Ideas for a More Prosperous Society

ECONOMIC NOTES

TAXATION SERIES

FEBRUARY 2024

PRO-MARKET REFORMS PROMOTE INCOME MOBILITY: THE CASE OF ALBERTA

By Vincent Geloso, Justin Callais, and Alicia Plemmons

Income mobility is the ability of individuals to climb the economic ladder. There is a common fear that in highly unequal societies, someone born in the poorest class will remain trapped there.[1] This has motivated numerous calls for more government intervention in the economy, notably by increasing funding to education or social policies.[2] Until fairly recently, little consideration was given to the role of pro-market reforms in promoting income mobility. The present study highlights their importance by using the case of Alberta's economic reforms during the 1990s, in which reduced government spending led to increased income mobility among the poorest segment of the population.

ECONOMIC FREEDOM CREATES OPPORTUNITIES

Recent research has shown that societies exhibiting higher levels of economic freedom (that is, strong protection of property rights, limited regulation, open trade, and limited government) tend to have far higher levels of income mobility (both within and across generations) and faster transitions out of poverty.[3] This new research shows not only that inequality is a weaker determinant than economic freedom, but also that government spending has ambiguous effects, suggesting that piecemeal government solutions may not actually facilitate mobility, as was once thought.[4]

Economic freedom, on the other hand, has the potential to promote income mobility both directly and indirectly. The direct effect comes from the relative absence of legal and regulatory barriers to people's efforts to climb the income ladder, as well as the ability to retain more of the fruits of their labour thanks to low taxes and secure property rights.

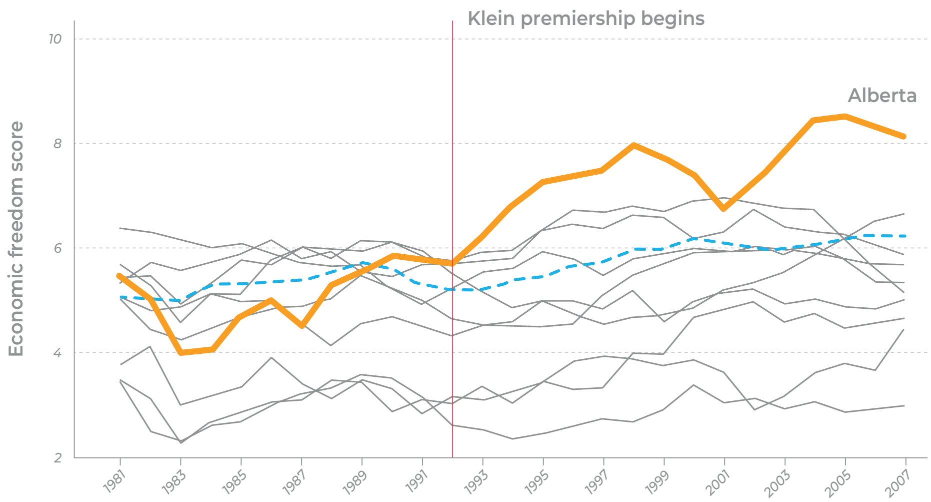
This Economic Note was prepared by **Vincent Geloso**, Assistant Professor of Economics at George Mason University and Senior Economist at the MEI, **Justin Callais**, assistant professor of economics at the University of Louisiana at Lafayette, and **Alicia Plemmons**, assistant professor of economics and business at West Virginia University. The MEI's Taxation Series aims to shine a light on the fiscal policies of governments and to study their effect on economic growth and the standard of living of citizens.

Occupational regulations, for instance, impose high fees and restrictions on certain professions. Studies of these regulations suggest that their burden falls disproportionately on the poor by limiting their chances at upward mobility.[5]

The indirect effect, meanwhile, is felt through economic growth, which is stimulated by economic freedom.[6] Economic growth obviously promotes absolute income mobility, namely how much one's income increases relative either to one's parents or one's past self. However, it also improves relative income mobility, which is to say, one's movement up the income ladder relative to one's initial position. As long as an extra dollar of GDP opens up more opportunities for the poor than the rich, it will help the poor rise up the ladder.

Figure 1

Economic freedom in Canadian provinces (solid lines) and American states (average, dashed line)



Source: Justin Callais, Vincent Geloso, and Alicia Plemmons, "Income Mobility, Austerity, and Liberalization: Evidence from Alberta's Reforms in the 1990s," Working Paper, George Mason University Department of Economics, 2024, p. 3. Based on data from Dean Stansel *et al.*, *Economic Freedom of North America 2023*, Fraser Institute, November 2023.

ALBERTA'S REFORMS IN THE 1990s

The economics literature, however, speaks of a correlation rather than a causal effect. It is certainly conceivable that more mobile societies foster economic freedom, and thus that the causal link might run in the opposite direction.

Societies exhibiting higher levels of economic freedom tend to have far higher levels of income mobility and faster transitions out of poverty.

Alberta's experience offers us a chance to assess which way the causal link runs.[7] In December 1992, Ralph Klein became premier of the province. From the start, he argued that Alberta did not have a public revenues problem, but rather, a spending problem.

Many public sector workers were thus fired, and program spending was reduced. Between 1992-93 and 1996-97, government spending per capita (adjusted for inflation) fell by 32%.[8] Simultaneously, reforms were enacted to lighten the regulatory burden, most notably in the energy sector;[9] some crown corporations were privatized;[10] and personal and corporate tax rates were reduced.[11]

Indicators of economic freedom available at the sub-national level show that these were major reforms, as can be seen in Figure 1. During the 1980s and early 1990s, Alberta was very similar to the average Canadian province or American state. The reforms propelled it to first place in terms of economic freedom, ahead of all Canadian provinces in all years and ahead of most American states in most years.

POSITIVE EFFECTS ON INCOME MOBILITY

Such momentous and unique reforms are ideal for assessing the causal effect of pro-market policies on income mobility. In order to do so, we employed data from Statistics

Canada, which publishes two income mobility datasets (over one-year and five-year rolling windows) using tax records. For example, one group of people is tracked during the period from 1982 to 1983 (or from 1982 to 1987 for the five-year window), another group is tracked during the period from 1983 to 1984, and so on.

Over each of these windows, we evaluate how much the group's incomes changed. Most importantly, the data allow us to consider the income changes of the poorest 10% (or the poorest decile) of the population. The income mobility of this segment of the population is the most interesting, as they are the most vulnerable. We also estimate income mobility using both market income (earnings from employment, investment income, and private pensions) and after-tax income (post-tax and post-government transfers).

We use four separate but complementary measures: i) the percentage change in average income[12] over the period; ii) the proportion of individuals who experience income increases greater than 50% for the one-year window, or 200% for the five-year window; iii) the average number of deciles a person in the poorest decile jumped up; and iv) the proportion of individuals in the bottom decile who jumped up more than three deciles.

We moreover use a method known as "synthetic controls" to create a composite Alberta from a mixture of other provinces. It is meant to approximate what Alberta would have looked like without the policy changes of the first half of the 1990s. The difference between the synthetic Alberta and the real one points to the causal effects of the pro-market reforms on income mobility.[13] Our synthetic Alberta is composed of a mixture of British Columbia, Saskatchewan, and Ontario. This is justified by geographical similarities, notably the importance of natural resources in their respective economies.

Table 1 shows our results for the effects of the reforms on income mobility by 2005 for the poorest 10% of the population. The top and bottom panels of the table show the effects on market income and after-tax income respectively, while the left- and right-hand columns show the effects on one-year and five-year mobility measures.

With after-tax income, there are important positive effects. For example, based on our estimates, the incomes of the province's poorest 10% increased 73 percentage points more over each five-year window than predicted if Alberta had not enacted its reforms. This represents two-thirds of the income mobility that they actually enjoyed. The proportion of the poorest Albertans who saw their income increase by more than 200% over each five-year window also increased significantly, with an extra 11.9% (over 8,600 Albertans) enjoying such large jumps thanks to the reforms.

During the 1980s, Alberta was very similar to the average Canadian province. The reforms propelled it to first place in terms of economic freedom.

These gains are so substantial that many found themselves far higher up the income ladder. On average, over each five-year window, the poorest Albertans enjoyed an extra 0.80 decile jump up thanks to the reforms, which is roughly one third of the total observed mobility. This is echoed by the proportion of those who jumped up more than three deciles: an extra 12% of the poorest Albertans within five years thanks to the reforms, which is close to half of the total observed mobility with this measure.

These after-tax income results are particularly telling, since after-tax income accounts for changes in government spending in the form of reduced transfers to individuals. Yet, in spite of these reductions in government spending, income mobility went up considerably.

Table 1

Summary of the causal effects of Alberta's pro-market reforms on different measures of income mobility by 2005

	Market Income	
	1-Year Mobility	**5-Year Mobility**
i) Per capita average income change	No significant effect	+ 100 percentage points
ii) Proportion with more than 50% income increase (more than 200% for 5-year mobility)	No significant effect	+ 5.6%
iii) Decile jumps up	No significant effect	+ 0.48 deciles
iv) Proportion jumping up more than 3 deciles	No significant effect	+ 7.6%
	After-Tax Income	
	1-Year Mobility	**5-Year Mobility**
i) Per capita average income change	+55 percentage points	+73 percentage points
ii) Proportion with more than 50% income increase (more than 200% for 5-year mobility)	+15.0%	+ 11.9%
iii) Decile jumps up	+ 0.63 deciles	+ 0.80 deciles
iv) Proportion jumping up more than 3 deciles	+7.6%	+ 12.0%

Note: The definition of after-tax income used by Statistics Canada includes some adjustments (notably for household size) such that the synthetic, business-as-usual Alberta created for the market income comparisons differs somewhat from the synthetic Alberta created for the after-tax income comparisons. The top and bottom halves of the table are thus not strictly comparable with each other.
Source: Justin Callais, Vincent Geloso, and Alicia Plemmons, "Income Mobility, Austerity, and Liberalization: Evidence from Alberta's Reforms in the 1990s," Working Paper, George Mason University Department of Economics, 2024, pp. 15-24.

The main reason for this is that the reforms also boosted market income mobility. Since this measure of income is based on employment and investment income, mobility will capture the effect of additional economic opportunities. This is confirmed in the top panel of Table 1, where the results for market income are shown. There are no significant effects on the one-year mobility measure. However, with the five-year income mobility measure, there are significant gains due to the reforms. In other words, the reforms that Alberta enacted in the 1990s promoted income mobility powerfully by enhancing economic opportunities for the poorest 10% of the population.

These lessons from Alberta tell us that it is possible to promote income mobility and improve the lot of the poor without increasing taxes and spending. What matters most is removing hurdles that make it difficult for people to help themselves. Other Canadian provinces would do well by their most vulnerable residents to consider enacting similar reforms.

The reforms that Alberta enacted promoted income mobility powerfully by enhancing economic opportunities for the poorest 10% of the population.

REFERENCES

1. Miles Corak, "Income Inequality, Equality of Opportunity, and Intergenerational Mobility," *Journal of Economic Perspectives*, Vol. 27, No. 3, 2013, p. 79.
2. One example is that of Sonny Scarfone *et al*., "Le Québec est-il égalitaire? Étude de la mobilité sociale et de l'égalité du revenu au Québec et au Canada," Institut du Québec, 2017, p. 7. In this source, the only solutions proposed to promote social mobility involve bigger government, notably through increased funding for education.
3. Justin T. Callais and Vincent Geloso, "Intergenerational income mobility and economic freedom," *Southern Economic Journal*, Vol. 89, No. 3, 2023, pp. 749-750; Vincent Geloso and James Dean, "Economic Freedom Improves Income Mobility: Evidence from Canadian Provinces, 1982–2018," *Journal of Institutional Economics*, Vol. 18, No. 5, 2022, pp. 815-823.
4. Nobel laureate James Heckman emphasizes that the size of the government (in terms of social spending) and inequality are weak factors. James Heckman and Rasmus Landersø, "Lessons for Americans from Denmark about inequality and social mobility," *Labour Economics*, Vol. 77, August 2022, pp. 12-13. As for the ambiguous effects of government spending, the high taxes needed to fund certain policies might well end up discouraging investment (including in education). Horst Feldmann, "Economic freedom and human capital investment," *Journal of Institutional Economics*, Vol. 13, No. 2, 2017, p. 436.
5. Brian J. Meehan *et al*., "The effects of growth in occupational licensing on intergenerational mobility," *Economics Bulletin*, Vol. 39, No. 2, 2019, p. 1525.
6. Joshua C. Hall and Robert A. Lawson, "Economic freedom of the world: An accounting of the literature," *Contemporary Economic Policy*, Vol. 32, No. 1, 2014, p. 8.
7. Most of the rest of the present study is based on our work in Justin Callais, Vincent Geloso, and Alicia Plemmons, "Income Mobility, Austerity, and Liberalization: Evidence from Alberta's Reforms in the 1990s," Working Paper, George Mason University Department of Economics, 2024.
8. Tegan Hill, Ben Eisen, and Milagros Palacios, "Lessons for Fiscal Reform from the Klein Era," Fraser Institute, February 2021, p. 8.
9. Patrick Impero Wilson, "Deregulation and natural gas trade relationships: lessons from the Alberta-California experience," *Energy Policy*, Vol. 25, No. 10, 1997, pp. 865-868.
10. Mark Milke, "Want smarter government? Focus it," *Calgary Herald*, October 4, 2014.
11. Matthew Lau, "Alberta's Spending and Tax Cuts are Eminently Sustainable," *C2C Journal*, December 17, 2019.
12. We are using the average income of the bottom 10%; the median changes by roughly the same proportions in that group.
13. For a discussion, see Alberto Abadie, "Using synthetic controls: Feasibility, data requirements, and methodological aspects," *Journal of Economic Literature*, Vol. 59, No. 2, 2021, pp. 391-425. For an application to Canadian-specific examples, see Vincent Geloso and Kevin B. Grier, "Love on the rocks: The causal effects of separatist governments in Quebec," *European Journal of Political Economy*, Vol. 71, 2022; and Vincent Geloso and Chandler S. Reilly, "Did the 'Quiet Revolution' Really Change Anything?" CIRANO, 2022.

910 Peel Street, Suite 600, Montreal (Quebec) H3C 2H8 T 514.273.0969
150 9th Avenue SW, Suite 2010, Calgary (Alberta) T2P 3H9 T 403.478.3488