INCOME INEQUALITY IN CANADA vs. THE US

Measured after taxes and income transfers, income inequality is less in Canada than in the US, but the difference is not always so large, or in the way one might imagine.

The red and blue lines in the figure are Lorenz curves, graphical representations of income inequality. A Lorenz shows the share of income available to households when they are grouped according to their income. Lorenz curves are closely related to the Gini coefficient, a popular measure of income inequality.
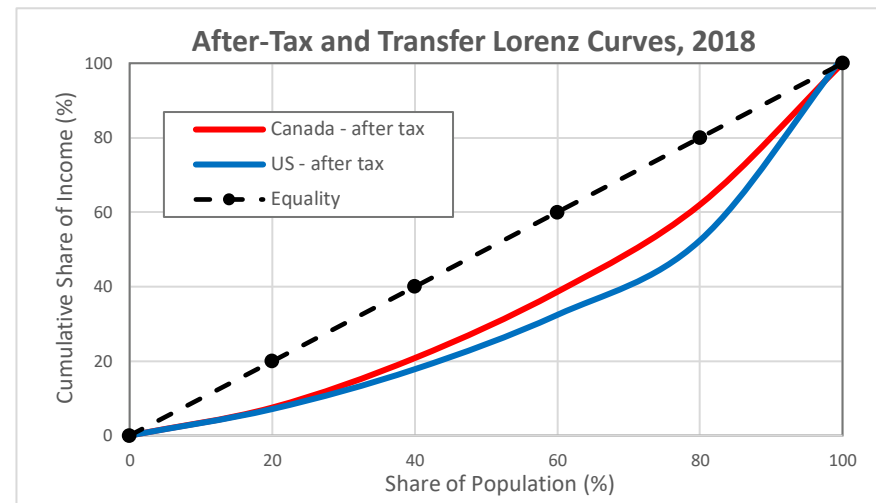
In the figure, the black dashed line shows what complete income equality would look like. The first 20% of the population would have access to 20% of all the income available in Canada, the next 20% of the population would also have access to 20% of all the income available, and so on. With complete income equality, everyone's income is the same.

Plotting income data from the real world produces a line that bows below the dashed line. The line bows for two reasons. First, some people have skills that are more highly valued in labour markets than others and so earn higher incomes. The greater the difference in earned incomes, the more bend there is to the curves. The second reason for the bow is due to taxation and income transfers. In Canada and the US, some of what is earned by high income households is taken away by taxation and transferred to households with lower income. This reduces the bend of the curve by making after-tax incomes more equal.

Progressive taxation and income redistribution play significant roles in reducing income inequality. More is done in Canada than the US but at the low end of the income distribution, the difference is hardly noticeable.

The red and blue lines in the figure show Lorenz curves for Canada and the US, respectively. Income is measured after taxes and after income transfers. The data is from 2018. The red line has less of a bow than the blue line indicating that after taxation and income transfers are accounted for, there is less after-tax income inequality in Canada than in the US.

The gap between the lines indicates the main source of the difference in income inequality in the two countries is due to differences at the upper end of the distribution of incomes.

After-Tax and Transfer Lorenz Curves, 2018

Legend: Canada - after tax, US - after tax, Equality

X-axis: Share of Population (%)
Y-axis: Cumulative Share of Income (%)

Sources: Statistics Canada Table 11-10-0193-01 and Congressional Budget Office.

Households with incomes in the top 60% retain a noticeably greater share of after-tax income in the US than similar households in Canada.

But look at the low end of the income distribution. The tax systems in Canada and the US leave the 20% of households with the lowest incomes with nearly identical shares, just over 7%, of all income. If the Canadian tax system is more progressive than that in the US, why is it not reflected in the relative size of the after-tax income shares of low-income households?

The answer is that low-income households *earn* a noticeably smaller share of total income in Canada than in the US. This is offset by Canadian households receiving higher income *transfers*, leaving the two groups with the same share of all after-tax incomes. Thus, while the Canadian system is more progressive in the sense of shifting more income to low-income households, the need for such shifts is also larger in Canada. An interesting issue for public policy is whether it is better to emphasize supporting low-income households with income transfers, as in Canada, or with ensuring greater opportunities to earn income, as in the US. Advocates of policies to promote what has been referred to as inclusive growth suggest the latter approach is to be preferred.