



## CHAPTER 1

# Mission Possible: *a framework for policy action*

***Labour migration is on the rise worldwide notwithstanding stringent restrictions on international labour mobility that impose a far greater burden on the global economy than trade restrictions. In recognition, government policy on migration needs to explicitly incorporate the economic impact of migration to both host and sending nations, in addition to security and social issues that traditionally dominate such assessments.<sup>1</sup> The purpose of this report is to enable a more meaningful discussion of the economic issues of migration in the Pacific context than has been possible to date.***



## Section 1.1 Introduction

The potential benefits of migration are especially important for small states and islands. The high costs facing small remote states may be well-known to policymakers, but what is new is the emerging recognition that existing prescriptions have been unable to mitigate these costs. Trade preferences, which were designed to provide access to markets until small producers gained competitiveness, have instead perpetrated inefficiencies in production and, in any case, are in question in the global trading environment. Similarly, aid, which has helped build infrastructure and deliver important services to recipients, may also have only limited ability to mitigate the disadvantages facing small states. If small states are to find ways to integrate globally by diversifying their economies in order to reduce economic volatility, then, along with efforts to improve their domestic business environments, the export of labour to deliver services to industrialised countries needs to be seriously considered as an option.

Of course, the movement of labour is not going to solve all the problems of the Pacific. No one policy instrument is ever a 'silver bullet'; and in the spirit of export diversification, no one sector for export should be expected to carry the burden of future development for the nation. However, any chance to broaden the export base and reap positive externalities for all citizens needs to be encouraged through the development of sound export strategies as well as the reduction of import barriers in destination countries. While the economist's favoured Heckscher-Ohlin model predicts that trade in goods could be a substitute for the movement of people (due to embodied factors of production) and could result in factor price equalisation across borders, in reality this has not happened. However, productivity adjusted wages do seem to be converging, and evidence shows that these differences in productivity are highly location specific (World Bank, 2006). This means that a ready stock of migrants would be able to raise their incomes by moving to high-paying locations. And if these new locations happen to be facing worker shortages, this creates an even more favourable scenario for mutually beneficial movement of labour.

This report is an attempt to look at the economic case for mutually beneficial movement of labour in the Pacific Region.<sup>2</sup> The movement of people, however, cannot be approached like the movement of goods since the movement of labour creates not just economic but also significant intended and unintended social consequences for both receiving and sending countries. Recognizing the complexity of this issue, this report attempts to shed light on some aspects of the economics of labour mobility through new research that presents empirical and analytical findings, while drawing on other studies and discussions to highlight the broader social consequences of the movement of people.

This report focuses on three main questions:

- (1) Are there demographic pressures facing the Pacific Region that set the stage for increased labour mobility?*
- (2) Where labour mobility exists, what has been the economic impact on households in migrant-sending countries through the receipt of remittances?*
- (3) If labour mobility was to be enhanced in the region, what sorts of migration programs could be designed to balance the benefits and concerns of sending and receiving countries?*

Chapters 2, 3, and 4 of this report deal with the above three questions respectively. Chapter 1 is organised as follows:

*Section 1.2 presents evidence of the challenges facing small island states and highlights the importance of economic integration in meeting those challenges.*

*Section 1.3 outlines the case for labour market integration in particular and presents evidence of the welfare impact of labour movements globally and in the Pacific Region.*

*Section 1.4 lays out the underlying framework for understanding the complex aspects of labour mobility in the Region. It provides a synthesis of the main empirical findings and policy implications of this report, positioning them in the global findings and literature where possible and relevant.*

## Section 1.2 Special Challenges Facing Small Island States

The issues that small states face have not received steady and rigorous attention until recently. Some 20 years ago small states were considered to be bestowed with special advantages, such as endowments of natural resources and small homogenous populations that allowed for political consensus to be reached easily and for adaptation to be made more manageable (Srinivasan, 1986). Even the presence of higher risk premiums for private investment was not considered a problem, as it was thought to be compensated for by higher aid flows. Their openness to trade was also considered an asset that positioned them for higher growth. Overall the message was that the lessons from the growth experience of other developing countries could be easily applied to small states (Easterly and Kray, 1999; Winters and Martin, 2004); and examples such as Hong Kong, Singapore, Luxembourg, Switzerland, and Qatar were cited to support these views.<sup>3</sup>

With time and experience, our understanding of these issues has progressed, in the process of overturning some of these views. We know now that greater openness to trade is also accompanied by greater volatility in small, undiversified economies that are price takers. Natural resources, unfortunately, can be more of a curse than a blessing as small populations typically have a difficult time avoiding capture by special interests since interest groups can be especially influential. We also know now that aid and private investment are not interchangeable, and that aid may crowd out investment and possibly undermine the incentive framework in some cases.

Efforts to quantify the costs of these constraints have highlighted the costs of size and location, as well as the significant costs of vulnerability to natural disasters that can impose economic volatility on the citizens of small states.

### COST OF SIZE AND LOCATION

The price of smallness manifests itself in the form of higher costs for transporting exports and imports, higher utility costs, and higher wages and rents (Winters and Martin, 2004). Given the price-taker status of small countries in world markets, these cost premiums are hard to pass on to customers, which implies that the only way these economies can export at world prices is if some factor of production accepts lower returns than it would get in larger economies. Winters and Martin (2004) have calculated such ‘income penalties’ and found that capital would earn negative returns if it were invested in a micro-economy and had to bear the cost of local inefficiencies. Similarly, even if wages were zero in a micro-economy, total costs would still exceed world prices (Table 1.1). This is true for manufacturing as well as a service industry such as tourism.

Why are the costs of smallness so large? Limited market size and geographic isolation have a lot to do with it.

## Market size

Market size is defined as the scale of economic activity over which agents can contract. Usually national borders define the scope of this contractual space. The larger this space the greater the potential for reaping economies of scale and the greater the scope for specialisation. Reaping economies of scale and scope requires specific investments in physical and human capital, as well as marketing channels, which are constrained when the scale of economic activity is small. This is true not only when producing and exporting goods, but also when providing government services—whether public utilities or general government administrative functions where indivisibilities in certain services can increase the overall size of the public sector.

**TABLE 1.1 CENTRAL CASE COST INFLATION FACTORS AND INCOME PENALTIES**

	Electronic assembly				Clothing				Hotels and Tourism			
	Micro	V. small	Threshold	Small	Micro	V. small	Threshold	Small	Micro	V. small	Threshold	Small
Cost inflation factor	36.4	14.3	5.0	2.7	36.3	14.3	5.1	2.7	57.5	28.5	11.9	6.2
Income penalty (% of median-country's income flow)												
all domestic supplies	-38.8	-11.6	-3.0	-1.2	-40.1	-12.0	-3.1	-1.3	-36.2	-17.4	-7.1	-3.3
factors and services	-42.6	-13.3	-3.6	-1.5	-44.7	-14.0	-3.8	-1.6	-46.3	-22.3	-9.1	-4.3
value added	-88.0	-29.2	-8.6	-3.8	-86.0	-28.6	-8.4	-3.7	-71.9	-34.0	-13.7	-6.5
capital	-245.1	-91.8	-30.9	-14.1	-263.9	-99.9	-34.0	-15.6	-202.1	-98.4	-40.5	-19.2
labour	-175.5	-62.5	-20.1	11.2	-161.0	-57.3	-18.4	-10.2	-116.5	-56.6	-23.4	-12.4

Source: Winters and Martin, 2004.

Of course, the moot question is how much does domestic market size matter if the country has open trade policies, which small countries do generally adopt? It appears to matter quite a lot, as international fragmentation seems to affect trade and capital flows, and consequently price equalisation. McCallum (1995) found that trade between Canadian provinces was 20 times larger than with an equidistant US state (despite the fact that the United States–Canada border is perhaps the easiest to cross, given similarities in economic development as well as broad cultural characteristics). Similar evidence from Engel and Rogers (1996) found that crossing a border is the economic equivalent of adding thousands of miles to the distance between cities. Parsley and Wei (2001) estimate that crossing the US–Japan border adds 43,000 trillion miles to the process of price convergence between cities.

These ‘border effects’ could also translate into a negative impact on output levels—and hence, possibly growth rates to transition into higher income levels—as trade has significant effects on income. An increase in trade of 1 percent raises income by 0.33 percent over 20 years (Frankel and Romer, 1999). As new small states emerge, so do new transaction costs, which seem to limit both foreign and domestic trade and, hence, income in the long run. It is possible that the increased transaction costs or border effects could be compensated for by the positive impact of sovereignty if the latter prompted independent nations to adopt policies superior to the ones that may have been imposed on them earlier. The broad empirical evidence from Africa, the Caribbean, and the Pacific however indicates that countries typically do not experience acceleration in their growth rates after independence. Furthermore, the evidence from the Caribbean suggests that the old independent states are the poorest while the dependants are the richest (Hausmann, et al., 2002). This suggests that the costs of sovereignty may not be trivial.

## Geographic isolation

In addition to market size, distance from markets or the main centres of economic activity plays a role in inflating the cost disadvantages faced by small countries. Remoteness or isolation from trading partners, as well as main economic hubs, exacerbates the disadvantages of small market size that prevent specialisation.

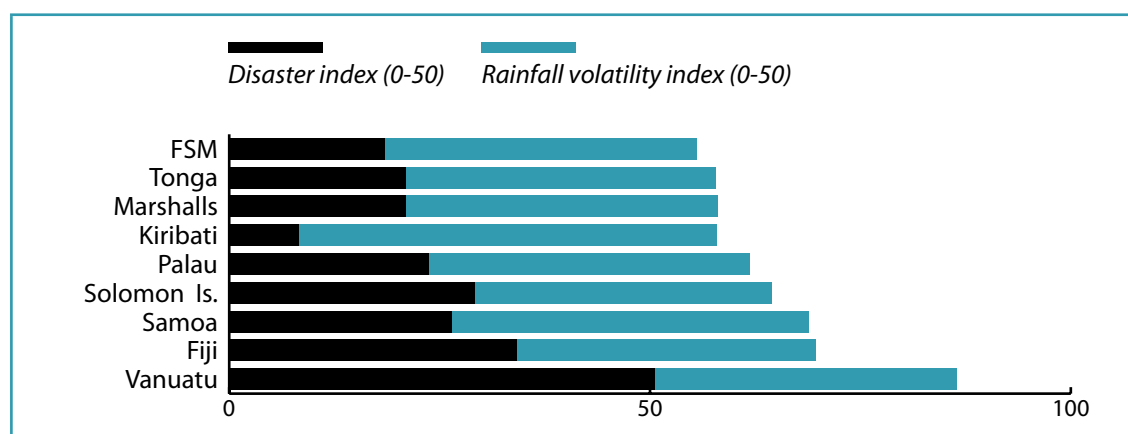
Most island countries that are small, particularly in the Pacific Region, are also remotely located. In empirical studies, it therefore becomes hard to disentangle the size effect from the isolation effect. Winters and Martin (2004) are able to get around this by introducing a distance variable into their regression equations for estimating costs. For sea freight costs, as well as the cost of passenger travel, distance turns out to have a significant effect. Given the large percentage of imports in the consumption basket and the need to export products to larger and faraway markets (particularly for the Pacific where inter-island trade is negligible), the higher cost of sea freight poses a major disadvantage to Pacific islanders. The high cost of passenger travel to distant locations also limits the ability of small islands to sell tourism services to the rest of the world. Another type of transaction cost faced by businesses in small states results from the disruption of services, such as utilities or the lack of skilled workers. If disruptions and skill shortages are true of small countries in general, then those small countries that are surrounded by miles of ocean—as is the case in the Pacific—must be affected much more.

## COST OF VULNERABILITY

Small countries, and small island countries in particular, tend to be more susceptible to natural shocks—that is, to both natural disasters (cyclones and other storms, floods, droughts, volcanic eruptions, and earthquakes) as well as volatile rainfall patterns. Brown et al. (no date) try to measure how vulnerability to natural elements translates into macroeconomic volatility. Figures 1.1a and 1.1b depict indices of natural disaster frequency and rainfall volatility for Pacific member countries (PMC).<sup>4</sup>

The data show that countries vary considerably in terms of their susceptibility to natural shocks, with Vanuatu, Fiji, and the Solomon Islands being the most susceptible. Also, susceptibility to natural disasters and general rainfall volatility are not positively correlated. Kiribati has by far the most volatile rainfall but is not so prone to other disasters. Less climatically volatile countries include the Federated States of Micronesia (FSM), Marshall Islands, and Tonga.

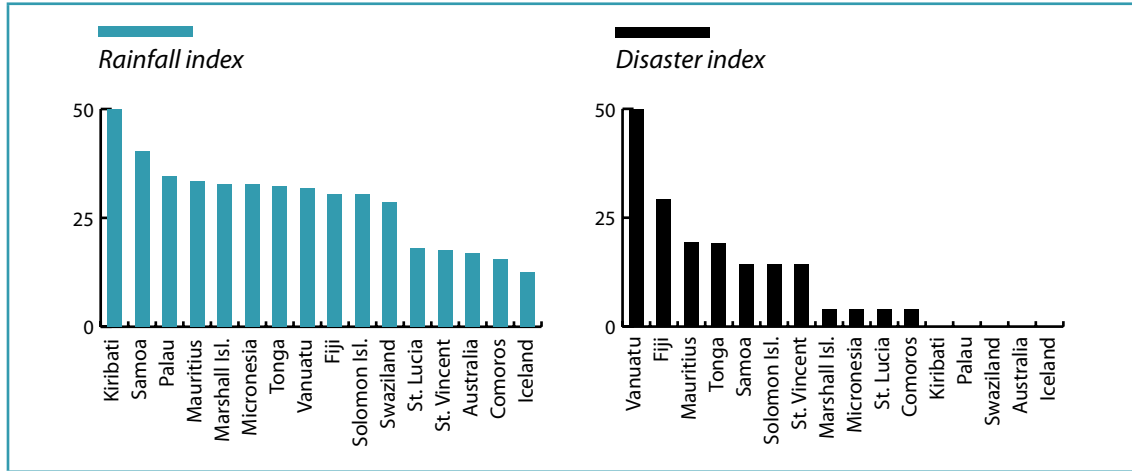
**FIGURE 1.1A RELATIVE VULNERABILITY TO NATURAL SHOCKS AND CLIMATIC VOLATILITY**



In comparing the Pacific member countries to the control countries in terms of the same two indices, it seems that only Mauritius and Swaziland have rainfall volatilities comparable to

the Pacific member countries, while only Mauritius and St. Vincent and the Grenadines have experienced a comparable number of natural disasters.

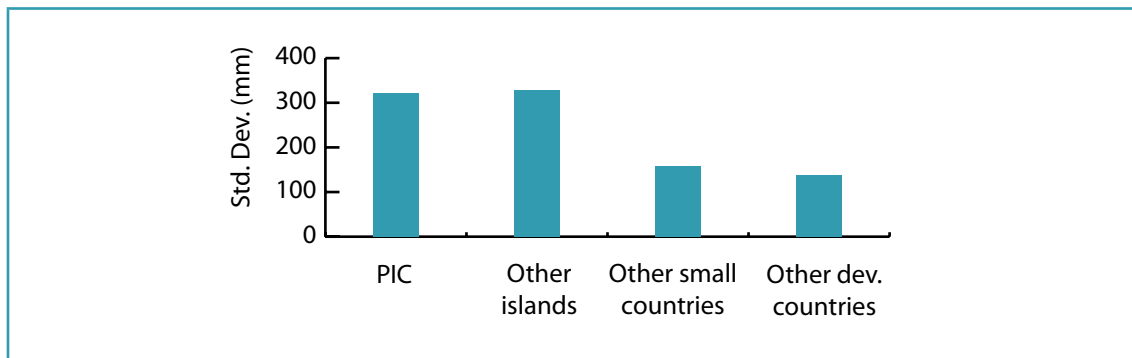
**FIGURE 1.1B COMPARISONS WITH CONTROL COUNTRIES**



*Note. This disaster index does not include floods or droughts, hence the rankings are slightly changed for the PMCs. Also, Australia and Iceland, being aid donors rather than recipients, will not have any registered disasters by definition.*

While the Pacific member countries share similarly high rainfall volatility with other island states (Figure 1.2), island countries have rainfall volatilities which are twice as high as other developing countries, including other small economies. It would therefore appear that many of the Pacific member countries are more susceptible to both natural disasters and volatile rainfall patterns than most other developing countries.

**FIGURE 1.2 RAINFALL VOLATILITY COMPARISONS**



Does this vulnerability translate into greater volatility of agricultural production and aggregate production (gross domestic product)? Time series data on a country-by-country basis show that natural disasters, including rainfall shocks, may have adverse impacts on both the rural sector and the overall economy. As an example, growth in food production and aggregate production mirror each other quite closely in Fiji, and both appear to be adversely affected by natural shocks given that troughs in production coincide with the incidence of shocks.<sup>5</sup> Overall, the evidence suggests that both the rural sector and the aggregate economy in the Pacific member countries can be affected by natural shocks, but the degree of susceptibility and vulnerability differs across countries.<sup>6</sup>

## Section 1.3 The Solution: Economic Integration

Unfortunately neither size nor geography can be altered by policies. To overcome the adverse impacts of these unfavourable circumstances, the Pacific member countries need to devote extra attention to ensuring that the cost of doing business remains as low as possible through improvements in the regulatory framework; building resilience to natural hazards in infrastructure; and, most importantly, institutional quality. Some of these changes can be achieved at relatively low cost while others will certainly require more fundamental long-term changes that should remain a priority for PMC governments and their development partners.

Alongside the domestic reform agenda, tighter economic integration can partially compensate for unfavourable size and geography as it would reduce some of the 'border costs' faced by small isolated economies quite substantially. Bertram (2004) empirically tests the hypothesis that the per capita gross domestic product (GDP) of small island economies and their growth over time are explained to a large extent by two variables: the political-economic linkages tying each island to a corresponding metropolitan patron in the core of the world system, and the GDP level in the metropolitan patron economy (Bertram, 2004). The results show that a US\$1.00 increase in the per capita GDP of the metropolitan patron economy increases per capita GDP of its linked economies by US\$0.44.

The study also points out that, for a sample of 22 Pacific island economies (Table 1.2), sovereign independent states had an average per capita GDP of only US\$1,229 compared with US\$2,187 for territories in free association with the United States or New Zealand (Cook Islands) and US\$22,615 for territories that were politically integrated with France or the United States (such as French Polynesia and Hawaii).

The reasons for this wide variance probably reflect the issues of limited market size, economies of scale, and specialisation that independence poses for small economies, coupled with the large fiscal transfers and provision of several government services where there is political integration with a larger economy.

While political integration for the Pacific island countries is not a realistic option, the critical question is whether aspects of economic integration that are associated with political integration can be replicated in a way that alleviates some of the constraints that size imposes in order to deliver the positive income benefits to their citizens. Labour market integration should be examined seriously in this context.



**TABLE 1.2 GDP PER CAPITA VARIANCE ACROSS PACIFIC ISLAND COUNTRIES, ABOUT 1999**

	GDP per capita, PPP estimates, US\$	Patron economy	Patron economy's GDP per capita, PPP estimates 1999	Political status of the island territory
American Samoa	8,000	USA	36,200	Integrated
Cook Islands	5,000	New Zealand	17,700	Associated
Fiji	7,300	Australia	23,200	Independent
French Polynesia	10,800	France	24,400	Integrated
Guam	21,000	USA	36,200	Integrated
Hawaii	34,312	USA	36,200	Integrated
Kiribati	850	Australia	23,200	Independent
Marshall Islands	1,670	USA	36,200	Associated
Micronesia, FSM	2,000	USA	36,200	Associated
New Caledonia	15,000	France	24,400	Integrated
Niue	2,800	New Zealand	17,700	Associated
Nauru	5,000	Australia	23,200	Independent
Northern Marianas	12,500	USA	36,200	Integrated
Palau	7,100	USA	36,200	Associated
Papua New Guinea	2,500	Australia	23,200	Independent
Samoa	3,200	New Zealand	17,700	Independent
Solomon Islands	2,000	Australia	23,200	Independent
Tokelau	1,000	New Zealand	17,700	Integrated
Tonga	2,200	New Zealand	17,700	Independent
Tuvalu	1,100	Australia	23,200	Independent
Vanuatu	1,300	Japan	24,900	Independent
Wallis and Futuna	2,000	France	24,400	Integrated

Source: Bertram, 2004.

Recent commentary on the challenges and opportunities for growth in the Pacific has highlighted the relative success of two countries in the Region, Samoa and Cook Islands, which have been able to register sustained growth (AusAID, 2006). In looking for best practice examples in whose footsteps other small islands should follow the report points towards Mauritius. While it is always dangerous to look for common themes across countries—as each would have their own idiosyncratic factors that have led to their success—it would be hard to deny that each of these three countries present a strong case for labour mobility. Samoa has had a long history of migration into New Zealand through the treaty of friendship for over 30 years, Cook Islands is in free association with New Zealand, and the Mauritius miracle (thus far unexplained by purely economic factors) may well be a classic story of a well-managed immigrant success.

## THE CASE FOR LABOUR MARKET INTEGRATION

An obvious question comes to mind: *Is integration in labour markets through labour mobility necessary at all in the presence of high and increasing trade in goods?* After all, economic theory predicts that, under certain conditions, the free movement of goods was a substitute for the free movement of the factors embodied in the production of those goods; hence trade in goods that were highly labour-intensive should do the same for wages as a physical movement of people, accomplishing a result close to factor price equalisation in the end. This is not borne out by reality, in part, because the conditions listed in textbooks are not present in the real world. But once allowance is made for productivity differences, there is stronger evidence of price equalisation, implying that workers are willing to move to places where they can enhance their productivity and incomes (i.e., if wages are location-specific then workers are ready to change their location). Where workers cannot change their location to enhance their productivity, it is possible to conceive of moving the more productive capital to the labour; and this is being practised to some extent through foreign direct investment and outsourcing of business processes. While outsourcing has barely scratched the tip of the surface yet, there are limitations to when capital mobility can be a substitute for labour mobility. For instance, capital may also be more productive in certain locations due to other complementary factors present, such as institutional quality, and moving it may erode some of its productivity. So in the end it may be better to move labour instead. Also, in some cases the productive capital may be immovable (e.g., land) and therefore labour would need to move to perform services in the agricultural sector.

From a macroeconomic point of view, migration could provide a boost or deflate trade volumes. Rising incomes from migration could cause a rise in trade volumes—but the larger the share of skilled workers in migration, the greater the possible decrease in trade (since skilled workers produce tradeable goods); while the larger the share of unskilled workers in migration, the smaller the trade reduction (since unskilled labour is typically engaged in the non-tradeable sector). The wage convergence for unskilled labour due to trade is a negligible fraction of the prevailing wage differentials which are five-fold or more (Freeman and Oostendorp, 2000; dataset by International Labour Organisation). Unpredictable effects on the current account of migrant-sending countries due to the effect on exchange rates may also affect trade either way. So trade and migration should be evaluated on their own merits rather than as a substitute for one another.

Another important difference between trade liberalisation and labour market liberalisation is worth discussing now because it has implications for the proposals set forth in this report later on. Whereas in trade there is a solid argument for multilateral and nondiscriminatory liberalisation policies, the opposite is true for migration where there is little support for such approaches to migration because of the very different implications of nondiscrimination in trade and migration. In trade, multilateral and nondiscriminatory liberalisation maximises economic efficiency by allowing the lowest cost producer to compete, thus forcing high-cost producers to improve efficiency or exit the market. But such adjustments are not possible (and may not be desirable) in labour markets in industrialised countries due to minimum wage laws and social insurance schemes, thus the benefits of multilateral and nondiscriminatory liberalisation are also weaker in the case of labour market liberalisation. An important reason is also that migration has several implications pertaining to social integration and impact on public services. Thus countries will often choose to follow a discriminatory policy on labour inflows—either on the basis of skill or on the basis of country through strict bilateral schemes—in order to achieve the same sort of outcomes.

### *What would be the welfare impact of greater labour movement?*

There is strong evidence now showing that labour market restrictions are imposing a much greater burden on the global economy than the remaining trade restrictions. Through general equilibrium

models, it has been estimated that a complete and free movement of labour globally would double global incomes whereas a feasible amount of labour mobility would increase gross wage income worldwide by US\$772 billion in 2025.<sup>7</sup> When correcting for price changes faced and caused by these movements, the gains fall to US\$356 billion which is a 0.6 percent increase in global income. To put these numbers into perspective, it may help to note that US\$356 billion is roughly three times all the official development assistance in 2003 and dwarfs the expected gains from all remaining trade liberalisation. This increase would also translate into a slightly more favourable distribution for developing countries as their share of aggregate gain is 1.8 percent, whereas gain to native high-income countries is 0.4 percent relative to the baseline.

Computable general equilibrium modelling results for modelling labour movements in the Pacific show that an increase in labour from the Pacific islands would raise welfare in the Pacific island countries as well as Australia and New Zealand (Walmsley, et al., 2005). When the model differentiates between skilled and unskilled labour, the gains to the Pacific economies unequivocally come from the movement of unskilled labour. Therefore the movement of unskilled labour warrants further policy attention, recognizing the obvious fact that large or permanent movements of unskilled workers would not be acceptable to the citizens of most destination countries.

What are the channels through which these welfare gains and losses work themselves through the economy? The next section attempts to delineate those channels by presenting a production-function framework to position the analytic arguments and empirical findings of this report.

## Section 1.4 Analytical Framework, Empirical Findings, and Policy Implications

The framework adopted here follows a traditional ‘production function’ approach where improvements in economic welfare can be thought of as resulting from movements along the production function or by pushing out the production frontier. These movements can occur for any of the following reasons: (i) there has been an increase in the amount of total resources available, (ii) there is an improvement in the way resources are combined or allocated, and (iii) positive externalities exist and can be captured. This framework is used to organise the analytic and empirical findings for both, migrant-sending as well as migrant-receiving countries.

### MIGRANT-SENDING POINT OF VIEW (PACIFIC)

#### (i) Increase in amount of resources available

Remittances are monies or goods sent home to family members or communities by migrants who live and work in other countries. The export of labour results in a national loss of the abundant factor but frequently results in an inflow of capital through remittances. In a simple world, if the productivity of labour is low in labour abundant countries, then an injection of capital through remittances should improve the productivity of labour that remains behind by virtue of it being combined with more productive capital. If there is an improvement in labour market conditions due to the departure of some excess labour then that would further increase the benefits to domestic resident labour. And if these additional capital resources respond positively to adverse economic conditions (i.e., are counter cyclical) as they are often presumed to be, then the injection is even more precious because it comes at a time when the country needs it most —unlike private capital which may pull out in adverse times and make bad economic conditions worse.<sup>8</sup> To add to this, there may be multiplier effects if the economy is demand-constrained and remittances could increase the output of many sectors.

The impact of remittances of migrant-sending communities is not trivial and evidence is growing worldwide that remittances have had a deep and far-reaching positive impact on immediate household members as well as broader communities. In an effort to understand the size and impact of remittances in the Pacific, we commissioned household-level surveys in Fiji and Tonga.<sup>9</sup> Over 900 households answered detailed questions on their household characteristics, migration behaviour, size and frequency of remittances, the household’s spending patterns, and broader socio-economic status.<sup>10</sup> These surveys have been analysed and have pointed to the following main results:

- The amount of resources received in these countries through remittances is significant. In Tonga, over 90 percent of households surveyed received remittances in comparison with 43 percent of households in the Fiji sample. Among remittance receivers, Tongan households receive an average of US\$3,067 in comparison with US\$1,328 in Fiji.
- The positive impact of remittances on poverty reduction is strong using a variety of measures of deprivation. After taking remittances into account, all measures of relative deprivation improve with different intensities in rural and urban areas. Interestingly, whereas Tonga suffers from more relative deprivation than Fiji before remittances are included, deprivation on the main islands in Tonga taking remittances into account is reduced to such an extent that the situations is better than both rural and urban Fiji.

However, it would be too simplistic to assume that the loss of one resource—labour—is fully compensated for by an increase in another resource—capital. We will return to this important issue at various points in this chapter. From the perspective of assessing the impact of increased resources on the economy, at least three questions come to mind which point to the potentially negative effects of remittances. Each of these is important in the Pacific context.

*Do remittances suffer from the problems associated with resource rents?* This refers to what economists call the ‘curse of natural resources’ when windfall gains from natural resources like oil or timber have tended to impede governance and modernisation in most countries by taking away the pressures that push for broad-based growth. There are at least two fundamental differences between remittances and resource revenues that should lead to different outcomes. First, natural resource income is of a large magnitude and highly concentrated in the hands of a few, creating a pocket of powerful rent-seekers; whereas remittances are small and widely dispersed in the country (see chapter 3). Second, remittances avoid the government as middleman that resource rents cannot, thus allowing the middleman to follow arbitrary policies that may promote corruption and retard growth.

*Are remittance inflows akin to aid inflows which also increase capital resources available to a country?* In particular, can remittances cause inflation, overvaluation of the exchange rate and render the tradeable sector uncompetitive? Economists call this the ‘Dutch Disease’ when the effect of large inflows of foreign exchange causes appreciation of the exchange rate making exports uncompetitive in world markets, hence doing a disservice to productive sectors in general. The difference however is that remittances typically are small and grow slowly over time making the effects also small and the time period long enough to allow other sectors to adjust. Where this is not the case—and Fiji (rather than Tonga or Samoa) may fit that description—there is the possibility of adverse impacts of exchange rate appreciations. Overall however, aid and remittances are not to be equated. Whereas aid is an external injection into the economy and raises all sorts of questions about ownership, capacity, and governance, remittances are not really that different from any other export income for its citizens when the export is the service being performed outside of the national borders. In fact, when remittances are treated as income in the calculation of debt/GDP and debt/export income of countries, these ratios drop quite significantly thus raising the credit-worthiness of these countries in international financial markets and further improving access to capital (World Bank, 2006).

*Do households that receive remittances work less?* The third question relates to the impact of remittances on household labour supply. Economists call this the ‘backward bending supply curve’ response when increased income does not cause more labour to be forthcoming and individuals choose leisure instead of work.<sup>11</sup> It is possible that remittance-receiving members of the household may raise their reservation wage and prefer to stay out of the labour market; but the evidence from Guatemala, Jamaica, and the Philippines shows that remittance-receiving households tend to invest more in education (i.e., opt for more schooling instead of working early); and shows reduction in child labour and an increase in self-employment. Similar evidence from the Pacific is discussed in the next section in the context of decisions surrounding the allocation of resources.

### **Policy implications**

Can policy help increase the inflow of remittances? Since remittances are essentially a person-to-person transfer shaped by family ties and shared cultural values, it is hard to think of policy measures that make migrants send more money home. While the flow of remittances will vary with the changing circumstances of individuals and families, a larger migrant stock would in general be correlated with larger remittances. Holding other parameters constant, temporary workers are also likely to remit more to their home countries than permanent workers. This point is taken up later on.

Beyond enhanced labour mobility in general, a reduction in the transaction cost of making financial transfers would ensure that recipients get most of what is sent to them. Evidence points to unduly high transaction costs in the Pacific. For example, remitting NZ\$100 (US\$68) to Tonga through channels other than the ATM costs 25 to 30 percent of the amount remitted. Using non-bank financial institutions, remitting earnings from Australia to Fiji, Samoa, Tonga, and Vanuatu costs between 10 to 20 percent of the amount remitted (McKenzie, 2006). These transaction costs are much higher than those faced by remitters in other regions of the world. For example, the cost to remit US\$200 in the US-Mexico corridor is about 5 percent, and even lower in the US-Philippines corridor at 1-2 percent. (World Bank, 2006). A reduction in the transactions cost of remittance transfer in the Pacific could translate into significant additional amounts of income received, especially for the poor, given the size of remittances flowing into the Pacific. Further, the size of remittances is indeed responsive to the costs; hence a reduction in cost of 1.0 percent is likely to induce more than a 1.0 percent increase in remittances (Gibson, et al., 2006). A lowering of costs in the financial system would also enable senders to use formal channels rather than informal channels, such as mailing or personal deliveries. This would allow better data to be recorded and enable central banks to make necessary changes to monetary policy when needed.<sup>12</sup>

The Pacific islands could further enhance the benefits of labour mobility by increasing the flexibility of their own labour markets and allowing in skilled labour from neighbouring industrialised countries. While there is bound to be some asymmetry in the numbers flowing in and out, even a small addition to the pool of skilled personnel in the small Pacific islands is likely to have far more benefits than costs. Often prompted on nationalistic grounds, it is not unusual for small countries to construct barriers to entry of foreign skilled labour on the grounds that their entry would hurt domestic labour. However, these concerns appear to be unwarranted. Most islands face difficulty in retaining their skilled labour because it is relatively mobile. Some attempts at quantifying the impact on employment creation from skilled immigration estimate that every skilled migrant into the Pacific may be able to create nearly 10 jobs for local labour (Duncan, 1997). It would therefore be in the Pacific's economic interest to promote such labour exchanges, especially in the context of bilateral agreements, rather than restrict the entry of skilled workers willing to enter with their capital, know-how and employment-enhancing potential.

Similarly, some voluntary return migration of skilled workers may also be encouraged by removing penalties on seniority in government positions, and pursuing discussions with the major destination countries for Pacific migrants on dual citizenship agreements, as well as fiscal incentives such as portable pension schemes. (Follow-up work is underway in the World Bank on portable pensions for the Pacific.)

## **(ii) Improvement in allocation of resources**

In addition to the static effects stemming from the increased remittance resources, migration may be able to influence the way resources are allocated, both at the aggregate level as well as at the household level. At the aggregate level, remittances can alter the allocation of resources among groups of households by changing the underlying distribution of income. At the micro level of the household, the prospect of migration and the subsequent receipt of remittances can have profound effects on the allocation of income towards consumption or investment. We take up these effects in turn.

In countries where the poor have migration options, remittances tend to benefit the poorest and hence result in reducing income inequalities. When the relatively well-off migrate or when migration is skewed towards the highly skilled, income inequality may worsen. As income distribution changes, so does access to assets—such as capital equipment or land; and the final outcome of how labour, land, and capital are combined in productive activities. But it has not been possible yet to map out empirically these effects. In fact, even measuring income inequality

itself poses some methodological challenges. Measures, such as the Gini coefficient, may remain unchanged despite the fact that the shape of the underlying distribution curve changes. Further, such measures cannot take into account the fact that different cohorts of people may go in and out of certain income quintiles making it necessary to use panel data, which is very hard to come by. Through household survey data collected in the Pacific, we are able to show that remittances and other unrequited internal transfers have a strong positive impact on income distribution. In Tonga, the poorest 40 percent of the population's share of cash income increases from 7.3 to 18.7 percent, and the share of the richest 20 percent falls from almost 63 to less than 50 percent. In Fiji, the impact is also positive but weaker than in Tonga (as one would expect given fewer remittance-receiving households) where the share of the poorest 40 percent increases from 9 to 11.6 percent, and the share of the richest 20 percent of the population falls from 57.8 to 53.8 percent.

At the individual or household level, several studies have looked for a direct link between remittances and the consumption-investment mix of household expenditures, and journalistic references to the issue have often criticised the preponderance of remittance-funded consumption. There are important reasons to question the validity of these views.

From a welfare perspective, an extra dollar of investment is only better than an extra dollar of present consumption if the marginal social value of investment is greater than its marginal private value. At low levels of income—or when there is great volatility of income—access to a steady and reliable source of income for poor vulnerable households serves an important social protection role. Very few policies and instruments are available that can claim to cushion the poorest in direct and effective ways like remittances have shown to be able to do. Also, if the life-cycle model of remittances captures the motivation behind remittances, then it is useful to bear in mind that they are sent first to parents, then siblings, and only later dedicated to building a 'nest egg.' Brown and Walker (1994) in their survey of Tongan and Samoan migrants fully support this pattern. Remittances sent to parents are a form of pension payment, and therefore one should expect these funds to be spent on consumption rather than investment (the investment has already occurred). Remittances sent to siblings tend to be devoted to meeting their educational needs, which should not be viewed the same as consumption.

Positive externalities can exist in investment expenditure, and it is for this reason that it is considered desirable to see remittances funding investment. But efforts to identify the causal effect of remittances on investment often run into various problems. First, investment is correlated with the opportunities that exist, that is only countries with good investment climates should expect to see remittances fund investment. Second, when more enterprising households are the ones sending migrants, high investment may be wrongly associated with remittances due to self-selection. Third, income is fungible, and it is difficult to isolate the effect of remittances from those of other sources of income. Simply asking how remittances are spent is unlikely to reveal the marginal effect of remittances on spending because remittances, even when spent on investment, are likely to free up the marginal dollars for consumption. This is why there is often a difference between *anecdotal and survey data* that show the *average* percentage of spending on consumption and *econometric data* that calculates the *marginal* propensities by modelling remittances as an exogenous positive shock to household income.

In the household surveys conducted in Fiji and Tonga, questions on savings were posed directly rather than attempting to deduce it from consumption expenditures. In Fiji, 79 percent of those who had received remittances had saved in comparison with 62 percent of those who had not. In Tonga where over 90 percent of households had received remittances, there is still a difference, albeit not as great, with 59 percent of those who received remittances having saved in comparison to 52 percent in the case of those who had not received remittances. A relatively higher proportion of Indigenous-Fijians in the lowest two quintiles had saved, and the mean levels of saving in these two groups were significantly higher than the levels for Indo-Fijians in the same income quintiles.

This is consistent with the earlier observation that the Indigenous-Fijian households in the lower two quintiles received a much higher level of remittances than their Indo-Fijian counterparts. It would therefore seem that being in receipt of remittances at lower ends of the per capita income spectrum can make a significant difference to saving. The econometric analysis considered both the impact of remittances on saving and the influence of saving by the household on the levels of remittances it received. It was found that in both samples remittances had a strong impact on saving, especially among the Fiji sample where the estimated marginal propensity to save from remittances was 73.4 percent. When the effect of remittances on saving was estimated for the two ethnic groups in Fiji, it was found that the strong remittances effect on saving is associated with Indigenous-Fijian households. The analysis also found that in Indigenous-Fijian households this relationship runs in both directions, indicating that migrants have a higher propensity to remit when the household saves more.<sup>13</sup>

In Tonga, evidence is also found that migration and remittances tend to increase income from non-wage sources, such as business or farm income. This means that households with migrants are able to direct resources towards business activity. Tongan migrant households very often have their members spread across a number of activities and can act as a stimulus and conduit for business activity acting as 'transnational corporations of kin.' The Fijian results do not tell a similar story perhaps because the remittances are still a relatively early phenomenon and are smaller, and Fijians are engaged in different occupations from their Tongan counterparts.

Savings and investment may also take different forms. Income spent on building human capital should be viewed as investment rather than consumption. It is interesting to observe the decision of remittance-receiving households in determining investments in human capital through expenditures on education. In theory, there should be a positive impact on the demand for education for two reasons: first, the credit constraint on schooling of dependants of migrants is reduced when remittances become available; and second, the mere possibility of migration increases the incentives for investing in schooling by raising the return on education.

The results from the Pacific give empirical support to the above hypothesis. Primary and secondary education to age 14 in Tonga is compulsory and free. It is possibly for this reason that there was little variability in educational attainment, and the econometric analysis indicated that migration and remittance effects were not evident. In Fiji, 8 years of education is supplied by the government, but it is not compulsory. This probably explains why there is considerably more variation in the education attainment in the Fiji sample.<sup>14</sup> The analysis showed that remittances are associated with better educational attainment at the secondary level (by alleviating the budget constraint). In the second part of the econometric analysis, the impact of household migration on post-secondary education for both Fiji and Tonga was assessed. It was found that having a migrant (rather than remittances) in the household increased the likelihood of other household members acquiring post-secondary education (by inducing investment in education). The relationship is stronger in Fiji where the remaining family members have an incentive to undertake further investments in education due to the size of the domestic economy and also have access to domestic education institutions in Fiji, which is less likely to be the case in Tonga. These findings are relevant from a policy perspective for they indicate that any potential negative brain-drain effects of migration could, to some extent, be countered by larger investments in education by remittance-receiving households.

### **Policy implications**

In order for income distribution to become more equitable due to remittances, migration options must be extended to the poor and unskilled rather than be reserved for the highly skilled or well-off. Many of the poor lack the financial resources or social networks to migrate, so programs that explicitly target those at lower quintiles of the income distribution would yield the greatest benefits. Given social and political concerns regarding such migration, it will be important to balance



these benefits with recipient country concerns; and this balance might be best achieved through managed migration programs designed for those who are relatively less endowed with wealth or skills. Existing literature also suggests that temporary workers remit more than permanent workers, and poor migrants who are not likely to travel with their families are likely to remit the most and help achieve greater social equality.

It is not clear whether policy can influence the decision to invest or consume at the household level. More importantly, it is not even clear whether that is a desirable goal at all since remittances, by funding consumption, are providing an important social protection role for the poorest and most vulnerable sections of society. Remittances should be thought of as any other income; most households will expect to fund mostly consumption expenditures at fairly low levels of income.<sup>15</sup> As income rises and savings and investment opportunities grow, the ability and attractiveness of saving will also grow. It may then be desirable to provide information to remittance senders and receivers on various financial instruments that are available to save and invest in. Such non-interventionist policies that remove information market asymmetries in the system are likely to be helpful in the long run in introducing households to the idea of saving. Any improvements in the business environment in the Pacific are likely to further enhance the positive impacts of remittances; so this should serve as a reminder that remittances are not a substitute to carrying out structural reforms but rather expected to be boosted by complementary reforms.

There are proposals in some writings for matching grant schemes where public funds match remittance funds or exceed them by a factor of two or three (Johnson and Sedaca, 2004). Such schemes are in practice in some communities in Asia and Latin America; the schemes are said to be channelling remittances into investment-like activities and should be commended for delivering important services to the community. But from a public policy perspective it is not clear whether public resources are being diverted away from better uses and also what the rationale is for subsidizing remittances when other forms of financial inflows are not subsidised by governments.

### (iii) Capturing the positive externality from migration

The economic literature has identified and recent experience has borne out that there are strong positive externalities that arise from the migration of people. The influence of the Diaspora in promoting technology transfers and knowledge networks acquired abroad by serving as 'reputational intermediaries' have come to challenge the traditional brain-drain arguments put forth against migration from developing countries. Anecdotal and empirical evidence of this type is increasing for India, South Korea, and Taiwan (China), but externalities of this type may still be premature for the Pacific island countries. This is because the volume and concentration of highly-skilled labour as a percentage of the island countries' total populations is still relatively small. Also, in the absence of strong economic growth in the Pacific island countries, the demand for return migration or links with migrants overseas has not yet emerged strongly.

However, once workers have been exposed to efficient governments and private sectors abroad, they can be expected to demand an improved incentive environment that would enforce greater discipline and efficiency on the allocation of internal resources from their governments and private sectors at home. A transient population of workers rotating between remote developing regions and industrialised metropolises is more likely to induce demand for better governance within the islands while cementing closer regional ties. This kind of 'social remittances' can be a powerful vector of norm diffusion with long-term economic consequences (Kapur and McHale, 2005).<sup>16</sup>

But again, it is important to remind ourselves that these positive externalities may come at a cost. We are talking about people who are moving abroad; people who are absent from participating in national debates at home; people who are unable to write editorials in their national newspapers

or speak on local radio stations when governments are due criticism; people who are not available to teach and mentor the next generation, and sometime not available to parent their own children. The costs on society of these absences are impossible to estimate in any economic model but are surely deeply felt. And these costs may change depending on who migrates. If migration is skewed towards the skilled, it is likely that the costs to society are greater than if the unskilled migrate. Estimates from the computable general equilibrium model—that experiments with a 1.0 percent positive shock to the (skilled and unskilled) labour flow from the Pacific islands, Australia, and New Zealand—show that welfare in the Pacific islands could fall due to the loss of skilled labour force and the consequent rise in real skilled wages, which is not compensated for by the increased remittances sent back home.<sup>17</sup>

These monetary losses would probably increase by multiples if the long-term social and institutional costs of losing skilled labour alone could be included. Workers who have invested in human capital are more likely to affect both the supply and demand for institutions. While the effect on supply of institution builders is obvious, the effect on demand is more subtle because this labour force represents the people who have the strongest interest in seeing better institutions develop since they are making the choice to leave or stay.

At a time when institutional quality is central to discussions on promoting growth and development in the Pacific, it is important to understand the impact that internationally mobile human capital has on building effective domestic institutions. Although institutions have been considered the essential element of development, our understanding of how successful institutions actually develop is still nascent. But one could state with reasonable certainty that successful institutions depend to a large extent on having a critical mass of people with high levels of human capital, and this is even more likely to be the case in the initial stages of a country's economic development (Kapur and McHale, 2005).

Faini (2002) shows that migration, via remittances, contributes to growth in the migrant-sending country but is a declining function of the skilled composition of the migrant labour force. This indicates that the negative impact from brain drain may not be compensated by a larger flow of remittances, hence recommending host countries to limit their bias in immigration policies towards skilled labour. Anecdotal evidence from the Pacific seems to suggest that the loss of the very limited skilled workers poses quite a significant problem to the island countries. In that context the Australian policy to help establish training colleges to augment the supply of skills should be applauded and welcomed in the Region as it would help compensate Pacific governments for the training of emigrants and also improve the qualification of workers.

### **Policy implications**

From a policy perspective, if social remittances are to serve an important role in transforming societies then non-elites must have the greatest access to these social remittances. A mobile pool of workers who are exposed to industrial world institutions and are able to bring back home new ideas and practices can be a powerful agent of change. Hence, migration schemes that maintain a steady flow of non-elite workers are likely to help most usefully to this achievement.

In order to give institutions a fair chance of developing in the small islands, some balance in the immigration policies of industrialised nations would also be beneficial. While more balanced immigration would be fairer and better, even selected liberalisation of barriers is better than no liberalisation at all. Very small countries with populations of less than a couple million may simply lack the capabilities necessary to be able to retain talent in many sectors. Just as small towns in rich countries find it extremely difficult to prevent bright young people from leaving, so do small states (Pritchett, 2003). The public policy priorities for them are best directed to facilitate the movement of talent from these small countries to proximate larger countries and regional integration of labour markets that can help build a critical mass of human capital. At the other end

of the spectrum are the large countries which can not only cope with the loss but also benefit from the resulting networks. Of course, if foreign-skilled labour wishes to work in these small states, their entry should be encouraged rather than restricted.

But rather than remove emigration options for those lucky enough to have them, it would be better to explore ways for more people to share those gains where available.

## MIGRANT-RECEIVING POINT OF VIEW

### (i) Increase in amount of resources available

Migrant-receiving industrialised country markets are expected to gain from inward labour mobility because their current endowments favour capital rather than labour. Influx of the scarce factor—labour—would increase the productivity and hence returns to capital. Through general equilibrium modelling, it is estimated that industrialised countries would gain US\$139 billion in real income. The computable general equilibrium modelling for Australia and New Zealand shows that an increased inflow of workers from the Pacific would increase welfare of residents in these countries by US\$302.61 million and US\$26.5 million, respectively by raising output in all sectors. Most of these gains would come not from the movement of skilled labour, but rather from increases in the supply of unskilled labour. In fact, it is possible that the economic benefits of migration for industrialised countries could be even greater than those predicted by the models due to factors that have not been quantified, such as increased productivity of migrants and their future offspring; increased investment levels in response to higher returns to capital, and possibly higher labour force participation rates among citizens of industrialised countries as support services become available.

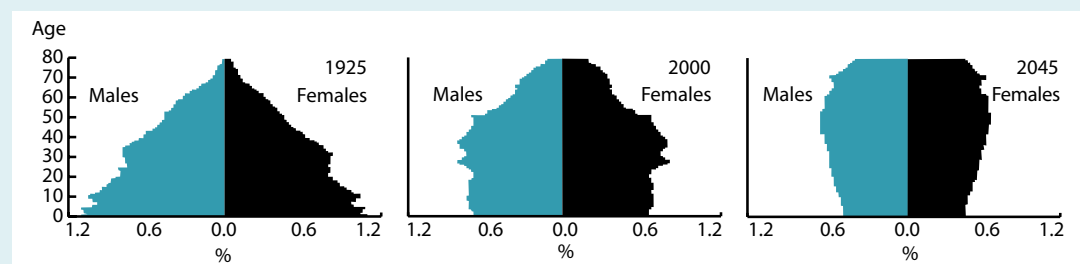
Low and further declining fertility rates in many industrialised countries are causing higher age dependency ratios and have given rise to concerns regarding worker deficits to deliver services to a growing stock of dependants (young and old). In Australia and New Zealand, it is estimated that the proportion of population over the age of 65 is expected to more than double between the years 2004-51 (Box 1.1). The demographic projections suggest that the next 40 years will see substantial labour shortages in advanced economies (McDonald and Kippen, 2000), increasing the pressure for skilled labour as well as unskilled or semi-skilled labour in sectors not filled by domestic workers.

A variety of proposals such as increasing the retirement age and inducing more women into the workplace are being considered in industrialised countries. Migration is an option that would allow countries to import taxpayers as well as young workers in the face of labour shortages and ageing populations. But the levels of immigration required to make a dent into these problems may not be considered feasible in most countries, and hence a variety of policy options will need to be considered properly to understand and prepare adequately for the future.

### BOX 1.1. POPULATION PROJECTIONS FOR AUSTRALIA AND NEW ZEALAND, 2004-2051

According to the Australian Bureau of Statistics (2006), the estimated resident population at June 2004 is projected to rise to between 25 and 33 million in 2051, with the median age reaching 46 years. By 2051, the proportion of Australia's population aged 65 years and over is projected to average 32 percent, more than double the 2004 proportion. If future net migration falls to zero and the below replacement fertility level lowers, the current beehive-shaped age structure of the population could take on a coffin shape, indicating a sizeable reduction of the labour force (McDonald and Kippen, 1999).

#### From Pyramid to Beehive to... Coffin?

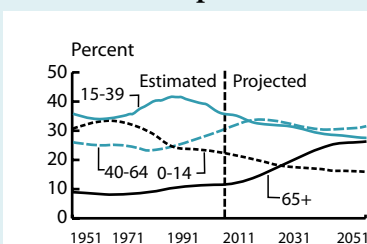


Source: Productivity Commission, 2005.

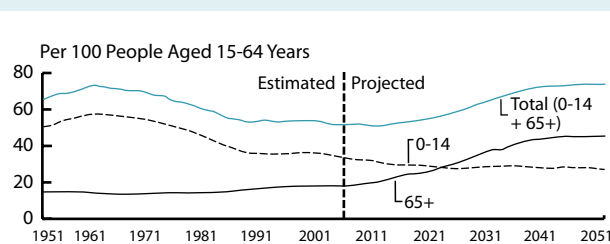
As Australia's population ages, future labour supply is projected to be sluggish, through a decline in aggregate labour force participation rates (by about 7 percentage points) and reduced average hours worked. Rapidly rising expenditure on health care and pensions is projected to lead to a gradual build-up of a fiscal gap of around 6.4 percent of GDP by 2044-45 (Productivity Commission, 2005).

A similar story is presented for New Zealand. According to Statistics New Zealand (series 5), its national population at June 2004 is projected to reach 5.05 million by 2051, with half of the population 46 years and older. By 2051, one in four New Zealanders is projected to be aged 65 years and over, a doubling of the ratio in 2004 – and for each 65+ person, there will be 2.2 people in the working-age group, compared with 5.5 people in 2004.

#### Age Distribution of Population



#### Dependency Ratios



Source: Statistics New Zealand, 2006

Studies suggest that the ageing population could raise government expenditure (excluding financing costs) by about 7 percentage points of GDP by 2050, particularly in health and superannuation, and reduce living standards (measured as real consumption per person) though not to below current levels (Davis and Fabling, 2002; Bryant, et al., 2004; Guest, et al. 2003).

*While migration increases the supply of labour, could it drain fiscal resources?*

The fiscal implications of immigration are not well understood and remain difficult to quantify. While there have been attempts to estimate this for various countries, there remain challenges to calculating properly the fiscal impact of immigration because it depends heavily on several factors:

- the methodology used that dictates whether the unit of analysis is the individual or the household;
- expenditures and revenues that are included;
- public services that are regarded as pure public goods;
- extent of economies of scale in expenditures;
- age structure of the immigrant populations and their level of skills, education, and fertility.

For small numbers of migrants, especially a rotating pool of migrants, it does not seem likely that the burden on resources would overshadow the large economic benefits that are estimated through the computable general equilibrium model. In Chapter 4 some features of migration schemes are shown that keep the fiscal costs manageable.

*Given that labour shortages exist in most industrialised nations and in Australia and New Zealand, is the Pacific Region the best place to look for importing labour?*

After all there are other labour abundant economies with a large supply of valuable skills and history of immigration benefits; China and India are obvious examples. As shortages of skilled labour intensify, international markets for skilled labour will also function with more speed and efficiency; and it will be unavoidable and indeed necessary to recruit workers from a global pool of talent that competes fiercely. The comparative advantage of the Pacific is not in competing with the large countries for skilled entry into Australia and New Zealand, although many skilled Pacific islanders do enter on that basis. What the Pacific needs is access to regional labour markets for its labour that is unlikely to find formal employment opportunities at home. Much of this labour is engaged in the informal sector or underemployed and hence is migrating to the capital cities in the Pacific in search of formal employment and social services, but not finding it. Whereas the development impact of sending small numbers of workers abroad is likely to be minimal in the larger countries of Asia, a similar movement from within the Region would have a significant impact on improving Pacific livelihoods over some length of time and also enhance regional integration and stability. These points are further developed in the remainder of this paper.

## **(ii) Improvement in allocation of resources**

Enhanced labour mobility can lead to an improvement in the allocation of resources by allowing a better skills/job fit in the host country's labour market. Having engineers drive taxi cabs or medical students on holiday sign up for performing farm labour reduces the overall allocative efficiency in the economy. Hence the aim of public policy should be to facilitate a more efficient allocation of human resources through flexible labour markets.

While shortages are expected in several occupations, skilled migration schemes are already in place and will probably be further liberalised. Markets for skills are working well and likely to get even more efficient. It is the movement of unskilled labour that is most constrained and likely to remain so at the global level. However at the regional or bilateral level, there is considerable scope for some mutually beneficial exchanges of labour. Recipient countries would benefit because higher participation in schooling in rural areas coupled with high wages in retail and services have attracted away young workers from activities, such as agricultural work, creating shortages. Trying to make agricultural work more attractive for those with other employment options may not be

the most efficient or desirable policy option given the opportunity cost of these workers. Since a ready supply of unskilled labour exists at the doorstep in the Region, a combination of skilled and unskilled access to Australia and New Zealand markets would instill greater balance into the immigration policies of the recipient countries, which would translate into greater distribution of benefits to the Pacific populations.

Numerous possibilities exist for fine-tuning migration policies to improve the fit with labour market needs through bilateral agreements. The next section discusses this to some extent and Chapter 4 details the various arrangements that could be put into place to customise seasonal labour schemes.

### (iii) Capturing the externality from migration

While immigration may deliver tangible economic benefits to destination countries and make their populations better off for the most part, there is usually overt or inherent resistance to the idea of increased immigration in industrialised countries, especially of unskilled labour. The concerns can be expressed in several ways:

- *On monetary grounds, such as the possibility of migrants presenting a fiscal drain on the system or taking jobs away from the domestic unskilled population;*
- *On social grounds regarding the difficulties of integration into destination country societies, the potential for overstaying and creating an illegal migrant underclass;*
- *On perceived compromise to national security in an increasingly security-conscious global environment.*

Such concerns are widespread and understandable, and hence would need to be addressed adequately. For destination countries in this Region, the likelihood that Pacific unskilled labour would displace local labour does not seem to be an immediate worry given that most of the agricultural towns in these countries claim to be suffering from the absence of a reliable supply of labour suited to agricultural work. For example, the New Zealand government has recently declared certain agricultural regions as being severely impacted by shortages and unlikely to meet its labour needs through domestic workers alone. Efforts to bring the unemployed into the workforce in destination countries have had only partial success and should continue to be pursued, but cannot be relied upon to address the long-standing labour shortages.

Concerns regarding illegal overstay, social integration, and access to services will need to be addressed; and the appropriate mechanism is through the careful design of a temporary movement of persons (TMP) scheme. However, not all TMP schemes worldwide have been considered successful; and indeed some have left lasting memories of exploitative relationships or policing of workers to enforce compliance with immigration rules, leaving destination countries wary of considering such programs again, especially for unskilled workers. But given how large the potential benefits could be from the movement of labour in the Region, it would be a lost opportunity to let previously ill-designed schemes hold back constructive dialogue on this issue today. In fact, past experiences have much to offer by way of lessons that could usefully influence the design of new programs in the current economic context.

A careful review of global experiences reveals that success or failure can be predicted with reasonable accuracy based on the particular features of the bilateral agreements in place.<sup>18</sup> In particular, the design of the Canada-Caribbean agricultural worker scheme offers much guidance to policymakers in the Region today and has less to do with 'cultural values' than with economic incentives that are built into the scheme that predispose employers and workers to follow the rules. For instance, Canada allows a revolving door of migrants to perform agricultural work, which suits employers and workers alike in that good workers are rewarded with re-entry in

the next year. Whereas similar schemes in the United Kingdom make entry a one-off option, increasing the probability that a worker will jump their visa conditions and overstay or go AWOL. Again, recruiting university students from other countries to perform agricultural work, along with imposing all the upfront costs of travel and insurance on the worker, is almost a sure way to encourage overstays since the migrant will try to amortise the costs over a longer period; and being overqualified for the job predisposes them to using the farm jobs as a stepping stone.

To showcase some of these design features and draw attention to the attributes that could go a long way in shaping the workings of a TMP scheme into the industrialised countries of the Region, we have undertaken a case study of a small region in Australia that is suffering from labour shortages. The case study gathers information through surveys and interviews on the metrics of a viable TMP scheme for the Pacific. This case study highlights the many important details of the program that would demand careful attention of policymakers and offers preliminary advice on how a small pilot scheme, based on bilateral negotiations, could be tailored to best suit the needs of the Pacific islands as well as the destination countries.

Bilateral agreements can also stipulate that the numbers of workers sought each year be determined on a market-driven flexible basis, dictated by the prevailing labour market conditions in destination towns rather than by arbitrary quotas that become quickly out-dated as labour market conditions change in destination countries. Some of these features also offer instructive guidance for similar schemes into New Zealand—although some parts of the analysis would need to be customised to fit domestic rules and regulations. Some preliminary analysis is underway, and the features of such schemes are being carefully considered for proposed pilots in selected agricultural towns in New Zealand. In fact, the features highlighted as being essential to a successful TMP scheme have universal applicability. Indeed all countries facing labour shortages for unskilled labour and with an economic interest in the Pacific Region are encouraged to consider fine-tuning the generic features of the proposed model to suit their current and/or future labour needs.<sup>19</sup>

Concerns about immigration compromising security are also widely held in a post-9/11 world and will need due attention in putting in place well-managed recruitment procedures. Given how small the initial numbers per country can be, there is plenty of room for adjusting recruitment procedures to reach maximum efficiency.

And security concerns can work both ways. If ‘failed states’ themselves present a security concern for surrounding industrialised nations, then any policy that reduces the fragility of these small states—and indeed of the most vulnerable sections of these fragile states—should be seriously considered. In a recent paper, Urdal (2004) shows that in the presence of a preponderance of a young population and low domestic employment prospects in a country, the probability of social conflict rises unless there is a safety valve of migration. In the Pacific, fertility rates are high and appear to be coming down only slowly contributing to the projected population growth of as much as 2.5 percent per annum. Even under assumptions of faster declines, significant population growth rates will continue for many years because of the population momentum that has been built up. Melanesia in particular, which is characterised by high fertility rates, low formal sector employment, and very limited migration options, will generate the highest proportion of excess labour. For example, in Solomon Islands and Vanuatu where formal sector employment is already among the lowest in the Region, the working-age populations are expected to increase by another 30 percent within the next decade. While some domestic employment opportunities will also be created, it would still leave nearly 90 percent of the populations of these countries outside the formal sector. Estimates presented in this report indicate that over 370,000 people in Fiji, 279,000 in the Solomon Islands, and 129,000 in Vanuatu would not be able to find formal sector employment in their countries by 2015.

These estimates present a sense of urgency about the reform agenda in the Pacific which should focus on improving the environment for domestic business formation, facilitating the formation of high-quality institutions, and pursuing stronger regional integration. While no single policy instrument can hope to ensure economic and social stability, a comprehensive package that promotes regional integration in products, as well as factors of production, would have the best chance of succeeding in the small Pacific island nations.

## Section 1.5 Summary and Conclusion

Figure 1.3 summarises the main thrust of the arguments in this report and within this context makes a brief mention of some of the follow-up work, which is underway.

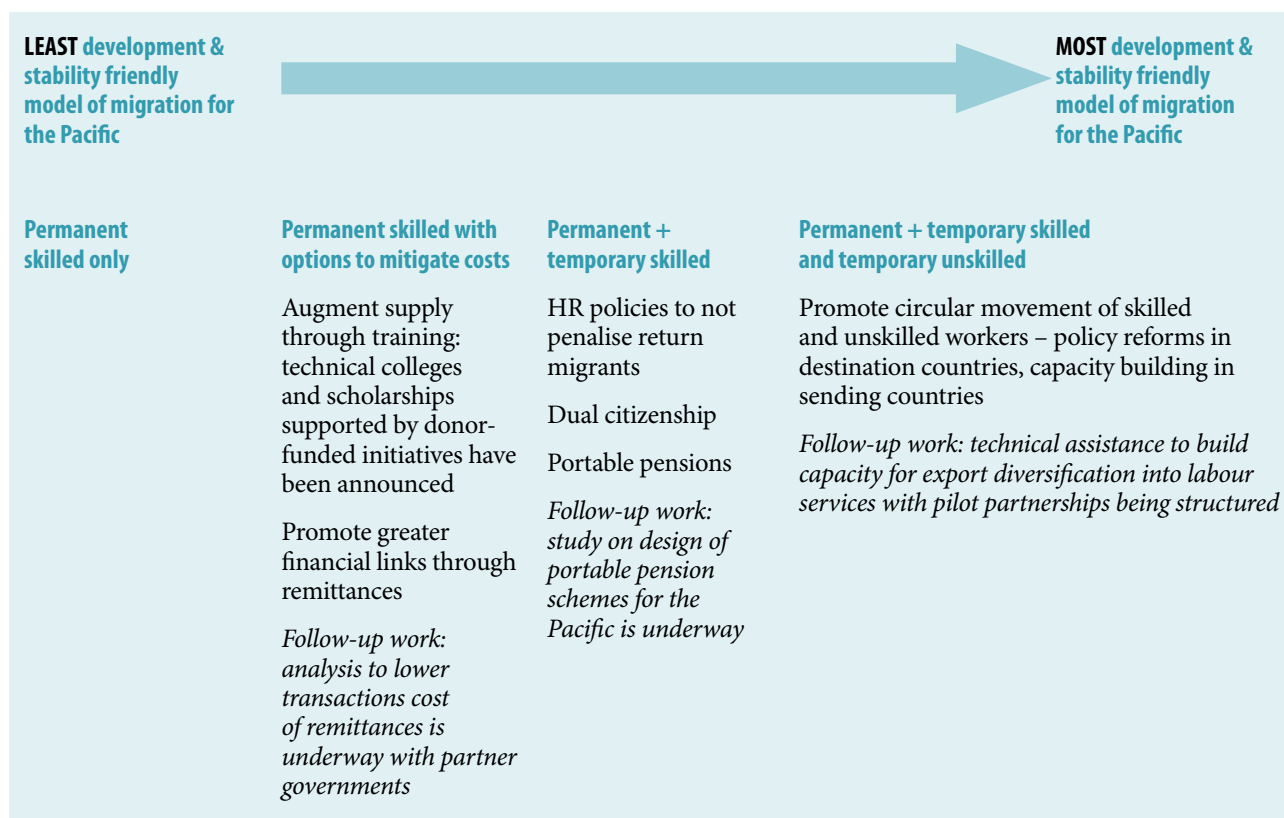
In ranking migration policies on the basis of their ability to support economic development and social stability, a scenario of only skilled workers migrating permanently with zero mobility for unskilled is probably least development-friendly (no migration at all for skilled could probably be worse); while a scenario of both skilled and unskilled moving in a circular fashion, generating financial flows as well as serving as conduits of social change, is likely to be most development-friendly for the Pacific. In between this worst and best-case scenario are approaches that provide compensation to sending countries by augmenting supply, which is very welcome in small states, as well as ensuring that financial links are strong. Efforts to encourage two-way flows of skilled workers would further bestow some pro-development outcomes but cannot be forced since there are good reasons for host countries and skilled migrants themselves to favour some permanent migration. This representation is intended to be interpreted in a heuristic manner rather than attempting to quantify costs and benefits linearly along the spectrum.

As a final comment, it is worth noting the regional experience of expecting strong development outcomes by focusing on the high-value sectors, such as fisheries or timber, has led to disappointment. This is because such sectors are characterised by high rent-seeking behaviour resulting in large incomes being concentrated in the hands of a few citizens. Instead, what Pacific islanders need right away—in the face of increased challenges of demography, as well as rapid globalisation of production and trade—is to explore as many different avenues as possible to allow them access to productive employment and the opportunity to create an economically safe future for themselves and future generations. While labour mobility alone will not transform the economic fortunes of Pacific islanders, it can make a significant contribution to the economic development and social stability in the region.

As labour mobility is being transformed from being purely an issue of domestic immigration policy into a complex development issue, this report hopes to make a timely contribution to the development dialogue in the Pacific Region.



**FIGURE 1.3 THE MIGRATION AND DEVELOPMENT NEXUS**



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## Notes

- 1 Restrictions on illegal migration are a separate issue. The focus of this chapter is on legal migration.
- 2 Pacific Island countries (*population and GDP per capita in 2004*) that are members of the World Bank Group are Fiji (840,800 and US\$3,098), Kiribati (97,800 and US\$633), Marshall Islands, Republic of (61,200 and US\$1,803), Micronesia, Federated States of (109,700 and US\$1,786), Palau (20,000 and US\$6,350), Samoa (183,700 and US\$2,030), Solomon

- Islands (465,800 and US\$513), Tonga (102,000 and US\$2,087), and Vanuatu (207,300 and US\$1,472).
- 3 These countries are not the micro-states that characterise the Pacific or even small states more generally.
  - 4 Both indices range from 0 to 50, and a total score of 100 would indicate maximum vulnerability to the elements. Positive ('floods') and negative ('droughts') rain shocks were generated by regressing yearly rainfall data against a time trend. (That is, climate change is assumed rather than constant mean temperatures.) The residuals from these regressions were then used to measure shock years which were arbitrarily defined as years in which rainfall was one standard deviation above the trend (predicted) value (to give 'floods') or one standard deviation below (to give 'droughts').
  - 5 The pattern for the Solomon Islands, however, is not as strong, though it is interesting to note positive growth in food production for the 1990s, a period which was relatively free of natural shocks, but negative growth in GDP, which is most likely explained by political instability and export price shocks.
  - 6 The impact of shocks on economic volatility is dependent on a number of attributes such as size of the agricultural sector, resilience of infrastructure to physical shocks as well as the financial structures. Financial institutions have significant impacts on how organisations cope with shocks through the process of credit rationing but the link between external shocks experienced and the development of the financial sector can be endogenous as frequent large shocks can inhibit the development of financial depth and risk prone financial institutions may send signals to overseas investors.
  - 7 The assumption is that the overall stock of workers in high-income countries would go up by 3 percent, implying mobility of 14.2 million workers from developing to high-income countries by 2025 (World Bank, 2006).
  - 8 Causality with adversity at the household level is hard to establish from data usually because of the likelihood of reverse causality where remittance receiving households can mitigate adversity better (better nutrition, frequent health checks). A follow-up study using macroeconomic data to assess the cyclicity of remittance flows is underway.
  - 9 The emigration and remittance experience of the North Pacific countries (FSM, RMI, and Palau) is quite different from that of the South Pacific. Citizens of these North Pacific countries can move freely to the United States and those who are successful in finding employment there are able to move immediate and extended family members without any restrictions. In addition, these countries receive fairly large compensation from the United States in exchange for access to these atolls for defense-related uses. For example, the Kwajalein landowners in the RMI get over \$14 million in annual payments each year in exchange for the right to use the atoll. Many of those recipients maintain their residences in the RMI but tend to live in their US homes. At a macro level, these outflows may be dwarfing any incoming remittances.
  - 10 Previously collected and analysed data from Samoa is also available and referred to where relevant.
  - 11 Or where the income effect is smaller than the substitution effect.
  - 12 World Bank study (forthcoming) will identify measures to reduce the barriers to competition in certain corridors.
  - 13 The decision to save remittance income may also be influenced by the temporariness of the positive income shock (temporary income tends to be saved more); a change in mental accounting on the part of the household; or the migrant's explicit preferences on how remitted income ought to be spent.
  - 14 Similar inquiry into a sample of Sri-Lankan households found some evidence of a shift from public to private education with the receipt of remittances.
  - 15 Depending on the temporal properties of income, the mental accounting of how this income is spent could vary.
  - 16 Experience in Egypt of the Moroccan migrants who took on Egyptian fertility rates went against the predictions in the 1970s of demographers who were estimating a sharp decline in fertility in Egypt and only a gradual one in Morocco. Two decades later the opposite had occurred despite higher rates of economic growth and levels of education in Egypt, signaling a transfer of 'values' particularly to the second generation of Moroccan-origin emigrants in Europe. Mexican data also showed how emigration can expose non-elite family members to the preferences of foreign country. A panel study of political attitudes in a cross-section of Mexico's population prior to the country's elections in 2000 questioned some 2,400 respondents about their party affiliation, their views on various political issues, and details about their families. This study revealed that those with relatives in the United States were more 'neoliberal' than those without similar connections.
  - 17 These results are at odds with global evidence where even the movement of skilled labour increases welfare, although emigration of unskilled labour increases welfare by much more for the sending country. The difference may be emerging from the fact that in the global exercises, much of the labour movement is emerging from large developing countries who may either have an over-supply of skilled workers to start with, or can quickly make up the loss and hence attenuate the rise in wages of skilled labour.
  - 18 Most liberal schemes are between countries that enjoy geographic proximity and similar levels of development. Less liberal are those that are among countries that are geographically close but differ substantially in their incomes.
  - 19 Malaysia and South Korea have indicated their interest in receiving labour from Timor-Leste to work in the construction and agriculture sectors. In particular, the Korean Government has agreed to accept 200 Timorese workers to work in the construction sector (with the request that the workers learn the Korean language). The European Commission's 'Strategy for a Strengthened Partnership with the Pacific Community, 2006' also notes the importance of access to industrialised country labour markets for Pacific islanders.

