

Brexit and immigration¹

- Net inward migration from the EU has been running at record levels in recent years, although the steep increase in new National Insurance numbers issued suggests that the official data may be understating the level of immigration. There was a clear step up in inflows after both expansions of the EU into central and eastern Europe, while the relative strength of the UK labour market has been an important driver of the more recent rise in inflows.
- High levels of immigration have helped to offset the impact of an ageing population and ensured that the UK has enjoyed stronger labour supply growth than many of its peers. With migrants typically being better educated than their UK-born counterparts, the quality of the stock of labour has also improved, and migrants have been found to have a net positive fiscal impact.
- But there have been some downsides, with evidence that high immigration has had a small dampening impact on wages. That migrants tend to head to London and the other southern regions over other destinations has exacerbated the imbalances in regional housing markets.
- Given that a desire to have greater control over immigration is usually one of the key motivations for those favouring Brexit, a vote in favour of leaving the EU is likely to see the UK abandon the policy of free movement of labour. This would probably see the UK extend the points-based system that it currently uses for non-EU countries to include EU migrants.
- Our modelling suggests that the adoption of a 'populist' immigration policy which lowers net inward migration by 60,000 a year could reduce the level of GDP by 1.1% in 2030 compared with our baseline forecast.

Introduction

The Ipsos MORI *Issues Facing Britain* survey² has consistently found that respondents cite immigration as the most important issue facing Britain. The UK's membership of the EU is an important part of this issue; the free movement of workers is one of the four freedoms enjoyed by EU citizens and the limitations that this places on the UK's ability to regulate the level of immigration is one of the main sources of unease amongst those favouring Brexit.

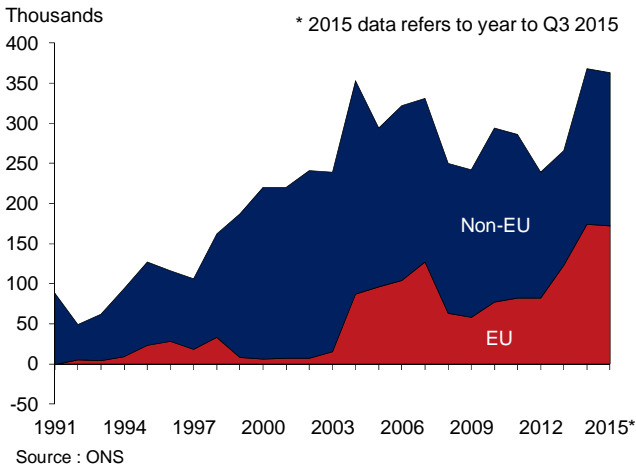
EU immigration has increased in importance in recent years

The level of net inward migration has been running at record highs in recent years, with the latest data showing net inflows of 323,000 over the year to Q3 2015. Net immigration from EU countries was 172,000 over this period, only a touch lower than the record high of 184,000 recorded over the year to Q1 2015. While net inflows from non-EU countries have been relatively stable throughout the past decade, there has been a significant pickup in immigration from the EU. For the ten years up to 2004, net inflows from the EU averaged just 15,000 per year; since then the average has been 104,000 with the figures for recent years being considerably higher still. However, net inward migration from EU countries still only accounts for a little under half of total net inward migration.

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² *Economist* / Ipsos MORI March 2016 Issues Index, <https://www.ipsos-mori.com/researchpublications/researcharchive/3715/Economist-Ipsos-MORI-March-2016-Issues-Index.aspx>

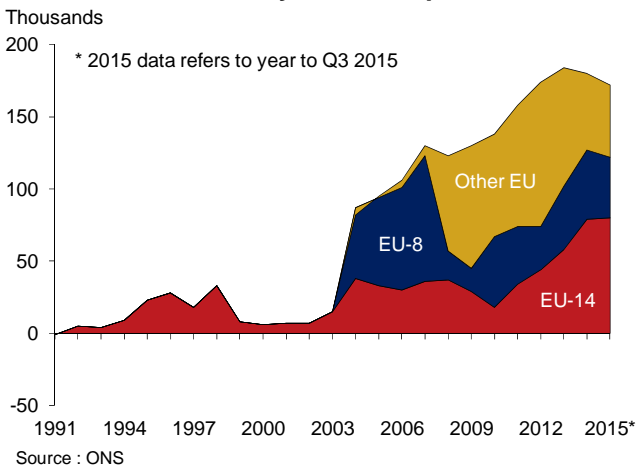
UK: Net inflows by citizenship



Higher inflows from the EU has been a function of EU enlargement...

Outflows of people from the UK have remained relatively stable throughout, so the change is almost entirely due to an increase in the number of people entering the country. There appears to be two main factors explaining the increase in inflows. Firstly, as the chart below demonstrates, the expansion of the EU into central and eastern Europe³ has encouraged significant numbers of migrants from these countries to exploit their new found ability to work in the UK.

UK: Net EU inflows by citizenship



The UK is by no means unique in seeing this pattern, with many other western European countries also

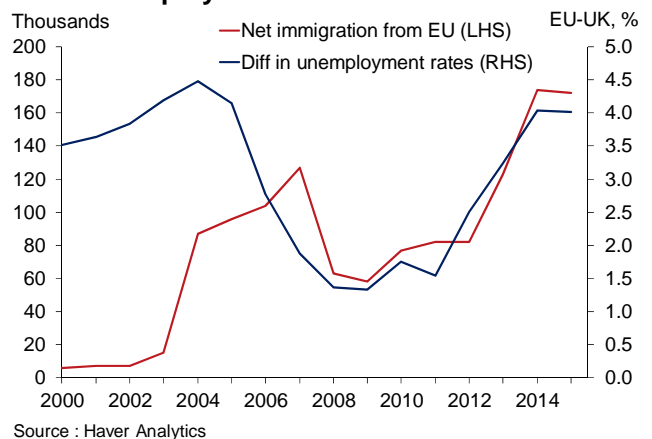
³ The two phases of EU enlargement were (i) in 2004, when the EU-8 (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia) joined along with Malta and Cyprus, and (ii) in 2007 when the EU-2 (Bulgaria and Romania) joined.

seeing a large step up in inflows. It is also the case that following an initial surge immediately after enlargement, inflows from both groups of countries have subsequently tailed off a little. But it is clear that the UK remains an attractive option for migrants from central and eastern European countries and this is likely to remain the case while wage differentials persist. Indeed, the recent introduction of the National Living Wage may increase the relative attractiveness of the UK as a destination for migrants.

...and the relative strength of the UK labour market

The second factor behind the increase in inflows has been the strength of the UK's labour market in comparison with that of other EU countries in the period since the global financial crisis. Migrants tend to be attracted to strong labour markets and, as the chart below shows, there is a close relationship between the level of net immigration from the EU and the unemployment rate in the UK versus the rest of the EU. This is likely to explain why net inflows from the EU-14 – the more established core of the EU – have increased so much in recent years.

UK: Net immigration from EU & difference in EU & UK unemployment rates



This notion is corroborated by the International Passenger Survey (IPS) data on the reasons for migration. The number of EU citizens coming to the UK to do a job that they had already secured has risen from 56,000 in 2011 to 96,000 over the year to Q3 2015, while the number coming to look for work increased from 37,000 to 69,000 over the same period. By contrast, the number of people coming to the UK to study has remained broadly flat over the past few years.

We expect unemployment rates in other EU countries to drift downwards over the remainder of the decade as their recoveries become more firmly entrenched, while the scope for UK unemployment to fall further would appear to be relatively limited. Therefore, as the differentials begin to close, we would expect net inflows to slow.

It is possible that inflows from the EU could be higher

The data that we have presented above comes from the IPS. This survey is administered by the ONS and counts those people who are intending to come to the UK for more than 12 months. However, other sources suggest that inflows could be much higher, in particular the number of new National Insurance numbers (NINo) issued. While the IPS suggested that 232,000 people immigrated from the EU in the year to September 2015, statistics from the Department for Work and Pensions reported that 655,000 new NINos were allocated to EU nationals over the same period. Given that a NINo is required by any overseas national in order to work or claim benefits and tax credits in the UK, this could indicate that immigration is a lot higher than the IPS data would suggest, although it is possible that a proportion of these NINos are allocated but not actually used; HMRC has promised to provide this information to the Treasury Select Committee shortly.⁴

High inward migration has mitigated the impact of an ageing population

The most obvious impact of higher levels of net inward migration has been to boost labour supply. The bulk of migrants are of working age, with the 2011 census reporting that half of those who had migrated in the previous year were under the age of 25. Chiming in with the IPS data on reasons for migrating, evidence from the Labour Force Survey suggests that the employment rate for migrants is substantially higher than that of the domestic-born population. In Q4 2015, the employment rate for those born elsewhere in the EU and living in the UK was 70% – well above the equivalent rates for those born in the UK and in non-

EU countries (both 60%). The figures are particularly high for the newer members of the EU, with the employment rates for those born in the EU-8 and EU-2 countries 81% and 80% respectively. The net result has been a 123% increase in the number of people working in the UK but born in other EU countries over the 10 years to Q4 2015. As a result, the EU now accounts for 41% of all foreign-born workers, up from 31% in 2005.

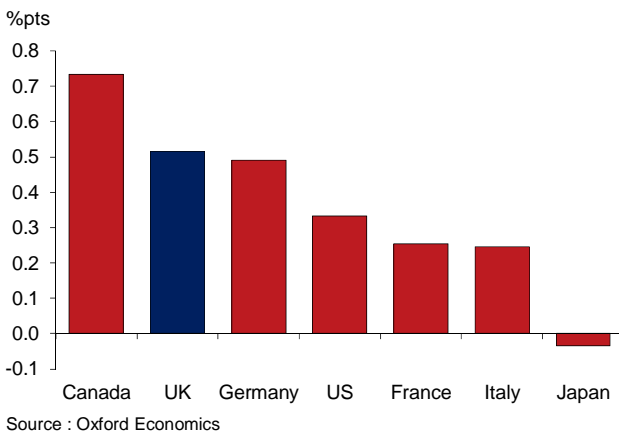
This inflow of young migrants has helped to offset the impact of an ageing indigenous population and ensured that growth in labour supply has continued to make a sizeable contribution to potential output growth. In the *Oxford Global Model* we use a production function approach to estimating potential output⁵ which relates the level of potential output to contributions from factor inputs – labour and capital – and the efficiency with which those inputs are used (so-called ‘total factor productivity’). This framework allows us to compare the relative contribution from growth in labour supply across countries and different time periods.

We estimate that growth in labour supply contributed 0.5ppt per year to UK potential output growth between 2005-15. In the G7 this is second only to Canada (0.7ppt). This helped the UK to achieve the second fastest growth in potential output in the G7 over this period, again narrowly behind Canada. The UK also fared better than most of its peers in terms of sustaining growth in labour supply compared with earlier periods, when the impact of an ageing population was less influential. The contribution from growth in labour supply in the UK slowed from 0.7ppt a year in 1995-2005 to 0.5ppt in 2005-15, but in the US and France the contribution fell by 0.4ppt between these two periods and in Canada the decline was 0.5ppt. Some of the UK’s relative success will also be attributable to the trend towards greater activity amongst older age groups, but migration has undoubtedly played a key role.

⁵ We use a Cobb–Douglas production function, $Y^* = A + L^\alpha + K^{(1-\alpha)}$, where: Y^* is potential output; L is potential labour supply, which is equal to the labour supply at the NAIRU (non-accelerating inflation rate of unemployment); K is the capital stock; and A is total factor productivity (TFP). This is rewritten in natural logs, with α equal to 0.65: $\ln(Y^*) = \ln(A) + 0.65\ln(L) + 0.35\ln(K)$

⁴ ‘HMRC will deliver full set of migration information’, Commons Select Committee, 4 April 2016, <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/hmrc-correspondence-chairs-statement-15-16/>

G7: Contribution of labour supply to potential output growth



The recent high levels of immigration have also improved the quality of the stock of labour. A study of Labour Force Survey data by the Migration Observatory⁶ found that foreign-born workers tend to be better educated than their UK-born counterparts. And the gap is particularly marked for recently-arrived migrants; in 2014, 54% of recently-arrived foreign-born men and 58% of women had stayed in education until they were at least 21, compared with the equivalent UK figures of 26% and 28% respectively.

Migration tends to be a net positive for the UK fiscal position

That migrants tend to be workers, rather than dependents, means that immigration has generally been seen as a positive for the UK's fiscal position. Furthermore, migrants from the EU tend to be much less likely to claim working age benefits than those from non-EU countries; the ratio of working age benefit claimants to total employment for those born in the UK is 18% but for those born in the EU it is just 5.8%, with the figures for the newer member countries particularly low (2.7% for the EU-2). This suggests that the 'emergency brake' on access to the welfare system, which the Prime Minister secured as part of his re-negotiation of the UK's relationship with the EU, is unlikely to have a material impact.

⁶ 'Characteristics and Outcomes of Migrants in the UK Labour Market', The Migration Observatory, January 2016, http://www.migrationobservatory.ox.ac.uk/sites/files/migobs/Briefing%20-%20Characteristics%20and%20Outcomes%20of%20Migrant%20in%20the%20UK%20Labour%20Market_0.pdf

There have been several studies which have aimed to quantify the impact of migration on the UK's fiscal position, with broadly similar results. A 2013 study by the Centre for Research and Analysis of Migration⁷ found that between 1995 and 2011, immigrants from the European Economic Area (EEA) contributed 4% more to the fiscal system than they received in transfers and benefits, with the net contribution of more recent migrants being higher still. A 2013 OCED study⁸ also found a positive fiscal impact, albeit one which was relatively small at +0.46% of GDP for the 2007-09 period.

There is evidence that immigration has had a modest dampening effect on wages

On the flip side, this period of high inward migration and strong growth in labour supply has coincided with a period of unprecedentedly weak wage growth. Coincidence does not mean causation and when looking at this period it is difficult to disentangle the impact of immigration from that of higher activity rates amongst older people. But most studies have found a link between migration and wages, albeit one which suggests that the impact is typically small. Most recently, a Bank of England working paper⁹ found that a 10% increase in immigration lowers average wages by around 1% – a conclusion which is similar to the other studies in this area – although the impact is closer to 2% in the semi/unskilled services sector.

Immigration has added to housing market imbalances

One area where the negative impact of immigration is clearer cut is with regards to regional housing markets. The ONS mid-year population estimates suggested that in 2014 41% of net UK inflows of 260,000 settled

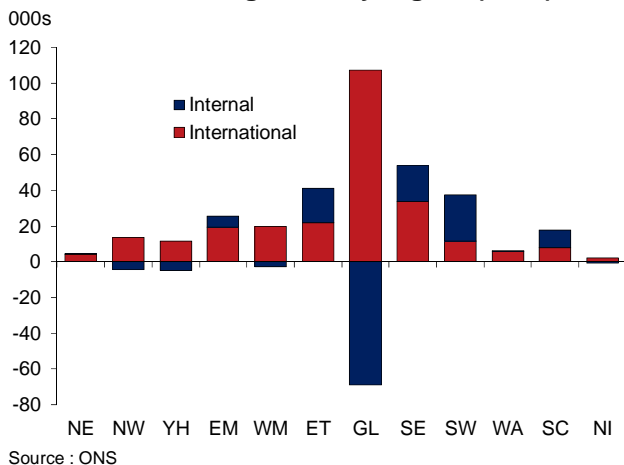
⁷ 'The Fiscal Effects of Immigration to the UK', Centre for Research and Analysis of Migration, November 2013, http://www.cream-migration.org/publ_uploads/CDP_22_13.pdf

⁸ 'The fiscal impact of immigration in OECD countries', OECD, June 2013, http://www.oecd-ilibrary.org/social-issues-migration-health/international-migration-outlook-2013/the-fiscal-impact-of-immigration-in-oecd-countries_migr_outlook-2013-6-en

⁹ 'The impact of immigration on occupational wages: evidence from Britain', Bank of England Staff Working Paper No 574, December 2015, <http://www.bankofengland.co.uk/research/Documents/workpapers/2015/swp574.pdf>

in Greater London, with a further 13% heading to the South East, continuing a well-established pattern.

UK: Net inward migration by region (2014)



In the case of London, the impact was mitigated somewhat by a net outflow of 69,000 people to other regions in the UK, but the net impact was still an increase of 39,000. Meanwhile the South East saw net inflows from both abroad and elsewhere in the UK, yielding a total population rise due to migration of 54,000.

In general, the areas with the highest inflows of migrants have tended to be those areas where there are already shortages of housing and problems with housing affordability. Looking just at the data for 2014, total (international and internal) net inflows into the four southern English regions (Greater London, South East, East of England and South West) were 174,000, some two-thirds of the UK total. Given the ongoing struggle to increase housing supply in the south of England and, in particular, in Greater London, these persistently high inflows are exacerbating existing imbalances and risk further pushing up house prices.

A post-Brexit UK would probably extend the existing points-based system...

If the UK did vote in favour of leaving the EU, it would have a range of options for immigration policy post-Brexit, although the availability of some of the alternatives would be dependent on choices made in other areas of the negotiations. For example, if the UK wanted to retain its membership of the EEA in order to have full access to the single market, it would have to retain free movement of people. However, we would see that as a relatively unlikely outcome; if the

electorate had just voted to leave the EU, it would be unlikely to accept the relatively minor degree of change afforded by EEA membership. And that is particularly the case in terms of the arrangements around immigration, with the ability to regain full control of immigration policy often cited as a key motivation for voting to leave.

More likely is that the UK opts to negotiate a looser relationship with the EU. This would enable it to apply a similar points-based system for migrants from the EU to that currently in place for countries outside of the EU. This would enable the UK to restrict immigration to those sectors where there are not sufficient skills amongst the domestic population. It is possible that the new rules could be applied retrospectively to EU-born workers already living in the UK, although this would be contentious and we would expect some form of transitional arrangements to be put in place.

...but this would not be enough to achieve the Conservative's manifesto pledge

It is harder to identify the level at which a post-Brexit government would attempt to cap immigration. The Conservative party manifesto¹⁰ for the 2015 General Election committed to reducing annual net inward migration to "tens of thousands." However, given that net inflows from outside the EU are running at almost double that level, merely having the ability to restrict inflows from the EU will leave the government well short of achieving this commitment. Therefore, an additional tightening of immigration policy would be required to get close to fulfilling the Conservatives' commitment.

In our research programme¹¹ on the longer-term economic implications of Brexit we modelled scenarios with a variety of assumptions on migration levels. These ranged from a more 'populist' policy, where net inward migration was 60,000 lower per year than in our baseline forecast (which assumes that the UK remains in the EU), to a more liberal 'pro-business' approach, where the government makes only modest attempts to curb immigration.

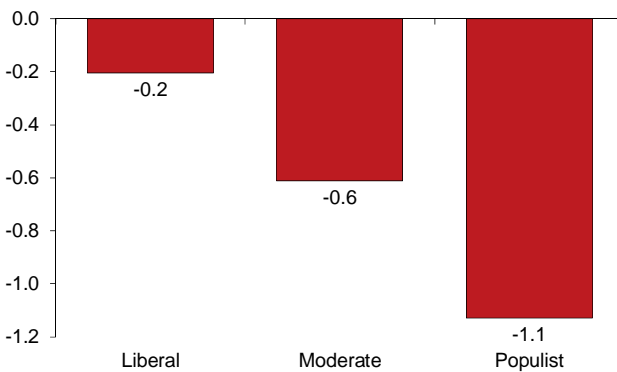
¹⁰ 'The 2015 Conservative Party Manifesto', <https://www.conservatives.com/manifesto>

¹¹ For more information about this research programme, see <http://www.oxfordeconomics.com/brexit>

If we isolate the migration effects¹², the results suggest that under the more ‘populist’ migration policy, the working age population would be more than 700,000 smaller than in our baseline forecast by 2030. Given that the vast majority of migrants are of working age, this would mean that the labour supply would be around 650,000 lower in 2030. This, in turn, implies a smaller contribution from growth in labour supply to potential output, so the level of GDP would be 1.1% lower in 2030. In contrast, the more liberal policy would reduce the working age population and labour supply by around 120,000. As such, the damage to GDP would be less severe, with the level of GDP in 2030 only 0.2% below the baseline.

UK: Impact of different migration assumptions on potential output growth

%pt contribution to change in GDP compared with baseline in 2030



Source : Oxford Economics

Brexit would also have implications for UK citizens living elsewhere in the EU. These citizens currently enjoy access to public healthcare and certain state benefits, while their state pension payments are protected against inflation. However, should the UK leave the EU, it is uncertain whether these arrangements would continue, with the provision of free healthcare looking particularly vulnerable. If the post-Brexit settlement was particularly unfavourable to UK citizens living in the EU, we could see more of them moving back to the UK. And given that many UK citizens living abroad are retirees, this could increase the UK dependency ratio.

However, UN data¹³ suggests that while 1.2 million UK citizens live in the EU, 2.9 million EU citizens live in the UK. Therefore, any changes to the arrangements governing existing migrants are likely to have a much larger effect on flows from the UK to the EU than vice-versa.

Conclusions

There has been a substantial increase in the level of immigration from the EU to the UK over recent years. This partly reflects the influence of the EU’s enlargement into central and eastern Europe, but it is also a function of the relative resilience of the UK labour market. Even if the UK were to remain part of the EU, we would expect net inflows to moderate as unemployment rates drop back elsewhere in the EU.

With migrants to the UK typically being of working age, the recent high levels of immigration have mitigated the impact of an ageing population and ensured that growth in labour supply has continued to make a strong contribution to potential output.

In our view, the most likely scenario post-Brexit would be that the UK extends the current points-based system for non-EU countries so that it also covers immigration from the EU. It is questionable whether this would be applied retrospectively – at the very least we would expect the government to put in place some form of transitional arrangements. If Brexit were to result in the government pursuing policies which reduced the flow of migrants into the UK, this would damage UK growth prospects.

¹² There are many other ways that Brexit will affect GDP, but in order to try and isolate the migration effects, we show the results for scenarios which all assume that the UK signs a free-trade agreement with the EU.

¹³ See United Nations dataset on International migrant stock 2015, <http://www.un.org/en/development/desa/population/migration/data/estimates2/estimates15.shtml>