

PROTECTING HOME ABROAD

FINANCIAL RESCUES AS MIGRATION PREVENTION

David Leblang
University of Virginia

Christina J. Schneider
University of California, San Diego

Jennifer L. Tobin
Georgetown University

Abstract

We argue and show that countries experiencing financial crises are more likely to receive bilateral bailouts when the crises could lead to migration flows that would be politically costly to creditors. Financial crises are usually accompanied by economic recessions that create outward migration pressures in crisis countries. Creditor country politicians are particularly worried about greater migration from crisis countries when immigration heightens economic, religious or cultural fears, causing social conflicts and political backlash. If potential creditors expect that a financial crisis would lead to increased immigration that could increase social conflicts, and thereby contribute to a political backlash, they use a variety of instruments to minimize migration. By providing additional liquidity to fill financing gaps through bilateral bailouts, crisis countries may be better able to avert the worst consequences of financial crises, thereby minimizing the migration pressures for the creditor government. We test our hypothesis using an original data set on bilateral bailouts by 36 OECD countries to 108 crisis countries in the year of the financial crisis between 1970 and 2010. Our statistical analysis supports our argument that as the potential for politically costly migration increases during financial crises so does the likelihood that the government provides a bilateral bailout. We support our statistical tests with qualitative evidence of U.S. bilateral bailout discussions for Mexico to trace the causal mechanisms of our argument.

In 1994, due, in part, to profligate monetary policy, Mexican monetary authorities were forced to abandon the peg of the peso to the US dollar and significantly devalue their currency. That shock resulted in what has been colloquially termed the ‘tequila effect’ as the effect of the Mexican devaluation rippled across Latin America. Among others, Argentina’s economy was significantly affected by the Mexican devaluation and suffered similar losses. Interestingly, during the Mexican peso crisis, the United States provided \$20 bn. to Mexico’s financial rescue yet ignored Argentina, leaving that country with a tremendous hangover (Lustig 1995). Why do we observe this variation in creditor responses; how can we make sense of the strategic use of financial bailouts across potential donor countries?

Creditor countries, such as the United States, are not altruistic; they do not provide financial assistance because it is in the best interest of the crisis country, but rather, to protect national political and economic interests. It is not surprising to find that bilateral financial rescues are especially likely when economies are intrinsically linked to each other, and creditor countries are highly exposed to the crisis country. The repercussions of economic crises, however, are not limited to financial and commodity markets. Oftentimes, they are associated with deep recessions in the crisis countries as markets and firms struggle to recover from the financial crisis. High unemployment rates, the collapse of housing and real-estate prices, and the social and economic repercussions from the necessary austerity measures have human consequences. In some cases the crisis leads individuals to seek economic opportunities abroad, inducing widescale economic emigration. And with even potential emigration to host countries comes the fear of social, cultural and economic conflict.

This paper addresses why and how governments in potential host countries use bilateral bailouts in order to cope with these crises-induced migration pressures. We argue that governments that fear domestic political backlash from increased migration pressures from third countries that experience financial crises have incentives to use bilateral bailouts as one possible foreign policy instrument to minimize expected immigration from those countries. Our argument traces the expectations that governments have in highly uncertain environments where financial crises in other countries may lead to greater immigration pressures. Financial crises are oftentimes accompanied by deep and lasting economic recessions in the crisis country. The economic repercussions of financial crisis increase the incentives and pressures for crisis country citizens to emigrate to countries where they expect to be better off. This is not necessarily a concern for potential host countries. However, this potential migration can be politically costly if the immigrants are culturally, socially, or economically different from their own citizens as this likely leads to social and economic frictions in the host country, with negative effects for the politicians’ tenure in office. If politicians expect that financial crises in the crisis country lead to greater migration that is politically costly, they can use bilateral bailouts as one potential foreign policy instrument to avert these costs. Bilateral bailouts inject substantial financial liquidity into the crisis country, which may decrease the depth and length of the financial crisis, thereby reducing the migration pressure *ex ante*.

We test the empirical implications of our theoretical argument using original data on bilateral bailouts of 36 OECD countries to 108 countries that experienced financial crises between 1970 and 2010. Using spatial logistic estimation, we show that as the potential for politically costly immigration increases from a country experiencing significant financial distress, governments are significantly more likely to offer those countries a bilateral bailout, all else equal. The results are robust to including economic and political factors that are typically associated with the provision of bilateral financial rescues and they are not driven by lobbying efforts of existent migration populations within the creditor country.

The findings offer several interesting implications for scholarship on both financial rescues and migration. First, economic analyses of bilateral bailouts have focused on more narrow economic criteria (Kindleberger 1986; Frankel and Roubini 2001 Broz 2005); strategic economic

and political considerations have only played a minor role in these analyses (Lipsy 2003; Schneider and Slantchev 2019; Schneider and Tobin 2018). For example, in his qualitative analysis of the Asian Financial Crisis, Lipsy (2003) argues that cross-temporal variation in the incentives to provide bailouts mainly depended on the importance of the crisis country's economy for the creditor country. Our approach offers a political rationale for providing bilateral bailouts that goes beyond strategic and non-strategic economic considerations. By providing bilateral bailouts, politicians may hope to stave off migration from other countries in the hope of minimizing the political backlash that is associated with crisis-induced migration. In addition to demonstrating that migration potential matters, our theory and tests provide insights into the conditions under which it is likely to matter. Based on the existing migration literature (e.g., Bernhard and Leblang 2017), we show that politicians only have incentives to provide bailouts when potential migration is expected to be politically costly (i.e., by causing social and economic frictions). If there are no expected costs associated with migration, governments have little incentive to offer bilateral bailouts, even if the migration potential is relatively large.

Finally, our findings highlight the centrality of government expectations. Their incentives to provide bilateral bailouts are neither grounded in the information about actual migration nor in the exact knowledge about the effectiveness of the bilateral bailout. Rather, we argue and show that governments' expectations about costly migration pressures are sufficient to motivate action. Fear of potential political backlash gives governments the incentive to use foreign policy tools—here, a bilateral bailout—to avert this politically costly migration. Whether this policy tool is effective is highly questionable. But, the expectation that it might be is enough for governments to use it as one tool out of their toolbox of policies. The fact that this tool is important despite controlling for other, potentially more effective instruments such as more restrictive immigration policies, makes us more confident that politicians see bilateral bailouts as one important policy to battle costly migration.

FINANCIAL CRISES, MIGRATION, AND BILATERAL BAILOUTS

Policymakers use a wide variety of tools to maintain power. During times of uncertainty, their behavior often reflects a perception of reality rather than facts observed *ex ante*. Our theory focuses on how expectations—in the face of the uncertainty brought on by financial crises elsewhere—affect a government's decision to provide bilateral financial rescues. We focus specifically on an increasingly salient political fear: an expectation of unpopular immigration and its consequences for a politician's ability to remain in office. We argue that creditor governments may be more willing to provide bilateral bailouts to a country experiencing a financial crisis if they estimate that the bailout will decrease the risk of politically costly immigration.

Our discussion focuses on the decision of a government in a potential creditor country to bail out a country that is experiencing a financial crisis and is in need for emergency liquidity to serve its obligations to financial investors. While financial crises come in various shapes and forms, they typically lead to a situation in which the demand for liquidity outpaces the supply of capital. To close this external financing gap, actors in crisis countries either have to find credit elsewhere or make policy adjustments to reduce spending. The dilemma is that countries experiencing financial crises are typically shut out of the international financial markets. In these situations, crisis governments rely on support from international creditors to provide them with sufficient liquidity and other resources (including technical assistance) to solve their credit constraints. Whereas the International Monetary Fund (IMF) is the main coordinating actor in the financial rescues of countries, it is bilateral funding that offers the largest amounts of resources to countries in crisis.¹

¹ IMF loans are typically insufficient to serve the financing gap and usually rely on additional loans from bilateral creditors. Further, currency swaps and privately financed haircuts are less politically salient means for obtaining funding.

Financial crises, particularly when they are severe, are accompanied by deep recessions. More often than not, financial crises lead to a decline in economic activity that Rogoff and Reinhart (2007: 225) have described as “breathhtaking,” both in length and in depth. Crises lead to collapses in housing and equity prices, profound declines in economic output and employment, and explosions of government debt (by about 86% in some cases, typically driven by a significant decline in tax revenues). Across a number of different crises, Rogoff and Reinhart (2007: 224) found that the unemployment rate rose by an average of 7% in the years following a financial crisis; output declined by over 9%. Countries take years to recover. Years in which citizens are plagued by unemployment, declining income, and significant (negative) changes to their overall quality of life. The deep recessions and economic uncertainty that accompany financial crises. Consider the case of Greece which has experienced a particularly severe debt crisis since 2008. Along with a decline of GDP growth of five percent, the unemployment rate climbed from an already high 14.1% in 2010 to an astounding 27.6% in 2013 and still lingered at 20.6% in early 2018. Youth unemployment has been particularly high with the affected people mainly of the age 15 to 24. In 2017, 42.3% of the young active population was unemployed (easing from 47.1% in 2017). Both, consumer and business confidence crashed in 2009 and have not recovered to this date (Schneider 2019).

The effect of unemployment and financial hardship is not limited to the crisis country, especially when the economic and political uncertainty incentivizes individuals to seek opportunities elsewhere. Financial crises lead to migration. Between 2008 and 2016 alone, over 427,000 Greeks left Greece seeking a better life abroad. This “third wave of mass emigration of Greeks,” much like the first two waves, coincided with periods of intense economic recession and observers generally agree that the main reasons for all three major Greek emigration waves are economic.² In 2013 alone, Greek emigrants – mostly young, educated professionals – represented more than 2% of the total workforce of the country.

The example of Greek emigration is consistent with broader theoretical approaches to understanding why people move from one place to another. The standard micro-economic model of migration holds that, all else equal, an individual is more likely to move from country *i* to country *j* if the expected wage in country *j* exceeds the expected wage in country *i*, less transaction costs (Ortega and Peri 2012). Gravity models of international migration—models that test this micro-level intuition on observed flows of migrants between countries—control for additional linkages between home and host countries, including unemployment in the potential destination and other push and pull factors associated with the migration decision. At the macro level, there is strong support for the proposition that migrants seek higher wages and more certain economic prospects, especially in times of financial crisis (Hatton and Williamson 2005).

Countries that, based on their income levels, tend to be in a position to provide bilateral financial rescues also tend to be destination/home countries for large numbers of migrants in part because of their economic opportunities and political liberties. But what is the expected political effect of immigration from a crisis country to a potential creditor country? We know that migration—both anticipated and unanticipated—affects the political fortunes of governments in receiving states (Bernhard and Leblang 2016; Bernhard, Leblang, and Post 2017). For instance, a government that admits a small number of foreigners may appear humanitarian and compassionate and, in turn, receives a small boost in terms of public support at home. But large flows may strain asylum processes, welfare systems, job security, and cultural, religious, and racial homogeneity within a country.

² Based on a report from the Bank of Greece “Fleeing of Human Capital: Contemporary Migration Tendencies of the Greeks in the Years of Crisis.” Cited in Philip Chrysopoulos. “Economic Crisis Marks 3rd Emigration Wave of Greeks.” Greek Reporter. July 2, 2016 (<http://greece.greekreporter.com/2016/07/02/economic-crisis-marks-3rd-emigration-wave-of-greeks/>)

These costs are likely to hurt the incumbent government for a number of reasons. Voters may (mis)perceive an increase in labor market competition due to immigration and may pin the cause of unemployment on the influx of foreigners. Higher rates of unemployment or a decline (or even stagnation) in wages associated with an inflow of migrants can have negative consequences for the incumbent party. In real terms, an influx of migrants may have a negligible or even a null effect on wages depending on the sector and skill level of the native worker. But a small effect on wages as a result of immigration can often be perceived as a significant problem by mass publics where migrant inflows can influence how they assess the causes of unemployment and contribute to cross-cultural frictions (Facchini and Mayda 2010; Boeri 2009). This effect may be especially important during periods of economic uncertainty and economic stress (Dancygier and Donnelly 2013; Zamora-Kapoor and Vereba 2014). In fact, Fritzsche et al (2011) argue that groups that are threatened during times of social crises fear losing ground and are more likely to empathize with the in-group, rather than the out-group. This means that people become more ethnocentric in times of uncertainty with important political consequences for the government.

More broadly, citizens in the host country may be more sensitive to migrants who are socially and culturally different from themselves. If immigrants are culturally or racially more diverse, then immigration is likely to lead to a decline in social trust and an increase in social fragmentation (Alesina and La Ferrara 2000, 2005; Ben-Nun Bloom et al. 2015; DeMireva 2017). Native publics tend to oppose immigration when immigrants are culturally dissimilar (Bridges and Mateut 2014). In this light, the rise of anti-immigrant populist parties in the United States across the European Union following the Syrian Refugee Crisis in 2015 and the US election of 2016 should not be surprising (Georgiadou, Rori, and Roumanias 2018).

The perceived social, economic, and cultural impact of an influx of migrants has consequences for a leader's popularity. In the case of Florida, many citizens criticized President Carter for not preventing the flood and President Reagan for not appropriately lessening its impact.³ In the case of Greece, the influx of Greek migrants into Germany threatened to cut short the German chancellor's tenure in office (Bernhard and Leblang 2016). More generally, refugee shocks—an influx of refugees larger than what was expected—have a negative effect on a leader's time in office across OECD destination countries, decreasing the expected duration of a leader's tenure by an average of ten percent (Bernhard, Leblang, and Post 2017).

Leaders are keenly aware of this. To protect against the negative political consequences of immigration, governments typically turn to foreign policy tools such as foreign assistance or military intervention (Bermeo and Leblang 2015; Findley and Marineau 2015). However, in cases of financial crisis where short-term solutions are possible, creditor governments can hope to reduce the potential for immigration by lessening the financial and economic impact on the country in crisis. The most common way to close the liquidity gap in the crisis country is through multilateral and/or bilateral bailouts. Bailouts have the potential to limit the negative economic consequences in the short-run, and therefore to prevent or at least limit potential migration. That is, rather than having to address the migration problem *post facto* – i.e. once it has already incurred political costs – governments could try to use bailouts to minimize the likelihood that the problem occurs *ex ante*.

Multilaterally, the creditor country could pressure the IMF to provide emergency loans that minimize the negative consequences of financial distress a crisis country experiences. While the IMF is often involved, the major drawback is that the IMF faces both a problem of unresponsiveness (due to the multiple stages of the decision-making process from the initial request to the first tranche of a loan) and a problem of resource insufficiency (due to the quota system which limits the loan amount that any country may receive) (McDowell 2017). Both problems are troublesome for a politician who fears crisis-induced immigration. The insufficiency of resources that the IMF typically provides implies that the IMF loan by itself may only have a

³ http://articles.sun-sentinel.com/1985-09-26/news/8502100720_1_mariel-boatlift-criminals

short-term or insufficient impact on the financial situation in the crisis country. Unless the IMF loan is sufficient to reinsure investors or the crisis country is able to use the IMF to attract additional loans or haircuts from official or private donors, the financial crisis could still lead to increased potential for migration, with the negative political consequences discussed above.

Bilateral bailouts have two important advantages. They usually can be provided faster than multilateral rescues because they do not have to be negotiated amongst a large group of sovereign governments. In many cases, bilateral bailouts involve executive decisions with relatively little parliamentary scrutiny. For example, the U.S. Treasury Department has a great deal of freedom from Congress to use the Exchange Stabilization Fund (ESF) to provide rapid bilateral bailouts to crisis countries. Second, as long as the creditor countries are wealthy enough, they are also less constrained in the amount of resources they can provide. The IMF has been historically underfunded; its financial resources in relation to cross border capital flows have declined significantly over the last two decades (McDowell 2017: 30f). The resources it can provide to help troubled economies falls woefully short of what is usually needed to fill the financing gap. While many bilateral donors, even amongst the G7, do not have unlimited funds, they are less constrained by existing quota systems, and have the potential to pony up vast resources, especially if its in their own economic or political interest to do so. Allowing crisis countries to fill the financing gap reduces the pressure to implement drastic austerity measures, which in turn may protect the country from having to undergo the serious economic recessions that lead to migration in the first place. In fact, much of the criticism of about whether the EU should provide a bailout to Greece in 2010 centered on the question of whether to provide a larger bailout with fewer conditions in order to lessen the economic suffering of Greeks during the period. Germany's fiscal hawks prevailed and the bailout was relatively small (at least initially) and tight to tough austerity conditions; a decision that contributed to the serious economic downturn in the Greek economy following its sovereign debt crisis. If politicians expect that bailouts can lessen the economic impact of a financial crisis, and that this may help stem costly migration, they should have strong incentives to offer such a bailout to a country experiencing a financial crisis, all else equal.

This leads to the following testable hypothesis:

Hypothesis: Creditor governments are more likely to provide bilateral bailouts to countries facing financial crises if there is the potential for politically costly immigration from the country in crisis, ceteris paribus.

It is important to note that our theory neither assumes that financial crises always lead to costly migration pressures nor that bilateral bailouts are always effective at protecting the creditor country from costly migration. In environments that are highly uncertain it is difficult to forecast the course of the crisis, the extent of migration, and even the ability of a particular bailout to address a crisis—politicians have to make choices that are based on expectations. If governments expect that a financial crisis in another country is likely to lead to immigration from that country, and if that immigration is perceived to be politically costly (for example, because of cultural heterogeneity), then they have an incentive to use a variety of tools to try and prevent it. Our focus here is on bilateral bailouts as one potential tool. Governments could also close their borders or make immigration policies more restrictive in order to deter future immigration. While we believe that policy-based responses are more effective in the medium-term, one advantage of providing bilateral bailouts is that they are easier to implement quickly, they may have an immediate effect if they are large enough to prevent a further deterioration of the economic situation for potential emigrants, and therefore, should be an attractive tool for governments who want to avoid the negative consequences of economic turmoil in other countries for their own political survival in the short-term. In our quantitative tests, we will control for the availability of such alternative tools and the variations in existing immigration policies to account for the pressure for governments to rely on bilateral bailouts as immediate remedy.

In addition, our argument focuses on the incentives for governments to provide bilateral bailouts in order to prevent negative political effects that arise from the migration-induced social frictions in their country. That is, the bailout is to be seen at least in part as a migration prevention tool. One could argue that the same governments may be more likely to bailout the crisis country because existing migrants from the crisis country lobby the creditor country government for a bailout. The reasoning is similar with respect to some of the mechanisms detailed above: there are a number of factors that explain where migrants emigrate to and if a crisis occurs, migration is likely to simply increase the flows to typical destination countries. Thus, the more migrants that a country already hosts, the more likely the existing stock of migrants to put pressure on the government to provide a bailout to their home country. The main difference is that the pressure to provide a bailout in our migration prevention argument depends on the *potential for migration* whereas the pressure to provide a bailout in the lobbying story depends on the *existing stock of migrants* in a country. We believe that the lobbying story is an important part of the decision-making calculus, and complements our migration-prevention argument. In the empirical analysis we will distinguish between these two arguments to test whether the migration-prevention argument is supported but not driven by the lobbying of existing migrants in the country.

MIGRATION PRESSURES AND THE U.S. BAILOUT TO MEXICO

Before moving to a quantitative test of the empirical implications of our theory, we turn to a case that exemplifies the mechanisms of our argument: the U.S. bilateral bailout of Mexico during the Mexican peso crisis in 1994-95. The U.S. bailout of Mexico was at least partially driven by President Bill Clinton's fears that the financial repercussions of the crisis in Mexico could lead to a politically costly wave of immigration to the US.

Not even a year after joining NAFTA, in January of 1994, the euphoria of investors who had willingly lent money to the Mexican government had turned into a veritable panic with a flight of capital from Mexico into the United States. This led to a sudden devaluation of the Mexican peso against the U.S. dollar in December 1994. It was the largest depreciation of the Mexican currency in a single year and contributed to the worst banking and sovereign debt crisis in Mexican history. The financial calamity led to an economic calamity. On January 3, 1995, Mexican President Zedillo made a speech that laid out plans to deal with the economic crisis including austerity measures. Wages and prices were to rise slower than inflation and government spending was to be cut; the Mexican economy was expected to grow less than one percent in 1995, with inflation at 15-20%.⁴

The developing Mexican crisis was not only problematic for the millions of Mexicans who faced unemployment and significant reductions in social welfare. US officials also began to worry. Aside from the effect on political stability on the southern border and potential negative economic spillover effects, much of the discussion in the U.S. administration centered around a potential migration shock induced by the Mexican crisis. In particular, the peso devaluation, by raising the value of wages earned by Mexican migrants in the US by about 40%, increased the prospect that vast new numbers of Mexicans would seek illegal entry into the United States. The U.S. government argued that the failure to provide financial help could result in as many as 500,000 additional illegal Mexican migrants in the next year.⁵ The Peso devaluation also increased the value of remittances sent back by Mexican workers earning dollars in the US, further increasing expectations about impending immigration of Mexicans into the United States.

⁴ <https://migration.ucdavis.edu/mn/more.php?id=553>

⁵ <http://lanic.utexas.edu/project/archives/lilas/cswht/paper5.html>. Importantly, this paper also argues that economic growth can at least in the short-term lead to more migration because it give migrants to means to emigrate to begin with. So the evidence as to the effect of economic growth on migration is not quite straightforward => again, though, importance of expectations!

The U.S. administration was not simply worried about immigration in general, but about the economic, cultural, and social costs that were anticipated if the additional Mexican migration occurred. In 1994, Americans tended to have a relatively negative view of immigrants in general. Over 63% of Americans believed that immigrants posed a burden to the country by taking jobs, housing and health care.⁶

Of course, the impending migration was by no means a certainty. Many observers even doubt that there is a robust relationship between devaluation and emigration.⁷ The U.S. administration had to rely on educated predictions about the potential that Mexican job seekers would flood the American economy. And many indicators led officials to believe that this migration shock was quite possible. One main concern came from the U.S. experience during the Mexican financial crisis in 1982. The 1982 peso devaluation of 72% was followed by a 30% increase in apprehensions in 1983 and 1984, from about 1 million to 1.3 million. Models that predict the potential of migration make similar predictions on the migration of Mexicans to the United States in 1982 and 1994. Figure 1 illustrates this using our own gravity model of migration potential (as described in the research design section). During both crises, the threat of politically costly migration to the U.S. was by far greater than to any other OECD country that could have provided a bailout. In fact, in our sample, the crisis-induced migration potential of Mexico to the United States in 1994 is the largest in our sample.



Anthony Lake who the National Security adviser at the time put it aptly:

*“This crisis poses the risk of political instability and economic decline that could undercut U.S. exports and boost illegal immigration.”*⁸

⁶ <http://www.pewresearch.org/fact-tank/2016/04/15/americans-views-of-immigrants-marked-by-widening-partisan-generational-divides/>

⁷ <https://migration.ucdavis.edu/mn/more.php?id=553>.

⁸ https://www.washingtonpost.com/archive/politics/1995/02/13/peso-crisis-caught-us-by-surprise/724b15d1-7985-444c-85fc-d2bc6cb03a56/?utm_term=.5c94f497c797

It did not help the administration that 1996 was an election year and that the brunt of illegal immigration would focus on Texas and California, two key states that in the elections would have impacted Clinton's chances of reelection.⁹

Given these assessments, the Clinton administration sought formal legislative authorization to extend a \$40 billion financial rescue package to Mexico on January 12, 1995.¹⁰ In his 1995 State of the Union address, Bill Clinton defended his support for a U.S. bilateral bailout of Mexico during the Mexican financial crisis by referring to the necessity to protect American borders:¹¹

"The financial crisis in Mexico is a case in point. I know it's not popular to say it tonight, but we have to act. Not for the Mexican people, but for the sake of the millions of Americans whose livelihoods are tied to Mexico's well-being. If we want to secure American jobs, preserve American exports, safeguard America's borders, then we must pass the stabilization program and help to put Mexico back on track."
(Bill Clinton, State of the Union Address, 1995).

The President secured the support of congressional leaders from both parties and at least initially a relatively speedy and affirmative vote seemed feasible. This assumption turned out to be incorrect. The Senate Committee on Banking, Housing, and Urban Development, led by Senator Alphonse D'Amato, strongly objected to the transaction and immediately launched document-discovery demands and held hearings on five different days over a four-and-a-half-month period. Even after the President had reduced the amount to be spent, Senator D'Amato declared that "billions of taxpayer dollars were wasted, put in jeopardy, and may ultimately be lost because the President used the Exchange Stabilization Fund—the ESF—in an unprecedented action to bail out global speculators." The staunch opposition was not, however, caused because members did not worry about the threat of migration. In fact, many in Congress wanted to go even further than the President and make the loan guarantee conditional on Mexico cooperating with the US to reduce illegal immigration with an understanding that Mexico would cooperate with the US to manage migration.¹²

The resistance of many Republicans was driven by negative public opinion at the time. For example, a Los Angeles Times poll taken in late January showed that 81 percent of Americans opposed the granting of loan guarantees to Mexico (Los Angeles Times, 24 January 1995). Members of Congress from both parties felt uncomfortable approving a sizeable rescue package for Mexico at the same time that they advocated austerity measures in the United States. To further complicate things, Republicans had just captured Congress based on a mandate of decreasing spending, not increasing it. Many of the new Republican members were isolationists and unsympathetic to NAFTA and Mexico. Republican leaders agreed with conservative Pat Buchanan's assessment of the loan as "daylight robbery of the nation's wealth. [It is money] the American taxpayers will never see again."¹³ The conditions to be requested from Mexico began to mount, and they eventually covered the entire range of bilateral issues: migration, relations with Cuba, extradition practices, narcotics trafficking and so on (Lustig 1998: 179).

In the end, Clinton was forced to withdraw the proposal in January and instead use the ESF—a Treasury Fund that was created by FDR to stabilize the dollar, and which does not require Congressional approval—to offer a \$20 billion bailout to Mexico. His logic did not change:

⁹ <https://www.nytimes.com/1995/04/02/business/us-bailout-of-mexico-verging-on-success-or-dramatic-failure.html>

¹⁰ <https://migration.ucdavis.edu/mn/more.php?id=553>

¹¹ WE SHOULD CHECK HIS MEMOIRS TO SEE IF HE TALKED ABOUT THIS AT ALL

¹² The bilateral bailout did in fact include requirements for Mexico to help stem the flow migrants (Wroe 2008, 127).

For example, the Mexican government agreed to participate in a pilot program that would transport illegal immigrants from Mexico that were detected in the United States back to Mexico.

¹³ <https://www.history.com/this-day-in-history/clinton-authorizes-loan-to-mexico>

“We must act now in order to protect American jobs, prevent an increase flow of illegal immigrants across our borders, ensure stability in this hemisphere, and encourage reform in emerging markets around the world. This is an important undertaking, and we believe that the risks of inaction vastly exceed any risks associated with this action. We fully support this effort, and we will work to ensure that its purposes are met.” (Bill Clinton, Statement with Congressional Leaders on Financial Assistance to Mexico).

This case illustrates how concerns over the political costs of a migration shock contributed to the U.S. administration’s decision to provide a bailout despite the large-scale opposition of domestic voters. Whereas voters were mainly concerned about the waste of taxpayer’s money, Clinton anticipated that the medium-term costs of increased immigration of Mexicans into the United States would have been prohibitively more costly to the government than a \$20 billion bailout. The administration’s hope was to minimize the migration shock by providing enough liquidity to Mexico to avert the most negative economic consequences of the crisis, thereby reducing the incentives for Mexicans to migrate to the United States. Electoral concerns clearly played a role in a time. Tracing the discussion and justifications of the U.S. administration provides us with a unique glimpse of the calculus of decision-makers at the time; something that is difficult to do with quantitative studies. Of course, the U.S. bailout to Mexico is only one example where migration matters in times of financial crisis, and it is an easy case. Not only was the U.S. economically exposed to Mexico in 1995 and should have had great incentives to provide a bailout, but the close geographic proximity accelerated the risk of a migration shock. We now turn to a large-scale quantitative analysis of the relationship between crisis-induced migration potential and the decision of policy-makers to provide bilateral bailouts.

RESEARCH DESIGN

We argue that creditor governments are more likely to provide bilateral bailouts to countries facing financial crises if there is the potential for politically costly immigration from the country in crisis. To test the empirical implications of our theoretical argument, we constructed a data set with a sample that includes data on the provision of bilateral bailouts from individual OECD countries to all countries that experienced a financial crisis between 1970-2010. The level of analysis is the potential creditor country-crisis country dyad in the year of a financial crisis. For example, the United States as the creditor country and Mexico as the crisis country in 1994 would constitute one such dyad. Mexico also enters the dataset in dyads with all other OECD countries (potential creditors) in the same year, but not in subsequent years.

Universe of Cases

We define a crisis country as a country that has undergone a balance of payments crisis, currency crisis, sovereign debt crisis, or a banking crisis. To obtain data on financial crises, we rely on the two most cited papers and data sources on financial crises (Reinhart and Rogoff 2009; Valencia and Laeven 2012). These two sources overlap significantly and provide the most comprehensive listing of countries that have undergone these types of financial crises. We define a potential creditor country as a state that has the potential to offer bilateral bailouts to a country in crisis. Creditor states tend to be large countries with resources sufficient to mitigate economic hardship via relatively large rescue packages (almost all bilateral rescue packages are greater than one billion US dollars). For this reason, we include the members of the OECD as our sample of creditor countries.¹⁴ To the best of our knowledge, this sample includes nearly the entire population of countries that gave bilateral bailouts during this time period.¹⁵ As the G7 countries give over 75 percent of the bailouts in our sample, in our robustness checks, we exclude all potential creditors outside of the G7 and find further support for our results. While all OECD countries are included

¹⁴ See the online appendix for the list of OECD countries included in our sample of creditor countries.

¹⁵ Some curious exceptions exist. For example, the Faroe Islands gave a bilateral bailout to Iceland in 2010.

in the analysis as potential creditor countries, they are included in dyads only with those countries that experienced a financial crisis in the year that their crisis began. Thus, Mexico in 1994 is included as a dyad with each OECD country in that year, but not in years preceding or following the financial crisis.

Dependent Variable

Our dependent variable is a binary measure equal to one when a creditor country gave a bailout to a crisis country in a given crisis. Data on bilateral financial rescues are not readily available from creditor countries, the IMF, or other international organizations. We rely on Schneider and Tobin (2018) for data on whether or not a bilateral bailout exists in any of our cases. Appendix Table A displays the 108 crisis countries in our sample, years that countries experienced a financial crisis, and the number of bilateral bailouts each country received.

Immigration Potential

Our main argument is that an increase in the expected threat of politically costly migration should increase a creditor country's willingness to provide a bilateral bailout, all else equal. That is, we need to define and generate a measure of potential migrant flows between a source (crisis) and destination (donor) country. Existing models of bilateral migration flows include an array of covariates to measure the forces leading individuals to leave their homes and a set of other factors to capture the characteristics of potential destination countries that attract immigrants (e.g., Fitzgerald, Leblang, and Teets 2012). However, many of these covariates are likely to be correlated with factors influencing whether a destination country would provide a bailout (e.g., government partisanship, government turnover, and political openness) or whether there would be a crisis in the sending country (e.g., poverty, inequality, or repression). Using these existing models to measure immigrant flows would potentially bias our subsequent statistical analyses.

Our approach to measuring immigrant potential, therefore, begins by utilizing a canonical 'gravity' model, which has been deployed as a framework to model flows of commodities, capital, and populations. The gravity model holds that the flows from an origin to a destination is positively related to the mass of the origin and destination and negatively related to the distance between them. We follow existing practice and measure mass in terms of the size of the two countries populations and distance as the great circle distance between the two countries. More recent approaches that use a gravity model to generate variables useful as instruments for statistical analysis augment this canonical model by including other bilateral factors that account for linguistic and cultural distance as these factors influence the transactions costs associated with moving from one country to another. These factors include the existence of a common border, the existence of a common official language, and whether the two countries share a common colonial heritage. We also include a set of dummy variables for all origin and destination countries.

One problem with this type of specification is that it contains little exogenous variation over time. To deal with this problem, we follow the literature and interact year dummy variables with distance—the idea is that over time we should experience a decrease in the transactions and transportation costs associated with moving from one country. We include both a set of annual time dummies as well as the interaction of those dummies and bilateral distance in our model. We estimate our gravity model of migration flows as:

$$\begin{aligned}
 M_{ijt} = & \alpha_0 + \beta_1 Population_{it} + \beta_2 Population_{jt} + \beta_3 \ln(Distance)_{ij} + \beta_4 Border_{ij} \\
 & + \beta_5 Language_{ij} + \beta_6 Colony_{ij} + \beta_6 MigStock_{ijt} + \sum \gamma_j + \sum \gamma_i \\
 & + \sum Distance * Year + \sum Year + \varepsilon_{ij}
 \end{aligned} \tag{1}$$

where M_{ijt} denotes migrant flows from country i into country j at time t , population refers to the log of population in country i or country j at time t , distance is the log of the great circle distance between i and j , and border, language, and colony are all dummy variables coded as 1 if the countries share a common border, common official language, or common colonial heritage, and 0 otherwise. *MigStock* measures the accumulated stock of migrants (the foreign-born population) from country i residing in country j at time t . Finally, γ denotes a set of dummy variables for all origin and destination countries. We obtain the data for migrant flows and stocks from Fitzgerald, Leblang, and Teets (2012). Data on population are from the World Bank's World Development Indicators.¹⁶ Finally, data on distance and commonalities are from the CEPII database.¹⁷

To measure migration potential for a destination country j , we estimate equation (1) using a Poisson regression and obtain \widehat{M}_{ijt} , the predicted inflow of from country i into country j at time t . Theoretically, we are not interested in the predicted number, but instead in the potential flow of migrants. To capture this concept, we use the upper bound of the 95% confidence interval around \widehat{M}_{ijt} to capture *Migration Potential*.

We now have a measure of overall migration potential. Not all migrant shocks, however, will have the same impact on the government's popularity; that is, they are not all expected to be politically costly. Only politically costly migration should induce governments to provide bilateral bailouts. As we discuss above, migration shocks generate political problems for incumbent politicians when the immigrants are from ethnically, culturally, and/or religiously different countries than the host country. The integration—or attempted integration—of ethnic, cultural, and/or religiously different populations often results in social, economic, and political conflict in the host country.

To assess the expected costs of potential migration, we weight *Migration Potential* by (a) a measure of genetic distance between creditor and crisis countries and (b) a measure of the cultural distance between these countries. These weights, generated by Spolaore and Wacziarg (2015), attempt to measure the time-invariant differences between countries across a number of different dimensions.¹⁸ The underlying theoretical basis for these weights is the idea of relatedness—who is related to whom on the basis of common ancestry. Spolaore and Wacziarg (2015), following the work of Cavalli-Sforza, Menozzi and Piazza (1994), generate measures of genetic distance based on differences in genetic markers found in blood samples of different ethnic groups. These differences provide a rough proxy for the probability that an individual from group A is related to an individual in group B. Spolaore and Wacziarg (2015) show that the measure of genetic distance is highly correlated with other religious and linguistic differences that are observed across the world's population. We weight our measure of Migration Potential by genetic distance—*Migration Potential (weighted)*—to proxy for the potential social conflict that may occur with the inflow of people from a country with a (very) different culture than the donor country.

Control Variables

In addition to our primary variable of interest, there are a series of creditor country-, crisis-country and dyadic-level variables that may help to determine whether or not a country receives a bilateral bailout during a financial crisis. Schneider and Tobin (2018) show that a number of dyadic economic and political relationships between potential creditor and crisis countries help to determine the probability of a bailout. While they demonstrate these relationships as both individual variables and indexes grouped according to economic exposure, international political exposure and domestic political constraints, we utilize their indices as we are not interested in the direct relationship between these variables and the probability of a bilateral bailout. *Economic exposure* includes both financial exposure, that is, domestic banks debt holdings in the crisis

16 <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

17 http://www.cepii.fr/cepii/en/bdd_modele/bdd.asp.

18 The data were downloaded from Spolaore's webpage: <http://sites.tufts.edu/enricospolaoire/>.

country (because of the possibility of default) and trade exposure, that is the dollar amount of a creditor country's total bilateral trade with the crisis country (because of the possibility of loss of important markets). *International Political Exposure* focuses on the crisis country's strategic importance and geopolitical similarity to the creditor country. This index accounts for whether or not the dyad is involved in a defense alliance, whether both members of the dyad are of the same regime type (democracy vs autocracy) and similarity of foreign policy preferences based on distance in UN General Assembly ideal points. *Domestic Political Constraints* focuses on the ability of the executive to act independently in deciding on the bailout. This variable is a combination of whether or not an election is held in the creditor country in the same year as the financial crisis (close elections make it more difficult for governments to spend on non-domestic interests) and the number of veto players and their alignment across branches of government (to account for political constraints).

In addition to economic and political constraints, we include further variables on the creditor-country level and on the crisis-country level. First, a potential creditor country facing their own economic issues is less likely to participate in a bailout of another country. Thus, we measure the economic well-being of the creditor country with both its economic growth rate and the unemployment rate. Data are from the World Bank. Second, we control for the effect of a creditor and crisis country's income on the likelihood of a bilateral bailout. Crisis countries with higher per capita incomes are less likely to participate in bailouts while creditor countries with higher per capita incomes are more likely to participate. Per capita income is measured as the per capita GDP in thousands of constant US dollars. We include an additional proxy for the crisis country's financial health with the current account as a percentage of GDP. Third, cultural and geographic proximity between the creditor and crisis states might lead to a deeper connection between the countries and therefore might affect financial rescues. We include the logged distance (in miles) between the creditor and crisis state. Finally, we account for the relevance of the IMF in providing bilateral bailouts. First, the size of any IMF bailout is likely to affect the decision to bailout. To control for this, we include the logged amount of any IMF loan. Data are from the IMF. Second, during times of global crisis, the IMF may be credit constrained and turn to potential creditors to make bilateral bailouts (these discussions are private). We include a measure of IMF liquidity to account for the possibility that a bilateral bailout is a response to IMF credit constraints. We measure IMF liquidity as the natural log of the IMF's holdings minus its disbursements in a given year (cash on hand), data from the IMF.

We argue that the potential for an inflow of migrants has a disruptive effect on the donor country's political and social system, so it is reasonable to assume that, cognizant of this potential, donor countries will implement strict(er) immigration restrictions. To account for the fact that donor countries with more restrictive immigration policies may feel less vulnerable to an unwanted inflow of migrants, we include a measure of immigration policy (Helbing et. al. 2017). This variable—based on the coding of three dozen different policies—takes greater values for donor countries that have a more liberal (open) immigration policy and smaller values when countries have a more restrictive (closed) policy for migrant entry.

The online appendix provides descriptive statistics and sources of all of the variables included in the model.

MODEL SPECIFICATION

A creditor country's decision to bailout a crisis country is a dichotomous decision. Thus, we estimate the following logistic regression:

$$\begin{aligned}
\Pr(\text{Bilateral Bailout}_{ijt} = 1 | X_{ijt}) \\
&= P(\beta_1(\text{Migration Potential (Weighted)}_{ijt}) + \beta_2(\text{Controls}_{ijt}) \\
&+ \varepsilon_{ijt} \quad (2)
\end{aligned}$$

where *Bilateral Bailout*_{ijt} is equal to one in cases where a financial bailout of crisis country *i* by creditor country *j* in year *t* occurred, and 0 otherwise. *Migration Potential (Weighted)*_{ijt} is our main independent variable of interest. *Controls*_{ijt} represents a vector of control variables defined above that are expected to impact the probability of a bilateral bailout, and ε_{ijt} is the error term. We use robust standard errors to control for heteroscedasticity and cluster the standard errors by the creditor country.

Our data structure would result in biased estimates if we used a simple logistic specification. We now turn to those issues and our corrections. First, the structure of our data is different from the typical binary dependent variable time series cross sectional analysis. While we are concerned with the possibility of temporal dependence, we do not analyze all dyads in all years, but analyze countries only in times of financial crisis. Thus, we do not include (nor would we be able to include) cubic splines to account for temporal dependence as suggested by Beck et al (1997), but rather include time dummies as a robustness check. Second, we may worry that any individual creditor's decision could be based on the decision of other creditors. For example, the United Kingdom's decision to bailout Iceland in 2008 could have been partly based on the fact that Germany was also planning on giving a bailout to Iceland. Following Schneider and Tobin (2018), we deal with this potential interdependence between actors by including a spatial weight that uses distance between creditor and crisis countries to control for the possible interdependence of the bailout decision. Third, the IMF loans that we include as a control could not only influence the decision of a creditor country to provide a bailout, but the decision of a creditor to provide a bailout could also inform the decision of the IMF to offer a multilateral loan. To deal with this possible endogeneity (which could affect our coefficient estimates), we follow Lang (2016) and exploit exogenous variation over time in the IMF's liquidity, interacted with a country's probability of participating in an IMF program. This instrument introduces variation across countries, is correlated with the IMF loan, but should be uncorrelated with the probability of a bilateral bailout. In the first stage, we regress the IMF loan amount on the interaction of IMF liquidity with a country's probability of receiving an IMF loan and substitute these predicted values for the IMF loan amount in a second stage.

EMPIRICAL RESULTS

Table 1 reports the results of our analysis by log-odds ratios. Model 1 presents a standard model of bilateral bailouts without including potential migration. Models 2-4 include different measures of *Migration Potential*. The results in Model 1 square with our expectations and with prior work. Bailouts are more likely to be preferred by donor countries that have strong economic (trade and banking) connections with crisis countries, between countries that are geographically closer to one another, and interestingly, countries that do not share a common border. Donors, all else equal, are less likely to offer a bailout during an election year—which supports our prior that politicians in donor countries are sensitive to political conditions.

Model 2 includes the unweighted measure of *Migration Potential*. Recall that this measures the upper bound of the predicted number of migrants from the crisis country who could enter the donor country based on a structural gravity model. All else equal, the effect of migrant potential is statistically indistinguishable from zero. This is not surprising; our hypothesis is not that all potential migration yields a political response, but that politicians fear migration that may generate political, social, and/or cultural conflict. We expect that politicians are more likely to utilize bilateral bailouts when they expect an increase in politically costly migration. Models 3-5 account

for the expected political costs of migration using measures of *Migration Potential* that are weighted by various measures of genetic and cultural distance.

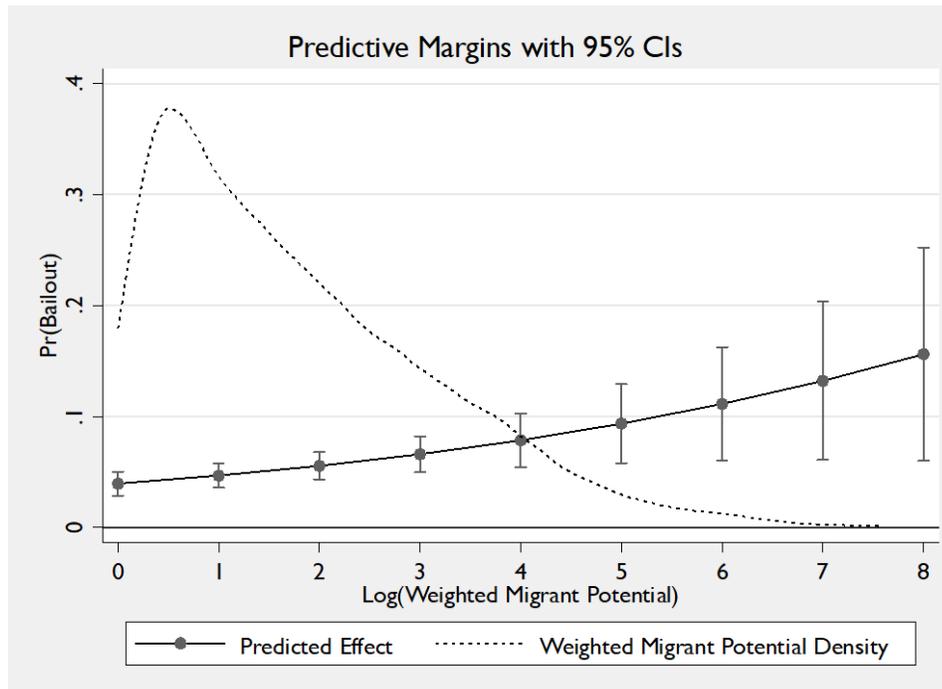
Model 3 includes the *Migration Potential* variable weighted by genetic distance—with weights increasing as the genetic distance between donor and crisis country increases. This variable is positive and statistically significant, indicating that as the probability of migration from ethnically, culturally and/or religiously different crisis countries to a potential creditor country increases, so does the probability of a bilateral bailout. To better understand the magnitude of this effect, Figure 1 presents the marginal effect of an increase in the potential for politically costly migration on the probability of a bilateral bailout (holding all other variables at their means). The upward sloping line in Figure 1 provides support for our hypothesis that as potential politically costly migration increases, so does the probability that a creditor will provide a bailout to the crisis country. Importantly, creditor countries that expect great levels crisis-induced migration are significantly more likely to offer a bailout than creditor countries that expect lower levels of crisis-induced migration.

Table 1: Financial Crises, Migration Potential, and Bilateral Bailouts

	Model 1 (Baseline)	Model 2 (Unweighted)	Model 3 (Weighted)	Model 4 (Weighted, 1500)
Migrant Potential		0.127 (0.14)	0.283** (0.10)	0.167 (0.09)
Economic Exposure	1.555*** (0.21)	1.394*** (0.28)	1.470*** (0.21)	1.625*** (0.24)
International Political Exposure	0.051 (0.17)	0.086 (0.16)	0.103 (0.15)	0.081 (0.15)
Election	-1.166** (0.36)	-1.206** (0.37)	-1.297*** (0.35)	-1.281*** (0.38)
Spatial Weight	3.410*** (0.85)	3.451*** (0.89)	3.285*** (0.82)	3.232*** (0.81)
GDP growth (Creditor)	0.104 (0.14)	0.104 (0.14)	0.109 (0.12)	0.107 (0.13)
Creditor Unemployment	-0.107 (0.07)	-0.111 (0.07)	-0.101 (0.07)	-0.098 (0.07)
GDP per capita (Creditor)	-0.000 (0.00)	-0.000 (0.00)	-0.000 (0.00)	-0.000 (0.00)
GDP per capita (Crisis)	-0.000 (0.00)	0.000 (0.00)	0.000 (0.00)	0.000 (0.00)
Current Account (Crisis)	0.078** (0.03)	0.082** (0.03)	0.081* (0.04)	0.080* (0.04)
Distance (log)	-0.334 (0.19)	-0.303 (0.20)	-0.580** (0.20)	-0.604** (0.23)
IMF Loans	5.796*** (1.53)	6.109*** (1.50)	6.601*** (1.83)	6.614*** (1.85)
IMF Holdings & Disbursements	-0.091* (0.04)	-0.092* (0.04)	-0.118** (0.05)	-0.100* (0.05)
Contiguity	-2.218 (1.33)	-2.236 (1.32)	-2.215 (1.35)	-2.075 (1.30)
Common Language	0.086 (0.73)	-0.080 (0.74)	-0.387 (0.66)	-0.292 (0.71)
Migration Policy Restrictions	0.086 (1.53)	-0.093 (1.54)	-0.589 (1.74)	-0.293 (1.80)
constant	0.499 (2.87)	-0.642 (3.17)	2.030 (2.85)	2.101 (2.91)
N	990	990	894	894
Pseudo R2	0.3591	0.36	0.3722	0.3677

* p<0.10, ** p<0.05. Robust standard errors clustered by donor country in parentheses

Figure 1



It is important to note that this effect is statistically significant even though we control for a multitude of other important reasons for which creditor countries decide to offer bailouts. The results of the control variables are largely in line with the existing literature on bilateral bailouts and indicate that bailouts are more likely when the creditor country is (a) economically more exposed to the crisis country, (b) when domestic political constraints are minimal, and (c) when the IMF is willing to provide a loan (thereby minimizing moral hazard concerns) but is unable to provide sufficient liquidity to address the financing gap. The decisions of other creditor countries, as captured in the significant spatial lag, matter as well but neither of those effects drive our main results. Governments in creditor countries are significantly more likely to offer a bilateral bailout to the crisis country when they expect that financial crises in other countries lead to migration shocks that are politically costly to them. Conversely, the likelihood of a bailout declines if migration potential is low, or if the costs associated with large migration potentials are low.

One may be concerned that our genetic distance weight is endogenous or simultaneously determined as countries that engage in bilateral bailouts may be tied to one another through a variety of other factors including migration. Our baseline model includes both continuity and common language dummies to guard against simultaneity. In Model 4 we push that one step further and weight migrant potential by genetic distance in the 16th century (circa 1500). Data are from Spolaore and Wacziarg (2015). And, as in column 3, we find that weighted migrant potential has a statistically significant and positive effect on the probability of a bilateral bailout.

CONCLUSION

Financial crises and the economic recessions that accompany them often lead to outward migration pressures in the countries facing the crisis. The potential destination countries for these immigrants may look to quell these pressures, if the migration would be costly for them—politically or otherwise. While a number of domestic policy measures are available to these destination countries, one unexplored tool used by governments is to provide liquidity to the crisis country to help in staving off some of the worst economic consequences of the financial crisis, and thereby minimizing the potential for politically costly migration. We show that this is indeed the case: potential creditor countries facing politically costly migration are more likely to provide a bilateral bailout to the home countries of these migrants—even controlling for a host of political and economic drivers of bailouts.

Our work offers important insights into the literatures on both migration and bailouts. We offer a foreign policy tool beyond specific migration policies, with—superficially—little to do with migration as a potential tool for creditors. For bailouts, we go beyond the more narrow economic criteria on which scholars have focused and demonstrate that even an expectation of politically costly migration can induce a potential destination country to act. Yet, our results do not imply that bailouts are effective in averting migration or in averting deepening financial crises. Rather, we provide insight into how expectations of domestic political reactions can affect foreign policy decisions.

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