

Labour mobility post-Brexit

Brexit will end the UK's commitment to the free movement of people from the EU. The British government will henceforth regain full control of borders and immigration. This paper will argue that post-Brexit migration policy should correct a system that promotes reliance on foreign labour to fill taxpayer-subsidised jobs.

Supporters of free movement in its existing form often justify it by appealing to economic need. It is treated as a feature of a free market in labour.

However, the UK's labour market is not free. Market wages are distorted by means of public subsidy via in-work tax credits. The government has made it artificially cheap for companies to hire workers by paying part of the cost of their employment. Tax credits have consequently skewed the economy toward labour-intensive production, sustaining the viability of low-wage jobs that would otherwise have been automated. This system of corporate welfare is one of the reasons productivity in the UK is so low.

Free movement should be considered in light of income support. Tax credits were expanded at the same time as the British labour market was Europeanised, following the 1992 Maastricht Treaty and the admission of A8 nationals in 2004. Since EEA nationals working in the UK have the right to reside under the rules of free movement in the EEA, they are automatically eligible for tax credits. The take-up rate of tax credits is higher among A8 nationals than across the UK as a whole. The import of cheap labour from the EU is thus filling many jobs that would not exist were it not for tax credits. It is catering to artificial demand for labour that imposes a growing cost on taxpayers.

Restoring control over migration provides an opportunity for a policy correction. Migration policy post-Brexit should make it simple for British employers to access foreign workers where necessary, especially high-value-added skilled labour. However, it must no longer perpetuate an artificial low-wage economy.

This paper set out a threefold approach to make skilled and necessary migration simple, without continuing low-wage migration. First, the numerical cap on the points-based Tier 2 visa for skilled workers should rise. Second, the Seasonal Agricultural Work Visa should be reintroduced on a temporary basis. Third, the Tier 3 visa for general workers, which was never introduced because of the availability of EEA labour, should now be launched, but with three provisos: a numerical cap; a restriction to migrants from developed economies; and a wage floor.

1. Subsidised movement

a) Tax credits

Tax credits have a major influence on the UK labour market. Public expenditure on tax credits has risen considerably since they were introduced sixteen years ago – from £4.5 billion in 2000/2001 (the first full year in which they were awarded) to £28.5 billion in 2015/16.¹ Although the child tax credit is payable to the unemployed, tax credits are predominantly in-work benefits, which decline progressively with income. Since tax credits are dependent on various circumstances, however, there is currently no defined maximum income beyond which claimants are ineligible for tax credits.

Since they are refundable (i.e. they can exceed the recipient's tax liability), tax credits can represent a significant proportion of the recipients' income, especially for those with children. In 2016, a couple with no dependents and a gross annual household income of £11,232 (based on one person earning the minimum wage and working 30 hours per week) would receive working tax credits totalling £2,810.² Ordinarily, those with no dependents would cease to receive tax credits once their income exceeded around £18,000 p.a.

For those with children, tax credits are payable up to much higher incomes. A household with three children would receive a maximum award of £12,865 p.a., tapering to zero at a household income of around £40,000 p.a.³ For those requiring childcare, the award is even higher: up to £23,125p.a. for a household with three children on the lowest income, tapering to zero at a household income of around £65,000 p.a.⁴

¹ 'Outturn and forecast: Autumn Statement 2016', Benefit expenditure and caseload tables 2016 (Department for Work and Pensions)

² Tax credits entitlement tables: working and have no children (HMRC, 06/04/16)

³ Tax credits entitlement table: working at least 16 hours and no childcare (HMRC, 06/04/16)

⁴ Tax credits entitlement tables: working at least 16 hours and paying childcare (HMRC, 06/04/16)

From 6 April 2017, the child tax credit will be reduced, but only for children born subsequently. Families of children born after 6 April 2017 will not be eligible for the family element of child tax credit, while the child element will only be awarded for up to two children born.⁵ However, neither change will affect the award of either element of child tax credit for those responsible for children born before the 2017-18 fiscal year – even for new claimants.

As of December 2016, 4.1 million families in Britain were in receipt of tax credits.⁶ A significant proportion of these were EEA nationals.

b) EEA immigrants claiming tax credits

The expansion of tax credits has taken place in tandem with the Europeanisation of the labour market. Free movement of people, which began with the Maastricht Treaty, has been one of the main drivers of British immigration since 2004, when nationals of the eight Eastern European accession countries were allowed to live and work in the UK. The number of EU-born UK residents, which had remained relatively constant at just over one million between 1993 and 2004, has since risen to 3.5 million, including 1.8 million from born in Accession countries (A8, A2, Malta, Cyprus, and Croatia).⁷ Since 2011, the number of Accession-born in employment has exceeded those born in the EU 14.⁸

The tax credits system incentivises EEA nationals to work in the UK and British companies to rely on low-wage labour. Because EEA (and Swiss) nationals have an essentially automatic right to reside in the UK (see section 1c below), they also have the automatic right to claim tax credits. The proportion of EEA nationals in the UK that claim is comparatively high.

While EEA-born residents claim fewer out-of-work benefits per capita than UK-born residents, they claim greater in-work benefits per capita – especially those originating from Accession countries. Citing data from the 2015 Labour Force Survey, a report published in 2016 by Oxford University's Migration Observatory notes that 12% of UK residents born in EEA countries reported receiving tax credits in 2015, rising to 16% among those born in Accession countries, compared to 10% of UK-born residents.⁹ Among EEA-born adults reporting receipt of tax credits in 2015, 90% had dependent children.¹⁰

Among recent arrivals (2011-2014), Accession-born UK residents to the UK were the highest tax-credit claimants of any immigrant group in 2015, with 13% receiving tax credits, compared to 9% for Non-EEA arrivals, and 5% for those from the EU-14.¹¹ It should be noted that this figure largely excludes immigrants from A2 countries (Bulgaria and Romania), on whom immigration restrictions were only removed in 2014, and who comprised 25% of immigration from the EU in 2015.¹²

HMRC figures also testify that the proportion of EEA-born UK residents claiming tax credits exceeds their share of the working-age population. According to HMRC data from the first quarter of 2014, families with an EU migrant adult accounted for 6.8% of all tax credit claims, while the share of the working-age population born in EEA countries at the time was 5.6%.¹³ Since there is some variance between HMRC and LFS data, the Migration Observatory estimates that between 10 and 20% of recently arrived EU adults were receiving tax credits in early 2014.¹⁴

The greater propensity of Accession-born residents to claim tax credits correlates with their lower average income. The Migration Observatory records that, in 2014, the average gross hourly wage for an A8 national in the UK was £9.29 for men and £8.43 for women, which, based on a 40-hour week, would have equated to annual gross earnings of £19,323 and £17,534 respectively.¹⁵ In comparison, the average gross hourly wage across the UK was £15.23 for men and £12.17 for women respectively.¹⁶

⁵ 'Child Tax Credit', HM Government: <<https://www.gov.uk/child-tax-credit/what-youll-get>>, <<https://www.gov.uk/child-tax-credit/overview>>

⁶ Child and Working Tax Credits Statistics, UK (HMRC, 12/2016) p.8.

⁷ *EU Migration to and from the UK* (Migration Observatory, 31/10/16), Figure 1.

⁸ Ibid.

⁹ *EU Migration, Welfare Benefits and EU Membership* (Migration Observatory, 02/05/16) p.8.

¹⁰ Ibid. p.11.

¹¹ Ibid. p.8.

¹² *EU Migration to and from the UK*, p.6.

¹³ *EU Migration, Welfare Benefits and EU Membership* p.7.

¹⁴ Ibid. p.8.

¹⁵ *Characteristics and Outcomes of Migrants in the UK Labour Market* (Migration Observatory, 11/01/16) Table 2.

¹⁶ Ibid.

The evidence suggests, therefore, that expanding the tax credits system while at the same time opening the UK labour market to the Accession countries has supported the incomes of Eastern European migrant workers to a greater degree than the British workers it was ostensibly designed to benefit. The movement of people from the EU to the UK, therefore, is incentivised by British taxpayers.

c) EU free movement rules & tax credits

The additional incentive to work in the UK provided by tax credits has been facilitated by EU free movement rules, in several respects. First, since eligibility for tax credits is contingent on the right to reside in the UK, and EEA nationals have the automatic right to reside in the UK if they are employed, any EEA national working in the UK is automatically eligible for tax credits on the same basis as UK nationals. This is not the case for non-EEA nationals working in the UK (see 1d below).¹⁷

Furthermore, free movement rules allow EEA nationals to relocate to the UK even if they do not already have a definite job to assume on arrival. Although the Treaty on the Functioning of the European Union (as amended by the Treaty of Lisbon [2007]) chiefly refers to freedom of movement of workers, there has been free movement of people – rather than workers – within the EU, both *de jure* and *de facto*, since the implementation of the Treaty of Maastricht (Treaty on European Union [1992]), which explicitly provided for the free movement of persons as a facet of common EU citizenship.¹⁸ Member states may only restrict the residency rights of EU citizens in limited circumstances, even if those citizens are not employed.

Consequently, many EU nationals come to the UK to seek work, rather than to take up a position they have already been offered. In 2015, 41% of EU nationals reported moving to the UK to assume a definite job, while 32% reported moving to look for work.²⁰ Among A2 and A8 nationals, the proportion moving to look for work is higher: 34% and 42% respectively.²¹ It is also worth noting that 10% of EU nationals immigrating to the UK in 2015 did so either to join or accompany others (7%), or for no stated reason (3%).²² While the majority of EU migration is labour-related, therefore, much of it is speculative – responding to general demand or opportunity in the UK, which is increased by in-work benefits, rather than to fill a specific vacancy.

d) Non-EEA migrants & tax credits

Unlike EEA nationals, non-EEA nationals do not have an automatic right to reside; their ability to claim tax credits is therefore limited. Non-EEA nationals may only claim tax credits if they have indefinite leave to remain. Those on work visas (ordinarily Tier 2) are therefore ineligible for tax credits in most circumstances. Holders of Tier visas may apply for indefinite leave to remain only if they have been continuously resident in the UK for five years, their annual earnings exceed £35,000 p.a., and they are still needed by their sponsoring employer.²³

e) The effect on productivity

The combination of taxpayer-subsidised low-wage jobs with the supply of cheap EU labour has arguably contributed to the UK's poor record in productivity over the last decade. UK productivity growth averaged only 0.5% p.a. between 2005 and 2015, compared to 2% p.a. between 1995 and 2005.²⁴ Moreover, while in the preceding decade the UK's productivity growth surpasses that of every G7 country bar the United States, the UK has most recently lagged every other G7 country bar Italy.²⁵ At the same time, incomes have fallen in real terms since the financial crisis, as relatively high employment has been maintained in part by means of wage compression.²⁶

The correlation between income stagnation, the expansion of tax credits, the increase in migration, and low productivity is no coincidence. By making it artificially cheap for companies to hire workers, the government may have helped keep unemployment down. However, it has achieved this only at taxpayers' expense. In effect, tax credits are corporate welfare.

¹⁷ See <<https://www.gov.uk/tax-credits-if-moving-country-or-travelling/your-family-lives-abroad>> & <<https://www.gov.uk/right-to-reside>>

¹⁸ Treaty on the Functioning of the European Union (2012), Article 45.

¹⁹ Treaty on European Union (1992), Articles 3, 8, K.1: <https://europa.eu/european-union/sites/europaeu/files/docs/body/treaty_on_european_union_en.pdf>

²⁰ EU Migration to and from the UK, figure 6.

²¹ Ibid.

²² Ibid.

²³ See <<https://www.gov.uk/settle-in-the-uk/you-have-a-work-visa/tier-2-general-visa>>

²⁴ Mark Reckless AM, *Making Britain More Productive* (UKIP PRU, 31/10/16) p.1:

<<http://ukippolicyforum.com/papers/18/download/Making+Britain+more+productive.pdf>>

²⁵ Ibid. p.3.

²⁶ 'Analysis of real earnings: Feb 2017' (ONS, 02/2017):

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/supplementaryanalysisofaverageweeklyearnings/latest>

Tax credits have enabled employers to pay lower wages in the knowledge that the public purse will top them up. In the absence of tax credits, it is reasonable to assume that the gross wages paid by employers would need to be higher to maintain the same net employee earnings, and consequently the same labour supply. However, if the full wage burden were to fall on employers, they would have greater incentive to promote capital-intensive, rather than labour-intensive, production. More jobs therefore, would likely have been automated in sectors where mechanisation is possible. Instead, these sectors have relied on migrant labour.²⁷

Increased automation would be possible in many of the sectors that have come to rely most on cheap EU migrant labour. According to data from the ONS and the Labour Force Survey, EEA nationals comprise 14.2% in accommodation and food services, 10.2% of the British workforce in manufacturing, 9.6% in administrative and support services, 9.6% in transport and storage, and 9.1% in construction. (The sector in which EEA nationals make up the highest proportion of the British workforce by far [26.8%] is 'households as employers' – i.e. domestic service. Contrary to some reports, EEA nationals make up only a small proportion of the workforce in health and social care [5.2%].)²⁸

Low-wage migrant labour, therefore, is not an indispensable feature of the British economy per se. It is a feature of an artificially skewed labour market that fosters a low-productivity economy. That is not an economic model the government should seek to perpetuate. Brexit provides an opportunity to change it.

2. Post-Brexit migration policy

After Britain leaves the EU, Parliament and the government will regain sole control over immigration policy. It will therefore be possible to make that policy much more responsive to both the concerns of voters and the needs of employers.

While there is a broad consensus in favour of skilled immigration, the benefits of unskilled immigration are disputed. In opposition to those who claim that low-wage, low-skilled labour is an economic necessity, this paper has argued that it needs to be considered in light of the effect of tax credits. The import of cheap labour is not a reflection of a free labour market, but rather a subsidised labour market.

If the purpose of immigration is to address fundamental skills and labour shortages as they arise, Britain needs a new model post-Brexit. Free movement of people from the EEA to the UK will end once the UK leaves the EEA. For the reasons given above, the UK should not attempt to recreate it post-Brexit, either in the form of a preferential arrangement in a bilateral agreement between the UK and the EU, or unilaterally. However, it is in the UK's interests to develop an easy system for employers to recruit from abroad for higher-value-added positions where necessary.

Skilled migrants already have a route into the UK via the Tier 2 visa system. It is reasonable to expect the numerical cap on Tier 2 visas to rise. There is also an argument for restoring the Seasonal Agricultural Workers Scheme, at least temporarily, and for introducing the Tier 3 visa for general workers. However, neither of these immigration routes should be not be implemented with the aim of perpetuating an artificially low-wage labour market. Both require provisos.

a) The Tier 2 visa

The points-based Tier 2 visa, for skilled migrants, is currently capped at a maximum of 20,700 allocations per year; after EEA nationals lose their automatic right to work in the UK, there is likely to be sufficient employer demand to raise the cap. It should be noted that, for most occupations, eligibility for a Tier 2 visa is contingent on a minimum earnings threshold, which is rising to £30,000 p.a. from April 2017. As noted above, Tier 2 visa holders are ordinarily ineligible for tax credits. Consequently, raising the Tier 2 cap would not perpetuate the dependency on low-wage migrant labour. Post-Brexit, the cap should be subject to an annual vote in Parliament.

b) Seasonal Agricultural Workers Scheme

The Seasonal Agricultural Workers Scheme (SAWS), which was open only to Romanian and Bulgarian nationals from 2007 to 2013, was closed after immigration restrictions were lifted on Romania and Bulgaria; now that the UK is

²⁷ See Mark Reckless AM, *Making Britain More Productive*

²⁸ Oliver Hawkins, *Migration Statistics* (House of Commons Library, 27/01/17) p.25.

leaving the EEA, there is substantial pressure from the agricultural sector to restore it. However, a restoration should not be open-ended, or extended beyond nationals of developed economies.

The availability of cheap migrant labour has potentially disincentivised capital investment and increased automation in the agricultural sector. Citing evidence from the United States, the think tank Migration Watch observes that restrictions on cheap migrant labour have led to greater mechanisation in the tomato industry. Moreover, the agricultural sector will have to adapt to rising costs of labour in any event, by dint of the national living wage – which would limit the benefits of the scheme to employers even in the short term.

It is also worth noting that tax credits may have some impact on EU migrant workers in agriculture. Currently, EEA nationals make up 6.5% of the British workforce in agriculture, forestry and fishing. Although A2 nationals have only been eligible for tax credits since the closure of the SAWS, workers from other EEA countries (outside the SAWS) have been eligible for longer. Low-wage migrant labour in agriculture has potentially been facilitated in part by taxpayer subsidy over the last decade.

If the SAWS is to be restored, therefore, it should be on a temporary basis (e.g. five years), and subject to parliamentary review. A numerical cap on entrants under SAWS should be set by Parliament annually. To avoid an unmanageable surge in applicants from developing economies, it should be restricted to applicants from developed economies, initially comprising the EU and the Anglosphere (Australia, New Zealand, Canada, and the United States). However, longer-term, increased mechanisation may prove a more efficient solution than cheap imported labour for the agricultural sector. The role of automation should be taken into account when Parliament considers renewing the scheme.

c) Tier 3 visa

Since the Tier 3 visa for general workers was never introduced because of the availability of cheap labour from the EEA, its introduction is likely to be advocated post-Brexit. However, it would be an error to use the Tier 3 to continue free movement by other means. Rather, it should be used as an alternative skills-based visa to the Tier 2, with skills determined by the market, rather than the state.

The Tier 3 should not be used to perpetuate a taxpayer-subsidised, low-wage labour market. Since EEA nationals will lose their automatic right to reside in the UK post-Brexit, EEA nationals on a Tier 3 visa would no longer be automatically eligible for tax credits. However, no special arrangement should be struck with the EU to enable preferential access to in-work benefits for EEA nationals.

Even assuming Tier 3 visa holders would not be eligible for tax credits, there should be further conditions attached to the Tier 3 to counterbalance the longstanding, artificial dependency of the UK on low-wage labour. Specifically, the award of Tier 3 visas should be contingent on a minimum earnings threshold, like the Tier 2. Initially, the level might be set at the current Tier 2 threshold of £25,000 p.a. Like the proposed SAWS, it should also be restricted to applicants from developed economies, to avoid an unmanageable surge in applications from lower-wage economies around the world.

The Tier 3 would therefore function as another form of visa for skilled workers. The key difference between the Tier 2 and the Tier 3 would be that the skills criteria for the Tier 2 would be determined by the state, whereas the criteria for the Tier 3 would be determined by the market. The two visas would thus cater to different employers.

As with the Tier 2, Parliament should determine both the earnings threshold and the annual quota to be allocated. Given that the Tier 3 would not be points-based, the quota would be filled on a first-come-first-serve basis (like the American H1B) – unlike the Tier 2, for which applications are prioritised based on applicants' fulfilment of the criteria. Again, this would enable two competing routes for employers.