INCOME INEQUALITY: A CRISIS IN CANADA OR A POLITICAL PLOY?

by Matthew Lau

In the months leading up to the federal election, there seems to be one issue that refuses to go away: income inequality. Misleading ads are airing on television, claiming that inequality is “skyrocketing” (Akin, 2015). Meanwhile, the opposition parties have made promises to tackle the apparent income inequality problem: the New Democrats want to impose a national $15 minimum wage (Curry, 2014), while the Liberals have promised a more redistributive income tax system (Liberal Party of Canada, 2015).

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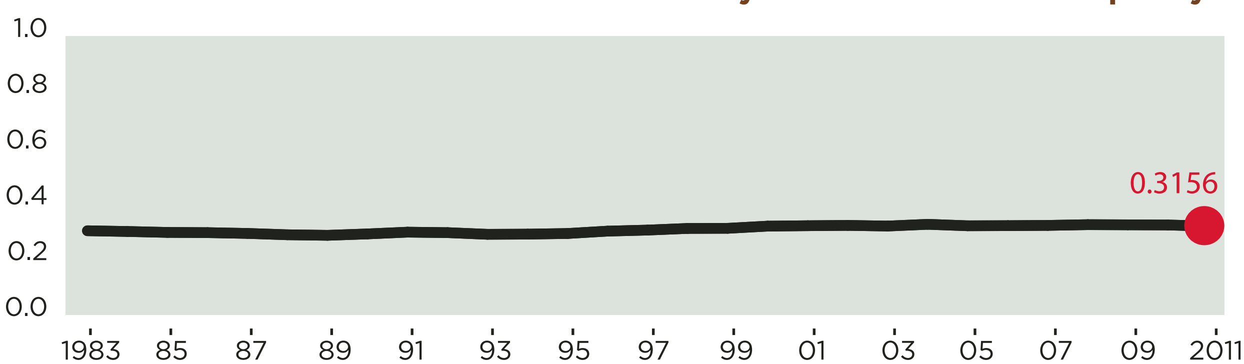
All of the attention surrounding income inequality masks the fact that there has been virtually no rise in income inequality since the turn of the century. A TD Economics report from last year, citing Statistics Canada data, notes that inequality increased in the 1990s, but since 2000 “income inequality has been relatively flat” (Alexander and Fong, 2014).

Since 2000, Canada’s Gini coefficient—the most common measure of income inequality—has barely changed, according to the most recent data from the OECD. A country’s Gini coefficient is the fraction of national income that must be re-distributed to achieve total equality. The Gini coefficient is measured on a 0–1 scale; a Gini coefficient approaching 1 reflects more inequality, while a Gini approaching 0 reflects more equality.

In 2000, using income including government transfers and after taxes as the measure, Canada’s Gini coefficient was 0.3153. Since then, it has risen by a mere 0.0003 points to 0.3156 in 2011, the most recent year for which data is available. Before factoring in taxes and transfers, Canada’s Gini coefficient has dropped by 0.002 points, from 0.4399 to 0.4379.

Canada’s Gini Cofficient Measures the Country’s Rate of income inequality



Source: OECD (undated). OECD StatExtracts. <http://stats.oecd.org/Index.aspx>, as of May 9, 2015.

For the 17 OECD countries for which data were available in 2000, nine have seen their income inequality increase (a rise in their Gini coefficient using income post government transfers and after taxes as the measure), and eight have seen a decrease in income inequality (a drop in their Gini coefficients).

Special interest groups focus much of their political efforts on income and wealth inequality.

Although the numbers suggest that there is no inequality crisis in Canada, income inequality and wealth inequality are issues on which special interest groups tend to focus much of their political efforts. In December 2014, the Broadbent Institute published a report titled *The Wealth Gap: Perceptions and Misconceptions in Canada*, which claims that ideally, the middle fifth of the population (quintile) would somehow control more wealth than the second-richest quintile. The report misses numerous important points.

First, even if the government hypothetically wanted all citizens to enjoy an equal standard of living, wealth inequality will still exist. For example, a young couple with a lower net worth than a couple about to retire is not the result of an unfair society, but rather the result of time. The older couple has simply spent more time accumulating wealth and the younger couple has more future opportunity to do so themselves. In other words, those with little wealth today are usually not the same individuals as those with little wealth in the future. Much depends on their stage of life.

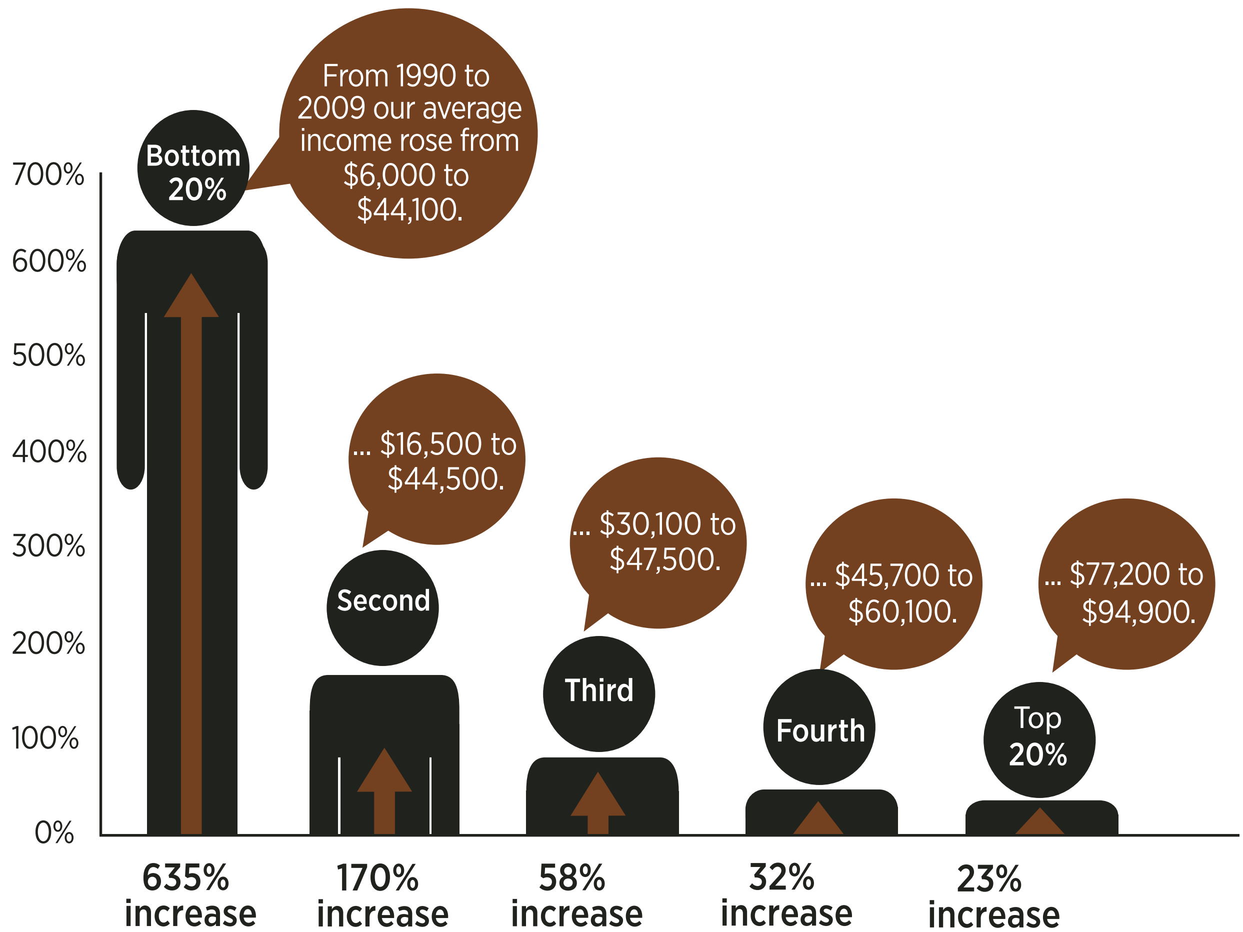
What is true about wealth (net worth) is true also about incomes (annual cash intake). Most people who are at the bottom today will be

able to advance upwards. Income mobility in Canada is quite high; 87% of Canadians with earnings in the lowest quintile in 1990 had advanced to a higher income group by 2009 (Lammam, Karabegovic, and Veldhuis, 2012). Between 1990 and 2009, the average income of Canadians originally in the lowest quintile increased 635% (after adjusting for inflation). By contrast, the average income of Canadians originally in the highest quintile increased only 23% (Lammam, Karabegovic, and Veldhuis, 2012).

Income mobility - most people who are at the bottom today will be able to advance upwards.

Just as those with small amounts of wealth are often young people who are more likely to experience rapid income growth in the future, so are those earning the lowest incomes. When people at different stages of the life cycle are compared, their inequality, measured either as wealth or income, is overstated.

Average Income of the Same Group of People in 1990 and the Increase in Dollars and Percentage



Note: Income is measured by wages and salaries and adjusted for inflation

The Broadbent Institute's prescribed solution to inequality—higher taxes and more income redistribution—is problematic. Taxes discourage wealth creation because "if incentives to work decline, the quantity of work—and thus the quantity of goods produced—will also diminish" (Kelly-Gagnon, 1999). Canada's progressive tax system means those with higher earnings pay higher marginal tax rates. In other words, members of society who are more productive are disproportionately penalized.

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Not only do high tax rates discourage the employed from working more, high transfers to the unemployed discourage them from finding work. Munir Sheikh, formerly Canada's Chief Statistician, noted in a recent study that "in Canada, many inappropriate tax-transfer policies have helped to condemn people to being trapped behind low-income and poverty walls and, rather than improving social mobility, may have worsened it" (Sheikh, 2015).

A similar paper by Philip Cross, former Chief Economic Analyst at Statistics Canada, concludes that those concerned about income inequality should not advocate for increasing taxes on high income earners. "A better approach is to adopt policies that encourage market incomes to grow, rather than focusing on the tax and transfer system to redistribute and possibly stunt income growth" (Cross, 2015).

Philip Cross's suggestion that Canadians, even those with low incomes, would be better served by policies that encourage growth as opposed to redistribution, is one that is backed up by the recent economic evidence. According to the Montreal Economic Institute, the average after-tax household income for the poorest quintile rose by only 4% in real terms (after controlling for household size) from 1976 to 1995; however, there was a 23% increase from 1995 to 2009, despite the fact that inequality was stable in the former time period and increased in the latter (Labrie, 2012). That the lowest income group prospered more despite a period of higher static inequality suggests that income inequality in Canada is, at the margin, benign.

In short, engaging in higher levels of wealth redistribution is the wrong policy response to an exaggerated problem. Politicians would do well to consider the facts about income inequality and the negative economic implications of increasing wealth redistribution, and reject misleading analyses.

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