

Submission by Ed Broadbent, Chair of the Broadbent Institute, to the House of Commons Standing Committee on Finance Study on Income Inequality in Canada. April 30, 2013.

Last September, the Broadbent Institute issued a major discussion paper “Towards a More Equal Canada” which addressed the issue of rising economic inequality. For every \$1 increase in national earnings over the past twenty years, more than 30 cents have gone to the top 1% of earners, while 70 cents have had to be shared among the bottom 99%. Middle class incomes have now been stagnant for thirty years.

Today is the deadline for filing personal income tax returns. It is a day to remind ourselves that our tax system could move us to a more equal Canada if we made the system fairer, with a particular focus on expanding tax credits for low and middle income Canadians. Canada’s poverty rate is, at 8.2% for children and 10.1% for working-age adults in 2010, far too high and could be reduced significantly through the targeted measures we propose.

Our discussion paper drew upon the work of many distinguished experts, examined the causes and consequences of the growth of economic inequality over the past thirty years, and set out a broad policy framework to reverse the trend and lead us back to a more equal Canada. (<http://www.broadbentinstitute.ca/issue/towards-more-equal-canada>)

We have just released another paper “Union Communities, Healthy Communities” that highlights the importance of a strong labour movement in building a more equal Canada. And we have also published more than twenty responses to our reports from a wide range of points of view, as well as the results of an independent poll of Canadians that revealed their opposition to the growth of inequality and their strong support for corrective measures.

Extreme economic inequality undermines democracy and the common good. Very unequal societies do much worse in terms of both social and economic performance, including in such fundamental terms as health and life expectancy, social mobility (equality of opportunity for children), crime levels, the quality of democracy, and levels of social trust.

The level of inequality in a nation is ultimately a matter of political choice. While it is true that rising inequality is due in significant part to fundamental economic changes such as globalization and technological change which are difficult to manage, it is

equally true that some advanced industrial countries have been able to remain much more equal than others. Political choices matter. The empirical evidence – from Canada, the US, Europe and the OECD – is clear.

The rise of extreme income inequality has been much greater in those countries which have most strongly embraced a fundamentalist so-called free market agenda, and much less in those countries which have continued to believe in the need for shared progress.

The Broadbent Institute believes that we must, as a society, strike a balance between the roles of the market and democratic government in determining the distribution of economic resources.

The market, properly regulated, is a useful tool for creating wealth. But democratic governments must ensure that the needs of all citizens, such as access to health care and education as well as the means to secure a decent livelihood, are met regardless of the level of wealth and income acquired through the market.

A very important goal of democratic governments should be to protect and promote not only political and civil rights but also to promote social and economic rights. This is essential to secure genuine equality of opportunity, and to ensure fair outcomes for citizens. It is why Canada signed on to the two UN covenants that include both categories of rights in the mid 1970s.

Research by the OECD and the Conference Board among others shows that Canada used to do quite well at striking a balance between having a growing market economy and securing a fair distribution of the fruits of economic growth. But cuts to social programs and public services as well as changes to transfers (income support programs) and the personal income tax system since the mid 1990s have compounded the rising inequality which has been delivered by the market economy

Growing inequality of market income has, as shown in our recent paper “Union Communities, Healthy Communities,” been driven in significant part by the decline in union density and bargaining power since the 1980s. Respect for labour rights by governments enables unions to ensure that the gains of a growing economy are equitably shared with workers, and collective bargaining has been shown to narrow pay differences, especially pay gaps between women and men.

Another major part of the problem has been the increase in precarious employment, meaning that more than one third of working Canadians do not have permanent, full-

time paid jobs. Many fall below the poverty line due to low hourly wages and/or not enough weeks of work. These issues have been highlighted in recent reports from the Law Commission of Ontario and the United Way. Yet we have failed to support these struggling workers and their families through the tax system and through improvements to basic employment standards.

As recognized in the Broadbent Institute discussion paper on inequality good jobs are the basic building block of successful societies, and a successful economy combined with strong labour rights is a major force for equality. It has been well documented that countries with strong trade union movements are much more equal in terms of the distribution of market income, and that such countries also tend to be prepared to invest more to promote greater equality through public services and social programs. Canada's already acute inequality problem will become much worse if Canada imports from the United States so called right to work laws, as well as legislation that limits the ability of the labour movement to act as political advocates for their members and all workers. Bill C-377, passed by the House of Commons and now before the Senate, singles out unions for highly onerous reporting requirements under tax law which do not apply to the activities of other associations, including business associations.

Providing key services to citizens outside of the market mechanism is crucial to promoting the goal of greater equality. Our public health care system provides important rights, and these should be extended by ensuring that all citizens have a right to prescription drug coverage and to home and elder care as needed by reason of disability or old age. There is perhaps no more powerful tool for securing real equality of opportunity than major public investments in education, from child care and early learning through post secondary education and adult learning.

As requested by the Committee and spelled out in the motion, this brief will focus on the role of the tax/transfer system in promoting greater income equality.

Providing a basic income-tested guarantee to all citizens through a fairer personal income tax system would be a powerful force for greater equality.

The tax/transfer system equalizes income in two important ways first, progressive income taxes mean that the affluent pay to governments a higher percentage of income earned in the market than do middle and low income earners.

Second, these taxes help finance income transfer programs (such as public pensions, Employment Insurance, child benefits and refundable tax credits) which benefit those

who have middle and low incomes more than those with high incomes. The result is that incomes after taxes and transfers are more equal than incomes earned in the market.

Statistics Canada data (CANSIM Table 202-0703) show that the top 20% of Canadian families receive 47.0% of all market income, but a lower 40.0% percent of all income after taxes and income transfers. The bottom 20% receive just 3.4% of all market income, but a higher 7.1% of all income after taxes and transfers. The middle-class (the middle income quintile) has about the same share of market and after tax and transfer income (16.0% and 17.2% respectively).

The Centre for the Study of Living Standards calculate that the income tax/income transfer system reduces inequality as measured by the Gini co-efficient by 24%, with the transfer system having about twice as great an equalizing impact as the personal income tax system. <http://www.csls.ca/PressReleaseSeptember272012.pdf>

However, while our tax/transfer system remains modestly re-distributive, the fact remains that we still have a very unequal distribution of income after the impact of taxes and transfers has been taken into account. And, according to the OECD, the re-distributive impact of the system in Canada has been declining since the mid 1990s.

The Centre for the Study of Living Standards has also shown that the inequality reducing role of the tax/transfer system in Canada has been falling, and is now 20% below the OECD average. The major reason for the decline in redistribution has been the cuts to social assistance and Employment Insurance programs of the mid 1990s combined with our failure to respond to the growth of more precarious and low paid work.

What major changes might we make to our tax/transfer system?

The Broadbent Institute believes that we should embrace the goal of a basic income guarantee sufficient to eliminate poverty and to help close the growing gap between low and higher income Canadians.

This goal should be met by building incrementally on existing income support programs targeted to different age groups and by promoting greater tax fairness.

Step 1: The Broadbent Institute supports the long-standing position of Campaign 2000, other anti poverty groups and research institutions that the maximum level of

income-tested child benefits should be raised to cover the full cost of raising children.

Canada has a basic income guarantee for children in the form of refundable federal child benefits (with additional contributions by some provinces.) Child benefits are delivered through the income tax system and are “refundable”, meaning that they are paid even to tax filers who do not have a tax obligation. Benefits are paid on a regular basis and are changed as family income changes from year to year.

Research by the Caledon Institute among others shows that Canada’s system of income-tested child benefits has been effective in reducing (though far from eliminating) child poverty, and still pays significant amounts to middle-class families to help meet the costs of raising children. The problem is that the maximum benefits paid by Canada Child Tax Benefit and the National Child Benefit Supplement fall well short of the costs of supporting children.

The cost of raising these child tax credits should be offset in part by eliminating the poorly targeted Universal Child Care Benefit.

Step 2: We should significantly increase the federal Working Income Tax Benefit to support working poor individuals and families and to deal with the growing reality of low pay and precarious work.

The greatest gap in the current architecture of Canadian income support programs is for the working age population, especially the growing part of this population who are employed in precarious and low-paid jobs. The working poor and near poor – those who move in and out of low paid jobs but often fail to attain a decent standard of living – is disproportionately made up of recent immigrants, especially those belonging to racial minorities, persons with disabilities, women single parents, the single near elderly, Aboriginal Canadians, and young people trying to get into secure employment.

Credit should be given to the present federal government for creating the Working Income Tax Benefit, a new form of benefit which has been shown in the US and elsewhere to reduce poverty while promoting employment as the best path out of poverty.

However, the current benefit is extremely modest (less than \$1,000 for a single person and less than \$1,800 for a family) and is lost completely at low levels of employment income (\$18,000 for a single person and \$27,000 for a family.)

The maximum benefit should be increased significantly and phased out more slowly as income rises so that recipients are always better-off if they find more weeks and hours of work or find better-paid jobs.

Increases to the Working Income Tax Benefit should be matched by incremental increases in minimum wages to raise incomes and also to ensure that income supplements for the working-poor do not become subsidies to low wage employers. Minimum wages should be set at a level sufficient to ensure that a single person working full time for a full year does not live in poverty.

Improving conditions for low wage workers will also involve raising minimum employment standards covering issues such as hours of work, rights of part-time workers and pay and employment equity, pro actively enforcing such standards, facilitating access to unionization, and greatly expanding skills training programs for unemployed and under-employed workers.

Canada ranks among the bottom of OECD countries in terms of adequate income support for the unemployed. Our Employment Insurance system currently fails to provide benefits to 60% of unemployed workers even though all workers and their employers pay into the system. We must reform EI so that we provide income security to all persons who experience temporary involuntary unemployment.

Step 3: Eliminate poverty in old age.

Canada already has a basic income guarantee for seniors in the form of the Guaranteed Income Supplement (GIS) to Old Age Security (OAS). The GIS is gradually phased out as income rises and is currently received by about one in four seniors. The fact that the OAS plus the maximum amount of GIS is very close to the poverty line means that very few seniors live in poverty. Indeed, the fact that Canada has the lowest poverty rate for seniors among the advanced industrial countries is evidence of a very successful public pensions policy dating back to the 1970s. However, the GIS does need to be raised to ensure that provides all Canadian seniors with an adequate standard of living, particularly single women seniors in large urban areas who are most likely to experience poverty.

Step 4: As a long term goal – and this would clearly involve complex negotiations with the provinces – we should abolish welfare as it currently exists and replace it with an income support program for working age-adults delivered through the tax system in the form of a negative income tax. This program would deliver regular

benefits based on family income, phased-out as income from employment and other sources rises.

Canada's income security program of last resort, social assistance, paid for by the provinces, provides meagre and stigmatizing benefits which are, as shown in reports by the recently abolished National Council of Welfare, far below the poverty line for almost all family-types in all provinces.

The aim has been, as in the Victorian era Poor Laws, to ensure that even extremely low wage jobs will deliver more income than does welfare. Yet the evidence shows that the vast majority of recipients who are able to engage in paid work do, in fact, seek to work.

Social assistance is of no help to the working poor. A recipient must be unemployed, have no access to family income, and must have exhausted almost all assets in order to qualify. Benefits are cut off after only a very few days of work. At the same time, it is very difficult for many recipients, especially persons with disabilities and single parents of young children, to climb the "welfare wall" since leaving social assistance often also means giving up health and housing benefits and since the needed supports and services, such as affordable child care, are not in place.

The aim would be to ensure that working age adults with no or very low incomes from paid work, unemployment insurance, disability benefits and other sources receive a supplement which would be sufficient to secure an acceptable basic income. The supplement would be phased out with rising income rather than being turned off as soon as a person starts to receive employment income. Such a supplement could be partly financed by folding in some current tax credits such as the GST credit.

Such an alternative, a negative income tax, has been broadly championed across the political spectrum, including by Senator Hugh Segal in his published response to the Broadbent Institute paper on inequality, and by the late Tom Kent, the prime architect of Canada's social reforms of the 1970s, who wrote the first paper published by the Institute.

Without addressing the complex issues, there is also a pressing need for reform and improvement of disability benefits.

Step 5: Improvements to income support programs could and should be financed by making our income tax system much fairer.

The incomes of the top 1% have risen from 7% to 11% of the total income of Canadians since the early 1980s, while the incomes of middle-class and working Canadians have increased little in real terms. The rising share of the top 1% is the main reason why market income inequality in Canada increased so significantly from the early 1980s to 2009.

Recent Statistics Canada data show the effective income tax rate on the top 1% has fallen from 39.4 per cent to 33.3 per cent since 2000, and the effective income tax rate on the top 0.1 per cent of Canadians, whose incomes start from \$685,000 and average \$1,519,000, has fallen sharply from 41.6 percent to 35.4 per cent. Thus, even as the income share of very high income earners has risen, their effective tax rate has fallen significantly. As we have said before, we should consider changes to top income tax rates.

We should also scale back special tax breaks that deliver huge benefits to the very well off, such as the exclusion of 50% of capital gains incomes from taxes and low tax rates on gains from stock options. (It is reasonable only to tax capital gains above inflation over the period for which assets were held.) We should also be cracking down on tax avoidance by the very rich through offshore tax havens and other means such as sheltering income and wealth within private companies and family trusts. It is time to crack down on the tax cheats who undermine government finances and public belief in the fairness of the tax system, and the present federal government should be commended for their 2013 Budget proposals in this area. Additional revenues can also be gained by more broadly applying the principle of “polluter pay.” Our current tax system allows corporate polluters to offload risk and current and future payments for cleaning up their mess to individual taxpayers. This isn’t fair, and needs to be changed.

There is much more to dealing with inequality than reforms to the tax/transfer system. However, changes in this area could narrow the widening gap between the very affluent and the middle-class, and also lead us closer to the goal of eliminating poverty in Canada.

In summary, concrete steps can be taken to make our tax system a much more effective vehicle for closing the growing gap in Canada between the very rich on the one hand, and the middle-class and the poor on the other. The priority should be to eliminate poverty by expanding refundable tax credits, especially for the working-poor who fall through the cracks of our current income support system. Our tax system would also be much fairer if we closed special tax loopholes for the very affluent, ensured that corporations pay to clean up their own mess and cracked down

on tax cheaters.