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REVIEW ARTICLE

The Role of Monetary and Fiscal Policies on Income Inequality in Canada During Covid-19

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ABSTRACT: The motivation for my research is the impacts of the COVID-19 pandemic on wealth and income inequality in Canada, focusing on the factors that triggered these inconsistencies. Income inequality has been a concern recently, particularly following the global financial crisis of 2007-09 and the COVID-19 pandemic. Data show that this increase disproportionately in wealth affected low-income earners and younger people, while older individuals benefited from higher retirement income. These findings suggest the potential role of monetary policy in driving changes in income inequality and the extent to which monetary policy decisions reflect observed inequality.

KEYWORDS: Finance; Economics; Monetary policies; Fiscal policies; Canada; Covid-19; Wealth gap.

Introduction

Monetary policies alone, such as changes in interest rates and the use of unconventional measures such as quantitative easing or tightening, cannot fix the income inequality problem in a given country. However, monetary policies, coupled with respective fiscal measures and progressive taxation, can impact income inequality in a significant way.[1] During the COVID-19 pandemic, the Bank of Canada cut its policy interest rate to near zero and implemented quantitative easing measures, such as purchasing government bonds and other financial assets. Alongside these monetary measures, the federal government launched a series of temporary cash transfers to support businesses and low-income workers and revitalize the national economy.[2] How do monetary policies that the Canadian government implemented to tackle the COVID-19 crisis contribute to exacerbating income inequality? My research aims to discuss how monetary policies influence overall economic activity and widen the inequality between higher-income individuals and lower-income groups by leading to asset price hikes.

The inequality in income caused by the pandemic leads to social and economic problems, such as increased poverty and social unrest.[2] A comprehensive overview of the factors that contribute to income inequality allows policymakers to work on addressing and mitigating these adverse outcomes. Income inequality has long-lasting impacts on individuals and communities where a population faces economic instability, financial crisis, debt, and inflation. By identifying the drivers of income inequality during the COVID-19 pandemic, policymakers can work to address these issues in the short term and prevent them from becoming entrenched over the long term.[3]

Literature Review

The literature on wealth and income inequality in Canada mainly draws attention to the economic policies pursued during the neoliberal era, Canada's liberal welfare regime, and regressive fiscal policies since the early 1980s.[1] Although monetary policy is not a single driver of income inequality, it has an overall impact on the economy and can be utilized to narrow down the income gap. In this respect, my research aims to build on how, against the backdrop of neoliberal economic measures, the monetary policies have widened the income gap in Canada during the COVID-19 pandemic. Understanding the income inequality caused by monetary policies during the COVID-19 pandemic is important for designing effective and equitable economic policies that can benefit all members of society.

This paper contributes to two main strands of literature. The paper that my research supports is on the changes in income inequality in Canada, examining the gap from the early 1990s and the underlying factors that impact these income gaps in the past.[1] The paper examines Gini coefficients (a measure of inequality in the underlying distribution, in this instance of household market income across the population) to find that the largest and most persistent income inequality increase occurred during the 1980s and 1990s recession. The paper suggested various factors driving the increase in income inequality, the most prominent one being policy and institutional changes. The Bank of Canada and the Department of Finance introduced the inflation-targeting monetary policy framework in 1991 in an effort to address the high and persistent inflation that was observed in Canada during the 1970s and 1980s. Some have argued that the efforts to bring down inflation through this policy framework may have contributed to or exacerbated the recession that occurred at that time.[4] It is believed that this may have led to structural unemployment, which can have long-lasting impacts and contribute to rising inequality. During the period in question, there were several changes to fiscal policies in Canada.[4] These changes, which may have contributed to rising after-tax income inequality, included federal tax increases on items such as sales, excise, and payroll taxes and shifts in provincial tax and transfer systems that placed less emphasis on equality.[3] These consolidations were implemented in response to growing public sector debt.

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A similar piece of literature that contributes greatly to my research area is focused on the rise of income inequality through stocks in the United States during the COVID-19 pandemic. The New York Times author Robert Gebeloff states that job losses disproportionately affect lower-wage workers. At the same time, other Americans benefited in gains from share prices, including those who own individual stocks in brokerage accounts and those who own stocks in personal retirement accounts.5 His research on income inequality is further proven through the unequal distribution of income through ownership of financial assets in general and stocks. In the United States, many Americans benefitted from rising stock prices, but wealthier families own a far greater share of overall equity holdings and benefited far more. According to the article, the top 10% of households by income own 84% of all stocks, while the bottom 50% own just 0.5%. The article also notes that the stock market has performed well during the pandemic, with the S&P 500 index increasing by more than 50% since March 2020. This has led to a further increase in the wealth gap between those who own stocks and those who do not. The article discusses various factors contributing to this unequal distribution of stock ownership, including the rise of passive investing, the increasing concentration of corporate ownership, and the declining number of publicly traded companies. The article concludes by discussing the potential consequences of this inequality, including the potential for social unrest and the need for policy interventions to address it. The author's research supports my hypothesis that the COVID-19 pandemic increased the inequality in wealth; the rich get richer, and the poor get poorer.

Building upon the policy implications that deepened the 1990s recession and led to inequality, this research aims to investigate how similar policy measures implemented during the COVID-19 pandemic have contributed to an increased income gap. By examining the impacts of these policies, it seeks to shed light on the underlying dynamics that have exacerbated income inequality.

Canada's Neoliberal Era:

Neoliberalism, characterized by its emphasis on free markets, deregulation, privatization, financialization, small government, and fiscal austerity, has profoundly affected advanced economies, leading to the rollback of social assistance programs and welfare state retrenchment. In the early 1980s, following the footsteps of other advanced capitalist states, Canada had replaced the Keynesian consensus with neoliberal economic and monetary policies. Coupled with the economic policies that favored free markets and corporations over labor and government spending on social assistance, the Bank of Canada's monetary policies focused on controlling inflation and price stability during the neoliberal era.[1-6] As a result of such neoliberal economic and financial policies, over the course of the 1990s and 2000s, wealth and income inequalities in Canada have notably increased. Although Canada's GDP per capita increased from around $16,000 in 1946 to $57,000 in 2022, these income gains have been unevenly distributed.[7]

Understanding this neoliberal backdrop is crucial to understanding how wealth and income gaps have steadily widened in the last 40 years. The pandemic has exposed and exacerbated existing disparities, as the neoliberal framework has already weakened social safety nets and contributed to income inequality.[6] As the pandemic unfolded, certain groups, such as low-wage workers and marginalized communities, were disproportionately affected, highlighting the underlying structural inequities that persist in the country. Examining the intersection of neoliberalism and the pandemic response underscores the importance of addressing the systemic issues rooted in neoliberalism to build a more equitable and inclusive society moving forward.

Methods

Policy Responses to the Pandemic:

During the COVID-19 pandemic, the Canadian government implemented a number of monetary and fiscal policies to support individuals, businesses, and the economy as a whole and to prevent a recession. These measures aimed to provide immediate financial relief to individuals and households facing job losses, reduced income, and economic hardship.

Table 1: Major policy responses to the COVID-19 crisis.[8]

Action	Description	Date
Policy rate cut by 0.5 percentage points	The Bank of Canada lowered its rate target to 1.25 percent.	March 4, 2020
Additional bond purchases and lending	The Bank expanded the frequency and scope of term repurchase operations and (as fiscal agent of the Government of Canada) of bond repurchase operations.	March 12, 2020
Domestic stability buffer lowered by 1.25 percent	The Office of the Superintendent of Financial Institutions (OSFI) lowered the common equity Tier 1 required of domestic systemically important banks from 10.25 percent to 9 percent of risk-weighted assets.	March 13, 2020
Policy rate cut by 0.5 percentage points	The Bank lowered its rate target to 0.75 percent.	March 16, 2020
Canada Mortgage Bond Purchase Program (CMBP)	The Bank began purchasing Canada Mortgage Bonds in the secondary market (with primary dealers).	March 17, 2020
Bankers' Acceptance Purchase Facility (BAPF)	The Bank began purchasing bankers' acceptance securities in the secondary market (with primary dealers).	March 23, 2020
Provincial Money Market Purchases (PMMP)	The Bank began purchasing provincial securities through the primary issuance market.	March 25, 2020
Policy rate cut by 0.5 percentage points	The Bank lowered its rate target to 0.25 percent.	March 27, 2020
Regulatory flexibility for liquidity coverage ratio (LCR) announced	OSFI announced its expectation that banks use their unencumbered high-quality liquid assets during periods of liquidity stress, even if they go below the 100 percent of the liquidity coverage ratio requirement.	March 27, 2020
Government Bond Purchase Program (GBPP)	The Bank began purchasing Government of Canada bonds on the secondary market (with government securities distributors and customers).	April 1, 2020
Reserves and sovereign securities exempted from leverage ratio	OSFI temporarily exempt central bank reserves and sovereign-issued securities from leverage regulation	April 9, 2020
Corporate Bond Purchase Program (CBPP)	The Bank began purchasing corporate bonds on the secondary market (with primary dealers or registered portfolio managers or pension plans).	May 26, 2020

On the monetary policy side, the Bank of Canada (BoC) slashed its policy interest rate to a record low of 0.25% in March 2020 (Table 1), making borrowing cheaper for households and businesses. The BoC also launched a large-scale asset purchase program, known as quantitative easing (QE), to further cut down borrowing costs, increase liquidity, and stabilize financial markets.[2-8] Then, the BoC has opened several lending facilities to support credit in the economy, including the Large Value Transfer System and the Bankers' Acceptance Purchase Facility.[8] During the pandemic, the

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BoC's monetary policies had the intended effect as they contributed to economic growth, raised employment prospects, kept funding markets functioning, and enabled individual financial institutions to have sufficient liquidity to lend. However, the bank's large-scale security purchases increased asset prices and made the rich richer. Such purchases disproportionately benefited the wealthy, who hold assets like stocks and bonds, widening the overall inequality among Canadian households. The pandemic-era easy lending has also worsened Canada's housing crisis by leading to a dramatic price hike in the real estate market and furthering the financialization of housing.[8,9]

On the fiscal policy side, the Canadian government implemented a number of measures to support individuals and businesses affected by the pandemic, such as the Canada Emergency Response Benefit (CERB), the Canada Emergency Wage Subsidy (CEWS), and the Canada Emergency Business Account (CEBA) program (Table 1).[10] These programs were designed to provide direct financial support to those who lost their jobs or experienced significant income reductions due to the pandemic. However, these policies have yet to be equally effective in addressing income inequality, with some gaps and limitations. For example, not all workers have been eligible for CEWS, and self-employed or gig workers may have been eligible for CERB but not for the other programs.[10,11] In addition, the benefits provided by these programs have been temporary, and some individuals and families continue to struggle with lost income and insecurity due to the pandemic.

The pandemic itself has had a significant impact on the economy and employment in Canada, which has led to changes in income distribution and an increase in income inequality. Undeniably, the measures the government has implemented have helped mitigate the pandemic's impact on income. Still, they have yet to produce a substantial redistributive effect and may not have even reached those most in need.[8] This is why the monetary and fiscal policies implemented in Canada during the pandemic have generated the opposite of the intended effect, to a certain extent, deepening wealth and income inequality and furthering the stickiness of the top and bottom of Canada's economic spectrum.[2]

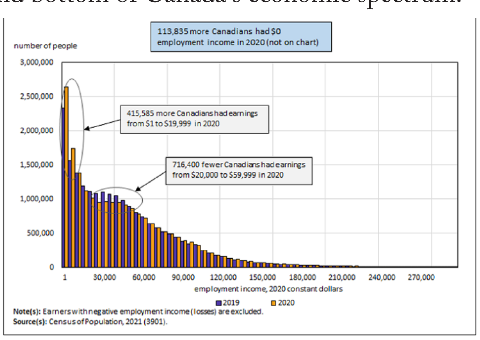

Figure 1: Those at the bottom of the earnings distribution were disproportionately impacted during the pandemic.[12]

Figure 1 shows the income inequality during the pandemic by showing the number of people earning within each income group in 2019. It shows that the pandemic disproportionately impacted those at the bottom of the earnings distribution. The bar chart displays the number of people earning in each income group from $1 to $3,000,000, with the horizontal axis representing the employment income groups in 2020 constant dollars from $1 to $300,000,00 and the vertical axis showing the number of people earning within each income group.[12] It can be seen that the number of people earning in lower income groups is higher than those earning in higher income groups. This suggests that the pandemic affected individuals earning lower incomes more than those earning higher incomes.

Canada's Housing Crisis:

The BoC's monetary policies during the pandemic contributed to wealth inequality by deepening Canada's housing crisis, as low interest rates made getting mortgages easier with relatively lower down payments. However, this easy lending process during the pandemic has driven up average house prices in many urban and suburban areas across the country and led to price hikes in metropolitan areas like the Greater Toronto Area and Metro Vancouver.[6]

Since the early 1980s, neoliberal economic and financial policies have planted the seeds of Canada's present housing crisis. Under neoliberal policies, market-based approaches gained momentum against public spending for the housing market. This has led to a housing market prioritizing profit and speculation rather than ensuring affordable and adequate housing for all. The privatization and deregulation policies have allowed for increased financialization of the housing sector and driven up house prices, making homes less affordable for a significant portion of the population, particularly the lower-income and marginalized communities.[6-11] Neoliberal policies have also contributed to a lack of investment in public housing and weakened social housing programs. As a result, the supply of affordable housing has not kept up with the growing demand, causing a housing crisis and, by extension, increasing inequality.

Canada has faced a significant housing crisis exacerbated by a combination of neoliberal policies and a lack of investment in public housing. The financialization of housing has played a crucial role in perpetuating inequality in the country. The rise of FIRE capital (financial capital, insurance capital, real estate capital) has transformed housing into an investment instrument rather than a basic necessity. As a result, housing has become increasingly unaffordable for the bottom 30% of the population, further widening the wealth gap.[6] The policies implemented in response to the COVID-19 pandemic have deepened the housing crisis. While some individuals have experienced a decrease in the value of their homes, others have encountered difficulties in both selling and buying properties. These market disruptions impacted household wealth, exacerbating income inequality within the country. Addressing the housing crisis in Canada requires a comprehensive approach that tackles both the financialization of housing and the lack of accessible public housing options. By implementing policies that prioritize affordable housing and sustainable development, the country can work towards reducing income inequality and ensuring adequate housing for all Canadians.[13]

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Neoliberalism's influence on the housing crisis is evident in the unequal distribution of housing resources and the widening wealth gap. The speculative nature of the housing market, driven by neoliberal policies, has further entrenched disparities, making it increasingly challenging for many Canadians to secure stable and affordable housing.[1,2] Thus, addressing the housing crisis requires reevaluating neoliberal approaches and adopting policies prioritizing the right to housing, affordable housing development, and increased public investment in housing infrastructure. This shift would involve recognizing housing as a fundamental human right rather than a speculative commodity, leading to more equitable access to housing and reducing the inequalities caused by neoliberalism.[13]

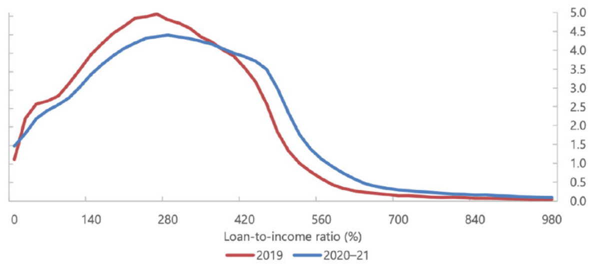

Figure 2: Distribution of loan-to-income ratios for new mortgages.[1]

Figure 2 shows that the rapid rise in house prices during the pandemic has led to an increasing share of households taking out new mortgages that are large relative to their incomes. This means that households are taking on larger amounts of debt in relation to their income, which can make them more vulnerable to financial shocks such as a rise in interest rates.[1] Additionally, the fact that a growing share of these mortgages has variable rates means that these households may be more affected by future changes in interest rates. In this context, monetary policy's decision to raise interest rates could lead to an increase in income inequality as the households that have taken out mortgages with high loan-to-income ratios may have more difficulty servicing their debt at higher rates, which could lead to a decrease in spending and may affect the whole economy. Monetary policy may impact income inequality in Canada through its effect on interest rates and housing affordability.[9] Rising interest rates may have an immediate impact on new homebuyers but a more gradual impact on existing homeowners. The rapid rise in house prices during the pandemic has led to an increasing share of households taking out new mortgages that are large relative to their incomes, with a growing share of these mortgages having variable rates.[1-3] This can amplify the impact of rising interest rates on households with high loan-to-income ratios and could worsen the impact of a future shock, potentially affecting the whole economy.

The loan-to-income chart indicates how much of a household's income is being used to pay off a mortgage. It shows the distribution of loan-to-income ratios for new mortgages, and it can be used to assess the risk of households falling behind on mortgage payments as interest rates rise. In this context, the chart is being used to show that there has been an increasing share of households taking out new mortgages that are large relative to their incomes, and a growing share of these mortgages have variable rates. This is a concern because high indebtedness could amplify the impact of rising interest rates, and it could also worsen the impact of a future shock, such as a drop in house prices. The Bank of Canada uses its rich data capabilities to monitor how households respond to monetary policy to mitigate these risks.[3]

Low interest rates can impact loan-to-income ratios for new mortgages in several ways. First, low interest rates can make borrowing more affordable, allowing borrowers to take on larger loans while maintaining a similar monthly payment level. This can increase demand for housing and drive up prices, exacerbating income inequality by making it more difficult for low-income individuals and families to afford a home.[1] Low interest rates can also lead to an increase in the number of people taking out mortgages, as the lower rates make it more affordable for them to do so. This can also contribute to rising housing prices and exacerbate income inequality by making it more difficult for low-income individuals and families to afford a home.[8,9] In addition, low interest rates can encourage financial institutions to loosen lending standards, leading to more high-risk loans and ultimately increasing the risk of a housing market crash. This can further exacerbate income inequality as low-income households are more likely to be affected by a housing market crash than high-income households.[12]

Results and Discussion

The Canadian government implemented both monetary and fiscal policies to support individuals, businesses, and the economy. The Bank of Canada (BoC) reduced interest rates and launched quantitative easing measures to stimulate economic activity and stabilize financial markets. However, these actions inadvertently contributed to wealth and income inequality by increasing asset prices and exacerbating Canada's housing crisis.

Programs like the Canada Emergency Response Benefit (CERB), Canada Emergency Wage Subsidy (CEWS), and Canada Emergency Business Account (CEBA) were introduced to provide direct financial support to those affected by the pandemic. While these measures offered relief, they could have been more effective in addressing income inequality, with certain workers being excluded and the benefits being temporary in nature.

The pandemic further highlighted income inequality, as individuals with lower incomes were disproportionately impacted. The housing crisis, driven by neoliberal policies and a lack of investment in public housing, also played a significant role in perpetuating inequality. The financialization of housing, combined with low interest rates, increased household debt and made housing less affordable for lower-income and marginalized communities. Addressing these challenges requires comprehensive approaches that prioritize affordable housing, increased public investment, and a reevaluation of neoliberal policies.[13,14]

Reforming Canada's Welfare Regime:

During the pandemic, the cash transfer programs were designed to help individuals meet their basic needs and maintain a level of economic stability during a time of widespread uncertainty and disruption. While these cash transfer programs were crucial in providing immediate relief and preventing a severe economic downturn, it is important to acknowledge that they were temporary measures with an emergency focus.[8-14] As the pandemic unfolded and the economic impact persisted, discussions around the need for longer-term support and systemic changes to address income inequality and social protection gaps have gained momentum. Implementing temporary cash transfer programs during the pandemic highlights the necessity for comprehensive and sustainable social safety nets to respond to future crises and address underlying issues of inequality and vulnerability in Canadian society. Moving forward, policymakers must consider how to build on these temporary measures to create a more robust and equitable social welfare system that can better withstand and mitigate the impact of future crises.[13]

Reforming Canada's liberal welfare regime is crucial to addressing the systemic inequality highlighted and exacerbated by the pandemic. The current policies have failed to effectively address the disproportionate impact on specific sectors, industries, and occupations. Low-paying sectors like retail and hospitality have experienced significant job losses and income reductions compared to industries less affected by the pandemic, such as technology and healthcare. Marginalized communities, including immigrants, refugees, black, Indigenous, and other people of color, have been disproportionately affected by business closures, travel restrictions, and quarantine measures. To combat inequality, Canada should consider implementing a progressive tax system that targets the wealthy and individuals with multiple properties. This would help redistribute wealth and create a more equitable society. In particular, adopting elements of a social democratic welfare regime akin to the Scandinavian or Nordic model could be beneficial. This might involve instituting a universal basic income program to provide a guaranteed income to all citizens regardless of employment status.[13-15] These measures would reduce income inequality, ensure greater social protection, and promote a fairer and more inclusive society in Canada.

Conclusion

The findings emphasize the unintended consequences of expansionary monetary measures, which led to asset price inflation and disproportionately benefited higher-income individuals. Similarly, while fiscal policies provided much-needed support, limitations and gaps in their distribution resulted in unequal benefits and inadequate assistance for certain groups. My findings underscore the need for policymakers to consider the systemic factors contributing to income inequality, such as neoliberal economic policies and the housing crisis, and prioritize inclusive growth strategies that address these root causes.

Moving forward, policymakers must implement measures that promote economic equity and social well-being for all Canadians. This requires a comprehensive approach that tackles the structural issues perpetuating income inequality. Addressing the financialization of housing, investing in affordable and accessible housing options, and designing targeted fiscal policies that prioritize the needs of vulnerable populations are essential steps toward reducing income disparities. By recognizing the long-standing impact of neoliberalism and adopting policies that promote inclusive growth, Canada can work towards building a more equitable society where all share opportunities and prosperity.

Reforming Canada's Welfare Regime:

When more data is available, one can identify the growth in financial assets and value per household and the growth in real estate and value per household in 2021. While wealth is an integral part of inequality, publicly available time-series data on wealth in Canada should be more comprehensive regarding granularity. They can use the Distributions of Household Economic Accounts, which have data only from 2010 to 2021. Breaking down wealth by income quintile, we can see that all income quintiles have increased over the last ten years. If we look at the growth of different components of wealth, we see that both financial assets and real estate have driven the increase in wealth for all income quintiles. Various government support programs targeted at low-income households during the pandemic period undoubtedly explain some of this in more recent years.

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