
November 14, 2013

How globalization has left the 1 per cent even further ahead

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Canada is at a crossroads. A gap has grown between the middle class and the wealthy. Now, that divide is threatening to erode a cherished Canadian value: equality of opportunity for all

This is part of The Globe's Wealth Paradox series¹, a two-week examination into how the income divide is shaping Canada.

Income levels for most Canadians haven't changed much in recent years, but for one group: The wealthy are pulling away from the pack.

An analysis of top earners shows their annual incomes have more than doubled over the past three decades while the median taxpayer's income has changed very little, suggesting that in Canada – as in the United States – the wealthy have benefited most from economic growth and productivity gains.

Globalization is the crucial driver: The top 1 per cent of earners have seen growing demand for their specialized skills in the knowledge economy, while lower-income earners have felt the pressure of offshoring and technological change. But though education, field of expertise and hard work help propel people into the 1 per cent, there are signs that mobility is being somewhat compromised. There's more stickiness at the top – once people reach the top 1 per cent, they're more likely than in the past to stay there.

At the very top, skyrocketing executive pay in the U.S. has had ripple effects as Canada and other countries try to lure and retain talent. Highly skilled workers – from scientists to specialized engineers – are also in greater demand, particularly in cities with tighter labour markets, such as Calgary. Those with the prized skills for today's economy are seeing above-average rewards, while demand for others is dwindling – creating a more polarized job market.

"The market for people at the top has only improved because they've got more scope for their skills. Meanwhile, people in the middle to the bottom end in Canada are put in a position where they are competing with workers globally," said Michael Veall, economics professor at McMaster University, who has been studying income trends for 25 years. "One group has had a better market and one group has had a worse market for their skills."

Other forces are also at work. Declining unionization has contributed to wage inequality, while government policy has also played a role, with cuts to transfers and lower marginal tax rates since the 1980s making Canada's tax-and-benefit system far less of an equalizer than in past decades, according to the Organisation for Economic Co-operation and Development.

The higher up the income ladder, the larger the gains. Incomes among the top 1 per cent have climbed 80 per cent since 1986, according to inflation-adjusted calculations by Prof. Veall. They're up 138 per cent for the top 0.1 per cent of earners and 169 per cent among the top 0.01 per cent – compared with gains of 19 per cent for the bottom 90 per cent of earners. Thus the most affluent are gaining a greater share of the income pie.

Canadians, Prof. Veall said, need to discuss "how we adjust to a fairly remarkable social change."

Executive pay has soared since the 1990s, spurred by new regulations that require pay disclosure for top executives – leading to a competitive race to keep pace with the highest paid – and by a growing push to pay executives increasing amounts of equity compensation, such as share units, which have led to bigger payouts.

The most elite – who are skewing the average upwards – tend to be concentrated in finance and management. In the decade since 2001, median pay for CEOs at Canada's 100 largest companies has almost tripled to \$4.1-million from \$1.4-million. (The pay totals are even higher, but the calculation excludes the value of stock option grants and pension accruals in both periods because there is no comparable data available from 2001, when the information did not have to be disclosed.)

"The market has grown a lot bigger, so the top sports stars, movie stars and business executives make mega bucks, because the catchment area for their appeal is huge – it's now global, whereas 10 or 20 years ago it was more localized," said Michael Wolfson, an economist and Canada research chair at the University of Ottawa.

Canada has long been considered more equal in income than the U.S. due to its stronger social support programs, but that's changing with global competition and more porous borders. "It's been a lagged adjustment in Canada. But the more egalitarian tendencies just couldn't stand up, particularly at the high end of the income distribution, to the pressures from U.S. competition," where CEO pay is skyrocketing, Mr. Wolfson said.

It's not just executives and elite athletes who are seeing wages climb. To join the top 1 per cent of earners requires \$201,400 in annual earnings, and the group encompasses doctors, dentists, lawyers, veterinarians, real-estate agents, architects and engineers. The knowledge economy means that these jobs are much more valued than in the past.

Engineers, for example, have seen their earnings climb 35 per cent in the past 25 years after adjusting for inflation, data from Statistics Canada show. The gains have been even greater in Alberta, where the most senior group of specialized engineers has seen median base salaries rise 18 per cent in the past five years alone, according to the Association of Professional Engineers and Geoscientists of Alberta. Their median base salaries of \$218,000 a year – with total median compensation of \$325,000 – puts them squarely in Canada's top 1 per cent.

The picture differs across Canada. More than half of the income surge experienced by Canada's top 1 per cent in the past three decades came from two cities alone – Toronto and Calgary, according to an as-yet unpublished study by Statistics Canada economist Brian Murphy and Prof. Veall.

The recession walloped those at the top of the earnings ladder as their investment incomes dropped. But wealthy Canadians appear to be regaining their footing. The number of millionaires, in terms of total annual income, ebbed after the recession, but most recent tax-filer data show their ranks are climbing again, with growth between 2010 and 2011. Last year, the number of high-net-worth Canadians (defined as those with investable wealth of \$1-million or more) rose to a record, according to the Royal Bank of Canada.

And top 1-per-cent earners have seen their share of total income remain high compared to past decades. By this measure, "the concentration of incomes has returned to Depression-era levels," said Thomas Lemieux, an economics professor at the University of British Columbia who co-wrote a paper on trends in income inequality last year.

Earnings at the top have also been boosted by the investment portfolios of wealthier Canadians. Canada's top 10 per cent earned 57 per cent of all reported investment income in 2010, according to Statistics Canada. Despite all the market volatility of the past five years, the S&P/TSX composite index is up 77 per cent from its bottom in March, 2009, providing income gains for those in a position to take advantage of them.

Then there's the issue of mobility. There is evidence that once people climb into top income brackets, they're more likely than in decades past to stay there. In 2010, 52.7 per cent of top 1 per centers had been there five

years earlier – up from 43.9 per cent in 1987. Meanwhile, people are also becoming more likely to be stuck in the bottom decile, according to Statscan. Worsening mobility can dent aspirations and the incentive to work hard.

That impact on mobility concerns John Arnold, an Ottawa manager whose family income is over \$200,000 a year. He believes high-income earners should care about income inequality because it shapes the society they live in. Stark inequality can erode a country's social fabric and breed resentment and crime, he says.

"I feel that income inequality and the related social inequality in Canada is one of those insidious issues that continue to erode Canadian society," he said.

In Toronto, David Langille says he and his wife are "likely in the top 2 per cent" of income earners in Canada but do not feel affluent. The instructor at the University of Toronto and York University says they live in a modest home in central Toronto with a growing line of credit and an older car.

He says academic research has convinced him there is a clear link between more equal wealth distribution and societies that are happier and healthier – and he worries that Canada will see those advantages erode.

Wealthy Canadians, he said, "have a vested interest" in caring about inequality, even if they are comfortable.

"I'm very happy to be able to live in a mixed-income neighbourhood where there aren't terrible extremes of wealth and poverty, because it affects our safety," he said. "I'm proud that I don't have to live in a gated community that is secured at night. I don't believe in creating ghettos of poverty or wealth."

WHO ARE THE 1 PER CENT?

- There were 254,730 tax filers in the top 1 per cent category in 2010, 79 per cent of them male and 21 per cent female. The vast majority – 83 per cent – were married or in common-law relationships, with a median age of 51.
- The threshold to reach the top 1 per cent in 2010 was \$201,400, while the median income in the middle of the 1-per-cent pack was \$283,400 and the average income of 1 per centers was \$429,600.
- The 1 per cent are more educated than average, with 67 per cent having completed university degrees (compared with 21 per cent of all Canadians over age 15). More than half of the 1 per cent have degrees in three areas of study: business (29 per cent), health (15 per cent) and engineering (11 per cent).
- The vast majority of those in the 1 per cent – 88 per cent – work in five broad occupation groups: management (39 per cent), health care (14 per cent); business and finance (14 per cent); education, law, community and government service (11 per cent) and natural and applied sciences (10 per cent).
- The 1 per cent paid 21 per cent of all federal and provincial taxes in Canada in 2010. Their median tax bill was \$90,100 in 2010, up from \$32,300 in 1985.
- A growing proportion of the 1 per cent live in Alberta – 20 per cent of them, up from 10 per cent in 1990 – while 43 per cent live in Ontario, 17 per cent in Quebec and 12 per cent in British Columbia.
- The 1 per cent are growing more likely to stay at the top. In 1987, 44 per cent had also been in the 1 per cent five years earlier, a proportion that climbed to 53 per cent by 2010.
- Highly educated men are increasingly likely to marry women with similar education levels, further boosting incomes at the top. In 2001, 54 per cent of couples marrying in Canada had the same education level, up from 42 per cent in 1971.

Source: Statistics Canada

References

1. www.theglobeandmail.com/news/national/time-to-lead/our-time-to-lead-income-inequality/article15316231



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