Panel 2

Introduction

Seizing the Opportunity

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The current status

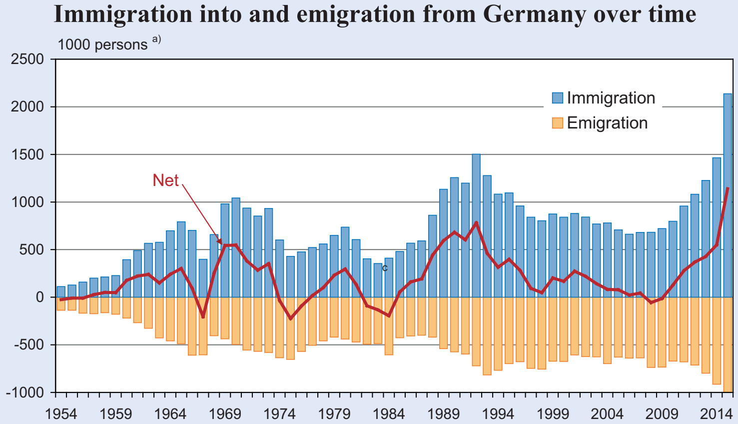
In 2015 Germany experienced an unprecedented wave of immigration. According to the most recent data, 2.1 million persons immigrated into Germany. Moreover, as shown in Figure 1, the number of persons leaving Germany was at an all-time high of about 1.0 million. Accordingly, the country registered a net inflow of 1.1 million persons. This amounts to a net migration rate of 1.4 percent of the German population. Rarely in history has a single country experienced a larger yearly influx relative to its initial size. Germany has tended to receive net inflows of people since the early 1950s. These flows fluctuate with the domestic and the global business cycle, but they also reflect geopolitical events such as the end of communism around 1990, the civil war in former Yugoslavia and the recent refugee crisis.

The fact that net immigration is substantially smaller than gross immigration is typical for a rich, modern country that is relatively well integrated into the European labour market. Since the guest-worker period from 1960 to 1972, a high rate of return migration was actually intended by law makers. Workers' freedom of mobility within the European Union also encourages such behaviour. Nonetheless, even if immigration and emigration flows may cancel out in some years (as was the case in the period 2004–2009), gross migration still matters, as it indicates the extent to which the labour market and society at large are confronted with mobility. Figure 2 shows an index of population churning. It is based on the absolute number of migration flows in a year (emigration plus immigration) relative to the total population one year earlier. The figure shows that the amount of movement first peaked in the late 1960s, and subsequently towards the end of communism in Europe. However, it remained remarkably stable from the early 1960s until the break-out of the global financial crisis in 2008. From then on, the index kept rising steadily and reached an all-time high in 2015.

Figures 1 and 2 do not differentiate among German nationals, EU citizens and others. Table 1 carries out this breakdown for 2015. It shows that around 40 percent of all immigrants into Germany came from other EU countries, about 6 percent were German nationals, often migrating back from a stay abroad, and 55 percent of immigrants came from outside of the EU. The non-EU share (defined based on the EU's current borders) oscillated between 30 and 35 percent from 2006–2013, which leaves 2015 clearly looking like an extreme outlier. This effect is even more extreme when one looks at the share of immigrants from outside geographical Europe. That share averaged at

Figure 1

Immigration into and emigration from Germany over time



Note: Migration into the former area of the Federal Republic of Germany until 1990, afterwards into the enlarged area.
[a] German and non-German citizens.
Source: Destatis.

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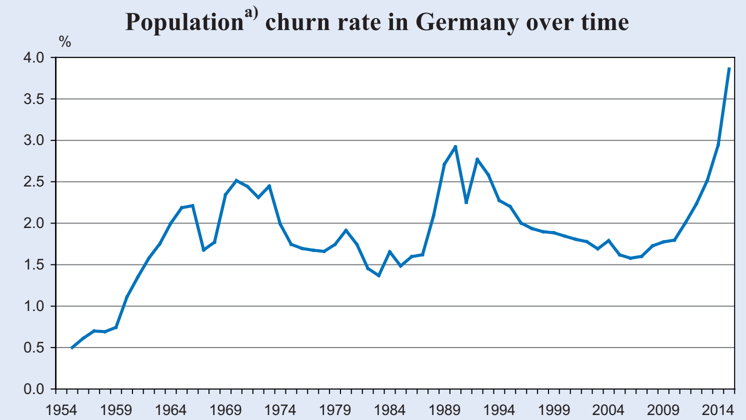
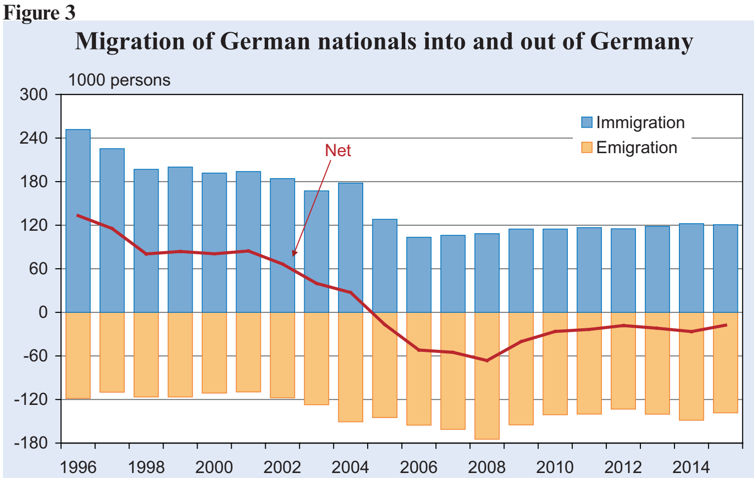
Figure 2



Note: Emigration plus immigration out and into the former area of the Federal Republic of Germany until 1990, afterwards into the enlarged area relative to the lagged number of residents.
[a] German and non-German citizens.

Source: Destatis.

Figure 3



Source: Destatis.

around 21 percent from 1996 to 2013, but stood at exactly double that figure (42 percent) in 2015.

As for emigration rates, the share of non-EU nationals has fallen. It is also interesting to note that the emigration of German nationals slightly exceeded immigration to Germany. This general pattern can also be seen in previous years (see Figure 3). According to the migration statistics of the Federal Statistical Office, more Germans have left the country than returned to it since 2005. Thus, Germany is as much an emigration county as an immigration country.

The official data on migration are problematic. They tend to underestimate emigration rates, particularly prior to 2008, after which point information from tax records was used to purge non-residents from the statistics. A recent study attempts to deal with this problem (SVR 2015). It also excludes the so-called *Spätaussiedler* (i.e. ethnic Germans born abroad who return to Germany, often from the territory of the former Soviet Union). It finds that there was a net outflow of German nationals every single year from 1967 onwards. In total, the loss of nationals amounted to around 1.5 million persons. Moreover, the share of highly-skilled German emigrants was substantially larger than the share of highly-skilled returnees, signalling a brain drain, albeit on a rather modest scale.

Finally, we turn to the detailed structure of the migration statistics for 2015. Table 2 reports the facts for the top 20 sending and receiving countries. In 2015, Syria was the most important source country and accounted for about 16 percent of total immigration into Germany, but for just 1.2 percent of emigration. Over a quarter of net immigration is attributable to Syrians alone. Romania and Poland were the next most important sending countries with 212,000 and 190,000 persons respectively. In both cases, however,

Table 1

An overview of German immigration statistics of 2015

	All		Germans		Other EU citizens		Non EU-citizens	
	Number (1,000s)	% of 2014 population	Number (1,000s)	% of total	Number (1,000s)	% of total	Number (1,000s)	% of total
Immigration	2,137	2.6	121	6	846	40	1,170	55
Emigration	998	1.2	138	14	518	52	341	34
Net	1,139	1.4	– 18	– 2	328	29	829	73

Source: Destatis.

Panel 2

Table 2

Immigration of non-Germans into Germany from partner countries in 2015

	Immigration		Emigration		Balance		Index of circular migration
	number (1,000)	Share (%)	number (1,000)	Share (%)	number (1,000)	Share (%)	
Syria	326	16.2	10	1.2	316	27.3	6.0
Romania	212	10.5	126	14.7	86	7.5	74.5
Poland	190	9.4	127	14.8	63	5.4	80.1
Africa	110	5.5	29	3.4	81	7.0	41.4
Afghanistan	95	4.7	5	0.6	90	7.8	9.7
Bulgaria	83	4.1	45	5.3	38	3.3	70.6
Iraq	72	3.6	5	0.6	67	5.8	12.4
Italy	72	3.5	36	4.2	36	3.1	66.9
Albania	69	3.4	22	2.5	47	4.1	48.2
Croatia	57	2.8	20	2.4	37	3.2	52.4
Hungary	56	2.8	37	4.3	18	1.6	80.2
Serbia	42	2.1	34	4.0	8	0.7	89.3
Kosovo	41	2.0	21	2.5	20	1.7	67.9
Greece	32	1.6	16	1.9	15	1.3	68.0
Spain	30	1.5	18	2.1	11	1.0	76.2
Turkey	28	1.4	24	2.8	4	0.4	92.0
China	25	1.2	15	1.8	10	0.9	75.1
Pakistan	25	1.2	1	0.1	24	2.1	4.5
Macedonia	25	1.2	12	1.4	12	1.1	66.3
India	24	1.2	14	1.6	10	0.9	73.4
Bosnia & Herzegovina	23	1.1	16	1.8	7	0.6	81.7
USA	22	1.1	19	2.2	3	0.3	92.2
France	17	0.8	14	1.6	3	0.3	90.3
UK	13	0.7	11	1.3	2	0.2	90.2
Total	2016	100.0	859	100.0	1,157	100.0	59.8

Source: Destatis.

there was substantial return migration too, meaning that the two countries were responsible for 7.5 percent and 5.4 percent of total net immigration only. The last column in Table 2 shows an index of circular migration, which mimics the well-known Grubel-Lloyd index used in the analysis of international trade data. A value of 100 indicates that a country receives as many immigrants as emigrants, i.e. that there is pure population exchange without any net increase in the stock. That index is very low for Syria, but it is rather high for Poland.

The fourth most important sender of migrants to Germany in 2015 was Africa. The figure for the continent as a whole is not broken down by country, as this would excessively inflate the table. The most important African sending countries were Eritrea (18,000 persons), Nigeria (12,000), Morocco (12,000), Somalia (10,000), and Algeria (6,000). In all of these cases, return migration was relatively minor, and the index of circular migration was substantially lower than the average (59.8).

Circular migration dominates for many countries. It is most important for rich OECD countries; for example, the index reaches a value of over 90 for France, Britain and the United States. This figure is also high for former guest-worker source countries such as Turkey or Serbia. It appears that the wish to return to the home country is generally strong, but people only migrate back after some years in Germany and once the situation in their home countries has improved. Most migrants from Asia and Africa come to Germany with the objective of requesting refugee status. Indeed, the Federal Agency for Migration and Refugees registered about 1.1 million persons during 2015. In other words, around half of the total gross immigration inflow seems to be driven by the refugee crisis.

Huge migration pressure expected to persist

Germany is one of the richest countries in the world. Moreover, the distribution of net disposable income is relatively equal. These factors make the country a very attractive destination for prospective migrants, at least from an economic point of view. Table 3 reconsiders the most important sending countries as of 2015. It shows the population, the share of the population that actually migrated to Germany in 2015, and the countries' levels of per-capita income relative to Germany, measured in purchasing power parity terms. Clearly, the gaps are huge. In 2014 living standards in the most important sending countries ranged from 9 percent (Syria) to 12 percent (Nigeria) and 45 percent (Ro-

Table 3

Income and inequality gaps of most important sending countries relative to Germany

	Population (million)	Emigration rate (%)	GDP per capita (in PPP) relative to Germany (%)	Gini coefficient of disposable income	Gini relative to Germany
Africa	1,184	0.01	12	46.8	1.53
Albania	3	2.38	23	31.7	1.04
Bosnia & Herzegovina	4	0.60	22	35.6	1.16
Bulgaria	7	1.16	38	36.2	1.18
China	1,369	0.00	27	47.8	1.56
Croatia	4	1.34	47	30.3	0.99
Greece	11	0.29	57	34.1	1.11
Hungary	10	0.56	56	27.4	0.90
India	1,295	0.00	11	33.9	1.11
Iraq	35	0.20	26	36.0	1.18
Italy	60	0.12	78	35.2	1.15
Macedonia	2	1.18	29	43.2	1.41
Pakistan	185	0.01	10	30.0	0.98
Poland	39	0.49	55	34.1	1.11
Romania	20	1.08	45	30.0	0.98
Serbia	7	0.59	29	27.8	0.91
Spain	46	0.06	74	34.2	1.12
Syria	19	1.74	9	35.8	1.17
Turkey	78	0.04	42	42.2	1.38

Source: Population data and GDP per capita (expenditure-side real GDP at current PPPs (in million 2011 US dollars)) data are from 2014 and taken from the Penn World Table 9.0. The Gini data come from the World Bank and refer to the most recent available year.

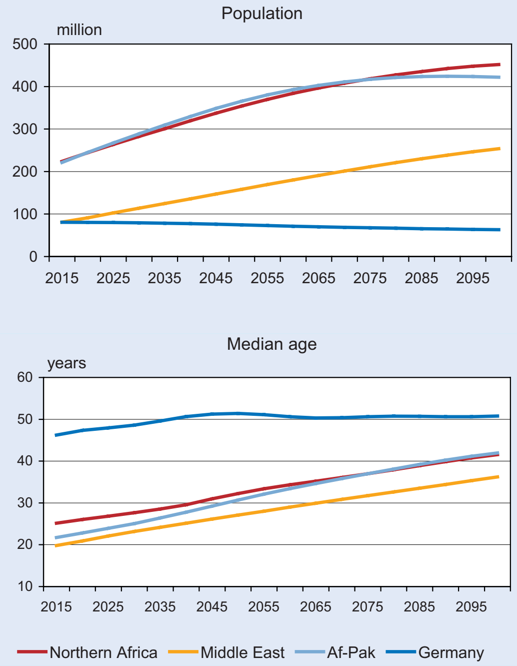
mania). This implies that average persons from these countries can hope to substantially improve their material standards of living, often by a factor of 10. Even within Europe, the gaps are still sizeable. While the income levels of poor countries are converging, the process is slow, and gaps will persist for many decades to come. Moreover, as Table 3 shows, many countries face relatively high levels of economic inequality relative to Germany. This is another factor that encourages migration towards Germany; see below for more discussion.

Moreover, many of the sending regions are facing very dynamic demographic situations, particularly when compared to Germany. According to forecasts of UN population division, under a very modest migration scenario (assuming a net immigration into Germany of 200,000 persons a year) Germany's population is going to shrink from 81 million inhabitants today to 73 million in the year 2050 and 63 million in the year 2100. At the same time, the median age in Germany will rise from 46 years today to above 50 years 2030 and is expected to remain at that relatively high level.

Other European countries, particularly in the South (e.g. Italy) and the East (e.g. Hungary), are facing a very similar demographic future to that of Germany. However, the situation in the source countries of refugees around Europe is very different. As Figure 4 shows, median ages are very low in Northern Africa, the Middle East and the Afghanistan-Pakistan (Af-Pak) region. The UN predicts some convergence to the German level, but at a very slow pace. In 2050, median ages will lie between 27 and 32 years in the refugee source countries; by 2100 this figure will rise to between 36 and 42 years. So the age structure is expected

Figure 4

Future demographic change in refugee-source countries until 2100



Source: UN World Population Prospects, Median Variant, Oct. 2016.

to remain strikingly different for the next 85 years and beyond.

Fast population growth, a persistently young work force and major differences in living standards between Germany and the refugee-source countries imply that migration pressure will remain high. The size of their populations is so large, that any flows triggered by civil wars or climate change are likely to be very substantial. Unfortunately, such shocks are likely in the regions studied. Forecasts by the Intergovernmental Panel on Climate Change (2015) predict particularly severe damage (acute water scarcity) in North Africa and the Middle East. Moreover, these regions suffer from political instability, which might even be exacerbated by the world's move away from fossil fuels (a main source of export revenues in the region). Therefore, one must conclude that the sharp increase in immigration faced by Germany in 2015 is unlikely to be a one-off event. Immigration pressure will persist and may even grow. This implies that migration requires immediate management, as an increasing, young, and footloose population in Europe has much to gain by migrating to Germany.

When does immigration benefit the natives?

As shown above, migrating from a poor Southern country to Germany typically improves the quality of life of a migrant substantially. If it were otherwise, foreigners would not voluntarily move to Germany. Certainly, in the case of refugee migration, it is possible that people may be forced to leave their homes. But they may exercise discretion over which country they want to move to. Syrian refugees, for example, could have stayed in Turkish camps, but they decided to move on to Germany rather than to stay or to move to a different country like Austria, for example. The more interesting question then is how immigration affects the native population in the host country. There is a large body of literature that looks into this question. Much analysis is carried out in a very simplistic neoclassical labour market model, which gives rise to very clear predictions. Borjas (1995) presents an overview.

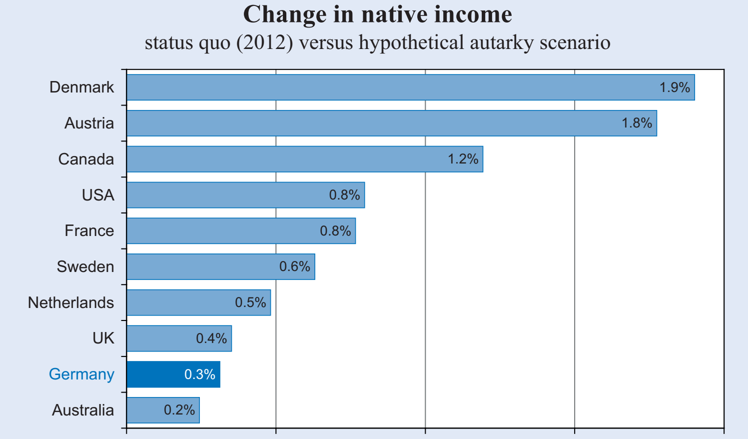
Let us assume that there are owners of capital who employ workers along a downward-sloping labour demand schedule. With a friction-free labour market, the market wage is equal to the contribution of the marginal (last) worker added to the labour market. In other words, immigrant workers will bid the ongoing wage down, otherwise employment could not grow and unemployment would go up by exactly the size of the immigrant inflow. Ruling this out, an additional immigrant must lower the wage of all workers, including the wages of foreigners already in the country (the so-called infra-marginal migrants). What those incumbent migrants add to total output in the economy does not change with immigration of an additional person. Due to the lower wage, however, a larger share of the output generated by any migrant accrues to the owners of capital. If the owners of capital are natives (which is assumed in the sequel), their income goes up. The additional native capital income necessarily exceeds the loss of native wage income, because the economy makes a net gain on every new immigrant. Aggregate native income therefore goes up, but its distribution changes.

This mechanism works more generally: workers who are substitutes for immigrants tend to lose out, owners of factors (capital, land, high skills) that are complements to immigrant labour, tend to benefit, while overall native income rises too. The latter effect is called the 'immigration surplus'. Not only this benefit, but also the distribution effects necessarily associated with it, may be short-lived. The reason for this phenomenon is that higher returns on capital invite greater capital accumulation until the returns on capital come back down to their initial (equilibrium) level. In turn, a higher capital to labour ratio drives up wages, as a better capital endowment makes workers more productive. With factor prices restored to their initial levels, both the aggregate surplus and the distribution effects will vanish again. The effects on the remaining people in the sending countries are of an opposite nature. Emigration drives up the wage rate, lowers returns on capital and reduces aggregate income since the income obtained from employing the emigrants is lost.

Importantly, this theory generates gains regardless of whether immigrants are, on average, less or more skilled than natives. What matters to the existence of an immigration surplus is that the skill structure of the immigrant workforce differs from that of its native counterpart. Moreover, the existence of the surplus necessarily comes with distributional consequences. Unrealistically, in the simple setup, if the immigrant work force structurally differs from the native one, the surplus strictly increases by the size of the inflow. In other words, the bigger, the better. Thus, the model essentially rationalizes unlimited immigration. This seems implausible, particularly against a backdrop of negative public sentiment regarding immigration.

The problem with this view is that it requires neoclassical assumptions: no labour market imperfections whatsoever, and no welfare state that redistributes from rich to poor. In Battisti *et al.* (2014 and 2015) we have tried to relax these restrictive assumptions. The model allows for unemployment and for realistic patterns of wage bargaining. Moreover, there is a welfare state, which redistributes income through fiscal transfers and the provision of public goods. However, the neoclassical channel described above is still present.

Figure 5



Note: Autarky refers to a situation, in which the existing stock of foreign-born workers is counterfactually set to zero.

Source: Battisti et al. (2014).

We have calibrated the model to rich data from 20 OECD countries and simulated the effects of a number of migration scenarios. Figure 5 shows the results for a couple of interesting countries. A couple of important observations stand out: firstly, for the countries shown (and for the other ones covered in the paper) the presence of a foreign-born labour force has indeed benefitted the natives. However, the gains are of different sizes. If all of the present migrants in Denmark were to leave the country, the average Dane would lose income worth 1.9 percent of his/her current income (as of 2012). The same scenario in Germany, by contrast, would leave the average native German just 0.3 percent poorer.

So, even if unemployment, wage bargaining and the welfare state are accounted for, immigration still makes the average person in the 20 OECD countries better off. In Germany, the gain is worth some 120 euros per person. At 2012 prices, the annual aggregate net gain is worth about 8 billion euros. It consists of a 'gross' economic benefit of about 17 billion, and of transfers to immigrants from natives worth about 9 billion euros.

Battisti *et al.* (2014) use the model to ask which factors favour aggregate gains. They find that the most important contribution towards benefits for natives is the skill composition of the stock of immigrants. If the share of highly-skilled immigrants is high relative to that of natives, the surplus grows. This is because highly-skilled immigrants are more likely to work and to earn high wages. This, in turn, reduces the amount of redistribution. Moreover, highly-skilled immigrants complement poorly-skilled natives (e.g. when they create own companies), making the latter more productive. Looking at Germany, the share of highly-skilled immigrants relative to natives is 0.7; while the average across 20 OECD countries is 1.0. In other words, Germany does not score very well on this statistic.

The second most important factor is the unemployment rate of poorly-skilled immigrants relative to natives. The lower this ratio is, the more likely a large native surplus is to emerge. Again, with a value of 1.8, Germany is doing worse than the OECD average (1.6). Thirdly, the more a country redistributes from the rich to the poor, the smaller the aggregate benefit will be, since (in the data) immigrants tend to have lower average earnings than natives. In this respect, Germany performs equally as well as the OECD average. The fourth driver is the size of the stock of foreign-born workers relative to the total population of workers. Medium values work best: here Germany performs very close to the OECD average of 17 percent.

In short, natives benefit more from immigration if immigrants are well-educated and have high incomes, if their rate of unemployment is low, and if the degree of income redistribution is not too high. Figure 5 indicates that Germany does not seem to benefit as much as other OECD countries. The problem is that, in the past, Germany has attracted relatively poorly-skilled immigrants.

Figure 6

Gross average wages of foreign-born workers in Germany 2013

a) 2015 level translated into 2013 prices.

Source: Socioeconomic Panel; Battisti et al. (2015).

On the quality of immigrants (and emigrants)

We have seen that the quality of immigrants is a key determinant of whether natives benefit or not. Highly-skilled migrants tend to have higher than average earnings and fewer unemployment skills. Thus, they contribute to the budget of the welfare state. The fact that highly-skilled immigrants complement poorly-skilled natives means that they boost the wages and employment possibilities of the latter, which further eases public finances.

However, as discussed above, in the past, Germany has not been very successful at attracting highly-skilled immigrants. This translates into relatively low hourly wages, as shown in Figure 6. In 2013, German natives earned an average hourly wage of around 15.50 euros. Immigrants from Western countries (i.e. the EU and other rich OECD countries), who have been in Germany for at least 10 years, have earned slightly higher average wages (15.90 euros). However, those who have spent less than 10 years in the country (year of entry between 2003 and 2013), have earned substantially less. The gap between this figure and the earnings of the average native can be as high as 5 euros per hour. This difference reflects many determinants: migrants are younger than natives and less experienced, but they are also less skilled. It is this latter fact that matters for an evaluation of the immediate effects of immigration.

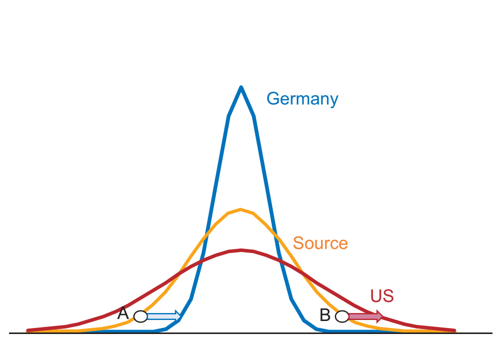
Things are substantially worse when one turns to immigrants from 'non-Western' sources (including Turkey). Even after 10 years in the country, the average hourly wage of this group amounts to only 11.70 euros; this is about 75 percent of the average wage of German natives. Immigrants who arrived after 2007 on average earn just 8.65 euros an hour. Figure 6 also shows the percentage of persons earning less than the minimum wage of 8.50 euros (valued in 2013 prices, this amounts to 8.32 euros). While about 12 percent of the native population earned less than this figure in 2015, the share of the non-Western immigrant population that arrived after 2007 and earning less than the minimum wage was 49 percent.

These data show that the wages of immigrant groups can lie substantially below those earned by German natives. Given that the purpose of the welfare state is to redistribute from individuals with above-average incomes to those with below-average incomes, and because immigrants are integrated into the German welfare state (fully, when they work), their presence implies a drain on the public budgets. As explained above, this cost has to be set against the benefits for the labour market. However, the smaller the costs are, the bigger the benefits will be.

Why does Germany attract a higher number of poorly-skilled workers than highly-skilled migrants, and why is it doing worse than other OECD countries (e.g. the United States or Switzerland)? According to Borjas (1987) and a large body of subsequent theoretical and empirical research, the distribution of net wages plays an important role. Figure 7 considers three countries with the same average net wage income, but different degrees of income dispersion. Suppose an individual A in a source country is considering immigration into Germany or into the Unite States. Let this person occupy a rank at the lower bottom of the source country's wage distribution, say at the 10th percentile (10 percent of the population have earnings below the associated wage level, 90 percent above). If that person can expect that his/her rank in the host country's wage distribution would be similar, i.e. again at the 10th percentile, migrating to the United States would be associated with a likely income loss, as the 10th percentile in the United States comes with a lower wage than in the source country. Migrating to Germany, by contrast, turns out to be

Figure 7

The role of income distributions for selection of migration country



Source: Own illustration.

beneficial, since the net wage at the 10th percentile would be higher than in the other countries due to a well-developed welfare state (fiscal transfers plus provision of public goods financed by progressive taxation). By the same token, a person from the United States would also be better off moving to Germany. By contrast, person B who occupies a place at the top of the source-country's wage distribution (at the 90th percentile, say) would rather prefer to emigrate to the United States than to Germany, because the associated net wage in the United States would be higher there.

Clearly, this example is stylized, mainly for two reasons: firstly, average wages across countries differ and form a powerful incentive for mobility on its own (see above); and secondly, migration is costly, not only due to direct mobility costs, but also because living in a foreign country may involve psychological costs. The overall message, however, should be clear: the more compressed a net wage distribution is, the more attractive it is, *ceteris paribus,* for relatively poorly-skilled migrants; while the more unequal distribution is, the more attractive it is for highly-skilled workers. This mechanism has been reviewed empirically in many studies. Paray *et al.* (2015) provide convincing evidence for emigration from Germany, and Borjas *et al.* (2015) for Denmark.

Not only does this welfare magnet mechanism bias immigration towards poorly-skilled workers, which is problematic for the sustainability of social systems, it also leads to the misallocation of labour across countries. Since workers react to net wages rather than gross wages, elaborate welfare states invite migration to exploit differences in welfare systems, rather than in the economic returns to skills. This can lead to a situation whereby there is no immigration surplus at all, so that the fiscal costs unambiguously dominate.

Economic policy implications

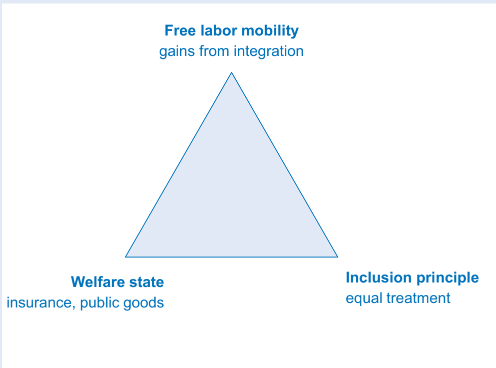
What does this mean for economic policy in Europe? First of all, it is important to ensure that immigrants work so that they contribute to the creation of added value in the host economy. Only under such circumstances can there be an immigration surplus, and the migrants can participate in financing the welfare state. In other words, to make immigration beneficial for natives, labour market institutions must allow and encourage immigrants to work. In the German context this may mean that the minimum wage needs to be rethought. One way to avoid trapping poorly-skilled immigrants in unemployment may be to exempt persons without a certain professional experience (say of three or five years) from the application of the minimum wage law.

It is also crucial to acknowledge the existence of a policy trilemma. Figure 8 shows three policy objectives, only two of which can be simultaneously pursued in a sustainable fashion.

Empirically, institutions that insure residents against bad luck (e.g. unemployment, sickness, poverty) and provide public goods (e.g. education, security, transport infrastructure) exist everywhere, but their generosity and quality differ substantially. This may reflect social preferences (the French are more risk-averse than the British), or the level of development (Germany has a more extensive welfare state than Romania), or simply the course of history (in conti-

Figure 8

An impossible trinity



Source: EEAG (2015).

nental Europe, after World War II, the pension system was essentially nationalised).

We have discussed above that countries with particularly elaborate welfare states tend to attract poorly-skilled workers who tend to be a net burden to the welfare system. In the long run, the country would have to reduce the size of its welfare state. Of course, this would only happen with open borders (free labour mobility), and under the assumption, that foreign citizens have access to the same services as natives (inclusion principle). Consequently, instead of curbing the welfare system, countries could also limit migration, or abandon the inclusion principle. To be sure, the welfare state is a major achievement, and there is a broad consensus in our societies that it should be maintained. Indeed, given the challenges from globalization and technological change, it may be necessary to expand the role of the state in providing insurance to citizens. Therefore, curbing the welfare state is not an option.

The two remaining options are (i) restricting migration, or (ii) abandoning the inclusion principle. Option (i) seems problematic, as it implies giving up the economic advantages that immigration confers to natives, and, even more so, to the migrants themselves. Some countries such as Canada or Australia have policies in place that effectively limit migration to high-skilled workers only. Such a policy might not be suitable for Germany: firstly, it is questionable whether Germany is attractive for highly-skilled workers given its relatively high tax burden (compared to e.g. Switzerland or United States); secondly, due to demographic change, Germany may well need poorly-skilled migrants too, e.g. in services industries such as health care, accommodation or logistics. Option (ii) is more promising, because it would limit the fiscal costs of poorly-skilled immigration. It implies that migrants would remain in their source country's welfare states to which they would continue to contribute and from which they would receive benefits. In other words, differences in welfare states would cease to act as an incentive for migration. This regime would maintain economic efficiency, but it would essentially create a two-tier society in the host countries of native and immigrant workers covered by different systems. This does not need to be unfair, however, since migrants from low-welfare-state countries would receive smaller benefits, but would also pay lower contributions. An added advantage of this scheme would be that source country governments do not lose resources. Clearly, there should be some transition process whereby migrants are gradually moved from their source country regime into the host country system.

Replacing the inclusion principle with the source country principle would change the rules of the European Union, and it would require agreements with sending countries outside of the EU. However, it would limit abuse and solve the impossible trinity. Ideally, the EU should design a system of portable social security claims. This would facilitate the efficient functioning of a truly European labour market, where workers' contribution to welfare systems could be transferred from one country to the other, but their entitlements would be shaped accordingly. Moreover, as shown by Felbermayr and Kohler (2010), the immigration surplus can only be redistributed to natives such that everyone (i.e. highly- and poorly-skilled workers) is made better off, if migrants themselves are excluded from such a redistribution scheme.

Europe faces an unpleasant choice, both in terms of internal and external migration. Without changing the inclusion principle, support for the free movement of labour between EU member states will come under increasing political pressure. Abandoning the principle, however, would risk making our societies more unequal, as the social security treatment of different individuals would be heterogeneous.

With respect to external migration, the trade-offs are even starker: if Europe becomes a fortress that prohibits the immigration of poorly-skilled workers, it denies the possibility of a better life to millions, but it can maintain inclusive social systems. If it allows unlimited immigration but includes everyone in its welfare systems, fiscal sustainability will be jeopardized. If, on the other hand, it allows for the different fiscal treatment of immigrants (foregoing the inclusion principle), it could combine relatively free immigration, guaranteeing large gains to the migrants themselves and more modest ones to the average native, with the existence of a welfare state, but the price would be the presence of a (temporarily) underprivileged class. Again, limiting the inclusion principle appears to be the best choice. In this way, our societies could maintain relatively open borders, guaranteeing gains to natives and migrants. This solution, however, involves sacrificing a golden calf: namely the inclusion principle.

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Panel

Can the new wave of migration turn into a win-win situation for both the immigrants and for Europe? This was the question addressed by Panel 2, chaired by **Edward Lucas**, Senior Editor of *The Economist,* London.

After an introduction by Gabriel Felbermayr, Mr Lucas asked panel member **Kemal Sahin,** founder of the Sahinter Group in Istanbul, about the employability of the recent migrants. Mr Sahin argued that immigration is necessary in light of the need for skilled workers, as well as the problem of ageing societies. His own factory in western Turkey has difficulties finding skilled workers. In the border region to Syria, the refugees have been given work permits, and border cities like Gaziantep are now prospering. Mr Sahin said that his clothing business has become increasingly global and has learned to deal with different national cultures. He has also set up a foundation in Cologne, that helps young immigrants to realise their potential and shows them the benefits they stand to reap from their own cultural backgrounds. Schools, he noted, must also learn how best to promote children from different cultures. Politicians need to stress the contributions made by immigrants, especially to financing the retirement system.

The next panel member, **Reinhard Ploss** of Infineon Technologies, observed that his company needs highly educated personnel to continue growing, and that these people must be sourced internationally, especially in order to compete in global markets. The education levels of current migrants in Germany vary significantly. At Infineon, Mr Ploss sees the diversity of integrated cultures as an enriching factor. “There is a great opportunity in migration”, he noted. All employees, however, must accept the values that the company is based on. This also holds for society in general. The situation we are now facing can only be handled in a multi-generational effort. “We as a country need this migration in order to bring in capable people”. In a global economy, it is wrong to think only in isolated, national terms. Mr Ploss was impressed by how people in Germany dealt with the huge inflows of refugees in 2015. “The message from the people was: we see this is a major problem, we don’t know how to deal with it, but we’re willing to tackle it”. Politicians must also learn to talk about the practical solutions to the refugee crisis.

Elmar Brok of the European Parliament subsequently presented a politician’s view of the current refugee crisis. For him the fear of losing one’s economic and social position is behind the rise of populism in Europe, although this fear does not stem from migration alone. The wave of migration in recent years, however, has given rise to the widespread belief that politicians are not in control of the situation. For years, the EU Commission has made proposals regarding refugees that were not accepted by the member states. Germany changed its mind last July when faced with a flood of refugees. “Now we must painstakingly introduce order in this process to convince public opinion that politicians are able to cope with the problem”, noted Mr Brok.

Responses to the crisis also differ from state to state across Europe: the French do not have the same demographic problem as the Germans. The refugee agreement with Turkey has been a success in that it supports the refugees on the ground and combats human smuggling. In terms of migration from Africa, we have a long-term development problem that must be dealt with using new trade policies and a new Africa policy. In Mr Brok's view, the problem with human smugglers in Libya, which is controlled by ISIS, is particularly grave. This 'business model' must be destroyed or else we will see a new wave of refugees, but this can only be achieved if the African shores can be controlled. A European asylum policy can only be developed if the pressure is removed and countries can rest assured that inflows of immigrants can be limited.

The brain-drain is another problem that urgently needs to be addressed. An immigration policy must not only egoistically look at what European countries need in terms of human resources, but also at what is best for the development of the countries-of-origin that immigrants are leaving. Those with refugee status should receive vocational training, so that they can return to help rebuild their homelands combined with EU assistance to these countries. Finally, Turkey, which has taken in three to four million refugees in recent years, now needs help. Mr Brok described cutting assistance for food in the refugee camps as 'a glaring mistake of Western policy'.

Mr Lucas then asked Gabriel Felbermayr to go into more detail on the distribution of the net gains of migration. "Where are the gains and where are the adjustment costs? What policy measures can help cushion the adjustment costs for those sections of society that feel they are bearing the brunt?" Mr Felbermayr agreed that the low-skilled often lose out from labour mobility, as well as from immigrant labour. It is important to signal to these people that immigration is under control and to show that the welfare state is helping to provide economic security. Investments in human capital enable low-skilled individuals to move out of the market segments that are under pressure and be better off in the long run. This, of course, assumes flexible labour markets and government incentives for workers to upgrade their skills. Keeping immigrants out of the labour market creates pressure elsewhere, namely on the welfare state. If they work, this represents a gain for both the domestic population and the welfare state. "We need a welfare state that both cushions and incentivises participation in upgrading the skills of natives and immigrants at the same time", noted Mr Felbermayr.

Mr Sahin observed that the refugees in Turkey possibly contributed to the unexpectedly high economic growth (4.8 percent) in the first quarter of 2016. This growth was generated by domestic demand and immigrants certainly played a role in fuelling it. Lowing the minimum wage for immigrants, according to Mr Brok, would send out a 'catastrophic message' to native workers that immigrants are taking their jobs.

The first comment from the floor came from former US diplomat and international business consultant **John Kornblum.** In his experience, Germany is not seen as a country that welcomes immigrants. In Berlin, a community action group that works with him has met with strong opposition from bureaucracy in the city government. **Christine Kuptsch,** Senior Specialist in Migration Policy at the International Labour Office, suggested that Mr Felbermayr change his terminology of 'welfare tourism' in connection with the attraction of the welfare state. Migration research has confirmed that decisions to migrate are not made based on welfare-state considerations, people tend to go where they can find work. Mr Felbermayr agreed that although the welfare magnet exists, it is of minor importance in terms of the overall volume of migration flows.

Winding up the questions from the floor, Mr Lucas asked: "how can we define the actual practical steps that need to be taken to get out of this serious crisis?" Mr Brok observed that a great deal of progress has been made at the EU level since last autumn. More implementation is now needed at the national level, for example, in sending the promised personnel to Greece to control immigration. "We have wonderful decisions at the European level, but not so wonderful implementation at the national level", observed Mr Brok. He expressed the hope that the Brexit shock will help us to concentrate on issues that member states cannot resolve on their own: "if we can show that we can bring order in immigration at the European level, the rest will follow".