

Structural Aspects of Unemployment in Canada: Introduction and Overview

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With the strong aggregate demand growth experienced in recent years, the unemployment rate in Canada has fallen from 9.6 percent in 1996 to 7.8 percent in 1999 and to 6.7 percent in the first half of 2000. Despite this decline in the unemployment rate, the inflation rate in Canada has remained low, with core inflation (the Consumer Price Index excluding the volatile energy and food components) rising only 1.4 percent in 1999 and at a 1.4 percent annual rate in the first half of 2000.

There are a number of implications of these developments. First, the relative importance of deficient-demand unemployment, which affected Canada throughout the 1990s, has declined with the buoyant economy. Second, the decline in the unemployment rate below earlier estimates of the NAIRU without any increase in inflation suggests that the structural rate of unemployment has fallen. Third, with the decline in demand-deficient unemployment, the relative importance of structural unemployment has increased.

The papers in this volume primarily address the third of these implications. Looking ahead, ongoing sustainable reductions in aggregate unemployment may well depend on better structural performance of Canadian labour markets. And strong growth in the available workforce will depend on reductions in structural unemployment. Consequently, the im-

portance of structural labour market policies as a means to lower unemployment and sustain economic growth will increase in the early years of the new millennium.

The origins of this volume go back to 1998 when the Centre for the Study of Living Standards (CSLS) was approached by Finance Canada and Human Resources Development Canada to organize a conference on these structural aspects of unemployment. The CSLS commissioned a number of papers from both Canadian and international economists and held a conference on 22-23 April 1999 in Ottawa. This special issue of *Canadian Public Policy/Analyse de Politiques* contains revised versions of the papers presented at the conference.

OVERVIEW OF PAPERS

The 15 papers in this volume are organized under six sections: Canada's Labour Market Performance in the 1990s; the Youth Labour Market in the 1990s; Determinants of Structural Unemployment: Labour Market Mismatch and Unemployment; International Unemployment Experience; and Policies to Reduce Unemployment.

In the first section, the first paper by Garnett Picot and Andrew Heisz examines the performance of

the Canadian labour market and finds no evidence that structural factors increased unemployment in the 1990s. In the second paper, Jim Stanford looks at Canada's labour market developments in the 1990s from an international perspective and concludes that Canada's labour market is in many ways more flexible than the US labour market, although it is more regulated.

In the first paper in the second section on the youth labour market, Thomas Lemieux, Paul Beaudry, and Daniel Parent analyze what is happening in the youth labour market in Canada and conclude that demographic trends and the general deterioration in labour market conditions, not youth-specific factors, account for lower youth participation and higher unemployment. In the second paper, Morley Gunderson, Andrew Sharpe, and Steve Wald examine the evolution of the relative youth unemployment rate over the past two decades, finding that teenagers, particularly teenagers who are full-time students seeking part-time work, account for most of the rise in the relative 15-24 group unemployment rate in the 1990s.

In the first paper in the third section on the determinants of structural unemployment, Craig Riddell discusses how certain groups on the margins of the labour force are treated in the measurement of unemployment, and finds that the labour market behaviour of some of these groups (e.g., persons on temporary layoff, future starts) is similar to persons in the labour force, suggesting they should be counted in a broader measure of unemployment. In the second paper, Tim Sargent examines the issue of whether technological change has contributed to the rise in unemployment in Canada in the 1990s, and finds little evidence of skill-biased technical change on either employment patterns or the unemployment rate. In the third paper, Pierre Fortin argues that the lowest sustainable rate of unemployment (LSRU) in Canada is now as low as 6 percent and that through possible hysteresis effects low actual unemployment will produce an

even lower LSRU. In the fourth paper, Gordon Betcherman looks at evidence of the importance of labour market policies and institutions for structural unemployment and while he finds that the generosity of the unemployment insurance system has been systematically associated with higher levels of unemployment across OECD countries, he concludes that a variety of different institutional regimes can serve the public policy goal of an efficient labour market.

In the first paper in the fourth section on labour market mismatch, Lars Osberg and Zhengxi Lin ask how much of Canada's unemployment reflects a mismatch between available jobs and persons seeking employment and conclude that it is very little — as low as 0.45–0.75 percent of the labour force, or less than one-eighth of the unemployed. In the second paper, Richard Roy and Yves Gingras find no general skill gap in the Canadian labour market as the supply of postsecondary-trained workers has increased dramatically in the 1990s, more than keeping pace with skill requirements.

In the first paper in the fifth section, Rebecca Blank looks at the factors behind the improvement in the inflation-unemployment trade-off in the United States in the 1990s and concludes that expansionary monetary policy and “making work pay” policies have both contributed. In the second paper, Richard Freeman poses the question of whether the US economic model represents the lode-star for advanced capitalism, noting that with the recent improvement in the economic conditions of persons in the lower levels of the income distribution, the low unemployment and strong productivity performance appear to make the United States a legitimate candidate for peak economy. In the third paper, Steven Nickell and Jan van Ours examine the factors behind the reduction in unemployment in the United Kingdom and the Netherlands, concluding that weaker unions reduced equilibrium unemployment in the UK while coordinated wage bargaining and the restructuring of unemployment benefits decreased unemployment in the Netherlands.

In the sixth and final section, the first paper by Sherri Torjman looks at customized training programs as a way of integrating the unemployed into the workforce, and documents a number of cases where non-profit organizations have developed effective customized training programs to train hard-to-employ persons for specific positions with employers. In the second paper in this section, and final paper in the volume, John Greenwood examines labour market experiments that have attempted to use earning supplementation as a means to reintegrate the unemployed, finding that such programs appear relatively effective for single-parent welfare recipients but are not effective for displaced workers and repeat users of unemployment insurance.

KEY THEMES ADDRESSED IN THE VOLUME

This section of the introduction synthesizes the findings of the volume around six themes or questions: the definition of structural unemployment; what happened to structural unemployment in Canada in the 1990s; is labour market mismatch a problem; what are the lessons for Canada from the international unemployment experience; and what are the most effective policies to reduce unemployment?

DEFINITION OF STRUCTURAL UNEMPLOYMENT

Unfortunately, the term “structural unemployment” has no one definition in the literature and different meanings are used by the contributors to the volume. For example, Fortin, Nickell and van Ours define structural unemployment as the unemployment rate consistent with stable inflation, or the non-accelerating inflation rate of unemployment (NAIRU), although neither uses this term (Fortin uses the lowest sustainable rate of unemployment and Nickell and van Ours use the equilibrium rate of unemployment). In contrast, Osberg and Lin see structural unemployment occurring “when workers are unable to fill available jobs because they lack the skills, do not

like where jobs are available, or are unwilling to work at the wage rate offered in the market” and identify the job vacancy rate as the upper limit of the rate of structural unemployment. A rise in job vacancies indicates greater structural unemployment as labour market mismatch is increased. Two other definitions of structural unemployment are mentioned in the volume, but not used for analytical purposes. The first is structural unemployment as the unemployment rates predicted by the structural parameters of an economic model and the current values of the exogenous variables. The second is the use of structural unemployment as a synonym for long-term unemployment or persistent unemployment.

TRENDS IN STRUCTURAL UNEMPLOYMENT IN CANADA IN THE 1990S

A number of contributors address the issue of what has happened to structural unemployment in Canada in the 1990s. Using the NAIRU definition of structural unemployment, no factor was identified as increasing structural unemployment, while a number of factors are identified as reducing structural unemployment: most importantly, demographic trends and the reduced generosity of (un)employment insurance.

A strong consensus emerges from the papers in the volume that structural unemployment has fallen in the 1990s and that the high unemployment experienced this past decade largely reflected deficient aggregate demand.

THE MAGNITUDE OF LABOUR MARKET MISMATCH

It is often asserted that Canada has serious labour shortages and that if these available jobs were filled, the unemployment rate would be much lower. The papers by Osberg and Lin and by Roy and Gingras in this volume provide evidence contradicting this assertion. Roy and Gingras find no evidence of any

basic supply problems in the skills area, although shortages may exist in certain narrowly defined skills areas. They find that the social returns to education are not particularly high, that they have not increased in the last 25 years, that there has been no increase in the earnings premium to education, and that Canada has the highest proportion of population with postsecondary education in the OECD countries and the highest post-secondary enrolment rate. Osberg and Lin find that the number of unfilled positions is very low, less than 1 percent of the labour force. Even if all these job vacancies were immediately filled by the unemployed, the unemployment rate would drop by less than one percentage point.

YOUTH UNEMPLOYMENT

The youth unemployment issue has received particular attention in the 1990s and a number of policy interventions have been targeted to youth. While youth unemployment has certainly been high, this development seems not to have been due to youth-specific factors, but rather to overall labour market conditions. This suggests that youth unemployment may well decline with overall reductions in unemployment and so, targeted programs may not be necessary. Indeed, youth may be well served by non-age-specific policies. It should also be noted that the youth labour market is not homogeneous as labour market behaviour varies considerably between teenagers and young adults, males and females, and students and non-students. For example, teenage unemployment largely involves full-time students seeking part-time jobs, while this is not the case for young adults (20-24 year olds).

LESSONS FOR CANADA FROM THE INTERNATIONAL UNEMPLOYMENT EXPERIENCE

A number of countries have experienced much lower unemployment than Canada in the 1990s and the obvious question is whether there are any lessons

from their experiences for Canada. An important lesson of the US experience is that an expansionary monetary policy that prudently probes the limits of the NAIRU can produce large reductions in the unemployment rate. A second lesson is that policies that make work pay, such as the Earned Income Tax Credit could have a positive effect on employment, particularly for women and could serve to increase labour supply and reduce unemployment.

Indeed, as the following quotation from the paper by Betcherman illustrates, Canada has already pursued many of the appropriate policies to reduce structural unemployment in the 1990s.

There may be a “flexibility threshold” that all countries (perhaps with the exception of certain small northern European ones) must meet. But it would be hard to argue that Canada has not met that standard. The generosity of the unemployment insurance system has been diminished considerably over the past 15 years. The features of the wage bargaining system (relatively low coverage and a decentralized structure), minimum wage levels, taxes and employment protection legislation are all in line with what the cross-county evidence suggests should be supportive of low unemployment levels.

Another lesson of the international experience is that there is no magic institutional bullet for unemployment reduction. Different countries have achieved low unemployment using different institutional arrangements. As Stanford points out, both countries with unregulated (the United States) and regulated labour markets (the Netherlands) can achieve low unemployment, although favourable demand conditions are needed. In the United States, job insecurity in a deregulated labour market has allowed the Federal Reserve Board to pursue expansionary monetary policy without inflation. In the Netherlands, union-employer wage policies permitted expansionary macroeconomic policies without excessive wage increases.

OTHER POLICIES TO REDUCE STRUCTURAL UNEMPLOYMENT

The motivation for this volume was to identify policies that could reduce structural unemployment (defined as the NAIRU) in Canada. A key finding is that a low actual rate of unemployment in itself can reduce the NAIRU (just as a high actual rate of unemployment raises the NAIRU). Thus, appropriate macroeconomic policies do have the potential to reduce structural unemployment. Indeed, as the US experience demonstrates, there is nothing better for persons who have experienced labour market problems than tighter labour market conditions where employers are very keen to hire workers. To paraphrase Robert Solow, aggregate demand may in effect “melt” structural unemployment. Of course, microeconomic policies that act on the supply-side can also contribute to unemployment reduction, although the success of these policies is largely conditioned by the macroeconomic policy environment.

Among the supply-side microeconomic policies, the volume mentions certain policies designed to assist low-skilled individuals to improve their employment prospects and therefore facilitate the ease with which robust economic growth might be able to melt pockets of structural unemployment. Efforts by governments to encourage completion of high school for youth and basic literacy and numeracy for adults are among such policies. The volume iden-

tified customized training programs, where a non-profit organization contracts with a firm with skill shortages to train unemployed persons, generally welfare recipients, for these positions, as an effective means to provide jobs for the hard-core unemployed. Earnings supplementation schemes were also identified as an effective means to reintegrate unemployed social assistance recipients into the workforce. But a key caveat in the implementation of labour market programs is that no one size (or program) meets all needs, so programs must be appropriately targeted.

CONCLUSION

In the fall of the unemployment rate from 10 percent in the early 1990s to the current level of 6.6 percent (June 2000), the Canadian labour market has encountered no structural barriers. Indeed, some of the papers in this volume suggest that some further reductions might be possible before significant increases will be experienced in wages and prices. The institutional reforms undertaken by Canada in the 1990s (in particular those affecting the [un]employment insurance system), along with demographic developments (in particular the decline in the proportion of youths and the aging of the baby-boom cohort) have improved the inflation-unemployment trade-off in this country by significantly lowering the structural rate of unemployment.