Paradise Lost?

The race to maintain Australian living standards
Table of Contents

Acknowledgments .............................................................................................................. 3
Executive Summary .......................................................................................................... 4
Introduction ...................................................................................................................... 6
What’s really happening with Australian living standards? .............................................. 8
Other dimensions of work affecting living standards ....................................................... 11
What’s the outlook from here? ........................................................................................ 12
What are we to do? ........................................................................................................... 15
References ....................................................................................................................... 17
About the Author

David Hetherington is the founding Executive Director of Per Capita. He has previously worked at the Institute for Public Policy Research in London and for L.E.K. Consulting in Sydney, Munich and Auckland. He has written over 100 major reports, book chapters and opinion pieces on a wide range of economic and social policy issues, including fiscal policy, market design, social innovation, employment, education and training, disability, housing, and climate change.

David has been an expert witness to Parliamentary Committees and frequently speaks at Australian and international conferences, including the Banff Forum and the Progressive Governance Summit. His articles have appeared in the Sydney Morning Herald, The Age, the Australian Financial Review, The Guardian, and The Australian, and he is a columnist for Policy Network’s State of the Left. He was a longstanding contributor to Radio National’s Life Matters and is a regular panellist on The Drum on ABC TV.

David holds a BA with First Class Honours from UNSW and an MPA with Distinction from the London School of Economics where he won the George W. Jones Prize for Academic Achievement.

About Per Capita

Per Capita is an independent progressive think tank which generates and promotes transformational ideas for Australia. Our research is rigorous, evidence-based and long-term in its outlook, considering the national challenges of the next decade rather than the next election cycle. We seek to ask fresh questions and offer fresh answers, drawing on new thinking in science, economics and public policy. Our audience is the interested public, not just experts and practitioners.

Like our work? You can support research like this by becoming a Member or Friend of Per Capita. For more information, go to our website: percapita.org.au/membership.

https://www.facebook.com/PerCapitaAustralia  https://twitter.com/percapita

This paper is the original work of Per Capita Australia Ltd, and has not been commissioned, edited or endorsed by any other organisation.

© Per Capita Australia Limited 2015
Executive Summary

After the long Goldilocks period of the Australian economy, living standards for middle Australia are now under threat. Nominal wage growth is slowing quickly. Real wages have actually fallen.

Two decades of unprecedented prosperity added to the myth of Australian exceptionalism. Not only did the Australian economy grow incredibly strongly, it distributed the gains more fairly than almost any other developed economy. Lower- and middle-incomes rose year on year: the rising tide did lift all boats.

There’s no agreement that this was a good thing. Numerous business leaders, like Maurice Newman (2013) and Gina Rinehart (2012), have suggested that local wages are too high for Australian companies to remain competitive.

When living standards were rising steadily, the debate was academic. But now it matters. If we don’t get it right, the living standards of working Australians will fall. What’s more, Australia’s straitened budget position will deteriorate further as lower wages result in lower income tax receipts for government.

This paper explores what has driven rising wages growth, why the gains were more fairly distributed, why it’s come to a halt, and what we can do about it.

It finds that wages growth was driven by a combination of impressive policy reform and good luck, in the shape of a commodities super-cycle. Our analysis shows that this combination put, on average, an extra $484 each year in the pocket of the median Australian worker from 2001 to 2014.

These gains were possible because of strong improvements in labour productivity. Newman and Rinehart were wrong: productivity made these wages rises affordable. They flowed to workers because, unlike in other rich countries, Australia’s collective bargaining system meant workers got a fairer slice of aggregate economic growth.

Set against these income gains, we find that workers are commuting an extra 56 unpaid hours per year compared to 2002, and are bearing considerably more employment risk as a result of casualisation.

Now, as the effects of economic reform and the commodities boom have passed, wage growth has slowed dramatically. Nominal wage growth has fallen or remained flat in each year since 2010, and in 2013, real wages actually contracted, taking $118 out of the pocket of the average worker.
In addition Australia’s collective bargaining framework is weakening, as union coverage diminishes, shifting the split of national income towards profits and away from wages. Wages’ share has fallen from 65.6% at the turn of the century to 59.7% by 2012 (Cowgill, 2013: 9).

As Ross Garnaut has warned (2013), Australia must either reform once again or face a dramatic downwards adjustment in wage levels and living standards. This reform must start now. To continue to lift labour productivity, we must lift our national investment in hard infrastructure like transport and broadband, as well as soft infrastructure like skills and education. A reluctance to borrow is not an excuse for not investing. What’s more, we must maintain the employment protection framework that has made Australia’s economy so fair.

The absence of such reform would mark a failure of capitalism in the modern social democratic context. If the promise of capitalism today is higher living standards over time, it is in danger of failing ordinary Australians in the years to come. And if Australia, for so long the workers’ paradise, can’t deliver better living standards, what social democracy can?
Introduction

During Australia’s long run of economic prosperity, from the early 1990s to the early 2010s, it became fashionable to refer to Australia as the ‘Goldilocks economy’. Not too fast, not too slow, but just right.

All the main indicators seemed to move simultaneously in the right direction. Annual GDP growth ranged between 1.7% and 5.0%. Real GDP per capita increased from US$27,899 in 1992 to US$42,810 in 2013 on a currency-adjusted basis: the average Australian’s real income increased by more than half (Trading Economics, 2015). Inflation was low, and unemployment remained below 6%. The economy did not once fall into recession, even during the global recession of 2008-09.

Yet perhaps the most impressive achievement during this period was that lower- and middle-incomes continued to rise steadily. They mightn’t have risen as fast as incomes at the top, but it’s clear that Australia’s economic performance raised living standards for everyone. The rising tide did indeed lift all boats.

This was in marked contrast to other developed economies, where incomes in the middle and at the bottom of the distribution have either not moved or fallen markedly. In the United States, living standards for the middle class are stuck in a rut: median real wages have not increased in 40 years. In Britain, real wages fell by 7.1% between 2007 and 2013. In Greece, average wages by 2013 were an incredible 24.2% below their 2007 level (ILO, 2014).

There are well-established explanations as to why Australia has fared better, both in aggregate performance and in the equitable distribution of its gains. The conventional view, argued prominently by journalist and author Paul Kelly (1992, 2009), is that the liberalization and deregulation agenda pursued by the Hawke, Keating and Howard governments fundamentally repositioned Australia to enjoy two decades of unbroken growth. Then in a stroke of remarkable good fortune, a commodities ‘super-cycle’ arrived just as Australia was bedding down this agenda, multiplying the economic growth made possible from these reforms.

Why were the gains distributed more fairly than in other countries? The simple answer is that Australia maintains a strong minimum wage and employee protection framework that ensures workers a decent share of these gains. As the Centre for
American Progress has written, “Australia’s workers face the same global trends yet its switch to collective bargaining over and above a strong set of minimum conditions has helped workers keep more of their productivity gains in take-home earnings” (2015: 28). It’s important to note that wages’ share of national income has still fallen relative to profits’ share; nonetheless, Australian wage-earners have done comparatively well.

What’s curious is that there are competing views in Australia over whether the lift in incomes at the bottom and the middle has been a good thing. Former Treasurer Wayne Swan has hailed it as one of Australia’s great achievements: “Australia has done a better job matching strong economic growth with social equity than just about any other developed economy”, he argues (2015).

On the other hand, numerous business leaders and commentators have suggested that Australia’s wages grew too fast, and that this will damage future economic performance. Gina Rinehart and Maurice Newman, both business leaders, have argued that Australia’s relatively high wage rates will hold back business investment and erode profitability. Ross Garnaut, an economist, has suggested (2013) that Australia must find a new wave of productivity-boosting reforms or face a wage correction that reduces real wages considerably over time.

Over the last two years, however, there has been a turnaround in Australia’s wage growth that means these arguments are now being put to the test. In contrast to the healthy wage rises of the boom years, income growth for Australian wage earners is slowing rapidly. In the 2013-14, Australia experienced negative real wage growth for two consecutive quarters and the data for the September 2014 quarter show the lowest nominal wage growth since the Australian Bureau of Statistics (ABS) started publishing the data in 1998 (ABS 2015). This is putting increased pressure on the Commonwealth Budget as income tax receipts are growing more slowly than previously forecast.

This turnaround raises profound questions. Firstly, what’s driving it? Secondly, what does it mean for the arguments of Swan, Rinehart, Garnaut and others about the causes and importance of strong wage growth, particularly for middle- and low-income earners? Finally, and most importantly, what does it mean for the living standards of ordinary Australians who rely on wage income from employment?

This short paper seeks to answer these questions. It begins by examining what shrinking wage growth means in dollar terms for the median income earner today. Capitalism is failing if the rising tide has stopped lifting all the boats. If the promise of capitalism today is higher living standards over time, what has this meant for ordinary Australians in recent years and what’s it likely to mean into the future? The paper then explores some of the other issues that have affected living standards over this period, including tax changes, commuting times and job security. Finally, it proceeds to explore the causes of falling wage growth in Australia, and concludes by assessing the options open to policy makers to revive income growth for Australian workers.
Let’s start with what the official statistics tell us about Australian workers’ incomes. To paint the picture in a way that’s easy to understand, it’s still necessary to use the empirical data as our departure point. The statistics tell us that nominal wages have grown in a healthy 3.5% to 4.0% range over most of the period since 2000. The fastest rate of growth during this period was 4.3% in 2008 at the end of a long build-up in commodity prices. The lowest was in 2013 when 2.5% was the slowest wages growth on record, before increasing fractionally to 2.6% in 2014. Essentially, nominal wages have fallen or remained flat in each year since 2010.

What’s really happening to Australian living standards?

The nominal figures only tell part of the story, though. What’s more important is what’s happening to real wages, after we take into account changes in cost of living. For most of the period since the turn of the century, real wage growth has sat in the 1.0-1.5% range. However, it turned sharply in 2013 and for the first time since the introduction of the GST in 2000 (essentially an aberration), Australian real wages fell in that year. They rebounded somewhat in 2014, but this was not driven by strong nominal wage growth, but by the fact that inflation was so low, largely due to falling petrol prices.
So the data tell us that nominal wages growth is slowing steadily, real wages have actually fallen before bouncing back, and that it is low inflation rather than headline wage rises which are primarily responsible for the bounce back. Should inflation increase again from 2015, as the Reserve Bank of Australia forecasts it to do, real wages will come under renewed pressure. The outlook for Australian workers’ living standards is dimmer than it has been for a generation.

But these abstract percentages mean little to the ordinary worker. To get a sense of what changes in wage levels have meant for the household budgets of Australians, we need to describe them in ways that householders understand, to explain them in terms of dollars in the pocket today. We have done this by applying the nominal and real growth rates of wages since 2001 to the average total earnings of Australian workers in 2014.

This gives us a notional dollar amount that represented the improvement in the average worker’s gross pay in each year. It is not exactly the same as the dollar increase the average worker would have received in those years; instead it is those increases represented in 2014 dollar terms as a share of 2014 average earnings.

Calculated on this basis, the average increase in nominal wages since the turn of the century has been $2,087 each year. The biggest increase was $2,533 in 2008, while the lowest was $1,473 in 2013. Since 2011, the increase has fallen steadily from $2,238 to $1,708, a decline of 9% p.a.

Yet this is not a complete picture of the benefits of growth to wage-earners as it doesn’t account for rises in cost of living during the period. If we apply the real growth rate of wages shown in Figure 1 to the 2014 average wage, we get a sense of the actual improvement in wage levels since 2001 expressed as a share of today’s wages. This is a more accurate barometer of increases in living standards and one that will be readily understood by today’s wage earner.

This analysis shows us that the average increase in real wages from 2001 to 2014 (expressed in 2014 dollars) was $484 per year. The highest increase was $825 in 2003 while in four other years, the annual increase exceeded $700. The lowest was in 2013 when real wages actually contracted by $118.
In 2011-12, it was increased to 32.5% but this was compensated for by an increase in the tax-free threshold from $6,000 to $18,200.

Of course these figures represent pre-tax income, not what actually landed in workers’ pockets. Throughout the majority of this period, the marginal tax rate on the median Australian income was 30%*. Taking this into account, the average increase in net real wages since 2000 has been $339 per year. The remaining $145 was paid in taxes which governments spend on infrastructure and public services for the benefit of citizens. Since it is spent on their behalf, this sum represents an increase in welfare for workers, but it is the $339 jump in net real income each year that workers will value most.

This record of real wage growth is an impressive achievement, especially in light of the global recession of 2008-09. It means that an average worker could afford, over and above last year’s income, dental treatment for children or an interstate flight to visit relatives or two movie tickets a month. Wayne Swan is right to argue that the Australian economy was delivering for workers during this period.

* In 2011-12, it was increased to 32.5% but this was compensated for by an increase in the tax-free threshold from $6,000 to $18,200.
OTHER DIMENSIONS OF WORK AFFECTING LIVING STANDARDS

In addition to wage rises, it’s valuable to consider how changes in other dimensions of work have affected quality of life for working people in Australia. Two of the biggest issues are commuting and casualisation.

In 2002, the average Australian worker spent 3 hours 37 minutes per week travelling to and from work (Barbato and Flood, 2005: vii). By 2014, this figure had increased to 4 hours 50 minutes (Regus, 2014). If our average worker commutes 46 weeks per year (deducting annual leave and public holidays), this equates to an extra 56 hours commuting time per year. So compared with 2002, our worker is now earning an extra $4,577 in post-tax real income but they are also working an extra 56 unpaid hours.

A second issue, the casualisation of the workforce, is also affecting quality of life. Casualisation has increased dramatically over the last generation. From 1992 to 2009, the number of part-time employees with paid leave more than doubled, the number of full-time casual employees almost doubled, and the number of part-time casual employees rose by more than half. By contrast, the numbers of self-employed and full-time employees with paid leave grew by less than 30% (ABS, 2014).

The key attribute of casualisation is the increased risk that a worker bears through lack of employment security: simply put, they can’t be sure that their employment and income will extend past the end of the month. For some workers, the benefits of increased flexibility will offset this newfound lack of security, but for many, it’s not a welcome trade-off. It’s not straightforward to quantify in dollar terms the value of this risk shift from employers to employees. However, when we are considering the benefits to living standards of increased real wages, we must set these against not only the explicit costs of changes to work like increased commuting times, but the implicit costs such as the increased risk attached to casualised work.
What’s the outlook from here?

The outlook for wages, and by extension living standards for Australian workers, is less rosy than it has been for many years. As noted above, nominal wage growth has fallen each year since 2011, and real wages actually contracted in 2013 before rebounding somewhat last year.

There are no signs of strong wage growth returning anytime soon. Unemployment has steadily ticked up, reaching its highest level for 13 years, meaning there is little competitive pressure driving wages. Business confidence remains low, meaning firms are reluctant to hire. Our terms of trade have fallen, meaning that the price of goods and services we produce are not rising as fast as the price of others’ goods and services that we consume.

Inflation is forecast to pick up again now that the oil price falls have passed through, so any nominal wage growth will need to be commensurately higher to maintain existing growth in real wages. The bottom line is that Australian living standards will be under more pressure than they’ve been for 20 years, even before one accounts for things like commuting and casualisation.

Facing this situation, the critical questions to ask are: 1) what creates real wage growth over the long-term; and 2) recognising the sources of real wage growth, how can we respond as a country to turn the situation around?

Economic theory tells us there is only one fundamental source of long-term real wage growth - increasing labour productivity. If each worker produces greater output per hour – is more productive – then the economy has more output for each hour of labour used, and wages should rise to reflect a share of that increased output.

One of the recent laments of some Australian business leaders has been that Australia’s productivity performance has been poor and that our wages have been too high. These business leaders are wrong; the record tells us something different. Since 2000, gross value added per hour worked (labour productivity) has considerably outpaced median real wages, as shown in Figure 4 (ABS 2014b).
That is, there have been strong increases in labour productivity but these have not been fully reflected through matching increases in real wages. Any argument that Australian wage levels are too high because they do not reflect underlying productivity growth should be summarily rejected.

But if better labour productivity is the underlying driver of real wage rises, why have wage rises lagged productivity for the last 15 years? Where have the remaining fruits of those productivity gains gone?

The answer is to be found in the split of national income between labour and capital. While national income has grown strongly over Australia’s long run of prosperity, the benefits of this growth have flowed disproportionately to capital through profits rather than to labour through wages. Between 2000 and 2012, labour’s share of national income fell from 65.6% to 59.7% during a period when income grew strongly (Cowgill, 2013). Economic theory would suggest that this might be explained by differential productivity performance between labour and capital: that while the performance of labour had been strong, the performance of capital had been even better, explaining its increased share of the income pool.

Yet this is not what happened. In fact, labour productivity growth was considerably stronger than capital productivity growth during the period, providing the bulk of the gains in overall productivity. There are good reasons for this – the construction phase of the mining boom meant much capital was being sunk in advance of production starting – but it does not hide the fact that profits grew far quicker than productivity suggests they should have, while wages grew more slowly. It may be right to say that Australia’s strong workplace protection framework has meant wages have grown more strongly than in peer countries, but they still did not grow as fast as labour productivity suggested they should.

Why? The answer is found in the relative power of capital and labour. Put simply, firms have grown increasingly powerful relative to workers in recent decades and are able to keep the bulk of the gains of labour productivity improvement, rather than pass them on to workers. The theory of real wages
being driven by labour productivity falls down in practice. As American
economist Mike Konczal has argued (2015):

“...over the past thirty-five years, a ‘shareholder revolution’ has
re-engineered our companies in order to channel wealth toward the
top, especially corporate executives and shareholders, rather than
toward innovation, investments and workers’ wages.”

This ‘revolution’ has been a primary cause of the rise in inequality in
developed economies since the 1980s. This represents a failure of capitalism.
The promise of capitalism was to lift living standards for all: the rising tide
would lift all boats.

In the last few years, this failure has been widely accepted by pillars of the
global economic establishment. The International Monetary Fund (Ostry et
al, 2014) and the OECD (Cingano, 2014) have each explicitly highlighted the
dangers of growing inequality. Mark Carney, the Bank of England Governor
(2014), and Martin Wolf, the Financial Times’s chief economics commentator
(2014), have each observed that rising inequality inhibits the economic growth
that makes increases in living standards possible. Capitalism is failing on its
own terms: growth is not lifting all boats and wealth is not trickling down.

The narrow interpretation of capitalism embedded in the ‘shareholder
revolution’ described by Konczal above has meant that it has ceased to
lift living standards in most developed economies. Growth continues and
national income rises, but the benefits flow to the top, not the middle or the
bottom. Through good management and good luck, Australia has been a lucky
(and partial) exception to this pattern. No longer.
What are we to do?

In his book, *Dog Days: Australia after the boom* (2013), Ross Garnaut argues that without difficult reform, Australia faces an inevitable correction in its income and wage levels, with real wages falling markedly to reflect the country’s changed economic circumstances and lack of reform over the last decade (2013).

Garnaut is right. Nominal wage growth is slowing steadily, real wages have already had one period of contraction, and these patterns are likely to continue. Those who will suffer are not the top- and upper-middle income earners who derive a considerable share of their income from capital. They are middle- and lower-income workers who depend on wages to sustain their standards of living.

We can, however, choose an alternative path where we recognise the seriousness of our current predicament and respond to it through reform.

The necessary response has two parts: one to address underlying productivity, and the other to address the power imbalance that sees income growth overwhelmingly channeled to profits rather than wages.

The path to productivity improvement lies in continued investment in infrastructure, research and development, education and training from both the public and private sector. Australia’s exaggerated “budget emergency” has meant that governments are unwilling (rather than unable) to continue to invest on the roads, ports, bridges and housing needed to sustain labour productivity growth. Even worse, they are seeking to cut or freeze spending on science, schooling, TAFEs and universities.

This combination of underinvestment in hard and soft infrastructure almost guarantees that labour productivity will continue to flag. And as Konczal argues above, companies have been equally complicit in their reluctance to channel profits to innovation and investment, instead seeking to boost short-term profits and executive pay. They expect government to make these investments while refusing to do so themselves, and minimizing their tax payments along the way.
To reverse this situation, Australian governments must make the hard case to the electorate that “budget repair” will take longer than expected, may involve tax rises and will certainly involve greater spending on infrastructure, education, skills and innovation. The broader public might find this argument more compelling than many in politics realise, especially if the alternative is a slowly falling standard of living.

This is only part of the solution, though. To ensure working Australians enjoy the full fruits of their labour, it is critical that we maintain the employment protections that have sustained living standards in this country for decades – a decent minimum wage, collective bargaining, minimum shift provisions, full superannuation entitlements for all workers and unfair dismissal provisions. Some voices argue that Australia’s employment protections are too strict and should be further loosened (see, for example, Willox, 2012). However, OECD data shows that despite popular conceptions to the contrary, Australia’s employee protections are relatively limited: we fall in the bottom quartile of OECD countries in terms of strictness of employee protections (OECD, 2015). Given this, we should be seeking to avoid further erosion of employee protection which will only exacerbate weakness in wage growth.

In his book on Australian inequality, Battlers and Billionaires, Andrew Leigh has noted how the erosion of union coverage in Australian workplaces, particularly in the private sector, has exacerbated income inequality (Leigh 2013). Unions are seeking to reverse this decline in coverage by seeking to engage with workers in their communities, rather than only in the workplace or through the narrow channel of party political activity. Whether or not they are successful in this turnaround, the protections that unions have won for workers should not be eroded.

The current Productivity Commission enquiry into Australia’s workplace relations framework will examine precisely these issues. In doing so, it should take careful note of how this framework has ensured that at least some of the productivity gains of Australian workers have been channeled into increased living standards across our society. It would be a travesty to dismantle the framework that has made this possible.
References


Garnaut, R. (2013), Dog Days: Australia after the boom, Black Inc: Melbourne


--- (2009), The March of Patriots: The Struggle for Modern Australia, University of Melbourne Press: Carlton


Leigh, A. (2013), Battlers and Billionaires: The story of inequality in Australia, Black Inc: Melbourne


Regus (2014), Rush Hour: The daily commute just got longer, Regus: Sydney


