribution to UK public finances.

The analysis of data on the size of A8 migration flows the UK since the 2nd quarter of 2004 (EU enlargement took place on May 1st 2004) show that their net inflow was positive and sustained until about the second quarter of 2007; however since the first quarter of 2008, the stock of A8 immigrants remained basically stable.

Some of the key characteristics of A8 immigrants, compared to native workers, are illustrated in figure 1. A8 immigrants arriving between the second quarter of 2004 and the first quarter of 2009 are younger and better educated than the native population.

They also have a higher labour market attachment than natives with a labour market participation rate of 88% (79% among natives) and an employment rate of 83% (75% among natives).

Figure 1 *Comparisons among some key characteristics of migrants and natives in the UK*



Data source: Christian Dustmann, Tommaso Frattini and Caroline Halls , *The Fiscal effects of A8 migration to the UK,* UCL, Department of Economics and CReAM

Despite the higher level of education among A8 immigrants, they are disproportionately concentrated in the least skilled occupations (71% are in routine or semi-routine occupations vs. 24% of natives) and their hourly wages are considerably lower than those of natives, throughout all parts of the wage distribution. However, there is a remarkable increase in average wages; for example, for the cohort that arrived in 2004/2005, wages have increased by 40 percent after four years in the UK.

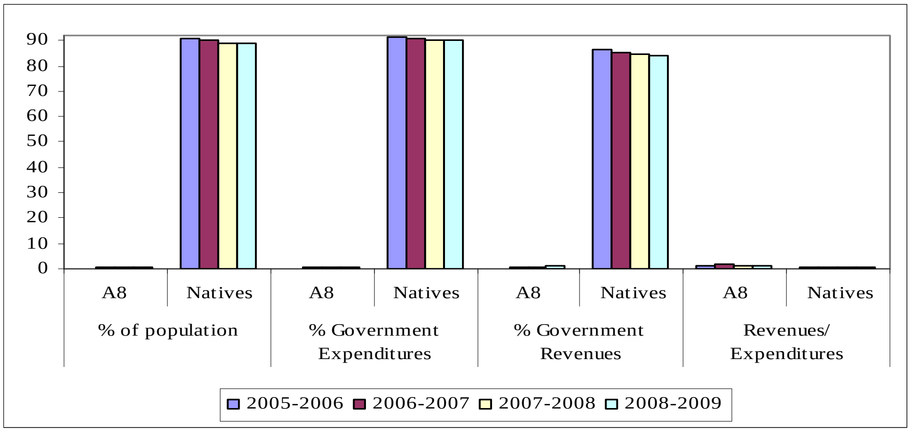
Restricting analysis to those immigrants who have been in the UK for more than one year as A8's eligibility for many benefits is limited for the first year in the UK, the study finds that A8 immigrants are about 60% less likely than natives to receive state benefits or tax credits, and to live in social housing. Even if A8 immigrants had the same demographic characteristics of natives, they would still be 13% less likely to receive benefits and 28% less likely to live in social housing.

The fiscal impact of A8 immigrants was determined by constructing the ratio of transfers made to native-born workers and A8 immigrants to the taxes and contributions the two groups make to the welfare system.

The key results are that in each fiscal year since enlargement in 2004, A8 immigrants made a positive contribution to public finance (figure 2). For instance, in the latest fiscal year, 2008-2009, A8 immigrants paid 37% more in direct or indirect taxes than they received in public goods 4 and services. This is even more remarkable because the UK has been running a budget deficit over the last years.

In contrast, in 2008-09 UK born individuals contributed to the Exchequer 20% less than they received in terms of public goods and services.

Figure 2 *The contribution of A8 migrants and natives in the UK public finances*



Data source: Christian Dustmann, Tommaso Frattini and Caroline Halls , *The Fiscal effects of A8 migration to the UK,* UCL, Department of Economics and CReAM

The analyses show that A8 immigrants receive on average lower wages than UK born workers, despite their better educational background (in particular, immediately after entering the UK). The A8 immigrants have a higher labour force participation rate (increasing the number of fiscal contributors), are likely to pay (proportionately) more in indirect taxes like VAT, and – most importantly- make much lower use of benefits and public services. For instance, in the period 2008-0909, A8 immigrants represented 0.91% of the total UK population, but contributed to 0.96% of total tax receipts and accounted for only 0.6% of total expenditures.

The analysis also suggests that the labour market situation of immigrants substantially improves with time in the UK, in terms of both wages and labour force attachment.

The strong wage growth of A8 immigrant arrival cohorts that we have observed so far is likely to continue with time in the UK, so that the contributions A8 immigrants make to the tax system are likely to rise considerably. In fact, if in the long run A8 immigrants receive wages relative to their levels of education similar to those of native born workers, then – as A8 immigrants are far better educated than natives in the same age cohort –their contributions to the 5 tax system could supersede those of natives.

Thus, there is in our view little reason to believe that in the longer run, A8 immigrants who arrived between 2004 and 2008 will constitute a net burden to the welfare system.

This is also in line with the results of the analysis on the probability of welfare claims, which shows that A8 immigrants – even if they were identical in a large number of characteristics to natives, like age, education, number of children and disability – would still be less likely to claim benefits.

In conclusion we can say that people typically do not migrate because of social transfers that are paid in potential receiver countries. However, given that people have decided to move, differences in the social safety net play an important role for the differential migration decision. The high flexibility of migrants in their location choice triggers an intensive fiscal competition among potential receiver countries.

Each country tries to lower its own fiscal burden from immigration by lowering social transfers and thus diverting some migrants to other receiver countries. In the end, all countries will have excessively scaled down their welfare states.

Fiscal competition becomes even more intensive if network effects play an important role in the migrants' choice of location. Migrants ceteris paribus prefer those countries where they have some prior information from earlier migrants.

A country that once experiences significant immigration will become an attractive immigration country for future migrants. This path-dependence intensifies the fiscal competition in the early phases of migration. Each country has now an even stronger incentive to deter migrants as the direction of early migrants will also determine the migratory flows for many years to come. Hence, even if the absolute number of migrants per year is relatively small, the welfare losses of fiscal competition can still be quite significant.

If network migration plays an important role, temporary restrictions on free migration – as in the case of EU enlargement – can help to reduce the initial fiscal competition in a twofold manner. Firstly, immigration restrictions immediately reduce fiscal competition. Secondly, a temporary immigration restriction may also shift some of the migration into the future. This leads to a more severe erosion of the welfare state in the future and, therefore, reduces the current pressure for an intensive fiscal competition. The policy of temporary migration restrictions comes at a cost. Even though welfare rises in the period when migration restrictions are in place, welfare will be reduced once the migration restrictions are lifted. Therefore, the net effect of such a policy is ambiguous.

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