



INEQUALITY: THE FACTS AND THE FUTURE

August 2016



Note from the authors:

The Commission is a project of the Chifley Research Centre, the official think tank of the Australian Labor Party. This paper has been prepared with the assistance of Equity Economics and Development Partners Pty Ltd.

The report is not a policy document of the Federal Parliamentary Labor Party. Commissioners have acted in their private capacities. The Commission's publications do not represent the policy of any other organization.

As in any collaborative process, there has been much give and take among the participants in developing this paper. We all subscribe to the broad analysis and principles articulated here. There may be specific matters, however, on which some of us have different views.

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Whether you think it is due to technology or to globalization or to the mal-distribution of political power, something very serious is happening in our society...

Lawrence H Summers

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INTRODUCTION

This is not some tepid third way Davos fudge in which we pretend the only response to growing wealth and income inequality and disruptive technological change is world class education and training. Wayne Swan MP

The Inclusive Prosperity Commission is a major policy project of the Chifley Research Centre, the think tank of the Australian Labor Party. Since its launch in 2014, the Commission has been exploring the threat to Australia's future economic growth presented by growing inequality - and new policies to respond.

The Commission's task has been to develop a new economic policy framework to guide Australia beyond the global financial crisis and the peak of the mining boom. Much of that is contained in this, the Commission's formal public report - *Inequality: the facts and the future*.

Co-chaired by Wayne Swan MP (Federal Member for Lilley, former Deputy Prime Minister and Treasurer of Australia, author of 'The Good Fight', Allen and Unwin, 2014) and Michael Cooney (Executive Director of the Chifley Research Centre, former speechwriter to Prime Minister Julia Gillard and author of 'The Gillard Project', Penguin, May 2015), the Commission's membership is broad with high profile and credentialed policy makers from across the spectrum. A group of academics, business people and economists, along with business and civil society leaders, including leaders of trade unions, have acted as Commissioners in their private capacities. We are grateful to Cameron Clyne, David Hetherington, Dave Oliver, Peter Whiteford, Rebecca Huntley, Stephen Koukoulas, Tony Nicholson and Verity Firth for their service. Amanda Robbins of Equity Economics has led the Commission's staff.

This report will sit alongside new analysis from the IMF, World Bank and influential publications such as Thomas Piketty's 'Capital in the Twenty-First Century' which point to the need for greater government involvement and regulation in many parts of the world, particularly through stabilising labour markets and restoring progressive taxation.

The Commission has built on the trans-Atlantic report of the Center for American Progress (CAP), chaired by ex-US Treasury Secretary Larry Summers and British Shadow Chancellor, Ed Balls (see: www.americanprogress.org/issues/economy/report/2015/01/15/104266/report-of-the-commission-on-inclusive-prosperity/) of which Mr Swan was a commissioner. The Chifley Research Centre is grateful for the contribution of the Center for American Progress as a project partner for the Commission.

EXECUTIVE SUMMARY

If only ten percent of people win when the economy does well, ten percent of people will care if the economy does well. Michael Cooney

The central argument of *Inequality: the facts and the future* is a simple one. Australia is well placed to resist the economic and political pressures which can make us more unequal over time. If we do this, our economy will continue to grow strongly and middle Australia will see the benefits of that growth in higher living standards. The alternative – to go down the American road of rising inequality, slowing growth and stagnant living standards – would be bad for all of us and political instability.

This core argument stems from scholarship that is at once relatively new, firmly established and approaching a consensus among key international economic institutions.

The IMF, the World Bank and the Bank of England are among the global economic authorities warning that rising inequality is a serious threat to the future growth of advanced economies. This is an important development in the global economic debate.

We find an inverse relationship between the income share accruing to the rich (top 20 percent) and economic growth. If the income share of the top 20 percent increases by 1 percentage point, GDP growth is actually 0.08 percentage point lower in the following five years, suggesting that the benefits do not trickle down.¹

This reflects the growing evidence that excessive concentration of wealth and rising income inequality has destabilising effects on financial markets and distorts investment incentives. It also reflects the emerging argument that sluggish global growth and weak economic demand are actually being reinforced by economic policies and market outcomes which limit public investment, squeeze living standards and restrict wages growth.

Australia has a strong starting point. Our economy is stronger and fairer than that of most other countries. We have both grown faster than others and been more equal than others, and this is no coincidence. But there are emerging economic threats that demand a long-term policy response. Inequality has been rising for some time in Australia: unemployment is rising and real wage growth is slow, houses are harder to afford, some kinds of health care cost patients more than ever, education funding is inadequate and is often poorly targeted, and both pensions and superannuation systems are threatened. Ineffective action on climate change and a politics subject to deep partisanship and short-term decision-making further darken the picture.

New economic trends are emerging as future threats to shared prosperity as well. The global disruption to workers and business imposed by digital technology, the rise of Asia, longevity in Australia, and the end of the mining boom, are all challenges that could result in big benefits to the vested interests who benefit from a further concentration of wealth and income, while middle Australia misses out.

Finally, the conservative policy consensus is a political threat to Australia's traditions of egalitarianism and social mobility; it will only fuel rising inequality. The conservative plan for Australia attacks our tax base, weakens our labour market institutions, limits wages and incomes, and shrinks the social democratic state. It is driven by vested interests and reinforced by conservative prejudices: a denial of the inherent link between economic equality and social mobility, and a misunderstanding of the broader societal role of government and the relationship between economic growth and long-term fiscal strength. To pursue this plan in coming years would be to lock rising inequality into the Australian political economy and lock middle Australia out of the benefits of growth and undermine the deep drivers of that growth. It also risks deep damage to public support for the type of productivity enhancing structural reforms required to lift national income and enhance social mobility.



The existing and emerging economic threats present a long-term policy challenge, one decision-makers must confront, preferably sooner rather than later. However, it is the conservative policy consensus which is increasingly forcing an urgent choice upon Australians.

Australia's economic future requires a very different framework from the conservative consensus – and a marked evolution from the economic approach that led Australia out of stagflation in the 1970s and early 1980s and into the long boom that gained enormous traction in the early 1990s. There are big possibilities for our country that demand new approaches, while the new problems of inequality require new solutions. What got us here won't get us there. Which direction will Australia take?

So how do we create a stronger, fairer, and more sustainable economic model in which the many and not just the few benefit from rising prosperity now and into the future? This is not just a question for governments but for companies and citizens as well.²

The view of the Inclusive Prosperity Commission is that Australia should stoutly resist bad policies that worsen inequality and undermine long run growth. There are divergent economic paths available to us – and politics is bringing us to a definite fork in the road.

In *Inequality: the facts and the future* we aim to articulate a better way ahead by identifying five 'sign posts for inclusive prosperity':

- good jobs and wages
- housing you can afford
- health care when you need it
- education for the future
- secure income in retirement

These 'sign posts' are the tests of a well-functioning economy and society and the guide to an effective economic policy; they guide us to the choices we should make to secure a broad based prosperous society in the 21st century. Economic growth which does not generate these benefits for working-class and middle-class households has no social purpose and cannot be sustained, neither economically nor politically. Policies which put these outcomes at risk weaken the economy – policies that lead us in this direction strengthen the economy over time.

A strong middle class is a source of growth not just a consequence of it ... Understanding that policies to help strengthen the middle class are by and large good for the economy and not job-killers is potentially revolutionary – not because it leads directly to a particular policy victory, but rather because it provides a framework that can lead to the success of a broad progressive agenda.³

A clean environment and good government are essential underpinnings and must not be put at risk in pursuit of these objectives.

With the right choices made, and the signposts well in view, the Commission recommends new policy measures to get us there – a practical, credible and progressive plan.

First, what we term a 'high-pressure economy' with job creation and economic growth grounded in high productivity and strong aggregate demand: based on full employment and a modern regulation of work – and a tax and transfer system that promotes fairness.

Second, a 'progressive supply side agenda': support for innovation, long-term investment in public infrastructure and sustainability, quality health and education for all – and incentive for long term private sector investment.

This is a new agenda for the Australian economy and one that reflects the present direction of economic thought in much of the developed world. This report builds on the work of our project partners the Center for American Progress and is informed by this egalitarian turn in global economic thought. Yet our starting point is the facts in Australia, and our particular responsibility is the Australian future. This is the basis on which our report begins.


THE SCOPE OF OUR WORK



An important advantage in taking inequality as a starting point for our analysis of Australia's economic future is that it leads us to analyse many phases of Australian life. Naturally, this also requires a sensitive understanding of the scope of our project – both the logical limits of this Report and its connection with other related research and publications. In what follows below, many important issues are left undiscussed.

Growing Together: Labor's agenda for tackling inequality, released by Jenny Macklin MP in March 2016, is a key document which touches on many important areas not addressed in *Inequality: the facts and the future*. We recommend it.

Perhaps no Australian inequality is of greater civic importance than the gap between our Indigenous and non-Indigenous citizens. A detailed consideration of this issue is beyond the scope of our work in *Inequality: the facts and the future*. Inclusive prosperity is a policy framework which we believe is necessary, but far from sufficient, to close this gap. Indigenous Australians must benefit from the prosperity of this country.



PART 1: THE FACTS

*Where does Australia
stand today?*

A STRONG EGALITARIAN PLATFORM ...

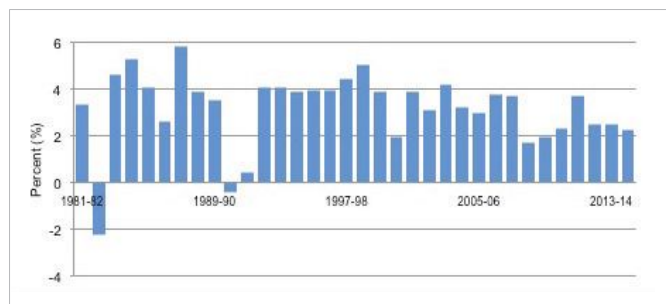
Over two decades of unprecedented prosperity, the Australian economy not only grew incredibly strongly, it distributed the gains more fairly than almost any other developed economy. David Hetherington

Strong economic growth and a once in a lifetime commodities boom

Australia's last recession ended in 1991 and over the past 25 years the Australian economy grew strongly at an average annual rate of 3¼ percent (see Figure 1). Economic reforms delivered by a progressive egalitarian government drove productivity growth and rising living standards through the 1990s. In the 2000s, ongoing rapid industrialisation in China and other emerging markets generated a massive increase in Australian commodity export incomes. At the same time, Australian consumers and businesses benefited from access to cheaper manufactured goods from Asia. The combined effect was to boost real incomes in Australia.

We have grown the economy

Figure 1: Real GDP growth



Source: ABS National Accounts, Cat. No. 5206.0

By the early 2000s, Australia achieved low inflation, rising real wages, and low unemployment

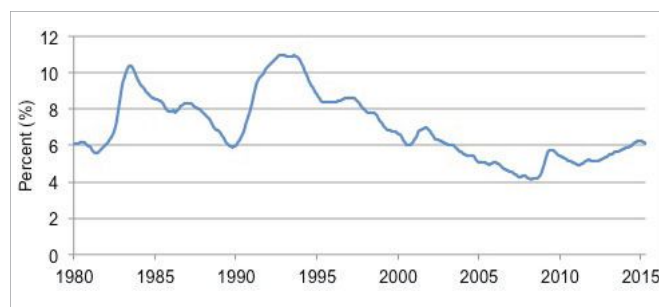
A vital aspect of the prolonged expansion phase has been the containment of inflation to an average rate of 2.5 percent, exactly the mid-point of the Reserve Bank of Australia's target band of inflation of 2 to 3 percent. At the same time, annual wages growth has averaged around 3.5 percent, which means that workers' purchasing power increased by 1 percent per annum. Businesses have also flourished with strong profits and returns on investment.

Sustained economic growth delivered ongoing job creation and the unemployment rate remains low compared to the 1980s and 1990s (see Figure 2). Until recently the structurally lower unemployment rate boosted household incomes and complemented the rise in real wages to the point where there has been a broad-based increase in living standards, although there are also too many Australians who have not seen these benefits.

Over the same period, the workforce participation rate also increased from around 61 percent of the workforce in the 1980s to around 65 percent today. Most striking has been the lift in female participation which has risen from 45 percent to around 58 percent of the workforce over the same period (see Figure 3).

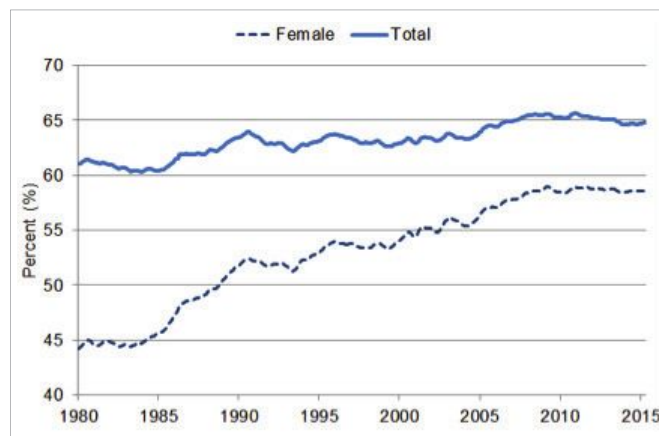
We have grown jobs, especially for women

Figure 2: Unemployment rate



Source: ABS Labour Force Australia, Cat. No 6202.0

Figure 3: Participation rate



Source: ABS National Accounts, Cat. No. 5206.0

Australia avoided several cyclical downturns

Over the past 25 years, fiscal and monetary policy in Australia have adjusted well in the face of global shocks, including the Asian financial crisis of 1997-98 and the tech bubble in the United States in 2001-01. The strongest test was the global financial crisis of 2007-08.

The bursting of the US housing bubble and subsequent global banking crisis was the catalyst for the most serious and widespread global financial crisis in generations. Policy makers in Australia reacted swiftly. The Australian Government banned short selling of stock and introduced a residential mortgage backed securities investment program. With growing nervousness among depositors, the Australian Government extended the guarantee arrangements to deposits. The Government also guaranteed the wholesale funding of banks. These decisions were followed by a world-leading fiscal stimulus program and significant cuts to interest rates by the Reserve Bank.

Several international commentators have identified rising inequality in leading nations as one of the key drivers of the financial crisis⁴. They have argued that high wealth concentration was a destabilising factor in extremely deregulated financial markets – with ultimate economic costs even for more equal national economies. The Australian story was very different. There was a rise in inequality in Australia over the same period, but it was more moderate with middle income earners in Australia doing much better than other developed nations. In Australia, stronger financial regulation prevented the build up of extreme financial risks – and this was matched by a better policy response when the crisis hit. As a result, Australia largely avoided the global downturn in 2009 and sharp rise in unemployment experienced by other advanced nations (see Figures 4 and 5).

We have stayed out of recession

Figure 4: Real GDP growth

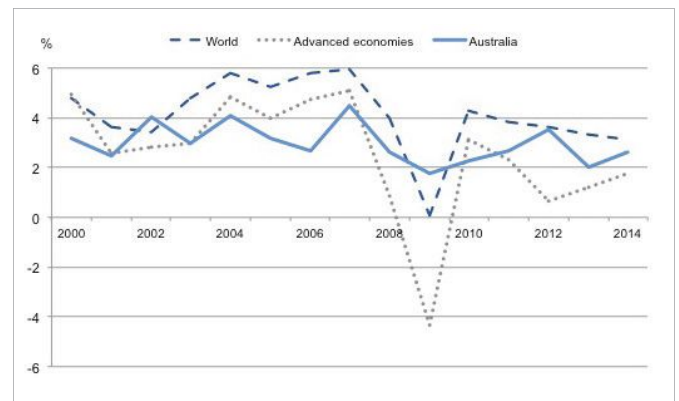
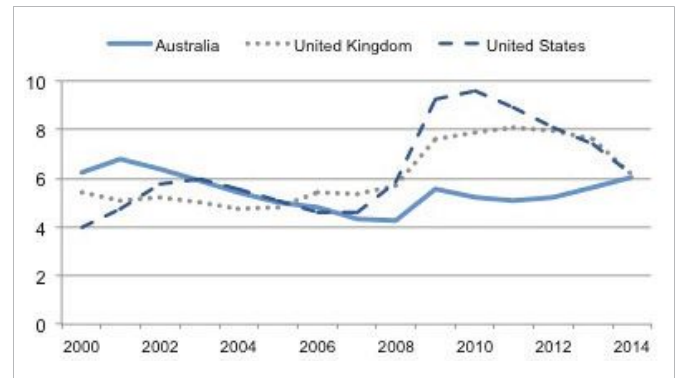


Figure 5: Unemployment rate



Source: IMF World Economic Outlook, April 2015





Australia is one of the few advanced countries with incomes rising on average across the board in recent decades

Australia's growth experience has been one where households across the income distribution benefit on average. Not everyone has benefited and disadvantage persists. Yet strong growth across the distribution has set Australia apart from many other OECD countries⁵.

One illustration of this is provided in Figure 6, which shows major economies experiencing slow growth or a fall in middle incomes over the 2000s, while Australia achieved a large increase.

We have shared the benefits of growth

Figure 6: Average real income growth of those outside the top 10 percent, by decade



Source: The World Top Incomes Database <http://topincomes.g-mond.parisschoolofeconomics.eu>

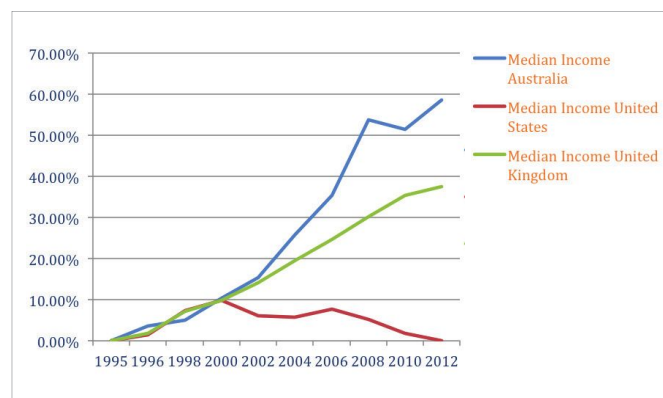
Bottom 90 percent average income, Accessed July 2015

Lighter shading indicates less than a full decade of data available

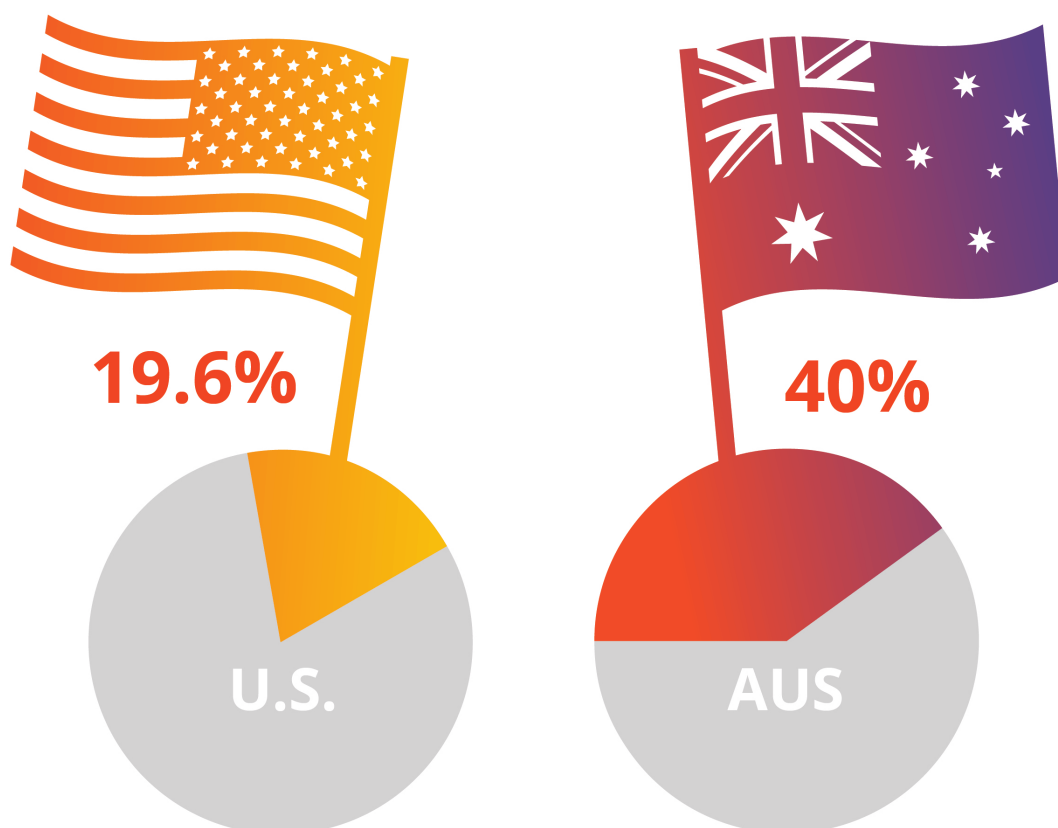
At the lower end of the income distribution, Australian households experienced rising incomes as workers benefited from growth following recovery from the 1990s recession. People in middle-lower income households were more likely to work, and part-time workers took on more hours.

It is no coincidence that we have grown more strongly than many countries while making sure more of our people benefit from our growth. Rising living standards in middle Australia have strengthened our economy in a period when run-away inequality and wealth concentration destabilized both the economy and the politics of the US and much of Europe.

Graph 6 Median Income Growth 1995-2012



Our middle class still has a
greater share of national wealth



Australia has **not yet** gone down the
American Path

... BUT EMERGING ECONOMIC THREATS. INEQUALITY HERE IS ALREADY RISING ...

In Australia, not only have we achieved gender equality in education, we are among the best. Yet it has not translated into the workforce and it has not translated to equal pay outcomes. That is a very big challenge for Australia. **Verity Firth**

Australia's egalitarian economy, supported by sound policy and natural endowments, has performed strongly for 25 years. However, even through this period, threats to equality have been emerging, limited in some cases by effective public policy but real nevertheless. Australians need to understand these emerging threats to our equality if we are to prevent them from threatening future economic growth.

Income inequality in Australia has been rising

Although there have been periods where inequality has risen and fallen over the past 30 years, the overall trend is an increase in inequality. According to the most commonly used measure of income equality, the Gini coefficient⁶, inequality in Australia has risen from 0.27 in 1981–82 to 0.33 in 2013–14⁷. Australia stands at around the OECD average in terms of income inequality (see Figure 7) and well below major trading partners like Germany and Korea. This is during a period of increasing inequality amongst almost all OECD countries, including those that traditionally had low inequality (e.g. Denmark, Norway, Sweden).

Overall, Australia's strong growth and employment record, matched with policy and institutional settings, has acted to slow the growth of income inequality compared to the experience in countries such as the United States and United Kingdom. These settings include: a strong social safety net, including means-tested welfare, universal healthcare, and universal superannuation; progressive income tax and a low level for a consumption tax; high public investment in education; a solid minimum wage and minimum employment standards; and anti-discrimination protection. It is worth noting that many of these fundamentals are exactly the features of Australia's economy that are clearly in the sights of the current Coalition Government. There is also an argument that comparing Australia to other countries on measures of the relationship between 'the top' and 'the bottom' understates our relatively strong performance in 'the middle'. Market inequality (before tax and transfer payments) is relatively low in Australia, and middle-income earners have had better growth in living standards particularly through the wage system than in many countries, notably the United States.

Australia also has a distinctive, indeed close to unique, welfare and tax system and this has acted to moderate growth in income inequality. In particular, Australia relies more heavily on income testing and directs a higher share of benefits to lower income groups than any other OECD country⁹. The 2009 increase in the Age Pension, for example, sharply reduced income inequality amongst older people. However, there is evidence that the egalitarian impact of the social security system has reduced over time, mainly due to its smaller relative scope in a period of strong employment and income growth, but also due to the effect of continuing income tax cuts, which have reduced the overall tax take, and the delinking of benefits levels from wages growth¹⁰.

We're now in the bottom half of the equality ladder

Figure 7: Select OECD nations ranked from lowest to highest inequality, 2013⁸

Country	Gini
Denmark	0.25
Norway	0.25
Finland	0.26
Sweden	0.27
Netherlands	0.28
Switzerland	0.29
Germany	0.29
Luxembourg	0.30
Korea	0.30
Ireland	0.30
France	0.31
Canada	0.32
OECD average	0.32
Australia	0.33
Italy	0.33
New Zealand	0.33
Spain	0.34
Japan	0.34
Portugal	0.34
Greece	0.34
United Kingdom	0.35
Israel	0.36
United States	0.40
Turkey	0.41

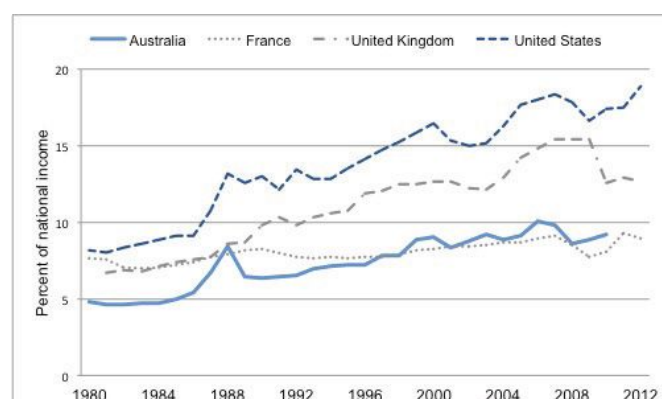
Source: OECD Income Distribution Database

Since the 1980s, those at the top have been taking a greater share of Australia's income

Those at the top of Australia's income distribution have experienced stronger gains in earnings and investment income. This is most starkly illustrated by the rising income share of the top one percent (see Figure 8). Although Australia is starting from a lower base compared to other countries such as the United Kingdom and the United States, the proportionate increase is about the same.

Income concentration is not as bad as the US, but it's not good and it's getting worse

Figure 8: Top one percent share of national income



Source: The World Top Incomes Database <http://topincomes.g-mond.parisschoolofeconomics.eu>



Since the mid-2000s, wages have failed to keep pace with productivity improvements

Labour earnings are the largest component of income for most Australians, and therefore the most important driver of income inequality. Average wages today are growing more slowly than productivity, contributing to inequality in the short term and threatening future productivity growth.

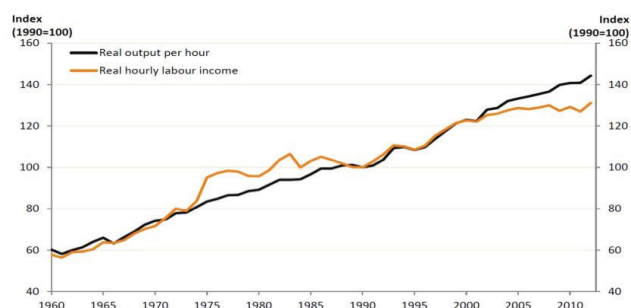
In the past there have been concerns over ‘wage breakouts’ threatening inflation and competitiveness. The evidence indicates our record terms of trade boom did not lead to a wage breakout – at best, wages are now only just matching productivity and there is some evidence wages have now become disconnected from productivity growth.

Figure 9 maps the relationship between labour income and productivity since the 1960s and shows several distinct phases. In the 1970s, real wages growth in Australia exceeded productivity growth leading to the 1980s Prices and Incomes Accord. As part of this Accord, unions agreed to restrain their claims for wage increases in return for changes to public policy that aimed to increase workers’ standard of living through other means, including Medicare and superannuation. In the 1990s, rapid productivity growth was evenly shared between labour and capital. But since 2000, there has been a significant ‘decoupling’ where wages have failed to keep pace with productivity improvements.

Figure 10 shows that labour’s share of national income has been steadily declining since the 1980s. This is consistent with the experience of most other advanced economies¹¹, although more recent data may suggest a recovery. Such a decoupling would not necessarily imply declining living standards for workers – average real wages grew solidly in Australia up until 2012 – but it would imply rising inequality, with middle Australia missing out on a growing share of income growth, and it would pose risks to future productivity improvements and overall growth.

Workers now benefiting less from increased productivity

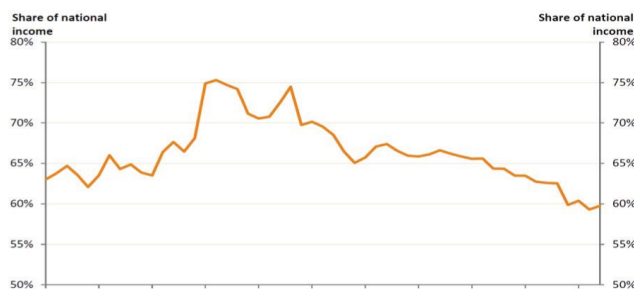
Figure 9: Labour income and productivity in Australia¹²



Source: ACTU calculations based on ABS 5204, ABS 6291.0.55.001, and Butlin (1977) A Preliminary Annual Database 190001 to 1973-74 RBA Research Discussion Paper 7701

Falling labour share of income has accelerated since mid-2000

Figure 10: Labour share of national income¹³



Source: ACTU calculations based on ABS 5204, ABS 6291.0.55.001, and Butlin (1977) A Preliminary Annual Database 190001 to 1973-74 RBA Research Discussion Paper 7701

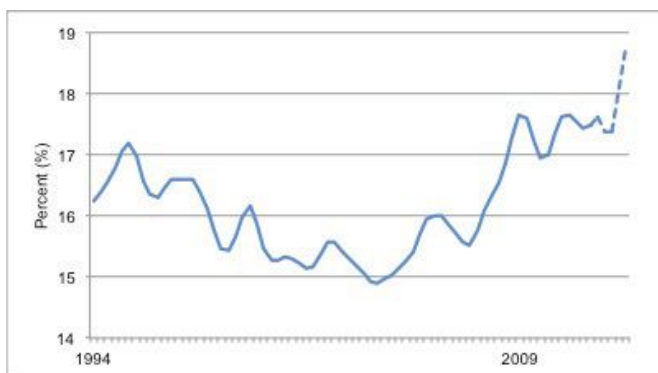
Alongside the emerging disconnect between labour income and productivity, we identify other worrying trends.

The gender pay gap is also widening

Around the world, increased female participation in the workforce, a higher share of women working full-time and higher relative wages for women have acted to put a brake on rising inequality. Of concern for Australia is that since mid-2000, the gender pay gap has increased significantly (see Figure 11). Several factors contributing to this gap include: female dominated industries and jobs tending to attract lower wages, relatively fewer women in senior positions, workforce absences due to caring responsibilities and discrimination¹⁴. Other factors include: low wages and job security in the government-funded services sector affecting social and community work mainly performed by women¹⁵ and the tendency for more women to be employed in part-time and casual positions and to rely on a safety net which has diminished over time¹⁶.

Women are particularly missing out

Figure 11: Gender Pay Gap¹⁷



Source: ABS Average Weekly Earnings Cat. No. 6302 (Full-time ordinary adult earnings). Data frequency changed from quarterly to bi-annual in 2012

Some Australians are still being left behind

Despite decades of strong economic growth, an estimated 4–6 percent of Australian society continues to experience chronic poverty and deprivation¹⁸. The Committee for Economic Development of Australia notes that the people who find it hardest to escape from disadvantage appear to fall into six main categories: older people, less educated people, households with no employed members, particular geographic areas, Indigenous Australians and those with chronic health problems.

Moreover, the conclusion that everyone is better off now than two decades ago masks the complexities of analysing income trends. The rising tide of prosperity has not lifted incomes for all households: averages for income groups mask changes within those groups, while excluding the effect of households whose own income decline moves them into a lower category. Policy also matters: indexing allowances for the unemployed and the sick to prices rather than community-wide incomes has led to households reliant on these payments slipping down the income ladder for the last two decades.

Growing Together: Labor's agenda for tackling inequality offers a more extended discussion of these factors.





The Liberals want Australians to embark upon a radical, expensive experiment in trickle-down economics. We know how this story ends. Reagan tried it. Thatcher tried it. A generation later we got Trump and we got Brexit.²²

Bill Shorten MP

Wealth is far more unequally distributed than income

Wealth is an important source of economic security. Wealth enables a household to tide over bad times when the normal flow of income is reduced. Wealth also enables households to invest for the future. In Australia, wealth is far more unequally distributed than income and wealth concentration has been rising over time. In 2003–04, the net worth of the wealthiest 20 percent was 57 times as high as the least wealthy 20 percent. By 2013–14, the wealthiest [20 per cent of] Australian households had 71 times the net worth of the least wealthy [20 per cent]¹⁹.

Comparing wealth distributions across countries is difficult due to different methods in valuing wealth. The 2014 Credit Suisse Global Wealth report places Australia in the ‘medium inequality’ group countries with the top 10 percent holding over 50 percent of the nation’s wealth²⁰. Very high inequality countries (top 10 percent holds over 70 percent total wealth) include Switzerland and the United States. The relatively less unequal distribution of wealth in Australia reflects high levels of home ownership, particularly among those of Age Pension age. This is because people accumulate wealth over their life course. As a result, older people have much higher average wealth, but generally have lower incomes, than younger people.

A key challenge for Australia is that households unable to access the housing market miss out on an important store of wealth and economic security. For example, single-parent households have only half the rate of home ownership as two-parent families (37 percent compared to 75 percent)²¹. Further falls in home ownership could see this wealth inequality become more pronounced.

Of even deeper long-term concern is the link between growing wealth concentration and rising political instability, now clearly displayed in the developed world.

...WHILE NEW ECONOMIC TRENDS ALSO CHALLENGE OUR EQUALITY

A new level of inequality is emerging in Australia and this is a serious threat to our future economic growth. Michael Cooney

A strong, inclusive economy is the platform for a socially mobile and successful society. For Australia to thrive as a nation, rising prosperity must be within reach of all of our citizens.

Australia's economy is renowned for its resilience. We have achieved 25 years of continuous economic growth and weathered several economic crises, including the Asian financial crisis in the late 1990s, the tech bubble of the early 2000s, and the global financial crisis. Throughout this time, the living standards of Australians rose on average across the board. Sound policy settings and institutions underpinned rising incomes from a once in a lifetime mining boom.

A majority of Australians did relatively well in sharing in our nation's prosperity. However, our past performance is no guarantee of shared prosperity going forward, especially when the fundamental mechanisms that drove inclusive growth in the past are under renewed political attack. In addition, while we have charted a good course, we now face strong winds of change.

Key trends that will define our future include:

- **Economic transformation of Asia** – As Asia continues to grow and change global supply chains, the rise of the middle-class presents many opportunities for a country like Australia.
- **Technological progress and digital disruption** – Rapid computerisation is replacing routine, semi-skilled and even highly-skilled tasks and shifting patterns of work. The digital age has immense potential to improve working lives for the better, but managing the disruption in an inclusive way is the key.
- **Diversification of the Australian economy** – As Australia transitions from the mining boom, we will continue diversifying into more services and advanced manufacturing. New industries such as clean energy will also emerge in line with changing global trends.
- **Ageing population** – In the next decade or two, we will face the unprecedented situation of two generations of retirees living at the same time. Finding new and inclusive sources of growth is critical to generating continuous improvements in living standards.

Against this backdrop, inequality is rising. Our decades-long growth has not lifted incomes and wealth in the same way across all households. Those at the top of the distribution have experienced stronger gains, at the expense of middle Australia. This has implications for our ability to sustain aggregate demand and economic growth going forward.

Rising inequality is not a necessary evil that is the inevitable result of economic growth; in fact it is now recognised as a threat to sustainable economic growth. We can work to ensure the winds of change pull us in the same direction, rather than apart. There are steps that can be taken by policy makers to drive inclusive growth, but business as usual will not deliver this.

We need a new policy approach to economic growth – one that has both efficiency and equity at its core. In the new era of technological change and the globalisation of the business cycle fiscal policy remains a potent tool for the government to achieve its redistributive goals. Fiscal policy should not be used simply to increase the expenditure side of the budget nor does it hold a surplus as the single test of fiscal rectitude. Inclusive growth can be entirely consistent with budget repair especially if it focuses on restoring fairness in tax and expenditure systems. As Australia's past two decades have shown, an economy that is more inclusive is more resilient.

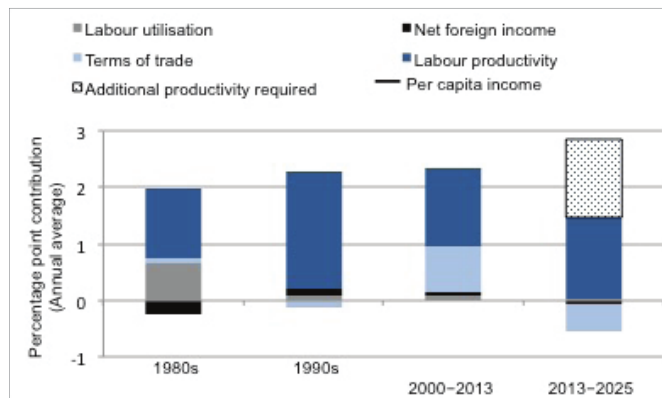
We must build on our past strong performance in a way that ensures all Australians believe they will have a share and a say in our future economic prosperity. Wayne Swan MP

Australia's impressive run of economic growth has translated to improved living standards for many Australians, but this cannot be taken for granted in the decades ahead. Inequality is rising and this poses a threat to growth.



As shown in the Treasury representation below (Figure 12), Australia's national income grew in the 1980s as a result of increased labour utilisation (participation of women) and improved productivity. In the 1990s, productivity contributed most to income growth. Reforms including internationalising the economy, expanding school and university achievement, increased competition in utilities and productivity-based enterprise bargaining led to increased productivity. The adoption of new information and communications technologies also helped workers to undertake existing tasks more efficiently. In the 2000s, declining productivity growth was offset by the terms of trade boost, but in the years ahead, the effects of the terms of trade can be expected to reverse.

Figure 12: Contribution to national income growth



Source: Treasury (2014) Budget Paper 1. Lighter shading represents additional labour productivity growth to achieve long run average growth in real national income per capita

Increasing productivity is key to improving living standards but cannot be a cover for cuts to jobs and wages. Productivity and competition should always be seen as means to an end, and subject to important caveats including economic equality and financial stability, not as policy goals in isolation. The deep drivers of productivity need to be fostered; drivers like skills, technology and innovation in process and products. Productivity growth based on weakened worker rights and diminished wages is a false gain that fails to improve ordinary people's living standards. The link which was forged between wages and productivity ended the era of the 'wage breakout' – restoring that link is important to restoring incentives for productivity growth, reviving living standards in middle

Australia and achieving community consensus for inclusive reform.

In coming decades, Australia must adapt to the 'third wave industrial revolution'. That is, disruptive technological change that is allowing machines to replace even complex and highly skilled forms of human work. This changed environment offers a host of new opportunities. Technological change brings the possibility of new products and services and opportunity for workers to enter new, potentially higher-paid and more rewarding forms of work. At the same time, without adequate policy responses, these changes could put immense pressure on middle Australia.

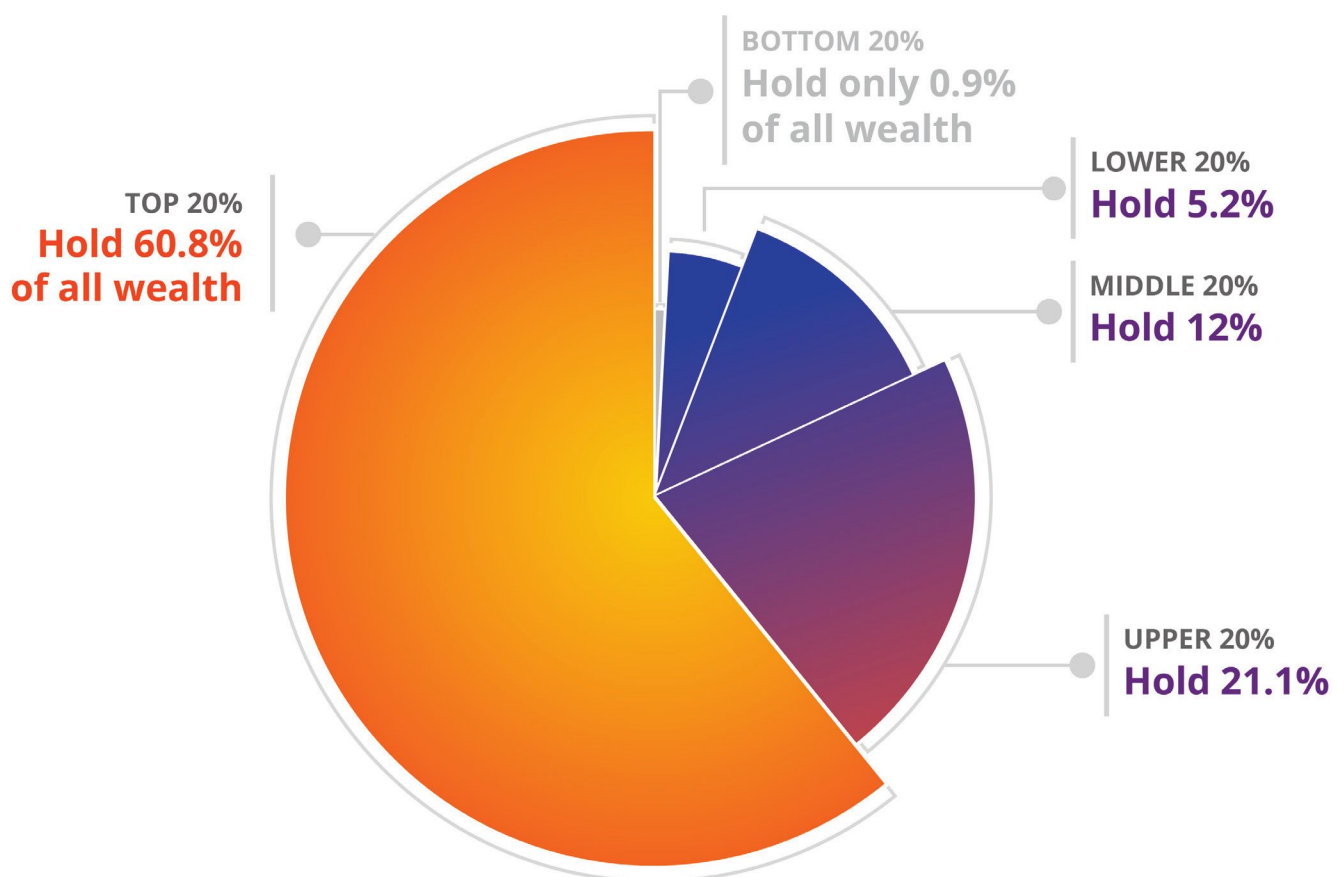
A great divide is emerging between skilled and unskilled labour, capital owners and workers. New jobs are being generated that privilege people with the right skills, qualifications and experience. Already Australia has seen the number of long-term unemployed (out of work for more than 12 months) climb to 190,000, the highest level for 16 years²³. One in every four Australians now looking for a job is long-term unemployed.

Spatial inequalities are also arising in Australia's major cities – and their future growth could make these worse. Equity and growth depend on the availability of jobs and housing. The outskirts of major metropolitan areas often have higher levels of unemployment, lower levels of education, poorer health outcomes and more limited access to infrastructure. Demographic change creates great social goods and complex opportunities for a new kind of society in which many Australians live much longer.

Amongst these challenges there is reason for optimism if we make good policy choices.

Amid advanced economies, Australia is almost uniquely well-placed to take advantage of the continued rise of China, India and the rest of Asia. Australia has a legacy of delivering successful structural reform and responding to global shocks. Our established social preferences for good wages, quality housing, excellent education, universal health care and secure retirement are also now the underpinnings for wealth creation and economic growth.

The middle **60%** of households now hold just **38%** of all Australian wealth



THE CONSERVATIVE CONSENSUS IGNORING INEQUALITY IS CREATING A POLITICAL “FORK IN THE ROAD”.

Australians don't want the levels of income inequality, corporate tax avoidance, high cost healthcare, dysfunctional education systems, and social problems that have become prevalent in America. Dave Oliver

The emerging economic threats to our equality are gradual trends – the ‘danger zones’ we seek to avoid – and can be steadily addressed. There are steps that can be taken by policy makers to drive equitable growth, to build on our history as an open, prosperous economy, and deliver improved living standards for all.

The future will be bright – but only if we grow wages, jobs and productivity together; have sensible progressive tax policies which don't squeeze the middle or distort housing and which do adequately fund the social democratic state; and pursue a range of modernising measures which support competition and innovation.

There is nothing commendable about seeking faster growth by leaving some Australians behind and squeezing living standards for the many. Policy changes that raise inequality are not necessary or tough, they damage our future prospects. Inequality is not a necessary evil or the price of progress, but if left unaddressed, it undermines our social strength, destabilises our economy and threatens future growth. An increasingly unequal structure of income and wealth also damages social mobility: to adapt Tawney's expression, “opportunities to rise” rely on a “general diffusion of the means of civilization”. What Australia needs is a deeper conversation and policy prescriptions about the future sources of growth and policies that support the inclusion of all Australians in that growth.

In the face of this, the conservative policy consensus that denies all this is a political threat to equality. The conservative plan for Australia would take us a long way down the wrong path.

This approach attacks our tax base – precisely the revenue needed to limit the worst of inequality. A volatile mix of interests is at play here. Global firms avoiding tax and domestic firms wanting to minimise tax in response, conservative advocates wrong-headedly chasing ‘competitiveness’ (and instead risking a revenue race to the bottom) and conservative politicians wanting to reward upper-income voters and (in some extreme cases) wanting to ‘starve the beast’ of the state combine to put the long term public revenue at risk. Proponents of increases in the goods and services tax miss the point that such a change would increase inequality.


It is perhaps no coincidence that the conservative consensus which sees economic equality as a threat to future growth also sees the organized voice of working people as a threat.

So the conservative consensus not only weakens our labour market institutions and undermines wages and incomes – attacking one of the great strengths of our system, that it generates rising living standards for the great mass of the people through the real economy and strong wages, not only through tax and transfer systems – but it also seeks to exclude labour unions from the public debate and political institutions. This conservative attack – not only on living standards for most people who work but on the worker voice – is similarly motivated to its attack on the integrity of the tax base. Global players are part of this conservative consensus. They want to pay the same wages they can pay overseas, they are joined by domestic, vested interests obsessed with cost-cutting, commentators who still fear 1970s-style wage breakouts, and politicians wanting to eliminate progressive civil society institutions that resist their political agenda.

And it attempts to shrink the social democratic state. Seemingly every conservative budget measure in relation to public health and education, the pension or disability care, construes these institutions of Australian egalitarianism as threats to our economy and seeks to limit them now, if not eliminate them over time. This represents a cocktail of conservative prejudices: an ideology set against modern good government, a panic over growing longevity, a misplaced confidence that, under conditions of rising inequality, affluent conservative constituencies can self-provide – and an indifference to the living standards of middle Australia.

To pursue this plan in coming years would be to lock rising inequality into the Australian political economy and lock middle Australia out of the benefits of growth for years to come.

Australia's economic future requires a very different framework from this conservative consensus – and a marked evolution from the economic approach that led Australia out of stagflation in the 1970s and into the long boom which began in the early 1990s. The times and challenges have changed and, with them, so has the necessary policy approach. In Part 2 The Future – taking the right road, we aim to articulate a better way ahead by identifying five ‘sign posts for inclusive prosperity’.



**PART 2:
THE FUTURE**

Taking the right road

SIGN POSTS FOR INCLUSIVE PROSPERITY – A VERY DIFFERENT WAY AHEAD

The pillars of egalitarianism in Australia were high wages, high home ownership and low unemployment. Peter Whiteford

Inclusive prosperity is a new way of thinking about Australia's economy. At the heart of the matter is a simple premise: economies grow faster when everyone shares in the growth. More and more evidence now shows that rising inequality is a threat to economic growth, while only broadly shared prosperity can be sustained in the long-term. Inclusive prosperity means embracing the economic opportunities of our time and finding ways to ensure they serve the vast majority of society.

This creates an opportunity for the Australian economic debate to catch up with trends in global economic thinking. The importance of lifting equality as a key to lifting growth – and the economic and political risks of wealth concentration – are central to the considerations of the IMF and OECD, as well as the World Bank and global central banks. Not only as general driver to future growth, but as a particular response to the present situation of weak global demand, policies for economic inclusion are now critically important. Our starting point for inclusive prosperity is what matters to a household. Putting people at the centre of prosperity reminds us that economic growth is a means to an end – one that delivers improved living standards for all Australians. We identify five key elements which we see as the signposts for inclusive prosperity:

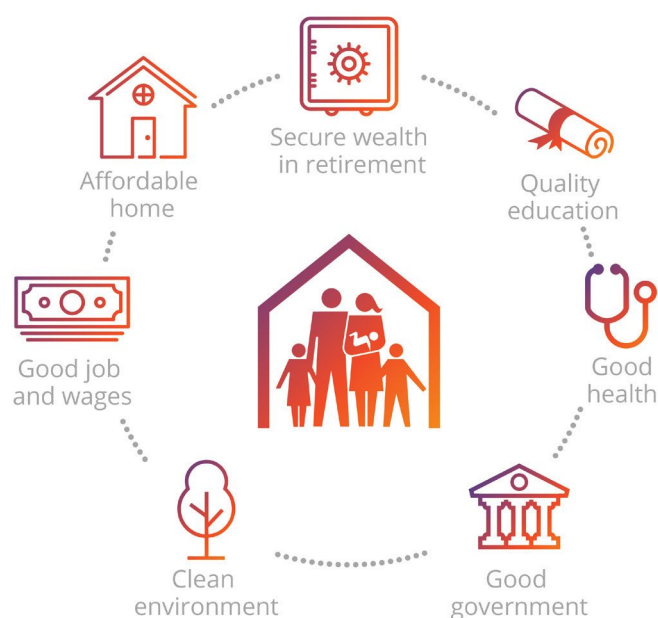
- Good jobs and wages
- An affordable home
- Security in retirement
- Quality education
- Good health

Wrapping around these household-level assets are:

- Clean environment
- Good government

In this section, we discuss the strengths of each area alongside emerging challenges. In part three we go on to outline several policy options to follow the sign posts and promote inclusive growth.

What does inclusive prosperity mean to **households**?





Good jobs and wages

Access to quality employment is an essential building block for inclusive prosperity. For a majority of households, earnings from work are the largest component of income; jobs are central to well-being and social cohesion. Quality employment involves well-paid, productive, rewarding, safe, secure work with good employment protections and a healthy degree of autonomy, dignity and ‘voice’ in the life lived at work. This should be underpinned by a strong social safety net for those looking for work or out of the workforce due to caring responsibilities, illness or disability, a point returned to in Section 3.5 (Taxes and transfer that promote fairness).

Australia’s labour market system consists of a relatively robust and sustainable minimum wage, and minimum employment standards underpinning collective bargaining. The system is working as designed to support economic growth. For example, between 2008 and 2010, Australia experienced a high point for the employment to population ratio which coincided with a moderate pick up in wage growth and exceptionally low unemployment. The unemployment rate was as low as 4 percent and the employment to population ratio hit a record high of 63 percent, confirming that Australia’s existing minimum wages system can support participation and a strong labour market²⁴.

Australia’s wages and employment policies have delivered a flexible, skilled and dynamic labour market. This record has supported aggregate demand and confirmed the importance of decent wages to achieving inclusive growth.

However in recent years the relatively fair nature of Australia’s labour market declined. Australia has just recorded its lowest wage growth in 18 years. It is clear that wage growth is lower than implied by its historical relationship with unemployment. Even the RBA in its August 2016 statement notes that wage growth has been low in every industry and across all states.

While many have benefited, vulnerable workers have been caught in a pincer movement over the last 30 years between the forces of globalization and reforms designed to provide greater labour market flexibility. The latter has included a long term reduction in the numerical and industrial strength of unions, the decentralization of wage determination and reduced reliance on awards, the rapid expansion of non-standard forms of work and reduced employment protection. This combination of changes is toxic.

Vulnerable workers have simultaneously faced a massive increase in competition from low paid workers in and from low wage, low living standards countries like China and elsewhere and, on the home front, the weakening of labour market institutions that once protected them and helped ensure a strong link between productivity and wages growth. This simultaneous attack from the outside and the inside is the main long-term explanation for the slow-down in wage growth and the accompanying increase in income inequality²⁵.

As the United States and United Kingdom pursue policies to lift what are extraordinarily low minimum wages, Australia must maintain the foundation of our jobs and wages policies to continue to support full employment in an economy where work pays. And, as the labour market continues to evolve, there is a need to update the system to ensure everyone that works, no matter how they work, is protected by a set of minimum conditions.

A widely used way of comparing minimum wages over time and across countries is the ‘minimum wage bite’. This measures the minimum wage as a proportion of the average or median wage. As a result of the 2016 Fair Work Commission’s decision the national minimum wage will be just 44.8% of average weekly ordinary time earnings. This is less than the comparable ratio in many other countries. We need to increase the minimum wage in an effort to boost this ratio and tackle inequality in the bottom part of the income spectrum. Minimum wage levels remain stubbornly low: Australia should not seek a US-style underclass of working poor.

There are concerns about low wages and inadequate demand in the economy. One certain way to boost demand is by increasing the wages of low paid workers. Unlike when the rich receive a tax cut or a big bonus, low-income earners do not have the luxury of saving additional income. For every extra dollar in the weekly budget of a poor family, a very high proportion will be spent on food, clothing and basic necessities. Moreover low income families tend to buy a relatively high proportion of basic goods and services that Australian farmers and enterprises produce.

This is why a more substantial increase in the minimum wage would have positive benefits for economic growth and employment. It is a proven way to promote consumption led growth and to rebalance our economy towards the domestic market in the current global economic environment²⁶.

Place and prosperity

In Australia, the distance between where people live and where they work is growing. In cities, more jobs are concentrated in the centre, while new housing is mostly at the edge³⁰. The daily commute is getting longer, putting pressure on social and family life and driving up living costs³¹. Women in poorly-connected areas face more difficult compromises. It is harder for women caring for children in outer areas to participate in the workforce³². Transport and housing policies will need to adjust to enable a broader range of workers to take advantage of the emerging demand created by workers in city centres.

Housing you can afford

A home you can afford in a place you want to live is at the heart of a good life. When housing becomes unaffordable and insecure, is too far from employment centres or distributed badly among social and economic groups, the wider economy is gravely distorted. So, it is no accident that Australian economic policy has strongly emphasised home ownership as a key goal.

In Australia, one of the most important household assets is the family home. The prevalence of home ownership in Australia has been broadly stable at around 70 percent since the 1960s²⁷. Now the latest HILDA report (2016) shows it dropping to 64.9% – about a 50 year low. Overall, Australia's home ownership rates are consistent with other OECD countries, with most in the 60–80 percent range²⁸. What differentiates Australia is that we have historically had relatively high home ownership rates across the income distribution. However, there is evidence that housing ownership is falling for younger ages, particular among those on low incomes²⁹. Substantial public debate about this problem has grown, with particular attention to the intergenerational equity elements at stake. The 2016 election featured important Labor proposals to address the situation and strengthen the position of owner-buyers.

This reflects a welcome recognition of a major challenge to inclusive prosperity in the decades ahead.

Security in retirement

Security in retirement is an important sign post.

The Superannuation Guarantee sets a mandatory contribution to be made by employers into a superannuation fund (currently 9.5 percent of earnings). This level will need to increase. Additional contributions may also be made voluntarily at the same concessional tax rate. The Age Pension is available as a safety net for those with inadequate personal superannuation savings. The system has worked well to create a large pool of savings for retirement in the aggregate. But there is room for reform, with the system through which superannuation earnings are taxed disproportionately benefiting high income earners and many future retirees now uncertain that their superannuation savings will be sufficient to provide adequacy.

Retirement savings are a major source of asset accumulation for Australian households. In addition to housing, households can accumulate wealth via small business ownership. Australia has a strong culture of early stage entrepreneurship³³ and performs well on ease of starting and running a business. Compared to other advanced nations, Australia rates highly on indicators such as time and cost to start a business, resolve insolvency and ease of paying taxes³⁴. Asset building is also important for household economic security and provides the primary ladder to the middle class and beyond. Asset accumulation can also create a pool of savings available for investment in productivity-enhancing activities for the benefit of the economy as a whole.

Underpinning asset accumulation is Australia's financial system³⁵. Our system is strong and has performed well since the Wallis review of the late 1990s. We avoided the extreme build up of risk that precipitated the global financial crisis elsewhere. Nonetheless, our system has room for improvement. The market power of the big four banks is highly contested and the Murray Review has highlighted other deficiencies in the system³⁵. As the financial system is a key enabler for the economy and inclusive prosperity, aspects are discussed throughout the policy sections below.

Education for the future

Education is a key factor in opportunity and social and intergenerational mobility. An unequal allocation of the resources to add to the knowledge and skills of future workers has obvious general economic costs and leads to growing inequality in the real economy. Economic inequality in turn restricts the ability of people left behind to invest in their own education and training.

Above all, unequal access to the opportunity to learn is a deep affront to human dignity.

Australia is typically ranked near the top of world-wide comparisons of education attainment (years of schooling)³⁶. However, equity and quality are areas for improvement: Australia has a significant gap between its highest and lowest performing students, far greater than in many OECD countries³⁷. Australia also has a persistently high link between low levels of achievement and educational disadvantage, particularly among students from low socioeconomic and Indigenous backgrounds³⁸.

This does not mean our system is 'good enough but not fair enough', it means it is not good enough. The waste of human potential and loss of economic production when children in school are denied opportunity is enormous, and this risks becoming pervasive in Australian schools.

In higher education attainment, Australia has performed relatively well by international standards. Australia's tertiary education outcomes have surpassed many other OECD nations. In 2000, 31 percent of 25-34 year olds in Australia had earned tertiary degrees. By 2014 the share had increased to 48 percent³⁹.

Important skills are also acquired through vocational training and apprenticeships. Australia has a well-established and expansive apprenticeship system compared to countries such as the United States. However, apprenticeships are of lesser quality compared with nations such as Germany and Switzerland⁴⁰ and completion rates are too low. Similarly vocational training programs are of variable quality and not always fit for purpose with the needs of employers or students.



Health care whenever you need it

Good health is central to household well-being and for enhancing human capital, productivity and economic growth. Where a more egalitarian health system is in place and population health is better, workforce participation will be higher over time, with general economic benefits (this was further explored in the Stephen Koukoulas in his paper for the Commission released in November 2015: <https://cdn.laborherald.com.au/wp-content/uploads/2015/11/How-reducing-income-inequality-can-enhance-productivity-and-growth.pdf>). The general evidence that health care systems which are structured around public funding and provision are not only more equal but also cost less overall is particularly striking and powerful.

There are many different ways that health systems are organised around the world to deliver this outcome.

Australia's universal public health system (Medicare) is set up to provide Australians with access to affordable, accessible and high quality health care. Access to essential medicines is also subsidised through the Pharmaceutical Benefits Scheme.

The OECD finds that Australians enjoy one of the highest levels of health across advanced nations. Australia's life expectancy at birth is 82 years, almost two years above the average life expectancy for the OECD⁴¹. Australia consistently rates among the top five OECD countries in terms of survival after being diagnosed with cancer, or after suffering a heart attack⁴². These good outcomes are achieved at a reasonable price, with Australia spending 8.9 percent of GDP on health compared to an OECD average of 9.3 percent⁴³.

Australia is performing well against our peers, and has done so over the past few decades. But past good performance does not guarantee we are well-positioned for changing health-care needs⁴⁴. Meeting the challenges posed by rising health costs into the future will require new models of care to deal with the burden of chronic disease and potentially new systems of funding. However, any increase in reliance on user pays in the Australian context risks not only undermining the efficiency of the current system but also putting further pressure on family budgets. Australians already pay more in out-of-pocket health care costs than the OECD average. On a purchasing power basis, in 2012 Australians spent on average US\$771 in out of pocket expenses compared to the OECD average of \$589⁴⁵. Further work is required to identify and implement reforms that will work in the Australian context and build on the strengths of the existing health system.

A clean environment ...

Even with the sign posts for inclusive prosperity in clear view – when households in middle Australia have jobs, homes, secure retirement income, good education and health – families and individuals do not exist in isolation. Inclusive prosperity also relies on a clean environment and healthy politics.

The environment matters to households. The prevalence of air pollution, extent of biodiversity, availability and affordability of clean water, and frequency of natural disasters all affect the living standards of Australians.

Australians on average have low levels of exposure to air pollution due to a majority of the population living away from heavy industry. Nevertheless, researchers have found that Australians living in poorer communities, with lower employment and education levels, as well as communities with a high proportion of Indigenous people, are significantly more likely to be exposed to high levels of toxic air pollution⁴⁶. On a global scale, Australia is the worst greenhouse gas emitter among OECD nations (on a per capita basis)⁴⁷, and a substantial producer of CO₂ emissions in the aggregate⁴⁸. Australia therefore has a key role to play in global efforts to address emissions.

In the coming years, climate change will increasingly put pressure on Australia's environmental resources with impacts for all Australians. The frequency and intensity of natural disasters is expected to increase due to climate change, with implications for disaster relief funding borne by all taxpayers. The transition to clean energy this requires is a key opportunity to invest in industries that will deliver skilled, well paid work for the future – while including the workers and communities most affected by climate policies in the benefits of change. Australia is middle of the pack for biodiversity protection, falling outside the top-third of all countries for designated land or marine protected areas⁴⁹. On water use, Australia is the world's driest continent and has built successful water management strategies amid drought and flood. All this points to the importance of Australia's solid framework for environmental regulation and greater efforts required to address climate change.

... and good government.

Governments create the space for economic growth and write the rules that enhance (or detract from) the ability of households to prosper. There is no single method for successful stewardship of the economy, but economists have identified three key principles:

- Integration with the global economy through trade and investment.
- Sustainable government finances and sound monetary policy.
- An institutional environment of market-orientated incentives where property rights are established and contracts enforced⁵⁰.

Australia performs relatively well across these parameters. As an open economy with a flexible exchange rate, Australia is well integrated into the global economy and monetary policy is sound with inflation firmly in check. Government debt is low by international standards and a balanced budget is the strategy for the medium-term. This ought to permit an effective use of fiscal policy to support the levels of growth which are the underpinning of strong public finances in the long term. Fiscal policy which supports stable demand and long term investment is essential.

There is certainly work to be done here, but overall we are starting from a good position with space for greater public investment in productivity-enhancing assets such as transport and urban infrastructure. A strong public sector to deliver essential services must not be compromised.

Good government also means limits on corruption and rent-seeking, along with sound competition policy. The World Economic Forum finds Australia around the middle amongst advanced economies on measures to combat corruption and diversion of public funds⁵¹. However, Australia performs poorly on regulatory protection of incumbents, the extent of market dominance and, to a lesser extent, concentration of banking assets⁵².



This is a key point to consider. A competitive market economy cannot long be maintained if tendencies to rent-seeking and oligopoly behaviours are not actively resisted by public policy. Not only must corporate regulation be strong and sound, but a balance of economic resources must be maintained through effective labour market institutions and adequate tax and transfer systems.

Finally, good government also means maintenance of social cohesion, trust in the political process and tolerance of diversity. Researchers have found Australia is a highly cohesive society with a consistent pattern of positive identification with Australia, agreement that there is opportunity and reward for hard work, and satisfaction with financial circumstances⁵³. Nonetheless, over the past decade, there has been a decline in social cohesion, particularly around acceptance of diversity and concerns about the workings of Australia's democracy⁵⁴. An agenda for shared prosperity is key to rebuilding trust in our institutions and government.

Overall, Australia has strong foundations in many of the areas that matter for inclusive prosperity. Former Treasury Secretary Ken Henry has referred to a similar set of attributes as national endowments, and the source of our competitive advantage in the Asian century⁵⁵.

Yet, there is always room for improvement. Moreover, as we move to new sources of growth, the challenge is to ensure the gains are broadly shared (and losses minimised for those that have the least ability to adapt). In the next section, we consider policy choices to strengthen our foundations and leverage our changing economy for shared prosperity in the decades ahead.



**PART 3:
BEYOND THE FORK
IN THE ROAD**

A progressive plan



A PRACTICAL APPROACH TO REACH OUR GOALS – POLICY STRENGTHENERS

The idea of an egalitarian society and the right to ‘a fair go’ is one that Australians still hold dear ... Australians across divisions of class, gender and generation still believe that Australia is and should fight to remain an egalitarian society. **Rebecca Huntley**

Just as Australia’s economy, households and businesses must adapt and innovate to embrace the opportunities of the 21st century, so must policy. The Commission has identified five key policy areas that need to be developed to deliver inclusive prosperity. The list is by no means exhaustive, but these are major areas that will lead to more Australians driving, and sharing in, economic growth.

In developing a balanced economic framework to guide the policy choices, the Commission has structured policies in two broad groups:

A high-pressure economy with strong aggregate demand

A high-pressure economy⁵⁶ is one in which economic growth is stronger than average and unemployment is low. Sustainable growth in aggregate demand is the virtuous cycle that links job creation, rising living standards and rising economic growth in advanced economies. When firms know they will enjoy predictable, rising demand for products in the future, they invest in their future profits⁵⁷.

Policy areas that fit here are:

- full employment in an economy where work pays, and
- a tax-transfer system that promotes equality.

A progressive supply side agenda.

On the supply-side, Australia must increase the productive capacity of its management and workforce, make much-needed investments in public goods and infrastructure, and put in place the conditions for innovation that are the best way of increasing trend growth⁵⁸. Policy areas that fit here are:

- support for innovation, robust competition and anti-monopoly policies
- long-term investment in infrastructure and climate sustainability, and
- better education and health for all.

The policy agenda is about both growing the economy and driving greater inclusion. As shown in Figure X, the two elements are mutually reinforcing. This stands in contrast to policies solely focussed on economic growth and relying on the ‘trickle down’ effect to raise living standards for all. Our agenda is both pro-business and pro-labour. Successful businesses are necessary for economic success, but they are far from sufficient. Similarly, a skilled and healthy workforce needs growing job opportunities. Both must work hand in hand to create inclusive prosperity.

The tip of the **iceberg**

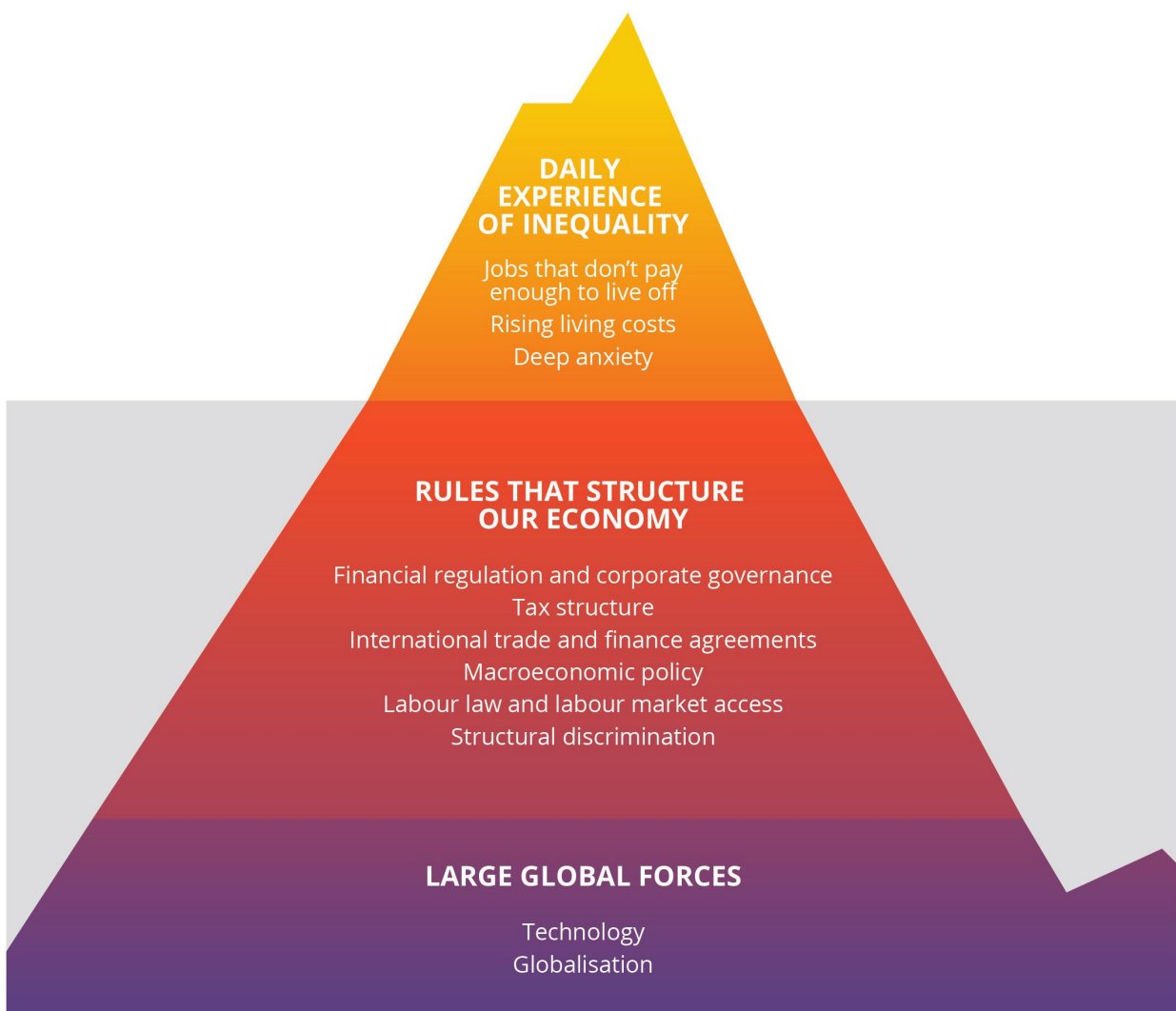


Figure X

Source: <http://rooseveltinstitute.org/wp-content/uploads/2015/10/RTW-Social-Share-Iceberg.jpg>

A HIGH PRESSURE ECONOMY WITH STRONG AGGREGATE DEMAND

Government has a central role to play in promoting inclusive workplaces. Strong labour market institutions are a critical and positive part of the wealth creation story. Wayne Swan

Full employment in an economy where work pays – the future of work

The Australian economy is in transition and so is the labour market. Following the peak of the commodities boom in 2011, unemployment has risen to 5.8 percent and wages growth has slowed to a record low⁵⁹. Longer-term, structural changes include: increased workforce participation of women and older people, growing employment in services, more jobs requiring higher skills, decline of union membership, technological disruption, and greater diversity in forms of work. In addressing these changes, the Commission sees a need to focus squarely on inclusion by: maintaining fair take home pay for low wage workers, improving family-friendly labour market policies, continuing to support collective bargaining, and generating better evidence based programs to support people to find work.

Maintaining take-home pay for low wage workers

The minimum wage is a foundation of Australia's workplace policy and has played an important role in supporting demand and achieving lower levels of inequality. It has also been a driver of a higher workforce participation rates. Australia has historically had a relatively high minimum wage by international standards. On an hourly purchasing power parity basis, Australia had the third highest minimum wage among OECD nations in 2014⁶⁰. However, over the last decade, minimum wages have not kept pace with overall wages growth in Australia.

Maintaining the minimum wage relative to other incomes, penalty rates and minimum employment standards is critical to upholding the social contract between employers and employees in Australia. It is also an essential factor in supporting aggregate demand across the economy.

Beyond maintaining the minimum wage and employment standards, there is a need to consider other avenues to ensure low and middle incomes keep pace with cost of living pressures. We cannot afford to only provide a floor below which no working Australian can fall. Wages and living standards throughout middle Australia must grow over time for the economy to be strong.

For this reason, there is a strong economic case for strengthening the bargaining power of workers, not only to protect their own living standards but to strengthen what are key drivers of future growth – rising real incomes and rising demand.

The income tax regime provides another policy avenue to support incomes while boosting participation. Over the medium to longer term, more progressive tax policies for low and middle-income earners should remain a priority for tax reform, including addressing high effective marginal tax rates due to interactions between the tax and social security systems.

AN EMPLOYMENT REGULATION SYSTEM THAT PROVIDES DECENT WAGES AND WORKING CONDITIONS FOR ALL

Every day unions are looking for ways to represent Australian workers and it has become very clear that as workplaces modernise, so must unions. Dave Oliver

As the composition of Australia’s economy continues to change, there is a need to adapt our industrial relations regime to ensure all Australians reap the benefits of work.

The traditional model of work is continuing to change with new modes of work, less worksite-based employment or enterprise-based employment. The employment relationship is increasingly diffuse. This has benefits for many as well as down sides – but has unfairly shifted the risks of employment and financial security to workers. To ensure these types of employment are sustainable and that the benefits are broadly shared, protections must modernise just as rapidly as the work contract itself. In this environment, it is necessary to consider how employment standards are modernised.

Currently in Australia, the labour law that applies to a worker depends on the way a worker is engaged. This results in some workers getting different rights and protections, even when doing similar work and in similar work environments. As a result, our federal “industrial relations laws” fall far short of the mark of providing rights and protections to working people in the variety of different working arrangements that are now commonplace.

In Australia, around 40 percent of workers are in alternative forms of work (independent contractors, business owners and casuals)⁶². These workers are either not covered by employment protections in the Fair Work Act (independent contractors or business owners), or have weaker rights (casuals). For instance, casual workers are not generally provided sick leave, holiday pay or paid-parental leave, even in circumstances where those workers may have been in ‘casual’ positions for many years. The disadvantages of this are disproportionately felt by women, who are over-represented in these forms of work; this reinforces existing gender inequalities in the economy.

In addition, different forms of engagement can provide artificial mechanisms to alienate income from work, reducing tax for groups of individuals and firms, with impact on tax revenue over time.

There are two reasons to think about future employment protections now. Firstly, the continued growth in services and technology is likely to drive increases in alternative forms of work. Secondly, there is evidence that those at the higher end of the income distribution can move seamlessly between standard and non-standard work whereas those at the lower end may not⁶³. Hence, there are important distributional issues to consider in the way the labour market is regulated going forward.

The Commission supports more consistent rights and enforcement across all forms of work as labour markets change. The adoption of such a principled approach should aim to build on and adapt existing standards in the Australian workplace that are currently applied inconsistently or actively avoided in some cases.

How this could benefit workers – An Example: Securing Super

It is becoming increasingly clear that, despite a sound framework built on minimum wages and employment standards through awards, there are parts of the economy where work is being designed in such a way as to intentionally avoid even the basic employment safety net. For example, there is growing evidence of a rising number of eligible workers not being paid their superannuation entitlements. Analysis by Tria Investment Partners found that around 650,000 Australians did not receive a total of \$2.5 billion of superannuation entitlements in 2012⁶⁴. The Australian National Audit Office found that “The ATO’s own internal risk assessment indicates that as many as 11 to 20 percent of employers could be non-compliant with their SG [Superannuation Guarantee] obligations”⁶⁵. This has implications not only for workers but also the effectiveness of Australia’s superannuation system. Modernised regulation of work, not just employment, would go some way to better educating the public and employers about entitlements.



The Commission recognises that major design questions need to be considered, but is encouraged by the fact that some existing modes of addressing the question of fair standards, including throughout supply chains, have proven successful in particular sectors. For example, the combined State and Federal regulatory regime for the protection of outworkers in the textile clothing and footwear industry, multiple models of minimum contract determination and aspects of the modern approach to health and safety regulation all bear consideration in this context, as do efforts to ensure greater portability and accessibility of accrued entitlements across different jobs and through different stages in workers' lives.

The great payoff is more easily understood standards, accepted as the foundation of work in Australia and an end to the silent erosion of important rights and protections that have supported safe, valuable work in Australian workplaces.

How this could work – An Example: The 'gig' or 'sharing' economy

The 'gig' or 'sharing' economy has significant potential to boost economic growth while providing benefits to consumers and flexibility to workers who seek it. As noted by economist Michael Spence, the process of sharing under-utilised resources is both unstoppable and accelerating. The long-term benefits consist not just in efficiency and productivity gains, but also in much-needed new jobs requiring a broad range of skills⁶⁶. The McKinsey Global Institute estimates the largest benefit (in terms of global GDP) from labour sharing platforms is work for currently inactive people and increased hours for current part-time workers⁶⁷.

An inclusive prosperity framework requires that Australia support innovation and the potential of the shared economy while also ensuring we continue to lift living standards for all. As the Center for American Progress has recognised, "These ventures will be future engines of growth for advanced economies, so it is important to ensure that the winners succeed on the strength of their innovative products and not at the expense of their workers⁶⁸." A new approach to labour relations of the type we advocate for is one way to achieve both flexibility and fairness.

Family and age friendly labour market policies

Boosting participation in the workforce remains critical to supporting growth and inclusive prosperity. Women, sole parents, people with disability and older workers continue to have lower rates of participation in Australia compared with similar industrialised economies. Central to an inclusive growth agenda and addressing widening inequality is increasing participation amongst these groups.

Equal pay remains a critical step in boosting women's participation. The UK is tackling the gender pay gap by requiring large companies (over 250 employees) to publish what they pay as an important transparency measure. Ensuring access to affordable, quality childcare is also important. In addition, government policy can support changes in workplace culture and flexibility. This includes avoiding any dilution of the paid parental leave scheme, and instead adopting a policy of expanding the scheme over time and improving the rights of employees with caring responsibilities to family-friendly work arrangements.

Beyond these measures, there is an ongoing need for cultural change to support flexible working hours not just for women but also sole parents, the disabled and those older workers who can and wish to remain in the workforce. Leadership is needed from workplaces and corporates to build an environment supportive of flexible work for all.

Expanding the opportunity for collective bargaining

Research by the Australian Government has found that collective bargaining is an important part of the Australian employment framework⁷⁶. However, more could be done to expand the availability of collective bargaining across sectors, particularly as the structure of the economy changes. For instance, the Fair Work Act emphasises enterprise-level collective bargaining; this may be inadequate as work arrangements change⁷⁰.

Expanding the opportunity for collective bargaining is an important measure to respond to the economic and political drivers of inequality. The falling share of national income going to people who work and falling return to working people from productivity increases are economic problems for Australia. Those problems arise not only from the necessary dynamics of wealth creation in the real economy, or even from changing patterns of work driven by specific contemporary economic change, but from consequential changes in the balance of power between employers and employees – and from policies designed to weaken employees' bargaining power. The balance has clearly shifted away from employees and this has had a clear negative impact on wages growth. A new policy goal based on the contemporary economic reality to strengthen workers' bargaining power, ensuring productivity-based wages growth and limiting inequality, should be adopted.

Securing and strengthening the longstanding role of collective bargaining in Australia will remain an important means to achieve the goals of maintaining minimum wages and employment standards, adoption of family-friendly workplace practices, promoting participation and supporting worker representation – all critical to achieving inclusive growth. Collective bargaining as an instrument, including at the enterprise level, is a key mechanism for egalitarian distribution of the economic resources. Well-balanced bargaining over wages and conditions based on productivity and an appreciation of worker as well as company interests is the key.

When the system works, firms and workers co-operate to lift productivity and to share the benefits. This is good for the living standards of millions of people who benefit from productivity-based increases in take home pay and secures long-term growth for firms and the economy as a whole. It also locks in the incentives for future productivity growth. And the resulting balance of economic power reinforces these positive trends for the future.

The conservative political consensus demands a political attack on trade unions which is entirely antithetical to this. Falling union density makes the problem worse.

The virtuous circle we seek of shared productive endeavour and shared returns requires not only a balanced legislative framework, but healthy labour market institutions operating within that legal system. This is in the first instance a challenge to those institutions and their leadership. However, public policy which seeks the general good will see the national interest in healthy trade unions as part of a balanced labour market and inclusive economy. This will require a major shift from much present thinking.

Addressing youth unemployment, long-term unemployment and under-employment

There are significant social and economic costs of unemployment. An inclusive growth agenda requires measures that boost participation, including for young people not in education, employment or training, the long-term unemployed and underemployed Australians. Central to Australia's policy response to the challenge of unemployment have been the provision of training and financial support predominantly through Jobs Services Australia, now jobactive. Given the large expenditure involved of around \$1.5 billion administered costs per annum⁷¹, there is an ongoing need to consider the evidence base for these programs and ensure the approach is improving employment outcomes.

A review of the jobactive program would be timely and could consider new ways to support transitions into work and more effective approaches to training and employment. Analysis of the experience of under-employment and even over-employment would also be of value as other nations, such as Sweden which is piloting a six hour working day, consider innovative ways to share the benefits of work more evenly across households.

Underemployment has been increasing and is a significant problem. A large proportion of those exiting unemployment have not been able to find full time jobs. They are stuck in involuntary part-time work and various casual and precarious work arrangements. This means we now have a high proportion of marginalized workers with weak bargaining positions. This should be addressed by raising labour demand and strengthening labour market institutions.

One wonders what the picture of the labour market will be in the years ahead if underemployment and casualisation is not addressed. We risk a scenario where it becomes normalised for workers to be underutilized in precarious work arrangements with low wages and leading to rising income inequality.

The exploitation of temporary foreign labour only makes this problem worse and stands as a major area requiring policy change.

Rising income inequality will have profound social and political implications. If income inequality continues to grow, and the link between wages and productivity is not restored, we will see the increasing Americanisation of Australian society. American workers have not had an increase in their national minimum wage for seven years. The United States has the weakest labour laws and the most rapid increase in income inequality in the OECD. Few Australians would seek the economic, social or political outcomes which this has delivered for the United States. Australia should not go down the American road.

SUPPORT FOR INNOVATION, CITIES AND REGIONAL CLUSTERS - THE FUTURE OF JOBS

Equity and growth depend on the availability of jobs and housing. The outskirts of the major metro areas are where you see high levels of unemployment, lower levels of education and insecure incomes. Addressing spatial inequalities emerging in the growth corridors is key to building more inclusive cities. Tony Nicholson

Support for innovation, cities and regional clusters – the future of jobs

Alongside ensuring that workers are well-skilled and able to participate in the labour market, Australia must continue to push the technological frontier. The pace of innovation or technological progress is often reflected in multi-factor productivity which measures the efficiency with which labour and capital are transformed into output. Improvements in the ways of doing things (technical progress) drive multi-factor productivity. Australia, like other OECD nations, has experienced a slowdown in this area over the past decade⁷².

There are strong reasons, therefore, for a policy agenda that seeks to support inclusive innovation and technological progress. The Commission emphasises core elements of innovation policy – focusing on areas to drive greater inclusion in a changing economy. In summary, the Commission sees a role for government to invest in research and development (R&D) and entrepreneurs, support innovation clusters and promote competition. Equally important is investment in human capital, as discussed in Section 3.4 (Education and health for all).

Invest in research and development

R&D is an obvious key to long-term productivity—one in which the public and private sectors both play crucial, complementary roles. Public support for basic research is the only way to ensure certain kinds of foundational research can happen. Nonetheless, the vast majority of applied research and innovation comes from the private sector, where good public policy means a system that rewards private R&D when it is oriented towards widespread adoption⁷³.

In 2014, Australia’s public investment in R&D was at a 30 year low as a portion of total budget expenditure⁷⁴. As a share of GDP, Australia is consistently below the OECD average for R&D spending⁷⁵. We need to do better here. Investment in basic science is the cornerstone of innovation. Moreover, public investment in R&D tends to crowd-in more private investment⁷⁶. More investment in science includes stable funding for our pioneering CSIRO and also Centres of Excellence and Cooperative Research Centres which have been shown to generate high levels of innovation activity in the form of patents and trademarking (see below).

To incentivise private investment, Australia has long had a system of R&D tax concessions. In 2011, a re-worked R&D Tax Incentive was introduced to better cater to small and medium sized innovative enterprises. It has two core components: a refundable tax offset for entities with aggregated turnover less than \$20 million; and a non-refundable tax offset for others⁷⁷. As with any tax scheme, the net benefits of the program should be regularly and rigorously investigated to ensure appropriate targeting and value for money, and with a view to consistency of policy over time.

Beyond the creation of knowledge, Australia needs to do more to spread innovation throughout the economy. New OECD research shows that the main source of the global productivity slowdown is not so much a slowing of innovation by the most globally-advanced firms, but rather a slowing of the pace at which innovations spread out throughout the economy⁷⁸. In other words, the globally most productive firms have continued to experience strong productivity growth, but spillovers to other firms have been weak.

Countries adopt a range of measures to increase technological diffusion. Lowering barriers to entry and greater collaboration in R&D are just a few. Australia has the lowest rate of university and business collaboration in the OECD. Out of a total of 33 countries, Australia ranks 32nd on business-to-research collaboration for small to medium enterprises, and 33rd for large firms⁷⁹. While several universities are already establishing “innovation precincts”, it is reasonable to investigate how government can facilitate greater collaboration. At the same time, we should not lose sight of the key role of universities, which is to educate and generate public-good research. This core purpose was recognised in a major review of Australia’s innovation system in 2008 (Cutler review)⁸⁰. Lowering barriers to entry, or promoting greater competition, is discussed towards the end of this section.



Invest in entrepreneurs

Australian startups are crucial to building the jobs of the future. Young small and medium size enterprises make the highest contribution to net job creation in Australia (40 percent) and startups (firms aged 0–2 years) are responsible for most of this growth⁸¹. Most micro start-ups (those with fewer than nine employees), exit quickly or grow very little. But this dynamic process is important for innovation. A fraction of these startups go on to grow dramatically and continue to create jobs. These high growth startups can be found in all sectors of the economy⁸².

Key to increasing startup activity is entrepreneurial talent. Australia's pool of entrepreneurs has natural limits due to the comparatively small size of our population. The UK, Singapore, New Zealand, Ireland and others have all created specific visa policies to attract a growing pool of early-stage entrepreneurs. Building on Australia's highly successful skilled migration program, additional visa categories for early stage entrepreneurs would better position Australia to compete for the best and brightest global talent and enhance Australia's domestic startup ecosystem.

In parallel, we should build our own base of entrepreneurs. Although Australia performs well on early stage entrepreneurship overall (on par with the United States and Canada), one area where Australia lags behind is entrepreneurship among young adults (18–24 year olds)⁸³. University students could be offered well-designed, income-contingent loans through the HECS-HELP system to develop innovative startup ideas. Accelerator or incubator programs would combine with traditional learning to spur youth entrepreneurship and stronger links with industry.

Support innovation clusters

Economic geography has long recognised that producers, specialised suppliers, and workers tend to cluster together for mutual benefit. Prosperity depends on the synergy between companies, on the cluster, not the individual entrepreneur⁸⁴. In some cases, there may be a role for government to create or support the environment for entrepreneurship. Porter has argued that “government should reinforce and build on established and emerging clusters rather than attempt to create entirely new ones,” seeing a role for government in “cluster upgrading,” which focuses on “removing obstacles, relaxing constraints, and eliminating inefficiencies⁸⁵.” Moretti notes that it is really hard to engineer an innovation cluster, instead advocating for the use of R&D and education policy to lay the groundwork for successful clusters⁸⁶.

Figure Y shows that in Australia, business R&D expenditure is concentrated around the major cities of Australia – Sydney, Melbourne, then Brisbane and Perth. More intensive levels of innovative entrepreneurship (as measured by expenditure on R&D, intellectual property applications and business entries) occur in our major cities, even after taking population size into account⁸⁷.

High levels of innovation activity and business creation is also observed in areas of New South Wales and Queensland, where large numbers of businesses were generated in the professional, scientific and technical services industry. The presence of publicly funded research organisations in a region (often universities), particularly those hosting Centres of Excellence and Cooperative Research Centres, have produced levels of patenting and trademarking three and a half times higher than the national average⁸⁸.

Figure Y: Geographic spread of innovation in Australia



Source: Department of Industry, Office of Chief Economist, Median Business R&D Expenditure 2008–2011
<http://www.industry.gov.au/Office-of-the-Chief-Economist/Pages/National-Innovation-Map.html>

Fig Y shows that innovation is occurring in regions throughout Australia. It also highlights the special potential of cities to drive shared prosperity if they can be made more inclusive. The gains from supporting innovation clusters are not confined to high-technology businesses and workers. There is evidence that the wages of less-skilled workers rise as the concentration of highly-educated workers in a city increases⁸⁹. When a city becomes a ‘brain hub’, jobs for plumbers, teachers, nurses and other local services are created at a rate of five to one over other cities, raising salaries and standards of living for all⁹⁰.

Using the example of Seattle in the United States, economists have pointed out that a combination of land-use policy and transport investment can be crucial to supporting the development of innovation clusters and more inclusive cities. Glaeser notes that Seattle’s decisions to support high-density housing and to build transport systems that make high-density living workable have combined to keep the cost of housing in Seattle within reasonable bounds⁹¹. This has made it easier for Seattle to attract high-technology businesses and to supply the support services that are needed for these businesses. Moretti also notes that infill urban development in Seattle contributed to a greater sharing of wealth between homeowners and renters⁹². This is a model that Australia should aim to learn from in the years ahead, especially if home ownership rates continue to fall and renting becomes more common.

Robust competition policy

Competition reforms are broadly aimed at promoting economic growth for the benefit of all households, including those on low incomes, through lower prices. This is particularly important in Australia where a high degree of concentration is evident in many consumer retail and enabling services markets. Robust competition should safeguard the interests of workers and consumers.

Competition is also a key driver of innovation, and should not be overlooked in this area. Separated by decades of thought, Schumpeter’s gale of creative destruction and Christensen’s theory of digital disruption both point to the competitive forces underpinning innovation. More broadly, as competition reforms take place, it is also important to consider the nature and consequences of new technology and economic change – and policy should be regularly revised in the light of changes in the real economy.

Encouraging competition and technological diffusion will require rethinking intellectual property arrangements. As noted by the Center for American Progress⁹³ patent laws reward firms with significant market advantage if they win races on innovation; this is good. However over time the rewards can and should be shared. New ways are emerging to incentivise individual discoveries that should play a larger role in lifting Australia’s prosperity.

For example, awarding cash prizes for innovations may be a more efficient process of promoting productive innovation. Prizes immediately benefit firms that successfully innovate without creating disincentives for rapid information sharing among innovative companies. The Productivity Commission should be encouraged to consider these and other innovations in the upcoming review of intellectual property arrangements.



The technology-enabled disruption occurring across the world throughout supply chains and consumer markets – remaking underlying costs of entire markets and profoundly threatening incumbents – is another key change for competition and innovation policy. The balance between regulation and competition of these markets is being tested in circumstances that have not been experienced before, while the boundary between competition regulation and regulation for purposes like safety or service standards is not always clear.

Market power is arising in new ways and circumstances as market dynamics are changed by technology. Digital disruptors move from market entrants to market leaders in the space of a few years, bringing changes that release enormous consumer benefits while also prompting market power complaints. As traditional barriers to market entry fall, so-called network effects have become increasingly important and of interest to competition regulators.

We see this in the principle that each additional user of an online service adds value to the network of users exponentially, making it ever more difficult for alternative suppliers to enter the market. The value of the network of users lends itself to the entry and potential domination of other, adjacent markets.

For the long term, a more holistic discussion about the approach to market power regulation may offer greater possibilities for reform. For instance, the European model, which strongly examines market power of firms rather than conduct of firms in the market, would be worthy of closer examination. This would offer quite a different way of considering the competition issues arising from network effects and new technology than the so-called ‘effects test’ proposed by the Harper review.

The recent intervention by the head of the Australian Competition and Consumer Commission, Rod Sims, who told the Melbourne Economic Forum in July that selling public assets has created unregulated monopolies that hurt productivity and damage the economy, is another powerful argument for significant policy updating.

Sims pointed especially to transport and power infrastructure. There are also clear grounds for concern that other important sectors of the economy are dominated by duopolies and oligopolies whose interests are not those of the economy as a whole. Regulation and policy reform is required to ensure the economic, and perhaps political, power of these market players does not distort the wider economy.

The Federal Parliamentary Labor Party’s policy for a Royal Commission into the banking and financial services sector is an important initiative in this respect. It now seems clear that simple, competitive pressure has not been sufficient to protect consumers or the economy from the risks and costs of serious unethical behaviour in major financial institutions.

Powerful economic elites have benefited from these policy failures while individuals and firms have suffered serious adverse consequences. This is a sharp instance of the interaction between the concentration of wealth and power in our society and the damage to the wider economy which can result. It demands a robust policy response.

A PROGRESSIVE SUPPLY SIDE AGENDA

Inequality is not inevitable: it is a choice we make with the rules we create to structure our economy. Joseph E Stiglitz

Long term investment returns over short-term gains and economic rents

Inclusive prosperity relies on markets that work for the long term, supporting critical investments in infrastructure and climate sustainability. There is also great potential in Australian super funds for long-term investment in infrastructure, whilst maintaining their core mandate of growing retirement incomes.

Only if we solve the problem of a lack of investment can we fix the lack of demand. This is urgent -- and timely. With the currently low cost of capital, there is no better time than now to undertake public investment which boosts short-term demand and achieves long-term growth.

An economically progressive public investment agenda in both the US and Australia could include increases in infrastructure investment, human capital investments, greater access to quality child-care -- all measures that boost both aggregate demand and supply.⁹⁴

Long term investment

Infrastructure investments provide strong and well-paid jobs and productive assets that serve as the foundation for long-term economic competitiveness, increased prosperity, and a high quality of life. Infrastructure investment has a higher multiplier than other types of government spending – the IMF estimates infrastructure investment has a multiplier of 1.5, on average, within four years⁹⁵. For a country like Australia, the multiplier may be as high as 2.6 over the medium term⁹⁶.

In a context of low borrowing costs, the IMF and outgoing RBA Governor Glenn Stevens have each noted that public debt financed projects could have large output effects without increasing the debt to GDP ratio, if done correctly. In other words, public infrastructure investment could pay for itself⁹⁷. Australia's debt to GDP ratio is low compared to other advanced nations. Gross debt (total cumulative borrowing) is estimated to be 41 percent of GDP by 2020 and net debt (cumulative borrowing less financial assets) only 22 percent.

By contrast, the average gross debt for advanced economies is expected to reach around 100 percent of GDP by 2020, with net debt of 70 percent⁹⁸. Australia has space to move in this area.

Australia has a well-demonstrated infrastructure deficit, with the economic cost of underinvestment in cities alone projected to reach \$53 billion by 2031⁹⁹. This will increasingly become a drag on growth and living standards. Governments at all levels agree that more infrastructure investment is warranted. However, they differ on funding mechanisms and priorities. We must overcome fundamental market failures in getting new infrastructure projects developed and financed. At the same time, we must ensure investments are efficient, transparent and well governed to minimise waste.

There is scope for the Commonwealth body, Infrastructure Australia, to play a more active role in the infrastructure market. This includes:

- **Independent assessment:** Ensuring all major infrastructure projects are assessed on the basis of economic and social benefits, commercial viability and contribution to national productivity.
- **Transparency:** Publishing the business case for investment and strengthening engagement with the community.
- **Brokering:** Working with the States, long term investors, the private sector, financiers and constructors to broker deals and address the market failure in bringing new infrastructure projects to the market.
- **Financing:** Catalytic financing in the form of guarantees, loans or equity to get new projects started and crowd-in private investment. Australia has an established track record in this area with the Clean Energy Finance Corporation.



A reliable sequence over time of transport and urban infrastructure projects is critical to unlocking sources of capital to increase investment for long-term prosperity. In parallel, efforts to increase the supply of affordable housing must also continue. Programs such as the National Rental Affordability Scheme contributed to the stock of affordable housing and funding certainty to support investor confidence in similar programs is required to continue to boost supply. Ongoing effort by local and state governments on zoning rules – including increasing requirements for affordable housing in major developments – is also necessary to support greater supply of affordable housing while also promoting inclusive communities.

Public investment can have great impact, but well-structured incentives for productive long-term private investment are also vital. Here, a growing global debate may offer lessons for Australian policy-makers.

The essential argument being made is that regulatory and investor pressures for short-term returns increasingly force short-term decision-making upon publicly-listed firms. These pressures are only worsened where the executive leadership have their own incentives structured around short-term returns to shareholders. This creates risks and costs at the micro-level, neglecting valuable investment for a firm's own future growth in favour of dividends and other returns. In the light of overall slow economic growth, these same risks and costs can be seen as a worrying piece of the macro-puzzle of sluggish global growth since 2009.

A variety of solutions is now being publicly discussed.

The expression “quarterly capitalism”, first coined in an influential Harvard Business Review article¹⁰⁰, has grown in prominence as a short-hand for the negative incentives created for the management of publicly listed companies when capital markets have an excessive focus on short-term earnings as a proxy for corporate performance. The US Democratic presidential nominee Hillary Clinton addressed New York University on the topic in July 2015 (<https://medium.com/hillary-for-america/moving-beyond-quarterly-capitalism-7abec53733f6#cb58rq45s>)¹⁰¹ and the Roosevelt Institute's June 2016 report *Untamed: How to Check Corporate, Financial, and Monopoly Power*¹⁰² offers a substantial discussion. The arguments that Australian political and bureaucratic leaders face pressures which encourage short-term decision-making are familiar. In our view, the private sector can benefit just as clearly from sounder incentives to act for the long term.

The structure of executive compensation, a tax regime that encourages longer term investment and the empowerment of longer term investors are all matters for serious debate.



Ensuring secure long term returns for superannuation savings

Australia has one of the world's largest saving pools with close to \$2 trillion in superannuation funds¹⁰³. Many have identified these funds as a potential source of finance for productivity-enhancing investments, including infrastructure and innovation.

It is important to maintain the primary purpose of superannuation savings as a crucial vehicle for meeting the retirement income needs of the Australian population. This demands the greatest possible variety of high quality vehicles in which superannuation funds can invest. This is why superannuation funds themselves are increasingly looking for innovative opportunities to invest, where they continue to meet their appropriate requirements to maximise and manage the retirement savings of their members.

Opportunities exist to improve the structure and financing opportunities of major infrastructure projects and procurement to better meet the investment needs of superannuation funds. Infrastructure investment with its long timelines and relatively secure values and returns is a natural vehicle for this – and meets important national economic needs at the same time. Improvements in the planning and procurement processes for major infrastructure projects, as proposed with the support of Infrastructure Australia, may support greater investment by superannuation fund managers.

Further opportunities for equity investment, annuities and the development of fixed-income investments underpinned by infrastructure assets, should be further examined as avenues to support greater investment by superannuation funds in major infrastructure projects.

Tackling climate change

A key element of long-term investment is the fulfillment of environmental commitments. All countries, including Australia, have agreed to work together to reduce emissions to a level that keeps global warming below the 2 degrees threshold. Climate science tells us that warming beyond that threshold is likely to have increasingly severe social, economic and environmental impacts, not least in a dry continent like Australia. Avoiding those impacts will require concerted global actions with all countries—Australia included—shouldering a fair share of the emissions reduction burden¹⁰⁴.

Most countries see the future in an emissions trading scheme with a price on carbon. In Australia, many economists and policy architects also see this as the preferred policy approach to effectively address climate change at lowest cost¹⁰⁵. As an interim step, Australia is well placed to continue the move towards more renewable energy – a policy which in due course may form part of an emissions trading arrangement. Importantly, a robust renewable energy target provides a credible and predictable direction for investors.

Central to the switch to renewable energy will be the continued operation of the Clean Energy Finance Cooperation (CEFC). The CEFC is a government-backed institution which co-finances and invests in renewable energy, low-emissions technologies and energy efficiency for a positive return to taxpayers. The CEFC is also drawing in significant private sector funding to the clean and renewable energy sector in a ratio of approximately 1 to 1.80¹⁰⁶.

The economic transformation that will be required to seriously address climate change will have severe impacts for certain sectors of the economy and regions of Australia, like coal power generation, coal mining and others. It is imperative that these workers and communities see a just transition to a low carbon economy, with sufficiently resourced and targeted policies at the local, state and federal level to attract new industries, boost infrastructure and ensure worker training and support. We cannot allow our transition to a clean economy be at the expense of these workers and communities.

EDUCATION AND ACCESS TO HEALTH SERVICES FOR ALL

Universal access to education and health are in fact economic benefits, not just social benefits. There is no question that business benefits from access to an educated and healthy workforce - the more people that have good and free access, the better. Cameron Clyne

Investing in people's capacity through education and health is a social good and is also vital for increasing Australia's productivity. We have strong foundations, but need to do better to stay ahead. In terms of education, raising skill levels is critical to increasing growth in the long term. We see a need for a greater focus on early childhood education, addressing disadvantage in schooling, and increasing access to and quality of higher learning, to drive higher skill levels across our economy.

On health, the Commission sees an opportunity to improve access to services while ensuring the sustainability of health costs through adequate funding, improved oversight and data on health service and hospital performance, investing in primary and preventative care, ensuring the mix of public and private health funding remains sustainable and driving innovation in specific health industries.

Step up coverage of early childhood education

Early education is widely recognised by economists as an important foundation for economic growth and improved living standards¹⁰⁷. At an individual level, the environment in which very young children develop has lifelong effects on income, health and cognitive development¹⁰⁸. At an economy-wide level, investment in the early years is important for skills formation and avoiding remedial costs associated with children who fall further behind as they grow up.

In Australia, while a majority of children are doing well, not all have the opportunity to engage in quality early education. While some States such as Western Australia and Tasmania have an estimated 97 percent of preschool age children enrolled in a 15 hour per week preschool program, in New South Wales, enrolment is only 59 percent¹⁰⁹. These averages also mask variances in enrolment for children with additional needs – Indigenous children, children living in socio economically disadvantaged communities, children in remote areas and children from non English speaking backgrounds. For many of these groups, the highest rate of return in early childhood development comes from investing as early as possible¹¹⁰.

In its assessment of Australia's growth prospects, one area the OECD recommends Australia prioritise is performance and equity in education¹¹¹. The OECD notes that enrolment rates in pre-primary education are relatively low, and children from disadvantaged backgrounds face severe educational and skills shortfalls. Australia is working towards universal access to quality early education in the year prior to primary school and school funding reforms are underway (see below). However, there is scope to start much earlier with disadvantaged children before they arrive at preschool. The human and economic cost to children and the community as a whole of neglect in the early years is never recovered, only mitigated.

Addressing disadvantage in schools

High quality schools are essential for achieving inclusive prosperity, fostering community cohesion, encouraging a genuine stake in society, and participating in democratic structures. Educational failure imposes high costs on economies and society. Poorly educated people limit an economy's capacity to produce, grow and innovate. School failure damages social cohesion and mobility, and imposes additional costs on public budgets to deal with the consequences¹¹².

We know that government spending is not the only determinant of school quality, but it is a critical part. Funding does matter. It is clear that it matters to parents and it matters to teachers, who understand what extra resources, particularly extra staff, can mean for learning outcomes at a school.

The landmark Gonski review of school funding stressed the importance of an equitable school funding system focused on student need. The model is part implemented with Federal-State funding agreements in place in five out of eight jurisdictions¹¹³ and Commonwealth funding committed for four out of six years (i.e. until 2017). Finalising agreements with all States and Territories and funding the full six years is important to give certainty to Australia's efforts to deliver a more inclusive education system.

Increasing access and quality of higher learning

Post-school qualifications are an essential source of economic growth in a diversified modern economy. Quality tertiary education is vital for lifting living standards, upskilling our workforce and creating new industries, opportunities and jobs. Investing in our universities and vocational training providers is among the most important things we can do to maintain Australia's prosperity and ensure we deliver the jobs of the future.

Australia has a good system to support access to university. Australia's higher education loan scheme (HECS-HELP) is a world class mechanism that other countries seek to emulate. Students contribute on average 40 percent of the cost of higher education which may be paid upfront or taken as a loan. Repayment is contingent on graduates earning income above a certain threshold. The balance in costs is met in part by a Commonwealth subsidy¹⁴.

Nonetheless, access can be improved by investing more in universities and putting in place incentives (in addition to base funding) to improve diversity and outcomes for disadvantaged students. In particular, equity can be improved for students on low incomes, from rural and regional areas, Indigenous Australians, first generation migrants, students with disabilities, and other students from disadvantaged backgrounds. To boost completions for equity groups, we need to address underlying factors such as financial security, housing affordability and ability to undertake full time study straight after high-school¹⁵.

Improving completions and quality of higher education will deliver great gains. Department of Education figures show that 23 percent of people who started a degree as full-time students in 2006 had not completed it after eight years¹⁶. On the demand-side, incentives for students should be introduced to ensure higher completion rates. On the supply-side, improvements in quality will go some way to boosting retention. This means strengthening the university standards body (TESQUA) to motivate a lift in the quality of teaching and resources for a high-quality degree.

Similarly, quality and oversight of the vocational education and training (VET) sector is critical to growing Australia's skills base. Australia's VET system is the place where young people can gain alternate skills to academia and where workers can retrain to keep pace with our changing economy. Increasingly, trades will involve technology-based skills and new trades and professions will emerge that require upskilling and quality training programs.

Australia's VET system is jointly funded by the Commonwealth and States, but administered by the States. There is wide variation in investment levels, the mix of public and private provision, and course funding. Student fee assistance (known as VET FEE-HELP) is available for courses at diploma level and above, similar to the higher education scheme. Sustainable funding will become increasingly important as training needs accelerate. Equally important is addressing long-standing concerns over quality by better resourcing the regulator (ASQA). Efficiency in funding and better regulation of VET should be progressed as a matter of priority by Commonwealth and State Governments. There is merit in strengthening the market through a primary public provider (TAFE), complemented by a quality private sector.

More should also be done to arrest the decline in apprenticeships, a sub-set of vocational training which provides a strong connection to workplaces. Outcomes for apprentices and trainees who complete their training are generally strong. In 2014, 86 percent of apprentices and trainees were employed six months after completion¹⁷. Since 2011, apprenticeships have fallen sharply to reach their lowest levels since the early 2000s¹⁸. Although part of this is cyclical as the mining boom eases, analysts have also pointed to structural factors including a lack of clear pathways for school leavers¹⁹. Apprenticeships should be an area for greater focus in an economy undergoing transformation in the years ahead.



Access to sustainable and quality health services

A reduction in inequality as a catalyst for a stronger economy also applies to access to health services. The intuitive proposition that a healthy population is important for economic growth is backed up by the US National Bureau of Economic Research which found that good health has a positive, sizeable, and statistically significant effect on aggregate output¹²⁰. As Australia's population ages and health technologies become increasingly sophisticated, managing costs is critical. However, we should never lose sight of maintaining universal access to quality health care through Medicare.

Many areas within the health sector require detailed consideration. For instance, unnecessary or ineffective treatments could be reduced through better management of hospital data and monitoring of treatments by “outlier hospitals”¹²¹. Investing in primary and preventative care also has significant potential to avoid longer-term costs¹²². In areas like mental health and chronic disease management, it is worth increasing initial investment to avoid much higher long-term costs and impacts on quality of life are necessary. For instance the costs of mental illness in Australia are estimated to be \$20 billion a year, which includes the cost of loss of productivity and labour force participation¹²³.

While sensitive, competition policy has the potential to play an important role in the delivery of health services. Striking the right balance between public and private health services remains an important and ongoing challenge for Australia's unique health system. In light of this, a review of Private Health Insurance (PHI) would be timely.

TAXES AND TRANSFERS THAT PROMOTE FAIRNESS

Income and wealth redistribution, if implemented correctly and in a measured way, can be at zero cost to the government's budget bottom line. A move to lesser inequality can be the catalyst for higher productivity and stronger growth. **Stephen Koukoulas**

Australia has a well designed tax-transfer system that has substantially moderated the increase in market-based income inequality. However, it has not done so completely, nor has it effectively addressed the increasing concentration of wealth. This section highlights measures to make the tax transfer system more equitable, while still maintaining efficiency and incentives to work, save and invest.

Between 2001 and 2009 - a very prosperous period of Australia's history - 65.7 percent of working-age households contained someone who received a welfare payment at some time¹²⁴. Not family payments nor age pensions, a welfare payment. People move in and out of work. People become ill or suffer from disability. And families can break down. The social safety net is there for all of us. Peter Whiteford

Australia's tax-transfer system has been found to be largely progressive (although less so in recent times), and also well-targeted¹²⁵. Australia's transfer system, in particular, is unique. Payments related to old age, disability, sickness and unemployment are funded entirely from general revenue. In most OECD countries, these payments are at least partially funded through social security contributions from employees, employers or both. Australia's transfer payments are flat-rate, means-tested and continue indefinitely for as long as individuals remain entitled. Again, this is different to most other OECD nations where eligibility depends on prior earnings.

As a starting point, improving outcomes for the most disadvantaged should support people to find well-paid jobs with good employment protections and working conditions. Increasingly, this will also require ensuring that young people finish high school and have access to effective technical and further education opportunities. Policies in these areas are discussed in Sections 3.1 and 3.4. For those looking for work, or out of the workforce due to caring responsibilities, illness or disability, the safety net should allow individuals and families to share in rising national prosperity.

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One area where benefits have not kept pace with living standards is unemployment benefits (Newstart) which are indexed to prices rather than wages. A single person on unemployment benefits today is on about the same standard of living as in the 1990s. Yet, Australia is a great deal more prosperous. This decline in the relative standard of living of people who are looking for work and others is a growing source of inequality which must be addressed.

There are also major challenges for the adequacy of benefits for people renting in the private sector, with affordable housing for low income groups being increasingly unavailable. Solutions to this challenge are likely to involve a combination of approaches including improved rent assistance, investment in public housing and supply-side initiatives (as discussed in Section 3.3).

Finally, Australia's family payment system is an essential component of the safety net for those in paid work and those outside the labour force or unemployed - assisting with the costs of raising children and reducing child poverty. Over time, changes have reduced some of the earlier strengths of the system, for example the "sudden death" income test for Family Tax Benefit Part B, now at \$100,000, creates a cliff where a small increase in family earnings can result in the loss of thousands of dollars. A review of the whole system, including its interactions with child care support and paid parental leave would be desirable both to ensure fiscal sustainability and to guarantee effective support for Australian families.



In terms of wealth, Australia is starting from a solid base with the world's highest share of adults in the middle-class (66 percent), as measured by Credit Suisse¹²⁶. By contrast, only 38 percent of adults in the United States qualify as being in the middle class due to high wealth inequality and decades long hollowing out of the middle class. For broad-based wealth generation, the middle class is a major source of business owners and entrepreneurs who aim to satisfy new demand, and of the funding needed to support new businesses, particularly in the early stages¹²⁷.

Despite our broad base, in Australia as in most other countries, middle-class wealth has grown at a slower pace than wealth at the top end, and wealth is increasingly becoming more concentrated at the top. This points to challenges to achieving shared prosperity in the decades ahead, both between families and between generations of Australians.

The IMF agrees that Australia's tax rates are relatively progressive, but significant exemptions and concessions act to erode this progressivity – in particular, tax exemptions on income from wealth (housing and superannuation)¹²⁸. On housing, the Commission notes that the relatively high rate of home ownership spread across income groups in Australia has been an important wealth equaliser in the past and source of economic security. Therefore we do not propose changes to arrangements for owner occupied housing.

However, current incentives for investor housing do little to equalise wealth and distort efficiency by driving up house prices. Strong incentives for 'negative gearing' of investment properties (rental income less than the cost of borrowing and other expenses) are created by the combined effect of allowing deduction of losses against all income and a 50 percent discount on capital gains. The policy proposals brought to the 2016 election by the Federal Parliamentary Labor Party were widely welcomed as addressing this policy problem in a systematic and thoughtful way and should be the basis for policy reform in this area.

Similarly, Australia's superannuation system is not working as well as it could. Super contributions are taxed at a concessional 15 percent, much lower than the top income tax rate of 47 percent. In addition, earnings on superannuation accounts are taxed at 15 percent in the accumulation phase (while people are working) and untaxed in retirement. The sound policy rationale is to encourage more saving and improved living standards in retirement. However in practice, this has resulted in a disproportionate benefit to high income earners. The top 10 percent of income earners receive more than 35 percent of Australia's super tax concessions¹²⁹.

This is not sustainable or fair. Again there are a number of ways these issues can be resolved and care must be taken to not unduly penalise those who have made decisions based on current policy. To make the tax system more progressive and subsidies for savings more transparent, the Commission considers that tax rates and thresholds for mandatory superannuation contributions and earnings should be aligned more closely with income tax rates (though they should still be lower to incentivise saving).

Addressing multinational tax avoidance and company tax adequacy

Fairer tax also means addressing aggressive tax avoidance. As the ATO notes, a majority of Australian individuals and businesses pay their tax in full and on time. Australians see the value of spending on public services, especially health and education, and are even willing to pay more tax to enable this to occur¹³⁰.

A problem common to economies around the world is multinational tax avoidance. The rise of global supply chains has led to opportunities for multinational corporations to shift profits in ways that reduce a corporation's tax obligations in high-tax locations and given rise to significant amounts of globally untaxed corporate income. This situation is compounded by the increasing mobility of income and the growth of digital assets¹³¹.

The Senate inquiry into corporate tax avoidance has exposed the extent to which a large number of multinationals have evaded or aggressively minimised their tax obligations in Australia. In conjunction with investigative reporting of the highest calibre by some of this country's top journalists, and the diligent and tenacious public service of Australian taxation officers, the inquiry has drawn attention to the legally questionable and ethically bankrupt tax practices of some of Australia's most senior corporate citizens. The so-called Panama Papers have revealed the scope and depth of this problem globally, not only emphasising the scale of public revenue at stake but exposing the involvement of establishment economic and political figures in many countries.

When some companies fail to pay their fair share of tax, revenue must be found elsewhere, either from businesses, particularly SMEs, who already obey Australia's tax laws or from individual taxpayers who already pay direct and indirect tax. When multinationals avoid their tax obligations, the Australian people pay, either in higher taxes or in fewer and lower quality services. It is undeniable that aggressive multinational tax avoidance represents a significant income and wealth transfer from middle Australia to shareholders of multinational corporations.

Complex tax legislation introduced in the period of the Howard-Costello Government opened loopholes that mining companies, banks and other large businesses exploited, to the disadvantage of taxpaying domestic firms, and at the expense of the efficiency, equity and sustainability of the tax system. The end of the long revenue boom has brought this and other weaknesses in the revenue base into very sharp relief, and efforts to address this have been underway for some time.

In 2012, a cross-border transfer pricing bill sought to wind back multinationals' overvaluation of assets in international transactions. The 2013-14 budget included an integrity package to address the erosion of the corporate tax base that would have yielded \$1.4 billion over the forward estimates. The budget dedicated \$109 million to help the ATO target foreign marketing hubs, counter aggressive tax avoidance structures and close a range of loopholes which have facilitated profit shifting by multinationals. In addition, the Parliament in 2013 closed loopholes in transfer pricing rules in order to counter tax avoidance and multinational profit shifting.

The OECD is leading international efforts to tackle Base Erosion and Profit Shifting and Australia is part of this global effort to address multinational tax avoidance. Since 2013, the Australian government has been slow in meeting its G20 obligations, and has ignored 10 out of the 15 pledged actions on the OECD's action plan, paid lip service to only four actions and is likely to implement just one. In the meantime, there are measures Australia can and should take to ensure multinational companies operating in Australia pay their fair share of tax.

These include measures to address debt-loading, whereby companies artificially inflate lending between related entities to claim deductions and reduce profits; standardising rules for classifying assets such as equity or debt so companies cannot claim tax exemptions in one country and deductions in another; increased transparency and better resourcing the ATO to boost compliance.



These revelations of systematic and wide scale tax avoidance by multinational companies and wealthy individuals including those operating (or living) in Australia have badly damaged the remaining arguments for corporate tax cuts.

The ‘revenue recession’ experienced by Federal governments since 2010 might of itself be considered sufficient to ensure that major changes to the company rate are simply not fiscally sustainable in the foreseeable future. The explicit promotion by the Australian Chamber of Commerce and Industry of Laffer curve theories – ACCI brought Dr Laffer to Australia in March 2015 – is both a remarkable instance of extreme conservative politics in itself, and a concession that there is no serious answer to the fiscal objection to company rate cuts other than voodoo economics.

In some respects even less convincing are the arguments for company tax reductions funded by forgoing public investment in education. For the reasons outlined above, these investments are essential to future growth and equality. Cutting them to increase shareholder returns or in a bland pursuit of competitiveness is indefensible.

Finally, the argument for a tax mix switch which funds corporate tax cuts from increases in indirect taxes on consumption appear seriously unconvincing and out of date. The stubborn instance that such tax cuts create a return for workers through job creation, even were it well-founded and not a highly controversial claim, does not account for the impact on living standards of those already in work by funding such cuts through for instance a higher goods and services tax. Nor does it account for the employment effects of such a funding arrangement. Given sluggish overall growth and the importance of consumers to overall demand, substantial increases in consumption taxes bear evident risks to growth in the short term.

In the contemporary Australian context – fiscal scarcity, disappointing educational achievement, low wage growth, fragile demand and above all rising inequality – the argument for substantial across-the-board company tax cuts fails. ■

When middle Australia benefits the **economy gets stronger**



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APPENDIX 1:

*Extract from: How reducing inequality
can enhance productivity and growth*

INCLUSIVE PROSPERITY

How reducing income inequality can enhance productivity and growth

Stephen Koukoulas



There is a growing consensus that Australia's potential or trend rate of real gross domestic product (GDP) has fallen. Led by Glenn Stevens, Governor of the Reserve Bank of Australia (RBA), the economics profession is digesting the rising probability that the trend pace for annual GDP growth is now a touch under 3 per cent, where past research was almost unanimous that potential growth was around 3.25 per cent.

There are many reasons raised why this ratcheting down in the limit to Australian economic growth may have occurred, with rising income inequality rating highly. Why?

First, greater equality can lift overall demand.

Academic research on the link between income inequality and economic growth has been prolific in recent years with the conclusions perhaps best summarised in the following stylised example.

Let's assume that an economy gains \$1 billion of income. At one extreme of inequality, \$200 million could accrue to each of the five richest people; at the other extreme, the 1 million poorest people could be given \$20 per week for a year.

If this economy was Australia, each of the five richest people would start from the position of having existing wealth of at least \$6.9 billion. An extra \$200 million would be unlikely to make a material difference to their spending on food, clothing, shelter, education, entertainment or holidays, for example. It may, at the margin, feed into their investment decisions, but the overall injection and circulation of that extra \$1 billion would yield a small addition to the rate of national economic growth.

For the very poor people, each with wealth of close to zero and an income invariably below \$400 per week, the extra \$20 a week or \$1,000 over the course of a year would almost certainly all be spent. This is because for the poorest in society, what economists call the "marginal propensity to consume"

is high. With the extra \$20 a week, the poor might buy new clothes, food or shelter with the extra cash – but we know they won't simply save it. In fact it doesn't really matter where the money is spent in this example; the key point is that the rate of economic growth would increase and be significantly more than that if the money accrued to the five richest individuals.

It is noteworthy that this benefit of equality extends to middle income earners who, according to Andrew Leigh, have a similar marginal propensity to consume as low income earners.¹

The end point of this example is to show that a move towards greater income equality should increase spending. In turn, a move towards greater income inequality should enhance economic growth compared to the experience of greater inequality.

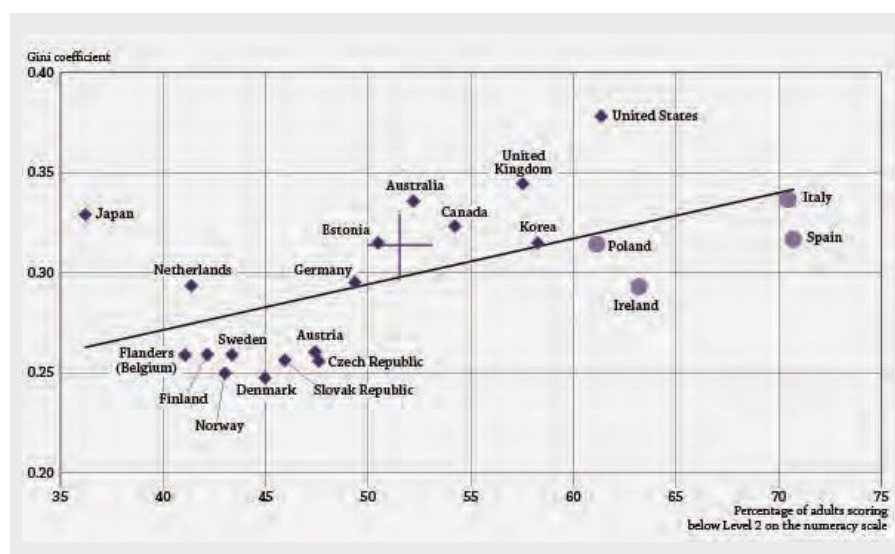


Second, greater equality lifts education and skills.

This aspect of income inequality and its impact on economic growth and productivity is through less direct or obvious effects and policy choices.

According to several OECD research reports ^{2,3}, the greater the degree of income inequality, the lower the level of educational attainment and skill in the general population. In the example of numeracy, the more numerate a society, the lower the Gini coefficient (greater equality).

Relationship between the percentage of adults with low proficiency in numeracy and the Gini coefficient



“inequalities in well-being among adults translate into inequalities in opportunities for their children”

Why? One of the OECD’s reports concluded that

“inequalities in well-being among adults translate into inequalities in opportunities for their children”.

In other words, greater income equality provides greater educational opportunities for young people. With that, they will derive higher incomes on average over the course of their life than if inequality was entrenched. Per capita incomes in countries with poor education and academic attainment are lower and those countries have weaker economies, on average, than those with higher education attainment and skills.

Spending money on access to widespread education, especially for the poor, is good for economic growth. Generating greater income equality, allowing people to invest in their own education and skills, is even better.

