5 Population growth and the resources boom

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The 2010 federal election saw a bipartisan shift from ‘Big Australia’ towards ‘Sustainable Australia’. As a result of that shift and policy decisions affecting the link between studying in Australia and gaining permanent residency here, there has been a notable fall in net international migration to Australia. Having peaked at annual rates of 320 000 at one stage in late 2008, net international migration to Australia fell to 206 000 through 2010, with further falls in prospect.

That means a sharp switch in short-term prospects for the supply side of labour markets. Working-age population gains hit a high when we needed it, rising to a migrant-fuelled peak in 2008 as the first phase of the resource boom flamed out amid the global financial crisis.

The current phase of the resources boom involves bigger dollars, but the supply side of labour markets looks hard-pressed to feed the requisite people power into the strong job demand being created by the boom. That is not merely because migrant numbers are falling away, but also because the pace of baby boomer retirement is picking up.

The last time job demand went through the roof, Australia had more people power to help satisfy that job boom. Now the job boom is back, but working-age population numbers are set to crawl through a period in which ideally they would still have been sprinting.

The upshot is that Australia will have to get through a considerable commodity boom with working-age population growth that is set to halve from the highs it reached in 2008-09, implying a greater risk for skill shortages and interest rates than need be the case.

Bigger is not better: it never has been. But Australia's migration program has long been rather more focused on quality than quantity — the average migrant is well skilled and of an age such that he or she is likely to work for longer than the matching Australian workforce. That means migration has been helping to boost productivity and participation — the two more important elements of Treasury's focus on its 3Ps. (Yes, adding migrants dilutes the national capital stock of mines, factories, computers and roads per worker, but that is only ever a temporary impact — extra migrants raise the demand for and profitability of new infrastructure, thereby prompting businesses to build.)

Ironically, most of the harm from this policy shift is short term. Deloitte Access Economics' longer term population forecasts are little changed, and we doubt Treasury's have either — most projections had already assumed a substantial fall from a one-off migration peak. However, the sharp shift in the politics of migration means that migration is falling fast at a time when the terms of trade are at record highs — an uncomfortable mix with unnecessary costs.

5.1 Longer term issues: migration and the 3Ps

Well-regarded Fairfax columnist Ross Gittins[1] recently argued:

> The original bipartisanship [on migration] was a kind of conspiracy. The nation's business, economic and political elite has always believed in economic growth and, with it, population growth, meaning it has always believed in high immigration.

He therefore welcomed the more open debate that accompanied the last federal election.

Gittins addressed the basic policy question here — whether 'bigger' also means 'better' — by noting:

> The most recent study by the Productivity Commission found an increase in skilled migration led to only a minor increase in income per person, far less than could be gained from measures to increase the productivity of the workforce. What's more, it found the gains actually went to the immigrants, leaving the original inhabitants a fraction worse off …
>
> Why doesn't immigration lead to higher living standards? To shortcut the explanation, because each extra immigrant family requires more capital investment to put them at the same standard as the rest of us: homes to live in, machines to work with, hospitals and schools, public transport and so forth.

1 http://www.smh.com.au/opinion/stop-beating-about-the-bush-and-talk-about-big-australia-20100803-115bg.html.

> Little of that extra physical capital and infrastructure is paid for by the immigrants themselves. The rest is paid for by businesses and, particularly, governments. When the infrastructure is provided, taxes and public debt levels rise. When it isn't provided, the result is declining standards, rising house prices, overcrowding and congestion.

In essence, then, Ross Gittins invokes the Productivity Commission (PC) to argue that the need to build new infrastructure for migrants turns the balance of economic arguments against them.

In fact, the PC report is not recent — it dates from 2006 — and its conclusions are not quite as summarised by Gittins.[2] That paper concluded that:

> Some effects of migration are more amenable to measurement and estimation than others. Effects that cannot be reliably measured or estimated might still be significant.
>
> - Positive effects from additional skilled migrants arise from higher participation rates, slightly higher hours worked per worker and the up-skilling of the workforce.
> - Some of the economy-wide consequences lower per capita income, such as capital dilution and a decline in the terms of trade.
> - The overall economic effect of migration appears to be positive but small, consistent with previous Australian and overseas studies.
>
> In terms of the selection criteria of the Migration Program:
>
> - the greater emphasis on skills has been associated with better labour market outcomes for immigrants
> - English language proficiency stands out as a key factor determining the ease of settlement and labour market success of immigrants.

Indeed, a PC staff member summarised the findings of that report as follows:

> Migrants affect many aspects of the community and economy in which they live. Some of the direct economic effects of migrants living within Australia were described in the Productivity Commission's (2006) report on the Economic Impacts of Migration and Population Growth. That report showed that migrants tend to raise Australian living standards — measured as GDP per capita — somewhat, because Australia's migrants are more highly skilled than the locally-born population on average and more concentrated in working age groups. This paper focuses on a less direct way in which migrants may affect living standards: by strengthening international social and business networks, thereby facilitating trade and investment flows. (Dolman 2008)

It is probably no coincidence that the 2008 assessment from the PC was even more positive, because the makeup of Australia's migration intake had changed in the interim, moving to a sharper focus on skilled migrants.

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2 The Productivity Commission's summary of its conclusions from its research is available at http://www.pc.gov.au/ projects/study/migrationandpopulation/docs/finalreport/keypoints.

That said, the PC's December 2010 summary was less clear cut, merely noting that 'The impacts of immigration growth on GDP and GNI per head of the existing resident population are ambiguous …' (PC 2010)

This debate is important, because it goes to the heart of the policy (as opposed to political) arguments around migration. Central to it is the argument raised by Ross Gittins that extra infrastructure is only partly paid for by migrants themselves, with the rest paid for by business and governments.

Yet businesses do not build infrastructure for the pleasure of doing so — they build because of the potential for profit. That means the prices they charge for infrastructure provide them with the necessary return. If so, then business-provided infrastructure is paid for by users and, if population increases due to migrant numbers, then the lift in revenue and profitability acts as a signal to build new infrastructure.

What of the argument that governments fund much infrastructure? Government spending is ultimately funded by taxpayers, meaning that this issue boils down to the question of whether migrants pay more or less than their fair share of tax. And the answer is that they pay above-average taxes. They do so because Australia's migrants are more skilled on average than the existing population, and because they are more likely to have a longer career in the workforce than Australia's existing population (because migrants are more skilled and earn higher incomes, they have an incentive to stay working for longer).

Hence, both elements of these arguments fall away. Let us be very clear here: if you took these arguments at face value, then they would also be arguments against any births in Australia — because those babies, even as adults, would pay only a portion of the infrastructure costs they invoke, with the rest paid for by 'business and governments'.

More broadly, you can think of 'government' as representing a social contract by the Australian community with itself — as a society, we tax workers so as to pay for subsidies to the young and the old.

Australia's migrants are of net benefit to that national social contract. On the one hand, the age profile of migrants means that we are providing relatively less to them to subsidise their education and health care while young — taxpayers in other nations do that for us. Moreover, the age profile of migrants to Australia means that they are likely, other things being equal, to be in the workforce for some time. In addition, many migrants (especially temporary migrants on the likes of 457 visas) do not qualify for some government benefits (or qualify only after a waiting period).

Furthermore, and most importantly, migrants to Australia are more skilled than the existing workforce. Those relatively higher skill levels mean they earn relatively higher wages and hence pay relatively higher taxes, which are a key component of the benefit to the rest of the nation. Moreover, the likelihood that migrants will work for longer than existing residents rests not merely on their age profile, but also on their skills — the high return to skills makes it more likely that they'll work for longer.

Note that the above arguments do not boil down to 'bigger is better'. Bigger is neither better nor worse unless there is a change in quality. However, it is exactly that which Australia's current migration program generates. Think of it in terms of the 3Ps of growth often invoked by the Treasury: population, participation and productivity.

The key benefit of migration to the average Australian lies in the improvement in the national average in productivity and participation from the relatively higher skills of migrants and their relative age profile.[3]

Or, in other words, the macroeconomic arguments in favour of migration focused on skilled workers arise not because migrants generate a bigger Australia, but because they support a 'better quality' Australia through lifting workforce productivity and participation.

Hence, at least at the macro level of Australians' social contract with ourselves, a skilled migration intake makes good sense.

But what of the macro cycle? Surely inviting migrants into Australia at a time of high or rising unemployment simply risks adding to the ranks of the unemployed?

Space does not permit us to address this issue at any length, but in passing it is worth harking back to a 1970s debate that also focused on the evils of new entrants to the workforce who were seen as 'stealing jobs'. Those new entrants were married women — and they had no lingering impact on unemployment at all.

3 The evidence from the Department of Immigration and Citizenship (DIAC 2010) shows that skilled migrants have lower unemployment and higher participation. Their salaries are an indirect measure of productivity. Those salaries are only a little above the Australian average overall, but are above the average when you compare income by age with the matching Australian averages. The Australian Bureau of Statistics also has the participation data in detail. For example, http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6291.0.55.001Feb%202011? OpenDocument shows that, in the past three months, migrants who arrived in Australia in the past decade had a participation rate of more than 72 per cent, comfortably above the national average of almost 66 per cent.

That is because they took the money earned from their labour supply and they spent it — meaning that the addition to labour supply also added to labour demand.

Although there are minor issues to do with both timing and the extent of income remittances, the same is broadly true of migrants: they get jobs and they spend their resultant incomes, thereby adding to both the supply of and demand for labour, with no lingering impact on unemployment rates.

5.2 Recent developments in Australian population and migration trends

In late 2009 the federal Treasurer, Wayne Swan, indicated that Treasury's view of Australia's population 40 years hence had changed markedly since the *Intergenerational Report* was released in April 2007. At that time, Treasury expected a future Australian population of 27 million. However, by late 2009 that projection had changed to 35.9 million.

In October 2009, then Prime Minister Kevin Rudd commented on those Treasury projections, saying:

> I actually believe in a big Australia. I make no apology for that. I actually think it's good news that our population is growing. Contrast that with many countries in Europe when it's actually heading in the other direction. I think it's good for us, it's good for national security in the long-term, it's good in terms of what we can sustain as a nation.

Then Opposition leader, Malcolm Turnbull, gave qualified support at the time.

But the 2010 federal election saw a bipartisan shift from 'Big Australia' towards 'Sustainable Australia'. Accordingly, Australia's population growth is slowing fast at a time when our need for workers is rising fast. The slowdown is not due to births, which averaged 250 000 a year in the two decades to 2004 but rose to 300 000 by 2008. The jump wasn't due to the effectiveness of baby bonuses. It was partly because the trend towards having babies later in life had started to reach natural limits, but more notably because an extended bout of prosperity made many couples comfortable with their fiscal future — comfortable enough to have kids.

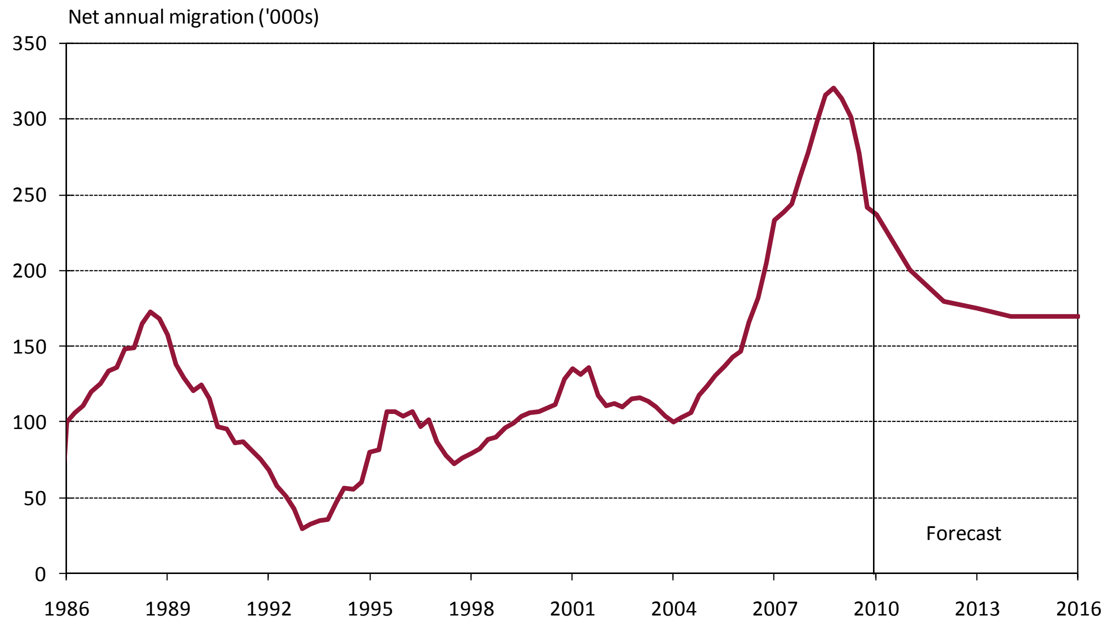
The upswing in births seen since 2004 has now mostly run its course, but the downswing in population growth now underway is rather more the result of policy impacts on migration flows. Australia saw record numbers of migrants from 2005 until recently, aided by the strength in our economy, which drew workers here amid growing skill shortages. The lift in migration was also partly the result of rules that eased the path to permanent residency for those studying in Australia. Although those rules had been around for the better part of a decade, there was a rapid increase in student numbers in the late 2000s.

Now, however, migration numbers are falling fast: the Australian Government cut the skilled migrant intake twice during the recent global crisis, following that up with changes that loosened the link between studying in Australia and getting permanent residency here.

The latter was a much-needed policy change, but it came just as the international education sector sailed into a perfect storm. Publicity over the treatment of Indian students, the closure of colleges leaving some students high and dry, an increase in visa costs, the change in the ease of getting permanent residency, and the rapid rise of the Australian dollar have all conspired to cut very sharply into foreign student numbers. That impact is most evident in vocational education and training courses, in English language courses, among Indian students and in Victoria (where the publicity has identified many of the problems).

Migration, having peaked at annual rates of 320 000 at one stage in late 2008, fell to 206 000 through 2010. As figure 5.1 shows, Deloitte Access Economics' demographic model (AE-DEM) points to further falls in prospect.

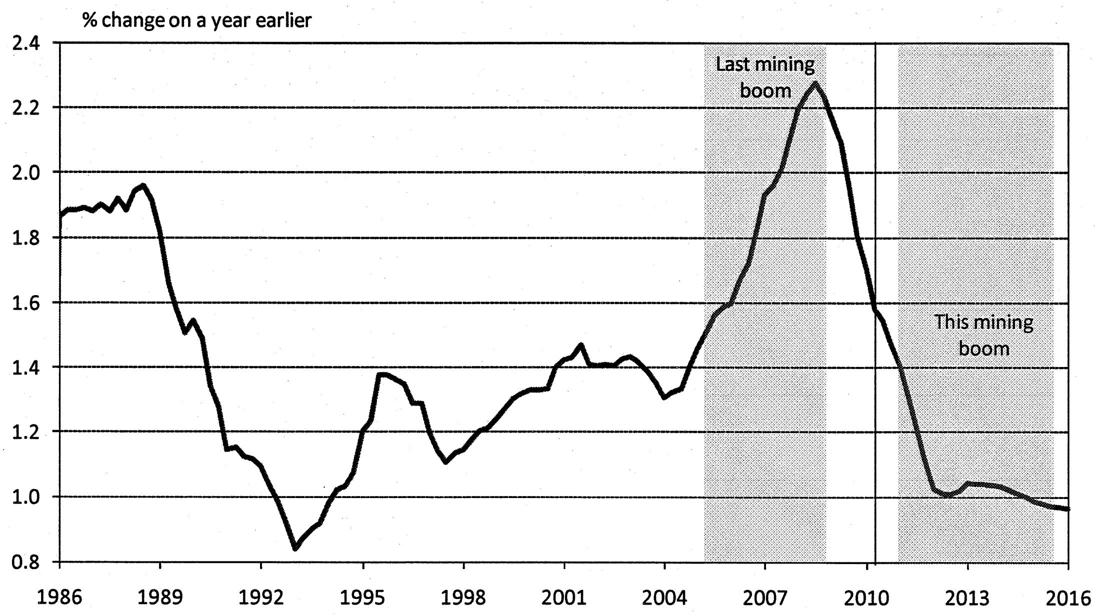
Figure 5.1 **Net migration to Australia**



Data sources: ABS, Deloitte Access Economics AE-DEM model.

Unsurprisingly, Deloitte Access Economics thinks population growth has already peaked, and that it will trail down alongside migrant numbers. The resultant downswing in population growth is large. Moreover, as figure 5.2 shows, it is larger still for the working-age population, given that many baby boomers will drop out of the workforce in the next few years.

Figure 5.2 **Australia's working population growth rate**



Data sources: ABS, Deloitte Access Economics.

5.3 Shorter term issues: Australia's 'migration equation'

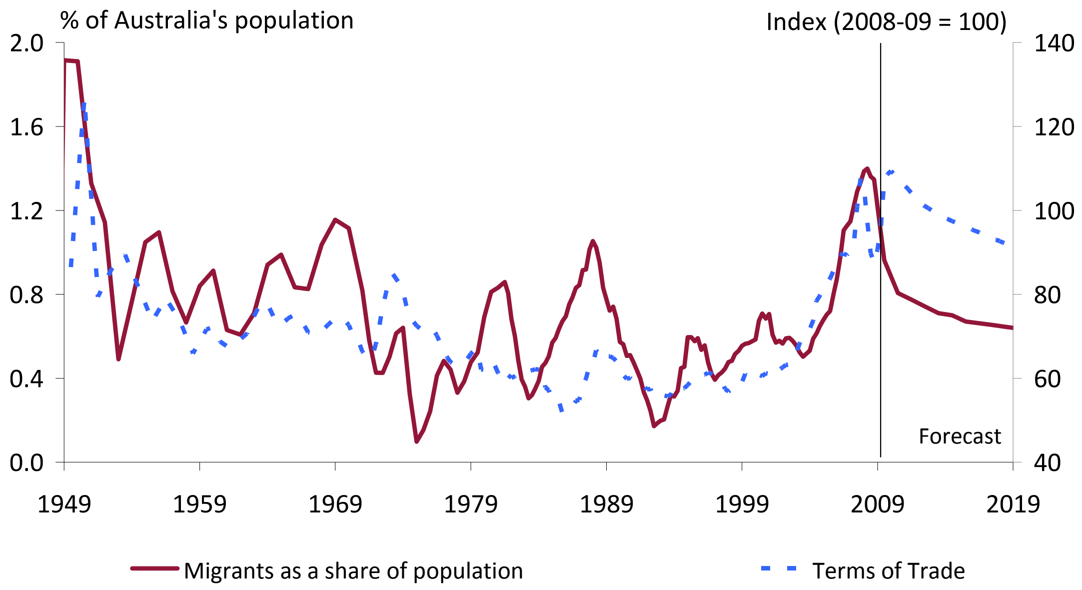
The pace of the current fall-off in working age population growth raises a macro cycle issue worth pursuing. As figure 5.3 suggests, the single best leading indicator of migration flows is the terms of trade — the ratio of export prices to import prices.

There are good reasons for that. When the world gives Australia a pay rise (as it does when it 'costs' fewer tonnes of iron ore to buy a TV)[4], then purchasing power goes up, construction and retail spending lift, employment makes gains, unions

4 As the Reserve Bank Governor has noted, five years ago a shipload of iron ore was worth about the same as about 2200 flatscreen TVs. Today it is worth about 22 000, due partly to falling TV prices but more to the price of iron ore rising by a factor of six.

backpedal on their opposition to migration, business groups demand action to address developing skill shortages, expatriates find returning home more attractive, would-be expatriates are given pause, and those who face fewer restrictions on their movements — such as New Zealanders — are more likely to come.

Figure 5.3 Migration and the terms of trade — mind the gap



Data sources: ABS, Reserve Bank of Australia, Deloitte Access Economics, St. George Economics.

That explains the broad relationship — the 'migration equation' — shown in figure 5.3: economic good times foster migrant inflows, while downturns see those flows ease off.

Yet the chart also points to an important gap in coming years. Our national migration equation will be well out of equilibrium. The terms of trade have now bettered their 2008 peaks to stand at their highest since the early days of the Korean War. That means the economic drivers shown in figure 5.3 are underpinning demand for higher migration inflows.

Yet, as these forecasts also show, migration inflows have already fallen notably, producing a gap between the 'economic demand for migration' on the one hand and the 'politically constrained supply of migrants' on the other.

The underlying problem here is that Australia is still playing catch-up to China's strength, and the resultant re-engineering of our economy is resulting in considerable demand for labour. Unemployment is near 5 per cent and is projected to fall below that point in coming months.

5.4 The short-term costs of a ‘less big’ Australia

That means Australia’s labour market concerns are about to revolve around a lack of supply rather than a lack of demand.

The last time that was an issue was in 2006-07 and 2007-08, when Australia was struggling to rise to the challenge of the first phase of the resources boom. Income and employment were leaping, but so too were skill shortages, while wage and price inflation were rising.

The latter had to be doused by higher interest rates. Simply put, the engine of the economy was starting to blow smoke: demand had risen too fast for supply to cope, and the boom was spilling over from growth-related positives into a bunch of price-related negatives.

Then the global financial crisis came along, and the resultant cut to demand meant skill shortages lessened, wage and price inflation fell, and interest rates tumbled.

Yet now Australia is back amid what the federal Treasurer has dubbed ‘Resources Boom Mark 2’. Incomes are leaping higher than they did in the two years to mid-2008, and job growth over the past year has been even faster than the surging gains recorded in the first phase of the boom.

It is not quite a case of déjà vu. In the past three decades, Australia’s working-age population — those aged 15 to 64, a handy proxy for those available to work — grew by an average of 180 000 people per year.

However, there was a matching boom in migration during the first phase of the resource boom, and working-age population growth kicked up, meaning we added almost 330 000 potential workers through 2008. If Australia hadn’t done so, inflation and interest rates would have had to go higher still.

Yet, even with that supply-side surge, Australia was fast running out of workers. By early 2008 the unemployment rate was down to 4.0 per cent, skill shortages were worsening fast, and the Reserve Bank was jacking up interest rates amid a scramble to rein inflation back in.

Or, in other words, last time around even a surge in numbers of potential workers could not insulate the Australian economy from the damage that ‘too little supply’ can wreak — shortages, higher prices and higher interest rates.

Therein lies the problem. This time around the dollars are even bigger and the job gains have been even larger, but working-age population is amid a sharp slowdown.

5.5 The final result: what’s the fuss about?

The result is that the bipartisan choice to turn away from ‘Big Australia’ has left Australia ill-positioned to benefit as fully from the current boom in global commodity prices as we might have done — we will lack the ‘people power’ required.

Employers will have to ride out the renewed commodity boom with only two-thirds of the migrant flows that Australia won in 2008. Nationally, working-age population gains will slow from the peak of an extra 330 000 potential workers in 2008 to projected gains of 230 000 in 2010, 190 000 in 2011 and just 160 000 in 2012.

That is not enough, and that is a shame. In the short term, Australia looks like having too few workers to spread across too many jobs, meaning that some of the benefits of current high commodity prices will be lost in higher interest rates.

Ironically, it was also unnecessary — ‘Big Australia’ was never as big as it appeared.

Although the political landscape appears to have shifted sharply, most longer term demographic forecasts have changed little in the past year.

How can it be that the political backdrop has shifted so sharply but the numbers have not?

It is because the projections made by Deloitte Access Economics and the federal Treasury ahead of the recent policy changes had always assumed that Australia was seeing a short-term peak in its migration flows, driven up by a combination of factors that were never expected to last.

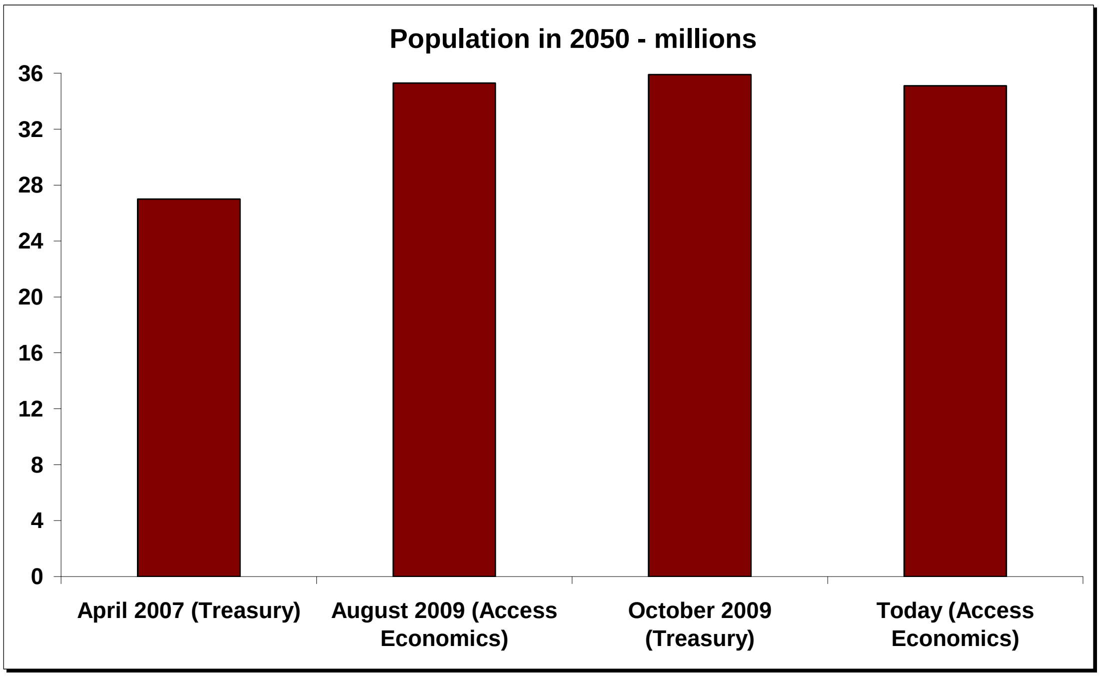
Even if the Government hadn’t cracked down on students studying in Australia as a better route to obtain permanent residency, the size of the international education sector in Australia would have levelled off anyway — meaning that the impact of students on migrant numbers (and overall population levels) was always mostly a one-off increase as those numbers accelerated.

More broadly, all the major forecasts were always predicated on migration falling back to something like 160 000–180 000 per year. In practice, the peak in migration numbers in 2008 was higher than expected, and the political backlash it helped to generate means that the winding back of migration numbers is happening now. Yet so far the expectation is that the migration numbers will merely go close to halving from their peaks, not falling even further than that.

And that is pretty much what had already been factored into our forecasts. For example, in an August 2009 report for a major corporate client, we estimated Australia's population in 2050 at 35.3 million. In October 2009, the federal Treasury's estimate of 35.9 million was released, and promptly generated a considerable furore.

Yet, Deloitte Access Economics' latest forecast for Australia's population in 2050 is still 35.1 million (see figure 5.4).

Figure 5.4 **Population forecasts made at different times**



Data sources: Deloitte Access Economics, federal Treasury.

Or, in other words, it was a storm in a teacup. All that it managed to do was speed up what had always been expected to be a slowdown in migration anyway.

Sadly for those with mortgages, however, the bring-forward in the timing of the slowdown in migration means that Australia lacks the ‘people power’ to feed the job demand expected in the next couple of years. The deliberate decision to lower the speed limits on economic growth means that Australian families will — other things being equal — see less of the commodity boom show up as faster growth in our economy, and more of it show up as higher interest rates.

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