An economist's scepticism about large-scale (non-citizen) immigration to New Zealand

Address to Rotary Club of Port Nicholson

Wellington

5 July 2017

Michael Reddell[1]

Most people live and die not that far where they were born. Always have, and probably always will. So, globally, immigration is a distinctly minority experience, even if often doesn't feel that way in New Zealand.

There is a sense in which it is fine to talk, as many do, of New Zealand as "a nation of immigrants". New Zealand was the last major land mass on earth that was settled, perhaps less than 1000 years ago. Those of us without Maori ancestry trace the arrival of our families back to perhaps as far as 200 years ago.

But, frankly, the "nation of immigrants" line is mostly a (perhaps deliberate) distraction from a serious discussion and debate about the role of immigration policy in New Zealand today. And it also distracts from a recognition of just how unusual our immigration policy is. Unusual, and so I've been arguing for some years now, not remotely fit for purpose, if we want to be able to offer our children (and their descendants) living standards in New Zealand as good as those anywhere in the world.

What makes us unusual? At least three things.

First, as an island country, a long way from anywhere, we don't have much of a problem with illegal immigration. We make a conscious decision to allow in every non-citizen who arrives here. We don't face the same stresses Greece or Italy do. We don't have large scale illegal immigration as the US did. That means, we've been able to be clear about why we promote the immigration we do. And successive governments for 30 years now have been explicit that the main policy purpose is to

[1] After a career focused on macroeconomics and financial markets, Michael Reddell is now a stay-at-home parent and independent economic commentator. His blog, focused on issues around economic performance and immigration on the one hand, and macroeconomic policy and the Reserve Bank on the other, is at www.croakingcassandra.com.

help lift the economic performance of NZ and lift the living standards of NZers. If only it were working.

If we are unusual because we have full control of non-citizen immigration, we are also unusual in just how ambitious our immigration policy actually is. The centrepiece is a “planning range” for how many people get residence visas approved each year. That target - currently centred on 45000 per annum - is around 1 per cent of our population. By contrast, the US immigration system grants residence visas - green cards - to around a third that number of people, in per capita terms. And by international standards, the US is reasonably open to immigration. Most countries don’t get, or want, that many migrants. Three democratic societies come close - Australia and Canada take in fewer migrants than we do (per capita) but they’ve been catching up and the difference now isn’t that large. And then there is Israel. By law, Israel takes any Jewish person who wants to come. In practice, ongoing military threats mean they are mostly keen to do so.

But we are also unusual in how many of our own people have left - around 850000 in the last 40 years. As a share of the population, it is a simply unprecedented outflow for a modern free and democratic state. The people who know the country best are leaving, and yet for some reason governments have thought it made sense to bring lots more in.

Almost a decade ago now, I was at The Treasury trying to make sense of why New Zealand’s economic performance hadn’t been better. 100 years ago, you see, living standards in New Zealand were as high as those anywhere in the world - only the US and Australia were really close. These days, depending how you measure these things, we rank around 35th. When we analyse economic performance, economists put a lot of weight on measures of productivity – what a country manages to produce with the inputs its uses. The most accessible measure of productivity is real GDP per hour worked. And since 1970 we’ve had the second slowest productivity growth rate of any of the member countries of the OECD. Even in just the last 25 years, after all the reforms we did, we’ve still had productivity growth near the bottom of the OECD.

When I was a young economist, we all told ourselves - and others - stories about the role of daft interventionist policies adopted from the 1930s to 1980s - assembling cars or TVs in New Zealand, rigid control on access to foreign exchange, and disasters such as Think Big. I’m sure they all hurt our living standards. But they can’t really explain why we are still doing badly. We stripped away those crazy policies decades ago. But only 30 years ago countries like Slovenia and Slovakia which were still part of communist dictatorships and non-market economies, and they already have productivity levels very similar to New Zealand’s and look set to go ahead of us.

Several other things stand out about New Zealand that one needs to account for explaining our underperformance:

- Despite our dismal productivity growth, we've consistently had the highest real interest rates in the advanced world, and
- Our exchange rate - while volatile - has averaged persistently high, and
- Exports as a share of GDP had been flat. Exports aren't uniquely special, but a mark of success tends to be an ability to sell lots of stuff in the much bigger markets of the world (and buy lots of other stuff), and
- Business investment as a share of GDP had been very weak. Even though we'd have some of the fastest population growth, we hadn't had much investment taking place here.

I sought to develop a story which tried to tie all these symptoms together. At its heart were the pressures created by repeated large scale immigration inflows. Rapid population growth means a lot of investment spending just has to take place - roads, schools, shops, offices, houses. In a country where people don't save much, those demands put upward pressure on interest rates. That in turn puts upward pressure on the exchange rate. Everyone needs a roof over their head. And government activity doesn't face a market test. It is the market-sensitive activities (the ones that have to turn a profit) that get squeezed. In particular, business investment, and particularly investment in the tradables sectors, the bits of the economy exposed to international competition. At just one illustration of what that means in practice, New Zealand has now had no growth at all in the output of the tradables sector (in per capita terms) for almost 20 years.

Only one OECD country that has had a lot more immigration than NZ has had over recent decades. That's Israel. Probably not coincidentally, their productivity growth has been almost as bad as New Zealand's. And despite all the hype about high-tech Israel, their per capita incomes are very similar to ours - both trailing far behind the leading advanced countries. GDP per hour worked in places like Germany, France or the Netherlands is now around 60 per cent higher than that in NZ or Israel.

But there is another important strand to the New Zealand story, that reinforces just how unwise our immigration policy is turning out to have been.

New Zealand is almost totally reliant, in its foreign trade, on what able people can do with a fixed quantity of natural resources. Not many advanced countries are now in that position - Norway and Australia are the others. It has been the New Zealand story throughout our modern history. First, we exported whales, and seals, and tall trees as mast for sailing ships. That didn't take many people. Then the possibilities of wool were discovered. But even that didn't support many people. The gold rushes were a big income boost for a while, drawing in lots of people and dominating our exports. But by 1880, it again wasn't really clear quite what could be profitably sold abroad from here on the sort of scale that would support much of a population with high living standards. How would people here pay for what they aspired to consume? Two things changed the outlook. First was refrigerated shipping, and the second was a series of technological and managerial innovations that made butter and cheese exports feasible. Within 25 or 30 years, meat and dairy went from nothing to dominate our exports. That change, in turn, made possible the position we found ourselves in 100 years ago, - the highest material living standards anywhere, for a small but quite rapidly growing population.

But that was 100 years ago.

The problem since then is that there has been nothing similar that has favoured production based in New Zealand. Of course, we've shared in the general advance of technology and prosperity - every advanced country is better off than 100 years ago - but there has been nothing specifically favouring us. Meanwhile, we are about as dependent on natural resource based exports as ever. And with population growth that has been a lot faster than average, we've been slipping gradually down the league tables. There are now so many things other advanced countries we were once richer than (think Belgium or Germany) can offer their citizens that we simply can't. That is what economic underperformance means - eg medical treatment and drugs other countries can offer, but we can't.

For decades - many decades - people in New Zealand have talked about developed industries that weren't simply reliant on natural resources. Not only talked, but crafted strategies, and even offered subsidies. And mostly it hasn't come to much. Even today around 85 per cent of our exports rely on natural resources - farm output, wine, fish, oil, aluminium/electricity, gold and tourism (people come for the landscape, not the medieval cathedrals or art galleries). There is some other stuff of course - some is heavily subsidised, whether directly (film) or indirectly (export education). But New Zealand's exports of services are small as a share of GDP by advanced country standards, and in fact are smaller now than they were even 15 years ago. I wish it were otherwise, but it isn't.

Australia has been no more successful in that game than NZ has. The only real difference is that Australia turned out to have a lot more natural resources than they thought they did (all that coal, iron ore, gas etc). We've had nothing similar, and we still haven't seen large scale alternative industries, successfully competing on global markets, that both develop here and stay here. The problem isn't that our people aren't smart, skilled or entrepreneurial. As much as their peers in other advanced countries they are. It isn't that our government institutions are poor - we rank high on the economic freedom indices, and it is technically easy to set up businesses here. And if company tax rates are now too high, overall our policy framework ranks no worse than a typical advanced country. But most of them are now much richer and more productive than we are.

The problem appears to be that even as communications technology has developed apace, personal networks and connections now seem to matter more than ever. And so-called "value-chains" are a big part of modern manufacturing - componentry perhaps manufactured in several different countries, and the final product assembled in yet another. When you are the last bus stop before Antarctica your firms aren't going to be part of very many. And so firms that are based in places like Northern Europe, or coastal US cities, or central places in east Asia (such as Singapore) find it much easier to prosper, and are much more valuable to their owners, than if those businesses are based in NZ. Smart and energetic NZers will start lots of good businesses here, but typically even if they succeed those businesses will be more valuable abroad. What seems to end up based here is mostly what was always based here - industries that rely on location-specific resources (be it pastureland, minerals, fresh water, hydro power or whatever). The story is no different in Australia.

But please hear me correctly. Depending on natural resources isn't a recipe for poverty. Norway for example is the richest advanced economy, and that prosperity rests on able people and abundant oil and gas. But if it isn't a recipe for poverty, it is a recipe for being cautious about letting in lots more people. More people, however able, means the fixed resources are simply spread more thinly. Australia and Norway both have huge mineral resources, but with 23 million people, and not a very propitious location, the average Australian is much poorer than the average Norwegian. With nothing like Australia's mineral wealth, and yet in many areas policy settings at least as good if not better, we are now that much poorer again. Only 50 years ago, we and Australia were level-pegging. Smart New Zealanders realised opportunities here were deteriorating and left for Australia in vast numbers. Central planners in Wellington came along a few years later and insisted on trying to replace them. We live with the consequences. Imagine governments tried to insist on replacing all the people who moved away from Taihape, Invercargill or Denniston. That way lies madness. But that is what all our political parties subscribe to in one form or another.

Many of you are, no doubt employers, and the common response to all this is "but we need immigrants to cover skill shortages, and the economy would fall apart if we changed policy". Employers have been running this line for 100 years now - every decade. And yet even with really large migration inflows, somehow the shortages are never met, and all the time New Zealand's performance has been going backwards. Somehow other countries manage - and prosper.

The problem with the argument is that not many people distinguish between an individual employer's perspective, and that of the whole economy. For an individual employer - who has to take as given the rest of the economy – one more immigrant recruit may be a real bonus. That person genuinely eases a pressure, and if your competitor could hire abroad and you couldn't you might genuinely be in strife. But immigrants are people too. We bring in people who, quite reasonably, expect decent housing, and who need schools, shops, hospitals, roads etc. Immigrants eat and want entertainment, travel and so on. For decades, the evidence has been quite clear in NZ that each new immigrant adds to demand at least as much as they add to supply. Demand means, among other things, demand for workers. So immigration doesn't ease overall skill shortages, it accentuates them. Macroeconomists have been telling us this for decades.

I've been arguing for some time that that residence approvals target should be cut from around 45000 per annum, to around 10000 to 15000 per annum. Recall that this target is just about non-citizens coming in. We don't, can't and shouldn't control people leaving, let alone control what NZers do. The cry goes up, "but where would I get workers?" - be it in rest homes, restaurants, farms, the building sector, or wherever. It all assumes that somehow we cut immigration, and everything except the number of foreign workers stays the same. The broad-brush economist's response is "but, in fact, the economy as a whole would be quite different".

Just take one obvious sectoral example. Cut our immigration target by that much and suddenly the population will be growing much more slowly. General spending levels will drop. And specifically, many fewer houses will be required, and many fewer workers will be required in sectors that drive directly off housing activity (carpet layers, electricians, furniture salespeople, and so on). Those people will need to find work in other sectors. As spending dropped, our interest rates would fall - to around those in the rest of the advanced world. And our exchange rate would fall, probably be quite a lot. Export-oriented industries will be doing better, and wanting more workers. Some like the dairy sector, currently quite reliant on immigrant labour, or the tourism sector, would find they could afford to pay higher wages to attract New Zealand workers. But others would find things tough. Typically, they would be the domestic-oriented sectors. But for the last few decades it is the outward-oriented sectors that have had it tough. And really the only path to reversing our decades of underperformance rests in an economy that is more oriented to successfully selling stuff to, and in competition with, the rest of world. It isn't using policy to skew the economy to exports, but about getting out of the way the government-imposed skew that works against growth in international trade (the large scale annual inflow of new people).

If we did, we might even find that more of those companies founded by smart NZers might find it rewarding to stay. Recall my list of areas of underperformance: exports as a share of GDP would be rising, and so would business investment. To some extent, as a bonus, we'd also take some of the pressure off house prices.

There are other benefits. Many New Zealanders are increasingly concerned about water pollution associated, particularly, with the dairy industry. Rapid population growth, and little growth in non-resource based exports, has meant we've in some sense needed rapid growth in dairy to support our demands (all the stuff we want to import) on the rest of the world. With lower population growth and a lower exchange rate, it becomes more feasible to impose tough restrictions on pollution in ways that don't impair our future prosperity too much. Much the same might apply to the political feasibility of tough controls, or demanding pricing, on greenhouse gas emissions from the pastoral sector. As it is, we seem to be pushing our fixed natural resources beyond their ability to support <u>both</u> top-tier material living standards and the sort of environmental outcomes citizens in advanced economies expect.

40 years ago, Sir Robert Muldoon, Bill Birch and the rest of that government launched the series of incredibly costly energy projects known as Think Big. It was, with the best will in the world, an utter disaster. But it came to end after only a few years. By contrast, our immigration programme, which has now run this way for almost 30 years is really much more deserving of the label Think Big: it is bigger, has skewed the economy more, has lasted longer, and has done much more to damage the prospects of New Zealanders living here. There has been a central planners' conceit that we can simply ignore what NZers are doing - leaving, typically in large numbers - and bring in lots of (modestly skilled) foreigners, and concentrate them in Auckland. Do so, so the implicit story goes, and new highly rewarding industries and opportunities will arise - the wonders of what economists call agglomeration. It has proved to be an incredibly flawed strategy. In successful big cities abroad, GDP per capita far exceeds that in the rest of the respective countries, and the gaps are growing. Think London, or Paris or Shanghai, or San Francisco or Amsterdam. But just don't think Auckland. Despite really rapid population growth over decades, Auckland's GDP per capita exceeds the New Zealand average by only a modest margin. And worse, for the 15 years for which we have data, that gap has been shrinking, not widening. British exports are London-based, but it is hard to think of a material export industry that is based in Auckland (or Wellington).

We need to start taking more seriously the terrible disadvantages our distant location imposes. That means it is time to give up the big (population) ambitions that have guided - probably subconsciously - most political leaders since at least Julius Vogel, and instead make the most of the strengths we already have: smart and energetic people and strong institutions. Perhaps one day we'll have exceptional productivity growth, and so many opportunities here that we simply can't make the most of with the people we have. For decades, it hasn't been that way. It isn't now. So we should stop the mythmaking, and revert to being a normal country - one that makes its own prosperity, with its own people - rather than endlessly hankering (as our officials and ministers constantly seem to) after some better class of people over the water who, if only we could get them, in enough numbers, might finally reverse our century of decline. It simply won't happen. We need to change course.

Thank you.

Appendix

Some specifics of how I would overhaul New Zealand's immigration policy:

1. Cut the residence approvals planning range to an annual 10000 to 15000, perhaps phased in over two or three years.
2. Discontinue the various Pacific access categories that provide preferential access to residence approvals to people who would not otherwise qualify.
3. Allow residence approvals for parents only where the New Zealand citizen children have purchased an insurance policy from a robust insurance company that will cover future superannuation, health and rest home costs.
4. Amend the points system to:
    a. Remove the additional points offered for jobs outside Auckland
    b. Remove the additional points allowed for New Zealand academic qualifications
5. Remove the existing rights of foreign students to work in New Zealand while studying here. An exception might be made for Masters or PhD students doing tutoring.
6. Institute work visa provisions that are:
    a. Capped in length of time (a single maximum term of three years, with at least a year overseas before any return on a subsequent work visa).
    b. Subject to a fee, of perhaps $20000 per annum or 20 per cent of the employee's annual income (whichever is greater).