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››› Labour mobility in Europe does little to mitigate economic shocks – national labour markets absorb adjustment pressure

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In a currency union as large and heterogeneous as the euro area, asymmetric shocks are inevitable. Its common monetary policy cannot effectively respond to such shocks because it has to meet the needs of all 19 member states at the same time. It cannot apply exchange rates as a correction mechanism, fiscal policy is governed by strict rules, and different adjustment channels are needed.

The overarching objective of labour migration in Europe is to bring about convergence between the EU members. It could in principle help to cushion economic shocks as well. However, cross-border migration faces high informal barriers in Europe. That limits its potential to prevent friction resulting from shocks with unequal impacts. Against this background, flexible and well-functioning labour markets play a particular role. They have to absorb much of the adjustment pressure until the euro area is sufficiently evolved at institutional level.

Adopting the euro means giving up national monetary policy

Economies have come together in the euro area in order to benefit from the advantages of a monetary union. These include greater stability of the currency and capital flows, and the elimination of exchange rate risks and transaction costs. But acceding to the euro area also involves losing a monetary policy that is aligned with national needs. Member states lose the possibility to manage their inflation or adjust exchange rates, for example to become more competitive and improve their external trade results.

The ECB is responsible for the monetary policy of the entire currency area. This area is heterogeneous, so imbalances will occur, for instance in national inflation rates, which ranged from -0.2 % in Ireland to more than 2 % in Belgium and Estonia in December 2016, in economic growth, and in current account balances. Even if the ECB pursues a monetary policy that is appropriate for the euro area as a whole, the conditions in the member economies often mean that, at national level, a slightly different monetary policy would be optimal.

Especially when economic shocks occur, such as sudden crises, it would be useful to have a monetary policy that is tailored to fit the needs of a national economy. Inflation and growth often move in the same direction. If, for example, the ECB fights low inflation during a crisis, its measures provide growth impetus at the same time. In this way, monetary policy can contribute to stabilising the business cycle.

In asymmetric shocks, when events primarily affect individual economies and not the entire currency area, monetary policy does not respond in an optimal manner from the perspective of the affected state. A single currency area therefore must provide other mechanisms to lessen the impacts of asymmetric shocks – and/or spread them across the community of states, because an increasingly symmetric shock can be responded to by monetary policy.

Fiscal policy has a limited stabilising effect

Along with monetary policy, anti-cyclical fiscal policy can act as a stabiliser. But because the consequences of excessive indebtedness of individual economies can radiate all across the currency area, the member states of the euro area have adopted strict rules for their respective national fiscal policies. So far, a European fiscal policy exists only in rudimentary form. At the same time, comprehensive stimulus packages aimed at bolstering economic activity today face higher barriers than before the financial crisis. For one thing, debt levels were lower then: in 2007, average sovereign debt in the euro area was 65 % of economic output. Then the debt crisis emerged and this ratio surged to 90 % in 2015. For another, the financial crisis gripped the entire region. A loose interpretation of fiscal rules was therefore in the interest of all member states – unlike in the diverging environment of the past years. Overall, fiscal policy has limited scope to act as a stabiliser amid shocks with unequal effects.[1]

Adjustment through increasing labour migration

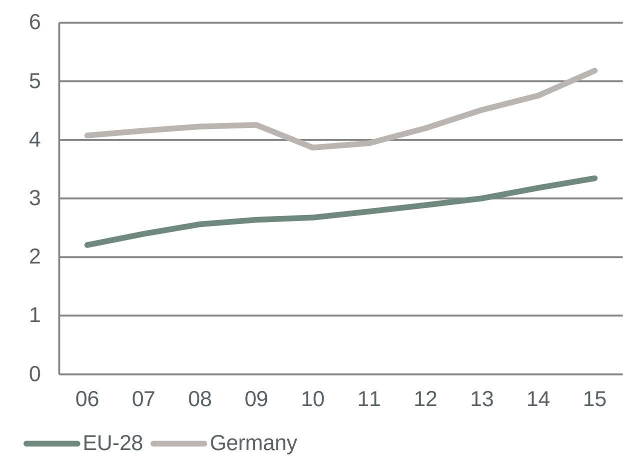
The theory of optimal currency areas identifies flexible prices, wages and interest rates as well as the mobility of labour and capital, among others, as helpful in adjusting to economic shocks.[2] The primary goal of labour mobility in the EU is to contribute to economic convergence between the member states. However, labour mobility can also help mitigate shocks by allowing workers to leave the disadvantaged region and prevent the emergence of unemployment. This releases the state from having to make income support payments for job seekers.

Free movement of people is becoming increasingly important

The European Union guarantees the free movement of workers, which means that citizens of an EU state can freely access the European labour market. People are making increasing use of their right to choose their workplace freely. In the past ten years alone, the share of EU-foreigners in an EU state's population of working age increased by a good one percentage point on average to 3.3 % (Figure 1). Germany is a traditional immigration country. Between 2006 and 2015, the share of non-German workers from the EU was around 1.5 percentage points above the EU average. This proportion has recently grown fast. The reason is that economic motives predominate in intra-European migration and Germany's economic prowess has made it more attractive.[3] Considering Germany's demographic trend, this development is very positive for its long-term growth.

Figure 1: Workers in the EU are increasingly mobile

Percentage of EU foreigners in overall population (15–64 years)



Source: Eurostat

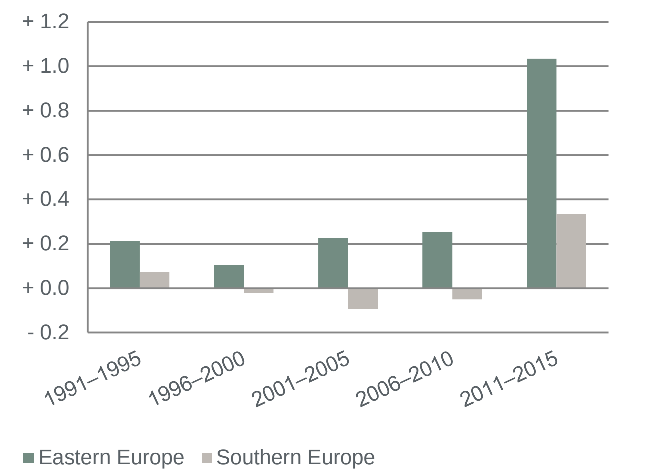
East-west migration dominates within the EU

The debt crisis can be interpreted as an asymmetric shock: recessions in Greece, Italy and Spain, for example, contrasted with strong performances in Ireland, the UK and Germany. This economic imbalance caused intra-European migration flows from southern to northern and western Europe. Differences in unemployment rates in particular usually trigger migration movements between countries at similar stages of development. Above all, high discrepancies in youth unemployment cause migration because young people have looser family ties and, often, lower language barriers, which makes them more mobile.[4] The growing importance of this crisis-driven migration from southern Europe is illustrated by Germany's migration balance, for example. Consistent net outward migration between 1996 and 2010 contrasted with net inward migration of nearly 350,000 persons between 2011 and 2015 (Figure 2).[5]

However, migration flows of eastern Europeans from the countries that joined the Union from 2004 to older member states predominate within the EU. The reason for these movements is the prosperity divide between the older and the newer member states. In 2015 per capita GDP in the eleven eastern European EU states averaged around EUR 12,000, while in the classic immigration countries Belgium, Germany, the UK, Ireland and Austria it was just under EUR 40,000. Differences in achievable wage rates are the main drivers of migration.[6]

Figure 2: Influx from eastern Europe dominates migration flows in Germany[7]

Aggregate migration balance between Germany and country of origin / destination, in millions of persons



Eastern Europe = Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia
Southern Europe = Cyprus, Greece, Italy, Malta, Portugal, Spain

Source: Destatis

The sharp increase in migration to Germany from 2011 onwards can be explained by the EU's enlargement to the east in 2004. In order to reduce migratory pressure and prevent distortions on the labour markets, older member states were able to suspend the free movement of workers for the new EU member states for up to seven years. Germany made use of this option and therefore recorded rising migration from eastern Europe primarily in the last five years.

Compared with this influx, the migratory movements between southern Europe and Germany over the past 25 years were insignificant.[8] Appreciable movements did not set in until the debt crisis. They reached their peak in 2013, however, and have been levelling out again ever since the situation in the former crisis countries stabilised. If we disregard the large portions of migratory movements that can be explained by significant differences in levels of prosperity and take into account only foreigners from euro states – most of which are not located in eastern Europe – their share in Germany's total population drops from 5.2 % in 2015 (see Figure 1 for share of EU-foreigners) to 2.5 %. Thus, the free movement of people does not yet have the same significance in the monetary union as it does in the European Union as a whole.

Structural barriers remain – labour migration in the euro area does little to lessen shocks

Despite the recent surge in migration, several structural barriers stand in the way of a significant increase in intra-European labour mobility. A major barrier is lack of language skills required to work in many occupations in the destination country. That is why there are more migratory movements between countries with the same language than between countries with unrelated languages. Measured by population size, the share of Austrians is currently eleven times higher than the share of French nationals living in Germany. According to studies on labour migration, further barriers are cultural differences between countries and difficulties in the recognition or assessment of vocational qualifications.[9] Such structural barriers cannot be dismantled in the short term, so migration in the EU is not likely to intensify suddenly.

The barriers to migration to Germany should be lowered as far as possible. To achieve this, language course offers might be established already in future migrants' countries of origin. In addition, enabling the comparability of qualifications is an important goal of education policy. Both would help to dampen a demographic trend that is adversely affecting Germany's growth.

Labour migration is low overall and can do little to cushion asymmetric shocks in the euro area. In Spain, for example, the number of unemployed persons of working age increased by a total of 3.5 million between 2008 and 2013. This growth was accompanied by intense net outward migration to other European countries. Between the financial crisis and 2013, however, net migration from Spain was a mere 180,000 persons. Migration thus did not make a significant contribution to eliminating unemployment.[10] The potential for offsetting shocks will be further reduced by the imminent exit of the United Kingdom from the EU and the probable tightening of restrictions on immigration in the future.

Conclusion: In adjusting to economic shocks, the focus is on labour markets

Single currency areas cannot use exchange rates as correction mechanisms for economic shocks. A larger portion of the adjustment pressure is therefore on prices and wages, especially until the euro area has evolved further at institutional level and until it has more effective inter-state coordination and equalisation mechanisms. However, wages in particular tend to exhibit greater inertia than exchange rates, that is, they respond more slowly to a changed environment. Rigid wages delay the adjustment process, leading to unemployment – with high costs for businesses, workers and society.

Intra-European migration could reduce the adjustment pressure. Against this backdrop, the growing mobility of young Europeans is cause for optimism. But migratory movements are still too moderate overall. Therefore, labour markets in the euro area play a crucial role. Flexible and well-functioning markets reduce the friction that inevitably arises from adjustments to asymmetric shocks in the absence of a national monetary policy. In an OECD comparison, the labour markets of the large euro area countries are generally highly regulated. Nevertheless, far-reaching reforms have created more flexibility in the past years, so it should become increasingly easy to adjust to a changed environment.[11] ■

[1] It is true that the modified fiscal rules adopted after the financial crisis increasingly take into account the cyclical situation of a particular economy. Nevertheless, the flexibility with which countries can respond to economic difficulties remains limited. This applies to highly indebted states in particular.

[2] Cf. Mundell, R. (1961), A theory of optimum currency areas, American Economic Review, Vol. 51, No. 4 sowie Frankel, J. (1999), No single currency regime is right for all countries or at all times, Essays in International Finance, No. 215, August 1999, Princeton University.

[3] A further study conducted by KfW Research examined the importance of EU labour mobility for small and medium-sized enterprises in Germany, cf. Leifels, A. and M. Schwartz (2017), Foreign workers in German SMEs: a strong plea for free labour markets, KfW Research, Focus on Economics No. 154, January 2017.

[4] In 2015, youth unemployment (age <25 years) was nearly 50 % in Spain but only 7 % in Germany. However, this indicator exaggerates the problem because it describes the number of job-seeking youths only as a percentage of the workforce in this age group and ignores those who are still undergoing training and not available to the labour market at all; cf. Lüdemann, E. and B. Richter (2014), Youth unemployment in Southern Europe – Result of the crisis or a flaw in the system? KfW Research, Focus on Economics No. 43, January 2014. If we include this broader comparison group, youth unemployment in 2015 was only 17 % in Spain and less than 4 % in Germany.

[5] The migration balance from the aggregate of the remaining ten EU countries was less than +50,000 persons in 2011–2015.

[6] Cf. Barslund, M., Busse M. and J. Schwarzwälder (2015), Labour mobility in Europe: An untapped resource?, CEPS Policy Brief No. 327.

[7] War refugees from Syria, for example, are not part of the intra-European migration captured here. Recording the inflow of persons from third countries through transit countries on the basis of citizenship instead of country of origin does not produce any significant variations in the results.

[8] Migration from eastern Europe is concentrated on countries such as Germany and Austria due to their geographic proximity. Nevertheless, the assertion that intra-European migration beyond the migration from eastern Europe is relatively limited tends to apply to the other states of the union as well.

[9] Cf. e.g. Belot, M. and S. Everdeen (2012), Cultural barriers in migration between OECD countries, Journal of Population Economics, Vol. 25, No. 3, and Eurofund (2014), Labour migration in the EU: Recent trends and policies, Publications Office of the European Union, Luxembourg.

[10] Cf. Elsner, B. and K. Zimmermann (2013), 10 years after: EU enlargement, closed borders, and migration to Germany, IZA Discussion Paper No. 7130, and Holland, D. and P. Paluchowski (2013), Geographical labour mobility in the context of the crisis, European Employment Observatory. Intra-European migration is noticeably lower than within the USA, for example. In 2014, 27 % of US citizens living in one state were born in another, cf. US Census Bureau 2016, State of residence by place of birth 2014, American Community Survey, http://www.census.gov/data/tables/2014/demo/geographic-mobility/place-of-birth-acs-2014.html. In the EU the share of foreigners was only around 5 % overall in 2014. However, this comparison, which is often made in the literature, is flawed because migratory movements within the USA face much lower barriers, for instance in terms of language or culture, than cross-border migration within Europe.

[11] For an analysis of the functioning and recent reforms of labour markets in the euro area, cf. Ehmer, P. and A. Schwegmann (2017), Labour markets in the euro area: reform successes are good news for employment, KfW Research, Focus on Economics No. 155, January 2017.