

# Submission on “Immigration – Fit for the future Preliminary findings and recommendations” New Zealand Productivity Commission November 2021

## Introduction

1. There is a lot of helpful, factual information and analysis in the Commission’s paper, and some worthwhile recommendations.
2. Overall, however, I think the Commission has not adequately grappled with or reached robust conclusions on the critical issues regarding New Zealand’s immigration policies, namely:
  - whether or not policies to allow or encourage high rates of immigration enhance or hinder New Zealand’s productivity performance (the Commission’s remit)
  - what rate of immigration would maximise New Zealand’s productivity performance and prosperity (per capita) over time.
3. I think it is clear that high rates of net immigration skew the economy towards relatively sheltered domestic sectors (like housing and infrastructure and services) and penalise our exporters, both traditional and new. This impedes our productivity performance and prosperity.
4. Exports are critical because, as a very small economy, we are dependent on buying the world’s goods and services<sup>1</sup> for our prosperity. The poorer our export performance the more expensive these goods and services (via our exchange rate): in other words the less prosperous we are. In addition, the productivity of our export/tradable sectors is much higher than for our sheltered domestic/non-tradable sectors.
5. It is notable that exporting is not mentioned in the key points of, or media release for, the Commission’s paper. And in the paper’s findings the impact of high immigration rates on exporting and productivity is dismissed as “minor or conditional” (the “conditional” seemingly referring to building housing and infrastructure in advance of need in order to better “accommodate and settle new arrivals”).

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<sup>1</sup> Including international travel

6. This dismissal of exporting in the conclusions of the paper is surprising since the key conclusion in the Commission's Frontier paper<sup>2</sup> is that the best way to improve our prosperity is to "export distinctive products at scale".
7. My submission focuses on these points. It also adds some brief comments on housing and greenhouse gas emissions and a conclusion. It provides, at the end, more specific comment on some of the summary findings and recommendations of the paper.

**Key issue: whether high rates of immigration are good or bad for New Zealand's productivity performance**

8. This issue is discussed in detail in the Commission's Wellbeing working paper.<sup>3</sup> The discussion gets to the nub of the issue with a summary and brief analysis of the so-called "Reddell Hypothesis".<sup>4</sup>
9. The Commission considers that there are two parts to the Reddell hypothesis:
  - Firstly, that New Zealand's long-standing policies of encouraging high rates of immigration are a key reason for New Zealand's chronically poor productivity performance, low and declining rates of exports as a proportion of GDP, and long, slow slide down the OECD rankings of GDP per capita (the macroeconomic story)
  - Secondly, and as a related point, that New Zealand's prosperity is limited by its natural resource base and its geographical remoteness. That is, "geography matters". As a consequence New Zealand is unable to sustain high levels of per person income if our population is encouraged to grow beyond the economy's capacity.
10. The Commission concludes that it "is not taking a definite view on the Reddell story" (which appears to refer to the macroeconomic part) and that "the Commission is not persuaded that New Zealand's prospects are limited by its fixed stock of natural resources."<sup>5</sup>

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<sup>2</sup> "New Zealand firms: Reaching for the frontier, April 2021". Hereafter referred to as the Frontier paper

<sup>3</sup> "The wider wellbeing effects of immigration" Working paper 2021/07. Hereafter referred to the Wellbeing paper. The Commission's paper "Immigration – Fit for the future Preliminary findings and recommendations", November 2021 is referred to as the Findings paper.

<sup>4</sup> Pp15-17 Wellbeing paper

<sup>5</sup> P17

11. I find Reddell's views persuasive. I have set out my reasons in the next sections.

### **Macroeconomic story**

12. My summary of the macroeconomic story is as follows.

13. High rates of immigration are a key reason for New Zealand's chronically poor economic performance in terms of productivity, exports and GDP per capita<sup>6</sup> over the last 50 years or so. This outcome is notwithstanding the fact that "many of New Zealand's framework policy settings rate well in international comparisons. These include its fiscal and monetary frameworks, the quality of its institutions, its low levels of corruption, and its settings relating to the ease of doing business."<sup>7</sup>

14. The reasons why high rates of immigration are detrimental to productivity, exports and growth per capita can be summarised as:

- The incremental demand created by new immigrants, especially for housing and infrastructure, exceeds the additional supply created by them at least for a number of years, leading to an elevated exchange rate and interest rates. This erodes the profitability of exporters and import substitution businesses.
- The need for additional housing and infrastructure (which includes both the building and staffing everything from transport to schools to hospitals to energy to water services to retailing and hospitality) skews the economy towards these activities and away from exporting and import substituting businesses. This is because housing, infrastructure and services are subject to much less competitive pressure than the export and import substitution sectors. They are therefore able to outcompete them for resources (labour, capital and land), driving up their costs.<sup>8</sup>

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<sup>6</sup> On p7 of the Findings paper the Commission notes that New Zealand's GDP has grown on average by 1.5 percent per year over the last two decades, which is comparable to other OECD countries. The implication is that we are not doing too badly. But simply keeping up with average OECD growth rates leaves us slowly falling behind the top half of the OECD because we started from a lower base and therefore the absolute gap gets a little larger each year. That is, we need to do better than the OECD average to try to reduce the gap, particularly with Australia which acts as a magnet for our skilled workers.

<sup>7</sup> Finding 2.1, p193, NZPC 2021d (Frontier paper)

<sup>8</sup> I think this competition point is additional to the exchange rate story. That is, even with a fixed exchange rate the same dynamic would apply.

- The skewing of the economy towards relatively sheltered sectors has a direct impact on our productivity performance, because the productivity of export and other tradable sectors is significantly higher than non-tradable/domestic sectors.<sup>9</sup> This is unsurprising, since the former are relatively or entirely sheltered from competition while the tradable sectors are not.

15. These are not one-off effects, because the continued flow of new migrants continues the problem. “This makes a difference – the resource shift to non-tradables does not reverse but becomes embedded.”<sup>10</sup>

16. Notwithstanding these clear effects, the Commission says that “At this stage of its enquiry, the Commission is not taking a definitive view on [this] story. For example, it notes that policies to improve housing and infrastructure supply and to invest in them *prior* to migrants arriving could do much to avoid the problems of excess demand in those areas [my italics].”<sup>11</sup>

17. This comment is surprising and unconvincing on many levels.

18. For a start, this is the extent of the analysis. No other examples or comments are made as to of why the Commission has not yet made up its mind (on the macroeconomic story).

19. Secondly, its own analysis in the preceding section, headed “Macroeconomic effects may be less visible but are important” says much the same things as this part of the Reddell hypothesis.

20. Third, the comment (about policies to improve infrastructure supply prior to migrants arriving) does not actually address the issue about the on-going costs to productivity, exporting and prosperity of skewing the economy towards the domestic sector (largely non-tradables) and away from exporting and import substitution.

21. Fourth, moreover, the proposal to invest in housing and infrastructure *prior* to the arrival of new migrants is unpersuasive on many levels:

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<sup>9</sup> Figure 3.2, p19, Wellbeing paper

<sup>10</sup> p14 Wellbeing paper

<sup>11</sup> Wellbeing paper, p17. The Commission says this is an *example* of why it has not yet reached a definitive view on these macro-economic effects, but it is the only examples it gives, and no other analysis is offered.

- It has a whiff of central planning, which has a world-wide history of failure, including in New Zealand (the latest being Kiwibuild). Building accommodation and infrastructure *before* demand occurs will require central planning and funding. As the Wellbeing paper itself comments “[J]ust how this would work – including who would finance these investments and bear the risks of the demand not materialising - is unclear.”<sup>12</sup>
- We have chronic deficits in housing and infrastructure (hence our socially disastrous house prices), so it is hard to imagine we can make up for this deficit and maintain/renew our infrastructure *and* get ahead of the game by building and staffing them *before* new migrants arrive.
- Building and staffing additional infrastructure and housing will require *more* immigration, but these additional immigrants in turn create incremental demand for housing and infrastructure and so it goes on. There’s a strong element of “chasing one’s tail” here.
  - The Commission says “Paradoxically, while a flow migrants with construction skills will help reduce the housing and infrastructure deficit, in the short run the new arrivals add to the pressure.”<sup>13</sup> This is hardly paradoxical, more an inherent feature of high rates of immigration. That is, the higher the rate of immigration in the near past the higher the rate required in the near future, and so on.
- There are long-standing and seemingly intractable barriers to bringing on new supply in housing and infrastructure. The Commission identified these in its 2012 report on housing, but few of its main recommendations have been taken up. The reforms to the RMA look more likely to impede rather than improve planning processes and requirements, and there is strong resistance to freeing up more land for building for climate change reasons. It is hard to understand why the Commission considers it feasible to get *ahead* of demand created by new arrivals when it comes to housing and infrastructure.

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<sup>12</sup> P8, Wellbeing paper

<sup>13</sup> P11 Wellbeing paper

22. Fifth, as noted earlier, the Commission's own analysis shows that the productivity of the tradable sector/exporting is notably higher than that of the non-tradable/domestic sector.<sup>14</sup>

23. Sixth, the steady increase in the size of the construction sector in the economy over the last 30 years (when New Zealand had one of the highest rates of net immigration in the OECD<sup>15</sup>) is as predicted by the Reddell hypothesis (and the Commission's own macroeconomic analysis). The fraction of the workforce in the construction industry has increased substantially from 4.8% in 1992 to 8.2% in 2016.<sup>16</sup> It is almost certainly more now.<sup>17</sup> Growth from 2015 to 2019 was higher for construction than for average annual GDP growth.<sup>18</sup>

24. Seventh, the brief history of the ambitious and comprehensive Business Growth Agenda 2015 is instructive. The Agenda set a target for exports of 40 percent of GDP to increase our prosperity at a time when they were about 30 percent of GDP. At the same time (and in the preceding year or so), successive governments encouraged a particularly strong period of immigration growth. Exports have since declined towards around 25 percent of GDP as the Reddell hypothesis would predict (because growth has been skewed towards domestic sectors).

- It seems unlikely that the Commission's prescription of building housing and infrastructure *prior* to the arrival of these new immigrants would have *improved* our export performance, given that it would have sucked even more resources into sheltered domestic sectors, created more headwinds for exporting sectors and required more net immigration to help undertake the building and servicing of, well, everything.

25. Eighth, cross-country comparisons support the Reddell hypothesis. Other countries which have, in general, pursued high immigration policies, such as Australia, Canada, and Israel, have also experienced relatively low productivity growth rates, albeit better than ours (noting that their geography and natural resources are also more

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<sup>14</sup> Figure 3.2 p18 Wellbeing paper.

<sup>15</sup> P3 Wellbeing paper

<sup>16</sup> P14 Wellbeing paper

<sup>17</sup> The Infrastructure Commission estimates that we will need an additional 118,000 infrastructure construction workers by 2024. <https://www.nzherald.co.nz/business/infrastructure-price-of-a-world-class-infrastructure-system/KKBVWZTH2TELTGNMEJI7JAYX34/>

<sup>18</sup> P8 Wellbeing paper

favourable than ours, except for Israel). In contrast, countries which the Commission regards as successful small advanced economies (SAEs), such as Denmark, have low rates of net immigration.

26. Lastly, the “stylised facts” about the New Zealand’s economy<sup>19</sup> do in fact fit the Reddell hypothesis. It is noteworthy that the Commission does not identify any factors that do not fit or indeed other more credible explanations for those facts. (Reverse engineering from the recommendations of the Frontier paper - that is, for a list of things we haven’t done adequately in the past - do not really work as a compelling explanation, as argued in the next sections).
27. The Commission itself, in the Wellbeing paper, almost seems to get there when it says “for exporters to have the ‘room’ and resources to thrive, a sensible precaution is to moderate the rate of immigration-driven population increase to avoid high demands for non-tradeable production at the expense of the tradeable sector.”<sup>20</sup> But it balks at taking this through to its Findings paper.

### **The constraints of geography**

28. The second but important part of the Reddell hypothesis is that New Zealand’s prosperity is limited by its natural resource base and geographical remoteness, now that it is no longer a ‘frontier economy’ where labour is scarce relative to natural resources. That is, “geography matters”.

29. The argument about geography is that:

- “New Zealand’s small size and distant location make it difficult to generate much innovation-based wealth in sectors outside the primary sector. New Zealand is just too far away from the high-performing, skill-intensive and research-intensive centres of population in the rich world to make it an attractive location for investment in sophisticated products or to enable it to generate its own agglomeration economies.”<sup>21</sup>
- Geography matters – our limited natural resource base, small market size, distance from markets and agglomeration centres constrain the aggregate income New Zealand can produce and therefore the number of people for which it can provide a high income.

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<sup>19</sup> P16 Wellbeing paper

<sup>20</sup> P18 Wellbeing paper

<sup>21</sup> P15 Wellbeing paper

30. As a brief aside, in addition to our smallness and unique remoteness<sup>22</sup>, our physical geography is also challenging: including two long skinny islands, extensive mountain ranges and hill country<sup>23</sup>, low population density, the difficult topography of several of our major cities including Auckland and Wellington, and our highly active geology. These all add costs. The impact of earthquake risk on our building and infrastructure costs, and insurance costs, is under-rated in my view.

31. The Commission says it is not persuaded by these arguments regarding New Zealand's prospects.<sup>24</sup>

- More precisely it says “the Commission is not persuaded that New Zealand's prospects are limited by its fixed stock of natural resources.”<sup>25</sup> I don't like Reddell's “fixed stock” terminology as it can be read to imply (even though I am sure this is not intended) that we cannot extract more from these natural resources over time with smarter approaches and technologies. I prefer phraseology such as “constrained natural resource base”. This captures both the limits of our natural resource base which provides our main comparative advantage for exporting and the crucial point that our scope for expanding production and exports at scale from those resources is increasingly limited by environmental and other factors. More importantly, I think the Commission's characterisation of the argument about the importance of geography (“fixed stock of natural resources”) does not capture Reddell's point about the *combined* effect of smallness, distant location and constrained natural resource base.

32. The Commission's analytical comment here is that “it argued in its Frontier Firm inquiry that New Zealand has the potential (yet to be realised) to prosper by innovating both within and beyond its primary sector. To do so, it needs to produce specialised, distinctive, high-value products and export them at scale.”

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<sup>22</sup> Unique for an advanced economy our size.

<sup>23</sup> Fun fact: the highest point in Denmark is the top of a bridge, at sea level, between two islands, one of which is called Zealand.

<sup>24</sup> P17 Wellbeing paper

<sup>25</sup> P17 Wellbeing paper

33. It adds that “As with other small successful economies... New Zealand must specialise in what the Commission called selected ‘areas of focus’ by investing in a high-performing innovation eco-system in each of these areas (NZPC, 2021d).”<sup>26</sup>
34. I turned to the Frontier Firms Inquiry for more information on whether the Commission’s arguments refute the proposition that “geography matters”. I was unpersuaded, on many grounds.
35. As an aside, the Commission concludes in a finding in the Frontier paper that “Geography is not destiny.”<sup>27</sup> It also says in a headline (page 3) “Geography is not destiny: New Zealand can do better”, and the first sentence reads “The Commission does not accept that geography is a life sentence condemning New Zealanders to low living standards”. This is classic straw man stuff. Nobody that I am aware of argues that New Zealand can’t ‘do better’ or that we are ‘condemned to low living standards’.
36. In my view the more compelling argument is that geography (including natural resource endowments) matters a great deal.
37. Take the countries that the Commission identifies as examples of “successful small advanced economies”. (It analyses the characteristics of the frontier firms in these countries to identify the characteristics and strategies that make them and their countries successful in terms of productivity, exports and economic growth per capita).
38. The first set comprises European countries, namely Sweden, Denmark, Ireland, and the Netherlands.<sup>28</sup> But the crucial geographic fact about these countries is not that they are small, but that they are part of a prosperous continent of 750 million people and have free trade access to 450 million of the most prosperous of them. Under these circumstances the fact they are small is basically irrelevant. They have much more in common with regions or states in the USA from an economic perspective than they do with New Zealand. Smallness is only relevant if a country is not part of and does not have open access to a large, prosperous, accessible, contiguous market. Like New Zealand.

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<sup>26</sup> P18 Working paper 2021/06

<sup>27</sup> Finding 2.5, Frontiers paper

<sup>28</sup> P3, but with a somewhat different set on p194

39. The Commission's other examples of successful SAEs are Israel and Singapore.
40. Israel is interesting. It is small *and* it is surrounded by hostile and poor neighbours (geography again). Like New Zealand it also has high rates of net immigration. Instructively, its productivity performance and GDP per capita is as poor as New Zealand's. It's not clear that it should be characterised as a successful SAE if New Zealand is not.<sup>29</sup>
41. Singapore is also interesting. It certainly falls into the successful SAE category. But its defining characteristic is a highly strategic location. As a thought experiment, it has a similar physical size as Stewart Island, but it's unlikely it would be as successful if it had a similar location. Of course, Singapore's location is not sufficient for it to be an economic powerhouse but it is a critical component. Other crucial characteristics are its highly capable and entrepreneurial people (with the Chinese, now 75 percent of its population, undoubtedly attracted there by the opportunities provided by its location); an education system sharply focused on STEM subjects and vocational training; a stand-on-your-own feet social assistance approach, and, relevant to the immigration story, a particularly tough-minded focus on high-skills immigration.<sup>30</sup>
42. It is also instructive that the Commission does not include Australia in the list of successful SAEs despite the fact that key geographical characteristics of Australia have more in common with New Zealand than the Commission's list of successful SAEs, in particular its combination of relatively small population (while over 5 times larger than New Zealand it is only 50 percent larger than the Netherlands, one of the Commission's successful SAEs) and relative isolation (but much less so than New Zealand). Its exports are dominated by stuff (minerals) it extracts from the ground (geography again) and ships out in bulk, which is a relatively easy way to generate export income. While its productivity and GDP per capita (not surprisingly) is notably better than New Zealand's, it is far from a top performer. Instructively, like New Zealand, but unlike the Commission's successful SAEs except relatively unsuccessful Israel, it has also pursued a high immigration policy.
43. All of this is more supportive of the argument that geography matters than that it can be overcome by better policies. Moreover, the more extreme or unique the

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<sup>29</sup> Perhaps confirmation bias was operating here: Israel fitted the narrative regarding innovative eco-systems.

<sup>30</sup> Working Paper: Immigration policy: International Approaches, p22.

geography, the more it matters, at least as far as economic development goes (as I'm sure the 2.5m inhabitants of the Sahara can attest).

44. As argued in more detail in my submission on the Commission's Issues paper, our natural resource endowment, in combination with our other geographic characteristics, largely determines our areas of comparative advantage (and disadvantage): grass-based agriculture, pine forestry, off-season horticulture, fishing rights, some good low-cost energy resources, scenery. Of course, our resource base is wider than this, but this is the bulk of it. Importantly, our growth prospects *at scale* in these areas are increasingly constrained, primarily by environmental factors.
45. The reason the Commission gives in its Frontier paper for concluding that "Geography is not destiny" is "The existence of a few New Zealand firms at or close to the global frontier shows that it is possible to overcome the disadvantage of a small domestic market and distant location."<sup>31</sup>
46. This is not very convincing given that elsewhere the Commission says: "A striking finding of this inquiry is that the labour productivity of New Zealand's frontier firms is less than half (45%) that of the best frontier firms in other small advanced economies."<sup>32</sup> That would tend to imply that it is not so easy to "overcome the disadvantage of a small domestic market and distant location", particularly if high rates of immigration divert resources into domestic sectors.
47. The Frontier paper does acknowledge of course that New Zealand is "not a standard OECD country" and faces an "unusual set of challenges", but underplays this in my view and proceeds to draw lessons from other SAEs that are very different from New Zealand in critical ways and similar only in a largely non-critical way (smallness).

#### **The Commission's prescription for overcoming the disadvantages of geography**

48. The Commission's prescription, in the Frontier paper, for how New Zealand should overcome its geography is also not very persuasive.
49. My summary of the main points is:
- Adopt new technology
  - Innovate

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<sup>31</sup> F2.5, p193 Frontier paper

<sup>32</sup> P1 Frontier paper

- Attract more high quality foreign direct investment
- Build more dynamic businesses<sup>33</sup>
- Export distinctive products at scale
- Identify and invest in “innovative eco-systems”. This involves “high-level governance arrangements that bring together senior government ministers and officials, top industry representatives (firms and workers), and leading researchers and educators to select broad areas for focus, shape the strategic direction, marshal the resources needed for success, and provide durable strategic direction across successive governments.”

50. There’s nothing wrong with these recommendations as such, although some fall into the category of bromides and are akin to advising a 100m runner that if they want to improve their performance they need to run faster.

51. Others have a distinct déjà vu air about them.

52. A number of voluminous government studies and reports have come to similar conclusions. These include:

- The Planning Council’s reports
- Industry studies/plans of the 1970s and early 1980s (as part of the process of phasing down import licensing)<sup>34</sup>
- Founding documents for New Zealand Trade and Enterprise and its predecessors, from 1987, which advocated focusing, among other things, on soliciting more high-quality foreign investment
- The Knowledge Wave conference 2001
- Growing an innovative New Zealand 2002
- Business Growth Agenda 2015.

53. Much of the language has been the same: innovation, value-added, moving up the value chain, specialisation, focus, task-forces, training and skills development, business leadership, research and development, more resources and support,

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<sup>33</sup> “Businesses primarily, supported by government, will need to deploy dynamic capabilities to identify areas of competitive advantage in export markets and drive innovation that will push out the productivity frontier.” F2.8, p194, Frontier paper

<sup>34</sup> When I started work in the Department of Industries and Commerce in 1972 (in the newly formed Productivity Centre!) I was told by the most senior person in the department responsible for overall industry policy that New Zealand should aim to be the Switzerland of the Pacific region for machine tools.

partnership between government and stakeholders including industry and universities and research centres and so on.

54. Even the Commission's examples of areas for focus (biotechnology, digital technologies, creative industries) and its case studies of exporting industries of significant size and export potential (dairy/horticulture/healthcare and software products and services) are very similar to those identified nearly 20 years ago in Growing an Innovative New Zealand.
55. The Commission appears to acknowledge that much of its prescription has been recommended and tried before, but appears to attribute the less-than-stellar results to past "fragmentary" and "uncoordinated" efforts.
56. An alternative explanation for the lack of success is probably closer to the point, namely the fairly unique geographic constraints we face (smallness plus unique isolation plus the nature of our natural resource endowments) combined with our policy of encouraging high rates of immigration.<sup>35</sup>
57. One would expect, in a situation where our overall policy settings are pretty good (see paragraph 13 above), that if there were profitable business opportunities "at scale" in new export activities we would have seen business investment, including foreign direct investment (FDI), in those activities.<sup>36</sup> And if government efforts to

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<sup>35</sup> There have been other poor policy choices too, in my view, including in education, some welfare settings, and on infrastructure and housing.

<sup>36</sup> It is sometimes argued that New Zealand's export successes in the IT sector shows great promise and that we can overcome the "tyranny of distance". I'm not so sure. For a start the extravagant claims of the IT sector need to be taken with a large grain of salt, for example, see <https://www.nzherald.co.nz/business/kate-macnamara-what-jacinda-ardern-misses-in-hopes-of-tech-rivers-of-gold/RSAFNO4ELTQFLHZCQFQNIK5ZJM/> and <https://croakingcassandra.com/2017/10/19/the-tech-sector-and-ongoing-economic-underperformance/>

Additionally, other factors to consider include:

- It is clear we need to import the main resource (labour) of the IT sector, as the ongoing lobbying of the IT sector makes clear. It is hard to see how that gives us a comparative advantage unless there is something in our water or fresh air or wider environment that triggers superior IT performance here by new (IT) immigrants
- Moreover, the need to import the resource (people) has the wider effect of diverting resources into the domestic economy to provide additional housing and infrastructure, negatively impacting other export sectors
- Our worsening education performance and long tail of underachievement limits our domestic resource base
- The high costs of living here, in particular our housing costs, makes us increasingly unattractive to high performing IT immigrants
- The growing ability to, and popularity of, working remotely (in IT's case, anywhere in the world) limits the gains to New Zealand from growth in our IT export sector.

lead a coordinated effort to improve our rates of innovation and export performance were effective we would have seen better evidence of it by now.

### **Innovative eco-systems.**

58. A key learning for the Commission from the study of frontier firms in successful SAEs is the strategy of supporting and investing in “innovative eco-systems”.<sup>37</sup>

59. The implication is that successful SAEs have identified potential winner sectors and then built innovative eco-systems and that business investment and “distinctive exports at scale” have followed. In my view it’s more likely that the growth was organic and that the key sparks were businesses identifying opportunities and making investments. Where those paid off, usually reflecting some comparative advantage, research and other government support systems developed in response. We have seen this in New Zealand: our key comparative advantage is in agriculture (especially grass-based such as dairy) and horticulture and forestry. Businesses (including, obviously, farmers) have invested, these sectors have become successful, and government-funded research and training has grown up around them in support.

60. That is, it’s not clear that distinctive exports at scale have *followed* from government-led task-forces identifying winning sectors and investment in research and development *prior* to successful business investment.<sup>38</sup> Some Asian countries, including Singapore, have probably also had success with Government-led strategies, but their institutional arrangements and cultures are very different from New Zealand’s. Doubts about the ability of governments here to deliver large-scale projects, no matter how well-intentioned and resourced, have been confirmed by the failures of Kiwibuild and some aspects of our Covid-19 response.

### **“Least regrets” policy**

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- The on-going sale of our IT businesses to overseas companies which have the advantage of scale and proximity to markets. As Reddell says, if a new idea is successful here it’s likely to be even more successful in larger markets.

<sup>37</sup> P43 Findings paper provides a description of “innovative eco systems”

<sup>38</sup> Government sponsored R&D has clearly been the basis of large-scale business investments and exports in some cases, such as the USA and Israel, but the primary motivation of that investment has usually been military or scientific/geo-political such as space exploration.

61. The Commission’s analysis of the Reddell hypothesis in its Wellbeing paper does lead it to conclude that a “least regrets” policy would be to slow the rate of net immigration:

*“[This] would avoid the risk of large costs from forgoing the substantial productivity benefits from an economy re-balanced towards exports. On the other hand, the potential costs of lowering net migration to more manageable rates of flow appear modest – some short-term disruption and costs for businesses, and small productivity losses [italics added].”*<sup>39</sup>

62. It is noteworthy that this key conclusion does not make it into the findings or recommendations or key points of the Findings paper, even though it goes to the heart of the issue, namely the rate of net immigration that best delivers on New Zealand’s long-term productivity performance (and therefore wellbeing).<sup>40</sup>

### **Historical parallel**

63. In my view, this “least regrets” weighing-up of labour market benefits against wider macroeconomic effects has an historical parallel, namely the debate over import licensing in the late 1970s and early 80s.

64. The benefits to the labour market (and industry policy) from import licensing were obvious and well-supported by beneficiary businesses and unions: jobs, skills, increased capability in the industrial sector, spill-over benefits to related sectors. And there were obvious fiscal benefits, particularly from high rates of employment.

65. But the costs to the wider economy were becoming more and more apparent, until even the Manufacturers’ Federation, which mainly comprised businesses protected by import licensing, reluctantly accepted the need to reduce the scope of import licensing.<sup>41</sup> The cut-through argument was that import licensing penalised exporters and import substitution businesses by enabling protected sectors to outcompete them for resources.<sup>42</sup> The result was an increasingly distorted economy where the

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<sup>39</sup> F3.3 p19 Wellbeing paper

<sup>40</sup> There is a very brief and conditional reference in the text to a “least regrets” policy, viz *“If other changes are not made to ease restrictions on housing construction and to boost investment, a “least regrets” approach implies setting the planning range at lower levels than has been the case in recent years [italics added]”* P47, Findings paper.

<sup>41</sup> <https://teara.govt.nz/en/government-and-industrial-development/page-4>

<sup>42</sup> The exchange rate and interest rates were largely fixed at the time.

government ended up having to subsidise our key export sector (farming) to try to offset the impacts of protectionism.

66. Of course, we do not have hard protectionism like this today. But we do have ‘soft’ protection in the form of a growing but sheltered domestic market (because of our geography) including large and growing non-tradable sectors, boosted by high rates of immigration. These sectors are able to out-compete export sectors, including potential new exporters, for resources. This ‘protection’ also sustains an elevated exchange rate and interest rates for the reasons outlined in the Wellbeing paper. The outcome is a skewed and underperforming economy in terms of productivity, exports and prosperity.

67. In the import licensing debate there wasn’t *proof* that the macroeconomic costs outweighed the microeconomic and fiscal benefits. Rather, judgement calls were required based on weighing up all available evidence.

## Housing

68. The Wellbeing paper also comes to some robust conclusions on the impact of high rates of immigration/population increases on house prices:

“Housing and infrastructure shortages arising from rapid population growth reduce the wellbeing of the existing population including some vulnerable groups when they result in rapidly rising house prices and rents, overcrowding, homelessness, substandard drinking and wastewater, traffic congestion and lack of affordable accommodation close to jobs.”<sup>43</sup>

“[N]ot enough houses have been built for this country’s fast-growing population, [resulting in] sky-rocketing prices ... [which] have greatly exacerbated wealth inequality in New Zealand and seriously damaged wellbeing.”<sup>44</sup>

“Research points to *two key drivers* [of house price growth] - *high rates of net migration that drive demand*, and restrictive national and local planning and other compliance rules hindering the response of housing supply to the increased demand [italics added].”<sup>45</sup>

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<sup>43</sup> P4 Wellbeing paper

<sup>44</sup> P5 Wellbeing paper

<sup>45</sup> P5 Wellbeing paper

69. The point that the key driver of rapid house price rises on the demand side is high rates of net migration is obviously correct. A simple thought experiment confirms this. That is, imagine that instead of a near 2 percent increase a year in our population in the period 2013-2020 (driven primarily by net immigration) our population had declined by 2 percent a year. The result would have been a decline, potentially a significant decline, in house prices.<sup>46</sup>
70. Of course, one can run an alternative thought experiment which says: ‘Imagine that we were unconstrained on the supply side and had built sufficient new houses to accommodate our rapid population increase. The net result would have been a relatively small increase in house prices (compared to actual increases)’.
71. This is also true. The difference between the two scenarios, however, is that the demand side is relatively easily amendable to Government action (by constraining the rate of new immigration) whereas unconstraining the supply side, including that for the required infrastructure, is very difficult as the Commission’s analysis shows.<sup>47</sup> Moreover, in my view it is likely to get more difficult in future, not less so, for a range of factors, including environmental and cost factors.<sup>48</sup>
72. More importantly the supply-side scenario has the major disadvantage that it would further divert resources towards relatively or fully sheltered domestic sectors and away from exporting.
73. Once again it is notable that the relatively robust conclusions in the Wellbeing paper about the impact of high rates of net immigration on rapid house price increases are muted and caveated in the key points of the Findings paper and the accompanying media statement. The weight of explanations for rapid house price increases is on the supply side (especially infrastructure) issues, and the impact of high rates of net

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<sup>46</sup> As an aside, it does not make sense to blame investors for rapid house price rises. If house prices had fallen, or been expected to fall in a declining population scenario, investors would have turned elsewhere. The existence of investors does not drive house prices upwards over time, although they do make a difference to the relative affordability of renting versus buying.

<sup>47</sup> As another aside, the Wellbeing paper (p8) includes the comment that “even with a flexible and responsive supply side, housing supply responses can lag unanticipated demand changes by many *months* [italics added]”. This surely should read “years”, not months.

<sup>48</sup> Even the most unconstrained housing markets on the supply side can be overwhelmed by high rates of migration. See <https://www.nytimes.com/2021/11/27/us/austin-texas-unaffordable-city.html> Austin Texas is building accommodation at 4 or 5 times the rate of New Zealand (relative to population size) but is unable to match demand, resulting in rapid house price increases and the poorest and most vulnerable being squeezed out the bottom into marginal housing and homelessness.

immigration is referred to in the key points as “contributing to burdens on the wider community” and “putting pressure on the country’s ‘absorptive capacity’”.

74. Moreover, it is clear that the Commission’s preferred solution is to build more housing and infrastructure in advance of the arrival of new migrants rather than significantly moderate the rate of net immigration.
75. Our house prices are a social disaster, plain and simple. It’s a pity the Commission has downplayed the key role played by high rates of net immigration in recent years in its Findings paper and media statements.

### **Greenhouse gas emissions**

76. In response to comments (including mine) that sustained high rates of net immigration will make it more difficult and costly for us to meet our 2050 zero net emissions target, the Wellbeing paper concludes:

“Although population growth has contributed to increases in greenhouse gas emissions, it is responsible for a relatively small share of total emissions. The impacts of future population growth on emissions will depend in large part on behaviour and technology uptake (eg, of electric and other low-emission vehicles)”.<sup>49</sup>

77. This does not seem right. I accept that nearly half of our emissions come from the agricultural sector (primarily for export), and that this will not change much as a result of population growth in New Zealand.
78. However it appears that the reason for downplaying the importance of emissions related to population growth is because the finding only relates to *direct* emissions by people<sup>50</sup> and in particular for personal transport, hence the reference to electric vehicles. But the impact of human activity is far greater than this across the entire economy including building and construction, energy production and use, economy-wide transport systems, heat and industrial processes, food production and supply, waste and so on, all of which are driven by human activity. Indeed, greenhouse gas emission targets relate only to anthropogenic (caused by human activity) emissions.

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<sup>49</sup> Finding 5.1 (p26)

<sup>50</sup> See paragraph preceding the Finding (p26 Wellbeing paper)

79. As noted in the Wellbeing paper, over time the relationship between infrastructure demand to population is roughly proportional.<sup>51</sup> Even if we all adopt electric vehicles this will make little difference to the point that the more people we add<sup>52</sup> the harder and more expensive (leaving aside agriculture for export) it will be to achieve our net zero emissions goal from where we are now.

### Some final comments

80. In my reading of the Commission's papers, there seems to be a clear shift in focus:

- from the robust wording in the key working paper on the wellbeing effects of immigration which finds only small positive benefits and identifies costs in terms of productivity, exporting and prosperity (although these findings are not as robust as they should be and the Commission has not been able to come to a definite view on some of them);
- to the finding in the Findings paper that "impacts" (presumably meaning negative impacts) of high rates of immigration on innovation, exporting and productivity are "minor and conditional";
- to the media statement which doesn't mention negative impacts on exporting and productivity at all, and concludes that the government should plan and invest more in infrastructure "in advance" to "accommodate and settle" more people to remove the only downside from high rates of immigration.

81. Another key point in the Wellbeing paper that didn't make it into the Findings paper or media release:

"New Zealand could choose a future rich in wellbeing by *moderating its population*, keeping within biophysical limits, and nurturing and celebrating its abundant and diverse natural capital. This could make New Zealand an attractive destination for discerning migrants [*italics added*]."<sup>53</sup>

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<sup>51</sup> P9 Wellbeing paper

<sup>52</sup> The Infrastructure Commission expects New Zealand will add some 1.7 million people by around 2050, a more than 33 percent increase. Since our birth-rates are now below replacement, this has to be almost entirely net immigration. See <https://www.nzherald.co.nz/business/infrastructure-price-of-a-world-class-infrastructure-system/KKBVWZTH2TELTGNMEJI7JAYX34/>

<sup>53</sup> P1, 8<sup>th</sup> bullet point, Wellbeing paper

## Conclusions

82. The key messages I hope will be included in the Commission's final report include:

- Migrants make a vital contribution to the New Zealand economy
- But the rate of net immigration is important. Where the rate exceeds the capacity of the economy to benefit, this
  - impedes productivity and exports and prosperity, and
  - imposes high social costs, for example in the housing sector
- Looking to the future, the rate of net immigration prior to the pandemic is unsustainable. A feature of immigration during that period was strong growth in relatively unskilled immigration.
- New Zealand needs a smarter immigration policy that focuses on skilled migrants able to help improve New Zealand's productivity, export performance and prosperity
- "New Zealand could choose a future rich in wellbeing by moderating its population, keeping within biophysical limits, and nurturing and celebrating its abundant and diverse natural capital. This could make New Zealand an attractive destination for discerning migrants."

83. To note the obvious: none of this is about *immigrants*. It is about government policies concerning the *rate* and *type* of immigration New Zealand needs. Immigrants are simply (almost invariably) good people responding to government policies.

84. I am pessimistic that much will change in future. Both governments and businesses, especially the latter, benefit from high rates of immigration. For businesses, high rates of immigration create steadily increasing demand and profitable opportunities in the relatively or fully sheltered domestic market and provide a ready supply of skilled and unskilled labour.

85. We can expect, therefore, continual vigorous lobbying from businesses and business groups for higher rates of immigration post-pandemic. And indeed there is a valid case that we will in fact need high rates of immigration to (a) try to make up for the housing and infrastructure deficits caused on the demand side mainly by previous

high rates of net immigration; (b) recover from the pandemic; and (c) replace New Zealanders who migrate to (wealthier) Australia.

86. For governments, high immigration rates have multiple benefits, including finding favour with businesses, boosted headline GDP numbers, and increased tax revenue to dispense in headline grabbing announcements.

87. In sum, there is strong path dependency created by previous high rates of immigration. This creates a continuing increase in profitable domestic demand, the need for more migrants to meet that demand, and vested interests in support of continuing high rates of immigration.

88. But the long term result of high rates of immigration is likely to be continuing poor productivity and exporting performance and the continuation of our long, slow decline in prosperity, not in absolute terms, but relative to most other OECD countries, and the continued increase in the Kiwi diaspora.

## Comments on the preliminary findings and recommendations in the Findings paper.

### *Finding 1*

*Immigration's main contributions to productivity and wellbeing come through:*

- *raising the long-term levels and diversity of human capabilities in New Zealand; and*
- *supporting the achievement of other social and economic policy objectives; expanding public services, strengthening innovation ecosystems and extending international relations.*

This is first finding of the paper, and this primacy and the way the finding is worded implies that the contribution of immigration to productivity and wellbeing is *only* positive. Other findings in the paper, and in particular in the Wellbeing paper contradict this. The wording is therefore misleading and partial.

### *Question 1*

*To what extent does access to migrant labour **reduce training and upskilling activity** by employers? Do effects on training and development differ by industry? Are there areas of the economy in which New Zealand should be training people that are currently disproportionately supplied by migrant workers? How could policy best respond?*

It is likely that ready access to migrant labour reduces training and upskilling activity by employers (the contrary seems implausible). The Australian Productivity Commission reached a similar conclusion in 2016: “[employers’] incentives to invest in training of their workforce are likely to be dampened as a result of ready access to skilled labour”<sup>54</sup>

The Commission should be sceptical about any employer claims that ready access to migrant labour has little effect.

### *Finding 5*

***Large queues of applicants for residence visas** have increased uncertainty and reduced the likelihood of achieving a pathway to residence. This has left many migrants in flux and unable to settle. Does the system consider wider impacts on wellbeing and productivity?*

The large increase in temporary visas that come with the promise (implied and specific) that they provide a pathway to residence, such as temporary work and student visas in particular, is either (a) plain bad faith if there is no realistic pathway to residency or (b)

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<sup>54</sup> P27 Findings paper.

bad for the New Zealand economy by putting pressure on our ‘absorptive capacity’ and productivity performance.

I think it is evident that our immigration policy settings do not adequately consider wider impacts on wellbeing and productivity (see the main part of my submission).

#### *Finding 6*

*Increases in New Zealand’s population from net migration have exacerbated **rapid house price increases**, reflecting several factors including underlying and persistent constraints on the supply of housing.*

Agree, although I would put it more strongly than this. In my view the recent socially disastrous increases in house prices, given the seemingly intractable nature of many of the impediments to supply (notwithstanding the Commission’s recommendations), are mainly attributable to high rates of net immigration from 2014 to 2020. See paragraphs 70 – 77 above.

#### *Finding 7*

***Microeconomic evidence suggests positive, but small, impacts** from immigration on average levels of labour productivity. New Zealand evidence on the **impacts of immigration on innovation and exporting** as channels for productivity growth finds **minor or conditional effects**.*

The second sentence is implausible.

As argued in the main part of my submission, the much more compelling conclusion is that high rates of net immigration are a significant drag on exporting (including on new, innovative exporting businesses), because they skew the economy towards sheltered domestic /non-tradable sectors (which have relatively low productivity). This results in elevated exchange and interest rates and pushes up the cost of resources for exporting sectors because domestic-oriented businesses can out-compete them for resources.

#### *Finding 8*

*An infrastructure deficit and associated pressures are the result of a failure to align investment rates with population growth and **build the assets needed to properly support more people in the community ahead of time**. The inability or unwillingness in the past to fund this infrastructure suggests that pre-pandemic rates of inwards migration will not be sustainable in the future.*

I agree with the conclusion that “pre-pandemic rates of inward migration [are] not sustainable”. But the wording is tentative, and implies (which is elsewhere specifically recommended) that all we need to do is build more infrastructure “ahead of time”.

Indeed the wording in the media statement explicitly says “To ensure immigration contributes to the productivity and wellbeing of New Zealanders, governments need to build the assets and infrastructure needed to support a growing population, in preparation for the number of new residents, ahead of time”

The wording in the finding also doesn’t appear to include housing.

Finding 9

***Policy reforms such as better planning, land use regulation, and improved funding and building of infrastructure would have significant wellbeing and productivity benefits for New Zealanders, and should be pursued regardless of immigration levels.***

Agree.

Finding 10

***Access to a migrant workforce can unlock complementarities and specialisation, but also introduce resilience risks. Whether or not there are negative consequences on innovation and productivity from using migrant labour depends on a range of factors, including underlying labour market conditions and whether technological alternatives are available.***

Again, like finding 1, this has an exclusive focus on the labour market effects of immigration and doesn’t weigh them against the negative macroeconomic effects, as covered in particular in the Wellbeing paper 2021/07.

Finding 11

***The disconnection of immigration from other policy areas has meant that the rapid growth in net migration and population in the years preceding the Covid-19 pandemic exceeded New Zealand’s ability to successfully accommodate and settle new arrivals.***

Again the clear message is that all we need to do is connect with other policy areas (eg building infrastructure and housing “ahead of time”) and we could “accommodate and settle” many more new arrivals.

This is not the full picture in my view, and ignores the wider macroeconomic effects of high rates of immigration (as covered in the Wellbeing paper).

It also seems to have an undue focus on what is good for new arrivals (hence the focus on accommodating and settling them) rather than on what is good for New Zealand's productivity, exports and prosperity.

*Recommendation 1*

*The **Immigration Act** should be amended to require the Crown to take account of the country's absorptive capacity (our ability to successfully accommodate and settle new arrivals) when determining the "national interest".*

Agree that the Immigration Act should be amended, but it should focus on net benefits to New Zealand in terms of productivity, exports, and prosperity on a per capita basis. The focus should be on what is best for New Zealanders. The wording "successfully accommodate and settle new arrivals" puts the focus on new arrivals and seems more appropriate for our refugee policies.

Of course, we want new arrivals to be accommodated and settled, because they are thereby more likely to be happy (a good in itself) and productive and stay and make their best contribution to New Zealand, but the outcome focus should be net benefit to New Zealanders rather than the new arrivals.

*Recommendation 2*

*The Immigration Act should be amended to require the Minister to regularly develop and publish an immigration **Government Policy Statement (GPS)**. These amendments should specify that a GPS must include:*

- *short-term and long-term objectives, and relative priorities;*
- *performance measures or indicators;*
- *how it recognises the Treaty of Waitangi interest in immigration;*
- *a description of how the demand for temporary and residence visas will be managed over the period of the GPS; and*
- *specification of planning ranges for new residents over the period covered by the GPS, and a description of how the planning range will affect other government policy objectives.*

Agree

*Recommendation 3*

*Amendments to the Immigration Act should specify that, in preparing an immigration GPS, the Government must describe what it considers **New Zealand's absorptive***

*capacity to be and how it intends to manage that capacity, or invest to expand capacity, in order to align it with long-term policy objectives.*

Agree

*Question 2*

*What **objectives** should be included in an immigration Government Policy Statement? Why?*

The objective should be net benefit to New Zealand in terms of prosperity per capita.

*Recommendation 4*

*The Ministry of Business, Innovation and Employment should develop and publish an **evaluation programme for major visa categories**, to assess their net benefits. Uncapped visa categories and those that offer open work rights, such as the various bilateral working holidaymaker schemes and student work visas, should be priorities for evaluation. The Investor 1 and 2 migrant categories would also merit evaluation.*

I think it is a cop-out for the Commission to recommend that someone else do an evaluation of the net benefits of these programme when the Government's request was that the Commission should analyse and make recommendations on our immigration settings. The Commission seems to have had it mind to do such an evaluation judging by some of the questions in its Issues Paper (June 2021), such as on student visas and working holiday visas.

*Recommendation 5*

*The **allowable volume of temporary migrant visas** with potential residence pathways should be managed to be compatible with the number of residence visas on offer.*

Agree. It is bad faith not to do this and leads to continual negative publicity both here and overseas.

*Question 4*

*Should the **annual number of residence visas** on offer be reduced? If so, to what level and why? And if not, why not?*

Yes the number of residence visas available should be reduced, because high rates of immigration have net costs in terms of productivity, exports, and prosperity per capita.

I suggest a level of around 10,000 per year. I note that Denmark's net migration rates (including humanitarian) appear to have settled at around 15,000 per year (out of a population of about 5.8 million).

An alternative approach would be to set an overall target for population growth on, say, a 3 year rolling basis, that the New Zealand economy is likely to be able to handle and benefit from (in terms of housing, infrastructure and minimising the adverse impacts on productivity and exports).

Of course, this would include both the rate of natural increase (relatively easily forecast) and net migration to/from Australia (which is much less easily forecast).

The percentage target could be, say, 0.2 to 0.6 percent a year for population growth with a mid-point of 0.4 per year on a rolling 3 year basis.

Why this level? Well, it's a lot less than the clearly damaging rates in the period 2013 – 2020. I also note, again, that it appears to be about the level of net immigration for Denmark<sup>55</sup> which the Commission regards as a particularly successful small advanced economy (SAE).

The big issue of course is our open border with Australia. I am aware of scepticism regarding attempts to forecast likely movements to and from Australia, and that a Reserve Bank study<sup>56</sup> concluded that they were essentially unpredictable. I am also aware that the Treasury consistently got its forecasts of net immigration wrong over many years, basically (in my view) because it didn't adequately factor in the effect on migration patterns of the Australian policy, introduced in 2001, to deny New Zealanders access to Australian employment and welfare benefits, which was always going to result in fewer New Zealanders migrating to Australia and more returning during any Australian downturn.

Thus there is a major risk of under-shooting and overshooting in terms of getting the rate right, because (a) forecasting is difficult and (b) there are lags in the availability of data, the response of Government to changes in forecasts and in the response of potential immigrants.

However, I'm not so convinced that it is ill-advised to even try to do rolling short-term forecasts (3 years), updated 6 monthly or following any major policy initiative on either side of the Tasman, as the basis for setting a number range for residence visas. I think the odds are that it would result in a less volatile, and lower, rate of population growth than we have experienced in the past. It is, at least, worth a (another) try.

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<sup>55</sup> This excludes the temporary surge in immigrant numbers following the Syrian refugee crisis of 2015-16.

<sup>56</sup> P48 Wellbeing paper

It is good to see that Commission is going to do further analysis of the feasibility of smoothing inwards migration<sup>57</sup>

*Recommendation 6*

*Immigration New Zealand should continue counting points past the minimum thresholds and rank candidates within the **Expression of Interest pool**. It should select those with the highest points first; actively publicise the point ranges of the successful applicants to emphasise that the minimum threshold is not the target, and raise the minimum threshold on a regular basis to manage application volumes.*

Agree

*Recommendation 7*

*MBIE should develop more **data-informed and dynamic skills shortage lists**. Occupations that have shown no labour market reaction (such as wage movements), high turnover rates and a continued reliance on temporary migrants, should be brought up for review, with the burden placed on the industry to provide sufficient evidence to justify their continued placement on the list.*

Agree.

*Finding 13*

*New Zealand is unusual in giving **permanent residence visa holders an indefinite right to return**, even if they have re-migrated elsewhere in the world. Other countries either require residents to return at regular points or remain in the country for specified periods if they wish to retain or renew their permanent residence visa.*

Agree

*Question 5*

*Should the **right to return for permanent residents** who re-migrate out of New Zealand be limited? Under what conditions? What would be the costs and benefits?*

Yes. I think the current system encourages migrants who want a bolt-hole far away from potential trouble spots or who want a back-door way of getting into Australia. This must lower their commitment to New Zealand and, if the numbers keep growing, increasing

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<sup>57</sup> P47 Findings paper

our vulnerability to surges in numbers who may suddenly want to return to New Zealand.

*Question 6*

*Should efforts by migrants to learn **te reo** be recognised in the residence or permanent residence approval process? If so, how would this best be done?*

No. I think introduction of such an incentive or requirement is likely to put off some otherwise highly skilled and qualified migrants given the very limited utility of te reo compared to other (international) languages. This is especially likely to be the case for migrants who do not speak English as their first language and who would likely be better off (for themselves and New Zealand) improving their English, and for potential migrants who need to study to gain New Zealand recognition of their professional qualifications.

*Recommendation 8*

*The Government should **remove visa conditions that tie temporary migrants to a specific employer**. These conditions increase the risk of exploitation and limit the ability of workers to find better job matches, which can promote wellbeing and productivity. Where there are concerns about displacement of New Zealanders, work rights could be limited to specific regions, occupations, industries or accredited employers.*

Agree

Mike Lear  
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8 December 2021