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Jobs and Skills Summit Research Note

Does the Decline in the Labour Share of National Income point to the Affordability of a General Rise in Real Wages?

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Synopsis

The argument has been made that businesses across the economy can afford to lift wages because there has been a distinct fall in the labour share of income and a rise in the capital share of income.

This note digs into the changes in income shares and concludes that:

- For over 80 per cent of the economy, including most employees and most Australian industries, the labour share of industry income has not declined
- The decline in the labour share of national income does not support the proposition that businesses in general have a greater share of industry income from which they can pay higher wages.

The note also discusses the large stakes that current and former employees have in the higher capital share of national income.

Does the Decline in the Labour Share of National Income point to the Affordability of a General Rise in Real Wages?

Introduction

The argument has been made that businesses across the economy can afford to lift wages because there has been a distinct fall in the labour share of income and a rise in the capital share of income.

This note digs into the changes in income shares and concludes that:

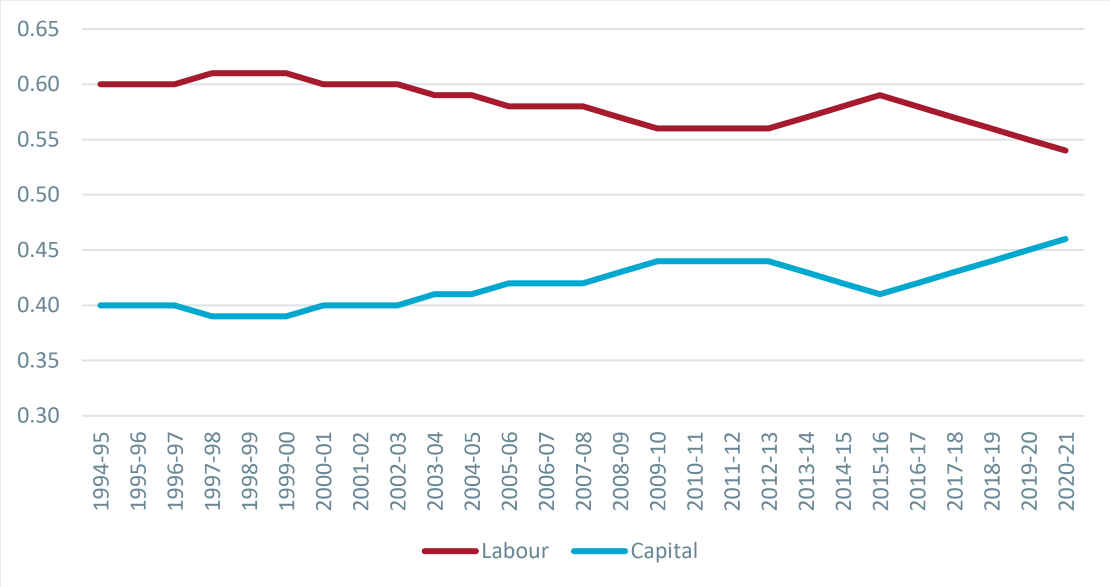
- For over 80 per cent of the economy, including most employees and most Australian industries, the labour share of industry income has not declined
- The decline in the labour share of income is more nuanced than may appear at first sight and it does not support the proposition that businesses in general have a greater share of income from which they can pay higher wages.
- Aside from the share of national income related to labour income, Australian workers also have considerable stakes in capital income

Income shares

Chart 1 looks at the most recent ABS measures of labour and capital income shares in the market sector of the economy[1] over the past quarter century. It records an uneven decline in the labour share and a commensurate rise in the capital share of market sector income in the years since 1994-95.

[1] The market sector excludes education, health and public administration as well as the share of national income associated with the ownership of dwellings.

Chart 1: Labour and Capital Income Shares in the Market Sector: 1994-95 to 2020-21



Source: ABS, 2021, Estimates of Multifactor Productivity Growth (5260.0.55.002, Table 2).

A few years ago (2019) the Reserve Bank of Australia (RBA) examined the labour and capital income shares in Australia and observed a similar overall trend not only in Australia but also across OECD countries.[2]

The RBA paper covered a longer period than in Chart 1 above although its only had available data to 2018. Its conclusions nevertheless remain highly relevant.

The central conclusion in relation to the labour share in the market sector of the Australian economy in the years to 2018 was: "Excluding the financial sector, the *aggregate* labour share of income has been unchanged since 1990" (see Chart 2).[3]

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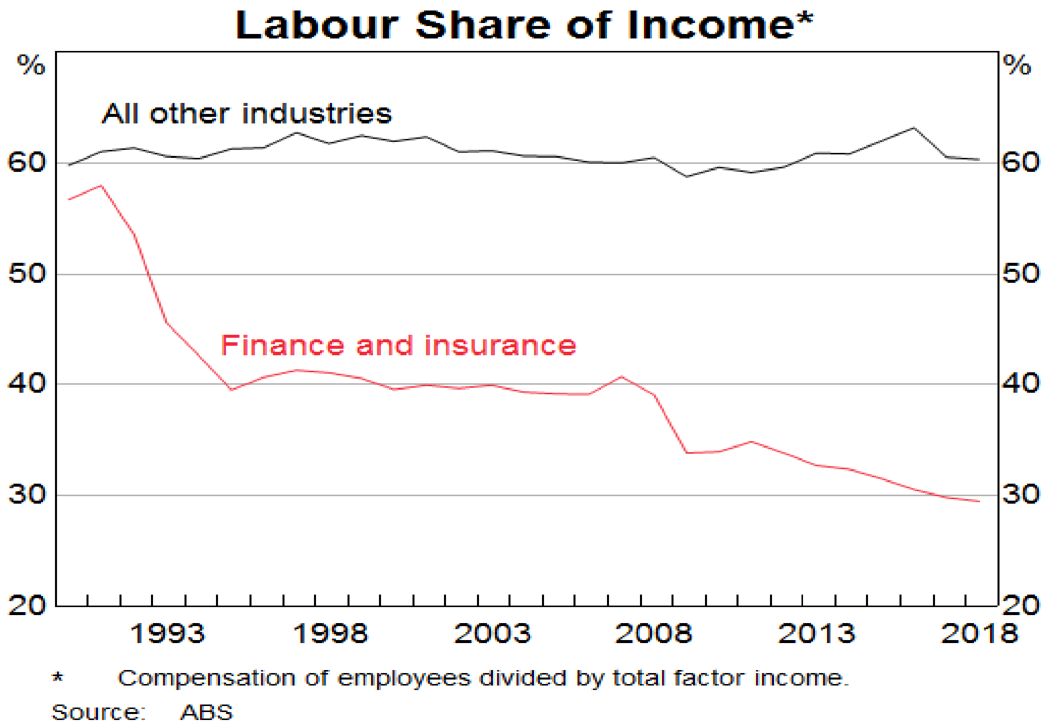
[2] Gianni La Cava, The Labour and Capital Share of Income in Australia, RBA Bulletin, March 2019.

[3] RBA 2019 p.13 (emphasis added). The market sector excludes education, health and public administration. The RBA paper also looks at incomes shares in some of the non-market sectors finding a small increase in the labour share in health and a small fall in the labour share in education.

Chart 2: Labour Income Shares: Finance & insurance sector and all other industries (RBA 2019)



What happened in the finance sector?

The RBA analysis of the decline in the labour share in the financial sector found the decline related to:[4]

- The impacts of structural changes including financial sector deregulation
- The relatively sharp rise in multifactor productivity associated with the much stronger investment in labour-saving information technology in this sector compared with the rest of the economy.

What happened in other industries?

The RBA also noted a dispersion of experience among non-finance sector industries finding small falls in the labour share in utilities, mining and transport and offsetting small rises in the labour share in many services industries including rental, hiring and real estate services, administrative services and "other services".

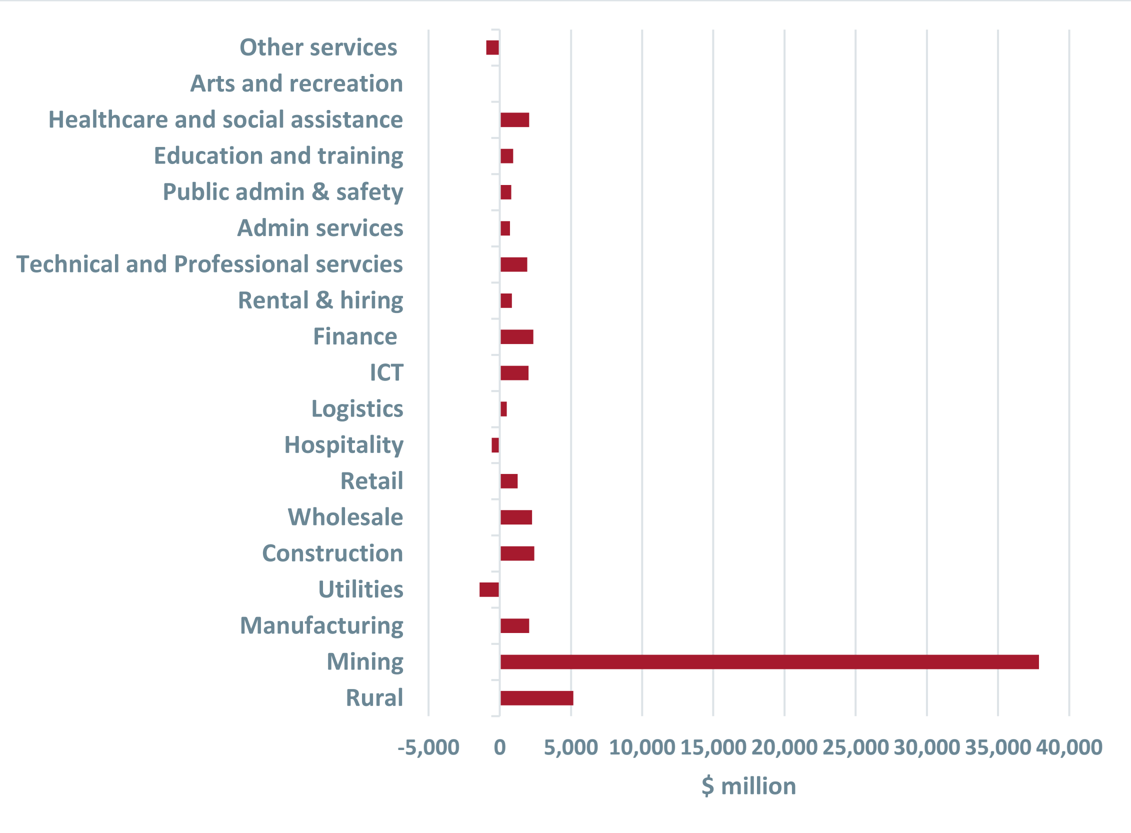
Interestingly the impact of the mining sector on income shares, at least in the period to 2018 covered by the RBA paper, was considerably less decisive than the financial sector changes.

[4] RBA 2019: pp. 11-12 (the RBA also attributed some of the decline in labour share to technical issues in the measurement of finance sector output).

Over this period (1990–2018), the mining sector saw a fall in the labour share of sector income of less than ½ a percentage point.[5]

Since about 2010 the impacts of the mining investment boom and periods of sharp increases in commodity prices have had a greater impact on income shares and since 2018, as shown in Chart 1 above, there was a further fall in the labour share of national income. The dominant share of this further fall is attributable to the surge in mining profits driven by commodity prices. This surge is highlighted in Chart 3 below.

Chart 3: Change in gross operating surplus (GOS) and gross mixed income ($m): March quarter 2018 to March quarter 2022



Source: ABS National Accounts, Table 45.

In the four-year period from the March quarter of 2018, the mining sector accounted for over 60% of the increase in Gross Operating Surplus.[6] This from a sector that contributed around 10% of gross value added in the March quarter of 2022.

It is clear both from the RBA analysis of the period to 2018 and the dominance of mining in profits in the period since 2018, that the change in the income share of market sector income

[5] With mining making up considerably less than 10 per cent of GDP over the 1990-2018 period, the impact of mining on the aggregate labour share across the economy was only a small portion of the overall trend decline.

[6] These proportions exclude GOS and GVA attributed to the ownership of dwellings. The measure used here for GOS includes gross mixed income and will somewhat understate the mining share in profits.

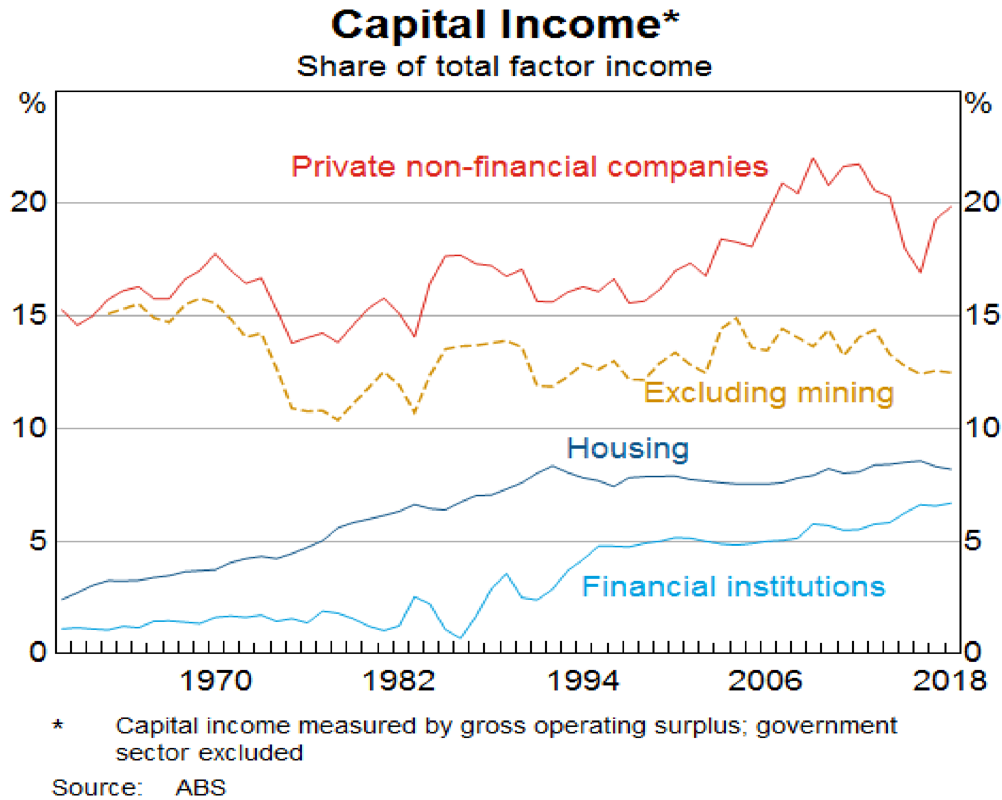
has been concentrated in just two sectors: mining and finance & insurance. Outside of these sectors, the labour share of market sector income has not fallen.

In March 2022 mining made up of about 10.8 per cent of gross value added and finance & insurance made up about 6.1 per cent.[7] Thus, for the vast bulk (over 82%) of the Australian economy, the labour share of industry income has not fallen.

Housing and the increase in the capital share of national income

A considerable portion of the RBA paper is devoted to the role of housing in the change in the capital share of national income. Housing is not part of the market sector discussed above but the returns to investments in housing are decisive in the increase in the capital income share and therefore also in the fall in the labour share of total national income.

Chart 4: Components of Capital Income: 1960 to 2018 (RBA 2019)



The central conclusion by the RBA in relation to housing was:[8]

> *The increase in the housing capital income share … is due to a higher share of domestic income being paid in rents, including both higher cash rents paid to landlords and, even more noticeably, higher rents imputed to homeowners.*

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[7] ABS, National Accounts (not including GVA attributed to the ownership of dwellings).
[8] RBA 2019, p.7.

The increase in the returns to housing constitutes a large portion of the increased capital share of national income and therefore is an important component in the fall in the labour share of national income. It is not, however, something that can be used to support an argument about the general affordability of wage rises.

Claims on the higher share of capital income

A major and growing share of Australian investment is undertaken by superannuation funds on behalf of their members. According to the ABS[9], between mid-1988 and June 2022, the total Australian held assets of superannuation funds increased from around $77 billion to around $2,817 billion (an increase of over 3500%). Overwhelmingly, super fund members are current and former employees with the funds in Australian superannuation sometimes referred to as "workers capital". The claims on this income are widely dispersed. The rising share of "workers capital" in the capital share of national income is an important, if complicating, consideration for the conclusions that can be drawn from the decline in the labour share of income.

As discussed above, economy-wide capital income also includes the returns to housing. Most of these returns are widely dispersed among owner-occupiers which include many current and former employees. Further, ownership of rental accommodation is also widely dispersed with considerable representation among current and former employees. Thus, a good share of the housing income segment of capital income could also be characterised as "workers capital".

Concluding comments

Changes in the labour share of income in the national income cannot be taken at face value. In the market sector of the economy, the changes stem from developments in just two sectors: mining and finance & insurance. For the remaining 82 per cent of the economy there has been no fall in the labour share of income.

The fall in the labour share of market sector income does not therefore support the proposition that businesses in general have access to a greater share of industry income from which they can pay higher wages.

Beyond the market sector, a further factor in the fall in the labour share of national income is the rise in the share of national income attributed to the ownership of dwellings. This source of income growth is a significant contributor to the rising capital share of national income. It certainly could not be used to support an argument about the affordability of wages rises.

Finally, any consideration of the fairness or otherwise of the growth of the capital share of income needs to consider the rising and widely dispersed claims on capital income that accrue to the current and former employees who are members of superannuation funds and/or owners of houses.

[9] ABS, 2022, Managed Funds, Australia (ABS 5655.0, Table 4).

Australian Industry Group contact for this report

Peter Burn | Chief Policy Advisor
The Australian Industry Group
peter.burn@aigroup.com.au