Briefing Note:

Labour Share of Australian GDP Hits All-Time Record Low

By Jim Stanford, Economist and Director
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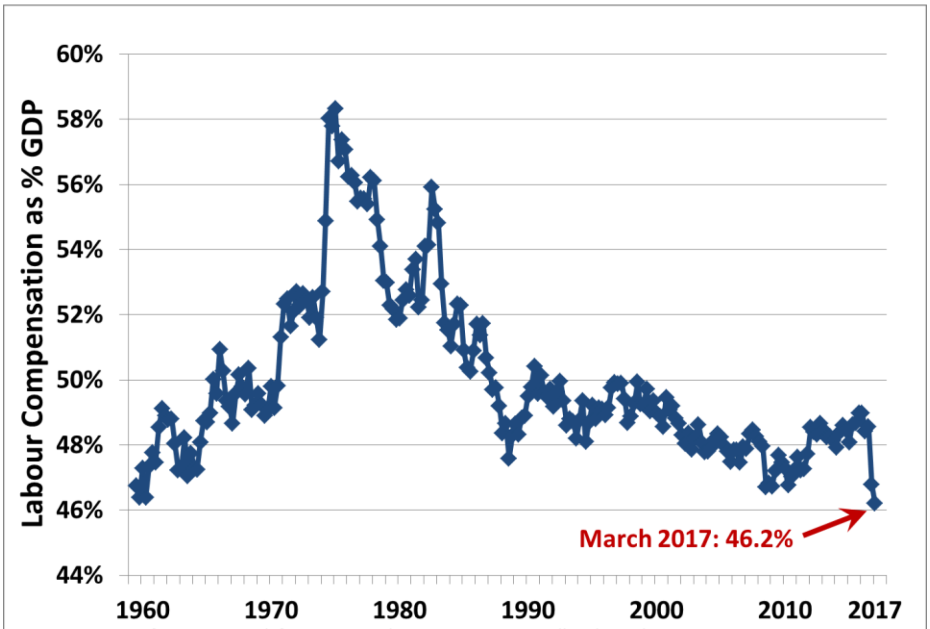
Amidst increasing concerns among economists and budget forecasters about the historic stagnation of Australian wages, the latest GDP statistics from the Australian Bureau of Statistics have confirmed that the proportion of national economic output that is paid to workers has reached an all-time low.

Figure 1. Labour Compensation as a Share of Nominal GDP

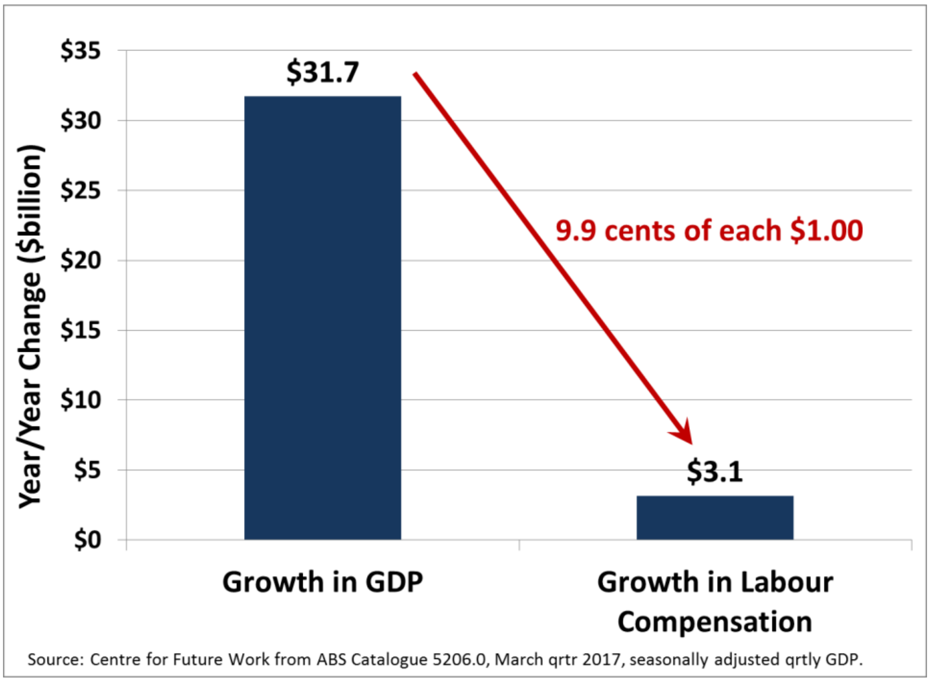


Source: Centre for Future Work from ABS Catalogue 5206.0, seasonally adjusted.
Employee compensation includes wages, salaries, and employer super contributions .

In GDP data released last week for the March 2017 quarter, total labour compensation (counting wages, salaries, and other compensation including superannuation contributions by employers) accounted for just 46.2 percent of total gross domestic product (Figure 1). That represents the lowest labour share of GDP since the ABS began publishing quarterly national income statistics in 1959. The previous low point for the labour share was 46.4 percent, set at the end of 1959.[1]

Labour compensation has fallen sharply as a share of GDP for two consecutive quarters, reflecting the unprecedented combination of stagnant nominal wage payments alongside rising total output. In the year ending in March, total quarterly nominal GDP grew by over $31 billion. But just $3.1 billion of that – only 9.9 percent of the new GDP – was reflected in higher labour compensation (Figure 2). In other words, of each dollar in new GDP produced in Australia over the past year, less than 10 cents found its way into increased labour compensation. That proportion (increased labour compensation as a share of increased GDP) was the smallest of any non-recession 12-month period in Australia's postwar history.[2] In short, the link between GDP expansion and workers' incomes has never been weaker.

Figure 2. GDP Growth and Labour Compensation



With new labour compensation accounting for such a small share of the incremental expansion in output, the labour share of GDP declined by 2.78 percentage points in the year ending in the March quarter. That represents the second-largest one-year drop in the labour share in the history of the ABS quarterly data. Only the 12-month decline in labour share experienced in late 1983 and early 1984 was larger.

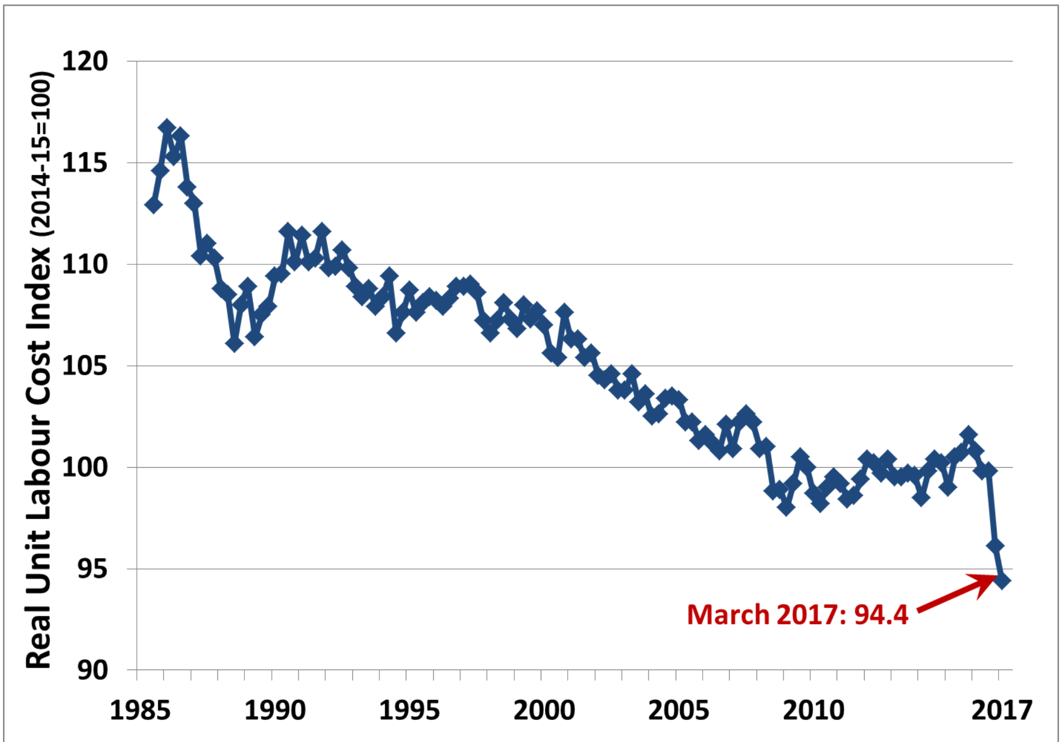
It should be noted that the measure of labour compensation in the preceding analysis is a broad one, and includes salaries paid to executives and top managers. Evidence

[1] Figure 1 illustrates the labour share calculated on the basis of seasonally adjusted GDP data; using trend data, a similar result is obtained, and the March 2017 labour share is also the lowest in the history of the data.
[2] During economic downturns nominal GDP may contract, in which case the ratio of the growth in labour compensation to the growth in GDP is not meaningful.

indicates that wage and salary income has become more polarized in Australia,[3] even as the overall share of labour compensation has been dropping. So the data above understate the true erosion of the share of national income going to employees *other* than top-tier executives and managers.[4]

Arithmetically, a declining labour share of GDP implies that average real compensation to labour is growing more slowly than real labour productivity (that is, real output per unit of work). On average, each hour of work in Australia's economy produces about $90 of value-added; adjusted for inflation, labour productivity has grown by almost 20 percent over the last decade.[5] Real wages, however, have grown only 6 percent over the same period[6] – less than one-third as fast as real labour productivity. With real labour productivity growing faster than real labour compensation, this implies that the share of produced output paid to labour must be declining.

Figure 3. Real Unit Labour Cost



Source: Centre for Future Work from ABS Catalogue 5206.0, Table 42, seasonally adjusted.

[3] See, for example, *Inequality in Australia 2015: A Nation Divided* (Strawberry Hills: Australian Council on Social Service), http://www.acoss.org.au/wp-content/uploads/2015/06/Inequality_in_Australia_FINAL.pdf.
[4] An effort to disaggregate the labour income paid to top executives from that paid to other workers was undertaken by Matt Cowgill, *A Shrinking Slice of the Pie* (Melbourne: Australian Council of Trade Unions, 2010), Appendix D, https://www.actu.org.au/media/297315/Shrinking%20Slice%20of%20the%20Pie%202013%20Final.pdf. Cowgill estimates that the labour share of national income excluding top executives is 3-4 percentage points smaller than the broader data described in Figure 1.
[5] Author's calculations from ABS Catalogues 6202.0 (Table 21), 5204.0 (Table 13), and 5206.0 (Table 7).
[6] As reflected by CPI-adjusted growth in the wage-price index; author's calculations from ABS Catalogues 6345.0 (Table 1) and 6401.0 (Table 1). Alternative measures of real labour compensation (such as inflation-adjusted weekly earnings, for example), show an even greater gap between realised labour productivity and real compensation.

Another indication of the same trend is provided by the decline in unit labour costs in Australia: which measures changes in real compensation relative to real productivity. If wages were growing in line with productivity (as many economists assume should occur automatically), then real unit labour costs should be roughly constant. Figure 3, however, indicates that real unit labour costs in Australia have declined steadily, because of the lagging of wages behind productivity.[7] In the March quarter, the ABS's real unit labour cost index (benchmarked to a level of 100 for the 2014-15 financial year) reached the lowest level ever in this historical series (which dates back to 1985).

The erosion of labour's share of national income is a long-standing phenomenon in Australia's economy. The labour share grew steadily during the postwar decades, driven by strong employment growth, strong unions, and the shrinking agricultural population. It peaked in the mid-1970s (at around 57 percent of total GDP), at that time reflecting a combination of rapidly rising real wages coincident with a macroeconomic slowdown. Labour's share fell over the next 15 years as anti-inflation policies were consolidated and labour laws transformed. After stabilising, a more gradual decline in the labour share took hold beginning in the late 1990s. But the sharp reduction in labour's share over the past year now seems to indicate a further structural break in the trend. The ongoing decline in real unit labour costs has been more consistent, but by this measure, too, the experience of the past year indicates an underlying break in the relationship between labour productivity and compensation.

The labour share has declined by a cumulative 11 percentage points of GDP since the mid-1970s. The erosion of the labour share since the peak represents the redirection of about $200 billion of annual output from workers to other economic stakeholders. By far the major beneficiary of that redistribution has been the private corporate sector, which has increased its share of GDP by about 10 percentage points over the same period – reaching 24 percent of GDP in the March quarter.[8]

Economists are working to better understand the breakdown of the traditional relationship between productivity and compensation, and the corresponding stagnation of wages in Australia.[9] The most likely explanations for falling unit labour costs and the erosion of labour's share of national income include:

- Institutions and instruments aimed at supporting wages have clearly weakened over the last 30 years. This is visible in indicators such as declining union density and enterprise agreement coverage, the erosion of the minimum wage

[7] While similar in concept, there are several methodological differences between the labour share of GDP pictured in Figure 1 and real unit labour costs illustrated in Figure 3 – for example, the latter includes a portion of mixed income of farms and small businesses that is attributed to the labour effort of proprietors.

[8] Measured by the gross operating surplus of financial and private non-financial corporations. It is interesting to note that the gross operating surplus of *publicly*-owned non-financial corporations has declined dramatically: from 4 percent of GDP in the early 1990s to less than 1 percent at present, primarily because of widespread privatisations.

[9] See, for example, James Bishop and Natasha Cassidy, "Insights into Low Wage Growth in Australia," Reserve Bank of Australia Bulletin, March 2017, https://www.rba.gov.au/publications/bulletin/2017/mar/pdf/bu-0317-2-insights-into-low-wage-growth-in-australia.pdf, or Cowgill (2010), op. cit.

(relative to median wages), and more. For example, the national minimum wage declined from 65 percent of median wages in 1985, to just 53 percent in 2015.[10] Trade union membership has declined to under 15 percent of paid employment, compared to over 40 percent in 1990, and coverage by enterprise collective agreements has also fallen correspondingly (to just over one in three workers as of 2016).[11] The enforcement of basic minimum standards has also become questionable (given lack of regulatory attention), further undermining their real effect in supporting wages. The weaker power of redistributive instruments directly undermines workers' collective ability to demand and win higher wages.

- Demand conditions in the labour market have been chronically weak for most of the past decade. The official unemployment rate (currently under 6 percent) no longer provides an accurate reading of the degree of excess labour supply, as it doesn't count other forms of unutilised labour (including involuntary part-time work, the potential supply of people "marginally attached" to the labour force, and other pools of surplus labour).[12] In this environment of ongoing labour market weakness, workers (both individually and collectively) feel less confident demanding higher wages.

- Wage determination has also been undermined by the shift toward more precarious, contingent job structures. Around half of all working Australians are now engaged in positions other than the once-"standard" practice of full-time, permanent employment with regular entitlements. This includes part-time jobs, labour hire positions, casual or temporary employment, independent contractors,[13] and self-employment.[14] Workers in these insecure settings find it particularly difficult to negotiate wage increases. And employers are easily able to respond to upswings in market conditions by incrementally increasing hours for existing employees, with no need to boost wages in order to attract more workers.

- The labour share of GDP demonstrates a cyclical pattern, in addition to a longer-run structural trend: it tends to rise modestly during recessions (because profits fall during an economic downturn), and then fall back during a recovery (as profits recover). The rebound in nominal GDP during the last two quarters

[10] "Minimum Wages Relative to Median Wages," OECD Employment and Labour Market Statistics, http://www.oecd-ilibrary.org/employment/data/earnings/minimum-wages-relative-to-median-wages_data-00313-en.

[11] ABS Catalogues 6333.0 (Table 16) and 6306.0 (Data Cube 9).

[12] Previous research by the Centre for Future Work suggests a more inclusive measure of labour market slackness would be in excess of 17 percent of the labour force – or three times as high as the official rate. See Jim Stanford, "Australia's Unemployment Rate Isn't What It Seems," *New Matilda* (August 10, 2106), https://newmatilda.com/2016/ 08/10/australias-unemployment-rate-isnt-what-it-seems/.

[13] Many of these "contractors" perform tasks once performed in standard paid jobs, but without the same security of work or income.

[14] Most of these self-employed workers have no employees other than themselves, and many are not even incorporated.

(following a decline in real output in the September quarter of 2016) is one factor behind the unusually rapid decline in the labour share in recent months.

- The composition of GDP growth, as well as its level, can impact the labour share. Two of the more important sources of recent GDP growth – the mining and financial sectors – are relatively capital intensive: generating relatively few jobs with each additional billion dollars of value-added output. This sectoral shift can thus reinforce the shift away from labour compensation toward profits. A related factor in Australia's context is the importance of global commodity prices (received for minerals exports) in nominal GDP. Higher commodity prices (as were experienced in later 2016 and early 2017) show up more directly in profits for minerals producers, than in labour income – all the more so given the aggressive cost reduction efforts undertaken by many minerals producers after the 2014-15 decline in commodity prices.[15]

The historical data on the composition of GDP also indicate two factors which clearly did *not* cause the decline in labour's share of total output. First, despite the growth of self-employment and contractor positions in recent years, the share of the "mixed income" earned by small businesses and self-employed individuals in total GDP has not increased. Thus the decline in the labour share cannot be attributed to workers shifting categories from employed to self-employed. While many employees have been shifted to nominally independent "contractor" positions, this has not expanded the overall share of small business in GDP – which has remained relatively stable at around 9 percent of GDP over the last quarter-century. Even though more individuals are now self-employed, the share of national income going to this sector has not kept pace, likely because small business incomes are squeezed by some of the same factors (such as weak aggregate demand conditions, and the strong market position of large companies) as have suppressed labour incomes.

Secondly, the relative importance of indirect taxes (such as the GST), net of subsidies paid back to business, has also been relatively stable, and hence cannot explain the decline in labour's share of GDP. Indirect taxes (net of subsidies) has accounted for a stable share of just under 10 percent of GDP for the last decade. This is about one percentage point larger than the share in the 1960s, but about one percentage point lower than the share in the years after the GST was first introduced after the turn of the century. Neither the role of small business, nor indirect taxes, can explain the decline in labour's share of total GDP, therefore. Instead, the dominant explanation for the dramatic shift in incomes across factors in Australia over the last generation clearly lies with structural changes in labour markets and the processes of wage determination.

In summary, the record low labour share of GDP recorded in the March 2017 quarter reflects a combination of the longer-run structural trend in income distribution (away from wages and salaries, toward profits and other forms of income), and immediate

[15] Global commodity prices have declined in recent months, suggesting that the dramatic growth in Australian profits recorded in recent quarters may be partly reversed in future GDP data. This may lead to a partial rebound in the labour share of GDP, but certainly will not reverse the longer-run structural trend.

factors (such as the sharp rise in commodity prices last year). What is evident, however, is that the traditional expectation that future expansion in GDP will automatically lift wage incomes is no longer valid. Wages no longer rise in tandem with either aggregate economic output nor with labour productivity. The traditional redistributive institutions which helped to create and maintain a correlation (evident in the initial postwar decades) between growth, productivity, and wages, have been battered by years of government neglect or outright hostility.

These findings indicate the need for a systematic effort by policy-makers to rebuild and modernise the institutions that regulate income distribution. There is no reason to believe anymore (if there ever was) that economic growth alone will "lift all boats," and automatically "trickle down" into wages and salaries for working Australians. They can work more productively, and produce a larger economic pie. But they need pro-active supports (including stronger and more comprehensive minimum wages, protecting penalty rates rather than cutting them, strengthening employment standards, and rebuilding collective bargaining) to win a fairer share of that pie.

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