IS AUSTRALIA THE LAND OF THE FAIR GO?

ACTU Whitlam Lecture, Melbourne, Tuesday, November 30, 2010

Ross Gittins, economic columnist, SMH and The Age

In writing and talking about equality and inequality, I always feel myself at a disadvantage. Everyone thinks they know more about it than I think I know. Just about everyone has it firmly fixed in their mind that the gap between rich and poor is growing - the rich are getting richer and the poor getting poorer. This trend, they know, has been running for decades, perhaps forever. My disadvantage is that when you express your opinions in a respectable newspaper rather than the pub, you're supposed to base them on actual evidence. And when I recount the evidence, it's never as bad as everyone knows to be the case.

Even so, let me try to summarise the evidence about the distribution of income. The general story in Australia is similar to that throughout the developed world. During the first three-quarters of the 20th century, the gap between the highest and lowest incomes got progressively and significantly narrower. So some time in the 1970s was the point where the gap between rich and poor was probably the smallest it had been in many centuries. Since then, however, the gap has begun widening, undoing much of the progress we made in the post-war period.

In Australia, the Bureau of Statistics began surveying the distribution of income between households in 1995, and has continued conducting surveys every few years since then, with the latest in 2008. In the period between 1995 and 2004 - that is, most of the term of the Howard government - everyone was convinced Australia was rapidly becoming more unequal, but the bureau's figures showed only a modest worsening. How could this be? Well, it's important to understand how the distribution of income is calculated in these exercises. You start off with 'market income' (mainly wages) add government pension and benefit payments and subtract income tax to get 'disposable income'. You do this not for individuals, but for families (or other households). So many households have more than one wage-earner or pension-recipient, and most families with children receive family benefits. What seemed to have been happening is that, though wage income had been getting more unequal, this was offset by the increase in working wives and by John Howard's large and repeated increases in family benefits.

That was the story until 2004, and though I kept writing it, I doubt if many people believed me. But we've had two more official surveys since then, and the period to 2008 - essentially, the last years of the Howard government - saw a quite marked increase in inequality. If disposable income was equally distributed between households, the bottom 20 per cent of households would have 20 per cent of total income and the top 20 per cent of households would also have 20 per cent of total income. In fact, the latest figures show that the bottom fifth has just 7 per cent of the income, whereas the top fifth has more than 40 per cent. And over just the last four years, the shares of the four bottom fifths fell by about 0.5 a percentage point each, allowing the share of the top fifth to rise by 2 percentage points. Why this sudden deterioration? No one can say with any certainly. Various factors could have contributed: the resources boom and the booming sharemarket before the global financial crisis, the continued rise in executive and finance-sector salaries and maybe the succession of income-tax cuts that benefited people on high incomes.

It would be a mistake to conclude, however, that all families with income sufficient to put them in the top 20 per cent have benefited equally. It's far more likely that the closer you are to the top of that 20 per cent the better you've done. It's even possible that the share of people in the second-top 10 per cent has declined, as have the shares of the bottom 80 per cent of households.

Support for the proposition that it's only those at the very top of the distribution who've done particularly well for themselves comes from research by Andrew Leigh - formerly an economics professor at ANU, now a federal Labor backbencher - using income tax statistics. His estimates show that (in round figures) the top 20th of a per cent of individual taxpayers account for about 2 per cent of total taxable income. The top 10th of a per cent accounts for 3 per cent, the top half a per cent for 6 per cent, the top 1 per cent for 9 per cent, the top 5 per cent for 21 per cent and the top 10 per cent for 31 per cent [figures for 2002]. The shares of these top earners were declining until the early 1980s, but have increased since then, with the share of the top 10 per cent growing from 25 per cent to 31 per cent. Why has this happened? I think it would have to do mainly with the explosion in executive salaries and the phenomenal expansion of the phenomenally paid financial services industry. (Remember however, that the top 10 per cent of income earners would include most of the people in this room.)

Remember, too, that just because an income group's share of total income has declined, that doesn't mean it's been getting poorer. The bureau's income distribution figures show that, over the 13 years to 2008, the disposable income of the bottom fifth of households - mainly pensioners and the unemployed - has risen by 47 per cent in real terms. So the poor have not been getting poorer. The incomes of the next 60 per cent of households rose by about 52 per cent in real terms - which hardly means they got screwed. It's just that the incomes of the top fifth grew by 70 per cent in real terms (and, as we've seen, it's likely that much of that increase actually went to people right at the top of the top 20 per cent).

So yes, it's true that incomes have become much more unequal in recent decades - the gap between the top and the bottom has widened quite a bit - but this has occurred not so much because the people at the very bottom have been cheated, nor the people in the middle (who you represent), but because the relatively small group of people at the very top have done so extraordinarily well for themselves. It may surprise you, but I draw a bit of comfort from this. Why? Because it says the gross unfairness is quite limited in its extent. And because I don't believe in envying the rich. I thoroughly disapprove of the obscene incomes chief executives pay themselves; I can't understand how they could be so insensitive to the unfairness of the way they treat themselves compared to the other employees of their companies; I don't for a moment believe their contribution to their company's success is as great as their remuneration packages, nor that the explosion in executive salaries is the product of market forces rather than market failure. And I'm still hoping to meet someone who can propose a way for the government to limit the growth in executive salaries that wouldn't backfire in some way or be easily circumvented.

But I don't sit around envying those greedy bastards. I don't let it get to me. The fact that they're so grossly overpaid doesn't prove to me that the rest of us are under-paid. What's more, the accountant in me knows that if we were to strip the CEO down to a reasonable salary and distribute his ill-gotten gains among all the other employees, they'd hardly notice it. If all of a big company's employees were to be given the same percentage pay rise that the boss and his cronies awards himself, the company's profits would be hit for six. But the boss can award himself such an increase without a noticeable effect on profits. That's what's so pernicious about it; that's why they get away with it. The truth is that, from a policy perspective, I'm not too worried about the greed of the bosses. If that's your main reason for believing Oz is no longer the land of the fair go, your sights are far too narrow.

Before we move on, we should pause to consider how what's happened to income distribution in Australia compared with other developed countries. The trend is very similar, especially in the other English-speaking economies. I hope no one still deludes themselves that Oz is the world's egalitarian paradise but, by the same token, it would be wrong to conclude we're the worst in the world. We're in the middle somewhere; not as close to equality as the Nordic countries and much of Europe, but not as far from it as the other Anglos, in worsening order: Canada, Ireland, New Zealand, Britain and the US. Returning to Andrew Leigh's figures for the top 10 per cent of taxpayers' share of total taxable income, our share in 1998 of 30 per cent was higher than Sweden's 26 per cent and Holland's 28 per cent, but lower than New Zealand's 34 per cent, Britain's 39 per cent, Canada's 41 per cent and America's 42 per cent.

When people decide something should be done to reduce inequality, their thoughts turn immediately to taxation: let's redistribute income from the rich to the poor by making the tax system more progressive. I don't have a problem with that and, as a former accountant, I could now happily spend the rest of my time discussing the pros and cons of various tax reforms. But I want to take this discussion beyond taxation, so I'll limit myself to just a few remarks. The first is that the most obvious way to strike a blow for greater equity via taxation is to reform the taxation of superannuation, which is biased heavily in favour of high income earners. The Henry report made good proposals in this area, shifting a lot of the concession from high income earners to low-wage and part-time workers, but in its response the government opted to add a rebate for the low end without reducing the favourable treatment of the top end. Next on the list, the concessional tax treatment of capital gains greatly favours higher earners.

The Henry report's proposal for a new income-tax scale with a very high tax-free threshold, almost everyone taxed at a rate of 30 per cent, but a top rate of 45 per cent is <u>not</u> a flat-rate scale. It would still be progressive rather than proportional, but it would be significantly less progressive that the present scale and would continue the long-standing trend towards reduced progressivity. Fortunately, the simpler scale would produce so many losers among people on incomes a bit above the average that I doubt if either party will adopt it.

I have to say that I've been writing about the inequity of tax changes since Malcolm Fraser's 'fistful of dollars' tax cut in 1977, but I've never felt I was stirring up much indignation. If you're wondering why regressive tax changes meet so little resistance and governments so often duck progressive reforms, consider this. It's well understood by researchers in this area that the public's disapproval of the growing signs of inequality far exceeds its interest in seeing anything done to correct that inequality. One survey had 87 per cent of respondents agreeing that the gap between high and low incomes was too large, but less than half that (42 pc) agreeing that 'government should distribute from those who are better-off to those who are less well-off'.

But that's enough about tax. What too many people in the labour movement don't realise is that most of the redistribution that's done in the budget - and be under no illusion, the budget does a considerable amount of redistribution - is done on the spending side. Specifically, it comes from our flat-rate, tightly means-tested welfare system. When you tax higher income-earners but then exclude them from most cash transfers, you really redistribute income from top to bottom. This why John Howard's move into middle-class welfare - in superannuation, private health insurance rebates, grants to private schools and much else - was such a retrograde step and why people who profess to care about a fair go should be pressing the Gillard government to keep rolling it back.

I have to remind you that the people most at risk of not getting a fair go aren't your members. The most glaring case in point is Aborigines. For decades we've put far too little effort and money into Closing the Gap. Coming well behind the indigenous in the most-deserving stakes are the long-term unemployed and sole parents. Here the Labor government has blood on its hands. In the 2009 budget it announced generous - and hugely expensive - increases in age and disability pensions, but carefully excluded unemployment benefits from its largesse and limited the flow-on to sole parents. Years of deliberate niggardliness towards the jobless have left the dole payment for a couple with two kids $97 a week below the Henderson poverty line and, for a single adult, $118 below. If you wonder why the real incomes of households in the bottom fifth of the distribution rose by less than those in the middle of the distribution, that could be a big part of the reason. Why is even a Labor government screwing the unemployed and sole parents? Because they lack political clout. And they lack clout because even many of your members - and those you wish were your members - have no sympathy for them. The union movement ought to be about solidarity, not just self-interest.

But our thinking about equality and a fair go needs to go a lot broader that just the distribution of incomes - even disposable incomes that take account of government income payments. Central to the question of whether Oz is still the land of the fair go is what academics call 'social mobility' - whether people are locked in class system, or whether bright or hard-working young working-class people can better themselves and, on the dark side, whether people from privileged backgrounds can drop back in socio-economic status if they don't try hard enough. The research here isn't as good as it should be - it's not easy to track people across the generations - but work by Andrew Leigh suggests that social mobility in Australia hasn't changed much over time. Looking at various studies suggests that, compared with other developed economies, Oz is somewhere in the middle - not as socially mobile as the Nordic countries but a lot more mobile than Britain and, particularly, America. The land where they most fervently believe you can make it from log cabin to White House is the land where it's least likely. Again we've exposed Oz's egalitarian myth, but again we've discovered we're not as bad as some.

Getting more practical, if the people in the bottom half are to get a fair go - if they're to enjoy equality of opportunity - then the place that starts is in our public schools. The Howard government rigged the formula for federal grants to schools in favour well-off schools, adding to the public schools' relative disadvantage. The Rudd government went to the 2007 election promising to leave Howard's formula untouched throughout its first term; the Gillard government went to the 2010 election promising to further delay any change - even though a long-time expert in this area, Jim McMorrow, has come up with a clever way of shifting the growth in funding in favour of needy schools - whether public or private - without reducing the real value of any school's grant.

In thinking about equality and a fair go we need to be aware of how it's been affected by changes in terms and conditions of employment. When I studied economics at university 40 years ago, I can't recall any mention of the word 'risk'. But as businesses have become more conscious in recent decades of the need to 'manage' the many and varied types of risk they face, too often their solution has been simply to shift risk from their own corporate shoulders on to the shoulders of their individual employees. One instance of this of which you're all aware is the growing casualisation of the workforce, including the spread of sham independent contracting. Another example is the shift - particularly for government employees - from superannuation based on a defined end-benefit to super based on a defined employer contribution, leaving the employee to bear the risk of the performance of the share market.

Another example of risk-shifting comes with the advent of just-in-time inventory management. In the old days, manufacturers held large inventories of raw materials and parts so production could continue despite the disruptions suffered by their suppliers. But holding large inventories ties up a lot of working capital and thus involves high costs, and the computerisation of inventory records has allowed more continuous ordering of small quantities and the holding of much lower levels of inventory, thus greatly reducing cost. The consequence, however, is to shift the risk of disruption from the firm to the employee. When a supplier is unable to maintain the supply of a key component, the factory stops working and employees are laid off without pay.

One of the principles of risk management is that risks should be borne by the collective rather than the individual. The wider and more thinly spread the risk is, the more the individual can be protected at minimal cost to others more fortunate. This, of course, is the rationale for the welfare state, for the risk of unemployment or ill-health being borne by taxpayers in general rather than individuals. Efforts to dismantle the welfare state in the name of smaller government and lower taxes seem oblivious to this risk-sharing role. Fortunately, however, we can point to progress in the opposite direction: the push to fill a big hole in the safety net with a national disability insurance scheme. Your former colleague Bill Shorten can be given much credit for this.

One of the benefits of a disability scheme would be to afford people a greater sense of security - an intangible but nonetheless important and valuable component of 'a fair go'. This, of course, is one of the costs of all the risk-shifting we've seen: a reduced sense of security. There is more I could say about inequality, but I must stop. My answer to the question I was posed - Is Australia the land of the fair go? - is - not particularly, though there are worse places to live. If we'd like a better score than that, if we'd like Australia's reality to be more in accord with its proud self-image, there's a lot of work to be done.