

Immigration and social insurance design

This policy brief is an excerpt from the report
Integrating Immigrants into the Nordic Labour Markets



Summary

We point out two reasons why policy-makers may consider redesigning social insurance systems in the light of increasing migration flows. First, immigrant labour supply is particularly sensitive to social insurance parameters. Second, employers and migrants may benefit from the creation of low-paying jobs, which means that generous benefits may affect both the level of immigration and its composition. Still, we do not recommend a reduction in the level of benefits or the imposition of tighter regulations on migration. Instead, we call for a more activity-oriented social insurance policy.

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Background

Social insurance programmes entail trade-offs. Their primary role is to insure citizens against income shocks. A possible downside of social insurance programmes, however, is that they involve moral hazard and may reduce individual efforts to avoid unemployment and benefit dependence. Based on our studies of Norwegian register data, we discuss two aspects of social insurance that are specifically related to immigration. First, do immigrant and native residents respond differently to a given set of social insurance parameters? Second, do these parameters also affect the size and composition of migration flows?

Immigrant responses to social insurance

A study of changes in the level of Norwegian temporary disability benefits following a reform in 2002 shows that immigrants from low-income source countries are on average more responsive than natives to social insurance parameters. This discrepancy largely reflects differences in employment and non-employment opportunity sets. Due to lower expected earnings in employment, as well as some progressive elements of the social insurance system, immigrants from low-income countries have on average less to gain than natives from moving from non-employment to employment.



Social insurance design, migration, and labour churning

When individuals are entitled to move between countries, social insurance generosity may directly impact migrant flows. In the context of the integrated European labour market, employers and migrants may have a common interest in the creation of temporary, low-paying jobs. Domestic employers benefit from paying low entry-level wages, while migrants gain access to generous benefits and/or a higher wage than they would earn in their home country. However, welfare entitlements in the host country also mean that employers have an incentive to lay off workers entitled to unemployment benefits and replace them with new migrant workers willing to accept a lower wage. This phenomenon, labelled “excess labour churning”, reduces efficiency due to the employment subsidy implicit in generous benefits. Our study of Norwegian registers has uncovered empirical evidence of such practices. Excess churning is higher the larger the migrant workforce in the firm is, and newly hired workers are paid less than those who separate from the firm and receive unemployment benefits.

Policy implications

Our findings may be interpreted as advocating for a reduction in benefits, or for designing a new system in which natives and immigrants are treated differently. However, doing so would exacerbate economic inequality, make the social insurance system less effective as a means of sharing risk, and also run counter to the egalitarian values that have traditionally enjoyed broad support in the Nordic countries.

Another policy option is to regulate migration more strictly, as the Nordic countries have done in recent years. The limitations of this policy instrument are

primarily set by humanitarian rather than economic considerations, as well as international agreements. However, the free movement of labour within the European Union is a policy that has been motivated, at least in part, by economic considerations – the idea being that it is of mutual benefit for all member states. If the evidence points to unintended costs in terms of excess and inefficient migration, it should therefore be possible to make adjustments.

Given that the free movement of labour in Europe also entails significant economic benefits, one alternative is to seek ways of offsetting the externalities generated by differences between the countries’ welfare state institutions. We argue that these differences may, in effect, subsidise inefficient migration, resulting in low-productivity jobs. One policy option, therefore, could be to implement and enforce (higher) minimum wages and other standards in the labour market. Another could be to strengthen employment protection legislation to avoid excess churning of labour. However, while such measures may prevent inefficient migration, they may also limit the creation of more productive jobs and increase the risk of some low-skilled workers (including immigrants) becoming unemployed.

An alternative to cutting benefits across the board, or for immigrants in particular, is a more activation-oriented social insurance policy. In our chapter, we provide evidence that tighter activation requirements in the Norwegian social assistance programme have reduced immigrant welfare dependency and increased immigrant employment. Offering income through activation, rather than just providing money, may have the twin advantages of reducing moral hazard problems and facilitating the productive use of vacant labour resources.

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