COMMENT ON JAMES GIESECKE: THE ECONOMIC IMPACT OF A GENERAL INCREASE IN SKILLED MIGRATION

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A previous issue of People and Place carried an article by James Giesecke[1] claiming that increasing Australia's immigration program would disadvantage incumbent Australians. This claim is inconsistent with economic theory and seems unsound. Skilled migration intakes are likely to provide long-term net economic benefits for incumbent Australians.

James Giesecke uses the MONASH model of the Australian economy[2] to assess the effects on Australia's economy of a sustained 50 per cent increase over 2004–05 levels in skilled visa immigration. He runs this analysis over the period 2005 to 2025. The effects of the increase are unsurprisingly to make the Australian economy larger. Surprisingly however, while GNP per capita rises very modestly with the inflow of additional skilled migrants, the income accruing to Australia's incumbent population falls long-term. If it is the incumbent population who determine immigration policy and they do so on the basis of the effects of the migration on their steady state incomes and those of their progeny then, as Giesecke concludes, 'a general expansion in skilled immigration would not appear to be an appropriate policy response to popular perceptions of a current "skills shortage"'. Moreover, if it were true that there was lower social welfare dependency and increased skill externalities from skilled rather than unskilled migrants then the Giesecke study has the stronger implication that, from the viewpoint of the long-term welfare of incumbents, we should scrap the current immigration program entirely and have zero net immigration.

This conclusion is difficult to accept and is inconsistent with prior studies of the economic effects of immigration. In these studies a positive or at worst benign long-term economic effect of immigration on incumbent welfare obtains (see for example Borgas, and Ottaviano and Peri).[3] What is disturbing about this conclusion is that it also seems to be implicit in the Productivity Commission's 2006 study *Economic Impacts of Migration and Population Growth*.[4] The conclusion is misleading and inconsistent with the substantial body of economic theory and evidence that analyses immigration impacts.

The standard economic assumption is that having extra people to trade with should provide average gains to incumbents once all macroeconomic adjustments have worked themselves out. The argument supporting this assumption is a particular case of standard economic arguments for getting rid of trade restrictions by liberalising markets. If incumbent residents of Australia trade among themselves to better their economic life how can they be worse off on average if they are given the option to trade with a larger group (the incumbents plus a group of skilled migrants)? One can formalise this argument using 'gains-from-trade' modelling (see Berry and Soligo for an early treatment and Kemp for a very general discussion)[5] but the basic argument is straightforward.

One can think of obstacles to a society realising such gains-from-trade. The existence of a social security system that could be exploited by immigrants or of congestion or pollution externalities that are aggravated by the immigrants can potentially eliminate such gains but these are not the issues that drive the model Giesecke uses. In fact skilled workers are likely to have both low unemployment and low social welfare dependency. Environmental issues are not even addressed in the Giesecke analysis.

What does drive the Giesecke result? It is difficult to pin down, given the complexity of the MONASH modelling, but the effects of immigration in worsening current account deficits and thereby driving unfavourable terms of trade effects seem to be a part of the Giesecke explanation. The claim is that new immigrants drive higher import demands for consumer durables and for imported capital goods to maintain pre-immigration capital/labour ratios. This then calls for more exports of goods that are imperfectly price elastic. In simple terms, more coal and agricultural products need to be exported to pay the increased import bills incurred as a result of the immigration. Since Giesecke supposes that exporters are not price-takers in international markets, export volumes will need to be expanded at lower prices to fund such increased imports. This unfavourable movement in the 'terms of trade' is then supposed to cut into the real incomes of incumbents.

This is not however plausible. Australia has only limited capacity to set prices in the markets for its major exports—for the most part we are close to being price-takers in such markets. In addition, having more skilled immigrants increases Australia's capacity to export as well as import demands, an offsetting impact boost to the terms of trade. Most importantly, Australia is a nation of immigrants and if immigration were always to have the effect of driving a secular deterioration in the terms of trade we would have now have very low living standards in Australia.

Moreover, debt acquired as a consequence of the immigration per se is not a reason to oppose the immigration. Incumbent citizens should be unconcerned if well-informed immigrants borrow from well-informed lenders to purchase such things as consumer durables and housing. Nor, for the same reasons, should incumbents be concerned if firms borrow to fund capital expansions that are feasible because of the existence of extra skilled migrants. Neither of these events impact on long-term living standards.

It can be claimed that immigration reduces social cohesion in a society, which is socially costly, or that the skills sought in developing countries are not particularly useful in the Australian economy. Birrell makes the latter claim.[6] It can be argued that, in the absence of appropriate environmental policies, immigration-fuelled population growth worsens such problems as congestion or pollution. Finally, immigration almost certainly does worsen the functional distribution of income between capital and labour by boosting the value of an economy's capital assets while at the same time depressing wages. These arguments might be valid in certain circumstances and provide valid arguments against immigration but they are not the points being made in the Giesecke critique.

Elaborate economic models should contribute towards our understanding of economic problems and be consistent with economic theory and commonsense. The Giesecke analysis fails to meet these criteria. The more plausible conclusion is that Australian incumbents derive long-term economic advantage from pursuing an active immigration program, an advantage that is improved if skilled rather than unskilled migrants are selected.

References

1 J. Giesecke, 'The economic impact of a general increase in skilled migration', *People and Place*, vol. 14, no. 3, 2006, pp. 48–63

2 See P.B. Dixon and M.T. Rimmer, *Dynamic General Equilibrium Modelling for Forecasting and Policy Analysis: A Practical Guide and Documentation of MONASH*, Contributions to Economic Analysis 256, North Holland, Amsterdam, 2002.

3 G.J. Borgas, 'The economic benefits of immigration', *Journal of Economic Perspectives*, vol. 9, no. 2, 1995, pp. 3–22; G.I.P. Ottaviano and G. Peri, 'Rethinking the gains from immigration: theory and evidence from the US', *National Bureau of Economic Research Working Paper* 11672, September 2005

4 Productivity Commission, *Economic Impacts of Migration and Population Growth*, Productivity Commission Research Final Report, Melbourne 2006

5 R.A. Berry and R. Soligo, 'Some welfare aspects of international migration', *Journal of Political Economy*, vol. 77, 1968, pp. 195–221; M.C. Kemp, 'The welfare gains from international migration', *Keio Economic Studies*, vol. 30, 1993, 1–5

6 B. Birrell, 'The Productivity Commission on the economics of immigration', *People and Place*, vol. 14, no. 1, 2006, pp. 1–7