

## Erkki Liikanen: Internal migration in Europe

Speech by Mr Erkki Liikanen, Governor of the Bank of Finland, at the Conference by the Economic Council of Finland and the European Economic and Social Committee, Helsinki, 4-5 September 2006.

\* \* \*

Monetary policy has no direct connection to labour mobility, whether occupational or geographical, but important links can be found. According to the so-called 'optimal currency area' theory, factors of production – labour included – should in principle move flexibly within the euro area.

This is not the case, even though there are no formal limits on migration within the euro area. Rigidities of mobility manifest themselves in varying degrees of unemployment in EU countries.

When talking about internal migration in Europe, and especially within the EU, it is important to bear in mind that it is a part of a much greater, global reallocation of labour and capital.

Following the opening up of the international economy, developed countries have been compelled to confront the strong expansion of a proportion of labour in the world economy. Work is flowing even from the new member states to countries where wages are lower. Labour is also moving to countries where wages are higher.

Following these changes, productivity in the world economy will improve, and wages and prices increases slow down in developed countries. This development has supported low level of interest rates.

The enlargement of the EU has resulted in a higher proportional increase in labour than in capital in the EU. Yet, compared to the global change, the shift in the EU's internal production factors has been very small.

Although internal migration of labour and capital within the EU has attracted a great deal of attention – at times passionate one – its advantages and disadvantages seem to remain much weaker than initially thought. A massive flow of migration from the new member states to the old has not materialised.

Although Europe's internal migration of labour and capital shares common features with global problems, important differences can also be found.

As to intra-European migration, a positive difference relative to the global situation is the fact that the general level of education in both old and new member states is more or less the same. This naturally facilitates and speeds up integration of economies significantly and is likely to reduce the need for labour migration.

The high level of education in new member states has accelerated the shifting of functions requiring highly qualified personnel, such as IT functions, to new member states. The level of pay of highly educated labour has increased in new member states, while in the old member states the growth rate of comparable salaries has slowed down. The purchasing-power-adjusted difference in the standard of living has narrowed down.

In some professional groups, however, such as doctors and nurses – who in earlier communist times were notoriously badly paid – emigration has been wide, causing substantial problems to the countries which have been drained of employees in these professional groups.

It is nevertheless evident that the majority of people prefer to remain in their home lands. The need for labour to migrate will decrease if capital moves towards labour. This has, in fact, happened broadly throughout Europe.

Differences between global developments and the EU's internal development can also be found in capital flows. Developments within the EU have followed the 'normal theory', investment has flowed from wealthy economies to economies with a low capital stock. In contrast, global developments have taken the opposite direction: investment has flowed from developed and from not so developed economies with surplus to the United States. This has been the cause of a major debate.

Investment flows to new member states are generally reflected in large current account deficits in these economies. These imbalances in financing conditions must be taken into account in economic policies and at central banks. A large current account deficit is often a serious problem, but not always.

If the deficit is financed through a stable and long-term arrangement and the funds are directed in effective real investment, a large current account deficit is an indication of the strength of the economy, rather than of its weakness.

By and large, deficit financing in the new member states is quite reliable. Arrangements such as internal financing in international corporations have already been experienced.

Yet, the rate of indebtedness of some countries raises certain doubts.

It can be taken as a positive development that the primary reason for the transfer of investment capital does not seem to be only the member states' cheaper labour, but largely companies' desire to establish their presence in new member states' rapidly growing markets and to diversify their supply chain.

Although capital flows in the EU are free from currency regulation, flexible movement of capital even within the euro area is not fully effective. European financial market integration is still not complete. Many surveys show that higher depth and liquidity and improving the efficiency of payment transfers and the securities markets would make a substantial contribution to transforming the structures of the economy.

Movement of labour is complicated by a number of problems. It is difficult for individual people with poor language skills to move to a foreign country and take up jobs that are below their qualifications. Countries that lose labour, are deprived of an active labour force, and pressures can aggravate differences in salaries. In the receiving countries, in contrast, employees often reject newcomers as competitors that are willing to work for considerably lower pay.

Long-term advantages may nevertheless greatly benefit all parties. Economic growth in the receiving country accelerates and over time, the salary levels of old employees in the competed sectors also increase.

An important factor in the present migration movement is also that the emigrants are more likely to return home than earlier. Recent evaluations show that nowadays most emigrants will eventually return home, bringing with them improved skills and accumulated wealth, with which they facilitate economic development in their home region.

It is evident that a broad migration in both directions will significantly contribute to improvements in productivity and economic activity within the EU. It will improve the level of education, the transfer of know-how from country to country and networking. These matters must be taken seriously and must be emphasised, even when faced with the problems associated with migration.

For the sake of balance it is, of course, important to aim at relatively modest net migration flows. It is evident, for example, that population ageing will affect all EU countries; it is unlikely that any of them will be able to handle the challenge primarily by attracting young population from other EU countries.

Migration is – and of course has to be – primarily market-driven. To the extent that changes in the production structure seem unavoidable, they should not be retarded through economic policy; rather, support should be provided in the event of problems caused by these changes. Problems in the transition period must also be acknowledged, but the advantages generated as a result of the changes should be emphasised.

Member states and the European Commission have already provided wide support to the free movement of labour by removing obstacles that limit migration and introducing active measures that facilitate migration. Support should be channelled to workers rather than work places. Re-education as well as occupational and geographical support and security in connection with migration are key measures that governments should take in order to facilitate the reallocation of labour force.

The ECB and other central banks within the EU can enhance the regional and professional allocation of labour force by improving the integration and efficiency of financing markets and payment systems throughout the area. This development work must naturally be shared by governments.

To conclude, there still remains much to be done to improve the situation.