# LABOR MARKET AND EU ENLARGEMENT: IS THERE A REAL THREAT FOR EU – 15?

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**Global competition and the need for reforms in the EU**

The general implications of globalization as well as those resulting from 2004 and 2007 enlargements have forced EU to think seriously about approaching issues related to rigidity and stagnation in the major EU economies. The problems are well known and recognized. Their solution implies anyway to accept a number of liberal measures characterized by competitive labor markets and mobile capital. In this context, during the British presidency of the second half of 2005 Tony Blair mentioned clearly the areas which needed reform (although he was not very popular because of that): labor markets, energy dependency, innovation, falling demographics, and the need for balance between work and lifestyle[1].

In fact it seems that the citizens of EU-15 resent above all the idea of competition be it due to globalization or to enlargement. EU-15 has a labor force used to the comfortable benefits of the welfare state and quite unhappy to change or give up any of that. If we compare the 35 hours working week in France with the 7 days a week work in China we can quite easily understand why competition due to globalization is an ugly world for many Europeans.

To a less extent the same reaction holds true for the position vis-à-vis the new EU member states from Central and Eastern Europe. As someone noted, "Western Europe used to be afraid of invading Warsaw Pact troops. Now Western Europe fear an invasion of Polish plumbers!"

In 2004, when 10 countries have joined the European Union 73 million new EU citizens acquired the right to settle in all other EU member states. Anyway they did not get at the same time full access to the EU labor market because free movement of workers has been temporarily postponed for up to seven years.

Immediately after the 2004 enlargement 12 out of the 15 "old" EU member states restricted access to their labor markets for citizens of new EU member states. During the period 2004-2006 Ireland, Sweden and the United Kingdom did not implement such restrictions, while countries like Austria, Italy and the Netherlands offered labor permits on a quota base.

In 2006 Finland, Greece, Portugal and Spain finally decided to give EU citizens from Central Europe and the Baltic States (EU8) full access to their labor markets. In 2007 the Netherlands are likely to follow their example.

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[1] Dale (2005).

It is interesting to note that, as result of their option, the United Kingdom and Ireland have experienced robust economic growth. There migrant labor from new EU member states has played a vital role in achieving this result.[1]

By October 2006, less than 3 months before the EU enlargement with Romania and Bulgaria, new debates emerged the EU-15 media on the risks for their labor market associated with an open labor policy. For instance, the British government is planning to restrict the numbers and categories of workers from Bulgaria and Romania who wish to come to the U.K., even after those two nations join the European Union on January 1, 2007.

This type of mixed reactions asks for a more in-depth analysis. Which is in fact the real problem in the EU-15 labor market ? And, more generally, which is the problem with the EU-15 economy in the global context ?

**EU's competitivity dilemma: to reform or not to reform ?**

The difficulties experienced by the EU-15 member states in the context of economic global competition require flexibility and reform in response to the fast changes determined by globalization. The EU's dilemma is: to reform and become more competitive internationally but in this way to affect the welfare state and generate negative reactions from voters or to postpone or soften the required reforms and to further lose ground in the global competition game ?

Up to now the second option prevailed and attempts to do some serious reforms (like in Germany or France) determined quite serious negative social reactions.

In fact, if we reduce globalization to competition, then EU has to reduce costs in order to remain competitive and, in order to do that there are, among others, two ways of action:

- increase the use of immigrants (in a US style). This is not new, the use of immigrants was used for instance by West Germany some decades ago. Starting from the early 1960s and well into the 1970s, large numbers of Turkish nationals migrated to Western European countries, particularly West Germany. This phenomenon started with an agreement signed by the Turkish and West German governments in 1961. The agreement coincided with a West German economic boom which lasted until the economic downturn in Western Europe that arrived with the oil crisis of 1973[2]. Interesting to note, in 2006, many Western European countries started to think about a selective acceptance of foreign labor based on skills and qualifications.
- Enlarge towards Central and Eastern Europe in order to achieve economies of scale and a regulated access to cheap labor.

From a political perspective it is obvious that the second approach is much more favorable from all points of view. Among other things, the second solution solves not only labor issues but also boosts exports and allow access to a significant amount of resources. Even more, enlargement could be also supporting the needed reform of EU institutions just because 27 member states require new institutional and organizational rules and even the most conservative members could not deny this reality.

[1] Zackrisson (2006).
[2] Kirisci (2006).

**EU enlargement as an acceptable reform that improves competitivity**

Estimates calculated after the first two years showed that the enlargement has had a positive economic impact on all EU member states, the gains being obtained mostly in trade and investment. Some EU countries, in particular Austria and Germany, have done particularly well out of exporting to Central and Eastern Europe's fast-growing markets. And many West

European companies have profited substantially from investing in retail, telecoms, energy or the media in the new EU member states.

At the same time the EU enlargement towards Eastern Europe improved the region's competitiveness in a globalized world. The price of enlargement was very convenient as it amounted to less than 0.1 % of the EU's combined GDP.

Some analysts consider anyway that the main bonus of the enlargement is not the positive economic impact but rather the fact that the enlargement has forced EU's economy to start making the reforms required to maintain competitiveness in a globalized world. From this perspective the enlargement has been EU's "trial run" for globalization.

The rationale for this explanation is that the economic integration between Western and Eastern countries began at a time when global competition put an increasing pressure on the EU-15. Companies from EU-15 responded by outsourcing labor intensive production to low-wage areas in Eastern and Central European countries. This happened not only due to the geographical location of the Eastern European countries, but also due to the fact that the enlargement process continued to diminish the differences between the business environments in the old and new EU countries.

**Enlargement, labor movement within EU and economic growth: the need for a better understanding**

In fact outsourcing of production from Western to Eastern Europe has enabled more Western European companies to maintain their competitiveness. Enlargement has determined a new European division of labor in which the lost factory jobs in the Western part were replaced by new jobs in development, research, and design[1].

We can quote here some foreign investors in Romania that said that without relocating their operation to the East they would be out of business due to global competition. At the same time German car companies, Swedish mobile phone producers and Italian fashion houses have reacted to heightened global competition by shifting some production processes into Eastern Europe, where wages are cheaper.

This changes forced the European companies to meet the challenges of increased international competition, to streamline their businesses, and to make the hard, but necessary decisions. In this way enlargement represented a true training room for globalization.

From an economic point of view the enlargement towards Central and Eastern Europe may be exactly what the EU needs to return to higher growth. The new members are too small to act as an economic engine for the slow growth euro zone. However, the availability of a large pool of low-cost, highly skilled workers at their doorstep has helped

[1] Jensen and Christensen (2006).

West European companies to better cope with globalization. And it has put pressure on governments in the old EU to make their labor markets more flexible and their business environments more attractive[1].

The next step is more difficult: the political system in the EU should adapt to the changes that took place in economic areas.

For EU enlargement can be a successful policy tool only if it decides to deal with the misperceptions that fuel public opposition to enlargement. EU decision makers have to explain how enlargement has benefited both Western and Eastern Europe.

EU officials have to explain that globalization would have forced Western Europe to change anyway, and that enlargement has helped many West European companies to stay competitive. At the same time Western European politicians should stop exploiting fears of an invasion of Eastern European low cost immigrants and instead pursue the kind of reforms that would allow their economies to benefit from a larger participation of East European workers. A key point is to understand that reforms are to be done not because of enlargement but because of globalization.

The fact that this public awareness campaign on the benefits of enlargement to Western Europe is far from being effective is well understood in Romania where one can read in the pre-accession period until January 1, 2007 almost daily about negative reactions in the old member states on the possibility of waves of low cost labor from the new member states invading the labor market in Great Britain, Germany or France.

And yet the reality is just the opposite. A recent survey carried out in 2006 by the Caixa Catalunya Savings Bank (Spain) showed that the GDP per capita in Spain in the past 10 years (1995 – 2005) would have been decreasing by 0.6 % without the 3 million immigrants, many of them from Central and Eastern Europe. In fact, these immigrants contributed themselves with about 2.6 % of each year's GDP growth in Spain. During the decade 1995 – 2005 immigration was responsible for more than 50 % of employment growth in Spain.

At the same time, without immigration, per capita GDP growth in Ireland would have dropped from 5.9 % a year to 1.1 %, and in France, from 1.6 % a year to 0.3 %. In most European countries, economic activity would have posted negative rates without the labor of foreign nationals, particularly in Germany (-1.5 % a year) and Italy (-1.2 % a year)[2].

The Caixa Catalunya study showed that the contribution of immigrants to economic growth in the EU as a whole has averaged 2 % a year over the last 10 years. Without their presence, GDP growth per person would have fallen to -0.2 percent a year.

The same survey showed that the GDP per capita in many European Union countries like Great Britain, Germany or Sweden would have decreased without the cheap labor from the Central and Eastern Europe.

The fact that EU is still far from a pragmatic approach to globalization is also supported by the proposal made by the European Commission in 2005 for the establishment of a Globalization Adjustment Fund, which will give an average of $10,500 each to approximately 50,000 workers a year who lose their jobs because of competition.

[1] Barysch (2006).

[2] Alfieri (2006).

The proposal of this Fund is a proof that subsidies are proposed a lot quicker than reform[1].

This concept of a Globalization Adjustment Fund is not tied to education, research and development, and the other preconditions necessary for the creation of job growth. It is not clear how this Fund will compensate when a member state loses jobs because of competition from a neighboring member state. With corporate tax rates ranging from single figures to nearly 50% within the EU25, competition among EU member states may prove more dangerous than China or India.

What would be the solution ? Western Europe needs to improve its entrepreneurship, innovation and dynamism, not protectionism or social protection. And in this respect, maybe once again, EU may look to the US model.

The United States has faced the same economic pressures as the rest of the world, and its tax-cutting, low-regulating, high-tech investment strategies have thus reaped the rewards of global growth. It is easier to get fired in the United States, but it is also a lot easier to find another job relatively quickly.

This economic mobility has seen unprecedented social mobility in all quarters of society, most notably among immigrants and young people.

For EU a combination of liberal reforms with large public awareness campaigns related to the benefits of enlargement towards Central and Eastern Europe would definitely help in turning globalization from a menace to what it really is: a giant opportunity.

This is why we consider that after 2004 and 2007 enlargements EU would be better if accepts a deepening of the liberalization of its markets, particularly of the labor market, instead of being afraid of it.

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[1] McNamara (2006).