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ABSTRACT

'Inequality Is the Root of Social Evil,' or Maybe Not? Two Stories about Inequality and Public Policy*

Income inequality is on the rise, and everyone, from President Obama and Pope Francis to Prince Charles and Standard & Poor's, is talking about it. But these conversations about what are arguably the most significant changes in the distribution of incomes and earnings since the 1940s are leading to very different views on how public policy should respond. This is as true in Canada as it is in almost all of the other rich countries where inequality has risen. In this paper I tell two stories about inequality – one from the perspective of those who feel it is not a problem worth the worry, and the other from the perspective of those who see it as "the defining challenge of our time" – in order to clarify the issues facing Canadians, and what public policy should do about them.

JEL Classification: D31, I32, J62, J65

Keywords: inequality, poverty, middle class, top incomes, social mobility

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* This paper is based upon the Canadian Public Policy Lecture I was honoured to give on May 30th, 2015 at the Annual Meetings of the Canadian Economics Association, which were held in Toronto at Ryerson University. I warmly thank Katherine Cuff for extending the invitation to present this lecture. I was also very honoured to present the first version as the 2014 Mabel F. Timlin Lecture at the University of Saskatchewan on September 22nd, 2014 under the title "Inequality and its Discontents." I thank Kelly Foley, Don Gilchrist, Krishan Lal, Robert F. Lucas, and the other members of the Department of Economics at the University of Saskatchewan for their invitation and hospitality. I have also presented earlier versions at the Queen's University School of Policy Studies Speaker Series, at Harvard University, as the Graham Lecture at Dalhousie University, and in an abbreviated form as the Inaugural Sefton-Williams Memorial Lecture at Woodsworth College, University of Toronto. I am grateful to participants at these events for their interest and feedback. I would also like to acknowledge helpful comments and support from Tony Atkinson, Ailish Campbell, Diana Carney, Andrew Heisz, Brian Murphy, and Michael Veall. My references to the characters and script of the George F. Walker play, The End of Civilization, are used with the permission of the playwright, for which I am also grateful. The first phrase of the title is a quotation from Pope Francis, and is cited in the text. I am a professor of economics with the Graduate School of Public and International Affairs at the University of Ottawa, and was a visiting professor of Economics at Harvard University during the 2015-16 academic year when this paper was completed. You can reach me with comments and suggestions at MilesCorak.com or on Twitter @MilesCorak.

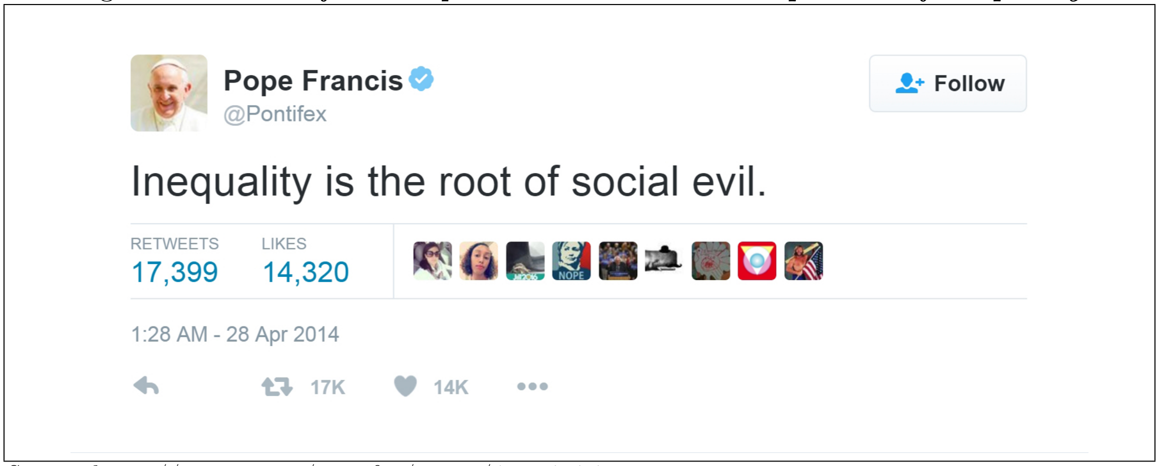
1 Introduction

On the afternoon of December 6th, 2011, President Obama stood at the podium of the Osawatomie High School in Osawatomie Kansas to give a speech, a speech referred to on the White House website as simply “Remarks by the President on the Economy in Osawatomie, Kansas”. This particular town was chosen for this particular speech not simply because the President’s mother was born in Kansas, and certainly not because the President wished just to speak to as many people from a town with a population of somewhere between 4,000 and 5,000 who could fit into a high school auditorium, but quite clearly because he wanted to speak to all Americans about a topic that had a clear echo from the past, an echo that he hoped would amplify his own message. It was also in Osawatomie, almost exactly a hundred years earlier in 1910, that Theodore Roosevelt delivered a speech before, reportedly 30,000 people, that articulated a vision of a “new nationalism,” a vision for a new policy agenda to tackle the high and growing inequality that had come to characterize the American economy as the 1800s turned to the 1900s. When President Obama proclaimed that “this kind of inequality—a level that we haven’t seen since the Great Depression—hurts us all,” he was underscoring how dramatically the outcomes of economic growth had changed, but also recalling a vision of government activism that Americans had not seen for many decades.

While the President of the United States may feel he needs the props of geography to draw inspiration from history, Prince Charles certainly does not. His very presence is enough. And His Royal Highness, perhaps not with the hubris of a Teddy Roosevelt, but certainly with equal gravitas, opened a conference held in London on May 27th, 2014 by discussing “the need for a new form of inclusive capitalism.” It may be too much to expect that the heir to the British throne would use the word “inequality” in an address of this sort, and while a good part of his remarks dealt with environmental challenges, he was certainly clear in expressing a serious and more general concern about the workings of the economy, and the short term calculus that has little regard for civic, or for that matter civil, society. At the same conference—“Inclusive Capitalism: Building Value, Renewing Trust”—Mark Carney, the Governor of the Bank of England, was much less circumspect saying that inclusive capitalism “is fundamentally about delivering a basic social contract comprised of relative equality of outcomes; equality of opportunity; and fairness across generations,” and suggested that there is a growing unease that this “trinity of distributive justice” was breaking down, an unease confirmed by “hard data.” As many of you know, over the course of his career Mr. Carney has straddled the role of public servant and business person, and while at one point remarks by a central banker, or for that matter leaders of the business community, about inequality may not have been common, that is hardly the case now. Standard & Poor’s offers just one example in a report titled “How Increasing Income Inequality Is Dampening U.S. Economic Growth, And Possible Ways To Change The Tide.”

But none of these authorities speaks with more weight—though members of the British monarchy may not entirely agree—than the Pope, who also got into the game by releasing

Figure 1: ***A tweet from Pope Francis on the consequences of inequality***



Source: https://twitter.com/pontifex/status/460697074585980928.
accessed September 20, 2016.

a blistering indictment of the workings of the global economy in the aftermath of the Great Recession. Pope Francis described the birth of a "new tyranny," stating that

> [w]hile the earnings of a minority are growing exponentially, so too is the gap separating the majority from the prosperity enjoyed by those happy few. This imbalance is the result of ideologies which defend the absolute autonomy of the marketplace and financial speculation. Consequently, they reject the right of states, charged with vigilance for the common good, to exercise any form of control. A new tyranny is thus born, invisible and often virtual, which unilaterally and relentlessly imposes its own laws and rules. ... To all this we can add widespread corruption and self-serving tax evasion, which have taken on worldwide dimensions. The thirst for power and possessions knows no limits. In this system, which tends to devour everything which stands in the way of increased profits, whatever is fragile, like the environment, is defenseless before the interests of a deified market, which become the only rule. (Francis, The Holy Father, 2013, pages 47-48)

Presidents and princes, popes and high priests of capitalism, all, it now seems, have an opinion on the nature and consequences of inequality, and they all think it is a problem worthy of public policy attention. "Higher levels of income inequality," the Standard & Poor's report says, "increase political pressures, discouraging trade, investment, and hiring. ... [I]ncome inequality can lead affluent households ... to increase savings and decrease consumption, while those with less means increase consumer borrowing to sustain consumption . . . until those options run out. When these imbalances can no longer be sustained, we see a boom/bust cycle such as the one that culminated in the Great Recession." In other words, inequality is a concern because it makes the macro-economy more volatile and difficult to manage, leading to lower economic growth, and little, if any, improvement in the living standards of the broad majority. In this sense it is little wonder that the Great Recession has brought the prospects of the middle class to the forefront of public policy discussion and linked its fate to the distribution of incomes. Seeing the economic pie shrink in front of their very eyes may well make the typical citizens wonder more intensely about how the slices are being shared. A public policy narrative based on inequality resonates in the United States, where the impact of the Great Recession was greatest, or at least that was the hope behind President Obama's Osawatomie speech, which was surely intended to frame the political discourse in advance of the 2012 Presidential election.

This narrative has, it seems to me, four elements: (1) inequality has, in fact, increased; (2) this has consequences—moral or material—for the well-being of the broad majority; (3) it is both possible and necessary for public policy to do something about it; and (4) in addressing inequality policy will also solve other related problems like social exclusion. One wonders if this story resonates in Canada in the same way that it does in the United States. Canadians elected a new federal government in 2015 that in part promised to address middle-class concerns and growing labour market inequality, and it is also surely the case that all the leaders of the major political parties have refined their positions on these issues. But Canada 2016 is not America 2012. It is certainly fair to say that the 2008 recession did not have the sharp edges, and the recovery was quicker and more robust, north of the 49th parallel. And it seems that in policy discussions Canadians have also relied on an alternative narrative, one certainly also present in American debates, that may well carry more weight. This narrative is also based on "hard" facts to suggest (1) inequality has, in fact, not increased; (2) that even if it has, the consequences are benign; (3) that even if they are not benign, there is little that can be done about it; and finally (4) even if public policy has punch, the effort directed to a fight against inequality diverts attention from more pressing problems, such as absolute poverty.

In this paper, I would like to tell two stories about inequality, one from the perspective of those who feel it is not a problem worth the worry, and the other from the perspective of those who see it, to quote from another of President Obama's speeches, as "the defining challenge of our time." I would like to tell these stories to clarify their underlying logic but also to clarify both the challenges facing Canadians, and our understanding of what public policy should do about them. But I also have another motive. I would like to underscore the value of economic theory and statistical methods to a public policy discussion of this sort. It seems to me that without an appreciation of some basic elements of theory and measurement it is too easy for the policy conversation to go astray.[1]

[1]The sources for the citations made in these opening paragraphs are as follows: White House (2011a, 2011b, 2013), Prince of Wales, HRH (2014), Carney (2014), Standard & Poor's (2014), Francis, The Holy Father (2013, pages 47-48). Janet Yellen, the current chair of the Federal Reserve System in the United States, offers an additional example of a Central Banker who has spoken directly on inequality. See Yellen (2014).

2 Two stories, just the facts

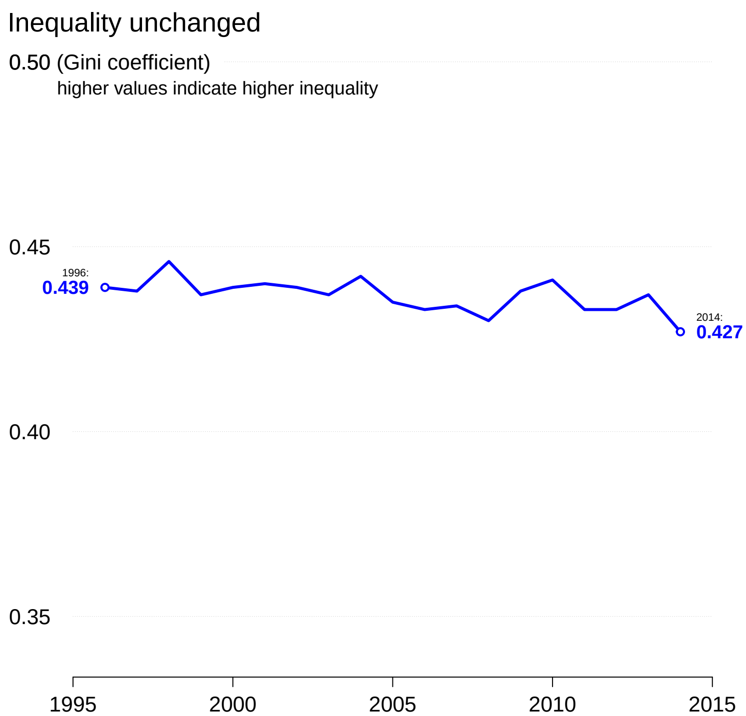
I am not in a position to address all aspects of these two stories, particularly not the aspects most closely knit to ideologies about the effectiveness of public policy and the appropriate role of government in our lives. One story may easily appeal to those with a libertarian bent, who are more keenly aware of the advantages of markets, or more attune to the risks of government failures. Likewise, the other story will have adherents among those with more collectivist views, who are sensitive to market failures as well as to government as a force for good. So putting aside deeply held beliefs, I'm going to focus our attention on the facts that support these stories, and the potential for us to go astray or to be misled if these facts are presented, interpreted, or even defined in particular ways. So let's begin by being clear that we are focusing on numbers neither others nor I have made up on the basis of ideological predispositions. Let's focus on numbers constructed and disseminated by the country's national statistical agency, Statistics Canada, which have therefore a certain amount of credibility. These are the so-called "hard" facts.

2.1 Story 1: Inequality is benign

What I call Story 1 starts with the fact that inequality has not increased. This is depicted in Figure 2, which clearly shows that inequality is no different in 2014 than it was 18 years earlier, perhaps even a bit lower. Eighteen years is long enough for young people, newly graduated from high school, college, or university, to establish themselves in the labour market, form their families, and reach the peak of their career earnings. It is also long enough for mid-career families, already in their peak years, to have seen their children grow up, and to have begun, or come very close to beginning, retirement. To be specific, the value of the Gini coefficient is pretty well the same at the end of this period as it was at the beginning, and there have been no significant changes in between. The Gini coefficient is the workhorse of inequality researchers. It is, and has been for years, just under 0.44. The Gini coefficient can be thought of as half the expected difference in incomes of any two randomly chosen individuals expressed relative to the average income. A value of 0.44 would suggest that the incomes of any two Canadians would be expected to differ by 88 percent of the country-wide average.[2]

[2] The Gini can vary from a minimum of 0 to a maximum of $\frac{n-1}{n}$, where n represents the number of people we are examining. For samples of any reasonable size the maximum will be one. Perfect equality of incomes would be indicated by a value of zero, and perfect inequality by a value of one. The Gini has a number of desirable properties that make it a statistic of choice. These are associated with the fact that it is derived by making pair-wise comparisons between all individuals. But it also has some shortcomings, and embodies a value judgement on how much weight to attach to each individual according to their rank in the income distribution. If you are interested in the details, Amartya Sen (1973) offers a careful and often-cited discussion of the Gini coefficient and other measures of inequality in Chapter 2 of his book *On Econoimc Inequality*. For more detail, see Cowell (2011). Detailed notes to this and all figures, offering the data sources and other information, are provided in the Appendix.

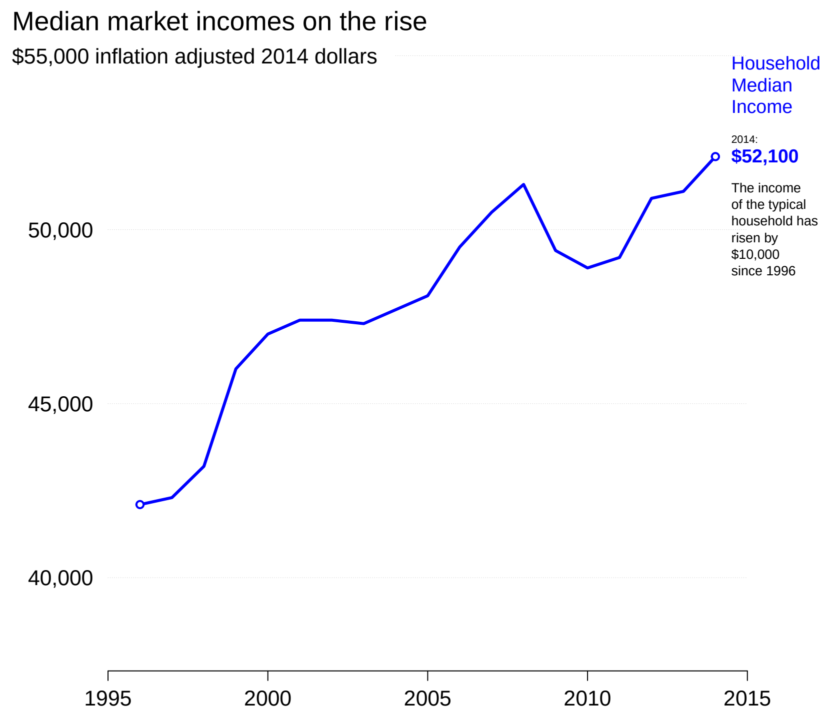
Figure 2: **STORY 1*Inequality is unchanged***



All this talk about inequality, yet it hasn't changed at all during the adulthood of many Canadians. But an associated fact is just as important. The typical household income has steadily increased since 1996. This is depicted in Figure 3. There is no single way of characterizing a "typical" income, but a reasonable approach is to use the middle-ranking income in the country, the so-called "median" income. This way of looking at things shows a pretty clear picture of almost steady growth. In 1996, the typical household had an income just over $42,000, and by 2014, of more than $52,000. To be sure, there is a significant drop after 2008, but this occurred because of the recession that began in that year and reversed itself as recovery took hold. Together with the fact that inequality has not changed, this implies that the material well-being of Canadians has very likely improved. This is what prosperity looks like.

If you doubt it, look at Figure 4. Rising middle incomes have been accompanied by lower poverty. By 2014, the poverty rate had plunged to an unprecedented low. In 1996,

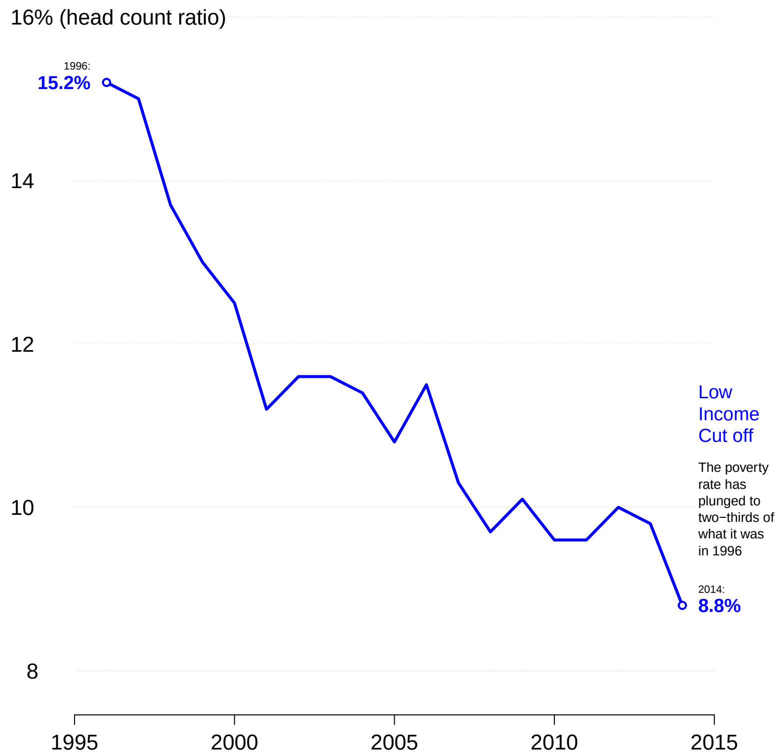
Figure 3: **STORY 1 (Continued)** ***Incomes are higher for the typical family***



about 15 percent of Canadians, almost one in seven, had incomes putting them below what Statistics Canada calls the "Low Income Cut-Off," a *de facto* poverty line that has been used by poverty analysts and advocates since the 1970s. In 2014, less than nine percent were poor according to this way of measuring things. Certainly, a poverty rate of nine percent is something to be concerned about, but the economy is clearly moving in the right direction. Just as importantly, this progress is not being chocked off by the fact that the richest segment of society has seen its standing rise. Top income shares have increased, but not by all that much. In 1996, the members of the top one percent obtained just over ten percent of all market income in the country; in 2013, they obtained about one and a half percentage points more, amounting to 11.7 percent of total income. Besides, lately this share has been sliding down, as clearly shown in Figure 5.

So here is the plot line of Story 1: a falling share of the population in poverty, progress in absolute incomes for the typical household, and a slightly larger slice of the pie for the very rich that doesn't seem to do much harm, particularly if we also recognize that they are working for their money—that it comes from market sources, not inherited wealth—and that their earnings have something to do with talents that increase productivity, create new goods and services, and lower prices for us all. The face of the top one percent is Steve Jobs, who should in some sense be praised for innovations and products that have made the

Figure 4: **STORY 1 (Continued)** ***Poverty is down***

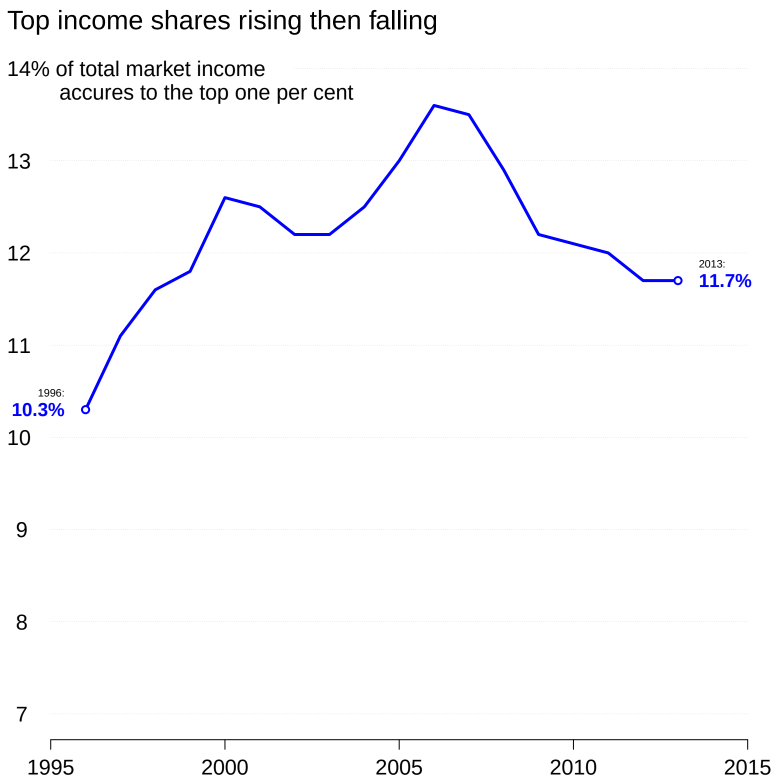


lives of owners of Apple computers, iPads, and iPhones more interesting and productive, and also, without exaggeration, all our lives. That he made a significant amount of money is almost beside the point. He deserved it. This is what prosperity looks like.[3]

All very good, but even if inequality has not changed, some of us might nonetheless feel that it is unacceptably high. Story 1 concludes with a fact that addresses this concern. Inequalities in market income as measured by the Gini coefficient are snapshots taken once a year. They do not tell us anything about the experience of individuals as they move through life, year-by-year, decade-by-decade. Families are in motion, and their experiences and positions in the income distribution change through time and across generations. Though its calculations do not include Canada, the OECD (2015b, page 177, Figure 4.2,) shows

[3] Walter Isaacson (2011) relates an incident in his biography of Steve Jobs suggesting that earning money was hardly what drove the late entrepreneur. After having been ousted from Apple, Jobs laid out a convoluted plan to get back into the company he co-founded to his friend Larry Ellison, the chief executive officer of Oracle. Ellison had been offering his support by suggesting he'd simply buy Apple and install Jobs as chief executive officer. As told by Isaacson: "Ellison thought that Jobs was missing a key point. 'But Steve, there's one thing I don't understand,' he said. 'If we don't buy the company, how can we make any money?' It was a reminder of how different their desires were. Jobs put his hand on Ellison's left shoulder, pulled him so close that their noses almost touched, and said, 'Larry, this is why it's really important that I'm your friend. You don't need any more money.' " (Isaacson 2011, page 300) If you are not a fan of Mr. Jobs or Apple, you can of course choose from any number of highly successful entrepreneurs to illustrate the same point: Bill Gates, Warren Buffet, or Elon Musk among others.

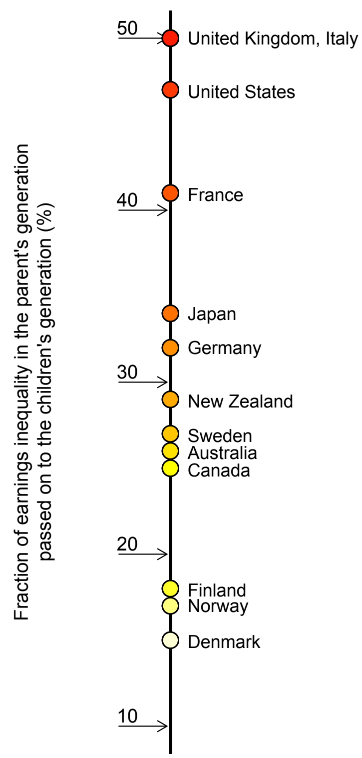
Figure 5: **STORY 1 (Continued)**
The very rich are better off but not by that much



that when incomes are measured over a 10- to 20-year horizon the Gini coefficient falls in many countries by on average one-quarter. The degree of mobility across generations has even more resonance. Many Canadians may reasonably feel that income inequality is less objectionable if it is the result of a fair process, and specifically if it is the result of equality of opportunity. If children have the capacity to become all that they can be regardless of their starting point in life, then inequality at any particular point in time might not be of consequence.

The facts show that in Canada inequality is accompanied by a good deal of mobility across generations. The children of the rich will no more inherit a privileged station in life than the children of the poor will be trapped in a cycle of poverty. This is clear from the information in Figure 6, which ranks a set of rich countries according to an often used indicator associated with equality of opportunity, what economists call the "intergenerational

Figure 6: **STORY 1 (Concluded)**
Market outcomes seem fair and reflect equality of opportunity since a smaller fraction of economic advantage or disadvantage is passed across generations in Canada than in many other countries



elasticity of earnings." The figure shows the relative income advantage one child would have over another if one set of parents had twice the income of the other. In some countries this 100 percent differential in parental incomes shrinks to less than 20 percent between the children when they reach adulthood, while in other countries it is close to 50 percent. According to this measure, Canada compares relatively well, with only about one-quarter of any income advantage echoing across the generations, about half the proportion in the United States.[4] In other words, family background is not destiny, and even if inequality

[4]To be strictly correct, the information in the figure refers to the elasticity between the earnings of fathers and sons. There are studies of family income, and also of daughters, but these are not as common, and therefore do not permit a large number of countries to be compared. Canadian studies have found that the father-daughter intergenerational elasticity is somewhat weaker. (see Corak 2001 and Chen, Ostrovsky and Piraino 2016). But this does not account for family income, or the interaction between labour market behaviour and the marriage market. Blanden (2005) shows that the earnings of young married men are

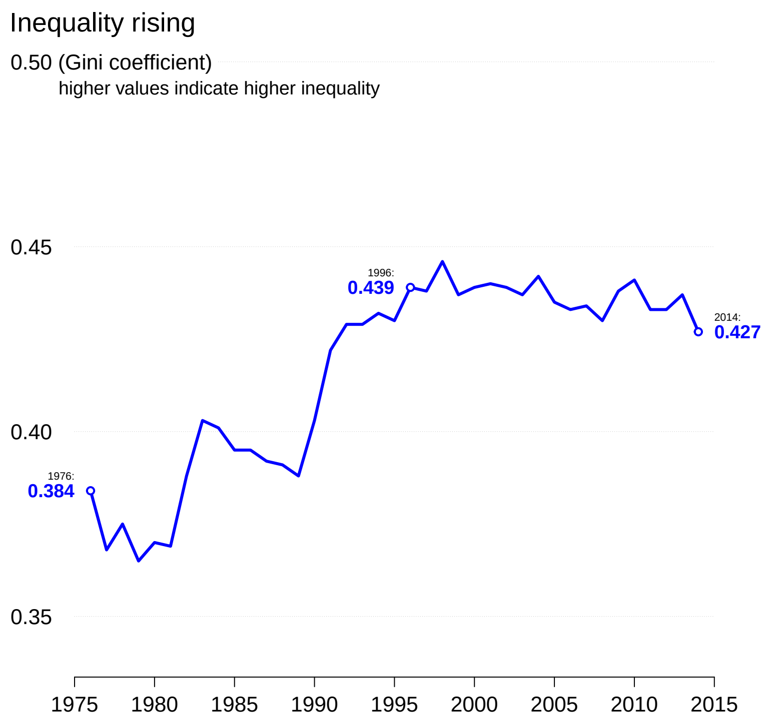
persists through the decades, there is likely to be a significant trading of positions as children rise and fall in the income hierarchy according to their own talents and energies, and not according to the position their parents occupied. In other words, if there is what seems like a high level of inequality in the country, it should not be thought of as unfair, or violating equality of opportunity.

What are the public policy implications of this view? Or to phrase this in another way, how are middle-class concerns being addressed? Story 1 and the facts upon which it is based would support the suggestion that the Canadian economy is in a benign equilibrium, and there is no need for activist policy. The middle class need a sense of growth and progress, a sense of security, and to be treated fairly. Progress has in fact occurred, and with it has come security. Incomes are higher, and the risk of poverty lower. Steady job growth has been the source of both. Even the Great Recession of 2008 did not put a kink in this confident outlook. At the same time, fairness has not been compromised. Inequalities of outcomes have not changed at all. Top incomes have not grown all that much. Furthermore, what growth there has been in top incomes is associated with newer and better products and opportunities—opportunities that are increasingly open to our children. If this equilibrium is somewhat less than benign for some, and if inequality continues to be pressed onto the public policy agenda, then the only basis for this concern is envy. But envy is not a sound basis for policy, and a framing in these terms should be resisted. At this point, advocates of Story 1 can justifiably reach to Adam Smith's *Wealth of Nations* for wise analysis and council on the conduct of policy. Smith, the father of economics, clearly saw the virtues of the market and offered a limited role for the state when in 1776 he wrote,

> The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security. He is at all times surrounded by unknown enemies, whom, though he never provoked, he can never appease,

related to those of their fathers-in-law, so that there is some degree of assortative mating that leads to more stickiness between father-daughter incomes. Also, it should be noted that the estimates presented in Figure 6 are based upon a set of "best" estimates for comparisons, not necessarily the best estimate for any particular country. It is somewhat more challenging to determine the intergenerational elasticity of earnings than the Gini because of the need to accurately estimate incomes and earnings across two generations of the same family. Researchers make different analytical decisions according to the data available to them, and to their understanding of the best way to correct for a host of potential biases. Differences in these choices are controlled for in the data that are presented in Figure 6, which are drawn from Corak (2013a, 2013b). Chen, Ostrovsky, and Piraino (2016) suggest that the best possible estimate for Canada is about 0.32 for sons and 0.23 for daughters when income is measured as labour market earnings. This remains about half the value of comparable estimates for the United States, which with similar methods put the American estimate as high as 0.6 (see Mazumder 2005 and also Chetty, Hendren, Kline, Saez 2014). In addition, note that interpreting the elasticity as the income advantage accruing to a child having parents with twice as much income as the parents of another child is an approximation. Differences in logarithms are approximations of percentage differences. If one set of parents had twice the income of another, the percentage difference in the incomes of their children would be 41 percent if the intergenerational elasticity was 0.5, not 50 percent. These approximations are more accurate for percentage differences less than 20.

Figure 7: **STORY 2*Inequality is higher***



and from whose injustice he can be protected only by the powerful arm of the civil magistrate continually held up to chastise it. (page 670)

2.2 Story 2: Inequality is a concern

Story 2, to remind you, also has four elements: inequality has increased, this is of consequence for the broad majority, it is possible and necessary for public policy to address it, and in doing so policy addresses other deeper problems like social exclusion. The starting point is the most important. It is a matter of fact that inequality has increased. This is depicted in Figure 7, which clearly shows that inequality of market incomes is on the rise, being significantly higher in 2014 than almost 40 years ago. During the mid- to late 1970s, the Gini coefficient hovered at around a low of 0.37; it rose during the business cycle recession in 1981-82, but fell during the subsequent recovery. Then it rose again during the 1990-92 recession, but did not fall in subsequent years in spite of significant economic growth. During the 2000s, the Gini remained stuck six or seven percentage points higher than four decades ago. This implies that our best guess of the expected income difference between any two randomly chosen Canadians would be almost 90 percent of the average income, much higher than 75 percent or so of the late 1970s.

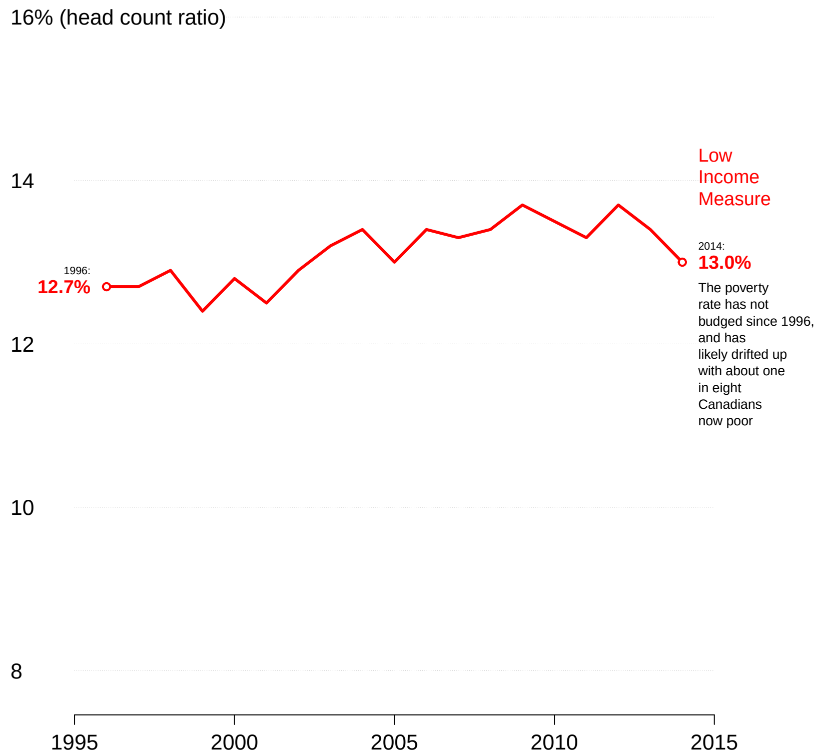
But an associated fact is just as important. The typical income has not improved, and

Figure 8: **STORY 2 (Continued)** ***Incomes are lower for the typical family***

may have declined. Median household incomes move up and down with booms and busts in the macro-economy, so it is important to keep our eyes on the underlying trend associated with the changing structure of the economy, and measure the trend when the economy is operating at its full potential. The typical household earned almost $55,000 during the late 1970s and early 1980s, somewhat lower at the next cyclical peak in the late 1980s, and a bit lower still in 2008 before the Great Recession hit. This is depicted in Figure 8. Together with the fact that inequality has increased this implies that the material well-being of Canadians has not improved. This is not what prosperity looks like.

This is as true for households lower in the income distribution as it is for middle-income households. Look at Figures 9 and 10. There has been absolutely no reduction in the poverty rate since 1996, and the top one percent is taking home a significantly larger share of total market incomes. The evolution of the poverty rate has been nothing but discouraging, remaining pretty well stuck at about 13 percent in spite of years of economic growth and thousands upon thousands of jobs being created. In 1996, 12.7 percent of Canadians had market incomes that put them below what Statistics Canada calls the "Low Income Measure," a *de facto* poverty line that has been used by poverty analysts and advocates since the 1970s. The economy has not been moving in the right direction, growth being of no benefit to the relatively poor.

Figure 9: **STORY 2 (Continued)** ***Poverty has not fallen at all***



Where have all the benefits of economic growth gone? They've gone to the top. Top income shares have increased significantly. During the late 1970s and early to mid-1980s, the top one percent obtained about 7.5 percent of all market income. This share grew steadily and was fully six percentage points higher in 2008, amounting to about 13.5 percent. The top share has since fallen, but that is likely due to the business cycle downturn, and just as we might expect top incomes to be more sensitive to downturns, they are also more likely to increase during recovery and expansion.

So here is the plot line of Story 2: persistent poverty rates, no progress in absolute incomes for the typical household—indeed, declining incomes over more than 35 years of economic growth—and a much larger slice of the pie for the very rich, all imply higher inequality than what previous generations experienced. This is particularly troublesome when we recognize that the very rich have done little to deserve their greater share, engaging in rent-seeking behaviour that does little to enhance overall productivity, and only shovels collective wealth into private pockets. This is hardly deserved, and it is hardly what prosperity looks like. The face of the top one percent is more likely to be a CEO in the resource sector, whether oil or potash, where excess profits are earned not simply through risk-taking or innovation, but through either managing or benefiting from the management of cartels in product markets or movements in commodity prices and exchange rates that have little

Figure 10: **STORY 2 (Continued)** ***The very rich are much richer***

relation to individual effort. This does not enhance market efficiency, and the returns are a pure "rent", in the sense that economists use the term to refer to returns well above what is required to call forth the productive effort, capital, and skills needed to produce a good.[5]

But the story does not stop here. High and growing inequality is not acceptable only because it is intrinsically wrong, it is also unfair because it erodes equality of opportunity.

[5]Besides, all the examples of successful and innovative entrepreneurs I offered in telling Story 1 are Americans, not Canadians. Advocates of Story 2 might be more inclined to show pictures of William "Bill" Doyle, the former chief executive officer of The Potash Corporation of Saskatchewan Inc. as an example of someone whose income is supported by rent-seeking behaviour, in this case the resulting excess profits and high salaries being associated with the management of an international cartel. This rent, the story goes, would have been captured by the public at large when the Corporation was publicly owned. Doyle is reported to have had a personal stake in the company's shares worth more than $100 million, with options for many millions more (Humber and Donville 2014). This sort of behaviour does little to contribute to lower costs for producers and consumers. To rub salt in the wounds the tellers of Story 2 would remind us that Mr. Doyle is an American based in Chicago. His tenuous residency in Saskatchewan was reported to have grated the public sensitivities of Saskatchewan politicians (Ladurantaye, 2011).

Story 2 concludes with a fact that raises this concern. Inequalities in market income as measured by the Gini coefficient are snapshots taken once a year, but they shape how inequality will evolve through time, and in particular the degree to which it will be passed on to the next generation. Many Canadians may reasonably feel that income inequality is objectionable because it erodes equality of opportunity. Children raised in an era of high inequality will, at one extreme, lack the resources to become all that they could be, while at the other extreme be given extraordinary advantages implying a head start in life, and increasing their chances of success in a way that has less to do with talent and more with privilege.

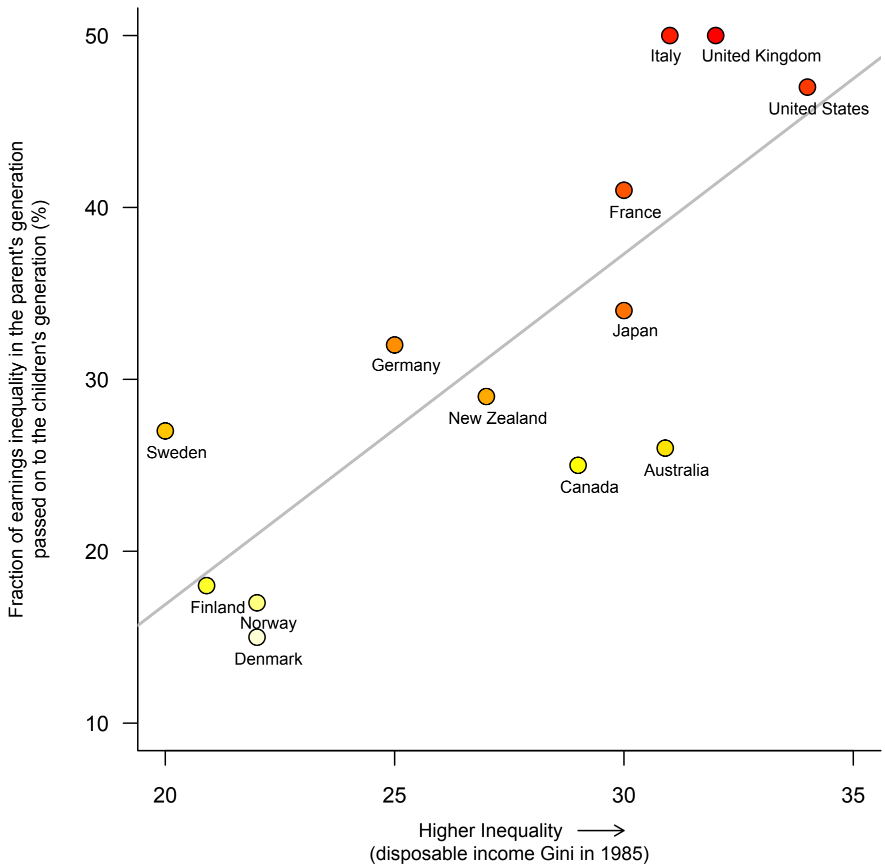
This is clear from the cross-country comparison shown in Figure 11, which ranks a set of rich countries along two dimensions: in the horizontal direction from the least to the most unequal according to the Gini coefficient that prevailed about a generation ago, and in the vertical direction from the most inter-generationally mobile, where child adult incomes are weakly associated with parent incomes, to the least inter-generationally mobile where the "stickiness" of parent and child incomes is greatest. The data show that more unequal countries have less income mobility across generations. The United States, the United Kingdom, and Italy had the highest Gini coefficients during the 1980s with the result the children raised during this period were more likely to occupy the same position in the income distribution as their parents. Canada occupies a middle ground along this relationship, which has become known as "The Great Gatsby Curve".[6]

We should not lose sight of the fact that the relationship depicted in Figure 11 refers to cohorts of young people born in the early 1960s, who attended the primary and secondary schools of the 1960s and 1970s and the colleges and universities of the 1980s, who began establishing their careers in the 1990s, and whose adult income is measured in the late 1990s and early 2000s. These are people who grew up in an era of lower inequality. Opportunities will be more skewed for the next generation now growing up in an era of higher inequality. Canadians are running the risk of sliding up the Great Gatsby Curve, something we will not actually see in the data until these children reach adulthood in the coming decade, well after it is possible to do something about the associated inequality of opportunity. In other words, if there is what seems like a high level of inequality in the country, it is unfair not just intrinsically, but also because it erodes equality of opportunity.

What are the public policy implications of this view? Or, to phrase this in another way, how are middle-class concerns being addressed? Story 2 and the facts upon which it is based

[6]This statistical association was given its name by Alan Krueger, the Princeton University economist, when he was the Chairman of the Council of Economic Advisors during President Obama's second term (Krueger 2012). See Corak (2013a) for its origins in the literature and also Greely (2013), offers more background and reports that the suggestion for the name came from a research intern working at the White House at the time. In fact, Krueger instructed his staffers, Reid Stevens and Judd Cramer, who were working with him on the speech, to come up with suggestions for a name by brainstorming with the group of junior staffers attached to the Council of Economic Advisors. When his two staffers returned to the chairman's conference room with a list of possibilities, Krueger choose the name Judd Cramer had added to the list. I thank Judd Cramer, Jason Furman, and Alan Krueger for their versions of this story.

Figure 11: **STORY 2 (Concluded)**
Higher inequality is associated with lower social mobility, and the next generation will likely face less equality of opportunity



lead to the suggestion that the Canadian economy is moving in a troubling direction, and there is a need for activist policy. The middle class need a sense of growth and progress, a sense of security, and to be treated fairly. But this is not happening. There is no sense of growth over the longer term as middle incomes have stagnated and even declined. For many, security has not been found in employment. Investments in schooling and seniority with a particular employer often don't pan out as jobs are more precarious, increasingly contingent, and lower paying than they were a generation ago. The risk of facing poverty has not improved at all. But for a lucky few, the payoffs can be substantial. These more highly unequal outcomes are unfair in their own right. But they also limit upward mobility for the poor, and raise the fear and insecurity of downward mobility for the middle class and their children. Inequality threatens fairness, creating entitlement among the few, and shame among the many. A public policy response is required to reduce it, and in doing so, to battle against the resulting social exclusion. At this point, advocates of Story 2 can justifiably reach to Adam Smith's *Wealth of Nations* for wise analysis and council on the conduct of public policy. Smith was not just the father of economics, he was also a moral philosopher who grounded his thinking about the market by asking us to conduct ourselves, and public policy toward each other, with empathy for others, as if we had a friend perched on our shoulder whispering in our ears about the circumstances of others. His view of poverty is clear on this. Poverty is a social construct, more akin to what we would call "social exclusion." According to Smith, all people should have sufficient resources to participate normally in society, and these resources therefore will vary over time and across place. He uses words like: *custom*, *decency*, and *shame* in describing the lack of sufficient resources.

> By necessaries I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without. A linen shirt, for example, is, strictly speaking, not a necessary of life. ... through the greater part of Europe, a creditable day-labourer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty which, it is presumed, nobody can well fall into without extreme bad conduct. Custom, in the same manner, has rendered leather shoes a necessary of life in England. (Smith 1776, pages 821-22)

3 Stories as conversation, some theory

3.1 Has inequality increased?

Has inequality increased? It has, but we need to appreciate in what ways, the extent to which the change is salient, and the lessons we should draw from the changes we observe.

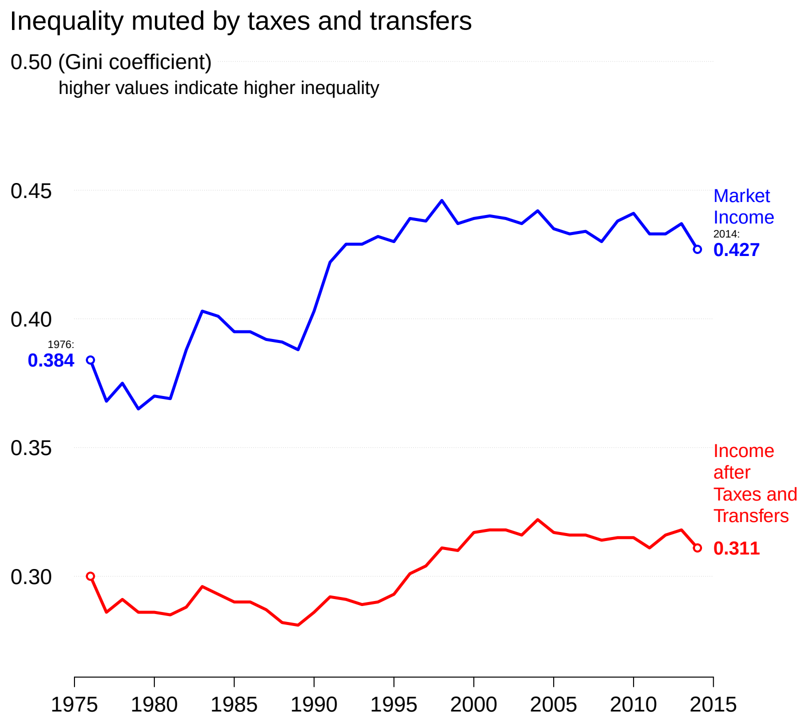
There is an argument to be made that inequality has not increased, or at least not by a degree that might be considered salient. This has nothing to do with the way I have depicted Story 1, which finds supporting data by looking back over a conveniently chosen horizon, as the contrast between Figures 2 and 7 shows. I don't mean to imply that looking back 18 years is inappropriate or done selectively to support a preconceived view, though I'm certain the selective choice of start and end points is often made in pubic policy discussion. As I suggested, 18 years is certainly a long enough horizon to capture the experiences of a whole cohort of young people. That median incomes are higher and that there has been no increase in inequality as measured by the Gini coefficient during the lives of many people is a message that should not be lost. After all 18 years is a long time in the life of a 35-year-old. But at the same time, if we are to base public policy on an understanding of the drivers of economic developments, we should always make use of the full horizon of data available to us, proceed with caution when that horizon is not long enough to capture changes in the kinds of causal forces to which economic theory alerts us, and bemoan decisions that needlessly reduce the comparability of historical data series or delay the release of updated data. As long as 18 years may be in the life of a 35-year-old, it is not long enough to fully appreciate the consequences for wage determination, labour supply and family demographics, and ultimately for individual and household incomes, of changes in structural policies like free trade, tax reform, or inflation targeting, or of economic developments like the dramatic fall in the cost of computing, the rise of globalization, and of other institutional changes in labour markets.

There is another argument to be made that inequality has not increased by a politically important degree. In his book *Inequality: What can be done?* Tony Atkinson (2015, page 54) suggests that the change in the Gini coefficient should be at least three percentage points to be considered substantive. He estimates that a three-point rise would require, roughly speaking, a five percentage point increase in the tax rate to be offset. This would be a substantial change in tax rates for any Minister of Finance, and in this sense is policy salient. Atkinson's review of the evidence in the rich countries suggests that the increase of inequality in countries like Spain, Norway, Australia, Finland, and particularly the United States and the United Kingdom was, in this sense, salient. He also suggests that the increase in Canada over the 30-year period since 1980 was not. Atkinson's argument is different from that underpinning Stories 1 and 2. He calculates his Gini coefficients using incomes that include not only all market sources, but also government income support and taxes paid. You can see the important difference between inequality measured using market incomes only, and total income including taxes and transfers by comparing the two Gini coefficients displayed in Figure 12. This effect is so strong as to have completely undone the entire increase in market income inequality during the 1980s and early 1990s. The job market may have become a lot more unequal, but this did not show up in take-home pay. And if to some degree the changes to the tax and transfer system during the mid-1990s eroded its redistributive impact, it continues to have a big influence on inequality, reducing, for example, the market-based Gini by 12 points in 2014.

Public finances significantly reduce inequality. This has also been recognized by many Canadian researchers, including Beach and Slotsve (1996), Frenette, Green, and Milligan (2007), Heisz (2007) and Sarlo, Clemens, and Emes (2015). Heisz and Murphy (2016) carefully document the extent and nature of the redistributive impact of the tax and transfer system, summarizing their findings by saying

> that the cumulative increases in market income inequality that occurred during the recessions of the 1980s and 1990s were completely offset by a tax-and-transfer system that became more redistributive over this period. As a result, there was no increase in aftertax income inequality up to 1995. This pattern changed during the second half of the 1990s. Market income inequality remained at the higher levels reached in the earlier recession, but the tax-and-transfer system became less redistributive and after tax income inequality increased as a consequence. In the 2000s, after tax household income inequality more or less stabilized as market income inequality and overall redistribution held steady up until the most recent recession. (pages 462-63)

Figure 12: **FACTS WITH THEORY**
The tax-transfer system significantly lowers inequality and has muted its increase



Their analysis points out that changes in taxes did not play a major role in fighting inequality. Tax rates fell on average, something that might imply less redistribution, but this was countered with more progressivity, tax rates falling more for those with lower incomes. The big punch came from the transfer system, and if the overall system had somewhat less impact on inequality after the mid-1990s, it was in large part due to a fall in the redistributive impact of transfers, most notably a decline in the generosity of Social Assistance and Employment Insurance. In summary, the public finance response was to lower taxes in a neutral way, and to cut the transfer system in a way that on net lowered its redistributive impact. Some policy changes, such as the introduction of more progressive and targeted child benefits, promoted redistribution, but others involved cuts to programs most closely tied to providing security in the jobs market and worked in the opposite direction.

Has inequality increased? It may appear fair to say that the extent of the increase in inequality has not been 'salient' when taxes and transfers are recognized. But this should be a tentative conclusion. It relies too much on the signals sent by the Gini coefficient, and as a result does not fully capture the public policy challenge. Besides, the Gini lets us down in two ways. It underestimates the extent of the change in inequality, and it does not offer enough detail to understand the underlying drivers.

We have seen that market income inequality appears not to have changed significantly after 1995, yet we've also seen—as Figure 10 documents—that the share of income going to the top one percent increased significantly all the way to 2008. If the slice of the pie going to the top one percent is increasing, why is the Gini registering no change?

This could happen if there are offsetting changes elsewhere in the income distribution, but more likely because of two statistical limitations. The information on the income shares of the top one percent comes from administrative data associated with the income tax system, specifically the T1 forms Canadians submit to the Canada Revenue Agency. However, the information to calculate the Gini is based upon surveys of a sample of Canadian households. Survey-takers face challenges in getting complete coverage and accurate reporting of incomes from the very poor and the very rich, two groups who are less likely to participate in voluntary surveys, and when they do are less likely to accurately report their incomes. This is certainly an issue, and is examined in more detail by Frenette, Green, and Milligan (2007). Statistics Canada recognizes this challenge by reweighting the information its surveys capture from respondents in these groups. A response to a survey by one individual from the one percent is counted multiple times to represent the under-reporting from that group. But the one percent are by definition a small number even in a survey that may have tens of thousands respondents, and it is hard to say much with these data about anything more narrow than the top ten percent. Frenette, Green and Milligan (2007, tables 3, 5 and 6) use Census information to point out that the Gini is understated in the data charted by Figure 12 by just under three points for market incomes, and by about 2.6 points for after tax and transfer incomes. The Census offers greater clarity because it has a much larger sample (up to one-in-five Canadians), and at the time of their analysis was obligatory to complete. These estimates are for the year 2000, and it should be recognized that Statistics Canada has since revised the survey weights so that they align more closely with census data. Heisz (2007) notes that this cuts the understatement of the Gini by half.

These kinds of statistical concerns are some of the reasons that the information in Figures 5 and 10 on the income shares of the top one percent is based on tax data, because we can be more certain to capture the entire population and to get a more accurate reporting of incomes. But even this is less than perfect. Wolfson, Veall, Brooks, and Murphy (2016) point out that using T1 information is likely to significantly underestimate top income shares because the tax system permits high income earners to lower their tax burden through the use of Canadian Controlled Private Corporations. They can do this by using these corporate entities to choose a mix of salary or dividends that is advantageous for tax purposes, by moving the receipt of their income forward to a point in time when they may be in a lower tax bracket, or by splitting income with family members who may be in lower tax brackets. For example, the authors estimate that the share of after tax-and-transfer income going to the top one percent was about ten percent in 2011, but at least 13.3 percent when retained earnings inside of Canadian Controlled Private Corporations are recognized (Wolfson, Veall, Brooks, and Murphy 2016, Figures 10 and 11, Table A3).[7]

However, the Gini coefficient would likely be under-estimating the change in inequality even if we had a completely accurate reporting of incomes across the entire income distribution. By its very design, this statistic is most sensitive to changes occurring in the middle of the income distribution. It is much less sensitive and less likely to register a change if the income distribution changes at the extremes, at the bottom or at the top. This is about more than the challenges survey takers or tax authorities have in getting complete coverage and accurate reporting of incomes. It is a hard-wired limitation.

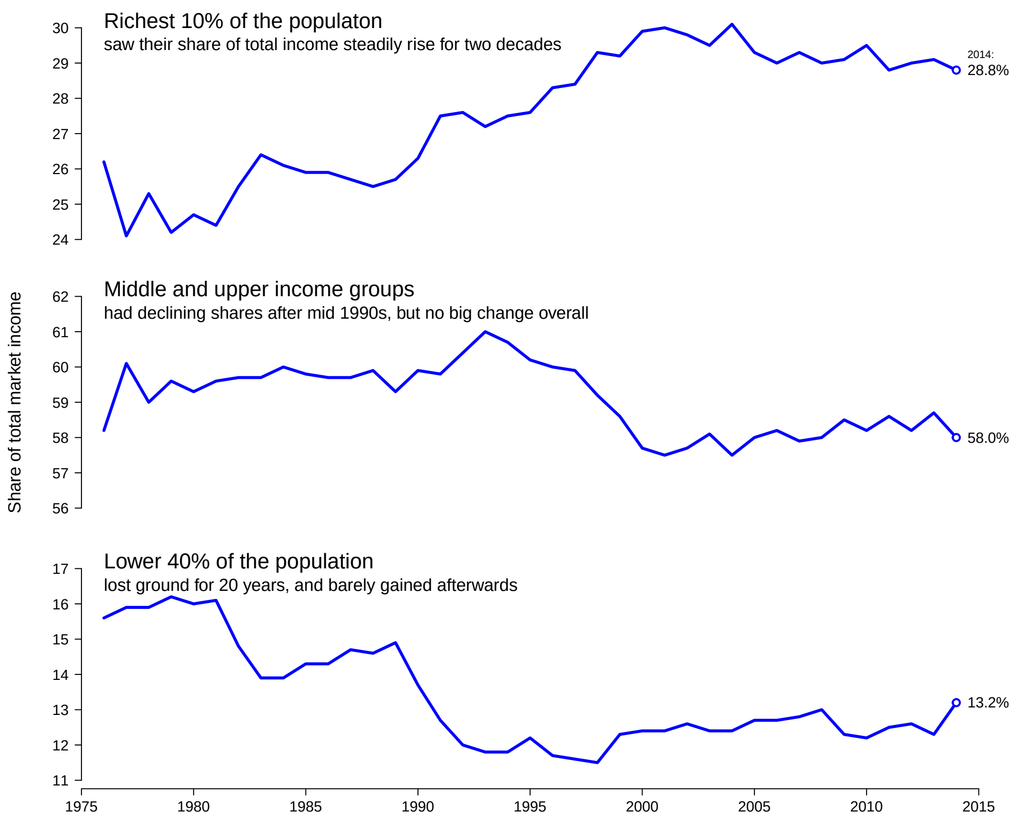
All of this—the undersampling and underreporting of top and bottom incomes in survey data, the underreporting of top incomes in administrative data, and the limited sensitivity of the Gini to changes in the tails of the income distribution—suggest that the increase in inequality is understated, and more so with time as top income shares increased. Inequality was likely growing when the Gini suggested it was flat. Besides, a single summary statistic can never paint a sufficiently nuanced picture to allow us to be more aware of the nature of inequality and its underlying causes.

This suggests that we should complement the Gini with a more detailed look at specific income shares. Figure 13 does this by subdividing the entire population into three groups. I have partitioned the Canadian population into those with incomes putting them in the top ten percent, those with incomes putting them in the bottom 40 percent, and the remaining 50 percent of the population who are middle- and upper income earners. This classification has not been commonly used in the Canadian discussion of the "declining middle class," but it conveniently summarizes the patterns in the decile shares, and in borrowing it from Palma (2016), I feel it helps highlight the distinct circumstances and concerns of different groups in the population in a way that is missed by focusing on "middle income" groups, who are often defined as some share of the population either side of the median.

The richest tenth of the population has a growing share of total market income, rising from about 25 percent and reaching almost 30 percent. The bottom 40 percent lost ground for 20 years, and since the mid-1990s has barely made any gains, obtaining since that time about 12 percent to 13 percent of total income. The middle- and upper income groups lost some ground during the mid- to late 1990s, but overall have not experienced a big change in their share of total market income, just less than 60 percent of all income in the country over these years. The distinct rise in market income inequality tells us that the labour market is a much more polarized place now than it was three decades ago, and the clear winners have been those in the top ten percent of the earnings distribution. This is the very pattern the Gini has difficulty capturing. For public policy, we should wonder about why this has happened, and recognize that these forces—associated with globalization, the computer revolution, and corporate governance—are not going to go away. These trends

[7] An example of an easy how-to-guide is available from DMC Law, a group of dental lawyers. See Carabash (2011), who is writing for dentists, but much the same would probably apply for the medical community. I obtained this reference from Kevin Milligan's Twitter feed.

Figure 13: **FACTS WITH THEORY**
Inequality of market incomes rose because the share of income going to the bottom 40% fell, and that going to the top 10% increased

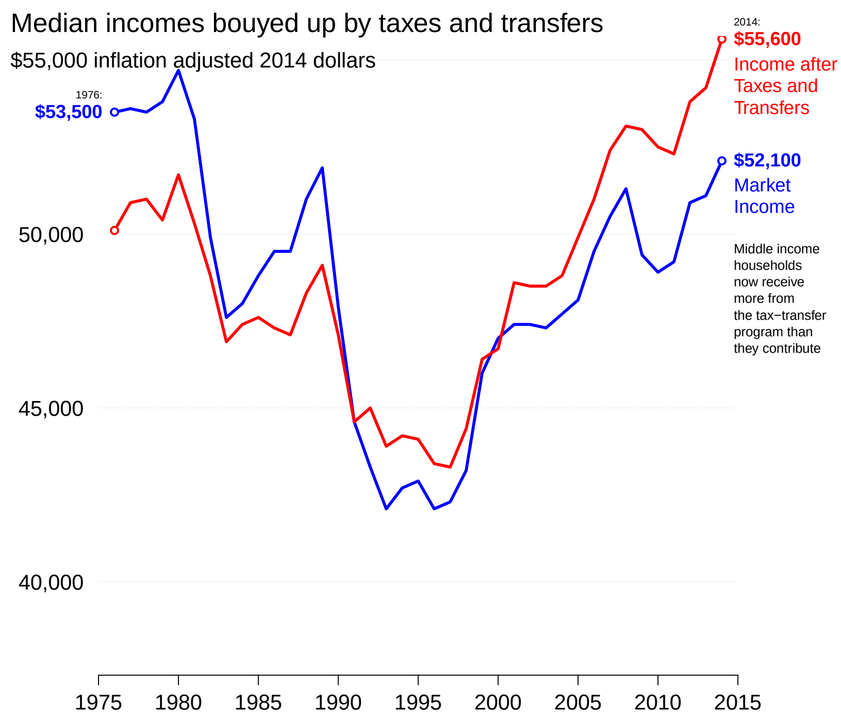


influence all sorts of individual decisions from whether to work or not; how much education to get; when to buy a home, marry and have a child; and ultimately the capacity to be self-sufficient. The tax-transfer system is a powerful tool, and it has played a major role in muting inequality. But if it is to be sustainable in an era of higher market inequalities that show no signs of abating, however, it has to be put on a solid footing responding to the circumstances and needs of each of these three groups.

3.2 Have middle incomes gone up or down?

A significantly larger and larger swath of the population relies on income support from the public sector. During the 1970s, the median household was a net contributor to the public finances, paying more in taxes than receiving in benefits, but this has changed since about the early 1990s, as you can see in Figure 14. The household ranked half-way up the income distribution has switched from being a net contributor to a net recipient, receiving more in income transfers than it pays in taxes, and therefore seeing its income bolstered by

Figure 14: **FACTS WITH THEORY**
The tax-transfer system has buoyed middle incomes since the early 1990s



governments.

Have middle incomes gone up or down? We don't have to choose between Story 1 and 2 on this issue. The trend in market incomes is flat or even down. And if the trend is up on an after-tax-transfer basis, is this a good thing? Is it a good thing that after more than 35 years of economic growth the typical household's material standard of living is higher only because it now receives more from the tax-transfer program than it contributes? Is the basis for prosperity sustainable when, by implication, at least half the population receives more than it contributes to the public finances?

The trend in middle incomes since the mid-1990s, though, has been strongly up. Will this continue, and does it herald a new prosperity and greater income security through the market and ultimately less reliance on the state? This is why our focus on market incomes is important. The market is the major source of total income, and its evolution is at the core of why these households are now relying more on the public sector. Understanding this evolution allows us to imagine a smarter tax and transfer system that addresses the middle-class need for prosperity and security, a system based on the labour market realities of this century, not the last. Both Story 1 and Story 2 can help our understanding of these issues.

Household incomes are the result of the number of people in the household, the number who work, how many weeks and hours they work in a year, and the wage rate they receive per hour. Household demographics, labour supply, and the prices paid for this supply, all come together to determine incomes. If the old adage for an investigative journalist looking for the answer to a puzzling question is "follow the money," then the equivalent for an economist is "watch the prices." The price relevant for a discussion of income prospects is the wage rate because it influences labour supply and demographic choices. As such, economic theory tells us that the search for a "declining middle class" should begin not with household incomes, but with individual wage rates. They are the clearest signal of how labour markets and jobs have changed, the kinds of opportunities and challenges that result, and how Canadians have responded.

There is an established literature on wage polarization, and important work in the United States is associated with David Autor (Autor 2015, Autor, Levy, and Murnane 2003), but a particularly careful analysis that is both informed by Autor's framework yet sensitive to Canadian realities is offered by Green and Sand (2015). The story goes something like this. Wage rates and job opportunities have increased in occupations requiring judgement and management, they've decreased in occupations that are routine. A future of higher wage inequality is here; it implies both unprecedented opportunities and substantial risks. It is commonplace to think about the fate of the "traditional" assembly line worker in a manufacturing plant who has been replaced by a robot designed and made by highly educated engineers. But the economic dynamics are broader than the replacement of physical labour with cognitive or workers holding high school diplomas with those holding university degrees. Mesh another dichotomy on top of this physical versus cognitive division of tasks, one associated with routine versus judgement. Middle managers and X-ray technicians are as much at risk as old-school assembly line workers. It is workers doing routine jobs—whether they involve physical or cognitive tasks—that face bigger risks of losing their jobs, getting paid a lower wage rate, and on this basis different incentives and opportunities to participate in the labour market, get more education, establish a long-term relationship with a partner.

The underlying driver of all this is the computer revolution, a revolution that has been hypercharged by freer trade. The economy has changed tremendously, and to get a full picture and understand these forces and the adjustments to them it's important to look at the available data with as long a time frame as possible, certainly before the Free Trade Agreement was launched, and back at least to the 1970s, just before computers started changing production and management processes in a major way. Nordhaus (2006) describes the astounding fall in the costs of performing routine calculations with computers—a two trillion-fold fall during the 20th century—with particularly rapid improvements made in the decade after World War II and then again between 1985 and 1995. "Given the enormous decrease in computational cost relative to labor cost, it can hardly be surprising that businesses are computerizing operations on a vast scale" (Nordhaus 2006, page 19). If you perform a routine task—whether physical or cognitive—you are competing head-on with the mother of all revolutions.

Our attention is naturally drawn to the plight of individuals who have experienced the consequences most sharply: workers with a good deal of seniority with one company, whose skills are specific to that firm or industry, and suffer a permanent lay off. This is the plight of Henry Cape, one of the main characters in George F. Walker's play, *The End of Civilization.* Henry has been laid off "after twenty years of loyal service," and after two years of looking for a job finds himself in a motel room with his wife Lily, having left the kids behind with her sister, in a last ditch attempt to find work in a distant city. But mostly Henry is trying to hold onto the last threads of his self-esteem as the sole provider for his family. "I know you're trying," counsels Lily, "But well ... why don't you just take something. Anything. ... Anything. Something that pays" (Walker 1997, page 255). Things do not go well. Bonikowska and Morissette (2012), among others, show that workers like Henry need to confront a very different future. They cannot reasonably expect to be working in the same type of job making the same wage. They are more likely than not to face a permanent pay cut, which the authors calculate turns out on average to be from ten percent to as high as 20 percent five years after being laid off.

As gut wrenching as this is, we should not lose sight of the fact that the challenges of adjusting to new labour market realities are broader and, although more subtle, just as significant. The labour market continually responds at its most flexible margins. It is new entrants into the job market, particularly the young without significant job experience, that have had their career prospects change. Year in, year out, each successive cohort of young people has faced a lower starting wage and a slower progression of wage gains with their job experience. Green and Townsend (2010) estimate that for less educated workers this has amounted to a 20-percentage-point fall in starting wages when comparing cohorts that entered the labour market in the early 1980s to those entering in the 2000s. Although this reflects a host of forces associated with bargaining power, because unions and minimum wages have lost their clout, it is also true that the computer revolution and globalization are at work. The young, less skilled and less experienced, have taken a hit to their lifetime earnings prospects that is just as significant as, if not more than, that faced by the Henry Capes of the Canadian economy. This said, it is certainly true that while the growth of a new economy offers greater risks for many, it also presents greater opportunities for others. Young people have also benefited from these structural changes. With the right education, skills, and personality, some of them are, or have the potential to be, among the top earners.

Whether you are just starting out or have 20 years of loyal service, a job does not guarantee prosperity and security in the way that it did three or four decades ago, when there was less wage rate polarization, and when significant annual pay increases were the norm. The average hourly wage measured in inflation-adjusted 2013 dollars went from about \$11 an hour during the early 1960s to almost \$21 an hour during the mid- to late 1970s, but then it stagnated and even drifted a bit lower all the way to the late 1990s (Corak 2014). Story 1 makes clear that things began to change afterwards, the increase in median household incomes being underpinned in part by higher average wage rates, which rose by almost 15 percent between 1996 and 2011. But does this rise in average wages and median incomes imply, as Story 1 suggests, that prosperity is inclusive, sustainable, and shared among the broad middle income groups?

In part, these changes reflect the recovery from an extra long and deep recession during the early 1990s, one that was made-in-Canada, reflecting a policy priority to fight inflation and engrain a credible zero inflation target into the workings of the labour market. In large measure, though, it should also be no surprise that the growth in median incomes reflected the strong boom in commodity prices. Incomes were driven up, not by a broad-based inclusive growth, but by resource booms in Alberta, Saskatchewan, and Newfoundland and Labrador. These economies were on fire, and workers captured some of the rents associated with favourable commodity prices because labour demand outstripped labour supply. Figure 15 shows that in Newfoundland and Labrador the median household income went from well below $30,000 in 1992 to almost $50,000 in 2014, and the changes were more dramatic in the other two provinces. Median incomes rose from well below the Canada-wide level in Saskatchewan to well above, and they increased steadily in Alberta to reach almost $80,000. However, all this did not spill over in a major way to workers in other economies. In Ontario, the median household income, after recovering from the recession, was flat during the late 1990s and the first decade of the 2000s. There was little progress in Quebec. When David Leonhardt and Kevin Quealy (2014) wrote in *The New York Times* that the Canadian middle class had likely overtaken the American, making it the most prosperous among the nine countries they examined, their analysis did not focus on the underlying drivers, and therefore did not note that the run-up in the prices of oil, potash, and other minerals was a major boost to Canadian incomes. The regions that benefited weighed more heavily in Canadian national statistics than places such as North Dakota, which also experienced a resource boom. As we well know from the vantage point of 2016, commodity prices can swing dramatically in the opposite direction. Unfortunately, I am not in a position to chart the impact of the fall in oil prices as Statistics Canada has yet to make more recent income data available. It should be clear that commodity prices were behind the rise in the wages and incomes to which Story 1 points our attention, as detailed studies by Fortin and Lemieux (2016) and Marchand (2015, 2012) show and as implied by Green and Sand (2015).

Families have responded to all of these changes—structural changes associated with the computer revolution and globalization, cyclical booms and busts, and the ups and downs of commodity prices—in many ways. Their response to changing wage rates ultimately determines their total incomes. They have done a good deal to buffer their children from poverty and take steps up the income ladder. To illustrate, let me come clean with one statistical sleight of hand that has remained implicit in our discussion of median incomes. All of the

Figure 15: **FACTS WITH THEORY**

Middle incomes rose after the mid 1990s because three provinces were red hot with resource booms

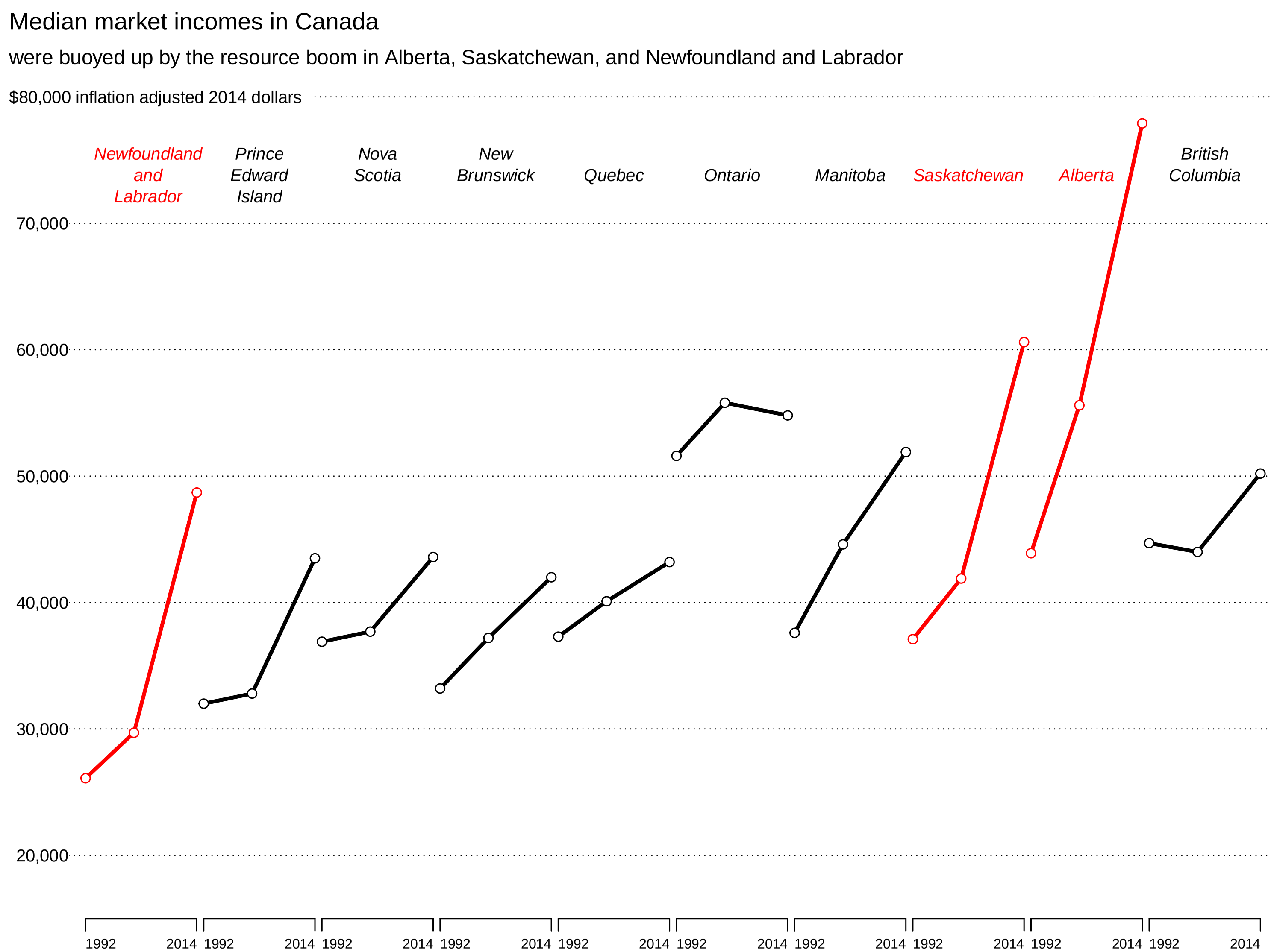
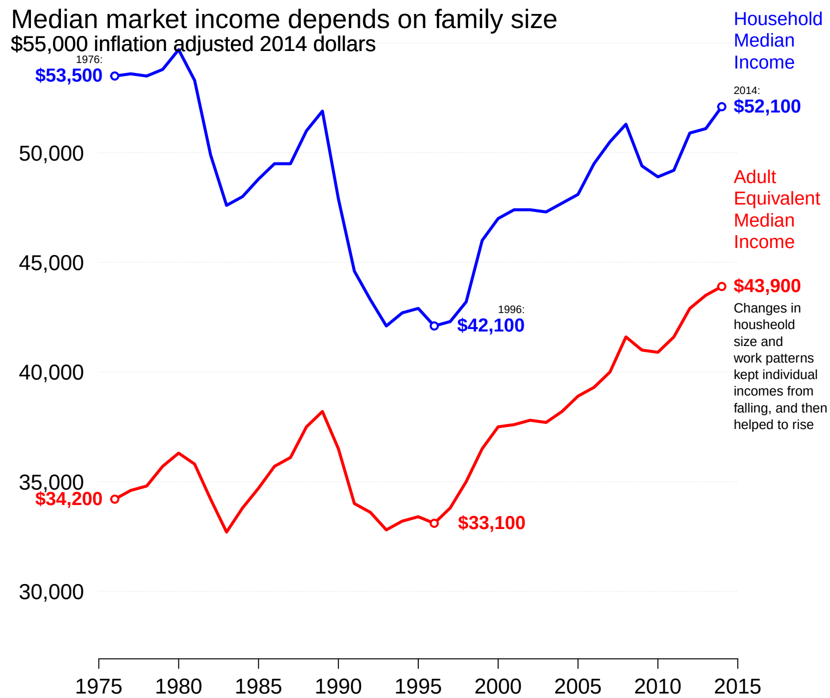


Figure 16: **FACTS WITH THEORY**
Family demographics, education, and labour supply changed in a way that supports individual incomes



information I have offered on inequality is based upon income adjusted for household size. All the Gini coefficients should be interpreted as describing inequality among individuals. However, all the information I have offered on median incomes refers to household income regardless of the number of members in the household. The evolution of median incomes looks very different if we calculate it for individuals, and I offer both sets of numbers in Figure 16.[8]

The decline in median household incomes during the first part of the period is paired with little change in median individual incomes, and the rise in the second part is exactly mirrored. The family has changed in major ways over these decades and, I would argue, in

[8]To be clear, the income adjustment for household size is a bit more complicated than simply dividing total household income by the total number of people in the household. The information I use is based upon a particular equivalence scale. The adjusted household income is derived by dividing the total household income by the square root of the number of people in the household. This implies that a household of four needs only twice the income of an unattached individual to maintain the same per-person income. Equivalence scales are used to account for the economies of living together, household expenses not having to double when the number of members double. Other ways of making this adjustment are certainly possible, but the use of the square root of household size is a standard used by many, and in particular by Statistics Canada. For more information see a helpful note published by the OECD called "What are Equivalence Scales?", which you can download at http://www.oecd.org/eco/growth/OECD-Note-EquivalenceScales.pdf.

response to more polarized economic realities. Lu, Morissette, and Schirle (2011) and Chen and Corak (2008) show that these changes have tempered the growth of household inequality, and lowered the chances children are raised in low income households. In some measure, these changes reflect compositional changes in the structure of families associated with the baby boom generation's coming of age and starting their families. In some measure, though, they also reflect individual and household decisions in response to labour market realities. Marriage has been delayed, and mothers are older at the birth of a first child. Fertility has fallen, as has teenage motherhood. In addition to these fundamental demographic changes, people are more educated, and both partners more likely to be active in the job market and working more hours (Burton and Phipps 2011). In fact, Lu, Morissette and Schirle (2011) offer a bit of evidence to suggest that women are at the heart of many of these changes, because they are much more educated now yet at the same time show a tendency to "marry down," men with lower education still able to find a partner. In this way, the degree of assortative mating, a factor that has served to increase inequality in the United States, has been tempered. When household incomes fell, this was not necessarily driven by lower individual incomes. Households managed because they changed. They became smaller, more educated, and worked longer hours. As a result, when household income rose, this did reflect higher individual incomes.

Have middle incomes gone up or down? They have done both in a way that reflects important changes in labour markets, developments in taxes and transfers, and the demographic responses of families. It should be clear that "middle" families have responded in ways to sustain incomes, but clearly their plight is less, not more, secure than it was decades ago. The capacity of families to change and adapt has its limits, commodity prices swing not just up but also fall down, and the tax-transfer system has not been fully thought through to be of more benefit in a sustainable way to address these limits and their attendant insecurities.

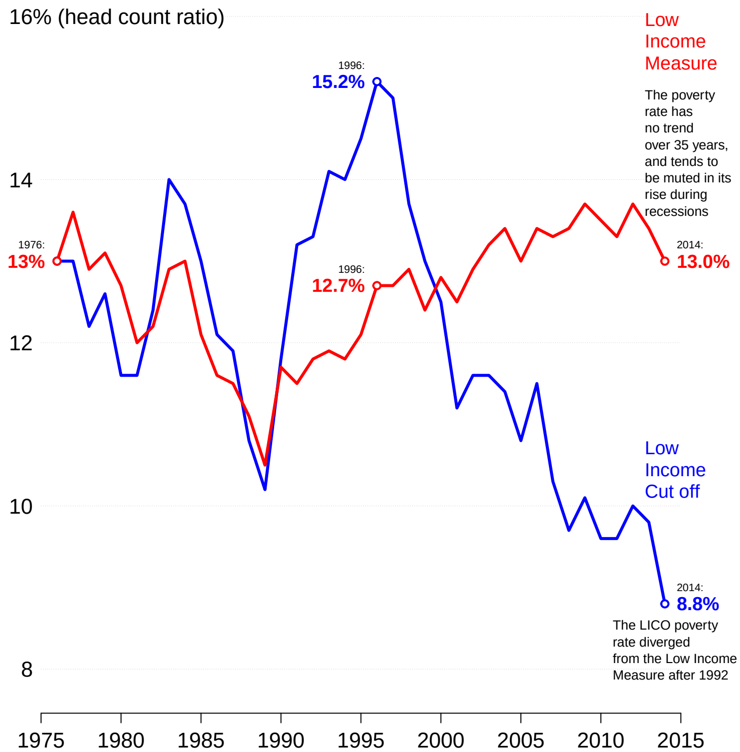
3.3 Has poverty fallen or not?

Story 1 claims that the poverty rate has fallen to unprecedented lows; Story 2 claims there's been no fall at all. Both stories rely on 'hard' data. Either Story 1 is right, or Story 2 is right; they can't both be right.

But I would ask you to entertain a third possibility: they are both wrong.

Figure 17 shows the trends in the two poverty statistics underpinning these stories over as long a time period as possible. The patterns are curious. The two statistics—the poverty rate according to the Low Income Cut-off and that according to the Low Income Measure—track each other rather closely up to the early 1990s, then diverge quite markedly as the Low Income Cut-off falls steadily to an unprecedented low. Is there something substantive behind this divergence, or is it a statistical mirage? The cyclical patterns also differ, with the Low Income Measure registering higher poverty during business cycle recessions only before the

Figure 17: **FACTS WITH THEORY**
Statistics Canada data offer mixed signals on changes in the poverty rate



1990s, and in a way that is more muted and lagging the movement in the Low Income Cut-off. It also signals a rise in poverty only well after the onset of the 1990-92 recession, and both measures show no upturn in poverty during the Great Recession, which began in 2008. For something that is central to so many policy debates, the Canadian "poverty" rate is notoriously confusing, and it is easy to imagine that public policy discourse may be misled.

In fact, *poverty* is a word that is banned from the Statistics Canada lexicon. The former Chief Statistician, Ivan Fellegi, made a point of stressing that Canada's national statistical agency is not in the business of measuring poverty. He counsels that

> there is still no internationally-accepted definition of poverty—unlike measures such as employment, unemployment, gross domestic product, consumer prices, international trade and so on. This is not surprising, perhaps, given the absence of an international consensus on what poverty is and how it should be measured. ... The underlying difficulty is due to the fact that poverty is intrinsically a question of social consensus, at a given point in time and in the context of a given country. Someone acceptably well off in terms of the standards in a developing country might well be considered desperately poor in Canada. And even within the same country, the outlook changes over time. A standard of living considered as acceptable in the previous century might well be viewed

with abhorrence today. (Fellegi 1999, page 36)

In other words, we should understand poverty to be the minimum level of resources necessary to participate "normally" in society. Money income will be an important component of those resources in a market-based society, but surely not the only component. And "normal" is clearly something that will vary across time and place. The best economic theorists who have considered the issue, from Adam Smith (1776) to Amartya Sen (1983), would agree. Dr. Fellegi is absolutely correct when he argues that it is not the statistical agency's place to explicitly, or even implicitly, embed these kinds of judgements in its numbers. And because poverty cannot be defined in a rigorous and scientifically acceptable way, Statistics Canada should be seen to be in the business of only measuring "low income."

It turns out, however, that it is hard for the Agency's actual practice to live up to the standards it has set for itself, with the result that value judgments are in fact embedded in the low-income numbers it produces. This is what leads to very different profiles of how poverty has evolved in Canada. In this area of public policy, it has been all too easy to harness different numbers in support of competing story-lines. In part, this starts with the understandable demand for a hard number. Just how many Canadians are poor? This is a natural question for a politician to ask, as it would give an immediate sense of the scale and salience of the problem. Serving this communication need is the most important purpose of the poverty line. But expressing this need without also being explicit on what sort of financial and non-financial resources should be measured, where to draw the line between poor and non-poor, and how to update that line, puts an unfair onus on official statistics. So if we are to understand the patterns in Figure 17, we need to be clear on just how the Low Income Cut-off and the Low Income Measure are defined. Once that is clear, then we can reflect on how a poverty measure should be defined to serve our policy goals.

The poverty rate derived from the Low Income Measure is the fraction of the population with an income lower than one-half of the median income in that year. If an individual has an annual income (appropriately adjusted for family size) that is less than half as much as someone at the halfway point in the income distribution, then that individual is considered to be in low income. It is clearly a statistic based just on money, in no way capturing other dimensions of poverty, whether they be things many of us would consider basic necessities such as an adequate diet, clothing and shelter, or other things that allow us to develop our capabilities and participate fully: a loving and secure family life, access to education, health care, and transportation, or even access to the Internet and a cell phone. Clearly, Statistics Canada is being true to its values in sticking to income, and not trying to define and measure all these other resources. But in another sense it is not being purely objective, and just as important for our purposes is another value judgment that is hard-wired into this statistic. What it means to participate normally is assumed to change on an annual basis, from year to year as the median income changes. In 2014, the Low Income Measure was $21,773, but this measures differs for each year in Figure 17 as adjustments are made for the annual change in median incomes. The value judgement embedded in this implies that what it takes to participate normally not only evolves through time, but so rapidly as to change from one year to the next. Among other things, an annual updating could, in principle, lead to the poverty rate falling or not rising very much if the economy goes into a recession. This perverse signal would happen if the median income falls, something we may well expect as people lose their jobs, unemployment rises, and incomes decline. Consequently, cyclical changes in the Low Income Measure may have a tendency to be slow and muted. The poverty rate does not go up as sharply during a recession because at the same time median incomes are lower. As a result, the poverty line is adjusted to be lower during a recession. This is odd. It is reasonable to suggest that the poverty line should be adjusted as what it takes to participate normally evolves. But it is hard to accept that this happens so quickly as to require changes from one year to the next.

The Low Income Cut-off is a bit more complicated. It is different both in nature and, more crucially, in the way it is updated. In this case, the poverty line is tied to the proportion of income the average household spends on food, shelter and clothing. Like the Low Income Measure, it is adjusted annually for changes in inflation, but it has been updated only four times in a more fundamental way to reflect changes in family spending patterns. The Low Income Cut-off was first published in 1967, when it was based upon 1959 expenditure patterns. At that time, the household with an average income spent 50 percent of its income on food, shelter and clothing. Statistics Canada adds 20 percent to this, and determines the Low Income Cut-off from the data as the income level associated with the households spending 70 percent of their income on these necessities.[9] There were a series of regular updates reflecting changes in spending patterns. In 1973 the Low Income Cut-off was published using 1969 expenditure patterns; in 1980 using 1978 patterns; in 1987 on the basis of 1986 spending; and finally in 1992 using spending patterns in that year. By 1992, the household with an average income was spending just under 35 percent of its income on food, shelter and clothing (Cotton, Webber, and Saint-Pierre 1999, pages 23-24). On this basis, Statistics Canada points out in an important consultation report released in 1999 that "it is clear that the proportion of income being spent on food, shelter and clothing has declined substantially over time. Other things being equal, as average income goes up and the proportion of income spent on essentials declines, the low income cutoffs rise. This rela-

[9] The reason for this particular mark-up is stated simply as follows: "Twenty percentage points were added to this figure, on the rationale that a family spending over 70 percent of its income on these essentials would be in 'straitened circumstances' " (Cotton, Webber, and Saint-Pierre 1999, page 7). I am told that Statistics Canada folklore attributes this to Jenny Podeluck, the long time manager of income statistics, who developed the Low Income Cut-off. She chose the 20-percentage point mark-up to be comparable with the United States poverty line and picked the phrase "straitened circumstances" from the *Oxford English Dictionary* to replace the "p-word." I thank Jamie Carson for this information. This said, by anchoring the Low Income Cut-off on food, shelter and clothing and marking up these expenditures up by a rough rule of thumb, Statistics Canada drifts away from measuring just income, and takes a stand on what are the necessities of life. In this sense, the Low Income Cut-off as originally conceived was a curious mixture of "absolute" and "relative" in nature, the absolute being associated with particular expenditures, and the relative being associated with regular updating.

tionship, ... underscores the fact that LICOs are a *relative* measure of income deficiency..." (Cotton, Webber, and Saint-Pierre 1999, page 11. Italics in original.)

The updating came to an end for purely pragmatic reasons, without any guidance from theory or first principles. The survey that was used to track family expenditures—the appropriately named Family Expenditure Survey—was conducted about every four years or so, but discontinued after collecting information for the last time in 1996.[10] The information in Figure 17 is adjusted for inflation, but based entirely on 1992 family expenditure patterns. It should be interpreted in the following way: in 1976, 13 percent of Canadians were poor in the sense that they had an income associated with spending a significantly larger fraction on food, shelter and clothing than the average family in 1992. Similarly, in 2014 8.8 percent were poor in the sense that they too spent a significantly larger fraction of their annual income on necessities than the average family in 1992. That is to say, the 1976 number refers to the material resources necessary to participate normally in the society of 1992, some 16 years in the future. In a similar way, the 2014 number refers to what it takes to participate normally in the society of 22 years earlier. We should be clear that the Low Income Cut-off, in spite of what Statistics Canada stated in its 1999 consultation paper, is no longer a relative measure of low income. It is based upon a fixed, not a moving, income threshold based on spending patterns in 1992. The Low Income Cut-off we are now using is the not the same beast as it was when originally conceived and which Canadians used for the twenty years up to 1992. The updating of a poverty line represents an important value judgement, and the decision to anchor the Low Income Cut-off is an important change in the meaning of this statistic, one made arbitrarily by Statistics Canada.

If poverty is intrinsically a question of social consensus, then what value judgment are we asked to agree to when policy analysts use these statistics? The patterns in the two statistics can be understood in this way. As the lower line in Figure 16 shows, the adjusted median income for an individual was relatively constant up to the mid-1990s. In essence, the threshold associated with the Low Income Measure did not change that much, and was in the range of the Low Income Cut-off, which in turn was anchored at its 1992 base. So the two poverty rates moved together, with the Low Income Measure being less cyclically sensitive because the poverty threshold falls as median incomes fall during recessions. After about 1996, the two poverty rates diverged because, on the one hand, the Low Income Cut-Off stays fixed, but the Low Income Measure rises in step with the annual increases of the median income during these years. These are two very different views of the nature of

[10] At that time it was replaced by the Survey of Household Spending, an annual survey that first began collecting information in 1997. The major difference between the two surveys for the purposes of poverty rates is that the shelter cost component of the Survey of Household Expenditures lumps principal and interest payments of mortgages together. This makes the calculation of shelter costs a more challenging exercise since the Family Expenditure Survey was able to use only the expenditures on interest payments in deriving the Low Income Cut-off. The 1996 Family Expenditure Survey determined that the average proportion of income spent on food, shelter and clothing was 31.9 percent, but in 1997 was recorded by the Survey of Household Spending to have risen, a pattern never previously seen in the data (Cotton, Webber, and Saint-Pierre 1999, Chart 2).

poverty. If you have a tendency to see poverty as being subsistence, tied to basic needs, and absolute or fixed in nature, then you will be inclined to believe Story 1, though it still has to be explained why your notion of subsistence is tied to spending patterns of the average household in 1992. Why not 1986, 1969, or even 1959? If you have a tendency to see poverty as an aspect of inequality in the lower part of the income distribution, tied to a continually evolving median income and relative or moving in nature, then you will be inclined to believe Story 2, though it still has to be explained why your notion of relativities should be adjusted so regularly, and even during recessions when the income of the median household might also fall. Both of these perspectives are based upon extreme judgements of what it takes to participate normally in society—something never changing, something always changing—and for this reason I would suggest that they are both wrong, and have misled our understanding of how Canadians have lived their lives.

3.4 Should we praise the top one percent or worry about them?

In summarizing the thesis of her book examining inequality and American values, Leslie McCall, a professor of sociology and political science at Northwestern University, says that "beliefs about economic inequality are shaped by views about the rich and not the poor" (McCall 2013, page xi). There is a certain truth to this, and it resonates with economic theory. If inequality is to be a policy concern, there has to be an interrelationship of some sort between the well-being of the less rich and more rich, or as economists are inclined to put it, the social welfare function cannot be additively separable. Somehow the well-being of the less rich must be impacted by the well-being of the rich. How we imagine this inter-relationship will inform our perspective on public policy. Both Story 1 and Story 2 recognize this. Story 1 ends with the interesting observation, that if inequality resonates in public policy discussion it is because of envy, and we should deny this as a basis for policy because in some sense top earners merit their earnings, these being the just deserts of hard work and talent. Story 2 questions this, suggesting that top earnings reflect economic rents not tied to effort, and appeals to the more elusive notion of social exclusion as the basis for this interrelationship. Without denying either of these perspectives, I have suggested another basis for this interrelationship, one rooted in the link between inequality and intergenerational mobility. We should worry about the top one percent to the extent that their higher incomes lead to changes in public policy and social institutions that erode equality of opportunity. This might be a specific aspect of social exclusion, but in being more precise and measurable helps us to focus on public policies that will promote economic mobility over the longer run, and make inequality of less consequence.

This said, a good deal of discussion about the top one percent takes either Story 1 or Story 2 as a starting point because of a concern over the conduct of tax policy. Story 1 would suggest caution in attempting to raise top marginal tax rates. This would have a potential efficiency cost, because high taxes drive top earners to work less, save less, or leave the jurisdiction altogether. The overall size of the economic pie would fall, and everyone would be made worse off. Tax policy needs to balance this trade-off. Alternatively, according to Story 2 incomes are not tied to effort or talent, and reflect economic rents. If this is the case, then there is no efficiency cost at all, and tax rates should be more progressive, subject to also recognizing the capacity of the rich to avoid taxation by exploiting loopholes in the system.

In fact, careful analyses lean to the view that higher rents may be behind the greater incomes of the Canadian top one percent. Lemieux and Riddell (2016) conclude their detailed study by saying: "On balance, we think that our findings are more consistent with a rent-extraction story than with a market-based explanation. ... although some high incomes are surely compensation for hard work, the growth in top incomes over time has been so large that rent extraction must be the major contributing factor" (page 134). They show that top earners are particularly concentrated in certain professions. For example, about one-quarter of those with top one percent incomes in 2011 are trained in medicine, law and jurisprudence, or business and commerce. Over a twenty-year period, the fraction of the top one percent working in finance doubled from about five to ten percent, as did the fraction working in oil and gas extraction industries, moving from less than three to more than seven percent of all top earners. This is consistent with research by Murphy and Veall (2015), who document that the top one percent are disproportionately found in Toronto and Calgary. Together, these facts are all suggestive of the possibility that institutional factors—such as the capacity to negotiate the terms of compensation from governments, as in the case of doctors, or from boards of directors, as in the case of senior managers—determine pay. They are also suggestive of the possibility that factors beyond individual effort, like commodity price and exchange rate movements, also create opportunities for higher pay.

There is, however, a more subtle counter-argument to Story 1 on this issue. Even if we accept that talent and effort are central to incomes, this does not imply "merit" or just deserts. This story accepts that in a perfectly competitive market the factors of production—labour, capital, land—are paid according to how much they each separately contribute to total production, they are paid their "marginal product." This theory was indeed originally put forward as a theory of just deserts in 1902 by the American economist J.B. Clark. Even as long ago as 1950, the great economist Paul Samuelson (as cited in Sen 1973) stated that to "my astonishment I find that the arbitrariness of J.B. Clark's views on the deservingness of competitively determined rewards is not universally recognized" (page 101, note 33). We should continue to express astonishment that it still plays a role in contemporary policy debate.

One reason is that if everyone were paid according to their marginal contribution, the total payments would still leave money on the table if there were economies of scale in the production process. The very argument used to justify the high productivity of the rich, also assumes that that is the case. This relies on the "economics of superstars." Talent is unique. Or, as the late University of Chicago economist Sherwin Rosen (1981) wrote in an article published in the *American Economic Review*, "Hearing a succession of mediocre singers does not add up to a single outstanding performance" (page 846). When he was at his best there was only one Wayne Gretzky, and I guess that is why they nicknamed him "the Great One." To those of us listening to the opera, or watching the hockey game, the superstar is one of a kind. And because there are no substitutes, the superstar gets paid much more than even the second best. This only explains that there is a top one percent, and that as the most talented they get paid a good deal more. It does not explain what has changed: why have they been taking away a bigger and bigger slice of the pie since about 1980?

Rosen's (1981) other insight was that the farther a superstar's talent could be projected, the greater the earnings. It does not take more effort for a talented novelist to write a book that will be read by ten people than to write on that will be read by ten million; singing an aria to a community theater requires no more preparation than singing it to the Metropolitan Opera House; playing hockey in the large market covered by Madison Square Garden is no harder than playing in a small market such as Edmonton, and certainly no harder if your performance is projected farther on national television, and even farther still on the Internet. The bigger the market, the greater the revenues, and this is pure gravy until the marginal costs of reproduction start rising or there is a significant deterioration in the quality of the consumer's experience.

Since the 1980s, globalization and changes in technology have, in fact, permitted superstars to engage with a larger and larger market. Products can now be reproduced instantaneously at near-zero marginal cost and little additional congestion costs as more and more people consume the product. Writing in 1981, Rosen whimsically wondered about "what changes in the future will be wrought by cable, video cassettes, and home computers?" (page 857). The digital revolution has not only decreased the costs of providing the services we enjoy, it has also increased the size of the audience an individual performer can attract. This is the reality we are living. Everyone now has the opportunity to listen, watch, or to read the best in a way that was not possible only thirty-five years ago. This logic is often extended beyond the example of entertainers and sports stars to the providers of all kinds of professional services—including lawyers, CEOs, and the managers of hedge funds, possibly even doctors—allowing them to attract larger national and indeed global markets. Let's accept that the top one percent are more talented, but does this imply they "merit" their earnings? After all, changes in technology and market size have amplified their incomes in ways not seen for generations, and this has little to do with individual merit. There is money on the table because of these economies of scale, and we should not loose sight of the fact that relative bargaining power—between CEOs and shareholders, between managers and workers, between public and private sectors—plays a role in determining compensation.

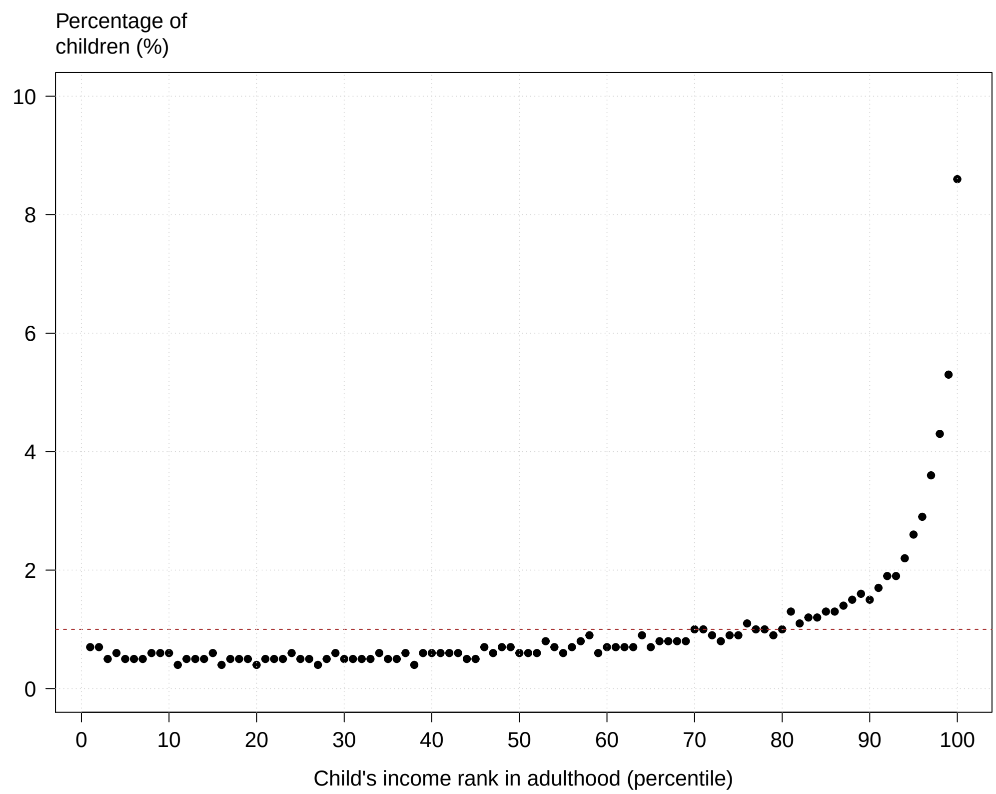
More fundamentally, we should also ask, where does this talent come from? And are there other ways of getting into the top one percent? If so, is the playing field level, and do we all have the chance of getting there? If the members of the top one percent are there because of connections or political power—rather than by the force of their talent, energy, and motivation—then we should be rightly critical about claims that they merit their fortunes, and question the contribution they make to economic productivity. And at the same time we should wonder about the sources of mobility, and the influence of the top one percent on public policies that develop the capabilities of all children.

The interpretations of the degree of intergenerational mobility in Figures 6 and 11 by both Story 1 and Story 2 are only partial because these data refer to overall averages, not to the specific situation of the rich or the poor. In fact, the degree of earnings mobility for children from the very broad middle—parents whose income ranges from the bottom ten percent all the way to the cusp of the top ten percent—is not tied strongly to family income. These children tend to move up or down the income distribution without regard to their starting point in life. This may be one element of insecurity among the middle class: in spite of their best efforts, their children may be as likely to lose ground and fall in the income distribution as they are to rise. The situation is very different for children raised by top-earning parents. Figure 18 illustrates the intergenerational cycle of privilege, the percentile rank in adulthood of children raised by top-one-percent parents. This playing field is clearly not level. If it were, all the points in the Figure would be the same, all lining up along the dashed horizontal line drawn for reference at one percent. The most likely adult outcome of the children of top earners is to also be in the top one percent, and they are disproportionately unlikely to fall below the top fifth. Some of the sources of this intergenerational stickiness in top incomes may not be seen as fair, and may even be perceived to present a barrier to upward mobility for the children of the majority.

For example, the most common way to find a job is through family and friends. That holds true for all of us, but it is immensely more likely for the kids of the very rich. Corak and Piraino (2016, 2011) show that about 40 percent of young Canadian men have at some point worked for exactly the same firm that at some point also employed their fathers. But if dad's earnings put him in the top 25 percent, these chances are above average; they start taking off if dad was in the top five percent and are higher still for top earners. Almost seven out of ten sons of top-one-percent fathers had a job with an employer that had also employed their fathers. All parents want to help their children in whatever way they can. However, top earners can do it more than others, and with more consequence: virtually guaranteeing, if not a lifetime of high earnings, at least a good start in life.

Connections matter. And for the top earners this might even be nepotism. This is not a bad thing if parents pass on real skills to their children, skills that might be specific to particular occupations, industries, or even firms. If this is the case, then it makes economic sense to follow in your father's footsteps. Wayne Gretzky often talked about the role his father played in developing his skating and stick handling skills. He spent hours and hours

Figure 18: ***The intergenerational cycle of top incomes: children raised by parents in the top 1% of the income distribution are most likely to grow up to be the next generation of top earners***



with his father on the backyard rink. But not all top earners got to where they are because of this sort of investment. In fact, sons of top-earning fathers who do not work at the same employer as their fathers are much more likely to fall out of the top than those who do (Bingley, Corak, and Westergard-Nielson 2012). Bad nepotism promotes people above their abilities by virtue of connections, and it erodes rather than enhances economic productivity. Richard Reeves (2013) of the Brookings Institution encapsulates this intuition when he speaks of a "glass floor" supporting untalented rich kids, a floor that at the same time limits the degree of upward mobility for others.

There is, however, an even a larger cost. Social mobility is about a lot more than just using job contacts to make it into the top one percent. It is also about making investments in the health, education, and opportunities of all children and supporting families in a way that complements their efforts to promote the well-being of their kids. If the rich leverage economic power to exercise political power, they can also skew broader public policy choices—from the tax system to the education system, and other sources of human capital investment—in a way that limits possibilities for the majority. Social mobility is turned into a race, a race through a course with many "bottlenecks" that the relatively advantaged are best at maneuvering (Fishkin 2014). Besides, all of this discussion refers simply to the correlation of earnings across generations, which is only a partial measure of mobility. The inheritance of material wealth, not just earnings advantage, should also be part of the way we measure and think about social mobility. Much higher incomes at the top over an extended period translate to a higher stock of wealth, and this may advantage the next generation in a way that is not tied to their earnings capacity. All of this may start eroding the belief that labour markets are fair, and that anyone can aspire to the top. It is not envy that is at the root of a connection between the well-being of the less rich and the rich, but rather a concern over fairness as equality of opportunity. If the rich can't leverage economic power to exercise political power, then it is quite possible for the majority to live with a richer top one percent, and be less concerned about how this minority will influence their welfare and the prospects of their children.

Should we worry about the top one percent? It depends. We would be in a better position to answer this question if we put aside questions of merit and just deserts and focus more on the sources of social mobility and the capacity to conduct policy to support it in an era of higher inequality.

4 Stories as conversation about policy

What are the major messages we are left with?

The distribution of the economic pie in Canada has changed in an important way, reflecting changes in wage rates and jobs in the face of the tremendous increase in the power of information technology, globalization of goods and capital markets, and changes in public policy. Inequality in market outcomes is higher, reflecting losses among those in the bottom 40 percent and gains among those in the top ten and particularly top one percent. Middle incomes have stagnated over the longer term, but they have also varied a good deal over the medium term: rising when the demand for labour outstrips supply, and falling when the opposite is the case. Families have also changed in response to these long- and medium-term influences, including most notably working longer hours to maintain the same income earned by past generations. Tax-transfer policy has played an important role in muting some of these changes and supporting families, but seems to have reached a limit, in part reflecting cuts to income support programs, particularly to unemployment insurance. Fairness as equal opportunity seems on average not to be threatened, but the statistics supporting this view look back to the experience of previous generations, and besides overall averages are less informative in an era of higher inequality. We should wonder about our capacity to prevent or reduce intergenerational cycles of poverty, an issue not fully captured by an indicator of average intergenerational mobility for the entire population. Finally, the data available to us, and the tools we bring to bear in interpreting them, both focus and distort our picture of all of these changes. The downside is most obvious in the confused picture official statistics have painted of the poverty rate, but it is also evident in the need for a certain savvy in appreciating both the value and the limitations of common measures like the Gini coefficient, the incomes of the top one percent, and indicators of intergenerational mobility. Without an appreciation of statistical methods and economic theory we are disadvantaged in moving from competing narratives to constructive conversation.

So, what are the policy implications? Keith Banting and John Myles write that "[p]olitics is a three front war. It is conducted through three simultaneous battles: a battle of ideas, a battle of organized interests and a battle of political parties." (Banting and Myles 2016, page 523) Their perceptive essay covers some of the same ground as our discussion, but more strongly emphasizes that ideas are only one competing element in the design of policy. If we leave things simply at the level of competing narratives there is more scope for so-called organized interests to skew policy in ways that may not fully address the concerns of all citizens. I hope that our discussion can make headway in strengthening the role of ideas in a conversation about policy. There is no shortage of ideas about how to best address inequality, particularly in the wake of influential books by among others Atkinson (2015), Milanovic (2016), OECD (2015a, 2011), and Piketty (2014). I put forward only a few suggestions that relate most directly to my presentation and discussion of the Canadian facts and that in large measure are feasible options falling in the domain of the federal government, but which at the same time clearly are partial and do not in any way represent a comprehensive program.

4.1 Middle incomes

The first policy lesson from our overview is reflected in the focus I have placed on market incomes and wage rates. Public policy needs to be conducted, both in the medium and longer term, with an appreciation for how labour markets work, how they have changed, and how they will continue to evolve. Jobs and pay are the key to offering the middle class and others a sense of growth for themselves and their children, a sense of security, and the basis for fulfilling their need to be treated fairly. High pressure, inclusive labour markets are important for growing the incomes of the middle class. As we have seen, middle incomes have gone up and down in response to medium- and longer term forces, and public policy has at times played an important role in influencing these changes.

Wage rates are ultimately determined by the bargaining power that workers have relative to employers. This is a basic tenet of economic theory, but also basic to how incomes have actually evolved in Canada. The impact of the boom (and now the likely impact of the bust) in commodity prices on middle incomes makes this clear. Excess labour demand shifts the bargaining power to workers by giving them more employment options, and this translates into higher wage rates and incomes. This is the way many lower skilled workers captured some of the rents in the provincial economies that experienced resource booms. Excess labour supply does the opposite, as evidenced by the severe recessions induced by the Bank of Canada to lower inflation rates during the early 1980s and 1990s. These recessions had long and lingering effects on the incomes of typical families. Public policy certainly needs to be cognoscente of trade-offs between competing macroeconomic objectives, but the dimensions of these trade-offs are not as clear-cut as they are often made out to be, and the distribution of income has not in the past been given explicit attention. Now is an important time to be reconsidering this since the Bank of Canada is currently reassessing its inflation targeting (Côté 2014). For example, Pierre Fortin (2016) has argued that the hard-nosed pursuit of a zero-inflation target has significant costs in terms of keeping the macro economy below its full potential, and the unemployment rate higher than it would be if the Bank of Canada's target rate of inflation were higher.

Macroeconomic shocks, whether policy induced or not, change the demand-supply balance in the labour market, but so do microeconomic shocks and policies. Many of these reflect the workings of a competitive marketplace as consumer preferences shift, technology evolves, or the costs firms must pay to hire resources change. In response, wage rates change and thereby signal the need for more or less workers in particular industries and places. These market dynamics do not work perfectly or instantaneously, but it would be counterproductive to conduct policy as if they did not work at all, or to intervene in markets in a regressive way from the perspective of the income distribution without a clear rationale based upon correcting an identifiable market failure.

From this perspective, "counterproductive" would be the charitable way to describe the significant expansion of the temporary foreign worker program, and in particular the very large influx of lower skilled workers it promoted up to about 2014. The federal government describes the goal of the program this way: "The Temporary Foreign Worker Program ... allows Canadian employers to hire foreign nationals to fill temporary labour and skill shortages when qualified Canadian citizens or permanent residents are not available" (Canada 2012, para. 1). There is no identifiable market failure that this program is intended to address. A shortage, for believers in markets, is just another way of saying that the wage rate is too low. The Temporary Foreign Worker Program, in other words, is a wage subsidy to employers of low-skilled workers, a subsidy that shifts bargaining power away from workers and keeps wages lower than they otherwise would have been. Given that labour markets are now predisposed to create lower skilled, lower paying jobs, there is no reason—if our concern is the distribution of income—to promote this tendency. The fact that these firms would have to pay higher wages, or be more innovative in order to satisfy consumer demand, is not a market failure and not a justification for offering a subsidy by giving them an independent source of workers who by law are bound to a particular employer and have limited, and even no, outside options in the market (Nakache and Kinoshita 2010). Given our understanding of how immigration influences wage rates, the expansion of this program, as well as a long-standing policy of maintaining the number of immigrants entering the country during cyclical downturns, likely put limits on the growth of wages at the lower end of the skill distribution, probably having a disproportional impact on new entrants to the labour market, the young and previous cohorts of immigrants (Aydemir and Borjas 2007, Institute for Competitiveness & Prosperity 2007, Worswick 2013).

The very least we should ask of both macro- and microeconomic policies is that they do no harm, and this requires the potential impact on the income distribution to be given explicit consideration alongside other policy goals.

The middle class also needs a sense of security. When Lily counsels Henry to just take "[a]nything. Something that pays," you can imagine how difficult this must be for him. "I could be a janitor. Clean banks at night. Me and those untrained immigrant women." Henry's indignation is red hot, his insecurity brewing with a sense of injustice: "All the rules of the game are suspended. I went to school. Worked hard. Paid my way. I was a useful citizen. I'd made a contract with the world and I obeyed the rules and stipulations of that contract. But if the contract is null and void ... if I can just be discarded, thrown away like garbage then okay" (Walker 1997, pages 255-56). In fact, the research literature documents that this toxin takes its toll on many long-tenure, permanently laid off workers, affecting their health, well-being and longevity, and even the future prospects of their children (Elberts 2014, Oreopoulos, Page, Stevens 2008, Riddell 2014). This sort of job loss seems to be the very kind of risk that unemployment insurance should fully cover: an involuntary job loss with significant financial consequences. Our existing program used to do just that, but for a different era, when most workers had the same basic type of skills, and when employers required nothing more. In this past era, social insurance was required to cover temporary periods of unemployment that would eventually lead to a recall by the former employer, or being hired with another employer, but doing much the same type of work. Offering insurance for temporary periods of unemployment in this kind of labour market was the same thing as insuring wages and incomes. This is a bygone era, and even if there are relatively few workers facing the kind of dilemma that Henry Cape must deal with, taking a totally different type of job and accepting a lower wage, the costs of this experience are very severe for them, and a constant worry for many others.

The Canadian unemployment insurance program, which goes by the name Employment Insurance, should recognize this, and also offer wage insurance. This new dimension of the program would have a relatively long eligibility rule—say at least five years of steady employment with one or more employers and no unemployment insurance claims—and would insure subsequent incomes by offering benefits at initially a very high replacement rate. The program would in effect be giving Lily's advice to those who are eligible: just take anything, something that pays. Conditional on being employed after a layoff, the wage insurance program would top up wage rates with the intent of maintaining an income level close to the average earned during the previous five years of employment. As each year passes the compensation would gradually fall over the course of the next five years when payments would stop. In effect, this would offer laid-off workers a soft landing, smoothing income in the adjustment to a new job that will likely be lower paying because of lost firm or industry-specific skills. Severance payments to some extent do just that, but without promoting job reentry, in fact likely discouraging it.[11]

Wage insurance is a long-standing public policy proposal, initially put forward in the United States (Lalonde 2007). A modest version is currently proposed by the Obama administration (White House 2016), and Bloom *et al.* (1999) describe a Canadian evaluation of a specific design.[12] But there are also precedents for this idea in the Work Sharing envelope of the current Canadian Employment Insurance program. This feature offers an important hint at and precedent for developing full-fledged wage insurance. Work Sharing involves an agreement between employers, employees, and the government that allows employers to move workers to a part-time status, cutting their hours to anything from one to three days a week. The employees are eligible to collect regular benefits without having to serve the standard waiting period. In this way, employers are able to adjust to temporary shocks by cutting hours rather then resorting to layoffs. There is a sense in which we can think of this as a wage insurance program. Workers are in effect being asked to accept a different, lower-paying job, albeit in this case temporarily with the same employer with the income fall being associated with lower hours. The point is that the Employment Insurance program is being used to temporarily top up the incomes of employed individuals to some previous standard.[13] This precedent should be built upon since Work Sharing leaves a similar group of workers, those laid off because of a plant closing, out in the cold.

In the past, there would have been more of a tendency for families to self-insure in situations of this sort. What economists call the "added worker effect" would have kicked in, the possibility that a job loss leads other members of the family to begin looking for work, or to work more intensely, in order to maintain the family's income. This is less an option now than it was for past generations. Female employment rates and hours of work have been trending upwards for decades, and there is no longer the same capacity to increase them

[11] This is the case because of what economists would call a pure "income" effect that induces less labour supply; in contrast a policy that raises the wage rate induces a countervailing "substitution" effect toward more work. Wage Insurance would have a stronger substitution effect because it raises the effective wage rate that an unemployed person can expect to earn. Admittedly, this is more complicated in labour supply models with longer planning horizons.

[12] The evaluation focuses on reemployment outcomes, and is rather pessimistic about the costs and benefits of wage insurance in these terms. However, this leaves other important outcomes associated with the benefits of insurance unaddressed: income replacement for those using the program, and the welfare of those who feel more secure because of the availability of the program even if they have not suffered a layoff and do not use it.

[13] The Work Sharing agreements may have a duration as long as 38 weeks. The specific conditions for this program are described in Government of Canada, Service Canada (2013), "Work-Sharing Program: Applicant Guide." Available at http://www.servicecanada.gc.ca/eng/work_sharing/ws_applicantguide.pdf, accessed on February 21, 2014. My own view is that wage insurance should, in part, be financed from the envelope of funds currently devoted to the Labour Market Development Agreements with the provinces, the source of funding for training programs. These also provide a "soft landing" for permanently laid-off high-seniority workers, promoting their transition to lower paying jobs. The evaluations of these programs show little, or at best mixed, evidence of improving the earnings prospects of participants, though these are not based on the particular target group I have in mind for the wage insurance (Brisson 2015). In particular, the wage subsidy component of this funding pays money to the employers, not to the employees.

temporarily when a family member is unexpectedly laid off. This change in the way families interact with labour markets gives more salience to the need for wage insurance, but also raises other issues associated with time stress and "demographic risks." As I have suggested, the higher employment rates of women, the fact that each successive cohort is better educated, and the resulting steady increases in wage rates and incomes—both in an absolute sense, and relative to men—have been one of the major forces muting the rise of income inequality in Canada. At the same time, this has layered on a higher level of stress as parents struggle to balance family and work responsibilities. The most fundamental private choices that citizens make about their lives are affected: living arrangements, the number of children to have, when to have them. Work-family balance raises several important issues that no single policy can address, and there is certainly much debate and discussion about child care arrangements as a part of this. An era of higher inequality raises the salience of these issues because the work-family balance is tipped by a more polarized labour market. I offer only one suggestion partly related to unexpected events, and therefore possibly amenable to insurance-type policies. This involves a redesign of the so-called "Special Benefits" envelope of the Employment Insurance program.

The expanded coverage of the unemployment insurance program to cover a host of contingencies associated with family life has been particularly important in recent decades and offers another important precedent for the direction of future reforms. In part, this reflects the changing interaction between families and labour markets, and the more pressing needs and time constraints of single-parent and dual-earner households. There are now five types of "Special Benefits" that in 2014-15 collectively amounted to almost $5 billion in expenditures, just under one-half of what was paid in Regular Benefits. In other words, this is a significant part of the Employment Insurance program. Special Benefits include sickness benefits for claimants unable to work, which are payable for up to 15 weeks, and they also include a host of benefits dealing not with individual risks, but with family life: maternity and parental benefits associated with the birth or adoption and with the care of an infant, which are payable for up to 15 and 35 weeks respectively; compassionate care benefits for the care of a family member facing an imminent risk of death, which as of 2016 are payable for up to 26 weeks; and the Parents of Critically Ill Children Benefit, which pays up to 35 weeks of benefits for parents to care for a "critically" ill child. Generally, individuals who are major attachment claimants qualify for these benefits with there being no differentiation of their contribution rates, their incomes and capacity to save or self-insure, and their individual choices. The major exception is the self-employed, who otherwise do not qualify to receive regular benefits, but are eligible for all special benefits as of 2010 if their self-employment income meets a minimum threshold, if they register for the program, and if they make contributions for one year before starting a claim.[14]

[14]They may withdraw at any time subject to not having made a claim, but if they do make a claim they must continue to make contributions "for the duration of their self-employed career." For more details and the sources for the information in this paragraph see: Government of Canada, Human Resources and

The federal government has been incrementally adjusting the unemployment insurance program, sometimes pushed by the courts, to address demographic risks. This signals a growing need among Canadians, but at the same time this need has not been addressed in a way guided by a set of underlying principles, nor in a way that appreciates greater inequality in wage rates and incomes. The piecemeal approach has led the government to only recognize the contingencies that "organized interests" or court decisions push it to address, rather than comprehensively thinking of the challenges and insecurities of family life in an era of higher inequality. At times, it also lends a ring of paternalism to the management of these programs. For example, compassionate care and critically ill child benefits are based on a view that special benefits need be provided for only the gravest of illness or circumstances of only the youngest and oldest family members. This narrow scope then requires the government to set eligibility rules that clearly limit the autonomy of families to make decisions based upon their own needs and information, the management of these programs requiring that a doctor's note be submitted to attest to critical illness of a child, or to the likelihood a parent will die. My point is that the narrow framing of these special benefits leaves many contingencies unaddressed—those of lesser severity than critical illness or death, and those that occur at other points in the life-cycle—and in doing so creates a paternalistic and bureaucratic imperative that robs many families of agency.

At the same time some benefits, like maternity and parental benefits, do not address risks and should more properly not be seen as insurance because they address foreseeable demographic events. For example, the scope for including maternity and parental benefits in an insurance program is limited to the extent that family planning is generally available and used. Increasingly the timing of a birth is less an unknown contingency than a planned event, and in this sense is not an insurable risk. These income transfers in the current program could well be regressive in their impact on the income distribution as they require steady employment to qualify. They may also be of relatively more benefit to relatively higher income groups as those with the most stable and well-paid jobs are more likely to have employers providing supplements to Employment Insurance maternity and parental benefits, raising the replacement rates close to 100 percent of earnings.[15] And even in this case there is a ring of paternalism, as the timing of pregnancies and births may well be influenced by the eligibility rules that must be met to qualify for benefits. Why should the design of a government program influence the spacing of births?

Both insurance and savings are needed for a wide ranging set of demographic events.

Skills Development, "EI Monitoring and Assessment Report 2014/2015," Annex 2 – Employment Insurance benefits data tables, available at http://www.esdc.gc.ca/en/reports/ei/monitoring2015/index.page, accessed on June 9, 2016; Government of Canada, Service Canada, Digest of Benefit Entitlement Principles, Chapters 22, 23, 24, available at http://www.esdc.gc.ca/en/reports/ei/digest/index.page, accessed on June 9, 2016; and Léonard (2014).

[15] Government of Canada, "Supplementing maternity, parental, compassionate care or parents of critically ill children benefits," available at http://www.esdc.gc.ca/en/ei/employers_maternity_parental_benefits.page, accessed June 9, 2016.

I suggest that Special Benefits be redesigned and based on individual accounts, to which individuals contribute and which are topped-up by government contributions geared to income, and from which individuals and families are free to draw for time away from work for whatever purpose they deem appropriate. The government should be put out of the business of defining which family events require “special” benefits, and certainly out of the business of asking citizens to submit doctor’s notes to support their claims. Individuals should have complete sovereignty over their own accounts, building them up and running them down according to their life circumstances and choices. The current contributions that individuals make to the Employment Insurance program would be directed to their own accounts, and any amount or kind of employment could be used to build up an individual account, stable work in an employer-employee relationship, contract work, or self-employment. Employer contributions as they currently stand would be directed solely to the funding of Regular Benefits. It is not at all clear why employer contributions are currently directed to the funding of Special Benefits. But we could well imagine the federal government making a base contribution to all individual accounts that would be taxed back for higher income individuals much in the way that Old Age Security Benefits are targeted to lower income individuals in the Canada Pension Plan. This would ensure that all individuals regardless of income have at least some minimum amount in their account, particularly during the first years of their working life. It would also introduce a progressive element to the financing of the program as the government contribution would come from progressive income taxation. Raising the maximum insurable earnings could enhance this progressive element.

As such, this tier of the Employment Insurance Program would incorporate features of both insurance for unexpected events, and a savings program for contingencies and wants under an individual’s control, from pregnancy to simply taking time off work. It would allow individuals and families freedom to manage the stresses associated with balancing family and work life, whenever they or their children need the support, and for whatever reason. Individual accounts would at once be an encouragement for individuals to remain engaged in the labour market, regardless of the quality of the jobs available to them, and at the same time give them the opportunity and time to pursue other activities, whether out of necessity or out of choice. For many people life satisfaction will not come from their market work, and these accounts would give them the flexibility, in a small way, to engage in what they deem to be more rewarding activities. At retirement any surplus in these accounts would be converted to a retirement income fund. Obviously there are many design features to be thought through, as discussed for example by Feldstein and Altman (2007)—though their proposals imagine a much wider scope for individual accounts—but the underlying objective would be to give individuals and families sovereignty and freedom to balance work-family commitments and a bit more certainty about the unexpected, and it would tilt the income distribution toward more equality of outcomes.

4.2 Low incomes

Angus Deaton, the Princeton University economist, wrote in the opening paragraph of his acceptance speech for the 2015 Nobel Prize in economics that

> [m]easurement, even without understanding of mechanisms, can be of great importance in and of itself—policy change is frequently based on it—and is necessary if not sufficient for any reasoned assessment of policies, including the many that are advocated for the reduction of national or global poverty. We are wise to remember the importance of good data, and not to neglect the challenges that measurement continuously poses. (Deaton 2016, page1221)

This nicely sums up the tone of our discussion, that a conversation about public policy directed to poverty has not been well served by the confusing and conflicting information provided by official statistics. Although there are a host of important and debatable issues in the design of income support policies, I leave these unaddressed and focus on how we should measure poverty, particularly given that this is part of the mandate the current prime minister has given his minister of Families, Children and Social Development, directing him to "Lead the development of a Canadian Poverty Reduction Strategy that would set targets to reduce poverty and measure and publicly report on our progress" (Trudeau, undated). This is reminiscent of the approach to eliminating child poverty used to great effect by the United Kingdom government during the Blair-Brown years: define clear indicators, establish goals and benchmarks, and publicly document progress (Waldfogel 2013). So a good deal rests on measurement, and the Minister's first task will be to offer a definition of the poverty rate. However, the challenge is somewhat different from that faced by Gordon Brown when he received a similar directive from Tony Blair. In addressing this issue the Canadian minister must deal with the provinces, some of which have over the years—albeit off and on—proffered specific poverty reduction strategies that are based on their own reading of what is an appropriate poverty statistic.

It would be unfortunate if politics enters into this issue in such a basic way, but at the same time understandable. The definition of a poverty line, as I have suggested, requires a value judgement to be made, not just with respect to what resources to measure, but also where to set and how to update the line. It should not be a surprise that politicians in a federation as diverse as Canada should have different views on this. But these conflicting views would be more constructively debated if they avoided bureaucratic inertia associated with the imperfections of our existing statistics. The long-standing publication of the Low Income Cut-off by Statistics Canada has given this statistic a "Good Housekeeping Seal of Approval" that, whatever its past merits, is currently undeserved, and that weighs down the development of good public policy.

Allow me to cite a personal example. The Government of British Columbia publishes, through its Representative for Children and Youth and the Provincial Health Officer, a report on child well-being called "Growing Up in B.C.", or simply, as the most current issue is referred to, GUIBC - 2015. The report's analysis of income poverty uses the Low Income Cut-off, and as you can imagine shows a steady decline in the fraction of children living in poverty, and in fact no increase during the Great Recession. As an outside expert, I was invited to review a draft of the report and submit a commentary that was to be published as one of several "Research Voices." I wrote,

> At first look, GUIBC - 2015 seems to indicate that [the risk of poverty] is falling: the child poverty rate peaking at almost 20 per cent in 2003, but steadily falling since, and now hovering at between 10 and 11 per cent. A fall in the child poverty rate from one-in-five to one-in-10 would be something to be applauded if it were credible. Unfortunately it is not. The measure used in GUIBC - 2015 is the Low Income Cut-off, an outdated and inappropriate poverty line that Statistics Canada continues to make available. ... It tells us what the child poverty rate would be if children had access to the minimal financial resources required to participate normally in the B.C. of almost a quarter of a century ago. This statistic tells us nothing about what children need to participate fully in the society of today, and how this prepares them for the society of tomorrow. (British Columbia 2015, pages 36-37)

It is to their credit that they published my comments in full and without any edits, but they could not resist adding a revealing footnote: "Note: GUIBC - 2015 reports on after-tax low income cut-off (LICO) as a measure of incidence of low income because it is arguably the best known working measure of poverty in Canada, and it allows for comparison with LICO data presented in the 2010 GUIBC report." In other words, we use the Low Income Cut Off because everyone else does, and because we always have.

This is just the type of thinking that needs to be transcended and that gets implicitly supported by Statistics Canada. As the policy agenda on poverty measurement moves forward, one wonders if this kind of inertia will frame the discussions. After all, some provinces have even more at stake in the issue, having articulated poverty reduction strategies and in some cases embodied them in legislation (AuCoin, Hills, Notten 2015). A constructive conversation would require articulating and defending the set of value judgments necessary to define and regularly update a poverty threshold.

In this spirit, I put forward the following suggestions, based in part upon Corak (2006) and UNICEF (2005). First, the Low Income Cut-off should no longer be Statistics Canada's headline measure of low income, nor should the Low Income Measure. I would go so far as to suggest that there really is no merit in continuing to produce the Low Income Cut-off. There is probably more merit in continuing to publish a poverty rate based on the Low Income Measure as it is often used for international comparisons. As such, it would be used as a point-in-time estimate, offering a basis for comparing inequality in the lower half of the income distribution across countries but not over time within the country. It should not be a headline measure for Canadian purposes that involve comparisons over time, which is what policy-makers need. Rather, I would propose that for this purpose these two poverty lines be replaced by another pair: the first to be used as a headline measure for the general understanding of how low income is evolving in the country, and the second for the specific purpose of assessing a government's progress in meeting a poverty reduction target. Both of these measures make explicit the value judgements governing a regular updating of the poverty threshold.

The first poverty line would be one-half of a five-year moving average of median individual income (calculated on an adult equivalent basis, and using incomes after taxes and transfers), what we might call a *Moving Low Income Measure*. What it takes to live normally in a society evolves, and there is no hard statistical way of deciding upon the threshold, and how rapidly it should change. We can, however, rely on rules of thumb that have general agreement. For example, there is a social consensus among Canadians that a census be taken every five years. For whatever reason, we have come to feel that our society changes sufficiently that a new picture is needed at five-year intervals. Five years was also roughly the time interval at which the Family Expenditure Survey was conducted, the survey used to update the Low Income Cut-off before updating was arbitrarily halted in 1992. I suggest a five-year moving average of median incomes on the basis of these precedents. This would allow the poverty threshold to continually change, but at a rate much less gradually than the current updating of the Low Income Measure. This said, there is nothing magical about setting the threshold at one-half of the median, though having half as much as someone half way up the income ladder does appeal to a common sense of fairness, of splitting the difference. I imagine one-half of the median being Statistics Canada's headline measure, but the idea is that in the background a host of poverty measures from 30 to 70 percent of the median would be offered to paint a full picture of inequality in the lower half of the income distribution.

I suggest updating the threshold in a different way for the purpose of setting a specific public policy target for governments, whether federal or provincial. The threshold should be fixed in the year the government takes office at one-half of the average median income during the previous five years. We might call this an *Anchored Low Income Measure*, and it would represent the situation the government inherited, the income patterns associated with social inclusion at that time. The government should be held to account for changes in the poverty rate according to this standard. A worse-case assessment of the government's performance would see it leaving office with a higher poverty rate as measured against the Anchored Low Income Measure; a best-case scenario being that poverty is lower both according to this fixed standard, and according to the Moving Low Income Measure (provided that the latter threshold has actually increased over the five years). When a new government comes to office the Anchored threshold would be updated to reflect the five-year median income at that time. Statistics Canada would produce these Anchored Low Income Measures, but not use them as specific social indicators, much in the same way that it produces a core inflation rate for the Bank of Canada, based upon the Bank's instructions, which the Bank then uses for public policy.

Both of these alternatives are improvements over the current low income measures produced by Statistics Canada in the sense that while they are based on rules of thumb in guiding the updating process, these are at least explicit and arguably more reasonable than the status quo. However, one further important change would be required to make this operational for public policy. The data would need to be made available much more quickly than they are currently being produced. Statistics Canada releases income statistics with at least a one-and-a-half-year lag, and sometimes even longer. There may be operational issues associated with this delay. For example, in an effort to reduce respondent burden and increase the accuracy of income information, Statistics Canada relies upon administrative information from income tax files. Respondents who give permission for this linkage of their personal information need not respond to the bank of survey questions on their incomes. As such, the production of income information cannot be completed before the Canada Revenue Agency develops a complete file of T1 tax returns suitable for the purpose. Ultimately, however, the delays reflect the allocation of budgetary resources to the production of income statistics. In an era when the income distribution was not changing very much, or was not a public policy priority, I suppose it may have made sense to give less budgetary priority to the topic. But that is not the case now. And although it is unfortunate that in writing an article on income inequality in 2016, I am restricted to using data that extend only to 2014, it is all the more disconcerting that if government ministers wish to set a poverty reduction target and to regularly report on it, they will not be able to measure the situation that prevailed when their mandate began until the mandate is close to being half over. When Angus Deaton tells us that we "are wise to remember the importance of good data," we should understand that the meaning of good data includes timely data.

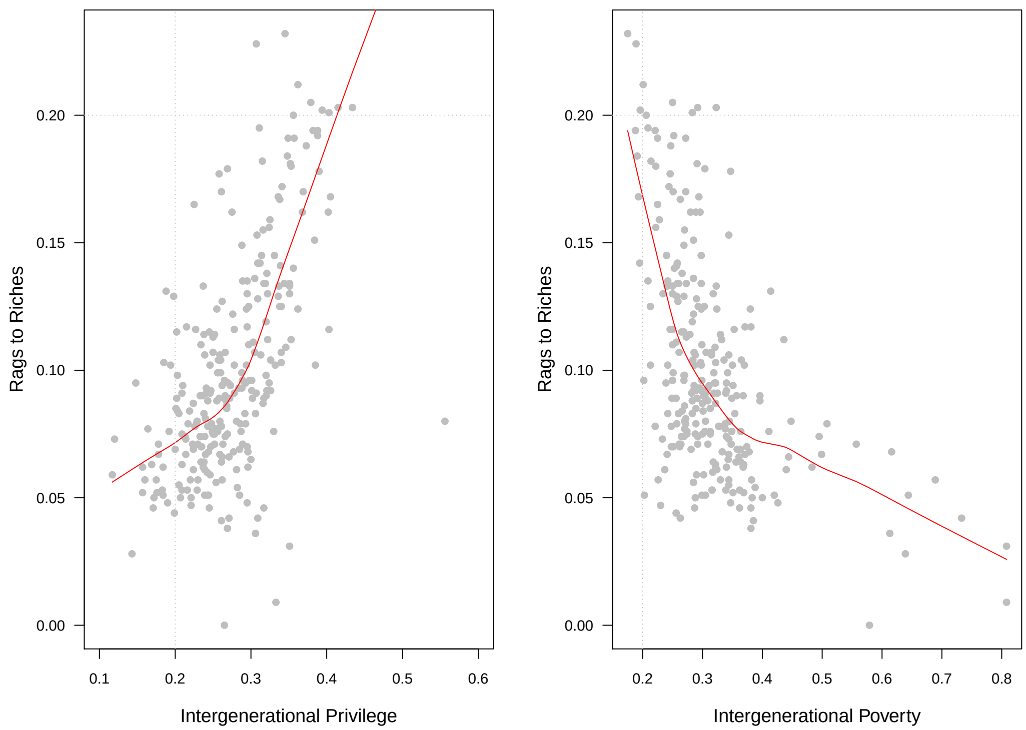
4.3 High incomes and social mobility

The influence of the top one percent on public policy is probably most directly felt when it comes to tax policy, and it likely makes most sense to suggest that in an era of higher inequality Canadians should be concerned about the rich having undo political influence in this domain. This is particularly so if we focus not just on income tax rates and exemptions, but also on how the tax system treats capital income, wealth, and inheritances. The OECD (2011, pages 361-68) discusses the advantages and challenges of taxing top income earners, suggesting policy-makers should focus as much on minimizing the differences in tax rates between different kinds of income—including minimizing tax exemptions that favour the rich—as they do on raising marginal income tax rates. Focusing on these policies will raise revenues and reduce the incentive for top earners to engage in tax avoidance activities. Osberg (2015) and Veall (2012) bring specifically Canadian perspectives to the debate over these issues, but as Boadway (2015) notes broader issues associated with the taxation of capital and wealth have not received as much attention. Peter Diamond, a Nobel laureate in economics and long-time professor of public finance at M.I.T. has gone so far to say, "My favorite tax ... is the estate tax, if done right. I think, in terms of deadweight burdens [that is, in terms of its efficiency cost] it really comes in as the lowest one around" (Diamond 2016, page 408). If we should worry about the top one percent because of the potential impact they may have on social mobility, then capital, wealth, and estate taxation is probably the area of public policy that requires most attention. How wealth is passed on across generations will have an important influence on inequalities in the economic well-being and security of young people who are coming of age in the wake of the aging baby boomer generation. Some will be significantly advantaged by financial transfers from their parents in a way that has little tie to concerns about merit, effort, and earnings power. The most obvious example of the role of the tax system in influencing these inequalities and benefiting the relatively well-off are the host of ways in which some capital is exempt from taxation, the capital gains of owner-occupied housing being a prime example. In fact, exempting capital gains from owner occupied housing may lead to significant distortions in economic behaviour, as it may divert investment from activities more likely to promote economic growth (OECD 2011, page 366). In this way, it may also contribute to bubbles in the housing market. While looking favourably on eliminating this distortion introduced by the tax system, the OECD (2011) also points out that the "political and practical obstacles to taxing the return on (owner occupied) residential property at progressive rates appears, though, to be significant, with no country examples within the OECD area" (page 368).

Although the rich may have a disproportionate influence on the design of the tax system, my own sense—without having the expertise of a political scientist—is that their preferences and power are not as deeply and structurally imprinted on the political process as in the United States, in a way documented, for example, by Bartels (2008), Hacker and Pierson (2010), and others. The characterization that Banting and Myles (2013) offer for the "fading" of the redistributive role of Canadian policy is much more—to use their word—multidimensional. In particular, the top one percent may not have a disproportionate influence on policy addressed to intergenerational mobility. If avoiding intergenerational cycles of low income, and promoting upward mobility from the bottom are our prime concerns, then the rise of the top one percent does not necessarily present a barrier to making progress. The bigger barrier may be the political imagination and capacity needed to design effective policies that deal with new challenges or address intractable issues that Canadian governments have long left unaddressed.

This is particularly so if we reasonably think of "top" more widely than just the top one percent. As an illustration consider Figure 19, which correlates the probability that a child raised by parents in the bottom fifth of the income distribution will have an adult income in the top fifth—what I've labelled as "rags to riches" movement—with two related probabilities: in the left panel, the probability a child raised by top income parents stays

Figure 19: ***Rags to riches mobility across Canadian municipalities is not hampered by intergenerational cycles of privilege, but is less likely the greater the chances of intergenerational cycles poverty***



at the top, and in the right panel the probability a child raised by bottom income parents stays in the bottom, where *bottom* and *top* refer to the top and bottom fifth of the national income distribution. These probabilities are displayed for each of the 266 Census Divisions defined in the 1986 Canadian Census, roughly speaking the municipality in which the child was raised as a teenager. Transition probabilities of this sort are more tightly related at a national level; there is, after all, an adding-up constraint as more than 20 percent of the population can't be in the top 20 percent. The strength of intergenerational cycles of poverty and privilege will put a limit on the chances of moving from rags to riches, because few people can either break out of the bottom or break into the top. When we focus on subnational communities, however, there is more slack in this adding-up condition given that as adults children are not restricted to living in the community where they grew up. Geographic mobility is a dimension of social mobility.

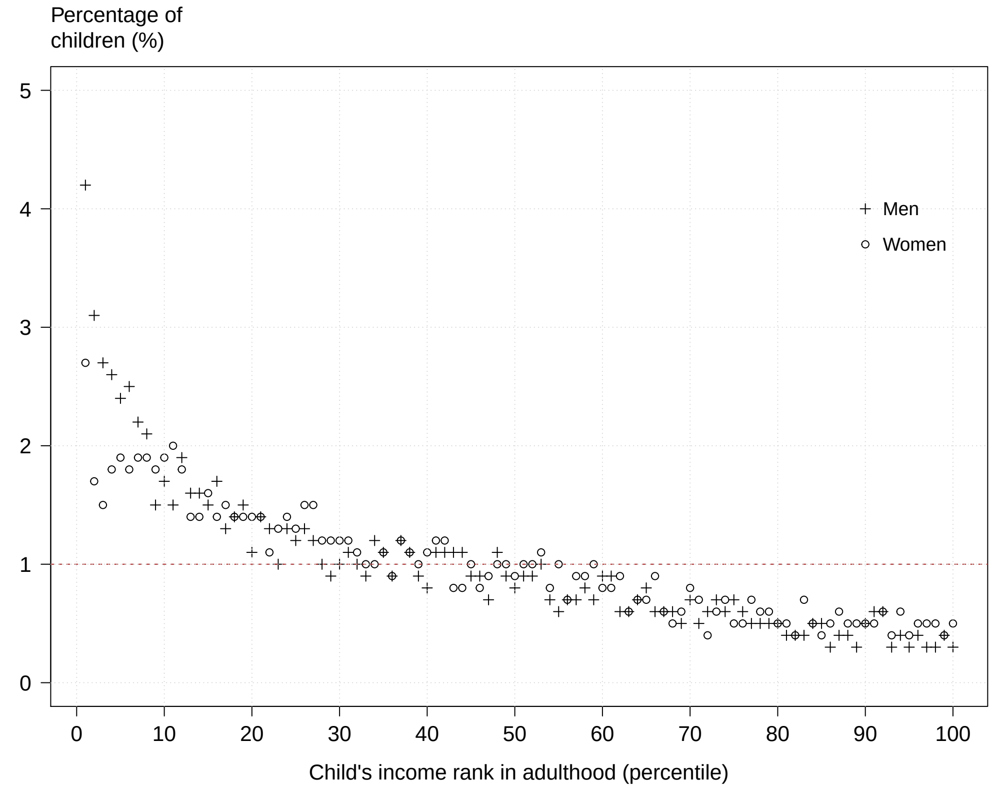
Twenty percent is a useful, but nonetheless rough, benchmark for assessing whether the degree of upward mobility and intergenerational cycles of privilege and poverty in Figure 19 are too high or extremely low. If the distribution of parents and children is divided into five equal parts according to their income rank, and if there were no relationship between parent and child ranks, then we would expect children to have the same chance of being in the top, in the bottom, or anywhere in between, regardless of their parents' income rank. Everyone's chance would be 20 percent. The first impression from Figure 19 is that upward mobility from the bottom fifth to the top fifth is rather limited. In only nine of 266 municipalities is it above 20 percent, and overall in about only one-in-ten is it above 15 percent. However, intergenerational cycles of privilege and poverty are very common, being greater than 20 percent in most communities, particularly so for cycles of poverty, which in a significant number of communities are greater than 30 percent, and in some cases higher than 40 percent.

The relationship between these probabilities is also interesting. Perhaps contrary to expectations, intergenerational cycles of high income don't seem to put a constraint on breaking into the top. In fact, there is a positive relationship between intergenerational cycles of privilege and upward mobility into the top. The message for public policy is that children of top income parents aren't supported by a hard glass floor limiting room at the top for those with family origins lower in the income distribution. The families, labour markets, and social investments in these communities that prepare children in high-income families to take advantage of opportunities, wherever they may be located in the country, also have a tendency to do the same for children in low-income families. In contrast, and as we might expect, there is a strong negative relationship between intergenerational cycles of low income and the chances of upward mobility to the top. The message for public policy is that if we want to promote upward mobility, we need to address the reasons why it is so hard to break out of the bottom.

What is going on at the bottom? Who should be a priority for policy? Where are the risks of poverty cycles highest? I would suggest, as a very rough first cut, that three groups face a disproportionate chance of falling into an intergenerational cycle of low income with the attendant low chances of upward mobility. The first group is a very broad one: boys. Public policy needs to be informed by a new gender economics, at least when it comes to social mobility. There are important differences between the life prospects of boys and girls from less advantaged families, and these were already evident in the experiences of men and women born in the 1960s who are raising, or even have already raised, the next generation of children coming of age in an era of higher inequality.

Figure 20 is based upon the adult family incomes of children—their incomes from income tax records averaged over several years ending in 2008—raised by parents whose income put them at exactly the bottom five percent of their income distribution when the children were in their early teens, in the late 1970s and early 1980s. This information is similar to that in Figure 18, except it focuses on the children of low-income parents rather than the top one percent. The figure shows the rankings of children from low-income families, what fraction stand on each of the 100 rungs defined to equally divide the population across their adult income distribution. The likelihood of an intergenerational cycle of low income is clearly evident. If adult incomes were completely independent of family income background,

Figure 20: ***Boys from families in the bottom 5% of the income distribution are more likely to fall into an intergenerational cycle of low income than girls***



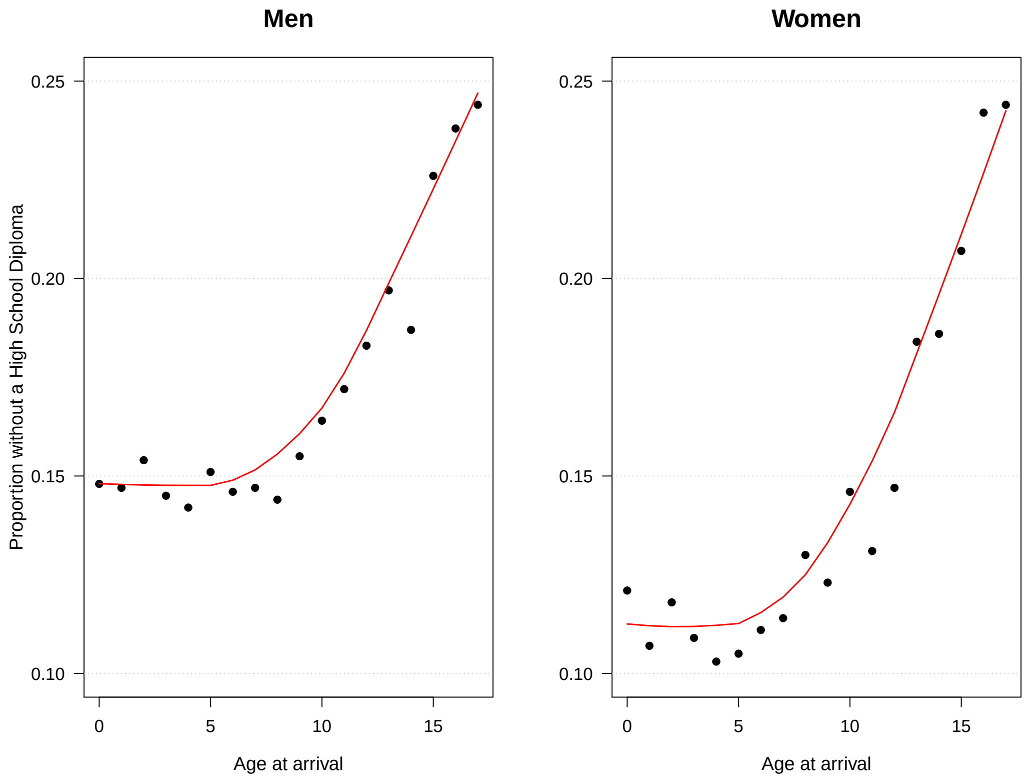
then we would expect one percent of these children to be on each of the 100 divisions of the income distribution. The children of low-ranking parents would be as likely to rise to middle incomes, or even to the very top, as they would be to stay on the same rung as their parents, or even to fall lower. In fact, this cohort of Canadians were much more likely to be the low-ranking adults of the next generation, more likely to repeat the experiences of their parents. This is true for both boys and girls, but more so for boys. Although there is considerable upward rank mobility among these children, men raised by parents who were outranked by 95 percent of their counterparts are most likely to fall even lower, to the bottom one percent adults—to be outranked by 99 percent of their cohort—than to occupy any other rung on the income ladder. Their chances of falling to the bottom one percent are over four percent. More broadly, they are most likely to remain in the bottom ten percent of the income distribution. Although an intergenerational cycle of low income is also the most likely outcome for women, the chances are significantly lower, hovering in the neighbourhood of two percent for each of the rungs up to about the tenth.

The second group facing disproportionate risks of intergenerational cycles of low income is more narrowly defined. It also refers to boys, but to the sons of specific groups of immigrants. Immigration has been in the public policy spotlight almost continuously for decades, but less often from the angle of social mobility. A good deal of research shows that the earnings of immigrants have increasingly fallen below the average earnings of the Canadian born, each successive cohort earning less and experiencing slower wage growth with time in the labour market. This has raised broader concerns about social inclusion, particularly since the reasons for lower relative earnings are in part rooted in very important changes in the countries from which immigrants are coming to Canada. Public policy has strongly moved away from preferential treatment that favoured immigrants from European countries. This has been a major factor in the development of a multicultural ethic, but it also implies that educational credentials, levels of fluency in one of the official languages, and the job skills developed from work experience have all changed in a way detrimental to immigrant earnings potential in the Canadian labour market (Aydemir and Skuterud 2005). As challenging as this may appear, it should be judged in part by the longer term challenges and successes of the children of immigrants, both those who came to the country with their parents, and also those born here to parents who were born in another country, so-called "second-generation" Canadians. After all, many immigrants are willing to pay the often huge monetary and psychic costs of leaving for a new land because of the perceived benefits for their children.

The hopes that many immigrants have for their children are very likely to be fulfilled. This is an important dimension of social mobility that Canadians should rightly celebrate. Second-generation Canadians are among the most educated segments of Canadian society, and this is reflected in their earnings and broader measures of their capacity to participate and contribute to society. To cite only one example, young women with an Asian background have among the highest university completion rates of all demographic groups (Corak 2008). Of course, there is a good deal of variation in the adult outcomes of these children that is related to parental background: countries of origin, mother tongue, and parental education, all echoing across generations. But the general pattern, however, seems to be that most second generation Canadians are as, or more, educated than their Canadian-born counterparts with Canadian-born parents. Accordingly, they have moved up the income ladder. This is not to say that they do not face barriers in the labour market. In fact, there is a tendency to over-invest in education to get a step over job market hurdles put in their way by overt discrimination or not having access to social networks that facilitate the way to better paying jobs (Aydemir, Chen, and Corak 2013, 2009).

Research also shows, however, that there are some distinct groups that have fallen through the cracks, "hot spots" in the landscape of social mobility where hopes are dashed. These can potentially have sharp and severe individual and social consequences. Corak (2008) suggests these groups look something like this. Parents have above-average education—that is, above the Canadian average—but earn less than average, whether due to their educational credentials not being recognized, their foreign job experience being under-valued, their fluency in one of the official languages being less than perfect, or to discrimination based on the colour of their skin or, as Oreopoulos (2011) shows, the spelling of their last name.

Figure 21: ***The chances of dropping out of high school are higher for immigrant children arriving in Canada after about nine years of age***



They may well reconcile themselves to lower incomes and social ranks because they see them as the price to be paid for their children's future. If this optimism proves misplaced, however, if in spite of their sacrifices their children make no progress, getting as much or even more education than the Canadian average but lower earnings, status, and security, you can imagine their disappointment, and also the potential for a much more jaundiced perspective developing among their children, who saw their parents play by the rules to little effect. This intergenerational dynamic can be fertile territory for anti-social behaviour. The evidence shows that relatively few second-generation Canadians fall into this dynamic, but those who do are a telling group: boys, of visible minority status, whose parents came to Canada from a small group of countries in the Caribbean and Africa (Aydemir *et al.* 2013, Corak 2008). These patterns relate to past experience, and so they could well be different among more recent immigrants and their children, raising the need, as always when it comes to thinking about social mobility, to be forward looking. In forthcoming research, Chen and Hou (2016) take an important step in this direction, underscoring the increasing diversity among the visible minority second-generation population, and the different pathways leading to both desirable and more risky outcomes. Their analysis adds individuals with Filipino, West Asian, and Arab backgrounds to the groups I have highlighted.

There is an additional risk factor at play when it comes to children who come to Canada with their parents. For those coming from countries where one of Canada's official languages is not spoken, the age at arrival matters. For example, when these children arrive at a relatively young age, younger than about nine or ten, their chances of dropping out of high school don't vary with age at arrival, and are not much different than the Canadian average. They may enter primary school with less-than-developed language and literacy skills, but by the time they leave they have caught up to or even surpassed their Canadian-born counterparts, ready to confront and meet the challenges that secondary school and the teen years pose (Worswick 2004). However, for every year that they arrive in the country past about nine or ten years of age, the chances of eventually not obtaining a high school diploma rise. Figure 21, taken from a more detailed analysis described in Corak (2012), clearly shows this hockey stick pattern, with the chances of being a high school drop out distinctly changing and then steadily increasing with age at arrival. Social mobility is put at risk for those children coming to Canada during their teen years from countries where one of the official languages is not spoken.

The third and final group to which I would like to draw public policy attention is the children of First Nations peoples. Obviously the situation and circumstances of the Indigenous population, and their relationship with the broader Canadian community, are complex and of long-standing public policy concern. The relationship between income poverty and its potential to ~~be~~ an intergenerational cycle is certainly part of these concerns. The general perception is that this is one part of the Canadian fabric that is most frayed when it comes to the matter of social mobility, and that a focus on the overall average degree of intergenerational mobility, which we have seen is probably something to applaud, is most misleading when it comes to this group. That said, this has not been addressed by the economics literature to the extent that is merited. Feir (2016) is one exception. She examines the long-term consequences of a very extreme childhood experience, attending a residential school that separated children from their parents for long periods, for months and even years at a time. Her analysis is focused on schools that closed before the late 1960s and puts aside cases of the most abusive institutions. The results point to a stark trade-off. Attending a residential school promoted economic independence in adulthood: significantly raising the chances of completing high school, reducing the likelihood of relying on government income support, and increasing the probability of being employed. But this came with important social changes, involving a greater chance of living outside of an aboriginal community, a lower likelihood of engaging in traditional activities, and a lower likelihood that the home language is Aboriginal.

As poignant as this example is for the community of concern, I in part raise it because it brings a general lesson into sharp relief for all three of these risk groups, and because it aids in understanding the drivers of social mobility. Intergenerational cycles of poverty, the chances of upward mobility, and for that matter intergenerational cycles of high income, are the result of a complicated process involving three broad overlapping influences: the family, the labour market, and public policy. The configuration of these forces is somehow failing the full development of young children in the groups I've highlighted. This is most clear in the case of those native peoples who were forced to attend residential schools: the full force of public policy being used to remove children from their families in a battle over cultural identity, providing some development of human capital and enhancing earnings potential, but geographic distance from employment opportunities and labour market discrimination probably leaving this potential less than fully tapped. In a similar way, we may wonder about how families, labour markets, and the education system are failing to serve boys, or particular groups of immigrants.

The dialogue between Story 1 and Story 2 on the issue of inequality and social mobility is probably more constructive if we confront head on the deeper differences between these perspectives on the effectiveness of government policy, rather than the first-level differences on whether or not inequality puts social mobility at risk. It is incorrect to ignore the relationship between inequality and social mobility in the manner of Story 1, but it is equally questionable to suggest that income inequality is entirely causal, as is implicit in some Story 2 interpretations of the Great Gatsby Curve. Income inequality matters for social mobility, but just as pressing are other forms of inequality associated with family resources, values, and expectations; with open, accessible, and inclusive labour markets; and with government policies that offer income support and insurance, but that also invest in human capital that complement family investments and labour market opportunities. Progressive health care and education systems, that are both effective and equitable—being of relatively more advantage to the relatively disadvantaged—are the central planks upon which the country's relatively high level of social mobility is built, and I think we can reasonably expect to be sustained even in an era of higher labour market inequalities, even with a growing share among the top one percent. The challenges ahead, though, require the design of policies that continue to serve the broad majority, while effectively addressing the needs of those groups at risk of an intergenerational cycle of poverty. Addressing income poverty is certainly an aspect of this, but it is equally important to address the poverty of expectation, aptitude, and personality, and the hard-wired structures of labour markets that discriminate and limit the full realization of potential. These require more than just money—more than governments exercising their power to tax and transfer—to fully develop equality of opportunity for all.

5 Conclusion

Public policy discussion is, naturally enough, often conducted as a debate, but too often entered into with the moral certainty of a religious leader, the historical entitlement of a prince, or the determination of a politician. We are all increasingly encouraged to adopt strong opinions, pushing our policy ideas, like gladiators, into the public arena to battle it out, the last one standing declared the winner by the verdict of the crowd's loudest approving roar. In this context there can easily be a good deal of confusion among thoughtful citizens over how to correctly interpret the facts. As a result there is a danger that many will become cynical, believing that data don't embody truth, and that policy debate is about lying with statistics. Or they may adopt a type of relativism, believing the truth must lie somewhere in the middle, that everyone is entitled to their own opinion. Writing with a somewhat different purpose, but I think in a way that is still appropriate to the point I am trying to make, the noted film critic A. O. Scott (2016) says,

> Gathering facts is treacherous and confusing work, in constant need of internal and external policing and correction, a need that has given rise to a cottage industry of conspiracy mongering, slippery fact-checking, and cheap-shot media criticism. The result is a perpetual and self-perpetuating state of epistemological crisis, in which the default position is not that we *don't* know but that we *can't*. In possession, as if by some inviolable birthright, of our own truths, we are permitted—indeed encouraged—to argue. But we're not allowed to say "You're wrong." That would be uncivil! Instead, we fall back on the pseudowisdom of the Dude in *The Big Lebowski* and say, "That's just your opinion, man." (page 170, italics in the original)

I have told and examined two stories about equality, the first based on a view suggesting that inequality has not increased in Canada, and even if it has, it is either not of consequence or there is nothing government can do about it, the second viewing the numbers to suggest that inequality has increased, and interpreting them as the root of social malaise that calls for policy action. I have told these stories not to offer you lessons on how pundits and politicians lie with statistics or to suggest that we are left with little but competing opinions, but rather to present the tools and perspective needed to turn them into a conversation that highlights what Canadians need to lead better lives, and informs constructive, feasible, and effective suggestions for public policy.

It is certainly true that "[g]athering facts is treacherous and confusing work, in constant need of internal and external policing and correction," but we should resist using opinion to fill any vacuum when the numbers prove—as they surely will—to be a less-than-perfect guide to action. No doubt, the numbers are not a complete guide. There are few hard facts that readily tell us a coherent story for the simple reason that measurement cannot proceed without theory. I have argued that what is necessary to interpret the numbers in a way appropriate for the wise conduct of public policy is—first and foremost—an application of economic theory and statistical methods, but also an historical and institutional perspective, an aspect of which is an awareness of the pragmatic choices statistical agencies make to render measurement feasible, even if imperfect.

What emerges is a third story, that in summary goes something like this. Has inequality increased? It really doesn't matter how you cut it; inequality of market incomes has increased. The more interesting question is how and why it has increased. The rise reflects a number of drivers that have changed how businesses operate, the structure of labour markets, and the bargaining power of different groups. The most notable drivers are globalization, and the computer revolution. Inequality has increased, but in different ways, at different times, and it takes a number of different statistics, focused on different dimensions of incomes, used over as long a period of time as possible, to bring the picture into focus. Inequality increased at first through a fall in the share of market income going to the bottom 40 percent of the population, but also through an ongoing rise in the share captured by the very top.

Equally clear is that there is a good deal we can do about inequality of outcomes. The tax and transfer system has been a very powerful tool that significantly mitigated the trend to higher inequality of market incomes up to the mid-1990s. Other public policy priorities then took hold. The tax-transfer system came to play a lesser role as the increase in market inequality leveled off, and as significant cuts to important transfer programs—notably social assistance and unemployment insurance—kicked in.

We cannot really say if this rise in inequality is of consequence for the well-being of Canadians without also understanding what has happened to the absolute level of income, and its variability for individual families. Canadians are better off if they can reasonably expect tomorrow to be better than today, for themselves and their children; if they have a sense of security, knowing that they will be able to weather whatever risks the future may hold; and if they have a sense of being treated fairly by markets and governments, both in terms of economic outcomes and in terms of opportunities for their children. Growing inequality is both an outcome—a reflection of underlying structural changes in the economy—and a causal force that can limit the prospects for economic growth, create uncertainty and insecurity, and erode fairness and equality of opportunity. Have middle incomes increased? The economic pie is no doubt larger than four decades ago, but middle incomes have not increased by all that much. To the extent that the median household income has risen over the long term it reflects greater reliance on income support from government, and important changes in the fertility, work patterns, and earnings potential of households, who as a result are more time stressed and less secure about their future. Furthermore, progress cannot be taken for granted. Middle incomes can swing down as easily as they swing up. Some of the downswings reflect government decisions to use monetary policy to fight inflation. Others reflect important changes in the nature of economic growth. No doubt, the growth associated with the commodity price boom up to 2014 helped to raise incomes in certain regions of the country, but that was little comfort to those in other regions, and from the perspective of 2016 looks less secure than may have been imagined.

Has poverty fallen? We do not know. We do not know, not because we can't know, but in large part because the statistical system we have put into place has failed us, offering a menu of poverty statistics that are not reliably grounded in the way Canadians live their lives, and that ultimately cloud the picture, and confuse the conversation. This limits our ability to design income support policies for lower income groups, and to evaluate the policies we put in place.

With inequality up, with no strong upward trend in middle incomes, with a good deal of volatility and uncertainty in job prospects and market incomes, and with an unclear picture of the population living in poverty, we should exercise a certain caution in suggesting that the welfare of all Canadians has unambiguously improved over the last 40 years. But it has certainly improved for the top one percent, and our judgement about social well-being for all depends upon how we view the interrelationship between the very rich and the rest. Should we praise the top one percent or worry about them? Do they illicit rather dishonourable sentiments like envy that should be given little weight? Or do they challenge our need for community and inclusion, influencing the way we live our lives in more fundamental ways? I do not offer a complete set of answers to these questions but suggest that one way to appreciate the relationship between the welfare of the top one percent and the broad majority is to ask if the rising inequality due to greater top income shares somehow threatens social mobility and equality of opportunity.

From this perspective, our biggest worry about the top one percent should probably be their influence over the design and use of the tax-transfer system, which needs to be reformed for a new era of economic growth and income insecurity. The influence of the top one percent on tax policy could well question our sense of fairness, and influence equality of opportunity, particularly when it comes to the treatment of capital income, inheritances, and other mechanisms for transferring income between family members across generations. In a broader sense, though, if our policy focus is on promoting upward social mobility in an absolute and relative sense—particularly for those at the very bottom of the income distribution—then we should worry more about designing effective investments in our children, and promoting inclusive labour markets. It is not clear that the top one percent has stood, or currently stands, in the way of this. Promoting upward mobility certainly involves providing adequate income support and income security to lower income families. This requires public resources, and is clearly impacted by the design of the tax system. But it is wrong to suggest that simply more money will remove the barriers keeping disadvantaged children from becoming all they can be. As effective as it is in promoting equality of outcomes, this does not mean income redistribution policy on its own is effective in solving other related problems associated with social exclusion, particularly the intergenerational cycle of poverty that is very severe in some communities, and that going forward will be an increasingly important concern for new high-risk groups. More than money matters, and there are significant challenges in designing public policies to effectively overcome long-standing concerns. The top one percent likely do not stand in the way because of the solid foundation offered by progressive schooling and health care systems. The challenges ahead are not simply about the need for more overall funding. They are equally about how public funds are allocated—to the old or to the young, to health care or to schooling, to some regions and communities or to others—and whether existing or new interventions can be designed to better effect.

This third story is the basis for some policy ideas. The ideas I put forward should not be thought of as a comprehensive program, but rather suggestions speaking to the specific issues our conversation has uncovered. They are based on precedents and existing innovations, and hence might be seen as feasible. They are also partial by focusing on federal responsibilities.

The middle class should be a policy concern, but it is helpful to view this group both very broadly, and also in a more nuanced way, distinguishing perhaps the middle and upper middle income groups from the bottom 40 percent. A major reform of Canada's unemployment insurance program in the mid-1990s really amounted to a major cutback, rather than a redesign for a more polarized labour market. These cuts were an important component in limiting the redistributive role of tax-transfer policy. The federal government would do well to rethink this program, but building upon its best—forward looking—features, treating them as precedents that embody principles for reform. I offer two suggestions addressed to middle class concerns, the first to the concern for more income security, and the second to demographic risks and time stress. First, wage insurance should become a component of unemployment insurance. This will offer more security to high-seniority workers who face a permanent layoff and a transition to lower paying jobs. Second, the special benefits envelope of the program should be redesigned to have individual accounts that will give all workers the sovereignty to use their contributions to deal with family and other responsibilities. This leaves income support for lower income groups unaddressed, and this should also be an important policy challenge in the coming years. To some degree the tax system is being effectively used to support low- and middle-income families with children, but this leaves many others, particularly young adults, in the cold. I make no suggestions in this regard, except to recognize a need to put the measurement of poverty on a sound footing, particularly if the federal government sees the formulation and development of a national poverty reduction strategy as a priority. Statistics Canada should discontinue the production of the Low Income Cut-off, and replace it with a pair of poverty statistics similar to the Low Income Measure, but updated more gradually: a "Moving Low Income Measure" that is based upon one-half of the five year moving average of the median income, and an "Anchored Low Income Measure" that fixes the Moving Measure in the year a new government takes office, and is then updated again for the next government. Together they would form the basis for measuring progress in poverty reduction. Finally, with respect to promoting equality of opportunity and social mobility, I suggest the focus of policy should be on upward mobility from the bottom, noting that this varies significantly across Canadian municipalities. Although I stop short of offering specific policy recommendations, I note that these should be designed with an awareness of some important risk groups—boys, the children from some immigrant communities, and the children of some Aboriginal communities. How our families, labour markets, and public policies address the challenges facing these groups are important markers of their chances for upward mobility. Having said this, the case as to whether any imagined public interventions will be effective is an open one, requires specific institutional knowledge, and is difficult to evaluate.

Finally, in the most general way, I suggest that changes in the income distribution should be recognized as an aspect of policy design, whether macroeconomic policy associated with inflation fighting and deficit cutting or microeconomic policy associated with immigration levels and labour market regulations. Canadians have been repeatedly asked by their political leaders to make sacrifices and undertake changes in the name of greater productivity and prosperity, but these calls are less clearly accompanied by visions of how prosperity will be shared, and how the losers—and inevitably there are always some who shoulder a disproportionate burden of the costs—will be insured and compensated. Three or more decades ago Canadians were told to make "a leap of faith" and accept free trade with the United States, and once negotiated told to face the challenges of "Adjusting to Win." They were told this for the sake of greater productivity and prosperity. In the 1990s, they were told to endure a major recession, made longer and deeper than elsewhere by the Bank of Canada, in the fight to attain zero inflation; to accept a major reform of the tax system, including the introduction of a value added tax and lower tax rates at the top; to join the battle against government deficits "come hell or high water." They were told this for the sake of greater productivity and prosperity. They were also told to get more education, to get university degrees, even as tuition fees increased significantly, in order to participate in the "knowledge economy"; and then to get community college diplomas to fill skill shortages as welders, plumbers, and technicians when it turned out that economic growth was based on mineral and oil extraction. All for the sake of greater productivity and prosperity. In the end, they have even been lectured and told that "There is no bad job, the only bad job is not having a job," as if the world of work has not changed in 40 years, as if wage rate growth for the young of the 2000s is as much a guarantee as it was for those of the 1950s. All for the sake of greater productivity and prosperity.[16] And Canadians, after all, have made very significant changes in the way they work, their living arrangements, how they raise their families, including the hopes they hold for their children. It is clear they have adjusted to these economic realities and the policy priorities their leaders have set for the sake of productivity and prosperity, but it is also clear that not all of them, and maybe only

[16] The chair of The Royal Commission on Economic Union and Development Prospects for Canada, Donald MacDonald, used the "leap of faith" phrase in putting forward the Commission's 1985 recommendation that Canada pursue a free trade agreement with the United States (McMillan, 2007), whereas "Adjusting to Win" is the title of the 1989 report of the Advisory Council on Adjustment commissioned by the federal government (Corak 1989). Former federal finance minister Paul Martin made the "come hell or high water" comment to a parliamentary committee in discussing the 1995 federal budget (Palmer and Egan, 2011), and the "There is no bad job" comment was made by former federal finance minister Jim Flaherty in defending changes to the unemployment insurance program in 2012 (Canadian Broadcasting Corporation 2012).

a few, have clearly won. For Canadians, it may well be debatable as to whether inequality is the defining issue of our time, but it should, in the least, be *an* issue.

Appendix: Data Sources for figures

Figure 2: Story 1 Inequality is unchanged

Statistics Canada. CANSIM Table 206-0033, Gini coefficients of adjusted market income, Canada. Based upon adult equivalent incomes, using the square root of household size as the equivalence scale. (accessed: July 27, 2016)

Figure 3: Story 1 (Continued) Incomes are higher for the typical family

Statistics Canada. CANSIM Table 206-0011, Median market income (2014 constant dollars), Economic families and persons not in an economic family, Canada (accessed: July 27, 2016).

Figure 4: Story 1 (Continued) Poverty is down

Statistics Canada. CANSIM Table 206-0041, Low income cut-offs, income after taxes and transfers, percentage of persons in low income, 1992 base. Canada. (accessed: July 27, 2016)

Figure 5: Story 1 (Continued) The very rich are better off but not by that much

Statistics Canada. CANSIM Table 204-0002, High income trends of tax filers, Market income, Top 1 percent group, share of income (percent). Canada. (accessed: July 27, 2016)

Figure 6 Story 1 (Continued) Market outcomes seem fair and reflect equality of opportunity since a smaller fraction of economic advantage or disadvantage is passed across generations in Canada than in many other countries

Corak (2013a), data refer to consensus estimates of the intergenerational earnings elasticity between fathers and sons as discussed and explained in footnote 4. More details on the methods used for international harmonization are available at `http://www.iza.org/en/webcontent/publications/papers/viewAbstract?dp_id=1993` .

Figure 7: Story 2 Inequality is higher

Statistics Canada. CANSIM Table 206-0033, Gini coefficients of adjusted market income, Canada. Based upon adult equivalent incomes, using the square root of household size as the equivalence scale. (accessed: July 27, 2016)

Figure 8: Story 2, (Continued) Incomes are lower for the typical family

Statistics Canada. CANSIM Table 206-0011, Median market income (2014 constant dollars), Economic families and persons not in an economic family, Canada (accessed: July 27, 2016).

Figure 9: Story 2 (Continued) Poverty has not fallen at all

Statistics Canada. CANSIM Table 206-0041, Low income measure, income after taxes and transfers, percentage of persons in low income. Canada. (accessed: July 27, 2016)

Figure 10: Story 2, (Continued) The very rich are much richer

Statistics Canada. CANSIM Table 204-0002, High income trends of tax filers, Market income, Top 1 percent group, share of income (percent). Annual information from 1982 to 2013 Canada. The World Wealth and Income Database. Top 1 percent income share, Annual information from 1976 to 1981 Canada. (accessed: July 27, 2016)

Figure 11: Story 1 (Continued) Higher inequality is associated with lower social mobility, and the next generation will likely face less equality of opportunity

Corak (2013a), data refer to consensus estimates of the intergenerational earnings elasticity between fathers and sons as discussed and explained in footnote 4. More details on the methods used for international harmonization are available at `http://www.iza.org/en/webcontent/publications/papers/viewAbstract?dp_id=1993` .

Figure 12: Facts with theory, The tax-transfer system significantly lowers inequality and has muted its increase

Statistics Canada. CANSIM Table 206-0033, Gini coefficients of adjusted market income, and adjusted after-tax income, Canada. Based upon adult equivalent incomes, using the square root of household size as the equivalence scale. (accessed: July 27, 2016)

Figure 13: Facts with theory, Inequality of market incomes rose because the share of income going to the bottom 40% fell, and that going to the top 10% increased

Statistics Canada. CANSIM Table 206-0032, Income shares (percent) of adjusted market income by decile, Canada. Based upon adult equivalent incomes, using the square root of household size as the equivalence scale. annual (accessed: July 27, 2016)

Figure 14: Facts with theory, The tax-transfer system has buoyed middle incomes since the early 1990s

Statistics Canada. CANSIM Table 206-0011, Median market income and Median after tax income (2014 constant dollars), Economic families and persons not in an economic family, Canada (accessed: July 27, 2016).

Figure 15: Middle incomes rose after the mid 1990s because three provinces were red hot with resource booms

Statistics Canada. CANSIM Table 206-0011, Median market income (2014 constant dollars), Economic families and persons not in an economic family, Provinces, 1992, 2001, 2014. (accessed: July 27, 2016). The figure depicts information for 1992, 2001, and 2014.

Figure 16: Facts with theory, Family demographics, education, and labour supply changed in a way that supports individual incomes

Statistics Canada. CANSIM Table 206-0011, Median market income (2014 constant dollars), Economic families and persons not in an economic family, Canada. CANSIM Table 206-0032, Upper income limit, Fifth decile, Adjusted market income, based upon adult equivalent incomes, using the square root of household size as the equivalence scale. (accessed: July 27, 2016)

Figure 17: Facts with theory, Statistics Canada data offer mixed signals on changes in the poverty rate

Statistics Canada. CANSIM Table 206-0041, Low income cut-offs, income after taxes and transfers, percentage of persons in low income, 1992 base. Low income measure after tax. Percentage of persons in low income. Canada. (accessed: July 27, 2016)

Figure 18: The intergenerational cycle of top incomes: children raised by parents in the top 1% of the income distribution are most likely to grow up to be the next generation of top earners Statistics Canada, special tabulations from the Intergenerational Income Data. Income ranks are defined according to the national income distribution based upon income from both partners in the household averaged over a five year period for a cohort of children born in the mid 1960s. Their parents' income is measured during the years they were 15 to 19 years of age, and their adult income is measured ending in 2008. Income is defined as total market income from income tax files. The figure is based upon data in one row of the percentile transition matrix between parent and child incomes, representing the percentile ranks of children raised by parents in the top percentile. Detailed discussion and interpretation of the data are available in Corak (2016), from which the figure is reproduced.

Figure 19: Rags to riches mobility across Canadian municipalities is not hampered by intergenerational cycles of privilege, but is less likely the greater the chances of intergenerational cycles poverty

Statistics Canada, special tabulations from the Intergenerational Income Data. Income ranks are defined according to the national income distribution based upon income from both partners in the household averaged over a five year period for a cohort of children born in the mid 1960s. Their parents' income is measured during the years they were 15 to 19 years of age, and their adult income is measured ending in 2008. Income is defined as total market income from income tax files. The figure is based upon data three entries in the quintile transition matrix between parent and child incomes, representing the quintile ranks of children raised by parents in the bottom quintile who move to the top quintile, labelled as Rags to Riches, children raised by parents in the bottom quintile who stay in the bottom quintile, labelled as Intergenerational Poverty, and children raised by parents in the top quintile who stay in the top quintile, labelled as Intergenerational Privilege. The quintile transition matrices are defined for each of 266 Census Divisions defined according to the 1986 Census, and all ranks refer to the national income distribution. The continuous lines are an estimated local polynomial smooth based upon weighted data, and calculated using a span of two-thirds and a tricubic weight. Detailed discussion and interpretation of the data are available in Corak (2016), from which the figure is based.

Figure 20: Boys from families in the bottom 5% of the income distribution are more likely to fall into an intergenerational cycle of low income than girls

Statistics Canada, special tabulations from the Intergenerational Income Data. Income ranks are defined according to the national income distribution based upon income from both partners in the household averaged over a five year period for a cohort of children born in the mid 1960s. Their parents' income is measured during the years they were 15 to 19 years of age, and their adult income is measured ending in 2008. Income is defined as total market income from income tax files. The figure is based upon data in one row of the percentile transition matrix between parent and child incomes, representing the percentile ranks of children raised by parents in the fifth percentile from the bottom. Detailed discussion and interpretation of the data are available in Corak (2016), from which the figure is reproduced.

Figure 21: The chances of dropping out of high school are higher for immigrant children arriving in Canada after about nine years of age

Statistics Canada, Census of Canada 2006. Each data point represents the proportion of individuals by Age at Arrival without a High School Diploma who are 35 to 55 years of age in 2006. The continuous lines are an estimated local polynomial smooth based upon weighted data, and calculated using a span of two-thirds and a tricubic weight. The figure is based on Corak (2012), Figure 4.1.

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