



Home Office

THE ECONOMIC AND FISCAL IMPACT OF IMMIGRATION

A Cross-Departmental Submission to
the House of Lords Select Committee
on Economic Affairs

Produced in partnership with

DWP Department for
Work and Pensions



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House of Lords Select Committee on Economic Affairs

Presented to Parliament
by the Secretary of State for the Home Department
by Command of Her Majesty

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Authors

This is a cross-departmental submission. Each section has been produced by a lead department, with input from others as appropriate. The lead departments were:

Section 1: Office for National Statistics

Section 2: Home Office (Economic and Resource Analysis)

Section 3: HM Treasury

Section 4: Department for Work and Pensions

Section 5: Home Office (Economic and Resource Analysis)

Section 6: Home Office (Economic and Resource Analysis)

Section 7: Home Office (Economic and Resource Analysis)

Section 8: Office for National Statistics

Section 9: Home Office (Border and Immigration Agency)

1 Numbers

Key Points

- According to the UN, over recent decades the number of people worldwide who live abroad has increased from 75 million to 191 million;
- The UK has shared in this increasing migration: in the year from mid-2005 to mid-2006, 385,000 people left the UK on a long-term basis (for more than one year) whilst 574,000 entered the UK on a long-term basis;
- Estimating future migration flows is difficult and official assumptions about future migration are usually based on past trends;
- The new ONS official 2006-based population projections will assume net long-term migration of 190,000 per annum.

1.1 ONS submission to the House of Lords Select Committee

1.1.1 The Office for National Statistics (ONS) has provided the House of Lords Select Committee with a separate statistical submission. This contains the following sections:

Section 1: Background

Section 2: Numbers and characteristics of immigrants

Section 3: Population projections and migration

Section 4: Employment of immigrants

Section 5: How can data on immigration be improved?

Annex A: How immigration is reflected in the national accounts

1.1.2 The ONS submission provides the statistical background to this cross-departmental submission. Whilst not replicating all of the material contained within the ONS report, this cross-departmental submission does highlight some of the headline data to provide context for the rest of the report.

1.2 What are the numbers of recent immigrants?

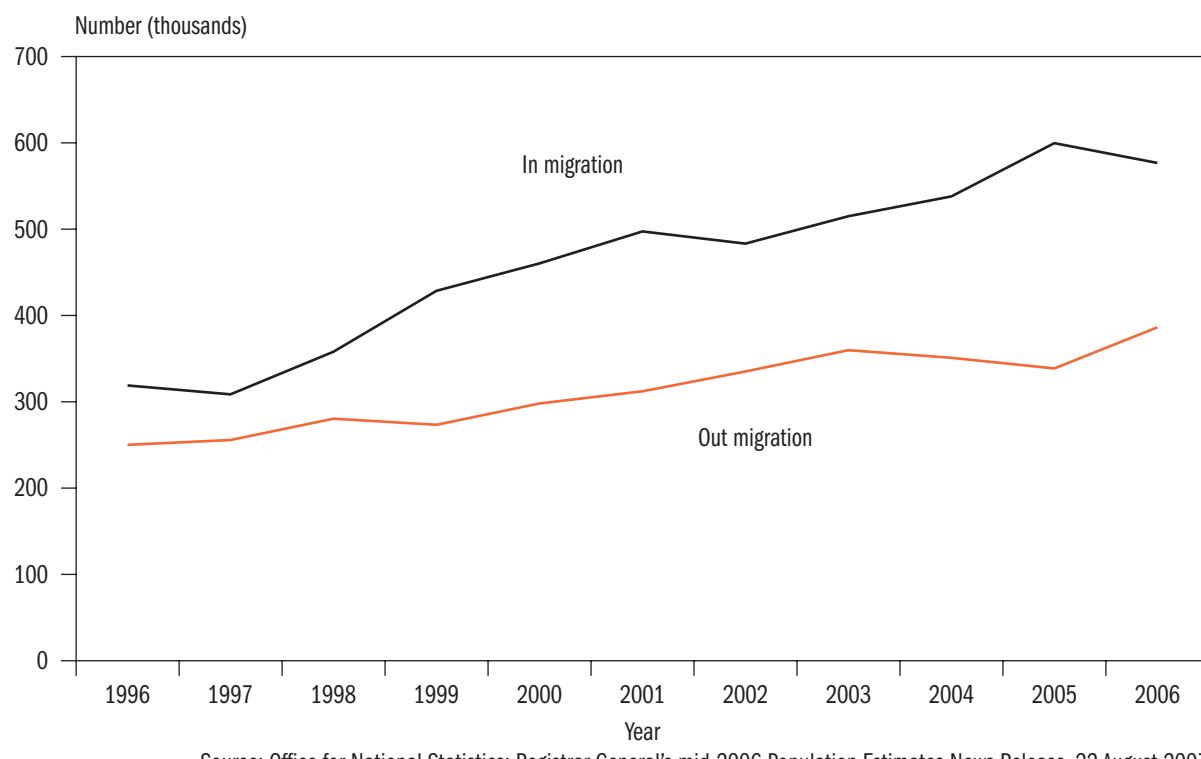
1.2.1 According to UN statistics, between 1960 and 2005 the number of persons across the world who were living abroad more than doubled from 75 million to 191 million (about a fifth of this increase was due to the transformation of internal to international migrants following the fall of the former Soviet Union - in particular, the split of former Yugoslavia and the division of former Czechoslovakia).

1.2.2 Figure 1.2.1 shows UK total international long-term migration from mid-1996 to mid-2006. In the year to mid-2006, the flow of long-term migrants into the UK was 574,000 and the outflow was 385,000. Net international migration (the difference between long-term migration into and out of the UK) was 189,000 in 2006, down from 262,000 in the year to mid-2005.

1.2.3 These figures report the total number of international migrants – that is, without any separation by country of birth. In accordance with the United Nations definition, these figures also include British nationals returning after a year or more abroad¹.

¹ Data are not yet available to break down total international migration for the year to mid-2006 by country of birth. The most recent figures relate to the 2005 calendar year. They show a net *inflow* of 296,000 foreign-born migrants, a net *outflow* of 111,000 UK-born migrants and therefore an overall net inflow of 185,000 for the calendar year as a whole. 77,000 UK-born migrants returned to live in the UK after a year or more abroad.

FIGURE 1.2.1: UK TOTAL INTERNATIONAL MIGRATION, MID-1996 TO MID-2006



Source: Office for National Statistics: Registrar General's mid-2006 Population Estimates News Release, 22 August 2007

1.3 What are the expected future trends for immigration from within and outside the EU?

1.3.1 For the purposes of producing population projections, assumptions are made about future levels of migration. It must be stressed that assumptions about future migration are assumptions based on past trends. They are not forecasts. As a result they do not take into account future policy changes (e.g. the impact of the Points Based System on future migration flows). For the 2004-based projections the assumption was made that, in the long term, there would be an inflow of 500,000 people year coming to live in the UK on a long-term basis. On the same basis, the assumed outflow was 355,000, giving total long-term net migration of 145,000 per year. The assumptions about the groups comprising these figures are shown in Table 1.3.1.

1.3.2 On 27 September ONS published the headline assumptions that will underpin its 2006-based population projections². The new figures increase the net migration assumption to 190,000 per year, up from 145,000 in the 2004-based projections. This increase is partly due to taking account of data for two new years (2004 and 2005) where net migration to the UK has been at record levels, and partly because of methodological changes. The ONS submission discusses the differences between the 2004 and 2006-based assumptions in more detail. The full set of 2006-based population projections and the underlying migration assumptions will be published on 23 October 2007.

² Office for National Statistics (2007) **2006-based national population projections: underlying long-term assumptions**, available at http://www.statistics.gov.uk/downloads/theme_population/PT129_Long-term_assumptions.pdf

TABLE 1.3.1: ASSUMED ANNUAL LONG-TERM GROSS MIGRATION FLOWS, UNITED KINGDOM, 2007-08 ONWARDS

	Inflow (000s)	Outflow (000s)	Net flow (000s)
Illustrative breakdowns of IPS component			
<i>British citizens</i>			
Old Commonwealth & USA	40	65	-25
New Commonwealth	10	5	5
EEA	30	65	-30
Rest of the World	20	20	0
<i>Non-British citizens</i>			
Old Commonwealth & USA	90	55	40
New Commonwealth	75	10	65
EEA	75	50	25
Rest of the World	105	40	65
Total IPS migration	450	305	145
Adjustment to IPS data (see text)			
Visitor switchers	35	20	15
Migrant switchers	-25	-5	-20
Asylum seekers	30	15	15
Total civilian migration	500	355	145

Note: Figures are independently rounded to the nearest 5,000. Therefore, component figures may not sum to totals.

Source: Government Actuary's Department and Office for National Statistics: National Population Projections: 2004-based, Series PP2 no 25

Notes

The projections in this table are based mainly on data from the International Passenger Survey (IPS). This is a sample survey of passengers arriving at, and departing from, the main United Kingdom air and sea ports and the Channel Tunnel. Figures based on the IPS shown in this table are based on relatively small sample numbers. For this reason, the disaggregation of the IPS totals should be regarded as purely illustrative.

Migrants are defined as individuals who change their country of usual residence for a period of at least a year. Adjustments to IPS data are required for people who originally intend to enter or leave the country initially for a short stay but subsequently decide to remain for a year or more (visitor switchers), and for people who intend to be migrants but in reality stay in the UK or abroad for less than one year (migrant switchers).

The IPS excludes most, but not all, persons seeking asylum and some dependants of such asylum seekers. An adjustment for those not covered by the IPS is needed for this reason. Asylum seeker assumptions are based on advice from the Home Office. The assumption for the 2004-based projections covers the migration of all asylum seekers (including failed asylum seekers) not captured by IPS flows, and is on a consistent basis with the annual estimates of asylum seeker migration made by the ONS.

Flows between the UK and the Republic of Ireland are based on Irish data sources including the Irish National Quarterly Household Survey. Following consultation with the Central Statistics Office in Ireland, an assumption of a future annual net outflow of 10 thousand has been made.

Old Commonwealth: This is defined as Australia, Canada, New Zealand and South Africa.

New Commonwealth: This is defined as all other Commonwealth countries, British Dependent Territories and British Overseas citizens. This excludes Hong Kong, Malta and Cyprus are included in the New Commonwealth grouping.

EEA: European Economic Area – this consists of the EU Member States as constituted on 1 May 2004 as well as Iceland, Liechtenstein and Norway.

2 Public finance and net fiscal impacts

Key Points

- The fiscal contribution of migrants must be considered in both the long and short run;
- The impact on the public finances will depend on the impact on tax revenues (through personal tax, corporate tax, VAT, etc.) and the extent to which migrants or their families draw on public services and benefits. The overall magnitude of any effect will also be influenced by whether the current budget is in surplus or deficit;
- A Home Office research study found that, in 1999/2000, first generation migrants in the UK contributed £31.2 billion in taxes and consumed £28.8 billion in benefits and public services – a net fiscal contribution of £2.5 billion;
- More recent work by the Institute for Public Policy Research (IPPR) found that migration has a positive and growing impact on the public finances. By 2003-04 it was estimated that migrants contributed 10 per cent of government receipts and accounted for 9.1 per cent of government expenditure;
- Though based on a previous set of migration assumptions, analysis by the Government Actuary's Department suggests that, in the long term, immigration helps to reduce the burden of contributions to the National Insurance Fund.

2.1 How does immigration affect the public finances?

- 2.1.1 Migrants to varying degrees pay taxes, claim benefits and consume government-provided goods and services for the entire time they live in the host country. Through their participation in these activities they have a direct impact on government expenditure and revenue. If migrants pay more in taxes than they consume in benefits and state services they are said to be net fiscal contributors. If migrants consume more in public services than they contribute through taxes, they are a net fiscal cost to the state. The former represents a net transfer of resources from the migrant to the native population. The latter represents a transfer of resources from the native population to the migrant.

2.2 Do immigrants contribute more in taxes than they use in public services?

- 2.2.1 In broad terms, the lifetime fiscal profile of an individual can be split into three distinct stages. From birth, until the end of state-funded education, an individual will be a net fiscal cost to the state. Once an individual enters the job market, he or she is likely to be a net fiscal contributor; the magnitude of this contribution will depend on the rate of employment and the level of earnings. At the end of an individual's working life, he or she is likely to again become a fiscal cost through the state-funded pension and increased health costs. If society treats every age cohort equally, then the net contribution from these distinct phases will average to zero over a lifetime.
- 2.2.2 Given this outline of the fiscal system, it is clear that the fiscal contribution of immigrants must be considered in both the short and long run. In the short run, the impact on the public finances will depend on the amount of tax migrants pay (a function of their rate of employment and level of earnings) and the extent to which they or their families draw on public services and benefits. The overall magnitude and direction of any effect will also be heavily influenced by whether the current budget is in deficit or surplus. For this reason it is best to compare the net fiscal contribution of migrants to that of non-migrants in particular years.

- 2.2.3 In 2001, the Home Office published a research study, '*Migration in the UK: an economic and social analysis*'³. This was supplemented in 2002 by a more detailed look at the fiscal impact of migration, '*The Migrant Population in the UK: fiscal effects*', by Gott and Johnston⁴. The headline finding of the more detailed paper was that migrants contributed more than natives. In 1999-2000, first generation migrants in the UK contributed £31.2 billion in taxes and consumed £28.8 billion in benefits and state services. After rounding, this amounted to a net fiscal contribution of £2.5 billion. A number of assumptions were made to arrive at this estimate but the main characteristics driving the effect were a smaller proportion of people over 65 in the migrant population and a larger percentage of migrants of working age than in the native born population. Further, although at that time a greater proportion of migrants were unemployed than was the case for the native population, a higher percentage were employed in professional and other high-skilled occupations.
- 2.2.4 There are two main caveats to the 2002 Gott and Johnston study. Firstly, the average nature of the calculation masks variations across different migrant groups. Secondly, the calculations relate to 1999-2000, when the government budget was in surplus overall. As a result, the average fiscal contribution of both natives and migrants was positive. Nonetheless, whilst the UK-born population was estimated to have paid almost 5 per cent more in taxes than it received in terms of public services and welfare benefits, migrants were estimated to have paid 10 per cent more than they received.
- 2.2.5 In 2005, the Institute for Public Policy Research (IPPR) produced updated estimates of the net fiscal impact of migration, based largely on the Gott and Johnston work⁵. Again, the authors found that migration had a positive influence

on the public finances, but also that the impact was growing. Between 1999-2000 and 2003-04 it is estimated that revenue from migrants grew by 22 per cent in real terms as opposed to 6 per cent for the UK-born population. In 1999-2000 the study estimates that migrants accounted for 8.8 per cent of government receipts and 8.4 per cent of government expenditure. By 2003-04 it was estimated that migrants contributed 10 per cent of government receipts and accounted for 9.1 per cent of government expenditure.

- 2.2.6 **In the long run, it is likely that the net fiscal contribution of an immigrant will be greater than that of a non-immigrant.** For migrants of working age who enter the country this is relatively clear; the UK is receiving the fiscal contribution of their work, without paying for the education and training that enables them to work. Even for young children, by assuming as we do that each age cohort is treated equally through the fiscal system, then, in the long run, migration to the UK is still likely to mean a net fiscal transfer to the native population.
- 2.2.7 A 2006 paper by MigrationWatch⁶ criticises the methodology of the 2002 Home Office paper and the subsequent IPPR work. The criticism centres on the treatment of UK-born dependent children of migrants. Specifically, the large number of UK-born children of mixed households (one migrant and one non-migrant parent) were included as UK-born children in the Home Office and IPPR studies. MigrationWatch argue that such children should be apportioned 50:50 to migrants and non-migrants, although once they reach working age they are regarded as non-migrants. No usual definition of "migrant" would consider such children as migrants, and doing so would substantially bias the calculation against migrants. Children born in the UK are UK citizens and it is inconsistent to view them as 'part migrant' before the age of 16, but UK nationals after that age. An article providing further details of this issue and the subsequent Home Office critique of the MigrationWatch findings was submitted as written evidence to the House of Commons Select Committee on Home Affairs⁷.

³ Glover, S., Gott, C., Loizillon, A., Portes, J., Price, R., Spencer, S., Srinivasan, V. and Willis, C. (2001) *Migration: an economic and social analysis*, Home Office RDS Occasional Paper No 67, available at <http://www.homeoffice.gov.uk/rds/pdfs/occ67-migration.pdf>

⁴ Gott, C. and Johnston, K. (2002) *The migrant population in the UK: fiscal effects*, Home Office RDS Occasional Paper No 77, available at <http://www.homeoffice.gov.uk/rds/pdfs/occ77migrant.pdf>

⁵ Sriskandarajah, D., Cooley, L. and Reed, H. (2005) *Paying their way: the fiscal contribution of immigrants in the UK*, IPPR, available at <http://www.ippr.org/publicationsandreports/publication.asp?id=280>

⁶ Migration Watch (2006) *The Fiscal Contribution of Migrants*, available at http://www.migrationwatchuk.org/Briefingpapers/economic/1_10_Fiscal_Contribution_of_Migrants_Aug_06.asp

⁷ See <http://www.publications.parliament.uk/pa/cm200506/cmselect/cmhaff/775/775awe60.htm#note44>

2.2.8 To our knowledge, there are no published estimates of the long-run fiscal contribution of an immigrant to the UK. Any such estimate would of course be subject to a large degree of uncertainty as the tax and benefit system and earnings and employment profiles are difficult to predict accurately in the long run. Despite these uncertainties, estimates of the lifetime net present value of a migrant to the US fiscal system were published in 1997⁸. The results of the work estimate that, on average, an immigrant has a net present value of around \$80,000 to the US fiscal system, in 1996 US Dollars. This surplus is estimated to be very large for highly skilled migrants (around \$180,000) and slightly negative for individuals educated to below secondary high school level (around -\$13,000). These estimates do not make any assumptions about migrants increasing the productivity of native workers. If this type of effect was incorporated into analysis of the long-run fiscal contribution of migrants, then the contribution of migrants would be enhanced.

2.3 As the UK population ages, does immigration affect the shortfall in pension funding?

2.3.1 To our knowledge, there are no published estimates of the direct impact of immigration on the shortfall in pension funding in UK. Any attempt to produce such an estimate would have to take into account that whilst immigrants are more likely to be of working age and hence reduce the dependency ratio, in the long run these migrants will also age. Nonetheless, theoretical considerations suggest the impact is still likely to be beneficial in the long term⁹.

2.3.2 Analysis by the Government Actuary's Department (GAD)¹⁰ looks at the impact of different migration assumptions on the National Insurance Fund. As well the state pension, the National Insurance Fund contributes funding for items such as incapacity benefits, bereavement benefits and the Jobseekers' Allowance. The GAD bases its calculations on 2001-based interim population projections¹¹. Whilst these assumptions are some way from those used in the latest set of population projections, the calculations still provide a useful illustration of the impact of immigration on the public finances.

2.3.3 The GAD analysis looks at the joint (employer and employee) Class 1 National Insurance contribution rate necessary to balance income and expenditure in the year. Under the low migration scenario, the joint contribution rate would need to be 27.9 per cent in 2060-61 to balance the fund. Under the high migration scenario, this rate would fall to 26.3 per cent. The positive long-term impact of immigration on the National Insurance Fund should not, therefore, be overlooked.

2.3.4 Section 6 of this submission considers more fully whether immigration could ease the pressure on the public finances resulting from population ageing.

8 Smith, J. and Edmonston, B. (eds.), (1997), **The New Americans: Economic, Demographic, and Fiscal Effects of Immigration**, Washington DC: National Research Council, National Academy Press.

9 See Munz, S. and Werding, M. (2003) **Public pensions and international migration: some clarifications and illustrative results**, IFO Institute for Economic Research and CESifo, available at http://ideas.repec.org/a/cup/jpenef/v4y2005i02p181-207_00.html

10 Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000, published October 2003, available at http://www.gad.gov.uk/news/documents/quinquennial_Review_05-Full_Report.pdf

11 The 2001-based principal variant projections used in the GAD report assume long-term net migration to the UK of 101,500 per annum. A low-migration variant reduces this figure to 41,500 and a high-migration variant increases it to 161,500.

3 Macroeconomic impacts: what has been the impact of immigration on key macroeconomic indicators

Key Points

- Migration affects trend growth principally through changes in the working age population;
- Work by the National Institute of Economic and Social Research suggests that around 17 per cent of economic growth in 2004 and 2005 is attributable to immigration;
- The Treasury estimates that between Q3 2001 and mid-2006 migration added 0.5 per cent per annum to the working age population and therefore supported growth in economic output. On this basis, migration contributed around £6 billion to output growth in 2006;
- There is no quantitative evidence available on the impact of immigration on GDP per head. Wage data suggest migrants may have a positive impact directly through their own output and indirectly through raising the productivity of others.

3.1 What is the impact on growth?

- 3.1.1 Immigration has clear benefits for both the labour market and the economy as a whole. Riley and Weale (2006)¹² have estimated that the economy grew by 5.3 per cent in 2004 and 2005 together. Of this, 0.9 percentage points can be attributed to the direct effect of immigration. That is, approximately 17 per cent of economic growth during the period is attributable to immigration.
- 3.1.2 Immigration, along with greater labour force participation among older people, has been a key source of additional labour supply in recent years. Concerns that native workers would be displaced by migrant workers, especially following the accession of the new member states in 2004, seem ill-founded, as migrant workers appear to have complementary skills to the native labour force¹³.

12 Riley, R. and Weale, M. (2006) Commentary: **Immigration and Its Effects**, National Institute Economic Review, No. 198 October 2006

13 Blanchflower, D. (2007) **Recent Developments in the UK Labour Market**, Bank of England Quarterly Bulletin, 2007 Q1

- 3.1.3 This is supported by the OECD in its assessment of the UK in its Economic Outlook in November 2006¹⁴:

"Record high inward migration has been adding to potential growth while fuelling domestic demand. ... Since strong labour force growth also leads to a higher path for potential output, stronger growth achieved through this channel would not necessarily result in an acceleration of inflation. On the contrary, international as well as UK evidence suggests that immigration can serve to make the labour market as a whole more fluid and wages less sensitive to demand fluctuations."

- 3.1.4 Recent ad-hoc survey evidence from business further supports the view that migrant workers make a significant positive contribution to the UK economy¹⁵. This evidence highlights the benefits arising from the skills, higher productivity and work ethic that migrant workers bring.

3.2 What is the impact on trend growth?

- 3.2.1 The Treasury's framework for assessing trend growth¹⁶ measures the change in four components:
- Average output per hour of the working age population;
 - Average hours worked per worker;
 - Employment rate of the working age population;
 - The working age population.
- 3.2.2 From the start of the economic half-cycle in 2001 Q3 to mid-2006 migration added around 0.5 per cent per annum to the working age population, stimulating growth in total output. Average output growth over this period was around 2.7 per cent per annum and migration is estimated to have contributed around 15-20 per cent of this. On this basis, migration contributed around £6 billion to output growth in 2006.

14 OECD Economic Outlook 80, November 2006

15 See **Immigration – The Business Perspective**, Institute of Directors, January 2007; and **Migration – Plugging the Gap**, The British Chambers of Commerce, February 2007.

16 The rate at which the economy can grow without putting upward or downward pressure on inflation

3.2.3 Looking ahead, migration is expected to continue to contribute towards growth in the population of working age, and hence overall growth in the economy. While projections of net migration are subject to uncertainty, data on migration released during 2006 provided evidence to support an upward revision of the assumed working-age population growth rate post-2006, from 0.4 per cent to 0.6 per cent. Details of this are set out in Trend Growth: new evidence and prospects, published alongside the 2006 Pre-Budget Report¹⁷.

3.3 GDP per head

- 3.3.1 The Committee has asked about the impact of migration on GDP per head. It is of course important to consider not only the impact of migrants on GDP, but also how they might contribute to an increase in wealth in the population as a whole. Because it may take migrants some time to fully integrate in the UK labour market, and because changes in migrant numbers in any one year are marginal to the totality of economic activity, it will always be difficult to determine exactly what effect migrant labour as a whole has on economic activity and hence GDP per head in the medium term.
- 3.3.2 There are two ways of approaching this question: the direct effect of migrants on employment and earnings; and their indirect effect on non-migrant workers.
- 3.3.3 The first way is to examine the contribution to GDP per head that an individual migrant makes through his or her personal contribution to economic production. If migrants gain employment and earn at a rate above the national average, they will tend to raise GDP per head through a simple averaging effect. The earnings and employment propensities of foreign-born workers are discussed in more detail in Section 5.4 of this submission. This suggests that, on average, migrants contribute more to GDP than natives, so raising GDP per head. However, even 200,000 additional migrants in any one year constitute a relatively small proportionate increase in the overall population of the UK, so the direct impact of migration on GDP per head will inevitably be small.

- 3.3.4 As noted elsewhere, migrants differ markedly in their characteristics and economic outcomes. The impact of an ‘average’ migrant is therefore not representative of the impact of any given migrant. A decrease in high-skilled economic migration would, for example, have a much greater negative impact than the average data would suggest.
- 3.3.5 The second approach is to ask what contribution foreign-born workers make to the economy, jointly with their UK-born counter-parts. If migrant workers complement the activities of native workers, then the productive contribution of all workers is increased, with the potential for larger increases in wealth. Over the medium to long term this effect is likely to dominate, but is much harder to quantify than the direct effect.
- 3.3.6 Again, examination of earnings can help shed some light on this question. There is some evidence on complementarities from the Low Pay Commission, discussed in Section 4.4. This suggests that migrant workers raise the earnings of native workers by not insignificant amounts overall (a 1 per cent increase in the ratio of immigrants to natives would lead to a 0.3 per cent to 0.4 per cent increase in average earnings for natives). Earnings growth is higher in the middle and upper part of the native earnings distribution, and lower at the very bottom, relative to the position in the absence of migration. This suggests migrants may raise the productivity of those in the middle and upper part of the distribution and so raise GDP per head. The transmission mechanisms which lead to differential effects in different parts of the earnings distribution are, however, as yet unclear.
- 3.3.7 Migration might impact on components of GDP other than earnings, such as the returns to capital. We are not aware of any research providing quantification of this issue.
- 3.3.8 The labour market integration of migrants seems to improve over time, as they gradually move towards full assimilation as workers, gaining from work experience, improved language skills and better work search techniques. This means that estimating the full contribution to wealth of migrant workers on the basis of the immediate contribution of the annual inflow in any one year will be misleading.

17 See http://www.hm-treasury.gov.uk/media/3/1/pbr06_trendgrowth_345.pdf

3.3.9 In addition, it would not be right to estimate the *total* contribution of all migrant workers simply by subtracting their productive output and numbers respectively from the numerator and denominator of the GDP per head ratio calculation. The integration of migrant workers in the economy, and their ability to complement the activities of other workers, means that the impact on national output of a total withdrawal of migrant labour would be likely to be very substantial. However, quantifying this impact is difficult given the lack of data in this area and the large number of assumptions that would underpin estimates of productive potential.

3.4 Productivity and innovation

3.4.1 Migrants' impact on aggregate productivity is dependent on the level and composition of their skills, their ability to employ these skills effectively in the host country and the ability of the host economy to employ them effectively.

3.4.2 Migrant workers may boost the labour productivity of UK workers if their skills are complementary, and contribute to technical progress and innovation. Contact with people from different backgrounds and experiences of alternative work practices can contribute to both process and product innovation and raise productivity through these channels. Evidence from the US points to highly skilled migrants encouraging technical progress¹⁸.

3.4.3 In addition, the impact on productivity depends on the amount of capital available in the UK economy. If the capital stock is fixed in the short term, inward migration may depress aggregate labour productivity, though this depends on the extent to which migrant workers complement the existing workers. However, investment is likely to increase in the face of an increase in the labour supply as the return to capital increases and firms expect a larger population to demand more goods and services.

3.4.4 Past episodes of large immigration flows have indeed been associated with periods of rapid capital accumulation, though the sunk costs and adjustment costs associated with investment can imply a lag between inward migration and increased investment¹⁹. With liberalised capital markets such as in the UK, capital flows are likely to respond fairly rapidly to an increase in labour supply.

3.4.5 It is important to note that the impact of migration on measured aggregate productivity will depend on the sectors and occupations where migration is concentrated. For example, if the migration is concentrated in lower productivity sectors this may dampen *aggregate* productivity (since it increases the number of workers in lower productivity sectors) but could at the same time raise the productivity of every individual in the economy (both migrants and non-migrants) if migrants and native workers are complementary.

3.4.6 Wages over the longer term are an indicator of labour productivity as they reflect the value added of workers, though wage differences could in part reflect sectoral labour demand and supply imbalances. The mean wage for the foreign-born is £424 per week, compared with £395 for the UK-born, suggesting migrants have higher productivity than UK workers²⁰.

18 See the following papers:

- Zucker, L., Darby, M. and Brewer, M. (1998) **Intellectual human capital and the birth of the United States biotechnology enterprises**, American Economic Review, Vol. 88, pages 290–306
- Stephan, P. and Levin, S. (2001) **Exceptional contributions to US science by the foreign-born and foreign-educated**, Population Research and Policy Review, Vol. 20, No. 1, pages 59–79
- Chellaraj, G., Maskus, K. E. and Mattoo, A. (2005) **The Contribution of Skilled Immigration and International Graduate Students to U.S. Innovation**, working paper, Department of Economics, University of Colorado Boulder

19 Bank of England Quarterly Bulletin, 2007 Q1, Volume 47 No. 1, page 53, available at <http://www.bankofengland.co.uk/publications/quarterlybulletin/qb0701.pdf>

20 DWP calculations, based on the Labour Force Survey

4 Labour market, productivity and skills impacts

Key Points

- In the final quarter of 2006, people born overseas accounted for 12.5 per cent of the UK working age population, up from 7.4 per cent a decade earlier;
- Since 1997, the number in of people in work has increased by around 2.7 million; ILO unemployment is has fallen by 1.8 percentage points to 5.4 per cent; and the claimant count rate has fallen by 1.9 points to 2.6 per cent;
- Migration is one source of labour market growth but not the only one – there are now more older people, lone parents and disabled people in work;
- DWP evidence shows that migration has not had a negative impact on labour market outcomes such as wages and unemployment.

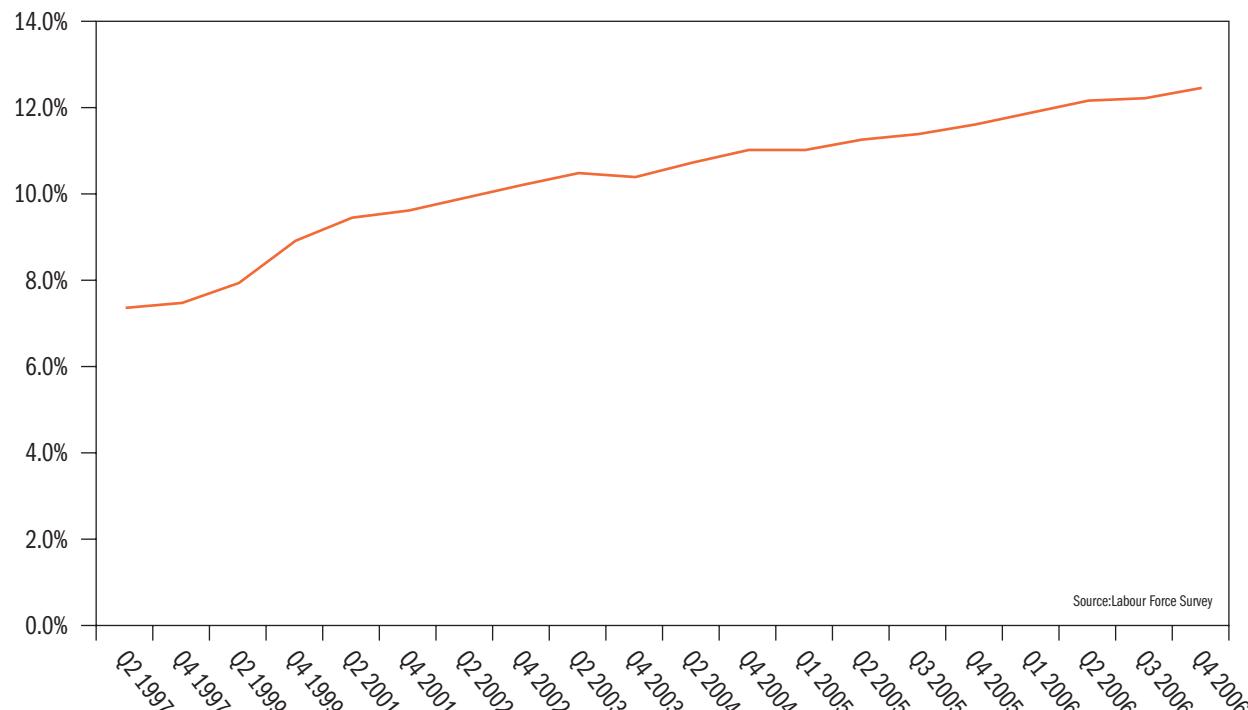
4.1 The labour market impact of immigration: Context

4.1.1 Over the last ten years the UK labour market has performed strongly, delivering both high

employment and low unemployment. Since 1997 the number of people in work has increased by around 2.7 million. This reflects both reductions in unemployment and improvements in economic activity. The ILO unemployment rate has fallen by 1.8 percentage points, to 5.4 per cent, and the claimant unemployment rate by 1.9 points, to 2.6 per cent. Excluding students, inactivity has fallen by 1.3 percentage points of the population, to 16.2 per cent, as some individuals who were previously not looking for work have been drawn back into the jobs market. Migration is one source of labour market growth, but not the only one. Firstly, there are more older people, lone parents and disabled people in work. Secondly, and more broadly, there are more people returning to work and more people staying in jobs for longer²¹.

4.1.2 Meanwhile, the number of foreign-born in the labour force has risen noticeably, particularly following the expansion of the European Union in 2004 and the decision to allow free movement of workers from the new Member States (the "A8"). According to the Labour Force Survey (LFS), in Q4 2006 people born overseas accounted for 12.5 per cent of the UK working age population, up from 7.4 per cent a decade ago (see Figure 4.1.1 below).

FIGURE 4.1.1: FOREIGN-BORN WORKING AGE POPULATION AS A PERCENTAGE OF THE UK WORKING AGE POPULATION, Q2 1997 TO Q4 2006



21 As of August 2007, see Labour Market Statistics Report August 2007:
<http://www.statistics.gov.uk/pdfdir/lmsuk0807.pdf>

4.2 The labour market impact of immigration: theory

- 4.2.1 In theory, immigration could have a number of impacts on the labour market and in particular the labour market outcomes of natives. Depending on the characteristics of migrants and the labour market adjustment process, impacts could be seen on both employment and wages.
- 4.2.2 There is no theoretical reason why immigration need either depress native wages or increase native unemployment. Given that there is a strong long-run correlation between the size of the labour force and employment, there is no “lump of labour”; it is not true to say that there are only a fixed number of jobs to go round. It is increasingly recognised that, given sound macroeconomic management, unemployment is primarily a structural phenomenon. If that is the case, then migrants will have no effect on the job prospects of natives (in the medium or long term); and the appropriate policies for Government to pursue to address unemployment among natives (and, to the extent relevant, among past and present migrants) are active labour market policies designed to connect people with the labour market, including by increasing their skills and employability. This is what the Government is doing with its current programme of welfare reform²². A key element of this is a new jobs pledge that aims for major employers to offer a quarter of a million job opportunities to local people at a disadvantage in the labour market. This pledge will be delivered through Local Employment Partnerships.
- 4.2.3 Nor is there any theoretical reason to expect that immigration will lead to a reduction (or increase) in native wages, either overall or for specific groups. If the result of migration is not to increase labour market competition at any particular level, but to change the nature of the production in the economy – and hence of labour demand as well as labour supply – there is no necessary impact on wages. If migration raises the productivity of native workers through complementary skills, then wages may rise. Indeed, the academic consensus is that the impact of migration on native labour market outcomes, especially in a relatively open and flexible economy like the UK, is likely to be small or zero:

“The usual theoretical models do not establish a presumption for or against the existence of long-run employment or wage effects. If the economy is characterised by a large and heterogeneous traded goods sector, employment and wages may be insensitive to immigration” (Dustmann *et al.*, 2003)²³

“There is some presumption that output-mix adjustment fully absorbs the immigration shock... our presumption should be that immigration has no long run effect on labour market outcomes” (Gaston and Nelson, 2002)²⁴

4.3 The impact of immigration on employment

- 4.3.1 This theoretical presumption appears to be supported by the available empirical evidence for the UK. A number of papers have looked at the employment impacts of migration; none appears to have found a statistically significant impact.

“The empirical literature from around the world suggests little or no evidence that immigrants have had a major impact on native labour market outcomes such as wages and unemployment. Recent work by a number of other authors for the UK is also consistent with this view.” (Blanchflower, 2007)²⁵

- 4.3.2 Dustmann *et al.* (2002)²⁶ looked at all migrants in the UK using a range of available migrant data sources and found that:

“...if there is an impact of immigration on unemployment then it is statistically poorly determined and probably small in size.”

- 4.3.3 However, this paper looked at migration flows over a long period, and recognised that given the nature of the adjustment process it might not be possible to isolate the direct impact of migration.

23 Dustmann, C., Fabbri, F., Preston, I. and Wadsworth, J. (2003) **The local labour market effects of immigration in the UK**, Home Office Online Report 06/03, available at <http://www.homeoffice.gov.uk/rds/pdfs2/rdsolr0603.pdf>

24 Gaston, N. and Nelson, D. (2001) **The Employment and Wage Effects of Immigration: Trade and Labour Economics Perspectives**, The Leverhulme Centre, research paper 2001/28, available at http://www.gep.org.uk/shared/shared_levpublications/Research_Papers/2001/01_28.pdf

25 Blanchflower, D., Saleheen, J. and Shadforth, C. (2007) **The Impact of the Recent Migration from Eastern Europe on the UK Economy**, Bank of England, available at <http://www.bankofengland.co.uk/publications/speeches/2007/speech297.pdf>

26 Dustmann, C., Fabbri, F., Preston, I. and Wadsworth, J., (2003) **The local labour market effects of immigration in the UK**, Home Office Online Report 06/03, available at <http://www.homeoffice.gov.uk/rds/pdfs2/rdsolr0603.pdf>

22 DWP (July 2007) In work, better off: next steps to full employment, available at <http://www.dwp.gov.uk/welfarereform/in-work-better-off/>

- 4.3.4 More recently, a particularly strong test of the labour market impact of migration is given by experience with the accession of eight new European Union Member States in May 2004. This initially led to significant inflows to the UK labour market over a relatively short period of time. Moreover, the new migrants were concentrated in certain occupations and in certain areas of the country²⁷. Whilst the occupational distribution of non-A8 foreign-born is broadly similar to that of the UK-born, the A8-born are concentrated in lower skill occupations. The A8-born have also gone to parts of the country that are not traditionally associated with migration. So if immigration was to have a significant impact, we would expect to see it reflected in the more recent data.
- 4.3.5 The claimant count increased between 2004 and 2005 around the same time as the A8 countries joined the EU and migrants from these countries began to come to the UK in significant numbers. Between January 2005 and June 2006 the claimant count increased by over 130,000. At the same time 310,000 A8 migrants registered for work in the UK on the Workers Registration Scheme. It has been suggested that the new A8 immigration might have caused the rise in claimant unemployment.
- 4.3.6 The Department for Work and Pensions (DWP) has performed an extensive and thorough statistical analysis of claimant count data, the Annual Labour Force Survey and the Workers Registration Scheme (WRS). **This analysis found no discernible statistical evidence that A8 migration has resulted in an increase in the claimant count rate since May 2004.**
- 4.3.7 Vacancies, including those in sectors where migrants are concentrated have been and remain historically high. The magnitude of vacancies in the UK in a given month is far greater than the inflow of A8 migrants.

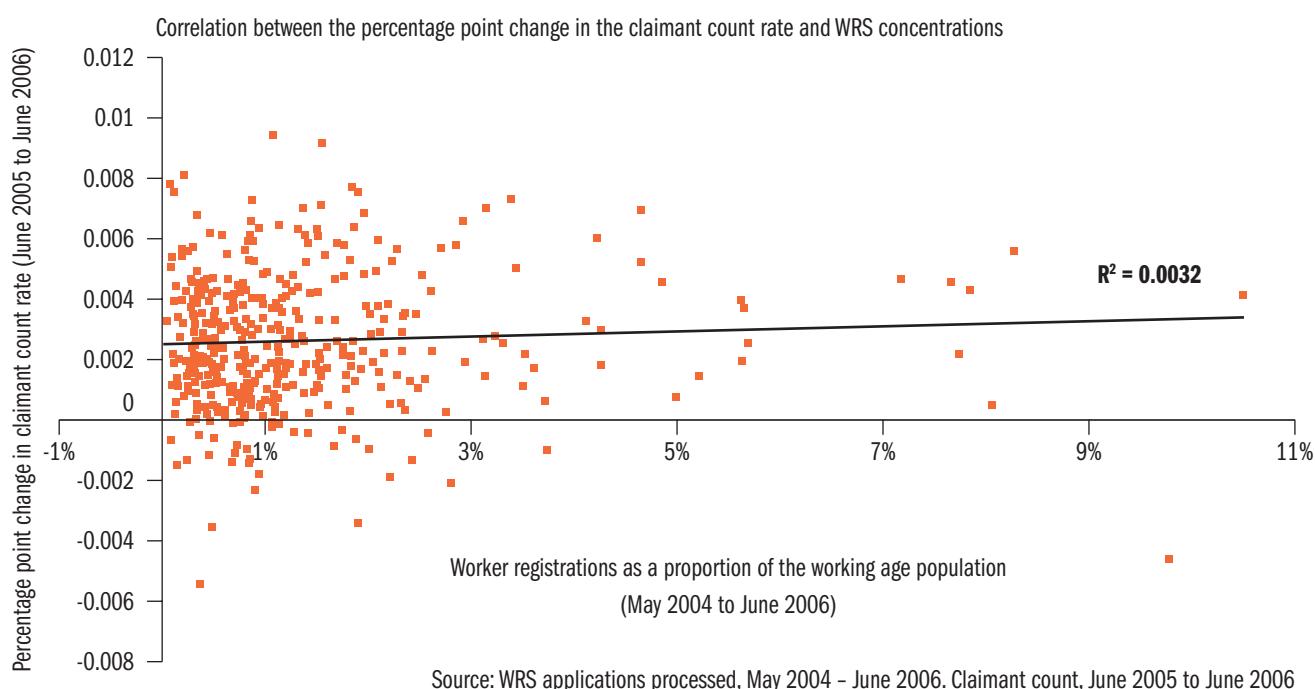
TABLE 4.3.1 NUMBER OF VACANCIES BY INDUSTRIAL SECTOR SEPTEMBER 2006 TO AUGUST 2007

Industrial Sector	Vacancies
Agriculture & Fishing	1,635
Energy & water	1,853
Manufacturing	12,024
Construction	10,383
Distribution, hotels & restaurants	57,091
Transport & communication	12,163
Banking, finance & insurance	182,323
Public admin, education & health	36,333
Other services	12,254
Total	326,058

Source: ONS Vacancy Survey, monthly average September 2006 to August 2007, figures relate to GB

27 See Section 2 of the ONS statistical submission to the House of Lords for more details on the geographical distribution of immigrants

FIGURE 4.3.1: RELATIONSHIP BETWEEN UNEMPLOYMENT AND THE DENSITY OF MIGRANTS IN UK LADs



4.3.8 The chart above shows that there is no relationship between the change in the claimant count rate between 2004-05 and 2005-06 and the concentration of A8 migrants across local authority districts (LADs) in the UK. If A8 migrants had caused an increase in the claimant count we would expect the line of best fit to slope upwards from left to right, i.e. areas which have seen a increase in the claimant count rate would also have a relatively high concentration of A8 migrants and vice versa. In fact it is effectively flat.

4.3.9 In the DWP paper, Gilpin *et al.* (2006)²⁸ performed a number of further sophisticated econometric tests of this data, and concluded:

“...we have found no discernible statistical evidence to suggest that A8 migration has been a contributor to the rise in claimant unemployment in the UK.”

4.3.10 So far, both theoretical and empirical analysis suggests that migration has had no impact on the employment prospects of UK natives. The August 2007 Labour Market Statistics report²⁹ showed that employment had reached a near all time high of 29.07 million while the claimant count had fallen for ten of the last twelve months, despite the continuation of significant inflows from the new Member States.³⁰

28 Gilpin, N., Henty M., Lemos, S., Portes, J. and Bullen, C. (2006) **The impact of free movement of workers from Central and Eastern Europe on the UK labour market**, Department for Work and Pensions, Working Paper No. 29 available at <http://www.dwp.gov.uk/asd/asd5/wp29.pdf>

29 Office of National Statistics, **Labour Market Statistics**, August 2007, available at <http://www.statistics.gov.uk/pdfdir/lmsuk0807.pdf>

30 It should be noted that evidence from the WRS suggests that the occupational and geographic mobility of A8 migrant workers has increased since the period just after EU enlargement. All else being equal, we would expect this to dampen any potential impact on the UK labour market

4.4 The impact of immigration on wages

4.4.1 Research commissioned by the Low Pay

Commission (Dustmann *et al.* 2007)³¹ looked at the inflow of migrants to the UK between 1997 and 2005, largely pre-dating the recent wave of immigration from the A8 countries, and found that while there was, on average, a slightly positive effect on wage growth there were very modest negative effects at the lower end of the distribution. These findings are in line with planned changes to Government immigration policy. Under the new Points Based System, the Resident Labour Market Test will only apply to jobs below a certain salary, since it is here that there is most public concern about the impact of migrant labour on the domestic labour market³².

4.4.2 To put their findings into perspective,

Dustmann *et al.* (2007)³³ look at the wage impact of immigration within the context of overall wage growth for different groups of workers. Over the period considered, the real hourly wage grew by an average of 18 pence per year at the first decile. Without immigration, this figure would have been 0.7 pence higher. Further up the wage distribution, immigration added about 1.5 pence per year to real hourly wage growth at the median, and 2.3 pence at the ninth decile. The authors conclude that the wage effects at the low end of the wage distribution are "very modest". The paper also notes that the National Minimum Wage (NMW) has played an important role in insulating the wages of low-paid workers from a larger impact.

4.4.3 It is not clear how to interpret these results.

Some commentators (Borjas 1994³⁴, Dustmann *et al.*, 2007³⁵) have argued that low-skilled migration might reduce wages at the lower end (through substitution and competition) while

increasing them at the middle and upper end (through complementarities). It is important to note that over this period (which predicated the large expansion of migration from the Accession countries) migrants were on average higher skilled, and higher paid, than natives. Another hypothesis is that migrants increase the overall flexibility and dynamism of the economy and hence the productivity and earnings of natives, at least in certain sectors, but further analysis is required.

4.4.4 Dustmann *et al.* (2007)³⁶ also note that many

new arrivals initially move into lower level occupations than their skills would dictate, increasing competition for jobs at the lower end of the wage distribution. This suggests that the problem is not caused by immigration per se, but by frictions that hinder migrants' ability to move into jobs that are appropriate to their skills. This is something that policy is addressing through initiatives such as English language training (ESOL), so that language does not represent a barrier to migrants putting their skills to maximum productive use.

4.4.5 Furthermore, the downward impact on real wages amongst lower paid workers is relatively small compared with the large upward trend of earnings growth at the bottom of the distribution over the period. Deflating using the RPI, real wage growth in the 5th, 10th and 50th percentiles was 22 per cent, 15 per cent and 11 per cent respectively, hence lower paid workers experienced real wage increases well above the average.

Estimates by BERR show that in the absence of increased immigration over the 1997-2005 period, additional real wage growth at the lower end is likely to have been minimal, i.e. around 1-2 percentage points higher.

4.4.6 Recent migration from the new Member

States provides additional evidence. It has been suggested that since May 2004 A8 migration has reduced wage growth in sectors in which migrants are concentrated. However, this is not supported by the evidence. For example, there have been particular concerns about the construction sector, but wage growth in the construction sector exceeded average wage growth in both 2005 and 2006 (see Table 4.4.1). Of course, it may still be the case that migration reduced wage growth in certain sectors relative to what it would otherwise have been. DWP continues to undertake research in this area.

31 Dustmann, C., Frattini, T. and Preston, I. (2007) **A study of migrant workers and the national minimum wage and enforcement issues that arise**, report commissioned by the Low Pay Commission, available at <http://www.econ.ucl.ac.uk/cream/pages/LPC.pdf>

32 In the current system an employer seeking a work permit needs to satisfy the Border and Immigration Agency that they have advertised a job in an appropriate medium and that they had no suitable applicants who were nationals of the European Economic Area. The test is waived by Border and Immigration Agency staff in certain circumstances.

33 Dustmann, C., Frattini, T. and Preston, I. (2007) **A study of migrant workers and the national minimum wage and enforcement issues that arise**, report commissioned by the Low Pay Commission, available at <http://www.econ.ucl.ac.uk/cream/pages/LPC.pdf>

34 Borjas, G. (1994) **The economics of immigration**, Journal of Economic Literature, Vol. XXXII, available at <http://ksghome.harvard.edu/~GBorjas/Papers/JEL94.pdf>

35 Dustmann, C., Frattini, T. and Preston, I. (2007) As above

36 Dustmann, C., Frattini, T. and Preston, I. (2007), As before

TABLE 4.4.1: GROWTH IN WEEKLY EARNINGS AND OVERTIME BY INDUSTRIAL SECTOR IN 2004-5 AND 2005-6 FOR ALL EMPLOYEES

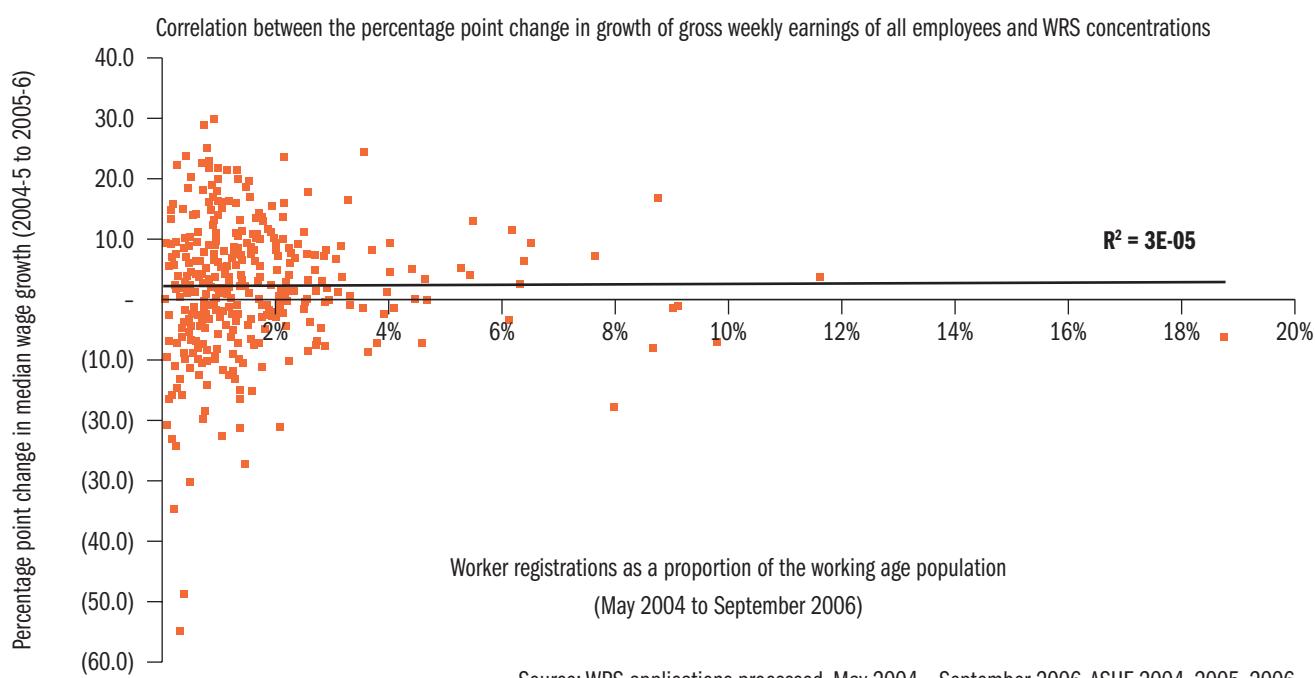
Industry	Growth in basic pay 2004-5 (%)	Growth in overtime 2004-5 (%)	Growth in basic pay 2005-6 (%)	Growth in overtime 2005-6 (%)
Electricity, Gas and Water Supply	8.9	1.6	-1.0	14.1
Real Estate and Business Activity	-1.3	-9.1	3.2	10.2
Education	3.8	-6.8	3.2	5.2
Manufacturing	3.9	-3.8	3.7	3.1
Agriculture, Hunting and Forestry	3.3	-13.1	3.8	22.8
Construction	3.0	2.3	4.3	4.2
Transport and Communication	1.1	5.5	4.6	-3.8
Other Services	0.1	8.2	4.6	-1.7
Public Admin and Defence	2.9	10.9	4.7	-11.5
Health and Social Work	4.3	2.0	4.8	-0.5
Financial Intermediation	3.7	-6.2	5.9	9.2
Distribution	1.4	-9.0	6.4	-1.7
Hotels and Restaurants	-4.9	-20.7	6.7	1.4
Mining and Quarrying	9.0	0.0	15.5	0.0
All	1.9	-5.0	4.1	0.9

Source ASHE: 2004-2006

4.4.7 Using a similar methodology to that described above for employment, we can use the ASHE data from 2004 to 2006 broken down to the LAD level to perform simple linear correlations comparing wage growth with the concentration of A8 migrants in LADs across the UK, based on

Worker Registration Scheme (WRS) data. The chart below shows that there is no discernible statistical relationship between the change in the growth of wages between 2004-5 and 2005-6 and the concentration of A8 migrants across LADs in the UK.

FIGURE 4.4.1: RELATIONSHIP BETWEEN EARNINGS GROWTH AND THE DENSITY OF A8 MIGRANTS IN UK LADs



5 Sectors and occupations

Key Points

- A8 migrants are more concentrated in sectors such as manufacturing and construction, and in the lower-skill occupational groups, than migrants from other countries;
- Whilst the gap is closing, the employment rate for foreign-born workers remains below that for the UK-born. The overall foreign-born employment rate of 68 per cent conceals a large variation in labour market outcomes for those from different groups;
- Full-time workers from developed Western economies and the Middle East earn more than their UK-born counterparts. In contrast, those from the A8 and A2 countries earn noticeably less than UK-born workers;
- Since 2001, average UK-born wage levels have steadily risen, while average foreign-born wages have fallen, causing the weekly wage gap to fall from £76 in 2001 to £28 in 2006. This reflects the tendency for recent migrants to work in lower-paid jobs than those in the past;
- The ability to speak English, along with the length of time in the UK and level of education, is important for migrant workers to achieve better labour market outcomes;
- Upskilling the labour force is essential in a competitive global economy. To the extent that the supply of skilled labour remains deficient, migration is an important complement to these activities.

5.1 Definition of immigration

5.1.1 The analysis below draws heavily on the Labour Force Survey (LFS). It should be noted that the LFS figures on the foreign-born population do not match the UN definition of 'long-term international migration'³⁷. They instead

³⁷ The United Nations recommended definition of a long-term international migrant is: "A person who moves to a country other than that of his or her usual residence for a period of at least a year (12 months), so that the country of destination effectively becomes his or her new country of usual residence. From the perspective of the country of departure the person will be a long-term emigrant and from that of the country of arrival the person will be a long-term immigrant."

cover the foreign-born household population, irrespective of year of arrival. They do not include certain short-term migrants and those living in communal establishments. One consequence of the latter point is that the number of foreign-born workers in sectors such as construction and agriculture may be under-reported. More broadly, these survey results are inevitably subject to a margin of uncertainty due to sampling variability.

5.2 Why do employers want to hire migrants?

5.2.1 The best source of data in this area is a report commissioned by the Home Office³⁸ which conducted in-depth interviews with employers in order to produce a qualitative survey. Interviews were conducted in five sectors:

- Construction
- Administration, Business and Management
- Finance and Accountancy
- Hotels and Catering
- Agriculture and horticulture
- The interviews were undertaken in East Anglia, London and the North East.

In total, 50 employers were interviewed, each falling into one of three groups:

- Those employing migrant workers through particular schemes;
- Employers of migrant workers outside of these schemes;
- Employers not utilising migrant workers.

5.2.2 The overwhelming majority of employers across sectors and regions started to recruit migrant workers because they could not get applications from domestic workers for low-skilled jobs. In some cases employers noted that a greater proportion of applications were from foreign nationals, possibly because they are more mobile than UK nationals, who may limit their job search to the local labour market.

³⁸ Dench, J., Hurstfield, S., Hill, D. and Akroyd, K. (2006) **Employers' use of migrant labour**, Main report, Home Office Online Report 04/06

5.2.3 Nonetheless, the report also found that, in some areas, employers preferred migrant workers to non-migrant workers for a number of reasons listed below.

Reliability

5.2.4 Native workers sometimes proved unreliable in certain sectors, especially Agriculture and Hotels and Catering, which makes a business difficult to run. Some employers had tried recruiting applicants via a Jobcentre, but found that they sometimes turned up for interviews purely to get a form signed to enable them to receive Jobseekers' Allowance.

Skills/labour shortages

5.2.5 In Construction, where employers were seeking skilled workers, the recruitment of migrant workers was directly related to skills shortages. Polish workers were generally valued in London, where they were seen as highly-motivated skilled workers who could fill a skills gap.

5.2.6 One employer in the Finance and Accountancy sector said that there was only a very small pool of qualified applicants in the UK. The employer used headhunters who could recruit internationally and took the best-qualified candidate.

5.2.7 In lower-skilled jobs, the issue was, unsurprisingly, a shortage in the supply of labour rather than skills. This supports the notion that migrants are filling jobs that natives will not do rather than competing for the jobs that they will.

Other positive attributes

5.2.8 Only a minority of employers thought there were no particular advantages to using migrant workers, other than that they were available. The majority cited a range of positive attributes. The ones most frequently mentioned were:

- Reliability;
- Willingness to work hard. This was sometimes defined in terms of migrant workers' productivity and speed. But it was also related to their willingness to work long hours, beyond the normal working day. Several employers also mentioned that migrant workers actively sought overtime to earn extra money;

- General attitude to work. Sometimes employers referred to the work ethic, or said that they were motivated and keen. Less often mentioned, but underlying some of the comments, was the fact that migrant workers were more likely to be satisfied with the minimum wage;

- Some employers also mentioned lower staff turnover.

Other survey evidence

5.2.9 Two other recent surveys confirm that business sees migration as a good thing for the UK economy. A survey conducted by the Institute of Directors (IoD) in December 2006³⁹ found that three-quarters of IoD members supported the view that migrant workers made a significant positive contribution to the UK economy. This finding was mirrored in a similar study by the British Chambers of Commerce (BCC), also undertaken in December 2006⁴⁰. Both surveys indicate that business focuses on migrants' skills, higher productivity and better work ethic, rather than lower wage costs. The IoD survey reported that migrant workers significantly outperform the existing workforce in terms of productivity, education and skills, work ethic, reliability and the amount of sick leave. The BCC survey found that less than 6 per cent of employers employed migrant workers because of the potential for lower wage costs.

5.3 In what sectors and occupations are immigrants employed?

5.3.1 Foreign-born workers may be divided between those from the A8 countries and those from other countries. A significant proportion of "other foreign-born" are working in the public administration, education & health (29 per cent), distribution, hotels & restaurants (21 per cent) and banking, finance & insurance (19 per cent) sectors. A8 foreign-born are particularly concentrated in the distribution, hotels & restaurants (24 per cent), manufacturing (21 per cent) and construction (14 per cent) sectors.

³⁹ Immigration – the business perspective, Institute of Directors, published January 2007, available at http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_paper_immigration_business_perspective.pdf

⁴⁰ Migration: Plugging the Gap, The British Chambers of Commerce, published February 2007, available at http://www.chamberonline.co.uk/policy/pdf/migration_survey_2007.pdf

TABLE 5.3.1: PROPORTION OF FOREIGN-BORN AND UK-BORN WORKING IN EACH INDUSTRIAL SECTOR, 2006

Industrial Sector	UK-born	A8 foreign-born	Other foreign-born
Agriculture & fishing	1%	1%	–
Energy & water	1%	*	1%
Manufacturing	13%	21%	11%
Construction	9%	14%	4%
Distribution, hotels & restaurants	19%	24%	21%
Transport & communication	7%	10%	8%
Banking, finance & insurance	16%	12%	19%
Public admin, education & health	29%	11%	29%
Other services	6%	8%	6%
Total	100%	100%	100%

Source: A four-quarterly average is used, LFS Q1 to Q4 2006

* Denotes where sample size is too small to report a robust estimate

– less than 0.5 per cent

Totals may not sum due to rounding

5.3.2 A large proportion of the “other foreign-born” (49 per cent) are working in higher skilled occupations, while only around 13 per cent are working in elementary occupations. The majority of A8 foreign-born work in elementary occupations (38 per cent), as process, plant and machine operatives (16 per cent) and in skilled trade occupations (15 per cent).

TABLE 5.3.2: PROPORTION OF FOREIGN-BORN AND UK-BORN IN EACH OCCUPATIONAL GROUP, 2006

Occupational Group	UK-born	A8 foreign-born	Other foreign-born
Managers and senior officials	15%	4%	16%
Professional occupations	13%	5%	18%
Associate professional and technical	14%	4%	15%
Administrative and secretarial	12%	5%	9%
Skilled trades occupations	11%	15%	8%
Personal service occupations	8%	9%	8%
Sales and customer service occupations	8%	4%	7%
Process, plant and machine operatives	7%	16%	7%
Elementary occupations	11%	38%	13%
Total	100%	100%	100%

Source: A four-quarterly average is used, LFS Q1 to Q4 2006

Totals may not sum due to rounding

5.4 How do immigrants' labour market outcomes – including their employment rates and earnings – compare to those of local workers?

5.4.1 The Labour Force Survey shows that both UK-born and foreign-born employment has risen in the UK over the last ten years. The UK-born employment rate rose until 2001 and has remained at around 75 per cent for the last five years. The overall foreign-born employment rate has improved to reach 68 per cent, closing the 'UK-born/migrant employment rate gap' from 10 percentage points in 1997 to 7 percentage points in 2006 (Figure 5.4.1). The employment rate of the foreign-born has increased as more

migrants appear to be coming to the UK for work-related purposes than in the past. These figures are based on the standard definition of the employment rate (employment as a proportion of the *working age* population). It is worth noting that employment as a proportion of the *total* population is higher for the foreign-born than for the UK-born (54 per cent against 48 per cent in the final quarter of 2006), because migrants have a younger age profile.

5.4.2 The current foreign-born employment rate of 68 per cent hides a large variation in labour market outcomes for those from different country groups (Figure 5.4.2).

FIGURE 5.4.1: NATIVE AND FOREIGN-BORN EMPLOYMENT RATES, Q2 1997 to Q4 2006

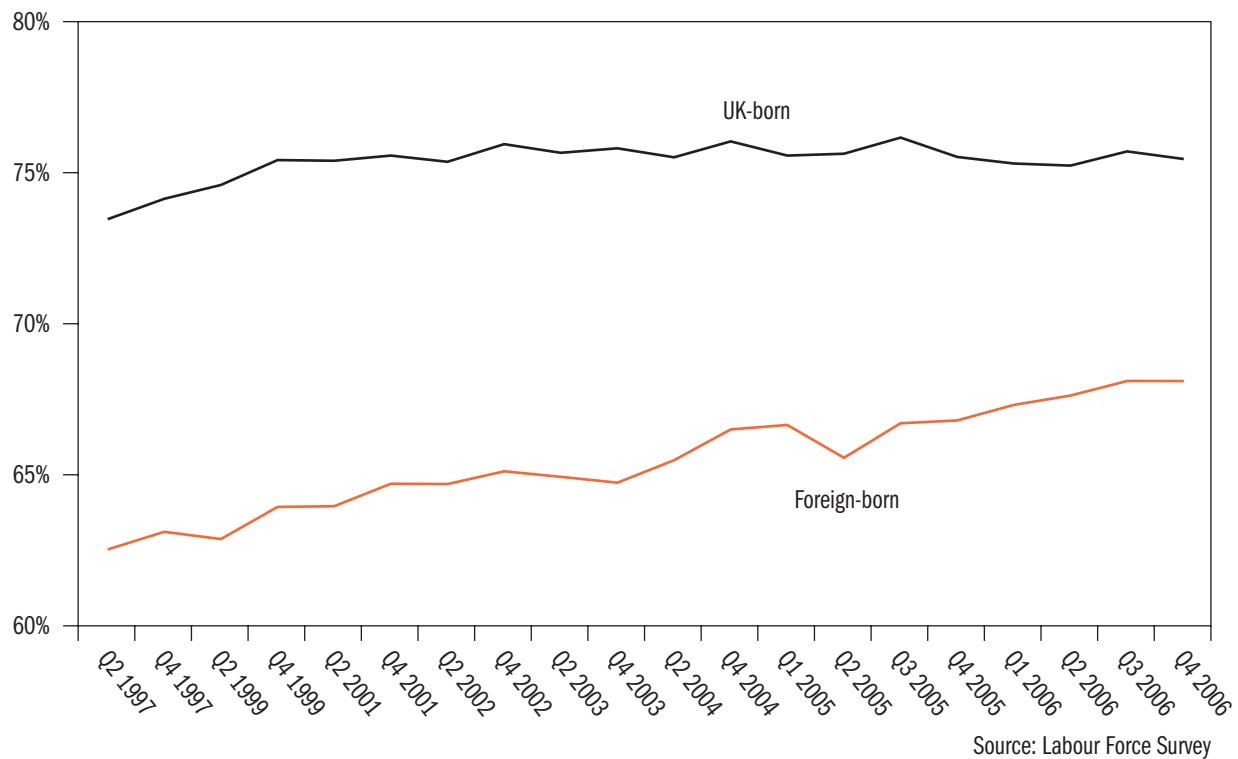
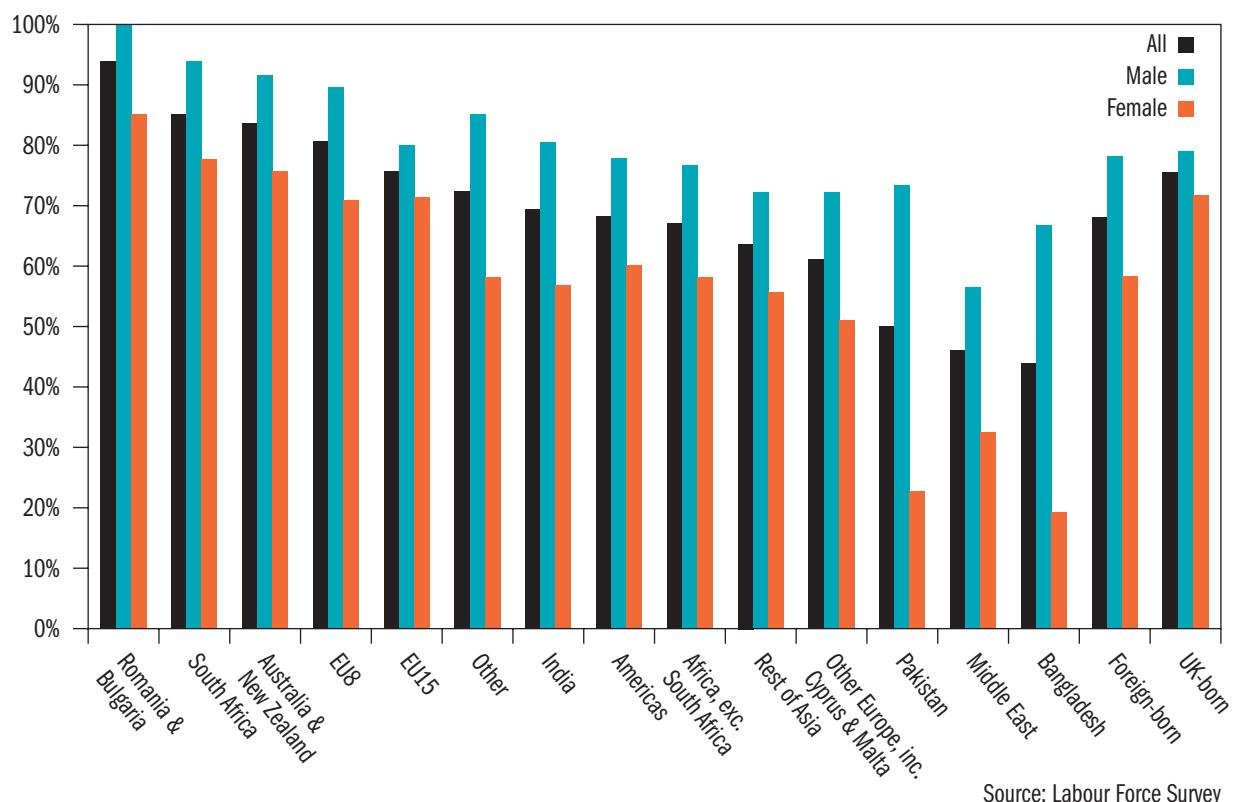


FIGURE 5.4.2: MALE AND FEMALE EMPLOYMENT RATES BY COUNTRY OF ORIGIN, Q4 2006



Source: Labour Force Survey

5.4.3 Foreign-born men compare quite well to UK-born men in employment outcomes, with the exception of those from the Middle East who have an employment rate of 56 per cent, 23 percentage points lower than UK-born men (79 per cent). Further research is needed to understand the reasons for these differences, but one possibility is that different groups have different reasons for coming to the UK.

5.4.4 Foreign-born women fare far worse in comparison to UK-born women. This is particularly true for Pakistani women (who have an employment rate of 23 per cent, 50 percentage points lower than native women) and for Bangladeshi women (who have an employment rate of 19 per cent). This discrepancy could arise for a combination of reasons, such as English language ability, discrimination⁴¹ and cultural differences.

5.4.5 The approximate 50:50 gender split of the foreign-born UK working age population means that low female employment rates in most migrant groups significantly reduce overall employment rates. For example, the employment rate for Pakistani men is 6 percentage points lower than for native men, but the female rate is 50 percentage points lower than for native females, resulting in the overall Pakistani employment rate being 26 percentage points lower than for all natives.

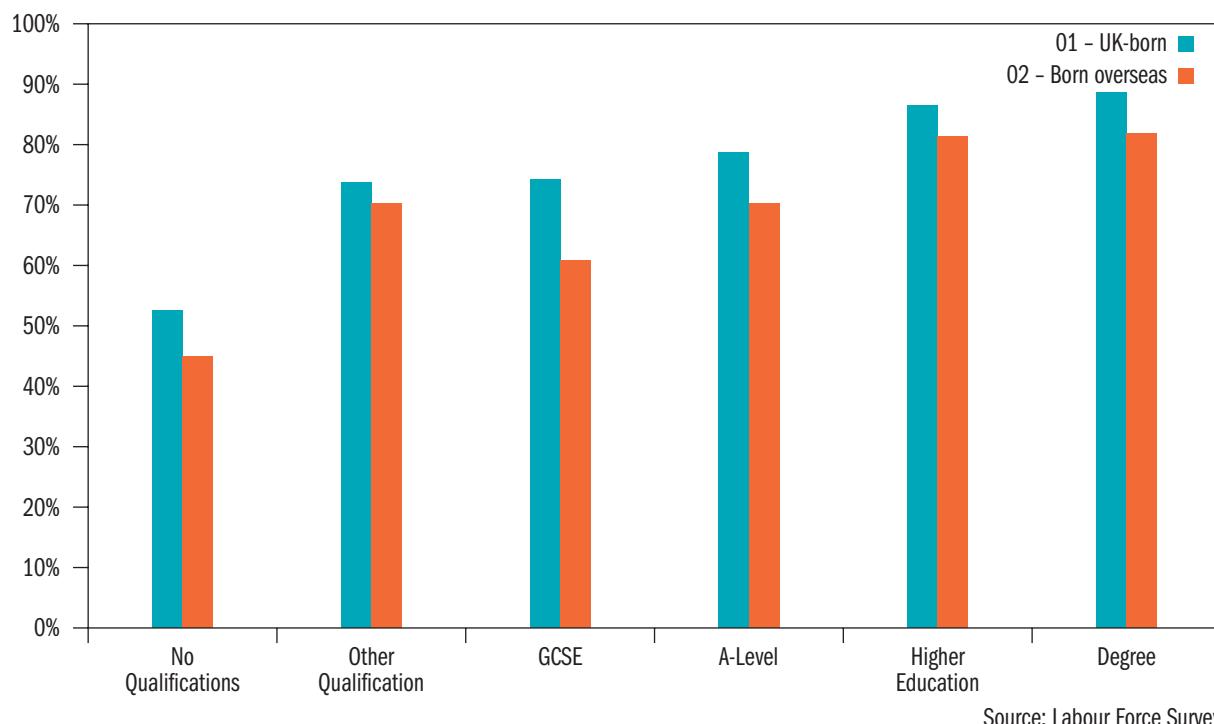
5.4.6 Foreign-born from Romania & Bulgaria (94 per cent), South Africa (85 per cent), Australia and New Zealand (84 per cent), the A8 countries (81 per cent) and EU15 countries (76 per cent) have higher employment rates than UK-born workers (76 per cent).

5.4.7 The employment rate of foreign-born is lower than for UK-born at all levels of education, although the size of the gap falls as the level of education rises (Figure 5.4.3)⁴².

41 See DWP (September 2006) **Barriers to employment for Pakistanis and Bangladeshis in Britain and constraints**, Research Report No. 360, available at <http://www.dwp.gov.uk/asd/asd5/rrs2006.asp#barrierstoemp>

42 Comparing levels of education across those from different countries can be problematic, so this result should be treated with caution.

FIGURE 5.4.3: EMPLOYMENT RATES BY LEVEL OF EDUCATION, Q4 2006

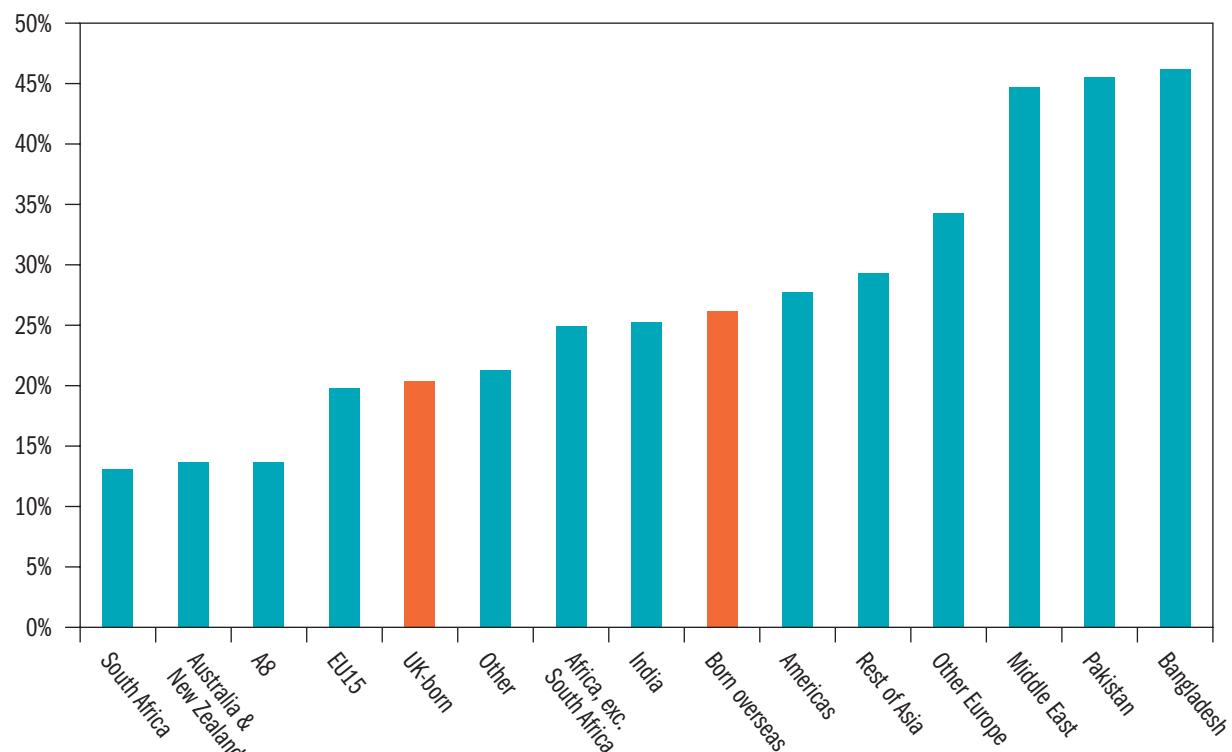


Source: Labour Force Survey

- 5.4.8 The proportion who were economically inactive, in the final quarter of 2006, was 14 per cent of the working age population born in A8 countries

and around 20 per cent amongst those born in the UK and other EU countries. The equivalent figure for all overseas-born was 26 per cent.

FIGURE 5.4.4: PROPORTION OF WORKING AGE POPULATION⁴³ THAT ARE ECONOMICALLY INACTIVE, Q4 2006



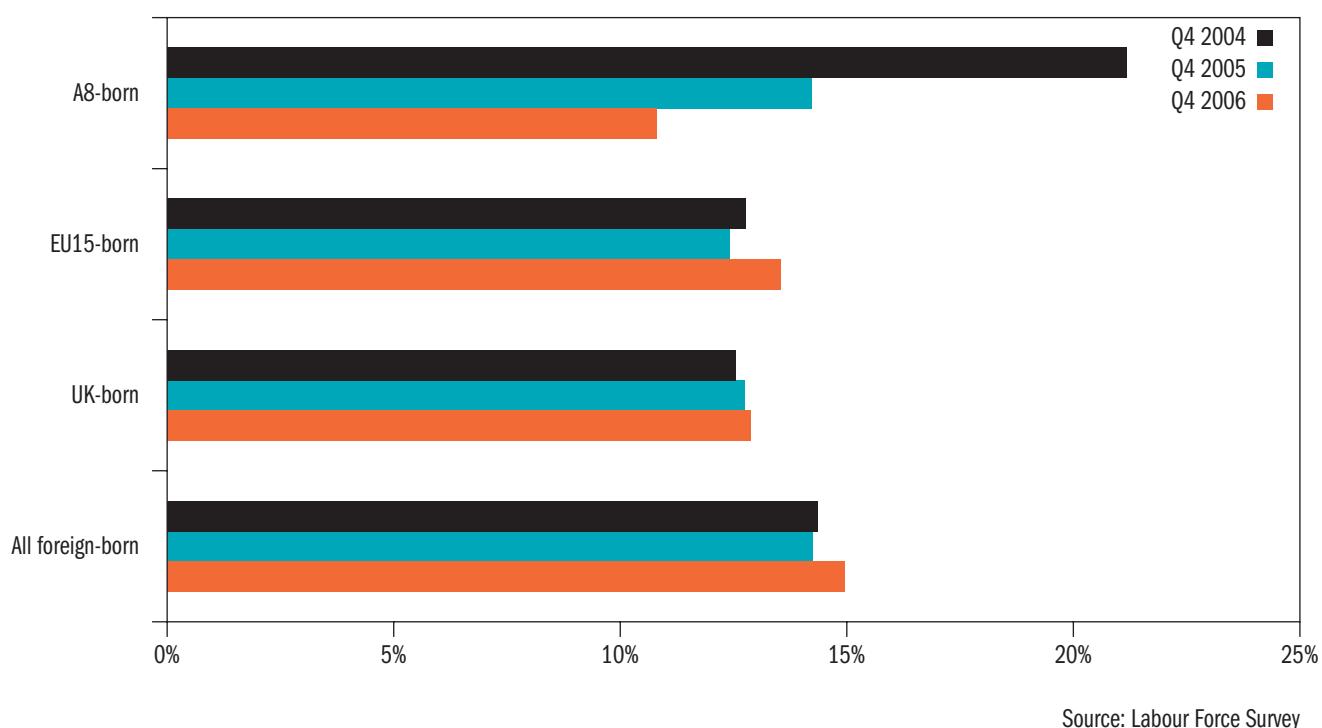
Source: Labour Force Survey

43 Males and females

5.4.9 Overall, all foreign-born have a similar **self employment rate** (15 per cent) to UK natives (13 per cent). Some migrant groups such as those from Romania and Bulgaria (55 per cent)⁴⁴, Pakistan (30 per cent) and the Middle East (24 per cent) have above-average proportions of employed workers in self-employment. A8 foreign-born are notable because the proportion in employment that are self-employed has fallen over the last three years from over 21 per cent in the final quarter of 2004 to about 11 per cent in the same quarter of 2006.

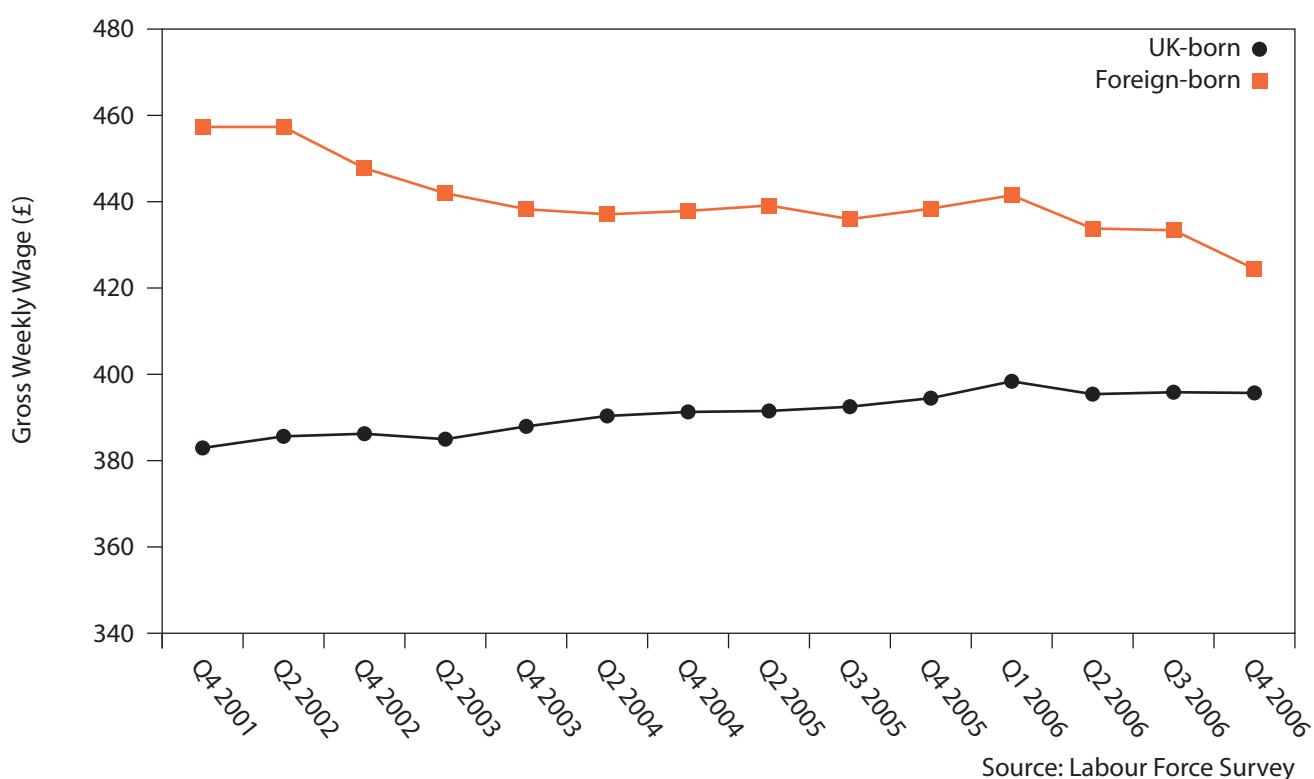
5.4.10 Since 2001, average UK-born wage levels have steadily risen while average foreign-born wages have fallen, causing the weekly wage gap to fall from £76 in 2001 to £28 in 2006 (Figure 5.4.6). This apparent fall in wages amongst foreign-born workers is a compositional effect. Historically, foreign-born workers coming to the UK have tended to take-up high-paid jobs. More recently, a greater proportion of migrants have come to the UK to work in low-paid jobs. This is particularly true for those coming from the A8 countries during the last three years (see far right-hand bar in Figure 5.4.7). The growing proportion of foreign-born workers taking low-paid jobs has pulled down the average wage for all foreign-born workers.

FIGURE 5.4.5: PROPORTION OF THOSE IN EMPLOYMENT THAT ARE SELF-EMPLOYED, Q4 2004 to Q4 2006



⁴⁴ Bulgarian and Romanian nationals who are self-employed have free labour market access. Otherwise they require a work permit.

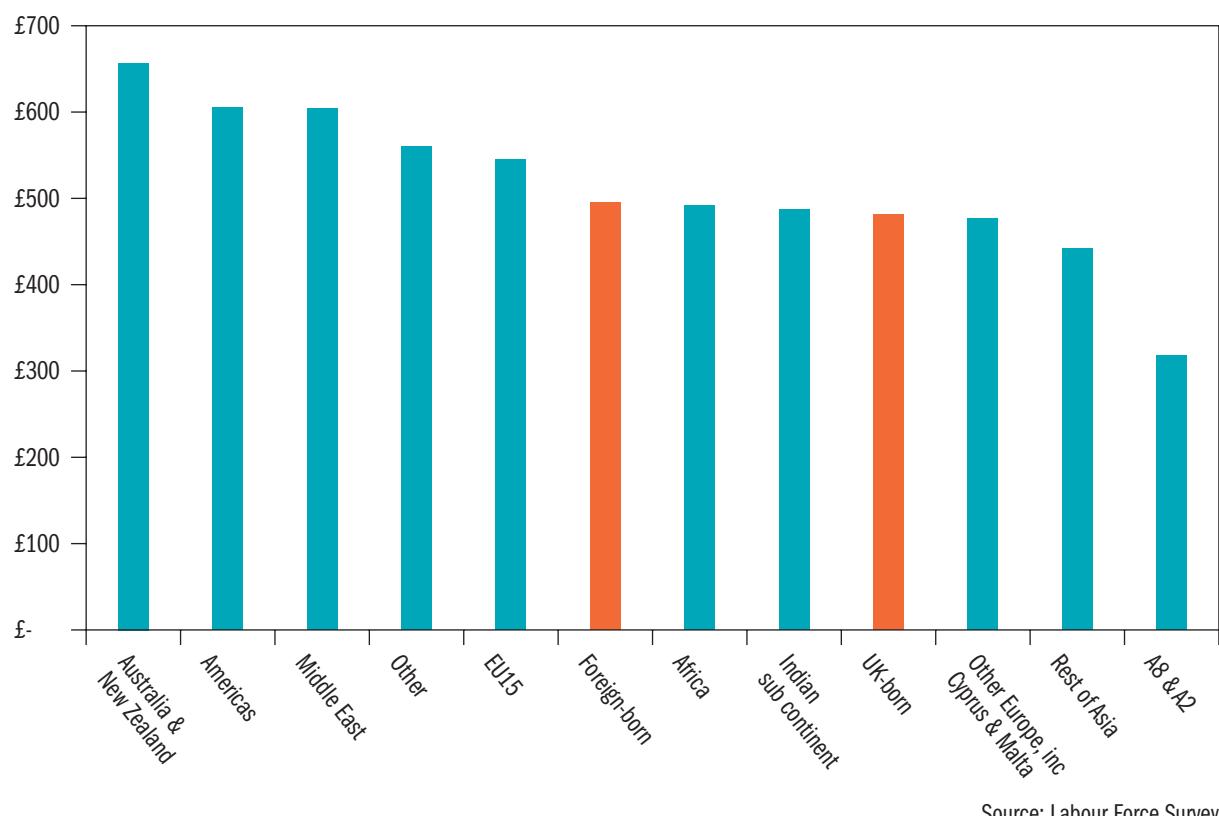
FIGURE 5.4.6: MEAN GROSS WEEKLY WAGE OF FOREIGN-BORN AND UK-BORN, 2001 Q4 to 2006 Q4 (2007 PRICES)



5.4.11 Figure 5.4.7 looks at wages by region of birth and the data are calculated on a slightly different basis from those presented above. They are calculated only for full time workers and look at the average for all of 2006, rather than just the final quarter. They demonstrate that full-time workers from developed Western economies and the Middle East earn more than their UK-born counterparts. In contrast, those from the A8 and A2 countries earn noticeably less than UK-born workers.

5.4.12 On average, foreign-born workers in full-time employment have higher skill levels than their UK-born counterparts. This is particularly true for those from the countries on the left-hand side of Figure 5.4.7. As a result, foreign-born workers have higher productivity and, on average, are employed in more highly-skilled jobs than the UK-born, and therefore earn higher wages.

FIGURE 5.4.7: MEAN WEEKLY WAGE IN FULLTIME EMPLOYMENT BY REGION OF BIRTH, JANUARY TO DECEMBER 2006



Source: Labour Force Survey

5.5 What determines immigrants' performance and integration in the UK labour market?

Language

- 5.5.1 Migrants who speak functional English are more likely to find work because they are able to communicate more effectively with employers, use job vacancy facilities and meet employers' English language requirements.
- 5.5.2 English language skills can influence wages directly through greater productivity, resulting from an ability to communicate effectively. There may also be an indirect impact because those with stronger language skills are likely to obtain more benefit from their education and previous labour market experience, finding a job that better fits their skill levels.

5.5.3 There are waiting lists for ESOL (English for Speakers of Other Languages) classes. Many migrants do not have time to learn English because they are always working. They often work alongside other migrants and so cannot learn from work colleagues. The Commission on Integration and Cohesion⁴⁵ identified a number of employers for whom there was a sound business case for providing free English classes on work premises, or giving staff time off to attend outside classes.

5.5.4 Wheatley-Price and Shields⁴⁶ conclude that fluency in English (assessed by an interviewer and not through a formal test) increases the average hourly occupational wage by approximately 20 per cent.

⁴⁵ See <http://www.integrationandcohesion.org.uk/>

⁴⁶ Shields, M. A. and Wheatley-Price, S. (2002) The English language fluency and occupational success of ethnic minority immigrant men living in English metropolitan areas, *Journal of Population Economics*, pages 137-160.

5.5.5 A Canadian study⁴⁷ concluded that immigrants who do not usually speak either English or French (the two official Canadian languages) at home have earnings 10 per cent to 12 per cent lower than those who do. This study also found that those with better language skills receive more benefit from an additional year of education (in terms of the wages earned).

5.5.6 Dustmann and van Soest⁴⁸ find that language proficiency increases productivity and hence the market wage.

Time

5.5.7 Migrants' employment outcomes improve over time. Dustmann and Van Soest⁴⁹ found lower employment rates for migrants upon arrival in Germany, but they increased with years of residence, as job search costs decrease over time (due to more information and networks, and greater language fluency).

5.5.8 Turning to the UK evidence, Dustmann *et al.* (2003)⁵⁰ suggest that the labour market performance of the foreign-born relative to the UK-born changes with length of residence. The foreign-born may acquire additional skills, specific to the UK-economy, or tailor their existing skills to the UK labour market. Information acquired about the UK labour market after arrival will also make it easier to find work as time passes. The authors find that:

“...employment and participation probabilities of minority immigrants are initially substantially lower than those of UK-born whites, but there is adaptation. We estimate that after about 20 years of residence, participation and employment probabilities are similar to those of UK-born whites”

However, the employment and participation probabilities for white migrants relative to British-born whites are not found to significantly vary over time.

47 Chiswick, B.R. and Miller, P.W. (2003) **The complementarity of language and other human capital: Immigrant earnings in Canada**, *Economics of Education Review*, vol. 22, no. 5, October 2003, pages 469-80.

48 Dustmann, C. and van Soest, A. (2003) **The language and earnings of immigrants**, *Industrial and labour relations review*, Vol 55, No 3

49 Dustmann, C. and van Soest, A. (2003) as above

50 Dustmann, C., Fabbri, F., Preston, I., Wadsworth, J. (2003) **Labour market performance of immigrants in the UK labour market**, Home Office Online Report 05/03, available at <http://www.homeoffice.gov.uk/rds/pdfs2/rdsolr0503.pdf>

Education and qualifications

5.5.9 Bell⁵¹ finds that the number of years of schooling has a greater positive impact on wages than the number of years of UK work experience.

5.5.10 Battu and Sloane⁵² also find that foreign qualifications receive lower returns in the UK than domestic ones.

Work experience

5.5.11 Bell⁵³ finds that immigrant wage rates are positively related to experience, but foreign experience is worth significantly less than UK experience. Amongst the groups in the study, 'Black with significant foreign experience' experiences the greatest wage disadvantage, although this disadvantage reduces over time in the UK.

5.5.12 In Canada, Schaafsma & Sweetman⁵⁴ found that foreign experience appeared to yield virtually no return in terms of wages.

Ethnicity (country of origin)

5.5.13 This sub-section draws on evidence from Dustmann *et al.* (2003)⁵⁵, who compare white UK-born individuals with immigrants of the same age, education and geographical distribution.

5.5.14 The study found that white immigrants have similar employment probabilities to white non-migrants, but minority immigrants have, on average, poorer employment prospects than these groups, with Pakistanis and Bangladeshi immigrants exhibiting some of the lowest employment rates amongst the groups studied. This applied for both men and women.

51 Bell, B.D. (1997) **The Performance of Immigrants in the United Kingdom: Evidence from the GHS**, *The Economic Journal* (Oxford: Blackwell Publishers), 107, pages 333-44.

52 Battu, H. and Sloane, P (2002) **To What Extent Are Ethnic Minorities in Britain Overeducated?**, *International Journal of Manpower*, Vol. 23 (3), pages 192-208

53 Bell, B.D. (1997) As above

54 ScSchaafsma, J. and Sweetman, A. (2001) **Immigrant earnings: age at immigration matters**, *Canadian Journal of Economics*, 34(4), pages 1066-99

55 Dustmann, C., Fabbri, F., Preston, I. and Wadsworth, J. (2003) **Labour Market Performance of Immigrants in the UK Labour Market**, Home Office, 05/03

5.5.15 Pakistanis and Bangladeshis are among those with the lowest participation rates. They also found that individuals from most white immigrant communities have, on average, higher wages than UK-born whites with the same characteristics. This is in contrast to immigrants from ethnic minority communities who tended to have lower wages than UK-born white workers.

5.5.16 After about 20 years of residence, participation probabilities for male ethnic minority immigrants are approximately the same as for UK-born whites. For ethnic minority female immigrants, however, participation is still 10 percentage points lower than UK-born whites after 40 years of residence.

5.5.17 Evidence on wage convergence was less clear due to the limited number of observations. For all groups of immigrants in the study, the authors find no real trend in wage profiles, except for Irish and European immigrants, who have wages that are initially higher than those of UK-born individuals, but the difference diminishes with time of residence.

5.6 Which sectors and occupations in the UK economy are particularly dependent on migrant labour and why?

Survey evidence⁵⁶

5.6.1 Almost all employers in Agriculture said that migrant workers were crucial to their business. Several went so far as to say that the business would not survive without migrant workers.

5.6.2 In the Construction sector, views were more varied. Some said that migrant labour was not important to them, while others said it was crucial.

5.6.3 In the Hotels and Catering sector in London, several employers reported that migrant workers were crucial to the business. In the North East, some Hotels and Catering employers agreed that migrant workers were very important to the business. However, there was less sense than in London that business depended on migrants. In East Anglia, several employers said that migrant workers were very important because they simply could not fill staff requirements without them. Some respondents in the North East and East Anglia noted that migrant workers in Hotels and Catering were an asset by bringing a mix of cultures and a positive attitude in a sector that strives to be international.

Work permit approvals

5.6.4 Employers can use the Work Permits system to fill vacancies that cannot be filled from the existing EU labour market. The table below shows how demand for work permits has varied over time between the sectors of highest demand.

TABLE 5.6.1: WORK PERMIT APPROVALS, TOP SIX INDUSTRIES, APRIL 2003 TO MARCH 2006

Industry	Apr 03-Mar 04	Apr 04-Mar 05	Apr 05-Mar 06
Health and Medical Services	45,873	46,608	38,366
Computer Services	18,630	21,644	22,978
Hospitality & Catering	21,279	16,551	12,152
Admin, Bus & Man Services	14,662	15,163	15,120
Education & Cult Act.	11,570	10,771	10,777
Financial Services	6,453	7,749	9,277

Source: Home Office

56 These findings are also from Dench, J., Hurstfield, S., Hill, D. and Akroyd, K. (2006). **Employers' use of migrant labour**, Main report, Home Office Online Report 04/06

TABLE 5.6.2: MAIN OCCUPATIONS FOR A8 MIGRANTS, JULY 2004 TO JUNE 2007

Occupation	Number
Process operative (other factory workers)	163,150
Packer	37,380
Kitchen and catering assistants	36,525
Warehouse operatives	47,230
Cleaner, domestic Staff	33,515
Farm worker/farm hand	27,135
Waiter/waitress	22,905
Maid/room attendants (hotel)	21,500
Care assistants and home carers	17,845
Labourer, building	17,750
Other/not-stated	192,630

Source: Worker Registration Scheme.

EU accession

5.6.5 Since May 2004, significant numbers of migrants from the eight new EU members in Central and Eastern Europe (A8) have registered under the Worker Registration Scheme (over 600,000 workers were registered for the period up to June 2007). These workers are principally working in lower paid jobs, and this may account for some reduction in the number of work permits approved in sectors such as hospitality.

Labour Force Survey Evidence

5.6.6 The analysis above draws on different data sources to build up a picture of the parts of the economy which are most dependent on migrant labour. An overall picture is perhaps best provided by data from the LFS (see Table 5.6.7).

TABLE 5.6.7: COUNTRY OF ORIGIN OF WORKERS IN EACH INDUSTRIAL SECTOR

Industrial Sector	UK-born	A8 foreign-born	Other foreign-born	Total
Agriculture & fishing	95%	1%	4%	100%
Energy & water	93%	–	7%	100%
Manufacturing	90%	2%	8%	100%
Construction	93%	2%	5%	100%
Distribution, hotels & restaurants	87%	1%	11%	100%
Transport & communication	87%	2%	11%	100%
Banking, finance & insurance etc	87%	1%	12%	100%
Public admin, education & health	89%	–	10%	100%
Other services	89%	1%	10%	100%

Source: A four-quarterly average is used, LFS Q1 to Q4 2006

– Less than 0.5 per cent

5.6.7 Overall, the “other foreign-born” account for around 10 per cent of those employed in each industrial sector in the UK, although lower proportions are recorded for agriculture & fishing and construction. As discussed in paragraph 5.1.1, this could reflect the fact that the data do not capture short-term migrants and those living in communal establishments.

5.6.8 Construction and manufacturing have the greatest reliance on workers born in the A8 countries, but even here they account for less than 2 per cent of the total employed. Distribution, hotels & restaurants and transport & communication have a relatively strong reliance on non-A8 foreign-born workers. Whilst there are relatively few A8-born workers in banking, finance & insurance and public administration, education & health, these sectors do rely on foreign-born workers from other countries.

5.7 What is the impact of immigration on mechanisation and investment in technical change?

5.7.1 Productivity depends on the amount of labour and capital available and the efficiency with which they are combined. Migration may have an impact on both the supply of capital, and the technical progress of the economy.

5.7.2 Immigrants will increase both the overall population and the workforce. As the population increases, it will increase the demand for goods and services. This may feed through into demand for both capital and labour as companies seek to increase production. As the workforce increases it could increase the returns to capital as there are more workers for each unit of capital. It is therefore possible to argue that investment will increase in the face of an increase in the labour supply due to migration⁵⁷. Previous periods of migration have tended to coincide with periods of rapid capital accumulation. However, there is very little evidence in this area and much of it is anecdotal.

5.7.3 From the information that we have on wages, it would be expected that any increase in capital would be slightly higher in sectors employing staff at the higher end of the distribution.

5.7.4 An increase in the number of migrants could increase the technical progress of the economy. They could do this directly, through having different knowledge to native workers. Alternatively, they might be more capable of innovative work in research and development. These arguments are explored in more detail in Section 3.4 of this report.

5.8 What are the alternatives to immigration to reduce labour shortages?

5.8.1 Economic theory provides a range of options, not all of which are practical.

5.8.2 Education and training of native workers is one option for reducing skills shortages.

Whilst labour force participation is already high in the UK by international standards, raising the labour force participation rate and the skills of the native population remains a government priority and will continue to support the supply of skilled labour. For example, in July 2007 the Department for Work and Pensions (DWP) published a Green Paper⁵⁸ setting out a series of measures designed to meet the long-term objectives of an employment rate of 80 per cent and the eradication of child poverty. A key element of this is a new jobs pledge which aims for major employers to offer a quarter of a million job opportunities to people at a disadvantage in the labour market. The Green Paper also sets out the following proposals to be introduced following consultation and as resources allow:

- Helping lone parents out of poverty through employment. This means matching increased support with additional responsibility to look for work, starting with lone parents whose youngest child reaches age 12 and subsequently reducing this age to 7;

57 See Ottaviano, G. I. P. and Peri, G. (2006) *Rethinking the gains from immigration: theory and evidence from the US*, Fondazione Eni Enrico Mattei, Note di Lavoro 52.2006, available at <http://www.feem.it/NR/rdonlyres/D8689978-76C2-428D-A625-D0E49BBA81CE/2198/5206.pdf>

58 DWP (2007) *In work, better off: next steps to full employment*, Welfare Reform Green Paper, available at <http://www.dwp.gov.uk/welfarereform/in-work-better-off/in-work-better-off.pdf>

- Building on the success of the New Deal with a more flexible, responsive and personally tailored programme for job seekers, including fast-tracked support for those who have previously struggled to find a stable pattern of work;
- Better integration of employment and skills services, responding to the challenges set by the Leitch report on skills⁵⁹;
- Strengthening Jobcentre Plus' role at the heart of the system of help and support, particularly early in a benefit claim;
- Making better use of specialist support for more disadvantaged customers, at an appropriate point in their benefit claim, through contracted provision with public, private or third sector bodies;
- Improving value for money through specialist support. This should focus on achieving results for customers and have greater flexibility, building on the work done by the Freud review⁶⁰.

The Government is consulting on these proposals and wants to build a consensus in support of full employment as a key aim of government policy.

- 5.8.3 These measures go alongside others announced in the 2006 Green Paper “A New Deal for Welfare: Empowering People to Work”⁶¹, where a particular focus was on providing extra support to people with health conditions and disabilities.

- 5.8.4 Upskilling the labour force is essential in a competitive global economy. To the extent that the supply of skilled labour remains deficient, migration is an important complement to these activities. The increased focus on joined up skills/employment in the UK should boost the skills of disadvantaged workers, while we will ensure that the work of the Migration Advisory Committee (MAC), which will advise Government on where in the economy migration can fill labour shortages, will complement that of the Commission for Employment and Skills. The latter body will be represented on the MAC.

- 5.8.5 The Government is also targeting improvements in the skills of the population at all levels. *World-Class Skills*⁶², published in July 2007, set out the Government's response to the Leitch Review of Skills⁶³. It presented the Government's new ambition for a world-class skills base by 2020 and a series of underpinning reforms in England to allow for progress against this ambition, including:
- Doubling the Train to Gain service by 2011 to increase support for the training of low-skilled individuals in the workplace;
 - Introducing new Skills Accounts to give individuals greater ownership and choice over their learning;
 - Creating a universal adult careers service to ensure everyone is able to access the help they need to develop their skills and progress in the labour market;
 - Better integration of employment and skills services, including a new objective of sustainable employment and progression for DWP and the Department for Innovation, Universities and Skills (DIUS).

59 Lord Leitch / HM Treasury (2006) Leitch Review of Skills, **Prosperity for all in the global economy – world class skills**, available at http://www.hm-treasury.gov.uk/media/6/4/leitch_finalreport051206.pdf

60 Freud, D. (2007) **Reducing dependency, increasing opportunity: options for the future of welfare to work**, DWP, available at <http://www.dwp.gov.uk/publications/dwp/2007/welfarereview.pdf>

61 Available at <http://www.official-documents.gov.uk/document/cm67/6730/6730.pdf>

62 **World Class Skills: Implementing the Leitch Review of Skills in England**, Department for Innovation Universities and Skills, July 2007

63 Lord Leitch / HM Treasury (2006) As before

5.8.6 Another alternative to immigration is to **raise fertility rates**. The impact of government policy in this area is likely to be limited. An OECD paper⁶⁴ reviewed the evidence on the impact of various policies on fertility rates across OECD countries. The paper drew the following generalised conclusions:

- **Family benefits:** likely to have a small positive impact on fertility rates;
- **Tax policies:** the OECD report refers to evidence from the US and Canada, which suggests that such policies have a positive impact on fertility;
- **Family friendly policies:** the availability of part-time and flexi-time working tends to have a positive effect on fertility rates. The evidence on maternity leave is more mixed, however, with some studies finding a weak positive impact and others finding little discernable effect;
- **Availability of child care:** this tends to have a positive impact, although the impact is weak in some countries.

So, whilst there is some suggestion that governments may be able to have at least some effect on fertility rates, it is worth noting that this is a long-term solution. It would be a long time before the labour market felt any benefit.

5.8.7 **If Britain imported more labour intensive products instead of producing them at home this could decrease the reliance on unskilled labour and therefore unskilled migration.**

However, Britain already imports most labour-intensive products, so the scope for further substitution of domestically-produced goods with imports is likely to be limited. Moreover, much unskilled migration is in the service sector, where work must be done close to its point of sale (e.g. a haircut).

5.8.8 **Off-shoring the production of goods and services** that require large amounts of migrant labour would reduce demand for migrants within the UK. However, as above, many service sector roles cannot be off-shored.

5.8.9 **The labour market could be left to find a ‘without migration equilibrium’.** The benefits of migration are very similar to the gains to trade. If we allowed the economy to find a ‘without migration equilibrium’ we would expect people to be moved away from their area of expertise. Sectors that currently rely on migrants would need to increase wages in order to attract UK workers to fill vacancies. This would reduce the competitiveness of the UK economy. It could also lead to reduced output as certain industries contract.

5.8.10 In reality, in a dynamic and flexible economy, there will always be skill shortages in certain sectors at any point in time, and some of these will always be most efficiently filled by migration. In the absence of migration, the economy would still function at some equilibrium point, but the result would be a reduction in overall flexibility, and ultimately lower productivity and output growth.

64 Sleebos, J. (2003) **Low fertility rates in OECD countries: facts and policy responses**, OECD Labour Market and Social Policy Occasional Papers, No. 15, available at <http://www.sourceoecd.org/vl=1986418/cl=11/nw=1/rpsv/cgi-bin/wppdf?file=5lgsjhvj7qg7.pdf>

6 Economic effects of demographic impacts

Key Points

- The key demographic challenge for the UK in the years ahead will be population ageing. The proportion of the population aged over 65 is expected to rise from 16 per cent in 2007 to 26 per cent by 2056;
- Assuming long-term net migration to the UK of 145,000 per annum, the dependency ratio will rise from 61 per cent in 2007 to 74 per cent by 2056. This indicates that there will be fewer people of working age to support the young and old, and therefore greater pressure on the public finances;
- With zero net migration, the situation would be considerably worse: the dependency ratio would rise to 82 per cent by 2056;
- In the long term, migrants themselves will age and contribute to the increasing dependency ratio, but only assuming that they remain in the UK during retirement.

6.1 What is the economic impact of a net change in the UK population?

- 6.1.1 The impact of immigration on the public finances is discussed in Section 2 and the macroeconomic impact of immigration is discussed in Section 3.

6.2 If there is a net increase, does the impact differ when this comes from higher immigration rather than from changes in birth and death rates?

- 6.2.1 Based on the Government Actuary's Department 2004-based projections⁶⁵, the overall population of the UK is expected to continue to grow, driven by positive natural change (more births than deaths) and net in-migration. However, the key demographic challenge for the UK in

the years ahead will be population ageing. The proportion of the population that is aged over 65 is expected to rise from 16 per cent in 2007 to 21 per cent in 2027, and then to 26 per cent in 50 years' time, due to continued increases in life expectancy and the ageing of the post-WW2 baby boomers.

6.2.2 Population ageing will place increased pressure on the public finances as state pension and healthcare expenditure rises, with no corresponding increase in tax revenues. A simple measure of how the likely degree of pressure on the public finances will change over time is provided by the dependency ratio. This calculates the ratio of dependents (children and those of state pension age) to those of working age. Under the Government Actuary's Department principal population projections, this dependency ratio will rise from 61 per cent in 2007 to 63 per cent in 2027, and then to 74 per cent by 2056⁶⁶. These figures assume positive long-term net migration to the UK of 145,000 per annum. It must be stressed that these, along with all the other assumptions about future migration in this section, are stylised assumptions based on past trends and not forecasts.

6.2.3 If it is instead assumed that there is zero net migration, the dependency ratio would be slightly higher at 66 per cent in 2027, but would rise to 82 per cent by 2056. This is because migrants into the UK are predominantly adults of young working age. In fact, by the mid 2030s, it is estimated that the 'natural' change in population (resulting from births and deaths) will be negative, leaving the UK entirely reliant on net migration for population growth.

65 The figures in this section are based on the Government Actuary's Department's 2004-based Principal projections, available at <http://www.gad.gov.uk/Population/index.asp?v=Principal&y=2004&subYear=Continue> See Section 1.3 for discussion of the new 2006-based projections

66 The figure for 2007 is based on current state pension age (SPA) of 65 for men and 60 for women and the figures for 2027 and 2056 are based on a common SPA of 65 for both sexes. Under the provisions of the Pensions Bill 2007, SPA will be 66 for both sexes by 2027, and 68 for both sexes by 2056. This would decrease the dependency ratios at 2027 and 2056 to 60 per cent and 64 per cent respectively.

6.2.4 These calculations are based on the 2004-based population projections. A new, 2006-based projection set is currently being prepared and the assumptions for this have just been published⁶⁷. The long-term migration assumption has been increased to 190,000 per annum, and the fertility assumption has also increased in response to several years' of rises in births within the UK. In addition, the published dependency ratios from the new projections will take account of the Pensions Bill 2007, which has recently become law. This will raise the state pension age, in three stages, to 68 for both sexes by 2046. However, since work on the new projections is not complete, the current submission is based on the 2004-based projections. The reasons behind the increase in the separate ONS statistical submission.

6.2.5 As part of their 2004-based work, GAD also produced a range of other variant scenarios using different combinations of assumptions about fertility, life expectancy and net migration, which can be compared to see how each affects the resulting dependency ratios. These assumptions, along with those dependency ratios, are shown in the table below:

Table 6.2.1: Dependency ratio projections under varying population assumptions

	Assumptions			Dependency Ratio, %						
	Fertility	Life expectancy	Long-Term Net Migration (000s pa)	2007	2017	2027	2044	2056	2066	2074
Principal Scenario	Principal	Principal	145	61	60	63	70	74	76	76
Zero Migration	Principal	Principal	0	62	61	66	78	82	84	86
High Medium-Term Dependency	High	High	85	61	63	68	76	N/A	N/A	N/A
Low Medium-Term Dependency	Low	Low	205	61	57	59	63	N/A	N/A	N/A
Young	High	Low	205	61	61	64	67	68	67	66
Low Migration	Principal	Principal	85	61	60	64	72	76	77	78
High Migration	Principal	Principal	205	61	59	63	68	72	74	75
High Fertility	High	Principal	145	61	62	66	71	74	74	74
High Population	High	High	205	61	62	66	73	78	80	81

67 See Population Trends 129, available at <http://www.statistics.gov.uk/StatBase/Product.asp?vlnk=6303&Pos=&ColRank=1&Rank=422>

- 6.2.6 In the table, fertility, migration and life expectancy assumptions are either the central estimate, as used in the Principal scenario, or GAD's high or low variant assumptions⁶⁸. In addition, a zero net migration projection was produced, assuming no migration and principal fertility and life expectancy assumptions. The dependency ratios resulting from each combination of assumptions are shown on the right-hand side. If a ratio is lower than under the Principal scenario in a given year it is shown in blue. If it is higher, it is shown in red.
- 6.2.7 A higher dependency ratio indicates that there will be relatively fewer people of working age to support children and old-age dependents within the economy. Higher dependency ratios are therefore associated with a greater degree of pressure on the public finances and, all else being equal, to a greater burden of taxation on the working age population.
- 6.2.8 Varying the assumptions in the way described makes it possible to look at how projected dependency ratios change over time when population growth comes from different sources. For example, the 'High Medium-Term Dependency' scenario considers a case where fertility and life expectancy are higher than in the Principal scenario, but migration is lower. This increases the number of children and older people in the population, causing the dependency ratio to rise to 76 per cent by 2044 (the last year for this set of projections), compared to 70 per cent in the Principal scenario. The total population is around 2 million higher by this time.
- 6.2.9 The opposite case is considered in the 'Low Medium-Term Dependency' scenario, which assumes that migration is higher than in the Principal scenario, but that fertility and life expectancy are lower. Under these assumptions, the dependency ratio is 63 per cent by 2044, up only slightly from 61 per cent in 2007. At just under 67 million, total population is about 2 million lower than in the Principal scenario.
- 6.2.10 In the very long term, the 'Young' scenario results in the lowest possible dependency ratio, although the pessimistic assumptions about life expectancy may not be regarded as desirable.
- 6.2.11 The Low Migration and High Migration scenarios demonstrate the effects of varying the migration assumption whilst holding fertility and life expectancy at their central levels. In both cases, the resulting dependency ratio is little different to that produced by the Principal scenario. Combining higher fertility rates with central life expectancy and migration has a slightly bigger impact on dependency ratios in the long term.
- 6.2.12 Unsurprisingly, the highest total population is achieved by setting all three assumptions to their higher levels. However, this does not provide a solution to the challenges of population ageing: the resulting dependency ratios are higher than under the Principal scenario.
- 6.2.13 On balance, the scenarios provide a useful illustration of how the dependency ratio, and therefore the likely degree of pressure on the public finances, changes when different assumptions are made about the source of population growth. Although the levels of the dependency ratio are sensitive to the assumptions made, and will change when the results of the 2006-based projections are known and can be compared in the same way, the comparison between the different variant scenarios is still valid.
- 6.2.14 There is a great deal of uncertainty associated with these projections, particularly over such a long time horizon. Nonetheless, it is possible to assert that:
- Under central assumptions about fertility and life expectancy, the long-term effects of population ageing on the UK public finances would be significantly worse without any net in-migration;
 - But increasing GAD's central projection for long-term net migration by 60,000 per annum or reducing it by the same amount only has a small impact on the dependency ratio;

68 For fertility assumptions, see <http://www.gad.gov.uk/Population/2004/methodology/varfertass.htm>

For mortality assumptions, see <http://www.gad.gov.uk/Population/2004/methodology/varmortass.htm>

- In the medium term, the most effective means of limiting the expected increase in the dependency ratio from population ageing would be a combination of higher migration and lower fertility and life expectancy than in the Principal scenario. However in the long term, migrants themselves will age and ultimately contribute to the increasing dependency ratio⁶⁹. Thus increased fertility would also be required to achieve the lowest possible dependency ratio. This analysis assumes that immigrants remain in the UK for their period of retirement. Some migrants may return to their home country before reaching retirement age, in which case they will not increase the dependency ratio⁷⁰.

6.2.15 In reality, it is questionable whether it would be possible to deliberately engineer these kinds of demographic changes. As discussed in paragraph 5.8.6, international evidence suggests that many policies designed to influence fertility rates have a relatively modest effect.

6.2.16 It may be easier to address the problems of population ageing through policies to influence participation rates and the effective age of retirement. Shaw (2001)⁷¹ highlights the difficulties in influencing migration flows, which typically depend on a combination of socio-economic and political circumstances in receiving and sending countries, and concludes that “*measures such as raising workforce participation rates or discouraging early retirement are likely to remain a more practical tool for increasing the working population than attempting to influence demographic behaviour*”.

69 Whilst we can draw this conclusion about the overall dependency ratio, and therefore the likely impact on public finances overall, it is not theoretically correct to say that because migrants age too, they cannot help to pay for *pensions* in the long run. This is explored in detail in Munz, S. and Werdung, M. (2003) **Public pensions and international migration: some clarifications and illustrative results**, IFO Institute for Economic Research and CESifo, available from http://ideas.repec.org/a/cup/jpenef/v4y2005i02p181-207_00.html

70 Whilst migrants returning to home countries would not contribute to the UK dependency ratio (which is based on the UK population), it should be noted that some may still be eligible to receive a UK state pension. This would be the case if they had made sufficient National Insurance contributions whilst working on the UK. Nonetheless, they are still likely to cost the UK exchequer less than a retired immigrant resident in the UK as non-residents will make less use of other public services

71 Shaw, C. (2001) **United Kingdom population trends in the 21st century**, in Population Trends 103, Spring 2001, National Statistics, available at http://www.statistics.gov.uk/downloads/theme_population/PT103book_v3.pdf

7 The economic impact of illegal migration

Key Points

- Analysis of illegal immigration is hampered by an intrinsic lack of information since illegal migrants wish to remain unobservable to the State;
- Illegal immigrants live without the protection of the State;
- Companies employing illegal workers could have an unfair competitive advantage.

7.1 Background

- 7.1.1 Analysis of illegal immigration is hampered by a lack of information. This is intrinsic to the issue: illegal migrants wish to keep themselves unobservable to the State. Nonetheless, we can make best estimates using the information that we do have.
- 7.1.2 The ‘unauthorised’ or ‘illegally resident’ migrant population in the UK is made up of quite distinct categories. Broadly, these cover anyone who does not have valid leave to remain in the UK and will include:

- Illegal entrants (including clandestine entrants and those using deception on entry by presenting false documents or misleading immigration officials);
- Overstayers (those who have not left the UK after valid leave to remain has expired);
- Failed asylum seekers who do not comply with instructions to leave the UK, who are not appealing or who have exhausted their rights of appeal (including those who abscond during the process).

7.1.3 No government has been able to produce an accurate figure for the number of people who are in the country illegally. However, a number of different studies have attempted to estimate the size of the unauthorised migrant population. These include:

- Woodbridge, J. (2005) **Sizing the unauthorised (illegal) migrant population in the United Kingdom in 2001**, Home Office Online Report 29/05
- Black, R., Collyer, M., Skeldon, R. and Waddington, C. (2005) **A survey of the illegally resident population in detention in the UK**, Home Office Online Report 20/05
- Anderson, B., Ruhs, N., Rogaly, B. and Spencer, S. (2006) **Fair enough? Central and East European migrants in low-wage employment in the UK**, COMPAS.

7.2 The economic importance of illegal immigration

- 7.2.1 Work on the economic importance of illegal immigration is underdeveloped, although there have been some studies which relate to the UK. For example:

- Black, R., Collyer, M., Skeldon, R., and Waddington, C. (2005) **A survey of the illegally resident population in detention in the UK**, Home Office Online Report 20/05; and
- Institute for Public Policy Research (April 2006) **Irregular migration in the UK, an IPPR factfile**

7.3 The costs of illegal immigration

- 7.3.1 Illegal immigrants live without the protection of the State and are therefore vulnerable to **exploitation**. Since, by definition, they are working illegally, their employers are perhaps more likely to break the law and deny them the National Minimum Wage and other worker protections, such as health and safety provisions and the working hours directive. They may also have low job security, no bargaining rights, and be unable to get an employer's reference.
- 7.3.2 HM Treasury (2000)⁷² argue that **companies employing illegal workers could have an unfair competitive advantage**, which may force competitors to resort to illegal employment as well, or move parts of their production to countries where labour is cheaper.
- 7.3.3 It is hard to measure the effects of illegal migrants on regular workers as they make themselves as unobservable as possible. Moreover, they often perform work that is dirty, dangerous and difficult. These jobs are likely to be the least favoured amongst legal residents.

8

How can data on immigration be improved?

Section 5 of the ONS submission to the House of Lords Select Committee provides details of the recommendations made by the Inter-Departmental Task Force on International Migration Statistics (December 2006). This Task Force made recommendations on how improvements could be made to estimates of migration and migrant populations in the United Kingdom, both nationally and at a local level. The ONS submission also provides details on the improvements that have already been put in place, work in progress and plans for further improvements over a two to five year period.

⁷² HM Treasury (March 2000) **The Informal Economy: A report by Lord Grabiner QC**

9 Government Policy on Immigration

Key Points

- The Government's new Points Based System (PBS) is a five Tier framework covering the main routes through which people coming to work, study or train will enter the UK;
- The PBS provides a points-based approach to determining which migrants will be successful with their applications. The inclusion of sponsors will help ensure that the system is not abused;
- The PBS will be supported by open and objective policy-making, reflecting the UK's migration needs;
- A new Migration Advisory Committee (MAC) will provide evidence-based advice to the Government on where migration might sensibly fill labour shortages within the economy;
- The MAC will be accompanied by the Migration Impacts Forum (MIF), which will focus on the wider impacts of migration experienced by local areas;
- An important principle of the PBS is to retain the flexibility to respond to the changing needs of the UK labour market.

9.1 How will the points system for immigrants from outside the EU operate?

9.1.1 Central to the design for the new system is a five Tier framework covering the main routes through which people coming to work, study or train will enter the UK; a points-based approach to determining which migrants will be successful with their applications; and the inclusion of sponsors to help ensure that the system is not being abused.

- 9.1.2 The five Tiers of the Points-Based System will replace the existing 80 different routes by which a non-EEA national can come to the UK to work, study, or train. This will help people understand how the system works and direct applicants to the category that is most appropriate for them:
- Tier 1: Highly skilled individuals to contribute to growth and productivity
 - Tier 2: Skilled workers with a job offer to fill gaps in the UK labour force
 - Tier 3: Limited numbers of low-skilled workers needed to fill specific temporary labour shortages
 - Tier 4: Students
 - Tier 5: Youth Mobility and temporary workers: people allowed into the UK for a limited period of time to satisfy primarily non-economic objectives
- 9.1.3 For each Tier, applicants will need sufficient points to gain entry clearance or leave to remain in the UK. Points will be awarded according to objective and transparent criteria. In all tiers points will be awarded for control factors which indicate whether the applicant is likely to comply with their immigration requirements in the UK. In Tiers 1 and 2, points will also be awarded for attributes such as age, previous salary or prospective salary and qualifications. Prospective migrants will be able to assess themselves against these criteria, and see whether they are likely to have enough points to qualify before paying an application fee.
- 9.1.4 All applicants in Tiers 2-5 will need to provide a certificate of sponsorship from an approved sponsor when making their application. The certificate will act as an assurance that the migrant is able to do a particular job or course of study. Sponsors will need to be licensed by the Border and Immigration Agency, after which they will be placed on the sponsor register. The Border and Immigration Agency will review sponsors' behaviour and compliance with the rules and take appropriate action where there is evidence of transgression.

9.2 How will the Government decide where there are skills shortages in the economy as the basis for its points system?

- 9.2.1 The Government is establishing a new Migration Advisory Committee (MAC) which will provide evidence-based advice to Government on where migration might sensibly fill labour shortages in the economy. In particular it will advise on:
- What the shortage occupations should be under Tier 2 of the Points Based System (skilled workers). Migrants coming in to take jobs in shortage occupations will not need to meet the points criteria, nor will the jobs need to be advertised to the resident labour market, as is normally the case under Tier 2;
 - What, if any, schemes should be established under Tier 3 of the Points Based System for low-skilled workers. Tier 3 schemes can only be set up once restrictions on employment rights of Romanian and Bulgarian nationals have been lifted;
 - Other migration-related questions as Government may put to it from time to time.
- 9.2.2 David Metcalf⁷³ has been appointed Chair and we are in the process of appointing the MAC's membership, which will comprise experts on the labour market. The MAC will be established in Autumn 2007 and will be fully operational by April 2008.
- 9.2.3 The MAC will be accompanied by the Migration Impacts Forum (MIF). This will provide a forum for proper, regular and organised dialogue with interested parties outside of central Government, focussed on the wider impacts associated with migration experienced by local areas. The Forum will meet quarterly and be chaired jointly by a Home Office and a Communities and Local Government Minister.

9.3 How will the Government respond to employers asking for non-EU workers to fill low-skilled jobs?

- 9.3.1 Low-skilled migration requirements are currently met through two schemes. These are the Seasonal Agricultural Workers Scheme (SAWS) and the Sector Based Scheme (SBS). In 2007, 100 per cent of the SBS and 40 per cent of the SAWS has been drawn from Romania and Bulgaria only. As of 2008, 100 per cent of both schemes will be restricted to Romania and Bulgaria.
- 9.3.2 These restrictions reflect the Government's policy to phase out low-skilled migration schemes for non-EU nationals unless evidence of significant labour shortages is identified in specific sectors. There is currently believed to be sufficient low-skilled labour in the UK and EU to meet the requirements of the UK economy.
- 9.3.3 These restrictions are also in keeping with the EU Accession Treaties, which require the UK to give preference to EU workers over non-EU workers. So, as Bulgarians and Romanians are subject to quotas, there will not be a scheme for migrants from non-EU countries to do those low skilled jobs.
- 9.3.4 Nevertheless, it is an important principle of the Points Based System that we maintain the flexibility to be responsive to the changing needs of the UK labour market. Therefore, if, following consultation with employers and industry stakeholders, the Migration Advisory Committee advise that there is a low-skilled labour market shortage that can sensibly be filled by migration and once restrictions on Romanian and Bulgarian access to the labour market have been lifted, then it will be possible to set up a low-skilled scheme under Tier 3 of the Points Based System. However, we have no current plans to introduce Tier 3.

⁷³ Professor of Industrial Relations at the London School of Economics.
For further information see <http://press.homeoffice.gov.uk/press-releases/new-chair-migration>



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