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REVIEW OF "MIGRATION AND THE WELFARE STATE: WHY IS AMERICA DIFFERENT FROM EUROPE?"

BY ASSAF RAZIN AND EFRAIM SADKA

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In summarizing the political economy of the decade following the Great Recession of 2007–08, one could do worse than Joseph Stigliz's phrase "Globalization and its Discontents" (Stiglitz, 2003). We live in a world of increasing international openness to trade, capital flows, and even migration. Advances in information technology have facilitated nearly costless communication and cheap travel across borders. By some measures, this degree of openness is unprecedented in human history. By others, it is matched only by the previous round of globalization at the turn of the 20th century.

Knowing how the previous round of globalization ended, we ignore political economy and geopolitical considerations at our peril. The previous golden age of globalization bred Communism, Fascism and two world wars. The current round of globalization has led to discontent whose consequences are too early to judge. Globalization has left a portion of the population behind, leading to political movements ranging from Donald Trump's calls to build a wall along the US-Mexico border on the right to protests against the Trans-Pacific Partnership on the left wing of the Democratic Party. In Europe, Britain has turned against half a century of European integration with "Brexit". A Communist party now governs Greece and right-wing populist parties have come to power in Eastern Europe, reminding us that liberal democracy is only a recent phenomenon in these countries. The rise of left-wing populists in Spain has led to seemingly intractable political gridlock, while right-wing anti-immigrant parties have been in the ascendance in Scandinavia. It is still unclear whether the Eurozone crisis will lead to further integration, the disintegration of the monetary union, or some combination of the two.

In search of a conceptual framework to make sense of globalization and its political consequences, one need look no further than the contributions of Assaf Razin and Efraim Sadka over the past several decades. Together with a number of collaborators they have developed theoretical frameworks and assembled empirical evidence to make sense of a world of increasing economic integration. In previous work, they have explored international flows of labor and capital (Razin and Sadka 2002), foreign direct investment

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(Razin and Sadka 2009) and monetary integration (Razin and Sadka 2012). They have also explored the implications of globalization for public finances including international taxation (Frenkel, Razin and Sadka 1992) and the welfare state (Razin, Sadka and Suwankiri, 2011).

Their newest addition to this body of work builds on the intellectual foundations they have laid over the past twenty years. This new monograph brings political economy to the forefront, thus studying the "discontent" more explicitly than their earlier studies of globalization. The monograph is framed through the comparison between the American and the European welfare state and differing attitudes towards migration on the two sides of the Atlantic. They put forth a unified theory that simultaneously explains the greater generosity of the European welfare state and differences in immigration policy in the US and in Europe.

Grossly simplifying the rich detail in this book, their thesis could be concisely summarized as follows. Immigration of low-skilled workers creates winners and losers. Low-skilled native workers are typically harmed. Low-skilled immigrants compete for their jobs and depress their wages. Low-skilled immigrants are also more likely to be net beneficiaries from a generous welfare state, the burden of which low-skilled workers share. In contrast, skilled immigrants may increase the productivity of the low-skilled population and are net fiscal contributors, making them a more attractive form of immigration. The low-skilled native population therefore comprises the discontents with immigration and would push to tilt the composition of immigration toward high-skilled workers. Other groups are more likely to gain from low-skilled immigration. They increase the wages of high-skilled workers and do not necessarily impose a fiscal burden on retirees, who no longer fund the welfare state. This framework echoes the Stolper Samuelson (1941) theorem, but goes further not only in considering immigration but also immigrants' fiscal (and in later chapters their political) implications.

Predictions appear consistent with the recent wave of anti-immigration sentiment. The core of the "wall-building" coalition in the US is white males with low educational attainment. Low income Brits were far more likely to support Brexit in the UK. The call for a "points based" immigration system from the Brexit campaign was an explicit call to increase the skill composition of UK immigrants.

How does the size of the welfare state affect the skill composition of immigration? A more generous welfare state is more attractive to low-skilled immigrants, known as the magnet effect (Borjas 1999). This is a supply-side explanation for the different composition of immigrants in the US and Europe. Europe, with its generous welfare states, is an attractive destination for low-skilled immigrants, but far less so for high-skilled immigrants who are likely to be net fiscal contributors. Indeed, immigration to the US is tilted far more towards high-skilled immigrants than immigration to Europe.

The demand for immigrants, however, goes in the opposite direction. A more generous welfare state (particularly with an aging population) has financing needs that immigrants could fill. With high-skilled immigrants more likely to pay in rather than draw on the welfare state, more generous welfare states are more inclined to try to attract high-skilled immigrants.

Why have European countries been unsuccessful in either encouraging high-skilled immigration or in limiting the size of their welfare state? Razin and Sadka take a page out of their earlier work on tax competition to provide insights. They argue that fiscal independence in a migration union like Shengen leads to policy distortions. Shengen members do not fully internalize the degree to which their generous welfare states attract immigrants, as the costs of immigration are borne by the union as a whole. This contrasts with the US, where both fiscal and immigration policy are set at the national level. Much has been written about the need for fiscal unity in a monetary union, but Razin and Sadka's insight on the need for fiscal unity in a common immigration zone is novel.

The last chapters of this book elucidate the political economy of the welfare state and migration in a very elegant framework. This framework is reminiscent of recent contributions by Hassler et al (2003), but includes immigration. Put simply, there are roughly three constituencies: High-skilled workers, low-skilled workers, and retirees. These three groups have differing views on the size of the welfare state and on immigration. Their views on immigration take into account not only current economic costs and benefits, but also how immigration affects the future composition of the electorate.

The politico-economic differences in the US and Europe are then explained by different coalitions of interests on either side of the Atlantic. In the US, Razin and Sadka argue, the high-skilled are dominant. This is subtly linked to higher population growth in their group, but could easily be explained by American special-interest politics as well, which might put a greater weight on the preferences of the rich. The high-skilled restrict the generosity of the welfare state and opt for selective (high-skilled) immigration, as is observed in the US. In contrast, the authors posit that Europe is in an equilibrium dominated by retirees, who demand a generous welfare state and are open to immigration (even low-skilled) as a financing source. Interestingly, they show that retirees may even accept migrants who have a net fiscal burden on the economy as a whole.

This book exhibits masterful use of economic theory and any economist interested in international migration and public finance would benefit from studying its contents. As with much economic and political economic theory, pecuniary incentives, particularly those that are policy-generated, are front and center. Other factors, such as culture and feasibility of immigration controls, take a back seat. However, these "softer" factors are central to understanding both the motivation of immigrants (the immigration supply) and the preferences of native populations (the demand for immigration). These are important avenues for future research.

Few people take the decision to leave their country of origin lightly. Their choice of destination has similarly important implications for their social, not only economic, life. Gravity models have shown great success in predicting trade flows: distance matters in international trade. Human migrants certainly care more about the distance of their host country from their countries of origin than do commodities. Linguistic similarity has been shown to play a role in predicting cross-border investment. Ability to communicate obviously matters more to an immigrant than to a portfolio investor.

In addition, borders are porous and illegal migrants will choose the path of least resistance. Legal immigrants are attracted to destinations where there are established migrant communities of their culture and language of origin. Concretely, there are roughly 14 million Mexican immigrants—more than 10% of the Mexican population—residing in the US. Most of these are low-skilled workers. The share of Mexican immigrants in Europe is negligible. From a purely pecuniary perspective, this may seem puzzling: the European welfare state is far more generous and these are poor immigrants who may draw on public and social services. The explanation, though, is obvious: Mexico shares a border with the US.

Perhaps herein lies a simpler explanation for the skill composition of American immigration. An ocean separates the US from most of the developing world and Mexico has a population only a quarter that of the US. There is a relatively limited supply of low-skilled immigrants who have easy access to the US. The US therefore has greater power to determine the share of its incoming immigrants that are educated. The EU, in contrast, borders the Middle East and the former Soviet Union and is across the pond from Africa. The stock of potential low-skilled immigrants to the EU is arguably two to four times the population of the Union itself. Syrian refugees and Ethiopian economic migrants may perhaps consider the size of the European welfare state when choosing their destination. But we must also consider that they are a short (yet dangerous) raft ride away from the EU, while no similar strategy is available to them in attempting to immigrate to the US.

Non-pecuniary factors also play a role in the preferences of the native population. Brexit provides a case in point. Immigration was central to the campaign for the UK to leave the EU. But immigrants to the UK provide a net fiscal contribution to the UK Treasury (Dustmann and Fratini 2013) and this was advertised widely in the run-up to the referendum. In fact, immigrants from the EU have a far more positive fiscal impact than do immigrants from the rest of the world (whose net contribution is negative). According to Razin and Sadka, retirees should have been the greatest supporters of immigration, particularly from the EU. Yet 60% of voters aged 65 or older voted to leave the EU. This group was perhaps the strongest base for the Leave campaign. Clearly non-fiscal considerations factored in to their choice.

These avenues for future research should not detract from Razin and Sadka's achievement. They have provided us with a very useful framework to think about immigration and its interaction with the welfare state. They show how this interaction may help explain salient differences between the US and European states. Their work is a useful point of departure for students and researchers of these questions.

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