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**Demographic ageing, migration and the challenge
for labour market and pensions**

by

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1. Introduction

My presentation is divided in two parts. In the first part, I will focus on the demographic implications in the labour market and pensions and I will attempt to draw some conclusions about the size of future needs in human resources. In the second part, I will pinpoint some of the key challenges related to the economic and social integration of immigrants in our societies.

The period of reference used in this paper refers to: 2000-2040, since the year 2000 represents a convenient starting point marked by the setting of Lisbon objectives on employment growth, while 2040 represents the time at which, according to the demographic projections, the rate of growth of demographic dependency will start declining indicating the beginning of the end of this post-war demographic shock.

Given the difficulties to foresee economic developments within such a long period, the approach mainly relies on demographic projections, which provide a more solid basis for medium to long term analysis.

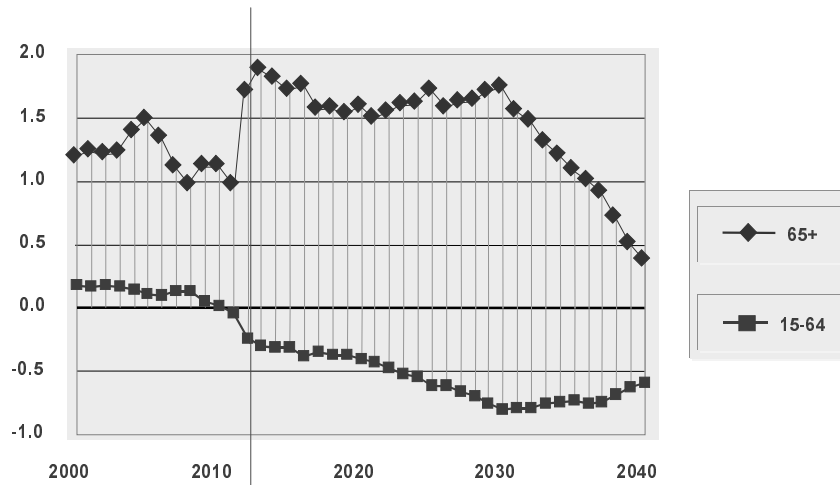
2.1 The implications of demographic change on employment

Let's first examine the demographic perspective. The baseline demographic scenario of Eurostat based on the hypothesis of a more or less stable migration inflow of around 630,000 people per year, still forecasts a modest growth of working age population until the end of this decade. This is because during the decade 2000-2010 the bulk of departures from the labour market will still relate to the less numerous generations born before 1950. Therefore, during this period, the effects of population ageing at EU level will be visible but not particularly strong when compared with what will follow. The sharp growth of departures soon after 2010, when the massive volume of baby-boom generations will start to retire, will, in a few years, radically change the picture both in relation to the labour market and pensions. The pace of exits from the labour market (see graph 1) could increase steadily over the period 2010-2030 thus generating year after year a cumulative pressure both in the labour market and on pensions provision.

These trends underline two dimensions that should be given due attention:

Firstly, the foreseen demographic decline of the working age population is a lasting phenomenon which will profoundly affect the EU labour market in the next 4 decades.

Graph 1 Annual rate of growth of population aged 65+ and 15-64, EU25, period 2000-2040



Source: Eurostat

According to the baseline demographic scenario of Eurostat, the working age population will start falling - both at EU-15 and EU-25 level - at the beginning of the next decade.

This implies that the objective of higher employment rates, particularly after attaining the Lisbon targets of 70%, will stop being a sufficient condition for employment growth in volume. The combination of employment rates beyond 70% with a declining working age population will require setting up further targets in terms of employment volume. This new situation may last several decades as the working age population cannot be affected by fertility and mortality in the short or medium term.

Secondly, demographic ageing also raises new policy challenges for economic growth. The period of the 70s and 80s, where the low volume of job creation and the poor levels of GDP growth were the limiting factors for providing adequate employment growth for the fast growing EU working age population is giving way to a new policy environment, where the stagnation and decline of working age population may now become a limiting factor for GDP growth.

The ability of the Union to increase productivity and successfully manage substantially larger migratory inflows will greatly influence its overall capacity to master economic transformation and social change. Immigration and integration policies should anticipate these trends and develop adequate responses in time.

There are a number of uncertainties related to the timing of this foreseen jump in the rate of departures. The first relates to the reliability of the net migration assumptions of the demographic projections. The baseline scenario assumes an average net inflow of migration of 630,000 people contributing to an annual inflow in the working-age population of around 450,000 people. Evidence over the last years indicates important gaps between the natural (births-deaths) and the total growth of population. According the latest Eurostat figures the net international migration in the EU was 1,150,000 people in 2001 while the projection for

2002 is again around 1 million. Those working with these scenarios back in the mid 90s will remember that demographic scenarios had anticipated a decline of the working age population both in Germany and in Italy by the end of last decade. This point has not been crossed in either of these two Member-States so far. These are indications that net migration levels are higher than those of the scenarios included in the Demographic projections.

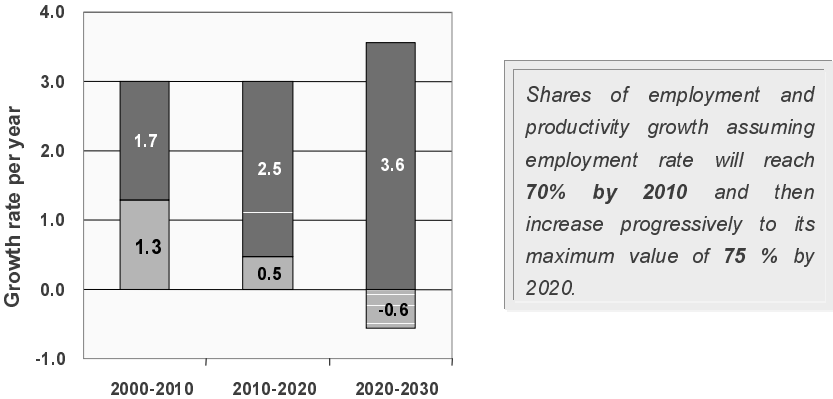
The second uncertainty relates to the effective year of retirement. The scenario presented in graph 1 assumes departure at 65. In reality the process of departure from the labour market will more gradual. At present, the average age of departure is much lower at 59. A considerable progress in increasing the age of departure is expected mainly due to education effects and the progress in female participation, employment policy measures and pensions reforms.

2.2 The impact of demographic change in employment and its implications on economic growth

It is worth noting the implications for economic growth of this new demographic landscape. A decrease in the overall volume of employment will substantially affect the potential in economic growth. Graph 2 illustrates developments in the contribution from employment and productivity that will be needed to maintain GDP growth of 3%.

Graph 2 Scenario of sustained GDP growth* Relative contribution of growth in employment and in productivity

EU15: Productivity gains required for sustained GDP growth*



Shares of employment and productivity growth assuming employment rate will reach 70% by 2010 and then increase progressively to its maximum value of 75 % by 2020.

*EU-15 GDP annual rate = 3%
Source: Eurostat

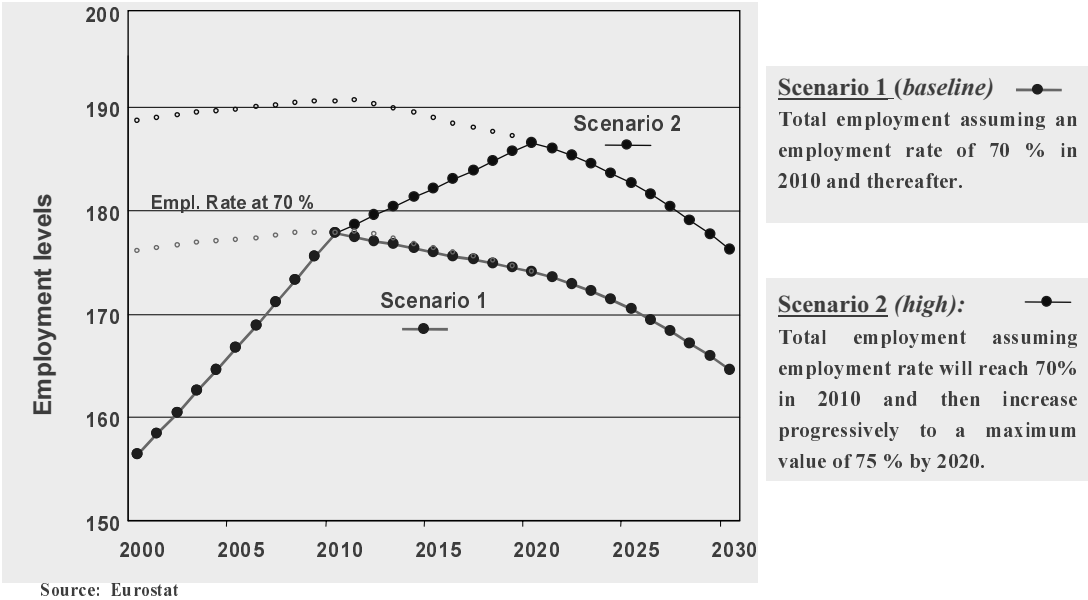
Again, this simulation is based on the Eurostat baseline demographic scenario. The reduction in total employment under this scenario would imply that between 2010 and 2020 productivity growth would have to reach 2.5% and between 2020 and 2030 it would have to continue climbing beyond 3.6%, if the fall in the volume of employment were to be compensated. In the absence of strong immigration growth, GDP growth is expected to decrease significantly in the long run, unless productivity growth exceeded 3%.

2.3 The compensatory effect of the existing employment reserves

Let’s look now at the employment potential of the EU. Today, there are 13 million people in Europe who are in search of employment. There would be almost as many available for the labour market if all Member States would reach the employment rate of the best performing European countries.

The European Employment Strategy targets the full utilisation of these untapped employment reserves. The Lisbon objective for an employment rate of 70% in 2010 is certainly feasible as far as the availability of human resources in 2010 is concerned. But what about employment growth after 2010? Are there any labour resources to provide for a reasonable employment growth after 2010?

Graph 3 **Lisbon employment objectives and potential for employment growth, EU15**



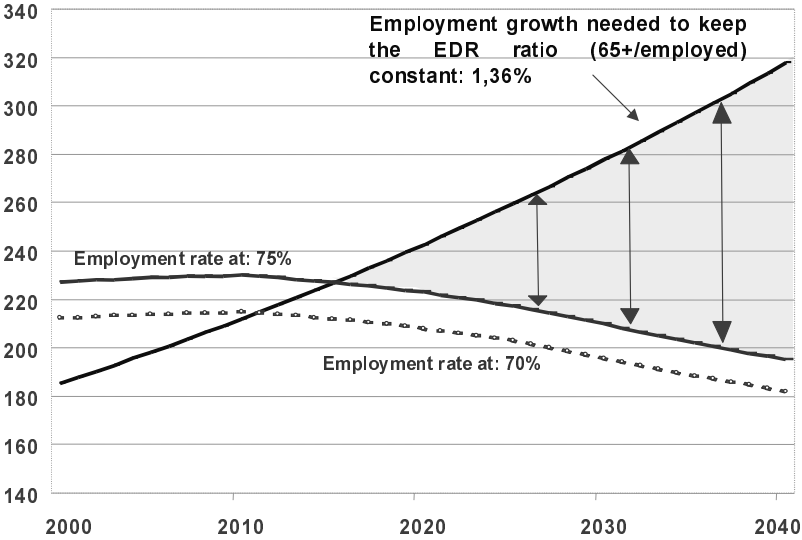
Graph 3 illustrates two scenarios of employment growth based on the Lisbon objectives up to 2010 and then assuming maximum employment rates of 70% (Scenario 1) and 75% (Scenario 2) after 2010. It is observed, in both scenarios that the potential of employment growth is very limited. Soon after 2010, the overall volume of employment could start diminishing as a result of the shrinking working-age population. Even though we may observe some growth of the employment rate for a few more years (scenario 2) the decrease in the volume of employment will be unavoidable. In other words, attaining a high employment rate will not anymore be a sufficient condition for employment growth. Additional policy targets aimed at increasing employment in volume would be required.

2.4 Demographic ageing and the link between employment and pensions

The link between employment and pension systems is also of critical importance.

The progressive departure of baby-boomers would require at EU-25, *ceteris paribus*, a constant average annual rate of net entries in employment of 1.36%, equal to the rate of departures of the 65 year old between 2000-2040 (1.37% at EU-15 level). This represents a very high rate of employment growth compared with, for example the average levels since 1995 (1.1%) but also taking into consideration the declining trend of working age population.

Graph 4 Demographic decline and the Employment growth potential of EU25 in the period 2000-2040



Source: Eurostat

Graph 4, based on the Eurostat baseline demographic scenario, illustrates this situation considering two levels of maximum average employment rate of 70% and 75%¹. An employment rate of 75% represents the highest level presently achieved in the Union (red line). The scenario of employment growth of 1.36% indicates the levels of employment growth and the corresponding employment levels needed to maintain the ratio of 65+/15-64 constant, all the other factors remaining equal. The increasing gap between this employment growth scenario and the level of maximum employment (75%) demonstrates the growing difficulty in financing pensions through employment growth. The EU-25 could not sustain the growth in human resources needed for pension sustainability later than 2016 even if the necessary demand side conditions were met.

¹ As the main objective of this exercise is to demonstrate the demographic effect in labour supply it do not consider demand side questions.

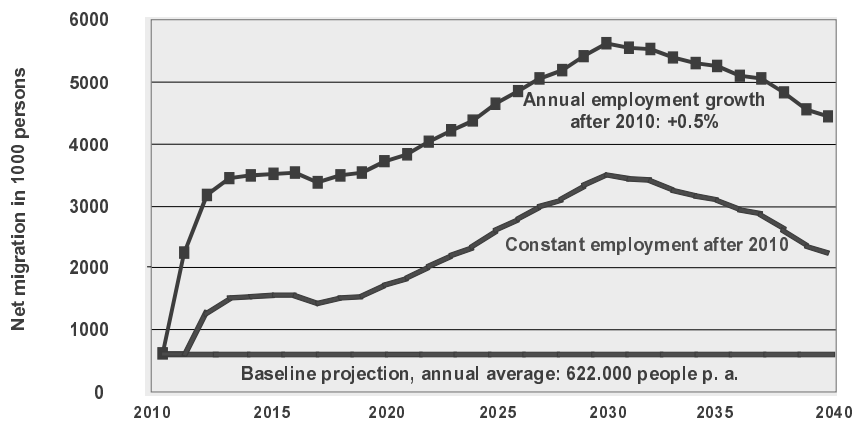
Graph 5

Long-term needs of human resources EU15

Levels of net annual migration inflows needed:

- After having fulfilled the Lisbon target of 70 % employment rate by 2010 (maximum employment rate);

- Migrant employment rate equals domestic employment rate.



Source: Eurostat and Internal Calculations

Pension systems are not very sensitive to immigration increases. Simulations confirm that even doubling or tripling the levels of annual immigration flows provided by the baseline demographic scenario for the next 40 years could not compensate for the growth of the economic dependency ratio.

To illustrate these effects, Graph 5 shows the number of net migrants needed under two theoretical scenarios for the period 2010-2040: a) assuming both average employment rates of immigrants and EU nationals equal to 70% and b) assuming annual employment growth equal to 0.5% (scenario 1- dotted line) and constant zero employment growth (scenario 2- plain line)

This simulation indicates that substantial growth of net annual inflows will be necessary particularly after 2020 even to simply compensate for working age population decline and maintain employment volume unchanged, while increasing employment at an average annual rate of 0.5% would require an average annual net migration inflow of more than 4 million immigrants. Immigration growth could have an even more modest attenuating effect in compensating for the demographic effect on pensions and therefore the need to reduce the dependence of pension systems on demographic trends should mainly rely on pension reforms including raising the effective age of retirement.

2.5. The regional and skill dimension of demographic ageing and the link with immigration

Analysing the ageing trend at aggregate level provides a good overview but it is not sufficient to identify the various issues brought about by the ageing process in the different Member States. Both national and regional level analyses reveal important differentials in the

intensity and timing of the ageing trend. By 2005, more than one third of the European regions will already have a declining working age population. Moreover, there are substantial differences between Member States, both in terms of economic characteristics and institutional arrangements which should be brought into the picture.

In addition to geographical differentials, skill mismatches may also grow as a result of the decrease of labour reserves but also because of demands for new skills and competencies.

3. Tackling the problems of economic and social integration

The above brief analysis has shown that more immigrants with higher employment rates will be needed in the future to compensate for the demographic ageing trend. It has become obvious that immigration growth alone could not satisfy our needs in the labour market and pensions in the long run. Once maximum employment rates are attained, even maintaining the same level of employment would require a very important growth of the annual inflow of immigrants. Even maintaining zero growth of employment – i.e a 70% of employment rate of both natives and immigrants after 2010 (see scenario 1, graph2) - would require an average annual net inflow of around 2.2 million of immigrants (total number) for the period between 2010-2040. It is perhaps useful to remember that a zero employment growth scenario implies that economic growth will rely exclusively on productivity growth.

However, the optimal orders of magnitude of immigration inflows are not only determined by the economic considerations. They will also strongly depend on the economic and social environment of the host societies. Different societies in space and time have shown widely different degrees of tolerance to immigration. Michael Teitelbaum and Jay Winter, in their particularly interesting book *“A question of numbers: High migration, low fertility and politics of national identity”*, show how low fertility trends and gloomy economic outlook may relate to xenophobic attitudes and more conservative views on immigration.

It is beyond the scope of this presentation to further elaborate on this issue but, before I close my presentation, I would like to briefly refer to some elements of the analysis developed in the context of the Commission report "The Social Situation in the European Union 2002" which relate to the issue of the economic and social integration of the immigrants in the host societies.

International experience suggests that the contribution of immigration to higher levels of employment depends firstly, on the capacity of immigrants to integrate fully in socio-economic life and secondly, on their acceptance by the host societies. Social policy is very important in this respect. A well-balanced mix of social and employment policies can minimise the economic and social costs of migration and provide new opportunities for economic growth and social progress.

Within this context a number of considerations are of particular relevance:

- Present employment rates of immigrants are not satisfactory. At 54.1% the employment rate of the non EU-25 nationals is significantly lower than the 68.8% rate for EU-nationals. The difference is particularly strong for women. More effort will be required in this area if we want to target at higher migration inflows.

- Handling employment issues will require the development of a variety of forms of employment and residence status. Although the bulk of immigrants settle permanently, providing for forms of employment that do not necessitate permanent settlement can in many instances provide win-win situations for all stakeholders. Establishing tailored opportunities for temporary/seasonal immigration and cross-frontier mobility of foreign workers can be used to ease bottlenecks in specific sectors, as well as to transform part of the illegal immigration of low and unskilled workers into legal or regular immigration.
- Illegal immigration has been one of the most sensitive issues. A growing trend of illegal entries has been observed across the EU over the last decade. Europol estimations place the annual figure of illegal entries at 500,000 people. This is also confirmed by successive waves of "regularisation" which have been introduced in several Member States. Illegal immigration and undeclared work feed on one another. To a great extent our credibility in setting up a framework of legal economic immigration will depend on the ability to combat undeclared work and illegal immigration.
- The link between education and employment rate also is clear as seen in see Graph 6. More educated immigrants will facilitate increasing employment rates.

Graph 6 Education level and employment/unemployment rates of the immigrants in the EU15 in 2000



High education levels appear to be the greatest facilitator for the economic and social integration. Among the different immigrant groups the more educated ones are the more adaptable, have better language skills and find it easier to re-establish a social network in the new place of settlement.

However, the bulk of immigrants particularly those arriving from countries of the developing world are of a much lower level of education. This calls for integration strategies that pay particular emphasis at language learning and full access to education and training.

- The litmus test of integration policies is whether they manage to secure levels of participation and employment for the second generation. While higher levels of social and employment problems for first generation immigrants may be expected it is unacceptable that major differences persist into the second generation. Facilitating access to education for low-education immigrants and their children, promoting employment opportunities, removing barriers related to housing and addressing the gender inequalities are among the key issues for this category of immigrants.
- Addressing the needs of immigrant women will be critical not only in order to ensure their equal and full integration but also in order to maximise the overall benefit from immigration. Being transmitters of cultural values and social attitudes immigrant women are key actors in strategies to secure a successful integration of second and third generation immigrants.
- Last but not least, with reference to the host societies, social exclusion and discrimination must be fought and diversity respected. Fighting against discrimination and the barriers to social participation - whether in the structures, capacities and attitudes of the receiving communities or in those of the arriving immigrants – will increase possibilities for integration and strengthen social cohesion.

4. In conclusion

Well-managed migration inflows could provide a positive contribution to employment and economic growth if we manage to successfully promote the integration of immigrants in our societies.

However, even doubling present levels of immigration flows could not offset the implications of ageing in the labour market and pensions. We will still need to focus our efforts on employment policies and pensions reforms, if we are to achieve sustainable labour markets and pensions systems. Immigration policy should be seen as a contributing element within a comprehensive policy package including a variety of policy measures. The ability of the Union to successfully manage substantially larger migratory inflows in the future will influence its overall capacity to master economic transformation and social change.

The observed emphasis of the public debate on immigration restriction and prevention does not rely on any solid argument. However, it will perhaps be a mistake to attribute this xenophobic attitude to European societies. Rather, it is the restrictive and backward looking approaches to immigration of the past 30 years and their interaction with the high migratory pressures of the '90s which should be blamed instead.

Fulfilling the ambitious goals of Lisbon for sustainable economic growth and social cohesion beyond 2010 will require, among other, shifting the emphasis from immigration controls to better immigration management. The time horizon until 2010 is particularly critical since it provides perhaps the last opportunity for the EU to benefit from a relatively slow ageing process and prepare for the more severe and lasting trends that will follow over the next 3-4 decades.