

# **Immigration and wage growth**

**Discussant paper, Low Wage Growth, RBA Conference 2019**

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## Acknowledgements

Many thanks to the Reserve Bank for picking what is an excellent topic, for three reasons. First, explaining slow wage growth is a genuinely difficult but interesting intellectual problem where thoughtful and well-informed people disagree about the big things rather than the footnotes. Second, it's a current policy issue that is front and centre of political and policy debate, and how you explain the phenomenon has a big impact on the policy responses. And third, it's particularly unusual to have a topic that fits both those criteria at the same time.<sup>1</sup>

Thanks too to the Reserve Bank for assembling so many thoughtful and well-informed people to talk about the issue in this environment that is so conducive to a thoughtful and informed discussion.

Thanks to Prof Christian Dustmann for a very thorough review of all the ways we could think about the effects of migration on wages, and of the literature that has tried to do so. It's a very clear structure for approaching the part of the problem that I've been asked to discuss.

I'm not going to be able to add very much to the literature analysis that Christian has provided. One conclusion that might be drawn from his paper is that the most reliable evidence on this question in Australia is the paper written by Robert Breunig for the Productivity Commission.<sup>2</sup> Robert is a participant in this conference, and infinitely better qualified than I am to talk about that paper's analytical approach.

The weight of that literature establishes that *in general* migration does not lead to slower wages growth. But I want to ask whether a substantial influx of low-skill young migrants might lead to slower wages growth for low-skill low-experience jobs, particularly when there is a

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1. I should also acknowledge helpful comments on an earlier draft of this paper from a number of conference participants, Grattan staff, Henry Sherrell, and Abul Rizvi.
  2. Breunig et al (2017), originally published as Technical Supplement A to Productivity Commission (2016), *Migrant Intake into Australia*.

relatively high minimum wage. I will suggest that the literature might be missing something because it uses data that are likely to miss some of what is going on, and it uses models that look for a general effect rather than taking into account the specific issues that arise with a legislated minimum wage.

## A story

My approach starts with my two daughters, aged 18 and 20, living in Melbourne. Both of them are studying, both of them are working part-time. Both of them have lots of friends with jobs that pay less than the minimum wage. 'Everybody knows,' they tell me, 'that you don't get a minimum-wage job unless you have a couple of years of experience on your resume. And if you haven't got experience, then you work in retail or hospitality where it pays \$14 an hour.' I note that this is casual work, so the minimum wage is around \$18 an hour, depending on age.

One should be careful not to extrapolate too far from one anecdote and two data points. But the interesting thing about this story, confirmed by conversations I've had with a number of other parents, is that their children all seem to know what is the accepted market price for this kind of low-skill student work. Not surprisingly, the price appears to vary by location, no doubt depending on the local supply and demand for labour, and it is often, but not always, beneath the minimum wage.

## Data issues

So is this a general story? The short answer is, we don't know. Data on people being paid less than the minimum wage is inherently ropery.

The data sources are picking up *some*, but I suspect nothing like *all*, of the underpayment.<sup>3</sup> A lot of this work is not reported accurately to the ATO, because it is part of the cash-in-hand grey economy, or the

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3. For a discussion of the issues, see Nelms et al (2011).

hours worked are misreported. HILDA will pick up very few temporary migrants: its data only includes households that entered the last panel intake in 2011, and as I will show, temporary migrants who have arrived since then are likely to be a material part of the story.

Even when data sources do contain a representative sample of the population, they may well under-report underpaid wages. Employers are unlikely to tell survey collectors that they underpay.

Employees may also be reluctant to 'fess up. If many of those being underpaid are in breach of their visa conditions because they are working more hours than are permitted, they are unlikely to draw attention to themselves. For people entitled to work, \$14 an hour is better than no work at all, and they may well prefer not to imperil their employment. And it doesn't matter how much the survey collector promises that the data is anonymous, the risk of the collector passing on the information to authorities is likely to be *perceived* as much greater than the risk of simply telling fibs to the collector.

What we do know is that when the Fair Work Ombudsman (FWO) conducted a review of 20 7-Eleven stores, it found that 60 per cent appeared to be underpaying staff, and record-keeping was inconsistent, incomplete or misleading in 95 per cent of stores.<sup>4</sup> As Allan Fels, appointed by 7-Eleven to investigate found, 'My strong impression is that the only way a franchisee can make a go of it in most cases is by underpaying workers.'<sup>5</sup>

The FWO investigation of horticulture and viticulture businesses along the Harvest Trail found serious underpayment at 130 of the 836 businesses investigated.<sup>6</sup> And a series of other FWO investigations suggest that underpaying of low-skill migrant workers is widespread.<sup>7</sup>

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4. Fair Work Ombudsman (2016).

5. Ferguson and Toft (2015).

6. Most of the businesses were randomly selected: Fair Work Ombudsman (2018).

7. Keane (2019).

Peter Mares' book, *Not quite Australian*,<sup>8</sup> recounts many stories, particularly of working holiday makers who earn the right to spend a second year in Australia provided that they work for at least three months in a regional area in a primary industry.<sup>9</sup> The scheme gives employers enormous bargaining power, and as a result, Mares claims, many migrants work for much less than minimum wages.<sup>10</sup>

Once underpayment takes hold in a material minority of cases in a particular labour market, it can change how other employers behave. If a dishonest employer underpays, then they can offer prices that undercut an honest employer who does pay minimum wages. So if in a particular industry a significant number of employers employ and underpay many migrants, then they pressure all the other employers in the industry to do the same – and to underpay *non*-migrants as well.

### The problems for assessing the economic effects of migration

If underpayment of temporary migrants is a general story – and I repeat, we don't have the data to know for sure – does it matter?

At the very least it questions some of the assumptions made by those trying to assess the economic effects of migration. The quality of the analysis can only be as good as the underlying data. If a material number of people are being paid less than the minimum wage, there's a good chance that they're not going to show up in the data being analysed. Wage growth in low-end jobs may be even lower than the statistics suggest, because wages in these roles are systemically under-reported.

Of course, these unobserved wages may affect the wages that can be observed in the official economy. An employer is under less pressure

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8. Mares (2016).

9. Department of Home Affairs (2019a). See also Commonwealth of Australia (2019).

10. Mares (2016, pp. 233-243).

to pay *more* than the minimum wage, because earning the minimum wage is a lot more attractive than alternative employment for many of the potential employees. As my children tell me, there tend to be a lot of applications for any job with a 'big' employer known to reliably pay the minimum wage.

The effect of migrants being paid less than minimum wages also creates methodological issues. If minimum wages don't in fact bind (and at least some of the time I suspect they don't), then you get a discontinuity around the minimum wage. If an employer is going to pay close to the minimum wage, they might as well pay the wage properly and put an employee 'on the books'. But if the employer is not going to pay minimum wage then it makes sense to pay materially less, given the administrative headaches that might come with failing to pay 'on the books'. That discontinuity needs to be fed into any modelling.<sup>11</sup>

Of course, the issue I am raising does not affect a majority of Australia's workforce. The majority are paid on the books, and much more than the minimum wage. But a little over 20 per cent of the workforce are paid at minimum wages,<sup>12</sup> suggesting that 'low skill' employment at or below minimum wages could be big enough to matter.

### What the data does show

The key study on migration and labour force outcomes for Australia by Breunig et al, as Dustmann identifies, compared employment outcomes (wages, participation and unemployment) with the proportion of migrants for segments of the labour force, each with a different combination of education and experience.<sup>13</sup> It found few statistically

significant associations between employment outcomes and the proportion of migrants, and any effects were small. The most significant effect was that higher immigration was associated with *lower* unemployment for women.

But this study used Census data from 2001 to 2011. As shown below, the shape of Australia's migration system<sup>14</sup> has shifted significantly over the past six years, towards younger, less-skilled migrants.<sup>15</sup>

The effects of this shift may be visible in more recent data that tracks wages growth by skill level and age. The paper by Kalb and Meekes presented at this conference<sup>16</sup> tracks the wages growth of individuals over the period 2002 to 2008, and over the period 2009 to 2017.<sup>17</sup> Across the sample, annual wages growth is about 2 per cent per year slower between 2009-2017, when compared to 2002-2008. But wages growth has decelerated more for younger people. Those aged under 30 have wages growing 3 per cent per year slower between 2009-2017, when compared to 2002-2008. And wages growth in low-skill occupations, particularly sales and machinery operators and drivers, has decelerated a lot. Sales has gone from being an occupation with relatively high wages growth (10 per cent per year) between 2002-2008 to relatively low wages growth (only 6 per cent per year) between 2009-2017.<sup>18</sup>

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14. I use the term 'migration system' in deference to official sources that arbitrarily exclude temporary migrants when they refer to Australia's 'migration program'.

15. An update to this analysis published after these remarks were delivered used data from the ABS Survey of Income and Housing (2015-16): CEDA (2019). This more recent study came to similar conclusions as the Breunig study, although it did not test the specific hypothesis that young low-skill workers are being particularly affected by the influx of temporary low-skill migrants.

16. Kalb and Meekes (2019).

17. Tracking individuals as they gain experience, and often higher wages, this study observes wages growth much higher than for the workforce as a whole (which maintains more or less constant levels of experience as older people exit, and younger people enter, the workforce).

18. Kalb and Meekes (2019, pp. 12-13).

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11. This discontinuity may be mitigated if an employer is tempted to pay minimum wage (forestalling complaints from the employee), but keep them off the books (to avoid other on-costs such as payroll taxes and workers' compensation insurance).

12. 'Award only' workers are 22 per cent of employees: ABS (2019a).

13. Breunig et al (2017).

### Australia's low-skill migration system

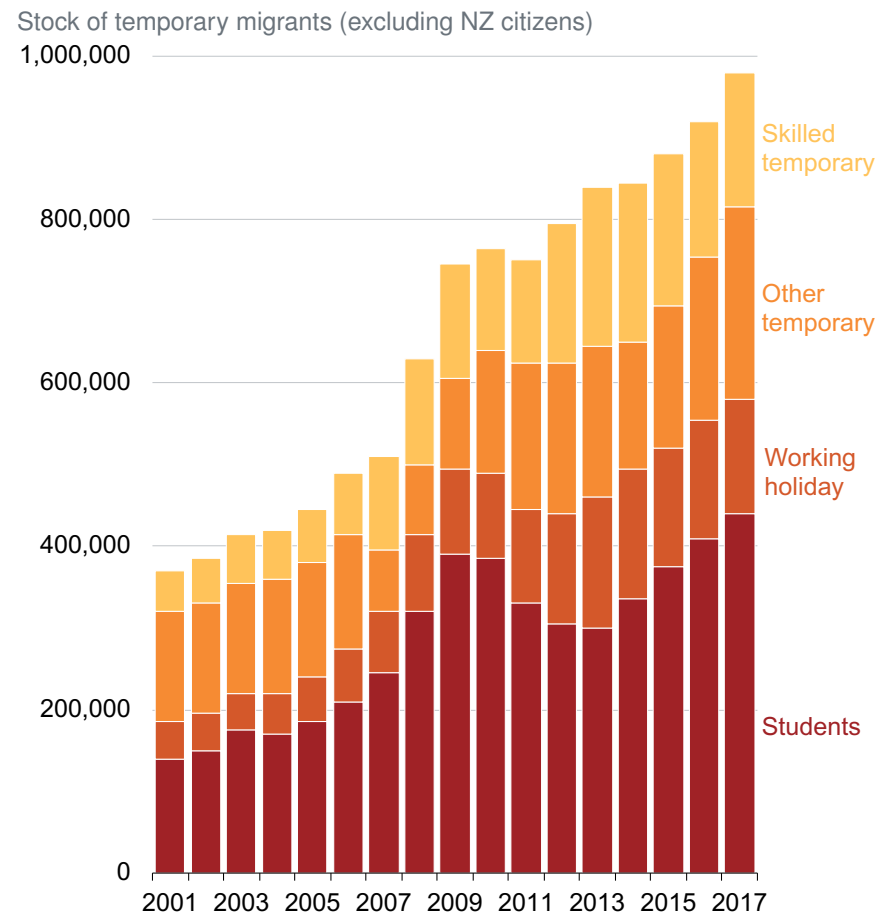
Many believe that Australian migration is highly skilled and has nothing to do with the underpayment of minimum wages. That might have been true in the past, but it's less true now.

Some migrants are permanent. But many are temporary, although they can remain 'temporary' in Australia for a long time, before either leaving or transferring onto a permanent visa. The growth of long-term temporary migrants is the consequence of a migration system that has quotas for the number of permanent visas issued, but doesn't cap the numbers of some categories of temporary visa.

As a result, the number of temporary migrants (other than New Zealanders) in Australia has almost doubled since 2007 to almost 1 million (Figure 1). That's 4 per cent of the population (migrants in total are about 28 per cent of the population, most are now citizens, and many have lived in Australia for decades). New migrants to Australia are disproportionately 18-40 years old.<sup>19</sup> They have particularly strong incentives to work because they generally don't qualify for welfare payments. Consequently, temporary migrants are about 10 per cent of the younger-aged workforce.<sup>20</sup>

Of those 1 million temporary migrants, 450,000 have student visas, and 150,000 have working holiday visas. If they were all working,<sup>21</sup> then around 4 per cent of Australia's workforce of almost 13 million

**Figure 1: Australia's stock of temporary migrants increased rapidly from 2007**



Source: Treasury and Department of Home Affairs (2018, figure 16).

19. See Daley et al (2018, p. 34).

20. Dhillon and Cassidy (2018) estimate that 10 per cent of the 15-24 year-old workforce are migrants (a large proportion would be temporary). The Productivity Commission estimates that students and working holiday makers are 12 per cent of youth employment: Productivity Commission (2016, pp. 199-201).

21. The ABS survey of recent migrants reports that 63 per cent of students and 71 per cent of all other temporary migrants are employed. As discussed above, official data is likely to understate employment rates: ABS (2017).

people<sup>22</sup> are relatively lower-skill temporary migrants. In addition, there are 250,000 temporary migrants on 'other' visas.<sup>23</sup>

Of those temporary visa holders who do work, most (59 per cent) are in low-skill occupations. Of those with student and working holiday visas who work, even more (about 75 per cent) are in low-skill occupations, primarily labourers and personal and community service (Figure 2).<sup>24</sup>

If we look at the *flow* of migrants, the story is even starker. Net overseas migration for 2017-18 was 237,000 people. Of these, 105,000 (of the *net* migration) were students, 27,000 were working holiday makers, and 58,000 were visitors<sup>25</sup> (Figure 3 on the next page). We do not know how many of these visitors are low-skill. As Rizvi has analysed,<sup>26</sup> these 'visitors' include mainly workers who are effectively employer-sponsored and apply for a working visa once onshore, partners who are avoiding ballooning processing times for spouse visas, and people whose claim for asylum can be pending determination for several years (today, overwhelmingly those who have arrived by plane).

These categories have formed a growing share of net overseas migration over the past few years (Figure 3). About three quarters of

22. ABS (2019b).

23. These include recently graduated international students with a right to work in Australia for two years after graduation, and people with 'employer sponsored' visas, or 'bridging visas' pending determination of other applications. Many of these migrants may also not be high-skilled, particularly if they came to Australia as visitors and then transferred visa category.

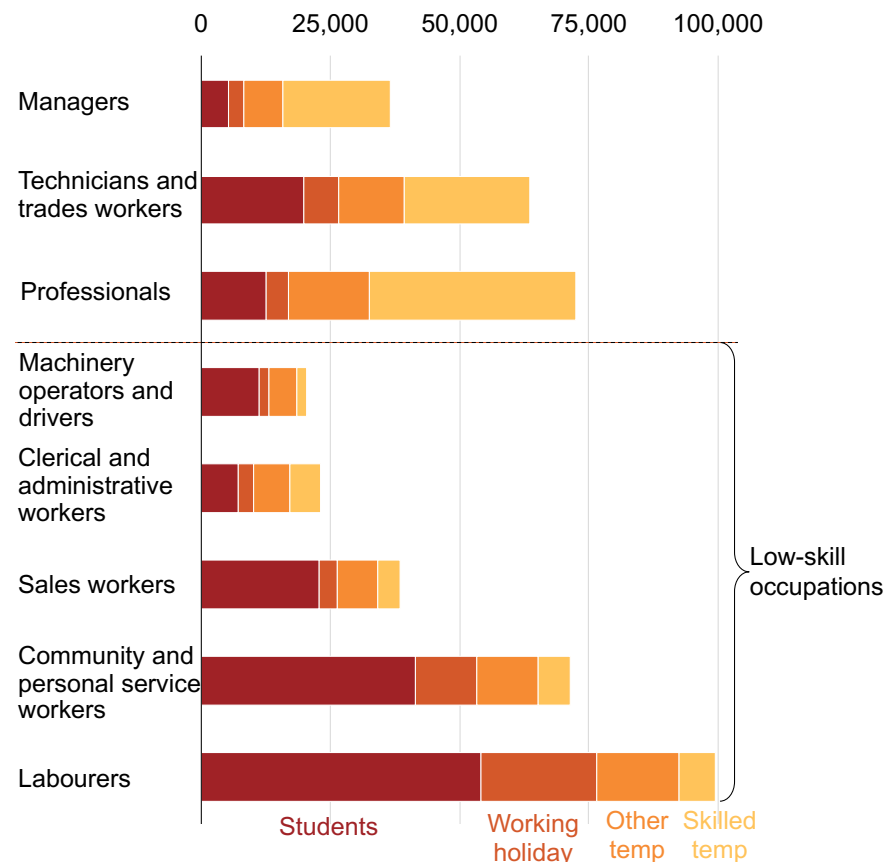
24. Based on ABS (2019c). This publication illustrates the issues with data collection from temporary visa holders. According to the migration records, there are about 600,000 people in Australia with student or working holiday visas. But the matched dataset from the Census identifies only about 230,000 people with these visas who are working. That number is implausibly low.

25. These figures only include people who stay in Australia for more than 12 months; they do not include changes in the number of short-stay visitors, which probably includes a substantial number of working holiday makers.

26. Rizvi (2019).

**Figure 2: Most students and working holiday makers are working in low-skill occupations**

Occupation by visa type, employed temporary residents, 2016

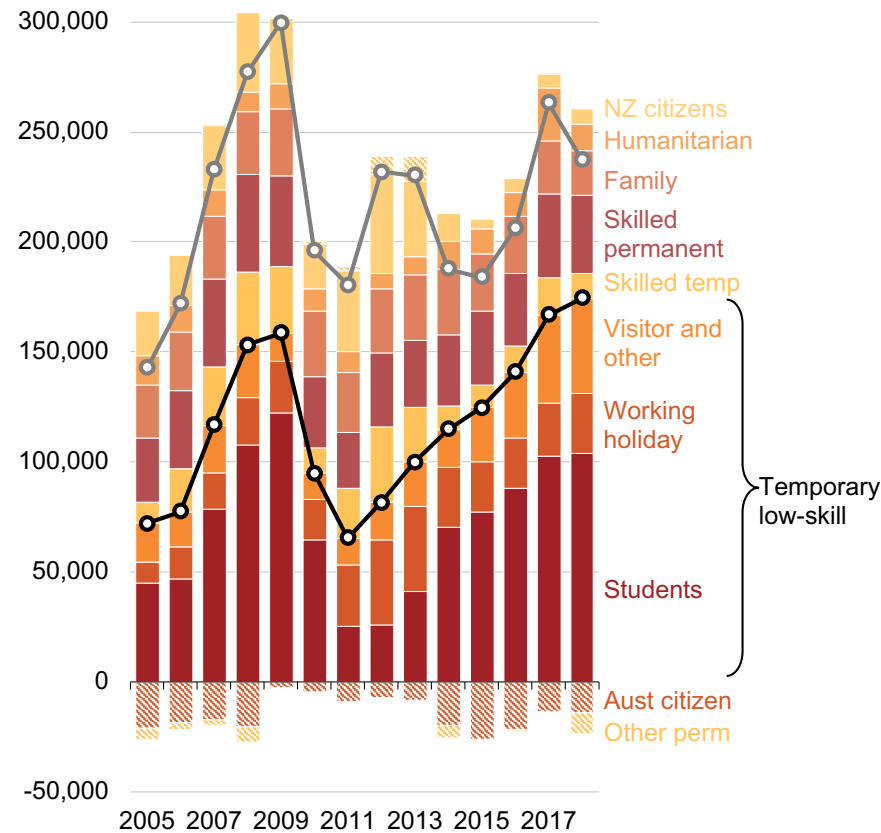


Notes: Temporary work = skilled, subclass 457; Working holiday maker = subclass 417 and 462. Special category visa (subclass 444) for New Zealand citizens not shown.

Source: ABS (2019c, table 16).

**Figure 3: An increasing proportion of migration to Australia is relatively low-skill**

Net overseas migration (NOM), financial year ended

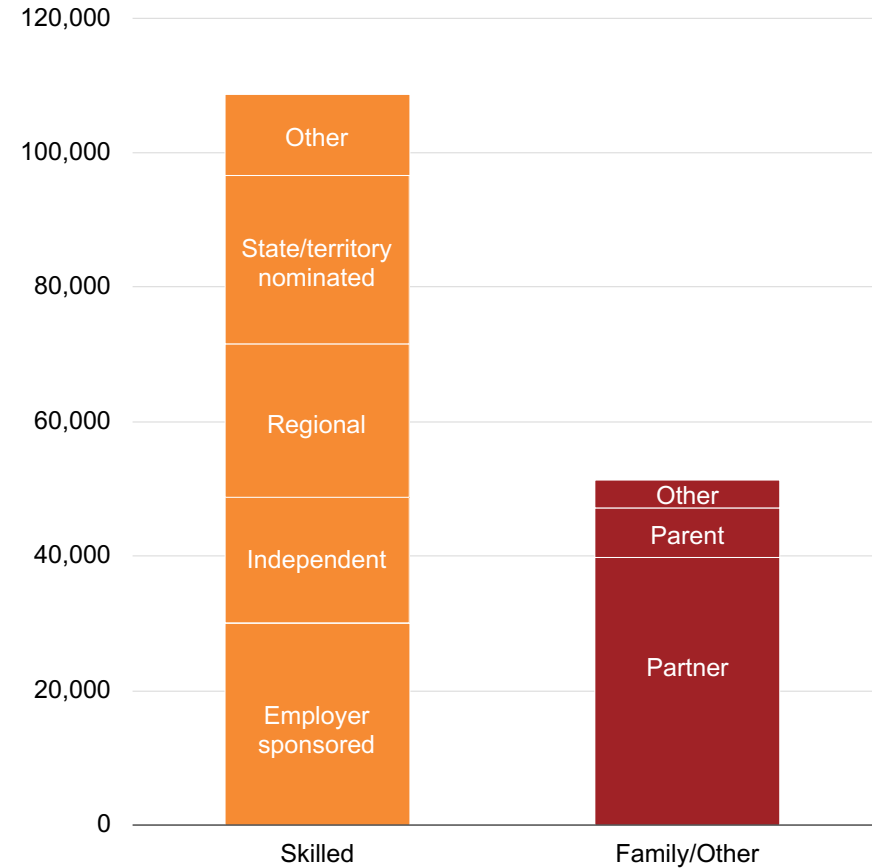


Notes: This analysis is approximate because arrivals are classified by the visa used when entering Australia, while departures are classified by the last visa issued. So a person would add to 'Student' NOM when entering with a student visa, and subtract from 'Visitor and other' NOM when departing on a temporary graduate visa.

Source: ABS (2019d).

**Figure 4: Most permanent migration is skilled**

Permanent migration visa quotas, 2019-2020



Source: Department of Home Affairs (2019b).

net migrants to Australia today are not high-skill, at least when they arrive. Permanent migrants, by contrast, are much more likely to be high-skill (Figure 4).

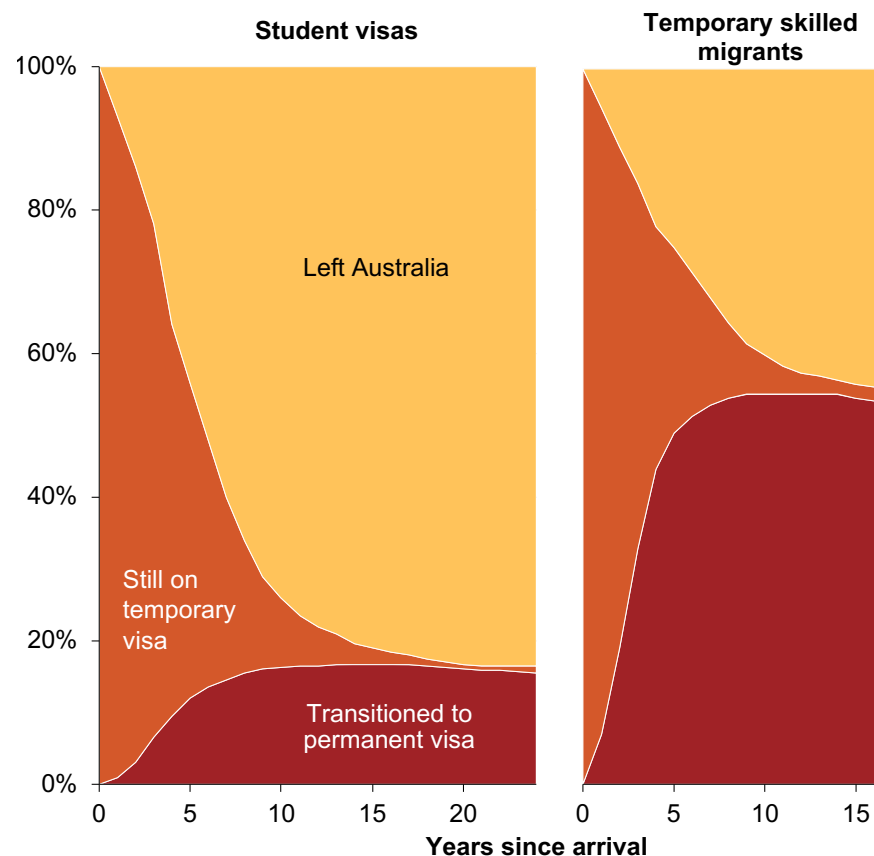
Some of the temporary student migrants will complete their course, and ultimately work in more highly skilled roles as they become more experienced. But most don't. While 50 per cent stay for 5 years, almost 80 per cent have left within 10 years (Figure 5). So most student visa holders leave before they have acquired much experience, and they are replaced by an even larger fresh cohort of young students, with limited skills and experience. The *stock* of temporary students remains relatively low-skill. This contrasts with skilled temporary visa holders, most of whom become permanent residents within 4 years, although a substantial number remain as temporary migrants for longer (this category appears to be growing as quotas for permanent visas are tightened).

#### How might low-skill migration be affecting labour markets?

As the Productivity Commission noted, where migration does displace existing populations, it tends to affect people with low skills and youth most.<sup>27</sup> That seems to be happening in Australia. And because international students and backpackers are primarily looking for part-time work, they may affect *under*-employment more than *un*employment.

Youth under-employment was about 13 per cent between 1993 and 2008, and has risen to about 20 per cent today, with a significant increase starting in about 2013 (Figure 6). This timing does not coincide particularly closely with the increase in the stock of temporary migrants (Figure 1).

Figure 5: Skilled temporary migrants are much more likely than students to become permanent residents

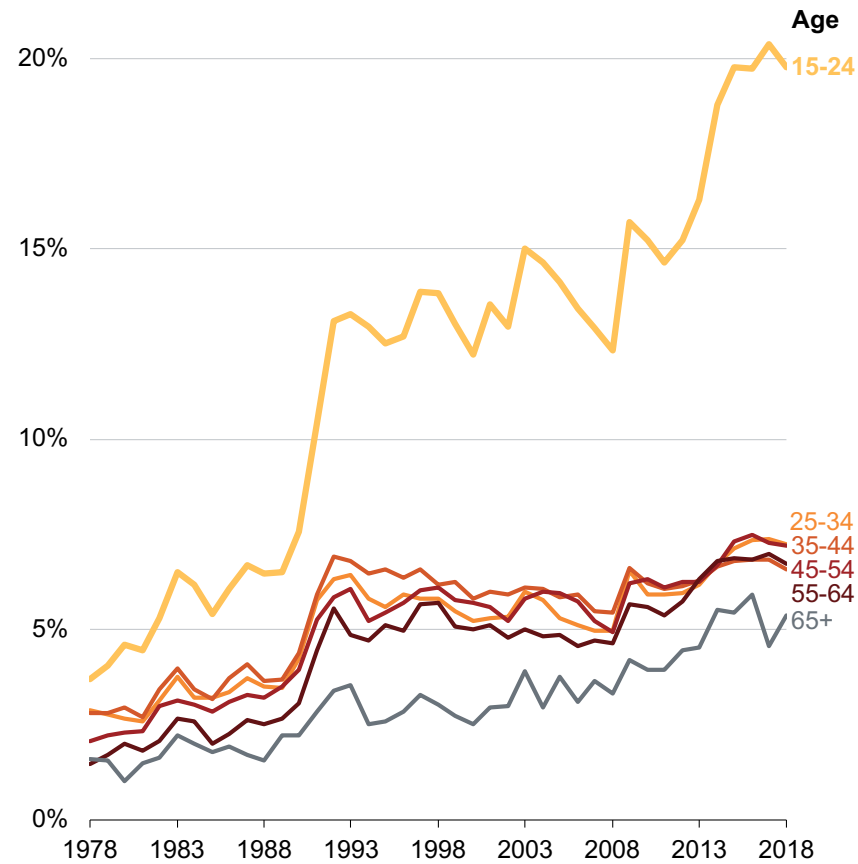


Source: Treasury and Department of Home Affairs (2018, figure 18).

27. Productivity Commission (2016, p. 199).

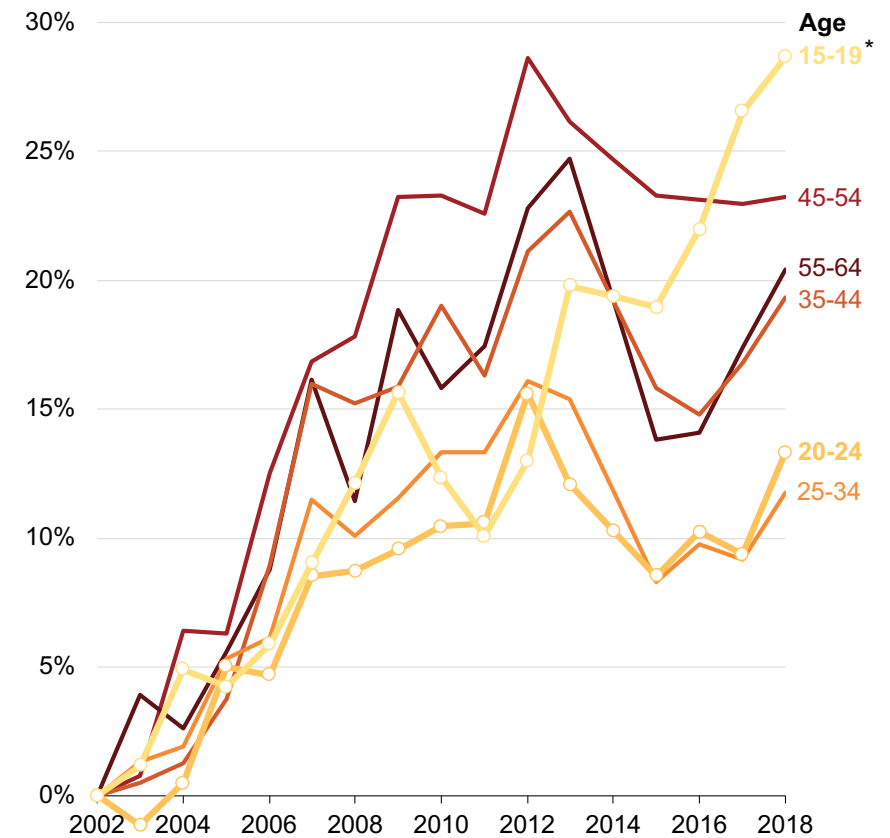


**Figure 6: Under-employment has become a big issue for young people**  
 Proportion of employed people who are under-employed



Source: ABS (2019b).

**Figure 7: Measured wages of workers aged between 20 and 34 have been growing more slowly**  
 Cumulative real change in average earnings for full-time employees in main job



Notes: More than 40 per cent of employed 15-19 year-olds were on award wages in 2018, compared to 15-20 per cent for other age groups.

Source: ABS (2013) and ABS (2018).

Low-skill migrants might also put downward pressure on wages (if accurately measured). The *measured* wages of those aged 20 to 34 have not risen as fast as the wages of older workers for some time (Figure 7). Measured wages for 15-19 year-olds have risen faster, because a much larger proportion of this age group are paid award wages, and the Fair Work Commission has increased minimum wages substantially faster than average wages over the past few years. This pattern, based on ABS labour force surveys, is consistent with the paper by Kalb and Meeke for this conference discussed above, which suggests that wages growth decelerated more after 2008 for workers under 30 and in some low-skill occupations and industries.

### Summing up

Australia is now running a predominantly *low-skill* migration system. People from this system form a material proportion of the younger workforce. Because of visa conditions, many of these migrants have incentives to work for less than minimum wages, and there is anecdotal evidence that many do. It is impossible for data sources on the Australian labour force to pick up all of this phenomenon. It is possible that the scale of this influx to the labour market is depressing wages and increasing under-employment specifically for low-skill younger workers.

Migration can't possibly explain more than a portion of the low wage growth story. The migration I have described would affect outcomes only towards the bottom of the income distribution. It does not explain why wage growth is also slow at the middle and the top of the income distribution. Migration may have led to lower wage growth and higher under-employment for youth workers, but it cannot be the primary culprit behind the broad-based slowdown in wage growth. The dominant explanation for low wage growth will have to be found in the other contributions to this conference.

It is an open question whether low-skill migration might explain low wage growth in other countries. As Dustmann's paper shows, many developed countries have experienced much faster rates of migration than Australia over the past decade as a result of the eastward expansion of the European Union, and migration from South to North America. The literature he outlines suggests that this migration has usually not much affected labour market outcomes in these countries.

### Policy implications

The primary policy implication is the interaction between Australia's minimum wage system and its migration system.

If Australia is going to run a substantial lower-skill migration system, and if it is committed to a minimum wages regime, then there should probably be more enforcement. In particular, the penalties are clearly far too low. At the moment, the major risk for an underpaying employer is that they might have to pay a portion of the wages that they should have paid in the first place. In terms of pure incentives, it is rational for many employers to underpay. That's particularly the case if the employer's competitors are underpaying. If there is little consequence for breaking the rules, then the overwhelming incentive is to cheat – repeatedly. It is likely that there would be less underpayment, despite migration, if the penalties for underpayment were higher – in particular if employers who systemically materially underpaid could go to jail – and if there were rather more resources dedicated to effective enforcement.<sup>28</sup>

It may also be that some visa conditions need to be rethought. Some conditions effectively give employers enormous bargaining power, and facilitate underpayment of wages. These conditions include the limit on international visitors working no more than 20 hours per week, and the additional residency permitted to working holiday makers who work

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28. Commonwealth of Australia (2019).

for a period in specified regions or in the agriculture industry. While these conditions serve public policy purposes, they need to be weighed against the cost of the extent to which they undermine Australia's minimum wages regime. And policy makers should consider alternative conditions that would serve the same public policy purposes, but give employers less bargaining power.

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