



## The macroeconomic consequences of migration diversion: Evidence for Germany and the UK

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### ABSTRACT

This paper examines the macroeconomic consequences of the diversion of migration flows away from Germany towards the UK in the course of the EU's Eastern Enlargement. The EU has agreed transitional periods for the free movement of workers with the new member states from Central and Eastern Europe. The selective application of migration restrictions during the transitional periods has resulted in a reversal of the pre-enlargement allocation of migration flows from the new member states across the EU. Based on a forecast of the migration potential under the conditions of free movement and of the transitional arrangements, we employ a CGE model with imperfect labour markets to analyse the macroeconomic effects of this diversion process. We find that EU Eastern enlargement has increased in the GDP per capita in the UK substantially, but that the diversion of migration flows towards the UK has reduced wage gains and the decline in unemployment there. The effects of the EU Eastern enlargement are less favourable for Germany, but the diversion of migration flows has protected workers there against a detrimental impact on wages and unemployment.

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### 1. Introduction

This paper examines the macroeconomic consequences of the diversion of migration flows during the transitional periods for the free movement of workers in the course of the Eastern enlargement of the European Union (EU). The EU has admitted eight new member states from Central and Eastern Europe in 2004<sup>1</sup> and another two countries

in 2007.<sup>2</sup> The income gap between the incumbent and the new member states is in case of the EU Eastern enlargement larger than in previous accession rounds. At current exchange rates, the gross national income per capita of the ten new member states (NMS-10) amounts to 21 per cent of the EU-15, and – measured in purchasing power parities – to roughly 40 per cent of the EU-15 at the outset of accession in 2004 (World Bank, 2009). This large income gap has fanned fears that the removal of immigration restrictions will yield a mass migration wave which will subsequently depress wages and increase unemployment in the incumbent EU member states.

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<sup>1</sup> The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia joined the EU at May 1, 2004. Cyprus and Malta also joined the EU in 2004, but the transitional periods for the free movement of workers do not apply to them.

<sup>2</sup> Bulgaria and Romania joined the EU at January 1, 2007.

Against this background the EU-15 countries decided at the Goeteborg summit of the European Council to impose transitional periods for the free movement of workers from the NMS. The so-called “2+3+2” formula allows the individual member states to suspend the free movement of workers for a period of up to seven years. An extension of the transitional arrangements for the free movement of labour is first considered after two years, then for a second time after three years. A second prolongation of the transitional period requires that the member state announces serious imbalances in its domestic labour market. However, the application of transitional arrangements for the free movement remains a sovereign decision of the individual member state.

In the course of the 2004 enlargement round, only Sweden applied fully the Community Law for the free movement of workers since the beginning, and the UK and Ireland opened their labour markets without restrictions. Although most other EU member states have opened their labour markets partially by granting work permits for seasonal workers, (small) immigration quotas or by concluding bilateral guestworker agreements, the remaining migration restrictions can be regarded as relatively tight in the sense that they effectively hindered labour migration between the new and the incumbent member states.<sup>3</sup>

The selective application of migration restrictions during the transitional periods had two effects: First, the existing restrictions have hindered migration such that total migration into the EU is presumably lower than in case of an EU-wide application of the Community Law for the free movement of workers. Second, migration flows have been diverted away from the preferred destinations towards countries which have opened their labour markets immediately after the EU Eastern enlargement.

Table 1 presents the migration development in the course of the EU Eastern enlargement. Migration data are poorly reported in most EU member states, such that some uncertainty surrounds the estimates of the actual scale of east-west migration.<sup>4</sup> Based on the information of those countries which provide migration figures by country of origin and on the information of the European Labour Force Survey (LFS) for those countries which do not, we can estimate the net increase in the number of foreign residents from the NMS-8 in the EU-15 at about one million people or about 250,000 persons per annum during the first four years following the EU's Eastern enlargement.<sup>5</sup> First data suggest that migration flows from the NMS-8 into the EU-15 have contracted in the course of the financial crisis, but EU wide data which would provide a comprehensive picture are not yet available.

<sup>3</sup> For details see European Commission (2006, 2007) and Brücker et al. (2009a).

<sup>4</sup> This is particularly true for Ireland and the UK, the main destinations of migration from the NMS since enlargement. For a detailed examination of the UK immigration data see Blanchflower et al. (2007) and Brücker et al. (2009a).

<sup>5</sup> Note that the number of foreign residents from the NMS-8 in Table 1 would have been about 70,000 persons higher in 2005 and 2006 if Germany would have not revised the foreigner statistics.

This increase in the migration flows is associated with a distinct diversion of migration flows away from Germany and Austria as the main destinations prior to Enlargement towards the UK and Ireland: In 2003, the year before the EU's Eastern enlargement, nearly 60 per cent of the foreign citizens from the NMS-8 residing in the EU were registered in Austria and Germany. This share has fallen to 41 per cent in 2007, while that of the UK and Ireland has increased to 52 per cent. At a net increase of the foreign population of 166,000 persons per annum in the first four years following the EU Eastern enlargement, the UK and Ireland receive 70 per cent of the net inflows since 2004 compared to 18 per cent before enlargement. In contrast, Austria and Germany receive only 18 per cent of the inflows since 2004.<sup>6</sup>

Interestingly enough, this diversion process did not affect the Scandinavian countries: although Sweden has opened its labour market completely and Denmark largely, the cumulative net migration flows into these two countries have been – at some 34,000 persons – almost negligible in the first four years since enlargement. Language, and, perhaps, differences in labour market institutions, might have also played an important role in shaping the direction of east-west migration flows (Ivlevs, 2007).

In this paper we analyse the macroeconomic effects of this diversion process for the two economies which are mainly affected in absolute terms, Germany and the UK. We apply different policy scenarios for identifying the macroeconomic effects of migration diversion. The first policy scenario simulates the case that the status quo regarding the immigration conditions is maintained until the end of the transitional periods in 2011, i.e. that Germany has a restrictive immigration policy in place while the UK keeps the doors for labour migration from the eight new member states from Central and Eastern Europe (NMS-8) open. The second policy scenario relies on the counterfactual assumption that both Germany and the UK have opened their labour markets for migrants from the NMS-8 already in 2004, which implies that Germany receives more and the UK less migrants. The comparison of these two scenarios enables us to analyse the effects of the diversion of migration flows from Germany to the UK.

The migration scenarios are based on forecasts of the migration potential from the NMS-8. We proceed in two steps to derive our scenarios. First, we estimate the aggregate migration potential from the NMS-8 into the entire EU-15 under the conditions of free movement and of the transitional arrangements, using the recent migration episode from the NMS and the migration experience from other countries for identification. Second, we derive the migration scenarios for Germany and the UK from reasonable assumptions about the allocation of migrants between the EU member states under free movement and the transitional arrangements.

<sup>6</sup> We have corrected for the revision of the migration statistics in Germany by using the net immigration figure for the increase of the migration stock in 2005 in the calculation of the net inflows and estimated the immigration stock in Ireland at 20,000 persons by the end of 2004.

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