Creating a common market for labour economics essay

ASSIGN BUSTER

Who benefits and who loses when a common market for labour is extended to more countries? Explain your answer with reference to (a) economic theory and (b) EU experience.

This essay is going to look at the benefits/loses when a common market for labour is extended to more countries with reference to economic theory and the European union experience.

A common market is a Group formed by countries within a geographical area to promote duty free trade and free movement of labour and capital among its members. European community (as a legal entity within the framework of European Union) is the best known example. Common markets impose common external tariff (CET) on imports from non-member countries. When a common market for labour is extended to more countries member states have always feared their economies would hurt due to the cheap labour coming from inferior nations. Since labour mobility is part of the core freedoms in the Union, the Treaty of Rome that was put into effect in 1958 committed member states to allow for the free movement of labour. This veiled that nothing would stop labour from moving within member states and there will be no discrimination against workers based on their nationality.

In order to determine the effects of creating a common market for labour we have to

See how wages are determined within these economies and why they differ? Wages are determined by the marginal value of productivity (MVP) of the last labour unit employed in a firm, this is because the company can only afford to hire workers if they generate enough output to cover the costs of Thus

wages are formulated where: conversely, the marginal value of productivity is different amongst countries within the European union for different reasons. e. g. A polish worker that has had the ability to benefit from a good state education system that teaches its students a wide variety of skills will have higher marginal value of Productivity than a worker from Sweden that was not able to finish high school. Also, the capital employed in Poland allows workers to maximize their marginal value of productivity since machinery employed Poland is more industrially advanced than machinery used in Sweden. Secondly, if workers in Poland receive more social benefits due to the institutional environment that drives for minimum wages and more privileges to workers will mean the workers will be ready to work harder. Hence from comparing of Poland and Sweden we have been able see that marginal value of productivity will be more in the wealthier nation, the wages will be higher and when the market for labour opens the tendency will be for workers to move from the low wage to the high wage economy.

Wages

productivityProductivity

Wages

productivityProductivity

Polish labour

productivityProductivity

Swedish labour

productivityProductivity

Wp

Ws

A B C

SwedenPoland Poland Sweden

Number of workers

(1)

Figure 1

The diagram above shows the condition for the two economies before the introduction of Sweden into the common market for labour. Wp are the higher wages paid to polish workers whereas Ws are the lower wages paid to Swedish workers. The assumption is that Swedish and polish workers have the same level of skills, so what causes the marginal product of labour to be higher in Poland is their use of “ improved” capital. When the common market for labour is extended to more countries, there is free Movement of labour between Poland and Sweden, so some Swedish workers will move to take advantage of the higher wages and production in Poland will rise, however, the marginal productivity of its workers will decline leading to reduced wage rates.

Dissimilarly in Poland since workers will be leaving even though production will decline, marginal productivity will increase leading to higher wages. This is all illustrated in the following diagram.

PLP

SLP

Wages

productivityProductivity

Wages

productivityProductivity

Wp

Wcm

A

Ws B

migrantsMigrants

A B2 B1 C

Poland Sweden

Number of workers

(2)

Figure 2

From the above diagram, migration from Sweden to Poland will occur from B2 to B1 and there will be output gain equal to triangle A and B, because, even though Swedish output reduces that amount is recaptured by the increase in polish output produced thus leading to a net gain in output. Furthermore, there will be a reduction in wages in Poland from Wp to Wcm and an increase in wages in Sweden from Wp to Wcm so wages will eventually converge in both countries to Wcm.

From the model illustrated, some conclusions can be brought into frame:

Firstly workers originally in the high wage country, in the diagram(i. e. Poland), will lose because wages will decline whereas workers that stay behind in the low wage country(Sweden), will benefit because of increase in wages . Producers in Poland will gain from the expansion of the common market because the inflow of cheaper workers will mean that they will produce a greater percentage of output at a lower cost within the customs union whereas producers in Sweden will lose out because the higher wages signify that they will account for a smaller percentage of

Output and will have a higher cost per unit produced. Moreover, the European Union as an entity gains due to the overall increase in output and the overall reduction in labour costs. From the above we could also conclude that immigration in the short term helps ease unemployment as labour moves from countries with high unemployment mostly linked with low marginal value productivity of labour to countries with lower unemployment

shown through high marginal productivity of labour. Also the country that labour migrates to, benefits from the skills this labour acquired at home and the country receiving them didn't have to pay for. Similarly the home country could benefit from the skills the labour gained in the foreign country if the labour returns.

Also, cost-push inflation is lowered as a result or reduction in the cost of l labour, this arises due to high costs of labour and consequently this inflation reduction will lead to higher growth rates. Since this model depends greatly on the theory we made of full employment, wage flexibility, capital fixed and wage differences arising from differences in capital as opposed to skill, we have to see if the conclusions we drew above from theory work by examining the extent to which they applied to European countries after the 2004 enlargement. Indeed we see that since the 2004 enlargement (when more countries joined the European union) there has been migration from eastern Europe to western Europe due to lower wages in the east and skill shortages in western Europe. Since the enlargement in 2004 when 10 countries joined the European Union, there has been fare that the incoming nations, some of which have a GDP of around 40% will destroy the European Union from one largest single market to an “ economic burden”

In conclusion, from economic theory and of the effects of EU expansion, overall migration is beneficial for both the economy that workers leave from and for the country that receives the migrants. This is because the country they leave from gains investment from family members sending money back home and higher wages due to the increase in the marginal value productivity of labour and the country they go to gains competitiveness due

to the fact that wages decline and gains in output due to the fact that it gets to utilize its high marginal productivity.