Profit share

Exploring data on profits in the Australian economy

The roles of profits, wages and costs in driving inflation has been widely discussed in recent months. Claims by the Business Council of Australia that profit shares are at a 20-year low are not supported by official data sources.

Discussion paper

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Introduction

In recent months the relative role of wages, costs of production and profits in driving inflation in Australia, and around the world, has been widely discussed. However, as is often the case in Australia, even simple questions such as ‘is the profit share rising or falling?’ and ‘have wages or profits played a bigger role in driving inflation?’ have become contested.

For example, while the Australia Institute and the ACTU[1] have argued that profit growth has contributed more to inflation than wage growth, and that the profit share of GDP is at historically high levels, the Business Council of Australia (BCA) is arguing the exact opposite. For example, the CEO of the BCA, Jennifer Westacott was recently reported as complaining that recent focus by the unions on the size of profits in Australia created an “us v them” narrative. Moreover, she was reported as saying that once mining profits were removed, the profits share of income had actually fallen to its lowest point in 20 years.[2] While it is of course possible that Ms Westacott was misreported, no corrections have been issued. And while she may have provided data to support her claim, the journalist who wrote the story made no reference to it, nor has the BCA provided any data to support their claim on their website.

Intriguingly, soon after Ms Westacott’s claims were reported the BCA’s Chief Economist, Stephen Walters, made a related, but significantly more cautious claim, namely:

> After excluding the miners and banks which are distorting this data and where wages are among the highest in the nation, the broader profit share actually has fallen.[3]

Not only does Mr Walters suggest that it is useful to exclude the profits of two industries to understand what it happening to profits in Australia (rather than just the one identified by his CEO) he makes no claims about the relevant period for analysis (as opposed to his CEO’s claim about trends over the last 20 years). Neither Ms Westacott nor Mr Walters explain why they are excluding an arbitrary number of profitable industries from their analysis of profits. But, as discussed below, if the volatility or recent growth of profits in some sectors is the explanation for their exclusion then it seems unusual that sectors with volatile or rapidly growing wage bills would not also be excluded from their analysis.

This paper presents a wide range of data from the Australian Bureau of Statistics (ABS) that suggests, contrary to recent claims made by representatives of the BCA, the profit share of GDP is rising.

[1] Taylor D (2022) “Corporations' profits soaring as inflation skyrockets and real wages fall, report reveals”, ABCNews, 3 August.

[2] Marin-Guzman D (2022) “Business says unions’ profit focus creates ‘us v them’ narrative”, *Australian Financial Review*, 22 July.

[3] Walters S (2022) “Business is not profiting at the expense of workers’ wages”, Australian Financial Review, 7 August.

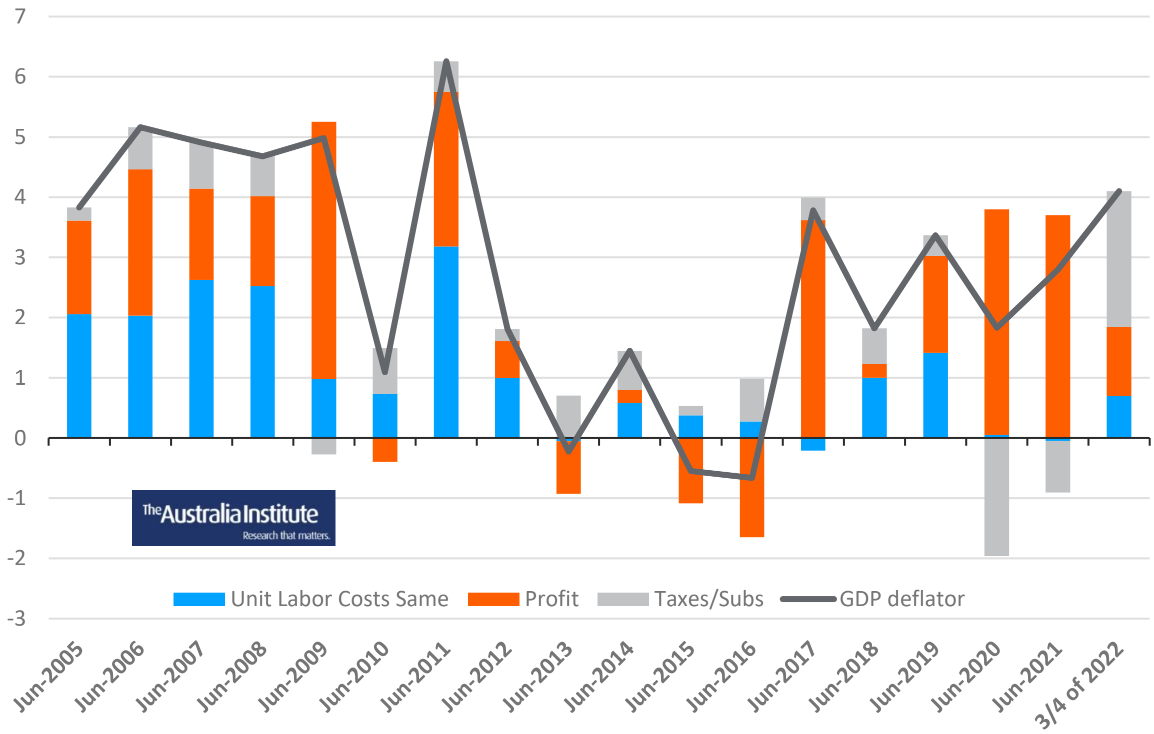
While the topic of this paper may seem esoteric, it is important to consider the consequences for policy debate in Australia of the inability of different groups to agree on thing as simple as whether profits are currently at historically high or low levels. As has been shown with climate change, if groups cannot agree on the nature of a problem it is difficult, if not impossible, for them to develop solutions.

What is driving inflation?

The Australia Institute recently published an analysis of the relative contribution of wages and profits to inflation in the Australian economy based on a method developed by the European Central Bank.[4]

The results, presented in Figure 1, decompose the GDP deflator, a wide definition of price increase, into its constituent income components of wages, taxes less subsidies, and profits. The method is explained fully in the analysis just referred to.

Figure 1: Components of price increases in Australia, percentage point contributions.



Source: Richardson D, Saunders M and Denniss R (2022) Are wages or profits driving Australia's inflation? An analysis of the National Accounts, July at https://australiainstitute.org.au/wp-content/uploads/2022/07/Are-wages-or-profits-driving-Australias-inflation-WEB.pdf

Figure 1 clearly shows that the contribution to inflation of labour costs has been very low which is consistent with simple analyses of ABS data showing that the wage share of GDP is falling and the profit share is rising (see below).

[4] See Richardson D, Saunders M and Denniss R (2022) Are wages or profits driving Australia's inflation? An analysis of the National Accounts, July at https://australiainstitute.org.au/wp-content/uploads/2022/07/Are-wages-or-profits-driving-Australias-inflation-WEB.pdf

How are profits measured in the national accounts?

Just as different company accounting concepts will likely result in different estimates of profit for an individual firm, different concepts in the national accounts will deliver different estimates of the amount of 'profit' earned in the economy as a whole. That said, it is important to note that the term 'profit' is not used within the national accounts. Rather, the following terms are used and the data presented below reflects these concepts.

- Gross operating surplus (GOS) is the surplus accruing from the production of enterprises, and from the ownership of dwellings. For the general government sector, GOS is equal to the consumption of fixed capital.

- Gross mixed income (GMI) is the surplus accruing from the production of unincorporated enterprises.[5] Mixed income refers to income of the unincorporated sector which the ABS calls "mixed" because it includes wage-like income as well as the profits that accrue to the owner/managers of unincorporated businesses.

The gross operating surplus is further split by the ABS into 'private non-financial corporations' and 'other' while mixed income is also included among the total primary incomes that make up total value added in Australia. Together with compensation of employees, the GOS and GMI comprise the sum of the primary incomes, as the ABS defines them, that are generated from economic activity in Australia.

When the ABS discusses the components of total primary incomes it then uses these components of value added, namely compensation of employees, the gross operating surplus and mixed income. For example, the March release of *Australian National Accounts: National Income, Expenditure and Product p*rovides data on the growth in each of these components of income which are summarised in Table 1 which is adapted from the ABS national accounts and has an additional row to represent total value added/primary incomes. This has been added just so the sum total effect of all income categories is apparent before adding taxes less subsidies on production and imports.

[5] https://www.abs.gov.au/statistics/detailed-methodology-information/concepts-sources-methods/australian-system-national-accounts-concepts-sources-and-methods/2020-21/chapter-21-state-accounts/gross-operating-surplus-and-gross-mixed-income

Table 1: Income components of GDP, nominal values seasonally adjusted.

	% Change	% points contribution to growth in GDP
	Dec 21 to Mar 22	Dec 21 to Mar 22
Compensation of employees	1.8	0.8
Gross operating surplus		
Private non-financial corporations	7.3	1.6
Other	1.2	0.1
Gross mixed income	-2.7	-0.2
Value added/Primary income components	na	1.5
Taxes less subsidies on production and imports	15.7	1.4
Gross domestic product	3.7	3.7

Source: Adapted from ABS (2022) *Australian National Accounts: National Income, Expenditure and Product, March 2022*, 1 June.

Table 1 highlights how the ABS organises its data and breaks down the incomes accruing to labour and capital respectively.

The data on income from both wages and profit is presented before tax and before any interest payments or nominal expenses such as depreciation or provisions for annual leave. Gross mixed income is also treated similarly in that it is pre-tax and interest and depreciation expenses are not deducted. Elsewhere the ABS clearly defines the concepts included in Table 1.[6] The ABS makes it clear that when considering income shares the components of value added have to be examined.

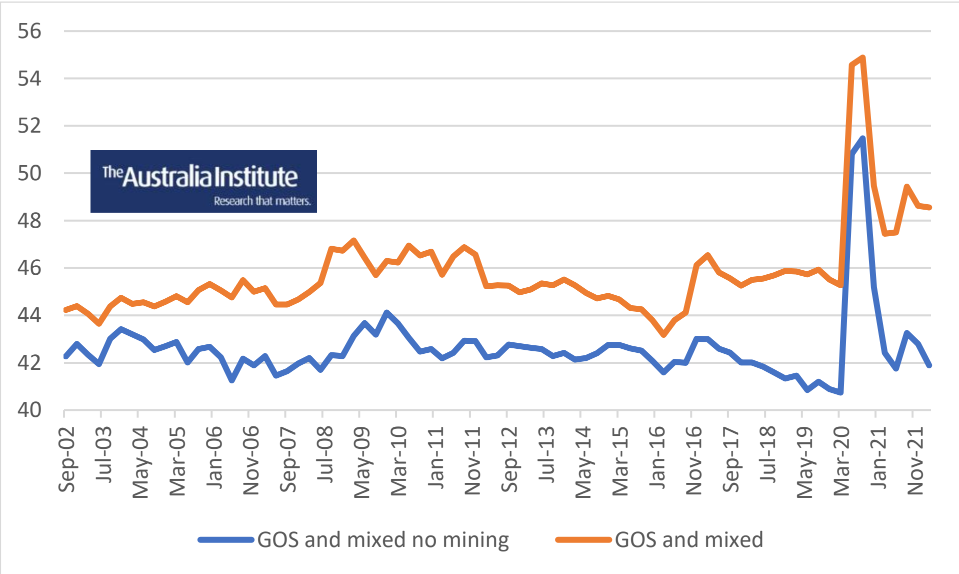
[6] ABS (2021) *Australian System of National Accounts Concepts, Sources and Methods* at https://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/29225F69B784BD1CCA25870C0021C201/$File/5216.0_2021.pdf

Measuring profit as a percentage of GDP

Each of the components of national income described above can be expressed as a percentage of GDP or of a portion of GDP. When talking about the profit share of GDP, for example, it is important to make clear which notion of profit is being used (such as Gross Operating Surplus, mixed income, or both) and when some industries (such as mining or finance) are excluded from the measure of profit care should be taken when deciding whether or not to exclude those same industries from GDP.

Figure 2 shows both the Gross Operating Surplus and mixed income as a share of GDP with and without mining. Note that mining's contribution is deducted from the GOS and its contribution to GDP is deducted from GDP itself.

Figure 2: Gross operating surplus and mixed income as % of GDP with and without mining



Source: ABS (2022) Australian National Accounts: National Income, Expenditure and Product, March 2022, 1 June.

From Figure 2 it is evident that the profit share (orange series) has increased over the last 20 years, albeit with significant volatility during the pandemic which saw a large public injection in the form of JobKeeper and a significant reduction in the denominator (GDP).

Figure 2 also shows the effect of removing the mining industry on the trend in the profit share of GDP (blue series). While profits without mining are inevitably lower than profits including mining it is interesting to note that the gap between the two series has more than trebled over the last 20 years from around 2 percent of GDP to over 6 percent. This gap is not a recent phenomenon, and the growth of this gap is precisely why so many economists have been calling for the introduction of some form of resource rent tax for so long as mining activity can have significant adverse impacts on the broader economy (known as Dutch disease), a point that seems to be missed by those suggesting our focus should be on profits in the non-mining sector.

While it is true that when only the profits of the non-mining sector of the economy are considered the strong upward trend for profits is not apparent, the data presented in Figure 2 does not support the claim made by Ms Westacott that the non-mining profit share of GDP is at its lowest level for 20 years. Indeed, Figure 2 shows that post COVID the non-Mining profit share surged to its highest level in 12 years although it did fall in the March 2022 quarter.

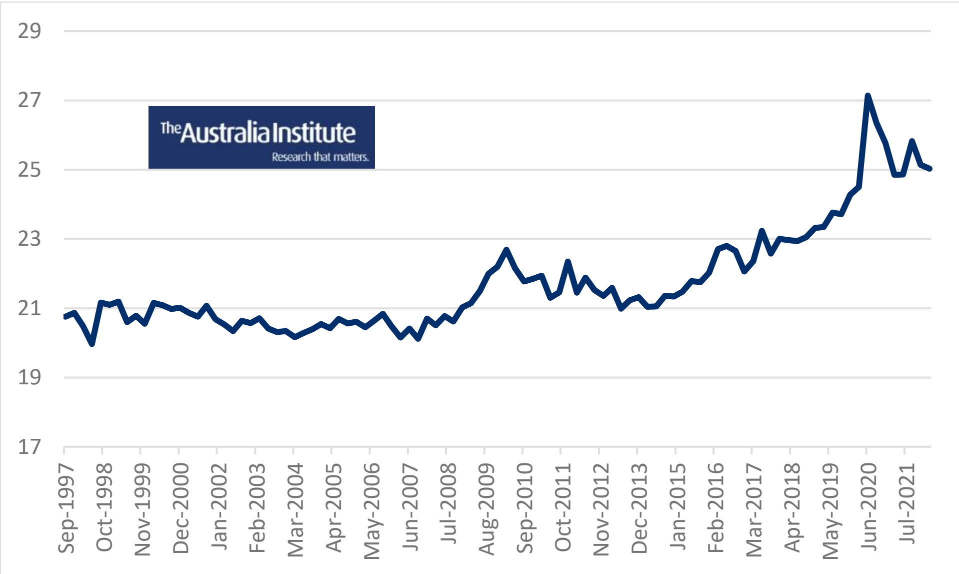
Measuring profits as a percentage of value added

Australia has recently experienced a significant decline in real wages at a time of positive economic growth which, all other things remaining equal, should inevitably result in a reduction in the wage share of GDP and an increase in the profit share. That said, all other things rarely remain equal.

As shown in Figure 3 there has been a strong upward trend in the size of the public sector since the Coalition were elected in 2013.

The ABS data is presented in Figure 3 as a share of GDP. It uses seasonally adjusted data for general government consumption expenditure plus gross fixed capital formation.[7]

Figure 3: General government as a share of GDP, %.



Source: ABS (2022) *Australian National Accounts: National Income, Expenditure and Product, March 2022*, 1 June.

The strong upward trend in government spending shown in Figure 3 may well have a large impact on the nature of the Australian economy. As the government sector is very labour intensive and generates very little gross operating surplus, the effect of such a large expansion of the government sector is to impart a bias towards growth in the wage share of GDP which is why it is also important to consider the relative wage and profit shares of the private sector as the ABS does in its annual *Australian Industry* series.[8]

[7] General government expenditures exclude the activities of public corporations.

[8] NB the ABS data excludes the finance sector

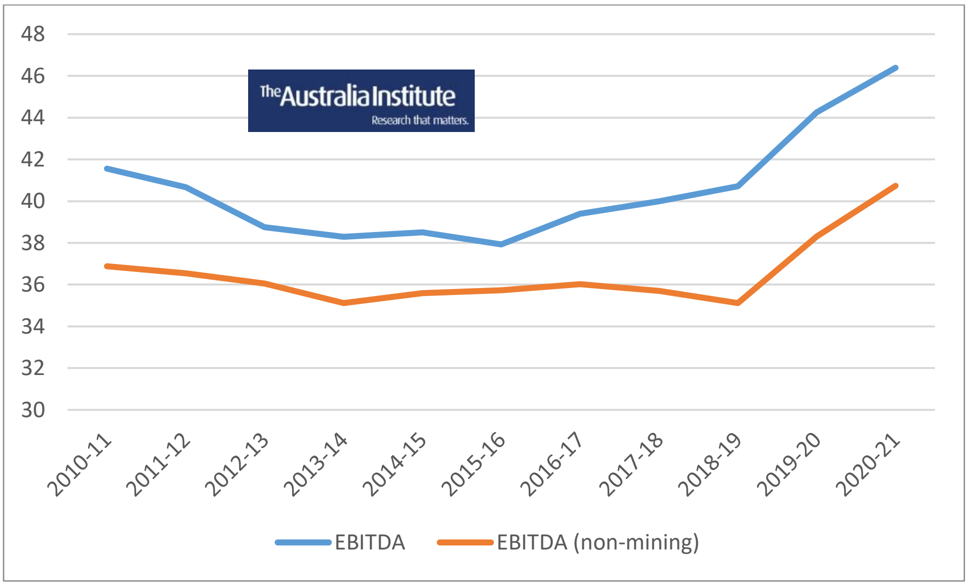
The ABS *Australian Industry* series provides data for private non-finance sector by industry and gives two different measures of profits:

- earnings before interest, tax, depreciation and amortisation (EBITDA).
- Operating profit before tax.

Both of these measures of profit provide good approximations for the non-wages share of the industry value-added and both can be expressed as a share of value added as has been done in Figures 4 and 5. Significantly, while no one accounting concept of 'profit' is ideal, what matters for this debate is the trend in each of these indicators.

Figure 4 shows the EBITDA for all (non-finance) industries as a share of total value added for the same industries (blue line) and the EBITDA and value added for all industries other than mining (orange line). The recent upward trend in profits (with and without mining) is quite apparent do not support the claims (detailed above) made by the BCA.

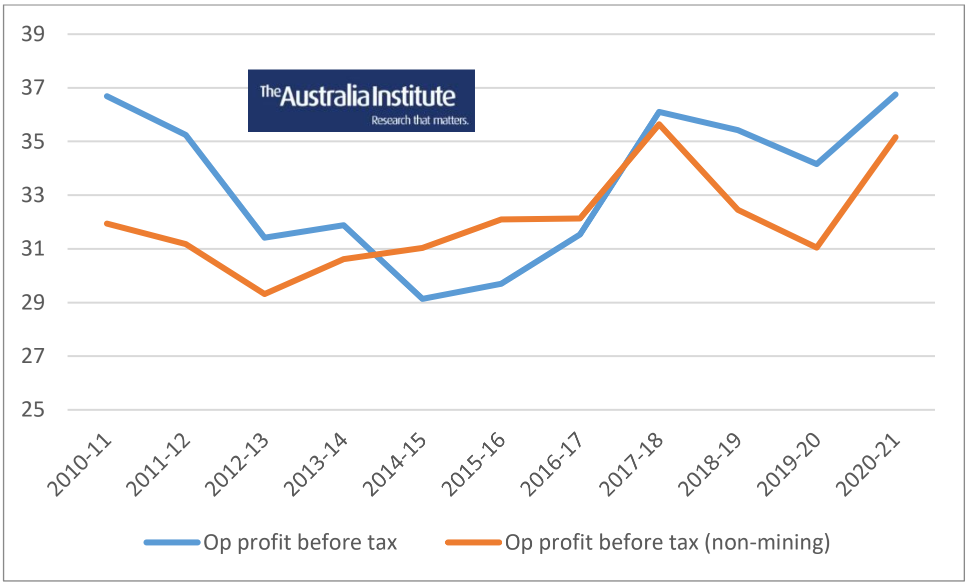
Figure 4: Non- Finance sector profits (EBITDA) as share of value added with and without mining %.



Source: ABS (2022) *Australian Industry, 2020-21*, 27 May.

Figure 5 below shows recent movement in non-finance operating profits before tax, with and without the mining sector. As with figure 4, this ABS data provides no support for the claims made by the BCA although the data are annual and do not include the most recent quarters of ABS data. They certainly do not suggest Australia is on a path to record low profits in the non-mining sector.

Figure 5: Non- finance profits (operating profit before tax) as share of value added with and without mining %.

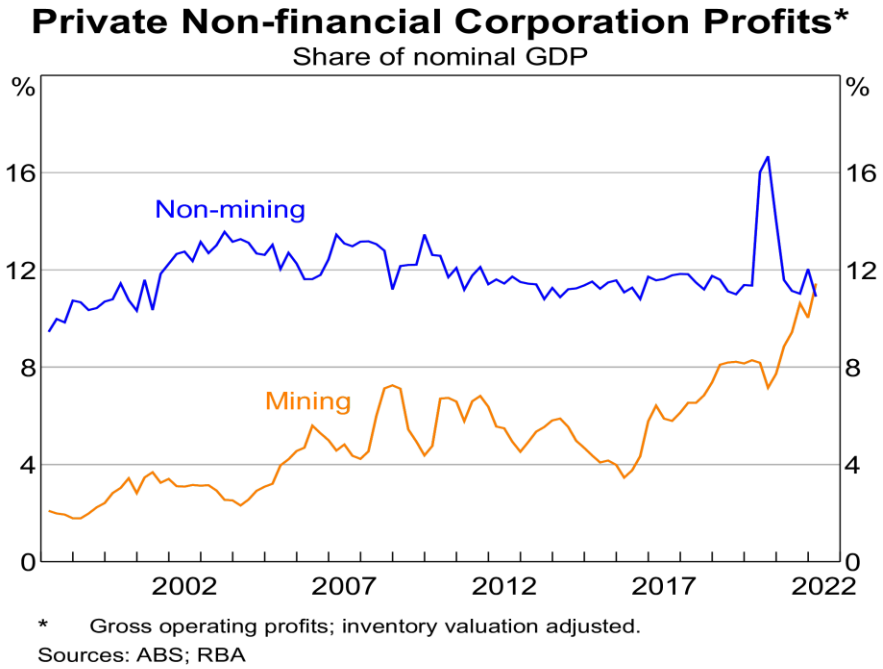


Source: ABS (2022) *Australian Industry, 2020-21*, 27 May.

Is there any support for the claims of low profit share?

While the ABS data presented above does not support the claim made by Ms Westacott there is a wide range of ABS data and other official sources, some of which might. For example, the RBA's chart pack includes the graph presented in Figure 6 below as a measure of private non-financial corporation profits as a share of GDP. [9]

Figure 6: Profit graph from RBA chart pack.



While the RBA does not appear to publish the data on which Figure 6 is based it might be the case that the 'Private Non-Financial Corporation Profits for the non-mining sector' was at a 20 year low in March 2022 (or it might equal the results for 2012 and 2017). That said, the data in question accounts for only just over 10 percent of GDP which raises significant questions about its usefulness as an indicator of what is happening to profits in the broader economy.

To put the data presented in Figure 6 into context, in March 2022 the wages share of GDP was 48 per cent.[10] If the wage share of GDP and the profit share depicted in Figure 6 are combined (around 10 percent) then they would only capture 58 percent of GDP. It seems unlikely that after excluding 42 per cent of GDP, data such as that provided in Figure 6 can still provide a useful insight into shifts in the share of wages and profits across the economy.

[9] RBA (2022) *The Australian Economy and Financial Markets Chart Pack, August 2022* at https://www.rba.gov.au/chart-pack/pdf/chart-pack.pdf?v=2022-08-12-07-30-08

[10] ABS (2022) Australian National Accounts: National Income, Expenditure and Product, March 2022, 1 June.

Why exclude mining and banking profits from a conversation about profits?

Real wages are falling, prices are rising and profits are at record highs. While it is true that profits from the mining industry, and to a lesser extent the finance sector, are large and volatile, it is not clear why it is important to exclude the profits of the biggest companies in the ASX from analyses of profits in Australia. Indeed, if the profits of the mining and banking industry are so large that they skew national data on profits then this alone should seem to provide a strong case for the introduction of specific taxes on the mining industry and an expansion of the 'super profits tax' that the Liberal Government introduced on the big 4 banks plus the Macquarie group.

If the argument for excluding mining from debates about the profit share of income revolves around volatility, then it would seem to follow that industries with volatile wage bills should be similarly excluded. For example, wages in the private sector supplying health care and social assistance services grew 18 per cent in the two years to 2020-21. Over the same period wages grew 39 per cent in non-store retailing and retail commission-based buying and/or selling.

Conclusion

Recently there has been a good deal of interest in the distribution of income in Australia between capital and labour. The Australia Institute made a contribution pointing out that there was virtually zero wages push behind broad measures of inflation in Australia. The purpose of the present paper was to examine the assertions by the Business Coucil of Australia that profit has “actually fallen to its lowest point in 20 years”. At least some of the motivation of the BCA seems to be to counter the view that it is profit push that is behind most of the inflation experienced in Australia to date.

Normally to examine income shares one would look at the primary incomes that make up value added in Australia. That is what the ABS itself does when it examines the growth in the incomes that make up national income and GDP. It may not be widely appreciated but the presentation of compensation of employees along with gross operating surpluses and mixed incomes are treated exactly the same in that all are pre-tax and do not deduct interest expenses and nominal magnitudes such as depreciation. Other measures of profit do not necessarily compare like with like. For comparative purposes it is essential that the income concepts are collected on the same basis.

Some of the aggregate data, as shown in Figure 2 above, does seem to support the view that without mining the Australian profit share has not shown a strong trend in recent years. However, it is exaggerating to suggest that it is the lowest in 20 years as Ms Westacott did. Mr Walters from the BCA suggests we should instead use the non-mining profits of the non-financial corporate sector and express that as a share of GDP. The Reserve Bank of Australia uses similar data in their chart pack which is reproduced here as Figure 6. That graph does not show a 20 year low in the profit share even on that definition. However, if that is the sort of measure the BCA rely upon then their profit figure is now about 10 per cent of GDP compared with 48 per cent for wages. They have not provided a convincing argument for why the remaining 42 per cent of GDP, which includes broader measures of profit, is irrelevant when looking at the wages and profit shares. Those who wish to rely on a subset of national data to make a point about the national economy should provide a strong justification for their choice of preferred indicator.

If the BCA thinks the mining sector, and also for Mr Walters the finance sector, is distorting profit shares there are other distortions in the system that might also warrant attention. For example, Figure 3 reveals that there has been a large growth in the labour-intensive government sector as a share of GDP which conceals the distribution of wages and profits within the private enterprises that the BCA represent.

When the private sector alone is examined there is clear evidence of a tendency toward higher profit shares in recent years. That remains true whether or not mining industry profits are removed from the analysis. It also holds for different measures of profit. In this study it was possible to examine earnings before interest, tax, depreciation and amortisation as well as operating profits before tax. These profit measures are both close to the ABS definition of gross operating surplus at the industry level. That means these data items are comparable to the wages shares.

Overall it appears that Ms Westacott and Mr Walters have chosen some non-standard database for their (quite different) assertions. If Australian citizens and policy makers are to make good decisions about economic policy then they need to be provided with good data. Those who wish to develop their own indicators of economic performance, and suggest that the ABS data alone is misleading, should take responsibility for providing clear evidence and strong arguments as to why their indicators should be preferred.