

Armine Yalnizyan**The Rich and the Rest of Us: The Changing Face of Canada's Growing Gap.**

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<http://www.growinggap.ca/research> (978-0-88627-531-0).

This report examines inequality in Canadian society reflected in distributions of income over time, drawing on national survey data from the Survey of Consumer Finances (SCF) and Survey of Labour and Income Dynamics (SLID) from 1976 to 2004. Published under the 'Growing Gap' project by the Canadian Centre for Policy Alternatives, the report paints a bleak picture of income disparity and increasing polarization over time for 'families raising children under the age of 18' — a family segment accounting for just under half of the entire Canadian population. As summarized by the author:

Greater inequality (the growing gap) and greater polarization (the growing distance between minority haves vs. the majority have nots) are being driven by one phenomenon: the economic gains of this period are accruing disproportionately to the richest 10% of Canadian families. Their incomes gains are disproportionate to their share of the population. And their income gains are also disproportionate to their work effort (p. 30).

The rich are getting richer, the poor aren't going anywhere and there are fewer people in the middle to mediate the two extremes. We ignore these trends at our collective peril (p. 31).

Rather than applying conventional economic tools or techniques such as Gini coefficients and Lorenz curves to precisely quantify and graphically portray the extent of inequality in income distributions, the author focuses on more basic descriptive statistics (percentage shares, medians and averages for deciles) and simple line charts to track change over time. By rank-ordering the incomes of Canadian families raising children and segmenting into deciles (each representing one-tenth of the population), the author highlights how the richest 10 percent of families (those in the top income decile) are "literally breaking away from the pack" (p. 10), with their share of total earnings increasing from 23 percent in the late 1970s to almost 30 percent (29.5 percent) between 2001-04, and share of after-tax earnings growing from 21 percent to almost a quarter (24.5 percent) over the same time frame, leading to the conclusion that "The richer the family, the richer that family is becoming" (p. 19). Further, the author concludes that growing income inequality and polarization have occurred during times of both economic expansion and recession, and that the highest levels of inequality and polarization observed most recently are during "the best of economic times" (p. 9), an era in which unemployment is low, Canadians are working longer and harder, and productivity rates are improving.

The author also considers the impact of Canadian government systems of taxes and transfers in redistributing income between advantaged and disadvantaged segments of society by examining 'after-tax' earnings of Canadian families raising children. She finds that the systems of taxes and transfers continue to play an important positive role in redistributing income and reducing the magnitude of income inequality in Canadian society, noting that "Canada's tax and transfer system helped to mitigate the earnings gap" (p. 27). However, while not diminishing the important 'buffering' role, the author concludes that "the tax and transfer system did not significantly reverse the trend in reduced shares of income for the majority of families"(p. 12).

One of the more alarming statistics highlighted in this report (and subsequent media coverage following its public release) is that in 2004 average total earnings of the richest 10 percent of Canadian families raising children was 82 *times* that earned by the poorest 10 percent of families (p. 3 under 'Introduction' and also at p. 17). However, this extreme number is more a statistical artifact than an accurate depiction of reality. As a measure of central tendency, the 'average' (arithmetic mean) is not resistant and is affected by extreme values (either high or low) in a distribution. This is especially important when considering tails (top and bottom deciles) of an income distribution which are truly open-ended in nature. While the author provides some control for this at the bottom end of the distribution (with negative earnings reflecting losses from investment or self-employment businesses being recoded to a value of zero – p. 34), there is no limit or control for distortions in the top income decile. In comparing means with medians, the author argues that "the average is a more appropriate measure to speak of differences between the two most extreme groups in society, the richest and the poorest 10%" (p. 34). However, the average for the top income decile will be distorted and inflated dramatically by even a small number of extreme income values. The minimum threshold for the top income decile in 2004 was \$131,200, but with no true upper limit to the range of income, we know that the calculated average for this decile will be substantially higher, contributing to the extreme measure of the gap between top and bottom 10 percent of families raising children.

Unfortunately, the author does not report any actual decile income averages used for this top / bottom decile contrast, but does include the derived 'earnings gap' for each year covered in the study (Table 7, p. 48). A quick inspection of these figures over time reveals substantial variations in the 'earnings gap' ranging from a low of 30.2 in 1979 to an astronomical 11,741.7 in 1996. These extreme variations in the 'earnings gap' reveal how extreme incomes in a given year can have a truly distorting effect on the measure, but also highlight the perils of working with sample data (even large, nationally-representative samples used in SCF/SLID) when focusing on the tails of an income distribution (top/bottom deciles). By comparison, the 'after-tax gap' also profiled in the report represents a much more stable measure of income inequality, ranging from a low of 7.5 in 1988 to a high of 9.9 in 2004 (Table 7, p. 48).

Beyond the problems of measuring the 'earnings gap' using averages from top and bottom income deciles, there is a more serious issue concerning what is really happening in that top income decile over time. In their recent analysis of high incomes in Canada, Saez and Veall (2005: 832) observe that top income shares have increased markedly between 1980 and 2000, but that "This change has remained largely unnoticed because it is concentrated *within the top percentile* of the Canadian income distribution" (emphasis added). They go on to show that the top 1 percent of income earning Canadian individuals and families exhibit nearly identical growth patterns in the share of wage income over time, going from about 5 percent in 1982 to about 10 percent by 2000 (Saez and Veall, 2005: 843, from Figure 6). These high income data provide compelling evidence that *most* of the 'increasing polarization' in the disproportionate share of income over time can be attributed to dramatic growth for the top 1 percent of earners (both individuals and families), rather than the top 10 percent (top decile) as portrayed in this report. While the author cites the Saez and Veall (2005) study in her report (p. 28, with reference on p. 54), she essentially ignores the analysis and conclusions of this important research on high incomes in Canada.

A much more representative and realistic measure of the gap between rich and poor would be to construct the 'earnings gap' as the ratio between top and bottom income deciles using more resistant median incomes from each decile (effectively contrasting the 95th and 5th percentiles, and thereby eliminating the extreme and distorting tails of the income distributions which are dramatically

inflating average values).¹ Contrasting top and bottom decile median incomes will reduce the absolute magnitude of income inequality, as well as the degree of polarization over time. Drawing on report data on median after-tax earnings, the ratio between top and bottom income deciles increases from 7.1 in 1996 to 7.7 by 2004.² There remains clear evidence of income inequality with the top 5 percent earning over 7 times the amount of the bottom 5 percent of families with children in after-tax incomes. There is also evidence from the median income ratios of increasing polarization in the income distributions over time, of growing income inequality. However, these results are much less dramatic than those highlighted in the report.

The dimension of working time is added to the analysis of income inequality of Canadian families raising children, highlighting increasing work effort over time:

The overall trend is that most families are putting in more work weeks, and most families are putting in longer hours. Almost all Canadian families are putting more time into the labour market than they did in 1996, with one notable exception: the richest 10% of families (p. 19).

... the majority of Canadian families raising children have had to invest more of their most precious resource – time – into the labour market simply to stay afloat, if not get ahead (p. 23).

The author belabours the point that families in the top income decile are not contributing more work effort over time, which serves to distinguish this top segment from all other income deciles. However, the author neglects to point out that there is clearly a ceiling effect for working hours and weeks per year (representing a realistic upper limit for the time dimension), and that families in the top income decile have been at or very near this ceiling consistently over time. Looking at the same set of income deciles from the perspective of work effort (expressed as average hours and weeks worked per year for families), it is apparent that there is considerable inequality in the distribution of work effort by either measure. Expressed as a share of total hours per year, in 2004 top income decile families accounted for approximately 13 percent of all working hours, compared to about 5 percent for bottom income decile families.³ Similarly, expressed as a percentage share, in 2004 top income decile families accounted for between 12 and 13 percent of all working weeks per year, compared to about 5 percent for bottom income decile families.⁴ Accordingly, a good proportion of the income inequality evident across Canadian families with children will be a function of the considerable inequality in work effort (expressed in working hours or weeks per year). However, the author does not control for these differences in work effort in her analysis of income inequality.

Income inequality cannot be examined in isolation, but must be placed in the context of differences in work effort. To properly control for inequality in work effort, income data should be expressed in standardized time units such as hourly wages or weekly earnings. If one statistically controls for differences in work effort, a different picture emerges. Drawing on report data, we can derive rough estimates of the extent of income inequality and polarization over time after accounting for differences in work effort.⁵ After-tax earnings are used in these calculations since median gross earnings data (Table 1, p. 36-37) are not reported for the bottom decile for many years including the 1996 reference year used for time comparisons. Controlling for work hours per year, the ratio of median after-tax hourly earnings for top and bottom deciles rose from 2.5 in 1996 to 2.9 in 2004.⁶ Controlling for work weeks per year, the ratio of median after-tax weekly earnings for top and bottom deciles increased from 3.0 in 1996 to 3.2 in 2004.⁷ While there is evidence of increasing polarization in income inequality over time, the magnitude of change is quite modest. These estimates reveal that working members within the top 5 percent of families raising children take in

about three times the after-tax weekly earnings of working members within the bottom 5 percent, and less than three times the after-tax hourly wage earnings.

By focusing on crude statistical differences in income distributions over time, the author neglects to address critical distinctions in the composition of top and bottom income deciles. By not statistically controlling for substantial differences in work effort (working hours and weeks per year) across the deciles, the author has missed important clues to these compositional differences. Differences in the percentage share of work effort across the income deciles alert us to the fact that there are significant differences in the numbers of individuals in a family working and contributing to family income across the income deciles. In terms of compositional differences, families in the top income decile are much more likely to have two or more workers contributing to family income, relative to those in lower income deciles. Conversely, families in the bottom income decile are much more likely to have only one contributing worker (typical of lone-parent families which would be much more common in this bottom income decile). Also closely related to work effort, families in the bottom income decile are much more likely to have members who are working on a part-time or casual basis (not regular full-time hours), and working at temporary or seasonal jobs (not working a full year). By comparison, the modality for families in the top income decile would most likely be two principal earners in full-time, full-year employment. These dramatic differences in work effort across the income deciles have a profound effect upon how much family income can be generated.

Beyond work effort, there are likely other important compositional differences which could account for the magnitude of income disparities evident across the income deciles — there are likely demographic distinctions which warrant much closer analysis. For instance, it is reasonable to assume that there will be significant age differences in working family members across the income deciles, with a much higher proportion of older workers in families in the top income decile, compared to much more younger workers in families in the bottom decile. Older workers would typically have greater work experience and seniority in the labour force, more accumulated human capital, ultimately contributing to higher family incomes. By comparison, the bottom income deciles are much more likely to include the youngest workers, recent labour force entrants with little or no work experience, lower job tenure, less human capital, and hence lower family earnings. Other demographic differences (such as whether lone-parent families are comprised of a female or male working head of household) would likely influence a family's location within the income distribution. There would likely be substantial differences in levels of educational attainment across the income deciles which in turn determine occupational choices and opportunities, ultimately impacting individual earnings and family incomes.

The author contends that data from SCF/SLID survey sources “represent a conservative estimate of the scale of the problem” of income inequality (p. 6), concluding that “In every respect the story reported in this study is based on the most conservative estimates of a growing gap” (p. 30). However, by not properly controlling for critical differences in work effort, or accounting for important distinctions in family demography and other factors, the author has in fact presented a case which exaggerates the scope and magnitude of problems of income inequality and polarization over time. This report is largely descriptive in nature, focusing on crude statistical contrasts without any real analysis or interpretation of the determinants or underlying causes of growing income inequality and polarization in Canadian society. The author cautions that:

‘The numbers in this report – the definition of the richest 10% of families raising children being those earning \$131,200 or more in 2004 – don’t sound like we are talking about the rarified world of the super-rich, as seen on TV.

And they are not. This is not the story of the Donald Trumps of this world.’ (p. 30).

On the other hand, other earnings research recently published under the ‘Growing Gap’ project by the Canadian Centre for Policy Alternatives points to just how extreme incomes at the top end of the distribution have become in recent years. Mackenzie (2007: 3) reports that in 2005 the 100 top-paid Canadian CEOs received incomes of between \$2.8 million and \$74.8 million, with an ‘average’ for this group of \$9.0 million. Inclusion of even a small number of extreme earners in Canadian society (CEOs or others) within a SCF/SLID survey sample will serve to dramatically inflate the ‘average’ earnings for the top income decile, and any derived ‘earnings gap’ based on such data. There is indeed income inequality and growing polarization over time in Canadian society, but it largely reflects the extreme economic gains of the top 1 percent of earners rather than income changes for the broader segment of Canadian individuals and families captured in the top income decile. By defining the top 10 percent of Canadian families as ‘rich’ and treating the aggregate decile as homogeneous with respect to earned income, this report presents a misleading portrait of income inequality and polarization in Canadian society.

Notes

1. Although the report does not provide average income figures used to calculate the ‘earnings gap’ and ‘after-tax gap’, recent Canadian income data presented by Saez and Veall (2005:833) illustrate the extent to which extremely high values in an income distribution can inflate the average or arithmetic mean. They provide data for thresholds and average incomes in top-end categories (fractiles) for individual Canadians in 2000 (Table 1) which shows the minimum threshold for the top decile (reported as P90 in Table 1) was \$59,232, and the median income for that top decile (reported as P95 in Table 1) was \$75,670. By calculating a weighted average for all brackets of earners in the top decile from data in Table 1, the average income is estimated to be \$105,263 – almost \$30,000 or 39 percent greater than the decile median value.
2. Drawing from data in Table 2 (page 39), in 1996, the median after-tax income for the top decile (the top 5 percent of families) was \$105,550, compared to \$14,774 for the bottom decile (the bottom 5 percent of families), which yields a median income ratio of 7.1. By 2004, the median after-tax income for the top decile had grown to \$135,810, compared to \$17,574 for the bottom decile of families, which yields a median income ratio of 7.7.
3. These percentage share statistics are estimated from data on average work hours per year as presented in Table 9 (p. 51). In 2004, top income decile families worked an average of 4,074 hours compared to 1,529 hours for bottom income decile families, which yields a top/bottom decile ratio of about 2.7 (rounded).
4. These percentage share statistics are estimated from data on average work weeks per year as presented in Table 8 (p. 50). In 2004, top income decile families worked an average of 113 weeks compared to 47 weeks for bottom income decile families, which yields a top/bottom decile ratio of 2.4.
5. Only median earnings data are provided in report tables, while work hours and weeks per year are reported as averages. Hence, it is necessary to ‘mix measures’ dividing median earnings by mean work hours/weeks for this estimation. This analysis focuses on after-tax earnings drawing data from Table 2 (page 39). Average annual weeks of employment data are drawn from Table 8 (p. 50) and average annual hours of employment data are drawn from Table 9 (p. 51). The earliest time point for work hours data is 1996 so data for this year is contrasted with the most recent year covered in the report, 2004.

6. In 1996, working members within the top 5 percent of families earned an estimated average of \$25.98 per hour in after-tax earnings (\$105,550 / 4,063 hours), compared to \$10.27 per hour for the bottom 5 percent of families (\$14,774 / 1,439 hours), which yields an estimated top/bottom decile ratio of 2.5. By comparison, in 2004 working members within the top 5 percent of families earned an estimated average of \$33.34 per hour (\$135,810 / 4,074 hours), compared to \$11.49 per hour for the bottom 5 percent of families (\$17,574 / 1,529 hours), which yields an estimated top/bottom decile ratio of 2.9.
7. In 1996, working members within the top 5 percent of families earned an estimated average of \$925.88 per week in after-tax earnings (\$105,550 / 114 work weeks), compared to \$307.79 per week for the bottom 5 percent of families (\$14,774 / 48 work weeks), which yields an estimated top/bottom decile ratio of 3.0. By 2004, working members within the top 5 percent of families earned an estimated average of \$1,201.86 per work week (\$135,810 / 113 work weeks), compared to \$373.91 per work week for the bottom 5 percent of families (\$17,574 / 47 work weeks), which yields an estimated top/bottom decile ratio of 3.2.

References

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