LOOK BEYOND THE TRADITIONAL METRIC OF INEQUALITY: TD ECONOMICS

Focus should be on improving economic prospects for low and middle income households

- Canadian income inequality rose significantly over the 1990s, but has remained surprisingly unchanged since 1998. However, the traditional benchmark for income inequality – the Gini coefficient – masks important underlying trends in income.
- Low income Canadians have had the fastest income growth since 1998, followed by high income Canadians. The slowest income growth has been for middle-income households.
- The sense that income inequality is a pressing challenge likely reflects the absolute level of income for low income Canadians; the increased share of income going to the top 1% of earners; and the wealth divide between the affluent and others.
- The policy focus should not be on income inequality, but rather how to improve economic prospects for low and middle income earners.

TORONTO – A new report from TD Economics examines household income trends and income inequality in Canada and the United States. The report highlights that Canada's relative superior economic performance has resulted in Canadian median household income exceeding that in the U.S. since 2006. It also finds that income inequality in Canada has been persistently lower than in America.

However, the report unmasks some surprising trends. On one hand, the authors point out, income inequality in Canada, as measured by the traditional economic benchmark – called the Gini coefficient – has not increased materially since 1998. "This may appear counterintuitive given the common perception that inequality has increased significantly over the last decade," said Craig Alexander, Senior Vice President and Chief Economist. "However, an examination of the underlying income trends shows that the challenge is the absolute level of income for low-income households and the poor growth of income for middle-income families."

Canadian households have more income than U.S. counterparts

The devastating impact of the financial crisis has pushed U.S. median household income to a 16-year low. Meanwhile, Canada's superior economic outperformance over the 2000s, a milder recession and a job-filled recovery have led to superior income growth since 1998. As a result, median household income has been higher than in the United States since 2006.

Income inequality a more pressing problem in America

"A discussion of incomes inevitably leads to the issue of how that income is distributed across society – this is especially true in the wake of the global financial crisis," remarked Alexander. U.S. income inequality has been rising in recent decades and it has clearly increased in the wake of the recession. America has experienced a jobless recovery from the recent recession and has seen its middle class hollowed out over the last two decades.

However, Canada's story is much less clear-cut. Income inequality, as measured by the traditional economic benchmark of the Gini coefficient, increased considerably over the 1990s when the federal government was deficit fighting and transfers to individuals were reduced. Since 1998, however, income inequality has stayed essentially flat.

“We wanted to understand why the traditional metric was not showing rising inequality,” said Alexander. An examination was made of income trends from 1976 to 2010. While families at the top 20% of the income scale enjoyed an after-inflation income gain of 18% since 1998, the real income growth for those at bottom 20% recorded an even larger gain of 20%. The lagging income performance was for middle-income households which recorded an after-inflation gain of 14%. It should be stressed that while the cumulative income gains over the twelve years may look impressive, the average annual growth has been 1.5% for low-income households, 1.1% for mid-income families and 1.3% for affluent households.

Look beyond the traditional metric of inequality

While the distribution of the income gains has kept the traditional benchmark of inequality relatively stable, that metric is only one perspective.

Although the fastest pace of income growth since 1998 has been at the low end of the income scale, the actual level of income is often not sufficient to meet a family’s basic needs. Even with the 20% increase in income, the after-inflation level of income only increased from $12,700 in 1998 to $15,200 in 2010.

While income across the entire economy has not become more unequal, this does not refute the fact that the income share taken by the top 1% has increased over time. Indeed, the top 1% of income earners in Canada has gone from accounting for 8% of total income in 1982 to 14% in 2010. While this may not be significant enough to skew the Gini coefficient, it is likely a key contributing factor to the sense that income inequality has intensified.

Finally, one could also broaden the definition of inequality to encompass personal wealth. The data indicate that roughly 70% of the nation’s net worth is concentrated among the richest 20% of Canadians. This perhaps represents a more tangible notion of inequality since a stronger net worth position generally translates into more expensive homes, luxury cars, and possibly other luxury goods beyond the reach of the majority of Canadians.

“The sense of rising inequality is likely the product of the low absolute level of income for many Canadians, the fact that the top 1% of earners are receiving a greater share, and the inequality of wealth across the nation,” remarked Alexander. “However, the policy focus should not be on income inequality in-and-of itself, but rather to ensure equality of opportunity and how to improve the prospects for low and middle-income earners," he added.

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