

Analysis of the Points Based System: London Weighting

Migration Advisory Committee Report

August 2010



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Chapter 1

Introduction

1.1 The Migration Advisory Committee

1.1 The Migration Advisory Committee (MAC) is a non-departmental public body, comprised of economists, which provides transparent, independent and evidence-based advice on immigration to the Government.

1.2 What we have been asked to consider and why

1.2 London weighting payments made by employers can affect the calculation of points under Tier 1 and Tier 2 of the Points Based System (PBS) and therefore, in some cases, decisions made regarding whether immigrants from outside the European Economic Area (EEA) can work in the UK. In March 2010 the previous UK Government asked the MAC the following question in relation to London weighting:

“Should the UK Government exclude the London weighting from the PBS in order to ensure that the PBS appropriately reflects regional wage differences across the UK, and what effect would that have on the labour market and the economy in the UK?”

1.3 This report provides information and a recommendation based on our analysis of the available data and our consideration of the evidence we received.

1.4 We understand that this report was commissioned following discussions between the Scottish Government and the previous UK Government about the impact of the PBS on immigration to areas outside London and the South East of England, with particular reference to Scotland. We have therefore taken special care to understand the views of the Scottish Government and other corporate partners with an interest in the Scottish labour market and economy. However, in order to address the specific question we were asked, we have provided advice with reference to the impact on the UK as a whole.

1.5 The majority of the work for this report was carried out in March and April 2010, prior to the current Government coming to office in May 2010. It was submitted to the Government, and published, in August 2010, on the clear understanding that the work was commissioned by the previous administration. The Government and the MAC are currently jointly consulting on limits on Tiers 1 and 2 of the PBS, and this report does not prejudge what policy changes may take place following those reviews. It is for the Government to decide whether and how it responds to the recommendations in this report.

1.3 Our approach

1.6 As economists and immigration experts, we focused on the potential economic and labour market impacts of excluding London weighting from the earnings used to calculate PBS points. We examined the relevant academic literature, carried out our own analysis and gathered evidence from corporate partners.

1.7 We considered only two options: first, whether the PBS points calculation should remain unchanged; and, second, whether London weighting should be excluded from the calculation of PBS points for earnings.

1.8 We recognise that how the PBS best meets the needs of the UK as a whole, as well as its countries and regions, raises a broader range of issues and options, such as the distribution of the population across UK regions and the impact of immigration on public services. Additional options include introducing explicit regional aspects into the PBS. We do not consider that the terms of the question allowed us to consider making such recommendations. While we do not address such matters in detail in this report, we do reflect some of the arguments that were put to us.

1.9 We focused on the Tier 1 General route and the Resident Labour Market Test (RLMT) and intra-company transfer routes of Tier 2 as these are the only PBS routes under which London weighting has an impact on the calculation of the points.

1.4 Working description of London weighting

1.10 We adopted a working description of London weighting as “**a specific and separately expressed component added to the salary for a post which relates to employment in London.**”

1.11 Our reasons for this description are that it would be operationally unfeasible for the UK Border Agency to exclude what may be implicit payment of London weighting from the PBS points calculation and our working description helps clarify the scope of our analysis by limiting it to cases where an employer explicitly pays higher earnings to reflect the job’s London location.

1.5 Analytical framework

1.12 The analytical framework we adopted to consider the question is set out in full in Chapter 3. We identified two key questions. First, whether including London weighting in the earnings that count towards PBS points is consistent with the objectives of the PBS. Second, what would be the likely economic and labour market impacts of ceasing to include London weighting in the PBS points calculation.

1.13 The reasons why employers choose to pay London weighting are key to determining whether or not its reflection in the PBS points calculation is

consistent with the objectives under which the previous Government put the policy in place. We have therefore tried to determine why employers may choose to offer higher pay in London relative to other regions of the UK. Potential reasons include:

- compensating wage differentials, which comprise compensation for higher living costs in London and the disamenity of working in London;
- composition effects where, even within a given occupation, the average London job may be more skilled, or senior, than an equivalent job elsewhere in the UK;
- relative scarcity of labour in London; and
- agglomeration effects, which potentially increase the productivity of the individual worker and the firm in large cities.

1.14 In Chapter 2 we discuss in more detail possible descriptions of London weighting and who pays it.

1.6 Structure of the report

1.15 Chapter 2 provides the policy context and contextual data on London weighting payments and immigration. Chapter 3 describes the analytical framework and the sources of information we used. Chapter 4 provides our main analysis of London weighting in the PBS points calculation. Chapter 5 summarises our recommendation and the reasons for it.

1.7 Thank you

1.16 We received important corporate partner input into this report. We appreciate the constructive and open nature in which interested parties engaged with us. We would like to thank all individuals and organisations who provided us with the evidence necessary to complete this report.

Chapter 2

London weighting policy and data context

2.1 Introduction

2.1 This chapter describes the Points Based System (PBS) and explains how London weighting counts towards the calculation of points for previous or prospective earnings in the PBS. It also presents relevant data on the flows, characteristics and occupations of immigrants for both London and the rest of the UK. It looks at data on pay in London and briefly considers definitions and usage of London weighting, before making some concluding remarks.

2.2 The Points Based System

2.2 In 2005 a public consultation was launched on a proposed new system for immigration (Home Office, 2005a) as part of a five year strategy on immigration and asylum (Home Office, 2005b).

2.3 The proposals were intended to ensure that *“Britain attracts the skilled labour force it needs to perform key jobs in areas such as engineering, the financial sector, as well as education and the health service...its aim is to ensure that those who can contribute most to the UK are selected for entry and that the country takes in only as many people as our economy needs at any one time.”*

2.4 Among the stated aims for the proposed system were to:

- fill skills gaps;
- attract highly productive and highly skilled workers; and
- attract investment and increase productivity and flexibility in the labour market.

2.5 In 2006, detailed proposals were published which stated that one of the key outcomes of the new system was *“better identifying and attracting of migrants who have most to contribute to the UK”* (Home Office, 2006).

Tiers 1 and 2 of the PBS

2.6 Tier 1 was set up by the previous Government to facilitate the immigration of highly skilled individuals, those who have completed degree level studies in the UK, entrepreneurs and investors. Tier 1 immigrants are not required to have found employment in the UK before entering the country.

2.7 Under the Tier 1 General route, points are earned for qualifications, previous earnings, age and relevant UK experience. A total of 75 points is required. An individual aged 35-39 with UK experience and a master’s degree would need to have previous earnings of equivalent to at least £50,000 per annum to gain the required 75 points for entry under this route.

2.8 Tier 2 comprises five routes:

- **Shortage occupation:** for skilled people coming to the UK for a specific vacancy in an occupation included on a list of occupations identified as experiencing a national shortage of skilled workers that can sensibly be filled with non-EEA immigration.
- **Resident Labour Market Test (RLMT):** for skilled jobs that cannot be filled after being advertised through Jobcentre Plus for a minimum of four weeks. The employer (sponsor) needs to show that there is no suitably qualified worker from the UK or EEA available to fill the vacancy.
- **Intra-company transfer:** for established employees of multinational companies transferred to a skilled job in a UK-based branch of the organisation.
- **Sportspeople:** for elite sportspeople and coaches whose employment will make a significant contribution to the development of their sport at the highest level.
- **Ministers of religion:** for those people coming to fill a vacancy as a minister of religion, missionary or member of a religious order.

2.9 The three principal routes of entry under Tier 2 are the shortage occupation, RLMT and intra-company transfer routes. The immigration routes for sportspeople and ministers of religion have separate entry criteria and are not discussed further in this report.

2.10 Immigrants entering the UK under Tier 2 must have a guaranteed job offer from a UK employer in an occupation that is identified as skilled by the Tier 2 codes of practice.¹ Consequently, it should not be possible for immigrants to enter unskilled employment via Tier 2, irrespective of whether or not London weighting counts towards earnings for the purposes of the PBS. The codes of practice also stipulate minimum 'going rate' salaries for occupations to prevent undercutting.

2.11 For the three principal Tier 2 routes the overall PBS pass mark is set at 70 points.² Points are awarded depending upon the entry route and the immigrant's qualifications and prospective earnings. Furthermore, all immigrants, regardless of route, are required to meet the maintenance and English language requirements.

¹ The skilled occupations list used by the UK Border Agency under the Tier 2 codes of practice is available here: <http://www.ukba.homeoffice.gov.uk/sitecontent/documents/employersandsponsors/pointsbasedsystem/soccodesummarytables>

² Intra-company transferees are not required to meet the English language requirement if their stay in the UK is shorter than 3 years. In this case the pass mark is 60 points (50 points for Tier 2 route, earnings and qualifications, and 10 points for meeting the maintenance requirement).

2.1 Table 2.1 sets out the Tier 2 points requirements and the corresponding points allocation.

Table 2.1: PBS Tier 2 (certain routes): routes, points and requirements						
Section	Routes		Requirements: Qualifications (or equivalents)		Requirements: Prospective earnings	
A (50 points needed)	Offer of job in shortage occupation	50	No qualifications	0	Under £20,000	0
	Offer of job that passes RLMT	30	GCE A-level	5	£20,000 - £23,999	10
	Intra-company transfer	25	Bachelor's degree	10	£24,000 - £27,999	15
			Master's degree or PhD	15	£28,000 - £31,999	20
					£32,000 +	25
B	Maintenance requirement (mandatory)					10
C	Competence in English (mandatory)					10
<p>Note: Those switching from a post-study route are exempt from the RLMT test as they are considered part of the resident labour market. Prospective earnings are before tax and can be adjusted periodically to reflect inflation and/or labour market requirements. Allowances will be taken into consideration in calculation of earnings, including any London weighting payments. Source: UK Border Agency (2010)</p>						

London weighting in the PBS

2.12 London weighting is relevant to points awarded for prior earnings under the Tier 1 General route. Immigrants applying from overseas will score points for their previous overseas salary, which will not include London weighting, but those applying from within the UK having previously worked in London may have been paid London weighting as part of their prior earnings. For example, individuals switching from the Post-Study Work Route (PSWR) into Tier 1 General may be awarded points for prior earnings that included London weighting.

2.13 London weighting is also relevant to those Tier 2 routes where points are awarded for prospective earnings, namely the RLMT and intra-company transfer routes of Tier 2. Unlike Tier 1, those applying in-country and out-of-country can include London weighting as part of their prospective earnings. London weighting is not relevant to the shortage occupation route because the construction of the points tables means that immigrants employed in a shortage occupation do not need to gain points for prospective earnings.

2.14 London weighting is mentioned only once in the PBS policy guidance. The policy guidance for Tier 2 (General), which includes the RLMT route, states that:

“We will consider basic pay (excluding overtime) plus any allowances, such as London weighting, which would also be paid to a settled worker in similar circumstances, provided these allowances are part of your guaranteed salary package.”

2.15 The policy guidance for intra-company transfers does not mention London weighting specifically. However, it does state that:

“We will consider basic pay (excluding overtime); and allowances (including daily payments to cover the additional cost of living in the United Kingdom but not including expenses to travel to and from your home country), provided these allowances are part of your guaranteed salary package.”

2.16 As discussed in MAC (2009a) the payment of allowances is particularly widespread for immigrants coming to the UK under the intra-company transfer route. We were told it was common practice to keep employees on their home country payroll and make up the difference between that and the equivalent UK salary by paying allowances. Many allowances are also paid to cover the cost of temporary accommodation and travel. It may be difficult to separate London weighting from other allowances paid with respect to relocating from overseas.

2.17 London weighting may also be taken into account when jobs under Tier 2 are assessed against the relevant codes of practice, which set out minimum rates of remuneration for each occupation. Within the codes of practice, 11 occupations are assigned a geographical minimum rate, including eight assigned specific minimum rates for London. These geographical minimum rates are outlined in Annex A.

2.3 Immigration data

Stocks and flows of immigrants in London

2.18 London has a higher population of individuals born outside the UK than any other country or region of the UK, reflecting an historic bias in patterns of migration towards London (Table 2.2). In the 12 months leading up to June 2009 approximately 38 per cent of immigrants (defined as non-UK born) in the UK population resided in London.

Table 2.2: Stocks of immigrants by country of birth for countries and regions of the UK, year to June 2009

	Population by country of birth (000s)			Migrant share of population within each region (per cent)		Regional share of total non-UK born (per cent)
	UK	EU	non-EU	non-UK	non-EU	
United Kingdom	53,919	2,141	4,701	11	8	100
Scotland	4,794	126	175	6	3	4
Wales	2,819	58	82	5	3	2
Northern Ireland	1,652	60	41	6	2	2
England (total)	44,654	1,898	4,402	12	9	92
of which...						
North East	2,424	38	82	5	3	2
North West	6,333	154	344	7	5	7
Yorkshire and the Humber	4,778	125	267	8	5	6
East Midlands	4,018	123	256	9	6	6
West Midlands	4,784	149	426	11	8	8
East	5,097	216	340	10	6	8
London	4,994	660	1,936	34	26	38
South East	7,406	290	570	10	7	13
South West	4,819	143	179	6	4	5

Note: Areas ranked by share of non-UK born population. EU figure excludes those born in the UK, but includes those born in the Republic of Ireland.
Source: Annual Population Survey, July 2008-June 2009, published ONS (2010a)

2.19 Similarly, the magnitudes of inflows and outflows of long-term migrants (defined as those entering or leaving the UK for a year or more) to and from London are greater than for any other country or region of the UK (Table 2.3). Approximately 28 per cent of long-term international migration inflows in 2008 were destined for London, while 27 per cent of the outflows were from London. London's share of the UK migration inflow has declined from a peak of 45 per cent in 1998 to 28 per cent in 2008, although the total stock of immigrants in London has increased over the same period.

Table 2.3: Flows of long-term migrants to and from countries and regions of the UK, 2008

	Long-term international migration (LTIM) (000s)			Net long-term migration (International Passenger Survey) by country of last or next residence (000s)		
	Inflow	Outflow	Balance	non-EU	EU	Total
United Kingdom	590	-427	163	121	8	129
Scotland	44	-25	20	12	6	18
Wales	16	-16	1	6	-7	0
Northern Ireland	18	-10	8			-
England (total)	512	-377	135	101	7	108
of which...						
North East	23	-7	16	8	6	14
North West	45	-41	4	3	-2	2
Yorkshire and the Humber	53	-20	32	29	35	22
East Midlands	23	-22	1	1	-2	-1
West Midlands	37	-25	12	11	-1	10
East	54	-38	16	17	-2	15
London	163	-113	50	24	15	40
South East	84	-71	13	15	-5	10
South West	31	-41	-10	0	-11	-11

Note: The first three columns report long-term international migration, which is based on the International Passenger Survey plus adjustments for asylum, changes of intentions and movements from the Republic of Ireland. The last three columns relate to the International Passenger Survey only.
Source: Estimates of Long-term International Migration 2008, ONS (2010b); International Passenger Survey 2008 (ONS, 2010c).

2.20 The International Passenger Survey records reasons for migration, including employment. However, estimates at the regional level are subject to substantial margins of error.

2.21 It is also not possible to accurately determine where Tier 1 or Tier 2 immigrants live in the UK. However, Tier 2 immigrants are tied to a sponsor employer and the location of the sponsor employer is known. Tier 1 immigrants do not require a sponsor and there are currently no data that reliably record their place of work.

Tier 2 immigrants in London

2.22 Applicants for Tier 2 must have both a sponsor and a valid certificate of sponsorship before applying. The sponsor is a UK-based employer who wishes to employ the applicant in the UK and is licensed by the UKBA to issue certificates of sponsorship.

2.23 Certificates of sponsorship are necessary but not sufficient to secure approval of entry to the UK. The data in this report capture 'used' certificates of sponsorship, where an application that corresponds to the certificate has been submitted but not necessarily approved.

2.24 From the launch of Tier 2, in November 2008, to March 2010, 45 per cent of Tier 2 immigrants were sponsored for employment within Greater London.³ Table 2.4 shows that during this period approximately 39,780 certificates of sponsorship were used by employers based in the Greater London area compared to 87,750 for the whole of the UK. Table 2.4 also shows that the majority of certificates in both London and the UK as a whole were issued for intra-company transfers. The allocation of certificates of sponsorship across the three main Tier 2 routes is similar in London, in proportionate terms, to the UK as a whole.

Table 2.4: Used Tier 2 certificates of sponsorship by Tier 2 route, Nov 2008 to March 2010

	Certificates of sponsorship issued in Greater London only (per cent of total)		Total certificates of sponsorship issued in the UK (per cent of total)	
Intra-company transfer	23,120	(58%)	45,750	(52%)
Resident Labour Market Test	12,880	(32%)	30,340	(35%)
Shortage occupation list	3,780	(10%)	11,660	(13%)
Total	39,780	(100%)	87,750	(100%)

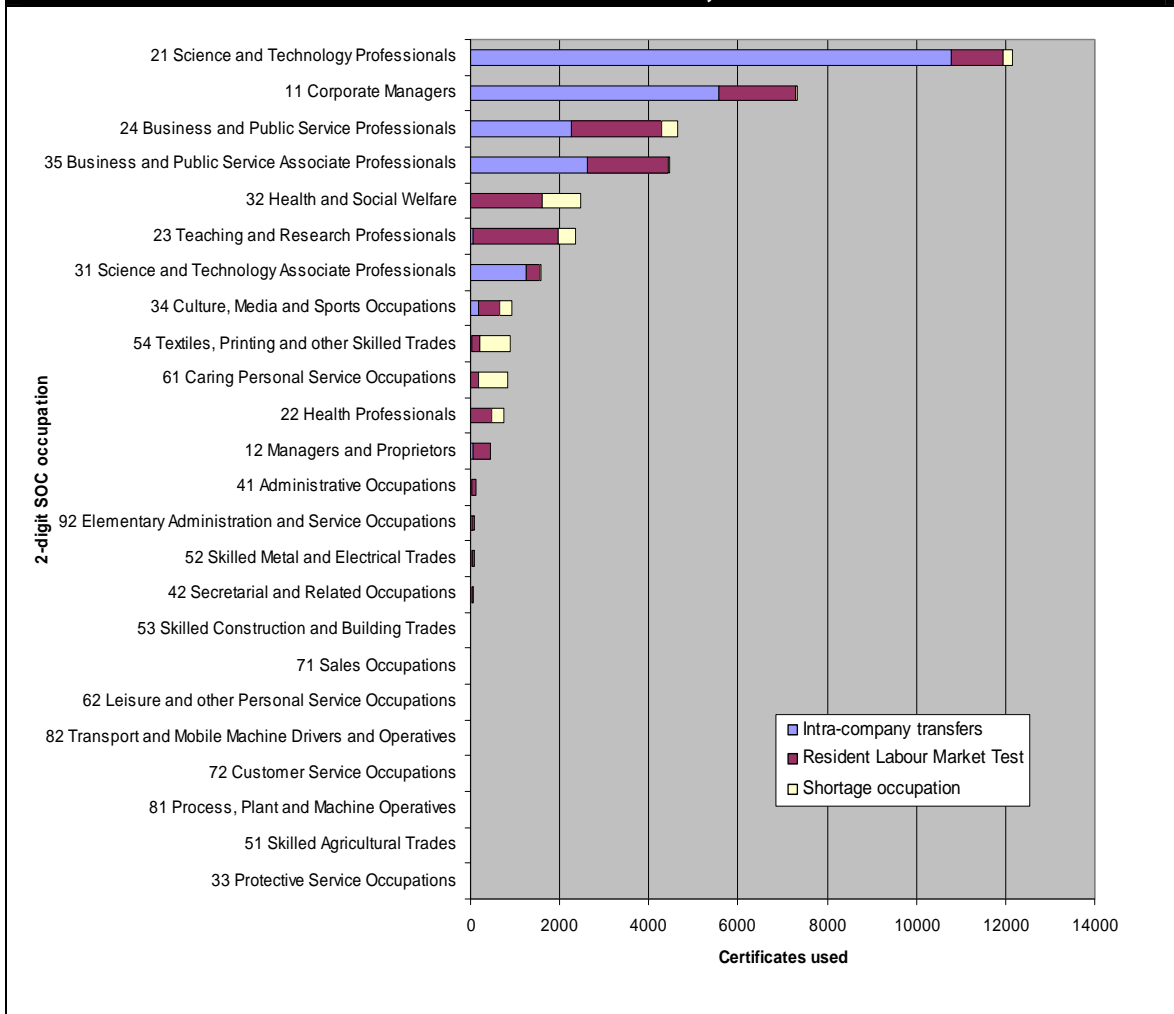
Note: The above figures describe 'used' certificates of sponsorship, where an application that corresponds to the certificate has been submitted but not necessarily approved. The number of used certificates of sponsorship has been rounded to the nearest 10.

Source: UK Border Agency management information data, Nov 2008 to March 2010

2.25 Figure 2.1 shows the occupations for which Tier 2 certificates of sponsorship have been used in the Greater London area, identified by the Standard Occupational Classification (SOC) at the two-digit level. Science and technology professionals, primarily employed by the information technology sector entering through the intra-company transfer route, outnumber other occupational groups by a considerable margin. Corporate managers are also strongly represented, again primarily using the intra-company transfer route.

³ Greater London is defined by postcode areas, rather than administrative regions. For this reason, we have not been able to make equivalent estimates for other regions of the UK.

Figure 2.1: Occupations for which certificates of sponsorship have been used under Tier 2 in the Greater London area, Nov 2008 to March 2010



Note: The above figures describe 'used' certificates of sponsorship, where an application that corresponds to the certificate has been submitted but not necessarily approved. SOC 2000 two-digit level occupations are shown. For each certificate of sponsorship, the occupation is chosen by the employer at four-digit level.

Source: UK Border Agency management information data, Nov 2008 to March 2010

2.26 Table 2.5 shows the occupations and salary bands into which Tier 2 certificates of sponsorship fall, distinguishing between those used by London-based sponsors and those used elsewhere. Approximately 63 per cent of Tier 2 jobs in London and 43 per cent of Tier 2 jobs outside London pay £32,000 or more, putting them in the highest band in terms of points for earnings.

2.27 There are only minor differences between the occupational profile of Tier 2 jobs in London and those elsewhere. London has a higher proportion of corporate managers, business and public service professionals and associate professionals within Tier 2. Overall, and within individual occupational groups, Tier 2 jobs in London pay more than jobs outside London. For example, 59 per cent of Tier 2 science and technology professionals outside London are paid £32,000 or more, whereas 66 per cent in London fall into that earnings band.

Table 2.5: Tier 2 certificates of sponsorship used by occupation and salary band, Nov 2008 to March 2010

	London					Outside London				
	Below £20K	£20-24K	£24-£28K	£28 - 32K	£32K and above	Below £20K	£20-24K	£24-£28K	£28 - 32K	£32K and above
11 Corporate Managers	190	170	290	300	6,250	160	200	250	280	3,620
12 Managers And Proprietors In Agriculture And Services	40	150	120	40	90	120	270	210	20	50
21 Science And Technology Professionals	1,060	80	970	2,010	7,940	1,260	350	1,930	3,800	10,770
22 Health Professionals	40	30	40	80	520	280	130	240	530	2,370
23 Teaching And Research Professionals	180	130	450	500	1,060	210	400	1,100	1,600	1,470
24 Business And Public Service Professionals	410	160	300	290	3,450	560	190	190	210	620
31 Science And Technology Associate Professionals	40	40	390	470	630	40	240	710	540	810
32 Health And Social Welfare Associate Professionals	140	290	970	570	400	670	2,210	1,290	340	250
33 Protective Service Occupations										
34 Culture, Media And Sports Occupations	130	90	100	40	550	350	60	50	40	260
35 Business And Public Service Associate Professionals	150	190	330	240	3,530	60	150	190	110	450
41 Administrative Occupations		30	30	10	40	10	30	10		20
42 Secretarial And Related Occupations	10	20	20	10	20		10	10	10	
51 Skilled Agricultural Trades						180	40			
52 Skilled Metal And Electrical Trades		10	30	10	20	110	50	120	40	70
53 Skilled Construction And Building Trades	10		10	10	10	10				
54 Textiles, Printing And Other Skilled Trades	490	230	90	40	50	1,820	390	180	20	10
61 Caring Personal Service Occupations	750	30	20			2,010	70	20		10
62 Leisure And Other Personal Service Occupations	10	10	10			10	10			
71 Sales Occupations		10	10		10	0	10			
72 Customer Service Occupations		10				0	20			
81 Process, Plant And Machine Operatives						60			20	70
91 Elementary Trades, Plant And Storage Related Occupations						70				
92 Elementary Administration And Service Occupations	20	30	30	10		70	40	60		
9999 Not stated	220	40	40	40	150	310	80	90	40	100
Total	3,890	1,750	4,250	4,670	24,720	8,370	4,950	6,650	7,600	20,950

Note: Figures shown cover all Tier 2 routes. Salary bands correspond with those in the Tier 2 points table. Data are rounded to the nearest 10 and for occupations with less than 10 certificates of sponsorship, no data are shown. No certificates fall into occupation group 82, transport and mobile machine drivers and operatives. Source: UKBA Management Information, November 2008 – March 2010.

2.4 Pay data

2.28 As shown in Table 2.6, average full-time annual earnings in London are, on average, 31 per cent higher than in the UK as a whole.

Table 2.6: Comparison of median full-time gross annual earnings in London and the whole of the UK for all occupations and the public and private sectors, April 2008 to March 2009

	London	UK	Difference between London and the whole of the UK (per cent)
All occupations	£33,701	£25,816	31
All public sector	£34,378	£27,686	24
All private sector	£33,707	£24,970	35

Note: Only workers who have been employed in the same firm for more than one year are included in these data.
Source: Annual Survey of Hours and Earnings (ASHE) 2009

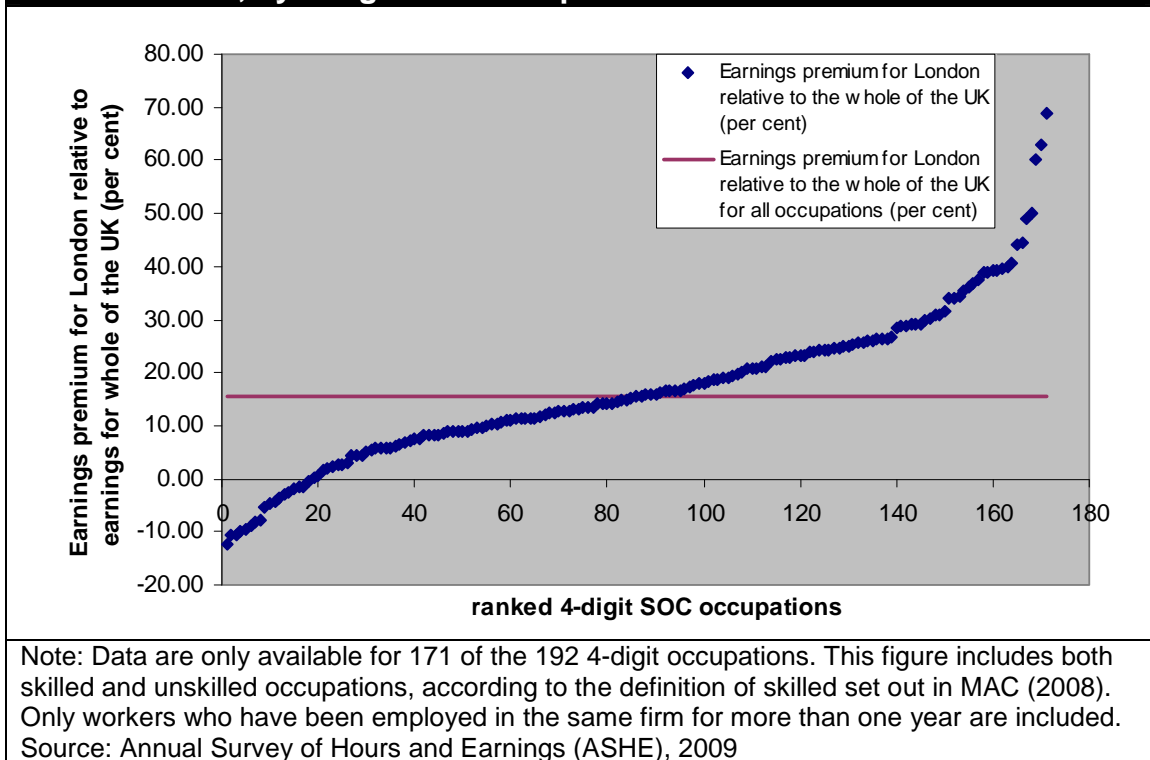
2.29 The London premium is higher in the private sector (35 per cent) than in the public sector (24 per cent). This could reflect the fact that public sector pay is far more likely to be negotiated at a national level than private sector pay, leaving public sector employers less freedom to vary earnings by region to reflect differing labour market conditions.

2.30 NHS organisations use a Market Forces Factor (MFF)⁴, an index of the relative differences in unavoidable costs faced by NHS organisations, to allocate their funding. The staff element of the MFF is based on the wage differential between the public and private sectors. Elliott *et al.* (2009) argued that NHS labour markets will be connected to private sector labour markets if the skills of the NHS staff are transferable to the private sector. In regions where private sector pay is considerably greater than public sector pay, NHS employers may need to offer increased pay to enable them to recruit staff and will experience greater turnover of staff and so increased recruitment costs. Therefore, the staff MFF is employed to allocate increased funding to particular regions to compensate for such differences in operating costs.

2.31 Roughly half of the 31 per cent difference between London and the whole of the UK can be attributed to the occupational composition of the London labour market. Figure 2.2 ranks the 171 4-digit SOC occupations for which data are available according to the size of the London premium relative to the UK as a whole. The median observation in this data set, which is for the occupation of paramedics, shows an “adjusted” London premium of 15 per cent: higher average pay in London reflects, in part, the fact that London has a higher proportion of employment in more highly paid occupations.

⁴ More information on the Market Forces Factor can be found at http://www.dh.gov.uk/en/Publicationsandstatistics/Publications/PublicationsPolicyAndGuidance/DH_087153

Figure 2.2: London median full-time earnings “premium” relative to the UK as a whole, by 4-digit SOC occupation



2.5 Definitions and usage of London weighting

2.32 The Convention of Scottish Local Authorities (COSLA) told us that London weighting was established by the London Pay Board in 1974, who said that *“the proper purpose of London Weighting is to take account of the different costs of working in London from elsewhere in the country”*. Furthermore, COSLA told us that the most recent review of London weighting, which was undertaken by the London Weighting Advisory Panel in 2002, stated that *“London premium is primarily an indirect cost compensation which uses market forces to indicate what level a premium should be set at”*.

2.33 In a recent report on London weighting, Incomes Data Services (IDS) did not use a formal definition, but instead tried to determine a “London premium”. IDS told us that determining this premium was complicated because the reasons for London weighting payments had evolved over time.

2.34 IDS also told us that London weighting payments were originally based on a set of indices that took into account higher costs of living in the capital. However, within the last 20 years employers have also used London weighting as a response to increased competition for staff. IDS told us that location payments have become as much about staff recruitment and retention as higher living costs and the indices on which London weighting was originally based are no longer published.

2.35 IDS (2009) found that, of the 132 organisations it examined, more than two-thirds operated a system of free-standing London allowances. London allowances were paid to employees in both the public and private

sector; as well as public sector employers in health, education and the civil service, private sector employers in sectors such as banking, insurance, retail and telecommunications were also found to pay London weighting. The IDS data show that location-based payments are not confined to London. For instance, police officers in Essex, Hertfordshire, Kent and a number of other counties in the South East may be eligible for location-based allowances. The IDS report also shows that the geographical definition of London varies considerably from employer to employer.

2.36 In 2009 the median inner London allowance across the 132 organisations was £3,407 (IDS, 2009). This varied across sectors: the median London allowance for the financial sector was £3,653, compared to £3,379 for the public sector.

2.37 IDS (2009) found that, in approximately two-thirds of the 132 organisations studied, the average inner London allowance payment in 2009 remained unchanged compared to the 2008 payment. It also found that the last 10 years have seen few significant increases in the average London allowance paid by employers in the banking sector. Most of the increase in the size of London allowances in recent years was found to be in 'key' areas of the public sector, such as the police service, the NHS and education. IDS (2009) found that many public sector organisations increase their London allowances on an annual basis in line with agreed increases in basic pay.

2.6 Conclusion

2.38 PBS policy guidance on London weighting under Tier 2 is limited and applicable only to the RLMT and intra-company transfer routes. London weighting can count towards prior earnings under Tier 1 General, including for individuals switching into that route from within the UK (particularly via the PSWR).

2.39 Of the UK regions and countries, London has by far the largest stock of immigrants, defined by country of birth, both in absolute terms and as a proportion of population. Immigrant inflows to, and outflows from, London have also been far greater in magnitude than any other part of the UK. Forty-five per cent of Tier 2 inflows between November 2008 and March 2009 were to London.

2.40 Under Tier 2, nearly 40,000 certificates of sponsorship were issued to London employers between November 2008 and March 2010. Of these around 36,000 were for the RLMT and intra-company transfer routes, with the highest share of certificates issued for science and technology professionals, who are primarily employed in the information technology sector. There are considerable gaps in the data in terms of the location and salary of Tier 1 immigrants.

2.41 After allowing for differences in occupational composition, average pay in London is approximately 15 per cent higher than in the UK as a whole. The premium to working in the private sector in London is higher than that to working in occupations dominated by public sector employment.

Chapter 3

Analytical framework, evidence and issues

3.1 Introduction

3.1 This chapter sets out the analytical framework we have used to consider the question we were asked. It examines whether the inclusion of London weighting in the earnings that count towards the Points Based System (PBS) points calculation is consistent with plausible economic policy objectives, focusing on those of the PBS. It also sets out how we consider the likely economic and labour market impacts.

3.2 The chapter also outlines the data and evidence that we used and highlights some issues beyond the scope of the question we were asked, but related to it.

3.2 Consistency with policy objectives

3.3 The PBS was set up by the previous Government with economic objectives in mind. It aimed, amongst other things, to fill gaps in the labour market and attract highly skilled and productive workers to the UK. In order to consider whether excluding London weighting from the PBS would ensure that the PBS appropriately reflects regional wage differences across the UK, we consider whether the inclusion of London weighting in the PBS calculation is consistent with possible policy objectives and, in particular, the objectives of the PBS itself. As illustrated in Box 3.1, the reasons why employers choose to pay London weighting are a key factor in determining this.

3.4 In their evidence to us the Scottish Government stated that the current design of the PBS *"effectively awards additional points for working in or around London, rather than recognising that a potential migrant will be paid less (reflecting the lower cost of living) for doing the same job in other parts of the UK or reflecting the skills that they bring to the economy."* The implication is that employers pay London weighting solely to reflect higher living costs. This additional payment does not reflect higher levels of skill or increased productivity and, consequently, its inclusion in the points calculation is incompatible with the economic objectives of the PBS in that it does not act to attract more highly skilled and productive workers. Some other corporate partners agreed with this argument.

"If MAC are to recommend that the London weighting is to continue to be included in a salary for the purpose of allocating points they need to provide clear evidence that such allowances are not primarily provided because of the additional cost of living in the capital."

Convention of Scottish Local Authorities in response to the London weighting question

Box 3.1: Illustrative example of how to consider the basis for including London weighting in the Tier 2 PBS points calculation

Consider a scenario where there are four job vacancies, two outside London (jobs A and C) and two in London (jobs B and D).

We assume, initially, that:

- Job A is equivalent to job B in terms of the level of skill required. Job C is similarly equivalent to job D.
- Jobs A and C are based outside London. Jobs B and D are based in London and London weighting is part of the pay package.
- Having been unsuccessfully advertised in the UK, all the jobs will be filled through the Resident Labour Market Test (RLMT) route of Tier 2.
- Based on the qualifications of the people filling the jobs, the required salary threshold is £28,000.



- Jobs A and B are both above the required earnings threshold, regardless of whether London weighting counts towards points.
- Job C does not meet the required earnings threshold, and can be regarded as inappropriate for inclusion in Tier 2.
- Job D meets the earnings threshold only if London weighting is included in the points calculation.

If London weighting is purely compensation for higher living costs, rather than a reflection of higher levels of skill, output or productivity, the economic value of job C is equivalent to job D, in real terms.

However, if London weighting actually reflects that job C has higher economic value, it may reasonably be taken into account under Tier 2.

3.5 As explained in Chapter 2, and outlined in more detail in Annex A, within the Tier 2 codes of practice eight occupations are assigned specific minimum rates for London. These codes of practice are designed to prevent less skilled immigration to London.

3.6 However, higher living costs are not the sole reason why employers choose to pay higher wages in a given occupation in London (and choose to do so via London weighting). It can be argued that, in a flexible and competitive labour market, an employer will generally not pay an employee either more or less than they are worth. Employers will not pay London weighting unless the employee is more productive in London than elsewhere. If this was not the case, it seemed to us that employers in London would find themselves out-competed by those with lower labour costs elsewhere.

3.7 Therefore, we considered several potential explanations for the payment of London weighting or, analogously, higher pay in London compared to elsewhere in the UK for seemingly similar work. These were:

- compensating wage differentials, which comprise compensation for higher living costs in London and the disamenity of working in London;
- composition effects where, even within a given occupation, the average London job may be more skilled, or senior, than an equivalent job elsewhere in the UK;
- relative scarcity of labour in London; and
- agglomeration effects.

3.8 On the first point, employers in London may offer higher wages than employers elsewhere in the UK because of the higher cost of living in London relative to the rest of the UK. Furthermore, Overman and Rice (2008) found that there are additional costs incurred by workers in large cities that must be compensated by higher earnings. For example, individuals employed in London face greater congestion on roads and public transport, as well as higher levels of pollution. Pay in London may need to be higher than elsewhere in the UK to compensate the worker for the higher living costs and the additional disadvantages of living in London.

3.9 The composition of the labour market in London may be different from that elsewhere in the UK. This will reflect an employer's choice to locate a job in London rather than in other regions of the UK. Even within the same occupational categories, skill levels and seniority may vary considerably, and jobs located in London may be biased towards these more skilled or senior jobs.

3.10 Payment of London weighting may also reflect the relative scarcity of skilled labour in London. This is compatible with the PBS objective of filling gaps in the labour market.

3.11 Regarding agglomeration, Overman and Rice (2008) argued that, by locating to an urban centre, such as London, firms benefit from the close proximity of a larger pool of potential suppliers, customers and employees. With access to a wider pool of labour, firms are more likely to find workers whose skills best match their production requirements. Agglomeration effects increase the productivity of the individual worker and the employer, which could explain why firms in large cities are willing to offer higher pay.

3.12 All these explanations may be interrelated. Costs of living, for instance, may be affected by the composition of the labour market in London, which in turn may reflect the greater presence of industries that benefit from the agglomeration effects that arise from locating in London. These interrelations are likely to make it very difficult to isolate individual factors to explain higher pay in London.

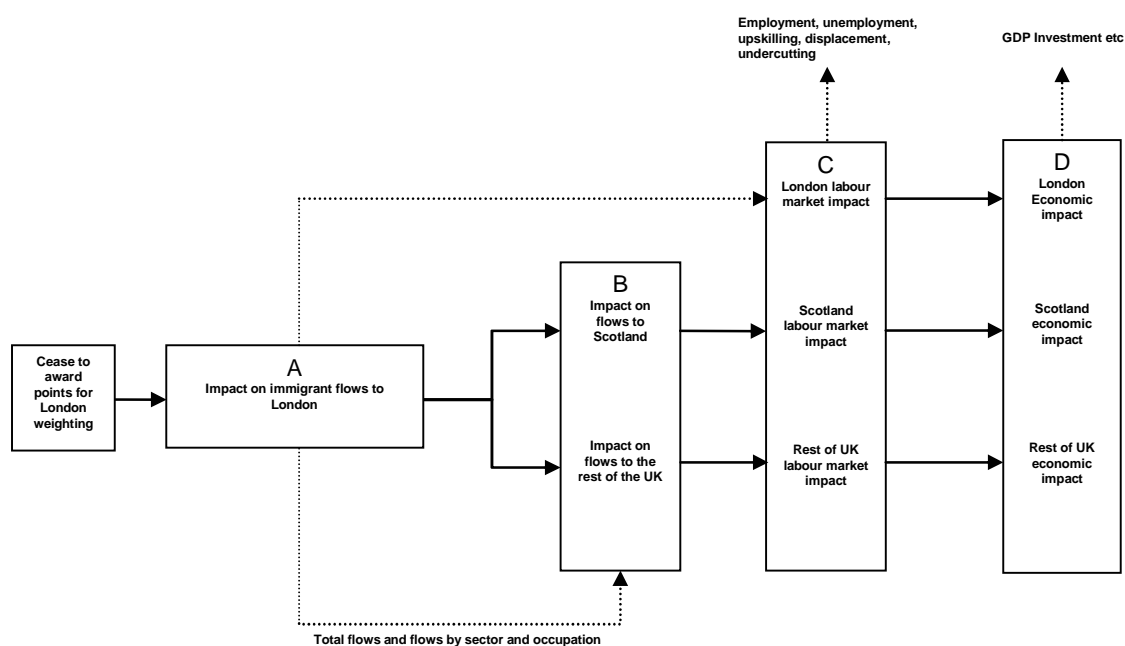
3.3 Analytical framework

3.13 We considered whether the inclusion of London weighting in earnings for the purpose of PBS points calculations is consistent with economic policy objectives. We also considered the economic impact of a change in the treatment of London weighting for PBS points purposes. Our framework, depicted in Figure 3.1 in schematic form, consists of analysing in turn:

- A. the impact of the relevant PBS policy change on immigration flows to London;
- B. the consequent impacts on flows to Scotland and the rest of the UK;
- C. the resulting impacts on labour markets in London, Scotland and the rest of the UK; and
- D. the economic impacts on London, Scotland and the rest of the UK.

3.14 Step A entailed considering the volume of flows to London that would be affected by excluding London weighting from the PBS points calculation. Under step B, we considered whether there is likely to be any impact on flows to Scotland and the rest of the UK. The economic and labour market impacts, considered in steps C and D, follow on from any effects on immigration flows. Methodological issues relating to steps A and B are set out in section 3.4 and those relating to steps C and D are discussed in section 3.5.

Figure 3.1: Analysis schematic



3.4 Impact on immigration flows

3.15 Excluding London weighting from the earnings used to award PBS points would reduce non-EEA immigrant flows to London. This is because, all other things being equal, it would make it harder for some non-EEA immigrants to obtain the necessary points to work in London. The impact may, however, be small because:

- many prospective immigrants will gain sufficient points regardless of whether London weighting is taken into account; and
- some employers may reclassify London weighting as basic pay to circumvent the change.

3.16 It seems likely that there would be little or no impact on flows to the rest of the UK. This is because immigrants who would previously have worked in London, but would not qualify to do so if London weighting were excluded from the earnings that count towards PBS points, will not gain the points necessary to work in the rest of the UK or Scotland either.

3.17 Two potential counter-arguments were provided by the Scottish Government. When we met its officials, they told us that many non-EEA domiciled individuals in the UK under the Post-Study Work Route (PSWR) were choosing to relocate to London after completing their studies in Scotland. We were told that, although these individuals did not always want to relocate to London, many decided to do so on the basis that they could earn the additional PBS points awarded for jobs in London due to the inclusion of London weighting in total earnings. These additional points made it easier for these immigrants to switch to Tier 1 General after their two years on the

PSWR. We were told that such cases were particularly damaging to the finance sector in Scotland.

“It is the experience of the Immigration Adviser that the finance sector in Scotland has the highest proportion of migrants who decide to move to London from Scotland in order to get the additional points provided by the inclusion of the London weighting. Those migrants working in the IT sector also struggle in Scotland to get a salary which would allow them to apply for Tier 1 General or Tier 2 General, this is now particularly so following the changes to the immigration rules in April 2010”

Scottish Government in response to the London weighting question

3.18 A second potential counter-argument from the Scottish Government, as described in their written evidence to us, was that *“salary levels are adjusted to increase or decrease levels of migration and currently decisions on this are based on **including** [their emphasis] the London weighting. If the London weighting was not included in earnings then there may not have been a need recently to increase the salary levels of Tier 2”*.

3.19 PBS points have not, in the recent past, been adjusted to change levels of immigration in the manner the Scottish Government suggests. The current points table for Tier 2 was calibrated by the MAC in 2009, when we reviewed the table at the request of the UK Government (see MAC 2009a), which largely accepted the spirit of our recommendations. Our report set out the basis for our recommended points table in detail and demonstrated that the recommendations were not made with the objective of increasing or decreasing immigration, but attracting the most economically beneficial workers to the UK.

3.20 Regarding the suggestion that it may have been unnecessary to increase the thresholds of the earnings bands for the Tier 2 points table had London weighting been excluded from the earnings used to calculate PBS points, it is correct that thresholds were calibrated using national earnings data, which included payments for London weighting. However, the overall impact of London weighting payments on these data will be small: around 14 per cent of UK jobs are based in London and London weighting itself is only, on average, a small component of total earnings for London-based jobs. We examine the effect of recalibrating the points tables for Tier 2 in Chapter 4.

3.5 Economic and labour market impacts

3.21 The scale of any economic and labour market impacts of excluding London weighting from the earnings that count towards PBS points, for London and the rest of the UK, will be closely linked to the impact on flows. For instance, if the impact on flows to other parts of the UK is small, it follows that the economic and labour market impacts are also likely to be relatively minor. To the extent that it is necessary to consider the labour market impacts of a change in the inclusion of London weighting in the PBS points calculation, we apply the same criteria in this report as we have used in previous reports.

3.22 These criteria are evident in our work to develop the recommended shortage occupation lists for the UK and Scotland (see for example, MAC 2009b). There we consider whether it is sensible for a labour shortage in a given occupation to be filled using immigration from outside the European Economic Area. We assess this, in part, by taking into account possible negative labour market impacts of immigration. These could take the form of displacement of UK resident workers, undercutting of the wages of UK resident workers and the degree to which encouraging the use of immigrant labour may disincentivise employers from upskilling the UK resident workforce. The same criteria underpinned our recommendations on Tiers 1 and 2 of the PBS (see MAC 2009a and 2009c).

3.23 Even if the overall impacts on flows, and consequently the labour market, are small, the impacts in London could still fall disproportionately on particular occupations. Public sector occupations with rigid national pay structures may find it harder to reclassify London weighting as basic pay, which may translate into a disproportionate impact on the public sector. We consider this issue further in Chapter 4.

3.6 Methods of investigation

3.24 Here we set out which data and evidence we used to consider the question on London weighting. We also outline some of the issues raised by our corporate partners that were not central to the particular London weighting question we were asked.

Data and research

3.25 In terms of primary data analysis, we analysed the frequency and level of London weighting payments among employers and attempted to establish empirically why such payments were made. Data sources used include the regional cost of living indices generated by the Office for National Statistics (ONS) in 2004, which helped us to understand the extent to which higher London earnings reflect higher London living costs. We also used a report published in October 2009 by Incomes Data Services (IDS) which detailed values of London allowances paid by national UK employers to their employees working in London.

3.26 We used UK Border Agency (UKBA) management information to examine the likely impact on immigration flows of a change of policy on London weighting. We also examined Jobcentre Plus data and regional vacancy rate data obtained directly from employers in the health and education sectors to assess whether a change of policy would be likely to increase, or to work against, equality of vacancy rates across regions.

Evidence from corporate partners

3.27 We announced on our website that we were considering this question and invited corporate partners to send us their views. We directly contacted a range of corporate partners and specifically targeted relevant

corporate partners in Scotland and London. The list of corporate partners who provided evidence is provided in Annex B.

3.28 We contacted the Welsh and Northern Irish Assemblies and invited them to send us their views. We wrote to our own Panel of corporate partners, which comprises the Confederation of British Industry, Trades Union Congress, the British Chambers of Commerce and the National Health Service. We offered to meet with the Panel, if they felt this would be beneficial, but the Panel preferred to provide us with written evidence.

3.29 We met with the Scottish Government and a number of Scottish corporate partners invited by the Scottish Government. Those attending included Immigration Advisors and representatives from the Convention of Scottish Local Authorities and Scottish Financial Enterprise.

3.30 We asked London First to collate and pass on to us the views of employers in key sectors such as financial and business services, property, transport, ICT, creative industries, hospitality and retail.

3.31 We met with GLA Economics which provides the Mayor and the Greater London Authority Group with advice and analysis on London's economy and the economic issues London faces.

Corporate partner views

3.32 We received evidence from 11 corporate partners. Of these, four were in favour of including London weighting in the earnings calculation for the PBS, four were against its inclusion and three corporate partners expressed no clear preference. One also expressed concern at the very limited evidence base in relation to potential regional variation in the PBS.

3.33 Three of those against inclusion had a particular connection to Scotland. The evidence we received from the Scottish Government, the Convention of Scottish Local Authorities and Frances Cairncross and Frances Ruane, two members of the Scottish Council of Economic Advisers, all argued that London weighting payments should be excluded from the earnings used to award PBS points. We outline some of their supporting arguments in this report. They also raised some other issues relevant to the PBS but not to London weighting in the evidence they submitted to us, which we discuss briefly below.

Broader PBS issues

3.34 We were told by the Scottish Government that the rate of population growth in Scotland is lower than in other countries and regions of the UK. The Scottish Government wishes to increase the attractiveness of Scotland to prospective immigrants to Scotland in order to boost the population growth rates required to achieve Scotland's targets for economic growth.

3.35 In its second annual report the Scottish Council of Economic Advisers (2009) recommended that the Scottish Government "*revisits its*

short-term population growth target in the light of circumstances that are hugely changed since the target was set. In this context, the Government may wish to clarify further the focus of its immigration strategy, specifically: whether it is to widen the specific skills base; to increase human capital more generally; to improve population balance by having more people of working age; or, more generally, to increase Scotland's population".

3.36 We considered that the issue of increasing Scotland's population was outside the specific remit of the question we were asked to consider.

3.37 The Scottish Government told us that there is potential population overcrowding in London and the South East of England. They argued that any policy that increases the attractiveness to prospective immigrants of regions of the UK other than London may benefit the UK as a whole by distributing immigrants more equally across the UK. This would relieve some of the pressure on public services in London and the South East.

3.38 In contrast, the Confederation of British Industry expressed the view that the PBS should not be used as tool to demand-manage the economy and that, if a concentration of migrant workers in London and the South East is considered a problem, this is the proper domain of social policy. Another corporate partner agreed with the sentiment of adjusting the PBS to make it fairer across regions, but was not convinced that removing London weighting from the PBS points calculation was the right way to do it.

3.39 The Scottish Government also argued that, as an alternative to excluding London weighting from the earnings used to award PBS points, separate points tables for Tier 1 and Tier 2 could be introduced for London (possibly also including the South East) and the rest of the UK with higher thresholds for the earnings bands for London. The Scottish Government argued that this would help make the system fairer and create a more balanced assessment of the UK as a whole. The Convention of Scottish Local Authorities and Frances Cairncross and Frances Ruane, two members of the Scottish Council of Economic Advisers, also suggested in their evidence to us that we consider this alternative.

"simply removing London weighting from the PBS will not alter the attractions of working in London for many immigrants who seek employment in other skilled occupations outside the sectors where the weighting applies... We therefore suggest that the Committee considers an alternative scheme... which would set a higher starting point for salaries earned in London than in other parts of the country. It seems illogical to remove London weighting from the PBS without looking at the impact of higher London earnings in general."

Frances Ruane and Frances Cairncross in response to the London weighting question

3.7 Conclusion

3.40 Consideration of whether London weighting should be included in the PBS points calculation depends, in part, on whether this is consistent with PBS policy objectives. This is, in turn, contingent on the question of why employers choose to pay London weighting.

3.41 There are several potential explanations for payment of London weighting or, analogously, higher pay in London compared to elsewhere in the UK for seemingly similar work. These are:

- compensating wage differentials, which comprise compensation for higher living costs in London and the disamenity of working in London;
- composition effects where, even within a given occupation, the average London job may be more skilled, or senior, than an equivalent job elsewhere in the UK;
- relative scarcity of labour in London; and
- agglomeration effects.

3.42 The economic and labour market impact of excluding London weighting from the points calculation will be driven by the impact on immigration flows to London and the rest of the UK. However, even if the impact on flows is small, there may be disproportionate impacts on certain occupations.

3.43 This chapter set out our broad conceptual framework and highlighted some of the other issues that were raised with us. Chapter 4 provides our analysis, based on the framework and associated issues.

Chapter 4

Analysis

4.1 Introduction

4.1 In this chapter we analyse the potential impact of excluding London weighting from the earnings used to award points under the Points Based System (PBS). First, we consider whether the inclusion of London weighting in the earnings that count towards PBS points is consistent with the objectives of the PBS. Second, we examine the potential impact on immigration flows to London and the rest of the UK of excluding London weighting from the PBS points calculation. Finally, we analyse the potential economic and labour market impacts on London and the rest of the UK.

4.2 Consistency with policy objectives

4.2 The first part of the question we have been asked by the UK Government relates to whether London weighting should be excluded from the earnings that count towards PBS points *“to ensure that the PBS appropriately reflects regional wage differences across the UK”*.

4.3 In Chapter 2 we demonstrated that, after adjusting for occupational composition, pay in London is approximately 15 per cent above that of the UK as a whole. This London premium will be reflected, in some cases, in payment of London weighting. If it is paid only to compensate for the higher cost of living in London compared to the rest of the UK, and these costs of living are independent of other factors, then there is a strong case for excluding London weighting from earnings for PBS points calculations as it will be demonstrable that London weighting is not compatible with the economic aims of the PBS.

4.4 However, as set out in Chapter 3, if higher earnings also reflect skill, scarcity or higher productivity then there is a strong case for not excluding London weighting from earnings for PBS points calculations. Therefore, we examine why wages vary between London and other parts of the UK for apparently similar jobs. Four possible explanations are discussed in turn below:

- compensating wage differentials, which comprise compensation for higher living costs in London and the disamenity of working in London;
- composition effects where, even within a given occupation, the average London job may be more skilled, or senior, than an equivalent job elsewhere in the UK;
- relative scarcity of labour in London; and
- agglomeration effects, which potentially increase the productivity of the individual worker and the firm in large cities.

Compensating wage differentials

4.5 The concept of compensating wage differentials can be traced back to Adam Smith in *The Wealth of Nations* (1776), who stated that they reflect “the agreeableness or disagreeableness of the employment themselves ... [and] ... make up for a small pecuniary gain in some employments.”

The compensating wage differential can also be argued to reflect higher costs of living in London.

4.6 Table 4.1 shows the most recent relative regional retail price levels for the UK, as calculated by the Office for National Statistics (ONS). The ONS study enables the comparison of the purchasing power of given pay in each region relative to the national average. These data were last published in 2004 and are, therefore, relatively dated. The table shows that retail price levels in London were around 9 per cent higher than the national average in 2004.

Table 4.1: Average regional retail price levels relative to the national average price (UK=100), 2004

Region	Using national weights ⁽¹⁾	Using regional weights ⁽²⁾
North East	94.2	93.0
North West	96.9	95.9
Yorkshire and Humberside	94.2	93.5
East Midlands	97.4	97.0
West Midlands	97.8	97.4
Eastern	101.1	100.5
London	109.7	109.1
South East	105.3	104.7
South West	101.3	100.8
Wales	93.1	92.1
Scotland	94.5	93.1
Northern Ireland	95.8	95.3

Note: (1) National weights price the regional cost of the national Retail Price Index (RPI) basket. This enables comparisons to be made of the relative purchasing power of the pound for a uniform basket of goods both between a region and the national average and between one region and another. The comparisons are not confounded by differences in the basket of goods being priced. However, the compilation takes no account of the differences in expenditure patterns between the regions.

(2) Regional weights apply regional consumption patterns to the RPI basket and price the regional cost of the corresponding regional basket. This enables comparisons to be made of the relative purchasing power of the pound, for a representative basket of goods for each individual region, compared with what that basket would cost if bought at national average prices. Because the basket of goods being priced is unique to a particular region, inter-regional price comparisons are confounded by differences in the goods being priced.

Source: ONS (2004)

4.7 Equality of real wages in London and real wages in the rest of the UK would require retail price levels in London to have been approximately 15 per cent higher than the national average in 2009. As we have outlined above, retail price levels in London were approximately 9 per cent higher than the national average when these data were last collected in 2004. This suggests

that it is possible that differences in the cost of living only partially explain why average earnings in London are higher than in the rest of the UK.

4.8 Compensating differentials can also reflect disamenity, which can be described as a disadvantage or drawback of living or working in a particular location. Employers may compensate London workers for this disamenity by offering higher real wages.

4.9 Disamenity is usually treated as non-monetary in nature, although it could be argued that higher transport costs faced by those working in London, possibly in the form of higher fares for longer commuting journeys by rail or through the London road congestion charges, may count as a disamenity. It will also reflect factors such as congested transport networks, longer journey to work times and pollution.

Composition effects

4.10 It was shown in Chapter 2 that there is a relative bias in the London labour market towards more highly paid occupations. It may be the case that London-based workers are, on average, more productive within given 4-digit Standard Occupational Classification (SOC) codes than their counterparts in the rest of the UK, possibly due to seniority. If these effects occur within individual occupations, they would not have been picked up by the analysis of London pay in Chapter 2. This may occur, for example, in instances where a firm has placed its global headquarters in London and more senior staff are employed in that office than elsewhere.

4.11 Incomes Data Services (IDS) told us that many multinational firms have their global headquarters in London and recruit highly paid workers to the City. Furthermore, IDS told us that the composition of jobs in London has a large impact on the observed pay differential between London and the rest of the UK.

Relative scarcity of labour

4.12 In considering whether labour is scarcer in London than in the rest of the UK, we focused in particular on health and education occupations because, as shown later in this chapter, public sector occupations are likely to be particularly affected by any exclusion of London weighting in the PBS points calculation. For reasons of data availability we used vacancy rates as a potential indicator of labour shortage.

4.13 Table 4.2 sets out regional vacancy rates using data from the National Health Service (NHS) and the former Department for Children, Schools and Families (DCSF). These data are only available for regions in England.

Table 4.2: Vacancy rates for English regions by 4-digit SOC occupation

Region	Vacancy rate by occupation (per cent)			
	Qualified nursing, midwifery and health visiting staff	Doctors	Secondary education teaching professionals	Nursery and primary education teaching professionals
North East	1.0	3.9	0.4	0.3
North West	2.2	6.0	0.4	0.3
Yorkshire And The Humber	3.1	3.4	0.6	0.4
East Midlands	2.8	3.6	0.6	0.4
West Midlands	2.3	5.4	0.9	0.8
East	4.1	4.7	1.1	0.5
South East	2.9	4.7	0.8	0.4
South West	2.6	5.3	0.3	0.3
London	5.1	7.3	1.1	0.7

Note: The data do not perfectly map to the 4-digit SOC occupations of similar name. They are only available for regions in England.
Source: NHS (2009) and DCSF (2009)

4.14 For the two health occupations, vacancy rates are higher in London than in other regions. In the case of the two education occupations, the vacancy rate for London is higher than in most other regions, with the exception of the East of England for secondary education teaching professionals and the West Midlands for nursery and primary education teaching professionals.

4.15 As explained in Chapter 2, a Market Forces Factor is used within the NHS because pay differentials between public and private sectors within a local area can potentially contribute to labour scarcity. Excluding London weighting from the earnings used to calculate PBS points could reduce the effectiveness of pay as a lever to address regional scarcity and so exacerbate disparities in vacancy rates between London and the rest of the UK. This, alongside relatively inflexible pay structures in the public sector as discussed in Chapter 2, could affect the quality of provision of essential public services. To the extent that recognising London weighting in the points calculation prevents this from happening, it can be argued that the inclusion of London weighting in earnings used to calculate PBS points is consistent with the objectives of the PBS.

Agglomeration effects

4.16 Including London weighting payments in the earnings used to calculate PBS points might also be consistent with policy objectives if payment of London weighting reflects the higher output or productivity of workers in London. One possible reason why locating employees in London may be considered to be of higher economic value is the potential to exploit the benefits of clustering and economies of agglomeration.

4.17 The net result of agglomeration economies, which have been empirically estimated by various studies, often in the form of increasing returns to spatial proximity, is that employers' average costs of production decrease or, put another way, average output per worker (productivity) increases. This results in an increase in the demand for labour at any given wage and therefore higher earnings paid to workers in large urban areas such as London will indirectly reflect higher levels of productivity.

“Economic theory [...] tells us that historically it was higher urban than rural wages which led to migration and growth of cities. For London, those wage differentials were then increased still further by agglomeration effects – the boost to incomes produced by the extra specialisation facilitated by agglomeration together with the ready availability of a client base. [...] These income differentials then become embedded because of price differentials, notably in housing: it needs a higher wage to enable London-based staff to obtain comparable housing to what they could expect elsewhere in the UK.”

Greater London Authority Economics in response to the London weighting question

4.18 Combes *et al.* (2009) said that the idea that firms and workers are, on average, more productive in larger cities is now firmly established empirically. Estimates of the magnitude of this effect depend on the occupational sector and the details of the estimation procedure. However, it is estimated that, for a large range of city sizes, doubling the size of the city leads to an increase in productivity of between 2 and 7 per cent.

4.19 To summarise the analysis in this section, it is very difficult, in practice, to separate the factors that contribute to higher salaries in London and payment of London weighting. These factors interact with each other in complex ways that cannot be determined from the available evidence. For example, relative scarcity of labour and composition effects could be reflected in the higher cost of living in London as well as in the higher pay. But we do consider that higher earnings in London, including London weighting payments, cannot be solely attributed to higher costs of living. The other factors described above are all active reasons why employers are willing to offer higher pay in London. Therefore, we consider that allowing London weighting to count towards points for earnings in the PBS is consistent with PBS objectives.

4.3 Impact on immigration flows to London

4.20 In this section we consider the potential impact on immigration flows to London of excluding London weighting from the earnings used to calculate PBS points.

Tier 1

4.21 Tier 1 General awards points for previous earnings, which may include a London weighting payment if the applicant has previously worked in

London. Therefore, excluding London weighting from the earnings used to award PBS points could affect in-country applicants for Tier 1 General who are switching from other routes, such as the Post-Study Work Route (PSWR). This exclusion could also affect immigrants who, after their initial two years' leave to remain entitlement under Tier 1 General has lapsed, apply to extend their leave entitlement for a further three years.

4.22 If London weighting were excluded from earnings considered for the PBS, it would become more difficult for applicants in receipt of London weighting to meet the Tier 1 earnings requirement. At least some of these affected applicants could fail to acquire the 75 points necessary to enter the UK. Therefore, excluding London weighting from the earnings considered for the PBS could generate a reduction in the inflow of Tier 1 immigrants to London.

4.23 Tier 1 immigrants can live and work anywhere in the UK. There are no data on the location of Tier 1 immigrants within the UK, therefore it is not possible to determine which regions would be most affected by any reduced inflow under Tier 1 General as a consequence of excluding London weighting from the earnings that count towards PBS points. However, it is reasonable to expect that the impact on London would be greater than for other UK regions. This is because any applicants affected by a change in the treatment of London weighting for PBS points purposes transferring to Tier 1 General from the PSWR would have previously been employed in London. It is likely that many of these immigrants will wish to continue their employment in London due to existing professional and social contacts.

Tier 2

4.24 UK Border Agency (UKBA) management information data show that, to the end of March 2010, there had been 39,780 used Tier 2 certificates of sponsorship in the Greater London area since the introduction of Tier 2 in November 2008. This is 45 per cent of the 87,750 certificates of sponsorship used in total under Tier 2 over this period.

4.25 When sponsors assign a certificate of sponsorship under Tier 2 they are required to state both the pay and any allowances paid. They are also asked to describe the allowances that are paid and this information is recorded in PBS management information data. Ideally, we would have used these data to identify the London weighting component of prospective earnings for each Tier 2 job and to have estimated the number of immigrants under Tier 2 that would have failed to gain the required 70 points if London weighting were excluded from the earnings used to calculate PBS points.

4.26 However, we have no data on the total points awarded under Tier 2 or Tier 2 immigrants' qualifications. We do not, therefore, know whether a Tier 2 immigrant has only just met the 70 point pass mark, or whether they have exceeded it. If an immigrant has exceeded the pass mark because they possess higher qualifications than the minimum needed, a reduction in the points awarded for prospective earnings may not affect their application.

4.27 There are also potential reporting problems with the data on allowances. First, some sponsors may fail to separate London weighting from pay, despite being required to do so. Second, the data may not accurately describe the allowances paid. Third, the total allowances paid may include other allowances in addition to London weighting. To account for these reporting problems, we have estimated an upper and lower-bound impact shown in Table 4.3:

- Upper bound: we assume that all Tier 2 jobs in London pay London weighting of £3,407, the median London weighting in the IDS (2009) report discussed in Chapter 2.
- Lower bound: we assume that only those applications where a London weighting is explicitly recorded would be affected. In this case, the value of the payment is recorded on the application.

Table 4.3: Estimating the impact of excluding London weighting from the Tier 2 points calculation

	Number of used certificates, November 2008-March 2009
Total certificates used in Greater London ⁽¹⁾	39,780
Upper bound: where subtracting an average London weighting from the salary of all used certificates would result in a reduction in the number of points achieved, possibly taking total points below the 70 required. ⁽²⁾	11,780
Lower bound: where a London weighting allowance is explicitly stated and where subtracting the stated allowance would result in a reduction in the number of points achieved, possibly taking total points below the 70 required. ⁽³⁾	370
<p>Notes: The figures describe ‘used’ certificates of sponsorship, where an application that corresponds to the certificate has been submitted but not necessarily approved. All successful immigrants are assumed to have gained exactly 70 points in the Tier 2 points test. The number of used certificates of sponsorship has been rounded to the nearest 10.</p> <p>(1) London is defined by postcode of sponsor. Used certificates of sponsorship for the shortage occupation route are excluded as points for prospective earnings are not required to meet the Tier 2 points requirement.</p> <p>(2) We have subtracted £3,407 from the total earnings of each Tier 2 immigrant in Greater London. This figure represents the median inner London weighting payment across 132 organisations in 2009, as measured by IDS (2009).</p> <p>(3) London weighting was identified using a text search for “London” and then auditing the results.</p> <p>Source: UK Border Agency management information data, Nov 2008 to March 2009; IDS (2009)</p>	

4.28 The upper-bound estimate equates to around 30 per cent of all Tier 2 certificates used in London between November 2008 and March 2010. However, it is highly unlikely that all Tier 2 jobs in London pay a London

weighting, so the removal of London weighting is likely to affect considerably fewer jobs than this upper bound suggests.

4.29 The lower bound represents those jobs where the UKBA have recorded a specific London weighting allowance and where the overall earnings are sufficiently close to the points threshold such that the exclusion of London weighting from the earnings that count towards PBS points is likely to cause the application to fail. London allowances were explicitly stated in 1,040 certificates but we estimated that excluding London weighting from earnings would only affect the outcome of the application in 370 instances.

4.30 It is likely that some employers have incorrectly specified or described the allowances paid, so the lower bound could be an underestimate. However, it is also possible that the allowance deducted includes other allowances in addition to London weighting, in which case the number of certificates affected may be overstated. Furthermore, as with the upper bound, in some of these cases immigrants may still have exceeded the 70 point pass mark by virtue of their qualifications.

4.31 We have not been able to accurately estimate the number of Tier 2 jobs that might be affected by excluding London weighting from the points calculation. We consider it is very unlikely to exceed 30 per cent of Tier 2 jobs in London. It may even be a very small number. This also raises operational questions about how the exclusion of London weighting from earnings for the PBS points calculation can be effectively audited and enforced, given the very small number of certificates where a London weighting allowance is explicitly recorded.

4.32 Table 4.4 presents the SOC breakdown of the 11,750 certificates of sponsorship within the upper-bound estimate. Of these, 52 per cent of the certificates of sponsorship were used under the Resident Labour Market Test route and the remaining 48 per cent were intra-company transfers.

4.33 This analysis shows that more than one third of all affected certificates of sponsorship were for information technology and software professionals. This occupation also accounts for approximately one quarter of all Tier 2 certificates of sponsorship used in the Greater London area.

4.34 Table 4.4 also shows that, for the upper-bound estimate, the health and education sectors may be significantly affected if London weighting were to be excluded from the earnings that count towards PBS points. Almost 20 per cent of affected certificates of sponsorship were for teaching and research and health and social welfare occupations.

Table 4.4: Used Tier 2 certificates of sponsorship that might not have been issued in London, assuming an upper-bound impact, had London weighting been excluded from the earnings used to calculate points for the PBS, by SOC occupation

Upper-bound impact: All certificates of sponsorship pay London weighting but do not declare this.		
	All Tier 2 certificates of sponsorship used in the Greater London area	All certificates of sponsorship that might not have been issued assuming an upper-bound impact
Total number of certificates of sponsorship	39,780	11,750
By 2-digit SOC (as percentage of all occupations)	Percentage of all occupations	Percentage of all occupations
11 Corporate managers	18	9
12 Managers and proprietors	1	3
21 Science and technology professionals	31	37
22 Health professionals	2	1
23 Teaching and research professionals	6	10
24 Business and public service professionals	12	7
31 Science and technology associate professionals	4	8
32 Health and social welfare	6	10
33 Protective service occupations	0	0
34 Culture, media and sports occupations	2	3
35 Business and public service associate professionals	11	8
41 Administrative occupations	0	1
42 Secretarial and related occupations	0	0
51 Skilled agricultural trades	0	0
52 Skilled metal and electrical trades	0	0
53 Skilled construction and building trades	0	0
54 Textiles, printing and other skilled trades	2	1
61 Caring personal service occupations	2	0

62 Leisure and other personal service occupations	0	0
71 Sales occupations	0	0
72 Customer service occupations	0	0
81 Process, plant and machine operatives	0	0
82 Transport and mobile machine drivers and operatives	0	0
91 Elementary trades, plant and storage related occupations	0	0
92 Elementary administration and service occupations	0	1
99 Not stated	1	1
By 4-digit SOC (Top 5 only as percentage of all occupations)	2132 IT, software professionals (25)	2132 IT, software professionals (34)
	3534 Finance and investment analysts/advisers (6)	3211 Nurses (9)
	3211 Nurses (5)	3131 Technicians, IT operations (5)
	2423 Consultants, actuaries, economists, statisticians (5)	3534 Finance and investment analysts/advisers (3)
	1136 Managers, information and communication technology (4)	2315 Teacher, primary and nursery education (2)
<p>Note: The above figures describe 'used' certificates of sponsorship, where an application that corresponds to the certificate has been submitted but not necessarily approved. Used certificates of sponsorship for the shortage occupation route are excluded as points for prospective earnings are not required to meet the Tier 2 points requirement. All successful immigrants are assumed to have gained exactly 70 points in the Tier 2 points test. The number of certificates of sponsorship has been rounded to the nearest 10.</p> <p>Source: UK Border Agency management information data, Nov 2008 to March 2010</p>		

4.35 Lower-bound estimates are broken down in Table 4.5. Under this scenario, approximately 370 immigrants would not have qualified for entry under Tier 2 had London weighting been excluded from the earnings used to calculate PBS points. These 370 jobs represent less than one per cent of all certificates of sponsorship used in London, which suggests that, assuming a lower-bound impact, excluding London weighting would have a very small effect on the total in-flow of non-EEA immigrants to London.

4.36 Table 4.5 shows that, under the lower-bound scenario, 46 per cent of the affected jobs are in nursing. The three occupations that would have been most affected are all predominantly public sector occupations: nurses, scientific researchers and medical practitioners. These account for more than 70 per cent of affected jobs.

4.37 Therefore, although the overall impact on flows for the lower-bound estimate is small, excluding London weighting from earnings when calculating PBS points could have a small but non-negligible impact upon the ability of employers in certain public sector occupations to recruit non-EEA immigrants. This issue was reflected in our corporate partner evidence.

“Health and social work activities [...] constitute the highest usage of certificates issued after an RLMT. The second largest user of the RLMT is the education sector. Taking health, social work and education all together, it appears that the public sector is a heavy user of the RLMT.”

Joint submission by the Trades Union Congress, Prospect (Connect sector) and Unite in response to the London weighting question

Table 4.5: Used Tier 2 certificates of sponsorship that might not have been issued in London, assuming a lower-bound impact, had London weighting been excluded from the earnings used to calculate points for the PBS, by SOC occupation

Lower-bound impact: Only those certificates of sponsorship that have declared a London weighting payment would be affected by excluding London weighting from the earnings that count towards PBS points		
	All occupations that pay London weighting	All occupations that pay London weighting and might not have been issued assuming a lower-bound impact
Total number of certificates of sponsorship	1,040	370
By 2-digit SOC (as percentage of all occupations)	Percentage of all occupations	Percentage of all occupations
11 Corporate managers	5	1
12 Managers and proprietors	0	0
21 Science and technology professionals	7	8
22 Health professionals	25	12
23 Teaching and research professionals	19	18
24 Business and public service professionals	3	2
31 Science and technology associate professionals	1	3
32 Health and social welfare	33	52
33 Protective service occupations	0	0
34 Culture, media and sports occupations	1	1
35 Business and public service associate professionals	3	1
41 Administrative occupations	0	0
42 Secretarial and related occupations	0	0
51 Skilled agricultural trades	0	0
52 Skilled metal and electrical trades	0	0
53 Skilled construction and building trades	0	0
54 Textiles, printing and other skilled trades	0	0
61 Caring personal service occupations	0	0

62 Leisure and other personal service occupations	0	0
71 Sales occupations	0	0
72 Customer service occupations	0	0
81 Process, plant and machine operatives	0	0
82 Transport and mobile machine drivers and operatives	0	0
91 Elementary trades, plant and storage related occupations	0	0
92 Elementary administration and service occupations	0	0
99 Not stated	3	2
By 4-digit SOC (Top 5 only as percentage of all occupations)	3211 Nurses (27)	3211 Nurses (46)
	2211 Medical practitioners e.g. doctors and surgeons (24)	2321 Researchers, scientific (14)
	2321 Researchers, scientific (10)	2211 Medical practitioners e.g. doctors and surgeons (11)
	2311 Teacher/lecturer in higher education (5)	2132 IT, software professionals (8)
	2132 IT, software professionals (4)	3222 Therapists, occupational (2)
<p>Note: The above figures describe 'used' certificates of sponsorship, where an application that corresponds to the certificate has been submitted but not necessarily approved. Used certificates of sponsorship for the shortage occupation route are excluded as points for prospective earnings are not required to meet the Tier 2 points requirement. All successful immigrants are assumed to have gained exactly 70 points in the Tier 2 points test. The number of used certificates of sponsorship has been rounded to the nearest 10.</p> <p>Source: UK Border Agency management information data, Nov 2008 to March 2010</p>		

4.38 Our analysis of used certificates of sponsorship under Tier 2 suggests that **excluding London weighting from the earnings used to calculate PBS points would reduce Tier 2 immigrant flows to London.** We estimate an upper-bound impact of 30 per cent of all certificates of sponsorship in Greater London being affected. However, this assumes that all jobs in London pay London weighting and, furthermore, that all Tier 2 immigrants have only just met the pass mark of 70 points. Given these strong assumptions, we consider it plausible that the actual impact would be much smaller than 30 per cent. Nonetheless, the possibility remains that excluding London weighting from the earnings that count towards PBS points could have a significant effect on flows to London and that this effect could be concentrated in a small number of occupations.

Reclassification of London weighting as basic pay and other operational practicalities

4.39 As set out in Chapter 3, excluding London weighting from the PBS calculation of points for earnings would only have an impact if employers did not reclassify London weighting as salary.

4.40 We put this point to the Scottish Government. They considered it unlikely that employers would choose to revise their pay structures to circumvent the exclusion of London weighting from the earnings that count towards PBS points, arguing that this would be an expensive administrative measure for employers to take to protect the very small number of immigrants who would be affected.

4.41 Notwithstanding this point, excluding London weighting from the PBS points calculation would distort the London labour market in favour of occupations where London weighting could be reclassified as pay at the expense of occupations where it could not.

“The result of [excluding London weighting from the PBS points calculation] would be to create a disparity between employers which pay London weighting explicitly and those which in effect pay it but not as a separately identifiable element of the remuneration package.”

Joint submission by the Trades Union Congress, Prospect (Connect sector) and Unite in response to the London weighting question

4.42 Some public sector employers would find it difficult to circumvent any potential recruitment difficulties caused by excluding London weighting from the PBS points calculation because public sector national wage structures often arise from negotiated agreements, of which London weighting forms a part. This argument also holds true for some private sector jobs, although probably to a lesser extent.

4.43 In addition to the potential for reclassification of London weighting as pay, a related enforcement problem would be the ability of the UKBA to define and identify a London weighting payment. Not all London employers define London weighting in the same way.

4.44 In a joint submission with Prospect (Connect sector) and Unite, the Trades Union Congress (TUC) told us that different sectors, and indeed different employers within sectors, use different definitions of regional allowances. The TUC told us that employers in the finance sector often pay location allowances under headings such as ‘Inner London’, ‘Outer London’, ‘South East’, ‘large cities’ and ‘large towns’. Therefore, it might be difficult and impractical for the UKBA to determine which components of earnings should be excluded from the earnings that count towards PBS points.

4.45 We were told that it may be impractical for employers, particularly small businesses, to extract London weighting payments from total earnings

for the purposes of PBS points calculations. For small businesses that are based only in London, a component of earnings that operates implicitly as London weighting would most likely be automatically incorporated within basic pay. In the case of larger businesses that have offices in multiple regions, London weighting is more likely to be expressed separately and, therefore, more easily identifiable for the purposes of excluding it from earnings for PBS points calculations.

"I also wonder about the practicality of removing the London weighting, especially for small businesses. I can understand that it may be fairly straightforward where a firm has offices in multiple regions (and so the London weighting is specifically stated in contractual paperwork) but where a firm has just one office in London, I would have thought that in most cases the London weighting is merely included in the salary rather than included as an added extra."

Rob Eatough in response to the London weighting question

4.46 Similarly, the TUC told us that some employers do not have a specifically defined London weighting payment. Instead, these employers use a 'market rate' pay approach which provides a London premium in the sense that an equivalent London weighting payment is absorbed into base pay so that London-based staff tend to have higher salaries than staff outside London. It would not be possible to enforce a policy that excluded London weighting from the earnings used to calculate PBS points in these cases, as there is no defined monetary amount to exclude. Thus, the proposed policy would create a disparity between firms that pay an explicit London weighting and firms that incorporate it into basic pay.

4.4 Impact on immigration flows to the rest of the UK

Tier 1

4.47 Tier 1 immigrants are free to live and work anywhere in the UK and there are no data on where they live. Therefore, it is not possible to determine which regions would be most affected by any reduced inflow under Tier 1 General as a consequence of excluding London weighting from earnings when calculating PBS points.

4.48 In principle, a change of policy on London weighting could lead to a small change in Tier 1 flows to other UK countries and regions in the following circumstances:

- An immigrant who had previously worked in London but wished to switch to Tier 1 General to take a job elsewhere in the UK may be prevented from doing so. That person may therefore leave the UK altogether.
- Under the Post-Study Work Route (PSWR), immigrants would not have London weighting payments taken into account in their

future points calculation, and so may choose to work in other parts of the UK.

4.49 In practice, we would expect such instances to be very rare. For instance, in the case of the second example:

- not all students from outside the European Economic Area enter the PSWR;
- for most who do, recognition of London weighting in the PBS is unlikely to be the deciding factor in determining where they work;
- even if it is the deciding factor, that person may not subsequently switch into Tier 1 General; and
- even if they do ultimately switch into Tier 1 General, they may still do so in order to work in London rather than elsewhere in the UK.

4.50 We believe that **any impact of a change in policy on Tier 1 flows to parts of the UK other than London will be insignificant.**

Tier 2

4.51 The points calculation for pay under Tier 2 is based on prospective earnings. Immigrants applying under Tier 2 for a job outside London have to show they will be paid enough to meet the points requirement. The exclusion of London weighting will not affect the prospective earnings of these immigrants. Any immigrant who is applying under Tier 2 for a job in London and who no longer meets the earnings threshold following the exclusion of London weighting from the points calculation will also not meet the earnings threshold anywhere else in the UK and so will not be able to come to the UK under Tier 2.

4.52 Consequently, **excluding London weighting from the earnings calculation for PBS points will have no impact on Tier 2 immigration flows to regions and countries of the UK other than London.**

“[...] we do not see that adjusting the PBS table by excluding London weighting would in any event make any material difference to attracting skilled migrant labour under Tier 2 to regions in the UK outside of London and the South East.”

Joint submission by the Trades Union Congress, Prospect (Connect sector) and Unite in response to the London weighting question

MAC calibration of points awarded for earnings under Tier 2

4.53 The earnings thresholds for Tier 2 of the PBS were increased in April 2010 following our review of Tier 2 in August 2009 (MAC, 2009a). The Scottish Government put the argument to us that, because these earnings thresholds were recalibrated using aggregated UK earnings data which included payments for London weighting, the thresholds had been increased to the disadvantage of UK regions other than London. The Scottish Government asked whether the earnings thresholds derived from our methodology might have been lower if London weighting had been excluded from the recalibration. The joint submission by the Trades Union Congress, Prospect (Connect sector) and Unite also expressed the view that exclusion of London weighting from the PBS points calculation would require further changes to the points table.

“If the London weighting was not included in earnings then there may not have been a need recently to increase the salary levels of Tier 2.”

Scottish Government in response to the London weighting question

4.54 We consider that the exclusion of London weighting would have little effect on the calibration of Tier 1 and Tier 2 earnings thresholds because:

- according to the Labour Force Survey (LFS), only 14 per cent of jobs are based in London;
- many jobs in London do not pay London weighting;
- for those jobs that do pay London weighting, it is estimated that this payment only represents approximately 10 per cent of average total pay⁵; and
- therefore, London weighting payments constitute a maximum of 1.4 per cent of the earnings used in the points calibration.

4.55 We have tested whether the thresholds for prospective earnings in Tier 2 that we recommended in August 2009 would have been different had London weighting been excluded from the calculations.

4.56 To do this, we followed the approach outlined in MAC (2009a). In that analysis, we used a three-step approach to recalculating the bands for prospective earnings in Tier 2.

4.57 The first step was to calculate the lower threshold for awarding 5 points for prospective earnings. In MAC (2008) we calculated a minimum earnings threshold for identifying skilled occupations of £10 per hour, given by the median hourly earnings for all employees, calculated from 2008 Annual Survey of Hours and Earnings (ASHE) data. For a typical working week of 40

⁵ IDS (2009). In 2009 the median figure for inner London allowances across the 132 organisations featured in the study was £3,407. Average basic salary in London was found to be £31,973.

hours, this figure is equivalent to £20,000 per annum, rounded to the nearest £1,000. Because Tier 2 is for skilled employment only, our recommended lower threshold for awarding 5 points for prospective earnings was therefore £20,000 per annum.

4.58 We were not able to recalculate this figure excluding London weighting from the ASHE data. Instead, we used the LFS. However, the LFS does not contain comprehensive data on whether London weighting payments have been added to earnings. Therefore, as an upper-bound estimate, we assumed that all jobs located in London (defined as central, inner and outer London) pay a London weighting. We also assumed that London weighting is equal to 10 per cent of total earnings.

4.59 Therefore, we calculated the median hourly earnings for all employees from the LFS under two scenarios: including and excluding London weighting. We then applied the percentage difference between these two figures to the threshold value of £20,000. When rounded to the nearest £1,000, this value is unchanged.

4.60 The second step in MAC (2009a) was to calculate a lower threshold for awarding maximum points for prospective earnings. We stated that an individual should be awarded maximum points if their prospective earnings were at least equal to the median earnings for full-time, working age employees in skilled occupations. This figure was again estimated from 2008 ASHE data and was equal to £32,000 per annum, rounded to the nearest £1,000. Our recommended lower threshold for awarding the maximum 20 points for prospective earnings was therefore £32,000 per annum.

4.61 As above, we calculated two figures from the LFS and applied the percentage difference to the threshold value of £32,000. When rounded to the nearest £1,000, this value was again unchanged.

4.62 The third step in MAC (2009a) was to calculate the lower thresholds for awarding 10 and 15 points for prospective earnings. To calculate these we used the earnings distribution between £20,000 and £32,000 per year from the LFS, which was approximately uniform.

4.63 We have recalculated this earnings distribution excluding London weighting, again assuming that all jobs located in London pay a weighting equal to 10 per cent of total earnings. This distribution is also approximately uniform.

4.64 Therefore, we consider that the bands for prospective earnings that we recommended to the Government in our review of Tier 2 would not have been affected by the exclusion of London weighting from the calculations.

4.5 Economic and labour market impacts

4.65 Earlier in this chapter we argued that higher earnings in London, and London weighting payments themselves, cannot be solely attributed to higher costs of living. They will also reflect factors such as compensating differentials, labour scarcity and agglomeration. For this reason, we believe that allowing London weighting to count towards points for earnings in the PBS is consistent with the economic objectives under which the policy was initially set up.

4.66 We next argued that excluding London weighting from the earnings used to calculate PBS points would probably have a small but potentially non-negligible impact on flows to London, and an insignificant impact on flows to the rest of the UK. For this reason, in order to assess the net impacts on UK economy and the labour market impacts, we have focused on the impact on London.

4.67 As a proportion of the whole London economy, even the upper bound of the number of jobs potentially affected is small. Therefore, the impact on the London economy as a whole of excluding London weighting from the earnings that count towards PBS points is also likely to be small.

4.68 However, our analysis of immigration flows to London suggested that the labour market in some public sector occupations, particularly the health sector, could be particularly affected by excluding London weighting from the earnings that count towards PBS points. There are two reasons for this:

- first, data on recent earnings and allowances suggest that a significant proportion of Tier 2 immigrants entering some public sector occupations, who currently gain sufficient points to enter, would not in future gain sufficient points to do so; and
- second, public sector employers would find it more difficult to incorporate London weighting payments into basic pay to circumvent the impact of this.

4.69 Our examination of data on earnings and vacancies also suggested that, in some respects, public sector employers in London are already at a disadvantage to those elsewhere in the UK. In particular:

- vacancy data suggest that health and education occupations in London already experience scarcity of skilled labour relative to other UK regions; and
- as demonstrated in Chapter 2, the average London pay premium in public sector occupations is smaller than in private sector occupations.

4.70 Excluding London weighting from the earnings that count towards PBS points would, everything else being equal, increase the disparity between vacancy rates in London and the rest of the UK. This could lead to increased labour shortages in public sector occupations in London relative to the rest of the UK, which could, at least in the short to medium term, have a significant impact on the quality of provision of key public services in London.

“[...] London is no less in need of skilled doctors than the rest of the country, and in this case, I would be reluctant to suggest any change that might reduce the overall chances of recruitment, internationally or otherwise. Despite occasional publicity to the contrary, there are shortages of medical staff in certain departments across the country, and anything we can do that improves the chances of trusts being able to recruit international medical graduates, we should do. I would therefore have thought that removing London Weighting (or any other location allowances) from the reckoning would be a counter-productive step at this stage, and ought to be opposed.

Chair of National Association of Medical Personnel Specialists (NAMPS) in response to the London weighting question

4.71 Because payment of London weighting is not uniform across occupations, and because some employers will find it easier to reclassify London weighting as salary than others, the economic impacts would not be felt uniformly within the private sector either. Ceasing to count London weighting for PBS points purposes would represent a distortion in the labour market and could lead to a suboptimal allocation of resources.

“Not all private sector companies in London explicitly pay a “London weighting.” For many employees, the “London premium” is inseparable from the basic salary. If a points-based system were to exclude London Weighting, this would discriminate against those employers who make the London Weighting explicit, including many in the public sector. This would represent a labour market distortion and would therefore lead to suboptimal resource allocation.”

Greater London Authority Economics in response to the London weighting question

Chapter 5

Conclusions

5.1 Introduction

5.1 This chapter summarises our recommendation on whether London weighting should continue to be considered as part of earnings in the Points Based System (PBS) and restates our reasons for this.

5.2 In accordance with our remit we have considered the former Government's question purely from an economic perspective and base our reasoning primarily on the net economic impact that excluding London weighting from the earnings that count towards PBS points would have on the UK as a whole.

5.2 Recommendation

5.3 We were asked: *"Should the UK Government exclude the London weighting from the PBS in order to ensure that the PBS appropriately reflects regional wage differences across the UK, and what effect would that have on the labour market and the economy in the UK?"*

5.4 We believe that including London weighting in the earnings counting towards the PBS points calculation is appropriate. We hence conclude that **London weighting should continue to be regarded as part of earnings in the points calculation in relation to Tiers 1 and 2 of the Points Based System.**

5.5 Our recommendation has been informed by economic theory, our analysis of available data and the evidence we received from our corporate partners. Below we summarise our reasons for this recommendation.

5.3 Consistency with policy objectives

5.6 The PBS was set up by the former Government to, amongst other things, fill gaps in the labour market and attract highly skilled and productive workers to the UK.

5.7 In order to determine whether inclusion of London weighting was consistent with the aims of the PBS, we looked at why employers pay London weighting. An individual employer's choice to pay London weighting will arise from a combination of some or all of:

- compensating wage differentials, which comprise compensation for higher living costs in London and the disamenity of working in London;

- composition effects where, even within a given occupation, the average London job may be more skilled, or senior, than an equivalent job elsewhere in the UK;
- relative scarcity of labour in London; and
- agglomeration effects, which potentially increase the productivity of the individual worker and the firm in large cities.

5.8 We concluded that London weighting is not paid solely to compensate for the higher cost of living in London and that its inclusion in the points calculation was therefore compatible with the aims of the PBS.

5.4 Impact on immigration flows to London

5.9 **Our analysis of used Tier 2 certificates of sponsorship concluded that excluding London weighting from consideration of earnings for the PBS would reduce non-EEA immigrant flows to London.** Based on our estimates, a change in PBS policy of this nature could affect Tier 2 flows to London by up to 30 per cent, although in practice the impact would probably be considerably smaller.

5.10 The impact is likely to be small because London weighting is only a small component of the earnings package for most employees and therefore in many cases will not make the difference between obtaining sufficient points for entry via the PBS compared to otherwise. Furthermore, many employers, especially in the private sector, would be able to reclassify London weighting as pay if such an action was required in order to secure better access to immigrant labour.

5.11 Our analysis also suggested that public sector occupations are more likely to be affected by the exclusion of London weighting from the earnings used to calculate PBS points. First, a large proportion of the jobs that would potentially be affected are in the public sector. Second, the means by which public sector wages are negotiated would make it more difficult for those employers to circumvent any policy change.

5.5 Impact on immigration flows to the rest of the UK

5.12 **Any impact of a change in the treatment of London weighting in the PBS calculation on Tier 1 flows to parts of the UK other than London will be insignificant.** It is possible in principle that excluding London weighting could reduce Tier 1 flows to other UK countries and regions. For instance, an immigrant who had previously worked in London, but wished to switch to Tier 1 General to take a job in Scotland, may be unable to do so. Furthermore, the inclusion of London weighting in the earnings that count towards PBS points means that immigrants on the Post-Study Work Route may face slightly stronger incentives to take jobs in London than in the rest of the UK. Such impacts will only occur in marginal cases, where London

weighting makes the difference between meeting or not meeting the Tier 1 entry criteria and are, therefore, expected to be negligible.

5.13 Under Tier 2, immigrants who failed to achieve sufficient points to work in London would not gain sufficient points to work elsewhere in the UK either. **Therefore, excluding London weighting from consideration of earnings in the PBS will have no impact on Tier 2 immigration flows to regions or countries of the UK other than London.**

5.6 Economic and labour market impacts

5.14 **The likely small reduction of Tier 1 and Tier 2 immigrant flows that would result from excluding London weighting from the earnings that count towards PBS points would have a correspondingly small economic impact on the UK. However, labour market distortions could potentially be generated.**

5.15 Because payment of London weighting is not uniform across occupations, and because some employers will find it easier to reclassify London weighting as salary than others, the economic impacts would not be felt uniformly. Discriminating against only some employers in this way would constitute a distortion in the labour market.

5.16 Furthermore, excluding London weighting from the earnings used to calculate PBS points could disproportionately harm the ability of public sector employers, notably the health sector, to fill vacancies in the short to medium term, and possibly longer. This could reduce the quality of the provision of key public services.

5.7 Other issues

5.17 Preparing this report has raised several interesting issues that concern the operation of the PBS but do not fall within the scope of the question we were asked by the UK Government. Many of these issues were raised at our meetings with corporate partners or in the written evidence that was submitted to us. We outlined some of these issues in Chapter 3.

5.18 Some evidence we received suggested the PBS should be used as a tool to share the distribution of non-EEA immigrants more evenly across the UK. We were told that this could help UK regions to achieve their targets for economic and population growth. Furthermore, we were told that the Government may find it beneficial to use the design of the PBS to help relieve population overcrowding in some regions of the UK.

5.19 Corporate partners also raised the question of whether the PBS should incorporate separate points tables for London and the rest of the UK, making the thresholds for the earnings bands higher for London than elsewhere in the UK.

5.20 Any consideration of introducing explicit sub-national arrangements into the PBS to reflect the types of issues outlined above would need to take into account the consistency with PBS objectives and the likely labour market and economic impacts as discussed above. Any further research into such arrangements would need to weigh any benefits in terms of a more even distribution of immigrants across the UK, as asserted by the Scottish Government, against any distortionary labour market and subsequent economic effects.

Annex A

Occupations with minimum going rates for London

Financial managers and chartered secretaries

- Financial director (London): £33.65 per hour
- Financial director (rest of England and Wales): £24.03 per hour
- Financial director (Scotland): £19.23 per hour
- Financial manager (London): £21.63 per hour
- Financial manager (rest of England and Wales): £16.82 per hour
- Financial manager (Scotland): £9.61 per hour
- Company secretary: £22.11 per hour
- Credit manager: £14.42 per hour
- Investment banker: £24.03 per hour

[Source: Michael Page International Finance Salary Survey 2007, Hays Legal Staff Salary Survey 2008, Institute of Credit Management Salary Survey 2007, Hudson Banking and Financial Services Salary Survey 2007]

Secondary education teaching professionals

Inner London

- Unqualified teacher: £19,007
- Qualified teacher: £25,000
- Head teacher, other school leader: £42,559

Outer London

- Unqualified teacher: £17,953
- Qualified teacher: £24,000
- Head teacher, other school leader: £38,634

London fringe

- Unqualified teacher: £16,106
- Qualified teacher: £21,619
- Head teacher, other school leader: £36,781

Elsewhere in England and Wales

- Unqualified teacher: £15,113
- Qualified teacher: £20,627
- Head teacher, other school leader: £35,794

Scotland

- Probationer: £20,427
- Unpromoted teacher: £24,501
- Chartered teacher: £33,588
- Principal teacher: £35,523
- Head teacher, deputy head teacher: £40,290

Northern Ireland

- Qualified teacher: £20,627

- Leadership Group: £35,794

These salary rates are based the following definitions of a full time teacher:

- England, Wales and Northern Ireland: Full time teachers are expected to work 195 days a year (190 of these must be working with pupils).
- Scotland: Full time teachers are expected to work 35 hours a week, 195 days a year over 39 weeks, with 5 days for in-service training

[Source: DCSF and devolved administrations in Scotland, Wales and Northern Ireland]

Primary and nursery education teaching professionals

- As for secondary education teaching professionals

Special needs education teaching professionals

- As for secondary education teaching professionals

Solicitors and lawyers

Solicitors and Lawyers (Greater London)

- Trainee solicitor: £24,663
- Newly qualified solicitor or lawyer: £39,000
- Solicitor or lawyer with 3 years' experience: £47,000
- Newly qualified in-house solicitor or lawyer: £45,000
- In-house solicitor or lawyer with 3 years' experience: £65,000

Solicitors and Lawyers (Scotland)

- Trainee solicitor: £14,000
- Qualified solicitor: £20,000
- Equity partner: £114,000
- Trainee, Crown Prosecution Service: £17,888
- Qualified Crown prosecutor: £30,138
- Principal prosecutor: £37,522

Solicitors and Lawyers (elsewhere in the UK)

- Trainee solicitor (England outside Greater London): £18,121
- Trainee solicitor (Wales): £17,171
- Newly qualified solicitor or lawyer: £23,000
- Solicitor or lawyer with 3 years' experience: £28,000
- Newly qualified in-house solicitor or lawyer: £25,000
- In-house solicitor or lawyer with 3 years' experience: £35,000

[Source: HAYS Legal Salary Guide 2006, Solicitors Regulation Authority salaries 2007/08. Judges' salaries are controlled by the Ministry of Justice.]

Gardeners and groundsmen / groundswomen

- Head greenkeeper - London (30 mile radius): £33,593
- Head greenkeeper - South East England, Essex, Hertfordshire: £32,289
- Head greenkeeper - Rest of United Kingdom: £29,822

[Source: The Committee for Golf Club Salaries – 2009 recommendations]

- Ground manager: £28,100
- Head groundsperson: £23,965
- Deputy head groundsperson: £19,160

[Source: The Institute of Groundsmanship Recommended Salary Bands 2009]

- Other jobs in this occupation code: £6.96 per hour

[Source: Annual Survey of Hours and Earnings]

Electricians, electrical fitters

London

- Electrician (or equivalent specialist grade): £13.28 per hour
- Approved electrician (or equivalent specialist grade): £14.49 per hour
- Technician (or equivalent specialist grade): £16.41 per hour

Elsewhere in England, Wales and Northern Ireland

- Electrician (or equivalent specialist grade): £11.86 per hour
- Approved electrician (or equivalent specialist grade): £12.94 per hour
- Technician (or equivalent specialist grade): £14.65 per hour

Scotland

- Electrician (or equivalent specialist grade): £10.93 per hour
- Approved electrician (or equivalent specialist grade): £12.00 per hour
- Technician (or equivalent specialist grade): £13.70 per hour

[Source: JIB national standard rate 2009, SJIB National Wage Rates 2009]

Tailors and dressmakers

- Bespoke or handcraft tailor (Saville Row level tailoring, London): £40,000
- Bespoke or handcraft tailor (elsewhere in the United Kingdom): £20,000
- Dressmaker: £20,000

[Source: Skillfast-UK, bespoke or handcraft tailor salaries based on a 40-hour week; dressmaker salary based on a 37-hour week]

Annex B

Consultation

B.1 List of organisations that submitted evidence

City of London Corporation
Confederation of British Industry
Convention of Scottish Local Authorities
Greater London Authority Economics
National Association of Medical Personnel Specialists
NHS Employers Federation
Prospect (Connect sector) (via the submission from the Trades Union Congress)
Recruitment and Employment Confederation
The Scottish Government
Trades Union Congress
UNITE (via the submission from the Trades Union Congress)

B.2 List of individuals that submitted evidence

Frances Cairncross
Frances Ruane
Rob Eatough

B.3 List of organisations met with

Convention of Scottish Local Authorities
First Permit
Greater London Authority Economics
Scottish Financial Enterprise
The Scottish Government

Abbreviations

ASHE	Annual Survey of Hours and Earnings
COSLA	The Convention of Scottish Local Authorities
DCSF	Department for Children, Schools and Families
EEA	European Economic Area
IDS	Incomes Data Services
LFS	Labour Force Survey
MAC	Migration Advisory Committee
NHS	National Health Service
ONS	Office for National Statistics
PBS	Points Based System
PSWR	Post-Study Work Route
RLMT	Resident Labour Market Test
SOC	Standard Occupational Classification system
TUC	Trades Union Congress
UK	United Kingdom
UKBA	UK Border Agency

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