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January 2012
Issue: 12-01

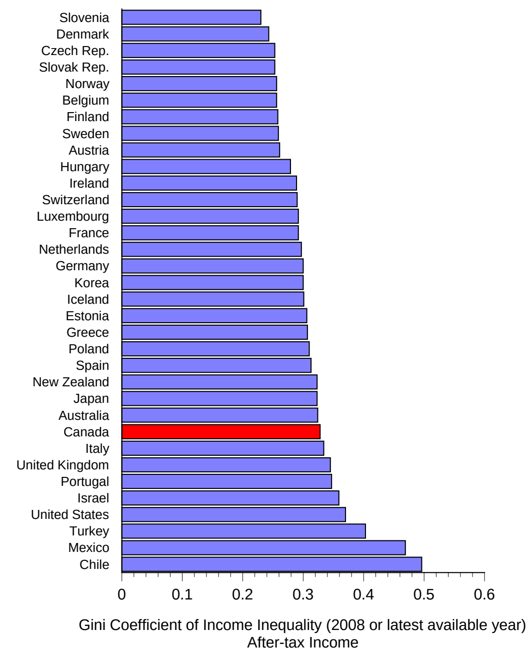
Business Indicators ◆ January 2012

Mind the Gap: Income Inequality Growing

The growing inequality in the distribution of wealth has struck a chord worldwide giving rise to the Occupy movement that began in New York in September 2011 and quickly spread around North America and other areas of the world. While concern over the gulf between the rich and the poor has likely been an issue since the time that currency was first exchanged for goods and services, the recent global economic downturn was probably the catalyst of the current protests. Many feel that those responsible for the financial crisis that precipitated the economic instability came away relatively unscathed, while many others paid the price through loss of employment, devaluing of pension funds and so forth. The resulting anger and resentment has put a spotlight on the growth in income inequality.

The Organization for Economic Cooperation and Development (OECD) released a study in December 2011 that confirmed that the gap between the rich and poor is indeed growing.[1] This was true in most of the member countries of the OECD and Canada was no exception. In fact, the OECD found that Canada had greater income inequality than most OECD nations. Canada ranked 26th out of 34 countries as measured by the Gini coefficient of income inequality.[2] In addition, the report found that the income gap has been growing over time.

Canada has more income inequality than most OECD nations



Source: OECD

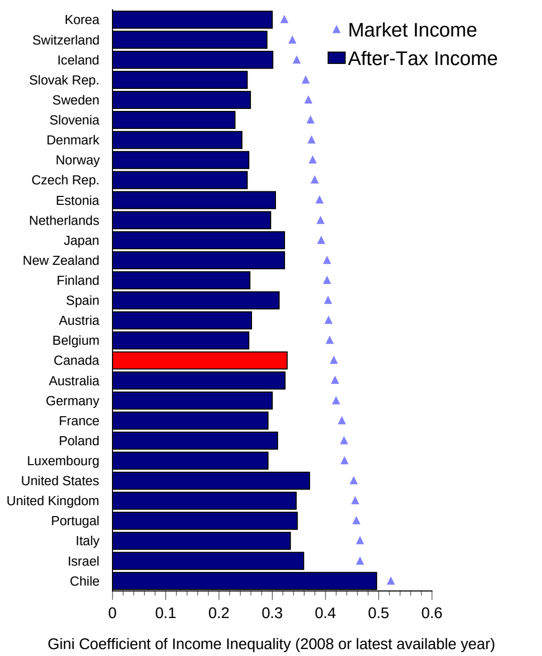
Based on data from 2008, the average income of the top 10% of Canadians was ten times higher than the bottom 10%, which is a significant increase from the early 1990s, when the ratio was eight to one. The OECD report attributed the growth in inequality to a combination of factors, including increasing disparity in the wages for high and low-paid workers, an increase in the number of self-employed (since they tend to earn less than employees), as well as a drop in the redistribution of income through taxes and benefits.

[1] OECD, Divided We Stand: Why Inequality Keeps Rising (Dec. 2011).

[2] The Gini coefficient is a measure of inequality. As a measurement of income inequality, it ranges from a value of 0, where all people have equal income, to 1, where one person has all the income. Therefore, higher values indicate greater inequality.

While tax cuts have benefitted people of all income levels to some extent, they have had less of a positive effect on the lowest income earners. This is because these lower-income individuals pay very few income taxes to begin with and are more reliant on the benefits and services that are paid for with tax revenue. According to the OECD report, prior to the mid-1990s, the Canadian tax-benefit system offset more than 70% of the rise in market income inequality, but this figure has fallen to 40%.[3] The report suggests that the main factor in the reduction in redistribution is declining benefit rates and less coverage for those programs (such as Employment Insurance and Income Assistance).

Canada's re-distribution programs are less effective than that of many other OECD nations

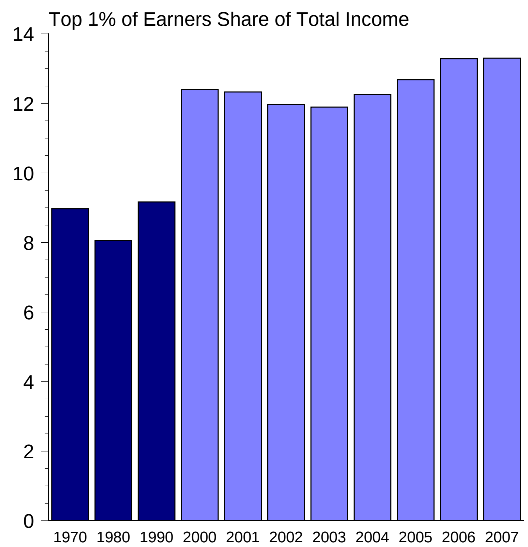


Source: OECD

Among the OECD countries, Canada's re-distribution programs ranked 22nd out of the 29 countries for which data were available in terms of their effectiveness in reducing income inequality.

The Occupy movement targeted the top one percent of income earners in their protests and the OECD study includes an examination of that thin slice of earners. According to the OECD, the richest one percent of Canadians earned 13.3% of total income in the country in 2007, well up from the 8.1% share they received in 1980.

Canada's top 1% of income earners have been getting a larger slice of the pie in recent years compared to earlier decades

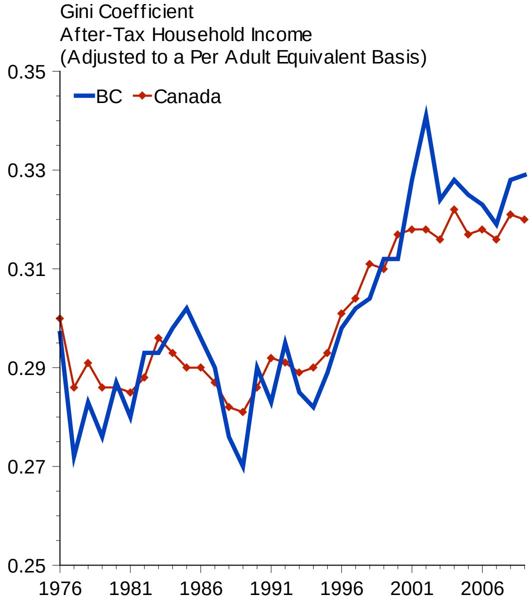


Source: OECD

The OECD figures are reflected in Statistics Canada data as well. According to Statistics Canada, there has been significant growth in income inequality in both BC and Canada as a whole over the last 15 years. Through the 1980s and 1990s the Gini coefficient of income inequality for British Columbia averaged 0.29, but from 2000 to 2009, it averaged 0.33.

3 Market income is comprised of earnings, investment income, retirement pensions and other income excluding government transfers.

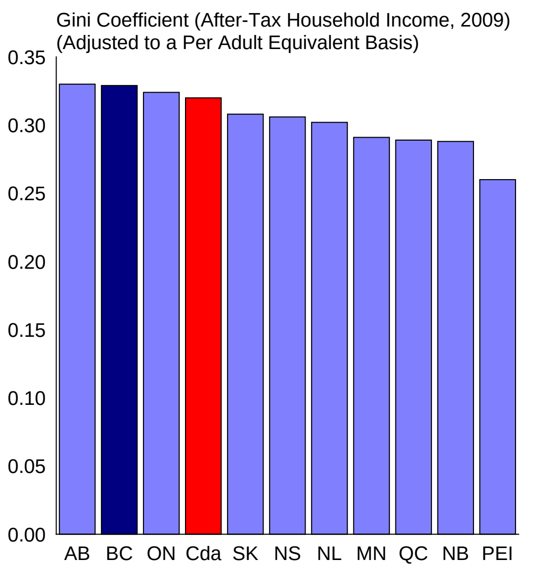
Income distribution in both BC and Canada as a whole has become more inequitable over time



Source: Statistics Canada

Among the provinces, only Alberta registered more after-tax income inequality than BC in 2009. The only other province above the Canadian average was Ontario. Prince Edward Island had the smallest income gap among the provinces.

British Columbia was second only to Alberta in terms of income inequality among the provinces

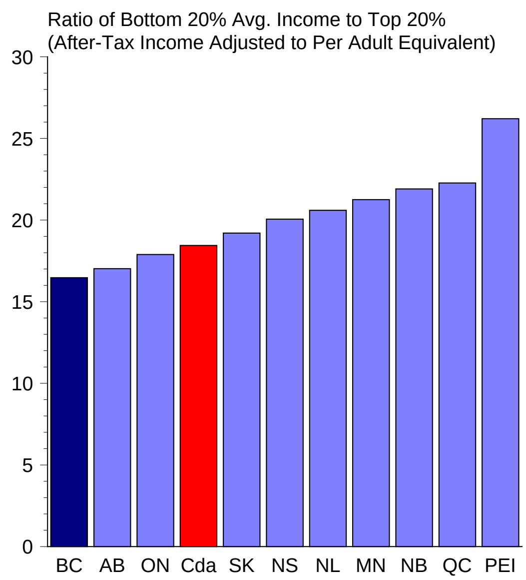


Source: Statistics Canada

However, British Columbia ranked fifth and Alberta seventh in terms of inequality when market income is used (i.e., excluding government transfers and before taxes). Newfoundland and Labrador had the most income inequality, followed by Nova Scotia, Ontario and Quebec. This indicates that these provinces have had more success in terms of redistributing income through their tax and benefit systems than have British Columbia and Alberta.

The disparity in incomes is readily apparent when one compares the top 20% of income earners with the bottom 20%. In British Columbia, in 2009, the lowest 20% earned just 7.7% of what the top 20% earned before transfers and taxes. After transfers and taxes, that figure improved to 16.5%. However, that is well down from the levels of around 22% seen in the early 1990s.

British Columbia had the largest income gap among the provinces in 2009 when comparing the lowest 20% of earners to the highest 20%



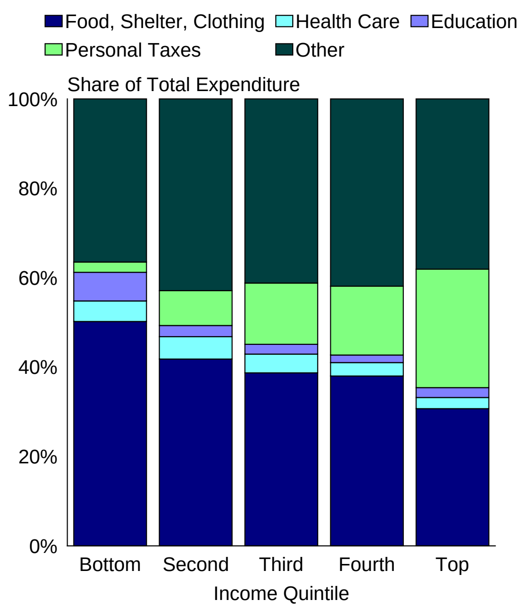
Source: Statistics Canada

Compared to other provinces, BC ranked dead last in 2009, with the largest gap between the top 20% and the bottom 20% of income earners. The Canadian average was

18.4%, almost two full percentage points above BC, but Alberta (17.0%) and Ontario (17.9%) were the only other provinces with a gap larger than the Canadian average. Prince Edward Island fared the best with the lowest 20% of earners in that province making 26.2% of what the top 20% of earners made (after transfers and taxes).

Data from Statistics Canada's 2009 Survey of Household Spending paint an interesting picture of the differences in expenditure patterns between those with lower incomes and those with higher incomes. For the bottom 20% of earners, food, shelter and clothing comprise half of all expenditures, compared to only 30% of spending for the top 20% of income earners. Health care and education costs represent another 10% of spending for the bottom 20% of earners and just under half that for the top 20%.

Food, shelter and clothing account for over half of expenditures for the lowest income British Columbians



Source: Statistics Canada Survey of Household Spending

Interestingly enough, once taxes are removed, the remaining share of income left for all other expenditures (personal care items, transportation, recreation, furniture, etc.) is just slightly lower for the bottom 20%. However, in dollar terms, that translates to less than $10,000 for the bottom 20% versus almost $60,000 for the top 20% (on average).

Given the level of discord over income inequality based on the number and size of protests in recent months, this issue is not likely to fade away any time soon. The OECD study offered some policy recommendations on how to tackle the problem. The top recommendation is to create more well-paying jobs that will give people a chance to escape poverty. In addition, the study suggests that education and training are key areas for investment. Finally, it suggests that tax and benefit policies should be reformed to increase redistribution and public services such as education, health and family care should be freely accessible.

In a free market society like Canada there will always be some that are better off than others, but the challenge is figuring out how large a gap between the highest and lowest earners should be considered acceptable. Given the size and vehemence of the Occupy protests, one would suspect that the current income gap is too large.