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Emigration and wages: The EU enlargement experiment

Benjamin Elsner *

Institute for the Study of Labor (IZA), Germany

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ABSTRACT

The enlargement of the European Union provides a unique opportunity to study the impact of the lifting of migration restrictions on the migrant sending countries. With EU enlargement in 2004, 1.2 million workers from Eastern Europe emigrated to the UK and Ireland. I use this emigration wave to show that emigration significantly changed the wage distribution in the sending country, in particular between young and old workers. Using a novel dataset from Lithuania, the UK and Ireland for the calibration of a structural model of labor demand, I find that over the period of five years emigration increased the wages of young workers by 6%, while it had no effect on the wages of old workers. Contrary to the immigration literature, there is no significant effect of emigration on the wage distribution between high-skilled and low-skilled workers.

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1. Introduction

Lifting the barriers to migration can lead to welfare gains of up to 150% of world GDP (Clemens, 2011). However, while a large body of literature has quantified the gains from migration for the receiving countries and the migrants, little is known about the impact of emigration on the sending countries. Given that migration is heavily restricted, there are few episodes of large migration waves that can be exploited to assess the impact of the lifting of these restrictions on the sending countries.[1]

This paper exploits a large emigration wave from Eastern Europe to analyze the impact of emigration on the wages of non-migrants in the sending countries. Following EU enlargement in 2004, the UK, Ireland, and Sweden opened their labor markets to workers from Eastern Europe, which prompted a migration wave of 1.2 million workers over 3 years. Indeed, the most-affected sending countries – Latvia, Lithuania, Poland and Slovakia – experienced an outflow of up to 9% of their workforce.[2]

To estimate the wage effects of emigration, I use a structural factor demand model (Card and Lemieux, 2001; Borjas, 2003). I first take a snapshot of the labor market prior to EU enlargement by estimating the model parameters using microdata from Lithuania. Based on observed immigration data from the UK and Ireland, I then simulate the emigration wave and calculate the wage change as the difference between the equilibrium wage before and after the migration wave. Compared to a reduced-form analysis, this approach allows me to isolate the effect of emigration from other factors that would otherwise impact wages, such as trade, FDI and TFP growth. Furthermore, it also delivers separate wage effects for groups of workers with different education and work experience, thus allowing for an assessment of the distributional impact of emigration.

The main finding is that emigration had a significant impact on the wage structure, and particularly on the wage distribution between old and young workers, causing a substantial wage increase for young workers yet no effect on the wages of old workers. By contrast, I find no difference in the wage effects between high- and low-skilled workers. These wage effects can be decomposed into an own-wage effect, caused by the emigration of workers with the same observable characteristics, and general equilibrium effects, caused by the change in the skill distribution of the workforce. The own-wage effect is positive; namely, a decrease in the number of workers increases their wage, while the sum of the general equilibrium effects, caused by the change in the demographics of the workforce, is negative. The own-wage effect dominates for young workers, who represented the majority of emigrants, while for older workers the two effects cancel each other out.

These findings stress the importance of labor market externalities in the assessment of the welfare impacts of emigration. Eastern Europe

* Schaumburg-Lippe-Str. 5-9, 53113 Bonn, Germany. Tel.: +49 228 3894 522.
E-mail address: elsner@iza.org.*URL:* http://www.benjaminelsner.com.

[1] See Kerr and Kerr (2011) for a review of the immigration literature. Estimates for the gains on the side of the emigrants can be found in Chiswick (1978), Borjas (1995), and Algan et al. (2010).

[2] Own calculations from work permit data.

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experienced a large outflow of young workers – a *youth drain* – from all education levels. Through the price mechanism of the labor market, the wages of young workers increased more than the wages of older workers. However, most literature on the sending countries assumes away these labor market effects, focusing instead on the human capital externalities. In this literature, high-skilled emigration changes the incentives of non-migrants to invest in education, which can have a negative "brain drain" or a positive "brain gain" effect (Gibson and McKenzie, 2011; Docquier and Rapoport, 2012) on economic growth. While indirect effects may be important for developing countries, this paper finds that the direct wage effects of emigration play a significant role in middle-income countries.

Given that the emigration wave from Eastern Europe was a sudden shock to labor supply, it allows for the identification of a short-run effect on wages. Moreover, the results have a clear interpretation, since all migrants left within a short period in time. By contrast, previous studies on the wage effect of emigration by Mishra (2007) and Aydemir and Borjas (2007) focus on longer time horizons, both finding a positive long-run impact in Mexico between 1970 and 2000. However, the results have to be interpreted *as if* all workers had left the economy at once, despite actually having left gradually over the last 50 years (Hanson and McIntosh, 2010). Dustmann et al. (2012) study a case similar to that in this paper — emigration from Poland, although the emigration wave in their period of study was rather small, with 2% of the workforce emigrating between 1998 and 2007. Recent evidence from quasi-natural experiments (Elsner, 2013; Gagnon, 2011) shows that emigration increases wages even in the short run. However, both studies use a reduced-form approach, only allowing them to determine an average effect. In this paper, I show that these wage effects only benefit the young workers. Moreover, a comparison with the reduced-form results of Elsner (2013) demonstrates the importance of the general equilibrium effects, without which the predicted wage changes would be considerably higher.

This paper also highlights the importance of wages as an adjustment channel to labor supply shocks in countries of origin. By contrast, the small effects of immigration on wages in migrant-receiving countries found in most studies imply that other channels are more important. Hanson and Slaughter (2002) and Lewis (2003) find that labor supply shocks in US states are mainly absorbed within industries. Industries switch to technologies that are more complementary to the increased type of labor, while there is little evidence of a change in the output mix towards goods produced intensively using the type of labor that has increased most (i.e. the Rybczynski effect). Gandal et al. (2004) and González and Ortega (2011) find similar results for the large immigration waves in Israel and Spain, respectively. Dustmann and Glitz (2011) show that the switching of industries to complementary technologies can be explained by firm entry and exit, given that new firms have no adjustment costs. However, the non-negligible wage effects of emigration found in this paper imply that other adjustment channels must play a lesser role than in receiving countries, with further research required to shed light on this issue.

Finally, this paper reveals that migration affects sending and receiving countries along different skill dimensions. In contrast to most studies on immigration, which find the main distributional effect between high-skilled and low-skilled workers (Borjas, 2003; Manacorda et al., 2011; D'Amuri et al., 2010), I find a significant distributional effect between old and young workers. The wage effect is larger in Eastern Europe than in the main receiving countries, which can be explained by the low degree of substitutability between old and young workers in transition countries: old workers in Eastern Europe were educated under socialism, while young workers received their education in a market economy. Therefore, young workers cannot easily be replaced by old workers, resulting in a stronger reaction of wages on emigration.

The remainder of the paper is structured as follows. Section 2 provides a historical overview and stylized facts concerning the emigration wave from Eastern Europe after 2004. Section 3 sets up the structural model. Section 4 describes the data sources that are used for the estimation of the structural parameters in Section 5. Section 6 details the simulation of the migration wave and calculates the wage effects. Section 7 concludes.

2. EU enlargement, migration and wages: stylized facts

This section provides an overview of EU enlargement and the subsequent migration wave from the new to old member states of the EU. In 2004, eight former socialist countries from Central and Eastern Europe joined the EU, with the high wage differentials between Western Europe and the accession countries creating a large incentive for workers from these countries to emigrate.[3] *Freedom of Movement*, a basic principle of the EU, guarantees every worker from the New Member States the right to migrate to any EU country and take up employment. However, only Ireland, the UK and Sweden immediately opened their labor markets and experienced a large influx of immigrants. Most other countries in Western Europe were concerned with potential negative consequences for their labor markets and welfare systems, and restricted the access for workers from the New Member States for up to 7 years. Between 2004 and 2007, 1.2 million workers migrated from Eastern Europe to the UK (770,000), Ireland (416,000) and Sweden (19,000).[4]

Most migrants came from Poland, Latvia, Lithuania and Slovakia. Despite Poland having the highest number of emigrants, Lithuania and Latvia had the highest share of emigrants. Between 2004 and 2007, 9% of all Lithuanian workers and 6% of all Latvian workers received a work permit in Ireland or the UK. While some workers only migrated for a short period, the majority stayed in the destination country for longer periods, with evidence from the Irish Central Statistics Office (2009) suggesting that around 60% of migrants from the New Member States stayed for at least two years after having received a work permit.

This study takes Lithuania as an example to study the impact of emigration on the wages of stayers. Lithuania presents an interesting case as it had the highest share of emigrants among the accession countries. At the same time, the results are externally valid with respect to other transition countries. For instance, Poland, Slovakia and Latvia share the same history of transition as Lithuania since the fall of the Iron Curtain in 1990. In addition, they were in a similar economic situation at the time of EU enlargement, with comparable levels of GDP per capita and unemployment.[5] Accordingly, an outflow of 9% of the workforce should have similar impacts on the wage structure in all four countries.

The number of work permits per year issued to Lithuanians increased sharply from 6400 in 2003 to 40,000 in 2006.[6] Around the same time, Lithuania experienced a phase of high economic growth, with GDP per capita growing in total by 37.5% between 2002 and 2006, which was also accompanied by a phase of considerable wage increases. The graph on the left in Fig. 1 shows the changes in average real wages for workers in different education and experience groups.

Although all groups gained, the wage changes were not spread evenly across groups of workers. Indeed, young workers with a work experience of up to 20 years gained considerably more than old workers. Furthermore, wage changes were on average larger for low-skilled workers. These uneven wage changes resulted in a change

[3] The difference PPP-adjusted GDP per capita, a proxy for wage differentials, amounted to 37% in Lithuania and 40% in Poland, compared to the UK. Source: Eurostat.

[4] Sources: Ireland: Central Statistics Office. UK: UK Home Office. Sweden: Wadensjö (2007).

[5] In 2004, the GDP in current prices was between EUR 4800 (Lithuania) and EUR 6300 (Slovakia), considerably below the average of the old member states withEUR 26,000. Source: Eurostat.

[6] See Table 1B.

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