THE PRODUCTIVITY COMMISSION ON THE ECONOMICS OF IMMIGRATION

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The Productivity Commission's recent Position Paper on the Economic Impacts of Migration and Population Growth examines the effects on productivity (output per hour worked) and GNP per capita of higher migration. It concludes that the effect of a 50 per cent increase in the numbers of skilled migrants over the twenty year period to 2024-25 will be to reduce average productivity slightly but increase GNP per capita slightly relative to current migration levels. However, the Position Paper does not assess the implications of the extra migrants for Australian residents (or incumbents). This paper argues that GNP per capita for incumbents will be to lower under the high migration scenario than if current migration levels are maintained.

The Productivity Commission (PC) has produced a 319 page Position Paper on the *Economic Impacts of Migration and Population Growth*. The report is a valuable compendium of recent information on Australia's migration trends and an objective review of relevant theory and opinion on the economic implications of these trends. It can also be downloaded freely from the PC website.

The report was commissioned by the Treasurer, Peter Costello. The terms of reference ask the PC to assess the relationship between population growth (including immigration) and productivity. These terms of reference leave open the possibility that boosting or pruning immigration could be associated with higher or lower productivity. However, the PC chose only to look at the implications for productivity of higher immigration. It did so by comparing the implications of two scenarios, one where the current immigration level is maintained to 2024-2025 (current migration), and the other where the skilled component of the program was increased by 50 per cent, thus adding an additional 39,000 migrants each year between 2004-05 and 2024-25 (high migration). Under the current migration assumption, Australia's population will increase from 20.2 million in 2004-05 to 24.85 million in 2024-25, and under the high migration assumption it will increase from 20.2 million to 25.54 million in 2024-25.[1] Thus the high migration assumption adds an extra 700,000 residents to Australia's population by 2024-25.

The economic modelling in the PC Report was based on the work of the Monash University Centre for Policy Studies (COPS). COPS used its model of the Australian economy to examine the implications for the Australian economy over the projection period of the demographic scenarios the PC wished to investigate.

According to the Position Paper, productivity (defined as output per hour worked) would be slightly lower by 2024-25 under the high migration scenario than it would be if current migration levels were maintained. Since productivity is the key to Australians' standard of living it could be concluded that we, the existing residents of Australia (or incumbents), would be better off with lower rather than higher migration.

The main reason why productivity is lower under the high migration scenario is that, under the assumptions embodied in the model, the growth in the economy

due to extra population will require an increase in imports. This in turn will require an increase in exports (to balance Australia's external account). The result of this is a decline in Australia's terms of trade. This is because the COPS model assumes exporters face downward sloping demand curves, and therefore that they must accept slightly lower prices for the extra product they sell overseas. The consequence is a lowering of the value of output relative to the cost of capital, and thus a decrease in the capital to labour ratio.[2]

The PC Position Paper considers that these productivity findings have little significance for Australians' living standards, since the difference in productivity levels between the two scenarios is slight and is dwarfed by the overall productivity gains expected under both scenarios. These gains are attributable to high levels of capital investment and technological progress, both of which are assumed to continue over the projection period.

It might have been expected that the PC's Position Paper would have been interpreted in the media as a challenge to the economic case for high migration. This was not generally the case. Rather, the media chose to focus on the PC's findings concerning projected growth in per capita GNP. Because of the anticipated jump in overall productivity referred to above, GNP per capita is projected to be some 36 to 37 per cent higher in 2024-25 than at present, no matter which migration scenario occurs.[3] However, the PC findings indicate that, under the high migration scenario, there is a marginal gain. Each Australian will be some $335 (or 0.6 per cent) richer on average than under the current assumption.[4] Again, the PC acknowledges that this difference is not significant. However, it was the focus of most media commentary on the report.

There is some technical dispute about these findings. Department of Immigration and Multicultural Affairs (DIMA) commissioned Econtech to model the economic implications of the two migration scenarios. Econtech's simulations produce slightly higher per capita GNP gains than COPS. *People and Place* readers will be able to assess the merits of the two approaches in the June 2006 issue when COPS and Econtech will outline their respective approaches and findings.

The summary of the PC Position Paper so far will no doubt have prompted readers to ask how can productivity per hour worked be slightly lower under the high migration assumption, yet GNP per capita be slightly higher under the same set of assumptions. The answer is that these GNP gains flow from the assumptions regarding the workforce participation and occupational patterns for skilled migrants which the PC required COPS to incorporate into its econometric projections.

As part of the background work done by the PC for this project, its staff investigated the labour force participation rates and output of skilled migrants in Australia in recent years. In the PC's words:

> The Commission has found that, on average, immigrants earn more per hour than Australia-born workers (chapter 5). To the extent that hourly earnings reflect productivity, immigrants as a group are more productive than the Australian-born population. This difference in productivity is because immigrants are, on average, more educated, older, more likely to live in capital cities and work in different industries compared with Australian-born workers. The increased skills focus of Australia's migration program has resulted in recent immigrants earning higher incomes than in the past, due mainly to their higher levels of education.[5]

In effect, the modellers had to make the Australian economy adjust to these

assumptions. The relatively high labour force participation and productivity levels assumed to result from the addition of skilled migrants were the main component of the gains in GNP per capita by 2024-25 by comparison with the current migration scenario. The assumption that the extra skilled migrants (mainly persons with professional qualifications) will fill high productivity positions meant that there would (inevitably) be gains in per capita GNP as a result.

The Position Paper's findings indicate that these gains in GNP per capita from the extra migrant workers offset several unfavourable outcomes for GNP which flowed from the high migration scenario. The most important of these is the lower productivity level attributable to the capital dilution effect described above. There is also a decline in the terms of trade which has a negative effect on GNP per capita. Another negative effect stems from the increased outflow of interest and dividends assumed to result from the increased dependence on foreign investment needed to grow the economy as a result of the high migration assumption.[6]

The PC acknowledges that there are a number of other factors, not included in the modelling exercise, which might affect the outcomes of the high migration scenario. These include possible economies of scale resulting from the higher domestic population and agglomeration effects — assumed by some to generate productivity gains where large numbers of firms crowd together. The authors also acknowledged that there are possible negative implications for productivity, including congestion effects flowing from growth in the population of Australia's major cities.

The economies of scale issue is of particular note. In the past, some modellers have assumed that significant economies of scale result from population growth. Where this is assumed, econometric models inevitably deliver average productivity and income gains for the entire population as a result of extra migration. COPS does not incorporate this assumption in its model on the grounds that there is insufficient evidence to justify its inclusion. The PC economists took the same stance.

Assumptions about skilled migration

The PC's conclusions about the economic benefits of high migration depend fundamentally on whether Australia will be able to find additional skilled migrants who will fill highly productive managerial, professional and trade positions in Australia's workforce. The PC assumes that this will be the case, but recent experience suggests that this is a questionable assumption.

If Australia is to recruit more skilled migrants they will have to come from non-western countries. This occurred with the recent upsurge in migration since the late 1990s and is likely to continue to be the case because, in the foreseeable future, most western societies will also be in the market for skilled workers.[7]

There are large numbers of Asians, especially from China, the Philippines and the sub-continent of India who hold university degrees and who would like to immigrate to Australia. But whether they have the technical skills and job experience relevant to Australian employer needs, or the high level communication skills expected of professionals these days, is another matter.

The employment outcomes for skilled migrants coming to Australia from Britain, New Zealand or South Africa are good. However, it is a different story for those coming from non-western coun-

tries. For example, for persons with degree-level qualifications in accounting from Britain and New Zealand who arrived in Australia between 1986 and 2001, some 75-80 per cent were employed as managers and professionals (mainly as accountants) in the year 2001. By comparison only 32 per cent of immigrants with accounting degrees from China, 32 per cent of those from India, and 15 per cent of those from the Philippines who arrived in Australia over the same period were so employed by 2001.[8] It is true that some of the Asian accountants entered Australia as family members (and thus did not have to get their credentials assessed before migrating) but so too did some of the British accountants. In the case of the New Zealand-born accountants there was no selection process at all, since under the Trans-Tasman arrangements New Zealand citizens can move freely to Australia.

The main source of growth in the skilled migration program over the past few years has been former overseas students trained in Australia who subsequently obtain permanent residence (PR). The number of principal applicants visaed under the onshore skilled overseas student category (visa subclass 880) grew from 5,284 in 2001-02 to 12,978 in 2004-05, by which time they exceeded the 11,826 visaed under the offshore skilled independent category (visa subclass 136). The two largest source countries for the 880 visa subclass were the People's Republic of China and India. The major occupations were computing and accounting, which together accounted for 70 per cent of all principal applicants visaed under the 880 visa subclass and 42 per cent of the 136 visa subclass.

Why hasn't DIMA drawn more heavily from skilled migrants located overseas? The answer is consistent with the proposition argued above. It is that there is only limited interest in skilled migration on the part of citizens of western nations. On the other hand many Asian professionals are keen to migrate, but only a fraction can meet the Australian Government's skill selection standards (let alone meet the standards expected by Australian employers if they do get visas). Before a person can apply for a skilled visa they must meet several threshold requirements, including that they possess functional English and that their credentials meet the standards specified by the relevant Australian accrediting authority. These threshold standards, plus various other hurdles put in place because of DIMA's concern to filter out applicants unlikely to do well in Australia, have limited the expansion of the offshore skilled program.

Partly because of this situation, the Australian government has opened up opportunities for former overseas students to obtain permanent residence after completing their courses in Australia. The decision to do this coincided with the dot.com boom of the late 1990s. Employers were afraid Australia would miss out on the boom because of a lack of locally trained professionals and thus were keen to allow overseas students in IT and accounting to stay in Australia. These concerns prompted the Australian Government in 1999 to preference these students by removing the work experience requirement which applied to applicants located overseas and by granting extra points for training in Australia. At the time policy makers thought that, because these students were trained to our specifications, and in English, they would add significantly to Australia's skill base. As indicated, the

numbers visaed have escalated since 2001-02.

However, these former overseas students have struggled to gain professional level employment in Australia, partly because of communication difficulties, partly because few have any experience in their occupation and partly because the courses they complete (which are increasingly two year Masters courses taught exclusively to overseas students) often do not provide high level vocationally specific knowledge or skills.

The PC acknowledges some of these issues.[9] Australia's immigration selection system may well be reformed to deal with some of these problems. Nonetheless the experience to date suggests that we cannot lightly assume that there is a stock of potential skilled migrants available who can achieve labour market outcomes similar to domestically trained persons.

There is a further question. If Australia needs an infusion of skilled persons, why not pursue an alternative strategy involving additional training opportunities for Australian residents? The reason why the immigration tap has been turned on in recent years is because the output of resident professionals and traditional tradespersons has not kept pace with the growth in the Australian economy. In the case of professionals this is largely because there was only a marginal increase in the number of subsidised university places between 1996 and 2004. Almost all the growth in university level training in Australia during this period has been amongst overseas students.[10] In the case of the traditional trades, training levels have barely increased because of the reluctance of employers and young people to take on indentures under the terms and conditions offered.

The PC does discuss this issue but does not evaluate the domestic alternative. It cites the work of Glen Withers who argues that high migration is in the interests of residents because the impetus it gives to the economy helps create new skilled openings which residents can fill.[11] The last decade of Coalition governance in Australia provides a 'natural experiment' which enables a test of this thesis. Skilled opportunities have opened up, partly because of the expansion of Australia's population. But residents have not benefited because of the unwillingness of the Coalition government to finance additional university places. Instead, the Government increased the immigration intake, though with only partial success from the point of view of providing employers with the skills they are seeking.

Who benefits from high migration?

The PC does not consider the question of who benefits from high migration. Its terms of reference did not specifically ask for such consideration. This is an unsatisfactory situation. Surely Australians ought to be informed on this vital issue.

There is no doubt that the additional migrants entering Australia under the high migration scenario will be the major beneficiaries, assuming that the PC is correct in its expectation that they will find professional and trade level employment. Since most will come from non-western societies their income levels will expand sharply. They will also enjoy the benefits of the accumulated investment in civic and economic infrastructure in Australia without having to pay an entry fee.

What about residents — or incumbents? The main losers will be young people, especially those with university training. This is because they will bear the brunt of the competition presented by the skilled migrants. Their wages and

conditions by 2024-25 will be considerably lower than would have been the case in the absence of the skilled migrant competition. Ironically, lower skilled incumbents will be less disadvantaged because, under the high migration scenario, there will be few extra migrants in their skill bracket competing for employment.

Young residents will also be negatively affected because they are not property owners. They will have to compete for entry into the housing market against the extra migrant households. Australia already experiences one of the highest ratios of detached house prices to household income in the developed world.[12] The extra migration will add to the demand side of the property price equation. It will do so at a time when, in Brisbane, Sydney and Melbourne, the respective State governments are trying to curb the spread of the suburban frontier.

The main winners from the high migration scenario, apart from the migrants themselves, will be the owners of businesses, whose markets will grow and whose profits will expand in the short to medium run as the labour to capital ratio rises. These beneficiaries include home builders, shopping centre proprietors, infrastructure providers and media owners. The beneficiaries also include most home owners, since their properties will appreciate as a consequence of the increased scarcity value of their holding with the influx of migrant households.

The high migration scenario thus seems to benefit the advantaged at the expense of the disadvantaged. Another way of viewing the situation, which supports this contention, is that the ownership of capital is skewed heavily towards the more elderly (since it depends on past savings). Hence the old win on this front too, because profits go up under the high migration scenario. Meanwhile the young lose because their lifetime wage earnings fall under this scenario.

Much of the business rhetoric about the benefits of higher migration has to do with the consequent growth in the size of the Australian economy. Yet, the Position Paper indicates that, when it comes to capturing the alleged benefits of economies of scale, 'trade and migration are substitutes'.[13] As is pointed out in the work of the Harvard economist George Borjas,[14] this insight has a profound bearing on the debate about the implication of high migration.

When Australia imports clothes from China, Indonesia or Fiji it, in effect, imports the cheap labour embodied in the manufacture of the garments. Instead of bringing such workers to make the garments in Australia we import the product. Likewise, when Australians import motor vehicles (currently more than 60 per cent of all motor vehicles sold in Australia are imported), they import the economies of scale that the Japanese and other major exporters have achieved. For Australia to reproduce such economies of scale (and the lower costs per vehicle associated), would require a massive increase in the domestic market (if the cars were to be sold in Australia). In other words, if Australians wish to benefit from the cheap labour and economies of scale available overseas or, for that matter, from the benefits of advanced technology in countries like Germany, it can import the products which embody these attributes. There is no need to expand migration to achieve these effects.

In order to capitalise on these benefits Australia's exports will have to increase. Currently Australia has the capacity to

maintain high levels of exports deriving from its renewable and non-renewable resources. It can only do this because of its small population, that is, because there is currently a substantial surplus between what can be produced and what is needed for consumption in Australia. There is very little relationship between extra migration and the scale of rural and mining output in Australia. However, a migrant induced increase in population has a direct relationship with the level of imports, in the sense that imports will rise at least as fast as the migrant population rises.

In these terms it is hard to see the economic argument for high migration, at least from the point of view of most incumbents. One of the more bizarre outcomes of current migration policy is the high intake of professionals from the Indian subcontinent and from China (particularly those who have studied in Australia). These migrants are arriving at the very time that Australian firms and consumers are drawing on the benefits of the cheap labour in their homelands — for consumer goods and increasingly for outsourced services. In India's case this includes the outsourcing of IT services. If Australian firms can access such professional services in India and China for a fraction of the cost of such persons once they are in Australia, why bring them here?

The PC Position Paper is a welcome contribution to the immigration debate. Its drawback from the point of view of public policy is that its findings may be taken at face value. However, as indicated, there are a number of implications of the study for incumbents which are not explored. These need to be considered by policy makers.

References

1 Productivity Commission Position Paper, *Economic Impacts of Migration and Population Growth*, January 2006, p. 258

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3 ibid., p. 141

4 ibid., p.139

5 ibid., p. 144

6 ibid., p. 145

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9 Productivity Commission Position Paper, op. cit., p. 156

10 B. Birrell, D. Edwards, I. R. Dobson and T. Fred Smith, 'The myth of too many university students', *People and Place*, vol 13, no. 1, 2005, pp. 63-70

11 Productivity Commision Position Paper, (quoting G. Withers) op. cit., p. 50

12 Demographia International Housing Affordability Survey, 2006, see http://www.demographia.com/

13 Productivity Commission Position Paper, op. cit., p. 146

14 See G. J. Borjas, 'Globalization and Immigration', in M. M. Weinstien (Ed.), *Globalization: What's New?*, Columbia University Press, New York, 2005, pp. 77-78.