

The Growing Economic Gap: What it means for Canadian families and the Canadian future

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I. Introduction¹

In 2008, the collapse of the market for securitized subprime mortgages in the United States triggered a financial crisis that spread rapidly around the world. Although Canada's financial institutions were not directly threatened as in other countries, the extent of continental economic integration meant that the crisis weakened the Canadian economy and profoundly affected the lives of many working Canadians. At the time of this writing, it is unclear when recovery will begin or how robust it will be. It is also unclear what longer-term effects the crisis will have on employment, the distribution of income, and the extent of poverty in Canada. We do know that every recent recession has brought with it a widening of income disparities and that the long term consequences of a growth in poverty and economic insecurity are felt for decades: in individual lives, on social development, and on economic performance.

In times of crisis, a preoccupation with the short-term future is understandable. Since responses to the crisis will have to address and build on (or dismantle, but at least deal with) the economic legacy of the recent past, it is especially useful to look back on the experience of the past few decades, and to ask who won and who lost from the impressive economic performance of the past decade. Before the crisis, the economy had been growing at a strong pace since 1997, representing the most sustained period of expansion since the 1960s. Interest rates and inflation were at their lowest

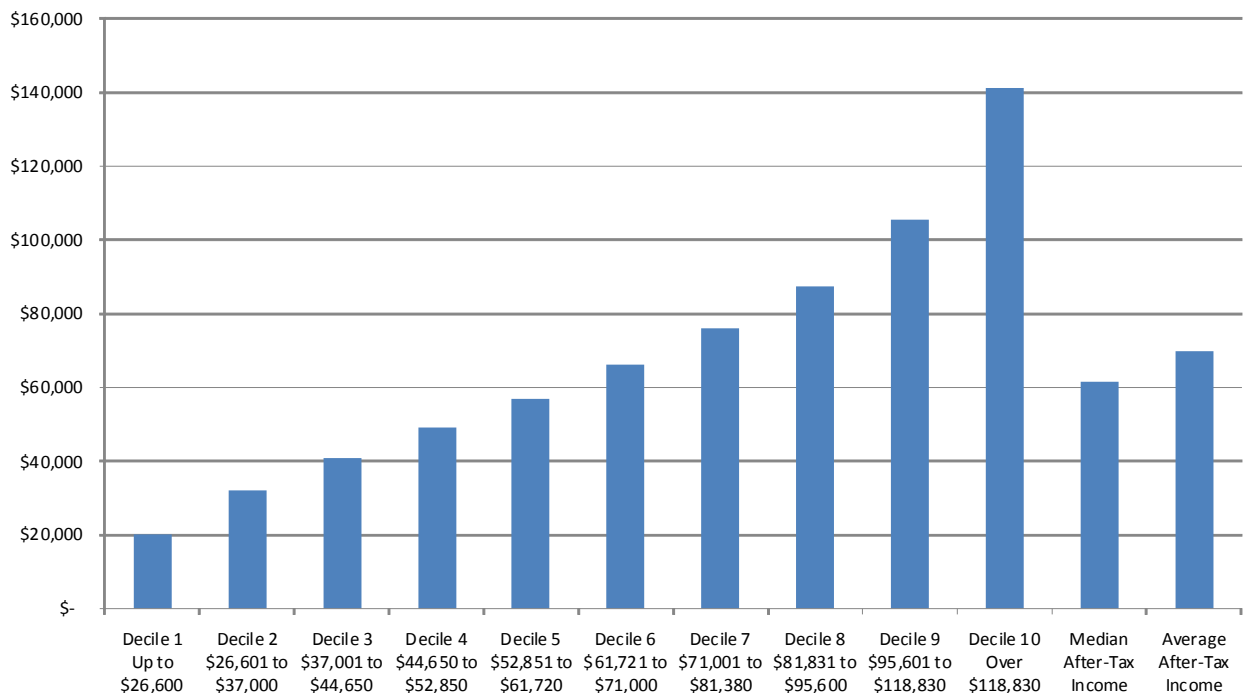
levels in half a century; officially measured unemployment in 2008 was at its lowest level in 35 years; and the federal government had run 11 consecutive budget surpluses (albeit, as noted in section 3, at a considerable cost in terms of social policy). By 2007 all provinces and territories as well as the federal government were running surpluses, an achievement that was 60 years in the making (Courchene, 2008).

This chapter describes how the economic gains of that period were distributed among Canadian families² raising children under 18 over the course of a generation (between 1976 and 2006). Families with children are not, of course, the only Canadians who matter. However, almost half of Canadians live in such families, and everything we know about the importance of childhood and adolescence indicates that the environment for children – the opportunities they have or don't have to survive and thrive, to grow up healthy and secure – matters powerfully for the future society that all of us will inhabit. The chapter is based on custom tabulations from Statistics Canada Survey of Labour and Income Dynamics, a sample of all such families divided into ten groups of equal size, from the 10% of households with the lowest incomes (the bottom decile) to the 10% with the highest incomes (the top decile).

¹ Research for this chapter was partially supported by Canadian Institutes of Health Research Interdisciplinary Capacity Enhancement team grant no. 80070 (Globalization and the Health of Canadians).

² A family, as defined for purposes of this chapter, consists of a household with at least one adult and at least one person under the age of 18. Thus, a single mother raising a child and a two-earner couple with several children are both "families" for purposes of this definition. Older children may be present, but there must be at least one adult and one child under the age of 18 to be part of the sample described here.

Figure 1: Where Do You Belong? Distribution of After-Tax Incomes Among Families Raising Children Under 18, Canada, 2006



It is easier to understand these abstract concepts if we attach numbers to them. For example, in 2006 the top decile of families raising children had earned incomes (that is, incomes generated from wages, salaries, commissions and self-employment) of more than \$140,000; the median earned income of families in that decile was \$173,600. (In other words, families with incomes higher than that figure constituted the top 5% of families in the income distribution.) After accounting for transfers and taxes, the lower limit of the top decile fell to \$118,900, and the median to \$141,500. On the other hand, the bottom decile of families had earned incomes that did not exceed \$10,400, but the median earned annual income for this group was just \$860 (Figure 1).³ In other words, a substantial

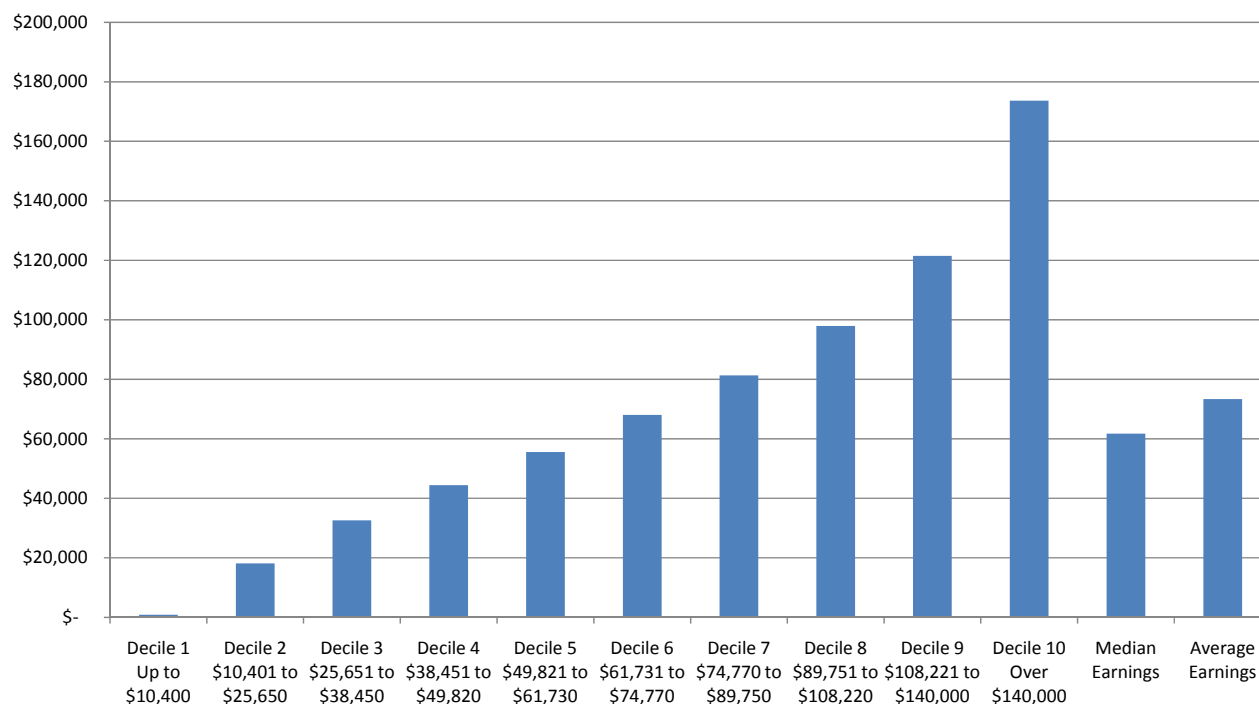
number of families in this bottom decile had no earned income at all. After taxes and transfers, however, the median income of the poorest decile rose to \$20,100 (Figure 2). So Canada's social safety nets make an important difference, although as we will see they are fraying.

There are at least two important stories here, as well as a number of unanswered questions. Part 2 of the chapter tells the first story, about inequality in earned incomes: that is, changes in the way families raising children earn their living. Part 3 tells the second story, about what the tax and transfer system did, and did not do, to offset the trend of rising inequality in market

³ This is the median earned income of all families raising children in the bottom decile, including those with no earned incomes and those with negative incomes (the

negative incomes having been converted to zero). Negative earned incomes can occur for those who are self-employed, who accounted for 15.5% of the employed labour force in 2008.

Figure 2: Where Do You Belong? Distribution of Earned Incomes Among Families Raising Children Under 18, Canada



incomes. Part 4 poses some hard questions about the future – questions that are made more urgent by the current recession and the apparent lack of public support for social and economic policies that would support all Canadian families raising children.

2. Growing inequality in earned incomes: the shift to the top

Despite the fact that the value of Canada's economic product more than doubled between 1976 and 2006 in real (i.e. inflation-adjusted) terms, families with children in the bottom half of the distribution of earned incomes were doing no better in real terms at the end of that

generation-long period than at the beginning. The bottom four deciles were doing substantially worse. The drop in the earned incomes of people in the bottom decile was especially precipitous – more than 70% over the course of a generation (Figure 3, on the following page). Conversely, the earnings of families in the top two deciles of the income distribution, and in particular the top decile, have increased substantially. In constant 2006 dollars, the median earned income of a family in the top decile was roughly \$127,000 at the end of the 1970s, but had risen to over \$169,000 in the opening years of the century (2003-2006) (Figure 4).

Figure 3: Changing Fortunes: Percent Change in Median Earnings, comparing 1976-1979 to 2003-2006, Families Raising Children, Canada

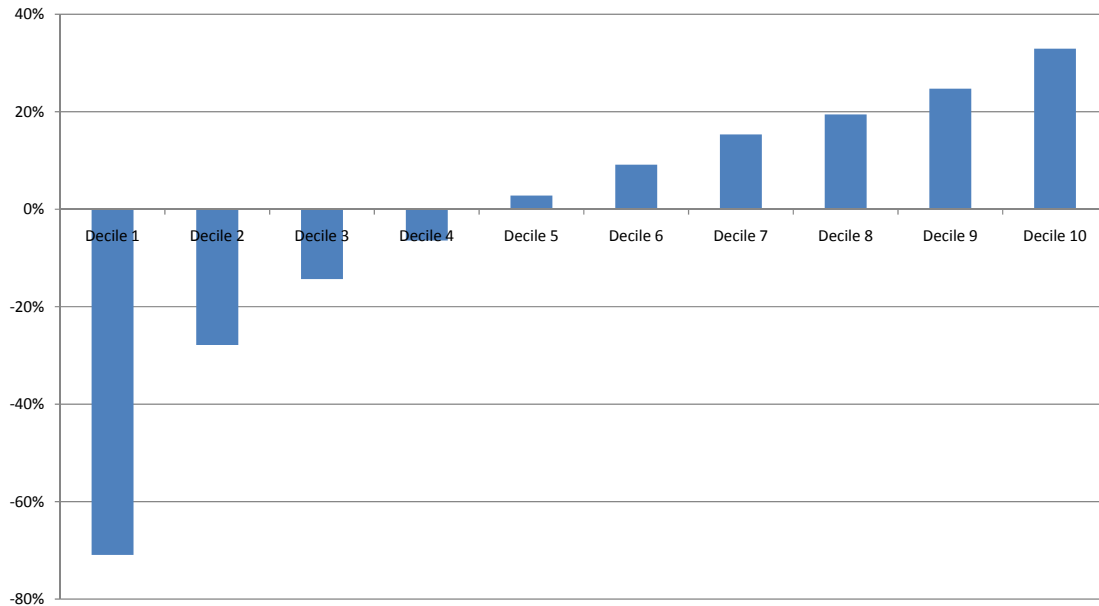
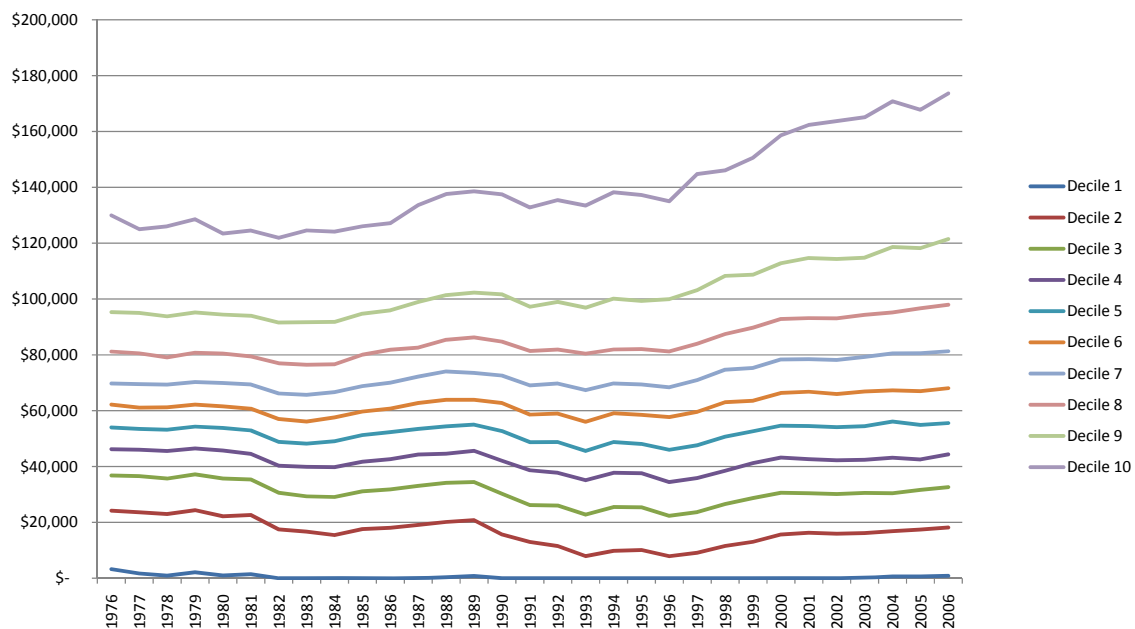
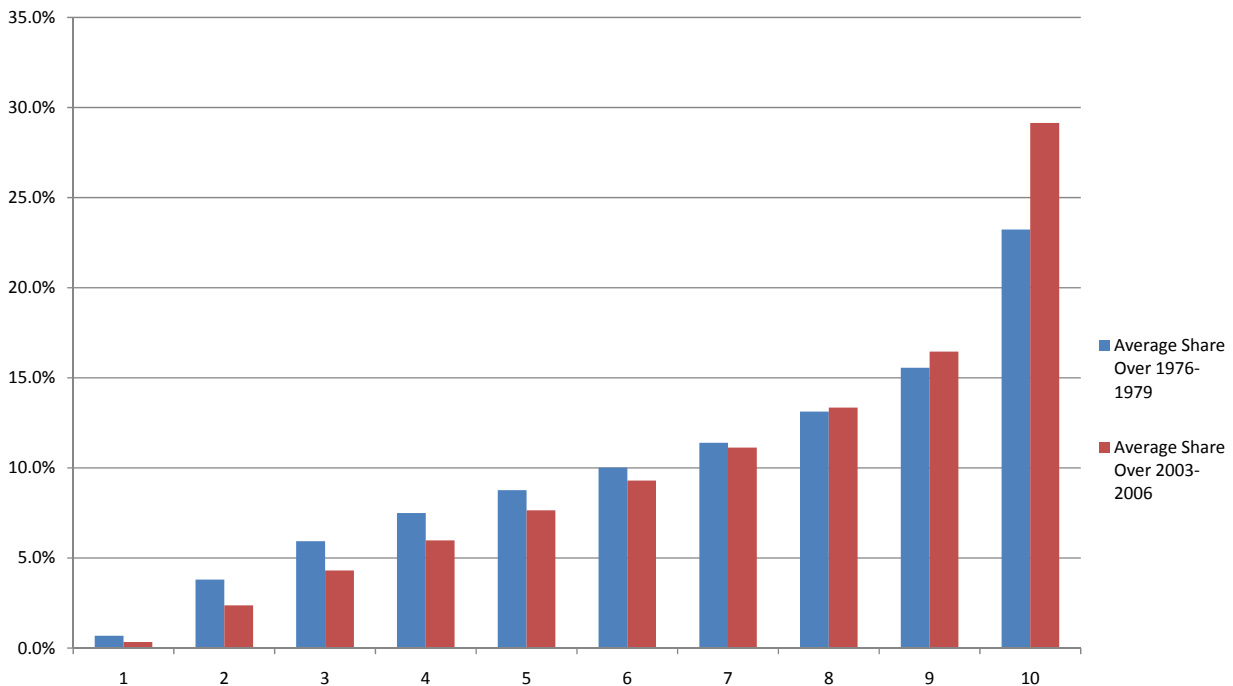


Figure 4: Richest 10% are breaking away from the pack: Median Earnings (in constant \$2006) of Families Raising Children Under 18, Canada, 1976 - 2006



**Figure 5: The shares of earnings are becoming more concentrated at the top:
Comparing distribution of earnings among Canadian Families with Children
in the late 1970s with today**



This shift can also be described in terms of the different share of all earned income flowing to each decile. Between 1976-79 and 2003-06,⁴ the share of income earned by the bottom 30% of families with children decreased from 10.4% to 7.0%, while the top decile's share increased from 23.2% to 29.1% (Figure 5). Stated yet another way, in 2006 average earnings of families in the top decile were 75 times as high as those of families in the poorest decile, compared to 32 times in 1976. The work of other researchers, using tax filer data rather than the sources used here, indicates that a substantial portion of this trend reflects a sharp increase in the share of income going to the very top of the income distribution. The income share of the top 1% of families grew

from just over 5% in 1982 to 10% in 2000 (Saez & Veall, 2005; Saez, 2005), and the share of income flowing to the top 0.1% (the top one-thousandth) of individuals grew from about 2% at the end of the 1970s to more than 5% by 2002 (Saez, 2005).

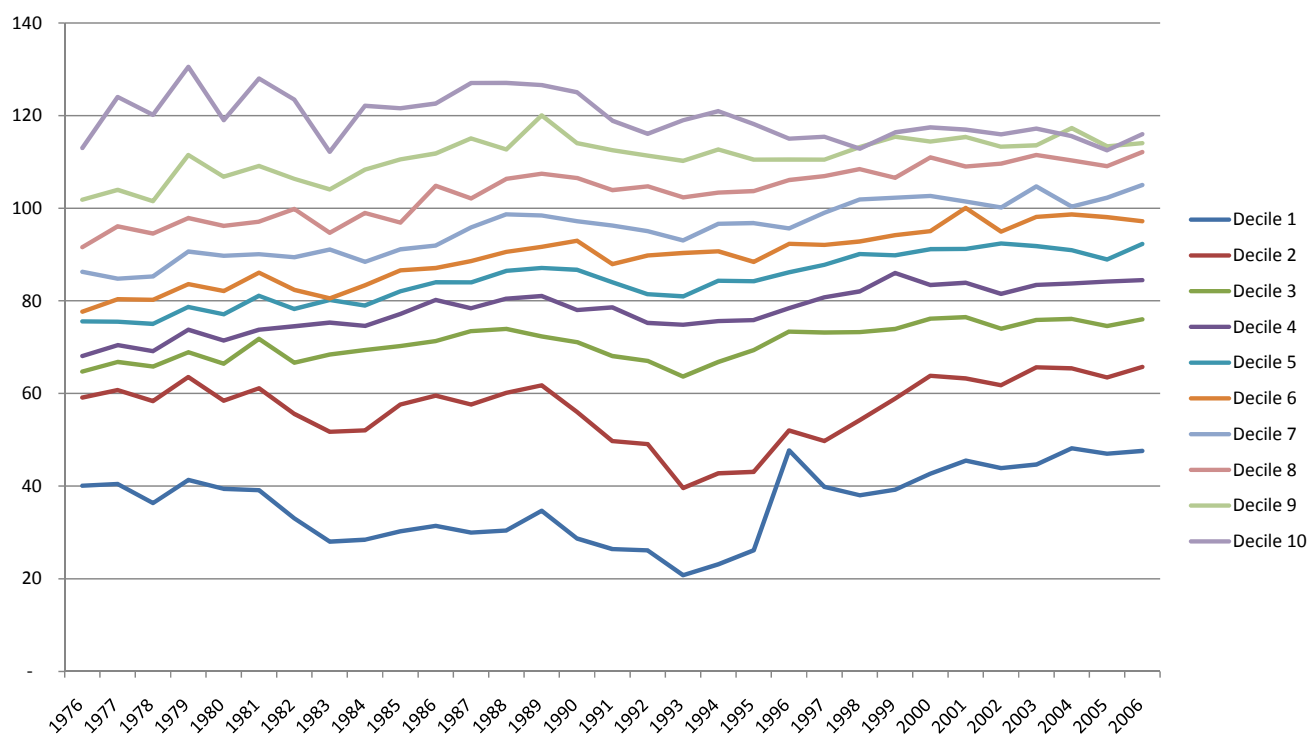
The trend to increasing inequality is driven by rates of pay (wages, salaries, and income from self-employment); it is not explained by a change in the number of hours worked. The same Statistics Canada data set shows that earners in households with children were, on average, working 185 more hours in 2006 than in 1996. This is not true of the richest decile, which showed essentially no variation in their annual hours of work over the decade. Data on hours worked are only available for 1996 and after, but data on weeks worked are available from 1976, and they show a similar pattern. In

⁴ Four-year averages have been used to avoid the inference that single-year dates have been 'cherry-picked' to skew the results.

every decile *except* the top one (Figure 6), the earners who support families were working more, but for most deciles this was not reflected in a commensurate increase in incomes. To the extent that the number of weeks worked reflects an increase in the proportion of families with two working adults, one inference is that for many Canadian families, having two earners served not as a way of getting ahead, but only as a way of not falling further behind. Indeed, although in the late 1970s most families raising children already had more than one worker in the labour market,

only the top two deciles normally had two full-year workers. Today, about half of Canadian families depend on two full-year workers, and families in the bottom half of the income distribution are catching up rapidly to the top half in terms of the total number of weeks worked by a household member. Yet the figures show that this is not translating into any reduction in economic inequality, although they clearly suggest that families with only one earner, unless he or she is close to the top of the income distribution, can expect an increasingly bleak future.

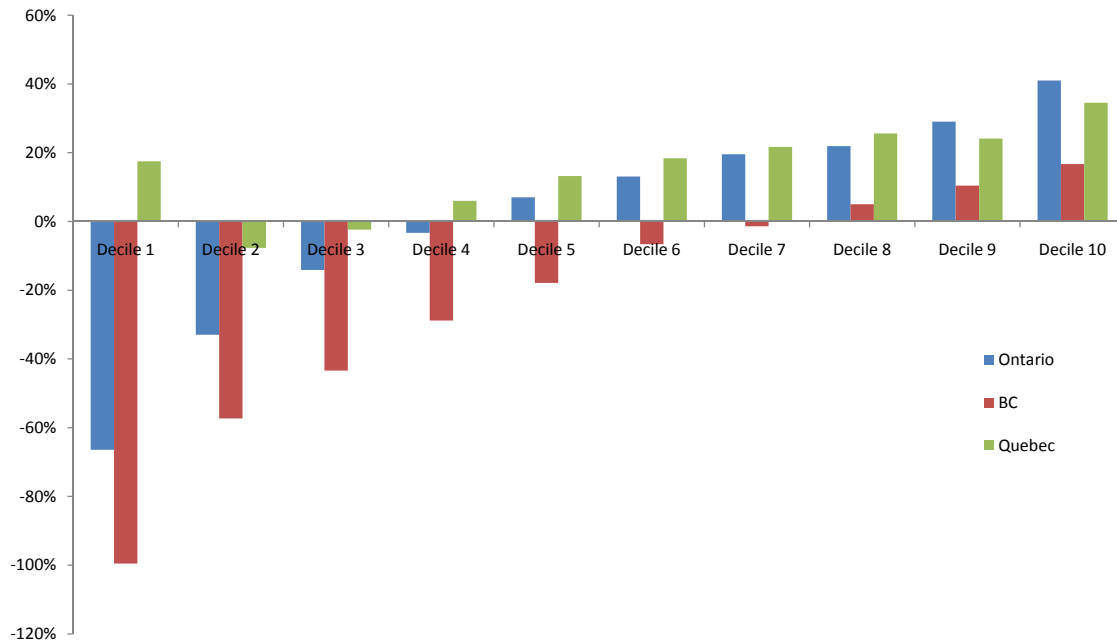
Figure 6: All Households Are Working More - Except the Top 10% Average Weeks Worked, by Decile, Families Raising Children Under 18, Canada, 1976-2004



Because this work was funded in part by a research project focused on the situations of low-income families with children in Canada's three largest metropolitan areas (Toronto,

Montréal and Vancouver), we looked separately at the income distribution patterns in the three corresponding provinces, whose economies are dominated by these three large cities (Figure 7).

Figure 7: Change in Earned Incomes, Comparing Families Raising Children in late 1970s to those in early 2000s, in Quebec, Ontario and B.C.



Ontario has the nation's widest dispersion in earned incomes, with median earned incomes for the top decile of families increasing from just under \$123,000 at the start of the recessionary 1980s to just under \$188,000 in 2006 (in constant 2006 dollars), while the bottom 40% of families were earning less than a generation earlier. In B.C., what is especially noticeable is a strong loss in earning capacity for the bottom 70% of the income distribution. In fact, the median earnings of B.C. families with children declined by 12% between 1976 and 2006. In Quebec, the bottom 50% of families raising children were earning less by the early 2000s than in the late 1970s, but the declines at the very bottom of the income spectrum were not as precipitous as in many other jurisdictions. This is because incomes for the poorest families with children were lower in Quebec than in any other jurisdiction with the exception of New Brunswick in the late 1970s.

What accounts for the general pattern of increased inequality of earned incomes? Although a detailed discussion would take us far beyond the scope of this chapter, a few possible contributors can be identified.

One, perhaps the most familiar in the economics literature, involves the rising returns to 'skill' – an ill-defined variable for which formal education is often used as a proxy – and the collapse in demand for "unskilled" labour throughout high-income countries (Nickell & Bell, 1995). Statistics Canada figures show that people with no more than a high school education experienced dramatic declines in their median earnings during the period 1980-2000, as compared with the experience of those with university degrees. However, during the period 2000-2005 strong growth meant that even the 'unskilled' experienced modest earnings gains (Chung, 2006). Nonetheless,

between 1997-98 and 2006-07, “average earnings of managers grew a solid 20%, four times the rate for other employees,” accounting for at least one-third of the earnings growth among the highest-paid five% of private sector employees. Only a small part of this growth was accounted for by the rising percentage of managers with university degrees (Morissette, 2008). So education, while obviously important in explaining earnings inequality, is only part of the picture.

A second factor, particularly relevant to the bottom of the income distribution, is a decline in minimum wage rates and other elements of the wage ‘floor’. Between 1976 and 2005, the real value of the minimum wage in B.C. and Québec dropped by 21%; in Ontario, it dropped by almost 17% (Murray & Mackenzie, 2007). Relatedly, as we show in section 3, systems of income support such as jobless benefits and social assistance were stripped back. The combination of a declining real minimum wage and the reduced availability and value of income support had direct effects on after-tax income, but also exerted downward pressure on the reserve wage: the price at which a worker is compelled to provide his or her labour. As noted in the discussion of education, a third factor is the rapid growth in rates of pay for those at the top of the income spectrum – compensation that has little relation to the productivity and/or profitability of the firm in question (Mackenzie, 2009).

It is plausible, in turn, to view these trends as reflecting the combined effects of privatization, economic deregulation and continental economic integration underpinned by the Canada-US Free Trade Agreement – all elements of the neoliberal economic agenda pursued by the Conservative government that came to power in 1984. Explaining interprovincial differences in earned income trends is more complicated. Growth in dispersion in Ontario after the mid-1990s might have something to do with the policies of a Conservative provincial government that

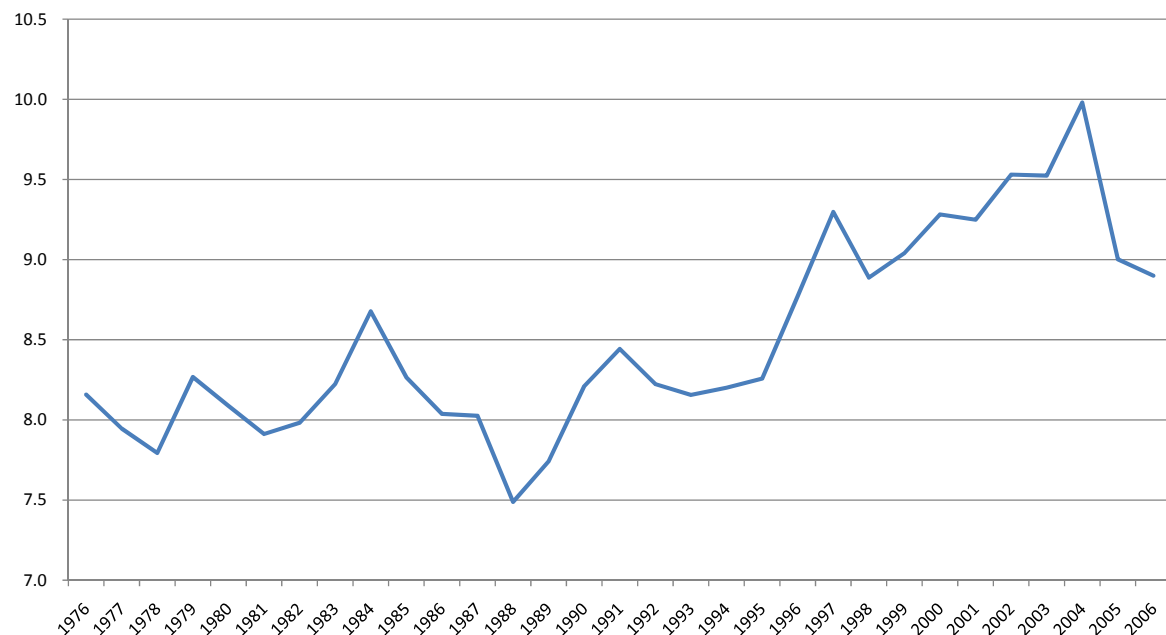
actively pursued closer integration with the US economy, including legalizing the 60-hour work week (a measure that was repealed when a new government took office), as part of a “North American region-state” (Courchene, 2001). The bottom of the wage spectrum saw downward pressure, as in all jurisdictions, and there was a marked increase in the prevalence of temporary and casual work without the protection of relevant or enforced employment standards. At the other end of the spectrum, Ontario is home to the financial capital of Canada, a sector in which executive compensation has exploded in the past decade, here as elsewhere, as economic growth has increasingly become driven by financial gains rather than increases in production. Such gains in executive compensation set the tone for accelerating increases in the price of high-level management in unrelated industrial sectors, viewed as the cost of competing to attract ‘talent’ where needed.

Whatever the explanations, the data provided here refute the claim that GDP growth necessarily leads to widely shared increases in prosperity. Instead, over the course of a generation during which the value of Canada’s economic product more than doubled, the earned incomes of families with children in the bottom half of the income spectrum declined.

3. Government makes a difference: the retreat from redistribution

Government makes a difference in income distribution both directly and indirectly. The public sector is a major source of employment in most high-income countries, and the wages, salaries and benefits it provides its workers establishes a model for compensation. Governments also determine the rules for private sector payment, and the levels of income below which citizens can expect not to be permitted to fall. The ‘floor’ is established through the standards government sets through minimum wages and other elements of labour law, and by redistributing income using taxes

Figure 8: After-Tax Rich/Poor Income Gap Soared Over Past Two Decades, in good times and bad



and transfers. In Canada, as noted earlier, the effect of transfers is particularly important in increasing the incomes of those at the bottom of the economic scale.

However, Canada's social safety nets have *not* prevented increases in economic inequality. As shown in Figure 8, the gap between the average incomes after taxes and transfers of the top and bottom deciles of families raising children, after remaining relatively stable for two decades, started a rapid climb in the mid-1990s. This trend can be attributed to the combined effects of several changes in social policy. For example, between 1990 and 1996, Canada's unemployment insurance system had been 'reformed' four times, reducing eligibility, duration of benefits and income replacement levels. During the recession of 1990-91, 83 per cent of the unemployed received jobless benefits. By early 2009, as the most severe global economic crisis seen since the 1930s engulfed world economies, only 43% of Canada's unemployed were in receipt of jobless benefits. Not since the early 1940s had

Canadians been so exposed to economic risk, and this occurred by design (Yalnizyan, 2009). Meanwhile, reductions in eligibility for jobless benefits meant that between 1995 and 2007 the Canadian government took in \$54 billion more in EI premiums from workers and employers than it paid out in benefits (Canadian Institute of Actuaries, 2007), making this payroll tax a major contributor to successive federal budget surpluses. Further, termination of the Canada Assistance Plan in 1995 marked "the end of at least a forty-year commitment by the federal government to play a direct and specific role in funding social assistance in association with the provinces" (Rice & Prince, 2000, p. 125). Contemporaneously, income tax cuts nationally and in at least two provinces (B.C. and Ontario) disproportionately benefited high earners (Lee, 2007).

The cumulative effect of these and other policy changes was described in a recent Statistics Canada report: "Redistribution grew enough in the 1980s to offset 130% of the growth in family market-income inequality -- more than

Figure 9: Government Transfers, Not Tax Cuts, Made the Biggest Difference
Most Families Raising Children in Canada Percent Change to Median
Incomes, by Decile, Comparing 1976-79 to 2003-2006

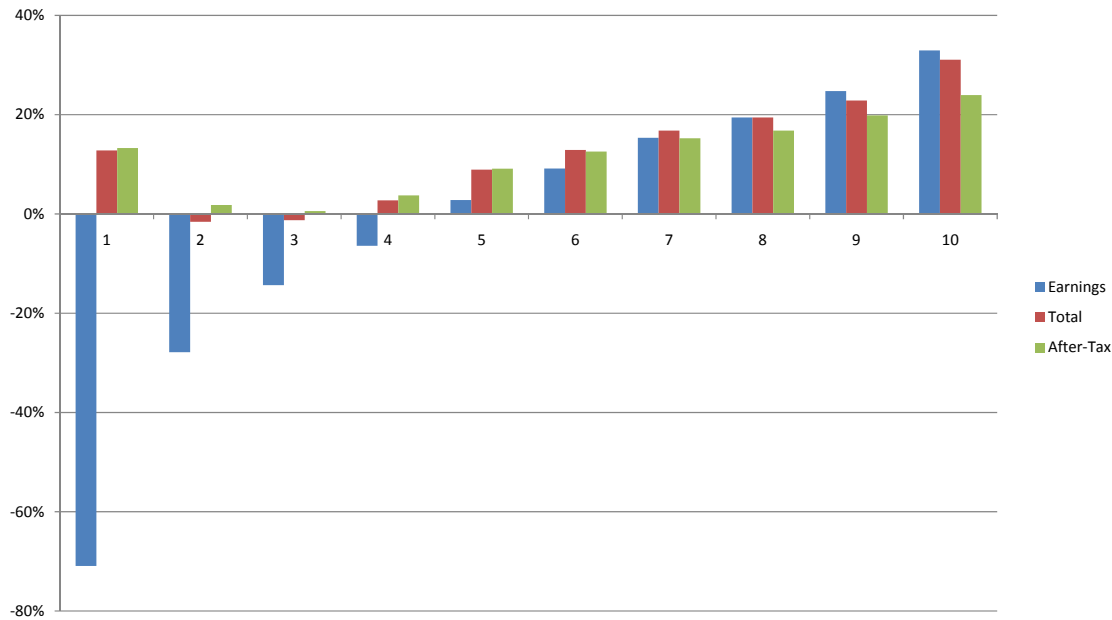
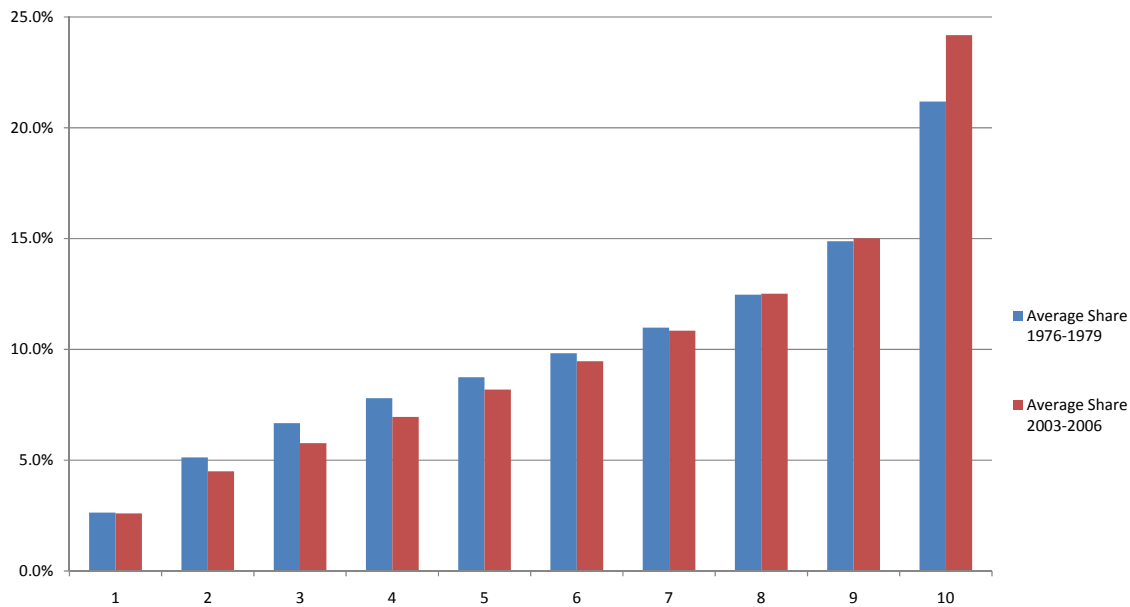


Figure 10: Top 10% only ones who increased share of after-tax income
Percentage Change in Shares of Incomes between the Periods of 1976-79
and 2003-06 for Families Raising Children, by Decile, Canada



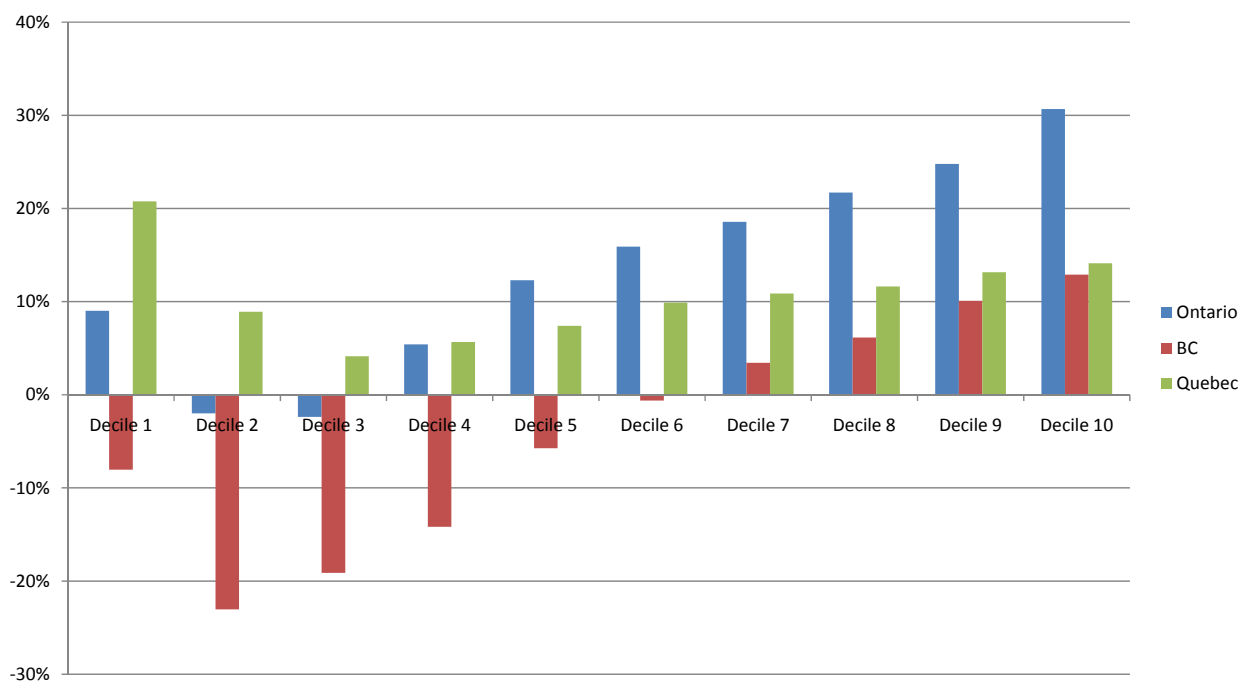
enough to keep after-tax income inequality stable. However, in the 1990-to-2004 period, redistribution did not grow at the same pace as market-income inequality and offset only 19% of the increase in family market-income inequality” (Heisz, 2007). This is entirely consistent with the broader pattern of neo-liberalization described by Wahl and by Goodman in their chapters in the volume.

Although there is no evidence of cause and effect, the social and tax policies pursued by the federal Liberal government post-1993 are remarkably congruent with the advice provided by the International Monetary Fund’s Mission to Canada in 1994 and 1995 (Halifax Initiative,

1999),⁵ and are best viewed as complementing and intensifying the market-oriented policies, in particular continental economic integration, initiated pre-1993.

Figures 9 and 10, on the preceding page, tell the story in different ways. Figure 9 shows that government transfers more than compensated for the precipitous declines in the earned incomes of families in the bottom decile over the course of a generation, but barely kept the rest of the bottom half from falling behind. And Figure 10 shows that the top 10% of families were the *only* group that increased its share of income after taxes and transfers in any meaningful way over the past generation.

Figure 11: Change in After-Tax Incomes, Comparing Families Raising Children in late 1970s to those in early 2000s, in Québec, Ontario and B.C.



⁵ The IMF Mission’s recommendations to Minister of Finance Martin were released to the Halifax Initiative in 1999, in response to an Access to Information Act request.

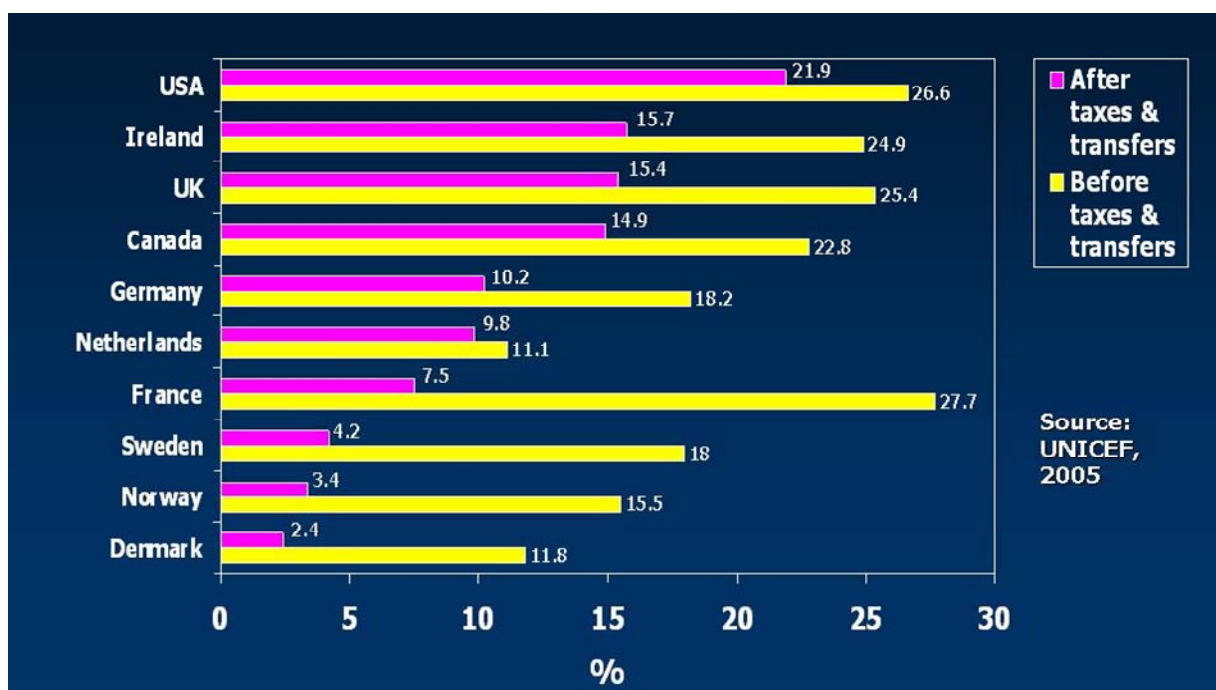
Striking interprovincial differences exist in the redistributive effect of taxes and transfers (Figure 11, on the preceding page). In Québec, transfers resulted in a large increase in median after-tax incomes for the bottom decile over the past generation, and a significant increase for the second decile, although almost no increase for families in the third decile. In B.C., by contrast, transfers did not prevent the bottom six deciles (60%) of families with children from losing ground economically, primarily as a result of reduced earning capacity; only the top 20% were significantly better off than a generation earlier. The Ontario picture shows that the poorest decile saw some improvements over the course of a generation (a 9% increase but in dollar terms, only about \$1,500 more, or \$130 a month). But the second and third deciles both lost ground. In contrast, the top three deciles saw important increases in their after-tax incomes, increases

of at least \$20,000 a year, in inflation-adjusted terms, from one generation to the next.

Improvements for families in the bottom decile of the distribution throughout the country were primarily driven by the introduction and enhancement of the federal Canada Child Tax Benefit in the early 1990s, which converted a universal family allowance to an income-targeted support. Child-targeted supports have been the only significant federal policy initiative for improving income redistribution since the early 1990s.

It is important to emphasize that governments' retreat from redistribution is not confined to direct income transfers. The retreat has also been evident in the reduced provision of various kinds of in-kind services: the reduced scope of provincial health insurance coverage and the withdrawal of the national (and some

Figure 12: The Impact of Taxes and Transfers on Child Poverty



provincial) governments from the housing policy field, adding to the problems of housing affordability experienced by lower-income families (Shapcott, 2009), are two examples with particular significance for families lower in the income distribution. Therefore, the description provided here almost certainly understates the extent to which the social protection functions of the Canadian state have been curtailed or privatized, in favour of a norm that at least implicitly regards a higher level of inequality as acceptable and shifts risk to the individual or the family (Fudge & Cossman, 2002). Tax reforms over the past decade could have been used to close the gap, as was the case in several European nations. However the net effect of tax reform in Canada was to do the opposite: provide most of the benefit of tax cuts to those already most affluent. A study comparing changes in tax policy across the OECD's 30 member countries between 2000 and 2006 concluded: "Across the OECD, tax-burden changes have tended to favour low-wage earners. But in a significant minority of countries, tax reforms have mainly benefited higher-income groups" (Organization for Economic Co-operation and Development, 2008, p. 39). Canada, like the United States and Australia, was among this minority.

The lesson that government can make a difference is clear from other international comparisons. Figure 12 shows child poverty rates before and after taxes and transfers in the late 1990s, using a standard measure of poverty (family income <50% of national median, adjusted for family size), for selected high-income countries. On the basis of market income, almost 23% of Canadian children, almost 28% of French children, and 18% of Swedish children would have lived in poverty. However, France used social spending to reduce this figure to 7.5%, and Sweden to 4.2% – a far more impressive performance than Canada's.

4. The future of inequality, and what it means for families

We have described a picture in which (a) the market has not benefited many Canadian families over the past generation, and (b) governments have gradually retreated from the responsibility for mitigating the effects of differences in earned income through social provision. It is too early to assess how the impacts of the severe recession that began in 2008 will be distributed, but if past patterns hold it is likely to result in a further increase in economic inequality, at least over the short term. Governments could have made creative use of deficit-financed fiscal stimuli to reduce both these impacts and the longer-term trend toward growing inequality, including both sharply increased direct transfers to low-income families and equity-oriented priorities for infrastructure investment, emphasizing such uses as affordable housing and public transportation. At time of this writing (June, 2009), little evidence can be seen either of this approach or of an effort to increase the progressivity of taxation (the extent to which higher-income and families pay a greater proportion of their incomes in taxes, reflecting their greater ability to pay).

Over the longer term, several issues are of concern. Increases in economic inequality at the national and provincial level have been accompanied by increases in the concentrations of high and low income in Canadian cities (Caryl Arundel and Associates, 2003; Ross, Houle, & Aye, 2004; Hulchanski, 2007). In the Toronto Census Metropolitan Area (CMA), 2001 census data showed that "the rising income gap between high and low-income families was mirrored by a rising gap between high and low-income neighbourhoods. In Toronto, median family before-tax income in the poorest 10% of neighbourhoods rose 0.2% from 1980. In the richest 10%, it was up 23.3% ... This increasing difference was observed in all larger CMAs. This steady rise in the income of high-income neighbourhoods suggests a

widening gap between the rich and poor that is not only seen in income polarization but also in terms of spatial polarization” (Heisz, 2006, p. 11). If a continued increase in inequality at the provincial level is reflected or magnified through spatial segregation at the metropolitan level, the effect on the social sustainability of our cities (Polèse & Stren, eds., 2000) and their desirability as places to raise families, for all but the wealthiest, will be highly destructive.

Further, simple arithmetic tells us that unless economic recovery is exceptionally robust, governments that are now going deeply into deficit (for good reason) may experience a debt hangover for the next decade. Today deficit spending is all the rage, but tomorrow the need to reduce those deficits and pay off the accumulated debt could be invoked to justify a further retreat from social provision, as even

today’s safety nets are declared unaffordable in a context in which shifting the burden of taxation to higher income families appears a forbidden topic. It is commonplace in 2009 to hear that the economic crisis has led to a reconsideration of the neoliberal, market-oriented policies of the 1980s. It is also possible, however, if recession leads to further increases in inequality the response will involve not a strengthening of safety nets but rather a new cycle of withdrawal from social provision, as recovery’s winners see little reason to pay taxes to improve the situation of those left behind. Already in 2006 Canadian health economist Robert Evans, citing rapid recent increases in economic inequality, wondered: “If we are back to a pre-war income distribution, how much of our post-war social policies can survive?” (Evans, 2006).

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