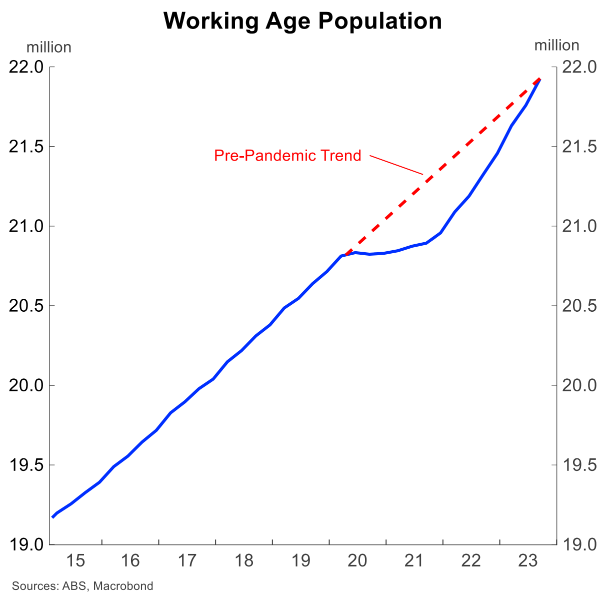
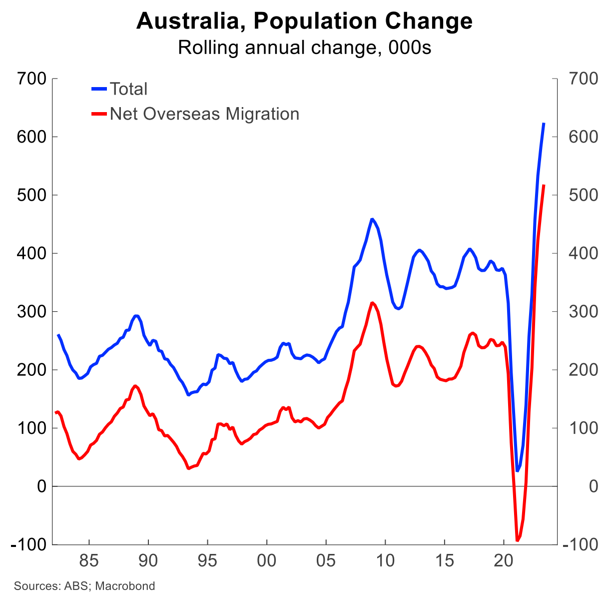
Friday, 15 December 2023

Population Insights
3 Reasons to Rejig the Migration Settings

- **Australia is on track to notch up a fresh record annual increase in net overseas migration in the 2023 calendar year. The rebound in migration has been so sharp that the population has now caught up to where it would have been had borders never been closed.**
- **Most of this rebound has been catch-up from the period of closed borders, especially students returning to in-person studies. Going forward, migration is poised to slow as the normal flow of departures resumes – we've have had the rebound in arrivals but not departures.**
- **Nonetheless, the surge has exposed some issues with the migration system. It is against this backdrop that the Federal Government announced reforms to the system. The announced changes are minor but go some way to address those issues.**
- **A more sustainable pace of migration will allow the capital stock to catch up, which will help unlock the full supply benefits of a larger working-age population. The capital stock simply cannot grow at the pace migration has been running.**
- **Population growth adds to both supply and demand. But the demand and supply impacts are generally not symmetrical. This makes the mix of arrivals extremely important, if it's not right the demand impacts could outweigh supply and exacerbate existing imbalances in the economy.**
- **A rate of migration that can be matched by growth in the capital stock, and that adds to the labour supply where it is needed most will maximise the benefits of migration.**
- **At a time when the Reserve Bank (RBA) is fighting hard to bring inflation down, while trying to preserve the gains in the labour market, a migration program geared toward supporting this objective can help make the RBA's job a little easier.**





Since the reopening of borders in February last year, the rebound in migration has been remarkably rapid. So much so, that the population has now caught up to where it would have been had borders never been closed. Recently released population data confirmed that net overseas migration was around 520k over 2022-23 – a record high. Further, Australia is on track to notch up a fresh record annual increase in net overseas migration in the 2023 calendar year.

Most of the surge represents catch-up as foreign students returned to in-person studies after several years studying at Australian institutions online from their home country. But applications for student visas also increased considerably over the past year. It is against this backdrop that the Federal Government this week announced reforms to Australia's migration system, following a detailed review into the current framework. The changes more closely resemble tweaks around the edges than wholesale reform but are steps in the right direction for making Australia's migration system more efficient.

The major changes include a crackdown on unscrupulous education providers and more rigorous approvals for student visas. This is expected to reduce the flow of new student arrivals in the future. The new policy also prioritises approvals for high-skilled roles paying annual salaries over $135,000. However, high paying trades, machinery operators and transport workers will be carved out.

Migration is a powerful fiscal lever and has been integral to Australia's growth over decades, but there are three key reasons the system needs to be rejigged to ensure policy settings are maximising the benefits of migration.

One: Playing catch-up

The labour supply benefits of the rapid increase in migration are undeniable. It has taken some pressure off wages, helping prevent a wage-price spiral, and provided much needed workers to fill labour shortages. Overall, this has helped kickstart to process of moving the labour market towards a more sustainable balance.

The drawback is the sheer speed at which labour supply recovered. Other production inputs, namely capital (machines, buildings, infrastructure), could not keep pace. As we have highlighted in previous research, this asymmetric boost to labour relative to capital is partly responsible for the mechanical fall in measured labour productivity which the economy has experienced since the pandemic. Importantly, this fall in productivity has increased unit labour costs, eroding part of the labour supply benefits from strong migration. Put simply, the full labour supply benefits of migration can only be unlocked when there is a commensurate increase in capital.

The response from the capital stock is underway and we expect it to continue, but if the current pace of migration is maintained, the catch up becomes more difficult - the capital stock simply cannot grow at the pace migration has been running.

An important part of this story plays out in the housing market. Like other areas of the capital stock, it takes time to increase the supply of housing. The rapid increase in population growth has pushed up against inelastic housing supply and contributed to a surge in housing costs. This has added to inflation and is source of financial pressure for many households, particularly those on lower incomes.

The pace of migration therefore needs to slow to allow the capital stock to catch up and – importantly – to unlock the full supply benefits of a larger working-age population. Some of this slowing will occur automatically as the normal flow of departures, particularly students, resumes. However, a policy response is warranted to ensure the slowdown is sustained.

Two: Rebalancing Asymmetries

Population growth adds to both supply and demand. But the demand and supply impacts are not symmetrical. The supply addition is only to labour, not capital or housing. The composition of the increase in population also matters. Currently, arrivals are skewing to young adults; the share of children arriving is lower than usual, so the addition to the working-age population and labour supply is faster than the growth of overall demand. The skills base of the arriving workers also matters, however.

The housing market is a good example of this. Australia’s housing imbalance has become significantly more apparent as the rapid surge in migration has added strongly to housing demand but has done very little to increase our ability to build new housing supply.

Ensuring migration provides the economy with the right skills is therefore critically important and is paramount to ensuring we maximise the positive benefits of migration. The mechanisms in Australia’s existing migration framework are currently falling short on this metric. The announced policy changes will go some way in fixing this.

Three: Fighting inflation

In combination, a sustainable pace of migration and the right mix of skills provides the best conditions for migration to help fight inflation. The net impact of migration on inflation is extremely difficult to deduce with sufficient conviction. However, a rate of migration that can be matched by growth in the capital stock, and that adds to labour supply where it is needed most will maximise the benefits of migration both on economic growth and on inflation.

This is because it will relieve sectoral constraints, rather than exacerbating them, provide the best foundations for achieving productivity growth and increase the diversity and skills in the economy.

At a time when the Reserve Bank (RBA) is fighting hard to bring inflation down, while trying to preserve the gains in the labour market, a migration program that is geared towards supporting this objective can help make the RBA’s job a little easier.

Bottom line

Migration has played an important role in Australia’s economic development. A sustainable and targeted migration program will ensure we reap the benefits while minimising the costs. To this end, the expected slowdown in migration numbers and population growth are appropriate given where we are in the economic cycle. Not only will this help ensure that the capital stock catches up and productivity outcomes improve, but it will also help the RBA in its fight against inflation.

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