Chapter 5
Labour-Market Structure

> *[T]he system as a whole has to be changed, not just one part such as the UI programme or the Social Assistance programme. Basic changes are needed as a prerequisite to new initiatives for long-term…employment.*
>
> House Royal Commission on Employment and Unemployment

Here are some puzzles for economists and policymakers. Why would pay rates rise rapidly in a region when the unemployment rate was soaring? How could a region with double-digit unemployment suffer from labour shortages? In particular, how could a shortage of unskilled workers develop in a region that is characterized by a low-skill work force? All of these apparently contradictory developments appeared in Atlantic Canada, beginning in the early 1970s.

As noted in earlier chapters, a pool of skilled labour willing to work at competitive wage rates is essential to economic growth. The key element in the corporatist strategy of both Ireland's and the Netherlands' turnaround was the control of labour costs, which government, business, and eventually even the unions came to believe were increasing too quickly and undermining economic growth (see McMahon 2000, chap. 2 and 3).

The question examined in this chapter is whether policy developments in Atlantic Canada have had any impact on wages and the flexibility of the labour market. And has policy had any impact on the quality of labour—in other words, on education, training, labour-force attachment, and standard work discipline?

Canada, like other developed nations, saw an increase in unemployment begin in the 1970s. An even more disturbing process was underway in Atlantic Canada, where the long-term increase in unemployment was substantially larger than elsewhere in the country.

Atlantic Canadian unemployment had been running less than two percentage points higher than the Canadian average, and it had virtually converged to that average by the end of the 1960s. Three of the four Atlantic provinces experienced at least one year with an unemployment rate below the national average.[1]

During the early 1970s, however, Atlantic Canadian unemployment rose sharply, until the rate averaged more than four percentage points above the Canadian unemployment rate, a difference that has remained ever since. By the mid-1970s, the regional rate had entered double digits, and it has remained very high ever since. Unemployment followed a similar pattern in all the Atlantic provinces (see Charts 5-1a through 5-1d).

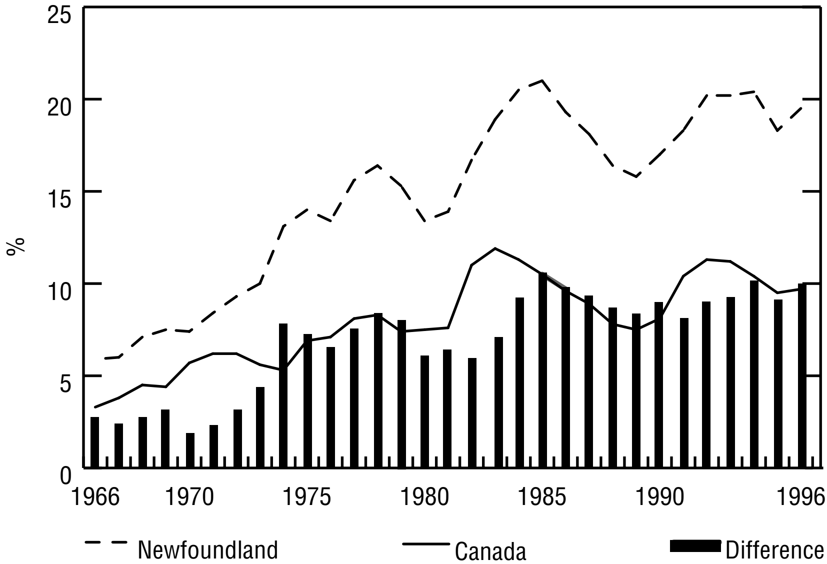
As discussed below, however, the official statistics vastly understate the full extent of real—though largely voluntary—unemployment in Atlantic Canada. Because government support programs have led many people to reject nonseasonal work, labour-market shortages have gone hand-in-hand with double-digit unemployment rates. Over the past three decades, the region's economy has featured a remarkable combination of escalating wages, labour shortages, and high unemployment.

Wage and Salary Patterns

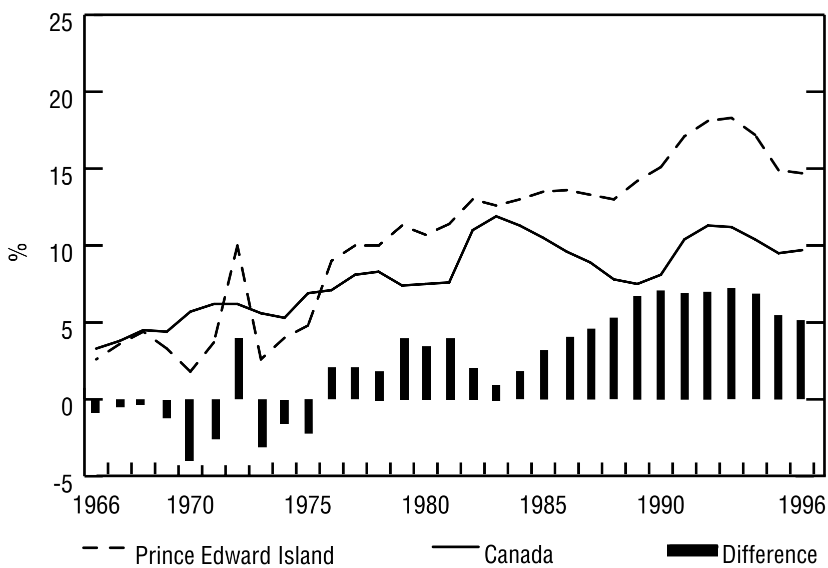
The pattern of wage and salary growth is itself remarkable. Panels a and b of Chart 5-2 trace the patterns of hourly earnings and of wages and salaries through 1983, when the data series ends, and the two panels of Chart 5-3 show them for the subsequent series. Notice that the pattern shown is not of nominal or real wages. Rather, the focus is on the ratio between Atlantic Canadian wages and the Canadian average. This representation discounts both inflation and the general rise in real wages through most of post-war history. It shows Atlantic Canadian wages rising much faster than wages elsewhere in Canada in the early 1970s.

1. A phenomenon never repeated in any Atlantic province in the three decades since, despite heroic job-creation spending and economic-development programs meant to spur job creation.

Chart 5–1: Unemployment Rates, Provincial and National
a: Newfoundland and National

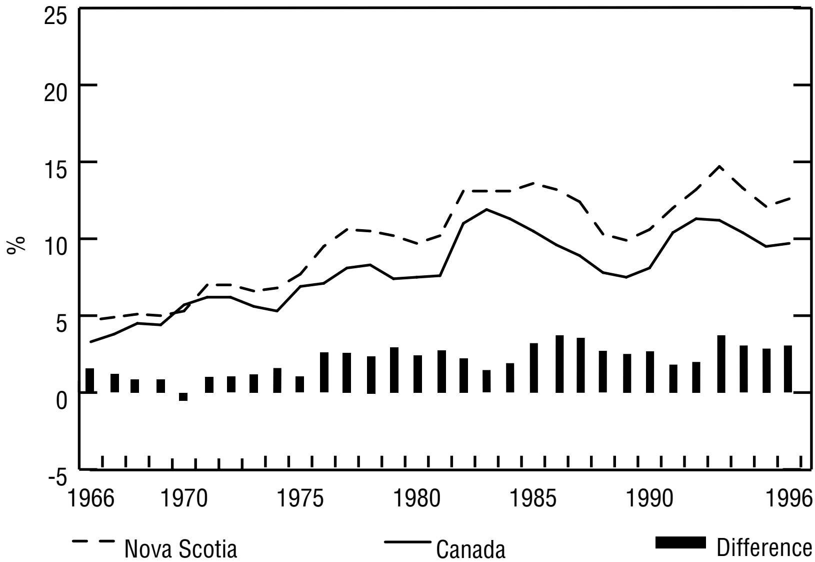


b: Prince Edward Island and National

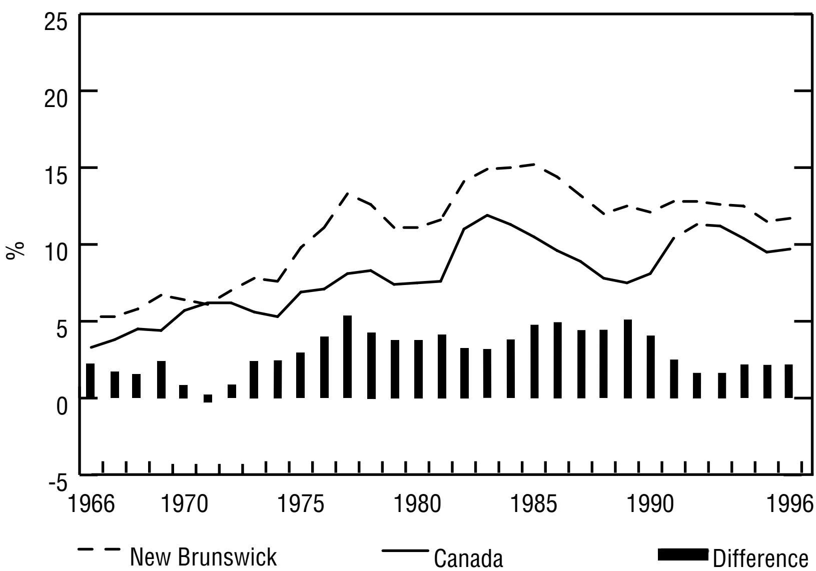


Source: CANSIM.

Chart 5–1: Unemployment Rates, Provincial and National
c: Nova Scotia and National

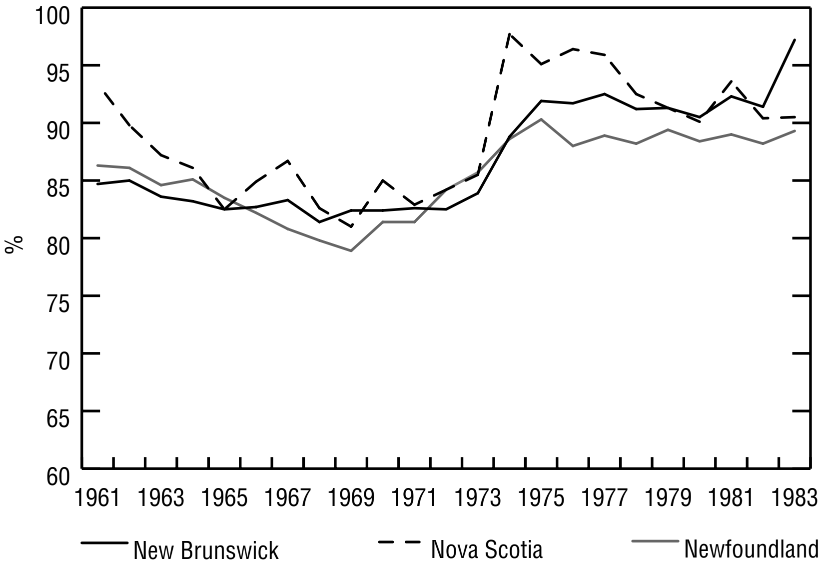


d: New Brunswick and National



Source: CANSIM.

Chart 5–2: Average Earnings as a Percentage of the National Average a: Hourly Earnings, 1961–1983•



Source: CANSIM.

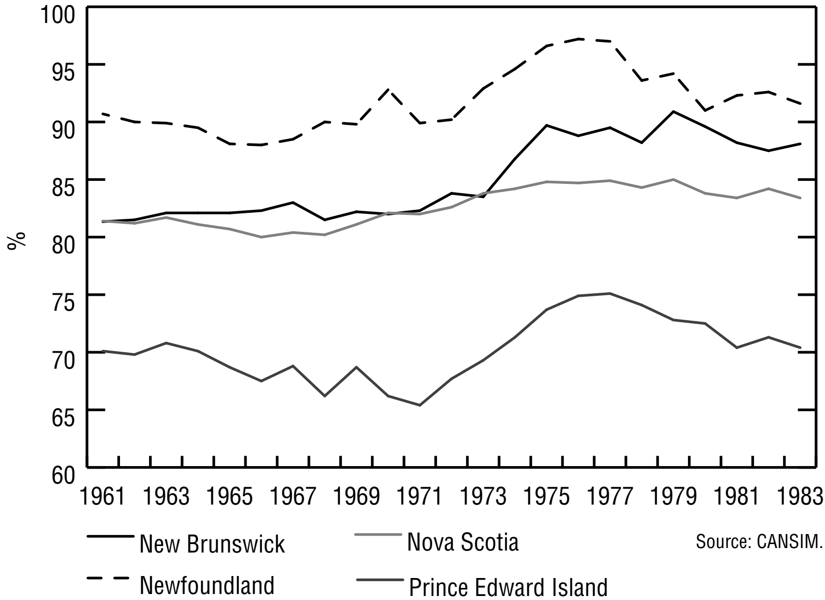
• Earnings in manufacturing, which is the broadest category in this data series. Note that Statistics Canada provides no separate data for Prince Edward Island. A new series was begun in 1983 (see Chart 5–3a).

What Happened?

The amazing fact displayed in the charts is that wages and salaries in Atlantic Canada rose dramatically against the national average *at the very time* regional unemployment was skyrocketing (see Charts 5-1a through 5-1d). Wages and salaries started rising with the renewed burst of federal wealth transfers in the late 1960s, which increased the size of public employment in the region. Government bid up wages in competition with the private sector.

Regional wage rates escalated further with the introduction of regionally enhanced unemployment insurance (UI) reforms in 1971. Now private-sector employers had to bid not only against government-employment opportunities, and the multitude of makework projects and government-subsidized jobs; they also had to bid against a UI sys-

Chart 5–2: Average Earnings as a Percentage of the National Average
b: Weekly Wages and Salaries*



Source: CANSIM.

• All industries. Statistics Canada started a new series in 1983 (see Chart 5–3b).

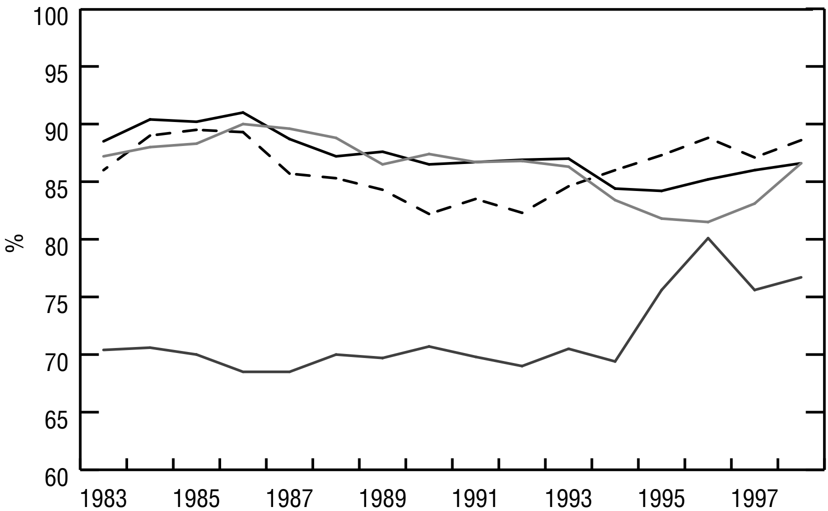
tem that gave generous year-round benefits for a few weeks of work. Worse, government soon entered the business of designing brief make-work projects to enable workers to collect UI benefits.

A stark fact is worth repeating. As the ratio of Atlantic Canadian unemployment to national unemployment rose, the ratio of Atlantic Canadian pay to national pay also rose. Such an unnatural economic effect can be due only to government-induced distortions in the labour market. These distortions differ in their short-term and long-term effects on wages. In the short term, wages are artificially inflated, raising the cost of doing business and thus suppressing investment. Thus, in the long term, such distortions suppress pay rates—the opposite of the short-term effect—by keeping the capital/labour ratio lower than it otherwise would have been and by suppressing skills obtained on the job.

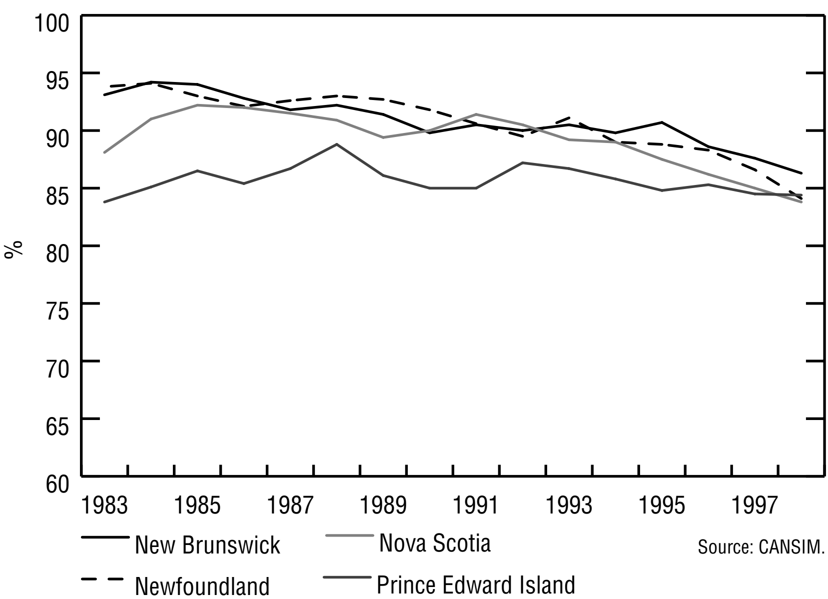
The short-term and long-term effects on unemployment are iden-

Chart 5–3: Average Earnings as a Percentage of the National Average, 1984–1997

a: Hourly Earnings*



b: Weekly Wages and Salaries*, All Industries



Source: CANSIM.

• All industries, which is the broadest category in this data series, started in 1983. Note that data exclude overtime pay.

tical. Wage inflation has an immediate impact on employers' ability to create and maintain jobs. And weak investment and lack of skill enhancement have lasting negative effects on employment.

Before the late 1960s, labour markets in Atlantic Canada appear to have been functioning more or less normally. High unemployment in the region relative to the rest of Canada in the early 1960s put downward pressure on wages, which, in turn, lowered the unemployment rate through two mechanisms. First, low wages made labour more affordable for existing businesses, which could thus hire more workers. Second, low wages drew in increased investment, which generated new jobs in the longer term. Both employment and investment rose rapidly in Atlantic Canada through the 1960s. In a flexible labour market, this process should have propelled Atlantic Canada's convergence with the rest of the nation.

But Atlantic Canadian wages started to rise in the early 1970s. Standard economic theory predicts that upward movements in the cost of labour, other things being equal, will result in increased unemployment, unless the rising wages are offset by rapidly rising skills, productivity, or an increase in capital intensity. *Road to Growth* (McMahon 2000) explores how militant wage demands in both Ireland and the Netherlands, combined with generous social programs, contributed to a rise in unemployment. Policymakers in both nations grew to understand the economic implications of artificially inflated wages and moved to reform government programs that put upward pressure on wages and other costs—high levels of government spending and social programs that were drawing people out of the work force—and established wage moderation as a consensus policy goal, one shared by the labour movement in both nations.

Why Did It Happen?

Why did wages increase faster in Atlantic Canada than elsewhere in Canada? There is no reason to believe the rapid rise in the early 1970s represented a fundamental economic change. Workers' skills did not suddenly improve in the Atlantic provinces. In fact, the evidence suggests skill deterioration if anything (as discussed later). Nor can an increase in capital intensity provide an explanation. In fact, investment flows to Atlantic Canada fell relative to the rest of the nation as wages rose, just as one would expect if the wage increases reflected not economic fundamentals but rather government-introduced distortions in the labour market.

An alternative explanation is that unskilled labour was being shed during this period, creating further unemployment while increasing the average rate of pay. But explanation fails because, as we shall see, unskilled jobs were not lacking. In fact, there was a shortage of workers willing to accept unskilled jobs (or other types of employment) through this period. Other possible explanations include a sudden, large increase in union power or a significant rewriting of labour regulations, creating new and large inflexibilities in the labour market. Neither of these events occurred.

The actual explanation seems to lie in standard, well-accepted economic theory: increased government spending puts upward pressure on wages and costs. As noted above, this forces private-sector employers to compete against an expanding government for workers.

Wage pressures are further increased if the funds come from external sources. The stimulus of the spending then is not offset by the dampening effects of increased taxes, local borrowing, or even the expectation of higher taxes in the future to pay off the debt. As already reported, net wealth transfers to Atlantic Canada significantly increased through this period.

As well, standard economic thinking ties generous social programs with wage pressure. And the regionally extended UI program—recently renamed Employment Insurance (EI)—made payments easier to obtain and more generous than they had been in Atlantic Canada or were in the rest of Canada. UI benefits were often more remunerative than working, and soon many more people were collecting UI in Atlantic Canada than were officially unemployed (a phenomenon discussed below in more detail).

Government-provided financial incentives to leave the labour market in order to collect UI reduced the labour pool, a situation that put tremendous upward pressure on wages. Businesses had to bid against both government-provided employment and UI benefits to attract workers.

Unemployment Insurance

The economic distortions created by the regionally extended UI program went far.

Virtually all forms of increased government spending put some upward pressure on demand and thus on wages, and certain programs have particularly strong effects. This brings us to the nub of the labour-market discussion. The introduction of regionally extended UI benefits in 1971 almost certainly had the largest impact of any government program on Atlantic Canada's economy and on its society.

"Lotto 10–42" and Its Results

Ultimately, the reforms made it possible for many Atlantic Canadians to work 10 weeks of the year and then collect UI for 42 weeks. The scheme was so widely used it became known as "lotto 10–42".[2] And it quickly led to profound adjustments in the economic and social life of communities throughout the region, as many researchers note (see, for example, the House Commission 1986; May and Hollett 1995; May and Gunderson 1996; and Vanderkamp 1986).

Work was reorganized into 10-week parcels, and anyone in a recyclable job who chose to work more than 10 weeks was often considered selfish or antisocial. Much of the fishing industry, in particular, moved to the 10-week work year. Government-subsidized plants sprang up throughout Atlantic Canada, and people were typically cycled through in 10-week segments.[3]

Provincial governments got into the "10–42" scheme. They had an incentive to maximize revenue flow to the region by drawing in more UI money, which does not count against equalization payments.[4] Any number of makework projects were set up and specifically designed to provide 10 weeks of work and no more.

The benefits were large for a provincial government. It might con-

2. After the national 6–49 lottery, in which participants pick 6 of 49 numbers on a form.

3. Interestingly, as May and Hollet (1995) point out, when UI rules were changed to require 12 weeks of work, job terminations at 10 weeks dropped dramatically and rose dramatically at 12 weeks. In fact, terminations were rare before 10 weeks (later 12 weeks) and equally rare afterward.

4. Provincial governments also picked up increased tax revenues, but these were mostly lost due to the structure of equalization.

tribute only a quarter of the cost for such a project, the rest coming from equalization payments and federal cost-sharing if the program was officially listed not as a makework project but as, say, a highway program. That was only the beginning of what the provincial quarter could leverage in the way of federal spending. For every 10 weeks worked, the federal UI program kicked in 42 weeks of income support. Moreover, makework projects were patronage plums. Provincial politicians and governments were eager to promote such projects. They could reap large political benefits at low cost.

Ottawa quickly joined the makework game, with projects designed to maximize UI payments. The cost calculation for federal politicians was surprisingly similar to the one provincial politicians faced. The cost to any federal cabinet minister of funding a makework project was quite small. His or her department would pay for only 10 weeks of makework—sometimes with the bill partially covered by other levels of government—but get political credit for a full year's income support, since UI, theoretically an *insurance* fund, automatically picked up the costs for the other 42 weeks. Thus, any cabinet minister could spend a small part of his or her budget to reap large political rewards or throw a favour to an influential colleague by providing year-round individual subsidies through a 10-week work program.

Soon, in many communities in Atlantic Canada, 90 per cent or more of the families with two (or more) income earners collected UI at some point every year. In at least one community, 100 per cent of such families collected UI (Courchene 1994).

The program had many other flaws, including its pro-cyclical nature, particularly in seasonal industries. Payments increased in good times and fell in bad times. "Instead of offering support in a counter-cyclical manner, UI has been perverted to become pro-cyclical in the fishery" (DRI Canada, APEC, and Canmac Economics 1994, 4–14).

The program was hugely inequitable.[5] Because it was not designed for income redistribution, it delivered a disproportionate amount of income subsidy to the most affluent families in many communities and a disproportionately small amount to the poorest families.

5. I do not examine this point at length since it has been fully discussed in other works, particularly May and Hollett (1995) and May and Gunderson (1996).

The distorting effect of such income-support payments is well known, as is the fact the money would have made a far greater contribution to the economy if it had been spent on infrastructure. Economists make similar points about the smaller European regional programs:

> [A] mechanism based primarily on income subsidies would not contribute to the achievement of sustainable growth [in lagging regions]. Rather it would act as a disincentive to effort in the region receiving the transfers, while possibly damaging the dynamism of the stronger regions. It would at best merely subsidize the continuation of the problem; it would not help solve it. Instead, it is more constructive to think in terms of equalizing the conditions needed for the production of goods and services. Here, the main difficulty faced by problem regions is a lack of an adequate infrastructure.... [P]eriphal regions need assistance to bring their infrastructure up to a similar level as that obtaining in the stronger regions of the Community. (Doyle 1989, 74–75)

Moreover, the “10–42” UI system further politicized the economy in a way that had a disturbing impact on attitudes toward economic development in Atlantic Canada (something documented by the House Commission 1986). The never-ending stream of short-term work projects centred the community on them, rather than longer-term development, and focused it and business people on government incentives, rather than private-sector growth. The easiest and richest rewards came from lobbying powerful politicians for makework projects, not from building sustainable businesses.

The Impact on Unemployment

The unemployment system distorted the regional labour market by rewarding people for not working. The rewards were in both leisure time and absolute income. A worker could do better with a high-paying 10-week job than with a low- or moderate-paying 52-week job. The UI program calculated benefits on the average weekly amount a person was paid over the weeks he or she worked. Once an individual had met full UI qualifications—had obtained sufficient “stamps”, in local parlance[6] —further work increased neither the collection period nor the size of the benefits.

In fact, further work might reduce the amount of benefit received. If a worker accepted a lower-paying job when already qualified for UI, this would reduce the average weekly pay during the time worked and thus lower UI payments.

The system also bribed people to avoid work once they had qualified for UI benefits. Accepting any job during the collection period meant they would have to give up government-funded leisure time, and work might well reduce their income. This situation put a premium on short-term high-paying work, rather than long-term employment. Year-round employers found it increasingly difficult to hire people at wages the firms could afford. Economic growth was stifled.

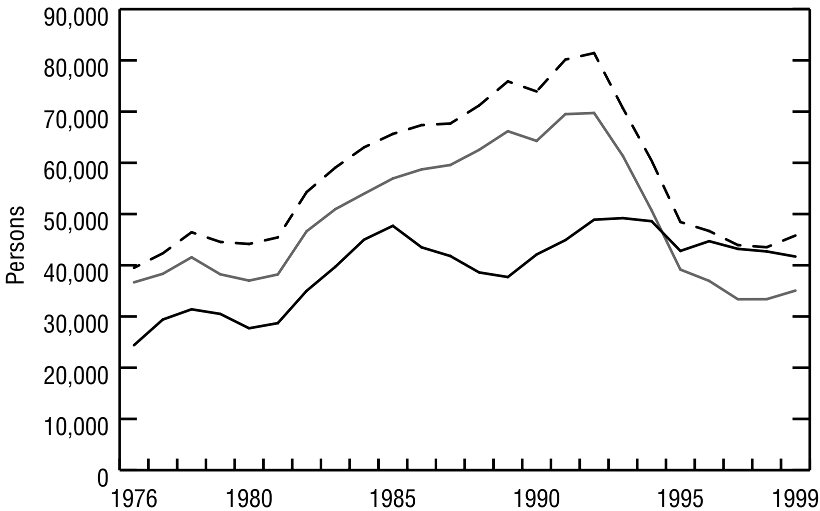
This effect is something researchers came to understand in the years after UI was regionally extended. One only need turn to the report of the Macdonald Royal Commission (Canada 1985) and some of the reports prepared for it to find such problems fully described. In one of these reports, Vanderkamp discusses workers' incentives and wage inflexibility:

> Suppose that an industry has been hit by an unexpected decline which will produce a 50 per cent reduction in output and employment unless there is a dramatic lowering of the wage rate. For the typical worker, a six-month layoff will still generate 80 per cent of the normal annual income before tax (with 60 per cent unemployment insurance replacement), and the after-tax situation is likely to be better. Moreover, the six-month layoff may be worth something in terms of leisure and related activities. As a result wage reduction is likely to be unacceptable. (1986, 100–101)

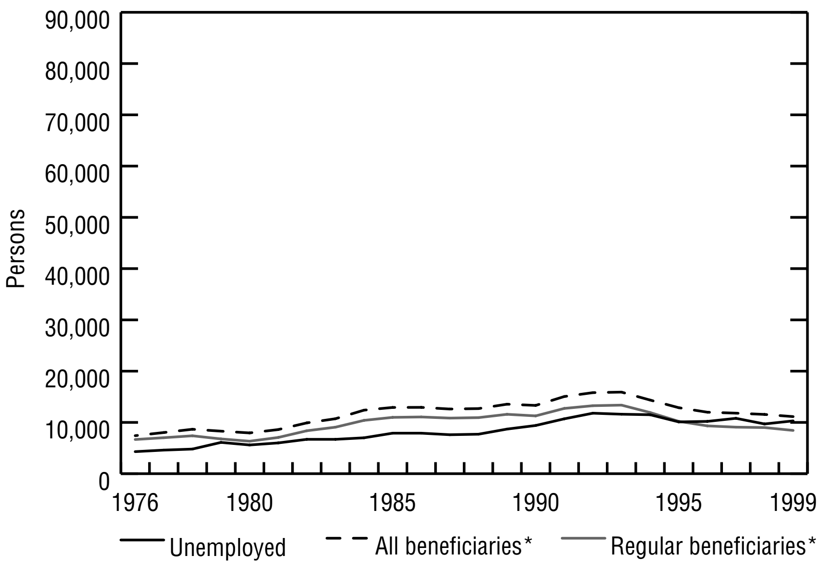
The problem Vanderkamp discusses is in relation to year-round workers who face a layoff. The situation is even clearer for a seasonal worker who, during this period, could get a full year's income, at a rel-

6. At one time, fish harvesters were issued stamps for the value of their catch. They were used to establish earnings and thus eligibility for UI benefits. The practice is now obsolete, but the term lives on (see May and Hollett 1995, 550).

Chart 5–4: EI Beneficiaries, Atlantic Provinces, 1976–1999
a: Newfoundland



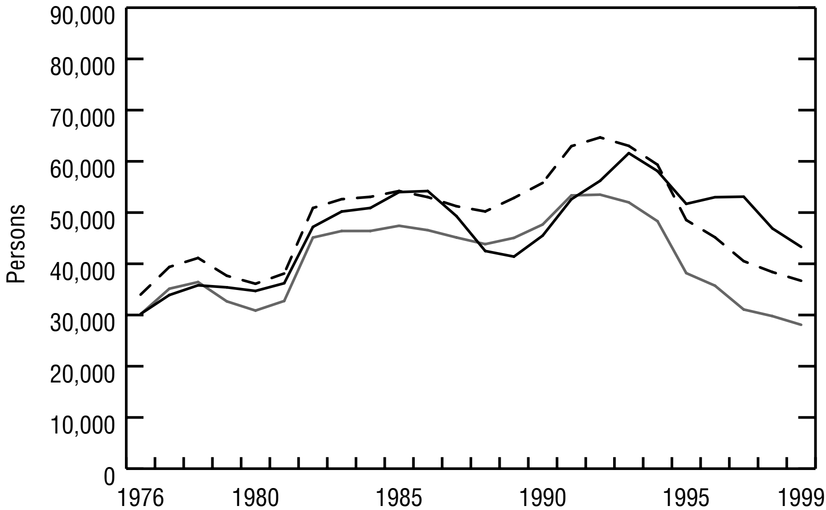
b: Prince Edward Island



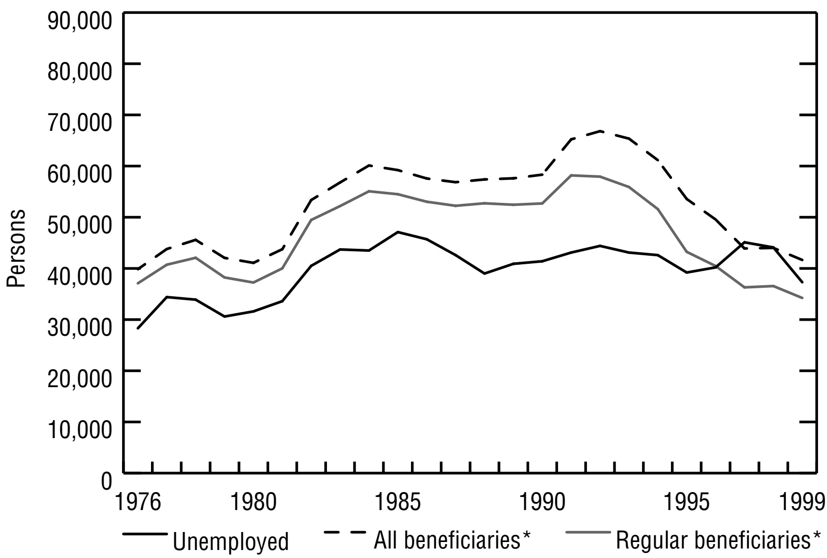
Source: CANSIM.

• The “all beneficiaries” category includes all individuals collecting benefits through any of a number of programs. “Regular” beneficiaries are those who collect benefits solely because they are unemployed and claim to be ready and looking for work.

Chart 5–4: EI Beneficiaries, Atlantic Provinces, 1976–1999
c: Nova Scotia



d: New Brunswick



Source: CANSIM.

• The "all beneficiaries" category includes all individuals collecting benefits through any of a number of programs. "Regular" beneficiaries are those who collect benefits solely because they are unemployed and claim to be ready and looking for work.

Box 5–1: The Charts on Unemployment

Calculating the numbers behind Charts 5-4 and 5-5 presented two problems. First, many more people are unemployed during the course of a year than at any given time. The same holds true about the number of people collecting UI/EI. Thus, any calculation over a long period of time introduces biases. To reduce this bias, I based the charts on monthly averages for the number of unemployed and the number collecting benefits.

Another problem was that the CANSIM data on beneficiaries are not seasonally adjusted. Yet seasonal variations in employment are so great that a chart plotting monthly numbers over several years would be visually uninterpretable. Thus, to make these charts, I averaged monthly recipients and monthly unemployed over each year to arrive at annual figures. Basing the annual figures on monthly periods reduces distortions and double counting that would appear if the calculations were based on longer periods.

This method produces a good approximation of the relationship between numbers of recipients and numbers of unemployed, but it is not entirely satisfactory, since it fails to pick up large seasonal variations. In some months, the number of people collecting UI/EI is more than double the official number of unemployed. The interested reader can find the monthly numbers in Appendix B.

Another problem is that the CANSIM data series for UI/EI begins in mid-1975, a few months prior to the unemployment series, which begins in the first month of 1976. I used numbers from 1976 on to construct the charts.

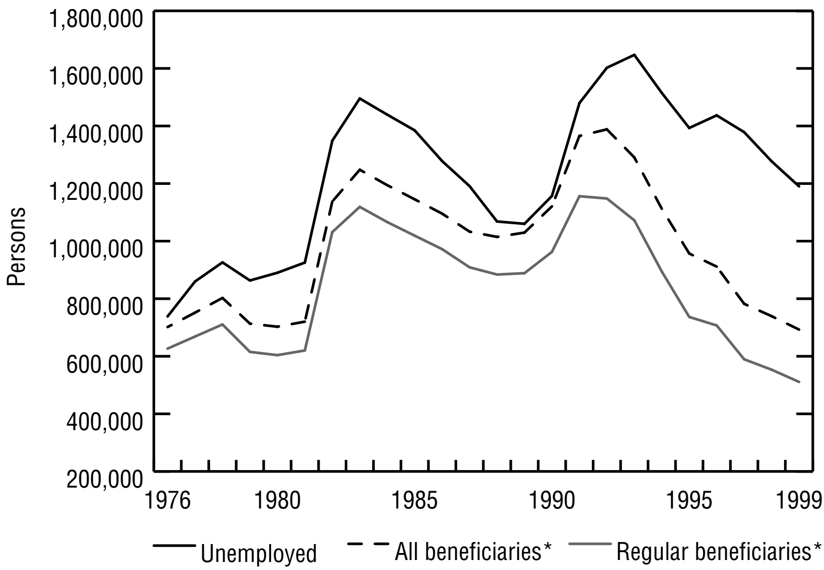
atively high level, for 10 weeks of well-paid seasonal work.

Soon, a remarkable situation arose in Atlantic Canada. The number of people collecting UI benefits—most of whom had to be unemployed to qualify–came to vastly outnumber the number of people who actually were unemployed. (See Charts 5-4a through 5-4d.[7] For a discussion of how they were constructed, see Box 5-1.)

This phenomenon did not occur simply in one or two of the Atlantic provinces. It appeared in all of them at the same time, as one would expect if the cause was a regionally extended program that affected all of them simultaneously with the same economic change.

7. Unfortunately, the CANSIM data series for the number of people collecting UI begins only in 1976, so it does not show how these numbers developed immediately after the introduction of UI reforms in 1971.

Chart 5–5: EI Beneficiaries, Canada, 1976–1999



Source: CANSIM.

• The "all beneficiaries" category includes all individuals collecting benefits through any of a number of programs. "Regular" beneficiaries are those who collect benefits solely because they are unemployed and claim to be ready and looking for work.

The figures for Canada (Chart 5-5) are more expected: the number of unemployed exceeded those collecting UI. The fact that many more Atlantic Canadians were collecting UI than were unemployed puts paid to any argument that UI payments increased so dramatically because of a spontaneous weakness in the region's labour market.

Until fairly recently, the number of regular beneficiaries in Atlantic Canada exceeded the number of unemployed. Yet the regulation is that regular beneficiaries have to be unemployed to collect benefits. (Some other groups—for example, women who recently gave birth—do not have to be unemployed to collect benefits.)

So we are left with a puzzle. Since the regulation was—and is—that people collecting regular benefits must be unemployed, how could their number exceed the number of the unemployed?[8]

The explanation of this situation lies in the fact that the statistics on beneficiaries and on unemployment are gathered in two different ways. The beneficiary numbers are collected directly from the unemployment-program records, which reflect how many cheques are processed.

In contrast, the government estimates unemployment through Statistics Canada's Labour Force Survey, which counts only people who say they are not working but are available for work. Many individuals collecting UI who were uninterested in working apparently tell the surveyors this and thus are not counted among the unemployed. Apparently, enough people fell into that category to explain the anomaly that the number of people collecting UI greatly exceeded the number counted as unemployed. (Later, we'll examine a related puzzle: how the region could have double-digit unemployment and yet suffer labour shortages.)

But other survey respondents, knowing the UI regulations, respond that they are available and are thus counted as unemployed even though they are not interested in working.

A recent study by the Social Research and Demonstration Corporation (Tattrie 1999) reveals the extent of the perversity of the system in Atlantic Canada. A pilot project was established to aid seasonal workers who found off-season work instead of collecting UI. The program would provide subsidies to make up three-quarters of the difference between their seasonal rate of pay and the pay in their non-seasonal jobs. Thus, taking a lower-paying off-season job would not result in a financial penalty, as it often does under the UI structure.

The researchers say in their report that they were startled by what they found. Most seasonal workers did not consider themselves unemployed in the off-season and were uninterested in looking for or accepting work. Only 41 per cent of workers approached even agreed to register for the program and to complete a questionnaire, though doing so entailed no risk or responsibility on their part. Of those, 88

8. Atlantic Canada is not unique in this situation. For example, the number of people collecting benefits in Ireland exceeds the numbers of unemployed, a situation also found in other European nations (see Tansey 1998, 92).

per cent expected to return to their most recent employer, suggesting how well-entrenched seasonal work and benefit patterns are. Of those who did register, fewer than 5 per cent found and accepted off-season work. That amounted to fewer than 2 per cent of all the individuals approached for the program.

An interesting aspect of this experiment was that at least two of the sites selected for it, Halifax and Moncton, are relatively high-employment areas. In both cities, off-season and full-time work are available. (Halifax's unemployment rate is often below the national average, and Moncton is one of Atlantic Canada's success stories.) Yet the take-up on the project at all sites where it was conducted was so small and potential beneficiaries were so uninterested in seeking employment that the researchers were forced to call off the experiment.

The implication is that UI/EI benefits reduce the pool of labour and thus produce artificial labour shortages, which, in turn, artificially force wages to a level that cannot be supported by fundamental economic conditions, weakening economic activity. This process leaves available jobs unfilled and taxes everyone to cover the benefit costs for people who otherwise would be employed.

The Development of Labour Shortages

Atlantic Canada's official unemployment rate overstates the actual number of people willing to accept work. Many UI/EI recipients know the regulations and, to be on the safe side, tell any official survey that they are available for work, whether or not they are actually willing to work at prevailing wages.

This view is supported by reports of labour shortages through Atlantic Canada beginning in the early 1970s, when a number of those officially unemployed were clearly unwilling to accept work and thus did not actually meet unemployment criteria. The real rate of involuntary unemployment in Atlantic Canada was much lower than the official rate of unemployment, which included people who were *voluntarily* unemployed and refused to either look for or accept work.

Labour shortages were noted in areas of double-digit unemployment soon after the UI reforms of 1971 were enacted. As the *Atlantic Report* says:

Somewhat surprisingly, in view of the high unemployment lev-

> els, constant complaints of shortage of workers are heard. Reports are common of the forest, fishing and farming industries being unable to obtain sufficient workers. Even the Job Vacancy Survey conducted by Statistics Canada, which excluded agriculture and fishing, shows an increase in job vacancies since 1971.... Another measure of employment opportunities in the region, the Help Wanted Index...also indicates increasing job opportunities. (APEC October 1973, 6)

Recent reforms to the system have made benefits less generous and more difficult to collect. Yet the situation described above endures as business owners across Atlantic Canada can testify. Press reports of recent examples show that problems related to the EI system remain prevalent in Atlantic Canada.

In late 1998, Kent Homes in Bouctouche, New Brunswick, a high-unemployment area, planned an expansion. The project had to be delayed when 50 semiskilled workers could not be found. In summer 1999, the Petit-Roucher fish plant in northern New Brunswick closed, leaving workers without enough weeks to qualify for EI payments. The provincial government stepped in with a makework project designed to give the workers their qualifying weeks. Then a fish plant in nearby Maisonette tried to hire the workers. It was getting new herring shipments and could provide enough work to enable workers to qualify for EI benefits. The workers turned the offer down flat. The 90-minute trip to Maisonette, they said, was too much to expect, even for the few weeks they needed to qualify. The makework project, the workers said, was clearly a superior way of gaining qualification. Even when the company offered free transportation, the workers still made it clear they preferred the makework program.[9]

This incident shows how the psychology has swung in Atlantic Canada. Jobs are no longer seen as a productive enterprise but rather as a means of collecting employment insurance.

9. This story drew national attention, and the government of New Brunswick in the end threatened to terminate the makework project if the plant workers refused to accept work in Maisonette (Jacques Poitros, Saint John *Telegraph Journal,* August 17, 1999).

These incidents are hardly meant to single out New Brunswick. Another revealing incident occurred in Sydney, Nova Scotia, when a local bank branch needed its roof repaired. To guard against vandalism, the bank manager was willing to hire unionized contractors and pay their going rate.[10] Although the Sydney area had an unemployment rate much higher than Cape Breton's general rate of about 25 per cent, he couldn't get the work done locally at any price. To get the roof repaired, he had to turn to a firm from Halifax, where the unemployment rate is lower than the national average. He ended up paying the workers' transportation costs to and from Sydney, paying them while they were in transit, covering their living expenses, and incidentally paying them to repair the roof.

It is extraordinary that any business would have to import construction workers to an area where unemployment was around 25 per cent and unemployment in the construction trades can be 80 per cent. In fact, unemployment among Sydney construction workers has been so high that their union recently called on Ottawa to create a TAGS-like program[11] to provide subsidies to those who leave the construction trade and to provide income support for those who remain in it.

People are reluctant to talk publicly about why workers sometimes need to be imported into an area with such a high unemployment rate. The best explanation is that employment isn't worthwhile unless it lasts long enough to provide a new round of EI stamps. If workers are collecting EI benefits, why give them up for work that won't provide qualification for more EI money? Repairing a roof requires a worker to give up EI benefits but does not provide enough weeks of work to qualify for another round of benefits.

As noted earlier, any number of studies document the incentives created by the UI system to reject full-time work when short-term, high-paying, makework jobs are available through government programs

10. He was presumably worried about an incident in Cape Breton a couple of months earlier in 1997. Many Canadians remember the startling television pictures of unionized construction workers burning an apartment building being constructed by nonunion workers. Police and firefighters were pushed, threatened, and barred from the site until only smoldering embers remained.

11. TAGS was the federal program designed to subsidize workers displaced by the closure of the northern cod fishery.

and subsidized industries that rotate workers to maximize unemployment benefits. Any period of low-income employment reduces the average rate of pay used to calculate UI benefits. Part-time work can both reduce the average wage and lead to direct clawbacks of benefits.

Thus, any employer offering part-time work, work at pay rates below those of seasonal shared-work or of government makework programs, or temporary work of insufficient duration to qualify for UI/EI faces immense difficulties in obtaining workers, a situation that stifles growth and expansion plans. The problem arises not because Atlantic Canadian workers are somehow different from other Canadians, but because accepting such work leads to a decline in income. This was a key mechanism putting upward pressure on wages and creating labour shortages while unemployment was in the double digits. It is a key explanation of Atlantic Canada's slow relative growth throughout the 1970s.

Time for People to Leave?

This discussion of UI/EI throws an interesting light on an impressive paper produced by an Industry Canada economist. Coulombe (1997) finds that the convergence effect has been at work among Canadian provinces, bringing productivity levels of individual workers in them to within the same range of dispersion observed in U.S. border states.

This process, he argues, has now about reached its full effect. Yet while productivity may have converged across provinces, per capita gross domestic product (GDP) has not converged to the same extent as in border states. Coulombe argues this difference is because participation rates and employment levels in lagging Canadian regions are lower than in other provinces and the U.S. states. Thus, since fewer people work, per capita GDP is lower.

Coulombe attributes the low levels of employment in lagging provinces to Canada's generous social programs, which have discouraged workers from going to where jobs exist and encouraged them to remain in regions where they cannot find work:

> [I]ncreased inter-regional redistribution [in recent decades] has not prevented differences in worker productivity from finally converging toward the levels observed in the bordering U.S. states. Thus the productivity of Canadians who have cho-

> sen to work in relatively poor regions has come quite close to that of workers living in more prosperous regions. In other words, equalization does not force workers to be economically inefficient. However, inter-regional distribution has certainly motivated Canadians to remain in the poorest regions, even if they cannot find work there. (1997, 24)

This is doubtless part of the story, but the evidence presented in this volume suggests a greater complexity. Rather than weak interregional migrations being the primary cause of low levels of employment, a perverse system of income supports have discouraged workers from taking available jobs in Atlantic Canada. Moreover, artificially high wages have eliminated jobs from the labour market. High costs, high wages, and the inability of local businesses to attract labour suppress business expansion and job creation, again weakening the employment rate.

The answer to the region's unemployment problem thus may be less in encouraging people to leave and more in removing a number of distortions in the economy and disincentives to work from the labour market.

Development of Human Capital

Government programs have also introduced another distortion in the labour market that weakens economic growth and job creation with directly tragic consequences for individual workers. The whole structure of regional programs has caused workers to undervalue education and skill enhancement. That structure removed incentives for further training by emphasizing low-skill, usually seasonal jobs and makework programs, where employment has nothing to do with a worker's skills and output. The job was created for the sake of creating a job.

UI, by itself, has had a detrimental effect on work-force attachment and discipline and a profoundly detrimental impact on training and education. The perverse impacts of UI on educational and training incentives are many. The most obvious problem is that individuals usually cannot collect UI while enrolled in an educational institution or in a training program (except for a subset of programs attached to the UI system). As well, the seasonal work that the unemployment system rewards requires little skill enhancement.

The results have been appalling. A study ranking Atlantic Canadian competitiveness among that of 48 nations puts the quality of the regional labour force at 43rd behind that of such nations as India, Mexico, Russia, Greece, and Egypt.[12] The region is listed at 39th for having enough skilled labour and 43rd at the quality of its managers (McNiven and Plumstead 1996.)

This study, sponsored by the Atlantic Canada Opportunities Agency (ACOA) and carried out by a Dalhousie University institute, used both objective criteria and survey responses to determine these ratings. Thus, it gives only an impressionistic view of the quality of labour in Atlantic Canada. Nonetheless, its findings are consistent with those of other labour studies in Atlantic Canada. A recent survey of employers reveals that 59 per cent of respondents reported difficulty finding recruits who possessed the necessary skills for employment. As well, "[l]iteracy is more of a problem in Atlantic Canada, particularly Newfoundland, than in the rest of Canada. About 61% of people in Newfoundland, 43% in Nova Scotia and 44% in New Brunswick are not capable of meeting most everyday reading demands compared to 38% nationally" (DRI Atlantic Entrepreneurial Institute 1992, cited in DRI Canada, APEC, and Canmac Economics 1994, 4–12). While the UI system is not the sole problem, clearly any system that discourages education, skill-advancement, and labour-force attachment must share some of the blame.

The system has also made low-skilled, seasonal jobs—rather than education, training, or year-round employment—attractive, particularly for young people. Income requirements are low at that time of life, and the attractiveness of leisure combined with a year-round UI income, perhaps supplemented by income from the underground economy, can be quite strong. Why should a young person sacrifice income and leisure for training or education when he or she can garner sufficient money through 10 weeks of work? (This, of course, results in reduced income later in life, when the skills acquired early on usually begin to pay off in wages and salaries well above what can be achieved through the UI system. But young people tend to have short time horizons.

12. Canada overall is sixth on the list.

I can personally attest to the influence of UI in the high school I attended. I come from middle-class Halifax, an environment full of opportunities. Yet people I knew spent as much time discussing how to find a 10-week makework project and to get some quality time for the rest of the year as they did discussing careers and university. It was fun to have lots of free time *and* money. From those days, I still know highly intelligent and capable people who never entered the professional job market and now work in low-skill occupations well below their capabilities. The draw of UI would have been much greater in poor rural communities, where opportunities are relatively more limited.

The impact on work-force skills and discipline was large, as detailed by, among others, the 1986 House Royal Commission on Employment and Unemployment. A recent column by one of Atlantic Canada's most influential journalists argues that the labour-market perversions detailed by that commission are still prevalent in Atlantic Canada. Parker Barss Donham succinctly summarizes its conclusions on the impact of UI/EI on work:

> "Working for stamps" undermines the intrinsic value of work, transforming it into a cynical means to an end, instead of a source of pride and accomplishment. The tacit understanding that one's work is meaningless—yet another cemetery fence—encourages bad work habits. Why bother showing up on time, working hard, or taking pride in the quality of what's accomplished, if it's all a charade whose real purpose is to accrue stamps? (Halifax *Daily News,* January 27, 1999)

The impact of generous unemployment systems on labour supply, wages, and unemployment is well understood, as Nickell and van Ours, note when they review the literature:

> Unemployment benefits influence equilibrium unemployment via their impact on the effective supply of labour. A more generous benefit system will exert upward pressure on wages at a given levels of unemployment both because it reduces the fear of job loss on the part of the existing employees and because the unemployed are more choosy about which jobs they will accept. (1997, 7)

They go on to explain that benefits that are large in relation to wages can be expected to increase unemployment while long-term benefits can be expected to increase long-term unemployment.

All three phenomena—wage inflation, increased unemployment, and increased long-term unemployment—occurred in Atlantic Canada after regional benefits were made more generous in the 1971 reforms.

Labour-market Disconnects

Other aspects of government activity in Atlantic Canada have also led to wage inflation. Many businesses in Atlantic Canada are highly dependent on government subsidies and contracts, which are usually announced with much emphasis on the number of jobs to be created. Workers, not surprisingly, realize they are working to earn government money, not to produce worthwhile goods and services. In other words, there is a disconnect between the worker's productive activity and the job itself, including the rate of pay, which is as much based on government supports as on his or her productivity. This often leads to large wage demands as workers believe, rather reasonably, that they, not the company, should benefit from grants or contracts meant largely for makework projects.

The IMP Group in Halifax, a relatively high-technology company that depends on markets but also on government, recently encountered this attitude. During a strike, union leaders bluntly argued that much of IMP's work was on government contracts. This government money, the leaders said, should not go to profit an individual firm but rather to wage increases. High profits were seen as little more than theft of the public's money, not a way for a company to invest for the future.

The Trenton rail works in Trenton, Nova Scotia, were saved by a private multinational company, which specializes in taking over defunct yards, introducing new efficiencies, and making them profitable. Its only unionized shop is in Trenton. Two things are being created that wouldn't exist without that company: profits and high-paying jobs. Despite the jobs, the union thought the company was making too much profit. It demanded more money and loudly attacked the company.

Such loud attacks have worked in the past in Atlantic Canada. Labour problems are bad for government; votes could be lost. The company pays up, and government helps out. But the company operating the rail works reacted differently. It has to sell on world markets. To be efficient, it requires consistently competitive wages, not inconsistent government handouts based on politics. Instead of being intimidated, the company redirected contracts away from the Trenton yards, saying the labour situation made completion of the work uncertain there. Failure to perform on contracts would affect the company's reputation with its customers.

Interestingly, the rail-works company said the language the union leaders used was a key reason it was redirecting contracts. Workers had to understand, the company believed, that they and management needed to cooperate. If not, the rail works were doomed to failure. Union leaders admitted to being shocked at the criticism of their rhetoric. This sort of language had a long tradition of grabbing the attention of politicians and leading to the translation of government money into higher pay. Ultimately, the union and management reached an agreement that reflected the economics of a market-oriented firm.

Had the firm been locally owned, the story might have followed a different scenario. The company might have displayed the lack of concern about quality, costs, and good management that is typical of some Atlantic Canadian firms, firms that have come to rely on government support (as we shall see in the next chapter). Such a firm would likely have paid off the workers and demanded more government support.

These stories reflect another distortion in Atlantic Canada's labour markets: a disconnect between management and workers. In successful companies, workers realize their livelihood and future depends on the success of their firm. But with a history of makework projects, bailouts, subsidies and rich government contracts, workers in Atlantic Canada can justifiably believe their future depends on lobbying the government, not on efficient production. As we shall see, both business and workers suffer from the same problem. Management has become far more interested in cultivating government work than in training and improving its work force. This attitude is fostered by the realization that government contracts are often awarded for political reasons. Price and quality are often secondary considerations. This means the productivity and quality-orientation of the work force are less important than they are to a market-oriented firm.

The attitude engendered in workers has been seen most recently in the reaction of the United Mine Workers (UMW) union to Ottawa's early 1999 decision to stop subsidizing the Cape Breton Development Corporation (Devco), the loss-making federal crown corporation that runs Cape Breton's coal mines. The federal plan involves shutting down the largest of the two mines, the Phalen colliery, and the privatization of the second, the Prince colliery.

The Cape Breton mines have actually been uneconomical since 1924, when cheaper, cleaner U.S. coal came on the market. They have been subsidized ever since and were nationalized in 1968. Cape Breton coal is the dirtiest coal mined in North America except for one much smaller (also government-subsidized) mine in New Brunswick.[13] The mines reach out under the Atlantic seabed while cleaner U.S. coal is available in surface mines. As well, Nova Scotia Power was required to buy the coal at prices well above the world level; nevertheless, Devco continued to lose money.

The UMW loudly protested the planned end of subsidies and set up demonstrations. After nearly 75 years of subsidies, union leaders claimed the mines made economic sense. They urged the government to keep Phalen operating and opposed privatization of the Prince colliery. The union successfully called on the provincial government to say it would deny mineral rights to any private buyer[14] unless Ottawa pumped more money the miners' way. The commercial prospects of the Prince colliery have been dubious in the best of circumstances, and this union militancy, supported by the provincial government,[15] will almost certainly scare away any potential buyer, destroying even more jobs in Cape Breton.

However, this consideration was unimportant. For at least two generations, federal and provincial governments have quickly bowed to political pressure, giving workers every right to believe that their future can be secured with political demands, rather than market-oriented

13. So dirty that it caused Nova Scotia to back out of an antipollution agreement negotiated in 1998 between the New England states and the Atlantic provinces.

14. There is some dispute over whether the federal or the provincial government owns the mineral rights to the coal.

15. A recent change in government has lessened support for the union's more militant demands.

work. This demonstrates a dramatic change from the 1960s, when the UMW opposed nationalization of the coal mines and called for their orderly closure (see George 1980, 3). A heroic federal government convinced the union that nationalization was the best course, though it too was at first intended to lead to the orderly closure of the mines.

Conclusion

Through the 1960s, a flexible labour market in Atlantic Canada helped propel the "Atlantic Revolution". The adjustment of wages to economic conditions went hand in hand with increasing investment in the region, with the region's strong economic performance through the decade, and with the convergence of its unemployment rate toward the much lower national rate.

Flexible wages are not a race to the bottom. They are part of a process that, in the long term, generates new job opportunities, economic growth, and even higher wages. By attracting investment, flexible wages lead to increases in the capital/labour ratio, which boosting productivity and leading to higher wages. This process also raises human capital through increased training and learning-by-doing, which also boosts pay rates in the long term. As noted in McMahon (2000), real wages rise quite rapidly in jurisdictions with flexible wages or with policymakers who take concerted action to establish wage moderation. Workers and investors can share the fruits of increased productivity, increasing wages while maintaining healthier profits, which provide the means and incentives for further investment.

In Atlantic Canada, however, government initiatives threw this process into reverse in the 1970s. Rapidly increasing government spending and regionally extended UI soon put considerable upward pressure on wages unrelated to economic conditions. Atlantic Canada's unemployment rate stopped converging with the national average, and then the gap started growing.

Commentators in the 1970s understood that wage inflation was underway in Atlantic Canada despite the high unemployment rate. Remarks on regional wage rates can be found in virtually every *Atlantic Report* from this period: for example, "Total wages and salaries in Atlantic Canada are currently increasing at a faster rate than in the nation" (January 1973); and "Total wages and salaries increased at a faster rate in the region than for Canada as a whole during 1973" (July 1974).

Economists at the time were able to draw a clear link between government policy and inflating wages. Nonetheless, their reports often appear to miss the full implications of government-induced wage inflation. For instance, the October 1975 *Atlantic Report* congratulates government for meeting its objective of boosting Atlantic Canadian wages while criticizing its inability to establish price stability or to achieve full employment. The report writers apparently missed the connections between inflating wages, inflation, and unemployment, seeing these three goals as mutually independent and thus compatible. The failure to connect the dots in the 1970s may have contributed to some of the perversities of policy in Atlantic Canada.

As government's Atlantic Canadian tool kit developed through the late 1960s and early 1970s, regional businesses found themselves squeezed between rising wage expectations and labour shortages. This put a brake on both employment and job creation, the first reflecting employers' inability to fill existing jobs and the second reflecting employers' inability to create new jobs.

The effects on human capital were equally unfortunate. The UI system penalized people who wished to further their education or training. Workers could collect UI if they agreed to do nothing but would be cut off in most cases if they undertook training programs or entered educational institutions.

The system also removed positive incentives for training and education. The UI system revolved around largely unskilled—though often highly paid—seasonal work and makework projects. No financial incentives were attached to skill improvement. Learning-by-doing, a key route of skill acquisition, was negatively affected by several factors. Lengthy spells of voluntary unemployment had an obvious negative impact. Moreover, there was not much to learn by way of transferable skills in many of the jobs the UI system supported. And high wages, by suppressing investment, also limited workers' exposure to new technology and new ways of doing things.

The tragedy here—and tragedy is an appropriate word for the effect on many individuals—is twofold. First, government programs provided incentives for individuals to resist training and skill enhancement, leaving them dependent, all too often, on unsustainable, heavily subsidized jobs. Poorly skilled workers lost control of their own fate and had to continue to depend on government largesse.

Second, future income growth was thwarted. Education and skill enhancement are the route to higher wages. Beginning wages in the private sector can be quite low, but as productivity and skills improve, wages increase. This path to a more affluent lifestyle became blocked when employment was untied from productive activity. The rumuneration may start at a level above what the private sector offers but provides little opportunity for growth, leaving people worse off in the long run.

Another unfortunate effect of the policy mix in Atlantic Canada was the disconnect it created between workers and their work. This lapse was most obvious in government makework projects and much of the fisheries, where employment was generated for its own sake, not to produce something of value.

The disconnect also affected workers in companies that were either heavily subsidized or received large government contracts. Government support of these companies separated pay rates from the value of output. Workers weren't the only ones affected. Government support also disconnected a firm's profits from the value and quality of its output. In other words, as we'll see in the next chapter, these policies separated managers from their firm's productive activity and from their work force. Both sides had hung up the phone.

This situation is not simply a problem of past years in Atlantic Canada. Government-distorted wages remain a problem. "Wage rate and other forms of government competition," according to a report prepared for Industry Canada (DRM Advisory Group 1994, 12), weakens the region's ability to compete in the world market. The OECD 1997 report on Canada (p. 52) argues the nation's failure to reform labour-market distortions have weakened its economic prospects, while the 1998 OECD report on employment policies notes that the perverse effects of the unemployment-insurance system are worst in areas with regionally extended benefits.

In brief, a jurisdiction seeking the worst possible mix of labour policies could look to Atlantic Canada as a model. The regional policy mix has inflated wages beyond what fundamental economic conditions justify and led to the absurd situation of labour shortages in areas with double-digit unemployment. It has suppressed training and education, with doubtless disastrous results for far too many individuals in Atlantic Canada and disconnected workers and firms from their productive activity. But workers were hardly the only ones affected by this policy mix. The business sector was too, as we shall see in the next chapter.