INCOME DISTRIBUTION IN CANADA IN THE 1990S: THE OFFSETTING IMPACT OF GOVERNMENT ON GROWING MARKET INEQUALITY

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Canada, unlike the United States, experienced in the first half of the 1990s no significant rise in the inequality of the distribution of income after tax, arguably the most relevant income measure since it gauges disparities in command over private goods and services. Like the United States, Canada did, however, experience a rise in income inequality before transfers. The divergence between trends in the distribution of income after tax and income before transfers is explained by changes in the relative importance of government transfers and income taxes. This article examines the offsetting impact of government on the growing market inequality of the period.

AVERAGE AGGREGATE INCOME TRENDS

An examination of income and income distribution trends in Canada in the first half of the1990s must look at three definitions of income: income before transfers, total money income, and income after tax. All three measures show that Canadian families became worse off in the first half of the 1990s. Real income before transfers fell 7.1 percent, income after tax 5.4 percent, and total money income 4.8 percent.[1] The larger decline in income before transfers meant that transfer payments increased in relative importance, rising from 9.9 percent of money income in 1989 to 12.1 percent in 1995. The slightly larger decline in income after tax compared to total money income meant that income tax increased as a proportion of money income-from 19.3 percent to 19.8 percent.

The overall declines registered in all three measures of real average family income were experienced by all income quintiles, although the relative severity of the fall varied by income measure and quintile, as is discussed below.

INCOME BEFORE TRANSFERS

Table 1 shows trends in income before transfers or market income (including both employment and investment income). While all quintiles experienced falls in income between 1989 and 1995, the lower the income quintile, the larger the magnitude of the decline. Income for families in the bottom quintile fell 20.2 percent, compared to only 2.8 percent in the top quintile. These divergent trends led to increased income inequality, with the share of the bottom quintile declining to 3.3 percent of total income before transfers from 3.8 percent, and that of the top quintile rising from 42.0 percent to 43.9 percent. The Gini coefficient rose 7.8 percent while the ratio of the average income of the top quintile to that of the bottom quintile rose 21.8 percent from 11.1 to 13.5.

The rise of market inequality in the 1990s reflects both cyclical and structural factors. Sharpe and Zyblock[2] found that about one-third of the rise in market family income inequality has been due to poor macroeconomic performance. High unemployment increases inequality because the burden of unemployment is disproportionately borne by persons in the bottom quintiles. The remaining two-thirds is related to poorly understood structural factors such as technological change favouring the skilled over the unskilled, and increased international trade.

TOTAL MONEY INCOME

The increase in inequality was much less for total money income than for income before transfers because of the growing importance of transfer payments (Table 2). The Gini coefficient for total money income increased only 3.3 percent in the 1989-95 period while the ratio of the average income of the top to bottom quintiles rose 6.8 percent from 5.9 to 6.3.

For the bottom quintile, the proportion of money income accounted for by transfers rose from 51.0 percent in 1989 to 59.0 percent in 1995. But this development reflected not so much large increases in transfers (in fact up only 6.3 percent), as the absolute decline in the quintile's market income. Transfers did increase significantly in absolute terms as well as relative terms for the second and middle quintiles. The former saw transfers jump 27.2 percent, with their share in money income rising from 18.7 percent to 26.0 percent. The latter experienced a 31.1 percent increase, with the share going from 9.4 percent to 13.0 percent.

Factors behind the growth of transfers include the growth of the 65 and over population, which increased old age security and C/QPP payments, and higher unemployment, which increased social assistance payments. Despite the cyclical downturn, unemployment insurance payments did not increase in the 1990s because of cuts to the UI system. Thus it was not increased generosity of social programs that accounted for rising transfers in the first half of the 1990s, but rather demographic developments and the larger welfare payments made necessary by high unemployment.

INCOME AFTER TAX

The increase in inequality for income after tax in the 1990s was even less than for the other two income measures as taxes increases hit high-income Canadians proportionally harder than low-income Canadians (Table 3). The Gini coefficient rose only 1.4 percent and the ratio of average income between the top and bottom quintiles actually fell 2.0 percent from 4.9 in 1989 to 4.8 in 1995. Income taxes for the top quintile rose from 24.8 percent of money income in 1989 to 26.1 percent in 1995. In contrast, for the bottom two quintiles, they fell-from 3.6 percent to 2.7 percent for the lowest quintile and from 12.2 percent to 11.0 percent for the second quintile.

CONCLUSION

Government transfer and tax policies have greatly dampened the inequalities of market income distribution. In 1995, they reduced the average income ratio between the top and bottom quintiles from a factor of 13.5 for income before transfers to a factor of 4.8 for income after tax, that is by 2.8 times. The Gini coefficient for income after tax was 69.6 percent of that for income before transfer. In the first half of the 1990s, these policies played an increasingly important role in constraining the growth of inequality. In 1989, for example, the ratio of the average income of the top and bottom quintiles only fell from 11.1 to 4.9 as one moved from income before transfers to income after tax, or by 2.3 times, while the Gini coefficient for income after tax was 74.1 percent of that for income before transfers.

In the last several years, to

attain the objective of a balanced budget, governments have dramatically cut transfer payments. For example, in 1995 the Ontario government slashed welfare payments and in 1996 the federal government again reduced the generosity of employment insurance. For 1995, the impact of these measures on income distribution was still relatively small, but by 1996 and 1997 it was becoming much more important. Preliminary data for 1996 indeed show a significant increase in income inequality because of the cuts to welfare in Ontario, given the concentration of social assistance recipients in the bottom quintile. If recent trends continue, it appears that the dampening effect of government transfer and tax policy on rising market income inequality will be less, with the result that income inequality as measured by income after tax, the most important indicator, will increase.

But current government cuts to transfers do not have to continue. Their rationale, namely to improve government's fiscal position, is no longer justified given the elimination of the deficit by the federal government and by most provincial governments. Even Ontario and Quebec will balance their budgets by the 2000-01 fiscal year at the latest. A strong case can be made that a priority for the use of fiscal dividend should be increased transfers and tax cuts targeted to low-income Canadians to offset growing market income inequalities and ensure a certain stability in the distribution of income after tax (or even greater equality).

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Table 1: Average Family Income Before Transfers in Canada, 1989 and 1995

	Share of total		1995$		
	1989	1995	1989	1995	% change
Lowest	3.8	3.3	$9,914	$7,907	-20.2
Second	11.5	10.4	30,035	25,191	-16.1
Third	17.9	17.2	46,735	41,826	-10.5
Fourth	24.9	25.3	65,056	61,404	-5.6
Highest	42.0	43.9	109,666	106,579	-2.8
Total	100.0	100.0	52,281	48,581	-7.1
Gini Coeff.	0.397	0.428			7.8
Q5/Q1	11.1	13.5			21.6

Table 2: Average Total Money Income for Families in Canada, 1989 and 1995

	Share of total		1995$		
	1989	1995	1989	1995	% change
Lowest	6.6	6.4	19,146	17,722	-7.4
Second	12.6	12.1	36,557	33,484	-8.4
Third	17.8	17.5	51,693	48,326	-6.5
Fourth	23.8	24.0	69,187	66,221	-4.3
Highest	39.1	40.0	113,542	110,465	-2.7
Total	100.0	100.0	58,025	55,244	-4.8
Gini coeff.	0.330	0.341			3.3
Q5/Q1	5.9	6.3			6.8

Table 3: Average Income After Tax for Families in Canada, 1989 and 1995

	Share of total		1995$		
	1989	1995	1989	1995	% change
Lowest	7.6	7.7	17,837	17,058	-4.4
Second	13.6	13.4	31,791	29,410	-7.5
Third	18.2	18.0	42,612	39,903	-6.4
Fourth	23.6	23.7	55,274	52,405	-5.2
Highest	37.0	37.3	86,627	82,646	-4.6
Total	100.0	100.0	46,828	44,284	-5.4
Gini coeff.	0.294	0.298			1.4
Q5/Q1	4.9	4.8			-2.0

Source: Income after tax, distributions by size in Canada, 1995, cat. 13-210, Statistics Canada, May 1997.

1. All rates of change in this article refer to real or inflation-adjusted figures.

2. See A. Sharpe & M. Zyblock, "Macroeconomic Performance and Income Distribution in Canada" (1997) 8(2) North American Journal of Economics & Finance 167.