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# The future of the fence around the European labour market

Henk L.M. Kox<sup>\*)</sup>

## Abstract:

*In international forums the EU calls for freedom of movement for goods, services and capital. Freedom of movement of labour - labour migration in other words - is excluded from this claim, certainly in relation to medium- and low-skilled labour. This paper addresses two questions. Firstly, what are the effects of EU's restrictive labour migration policy on welfare within and outside the EU? Both welfare effects are found to be considerable. Secondly, is this policy sustainable over the longer term, say towards 2030? The paper evaluates foreseeable pressures on the fence around the EU labour market, coming from within and from outside the EU. The paper sketches policy options for dealing with the dilemmas that may arise from these pressures.*

JEL codes: F22, F52, J61

Keywords: labour migration; European Union; migrant workers; welfare effects

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# **The Future of the Fence around the European Labour Market**

## **1. Introduction**

Non-EU nationals who want to work in the European Union have to pass a border check. This is no symbolic border. The admission criteria for the European labour market are so strict that the barrier remains closed for most potential entrants from outside the EU. Lower-skilled migrants in particular have little chance of getting into the EU legally.<sup>1</sup> There is a fence around the EU labour market, often even literally.

In international forums the EU calls for freedom of movement of goods, services and capital. Freedom of movement of labour – labour migration in other words – is excluded from this.<sup>2</sup> Why this exception? If its borders were open, the EU would, because of its size and economic power, act as a strong magnet for workers from a wide region around the Union.

This essay asks two questions. Firstly, what are the effects of EU's restrictive labour migration policy on welfare within and outside the EU? Secondly, is the policy sustainable over the longer term (towards 2030), in view of foreseeable pressures from within and outside the EU?

The paper is divided as follows. First we outline the main principles of the current EU policy on labour migration (section 2). In sections 3 and 4 we examine the economic implications of a restrictive labour migration policy and provide a number of empirical indications. In order to analyse the future of the fence around the European labour market, we discuss in section 5 a number of factors which will probably force a change in policy over the coming decades. In section 6 we summarise the expected dilemmas and choices. In section 7 we discuss policy options. And in section 8 we draw a number of general conclusions.

## **2. Main lines of EU labour migration policy**

The regulation of labour migration is an important and controversial part of public policy. Migration policy generates fierce political debate in all EU member states, with xenophobia and discrimination never far from the surface. The objectives of the policy are rooted in political choices. At European level these objectives are formulated very explicitly. The main reason for this is that responsibility for actual labour migration policy rests primarily with the member states. At a meeting of the European Council in Tampere, Finland, in October 1999, the member states formulated some basic principles; however, these do not go much further than that the 'national legislations on the conditions for admission and residence of third country nationals' will be coordinated 'based on a shared assessment of the economic and demographic developments within the Union as well as the situation in the countries of

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<sup>1</sup> When this paper refers to "migrants", we mean only labour migrants – not asylum seekers, refugees or family members being reunited – unless specifically stated otherwise in the text.

<sup>2</sup> An exception is also made for the market for agricultural products.

origin'. In practice the EU sets itself a task which is based exclusively on 'the needs of the market place' in the current EU member states:

*Admission for economic migrants should clearly address the needs of the market place particularly for the very highly skilled, or for lesser or unskilled workers or for seasonal labour. Admission policies for economic migrants must enable the EU to respond quickly and efficiently to labour market requirements at national, regional and local level [...]* (Commission of the European Communities, 2000:15).

Despite the lip service being paid to bearing in mind 'the situation in the countries of origin', current European labour migration policy is aimed primarily inwards and seeks to maximise welfare in the EU. It should not come as a surprise that migrants are not to be granted the same rights as EU nationals:

*The underlying principle of an EU immigration policy must be for different purposes, that persons admitted should enjoy broadly the same rights and responsibilities as EU nationals but that these may be incremental and related to the length of stay provided for in their entry conditions* (ibid., p. 16).

The admission of labour migrants is implemented in accordance with the labour market requirements and interests of the member states. In each EU member state the admission policy for labour migrants is determined by domestic forces:

- employers who want to bring in migrants for difficult-to-fill vacancies or because they will accept lower wages;
- trade unionists who guard against any negative effects of migrant inflows on wages and jobs;
- politicians who argue over the effects of migrant inflows on the social security system and social cohesion.

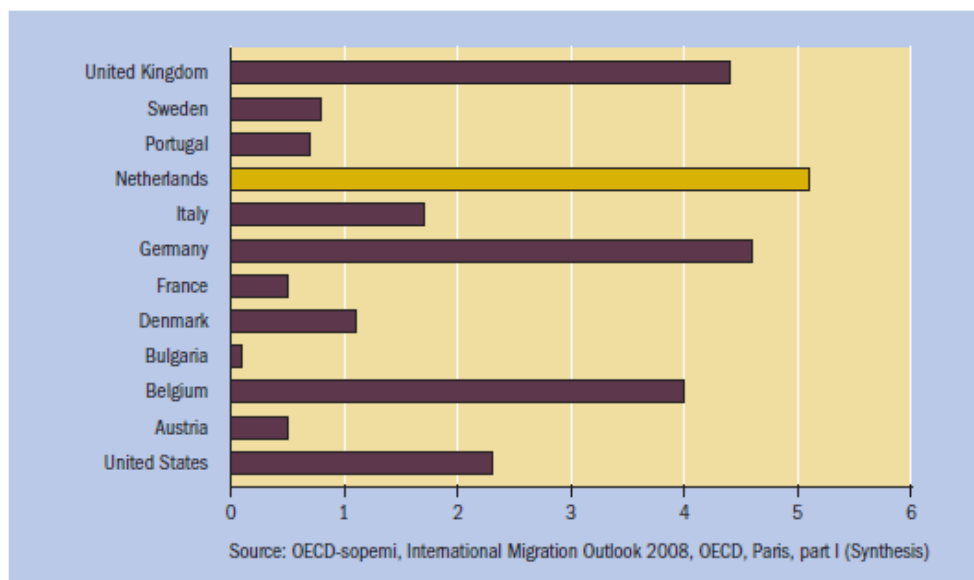
The preferences and the policy choices flowing from them may differ by member state. The visions of the member states tend to diverge in particular with regard to low-skilled immigrants. This is the reason why the European Commission has not developed any common policy in this area.<sup>3</sup> Figure 1 shows that the proportion of labour migrants with temporary residence status (most of them without higher education) differs considerably between individual EU countries. Incidentally, it is worth noting that there are elements in labour migration policy where the EU acts as a single entity, such as in enforcing and

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<sup>3</sup> The EU member states have repeatedly (2001, 2005) denied the European Commission the scope to develop a framework labour migration policy. On the Commission's website (DG Justice and Home Affairs), the implicit difference of opinion is formulated as follows: "The Commission fully recognises that decisions on the numbers of economic migrants to be admitted in order to seek work are a matter for the Member States. However, decisions to admit such third country nationals in one Member State affect others (right to travel within the Schengen area, to deliver services in other Member States, to move to other Member States once long-term residents status has been acquired; impact of the admission of third country workers on the EU labour market) and the EU has international obligations in relation to some categories of economic migrants. The Commission therefore believes that there is a clear case for agreeing transparent and more harmonised common rules and criteria at EU level for admitting economic migrants." See: [http://ec.europa.eu/justice\\_home/fsj/immigration/work/fsj\\_immigration\\_work\\_en.htm](http://ec.europa.eu/justice_home/fsj/immigration/work/fsj_immigration_work_en.htm).

guarding the external borders against illegal immigration (Laitinen 2008).<sup>4</sup> Since 2007 the EU has also been united in relaxing admission to the European labour market for scientists and other high-skilled knowledge migrants from outside the Union. But for low-skilled labour migrants the barriers remains the most restrictive.

**Figure 1 Labour migrants with temporary residency status per 1,000 residents in 2006, European Union and United States**



### 3. Economic implications of a restrictive labour migration policy

The analysis of wealth effects can offer relevant insights for the fundamental choices and formulation of labour migration policy. The objective of current EU labour migration policy can be summarised as maximising the “immigration surplus”, the net output growth generated by the deployment of new labour migrants. “Net” in this context means that account is taken of any displacement or substitution of EU workers as well as of the implications for social provision and taxation.<sup>5</sup>

The size of the immigration surplus depends primarily on whether the migrants have complementary qualities in comparison with the native EU labour force. If they have knowledge and skills which are scarce within the EU at that time, then their arrival will lead to additional output opportunities. Generally speaking it is the case that the more complementary the qualities and specialisations of the labour migrants, the greater the additional output opportunities; the upshot is a higher immigration surplus. The flip side of the coin, however, is that substitution effects are generated when labour migrants enter the EU whose qualities are comparable with those of part of native EU labour force. This is called “substitution” because the incomers will compete with EU workers for similar jobs, which puts pressure on the wages of this group of workers.<sup>6</sup> Firms that employ these workers will be

<sup>4</sup> A major role is played in this context by Frontex, an organisation with a budget of EUR 72 million established in 2004, which is responsible for the coordination of EU border security with the member states on the external borders.

<sup>5</sup> See Boeri and Brücker (2005), DeVoretz (2008; 2004), Roodenburg et al. (2003).

<sup>6</sup> Partial complementarity leads to in differentiated income effects. People with complementary characteristics compared to the labour migrants then become relatively scarcer, so that their incomes increase. Let us assume, for instance, that there are three low-skilled jobs for every two high-skilled jobs. In a large inflow of low-skilled

able to reduce their wage costs and boost their profits over the short term. Businesses are often the driving forces behind relaxations of admission policies for labour migrants. This gives them access to workers for difficult-to-fill vacancies or cheaper workers for existing jobs.

The above reasoning assumes that wages completely adjust to the supply of and demand for labour. But that need not be the case. The minimum wage which most EU member states have introduced for social reasons makes the labour market less flexible.<sup>7</sup> The structure of the minimum wage and social security benefits may be such as that native workers are not prepared to take on certain unattractive jobs. In that situation unfilled vacancies and unemployment can go together. Labour migration should in principle provide relief here. But when labour migrants make few demands and are even willing to work below the minimum wage, then it will not only be the difficult-to-fill vacancies that will be filled. A proportion of the migrants will find jobs at the expense of EU workers.

In labour markets with rigid wage structures, immigration will lead to more unemployment among comparable native workers. This is likely to happen at the bottom end of the labour market in particular, and will be reinforced by the existence of a compulsory minimum wage. When “native” unemployment increases at the bottom end of the labour market, then the minimum wage will probably also come under pressure.

### **3.1 Does the theory correspond with the practice?**

Empirical studies on substitution effects caused by labour migration show mixed findings. The empirical effects that are least disputed concern the impacts of immigration on wages and employment of the low-skilled workers. A large comparative study of hundreds of different studies concluded that a 1% increase in the ratio between immigrants and native workers leads to a 0.12% decrease in native wages (Longhi et al. 2006). The wage effect proved slightly higher in the European Union than in the United States. Some studies find substitution effects for native low-skilled workers.<sup>8</sup> Another striking outcome is that new migrants often compete more with already present migrants than with native workers. The inflow of low-skilled migrants seems to have a positive effect on the incomes of the higher-skilled, which points to a complementarity between these two types of workers.

The current EU admission policy applies selection at the gate, above all to attract migrants with scarce (and complementary) knowledge and skills and to counter substitution effects for low-skilled EU workers. The potential substitution effects are deemed to be greatest among the unskilled and low-skilled. In 2007 the EU admission policy for knowledge migrants was relaxed on the grounds that their knowledge and experience would be complementary and the substitution effects would be minimal. It is an open question whether this latter assumption is correct.<sup>9</sup>

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labour migrants, the high-skilled workers become relatively scarce and high-skilled salaries will rise. The reverse will happen if high-skilled migrants account for most of the inflow.

<sup>7</sup> See e.g. Nickell (2003) and CPB/SCP (2005).

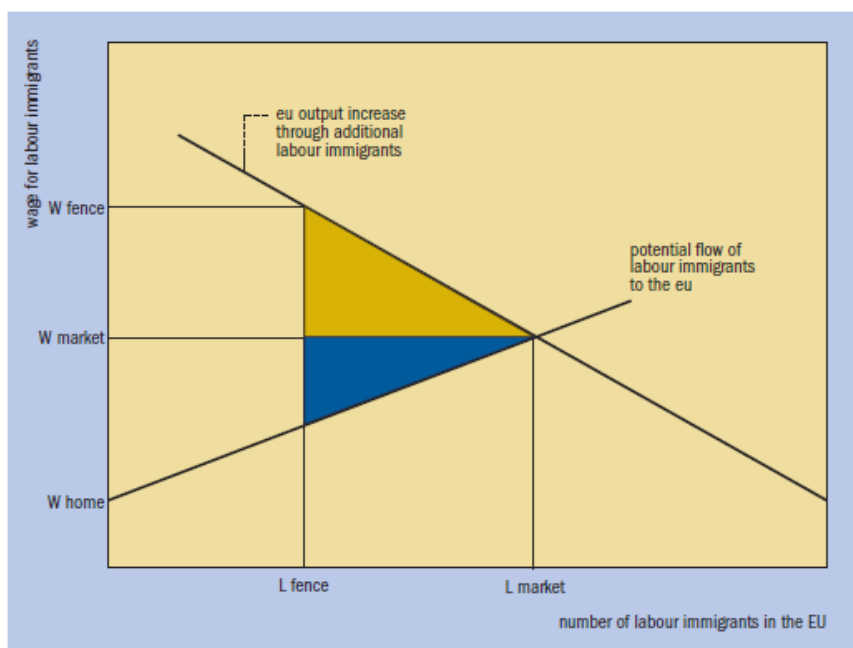
<sup>8</sup> Borjas (1999), Borjas et al. (1997) and Borjas and Katz (2005).

<sup>9</sup> For the Netherlands Noailly *et al.* (2005) did find substitution effects in the admission of high-skilled knowledge migrants. The relative lagging of salaries for high-skilled science and engineering graduates in the Netherlands could only be explained by the relatively large inflow of high-skilled foreign science and engineering graduates. Freeman (2005) draws similar conclusions with regard to the US science and engineering labour market. Borjas (2005) found that a 10% increase in the number of accepted foreign postgraduate students at US universities led to a 3-4% salary reduction for competing native postgraduates.

### 3.2 The welfare impacts of a fence around the labour market

When considering the effects of “the fence”, it helps to draw a comparison with the trade in goods. Using barriers to protect markets from imports is usually motivated by a wish to protect domestic producers.<sup>10</sup> A major effect is that this creates an artificial shortage at home. After all, because foreign goods are being kept out, home-produced goods are scarcer and will therefore fetch a higher price. The artificially created scarcity generates a “rent” income for home producers. Such “rents” also arise from the protection of the EU labour market. From the perspective of the operation of the global labour market, the EU admission restrictions artificially reduce the available labour volume within the EU. This is illustrated in figure 2.

**Figure 2 Basic effects of the fence around the EU labour market**



The potential flow of migrants to the EU is represented by the diagonal line running from “southwest” to “northeast”. This shows that migrants want to earn at least what they can earn in the home country (“W home”). Higher wages in the EU will attract a larger number of labour migrants from outside.

The demand for migrant labour arises from employers that can profitably produce additional output with migrant labour. This is represented by the diagonal line running from “northwest” to “southeast”. The point where both lines intersect marks the putative outcome for a completely open labour market without barriers. In this case the number of migrants would be equal to the “L market”, and the average wage would be equal to the “W market”. However, because of the fence around the EU labour market, only “L fence” migrants are admitted. We can now identify three effects. Firstly, the “W fence” wage is higher than in the situation with open markets. This makes the EU even more attractive for the potential migrants, and makes it more likely that (attracted by “W fence”) they will try to climb over the fence as illegal migrants.<sup>11</sup> Secondly, the yellow triangle indicates the total “rent

<sup>10</sup> This happens above all when domestic producers essentially produce too expensively compared to the world market, but also have a strong lobby (e.g. European sugarbeet growers) or because governments decide that they fulfil socially useful functions (e.g. organic dairy farmers in mountain regions).

<sup>11</sup> Note that without a fence there would no be difference in economic terms between legal and illegal labour immigration.

of the fence” for native EU workers. This rent is in fact an income redistribution from employers to native employees.

The employers can now realise less production in a profitable way due to higher wages, which they will eventually pass on to all EU citizens by raising prices. And thirdly, the blue triangle indicates the effects outside the fence. This is the total loss of potential income for the excluded labour migrants from the countries surrounding the EU.

The fence around the labour market thus means that the wages of EU workers contain a rent element (i.e. the difference between “W fence” and “W market”). This rent flows primarily to those EU workers with economic characteristics which most overlap with the potential migrants kept out by the fence, the low-skilled in other words. The internal rent (yellow triangle) is paid by EU employers in the first instance, but eventually all EU residents foot the bill through higher prices of goods. Moreover, the fence also has negative consequences in the surrounding countries. The total welfare impact of the fence in money terms is equal to the yellow and blue triangles in figure 2.

### **3.3 Is removing the fence the best option for EU welfare?**

Our analysis of the welfare impacts of the fence around the labour market assumed a basic scenario with open markets. A caveat should be mentioned here. The unfettered operation of labour market forces does not necessarily lead to an optimum welfare outcome, when “external effects” occur that neither the employers nor the labour migrants take into account in their choices.<sup>12</sup> For labour immigration these “external effects” may include the following:

- Effects on tax revenues and social security provisions. In a number of EU countries the welfare state guarantees its citizens a minimum level of social security provision from the cradle to the grave. The financing and sustainability of this “collective insurance policy” stands or falls with the taxes and insurance fees that workers pay during their working lives.<sup>13</sup> The sustainability of such a collective safety net comes into question at the moment when many labour migrants with a weak labour market potential flow into the country. These workers will make relatively large demands on the safety net, while contributing relatively little in taxes and insurance fees.
- Positive wealth effects as a result of the indirect contributions by migrants to new knowledge, technology, culture, entrepreneurship, goods and services.
- The demand from businesses for low-wage migrants may lead to a situation where weak industries are kept afloat unjustifiably. It may even lead to the deferral of a more structural approach to the industries’ waning international competitiveness, like innovation in products and production methods or and retraining of workers.
- Effects on social integration and cohesion. Large, wave-like changes in the influx of labour migrants with different cultures and customs may – in connection with competition on the labour market and claims on public services lead to social tensions and loss of cohesion (Van Dalen 2005; CPB/SCP 2005).
- Immigrants from developing countries are probably more used to a reference framework in which they tolerate restrictions of their economic and social rights as a price for obtaining jobs in the EU. This may have negative effects for the social capital and institutional quality of European society.

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<sup>12</sup> See e.g. Boeri and Brücker (2005) and Docquier (2006).

<sup>13</sup> The notion of a “group insurance policy” is used here as a metaphor for the whole system of schemes, benefits, contributions and rights which together constitute the welfare state.



The EU labour migration policy will also have to consider these “external effects” when making future-oriented choices. The “external effects” may differ by type of immigrants. Highly educated migrants are more likely to make a positive contribution to the “immigration surplus” through new knowledge, products and entrepreneurship. Because of their earnings they are also more likely than the unskilled workers to make a net positive contribution to the funding of the welfare state. Highly educated labour migrants tend to speak a EU language better and sooner, and consequently they can also adapt more easily than unskilled labour immigrants.

#### **4. Effects of the fence outside the EU**

Current European labour migration policy is aimed at maximising welfare within the Union. At the same time the EU ignores the effects of this policy beyond its borders. A small country like Denmark or Switzerland may conveniently assume that its national choices on labour migration will have negligible welfare impacts in other countries. But because the EU is such a large economic bloc, the effects of its policy decisions will bear more heavily on the surrounding countries. This also applies to the fence around the European labour market for low-skilled labour migrants.<sup>14</sup>

For many countries of origin, remittances from migrants abroad constitute a substantial proportion of their foreign exchange earnings. The migrants excluded by the EU represent missed incomes, and in that sense the fence around the European labour market is a negative factor for these countries’ national economic development. Their incomes are squeezed compared to a situation with fully open labour markets.<sup>15</sup> Incidentally, these countries are also markets for EU exports of goods and services. Thus the restrictive labour migration policy indirectly has a negative effect on European exports.

eu migration policy also has effects on the labour markets in the migrants’ countries of origin. Because many high-skilled workers but only a few lowskilled workers are selected, the EU is essentially cherrypicking the best and brightest from their labour forces. Precisely those people who could make a significant contribution to the development of their own country disappear in a “brain drain” to the EU. Although ultimately the decisions are made by individuals, the brain drain of high-skilled workers acts as a brake on the development of their origin countries. The example often quoted in this context is the negative effect of departing local doctors on the local health service.<sup>16</sup> Conversely, the departure of low-skilled workers to the EU would actually reduce local unemployment in the home countries and raise wages there.

These broader wealth effects are hardly considered in the European decisionmaking process. Nor are the problems and crime inflicted on neighbouring countries in connection with the trafficking of illegal migrants from countries of origin further away (see e.g. Cornelius 2001).

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<sup>14</sup> Hatton and Williamson (2006: 205) estimate that in 2000 the European Union was home to around 32% of the world’s migrants (including non-labour migrants), and the United States to around 23%.

<sup>15</sup> In figure 2 this wealth effect on “third countries” is indicated by the blue triangle.

<sup>16</sup> It should of course also be borne in mind that a proportion of the high-skilled migrants return from the rich countries with new knowledge, insights and experiences (World Bank 2006). In the migration literature there is also a view that the brain drain does not need to be a problem if the possibility of admission to one of the rich countries is in effect the incentive which persuades individual people to invest in their own development. This should lead to a broader participation in education than would have been the case otherwise, while in the end not everyone with a higher education will leave the country.

#### 4.1 How large are the welfare impacts “outside the fence”?

A number of recent studies based on micro-data show that a significant proportion of the international income differences between comparable workers can be explained solely by where the workers live. It matters whether one lives in Guatemala, Tunisia or Ghana rather than the United States or the European Union. Of course we should not compare apples with pears in such a comparison. But after adjustment for such factors as country of birth, country of education and training, number of years in education, number of years in work, gender, rural or urban background, a serious income gap remains.<sup>17</sup> Clemens et al. (2008) call this the “place premium”, that is, the income difference which can only be explained by the existence of a fence around the labour markets of the developed countries. The place premium gives an indication of the “rent of the fence” per worker. Table 1 compares wages in selected developing countries with those of comparable workers in the rich countries.

**Table 1 Average wage difference with workers in exactly the same occupations in rich countries, 1988-1992**

	type of developing country		
	richer developing countries	middle-income developing countries	poorest developing countries
wage difference in percent <sup>a</sup>	57 %	72 %	79 %

<sup>a</sup> This concerns the median wage in each national skill category compared with the highest wages of the skill group, with the corresponding ratio for the rich countries used as the numeraire. For example: the median wage in the middle-income developing countries (averaged across all skill categories) is only 28% of the median wage of workers in the same occupations in the rich countries, so that the place premium is 72%.

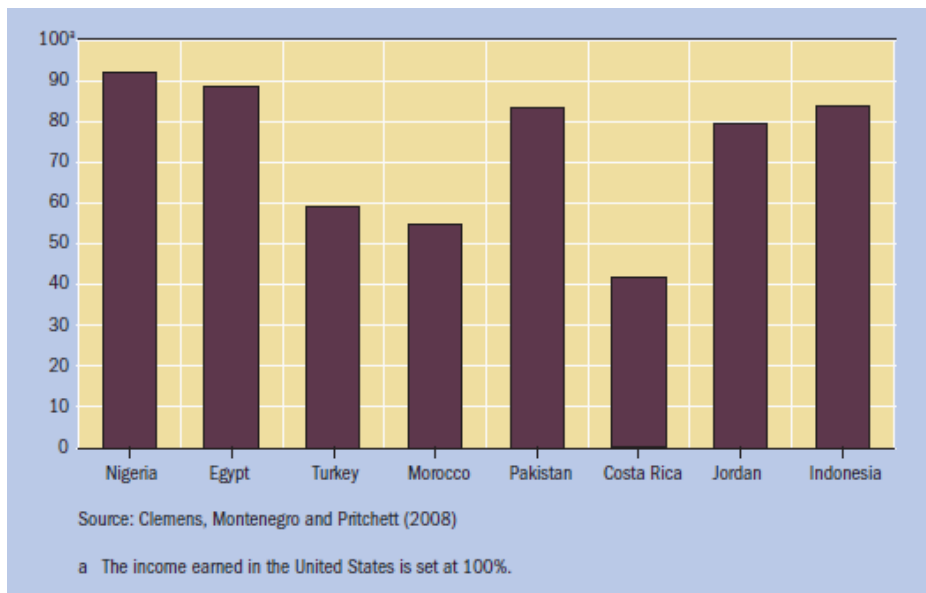
Source: Freeman and Oostendorp (2000)

It turns out that the place premium is highest in the poorest countries. Leaving aside the migration costs, this means that migrants from the poorest countries can earn about five times as much in the European Union or the United States. In similar research Clemens et al. (2008) calculated how much people with the same education and background could improve their incomes by going to work in the United States. Some of their results are shown in Figure 3. For instance, averaged across all skill categories, in their home country Egyptians earn only 12% of what they could earn in the United States.<sup>18</sup> So by migrating to the United States they could increase their income roughly eightfold. In so far as the place premiums offer an indication of the “rent of the fence” (per worker), there is a considerable difference indeed.

<sup>17</sup> See e.g. Hanson (2008), Clemens and Pritchett (2008), Freeman and Oostendorp (2000), and Clemens et al. (2008).

<sup>18</sup> This has been adjusted for national price differences, expressed in purchasing power parities (PPPs).

**Figure 3 Percentage improvement in wages when workers from developing countries perform the same job in the United States, 1999-2001**



Several studies have investigated scenarios for the macro-economic effects of a more generous admission of labour migrants from developing countries. An older study is that by Hamilton and Whalley (1984). They calculate that the economic effects of free migration for developing countries are typically several times larger than the effects of trade liberalisation. Free migration could even lead to a doubling of the world economy. Keijzer, Linnemann and Tims (1991) and Fischer et al. (1991) estimate that the restriction on labour migration by OECD countries leads to a “rent of the fence” of around USD 1 trillion.<sup>19</sup>

Winters et al. (2002) and Walmsley and Winters (2005) have made a differentiated estimate of a scenario in which the developed countries allow in 3% more unskilled and skilled migrants from developing countries. This would have a positive welfare impact worldwide of USD 156 billion. The income growth for the additional temporary labour migrants to the EU would be USD 64 billion. There is also a small, but positive, immigration surplus for existing EU residents of USD 3 billion. The latter is due above all to the higher output which becomes possible in the European economy. Strikingly, within the EU the largest output growth occurs in service sectors (trade, “other services”, construction). Walmsley and Winters also find that the relaxation of admission restrictions for unskilled labour migrants would have a significantly larger welfare impact than the same measure for skilled labour migrants.<sup>20</sup>

The World Bank has also run a scenario where the high-income countries allow in 3% more labour migrants, or around 13 million people (World Bank 2006). This would boost the world economy by more than USD 350 billion.<sup>21</sup> This is around double the estimate by Walmsley and Winters. It is also significantly more than the projected net effect of the Doha Development

<sup>19</sup> The “OECD countries” are the member states of the Organisation for Economic Cooperation and Development (OECD). Fischer et al. (1991), Keijzer (1994, 1998).

<sup>20</sup> The latter difference is mainly because the departure of skilled labour leads to more output losses in the countries of origin, the “brain drain” in other words.

<sup>21</sup> Adjusted for the differences in cost of living between countries (World Bank 2006: table 2.3).

Round sponsored by the World Trade Organisation (WTO). The positive effects would exceed total development assistance if the additional migrants would remit only one-third of their earnings to their countries of origin. Another interesting aspect is the distribution of the projected welfare impacts across various groups: “old” migrants which are already in the rich countries (– USD 88 billion); other residents of the developed countries (+ USD 139 billion); the new migrants (+ USD 143 billion); and the people left behind in the migrants’ countries of origin (+ USD 162 billion). The substitution effects caused by the new inflow of labour migrants will impact above all on previous migrants in the rich countries. But the wealth gains elsewhere are in principle large enough to offset the deterioration in the position of “old” migrants.

## **4.2 Conclusions on welfare impacts “outside the fence”**

All studies on the effects of barriers to international labour migration point in the same direction: the global economic effects are already very large. Even a modest relaxation of the admission policy for low-skilled migrants would have positive effects for the developing countries likely to be many times more than what can be achieved with development assistance or trade liberalisation. The large wealth effects “outside the fence” reinforce the need for sound and balanced choices with an eye to the future.

## **5 The fence around the European labour market comes under pressure**

Regardless of whether the fence around the European labour market should remain on social grounds, it is very much an open question whether the fence will actually last until 2030. There are two forces outside the EU which are putting the current policy under pressure: the widening income gap between the EU and the countries of origin of potential migrants (section 5.1), and the organised economic and political pressure exerted by the developing countries to further open the EU labour market for their migrants (section 5.2). Moreover, it is likely that the fence will be rattled from the inside as well. Section 5.3 considers the likely effects of population ageing on the European demand for labour.

### **5.1 Widening income gap between the EU and the migrants’ countries of origin**

At the moment income inequality within countries is considerably smaller than income inequality between countries. Research into income trends over the long term by Maddison (2001) shows that the income gap between countries is widening rather than narrowing. Bourguignon and Morrison (2002) calculated the changes in worldwide personal income distribution over more than a century. They concluded that until the 1930s the skewed income distribution within countries accounted for most of global income inequality. But since the 1960s in particular the skewed income distribution between countries has been responsible for more than 60% of personal income inequality. The gap has widened rather than narrowed in recent decades.

A comparison of gross domestic product (gdp) per head of the EU population compared with that of most migrants’ countries of origin also shows that the gap is widening rather than narrowing in most cases.<sup>22</sup> There exists a large and still widening absolute income gap with countries within a range of 1,000 km of the EU’s external borders (e.g. Weizsäcker 2008). Maintaining a fence

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<sup>22</sup> This remains the case even after adjustment for domestic purchasing power for the lower prices (Pritchett 2006).

around the EU labour market for the low-skilled will become more difficult in the future because of the intensifying pressure of illegal immigration. Illegal labour migration generally involves low-skilled workers. The higher-skilled more often need a paper track record, such as certificates and diplomas, in order to get work. The OECD (2006) has estimated that the number of illegal immigrants stood at 1-2% of the total EU population in 2001-2004.<sup>23</sup> The pressure will be greatest at the EU's external borders. Illegal migrants already account for around 60% of all migrants in Greece, and for 30% in Italy (Jandl 2004). The pressure of illegal border crossing at Europe's external borders will doubtless intensify. A 2009 opinion poll among Algerians found that 29% of men aged between 15-34 years said that they "certainly" intended to emigrate to Europe or elsewhere illegally, and 21% said that they "probably" would. The three main motives were: better paid jobs, more human rights and "more fun" (The Economist, 5 March 2009).<sup>24</sup> The costs associated with countering illegal migration will therefore probably increase under unchanged policies. This is important, because illegal labour migration generates stronger substitution effects for low-skilled natives than legal labour migration (Venturini 2004).

## **5.2 Political pressure from large developing countries to open the EU labour market**

Within the formal trade negotiations and other international negotiating forums the large developing countries will also bring pressure to bear for a further opening of borders to labour migration. The developing countries are already demanding such concessions in exchange for international agreements in other areas which the EU considers important. This will most probably become a more common pattern. Examples where this can play a role are the climate change negotiations or the WTO negotiations, where the EU champions agreements on intellectual property rights (TRIPS) and trade in services (GATS).

## **5.3 The effect of ageing on the European demand for labour**

The expectation is that population ageing in the EU, especially in Germany, Eastern and Southern Europe, will create bottlenecks on the labour market (Berkhout et al. 2007). As the bars in figure 4 show, the size of the European labour force will decline in absolute terms. What is worse, the balance between non-working people (children, pensioners) and working people will deteriorate sharply, especially after 2015. This is reflected by the line in figure 4 (which should be read with the right-hand scale).

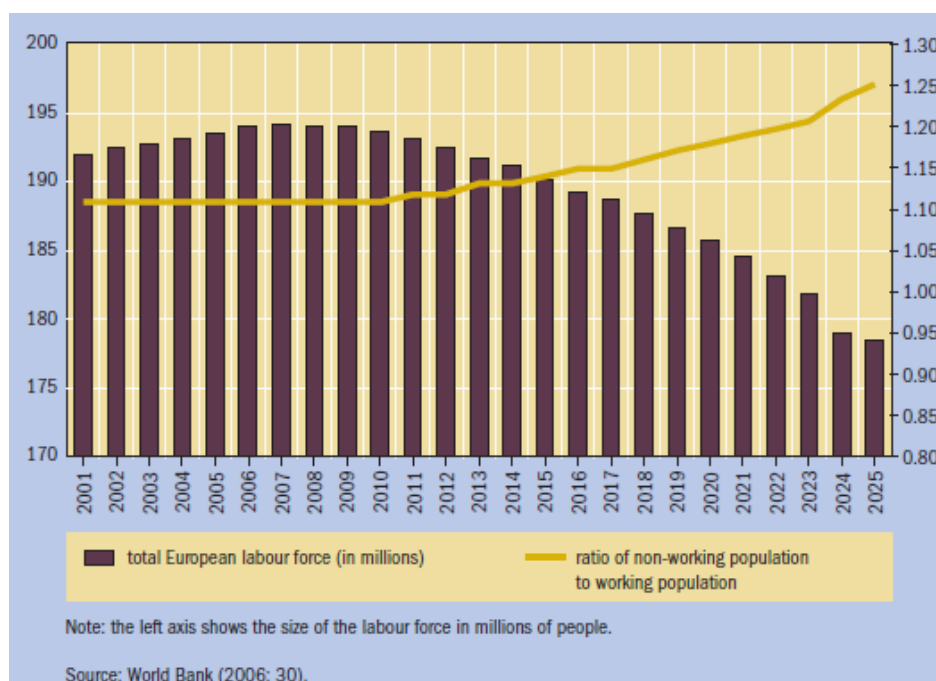
Labour migration cannot offer general relief for an ageing population, because the migrants themselves will also age and the immigration inflow would have to increase steadily (Coleman 2008). However, labour migration can ease future problems in public services such as education and healthcare, as well as in the hotel and catering industry, for instance. It is precisely in these sectors that ageing will have the most powerful effects. This is because these sectors are

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<sup>23</sup> This ranged from 125,000-230,000 (0.8-1.4% of the total population) in the Netherlands to 690,000 (1.6%) in Spain, 700,000 (1.2%) in Italy, 185,000 (1.8%) in Portugal and 370,000 (3.4%) in Greece. By comparison, the number of illegal migrants in the United States is estimated to be 10.3 million (3.6%).

<sup>24</sup> The 2011 uprisings in Northern Africa and the consequent disruptions in the economies of Tunisia, Libya and Egypt may have bolstered these opinions even further, as indicated by the large flows of illegal immigration into Malta and Italy.

**Figure 4 Ageing effects in Europe, 2001-2025**



characterised by limited scope for productivity gains owing to the nature of the services they provide. This has been called “Baumol’s cost disease”. By 2030, when the proportion of 20-65-year-olds will have fallen sharply as a result of ageing, these sectors will have the most trouble filling their vacancies. The larger group of older people will consume relatively more of these services, especially medical and care services. Moreover, the wages of these sectors will continue to rise in line with the national average. Inevitably these services will become ever more expensive in comparison with other goods and services (Pomp and Vujic 2008). Some healthcare services and forms of education may well become unaffordable by 2030 because of the scarce native labour supply, unless more labour migrants are admitted for these occupations and sectors. Precisely because command of the language and cultural assimilation are so important in these occupations, the filling of the foreseeable vacancies in this type of EU jobs requires a long-term vision. Many of the previous experiments with flying in non-eu labour migrants (e.g. in the healthcare sector) have proved less than successful, because it was wrongly thought that the migrants would be deployable at short notice. It seems more realistic to assume that for these occupations in particular an adjustment and assimilation period of at least five years will be required, a period during which the migrants must be able to invest in their human capital (language, culture, knowledge).

As the European labour force aged between 25-50 years shrinks as a result of ageing, the wages of this category of workers employed in exporting European businesses will probably rise, not least owing to the immigration restrictions. In industries where production is mobile, jobs can also move to the people instead of vice versa.<sup>25</sup> A number of companies are likely to relocate to countries where workers are more plentiful and cheaper. Such direct foreign investments relieve the pressure on the fence around the EU labour market in three ways. They reduce the demand for low-skilled workers in Europe, and they reduce the upward pressure on wages in Europe.

<sup>25</sup> Incidentally, this is not an option in sectors where production needs to take place close to consumers (as is the case for many services).

Both effects together reduce the “pull” factor in migration. What is more, the plants of the multinational companies also create more jobs and improve income prospects in the countries of origin of potential migrants. This will also weaken the incentive to emigrate to the EU to find a job.

## **6. Dilemmas for future EU labour migration policy**

In the coming decades the EU will be confronted with the question whether it can or wants to maintain its restrictive labour migration policy, and if so, in what form. It will become more difficult to resist the political pressure which the developing countries will exert against the negative effects of the European fence on their welfare. Less well organised, but perhaps even more important, will be the pressure generated when growing illegal immigration drives up the costs of patrolling the closed external borders. Within the EU, population ageing will tighten the labour market and make some public services (especially education and healthcare) unaffordable from 2015 in particular.

Should the principles of the current labour migration policy – namely maximising the immigration surplus, countering substitution effects for low-skilled EU workers, and preserving social cohesion – be abandoned under these circumstances? Certainly not. There seem to be sufficient means of retaining these principles while making borders more open. The extent of complementarity and substitution between migrants and the native labour force may shift between now and 2030, not least owing to the demographic changes which will occur over this time period. A combination of selective and temporary admissions with positive incentives for integration should ensure the right numbers, and above all the right qualities, of labour migrants. Under a selective admission of labour migrants, it is a government agency that chooses rather than blind market forces.

Public support for labour migration policy will remain important in the future as well. The quality of the immigrants is essential in this context. We can draw on a well-documented lesson from the past here. In the course of the mass European emigration from 1850-1910, a definite policy change took place in the then immigration countries (United States, Canada, Australia) – from hospitable welcomes to quotas and restrictive admissions.<sup>26</sup> This turnaround was not triggered by an increase in the number of immigrants, but occurred precisely when the composition of the migrant flow changed from predominantly skilled to predominantly unskilled (Hatton and Williamson 1998, 2004). At that point the enthusiasm among the native populations switched to xenophobia and discrimination, and policymakers decided to close off the immigration flows. With hindsight Hatton and Williamson conclude that the changed composition of the migrant flow can be traced to the weakening of the self-selection mechanism in the migrants’ countries of origin.

Positive self-selection among migrants develops above all through the fixed costs of migration: the cost of the journey, the costs of bridging the period without permanent earnings, the search and communication costs, the costs of intermediaries and traffickers, and the emotional costs

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<sup>26</sup> The US president Benjamin Franklin welcomed Irish immigrants to the United States as follows: “The only encouragement we hold out to strangers are a good climate, fertile soil, wholesome air and water, plenty of provisions, good pay for labor, kind neighbors, good laws, a free government and a hearty welcome” (Laxton 1996).

associated with leaving loved ones in the home country.<sup>27</sup> Meeting these fixed migration costs will be easier if migrants have better opportunities on the labour market in the immigration country as a result of their education, their ability to speak the language, and other capacities (Faini 2001). This leads to a positive selfselection effect in comparison with those who stay behind. The probability of positive self-selection of migrants thus increases in line with the level of fixed migration costs. For many people in the developing countries these fixed migration costs are still simply too high.<sup>28</sup> It explains why most labour migrants come from the somewhat richer developing countries. The physical distance between the origin country and the potential destination countries raises the fixed migration costs and hence reinforces positive self-selection. Table 2 illustrates this effect. The positive self-selection effect in terms of years of education is smallest in the Balkan countries and Mexico, which are relatively close to the large immigration countries. For these migrants the distance-related costs are lower (Clark et al. 2002). In short, physical proximity will continue to be a major factor in labour migration flows for some time to come.

Peridy (2006) used econometrics to estimate which factors determine migration to the EU.<sup>29</sup> He found that an increase in the income difference between the EU and the migrant's country of origin leads to a significant increase in the migration flow to Europe. He also found confirmation of the existence of fixed migration costs such as physical distance, language differences and living costs. If the income gap between the EU and the origin country is small, then these fixed costs stop a migration flow from taking off. If there is a network of migrants from the source country in the EU, then the migrant flow will increase. Age also plays an important role: the lower the average age in the source country, the more migrants will leave for the EU.

The positive self-selection among migrants weakens in response to the emergence of informal migration networks because the latter reduce the information and search costs for new migrants (Pedersen et al. 2008). It then becomes easier for migrants to survive without sufficient language competence and education (Chiswick et al. 2002). The development of an efficient and large-scale transport system has a similar reducing effect on the fixed migration costs. In the case of the wave of European emigration to the United States it was above all these factors which lowered the average 'quality' of the migrants (Hatton and Williamson 2004).

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<sup>27</sup> The costs for recruitment agencies are substantial. The fees they demanded for migration from Sri Lanka, India and Pakistan to the rich oil states in the Middle East ranged from USD 700-900; from Bangladesh the amount was USD 1,700; and help with migration from Thailand to Japan cost as much as USD 8,000 (World Bank 2006).

<sup>28</sup> Chen and Ravallion (2008) estimate that, in 1980, around half of the people in the developing countries lived on less than an international poverty line of USD 1.25 per day, and that around a quarter did so in 2005 (in constant prices). This spectacular improvement in incomes was concentrated in East Asia and has virtually passed Sub-Saharan Africa by. There, half of the population (380 million people) are still living on less than USD 1.25 per day. These people most probably cannot afford the fixed costs of migration in any case.

<sup>29</sup> Peridy's analysis covers emigration from 67 source countries to 18 EU member states between 1993-2002, on the basis of an OECD data set.



**Table 2 Years of education of people in the emigration countries and their migrants in OECD countries, around 1990**

	stayers in source country	migrants in destination country	difference (migrants compared with stayers)
Africa <sup>b</sup>	4.6	15.4	10.8
Eastern Europe, Balkan countries and Turkey <sup>c</sup>	7.8	12.6	4.8
Mexico	6.3	7.5	1.2
Asia <sup>d</sup>	5.8	14.4	8.6
Latin America <sup>e</sup>	5.9	12.5	6.6

<sup>a</sup> These figures cover all migrants. All figures are unweighted averages. Figures have not been adjusted for the fact that migrants tend to be younger than stayers, or that migrants may have had some supplementary education in the destination country. The stayers column is based on Barro-Lee, while the migrants column is based on the OECD census around 1990. Both columns use the country observations only when information was available on both stayers and migrants.

<sup>b</sup> Based on 4 countries.

<sup>c</sup> Based on 3 countries.

<sup>d</sup> Based on 15 countries.

<sup>e</sup> Based on 10 countries.

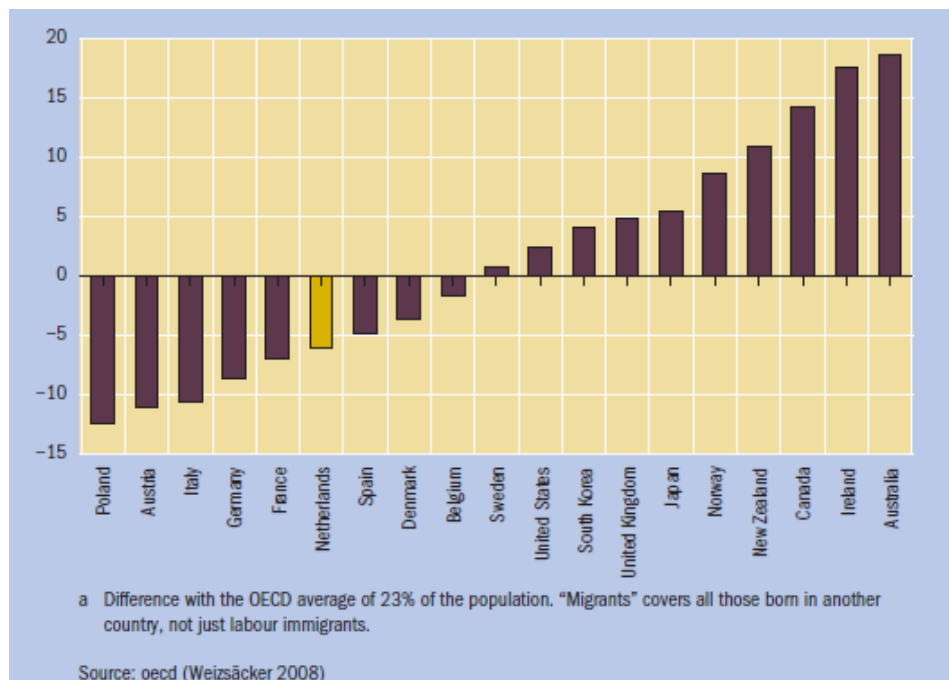
Source: Hendricks (2002, table B1)

One lesson from the past, then, is that a blind and undirected process of labour migration automatically leads to a weakening of the self-selection process and hence to a shift to lower-skilled immigrants who do not speak the language but still decide to take a chance. Peridy (2006) found indications of negative self-selection: the lower the education level in the source country, the greater the migrant flow to the EU. And a wider difference in welfare state provisions between the EU and the source country also boosts the migrant flow.<sup>30</sup> Lower communication costs (mobile telephones, internet), satellite navigation and other technological developments will probably further weaken the self-selection process among migrants by 2030.

Figure 5 shows that precisely in those countries which practise selection at the gate (Canada, Australia, New Zealand) the average educational attainment level of immigrants is higher than the average for the native population. In the case of the EU, migrants on average are less well educated than the natives.

<sup>30</sup> Pedersen et al. (2008) did not find any indication that the migration flow to the OECD countries is driven by negative self-selection, but the authors suggest that this may be because the OECD countries' restrictive immigration policies are effective.

**Figure 5 Comparison of migrants with academic qualifications compared with the OECD average<sup>a</sup>**



## 7. Towards controlled relaxation of low-skilled labour immigration

Owing to its economic weight, the EU acts as a strong magnet for labour migration from neighbouring countries. Table 3 shows that between 1965 and 2000 the proportion of migrants increased substantially in both the European Union and the United States, more than in the rest of the world.

The question is how this trend will continue. When self-selection by migrants becomes less important, selection "at the gate" will become relatively more important if the EU wants to widen the scope for labour migration from the rest of the world while still retaining broad public support for the migration policy within the Union.

**Table 3 Migrants as a percentage of the total population, world, Western Europe and North America, 1965-2000<sup>a</sup>**

	1965	2000	increase
world	2.3	2.9	0.6
Western Europe	3.6	10.3	6.7
North America	6.0	13.0	7.0

<sup>a</sup> These figures cover all types of migrants.

Source: Hatton and Williamson (2004)

Starting from the current situation with closed borders, a future scenario involving opening the borders completely to foreign labour need not lead to win-win situations in terms of wealth effects. The admission of migrants will intensify competition on the labour market for each job, which in

turn will lead to substitution. There is a real possibility that a complete opening of the borders will lead to negative short-term effects on wages and jobs for certain groups of EU workers. EU workers with low educational attainments and weak labour market positions may be hit disproportionately by substitution. This calls for a circumspect approach and, if necessary, selectivity in labour migration policy, with the aim of avoiding any shocks.

An examination of the welfare effects of “the fence” for the EU’s neighbouring countries may well reveal win-win opportunities which are currently being ignored or underestimated. The wealth gains which transpire in one group or country may be more than enough to compensate for losses among other groups or countries. Under the auspices of the EU’s neighbourhood policy the European Commission is considering whether to offer cooperation projects to neighbouring countries which help with the fight against illegal immigration (European Commission 2007). It may be possible to expand such cooperation by granting low-skilled labour migrants from these countries more generous preferential access to the EU.

To what extent are welfare compensations necessary and possible for people who are hit hardest by the more open borders? Is the labour market a market like any other, where foreign entrants will cause more competition? At least one very relevant difference is that native workers who experience substitution effects are citizens with voting rights, something that does not apply to the newcomers. This is a serious factor which national policymakers will want to take into account. From the literature on social contracts between different social groups (e.g. Acemoglu and Robinson 2006) we know that cooperative strategies over the long term stand or fall with the credibility of compensation for people who suffer a loss over the short term.<sup>31</sup> The compensation issue probably plays a decisive role in the liberalisation of access to the European labour market. There are two options:

- In theory the compensation problem for labour market substitution can be solved by auctioning the rights to jobs. To this end “work vouchers” are issued in the first instance to European workers who run the risk of displacement. These work vouchers can then be auctioned on a newly created market, the market for work vouchers, via the internet for instance. This solution would lead to a privatisation of the compensation (DeVoretz 2008a, Weinstein 2002, Ruhs 2008). A number of preparatory steps are required for this scheme. And a solution has to be found for the problem that it is actually quite difficult for the low-skilled to negotiate the valuation of work vouchers with foreign market players through an auction.
- In another variant the government intervenes in the compensation. It levies a tax on companies that employ labour migrants. The revenues generated by this tax can then be used to counter the negative welfare effects of labour market displacement and other externalities. For instance, Singapore is already working with a tax on the employment of foreign workers (Ruhs 2008).

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<sup>31</sup> Standard economic welfare analysis assumes that a policy choice will increase welfare if the associated welfare gains in one part of society are in principle large enough to fully compensate the welfare losses of others, even if it is decided not to actually apply the compensation (Hicks-Kaldor principle). It is doubtful, however, whether in such a controversial area as labour market displacement the existence of the scope for compensation will be regarded as sufficient in the political process.

Several policy options stand out that would allow a more relaxed admittance regime for low-skilled migrants coupled with measures that ensure selectivity. Some measures could already be taken in the very near future:

- The introduction of a selective immigration policy based on a points system, as is already happening in Australia, Canada and the United Kingdom. This safeguards selectivity with regard to substitution and integratability into European society. Table 4 shows the differences between selection on the basis of a points system and a system where selection is conducted primarily by employers.
- Negative selection among potential immigrants who are attracted by the relatively generous welfare state provisions in the EU can be reduced through the systematic use of temporary employment contracts for migrants from non-oecd countries, with some scope for renewal and with limited travel rights within the EU. However, this approach only makes sense if it is adopted by all EU member states.
- In several EU member states which have demand-led labour migration, individual companies play a major role in the quality selection of migrants. This is because migrants holding a job offer from an EU company have a much better chance of being admitted to the Union. To counter careless and superficial selection by companies, the government could ask companies for a deposit in advance for each labour migrant they employ, equivalent to the wage for half the contract period, say. This deposit would only be returned when the migrant has worked through half the contract period.<sup>32</sup> Such a barrier would certainly encourage companies to intensify their selection efforts.

Some developing countries are calling for labour migration to be placed within “mode 4” (temporary relocation of natural persons) in the General Agreement on Trade in Services (GATS) (Winters et al. 2002). Whether this is a sound and acceptable proposal is questionable. For it means that in principle all selectivity in the labour migration process can be undermined by invocation of the WTO negotiating principles.<sup>33</sup>

The prospect of obtaining an EU passport provides the strongest incentive for assimilation and investment in local human and social capital. This is confirmed by Canadian experiences (DeVoretz 2008b). In those sectors where the greatest ageing effects will occur (healthcare, education), investments by migrants in their own human capital is of overriding importance. This requires timely immigration of people with considerable potential and who can be expected to be able and willing to assimilate easily. This decision must be taken well in time, perhaps five to ten years before the migrants are needed, in order to avert problems with matching quality on the labour market. Policy for this group must therefore be based on a long-term outlook. As far as these migrants are concerned, the prospects of an EU passport and EU citizenship provide a guarantee for the necessary investment in the assimilation process and language learning (Chiswick 2008).

At the same time, EU-wide cooperation can prevent a situation where illegal migrants have a reasonable expectation that they will obtain EU citizenship after some years anyway. Large-scale regularisation actions, such as conducted by the Spanish government in 2006, during which more than 600,000 illegal immigrants became citizens overnight, send the wrong signal and are more likely to reinforce negative selection among migrants.

**Table 4 Demand management versus supply management in labour immigration: some options and choices**

	demand management in labour immigration	supply management in labour immigration
recruitment	<ul style="list-style-type: none"> <li>- recruitment for specific vacancies by individual companies and institutions;</li> <li>- general recruitment site for cooperating employers;</li> <li>- costs for private sector</li> </ul>	<ul style="list-style-type: none"> <li>- general recruitment by Dutch or EU authorities (e.g. via the EU Immigration Desk website);</li> <li>- limited costs for government</li> </ul>
selection	<ul style="list-style-type: none"> <li>- selection primarily by companies and perhaps a small role for labour market checks;</li> <li>- selection on the basis of vacancy period (no long-term prospects)</li> </ul>	<ul style="list-style-type: none"> <li>- selection via points system (on the basis of age, earning capacity, education, skills);</li> <li>- perhaps pre-immigration assessments by embassies (language, motivation, social skills);</li> <li>- checks on educational qualifications of high-skilled migrants (to reduce fraud risk);</li> <li>- substantial selection costs for the government</li> </ul>
procedural barriers	<ul style="list-style-type: none"> <li>- administrative burdens primarily for employers;</li> <li>- waiting times for employers and migrants</li> </ul>	<ul style="list-style-type: none"> <li>- transparent procedure;</li> <li>- employers compete for available supply of admitted labour migrants</li> </ul>
labour mobility	<ul style="list-style-type: none"> <li>- residence permit linked to a single employer, no labour mobility;</li> <li>- migrant very dependent on first employer</li> </ul>	<ul style="list-style-type: none"> <li>- completely mobile, equal to native workers</li> </ul>
social security	<ul style="list-style-type: none"> <li>- only temporary and partial call on social security provisions during employment contract;</li> <li>- unclear status after involuntary departure from first job</li> </ul>	<ul style="list-style-type: none"> <li>- no job security on arrival;</li> <li>- risk of call on social security provisions at an early stage (this risk is reduced by selection on the basis of a points system and pre-immigration assessments)</li> </ul>

## 8. Conclusions

This essay examined the welfare effects of the EU's restrictive labour migration policy, and then posed the question whether this policy can be sustained over the longer term – towards 2030 – in view of the expected pressures from inside and outside the EU.

The EU barriers are the most restrictive for low-skilled labour migrants. We concluded that the fence around the European labour market has three types of wealth effects for the low-skilled. Firstly, it leads to an artificial increase in EU wage earnings in comparison with a completely open labour market. Secondly, it leads to an income redistribution from EU employers to EU employees, and eventually employers will pass on the associated cost increase to all EU citizens by raising prices. And thirdly, the fence has major implications for the neighbouring countries beyond the EU. For them the fence means a loss of potential income because their labour migrants

are being excluded. This contributes to the income gap between the EU and the developing countries on its borders.

Several quantitative studies have calculated that the effect of the EU's migration restrictions on the economic situation outside the EU are substantial, to such an extent that they easily outweigh the positive effects of EU development assistance and the effects of wealth gains through trade liberalisation.

It is doubtful whether the policy in its current form can be sustained over the longer term – towards 2030 – even if the EU wanted that. The income differences between the EU and a large proportion of the surrounding countries will lead to growing pressure of illegal immigration. In international negotiations the developing countries will bring ever more political pressure to bear on the EU to relax its labour migration policy. Moreover, pressure for the relaxation of the restrictive admission policy for labour migrants will also increase from within the EU, in response to population ageing and labour shortages in public and private services. A range of studies has shown that the welfare gains from a policy shift could be considerable, both outside and inside the EU.

Relaxation of the European labour migration policy is not a question of all or nothing. There are a number of policy options which involve a more relaxed regime for admitting low-skilled migrants coupled with measure which ensure selectivity. This can guarantee the entry of migrants with qualities (knowledge, language and other skills) which match the needs. It is also possible to experiment with EU-wide cooperation on temporary labour migration. The costs of changing the EU's labour migration stance may be limited. An advantage of using a long-term perspective is that major changes in immigration policy can be introduced gradually, thereby avoiding shock adjustments and integration problems.

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