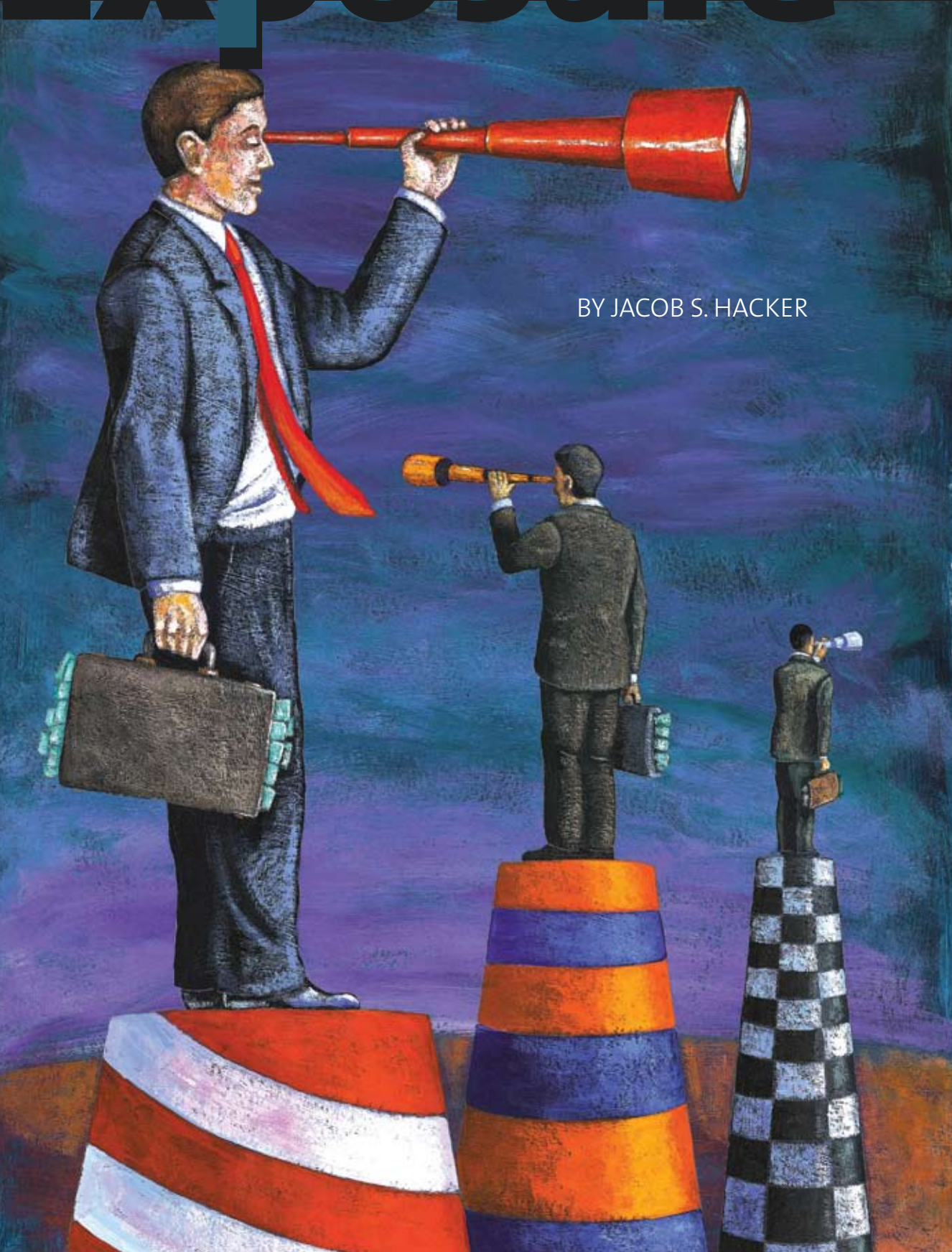


# Northern

LEARNING FROM CANADA'S RESPONSE TO WINNER-TAKE-ALL INEQUALITY

# Exposure

BY JACOB S. HACKER



If, as George Bernard Shaw once noted, “England and America are two countries separated by a common language,” Canada and America are two countries separated by a common language and a 5,500-mile border. Sister nations in the eyes of the rest of the world, the two enjoy a relationship marked by ambivalence on one side and indifference on the other. Avid consumers of American media and goods, Canadians nonetheless worry that their country will become too American: too individualistic, too crass, too disorderly, too materialistic. Meanwhile, despite regular cross-border infusions of Canadian pop music and comedic talent, Americans mostly ignore their northern neighbor. So marginal is Canada in the American view of the world that just the idea of the United States invading the country—the subject of not one but two hit comedies, *Canadian Bacon* (starring Canadian John Candy) and *South Park: The Movie* (featuring the Oscar-nominated song “Blame Canada”)—is seen as hilarious.

Today, however, a cross-border invasion of sorts is taking place. It does not involve tanks or troops, of course. It involves inequality—in particular, the growing concentration of income at the top of the economic ladder. Over the last generation, the United States and Canada (along with Shaw’s United Kingdom) have seen a remarkable rise in the fortunes of their richest citizens. In 1972, the richest 1 percent of Americans earned just over 5 percent of the nation’s income. During the 1980s and 1990s, however, their share of national income rose to nearly 13 percent. A similar, if more muted, trend has played out in Canada, though roughly a decade later: The share of national income earned by the richest 1 percent of Canadians rose sharply in the 1990s, exceeding 10 percent of national income by 2000.

It is tempting to see the rising fortunes of the super-rich in Canada and the United States as the result of the same overarching global causes. In the conventional account of growing inequality, after all, every rich nation is experiencing the pressures of increased foreign competition and of new technologies, like computers, that have expanded the

riches of the skilled. In this view, rising inequality is driven by market forces and has little to do with politics and public policy, except insofar as government steps in to help those on the losing end of these transformations. Yet the experiences of Canada and the United States suggest a different perspective, and different prescriptions for combating rising inequality. Runaway inequality and its negative effects have been much more limited in Canada than in the United States—a striking contrast that has much less to do with market forces than it does with political realities that have made Canadian leaders more responsive to the concerns of less affluent citizens.

### “Winner-Take-All” Inequality in the United States and Canada

At first glance, the well-off in Canada and the United States have experienced similar fortunes in recent years. The income required to be in the top 5 percent of families is almost identical for the two countries: \$154,000 in Canada, \$165,000 in the United States—which indicates just how similar the two countries are in overall wealth. Yet once we start looking within the top 5 percent, it becomes clear that the affluent in the United States are living in a truly distinctive world. The average income of the top 5 percent of families in the United States is \$416,000, fully 40 percent larger than the average income of the top 5 percent in Canada (\$296,000). The difference reflects the extreme concentration of income at the very top within the United States: The American super-rich—the top tenth of 1 percent (0.1 percent) and especially the top one hundredth of 1 percent (0.01 percent)—have far outpaced their Canadian counterparts.

The differences are jaw-dropping. The richest 0.01 percent

in Canada had average incomes of \$8.4 million in 2004. That sounds pretty impressive—until one discovers that this figure was less than a third of the average income earned by the top 0.01 percent in the United States (\$25.8 million). F. Scott Fitzgerald once remarked that the “very rich are different from you and me.” Ernest Hemingway replied, “Yes, they have more money.” It turns out that America’s super-rich are different from you, me, and the Canadian rich. They have lots more money.

Nonetheless, as Figure 1 shows, both countries have returned to levels of income concentration not seen since before the Great Depression. Other rich nations (again, with the exception of the United Kingdom) have seen nothing like this concentration of riches at the top.

### The More Limited Reach of Canadian Inequality

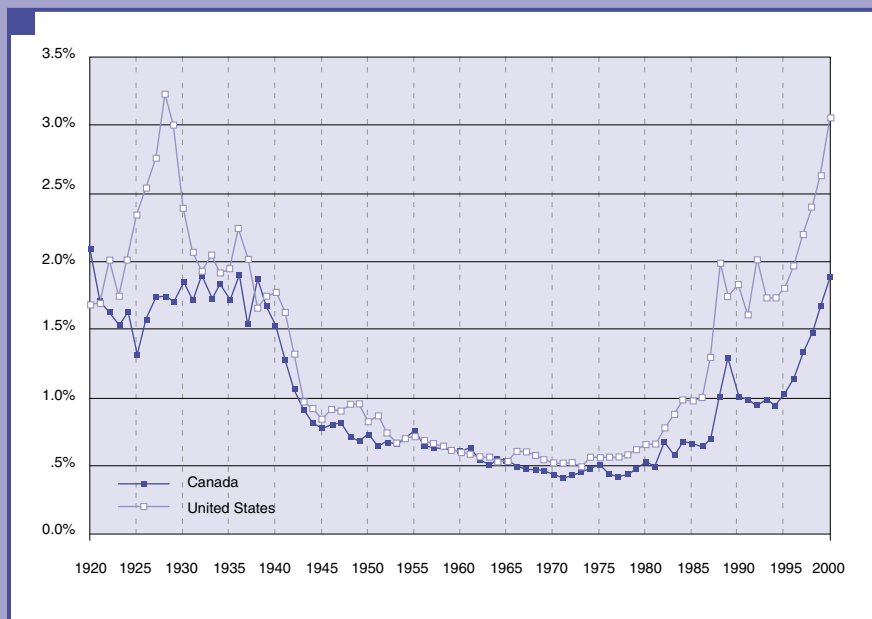
Looking beneath the very top, the tale of two countries becomes even more divergent. Economic inequality among most of the population has scarcely increased at all in Canada, and the economic standing of those at the bottom and the economic security of the middle class have both remained highly resilient. This stands in stark contrast with the United States, where winner-take-all gains at the top have been accompanied by a broad increase in inequality across the income distribution and a marked decline in the economic security of the middle class.

Consider the well-known Gini index, a measure of income distribution that is particularly sensitive to inequality in the middle of the income distribution, rather than at the extremes. From the early 1970s to 2000 in Canada, there was no measurable increase in the Gini index for family income after government taxes and benefits were taken into account—none at all. (The figures cited earlier on incomes at the top are before taxes and benefits, meaning that they don’t capture how Canadian tax and benefit policy reduces the ultimate level of take-home income inequality. They are also based on tax statistics, which better capture income at the very top, while the figures used to calculate the Gini index are from surveys of income that generally reach few truly rich people.)

Measured by the Gini index, Canadian inequality did increase modestly in the late 1990s, but it declined in the late 1970s and barely budged in the 1980s and mid-1990s, even while inequality in after-tax income increased substantially. Importantly, the reason for the stability in the Canadian measure is not that disparities in what people earned remained constant—in fact, they increased—but that Canadian policies did more to offset earnings inequality, keeping inequality after taxes and benefits largely constant.

Nor has poverty increased in Canada since the 1970s—again, in contrast with

FIGURE 1. Income share of the top 0.01% in Canada and the U.S.



Source: Emmanuel Saez and Michael R. Veall, “The Evolution of High Incomes in Northern America: Lessons from Canadian Evidence,” *American Economic Review* 95:3 (2005): 836.



the United States. Using a simple cross-nationally comparable measure of relative poverty (less than 50 percent of median income), poverty declined in Canada from 16 percent to 12.4 percent between 1971 and 2000. In the United States, relative poverty rates increased from 15.8 percent to 17.3 percent between 1974 and 2004. And this divergence occurred despite the fact that Canadian median income grew faster over this period than did American median income.

Finally, economic security has eroded far less in Canada since the 1970s as compared with the United States. Economist Lars Osberg has developed an index of economic security based on the risk of unemployment, the share of disposable income spent on medical care, and the risk of poverty in old age and among lone-parent families. As Figure 2 shows, Canadian citizens saw a decline in economic security by this measure in the late 1970s and the 1990s, and today stand at about the 1971 level. Americans, by contrast, witnessed a much sharper and earlier decline in economic security, with a sustained rise only during the strong economy of the late 1990s. My own research on the United States, looking at trends in family income instability and changes in the security of retirement and health benefits and family finances up through the mid-2000s, shows a dramatic decline in economic security as employers and government have transferred risk onto workers and their families—a trend that I term the “great risk shift.”

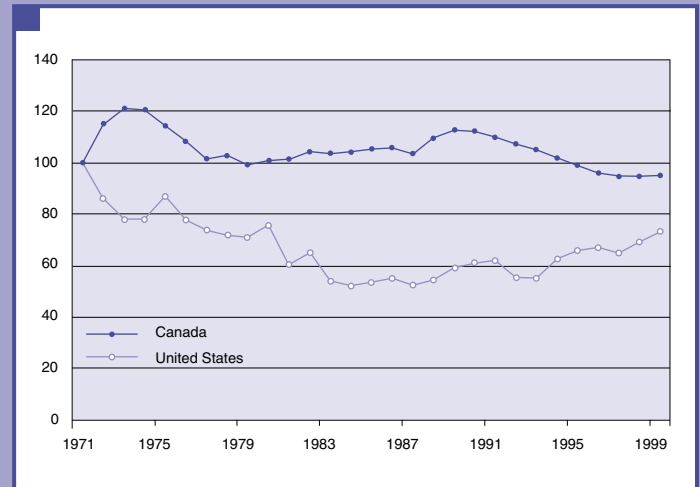
To some degree, these differences reflect the contrasting policies that these two nations had in place before the rise in inequality began—national health insurance in Canada, for example, versus a fragmented framework of private and public health insurance that leaves millions uninsured and underinsured in the United States. But to a substantial extent, the differences reflect how each nation has responded to rising inequality. And to a substantial extent, how each country has responded to rising inequality reflects how political processes and institutions have shaped and refracted the rising concentration of income at the top.

### Winner-Take-All Inequality: Made in the USA?

The natural urge is to see these two cases as separate examples of a larger cross-national phenomenon driven by globalization and technological change. That would be a mistake for two reasons.

First, Canada and the United States are not separate examples: The Canadian and U.S. labor markets have long been deeply interconnected—all the more so since the creation of NAFTA in the mid-1990s. And there is no question that the

FIGURE 2. Trends in Economic Security in Canada and the U.S. (1971 Index=100)



Source: Lars Osberg, "The Index of Economic Well-Being," <http://www.csls.ca/wb.asp>.

highest-earning Canadian workers find it hard to resist the gravitational pull of America's much more generous rewards at the top. Just their threats to leave for greener pastures doubtlessly encourage Canadian employers to raise top pay levels. One piece of supportive evidence: The rise in the share of income going to the top 1 percent has been much more modest among francophones in Quebec—who are generally reluctant to move south—than among English-speaking Canadians. Moreover, the substantial delay in the rise of American-style top-heavy inequality is also consistent with a story of contagion rather than a story of common technological and global forces—which, after all, should have hit Canada (and all of Canada) at roughly the same time.

A second reason to doubt the story of common external forces is that the historical record strongly indicates that domestic politics and government policy within the United States, not market developments, powerfully explain the emergence of an increasingly “winner-take-all” U.S. labor market. Indeed, the pivotal role of politics and policy becomes particularly clear in light of the Canadian experience, where the rise in top incomes occurred alongside continuing, if fraying, commitment to equality and security.

Research I am doing with Paul Pierson for our book, *Winner-*

**On the other side of the economic spectrum, American politicians have allowed, and even encouraged, the steady dismantling of the guarantees that ordinary workers once had of effective worker representation.**

# Canada has resisted the siren call of U.S. public policy, even as it has inevitably felt the pull of America's winner-take-all inequality. Canadian policymakers have proved at least partially willing to limit the fallout of the trend toward winner-take-all.

*Take-All Politics*, puts to rest the common notion that only global market forces and technological change dictated American developments. Perhaps the most damning evidence against this common story is that many nations facing the same forces and changes have not followed the American path. But we also go a step further, tracing the many important ways in which U.S. public policy helped fuel the concentration of income at the top. Some of the most important:

- In the United States, starting in the late 1970s, politicians slashed taxes for those in the very highest income categories. By themselves, these tax cuts probably account for roughly one-third of the improved after-tax economic position of the top 0.1 percent over the last 40 years. So dramatic is the shift that in 2007 Warren Buffet, the third-richest man in the world, could note that he paid about half the tax rate on \$46 million in income that his secretary did on her salary of \$60,000.
- Over the same period, political leaders also oversaw the development of a system of corporate governance that granted enormous autonomy to managers, including significant indirect control over executives' own pay. Through regulatory reforms and new tax breaks, political leaders also favored sectors like finance with highly unequal income distributions. Politicians also played a central role in fueling the meteoric rise of stock options, the heart of the executive-pay explosion. And the executive-pay explosion (in the financial sector and beyond) is, in turn, the source of much of the winner-take-all economy.
- On the other side of the economic spectrum, American politicians have allowed, and even encouraged, the steady dismantling of the guarantees that ordinary workers once had of effective worker representation. Since the late 1970s, repeated weakening and studious non-enforcement of protections for those seeking to form or support unions have encouraged a precipitous drop in union strength—from nearly a quarter of workers unionized in the early 1970s to only 7.4 percent in 2005.

In all these areas, American political leaders pursued policies that encouraged hyper-concentration of income at the top, while largely failing to augment or create policies that would help deal with the resulting fallout—from expanded health insurance to better job protections to more progressive taxation.

## Canada: Winner-Take-Some?

The Canadian story has played out much differently. In the mid-1990s, a major budget crisis prompted the Liberal Party—the

party most responsible for Canada's welfare state—to implement substantial cuts in a number of programs, including unemployment insurance and social assistance. But the era of cutbacks was fleeting. As Canadian social policy expert Keith Banting points out, "In retrospect, it is striking how short the period of retrenchment at the federal level actually was. By 1998, public finances were coming back into surplus rapidly, and cuts were replaced by 'the politics of reinvestment' in health care and child benefits." The resilience has been most striking in health care. Although Canada's national health system based on provincial "single-payer" programs is under strain, it remains a crucial source of economic protection and commands widespread political support.

Furthermore, Canadian public policy has been less solicitous toward the well-off than U.S. policy. Tax cuts for the rich have been more modest. Corporate governance policies have been less acquiescent toward compliant compensation boards (in part because Canadian institutional investors have more countervailing power). And Canadian policymakers have required greater disclosure of CEO pay and maintained limited incentives for stock options.

Canadian policy has also remained much more favorable toward unions. Once more limited in reach than their American counterparts, Canadian unions now enjoy much broader membership (about a third of the nonagricultural workforce) and have seen little decline—despite similar worker attitudes toward unions in the two nations. The Canadian economist W. Craig Riddell has found that little of the divergence between Canada and the United States can be explained by structural differences in the two nations' economies, or even by differing worker propensities to join a union. Rather, the difference is due to the much lower (and declining) likelihood in the United States that workers who have an interest in joining a union will actually belong to one—thanks to aggressive anti-union activities by employers during a weakening of American labor laws that guarantee workers' right to form unions.

And unionization clearly matters for wage inequality. According to work by UC-Berkeley economist David Card and his colleagues, the continuing sway of unions (encouraged by public policy) is probably the leading reason Canadian wage inequality is so much more muted below the very top—and stable since the 1970s—than wage inequality within the United States.

Most revealing of all, Canadian leaders have undertaken major efforts to reduce poverty that have yielded significant results. As the American sociologist Lane Kenworthy notes, "Canada's social welfare programs are more generous than those

in the United States in several areas where such generosity is particularly helpful in reducing poverty.” U.S. public assistance for the poor was prominently cut back in the mid-1990s. Meanwhile, Canada’s leaders largely maintained, and in some key areas expanded, means-tested benefits. In Canada, unlike the United States, cash assistance is available to poor individuals and couples without children, and it is relatively generous. Canada’s child tax benefit is offered not just to working families but to nonworking ones as well. As a result, poverty among female-headed lone-parent households has declined in Canada.

Another notable example of Canadian antipoverty efforts is a long-term policy initiative to reduce poverty in old age that has slashed the share of elderly Canadians in poverty. While this initiative originated in the 1950s and 1960s, Canadian leaders have maintained and deepened the commitments made in earlier years, including a guaranteed income supplement for lower-income elderly citizens and a special widows’ benefit to assist elderly women living alone. When pressure to cut back old-age programs emerged, American leaders simply trimmed Social Security, whereas Canadian leaders restructured the program more broadly to focus resources on the most vulnerable age and increase the investment income of the program. As Osberg points out, “The contrast with the United States is particularly striking. Although the poorest Canadian seniors were much worse off than American seniors 40 years ago, they are now much better off.”

### Beyond Policy: Learning from Canada’s Political Successes

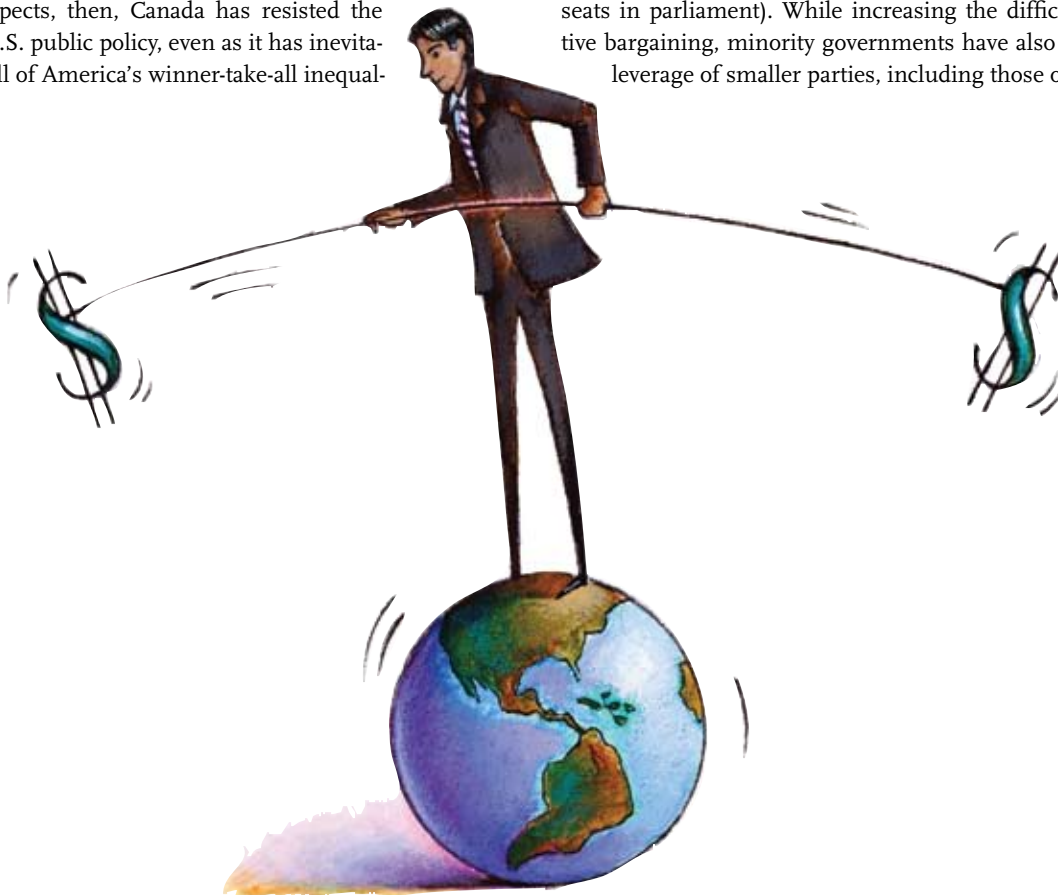
In crucial respects, then, Canada has resisted the siren call of U.S. public policy, even as it has inevitably felt the pull of America’s winner-take-all inequal-

ity. Canadian policymakers have proved at least partially willing to limit the fallout of the trend toward winner-take-all. This divergent response appears to reflect several features of Canada’s political structure that make political leaders more responsive to the concerns of middle- and lower-income Canadians.

One already mentioned is the much greater role played by unions. We are so used to thinking of unions as powerful economic actors, pressing for higher wages for workers or pushing back against high executive pay, that we often forget that they are also crucial political actors representing the interests of less affluent citizens and monitoring and fighting inequalitarian policy changes. In these efforts, unions have allied with the women’s movement—which Banting notes has a stronger social agenda in Canada than it does in the United States—as well as a broader network of advocacy organizations that have organized around Canadian social policies.

To be sure, political parties can also play this role, when they have the incentives and means to do so. But here again, Canadian politics looks different. While parties of the left have never fared particularly well in Canadian national politics, they have managed to gain a continuing foothold in key Canadian provinces. Unlike in the United Kingdom’s otherwise similar parliamentary system, Canadians have long supported regionally based parties at the national level, allowing relatively small localized parties to have relatively large national impacts—and parties of the left have been key beneficiaries of this situation.

The impact of small left-leaning parties has been heightened by the continuing reality of Canada’s minority governments (governments headed by a party with less than a majority of seats in parliament). While increasing the difficulty of legislative bargaining, minority governments have also increased the leverage of smaller parties, including those of the left.



Since the mid-1970s, around the time the Supreme Court struck down limits on campaign spending in the United States, Canada maintained strict caps on candidate and party spending. Canada also has public financing of elections, full disclosure of contributions, free broadcast time, and tax credits to encourage lower-income citizens to contribute. This framework, as one election law specialist notes, “has avoided the worst excesses of the American political system, most notably the unlimited spending by candidates and the proliferation of soft money.”

Finally, voter turnout has, until recently, been much higher in Canada than in the United States, encouraging politicians to respond to the demands of all income levels, not just the more affluent citizens who most regularly vote. This is partially reflective of multi-party competition, but also stems from Canada’s less restrictive laws for registration and voting. In Canada, the federal government takes responsibility for registering every eligible voter, with the consequence that more than 90 percent of eligible citizens are registered (compared with around 70 percent in the United States).

### Is the United States Canada’s Future? Is Canada the United States’?

But perhaps the most important lesson is that politics matters. Efforts to preserve political equality in Canada—not just campaign finance reform, but also continuing support for labor unions and broad voter registration—have fostered a democratic counterweight to pressures for rising inequality and limited the degree to which gains at the top have translated into losses for the rest.

If the United States were able to reinvigorate American workers’ right and ability to unionize, as is currently being considered in the halls of Congress, this could go a long way toward buffering against the negative fallout of winner-take-all. Strengthening unions in the United States would yield a double advantage of encouraging greater wage equality while building political will behind efforts to protect American workers from economic insecurity.

Nonetheless, unions are unlikely to revive quickly or easily. Even in Canada, private-sector unionization rates have declined (even as public-sector rates have risen enough to largely offset the decline). Much needs to be done, therefore, to encourage the revival of civil society more generally, through serious campaign finance reform and the fostering of large-scale membership organizations that, unlike today’s professional lobbying organizations, actually bring people into engagement with issues and the governing process. As the Canadian example suggests, this should involve creating alliances between the labor movement and other social movements (like the women’s movement) to create greater political leverage than any individual organization can muster.

Yet this list of lessons should not encourage complacency about Canada’s future, or despair about the United States’. Canadian politics has been in a state of disarray. Its national health system has seemed under constant siege. Both voter turnout and union density have recently waned. Just as President Obama enters office vowing to reverse some of the rise in inequality and insecurity in the United States, Canada is facing a crisis of confidence in its government and policies of historic proportions.

It would be an ironic, but hardly unwelcome, turn if the next American export to Canada was not winner-take-all inequality but a renewed sense of the need for social reform to reduce inequality and protect the economic well-being of the poor and middle class. For that to happen, however, the United States will need to heed the most important lesson of Canada’s greater success in combating inequality and poverty—that political reform is needed to ensure that the interests of all citizens are reflected in public policy.

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