Cut immigration to raise wages? If only it were all so simple.

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Will reducing the immigrant labour flow raise living standards for low-paid workers? Boris Johnson thinks so. In his Conservative Party Conference speech, the Prime Minister claimed: "We are not going back to the same old broken model with low wages, low growth, low skills and low productivity, all of it enabled and assisted by uncontrolled immigration."

Worker shortages in hospitality, farming, and for HGV drivers have bumped pay for some workers already. This has been held up as reflecting the seeds of a new economic model. Restricting immigration is now even seen by some Conservatives as a key tool to force businesses into investments in automation that will make British workers more productive.

It's difficult to overstate the shift in thinking necessary for Tories who grew up under Thatcher to believe that "supply-side restrictions are good for the economy, actually." But whether out of genuine conviction or just putting a positive spin on events, Conservatives should beware of using today's disruption as signalling a desirable paradigm shift in wage-setting.

Not just because the pandemic is driving many current labour market problems, with little indication these trends will deliver lasting real wage gains. But because there is scant evidence that restricting the flow of EU workers will result in rising pay overall.

First of all, labour markets are largely out-of-whack because Covid-19 and lockdowns have severely shaken up consumer demands, work locations, and people's career goals. Activity is gradually migrating to reflect these new trends.

In the U.S, we've seen high vacancies and spiking wages in industries such as hospitality, farming, and trucking for months too. So, clearly, what's happening today is not primarily about Brexit or immigration policy.

I called this Covid-19-related process “the reallocation economy” in my book. The shock of the pandemic has altered many households’ decisions on when to retire, whether to go into higher education, or the desirability of staying in their current commuter jobs.

Yes, there has been an exodus of EU-origin workers due to this turbulence and to Brexit, too, which has heaped pressure on certain sectors with large immigrant workforces. Wages and prices, though, were always going to be volatile as these supply and demand mismatches played out across the economy.

“Simply raise pay and invest in workers to solve shortages!” say keyboard economists to industries struggling to hire. A shortage of labour (other things the same) will indeed raise compensation within affected markets, as we’ve seen on chicken farms and for HGV drivers.

But wages are a business cost, not just something employers can adjust without consequence. In reaction, profit-seeking firms will raise prices, cut worker benefits, slash services, or leave the sector entirely if profits are squeezed tightly by a higher price for labour. This is capitalism: there is no free lunch.

This is the crucial mistake made by those who believe cutting off access to workers for certain industries will somehow be “good” for the economy. It’s a half-baked examination of the effects.

A policy-induced shortage of HGV drivers may raise pay rates for HGV drivers. But more expensive HGV drivers means increased transport costs, resulting in higher consumer prices of goods, fewer deliveries, or substitutions away to other transportation methods. The HGV drivers employed may well end up better off in real terms. But others in the economy will be worse off, facing higher prices or less reliable services. The very poorest could well end up subsidising these higher driver wages if they result in, say, higher food prices.

In response to this argument, some claim that only migration restrictions will induce companies to invest to deliver future productivity growth that ultimately benefits everyone. But encouraging otherwise uneconomic investments by creating shortages of workers clearly makes us worse off overall, not better off. Profits drive the adoption of efficiency-enhancing technologies. Forcing businesses to cope with a lack of inputs by tilting the deck against the most profitable business practices cannot be “good” at an aggregate level, or else businesses would have changed in that direction already.

In suggesting otherwise, Conservatives risk falling for the sort of supply-side fairytales of the left, who talk of regulation as a source of innovation. It’s the thought process that says that the minimum wage can be raised to £15 per hour, and that this will somehow be a boon for productivity growth (something yet to be observed after over a decade of minimum wage hikes).

To be clear: migration restrictions may well raise real pay rates in some sectors. This is more likely to occur in industries where EU labourers directly competed with British workers and where the presence of more EU nationals did not significantly raise demand for the goods or services in question.

But there's not a fixed amount of work, nor reason to believe EU migration reduced wages meaningfully in aggregate. Where foreign workers complement existing skills, fill shortages, or create new products or demand, they can also boost productivity and wages. That's why, overall, studies regularly found little effect of EU migrant flows on native wages.

Even the famous Bank of England study that broke down the impact by skill group implied that immigration over a decade may have lowered real pay for low-skilled service workers by around one per cent percent. That's against benefits from the free-flow of people, including cheaper produce and enhanced productivity from the entrepreneurship brought by other migrants.

Immigration's static effects on wages simply pale by comparison to other supply and demand factors. Median cash pay across the whole economy has grown by 9.8 per cent between September 2019 and 2021. For all the talk of the effects of shortages, there is scant indication of a broad wage boom in low-skilled sectors yet. HMRC's PAYE data shows a much lower 5.9 per cent growth in median "transportation and storage" pay and a mere two per cent increase in "accommodation and food services" during the last two years, the latter of which is a decline in real terms. Yes, the labour supply obviously affects pay levels, but this shows the power of demand shifts too.

Deep down, most Conservatives know this. The Government has already relented on poultry workers and HGV drivers, taking steps to liberalise at least some visas in recognition of the ongoing disruption. But they are setting a rod for their own backs in implying that ending free movement is key for rising low-skilled wages. Not only will any restrictions that deliver higher pay in some sectors lead to offsetting price rises for others, but the short and long-term evidence gives no indication that migration changes will meaningfully boost compensation for the low-paid as a cohort.

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