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The Impact on Redistribution on Income Inequality in Canada

The Centre for the Study of Living Standards (CSLS) today released report entitled "The Impact of Redistribution on Income Inequality in Canada and the Provinces, 1981-2010". The report is posted at http://www.csls.ca/reports/csls2012-08.pdf.

The objective of this report is to provide an overview of trends in income inequality, defined as the Gini coefficient, in Canada and the provinces over the 1981-2010 period and to investigate the impact of redistributive policies – namely, taxes and transfers – on these trends. Income inequality is measured in terms of market income, total income, and after-tax income, with the latter considered the most important from a well-being perspective. The main findings in this research note are outlined below:

- Canada's after-tax income Gini coefficient, which measures inequality after taxes and transfers, was 0.395 in 2010, 0.123 points or 23.7 per cent lower than the market income Gini coefficient (i.e. inequality before taxes and transfers) of 0.518. Of the total 23.7 per cent reduction in the Gini coefficient, 70.7 per cent was due to transfers and 29.3 per cent was due to taxes. It is evident that Canada's redistribution policies considerably reduce market income inequality.

- Between 1981 and 2010, the market Gini coefficient increased by 0.084 points, or 19.4 per cent. This growing market income inequality was partially offset by a larger dampening effect of both transfers and taxes on inequality (by 0.027 points and 0.010 points respectively), resulting in the after-tax Gini coefficient increasing 0.047 points or 13.5 per cent. In other words, 44 per cent of the increased market income inequality between 1980 and 2010 was offset by changes in the transfer and tax system.

- The lion's share of the increase in after-tax inequality over the 1981-2010 period (87 per cent) took place between 1989 and 2000. Since 2000, the after-tax Gini coefficient has only increased 0.003 points (0.8 per cent). Thus counter to popular perceptions, after-tax income inequality, while at an historically high level, has remained basically unchanged in the 2000s.

- The efforts by government to offset rising inequality peaked in Canada in 1994 when 0.146 or 28.7 per cent of market Gini coefficient was offset by spending and taxes. By

2010 this redistributive effect had declined to 0.123 points or 23.7 per cent. If the 1994 level of income redistribution had obtained in 2010, the after-tax Gini coefficient would have been 0.023 points lower at 0.372. This would have eliminated one half of the 0.047 point rise in the after-tax Gini coefficient between 1981 and 2010.

- The degree of income inequality varies greatly across Canada.. For example, in 2010 market income inequality in the most unequal province British Columbia was 22.1 per cent higher than in the least unequal province, Prince Edward Island.

- In 2010, the inequality-offsetting effect of taxes and transfers was largest in Newfoundland and Labrador, followed by Nova Scotia, Prince Edward Island and Quebec. British Columbia and Alberta did the least to counter income inequality.

- Growth in the after-tax Gini coefficient between 1981 and 2010 in Newfoundland and Labrador, British Columbia, Ontario and Alberta – the only provinces with substantial increases in income inequality – was driven by an increase in the market income Gini coefficient. Income inequality barely grew in Manitoba and Saskatchewan over this period, and it was unchanged in Prince Edward Island.

- Among the 35 OECD countries for which data are available, Canada ranked 24th in terms of after-tax income equality in the late 2000s. Canada also had the 25th lowest income inequality offsets among 30 OECD countries; the effect of taxes and transfers on income inequality in Canada was 0.030 points or 20.4 per cent below the OECD average.

- If Canada's redistributive effort were to be raised to the OECD average, nearly two thirds of the increase in after-tax inequality that has take place in Canada since 1981 would be eliminated. Equally, if the level of redistributive effort that was in place in Canada in 1994, the year where redistribution was greatest, had still been in place in 2010, one half of the rise in after-tax inequality between 1981 and 2010 would be reduced. Canada thus has much room to increase its redistributive effort. What is needed is political will.

For further information, please contact:

Andrew Sharpe
Executive Director
Centre for the Study of Living Standards
710-151 Slater Street
Ottawa, Ontario K1P 5H3
613-233-8891
Andrew.sharpe@csls.ca

The Centre for the Study of Living Standards (CSLS) is a national, independent, Ottawa-based not-for-profit research organization. Its primary objective is to contribute to a better understanding of trends and determinants of productivity, living standards, and economic wellbeing in Canada through research.