Income Inequality: The Canadian Story

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Context and Rationale

• Several factors brought the long-standing issue of rising income inequality to the centre of public consciousness: but the 2008 global recession and financial crisis marked a tipping point.

• Giving rise to the Occupy Movement (slogan: “We are the 99%”).

• Propelling the work of Stiglitz and Piketty to bestseller lists!

• The OECD sounded the alarm on the pervasive, decades-long rise in inequality in most countries -- warning of potentially detrimental effects on social cohesion, political stability, support for trade liberalization, and ultimately long-term economic growth (OECD 2008, 2011 and 2015).

• Speaking of the challenge inequality represents for his country, former U.S. President Obama called it “the defining issue of our time.”
Why a Major Research Project on Inequality in Canada?

• Canadian debate about inequality has been polarized and confusing (at times based on US facts and arguments).

• Competing narratives about what is happening; a tug-of-war between the inequality “Cassandras” and “deniers” to frame the debate (see Banting and Myles).

• The result is ambivalence on this issue. Evident in the last federal election: major focus on inequality policies but the parties’ messaging was about helping middle-class families, not inequality *per se*.

• Research project prompted by the absence of a comprehensive, in-depth examination of the Canadian inequality experience and the lack of consensus about whether it is a problem.

• 27 leading experts gathered to examine income inequality trends in Canada over the past four decades, the factors contributing to its increase and the role of policy.
Has income inequality increased in Canada? The short answer is yes

Source: Figure 3 Heisz and Murphy (in this volume).
Canada is not alone in having experienced rising wage and income inequality.

Source: Income Distribution and Poverty Database (OECD)
We need to look beyond the GINI to really see what has been happening in different segments of the income distribution.

![Market income growth by fractile, Canada, 1982-2010 (percent)](chart.png)

Source: Lemieux and Riddell (in this volume).
As in other countries, the market income share of top earners in Canada has increased steadily since the early 1980s (see Lemieux and Riddell).
The decline of the middle class is not a myth

There has been a marked reduction in both the size of the middle class and its share of overall earnings over an extended period.

Source: Beach (in this volume).
FTFY male and female earnings share by earnings level, 1970-2005

Source: Beach (in this volume)
Rising income inequality is often associated with growing poverty. But Canada has seen some progress on that front.

Share of population in poverty under LICO and LIM measures, Canada, 1976-2011

Source: Heisz (in this volume).
LICO = low-income cut-off
LIM = low-income measure
Why did inequality stop growing in Canada?

• Inequality continued to rise in most OECD countries in recent years but has been relatively stable in Canada since 2000.
• Our research shows that two Canada-specific factors played an important role in that stability
• Increases in the minimum wages since the mid 2000s have lifted up the bottom of the wage distribution.
• The extractive resources boom (mostly oil and gas) also lifted up the bottom and middle of the wage distribution
  • Strong demand for manual jobs, which raised the earnings of low skilled workers, especially males
Average minimum wage in Canada, $2015

[Graph showing the average minimum wage in Canada from 1997 to 2013. The wage shows a general trend of increase over time.]
Canada: Men and Women

-0.2 0 0.02 0.04 0.06 0.08 0.1 0.12 0.14

Percentile

0 10 20 30 40 50 60 70 80 90 100

Source: Fortin and Lemieux (2015)
The extractive resources boom
(while it lasted...)

• The dominant trend across provinces is the much faster wage growth in Newfoundland, Saskatchewan, and Alberta than in other provinces since the late 1990s.

• Using Ontario as a benchmark, average wages have grown by 20 percentage points more in these three provinces.

• The resource boom “lifted all boats” (especially less educated workers) and contributed to a decline in inequality.

• Over the 2000-2015 period income inequality trends in Ontario and Quebec were similar to those in the U.S.
Income Mobility: A Key Indicator of Economic Opportunity

- Most inequality measures use cross-section data
- Income mobility refers to degree to which individuals or families move within the distribution over time – need longitudinal data
- Recent StatCan studies follow families over 5-year intervals using tax data (see Heisz chapter)
- Income mobility fairly high in Canada but has declined recently
- Percent of individuals remaining in same decile rose from 26% in 89-94 to 33% in 2005-10
Inter-generational mobility

• Another important indicator of economic opportunity
• There is a correlation between inequality and inter-generational mobility – ‘Great Gatsby curve’
• Inter-generational mobility higher in Canada than US (Heisz Fig 11)
• However, some evidence indicates that intergenerational mobility is deteriorating
• See chapter by Heisz for summary of studies
Income inequality in Canada has increased significantly over the past 30 years.

Large increases in income among top earners; anemic income growth for the middle class and those at the bottom of the distribution.

Inequality was more or less stable in the 2000s, in part due to resource boom. But what happens now?

Evidence of decline in both income and intergenerational mobility.
The Bottom Line (2)

“Thus, middle-class and low-income families face not only a lack of progress in income for themselves, but also a genuine worry that their children will not be able to improve on their lot.”

“The combination of greatly increased concentration of income at the top, and reduced chances of getting there for the rest, signals a society that is substantially less equitable and less inclusive than it was three decades ago.”
Explanations for Rising Inequality

• The causes of increased inequality have been the subject of much recent economic research

• Leading explanations:
  1. Skill biased technical change/routine biased technical change
  2. Globalization of production, increased trade and openness
  3. Institutional changes: minimum wages, unionization, deregulation of product markets

• These factors are interdependent – e.g. technical change (ICT revolution) has facilitated globalization of production (‘death of distance’)

• Much evidence points to technological change and globalization of production playing major roles. But puzzles remain.

• More detail in appendix slides.
Institutional change

• Institutional changes in labour and product markets have also contributed to rising inequality

• Declining unionization and decreases in real minimum wage are key changes in labour markets

• Deregulation in product markets may have contributed to wage inequality but also to lower prices for consumers

• Minimum wages tend to reduce wage inequality but may also reduce employment opportunities

• Declines in real MW in US and Canada during 1980s and 1990s contributed to greater wage inequality

• Higher MWs in Canada since early 2000s have contributed to relative stability of wage inequality at bottom of distribution
Policy Options:
What Can and Should be Done?

• Green, Riddell and St-Hilaire set out the elements of an ambitious policy agenda to deal with inequality in Canada (chapter 1)

• Policy approaches consist of two main types:
  • Policies that impact pre-tax and transfer income inequality
  • Tax and transfer policies

• Although we prefer to focus on the former, we need a multi-pronged approach that includes both
Policy Options: General Themes

• Marginal changes to existing policies are unlikely to be effective – larger changes are needed.

• Although all advanced economies are affected by technological change and globalization of production, countries have choices – policies can influence outcomes

• Decline of worker bargaining power is a common problem that needs to be reversed
A declining share of income allocated to labour and the bottom 99%

Labour share of total income with and without the top 1 percent of earners, Canada, 1982-2008

Source: Lemieux and Riddell (in this volume).
Policy Proposals (Green/Riddell/St-Hilaire)

- Human Capital – from early childhood to post-secondary
- Labour market polices: minimum wages
- Labour market policies: unions
- Enhancing worker bargaining power: collective representation
- CEO compensation practices
- Corporate governance
- Income transfers: refundable tax credits
- Taxing top incomes
Human Capital Policy

• Education is often presented as something of a panacea.

• Foley and Green argue that human capital policy as currently done is not an answer to inequality –and more of the same may even make things worse.

• Post-secondary system has inter-generational unfairness built into it.

• Risk-averse lower-income households often don’t take up available options or respond to existing incentives (e.g, RESPs, Canada Learning Bonds).
Human Capital policy – The Bright Side

• An ongoing theme emerges: more of the same is not the answer.

• Early childhood policies and straight transfers to lower-income families seem to have beneficial effects in the long run.

• Our suggestions:
  • Change mindset on value and returns to education
  • Free tuition for lower tercile of income distribution
  • Income contingent student loans provided more broadly
  • Early childhood policies and income transfers targeting lower-income families (e.g. earnings supplements such as WITB)
Minimum Wages

• Minimum wage increases have had discernible effects in reducing individual wage inequality in recent years (Fortin and Lemieux).

• But previous literature indicates this does not translate into reduced household income inequality or poverty.

• Perhaps not surprising when standard minimum wage (even after recent increases) still leaves FTFY urban workers below the poverty line (LICO).

• Again, more of the same is not enough.

• Recommendation: raise the minimum wage to $15 in large cities.
Enhancing Worker Bargaining Power

• Decline of private sector unionization has contributed to wage inequality.

• Making labour laws more favourable toward unions would raise unionization, but would have little impact on wage inequality (Legree, Schirle and Skuterud).

• Reflects current state of unionization with only 17% of private sector workers unionized compared to 75% of public sector workers (who tend to be well educated and remunerated).

• Enhancing workers’ bargaining power requires stepping outside traditional ‘Wagner Act’ model.

• Among several potential models of how to do this, one promising route:
  • Build on existing statutory joint labour-management committees with specific mandates (e.g., workplace health and safety)
  • Broaden role of these joint committees to cover a wider range of issues
  • Provides form of workplace democracy (‘collective voice’) valuable in its own right
Reducing Bargaining Power at the Top

• Dramatic growth in top incomes driven by two groups: senior managers (especially CEOs) and those in banking and finance (Lemieux and Riddell).

• Important to not reduce ability to attract top talent.

• However, evidence indicates enormous pay increases primarily reflect ability to extract economic rents.

• This reduces share of national income going to shareholders and workers.

• Reducing rent extraction requires improved compensation practices and better corporate governance.
CEO Compensation Practices

- Well-designed compensation practices can better align interests of managers and shareholders.
- Much evidence that compensation practices for senior executives not well designed.
- Dramatic rise in executive compensation propelled by increased use of stock options and bonuses, in many cases without improvements in performance.
- Contributing factor is corporate directors’ mistaken view that stock options represent a less costly form of compensation than equivalent cash payment.
- Points to need to improve expertise of corporate boards and compensation committees.
Corporate governance in Canada also requires policy attention

• “Shareholder democracy in Canada remarkably stunted compared to US and UK despite shared Common Law heritage” (Mork).

• Much greater prevalence of dual class shares and pyramiding are key contributors to low international ranking in corporate governance.

• These practices can be altered by policy and capital market institutions.

• Insider trading in Canada is a striking example of rent capture.

• Need for a thorough assessment of how Canada’s tax regulations and other factors influence executive compensation to identify policies likely to be effective.
Income Transfers

Long history in Canada and elsewhere of policies to deal with low incomes.

We prefer policies that:

- Are well targeted at those with low incomes
- Strengthen work incentives
- Have broad public support
- Are relatively inexpensive to administer
- Interact well with other policies
Refundable Tax Credits

• Earnings supplements for working poor best meet these objectives.
  ✓ Prominent examples include: EITC in US, WFTC in UK, and WITB in Canada. Substantial body of research on EITC and WFTC.

• Canada adopted this approach much later than US and UK, and we have yet to embrace this approach in a meaningful way.

• Compared to EITC and WFTC, WITB earnings supplement is very small and affects a narrow and low income range (e.g., someone working FYFT at minimum wage receives nothing from WITB in most provinces).
Working Income Tax Benefit (1)

• To play a significant role in reducing low incomes, and to provide meaningful work incentives for the working poor, WITB needs to cover a wider range of income.

• Refundable tax credits also well-suited to help those with low incomes from non-standard work – an important source of low income in Canada.

• Either raise income level at which phase-out begins or reduce rate at which earnings supplements are phased out.

• Size of maximum earnings supplement also needs to be substantially increased.

• One reason WITB is currently phased out at a low income level is to minimize overlap with phase-outs of federal and provincial child benefits and provincial income supplements.

• However, new Canada Child Benefit incorporates gentler phase-out that starts at higher income levels – so room to expand WITB without generating high METR.
One attractive feature of earnings supplements is that they increase work activity of low-skilled workers.

Potential concern, however, is that by increasing labour supply they also reduce wages at low end of wage distribution, so benefits go in part to employers of low-wage labour.

Some evidence of this in US and UK, though reduction of wages is modest.

However, to the extent that this occurs, higher minimum wages and earnings supplements can interact to ensure that most of benefits go to workers.
Taxing Top Incomes (1)

• Higher income tax rates on top earners should be part of solution to reduce inequality. However, this solution may not be straightforward (Milligan and Smart).

• One reason is that top earners can respond to tax increases by reducing reported income through use of tax shelters and income shifting.

• Potential for income shifting greater for provincial than for federal tax increases.

• Progressive taxation at federal level doesn’t generate inefficient inter-provincial tax competition and provides revenue for national social programs.

• Our view: Making tax system suitably progressive should take place principally at federal level.
Taxing Top Incomes (2)

• There may be room for further increases in top tax rate, but it would be preferable to first let dust settle from recent tax-and-transfer changes.

• Furthermore, major cleanup of the tax system should precede further changes in rate structure, such as:
  ✓ Reduce or eliminate unnecessary tax preferences that disproportionately benefit top earners (various authors)
  ✓ Even out the tax treatment of capital gains and dividends by raising the 50% inclusion rate (Davies)
  ✓ Reassess Employee Stock Option Deduction (Veall)
  ✓ Review role of private corporations in providing preferential tax treatment to certain groups (Wolfson, Veall and Brooks)
Conclusion

- We have set out the elements of an ambitious policy agenda to deal with inequality in Canada.

- No single policy or approach will be enough to reverse the inequality that has become deeply embedded in Canada’s economy and society.

- The agenda we propose will require decades rather than years to implement and have an impact.

- But if the road is long, there is every reason to get started on it right away.
A must-read for anyone who wants to understand the disturbing trends in inequality in Canada — as well as what might be done about it.

- Nobel laureate Joseph Stiglitz
Appendix: Additional Slides
Explanations for Rising Inequality

• The causes of increased inequality have been the subject of much recent economic research

• Leading explanations:
  1. Skill biased technical change/routine biased technical change
  2. Globalization of production, increased trade and openness
  3. Institutional changes: minimum wages, unionization, deregulation of product markets

• Challenge for empirical research: determining the relative contribution of these driving forces
Skill Biased Technical Change

• Skill-biased technical change (SBTC): new technologies (especially those associated with the ICT revolution) complement workers’ skills and competencies in performing analytical cognitive tasks
• Thus SBTC increases the productivity of highly educated and highly skilled workers, increasing their labour demand
• Unless these changes in labour demand are offset by changes in labour supply, this results in widening earnings gaps between the skilled and unskilled
• Technical change isn’t necessarily skill-biased; e.g. Industrial Revolution lowered demand for skilled artisans
• But evidence suggests it has generally been so in past century – EG “The race between education and technology” (Goldin and Katz 2008)
Skill Biased Technical Change

• Major puzzle: wage gap between less-educated and highly-educated workers increased since beginning of ICT revolution while supply of well-educated workers was also rising.

• SBTC hypothesis was able to explain this phenomenon: SBTC was increasing relative demand for skilled workers faster than growth in relative supply.

• SBTC explanation did well during early period of computer adoption in the workplace beginning in 1970s and 1980s, but has difficulty explaining more recent behavior.
Routine Biased Technical Change

• More recently SBTC hypothesis reformulated as “routine biased technological change”

• How computerization affects workplace – replaces tasks based on well-defined rules and procedures

• Researchers classify occupations by tasks:
  • Cognitive-task occupations entail abstract thinking and analytical skills eg professional and managerial
  • Routine-task occupations involve repetitive tasks eg manufacturing and clerical
  • Non-routine manual occupations require non-repetitive tasks and personal interaction eg sales and service

• Routine-task occupations are replaceable with computers and are generally in middle of occupational wage distribution – eg book keepers
Routine Biased Technical Change

• Routine biased technical change thus leads to declining labour demand in the middle of the occupational earnings distribution

• Unless offset by supply responses, this implies lower employment and wages in middle-skill occupations --“job polarization” and “wage polarization”

• Evidence of polarization of family incomes in Beach chapter on decline of middle class

• But is there evidence of polarization for individual workers?
Polarization of labour markets

• Green and Sand “Has the Canadian Labour Market Polarized?” reviews international evidence and provides Canadian evidence
• Evidence of polarization in employment in US and Europe since late 70s/early 80s
• However, wages have followed different patterns
• Europe: wages of low-skilled occupations falling relative to middle, and ages of high-skilled occupations rising – ie growing wage inequality
• Evidence for US: rising wage inequality in 1980s and 2000s but job and wage polarization in 1990s
Job Polarization in Canada

• Green and Sand show clear evidence of job polarization over period 1971-2006
• Large increase in management & professional employment (cognitive task occupations)
• Also increase in sales and service (non-routine manual)
• Declines in middle of occupational skill distribution: secretaries & clerical and production, crafts, operatives
• However, job polarization stopped after 2000
Wage Polarization in Canada

- Green and Sand figures show changes in real wages by percentile by decade and over entire period
- Decades of 80s and 90s show clear evidence of increasing wage inequality, not polarization
- Much smaller increase in wage inequality in 2001-2006
- Modest evidence of polarization 2006-2011
- Resource boom plays some role – patterns are very different in Alberta vs Ontario
- Overall, limited evidence of wage polarization
Globalization of production

- Globalization of production and increased openness in world economy has reduced wage and employment opportunities for those whose work can be outsourced to low wage countries.
- Typically these are jobs in the middle/lower middle of the wage distribution in developed countries – e.g., manufacturing.
- However, outsourcing of services increasingly feasible e.g., accounting, legal, software code.
- Technical change plays a role here also, as it has made globalization of production more feasible.