Australia's Economic and Social Immigration Policies: A Labour Market Perspective

Leo Dobes

In the Winter 1989 issue of ***Policy****, Mark Harrison and John Logan proposed that Australia's annual immigration quota should be auctioned and allocated to the highest bidders.* ***Leo Dobes****, an Assistant Secretary with the Department of Transport and Communications, argues that economic immigration would best serve the welfare of Australian residents if existing labour market distortions were removed and employers were free to recruit workers from abroad according to specific needs.*

THE ultimate objective of immigration policy is to increase the welfare of existing Australian residents. This holds true regardless of whether other countries operate free immigration and emigration policies, and whether or not yesterday's immigrant (today's resident) increases his or her own standard of living by moving to Australia. The effect of Australian policy on world output or welfare is equally irrelevant.

This approach parallels closely the analysis of protectionist measures such as tariffs. Other countries' tariff policies are irrelevant; what matters is how Australian welfare can be maximised on the basis of comparative advantage, given the external trading environment. Similarly, our concern with immigration — particularly efficiency in the labour market — must relate to its welfare effect on the community as a whole, not merely its effect on special interest groups or just those workers affected directly.

In this article I argue that economic immigration should be viewed principally as a mechanism of labour market adjustment and as a complement, rather than an alternative, to the training of resident workers. However, I begin by identifying certain problems with Mark Harrison's and John Logan's proposals for marketing settlement rights, as set out in the Winter 1989 issue of *Policy*.

Three Problems with the Harrison-Logan Proposals

In his article 'Auctioning the Immigration Quota', Mark Harrison (1989) argues that Australia should choose the level of population that maximises net average benefit per person and that incumbents' benefit would be maximised if the quota were auctioned to prospective immigrants. In an accompanying article, John Logan (1989) adds the rider that quota sale rights should be allocated to individual residents, so that they, rather than the government, capture the benefits from their sale.

This is an interesting approach to immigration policy, but it fails to address three major problems.

First, the ability to pay for entry into Australia is unlikely to reflect an immigrant's potential to increase the benefit accruing to residents. Neither the auction price mechanism nor residents (who lack information) are able to discriminate between immigrants to ensure that economic or social benefits are maximised. At one extreme the whole quota might be purchased by rich geriatrics who impose large future medical costs on the community. Individual residents need to be able to choose the specific types of migrant they had in mind (e.g. pilots, fiancé(e)s, bricklayers) when weighing up the costs and benefits to themselves of a particular intake quota.

The second major practical problem skirted by Harrison and Logan is the mechanism for setting the optimum level of immigration. Residents are assumed to have sufficient knowledge to choose between immediate cash benefits and unquantifiable lower average living standards due to increased congestion or pollution. In a static model, an optimum desired entry quota could be reached iteratively as residents' information about costs and benefits increased. In the real world, residents' preferences (including the desire by some to buy up quota rights to deny entry to migrants) change over time and may even be quite volatile in the short term. Further, if social benefit is related to population size, as in Harrison's diagram, then residents who wish to leave the country should also be required to compensate those who remain.

Third, the effective analysis of migrants as commodities rather than as a factor of production permits Harrison to avoid the corresponding treatment of capital flows. Foreign investment in Australia and investment abroad by residents also yield differing benefits

and costs to individual Australians in terms of interest rates, exchange rates, land prices, pollution from factories, employment, etc. If we accept the Harrison-Logan analysis for labour flows, we should logically accept the auctioning of quota rights for capital inflow and outflow.

Australia's Three Immigration Programs

Australian immigration policy is officially based on a set of nine social principles. In practice a total entry quota is established by the government and then allocated broadly among three distinct programs that are designed to satisfy different aims: **humanitarian** (refugees), **social** (principally family reunion), and **economic** (principally the augmentation of the domestic workforce). The failure of most commentators to distinguish among the objectives of these different programs has resulted in a farrago of identified costs and benefits of an amorphous and nebulous concept of 'immigration'.

My first proposition is therefore that any discussion of immigration policy should establish the separate policy objectives of each of the three broad programs, before developing policy prescriptions. The Harrison-Logan approach would be directly applicable to social immigration policy, with scope for granting free places to refugees, or having the government bid for such places at auction according to its priorities in meeting its international commitments. Economic immigration policy, on the other hand, requires policy formulation in terms of domestic labour market needs.

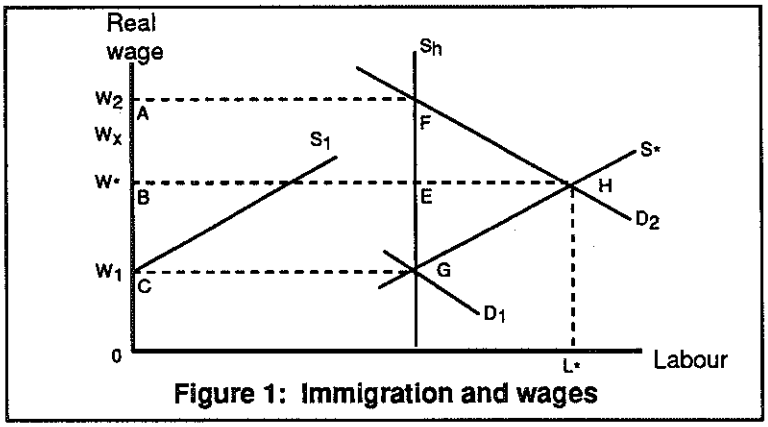

Figure 1: Immigration and wages

Economic Immigration and Labour Market Adjustment

My second proposition is that economic immigration (emigration is already unconstrained) should fulfil its role as an adjustment mechanism in individual Australian labour markets, just as free flows of capital permit unconstrained adjustment in capital markets. Employers themselves rather than governments can best determine the number of economic immigrants by being permitted to recruit labour overseas on their own initiative. In contrast to most studies, this article adopts a microeconomic approach, recognising the existence of highly differentiated and specialised labour markets rather than treating labour as a homogeneous factor of production.

Left to themselves, labour markets would adjust efficiently with relative wages and patterns of employment being determined by supply and demand in each labour market. If a surplus or shortage exists in a particular labour market, relative wages change so as to eliminate the imbalance by attracting workers or repelling them from the appropriate firms. In the real world, labour market adjustment may be influenced by the government through fiscal or monetary policy, training or retraining or workers through investment in human capital, or through immigration and emigration. (The non-specific nature of fiscal and monetary policies makes them inappropriate, blunt instruments of labour market policy, and they are not discussed further here.) The acquisition of skills may require on-the-job experience as well as formal training; this avenue of adjustment will often therefore be slow to work. Immigration and emigration provide an alternative adjustment mechanism because the shorter lags involved permit labour markets to clear faster.

In Figure 1 the demand D1 for a specific type of labour (shoemakers) is met by a fixed domestic supply (Sh) of such workers, so their wage is W1. At this wage, no foreign shoemakers (supply curve S1) are willing to migrate to Australia, but would be willing to do so if wages for shoemakers in Australia were higher. If the demand for Australian-made shoes increases (due to exports, fashion, etc.), then the demand for resident shoemakers also rises (to D2). In the short term at least, wages for shoemakers employed in Australia will rise whether immigration is allowed (W*) or not (W2).

In comparison to the situation where foreign shoemakers migrate to Australia in response to increased demand (D2), a prohibition on their entry would result in an opportunity cost (loss in potential welfare) to Australia of the triangular area FGH. If shoemakers' wages in Australia rise (W2) above those in other countries (Wx) because immigration has been restricted, the potential welfare loss may be even greater as some Australian firms close down or relocate overseas to remain competitive.

Training of domestic workers offers an alternative to immigration. But if the time required (e.g. a four-year apprenticeship) exceeds the time required to land an immigrant (e.g. one year), then the community will still suffer a welfare loss of FGH over three years if it precludes immigration. Similarly, welfare losses will occur where bureaucrats or politicians misjudge labour market demand for specific skills. It is highly unlikely that any predetermined quota system (including skill-oriented points systems or auctions of quotas) can satisfy accurately the fluctuating needs of different labour markets, especially when total entry levels and criteria are established up to 18 months ahead, as in the present system.

Immigration and Residents' Welfare

The third proposition is that immigration need not decrease the absolute level of welfare of existing residents, or even those workers with whom immigrants compete directly, if foreign investment is unconstrained, and immigration is permitted only in response to increased demand in individual labour markets. Standard textbooks (e.g. McCloskey, 1985:464) usually confine themselves to showing that the macroeconomic effect of immigration on a static labour market is to decrease the wages of domestic workers, but to increase national income overall.

In Figure 2 this is shown as a shift to the right of the supply curve for labour (from S1 to S2) due to the entry of RP immigrants when demand for labour is D1. Total product in the industry that employs this specific labour increases from OEFN to OEKP, although ABFG in resident workers' wages is redistributed to owners (including workers themselves) of factors other than labour, who also gain FGK. Because Figure 2 utilises a sloping supply curve rather than a vertical one (which would be more appropriate where there was a shortage of domestic labour), it also reveals that the lower wage OA resulting from immigration (or alternatively from an increase in training of domestic workers) discourages RN previously employed resident workers, who seek jobs in other industries or become unemployed.

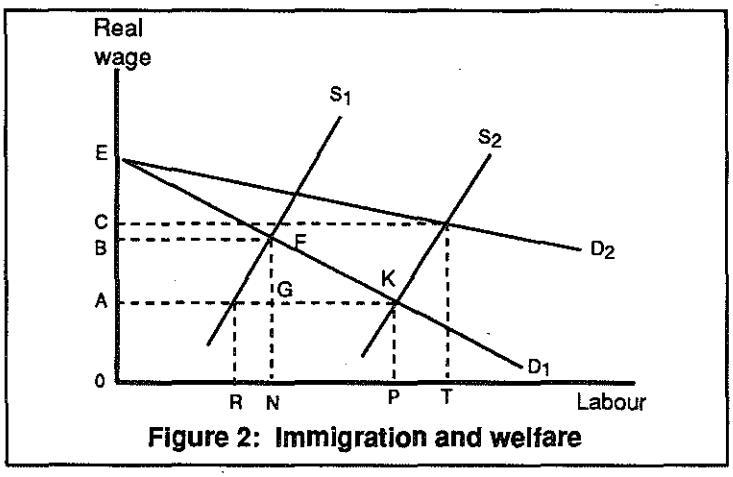

Figure 2: Immigration and welfare

However, wages and employment of resident workers are likely to fall only temporarily, if at all. In a growing economy such as Australia it is more likely that growth in demand for labour will precede or coincide with immigration, particularly where immigration policy is based in some way on a prior increase in the demand for labour. This is shown in Figure 2 as an initial shift in the demand (rather than the supply) for labour from D1 to D2, followed by a shift in the supply curve from S1 to S2 due to immigration. In a tight labour market these supply curves will be close to vertical so that the post-immigration wage level OC is likely to be above the pre-immigration level OB, and very little if any unemployment occurs amongst resident workers.

If wages nevertheless fall below their initial level of OB, the increased return to non-labour factors of production that results from lower wages will induce investment in the industry, thus increasing demand for labour and wages again. (In a much-neglected article, MacDougall [1958] appears to have been the first to analyse the interaction of capital and labour inflows in the context of the debate at the time over relaxing Australian controls over foreign investment). Where the capital inflow is accompanied by transfer of new technology, or migrants increase productivity, demand for labour may be further increased.

Residents are thus unlikely to suffer in the long run, if at all, from the immigration of competing factors of production, particularly when the free inflow of capital is permitted.

Immigration and Training

A fourth proposition is that employer-nominated economic immigration and the training of resident workers need not be mutually exclusive provided that existing economic distortions are removed.

A major concern of some opponents of a more market-determined immigration policy is that it would result in residents providing unskilled labour and migrants providing skilled labour, so that residents are effectively denied career and income advancement. This seems to be the underlying assumption made by DEET (1988:15), which portrays immigration as a cheap option for employing skilled labour so that employers neglect their social 'obligation' of training or retraining domestic workers.

This argument is reminiscent of the arguments advanced not all that long ago against microprocessors and computers (and other technology) because they would take jobs from workers. This assumption of a fixed number of jobs (or training places in our case) in the economy is the well-known 'lump of labour' fallacy. Its proponents in terms of training also ignore the fact that insufficient numbers of domestic workers with basic skills or education may be available for training or retraining. Not every unemployed mechanic or butcher can be retrained as a brain surgeon. More important, to limit immigration in preference to training residents is to ignore the costs to the community outlined in my third proposition. The logical corollary would be to prevent skilled Queenslanders from filling vacant positions in Western Australia on the grounds that locals should be trained first, irrespective of the welfare cost to the residents of Perth.

A more sustainable argument against immigration of skilled labour can be advanced by using the analysis of Chiswick (1982), who does not himself oppose immigration. If economic immigration is primarily 'skilled', it will tend to depress the wages of skilled domestic workers, but raise the income of land, capital and 'unskilled' workers. The compression of 'skilled' and 'unskilled' wage differentials will diminish incentives among 'unskilled' residents to undertake training. However, this compression of wage differentials is

unlikely to occur in a growing economy or where immigration occurs only in response to labour shortages (proposition three above). Indeed, Chiswick's analysis confirms the importance of my second proposition, i.e. that immigration should be determined by employers according to conditions in individual labour markets; otherwise a selection system biased towards skilled labour is likely to result in unwarranted imbalances in wage differentials.

Unfortunately, much of the recent debate regarding immigration versus domestic training is predicated on existing arrangements, which involve significant economic distortions. If employers paid (or shared with immigrants) the full cost of recruitment, travel to Australia, some form of unemployment insurance for an initial establishment period, and so on, their current preference for migrants would diminish. On the other hand, domestic labour market rigidities such as union-determined apprenticeship periods, lack of general provision for lower 'training' wages to reflect the cost to the employer of providing training in transferable skills etc. make the cost of training labour domestically relatively high. Individuals also face disincentives to training, including centrally-determined wage relativities that depress differentials between skilled and unskilled labour, and the inability of TAFEs to provide training on a user-pays basis. Employers will tend to recruit migrants and to train resident workers until the marginal cost to them of both sources of skilled labour is equal: the removal of existing distortions would result in a more realistic balance between the two.

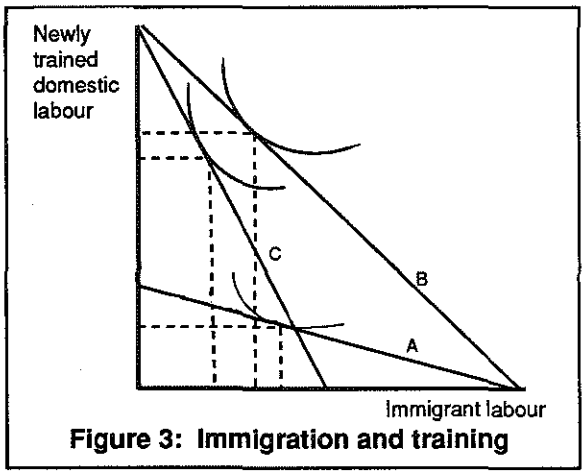

Figure 3: Immigration and training

A likely outcome of removing existing distortions is illustrated in Figure 3. Removal of existing labour market rigidities would result in a move from budget line A to budget line B due to a reduction in the costs of training workers domestically. If employers were also forced to bear the costs of recruiting workers overseas, a final equilibrium would be determined along budget line C. The balance between use of immigrants and domestically-trained labour would depend on an individual employer's indifference curves (harder working or more skilled immigrants may be preferred to residents with better English language ability or local knowledge) but the removal of all current distortions would be likely to result in at least some increase in the training of residents. The industry training levy proposed by Education Minister Dawkins is not a substitute for removing labour market rigidities. To the extent that it increases costs to employers, they will tend to resort to more creative accounting methods or will focus their expenditure as far as possible on firm-specific training rather than on transferable skills so as to retain any benefits arising from investment in training.

An Employer-Driven Immigration Program

My final proposition is that the right to enter Australia should continue to be determined by resident employers, not by prospective economic immigrants themselves.

In theory, and assuming free flows of all goods and factors of production, immigration would be unrestricted in order to maximise national income. In practice the availability in Australia of government or employer-funded job training, legally determined minimum wages, as well as social services such as unemployment benefits, would distort the decisions of foreign workers considering migration on the basis of international wage differentials. Harris and Todaro (1970) drew attention to this phenomenon in the context of migration from low-wage rural areas to minimum (union) wage urban areas in developing countries. Workers will migrate even if they are likely to remain unemployed for some time provided that the present value of their expected benefits (the joint probability of eventual employment and the expected minimum wage) exceeds the present value of the transactions cost of migration and unemployment.

A second best solution is therefore to continue to deny foreigners the right to unconstrained immigration into Australia, while permitting employers the right to recruit overseas at their own expense as well as removing labour market distortions, particularly those affecting the costs of training.

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