TD Bank Financial Group

TD Economics

Special Report

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LIFESTYLES OF THE RICH AND UNEQUAL: AN INVESTIGATION INTO WEALTH INEQUALITY IN CANADA

In an effort to assess the degree of economic inequality in Canada, Statistics Canada routinely publishes reports on the level of income and how it is distributed over Canadian families. This allows economists to track the changes in distribution over time and also carry out international comparisons. While these techniques are certainly instructive, they provide an incomplete picture of economy-wide inequality because they do not take into account how wealth is distributed over families. Unfortunately, data releases for the distribution of wealth are few and far between and rarely are there international comparisons. However, Christmas came early this year with the recent release of detailed Canadian wealth figures for 2005 (the previous edition of the survey was for the year 1999) as well as a study by the World Institute for Development Economics Research that provided reasonably comparable international statistics. With this new information in hand, we can now track the evolution of wealth since 1999, see how the distribution has changed, provide an international comparison, and compare and contrast the characteristics of families by wealth.

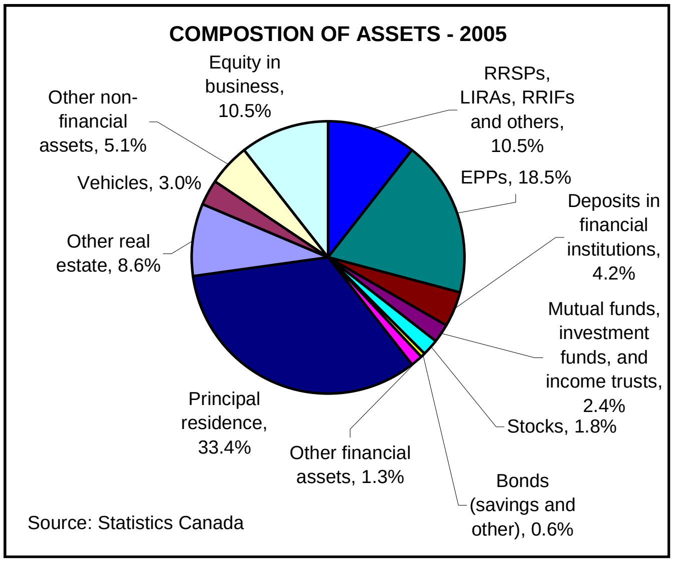
As a starting point, it is instructive to briefly review how income inequality has evolved between 1999 and 2004 (the most recent data available). For all family units[1], total inflation-adjusted after-tax income rose by 8.2% during this period. Within this time frame the distribution of income remained relatively unchanged as the income growth recorded by the lowest quintile (measuring the poorest 20% of Canadian income earners) kept pace with the highest quintile. When compared to the middle quintile, the lowest 20% of income earners managed to improve their relative standing as the middle-to-low average income ratio fell from 3.50 in 1999 to 3.38 in 2004. In terms of absolute inequality, the shares of total income held by each quintile were effectively unchanged over this period with the highest quintile earning 44% of total income while the bottom quintile accounted for just 5%.

HIGHLIGHTS

- **Small portion of Canadian families hold much of Canada's total wealth**
- **Real wealth rose significantly from 1999 to 2005 but the concentration among the wealthiest rose just slightly**
- **Canada's concentration of wealth among the wealthiest 10% is consistent with international norms and below the concentration of many other countries such as the U.S.**
- **Wealthy Canadian families tend to have higher incomes, be older, better educated than other Canadians**
- **Wealthy Canadians derive a larger portion of their wealth from ownership of businesses and financial portfolios and depend less upon the value of their principal residence**

Housing boom fuels wealth accumulation

From the perspective of wealth accumulation, the stars were clearly aligned between 1999 and 2005 as the housing market boomed and rising commodity prices helped equity markets recover from the aftermath of the tech-wreck in 2002. All told, total net worth increased by 41.7% to nearly $1.5 trillion in 2005. The impact of the housing



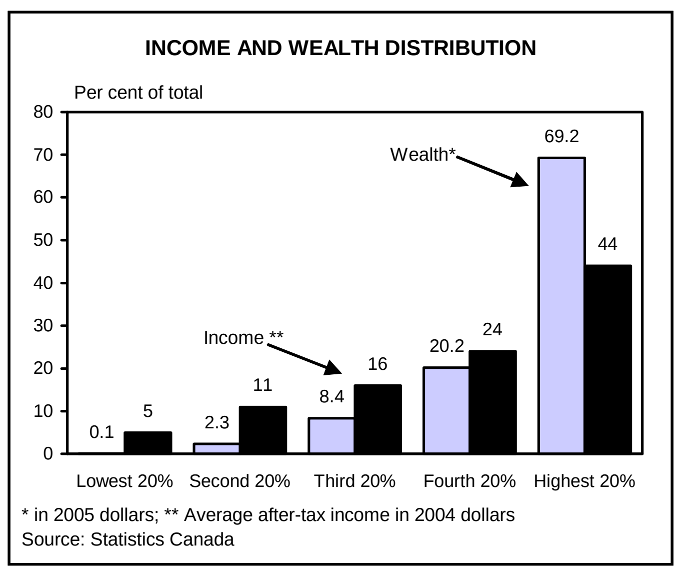
boom is clearly evident as the median value of non-financial assets grew by 23%, exceeding the growth rate in private pension assets (+18.1%) and non-pension financial assets (+15.1%). The rise in non-financial assets was especially relevant to Canadians since the principal residence represents the single most important source of wealth with a share of 33.4% of total assets. Meanwhile, private pension holdings represent the second largest asset class held by Canadians, making up 29% of total assets. Within this category, the share of employer-sponsored pension plans (18.5%) is twice as large as individual pension assets (10.5%) such as Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), and Locked-in Retirement Accounts (LIRAs). Holdings of non-pension financial assets (10.4%) and equity in business (10.5%) each represent a comparatively smaller portion of total asset holdings.

While total wealth in Canada has increased considerably between 1999 and 2005, the gains were not shared equally as the highest quintile received 71% of the total increase in wealth. Median net worth for this group now stands at $862,850, supported by median asset holdings valued at $925,584. By contrast, the lowest quintile saw their median real net wealth fall by 9.1% to just $1,000 between 1999 and 2005 as an increase in liabilities outpaced the rise in assets values. In absolute terms, the wealthiest 20% of Canadians have increased their share of the total wealth in the economy from 68.5% in 1999 to 69.2% in 2005. This increase has come at the expense of the second and third quintiles while the lowest and fourth quintile remained unchanged. When compared to the degree of inequality for income, it is clear that wealth is much more highly concentrated among a smaller proportion of the population. What is even a greater concern is that there is a significant portion of the population with little wealth or who carry more debt than assets resulting in negative net worth.

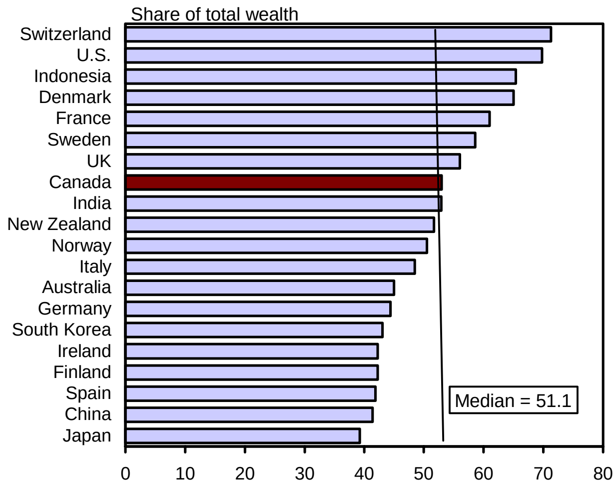
While at face value, the inequality in wealth in Canada may appear striking, when compared to other countries, Canada is well within the international norm. A recent international study showed that the wealthiest 10% of Canada's owned 53% of total wealth, which is fractionally above the median of the 20 countries considered. By comparison, in the United States the wealthiest 10% of the population holds 69.8% of total wealth and in Switzerland, the share stands at 71.3%.

What defines the top 20%?

When holding more than two-thirds of Canada's total wealth, the wealthiest 20% of Canadians is subject to a great deal of intrigue. Perhaps part of this is rooted in envy, but there is likely some benefit in identifying the characteristics of the wealthy if for no other reason than to provide a roadmap for those wishing to join the club. At first blush, the defining characteristic of the wealthy is higher incomes. Indeed, income and wealth are closely correlated as the family units with an after-tax income of $75,000 or more have a median net worth nearly three and a half times the population as a whole. In fact, the relationship between wealth and income creates a virtuous circle: Higher incomes allow for greater savings which in turn can be used to accumulate greater wealth. This larger



WEALTH SHARES OF THE WEALTHIEST 10%



Source: World Institute for Development Economics Research

pool of wealth then generates higher incomes through investment returns and the process begins again.

Time is also a powerful tool for the accumulation of wealth and it should come as no surprise that the wealthy tend to be older. In fact, elderly families have the largest median net worth of all family classifications. This result also ties back into the income story as young families typically begin their careers with a lower level of income and as a result tend to be dissavers as they pay off student debt and undertake major purchases such as cars and real estate. As families begin to age they place many of their significant purchases behind them and as they pay down their mortgage the value of their assets and net worth increase.

Educational attainment also plays a role in wealth accumulation as the median net worth increases uniformly with the amount of education received. For example, net worth in a family where the principal income earner has a university degree is two and a half times that of a family in which less than a high school education was attained. While the value of the degree plays a definite role, the positive correlation between wealth and education may reflect related characteristics. For example, individuals with a better education may come from wealthier families and that may provide certain advantages in attaining a high level of wealth themselves. Furthermore, receiving a certain level of education may also capture attributes within the individual that would lead them to greater wealth regardless of the amount of education received.

The composition of assets provides some insight into what differentiates the wealthiest 20% of Canadians. In general, while they are more likely to own a home, their portfolios tend to be more diversified with less reliance on their primary residence. The share of total assets dedicated to the primary residence for the highest quintile is just 24.4%, 9 percentage points below the population in general. However, the highest quintile does hold more secondary properties and these assets have a greater contribution to their overall wealth.

While holdings of private pension assets of the wealthy make up roughly the same proportion of total assets as for the population in general (31.5% versus 29.0%), a far greater number of families within this group hold these assets (95.1% as compared to 70.6% for the entire population). For financial assets held outside of pension assets, the wealthiest 20% have greater holdings of stock. For example in 2005, stocks made up 2.7% of total assets of the highest quintile which is more than 6 times as large as the share held by the second wealthiest group. In fact, slightly more than one-quarter of the families in highest quintile own stocks as compared to just 9.9% for the population in general. Another fundamental difference is that the highest quintile is more likely to have ownership in a business enterprise. The share of total assets for the highest quintile stands at 15.2%, nearly 5 percentage points higher than for the population in general.

CANADIAN ASSET HOLDINGS - 2005

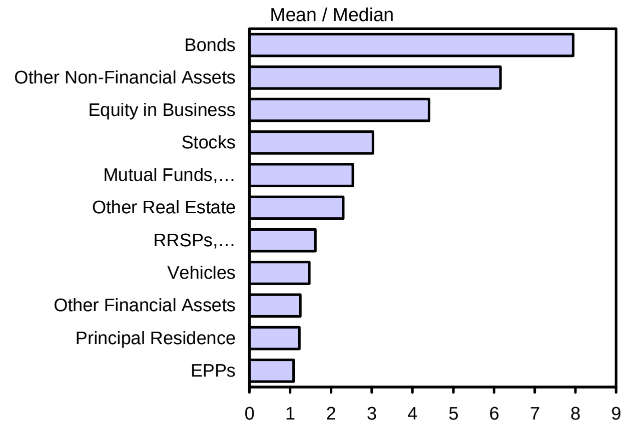
	Percentage Holding the Asset		Median Value (2005 dollars)		Share of Total Assets (per cent)	
	Top quintile	All quintiles	Top quintile	All quintiles	Top quintile	All quintiles
Principal Residence	96.9	61.9	275,000	180,000	24.4	33.4
Other Real Estate	37.0	16.1	170,000	85,000	10.8	8.6
Private Pension Assets	95.1	70.6	390,421	68,020	31.5	29.0
Stocks	25.2	9.9	47,000	11,500	2.7	1.8
Business Equity	30.7	16.6	150,000	15,794	15.2	10.5

Source: Statistics Canada

The inequality within the wealthy

What is also interesting is that there is a significant amount of inequality within the highest wealth quintile of Canadians. One can get an appreciation of this fact by noting the pronounced difference between the mean and median asset holdings. While median net worth for the top 20% is $862,900, the average stands at $1,264,200 suggesting a significant skew towards the extremely wealthy. This difference is even more pronounced when holdings of individual assets are compared for those who hold them within the highest quintile. The largest source of the skew towards the wealthy comes from the holdings of bonds which has a mean-median ratio of 7.9 (the larger the ratio, the greater the share of the asset is held by the top segment of the wealthy). The nebulous category of "other non-financial assets" also has a significant concentration in the super-wealthy. Included within this category are such items as the contents of the residence, valuables, collectables, as well as such high value and sparsely-held items as copyrights and patents. This result highlights the limitation of the Statistics Canada survey because since respondents are asked to value the items, there is a subjective element for these types of intangible assets. The wealthiest segment of the top quintile also owns a significant portion of equity in businesses and stocks. With a mean-median ratio of closer to 1, the value of the principal residence and Employer Pension Plans (EPPs) is more evenly distributed, suggesting that the value of homes is reasonably balanced and those in the super-wealthy category do not receive a company pension commensurate with their wealth.

ASSET SKEW IN THE HIGHEST QUINTILE



Source: Statistics Canada

Unfortunately it will be many more years before we get another look at the distribution of wealth. Housing prices are unlikely to continue to rise at the pace of recent years, but growth should remain in the black. Also equity markets should resume growth. A distinguishing feature of the 1999 and 2005 wealth surveys is the decline in the real value of stock holdings. As the wealthy hold a disproportionate amount of stocks, the decline in the real value is the principal reason why the concentration of wealth in the highest quintile did not increase by more. If investment returns rise the trend towards growing wealth disparities will likely intensify. This could be compounded by sluggish wage gains in the low end and the financial challenge of immigrants – the main source of growth in the younger, less affluent population.

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Endnotes

[1] Statistics Canada defines total family as including both "economic families (a group of two people who live in the same dwelling and are related to each other by blood, marriage, common law or adoption) and unattached individuals (a person living either alone or with others to whom he or she is unrelated)."