

The impact of the recent migration from Eastern Europe on the UK economy

In this speech,⁽¹⁾ Professor David Blanchflower, member of the Monetary Policy Committee, discusses the origins of the most recent influx of migrants to the United Kingdom. He also examines why the East of England has received a disproportionate number of these new workers and why employers choose to hire them. He concludes by looking at the consequences of migration on the UK economy in general, arguing that recent immigration has raised the supply potential of the economy by more than demand, and thereby acted to reduce inflationary pressures.

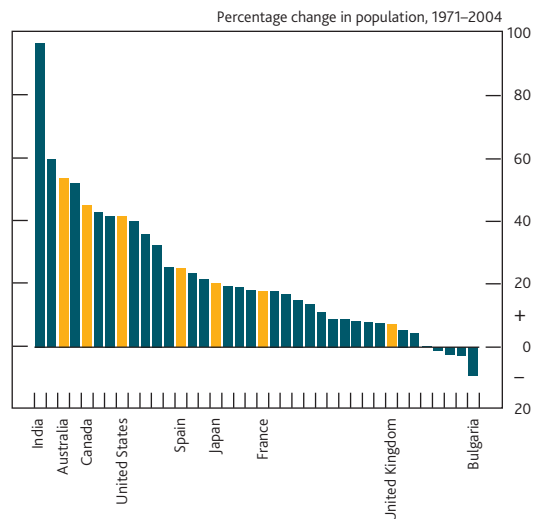
Immigration has been a growing issue for the UK economy in recent years, in more ways than one. The number of immigrants coming to the United Kingdom has risen sharply since the turn of the millennium, and the East of England appears to have been one of the most significant recipients of these migrants. And with Bulgaria and Romania having joined the EU on Monday (1 January 2007) it seems a pertinent time to be doing a speech on the subject. So I am very pleased to be here in Cambridge today to talk to you about my own feelings on the implications of migration for the UK economy, but also to learn your thoughts.

I have been thinking about issues associated with migration since joining the MPC back in April, and as background to this speech, I have published a paper this morning on the subject written jointly with two of my colleagues at the Bank, Chris Shadforth and Jumana Saleheen. The Bank has been at the forefront of thinking about immigration for some time — even hosting a conference on the subject in early 2006 — and this paper builds on what we already know, or what we think we already know! I say that because migration is very difficult to understand. What drives people to want to migrate? Who are these migrants? Why do they choose the United Kingdom? Why do they choose the East of England for that matter? How many have come? How many have returned home — perhaps to return in the future? What does it all mean for my colleagues and me on the MPC when we are setting interest rates? I hope to briefly guide you through some of these issues today, giving a flavour to some of the answers, but also asking for your help in answering a few of the outstanding questions.

Most of what I am going to talk about today reflects the national picture — since we set a national interest rate. But I am also going to talk briefly about a number of intriguing labour market developments that have occurred here in the East of England over the past twelve months.

Population growth in the United Kingdom as a whole has been remarkably low by international standards over the past 35 years (**Chart 1**). Between 1971 and 2004, the UK population grew by just 7%, less than most of the other EU countries, Australia, Canada, Japan, New Zealand and the United States. Moreover, the scale of net inward migration to the United Kingdom has been much lower than in most other EU countries until recently, and even now remains below the levels of both Italy and Spain.

Chart 1 Population growth, 1971–2004^(a)



Sources: Eurostat, *Health Statistics Quarterly*, Vol. 32, Winter 2006 and *US Statistical Abstract* 2006.

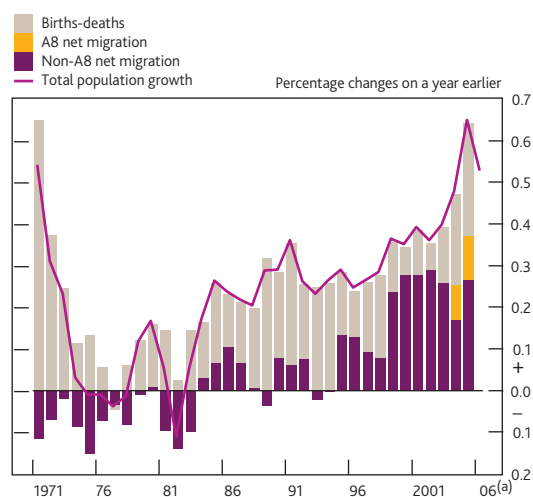
(a) The chart shows the ordering of population growth between 1971 and 2004 of the 38 countries listed in Table 2 of the full paper.

However, the UK population has grown at a faster pace since the turn of the millennium. This recent growth has been driven primarily by changes in net migration (**Chart 2**). Both the

(1) Delivered at a lunch with members of the Cambridgeshire Chambers of Commerce on 4 January 2007. The full version of this speech can be found on the Bank's website at www.bankofengland.co.uk/publications/speeches/2007/speech297.pdf.

inflow and outflow rates have risen, but the inflow rate has risen more rapidly, with an influx of migrants from eight East European countries — known as the Accession 8, or A8 for brevity (the Czech Republic; Estonia; Hungary; Latvia; Lithuania; Poland; Slovakia; and Slovenia). As you may have gathered from press coverage, the numerical flow has been particularly large from Poland, but as a proportion of the population, the flow has been especially dramatic from Lithuania and Latvia. Approximately 1.6% of the home population of Lithuania and 1.25% for Latvia have come to the United Kingdom in the past two years according to one data source, compared with 0.8% from Poland and 0.2% from Hungary.

Chart 2 Annual UK population growth, based on official estimates of migration



(a) Official disaggregated data are not yet available for 2006.

More generally, it appears that the propensity to migrate to the United Kingdom is higher the lower is GDP per capita in each of the A8 countries. So for example, we find that countries with the lowest GDP per head, such as Lithuania at 2,500 euros, are more likely to be registered on the UK Worker Registration Scheme (WRS) than those from countries with higher GDP, such as Slovenia, at 11,400 euros. The propensity to migrate is also negatively correlated with levels of life satisfaction or happiness, and Eastern European countries are well known to have low levels of happiness.

The increase in the net migration flow actually predates the influx of A8 migrants, reflecting a steady rise in the number of immigrants to the United Kingdom from Asia and the Middle East too. It is expected that there will be a further inflow from Romania and Bulgaria who joined the EU on Monday (1 January 2006), although early press coverage suggests that the restrictions the UK Government put in place on their ability to work in this country has stymied any mass migration. Indeed, some of the coverage suggests that individuals from these countries are keener to move to Spain

or Italy than the United Kingdom. It remains uncertain how many will come from these countries going forward, but it will obviously depend on which other EU countries open their borders and what job opportunities are available to them.

Only the United Kingdom, Ireland and Sweden allowed workers from the A8 complete access to their labour markets when they joined the EU in May 2004. Finland, Greece, Portugal and Spain subsequently opened their labour markets to these workers on 1 May 2006, while Italy followed in late July 2006. Five other countries (Belgium, Denmark, France, Luxembourg and the Netherlands) alleviated restrictions in 2006, and all restrictions have to be lifted within seven years of accession. As such, it is uncertain going forward whether the flows to the United Kingdom will remain as large as they have been given the other options that are now becoming available to migrants.

At the outset, it does need to be stressed, however, that the exact number of A8 migrants that has come to the United Kingdom to work thus far is to some extent uncertain. In part, this reflects the fact that there is no single database or record for nationals that have come from the A8 countries to the United Kingdom. However, there are a number of sources of information that can help us estimate how many migrants from the A8 countries might have come.

- 1 The **Worker Registration Scheme (WRS)**. Migrants from the A8 are obliged to register on the Home Office administered WRS if they are employed in the United Kingdom for a month or more. Workers who are self-employed do not need to register and are thus not included in these figures.
- 2 The **International Passenger Survey (IPS)**, which is a voluntary survey of individuals passing through the main UK air and sea ports and the Channel Tunnel.
- 3 **National Insurance Numbers (NINo)** that, as you all know, are required for employment/self-employment purposes or to claim benefits and tax credits.
- 4 The **Labour Force Survey (LFS)**, which is a quarterly survey of individuals living at private addresses, student halls of residence and health facilities.

The number of A8 migrants entering the United Kingdom since accession appears somewhat uncertain given these four data sources as they give quite a range of estimates. But the different sources vary in their coverage, both in terms of the migrants captured — including definitional differences — and the periods of observation. Following adjustment to ensure they cover the same period, the number of NINo applications and number of WRS applicants is broadly comparable at around 500,000.

The LFS and IPS data are much lower than these, but again comparable with one another. The remaining differences between the estimates reflect the groups of individuals covered and definitions employed. The LFS and IPS data are designed to capture only those migrants who stay in the country for an extended period of time — more than six months for the LFS and twelve months for the IPS. In contrast, the NINo and WRS capture all migrants, including those that might return home relatively quickly — or in some sense commute to the United Kingdom for work.

Having reconciled the differences as far as possible, there appears to be consistent evidence from the WRS and NINo applications that approximately 500,000 workers from the A8 countries had come to work in the United Kingdom between May 2004 and late 2006. It is, however, unclear as to how many of them are working in the United Kingdom at any one time, since many of them may have only been here for short time periods before returning home — maybe as many as a half based on LFS and IPS estimates. I suspect that a number of them have been employed in seasonal work, just as is the case of many Mexicans in the United States who come to pick crops in the Central Valley of California before returning home and then returning the next picking season.

To date, the East of England appears to have received a disproportionate number of the A8 migrants arriving in this country. One source — the WRS — which records the number of employees that have come to the United Kingdom, suggests that a total of 73,035 A8 workers have arrived in the East of England since accession — or 15.0% of all A8 migrants who have come to the United Kingdom, more than any other region — London is the next with 13.1%. That compares with a population in the East of England a shade less than 10% of the United Kingdom's.

The attraction of the East of England likely reflects the industrial composition of the region, which is skewed towards those industries in which we know A8 migrants tend to specialise: agriculture, business and administration (whereby we mean temporary agency work) and construction. **Chart 3** shows the importance of these industries in the East as a proportion of gross value added. **Chart 4** shows their importance in registrations under the WRS.

It also is likely that the East of England's booming labour market has acted to attract migrants, although that picture has changed somewhat over the past twelve months or so. The labour market here has declined more rapidly over the past twelve months than nationally on a number of measures. Maybe these labour market changes have had something to do with migration? Are they a cause or an effect? The answer is unclear, but probably a little of both. Given that the data on migration at a national level are uncertain, you can imagine how difficult it is to try and

Chart 3 East of England share of UK gross value added

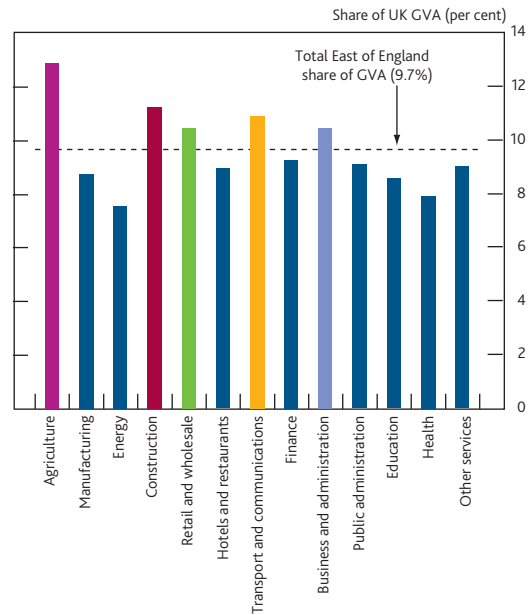
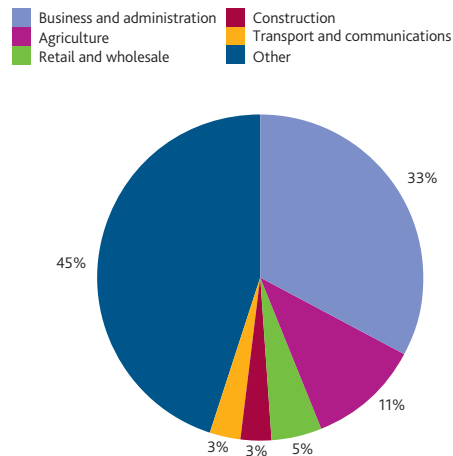


Chart 4 Distribution of total UK Worker Registration Scheme applications by industry



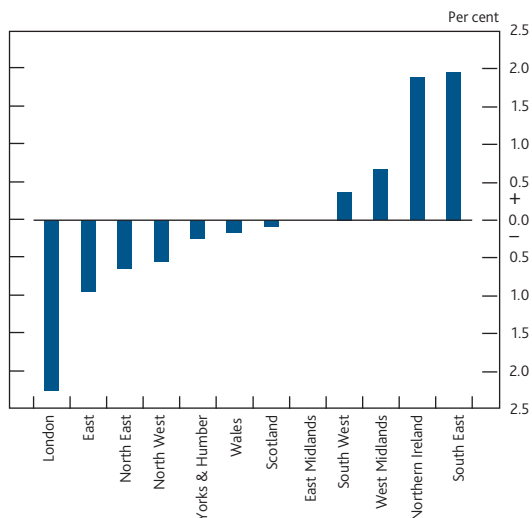
Source: *Accession Monitoring Report*, May 2004–September 2006.

disaggregate the data and tell stories at a regional level. We have had a go though!

It appears that while the total number of immigrants — including A8 immigrants — has continued to increase, the share of new immigrants settling in the East — those that have arrived in the past two years — has recently fallen. **Chart 5** shows the change in the share of new immigrants going to each region. The fact that the East is negative means that a smaller share of immigrants settled here in 2006, compared to 2005.

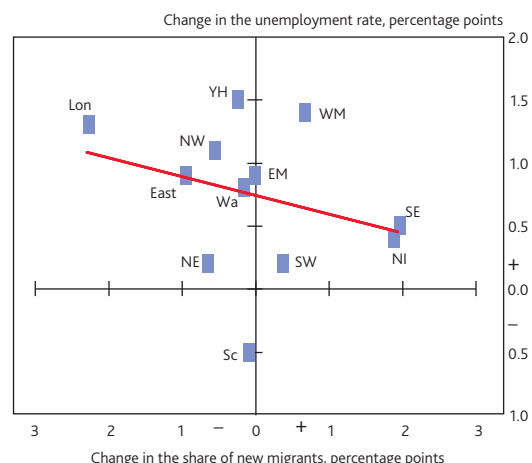
The other regions that have seen a falling share of migrants are London, the North East, the North West, Yorkshire and Humber and Wales: **Chart 6** shows that four (Y&H, NE & London) out of these six regions have also seen some of the

Chart 5 Change in the share of new immigrants going to each region (2006 less 2005)



Sources: Labour Force Survey microdata and ONS.

Chart 6 Change in regional unemployment rates and immigration (2006 less 2005)

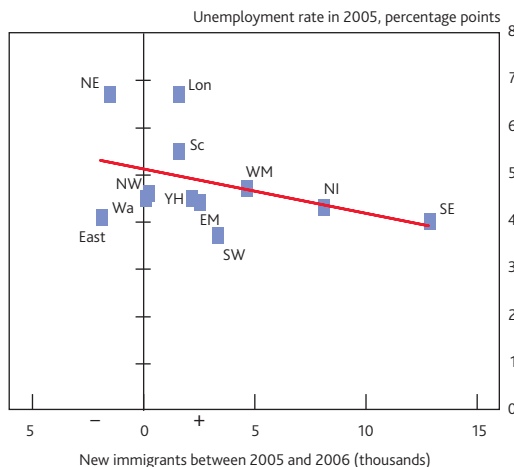


Sources: Labour Force Survey microdata and ONS.

largest increases in their unemployment rates, including the East. So **Chart 7** shows the opposite of what we might have expected; regions with the biggest increases in immigration tend to have had the lowest unemployment rates. And this is consistent with the possibility that foreign workers are attracted to those regions where the unemployment rate is the lowest and opportunities the greatest.

So, we might conclude that while the labour market in the East was booming migration to the region was high, but now other regions appear to be attracting a greater share of the new arrivals. That being said, the changing patterns of employment in the East might reflect an increased reliance on migrant labour, since A8 migrants tend to work disproportionately in temporary jobs or be self-employed. But why place a greater reliance on immigrant labour?

Chart 7 Regional unemployment rates in 2005 and the change in immigration (2006 less 2005)



Sources: Labour Force Survey microdata and ONS.

In a recent survey, some of the Bank's Agents' contacts suggested that A8 workers are more productive, more likely to show up on time and take fewer sick days than their domestic counterparts. This is consistent with the findings of a Home Office study on the use of migrant labour that concluded as follows.

'Employers cited advantages of migrant workers in terms of their general attitude and work ethic. They tended to be more motivated, reliable and committed than domestic workers. For example, migrants were said to be more likely to: demonstrate lower turnover and absenteeism; be prepared to work longer and flexible hours; be satisfied with their duties and hours of work; and work harder in terms of productivity and speed. In the view of some employers, the more favourable work ethic of migrant workers encouraged domestic workers to work harder.'

So what impact have these A8 migrants had on the UK economy? The empirical literature from around the world suggests little evidence that immigrants impact negatively on native outcomes including wages, employment and unemployment. The finding is of a small, yet significant downward effect on wages, but no impact on employment or unemployment. Work done by the Department for Work and Pensions confirms this result for the United Kingdom, suggesting that A8 migrants have had no significant impact on the claimant count. Recent work by a number of other authors for the United Kingdom is also consistent with this view.

The overall impact of immigration, including immigration from the A8 countries, on inflation and growth is on its own not clear-cut — there is no automatic rule of thumb that we can look to in order to determine the impact on the economy. This is because immigrants are both consumers and workers/producers, and so immigration affects both aggregate

demand and aggregate supply. And it is the balance between demand and supply (sometimes called the output gap) that determines inflation. So my colleagues and me on the MPC need to take a judgement about whether immigration has added more to supply or to demand in recent years. I'll briefly look at each of these in turn.

In thinking about the supply potential of the economy, most people would probably agree that extra (immigrant) workers in the economy would raise the supply potential of the economy. But the extent to which aggregate supply increases will depend on the economic characteristics of immigrants relative to native workers. Immigration of higher-skilled (or more productive) workers could temporarily raise the domestic rate of productivity growth. Furthermore, immigrant labour could lower the natural rate of unemployment — the rate of unemployment that would exist in the absence of cyclical unemployment — by filling skill gaps or by tempering wage demands, as wage bargainers become aware that they can be replaced more easily than in the past.

In support of the latter argument, the OECD *Economic Outlook* (2006) notes that 'international as well as UK evidence suggests [that] immigration can serve to make the labour market as a whole more fluid and wages less sensitive to demand fluctuations'.

In thinking about aggregate demand, most people would agree that immigrants are extra consumers and that they raise aggregate consumption demand. It is likely that immigrants spend a lower fraction of their income when compared to domestic workers because they remit part of their earnings to their home countries. If immigrants spend a lower fraction of their income in the United Kingdom — perhaps because they send remittances back home or spend less on durable goods

while temporarily resident in the United Kingdom — this would, on its own, suggest that immigrants raise demand by less than they raise supply. But aggregate demand might also rise because of increased investment.

The theoretical argument here is that firms require both labour and capital to produce their output. Immigration gives them more labour, and firms may wish to supplement this with more capital. But the extent to which investment rises, and how quickly, will depend on the skills of immigrants and the technologies of firms. If firms are able to substitute between labour and capital then there may be a smaller impact on investment than might otherwise be the case.

In summary, it seems that recent A8 immigration has acted to reduce the natural rate of unemployment in the United Kingdom and raised the supply potential of the economy. But it also seems that recent immigration is likely to have raised potential supply by more than it has raised demand, and thereby has acted to reduce inflationary pressures. This argument holds for three reasons. First, the consumption behaviour of native workers may have been affected by the increased 'fear' of unemployment resulting from a more flexible labour market. Second, the recycling of remitted funds back to the United Kingdom is unlikely to be perfect. Third, firms may be able to substitute between capital and labour, offsetting some of the potential for investment spending to rise.

Going forward, and with the accession of Romania and Bulgaria, immigration is likely to remain an issue of enormous interest to both the Monetary Policy Committee and you as business leaders. I hope what I have said today was of interest, and I'm keen to learn what you think.