Economic Integration and Free Mobility of Labour*

Prabhat Patnaik

There is a view that the discontent among the English workers that caused the Brexit vote was not because of European economic integration as such, but because of the policy of free internal migration that has accompanied this integration; that if Europe had not enacted free migration within the EU, then its economic integration would have been more successful. Its economic integration then would have remained confined to the free movement of goods and capital alone but not of labour, and that such free movement, i.e. of goods and capital alone, is beneficial for the countries being economically integrated.

The contemporary globalization, it may be recalled, is also confined only to free movement of goods and capital, and does not extend to free movement of labour. It follows from the above claim therefore that this globalization must be beneficial for countries caught in its web, and that those, who are arguing that economic integration involving free movement of goods and capital is harmful for the people of the countries being integrated, are wrong.

This view has been advanced recently (The Hindu July 14) by Dr. C. Rangarajan, the well-known economist and former Governor of the Reserve Bank of India, to counter those who see the fact of being caught in the free movement of goods and capital itself as the basic underlying cause of the distress of the English working class, and interpret the Brexit vote as an un-self-conscious revolt against it.

This argument that economic integration involving free movement of goods and capital over a certain region is likely to be successful if it is not accompanied by free mobility of labour over this region, runs contrary, however, to the tenets of even “mainstream” economic theory upon which in fact the EU project itself is founded.

Gunnar Myrdal, the renowned Swedish economist and recipient of a Nobel prize in the subject, had argued long ago that when capital gets located in a particular place, it tends to draw other capital to that place. It follows from this that if there is freedom of movement of capital and goods over a region, then some segments of it will become “developed” while other segments will become “underdeveloped”, through what he had called a process of “cumulative causation”.

Such a dichotomy, it may be thought, would be self-negating, since, in the absence of labour mobility from the underdeveloped to the developed segment, the wages in the former would fall below those in the latter and that this fact would attract capital from the latter to the former. The process of “cumulative causation” in other words would be checked at some point by the development of a wage-differential between the two segments.

But this does not follow. The potential advantage that capital would derive from locating plants in the lower-wage underdeveloped segment may be more than offset by the disadvantage of moving away from the developed segment where several “external economies” (such as proper infrastructure) would be available to it, especially if labour cost is a comparatively small part of the total cost of production (so that lower wages do not make much of a difference).

Exactly the same can be said about exchange rate depreciation in the underdeveloped segment. Even if the wage rates in the two segments are equal at the initial exchange rate and neither wage rate changes, a depreciation of the exchange rate in the underdeveloped segment has the effect of cheapening its cost of production, exactly the way that a fall in its wage rate would do. But if the lowering of the wage rate cannot overcome “cumulative causation”, then an exchange rate depreciation too will be ineffective for the same reason.

Besides, within a common currency area, the question of exchange rate depreciation of one particular segment of the area does not arise anyway.

Even when the two segments do not belong to a common currency area, a depreciation may nonetheless be eschewed owing to its inflationary consequences (because imported inputs then cost more and this gets "passed on" in the form of higher prices). Such inflationary consequences, apart from hurting the people (for the sake of uncertain gains from an exchange rate depreciation), even negate to an extent the effect of the depreciation itself. If for instance there is a10 percent exchange rate depreciation in nominal terms, and if this causes, through cost-plus effects, a 6 percent rise in prices, then the real effective depreciation is no longer 10 percent but only 4 percent, i.e. (10-6), whose impact correspondingly on enlarging the level of activity in the underdeveloped segment, gets diminished.

Finally, an exchange rate depreciation is always opposed by the financial interests belonging to a particular segment. This is because the confidence of wealth-holders in holding its currency or currency-denominated assets, gets undermined if its currency acquires a reputation of being subject to depreciations, which therefore reduces the business of the financial interests located in that segment. (This incidentally is why Britain despite not being in a common currency area, and despite having a current account deficit on the balance of payments that is as high as 7 percent of GDP at present, does nothing to lower the value of the pound sterling: the City of London, where British financial interests are located, is opposed to a devaluation of the pound sterling).

For all these reasons, attempts at economic integration invariably face a hurdle, namely that the countries that are candidates for integration fear getting "underdeveloped" as a consequence, especially if they are part of a common currency area (so that exchange rate depreciation is simply not possible); and even if this may not happen to countries as such, particular areas within countries may become progressively more and more "underdeveloped" as a consequence of the country's economic integration with a larger entity.

The obvious way of overcoming this hurdle is by instituting free labour mobility between the different segments that are getting integrated. This ensures that even if capital does not flow to the backward segments, the work-force of that segment does not remain trapped within an unfolding scenario of "underdevelopment"; it escapes its distress by migrating to the developed segment.

An essential condition for the success of economic integration therefore is free labour mobility over the area that is coming together through such integration, for in its absence, sovereign countries will be reluctant to enter into such integration; and the need for free labour mobility is even greater when integration takes the form of a currency union, such as the Eurozone. In fact so essential is labour mobility for successful economic integration that economists often judge the prospects of integration by looking at whether the cultural and linguistic diversity within it makes labour mobility difficult.

Hence the view that economic integration such as what the EU represents would be more successful in the absence of labour mobility runs counter to the basic conclusions of "mainstream" economics. And precisely because of such conclusions the EU instituted free labour mobility within its boundaries, which was considered a novel feature that would make the attempt at integration a successful one, in contrast to similar attempts made in other parts of the world (such as Latin America).

The reason why the European project is failing is not because of free labour mobility (though that is the way that the Right would present the matter) but because of the acute crisis in which Europe is currently embroiled, which has afflicted Britain too. There was in any case, within the regime of globalization, a shift of several activities to lower-wage countries like

China and India from Europe which brought unemployment and economic hardships to certain sections of the European work-force, including that of Britain. (This may appear at first sight as contradicting Gunnar Myrdal's prognosis, since it suggests that lower wages are triumphing over the process of "cumulative causation"; but the activities being shifted out of the metropolis are of a lower order in the technological spectrum, which still leaves the more sophisticated and more technology- intensive activities in the metropolis). The superimposition of the crisis on this situation has only made matters worse for the European, and English, working class.

This crisis is a product of globalization for two obvious reasons: first, globalization prevents Keynesian-style State intervention in "demand management", since globalized finance capital whose writ is final is opposed to any State activism except for promoting its own interests. As a result the only possible antidote to a crisis or an incipient tendency towards over-production is the formation of an asset-price "bubble"; and since "bubbles" cannot be made to order, incipient crises develop into full-fledged ones and full-fledged crises keep persisting.

Secondly, globalization links (though it does not equalize) wages world-wide, and therefore keeps them restricted owing to the existence of the massive third world labour reserves. Hence the growth of wages everywhere lags far behind that of labour productivity, raising the share of surplus, both within countries as well as globally, precipitating a crisis of generalized over-production. We are in the midst of such a crisis.

The end to this crisis is nowhere in sight. This is because individual nation-States lack the autonomy, within the regime of globalization, to resist the pressures of globalized finance and undertake demand-stimulating measures within their own countries (with appropriate trade policy to ensure that such measures do not make the balance of payments unsustainable). At the same time there exists no supra-national or global State that could in principle have the strength to resist the pressures of globalized finance and undertake "demand management".

This is why the world economy, not just Europe or England, continues to remain mired in crisis. This also explains why the English working class un-self-consciously voted to delink itself from the EU that constitutes for it the proximate theatre of globalization. More such revolts are likely to follow in other countries. To imagine that globalization, together with its attendant measures of "austerity", will turn out to be beneficial if only curbs are imposed on free mobility of labour, is to accept the world-view of the Right-wing forces in Europe who attack immigration but not "austerity". Such curbs can at best export a bit of the workers' distress from one segment of Europe to another; but they cannot end the distress itself, even in a country that decides to leave the European Union and put barriers against immigration, since this requires that demand should be stimulated, i.e. that "austerity" should be overcome.

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