

RIETI-CEPR Symposium

Brexit:

On the future of the UK and the global economy

Handout



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November 7, 2016

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Brexit and the UK labor market

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November 2016

EU membership

- Direct effects on the UK labour market via free movement of labor and the contribution of immigration to GDP, the fiscal budget and productivity.
- Indirect effects via the impact of trade flows and foreign direct investment on aggregate economic activity.

First visible effect of Brexit vote: Increased uncertainty

- Clear signals of a hiring freeze shortly after the referendum outcome became known.
- In the week following the vote, online job ads fell by nearly a half – from nearly 1.5 million to about 800,000 (source: www.cebglobal.com).
- This drop is far outside normal fluctuations in online job ads, which are typically in the range of 5-10%.
- According to the Confederation of British Industry, business confidence has fallen to a record low since the peak of the financial crisis in 2009.
- The first survey of the UK private sector carried out after the referendum (Markit/CIPS purchasing managers' index) showed signs of the sharpest downturn in business activity since 2009, especially in the service sector.

Medium term impacts

- In the medium term, effects of Brexit on jobs and wages will be determined by the deals negotiated between the UK and other countries on international trade and the movement of labor.
- Key trade-off: between free trade and controls on labor movements (with some nuances in between)
- If the UK intends to remain a member of the European Economic Area and retain access to the single market, it seems it has to accept free movement of labor to and from the EU, as do other countries in the European Free Trade Area.
- Only weaker trade relationships, with higher transaction costs, would enable the UK to retain border control on EU immigration in a way similar to how non-EU immigration is restricted.

Where's the tradeoff?

- EU is UK's largest trade partner: EU member countries account for about half of UK trade flows
- Losing access to the single market would inevitably damage the UK economy.
- In an optimistic scenario in which the UK remains a member of the EEA, it would suffer a 1.3% decline in GDP per head, mostly resulting from the impact of non-tariff trade barriers on trade flows.
- But in a pessimistic scenario in which the UK leaves the EEA and trade between the UK and the EU is governed by World Trade Organization rules, the higher increase in trade costs would induce a fall in GDP per head of about 2.6%.
- To be added to this is the resulting fall in foreign direct investment, which is estimated to produce an even stronger decline in UK GDP than the increase in trade costs.

[Source: CEP-LSE Brexit Analysis - Dhingra et al, 2016a,b]

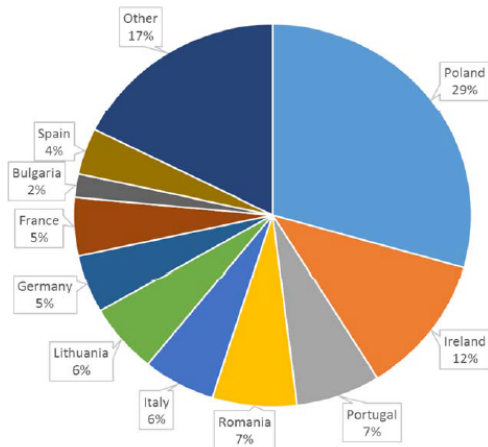
Is it worth it?

- Is it economically worthwhile to bear these costs in order to retain controls on immigration from the EU?
- To understand the potential effects of controls on EU migration, one needs to take stock of the current facts

A recent picture of EU migration into the UK

- EU migration has represented the bulk of the recent growth in the share of foreign-born population in the UK, especially after the EU enlargement of 2004
- EU immigrants were about 3.3m in 2015, up from 0.9m in 2005
- They represent 6.3% of the working age population..
- .. and 35% of all immigrants, mostly from Poland and Ireland

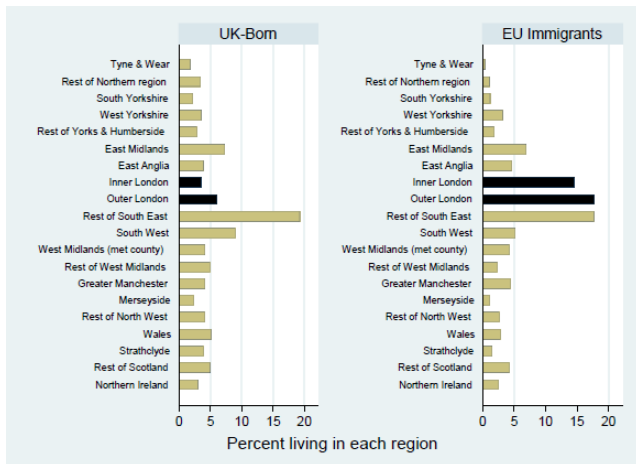
Where do EU migrants come from



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

Where do EU immigrants live

A third of EU nationals live in London (against 11% of UK natives):



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

How educated are EU immigrants

Age finished education	UK-Born	EU immigrants	A8 immigrants	All immigrants
High (21 or older)	23%	43%	36%	45%
Medium (17-20)	33%	42%	55%	36%
Low (16 or under)	44%	15%	9%	19%
All	100%	100%	100%	100%

[Source: CEP Brexit Analysis - Wadsworth et al 2016]

What do EU immigrants do

	UK-born	EU immigrants	A8	All immigrants
<i>% of whom:</i>				
Employed	72.5%	78.2%	81.9%	69.9%
Unemployed	3.3%	3.2%	2.65%	4.2%
Student	7.7%	7.1%	5.1%	7.6%
Inactive	16.5%	11.6%	10.5%	18.3%

[Source: CEP Brexit Analysis - Wadsworth et al 2016]

The impact of migration on natives

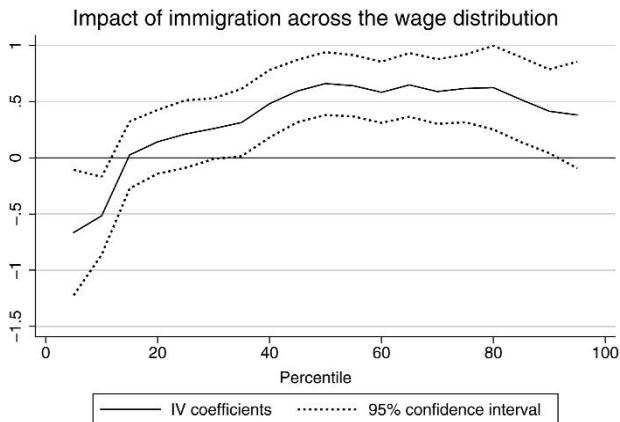
- Migration increases the number of people looking for work: does this imply that UK workers must be harmed by increased competition for jobs?
- Short answer is no. Should not believe in “lump of labour fallacy”.
- There would be harm only if the total number of jobs is fixed and if all immigrants were going was competing for jobs.
- But immigrants also consume local services and goods, improving job prospects of those who produce those goods and services.
- Migration raises the population, like a rise in the birth rate or a fall in the death rate. Over past 100 years, the UK population has grown by 50% but the unemployment rate has not trended upward.
- How about wages? Impact isn't necessarily negative. Alongside the increased demand via rising population, labor mobility allows countries to specialize production in what they are best at. Firms change the mix of their products to account for the new skills available.

Evidence on impact of migration on UK natives

- Existing research on the impact of foreign immigration to the UK has detected no negative effects on average wages of natives
- Manacorda et al (2012) partition UK native population into cells defined by education, age and time.
- Idea is that workers should be good substitutes for each in the labor market within cells, but not as much across cells.
- Then measure immigrants' penetration within each cell.
- Did native wages grow slower (or fall more) in cells that received relative larger flows of immigrants?
- No

The impact of migration on UK natives (II)

- Impact of migration may differ along the wage distribution (Dustmann et al 2013):



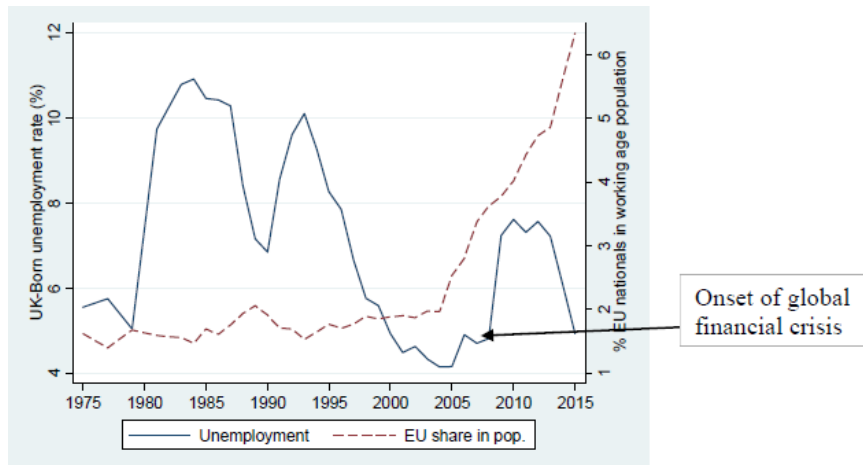
- But quantitatively the impact is throughout small

- EU migrants have contributed positively to the UK fiscal budget.
- Not surprising given that they are on average younger and more likely to be in work than the UK-born and therefore tend to pay more in taxes than they receive in benefits.
- Between 2001 and 2011, immigrants from 2004 accession countries made a net fiscal contribution of nearly £5 billion, and other EU immigrants contributed another £15 billion (Dustmann and Frattini, 2014).

A closer look at recent immigration

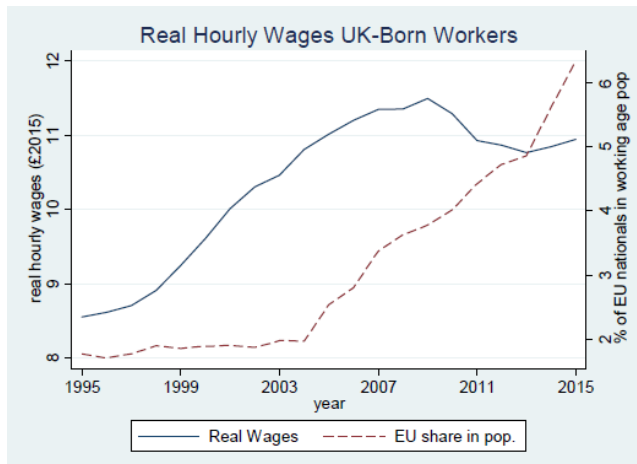
- Previous studies focused on periods of sustained economic growth
- Is migration detrimental to natives' prospects in bad times?
- Lessons from the Great Recession, the most severe economic downturn since the Great Depression of 1929
- Main study by Wadsworth et al (2016).

Migration and unemployment during the Great Recession



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

Migration and wages during the Great Recession



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

- Much of the rise in EU immigration has taken place at a time when the unemployment rate for the UK-born was rising and their real wages were falling – that is, during the recession years.
- But immigration from the EU kept rising after the end of the recession, while the unemployment rate of the UK-born was falling back to pre-crisis levels, and their real wages had started to grow
- No correlation between immigration and the labour market prospects of natives for the economy as a whole.

Are aggregate trends deceptive? (I)

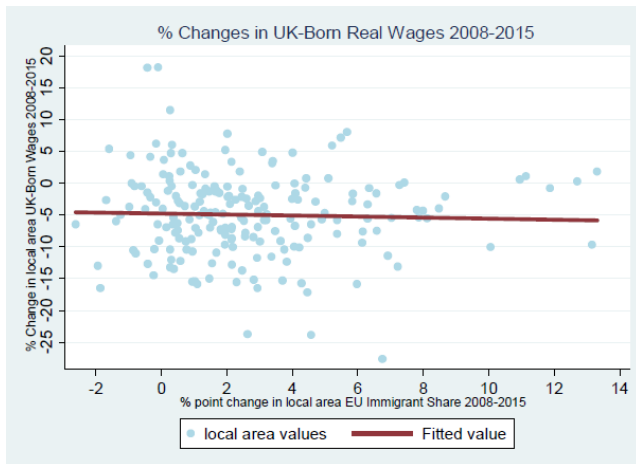
Lack of aggregate trends may in principle conceal losses in local areas that received higher numbers of immigrants. But in reality:



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

Are aggregate trends deceptive? (II)

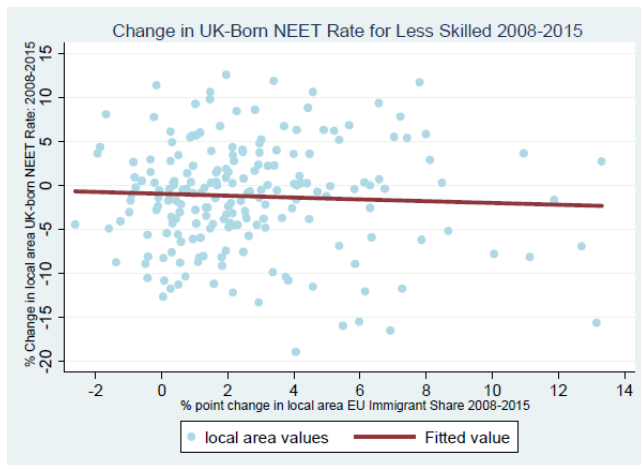
Wages:



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

How about the less-skilled? (I)

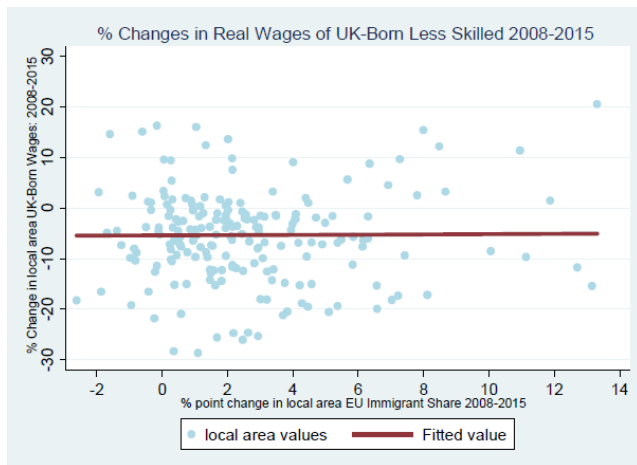
Not in Employment, Education or Training:



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

How about the less-skilled? (II)

Wages:



[Source: CEP Brexit Analysis - Wadsworth et al 2016]

Are there any losers from immigration?

- One group that does seem to suffer from the arrival of new migrants is the stock of pre-existing immigrants (Manacorda et al, 2012; Ottaviano and Peri, 2012).
- Key to understand this is the substitutability between new migrants, pre-existing migrants and natives in the host labour market
- Native workers and new immigrants are far from perfect substitutes, even for similar levels of education or experience, because they tend to work in different jobs and perform different tasks.
- Immigrants may have culture-specific skills and barriers
- Comparative (dis)advantages and immigrants' networks lead them to cluster in occupations and industries in which foreign-born workers are already over-represented.
- These mechanisms limit job competition between natives and migrants, but reinforce competition across different arrival cohorts of migrants.

- If the implementation of Brexit introduces restrictions on EU immigration [in a way similar to the visa scheme in place for non-EU immigrants], available evidence predicts no major beneficial effect for UK native workers.
- Digging deeper: effects of cuts in EU immigration are mostly going to be noticed in sectors and professions in which migrants are concentrated
 - towards the *top* and the *bottom* of the job ladder.

UK sectors most affected

- *Low-skill* EU immigrants tend to cluster in agriculture, low-tech manufacturing, construction and private households.
- They are disproportionately less likely than unskilled natives to hold managerial roles.
- *Skilled* EU immigrants tend to be occupationally polarized relatively to UK natives:
 - much more likely than UK natives to work in unskilled occupations for which they are over-educated
 - at the same time they are also over-represented in finance and higher education sectors.

Clusters of EU immigrants

Sector	% EU	
	low skill	high skill
Food processing	40	14
Crop picking	28	14
Private households	14	21
Hotels and restaurants	13	12
Construction	10	5
Higher education	5	10
Financial trusts and funds	9	19

[Source: Own calculations on UK Labour Force Survey, 2015]

- If gaps left by cuts in EU migration were filled by a higher labor supply of natives and non-EU migrants to these sectors, wages and employment in these sectors would remain unchanged.
- This is unlikely:
 - natives are imperfect substitutes for migrants, and – for given skills and industries – they have higher reservation wages than migrants.
 - existing visa quotas give little prospect of non-EU migration being expanded in a way that would offset cuts to EU migration.
- Labour shortages in sectors of the economy with a large presence of EU migrants
 - production could move abroad for tradable sectors;
 - increase in prices and wages for non tradable sectors.

Wage adjustments?

- Quantitatively, a study by the Resolution Foundation predicts that – even if the government were able to immediately halt net EU migration – real wages in occupation groups most affected by migration would rise only very mildly
 - from 0.16% in admin jobs to 0.62% in skilled trades.
- Much smaller gains than the Bank of England's revisions of earnings and inflation forecasts for 2018, implying a reduction of 2 percentage points in real earnings' growth than expected prior to the EU Referendum.

Technological adjustments?

- A further outcome might be greater mechanization and automation in some sectors, most notably low-tech manufacturing, as reduced migration may encourage – via slower growth in low-skilled labour supply – the adoption of labour-saving technologies and productivity growth.
- But other sectors like domestic personnel or high-skill services are unlikely to benefit from the same mechanisms.

