

Macroeconomic Research

**The German Refugee Crisis: A Macroeconomic Analysis**

IB Economics

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Word Count: 3165

Citation Style: MLA

Date: 17.03.17 – 22.03.17

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## **I. Introduction**

In 2015 and the majority of 2016, Europe saw an unprecedented flow of migrants into the continent. These refugees originated from the Middle East, fleeing war and violence in their native countries (most notably in Syria). Due to the European Union's open border policy, many of these refugees have been able to flee across the continent towards the most developed European countries, especially Germany. In total, Germany has received around 500,000 registered refugees (Euronews, data from Eurostat and Syria Regional Refugee Response).

Germany's chancellor, Angela Merkel, has received mixed comments for her staunch sympathy towards migrants, allowing them into the country fairly easily compared to harder-lined European leaders. Most criticism against Merkel has come from German citizens themselves, who claim that her overly-generous policies have incited extremist political opposition and Islamic radicalism. Germans blame the refugees for social issues in the country. However, many foreign countries, including those beyond the Middle East, view Germany very positively as a country determined to solve the problems of the international community. Germany has gained respect among its allies for its morality and EU leadership, meaning that the refugee crisis has led to initially positive political implications (Schuster).

Therefore, amid political and social debates concerning the refugee crisis, sheer economic analysis has been both minimal and largely overlooked in the media. The situation has implications on the macroeconomic focuses of growth and unemployment as well as the German government's economic policies.

## **II. Macroeconomic Analysis**

### **A. Economic Growth**

Economic growth refers to an increase in real GDP over time. The immigration of refugees into Germany has the ability to bring economic growth to the nation. This specific instance would increase the production possibilities within the country, meaning that the potential amount of output that the German economy is capable of producing will increase. More participants within the economy represent an increase in human capital, which, if employed, will increase the economy's level of production and, simultaneously, national income.

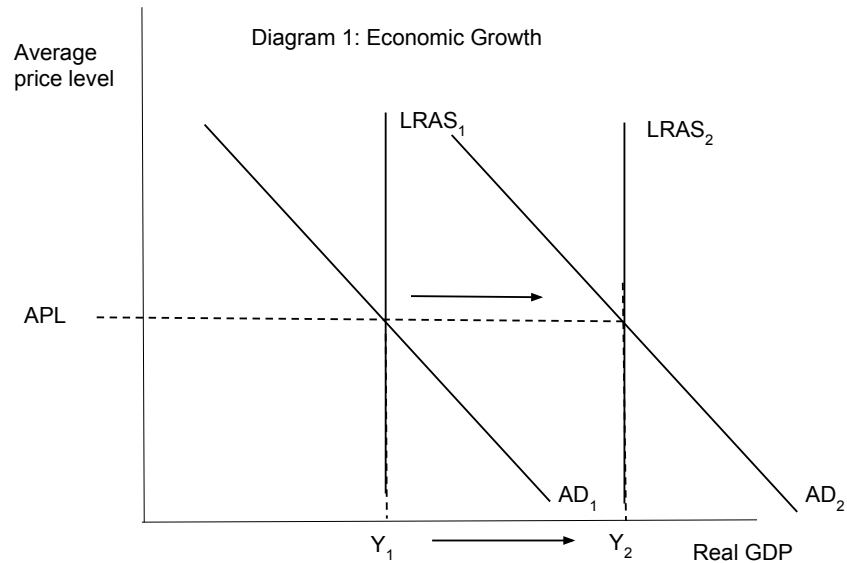


Diagram 1 demonstrates the effect of this increase in production possibilities. According to the supply-driven neoclassical model, the influx of refugees (once they become integrated within the economy) will eventually cause the long-run aggregate supply to increase from LRAS<sub>1</sub> to LRAS<sub>2</sub>. This would thereby lead to an increase in real GDP (and thus national income) from Y<sub>1</sub> to Y<sub>2</sub>. Logically, because economic growth allows civilians to have more income and buying power, the aggregate demand would also increase from AD<sub>1</sub> to AD<sub>2</sub>.

The German refugee crisis would bring economic growth through an increase in the labor force, thereby increasing human capital. Many incoming migrants are of working age and are actively seeking a job, meaning that they are candidates for employment and could thus contribute to an increased national output. This is especially valuable to Germany, who faces a decrease in its native working age population. There are about one million vacant jobs in Germany (Euronews) and that number is poised to increase because the percentage of the population that is too old to work is increasing. For example, about 20.5 percent of the German population in 2005 was above the age of 65 (when citizens are deemed to be entering retiring age); that number increased to 21.2 percent in 2015 and is projected to increase to 25 percent in 2025 (Btlas). Meanwhile, the overall population of Germany is expected to decline in the process due to its position in the latter stage of the demographic transition. Therefore, immigrants would be offsetting a trend in Germany that is counterintuitive to economic growth, since more workers are capable of producing more output (and thus expanding the economy) than a fewer amount of workers.

Germany could use the case of immigration into the United States in the late 1990s as a model to generate economic growth. The amount of people coming into the United States steadily rose throughout the decade and reached a peak in 1999, before dropping off to a much lower level into the new millennium (Passel). Meanwhile, the GDP growth rate (the principal indicator of economic growth) in the United States has overall risen in the 1990s after more than a three percent decrease in 1991. In the latter part of the decade, when immigration into the U.S. peaked, the GDP grew at its most stable rate, which was constantly above three percent (Trading Economics).

The 1990s immigration into the United States has also had positive long run implications, in terms of economic growth. By 2011, immigrants contributed towards 14.7 percent of total output and comprised 16 percent of the labor force despite making up only 13 percent of the population (Costa). Therefore, immigrants have been able to integrate into the American economy effectively, despite the social problems that many natives claim they create. Likewise, the German refugee crisis can help fill in vacant jobs and provide economic growth that is sustainable in the long term (since growth is necessary to employ the growing workforce of a nation experiencing immigration).

## B. Unemployment

In order for output to increase up to the [increased] level of production possibilities, a nation must put its unemployed resources to use. In the case of the German refugee crisis, members of the newly-refueled labor force must find jobs. If these refugees were to simply enter the labor force without finding employment, the unemployment rate would increase and the increase in human capital would be in vain.

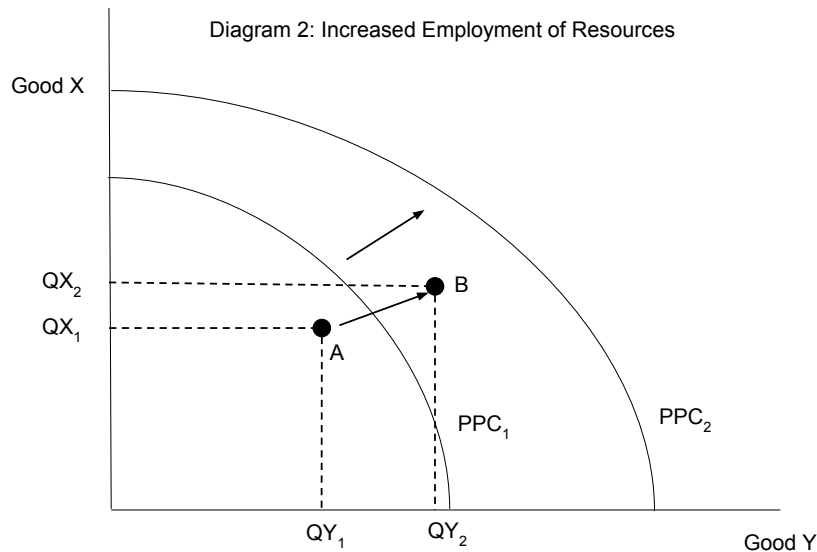


Diagram 2 shows the effect of a decrease in unemployment on the production possibilities curve after an increase in the economy's productive capacity. The increase in human capital (and thus potential output) is shown by the outwards shift in the production possibilities curve from  $PPC_1$  to  $PPC_2$ . This means that a nation's economy can produce more of both consumer and capital goods (represented by good X and good Y). However, an economy very rarely produces at its potential level of output since it is very difficult to achieve maximum employment of resources. With the outwards shift of the PPC, the economy is able to produce at a level of output at point B after shifting from point A. This movement demonstrates the placement of the economy's increased resources to use, representing a decrease in the unemployment of workers. The diagram shows that in order for economic growth to occur in reality, a nation's actual output produced must rise following a necessary increase in the level of production possibilities, since the economy can only produce up to the point that its resources (in this case, workers) will allow. Increased employment and potential output must accompany each other.

In Germany, there are one million vacant jobs that the refugees can possibly fill (Euronews), so the opportunity to grow the economy definitely exists. Historically in Europe, many of the jobs associated with migrants have been those that the natives find undesirable, such as trash pickup and bus driving. However, these refugees from Syria arrive with marketable skills, while 685,000 of the one million vacant jobs require skilled workers (Euronews).

Despite the amount of vacant jobs, refugees may still provide competition for natives that are currently frictionally unemployed, referring to those in the labor force that are searching for new and better jobs in the short-term. The German GDP increased by just under half of a

percentage point throughout 2016 (Trading Economics), indicating that the economy is still not fully recovered from the global recession of 2008, although the economy is still growing and the unemployment as of 2016 was low at 4.3 percent (CIA). Nevertheless, since the labor market is adding jobs fairly slowly, immigrants may increase German natives' unemployment in the short run (Costa).

However, in the long run, since the immigrants could help foster economic growth by demanding more goods and opening up more jobs in the German economy, they would only have a positive impact on the economic conditions of native workers. For example, in the United States, the unemployment rate steadily decreased towards less than four percent throughout the late 1990s (during the peak immigration waves), and only increased rapidly once the recession of 2001 hit the U.S. economy (Trading Economics). To make sure that refugees with marketable skills do not interfere with the employment of natives in the short term, it is important for them to be located to the correct job locations so that they fill in the labor gaps where they are most needed.

In reality, many of the refugees will find it difficult to achieve employment in jobs that require marketable skills. This is because of language barriers and the difficulty of adapting to an economy in a different country with a totally different economic structure. In the short-term, these workers may have to settle for unskilled labor, increasing the amount of underemployed workers (despite decreasing the unemployment rate) that are capable of enrolling in better jobs and contributing more to the growth of the German economy than they currently are.

To solve this problem, the government must step in to allow for the refugees to socially integrate into the country and apply their skills to benefit the nation as a whole. The best option would be to leave the low-income jobs to the unskilled workers and have the skilled refugees settle for frictional unemployment in the short-term. This would allow the government to provide immigrants with education, which would not be too costly given their prior skills. The most necessary type of education would logically be language training since the refugees must integrate into a new culture. The government must also extend its provision of health care to the refugees to make sure that they stay healthy and are thus capable of working effectively. Therefore, interventionist supply-side policies with a focus on investment in human capital should be enacted.

### C. Refugees Overcoming Common Economic Problems

The economic issues commonly associated with immigrants and unemployment largely do not apply to the refugees that have recently settled into Germany. Many immigrants into Europe in general are associated with poverty as well as a lack of sufficient health and education.

In addition, they often bring in higher crime rates with them, making a nation's society more unstable. The economic prospects of natives may also be worse off from immigration since much of the money earned goes back to migrants' place of origin (thus lowering the GNI of the country receiving the immigrants) rather than contributing to the economy of the nation where it is earned. Furthermore, migrants often have a low level of human capital (due to the lack of sufficient skills and knowledge), thus making a nation's economy less productive if hired.

However, many of the Syrian refugees into Germany in fact contain marketable skills that allow them to effectively contribute to the nation's possible economic growth. Meanwhile, these refugees are generally not poor and thus do not need as much aid as many Mexican immigrants into America. They are mostly healthy and bring their own unique skill sets to compete for jobs in Germany, including those in sophisticated industries such as technology (Euronews). Companies with vacancies would thus be more open than otherwise to hiring the refugees. In addition, many Syrian refugees of working age plan to either return home after a few years, once the wars have ended there, or stay in Germany to further their own careers rather than continuing to work in Germany and sending their profits to their families (Chebbi).

Moreover, Germany is a nation that is capable of integrating immigrants into its economy. As shown already, the country has many job opportunities across a wide variety of industries that allow for the employment of skilled and ready-to-work refugees (lessening worries about competition with natives for jobs). Now, the key for the German government is simply to give these refugees access to labor markets, which would help them avoid the development of ghettos and other negative byproducts of migration (Euronews). In addition, there is currently a very high level of income equality within Germany, seen by its low Gini Index of 27.0 (CIA). To alleviate any worries concerning poverty faced by low-income earning refugees, Germany increased its minimum wage from €8.50 to €8.84 in January 2017 (Trading Economics).

The danger of this recent policy, increasing the rigidity of the labor market, is that it might create structural unemployment by making firms less willing to hire workers. However, employment of the refugees would likewise assure that refugees do not fall behind native workers in terms of income. Therefore, the following proposal represents a more desirable way to ensure the economic well-being of refugees than an increase in the minimum wage.

#### D. Proposal: Government Expansionary Fiscal Policy

In order for the German economy to achieve all of these positive potential outcomes (associated with economic growth) made possible by the refugee influx, the German government must ensure that the new immigrants find employment. Under the most desirable circumstances,



unskilled immigrants would be matched with fitting jobs by giving them access to labor markets (such as by overcoming the obstacle of geography). Meanwhile, refugees with marketable skills would receive training to acquire the small culture-specific abilities that they lack (such as the ability to speak German) in order to work up to their full capabilities. The solution is increased government spending (both directly and indirectly through firms), also known as an expansionary fiscal policy.

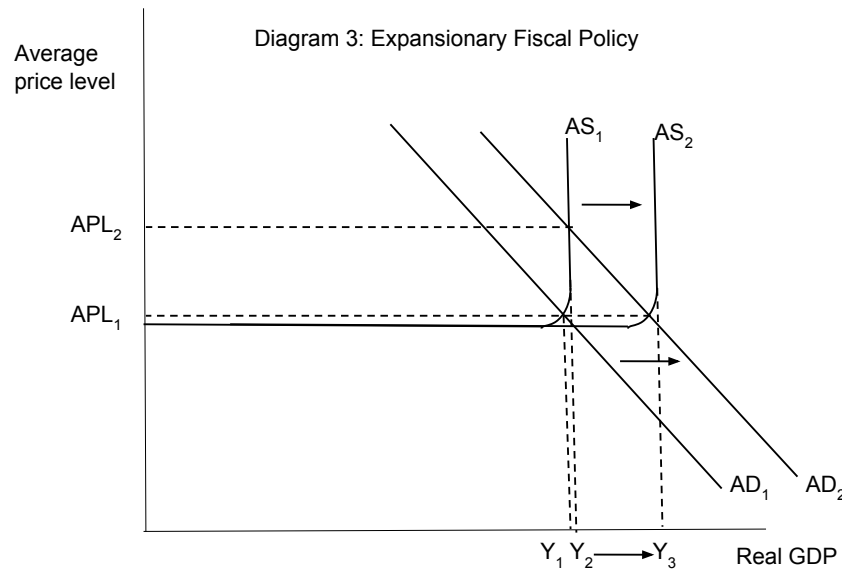


Diagram 3 shows the effect that an expansionary fiscal policy would have on the German economy, according to the demand-driven Keynesian model. Before the refugee crisis, Germany was producing at its level of potential output at  $Y_1$  since the German economy fully employed its resources, with an unemployment rate of around four percent (Trading Economics). An increase in government spending would increase the aggregate demand from  $AD_1$  to  $AD_2$ . Normally, the problem for an economy producing at its full employment level of output is that an increase in only aggregate demand would cause inflation (with a fairly large increase in the average price level from  $APL_1$  to  $APL_2$ ), but merely a very small increase in real GDP (from  $Y_1$  to  $Y_2$ ). In addition, an increase in only aggregate supply from  $AS_1$  to  $AS_2$  (due to a larger labor force) would keep real GDP constant at  $Y_1$  and also negatively create a slight downward pressure on wages and inflation, shown by the gap between the vertical section of  $AS_2$  and  $AD_1$  (Euronews). This increased unemployment of potential workers could result in an increase of unemployment benefits provided by the German government, which is very costly and causes the immigrants to

unjustly rely on them. Unemployment benefits would discourage current workers to work, as seen in Spain after the Great Recession (AFP News).

However, provided that the German government undertakes an expansionary fiscal policy to increase the aggregate demand from  $AD_1$  to  $AD_2$ , combined with the benefit of an increased labor force (an increase in aggregate supply from  $AS_1$  to  $AS_2$ ), the average price level will stay constant at  $APL_1$  while real GDP will increase to  $Y_3$ . This increased real output will raise the disposable income of both native workers and refugees while growing the German economy. In other words, inhabitants of Germany can afford to spend more in an economy that provides more goods and services.

The German government is already working on culturally and socially integrating the refugees, paying to process them into the country as well as providing them with food and housing (Euronews). The next step is to provide health care and specific forms of education to make sure that these potential workers can effectively contribute to the German economy. Likewise, the government must inform refugees and firms about potential hiring and working opportunities, as well as provide hiring incentives to businesses. Although the combination of cultural and economic integration of refugees is often difficult and costly to achieve, Germany is definitely capable of it. Companies like SAP are determined to find the talent necessary to achieve their corporate goals, which they prioritize over workers' place of origin or initial training setbacks (Euronews). In addition, the German government's surplus, which was at 0.8 percent in 2016 (Trading Economics), both shows that the country was able to process asylum seekers without heavily cutting into the government budget and that the government can afford to pay for the economic integration of refugees without running a deficit or increasing borrowing.

### **III. Conclusion**

According to the analysis above, the refugees have a greater possibility of providing benefits to the German economy than obstacles. They can help solve the labor shortage, which poses a key problem to the growth of the German economy. In addition, Germany has already shown signs of initial successful economic integration of refugees, with its unemployment decreasing from 4.3 percent to 3.8 percent in the last twelve months despite the influx of new members of the labor force (Trading Economics). The main problems associated with the refugees concern the social and cultural interests of the native German population and are separate from the economic implications of the crisis (since most of the refugees are not in poverty).

Since Germany may have more than one million refugees resulting from the crisis once they are all processed, the proposed government action will be costly. It will need to include the provision of basic necessities as well as career-specific training and job preparation, while it may be difficult to efficiently allocate workers to specific industries with job openings. However, this large initial government investment would be worth it because the economic growth would help overcome a possible deficit and outweigh the initial value of the government spending (given the Keynesian multiplier effect). According to Ian Goldin, the founding director of the Oxford Martin School at Oxford University, “[Government fiscal policy] is both a short term and a long term investment. In the short term it provides stimulus to the German economy which will grow about 0.2 percent faster than it would have without the refugees. In the longer term – there was a situation with one of the lowest fertility rates of the world in Germany and that will be vital for the long term sustainability of the German economy” (Euronews). Furthermore, the increased supply of workers in the economy is in vain without the employment of resources, which government spending will help ensure.

There is strong international support for the refugees to make a positive impact on the German economy. The Organization for Economic Cooperation and Development (OECD) prioritizes the oversight of migrant workers to make sure that they (as well as their children) receive education and opportunities equal to those of natives in order to contribute towards economic growth. The organization recognizes the necessity and value of migrants, especially in countries with aging populations such as Germany (OECD, pg. 29-31). Promotion of refugee integration, which Chancellor Merkel already embodies, from foreign countries will thereby expedite the process of all of its facets, including economic integration. Therefore, immigrants will be a key determinant in solving what are arguably the main long-term problems of the German economy, making the refugee “crisis” somewhat of a blessing.

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