Real disposable income per capita in Canada is currently C$13,000 higher than it was in 1980. In the US, it is US$25,000 higher. What’s behind that gap? The answer is complex, but a precondition for any policy initiative aimed at tackling this issue is a clear understanding of the trajectory of the main components that are contributing to this trend. That’s what we’re trying to do here.

**A Brief History of the Gap**

Over the past four decades, average real annual disposable income per capita in Canada has risen by 1.3%, notably slower than the 1.9% growth seen south of the border (Chart 1, left). On a cumulative basis, that measure in the US rose 40% faster than in Canada (Chart 1, right).

Now, four decades is a long time, and in order to fully appreciate the nature of that gap, we need to examine its trajectory over time. As illustrated in Chart 2, every decade has its own story. The 1980s and its double dip recession saw US income growth outpace Canada’s by close to 0.7% per year. But the real break away occurred in the 1990s, as the jobless recovery in Canada resulted in a dramatic widening in the gap, with the US outpacing Canada by an inflation-adjusted 1.5% per year during that decade. The 2000s started with relative stability in the gap, with income in both countries rising roughly at the same rate. But by the latter half of the decade, Canada started to make its move, and the gap began to narrow.

From this, we learn that over the past four decades, income growth in Canada was able to outpace growth in the US, on a
sustainable basis, only 15% of the time—and even that outperformance was helped notably by the fact that the US went through its worst recession since the Great Depression. We also can say that the US’s recovery since 2010, which saw the US-Canada income gap widen by 8%, almost completely erased Canada’s gains made since the latter part of the 2000s. This means that the gap generated in the 1980s and further in the 1990s remains intact.

This, of course, has important implications. For example, if it were not for that underperformance, Canada’s highly watched household debt to income ratio would have been 150%, as opposed to the current reading of over 170% (Chart 3).

Any attempt to try to fully understand the factors behind that underperformance must start with accounting for the sources of that gap. Is it about job creation? Wage growth? Taxes? Investment income? Let’s take a look.

The Demographic Factor

Our measure is real per capita disposable income. Let’s focus first on the “per capita” part. As illustrated in Chart 4, since 1980, population growth in Canada has outpaced growth in the US, with most of that outperformance occurring in the past decade. That faster population growth accounted for 15% of the widening in the income gap since the 1980s, and no less than half of the widening in the gap since 2010. But that, of course, is not really a good excuse. With that extra population growth, we should have seen proportionally extra income growth, and that obviously is not happening.

Taxes?

Next, we focus on the “disposable” part. To what extent did taxes and other transfers to governments account for the rising income gap? For obvious reasons, that component in Canada is much larger, accounting for more than 30% of gross income vs 10% in the US. As illustrated in Chart 5, growth in gross income in the US rose roughly at the same rate as net income. At the same time, in Canada, net income rose more slowly. We estimate that the impact of faster rising taxes and other transfers to governments (such as CPP) in Canada have accounted for close to one-quarter of the widening in the gap since 19801.

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1 Without the widening in the US-Canada income gap since 1980.
Keeping that in mind, we now turn our attention to the relative performance of gross income, and its components.

As illustrated in Chart 6, income growth in the US has outperformed income growth in Canada in each and every category. The most important factor here is obviously the performance of labour income, which in both countries, accounts for about 60% of total personal income.

On a per capita basis and adjusted for inflation, this component of income in the US has risen by an annual average of 1.5% since 1980. At the same time, in Canada, labour income per capita has risen by only 1.2%. No surprise—the trajectory here mirrors the trajectory seen in total personal income.

We estimate that the smaller increase in labour market income in Canada accounts for just over 50% of the entire increase in the US-Canada gross income gap since 1980. Lower growth in transfers from governments (in part due to the jump in unemployment insurance payments in the US in the 2000s and mostly during the Great Recession), accounted for 35% of the widening gap, while lower growth in interest/dividend and rental income in Canada accounted for the rest (Chart 7).

What’s Behind Labour Income Underperformance?

Given the importance of labour income for our story, we can go one step further and look at the factors behind Canadian underperformance here. Labour income comes from three sources: job creation, wage increases and labour composition.

Let’s start with job creation. As illustrated in Chart 8, over the past four decades, the pace of job growth on average in the US and Canada was very similar. That suggests that job creation was not a major factor impacting Canada’s underperformance in growth in labour compensation during the entire period.

However, real wages in the US rose notably faster, averaging real annual growth of just over 1.2% vs. less than 1% in Canada.
Since the 1980s, part-time employment in Canada more than doubled, while in the US it was little changed. Self-employment has seen a similar divergence. What’s more, the vast majority of the increase in self-employment in Canada has been in the form of unincorporated, one-person operations, which on average, earn 75% of the income earned by paid-employees.

Putting It All Together

Even putting aside the fluctuations of the Canadian dollar, the US-Canada personal disposable income per capita gap has widened by an inflation adjusted 48% since 1980. One-quarter of that widening in the gap was due to faster growth in taxes and other transfers to governments in Canada. Zooming in on gross personal income, just under one half of the widening in the gap is due to lower growth in rental and interest/dividend income in Canada, as well as faster growth in government transfers in the US. The rest is due to lower growth in labour income in Canada—all of which is due to a combination of slower wage growth and less favourable composition of job creation in Canada.

This analysis does not explore the root economic causes of the widening US-Canada income gap, nor does it discuss relative changes in income distribution. Rather, it provides an accounting framework, which permits a more focused picture of the widening gap. This should result in a better appreciation of the different dimensions of the poorer income growth performance in Canada, as well as the potential effectiveness of policy initiatives aimed at tackling the problem.

Note: (1) It also means, however, that Canada’s pension system is better funded.

The rest of the underperformance is due to less favourable job composition in Canada, as well as the role of part-time and self-employment in the Canadian labour market.