Income Inequality and the Pursuit of Prosperity

The topic of this year's Walter Gordon Massey Symposium could not be more timely. We are meeting at a pivotal moment in our history, a time of profound questions about what makes an economy good, about the very nature of prosperity.

The story of how we got into this global economic mess, and how we will get out, is inextricably bound up with the story of rising income inequality. After all, it was triggered by the interlocking fates of sub-prime mortgage holders – people who didn't have enough money to get a regular mortgage – and their lenders. Every part of the ensuing cascade of calamity was linked to the pursuit of ever greater returns, a promise of prosperity fuelled by easy money and reckless bets.

Looking at these events, and the developments of the last decade, through the lens of income inequality leaves clues as to how public policy could prevent future shocks to the system here in Canada and elsewhere.

Income inequality always rises during bad economic times and it usually falls in good times. But in the past decade, during the best of economic times, income inequality in Canada surged at a rate unparalled in our post-war history. We have just passed through a decade of the most sustained period of economic expansion in Canada since the 1960s. Back then, there were broad-based gains in wages for every type of job, and prosperity was not just a pocketbook issue; it was also a public affair, with more access to health care and education, and creation of a public infrastructure that included community centres, parks, libraries, rinks and pools, theatres and cultural spaces.

In contrast, this past decade saw the lion's share of wage gains go to Canadians at the top, and the public policy priority of the decade was tax cuts, which also primarily accrued to people at the top. Instead of using a steady portion of a rapidly expanding economy to invest in the things that define the good life for a society, we shrank governments and, not surprisingly, we found ourselves having trouble finding the money to keep existing public assets in good repair, or even keeping the pools and rinks and libraries open for our kids to use.

Yet our economy is vastly larger (five times larger than that of 1961, in inflation adjusted terms) than the base from which Canadians in the 1950s and 60s built the abundant life for all. By abundant life, I don't mean abundant stuff. I mean the stuff of life: freedom from fear and violence, freedom to develop one's potential. Without question we have way more stuff than our predecessors did a generation ago. But that's about it. As a society, we settled. We settled for so little of enduring value from this period of growth, and in the process privatized the very notion of prosperity. We consider vast excess at the top normal, and have grown accustomed to hearing that access to the basics – basics like housing, education, savings for retirement or a rainy day - is increasingly difficult to attain for many, and not just the poorest. Scarcity in the midst of excess is not news; but as we are learning, these kinds of imbalances can't last forever.

For rising inequality, in good times and bad, is not sustainable economically. It is not sustainable ecologically. And it is not sustainable politically. The growing gap is *another* inconvenient truth of our era, every bit as threatening to our health, our economy, our future as climate change.

Here's why rising income inequality is unsustainable, for the rich, the middle class and the poor alike.

Let me start with the good news – what happened to the rich. If your household was in the richest 10% of Canadians, you experienced the best that economic growth had to offer over the last generation. In 2006 your after-tax household income was over $105,000; and your income would have been at least 25% higher than that of your predecessors a generation ago, the top 10% of the late 1970s. These income improvements were mostly driven by changes in wages, not how much you worked, not the returns on your investments, not your tax cuts.

The higher up the income scale you go, the bigger the gains. Michael Veall and Emmanuel Saez's path-breaking work using tax data going back to the 1920s shows that the top 1% of Canadians doubled their share of wages, from 5% to 10% of all wages since the early 1980s. They show a concentration of incomes at the top end of the spectrum that rivals that of the Roaring Twenties and Great Depression.

My colleague Hugh Mackenzie has tracked how recent trends in the compensation of Canada's top bosses have compared to that of the average full-time worker. In 1998, the average compensation of the nation's top 100 CEOs was $3.5 million. By 2007 it had tripled, to $10.4 million. During the same period, the average wage of full-time workers increased from $33,000 to $40,000 – an increase that was just a little less than the inflation of prices (22.7%) over these years. So much for the increase. The average pay of the top 100 CEOs went from 104 times that of the average full-time worker to 259 times. Plato told Aristotle no one should make more than five times the pay of the lowest member of society. A century ago J.P. Morgan said 20 times was OK – and he was considered a robber baron. Today, what was unthinkable is considered normal. The global meltdown is exposing all sorts of bad judgment. In the case of executive compensation, it is putting the very notion of meritocracy on trial. To quote President Obama, what has been happening is not just bad taste, it's bad strategy.

The promise of meritocracy is this: get educated, work hard, and you too will get ahead. Today's generation of workers is playing by all the rules. It has invested more in education and credentials than any previous generation. Today's women are putting more time into the job market than any previous generation. Yet, compared to a generation ago, the bottom 70% of Canadian households are taking home a smaller share of the economic pie they helped bake…and the late 1970s was a time of higher unemployment. The promise of prosperity is ringing dangerously hollow.

Most people are pouring on the juice, hoping they can beat the odds. As documented in my report *The Rich and the Rest of Us,* it now takes two to get into and stay in the middle class. But the bottom **half** of the population of non-elderly Canadians are living on lower after-tax incomes today than their counterparts in the late 1970s. (The elderly are another story - in fact they are the biggest success story of social policy in Canada. Virtually all Canadians over 65 enjoy higher incomes today than their counterparts of the late 1970s, and the biggest improvements have been among the poorest elderly, who have seen their inflation-adjusted incomes basically double. This isn't theory, it's fact. When we want to, we can make a huge difference in peoples' lives.)

Let's take seniors out of the story because, essentially, this is a story about the value of work. The middle class is running faster to stay in the same place. And the promise of mobility, that notion that the future will be brighter for our children than for ourselves, appears to be in question. Charles Beach and others have noted that there has been a decline in income mobility since the 1980s. Mobility is partly a question of opportunity, and opportunity is partly a function of income. After all, money helps buy education and skills development throughout one's life. But as Miles Corak has pointed out, intergenerational mobility is a function of much more than money. Real education is not only bought; it's taught, by those who are interested in us, who believe in us, who take the time to be with us. Nurturing isn't dependent on income, but it is dependent on time. And that's something many families raising children are running out of. The average family raising children is working 200 hours more a year than they were a decade ago. Keeping family incomes afloat by simply working more is a time-limited option. It's an unsustainable strategy, economically and socially, if that's all that families can count on.

And it's not as if all this pedaling faster to stay in place has resulted in an over-worked but resilient middle class. Over time, there are fewer people in that band of income 20% on either side of the middle. The middle is getting squeezed, and that's not good for any of us.

That's because the middle class is the conveyor belt of ideas, social norms, cultural expectations. The more incomes are polarized, the less social glue we share. David Hulchanski and Alan Walks have shown that income polarization leads to spatial polarization over time. Create cities where you can predict poverty by postal code, and you are asking for trouble. Erode the middle and you erode the ability to identify shared public purpose. Both are not a long-term game-plan for public policy.

What about the poor? Poverty in Canada has declined over the past decade, primarily because when there are jobs, Canadians take them. But even after a decade of blockbuster job growth, poverty is only just back to levels of the late 1980s. Canadians in the bottom 10% of the income spectrum are working as many weeks a year as they did in the late 1970s, but the maximum earnings of workers at the bottom has fallen significantly, from $15,000 to $11,000.

We entered this recession with the rate of child poverty in Canada just below the level it was in 1989, when parliamentarians unanimously declared it a national disgrace in a nation as rich as ours (and vowed to eliminate it by the year 2000). Statistics Canada tells us in 2006 almost 3 and a half million Canadians were living below the poverty line. Another 2 million people were in the "near poor" category – incomes up to 25% above the low-income cut-offs. That means one in six Canadians were already struggling to get by in 2006, during the best of economic times. Many of these people are in a new category of misery that has emerged in the last decade: the working poor. Grace-Edward Galabuzi and Michael Ornstein tell us we entered this recession knowing that the rates of poverty are stunningly higher among non-white Canadians, and newcomers – the very people that we will rely on in the coming years as the labour market copes with a record wave of retirements. Most Canadians don't stay permanently in poverty, but we should be worried that it is getting harder to leave poverty behind even when working full-year, full-time. That kind of dynamic fosters a permanent underclass and can destabilize communities.

The rise of the rich, a squeezed middle class, and the revival of the working poor: *This* is what we accomplished during the best decade of economic growth in 40 years. In the coming months, we will be adding the nouveau poor to the déjà poor.

Roger Sauvé's annual reports on family finances shows Canadian households have never been so indebted – owing on average $1.41 of debt for every dollar of income; and that's before the job losses began. Given so many household budgets are predicated on two earners these days, we may be looking at a massive wave of economic dislocation, as people lose their jobs, go through whatever savings they have, sell their assets, and scramble for a cheaper place to live.

So this is the perfect time to ask the really serious questions about prosperity. How can we use this moment to set a foundation for more sustainable growth? How can we recalibrate public policy and harness economic growth so that it does not leave the majority behind, so it ensures a strong and vibrant middle class and fewer people struggling with poverty?

Governments across this country, including the province of Ontario, have started to sense the gravity of the problem, and are promising to combat poverty and social exclusion, and create pathways of opportunity.

This immensely positive (and long over-due) development leads some to conclude the real policy conundrum is stubborn poverty, not inequality.

But looking at what is happening in our world through the lens of inequality is shows us one inescapable fact: the system did not work for the majority. It can't be just a case of poor people making the wrong decisions, if 70% of the population failed to make any advances over the course of a generation.

Income inequality matters. If only the top get ahead, the middle are stagnant and the poor are losing ground, it becomes harder to define shared objectives, or pursue goals that benefit the majority. Public policy becomes increasingly mired in negotiated deals with the most effective lobbyists. Those with money can always find the most effective lobbyists. Without the rich feeling they are in the same boat as the rest of us, there is too much temptation to shift the risks – be they the risks of ill-health, joblessness or aging – to those who are least able to shoulder the burden.

If poverty reduction is truly a policy priority, it requires a pause from the single-minded pursuit of lowering taxes to stimulate economic growth – the creed of public policy that has brought federal spending and revenues to levels of the late 1950s and early 1960s. Arthur Donner and Doug Peters, business economists with long pedigrees in the investment and banking worlds, suggest the knee-jerk answers to our problems, the same ones that have been on offer for the past few decades -- tax cuts and smaller government -- are now part of the problem, not the solution.

When public policy fails to balance the needs of the powerless against the appetite of the powerful, the promise of democracy is shaken. The ideal of a government of the people, by the people, for the people starts to look like government of the elite, by the elite, for the elite. Such a system may last for a time, but its days are numbered.

Sometimes a crisis is what it takes to jolt us into action.

There is little debate now that governments, not markets, will set the agenda for how we move out of this recession. The question is: On whose behalf will governments intervene, and to what end? We need a plan that brings everyone to the table; not just to get back to where we were before the recession, but to get on track for a more sustainable future when the next phase of economic expansion begins. For that we need the twin engines of both public and private enterprise. We don't need small government, or even just smart government. We need governments that have, at the heart of their interest, the well-being of all their citizens.

The namesake of this event, Walter Gordon, would have agreed. No bleeding heart, he was born to privilege and was an accountant working for big business before and after his time as a statesman. Yet as Minister of Finance and President of the Privy Council in the 1960s, he championed the expansion of social programs and a sense of pride in what we could accomplish economically as a sovereign state, nationally, for the good of us all. He said "….I believe the profit motive is important, very important, but I do not believe it is the only motive that should be relied upon if our objective is to improve the level of human welfare for all Canadians – and to have something left over for those in less fortunate lands than ours….." (p. 84 Walter Gordon: A Political Memoir)

With the help of a handful of other politicians and bureaucrats, Walter Gordon transformed this vision into action that benefited a generation of businesses and households with a prosperity that has yet to find its equal.

Nothing less is required of this generation of public policy makers. Indeed this moment is a generational call for transformative change. Canadians have risen to the occasion before, and we can do it again. Walter Gordon's legacy is proof that we can shape our future, for the good of us all.