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How rising net foreign income can drive living standards in Australia

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Abstract

While material living standards are best measured by gross national income per capita, projections of living standards in Australia are often based on gross domestic product per capita, thus ignoring the potential role of changes in net foreign income. Owing to changes in the eight key factors influencing a country's net international investment position, including the population ageing and the maturation of the superannuation system, Australia is set to become a creditor nation in coming decades and have GNI per capita above GDP per capita. Drawing on data from Australian Bureau of Statistics, the Commonwealth Treasury, and World Bank, this paper replicates the Commonwealth Treasury's Intergenerational Report model for projecting future gross national income, adding a net foreign income component. Over the four decades to 2063, annual net foreign income could reach over \$500 billion in real terms. Under the modelled scenario, per capita GNI could reach over \$140,000, 13 percentage points higher than Treasury's forecast. If this eventuates, it has significant fiscal and policy implications: projected budget deficits and gross debt are much lower and the fiscal consolidation task facing the Commonwealth Government is far smaller. A different set of equity and tax policy areas emerge as policy priorities.

Keywords: Net Foreign Income (NFI), Gross National Income (GNI), Gross Domestic Product (GDP), Living Standards, Net International Investment Position (NIIP), Superannuation, Intergenerational Report (IGR), Fiscal Policy, Economic Modelling, Australia, International Investment, Ageing Population, Productivity Growth, Current Account Balance, Equity and Tax Policy, Economic Development, Household Financial Assets, Cross-border Investment

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I Introduction

Gross domestic product (GDP) is the most often quoted barometer of economic performance for a country because it is widely understood, it is easily measured, it is linked to conditions in the labour market, and it is a basis for measuring productivity (Stiglitz et al., 2009). However, economists have long acknowledged that Gross National Income (GNI) per capita is a better measure of material well-being than GDP per capita.

GNI and GDP per capita are almost equivalent. Two factors separate them: the impact of changes in the terms of trade, export prices compared with import prices, and net foreign income (NFI), income earned by residents from abroad, minus income earned by foreigners.

GDP per capita is often used as a proxy for living standards. Partly, it is out of convenience, but also because changes in terms of trade or NFI are often marginal or cancel out over periods of time. For the gap between GDP and GNI to *continually* widen or narrow, the terms of trade or NFI must be *continuously* rising (or falling). In the long run, economic models often assume terms of trade and NFI are constant, so they do not play a big role in forecasting living standards.

This paper focuses on NFI. It sets out some policy background in Section II. It builds on the theoretical and empirical work by economists internationally in this area (Section III) and brings it into an Australian context (Section IV). Section V replicates the Commonwealth Treasury's Intergenerational Report model for projecting future GNI, adding an NFI component. Section VI and VII have the results and implications respectively.

II Living Standards in the Intergenerational Report

The most widely used projections of Australia's future living standards are the GNI per capita projections in the Intergenerational Reports (IGR) from the Australian Treasury (2023), published about every five years.

The IGR is designed to provide a longer-term picture of the sustainability of Commonwealth government finances. The first edition was in 2002, following its enshrinement in legislation through the *Charter of Budget Honesty Act 1998*. Australia was a leading country in the international trend towards longer term reporting. The origins were outlined by Mike Wood (2023).

The creation of the IGR reflected the economic policy sensibilities of the time, namely, that a clearer picture of the long-term budgetary consequences of government spending would highlight risks and strengthen the case for fiscal discipline.

The fiscal outlook sketched in the IGR depends on the economic outlook, which in turn depends on a demographic outlook. 'Demography is density' was the mantra in the early editions of the IGR. The general narrative was that declining fertility rates and population ageing would, in relative terms, narrow the income tax base compared with rising spending on the age pension and health care.

By design, the IGR assumes no policy change from current settings, so the consequences of policy inaction are supposedly laid bare. Since 2002, five more IGRs have been published in 2007, 2010, 2015, 2021, and 2023.

Limitations of the IGR's accuracy and scope have been identified over the years and are summarised in Andrew Podger et al (2023) *More than fiscal: The intergenerational report, sustainability and public policy in Australia.* The 2002 IGR's forecasts for population growth were too low, the forecasts for workforce participation too low, and the forecast for the sustainability of the retirement savings system too pessimistic.

In 2023, the IGR had broadened its remit, looking beyond mere demographic change, to also analyse how technology change and climate change would affect the economic and fiscal outlook.

What is the economic outlook that underpins the fiscal outlook? The '3Ps Framework' – Population, Participation, Productivity – are the long-term determinants of economic growth. The 2023 edition has a diagram showing how economic growth affects government spending and revenue, and government policies circle back and influence the 3Ps.

This simplification of the model ignores the terms of trade and NFI complexities of GNI. Terms of trade receives a brief discussion on p.xi of the 2023 IGR. Net foreign income effects are shown in Chart 1 (p.xii) without any discussion. However, the appendices and 'chart data' on the website have more information.

Table A.4.2 on p.253 has the key figures: by 2062-63, Australia's GDP per capita rises from \$83,900 to \$131,800 and GNI per capita rises from \$82,100 to \$123,900.

The breakdown of what is driving growth in is in the 'chart data' and replicated in Table 1. It shows that GNI per capita growth is comprised of all components (labour utilisation is the combined effects of both the population and participation Ps).

Decade	Per Capita Income Growth	Labour Utilisation	Net Foreign Income	Terms of Trade	Labour productivity
1980s	1.7	0.6	-0.2	0.1	1.2
1990s	2.2	-0.1	0.1	-0.1	2.2
2000s	2.4	0.2	-0.1	0.9	1.4
2010s	1.1	-0.3	0.2	0.1	1.1
2020s	1.1	0.4	-0.1	0	0.9
2030s	1.2	0.1	0	0	1.2
2040s	1.1	-0.1	0	0	1.2
2050s	1.1	-0.1	0	0	1.2

 Table 1: Intergenerational Report GNI per capita model

Source: 2023 Intergenerational Report, chart data

The primary focus of economic commentators at the time of the IGR's release was on the final column, labour productivity, because the projection was 'downgraded', based on recent experience, from the previously used 1.5%. According to the Productivity Commission (2023), living standards would be 20% lower than if 1.5% productivity growth occurred, and 40% lower than if a previous productivity performance of 1.8% was achieved, which was the figure used in the 2002 IGR.

The other components received little commentary. Not the relatively small changes in labour utilisation. Nor the terms of trade, on which the IGR said: "Commodity prices and the terms of trade are assumed to decline and then stabilise at a lower long-term level so they cease to contribute to growth in real

GNI per person, which grows in line with real GDP per person." Nor was there any detail on NFI, which as Table 1 shows, is assumed to have (almost) no impact on GNI over the coming decades.

The set of figures in Table 1 is a great demonstration of Paul Krugman's (1994) observation that, 'Productivity isn't everything, but, in the long run, it is almost everything.'

Under the baseline scenario, by 2062-63, the budget deficit (measured by the underlying cash measure) reaches -2.6% of GDP, and gross (public) debt reaches 32.1% of GDP. In sensitivity analysis in the appendices, Treasury shows that if GNI growth was higher (or lower) because of changes to any of population, participation, or productivity, the fiscal outcomes could be better (or worse). For example, under the higher productivity scenario, the budget deficit is only 1.0% of GDP and gross debt only 16.3% of GDP.

Getting the projections for GNI per capita right are critical for the fiscal accuracy. However, NFI is dealt out of the game – assumed to be zero and absent from the sensitivity test tables.

The next section has some theory about why NFI might cause GNI to move differently from GDP over time, and then I look at the evidence in Australia.

It is surprising that the potential for NFI growth is a surprise. After all, if population ageing and lower productivity growth mean lower GDP growth and fewer investment opportunities at home, the flip side of this is simply that more funds will be invested overseas in search of returns.

III Economic theory about GDP and GNI differences

A comprehensive database of net international investment positions (NIIP) and GDP/GNI differences for 66 industrial and developing nations was created by Lane and Milesi-Ferretti (1999) for the 1970 to 1997.¹ They found significant differences in the experiences of developing nations (such as Botswana) and industrial nations. Of the 22 industrial nations:

- 4 were permanent creditor nations (positive NIIIP): Germany, Netherlands, Switzerland and Japan.
- 11 were permanent debtor nations (negative NIIP): including Canada, New Zealand and Australia.
- 7 were 'switcher' nations (change between positive and negative NIIP): including Norway, the United Kingdom and United States.

According to basic accounting, a nation's NIIP changes over time based on either valuation effects (of various assets) or the current account balance (a deficit causes the NIIP to deteriorate). The current account in turn reflects the savings and investment levels of a nation. If a country invests more and/or saves less, the current account is in deficit and, ignoring valuation effects, its NIIP will deteriorate.

Many factors can impact investment and savings levels. They could be summarised under seven headings: stages of development, productivity growth, terms of trade, attitudes to savings and bequests, demographic profile, inequality, size and openness, and government pension policy. Economists have written about each of these.

On stages of development, Eichengreen (1991) showed a positive relationship between the level of development and net foreign assets (NFA). As a country becomes richer and capital abundant, it is more likely to become a net creditor.

¹ An updated paper from 2007 covers a slightly different period, 1972 to 2004, and has a greater focus on the composition of NFA. But the original paper sets out most clearly the issues I am discussing in here.

On investment, Obstfeld and Rogoff (1995) found that a positive productivity shock would result in a deterioration of the current account balance through both the investment side (by attracting more investment from overseas) and the consumption side (by increasing the long run optimum level of domestic consumption). Investment levels are also determined by world interest rates.

On terms of trade, the same authors found a positive terms of trade shock acts as an exogenous wealth transfer, improving the current account balance (noting there can be complexities in how this plays out).^{2 3}

On savings and bequests, the same authors say overlapping-generations models might affect the current account directly because more bequest transfers equal a higher savings level and makes a country more likely to be a creditor nation. It can also affect the relationship between fiscal policy and the current account (by muting what might otherwise be a negative impact of a budget deficit on the current account).

On demographic profile, Kábrt (2024) found a negative relationship between fertility rates and the current account balance and savings rates in high income countries. Obstfeld and Rogoff also comment here, saying ageing populations may have more savings motivated either to provide bequests, or be driven by the precautionary motive for savings (i.e. they do not spend all their money because they do not know how long they will live). They may also face psychological barriers to spending out of assets.

On inequality, Mian et al (2021) show that higher levels of inequality result in higher rates of savings. This would result in an improving NIIP for a nation over time.

On size and openness, Lane and Milesi-Ferretti (1999) find that country size and openness to trade affect NIIP. They do so by affecting investment levels because the influence the riskiness of investing in a country.

On government pension policy, Razin and Sadka (1995) find that public pension systems are less likely to raise national savings and result in a current account surplus.

With these factors in mind, Australia's debtor status in the latter part of the twentieth century is well explained. In fact, even if the Lane and Milesi-Ferretti work were replicated today, Australia would still be consigned to the permanent debtor column because it has continued to have a negative NIIP, negative NFI, and a negative gap between GNI/GDP in all the years since 1997.

However, there are reasons to ask whether, based on the theory above, that Australia could become a 'switcher' nation in coming decades. In fact, Australia has experienced a 'positive' change in all the eight drivers of its current account position in the past twenty years: it has become more developed, not experienced a positive productivity shock, it has experienced higher terms of trade, it has rising levels of bequests, it has an ageing population, it has rising levels of wealth inequality, it is a small and

² Relatedly, their data from the 1980s (on pp26 and 48) notes that of 15 countries included, Australia had the *biggest* currency depreciation and (negative) change in net foreign assets (as a share of GDP) and had the highest level of investment to savings (both as a share of income).

³ Exchange rate movements can also, separately, have impacts on NFA and NFI, but it is important to note that 'switching' (to use the Lane and Milesi-Ferretti phrase) from a debtor to creditor nation does not in and of itself produce exchange rate movements that 'cancel out' an improvement in a country's NIIP. As a country invests more overseas, that puts downward pressure on the exchange rate. That might increase the Australian dollar cost of servicing unhedged foreign borrowings, but will at the same time increase the Australian dollar value of foreign assets and earnings. Moreover, foreign investment outflows on the capital and financial account also generate income inflows on the current account (which puts upward pressure on the exchange rate). Further, any depreciation of the currency caused by foreign investment outflows also makes exports more competitive and could improve the trade balance component of the current account. This is a long way of saying exchange rate effects do not prevent a country becoming a creditor nation.

open economy, and it has one of strongest frameworks for encouraging private pensions: compulsory superannuation.

IV Recent trends in NIIP, GDP and GNI in Australia

Analysis of recent trends in Australia's GDP, GNI, NIIP, and NFI, provides evidence to suggest it could become a 'switcher' to being a creditor nation.

Australia recorded its first current account surplus in 2019 in 44 years. This caught the attention of economists, signalling that the long-term balance of Australia's investment and savings could be shifting. Initially, economists were reticent to celebrate. One article in the Australian Financial Review (Kehoe, 2021) was titled: "The surplus that is bad news for the economy." This reaction could be in part put down to reflex. After arguing that a current account deficit was *not* a problem in the 1990s, but instead a sign of investment virility, a current account surplus could *be* a problem if it signalled *inadequate* domestic investment opportunities and activity.

The shift in Australia's NIIP was noted by the Reserve Bank of Australia representative Penelope Smith in 2023 in a speech titled "The Extraordinary Decline in Australia's Net Foreign Liabilities," where she observed that net foreign liabilities had fallen from 63% of GDP in 2016 to just above 30% by 2023. At that time, investors hypothesised that Australia had more savings because of the maturation of Australia's system of compulsory superannuation and could become a 'southern Switzerland' (Korporaal, 2023). But it was also a story of inadequate investment opportunities at home – in March 2025, Australia's largest superannuation fund, AustralianSuper was reported as saying it was months from reaching 'an effective cap on how much it can invest in ASX-listed companies.' (Baird, 2025). Indeed, APRA (2025) statistics show that the proportion of superannuation assets held *offshore* increased from 23% in September 2013 to 38% in September 2023.

But while there are these early signs Australia might be switching to being a creditor nation, and having a GNI per capita above GDP per capita, it is hard to disentangle the long-term story from short term fluctuations. The last decade has seen significant volatility in exchange rates, interest rates, and growth rates that blur the picture.

In 2024, Australia continued to record a significant net primary income deficit. While net primary income from equity assets was in surplus, the debt interest component was deeply in negative territory because of the sharp increase in global interest rates as economies emerged from the COVID-19 recession (ABS, 2025).

GDP/GNI figures from the World Bank tell the same story. After having a GNI per capita on average \$1300 *below* GDP per capita in the 2000s and 2010s, the gap fell to just \$655 in 2021. But then by 2023 it has jumped up to \$3000 because of interest rate and exchange rate effects (World Bank, n.d.). Longer term ABS figures show GNI catching up GNP – the gap fell from 17% to 4% between the 1990s and 2020s (so far), but this cannot be relied upon because it includes terms of trade effects (ABS, 2025a).

However, longer term indicators are more promising for Australia to be 'switcher', to have a positive NIIP and have GNI above GDP. Net wealth as a proportion of the economy increased from less than 5 times to over 9 times over the thirty years to 2025 (RBA, 2025). While some is more valuable (or expensive) housing, *financial* assets grew to be worth \$8 trillion, with superannuation the main driver.

Australia's superannuation assets are forecast to rise from being worth 157% of GDP in 2021 to 244% of GDP by 2061 (Treasury, 2021).^{4 5}

Rising investible assets that saturate domestic opportunities in an economy experiencing weaker GDP growth is a recipe for an improving NIIP.

I'd to conclude here with a brief comment on what is causing Australia to shift to being a creditor nation. Importantly, it is not one factor alone. Based on the factors outlined in Section III it is the combination of Australia reaching a higher level of economic development, having an ageing population, experiencing more inequality⁶, and having a comprehensive superannuation system supported by compulsory contributions and generous tax incentives. It also has a superannuation system that does not address longevity risk and may discourage dissaving. It also has lower productivity growth and fewer investment opportunities at home. And it has a culture (and policy settings) supportive of bequests. If Australia *only* had an ageing population, or *only* had compulsory superannuation, or didn't have a productivity slowdown, or if Australia was a developing country, or if hypothetically, bequests were banned, then maybe the shift towards creditor status might not happen.

V A model to project NFI's contribution to GNI growth

Incorporating NFI growth into the IGR's model for per capita GNI growth requires adopting the IGR's assumptions, making several more, having a forecast of growth in investible assets, and then applying this to NFI and GNI.

The key IGR assumptions relate to the exchange rate, inflation rate, interest rates, and the terms of trade. Obviously, these will move around in practice, but I'll keep them constant so we can see the effects of rising Australian investment abroad.

For simplicity, in the model I assume that growth in Australia's investible funds affects the NIIP through one channel – more Australian equity investment abroad. That is, Australia does not buy *back* the farm, pay off debt or start loaning money overseas. In the model, from 2024, Australian equity investment abroad grows strongly, foreign equity investment here grows modestly (by CPI is my assumption), and net foreign debt stays negative and grows at historical rates. The assumption is based on observed foreign investment behaviour of superannuation funds – according to APRA (2025) data, most foreign investment is in foreign equities (fixed income and unlisted infrastructure are the other two categories), and the most growth in the past decade has been in foreign equities.⁷ So, this approach is a reasonable simplifying assumption for an illustrative model.

There is another small component of the (foreign) income balance called 'secondary income' that includes foreign aid and remittances. It is negligible and I assume it continues to be negligible.

⁴ The 2023 IGR uses a lower base but still has superannuation almost doubling over the 40-year forecast period, from 116% to 218% of GDP.

⁵ What about the public sector? Could a deterioration in net financial worth of the public sector detract from or offset an improvement in NIIP and NFI caused by rising private sector wealth? In theory yes, but not according to the numbers. In the 2023 IGR, public sector net financial worth is projected to improve over the forecast period, from -29.5% of GDP in 2022-23 to -24.5% of GDP by 2062-63 (noting it gets better and then begins to worsen). But at least for the time period of this paper, the public sector's impact can be put to the side.

⁶ The 2021 IGR projects superannuation balances by level over the subsequent 40 years. An increasing share of balances are in the two top brackets of \$1 million to \$1.6 million and \$1.6 million plus (real dollars).

⁷ Further, the Lane and Milesi-Ferretti (2007, p.46) data shows that most industrial countries have positive net foreign equity positions and negative net foreign debt positions, so that would seem the more likely trajectory for Australia rather than the alternative.

The investment return figures I use come from long-term averages published by Canstar (Hayden, 2022). Returns on foreign equity investments abroad are 9.1%, returns to foreign owners of Australian equities are 9.8%, and returns to foreign owners of Australian bonds are 6%.

There is some complexity in how income is treated in the current account. I treat *portfolio investment – interest*, and *other investment returns* as debt, earning the 6% rate of return. All the other items are treated as equity, so they earn 9.1% for inflows and Australia pays out 9.8% on outflows.

For the growth in investible assets, I have used Treasury (2021) projections for the level of growth in superannuation assets. These are forecast to rise from \$3.1 trillion in 2021 to \$14.3 trillion (in real terms) by 2063.⁸ Applying the inflation rate to this figure over the next forty years provides a superannuation pool of \$38.5 trillion in nominal terms by 2063. Finally, I assume non-superannuation financial assets, grow at the same rate as super, as they have done for the past 15 years, so total household financial assets are \$73.8 trillion in nominal terms by 2063.

VI Results

		2024	2063
Stocks (\$ billion)			
Retirement assets		4,082	38,524
Household financial assets		7,823	73,830
Foreign assets equity		2,721	25,680
Foreign liabilities equity	-	1,986 -	5,202
Net foreign liabilities equity		735	20,477
Net foreign liabilities debt	-	1,389 -	6,005
Flows (\$ millions)			
Primary income credits - equity*		80,527	2,336,836
Primary income debits - equity	-	118,213	- 509,843
Net income debits - debt	-	43,693	- 360,316
Net foreign income	-	81,379	1,466,678
Households			
Population (millions)		27	41
GNI per person from NFI (\$)	-	3,014	36,214
Real GNI per person from NFI (\$)	-	3,014	13,487

Table 2: NIIP Modelling results

* debt returns are portfolio investment interest and other investment returns,

As shown in Table 2, the key findings of the modelling are:

• Australia's foreign equity investments abroad reach \$25.7 trillion by 2063 (i.e. they make up a third of household financial assets), while foreign equity investments in Australia grow to \$5.2 trillion, so net foreign equity is a \$20.5 trillion surplus.

⁸ I have performed two simple calculations, multiplying the projected GDP level for 2061 by the projected superannuation share of GDP for 2061, and used the same annual growth rate for two more years to obtain a 2063 figure.

- Australia's net foreign debt grows in line with its historical growth, 45% over a ten-year period), to be worth \$6.0 trillion in 2063.
- Australia achieves an annual net foreign income surplus of \$1.5 trillion by 2063 (comprised of \$1.8 trillion on the equity side minus \$360 billion on the debt side). This is \$546 billion in real terms, in 2023 dollars.
- NFI contributes \$36,000 per person GNI in nominal terms, or \$13,500 in 2023 dollars.

The NFI can be added to Treasury's IGR model for GNI per capita projects. It is not simply the total amount, but the turnaround, from a \$3,014 deficit to a \$13,500 surplus, that must be incorporated. That is, \$16,500.

Before I do, I'll try and answer this important question. While the NFI bonus itself can obviously be permanent, as witnessed in the Lane and Milesi-Ferretti data for four countries over 1970-1997, can the *growth* in the NFI bonus can be permanent?

The answer it can be, but it depends. Based on the trajectory of superannuation growth in the IGR, Australia will have an increasing NFI 'bonus' added to GNI until at least 2063, and maybe for the rest of the twenty-first century. However, the IGR has Australia's superannuation growth slowing (as a proportion of GDP), so it will eventually plateau. This is based on assumptions about the growth rates of contributions (which slow), earnings (which increase), and drawdowns (which increase). If earnings growth outstrips drawdowns, then yes, the NFI bonus (at least for a small open economy) could grow forever. But if future generations spend more, or foreign governments react by restricting or taxing these investments then that could end the growth.

VII Implications and discussion

Table 3 reproduces Treasury's IGR results but adds an extra row of the difference between GNI and GDP, and an extra column, of the model's results, which is simply the net NFI 'bonus' from the previous section, i.e. \$16,500 extra income per capita in 2062-63. The numbers have some important implications.

Table 3 GNI projection results

		Actual		IGR baseline	р	IGR high roductivity		Model
		2022-23		2062-63		2062-63		2062-63
Economic								
Real GDP per person (\$)	\$	83,900	\$	131,800	\$	144,000		n/a
Real GNI per capita (\$)	\$	82,100	\$	123,900	\$	135,400	\$	140,400
GNI-GDP (real, pp, \$)	-\$	1,800	-\$	7,900	-\$	8,600	\$	8,600
Fiscal projections (% of GDP)								
Underlying cash balance		0.2	-	2.6	-	1.0	-	0.5
Gross Debt		34.9		32.1		16.3		11.5
Sources: Treasury and author								

First, GNI per capita grows to \$140,401, 13% higher than the 2063 IGR forecast of \$123,900. About 28% of the growth in income over the next forty years comes from NFI, with the remainder largely coming from productivity growth.

Second, instead of Australia having a GDI per capita \$7,900 *lower* than it's GDP per capita, it has a GNI \$8,601 *above* its GDP forecast. It has become a Lane and Milesi-Ferretti 'switcher'. (I note here that the IGR projects the GDP/GNI gap to worse in coming decades, driven by lower terms of trade).

Third, if Australia achieves a GNI per capita of \$140,400 with additional NFI, this is higher than the IGR's high productivity scenario, where annual productivity growth is 1.5% rather than 1.2%. One could say that Paul Krugman is not right, productivity is not 'almost everything'; NFI is a non-trivial driver of long-run living standards growth. At least for a small economy operating in a global economy with cross-border investment flows.

While on the productivity point, one could ask: does this mean we do not need to worry about productivity growth? Not exactly, but it does mean we can worry less. Policies and investments that increase productivity growth would, for the most part, lead to even higher growth in per capita GNI. But there is one important caveat. An implication of Obstfeld and Rogoff's model is that it is precisely when productivity is lower and domestic investment opportunities are more limited that people invest more abroad and NFI contributes more to per capita GNI. So, anything that lifts domestic productivity would, to some extent, keep more investment at home and reduce the effects described here. That wouldn't necessarily be a bad thing. The good news from the analysis here is that if productivity growth does indeed remain subdued, Australia at least has this 'consolation prize' of earning more from foreign investments.

Fourth, higher future income means a totally different fiscal outlook for Australia: it's a much less gloomy picture. This is because higher income levels increase the tax revenue and reduce the cost of asset- and income-contingent government payments such as the aged pension. Under the high productivity scenario's income level, the underlying cash balance (as a % of GDP), is just -1.0% in 2063 (not -2.6%) and gross debt is just 16.3%, not 32.1% in 2063. If higher income improved these two measures linearly, under the model's income level, the underlying cash balance falls to -0.5% of GDP and gross debt to 11.5% of GDP by 2063.

This challenges the core conclusion of most IGRs and its initial raison d'être, i.e. that Australia must undertake fiscal consolidation to avoid a long-term budgetary problem. Instead, based on this analysis, the fiscal outlook for Australia is rather benign.

However, before slapping a 'she'll be right, mate' sticker on the IGR, it's important to note one big asterisk: Australia's tax system. The additional GNI that will be earned in the modelled scenario (through superannuation) is likely to be subject to lower tax than income in the higher productivity scenario (through waged labour) This makes the case for tax reform (to treat all income more equally and harmonise the taxation of savings as suggested by Sobeck, Breunig, & Evans, 2020) even more important.⁹

The analysis in this paper adds to the limitations of the IGR listed by Andrew Leigh in his 2023 speech launching the Podger book. It has been shown that previous IGR projections for population, participation and productivity have been off by some margin. Australia's population has boomed beyond expectations, the rapid decline in participation never happened, and the resurgence of productivity growth never materialised. We had an unforeseen commodity boom. Now we have a fifth problem – the IGR's disregard for the fifth factor that could be a serious basis for rising incomes over time.

With higher income growth, Australia's supposed fiscal woes may be nothing more than a trivial budget deficit of just 0.5% of GDP in 2062-63. As a basis for focusing policy debate, it's underwhelming to say the least. A far more worthy focus for policy would be how Australia's rising

⁹ Consider that, according to the 2021 IGR, between 2021 and 2061, the cost of the age pension will (only) fall from 2.6 to 2.1% of GDP, while the 'cost' of concessions on superannuation earnings will increase from 1 to 1.9%.

assets will be shared. Andrew Podger, Robert Breunig and John Piggott (2023) are dead right to say: "increasing equity, not costs, across generations is the intergenerational problem."

The 2023 edition of the IGR moves somewhat towards a proper economic foresighting piece. It incorporates technology and climate trends. Other good suggestions come from Andrew Leigh, John McCallum, Lindy Orthia, and Diane Hosking. They say Australia would be better served with an IGR that also looks at social capital, wellbeing, and existential risks (such as bioterrorism, nuclear war and rogue artificial intelligence).

A country reliant on foreign income faces a different set of risks that must be carefully considered by policy makers. Australia would face greater exposure to volatility and changes in investment laws abroad. Australia may need to review governance laws of superannuation funds, investment managers, and companies. There may lower tax collected for a given level of income, both because of different rates across income classes as mentioned above, and because earnings abroad itself may reduce transparency and create more opportunities for tax minimisation.

VIII Limitations and further research

There are a number of limitations of this modelling exercise that may not see the expected result of rising living standards from rising net foreign income. First, many of the variables assumed to be constant in the long term may not be. A major change in the terms of trade, exchange rate, interest rates, or inflation would change results. If there is a major change in any of the key investment propensities, between Australia and abroad, and between equity and debt, this will affect relative returns, and the magnitude of any net foreign income 'bonus'. If Australian investors, typically professional fund managers or corporations, are unsuccessful investing abroad, returns will be lower.¹⁰ Finally, if there are any major changes to foreign investment rules abroad or in Australia, including changes to tax policy, that could deter the cross-border investment activity upon which all this paper's thinking relies.

Further research could validate or refine the modelling in this paper in some important respects. A full NIIP model, using household assets and foreign investment propensities, could be formally incorporated into the IGR's GNI per capita growth model. Lane and Milesi-Ferretti's model could be fully updated, with cross country data of NIIP, NFI, GDP and GNI to establish long run econometric estimates of the relationship between these variables, for a more reliable projection than one simply based on rising household financial assets in Australia. This would need to take into account how different countries fund retirement, between private, public and hybrid systems.

¹⁰ The risks of international investment are not new though. Obstfeld and Rogoff reach all the way back to 1343 for a relevant example. They recall when the powerful Florentine banking houses, those of Bardi and Peruzzi, were bankrupted after providing foreign finance for King Edward III's invasion of France, and the sovereign was subsequently unable to meet his obligations.

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