

**CEEI 2008**  
**“The Integration of European Labor Markets”**  
**Opening Remarks**

**Vienna, November 17, 2008**

Ladies and gentlemen!

It is a great pleasure for me to open the 2008 Conference on European Economic Integration, which is devoted to the labor market effects of economic integration. The Oesterreichische Nationalbank has been hosting this event for many years now, and we are glad to bring together so many key experts from national and international institutions, policymakers, bankers and academics here in Vienna. I would like to mention that it has always been the objective of this conference **to offer a forum for discussion** for many distinguished people from various backgrounds and to stimulate the exchange between them.

**Vienna** is particularly well suited as a venue for a conference on the impact of integration on the labor market: The city can look back on **a long history of being a crossroads of migratory movements across Europe**, and a quick look at the Vienna telephone directory shows an unusually high percentage of family names for instance from Central and Eastern Europe. Additionally, **the OeNB is uniquely suited to presenting European economic integration issues**, as it has specialized in the analysis of economic developments in Central and Eastern Europe and has acquired considerable expertise in this field. So I would like to extend a warm welcome to you all in this melting pot of cultures.

I am very pleased to see that despite the financial crisis, numerous high-ranking speakers and participants have not shied away from attending – and contributing to – this conference, and I would like to take this opportunity to welcome all ambassadors, distinguished representatives from central banks and commercial banks, and university professors who have come to take part in the conference. Also, let me express my gratitude to the staff that has helped to organize this event.

Although central banks are not directly concerned with structural issues like trade or migration per se, of course there are many and obvious **linkages between the real and the monetary sphere** of an economy. For example, in the case of migration, an increased supply of labor might depress wage growth, which in turn may have a dampening effect on price inflation. Both migration and trade can alter **potential output**, which clearly has important consequences for macroeconomic policy.

The decline of **transport and communication costs** over the past decades has made it cheaper to trade goods internationally. Increasingly, services have also become tradable, with new information and communication technologies allowing for their cross-border delivery.

Among industrialized countries, the division of labor has been intensified not only by these technological innovations, but also by **regional economic integration** initiatives. At the global level, WTO trade rounds have reduced institutional barriers to trade and to migration. In Europe, most notably the establishment of the EU and the EU's attempts to create an ever deeper union have contributed strongly to labor mobility. As a result of enhanced mobility, production processes can be split up and different stages of production can be executed at different locations. This also has costs, e.g. environmental effects of transportation, costs not included in conventional GDP – so to a certain extent we may exaggerate the benefits of division of labor.

Within the EU, the **European single market** with its **four freedoms** allows for migration and internal trade as

- every EU citizen has the right to work and live in another Member State without being discriminated against on grounds of nationality, and
- national barriers to the free movement of goods within the EU have been removed.

After the last two enlargement rounds, “old” Member States pursued different labor market strategies. Some countries (e.g. the U.K., Sweden) followed an open-door policy of unrestricted migration, whereas others – like Austria – were stricter and requested **derogations** to limit the free movement of workers from new Member States for a **transitional period** of seven years at most. Now, five years after enlargement, the old Member States have a final period of two years left to limit the free movement of workers if they observe major disruptions or the threat thereof on their labor markets.

Over the last years, the Austrian labor market has experienced great improvements. The unemployment rate in October was at its lowest levels in decades (3.2%, Eurostat definition). Unfortunately, we have also to face the fact that this positive trend is now ending. The European Commission forecasts an **increase in unemployment over the next two years**, and several Austrian firms have already announced layoffs and plans to reduce working time. The unemployment rate in the EU as a whole is projected to increase from 7% this year to 8.1% in 2010. So, caution is warranted, as an immediate and full opening of the labor market may produce undesired side effects in difficult times. A more nuanced approach with opening up access to some sectors and some occupations could represent a viable option, avoiding further negative effects of migration on income distribution.

## The effects of migration on labor markets

Migration inflows change the labor supply in each country and therefore affect employment and wages. Moreover, international trade integration also increases the pool of labor available to firms by outsourcing or offshoring. Both migration and trade integration augment the domestic labor supply and can therefore be viewed as substitutes to some extent. Outsourcing and offshoring are sometimes referred to as job migration.

Migration and trade have rather different **social effects**: a large number of migrants can increase the demand for infrastructure, and migration often results in people with different cultural backgrounds and different languages living together, calling for suitable **integration** measures. Therefore, and rightly so, the political debates about migration are often not based on economic arguments alone, as migration is an encompassing social phenomenon. Economists tend to look only on the labor force side, but workers also have families and a social network.

Economically, migration not only changes the size of the labor supply, it will also change the **skill mix**. If migrants add to employment, net migration inflows increase GDP, but whether they increase GDP per capita depends mainly on the productivity of migrants. Subject to the average skill level of migrants, relative wages of high-skilled and low-skilled domestic workers will change as well. Empirically we have seen an increase in income disparity.

Sometimes, migration is actively used to **counter shortages** on the domestic labor market (e.g. of software engineers or of health care workers). Although such a measure may be useful in the short run, in the long run no country should rely on a permanent inflow of adequate skills. Therefore, enterprises and governments should aim to provide training and education to ensure that the appropriate skills are available to the economy.

Nevertheless, there is competition for employees with very high skills in Europe, and it is not going to decrease in the future. Here, it should be noted that highly skilled people can choose from many potential host countries; therefore, measures are needed to make it attractive for them to come and stay with their families.

Efficiency gains of migration not only depend on the educational levels of migrants, but also on the **recognition of foreign education** by domestic authorities and firms. Within the EU, the **Bologna process** has created some harmonization of higher education certificates.

Other determinants to maximize the benefits of migration are the **language skills** of migrants and the degree of **discrimination** in the labor market of the host country. In both respects, national action is warranted.

The social integration of migrants is a precondition for their employment chances and also influences the wages they receive; it is also crucial for the so-called second generation of migrants. For the latter, the key issue is access to the national education system of the host country. Again, host countries are in charge of advancing and widening access to education. The current situation in Austria – as in many other countries – could well be improved.

### **The effects of trade on labor markets**

From classical trade theory, we learn that in each country the abundant factors of production gain from trade due to specialization. If we assume that there are three factors, namely capital, labor and skills, countries with high GDP per capita – like Austria – should specialize in capital-intensive and skill-intensive production and others in labor-intensive production. As a result, relative wages of highly skilled workers could increase and those of low skilled workers decrease.

But we also know that the assumptions of the classical model are unrealistic, for example that all countries should use the same technologies regardless of their endowment and that all firms should face constant returns to scale. With respect to intra-EU trade, many new Member States have a skill endowment similar to that of Austria or of the euro area average. Hence, according to classical theory, increasing trade should change only the relative returns to capital and labor.

New trade theory, on whose main proponent the Nobel prize has recently been bestowed, emphasizes the importance of economies of scale and agglomeration effects, which make the assessment of trade effects on labor markets more an empirical matter. We will deal with attempts to estimate these effects in the course of the conference.

### **The role of labor market institutions**

Despite much talk about a European model, European **labor market institutions** are very **heterogeneous**, and the impact of migration and trade may differ from country to country. Through more **wage flexibility**, the employment effects of migration or trade may be mitigated, but wage pressures might have a greater effect. **Minimum wages** may work in the other direction. As especially many decisions of the European Court of Justice tend to undermine the trade unions, minimum wages may be the way to avoid a race to the bottom in open economies. The overall effect in any case will depend on effective demand.

The **eligibility** of migrants for social benefits differs across Europe. For the labor market outcome, it clearly makes a difference whether migrants are also covered by employment protection or unemployment insurance. As workers from EU Member States may not be discriminated against, it is also important whether benefits only are available after a longer period of employment.

This reflects cost structures, but it also would penalize newcomers, and migrants are newcomers almost by definition. These institutional differences may also be decisive for migrants' choice of a host country, and they may also be the cause for the different approaches of old EU member states towards the opening of their labor markets.

### **General policy implications**

To provide an optimal framework for the economic integration of European labor markets, the top priority should be to improve the **economic and social integration** of migrants. This integration process should be targeted at better access to **language skills** for nonnative speakers and better **access to schooling** for the low skilled.

Better access to education for low-skilled workers is warranted in general, also for domestic labor, as the relative wages of low-skilled domestic labor might be dampened by trade or migration.

Finally, policymakers should aim at **distributing the benefits from trade and integration** more evenly among the population, not only for equity reasons, but also to increase the general **acceptance of trade and integration**. If the gains from economic integration are only concentrated among a few or are perceived to be limited to a few persons, protectionist tendencies will arise.

### **Monetary policy implications**

Both migration and trade might have an impact on productivity and might consequently affect **potential output**, which has repercussions on monetary policy. Hence, it is important for central banks to closely watch the economic effects of migration and trade.

If migrants send a significant proportion of their wages home as **remittances**, domestic demand in their home countries may benefit from such transfer income. These remittances can partially substitute access to financial markets and help to finance consumption and investments.

According to IMF data, in 2007 remittances to Moldova amounted to 34% of GDP and remittances to Bosnia and Herzegovina came to 23% of GDP; in both countries **FDI inflows** were **much lower than the inflow of remittances**. For Albania, migrants' remittances were about 15% of GDP in 2006, when FDI inflows reached only 3.6% of GDP. These figures demonstrate the importance of remittances for European low-income countries, and several studies find evidence for their welfare-improving effects and their potential to speed transition. As remittances increase private consumption, the effects on fiscal balances are also positive (however, the economic slowdown will also impact on remittances).

Ladies and gentlemen!

Let me conclude by stressing again the relevance of successful integration of European labor markets not only from a monetary policy perspective but also from the perspective of economic welfare and social stability. Although now may not be an ideal moment for reflection and conferences, given that so many people are intently focused on dealing with the financial turmoil and its real economy consequences, I am nevertheless convinced that the conference topic is a timely one, and I am certain that we will learn a great deal today and tomorrow.

Now, it is a great pleasure for me to welcome our **first keynote speaker, Klaus Zimmermann**, President of the German Institute for Economic Research in Berlin, and Director for the Institute for the Study of Labor, Bonn.