

# Submission to the Productivity Commission inquiry on New Zealand's Immigration Policy

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1. Thank you for the opportunity to make a short submission on the Commission's draft report on New Zealand's immigration policy.

## **Overview**

2. There are plenty of individually interesting bits of material in the report (and supporting working papers) but overall, I'm left with the impression that the Commission has not yet done adequately what was asked of it. Specifically, in the Terms of Reference for the inquiry, you are invited to "explore what working-age immigration policy settings would best facilitate New Zealand's long-term economic growth and promote the wellbeing of New Zealanders", and in the next paragraph the connection to improving productivity is explicitly highlighted. Your draft report seems to touch on many of the more-detailed points listed in the Terms of Reference, but does not sufficiently stand back to evaluate the way in which immigration policy has (or has not) been contributing to productivity growth and material living standards of New Zealanders.
3. Doing so well would require at least a pretty comprehensive review of New Zealand's experience with large-scale non-citizen immigration over recent decades (arguably informed by the earlier post-war large scale immigration experiences that ended in the 1970s), including recognising that our approach to immigration policy has been something of an outlier among advanced countries, occurring against the (also unusual) backdrop of a very large net outflow of our own citizens. Without something of that sort, informed too by relevant overseas experiences and by a detailed engagement with the stylised facts of New Zealand's dismal productivity record (recognising that the scale of New Zealand's immigration policy structural "intervention" has been huge), it is difficult to see how you can reach a view on what future immigration policy would be most suited to maximising, all else equal, New Zealand's specific economywide productivity prospects. Moreover, nothing at all in the report seriously engages with the literature on economic geography, surely a startling omission when New Zealand immigration policy involves inviting large numbers of people to relocate to the most remote outpost in the advanced economy world, with the policymakers responsible claiming to have had explicit economic motivations for the policy.
4. Consistent with these omissions, two of the three highlighted Preliminary Recommendations are primarily process oriented, and the third is really a second-tier issue around absorption capacity. Other suggestions, some sensible, some questionable, play around the edges of the issue, perhaps focused simply on refining something like the last decade's status quo. None gets to the heart of the issue: what sort of immigration policy should New Zealand run in future, if governments were interested in maximising the productivity and income prospects of New Zealanders?

5. In the remainder of this submission, I focus primarily on what has become known as the “Reddell hypothesis”, (causally) connecting our high rates of policy-led non-citizen immigration to the continuing economywide severe productivity underperformance. I also offer fairly brief thoughts on a number of other aspects of the report and/or New Zealand immigration policy.

### **The “Reddell hypothesis”**

6. In your Working Paper 2021/07 you describe my hypothesis and the relevant stylised facts of New Zealand’s economic performance. The description is broadly accurate, although tends to put more weight on domestic monetary policy than I would do (the pressures are on real interest rates and real exchange rates, and neither is affected in the longer-term by domestic monetary policy)<sup>1</sup>. You appear to have been intrigued by aspects of the hypothesis, but no more. That doesn’t seem a particularly satisfactory approach, whether my story is largely right or is wrong in material respects. If it is wrong - and you can offer compelling and New Zealand-specific argumentation and evidence for where and how it is wrong – it would remove perhaps the most sustained recent critique of New Zealand’s post-liberalisation immigration policies. But if it is largely right, it must have material implications for the sort of future immigration policy that would make the best contribution to eventually reversing our dire long-term economywide productivity performance. As I’m sure you will agree, productivity is enormously important for future material living standards.
7. Moreover, although you were clearly intrigued by the real interest/exchange rate limb of the story,<sup>2</sup> you dismissed far too easily the issues around natural resource constraints. Indeed, your draft reports tends towards caricature in treating that aspect of the story, perhaps consistent with the fact that nowhere in the report do you explore the experience of other advanced countries where natural resource-based exports remain significant or where distance might be a significant factor in economic opportunities and performance. You fall back very quickly on the Commission’s recent Frontier Firms inquiry, even though that inquiry report suffered from the same problem - the comparators cited were mainly small advanced economies with locations that are very favourable to modern economic activity. The most important omission was any discussion of Australia’s economic performance - a country with rapid population growth, extensive natural resources, and yet which lags well behind the group of countries with the highest levels of productivity (real GDP per hour worked) in the OECD. That natural resource-based economies can generate very high levels of income/productivity is illustrated by (within the OECD) the example of Norway, with

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<sup>1</sup> However, it is worth noting here that the dynamics in a floating exchange rate system are different than those in a fixed exchange rate (or currency union) system. Large policy-led immigration inflows to New Zealand (or other floating exchange rate countries) tend to push real interest rates **up**. These effects are persistent so long as the *ex ante* savings/investment pressures continue. By contrast, for a small country in a currency union (think of Ireland or Spain in the 2000s) the same sets of pressures manifest differently, in fact resulting in **lower** real interest rates (because nominal rates are fixed and domestic inflation rises) for some years. This is typically not a sustainable model, often resulting in a severe domestic credit boom – since real interest rates are not in line with domestic resource pressures - and subsequent bust.

<sup>2</sup> And note that even now, with real and nominal interest rates so low in absolute terms, the gaps between long-term New Zealand real interest rates (and implied forward rates) and those in other advanced economies remain more or less as large as ever, in ways that simply cannot be explained by (for example) differences in sovereign debt levels (a factor generally working in New Zealand’s favour).

abundant oil and gas, but nothing like the sustained population growth rate of Australia (or New Zealand).

8. More generally, there is very little engagement in the report with the stylised facts you list (on page 16 of 2021/07). None of them individually is necessarily very conclusive; rather it is the combination in an overall narrative about how New Zealand's economy has unfolded, increasingly skewed inwards. Standard modern models of how immigration (especially skills-focused) immigration should be reflected in economic performance involve nothing like the mix of stylised facts we have actually seen in New Zealand. And yet the report does not really engage with the predictions of those models or the disconnect to the New Zealand experience.
9. Perhaps relatedly, at present the report is very weak on overseas comparisons. There are only three other OECD countries with large-scale immigration programmes - Canada, Australia, and Israel. None has performed particularly well on the productivity front over recent decades (Israel, despite the aura of a high-tech sector, has a performance over time strikingly similar to New Zealand's dismal economic record). It is at least suggestive that using policy to encourage lots of people to move to relatively remote locations may do more to continue a process of factor price equalisation - well-recognised as what went on in the first great age of globalisation, reflected in an extensive literature (and the Commission notes that the median migrant to New Zealand comes from lower income countries, as one would expect) – than to provide a useful impetus to accelerating economywide productivity growth.
10. Equally absent from the report (and the Frontier Firms report) were the relative economic success stories of the (formerly Communist) OECD economies in central and eastern Europe, none of which has had significant population growth, most of which have had significant net emigration towards the (higher paying and more productive) countries of western Europe. Of course, location helps those countries, probably rather a lot, but that simply helps highlight how important it is to engage with the limitations of extreme remoteness. Those limitations may suggest that the best prospects for a high productivity New Zealand rest with doing little to encourage people to locate here, accepting outflows to Australia while the existing income gaps persist, and marshalling our scarce resources to maximising (primarily) the opportunities our natural resource allow for a limited population. Note that nothing in my argument sees New Zealand as doomed to underperformance, but there is little sign of New Zealand having proved an opportune long-term location for many businesses based on things other than our natural resources (including adding value to them, finding smarter ways to produce/use them). There always have been plenty of interesting and exciting firms started in New Zealand - dating all the way back to Glaxo - but most of those based on things other than location-specific resources in time prove even more valuable located elsewhere. Distance has not died.
11. As a final note, the only serious discussion of economywide productivity in the main report was a summary of the paper, produced by your chairman's consultancy firm, some years ago. It is reasonable to report the results, but you make no effort to evaluate the usefulness of that model, or models of that type, for the purpose at hand. Thus, there was no mention of the fact that the model is set to produce no gains (or losses) in real GDP per hour worked - and thus can tell us, by design, nothing about productivity effects. Reported gains in real

GDP per capita result almost entirely from the higher labour force participation rates of (younger) migrant communities, and thus tell us nothing about gains (or losses) to existing New Zealanders. CGE models of that type appear useful for some purposes - e.g., the sectoral distribution of effects - but can tell us nothing about the value to New Zealanders of large-scale immigration programmes of the sort New Zealand has run in recent decades. In a similar vein, note that the 2006 report of the Australian Productivity Commission concluded - using models with similar limitations - that if there were economic gains from immigration, they were almost entirely accruing to the migrants themselves. There is nothing wrong with that per se, but the focus of domestic policy should be on the implications for those already here.

### **Fiscal effects**

12. The report and the supporting working papers appear somewhat unsure where to land on the fiscal effects of immigration, at times suggesting a material net positive and at times suggesting that the effects might not be large. As you note, existing estimates suffer from a number of weaknesses, and there is no dynamic model for New Zealand. Of the existing static estimates, I have previously highlighted a number of issues suggesting that the reported gains are overstated (including here [New Zealand Initiative on immigration: Part 4 Fiscal implications | croaking cassandra](#)). My own view is that any fiscal effects in New Zealand from the immigration programme as a whole are likely to have been quite small. In a sense, that is useful in itself: in some countries with a larger share of less-skilled migrants, the effects can be substantially negative.
13. My specific suggestion regarding fiscal effects is that you need to think harder, and talk, about the marginal effects of the least-(economically)-desirable migrants. The Commission has been asked to look for the best immigration policy for the future. If there were to be any reduction in target rates of non-citizen immigration - as in place you suggest might be desirable, if only from a "least regrets" perspective - we would presumably want to cut back on the least valuable, least qualified, least able to adapt, of the economic migrants. It is quite likely that the fiscal effects of that group of permanent migrants would be quite bit less favourable than the fiscal effects of the first tranche of highly-skilled and readily-adapting migrants. Shedding some light on how large those differences might be would be a useful contribution to the discussion ahead.

### **Skills**

14. The draft report appears to have bought into the idea that the large-scale immigration programme has added to the average skill level of the New Zealand labour force. But there are several points that could usefully be drawn out in the final report. The first is the OECD's adult skills data report from a few years ago which suggested although migrants to New Zealand were more skilled than those to most other OECD countries, the skill levels of the average migrant (person born overseas) were still a bit below the skill level of natives. The second issue is that although many migrants have reasonable paper qualifications - counting as quite skilled - many actually take a considerable time to match the earnings that a native with similar qualifications might achieve. If so, it raises questions about whether any apparent skill levels are actually showing up as gains to New Zealand's economy overall. And finally, there is a wide range of people gaining residency. Some are clearly very highly

skilled and command high salaries quite quickly. Others are not. We do not need to consider immigration as an “all or nothing” thing and we might hope that the final report sheds some more light on what tranches of those gaining residency are offering significant net gains to New Zealand. It might make sense for future policy to concentrate on those groups, paying attention to marginal gains, rather than focusing - as discussion often tends to - on averages. Finally, it is perhaps worth noting that none of the industries where you focused your discussion around the specific effects of immigration would be the sorts of future-facing industries probably envisaged in your Frontier Firms report (moreover, as you note the typical immigration worker in the dairy industry is at the lower end of the skills spectrum). If you want immigration policy to be consistent with that previous set of recommendations you would therefore have to be recommending something different than the immigration policies governments have run over the last couple of decades.

### **Wages**

15. Much of the discussion of the economic impact of immigration policy focuses on wage effects. Much of that literature is not particularly satisfactory, partly because rarely - if at all - are the demand effects of immigration taken into account. As various New Zealand models have highlighted, in the short term the demand effects (including demand for labour) of an immigration shock will outweigh the supply effects. In a tightening labour market, it is hardly surprising if economywide wages tend to rise. But none of that is very relevant to the longer-term question, which should really be about the impact on productivity - productivity growth being the largest longer-term influence on growth in real wage rates. In past post on my blog, I have shown how wage rates in New Zealand have over the last couple of decades run ahead of growth in nominal GDP per hour worked. This is consistent with a story of an economy skewed inwards, generating little productivity growth and yet generating a high demand for labour, and underpinning wage growth that is **high** relative to the growth in the economy’s overall ability to pay, but **low** in the absolute terms that would be required to close the gaps between New Zealand and other advanced countries. It would be useful if the Commission would engage with this perspective in its final report.

### **Cities**

16. Much of the modern discussion of immigration proceeds hand in hand with discussion of agglomeration benefits that can, in some circumstances, arise in cities. This seems a plausible perspective in much of Europe or in the United States where major cities typically have much higher GDP per capita (and by extension GDP per hour worked) than the rest of the countries. In the United States, New York and San Francisco are the best-known examples, but the picture for London and most other largest cities in countries in Europe. There is a logic to productivity benefits from immigration in such places - migrants typically flow to large cities, and interacting with workers already there may generate ideas and products etc that make the economy as a whole richer.
17. The picture does not hold in New Zealand (or, for that matter, in Australia or Canada). GDP per capita in Auckland and Wellington is higher than the national average but (a) not dramatically so by the standards of many other advanced countries, and (b) if anything the gap has been narrowing rather than widening over this century (the period for which we have data). However appealing these small gaps might be in some respects (inter-regional

equality etc), the failure of the gaps to widen is quite inconsistent with the official and private rhetoric around the possible economywide productivity gains from New Zealand's large-scale non-citizen immigration programme. It is, for example, difficult to think of many major export industries that have their foundations in Auckland (e.g., the Fonterra head office is there, but not the industry it serves). Given the rapid growth in Auckland's population of recent decades - large by the standards of almost any largest city in an OECD country - it should have been tailor-made to achieve the income and productivity gains the champions of the policy approach hoped for. That almost none of those gains has been realised should give you pause for thought, and prompt a reconsideration of the policy approach.

### **Attempting to smooth the flows**

18. Net immigration flows to/from New Zealand have historically been volatile, such that the net migration contribution to population growth has been much more volatile in New Zealand than in almost any other OECD country. The Commission's draft report hankers after changing that. You are not the first to anguish over the volatility, but there is not much that can sensibly be done about it. As you will recognise a huge part of New Zealand's migration flows reflects the choices of individual New Zealanders, and in particular the choice to go - or not go - to more productive and higher-paying Australia. Migration flows between New Zealand and Australia are very heavily influenced by the state of Australia's labour market - outflows from New Zealand tend to be largest when Australia's unemployment rate is very low, regardless of the state of our own labour market. We cannot control the Australian labour market, the exit option to Australia for New Zealanders is of undoubted benefit to New Zealanders, and in any case, we are no better at forecasting the Australian labour market than the Australian authorities themselves (not very good). Accordingly, the idea of attempting to tailor the rate of arrivals to New Zealand, or residence approvals, to expected fluctuation in the net outflow of New Zealanders offers almost nothing in practice - risking destabilising overall inflows - and should not be pursued any further.

### **Immigration policies large and small**

19. I have already noted the importance of looking specifically at the experience of the handful of OECD countries with large-scale non-citizen immigration programmes, notably Canada and Australia (with programmes similar to our own) and Israel. But in reading the existing cross-country studies that attempt to measure the economic effects of immigration, it is worth remembering that most OECD countries have (and have had) quite small immigration programmes, and that a large proportion of OECD countries are part of the EU, with relative freedom of movement across borders within the Union. Even the United States, long known for taking lots of immigrants (in absolute terms) has been granting green cards at a rate about one-third in per capita terms that New Zealand has been granting residency visas. I'm not suggesting there is nothing to learn from these other countries, but attempting to do so needs to be done (a) carefully, (b) with a particularly emphasis on countries operating policies at our scale, and (c) with an eye to whether there are any obvious examples of advanced countries in recent decades where large-scale non-citizen immigration can credibly be said to have contributed materially to an acceleration of productivity growth. Ireland, for example, reversed the historic pattern and had migration inflows early this century, but the upsurge in net migration **followed** the sustained upsurge in multi-factor productivity growth.

## **An alternative approach to New Zealand immigration policy**

20. As the report highlights there are two main strands to New Zealand immigration policy. We now (pre-Covid) have a large stock, and large flows, of people on short-term work visas. But the key way in which immigration policy affects the level of the population in New Zealand is through the residency approvals programme. Whatever the plausible stock of people here on work visas, those numbers will be swamped by the annual rate of residency approvals (at, say, 45000 per annum that would be 900000 approvals over 20 years, and even allowing for a proportion of those approvals who leave again, they still represent very large changes. My focus is primarily on the residency programme, where there is no convincing New Zealand specific evidence that the really large scale migration programme has generated any economic benefits for New Zealanders as a whole, and may - according to the Reddell hypothesis - have materially worsened the situation, preventing any progress in closing the productivity gaps to the rest of the OECD, even over a couple of decades when the terms of trade have been more propitious (supportive of business investment) than they have been for a long time.
21. Accordingly, I have argued that we should reduce residency approvals to around 10000 to 15000 per annum (which, as it happens, would be similar per capita to US approvals, and hardly at the restrictive end of the spectrum of advanced countries). After allowing for our refugee programme and for spouses/partners of New Zealand citizens (numbers that themselves would drop sharply if the overall migration numbers were cut back), that might leave perhaps 5000 to 10000 places a year, which should be firmly focused on attracting the most talented. There is no sign that we have any pressing need for more people simply for the sake of having more people, and we can afford to be quite selective (bearing in mind that New Zealand is generally not the most attractive place for most migrants to move, not generally a first preference destination).
22. Part of being highly selective should involve recasting the current points system to remove additional points for a job offer outside our major cities (the talent should flow to where the opportunities are, not be "subsidised" in particular directions), remove the additional points for New Zealand qualifications (acting as a subsidy to New Zealand tertiary providers), remove additional points for New Zealand work experience and/or job offers. If we want a relatively small number of the best people in the world, we don't want to skew the playing field such that people with education in the world's great universities are disadvantaged, or where getting enough points here depends on the expensive punt of first relocating self and family to this remote outpost. We should put an end to the practice whereby most residence approvals are granted to people who are already here. That simply biases our choice of who gets residency towards those with the least attractive alternative options.
23. In respect of short-term work visas, the adoption of a residency approvals approach of the sort outlined above would detach the two programmes from each other, and focus the work visa programmes simply on responding to short-term pressure points in the labour market. However, stating it like that should not be seen as an invitation to have government officials determine who can and cannot use short-term migrant labour. Those choices should be made by firms, reacting to the stable and predictable policy parameters set by the government. I have previously proposed a system in which a firm would be able to get a work visa employee for up to a maximum of three years, subject to paying a fee to the

Crown of, say, \$15000 per annum or 20 per cent of the salary of the employee concerned, whichever is greater. Such an approach gets government out of picking favoured sectors - which can have an incentive to pay low, so as to persuade officials there are no New Zealand takers - while setting a financial incentive (and a time cap) for firms that encourages them to develop and recruit New Zealand employees. There will always be a need for some short-term foreign workers - especially at the upper end of the skill range, where numbers are typically small - and the future policy framework should recognise this, without envisaging any necessary connection to longer-term settlement numbers. (In my own case, in the course of my career, I worked overseas on temporary visas for three separate two-year stints. In each case that employment seemed to be mutually advantageous, but in no case did I seriously think of trying to stay permanently.)

### **Other matters**

24. In wrapping up this submission, I would refer you to a number of earlier papers and speeches:

- [economic-effects-of-immigration-and-the-new-zealand-economic-historians.pdf \(wordpress.com\)](#)
- [drifting-slowly-ever-further-behind-nzi-retreat-presentation-17-march-20161.pdf \(wordpress.com\)](#)
- [fabian-society-speech-20-may-2016.pdf \(wordpress.com\)](#)
- [distance-still-matters-hugely-leanz-presentation-26-june-2017.pdf \(wordpress.com\)](#)
- [large-scale-non-citizen-immigration-to-new-zealand-is-making-us-poorer-mana-u3a-sept-2017.pdf \(wordpress.com\)](#)
- <https://croakingcassandra.files.wordpress.com/2021/06/rethinking-immigration-policy-for-a-post-covid-new-zealand-june-2021.pdf>

For the fullest recent articulations of my story

- [an-underperforming-economy-the-insufficiently-recognised-implications-of-distance-longer-version-of-book-chapter.pdf \(wordpress.com\)](#)
- [towards-an-economics-approach-to-immigration-fit-for-new-zealand-vuw-9-aug-2021.pdf \(wordpress.com\)](#)

In addition, several posts from my Croaking Cassandra blog deal with some individual issues in greater depth, including

- [The IMF's paper on New Zealand immigration | croaking cassandra](#)
- [IMF advocacy for immigration: some caveats | croaking cassandra](#)
- [Immigration, convergence and history | croaking cassandra](#)
- [Squeezing out business investment | croaking cassandra](#)
- [Eastern and central Europe, and us | croaking cassandra](#)
- ["Immigration Policy: Economics and Evidence" | croaking cassandra](#)
- [Outperforming cities...but not Auckland | croaking cassandra](#)

25. Finally, I would associate myself with much of the contents of the two submissions made by Mike Lear, and in particular his recent one (labelled Submission 108 on your website). Lear champions the so-called "Reddell hypothesis", and often does in a particularly clear and

useful way. I don't agree with him on everything in that part of his submission, but would probably endorse perhaps 95 per cent of his material and arguments.