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# Seven stories from *Rising inequality?* *A stocktake of the evidence*

**National Press Club Address**

**Peter Harris, Chair of the Productivity Commission**

**Jonathan Coppel, Commissioner, Productivity Commission**

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**Peter Harris:** It's a pleasure to be addressing the Press Club today.

Many years ago, I played the occasional game of Kelly pool upstairs. I generally left my money in the pocket of some member of the Press Gallery. It still hurts, four decades on.

A few years later, Michelle Grattan spoke to me and later sent me a book. It was on the anti-apartheid struggle, a passion of mine, and at the time I worked in PM&C on southern Africa for Malcolm Fraser. As a young public servant, I felt deeply compromised by this. Was I now that fearful object, a source?

But of course I didn't know anything — or anything much.

And Michelle never called me again.

I'm not sure what was worse — the fear of being a possible source or the reality of being too unimportant to be one.

And I have come to this very room with Bob Hawke who delivered my treasured two and a half sentences about road and rail reform in a 1990 speech announcing a new Commonwealth–State process to deal with structural reform in Australia — the Special Premiers Conferences, as COAG's progenitor was christened.

They were simpler times, no doubt. Problems rose up. Leaders dealt with them, even at great personal cost. Governments changed but the task of updating public policy mostly persisted.

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Today, the environment is different.

We are going to talk this afternoon about the multiple stories of inequality and entrenched disadvantage, which some may find hard to link to their preferred concept of the Productivity Commission, despite our track record with disability and aged care and child care and currently, veteran's entitlements.

But we focus today on this issue because the environment for policy-makers is not of that once and simpler time. And context matters if you are in the public policy design game, as the Productivity Commission certainly is.

So before we get to the detail of our latest own-motion research work, let me lay out the context as I see it.

On more than one occasion, Scott Morrison has said to me that there are few low-hanging fruit left in micro economic reform, and there is surely some truth in that.

On the other hand, as economists like to say, not all the fruit back then were low-hanging by any means.

And, more importantly today there is surely also an argument that reaching for a higher branch might be a significant political differentiator in this decade's febrile political environment, where ideas float up and then just as quickly burst and disappear.

What a stand-out then would be a commitment to a structural reform plan that had a shelf-life of, say, five years.

There is such an option.

And its principal beneficiaries are people, rather than firms — broadening the appeal of structural reform by focusing on

- higher workforce participation and personal wellbeing through preventing chronic disease
- more adaptable workforce skills through practical improvements to secondary and tertiary teaching
- Hilmer-style reforms to planning and zoning to make it cheaper and easier to live and work in our congested cities.

Moreover, it's not expensive, no more than the cost of reform to the sharing of GST amongst the States and Territories. All of us struggle to recall that, even if it was only a few weeks ago. Yet the benefits are multiple times that cost, and perpetual.

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This plan, released by the then Treasurer in October last year for consideration amongst all Treasurers through 2018, is *Shifting the Dial* — the Productivity Commission’s response to a specific request from the Treasurer on what could be done to address Australia’s flagging productivity level.

Because it is the case that, despite occasional spurts of growth, the engine that drives growth in our economy is sputtering, insufficient to put any power into wage growth amongst other impacts.

For some, this is a recent discovery. But in my first speech as Chairman of the Productivity Commission in 2013, we made that very suggestion: that income growth would fall by about half in the coming decade, if productivity performance this decade was as poor as it had been in the previous decade.

And so it has proven to be.

This contributes today to the general feeling of dissatisfaction which the Committee for the Economic Development of Australia found with its April 2018 survey — that 44% of Australians do not feel they have gained at all from nearly three decades of uninterrupted growth.

Productivity growth has indeed been in serious decline around the developed world since 2004, enough time to show up as more than a statistical novelty.

At the same time, around the developed world but most evidently in the northern Atlantic, a broad sense of anger and dissatisfaction with the sharing of the benefits of globalism emerged.

The two trends are not linked other than that the ability of governments to respond to the rise of populist sentiment is deeply hampered by being in an extended low growth phase; and having incurred outsized debt burdens during the GFC.

Moreover, some of the most powerful and reliable mechanisms of seeing economies return to higher growth — innovation, and removal of trade barriers — are guaranteed to raise the hackles of populist leaders.

These solutions thus are not easily advanced any more, effective though they have been in benefiting most of us. The evidence from our *Rising Inequality?* research released today shows in depth just how widely these benefits have been shared in Australia.

What we are yet to see in Australia is the kind of angry dissatisfaction expressed in the North Atlantic economies.

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But we have our own — and not just in the recent past with disappointingly low wage growth. Six years ago, former RBA Governor Glenn Stevens spoke on what was reported then as the ‘glass half full’ speech. This sentiment has been developing for a while.

And so as we look out on a fourth straight decade of uninterrupted economic growth, we need to consider dispassionately why it is that so many of us feel we have missed out.

To do that effectively is not to indulge in the hand-wringing of self-criticism.

It requires us to show how sound public policy *has* generally worked for the largest number of us, while acknowledging its weaknesses for some.

The research we release today on *Inequality* is a contribution to that effort.

Unlike North Atlantic nations now caught up in a populist vortex, the benefits of income growth since the last recession in 1990 have been fairly evenly shared across every income decile in Australia.

And the bottom decile, the 10% with least income, have done as well if not slightly better than most deciles. As Jonathan will later show, our tax and transfer system has ensured a sound effort in sharing income growth and governments of all stripes have generally maintained its effectiveness, viewed over 27 years.

This will be instantly rejected by some, since it is not the popular perception. But it is the unquestionable fact. And, moreover, we are clearly *not* the same as the UK or the US.

There are many ways of further slicing and dicing income data in the report, which we investigate in depth so that there can be no doubt about the veracity of what we say: regardless of how it is viewed — decade by decade; or by periods of high and low productivity; or periods of high and low investment — only in the early 90s did all income groups not experience at least some income growth.

But as we also know, income growth is not the same as inequality.

While it is generally used as a comparator between nations, the Gini coefficient is not the only way to measure inequality, and Jonathan will take you through what we have discovered in a deep dive on inequality data.

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**Jonathan Coppel:** Thank you Peter.

Let me begin with a fundamental question — the one posed by our report's title. Is inequality rising?

It is a question that draws diverse and competing views.

Some of you might be saying to yourself now, yes, it has risen based on this or that indicator. Others might say no, it has actually fallen, based on a different metric.

This is not a good place to begin a discussion on inequality and its social impacts.

For a serious discussion, it is first necessary to have a thorough and authoritative grip on where we stand today and how we got there.

This is the contribution our report seeks to make and hence its subtitle "A stocktake of the evidence".

But it's not a straightforward question to answer.

Unlike economic growth, no single metric is going to give a definitive answer.

So what we have done is to bring together and take stock of the latest and most complete evidence measuring the level of and trends in inequality, poverty and disadvantage in Australia.

We did this primarily using household level data and adjusting for the size and composition of the household.

This takes account of larger households needing more resources to achieve the same standard of living as smaller households, and for some economies when sharing living costs.

And it is on this basis that we reach our bottom line conclusion that inequality has risen slightly over recent decades.

This is most evident with respect to the distribution of wealth and consumption.

The trend in income inequality is more contested territory. Some data reveal a small upward tick and others show no change since the early 2000s.

One could get easily distracted dissecting the reasons for these differences. But this would blur the bigger picture.

The key point is that just looking at the distribution of income in isolation gives you a lopsided view of inequality.

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A few examples help to illustrate why:

- i. Many retirees, for instance, live on low incomes, but have high wealth.
- ii. There are also many young adults with higher consumption than income and little wealth.
- iii. And income patterns alone do not capture the importance of in-kind transfers from government, such as health, education and government housing.

This is why our approach deliberately eschews the specific and often self-serving use of any one measure of inequality, or make simplistic international comparisons.

Another reason why commentary on income inequality is contested territory is because the data reveals no uniform trend. It varies over time — sometimes in unexpected ways.

We were surprised, for example, to discover that ABS data since the GFC shows a decline in income inequality.

In fact, most of the uptick in income inequality over the past 27 years occurred during the mining boom period when wages growth was relatively strong.

It suggests that growth is no guarantee against a widening disparity between rich and poor.

Moreover and paradoxically, these inequality trends do not square with the perceptions of many in the community.

It appears that many Australians are confounding the very modest wages growth in the post GFC period with widening income inequality.

This again underlines the importance of first assembling the facts.

While the perception often is that the glass is half empty, the most accurate picture that can be drawn from the data suggest that each generation is still better than its predecessor.

To reach this finding we considered yet another way to look at inequality, and that is to dive deeper into the variation in income across age groups.

Most often, this variation reflects overall trends in the strength of income growth. When the economy is strong, all age groups benefit from higher income growth and when the economy is weak, all age groups suffer from lower income growth.

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Sometimes though, some age groups have benefited more or less than others. Most recently, the incomes of young people have grown relatively slowly.

But on average, the story is that each new generation has earned more income than the last at a given age, and reaches the same level of income earlier in life.

A further clear message from the data is that Australia's tax and transfer systems substantially reduce income inequality.

Relative to other OECD countries, Australia redistributes less income. But we do a much better job of targeting this redistribution to low income earners.

Overall, our progressive tax and highly targeted transfer system lower the summary measure of income inequality by about 30 per cent.

Government funded services, such as health, education and public housing have an additional equalising effect.

When these in-kind transfers are included in a more expansive measure of consumption, inequality is about 30 per cent lower again than that for disposable household income.

This is because people with low incomes receive the largest amount of in-kind transfers.

While there has been no material change in these equalising effects in the past 30 years, there is nothing inevitable about them either.

The inequality measures considered thus far give a snapshot of the distribution at a point in time.

While they show a slightly widening gap between "rich" and "poor" that does not mean the rich and the poor households at the beginning and the end of the period are the *same* households.

The distinction is important, and is why our report also looks at economic mobility — the gauge of whether the rich always remain rich and the poor always poor.

It matters, because a society with a given level of inequality and where incomes are static faces different and more serious policy challenges than a society with the same level of inequality, but where incomes are mobile.

A low level of mobility can erode the foundations of economic growth and give rise to feelings of social exclusion.

Mobility prospects are also an important determinant of life satisfaction and wellbeing.

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So how does economic mobility stack up in Australia? Well, there is both good news and bad news.

The good news is economic mobility is high in Australia. Most of the people in the top income decile today were not there fifteen years ago.

In fact, almost everyone moves across the income distribution through the course of their lives. To give a few examples:

- Over a 16-year period, the average Australian was classified in five different income deciles.
- Only one per cent of people remained in the same income decile over the whole period.
- And 9 per cent of the Australian population spent time in both the top and the bottom income decile.

Life events, such as transitioning from education into work, career advancement, household formation, having children, divorce and retirement, underpin some of the observed trends in economic mobility. Policy design also plays a part.

The bad news is we found the ends of the distribution to be 'stickier' than the middle.

Households in the top and bottom two income deciles at the beginning of the period were the most likely to be in the same decile 15 years later.

This is of particular concern because low mobility at the bottom typically extends beyond earnings to other dimensions of wellbeing, such as educational attainment and health outcomes.

To be sure, some 'stickiness' at the ends of the distribution is to be expected. I won't get into the reason for this, as it is somewhat technical.

But how much stickiness is too much?

There is no consensus on how much matters, but international benchmarking provides a basis for comparisons.

Relative to the United States, for example, economic mobility in Australia is higher overall and less sticky at the tails. A similar pattern of income mobility holds across a broader range of OECD countries.



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Another way of summing it up is that many Australians experience economic disadvantage at some stage in their lives, but for most of us, it is temporary.

For this group, sustained economic growth and reliable access to employment will continue to be the source of new opportunities.

But another group of Australians experience entrenched economic disadvantage; they are stuck at the bottom end of the mobility ladder.

To explain the nature of this group and what can be done about it, I will hand the floor back to Peter.

**Peter Harris:** Jonathan, that economic mobility slide is pretty impressive piece of work, my favourite summary of how we should probably view ourselves.

The value of longitudinal data sets can be seen here.

We have so few of them in Australia, badly lagging other developed nations. But they can show us remarkable truths. It's to be strongly hoped that the creation of National Interest Data sets out of the Commonwealth Government's response to our 2017 *Data Use Report* will invigorate investment in further similar data sets, and soon.

But if there is one lesson for the future out of our analysis of inequality, it is this: despite 27 years of uninterrupted economic growth, and unemployment stabilising at a notably lower level (generally starting with a 5 and not a 7 or an 8), and significant investment in redistribution of income via Family Tax Benefit and child care assistance in the 2000s, and a boost to indexation of the age pension late in that decade, we still have 9 to 10% of Australians living on very low incomes.

It has varied a bit throughout that period but today, for 2 million or so people, we are where we were thirty years ago.

It is not the same 2 million, as the mobility data shows. But the proportion of our society apparently doing very poorly should have reduced over that thirty years.

Of course, the gross number is a bit misleading. Included in that group will be many people for whom low incomes have an explanation *that does not need a policy response* — students in part-time jobs, small business operators building a capital asset, some older high net wealth persons.

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For the remainder, there are expert advisers that suggest we already know the answer. But after thirty years, perhaps simply shifting money around and doing more of the same is not sufficient. We have measures in this study to show how forms of poverty for children in particular have actually risen over the last twenty years. There are certainly no simple answers to inherited poverty.

So, as political parties ask themselves what are good ways to respond to the popular view that the benefits of growth are not being shared, rather than narrow the search to a favourable statistical model of inequality, perhaps it might be better to focus instead on persistently disadvantaged elements of this group.

It would be a complex task, and one for which there are few precedents.

We know a bit about this complexity. Aside from the major inquiries I mentioned at the start of this address, in 2015 we undertook a piece of research on *Housing Assistance and Employment* that focused on public housing tenants and the factors that reduced their employability. The conclusion of that work was that policies need to be much more adaptable to individual disadvantage, what I like to call hand-made policy.

And we completed a Report last year on *Reforms to Human Services* that again showed some innovative ways to address improved health and social service provision.

We increasingly have the data, thanks to digital collection, to be able to improve on this work across a wide range of aspects of disadvantage. We should use it, not bury it.

Making a commitment to a comprehensive policy response to persistent disadvantage matters not just because we ought to be able to do better by our fellow Australians as we look out at a fourth decade of uninterrupted economic growth.

It matters too because without a practical and specific focus on something that represents the genuine policy failure in as loose a subject as inequality, almost any form of tax or welfare benefit to the better off, or billion-dollar regional development boondoggle, or leap on to the bandwagon of the new Trump protectionism can be justified under that banner.

Finally, *Shifting the Dial*, our 5 year productivity plan I referred to at the outset, would complement such a commitment to focus on entrenched disadvantage.

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*Shifting the Dial's* serious structural improvements to human-scale gains in responding to:

- chronic disease
- education and training unsuited to a multi-career job market
- expensive, congested urban environments...

...would equip governments, State and Federal, facing the sentiment detected by CEDA with another part of the necessary ability to give a clear human focus to structural change.

And prevent us from being driven by fear to abandon that which we know works, even if it raises hackles to say it: lower barriers to trade; an active focus on innovation and basic research; and a healthy scepticism about the capability — let alone the efficacy — of governments setting prices or favouring some firms at the expense of others and calling it competition.