

European Union: Eastern Enlargement and Labour Migration

The economic integration of the associated countries of east central Europe into the European Union poses a number of questions for both parties – questions that have been examined by the DIW at the behest of the Federal Ministry of the Economy. The implications of eastern enlargement for the EU budget have already been discussed.¹ A second potentially explosive issue is that of east – west migration following the introduction of the free movement of labour. This report attempts to provide a quantitative evaluation of the population flows that can be expected, their longer-term dynamics and their most important implications.

The potential volume of migration from the five CEFTA countries² – the countries considered as candidates for the first round of eastern enlargement of the EU – is estimated at between 340 000 and 680 000 per annum. If the other five associated east central European countries³ are also included, the potential could rise to almost 1.2 million. Compared with these figures the actual size of the flows, currently still restricted by immigration regulations, is small. Even so, in the short term, problems will arise with labour market integration. However, these short-term "costs" of immigration must be seen against the substantial long-term social benefits of controlled immigration. By implementing transitional regulations following eastern enlargement it is possible to allow for both aspects.

It is widely feared that immigration of, and cross-border commuting by, labour from eastern central Europe, particularly from Poland with its large population, could drastically push up labour supply in the EU – particularly, in Germany due to its geographical proximity – exerting pressure on wages and an intolerable burden on social insurance systems. It has been argued that even a small absolute number of immigrants – compared with the volume of domestic employment – could be explosive in labour market and employment policy terms if they were to focus on a small number of industries. Besides construction and allied trades, this is

thought likely to apply to transport. It is indeed the case that, in contrast to goods and capital markets, labour markets have so far been largely excepted from multilateral liberalisation. And even since the Europe Agreements with the associated central east European countries, the maintenance of strict legal restrictions on the migration of labour to the EU remains permissible. Yet given that the free movement of labour, as the "third freedom", is a central element of the Single European Market, it ought to be granted to all countries, and the only questions to be considered should relate to the length of the transition period considered appropriate and the form such transition should take.

There is a substantial volume of literature dealing with the motives behind cross-border labour migration. The central factors are the underutilisation of labour supply and the latter's age structure in the country of origin, the earnings differential, geographical and cultural distance and the prospects for the development of the domestic economy. On top of this come, in the recipient country, the absorption capacity of the labour market, the state of the economy, the skill profile of the demand for labour, immigration controls and the availability of social benefits.

Immigration volume to date

There are no Union-wide regulations governing the employment of labour from non-EU countries. For the CEFTA countries the association agreements make provision for bilateral regulation. In the case of Germany the following groups can be distinguished:

- (1) those employed under standard German law on the basis of a permanent or temporary work permit;
- (2) so-called *Werkvertragsarbeitnehmer*, a type of short-term contract workers, who are employed under the social insurance conditions prevailing in their country of origin, but at German (minimum) wages, and for whom quotas are set for each country (moreover, they can only be employed if a clause protecting the regional labour market is not in operation);
- (3) seasonal workers (since 1993 excluding those in the construction industry), provided German (or legally equivalent) labour is not available;
- (4) "border workers" from the Czech Republic and Poland who commute daily or work for no more than two days per week in the border area;
- (5) guest workers who wish to further their vocational training in Germany in substantive or linguistic terms.

¹ Cf. Reforms necessary if eastern enlargement of the EU is to be financed, in: *Economic Bulletin*, vol. 34, no. 1, January 1997.

² The countries of the Central European Free Trade Area (Poland, Hungary, the Czech Republic, Slovakia and Slovenia).

³ Bulgaria, Romania, Estonia, Latvia and Lithuania.

So far the volume of east – west migration as a whole has been very limited. This is all the more true of EU regions outside Germany: more than 70% of all migrants from Poland, the east central European country with the greatest migration potential, go to Germany, and this trend towards regional concentration is still rising; besides Germany only North America plays a significant role as a target region.⁴ At 260 000 or 3.8% (1993) Poles also constitute the largest group from central Europe among the resident foreign population in west Germany.

Compared with the foreign resident population, the number of legal employment relations is small. On annual average figures for 1995 just under 41 000 *Werkvertragsarbeitnehmer* from seven east central European countries with which Germany has bilateral agreements were employed in Germany (cf. table 1). The number of guest workers from this region is, at 3 000, of negligible importance as is the number of border workers from Poland and the Czech Republic (7 000), although the latter are regionally heavily concentrated. Of far greater relevance in quantitative terms are seasonal workers of which there are around 150 000; by definition, however, they may only work in Germany for a few weeks of the year. In June 1994 just under 140 000 persons from the six east central European countries listed in table 2 were employed under standard working conditions – i.e. with no advantage in terms of indirect labour costs. While this figure is double the 1990 level, it marks a decline compared with 1993 and is in no way dramatically high, even if taken in conjunction with the *Werkvertragsarbeitnehmer*.

On the other hand, to these figures must be added those working illegally in Germany. The extent of illegal employment is, however, in no way comparable to that of Mexicans in the USA – in some respects a similar case. Firstly, surveillance of domestic firms is practically non-existent in the USA, making it correspondingly difficult to control illegal immigration by administrative means. Secondly, the incentive to enter Germany illegally is far less strong than in the case of the USA, as the children of illegal immigrants in Germany are unable to attend school there and children born in Germany do not automatically acquire German citizenship.

The potential for immigration from east central Europe

A number of factors suggest *prima facie* that the potential for immigration from the central east European countries is significantly higher than that indicated by current actual flows. Unemployment has risen during the transition process, either as a result of radical structural change or productivity growth within individual sectors. On top of this come the common borders or greater or lesser geographical proximity and the substantial income differentials to the existing EU member states. Therefore, in the case of labour market liberalisation, actual migration flows could be much higher than current levels.

A number of broad-based empirical estimates have been made of the dependence of migration on the income differential between the country of origin and the "target region": these are used here to estimate the potential for migration from central eastern Europe. The results vary significantly, however. A distinction needs to be made between migration within a country and that between countries. Longitudinal studies in the USA, Japan and Europe revealed, for an income differential of 10%, an annual net immigration rate within countries of between 0.1 and 0.3% of the population (a mean of 0.26) and a net immigration rate between countries of 0.05 and 0.15% of the population (mean: 0.08%).⁵ This relationship between income differential and migration rate is subject to sharp fluctuations over time, however. Moreover, significant correlations were also observed between other factors – such as climatic conditions and population density and migration.

Following a complete integration of the east central European countries into the EU labour markets, the migration rate would be expected to lie between the empirically measured migration movements within countries and those between countries, because the institutional conditions for migration correspond to those within countries, while the linguistic and cultural barriers correspond to those between countries.

A simple model calculation shows the way in which the migration potential could develop on the basis of the income differential to the EU, demographic trends and various assumptions on long-term economic growth in the EU (15), the CEFTA (5) and ECE (10) countries, and the impact of increasing political and cultural proximity. The model calculation is based on the assumption that, if the EU labour markets were opened, net immigration of 0.08% and 0.16% mark the lower and upper limits respectively for an income differential of 10%.

⁴ Cf. OECD, Trends in International Migration, Continuous Reporting System on Migration (SOPEMI), Annual Report 1994, Paris 1995, p. 104.

⁵ Cf. Robert Barro and Xavier Sala-i-Martin, Economic Growth, New York et al. 1995, pp. 401 – 410.

Table 1
Foreign *Werkvertragsarbeitnehmer* Employed in Germany¹⁾

	1992	1993	1994	1995
Poland	51 011	21 424	13 496	24 187
Hungary	12 186	13 563	9 055	9 116
Czech Republic ²⁾	10 550	4 565	1 656	2 151
Slovak Republic	.	994	1 405	2 048
Romania	7 341	13 895	2 425	292
Bulgaria	1 891	3 829	2 387	1 899
Slovenia	482	1 792	1 350	1 185
Total	83 461	60 062	31 774	40 878

1) Annual average. — 2) January to July 1993 CSFR, subsequently divided between republics.
Sources: Federal Labour Office.

As the economies of eastern central Europe recover, the income differential will narrow. Empirical studies have shown that incomes in open economic areas with comparable institutional conditions converge.⁶ On the basis of this evidence, following integration of the ECE countries into the EU an initial average rate of per capita GDP growth of 5% p.a. is assumed in this scenario for eastern central Europe – a rate that successively weakens as the countries approach per capita income in the

EU. For the EU, a constant annual growth of per capita GDP of 2% is assumed. Whatever the uncertainties regarding actual income trends, the income differentials seem certain to narrow only gradually. Assuming from an income level in the central east European transition countries which is just one-third of that in the EU, around 35 years would be required for ECE incomes to rise to two-thirds of the then EU level (cf. table 3).

Based on estimates by the World Bank (cf. table 4) the natural rate of population growth for the ECE area as a whole is assumed to average 0.15% per annum. On the basis of all these assumptions, three scenarios were derived. In the low-migration scenario annual net immigration to the EU amounts to 0.08% of the east central European population for each 10% of income differential. This translates into an annual net immigration of 590 000 persons in the early years, a figure declining to

⁶ Cf. Robert Barro and Xavier Sala-i-Martin, *Convergence across States and Regions*, in: *Brookings Papers on Economic Activity*, 1991, no. 1, pp. 107 – 182; William J. Baumol, *Productivity Growth, Convergence and Welfare: What the Long-Run-Data Show*, in: *American Economic Review*, vol. 76, 1986, no. 5, pp. 1072 – 1085; Steve Dowrick and Duc-Tho Nguyen, *OECD Comparative Economic Growth 1950 – 1985: Catch-Up and Convergence*, in: *American Economic Review*, vol. 79, 1989, no. 5, pp. 1010 – 1030.

Table 2
Persons from ECE (6) in Socially Insured Employment in West Germany

	1990	1991	1992	1993	1994
Poland	35 106	45 615	56 477	72 362	67 546
Hungary	10 912	13 433	15 154	15 549	14 070
(Former) CSFR	13 394	20 927	32 258	34 064	27 846
Romania	8 923	13 846	23 375	27 529	25 546
Bulgaria	1 635	2 421	8 000	6 146	3 673
Total	69 970	96 242	135 264	155 614	138 681

Sources: Volkhart Vincentz, *Auswirkungen der wachsenden Arbeitsteilung zwischen Deutschland und seinen östlichen Nachbarn auf Arbeitsmarkt, Investitionen und Güterströme*, Osteuropa-Institut Munich, Working Papers, no. 188, p. 138; Statistisches Jahrbuch 1995, p. 120.

Table 3

Estimated Potential for Migration from East Central Europe

	Per capita GDP		Population excl. migration Mill. ³⁾	Low-migration scenario			High-migration scenario			Progressive-migration scenario		
	US-\$ ¹⁾	% of the EU average ²⁾		Migration factor ⁴⁾	Net migration	Population following migration ⁵⁾	Migration factor ⁴⁾	Net migration	Population following migration ⁵⁾	Migration factor ⁴⁾	Net migration	Population following migration ⁵⁾
CEFTA (5)												
1996	6 104	35.6	66.0	0.08	-0.34	65.7	0.16	-0.68	65.3	0.08	-0.34	65.7
2000	7 307	39.3	66.5	0.08	-0.32	64.8	0.16	-0.62	63.1	0.09	-0.35	64.7
2005	9 008	43.9	67.0	0.08	-0.29	63.7	0.16	-0.55	60.7	0.10	-0.36	63.3
2010	10 941	48.3	67.5	0.08	-0.26	62.8	0.16	-0.49	58.6	0.11	-0.37	61.9
2020	15 584	56.5	68.5	0.08	-0.21	61.5	0.16	-0.39	55.2	0.14	-0.36	59.2
2030	21 412	63.7	69.6	0.08	-0.18	60.4	0.16	-0.31	52.6	0.16	-0.34	56.6
ECE (10)												
1996	5 180	30.2	105.6	0.08	-0.59	105.0	0.16	-1.18	104.4	0.08	-0.59	105.0
2000	6 315	34.0	106.5	0.08	-0.55	103.5	0.16	-1.07	100.7	0.09	-0.62	103.4
2005	7 945	38.7	108.5	0.08	-0.50	101.7	0.16	-0.95	96.5	0.10	-0.63	101.0
2010	9 825	43.4	110.3	0.08	-0.45	100.1	0.16	-0.85	92.8	0.11	-0.64	98.5
2020	14 412	52.2	113.3	0.08	-0.37	97.5	0.16	-0.67	86.7	0.14	-0.63	93.6
2030	20 255	60.2	118.9	0.08	-0.30	95.6	0.16	-0.53	82.1	0.16	-0.59	88.9

1) Per capita income at purchasing power parities (PPP) for 1993 according to World Bank data; subsequently own scenario with assumed income convergence. — 2) Based on an assumed annual average growth rate of the PPP-GDP of the EU in 1993 of 2%. — 3) Assuming average annual growth of 2% since 1993. — 4) For each tenth of the income differential to the EU. — 5) In the scenario migration between the ECE countries and between them and non-EU countries was not considered, so actual values may differ substantially.

Source: DIW calculations.

around 300 000 to the year 2030. In a high-migration scenario net immigration of 0.16% for each 10% income differential is posited, leading initially to annual net immigration of 1 180 000 persons from eastern central Europe, declining to 530 000 by the year 2030. Finally, in a third, "progressive" scenario it is assumed that the cultural and institutional barriers to mobility decline over time, so that net immigration for each 10% income differential increases from an initial figure of 0.8% to 0.16%. In this case annual net immigration to the EU would increase from 590 000 to 640 000 to the year 2010, subsequently declining once more to 590 000 by the year 2030. In the longer term, migration from the eastern central European countries to the EU would have a significant impact on demographic trends in the countries affected. The scenario does not take account of migration from eastern Europe to the east central European countries, however, so the figures almost certainly significantly exaggerate the extent of population decline.

Thus the calculations suggest that potential annual migration to the EU as a whole amounts to between 340 000 and 680 000 from the CEFTA (5) countries and to between 590 000 and 1 180 000 from the ECE (10) countries. In interpreting these figures it must be taken into account that, for the foreseeable future, it is only the CEFTA countries that are likely to be incorporated into

the EU. Against the background of natural population trends in the EU, immigration on this scale would be relatively limited.

According to the model calculations economic policy measures – such as financial transfers or support for direct investment – that seek to raise incomes in the eastern central European countries can be expected to exert a comparatively minor impact on the level of migration. Even rapid per capita income growth of 10% p.a. in the east central European countries would reduce annual immigration by only around 26 000 in the low-migration scenario and by around 52 000 in the high-migration scenario. If specific regions or labour market segments are considered, however, such measures could clearly exert a perceptible effect on migration flows.

The absorption capacity of the German labour market

Migration flows depend not only on income differentials, but also on the capacity of west European labour markets to absorb foreign labour. For years now this capacity has been falling in various sectors. Not only is domestic labour more likely to be unemployed if foreign

Table 4
Demographic Dynamics in Europe

	Population			Working population		
	Millions			Change in % ¹⁾		
	1993	2000	2025	1993 to 2000	1993 to 2000	1995 to 2025
Germany	81	82	76	0.2	-1.8	-0.3
France	57	59	61	0.4	0.4	-0.1
Italy	57	57	52	0.0	-0.1	-0.4
UK	58	59	61	0.3	0.1	-0.0
Austria	8	8	8	0.5	0.0	..
Sweden	9	9	10	0.5	0.2	0.0
Poland	38	39	42	0.2	0.8	0.3
Hungary	10	10	9	-0.4	0.3	-0.2
Czech Republic	10	10	11	0.1	8.2	..
Slovak Republic	5	5	6	0.4
Romania	23	23	22	-0.1	0.7	0.4
Bulgaria	9	9	8	-0.5	0.3	-0.1

1) Annual average rate.

Source: World Bank, World Development Report 1995.

workers are numerous rather than few the pressure on the wages of domestic labour is all too apparent.⁷ One indicator of this in Germany is the sharp cutback in the contingent of Polish *Werkvertragsarbeitnehmer* in the German construction industry from 65 000 in 1992 to 20 000 in 1994.⁸ Even if the economy picks up, there is little sign of a fundamental change here in the foreseeable future. On top of this comes the fact that firms must now pay heavy charges – at least DM 1 200 per person depending on the length of the employment contract – for the required work permits. Yet in such a situation some immigrants will be driven to take up illegal employment – given that Poles do not require a visa, immigration remains possible even under the prevailing difficult labour market conditions – so the statistics understate the real extent of foreign employment.

On the supply side a number of other causes besides income differential (the sole variable used here to estimate the migration pressure) will remain over the coming decades. This is true, for example, of unemployment in east central Europe that is currently possibly hidden by the still large – although declining – productivity gap with the EU. To this extent Germany and the EU will

⁷ Cf. Klaus F. Zimmermann, Tackling the European Migration Problem, *Journal of Economic Perspectives*, vol. 9, 1995, no. 2, p. 54. At the same time there are also numerous positive, complementary relationships between domestic and immigrant labour, and the negative overall effect of immigration on the domestic wage level is less pronounced than has until recently been supposed: cf. John Haisken-De New, Migration and the Inter-Industry Wage-Structure in Germany, *Population Economics*, Berlin 1996, p. 121.

⁸ Cf. OECD, op. cit., p. 148.

insist on a transition period, irrespective of the date of accession. During this period the immigration quotas would be gradually raised and – as previously with the quantitative import restrictions – responsibility for the quotas transferred to Community level. The slow rate of population growth and the relatively favourable macroeconomic growth prospects in the ECE countries will facilitate the gradual dismantling of the restrictions. This is in sharp contrast to the developments in the southern Mediterranean. According to one model calculation⁹ the migration potential there (persons of working age unable to find employment) will amount to not less than 22 million between 1990 and 2010, compared with just over 4 million in the 1980s.

On the absorption side an additional argument from both a German and a Union perspective for a transition period following accession to the EU with restrictions on the free movement of labour for ECE countries is the fact that the influx of labour is concentrated on "mobility-sensitive" sectors. As the debate within the Union on a directive on the employment of foreign construction workers has shown, there is a limit to the pressure that can be exerted on specific segments of national labour markets if dangerous social tensions and xenophobia are to be avoided. These sectors must be granted time to enable them to restructure, and domestic workers allowed time for retraining. A gradual extension of the principle of the free movement of labour would also

⁹ Cf. Michele Bruni and Alessandra Venturini, Pressure to Migrate and Propensity to Emigrate: The case of the Mediterranean Basin, in: *International Labour Review*, vol. 134, 1995, no. 3, pp. 377 – 400.

avoid a shock impact that may induce sudden migration. During the transition period the EU (15) will have to take effective measures to reduce the high level of unemployment – and this will, of course, serve to make the EU even more attractive. Those arguing that an extended transition period would prevent completion of the Single European Market need to be reminded that even now the single market still exhibits gaps and imperfections – particularly in the area of taxation – and it is not even clear when these will, respectively, be closed and rectified.

should not be achieved given the fact that the east central European countries, which constitute a "natural" reservoir for recruiting immigrants to Germany, Austria and Scandinavia, can be assumed to be highly cooperative, not least in view of their desire for closer ties with the EU.

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Positive longer-term effects of managed immigration

In the longer term, permanent immigration of young people from eastern central Europe would not prove harmful to Germany and the other west European countries, it would be a substantial benefit. Immigrants serve to stabilise demographic age structures and social security systems. In the absence of migration the German population would decline between 1993 and 2010 from more than 81 million to 73.5 million. By the year 2040 the population would be down to just 60 million. The labour force would decline from 40.5 to 36.5 million by the year 2020. Positive net immigration of 300 000 p.a. would serve to stabilise the size of the population and increase the labour force by 2 million. This figure is broadly in line with the average net immigration to Germany over the period 1989 to 1996. Even in the northern Mediterranean countries (France, Italy, Spain, Portugal and Greece) the substantial rise in the working population during the 1980s – 10 million – will soon be reversed, with a decline forecast for the coming decade.¹⁰

Net immigration makes it easier to maintain the "contract between the generations" embodied in the system of social security. However, if the overall fiscal and economic effects in the target countries are to remain positive, and the social tensions and xenophobia resulting from immigration mentioned above are to be avoided, the structure of immigration must be selectively steered from the outset. This steering should follow demographic and labour market-related criteria, should involve as few allocative efficiency distortions as possible¹¹ and will require support in the form of integration programmes. There is no reason why this

¹⁰ Bruni/Venturini, op. cit. p. 390.

¹¹ Cf. Thomas Straubhaar and Klaus F. Zimmermann, Towards a European Migration Policy, in: *Population Research and Policy Review*, 12/1993, p. 232.