Contribution to the HMI Dialogue Session on Regional Integration and Economic Impacts
Barcelona, 2-5 September 2004

Migration and Trade: A Change in Paradigm with EU Enlargement?

Gudrun Biffl – Austrian Institute of Economic Research

Key Issues (300 words)

1. With the signing of the Europe agreements in 1991, The EU gave precedence to trade rather than migration as a socio-economic development tool. Increased trade was linked with substantial industry restructuring in the EU as well as in the CEECs, resulting in regional specialisation of production.
2. While this promoted economic and productivity growth in the old and new Member States, employment growth was relatively weak. The process of industrial restructuring and reallocation of production had winners and losers in the West. Winners were the highly skilled workers and professionals; losers the un- and semiskilled and tradesmen, often migrants. As labour mobility within the EU (15) is comparatively low, industrial and trade specialisation resulted in a rise in unemployment and/or a decline in activity rates and/or a widening of wage differences by skill and occupation. The limited inter- and intra-member country labour mobility in the EU and the new member states have the consequence that the brunt of the adjustment processes has to be borne by wage and employment policy as well as education and training measures.
3. In the new member states, labour market conditions have been improving in the last couple of years, but there remains a big gulf between the EU (15) and the new member states in terms of employment and activity rates and wages on the one hand, and the role of the informal sector for income creation on the other. Informal sector production of goods and services is growing and jobs and incomes are created in the non-observed economy, both in the EU as well as CEECs; this may be a contributory factor to the rising number of illegal migrants who endeavour to improve their economic situation by migrating even if it means working in the informal sector.

Content (1200 words)

One of the important features of the increased socio-economic and political integration of the EU member states at the time of the implementation of a Single Market in 1992 and the Single Currency in 2002, is that it has neither given a significant boost to labour mobility of EU citizens within the EU nor to Intra-EU trade. The share of EU citizens living and working in another EU country has remained fairly stable at a very low level during the 1990s – on average 2 percent of the population/work force; while intra-EU (15) trade remained fairly stable at around 20 percent of GDP (2003). This suggests that specialisation of production within the region of the EU(15) had reached a free trade equilibrium by 1992 such that trade and migration within that region stagnated.

In contrast, the dismantling of the Iron Curtain set both migration and trade flows between the EU(15) and the CEECs in motion. Between 1990 and 2003, imports and exports in percent of GDP with CEECs increased from about 7 percent of GDP in the early 1990s to some 14 percent of GDP in 2003. The rise in labour migration was rather short-lived, however. After a sudden leap at the time of the fall of the Iron Curtain in 1989, the flow of labour from East to West slowed down significantly after a couple of years. This may well have been the result of two forces, the stabilisation of the economic, political and social environment in the CEECs on the one hand and legal barriers to migration on the other.

So far, increased trade with CEECs has promoted economic and productivity growth in the old and new Member States, employment growth was relatively weak, however. In addition, the process of industrial restructuring and reallocation of production had winners and losers in the West. Winners were the highly skilled workers and professionals; losers the un- and semiskilled and tradesmen, often migrants. As labour mobility within the EU (15) is comparatively low, industrial and trade specialisation resulted in a rise in unemployment and/or a decline in activity rates and/or a widening of wage differences by skill and occupation.

Empirical evidence suggests that, in the current period of socio-economic integration of Europe, economic, technological as well as political forces are behind the promotion of international trade rather than migration. Technological innovations such as the internet have tended to promote mobility of services rather than labour, while relatively small transport costs due to the geographical proximity of the new trading partners, promote trade in goods rather than labour mobility. In addition, the market for non-tradeables has been enlarged as large agglomerations of people are on either side of the border. In contrast, costs of migration for the individual are relatively high because of language and cultural barriers, problems of skill recognition across countries as well as housing costs (*Decressin & Fatas,* 1995, *Biffl,* 1997). At the same time, unfettered mobility of capital, technology and managerial skills boost inter- and intra-industry trade, constituting the main driving force behind productivity increases in the EU(15) and in CEECs (*Landesmann & Stehrer,* 2000).

Research into trade and industry specialization in the enlarged European trading zone suggests a gradual process of specialization, which is responsive to factor endowments, in particular to the relative supply of highly skilled workers (for R&D intensive industry clusters) and skilled tradesmen (for labour intensive industries). (*Traistaru et al.*, 2002*, Midelfart-Knarvik et al., 2000, Aiginger et al.*, 1999*, Fidrmuc et al.*, 1998, *Brülhart*, 2001) This seems to suggest that exogenous endowment, as emphasized in the traditional trade theories, and industry-specific economies of scale which are at the centre of the new economic geography theory, become more important causes for inter- and intra-industry trade.

Research indicates that the re-location of production from the EU(15) to CEECs goes beyond low-skilled and low-tech production. There is ample empirical evidence suggesting that this is the result of the better average skill endowment in the new member states. Some of the new EU countries outstrip the EU South in terms of human skills and are much closer to the EU core than Southern regions of the EU (*Boeri & Brücker,* 1999). With membership, remaining trade barriers are dismantled between the old and new member states, free mobility of labour is, however, not granted to the new EU citizens for at least two years to come, with the exception of Ireland. This may encourage trade within the enlarged EU also in the years to come. Increased migration may be expected to take place mainly of highly skilled workers who tend to be complementary to particular production modes (*OECD,* 2002).

The low labour mobility within the CEECs, within the EU (15) and between them, signifies (*Biffl,* 2000) that, especially under the restrictions of Monetary Union, the brunt of labour market adjustments resulting from increased trade (specialization) will show up in quantity adjustments such as changes in unemployment/activity rates and/or in increased flexibility of the wage system. This is a different pattern of development from that in the USA, which is marked by substantially higher mobility of labour within the country and a higher labour inflow from abroad. Higher labour mobility reduces the labour market adjustment costs of specialization in production and trade (*Blanchard & Katz,* 1992).

There is no a priori answer to the potential effect of the regional integration of the enlarged EU on the labour market and income distribution. Theory suggests that high capital and low labour mobility in combination with limited cross-border labour mobility favour dis-agglomerations, while high internal and low external labour mobility favour central locations.

The limited inter- and intra-member country labour mobility in the EU and CEECs (*Puga*, 1999, 2001) suggests that education and labour market institutions face a greater challenge with Eastern Enlargement than they did during the Southern Enlargement of the EU. (*Biffl,* 1997) If unemployment and/or increased wage dispersion are to be avoided, they will have to ensure that the skills of the respective resident populations, including migrants, will be adapted to the new needs arising from flexible specialization of production and the relative decline of Fordist mass production systems.

All that said, one has to admit that hard facts on migration flows are hard to come by. In addition to legal migration flows, there have been a rising numbers of illegal migrants who try to improve their economic situation by migrating even if it means working in the informal sector. (Biffl, 2002) The existence of informal sector production of goods and services and the creation of jobs and incomes in the non-observed economy in Western Europe may encourage illegal migration.

References

Aiginger, K., Böheim, M., Gugler, K., Peneder, M., Pfaffermayr, M., 1999, "Specialisation and Geographic Concentration of European Manufacturing", *Working Paper No. 1*, DG Enterprise, European Commission, Brussels.

Biffl, G., 1997, "Migration, Labour Market and Regional Integration: The Role of the Education System" in: OECD/CCET/WIFO (Eds.), Migration, Free Trade and Regional Integration in Central and Eastern Europe, Verlag Österreich.

Biffl, G., 2000, "Migration Policies in Western Europe and EU-Enlargement" in: OECD (Ed.), Migration Policies and EU Enlargement: The Case of Central and Eastern Europe, Paris.

Biffl, G., 2002, Labour market flexibility: the role of the informal sector in the context of EU-Enlargement and the need for a systematic statistical base. Paper presented at the 20th CEIES seminar, Budapest, 14 to 15 November 2002, Working Paper of the Austrian Institute of Economic Research, Vienna, (190).

Blanchard, J.B., Katz, L, 1992, Regional Evolutions, Brookings Papers on Economic Activity (1), 1-74.

Boeri, T., Brücker, H., 1999, The impact of Eastern enlargement on employment and wages in the EU member states, European Integration Consortium, German Institute of Economic Research (DIW), Berlin.

Brülhart, M., 2001, "Evolving geographic concentration of European manufacturing industries", *Weltwirtschaftliches Archiv*, Vol. 137:215-243.

Decressin, J., Fatas, A., 1995, Regional Labour Market dynamics in Europe, European Economic Review, pp. 1627-1655.

Fidrmuc, J. et al., 1998, "East-West Trade in Transition", in Gary Cook (Ed.), *The Economics and Politics of International Trade, Freedom and Trade,* Vol. II, Routledge Studies in the Modern World Economy, London and New York.

Landesmann, M., Stehrer, R., 2000, Industrial specialisation, catching-up and labour market dynamics, Metroeconomica, Vol. 51(1):67-101.

Midelfart-Knarvcik, K.H., Overman, H.G., Redding, S.J., Venables, A.J., 2000, "The Location of European Industry", *Working Paper No. 142*, European Commission, DG ECFIN.

OECD, 2002, "International Mobility of the Highly Skilled", *OECD Proceedings,* Paris.

Puga, D., 1999, "The rise and fall of regional inequalities", *European Economic Review*, Vol. 43: 303-334.

Puga, D., 2001, "European regional policies in light of recent location theories", *CEPR Discussion Paper* No. 2767.

Traistaru, I., Fidrmuc, J., Mundschenk, S., von Hagen, *J., 2002,* "European Union Enlargement: Economic Consequences and Perspectives for the European Union", in: Andrew M. Warner, Klaus Schwab and Jeffrey Sachs (Eds.) *The European Competitiveness and Transition Report 2001-2002,* Oxford University Press, 80-100.