
WHY CANADIANS SHOULD CARE ABOUT INCOME INEQUALITY

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Mark Cameron has over 15 years' experience working in government, consulting and industry, with a focus on public policy. He has worked for several MPs and Ministers, and in the Privy Council Office. He has also worked as a consultant on environmental and energy policy. From 2006 – 2009 he served as Director of Policy and Research and Senior Policy Advisor to the Prime Minister of Canada. He later worked for Ontario Power Generation and recently joined Research In Motion as Director, Global Public Policy. Mark was educated at McGill University and the University of British Columbia.

Income inequality in Canada has increased over the past two decades, although the extent and effects of this widening inequality have become most apparent in the past several years. The 2008 financial crisis, and the recession which followed it, led to job and asset losses, especially among those in lower income groups. Many people became rapidly and abruptly aware of the precariousness of their financial position.


Today, it is not only traditional voices on the left that are expressing alarm about widening inequality: centrist and conservative voices from business leaders to the Conference Board of Canada have also joined the conversation. But with a majority Conservative federal government that is pursuing an agenda of fiscal retrenchment, is income inequality an issue that could or should be on the short- or medium-term federal agenda? I would argue that it is.

It is worth asking, at the outset, why governments should concern themselves with inequality at all. Obviously, a primary objective for governments is securing economic growth and ensuring that the whole of society benefits from such growth. Theoretically, should it then matter if

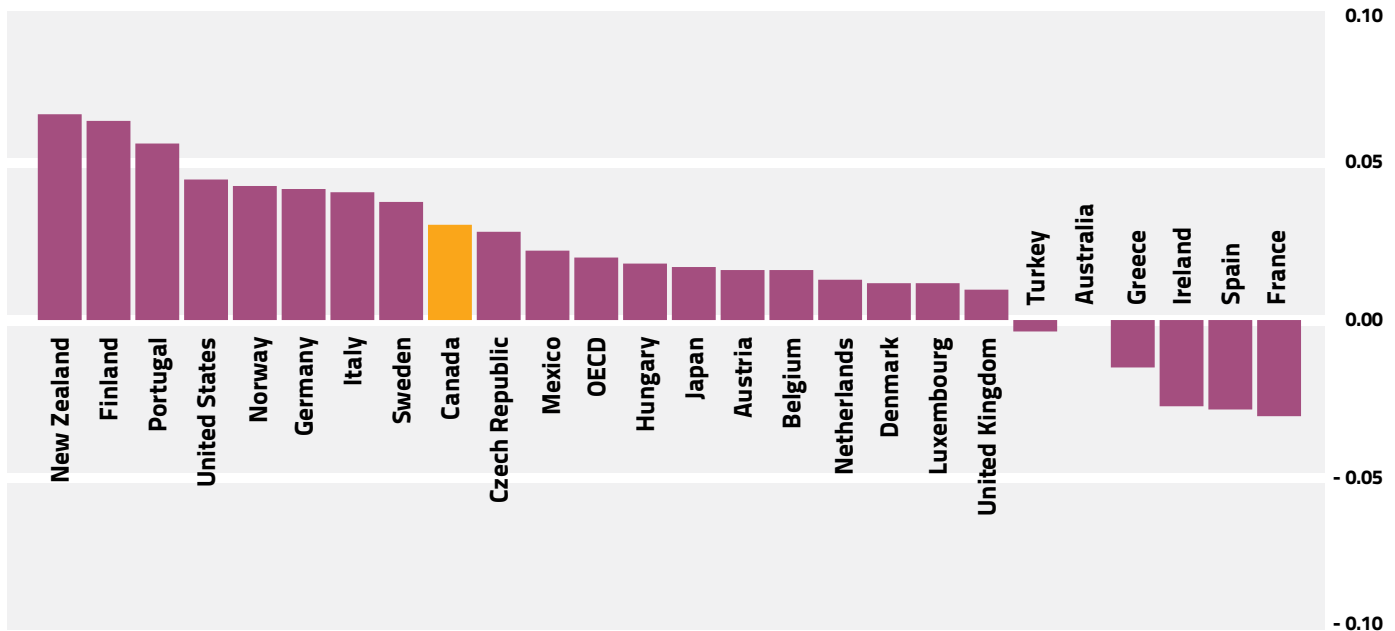
wealth and income at the top of the socio-economic ladder increases dramatically, as long as those at the middle or lower rungs are benefiting at least to a modest extent? Is relative inequality of income a problem if everybody's lot is improving at least somewhat?

Yes, relative inequality does matter, for several reasons. Extreme income inequality, even where the least well off are still making economic gains, can undermine the sense of social cohesion necessary for a democratic society. Human nature is acutely sensitive to relative fairness and positional status. We know from experiments in psychology and behavioural economics, such as the *Ultimatum Game* developed by Werner Güth and others, that most people will reject an apparently "unfair" distribution of rewards, even if rejecting it will make them personally worse off.¹ Similarly, surveys show that most people would rather live in a society where they make \$100,000 while everybody else makes \$85,000 than one in which they make \$110,000 while everybody else makes \$200,000, even when it is clearly explained that they will have higher purchasing

¹ Güth, W., Schmittberger, W. & Schwarze, R. (1982) "An Experimental Analysis of Ultimatum Bargaining". *Journal of Economic Behavior and Organization* 3 (4), 367–388.



Changes in Gini coefficients from mid 1980s to mid-2000s



SOURCE: OECD (2008) *Growing Unequal?: Income Distribution and Poverty in OECD Countries*.

Figure 1

power, a larger house size, etc. in the second scenario, as compared to the first.²

A society in which a small group is perceived to be benefiting unfairly, or where there are wide gaps between social and economic classes, can lead to dissension, jealousy and anti-social behavior, even if the less well-off are still making material gains. This, in turn, can lead to increases in crime, loss of participation in social and charitable organizations, and greater demands for government intervention to help deal with these social tensions. Such a scenario should concern not only social democrats or liberals who see equality as an important social goal in its own right, but also conservatives who are concerned about maintaining public support for free markets and limited government.

As conservative commentator David Frum has written, “Equality in itself never can be or should be a conservative goal. But inequality taken to extremes can overwhelm conservative ideals of self-reliance, limited government and national

unity. It can delegitimize commerce and business and invite destructive protectionism and overregulation. Inequality, in short, is a conservative issue too.”³

So, if there are ample philosophical and practical grounds for both left and right to be concerned about income inequality, what do we know about the state of income inequality in Canada and its underlying causes? And what can we do to address this?

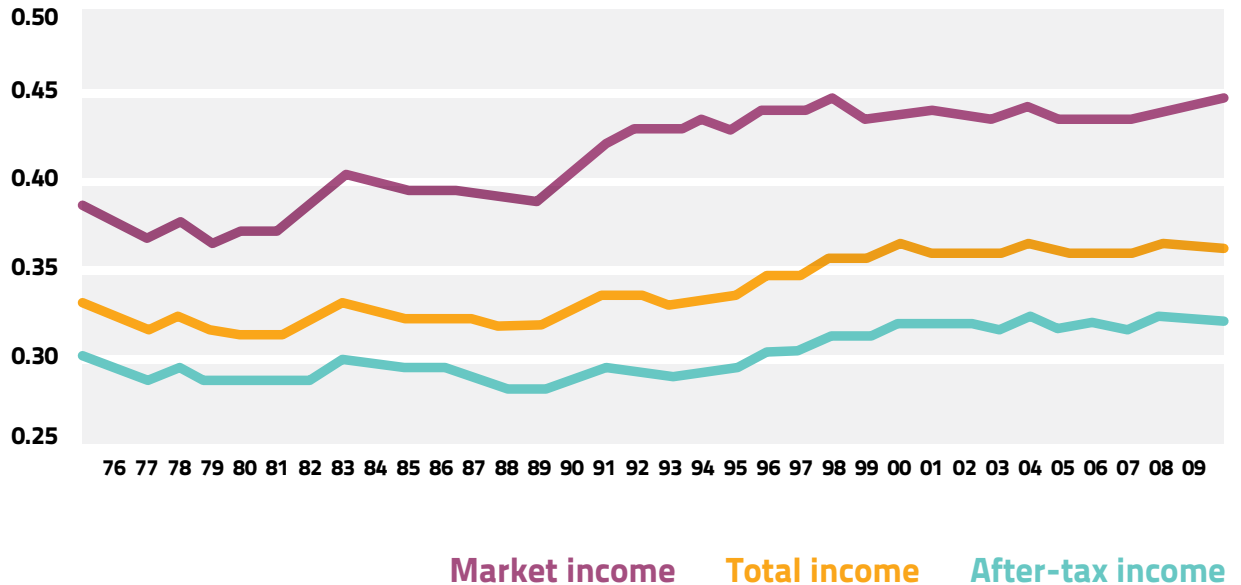
Choosing the right policy prescription requires an accurate diagnosis, so it is important to understand what has caused increases to inequality in Canada and elsewhere. Only then will we be able to identify measures that are likely to be successful in addressing it.

Inequality in market income has been growing in almost all advanced economies for the past several decades as a consequence of economic globalization, technological change, reduced progressivity in taxation, and the shift from an industrial to a service-based economy. Increased integration of the global economy

² Solnick, S. J. & Hemenway, D. (1998) “Is More Always Better?: A Survey about Positional Concerns”. *Journal of Economic Behavior and Organization*, Vol. 37, 373-383.

³ Frum, D. (2008) “The Vanishing Republican Voter”. *New York Times Magazine*, September 5, 2008.

Gini indexes using three measures of adjusted income



SOURCE: Conference Board of Canada (2011) *Canadian Income Equality*.
<http://www.conferenceboard.ca/hcp/hot-topics/canInequality.aspx>

Figure 2

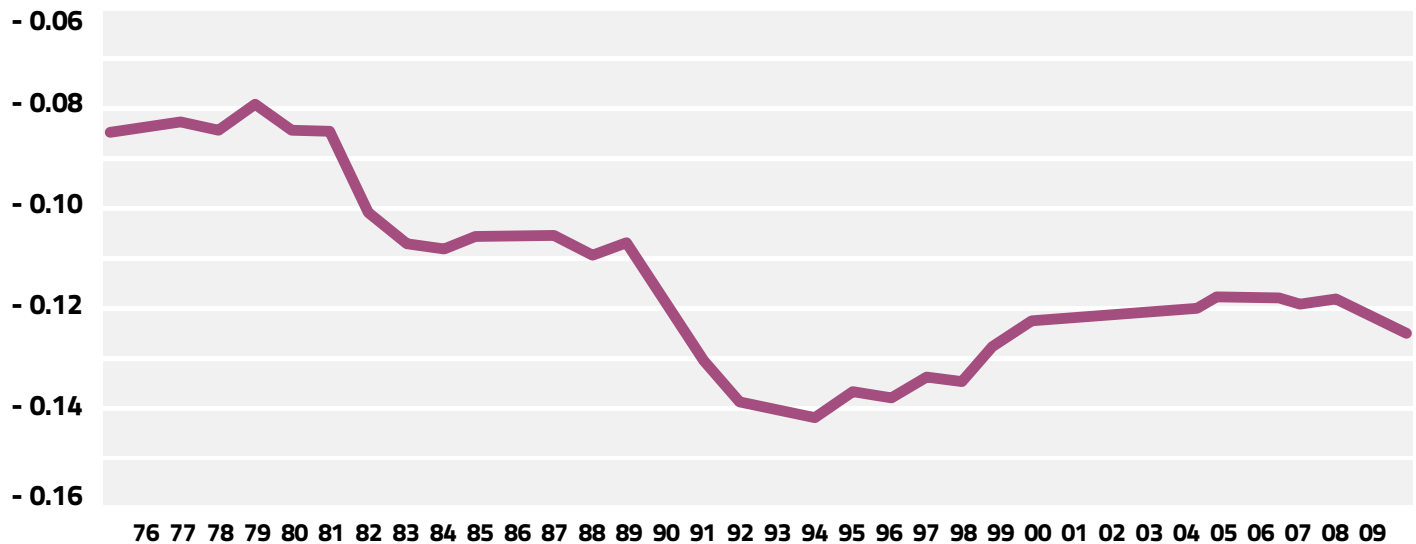
and rapid technological change have brought greater rewards for highly-skilled workers and managers. Lower-skilled workers, by contrast, have been forced to compete with workers in developing economies and have seen far smaller gains. While domestic policy can certainly address tax and transfer issues which, in turn, affect final income distribution, it is very difficult for any government to affect the broader shifts in the global economy that affect market incomes.

Figure 1 shows changes in Gini coefficients (essentially the measure of what percentage of income redistribution would be necessary to eliminate all income inequality) in OECD countries between the mid-1980s and mid-2000s. Income inequality has grown in the United States and Canada more quickly than the OECD average, but most OECD countries have seen inequality increase.

When looking at inequality data, it is important to note that inequality can be measured both in terms of market incomes (before taxes and transfers) and disposable incomes (after taxes and transfers). Focusing specifically on Canada, we see from **Figure 2** that inequalities in market income grew rapidly in the 1990s, as did inequality in disposable incomes to a lesser extent. Government policies have therefore had some effect in dampening the increase in post-tax and transfer disposable incomes.

However, **Figure 3** shows that while government policies became gradually more redistributive from about 1980 through the mid 1990s (so the difference between the Gini coefficient for market income distribution and that for post tax and transfer income distribution grew larger), during the late 1990s there was a considerable reduction in the level of redistribution. Taxes and transfers have

Difference between the Gini index using adjusted market income and adjusted after-tax income



SOURCE: Conference Board of Canada (2011) *Canadian Income Equality*.
<http://www.conferenceboard.ca/hcp/hot-topics/canInequality.aspx>

Figure 3

reduced inequality, but the impact is now smaller. This is likely the result of the reduction of federal transfer payments and the subsequent reduction in provincial welfare programs (motivated by the desire for cost savings, but also a philosophical choice in some provinces, as in the US, for welfare reform). Redistribution through tax and transfers has leveled off since 2000 and both market income and disposable income inequality have remained relatively stable. Nonetheless, the trend to greater inequality remains clear.

WITH THE SITUATION BECOMING WORSE, HOW SHOULD GOVERNMENTS RESPOND?

The broad international trend to increased inequality of market incomes in advanced economies is likely beyond the capacity of federal and provincial governments to address,

at least in the short term. But, as we have already seen, governments are in a position to address inequality in disposable income, especially through the tax and transfer system.

The current government has, in fact, put in place modest measures that reduce income inequality. Since 2006, the basic personal exemption has been increased, the Universal Child Care Benefit (UCCB) and Working Income Tax Benefit (WITB) have been brought in, and the Goods and Services Tax (GST) was reduced – all measures that benefited low-income households (even if many critics argued that the UCCB and GST cut should have been designed more progressively). As a result of these measures, Statistics Canada data shows that even while the market income of households in the lowest income

quintile dropped between 2005 and 2009, post tax and transfer disposable income for this group grew, and their relative share of disposable income remained constant.

The government should be encouraged to continue in the directions it has set for itself, remaining cognizant of the impact of

The government should continue to enhance the Working Income Tax Benefit

tax and transfer changes on lower income groups. In particular, the government should continue to enhance the WITB.

The WITB, which was implemented in 2007 and expanded in 2009, is one of the most important poverty reduction measures taken in recent years. It supplements the incomes of low earners and helps remove disincentives to seeking paid work instead of remaining on social assistance programs. As initially designed, however, WITB was brought in at such a low level that it excluded many of the working poor. Enhancements brought in in Budget 2009 will ensure that it will at least benefit anybody working full-time at minimum wage. Over time, the federal government should continue to extend

brought in the Universal Child Care Benefit, analogous to the old Family Allowance, and restored a per child tax deduction. Some social policy critics have argued that these measures, which are not targeted to lower income households, are regressive. However, restoring some form of universal recognition of the social value of child-raising was an important – and politically popular – objective of the current government which it will be loath to give up. But having restored a degree of universality to the child benefit system, the government should ensure that future increases are targeted more towards lower- and middle-income households through the Canada Child Tax Benefit (CCTB) and National Child Benefit Supplement.

While enhancing existing programs such as WITB and the CCTB are admittedly incremental measures that will only have a modest impact on income inequality, I believe this course of action makes the most sense at the present time. As the government seeks to eliminate the large fiscal deficit run up in response to the recent recession – and with the recovery still slow and uncertain – it is unlikely that any government would want to increase taxes dramatically in order to fund greater benefit increases. Instead, governments are more likely to be persuaded to build on programs they have already initiated or enhanced, such as the WITB and the CCTB.

Changes to taxes and benefits alone will not be able to turn around a 30-year international trend towards income inequality in advanced economies – although they can perhaps arrest the increase in inequality in disposable incomes. But governments should also keep in mind other means of ensuring social cohesion by ensuring that people are treated as equals and feel respected as equals, even if significant income disparities exist. As the American writer Mickey Kaus has argued, as economic disparities become harder to overcome with conventional policy measures, governments should move from policies that simply try to achieve more equal distribution of income towards policies that seek to enhance civic equality by

Governments should seek to enhance civic equality by emphasizing common institutions

WITB further up the income ladder, and provinces should integrate their income support programs with Ottawa to increase its impact.

The government should also continue to enhance child benefits. The current government

emphasizing common institutions where citizens meet as equals, regardless of income.⁴

In Canada, we are fortunate to have many of these public institutions – such as public schools and a universal health care system. While many have proposed reforms to health-care and education to reduce costs or improve efficiency, policy makers should keep in mind that these are institutions that help preserve social cohesion and social equality, and market-oriented reforms to education and healthcare should be structured in ways that do not allow the better-off simply to buy superior services or exempt themselves from these important social institutions.

Governments can also pursue other means of promoting social cohesion and civic engagement, whether through voluntary or military service, or greater knowledge of and pride in Canadian history and culture. The current government has taken some steps in these areas. It should also keep in mind that promoting the common values of citizenship

represents an important component of social equality. Just as extreme income equality can undermine social cohesion, measures aimed at improving civic engagement can help citizens to interact as equals in key areas of public life and social services.

As the economy recovers, the government should pursue a mix of strategies. It should increase benefits directed to the working poor and low income families, significant enough to ensure that the lowest income quintile continues to increase its level of disposable income in both absolute and relative terms, while also undertaking measures to enhance civic equality by protecting important public institutions and enhancing a common sense of citizenship. Through these measures Canada can ensure that the broader global trends driving income inequalities do not undermine Canada's social compact and the sense of civic equality that a free and democratic society requires. ■

⁴ Kaus, M. (1992) *The End of Equality*. New York: Basic Books.