PERSPECTIVE

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ELIMINATE BARRIERS TO REDUCE INCOME INEQUALITY

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Income inequality has increased significantly since the 1980s. Policymakers should be concerned. Unfortunately, the current public discourse is focused on the outcomes of the top 1% of earners versus the rest. A more effective and constructive approach would focus on those at the bottom half of the income scale. Reduce their barriers to economic opportunity and Canada will go a long way in addressing income inequality.

Inequality in market incomes was on a steadily rising trend over the 1980s and early 1990s but was kept in check by the offsetting effects of government transfers and taxes. That changed when inequality jumped sharply higher from the mid-1990s to the end of the decade. The inequality surge was due to government deficit fighting that reduced transfers to individuals and reflected weak labour markets. It was then aggravated by provincial tax cuts that raised after-tax income disproportionately for the wealthy.

In the 2000s, incomes in the middle and bottom of the spectrum finally began rising, but income inequality did not decline. While the Gini coefficient – the traditional benchmark for income inequality at the economy-wide level – was remarkably flat in the 2000s, the share of income going to the top 1% of earners increased.

It is difficult to assess the magnitude of the threat that income inequality presents. Even egalitarians agree that some income inequality is desirable. The prospects for improving one's standard of living through greater effort or application of one's talents is an important incentive to work, save and invest.

However an increasing body of research does demonstrate that excessive income inequality can be deeply harmful. If there are too many barriers to social mobility, either from the entrenched interests of the wealthy or from other market and policy barriers, or if the level of income at the bottom end of the spectrum is excessively low, then inequality can hamper economic growth and cause major social problems.

Yet what represents an appropriate level of income inequality? Nobody knows. Still, an increasing number of researchers intuitively believe that income inequality has become excessive. And, that may indeed be the case.

While this is an important subject, the language being used in the debate today is too narrow. The focus on the top 1% versus the rest implicitly carries a simple policy recommendation of income redistribution from the 1%. There are two fundamental problems with this focus.

First, we do not know how much of the income increase in the top 1% is due to appropriate labour market forces. There might be a market failure and the income premium on skills and talents of the 1% could be excessive. If so, we do not know by how much.

However, we do know that the Canadian tax system has become less progressive – for a variety of reasons the taxes paid as a share of personal income by those at the very top of the income distribution has fallen. Accordingly, a review of the tax system with respect to progressivity is a reasonable ask.

The second and far more important problem with focusing on the top 1% is that they are very small in number relative to 99%. As a result, a simple income redistribution from the 1% is unlikely to move the dial on national income inequality very much.

Policymakers need to look beyond the top of the income distribution. The "big story" underlying inequality trends has been the stagnation in middle and lower income levels for almost three decades, despite economic growth. A few examples drive home the point that too many Canadians are having difficultly climbing the income ladder.

Youth unemployment is elevated at more than 14%, double the national average. Poor labour market outcomes early in life can cause the erosion of skills and reduce income growth over decades.

While we face the risk of a lost generation of youths the unemployment rate of aboriginal Canadians is 15%. Why aren't we talking about the lost generations of First Nation peoples?

Immigrants are having terrible labour market outcomes, with an ever-growing gap of income relative to Canadian-born individuals, demonstrating that we are not valuing their education and skills.

All low-income Canadians face enormous hurdles to escape poverty and advance up the income ladder due to the claw back of government support programs. They also face other major challenges, like inadequate affordable housing.

Many lower and middle income Canadians are struggling to adapt to changes in the labour market caused by globalization and the IT revolution, which are depressing demand for many middle skill jobs.

While governments are fiscally constrained, they do have enormous resources at their disposable to address the inequality issue. In 2012, total government revenues were $772 billion. The starting point is to evaluate the efficiency of existing programs and consider how the current funds could be more impactful. As part of the assessment, extra consideration should be given as to how to create better outcomes for those in the bottom half of the income scale.

Improved education, skills development and health outcomes are all likely part of the solution. And, if existing resources are inadequate to fund the necessary programs to improve economic outcomes, then additional revenue options must be put on the table.

The enormous challenges faced by those in the bottom half of the income distribution suggest that Canada has an inequality problem. The good news is that concerted policy actions could be effective. If we reduce barriers to advancement and success at the lower end of the income scale, we will address many of Canada's pressing economic and social challenges.

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