Income Inequality in Canada

Submission to the House of Commons' Standing Committee on Finance

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Income inequalities have been on the rise in Canada over the last three decades, as acknowledged by a wide array of research institutions, think tanks and academics. Recent reports by the Organization for Economic Development (OECD) and the Conference Board of Canada paint a disconcerting picture (1;2). In Canada, between 1980 and 2007, income inequality, measured by the Gini coefficient (post-tax/transfer) increased from 0.28 in 1990 to 0.32 in 2009 (1). During this same time frame, the share of market income held by individuals at the top of the income distribution dramatically increased: for the top 1% and 0.01% from 8.1% to 13.3% and 2% to 5.3% respectively (2). However, average income trends can be distorting in terms of what most Canadians actually earn, which is better measured by using median income measures.[i] Comparing 1979 to 2006, families with children in the bottom decile of the income spectrum experienced a steep 70% drop in median incomes, whereas the top 10% experienced an increase of approximately 33% (3).

According to the OECD, the majority of the increase in income inequality was the result of a growing disparity in employment earnings between the top income earners and the bottom half of the distribution, and changes to redistributive tax policy (2). What is more, while market income inequalities widened rapidly since the early 1980s, the Canadian state at the same time minimized its role in income redistribution through changes to the taxation regime, leading to growing after tax income inequalities as well. Between 1980 and 2009, disposable (after taxes and transfers) income inequality increased by 13% (4). During this period there were many changes to the tax system, with the top federal marginal tax rate decreasing from 41% to 29% and the share of capital gains earnings eligible for taxation from 75% to 50%. Corporate tax rates are now the lowest of the G8 countries, with medium and large corporations in 2010 paying on average 26.9% of their profits in taxes, a steep drop from the 49.1% paid even in 2004. This led to significant declines in government revenues and undermined the ability of the Canadian state to address rising inequalities, as personal income taxes and government transfers (such as social assistance, unemployment insurance, old age security, and child benefits) play an important role in reducing income inequality in Canada (1). Tax revenue as a percentage of GDP in Canada declined from 39% in 1990 to 31% in 2010, ranking 24^{th} of 34 OECD member nations and well below the EU15 average of 40%. It is interesting to note that prior to the mid-1990s, the Canadian tax-benefit system was as effective as those in the Nordic countries in offsetting more than 70% of the rise in market income inequality (between 1980 and 1995). Since 1995 the tax/benefits redistribution system has offset less than 40% of the rise in market income inequality. This downward trend in redistribution is also driven by the reduction in means-tested transfers as benefits rates have declined over the last 20 years, being lower today than in the mid-1990s (in constant Canadian dollars) (5). Much of this can be traced to the federal government changing how it conducts cost-sharing with provinces, and limiting the amount of financial transfers to the provinces for health and social programs.

This has led to a steep decline of incomes for those on social assistance, contributing to growing after tax income inequalities. If benefit levels were restored to the same level of spending power as in 1994, a single person on social assistance in Ontario would receive $936 per month instead of the current rate of $606. Further contributing to this trend have been cutbacks to employment insurance (EI) benefits, with many Canadians in precarious employment that are unlikely to qualify for benefits or receive minimal duration. Again citing Ontario as an example, only 26% of unemployed workers received regular EI benefits in August, 2012. Another concern is how some of the provided benefits for those on social assistance are clawed back upon re-entering the labour market, creating a ‘welfare wall’ (6). For example, health benefits are available for those on social assistance, and those fortunate enough to obtain benefits through employment; however low income employed people generally cannot access health benefits through their employers. This situation in Ontario differs from innovators elsewhere, for example in Scandinavian countries, where extended health benefits are available to all low income adults.

Today's levels of income inequality are concerning for their potential to undermine the efficient operation of markets and to suppress future economic growth (7), with Nobel prize winning economists and the International Monetary Fund (IMF) now amongst those warning about the economic inefficiencies of soaring income inequalities (8;9). They are also problematic for their negative social side-effects, loss of social cohesion, and increased welfare costs related to rising levels of income inequality. These trends are of particular concern from a health equity perspective, with population health results strongly impacted by social determinants of health, especially income, and with greater income inequality often resulting in an increase in poverty rates, another central social health determinant. This, in turn, can create cost pressures in the health care system. A book by health experts Richard Wilkinson and Kate Pickett, *The Spirit Level*, demonstrates that there is no direct relationship between gross domestic product, or health spending per person, and life expectancy in rich countries (10). There is, however, a significant link between average life expectancy and income inequality: Citizens of more equal countries tend to live longer, and income inequalities above a Gini coefficient of 0.3 (Canada's is now above 0.32) lead to excess deaths in the 15-60 age group (11).

<u>Policy Recommendations:</u>

Employment Policy

Creating well-paid jobs that offer a way out of low income employment is a key pathway to reducing income inequalities. Given the important role that minimum wages play in setting overall wage rates, the federal government should play a leadership role by restoring its practice of paying a single minimum wage to all workers across Canada falling under federal jurisdiction (as it did before 1996). A restored federal minimum wage should pay an adequate amount (e.g., pegged to the after-tax low income cutoff or, alternately, half of average earnings) and protect its value over time via indexation. In addition, Canada spends much below the average on active labour market policies (ALMP) in comparison to other OECD countries[ii] and thus an immediate increase is warranted to address the skills shortage currently prevalent in the labour market, and to better reconnect unemployed workers with the labour market through retraining initiatives. Finally, expanding public sector employment during periods of recession has a much greater multiplier effect on economic growth (through consumption spending, and hence private sector production and subsequent employment) than using low tax measures or tax cuts as growth incentives (12). The federal government should review its austerity measures in light of the important role played by public sector employment and spending during recessions.

Taxation policy

Reforming the tax regime is the most direct instrument for increasing redistributive effects and providing revenue to retain public sector employment and social protection spending. The federal government should make its tax code more progressive, as the top federal marginal tax rate is currently 29% for incomes over $135,054. This threshold is well below the level of income for the top 1%, 0.1%, and 0.01% of income earners; therefore creating additional tax brackets to specifically target these groups of income earners would result in significant additional revenue. The growing share of income going to those groups means that they now have a greater capacity to contribute their fair share to burden sharing in society. The government should also review corporate tax rates in Canada, to see whether recent cuts should be reversed to increase revenue collection and thus enhance the capacity of the state to engage in income redistribution. Sine 2006 alone, more than 200 billion dollars in revenue has been lost to corporate tax cuts (13).

Welfare Benefits

The federal government should work with the provinces to address poverty issues with people currently in the lower end of the labour market and those on welfare trying to re-engage the labour market. The major issues to address are extended health benefits, providing childcare, offering employment services and income intervention either in the form of a working income supplement, or an increase in the minimum wage. To ensure the ability of provinces to provide adequate income assistance to those on social assistance, social transfers to the provinces would need to be increased substantially.

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[i] Median income is the amount which divides the income distribution into two equal groups, half having income above that amount, and half having income below that amount. The median income is considered by many statisticians to be a better indicator than the average household income as it is not dramatically affected by unusually high or low values.

[ii] ALMP spending 2011 (as percent of GDP): US: 0.14%, Canada: 0.33%, UK: 0.38%, Sweden: 1.14%, Finland: 1.78%, Denmark: 1.91%, OECD average: 0.66%.