

# Why has Unemployment Disappeared from Official Macro-Economic Policy Discourse in Canada?

Festschrift for Ian Stewart

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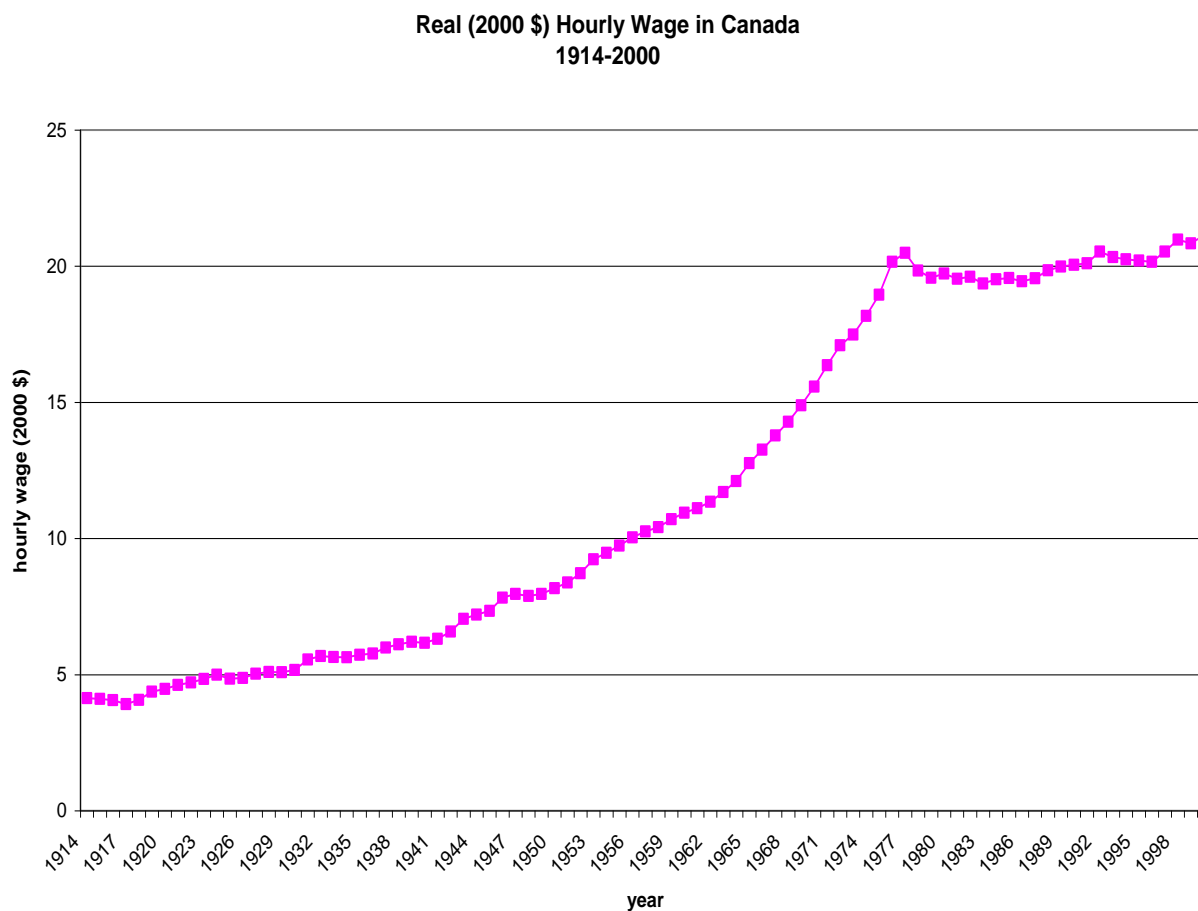
It is a great pleasure to participate in a Festschrift for Ian Stewart, partly because of the continued relevance of his work – Ian was at the centre of macro-economic policy making in Canada during the last extended period in which the real hourly wages and living standards of most Canadian families rose significantly. During his period, it was taken for granted that a major objective of modern governments was macro-economic stabilization that would minimize occasional cyclical deficiencies in aggregate demand and lessen the social costs of the unemployment thereby produced. However, although unemployment remained high over much of the 25 years following Ian's resignation, mention of it has virtually disappeared from macro-economic policy discourse. Since Ian's successors have been noticeably less successful in producing rising real wages and material living standards, the disappearance of unemployment from their radar screens has evidently not improved the ability of Ottawa decision makers to deliver these macro-economic policy outcomes. This essay therefore asks: why does official Ottawa no longer care about unemployment? Is it possible that macro-economic outcomes would be better if they did?

Section 1 of this essay starts by documenting the slowdown in real wage growth and family living standards of the last thirty years in Canada. Section 2 then contrasts the emphasis on unemployment as an important policy problem in official Canadian documents during the period before 1980 with the disappearance of the issue from official forecasts and pronouncements which is characteristic of the present day. Section 3 considers, and emphatically rejects, the possibility that unemployment is no longer discussed because economists have discovered that it is unimportant for human happiness and well-being. Section 4 examines briefly the evidence on the percentage of aggregate unemployment that is 'structural'. Although the macro policy levers which could produce faster real growth and lower unemployment have long been well understood, macro policy initiatives to produce low unemployment rates are considered unthinkable in official Ottawa. Section 5 therefore discusses the likelihood that changing perceptions of relative risks have driven policy choices to a corner solution, and asks whether the incentive structure of macro-economic policy makers aligns with the interests of most Canadians.

## 1. Stagnation of Real Wages and Living Standards

Ian Stewart earned his BA and MA from Queen's in 1953-54, and after attending Oxford and teaching at Queen's and Dartmouth, he received his PhD from Cornell in 1965. He joined the Bank of Canada in 1966 as a macro-economic model builder, moved to Treasury Board in 1972 and rose rapidly to become Deputy Minister of Finance for Canada between 1980 and 1982. His childhood and adult life were therefore spent in a Canada in which it was the norm for average real hourly wages to rise, year over year – and, as a professional economist, Ian participated in the policy decisions which produced rather rapid improvements in real living standards during the 1970s, as Figure 1 illustrates.

Figure 1



CANSIM1 I603501 1961-2000; URQUHART 1914-1960

Figure 1 splices together (in 1961) two statistical series, the latter of which ends in 2000. Its most prominent lesson is the structural break in average real wage growth at the end of the 1970s, as

Central Banks in North America and Europe raised interest rates to dramatic heights to bring down inflation. The anti-inflation crusade succeeded in reducing consumer price inflation in Canada from an average 8.1% between 1976 and 1980 and a peak of 12% in June 1981 to an average 3.8% between 1984 and 1988. Governor Crow's Hansen lecture of that year committed the Bank of Canada to "a path that leads towards underlying price stability" and after another round of high real interest rates and the resultant induced recession, inflation in Canada reached its target range of approximately 2% in January 1992. Since then, for the past twenty years, inflation has remained in the 1% to 3% range. Figure 2 documents the time path of average real wages for salaried and hourly paid employees over that period.

Figure 2

**Average Real Hourly Wages  
Canada 1991-2010**

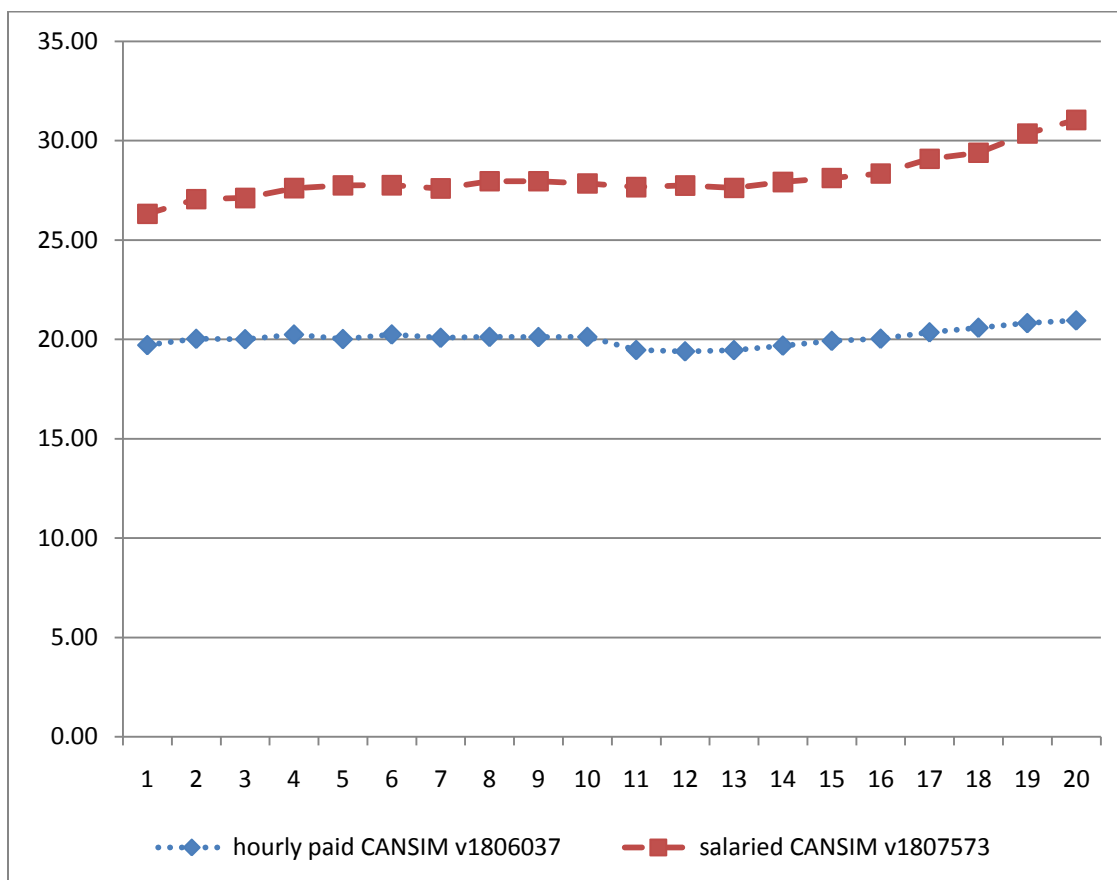
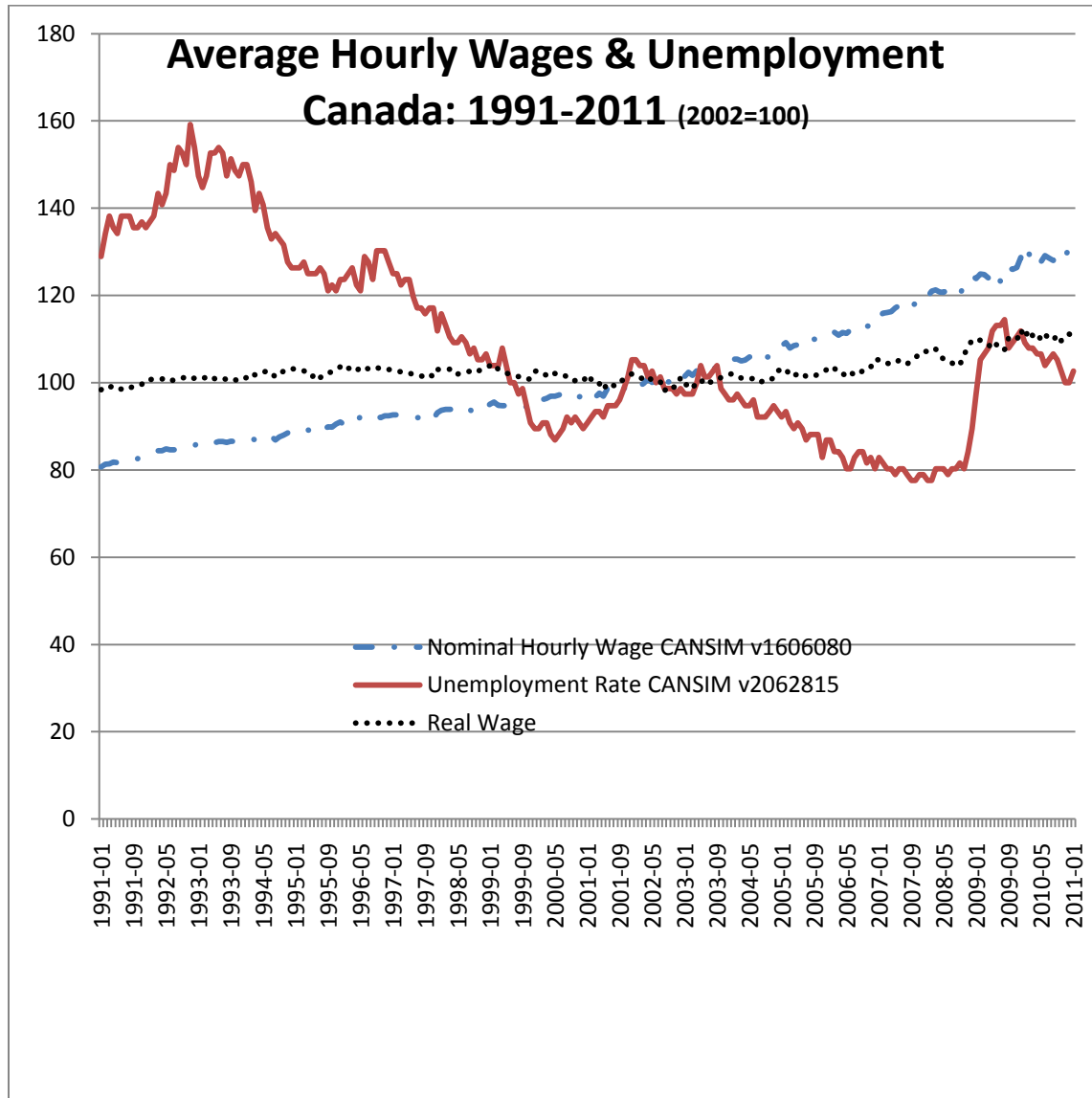


Figure 2 confirms the continuation to 2010 of the 1980 to 2000 stagnation of average real wages. Between 1991 and 2010 there was a little movement in average hourly real compensation of

salaried employees, but next to no movement at all for hourly paid workers. Over the same 1991-2010 period, the average annual inflation rate was 2.01%<sup>1</sup>. This was marginally below the average inflation rate of 2.2% during the 1951-1971 period, when real hourly wages more than doubled and the national unemployment rate averaged 4.9%.

Figure 3



<sup>1</sup> CANSIM v41693271 Canada; All-items

Figure 3 decomposes the trend in the overall index<sup>2</sup> of the average hourly wage of all employees into its real and nominal components. The steady increase in average nominal hourly wages, at approximately the rate of inflation, masks (with a slight uptick since 2006) the essential constancy of average real hourly wages. Although the unemployment rate has fluctuated significantly over the last twenty years, this has evidently been fluctuation over a range of unemployment rates that has never been so low as to produce a noticeable tendency to bid up average real hourly wages.

Real average weekly earnings in Canada did rise a bit and fall again between 1992 and 2003 before beginning a clear upward trend after 2003 – but data on weekly earnings mingle the impact of changes in the availability of paid work hours and any changes in the real price of labour time. As an indicator both of the marginal cost of labour to firms and of the trade-off for families between paid work and household production or leisure, the real hourly wage has clear conceptual advantages.

However, a major disadvantage of Figures 1 to 3 is their use of the mean as a sufficient summary statistic for the distribution of hourly wages. In the statistical literature, a commonly expressed opinion is: “The median is often regarded as a more appropriate measure of location than the mean when variables with a highly skewed distribution, such as income, are studied.” (Kuk and Mak 1989:261). It is well known that the distribution of wages has always been highly skewed, but the fact that it has become much more skewed in recent years<sup>3</sup> implies that data on average wages or earnings are increasingly misleading as indicators of trends in the living standards of most citizens.

Figure 4 presents data on trends in Canada between 1980 and 2005 in the after-tax average real income of each income quintile, adjusted for household size. However, although Figure 4 does show a clear contrast between the stagnancy of real incomes within the bottom four quintiles and the increase in the top quintile’s average real income, it is a bit misleading. In showing an upward trend in average incomes among the top 20% of households, Figure 4 does not reveal that most of that increase is actually concentrated in the top percentile. As Murphy and Wolfson (2007) and Veall (2010) have documented, income gains have been concentrated at the very top, particularly within the top 1%. Income gains there have pulled up the average of the top quintile, and the average of all incomes, but have left most household’s incomes unchanged.

Hence, if one of the objectives of macro-economic management is to increase material living standards over time, and if the criterion of success is person-weighted, then it appears fairly evident that the macro-economic managers who succeeded Ian Stewart at the centre of official Ottawa have not been particularly successful.

If they had been successful in raising living standards, one could of course have debated the relative importance of their macro policy decisions and trends in real inputs as the Canadian population

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<sup>2</sup> Figure 2 presents average hourly earnings including overtime for employees paid by the hour (salaried). Figure 3 shows the fixed weighted index of average hourly earnings for all employees (SEPH), excluding overtime. Both are derived from the Survey of Employment, Payrolls and Hours.

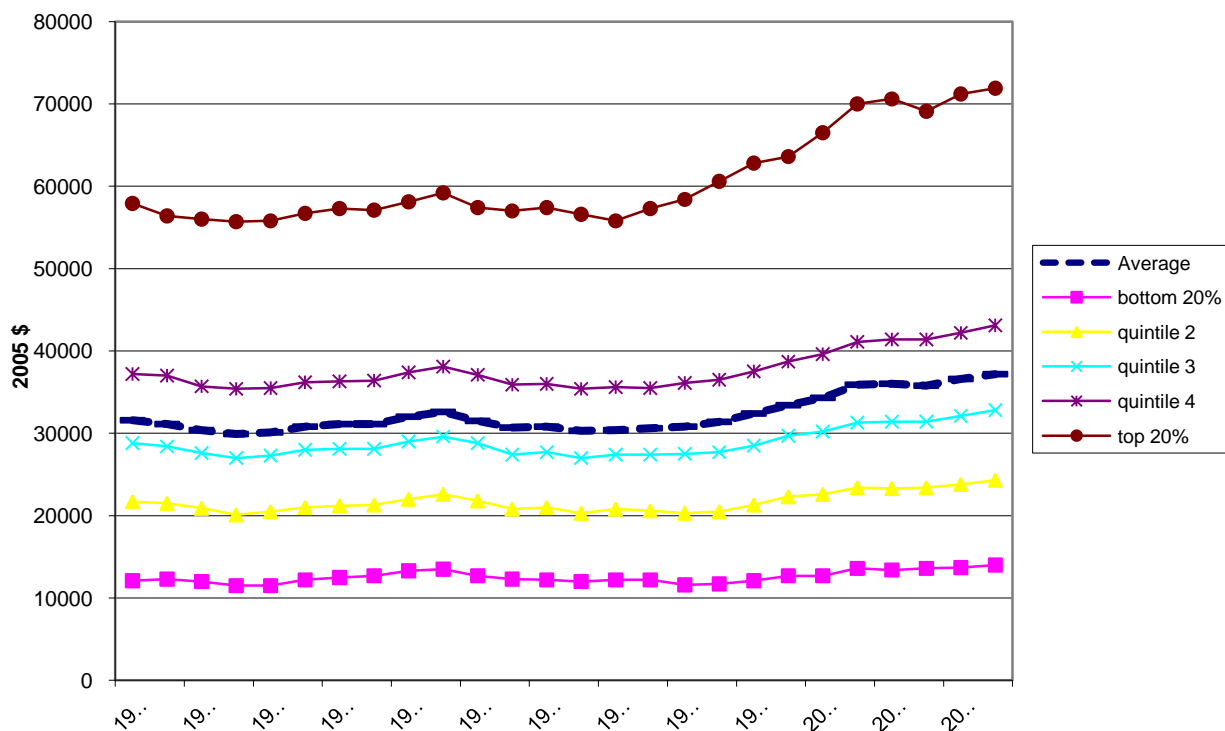
<sup>3</sup> See Atkinson and Piketty (2007)

increased substantially in education levels and as the Baby Boomers aged into their most productive years, working with an increased Capital/Labour ratio and substantial technological change. As well, over the last thirty years, a long series of micro-economic reforms have aimed at attaining great market efficiency – e.g. De-regulation, Free Trade (FTA & NAFTA & WTO), privatization of crown corporations, lower taxes and massive cuts to unemployment insurance and social assistance. These market-oriented reforms could have claimed partial credit, had an increase in living standards for most people been observed – but it wasn't.

Figure 4

### Real Income in Canada by Quintile 1980 - 2005

CANSIM v21188957-v21188962 ; After-tax income; Adjusted average (2005 Dollars)



One possible response is to argue that “times were tough all over” – so what does Canada’s macro-economic performance look like when compared to that of other affluent nations?

Country code	Country and period	Income growth	
		Median household income	GDP per capita, PPP (constant 2005 international \$)
AUS	AUSTRALIA 81-03	0.25%	2.46%
AUT	AUSTRIA 87-00	0.77%	2.79%
BEL	BELGIUM 85-00	2.25%	1.74%
CAN	CANADA 81-00	0.15%	1.98%
DNK	DENMARK 87-04	0.92%	1.75%
FIN	FINLAND 87-04	1.44%	2.35%
FRA	FRANCE 81-00	0.87%	2.14%
DEU	GERMANY (WEST) 81-00	0.69%	2.48%
IRL	IRELAND 87-00	7.14%	9.56%
ISR	ISREAL 79-01	1.53%	2.29%
ITA	ITALY 86-00	1.29%	2.28%
LUX	LUXEMBOURG 85-00	4.21%	6.43%
MEX	MEXICO 84-02	0.81%	0.93%
NLD	NETHERLANDS 83-99	3.28%	3.09%
NOR	NORWAY 79-00	2.88%	3.40%
ESP	SPAIN 80-00	3.62%	3.17%
SWE	SWEDEN 81-00	1.91%	2.19%
CHE	SWITZERLAND 82-02	0.38%	2.22%
GBR	UK 79-99	1.50%	2.73%
USA	USA 79-04	0.68%	2.53%

Atkinson and Brandolini<sup>4</sup> have called the Luxembourg Income Study (LIS) “the gold standard” for household income comparisons, because of its standardization of coding of the micro-data assembled from individual country surveys. Using LIS data offers the assurance that the same income concept is being compared, and the same adjustments to money income to account for taxation and possible differentials in household size are used<sup>5</sup>. The disadvantage, for the analysis of long term trends, is that only a few countries had high quality household surveys twenty five years ago and one must rely on data sets from individual country surveys, which are not always done in exactly the same year. Nevertheless, Table 1 presents the trends in LIS data on average annual growth rate of median real after tax equivalent household income, matched with comparably dated trends in GDP per capita.<sup>6</sup> Figure 5 presents the same information graphically.

For Canadians, it is particularly notable just how bad, in comparison to other high wage nations, Canada’s actual performance in raising median living standards has been. As Table 1 and Figure 5 illustrate, in this group of 20 OECD nations, Canada came dead last in rate of growth of median income – by a solid margin. Since a number of nations are fairly closely bunched in GDP per capita growth rates, Canada’s fourth from last ranking on that criterion could be argued to be less informative. Nevertheless, if the criterion of macro-economic performance is “to contribute to .. rising living standards for Canadians<sup>7</sup>”, neither indicator looks great.

In most cases, the average rate of growth of GDP per capita has exceeded the rate of growth of median income – but not in all. Spain, the Netherlands and Belgium were exceptions.

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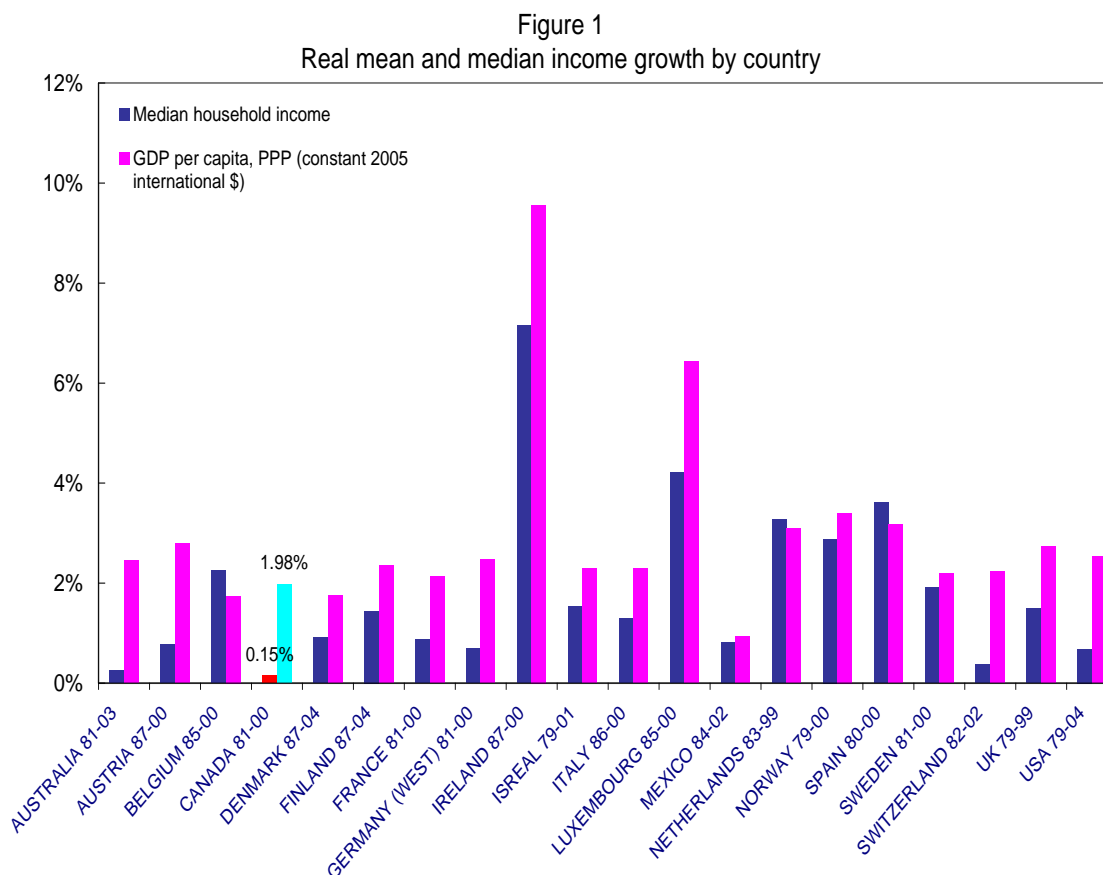
<sup>4</sup> [Atkinson](#) and Brandolini (2001: 771)

<sup>5</sup> For a full discussion of data methodology see <http://www.lisproject.org/keyfigures/methods.htm>

<sup>6</sup> GDP and GNI data taken from World Development Indicators Online (WDI)

<sup>7</sup> “The goal of monetary policy is to contribute to solid economic performance and rising living standards for Canadians by keeping inflation low, stable, and predictable.” <http://www.bank-banque-canada.ca/en/about/do.html>





Both convenience and principle can provide arguments to justify the use of average income statistics (like per capita real GDP). It is relatively easy to get a per capita estimate – one just divides aggregate income data (like an estimate of total GDP) by total population. Estimates of both aggregates are available for many countries and many years, but the micro-data on individual households needed to compute median income trends has been less commonly available. In principle, as well, redistribution of a given total income is always possible – and if such redistribution is costless, growth in per capita income implies that enough income is available that everyone could potentially be made better off, without anyone being worse off. Kaldor and Hicks therefore argued in the 1930s<sup>8</sup> that use of average income as a success criterion for macro-economic policy can be justified on the basis of potential Pareto superiority, because a larger per capita output could always be divided differently.

However, potential income does not pay the rent. As I.M.D. Little (1957) protested long ago, it is the distribution of actual income that enables consumption, and which must therefore be the basis for any welfare evaluations. Only if all individuals received identical incomes would there be really no problem of choice of summary statistic, since median and mean income would coincide. In the real world of actual inequality, reduced redistribution by Canadian governments has been accentuating the increasing skew in market incomes since the mid 1990s (Heisz, 2007), implying that the trend in average

<sup>8</sup> Kaldor (1939), Hicks (1939)

income is increasingly unrepresentative of trends in the central tendency of the distribution of income. Median real income (adjusted for household size, after taxes and transfers) is a better indicator – and by that criterion, Canada’s post 1982 performance is particularly bad.

## 2. Out of sight, out of mind? Unemployment and the changing rhetoric of Canadian public policy

In 2011, and for some years previously, the Monetary Policy Report of the Bank of Canada has presented a quarterly analysis of the key issues and prospects affecting the Canadian economy. The January, 2011 issue is representative. The MPR analyzes international trends in interest rates, inflation rates, US household savings, US housing markets, inflation in China, global commodity prices, global financial markets, oil prices, the current account, Canadian financial conditions and much else. The MPR also presents forecasts of key variables, such as the components of GDP growth and inflation.

Presumably, in presenting an analysis of Canada’s macro-economic situation, one discusses what one considers to be important and ignores what is unimportant. In the January, 2011 issue of MPR, unemployment in the United States is mentioned four times. Unemployment in Canada (then at 7.8%) is mentioned precisely once – not as something important in itself<sup>9</sup>, but as an indicator, among others, of “the persistence of slack in the labour market”. Although this issue was at a time when emergence from the Great Recession continued to be unsteady, the quarterly Monetary Policy Report of the Bank of Canada contained forecasts of inflation, GDP growth and other economic variables, but the unemployment rate was apparently considered too unimportant an aspect of the Canadian economy to be worth predicting.

Nor is this lack of attention to unemployment unusual. In the Federal Budget of 2008, for example, the word “unemployment” also appears precisely once. In the Economic Statement of October 2007, unemployment is mentioned twice, to congratulate the then lowest unemployment rate in 33 years (6.1%), and to express the expectation that it would hold at 6.2% in 2008 and 2009 and average 6.0% from 2010 to 2012. By the time of the 2009 federal budget, the recession had forced some consideration of unemployment back onto the agenda, and in 2010, when the unemployment rate was 8.3%, the budget document noted “While unemployment remains a concern, the rise in the unemployment rate has been smaller than was initially forecast by private sector forecasters.”

In Canada, institutional and professional amnesia about the possibility of low unemployment is probably partly a consequence of the fact that the Labour Force Survey was substantially expanded in scope and sample size in 1976, and only data from the new version of the Labour Force Survey is

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<sup>9</sup> It is an interesting commentary on the attitudes of public officials in Canada that the US unemployment rate is often more frequently mentioned than the Canadian unemployment rate, in macro-economic projections of the Government of Canada.

available instantly on CANSIM<sup>10</sup>. Researchers who are willing to look up paper books or historical tables can retrieve data from earlier periods, but that is harder to do. Mostly, the earlier Canadian historical experience with unemployment has disappeared down the memory hole. Hence, when the national unemployment rate reaches the 6% range, this looks like good times, compared to the post 1980 historical experience – macro-economic managers can say “mission accomplished” and turn to other issues.

By contrast, when the national unemployment rate rose from 5.4% in 1974 to 7.1% in 1975, this followed a long period in which it had fluctuated in the 4% to 7% range, averaging 5.3% over the 1953-1975 period<sup>11</sup>. Hence, 7% unemployment was then seen as “high” – a major national problem. In “People and Jobs”, The Economic Council of Canada discussed the meaning of the unemployment rate as an indicator of financial hardship (in the context of the 1971 revisions to Unemployment Insurance and the increasing prevalence of dual earner households) and cyclical, structural, frictional and seasonal components of its evolution over time. In government documents of the day, the wisdom of reducing the unemployment rate was certainly seen as something debatable and as a process with distinct limits – the minimization of inflation and the maintenance of budget balance were clearly also issues of major importance. But even if unemployment was not the only objective of macro-economic policy, it did at least get mentioned, as one item on the list of potentially desirable outcomes.

### 3. Is Unemployment Unimportant for Individual Well-Being?

Within Canadian labour economics, perspectives on unemployment have changed over time. When, for example, Stephen Peitchinis wrote *Canadian Labour Economics* in 1970, he began the chapter on unemployment by quoting Keynes: “The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary, and inequitable, distribution of wealth and incomes.”<sup>12</sup> In Peitchinis’ view, the Canadian economy had only attained full employment during the 1947-1953 period (when the national unemployment rate averaged 2.7%), so the average unemployment rate of 5.0 % for the 17 years since then represented a massive waste of economic potential.

All the same, when Peitchinis detailed the costs of unemployment, he stressed its socio-economic dimensions, arguing that: “The social aspects of unemployment are not fully appreciated by those who do not have the misfortune to experience unemployment. Particularly so the socio-psychological aspects

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<sup>10</sup> Larger sample size meant major improvements in geographic and demographic disaggregation became possible after 1975, but the questions defining ‘job search’ and the criterion of unemployment remained unchanged, hence aggregate national unemployment rates are quite comparable across surveys.

<sup>11</sup> See *The labour force*, Statistics Canada, Catalogue 71-001 Monthly

<sup>12</sup> Peitchinis (1970:229); The quotation itself is the opening sentence of the concluding chapter of *The General Theory of Employment, Interest and Money* – see page 372 of MacMillan edition, reprinted 1964.

– the way the man feels, as a member of society, and as a family-man with responsibilities; and the way his wife and children feel. These are subjective matters, and, therefore, cannot be appreciated through observation; they must be felt.(1970:230) He then goes on to provide a lengthy vignette of a middle class man's unemployment experience. In 1970, Peitchinis was not unusual in his condemnation of unemployment – the competing labour economics text by Woods and Ostry had begun their chapter on unemployment by describing it as 'the worst scourge of a free-enterprise system' (1962:358).<sup>13</sup>

Modern labour economics texts (e.g. Benjamin, Gunderson, Lemieux and Riddell, 2007) are shorn of any hint of moral outrage at unemployment, or empathy for the unemployed. Micro-market models of job search behaviour, implicit contracts and risk sharing, efficiency wages and monitoring are rehearsed. Structural change and sectoral reallocation of labour are discussed. Major attention is paid to the debate on how the 'incentives' of unemployment insurance in Canada may have influenced behaviour. The expectations-adjusted Phillips curve and the long-run vertical NAIRU hypothesis are presented.

But although modern labour economics does an excellent job explaining why there is some unemployment in all market economies, it has a harder job explaining why Canada had as much unemployment as it has had over the past twenty years. The large literature on longer job search and greater leisure preference possibly motivated by unemployment insurance incentives has to confront the implications of the fact that the system was dramatically cut back as it morphed into Employment Insurance in the mid 1990s. The question of why, now that the Sargent index of unemployment insurance generosity has returned to 1950s levels of generosity<sup>14</sup>, Canadians have not also seen a return to 1950s levels of unemployment, has not been answered satisfactorily. On balance, the micro-economic evidence also does not answer the question of why Canadian unemployment was rarely above 7% from 1950 to 1975 and almost continuously above it thereafter. Judicious survey of the sectoral shifts and labour market rigidities argument leaves Benjamin et al (2007:553) concluding "there is no evidence that the sectoral reallocation of low-skilled labour is behind the increase in aggregate unemployment". Similarly, Sargent (2000:S122) earlier concluded "technological change cannot be held responsible for the poor overall performance of the Canadian labour market over the 1990s."

Considered purely as a micro-market issue, one might have thought that some structural changes of recent decades should have reduced both frictional and structural unemployment. For example, the advent of internet-based job search (see Skuterud) and tele-commuting has increased the speed with which labour market matches can be found and lessened the necessity for the supply and demand for labour to be geographically matched. Airline deregulation and cheap air travel also now enable long-distance commuting (e.g. the new-found popularity of Cape Breton / Fort McMurray travel) to supply some of the labour required for resource boom development.

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<sup>13</sup> Woods and Ostry, as one might expect, do not make the casual assumption that the unemployed worker is male, and in fact discuss the differential implications of unemployment for male and female workers.

<sup>14</sup> See James et al (2007:11); also Grey and L'Italien (2001) who add consideration of uncertainty in job-finding and conclude "in labour markets where the arrival rate of job offers is low, individuals will tend to adopt a strategy of accepting the first available job offer because of the high risk of exhaustion of EI/UI benefits. This means that full use of benefits may reflect inability to find employment rather than a strategy to make full use of EI/UI benefits."

Although there is a huge amount of micro-data based economic research examining the relative probability of entering or leaving unemployment for individual workers of particular characteristics, this cannot explain the aggregate level of unemployment. And since the demand for labour is derived from the demand for commodities, there is no escaping the role of macro-economic demand management in determining the level of aggregate unemployment at a point in time.

Overwhelmingly, the “standard view” of the options facing macro policy makers is that of a level of potential output driven by some variant of the expectations-augmented Phillips curve with a vertical long-run NAIRU. For some years, there was a stiff debate about whether the NAIRU was unchanged at very low inflation rates, but this seems to have died down. The uncertainty surrounding estimates of the location<sup>15</sup> of the NAIRU has been reduced conceptually to occasional shadings of confidence interval bands around a central estimate of potential output. Nobody tries to answer the basic question: “How thick is the chalk with which you draw the NAIRU?”<sup>16</sup> If there is a finite range of unemployment rates consistent with non-accelerating inflation, what is the output gain associated with being at the bottom edge of that range, rather than at the top end? Is hysteresis of low unemployment possible, as skills and job habits no longer atrophy with disuse? Would employers look harder for ways to produce with less labour (i.e. improve productivity) if labour were scarce?

And, most fundamentally, in standard labour economics texts there is little sense that high unemployment is socially destructive. This is in distinct contrast with a large literature in social psychology [e.g. Kelvin and Jarrett (1985)]. As Jahoda (1979:423) has put it:

“There are latent consequences of employment as a social institution which match human needs of an enduring kind. First among them is the fact that employment imposes a time structure on the waking day. Secondly, employment implies regularly shared experiences and contacts with people outside the family. Thirdly, employment links an individual to goals and purposes which transcend his own. Fourthly, employment defines aspects of status and identity. Finally, employment enforces activity.

It is these objective consequences of work in complex industrialized societies which help us to understand the motivation to work beyond earning a living; to understand why work is psychologically supportive, even when conditions are bad, and, by the same token, to understand why unemployment is psychologically destructive.”

Economists who pride themselves on their quantitative skills have often tended to dismiss the case study and vignette description methodology of much of this social psychology literature. However, in recent years, economists have also begun to question the perspective of Peitchinis` generation that experiences of unemployment ` are subjective matters, and, therefore, cannot be appreciated through observation; they must be felt`. Self-reported survey responses have become increasingly accepted as

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<sup>15</sup> Setterfield, Gordon and Osberg (1992) demonstrated that minor changes in plausible specifications of the estimating equations implied alternative NAIRU estimates which spanned the historical range of observed unemployment rates.

<sup>16</sup> I owe this phrasing to Chuck Freedman

valid evidence. An explosion of articles on self-assessed 'happiness' and 'life satisfaction' in the last decade has begun to remind many economists that people typically do not like being unemployed. Winkelmann (2006:1) is representative of a large literature in saying:

“individual unemployment has a large negative effect on subjective well-being. This mirrors the well documented effect of unemployment on physical health and on mental health. This negative effect appears to be causal: we know from panel data estimators that the association persists once we follow the same individuals over time, and thereby control for individual specific fixed effects. Neither is it the case that unemployed people have a completely different personality, or that they anchor their responses on the well-being scale in a way that is systematically differently from the way employed persons anchor theirs. Nor does it seem that there is an instance of reversed causation, i.e., that unhappiness causes unemployment (or, for that matter, that happiness leads to idleness).

It is also clearly understood that the negative effect of unemployment on well-being goes well beyond the effect that the income loss associated with unemployment can bring about. Indeed, the non-pecuniary cost of unemployment seem to exceed the pecuniary cost by far.<sup>17</sup>”

Leuchinger et al (2008), among others, have also noted that higher unemployment decreases the self-reported well-being of the employed, as well as the unemployed, because “increased *economic insecurity* constitutes an important welfare loss associated with high general unemployment”. This accumulation of evidence on the unpleasantness of unemployment has undermined the foundations of perspectives which saw all non-work time as essentially similar, and pleasurable, and the voluntary choice models of unemployment built on those assumptions.

Recently, Helliwell and Huang have analyzed a very large (2.3 million) US sample and used multiple measures of well-being covering self-assessments of life, mental health and emotional experience. Their bottom line is that: “local unemployment has significantly negative effects on well-being among the entire population, including those who are still employed” (2011:21). Their results “confirm the findings in Winkelmann and Winkelmann (1998) that the non-pecuniary effect of becoming unemployed is much larger than the effect stemming from income losses which the unemployed experience. Specifically, they estimate that “if the direct monetary loss of the unemployed is 1, then the additional SWB (Subjective Well-Being) loss of the unemployed is 5, while at the population level the spill-over effects is 10, making the total well-being costs of unemployment fifteen times larger than those directly due to the lower incomes of the unemployed”.(2011:24)

In general, since the vast majority of Canadian households derive their market income almost entirely from labour earnings, it might be thought to be fairly obvious that increases in the price (i.e. the real hourly wage) at which they can sell their labour time is important to the material well-being of most Canadians. Since the unemployment rate is an indicator of the relative balance of aggregate supply and demand in the labour market, it indicates both the probability of being actually able to sell labour time

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<sup>17</sup> See also Frey and Stutzer (2002); Di Tella and MacCulloch (2003) and many others

at the going wage now and a signal of the likelihood that the real wage will increase in future periods. Hence, the unemployment rate always has had strong reason to be thought important as a predictor of individual material well-being.

However, Helliwell and Huang argue that the impacts of higher local unemployment go well beyond this. They control for the employment status of the respondent and note that the spill-over effects of unemployment could also come from worsening social conditions and economic prospects in local areas. They also examine the Clark (2003) hypothesis that when unemployment gets really high, social norms change such that the stigma of being unemployed is lessened and the well-being gap between the employed and the jobless disappears. Their estimates “suggest that the gap will disappear at 48.5% unemployment rate in the case of life satisfaction and 48.4% in the case of mental health”. (2011:30)

Interestingly, their data “does not provide any support to the hypothesis that more generous benefits narrow the well-being gap, regardless which measure of well-being and which replacement rate are used”. As they put it, “Similar to the European study in Di Tella et al. (2003), we uncover no evidence to support the view that unemployment benefits have made life too easy for the unemployed. To the contrary, we find the well-being gap to be greater in states that have higher benefit replacement rates (either measured at the legal maximum or at the average)”.

The literature on the impacts of unemployment on happiness is unanimous in finding empirically large and statistically highly significant negative impacts – Helliwell and Huang argue that their contribution is to use a very large sample of US data, a multiplicity of indicators of subjective well-being and a battery of robustness checks. Which raises the conundrum – now that we know more precisely than ever before that unemployment causes great unhappiness, why has it largely disappeared from official consciousness?

#### 4. Is Most Unemployment Structurally Unavoidable?

One possible reason for not talking about unemployment is that it might be unavoidable – if so, perhaps discussion of it would just add to the pain it causes. Could it be that most unemployment is “structural”<sup>18</sup>? Finance Canada has defined this as “structural unemployment occurs when workers are unable to fill available jobs because they lack the skills, do not live where jobs are available, or are unwilling to work at the wage rate offered in the market.”

Osberg and Lin (2000; 141) argued that this definition implies that the number of available jobs – i.e. the number of vacancies for immediate hire – sets an upper bound to the extent of structural unemployment. At that time, the Workplace and Employee Survey asked a relatively small (748) sample

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<sup>18</sup> In April 2011, Michael Ignatieff, in responding to a question about what a Liberal government would do for Canada’s unemployed responded: “In Canada, there are people without jobs and jobs without people” and went on to talk about the importance of retraining. (CPAC broadcast, approx. April 7, 2011)

of firms a question on vacancies, which implied that the vacancy rate was about 0.75% of the labour force. Lin and Osberg also used an estimated relationship between the Help Wanted Index and the Job Vacancy Survey (which Statistics Canada discontinued in 1979) to impute a current vacancy rate of 0.45%.

Osberg and Lin concluded by noting (2000:S152): “The measurement of vacancies is important for microeconomic labour market policy design and macroeconomic policy settings. Vacancies and the extent of structural unemployment could be systematically measured in Canada, but are not. The obvious conclusion is that perhaps it is time to get some better information on Canadian vacancies.....Since the cost of better information is likely to be small compared to the cost of bad policy based on bad statistics, perhaps it is time to invest in some more knowledge about the extent of structural unemployment in Canada.”

In the US, the Bureau of Labour Statistics has been publishing vacancy data from the Job Opening & Labour Turnover Survey (JOLTS) since January, 2001. Vacancies are defined as exactly analogous to unemployment: a position is considered a job vacancy if the firm is actively recruiting and has the funds available for immediate hire. The survey samples 16,000 business establishments nationally and asks a wide variety of questions surrounding the separation and hiring of workers. For a job to be counted as a job opening: (1) there must be a specific position and work available for that position, regardless of whether it is full-time or part-time, permanent or otherwise; (2) it must be possible for the job to start within thirty days, regardless of whether or not the firm is able to hire someone; (3) there must be active recruitment for workers outside of the firm in question.

Figure 6 is taken from Rai (2011) and plots the time path of unemployment and vacancies, both expressed as a percentage of the labour force, between 2001 and 2010. The vacancy rate in the US appears to be somewhat higher, as a fraction of the labour force, than the estimates of Osberg and Lin for Canada in the 1990s. In early 2001, when the US unemployment rate hovered just above 4%, vacancies were relatively common, at around 3.4% of the labour force. However, as one might expect, the vacancy rate has fallen sharply since 2008. In late 2010, the number of vacancies was only about a fifth of the number of unemployed people, implying that there is now significant room for expansion of employment in the US before further downward shifts in the unemployment rate would be meaningfully constrained by ‘structural’ unemployment<sup>19</sup>.

When the US unemployment rate was similar to Canada’s current unemployment rate of 7.7%, the JOST data indicate that the US vacancy rate was about six percentage points lower at 1.8% of the labour force. Does this imply that there is now similar room for stimulative macro-economic policy in Canada? When we consider the cost/benefit ratio for retraining programs to equip unemployed workers for ‘available jobs’, how many such jobs are there? What type of jobs are these? Where are they? How

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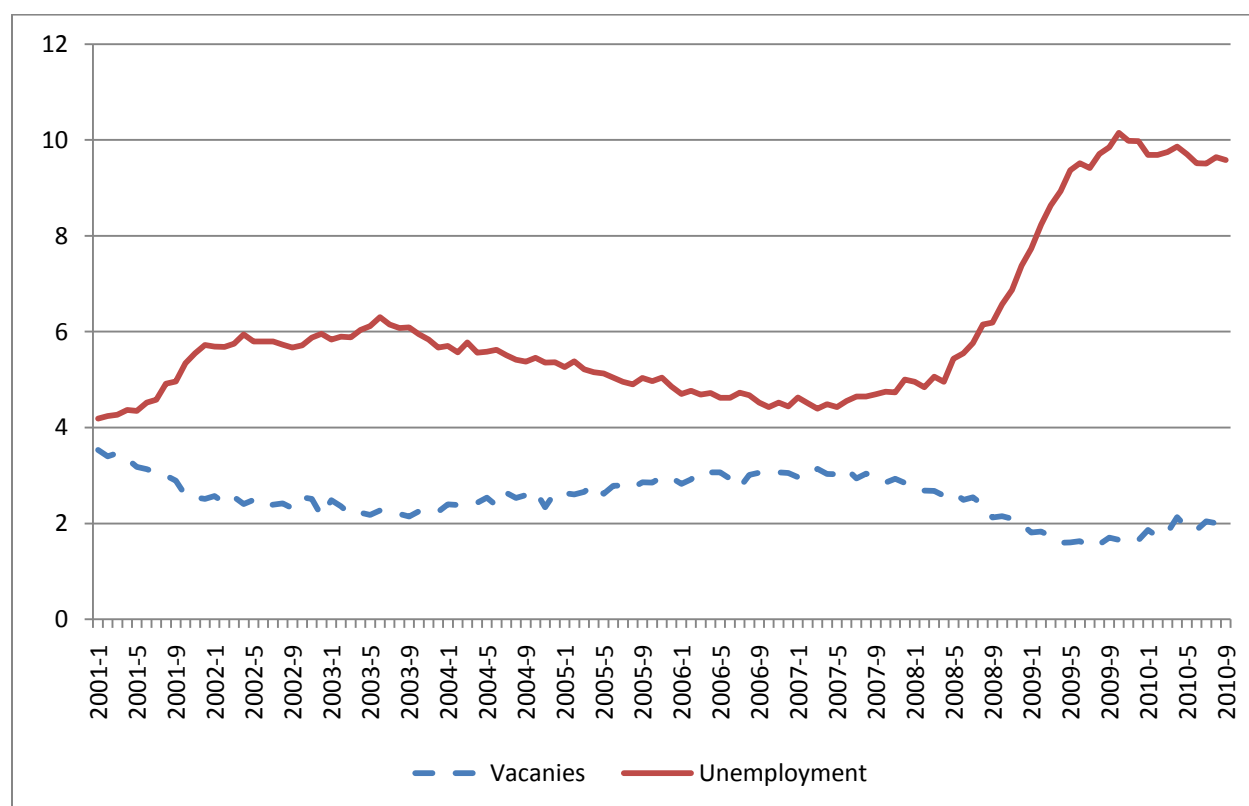
<sup>19</sup> Note that the number of vacancies at any point in time includes both “structural” vacancies that cannot be filled from the local labour pool and “frictional” vacancies that will be filled by locally available workers. The vacancy rate is an upper bound on structural unemployment and should not be interpreted as an estimate of structural unemployment.



much is it reasonable to invest in training? If we had good vacancy data in Canada, we could distinguish between the demand-deficient and structural roots of unemployment and answer such policy questions with greater certainty – but such data has not been collected. When government could collect such data, but chooses not to, one has to presume that it either does not want to know or thinks the information to be of little value, because unemployment is not an important problem to analyze.

Figure 6:

Unemployment and job vacancies as percentage of US labour force, 2001-01 to 2010-09.



In the UK, The ONS Vacancy Survey began in April 2001 (results became National Statistics in June 2003)<sup>20</sup>. On a monthly basis, rolled up to a three month moving average, it provides comprehensive estimates of the number of job vacancies across the UK economy. The survey asks employers how many job vacancies they have in total for which they are actively seeking recruits from outside their organisation, for example, by advertising or interviewing. In addition, statistics of Jobcentre vacancies, that is job openings notified by employers to Jobcentre Plus, are also collected from the Jobcentre Plus administrative system. In Australia, the Job Vacancies Survey provides vacancy data on an industry and state basis going back to 1983, and on a national basis to 1979<sup>21</sup>. The survey was briefly suspended

<sup>20</sup> See <http://www.statistics.gov.uk/STATBASE/Product.asp?vlnk=9390>

<sup>21</sup> See <http://www.abs.gov.au/ausstats/abs@.nsf/mf/6354.0.55.001>

during 2008-09, but has been continued since. The US, UK and Australian data should not be thought unusual – the OECD routinely publishes vacancy data for fifteen other countries<sup>22</sup>.

In Canada, by contrast, there has been no ongoing national survey of job vacancies since 1979. Historical data from 1971 to 1975 is available<sup>23</sup> but other data on vacancies is episodic and fragmentary. In early 2011, Statistics Canada ran a pilot survey<sup>24</sup> of 4500 firms with questions on job vacancies that closely matched the JOST survey in the US, but no public use micro-data file is planned and if a decision is eventually taken to institute an ongoing regular survey of vacancies, the data from this is some years in the future.

If macro-economic policy wanted to aim at producing national labour markets that were tight enough to produce rising real wages, but wanted simultaneously to avoid tightening labour markets to the point of producing an inflationary wage-price spiral, then it would appear sensible to learn how tight the labour market is – how many vacancies exist – at any point in time. Many nations have found it worthwhile to collect such statistics – but for over thirty years Canada has not. Measurement of labour market tightness is evidently not a priority, because reducing unemployment is not an important enough policy goal.

## 5. Incentive Alignment

(Not yet completed)

The analysis of this paper is conditioned on a belief that “downward nominal wage rigidity is an important feature of the Canadian labour market<sup>25</sup>”. In a low inflation environment, of course, the distinction between downwardly sticky real and nominal wages becomes somewhat moot. The key point is, however, that although wages do not necessarily fall when unemployment rises, average real hourly wages are unlikely to increase appreciably until employers have to start competing for employees. Hence, the perspective underlying this paper is the hypothesis that a necessary condition for the distribution of real hourly wages to shift up over time is a reasonably ‘tight’ national labour market.

For roughly thirty years, the average real hourly wage has hardly changed in Canada, and the national unemployment rate has simultaneously been high by historical Canadian standards. This stagnation of real hourly wages is historically unprecedented, not explicable in terms of adverse trends in productivity-related worker characteristics and is an important part

<sup>22</sup> See OECD. Statextracts Registered Unemployed and Job Vacancies (MEI): [Job Vacancies](http://stats.oecd.org/index.aspx?queryid=250)  
<http://stats.oecd.org/index.aspx?queryid=250>

<sup>23</sup> See <http://www.statcan.gc.ca/pub/11-516-x/sectiond/4057750-eng.htm>

<sup>24</sup> See <http://www.statcan.gc.ca/cgi-bin/imdb/p2SV.pl?Function=getSurvey&SDDS=5180&lang=en&db=imdb&adm=8&dis=2>

<sup>25</sup> See Stark and Sargent (2003:18), among others.

of the stagnation of median household income and material living standards. It coincides with a long period in which reducing unemployment has dropped off the list of stated priorities of macro-economic policy in Canada.

By contrast, during Ian Stewart's career as a macro-economic policy maker, as throughout the earlier 1951-1971 period, both unemployment and inflation were viewed as appropriate targets of macro-economic policy. Aggregate demand management certainly did not aim just at unemployment minimization – between 1951 and 1971, the rate of inflation in Canada averaged 2.2% annually. However, although it was well appreciated at the time that inflation could always be kept low if enough slack was maintained in commodity and labour markets, low inflation was thought to be no big accomplishment on its own. The skill of macro-economic policy making was then seen as keeping labour markets tight enough to ensure low unemployment and rising real wages, but not so tight as to produce unacceptable price inflation. Canadian policy makers succeeded in this for twenty years.

In the aftermath of the Vietnam War boom in the US and commodity price inflation globally (especially the dual oil price shocks of 1973 and 1979), inflation in Canada accelerated – and extreme policy measures were adopted to bring it under control (i.e. wage and price controls, followed by 20%+ nominal interest rates). Real wages continued to grow strongly in the 1970s, but the achievement of inflation targets in the late 1970s was highly unsatisfactory and discussion of inflation came to dominate the macro policy agenda.

The occasion of Ian Stewart's Festschrift is a useful time to reflect that Ian's departure from Finance in 1982 was at approximately the same time as a regime shift in official Ottawa's macro policy thinking, as the conviction became established that monetary policy should focus solely on inflation control. The growth of the debt/GDP ratio during the 1980-82 recession, combined with earlier tax policy changes, left public finances highly vulnerable to any increase in debt carrying costs. Hence when, in moving from 4% to 2% inflation, real interest rates were massively increased by the Bank of Canada in 1988-90, the interest burden of past debt skyrocketed. This, added to the cost of the automatic stabilizers of the recession of the early 1990s, produced a major public debt crisis<sup>26</sup>. The expenditure cuts of the mid 1990s succeeded in erasing the federal deficit, but discussion of federal finances came thereafter to be dominated by a rhetoric of budget balance.

In this new policy environment, the possibility that fiscal policy might be used to reduce unemployment slipped from official consciousness – until late 2008. Even then, it took an unprecedented level of threat to the political survival of the government of the day and the onset of what the IMF has called the worst global recession since World War II to resurrect fiscal policy stimulus to aggregate demand. Although in substance Canada's "Economic Action Plan" was as Keynesian a policy package as one can imagine, it resolutely refuses the label. Canadians are promised, by both major parties, a quick return to federal budget balance and a neutral fiscal stance.

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<sup>26</sup> See Osberg and Fortin (1996)

Meanwhile, the Bank of Canada focuses solely on inflation control. Given that single-valued objective, it has no interest in risking any possibility of tight labour markets. With monetary policy aimed solely at inflation control and fiscal policy aimed solely at budget balance, the unemployment rate has dropped off the macro-economic policy agenda. Given Canada's thirty year history of high unemployment, norms of public policy expectations have adjusted. Discussion of whether the national unemployment rate could be significantly lower – e.g. less than 6% for extended periods of time – just does not happen. It is considered wildly irresponsible to even imagine the possibility that stable prices and budget balance might be achieved at a range of unemployment rates, and that, if so, there are substantial real advantages to balancing a possible risk of inflation against a risk of perpetually low growth.

When unemployment, to the extent it is considered at all, is considered a micro-economic problem, it can be allocated to HRSDC. Inflation control, as already noted, is the sole stated objective of monetary policy makers at the Bank of Canada. Budget balancing is the turf of Finance. In the tidy silos of Canadian economic policy, no agency is interested in aggregate demand stimulation that might, in general, tighten up labour markets. Indeed, one who is cynical about bureaucratic incentives might think that if labour markets are kept forever slack, retraining programs have a bigger constituency of clients and inflation control is easier, so at least two major institutional players in Canadian economic policy are unlikely to rock the boat.

However, it does remain something of a puzzle why the constituencies of potential support for lower unemployment are so very feeble in Canada. It is easy to understand that advocates of labour's interests (such as the Canadian Labour Congress) are today where they have always been in Canada – outside the circle of influence. Since Canadians have adjusted their expectations of labour markets to fit the realities of the last thirty years, it is also easy to understand acquiescence in the wider body politic. Even if unemployment causes a great deal of unhappiness, and even if real hourly wages are stagnant, it is all “the new normal” – nobody is protesting much because nobody expects anything more.

Nevertheless, it is a bit harder to understand why the Department of Finance would not find it easier to balance the federal budget, if the rate of growth of aggregate output could be made marginally higher. And although lower unemployment might produce the dreaded ‘labour market shortages’ so feared by the business media<sup>27</sup>, it would also produce more sales and output growth. Historically, Canadian capitalism did well when unemployment was low, so the lack of advocates of growth in the business community is a bit surprising. The completeness of the absence of advocates for lower unemployment remains a puzzle to me – I look forward to the discussion.

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<sup>27</sup> In a remarkable victory of modern marketing, the business media have been successful in portraying the possibility of future labour market shortages due to demographic change as something terrible, rather than as a trend that could produce rising real wages and better job choices for that vast majority of Canadians who are labour sellers, not labour buyers.

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