

The Economic Case for an Open-Door Immigration Policy

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Mark Harrison (1989) has argued in this journal that the level of immigration into Australia should be determined by equating the marginal benefits to existing residents with the marginal costs faced by immigrants. He further proposes that the consequent immigrant quota should be allocated by means of an auction.

While we agree with the Harrison rule for identifying the optimal level of immigration, we argue that the suggestion that the quota can be auctioned for positive value stems from an unrealistic view of the immigration process. In the absence of distortions that we identify, a better proposal would be to remove all quantitative restrictions on immigration, since an 'open door' maximises the economic advantages accruing to existing Australian residents.

It may be desirable to hold a quota auction or charge an entry fee when the 'reservation wage' immigrants require (i.e. the wage required to induce immigration) increases with the immigration level (Mr Harrison, in contrast, assumes the reservation wage is fixed). This is because any good or input in inelastic supply may be subject to an 'optimal tariff' that exploits the economy's market power in demanding that good. It may also be thought that an analogous quota may be optimal when there are 'unpriceable' externalities associated with immigration, but we argue elsewhere that the conditions under which this is true are very stringent (Clarke & Ng, 1990a).

Finally, we argue that even if charging fees is less beneficial than an open-door policy, it is in some circumstances superior to quantitative restrictions on immigration.

We stress at the outset that we are concerned solely with the **economic** advantages accruing to existing Australian residents from immigration. We do not consider the broader social and cultural issues associated with the level of immigration.

The Harrison Model

The basis of Mr Harrison's analysis is 'club theory'. A potential immigrant is seen as attempting to gain membership of the 'Australian club', which includes all residents of Australia. Mr Harrison assumes that once membership has been granted, immigrants automatically receive (gratis) the average benefits enjoyed by existing members. Since these average benefits exceed the marginal benefits derived from immigration at the level of the desired immigration quota (i.e. where the marginal benefits to existing members equal the marginal costs faced by new members), it follows that new members can be induced to pay a membership fee. The idea is that the value of the membership fees can be maximised by auctioning the immigration quota; the proceeds can be transferred to existing members to compensate them for the effect new members have in reducing average living standards.

This argument is sound so long as immigrants receive average Australian benefits upon entry. But, so long as Australia is viewed as being a reasonably competitive economy, this is not how immigration works. New immigrants do not automatically enjoy equal membership of the Australian club. As workers in competitive labour markets they will be paid the value of the **marginal** product of their labour rather than the **average** product. Thus, for small immigration levels, immigrants get paid what they contribute to society: neither more nor less. Higher immigration levels will tend to decrease the value of labour's marginal product and hence wages. However, as is well-known from standard economic analysis of international factor movements, the increase in payments accruing to other productive inputs (capital, land and other resources) must more than offset this reduction in wages. On average, therefore, existing Australian residents are **always** better off with immigration.

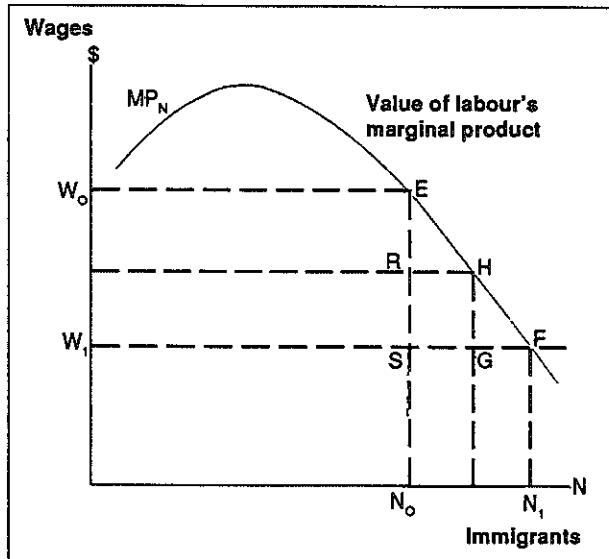
This can be easily seen in Figure 1, which illustrates the value of the marginal product of labour (MP_N) at different labour supply levels. The current labour supply is N_0 ; assuming labour is paid its marginal product, the current wage is W_0 . Assume a fixed reservation wage W_1 is required to induce migration and that W_1 is less than W_0 . When $N_1 - N_0$ immigrants come to Australia, the wage is reduced to W_1 . The immigrants receive area SN_0N_1F in earnings but contribute area EN_0N_1F to production, thus generating a net gain of area ESF to existing residents. Thus the loss in wage earnings is more than offset by the gain to non-wage incomes.

To Fee or Not To Fee

The same point can be made in a different way. It may at first seem sensible for existing residents to impose an immigration fee HG that extracts revenue equal to the area $RSGH$ from immigrants. However, if we ignore distributional effects, or assume the

possibility of lump-sum compensations, the optimal immigration fee from the viewpoint of existing residents is zero, because any positive immigration fee leaves some potential positive gain to existing residents unexploited (with the fee HG these unexploited gains are represented by the area HGF). With a zero

Figure 1



fee we move to the point F where the gain to existing residents is measured by the area ESF , which is the maximum gain possible. While the immigration fee HG generates revenue equal to area $RSGH$, it reduces the net gain to existing residents by the larger area $RSFH$.

However, a positive immigration fee makes sense if the immigrants' reservation wage is not fixed but increases with the level of immigration. In this case the effects of a positive immigration fee in restricting immigration are analogous to restrictive employment policies by a monopsonistic firm (i.e. a firm whose position as sole purchaser of labour gives it considerable market power). This is illustrated in Figure 2. Here, S is the supply curve of immigrants and MC is the curve marginal to S . The optimal immigration fee AB is determined where MC equals the value of labour's market product. This leaves apparently unexploited gains to existing residents of ABC but it is not possible to extract these gains without price discrimination, i.e. paying different workers different wages for doing the same job.

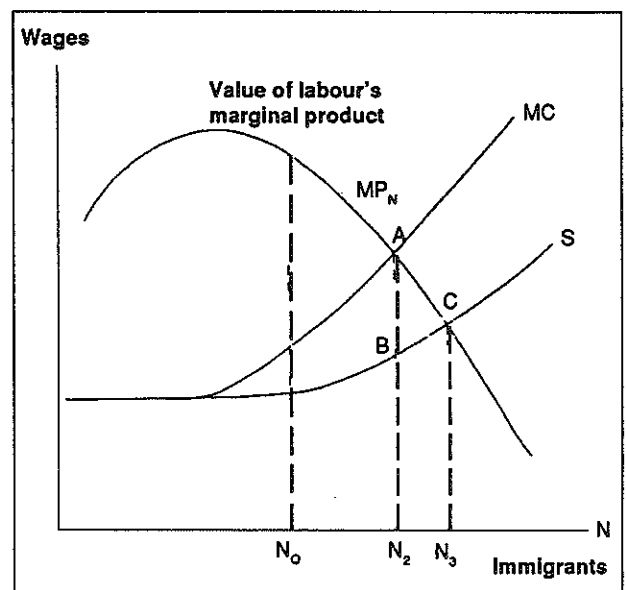
It is questionable whether the supply curve of immigrants has significant elasticity but, even so, the case for imposing a fee may be challenged on moral or political grounds. Just as we do not sell the right to vote because of what Tobin (1970) calls a 'specific egalitarianism' preference for universal suffrage, we may not wish to sell citizenship rights if this meant that, for example, the racial or religious composition of society would depend on the existing wealth dis-

tribution both inside and outside the country. (See Ng, 1988, for a treatment of these issues.)

However, from a purely economic point of view, a fee in some respects has better welfare effects than a quantitative restriction, since the latter is equivalent both to an infinite fee for those who fail the admissions test and to a zero fee for those who pass it. In fact, as Ramaswami (1968) notes, even when the supply curve of immigrants is upward-sloping, a fixed quota not supported by a fee is inferior, from the standpoint of existing residents, to an open-door policy: since no tax revenues accrue to residents, it is optimal to maximise the 'gains-from-trade' advantages promoted by unrestricted immigration. Some provision must certainly be made for family reunion and humanitarian immigration by reducing or waiving fees. However, for other categories of immigrant, a fee will not only be better than a quota, but will also have better welfare effects than some asset test (e.g. allowing entry to immigrants who bring in a certain amount of capital), since, with internationally-mobile capital, money brought into the economy will tend to crowd out capital elsewhere.

Our analysis has emphasised the effects of immigration on factor markets. But its consequences for the ownership of resources and for gains from trading in asset markets are equally clear. If migrants wish to own Australian houses, land, business premises and financial assets, they must pay for them with their savings. Moreover, the purchases must take place at prices seen as favourable by existing Australians. In short, if immigrants have to pay their

Figure 2



way rather than just be given the average benefits accruing to Australians upon entry, then, on average, existing residents cannot be made worse off with **unrestricted** immigration.

Some Possible Objections

There seem to be three main challenges to our case for an open-door policy from an economic viewpoint: (i) immigrants impose unpriced external costs such as increased pollution and congestion on existing residents; (ii) some of the resources receiving increased payments as a consequence of immigration may be foreign-owned; and (iii) the Australian welfare state, by taxing incomes and redistributing them to the population as a whole (including immigrants), may spread gains from increased trade opportunities so thinly that no net advantage may accrue to existing residents.

These arguments are unconvincing. As for (i), resources can be appropriately priced (or managed) and the revenues so obtained can be used to compensate existing resource-owners (see Clarke & Ng, 1990b). Changes in tax policy could offset the problem identified in (ii); in any event, it is the vast bulk of non-traded fixed assets (e.g. houses and land) that experience the most substantial rental increases with immigration, and these are predominantly owned by residents. Finally, (iii) is valid only if immigrants free-ride on the Australian welfare system more than existing residents by paying a proportionally lower ratio of taxes to public benefits received. The evidence from many studies (e.g. Simon, 1989) suggests that the reverse is true, since immigrants make above-average tax contributions to public expenditures.

These arguments do not therefore provide valid economic grounds for quantitative restrictions on immigration.

References

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Rejoinder

Mark Harrison

In my original article I addressed two distinct questions: First, what is the optimal policy given that immigration is to be restricted? Second, should immigration be restricted?

I think Dr Clarke and Professor Ng agree with my conclusion on the first question, i.e. that a price mechanism to help select immigrants would be a substantial improvement on present policy. An additional benefit is that Australians would have an incentive to admit more immigrants when they receive more revenue from doing so. This is likely to move immigration towards its optimal level, regardless of whether my analysis or Clarke and Ng's is correct.

On the second question, Clarke and Ng argue that the optimal level of immigration would be reached if immigration were unrestricted. They claim that 'the suggestion that the quota can be auctioned for positive value stems from an unrealistic view of the immigration process'. This means that they believe that the optimal immigration quota cannot be sold at a positive price; or, equivalently, that no entry fee should be charged to immigrants when immigration is unrestricted.

Clarke and Ng's entire analysis is based on the assumption that immigrants receive their marginal contribution to society. I readily concede that if we focus on narrow economic advantages accruing to Australians and assume that all assets are privately-owned then they would be correct. However, much of Australia's output consists of publicly-provided goods distributed on the basis of non-market principles, and many assets are publicly-owned. Much publicly-provided output is distributed in ways that give new immigrants as much claim as resident Australians. Underpricing publicly-owned assets can result in congestion and in immigrants imposing external costs on Australians. Immigrants will share in the revenue from government-owned assets, such as mineral rights. It follows that new immigrants can receive significantly more than their marginal benefit to residents. This provides a case for restricting immigration, whether by setting a quota and auctioning it or by charging an entry fee.

Clarke and Ng's response to this is that the best policy is to price the asset or output properly and use the revenue to compensate resident Australians. But they do not address the question of how the increased revenue from, and increased value of, publicly-owned assets can be distributed so as to ensure that resident Australians benefit from immigration. This can be done only by directly discriminating against immigrants in the distribution of revenue. But if immigrants are to be discriminated against after entering the

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