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## **CHAPTER TWO: LITERATURE REVIEW**

### ***2.1 Introduction***

This chapter presents summary of existing literature and focuses on impacts of immigration on economy of a country in general and focusing on economic models. There is a variety of economic theories and models that have been developed by economists to explain potential and obvious impacts of immigrants on economy. This chapter begins with a general discussion of impacts and then moves on to impact of immigration on GDP and then discusses impact of immigration on unemployment. There is also a discussion of economic models to explain the impacts of immigration on economy.

### ***2.2. Conceptualisation of Immigration***

The concept of immigration can be traced back to the era of the 1940s were in the Second World War; there was an increasing demand of the Labour for the war for the purpose of restoring the Britain economy. However, between the 1945 and 1949, there are over 100,000 workers who were admitted in the European Volunteer Workers scheme which is mainly displaced from the Home office records. They were allowed to remain in the Great Britain and over the 25,000 were the immigrants who were accepted as the post-war distressed relatives and the children belonging to the unknown nationality and their spouses.

In the light of Castles, De Haas and Miller (2013), immigration is regarded as the international movement of the people into their destination country because of which they are not called natives or where they do not possess the nationality for the purpose of settling or residing there, especially as the permanent residents or the naturalised citizens. From the economic effects, the research has suggested that the migration is beneficial for both sending and receiving the countries. According to De Haas (2010), the research has reflected that there are few

exceptions in which the immigration on average has positive economic impacts on the native population, but it is mixed with the low-skilled immigration that adversely impacts the low-skilled natives.

According to the study conducted by Richards et al., (2013), there are studies which have represented that the elimination of the barriers for which can have the profound effects on the GDP of the country within the estimation of the gains ranging between 67 to 147 percent. In addition to the above statement, the previous literature has provided mixed findings for the relationship amid the immigration and the criminal activities where the research has presented that the country of origin matters for the depth and speed of immigrant assimilation.

## ***2.3 Impact of Immigration***

### ***2.3.1 Paradox of average incomes***

There are many authors who conclude in their theoretical and empirical analyses that the destination countries of migration always obtain profits in absolute terms. In the event of the possibility of wage discrimination, if the newly settled immigrants have a lower income in the new country than the rest of the workers, will not their arrival mean a decrease in the average income of the country? (Borjas, 2013) On the other hand, if these same immigrants had below-average income in their country of origin, would not their average income increase in the country of origin? And finally, how do these two positions reconcile with the losses in the country of origin of the migrations pointed out by some authors (Peri, 2012)

In order to arrive at some conclusive explanation, Manacorda, Manning, and Wadsworth, (2012) makes a comparative numerical study between the United States and Mexico in which he

observes the evolution of population data and income levels in different cases: immigrants, permanent residents in the country Host and a group of people who benefit from the extra job offer in the country of destination (especially entrepreneurs) (Hainmueller, Hiscox, and Margalit, 2015).

There could be strong competition for jobs and a loss of income for indigenous workers in the country of destination, especially if newly arrived workers are relatively more skilled than those in the host country. The other possible scenario contemplates that there will be no rent losses for the native workers of the destination country of the migrations, because the immigrants cannot compete with these (Goldring and Landolt, 2012). In this case, immigrants will normally accept jobs to which the national unemployed show little or no interest: domestic service, construction and agriculture are good examples. In this way, the high level of unemployment would be compatible with a strong demand of immigrant labour (Genc, et al., 2012).

What is certain is that reality shows that each case is different and that in practice there are qualified and unskilled immigrants, although the largest group, in more general terms, could be the last (Blau and Kahn, 2012). A priori, it is considered that the profits that entrepreneurs obtain from immigration surpasses well the losses of native workers (in the case of competition in the labour market), so that the whole of the American society would receive in Net terms an insignificant gain from the arrival of immigrants to the United States (Dustmann, Frattini, and Preston, 2012).

#### ***2.4 Impact of Immigration on Economic Development (GDP Growth Rate)***

The debate on migration policy has never been so hot, both in the political class and in public opinion. Some do not hesitate to carry out various and varied economic studies to the aid

of their arguments (Peri, 2012). The most standard economic science (neoclassical) teaches us that an influx of immigrants is equivalent to a shock of labour supply, which, if the labour market is sufficiently flexible, is easily absorbed at the end of a short time period. But the reality is much more complex, since certain necessary rigidities (SMIC, labour contracts, etc.) slow down adjustments and thus create unemployment situations (what is currently seen in Germany with the influx of refugees) (Borjas, 2013).

Borjas (2014) recalls that this can lead to a net loss of wealth due to the compensation of this increase in unemployment by the natives. Economists have tried to estimate the impact of immigration on GDP and the labour market, but the conclusions differ widely. When Goldring and Landolt (2012) found that a contribution of immigrants temporarily increases the unemployment of the natives. Blau and Kahn (2012) conclude that it reduces it in the short term. The authors find that a 10% increase in the share of immigrants in an employment category degrades by about 3% the employment rate of natives with similar individual characteristics.

Concerning the GDP, Peri (2012) show, using a VAR model (Autoregressive Vector), that immigration has a positive effect, when Peri (2012) concludes the reverse. Finally, the OECD estimates the cost of immigration at about 10 billion euros a year and Manacorda, Manning, and Wadsworth, (2012) considers the positive impact. However, this latter study uses a methodology similar to "cavalry", which consists of recording only the current contributions of immigrants by omitting the future claims to which they give entitlement (pensions, etc.). By integrating the whole life cycle of an immigrant, it costs around 8,700 Euros according to Ottaviano and Peri, (2012) (especially because immigrants are older). More generally, the OECD estimates that the net contribution to the social and tax system of a household immigrated between 25 years of age

(the head of the family) and the end of one's life is 80,000 Euros lower than that of a native household.

All these studies, however, do not address the issue of second-generation immigration, which is the contribution of immigrant children. However, Bond, Iwasa, and Nishimura, (2013) (2010) shows that the children of immigrants from developing countries have a lower employment rate than their parents, in contrast to the second generation of countries in Southern Europe, for example. In order to estimate the impact of immigration on GDP growth, VECM (vector error correction model) is used, often used in econometrics, to simulate the impact of an immigration shock on GDP Per capita and the unemployment rate for example. Using the OECD data (for the migration rate), and INSEE (for GDP per capita and unemployment rate) over the period 1984-2013, it is found that the permanent increase of 1 % Of the legal entry rate of foreigners leads to a decrease of 0.17% in per capita GDP after 5 years (about 10 Euros per year), and a 0.3% increase in the unemployment rate.

Yet, with a similar methodology, but over a more limited period, Iwasa and Nishimura, (2014) found a positive impact of immigration on GDP (5 Euros per year for the increase of the 1% migration rate). This confirms the thesis that the current statistical and economic tools do not always lead to the conclusion of a beneficial economic effect of immigration, but also that immigration with a large, homogeneous and monolithic one does not exist. The economic effects depend on the skill level of the immigrants, the labour market situation of the host country and many other parameters

A recent publication by the Organization for Economic Co-operation and Development (OECD) attempts to answer the question of whether migration has a positive impact on the economies of host countries. Migration takes many forms internationally. Populations in host

countries rely on organized immigration to address gaps in their labour markets and meet a number of demographic needs to offset low fertility rates, aging of the population, a growing dependency on the elderly, a decline in the labour force and high emigration rates. Furthermore, migration within the European Union includes free mobility between Member States (Iwasa and Nishimura, 2014).

### ***2.5 Immigration and Unemployment***

To study the impact of immigration on local employment opportunities, the majority of empirical work is based on the spatial correlation methodology applied to labour force panel data. The spatial correlations approach, implies a decomposition of the labour market of the host country into geographical zones representing closed employment basins (cities, federated states, etc.), that is to say, spared by any significant interregional migratory movement. This method aims to reveal correlations between the performance of a local labour market and the state of immigration that it knows (Manacorda, Manning, and Wadsworth, 2012). A real situation (a labour pool experiencing immigration flows) is thus compared with a fictitious situation (without immigration) constructed for this purpose. Since this hypothetical situation does not exist, the comparison is based on an econometric regression of the labour market performance indicators of a given geographical area (employment and wages of indigenous peoples) on the relative amount of migrants in this region. This regression is carried out in a relationship that simply models the impact of a migratory shock on the local labour market (Yakita, 2012).

Studies that follow the spatial correlation approach agree on the modest impact of immigration on Aboriginal wages and employment. According to Ottaviano and Peri (2012), a 10% increase in the share of immigrants in the labour force reduces Aboriginal wages by less

than one percentage point. This result is robust empirically, although for Bond, Iwasa, and Nishimura, 2013), this wage cut can reach up to 3%. Iwasa and Nishimura, 2014) adds an estimate of the same order on the employment rate of native, given qualifications. Iwasa and Nishimura, 2014) are nevertheless suspicious of the volatility of the impact, which they consider too important, especially over time. According to them, the fact that the eigenvalue attributed to immigration may vary greatly depending on the region studied or the time of the measures cast doubt on the robustness of the results obtained by the spatial correlation approach. They therefore criticized this argument (Borjas, 2013).

First, cross-sectional zonal studies are unable to control fluctuations in relative labour demand from one area to another. However, it is essential to measure the local demand shocks correctly if one wishes to compare the migration impact in one region of intensive immigration with another where immigration is less important (Yakita, 2012). Collecting data during a period of strong expansion in the host region may lead to an underestimation of the negative impact of immigration on native employment opportunities or an overestimation if not (Hainmueller, Hiscox, and Margalit, 2015).

Second, the method of spatial correlations assumes that the distribution of immigrants in the regions of the host country is exogenous, that is, it is determined independently of the economic performance of the regions in question. However, for Borjas, 2013), migrants decide their place of residence according to their prospects for employment and social benefits. Regions with the best economic health before immigration takes place also offer the best prospects for migrants. These are therefore the most attractive. A bias is created if the hypothesis of exogeneity is overturned: cross-sectional studies may give migrants an improvement in the

economic situation, or remain blind to their depreciating effect, whereas it is precisely economic dynamism that attracts and masks this effect (Borjas, 2014).

In order to remove the suspicion of endogeneity of immigration in relation to the economic situation, Card proposes to use the previous flows of immigration as an instrumental variable determining the location of migrants irrespective of the conditions on the labour market in question. The underlying intuition is that migrants are accustomed to establishing themselves not in the most economically efficient region but in places where migrants of the same origin have already settled and where a host community favours their integration. According to Blau and Kahn, (2012), the absence of significant modification of the results after instrumentation invalidates the criticism: the dilution in space does not explain the weakness of the impact (Goldring and Landolt, 2012).

The last critique of Borjas, Freeman and Katz (1996 cited in Peri, 2012) deals with the consideration of international migratory flows alone. The internal flows between the regions studied are entirely neglected. If labour markets in different regions of the host country are not closed to one another, then the migrant workforce is not the only one that can be mobile. The natives can change their residence in turn to leave a saturated market, or refrain from settling in a region that is experiencing a strong international immigration. For Borjas, this is a serious empirical problem. However, Manacorda, Manning, and Wadsworth, (2012) show that it is not important. Bond, Iwasa, and Nishimura, (2013) confirm this. Iwasa and Nishimura, (2014) for the United Kingdom also find concordant results with Card. This criticism can therefore be rejected and estimates of the low impact of immigration on native job opportunities can be accepted.

## ***2.6 Economic Model and Theoretical Framework***

There are a variety of causes that lead to increase or decrease in the immigrants and immigration rate in an economy, however, this study is focused on impacts and therefore this discussion is also focused on impacts of immigration on economic development. It is important to study the consequences of migration from a purely theoretical perspective in order to understand the most important effects of migration on the economy of host countries (Peri, 2012). This theoretical approach is complemented by the empirical analysis by particularly focusing on case study of the UK in the next chapters (Boubtane, Dumont, and Rault, 2015).

### ***2.6.1 The Heckscher - Ohlin model***

According to this model the international trade occurs on the fact that there are differences in the resources of the countries. This is considered to be the classic and most influential economic theories of international economics. It was developed by two economists in Sweden namely Eli Heckscher and Bertil Ohlin, it has become the clearest exponent of the orthodox explanation of the ultimate cause of international trade since the 1930s. Following the hypotheses starting from Heckscher-Ohlin theory, goods differ in their requirements of productive factors and countries are characterized by different factor endowments (Manacorda, Manning, and Wadsworth, 2012).

The basic teaching of this model is that in a world in which it is assumed that the technological factor of production is exactly same between countries, trade will be determined by factoring, or what is the same, the cause of the existence of international trade is the difference in price ratios between countries. Thus, country gains comparative advantage in those goods that use intensively the factors that it has abundantly available (the comparative advantage is given

by differences in factor endowments). In this way, price equalization of factors will occur if the factor endowment of the countries do not differ too much (Bond, Iwasa, and Nishimura, 2012).

The model developed by Heckscher-Ohlin mainly has four theorems which are summarized below:

**Heckscher-Ohlin Theorem:** an economy gains comparative advantage over another in case of those products in which there is abundance of a factor of production and the economy uses this factor intensively (Bond, Iwasa, and Nishimura, 2013).

**Factor price equalization theorem:** Free trade is equal to real incomes (factor rewards) between two trading countries and it is a proxy for mobility of external factor. From a practical point of view, the theorem states that even in the absence of labour migration between countries, free trade in goods leads to a state of international equilibrium (Iwasa and Nishimura, 2014).

**Stolper-Samuelson's Theorem:** there is increase in the relative price of a good, with respect to both goods, based on the intensive use of abundant factors in the production of the good and there is a decrease with respect to both goods if there is a real retribution of other factors of production (Yakita, 2012).

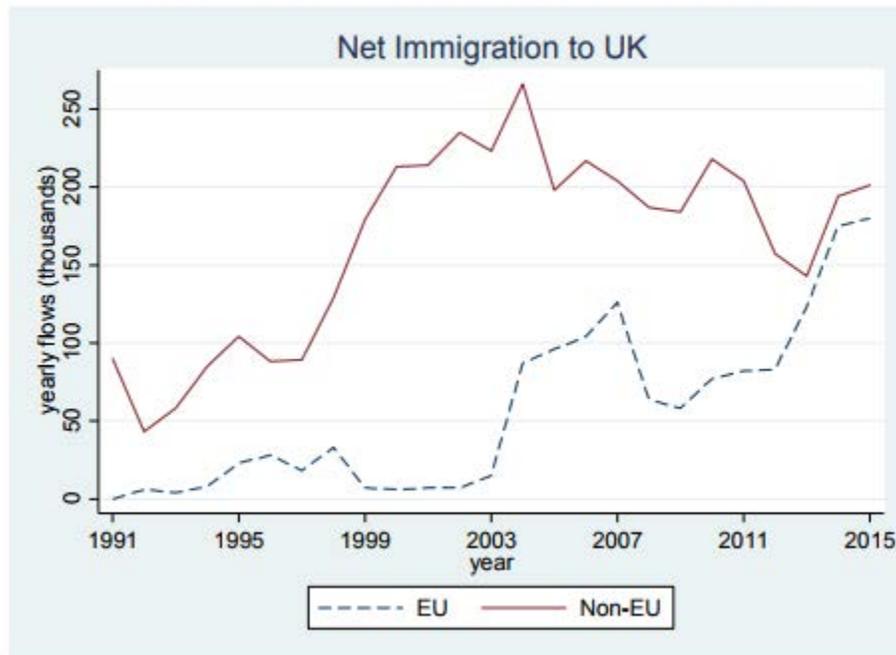
**Rybczynski's Theorem:** if production coefficients are available and quantities of factors are fully utilised, there is an increase in the endowment of a production factor and the output of that good that uses the factor that has been intensively increased and the Production of the other good (Bond, Iwasa, and Nishimura, 2012).

## ***2.7. EU Immigration within the UK***

In the light of Coale and Hoover (2015), the net immigration is regarded as the difference between the number of the people who are entering in the UK and the number of people who are

leaving the country. In addition, the countries immigrants are significantly increasing for the European Union and the non-EU immigrants. Furthermore, the East Europe has joined the European Union in the year 2004, where the immigration has increased significantly which again fell back after the period of recession occurred in the year 2007 (Richards et al., 2013). Moreover, the net inflows have significantly increased since the economy has regained.

**Figure 1: Net immigration to the UK, 1991-2015**



In the year 2015, there were a total of 3.3 million of the EU immigrants who are living in the UK which significantly increased from the year 1995. Moreover, around 2.5 million of the migrants are aged between the 16 and 64 years and the two million are at the work. Around 70% of the immigrants in the European Union were of the opinion that they come to the UK because they were finding employment opportunities in the country or for the purpose of the study (Wadsworth et al., 2016, p. 34). However, the immigration processes has increased the total number of the people within the work who are looking for the opportunities related to

employment which means that the UK workers must be harmed which increased the competition for jobs.

## ***2.8. Factors Associated with the Economic Development in the UK***

### ***2.8.1. Remittances***

In the light of Bloom, Canning and Fink (2010), there are the developing countries, where the remittances are considered as the important sources for the capital inflow and the outflow as it have significantly increased in the recent years. For a number of emerging and underdeveloped countries, remittances are considered as the major source for the external financing. In the light of Dhingra et al., (2016), the World Bank has estimated that approximately USD 543 billion remittances are transferred in the world by the end of 2012, where some of the amount estimated at 406 billion has been transferred to the developing countries. On the macroeconomic level, the remittances are the major contributor towards the balancing payment, balance deficits, and the foreign currency shortage which further reduces the barrier for the economic development. This implies that the money can be used for meeting the pressing needs of the country.

### ***2.8.2. Private Sector Investment***

The other major factor for the economic development is the private sector investment as the migration can promote the private sector investments within the country of origin in different directions. According to Brown and Wardwell (2013), there is possibility that the labour migrants will utilise their savings for engaging it into the business activities when they move to the abroad countries. In addition, the impact can be emphasised on the business start-ups by the returnees which can influence the employment situation in the country as it should be

overestimated and does usually the small family businesses does not offer a number of job opportunities for the outsiders. Therefore, there are likely chances that the immigrants would invest in the private projects which can contribute towards the betterment of the economy.

### *2.8.3. Promoting Trade*

In the light of De Haas (2010), the international migration can lead to increase in the trade flows between the origin country and the host country. Since the immigrants have the knowledge regarding trading possibilities within the international countries along with the market potentials and the distribution channels within the international and host country. In addition, they have the information regarding the language skills and the contacts that give migrants, the sustainable competitive advantage as they work with the traders. However, there are some economic trade barriers which can create obstacles in the trading or the exporting activities of the products from the perspective of quality control and product standards in the country of origin.

### *2.8.4. Vocational Training and Transfer of Knowledge*

According to Brown and Wardwell (2013), the migration of the labourers along with the vocational training, there are two important perspectives which should be kept into consideration that is explained as the decline in the population and the deficiency of the skilled workers within the industrialised countries. In the future, the industrialised countries will be suffering from the decline in the working population. In the present situation, there is an apparent shortage of the skilled workers within the sectors. Within the contest of improvement in the labour market, the training plays a significant role as it facilitates the human resources for the employment market. In addition to the above statement, the economic development can be benefitted by the equal

access to the vocational training and marginalised population groups which should be promoted in particular.

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