

# Intended and Unintended Consequences of Welfare Cuts for Refugees

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In response to increased immigration and rising anti-immigrant sentiments, many governments have limited welfare benefits for refugee immigrants to encourage workforce participation (see, for example, OECD International Migration Outlook 2006-2019, OECD Trends in International Migration 1997-2004). Yet, the immediate and long-term impacts on employment, earnings, and labour market participation remain unclear. Also, there could be potential adverse consequences of reducing benefits for vulnerable groups with low labour market attachment, such as single mothers (e.g., Mogstad and Pronzato 2012), unskilled individuals (e.g., Bargain and Jonassen 2022), and refugee-migrants (e.g., LoPalo 2019). A particular concern is the consequences for children in these families (Aizer et al. 2016, East et al. 2023, Løken et al. 2018).

In two recent papers, “Refugee Benefit Cuts” (Dustmann, Landersø, and Andersen 2024a) and “Unintended Consequences of Welfare Cuts on Children and Adolescents” (Dustmann, Landersø, and Andersen 2024b), we investigate these questions by studying the effects of a large reduction in the cash transfers that non-employed refugee immigrants were eligible for. The cash transfer reduction was intended to incentivise labour supply to “ensure that refugees and immigrants living in Denmark are better integrated and find employment more quickly,” as stated in the official government document to the reform. The policy (named “Start Aid”) was introduced in July 2002, cutting transfers by around 40% for all refugees granted residency in Denmark after the implementation date. From a research perspective, it provides an ideal setup to identify the policy’s causal effects on refugees and their children, as those granted residency just before and after the reform were identical in all dimensions except the transfers they were eligible for.

## **Reform effects on refugees’ labour market outcomes.**

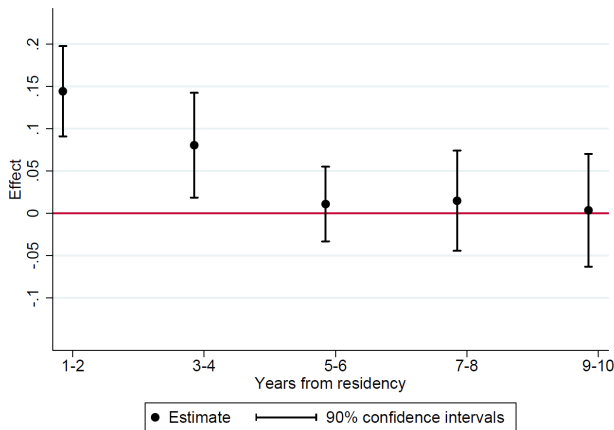
In its immediate aftermath, the reform doubled average labour earnings and increased employment rates. Yet, as Figure 1a illustrates, the short-run effects did not persist. The initial employment effects quickly faded and disappeared five years after reform implementation.

We argue in Dustmann et al. (2024a) that the success of reforms intended to incentivise labour force participation depends on the demand for the type of work target individuals can offer. Demand may be scarce if directed at low-skilled individuals, such as refugees, whose productivity may fall below the wage employers are required to pay. This is particularly so in a highly capitalised and high-wage economy like Denmark. Figure

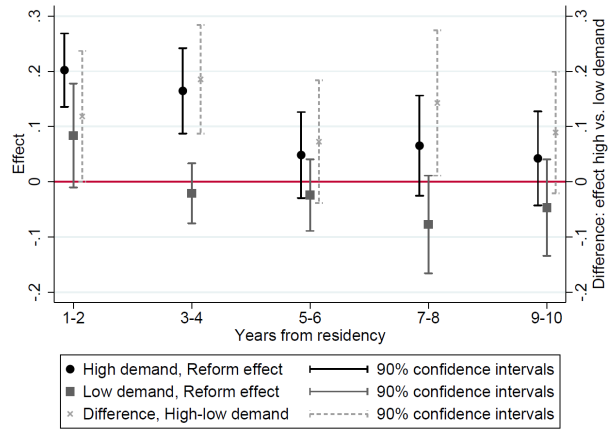
1b illustrates this by portraying the reform effects on employment in low- (grey squares) and high-demand (black circles) areas, as defined by the labour demand for low-skilled work in the municipality to which refugees were allocated. Whereas employment effects disappear after one year for refugees allocated to low-demand areas, they remain significant until year five after reform implementation for those allocated to high-demand areas.

**Figure 1: Long run reform effects on employment**

A) Average reform effects on employment



B) Reform effects by local labour demand



Notes: The figure shows the estimated effects of the reform on the fraction of refugee males with employment during years 1-2, years 3-4, years 5-6, years 7-8, and years 9-10 following reform implementation. Figure A) shows reform effects for all male refugees. Figure B) shows the reform effects separately by whether the refugee was allocated to areas with relatively low (black circles) or high (grey squares) demand for unskilled labour along with the differences in reform effects between low and high demand areas (light grey crosses).

We also show that the labour demand conditions in the assignment municipality strongly affected the *type* of jobs refugees find in response to the reform. While the reform increased employment in unstable low-quality jobs in low-demand areas, it led to jobs of higher quality in high-demand areas. Therefore, the reform increased refugees' average labour earnings during the first five years by almost 40% and reduced public expenditures by 60% in high-demand areas. In contrast, there are no significant changes to labour earnings and only a small decline in public expenses in low-demand areas.

These findings, which constitute the first direct *causal* assessment of the sensitivity of reform effects to local demand conditions, question the standard policy of equally distributing refugees across regions. They suggest allocation policies that assign refugees to areas that offer opportunities for the jobs they can perform.

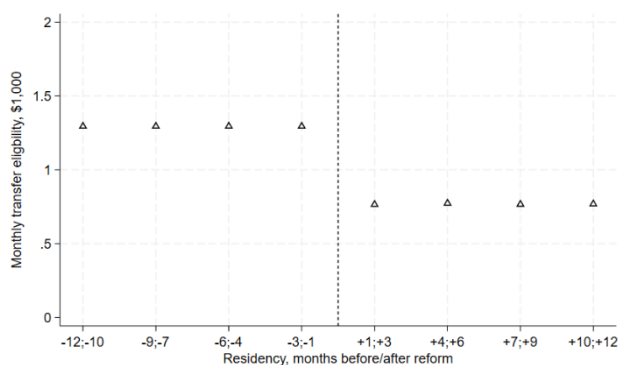
### Unintended reform effects

Figure 2 shows the reform effects on average disposable income in families with children. While the reform led some adults to find employment faster than they otherwise would have, this is the case only for a minority

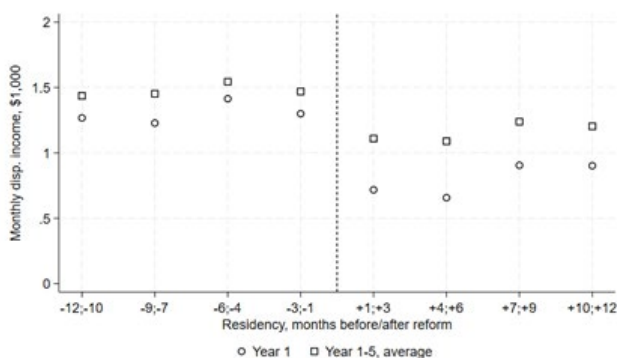
of refugees. Therefore, average disposable income (transfer income and earnings minus tax payments) dropped from around \$1,400 to \$800 (2020 USD) in families with children (see Fig. 2A), with the fraction with an average monthly disposable income below \$750 (approximately equal to the U.S. poverty threshold, U.S. Census Bureau, 2020) increasing from a pre-reform level close to zero to a post-reform level of around 50 percent (Fig. 2B).

**Figure 2: Disposable income by timing of residency**

A) Monthly transfers that individuals are eligible for, \$1,000



B) Monthly disposable income, year 1 and average average of year 1-5.



Notes: The figure plots the transfer levels refugees are eligible for and refugees' realised disposable (post-tax and transfers) income by the timing of residency relative to the reform in bins of three months. Figure A) shows transfers (pre-reform Social Assistance and post-reform Start Aid) that refugees aged 18-45 with children are eligible for on average. Figure B) shows the means of actual disposable (post-tax and transfers) income for refugees aged 18-45 with children at a residency in their first year after residency (circles) and the first five years after residency on average (squares).

Such dramatic drops in households' resources are likely to affect the outcomes of adults and their children, such as crime, children's educational attainment, earnings, test scores, language proficiency, and well-being (see, for example, O'Dea et al. 2021, Stabile and Milligan 2009, for earlier evidence of variation in family income on children's educational outcomes). Table 1 summarises some of these effects by comparing outcomes for those who received residency just before the reform (i.e., were eligible for higher transfers, row 1) and those who received residency just after (i.e., were eligible for lower transfers, row 2).

**Table 1: Adverse effects of the reform**

	(1)	(2)	(3)	(4)	(5)
	<i>Probability of crime, adults, year 1-5 after residency</i>	<i>Probability of crime, adolescents, year 1-5 after residency</i>	<i>Years of schooling</i>	<i>Earnings 15-16 years post residency, \$1,000</i>	<i>GPA in 9th grade, standardized relative to full population</i>
Pre-reform	0.09	0.16	12.17	13.57	-0.44
Post-reform	0.15	0.28	11.60	10.15	-0.62
Difference from pre- to post-reform	0.05 (0.02)	0.12 (0.05)	-0.57 (0.28)	-3.43 (1.47)	-0.18 (0.09)

*Notes: The table shows the estimated pre- and post-reform levels of crime, years of schooling, earnings, and grade point average (GPA). Crime is measured as the fraction of a conviction for a crime committed during the first five years after residency for adults and adolescents (those aged 14-18 at the time of residency). Years of schooling are measured in 2020 (17-20 years after residency to Denmark), and earnings (2020 USD) are measured as the average of earnings 15 and 16 years after residency, both for those of school age at the time of residency (aged 7-14). GPA is the average grade given in 9th grade to all students in Denmark; this has been standardised to have a mean of 0 and a standard deviation of 1. The bottom row of the table shows the differences between pre- to post-reform along with the standard errors in parentheses.*

The table shows that the transfer reduction had adverse effects on all outcomes. Among adults, crime rose sharply in the year after residency in Denmark (driven by property crimes such as shoplifting in supermarkets). Crime did not change immediately after reform exposure among adolescents but increased substantially in the longer run. Dustmann et al. (2024b) show that property and violent crime drive these effects. During the first five years in Denmark, crime rates for adults and adolescents increased by five and 12 percentage points, respectively, due to the reform (columns 1 and 2).

Among those of school age at the time of reform exposure, the lower transfer rates reduced their average educational attainment by six months (column 3), driven by increased school drop-out rates at ages 16 and 17, where many children instead took up work (thereby supplementing family income). In the longer run, the lower educational attainment of children also resulted in large reductions in labour earnings (column 4). Finally, the reform also led to lower test scores (column 5) among younger children (and lower pre-school enrolment and self-rated well-being (see Dustmann et al. (2024b) for more details)).

Combining the positive returns of the reform from adults' short-run employment response (see Figure 1) with the costs from children's lower earnings later on and the crime increases of both adults and children (see Table 1), we find that 15-16 years after the implementation, the reform had generated a negative return of around -\$12,000 (2020 USD) for the average refugee family. In contrast, a short-run evaluation of the

reform focusing only on the intended labour supply effects may have suggested that the reform led to a positive return.

### **Lessons for future welfare reforms**

The Danish 2002 Start Aid reform aimed to boost labour supply among individuals with weak labour market attachment, an objective shared by similar reforms worldwide. Our findings reveal partial achievement of this objective but with large unforeseen negative consequences. This has significant implications for designing welfare reforms targeting groups like refugees with weak labour market attachment (see Dustmann et al. (2022), for an assessment of Danish refugee policies).

While triggering notable initial employment responses, Start Aid failed to sustain employment and self-sufficiency, particularly in areas where low-skilled work is in low demand. This illustrates that the lack of demand for low-skilled labour poses a significant challenge to the labour market integration of some refugee groups. Balancing supply incentives with demand conditions is crucial for reforms targeting labour supply incentives to be successful.

Moreover, welfare reforms to increase labour supply through reduced transfer payments can have unintended, detrimental consequences for children. These adverse effects on children's education, labour market performance, and crime rates outweighed, in the longer run, the short-term effects on the labour supply of their parents. While our study focuses on a specific Danish reform, the conclusions are pertinent to ongoing discussions on welfare reforms targeting similar groups.

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