

Free Movement of Workers after Enlargement: The ignored substitution effects!

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As a general rule, immigration is a good thing for receiving countries regarding their GDP (not GDP per capita!) and overall employment level. But some vulnerable groups are negatively affected in terms of wages and unemployment. Let's have a closer look at the latter, although this is not an easy task at least for two reasons: Firstly, political correctness doesn't like us to talk about substitution effects of immigration. And, secondly, if you start talking about substitution effects, you easily find yourself in a situation of doing the job for right wing political parties – but who would like to be in that position?

In General

In a theoretical (textbook) framework immigration shifts the supply curve to the right, increasing overall employment levels but reducing the employment of nationals; substitution effects depend on the elasticities of demand and supply curves. Beyond that, immigration has a dampening effect on wages. Of crucial importance in this reasoning is the assumption of foreign and native workers being perfect substitutes. This might be the case for unskilled workers and persons with same qualifications, motivation and reservation wages. If their skills and competences are complementary, then immigration will even increase employment of nationals. These positive effects are particularly large when migrants fit to vacancies which couldn't be filled with natives. All in all, theory cannot predict the relation of immigration and employment of natives a priori; only empirical evidence can!

Anyway, employers normally like immigration because more labour supply has dampening effects on wages and more competition on the labour market makes it easier for employers to pick and choose. And normally, migration has positive effects for migrants themselves. But some labour market groups in the receiving countries – usually the ones with the same skills and competences as the immigrants – have to face negative effects regarding their incomes and employment probabilities. There are substitution effects!

Empirical research¹ normally concludes that an increase of the share of foreigners in total employment by 1 percentage point reduces wages of national employees in the short run by some 0.1%. In many studies, the correlation between immigration and wages or employment probabilities of nationals is insignificant. But these results might be due to "measurement errors" - this is my main point I would like to raise: You will not be able to detect substitution effects if you average out on a two large scale, i. e. for several years or for sectors on a national level. If you would allow your data to reveal substitution effects, you have to look on a regional and sectoral level, regarding occupations, skills and competences of migrants and nationals.

The long run empirical evidence of the labour market impact of immigration in Austria since 1989 is inconclusive in so far as measured at national level. But there are signs of displacement: Since the breakdown of the Iron Curtain employment of Austrian nationals increased by 8.8%, employment of non-nationals increased by 192.1%. In the same time, the unemployment rate of early school leavers increased by 94.6% (from 9.2% to 17.9% according to national definitions). Wage increases in Austria were quite moderate in this period. The yearly changes in employment show in many cases a parallel increase of both, nationals and foreigners. But in 2010, for example, 93% of overall employment increases was non-national, in 2011 the same figure was 61.2%. Beyond the overall situation at the national level, there is one important feature of immigration to the Austrian labour market, in

To conclude

Like it or not: Immigration leads to substitution effects of domestic workers, at least to some extent. To ignore and deny the problems of the negatively affected vulnerable labour market groups would be a politically risky strategy.

References

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¹ See for example Longhi et.al. (2004), Huber/Bös (2012) and Bock-Schappelwein (2008).

² See for example SEJ 11/10/2012, EU Labour Migration during the Crisis by Bela Galgoczi and Jeanine Leschke.

³ For details see Schweighofer (2012), p. 609ff.