North American Economic Integration and the Canadian Social Model

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Key Issue: Economic Integration and Downward Harmonization

policy. However, these come more from the increased power of business to trump the views of citizens than from any fundamental contradiction between progressive social policy and economic success.

Canada has a different social model than the US, which is highly valued by most Canadians. Among the enduring elements of difference, Canada has a more equal distribution of both earnings and after-tax / transfer (disposable) income. Our more narrow distribution of earnings reflects higher unionization, somewhat higher minimum wages, and a smaller pay gap between the middle and the top of the earnings spectrum. More equal after-tax incomes and lower rates of poverty than in the US reflect the impacts of a more ‘generous’ system of transfers acting upon a somewhat more equal distribution of market income. The level of public provision of services on a citizen entitlement basis is also higher in Canada than the US, reducing dependence on market income for some basic needs. Medicare is the key example. Greater equality has sustained better social outcomes in terms of health, crime and educational attainment.

Since the late 1980s, there has been a very significant increase in earnings inequality in Canada. The share of all pre tax income going to the very top 1% of taxpayers, those making more than about $150,000 per year, has risen from 9.4% to 13.6%. (Emmanuel Saez and Michael Veall. The Evolution of High Incomes in Canada. National Bureau of Economic Research Working Paper. 2003.) While incomes at the very top have risen sharply, real wages for most workers have stagnated, and the ranks of the working poor have grown. Increased earnings inequality combined with cuts to income transfers (mainly social assistance and Unemployment Insurance) have also increased gaps in after tax/ transfer incomes of Canadians. Between 1989 and 2001, the share of after tax/transfer income of the top 20% of families, which was unchanged in the 1980s, rose from 36.9% to 39.2%, at the expense of the bottom 80%.

Rising income inequality has been driven by income growth for high earners, and by cuts in social transfers. Neither can be blamed directly upon North American economic integration and, undoubtedly, a complex range of factors has been at play. However, there is a link between continental integration and the increased incomes of the most affluent, given that closer trade and investment links have led to some upward convergence of salary and options for corporate executives. Also, the FTA and NAFTA can be plausibly associated in a direct wa

Economic arguments for tax cuts for competitiveness are suspect since foregone public expenditures have positive impacts on productivity. Further, Canada-US corporate tax differences in the mid-1990s were small, and were offset by other cost factors, such as lower energy prices and lower health costs for workers. On the personal income tax side, high income earners did tend to pay somewhat more than in the US, but the gap was modest in the aftermath of the Clinton Administration's tax hikes, and the alleged 'brain drain' was hugely exaggerated. Nonetheless, the ideological and self-serving argument for tax cuts largely won the day after deficits were eliminated.

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It is important to spend money wisely and efficiently, but the scale of public spending clearly matters as well. The Canada-US difference has shrunk dramatically in the 1990s because of deep cuts to Canadian spending on social programs and public services, and this was clearly driven in significant part by the campaign of the right for downward harmonization of taxes, financed through social spending cuts. Competitive pressures trumped the desire of most Canadians to renew social spending once deficits had been eliminated. An EKOS survey ("Reinventing Government") which regularly charts differences between elite and non-elite opinion has found that the former very strongly favoured corporate and personal tax cuts as the best use of the emerging federal surplus. Corporate elite views were clearly the most influential in policy terms, and the desire of m pronounced erosion and downward harmonization of the Canadian social model in the 1990s, and will only increase in importance if economic integration continues and deepens.