

**Policy Regimes, Income Inequality and Growth in  
Canada since 1946**

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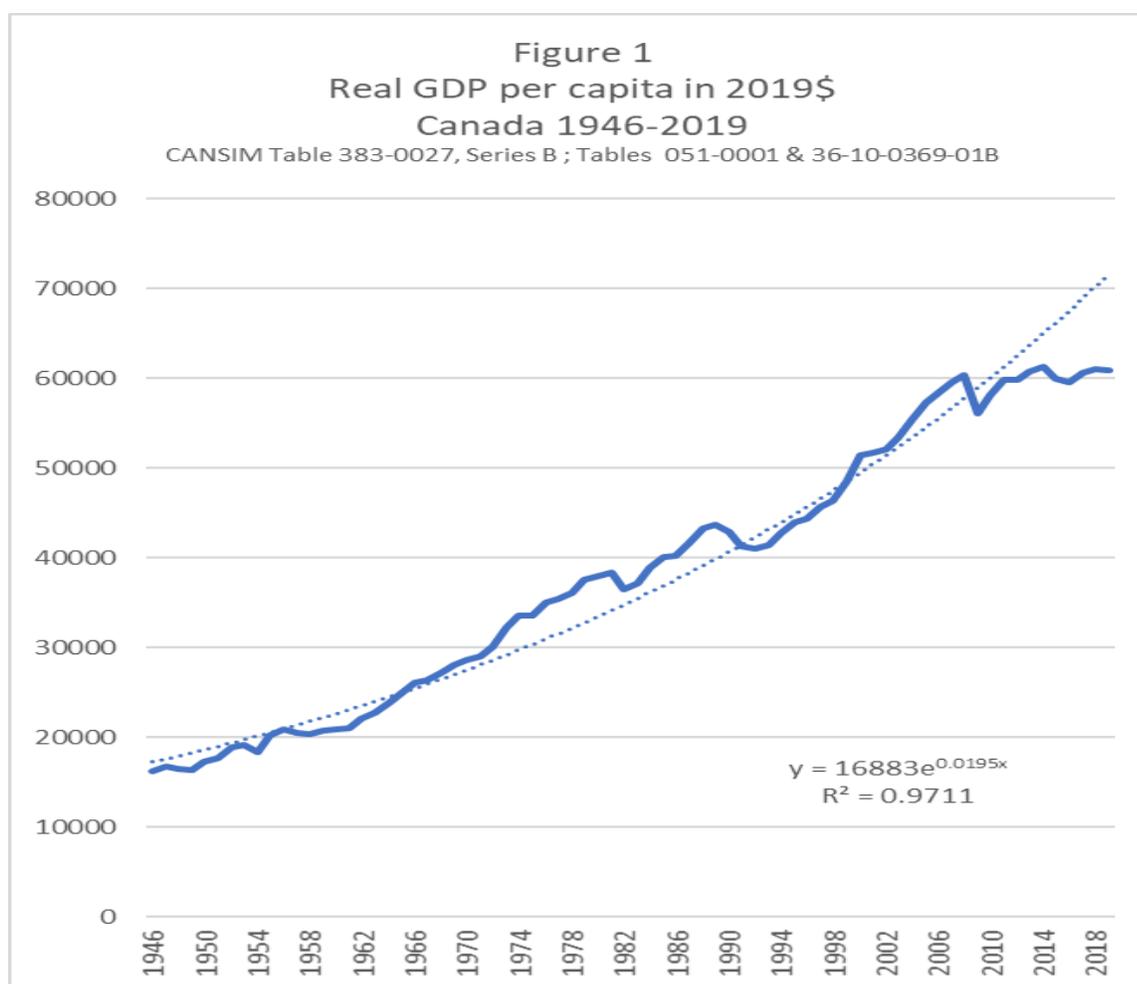
July 14, 2020<sup>1</sup>

If economic inequality is thought to be necessary to incentivize the supplies of labour, capital and entrepreneurship which produce economic growth, it can perhaps be seen as the price that a society pays to enable higher living standards. When economic growth is robust and broadly shared, this rationale for inequality may seem plausible to many people, which may reduce potential political discontent with unequal income shares and diminish demands for public policy changes. But what happens when a policy regime produces growth whose benefits are not widely shared – i.e. when mostly only the rich get richer? Or, even worse, when the economy contracts and there is less output to be shared? This essay examines the relationship between income inequality and economic growth in Canada between 1946 and 2020 and speculates about its future. It argues that the co-evolution of economic growth and income inequality in Canada can be best analyzed by distinguishing two main policy regime episodes, a balanced growth “Keynesian Consensus” phase followed by a “Neo-Liberal” period of unbalanced growth. Since the problems that policy regimes cannot solve create the social pressures that change paradigms, increasing inequality was by 2019 at the core of conflict over future policy directions – a conflict heightened by the unequal impacts of the 2020 COVID-19 Pandemic crisis and subsequent recession.

Section 1 summarizes the trends in output growth and income inequality since 1946. The “Keynesian Consensus” period (1946 – 1980) and the Neo-Liberal Ascendancy of 1981 to 2020 are then discussed in Sections 2 and 3 respectively, with a distinction between the Neo-Liberal Triumphant years 1981-2008 and the Zombie Neo-Liberal decade 2009-2019. Section 4 speculates on Post-COVID-19 scenarios and concludes.

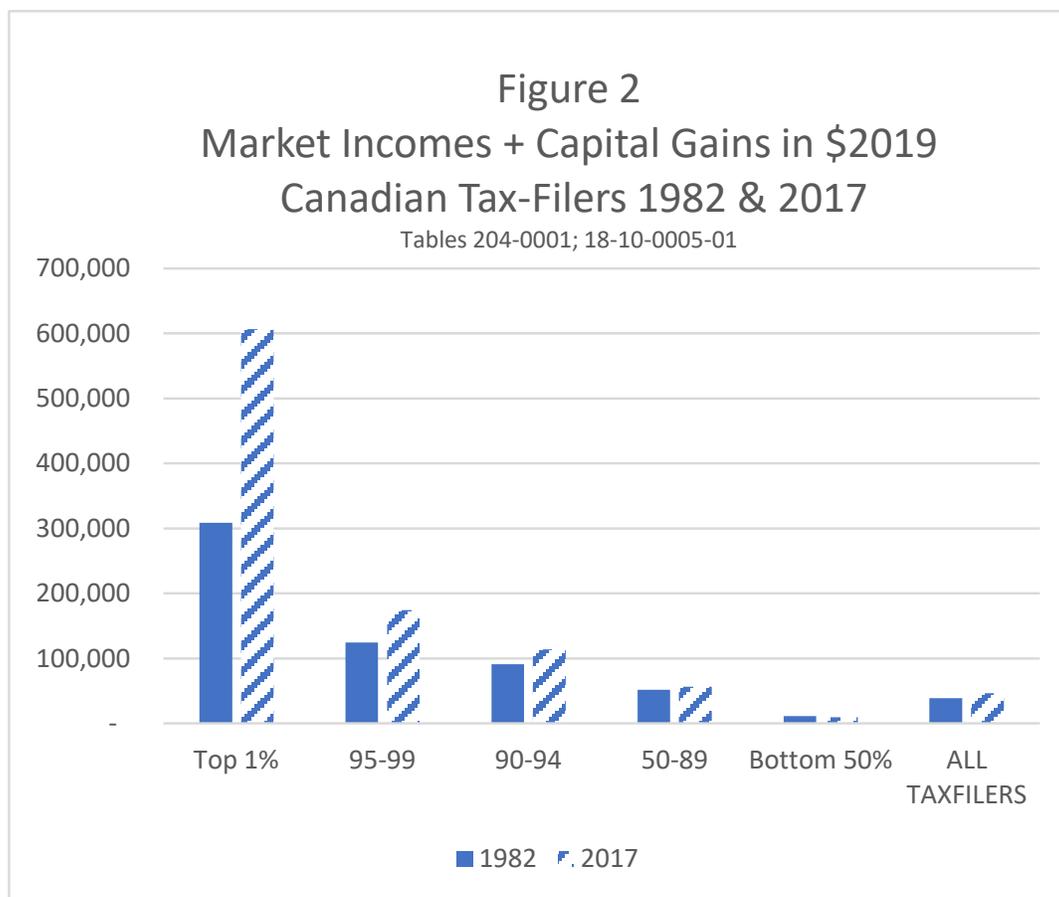
## 1. Long Term Trends

Figure 1 plots the evolution of real GDP per capita in Canada between 1946 and 2019 and compares it to a simple compound growth time trend. For this 73 year period as a whole, a simple time trend with an average 2% annual growth rate of real GDP per capita explains most of the variation in the data<sup>2</sup>. Recessions in the early 1980s and 1990s and in 2008 and 2015 show up clearly as actual declines in GDP per capita, with rebounds towards trend shortly afterwards. However, an initial recovery after the 2008-2009 Great Recession was followed by stagnation of per capita GDP growth between 2010 and 2019 – which is perhaps suggestive of a structural break in trend growth.

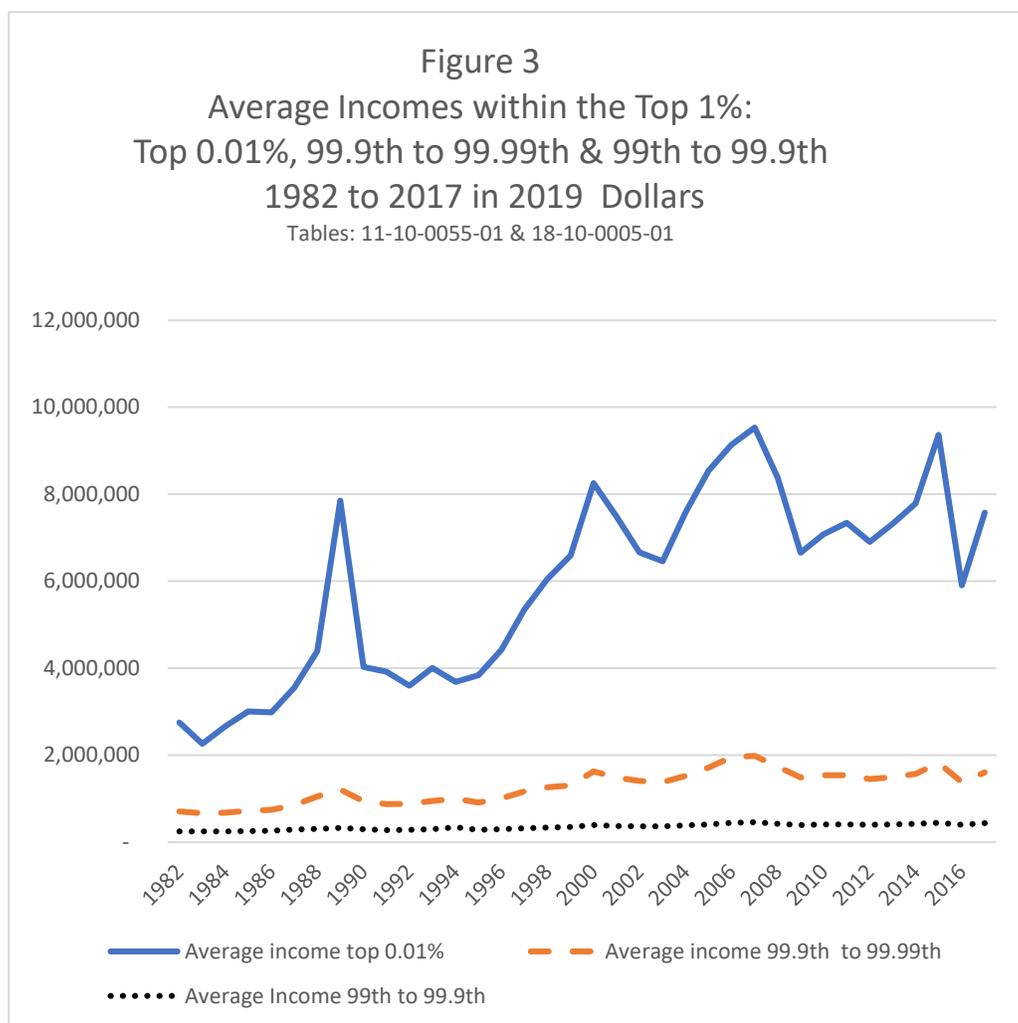


In both absolute dollar and percentage terms, growth in Canadian GDP per capita was more rapid during the “Keynesian consensus” phase of public policy than during the “Neo-

Liberal” period that followed. Measured in 2019 dollars, real GDP per capita increased annually by an average of \$640 (2.57%) between 1946 and 1980, compared to a yearly average \$596 (1.26%) from 1981 to 2019<sup>3</sup>.



However, a crucial characteristic of the Neo-Liberal period was that income gains were very unevenly shared, as Figure 2 illustrates<sup>4</sup>. While the average income of the top 1% of Canadian tax filers roughly doubled, income gains further down in the income distribution were far more modest – a still appreciable 40% gain for the rest of the top 5% but only a 10% income gain (spread over 35 years) for the upper part of the middle class (i.e. between the median and the 90<sup>th</sup> percentile) and declining average real income for taxpayers in the bottom half of the income distribution.



In the Neo-Liberal era, the general theme of inequality was that incomes grew faster, the further up one already was in the income distribution. Figure 3 illustrates with income tax data on incomes *within* the top 1%: the top 1% of the top 1% (i.e. the top 0.01%), the next 9% of the top 1% (99.9<sup>th</sup> to 99.99<sup>th</sup>) and the bottom 90% of the top 1% (99<sup>th</sup> to 99.9<sup>th</sup>). For the top 1% as a whole, average incomes increased by 121% over the 35 year period from 1982 to 2017 (from \$803,896 to \$1,774,581 in 2019 dollars). However, most of this came from the very top – the average income gains of the top 0.01% were \$4,826,759 (a 176% increase), which made the average increase of the 99<sup>th</sup> to 99.9<sup>th</sup> look puny (“only” \$188,451 or 77%)<sup>5</sup>.

As Figure 3 also illustrates, top end incomes rise and fall with the business cycle. Since executive compensation is often partly paid in stock options, top incomes fall during recessions

as capital gains on the stock market turn into losses. Canada's recessions thus stand out clearly in Figure 3. After a recession, it can take a while for incomes at the very top to recover to their previous levels – an example being the early 1990s, when recession produced a large income drop for the elite until 1995, before an even larger recovery.

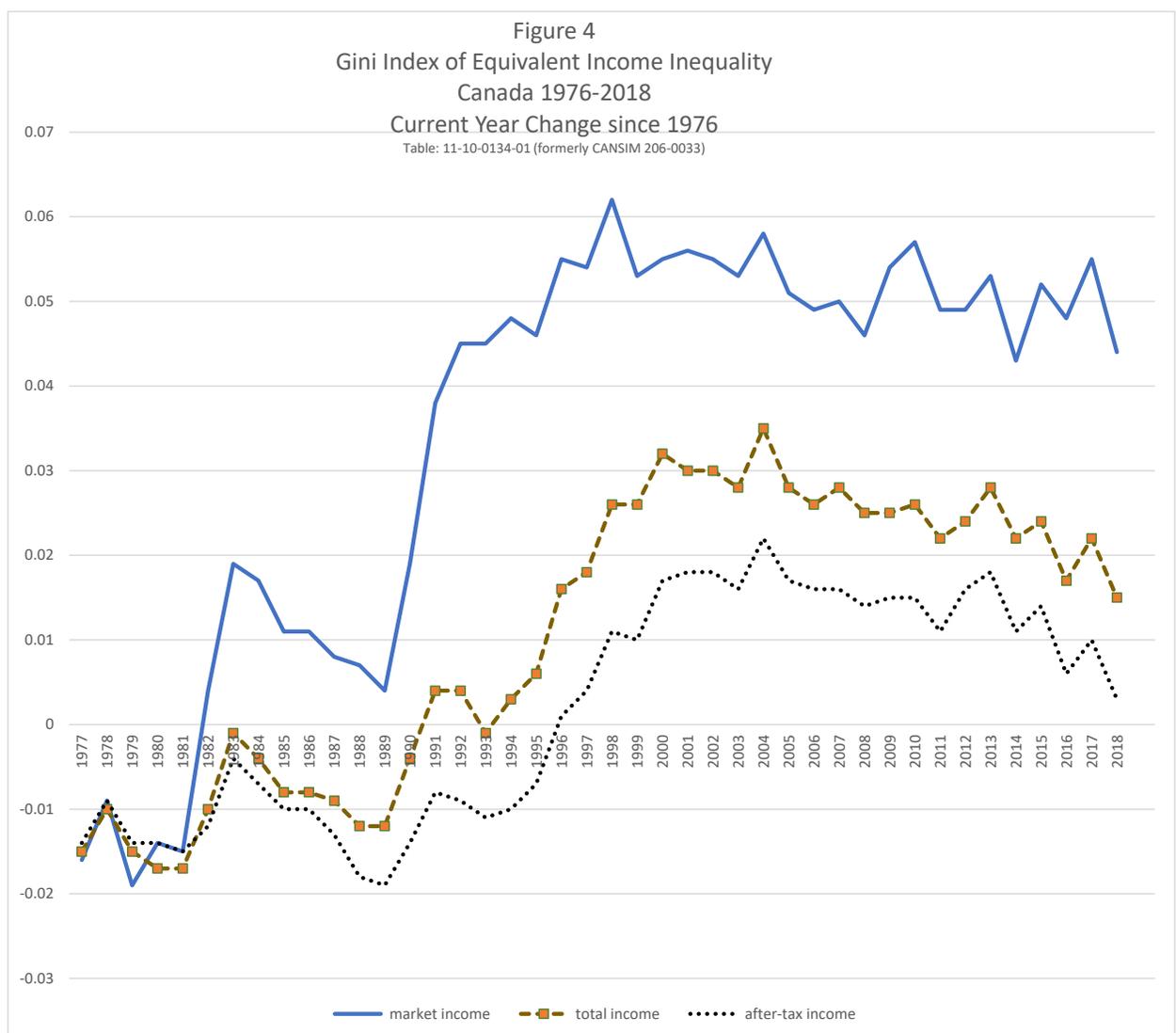
Figure 3 also illustrates how some of the variability in reported income at the top can be artefacts of tax avoidance. The upward spike in top 0.01% taxable incomes in 2015 is an example. Canada's affluent can often choose how and when they report income for taxation purposes. Because the Liberals won the 2015 election promising to raise the top rate of income tax in 2016, there was a tax advantage to shifting reported income into the 2015 tax year, which produced a surge in reported taxable income in that year, and a drop the next year.

Because there are very few billionaires, survey data rarely has enough observations on the top end to enable reliable inferences. Analysis of top incomes therefore depends on income tax data, but that is becoming increasingly unreliable, due to a long term trend to greater under-reporting of top incomes. In Canada, high-income people can often save on taxes by incorporating themselves as a Canadian Controlled Private Corporation (CCPC). The income they funnel through a CCPC does not appear on income tax forms and therefore does not show up in the Statistics Canada data on which Figure 3 is based. Wolfson, Brooks, Murphy and Veall estimated<sup>6</sup> that CCPC income in 2010 (the latest year available for their research) was at least \$48 billion, which is about 44 per cent of the total declared income of the top 1 per cent of tax filers. Since increasing tax avoidance through CCPCs meant they more than doubled as a percentage of GDP between 2002 and 2014<sup>7</sup>, the data underlying Figure 3 are, year by year, probably missing an increasingly large fraction of the actual incomes of the top 0.1%.

The Gini index of income inequality varies between zero (perfect equality – all incomes are the same) and one (complete inequality – one person has all the income). Although it is undoubtedly the single number most often used to summarize economic inequality, it mainly reflects what is happening to middle class incomes – i.e. there can be very large changes at the very top, with no changes at all in the Gini (see Osberg, 2016)<sup>8</sup>. Inequality in economic well-being also depends partly on living arrangements because family members who live together usually share in household income. Measurement of inequality therefore commonly adjusts total household income for family size (to account for the economies of scale in consumption) and

estimates, for each household member, their *equivalent* income (i.e. the income necessary to support the same effective level of consumption, if they had lived alone). Figure 4 reports the change in the Gini Index of Equivalent Income since 1976 (the first year for which this survey data was available).

In order to separate out the impacts of trends in market returns and the implications of government transfers and taxes, it reports separately trends in the Gini Index of inequality of Market Income (i.e. labour earnings plus capital income), Total Income (i.e. Market Income plus government transfers) and After-Tax Income (i.e. Total Income minus any income tax paid).



The solid line at the top shows the change, compared to 1976, in the Gini index of inequality of market income. As Figure 4 shows, from 1976 until 1981, the change was negative (i.e., inequality actually fell as market incomes became more equal), but there was a sharp increase in inequality from 1981 to 1983, mirroring exactly the increase of unemployment in the 1981 recession. The Gini index then trended downward as unemployment declined and the economy recovered from the recession between 1983 and 1989. The Gini index of market income in Canada then surged upwards from 1989 to 1992, followed by a more gradual increase until 1996 — again matching exactly the upward surge in unemployment during the recession of the early 1990s, but this time also reflecting the long period of high unemployment which followed.

Transfers and taxes have always made a considerable difference to the inequality of annual incomes in Canada<sup>9</sup>. The middle dashed line in Figure 4 is the Gini index of total income – i.e. market income from labour and capital plus transfer payments (Social Assistance plus (Un)Employment Insurance plus CPP/QPP and the Guaranteed Income Supplement or Canada Child Benefit). The third line is after-tax income, often also called disposable personal income (DPI). Because it includes the impact of income taxes, and all types of market income and all transfer payments (and is adjusted for household size), equivalent after-tax income (DPI) is arguably more relevant than market income for the inequality of annual “living standards”. However, to understand whether changes are due to changing earnings and capital incomes or to social program or tax policy changes, it is useful to look separately at trends in the inequality of all three definitions of income.

Between 1976 and 1980, the Gini index of after-tax inequality declined, mirroring exactly the decline in the Gini of market income (which indicates that the impact of taxes and transfers did not change). In the recessions of 1981–1983 recession and the early 1990s the market income Gini shot up, while the after-tax Gini rose by much less. In Canada in the 1980s and early 1990s, unemployment benefits and social assistance payments were determined by programs largely designed in the 1970s – i.e. during the Keynesian Consensus. Benefits then were higher and were received by many more people than is the case today. As unemployment surged upward in the early 1980s, increased Unemployment Insurance and other social

assistance transfer payments were able to offset a large part of the increase in market income inequality and there was a much smaller increase in after-tax income inequality than in market income inequality<sup>10</sup>.

During the 1983–1989 recovery, the Gini indices of market income inequality and of after-tax income inequality declined in parallel, reflecting the fact that there was not much change in the inequality-reducing impacts of taxes and transfer payments. During the 1989–1992 recession, Canada’s tax and transfer system kicked in again to offset much of the increase in market income inequality. Indeed, although the Gini index of after-tax income moved upward in the early 1990s, it was not until 1995 that it finally rose above its 1976 level. Throughout those years, unlike the U.S. or the U.K., Canadian inequality was not increasing because Canadian public policy decisions during the 1970s had created a tax and transfer system that successfully offset much of the increased inequality in market incomes<sup>11</sup>.

As Figure 4 illustrates, transfer payments reduce inequality more than income taxes do. However, added together, the total impact of the Canadian tax and transfer system on income inequality in Canada has always been quite significant: in 1976, a reduction of 0.084 Gini points and in 2018, a reduction of 0.125 Gini points. At its peak during the 1990s recession, in 1994, the impact of the tax and transfer system was - 0.142 Gini points. But while transfers and taxes played an increasing role in offsetting rising market income inequality until the mid-1990s, their impact reversed from 1995 to 2000, accentuating changes in market income inequality. From 2000 to 2014, the impact of the tax transfer system on the Gini index was roughly constant (about -0.12 Gini points). Since 2015, the redistributive impact of both taxes and transfers have increased slightly. The slight trend down reflects variations in the market income Gini, which in turn mirrored movement in the national unemployment rate.

Figure 4 starts with 1976 data because that is when the Statistics Canada survey data start – in the 1950s and 1960s, statistics on income inequality were usually reported in terms of the total income shares of each fifth, or quintile, of Canadian families and unattached individuals, from poorest to richest, without any adjustment for family size. As Table 1 shows, the key lesson is that changes in inequality before 1981 were small compared to changes since then. In the thirty years from 1951 to 1981, the income share of the top 20% fell by 1.2 percentage points, but from 1981 to 2018 it rose by 5.5 percentage points (i.e. its *increase* was considerably more

than the entire income share of the bottom quintile). From 1946 to 1981, income inequality in Canada was higher than in many European countries, but it was fairly stable, because balanced growth meant that real incomes increased by roughly the same percentage every year from top to bottom of the income distribution. Increasing inequality since then was thus a major change.

Table 1

## Families and Unattached Individuals: Income Shares from 1951 to 2018

	1951	1961	1971	1981	1991	1996	2001	2006	2010	2015	2018
Poorest 20%	4.4	4.2	3.6	4.6	4.5	4.3	4.1	4.1	4.1	3.9	3.9
2nd	11.2	11.9	10.6	11	10	9.6	9.7	9.7	9.5	9.3	9.5
Middle	18.3	18.3	17.6	17.7	16.4	16.4	15.6	15.7	15.4	15.4	15.5
4th	23.3	24.5	24.9	25.1	24.7	24.7	23.8	23.8	23.9	24	23.9
Richest 20%	42.8	41.1	43.3	41.6	44.4	45.2	46.9	46.8	47.1	47.4	47.1

Statistics Canada, *Income Distribution by Size in Canada*, (1998), Catalogue No. 13-207, CANSIM Table 202-0701 V1546461 to V1546465, CANSIM Table 206-0031 and Podoluk (1968)

## 2. Balanced Growth and the Keynesian Consensus

In many ways, the lack of change in income inequality in Canada before 1981 was quite remarkable, because Canada changed profoundly in many other ways between 1946 and 1981. The “baby boom” and high immigration doubled Canada’s total population, but because national income (GDP) was 4.5 times larger, per capita income more than doubled<sup>12</sup>. Urbanization and industrialization transformed the country – farmers were 27.1 per cent of the population in 1941 but less than 5 per cent by the 1970s. Horse-drawn wagons and steam engines were replaced, the telecom/computer revolution got underway and married women joined the labour force in unprecedented numbers. Medicare was introduced nationwide, post-secondary education expanded dramatically, the hippy phenomenon challenged social mores, the Canada Assistance plan funded provincial social assistance programs, Unemployment Insurance was expanded in 1971 and Old Age Security (OAS) and the CPP/QPP pension systems were established. But in the end, the distribution of annual income hardly budged, because incomes grew at roughly the same rate from top to bottom. The rich, the middle class and the poor all shared in economic growth.

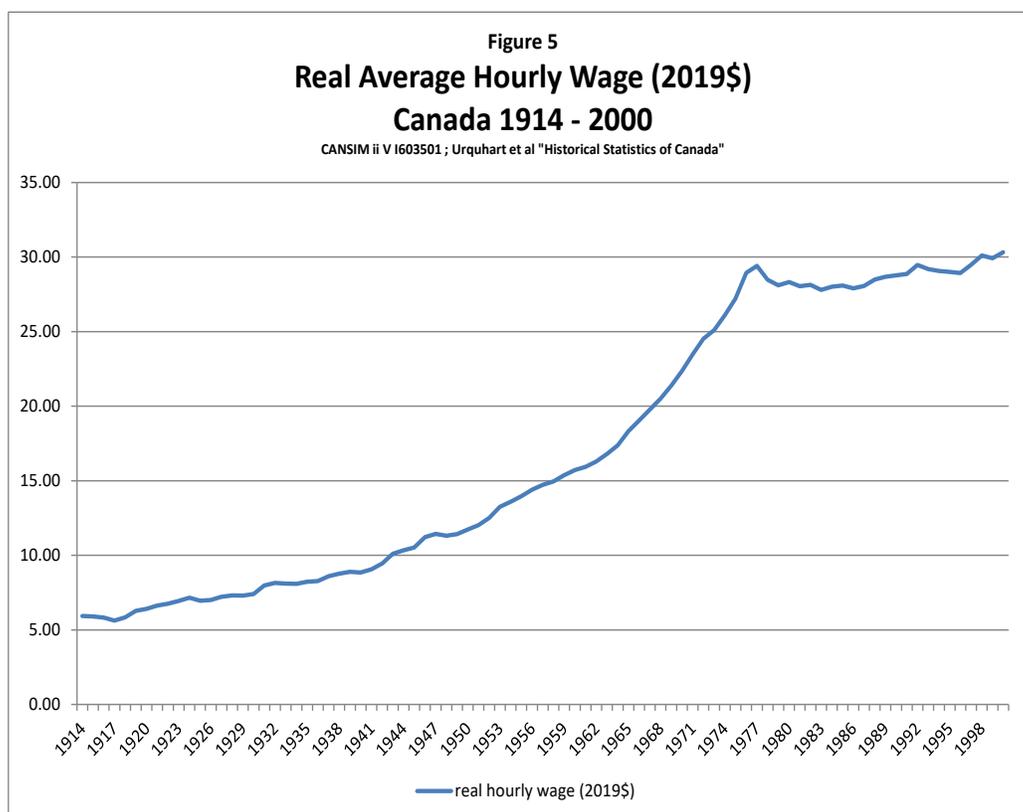
Keynesian full-employment macro-economics and welfare state social policy made balanced growth possible. It was an implicit social contract in which capitalists got growing markets, increasing dividends and continued political dominance while workers got jobs, rising wages and a taste of economic security. Like all historic bargains of political economy, it grew out of historic context, since the policy makers of the 1950s, 1960s and early 1970s had experienced the Great Depression of the 1930s and witnessed the immense suffering, loss of life and destruction of World War II. The lived experiences of the WWII generation produced, after the war, a widespread conviction that mass unemployment was the root cause of political instability and the growth of fascism and Nazism, and the totalitarian loss of freedoms and the wars which that had produced. Although influential voices had argued, throughout the 1930s, that balanced budgets and the avoidance of debt were more important than public spending, the rapid ramping up of wartime production had shown concretely how illusory these barriers to greater employment and output really were. As well, throughout the 1950s, 1960s and 1970s, domestic and international communist movements argued that mass unemployment was an inherent defect of market capitalism. This historical context produced a widespread “Keynesian Consensus” that maintaining sufficient aggregate demand to produce full employment and sharing the benefits of growth were essential functions of government.

Keynesian macro-economic demand management aimed at full employment without inflation and, for many years, was successful. After a brief Korean War surge, inflation averaged 1.4%<sup>13</sup> between 1952 and 1965 as the national unemployment rate fluctuated around an average of 5%. From 1966 to 1972, unemployment averaged 5.1% while inflation crept up somewhat to an average annual rate of 3.9%.

Keynesian macro-economics was combined with a pragmatic approach to the public sector. Canada has always had a predominantly privately-owned capitalist market economy but there was a long bipartisan tradition of pragmatically creating Crown Corporations, when deemed necessary – e.g. Liberal governments created Canadian National Railways in 1919, Air Canada (originally Trans Canada Airlines) in 1937, Polymer Corporation in 1942 and Petro-Canada in 1975 while Conservative governments created Ontario Hydro in 1906, and the CBC in 1932<sup>14</sup>. This pragmatic tradition also included occasional experiments with regulation and tripartite corporatism. Organized labour was then seen as an important stake-holder – e.g. the

Canadian Labour Congress was invited, along with representatives of the business community, to name members to the Economic Council of Canada and other bodies.

However, the 1973 oil price shock sparked a surge in inflation (to 7.8% in 1973 and 11.0% in 1974). Unemployment rose slightly, to 5.6% in 1973 and 5.4% in 1974 and the term “stagflation” was borne as confidence in the Keynesian consensus began to evaporate. In the latter 1970s, from 1975 to 1980, unemployment averaged 7.9% while inflation, despite wage and price controls 1975-1978, averaged 9.1%. But as Figure 5 shows, although price inflation created discontent, money wages rose even faster than prices and the average real hourly wages of Canadian workers grew at an annual average of 4.1% from 1970 to 1977<sup>15</sup>.



### 3. Neo-Liberalism

After 1980, inflation control became the over-riding objective of Canadian macro-economic policy. The recession of 1981-1983 was precipitated by monetary policy – interest

rates were raised to a peak of 21.3% in August 1981<sup>16</sup>. Unemployment was kept high, averaging 9.5% between 1980 and 2000. The sudden end of the growth of average compensation after the late 1970s produced by this increase in unemployment is unmistakable in Figure 5<sup>17</sup>. As Duclos and Pellerin (2016: 261) conclude that between 1980 and 2010, “Hourly compensation growth among full-time workers is driven largely by rising educational attainments. Once we remove the wage effects of changes in the composition of the labour force, average hourly compensation stagnates or even declines over the period.”

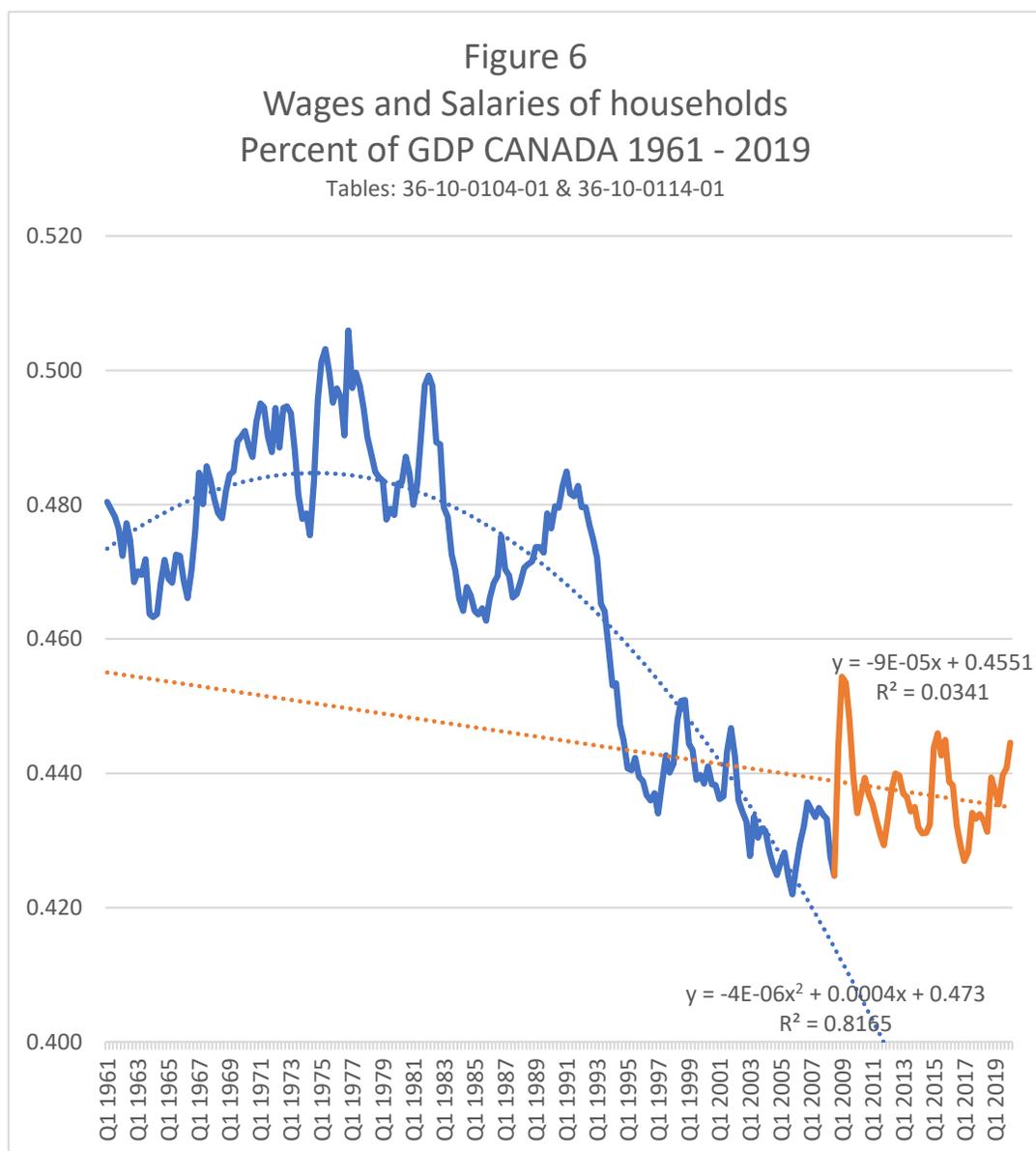
As the shift to higher unemployment might lead one to expect, after 1980 the distribution of income in Canada shifted against labour. As Figure 6 illustrates, labour’s share of Canada’s GDP fluctuates around long term trends, typically rising during the onset of a recession and falling in the recovery. The long-term trend depends on whether real wages are increasing faster or slower than the rate of growth of labour productivity – e.g. when wages rise more slowly than productivity, labour’s share of national income falls. In the 1961-2019 period, the underlying trend in labour’s share of Canadian GDP had three main phases – (1) an increasing labour share until the late 1970s, ending in 1980; (2) a trend to a declining labour share from 1981 to 2008Q3<sup>18</sup> and (3) a period since 2008Q4 of no clear trend.

The sudden stop in real wage growth and the shift in labour income share trends around 1980 coincide with the ascendancy of a “Neo-Liberal” policy regime. The Keynesian Consensus had been implemented by a generation of policy makers who had grown up in, and therefore witnessed, the Great Depression and World War II and were sceptical that the market mechanism would, by itself, produce either enough growth or a fair enough sharing of growth to be socially acceptable. But the policy makers who grew up in the 1950s and 1960s, when the Keynesian Consensus dominated economic discourse, grew up experiencing the world of stable inequality and balanced growth which the Keynesian Consensus had produced, and thinking it was normal. Social stability and balanced growth became, for them, something that could be taken for granted – assumptions<sup>19</sup>, not objectives. Faith in the market mechanism returned.

Faith in the efficiency advantages of markets to maximize total national income and belief in the unimportance of equity considerations about how that income is distributed underly the Neo-Liberal agenda. In this framework, governments should facilitate the operation of markets to the maximum extent possible, without worrying much about inequality implications.

In monetary policy, it means limiting the objective of the Bank of Canada to maintaining low inflation and jettisoning any mention of, or commitment to, maintaining full employment. In fiscal affairs, the policy priority became balancing the annual public sector budget and limiting its share of GDP. In trade policy, broadening the scope and size of markets through trade agreements which reduced tariffs, constrained regulations and removed any impediments to the movement of capital replaced economic nationalism. Rationalized by a rhetoric extolling the importance of labour supply incentives, social policies for poor and middle-class people (like unemployment insurance or social assistance) were slashed while for the affluent, top marginal tax rates and corporate tax rates were lowered. Pragmatism about the public sector's role was replaced by a dogmatism that the private sector is always more efficient, which was used to justify the privatization of Crown Corporations and the sub-contracting of activities within government.

Each of these policy ideas was advocated as necessary reform that would produce faster economic growth. Each can be debated on its individual merits – the benefit of using a generic summary term like “Neo-Liberalism” is as compact notation for an intellectually coherent set of policies which tended to reinforce each other in their practical implications – and which became, in short order, a dominant perspective in academic economics and within Canada's corporate, bureaucratic and political elite. Canadian governments implemented neo-liberal structural reforms like deregulating and privatizing Crown corporations (e.g. CN Rail, Air Canada, PetroCanada, Ontario Hydro) and signing a host of accords and free trade agreements, including the Canada-US Free Trade Agreement, the North American Free Trade Agreement and the World Trade Organization accords. Austerity in spending and tax cuts dominated fiscal policy discussion while monetary policy targeted low inflation (successfully) and the very word “unemployment” largely disappeared from official policy documents<sup>20</sup>.



However, although Neo-Liberalism did define the policy agenda of governments and did produce rising incomes for the top end of the income distribution, the sudden stop of real hourly wage growth in Canada throughout the 1980s and 1990s meant it did not deliver increasing prosperity to most Canadians. If real wages had increased, there might have been an interesting debate about which of these neo-liberal policies was responsible, or whether it was due to the substantial increase in the education and experience of Canada's workforce (the fraction of full-time workers with some college or more increased by 26.6 percentage points over the 1980–2010

period<sup>21</sup> and Canada's baby boomers entered the most highly paid years of their careers). But although Canadians were repeatedly assured this policy framework and all these institutional reforms would produce continually increasing prosperity, middle class incomes stagnated for twenty years until rising oil prices motivated an energy sector investment boom in Alberta, Saskatchewan and Newfoundland after 2000<sup>22</sup>. When that boom ended with the collapse of oil prices in 2014, real wage growth collapsed as well.

Intellectually, the 1980-2008 period of Triumphant Neo-Liberalism had been marked by remarkable hubris. Lucas, for example, had famously declared: "macroeconomics ..has succeeded: Its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades<sup>23</sup>". Macro-economists had routinely congratulated themselves on the presumed end of the business cycle and a "Great Moderation" of economic fluctuations. But this complacency was shattered by the depth and unforeseen suddenness of the Great Recession triggered by the Financial Crisis of 2007-2008, the slow speed of recovery and the consistent failure of macro-economic models to predict both the 2008 crisis and the slowness of recovery<sup>24</sup>.

Indeed, the 2009-2019 period probably deserves a "Zombie Neo-Liberalism" label, because although the Great Recession shattered the unquestioning faith in markets that had underpinned the credibility of the Neo-Liberal agenda, no coherent alternative policy paradigm emerged. Some policies therefore staggered on while others morphed incoherently into new forms. Emergency conditions in 2009 had necessitated massive increases in public spending and the national debt, as well as a sudden, previously inconceivable, public ownership role in major sectors, breaking major taboos on deficits and public ownership. Although governments could and did sell off their stock holdings (e.g. in auto makers) after 2010, returning to the certitude of the balanced budget mantra proved much more elusive. Indeed, the fiscal orthodoxy faith faced major defections. Rachel and Summers for example, argued<sup>25</sup> that public sector deficits since 2000 have been a good thing, because growth would have been even slower if governments had not injected aggregate demand by running increasing deficits.

A major tenet of the neo-liberal faith had also been the importance of low and stable inflation and the belief that inflation control should be the only objective of central bankers. But during the Financial Crisis and Great Recession the importance of maintaining the stability of the banking system was suddenly rediscovered. And in its aftermath, central bankers also

rediscovered that a major disadvantage of low inflation is the ineffectiveness of monetary policy that occurs when the zero lower bound on nominal interest rates has been reached.

The disadvantages of macro-economic neo-liberalism thus received more attention after 2010. The political economy implications of increasing inequality and rising insecurity also became more apparent, as populist appeals to the “left-behinds” of a globalized world of market dominance and welfare state withdrawal produced Brexit, Trump and ongoing political instability in many countries. But when zombies stagger on, inertia partly determines their direction – micro-economic neo-liberalism largely kept its trajectory. Rebranding Unemployment Insurance as Employment Insurance while cutting benefits and accessibility had, for example, been part of the mid 1990s austerity package – a drastic reduction in the social insurance role of the Canadian state and an increase in workers’ exposure to earnings risk that only worsened as the “gig economy” of insecure employment expanded in the 2000s. But in the neo-liberal faith, unemployment is believed to be almost always voluntary, so little need for a social safety net is perceived. In Canada, an implication of that belief was that Employment Insurance became increasingly inadequate as a social safety net, even before the COVID-19 pandemic hit.

#### 4. The COVID-19 Pandemic: Implications for Inequality

Between February and April of 2020, 5.5 million Canadian workers, amounting to 28.5% of the workforce, lost their jobs or all or most of their workhours. In February 2020, the official unemployment rate had been 5.9%, but its increase to a historic high of 13.8% by May understated the job market crash because it did not count the increase in jobless people who had not looked for work, believing none was available. If they had also been counted as unemployed, the May 2020 unemployment rate would have been 18.2%.<sup>26</sup> Although the uncertainty surrounding even short-term forecasts was such that the Bank of Canada’s April quarterly policy report avoided making any projections, the Parliamentary Budget Office (2020) forecast a 12% decline in annual GDP during 2020.

As Figure 1 has shown, growth in GDP per capita stagnated from 2010 to 2019 – and even before COVID-19 hit Canada in March of 2020, growth was slowing further. There was considerable uncertainty about how Canada could adapt to the end of the Oil Boom that had

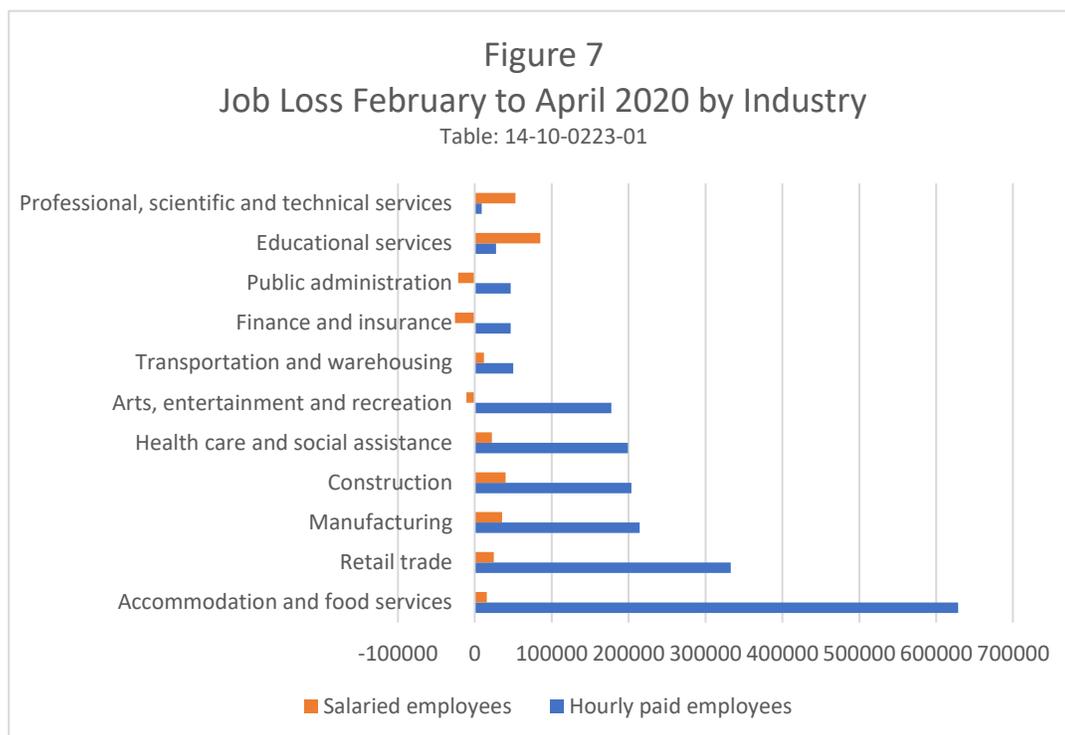
fueled prosperity until 2014 (especially in Western Canada), about the costs of population aging and its impacts on labour force growth and potential output, and about slowing productivity growth and the possibility of secular stagnation of GDP per capita. Layered on top of these long-term uncertainties were shorter term worries about the impacts of slowing investment and the implications of trade wars between the U.S. and China and Europe. Growth rate forecasts for Canada (e.g. by the OECD or IMF) were thus low by historic standards and being marked down further, even before COVID-19 surfaced in China in January 2020. Coincident with the pandemic, the Russia/Saudi Arabia price war depressed oil prices sharply. But the COVID-19 pandemic eclipsed all those issues, morphing with incredible speed, severity and worldwide synchronization from a global medical emergency into a global economic disaster.

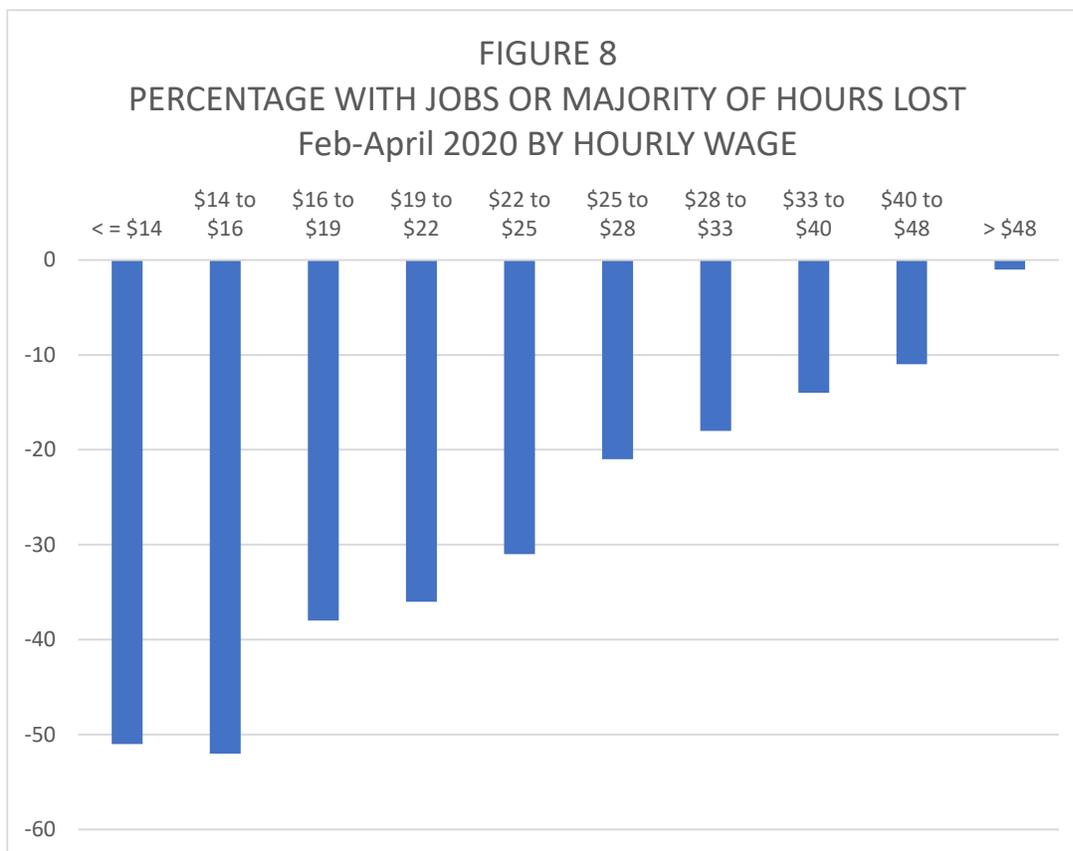
This paper has thus far contrasted balanced growth and stable income inequality during the Keynesian Consensus years with unbalanced growth and increasing inequality during the Neo-Liberal era. A major theme has been the importance of policy regimes to the sharing of the benefits of economic growth, and the social and political stresses created by unequal sharing. But by mid 2020, COVID-19 had already shown itself to be an unprecedentedly large negative shock to current output. The likelihood of a second pandemic wave and the uncertainty surrounding when or if any possible vaccines might arrive implied that COVID-19 would depress aggregate demand for several years, at minimum. Potential output also declined because the costs of adaptation (e.g. in physical distancing) amounted to a large negative shock to productivity, implying a slower future growth rate of potential output, from a diminished base. Hence, the COVID-19 pandemic changed the social problem. Instead of choosing the policy framework determining how the benefits of growth are shared, the problem became choosing the policy regime which allocates the costs of contraction,

The income distributional impacts of COVID-19 comprise the impacts of: (a) the initial lockdown shock; (b) the loss of output and income in the “new normal” of the recession following the end of the initial lockdown and (c) the changes to social and economic policy regimes driven by the political economy implications of [a] and [b].

In the short term, Canada’s Parliamentary Budget Office estimated<sup>27</sup> that “Relative to a counterfactual scenario in which the COVID-19 pandemic and oil price shocks did not occur, the level of nominal GDP in 2020 would be \$395 billion (16.6 per cent) lower.” At the time this

forecast was made, \$146 Billion in federal budgetary measures had been announced – a massive increase in federal spending and the federal deficit, but still substantially less than half of the income losses incurred in the downturn. These initial losses were very unequally distributed. Salaried professionals who could transition to working from home saw little change in income while the closure of workplaces involving face to face interaction meant drastic job cuts in the hospitality, travel and retail sectors<sup>28</sup>. Since the job-losing industries have always been disproportionately female, younger and lower-waged, these groups were dramatically affected. Figure 7 shows the very different losses of hourly paid and salaried workers, by industry and Figure 8 is a compact summary by hourly wage level of the distributional impact of the lockdown. In the COVID-19 world, continuing downward pressure on real wages at the bottom end of the wage distribution, increasing the inequality of market incomes, is to be expected.





But could changes in taxes and transfers shift the burden of COVID-19? The speed of events in 2020, when multi-billion dollar social programs were created and implemented in a matter of weeks, constituted an important “possibility proof” – that dramatic social policy changes can happen rapidly. The pandemic shock also revealed the failings of Canada’s public health system, the inadequacy of its social safety net and the importance of both to the well-being of Canadians. The issue, therefore, rapidly became one of political economy – whether the “new normal” of the Post-COVID-19 world would pivot back to Zombie Neo-Liberalism or be replaced by a new vision.

Even before COVID-19, the phrase “Green New Deal” had become shorthand for an activist public policy regime rejecting globalization and market dominance and emphasizing accelerated transition to a carbon free economy and greater economic equity, in the threefold sense of greater equality of opportunity, greater equality of income and wealth and greater

economic security. This vision requires greater public spending and greater tax revenue (e.g from a wealth tax and higher top income tax rates). But if COVID-19 produces slower growth, after a recession of indeterminate duration, higher taxes have to come out of a smaller national income. Although Canada's affluent did very well for themselves during the Neo-Liberal era, there was no evidence in 2020 that their appetites for increased income shares had abated. Hence, a clear prediction about the political economy impacts of COVID-19 is increased conflict over income shares.

Will the political economy of the post COVID-19 world ultimately be shaped by the same faith in low taxes and market based individualism that fueled Neo-Liberalism?<sup>29</sup> The COVID-19 pandemic is the formative experience of a whole generation, and will shape their lifetime political perspectives. In a pandemic, each individual's chances of remaining healthy depend on the health and behaviour of their fellow-citizens. As a concrete experience of a community's shared fates, it has been much more immediate than the gradual experience of climate change – but “we are all in this together” is the main lesson of both. Having so many incomes evaporate overnight, in a way that so obviously is not due to personal failings, is also an experience likely to produce a greater general appreciation of the insurance value of social safety nets. The Millennial generation also saw the Great Recession of 2008, entered the gig economy and rising top end inequality of the 2000s, incurred much of the earnings loss of the COVID-19 recession and can anticipate bearing the costs of climate change. Their early life experiences are thus very different from the social stability and shared prosperity that (thanks to Keynesian Consensus policies) shaped the Baby Boomers.

This essay has contrasted the balanced growth and stable inequality of the Keynesian Consensus era 1946-1980 with the unbalanced growth and increasing top end income shares of the Neo-Liberal years which followed. It has contrasted the policy choice of both past regimes – how to share the gains from growth – with the possibility that the immediate future of a post-COVID-19 world will be dominated by a more depressing choice – how to allocate the costs of contraction. As always, that choice will be conditioned on prior experiences. The era of Keynesian Consensus decision-making saw full employment and sharing of the gains from growth as central issues, because that generation had seen the costs of social instability. And although they could not solve the problem of inflation, they left a social insurance system and a

history of stable inequality to their Neo-Liberal successors which muffled initial discontent with the high unemployment, stagnant wages and increasing inequality of Neo-Liberalism. Neo-Liberalism could not produce fairness – and that matters. When social insurance protections are dismantled and top end incomes grow faster than middle class incomes, inequality and insecurity increase over time – so the legacy of Neo-Liberalism includes the populist political reaction of those who were “left behind”. The failures of Neo-Liberalism will therefore condition Canada’s responses to the challenges of the post-COVID-19 world.

<sup>1</sup> The comments of Mike Bradfield, Brian Gifford and Brian MacLean have significantly improved this essay. Remaining errors are mine alone.

<sup>2</sup>  $R^2 = 0.971$ .

<sup>3</sup> From 1981 to 2008, an average annual growth rate of 1.7%. Tables 383-0027, Series B ; 051-0001 & 36-10-0369-01 for 1946-1980; Table 36-10-0104-01 from 1981 to 2019

<sup>4</sup> Statistics Canada. Table 204-0001 – this data series begins in 1982 and had only been updated to 2017 at the time of writing in June 2020. All Items CPI (Table 18-10-0005-01) used to convert to 2019 Dollars.

Average Market Income + Capital Gains: in \$ 2019

	<u>1982</u>	<u>2017</u>	<u>2017/1982</u> <u>Ratio</u>	<u>2017– 1982</u> <u>Change</u>
Top 1%	308,911	606,681	1.96	+297,770
95-99	124,357	174,380	1.40	+50,023
90-94	90,914	113,577	1.25	+22,662
50-89	51,464	56,580	1.10	+5,115
Bottom 50%	10,900	9,387	0.86	- 1,513
ALL				
TAXFILERS	38,645	46,098	1.19	+7,453

<sup>5</sup> Average Incomes Within the Top 1%: \$2019 (Source Tables same as endnote 4)

	<u>1982</u>	<u>2017</u>	<u>2017/1982</u> <u>Ratio</u>	<u>2017-1982</u> <u>Change:</u>
<b>Top 0.01%</b>	<b>2,745,020</b>	<b>7,571,779</b>	<b>2.76</b>	<b>4,826,759</b>
<b>99.9th to 99.99th</b>	<b>704,057</b>	<b>1,600,920</b>	<b>2.27</b>	<b>896,864</b>
<b>99th to 99.9th</b>	<b>245,356</b>	<b>433,807</b>	<b>1.77</b>	<b>188,451</b>

<sup>6</sup> See Wolfson, M., Brooks, N., Murphy, B. & Veall, M. R., (2016), ‘Piercing the Veil – Private Corporations and the Income of the Affluent’, *Canadian Tax Journal* 64(1) 1-30.

<sup>7</sup> Increasing from 3.1% of GDP in 2002 to 6.9% in 2014 – see Finance Canada (2017) *Tax Planning Using Private Corporations* Background Paper: page 11, Chart 4

<https://www.canada.ca/content/dam/fin/migration/activity/consult/tppc-pfsp-eng.pdf>

<sup>8</sup> See “On the limitations of some current usages of the Gini Index” *Review of Income and Wealth*, Series 63, No. 3, September 2017, Pages 574 to 584, (published online 28 September 2016 DOI: 10.1111/roiw.12256)

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Gini Index of Equivalent Income: Canada 1976-2018

	<u>1976</u>	<u>1981</u>	<u>1986</u>	<u>1991</u>	<u>1996</u>	<u>2001</u>	<u>2006</u>	<u>2011</u>	<u>2016</u>	<u>2018</u>
market income	0.384	0.369	0.395	0.422	0.439	0.44	0.433	0.433	0.432	0.428
total income	0.33	0.313	0.322	0.334	0.346	0.36	0.356	0.352	0.347	0.345
after-tax income	0.3	0.285	0.29	0.292	0.301	0.318	0.316	0.311	0.306	0.303

Source: Table: 11-10-0134-01

<sup>10</sup> See Frenette, Green and Milligan (2009)

<sup>11</sup> See Osberg, Lars (2003) “Long Run Trends in Income Inequality in the USA, UK, Sweden, Germany and Canada - A Birth Cohort View” *Eastern Economic Journal* Vol. 29, No. 1 Winter 2003, Pp.121-142

<sup>12</sup> To 227 per cent of its 1946 level. See CANSIM v480567, v466668, v742084-6, v742092-4.

<sup>13</sup> Figures taken from Table 326-0021– All Items Consumer Price Index and Table: 14-10-0078-01 (formerly CANSIM 282-0086) Official Unemployment Rate

<sup>14</sup> Originally, the Hydro-Electric Power Commission of Ontario and the Canadian Radio Broadcasting Commission

<sup>15</sup> Figure 5 splices together two data series (1914 to 1961 and 1961 to 2000). It shows real average hourly labour compensation defined as total labour compensation (taken from the National Income accounts, and therefore including the employer cost of CEO stock options, as well as social insurance contributions and fringe benefits such as employer paid pensions), adjusted for changes in the consumer price index and divided by total hours worked in the economy.

<sup>16</sup> For a 5 year residential mortgage = see CANSIM V122497

<sup>17</sup> Figure 5 stops at 2000 and does not attempt to splice in succeeding series, because the labour compensation of all employees includes the pay of top executives, whose salaries and stock options increased rapidly after the mid-1980s. Increases at the top end pulled up average compensation even as middle-class earnings stagnated, making *average* compensation an increasingly unreliable indicator of general living standards.

<sup>18</sup> Canada’s experience was not unusual. As the IMF (2017:5) has noted: “In advanced economies, labor income shares began trending down in the 1980s, reaching their lowest level of the past half century just prior to the global financial crisis of 2008–09.” see Mai Chi Dao, Mitali Das, Zsoka Koczan, Weicheng Lian (2017) *Why is Labor Receiving a Smaller Share of Global Income? Theory and Empirical Evidence*. IMF Working Paper WP/17/169 Research Department, International Monetary Fund, July 2017

<sup>19</sup> Representative Agent Macro-economics, for example, by assumption has no possibility of conflict over distributional.

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- <sup>20</sup> See Osberg, Lars (2011), 'Why did unemployment disappear from official macro-economic policy discourse in Canada?', in Fred Gorbet and Andrew Sharpe, (eds), *New Directions for Intelligent Government in Canada: Papers in Honour of Ian Stewart*, Ottawa: Centre for the Study of Living Standards, pp. 127-165.
- <sup>21</sup> See Duclos, Jean Yves and Pellerin, M. (2016). The evolution of hourly compensation in Canada between 1980 and 2010, *Canadian Public Policy*, 42 (3; Table 4
- <sup>22</sup> See Green, David A. , René Morissette, Ben M. Sand and Iain Snoddy, (2019). "**Economy-Wide Spillovers from Booms: Long-Distance Commuting and the Spread of Wage Effects**," *Journal of Labor Economics*, University of Chicago Press, vol. 37(S2), pages 643-687.
- <sup>23</sup> Lucas, Robert E. Jr (2003), 'Macroeconomic priorities', *American Economic Review*, March, 1–14
- <sup>24</sup> See Turner, D. (2016), 'The use of models in producing OECD macroeconomic forecasts', in *OECD Economics Department Working Papers*, No. 1336, Paris: OECD Publishing;  
Guénette, Justin-Damien, Nicholas Labelle St-Pierre, Martin Leduc, and Lori Rennison (2016), 'The case of serial disappointment', Staff Analytical Note/Note analytique du personnel 2016-10, Bank of Canada;  
Lewis, Christine, and Nigel Pain (2015), 'Lessons from OECD forecasts during and after the financial crisis', *OECD Journal: Economic Studies*, 2014(1), 9–39.
- <sup>25</sup> Rachel, Łukasz and Lawrence H. Summers (2019) "On Falling Neutral Real Rates, Fiscal Policy, and the Risk of Secular Stagnation" *Brookings Papers on Economic Activity* 2019  
<https://www.brookings.edu/wp-content/uploads/2019/03/On-Falling-Neutral-Real-Rates-Fiscal-Policy-and-the-Risk-of-Secular-Stagnation.pdf>
- <sup>26</sup> Statistics Canada. Table 14-10-0077-01 Supplementary unemployment rates, monthly, unadjusted for seasonality
- <sup>27</sup> Parliamentary Budget Office (2020) *Scenario Analysis Update: COVID-19 Pandemic and Oil Price Shocks 30 April 2020*  
<https://www.pbo-dpb.gc.ca/en/blog/news/RP-2021-005-S--scenario-analysis-update-covid-19-pandemic-oil-price-shocks--mise-jour-analyse-scenario-chocs-dus-pandemie-covid-19-chute-prix-petrole>
- <sup>28</sup> See Messacar, Derek, René Morissette and Zechuan Deng (2020) Inequality in the feasibility of working from home during and after COVID-19. Statistics Canada Cat No 45280001 June 2020
- <sup>29</sup> In 2019, well before the COVID-19 crisis, about half of Americans under 45 expressed a preference for living in "socialist" country – see <https://www.documentcloud.org/documents/6145923-Axios-Tabs-1.html>