

# LABOUR MOBILITY IN THE EURO AREA: CURE OR CURSE FOR IMBALANCES?

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## EXECUTIVE SUMMARY

The euro area has to address its imbalances and instability. Labour mobility in a currency union can be both a curse or a cure in this context. When job seekers move from areas with high employment to regions with many vacancies, they act effectively as shock absorbers. However, when young and better educated individuals move from structurally weak regions to dynamic ones, they can contribute to imbalances.

We look at the years following the crisis of 2008. Did labour mobility increase or decrease imbalances in the euro area? In times of low growth, the data suggest that labour mobility is rather a cure than a curse. However, its potential for the citizens of the currency area is not fully exploited yet. For labour mobility to play a role in the stabilization of the euro area against future asymmetric shocks much more policy action is needed. This is true for the national as well as the European level.

To this end we discuss three complementary strategies. First, we need to facilitate more flexible working conditions and invest more in infrastructure that allows people to work and live in different countries. Second, we need to take measures to fully integrate the national labour markets into one European labour market. Third, we need complementary institutions such as a permanent adjustment mechanism to further reduce the effect of asymmetric shocks. Labour mobility is a necessary but not sufficient ingredient for reducing imbalances in the euro area. The data show clearly that in the wake of the Great Recession, increasing labour mobility has the potential to lower unemployment and stabilize the euro area.

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## WHY LABOUR MOBILITY CAN BE CURE AND CURSE

Whether labour mobility is necessary or harmful for monetary unions has been debated since the start of the Economic and Monetary Union. Blanchard and Katz noted in 1992 that the common currency works in the US because labour mobility is high and people frequently move between states.<sup>1</sup> By contrast, labour mobility in the 1990s was negligible in the European Union. Since then labour mobility has increased.

Even today Europe is a stay-at-home place<sup>2</sup>: The share of working-age residents who moved from one EU country to another is less than 1 percent; mobility across regions but within the same country is only slightly higher than 1 percent. By comparison, intra-state mobility in the US is closer to 3 percent. High labour mobility is one of the criteria for an optimal currency area. At the same time labour mobility also contributes to imbalances. Krugman warned in 1993 of the costs of labour mobility in a monetary union as it will contribute to specialisation.<sup>3</sup> As a result some regions will thrive, while others face a grim future.

”IT WAS CLEAR FROM THE BEGINNING THAT THE EURO AREA WAS NOT AN OPTIMAL CURRENCY AREA”

It was clear from the beginning that the euro area was not an optimal currency area complete with a fully integrated Single Market, and in particular sufficiently high rates of labour mobility as Robert Mundell postulated.<sup>4</sup> The euro area combines a single monetary policy with decentralised fiscal policy. Imbalances in the euro area have to be addressed without direct fiscal transfers between euro area member states and a national central bank. The European Central Bank has to take euro area average inflation rate into account and cannot react to single country’s needs. Increasing labour mobility has therefore been one of the priorities because it has the potential to serve as a long-term remedy for asymmetric shocks and foster economic integration.<sup>5</sup>

There are three ways in which labour mobility can act as a shock absorber in the euro area. First, if individuals move from structurally weak regions with high unemployment to dynamic areas, they find better jobs with higher wages. Second, labour mobility lifts some fiscal pressure off national governments, as individuals do not only leave their country but also its unemployment statistics and welfare schemes. Third, remittances help alleviate a strained fiscal situation of relatives back home during a crisis.

At the same time, labour mobility can also increase imbalances and reinforce asymmetric shocks. As the young and better educated flock to the new dynamic regions, they leave behind ageing communities with old industry, high unemployment, low wages, and low growth. Brain drain becomes a real threat. Temporary imbalances become permanent. Labour mobility may also accentuate imbalances, making economic governance of the euro area even more difficult. Therefore, policies to increase labour mobility as a shock absorber must at the same time address possible fall-outs.

The Great Recession that followed the crisis in 2008 is an interesting case to study the positive and negative effects of labour mobility. The difference in unemployment rates within the euro area has risen sharply. Has labour mobility been a cure or curse for the euro area?

1. Olivier J. Blanchard and Lawrence F. Katz (1992), “Regional Evolutions”, *Brookings Papers on Economic Activity* 1: 1-75

2. As data from Eurostat and the US Census Bureau show.

3. Paul Krugman (1993), “Lessons of Massachusetts for EMU”, in Torres, F. and Giavazzi, F. (eds.) *Adjustments and Growth in the European Monetary Union*, Cambridge: Cambridge University Press

4. R. Mundell, “A Theory of Optimum Currency Areas”, *The American Economic Review* 51 (4) (1961): S. 657-665.

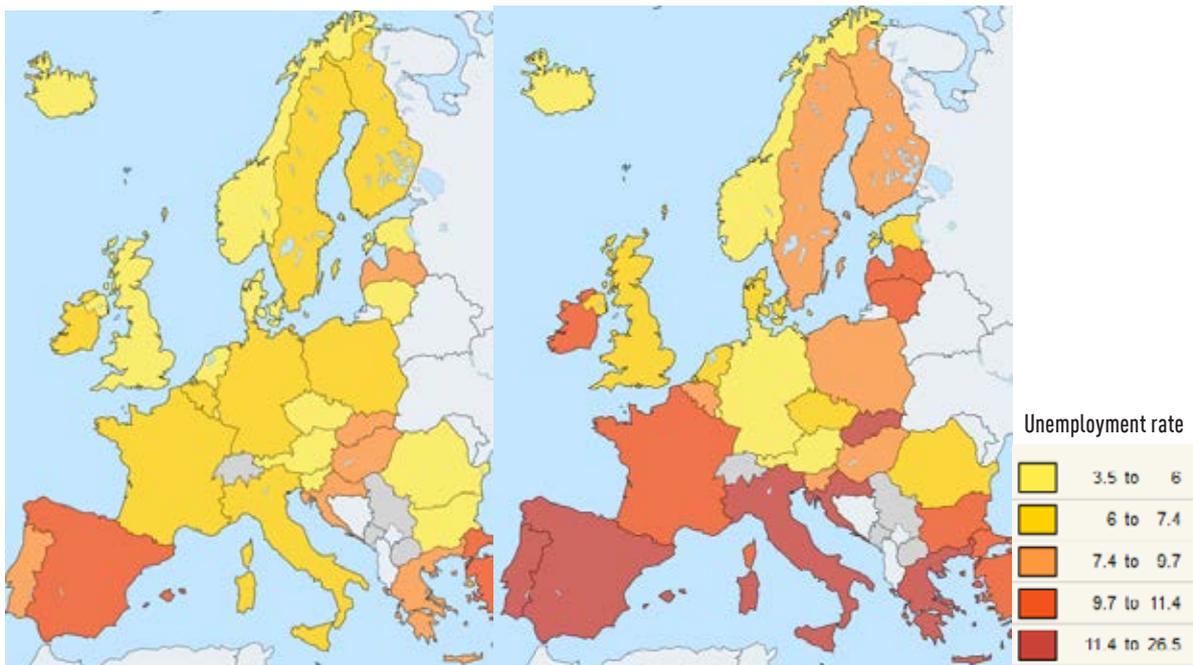
5. Arpaia A., Kiss A., Palvolgyi B. and Turrini B. (2014), “Labour mobility and labour market adjustment in the EU”, *Economic paper* (539), Brussels: European Commission.

The remaining of the paper is structured as follows: Section 1 discusses unemployment during the Great Recession, and tracks the movement of workers in the European Union. Section 2 concludes and discusses policy implications.

## 1. Mobility after the crisis: What the data tell us

The crisis in 2008 and the recession are an interesting case in point. Unemployment is a lagging indicator and began to increase with some inertia as the crisis unfolded. By 2013, unemployment differentials had reached highest levels since 1999 and have not recovered since then. Figure 1 displays the sharp divide in unemployment rates across the European Union. Unemployment in 2008 was rather similar, with only Spain displaying very high rates of unemployment. In 2014, the situation looks remarkably different: The spread in unemployment has widened and ranges between 4 and 27 percent. Most countries have seen an increase in unemployment, with the notable exception of Germany. High unemployment countries in the euro area are Portugal, Spain, Italy, and Greece.

FIGURE 1 ► Unemployment in Europe in 2008 and 2014



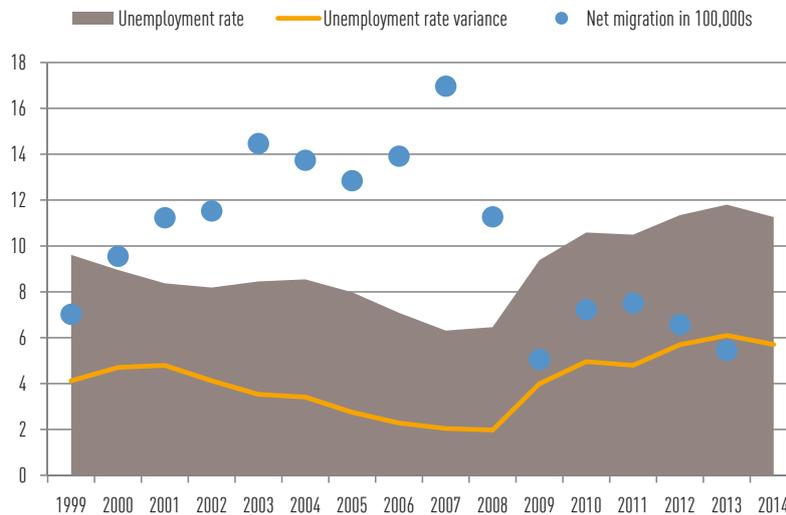
Source: Eurostat. © EuroGraphics.

How did labour mobility react to this large and persistent unemployment differential? Figure 2 shows the average unemployment rate in the euro area. From 1999 until 2008 unemployment rates converged in the euro area. The difference in unemployment rates (measures as the standard deviation from the euro area unemployment rate) was reduced by almost 50 percent. Net migration in the euro area during that time increased steadily from 700,000 in 1999 to 1,700,000 in 2007. By 2009, all three trends had been reversed: The euro area unemployment rate began to rise, the differences between countries started to increase, and net migration was reduced to less than 800,000.

It is interesting to note that unemployment within the euro area countries stayed relatively constant. In other words, the differences across (NUTS2) regions within countries was constant throughout the years as Eurostat data shows. This suggests that the shocks were indeed asymmetric, and country-specific and but not

region-specific. In addition, labour mobility within countries equalized the national unemployment rate and did not contribute to new regional imbalances.

**FIGURE 2** ▶ Unemployment and migration in the euro area



Note: This figure includes foreign nationals who migrated into the EU from abroad.

Source: Eurostat, authors' calculations.

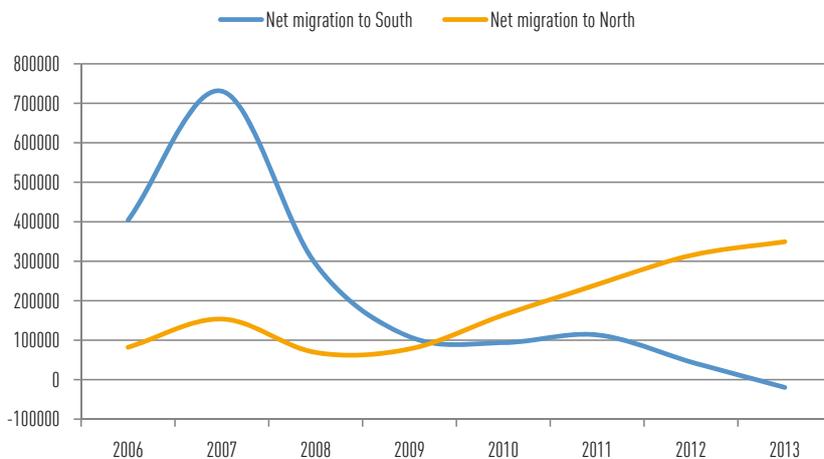
Let us look at migration flow data: Did individuals move from high unemployment to low unemployment regions? In other words, did labour mobility work as a shock absorption mechanism? During the Great Recession there has been a reversal of net migration flows in the EMU. Until 2007, many EU-citizens moved to the booming South of the currency union where they mainly found work in labour-intensive sectors such as tourism, construction and care. After the economic collapse following the burst of the bubble, the stream of EU-workers into these countries dried up rapidly. Instead, many flocked to Germany, Austria and other EMU-countries in the North. As shown in figure 3, this led to a reversal of migration flows.<sup>6</sup> However, this change of flows wasn't induced by citizens of Southern crisis countries themselves but rather by a redirecting of the East-West movements. Instead of Spain and to some lesser extent Italy, post-crisis migrants from Eastern Europe primarily chose to move to Germany, Austria and the Netherlands reflecting rising demand for labour in these countries in the aftermath of the crisis.

Considering the high unemployment rates in Southern countries, with youth unemployment still at almost 50 percent in Spain and Greece, this should be a sign of concern. The crisis did mark the beginning of a South-North movement but the numbers are still modest when compared to the pre-crisis migration to Spain. The observed effect in Spain for example was mainly due to the emigration of low-skilled workers from Eastern Europe and Latin America.<sup>7</sup>

6. See also Dawn Holland & Pawel Pachlukowski (2013), "Geographical labour mobility in the context of the crisis", *European Employment Observatory*.

7. A study by Deutsche Bank Research estimates that unemployment in Spain would have been 1.7 percent higher without emigration following the crisis. Dieter Bräuninger and Christine Majowski (2014), *Arbeitskräftemobilität in der Eurozone, EU Monitor European Integration* (85): 1-12.

**FIGURE 3** ▶ Net migration of EU 27-citizens to Southern and Northern Europe



Note: This figure only includes citizens from EU-27 countries who migrated from one EU-country to another. North: Austria, Belgium, Germany, Netherlands; South: Greece, Ireland, Italy, Portugal, Spain.

Source: Eurostat; authors' calculations.

Taking the U.S. as a benchmark, Europe has still low rates of labour mobility. From 2000 until 2005 2.4 percent of the total population moved between the 50 states in the U.S. By contrast, 0.95 percent moved within EU 15 and only 0.29 percent between EU 27 countries.<sup>8</sup> Evidence suggests that the labour market in Europe has reacted more strongly to the unemployment differential than in the United States.<sup>9</sup> However, this was not due to euro area mobility but to the inflow of third-national individuals.

**” YOUNG INDIVIDUALS FAIL TO FIND A JOB OR ARE OVERQUALIFIED FOR THEIR WORK ”**

Instead, the data suggests that many young people in high unemployment countries have moved in with their parents again to save rent. This adds to fiscal pressure and increases the skill-mismatch. As a result, even more young individuals fail to find a job or are overqualified for their work: the highest rates can be observed in Spain and Italy with more than 30 percent of workers with skill mismatch.<sup>10</sup> Research suggests that there is a high path dependency: Young individuals who graduated during recession will have lower earnings than their peers for up to 10 years.<sup>11</sup>

Germany emerged as the best-performing large economy of the euro area with record-low unemployment rates. Following the shock absorption logic, it should attract many workers from the euro area. The country indeed became the most attractive destination country for EU-citizens in the last years (together with the UK), but the vast majority of EU-workers came again from the new member states. Despite a steady increase of workers from Spain, Greece and Italy (albeit at low levels), the number of workers from old EU-15 countries (including the UK, Sweden and Denmark) in Germany has increased in total by only 150.000 since 1999.<sup>12</sup> The number of new workers from Poland alone has been higher than that of all the Southern crisis countries combined. Net migration from 2010 until 2014 to Germany amounted to 3,000 from Greece, 24,000 from Italy, 4,000 from Portugal and 11,000 from Spain. 73,000 from Poland and 93,000 from Romania stayed during the same period<sup>13</sup>.

8. OECD (2007), *Economic Surveys: European Union*, Volume 2007 (11), Paris: OECD.

9. Julia Jauer, Thomas Liebig, John P. Martin and Patrick Puhani (2014), "Migration as an adjustment mechanism in the crisis? A comparison of Europe and the United States", OECD Social, *Employment and Migration Working Papers* (155): 1-37.

10. OECD (2012), *Survey of Adult Skills*, OECD: Paris.

11. Philip Oreopoulos, Till von Wachter, and Andrew Heisz (2006), "The Short- and Long-Term Career Effects of Graduating in a Recession: Hysteresis and Heterogeneity in the Market for College Graduates", *NBER Working Paper* (12159): 1-74.

12. Eurostat and authors' calculations.

13. German Statistics Office Destatis (2015), *Ausländisches Zentralregister*

A look at the main migration flows within the entire EU suggests different motives between intra-euro area migration and the work migration within the entire union. The by far largest migration flows run from the East to the West and reflect a major wage differential between the older member states (EU15) and the newer member states following the three Eastern enlargements (EU13). Within the euro area, wage differentials are, albeit not to neglect, much smaller.

”THE POSITIVE EFFECTS OF LABOUR MOBILITY TRUMPED THE NEGATIVE ONES”

By contrast, the major differences in unemployment rates did not lead to migration flows comparable in scale to the East-West dynamics. This suggests that in the Single Market wage differentials can be a more powerful trigger than high levels of unemployment. Unemployment was the main driver for migration within the euro area, but this labour mobility did not reduce imbalances to a degree that could be considered an important shock absorber. Overall, the data suggest that labour mobility was more cure than curse: the positive effects were stronger in the aftermath of the crisis. Yet, labour mobility was still too low.

## 2. Three policy strategies for higher and more efficient labour mobility

Unemployment is a slowly moving indicator and labour mobility may increase in the future. Yet the evidence so far suggests that the Blanchard effect is more relevant than the Krugman effect. The euro area would have profited from more labour mobility to reduce imbalances. Specialisation may be a stronger driving force during an upswing. In any case, labour mobility was not high enough to act as a shock absorber. What should policy-makers do? In the absence of fiscal transfers or other redistributive mechanisms between the countries of the Eurozone we argue that higher labour mobility would only be beneficial. There are **three policy strategies**.

**First, facilitate more flexible work conditions.** Many jobs do not require individuals to move physically or permanently. They can be done from home or any workplace. Commuting and working in different places has become easier and cheaper. By contrast, moving around for work between countries is much more costly. Physical labour mobility might be the less efficient solution to unemployment differentials. Policies should focus on infrastructure investment that facilitates a mobile workforce to roam around freely without moving homes. The digital revolution transforms many jobs into individual tasks which are assigned to self-employed freelancers who work remotely. This mobility-replacing element of digitalization can be harnessed by infrastructure investment, for example in broadband connections, as envisaged in the Juncker Plan.

Facilitating more flexible work arrangements without moving around may a smart solution. The question is whether this will be enough. Many jobs, in particular in the still growing service sector, require individuals to be there physically and permanently. This means that facilitating work arrangements without moving workers can only be part of the solution towards a better functioning European Labour Market. Tackling administrative, institutional and linguistic barriers towards mobility should thus be high on the agenda.

Of the top three reasons of EU-citizens not to take up work in another member state, “language barriers” and “cultural reasons/family reasons” are continually cited in the regular Eurobarometer surveys on the Single Market. While language is usually cited as the highest barrier to movement, the increasing numbers of EU-citizens with a professional command of English, especially among young cohorts, is promising. English has become the de-facto lingua franca of the EU. More than 90 percent of all young individuals in secondary education learn study it (Eurostat). It will be easier for younger cohorts to work in an international context, but national languages will remain important.

In addition, institutional constraints keep people at home: degree recognition or regulated professions pose a problem. The question of the portability of social security entitlements, especially pension rights and social

insurance entitlements has still not been solved. Despite recent decisions to extend the portability of supplementary pension rights, there are still many questions attached to the issue of portability, not only regulatory but also political ones. The different pension and retirements schemes across the EU are diverse, there are huge differences for example concerning the effective retirement ages in many EU countries and the taxation of portable pensions also remains a regulatory challenge.

Social security entitlements, especially child allowances, have become a controversial topic: the indexation of child allowances according to the country of origin and the curbing of in-work benefits are the controversial centrepiece of the British renegotiation efforts in wake of the British referendum on further EU-membership in the summer of 2016. Nevertheless, more coordination on the systems of social security is needed.

” MORE REGULATED  
PROFESSIONS SHOULD GET  
THEIR CERTIFICATES AND  
DEGREES RECOGNIZED ”

One example is the duration of unemployment benefits of the country of origin for an EU-citizen who is looking for a job in another EU-country. Currently ranging from three to six months of stay in another EU-country they should be harmonised at six months. Three months is certainly not enough to get acquainted with a new country’s language, administrative and employment systems. Concerning the recognition of qualification, more regulated professions should get their certificates and degrees automatically recognized so that workers from other EU-countries do not have to enter bureaucratic fights over the recognition of their qualifications anymore.

National public policy is also in desperate need for a new narrative when it comes to the growing resentment towards working migrants in many member states. Instead of abusing migrant workers in a debate about alleged welfare tourism the focus of the discourse should be on the facts such as that EU-citizens in another country have a 3.5 percent higher employment rate across the union than native residents<sup>14</sup>.

**Second, work towards a true European labour market.** One way would be to expand existing European networks such as EURES, which could one day become a European employment agency. A better performance of EURES could be brought about by increasing its budget and outreach activities. Until today only 15 percent of Europeans have heard of this network and how it can match supply and demand for jobs in the EEA. By exchanging job offers and building up European databases national agencies could become brokers for job-seekers in the entire union. Your first EURES Job which was launched by the EU-Commission in 2012 combines the network of EURES and national partner agencies to create a service for young unemployed Europeans (18-35) who want to look for work abroad.<sup>15</sup> The service does not only include remuneration for travelling costs but it does offer assistance in the interviewing process with potential employers. The employers get access to a large pool of applicants which can help them to fill vacancies. Still, too few individuals participate each year.

Thus, assistance and increased cooperation will probably not be enough to address the persistent high unemployment, especially of young people, in the EU. Since there is no genuine European labour market yet, European programs investing in training and education for young people in another European country combined with employment in a company and financial support by the EU are promising.

This idea is taken up by Erasmus Pro<sup>16</sup>. The initiative combines mobility with the prospect of vocational training as an apprentice and a future employment option. Erasmus Pro aims to support up to 200,000 young individuals each year to gain a professional qualification in a different European country by 2020. National governments, employers, and the EU shoulder the costs of selecting, preparing, and training them. Successful graduates have not only acquired a professional qualification but also additional language skills and can either seek work in their new place of residence or return with new qualifications to their home country. The initi-

14. David Rinaldi, „A New Start for Social Europe“, with a foreword by Jacques Delors, preface by Nicolas Schmidt and contribution by Marianne Thyssen, *Studies & Reports No. 108*, Jacques Delors Institute, February 2016.

15. „Your first EURES Job“, Project Homepage: <http://www.yourfirsteuresjob.eu/en/home>

16. Jacques Delors, Henrik Enderlein, Pascal Lamy, Enrico Letta, François Villeroy de Galhau, António Vitorino, Jean-Michel Baer and Sofia Fernandes, „Erasmus Pro: for a million young European apprentices by 2020“, *Tribune*, Jacques Delors Institute, May 2015.

ative solves at least three problems at once: it reduces pressure on countries with high youth unemployment, it offers a larger pool of applicants, and it provides additional language training (and cultural know-how) and thereby helps to create a European labour market.

**Third, complement labour mobility with additional shock absorbers.** Lastly, policy measures which are complementary to labour mobility should be part of every policy mix for an enhanced European labour market. Different suggestions are already on the table and the advantages and disadvantages are well understood.<sup>17</sup> All of them feature elements of a cyclical adjustment mechanism after an asymmetric shock in a currency union. A cyclical adjustment mechanism based on indicators such as the output gap could help to protect countries against asymmetric shocks and distribute the cost more evenly. Moral hazard would be addressed by making access to the scheme conditional upon previous reforms. Depending on the model chosen a change of European Treaties might be needed to implement such a scheme.

A European cyclical adjustment mechanism can be seen as a tool to mitigate imbalances. By transferring money from regions and countries with high employment and growth to those with high unemployment after an asymmetric shock, the mechanism stabilizes aggregate demand in a downturn. This can help for example lower skilled people keep their work at home.<sup>18</sup> While there could be a potential negative impact on mobility, the figures for example from Spain since the crisis show that especially low-skilled people are not very likely to move anyway.

## CONCLUSION

The euro area has to address its inherent instability. In times of low growth, the data suggest that labour mobility is rather a cure than a curse. However, its potential for the citizens of the currency area is not fully exploited yet. For labour mobility to play a role in the stabilization of the euro area against future asymmetric shocks much more policy action is needed. This is true for the national as well as the European level. The sudden influx of refugees from crisis-ridden regions around the world requires both political attention and resources. Their integration into the labour market has become the new priority. Nevertheless, helping them to settle in and working towards increasing labour mobility in the EU can be complementary goals.

In this paper, we have discussed three complementary strategies. We should work on all three ends: First, we need to facilitate more flexible working conditions and invest more in infrastructure that facilitates a mobile workforce without permanent residence changes. Second, we need to work towards a true European labour market. Proposals are already on the table. Third, we need complementary policies such as a permanent adjustment mechanism to cushion asymmetric shocks that lead to high unemployment. In the wake of the Great Recession, increasing labour mobility has the potential to lower unemployment and stabilize the euro area.

17. Among them Bertelsmann Stiftung (ed.) (2014), *A European Unemployment Benefit Scheme*, Gütersloh: Verlag Bertelsmann Stiftung; Miroslav Beblavý and Itaria Maselli (2015), "An Unemployment Insurance Scheme for the Euro Area", CEPS Special Report No. 98, pp. 1-74; Grégory Claeys, Zsolt Darvas, and Guntram B. Wolff (2014), "Benefits and Drawbacks of European Unemployment Insurance", *Bruegel Policy Brief* 2014 No. 06, pp. 1-8; Henrik Enderlein, Lucas Guttenberg, and Jann Spiess (2013), "Blueprint for a cyclical shock insurance in the euro area", *Studies & Reports No. 100*, Jacques Delors Institute, pp. 1-97.

18. Laszlo Andor, *Fair Mobility in Europe*, Social Europe Occasional Paper January 2015, Berlin: Friedrich Ebert Stiftung

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Jacques Delors, Henrik Enderlein, Pascal Lamy, Enrico Letta, François Villeroy de Galhau, António Vitorino, Jean-Michel Baer end Sofia Fernandes, *Meinungsbeiträge*, Jacques Delors Institut - Berlin, Mai 2015

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