



# The Canada We Want in 2020

Towards a strategic policy roadmap for the federal government

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**REDUCING INCOME DISPARITIES AND POLARIZATION**

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# REDUCING INCOME DISPARITIES AND POLARIZATION

PREFACE AND INTRODUCTION

WHY CANADIANS SHOULD CARE  
ABOUT INCOME INEQUALITY

Mark Cameron

1

INCOME  
REDISTRIBUTION IN CANADA

Andrew Sharpe

7

INEQUALITY  
IS NOT INEVITABLE

Sherri Torjman and Ken Battle

14

## ABOUT CANADA 2020

Canada 2020 is a non-partisan, progressive centre working to create an environment of social and economic prosperity for Canada and all Canadians.

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The logo for Canada 2020 features a red curved line above the text "CANADA 2020.CA". The word "CANADA" is in red, "2020" is in grey, and ".CA" is in red.

CANADA 2020.CA

## PREFACE

# MAKING STRATEGIC CHOICES

GOVERNING IS ABOUT making choices. Sometimes the choices governments make are strategic, the product of hard thinking to address major hurdles which coalesce at a particular point in time. It is our belief that Canada is at such a point in time today and it is for this reason that we have produced this collection of papers to kick-start a discussion about the role of the federal government in Canada.

A serious public policy strategy for the country means doing less of some things, while focusing decisively and aggressively on a few important things. This requires in-depth analysis of the really big challenges and opportunities facing the country. It requires governments to be straight with Canadians about the risks and rewards that lie ahead, so that citizens will buy into a clear direction set by government.

The orientation of this volume – indeed the basic orientation of *Canada 2020: Canada's Progressive Centre* – is that the federal government has a vitally important role to play in developing and implementing strategic policies, focusing governments and other institutions in society on the big

challenges the country faces, and mobilizing consensus for action. In other words, we believe that the federal government can be a force for significant and positive change.

This does not mean big government. It means intelligent, innovative, analytical and strategic government. It could conceivably result in smaller government, focused on a few big and important areas of policy that really matter to the country's future.

### FIVE CHALLENGES FOR 2020

Today, Canada faces challenges and opportunities that are quite unprecedented in our recent history, although they may seem rather opaque to most Canadians. Our ability to overcome these challenges – and seize the opportunities – will determine the future trajectory of Canada's economy and society over the next generation. Our standard of living and quality of life could well hang in the balance. This is why we need federal leadership.

Canada 2020 contends that there are five fundamental, inter-related challenges confronting the country which require strategic political leadership and policy action from the federal government.

## 1 Increasing innovation and productivity

Productivity growth and innovation are the sine qua non for economic prosperity. Canada's lack of productivity growth has been a worrying feature of the economy for decades. Since 1984, relative productivity in Canada's business sector has fallen from more than 90% of the U.S. level to 76% in 2007. There are no signs of things improving: quite the opposite in fact.

Since the 1990s, the federal government has been taking steps to try to reverse this trend, primarily by investing in university-based research and development and by cutting personal income and corporate taxes, the standard policy remedies for dealing with flagging productivity performance. Yet Canada's productivity growth has actually become worse over the past decade.

It is therefore time for a much more aggressive, focused and creative federal policy response to Canada's productivity growth and innovation challenge. Without this, we risk falling further behind and losing the revenues that enable us to sustain our standard of living.

## 2 Rising to meet the Asia challenge

The global centre of economic power is inexorably shifting from the West to the East. This trend has been underway for twenty years, but it is now reaching a crescendo, partly as a result of the fiscal and economic problems plaguing Europe and the United States. There is no better evidence of this shift in economic and financial power than the recent efforts by the European Union to persuade China to help prop up the teetering European financial system.

Canada has been on a slow boat to China – indeed to Asia, more generally – for many years, notwithstanding the fact that we have some significant advantages over other countries in this region of the world. Over the past fifteen years,

successive federal governments have made incremental attempts to broaden and deepen Canada's trade, investment and economic relationships with Asian economies. Despite such efforts, Canada is not really on the map in China and India today, in stark contrast to many of our major competitors.

It is time for the federal government to take a much bolder, more creative and aggressive approach to help deepen Canadian ties with Asia and enable Canadian businesses to take advantage of unprecedented market opportunities in the region. We must leverage our unique strengths and advantages and become an indispensable part of the new Asian century.

## 3 Squaring the carbon circle

Canada has among the highest *per capita* levels of greenhouse gas (GHG) emissions in the world (although our total contribution to global GHG emissions is low as a result of the relatively small size of the Canadian economy). High Canadian emissions are due in part to our unique geography and harsh climate, but also to a weak culture of conservation and inadequate policy and regulatory regimes.

Modest measures to reduce emissions have been implemented over the past decade. But these initiatives have been neither significant nor strategic; as a result they have had little to no effect on Canada's overall GHG emissions.

Canada is also fast becoming one of the world's leading fossil fuel producers and exporters. It has even been suggested that Canada is "an energy superpower", or at least can realistically aspire to that goal. With that title are likely to come increased emissions, at least in the absence of meaningful measures to combat these.

As a G8 country, an original signatory to the Kyoto Protocol on climate change, and one of the world's largest per capita

carbon emitters, Canada has a moral responsibility to make progress on limiting GHG emissions (if for no other reason than to set an example for the big emitting countries). We are also at serious risk of missing opportunities in the low-carbon economy of the future and of becoming increasingly marginalized economically if we fail to act. It is therefore time for a serious, strategic effort, led by the federal government, to square Canada's carbon circle and put in place policies that will significantly decrease our GHG emissions.

**4 Reducing income disparities and polarization** Income inequality has been a creeping problem in Canada and other advanced economies for many years now. The bottom two quintiles of the income scale have seen their market incomes decline, in real terms, since the early 1980s (though transfers have resulted in some degree of after tax and transfer growth). At the same time, the top 1% of economic families have accumulated an ever-increasing share of Canada's wealth.

Income inequality, a feature of all market economies, is now giving way to income polarization. While this phenomenon is still more acute in the US than in Canada, some recent studies suggest the gap between rich and poor – and between the superrich and the middle class – is now growing faster in Canada than in the US.

Income polarization can have seriously perverse effects on the economy and on society. At an extreme, it can undermine social cohesion, unravelling the fabric of a country. The Occupy Wall Street protests, and their analogue in other countries, including Canada, are one early sign of the social discontent that can arise from income polarization and a growing perception that the economy is not working for most people.

Income polarization has not, up until now, been a big issue on the federal agenda. Various reforms to federal income security programs and the tax-transfer system have been put in place over the past twenty years, but these have not been aimed at dealing with income polarization. It is time for the federal government to analyze and consider the longer term effects of income polarization, and to consider strategic policy reforms to head off a looming problem.

## **5 Securing our health system for the future**

Universal, high-quality healthcare has been a defining feature of Canada and Canadian citizenship for 40 years. It is the public service Canadians value most. Yet the general consensus among experts is that if we stick with the current funding/administrative models and tax structure, Medicare as we know it is not financially sustainable.

Healthcare costs have been rising significantly as a fraction of our national income and as a share of government budgets (especially provincial budgets) for a generation now. The basic causes of healthcare inflation are well-known: expensive new technologies, procedures and drugs that permit us to live longer, coupled with an aging society.

While healthcare delivery is a provincial responsibility, healthcare financing – paying for the system – has been a dual responsibility, shared by federal and provincial governments, since the beginning of Medicare. In 2004, in response to rising costs and pressures on provincial treasuries, the federal government announced a major increase in federal fiscal transfers to the provinces for healthcare. With some \$41 billion in transfers for health over ten years, the 2004 Health Accord was billed “a fix for a generation”. Unfortunately, it has proven to be little more than a stop-gap for a decade.

As we approach the end of the Health Accord in three years' time, innovative, strategic policy approaches on health-care financing are urgently required. We also need the federal government to provide leadership on the organizational and accountability issues that underpin our health system in Canada.

The scope of federal government activity clearly extends well beyond these five issues. But our belief is that informed, strategic decision-making in these areas will go a long way towards securing the Canada We Want in 2020.

Our choice to address all the issues together has two implications. First, we will, as we move on, have an opportunity to examine the links between areas (for example, the effect carbon policy will have on our trading relations or the links between income inequality and productivity). Second, the broad scope of issues will give us a chance to reflect more critically on the role of the state, and the effectiveness of policy in general in addressing the key issues of our time.

#### **KICK-STARTING THE CONVERSATION**

This volume contains 15 papers, three in each of the five areas identified above. We have brought together a group of authors, all experts in their respective areas, and asked them to approach the issues from a strategic policy standpoint.

For this is what has been missing. The areas have all received attention in the past, but often not in a truly strategic way. Perhaps this lack of policy strategy and priority attention is due to the fact the tipping point has not yet been reached in any given area (although it is looming large in some, notably healthcare financing). Perhaps it is because

governments and politicians lack the ideas to address these issues. Perhaps it is because of scepticism that the federal government can really make a difference. Perhaps we have reached the limits of innovative public policy and governance. Or perhaps we are just avoiding the issues – in a collective state of denial – in the hopes that they will resolve themselves in an acceptable way through incremental policy action.

Whatever the cause, it is time for Canada to break out of this mindset. Many elements of Canadian society – the business community, NGOs, governments at all levels, educational institutions, and Canadian citizens generally – must work to address the challenges. No single entity has the solution. A collective effort is required.

Our goal is to kick-start a strategic policy conversation throughout the country about The Canada We Want in (or by) 2020. Such a conversation has not been evident to date in Parliament, in general elections, in political party platforms, or in the media – indeed in any of the places you would usually expect to see it. The time for that conversation is now. Perhaps it will lead to a consensus among political, business, academic and other leaders in Canadian society that the federal government needs to chart a strategic direction for the country to secure Canada's prosperity and the quality of life Canadians have come to expect. We present this volume as a starting point. ■

# INTRODUCTION TO OUR PROJECT

THIS VOLUME MARKS the culmination of **Phase 1** of our project: *The Canada We Want in 2020*.

The overall aim of the project is to launch a debate about the role of the federal government in Canada. This publication is intended to act as a focus for discussion and a core around which we can bring in ideas from a wider range of people. It is, in this sense, a starting point.

Canada 2020 has called on fifteen authors to share their wide-ranging views in the five areas. Sometimes they agree on policy prescriptions, sometimes they disagree. But what all authors have in common is a belief in the value of discussing the options and thinking strategically about the issues that Canada faces.

In **Phase 2** of the project we will stimulate further conversations in each of our five chosen areas. We will host a series of panel discussions and web-based exchanges that draw on the papers in this volume. These discussions will tease out areas of agreement and disagreement and begin to focus on implementation challenges. We expect to conclude this phase by mid 2012.

**Phase 3** will see us narrowing back down and reaching conclusions. Drawing on the materials from the previous phases, Canada 2020 will produce a final, consolidated publication towards the end of 2012. This document will summarize our conclusions in each of the five areas. It will take into account recent changes and lay out proposed future strategies. ■

## WHAT YOU CAN DO

Our aim is to draw as many viewpoints as possible into this project.

There are several ways you can get involved:

- // Attend our series of panel discussions in 2012**
- // Check our website: download documents, watch interviews and webcasts and make comments**
- // Contact us directly to arrange joint presentations or discussions**

Details are on our project site at: [www.canada2020.ca](http://www.canada2020.ca)

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# REDUCING INCOME DISPARITIES AND POLARIZATION

**POVERTY REMAINS A SIGNIFICANT** and growing problem in Canada. Income polarization is also increasing steadily, to a degree that could threaten social cohesion. Since technological advances and globalization both tend to increase inequalities as returns to unskilled labour decline, this is a problem that will not go away in the absence of significant policy action. It is also a problem, as our contributors stress, that is shared with many other developed countries, though recent increases in income inequality in Canada are towards the high end of the spectrum.

Of the papers in this section, only one – that by **Andrew Sharpe** – suggests a significant rethink of the income support system that has been in place, with little change, for more than 20 years. Sharpe argues that our system should be underpinned by an equality of opportunity agenda, in which greater efforts are made to smooth out both financial and human capital starting points. At present, by contrast, we have a system that takes unequal starting points as a given, focussing instead on correcting the subsequent excesses of market allocations.

A key change under such a system would be the imposition of an inheritance tax. This move would bring Canada in line with almost all other developed countries. Sharpe does not advocate abolishing the existing system of taxes and transfers. These would remain a vital pillar, as would continued public spend-

ing on services such as health and education: Sharpe's own research shows these to have an important equalizing effect. Yet he would like to move beyond these. He believes that the federal government should capitalize on the current heightened public concern about inequality – as evidenced by global protests – and take this opportunity to enact bold new measures in favour of the less well-off.

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**This is a problem that will not go away in the absence of significant policy action**

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All authors are at pains to stress the critical role that government taxes and transfers play in mitigating inequality. The remaining two papers in this section argue that these measures are – or could be – effective on their own. Thus, rather than moving beyond these, either in terms of rationale or actual measures, the federal government simply needs to increase the magnitude of the transfers it makes and/or to extend the number of people who are eligible.

**Sherri Torjman and Ken Battle** are highly concerned with the dynamics of poverty and inequality which, they assert, matters in its own right, over and above its relationship with poverty. **Mark Cameron's** paper also

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## Inequality matters in its own right, over and above its relationship with poverty

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notes the importance that we, as humans, attribute to fairness. His paper makes the case that even those on the right of the political spectrum, who believe in smaller government and less intervention, should be ready to do more to counter inequality. This is partly because in societies that begin to unravel due to social tensions arising from inequality, increased government engagement is likely to be required. To head this off, and to cater to our sense of fairness, the federal government should therefore pre-emptively increase its redistributive efforts.

Torjman and Battle's preferred vehicle for increasing federal government support to low and low-middle income Canadians is the Canada Child Tax Benefit (CCTB). Not only is this already in place, but it is (almost) universal. They also discuss the Working Income Tax Benefit (WITB) and call for this to be extended further upwards (in income terms). Cameron, on the other hand, favours the WITB over the CCTB, though recognizes the value of both. He also highlights the value of those institutions in our country that foster "civic equality" (for example, the health system and public schools) and cautions against piecemeal privatization of these which could dangerously undermine equality of access.

In short, though their starting points are diverse, all the contributors call for the federal government to take deliberate steps to counter soaring inequality and ensure that the Canada we want in 2020 is the Canada that less advantaged groups might want too. ■

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## All authors are at pains to stress the critical role that government taxes and transfers play in mitigating inequality

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# WHY CANADIANS SHOULD CARE ABOUT INCOME INEQUALITY

MARK CAMERON

**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.

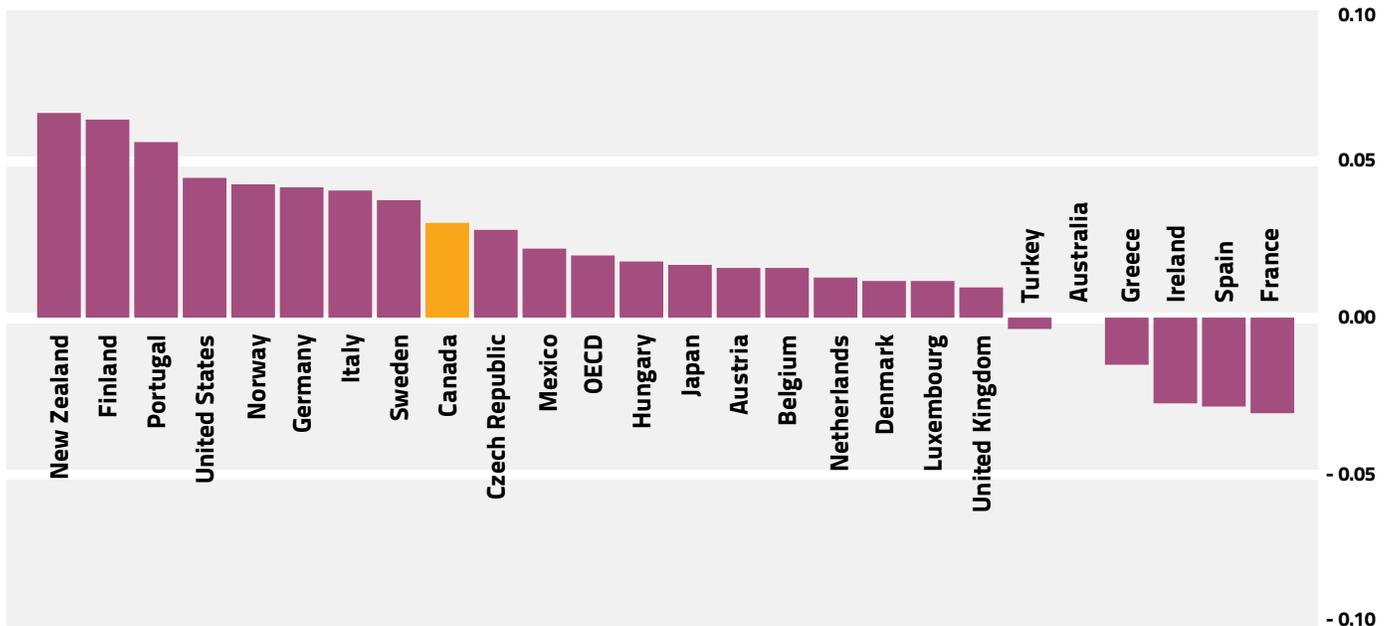
It is worth asking, at the outset, why governments should concern themselves with inequality at all. Obviously, a primary objective for governments is securing economic growth and ensuring that the whole of society benefits from such growth. Theoretically, should it then matter if

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.<sup>1</sup> 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

<sup>1</sup> 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.<sup>2</sup>

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.”<sup>3</sup>

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?

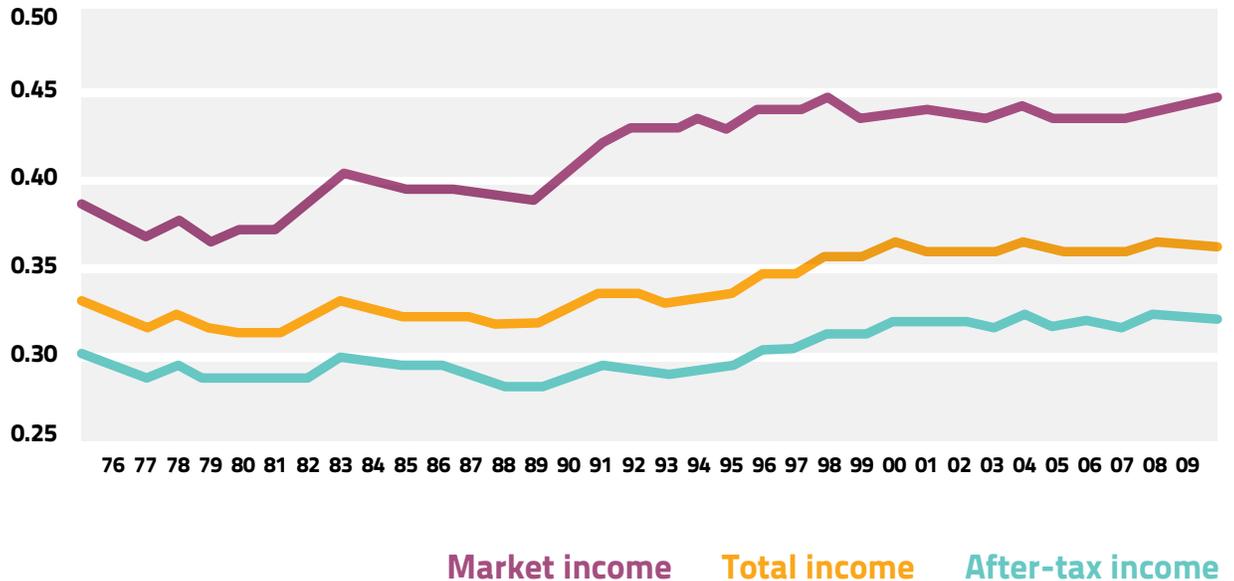
Choosing the right policy prescription requires an accurate diagnosis, so it is important to understand what has caused increases to inequality in Canada and elsewhere. Only then will we be able to identify measures that are likely to be successful in addressing it.

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

<sup>2</sup> 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.

<sup>3</sup> 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

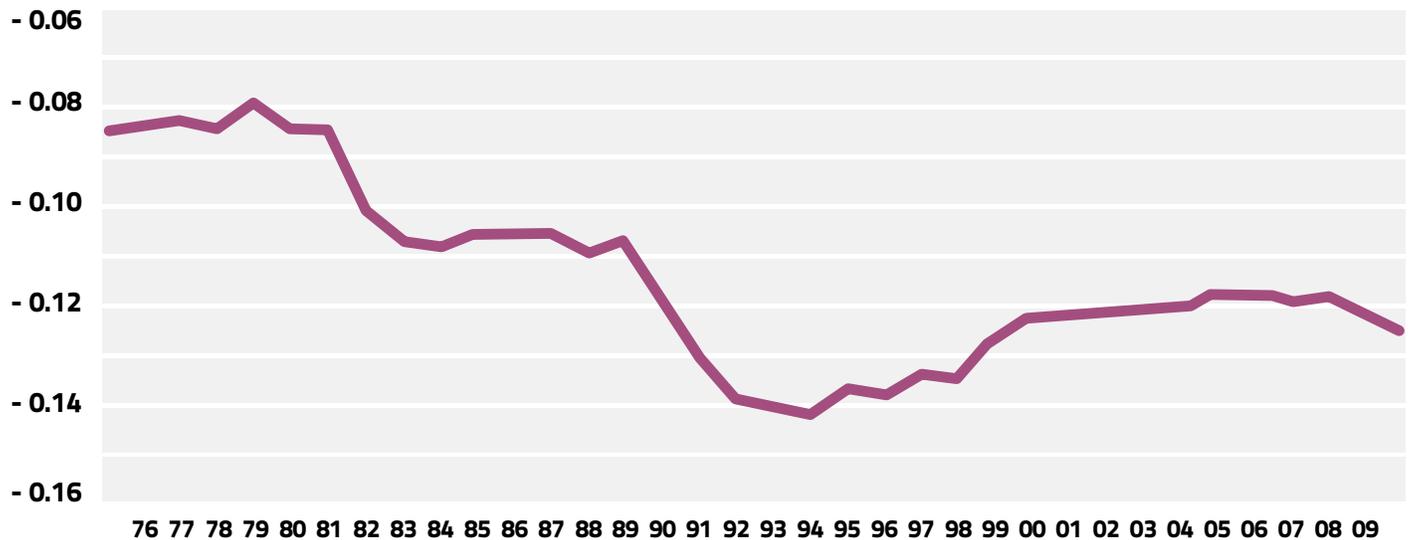
and rapid technological change have brought greater rewards for highly-skilled workers and managers. Lower-skilled workers, by contrast, have been forced to compete with workers in developing economies and have seen far smaller gains. While domestic policy can certainly address tax and transfer issues 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

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## The government should continue to enhance the Working Income Tax Benefit

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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

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## Governments should seek to enhance civic equality by emphasizing common institutions

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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

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

emphasizing common institutions where citizens meet as equals, regardless of income.<sup>4</sup>

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. ■

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

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# INCOME REDISTRIBUTION IN CANADA

ANDREW SHARPE

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**Andrew Sharpe** is Executive Director of the Ottawa-based Centre for the Study of Living Standards, a non-profit research organization he founded in 1995. Prior to this he was Head of Research at the Canadian Labour Market and Productivity Centre and Chief, Business Sector Analysis, at the Department of Finance. He is also founder and Editor of the *International Productivity Monitor* and Executive Director of the International Association for Research in Income and Wealth. He received a PhD in economics from McGill University in 1982.

Most developed countries have experienced increased market income inequalities in recent decades. A large number of factors have been identified as contributing to this development. The decline in unionization has meant that fewer workers enjoy the benefits of collective bargaining, an equalizing force in income distribution. Governments in many instances have failed to raise minimum wages in line with overall wage gains, disadvantaging the worst paid workers. Deregulation has often hurt certain groups of workers such as truck drivers and air flight attendants, as has privatization of public services.

At the same time, skill-biased technological change, related to the information technology revolution, has reduced the overall demand for the services of the poorly educated, and globalization has meant that employers can now outsource production to low-cost countries. This decreases the bargaining power of workers and so reduces their incomes further.

At the other end of the spectrum, faulty corporate governance oversight procedures have resulted in a massive rise in CEO compensation relative to the average worker.

This has hugely boosted the income of the top 1%, the income group that has been driving, almost single-handedly, the recent rise in inequality. Overly generous compensation practices in the financial sector have also contributed to the large increases in the incomes of top earners.

At a household level, increased assortative mating, defined as the tendency for persons with similar education and qualifications to marry one another (a male doctor who in the past married a nurse now marries another doctor), has led to the rise in the number of high income two-earner households.

## THE IMPACT OF INCOME TRANSFERS AND TAXES ON INEQUALITY IN CANADA

The distribution of income in this country is greatly affected by government policy. Statistics Canada produces estimates of income distribution based on three different measures: (i) market income, defined as earnings plus net investment income and private retirement income; (ii) total income, which includes transfer payments; and (iii) after-tax income (which includes all taxes and transfers). It is the after-tax distribution

## Ratio of top to bottom quintile income in Canada, adjusted for family size

	Market income	Total income	After-tax income
1981	9.70	5.66	4.78
1989	10.26	5.60	4.57
2000	13.13	6.95	5.69
2009	14.28	7.06	5.64

### Point change

1981–1989	0.6	-0.1	-0.2
1989–2000	2.9	1.3	1.1
1981–2000	4.6	1.4	0.9
1981–2009	1.1	0.1	0.0

### Total Growth %

1981–2009	47.2	24.7	18.1
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SOURCE: Statistics Canada (2011) *Income in Canada 2009*.

**Figure 1**

that is the most relevant from the perspective of private consumption, as it reflects the inequality in access to marketed output. It does not, however, reflect access to public services. Once this is factored in, we see a slightly different picture, as I explain below.

In 2009, the ratio of the market income of the top quintile to the bottom quintile was 14.28 to 1.<sup>1</sup> For every dollar of market income earned by a person in the bottom quintile, a person in the top quintile received \$14.28 (**Figure 1**). Income transfers greatly boosted the total income of those in the bottom quintile and reduced the top/bottom income ratio by one half to 7.06 to 1. This is the result of the high government transfer rate for the lowest quintile (amounting to 52.0% of adjusted total income of this quintile) compared to

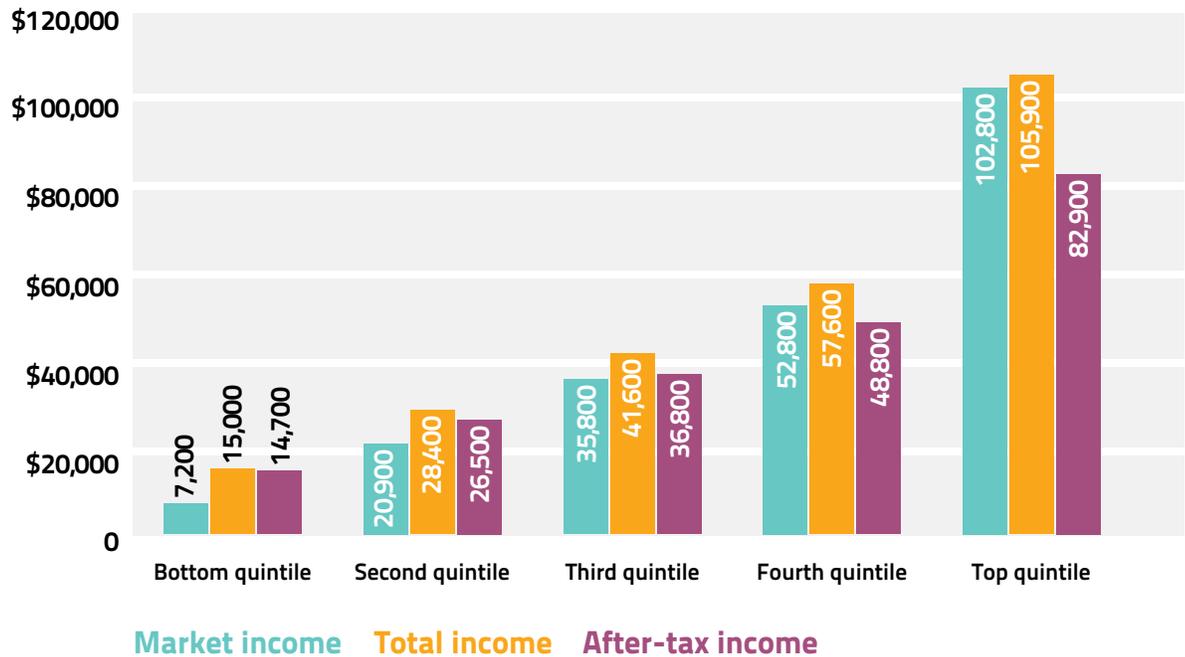
the highest quintile (2.9%). The final, after-tax ratio between the top and bottom quintiles was lower still at 5.64 to 1 or 40% of the market income ratio. **Figure 2** shows the absolute figures for the various measures of income for the year 2009.

To track broad trends in income inequality, the Gini coefficient is a well-accepted indicator. It reflects the dispersion of the income distribution, and its value ranges from zero to one. While a value of zero would indicate that income is equally divided among Canadians, a value of one would mean that a single household receives all the income in the economy. Therefore, when income inequality increases, the Gini coefficient goes up and *vice versa*.

The Gini coefficient tells the same story about the impact of transfers and taxes

<sup>1</sup> A quintile is a portion of a frequency distribution containing one-fifth of the total sample. The top quintile represents the average adjusted income of the 20% of all economic families who recorded the highest income; the bottom quintile is the same for those with the lowest income. The quintile distribution takes into account only economic families (not unattached individuals) and is adjusted for changes in family size over time.

## Adjusted income by quintile for economic families, 2009



SOURCE: Statistics Canada (2011) *Income in Canada 2009*.

Figure 2

on income inequality. In 2009, the Gini coefficient for market income was 0.515. When income transfers were included, it dropped by 16.5% (0.085 points) to 0.430. With taxes factored in, it was an additional 0.036 points lower at 0.394, a further 7.0% decline. Income inequality as expressed by the after-tax Gini coefficient was thus roughly three quarters (76.5%) of the level of inequality for market income.

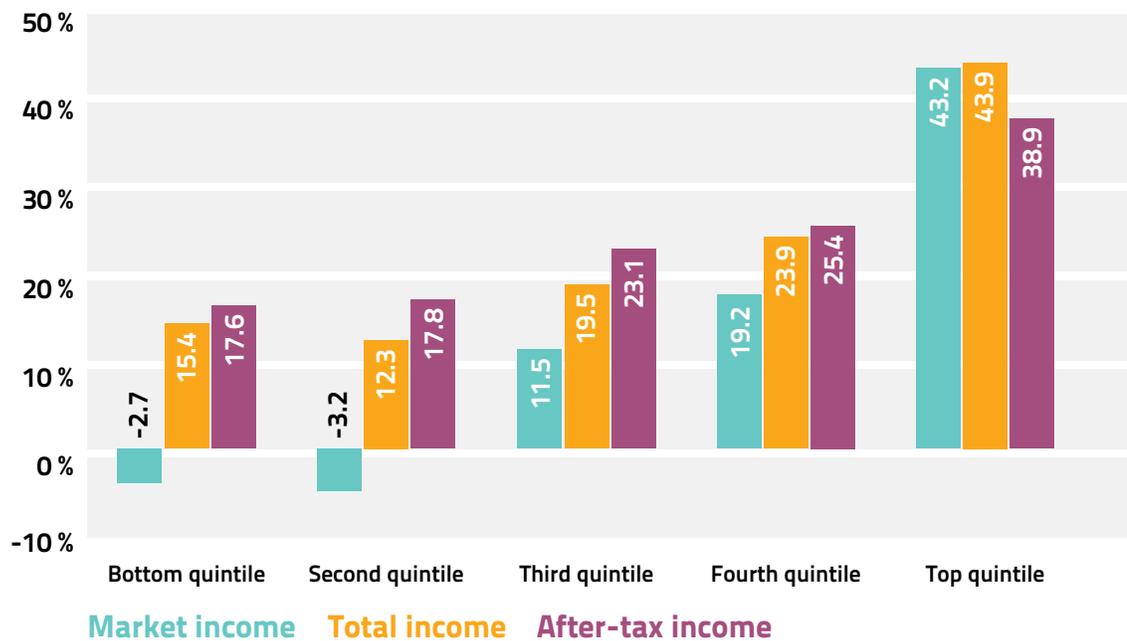
### HOW HAVE REDISTRIBUTIVE MEASURES CHANGED OVER TIME?

Between 1981 and 2009 inequality in Canada grew, according to both measures (top to bottom quintile ratio and the Gini coefficient). **Figure 3** shows that the real market incomes of the bottom two quintiles actually fell over this period, while that of the top quintile rose by 43.2%. When taxes and transfers are taken into account the incomes of both the bottom

quintiles grew by around 18%, the income of the middle quintiles grew by around 25%, but the incomes of the top quintile grew by close to 40%.

**Figure 1** shows the extent to which taxes and transfers have reduced market income inequality over the period 1981 to 2009. In 1981 the low to high quintile ratio of income after taxes and transfers was 4.78, or about half what it would have been for market income (9.7). By 2009 these figures had switched to 5.64 (after taxes and transfers) and 14.28 (market). In simple terms, then, after-tax income inequality rose by 18.1% over this period while market income inequality rose by 47.2%. Redistribution measures had more of an effect on the lowest quintile in 2009 than they did in 1981. But such measures were not strong enough fully to offset the sharp increase in market inequality that took place over this period.

## Percentage change in income for economic families 1981 – 2009



SOURCE: Statistics Canada (2011) *Income in Canada 2009*.

Figure 3

Gini coefficients for the time tell a similar tale. Canada was a more unequal society in terms of income distribution in 2009 than it was in 1981, but it would have been far more unequal without the greater redistributive role of the state.<sup>2</sup> Nonetheless, there was still a significant increase in after-tax income inequality in this country over the period: government could have done, and could be doing, more to offset rising market inequalities.

As noted, the top 1% of earners have accumulated massive sums in recent years. The market income share of the top 1% of super-rich households increased 5.9 percentage points from 7.7% in 1982 to 13.8% in 2007, accounting for the entire increased income share for the top quintile as a whole.<sup>3</sup> The after-tax income share of the top 1% increased 3.4 points from 6.5%

to 9.9% between 1982 and 2007. This means that 1% of Canadian households command nearly 10% of our total income, a trend towards income polarization that is at once alarming and very public. Such accumulation at the top has almost certainly contributed to the perception that overall inequality has risen more than is in fact the case. This is something that needs to be accorded special attention in the development of future federal government redistributive policies.

### A BROADER APPROACH TO REDISTRIBUTION

Discussions of redistribution are generally framed in terms of government taxes and transfer payments and the effect of these on various income groups. But the issues are much broader. The discussion can be extended

<sup>2</sup> Heisz (2007) reached a similar conclusion for the 1981 – 2004 period. While governments are now doing more on the redistributive front relative to 1981 – as gauged by their impact on after-tax income relative to market income – an OECD study found that the extent of this redistribution effort has diminished since 1994 (OECD, 2008). This decline has been largely driven by the declining role of transfers such as welfare payments and employment insurance.

to include government spending on public goods, such as education and health, and how this is distributed between groups. It can also take in other breakdowns of the population such as by age group, educational attainment level, and region.

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## Erosion of public services will tend to increase inequality

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The Centre for the Study of Living Standards (CSLS) has recently released a report that provides such a broader analysis of the net redistributive effects of government taxation and total spending.<sup>4</sup> It found that in 2005, the latest year for which data are available, net government expenditures in Canada were \$2,557 (2000 US dollars) per household, consisting of \$11,653 in government transfers i.e. income support programs, \$9,306 in public consumption (e.g. education, health), and -\$18,401 in taxes. A household in the bottom income quintile received \$4,245 in net government expenditure, in the second lowest quintile \$6,065, in the middle quintile \$7,588, in fourth quintile \$4,707, and in the top quintile -\$9,821.

It is notable that it is the middle quintile, not the bottom quintile, that benefits the most from net government spending and that it is the top quintile that benefits the least (largely because of the higher taxes paid by households in this quintile).

Different types of government expenditure programs have different redistributive impacts. For example, absolute spending on healthcare was found to be similar across income groups, implying an equalizing effect on the overall income distribution, given that this spending represents a much greater share of the broadly-defined income of the poor than of the rich. In contrast, education spending was concentrated in the

top four income quintiles, and was much weaker in the bottom quintile, largely due to differential rates of enrollment in post-secondary education.

This broader approach to redistribution highlights the important redistributive role played by government spending on goods and services such as health and education. Public services are therefore an essential element of the redistributive effort of government. Erosion of public services will thus tend to increase inequality, something that is not often at the forefront of discussion when cuts are proposed.

Another interesting fact that comes to light when taking a broader view of distribution issues is that the largest redistribution in Canada, in terms of net government expenditure, actually takes place across generations, not income groups. In 2005, households headed by a person 65 or over received, on average, net government spending of \$24,091, compared to -\$2,452 for households with a head aged below 65. This situation reflects the Old Age Security and Guaranteed Income Supplement payments made to seniors, the higher healthcare expenditures for this group, and the lower taxes paid, reflecting lower income.

This generational redistribution is a normal part of the implicit contract between the state and the population, whereby persons pay taxes during their working lives and then receive significant income support and health benefits during the latter part of their lives. However, this aspect of overall redistribution can easily be forgotten. There is a tendency for people to believe that most of the contributions they are paying to redistributive efforts favour the poorest income groups, when in fact they mostly favour the old (there is of course some overlap between these two groups).

<sup>3</sup> Veall, M. (2010) "Top Income Shares in Canada: Updates and Extension". *Working Paper Department of Economics*, McMaster University. (<http://worthwhile.typepad.com/veall.pdf>)

<sup>4</sup> Sharpe, A., Murray, A., Evans, B. & Hazell, E. (2011) "The Levy Institute Measure of Economic Well-being: Estimates for Canada, 2000 and 2005". *CSLS Research Report* 2011-09.

## POLICY RESPONSES

Fundamental changes have occurred in the Canadian labour market, and in society in general, in recent decades due to globalization and technological change. During this time, redistribution policies have played a key role in reducing income inequality in Canada. However, the tax/transfer system should do still more to ensure that the after-tax distribution of income in this country remains within a socially acceptable range.

The system must evolve to keep up with the changing economic environment. In a recent paper Robin Boadway from Queen's University has cogently argued that the redistributive role of the tax/transfer system in Canada is inadequate and needs rethinking.<sup>5</sup> He points out that the rate structure of the tax system as a whole has considerably flattened, especially at the provincial level, and that transfers to the least advantaged, such as those on welfare, have worsened significantly over the last 30 years. In his view, an equitable tax transfer system should redistribute so as to compensate for the (dis)advantages with which people are endowed "through the luck of birth" (page 176).

Boadway argues for an equality of opportunity agenda. This would be a significant modification of the system that we currently have in place, which is largely focused on outcomes and smoothing the excesses of market allocations, with relatively little regard for starting points.

Boadway focuses particularly on intergenerational inequality and access to post-secondary education.

### // Intergenerational inequality

Unlike most other developed countries, including the United States, Canada does not have an inheritance tax in place. The introduction of such a tax could contribute significantly to greater equality of opportunity in this country and should have a moderating effect on market income inequalities down the line. Critical implementation issues include the income threshold at which the tax kicks in (people with relatively modest estates should not be affected) and how to minimize tax avoidance possibilities for the rich.

### // Post-secondary education

There are a number of market failures associated with post-secondary education. Education is a particularly risky form of investment: low income individuals are subject to liquidity constraints because of the difficulty of borrowing against future human capital, and persons from disadvantaged backgrounds are poorly prepared to succeed. Government policies are needed to address these market failures. This would, in turn, help reduce inequality as more people from lower quintiles would be able to access the type of education that enables them to move up the income ladder. Potential policies in this areas include greater sheltering of investment in human capital through the tax system (for example, a wider range of deductions for expenditures linked to education), a fully-funded income-contingent student loan system, and more grants to students from low income families.

<sup>5</sup> Boadway, R. (2011) "Rethinking Tax-Transfer Policy for 21st Century Canada" in Gorbet, F. & Sharpe, A. (eds.) *New Directions for Intelligent Government in Canada: Papers in Honour of Ian Stewart*. Ottawa: CSLS.

A reasonable degree of equality is widely regarded as a key societal goal. Given the inherent tendencies of the market to generate inequality, it is important that government intervene through redistributive policies to offset market forces and ensure that income inequalities remain within socially acceptable limits. These policies take three forms. First, tax/transfer policies drive a wedge between market and post-tax income shares. Second, government spending on public goods and public services such as education and health is profoundly equalizing (something that needs to be clearly recognized as we plan for the future of such services). Third, equality of opportunity can temper the growth of market inequalities in the first place.

The way forward for Canada to become a more equal society must include all three policy approaches. Programs that are effective in assisting disadvantaged groups should be

expanded and the contribution that the rich make to achieving greater equality of outcomes should be increased. Public services that benefit all citizens, such as public transit, should be further developed. Measures that promote equality of opportunity, such as inheritance taxes and better access to post-secondary education for the poor, should also be implemented.

The Occupy Wall Street movement has focused the attention of the world on growing inequality. Many political leaders, including the Governor of the Bank of Canada and the Minister of Finance, have expressed sympathy with the issues identified by this movement. This situation provides an historic opportunity for Canadians to rethink our approach to addressing inequality. A national debate on how governments in Canada can most effectively redistribute income to prevent growing inequalities is urgently needed. ■

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# INEQUALITY IS NOT INEVITABLE

SHERRI TORJMAN AND KEN BATTLE

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Here's the bottom line:

- // Poverty and inequality matter.
- // Governments play a vital role in tackling poverty and inequality.
- // The federal government holds the key levers, which are already in place.

## POVERTY MATTERS

Canada has established a reputation throughout the world as a peace-loving and stable nation. Inside our borders, an equally bright image emerges. A recent survey by the Centre for the Study of Living Standards (CSLS) found that most Canadians consider themselves happy – or very happy – with their lot in life.<sup>1</sup> On July 1 this year, *Maclean's* released an article on why it is a great time to be living in Canada.

Unfortunately, all this sunshine fails to cast light on a serious problem lurking just below the sparkling surface.

Far too many Canadians do not count themselves among the happy campers. These are the families that live in poverty. These are the households that spend higher than average proportions of their income on food, clothing and shelter. Every day is a struggle just to get by. They choose between feeding

the kids and paying the rent, in the trenchant words of Mel Hurtig.<sup>2</sup>

At last count, in 2009, close to 3.2 million – one in 10 Canadians – lived on a low income. This national average masks the fact that certain groups (including aboriginal people, recent immigrants and persons with disabilities) face an even greater risk of poverty. Not surprisingly, the poverty rate rises and falls with the economic tides, as illustrated by **Figure 1**, which shows the close correspondence between the low income and unemployment rates.

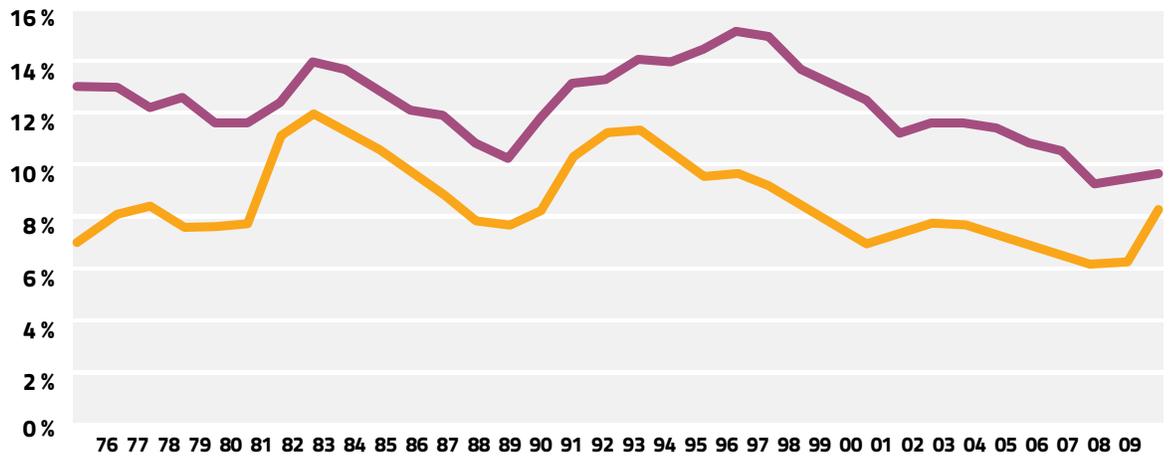
The undulating ups and downs of the poverty waves are enough to make you sick; at least that is the conclusion of a burgeoning body of international evidence. Of all the hazards of life below the poverty line, none so dramatically separates low-income Canadians from the rest of society as the health gap. People living on low incomes have a shorter average lifespan and run a greater risk of illness and disability than those with more money.

The struggle to live on an inadequate income increases the scope, frequency and severity of stress for families, thereby raising parents' and children's susceptibility to a

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<sup>1</sup> CSLS (2011) "Happiness as a Goal for Public Policy: Ready for Primetime?" *CSLS Research Note 2011-1*. (<http://www.csls.ca/notes/Note2011-1.pdf>)

## Low income rate and unemployment rate, 1976 – 2009



SOURCE: Statistics Canada

Low income rate Unemployment rate

**Ken Battle** is President of the Caledon Institute of Social Policy. Before founding Caledon in 1992, he was Director of the National Council of Welfare, a citizens' advisory body to the Minister of National Health and Welfare. Ken was educated at Queen's University and the University of Oxford, and has taught at both Queen's and Carleton. He has advised the federal government on key issues of social policy. Ken was awarded the Order of Canada in 2000 and the Saskatchewan Distinguished Service Award in 2004.

<sup>2</sup> Hurtig, M. (2000) *Pay the Rent or Feed the Kids?* Toronto: McClelland & Stewart.

<sup>3</sup> All these studies are cited in Ontario Association of Food Banks (2008) *The Cost of Poverty: An Analysis of the Economic Cost of Poverty in Ontario* (see pages 7 and 17).

wide range of physical, psychological and social problems. The relationship between income level and all these types of risk is typically strong and inverse.

The effects of poverty are felt very early in life. The odds of never seeing a first birthday are worse for low-income babies in general and aboriginal infants in particular. Low birth weight is an important predictive indicator of troubled childhood development and poor adult health.

But poor means more than just poor health. Poverty is a serious and stubborn problem, imposing heavy social, economic and personal costs that affect all Canadians. Low incomes lead to lost opportunities for individuals, the economy and society. The persistence of low incomes means that governments are called on for higher social spending while the tax revenue that is needed to fund the very programs that are aimed at preventing and reducing low income is foregone.

A US report estimated that child poverty in that country costs \$500 billion a year – or 4% of GDP – in increased crime, reduced productivity and poor health. A similar

study in Britain put its price tag at an annual £25 billion or 2% of GDP. Here at home, federal and provincial governments across Canada lose between \$8.6 billion and \$13 billion in income tax revenue to poverty every year.<sup>3</sup>

### INEQUALITY IS DIFFERENT FROM POVERTY: IT MATTERS TOO

Poverty is not, however, the only concern. It is closely linked to – but remains separate and distinct from – the related problem of inequality: the gap in the average incomes of rich and poor households. Over the past quarter-century, earnings of the wealthy in Canada grew by 16% while those of the poor actually dropped by 21%. The only positive note in this story is that inequality would be much worse in the absence of government measures in the form of redistributive social programs, and progressive taxes and benefits.

The numbers tell a powerful story. An exhaustive body of evidence from around the world shows the wide-ranging negative impact of extreme inequality.

Research on health inequalities and the social determinants of health has found that

Figure 1

social status has a powerful effect on health. The psychological damage resulting from being at the bottom of the socioeconomic ladder can be devastating. A groundbreaking study of UK civil servants found that those in the junior ranks were three times more likely to die in a year than colleagues from senior ranks, with a sliding gradation from top to bottom.

Societies marked by substantial inequality sooner or later pay the price. Regardless of a nation's wealth, it will be more dysfunctional, violent and unhealthy from both physical and emotional perspectives if the gap between income groups grows too wide. Poorer countries with less unequal wealth distribution have been found, on the basis of wide-ranging indicators, to be more healthy and happy than richer, more unequal nations.

#### VARIOUS FACTORS CONTRIBUTE TO POVERTY AND INEQUALITY

There are strong forces that fuel persistent low income; these are deeply rooted in the economy, in labour markets and in society.

Contrary to public perception, most poverty is not an inherited condition of a small, hard-core group that passes its "affliction" from one generation to another. While a substantial segment of the population has low income at some point, poverty is usually a transitory rather than persistent problem. Most of the poor escape poverty and their risk of falling back declines over time.

However, certain groups – notably single parents, unattached individuals, those with low education, visible minorities, recent immigrants and persons with disabilities – run a higher risk of persistent poverty. They tend to be poor longer, suffer more frequent bouts of low income and face diminishing chances of escaping poverty the longer they remain below the poverty line.

Most Canadians rely on employment as their chief source of income. Bouts of unemployment and underemployment, not sur-

prisingly, raise the risk of falling below the low income line. When unemployment rises, as it did in the recessions of the past few decades, more widespread and deeper low income is sure to follow.

But unemployment is not the only feature of the economy that contributes to poverty. The labour market itself is a prime driver of low income. More than half of low-income households in Canada can be classified as "working poor". People in these households work full time in the labour market but do not earn enough money to lift them out of poverty.

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## More than half of low-income households in Canada can be classified as "working poor"

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The problem is partly due to the growth of "nonstandard" work, which includes part-time, seasonal and temporary work. There has been a corresponding erosion of middle-wage employment, including middle management positions and well-paid blue-collar jobs in traditional industries, such as manufacturing and transportation.

Social factors are also major contributors to poverty. Unfortunately, poverty is a motherhood issue – literally. Bearing and raising children play an important part in making women vulnerable to low income, especially if they are raising children on their own.

An increasing number of families with children are headed by single parents, mainly women. Children raised by single mothers run a much higher risk of poverty than those in two-parent families – 21.5% compared to 9.5%, respectively (2009 figures). Fortunately, there has been considerable progress against poverty among single-parent families over the years, due to growth in mothers' employment rates and improvements to child benefits.

## GOVERNMENTS PLAY A VITAL ROLE IN TACKLING POVERTY AND INEQUALITY

Tackling poverty means countering these powerful forces. We need to have more good jobs; investment in workers through education and training leading to higher knowledge and skill levels; equal pay for work of equal value; and enforcement of child support agreements – to name just a few vital actions.

But while such remedies will prevent poverty for some Canadians, they cannot reduce poverty for others. Recessions continue to take their toll and so-called “bad jobs” are now a permanent feature of the labour market. Moreover, certain groups typically experience poverty regardless of the state of the economy – the result of such problems as employment discrimination (especially for new immigrants), weak job skills and lack of education, especially as the bar for a decent job has effectively been raised to post-secondary graduation.

This is where government is uniquely placed to intervene. Its actions can help offset the strong economic and social forces that contribute to poverty. Its measures can reduce the growing gap between those with high incomes and those who are poor.

There are two main instruments that governments can employ to bridge the widening gulf between the poor and the well-off: income security programs and measures within the income tax system. Income security programs for children, seniors and the unemployed pay money directly to individuals and families. The income tax system redistributes income and thus is another powerful and progressive instrument for tackling inequality. Canada has a progressive income tax system, which means that taxes paid increase with rising income. In recent years, both provincial/territorial governments and the federal government have made increasing use of the income tax system to deliver cash payments to lower-income Canadians through refundable tax credits.

Trends and patterns in income inequality are tracked by a statistical measure known as the Gini coefficient. It can theoretically range from zero (every family unit would have the same share of income) to one (one family unit would have all the income and the others would have none). The higher the Gini coefficient, the greater the degree of income inequality. **Figure 2** tracks inequality in Canadian families since 1976.

The top purple line in **Figure 2** represents market inequality, which has increased overall since the mid-1970s – from .387 in 1976 to .451 in 2009, a sizable 16.5% increase. The middle orange line shows the trend in the Gini coefficient for total family income, which includes both market income and transfers from government income security programs. The bottom blue line shows the trend in inequality after both income taxes and transfers from income security programs are taken into account. The Gini coefficient for after-tax income rose from .306 in 1976 to .329 in 2009, an increase of only 7.5%.

The three lines add up to one bottom line:

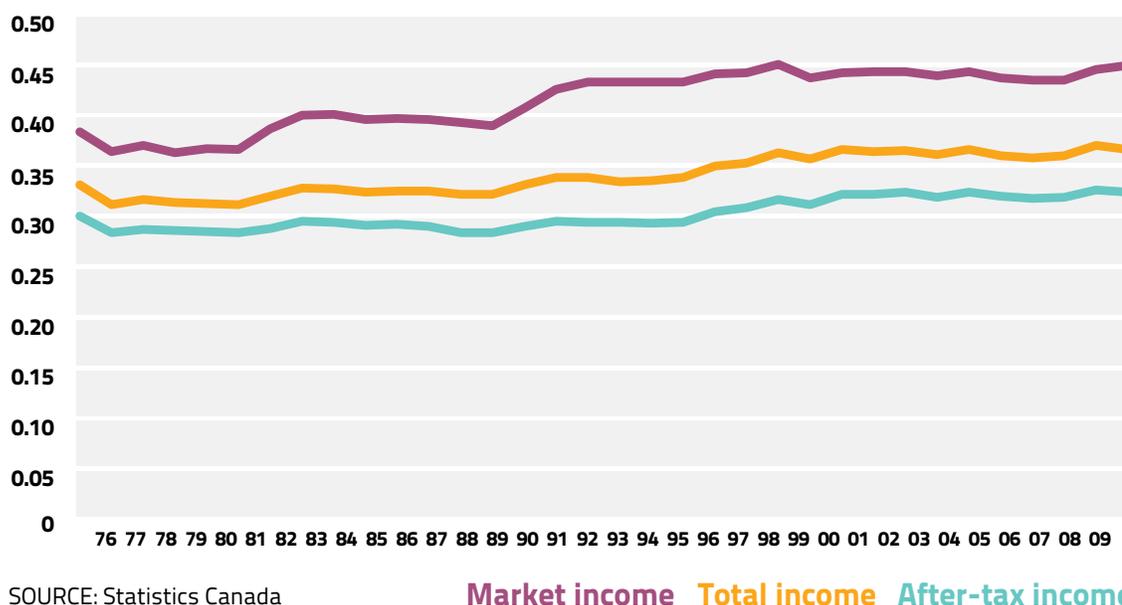
Government interventions in the form of transfer payments and progressive income taxes reduce market income inequality derived from employment earnings and investment.

## THE FEDERAL GOVERNMENT HOLDS THE KEY LEVERS

Poverty and inequality matter – and so do governments. But not all governments are created equal.

In the case of poverty and income inequality, the federal level is the only government with the ability to ensure the equitable treatment of citizens in all parts of the country. Equally important, the federal government already has the key levers – income security programs and a progressive income tax system – at its disposal to combat poverty throughout Canada.

## Gini coefficients indicate increasing inequality among Canadian families, though government reduces market inequality



SOURCE: Statistics Canada

Market income Total income After-tax income

Figure 2

Despite the important role of the income tax system, it is income security programs that do the heavy lifting in terms of redistribution. Income security programs fall into two categories: income supplementation and income replacement.

Income supplementation programs bolster low incomes. The Working Income Tax Benefit and Canada Child Tax Benefit are the two major income supplementation programs operated by the federal government. They boost low earnings and low income, respectively. Most provinces and territories also supplement low income through their own child benefits and refundable tax credits.

Income replacement programs, by contrast, replace income which has been lost due to such commonplace conditions as unemployment, disability and retirement. Employment Insurance, Old Age Security/Guaranteed Income Supplement and the Canada/Québec Pension Plan are the core

income replacement programs in Canada. Provinces and territories operate another major income replacement program: social assistance (welfare).

While income replacement programs in Canada are far from perfect, this paper focuses exclusively on the income supplementation function. Improvements in income supplementation measures offer the greatest prospects for making a real difference to both poverty and income inequality. Here's how.

Right now, one in four workers makes just \$10 an hour or less and close to half of all low-income households include at least one working adult. This is the problem of the working poor.

One crucial way for governments to help the working poor is to top up their low earnings. Québec, New Brunswick and Saskatchewan offer earnings supplements to their low earners. In its 2007 Budget, the federal government introduced its own earnings

supplementation program, the Working Income Tax Benefit (popularly known as WITB). Proposed by Liberal Finance Minister Goodale in his government's 2005 Economic Statement, the WITB was carried forward by his Conservative successor, Jim Flaherty, in the 2006 Budget and launched in 2007.

While promising in theory, the WITB in its first year provided a meagre payment of up to \$500 annually for single workers and \$1,000 for single parents and couples. The program was targeted so far down the income scale that it excluded many of the working poor.

We praised this first step and then advised the government to take more action: raise the value of the WITB and extend it higher up the earnings scale in order to help more of the working poor. Ottawa responded in 2009 by enhancing the benefit and expanding its reach.

However, the WITB still sits at a modest maximum \$944 for a single worker per year (\$1,714 for a family) and cuts out at a low net income of \$17,004 (\$26,218 for a family). This measure needs a healthy, multi-year injection of funds before it becomes a major weapon in the war on poverty and inequality. But at least the foundation is in place.

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## Child benefits make a real difference

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The Canada Child Tax Benefit (CCTB) is the most substantial income supplementation program in the country. It is also a powerful tool that the federal government can wield to tackle poverty and inequality. The program delivers cash payments to more than 90% of families with children. It is progressive in that its benefits decline as incomes increase.

The CCTB has a two-tier design. The base benefit goes to almost all families. It

is bolstered by an additional amount – the National Child Benefit Supplement – for low- and modest-income families. Together, the combined benefits pay low-income families an annual maximum of \$3,485 for the first child, \$3,240 for the second child, and \$3,149 for the third and each additional child.

This national measure has a number of strong points. It is a non-stigmatizing, inclusive program that delivers monthly cash benefits to the large majority of Canadian households with children. It pays the same amount to all families with the same level of income, regardless of source or family type. The CCTB is also pan-Canadian. It provides a stable and assured income supplement no matter where families live or work.

However, more can be done to assist families. We have proposed that Ottawa raise the CCTB to a maximum annual \$5,000 per child – \$1,515 more than the current \$3,485.

Child benefits make a real difference. If there were no federal child benefits, the low-income rate for families with children would have been 15% in 2008. Under the current system, the low-income rate for families with children was 9.3%. Our proposal would reduce that figure further to 8.3% and would lift an estimated 40,000 families above the poverty line.

Because the recommended increase to the CCTB would be achieved by boosting the base benefit and not the National Child Benefit Supplement, it would increase benefits not only for low-income families. It would also provide a sizable rise in child benefits for the modest- and middle-income majority of families.

A sole focus upon the lowest-income families would widen the gap between poor households and those with incomes above the poverty line but below average income. The latter modest-income families also struggle with constrained budgets and could certainly use additional cash for their children.

To help pay for a stronger CCTB, the federal government could draw on the estimated \$3.5 billion it now spends on the Universal Child Care Benefit and the non-refundable child tax credit. These poorly designed measures are inequitable, confusing and wasteful and contribute little to the war on poverty and inequality.

The Caledon Institute has also proposed a new disability benefit that would be delivered by the federal government. The new Basic Income would remove people with severe and prolonged disabilities from provincial/territorial welfare rolls and provide a more adequate payment that would be equivalent to seniors' benefits currently in place.<sup>4</sup>

#### A NOTE ON GUARANTEED ANNUAL INCOME

Some people argue in favour of a “start-from-scratch” approach to tackling poverty and inequality. They would prefer to scrap the existing array of income security programs and replace them with some form of single “guaranteed annual income” that would raise all poor Canadians up to the poverty line.

The problem with simple solutions such as this is that they are simplistic – and would do little to get at the root causes and dynamics of poverty and inequality. Poverty is a complex multi-dimensional issue that cannot be vanquished with a silver bullet. It requires a variety of strong programs and a range of effective services.

Proponents of a guaranteed income argue that it could be delivered as a form of negative income tax, using the income tax system to deliver cash to the poor. But, in fact, Canada already makes extensive use of the negative income tax concept in the design of a range of income-tested programs for various groups, including the Guaranteed Income Supplement, the Canada Child Tax Benefit and the Working Income Tax Benefit.

If we were to abolish these important measures and replace them with a guaranteed income, we would only end up reinventing the current benefits to meet the needs of specific groups in Canadian society.

Fortunately, the foundations to help slay the poverty and inequality dragons are already in place in this country. They do not have to be built – merely built upon – in order to stem poverty and reduce the growing gap between rich and poor.

The federal government needs to step up to the plate. It already has both the levers and the leverage to land a solid punch on poverty and inequality. ■

<sup>4</sup> Mendelson, M., Battle, K., Torjman, S. & Lightman, E. (2010) *A Basic Income Plan for Canadians with Severe Disabilities*. Ottawa: Caledon Institute of Social Policy.

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# PARTNERS

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As we approach 2020, the world around us is changing rapidly. For Canada, there are many opportunities, but also fundamental and inter-related challenges. **The Canada We Want in 2020** launches a debate about the role of the federal government in Canada in meeting those challenges.

This is the starting point of a year-long project that will culminate in Fall 2012.



## **ABOUT CANADA 2020**

Canada 2020 is a non-partisan, progressive centre working to create an environment of social and economic prosperity for Canada and all Canadians.

Join the conversation at [www.canada2020.ca](http://www.canada2020.ca)