

THE GAP IN PURCHASING POWER BETWEEN HIGH- AND LOW-INCOME HOUSEHOLDS IN CANADA

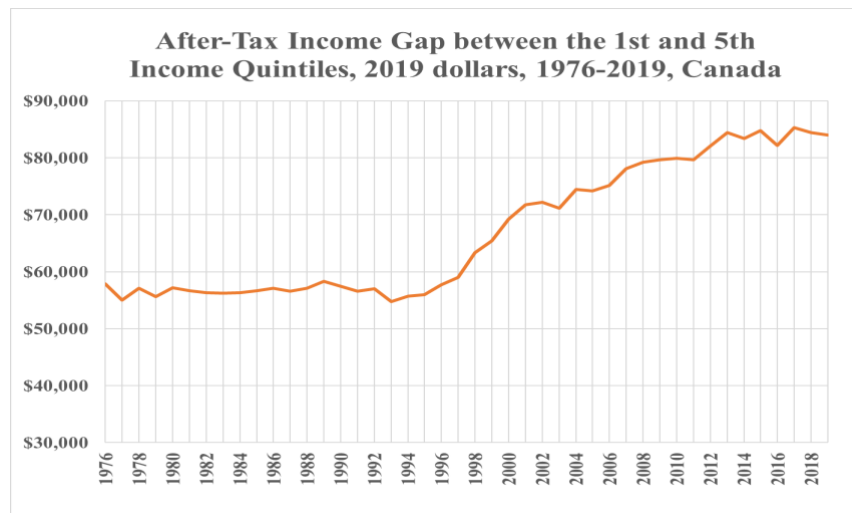
Progressive taxation and redistributive spending programs are designed to transfer income from high to low-income earners and in this way reduce differences in after-tax purchasing power.

The figure describes the difference, in the average real (inflation-adjusted) after-tax income, between earners in the *top* income quintile of Canadian households, and that of earners in the *bottom* income quintile of households. The difference represents the greater purchasing power of the top 20% of households relative to the bottom 20% of households ranked by after-tax income. In 1976, the difference was roughly \$58,000 when measured in 2019 dollars. By 2019 this had increased to over \$84,000.

A difference in *before-tax* purchasing power between these two groups is to be expected. Gross earned incomes are not evenly distributed. Some people earn more than others because their skills and knowledge are in greater demand in the marketplace. The size of the *after-tax* income gap, however, is a result of public policy.

Between 1976 and 1995, Canada's tax and transfer system maintained a relatively constant real income gap between high- and low-income earning households. Since the late 1990s the gap has steadily widened.

Progressive taxation and direct income transfers are ways governments move economic resources from high to low-income earners. In 1976, the incomes of the top income quintile of households were reduced by an average of 18.5% by taxation, while the incomes of the bottom income quintile of households were increased by 92%, thanks to income transfers. This shift in purchasing power has increased over time. In 2019 the incomes of the top income quintile of households were reduced by an average of 20% by taxation, while the incomes of the lowest income quintile of households saw their incomes increase by an average of 158%. While over the past four decades a growing amount of purchasing power has been transferred from high to low-income households, the gap in an after-tax purchasing power has grown since the mid-1990s after remaining steady during the 1970s and 1980s.



Source: Statistics Canada, CANSIM Table 11100193 and Authors' calculations.

It is important to stress that any concern about what is shown in the figure is not a concern about poverty. The purchasing power of households in the 1st income quintile has grown with the result that the percentage of Canadian households enduring poverty has [fallen](#) a great deal since the mid-1990s. The issue, rather, is whether the growing difference is judged to be appropriate by societal norms and values.

For those who express concern over these relative changes in purchasing power, one response is to advocate in favour of increasing still further the size of income transfers from rich to poor and in this way reduce the gap in after-tax purchasing power. Another response is to advocate in favour of public policies supporting what has been referred to as [inclusive growth](#). This approach targets the difference in *earned* incomes and aims to increase [opportunities and rewards](#) for Canadians who may have previously been less able to fully participate in the economy. Which approach best balances the joint needs for wealth creation and equity is an important topic for debate.