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# Welfare effects of migration in societies with indirect taxes, income transfers and public good provision

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**Abstract**

We construct a general equilibrium trade model of a two-class small open host or source country. When consumption tax revenue finances the provision of a public good, marginal migration reduces social welfare in the source country and raises it in the host. When consumption tax revenue is equally distributed among domestic households in each country, then migration has an ambiguous impact on social welfare in either country. When tariff revenue in either country is either equally distributed among domestic households, or it is used to finance the provision of a public good, then migration has an ambiguous effect on social welfare in the host country, and is expected to reduce social welfare in the source.


*JEL classification:* F22: International migration; H14: Public goods
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## 1. Introduction

Within the neo-classical trade literature, it has been established that finite permanent migration is welfare beneficial to the nationals of the host country and

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welfare detrimental to the non-emigrants in the source country, and that marginal permanent migration has no welfare effects in either country.[1] This result holds, regardless of the number of goods or factors of production, or of whether commodity prices are endogenously determined or exogenously fixed (see Wong, 1985; Quibria, 1988). Recent contributions to this literature have provided cases where the above results can be reversed, e.g., Djajic (1986), in a model allowing for immigrant remittances, and Djajic (1998), in a model with traded and non-traded goods, and foreign capital.

In general, these neo-classical trade results have shown migration-induced welfare gains to the host countries, despite certain losses to native workers substitutes for the immigrants. Contrary to this theoretical evidence, however, there is a widespread resistance against immigrants in host countries. Moreover, this resistance has been directed primarily towards unskilled, rather than skilled, immigrants who, as it is argued, exert downward pressures on wages in the host countries, and fiscally burden, at the expense of all domestic households, the host country's "welfare state".[2] That is, it is often argued that gains from trade associated with immigration are small relative to the increased costs of redistribution policies when transferring income from high-income natives to low-income, fiscal beneficiary immigrants, since they cannot be excluded from or discriminated against consuming congestable or quasi-private public services, such as health care, and public schooling.

In line with these concerns, it is only recently that models of international migration have departed from the notion of distortions-free theoretical settings, and have explicitly incorporated an active government engaged in redistribution policies through income transfers. For example, Wildasin (1994), in a single commodity model with income taxes and transfers demonstrates, among other things, the possibility of migration-induced Pareto-inferior outcomes when in the no-immigration situation, owners of the immobile factor are being taxed to provide transfer payments to mobile workers. Razin and Sadka (1995) use a two-class—high productivity (skilled) labor, and low productivity (unskilled) labor—model of international migration, where the government uses a redistribution policy (i.e., an egalitarian income tax and a lump-sum grant) in order to maintain the pre-migra-

[1] Permanent emigration is defined in the sense that immigrants do not remit any part of their income earnings back to the source country, and that their consumption and utility are part of the respective magnitudes in the host country. The other type of international migration considered in the relevant international trade and development literature is temporary migration. In that case, immigrants are viewed as guest workers in the host country, who remit their income earnings back to the source country, and whose consumption and utility are part of that country's consumption and welfare. For the distinction between permanent and temporary migration, and for its analytical implications see, among others, Wong, 1995.

[2] For example, Sala-i-Martin (1995) notes the argument against migration due to human capital externalities derived from human interaction.