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ECONOMIC CONSEQUENCES OF UK IMMIGRATION REFORM FOLLOWING BREXIT

Katherine Wu



Domestic sentiment toward outsiders in the UK has become fueled with negativity and wariness. A heated Leave campaign succeeded in convincing the public that EU citizens were destroying the economy. This article studies the true economic role of EU citizens in the UK prior to dissecting the proposed immigration policy following Brexit to predict the effect of reduced EU immigration to different sectors of the UK economy.

Introduction

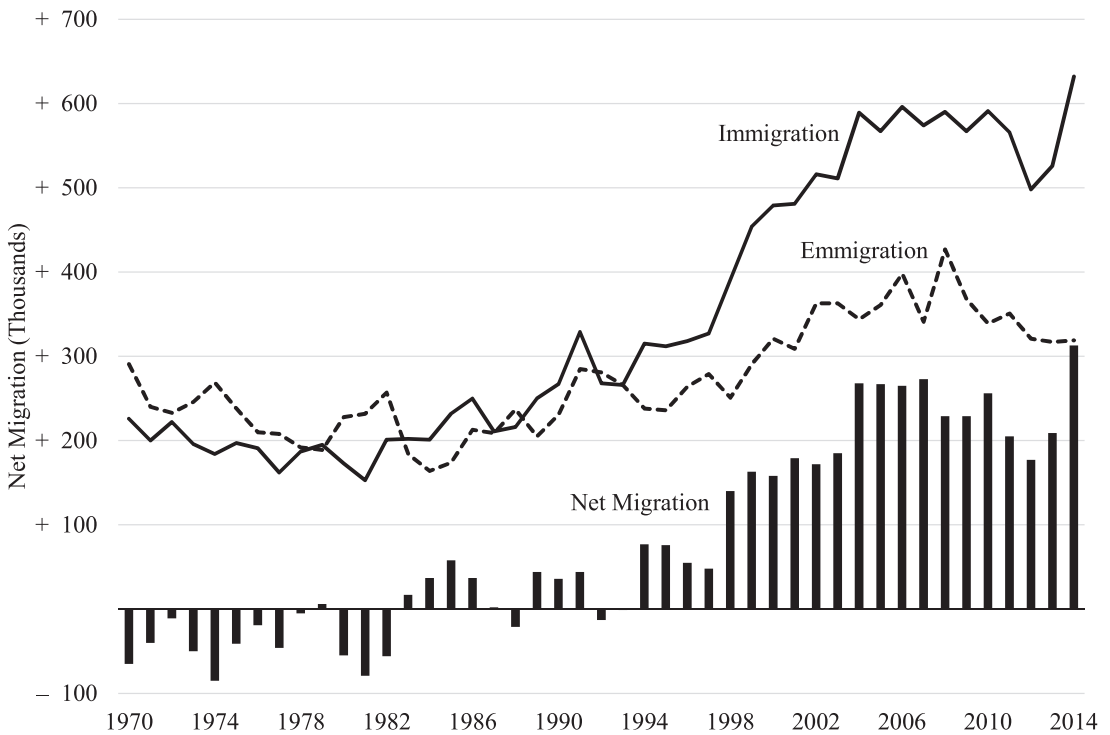
“We must break free of the EU and take back control of our borders.” This adamant declaration by Nigel Farage succeeded as an inflammatory and provocative advertisement for the Leave campaign (Stone). On June 23, 2016, with 17 million votes and a 51.9% majority, the UK voted to leave the EU, which the UK had belonged to since 1973 (“EU Referendum Results”). Thus began an era of significant economic, political, and legislative uncertainty in the UK.

Following the vote, Lord Ashcroft, a UK businessman and political figure, conducted a survey exploring the motivations of those who voted to leave; 49% voted to leave the EU because they believed the UK should have more control over its own affairs and 33% voted solely to have more control over immigration and the border (Roff). Thus, much of the incentive to vote for the Leave campaign coincided with an intense fear of outsiders. With independence

from the EU, the UK will no longer be required to abide by the EU’s freedom of movement directive. Having triggered Article 50 and begun the “divorce” process, the UK must now form its own policies regarding the inflows and outflows of people across its border. The implications of these policies will be felt by the entire country as the restriction of EU immigrants will, at the very least, dramatically change the make-up of the labor force in key industries within the UK economy.

The goal of this article is to estimate the ultimate economic effects of the UK’s new immigration reform. In order to explore the impact, likely demographic changes to the labor force that will occur within each major industrial sector as a result of this policy are examined. From there, sectors are identified that will likely suffer the hardest blow from immigration reform because they most depend on EU immigrants who fall in the categories that the UK is trying to deter from entering the country.

Figure 1
Net Migration to the UK, 1970–2014



Source: ONSb.

To fully comprehend the economic impact of a new immigration policy, the previous state of the UK economy must first be understood. Therefore, after an analysis of the state of EU immigrants and the economy prior to Brexit, potential policy options are examined, followed by a breakdown of how these policy changes will alter the previous immigrant economic environment.

The UK Immigration Debate: Its Origins and Importance

Immigration into the UK has substantially increased over the past couple of decades. With a desirable labor market and standard of life, the UK is a major recipient of immigrants looking for residence and work. Figure 1 shows that until 1998, net migration (net immigration minus net emigration) remained below 100,000 annually (ONSb). Then, net migration increased and remained at a higher

level, reaching 313,000 in 2014. It is evident that the driving factor for this increased net migration is the rapidly growing immigration, swelling from around 300,000 in 1970 to 632,000 in 2014 (ONSb).

With this rapidly increasing immigration, the demographics in the UK have shifted. The greater number of foreign-born people living in the UK reflects a more globalized country. However, negative sentiments toward “outsiders” and the idea that immigrants are “stealing” public services and jobs have become the overarching ideologies throughout many regions of the UK not accustomed to these different populations. According to the British Social Attitudes survey in 2013, when UK citizens were asked their preference for immigration levels in Britain, an overwhelming 77% chose that immigration should either be “reduced a lot” or “reduced a little,” with more than 56% choosing “reduced a lot” (Blinder).

Table 1
Net Fiscal Contributions to UK Government Based on Country of Origin

	UK Born	EU10	Other EEA	Non-EEA
Overall fiscal contribution (£ billions)	-616.53	4.96	15.26	5.21
Ratio (revenues/expenditures)	0.90	1.12	1.64	1.03
Education contribution (£ billions)	—	4.31	2.50	11.19

Source: Dustmann and Frattini.

Perhaps most importantly, public opinion regarding the economic impacts of immigrants is overall negative. Many UK citizens hold the belief that people coming into the UK are more expensive than they are contributive. According to the British Social Attitudes survey in 2013, when asked about migrants coming to work, UK citizens thought that their costs to the overall economy substantially outweighed their benefits (Blinder). But is this perception of non-contributive immigrants borne out by the economic evidence?

Economic Influence of EU Nationals Immigrating to the UK Before Brexit

EU workers did not dominate the pre-Brexit UK labor market. According to the Annual Population Survey (APS) conducted by the Office for National Statistics (ONS), EU workers comprised only about 7.2% of the UK labor force in 2016 (ONSa). Furthermore, additional data from the ONS document that 45% of incoming EU nationals to the UK already had a definite job while another 24% were coming to look for work (Vargas-Silva). Additionally, a much higher share of EU migrants was considered overqualified for their occupations than native workers, with 40% of EU8¹ nationals deemed overqualified

compared to 15% of UK natives (ONSa). Thus, data suggest that a majority of immigrating EU nationals came to the UK to contribute to the economy.

But did these immigrants substantially contribute to the UK economy or did they take more from public services provided than they contributed? Accounting for government costs for immigrants, it becomes clear that immigrants pre-Brexit provided more fiscal benefits to the UK economy than government costs. Data from the annual Labour Force Survey and further data from the ONS enable modeling government expenditures, revenues, and fiscal costs as well as the contributions of individuals to government budgets. In addition, the overall population can be broken down into four sub-groups to calculate the contributions of each: UK-born citizens, EU10 immigrants, other European Economic Area (EEA) immigrants, and non-EEA immigrants. Table 1 presents net fiscal contributions and implicit contributions through education over the years 2001 to 2011 by citizen type, as modeled by Dustmann and Frattini. Pre-Brexit, UK-born citizens imposed a large economic burden on public sector budgets, costing more in government expenditures than they contributed in taxes and fees, whereas immigrants were, on average, net contributors fiscally. In particular, immigrants from the EEA countries contributed the most of the three immigrant populations. Due to the disproportionate sizes of the various populations, the raw fiscal contribution figures could be misleading. To standardize, Table 1 also shows the ratio of expenditures to contributions. UK-born citizens have the lowest ratio of 0.895. Because this value is below 1,

¹ EU2: Bulgaria and Romania.

EU8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.

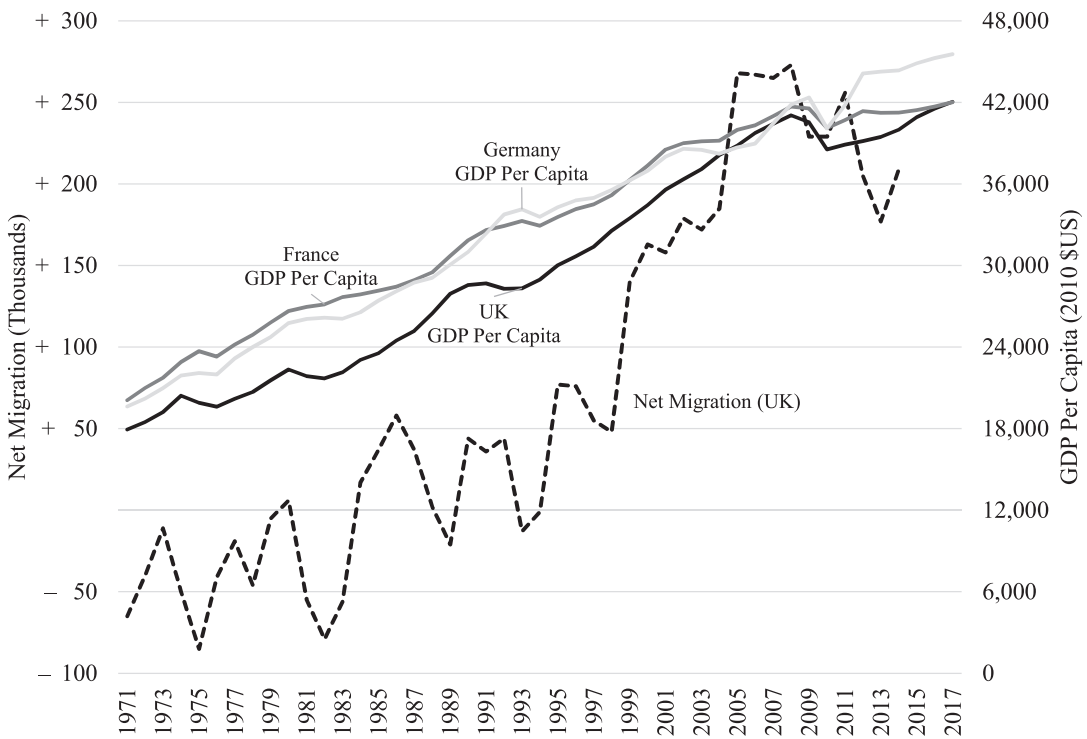
EU10: EU8, Cyprus, and Malta.

EU14: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Netherlands, Portugal, Ireland, Spain, and Sweden.

All EU countries: EU2, E10, E14, and Croatia.

EEA countries: all EU countries, Iceland, Liechtenstein, and Norway.

Figure 2
GDP Per Capita vs. Net Migration



Sources: FREDa; FREDb; FREDc.

their expenses outweighed their contributions. On the other hand, EEA countries have the highest ratio at 1.640. Since the EEA ratio is well above 1, their contributions substantially outweighed the costs they imposed on the UK economy. Simply put, UK-born citizens were a drain on public sector budgets, while immigrant populations were contributive.

The implicit costs and benefits that immigrants imposed on the UK pre-Brexit are now addressed. The previous two metrics measure the explicit revenues and costs of public services: monetary receipts and costs that can be directly calculated by examining the fiscal numbers. Implicit costs or benefits consist of opportunity losses or gains rather than monetary ones. These are often overlooked when considering the balance of economic contributions because they are not as tangible or obvious as actual money exchanges. A thriving economy has not only economically

contributive citizens but also intellectually beneficial citizens. Without brainpower, skill, and knowledge, an economy cannot grow. Because the immigrants to the UK, on average, were more educated than UK-born citizens, immigrants provided an even greater fiscal contribution. Immigrants were bringing a valuable commodity with them into the country that the UK did not have to pay for, an opportunity gain for the economy. The implicit educational savings alone between 2001 and 2011 total nearly £18 billion (Dustmann and Frattini).

Another way to evaluate the economic impact of immigrants is to examine the impact of immigrants on GDP per capita. If GDP per capita of immigrants is lower, on average, than that of the UK population, then they may be considered a detriment to the economy, potentially dragging the average down. If immigrants came to the UK as a non-

contributory force, then GDP per capita would plummet faster as the population increases with more immigrants and a stagnant GDP to divide among them. Looking at data from 1971 to 2014 and visualizing GDP per capita in the UK and net migration in the UK as functions of time, however, reveal a strong positive correlation between net migration and GDP per capita (Figure 2). This does not prove that increasing net migration causes this growing GDP per capita, but it provides evidence that the economy likely did not suffer due to the influx of immigrants. There is a small decline in GDP per capita in the UK between the years of 2007 and 2009; although, when the GDP per capita growth in the UK is compared with those of Germany and France, all these countries experience this dip during these years—the global effect of the Financial Crisis of 2008 (FREDA; FREDb; FREDc).

From these calculations, it can be concluded that in recent years, immigrants have contributed significantly more than they have received in benefits. And because these immigrants pay in more than their share of public expenditures, they are in turn reducing the fiscal burden of public services for UK-born citizens. In the wake of Brexit and impending immigration reforms, restricting immigrants from entering could result in a strong negative impact on public budgets and more broadly on the overall growth of the UK economy, given their relatively high education.

Core Concepts of UK Immigration Reform Regarding EU Nationals

In order to forecast the economic impacts of these reforms, it is necessary to understand some core concepts of the UK immigration proposals. The UK is in the midst of reconciling a final immigration policy, so uncertainty remains. However, by analyzing a document leaked from the UK government, the effects of the most influential reform concepts on labor force and economic productivity can be predicted.

To formulate post-Brexit immigration policy, the UK government turned to the Migration Advisory Committee (MAC), an independent, non-statutory public body. On July 27, 2017, MAC was commissioned

to advise the government on the impacts of immigration and shortages within industries (“Commissioning...”). After two months of research input from MAC, the government was ready to develop an initial plan.

On September 5, 2017, a leaked document labeled “official sensitive” from the Home Office was released online. The document, titled “Border, Immigration, and Citizenship System,” details a plan with three separate phases to integrate the new immigration policy with the reality of pre-existing EU nationals settled in the UK (Partington et al.).

The first phase seeks to ensure that the EU migration can be regulated through the UK’s legal framework. This involves a grace period of up to two years before a specific date by which EU citizens residing in the UK must apply for settled status, or a temporary residency permit. It proposes reform legislation to turn off the EU’s freedom of movement directive and move EU citizens under the rules and regulations that non-EU citizens are already required to follow in the UK’s pre-existing Immigration Bill of 1971. This first phase of the plan, therefore, would put EU citizens and other non-UK citizens under the same legal framework regarding immigration.

The second phase would occur after the official departure of the UK from the EU and would introduce an Implementation Period, which the document claims “provides a smooth and orderly exit for employers and individuals” through an initial unrestricted phase where EU immigrants can work, study, and reside without previous permission from the Home Office, followed by several periods of increased restrictions and requirements.

The final phase begins a period in which the UK imposes their own rules to control the volume and type of migration from the EU, both temporary and permanent, in the national interest. The exact rules are currently still being debated, but the UK intends to continue utilizing MAC’s research to consider social and economic impacts of immigration reform as the time to make these decisions draws nearer.

Two proposed changes to immigration rules stand out in this Home Office document. The first involves the methodology to decrease the numbers of lower-skilled workers entering

the country. The plan limits the length of temporary work permits to a maximum of two years for EU nationals seeking low-skilled occupations in the UK. Those in high-skilled occupations may be approved for longer expirations of three to five years. The draft also suggests that to limit the number of EU citizens entering the UK to undertake low-skilled work, there should be a salary threshold, some assessment of the skill level of the occupation, or an overall cap on the number of EU citizens allowed to immigrate into the UK. The second major change suggested in the document is requiring UK employers to look for employees from the native UK population whenever possible instead of the migrant population (similar to current policies in the US and Australia) to decrease the overall number of immigrants. This, the document suggests, would encourage employers to invest more in training programs to educate the native population rather than take on already-trained migrants. The government claims that this extra investment will be worthwhile, making the country more prosperous and successful as a cohesive, national unit.

While this leaked government report does not necessarily represent the immigration reform that will eventually evolve out of the Brexit negotiations, it does signal the government's primary goals for future reform, since the government is already developing that future immigration policy. Using these proposed changes, the impact on the UK economy can be forecasted. This analysis focuses on the potential impact of two main points: decreasing low-skilled worker immigration and decreasing immigration as a whole. This assessment begins by reviewing various studies predicting the impact of post-Brexit immigration reform on the UK economy.

Prospective Impacts of the New Policy

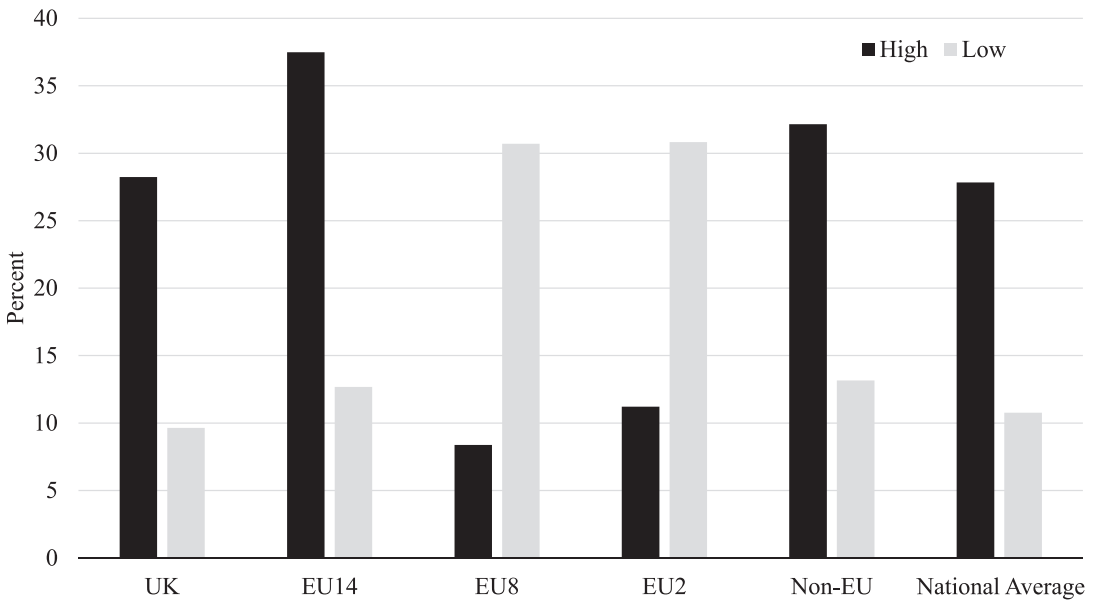
The government's main purpose in the leaked document is to develop an immigration scheme that benefits the UK. It claims that the old system was not sufficient because it allowed EU citizens "a right to reside in the UK regardless of the economic needs of the country." The new plan aims to cut yearly

migration from 250,000 EU citizens to only tens of thousands.

The Confederation of British Industry (CBI) is a business organization in the UK that lobbies for the policy interests of firms and performs research on the potential impacts of reforms on businesses throughout the country. The head of skills and employment policy at CBI, Seamus Nevin, argues that the UK needs an immigration system that "provides control while also enabling employers to access the foreign workers they need at all levels—whether it be short-term seasonal workers, intra-company transfers, or permanent solutions" (Horrocks-Burns). His concern regarding access to foreign workers is directly reflected in the rapidly increasing concerns of businesses. In polls between 2014 and 2015, the share of businesses deeply concerned about their future ability to access this foreign market, for both low-skilled and high-skilled workers, jumped up from 18% to 31%. After the referendum vote, this number rocketed again to 50%. Furthermore, by early 2018, 58% of companies believed that leaving the EU will hinder their access to the high-skilled workers they need to keep business running (Horrocks-Burns). All of this is a clear illustration of UK businesses' strong apprehension of the new immigration policy.

Research from the Centre for Economics and Business Research (CEBR) finds that if immigration is reduced significantly across sectors, productivity will suffer due to loss of creativity and diversity in the workforce, particularly in knowledge-intensive sectors. The CEBR assumed numbers from the government pledge to reduce migration to tens of thousands. Their economic model studied two different scenarios: 1) a slow reduction plan where the target of 73,000 net migration is achieved by 2027 and 2) a fast reduction plan where the target is achieved by 2021. The models show that by 2025, in the slow plan GDP would be 1.5% lower than without the changes and 3.1% lower in the fast plan. Longer term, by 2040, GDP would be reduced by 8.9% and by 10.4% in the slow plan and fast plan, respectively. After taking into account the reduction in the population due to immigrant cuts, GDP per capita would also be lower

Figure 3
Distribution of Workers in Each Nationality Grouped by Skill Level



Source: ONSa.

than without the changes. By 2025, GDP per capita would decline relative to no change by 0.9% and 1.5%, in the slow plan and fast plan, respectively, and by 2040 by 4.1% and 4.9%, respectively (CEBR). Thus, extant research tends to agree that reductions to immigration will likely hinder economic growth.

On the other side of the issue, UK-born citizens have slowly been changing their opinions on immigrants. UK-born citizens are beginning to think that immigrants may be beneficial to the economy. In 2011, 52% of UK-born citizens thought immigrants were “bad” for the economy, but four years later, only 35% viewed them as a negative force (Blinder). The Centre for Economic Performance at the London School of Economics has called the belief that the rising number of immigrants looking for work in the UK has harmed UK workers through increasing job competition the “lump of labour fallacy” (Wadsworth et al.). The Centre for Economic Performance claims the harm would only occur if the number of jobs available was fixed, not fluctuating to accommodate growing demand for services and goods with an increasing population. Far

from stealing jobs away from UK-born citizens, the increased number of migrant workers coming to the UK enables higher wages and a more productive economy.

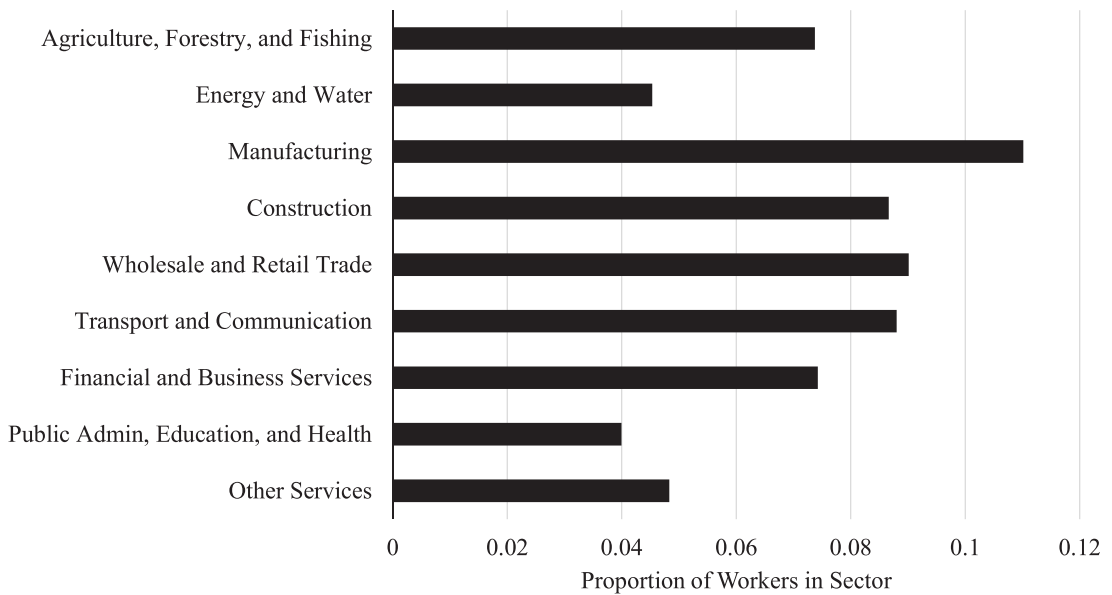
Expected Changes to Immigration Composition by Industry Post-Brexit

The impact of proposed changes to immigration can best be analyzed by examining the average required skill levels of employees within individual sectors. One of the main policy objectives outlined in the leaked documents is to cut the number of low-skilled immigrants entering the UK. Therefore, by conducting this analysis sector by sector, which sector will absorb the heaviest impact can be assessed.

According to the ONS,² jobs such as “corporate managers and directors,” “science, research, engineering and technology professionals,” “health professionals,” “teaching

²The ONS utilizes Standard Occupational Classification 2010 codes as the basis for defining the skill levels throughout their data.

Figure 4
EU Workers as Share of Overall Employment by Sector



Source: ONSa.

and educational professionals,” and “business, media, and public service professionals” are high skill. Any occupation other than these falls either into the middle-skill or low-skill levels, with the lowest-skilled classified as “elementary trades and related occupations” and “elementary administration and service occupations.” While the immigrant population spans all skills levels, a large portion does not fall into the highest skill tier. If workers are disaggregated by country of origin (UK, EU14, EU8, EU2, and non-EU) and skill level, 37% of EU14 nationals working in the UK occupy high-skilled jobs (Figure 3). Comparatively, only 8% of EU8 nationals work in jobs that require high skills. On the opposite side of the spectrum, EU8 nationals and EU2 nationals dominate the low-skilled and lower-middle-skilled jobs, with 31% of both EU8 and EU2 nationals working in jobs categorized as these levels (ONSa).

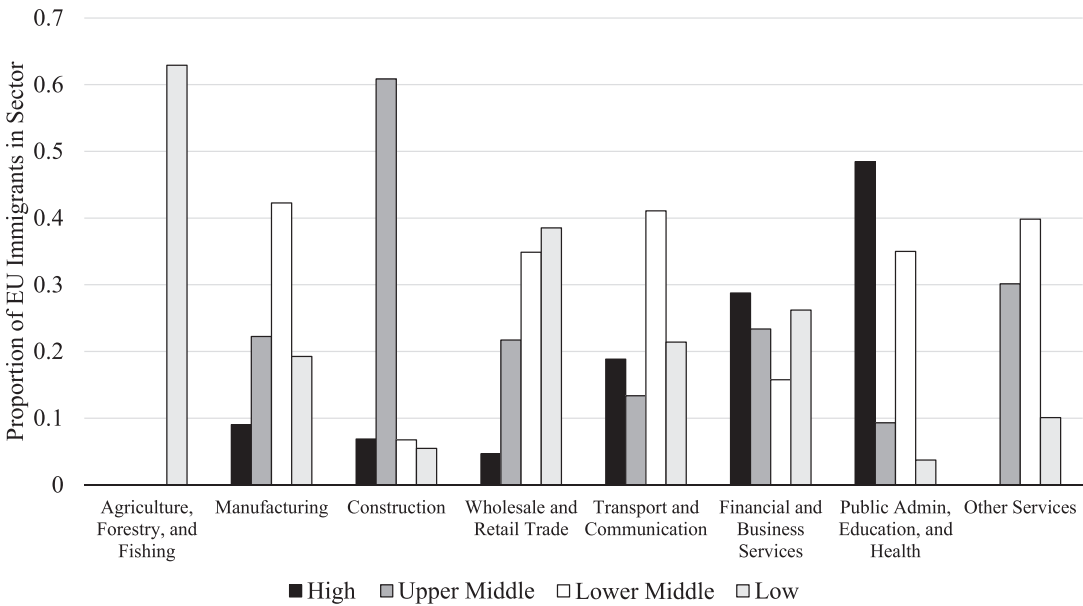
Breaking down the immigrant population by economic sector, immigrants tend to work in lower-level retail and food service jobs as well as construction, manufacturing, and financial and business services. Of the EU immigrant population in the UK in 2016, 24% were

employed in the wholesale and retail trade, hotels, and restaurants. An additional 18% of all EU immigrants were employed in financial and business services and 17% worked in public administration, education, and health. Turning to an alternate metric, the manufacturing industry has the highest proportion of workers from the EU, with 11% (Figure 4). Wholesale and retail trade is second, with 9% from the EU, followed by transport and communication with 8.8%. Thus, the proposed new immigration policies are likely to hurt manufacturing and wholesale and retail trade the most in terms of constricting available labor.

Combining the Annual Population Survey statistics for the EU14, EU8, EU2, and other EU immigrants, the most common skill level for EU immigrants entering the UK is “lower middle” at 31.95%, with “upper middle” at 23.43% and “low” close behind at 23.33%.

Dividing the population of EU immigrants in the UK by industry and skill level, 62.92% of EU immigrants in the agriculture, forestry, and fishing industry work in low-skilled jobs (Figure 5). Overall, the majority of the EU immigrants in the wholesale and retail trade

Figure 5
Skill Levels of EU Immigrants by Sector



Source: ONSa.

industry consists of low-skilled (38.58%) or lower-middle-skilled (34.87%) workers. As Figure 4 shows, 9% of employees in this industry are EU immigrants, meaning that in total 6.61% of all workers in this industry are lower-skilled EU immigrants. This group, although small, almost certainly will face significant immigration declines within the next few years. Similarly, the transportation and communication, manufacturing, and public administration, education, and health sectors also rely heavily on lower-skilled EU workers: 5.50% in transportation and communication, 6.78% in manufacturing, and 1.54% in public administration, education, and health.

Overall Economic Impact

It is well known that the UK economy is service based. In fact, 79% of GDP derives from service industries, whereas 14% comes from production industries and 1% from agriculture (Booth). Many of the industries identified previously are likely to suffer major setbacks from restrictions on lower-skilled EU immigrants who would have worked

in the service sector (transportation and communication, wholesale and retail trade, and public administration, education, and health). With service industries providing nearly four-fifths of the GDP, this could be extremely detrimental to the health of the economy.

A reduction in net migration to tens of thousands will inevitably upset the economy well beyond the impact of lower-skilled workers. The planned cuts to immigration are so large that it will not be possible to only target low-skilled immigrants. There also will be a need to cut high-skilled immigration, although to a lesser extent. In short, then, the diverse array of available evidence uniformly suggests that economic growth is likely to suffer a significant blow following the anticipated immigration reform.

Conclusion

The UK's decision to leave the EU came from a desire for self-preservation: UK citizens wanted more control over the UK, more control over who comes in and out of their country, and to improve their economy and

public services. These are all rational goals and make logical sense from the standpoint of a UK citizen who believes that the EU is holding the UK back from these opportunities.

But examining the facts and crunching the numbers paint a vastly different picture. Among the many different facets of the divorce bill that will come out of the Brexit proceedings, immigration reform may be one of the most vexing and conflicted. The new immigration policy formulated in the leaked document explicitly aims to take back control of the UK economy and untether it from the EU so it can thrive. Unfortunately,

the strict constraints on EU immigration—and low-skilled immigration in particular—will suppress the low-skilled worker supply. Factory workers, waitresses, bus drivers, baristas, and more are critical components of the economy. Because nearly 80% of the economy relies on the service industry, which in turn depends on EU immigrant low-skilled workers, a sudden void of these base workers will inescapably hinder national productivity. Paradoxically, the surprising milestone of Brexit, driven by aspirations of a freer, more affluent country, will likely result in a laggard economy and a less prosperous country.

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