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The Economic Impact of Immigration

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Immigration is a difficult subject. It raises hard moral choices about whom should we let into the country; how long should we let them stay; by what means should we control entry, indeed, are we morally justified in seeking to regulate entry in the first place? In the modern world, regulating entry means deporting or otherwise excluding people whose only reason for wanting to be here is to earn an honest living. Moreover, hostility to such people is stoked up by sections of the press that exploit abuses of the welfare system to demonize whole categories of immigrant, such as asylum seekers. Faced with these unpleasant realities, many liberals respond by arguing that immigration is to our economic benefit. Instead of fearing immigration, the British people should welcome even more of it than we have at present. Immigration, they argue, helps to offset the ageing of our population caused by lower birth rates and the fact that people are living longer. It means lower taxes for the existing population because immigrants pay more taxes than they receive in government expenditure. Immigrants will do the jobs that locals will not do and allow economic growth to continue that would otherwise be brought to a standstill by labour shortage. Moreover, local workers should not be afraid because immigrants pose no threat to their jobs or their wages.

I understand why liberals respond in this way. Indeed, I find the whole system of immigration controls unpleasant and I share many of their moral concerns. But I think their economic arguments are either wrong or misleading. It is true that certain types of immigration, such as that of highly skilled professionals or dynamic entrepreneurs are to our economic advantage and may help to create extra jobs for the less skilled sections of our society. However, this is only one type of immigration. Many immigrants, especially those from poorer countries, have a low educational

¹ An updated version of a lecture delivered at an IntelligenceSquared debate in January 2004.

level and are more likely to be unemployed or economically inactive than the domestic population. And if unskilled immigrants do get jobs it may be the expense of existing workers. Large-scale immigration of unskilled people may be beneficial for urban elites who enjoy the benefits of cheap servants, restaurants and the like, but it is not to the economic advantage of those who have to compete with these immigrants. Moreover, unskilled, unemployed or economically inactive immigrants may be a significant tax burden on the local population, especially if they settle permanently and require public support and care in old age.

These are not just my views. They are very similar to those expressed by Professor Mark Kleinman in a survey that he wrote for a book recently produced by Heaven Crawley's outfit, the Institute for Public Policy Research.² His argues that some forms of immigration are beneficial to the local population, whilst others are costly. But taken as a whole these effects mostly cancel out. He concludes that "The economic impact of migration on the UK is positive but not very large. Hence the argument for immigration restriction on the basis of 'unsupportable' economic costs is wrong. But at the same time, there is not a compelling long-term case for increased immigration purely in terms of economic benefits". In general, I agree with this assessment, although I would question his conclusion the overall economic impact of immigration is small but positive. In my view it is small but negative. I also believe that large-scale immigration of unskilled workers would be more harmful to unskilled workers in this country than Kleinman allows. However, these are minor differences.

Kleinman also questions the need for a major expansion in temporary work-permits for unskilled migrant workers. He argues

² Mark Kleinman, "The Economic Impact of Labour Migration" in Sarah Spencer, *The Politics of Migration: Managing Opportunity, Conflict and Change*, London, Institute for Public Policy Research, 2003.

that such ‘guest-worker’ schemes will inevitably turn into permanent migration. There is already a large pool of unemployed and inactive workers in this country who could perform such jobs. Our first priority should be to employ these people. I agree with this view.

The reason for citing Kleinman at length is that the IPPR is a highly influential think-tank which is represented here tonight by Heaven Crawley, who is arguing that Britain needs even more immigration than there is at present. It is striking that an economist commissioned by the IPPR to write a survey on the subject does not believe that there is an economic need for large scale immigration and is critical of the government policy to expand greatly the number of work permits.

I shall consider the impact of immigration can be considered under four headings:

- Unemployment and Wages
- Government Finances
- Ageing
- Population

Unemployment and Wages

A report by Christian Dustmann and others for the Home Office is often cited as evidence that immigration does not harm local workers. In fact, the conclusions of this report are inconclusive³. The authors find that immigration leads to lower employment for local workers but also to higher money wages for those workers who keep their jobs. The finding that immigration leads to higher money wages is at first sight surprising, but in fact it makes sense in the British context. The inflow of immigrants into an area may

^{3 3} Christian Dustmann, Francesca Fabbri, Ian Preston, Jonathan Wadsworth, "The local labour market effects of immigration in the UK", Home Office Online Report 06/03. Tables 4.1 and 5.1.

increase the demand for housing and push up the cost of living. To compensate their workforce many employers are likely to raise money wages. If the resulting increase in wages is less than the original increase in the cost of living, local workers will be worse off even though they are being paid more. Thus, the finding that immigration leads to higher money wages is plausible, but it is not conclusive proof that immigration is to the benefit of local workers.

Dustmann and his colleagues point out that their estimates are unreliable, because they are subject to such a large margin of error. In the language of econometrics, these estimates are not statistically significant. This is not surprising, given the limitations in the data they are using. To find firmer evidence we must look to other countries. Dustmann and his colleagues cite a number of studies that suggest that immigration in other countries has had a small negative effect on the local workforce. More recent evidence suggests that this effect may be quite large.

In a large study completed about eighteen months ago, the eminent migration economist George Borjas from Harvard University estimates that immigration into the United States has led to unemployment amongst native high school dropouts and reduced their weekly earnings by around 20 percent⁴. An article in the June 2003 issue of the *Economic Journal*, covering the countries of the European Union, claims that on average the addition of 100 immigrants to the labour force leads eventually to the loss of 83 jobs for local workers⁵. This estimate seems implausibly high, although the evidence provided in the article does support the view that immigration reduces employment opportunities for local

⁴ George J. Borjas, *The Labour Demand Curve Is Downward Sloping: Reexamining the Impact of Immigration on the Labor Market*, Harvard University, November 2002, mimeo, p. 32. For an opposing view see James P. Smith and Barry Edmonston, editors, *The New Americans: Economic, Demographic and Fiscal Effects of Immigration*, Washington, DC, National Academy Press, 1997

⁵ J. D. Angrist and A. D. Kugler, "Protective or Counter-Productive? Labour Market Institutions and the Effect of Immigration on EU Natives", *Economic Journal*, vol. 113, no. 488, June 2003, p. F332.

workers. The effect is greatest in countries where local workers enjoy the most job protection. In such countries, employers cannot easily sack existing workers, but when filling new jobs they will choose immigrants, because they are easier to sack than native workers. The authors conclude that more labour-market “flexibility” would reduce unemployment amongst local workers. If employers could easily dismiss local workers they would have no reason to prefer immigrants. Thus, immigration leads to either unemployment or greater job insecurity for local workers. Either way, they lose and the employers gain. This, at least, is what the article implies.

The conclusion I draw from this literature is that large scale immigration of unskilled labour does harm the local workers who compete with them, possibly by a large amount. Moreover, the workers who are harmed are not simply those in the locality where the immigrants arrive. They may also be located in other parts of the country. For example, an unskilled worker living in Clydeside may not move South in search of work, because jobs in the South have been filled by immigrants or housing costs have been pushed up and wages down by immigration. It is the conventional wisdom that such knock on effects of immigration are negligible. However, a very recent study by Tim Hatton and Massimiliano Tani finds that foreign immigration into the South of Britain has led to significantly reduced migration into the South from elsewhere in the country⁶. If their finding is correct, we should not expect to see the harmful effects of immigration to show up only in the South. They will also show up in the depressed areas of Scotland, the North of England and other places which have a surplus of labour that is deterred from moving South by competition from foreign migrants.

⁶ T. Hatton and Tani, M., *Immigration and Inter-Regional Mobility in the UK, 1982-2000*, CEPR Working Paper, DP4061.

It is often said that immigrants are needed to do the jobs that locals will not do. This may be true in a few cases, but in general it is false. In most parts of the country there are relatively few unskilled immigrants and it is the locals who do most of the jobs which British workers supposedly will not do. The problem in the end boils down to wages and conditions. When employers in the South of the country say that they cannot get workers to perform menial tasks, what they often mean is that local workers will not accept, or stay in, jobs at the kind of wages and conditions that they are offering. In this case, the problem is not an absolute shortage of labour, but a shortage of cheap labour. The most effective way to raise the wages of low paid workers is to maintain an artificial shortage of labour so that employers have no option but to pay more. This is inconsistent with the mass importation of cheap labour from abroad.

Government Finances

When she was at the Home Office Barbara Roche, who is speaking here tonight, commissioned a report on the fiscal impact of immigration by Ceri Gott and Karl Johnston⁷.

They estimated that in the fiscal year 1999/2000 Britain's 5 million migrants paid in aggregate £2.5 billion more in taxes than they received in government expenditure. This estimate is widely used to prove that the domestic population benefits from large-scale immigration and that we should want even more of it. Such a conclusion is unwarranted. As the authors themselves point out, there are many conceptual and practical difficulties in determining what the net fiscal contribution of the immigrant population is to the rest of the society. Depending on how it is measured, it can be made to look either positive or negative. The authors obtain a positive number, but using the information provided in their own

⁷ Ceri Gott and Karl Johnston, (2002), *The Migrant Population in the UK: Fiscal Effects*, RDS

appendices together with other plausible adjustments one can easily make this negative.

- *Unusual year.* The estimate refers to 1999/2000. That was a year when the government had a fiscal surplus and even the non-immigrant population paid more taxes than they received in government expenditure. A correction for this would knock £1.3 billion off the estimate⁸.
- *Corporation tax.* Part of the tax revenue imputed to immigrants is in fact corporation tax paid by shareholders resident abroad. A correction for this would knock off another £ 0.8 billion⁹.

When these two corrections are made, the net contribution of £2.5 billion by immigrants shrinks to a mere £0.4 billion in a normal year¹⁰. But this is not the end of the story. Any assessment of the fiscal contribution of migrants should take into account the cost of administering the immigration programme and providing for the special needs of immigrants. For example, in the fiscal year 1999/2000, government expenditure on “immigration and citizenship” was £797 million and two years later it had risen to £1631 million¹¹. There are also the tax revenues which are lost and the welfare expenditures incurred if competition from immigrants leads to job losses or lower wages amongst local workers. The conventional wisdom in liberal circles is that such job losses are negligible, but as I have argued above this may be wrong. There is also congestion to consider. Immigration is contributing to a rapid growth of population in the Southern England, and the resulting

⁸ In 1999/00 there was an overall budget surplus of £15.3 billion. Allocating this total according to their share in population yields £1.3 billion for migrants (8.4% of the total) and £14.0 billion for non-migrants.

⁹ In 1999/00 the total amount of corporation tax was £34.3 billion. Gott and Johnson (p. 31) imply that at least 28% (= £ 9.6 billion) of this was indirectly a tax on overseas shareholders and should not be included as part of the tax paid by UK residents. Allocating this total according to their share in the population yields £0.8 billion for migrants (8.4% of the total) and £8.8 billion for non-migrants.

¹⁰ Note that Gott & Johnson discuss both of these corrections in the course of their paper, but ignore them in their final conclusions.

¹¹ Table 3.6 in 'Public Expenditure: Statistical Analyses 2002-2003, HMSO.

congestion both hampers production and is costly to manage. Although difficult to measure this must be harmful to government finances.

On the positive side of the balance sheet, we could make the picture more favourable to immigrants by using a different convention for allocating certain central government expenditures such as defence. We could also take into account the fact that the immigration of skilled workers or entrepreneurs may create new or better paid jobs for local workers, thereby increasing the ability of the latter to pay taxes and reducing their dependence on welfare benefits. However, it is difficult to believe that these positive adjustments would offset the long list of negative adjustments given above. I conclude that the widely cited figure of £2.5 billion for the net fiscal contribution of immigrants is too big and the true figure could well be negative, though probably not by very much.

Even if we accept the figure of £2.5 billion at face value, this should be seen in perspective. It is equivalent to 0.3% of GDP, 0.4 % of individual consumption or 0.8% of total government expenditure. These are not very large amounts. Given the uncertainties involved and the small size of any likely estimate, the only thing we can really say is that past immigration into this country has not in aggregate led to a significant fiscal burden on the rest of society, nor has it provided a significant surplus. It has been broadly neutral.

This is also the conclusion which most studies in other countries reach. When all types of migrant are included, immigration normally has only a minor fiscal effect. Skilled migrants, who come disproportionately, though not exclusively, from other developed countries, typically make a large positive contribution, whereas other migrants, who come mainly from less developed countries, cost more on average in terms of government

expenditure than they pay in taxes. In most countries, the fiscal surplus of skilled migrants roughly offsets the fiscal deficit of other migrants, so the net impact of migrants as a whole on the government's fiscal balance is roughly zero.

The implications of this for public policy are open to debate. Perhaps we should take more skilled immigrants and fewer other types of migrant? This is what many migration economists suggest, but personally I have moral qualms. Many of the extra skilled workers would come from less developed countries which need them more than we do. There has already been an outcry about us recruiting medical staff from poorer countries. Should we step up this type of policy with a view to improving the government's fiscal balance? Surely not!

Ageing

We are often told that Britain is ageing and we need to import young people to support us in old age - "To pay for our pensions" - as it is often said.

To the extent that individuals have private or fully funded government pensions this is nonsense. Such pension funds can invest their money abroad where the financial return is unaffected by the state of the labour market in this country. The same is true of health treatment in cases where this is financed from the returns on private investment.

If health and pensions are financed by taxation it is theoretically correct that we could bring in young immigrants to work here and pay some of the taxes needed to support us. Moreover, given their cultural background, many of these immigrants would have relatively large families, and as the immigrant children grew up they would also start paying taxes. Unfortunately, this argument ignores two things. Like the rest of us, immigrants get old and if they remain in the country they will require support just like we

do. In addition, the fertility of immigrants normally converges to that of the host society after a couple of generations. Certain types of immigrant may have large families now, but most of their descendents will not do so in the future. As this cohort ages and their children begin to behave like the local population, a new wave of immigrants will be required to keep the country young. As the rejuvenating effect of this wave of immigration fades, yet another wave of immigrants will be required, and so on ad infinitum. A country seeking to retain its youth through immigration is like the 16th century Princess Elizabeth Bartory of Transylvania, who sought to keep herself young by bathing in the blood of young maidens. Each bath appeared to restore her youth for a time, but the effect would soon wear off and she would then require another bath, and then another bath, and so on ad infinitum. Moreover, the scale of permanent immigration required to keep the population young is truly massive and will eventually lead to a totally unsustainable explosion in national population. Permanent immigration on any feasible scale has only a marginal long-run effect on the age structure of a country.

Projections by the Government Actuary's Department indicate that ageing of the British population will lead to a sharp fall in the *potential* support ratio (aged 16-64/aged 65+) over the next thirty years, after which it will stabilise at a much lower level than at present¹². Projections also show the implications of different levels of immigration. The striking thing is how little difference they make to the *potential* support ratio. There is hardly any difference at all between the high and low migration scenarios. High migration means a slightly higher ratio of 16-64 year olds to the over 65s, but the difference is very small. Moreover, the potential support ratio is rather misleading. What matters is the *actual* support ratio. This ratio measures how many people there are in employment to support each person without a job. This

¹² C. Shaw, "United Kingdom Population Trends in the 21st Century", *Population Trends*, no 103, Spring 2001.

depends not just on the age structure, but also on the proportion of people in each age group who are employed. Permanent immigrants, especially the less skilled, are on average less likely to have a job than the existing population. When this is taken into account, it seems likely that the slight rejuvenating effect of increased permanent immigration could be more than cancelled out by the higher than average propensity of permanent immigrants to be workless. As a result, the actual support ratio might even get worse.

One way that immigration can significantly affect the age structure of a country is through the use of temporary migrants. Such workers come into a country when they are young, pay their taxes and leave before they become old enough to become a fiscal burden. However, temporary worker programmes are difficult to run, especially in a democracy where there are justified qualms about the morality of forcing people to leave after many years here.

Permanent immigration means a bigger population than would otherwise be the case, but on any feasible scale it has only a minor effect on long-run age structure. A large scale programme of temporary migration is not feasible for moral and political reasons. We must learn to accept ageing and manage it.

Population

It is often said that we need a bigger population to support a bigger home market, or a bigger military machine. The size of the home market is irrelevant in a trading economy like ours. If our firms do not have enough consumers at home they can export what they produce. Indeed, most of them do this on a large scale already. The military advantage to us of a larger population is marginal. We will never be more than a minor military power – what matters is quality not quantity. Our safety depends more on the alliances we forge than on the size of our population.

What about population growth? Is this economically desirable? Does population growth lead to a faster growth in per capita income? The empirical evidence suggests not. There is no statistical correlation between growth in per capita income and population in advanced countries, and the relationship is negative in poorer countries.

What about population decline? Are we facing the prospect of population collapse as some other countries are allegedly facing? The answer is no. The Government Actuary's Department has made long-range projections of the UK population. These suggest that in the complete absence of immigration, the population of this country would shrink from 60 million at present to around 49 million in 2070¹³. This gentle decline would take us back to the population this country had in 1950 and a full 10 million more than in 1900. Most people would probably welcome such a development on environmental grounds.

Conclusion

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. We also admit a large number of other migrants, such as spouses and asylum seekers. People who say that this country needs more immigration really mean that we should encourage the mass immigration of unskilled workers. This would be of negligible benefit to the local population as a whole. It would also

¹³ The Government Actuary's Department 2000-based 'natural change' variant projection which gives 48.9 million for the UK in 2070 (website).

harm the weaker sections of our society who would have to compete with such immigrants - including the more disadvantaged members of our existing ethnic minorities.