THE CANADA WE KNOW was built on the presumption of rising economic output over time. That faith has been factored into the way we live, from the social services and entitlements that are part of the furniture of our democracy to our expectations of greater opportunity for every generation that follows. | WHAT HAPPENS when the growth that sustains those programs and values subsides? In the following pages we ask not just whether we are fated to live with slower growth, but how we might adjust to living that way and, if we reassess how we define our sense of well-being, whether that shift could be a blessing.

Living with Slower Growth

Vivre en mode de faible croissance

TORTOISE PHOTOS: ISTOCK

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When the middle class meets slower growth

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One of the most high-profile issues of the day is widening income inequality, so a reasonable question to ask is what to expect when such distributional change is combined with a "new normal" of slower economic growth. If the overall size of the economic pie is no longer growing much, while the relative shares of some groups are slipping, what does this say about the real incomes of these groups?

Before one can address this question, though, one has to understand what has been happening to income distribution in Canada. A great deal of attention has been devoted recently to the "great divergence," and the Occupy Wall Street protest has expressed a broad inchoate frustration at the widening gap between rich and poor. Yet the details of distributional change show that there are important differences between Canada and the United States. The first task is to identify the main features of distributional change in Canada over recent decades.

It is useful to focus on three key distributional changes for Canada that jointly may be called "the new distributional paradigm." First, rising income inequality has been characterized by a dramatically rising share of income for top income recipients, and hence a widening gap between top incomes and the rest. Since the late 1970s, the Gini coefficient has gone up from 0.317 to 0.369 (sources for all statistics cited can be obtained from the author upon request). The rising inequality is basically being driven by what is happening to earnings in the labour market. The share of the top 20 percent of families rose from 38 percent of all family incomes to over 43 percent, while the share of the top 1 percent of tax filers went up from 7 percent of income to 10.6 percent in 2010. Over the same period, the median income of the top 1 percent of tax filers rose from 7 to 10 times that of the lower 99 percent of filers.

Second, there has been an increased polarization of earnings in the North American labour market and a hollowing out of previously middle class-type jobs. While the share of income of the poorest 20 percent of families has remained roughly the same since the late 1970s, between 1977 and 2010 the share of income of the middle 60 percent of families fell from 56.1 percent to 50.7 percent, or by about the same amount as the income share of the top 20 percent has gone up. So the rising top income share has come at the expense of a falling middle class income share.

Third, there has been a decline in economic mobility in Canada, resulting in receding opportunity to get ahead. Between the 1980s and the 1990s, the average probability of moving up or down in earnings classes over an eight-year period for male earners fell from 64.7 percent to 62.7 percent, and it fell for female earners from 59.9 percent to 58.4 percent. The probability of moving up across earnings classes also fell for both men and women. Evidence also suggests that it is getting harder for sons to move up the economic ladder than their fathers' generation.

The "great divergence" embodied in this new distributional paradigm since the late 1970s contrasts with the "great compression" that characterized North American distributions from the Second World War until the 1970s.

What are the implications of this new paradigm when it is combined with a new normal of slower economic growth? If the middle class share of overall income is declining, then average middle class incomes are growing more slowly than the average incomes as a whole. If income growth is low enough, then average middle class real incomes will actually decline.

We may be facing a historic shift away from a period in which middle class Canadians could expect their economic prospects to be better than their parents' were and more of them could expect to move up the economic ladder. Given that the middle class is where most Canadian votes reside, their reaction may carry considerable political consequences.

While rising incomes at the top end of the income distribution have received most of the media attention, it is the declining middle income shares that will likely be the more politically potent concern. ■