Canadian Policy Research Networks

Special to Globe and Mail *Update, Web-exclusive comment*
May 25, 2007

The Feds Are Widening, Not Closing, the Prosperity Gap

By

David Hay

Recently, columnist Margaret Wente ventured a thought or two on who's to blame for the prosperity gap. The question stemmed from a report by Statistics Canada that shows how after-tax, family-income inequality has increased in Canada over the past 15 years. The study suggests that the participation of more women in the labour market, particularly higher-educated women, may be an important contributor.

Ms. Wente looked at the relatively recent arrival on the scene of high-achieving women. Forty years ago, Ms. Wente argued, these women would have been at home. Today, with their equally high-achieving husbands, they form power couples who together draw a disproportionate share of wealth. Thus, she argued, the rich are getting richer, the middle class is shrinking and the poor are standing still.

Looking over the tables in the report, however, uncovers other potential contributors to rising after-tax inequality, and these have more to do with governments than the labour market.

Before looking at those contributors, we should define what kind of income we're talking about. After-tax family income is the result of adding together market income (income from employment and investments), income from government cash transfers (pensions, employment insurance, social assistance and other benefits), and subtracting the effect of the tax system.

Inequality in market income has gradually risen over the past 30 years, while inequality in after-tax income has risen slightly over the same period. Both have increased more quickly since 1989.

The steeper rise in after-tax income inequality over the past 10 to 15 years suggests that the tax and transfer system is doing less than it did in prior years to reduce family-income inequality. How much less, especially relative to the contribution of market income to family income, is not analyzed in the Statscan report. It could be inferred, however, that changes in the tax and transfer programs of governments have contributed to the increase in family after-tax-income inequality.

The report does highlight some of the changes that have been made to the tax and transfer system, such as a tightening of eligibility and entitlement levels of transfer programs (e.g. social assistance and employment insurance), introduction of new programs (e.g. the Canada Child Tax Benefit and the GST credit), and the reduction in real tax rates in the 1990s.

The net effect of these changes in tax and transfer programs is more money left in the pockets of families and less in the coffers of governments. If taxes had remained at the levels in place 10 to 15 years ago, governments would have had substantially higher revenues — in total, tens of billions of dollars each year.

All levels of government have trumpeted their tax reductions as substantially benefiting families and the health of the Canadian economy. While families are no doubt grateful to pay less tax, they are, at best, confused when they realize that less government revenue means less money for important government investments in social programs. And if, indeed, tax and transfer program changes are also contributing to increasing income inequality, the gains for many families at lower levels of income will be increasingly modest.

Modest income gains are insufficient to purchase the programs and services that families need to succeed in today's fast-paced knowledge economy. A combination of adequate education and a broad set of skills are key to well-paid employment. In other words: increased prosperity.

So what could be done to close the prosperity gap? How can we give lower-income families a chance to achieve higher levels of education and skill development? Two priorities should be in education programs for children and workplace initiatives for adult workers.

The first investment should be in universal, day-long education programs for Canadian three- and four-year olds. Not only would these children be better prepared and ready to learn when entering the school system as five-year-olds, but a Brookings Institution study from 2006 estimated that such an investment in the U.S. would, in time, increase annual GDP in that country by nearly 4 per cent. It's likely that results would be similar in Canada.

Second, we need to refocus on the elementary school system. In Ontario, for example, more than 40 per cent of Grade 3 children fail to attain the literacy level necessary for timely advancement through subsequent grades. Annual school board budgets, on a per-student basis, are declining, and this needs to be reversed if all children are to succeed.

Similarly, more than 40 per cent of adult workers are functionally illiterate, costing the Canadian economy billions of dollars in lost productivity. Investments in workplace training in Canada lag many other OECD countries, Canada's competitors in the global economy.

So when we are casting about for whom to "blame for the growing prosperity gap," maybe we shouldn't be focusing on the individuals who have managed to make gains. Instead, why not look at how we can share Canada's prosperity among a broader segment of the population. Tax and transfer programs have been an integral part of the problem in widening the gap. Can they not be an important means to narrowing it as well?

David Hay is Director, Social Development, for Canadian Policy Research Networks.