Australian Council of Social Service

25 September 2023

ACOSS submission to ACTU prices inquiry

Summary

Over the past two years, increases in the cost of essentials have put household budgets under severe strain, especially for people on the lowest incomes like the $54 a week Jobseeker Payment who were already unable to cover the basics. At the extreme end of our inflation problem, higher housing rents are casting many people into homelessness.

Our latest 'cost of living' report which surveyed people on income support payments in July 2023 found that, caught between inadequate incomes and rising prices:

- 73% were eating less or skipping meals;
- 73% cut back on heating or cooling their homes;
- 60% could not afford the health care or medicine they need;
- 94% of those renting their housing were in rental stress, paying over 30% of their income on rent.

We welcome the present inquiry as it's vital that we better understand the causes of inflation rather than resorting to blunt and brutal 'cures' such as excessive hikes in interest rates that are estimated to push 150,000 more people into unemployment:

- There is no evidence to suggest a wage-price spiral is under way - instead real wages have declined (cumulatively) by 8% over the past three years since the COVID recession in June 2020.[1]
- There is evidence to suggest that businesses have used their dominant market positions and pent-up demand for goods and services to increase mark-ups to grow or restore profits.
- 'Administered prices' for essential services funded by governments are among the fastest growing components of the CPI, as governments have shifted funding from public revenue to user charges.

Everyone – workers, businesses and people on income support – will benefit if we can reduce inflation without higher unemployment. While adequate profits are needed to encourage and finance investment that improves future living standards, the burden of high inflation and policies to reduce it is not being widely or equitably shared:

- Over the last three years since the COVID recession, Australian share prices (ASX200) have risen (cumulatively) by 9% after inflation, while real wages and

[1] That is, an average reduction of 2.7% per year over the three years, with the greatest reductions occurring over the latest year as inflation rose sharply.

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income support for people who are unemployed have declined (by 8% and 43% respectively).[2]

Rather than using high unemployment to curb inflation, ACOSS proposes that governments, business, unions and community work together to reduce it directly through:

- curbs on housing rent increases and urgent action to increase the supply of social and affordable homes;
- curbs on energy prices such as the recently imposed caps on gas prices;
- public investment to reduce reliance on fossil fuels and assist low-income households to use energy more efficiently;
- measures to strengthen competition in oligopolistic markets, including tighter regulation of mergers and more transparency over mark-ups. Specifically, we propose that the ACCC publish estimates of mark-ups for sectors dominated by a small number of businesses;
- in essential services such as aged care and child care, reducing reliance on user charges and 'competition' with for-profit providers and instead strengthening the public revenue base to properly fund them.

The government must also, as a matter of urgency, lift the lowest income support payments including Jobseeker Payment so that people can feed their families, maintain their health, and avoid homelessness.

[2] Jobseeker Payment was increased by $275 per week during COVID lockdowns but this was withdrawn a year later and subsequent permanent increases (of $25 and $20 per week) have been much less than this. People affected by these reductions in income support over the last three years - who struggle from week to week to cover the essentials - experienced a sharp fall in economic security and living standards.

Lifting unemployment to lower inflation is a cure worse than the disease

The main policy response to rising inflation has been the Reserve Bank's efforts to slow the economy via large and rapid interest rate increases:

- The Bank expects unemployment to rise to 4.5% by 2025, which means an extra 150,000 people will be out of paid work compared with the 3.5% unemployment rate sustained through the first half of this year.

As ACOSS has argued repeatedly, this is a crude and brutal way to curb inflation. We are abandoning the benefits of full employment – including opportunities for people excluded from employment, higher wages and living standards, higher investment and productivity, and lower income inequality – just as we were close to realising them.

High inflation is not caused by a wage-price spiral

Before resorting to such a harsh 'cure' we should have a clear understanding of the cause of the 'disease'. We welcome the present inquiry and hope is sheds light on these issues.

The evidence indicates that the direct causes of the latest bout of inflation include:

- bottlenecks in the supply of goods (such as fuel and energy) due to COVID restrictions and the war in Ukraine;
- pent-up demand for goods and services resulting from COVID income supports and the subsequent removal of COVID restrictions.

There is no evidence to suggest that a 'wage-price spiral' is emerging since wages have fallen well behind increases in consumer prices and are only slowly catching up.

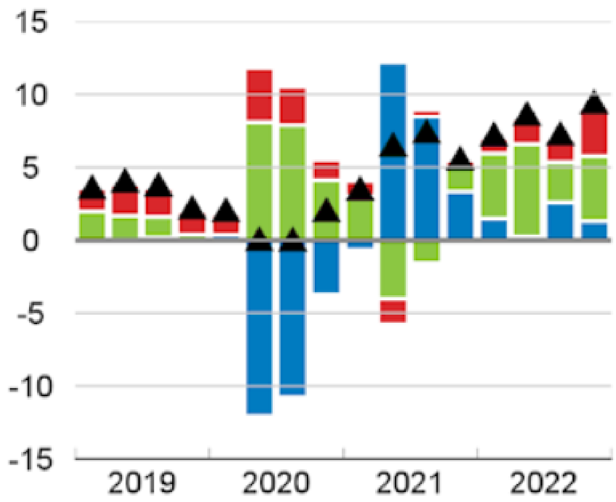
There is evidence that profits have contributed disproportionately to inflation over the last 12 months

It is likely that businesses have taken advantage of pent-up demand and their dominant position within key markets to either grow or restore their profit margins over the last 12 months.

Calculations by the Australia Institute and OECD based on Australian National Accounts price deflators suggest that over the past year, profits have contributed disproportionately to inflation (graph 1, OECD 2023 and Stanford J 2023a).

> *''the OECD data suggests that over the latest 5 quarters (to end-2022), higher unit profits accounted for an average of 51% of the year-over-year increase in the GDP deflator, while higher unit labour costs only 21%''* Stanford J (2023b)

Graph 1: Contribution to year-on-year GDP inflation from unit profits and labour costs

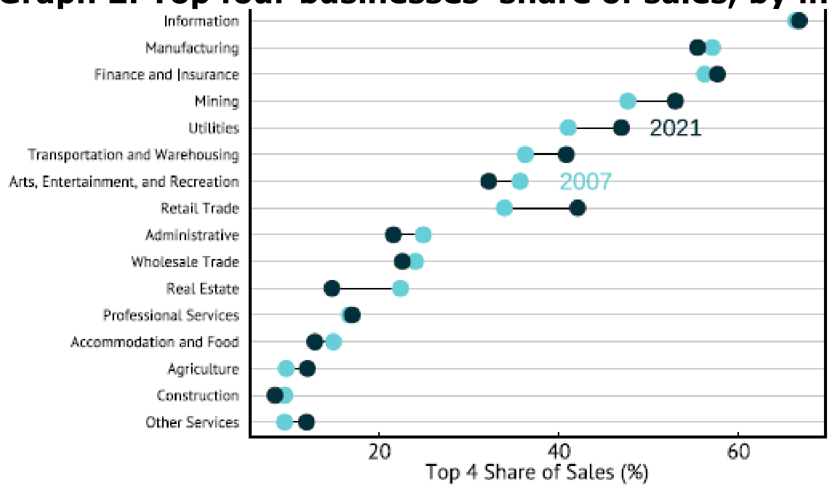


Source: OECD (2023)
Note:
Blue = taxes
Green = profits
Red= labour costs

Weak competition in private markets is likely adding to inflation

Major industries such as information, manufacturing, finance, mining, and utilities are oligopolistic – sales are dominated by the top four companies (graph 2).

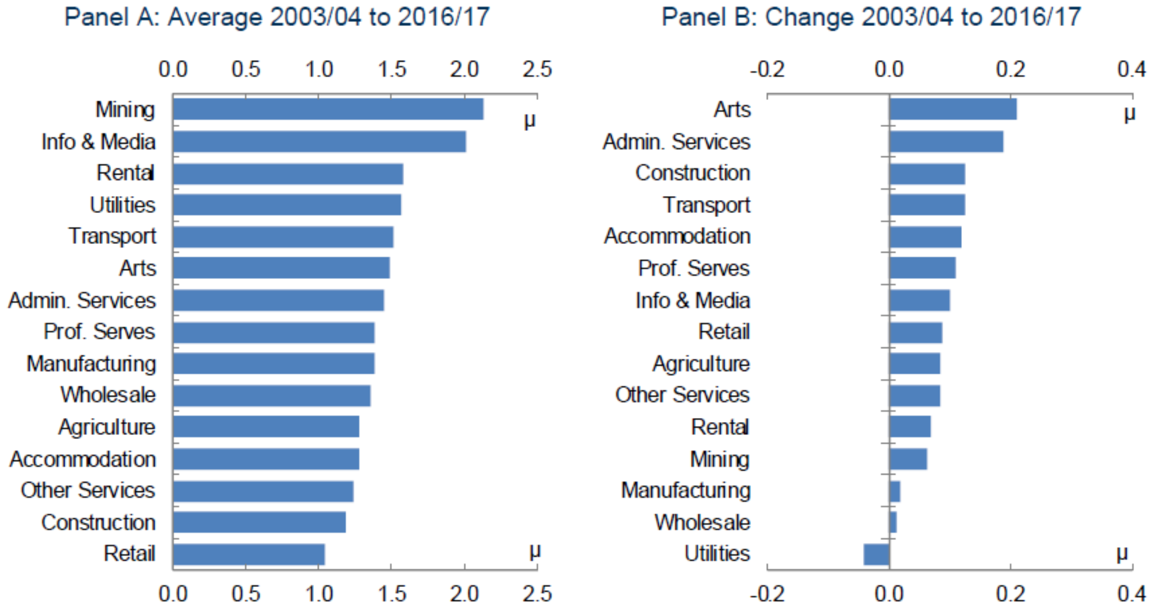
Graph 2: Top four businesses' share of sales, by industry (2007-2020)



Source: Andrews et al (2023)

Markups (the difference between prices charged for goods and services and input costs) are generally higher in these oligopolistic sectors (graph 3).

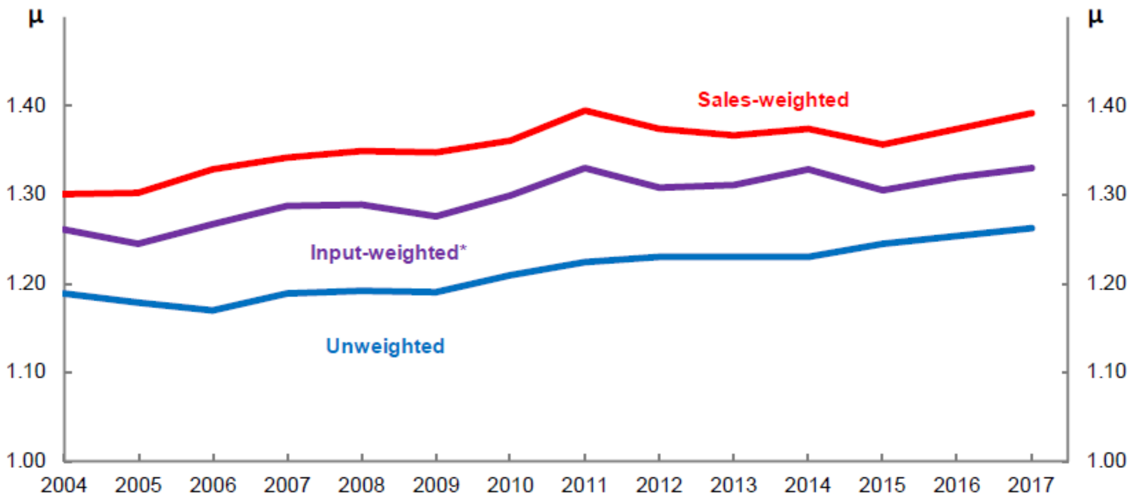
Graph 3: Average markups by industry



Source: Hambur (2021)

Treasury research suggests that well before the pandemic, weak competition in these markets allowed businesses to increase markups (graph 4).

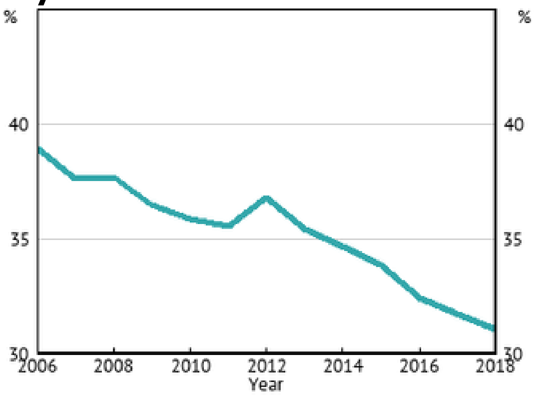
Graph 4: Sales-weighted average of firm-level mark-ups by industry



Source: Hambur (2021)
Note: Red line shows average markups in more 'concentrated' sectors in which the top four companies have a high share of sales.
Purple line shows markups using a different measure of concentration (share of inputs to production).
Blue line shows average markups across all sectors.

It is also likely that weak competition has reduced economic dynamism and productivity growth – for example by suppressing new entrants to markets (graph 5). The small number of dominant employers in oligopolistic sectors is also likely to suppress wage growth by limiting the employment options available to workers (Leigh 2023).

Graph 5: Probability of exiting the top 4 (by sales) of an industry within 3 years



Source: Andrews et al (2023)

Attempts to inject 'pseudo-competition' into essential community services have failed and are increasing costs for users

Competition among for-profit and not-for-profit providers was supposed to improve the quality and cost-effectiveness of essential services, such as care services, employment assistance, and household energy. Instead, these arrangements have led to ballooning user charges and quality has all too often been very poor, especially in services run by for-profit providers (Considine 2023).

A common feature of these essential services is their substantial reliance on public investment, recurrent funding and/or regulation - due to the inability of private markets to guarantee quality affordable services for all in these sectors. These are 'pseudo-markets', often with captive consumers who have little or no real 'choice'.

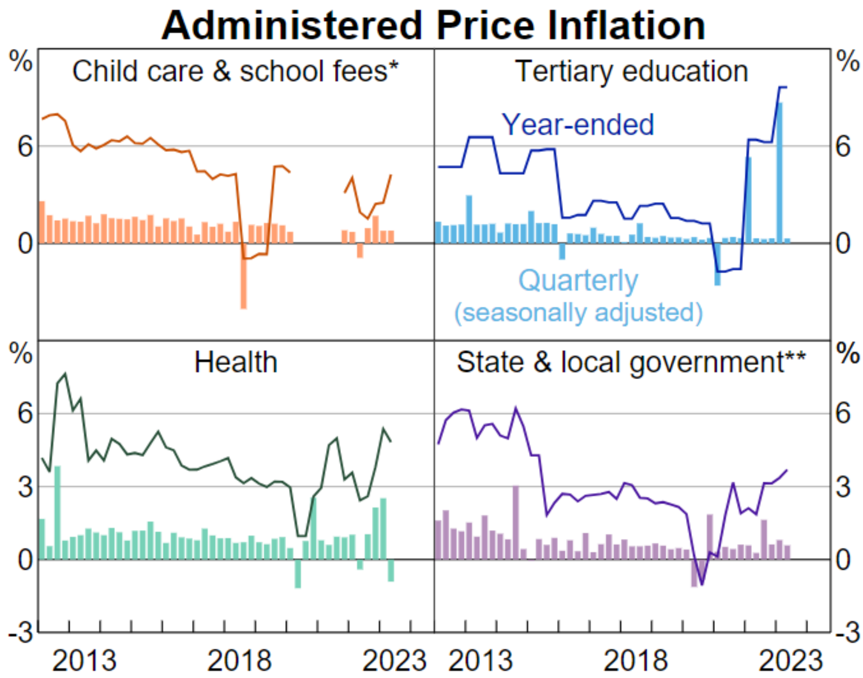
Over the last decade 'administered prices' (prices that are not responsive to changes in demand and supply- mainly for publicly funded or regulated services) have grown faster than the Consumer Price Index (graph 6).

To help curb inflation, governments should 'tidy up their own backyard', by:

- relying more on general revenue and less on user charges;
- shifting from commissioning models for human services that rely on open tenders and 'pseudo competition' towards grants-based funding models with direct

government oversight of service quality and cost effectiveness, informed by user experience and feedback;
- providing services directly or funding community-based organisations rather than relying on for-profit providers.

Graph 6:



RBA, Statement on Monetary Policy, August 2023.
Note: Administered prices are those which aren't responsive to changes in supply and demand (mostly for government-funded services) and represent around 15% of all expenditure.
The lines show annualised increases in prices. The CPI grew at an annualised rate of less than 3% for most of the period from 2012 to 2022.

The burden of the fight against inflation is not being equitably shared

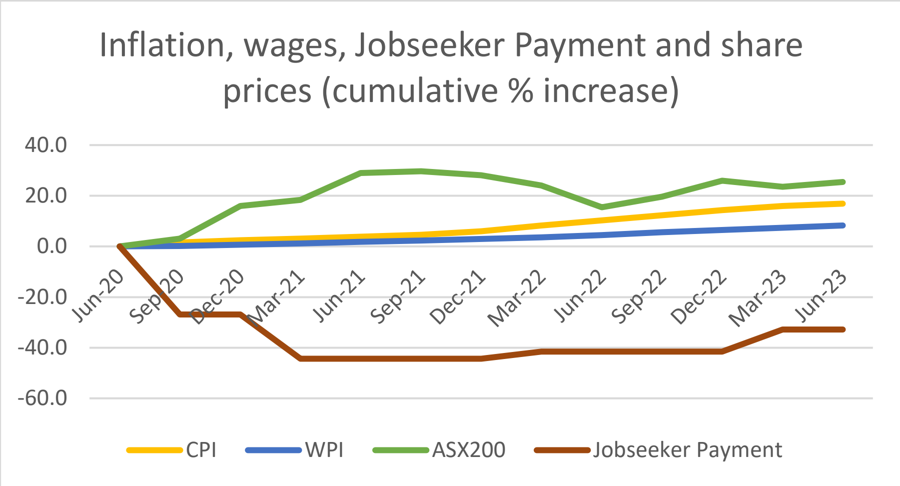
Adequate profits are necessary for reinvestment to improve future community living standards, but profits should not be achieved at the expense of decent jobs and pay for workers or excessive prices for consumers.

As the economy has recovered from the COVID recession over the past three years, the burden of restraint has been shared unequally:

- Real (after-inflation) wages have declined (cumulatively) by 8%;
- The lowest income support payments have fallen (cumulatively) by 43% after inflation, since they were sharply reduced when the Coronavirus Supplement

(which lifted recipients out of poverty for the first time) - despite modest *permanent* increases the Jobseeker Payment is just $54 a day;
- Australian share prices (a proxy for the benefits to shareholders of profitable companies) have risen by 9% after inflation (graph 7).

Graph 7: Shareholders have fared better than wage-earners and people on the lowest income support payments since the COVID recession



Source: ABS *Consumer Price Index, Wage Price Index;* Standard & Poors Global, *ASX 200 index*.
Note: Cumulative percentage change since the COVID recession.
Jobseeker Payment was increased by $275 per week during COVID lockdowns but this was withdrawn a year later and subsequent permanent increases (of $25 and $20 per week) have been much less than this. People affected by these reductions in income support, who struggle from week to week to cover the essentials, experienced a sharp fall in economic security and living standards.

The best way to curb the present bout of inflation is to reduce prices directly

Inflation is falling rapidly, but this is being achieved by suppressing growth in jobs and incomes. A better approach to control inflation for the benefit of all is for governments, business, unions and community to work together to reduce it directly.

ACOSS recommends:

- Curbs on rent increases;
- Curbs on household energy prices such as the recent gas price caps;
- Public investment to reduce reliance on fossil fuels and assist low-income households to use energy more efficiently;
- Measures to strengthen competition in oligopolistic markets, including greater transparency over mark-ups. Specifically, we propose that the ACCC publish estimates of markups for key sectors dominated by a small number of businesses (ACOSS 2022).

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