

Understanding inequality and what to do about it

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Three issues to talk about, ...

1 Description

just what has happened to inequality in Canada, and in other countries?
just what has happened to incomes going to the bottom and the top?

2 Explanation

why has this happened?

- what explains rising incomes at the top?
- what explains stagnant and declining incomes at the bottom?

3 Significance

why does it matter?

what policies should be put forward to address these developments?

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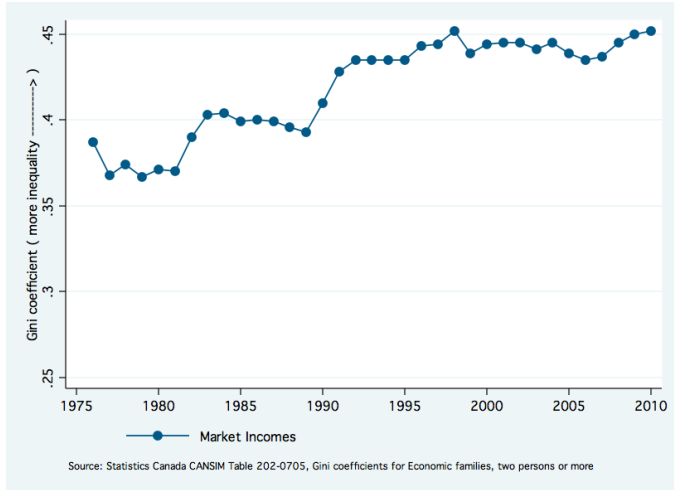
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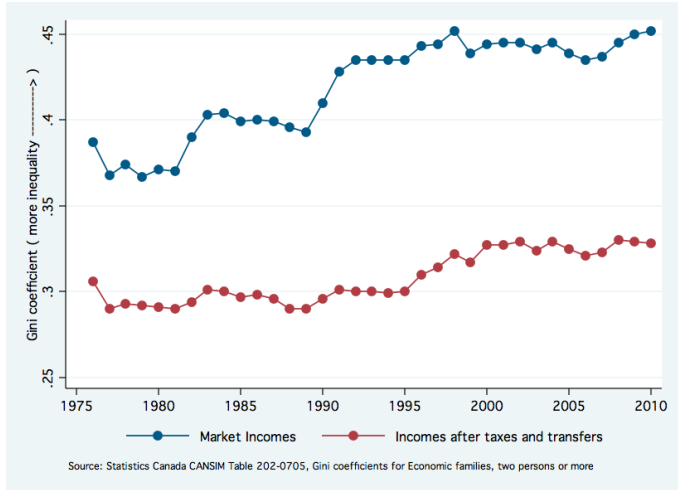
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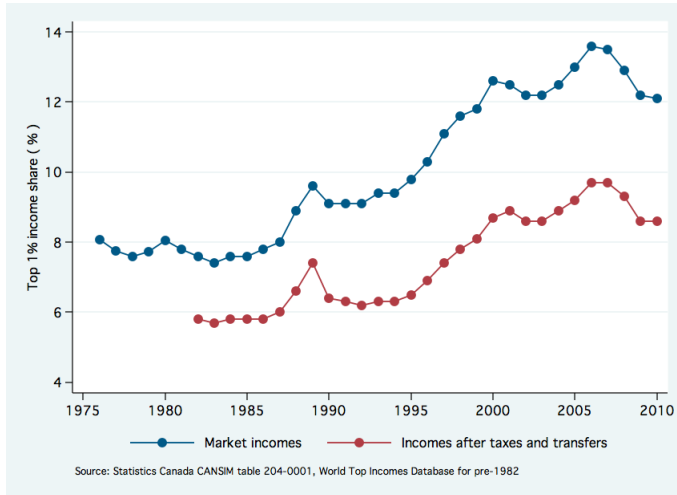
Market income inequality rose early on, ...



then disposable income inequality rose, ...



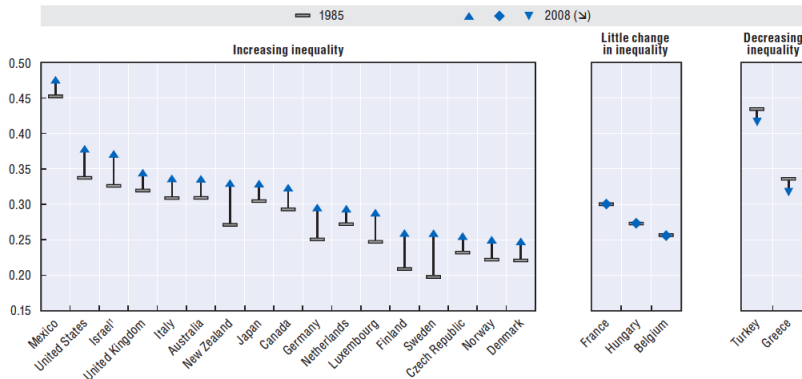
... but top incomes rose throughout.



Inequality has been rising in most countries, ...

Figure 1. **Income inequality increased in most, but not all OECD countries**

Gini coefficients of income inequality, mid-1980s and late 2000s

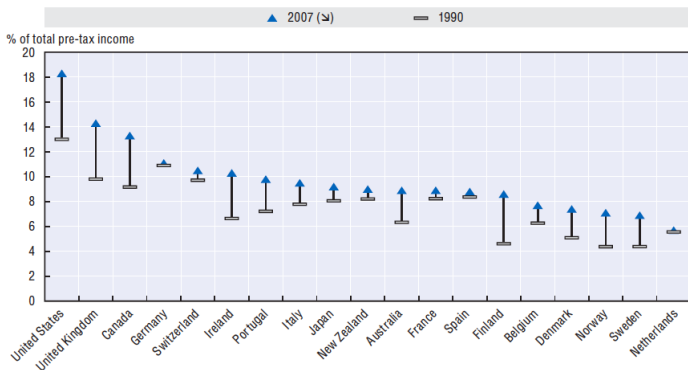


Source: OECD (2011) *Divided We Stand: Why Inequality Keeps Rising*, page 24.

... in part because top incomes have increased

Figure 12. **The share of top incomes increased, especially in English-speaking countries**

Shares of top 1% incomes in total pre-tax incomes, 1990-2007 (or closest year)

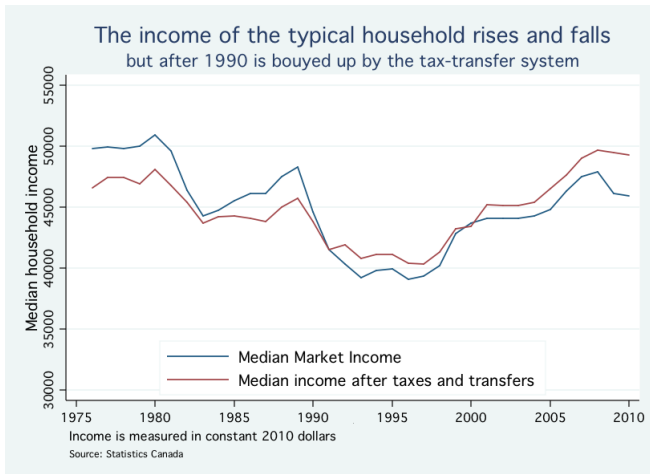


Source: OECD (2011) *Divided We Stand: Why Inequality Keeps Rising*, page 39.

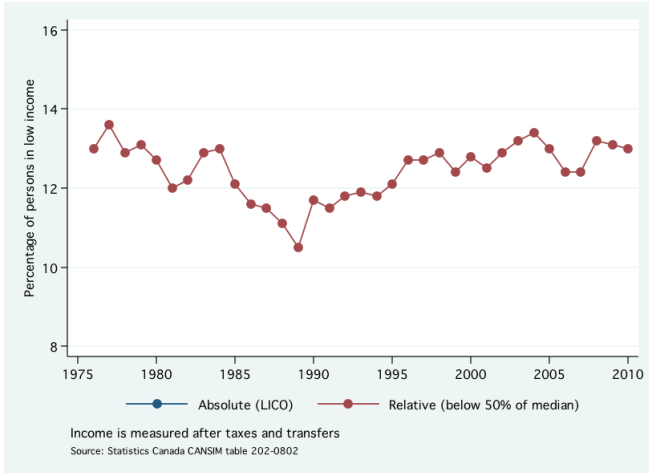
The average income in the top 1% is over \$400,000

- to be in the top 1% in Canada (in 2010) required about \$200,000 to \$215,000
- those with at least this much income had on average \$430,000 to \$488,000
- since 1982 top incomes have about doubled, increasing even more for the top 1/10th of one percent
- the average fraction of income paid in taxes is about 30%, the same as it was in the 1980s

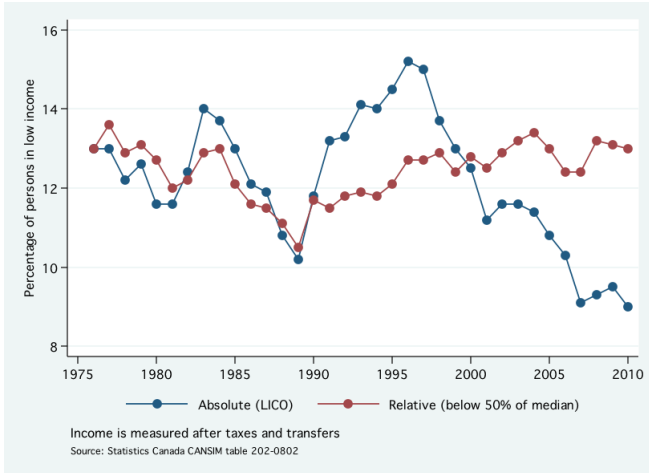
The typical household's income has not increased in 30 years



... and inequality in the lower half has not fallen



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Facts to take away

- 1 Inequality has been rising in Canada since the early 1980s, driven by stagnant and declining incomes in the middle and lower half during the 1980s and 1990s, and rising top shares throughout the last 30 years.
- 2 The tax-transfer system plays an important role in reducing inequality, but has not kept pace after about the mid 1990s.
- 3 Rising inequality is a global phenomenon. The change in Canada has been above average when compared to other rich countries, and particularly notable for the increase in top shares.

Growing labour market inequality

Three sources of inequality:

- the top 1% ... globalization, technology, corporate governance
- the top 20% ... returns to higher education and firm specific skills
- the bottom half ... decline in the return to skills associated with routine tasks

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In Canada the top 1% are a select group demographically ...

older,		highly educated,		men.	
the top 1%	the pop- ulation	the top 1%	the pop- ulation	the top 1%	the pop- ulation
only 5% younger than 35	29%	58% have a BA	12%	83%	48%
80% between 35 and 64	55%	30% more than BA	7%		

Source: Nicole Fortin et al. (2012).

... but a diverse group occupationally

	top 1%	the population
Management	19.1%	6.1%
Senior Management	14.1%	0.9%
Health Professionals	11.6%	2.0%
Professionals, business, finance	7.1%	1.8%

Source: Nicole Fortin et al. (2012).

- the resource boom has in part fueled top income, with one-in-twenty of those in the top 1% working in the mining, oil, and gas sectors

In Canada there has been a change in corporate culture arising from proximity to the US, and also a resource boom

There are a number of hypotheses to explain rising top income shares:

- 1 Globalization and skill biased technical change have combined to create an economics of “superstars”
- 2 Tax changes
- 3 Changes in corporate governance, and changes in social norms

Labour markets and institutions

The struggle to maintain a middle income existence is more difficult, and there has been a decline in average incomes at the bottom—particularly among the young and less educated—because:

- 1 Globalization and skill biased technical change favour the more educated, say the top 20%
 - in 1980 a BA implied 30% more earnings than a high school diploma, twenty-five years later 40%
 - but work experience also has a higher premium since earnings gaps by age cohort increased
 - someone starting work with a high school diploma earned 10 to 20% less in the 1990s and 2000s than in the 1980s

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 - minimum wages
 - Unions (within sectors, between sectors)

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- 2 Erosion of labour market institutions influenced lower earnings
- 3 The gender wage gap has been reduced and this is a force reducing inequality

Why is growing inequality a concern?

Fairness

Efficiency

- some inequality is important to send signals and offer incentives to respond
- but too much may signal “rents”
 - no efficiency gains
 - the macro-economies of more unequal economies may risk being more unstable

Opportunity

- more unequal societies display less “social mobility”

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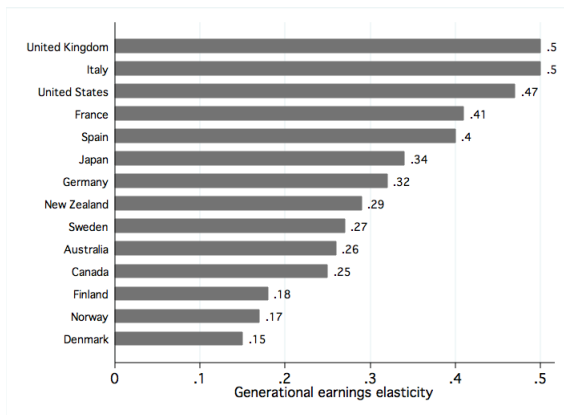
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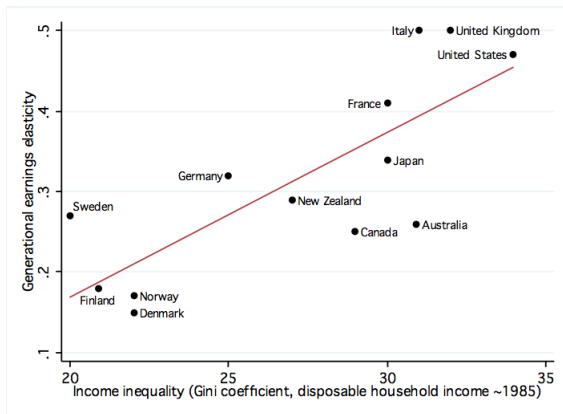
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The link between child adult outcomes and family background varies across the rich countries



Source: Corak (2013).

Social mobility is lower where inequality is higher



Source: Corak (2013).

Understanding what to do

1 Some things you can change, some things you can't

- inequality has risen during the last thirty years, and continues to do so
- the tax system plays an important role in reducing inequality, but less so over time

2 Don't make things worse, watch out for unintended consequences

- some of the causes are rooted in how labour markets function in an era of globalization and technical change
- there is no single cause, and the causes influence top and bottom earners differently

3 The most important consequence of higher inequality may be how it shapes opportunities

- this is long-term, and reflects how public policy "levels the playing field" by investing in human capital of the least advantaged

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