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Why high rates of net migration present problems for our investment performance

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Introduction

The first year of the Howard Government has seen no coherent population strategy emerge despite the public row over immigration. In this article, I argue why the Government has to articulate a clear and consistent population policy. There are three problems facing the Australian economy, which are all related to our population policy. First, high levels of unemployment remain and are being exacerbated by strong labour force growth. Second, despite a decade or more of trying to shift resources into the export and import competing sectors, our current account remains a significant constraint on growth. Third, investment funds are being diverted from their most productive use.

In earlier articles on immigration I have argued that the level of immigration in the 1980s was inconsistent with other stated economic objectives like reducing unemployment¹ and was likely to increase the long-term unemployment rate among skilled trades persons.²

In this article the focus is on the relationship between immigration and our physical capital investments. In the 1996 Federal Budget, severe cutbacks were made as part of a process designed to redress the chronic saving-investment balance in Australia. Outlays excluding net advances were cut by \$4.4 billion in 1996-97 and \$7.2 billion in 1997-98. The strategy is designed to improve our current account yet allow strong domestic growth to occur. The Government argued that investment can only grow and foreign debt fall if it reduces the public sector call on saving (manifest as a budget deficit).

Table 1 compares saving and investment as percentages of Gross Domestic Product (GDP) for Australia and the OECD. While saving have fallen as a percentage of GDP since the 1970s, the real decline has been in terms of the investment ratio, which in 1995 was actually below the saving ratio (the latter point casting doubt on some of the Government rhetoric). Table 1 shows that we have had higher rates of investment (and usually saving) than the OECD. Argy argues that “because of its relatively high population growth, Australia needed to, and generally did, invest at a higher rate than other industrialised countries”³ EPAC state that “Australia had tended to devote a higher share of its national product to investment than most other OECD countries, it also has one of the fastest rates of population and employment growth”, which leads to our *per capita* growth rate being “average at best”. Australia’s relatively high rate of investment is therefore due to our faster population growth.⁴

Table 1 Investment and Saving as a Percentage of GDP

	1974/79	1979/85	1985	1990	1995
Investment					
Australia	23.8	24.4	24.6	22.9	21.8
OECD	22.4	21.1	20.0	21.3	20.6
Saving					
Australia	24.2	21.6	23.5	24.0	22.3
OECD	23.7	21.7	21.3	21.5	21.5

Source: OECD Main Economic Indicators, various issues.

Several EPAC studies have demonstrated that Australia has relatively below OECD average performance in labour productivity and per capital income growth, despite slightly higher GDP growth overall, largely due to higher than average population growth.⁵ EPAC concludes ⁶

Combined with aggregate capital productivity for the business sector around 10 per cent below the OECD average, this has meant that Australia has need to maintain investment as a share of GDP above the OECD average.

While our investment needs are higher than the OECD average we also have a problem focusing this investment on the competitive export sector. Both of these reasons are related to our higher than average OECD population growth.

Economists distinguish between capital widening (which is the process of equipping new workers the same amount and usually the same type of capital which is average for the economy), and capital deepening (which involves increasing the capital per worker and usually involves the introduction of better techniques or technology). The higher the amount of capital per worker, the more productive the work force will be. Capital widening merely spreads more capital of the same type out over a larger work force and does not raise labour productivity.

Immigration increases the number of jobs that have to be created and encourages capital widening rather than capital deepening. Merely absorbing scarce investment funds in capital widening not improve productivity.

Nevile argued that ⁷

One of the few points of general agreement in the immigration debate is that high levels of immigration result in capital widening, and that this, *ceteris paribus*, will lower per capita economic growth rates in a relative sense. Capital widening results from the demands made by immigrants for ‘non-productive’ goods and services (e.g. urban infrastructure). Capital then moves into non-productive areas rather than ‘deepening’ investment in productive capital per worker.

The evidence for this is well documented.⁸

Pitchford argues that if there is the amount of capital per worker is constant, then reduced immigration (which would reduce the labour force growth rate) would “lead to the same percentage fall in the required capital stock and so to a reduction in the rate of investment.” However, he adds that it is likely that a lower immigration rate will lead to a higher capital/labour ratio (capital deepening) and so the rate of investment need not fall, but merely be allocated to increasing labour productivity. He also concludes that “a reduction in the immigration rate could have important short run effects in reducing investment needs without an offsetting effect on saving.”⁹

So what are our investment needs? EPAC discuss the relationship between the share of output that must be invested to sustain it and the rate of change of capital productivity. They use it to “derive the level of investment as a share of GDP consistent with desired growth rates.”¹⁰ Table 2 reports their findings.

Table 2 Investment needs and GDP growth

Desired GDP Growth Per Annum (per cent)	Change in Capital Productivity (per cent)	Gross Investment Needs (percent of GDP)
3	0	24.0
3	1	21.3
4	0	26.5
4	1	23.8
5	1	26.4

Source: EPAC (1995). Table 1.1, p. 13

The analysis is important because it can be related to the goal of reducing unemployment.¹¹ Mitchell demonstrated that GDP would have to grow by 4.9 per cent per annum, given the current growth rates in the labour force and productivity, to achieve a 5 per cent unemployment rate target by the year 2000. Just to maintain the current unemployment rate, under the same

assumptions, would required around a 4 per cent per annum increase in GDP.¹² This is stronger than the average for the period 1983-89 (3.90 per cent per annum) when Australia was the strongest growing economy in the OECD.

From Table 2, this implies investment ratios well in excess of their current levels. Further, increases in investment will be required to increase our productivity growth and hence our international competitiveness. Our high population rate due to the current levels of immigration only serve to exacerbate these requirements.

Given the current saving rate (Table 1), such growth rates would require an excess of investment spending over private saving. Only with a government sector in surplus could this avoid spilling over the to a current account deficit.¹³ Even if the public sector were in balance, the private sector would be spending more than it “earns” with the excess being financed by the saving of foreigners. Strong investment growth will undoubtedly require further foreign financing. EPAC estimate that overseas debt financed about 20 per cent of domestic investment in the 1980s.¹⁴

EPAC also concluded that given our saving-investment performance, debt stabilisation would require low rates of investment and growth. But, “one way to reduce the investment requirements, and hence the current account deficit, without slowing *per capita* income growth, might be to slow population growth.” They show clearly that some component of Australia’s current account deficit “can be attributed to our faster than average population growth.”¹⁵

EPAC conclude that if the investment to GDP ratio which characterised the late 1980s had to be continued to generate economic growth, then debt stabilisation is problematic and the “question is whether such growth could then be accommodated without causing unacceptable delay in external adjustment.”¹⁶

What are the solutions? To correct the current account problem, public and private saving must rise and/or private investment must fall. In addition, increasing the competitiveness of our traded goods sector will help to promote export income and allow import replacement to occur. An alternative path with is being pursued by the Government is to reduce the budget deficit to “free” up private saving. This strategy is dangerous when unemployment is high because there is a danger that a policy-induced slowdown in growth will cause both unemployment to rise and saving to fall, which may worsen the external position.

If investment was to fall, to the extent that it is externally financed, the current account will improve. But the growth target and saving will fall as national income falls. Alternatively, a rise in investment (relying heavily on imported capital goods) will cause an immediate deterioration in the external balance. But such investment not only stimulates growth in output, but also allows labour productivity to rise, unit costs to fall, competitiveness to rise, all of which helps to resolve, over time, the external problem. Economic growth also increases the level of saving which reduces the reliance on external financing of investment.

To avoid the high levels of investment to GDP, which characterised the 1980s (and the problem mentioned above of external imbalance), Australia needs to make every investment dollar count. Capital deepening must be our target to improve the economy's productivity and competitiveness. Inasmuch as immigration stimulates our population growth and encourages capital widening; it will continue to be counter to these goals.

EPAC claim that due to the lack of short-term migration into Australia, a common source of labour force augmentation in European countries, it is not feasible to use population policy as a vehicle for "counter-cyclical correction of our balance of payments."¹⁷ While this point is true, the sort of structural problems and solutions we are considering here are hardly cyclical. The problems are structural and require longer-term strategies. It is here that a variation in the immigration intake can be part of a sensible current account and debt adjustment process.

In this sense, a restricted immigration programme, to slow the rate of population growth, should be an integral part of our longer-term current account adjustment strategy, which will in turn allow us to achieve growth rates sufficient to reduce our excessively high unemployment rates, particularly among the youth.

The higher the net immigration, the more likely it is that the required investment to GDP ratio will approximate the levels of the late 1980s, and we will continually come up against the external constraint on growth.

It might be argued that increased saving come from a higher immigration level. CEDA found that migrants are not high savers. Their expenditure injection was found to be uneven and weighted to the early years after arrival. It was concentrated in the housing industry, which is clearly not the most efficient or productive use of our scarce capital.¹⁸ This type of concentration exacerbates

the capital widening that occurs in industry. The failure to use their capital for capital expansion helps to explain why *per capita* growth has not responded positively to migration.

To conclude, even achieving an average annual growth rate of 3 per cent throughout the 1990s will be difficult, given the external constraints. Mitchell has clearly shown that that sort of growth rate will not be sufficient to reduce the excessively high unemployment rate. Higher rates of growth require even higher amounts of investment and external debt. Maintaining the current level of immigration not only makes the task of reducing unemployment difficult because it promotes stronger than otherwise labour force growth.¹⁹

¹ Mitchell, W. 'Why high levels of net migration present problems for unemployment and external debt stabilisation', *People and Place*, vol. 4, no. 1, 1996, pp. 40-45

² Mitchell, W. 'The impact of immigration in the trades' labour market', *People and Place*, vol. 1, no. 2, 1993, pp. 23-26

³ Argy, V. Australian macroeconomic policy in a changing world environment, Allen and Unwin, Melbourne, 1988, p. 75

⁴ Economic Planning Advisory Council (EPAC), *Australia's Capital Needs in the 1990s*, Council Paper no. 43, AGPS, Canberra, 1990, p. 1

⁵ EPAC, 1990, *op. cit.*; EPAC, *Investment and the Cost of Capital*, Council Paper no 52, 1992, AGPS, Canberra; EPAC, *Australia's growth potential in the 1990s*, Background Paper no. 35, 1993, AGPS, Canberra

⁶ EPAC, *Investment and economic growth*, Commission Paper no. 9, AGPS, Canberra, 1995, p. 7

⁷ Nevill, J. "Population Growth and the Economy", in R. Birrell, D. Hill, and J. Nevill (eds.), *Populate and Perish?*, Fontana, Melbourne, 1983, p. 175

⁸ EPAC, 1995, *op. cit.*, p.7

⁹ Pitchford, J. "Investment and Immigration", *Background Paper No. 4*, EPAC, 1990, AGPS, Canberra, p.10

¹⁰ EPAC, 1995, *op. cit.*, pp.13-14

¹¹ Mitchell, 1996, *op. cit.*

¹² *ibid*

¹³ The current account has two components. The trade balance which reflects the sums of exports and imports of goods and services which fluctuates between surplus and deficit; and the net income component which is typically in deficit and is mostly comprised on interest payments on foreign debt. Over the 1980s and into the 1990s, the growth of the net income deficit has been the major reason why the current account deficit has grown. In turn, this growth is due to the increased level of foreign debt held by the public and private sector and the servicing costs that arise.

¹⁴ EPAC, 1990, *op. cit.*, p.38

¹⁵ EPAC, 1990, *op. cit.*, pp. 42-43

¹⁶ *ibid*

¹⁷ *ibid*

¹⁸ Committee Economic Development of Australia, (CEDA), *The Economic Effects of Immigration on Australia*, by N. Norman and K.Meikle in 2 volumes, (CEDA, Melbourne), 1985

¹⁹ Mitchell, 1996, *op. cit.*