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The Rising Isolation
of the Island Nation

Five Economic Themes That Will Dominate the Next Parliament

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Executive Summary

The world has changed dramatically since Australia's last federal election. In 2022, cost-of-living pressures from rising inflation were only starting to emerge in Australia, action to address climate change had some global momentum, and globalisation was still ascendant.

In just three years, the landscape has shifted. The world has become more fragmented and unpredictable, accelerating trends in populism and geopolitical tensions. This fragmentation has reshaped economic policymaking globally. The Biden administration's pursuit of an industrial policy strategy, through initiatives like the Inflation Reduction Act and the reshoring of semiconductor production, marked a significant shift in economic strategy. The new Trump administration is aggressively using tariffs as a negotiation tool across various domains from immigration to national security, trade and tax policy.

This may not be favourable to Australia. Much of Australia's prosperity was built on trade, openness to global capital and the relative stability of the post-World War II global order. These changing global dynamics also come as Australia faces domestic economic challenges, including a slowdown in productivity growth, and growing fiscal pressures. Australia's policy thinking and political system face a critical test.

Australia's last successful era of major economic reform in the 1980s and 1990s was underpinned by deep and broad-based policy thinking. This was the combined effort of leading free-market thinkers, union leaders, academics, think tanks, bureaucrats and media commentators. A new partnership between e61 and UNSW aims to contribute to the next stage of significant reform in Australia.

In this joint report by e61 and UNSW, we highlight five economic themes that will shape Australia's policy debate in the coming years. We hope this will assist policymakers as they adapt to the new global order and tackle domestic pressures by framing the big policy challenges and identifying where policy needs to adapt.

The 5 key themes are:

01 Negotiating a new global order

As the world moves away from a rules-based system, Australia must leverage its comparative advantages, push back against a closed world, build flexibility in the domestic economy and find opportunities in the move to 'friendshoring'.

02 Re-examining a high population growth model

As Australia's immigration system faces political pressure, policymakers may need to rethink how to manage domestic challenges, including housing affordability pressures and an ageing population.



03 Boosting productivity growth

The changing global and domestic landscape make addressing the drivers of Australia's productivity slowdown even more imperative.

04 Restoring fiscal sustainability

While Australia's budgetary pressures are only set to grow, a balanced budget and low debt can help Australia weather global shocks.

05 Achieving a sustainable intergenerational bargain

Without budget reform and improved productivity growth, Australia risks younger generations being worse off than their parents and grandparents.

Australia's policy challenges are significant: as large as at any time in the last four decades. The next Parliament will have to respond, and its response will be critical to the wellbeing of all Australians.



01

Negotiating a new global order

The global economic order has shifted. The rules-based system is giving way to a new era of power-based transactional negotiations, more like an arm wrestle among 'strongmen' leaders.

Many nations are abandoning open trade and climate action. Others will pursue one or both, but outside any multilateral, rules-based structure. Many are pursuing industrial policy in the name of resilience, self-sufficiency or sovereign capability.

This is not a temporary blip. A rules-based order relies on credible long-term commitment. The ripple effects of recent, dramatic US policy changes are far-reaching and cannot be easily reversed. There is no return to normal.

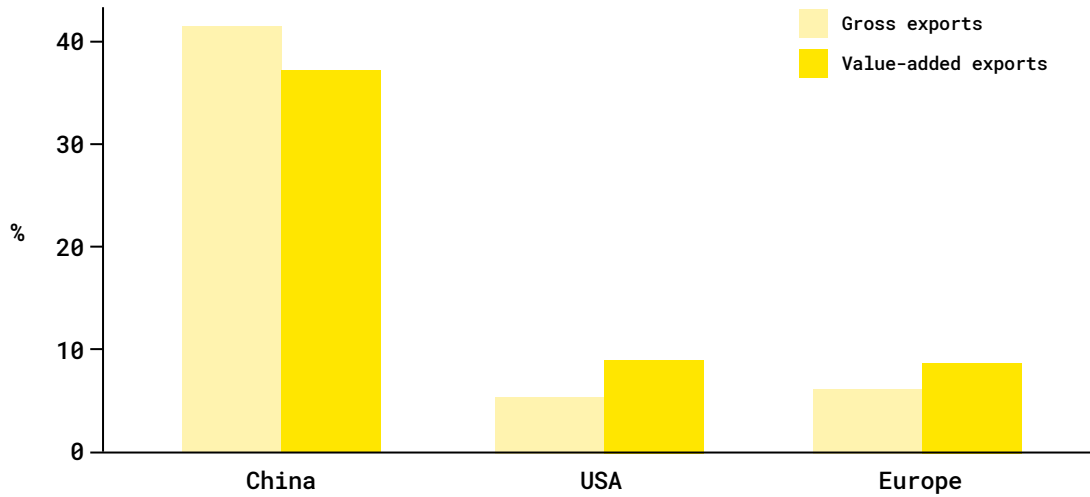
The risk to Australia is stark. China, Australia's most significant economic partner, and the United States, Australia's most significant geopolitical partner, are

engaging in an ever-increasing trade war. Australia's relationship with China has been complex for some time – a critical trade partner without strategic alignment. Now Australia's relationship with the US brings its own complexity – a strategic ally whose economic agenda conflicts with Australia's interests.

Australia's exposure goes beyond direct US tariffs on its exports. Australia sells goods and services to China, but the value-added embodied in these exports disproportionately ends up in the United States and Europe (Figure 1). If the trade route from China to the United States weakens, Australian exporters are highly exposed. Trade policies that weaken China's economy, on top of their existing structural weaknesses, will ultimately reduce Australian incomes.

FIGURE 1**Australian exports by major destination**

Share of total exports; 2020



Sources: e61; OECD

Meanwhile, climate change remains an urgent challenge. Australia's major parties are committed to net zero. But Australia's ambition to be a green energy superpower faces hurdles. It relies on foreign demand for green products, including energy-intensive value-added goods produced in Australia. But with global commitment to emissions reduction now less clear, and economies pursuing tariffs, industrial policy and onshoring, Australia's ability to export low-cost renewable power is in question.

Australia must respond to this new dynamic. While many nations have responded by protecting and building up their domestic manufacturing capabilities, Australia should take a different approach.

Instead, in negotiations, Australia should maximise and demonstrate its strategic advantages with the United States and China. Australia offers security to the United States, based on its location in the Indo-Pacific, and economic resources, such as raw materials, to China. Australia needs to also continue to advocate for open trade and market access at home and abroad. Beyond the fiscal costs, protectionist and industrial policies will not build the agility needed in an increasingly

unpredictable world. Policymakers should look to build greater economic flexibility to rapidly respond to new opportunities. As the Treasury Secretary highlighted recently, trade-exposed firms need to be flexible in switching their imports and exports to other countries as needed.¹

Altogether, this could position Australia to find opportunities in the shift to "friendshoring" – trading with trusted partners. In an increasingly unpredictable world, Australia is well placed to benefit. Australia's stable financial system, democratic institutions and rule of law make Australia increasingly attractive to other nations and foreign investors navigating this new world order.

1 Australian Treasury. (2025, February 25). Opening statement to the Economics Legislation Committee. <https://treasury.gov.au/speech/opening-statement-economics-legislation-committee-feb-25>

02



Re-examining a high population growth model

Immigration is a hot topic across the developed world. It has been a consistent theme in several elections as peer nations respond to the new global order by rolling back both planned and uncontrolled immigration.

Australia is not immune. The immigration system has come under scrutiny post-COVID, with record high net overseas migration driven by a catchup in migration following the re-opening of Australia's international borders.² Now both major parties are seeking to slow the rate of immigration, potentially to below pre-COVID levels.

Australia, more than almost any other developed country, has had a high population growth model. Over the past 20 years, Australia's population has grown by about 35 per cent – significantly higher than the OECD

average of 13 per cent, and faster than other young, developed nations like Canada (27 per cent) and New Zealand (30 per cent). This has come with clear benefits, helping keep Australia younger, filling domestic skill gaps and providing a rich cultural diversity. Treasury estimates that the average permanent migrant contributes \$127,000 more in taxes, net of benefits, than the average Australian over their lifetime.³

But migration has come with cumulative costs. Population pressures have increased housing demand, with supply failing to keep up. Both geography and policy have played a role in this imbalance. Australia has a rare combination of a highly urbanised population with disproportionate levels of detached housing, making it an outlier in the developed world (Figure 2).

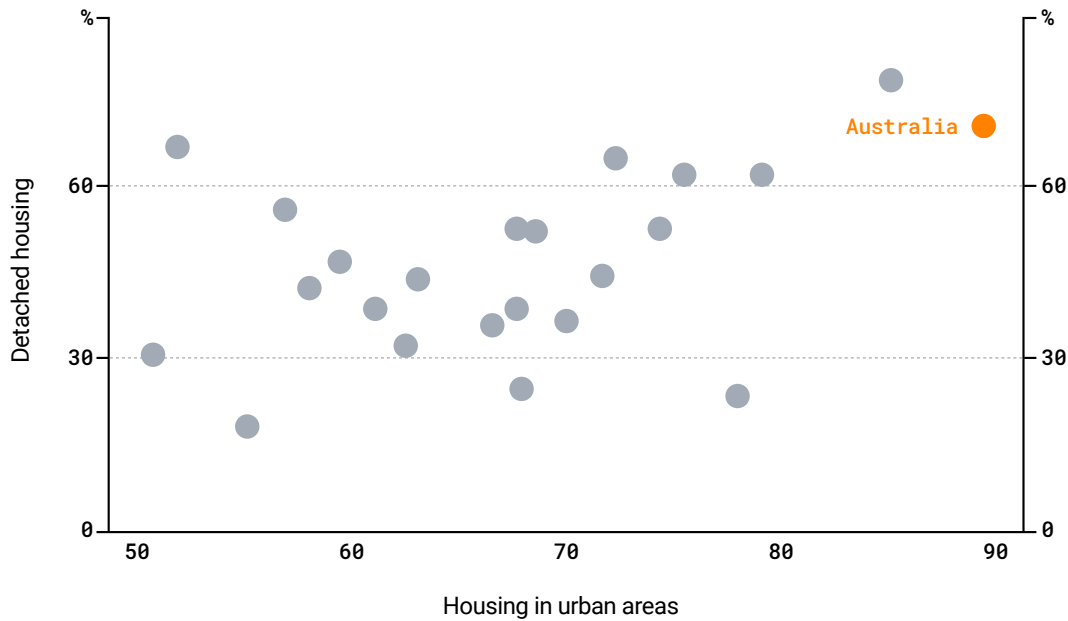
2 Australian Bureau of Statistics. (2024). *Overseas migration, latest release*. <https://www.abs.gov.au/statistics/people/population/overseas-migration/latest-release>

3 Varela, P., Husek, N., Williams, T., Maher, R., & Kennedy, D. (2021). *The lifetime fiscal impact of the Australian permanent migration program*. Australian Treasury. <https://treasury.gov.au/publication/p2021-220773>

FIGURE 2

Australia's unique housing stock

Detached housing (%) vs. housing in urban areas (%) across OECD countries



*Grey dots represent other OECD countries. Data is from the most recent year available.
Sources: e61; OECD.

Hence rapid population growth, largely housed in existing large cities, has inevitably required greater densification. This approach has created political challenges, as demonstrated during the current cost-of-living crisis where public support for immigration has seemingly declined. Densification has also come with fiscal pressures, particularly for state governments building expensive brownfield infrastructure.

And Australia's large construction sector compared to other developed countries (as a share of the economy) means Australia has been more affected by the global slowdown in construction productivity in recent decades. This has hampered Australia's ability to house a rising population in a timely and efficient way.

Australia may not be able to rely so heavily on immigration to boost growth, fill skills shortages and manage demographic challenges, but none of these challenges are going away. Treasury's 2023 Intergenerational Report estimated that the share of Australia's population aged over 65 will increase from 17.3 per cent to 23.4 per cent over the next 40 years.⁴ High immigration has mitigated Australia's rate of ageing but policymakers may now look inwards to address this challenge. This comes with its own risks, if policymakers try to manage ageing population pressures through expensive and ineffective fertility policies.

If immigration is potentially moderated, policymakers need to be asking what alternative economic growth strategies Australia has. Boosting productivity has historically been the method.

4 Australian Treasury. (2023). *Intergenerational Report 2023: Australia's future to 2063*. <https://treasury.gov.au/sites/default/files/2023-08/p2023-435150.pdf>

03



Boosting productivity growth

The changing global landscape makes boosting productivity critical. Australia's productivity performance is already on a decline: annual growth fell from over 2 per cent in the 1990s to under 1 per cent in the 2010s and has been flat since the start of COVID-19.

Below-trend labour productivity since 2014 has come at a cost of around \$11,000 in lost income per person, per year. To boost productivity, it's important for policymakers to understand the drivers of its slowdown.

International research links the slowdown in productivity growth to a decline in 'economic dynamism' – the extent to which the economy uses and reallocates resources.

Some explanations include slower technological progress and the impact of an ageing population on labour supply. But there are signs that the decline in economic dynamism is not totally benign.

The rate of new firms entering and old ones exiting has declined, leading to an ageing business population.⁵ Young firms contribute disproportionately to growth and place pressure on incumbent firms to improve their productivity. The decline in the rate of business entry has been particularly pronounced among firms that hire workers. Rising market concentration in key sectors could be a factor, creating barriers to entry for new firms.

On the worker side, fewer people are switching jobs.⁶ Job mobility is an important source of wage growth. On average, those who switch jobs obtain a \$5,700 wage gain relative to those who do not switch.⁷ When workers switch jobs less frequently, they may be staying in firms that do not best match their skills or interests.

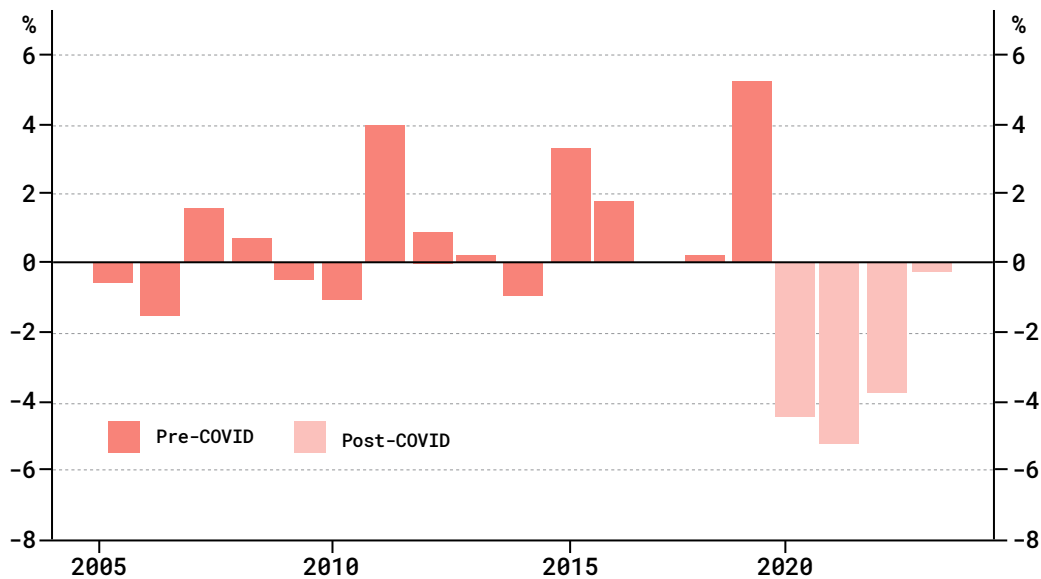
5 e61 Institute. (2022). *Better harnessing Australia's talent: Five facts for the Summit*. <https://e61.in/wp-content/uploads/2022/09/Better-harnessing-Australias-talent-five-facts-for-the-Summit.pdf>

6 Wong, A. (2024, February 15). *Climbing the wage ladder: Linking job mobility and wages*. e61 Institute. <https://e61.in/climbing-the-wage-ladder-linking-job-mobility-and-wages/>

7 Wong, A. (2024, February 15). *Climbing the wage ladder: Linking job mobility and wages*. e61 Institute. <https://e61.in/climbing-the-wage-ladder-linking-job-mobility-and-wages/>

FIGURE 3

Share reporting a well-matched job Difference from pre-COVID average*



*Controlling for age, education, occupation, and industry using an Ordinal Logit model.
Sources: e61; HILDA wave 23

Since COVID-19, the share of workers stating that they are using many of their skills or abilities in their job has fallen (Figure 3).⁸ While in 2023 this share improved, likely due to a historically strong labour market, it remains around, not above, pre-COVID averages. So, despite a tight labour market there are barriers to people finding a well-matched job. These barriers could include non-compete clauses,⁹ occupational licensing,¹⁰ and industrial relations policies that favour the principle of protecting jobs instead of workers.¹¹

Another potential contributor to the productivity slowdown is the rapidly growing care sector, which is now Australia's largest industry.¹² The care sector is labour intensive, and dominated by government provision, funding and regulation. It has a low measured level of productivity, as well as historically slow productivity growth. The care economy's workforce expansion has

been facilitated by workers leaving other industries, such as Accommodation and Food, and Retail.¹³ The sector provides critical services. But as it expands it drags down current, and potential future, economy-wide productivity growth and adds to a growing fiscal burden (section 4).

Given other challenges, boosting productivity is as important as ever for Australia's prosperity. There is no quick fix. Policymakers need new insights on how to create an environment conducive to the emergence and growth of high potential firms, how to remove barriers to job switching, and ways to achieve productivity growth in sectors like care, where it has traditionally been hardest.

Boosting productivity will also help deal with Australia's growing fiscal pressures.

8 Nolan, M. (2024, September 13). *Have we ended up in the wrong jobs post-COVID?* e61 Institute. <https://e61.in/have-we-ended-up-in-the-wrong-jobs-post-covid/>

9 Buckley, J., Rankin, E., & Andrews, D. (2024, October 14). *Non-compete clauses, job mobility, and wages in Australia.* e61 Institute. <https://e61.in/non-compete-clauses-job-mobility-and-wages-in-australia/>

10 Bowman, J., Hambur, J., & Markovski, N. (2024). *Examining the Macroeconomic Costs of Occupational Entry Regulations* (RDP 2024-06). Reserve Bank of Australia. <https://www.rba.gov.au/publications/rdp/2024/pdf/rdp2024-06.pdf>

11 Buckley, J. (2024, September 27). *Beware the unintended consequences of IR reform.* e61 Institute. <https://e61.in/beware-the-unintended-consequences-of-ir-reform/>

12 Maltman, M. (2024, December 20). *No economy for young men.* e61 Institute. <https://e61.in/no-economy-for-young-men/>

13 Maltman, M., & Rankin, E. (2024, October 10). *Care economy: Rebuilding for resilience.* e61 Institute. https://e61.in/wp-content/uploads/2024/10/Care_Economy-2.pdf

04



Restoring fiscal sustainability

Fiscal policy is the foundation on which broader economic policies are built. Weak public finances can undermine confidence about future policy and limit governments' ability to respond to adverse events.

Restoring Australia's fiscal sustainability is imperative if Australia is to deal with the challenges of this new global order.

Australia's debt-to-GDP ratio is low compared to OECD peers. But the direction of travel is concerning. Current estimates project the federal budget to be in deficit for every year over the next decade. The eventual return to balance is reliant on ever-increasing taxes, including through bracket creep, and no new spending priorities or emergencies over that period.

These projections, of course, don't include the potentially significant fiscal implications of the structural changes identified in this report. A fall in the price of exports due

to a strategic standoff with China, or global trade war, can quickly reduce government revenue – a US\$10 decrease in the iron ore price (relative to forecast) decreases federal government revenue by \$3.4 billion over the forward estimates.¹⁴ Any step-up in defence capability, or payments to domestic firms to become more flexible, will add to government expenditure.

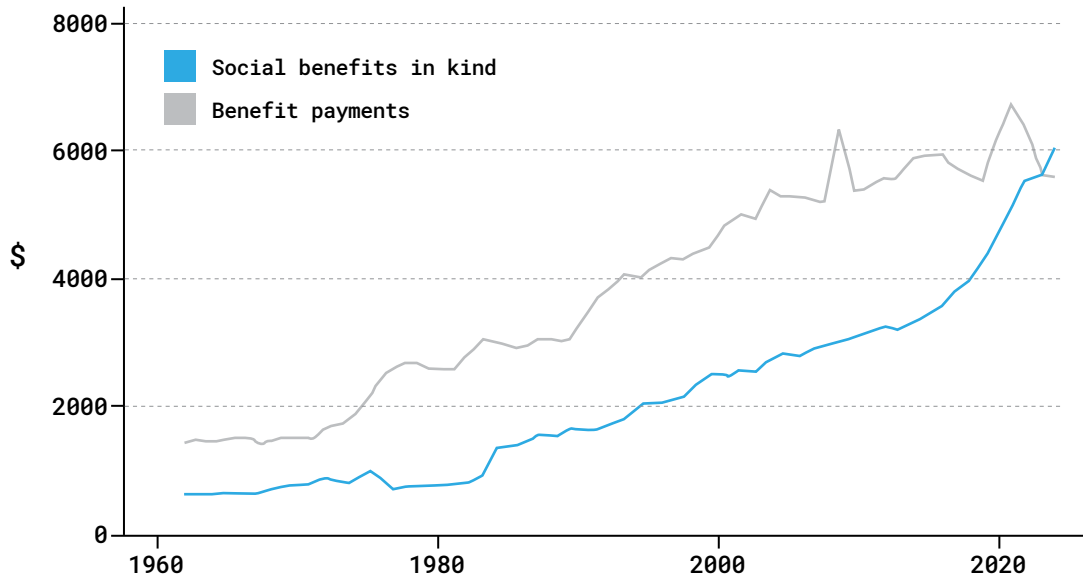
The focus on the Federal fiscal position often misses the increasing role of the States. State government budgets will add as much to the total fiscal deficit as the Federal government over the coming years, coming off the back of significant debt accumulated through the COVID-19 responses.

State deficits are driven by increased capital spending, arguably a belated response to strong population growth over the last two decades, and the ongoing lack of productivity growth in government service delivery. Increasingly, Federal government spending is also driven by direct service delivery.

¹⁴ Australian Government. (2024). *Budget paper no. 1: Budget strategy and outlook 2024-25*. https://budget.gov.au/content/bp1/download/bp1_2024-25.pdf

FIGURE 4

Real government spending per capita By type of spending; 2023/24 dollars



Sources: ABS; e61

The nature of government spending is shifting. Australia has a highly targeted welfare system relative to other OECD countries. It plays a significant role in reducing income and consumption inequality across households. But over the past decade government has decreased its relative reliance on this transfer system to provide social assistance (such as unemployment assistance and family payments), in favour of spending on in-kind benefits.

These benefits, such as aged care, childcare and the NDIS are less restrictively means-tested. In 2023-24, spending on these in-kind social benefits was larger than on benefit payments for the first time (Figure 4). These areas of spending are only projected to grow.

A balanced budget can help Australia weather global shocks. But how does Australia get there? It boils down to four (simplified) options: 1) grow faster; 2) tax more; 3) spend less; and/or 4) inflate away public debt.

The hopeful approach is boosting productivity, enabling faster growth. But Australia's track record in recent years is poor. Without that, serious consideration of tax and spending reform is needed. The current political approach by all sides has been to lock in ongoing spending and hang on to bracket creep and upside surprises in iron ore prices to boost revenue. This is likely far from the optimal policy mix.

Restoring fiscal sustainability is always a tough task, requiring difficult decisions with short-term political costs weighed against longer-term benefits. But it is imperative. Not only to deal with changing global conditions but also to ensure we can fulfill the intergenerational bargain that is implicit in Australian society.



05

Achieving a sustainable intergenerational bargain

Living standards tend to increase over time due to technological improvements, advances in information and education, and rising life expectancy. But there are no guarantees.

Younger generations may not end up better off than their parents and grandparents if housing affordability, fiscal pressures and lacklustre productivity growth put the intergenerational bargain at risk.

Taking a lifetime perspective is critical to understanding whether younger generations will be better or worse off than their parents. While younger generations may be feeling acute economic pressures, it's likely that, across their lifetimes, they will enjoy a cumulatively higher standard of living than their parents. This is thanks to the combination of income growth and higher quality of goods and services brought about by productivity growth.

However, the critical difference for younger generations compared to their parents is that the

timing of their consumption has potentially shifted to later in life. Young people are more likely to attend post-secondary education, have longer periods and higher rates of mandatory retirement savings, and experience larger upfront housing costs. As a result, they are shifting consumption from their younger years, when they are most liquidity constrained, to their later years.

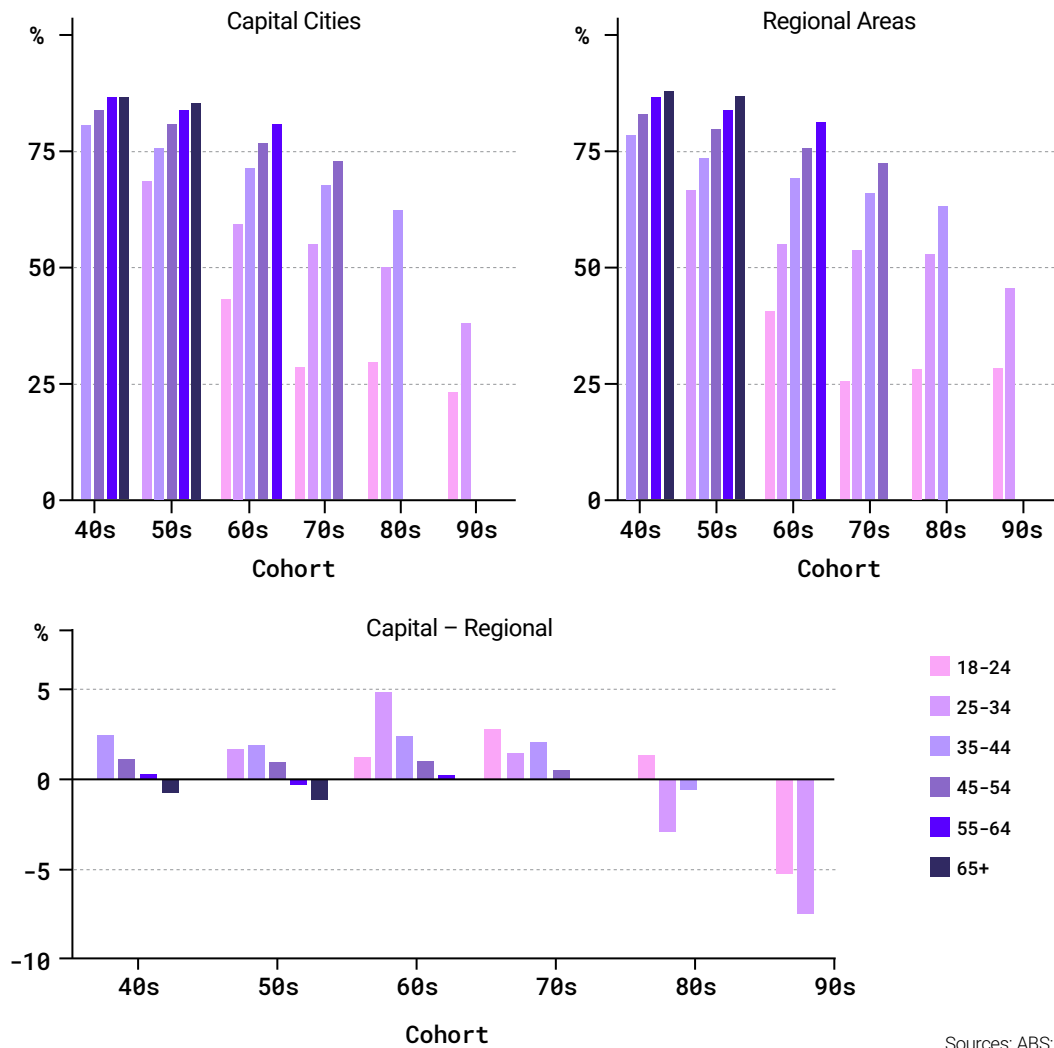
Housing stands out as one area of particular concern. Australia's preference for city living and policy decisions to keep economic opportunity in existing cities have likely contributed to housing affordability challenges for young people in capital cities. Today's 25- to 34-year-olds have a lower home ownership rate compared to their parents when they were the same age – with this disparity greater in capital cities (Figure 5). Historically, home ownership rates have shown some degree of convergence with age, but the important question is – could this time be different?

Housing affordability concerns could be contributing to the movement of prime-age workers away from cities.¹⁵ For Sydney – where housing challenges are most acute – this outward migration has persisted for

¹⁵ e61 Institute. (2024, November). *The lucky country or the lucky city?*
<https://e61.in/wp-content/uploads/2024/11/THE-LUCKY-COUNTRY-OR-THE-LUCKY-CITY-8.pdf>

FIGURE 5

Home ownership rate by birth cohort and age



Sources: ABS; e61

decades, while this trend is more recent in Melbourne. Notably, regional areas and other cities are not seeing similar outflows.

Achieving a sustainable intergenerational bargain depends on productivity growth and addressing fiscal pressures. Young people have already lost in this productivity slowdown. Those aged 25 to 34 saw their real incomes grow by less than older age groups over the 2000s and 2010s.¹⁶ Boosting productivity by promoting job mobility and reducing barriers to business formation are particularly important for young workers.¹⁷ They experience the largest wage gains, on average, from switching jobs and are disproportionately employed by younger firms.

In the absence of tax reform, ongoing increases in government spending will be funded overwhelmingly by higher income tax on working-age Australians, including via bracket creep. Alternatively, financing increased spending through higher deficits simply transfers tax burdens to future generations who do not directly benefit from current spending, further straining the intergenerational compact.

In an increasingly unpredictable world, it's important that Australia strikes a sustainable bargain across generations at home. Whether this takes place will largely depend on policymakers boosting productivity and restoring fiscal sustainability.

16 e61 Institute. (2022, September). *Better harnessing Australia's talent: Five facts for the Summit*. <https://e61.in/wp-content/uploads/2022/09/Better-harnessing-Australias-talent-five-facts-for-the-Summit.pdf>

17 e61 Institute. (2022, September). *Better harnessing Australia's talent: Five facts for the Summit*. <https://e61.in/wp-content/uploads/2022/09/Better-harnessing-Australias-talent-five-facts-for-the-Summit.pdf>

The e61-UNSW partnership

Policymakers face an unenviable task. They confront complex challenges without ready-made, well-defined solutions. The period described as the Great Moderation is behind us. We live in a time of stark political and strategic disruption and discontinuity.

To an extent, the broad evidence-based consensus built by academics, union and business leaders, media commentators and public servants that informed Australian policymaking from the early 1980s has fragmented. Researchers have a critical role to play in regaining this. They can help break down the complexity and uncertainty facing policymakers by making sense of the world and providing new evidence to guide the direction of future policy.

The new e61- UNSW Policy Research Partnership aims to be part of this. Bringing together rigorous academic capability, newly available datasets and a strong public policy focus, we hope to shed light on the big challenges our policymakers confront, such as the five themes raised in this paper.

Each theme raises key questions on which new evidence must be brought to bear. The following are some examples that arise from the discussion of each theme in this report, which can help guide researchers looking to contribute to a future evidence-based consensus.



POLICY RESEARCH PARTNERSHIP

01

Negotiating a new global order:

- What is the price of economic resilience? What is the effective insurance premium Australia pays, and the insurance value Australia gains, from building local supply and sovereign capability?
- In a world where services are traded internationally, where does Australia's comparative advantage lie?
- How rapidly do Australian exporters switch to new markets or products? Is this flexibility increasing or declining over time?

02

Re-examining a high population growth model:

- What are the respective roles of knowledge spillovers and match quality in driving the agglomeration benefits in Australian cities? Could these match quality benefits be replicated in other locations? What role could remote work play in this?
- There is a lack of evidence about construction sector productivity at the firm level. Given the fragmented nature of Australia's residential construction industry, are there barriers to the growth of the most efficient firms in the sector?
- Are skilled migrants effectively allocated to high productivity firms and locations?
- Is there a rising return to incumbency for firms and workers in the capital cities? How is this linked to the productivity slowdown?

03

Boosting productivity growth:

- What is the life cycle of firm productivity? At what age does the productivity of a young firm peak, and what causal factors influence this?
- What are better measures of the extent of rent-seeking activity in Australia? How has this changed over time? Where is it most significant and what are the returns to rent-seeking behaviour?
- In a services-dominated economy, are there models of service sector innovation that differ from well-established systems in agriculture (public R&D), manufacturing (private R&D) or mining (exploration)?

04

Restoring fiscal sustainability:

- As government has grown, through bracket creep and expanded in-kind services, what are the implications for the overall progressivity of government involvement in the economy?
- What fiscal targets are most appropriate for a commodity exporter with significant exposure to shifts in the terms of trade?
- What Australian evidence can be generated on the effects of taxation on decisions to invest in human capital, as opposed to property or physical capital?
- How do fiscal and monetary policies support self-insurance in Australia, as a complement to private insurance and social insurance via government support?

05

Achieving a sustainable intergenerational bargain:

- What is the life-cycle incidence of the Australian tax system, when combined with compulsory superannuation and income contingent loans? Do these instruments support efficient smoothing of consumption over the life cycle? And if so, how?
- What is the impact of inheritance at the household level?
- What is the relative role of financial inheritance/wealth transfers vs. the transmission of human capital through education from parents to their children?
- What has been the evolution of gender gaps in pay, home ownership and wealth across generational cohorts?



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Household, Income and Labour Dynamics in Australia Survey

This paper uses unit record data from Household, Income and Labour Dynamics in Australia Survey [HILDA] conducted by the Australian Government Department of Social Services (DSS). The findings and views reported in this paper, however, are those of the authors and should not be attributed to the Australian Government, DSS, or any of DSS' contractors or partners. DOI:10.26193/24EJST