Chapter 8: Economic integration, labour markets and migration

As the extent of economic integration approaches that of the United States, labour market institutions and labour market outcomes may also begin to resemble their American counterparts. [...] Full and irreversible economic integration may call for harmonization of social and labour-market institutions within the European Union.

Giuseppe Bertola (2000)
European labour markets: a brief characterization

Differently from goods, national labour markets in EU are on their own:
- limited migration within the EU;
- very different legislations and practices across countries.

On average, the EU is not doing well:

**Figure 8.1** An EU–US comparison, 1995–2014

*Note: Eurozone includes the 18 member countries in 2014.*

*Source: AMECO, European Commission*
European labour markets: a brief characterization

Figure 8.2 Employment-to-population ratios and unemployment rates in 2010–14: EU28 and comparable non-EU countries

Good performance: non-EU

Note: Averaged over the period 2010–14. The non-EU countries are Australia, Canada, Iceland, Japan, New Zealand, Norway, Serbia, Switzerland and the USA.

Source: AMECO, European Commission
Labour markets

- Demand from firms: balancing cost (wages + contributions) and benefit (marginal productivity of labour).
Labour markets

- Supply from people: balancing cost (disutility) and benefit (wage).
- Labor market equilibria A versus B
Labour markets

Notice that:

- point A: equilibrium with perfectly flexible labour market = full employment;

- point B: equilibrium with unemployment, due to:
  • salaries are collectively negotiated;
  • agreements hold for long periods, thus labour markets react slowly to changing conditions;
  • wage contracts are often regulated;
  • conditions for hiring and firing are also regulated;
  • unemployment benefits.

→ Labour market rigidities lead to involuntary unemployment.
Labour markets: collective negotiations

Most crucial feature is collective labour negotiations:

$\Rightarrow$ Collective supply curve is above individual supply curve.
Labour markets: Cyclical impact of wage rigidity

→ Wage rigidity explains that cyclical variations are accompanied by variations in involuntary unemployment.
Long-term Unemployment

Figure 8.6 Long-term unemployment, 2014

- Norway
- New Zealand
- Canada
- Israel
- Sweden
- Australia
- Finland
- Iceland
- Austria
- Denmark
- USA
- Luxembourg
- Switzerland
- Netherlands
- UK
- Poland
- France
- Japan

Note: Percentage of unemployed who have been unemployed for more than one year.
Source: Employment Outlook, OECD online database
Long-term Unemployment (cont’d)

Figure 8.6 Long-term unemployment, 2014

Estonia | Germany | Czech Rep. | Belgium | Latvia | Spain | Hungary | Slovenia | Portugal | Italy | Ireland | Slovakia | Greece

Note: Percentage of unemployed who have been unemployed for more than one year.

Source: Employment Outlook, OECD online database
Effects of trade integration on labour markets

- If the labour markets are fully flexible, wages should rise in the industries that expand and they should decline in the industries that shrink and workers would move from shrinking to expanding industries, until wages are the same in both = no involuntary unemployment.

- But with rigidities:
Effects of trade integration on labour markets

- So: trade integration does affect unemployment. However, trade is blamed for creating unemployment when trade is only the messenger, which reveals the adverse effects of underlying distortions.

- Economic integration creates winners and losers and willingness to undertake economic integration depends on the winners readiness to compensate the losers (i.e., social safety nets).

- ‘Social dumping’ is common held view = competition from 12 new Member States reduces social protection in older Member States.

- Such fears lead to calls for social harmonization but founding nations decided that harmonization of most social policies was not a necessary component of European integration.
### Median net earnings (annual), 2004-13

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Social dumping

- Model: flexible labour market where social protection with cost $T$ is introduced in country originally closed and then opened to trade.

- The figures show that competition ties the sum of wage and non-wage costs to workers’ productivity. EU founders therefore believed that the division between wage and non-wage costs could be left to the choice of each Member State.
Migration: some facts

- Europe has switched from net emigration to net immigration because of spectacular growth during the late 1950s and the 1960s.
Migration: some facts

- The 2004 and 2007 enlargements brought 12 countries (EU12) and about 100 million new citizens into the EU with the expectation of massive migration.

- As a result, most EU15 nations negotiated long transition periods during which EU12 citizens cannot move freely into their labour markets. But countries that opened their borders, such as Ireland, Sweden and the UK, report no or little increase in net inflows:
  - resistance to moving;
  - prospect to catch with the EU15 countries reduced the incentives to leave home, family and friends.
Migration: the simplest framework

- Start with the case where migration is not allowed between two nations (Home and Foreign) which initially have different wages and then allow migration.
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Migration: the simplest framework

In each country, some lose and some gain from migration.

What about each country?
- total wage earnings = wage rate $w$ times the amount of labour;
- total capital earnings = triangle between MPL and $w$.

In short, while migration creates winners and losers in both nations, collectively both nations gain, thanks to increased efficiency.

Migration improves the overall efficiency of the EU economy and the gains from this are split between Home and Foreign.
Migration and Unemployment

Figure 8.14 Unemployment and migration

[Graph showing wages and employment of native workers, with points A, B, C, and D indicating different scenarios.]
Migration and Unemployment

- Notice that unskilled workers complement skilled workers and capital and immigrants often have a skill mix that is very different from that of domestic workers: complementarity of migrants and native factors of production provides a win-win situation.

- Empirical evidence (inconclusive):
  - 1% rise in supply of migrants changes native wages by +/-1%;
  - increase or decrease of risk of unemployment, depending on type of workers, or no effect.
Barriers to mobility

- Two key results emerge:
  - immigration is likely to raise employment and national income;
  - immigration is unlikely to affect unemployment in either direction.

- These results provide a strong endorsement for the fundamental principle of freedom of movement of workers within the EU.

- Still, there is low mobility within EU:
  - Restrictions for new EU members’ nationals mobility;
  - Differing Pensions systems;
  - Unemployment benefits;
  - Regulated professions;
  - Language, housing, health systems, etc.