The 99% Solution

How globalization makes everyone’s income a little more equal

Don McIver

Director of Research, Atlantic Institute for Market Studies

February 2012

Atlantic Institute for Market Studies

The Atlantic Institute for Market Studies (AIMS) is an independent, non-partisan, social and economic policy think tank based in Halifax. The Institute was founded by a group of Atlantic Canadians to broaden the debate about the realistic options available to build our economy.

AIMS was incorporated as a non-profit corporation under Part II of the *Canada Corporations Act* and was granted charitable registration by Revenue Canada as of October 3, 1994; it received US charitable recognition under 501(c)(3) effective the same date.

The Institute's chief objectives include:

a) initiating and conducting research identifying current and emerging economic and public policy issues facing Atlantic Canadians and Canadians more generally, including research into the economic and social characteristics and potentials of Atlantic Canada and its four constituent provinces;
b) investigating and analyzing the full range of options for public and private sector responses to the issues identified and acting as a catalyst for informed debate on those options, with a particular focus on strategies for overcoming Atlantic Canada's economic challenges in terms of regional disparities;
c) communicating the conclusions of its research to a regional and national audience in a clear, non-partisan way; and
d) sponsoring or organizing conferences, meetings, seminars, lectures. training programs, and publications, using all media of communication (including, without restriction, the electronic media) for the purpose of achieving these objectives.

2000 Barrington Street, Suite 1302, Halifax, Nova Scotia B3J 3K1
Telephone: (902) 429-1143; fax: (902) 425-1393
E-mail: aims@AIMS.ca; Web site: www.AIMS.ca

THE 99% SOLUTION

How globalization makes everyone's income a little more equal

DON MCIVER
DIRECTOR OF RESEARCH, ATLANTIC INSTITUTE FOR MARKET STUDIES

Atlantic Institute for Market Studies
Halifax, Nova Scotia
February 2012

Published by the Atlantic Institute for Market Studies
2000 Barrington Street, Suite 1302
Halifax, Nova Scotia B3J 3K1

Telephone: (902) 429-1143
Fax: (902) 425-1393
E-mail: aims@aims.ca
Web site: www.aims.ca

Contents

About the Author ...…………………………………………..…………………………...…. iv

Executive Summary ...……………………………………………….…….……………..... 1

The Great Divide – Is income distribution “fair”? …………………………….…….…….. 2

Conclusion……………………………………...………………..…………………...... 10

References ………………………………………..…………………………………….…. 11

About the Author

Don McIver is a Halifax-based economist. A former Chief Economist with Sun Life Financial, he provided economic and financial projections in support of the company's global investment operations. Don has filled senior research positions with the Conference Board of Canada and the Canadian Bankers Association.

Don has worked closely with Canadian business organizations. He served two terms on the Board of Directors of the Metropolitan Toronto Board of Trade as well as chairing and serving on numerous policy committees of the Board. He sat on the Economic Policy Committee of the Canadian Chamber of Commerce and provided regular federal budget briefings for the Chamber. He is the former President of both the Toronto and Ottawa chapters of the Canadian Association of Business Economists.

In addition to his Canadian experience, Don has provided development advice to business organizations overseas—serving lengthy stints with Chambers of Commerce in Guyana, South America and in Sri Lanka.

He has published numerous newsletters and articles—including a number published by AIMS, where he served as AIMS' Research Director between 2003 and 2004. Don is the author of END OF THE LINE—a book describing the personalities and circumstances associated with a major train disaster in 1857 in Hamilton, currently in publication.

Executive Summary

The “occupation” campaign has heightened awareness concerning income distribution in developed and emerging economies around the world. Critics of the movement argue that, with no apparent leadership and without any focussed demands, it represents little more than a poorly-conceived “grump-fest”. Sympathizers assert that the development is a ground-root expression of disapproval of a further skew in incomes that has seen the rich getting richer and the poor getting poorer. In their view that is epitomized by the perceived hyper-wealth of the top 1 percent in contrast to the economic deterioration of those who number themselves among the “we are the 99 percent”.

This paper recognizes that “market” incomes in countries like the United States and Canada have certainly been increasingly skewed in favour of high income earners but argues that a more pertinent measure examines the distribution of “disposable” incomes after adjustment for tax progressivity and government transfers. By that measure Canada demonstrates substantially less distortion than the United States.

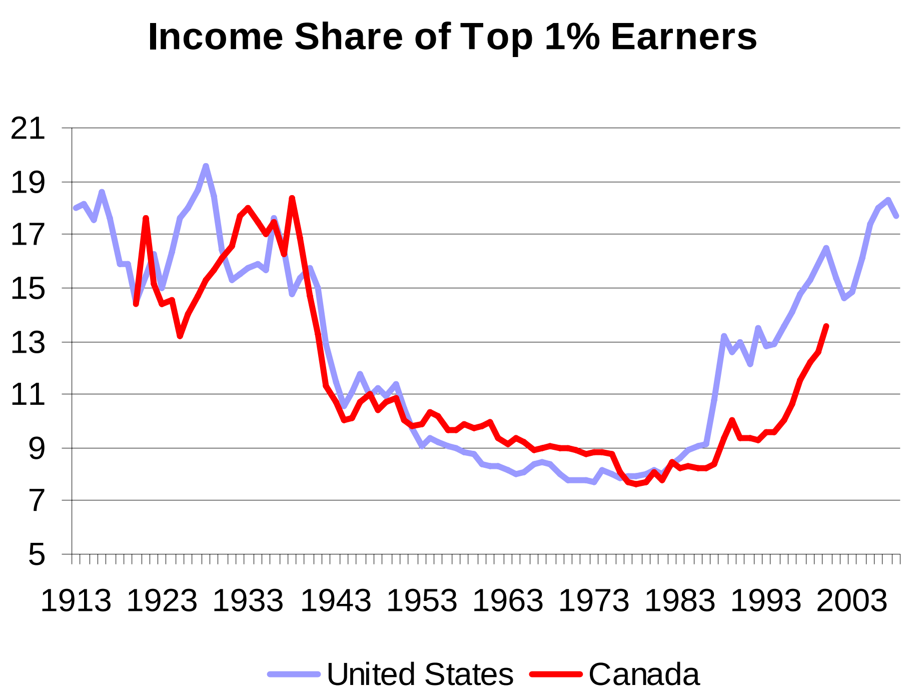
The author also argues that even as the process of “globalization” is being socially vilified for its apparent contribution to rising *national* income disparities it is substantially narrowing the income spread *between* countries—so that the same economic forces that stimulate wealth generation in advanced countries also foster a more equitable income share for developing countries.

The Great Divide
Is income distribution "fair"?

- Is it fair that 1 percent of the population earns almost 20 percent of a country's income?
- Is it fair that 1 percent of the population pays more than 20 percent of taxes?

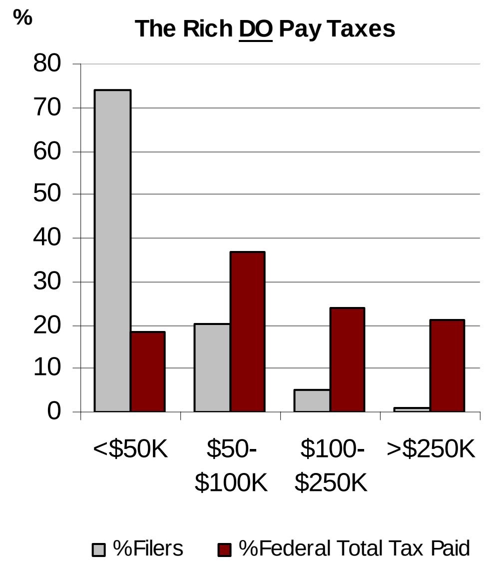
Your answers to those questions probably do not depend simply on whether you are in that 1 percent or not—they depend on whether you believe that the underlying economic system produces value for all.

Is it true that there is a huge disparity between the wealthy 1 percent and the 99 percent mass? Much of the evidence for this derives from research undertaken at the University of California Berkley by Thomas Piketty And Emmanuel Saez (see for example *The Evolution Of Top Incomes: A Historical And International Perspective*[1] and *Striking it Richer: The Evolution of Top Incomes in the United States—Update using 2006 preliminary estimates*[2]). These initiatives triggered a global research network of international data collection and comparison. The following chart details the findings for the United States and Canada:



Source: Piketty and Saez (see footnote 1) (latest data Canada: 2000; US:2008)

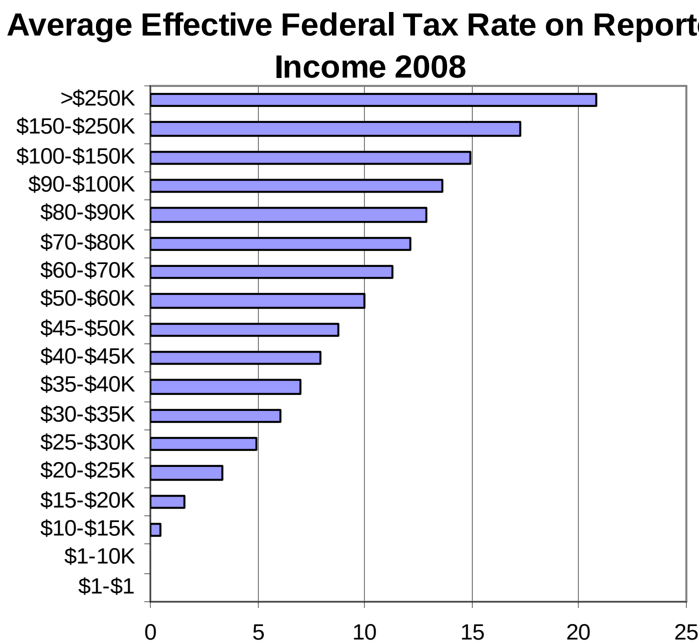
The data do appear to demonstrate a steady return to income distributions that have been unseen since the onset of the halcyon days of income democratization that coincided with the onset of the Second World War. Unlike census data that relies on the honesty of respondents, this data is derived from less subjective income tax returns—but contain a fundamental flaw, especially pertinent to Canadian reality, in that they are based on incomes from earnings and investments. They consciously exclude the crucially important incomes individuals receive from government transfers. In the Canadian context, that is a primary mechanism for redistributing income.



Source: Canada Revenue Agency

An examination of Canadian federal tax data that includes the distribution of transfer payments like government pensions, employment insurance, social assistance, and child benefits reveals a markedly different perspective. The vast majority of low income earners (even those whose income is predominantly derived from social transfers) contribute only a modest proportion of incomes taxes. Indeed as the following chart demonstrates, the proportion of total federal income taxes paid by the 74 percent of tax filers whose incomes are less than $50 thousand accounts for just 18.3 percent of taxes. The tiny three-quarters-of-one-percent fraction earning in excess of $250 thousand alone pays 21.2 percent of income taxes. The less-than-six percent representing those with $100 thousand and above pay 45 percent of the total tax bill.

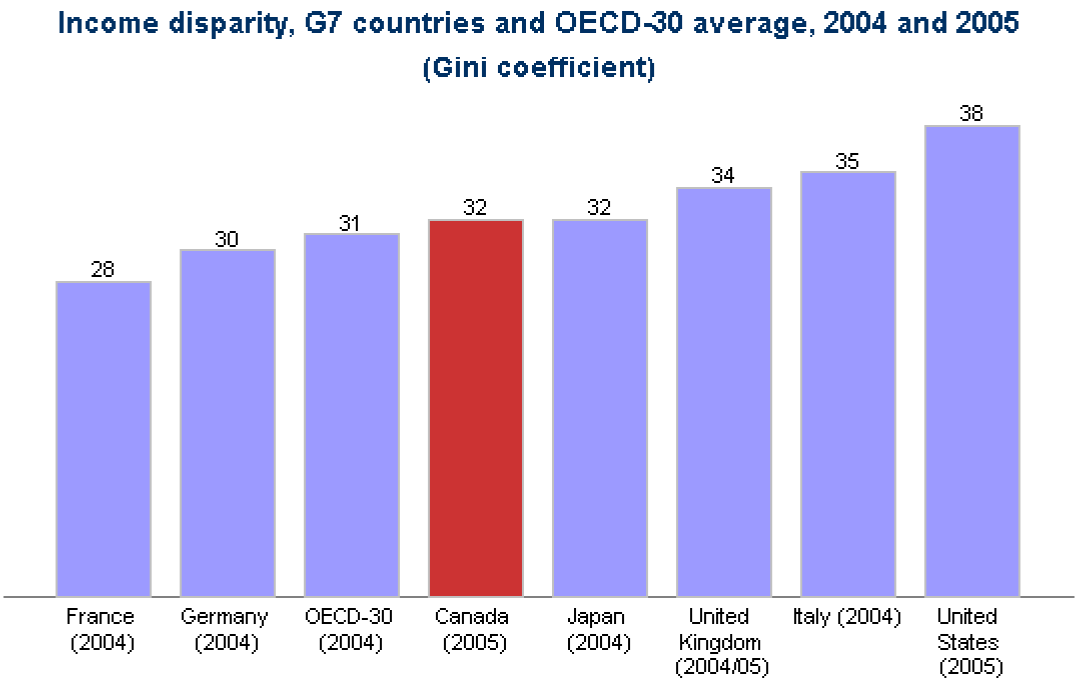
This data demonstrates that if one of the objectives of tax policy is to ensure that those with a "superior ability to pay" make a disproportionately greater contribution, then the system is working. It is sometimes argued that the wealthy have ways of avoiding tax—and there will always be those who arrange their affairs to avoid reporting incomes—but the reality is clear: higher income earners pay higher proportions of tax. That is not simply the rate they are <u>supposed</u> to pay—it is what they <u>actually</u> pay. The following summary statistics from the Canada Revenue Agency tell the story.



Source: Canada Revenue Agency

Of course even when the better-off taxpayers have paid their taxes they still enjoy a “superior ability to pay”. That creates a dilemma to both the social policy creator and the analyst: what degree of income equality is desirable or “fair”. That is an impossible question to answer. After taking account of the methodological issues in tracking disparities (and they are myriad—pre or post-tax; including transfers etc.) it is fair to argue that, among advanced economies Canada probably falls around the middle. That can be seen more explicitly by comparing analytical distribution measures.

One common measure is the GINI Coefficient—that computes the deviation of a distribution pattern from a totally even distribution. The lower the coefficient the more a country approaches totally equal income parity. According to the OECD calculation Canada is in the middle of the pack—less “evenly distributed” than some Nordic and western European countries; more “equitable” than the United States, Japan, UK etc. However dissatisfied social activists may be with Canada’s income characteristics, the evidence suggests it is anything but extreme.



Source Human Resources Development Canada—OECD[3]

As noted earlier, it is crucial to take into account the redistributive effects of tax and transfers rather than paying undue attention to the "raw" pre-tax earnings figures. The preceding chart makes these corrections and displays the "disposable" income GINI ratios.

In a recent study, the OECD note: *"Public cash transfers, as well as income taxes and social security contributions, play a major role in all OECD countries in reducing market-income inequality. Together, they are estimated to reduce inequality among the working-age population by about a quarter on average across OECD countries. This redistributive effect is larger in the Nordic countries, Belgium and Germany, while it is well below average in Chile, Iceland, Korea, Switzerland and the United States."*[4]

By either measure, Canada is roughly in the middle of the OECD pack—meaning that Canada's GINI coefficient for market income is nowhere near as pronounced as that for Chile or Mexico and well below that of many other countries including the United States and the United Kingdom and moreover, tax/transfer adjustments have a similar redistributive effect to that observed in most OECD countries. In consequence, whether measured in "market" (i.e. pre-tax) incomes or "disposable" (after-tax/transfer) Canadian income distributions are not extreme.

That conclusion should be read in a neutral sense. The degree to which a particular distribution represents an appropriate or inappropriate outcome is a matter of individual political interpretation. Economics can not deliver an optimal or desirable target for which to aim. However, what is strongly held by most economists who favour market-determined outcomes is that "too great a degree of redistribution" (however defined) will seriously constrain overall economic prospects.

One of the problems with striving for a more even income distribution is that one runs the risk of creating a uniformly poor economy. During the socialist era Chinese incomes were among the lowest in the world—but notionally apportioned: “to each according to their needs”. Recently the World Bank has reclassified re-born China as an upper-middle-income-country.[5]

The embrace of capitalism by China is a modern economic metamorphosis. It might be tempting to observe that the Chinese “miracle” has come at a “price”—i.e. increased income spread. But that would be to place a value judgement on the development. It would be more appropriate to simply observe that coincident with rising incomes, greater income disparity has been experienced. At the same time, absolute poverty reduction targets in China have been achieved.[6] This would be a classic manifestation of the maxim that: “a rising tide floats all boats.”

Even as the process of “globalization” is being socially vilified for its apparent contribution to rising *national* income disparities it is substantially narrowing the income spread *between* countries. The annual list prepared by Forbes magazine of the world’s billionaires shows the number in China doubling in a single year.[7] A Financial Times article on the phenomenon reports that: *“the BRIC countries – Brazil, Russia, India and China – had 301 billionaires, 108 more than in the previous year, and one more than Europe[8].”*

In a series of seminal lectures on economic growth, Nobel Price winner Robert E. Lucas, Jr. tracks the astounding contribution of the Industrial Revolution to the welfare of the human race. He is far from immune to the painful reality of uneven opportunities, but makes it clear that closing the gap is a manifestation of an open economic system:

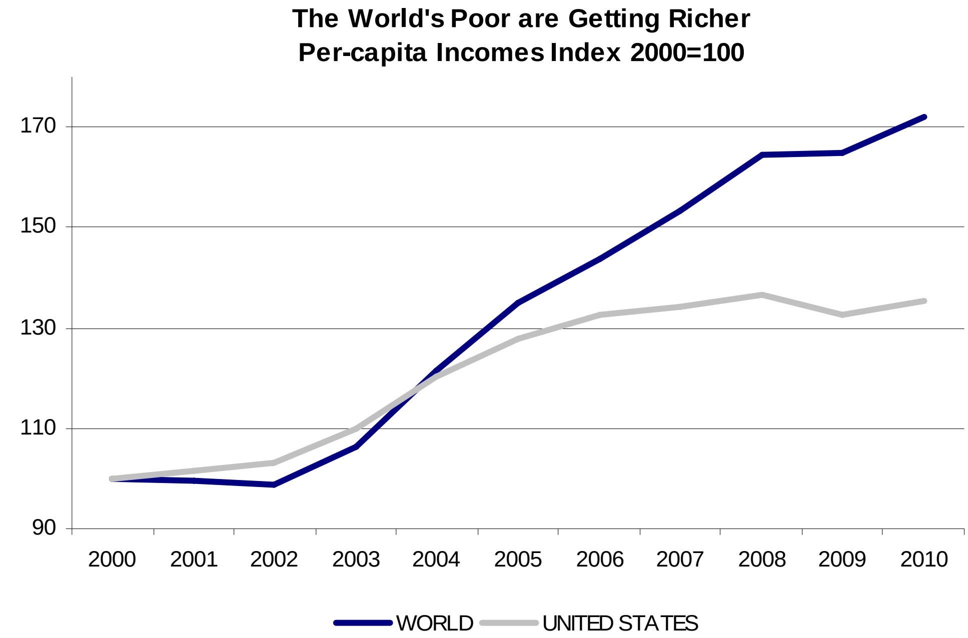
> *Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution. In this very minute, a child is being born to an American family and another child, equally valued by God, is being born to a family in India. The resources of all kinds that will be at the disposal of this new American will be on the order of 15 times the resources available to his Indian brother. This seems to us a terrible wrong, justifying direct corrective action, and perhaps some actions of this kind can and should be taken. But of the vast increase in the well-being of hundreds of millions of people that has occurred in the 200-year course of the industrial revolution to date, virtually none of it can be attributed to the direct redistribution of resources from rich to poor. The potential for improving the lives of poor people by finding different ways of distributing current production is **nothing** compared to the apparently limitless potential of increasing production.*[9]

So much of the current rhetoric of the “99 percent” is directed towards the supposed failure of capitalism. As Lucus so eloquently argues, capitalism has been a remarkable force for good. The fundamental economic forces that produce uneven incomes are the same that contribute positively to overall growth throughout the world

Whether or not the financial wizards on Wall Street are intrinsically worth their extravagant paycheques is debatable, but the reality is that many have created even greater value for their shareholder employers (although some equity holders will rue the day those smooth-talking gurus convinced them of their skills). Perhaps an argument can be made that regulatory gridlock encourages those excesses, but it is hard to conceive of a regulatory system that could be constructed with the flexibility and immediacy to respond to each new attempt to circumvent the rules.

The reality is that information technology makes it almost as easy for the next financial crisis to originate in Frankfurt, Singapore or Mumbai as it would be in New York—and preventing that would require a most unlikely consortium of international regulators.

Perhaps Karl Marx was correct to recognize that capitalist societies contain the seeds of their own destruction. What he did not predict was that the eventual subsidence of an economic empire would not destroy capitalism but rather help consolidate it in other societies. In these terms, the supposed excesses of capitalism in advanced economies have a positive counterpart in less developed countries. Along with a trend to higher degrees of income inequality *within* some countries, there is clear evidence of greater equity *between* countries. Specialization, comparative advantage and social equity—who would have thought that Adam Smith and Karl Marx would have so much in common!



As the preceding chart demonstrates, the past decade has seen a significant shift in the relative fortunes of the United States and other parts of the world. The chart[10] shows that per-capita incomes in the US have stagnated during the latter part of the decade while incomes in the entire world have risen markedly. Of course incomes in the entire world remain, in absolute terms, significantly below US levels. One way of interpreting the data is that: per-capita income in the United States rose by 35 percent over the period while total world income rose by 72 percent. Both are measured in US dollars—without taking into account inflation.

In other words, while still well ahead, Americans have not been doing as well as the rest of the world. That's exactly how capitalism works…economic empires eventually wane. It's exactly what humanitarians would wish for—that the ratio of resources available to the child in India improve, while incomes in the United States continue to rise (albeit at a slower pace). That development is occurring without the bureaucratic intervention of "official" redistribution.

The OECD analysis (op cit) addresses this issue indirectly by trying to explain "why" income inequalities are on the rise in developed blocks. The authors note: *"Increases in household income inequality have been largely driven by changes in the distribution of wages and salaries which account for 75% of household incomes of working-age adults. With very few exceptions (France, Japan and Spain), wages of the 10% best-paid workers have risen relative to those of the 10% least-paid workers. This was due both to growing earnings' shares at the top and declining shares at the bottom, but top earners saw their incomes rising particularly sharply. The highest 10% of earners have been leaving the middle earners behind more rapidly than the lowest earners have been drifting away from the middle."*

Referencing ongoing analysis and forthcoming interpretation they suggest: *"Over the past decades, OECD countries have undergone significant structural changes resulting from their closer integration into a global economy and rapid technological progress. These changes have brought higher rewards for* *high-skilled workers and thus affected the way earnings from work are distributed. The skills gap in earnings reflects several factors. First, a rapid rise in trade and financial markets integration has generated a relative shift in labour demand in favour of high-skilled workers at the expense of low-skilled labour. Second, technical progress has shifted production technologies in both industries and services in favour of skilled labour. All three structural changes have been well underway since the early 1980s and accelerating since the late 1990s."*

It is, at least a reasonable inference, to conclude that skilled labour is now a global commodity and that the rewards to its possession are less bound by the residence of the individual—or, alternatively, poorly-skilled labour no longer enjoys a privilege on the global stage simply by virtue of residing in the wealthiest economies. Which is just another way of arguing that market forces, unfettered by protectionism contributes to increased economic opportunity globally.

So why is the "occupation" movement receiving publicity, especially in the United States? A key part of the answer was probably foreshadowed by Emmanuel Saez[11] in the article referred to earlier. He points out that although the more pronounced income share of the "one percent" has been rising since the latter 1970s, the development was initially accompanied by strong improvements for the masses. For example, during the Clinton years (1993-2000) average real (i.e. inflation-adjusted) incomes for the top one percent were rising at an annual rate of 10 percent—but the bottom 99 percent were also experiencing substantial real gains of 2.4 percent. (The rising tide argument…again).

Present conditions are, as noted, markedly different. Now with overall US incomes stagnating—the mass of the population is not only losing relative ground to the wealthy few, but is losing ground to mass populations abroad. If trends towards more "equitable" distributions internationally persist, as they seem likely to do, then attempts to redress perceived US domestic imbalances will do little to change the reality that US workers will be increasingly competing with foreign workers.

One phenomenon that "globalization" has delivered is that the truly wealthy have become stateless. Big money—whether individual or corporate—can move seamlessly to where opportunities are the richest and taxes are the least punitive. That is a compelling reason to ensure that tax policies are designed to ensure outcomes we want to encourage: i.e. reinvestment in income producing employment, while discouraging consumption—or, at least, *wasteful* consumption.

Conclusion

Income distributions in advanced economies are shifting in favour of those factors of production that are most mobile and in high demand. Policy makers have a responsibility to review the consequences of these developments but the essential outcome of globalization is that the highest skills—whether in technology, business organization or finance—will likely command the greatest rewards, regardless of geography. As such, erstwhile under-developed regions, epitomised by BRIC countries, will likely continue to attract improved shares of global output. Rather than focus on the negative perception of rising national inequalities, perhaps more attention should be paid to the dramatic narrowing of income gaps between the "first world" and previously less-developed regions. A more open, less protectionist, world marketplace is contributing substantially to improved global fairness.

References

[1] Thomas Piketty And Emmanuel Saez; Proceedings of the American Economics Association May 2006 200ff

[2] http://elsa.berkeley.edu/~saez/saez-UStopincomes-2006prel.pdf

[3] http://www4.hrsdc.gc.ca/.3ndic.1t.4r@-eng.jsp?iid=22

[4] OECD: Tackling Inequality Growing Income Inequality in OECD Countries: What Drives it and How Can Policy Tackle it? *Forum, Paris, 2 May 2011* http://www.oecd.org/dataoecd/32/20/47723414.pdf

5 http://data.worldbank.org/about/country-classifications/country-and-lending-groups

[6] See, for example, United Nations Development Program UNDP: http://www.undp.org.cn/modules.php?op=modload&name=News&file=article&catid=10&sid=10; China has already achieved one eight 2015 UN Millennium Development Goals (MDGs) by halving absolute poverty levels.

[7] http://www.forbes.com/wealth/billionaires

8 BRICs becoming billionaire factory; Alan Rappeport; Financial Times: March 9 2011 20:46

9 Robert E. Lucas, Jr. The Industrial Revolution: Past and Future 2003 Annual Report Essay Federal Reserve Bank of Minneapolis

[10] Based on World Bank data (author's calculations)

[11] See endnote 2

Selected Publications from the AIMS Library

Publications on Globalization and Regional Development

Maine's Unrealized Human Potential *by Perry Newman*

Chasing the Jobs *by Bill Black*

Up, Down or Sideways *by John Risley*

AIMS' Submission to the House of Commons respecting CETA Negotiations *by Don McIver*

Selling Ourselves on Self-Interest *by Don McIver*

So What Can We Do? *by John Risley*

Wow, But at What Cost? *by John Risley*

An Economic Future with Fewer Numbers: The population and labour force outlook for the Atlantic region by Frank Denton, Christine Feaver and Byron Spencer

Zone-ability: Unlocking the potential of the Atlantica region with Special Economic Zones by Barrie B. F. Hebb

Go East Go West: The better shipping route from Asia to North America by John Huang

The Developing Workforce Problem: Confronting Canadian labour shortages in the coming decades by Jim McNiven

Careless Intentions: Regional consequences of national policies by Don McIver

We Need More Nova Scotians by Bill Black

Nova Scotians Without Borders *by Don McIver*

The Muddle of Multiculturalism *by Salim Mansur*

Other Publications of Interest

The Effectiveness of the Common Drug Review in Canada's National Drug Strategy *by Amir Attaran, Rosario Cartagena, and Andree Taylor*

Young Love: Will Generation Y ever get that special feeling for Atlantic Canada? *by John Kennedy*

The Post-Secondary Education Bubble *by Andreas Korfmann*

Perspectives, Perceptions and Priorities: An Economist's view on the Aquaculture industry *by Don McIver*

Budget Season *by Bill Black*

Healthy Alternatives *by David Zitner and George Cooper*

The Way We'll Get By *by Perry Newman*

Power Plays *by Bill Black*

Doin' the PRPP Walk *by Harry Koza*

Who Could Have Seen THAT Coming?: The history and consequences of the global crisis *by Don McIver*

The Real Costs of Public Debt *by Ali Nadeem*

Spending on Public Heslth Programs: Yet another national divide? *by Livio Di Matteo*

Get Understanding *by John Risley*

Till the End of Time: Just how long should we maintain our MLAs in the style to which they have grown accustomed? *by Don McIver*

Possible Federal Initiative without the Price Tag *by Stewart Kronberg*

Atlantic Institute for AIMS Market Studies

AIMS is an independent economic and social policy think tank. To borrow the words of Sir Winston Churchill, we redefine "the possible" by collecting and communicating the most current evidence about what works and does not work in meeting the needs of people. By engaging you, your friends and neighbours in informed discussion about your lives we make it possible for government to do the right thing, instead of trying to do everything.

We take no money from government, but we do have to pay the bills and keep the lights on. To HELP with that, just check three simple boxes below:

STEP ONE:
❑ YES! I want to support AIMS. (An official tax receipt will be provided for your donation.)

STEP TWO:
I want to become:
❑ a THINKER ($100 minimum)
❑ a LEADER ($1000 minimum)
❑ a SHAKER ($5,000 minimum)
❑ a MOVER ($10,000 minimum)

STEP THREE:
❑ Make my donation a SUSTAINING one. (committing to continuing your donation at this level for a minimum of three years)

....

Name: ––

Title: –––

Organization:–––

Address: –––

Telephone:––––––––––––––––––––––––––––– Facsimile: –––––––––––––––––––––––––

E-mail: ––

I am paying by: ❑ VISA ❑ Mastercard ❑ Cheque (enclosed)

Credit card #: –––––––––––––––––––––––––––––– Expiry Date:–––––––––––––––––––––––

Name on Credit card: –––––––––––––––––––––––––– Signature:––––––––––––––––––––––

Please send or fax this form to 2000 Barrington Street, Suite 1302, Halifax, NS B3J 3K1
Telephone: (902) 429-1143 Facsimile: (902) 425-1393 E-mail: aims@aims.ca
For more information please check our website at **www.aims.ca**

Atlantic Institute for Market Studies
Suite 1302 – Cogswell Tower
2000 Barrington Street
Halifax,. NS B3J 3K1
902-429-1143
www.AIMS.ca