Brief to the Finance Committee

April 6, 2013

RE: INCOME INEQUALITY IN CANADA

From Diana Gibson and Lori Sigurdson

University of Alberta's Parkland Institute and Alberta College of Social Workers.
Excerpted from: *A Social Policy Framework for Alberta*, published in 2012.

Income inequality is rising across Canada. Like most developed economies, Canada was on a path of continuous decline in both inequality and poverty rates for 20 years, but these have turned around dramatically and increased rapidly in the past 10 years. By 2011, Canada had reached levels above the average of other countries in the Organization for Economic Cooperation and Development (OECD),[1] ranking 12th out of 17 peer countries for poverty and inequality.[2]

The widening gap in income distribution, both in Alberta and across Canada, is being driven predominantly by rapid growth in incomes at the top. According to OECD figures, the richest 1 per cent of Canadians saw their share of total income increase from 8.1 per cent in 1980 to 13.3 per cent in 2007. Moreover, the income share of the richest 0.1 per cent more than doubled, from 2 per cent to 5.3 per cent.[3] The decade from 1997 to 2007 was Canada's fastest growing, with the richest 1 per cent taking 32 per cent of all income growth.[4]

The level of equality within a society is a key driver of wellbeing for the whole society. Though poverty is part of the wellbeing puzzle, relative income plays a critical role. [5] In fact, studies have shown that as income inequality increases, so too does poverty.[6] The two are faces of the same coin. Equality of opportunity or, on the flip side, social and economic disparity matters for the quality of life of all, from the less fortunate to the wealthiest.

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[1] Organization for Economic Cooperation and Development (OECD). 2011. "Divided We Stand: Why Inequality Keeps Rising." *Country Note*. December. http://www.oecd.org/dataoecd/44/48/41525292.pdf
[2] Conference Board of Canada. 2011. Op. cit.
[3] OECD (2008), Growing Unequal? : Income Distribution and Poverty in OECD Countries. Country Note: Canada.
[4] Yalnizyan, Armine. 2010. "The rise of Canada's richest 1 per cent." Canadian Center for Policy Alternatives. December. p.3. www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2010/12/Richest%201%20Per cent.pdf
[5] Wellbeing is used as defined by the Canadian Index of Wellbeing. See Canadian Index of Wellbeing. 2011. "How are Canadians Really Doing? Highlights: Canadian Index of Wellbeing 1.0." Waterloo, Ontario: Canadian Index of Wellbeing and University of Waterloo.
[6] Raphael, Dennis. 2002. "Poverty, Income Inequality, and Health in Canada." Toronto, Ontario: School of Health Policy and Management, York University and The CSJ Foundation for Research and Education. June.

2.1 Inequality is bad for the economy

There is a growing convergence in international economic opinion that high levels of inequality can have a negative impact on the economy. This represents a departure for many mainstream institutions, such as the International Monetary Fund (IMF), the World Bank and the Conference Board of Canada.

Previously, mainstream economic institutions such as the IMF had assumed that inequality of income distribution was a necessary part of economic growth, enabling a surplus of income at the top for investment and efficiency. This new research has turned that on its head, instead indicating that reduced income inequality may in fact improve efficiency and duration of growth.

Recent work by researchers at the IMF examining factors in the duration of growth identified that the factor most significantly correlated with longer-term economic growth is equality of income distribution. Levels of income equality showed a higher correlation with economic growth than stability of political institutions, trade openness, exchange rate competitiveness, external debt, or foreign direct investment. The IMF's conclusion was that: "...income distribution survives as one of the most robust and important factors associated with growth duration." The researchers added, "To borrow a marine analogy: a rising tide lifts all boats, and our analysis indicates that helping raise the smallest boats may help keep the tide rising for all craft, big and small."[7]

According to the Conference Board of Canada, when asking the question what is the impact of inequality on the economic wellbeing of a country, "The answer is that high inequality can diminish economic growth if it means that the country is not fully using the skills and capabilities of all its citizens or if it undermines social cohesion, leading to increased social tensions." [8]

Nobel Prize winner Joseph Stiglitz, author of *The Price of Inequality* and a former chief economist at the World Bank, has also reported on the risks to the economy of high levels of inequality. According to Stiglitz, inequality results in more instability, lower economic growth, less efficiency, and less productivity; it is bad for the economy. Further, he reports that the structures that have increased inequality have been part of the system becoming increasing unfair – the cards are perceived as stacked against some people. It has thus undermined democracy, moving from 'one person one vote' to 'one dollar one vote' and has undermined a well functioning democracy. There is a myth that the wealth accumulation at the top is merit-based. However, it is the society we have created that enable people's hard work to be translated into wealth. Stiglitz writes: "Paying attention to everyone else's self-interest – in

[7] Berg, Andrew G. and Jonathan D. Ostry. 2011. "Inequality and Efficiency: Is there a trade-off between the two or do they go hand in hand?" International Monetary Fund, *Finance & Development*, September 2011, Vol. 48, No. 3 http://www.imf.org/external/pubs/ft/fandd/2011/09/Berg.htm

[8] Conference Board of Canada. 2011. Canadian Income Inequality, Is Canada Becoming More Unequal? July.

other words to the common welfare – is in fact a precondition for one's own ultimate wellbeing… it isn't just good for the soul; it's good for business."[9]

The Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System also reported that the origins of the financial crisis included the growing levels of inequality.[10]

In summary, as Joseph Stiglitz said: "The top 1 per cent have the best houses, the best educations, the best doctors, and the best lifestyles, but there is one thing that money doesn't seem to have bought: an understanding that their fate is bound up with how the other 99 per cent live."[11]

2.0 Inequality hurts us all

There is a broad and robust body of research on the impacts of inequality on social and economic wellbeing. At the forefront of this work are Richard Wilkinson and Kate Pickett with *The Spirit Level.* [12] Based on data from scores of countries and studies, this research looked at inequality both between and within countries, rich and poor. What has emerged is a convergence of opinion that disparity is strongly correlated with a broad range of social ills and that it is harmful not only to social wellbeing, but to the very foundation of the economy. Key findings on the social impacts of inequality, outlined in the summary of Wilkinson and Pickett's work include:

Physical Health People in less equal societies have shorter life expectancy; more children die in infancy and self-rated health is lower.[13]

Mental Health People in less equal societies experience far more mental illness.

Drug Abuse People in less equal societies have greater addiction problems and are more likely to use illegal drugs.

Education Children in less equal societies do not do as well in school.

Imprisonment Unequal societies imprison a greater proportion of citizens.

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[9] Stiglitz, J.E. 2012. "The Price of Inequality: How Today's Divided Society Endangers Our Future." W.W. Norton & Company.

[10] Commission of Experts of the President of the United Nations General Assembly. 2009. "Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System." September.

[11] Stiglitz. 2012. Op. cit.

[12] Wilkinson, Richard and Kate Pickett. 2010. "The Spirit Level: Why Inequality Makes Societies Stronger." New York: Bloomsbury Press.

[13] There is a large field of research in inequality as a key social determinant of health. Public Health Agency of Canada. 2002. "The Social Determinants of Health: Income Inequality as a Determinant of Health." http://www.phac-aspc.gc.ca/ph-sp/oi-ar/02_income-eng.php. Wilkinson, R.G. 2005. "The Impact of Inequality: How to make sick societies healthier." London: Routledge.

Obesity Rates of obesity are higher in less equal societies.

Social Mobility There is less social mobility in less equal societies.

Trust and Community Life Communities are less cohesive and people trust each other less in less equal societies.

Violence Violent crime increases, homicide rates are higher and children experience more violence in less equal societies.

Teenage Births Teenage motherhood is more common in less equal societies.

Child Wellbeing Unicef measures of child wellbeing are poorer in less equal societies.

Rich and Poor Countries More equal societies spend a higher proportion of their income on overseas aid and perform better on the Global Peace Index.

Equality and Global Warming Inequality fuels status competition, individualism and consumerism. It makes it harder to gain public support for policies to reduce global warming.

Disparity jeopardizes the fabric of social relationships that make our communities good places to live, work, raise children and grow old. The social impacts identified by Wilkinson and Pickett are critical elements in the quality of life for all Albertans. Some measures – violence rates, trust, community life, and addictions – impact on all individuals directly, in their homes and communities. Others – obesity, incarceration rates and poor education and health outcomes – are expensive and result in higher costs across society. Some of these costs are quantified in the recent study *Poverty Costs, An Economic Case for a Preventative Poverty Reduction Strategy in Alberta*.[14] According to that study, poverty alone costs Alberta between $7.1 and $9.5 billion per year.

Drivers of Inequality:

Across Canada, the effectiveness of federal and provincial government income transfers in lifting children above the poverty line has increased over the years. However, the tax and transfer system have become less effective at addressing inequality. Recent data show that taxes and social program transfers reduce inequality less in Canada than in most OECD countries.[15] According to the OECD, Canada spends less on cash benefits such as unemployment and family benefits than most OECD countries. OECD

[14] Briggs, A. and C.R. Lee. 2012. "Poverty Costs, An Economic Case for a Preventative Poverty Reduction Strategy in Alberta." Calgary: Vibrant Communities Calgary and Action to End Poverty in Alberta.
[15] Luebker, Malte. 2012. "A Tide of Inequality: What can Taxes and Transfers Achieve?" *Social Europe*. February 16, 2012. www.social-europe.eu/2012/02/a-tide-of-inequality-what-can-taxes-and-transfers-achieve/

researchers conclude that, partly as a result, taxes and transfers do not reduce inequality by as much as in many other countries. Furthermore, their effect on inequality has been declining over time.

Generally, the Gini coefficient for market income is similar in Canada to Europe. The key difference lies in the tax and transfer system, which reduces the Gini coefficient for disposable incomes in Europe to 0.278, whereas it is left at an average of 0.343 in non-European developed economies, including Canada.[16]

Prior to the mid-1990s, the Canadian tax-benefit system was as effective as those in the Nordic countries in stabilising inequality, offsetting more than 70 per cent of the rise in market income inequality. The effect of redistribution has since declined,[17] driven by a combination of the reduced role of means-tested transfers and changes in taxation rates.

Conclusions

It is time to recognize the broader consequences of concentrating efforts at supporting the wealthiest citizens, and take concerted steps to ensure that all Canadians benefit from the nation's wealth. We have growing inequality. Political decisions taken in the early 1990s to shift to a more market approach to public services exposed Canadians to economic insecurity and social vulnerability. Even more, as this report has shown, inequality costs, not only in terms of its impact on economic growth, but more broadly in terms of its impact on all citizens through higher violence rates, addictions problems, poorer health, and lower social cohesion. Both economic and social disparity have been increasing and the wellbeing of Canadians has been jeopardized.

Canada is at a crossroads. An aging population, decreasing birth rates, increasing population diversity, and dwindling resources require greater understanding of what it will take to ensure economic growth and social cohesion in the future. Reducing economic and social disparity in Canada requires a multifaceted set of solutions. These include strengthening social programs, tax reform for better and fairer distribution of incomes, and greater democracy.

There are examples to look to in Europe where inequality and economic growth have been managed well and where governments have used tax and transfer systems to ensure redistribution of that wealth for current and future generations. Norway, as a resource rich jurisdiction is a pertinent example. With its higher taxes and larger public sector, Norway entered the recession later, exited it sooner and had the highest consumer confidence in the OECD, all while managing resource wealth and minimizing inequality. There are clearly alternatives for Canada.

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[16] Luebker. 2012. Op. cit.
[17] OECD. 2011 Op. cit.