

Fundamentals:

Mass movement



In what has become one of the biggest movements of people in recent memory, the EU migration crisis saw over 1 million people seek refuge in Europe in 2015, with potentially significant economic, social and political implications for years to come.

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In this edition of Fundamentals, LGIM economist Hetal Mehta discusses the impact of the migrant influx in terms of the

short-term fiscal cost for Europe, the possible longer-term economic impact and other risks relating to the crisis.

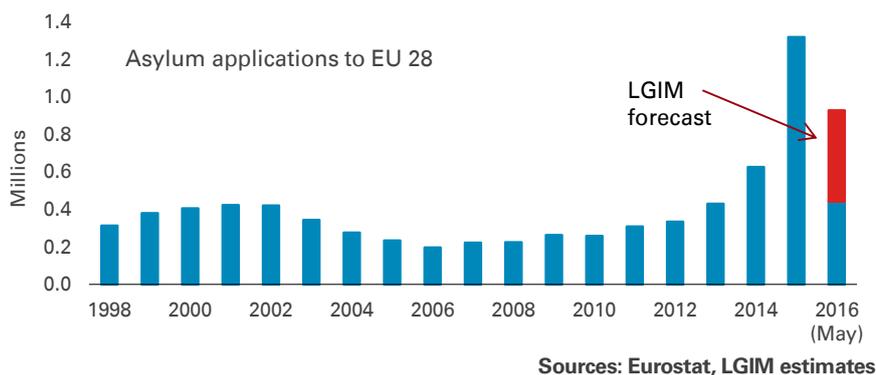
The civil war in Syria and the ongoing difficulties in other parts of the Middle East have prompted a humanitarian crisis and one of the biggest movements of people since the Second World War. Whether by land or sea, refugees have been heading for the relative safety and prosperity of Europe in unprecedented numbers.

WHO, WHERE, WHEN?

In 2015, the number of asylum applications to the EU more than doubled to 1.3 million (figure 1) with 28% of the applicants

from Syria, 14% from Afghanistan and 9% from Iraq. Within the EU, most of the migrants have headed for Germany, where economic prospects were seen as most appealing. Looking at the destination of asylum applications relative to population shows where the relative impact on the host countries will be most significant (figure 2) in the short term. Hungary, followed by Sweden and Austria, are the EU countries potentially facing the biggest immediate strains in terms of refugee arrivals, although the majority of asylum seekers may not stay in the country where their applications are being processed. Greece, being at the eastern frontier of Europe and with a large coastline, has also been the first EU entry

Figure 1. Asylum applications to the EU have jumped



point for many refugees, with an estimated 1,000-2,000 migrants crossing from Turkey to Greece every day until recently.

In absolute terms, Germany is likely to be most affected as it is the main recipient of refugees, with over one million recorded arrivals and nearly 500,000 asylum applications in 2015 alone. Much of our analysis is therefore focused there.

TURKISH DEAL-LIGHT

More recently, the asylum numbers have dropped drastically since a deal with Turkey took affect. The deal aims to reduce the incentives for refugees to make the journey across from Greece. The EU has agreed to provide up to €6bn of funding to Turkey, and for each Syrian refugee returned from Greece, the EU has agreed to re-settle a refugee directly from Turkey, up to a limit of 72,000.

While the deal faces big challenges, it seems to have stemmed the flow of migrants significantly so far – flows in April and May were around half of those seen in the same months of 2015. Whether the deal will hold and numbers remain low is uncertain, particularly as the weather improves in the coming months. However, we assume that asylum numbers remain relatively low compared to last year, and that it will take many months for the cap to be reached.

Furthermore, the deal has probably prevented the breakdown of the Schengen zone (passport-free travel), which we discuss in more detail later.

WHAT IS THE SHORT-TERM FISCAL IMPACT?

So what impact will the refugees have on the European economy? Whilst there is a high degree of uncertainty about the long-term effects, the short-term

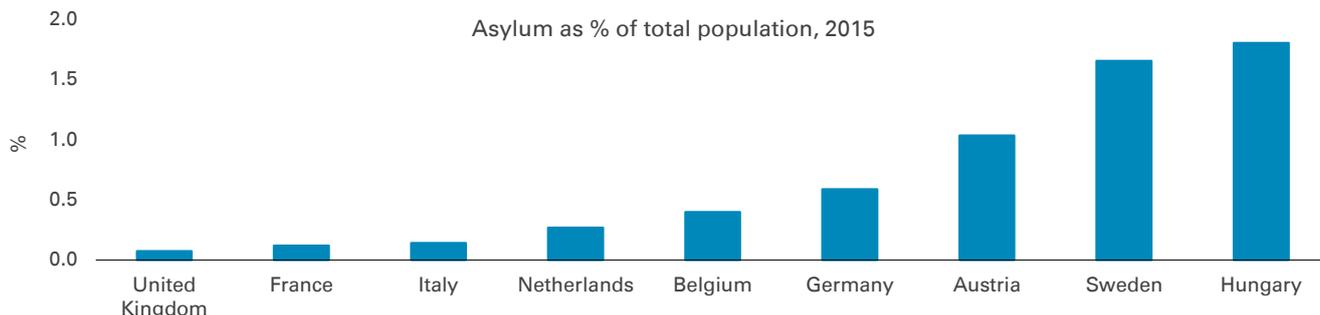
impact appears relatively straightforward: there is an immediate impact on government spending.

Most official government sources place the cost of food, shelter and other associated costs at approximately €12,000 per refugee per year. In Germany, in 2015 alone, this amounts to nearly €12bn (or 0.4% of GDP) on new refugees.

If we assume that asylum applications relative to 2015 levels are approximately 50% in the remaining months of 2016 and 25% in 2017 – a conservative assumption – a cumulative 2.6 million asylum seekers will have entered the EU between 2015 and 2017. We assume approximately 80% of new arrivals head to Germany, and that in the short term, even unsuccessful applicants are deported relatively slowly so require the same assistance (and do not yet join the labour force).

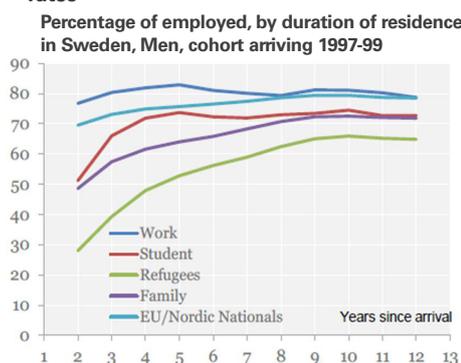
The annual spending on migrants by the end of 2017 could therefore be in the region of €23bn or 0.8% of German GDP. This would be a significant one-off boost to growth for an economy with potential growth of less than 1% (excluding the future labour force effects of migration).

Figure 2. The migration is likely to be felt most acutely in Hungary, Sweden, Austria and Germany



Sources: Eurostat

Figure 3. Case study: Swedish employment rates



Sources: Swedish Public Employment Services (Arbetsformedlingen)

In terms of the fiscal impact, the German economy is in healthy shape, so the spending on refugees should be easily accommodated without much deterioration in the deficit. Furthermore, any additional spending from Germany would be welcomed by the rest of Europe.

ASSESSING THE LONG-TERM IMPACT

Assessing the long-term economic impact of the migrants is much trickier, with many different aspects to consider. However, we can draw some qualitative conclusions by weighing up key factors.

Firstly, the cause of migration is an important consideration. For example, economic migrants often have different characteristics to refugees, including different language skills. Refugees often take longer to integrate into the labour force than migrants, who are more prepared (figure 3). Given the current wave of migration is predominantly refugees, the longer-term economic boost may be more limited.

Other factors to consider are the educational attainment of the refugees, their age and the conditions in the host country. United Nations data readings

show a degree of variance in education e.g. 20% of the Syrian arrivals are university educated while for Afghans this is only 9%. With a much higher proportion of the refugees entering Germany being of Syrian origin, the positive economic impact is likely to be higher, particularly for Germany where the labour market is tight and skills shortages are building.

Germany’s demographics problem is longstanding and well known. If the migrants make Germany their home, then not only will the immediate population (and potential labour force) increase, but with foreign-born women having a higher fertility rate (figure 4), the birth rate in Germany could increase in the long run.

With regards to age, Syrian migrants are considerably younger than the existing German population; this could also be a positive for potential growth.

Qualitatively at least, we can say that the inflow of many highly educated migrants into a country with full employment is likely to have a relatively high impact on long-term growth prospects. By the end of 2017, we estimate that the recent wave of migrants will add 2% to the German population and boost the labour force over time.

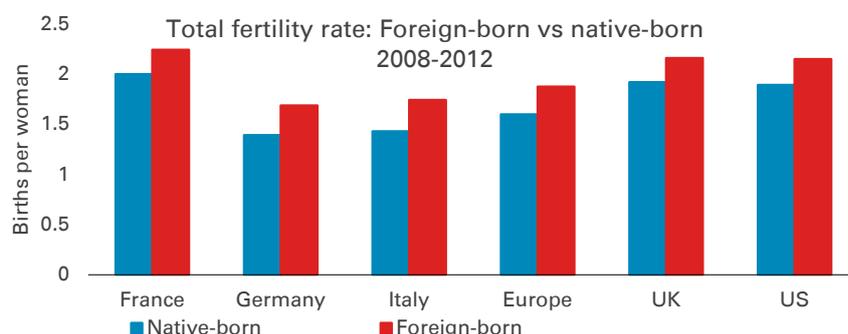
An OECD study assessing the net fiscal impact of cumulative migration over the past 50 years found on average that the impact was zero, and usually within 0.5% of GDP in either a positive or negative direction. Given the largely favourable characteristics of the current migrant flow, we would anticipate a positive impact.

SCHENGEN RISKS

Whilst the Turkey deal has reduced the migrant flow so far, and therefore some of the tensions associated with it, the risk is that the deal does not hold, or that further turmoil in Syria induces a resumption of the high flow seen in 2015. If this happens, it is possible that countries such as Austria, Hungary, and maybe even Germany, move to close their borders and effectively cause a suspension or collapse of the Schengen Agreement that allows people to cross the EU’s internal borders without being subjected to border checks.

While it may seem that the cost of showing one’s passport when crossing a border is a minor formality (as opposed to having to apply for visas), the inefficiency that arises from this, not just for tourists, but for those who cross borders as part of their daily commute, or for freight vehicles, could be significant although the European

Figure 4. Fertility rates



Sources: Eurostat

Figure 5. Schengen scorecard

	OVERALL SCORE*	Net Tourism, % of GDP	Direct Tourism, % of GDP	Cross border commuters**	Openess	Share of intermediate goods trade***	International Haulage****	Border Length (km)	No. of border countries
Hungary	9.1	2.9%	4.4%	1.1%	144%	58%	62%	2185	7
Austria	8.8	2.5%	4.9%	0.7%	76%	56%	30%	2562	8
Portugal	6.6	4.3%	6.3%	0.3%	60%	52%	56%	1214	1
Germany	6.5	-1.2%	1.1%	0.4%	71%	54%	12%	3621	9
France	5.6	0.3%	1.9%	0.7%	43%	50%	6%	2889	8
Spain	5.3	NA	4.7%	0.1%	48%	48%	26%	1918	5
Greece	5.3	6.9%	8.0%	NA	38%	43%	11%	1228	4
Italy	5.3	0.8%	2.2%	0.2%	46%	51%	13%	1899	6
Sweden	5.3	-0.9%	2.5%	0.5%	59%	51%	7%	2233	2
Netherlands	5.0	-0.7%	1.8%	0.3%	115%	50%	47%	1027	2
United Kingdom	1.5	-0.8%	1.5%	0.1%	7%	45%	5%	360	1

*High number = high adverse impact

**% of Total population

***% of Total goods traded

****% of Total freight journeys travelled

Sources: Eurostat

Commission estimates this to be only around 0.1% of EU GDP. Our Schengen 'scorecard' shows the countries most affected would be Hungary, Austria, Portugal and Germany (see figure 5).

A suspension of Schengen could also precipitate disorderly political developments, and have a knock-on impact on business and consumer confidence.

THE POLITICAL IMPACT

The rapid influx of migrants has not only raised questions of social cohesion but also of political stability, given the rise of nationalist parties and anti-immigration sentiment in a number of European countries.

In Germany, for example, the Alternative für Deutschland party has risen in popularity and made gains in the March regional elections. Austria's presidential election came close to electing a far-right candidate, while Hungary has also seen an increased popularity of far-right parties such as Jobbik.

With the next 18 months set to see a number of national elections in major countries – including the Netherlands (early 2017), France (spring 2017), Germany (autumn 2017), and possibly Italy (due before May 2018) – the potential ramifications are significant. Fears of the

break-up of the EU and the rise of anti-immigrant parties are likely to persist.

Overall, while one can only hope that the crisis driving a large number of people to flee their homes will soon become a thing of the past, the economic impact and the legacy of the EU's response to the migrant influx is likely to endure for some time.

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