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EU enlargement, migration and labour market institutions

*Per Lundborg**

This paper discusses free immigration to regulated labour markets (as in Europe) and to unregulated labour markets (as in the US), and explores the implications for migration flows of collective agreements, employment protection laws, product market regulations etc. It is argued that the European type of labour market institutions prevent wage dumping and restrict major immigration flows to periods of business peaks in the immigration country. Based on the empirical evidence on the differences in institutions, it is argued for instance that the UK and Ireland are likely to be exposed to larger wage effects than for instance Germany and Austria. Labour market institutions are likely to grow more similar across countries and stricter as a consequence of free mobility.

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* I am most grateful for useful comments from two anonymous referees.
For this paper only the author is responsible.

1 Introduction

Already a quick look at the basic facts indicates that there is great potential for immigration from the new EU member countries (EU10) to the old ones (EU15). First, the real wage differences are large: the EU10 today have a real wage level that is approximately only 40 percent of the real wages of the EU15. Though these differences are likely to diminish over time, they will nevertheless remain large enough for migration to be an attractive option for many years ahead. Secondly, the mere size of the labour force in the EU10 is large enough, with approximately 50 million people, for the real wage differences to trigger major labour movements. Finally, the geographical distance implies very low costs of labour migration.¹

The potentially large migration flows have prompted most of the EU15 to impose restrictions on labour immigration from the EU10. But even if labour immigration were restricted for the maximum seven years, the basic driving force of potentially large migration flows, i.e. large real wage differences, will remain until free migration is a fact of life. The basic issue that we discuss in this paper is how free immigration from the new member countries will affect the distribution of wages across regulated and unregulated sectors in the immigration countries, i.e. in the EU15. We also discuss the conditions under which the EU15 may experience large inflows of immigrants. The consequences of allowing free immigration are likely to differ a great deal depending on the labour market institutions of different immigration countries. Immigration is also likely to lead to changes in the structure of the labour market institutions across the EU15.

To understand the effects of immigration it is helpful to distinguish between two types of labour market: an unregulated “US-type” labour market and a regulated “European-type” market. If labour markets are not regulated by collective agreements, job security laws etc., not only will immigrants find it easier to enter the country but, by underbidding, they will also exert a downward pressure on wages. Facing a

potential fall in wages following immigration, it could be hard to obtain political support for free immigration and, for instance, US workers are in general likely to resent free immigration from Mexico.

In typical European labour markets, immigrant workers cannot underbid, at least not below the minimum wage stipulated in the collective agreements. Moreover, job security laws prevent employers from substituting cheap immigrant workers for expensive native workers. As these institutions prevent wage dumping and crowding out, political support for free immigration from low-wage countries is more easily gained.² The resistance to free immigration in the EU that we observe emanates primarily from the representatives of sectors where collective agreements are uncommon, union coverage is low, and where employers are not subject to job security laws etc.

It is argued here that the institutions of European labour markets then act as regulators of immigration. In particular, since wages are downwardly rigid, immigrant workers’ lower wage demands cannot be used to enter the country, and large-scale immigration will occur only during business peaks. Only when the labour market is characterised by over-employment, an abundance of vacancies and tendencies for wage drift, will there be chances for a large number of immigrant workers to enter.

Another important institution is the *job security laws* that prevent employers from substituting cheap immigrant workers for expensive native employees. Other institutions of importance for immigration are also discussed, including *competition regulations* in the different EU countries. These regulations largely determine the extent of immigrant workers as entrepreneurs in the immigration country. The trade unions’ ability to keep up *labour standards* may also regulate immigration. If immigrant workers find it unfeasible to compete for jobs by underbidding wages, they might find it possible to enter the present EU members’ labour markets by accepting poorer working conditions than native workers. This would be more common in sectors where unionisation is low. Hence, the rate of unionisation is likely to be a major determinant of immigration.

We also discuss the extent of institutions that may prevent immigration across the EU. The opening up

¹ Empirical estimates of future migration flows give widely diverging results, particularly due to differences in estimation methodology (Alecke et al. (2001), Brucker (2001)) Sinn et al. (2001) and Flaig (2001) forecast the long-term emigration potential from the EU10 to be 6–9 percent of the emigration countries’ population. As shown by Brucker (2001) and Alvarez-Plata et. al. (2003), these figures fall to 2–2.8 percent when fixed effects are accounted for. See also Bauer and Zimmermann (1999), Hille and Straubhaar (2001) and Boeri and Brucker (2001). For a survey, see Straubhaar (2002). Concerning the integration of previous waves of immigrants from EU10 to EU15, see Tübergen (2004).

² Wage dumping is hard to define exactly but here we refer to it as a significant drop in wages. Underbidding need not necessarily cause wage dumping.

of the labour markets to free immigration is expected to enhance the trade unions' incentives to regulate the labour market so as to prevent wage dumping. Thus, eliminating the international obstacles to free mobility could lead to more national obstacles. Moreover, if immigrants from the new member states find it easier to enter the less regulated countries of the EU, such as the UK and Ireland, and wages fall as a consequence, we should expect labour market institutions to become more similar across the EU. Hence, institutional convergence is a possible outcome of allowing free immigration.³

The paper is structured as follows. In the next section we go through some simple theories of wage setting and discuss how immigration is likely to affect wages in an unregulated labour market and in a regulated one. The effects of collective agreements and job security laws on wage dumping are discussed as well as the extent of these institutions in the EU countries. The discussion in this section leads to the conclusion that large-scale immigration to countries with regulated labour markets like those in the EU mainly occurs in economic booms. In section 3, we give evidence that the volume of migration in free labour markets is largely determined by the business cycle of the immigration (high-wage) countries.

2 Immigration to regulated and non-regulated labour markets

2.1 A theoretical framework

The free mobility of labour of the European Union means that the right to immigrate to another member country is limited to people in the labour force and to their family members. Normally, a wage earner will have arranged for a job already before arriving in the country of immigration. The conditions that are necessary for workers in the new member countries to have true access to vacancies in the high-wage countries will, however, depend on the labour market institutions in the receiving countries. In this section we shall discuss whether these conditions have negative effects on the host country.

Central importance in this respect is the role of the wage formation institutions. To proceed, we con-

sider two polar cases; one representing the free and unregulated US-type labour market and another representing the regulated European type labour market characterised by collective agreements, job security laws and more or less centralized wage setting.

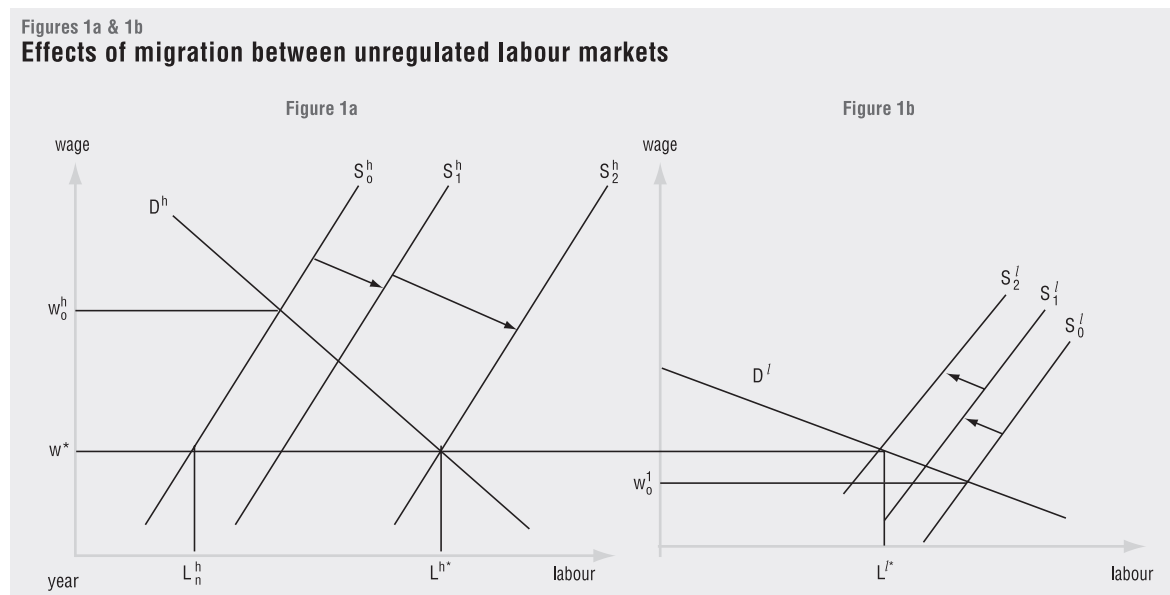
We shall present two well-known models and we do this explicitly to stress the crucial differences of the issue at hand. Let us consider first the well-known and simple textbook case of an unregulated competitive labour market. In Figure 1, *panel a* represents labour demand (D^h) and supply (S^h) in a high-wage country and *panel b* labour demand and supply in a low-wage country (D^l and S^l). The wage w and employment L are determined by the intersection of supply and demand. Before the establishment of free mobility we obtain a high wage w_0^h in the rich country and a low wage w_0^l in the low-wage country. As free mobility is established, the supply curve of the poor country shifts to the left (*panel b*) while the supply curve of the rich country shifts to the right (*panel a*). This adjustment continues until wages are equalized across the two countries, i.e. at w^* yielding employment L^{h*} and L^{l*} in the two countries. Thereafter, no incentives for migration remain.

In this case, the real wage differences between the high-wage and low-wage countries drive migration. The basic assumption is that immigrant workers can underbid the current market wage and, by using workers' competition for jobs, may enter the country and find employment. No native workers lose their jobs, but since the wage drops the supply of native labour may fall, thus reducing native employment to L^{h*} in the rich country. The extent of this drop, of course, depends on the elasticity of the domestic labour demand.

In this labour market, wages are set individually, and not by unions and firms in negotiations, and the price of labour is determined competitively. However, this simple textbook model, with the wage determined by intersecting supply and demand curves, is not a realistic description of wage setting in typical EU countries. Labour is assumed to be homogenous, which is a highly simplified assumption, and important obstacles to migration such as the lack of language proficiency are not accounted for. What is more important is that there is no room for wage bargaining, which in European countries determines the negotiated wage increases.

A more realistic situation is one where the wage is determined by the intersection of a demand curve, also known as a price setting curve, and a wage setting curve. Such a wage setting curve is obtained

³ Our focus in this paper is on the labour market institutions and wage differences across countries. This does not imply that we wish to play down other factors that affect migration such as differences in qualifications, language proficiency, preferences for working and living in certain countries etc.

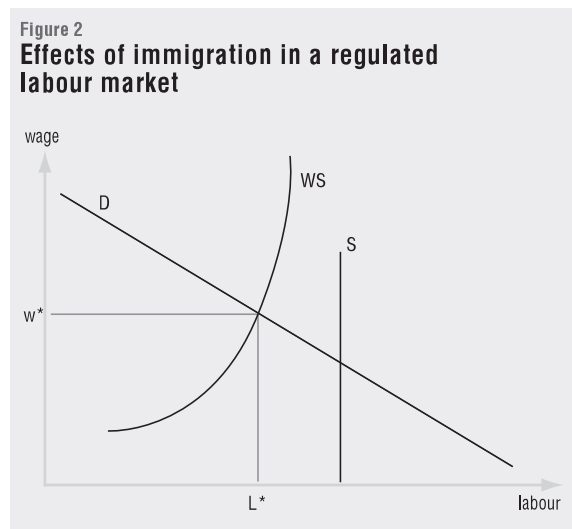


from a union-firm bargaining model, which is the dominating form of wage setting in European countries, as well as from an efficiency wage model. The case is represented in *Figure 2*.⁴

Here, the wage and employment are determined by the intersection of a demand curve, D , and a wage setting curve, WS , i.e. at w^* and L^* . The point of departure in the derivation of the wage setting curve that is determined by bargaining is the union's indifference curve between wages and employment. The curve is obtained by combining the indifference

curves and the shifting labour demand curves and it thus expresses the union's preferences concerning wages and employment. The curve tends to become horizontal if the union prefers a high wage over employment and tends to be vertical when the union prefers employment over high wages.

The bargained wage is then written into the collective agreement and underbidding which would lower the wage below the agreement's minimum wage cannot occur. The bargained wage will normally be set higher than the competitive wage and some unemployment will occur.



⁴ For a more detailed analysis of this model, see for instance Booth (1995).

A notable and crucial factor is that the unions are assumed to maximise their *native members'* utility. This means that if the labour market is opened up to free immigration from low-wage countries, the potential immigration will not affect the wage rate. The union will behave in the same manner as before the labour market was opened up to immigration and set the wage irrespective of the extent of potential immigration. Hence, the native workers that are union members can be expected to act as insiders keeping the outsiders, i.e. potential immigrants, away from the labour market by means of strong support for the collective agreements to prevent wage underbidding.

The question is whether the behaviour of firms will change due to potential labour immigration and whether they will substitute cheap immigrant labour for expensive domestic labour. The answer is no, since in the sectors for which this type of wage bargaining model applies, job security laws will prevent employers from such substitutions.

The extent of union-firm wage bargaining differs across European countries. Also the wages that are not formally determined by the social partners are affected by the bargained wage. In many countries, the coverage of the collective agreements goes way beyond unionisation, implying that the minimum wage stipulated in the agreements also applies to the non-unionised labour force.

2.2 Collective agreements in the immigration countries

If unions can easily demand collective agreements, this will make it more difficult for employers to

build up large firms based on immigrant workers being paid lower wages than their native colleagues. In Sweden, for instance, it suffices that one employee demands a collective agreement via union representatives for the employer to be forced to sign and thus pay the wage stipulated in the contract. The coverage of the collective agreements thus becomes an important factor when evaluating the potential wage effects of free mobility. It is therefore of some interest to look into the coverage of collective agreements and union density in the EU countries.

In general, we should find that the higher the coverage of collective agreements is, the lower the risk should be of immigration leading to wage dumping.

Table 1

Coverage of collective agreements and unionisation

Country	Coverage of collective agreements	Unionisation rate
Austria	98	40
Belgium	100	69
Denmark	85	88
Finland	90	79
Germany	90	9
France	67	30
Greece	–	32
Ireland	–	–
Italy	–	35
Luxembourg	60	50
Netherlands	78	27
Portugal	62	30
Spain	81	15
Sweden	94	79
United Kingdom	36	29
Cyprus	65–70	70
Czech Republic	25–30	30
Estonia	29	15
Hungary	34	20
Latvia	<20	30
Lithuania	10–15	15
Malta	60–70	65
Poland	40	15
Slovakia	48	40
Slovenia	100	41

Notes: Coverage refers to the percentage of employees covered by collective agreements.

Unionisation refers to the percentage of employees with union membership.

Source: See EEAG, Report on the European Economy 2004.

Table 1 presents the coverage of collective agreements and unionisation rates in the countries of the EU15 and EU10.⁵ Of the EU15 countries for which data are available, the United Kingdom stands out as having the lowest coverage rate, at 36 percent. In all the other countries the coverage is considerably higher. At the top we find Belgium (100 percent), Austria (98 percent) and Sweden (94 percent). Thus, the United Kingdom can be expected to be the country most exposed to the risk of wage dumping, while Belgium, Austria and Sweden would be the least exposed. In the EU10, the coverage of collective agreements varies considerably from Lithuania's 10–15 percent to Slovenia's full coverage.

The unionisation rate is also of some interest as an indicator of the strength of the trade unions. It is not entirely clear what unions can do to prevent wages from falling when immigration occurs, besides relying on collective agreements and job protection laws. The local unions could prevent the abuse of entrepreneur licenses and the deterioration of working conditions. Particularly for recently established firms, there will be incentives to avoid collective agreements and hire only low-paid immigrant workers. The gains from hiring workers way below the wage stipulated in the collective agreements may be very large.

Moreover, it is not obvious that employees from low-wage countries have incentives to demand that firms sign a collective agreement. The reservation wage may be very low for an immigrant and be determined by the wage level in the country of origin. Assume that a firm in the host country offers, say, € 15 per hour while the collective agreement stipulates € 20 per hour and the wage level in the home country is € 10. The immigrated employee might think that the firm's survival is threatened if forced to pay € 20 per hour. Thus, to avoid being forced to return to the home country and a € 10 wage, the immigrant might refrain from demanding a collective agreement and would thus accept a wage of € 15.

It is worth noting that it is difficult for large firms to avoid collective agreements. This implies that the risk of the firm being forced to sign an agreement grows dramatically as the number of employees increases.

The number of small firms with immigrant workers is likely to grow in industries where there are great

difficulties in organising labour. These are typically construction firms, transport firms, restaurants etc., but also firms lacking scale economies. In such industries both domestic firms and firms from the low-wage countries may become established and benefit from the cheap immigrant labour. These firms may be highly competitive compared with domestic firms that pay their employees according to collective agreements. Thus, small firms may be exposed to a major increase in competition as a result of the free immigration of labour. Trade unions are, however, likely to demand that firms sign the agreements or to lobby for legal amendments.

To a worker, the existence of such a collective agreement is *per se* no guarantee against wage competition. If a firm is expanding, native job seekers may be exposed to increased competition from immigrant workers whom firms can expect to have a high productivity. In particular, highly skilled workers may well compete with low-skilled workers in the immigration country.

2.3 Labour standards

If individuals who want to immigrate find it hard to enter the labour markets of the high-wage countries by underbidding, they might compete by accepting poorer working conditions. If an employer cannot fill a vacancy due to poor working conditions, and finds it unprofitable to improve the conditions, the jobs can be offered to workers from other countries. These cases need not only concern the working environment, but also inconvenient working hours, high risks of exposure to violence etc. In these respects, too, unions have a great influence and in order to avoid a general decline of working conditions, they might lobby for more regulations. Trade unions claim that the directives on the free mobility of services could exert a downward pressure on working conditions.

2.4 Product market competition

Free labour mobility also means that entrepreneurs can set up firms in other member countries. In this case one must consider that the reservation "income" of entrepreneurs from the low-wage member countries is considerably lower than that of entrepreneurs in the immigration countries. A worker who is unable to obtain a job in a high-wage member country can obtain a permit to start a new firm in the destination country, and there appears to be

⁵ These figures are those reported in EEAG (2004) but figures differ between studies. EIRO (2002) report different figures for individual countries, but in general the figures for the coverage of collective agreements are at similar levels in the two studies.

extensive misuse of such permits. These immigrated entrepreneurs are likely to accept a return from work that is way below what other entrepreneurs obtain but still exceeds the return that they would have obtained in their home country. Domestic entrepreneurs are likely to look upon this as a form of non-loyal competition.

Difficulties in entering the labour markets of the high-wage member states will probably encourage workers to become entrepreneurs. There is also a connection between job security laws and entrepreneurship. Countries like Italy, France, Germany and Sweden could receive a large number of such immigrants. There the costs of starting up a new firm are relatively low, and the fact that regulations make it difficult to compete for job openings could mean that quite a large number of people opt to become entrepreneurs. Thus *rules of competition* in goods market are of importance for the volume of immigration, and the easier it is to set up a firm, the larger the volume of immigration. A relatively high level of immigration of entrepreneurs can be expected in industries such as construction, restaurants etc. where small firms are commonly found. The prices of the goods and services may be put under pressure in such sectors.

2.5 Job protection laws

As noted above, another labour market institution of relevance in evaluating labour migration is *job security laws*, which largely prevent the displacement of native workers by immigrant workers. Such laws are created because there are gains to both social partners. For employees, uncertainty is reduced and for firms the laws can provide stable employment conditions that increase the employees' confidence in the firm. There could also be social benefits as the laws raise the costs of dismissal and thus may prevent firms from laying off workers when it is socially desirable for them to be retained in the firm.

The laws can be looked upon as a tax on the reallocation of the workforce. They force firms to adhere to certain rules and to pay for redundancies in a business downturn. In a business upturn, firms can be less likely to hire workers other than when they are certain to be able to retain the worker for a long time. Concerning the free mobility of labour, the laws imply some costs to the firms as they prevent firms from substituting the present workforce with immigrant workers who may be less demanding in terms of wages and work conditions.

Since job security laws may determine immigration flows to some extent, it is of interest to investigate how they differ across prospective immigration countries in the EU15. Many of the laws were introduced during the 1950s and 1960s, and in some countries the recessions following the oil crises of the 1970s further stimulated their introduction. Under pressure from the extensive labour market problems of the 1980s and 1990s, the general trend was towards deregulation, though some exceptions existed. Several of the countries that deregulated the protection laws, such as Finland and Spain, opted for more short-term employment and temporary contracts. The introduction of free labour mobility is another factor that may affect the extent of the laws in the future.

The OECD (1999) evaluated the job protection laws of the EU countries and ranked them according to the degree of "strictness". Of course, some of these protection laws are more important than others in preventing employers from substituting immigrant workers for native ones. In *Table 2* we have separated the protection laws that may be considered the most important ones when it comes to the protection of regular employment, and listed the degree of strictness in fourteen of the EU15 countries (Luxembourg is excluded). For comparison, but without ranking, we have also added three of the new members in column 1. The rankings of the fourteen EU15 countries are shown in parentheses.

Employers are exposed to a large number of costs when employees are dismissed. First, there are procedural requirements before the termination of the contract with the employee. A written statement of the reasons for dismissal may be required, it might be necessary to notify a third party and there may be delays before notice can start etc. As shown in column 2, in the late 1990s the Netherlands had the strictest rules in this respect followed by Germany and Portugal. The least strict rules are found in Belgium, Denmark and the United Kingdom.

Secondly, there are requirements concerning notice and severance pay. Such costs differ between blue-collar and white-collar workers, where they are normally higher for white-collar workers. Column 3 lists the OECDs evaluation and ranking of countries according to these costs of dismissal. In the three southern European countries Portugal, Italy and Spain employers face the highest costs when it comes to notice and severance pay. There are considerably lower costs in this respect in Ireland, the Netherlands and the United Kingdom, which are the three EU15 countries at the other end of the ranking.

The fourth column shows the constraints imposed on employers for unfair or unjustified dismissals. A dismissal is considered unfair if the employer cannot demonstrate previous effort to avoid dismissals or when social considerations or job tenure, including last-in first-out rules, have been neglected. Courts may order reinstatement after unfair dismissals, or compensation payments on top of severance pay. As shown under “difficulty of dismissal”, Portugal, Italy and Sweden are the countries with the strictest rules in this respect, while the United Kingdom, Belgium and Ireland are the countries of the EU15 with the least strict rules.

In the final column is found the OECDs evaluation of overall strictness of protection against dismissals. Portugal, the Netherlands, Italy, Sweden and Germany are the countries with the overall strictest rules against dismissal. We should expect to find that in these countries immigrants would have the greatest difficulties entering the labour market by substituting a native worker. At the other end of the rank-

ing we have the United Kingdom, Belgium, Denmark, Ireland and Finland, where immigrants are likely to have the least difficulty entering. From this perspective these countries are likely to be the ones most exposed to labour market displacement following immigration.

We may also note that the three listed countries of the EU10, the Czech Republic, Hungary and Poland, have relatively strict protection against dismissal.

One should remember, however, that it may be very difficult to determine whether the laws are lax enough for labour substitution to occur. For instance, in no EU country are employers allowed to substitute an immigrant worker for an employed native worker without good reason. Even in Great Britain, with the least restrictive laws, the laws may be strict enough to prevent such effects. The conditions for lay-offs are strict in all countries and the basic requirements in all countries are that an individual

Table 2:

Indicators of strictness of employment protection (regular employment)

Country	Regular procedural inconveniences (ranking)	Notice and severance pay for no-fault individual dismissals (ranking)	Difficulty of dismissal (ranking)	Overall strictness of protection against dismissals (ranking)
Austria	2.5 (7)	2.0 (6)	3.3 (5–7)	2.6 (6–7)
Belgium	0.5 (13–14)	2.3 (4)	1.8 (13)	1.5 (13)
Denmark	0.5 (13–14)	1.9 (7)	2.3 (10–11)	1.6 (12)
Finland	2.8 (5–6)	1.4 (10)	2.3 (10–11)	2.1 (10–11)
France	2.8 (5–6)	1.5 (9)	2.8 (9)	2.3 (9)
Germany	3.5 (2–3)	1.3 (11)	3.5 (4)	2.8 (3–5)
Greece	2.0 (8–9)	2.2 (5)	.0 (8)	2.4 (8)
Italy	1.5 (11)	2.9 (2)	4.0 (2)	2.8 (3–5)
Ireland	1.6 (10)	0.3 (14)	2.0 (12)	2.1 (10–11)
Netherlands	5.0 (1)	1.0 (13)	3.3 (5–7)	3.1 (2)
Portugal	3.5 (2–3)	5.0 (1)	4.5 (1)	4.3 (1)
Spain	2.0 (8–9)	2.6 (3)	3.3 (5–7)	2.6 (6–7)
Sweden	3.0 (4)	1.6 (8)	3.8 (3)	2.8 (3–5)
UK	1.0 (12)	1.1 (12)	0.3 (14)	0.8 (14)
Czech Republic	2.5	2.7	3.3	2.8
Hungary	2.0	1.8	2.5	2.1
Poland	3.0	1.4	2.3	2.2

Note: Ranked from most strict (1) to least strict (14).

Source: OECD (1999) Employment Outlook, Paris.

lacks the competence or simply that there is a work shortage. As these rules make it difficult for employers to fire workers the probability that free worker mobility should cause wage dumping and displacement can be assumed to be low in all EU countries.

In many countries the job protection laws do not prevent employers from replacing workers by firing them in a business downturn and then employing low-paid immigrant workers in a business upturn. Some countries prevent this by last-in first-out rules, implying that workers that have been laid off should be the first to be re-employed. But also in the cases when workers from the new member countries and new entrants to the labour market may compete with those previously employed, the latter have an advantage in that the employers have better knowledge about their productivity and the value of their education.

The rules of the labour market are not static, however. Should one find that, as competition for jobs increases, immigrant workers are preferred to native ones, there may be demands for stricter rules. Stricter labour market regulations may thus be a consequence of the free movement and such changes can, of course, mean that the benefits of free mobility are lost to some extent. Particularly in the countries with less restrictive rules, trade unions may find that employers can replace native workers with low-wage immigrant workers. The unions are then likely to demand stricter rules and in the immigration countries there could then be tendencies towards *institutional convergence*. Increased trade union cooperation will probably also lead to more similar labour market institutions.

It needs to be stressed that labour market regulations in Europe do not only differ in the respects that we have discussed above. All countries have their own specific labour-market features. A noteworthy case is the works councils ("*Betriebsräten*") in Germany, which could have specific effects on immigration, but discussion of this would go beyond the scope of the present paper. Moreover, the different forms of pay, such as bonuses, piecework pay or time wages and other forms are likely to make a difference to immigration and the effects of immigration.

The figures reported in Tables 1 and 2 are, of course, not static but change over time. It should be recognised that immigration may have a large impact on the figures, an issue that we shall return to in a section below.

3 The consequences of regulations on migration

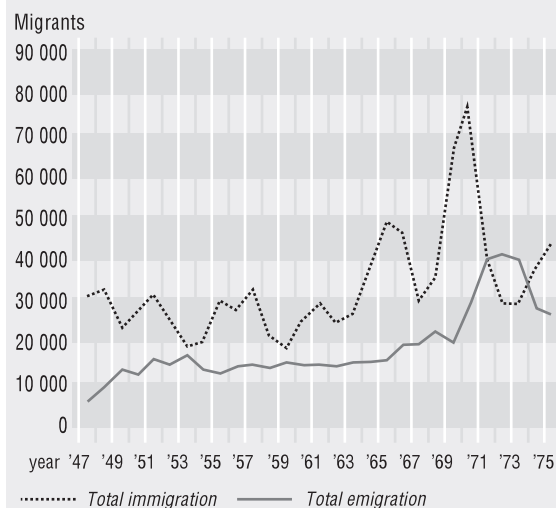
Are there no circumstances when immigration could occur under the present labour market regulations in typical European countries? Indeed there are. The wage (or wage increase) that the social partners agree upon and which is stipulated in the collective agreements will hold for a specified number of years ahead. While the wage then will be downwardly rigid, there are no restrictions on wages increasing upwards. One can then imagine a business peak during the contract period, which would allow for immigration. If demand for labour increases, unemployment among native workers will go down and the increased demand will tend to raise wages above the bargained level (wage drift) and also stimulate immigration. Immigrant workers will enter the labour market and reduce the wage drift.

Thus, our basic conclusion is that the labour market institutions prevent underbidding so that large immigration flows only occur in business peaks. To gain some empirical insight into this issue we consider the changes in immigration flows in Sweden during the period 1954–1975. At that time immigration to Sweden was heavily dominated by labour immigration rather than refugee immigration. In 1954, Sweden and the other Nordic countries signed the agreement of the free Nordic labour market. *Figure 3* shows total gross flows of immigration into Sweden 1947–1975.

Figure 3

Migration to Sweden during a labour immigration period

Total immigration and emigration. Sweden 1947–1975



First, despite the large differences in real wages between Sweden and Finland and the fact that Finnish workers had free access to the Swedish labour market, we see that there are no large changes in immigration when the labour market was opened up in 1954. This shows that it was not possible for large numbers of immigrants to enter the Swedish labour market despite the agreement of free mobility. Finnish workers could not gain access by underbidding and there were obviously not enough vacancies available. Between 1947 and 1963 immigration varied between 19 000 and 33 000 persons per year.

In the business peaks, however, Sweden was to become a popular destination for immigration. In the mid-sixties, Sweden experienced its first major business upturn, which stimulated quite a considerable inflow of immigrants. Unemployment then fell to 1.5 percent and many vacancies were available in Sweden. In two years, immigration doubled from around 27 000 in 1963 to 50 000 in 1965. It then fell back to 30 000 in 1967.

The largest immigration increase appeared in the extreme economic boom of 1969 and 1970. Gross immigration then rose to 64 000 in 1969 and as much as 77 000 in 1970. This boom was followed by a rather sharp increase in unemployment (to 2.5 percent) and immigration fell drastically as the labour market deteriorated. Immigration returned to the more normal level of 29 000 persons in 1972 and 1973, which again indicates a heavy dependence of immigration on the business cycle. These changes in labour supply indicate a major benefit from the free international mobility of labour.⁶

Employers are also likely to favour native jobseekers in periods when the labour market is overheated. This is so since employers are more familiar with the productivity of native workers and find it easier to evaluate their education than that of the immigrants. In particular, native workers' language proficiency could be a decisive factor in this context. Nevertheless, we should expect young workers, new entrants and previous immigrants to face more labour market competition from immigrants applying for jobs.

Therefore although regulations prevent mass immigration, vacancies will arise which in some situations can only be filled by immigrant workers. If, during

a business peak, vacancies cannot be filled by native workers, firms are likely to be able to fill many of these vacancies with foreign workers who have the right qualifications. According to this view, the extent of immigration will therefore be determined by the business cycle. The smoothing of the business cycle may represent one of the largest gains from free labour mobility.

The labour market conditions of the immigration countries are thus crucial and we will expect more immigration the larger the number of vacancies and the lower the number of unemployed. This means that it does not make sense to try to quantify actual immigration after the labour markets have been opened up. Immigration will vary over the business cycle and reach its maximum when the immigration country enjoys a business peak. Also the business cycle of other immigration countries will matter.

Of course, also in business downturns characterised by low labour demand, there will be some demand for specialised labour that native workers cannot fill. It is hardly meaningful to speculate about the type of workers from the new member countries that might be demanded under the free mobility of labour.

4 Concluding remarks

During the post-war period, most countries in western and northern Europe were immigration countries and the southern European countries supplied the expanding manufacturing sectors with cheap labour. To a large extent, immigration was driven by the favourable business development. Thereafter followed a period, generally starting in the early 1970s, of restricted labour market immigration, which was in turn followed by a period of refugee immigration. Today, the EU15 has entered a period when immigration is characterised by free labour mobility from a number of low-wage countries in their geographical vicinity. Again, immigration will to a large extent be determined by demand for labour, and major flows are likely to occur mainly during business peaks. Moreover, the demographic problems facing the European countries imply that demand for labour in the public sector may act as a driving force to unemployment and may determine much of the migration flows during the next 30 to 40 years. If demand for labour in the public sector increases as a consequence of the demographic changes, immigration is expected to give rise to a more stable development of wages than otherwise would have been the case.

⁶ It is also worth noting that foreign workers and accompanying family members had a high labour market participation rate and that the immigrants were quite easily integrated into Swedish society.

In this paper we have argued that, in regulated labour markets, large immigration flows are likely to occur only during business peaks. In other periods, European labour market institutions will prevent wages from falling and immigrants from entering the labour market by means of underbidding. Collective agreements, job security laws and competition regulations should contribute to this development of low immigration. During business peaks, however, things are different. At full employment, only immigrated jobseekers can fill the remaining vacancies. The macroeconomic benefits are obvious and appear in terms of less wage drift and smoother business cycles. If immigration occurs in business peaks and wage dumping is avoided, the integration of foreign workers should not constitute a major problem. This implies that the risk of social problems following enlargement should, in general, be quite limited.⁷

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⁷ See EEAG (2004) for a further discussion on the issue of social policy.