Interview with MP Andrew Leigh
June 2014

Jonathan: Andrew, you've been researching and talking about inequality for a long time. I actually have your work on inequality sitting on my desk at home.

Andrew: Good. Glad to hear it.

Jonathan: In a stack of to be read along with Pikkety's book as well actually. So the first question I have for you is why is inequality such an important issue?

Andrew: I think inequality is a public good. This is something that economists have touched on from time to time, but there is a notion that not just the poor benefit from their incomes being closer to the rest, but that people right across the income distribution would prefer to live in a more egalitarian society.

I've always liked the John Rawls *Failure of Ignorance* way of thinking about this, where he says imagine what sort of an income distribution you'd want if you were in utero about to be born into a society where you didn't know if you'd be born into the top 5^{th} or the bottom 5^{th}. Would you want the kind of Australia where the top 5^{th} has 62% of the wealth and the bottom 5^{th} has less than 1% of the wealth? If you knew that there was an equal probability of you ending up in either of those two quintiles, or would you maybe want a more egalitarian distribution of income.

And we know as a practical matter that more egalitarian societies tend to be more socially mobile societies. As the gap between the rungs in the ladder moves further apart it becomes harder and harder for a poor kid to climb the ladder over the course of a life time. So the post code into which you are born increasingly determines your destiny as societies become more unequal.

Jonathan: Inequality has increasingly launched itself into the centre of global discussion and discourse over the last few years. Thomas Piketty's new book appears to have taken the world by storm. Can you provide a brief synopsis of your take on Piketty's work?

Andrew: So first of all there's something thrilling to me about the idea that in the age of Twitter a 700-page hardback book by a French economist can take the world by storm. There's hope for our polite conversation yet.

Thomas Piketty was the founder of the approach of using taxation statistics, national accounts, and population data to together estimate top income shares. he did it for France in the late 1990s. Tony Atkinson read his book in French. Did it for the UK. And then a variety of other people estimated top income series for other developed countries, including Tony Atkinson looking at Australia.

And Piketty essentially uses those data and a host of others to map out why inequality fell so much in Europe from the 1800s to the 1900s and why it's risen principally in the Anglo-Saxon countries in the past generation. He focuses on the role of capital, and he talks about what he calls the Iron Law that when the rate of return on capital, the percentage gain that you get if you're an owner of a house or a bundle of shares tends to be greater than the overall rate of growth in the economy.

So he says when R > G, when the rate of return on capital exceeds the growth rate, then societies will tend towards inequality. I think this is an important theory. It's really important to think about capital shares. But for countries like the US and Australia, it doesn't explain the bulk of what's gone on over the past generation, which is actually to do with rising dispersion in wage incomes. The gap now between what an anaesthetist earns and what a cleaner earns is significantly higher than it was in Australia a generation ago.

Jonathan: So why do you think inequality in recent years, from about 2007-08 onwards has really launched itself to the centre of global discourse? What's changed?

Andrew: There's a lot of Henry Aaron's line from the late 1970s, where he said that at the stage, studying inequality was like watching the grass grow. And it reflected the fact that for a long period inequality had been softly trending downwards and had reached a period of stability in the 1960s and '70s. Part of the reason it's come into global prominence now is because it is like watching the grass grow on one of those super fast forward movies.

The top 1% share on Australia has doubled over the last generation. The top 0.1% share has tripled. We've seen a doubling in Porsche sales, a quintupling in Maserati sales, more helicopters, more private planes per head of Australians than in the past, so people can just see around them that Australia is becoming more unequal than it used to be.

I think the reasons for the rise in Australian inequality are three-fold. Superstar labour markets, driven by a combination of technology and globalization, which have acted together like a forced multiplier for people who are at the top of their game to increase the gap between what the CEO earns and what the average worker earns.

Secondly, the collapse in union density in Australia from half the workforce in 1980 to less than a 5th of the workforce today. Unions are a strong force for equality. And the sidelining of unions from the Australian workplace has increased the gap between rich and poor. And thirdly, cuts in top tax rates. And there were good reasons why we went down from a top tax rate of 93% in WWII to 70% in the 1970s to 40-something% today. But it is unambiguous to me from the evidence that those reductions in top tax rates played a rise in rising inequality. So they're my big 3 explanations - superstar labour markets, de-unionization, and cuts in top tax rates - for the increase in inequality that Australia is seeing.

Jonathan: Okay. I'd now like to turn the conversation toward the developing country context. The conventional developing country economic theory has said *a rising tide will lift all boats. Don't worry about inequality. As countries develop. Just grow-grow-grow as fast as possible*, but we've noticed in recent years that developing countries are observing an increase in inequality, larger than conventional rates of developing countries in the past. Should we, or developing countries themselves, by worried about this trend?

Andrew: Yes, absolutely. And I think it's most pronounced in China, where you've seen very large increases in inequality, and where some of our early analyses of inequality have somewhat understated the extent of inequality because the surveys have been based in urban China.

Once you have surveys to take into account rural China as well, you get a picture of a nation where the gap between the haves and the have nots has gone up significantly. Interestingly, China is also a country with very static social system. In work that I've done with co-authors at the Australian National University we found that the degree of social mobility, the ability of sons and daughters to move into a different income bracket from their parents in China was very limited. That Chinese society is even more static than say, the United States, which had previously been regarded as one of the least socially mobile societies around.

And as inequality rises, it's again that thing about the gap between the rungs in the ladder. Big gap between the rungs in the ladder in China will make it very hard for young Chinese born into modest circumstances to really make it. That's I think why you're seeing some of the pushback against the princelings, for example. A frustration among ordinary Chinese that the game is rigged against them.

That's just the story of one developing country, but I think similar observations can be made about inequality in a range of other developing countries. The work that Pierre van der Eng and I have done estimating top income shares in Indonesia, for example, was partly us pushing back against the World Bank view that Indonesia growth had been highly egalitarian.

And they again had that picture because they had been surveying expenditure rather than income. And the distribution of what people spend is always more equally shared than the distribution of people's incomes, because the rich share a large share of their income, and the poor don't save anything. So throwaway savings in a society can artificially look more egalitarian than it really is.

And we're able to show that Indonesian inequality is relatively high and rising.

Jonathan: A lot of developing countries rich in natural resources, especially in Africa, have been posting robust growth rates for the last decade. Do you think these growth rates can mask the fact that this growth might not be shared across the whole populace.

Andrew: Yeah, I mean a growth rate is always a mean. And the more inequality you get, the less your growth rate tells you what's happening to the typical person.

In some sense, just as we have median house price indices, and so house prices don't get skewed by the sale of multi-million dollar mansions, it would be ideal to have median income growth statistics for countries. it just turns out that's a really, really difficult number to put together on any high frequency basis. But the challenge for developing countries, as indeed it is for developed countries, is to make sure that the benefits of minerals are widely shared.

One of the most important development economic books that I've read over the last decade has been Paul Collier's *The Plundered Planet*, which very clearly argues that there's the potential for developing countries to turn the resource curse into a resource blessing, but it requires very careful policies, things like publically available geological surveys, auctioning of the mineral's rights, and transparency of the taxation flows. These are fundamental to making sure that the average person in a country benefits from a find of diamonds as distinct from suffering, which has been the standard story in Africa.

Jonathan: So turning again to Australia, which is hosting the G20, as we all know, and the C20 has been lobbying to have inequality recognized in the Brisbane G20 communiqué. Is inequality a topic that the G20 should be taking on? Or is it, since it is a function mainly of domestic policy, is it something that should be left to individual governments?

Andrew: Well the G20 discusses issues that are both international and comparative, that is issues which naturally flow across borders and common challenges that countries are facing. So in the global financial crisis, the G20 focused very much on common strategies for making sure that domestic unemployment didn't rise too high. That was an important role in the G20 and Australia pushed very strongly for that to happen.

I find it very strange that the G20's agenda was inclusive growth in Russia last year, but now that it's come to Australia, a nation with a proud history of egalitarianism, our government has decided to drop off the word *inclusive* and just focus on growth. that misses the fact that growth isn't an end in itself. it's a means to expanding well-being across the population.

And I worry that Tony Abbott and Joe Hockey aren't aware that they're senior leaders in a country that has experienced very large increases in inequality over the course of the last generation and where inclusive growth ought to be natural. I mean Hilda spoke at the launch of a report on inequality on Tuesday of this week, and former liberal leader John Hewson was there. And he was bemoaning the rise in inequality which has occurred and what he saw as the measures in the budget that would exacerbate that.

If a former member of the liberal party can see that, I very much would like to see the current leader of the liberal party recognizing it. So yeah. C20 has done exactly the right measure.

Jonathan: So G20 is a good forum for inequality to be discussed and try to be tackled.

Andrew: Absolutely. These are important challenges. They certainly have an international dimension. So the question of base erosion and profit shifting by multi-national companies is fundamental. If you can fairly tax multi-nationals, then you will be better able to manage inclusive growth within your society. You won't then need to cut back on pensions, for example, because you've lost $1B of revenue to multi-national profit shifting.

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Jonathan: So Piketty in his book talks about innovative taxation methods. Many of have been lobbying around innovative finance for global public goods for decades, since the days of the Tobin tax. Why is it so hard to orchestrate tax methods of this kind, and do you think they're a good?

Andrew: I think that Thomas Piketty's proposal for global wealth taxes will actually come to nothing. And I think instead we ought to be focusing on two Australian goods. One is making sure we have as few loopholes as possible in our tax laws. This is standard economics that you want to have broadly based taxes because then the rates can be as low as possible. If you have as many holes as Swiss cheese, then you need a bigger block of cheese in order to get the same nutritional value.

I don't see much of a push on this from the current government. And we talked before about the $1B they've taken out on multi-national profit shifting measures, where Labour would have pursued those measures harder. The other thing is just making sure that we're disproportionately investing in the most vulnerable. Tackling inequality isn't going to be about putting lead in the shoes of the fastest runners.

It's about looking at the pack about to start the race and noticing that there's a kid who's starting 10m behind everybody else and doesn't have a pair of school shoes. And that unless we put disproportionate resources into high quality preschool programs for indigenous children, unless we make sure that literacy and numeracy gaps are closed in schools, unless we have means-tested social safety net which continues to direct income support disproportionately to the poorest ,then we're not going to work to close the gap.

And by the way, if you care about gender pay gaps, if you pay about the gap between indigenous and non-indigenous Australians, then you must care about inequality.

Jonathan: Just quickly, one final question back on the G20, if you were in Tony Abbott's shoes, and inequality was on the agenda at the G20, what would be your pitch to the G20 about how to tackle it on a global scale?

Andrew: I think Australia has a good story about to tell about our means-tested social safety net. Ours, according to the data from Peter Whiteford, the Australian social security system does more to target resources at the most vulnerable than any other country in the OSCD.

I'd be proud too of Australia's record of two decades of uninterrupted growth, because you can't tackle poverty and disadvantage in a stagnant economy. It's very hard to be generous to the poor at home, let alone those overseas if you're not enjoying growth. But then also to recognize that there's things Australia can be doing better. We can probably do a better job of evaluating our social programs. And there's plenty of G20 nations that much more rigorously evaluate their educational and social interventions than Australia. And I'd be keen to learn from them, and particularly keen to show leadership in the area of base erosion and profit shifting.

Tony Abbott talks a good game on base erosion and profit shifting. But the only thing he's done since coming to office is to open loopholes which are very tough to close.

Jonathan: Okay Andrew. Thank you very much for your time.

Andrew: Thanks for the opportunity.

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