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INTERNATIONAL MIGRATION & THE LONDON ECONOMY

POPULATION AND GROWTH FORECASTS, AND WHY MIGRATION MATTERS

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EXECUTIVE SUMMARY

We have become accustomed in the last two decades to impressive growth in the London economy, typically well ahead of the UK as a whole. As a result, there is a tendency to forget that over a longer timescale, London has sometimes struggled. From 1939 until 1991 the capital's population fell markedly, from 8.5 million to 6.8 million people. And while that was partly due to the direct impact of the Second World War and its aftermath, it also reflected the subsequent decline of important sectors—notably the docks and manufacturing.

75 years

Time it took for London's population to return to pre-Second World War levels

From 1939 to 1991, it fell from 8.5 million to 6.8 million

Crucially, problems in those two sectors had knock-on effects on others, so that a vicious circle developed in the 1970s and 1980s in which both public- and private-sector investment fell, and both people and businesses lost confidence in London and moved away.

In the 1990s London returned to growth, helped by the expansion of financial services, market liberalisation, new policies of regeneration that drew in both public and private sectors, and an expanding population—boosted by inflows of people both from the rest of the UK and the European Union. London's growing scale, and that of its key businesses, raised productivity and competitiveness, creating a virtuous circle of success breeding success.

One important message here is that the close interconnections between different parts of the London economy, which in good times are a major part of the city's strength, can also become a weakness. A decline in one sector can adversely affect the viability of another, whether through supply linkages and weaker consumer spending, downturns in property markets combined with over-stretched public services, or through inflows and outflows of people—particularly the highly qualified.

This report describes Oxford Economics' baseline population forecast for London up to 2040. It assesses the contribution of both international and domestic migration flows, and projects that within the next five years, net migration for the capital will turn negative—and remain that way to the end of our forecast period. Amid the uncertainty of the Brexit negotiations and fierce competition from other internationally renowned cities, what does this population shift really mean for London—in terms of its future growth, employment levels, age demographics and cultural reputation?

The role of migration in London's growing economy

We do not think it likely that, within the foreseeable future, London will enter into a sustained period of decline. But nor should the city's track record of success be taken for granted.

One important feature of the capital is that, in general, faster population growth tends to be associated with, and indeed contributes to, faster economic growth for the city. Another is that net inflows of migrants from outside the UK have, in

24%

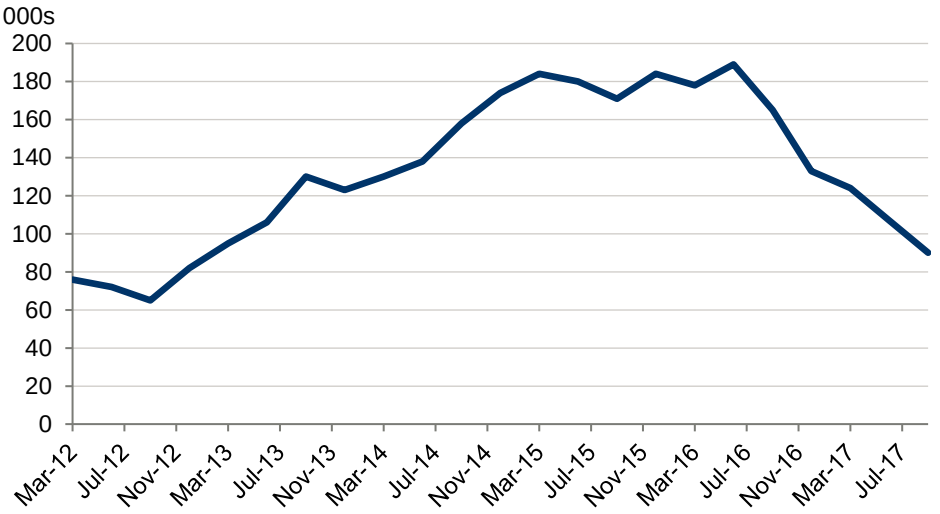
Share of 2016 London workforce who were international migrants

11 percent: equivalent UK figure

recent decades, made up a significant share of London's population growth, swelling its labour force and bringing additional skills to the city's economy. In 2016, 24 percent of London's workforce were international migrants, compared with just 11 percent for the nation as a whole. By coming to London to work, those people helped to avert the emergence of skill shortages in a number of sectors of the capital's economy.

In that context, the 2016 vote to leave the European Union may represent a significant challenge for London. Following the referendum, London experienced a decline in business confidence and weaker employment growth in 2017—and, more recently, a fall in house prices. As Fig. 1 shows, last year also saw a marked net decline in EU migration into the UK, with London accounting for a significant share of that national fall.

Fig. 1. EU net migration into UK, year-to-Mar 2012 to year-to-Sep 2017



Source: ONS

The extent to which these changes in economic performance and in migration were directly generated by Brexit is unclear – and indeed in the case of migration, perhaps not the point. Even before the Brexit vote, the government had a declared aim of bringing net migration into the UK down to the "tens of thousands". Achieving that has so far proved illusive, but the referendum result is now likely to make it a priority.

69%

Our forecast decline in annual net international migration into London

From 99,000 a year in 2012-16 to 31,000 a year in 2023-40

As a result, our expectation is that for London, international net migration into the capital will fall from 99,000 a year in the 2012-16 period to 60,000 a year in the 2017-22 adjustment period, and then just 31,000 a year in 2023-40. This includes any increased tendency for existing EU nationals to return home, and any changes in the tendency for UK nationals to move to, or back from, the EU post-Brexit. These are, therefore, net rather than gross flows.

Overall growth in London's population is—and will continue to be—rather higher than that. Natural change (births minus deaths) is a large source of population growth, and one that is expected to decline in the capital only slowly. However, overall net domestic migration tends to be negative, because young adults moving to London for work, often soon after graduation, are typically outweighed by families and retired people moving away. The result is that in

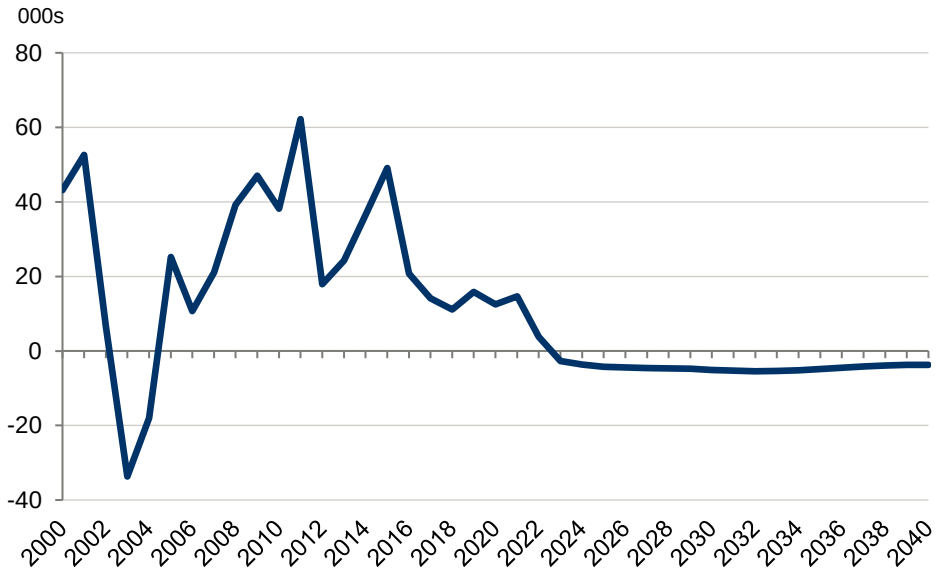
our forecasts, and as Fig. 2 shows, total net migration (international and domestic combined) turns negative within five years, thereby becoming a drag rather than a driver of London's economic growth.

5 years

The time until London starts to see net migration outflows.

Assuming net migration falls to the top end of the Government's 'tens of thousands' objective

Fig. 2. London's total net annual migration levels, 2000-2040



Source: ONS, Oxford Economics

What is the basis for our forecasts?

We regard the assumptions that underpin this report's population and other forecasts as cautious. In particular, we interpret the government's "tens of thousands" target for net migrants into the UK to mean the upper end of that size band, and we assume that London's share of the UK total will be similar going forward to what it has been historically.

We also do not expect inflows of non-EU migrants to fall as fast as the inflows of EU migrants, because these numbers are already tightly controlled and it would be difficult to push them down further. So it is migration with the EU which "takes the strain" when the government seeks to reduce overall inflows.

We have also produced forecasts for output and employment growth in London; these are fully consistent with our forecasts for its population growth. The slowdown is marked: over the past two decades, London has almost always grown markedly faster in terms of contribution to GDP than the UK as a whole; going forward to 2040, it still grows faster—but only marginally so. And whereas London has recently been among the three fastest-growing major cities in Europe, going forward it only just makes it into the top 10.

Slower migration is not the only, nor even the main, reason for London's slowdown—but it is a factor. Migration swells the size of the city, but it also provides London with a huge diversity of skills, and the capacity to develop a myriad of businesses and sectors. The result is a virtuous circle in which growth is self-reinforcing, heavily driven by innovation, networking and linkages.

Evidence for this is provided by the fact that London's economy is much more productive than the UK's (by about 40 percent), with productivity growth since 2000 also stronger (1.4 percent a year versus 0.9 percent for the UK overall). Even after allowing for differences in industrial structure, London's advantage is notable.

40%

Productivity advantage of London over the UK as a whole

Or 30% after adjusting for its favourable sectoral mix

However, a concern remains that looking forward, slower inward migration may weaken London's growth, partly through the direct effect of skill shortages, but perhaps more so through knock-on or "contagion" effects in London's unusually dense and interdependent economy, in which problems in one sector are likely to feed through to others.

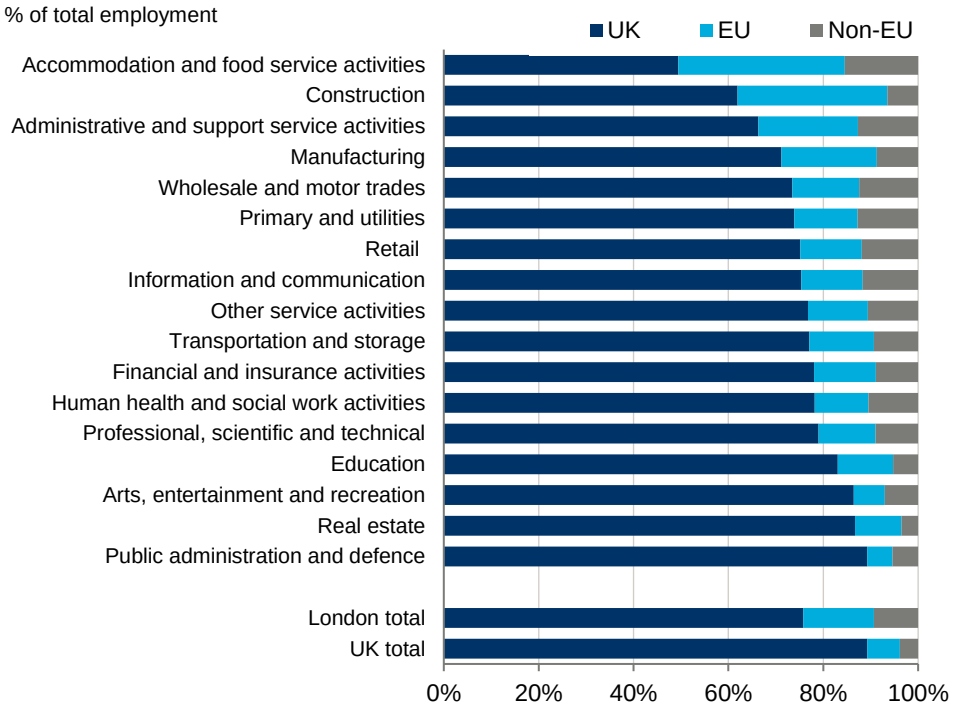
So although in our baseline London forecast, we do not expect that skill shortages will radically damage economic growth in the capital, they are part of the reason that we project a slowdown in growth for the London economy. And because everything in London is so interlinked, the risk of a larger impact cannot be discounted.

Sector shortages and the problem of contagion

Two sectors that are of particular significance for our forecasts are *professional and related services*, *and administrative and support services*. Between them, these sectors account for 47 percent of all the employment growth to 2040. Essentially, these are the higher- and lower-skills components of business services.

This raises one of the central issues of this discussion paper: how might these and other sectors be affected by the likely decline in migrants coming to London from the European Union?

Fig. 3. Employment by sector and nationality, London



Source: ONS

One way of looking at this is to consider two dimensions together: how fast is a sector likely to grow, and how reliant on EU migrant labour is it? The sector that stands out in this regard is *construction*, which, as Fig. 3 shows, has the second highest reliance on migrant labour from the EU.

That leads to an important point, which is rooted in the fact that London is a highly inter-connected city. Skill shortages in one sector might be more important overall than they appear to be in isolation, if they impact on other sectors. We call this **contagion**, and it is the mirror image of the positive interlinkages (known as agglomerations) that have been very important to London's growth in recent decades. Contagion effects were part of the problems of London in the 1970s.

An implication is that sectors such as *transport, retail, health & social care and hospitality*, even if they are not rapidly growing, may still have a disproportionate impact on London via their contribution to residents' quality of life—a key source of the city's competitiveness.

This does not invalidate our cautiously optimistic baseline forecast for London's economy, but it does highlight that the risks may be larger than they first appear.

That is why policy on EU migration is very important. But it does involve some difficult choices. For example, a migration regime which favours the higher skilled at the expense of the lower skilled is problematic, if it makes it hard for the health & social care sector to recruit (for example) care workers. The same is true for lower-skilled hospitality workers, and many others.

Again, we need to maintain a sense of perspective. Employers can respond to recruitment difficulties by investing in training or by introducing new technology, or they can simply pay more.

However, the evidence suggests that employers are reluctant to invest heavily in training because of the threat of losing the staff to rivals —and nowhere is that more likely to happen than in London. Investment rates are low and unlikely to rise in conditions of uncertainty, and offering higher pay essentially just shifts the problems to other employers, sectors or indeed (if it raises migrant inflows into London from the rest of the UK) regions.

All of this suggests that there are policy choices to be made which are not straightforward. Protecting the highly inter-connected London economy from the threat of contagion, whereby isolated skill shortages could have system-wide impacts, would seem to be one of the principles to adopt—not least because London is a major contributor to the success and wealth of the UK economy overall.

1. INTRODUCTION

This is not a report about the case for or against Brexit, and nor is it about the broad impact of Brexit. Instead, it considers how changes to migration flows, some of them associated with Brexit, are likely to shape London's population over the short, medium and long term—and what the impact of this on London's economy, sectors and property markets might be. We set out our central or "baseline" forecast, but we also identify some of the risks that this baseline does not capture.

This report has been commissioned by Grosvenor Britain & Ireland, as a contribution to a wider policy debate that it believes needs to take place to address a broad range of issues for London–many, but not all, of which we raise in the sections that follow.

In the next chapter, we describe London's population and migration changes over the distant and more recent past, detailing the impact of migration on the make-up of its current population at both city-wide and borough levels. We look at the immediate aftermath of the Brexit vote, and ask what the links are between London's migration levels and its economic growth—past and future.

In Chapter 3, we detail our population forecast for London up to 2040, and the assumptions underpinning it. This includes projected net international and domestic migration levels for the whole period, again at both city-wide and local levels, and an assessment of how this will impact on London's age demographic up to 2040.

In Chapter 4, we describe our associated economic forecasts for London, including a comparison with other European cities. We consider the impact on the capital's future employment levels, with a particular focus on key sectors that might experience a "skills shortage" as a result of our projected population changes.

Finally, in Chapter 5, we describe and discuss a range of possible policy responses to these forecasts.

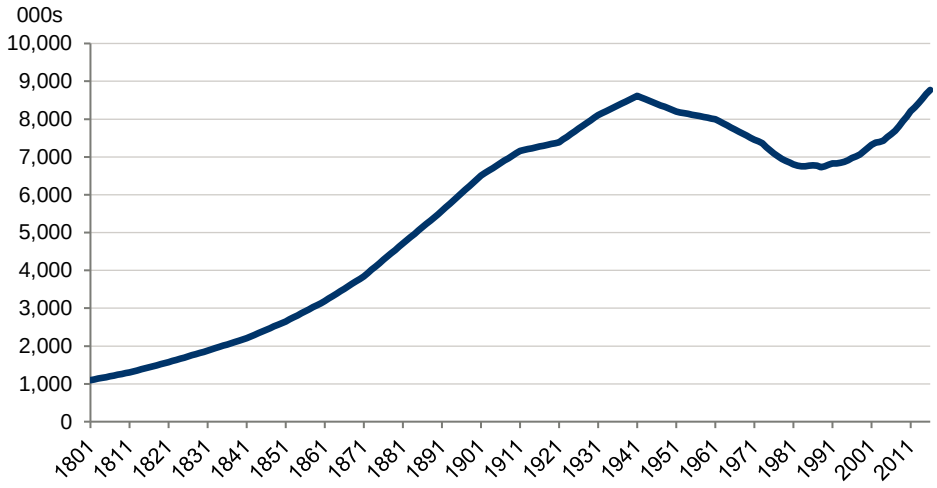
Note: this report considers the effects of both international migration (including British citizens leaving London to move overseas) and domestic migration (relating to movements to and from other parts of the UK). In all cases, unless otherwise stated, we describe "net" migration levels; this is the combined inflow and outflow of migrants in each category, and may therefore be positive or negative in value. "Overall migration levels" refer to the total net level of international migration plus the total net level of domestic migration.

2. LONDON'S POPULATION TO DATE

2.1 A LONG-RUN PERSPECTIVE

Over many centuries, London has evolved into one of the largest and most prosperous cities in the developed world. Its success has been so great that it is easy to forget this story is not one of perpetual growth. Indeed, as Fig. 4 illustrates, the capital's population **declined** from 8.5 million in 1939 to 6.8 million in 1991. It was only in 2014 that the number of residents once again exceeded the 1939 level.

Fig. 4. Population of London, 1801-2016



Source: London Datstore, ONS, Oxford Economics

Several factors explain this decline. The Second World War had an obvious and direct impact on London's population levels, while the subsequent reconstruction period through to the 1960s saw a deliberate policy of addressing overcrowding and slum-conditions by redistributing the population away from London to its surrounding counties and beyond.

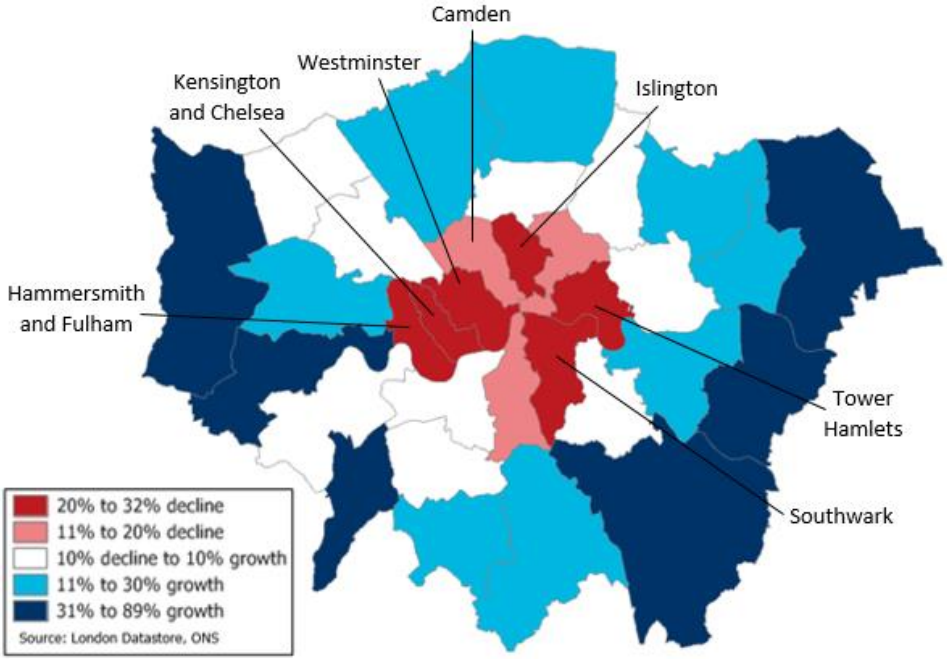
But the war and its aftermath were not the only reasons for London's population decline, and they certainly do not explain why the decline not only lasted so long and even accelerated. The other causes were economic: in particular, significant job losses in the docks, and also in the capital's once-large manufacturing sector.[1]

As a result, and like many other major cities around the world, London in the 1970s experienced a downward spiral of rising unemployment, overstretched public services, and the departure of more-affluent residents and more-successful companies.

[1] London manufacturing grew strongly throughout the industrial revolution and the Victorian period, and again in the 1930s, but declined, particularly in terms of employment, from the 1960s onwards.

Even today, significant parts of central London still possess smaller populations than they did just before the Second World War, as Fig. 5 illustrates. Until recently, the city's growth has occurred mainly in outer London, reflecting a mix of conscious policy ambitions, housing costs, and the preferences of Londoners regarding where to live.

Fig. 5. Changes in population of London's boroughs, 1939-2016

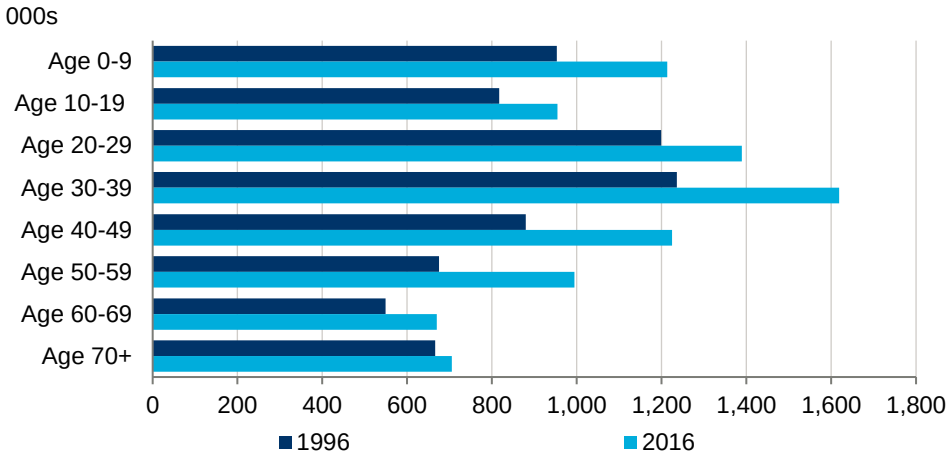


2.2 FROM 1996 TO 2016: LONDON'S POPULATION BOOM

Since the 1990s, London's population has been growing strongly. In 2016, there were 8.77 million people living in the capital, of whom 5.96 million were of working age—increases of 15 percent and 14 percent respectively over the equivalent 2006 figures (7.60 million and 5.22 million). This compares favourably with the same period's population gains of eight percent and five percent for the UK overall.

As Fig. 6 shows, the growth has occurred across every age group. There are more children, more adults of working age, and more elderly people in London now than there were 20 years ago.

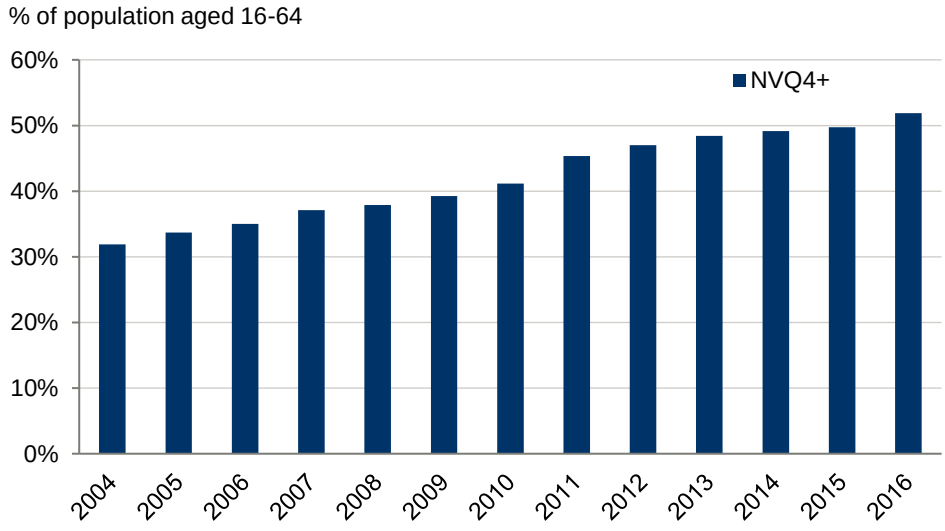
Fig. 6. London's population, 1996 & 2016



Source: ONS, Oxford Economics

The population of London has also become better educated, as Fig. 7 shows. Over half of all adult Londoners are educated to degree level or above. The equivalent figure for the UK is just 38 percent.

Fig. 7. Population with NVQ4+ qualifications, London, 2004-2016

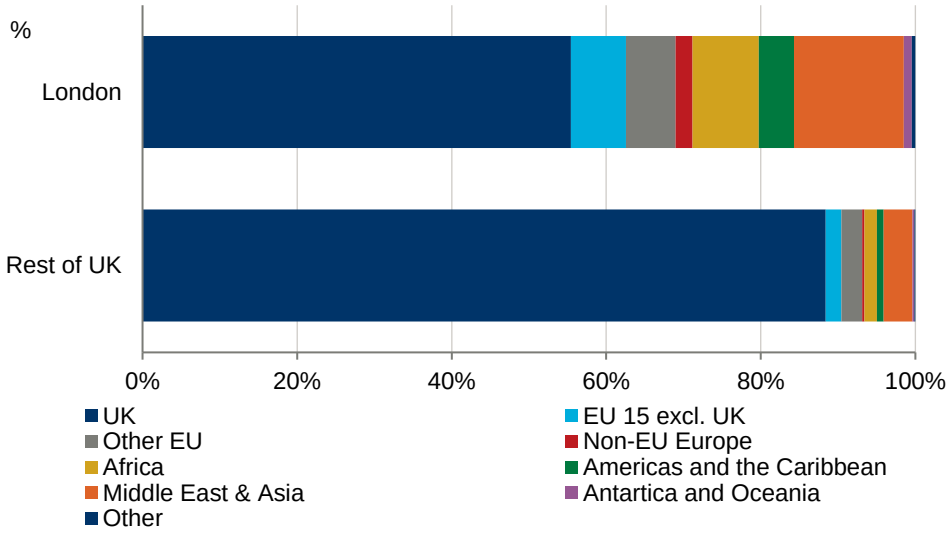


Source: ONS

London also compares favourably with its key European rivals. Eurostat figures for 2016 show that 57 percent of 25- to 64-year-olds living in London have completed tertiary education, compared with 47 percent in Paris, 43 percent in Amsterdam, 39 percent in Berlin and just 33 percent in Frankfurt. This is a factor behind London's competitive success, and it heavily reflects migration into the city, both domestic and international.

However, what is perhaps most striking is the extent to which Londoners tend to have been born outside the capital, and in particular, outside the UK. As Fig. 8 illustrates, in 2016 nearly half of London's population was born outside the UK, and 13 percent in the rest of the European Union. That makes for one of the world's most diverse cities, and makes London fundamentally different from the rest of the UK.

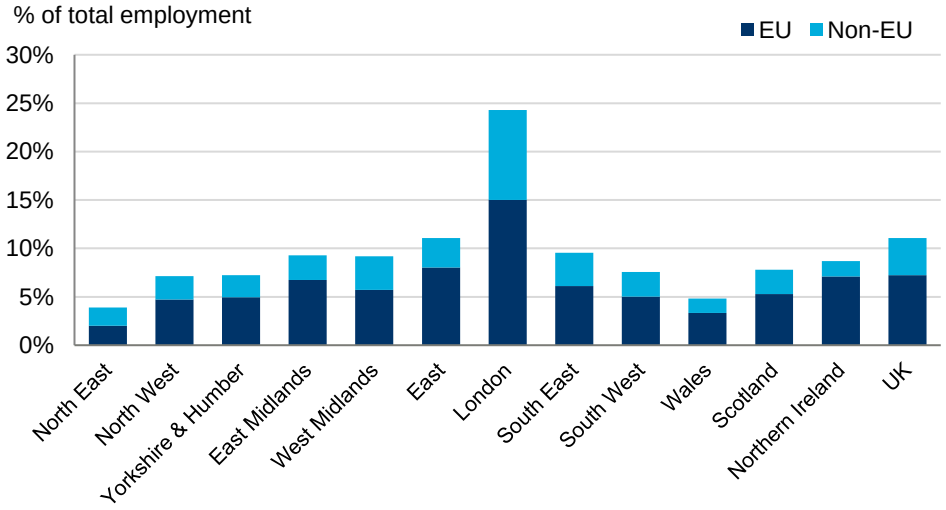
Fig. 8. Population by place of birth, London & UK, 2016



Source: ONS

The reason for this is of course a history of significant inward migration of people from the EU (and from other countries) into London.[2] Most of these have come to work. The result is that, as Fig. 9 shows, in 2016 24 percent of people working in London were migrants, of which 15 percent were from the rest of the EU, compared with 11 percent and seven percent respectively for the UK. At the other extreme, in the North East, the figure for total migrants was only four percent.

Fig. 9. Migrant share of employment, UK regions. 2016, %



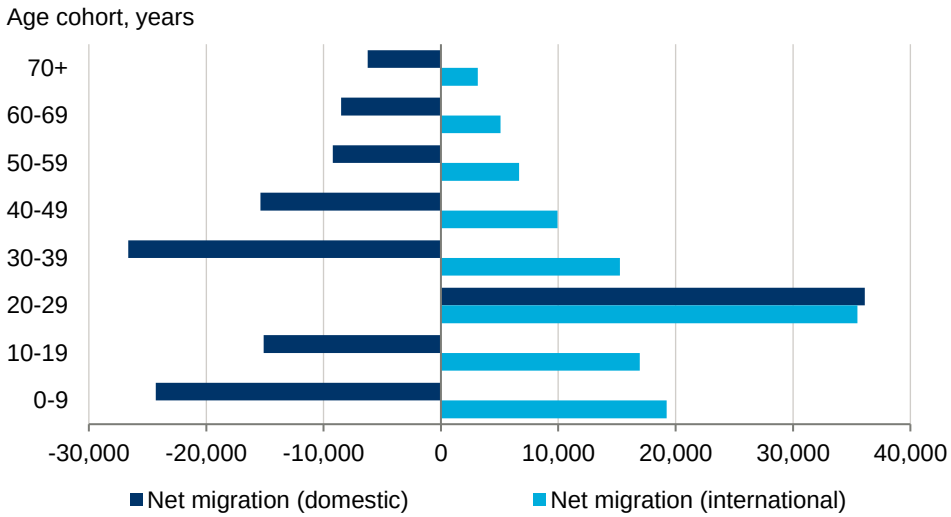
Source: ONS

[2] Note that nationality/citizenship and place of birth are not the same thing. An important reason is that many British citizens were born abroad and migrated to the UK, and others acquired UK nationality having lived in the country for several years.

That said, international migration has not been the only element in London's population growth. 'Natural' increases – the difference between births and deaths – are nearly as important in explaining the rise in the city's population. And in addition, there have also been large migration flows into London from the rest of the UK, mainly of young adults of working-age (often, recent graduates). But in the latter case, these have been **more than offset** by outflows from London of older working-age adults relocating to neighbouring counties while continuing to work in the capital, and of people of retirement age moving away altogether.[3]

Fig. 10 illustrates the overall pattern, showing large net inflows of people aged 20-29 from both the rest of the UK and overseas, but opposing net flows of people in other age groups.

Fig. 10. Greater London net migration, 2012-2016

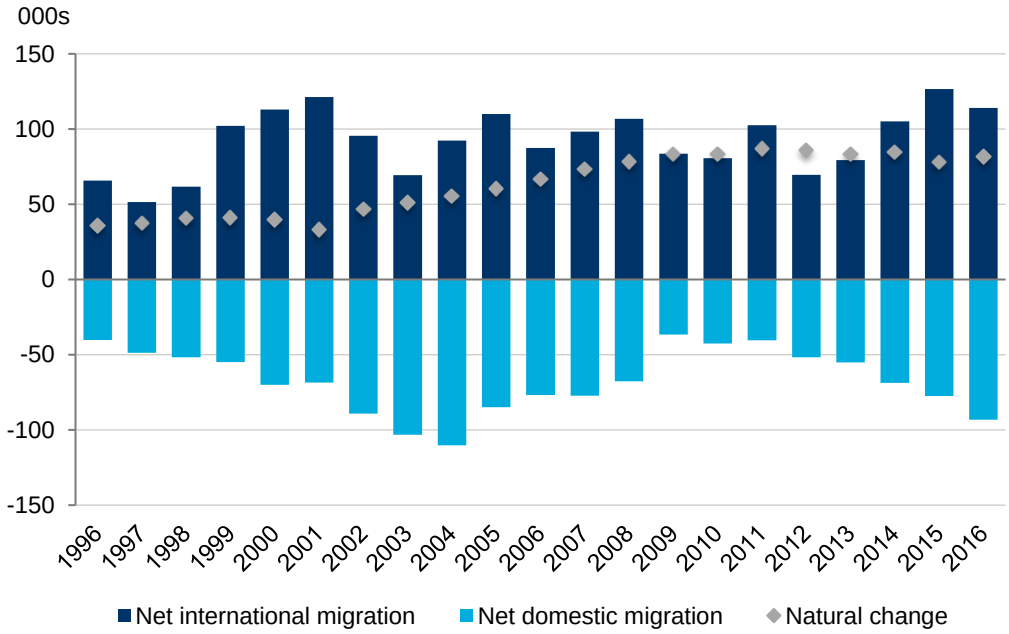


Source: ONS

Overall, in the period 2012-16, net international migration typically added 99,000 a year to London's population; natural growth added another 83,000, and net outward migration to other parts of the UK reduced London's population by -69,000 annually. That generated an overall average increase of 113,000 a year. Fig. 11 shows the rather longer period back to 1996, and shows how the figures have fluctuated from year to year, but with net international migration always an important source of population growth for London, and usually more so than natural increase, despite the importance of the latter.

[3] The distinction between net and gross flows is important. Overseas nationals moving to the UK are partially offset by other overseas nationals leaving the UK, usually to return to their home countries. And the numbers also include UK citizens going to live abroad, net of those returning from living abroad.

Fig. 11. International and domestic migration, London, 1996-2016, 000s



Source: ONS, Oxford Economics

International migrants into the UK, including into London, tend overall to be more highly-qualified than the existing resident population. A big reason for this is that the points-based migration system for non-EU migrants coming to work effectively means that such people have to be educated to at least degree-level, and need to be coming to occupy jobs at the same level. Another reason, which also applies to migrants from the EU, is that migrants tend to be younger than the average for the existing population, and hence are more likely to be highly-educated.

Nevertheless, it remains the case that migrants from the EU 14 countries (essentially the pre-accession members, excluding the UK itself) are particularly likely to be highly educated, as Fig. 12 shows. In contrast those from the EU 8 countries (the more recent accession member states) are mostly not degree-level educated—something that is reflected in the jobs that they typically perform.

Fig. 12. Qualifications & hourly pay, UK residents and EU migrants

Nationality	Gross hourly median pay (£) UK 2016	Degree educated. UK 2016, %	Degree educated London 2015, %
EU14	12.59	57	58
EU8	8.33	24	30
UK	11.53	33	44

Source: ONS

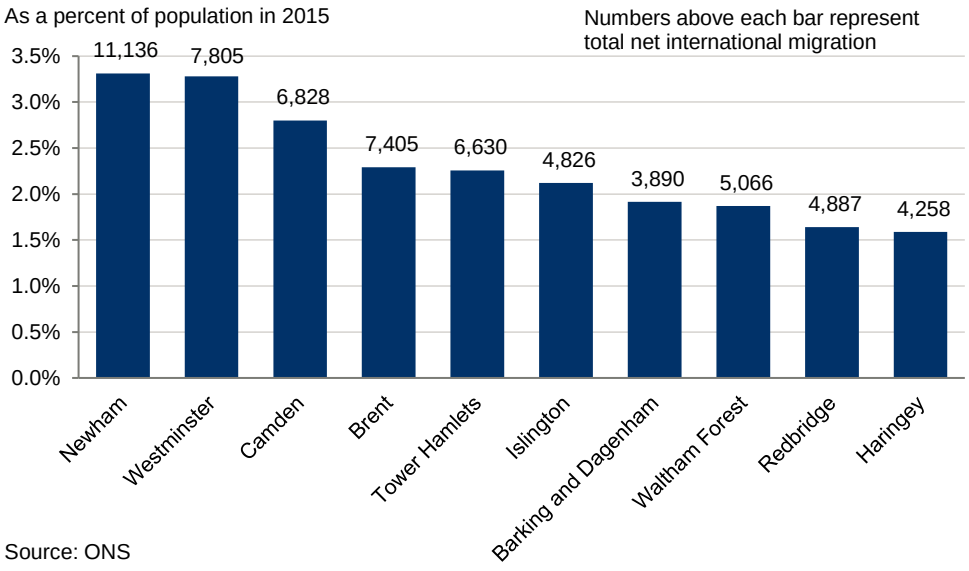
And as Fig. 12 also shows, these differences are reflected in average wage levels: higher for the EU 14 migrants than for the existing UK resident population, but lower for the EU 8 migrants.

2.3 MIGRATION AT THE BOROUGH LEVEL

The prevalence of migration has inevitably differed across London's various boroughs. This is true for both international and domestic migration: some boroughs have experienced stronger net inflows of migrants from the EU and other nations, and these have been added to—or, more often, offset by— net domestic migration movements.

By way of illustration, Fig. 13 shows the 10 London boroughs in which net international migration was highest in 2016, relative to their population. While the average international net inflow for London as a whole was 1.3 percent of the existing population, for several boroughs it was over 3 percent—with Newham and Westminster at the top at 3.3 percent each.

Fig. 13. Net international migration, boroughs with fastest rises, 2016



Source: ONS

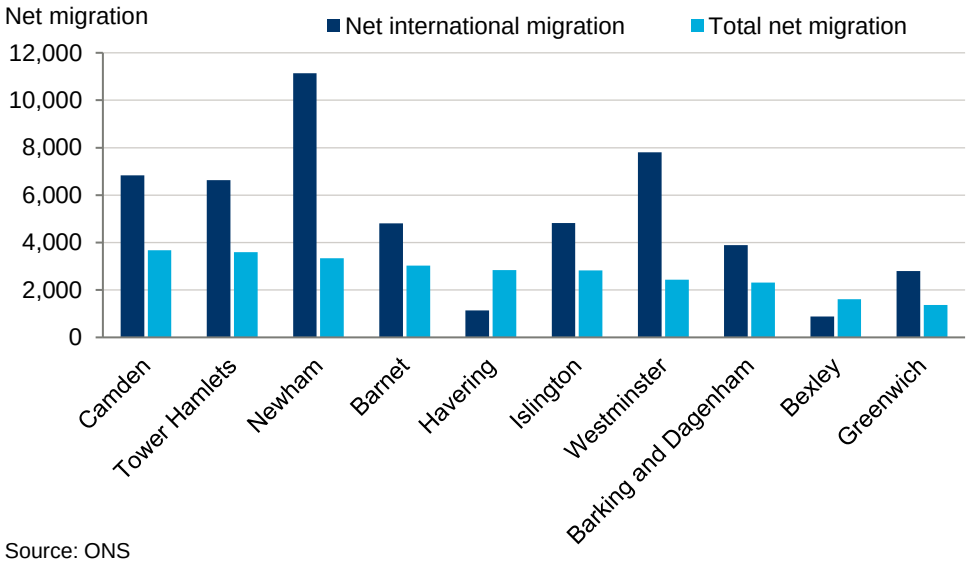
What is striking here is that Newham and Westminster are very different boroughs to one another. Indeed, the heterogeneity of the 10 is striking: wealthy and poorer boroughs, inner and outer London, east and west.

Complicating the picture is that different boroughs have different inflows or outflows of people to other parts of London, or to other parts of the UK. So the boroughs with large net international inflows may not experience the largest overall net migration increases, and hence may not experience the greatest impact on resource needs.[4] For example, in 2016 the approximately 7,800 net international migrants into Westminster were substantially offset by a net outflow of nearly 5,400 people going to live in the rest of the UK, including other London boroughs. The story for Newham is even more striking, as Fig. 14

[4] A full consideration of resource needs is beyond the scope of this paper, but clearly depends heavily on the relative ages of those who arrive compared with those who leave, among other factors.

indicates. Camden and Tower Hamlets were the boroughs with the largest overall net gains from migration, because they experienced relatively modest net domestic outflows.

Fig. 14. Net migration, boroughs with largest absolute rises, 2016



Source: ONS

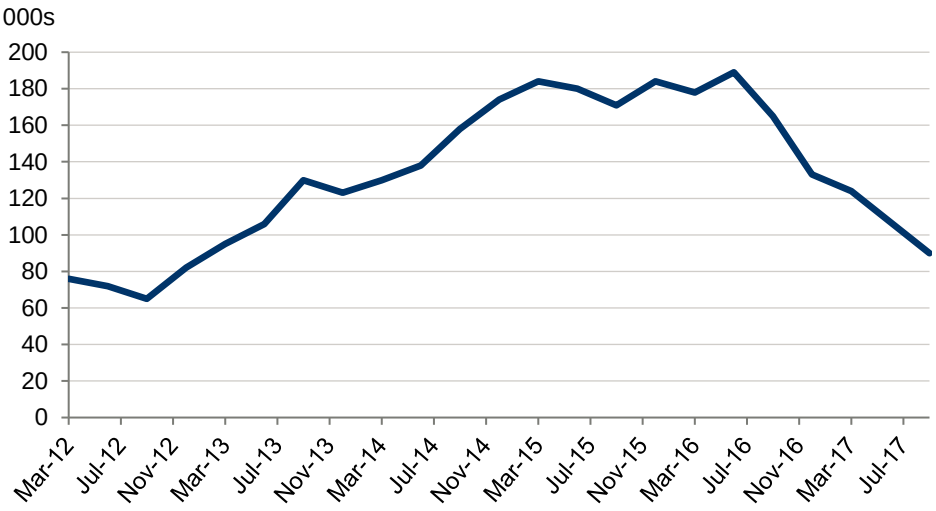
2.4 THE 2016 EU REFERENDUM: A POSSIBLE TURNING POINT?

By 2016, the positive trends over the previous two decades and more had become so well entrenched that they had come to be mostly taken for granted. London was a magnet for (young) workers, notably from the European Union, and so it seemed likely to remain. But then, in June 2016, the UK electorate voted to leave the EU.

For London, with its large accumulated total of EU residents and workers, and its large annual flows of people into and out of the EU, this represented a particularly significant break with the past.

Even at the national level the change was a striking one. Figures from the Office for National Statistics (ONS) shown in Fig. 15 indicate that the Brexit vote was followed by a falling away in net migration from the EU into the UK. In the year ending September 2017, EU net migration declined sharply, to 90,000, as fewer EU citizens were coming to the UK and the number leaving the UK increased. This was the first time since 2013 that the annual net inflow from the EU was less than 100,000, and it was significantly below the 189,000 reported in the year leading up to the referendum in June 2016.

Fig. 15. EU net migration into UK, year-to-Mar 2012 to year-to-Sep 2017



Source: ONS

How much of that was directly or indirectly due to Brexit is unclear. The fall in the exchange rate that followed the vote was a likely factor, and was itself probably partly (but not necessarily entirely) due to the referendum result. The improved performance of the EU economies relative to the UK was another consideration. What we can be sure of is that London shared in the EU migration net decline, and perhaps disproportionately so. There are no ONS data to demonstrate this, but our Oxford Economics estimates are that international net migration to London is currently running at around 75,000 per year, having been at around 120,000 in the year leading up to the referendum, with lower EU net migration underpinning this reduction.[5]

So, even before any new migration controls have been put into place as a result of Brexit, international migration into London has almost certainly fallen away sharply, with the Brexit vote as one of several possible explanations.

In the next chapter, we set out our forecast for London's migration numbers and population growth until 2040, before going on to explore the potential impact on growth and jobs, and the policy issues that our projections raise.

[5] The recent reduction in international net migration has been due to lower EU net-migration rather than from other countries, and London is likely to have a similar pattern simply because it accounts for more than a third of UK international net migration.

ANALYSIS: MIGRATION, AGGLOMERATION, AND LONDON'S ECONOMIC GROWTH

Has London's past economic success been the **consequence** or the **cause** of the capital's net inflows of migrants? There are reasons to think that causation has worked in both directions, and that this will also be true going forward. If future international net migration is lower, then economic growth is likely to be lower too.

Of course, it is important not to exaggerate the extent to which population growth and especially inward migration drives London's economy. The revival of the London economy since the early 1990s has clearly had several drivers: two that were linked were the growth of new, higher value-added service sectors, and the liberalisation of markets—starting with the City of London's "Big Bang", but extending to other markets such as home loans and telecommunications.

Linked to this, in turn, was the introduction of new technology, which has been a major driver of London's recent success. This has led to the growing tendency for boundaries between sectors to become blurred—a trend which plays to London's strength as a highly diverse and complex city.

How important is London's migrant population?

While the drivers of the city's economic growth are many and diverse, they have all been facilitated by the growth in London's working-age population, which has risen by 14% since 2006, up to 5.96 million in 2016. This population includes large netinflows of people from the rest of Europe, and the gradual expansion of the European Union has therefore played a role in London's expansion. Without EU migrants, all else being equal, London's economic growth is likely to have been slower.

However, there are several reasons for thinking that population growth, and migration in particular, is **not only a facilitator but also a driver of economic growth**—and particularly so where London is concerned. Part of the reason is scale: a growing population implies a city with scope for greater economies of scale, and hence higher productivity—which is, in turn, the basis for more growth.

A second part of the reason is that migrants have tended to raise the city's average levels of skills and qualifications. As we noted earlier, those who come to the UK from the EU 14 countries and from outside the EU tend to be more highly qualified than existing UK residents, something that is likely to be particularly important in London.

However, the third part of the argument may be the most important. London's population growth, and in particular its net inflows of international migrants, has provided the capital not only with higher average skill levels, but also with a great diversity of skills.

The advantages of agglomeration

London has developed an unusually diverse economy, characterised by strong linkages between businesses and sectors, strong networks and rapid innovation. This generates additional dynamism, known as "agglomeration"—and the capital is a classic example of this phenomenon. [6]

For example, London's world leadership in tourism complements, via the hospitality sector, its leadership in business services, which strengthens its leadership in financial services, which has created major opportunities for the digital sector, which has helped to build London's reputation as an exciting city—to the benefit of the tourism sector. And so on. Diversity leads to success, and

[6] For an analysis of agglomeration see Nathan M & H Overman, 2013 "Agglomeration, clusters, and industrial policy" Oxford Review of Economic Policy, Volume 29, Issue 2, Pages 383–404.

international migration promotes diversity.[7] That in turn is likely to raise overall productivity and hence average wage levels. This is mainly because it facilitates closer matching of specialist skilled-workers to specific jobs.[8] In addition, there are other more complex routes. For example, if more migrants mean that there are more care-workers, it becomes easier for highly-qualified people (typically women) to enter the labour market rather than providing care for children or others.

Many business surveys provide evidence on how important the range of skills, and the associated "cosmopolitan" character of London, is to the city's success.[9] But a different kind of evidence is provided by comparing productivity in London with productivity in the rest of the UK, where agglomeration opportunities are much more limited.

As Fig. 16 illustrates, London's economy is much more productive than the UK's (by about 40 percent), and productivity growth since 2000 has been stronger than the UK's (1.4 percent a year versus 0.9 percent).

Fig. 16. Productivity and productivity growth in UK regions, 2000-2016



Source: Oxford Economics

However, while London's industrial mix is favourable—it has a relatively high concentration of the most highly productive sectors, and those that have achieved the largest gains in productivity, since 2000—this doesn't explain all of the UK capital's "productivity premium".

Indeed, London's economy is both more productive (by about 30 percent) and has achieved faster productivity growth (by about 0.3 percentage points per year since 2000) than its industrial mix would suggest. This is strong evidence of the "agglomeration effect". London's expanding population—and probably, its strong net inward international migration levels in particular—has been essential to that.

[7] See Krugman P & A Venables, 1990, "Increasing Returns and Economic Geography," NBER Working Papers 3275, National Bureau of Economic Research.

[8] For the impact of migration on productivity see Ortega F and G Peri 2014, "Migration, Trade & Income" Journal of International Economics 92: 235-51, and for the impact on wages see Portes J, 2016 "Immigration, free movement and the UK Referendum" NIESR Review, 236.

[9] See, for example, the Global Financial Centre Index: http://globalfinancialcentres.net/gfci23/

3. POPULATION FORECASTS

3.1 FROM HISTORY TO FORECAST

If population has played an important role in London's past, and if the population trends have changed directions markedly and (at least as far as international migration is concerned) may in particular have done so recently, then there's an obvious need to think about what future population movements might be.

The only appropriate way to do that is to model the inter-relationships between demographic and economic variables, and to do so locally, for the city as a whole, and also nationally and internationally. In this section we focus on the demographic part of that and in the next we look at the economics; and finally in Chapter 5 we consider a third element: the policy framework.

3.2 LONDON'S POPULATION GROWTH TO 2040

Our baseline forecast for London's population substantially reflects, but is also a driver of, our expectations for employment in the capital, relative to employment growth elsewhere. We discuss employment in Chapter 4.

As Fig. 17 shows, a central conclusion of our baseline forecast is that London's population will continue to rise, from an average 8.8 million in 2016 to 9.3 million in 2022 and 10.6 million in 2040, having broken through 10 million during 2031. We see this as a very positive story.

Fig. 17. Population forecast, London, 2012-2040

000s	2012-16	2017-22	2023-40
Population, end of the period	8770	9332	10627
Change	461	562	1295
Annual averages			
International net migration	99	60	31
Domestic net migration	-69	-48	-35
Total net migration	30	12	-4
Natural change	83	82	76
Total change	113	94	72

Source: Oxford Economics

However, the rate of population growth falls markedly from 113,000 a year in the recent pre-Brexit period to 94,000 over an assumed period of adjustment to Brexit (from 2017 to 2022, so the official 'transition' period plus a year or two on either side to reflect the likelihood that some companies and individuals will still be 'adjusting' after the formal end of the transition agreement itself), and just 72,000 over the long-term. We regard that as a cause for concern, reflecting the points that we made in Chapter 2 about the impact of population on economic growth, and as we discuss in more detail in Chapter 4.

The challenge is therefore to **strike the right balance between confidence that London's population is likely to continue to grow and concern that the rate of growth looks set to slow by over a third**—with likely knock-on effects on economic growth.

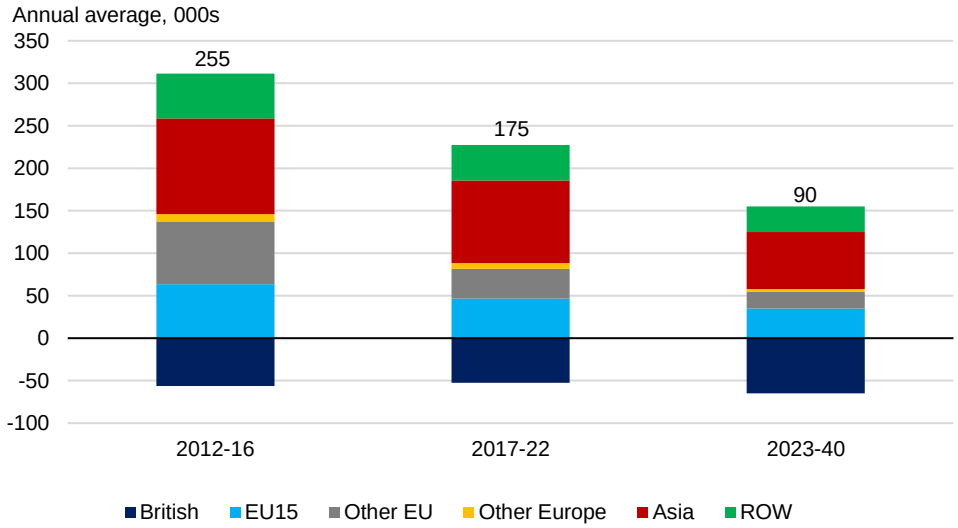
3.3 INTERNATIONAL NET MIGRATION INTO THE UK AND LONDON

Figure 17 shows a decomposition of London's population growth into three factors, starting with international net migration. As can be seen, this has been running at 99,000 a year, but we project that it falls to 60,000 a year over the 2017-22 period and then just 31,000 a year from then until 2040, with a profile that mainly falls away in the earlier years and then flattens out.

That reflects in part our broader view of migration **into the UK**, and assumptions, discussed in Chapter 5, firstly that the present government adopts a migration policy that succeeds in bringing net inflows into the UK down to the 'tens of thousands', and secondly that future governments maintain that policy. However, we think it realistic to assume that the flows will be at the top end of that range. We also expect that London's share of the UK total will remain broadly in line with its past average of 34 percent.

An important element within the national picture going forward is whether or not UK nationals continue to migrate out from the UK, as historically they have done, and as Fig. 18 shows.[10]

Fig. 18. Net international migration, UK, 2012-2040



Source: ONS, Oxford Economics

[10] In this report and for simplicity we mainly refer to the European union (EU) not the European Economic Area (EEA), although strictly speaking the current international mobility of labour arrangements relate to the EEA not the EU. In addition, it is likely that post-Brexit there will continue to be free movement of people with the Irish Republic, since that arrangement long-preceded the UK's membership of the EU and its predecessors. Again, for simplicity we do not directly address this.

It can be seen from fig. 18 that there continues to be an international outflow of UK residents. Indeed the outflow increases, because as the UK economy slows relative to the EU economies, the relative balance of job-opportunities will also shift.

But there are alternative and additional possibilities. One is that the UK's departure from the EU will precipitate a significant repatriation of UK citizens who are currently living in the EU. That does not feature in our baseline, on the assumption that the entitlements to work, receive healthcare, and so on of UK citizens who are already living elsewhere in the EU will not alter substantially as a result of Brexit. However, this is clearly still part of the negotiating process, so the outcome may be different from our expectation.

As Figure 18 also shows, the projected decline in the net inflows of people from the rest of the EU to the UK is particularly marked amongst nationals of the EU accession economies – the EU 8+2. This reflects our assumption that future UK migration policy will be more permissive towards the highly skilled, and that these people are more likely to originate in the EU 15 economies than in the EU 8+2. We return to this key issue in, below.

In contrast we assume that, to the extent that Brexit does cause EU citizens, currently resident in the UK, to decide to return to their home nations, that is spread proportionately among the higher and lower skilled, and proportionately among the citizens of different EU nations, and it occurs at **broadly the same rates for London and for the rest of the UK**. So these factors are not sources of change with respect to these relativities.

Another message from Figure 18 is that net inward migration from the rest-of-the-world into the UK also falls, but by less than the decline in EU inflows. This is because non-EU flows are already tightly controlled. This has the obvious consequence that overall net inflows become more tilted towards migration from beyond Europe.

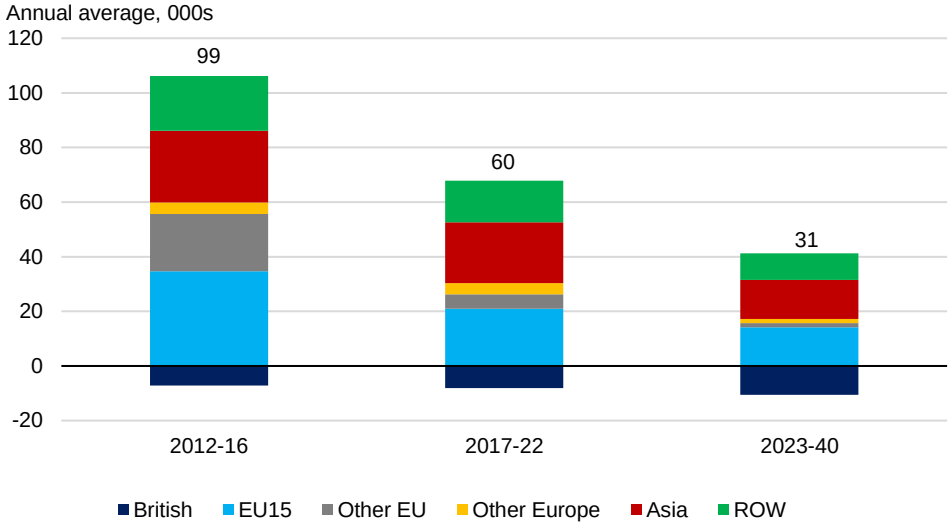
Here too, our expectation is that these patterns are **broadly the same for London as for the rest of the UK**. This is to be fair a judgement based on little hard evidence. London's exposure to migrant workers is high and that may mean that any decline in net UK inflows will affect London more than others. And London's migrants may also be more mobile because of their higher skills. That said, the 2017 decline in net migration into the UK was tilted towards people from the accession countries, suggesting that it is not the most highly qualified who are always the most mobile.

For all migrants it is important to remember that our figures are net. In particular the reduction in migration from the EU is a combination of fewer people moving to the UK and more people leaving the UK. The government has said that those who are already here will not lose any of their entitlements, and has recently extended this to those who arrive during the recently-agreed (at least in principle) transition period. Our assumption is that there will not be a large exodus of non-UK EU citizens from the UK. Indeed, the outflows of people currently in the UK may fall, if people fear they may not be allowed back in. Equally we are not assuming a surge of people moving into the UK during the transition period; if the UK's economic growth was dramatically higher than

elsewhere, that might make a difference, but as we explain in Chapter 4, it is not what we forecast.

The overall impact is shown in Fig. 19. As we noted above, the overall net numbers come down from 99,000 a year in the period immediately preceding the Brexit vote to 60,000 a year in the current adjustment phase, to a longer-run 31,000 a year once the transitional phase is over and the new migration regime (whatever this is—we discuss the alternatives in Chapter 5) has been fully put in place. This is a substantial adjustment for the London economy.

Fig. 19. Net international migration, London, 2012-2040



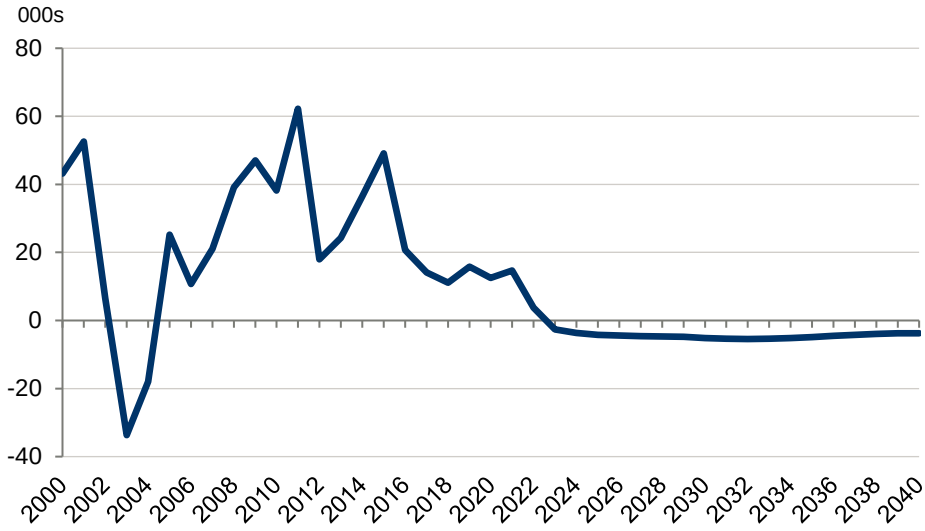
Source: ONS, Oxford Economics

3.4 DOMESTIC & TOTAL NET MIGRATION INTO LONDON

As we noted in Chapter 2, and contrary to what is widely assumed, net migration from the rest of the UK into London is typically negative, with net inflows of young adults more than offset by net outflows of older adults and children and young people. We expect this to continue, although not to the same extent as in recent years. This is because historically, when net international migration into London rises, net domestic migration out of London tends to fall, although not to the same extent. We assume that this relationship will continue into the future.

The combined effect of these changes is that **overall net migration of people into London**, both from overseas and from other parts of the UK, **swings from being positive** (30,000 a year) in the 2012-16 period **to marginally negative** by the 2023-40 period (–4,000 people a year). Fig. 20 illustrates this.

Fig. 20. Net migration, domestic & international, London, 2000-2040



Source: ONS, Oxford Economics

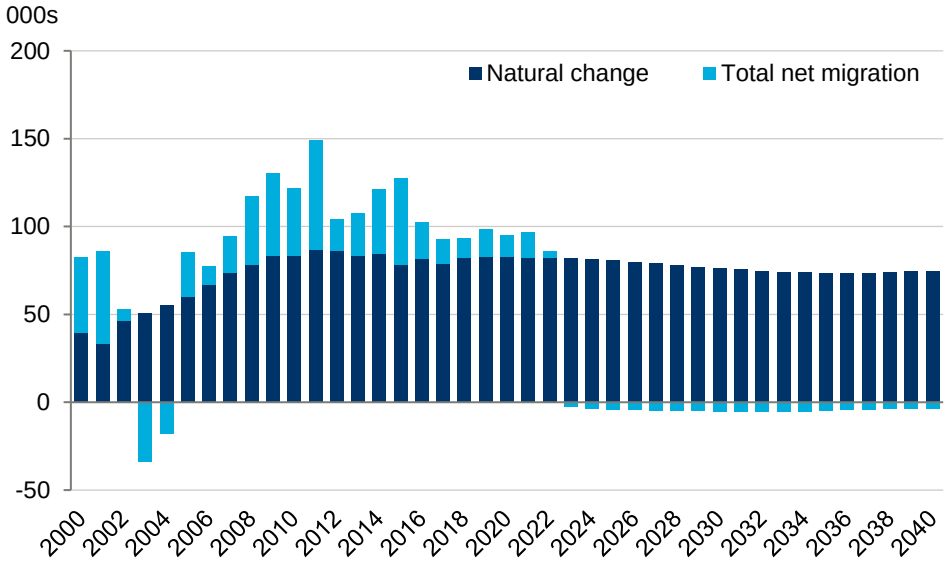
It should be noted that these are changes in **flows**: the impact on the **level** of population will not be nearly so noticeable. Even by 2040, and by the standards of the rest of the UK, London will still have an unusually large proportion of migrants as part of its population, and even more so a large proportion of people who were formerly residents of other countries.

However, in terms of the **dynamics** of the city this is likely to **feel like** a significant shift, and in terms of factors such as **skills availability**, it will genuinely be an important change. The extent to which the change in flows represents a real threat to London's economy is covered in Chapter 4, where we look in particular at issues to do with sectors and skill levels.

3.5 NATURAL CHANGE AND AGE PROFILE OF POPULATION

As we have already said, London's population will continue to grow strongly, even when net migration turns negative, and we forecast that it will reach 10.6 million by 2040. The reason is of course, and as Fig. 21 makes clear, the continuation of natural population growth. London has a large proportion of young adults relative to elderly people, and hence the number of live births is substantially greater than the number of deaths.

Fig. 21. Natural change and net migration, London, 2000-2040, 000s



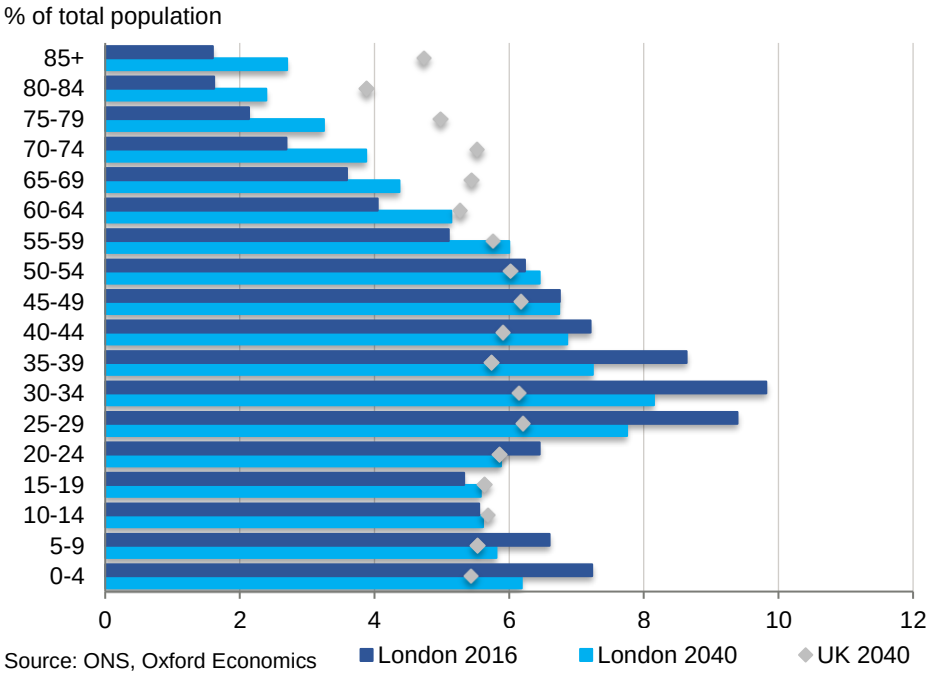
Source: ONS, Oxford Economics

Nevertheless, this pattern is also set to diminish through time, even if only slowly. The natural increase in population was 83,000 a year in the 2012-16 period; in the years 2023-40 we expect it to be 76,000 a year, so only a small decline in the scale of increase, in comparison with the more marked net migration falls discussed above.

Does this imply that the projected decline in migration does not matter, because it is overwhelmed by the natural increase in population? If migrants and existing residents were identical, that might be a reasonable conclusion. However, that is not the case, as we discuss in the following Section.

Linked to these trends in migration and natural change, the age profile of London's population will change over time, but not dramatically so. As Fig. 22 shows, the difference between London today and in the future will be less than the difference between London and the UK.

Fig. 22. Population by age band, London & UK, 2017 & 2040



Source: ONS, Oxford Economics

In particular, London will continue to have an unusually large number of people aged 25 to 39. That should help to prevent the population slowdown from feeding through fully into slower growth in GVA, but it still means that, as we discuss in the next Chapter, growth will be lower than it would be if population growth was higher – and so almost certainly lower than it has been in the recent past.[11]

3.6 WHAT THIS MEANS FOR LONDON'S BOROUGHS

As with the past, so with the future: variations between London boroughs are likely to be quite marked. Fig. 23 shows our international migration projections for different parts of London, with Inner London split into east and west and outer London split into three sub-regions.

[11] It is possible in principle that slower population growth generates an increase in productivity that cancels out the negative impact on GDP growth. We consider this in Section 4.

Fig. 23. Net international migration, London, 2012-2040[12]

000s	2012-2016	2017-2022	2023-2040
Inner London – East	37	20	10
Inner London – West	17	10	5
Outer London - East and North East	17	18	18
Outer London – South	6	6	6
Outer London - West and North West	22	15	7
London	99	60	31

Source: ONS, Oxford Economics

It can be seen that in recent years the largest international inflows have been into Inner London East. A key role has been played by Newham, which reports particularly strong flows in recent years and is expected to continue doing so. Nevertheless, we project that for Inner London East as a whole, the net international inflows are already almost halving, between the pre-Brexit period and the present 2017-22 adjustment period, and will then halve again over the long-run to 2040.

For completeness, Fig. 24 shows the equivalent figures for domestic migration.

Fig. 24. Net domestic migration, London, 2012-2040

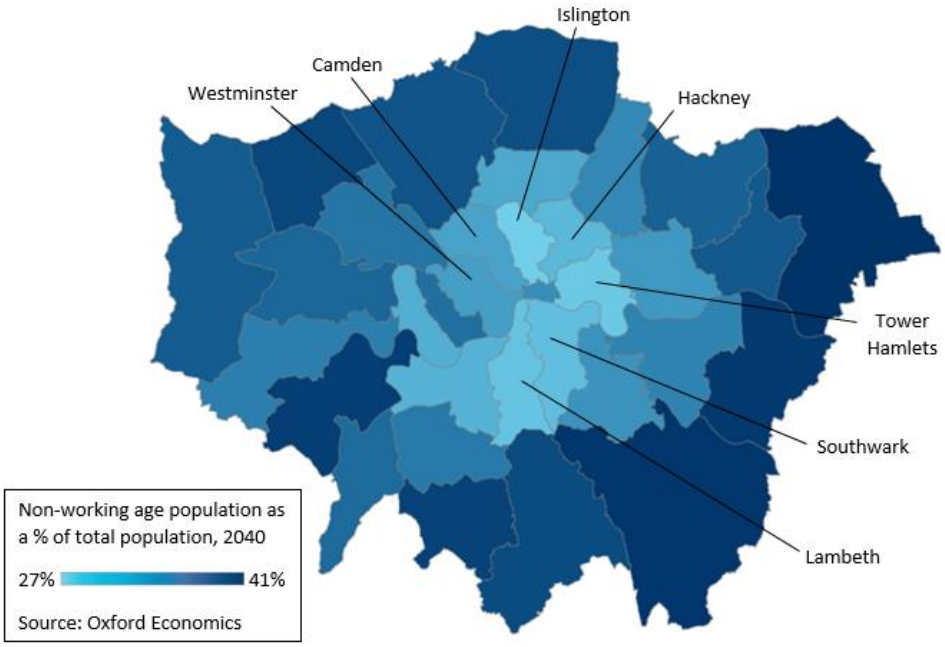
000s	2012-2016	2017-2022	2023-2040
Inner London – East	-22	-13	-8
Inner London – West	-14	-11	-7
Outer London - East and North East	-9	-8	-7
Outer London – South	-2	-2	-3
Outer London - West and North West	-22	-13	-11
London	-69	-48	-35

Source: ONS

Taken together, these changes will impact on the relative age profiles of London's boroughs' populations, going forward. One of the important consequences of this is the way in which the boroughs' dependency ratios (the proportion of the population above or below normal working age) varies across London. Fig. 25 shows this for 2040.

[12] For definition of these sub-London regions see – https://www.ons.gov.uk/methodology/geography/ukgeographies/eurostat#london

Fig. 25. Dependency ratios, London boroughs, 2040



It can be seen that the variations across London are set to be very large: higher in outer London and especially the eastern boroughs of outer London, but particularly low in Tower Hamlets and in Islington.

Once again, this implies that the 'feel' of London's boroughs will vary significantly – perhaps more so than at present – and that some of the social challenges that they face (such as the care of the elderly, or the provision of services to families with children) will be very different. That may not be problematic if London continues to grow rapidly, and if mechanisms are in place to recycle some part of the income growth to where it is most needed. If not, then some boroughs may face mounting challenges – ones that faster growth in the working age population might help to ease, if it were to occur and if its benefits were to be harnessed.

ANALYSIS: OUR POPULATION PROJECTION COMPARED TO GLA AND ONS FORECASTS

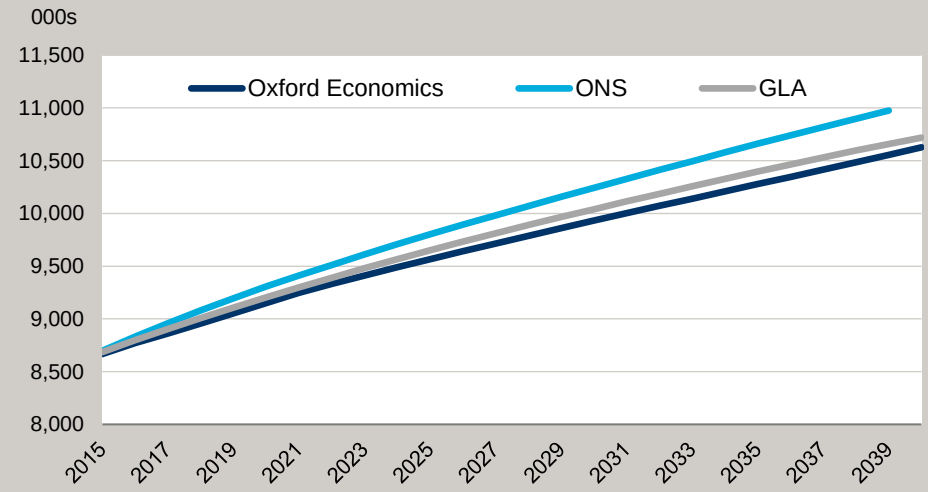
We produce our forecasts independently from those of either the Greater London Authority (GLA) or the Office for National Statistics (ONS). There are some similarities and some differences in the methods. The GLA's central forecast of population growth is for an extra 70,000 people a year, with the result that the capital's population is projected to rise from 8.90 million in 2017 to 10.72 million in 2040. This is similar to, but not the same as, our figures.

The GLA's calculations incorporate assumptions about future "natural change" in the population (the difference between births and deaths) which they source from the ONS, which generates estimates of age-specific fertility and mortality rates in the future. We also use those estimates in producing our own projections for London's population, and they are clearly the best source available.

However, the GLA estimates future net migration levels purely on the basis of extrapolating historical trends between 2007 and 2016. Given there has already been a sharp fall in international net migration into the UK, and there is likely to have been a fall in domestic net migration too, and that government policy is to reduce migration, these extrapolations from the past may not fully capture future prospects.

Our approach is to link migration projections to forecasts for London's labour market relative to the rest of the UK, to capture the notion that net-migration is correlated with labour market performance. As Fig. 26 shows, over the long-run, our method provides a slightly lower estimate of London's future population than that of the GLA.

Fig. 26. Population projections: Oxford Economics, GLA and ONS (2015-2040)



Source: ONS, GLA, Oxford Economics

Fig. 26 also displays the ONS Sub National Population Projections (SNPP) for the capital, which suggest that London's population will reach 10.98 million by 2039. It can be seen that these projections are markedly higher than our own, and also higher than the GLA numbers.

The reason is that the ONS takes the 2014 mid-year population estimate as its starting point, whereas both the Oxford Economics and GLA projections have the advantage of incorporating two additional years of data. We expect that the 2016-based SNPP for London, due to be published later in 2018, will show a downward revision to population growth, more into line with our own estimates.

4. ECONOMIC FORECASTS

4.1 LONDON'S RECENT ECONOMIC PERFORMANCE

Over the period 2012-16, London's economy typically outpaced that of the UK—as, indeed, it had done for some time before that. As Fig. 27 shows, there have been a number of years in which London's Gross Value Added (GVA) has grown significantly faster than the UK's, and almost no occasions when the capital's growth has been more than marginally lower, and then only temporarily.

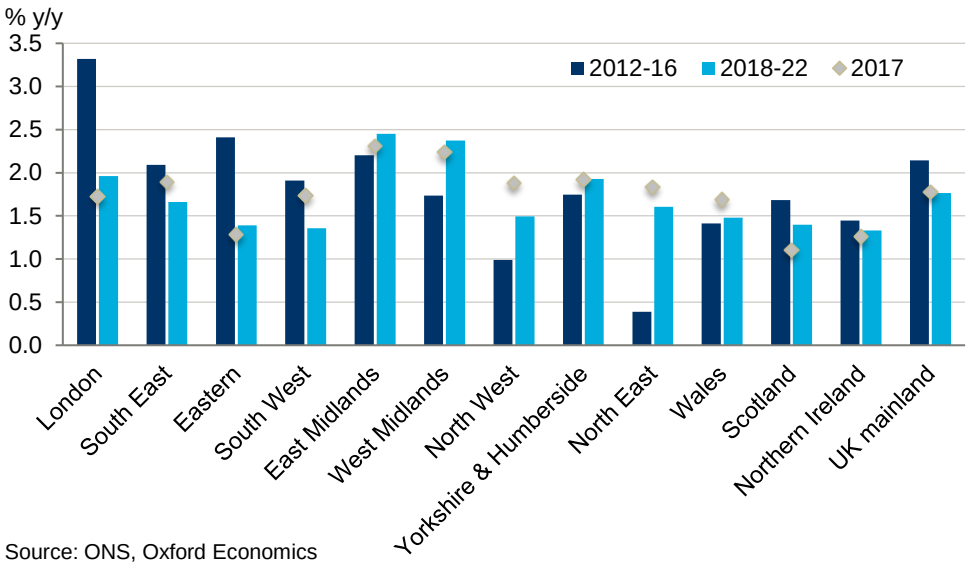
Fig. 27. Annual growth in GVA, London and the UK (1996-2016)



Source: ONS, Oxford Economics

However, 2017 saw a marked change, with the London economy slipping back sharply relative to other parts of the UK. As Fig. 28 indicates, London has changed from standing-out sharply in comparison with all other parts of the UK to only just making it into the top four for 2017 and 2018 combined.

Fig. 28. GVA, UK regions, 2012-2016 & 2018-2022, % y/y



Source: ONS, Oxford Economics

These figures are our Oxford Economics estimates and forecasts, but they reflect a wealth of survey evidence, as shown in the Panel, as well as our modelling of the underlying relationships.

Part of the reason for this change in relativities was the fall in the exchange rate following the referendum, which tended to benefit UK manufacturers in particular, and hence weakened London in **relative** terms.

However, London's economy weakened compared with its own history and not just relative to other regions. It seems likely that the 2016 Brexit vote was at least one of the factors generating a deterioration in London's performance, with individuals and businesses in the capital probably feeling themselves particularly exposed to any challenges that Brexit might create.

But what might those challenges be? Compared with other parts of the UK, London is not in general any more heavily dependent on EU markets, nor on EU funds, nor on foreign direct investment by businesses seeking to sell into the EU.

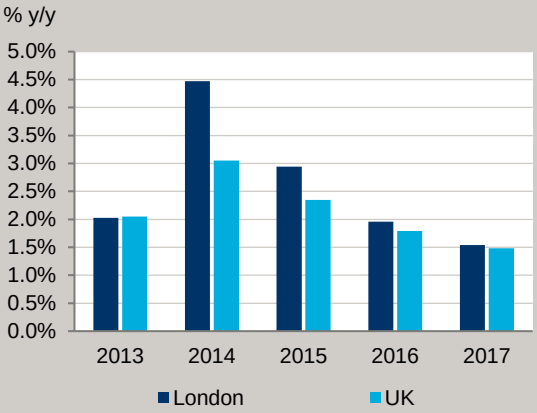
Two factors are, however, distinctive. One is the possibility of London financial services companies being excluded from EU markets. This was a big concern initially, and worries remain, although most commentators have now adopted the position (that we always subscribed to) that a deal will be struck which avoids a major transfer of business, and hence people, away from London.

The other concern is London's very high reliance on EU labour. While this is very unlikely to be the only or even the main factor at work, it seems reasonable to conclude that concerns over future skills availability has been an important part of the story, particularly following the decline in inward migration that has already occurred.

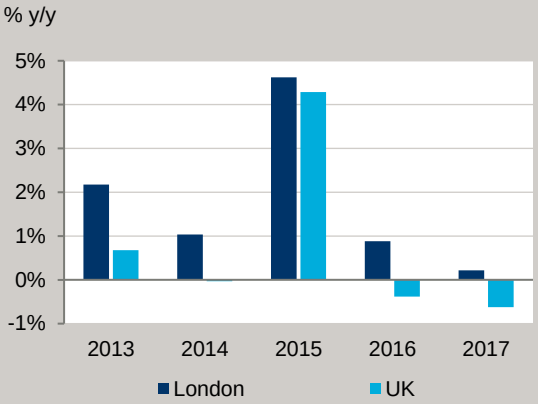
ANALYSIS: LONDON'S ECONOMY IN 2017

While London has historically tended to out-perform the UK on several measures at once, the same was not true in 2017. This was partly because the weak pound boosted manufacturing in other regions, but is also likely to have reflected problems specific to London including concerns over Brexit and perhaps recruitment difficulties from the fall in net international migration.

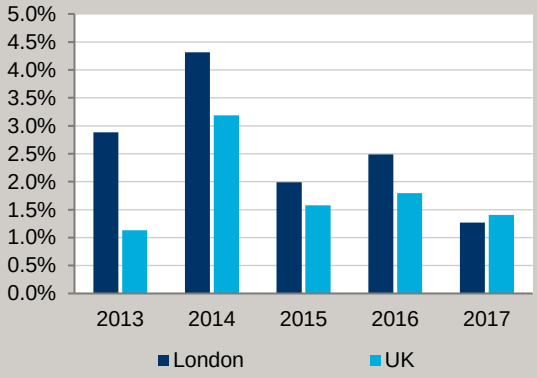
GDP



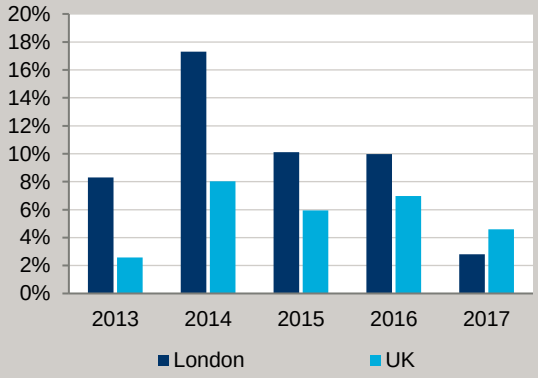
Income per head



Workforce jobs



House prices



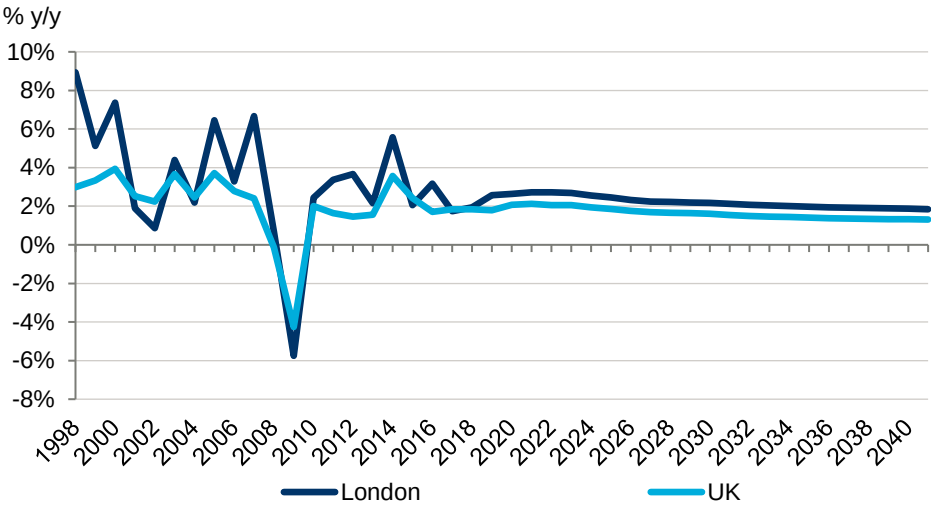
Source: ONS, Oxford Economics

4.2 ECONOMIC FORECAST FOR LONDON TO 2040

The challenge is to consider the risk that slower growth for London will transition from a short-term to a major long-term phenomenon. What, then, of our long-term forecasts? We project that to 2040 London's growth will be markedly slower going forward than it has been over the past two decades, and that the extent to which London drives the UK economy as a whole will also lessen.

As a result, London will continue to grow faster than other parts of the UK but the premium will be much reduced. Essentially London will become less 'special'. This is shown in Fig. 29.

Fig. 29. GVA growth, London & UK, 1998-2040

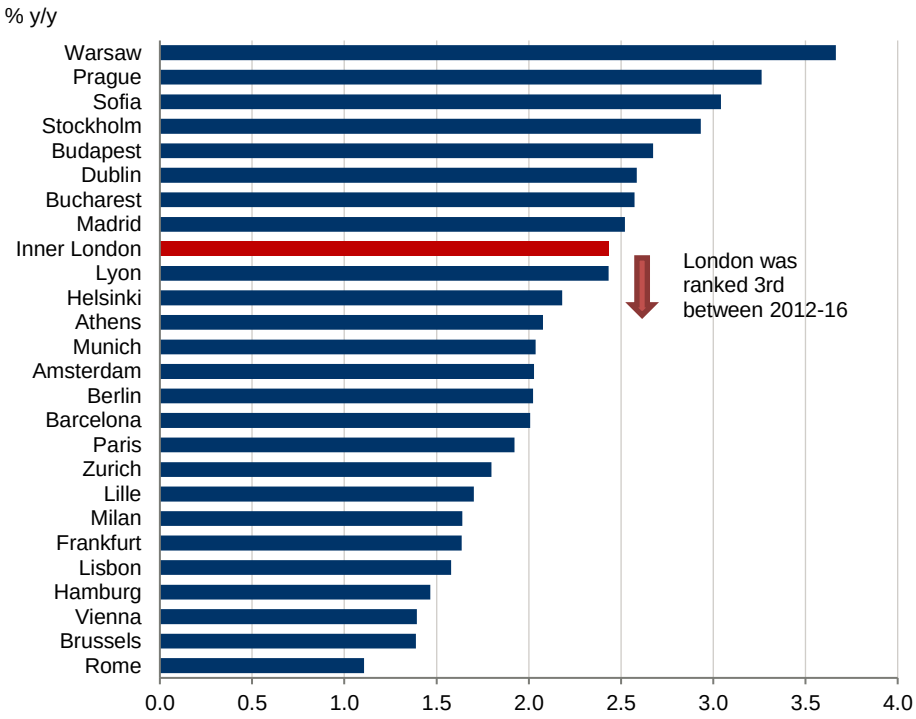


Source: ONS, Oxford Economics

4.3 LONDON'S GROWTH COMPARED TO OTHER EUROPEAN CITIES

Furthermore, not only does London cease to stand out compared with other parts of the UK, it also does so relative to European cities. Between 2012 and 2016 London was the third fastest growing out of Europe's 25 leading cities. Now, as Fig. 30 shows, we forecast that it will only just scrape into the top 10.

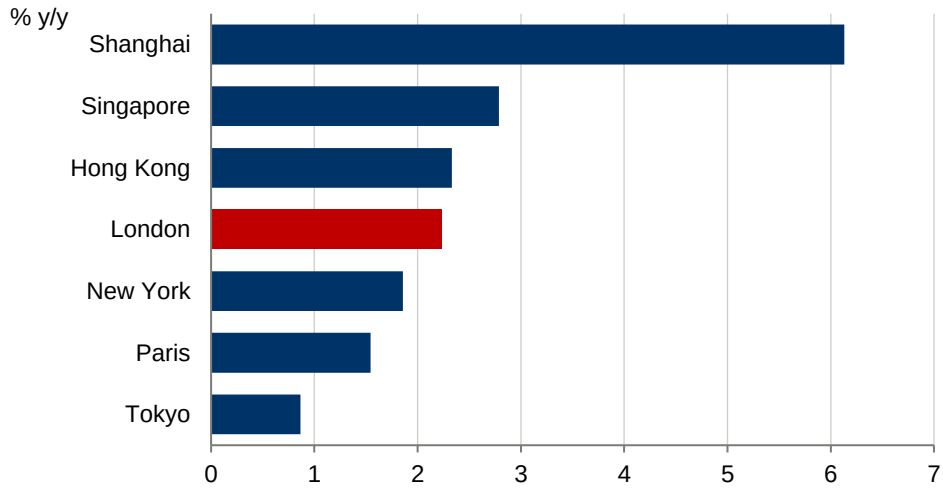
Fig. 30. Growth in GDP, European cities, 2017-2022



Source: Oxford Economics

Meanwhile, global competition is intensifying. While some cities such as Tokyo are set to seriously under-perform London (as has long been the case) others such as Shanghai are growing rapidly in both scale and sophistication. Fig. 31 provides key comparisons.[13]

Fig. 31. Growth in GDP, global metros, 2017-2022

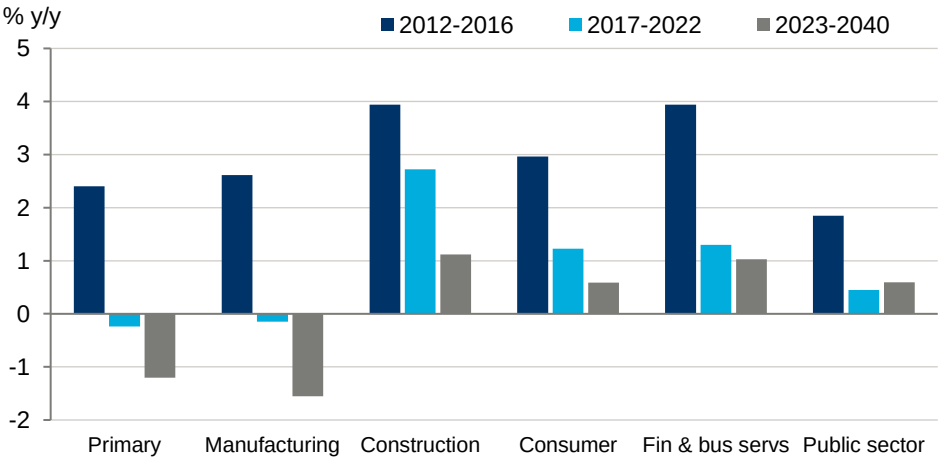


Source: Oxford Economics

4.4 FORECAST EMPLOYMENT GROWTH BY SECTOR

Slower GVA growth for London then translates into slower employment growth. Fig. 32 shows this for broad sectoral groupings. It can be seen that the slowdown is spread across all broad sectors.

Fig. 32. London employment by sector, 2012-2040, % growth y/y



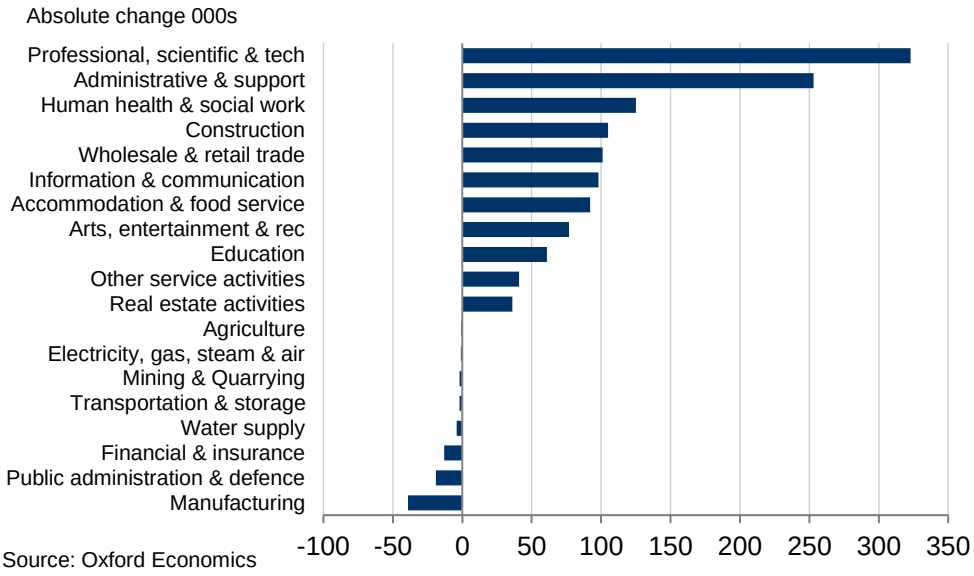
Source: Oxford Economics

A slightly different picture emerges when we look at the absolute growth in employment in more detailed sectors, as shown in Fig. 33. This makes clear

[13] The geographical boundaries of cities in Figures 30 and 31 are not the same. The former has narrow boundaries (notably, Inner London) for comparability with European cities while the latter has very broad metro boundaries for comparison with top-tier global cities.

just how important to London will be growth in business services jobs, split here into the higher value-added **Professional, scientific & technical services sector** which includes accountancy and law firms but also a range of others in for example marketing, consultancy and scientific research, and the lower value-added **Administrative & support sector**, which covers a range of activities such as security and facilities management, as well as employment agencies. Together, these two account for 47 percent of the London jobs growth that we forecast to 2040.

Fig. 33. Employment growth, London, 2017-2040



Source: Oxford Economics

Other sectors that see appreciable growth include Health & social care, Construction, Wholesale & retail and Information & communications.

Probably unsurprisingly, employment is projected to decline in **Public administration** and in **Manufacturing** – and also in **Financial services**. The last of these partly reflects jobs moving to other EU cities as a direct result of Brexit. However, that is not the main reason, because as we noted above, our forecast assumes that a deal is struck in which companies operating in London are able to undertake most of the functions that they currently perform. More important than Brexit in generating declines in London's financial services employment are technological factors, slow growth in UK consumer demand for financial services, and some relocation of jobs to other locations on cost grounds.

4.5 RISKS TO THE FORECAST: SKILL SHORTAGES IN KEY SECTORS

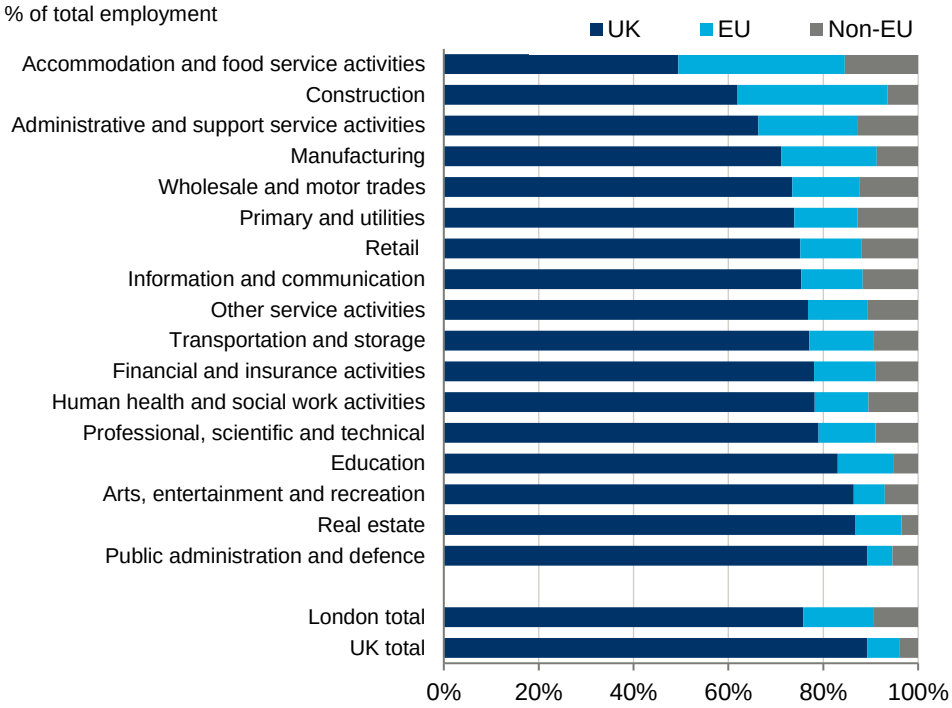
However, these sectoral forecasts are implicitly predicated on there being enough people available in London to fill the jobs.

Historically this has seldom been a problem, because of London's ability to attract migrants. And **at the aggregate level** we do not expect it to be a problem going forward. However, there may be issues at the **sectoral level**, if declines in net inward migration as a result of a tougher migration regime affect the availability of labour for some sectors in particular. And then there is a risk

which we discuss below that shortages in one sector impact on others. We call this a **contagion effect**.

One sector that may be particularly affected is construction.[14] Not only is it set to grow faster than most, it is also particularly highly dependent on EU nationals. As Fig. 34 shows, 32 percent of those working in the construction sector in London are (non-UK) EU nationals, whereas only 7 percent of people working across all sectors in the UK as a whole are (non-UK) EU nationals. The sector's exposure in London is therefore very stark.

Fig. 34. Employment by sector and nationality, London



Source: ONS

So, London's construction sector looks particularly vulnerable. And of course, if that sector experiences binding skill-shortages, then it has widespread impacts on all other sectors, as well as on London residents, if new infrastructure and buildings are not put in place, and if repairs and maintenance on existing structures cannot be undertaken.

However, construction may not be the only sector heavily affected in London by a tighter migration policy. Figure 31 indicates that the Administrative & support services sector, as well as being set to experience large growth in employment, has a high reliance on EU migrant workers.

But in terms of overall dependency on EU migrant labour, this is much less true for Health and social work and the other sectors that we identified as set to see relatively large employment growth. Meanwhile, although the hospitality sector

[14] Sectoral issues are discussed in detail in the report by London First: "Facing Factors: the impact of migrants on London, its workforce and its economy". See http://londonfirst.co.uk/wp-content/uploads/2017/03/Facing-Facts-The-impact-of-migrants-on-London-its-workforce-and-economyFINAL.pdf

(known here as 'Accommodation and food services activities') has a high reliance on EU migrant labour, it is not projected to see large scale employment growth. And the retail sector is neither set for rapid growth, nor has a high reliance on EU migrants.

However, with all these (and other) sectors we need to be very careful. Evidence submitted to the Migration Advisory Committee (MAC) indicates that the representative bodies for all these and other sectors, and also for London businesses overall, think that there will be serious skill shortage issues as a result of Brexit, assuming that the migration policy chosen by the UK government is significantly tighter than the one currently in place.[15]

As an illustration, the British Retail Consortium report that 56 percent of retailers across the UK are facing concerns from EU-national employees over their rights to remain in the UK, while 39 percent say that some employees are considering returning to the EU and 22 percent says that has already started to happen. It is likely that the figures for London would be the same or higher than those numbers, suggesting that EU residents' right to work in the UK is a widespread issue for the sector.

Similar problems arise in the hospitality sector, although perhaps of greatest concern is the challenge that appears to face the health and social care sector. The MAC received a large amount of evidence on this. To take just one example: the British Dental Association reported that in 2017 dental recruitment agents had experienced a 90-95 percent fall-off in applications from EEA residents wanting to work in the UK. While there must be a likelihood of that rebounding, the risk is that it will do so only partially.

The general point here is that even where migrants account for a small share of employment levels, they have often accounted for a large share of new recruitment. If their numbers do not fully rebound, then the scale of hard-to-fill vacancies in the relevant occupations and sectors is likely to rise very markedly. Brexit is likely to make it harder for such a rebound to occur.

That problem could then have a broader impact via the contagion effect that discuss below. In the example given above, difficulties to get dental care, if they were mirrored in many other areas of life, might impact on the preferences for living in London of many internationally mobile people. That would then affect London's overall competitiveness, with the danger of a vicious circle emerging.

So how worried should we be? In its Interim Report the MAC notes that some degree of scepticism is appropriate. What appears to be a skill shortage may just be a sign that employers need to adapt – and some no-doubt will, by investing in training, or by buying new skill-saving technology, for example, or simply by raising wages.

In Chapter 5, we consider how likely it is that such adjustments will happen, in response to any shortages. The MAC cautions against taking anything for granted, on either the optimistic or pessimistic side. Our baseline forecast is

[15] For the MAC interim report see https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/694494/eea-workers-uk-labour-market-interim-update.pdf. For evidence submitted see https://www.gov.uk/government/collections/impact-of-eea-and-non-eea-workers-in-uk-labour-market-responses

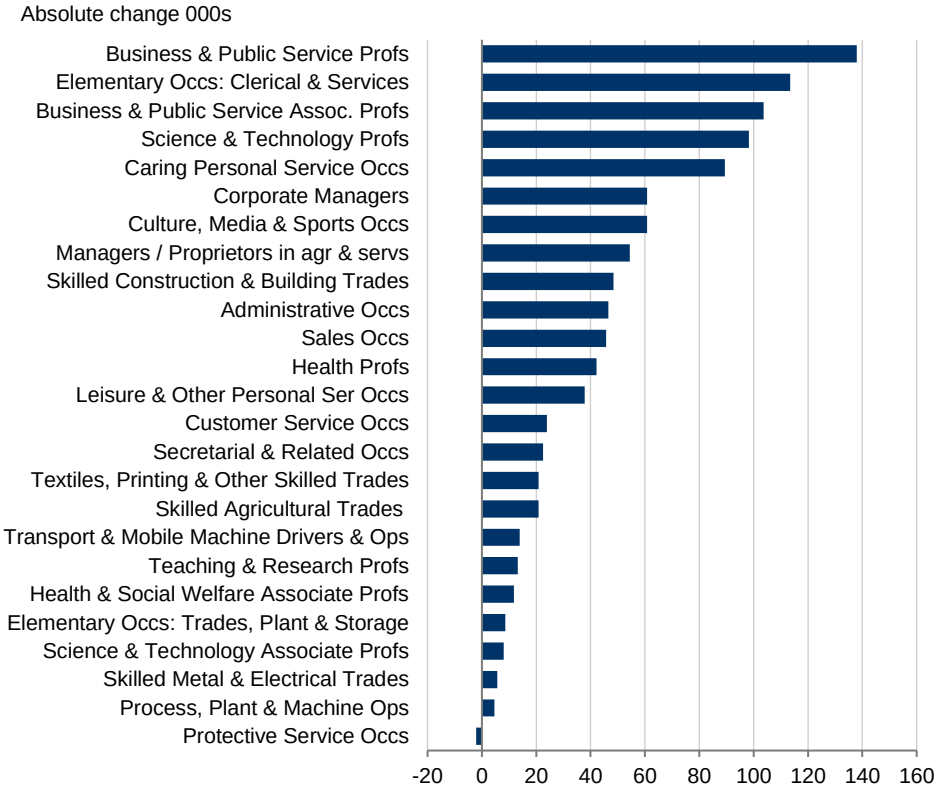
essentially predicated on the notion that skill-shortages are not severe enough to disproportionately reduce growth in these sectors. But since the sectors slow for other reasons that is little comfort. If demand for labour were to rise any faster than we predict, there would be an effective skills constraint, generated by lower migration into London. This is a troubling conclusion.

4.6 RISKS TO THE FORECAST: SHORTAGES BY TYPE OF WORKER?

The points made above have already opened-up what is perhaps the real issue. The situation may be much worse if skill shortages by **occupation** turn out to be more extreme than skill shortages by **sector –** or indeed, skill shortages by **occupation within particular sectors.** In our modelling, our occupational projections are derived from our sectoral projections – but the alternative might occur in which occupational shortages impact on the sectors, which are then unable to grow as fast as we expect (which is itself already slower than the historical trend) because of the occupation-specific shortages.

As Fig. 35 illustrates, we forecast that of the five occupations that are set to see the fastest employment growth in London, three are at the professional level. The other two are classified as “elementary”: administrative & secretarial workers, and personal care workers. So, if these have a high tendency to employ EU migrants, then they may face significant challenges.

Fig. 35. Employment growth by occupation, London, 2017-2040

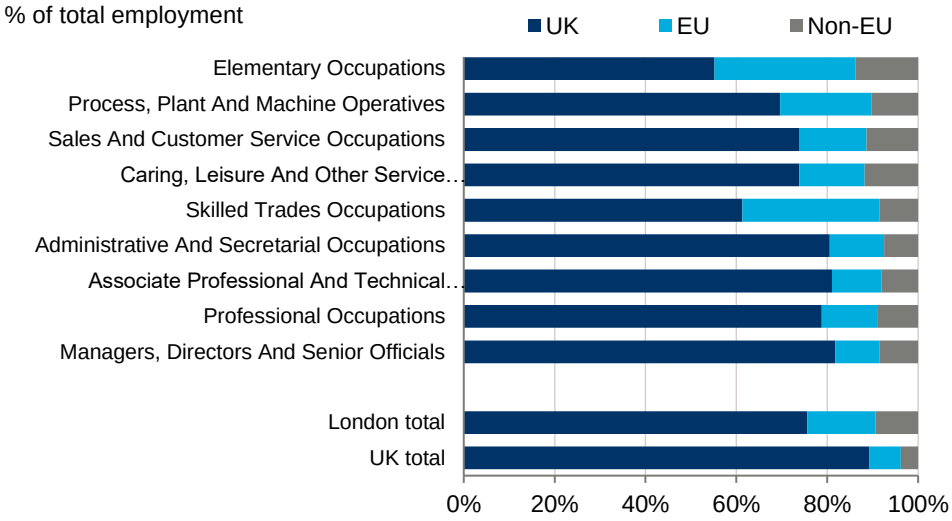


Source: Oxford Economics

However, as Fig. 36, shows the evidence on this is not so clear. The categorisation for this analysis is broader, which slightly obscures the picture,

but one of the two occupational groups which stands out as being very EU-migrant intensive is “elementary” occupations. These are mainly in the transport and manufacturing sectors, however, where we are not anticipating much, if any, employment growth. The other broad occupational group is “skilled trades”, and these are mainly in the construction sector, reinforcing the points already made about that sector.

Fig. 36. Employment by occupation and nationality, London, 2016



Source: Oxford Economics

However, many of the anxieties expressed by the representative bodies for the various sectors do emphasise precisely the point that there are certain occupations in which reliance on EU workers is very high. And skill shortages for just some occupations can affect the performance of the sector as a whole. This is part of the contagion problem that we cover in Section 4.8 below.

An argument that is quite rightly set out in the MAC interim report is that in many of these cases, the occupations that are in short supply are at the lower end of the skills scale. Our data supports that: some of the fastest projected growth and some of the highest reliance on EU workers is in occupations at the elementary end of the skills spectrum. Since these are defined as jobs that need little training, it could be argued that, if hard-to-fill vacancies do emerge because of lower migration, then by definition it ought to be relatively easy for employers to train somebody else to do the job.

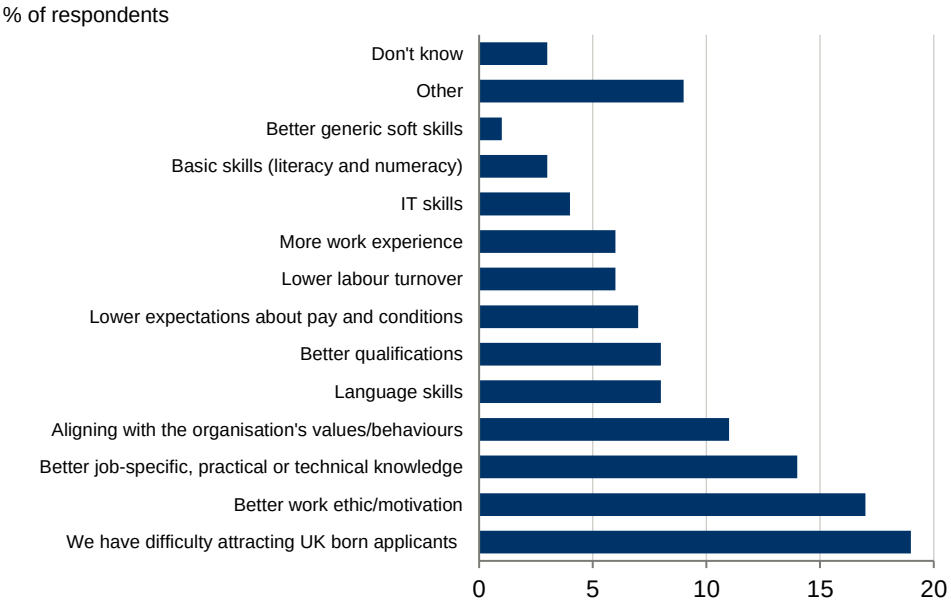
That is why some commentators suggest that the post-Brexit migration policy can and should be designed to favour higher occupations, rather than the less-skilled, just as the Points-based system for non-EU workers already does. This is often presented as a ‘cake-and-eat-it’ scenario in which migration is reduced significantly but skill-shortages are averted. We consider how realistic this response is in the following two sections, and also in Chapter 5.

4.7 RISKS TO THE FORECAST: THE 'QUALITY' OF MIGRANT WORKERS

Another skills-related concern that is sometimes raised is that EU migrants will be hard to replace with UK workers because, within any occupation or industry, the former are more skilful or more motivated than the latter.

There is some evidence that this is indeed an issue, as shown in Fig. 37, with substantial minorities of employers saying that migrant workers have better work ethics, or better job-related skills, or are more closely aligned with the employers' values, and that is why they tend to employ migrants.

Fig. 37. Reasons for employing EU nationals, UK, 2016-2017[16]



Source: CIPD

The scores are not particularly high individually, but when combined they become quite powerful. To be fair, the overall results are dominated by employers who say that they do not consider applicants' nationality, and for clarity, this response is excluded from the chart. However, this surely misses the point of the question, which seeks to establish whether characteristics such as alignment with an organisation's values and behaviour differs between migrants and non-migrants. The evidence is that there is a significant difference, which implies a likely economic loss if migrants are in short supply.[17]

4.8 RISKS TO THE FORECAST: THE DANGERS OF CONTAGION

Nevertheless, our general sense is that when different segments of the labour market are each taken **individually**, it looks as if although shortages of EU migrants are likely to cause problems, the scale of threat to the overall growth of the London economy is probably not great. High dependency on EU migrants is often in sectors or occupations that are not likely to see strongly

[16] 45% of respondents chose: 'Not applicable – we do not consider nationality.'

[17] It is possible that part of the reason why migrants score more highly for these characteristics is that they are more likely to be doing work for which they are over-qualified.

rising demand for labour, and those sectors and occupations where our projected employment growth is strongest are not necessarily highly reliant on EU workers.

However, this returns us to the point that we made in Chapters 2 and 3: that historically, London has done well or sometimes badly because of the **interdependencies** of different parts of the economy – virtuous and vicious circles.

The concern here is that the beneficial **agglomeration effects** that we identified earlier could turn into **contagion effects**, if one sector is slowed because of skill shortages in another sector, and that in turn impacts on a third sector, or if skills shortages in one occupation have an impact on employment in other occupations.

We have already referred to the most obvious example of this: construction. If that sector does experience binding skill-shortages, then that may mean that new transport infrastructure and buildings are not put in place, and repairs and maintenance on existing structures are not undertaken. But the same point could be made about other sectors including those such as transport, health and hospitality which are important for the quality of life.

So hospitality, for example, is part of London's overall competitiveness, and a key reason why London's economy suffered badly in the 1970s was that the quality of life deteriorated. Which means that the issue of skill shortages is not just about high-growth sectors, or high value-added sectors, or indeed about highly-skilled occupations. Hence potential shortages of the less-skilled does matter to London's future economic growth, and not just in terms of social or cultural factors.

For the health & social care sector, employers giving evidence to the MAC stressed that carers are currently not defined as highly-skilled, so that the points-based migration system prevents non-EU migrants from moving to the UK to undertake such jobs. But the work requires 'practical knowledge and emotional commitment' and that therefore finding suitable recruits can be difficult. Furthermore, this is not a problem that can be easily addressed through training. If going forward the same restrictions apply to would-be EU-migrants as to non-EU, then the sector is likely to face serious challenges.

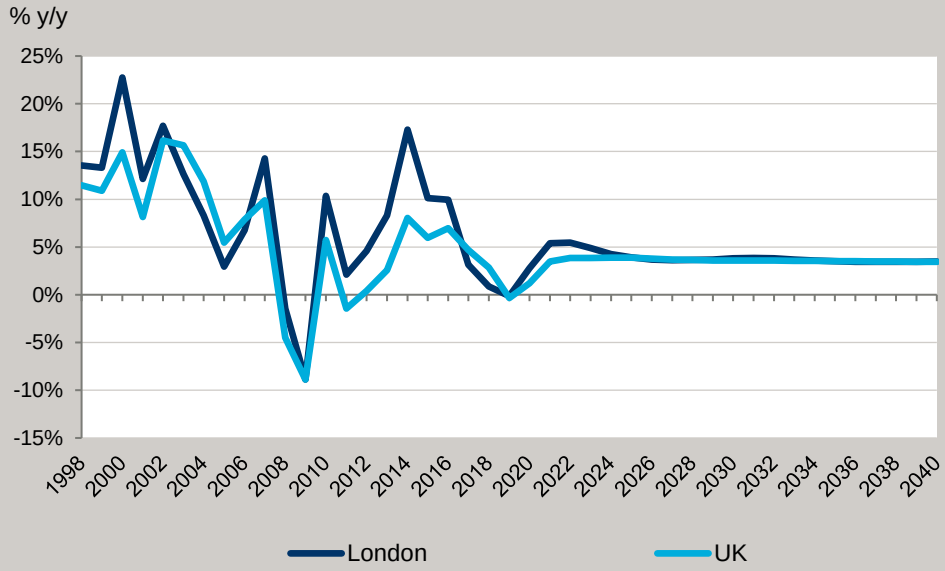
There is also the threat of contagion within a single employer. If a small number of jobs cannot be filled, then in time the entire operation may relocate elsewhere. This is something that London has benefited from in reverse in the past, most obviously in the financial sector; the anxiety now is that in the tech sector in particular, (but also in others) London could be vulnerable going forward. Again, some sector representative organisations have made this point strongly.

These points therefore suggest that the policy decisions that need to be made with regard to migration, both directly and indirectly, are not easy ones. We address this in the next chapter.

ANALYSIS: IMPACTS ON THE HOUSING MARKET

Clearly, a slower growth in the population and in employment will impact on growth in personal incomes and spending, and especially perhaps on the housing market. As we noted earlier, since the Brexit vote, London's very strong growth in house prices has been dented. But it is important to put that in perspective, which is that London house prices have been slowing for some time, as Fig. 38 shows. So Brexit is not the key issue here.

Fig. 38. House prices, London and UK (1998-2040)



Source: ONS, Oxford Economics

Going forward, we forecast a recovery in the rate of growth, followed by a situation in which prices cease to be driven by speculative demand and are instead driven by disposable income growth. That means price rises that are typically less than 5 percent a year. (To be fair, the forecast profile in the chart is probably more stable than is likely. In reality there will still be price surges, but our view is that these will be temporary. Their timing cannot be reasonably forecast.)

5. POSSIBLE RESPONSES

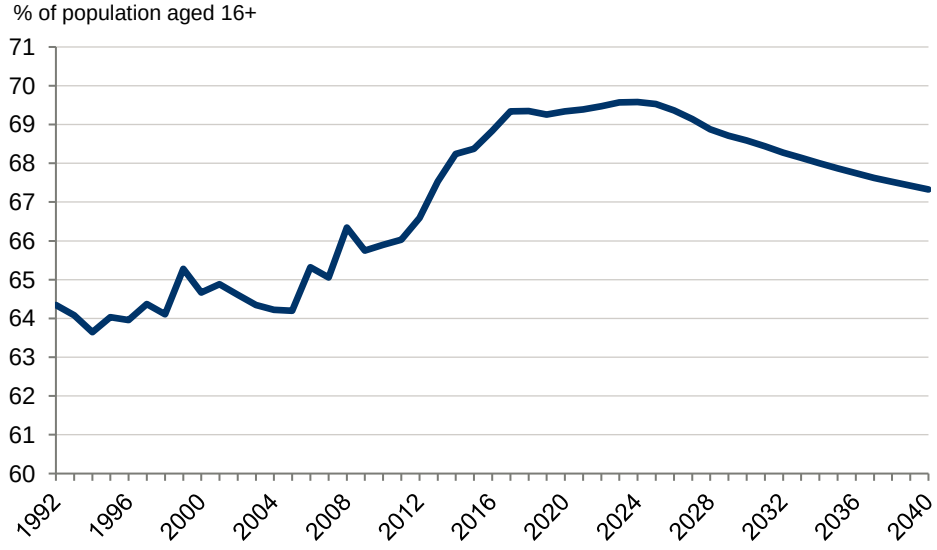
5.1 WILL THE LONDON ECONOMY SIMPLY ADJUST?

London's success has rested, and will continue to rest, partly on its ability to attract domestic and international talent. But our conclusions from Chapter 4 are that over the long-term London's economy looks set to grow more slowly than in recent years; that this partly reflects reduced inward migration; and that there is a small but disturbing risk that the outcome may be significantly worse than in our central forecast. That would happen if the virtuous circle of growth generating more growth (agglomeration) turned into a downward vicious circle (contagion). Reduced migration, if it was excessive, might play a role in changing the balance of forces here

But as we also noted in Chapter 4, to some extent, the economy will adjust to such challenges of its own accord. So it might be said that any risks are easily exaggerated. However, we think it is right to be cautious.

There are several potential adjustment mechanisms, but none is a panacea. First, if there is a shortfall, some of that is likely to be made up from higher participation of the existing labour force. However, the scale of this is likely to be slight, and concentrated on lower-skilled workers. Participation rates are already historically high, both historically and internationally, as Fig. 39 shows. Rates are particularly high for the highly qualified, so any adjustment is likely to apply mainly at the lower end of the skills spectrum.[18]

Fig. 39. People in work or seeking work in London, 1992-2040



Source: ONS, Oxford Economics

[18] It is true that in time the participation rate is likely to fall, as Figure 39 shows. However, this is because the rate is defined to include all adults, including the retired. Because the population is aging (though still young by most standards), an increasing number of retired people will in time distort this measure.

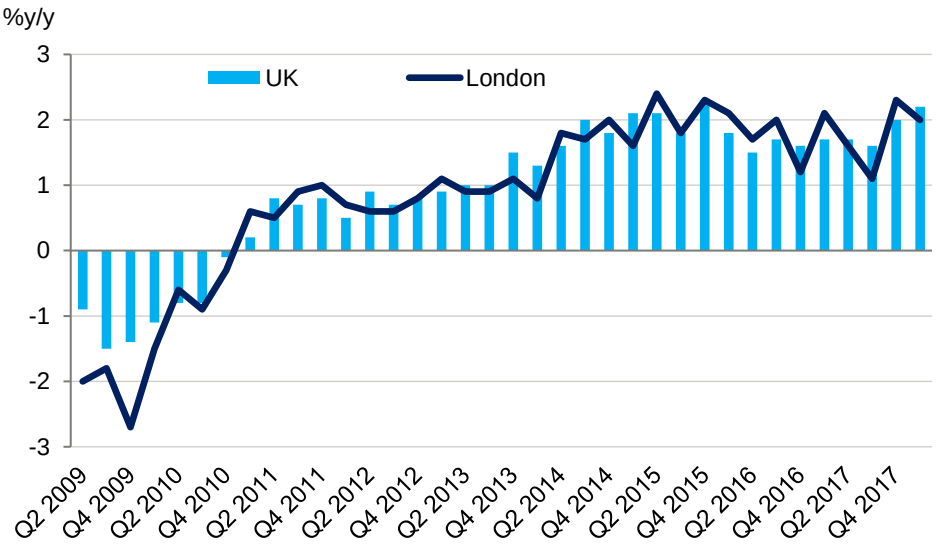
Second, increased inflows of migrants from the rest of the UK may also occur. However, their scale will probably be limited, not least because higher wage rates in London are more than offset by higher housing and other costs, which effectively constrains the numbers who can move to London. And although it is true that we forecast a convergence in the rate of increase in house prices between London and the rest of the UK, that still means an increasing absolute divergence. If meanwhile the growth in opportunities in London is reducing, then the likelihood that increased numbers of people will migrate into the capital in response to lower migration from outside the UK is not high.

In any case, if that happened it would simply pass the skill shortage problem onto other parts of the UK.

Much the same is true for job-switching. The likely scale is not great: and if it happens it just transfers the problem. As indeed does the most obvious response to skill shortages: raising wages.

Another possibility is that employers will increase their spending on training. However, they have historically been very cautious on this, mainly because of the problem of 'poaching' which is particularly high in a tightly-connected labour market such as London's. As Fig. 40 shows, investment in training tends to grow only slowly, mostly at about half the rate at which company sales grow.

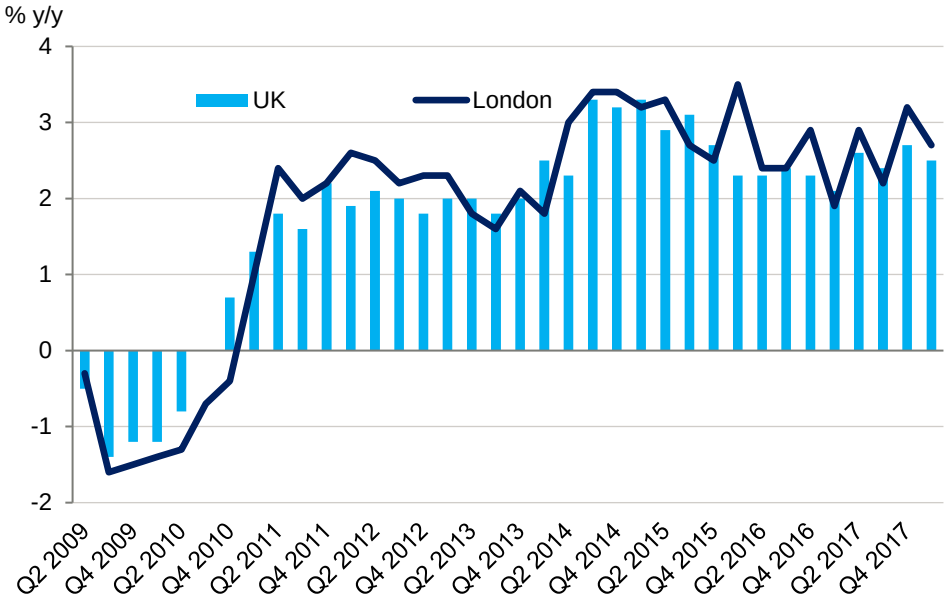
Fig. 40. Survey evidence, staff development budgets, London & UK



Source: ICAEW Business Confidence Monitor

Greater use of technology may also occur in some sectors and occupations. There is indeed a trend in this direction, reflected in automated check-outs in the retail sector and online banking. However, change in this area comes slowly and not universally, and there is little evidence yet of major shifts being possible at the higher end of the skills spectrum. Again, current low levels of investment, shown in Fig. 41, reinforce that conclusion. If investment rises slowly, so too will automation. And of course Brexit-uncertainty is one likely cause of weak investment growth in the UK.

Fig. 41. Survey evidence, capital investment, London & UK



Source: ICAEW Business Confidence Monitor

There is also an over-arching point that any and all of these adjustments, if they occur at all, will take time. If there were multiple other reasons for being very confident about London's economic growth that might not be a problem. However, as we have already noted, London's economy looks more fragile than it used to, and the competitive pressures from other cities are growing. There is a danger of London entering a period of 'adjustment' and then finding it difficult to break out.

5.2 THE GOVERNMENT'S OVERALL BREXIT STRATEGY

All of the above implies that policy does matter. In her January 2017 Brexit speech the Prime Minister said that maintaining sufficient supply of labour to meet employers' needs is an important policy goal, and this position has been maintained since then. However, that may prove difficult, which is why our forecast assumes some constraint on labour supply and consequent loss of economic growth.

One possible policy for the government is of course simply to maintain free movement of labour to and from the EU, by remaining a member of the **Single Market**.

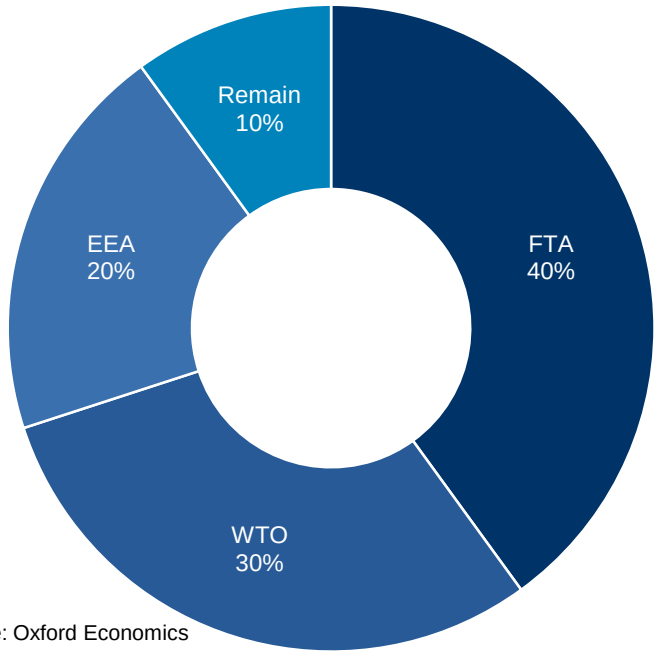
Another possibility is that, assuming that the UK's Brexit deal does not include membership of the **Customs Union**, the UK government will secure trading deals with other countries that also include concessions on migration. Indeed, several overseas governments (including the US, India and Australia) have said that lighter migration controls will be a precondition for agreeing a new and more generous trade deal with the UK.

If that were to mean a relaxation of existing rules for non-EU migrants then it might actually close the overall numerical gap caused by lower EU migration.

However, the likelihood is that there would be differences in the skills profiles of the non-EU migrants relative to EU migrants. If so this would be a reverse of the 'cake and eat it' scenario – no overall decline in migration, but a rise in skill shortages.

Our expectation, summarised in Fig. 42, is that the deal that will be struck between the UK and the EU will be a Free Trade Area and will feature neither the Single Market nor a Customs Union.

Fig. 42. Oxford Economics' Brexit assumptions: probabilities



Source: Oxford Economics

So future migration arrangements with the EU, and also perhaps with some non-EU nations, will almost certainly be different to those that currently prevail. With the EU, they are likely to be more restrictive than currently; with other nations they might be more relaxed, if that allows the Government to strike favourable trade deals.[19]

We also assume that the plan for a transitional period, ending on 31 December 2020, will prevail. This has after all already been agreed, although subject to the over-riding coda that "nothing is agreed until everything is agreed". The UK will therefore keep its existing migration policy in place during this transition.

[19] FTA refers to a Free Trade Agreement with the EU and we currently think that this is the most likely arrangement after the transition period, so free trade in goods but not free movement of labour. We do not expect this to cover services, and it would require a solution to the difficult Irish border problem. Membership of the European Economic Area (EEA) refers to the Single Market and hence free movement of labour as well as goods plus common regulations; for face-saving purposes a 'bespoke' deal might involve this in all but name. It would allow the UK to strike trade deals with other nations, although there would need to be arrangements ('rules of origin') to ensure that the UK did not become a backdoor for cheap low-tariff imports into the EU. If there is no deal then the UK will trade with the EU (and other nations unless deals are done with those) according to World Trade Organization rules. Given political uncertainties, we give a small 10% probability to remaining in the EU.

5.3 SPECIFIC MIGRATION POLICIES

In our forecasting we do not take an explicit view about exactly how the new post-Brexit system will work, just that there will be one. What we can say, and what we do assume and is implied in the forecasts discussed above, is that the change will not be immediate. As we noted earlier, the UK government has extended the existing rights of EU citizens to all those who arrive in Britain before the 2020-end of the transition period. It has said that it will not publish a new national immigration strategy until agreement with the EU27 has been reached on the full terms of Brexit. Political and practical difficulties therefore mean that any new regime is unlikely to come into effect until 2021 at the earliest.

Meanwhile, however, many potential new migrants from the EU, or ones already here, may have decided to base themselves elsewhere—as may some UK citizens. As we noted in Chapter 3, in our baseline forecast we are not assuming a large exodus of EU citizens currently living in the UK, nor a large in-surge of people wanting to 'beat the deadline'. These are, however, possibilities.

It is in principle possible that the new regime, when it does appear, will successfully address the issue of skill shortages that we have identified. Indeed, in our baseline forecast we implicitly assume that **to some extent** it does so, but only partially.

We do not, for example, expect a simple limit to the number of international migrants into the UK, either in total or on a country-by-country basis. That would mean that migration would be essentially random, and would probably leave some occupations, sectors and regions (probably including London) with severe skill shortages. It is not likely that this will be chosen, not least because it is not currently used for non-EU migrants.

A quota system by occupation and/or sector is an alternative, but forecasting demand by occupation and sector is clumsy and there are many administrative problems with such a system, including people switching jobs, or indeed cheating – pretending they are entering for one type of job, but actually taking up another. That can be addressed, but a large administrative burden for employers would be almost inevitable.

Similar remarks apply to a visa system or a points-based system. As noted in the interim report of the MAC, employers already report considerable frustration with the present points-based system for non-EU applicants. This is especially true sectors that are particularly important to London, such as technology.

Furthermore, for the reasons we have suggested, London will continue to need inflows of people at the lower end of the skills spectrum as well as the higher end. The existing points based system does include special arrangements that seek to allow for this, but the result is a much more complex system than is generally assumed, with consequent burdens on employers.[20]

[20] For a description of the current system and a discussion of designing a sophisticated system going forward that would address the issues raised here see

5.4 MIGHT THE NEW SYSTEM ALLOW IN MORE MIGRANTS THAN WE ARE ASSUMING?

Overall, the extension of the points-based system to EU migrants seems the most likely way forward. That has an important implication. A pure points-based system for EU migrants, as already applies to non-EU migrants, actually offers little or no control over the number of migrants (because the number of candidates and the degree of their eligibility are the only criteria).

This raises the possibility that deliberately or accidentally, migration from the EU will not, in fact, fall by as much as we forecast. It might even rise!

After all, the UK government's track record on controlling immigration is not impressive. In the early 2000s the introduction of a relatively open work permit system for migrant workers from outside the EU, and the May 2004 decision to open the UK labour market to East European workers, together with policies specifically intended to increase the number of foreign students coming to study in the UK, all increased net inflows into the country, in ways that were largely unexpected. And although the announcement in 2010 that the then government intended to reduce net migration from the 'hundreds of thousands' to the 'tens of thousands' resulted in stricter policies for admitting non-EU students, family members and workers, inflows actually fell by much less than the government expected.

Also, there is some evidence that when immigration policy is tightened against one nation or group of nations the main impact is to increase migration from other countries. In addition, the impact of tightening may be reduced if instead of applying directly, migrants move through illegal channels or alternative routes such as family migration or studying.[21] Also, restrictions may affect not only inflows but also return flows, if migrants already in the country decide not to risk leaving. Since a large proportion of migrants do normally leave, either permanently or on a temporary basis, if restricting inflows also reduces these outflows, the net impact could be very perverse, as we noted above.

More generally, the status of EU migrants already in London and the UK generally is of huge importance. If existing migrants mostly stay, the prospects are very different compared with if they mostly leave. An important issue here is how secure such migrants feel. The recent difficulties of people who migrated from the Commonwealth a generation ago and who thought their UK citizenship was beyond doubt illustrates how difficult these matters can become.

Also important is what system the EU imposes on UK nationals seeking to migrate there. Admittedly these flows have not been large, but if a tougher migration policy as a result of Brexit causes them to change, then that too has an impact on future Labour market conditions.

Finally, there is the powerful point that our forecasts extend over more than two decades – beyond the lifetime of any government in living memory. We have

http://www.migrationobservatory.ox.ac.uk/resources/reports/labour-immigration-brexit-trade-offs-questions-policy-design/

[21] The result of this might be continuing high levels of net international migration but a deterioration in the 'quality' of migrants—clearly a perverse result with likely unhelpful impacts on productivity, public finances, and so on.

implicit assumed that the present government's policy of reducing employment to the (high) tens of thousands is carried over by future governments. However, this is because we have no information to suggest that a future government might do otherwise. But past experience suggests that change will occur, in one direction or another.

These are therefore unchartered territories, and while we set out our assumptions on these matters in this report, the possibility of a large surprise should not be discounted.



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