

**tutor2u™**

Supporting Teachers: Inspiring Students

Economics Revision Focus: 2004

# A2 Economics

# Labour Market Migration

tutor2u™([www.tutor2u.net](http://www.tutor2u.net)) is the leading free online resource for Economics, Business Studies, ICT and Politics.

Don't forget to visit our [discussion boards](#) too as part of your Economics revision.



## Revision Focus on Labour Market Migration

The costs and benefits of labour migration has become a highly topical issue among economists and policy-makers over recent years. An increase in the rate of net migration can have significant effects on the labour markets of individual countries and wider macroeconomic effects on variables such as **economic growth, unemployment and inflation**. In this revision focus we consider some of the main factors that influence migration flows; we outline some of the **costs and benefits** of a rise in net migration (i.e. a net inflow of people into a country).

### Economic factors influencing migration decisions

There are many reasons why people choose to migrate:

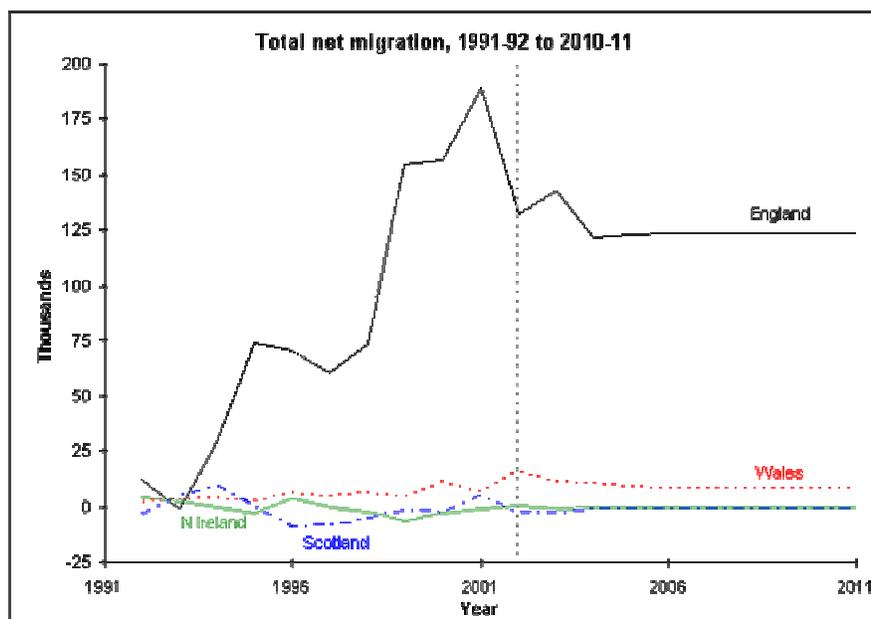
**Financial incentives:** Individuals may estimate the private costs and private benefits of moving from one country to another. The incentive to migrate is strongest when the expected increase in earnings exceeds the cost of relocation. In some countries there are significant differences in average wage levels that more than compensate for variations in the cost of living.

Estimates of **purchasing power parity** can be useful in establishing the real income gains from working in one country rather than another.

Financial incentives are also affected by the **tax and welfare** systems of different countries. Just as capital can move from one country to another seeking the highest post-tax expected rate of return, so workers may be induced to move because of variations in the **generosity of the welfare system** and differences in the **rates of direct income tax**.

**Non-financial reasons:** Other reasons for migrating, such as the opportunity to study in a foreign country, learn a new language, joining family members, or more generally improving living standards and seeking a better quality of life.

### Trends and forecasts for net migration for the UK



The chart opposite tracks migration flows for the UK since the early 1990s together with a projection for the next few years. The rate of inward migration has increased during the last decade and although the rate is forecast to settle down, the latest data suggests that migration will add around 130,000 a year to the UK population. The expansion of the EU with the entry of ten new countries will also increase migrant inflows albeit at a fairly modest rate. The UK Home Office estimates suggest that it could result in between 5,000 and 13,000 immigrants entering the United Kingdom each year.

In 2002:

1. 513,000 people migrated into Britain of which 95,000 were British people returning and 63,000 were migrants from other EU countries
2. 360,000 people migrated from Britain of whom 190,000 were British and 52,000 were other European Union nationals
3. Net migration into Britain was 153,400 people

### The economic costs and benefits of migration

“The economic effects of immigration depend not on population growth or density but on the characteristics of the immigrants themselves. While every mouth brings a pair of hands, these hands sometimes make more than they eat and sometimes less.”

“On balance, immigration usually produces economic benefits for the receiving country. Immigrants are more economically active than the native population; are paid less than natives with similar skills; are more energetic than natives; and more willing to take undesirable jobs, such as those with unsocial hours.”

*Adapted from an article by Professor John Kay in the Financial Times*

Does labour market migration create more of an economic burden for the host country? Or can it provide a valuable contribution to raising productivity, entrepreneurship and economic growth in the long term? There can be no definitive answer of course. What is certain is that migration will remain an important issue for the UK and for the European Union over the coming years. In our discussion below of the costs and benefits of migration we focus on legal immigration rather than the concerns that arise from the illegal movement and trafficking of workers from country to country.

### The benefits of migration:

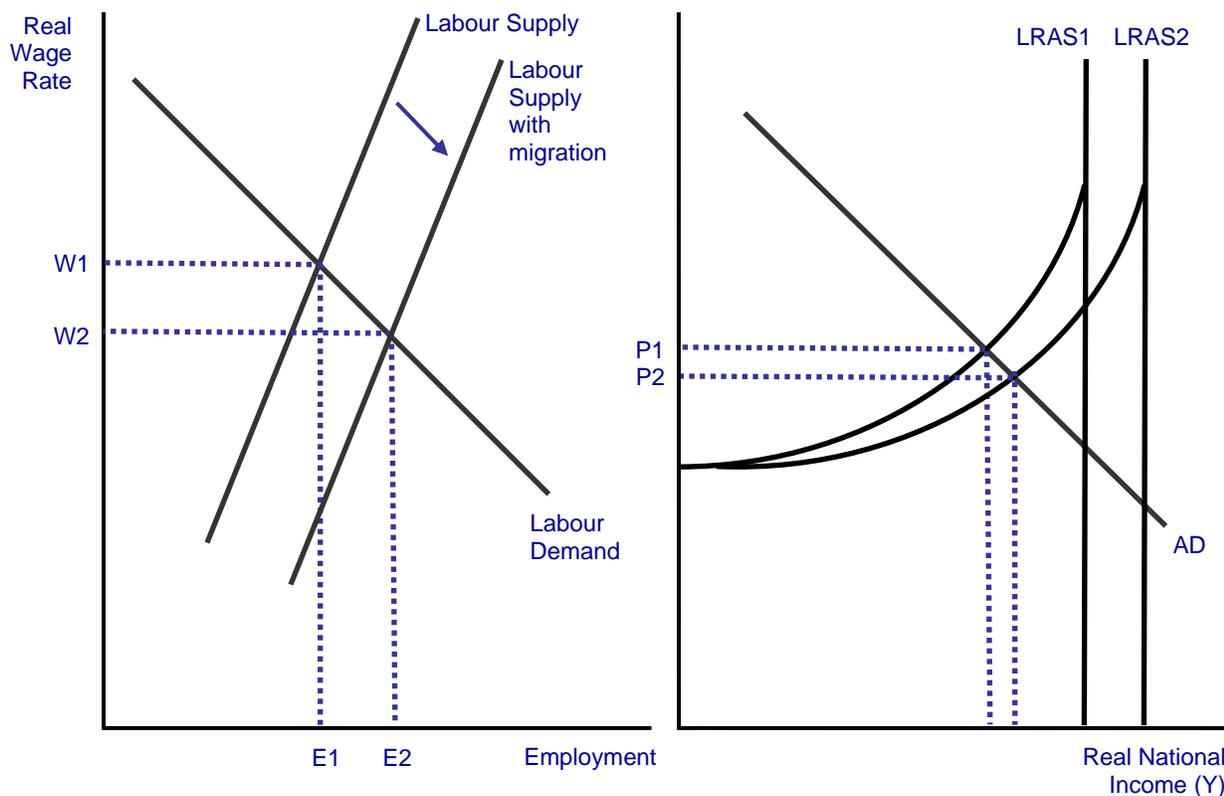
1. **An expansion of the labour supply** – migration can extend the pool of available labour for firms: for example, skilled migrants may alleviate shortages in sectors such as the NHS, agriculture, construction, computing industries and state education - allowing the government to meet targets for improving public services. Migrants tend to be young adults – so a rising trend of migration can help to increase the population of working age and also the flexibility of the labour market. Many migrants into the UK are highly skilled people, drawn particularly to the quaternary service sector, especially in finance, in London and South-east England.
2. **Reduced pressure on wage inflation** - an increase in labour supply from migration is likely to restrain wage growth in the short term, given the amount of labour that firms demand. This is shown in the diagram below. A slower rate of increase in wages has the effect of easing cost-push inflationary pressure which might then give the Bank of England more leeway to keep interest rates low. Immigrants are usually prepared to work for lower wages than domestic workers. This can mean lower costs of production for suppliers which can then feed through into lower retail prices for consumers.
3. **A fall in the NAIRU** - If migration effects are strong, it is plausible to argue that the non-accelerating inflation rate of unemployment might fall. Because when labour demand is very strong, whereas normally this could put upward pressure on wages, if labour supply can adjust flexibly to rising demand, then there is less risk of acceleration in wage and price inflation. However, we should be cautious about this idea – for there are always natural and institutional

barriers to the geographical mobility of labour. And the levels of migration we are seeing in the UK are not particularly large at the current time

4. **Aggregate demand effects**- economic migrants are likely to earn more than they spend contributing to the growth of the local or regional economy
5. **Entrepreneurship** – supporters of a more relaxed approach to migration claim that many of the migrants are younger and have the potential to be entrepreneurial in their approach – another potential supply-side gain for the economy
6. **Higher trend growth** - taken as a whole, a positive rate of migration can add both to short-term economic growth (via a rise in aggregate demand) and also a slightly faster trend rate of growth (which brings economic benefits in the long run). The UK Treasury has estimated that the economy might grow each year by an additional quarter of a percentage point—worth £2.5 billion—until 2006. That handy annual addition to GDP should also boost government tax revenues by about £1 billion every year. This assumes a net migration of between 160,000 – 180,000 per year

Strong inflows of labour into the economy can have the effect of increasing the labour supply – this puts downward pressure on real wages (for a given level of labour demand) e.g. through helping to relieve labour shortages in particular industries and occupations

If migration provides a boost to the labour supply and to average labour productivity, there is the prospect of an outward shift in a country's long run aggregate supply



### The costs of migration

We cannot rely on mass immigration to solve the problems arising from ageing of the population and alleged labour shortages. Mass immigration is not an effective solution to these problems. To the extent

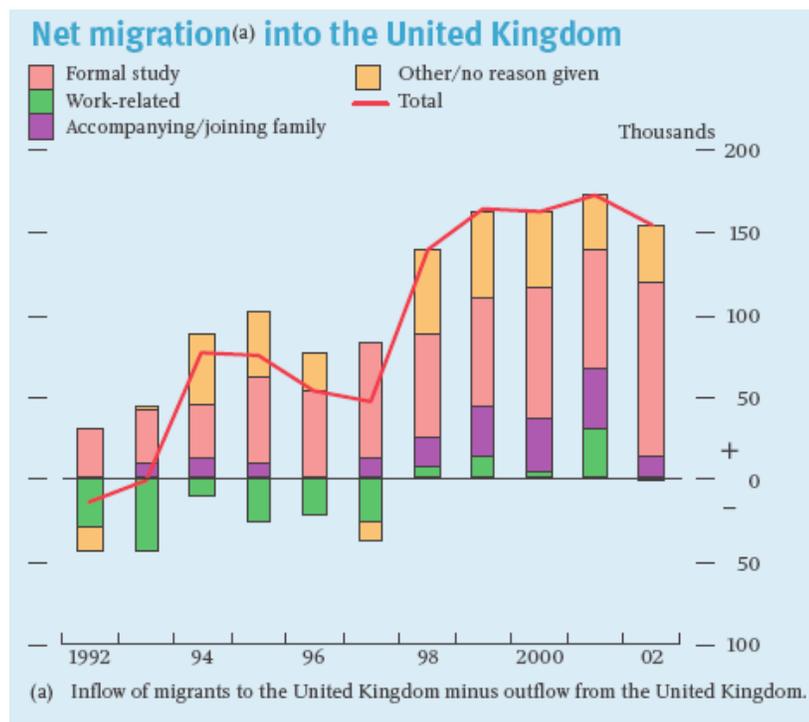
that they are real, such problems can only be effectively tackled by mobilizing the under-utilized talents and energies of the existing population. This does not mean that there is no economic benefit at all from immigration. It will always be in our collective interest to admit skilled and talented people. But this is happening already

*Adapted from a speech by Professor Bob Rowthorn, April 2004*

Opponents of labour migration highlight the potential costs of a growing inflow of new workers.

1. **Depressing the real wages of domestic workers** – e.g. an inflow of new workers will lead to an increased supply of low skilled workers and therefore drive down the equilibrium wage for domestic low-skilled employees
2. **Doubts about productivity effect:** Many immigrants, especially those from poorer countries, have a low educational level and are more likely to be unemployed or economically inactive than the domestic population.
3. **Increased pressure on the welfare state** (benefits, education, housing and health) – the taxpayer may eventually have to pay for the increased level of government spending needed to extend the economy's infrastructure
4. **Unemployment concerns:** There is a risk of higher unemployment if the skills profile of migrants does not match the demands of the growing industries in the economy
5. **Increased pressure on scarce resources:** The inflow of immigrants into an area may increase the demand for housing and push up the cost of living. To compensate their workforce many employers are likely to raise money wages

### Concluding comments



The longer term benefits and costs of increased labour migration are very hard to quantify and estimate. Much depends on

- The types of people who choose to migrate from one country to another
- The ease with which they assimilate into a new country and whether they find full-time employment
- The extent to which a rise in labour migration stimulates an increase in capital expenditure by firms and by government.
- Whether workers who come to the UK decide to stay in the longer term (this may involve members of their extended family joining them) or whether

they regard migration as essentially a temporary exercise (e.g. to gain qualifications, learn some English) before moving back to their country of origin.

The chart above is taken from a recent article on labour migration by the Bank of England. It suggests that the main reason for net migration into the UK is an influx of students into higher education – this process is expected to continue in future years, not least because students in the accession countries can now study in the UK under the freedoms of the EU single market.

***For comments on labour migration within the European Union, please refer to the revision focus on EU enlargement***