

The creation of income inequality: the impact of government policies in Australia and other OECD economies

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Productivity, inequality, and insecurity – ‘These...were the ancient preoccupations of economics’. (Galbraith 1970, p. 94)

In 1970, John Kenneth Galbraith thus summed up the optimism of the era in his book, *The affluent society*. Galbraith’s aim was to challenge the ‘conventional wisdom’ which saw economics as the science of scarcity, rather than the successful management of affluence. There were very real problems to address, such as the waste of resources on the weapons of war, lingering poverty (especially amongst African Americans) and the imbalance in quality between publicly provided services and privately produced goods, which he memorably summed up as ‘private opulence and public squalor’ (Galbraith 1970, p. 212). But the post-war years had delivered a new world, where the dominant concerns of the past were of declining importance, and none more so than inequality: ‘few things are more evident in modern social history than the decline of interest in inequality as an economic issue.’ (Galbraith 1970, p. 94). There were many reasons for this. While still profound, inequality was not getting worse. Most of the population had a sense of economic security. Real incomes for people at the bottom of society had risen dramatically while those at the top had stagnated. Even the rich had grudgingly accepted this, because:

Increasing production...has been the great solvent of the tensions associated with inequality. Even though the latter persists the awkward conflict which its correction implies can be avoided. How much better to concentrate on increasing output, a programme on which both the rich and poor can agree, since it benefits both. (Galbraith 1970, p. 104)

Simon Kuznets developed a theory to explain this transformation. As countries industrialised, and people moved from agriculture to industry, inequality would initially rise as some people became rich and many remained poor. But full industrialisation would lead to mass education, higher wages for the workforce, and political power for the mass of the population, all of which would in turn lead to falling inequality. An inverted U-graph, the ‘Kuznets curve’, gave an aura of mathematical certainty to this theory and Kuznets was rewarded with the 1971 Nobel Prize. Kuznets’ own work was methodical and far more nuanced than the common treatment of his curve; in fact he also argued that there were ‘forces in the long-term operation of developed countries [that] make for widening inequality in the distribution of income,’ including any concentration of wealth in the hands of the very rich (cited in Atkinson et al 2011, p. 7).

It is the optimism of Galbraith and the Kuznets curve which now has the status of ancient history. Income inequality has grown significantly in a majority of OECD countries in the past 20-30 years, and most alarmingly in the United States, Britain and Australia.

In this paper, I will begin by outlining the nature of the increase of inequality in the rich western economies, and some of the attempts to explain it, using both political economy and historical methodologies. Atkinson, Piketty and Saez (2011) reflected on their own experience of researching income inequality when they argued:

Statistical analysis can help us identify independent variation [in income dispersion] but it rarely proves fully conclusive. The conclusions that we draw inevitably involve elements of judgment. Judgment may be influenced by historical narrative. Piketty reached his conclusion regarding the role of progressive income taxation in France after an extensive discussion of the economic history of France over the twentieth century. While it would be reinforced by regression analysis in which the relevant tax rate variable had a highly (statistically) significant coefficient of a plausible magnitude, the conclusion was based on a reading of the events of the period.

I will argue that the increase in income inequality in most western countries has been the result of deliberate policy, as governments have sought to shift income from wages to profits, from low and middle-income earners to those on high incomes and to squeeze consumption in order to increase the rewards available for investment. I will use Australia as a case study to show that governments have experimented with a variety of strategies to increase the rewards for investment. Each strategy was a partial success, but as each exhausted its possibilities, another was tried.

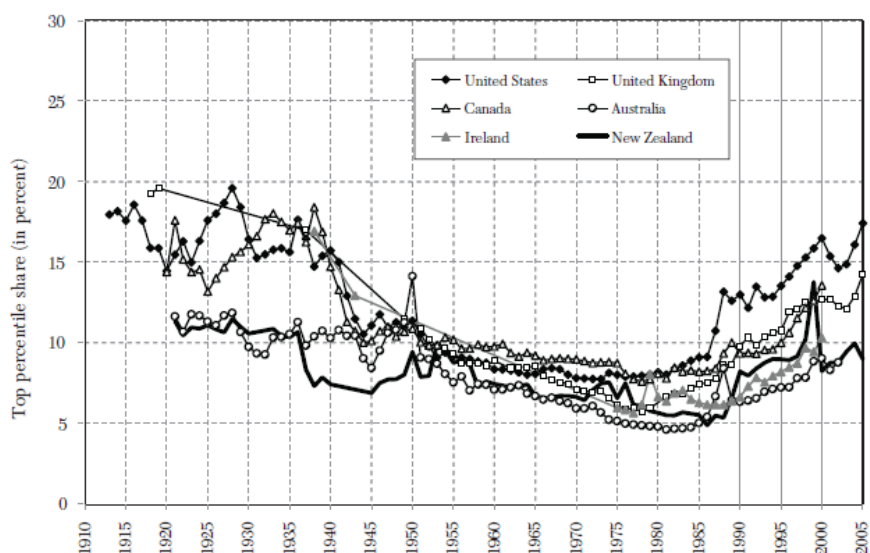
Changing income inequality in the OECD

In 2007, Brandolini and Smeeding used a variety of data sources to examine patterns of inequality in many of the rich, western democracies, and how they had changed over time. They found that in most countries, income inequality fell in the decades just before and after World War II, into the 1970s. The majority of economies then saw some period in the last 30 years during which inequality rose significantly.

In the United States, pre-tax income inequality fell very sharply from 1929 to 1944, and for the next 30 years inequality either reduced gradually, or remained constant. Then, from the mid-1970s, the process was reversed as the US 'entered a period of unrelenting increases in income inequality.' In Britain they also found income inequality declined substantially in the decade covering World War II and some years afterwards, and remaining largely steady until the late 1970s when they identified 'an unprecedented rise of income inequality' from 1985-90, with the Gini index for equivalent disposable income rising an extraordinary 7 points, remaining at approximately the new, higher level in the period since. They also find sustained but more modest rises in inequality over a long period in Sweden (early 1980s-2000) and Germany (1983-2000) and short periods in which income inequality increased significantly and enduringly in Canada (1989-2004), Finland (1994-2000), and the Netherlands (late 1980s). France is the exception to this picture, with inequality in

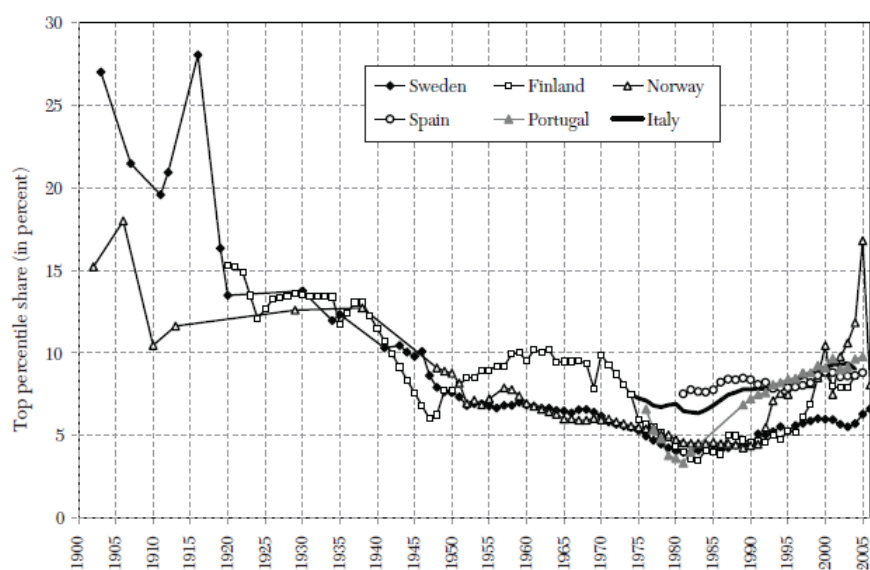
equivalent disposable income falling right through the post-war period until 1997, and then stabilising. The rise in income inequality can be seen in the share of income gained by the top 10% or top 1% of income earners in various countries (see Figures 1, 2, and 3).

Figure 1: Share of income gained by top 1% of income-earners in various English-speaking countries, 1910-2005

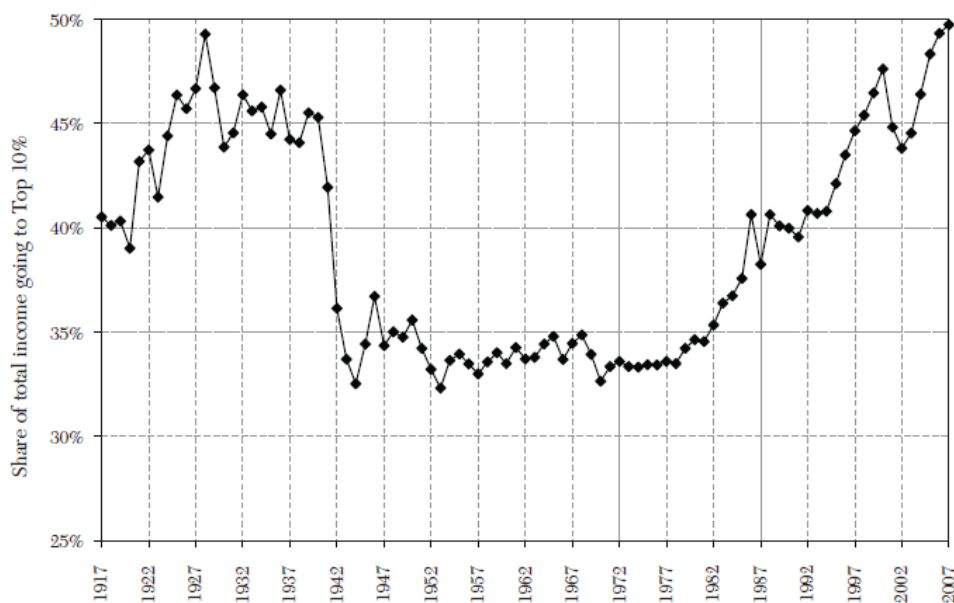


Anthony B Atkinson, Thomas Piketty and Emmanuel Saez, 'Top incomes in the long run of history', in *Journal of Economic Literature*, vol. 49, no. 1, 2011, pp. 3-71 (p. 41)

Figure 2: Share of income gained by top 1% of income-earners in various European countries, 1900-2005



Anthony B Atkinson, Thomas Piketty and Emmanuel Saez, 'Top incomes in the long run of history', in *Journal of Economic Literature*, vol. 49, no. 1, 2011, pp. 3-71 (p. 43)

Figure 3: The top decile income share in the United States, 1917-2007

Source: Anthony B Atkinson, Thomas Piketty and Emmanuel Saez, 2011, 'Top incomes in the long run of history', in *Journal of Economic Literature*, vol. 49, no. 1, pp. 3-71 (p. 6)

Factors increasing income inequality: Skill-biased technical change

There has been a lively debate over the factors that influence the distribution of market outcomes (Gordon and Dew-Becker 2008, Leigh 2003, Levy and Temin 2007). Perhaps the dominant explanation for increased income inequality has been the impact of skill-biased technical change, in part driven by globalisation (Gordon & Dew-Becker 2008; Rajan 2010, pp. 23ff; Helpman 2010, pp. 94ff;). According to Violante (2008):

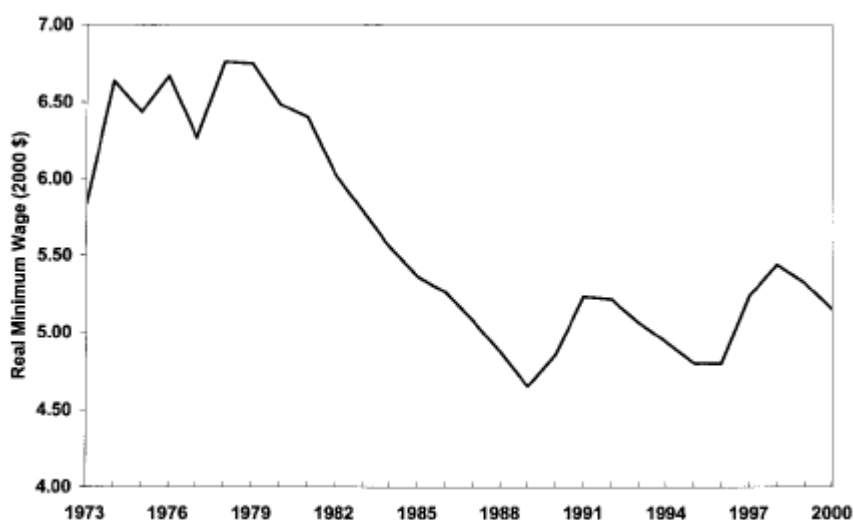
Skill-Biased Technical Change...is a shift in the production technology that favors skilled (e.g., more educated, more able, more experienced) labor over unskilled labor by increasing its relative productivity and, therefore, its relative demand... SBTC induces a rise in the skill premium—the ratio of skilled to unskilled wages.

Skill-biased technical change delivers premium wages to those with certain skills, and more generally to workers with higher education. This is summed up in the concept of the 'college premium', the ratio of the average wage of a university graduate to the average wage of someone without a university degree. This ratio has increased in most western countries, and a substantial literature suggests two main reasons. The first is the impact of globalisation, with the production of unskilled, labour intensive commodities being outsourced to lower-waged economies, reducing their price and also the demand for relatively unskilled labour in the rich economies. The second is the rise of production systems reliant on information technology, and other advanced technology, that has increased the demand for

higher-skilled and better educated workers, as against those with less education. In manufacturing, there is a rise in the relative employment of highly educated and skilled non-production workers, who receive relatively higher wages. Rajan (2010) points to the 2008 Current Population Survey in the United States which showed the median wage of high school graduates to be \$27,963, while the median wage of someone with an undergraduate degree was \$48,097 and for someone with a professional degrees, \$87,775. Many writers have linked the consequent divergence in incomes to the supposed deindustrialisation of the United States (and other countries), and the failure of their education systems to improve the skills and qualifications of enough of their people. Others have pointed to most industries showing increased demand for higher education and skills, and over a long period of time (Ryscavage 1999).

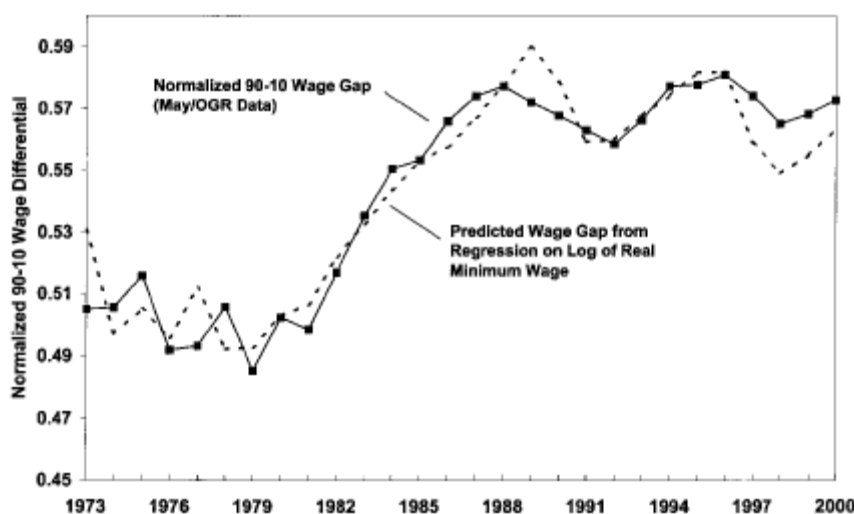
There have been a range of criticisms of the skill-biased technical change argument. David Card and John E. DiNardo (2002) argued that 'the evidence linking rising wage inequality to SBTC is surprisingly weak'; pointing to a dramatic rise in the ratio of the top 90% income decile to the 10% decile income in the United States in the early 1980s, while the most dramatic technological change came after that. Card and DiNardo see the changing value of the minimum wage as providing the closest fit to changes in the 90/10 wage gap. While they do not argue this as the dominant reason for rising income inequality, they suggest that changes to the minimum wage and other related developments, such as the decline of trade union coverage, provide a far stronger explanation (see Figures 4 and 5).

Figure 4: Real minimum wage, United States of America, 1973-2000 (\$ year 2000)



David Card and John E DiNardo, 'Skill-biased technological change and rising wage inequality: some problems and puzzles', in *Journal of Labor Economics*, vol. 20, no. 4, October, 2002, p. 775

Figure 5: Normalized 90/10 wage gap plotted against predicted wage gap from regression on log of real minimum wage



David Card and John E DiNardo, 'Skill-biased technological change and rising wage inequality: some problems and puzzles', in *Journal of Labor Economics*, vol. 20, no. 4, October, 2002, p. 775.

If Card and DiNardo are right, this would suggest that it is not skill-biased technical change itself that shapes income inequality, but the treatment of those workers whose career prospects are affected, and who lack skills required by employers. Such an interpretation would fit with research done by Alderson, Beckfield and Nielsen (2005), which showed that in some OECD countries, the middle-income layers of society had been 'hollowed out' by rising income inequality, while in others, they had not. Yet skill-biased technical change is a feature of all rich economies.

The importance of polarisation at the top of the income distribution

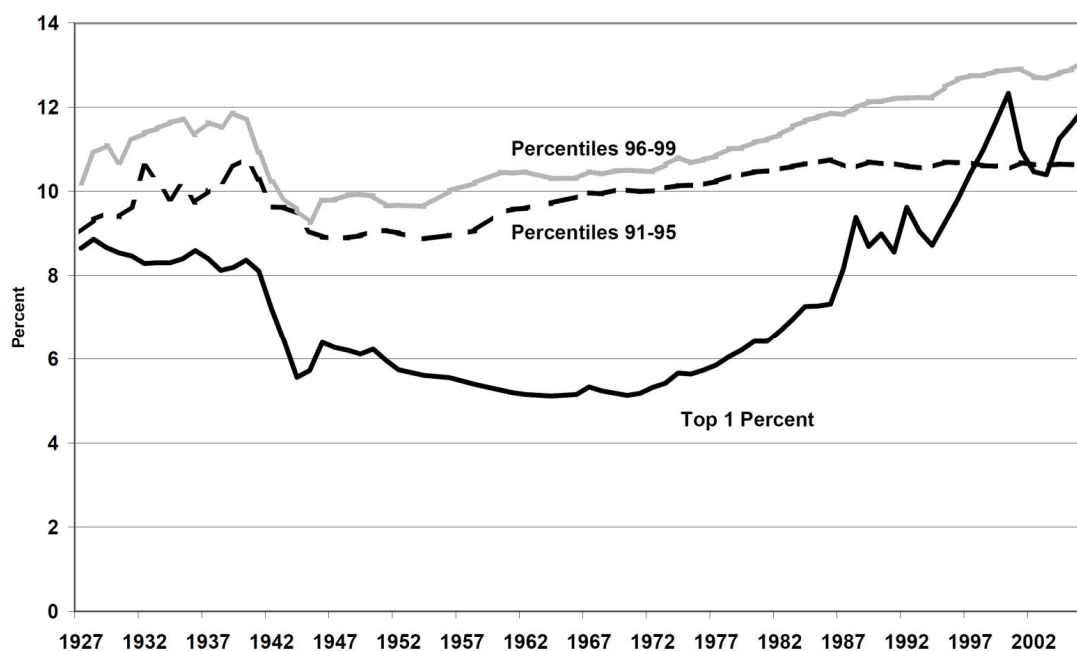
Alderson, Beckfield and Nielsen (2005) used the Luxembourg Income Study (LIS) to investigate the extent to which income inequality is a product of relatively lower incomes amongst poorer people ('downgrading'), or relatively higher incomes amongst richer people ('upgrading'), or a combination of the two. They found that in most cases, 'rising inequality is generally associated with polarization, rather than upgrading or downgrading alone', leading to a hollowing-out of the middle income layers of society. Furthermore, they found that, 'among those societies experiencing the largest increases in inequality, upgrading typically takes precedence over downgrading in the course of such polarization'. In crude terms, the well-off become much richer. Britain was the only exception to this pattern; a greater concentration of people on relatively lower incomes was the main driver of its sharply rising inequality in the 1980s.

This general pattern can be seen most clearly in the rapid rise in top incomes. In the USA, the share of total income captured by those in the top 10% fell from a peak of just under 50% in 1929 to around 32% in the early 1950s and stayed in a band of 33-35% until 1982 when climbed rapidly back to 50% in 2007 (see Figure 3).

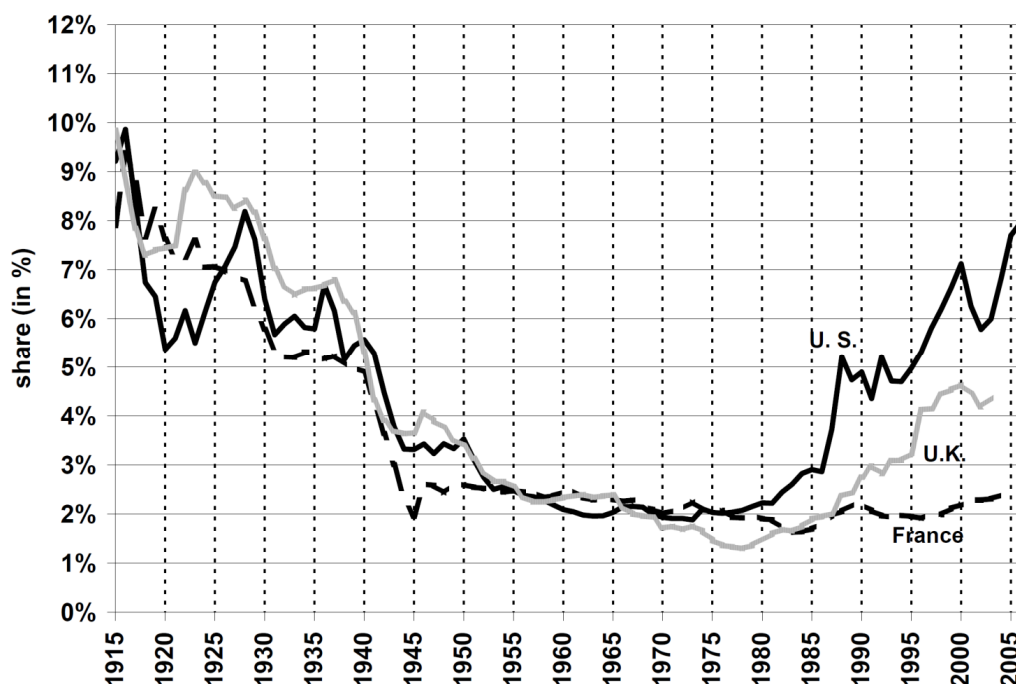
In 1970, when John Kenneth Galbraith celebrated the decline of inequality as an issue, he commented that, 'It no longer seems likely that the ownership of tangible assets of the republic and the disposal of its income will pass into a negligible number of hands.' Yet, within just a few years, this was precisely the way that the distribution of income had changed. The richest one-per cent of the population appropriated more than half the increase of national income to itself, yet that is what has happened in the United States (see Table 1, also Figure 6). Even more remarkable is the degree to which the top 0.1% of income earners have captured a disproportionate share of national income (see Figure 7).

As Atkinson, Piketty and Saez (2011) argue, average US growth rates give no indication of the experience of most of the population. In the years 1975-2006, average real incomes per family in the US grew 32.2%, but if you take out the top 1%, they grew by just 17.9%. Average real incomes in France over the same period grew by 27.1%, 5.1% less than in the United States, but taking out the top 1% of earners in France leaves all other incomes growing over the period at 26.4%, 8.5% more than in the US.

Figure 6: Wage income shares of the top 1%, plus percentiles 96-99 and 91-95 in the US for years 1927-2006



Source: Robert J Gordon, Has the rise in American inequality been exaggerated?, online http://faculty-web.at.northwestern.edu/economics/gordon/SFONBER_Combined_090902.pdf.

Figure 7: Top 0.1% income shares in the US, France and the UK, 1913-2006

Source: Robert J Gordon, Has the rise in American inequality been exaggerated?, online http://faculty-web.at.northwestern.edu/economics/gordon/SFONBER_Combined_090902.pdf.

Table 1: Top percentile share and average income growth in the United States

Period	Average income real annual growth	Bottom 99% incomes real annual growth	Top 1% incomes real annual growth	Fraction of total growth captured by top 1%
1976-2007	1.2%	0.6%	4.4%	58%
Clinton expansion, 1993-2000	4.0%	2.7%	10.3%	45%
Bush expansion, 2002-07	3.0%	1.3%	10.1%	65%

Source: Anthony B Atkinson, Thomas Piketty and Emmanuel Saez, 2011, 'Top incomes in the long run of history', in *Journal of Economic Literature*, vol. 49, no. 1, 2011, pp. 3-71 (p. 9).

These findings also challenge the primacy of skill-biased technical change as the core explanation for rising income inequality. Not only is the rise in top incomes far greater than that suggested by the extra productivity of skilled workers, but few of the top income earners are highly educated and skilled non-finance professionals (see Table 2). Data assembled by Jon Bakija, Adam Cole and Bradley T Heim (2010) suggests that it is managers and executives who have garnered the most extreme incomes in the United States.

Table 2: Occupations of top 0.1% income earners in USA in 2004

	Tax return data
Executives, managers, supervisors (non-finance)	40.8
Top non-financial executives, publicly traded firms	
Executive, non-finance, salaried	15.0
Executive, non-finance, closely held business	13.6
Manager, non-finance, salaried	4.7
Manager, non-finance, closely held business	4.6
Supervisor, non-finance, salaried	1.3
Supervisor, non-finance, closely held business	1.7
Financial professions, including management	18.4
Not working or deceased	6.3
Lawyers	6.2
Real estate	4.7
Medical	4.4
Entrepreneur not elsewhere classified	3.6
Arts, media, sports	3.1
Computer, math, engineering, technical (nonfinance)	3.0
Other	2.6
Business operations (nonfinance)	2.2
Skilled sales (except finance or real estate)	1.9
Professors and scientists	1.1
Farmers & ranchers	1.0
Unknown	0.7

Percentage of primary taxpayers in top 0.1% of the distribution of income (including capital gains) that are in each occupation in 2004: Tax return data.

Source: Jon Bakija, Adam Cole and Bradley T Heim, Jobs and income growth of top earners and the causes of changing income inequality: evidence from US tax return data, 2010, online http://indiana.edu/~spea/faculty/pdf/heim_JobsIncomeGrowthTopEarners.pdf.

The impact of tax and welfare regimes on income inequality

In most western countries where income inequality has increased, the increase has been fundamentally driven by increasing inequality of market incomes, while changes in tax and welfare regimes have sometimes reduced and sometimes increased the impact of market outcomes. This is the explanation of Heisz (2007) for the Canadian experience. He argues that there was an increase in the inequality of market incomes from 1979 to 2004, but that higher tax rates and increased generosity of social assistance and employment assistance through the 1980s acted to completely counteract the effect of rising inequality in market incomes for families. However in the 1990s, market income inequality grew even more rapidly than in the 1980s, and the tax and welfare system failed to reduce this polarisation. Frenette, Green and Picot (2004) argue that it was the lowering of personal taxes especially on the highest incomes, and the welfare reform of 1996 that dramatically reduced entitlement to unemployment benefits, that also help account for the rise in inequality through the 1990s. Both the increased social assistance of the 1980s and

the tax and welfare reforms of the 1990s were deliberate policy decisions with predictable impacts on inequality in Canada.

This pattern was repeated in Sweden, where the impact of taxation and welfare transfers actually reduced inequality in equivalent family incomes from 1967 to the early 1980s, when inequality began to rise again, in part as a result of tax reform. In Finland, a combination of government income policy which compressed differences between market wages, and an increase in government transfer payments worked to reduce inequality from 1966-76 and then keep it steady until the early 1990s, despite a severe recession. However, as with Canada, a change in incomes, welfare and tax policies saw a sharp rise in both market and disposable incomes from 1994-2000 (Brandolini & Smeeding 2007).

Brandolini and Smeeding (2007) conclude that we can see 'a general pattern suggesting that the redistributive impact of taxes and transfers initially increased and then stabilized or dropped in all countries except for the United States'. Clearly, government policy has significantly shaped the degree of inequality in disposable incomes in the rich western economies, and in almost every case, the most recent impact of government policy has been to increase inequality. Nowhere is this more true than in the United States. Piketty and Saez (2007) have shown that the proportion of income paid in federal taxes by high income earners has been dramatically reduced since 1970; and for the top 0.1% of income earners, the reduction is more than 50% (see Table 3).

Table 3: Proportion of income paid in federal taxes by income group: United States of America, 1960-2004

<i>Income Groups</i>	<i>Average federal tax rates (percent)</i>					
	<i>1960</i>	<i>1970</i>	<i>1980</i>	<i>1990</i>	<i>2000</i>	<i>2004</i>
Full population	21.4	23.3	26.6	25.8	27.4	23.4
P20-40	13.9	18.5	16.3	16.2	13.1	9.4
P40-60	15.9	20.2	21.4	21.0	20.0	16.1
P60-80	16.7	20.7	24.5	24.3	23.9	20.5
P80-90	17.4	20.5	26.7	26.2	26.4	22.7
P90-95	18.7	21.4	27.9	27.9	28.7	24.9
P95-99	23.5	25.6	31.0	28.6	31.1	27.2
P99-99.5	34.0	36.1	37.6	31.5	35.7	31.3
P99.5-99.9	41.4	44.6	43.0	33.0	38.4	33.0
P99.9-99.99	55.3	59.1	51.0	34.3	40.2	34.1
P99.99-100	71.4	74.6	59.3	35.4	40.8	34.7

Notes: The table displays the average federal tax rate (including individual, corporate, payroll, and estate) for various groups of the income distribution, for various years. 2004 figures are based on 2004 tax law applied to 2000 incomes adjusted for economic growth.

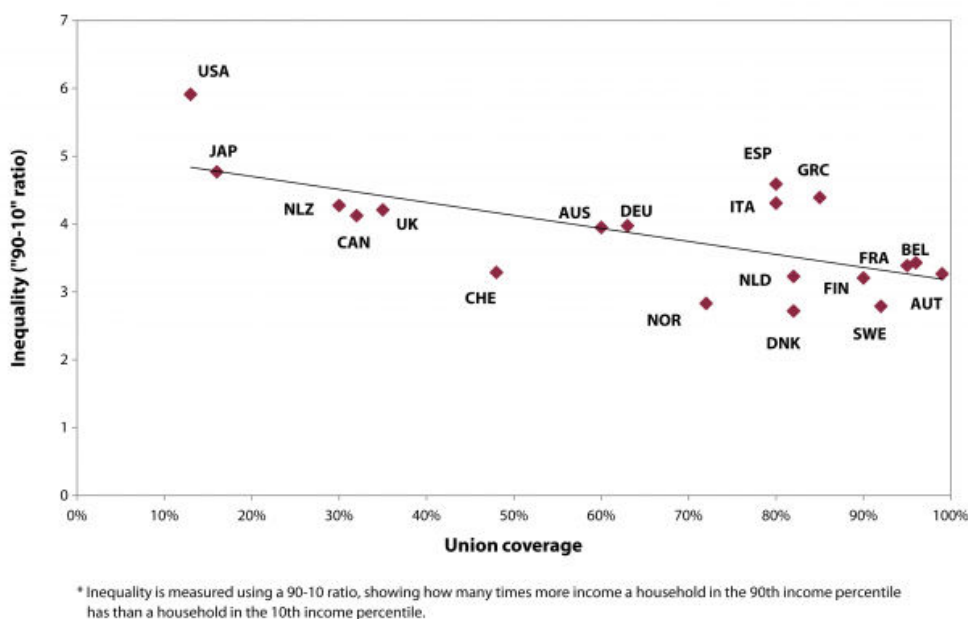
Thomas Piketty and Emmanuel Saez, 'How progressive is the U.S. federal tax system? A historical and international perspective', in *Journal of Economic Perspectives*, vol. 21, no. 1, Winter, 2007, pp. 3-24

Hacker and Pierson (2010, p. 49) argue that, 'if the effects of taxation on income at the top had been frozen in place in 1970, a very big chunk of the growing distance between the superrich and everyone else would disappear.' While recognising that skill-biased technical change had an impact on jobs and wages, they criticised what they called 'the fixation on inequality between large sections of the income distribution,' arguing that it had 'obscured the extent to which government policy has grown more generous towards those at the very top.' (Hacker and Pierson 2010, p. 51)

The importance of trade union strength

Most writers on income inequality see the extent and strength of trade union organisation as important in limiting income inequality (eg. Ryscavage 1999; Leigh 2003). This is linked to a widely-held view that the declining income inequality of the post-war years was produced by strong trade unions, progressive taxation, low unemployment and a generous welfare system (Levy & Temin 2007). John Kenneth Galbraith (1956) argued that organised labour exerted a countervailing power against that of big business. Richard B Freeman (2008, p. 112) argued strongly that collective bargaining 'reduce(s) the inequality of pay compared to pay in competitive markets.' The Economic Policy Institute (2011 mapped union coverage of employees in the USA against income inequality and found a strong inverse correlation. The diminishing coverage and strength of unions in the United States is linked to the decline in the real value of the minimum wage (see Figure 8).

Figure 8: Collective bargaining in relation to inequality



Economic Policy Institute, The state of working America, Economic Policy Institute, Washington DC, 2011, online <<http://www.stateofworkingamerica.org/charts/view/124>>

In his study for the United Nations, John Weeks (2005) concluded that, 'In countries in which inequality increased, this was primarily the result of the decline in the importance and bargaining power of organized labour, aggravated by unemployment and reductions in government expenditure.' But for Weeks the importance of organised labour is not simply in shaping wages:

In the long run, the three are closely related, because organized labour has historically pressed for full employment policies and a comprehensive welfare state. At the risk of oversimplification, it can be concluded that in the OECD countries, rising inequality results from a growing imbalance in the economic and political power of capital and labour.

Weeks' approach helps explain the history of rising inequality in Britain. The government of Prime Minister Margaret Thatcher (1979-90) initiated a series of 'reforms' to the tax system, to unemployment benefits and other forms of welfare all contributed to the dramatic increase in inequality 1985-90. This can be seen by comparing the Gini index for market incomes, which rose 3 points, with the Gini index for disposable incomes, which rose 7 points. In other words, it was deliberate government policy to pursue policies which would inevitably increase inequality. This surge in inequality was preceded by one of the most significant defeats suffered by the British trade union movement in its long history, the year-long miners' strike of 1984-85. The inequality surge came to an end at roughly the same time as the Conservative government faced its most profound crisis with the campaign against its proposed 'Community charge' (popularly known as the 'poll tax'), which replaced the local council rates which were based on the notional rental value of housing, with a flat tax on every resident. This was another profoundly regressive tax. But its implementation was hampered and by widespread non-payment, part spontaneous and part organised, and a long campaign of street protests that included a series of riots (Bagguley 1995). By the end of 1990, Margaret Thatcher had been forced to resign as Prime Minister, and while the Conservative government survived another six and a half years, it was a divided, unpopular and weaker administration. The first decision of the new Prime Minister, John Major, was to scrap the 'poll tax'. However, a decline in the rate of unionisation was an enduring legacy of Thatcher's victories over the labour movement. Hacker and Pierson (2010) chart a parallel assault on trade union rights in the United States, and link it to rising inequality and in particular the ability of managers to drive up their own salaries with minimal effective opposition.

Case study: income inequality in Australia

I now turn to examining the development of income inequality in Australia, using this as a case study. While the specific economic and political history is unique, it also underscores some of the more general themes already mentioned. However, the shift that saw the power of unions decline had a very different history from that in the United States or Britain, because, for a period, it included the active support of trade unions in limiting their own activities.

Part of the Australian national myth is that it is an egalitarian society. However income inequality in Australia is relatively high compared with other rich economies. Brandolini and Smeeding (2009, p. 93) compared the Gini indices for sixteen rich countries using data from the Luxembourg Income Study for 2008. They found Australia was amongst the most unequal, with a Gini index for market incomes of 0.48, as bad as the United States and Germany, worse than Finland (0.47), Sweden (0.46), the Czech Republic and Canada (0.44) and significantly worse than Denmark (0.42), Norway (0.41), Switzerland (0.40) the Netherlands and Romania (0.38) and Taiwan (0.33). Once taxation and welfare payments were taken into account, Australia's Gini index for disposable income was 0.32, dramatically worse than the least unequal societies, Denmark and the Netherlands (0.23), and worse than eleven of the sixteen, with only the UK (0.34), Israel (0.35) and the United States (0.37) more unequal.

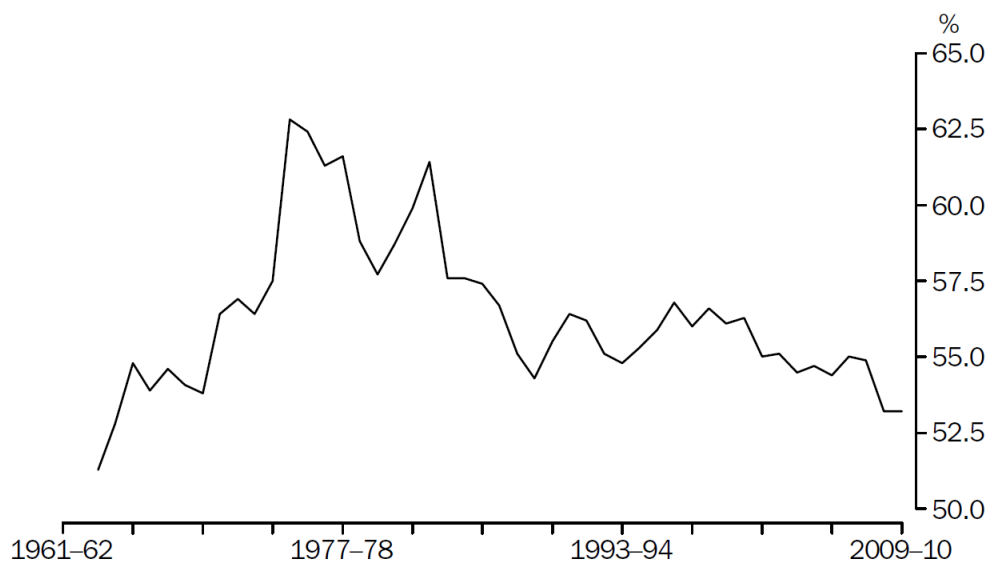
After a sustained period in which income inequality declined, from the 1920s to early 1970s, Australia has experienced a significant rise in income inequality since the mid-1970s. Paul Blacklow (2002) concluded that real equivalent disposable income inequality had risen 'consistently...throughout the period 1975 to 1998-99', with the Gini index rising from 0.273 in 1975-76 to 0.287 in 1984, 0.300 in 1988-89, 0.307 in 1993-94 and 0.322 in 1998-99. Using a different methodology, the Australian Bureau of Statistics (2011) put the Gini index at 0.292 in 1996-97, rising to 0.309 in 2002-03. The ABS changed its methodology from 2007-08, and recalculated its figures for 2003-04 and 2005-06 on the new basis. These showed a very sharp increase, from 0.306 in 2003-04, to 0.336 in 2007-8 and 0.328 in 2009-10. One of the key features of rising income inequality in Australia has been the large decline in the wages share of total factor income, as seen in Figure 9.

The wages share reached its peak in 1974 at the end of the post-war boom. It then declined for the first five years of the Fraser government, before rising again as a result of a short-lived boom from 1979-81. The greatest decline in the wages share occurred during early years of the Hawke government (1983-91), with a further significant decline during the later years of the Howard government and during the

global financial crisis. There has been a corresponding increase in the profits share, from 17% of GDP to 28% over the past 35 years (see Figure 10). Not surprisingly, there has also been a dramatic increase in the share of national income going to the very top income earners (see Figure 11). Again, the Australian experience reflects that of other rich economies which saw a major decline in top income shares in the decades after the World War II; in Australia's case, the decline extended from the period after the World War I through to the early 1980s, with a spike in the early 1950s associated with a very brief boom in wool prices. It is noticeable that the share of top incomes in Australia is dramatically lower than that in the USA.

It is the argument of this paper that increasing income inequality was the de facto policy of every Australian government from 1975 to the present, but that very different policies were required at different times to achieve this outcome.

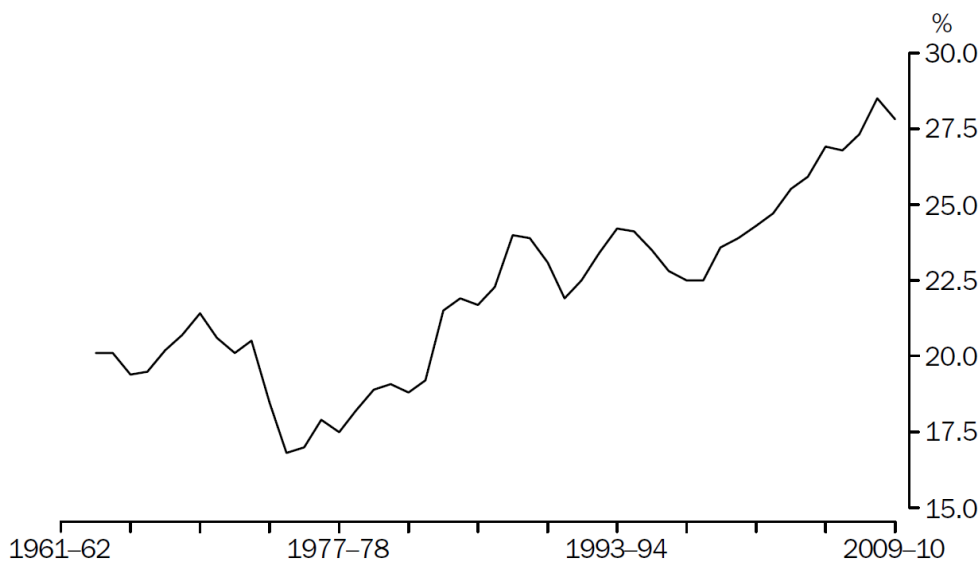
Figure 9: Wages share of total factor income, Australia 1961-2 to 2009-10



Source Australian Bureau of Statistics, 2011, Australian System of National Accounts, 2009-10: item 5204.0, 2011, online

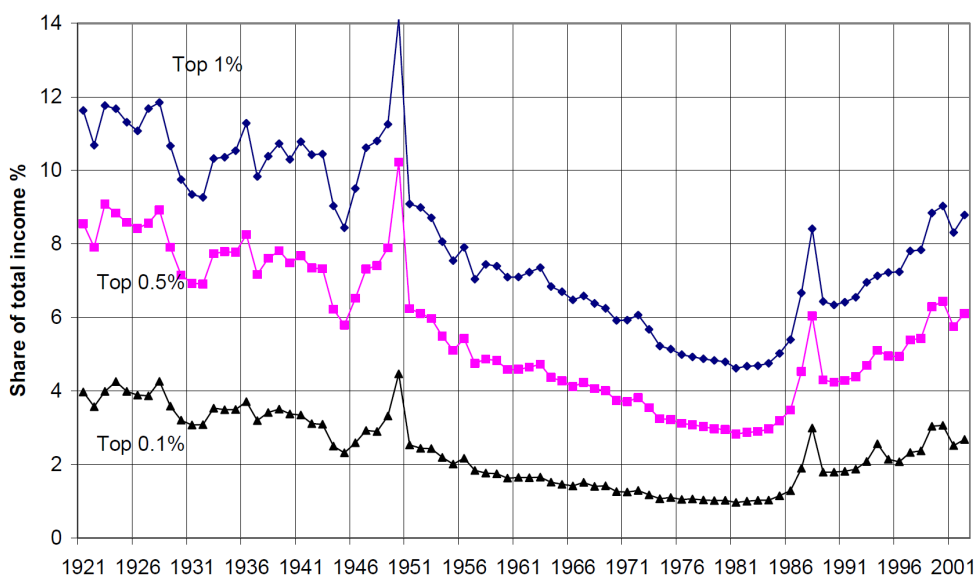
[http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/\\$File/52040_2009-10.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/$File/52040_2009-10.pdf).

Figure 10: Profits share of total factor income, Australia, 1961-62 to 2009-10



Source: Australian Bureau of Statistics, 2011. Australian System of National Accounts, 2009-10: item 5204.0, 2011, online
 <[http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/\\$File/52040_2009-10.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/$File/52040_2009-10.pdf)>, retrieved 1/10/2011

Figure 11: Share of total income gained by top 1%, top 0.5% and top 0.1% of income earners in Australia, 1921-2001



Source: AB Atkinson and Andrew Leigh, The distribution of top incomes in Australia, Discussion paper no. 514, Centre for Economic and Policy Research, Australian National University, March, Canberra, 2006, online <people.anu.edu.au/andrew.leigh/pdf/TopIncomesAustralia.pdf>.

The economic crisis of 1974-75 and the turn to promoting inequality

The shift by Australian governments to actively promote income inequality in Australia had its roots in the economic crisis of 1974-75, which erupted shortly after the re-election of the Whitlam Labor government in May 1974. At the time, government policy swung wildly from Keynesian stimulus to austerity, amidst bitter struggles between ministers over policy. Over the previous few years, Australia's trade unions had won pay rises of historic proportions, but inflation was spiralling out of control and business was alarmed. Society began to polarise sharply. Australia's strong and well-organised trade union movement attempted to defend jobs and to gain wage rises sufficient to maintain their real value as prices rose sharply, while the government attempted to restrain wages (Singleton 1990, pp. 30-45).

Australia was plunged into one of its most severe political crises, and one result was seven years of political impasse, as government, business and unions mobilised to attempt to defend their interests against the others. When the impasse ended in 1983, with the election of a new Labor government, there was an unprecedented restructuring of the economy, but one in which business and those on high incomes benefited disproportionately.

The first step in this process was the political crisis of the Whitlam Labor government in 1975. Its attempts to restrain wages and restore profit levels aroused bitter hostility with the trade unions who were its main organisational base. Working class voters also began to desert the government, angry at its inability to deal with the economic crisis. The parliamentary opposition, the business-based Liberal and National Party Coalition began a campaign to drive the government from office, and were able to block the passage of the national budget through parliament in October 1975. The national government was dismissed by the Governor-General, the Australian representative of Queen Elizabeth II. Mass strikes and street protests erupted in defence of the Whitlam government, and a general strike was narrowly averted by the leadership of the Australian Council of Trade Union (ACTU), Australia's peak union organisation. Sir Billy Snedden, the national leader of the Liberal Party 1972-75, believed 'the peace of the country was threatened and there could have been insurrection.' The celebrated public servant, HC Coombs, commented that 'in November 1975 Australia was brought closer to...serious civil strife than at any time in its history.' (Griffiths 2000; Bramble & Kuhn 2011, pp. 94-100).

The national election of December 1975 saw a strong majority for the conservative parties, led by Malcolm Fraser. At the centre of their agenda was a reduction in inflation, a restoration of profit rates, and in their minds this necessitated a reduction in real wages, a reduction in taxation, especially for business and high income earners, and a reduction of government spending, especially on services such as health, education and public housing (Head 1983). This was an agenda aimed at increasing income inequality, and this necessarily involved conflict with the trade

union movement, yet the means by which the government had been elected had polarised the working class and labour movement against the government, and created an atmosphere in which many believed that unions needed to prepare for confrontation with the government (Singleton 1990, pp. 50-61). Amongst business and conservative political organisations, there was a determination to wage a campaign to shift the dominant ideas of society from welfarism to an embrace of individualism and self-reliance, and to create widespread hostility to the trade union movement. The seven years of the Fraser government involved constant, polarised conflict with the trade union movement, over a wide range of issues, including its refusal to stimulate the economy to reduce high unemployment, its anti-union laws, attempts to reduce real wages, and cuts to government spending and services. In the late 1970s, a brief economic revival saw some unions win significant pay rises, while a new recession in 1982-3 meant that both business and popular support drained away from the government. Seven years of government-union hostility, conflict and political impasse had failed to resolve the underlying economic problems, and this made both business and trade union leaders open to more fundamental restructuring of the economy. Such a restructuring would be impossible under a government that lacked credibility and legitimacy. Many trade union activists and union leaders were also mentally exhausted by the long period of quasi-confrontation.

The corporatist strategy of the Hawke-Keating governments, 1983-96

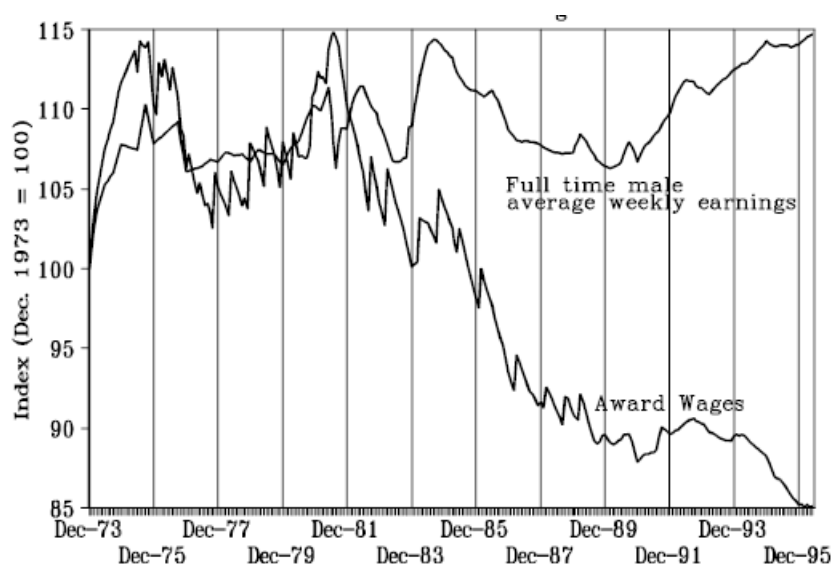
In 1983, the Labor Party, led by Bob Hawke, and the leaders of the trade union movement, proposed a Prices and Incomes Accord, a corporatist agreement by which the trade unions would guarantee industrial peace and wage restraint in exchange for a guarantee that the government would protect real wages and improve the social wage. Representatives of business and the trade union movement would be consulted on economic, tax and social policy. Labor decisively won the 1983 election and the Accord became the structure for government for much of the next decade.

A few weeks after his election, Prime Minister Hawke convened a national economic summit, involving representatives of business, trade unions, state governments and some non government organisations. The aim was to get agreement on an economic strategy which would raise profits by firmly restraining wages in the hope that increased profitability would lead to investment, economic expansion and reduced unemployment, all without inflation. The summit's communiqué is reproduced in Stilwell (1986). 'Business participants...maintain that to achieve the growth in GDP and employment on which the nation's prosperity will depend, increased profitability is now essential...' For its part, the trade union movement accepted 'that while the maintenance of real wages is a key objective, in a period of economic crisis, as now applying, it will be an objective over time.'

An economic policy in which the majority of real wages do not rise is one that delivers most gains from increased productivity to employers and managers, and hence inherently increases income inequality in society. The Accord went further, with a series of devices aimed at reducing real wages. There had been a six month wages freeze imposed in the final months of the Fraser government, effectively reducing real wages. There was a wage discount when the new government's Medicare health insurance scheme was introduced in 1984. In 1985 the government argued for partial indexation, in other words, a centralised pay increase that did not cover price rises on the basis that the government would cut taxes on average wages. In 1986, a new Accord agreement accepted a two-tier wages system which gave a small flat increase to wages; plus an additional sum which could only be gained on the basis of negotiating changed work practices with employers to increase efficiency.

While prices were monitored, any workplace or union that attempted to force up wages beyond the agreed maximum was disciplined; either by the leadership of their union, or the ACTU. One union, the Builders' Labourers' Federation, was deregistered and gradually destroyed for its industrial militancy. This had the support of the bulk of union leaders (Bramble 2008). One effect of this wages policy can be seen in Figure 12. Workers relying on the legal minimum award wages for their occupation and industry found them falling during the life of the Accord, while those whose wages were unregulated, including managers and professionals, found their real wages rising, with the average remaining largely constant.

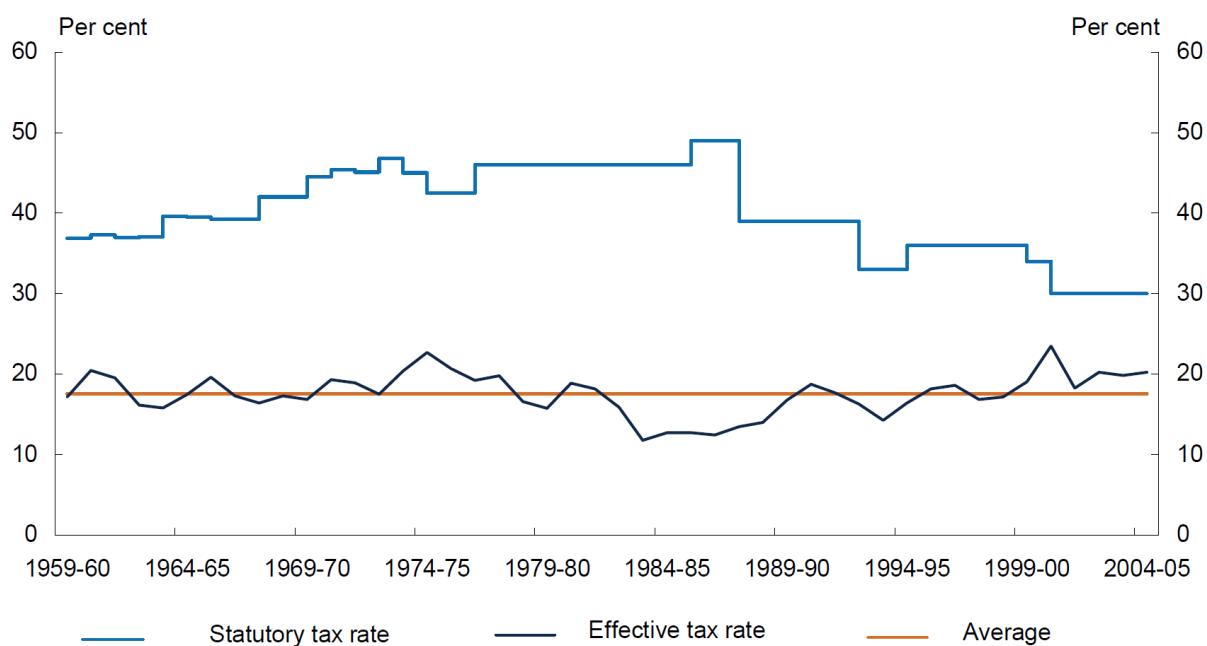
Figure 12: The growing gap between real average male weekly earnings and award (minimum) wages under the Accord, from 1983.



Source: Leigh Harkness, Submission to the Australian Industrial Relations Commission regarding the ACTU Living Wage applications, ?1996, online
http://www.buoyanteconomies.com/IRC_SUB1.pdf, p. 5

Alongside its wages policies, the Labor government restructured business taxation. The statutory rate was reduced, from 46% in 1983 to 36% in 1996, however changes in the rules applying to corporate tax had as great an impact, with the effective rate of corporate tax declining in the early years of the government, and then rising again (see Figure 13). In 1986, fringe benefits tax and a capital gains tax were introduced, and these were amongst the few measures to reduce income inequality (Reinhardt & Steel 2006). Personal taxes on high income individuals were cut in two main ways. The top marginal tax rate was cut in a series of steps from 60% under Fraser, to 47% by 1990-91. And the government introduced dividend imputation, which dramatically cut income tax on share dividends, a reform which primarily benefited the wealthy. Historically, businesses paid company tax, and then when dividends were paid to shareholders, they paid income tax on them. Dividend imputation meant that shareholders' income tax was reduced by the amount their shares had paid in company tax. The effect can be seen from Table 4. The overall effect of falling taxes on high income individuals, was that the average worker gradually paid a higher percentage of their income in tax, as seen in Figure 14.

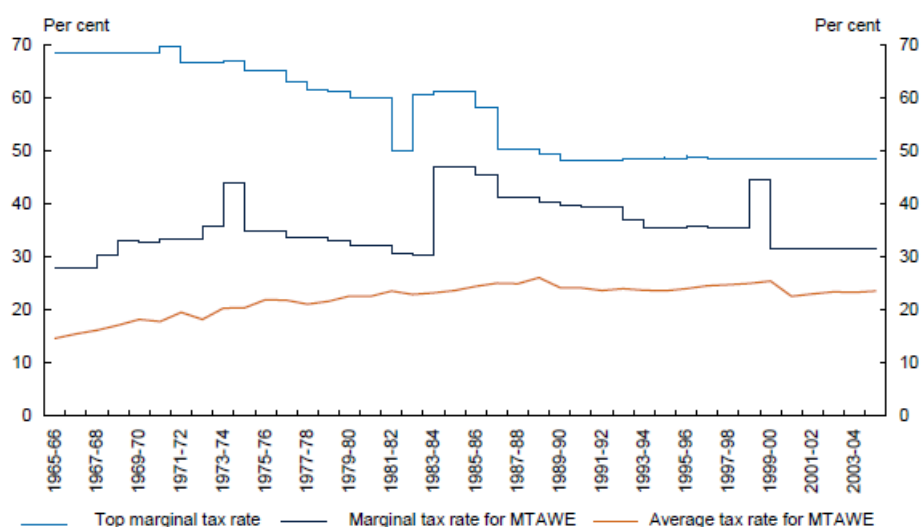
Figure 13: Statutory and effective corporate tax rates in Australia, 1959-60 to 2004-05



Source: Richard FE Warburton AO and Peter Hendy, International comparison of Australia's taxes, Report to the Treasurer, Commonwealth of Australia, 2006, online <http://comparativetaxation.treasury.gov.au/content/report/downloads/CTR_full.pdf>, p. 140

Table 4: Impact of dividend imputation

	Before dividend imputation	After dividend imputation
Company profit	\$1000	\$1000
Profit after company tax (@30%)	\$700	\$700
Dividend to shareholder	\$700	\$700
Income tax paid by shareholder (at top marginal rate of 45%)	\$315 700×0.45	\$150 (\$450 on full \$1000 profit less credit of \$300 paid in company tax)
Nett shareholder dividend	\$385	\$550

Figure 14: Marginal and average personal tax rates, Australia

MTAWE is male total average weekly earnings.

Source: Richard FE Warburton AO and Peter Hendy, International comparison of Australia's taxes, Report to the Treasurer, Commonwealth of Australia, 2006, online

<http://comparativetaxation.treasury.gov.au/content/report/downloads/CTR_full.pdf>, p. 63

The new government used its popularity and its close relationship with the trade union leadership to undertake the most significant restructuring of the economy since the creation of the Australian national government in 1901 (Kelly 1994). The Australian dollar was floated, banking and many other industries partially

deregulated, and this helped drive a major expansion in financial services. At the same time, core areas of manufacturing industry were restructured to either make them globally competitive or send them offshore. Large numbers of male workers in particular lost well-paid jobs, with the government offering retraining and assistance finding new careers. The government committed to the globalisation of the economy and the effective dismantling of industry protection. This represented an historic break with the industry policies of the previous 75 years. The deregulation of the airline industry and changes to industrial relations led to a boom in tourism and hospitality; while government also reconfigured tertiary education into a major export industry. One reason the government was able to successfully restructure the economy was that its policies helped spark an investment boom, which in turn created hundreds of thousands of jobs after a decade of recession and persistently high unemployment and gave some (but not all) of those who had lost their careers alternative employment (Kelly 1994; Edwards 2007). They also unleashed a wave of speculation, in shares and real estate.

Table 5: Change in male employment, Australia, 1983-2011

Period	New full time jobs for men	% up	New part time jobs for men	% up	Increase in male under-employment	% up
Feb 1983 to Feb 1996: period of Labor govt	273,000	6.9%	103,000	14.4%	138,000	112%
Feb 1996 to Aug 2011: Howard, Rudd & Gillard	993,000	23.5%	481,000	91.6%	75,000	28.6%

Source: Australian Bureau of Statistics, Labour force, item 6202.

Table 6: Change in female employment, Australia, 1983-2011

Period	New full time jobs for women	% up	New part time jobs for women	% up	Increase in female under-employment	% up
Feb 1983 to Feb 1996: period of Labor govt	160,000	8.5%	192,000	14.4%	201,000	137%
Feb 1996 to Aug 2011: Howard, Rudd & Gillard	771,000	37.6%	862,000	56.4%	152,000	43.7%

Source: Australian Bureau of Statistics, Labor force, item 6202

Borland, Gregory and Sheehan (2001) documented the jobs impact of the restructuring of the Hawke-Keating era, 1983-96, which delivered very few full time jobs. The trend towards part-time and casual work has been continued now for 30 years. These changes can be seen in Tables 5 and 6. The changed structure of employment helped drive a polarisation in incomes, with a rise in the (small) number of highly paid jobs, a dramatic rise in the number of poorly paid jobs, and a decline in the middle. There was also a dramatic rise in underemployment, in the number of people with some work who wanted longer hours, or a full time job.

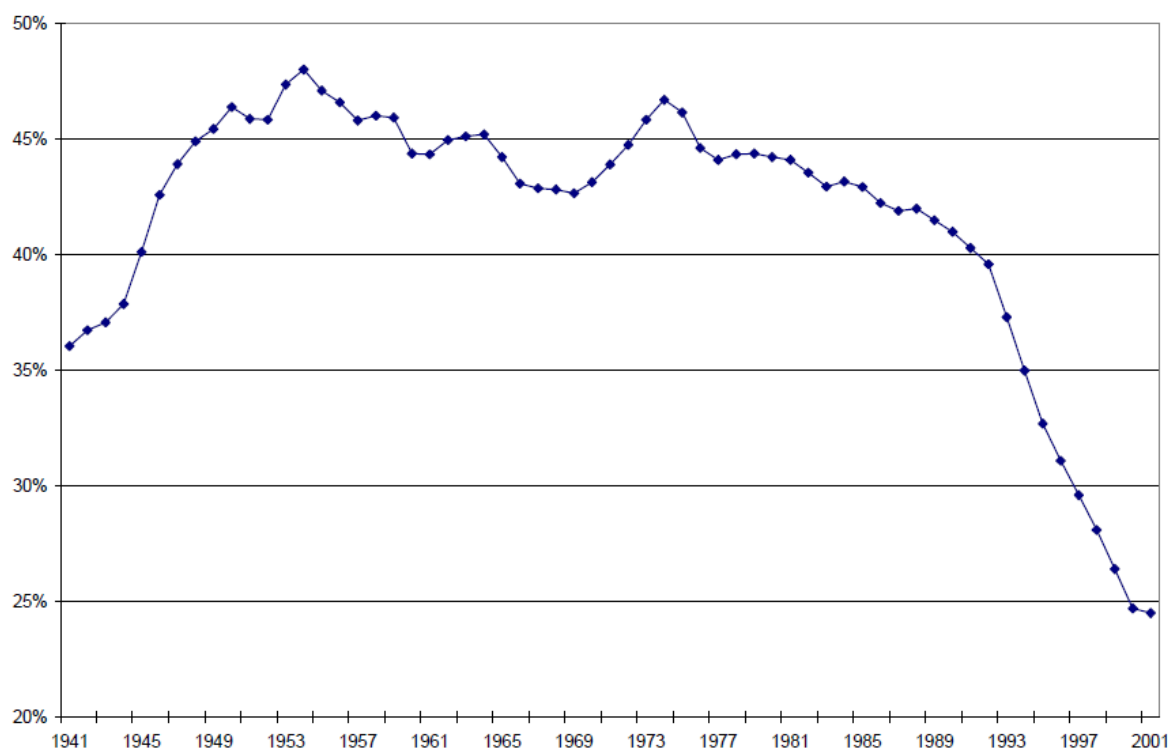
In its early years, the Hawke government improved welfare payments for unemployed people and old aged pensioners, introduced additional payments to families dependent on welfare and expanded important government services such as child care. These had a significant impact on many of the poorest families and had the effect of temporarily dampening the overall rise of income inequality. In a climate of gradually falling real wages for most occupations, household income levels fell less for two reasons: there was a rise in female participation in the workforce; and many people benefited from the normal process of promotion to better jobs and higher incomes. However this dampening effect was largely temporary. The respected welfare economist, Ann Harding, researched income inequality for the period from 1982 to 1993-94, which largely covered that of the Labor governments led by Bob Hawke and Paul Keating, 1983-96 (Harding 1997). While she found some increase in household income inequality for the period, this was cancelled out by a small decline in the number of people living in the average household and dependent on the average household income. She identified a significant increase in market income inequality, with the Gini index for earnings increasing from 0.500 in 1982 to 0.537 in 1993-94, but found that the impact of this was entirely counteracted by progressive taxation and a significant increase in welfare payments for low-income citizens. But behind this benign outcome, she found a significant redistribution of income away from middle-income households, with a drop of 5.6% in male, full-time wage and salary earners whose incomes were between 75% and 125% of the median. About two-thirds of these found themselves earning less and a third earning more; figures that reflected the changing job situation identified by Borland, Gregory and Sheehan (2001).

By the end of the Keating government in 1996, the corporatist process of the Accord was exhausted. There had been a major recession in 1992-93, which saw unemployment reach 11% and a recovery in output which failed to translate into employment. Wage restraint, and union cooperation with business and government had not protected workers from mass unemployment, economic insecurity, or declining standards of government services. By 1991, faced with widespread membership discontent and with unemployment rising rapidly, the ACTU leadership and government made a major shift in wages policy, agreeing to promote enterprise bargaining. This was a partial retreat from centralised wage fixing. But enterprise agreements had to be made on the basis that productivity gains were at least as great as any wage rise, and then be approved by the quasi-judicial Arbitration Commission. Union leaderships now found themselves agreeing to job

reductions, reclassification systems and other measures to raise profitability as the means to secure nominal wage increases (Bramble 2008).

The cumulative effect of union cooperation with Labor governments was a significant decline in unionism. For many workers and potential members, belonging to a union no longer seemed to mean improving wages and working conditions, or defending a workplace relations system built around well-paid full-time jobs for most workers. The union movement remained a significant force in workplaces and politics, but it had been greatly weakened and demobilised (see Figure 15).

Figure 15: Rate of unionisation in Australian workforce



Note: Horizontal axis is financial year starting 30 June.

Source: Andrew Leigh, What affects inequality? Evidence from time series data, Paper prepared for presentation to the Australian Social Policy Conference, University of New South Wales, Sydney, 9 July, 2003, online <www2.sprc.unsw.edu.au/ASPC2003/papers/Paper78b.pdf>, p 20.

The Howard government, 1996-2007

By the time the new conservative government, led by John Howard, was elected, the limited compromises of the Hawke/Keating government with the trade union movement were no longer necessary. The new Prime Minister, who possessed a life-long hatred for unions and the politics of economic equality, set out to decisively weaken the trade union movement and give employers control over workplace

relations. Its broader economic agenda was far less ambitious than that of the previous governments. It primarily aimed to manage the market economy successfully, and focused on reducing company and income taxes, and partially replacing these with a broad-based goods and services tax. All these would contribute to a further widening of income inequality.

The new government began by passing a new Workplace Relations Act that limited the legal rights of unions, and in 1998, combined with waterfront employers to attempt to destroy the Maritime Union of Australia, one of the most powerful of unions. While it failed to destroy the union, it did win a massive cut in waterfront jobs. It also put the trade union movement on the defensive, which allowed employers to continue to restructure work to increase casualisation and employee flexibility.

Howard's economic policy included further cuts in the company tax rate, reduced from 36% to 30%, and the introduction of a broad-based goods and services tax, another regressive measure. On average, welfare payments were maintained in real terms, but this meant they fell compared to average wages. The impact of increased market income inequality was transmitted to disposable incomes. The mining boom of the 2000s, and the fact that there was no recession in the Australian economy from 1996 until 2011, reduced pressure on the government for radical economic restructuring.

The growing income inequality during the Howard years, along with the decline in quality of government services (and especially government schools and hospitals), created a sense of discontent within the population, but not one that specifically focused on the government. There was widespread awareness of the rise in inequality. One of the largest and most reliable surveys of social attitudes in Australia is the Australian Survey of Social Attitudes. In 2003, the most recent published data, 84% of respondents agreed that 'there is too much of a difference between rich and poor in this country', up from 61% in 1987 and 66% in 1994. When asked about the power of big business, 72% of people in 2001 thought the power of big business too great, while 62% of people in 2003 thought business should have less power. Some 81% thought the big businesses went unpunished when they broke the law. When asked about living standards, 76% of people agreed that their standard of living was better than that of their parents at the same age, while 8% said it was worse and 15% said it was about the same. However only 48% expected their children's standard of living at the same age to be better than theirs, with 21% expecting it to be worse and 25% about the same (Pusey and Turnbull 2005). When asked about the best way to improve living standards, 30% thought the each individual should look after their own interests first, while 49% thought that it was important to look after the community's interests first (with 21% unable to choose). On just about every measure of social attitudes to the economy and business, the attitudes of the Australian people ran counter to those of the government, and increasingly so during Howard's term as Prime Minister.

This became particularly pointed when the Howard government attempted a radical restructure of workplace relations around individual contracts, called WorkChoices, with greatly reduced rights for union organising and representation, and reinstated an almost unfettered right for most employers to dismiss staff when it suited them. The 2003 survey had shown that 2.5 times as many people agreed that individual contracts favoured employers over employees compared with those who disagreed; and this was proven in practice when the Howard government was defeated on this issue in the 2007 election.

Conclusion

Society cannot be made more equal, and the horizons of the disadvantaged cannot be raised, without some compromise on the part of those already advantaged (Maddox 1989, p. 159)

The normal operation of the capitalist economy puts great economic power in the hands of the owners and managers of businesses, and especially in relation to their employees. Governments see no alternative but to facilitate the successful and profitable operation of business, and this includes protecting business owners from potentially harmful action by their employees.

Left unchecked, the normal operation of business delivers great economic and social inequality. Trade unions have been able to reduce this inequality to some extent, by raising wages and putting pressure on governments to support the unemployed, the sick, the old and other vulnerable people, and to impose progressive taxes on high income earners. It is for this reason that John Kenneth Galbraith saw unions playing a vital role as a 'countervailing power' to that of business (Galbraith 1956). These measures have tended to reduce income inequality, but under pressure by business, governments in most rich countries have set out to reduce 'the burden on business' and to weaken the power of trade unions as part of this. In Australia, the major achievements in this regard were a product of the Hawke and Keating governments from 1983-96, assisted by the leadership of the union movement themselves, even as they were weakened by the policies they supported. Their 'success' is reflected both in a long period of economic expansion, and in a large increase in income inequality, including rapidly rising incomes for the top 1% and top 0.1% layer of income earners.

Governments know how to reduce inequality, because they did it successfully in most western countries for over thirty years; decent minimum wages, low unemployment, high levels of social security and in particular unemployment benefits, higher company taxes and high marginal tax rates on high income earners were all part of the policy mix until the mid-1970s in most western countries. In most of these countries, economic prosperity and low unemployment allowed the strengthening of trade unions, even when governments wished to prevent this. Governments deliberately and explicitly turned away from this policy agenda in the

years after the economic crisis of the mid-1970s, and helped create the rising inequality that has followed. They did this because they sought to increase the rewards for investment in the hope that this would lead to a revival of job creation.

In most countries, job creation did revive, but the jobs were far more likely to be low paid and casual. And even these limited gains were always vulnerable to recessions, in the early 1990s and early 2000s, and now in the wake of the global financial crisis. The job gains might have been temporary, but the rise in inequality has been relatively permanent.

And while Australia has not experienced a recession since 1992, it has seen a dramatic rise in income inequality. There is little likelihood of any Australian government taking unilateral action to reduce this in the near future, given the current mobilisation of business against the very modest measures the Gillard government has taken. This mobilisation has targeted the special taxes on mining superprofits and carbon emissions. Business also wants the industrial relations laws amended to further weaken the rights of unions to restrict greater workplace flexibility. There is little parallel pressure from the labour movement.

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