Australian Institute for Progress

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An occasional brief issues brief

Are corporations eating employees' lunches?

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The Australian Institute for Progress exists to advance the discussion, development and implementation of public policy for Australia's future, from its base in Brisbane. The future does not look after itself.

Summary

Bill Shorten has claimed "This economy is the killer, this is the killer number and I'll stop at this, 39 per cent is the increase in corporate profits since you last voted for Malcolm Turnbull. Wages have moved 5 to 6 per cent."[i] But this is untrue. And as much as there have been large increases in corporate profits in the recent past it is largely due to volatility in corporate profits.

We examine wages and profits on a per-capita basis and find there has been very little change in the ratios between profits and wages in the last 10 years, with employees enjoying a better share of income now than they did in 2011 when Bill Shorten was Minister for Workplace Relations.

We also look at the history of the relationship between wages and profits and find that the assumptions of the Hawke and Keating governments were correct: you need to lift profits to lift wages and employment. In addition, the adoption of universal, compulsory superannuation shifts the balance so that all Australians receive a direct wealth benefit from higher corporate profits in their retirement incomes.

Companies also pay a high percentage of Australian taxes, and higher profits translate into higher taxes, which are then used to lower the taxes ordinary Australians pay.

Major findings are:

1. Bill Shorten is wrong. At no time has there been a 39% increase in profits while wages have only increased "5 or 6%". In the 11 quarters since the 2016 election, up until December 2018 (the latest available), there has been an increase in corporate profits per worker of 36% and 4.3% in wages.
2. If you take corporate profits per employed and compensation per employed since 2013-14, the year Labor lost and up to 2017-18 you find that profits increased by 7.47% and employee compensation by 5.08%, demonstrating that the figure is a cherry-pick.
3. The increase in profits followed **decreases** of 3.56% and 6.34% in the preceding years.
4. By campaigning to increase wages and decrease corporate profits Shorten is reversing the policies of the Hawke and Keating governments which introduced the Prices and Incomes Accord to reduce wage increases, and increase corporate profits and savings.
5. Mr Shorten's policy is likely to increase the level of unemployment.
6. Over the last 10 years the ratio of corporate profits to personal earnings has been lower ("worse" in Mr Shorten's terms) than it has been under the Coalition, including when he was the Minister for Work Place Relations.
7. The share of the economy held by wage income is currently comparable to what it has been all through the last 30 years, the time in which Australia has experienced unprecedented growth. Compulsory superannuation also means that workers receive a benefit from higher corporate profits through their retirement savings and earnings.
8. Company profits are more volatile than wages, effectively acting as an economic shock absorber. As a result they will decrease and **increase** much faster than wages. Such a decrease and increase happened in the last 4 years. But on average the change is similar between wages and corporate profits.
9. Australia needs corporate profits to increase to provide the basis for a sustainable increase in economic growth, wages and employment.

Have wages increased at 5 or 6 per cent while profits have increased 39%?

The first graph tracks increases in compensation per employed person against corporate profits over the period from July 2014 to December 2018[ii], which is the last set of accounts available from the Australian Bureau of Statistics. Most of the increase occurred in the first two quarters of the 2016-17 financial year. It should be noted that both these measures are very volatile and that no one actually experiences wage or profit growth individually that looks like this. Recent data will also be subject to review and it is also possible that profits and/or compensation may decline before the end of this financial year as well.

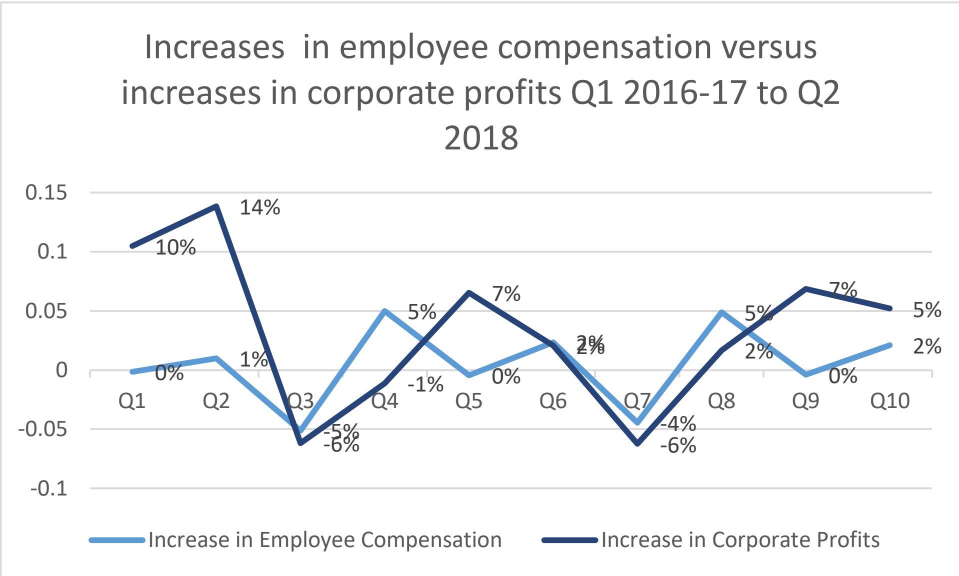

Figure 1: Increases in Employee Compensation versus Increases in Corporate Profits Q1 2016-17 to Q2 2018. Source ABS 5206044

The next graph tracks compensation per employed person against corporate profits per employed person over financial years, for the period from 1978-79 to 2017-18 (the latest available full-year figure). Corporate profits act as a shock absorber. Companies bear the brunt of poor economic circumstances before employees do. If companies are to survive they obviously have to make up for past losses by future profits, so an above average increase in profits is necessary at times, and an increase in some periods over and above that of wages, unavoidable.

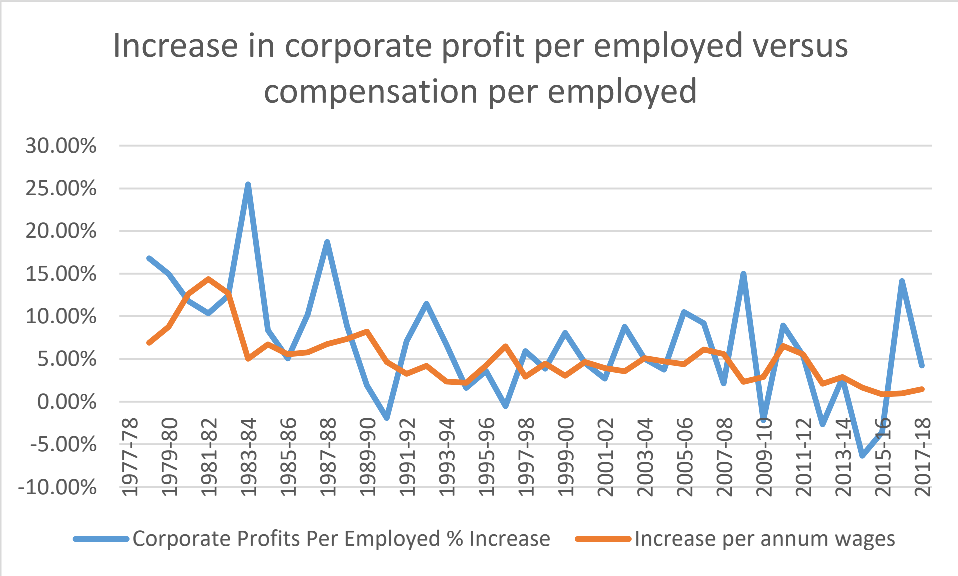

Figure 2: Compensation per employed against corporate profits per employed. Source ABS 5206044

In 2013-14 average corporate profit per employee was $34,426. In 2017-18 it was $36,998, an increase of 7.47%. In the same time period compensation per employee went from $66,691 to $70,082, an increase of 5.08%.

Historical relations between wages and corporate profits

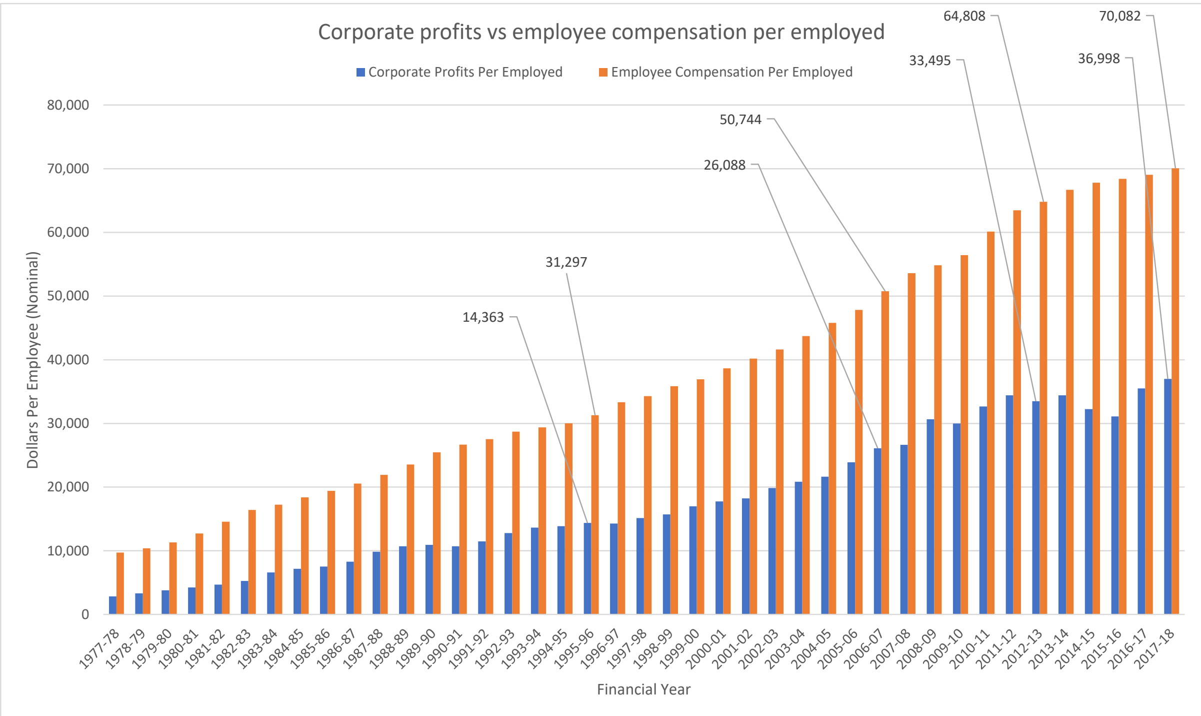

Figure 3: Corporate Profits vs Employee Compensation per Employed, Australia Source ABS 5206044

Historically growth in corporate profits and wages has been similar, with the exception of the last 10 or so years since the GFC when there has been substantially more volatility in corporate profits than there has in wages. That has led to the situation where it appears that profits have accelerated while wages have flat-lined.

The graph below expresses compensation per employed and corporate profits per employed as a ratio. Wages in 1977-78 were almost three and a half times profits. Today they are around 2 times. However, the steepest decline happened in the early 80s as a result of direct government action. We've put a trend line on the graph which suggests the ratio may be turning up.

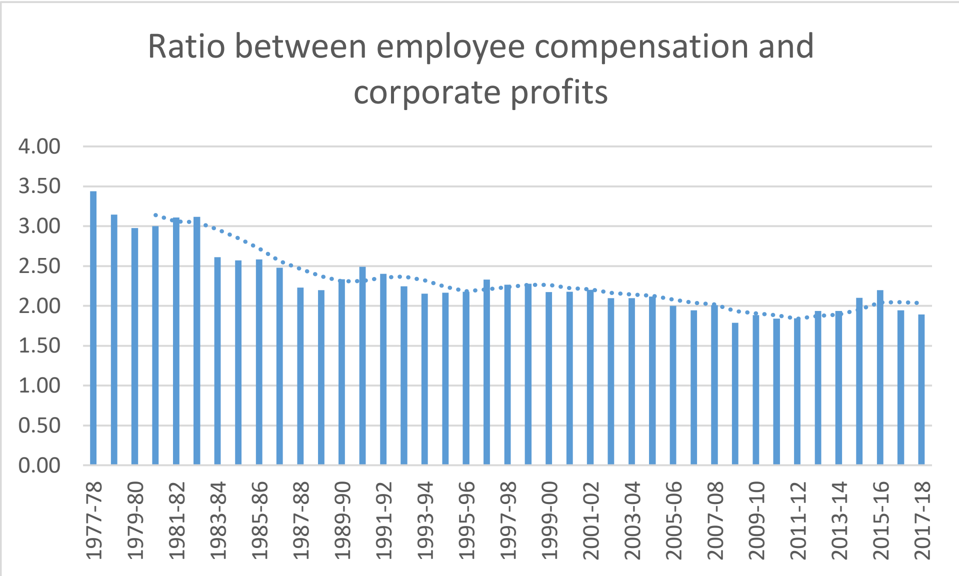

Figure 4: Ratio between employee compensation and corporate profits Source: ABS

As this graph below from the RBA[iii] shows the wage share of the economy was unusually high in the 70s, and in the period of the Hawke and Keating government the Labor governments determined that companies had to retain a greater share in profits, and implemented the Prices and Incomes Accord which restrained wages in return for superannuation contributions by employers, and an expectation of higher economic growth as a result of higher levels of investment and business activity.

It also demonstrates that the changes since 2000 have been marginal.

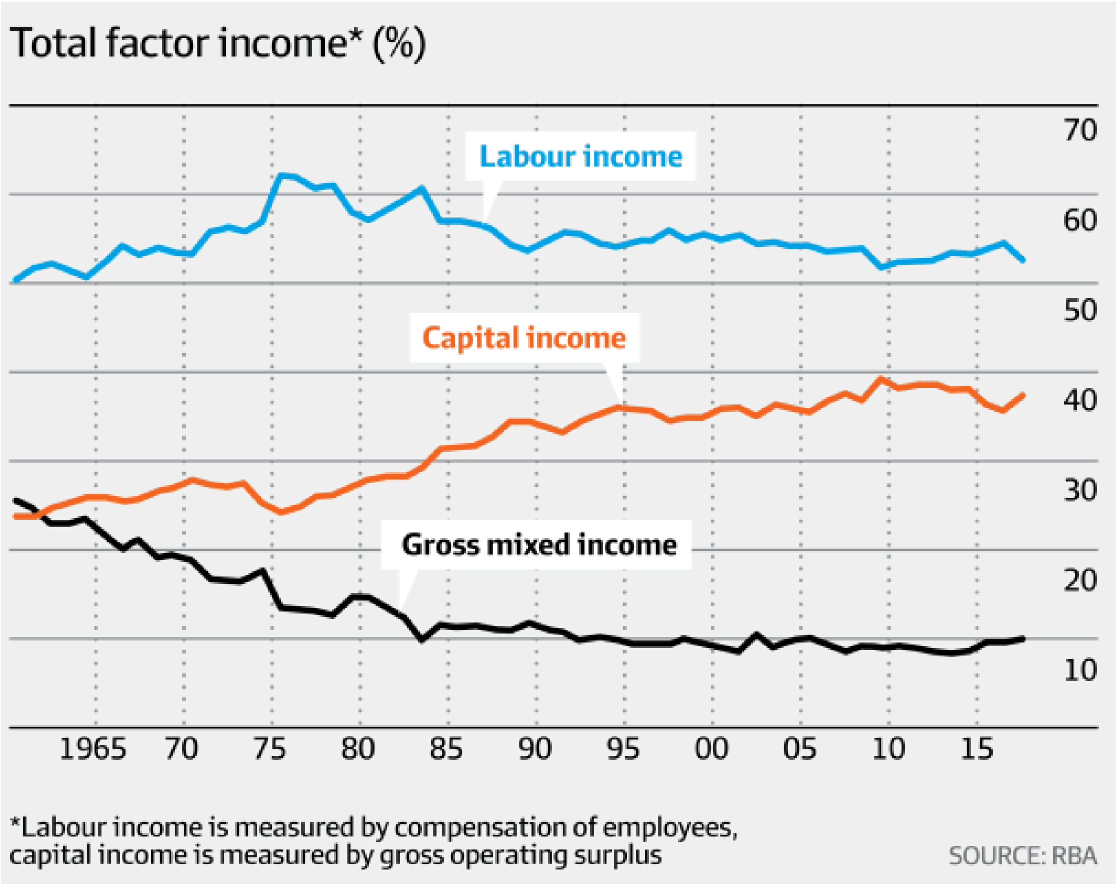

Figure 5: Total Factor Income Source AFR

The graph below demonstrates the relationship between growth, unemployment, incomes and profits. It suggests that the lower ratio is better for employment, and that a higher ratio could be worse. That was certainly the belief of the Hawke and Keating Labor governments.

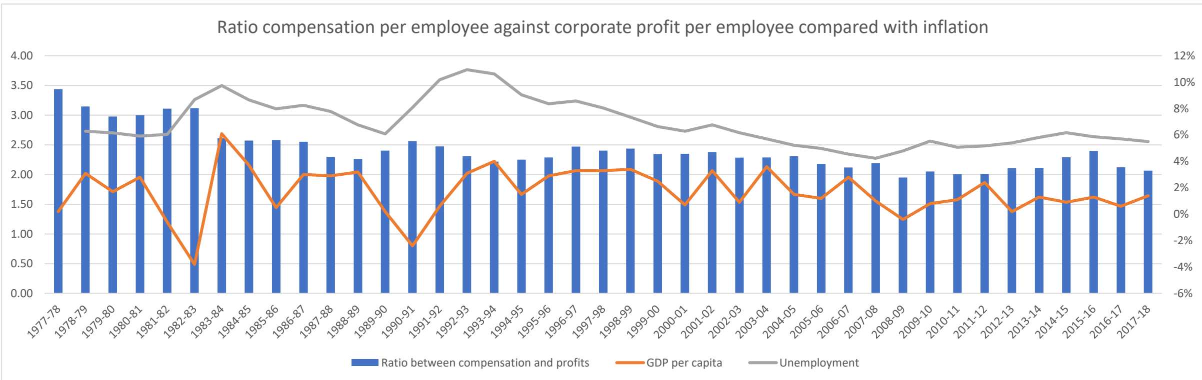

Figure 6: Ratio Compensation per Employee against Corporate Profit per Employee compared with Inflation per Employed Source ABS

What are corporate profits?

Companies are legal structures which confer rights of ownership on a number of parties, at the same time limiting the risk of those parties in operating together. The Joint Stock Company was one of the great inventions of the 17th Century.

Companies are not people. They don't eat, buy expensive clothes, cars and houses, go on holidays, or pay extravagant school fees. When they earn profits they do three things. They return some of them to shareholders as dividends, and they retain the balance and reinvest them in the business. When they reinvest the business grows, and so does its ability to pay higher salaries or employ more workers.

They also pay taxes. Some of the tax reductions currently on offer in this campaign are paid for by the increase in company profits. In Australia company tax makes a higher contribution to the budget than just about every other OECD country[iv]. The graph below is for 2016, the latest comparison available from the OECD. Company taxation is anticipated to be 4.69% of GDP in 2019/20, according to the 2019 Budget Papers[v].

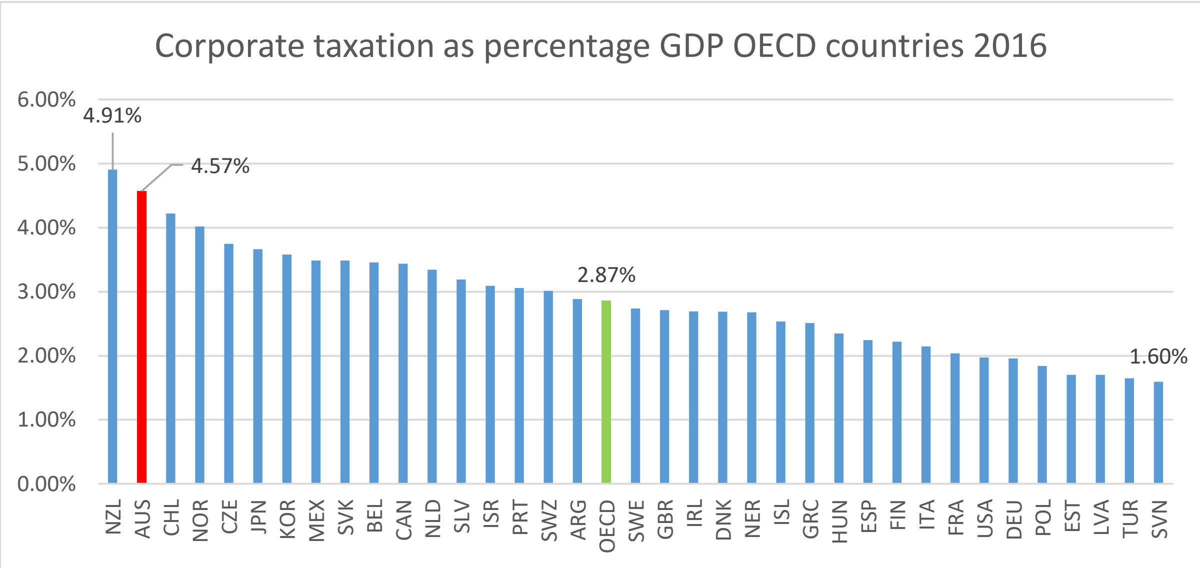

Figure 7: Corporate taxation as a percentage of GDP OECD countries 2016 Source OECD Gobal Revenue Statistics https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL

Company profits are not wages, but to most Australians they represent earnings and savings, either directly through owning shares in companies personally, or indirectly, through their superannuation, or other managed investments.

So the idea that workers are being penalised if corporate profits increase and wages don't is a false dichotomy. What it really represents is a shift from wages and salaries, to investment and saving. And history shows that over the long run, countries that invest more have the highest growth rates, and therefore ultimately the best standards of living.

Australian workers who reduce the profitability of Australian companies via unjustified wage increases lower their and future generations' standard of living to the extent that investment and the economy's productive capital stock is smaller. Higher wages also increase the unemployment rate, and hence rob other Australians of jobs.

What is the appropriate balance between wages and profits

As Figure 7 suggests, if you want a lower rate of unemployment, then a lower ratio appears to be better than a higher one. The ratio has been slightly smaller since the GFC, and incomes subdued. Conventional economics would say that if you want to get incomes up, and unemployment down further, then you need an acceleration in business growth. That would argue that we need company profits to grow again, which infers that the ratio may need to decline in order to change direction.

Times have also changed since the 70s when the ratio was much larger because share ownership has become almost universal via the superannuation system, which was a design feature of the Accord. Another design feature was to deliberately increase the share of the economy of company profits.

Conclusion

The current ALP/ACTU campaign is misguided, and at complete odds with Labor's historical approach to wages which was to stimulate the economy first understanding that wages and conditions would follow, which they did.

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[i] Sky News Courier Mail Leaders Debate Friday May 3, 2019.

[ii] ABS 5206044 National Accounts

[iii] The Australian Financial Review May 3, 2019 "Why the stolen wage rise is the economy's biggest myth".

[iv] OECD Global Revenue Statistics https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL accessed 6/5/2019 at 18:27 EST

[v] Budget Paper No 1, Statement 4 Revenue