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Chronic Rigidity: The East's Labour Market Problem and How to Fix It.

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Canada's generally good labour market performance over the past several years, exemplified in a 33-year, record-low unemployment rate, masks strikingly large regional disparities.[1] In September 2007, the national unemployment rate was 6 percent, but it ranged from 2.8 percent in central Alberta to 17.8 percent in southern Newfoundland and Labrador. Such wide variances are also present within single provinces, from 5.4 percent to 12 percent in New Brunswick, for example, in that same month.

These statistics suggest rigidity in Canada's labour market. The economy creates jobs at a rapid pace, but people do not readily move to where the jobs are, leaving large pockets of unemployment. And hence our economy as a whole does not achieve its full economic potential.

In previous work, I showed how, despite a 13-year downward trend in the unemployment rate, regional disparities in unemployment have increased (Guillemette 2006). To this end, I used a measure of the dispersion of regional unemployment rates around the national rate. Here, I use a slightly different methodology and update the results on regional unemployment rate dispersion (Figure 1).[2] This new measure, called the relative dispersion of unemployment rates, has an intuitive explanation: it is the number of people whose labour-force status would have to change — from unemployed to employed (or vice versa) — to even out unemployment rates among regions, expressed as a percentage of the number of people currently unemployed in all regions.

Old measure or new, the conclusion is the same: while the general unemployment rate remained on a downward trend since the end of the early 1990s

1 This situation is not new and has been pointed out many times in the past. Gower (1996), Coulombe (1997), Orr (2006) and Akyeampong (2007) are just a few examples.

2 Statistics Canada divides the country into 73 distinct economic regions to reflect the notion of a local labour market. In Guillemette (2006), I used the (unweighted) coefficient of variation of regional rates as a measure of dispersion. Here, the dispersion measure is calculated as a weighted mean of the differences between economic regions' unemployment rates and the national unemployment rate. Specifically, the absolute difference between each region's rate and the national rate is multiplied by that region's share of the national labour force. These products are added and the total divided by the national unemployment rate to produce percent dispersion (see Akyeampong 2007) for the formula. Each unemployment rate series is a three-month moving average seasonally adjusted using the US Census Bureau's X-11 procedure.

Figure 1: Dispersion of Regional Unemployment Rates in Canada and Average Unemployment Rate, Sept. 1987 to Sept. 2007

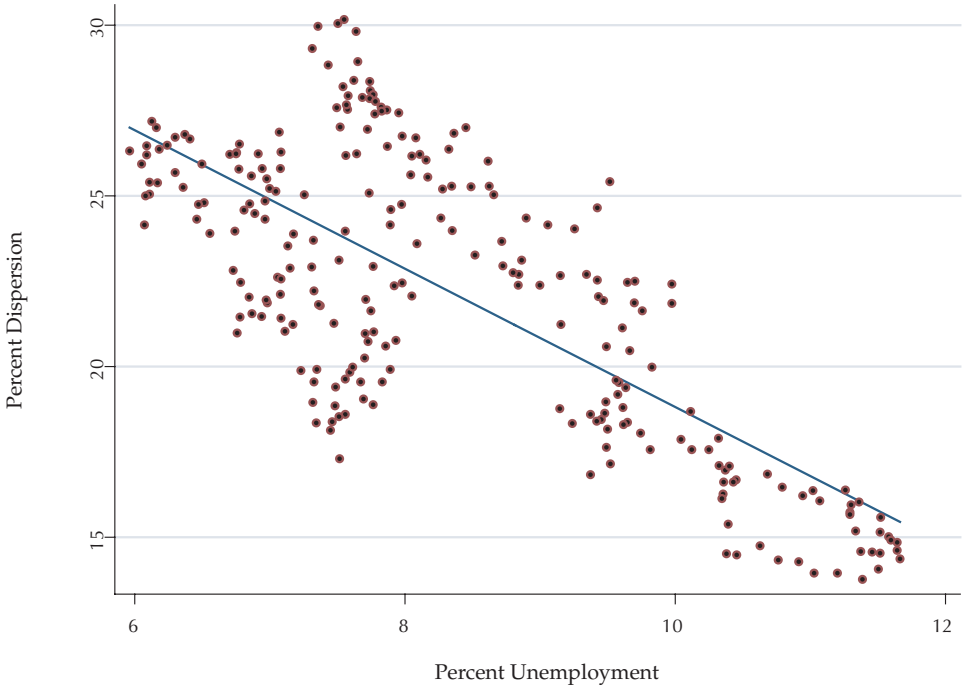
Sources: CANSIM Table 282-0054 and author's calculations.

recession, the dispersion of regional unemployment rose. In a shorter time frame, the most recent heating up of the labour market — from the beginning of 2002 through today — is associated with a significant rise in unemployment rate dispersion. In fact, the dispersion measure is inversely correlated with the unemployment rate; that is, dispersion tends to be higher when unemployment is lower (Figure 1 again). This inverse correlation is seen more easily by directly plotting national unemployment against regional dispersion for each month between March 1987 and September 2007 (Figure 2).

When dividing the country into six regions, from east to west, a negative correlation between unemployment and regional dispersion appears in only three: the Atlantic provinces, Quebec and Ontario (Figure 3). Further analysis of Ontario's numbers reveals, however, that the negative correlation is entirely due to higher unemployment rate dispersion before the early 1990s recession (the cloud of points in the upper-left corner of the Ontario chart).[3] The bottom-line conclusion is that the lack of flexibility in Canadian labour markets is mainly an eastern phenomenon. The same finding was reached in a more detailed International Monetary Fund analysis. It found greater labour market flexibility in Canada's West, with migration being the main process through which labour markets adjust over time (Bayoumi, Sutton and Swiston 2006).

3 Since 1992, unemployment rate dispersion in Ontario has been relatively stable, and eliminating pre-1992 data points removes the negative statistical association between low unemployment and high dispersion.

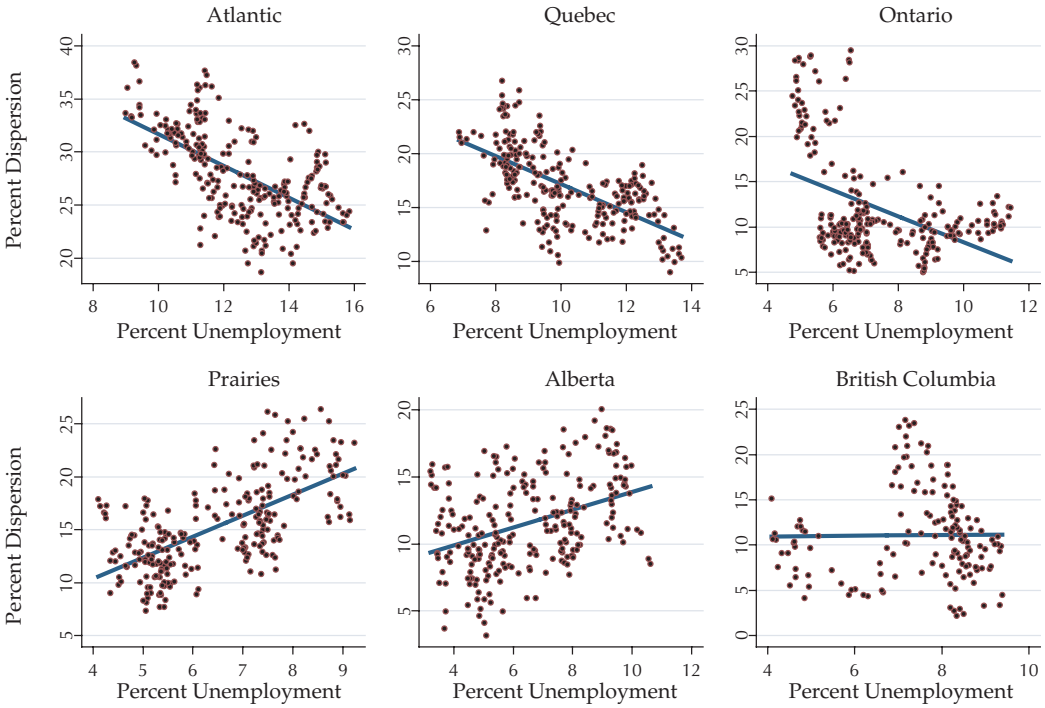
Figure 2: Nationwide, When Unemployment is Lower, Regional Dispersion is Higher



Note: National Unemployment Rate vs Regional Dispersion, March 1987 to September 2007 (Monthly).

Sources: CANSIM Table 282-0054 and author's calculations.

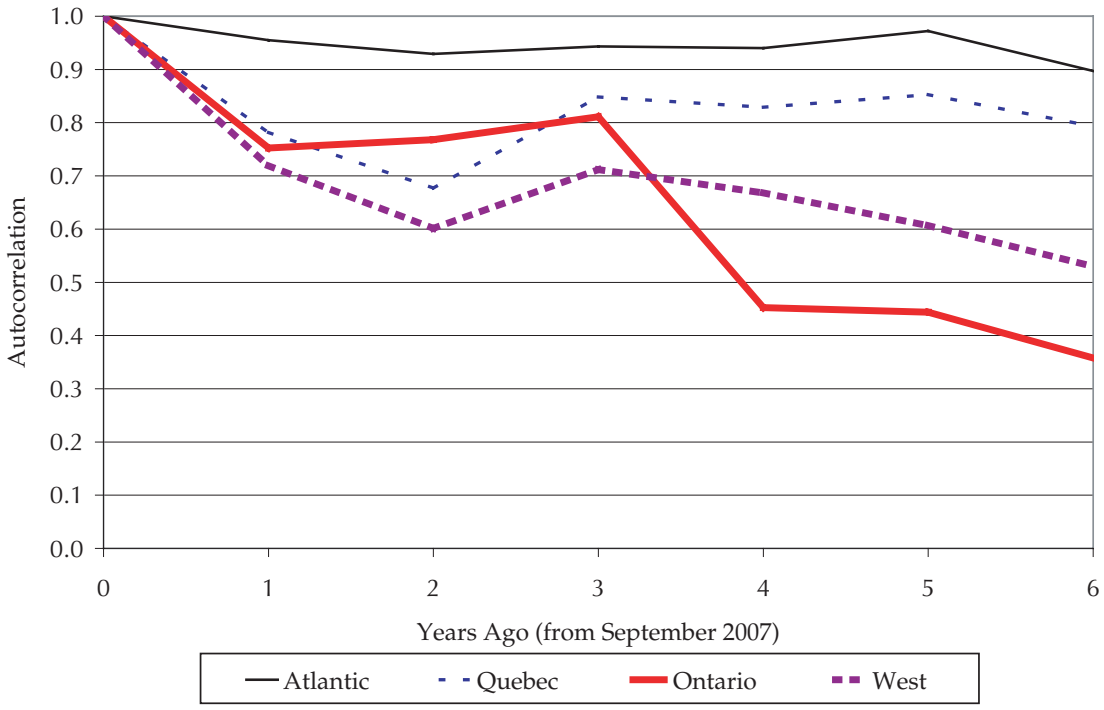
Figure 3: The Nationwide Pattern (Above) Can be Traced to the East, Where Dispersion is Higher in Times of Lower Unemployment



Note: Average Unemployment and Regional Dispersion by Province/Region, March 1987 to September 2007 (Monthly).

Sources: CANSIM Table 282-0054 and author's calculations.

Figure 4: Regional Unemployment Rates Are More Persistent in the East



Sources: CANSIM Table 282-0054 and author's calculations.

Not only are unemployment rate disparities high in Canada, they are very persistent and, once again, especially so in the East (Figure 4). In Ontario and the western provinces, the correlation between regional unemployment rates today and six years ago is less than 0.6, indicating that more than 40 percent of any regional unemployment problem is resolved over that time period. In Quebec and the eastern provinces, however, the correlation is 0.8 or more, suggesting that very little adjustment takes place. Large and persistent disparities in regional unemployment rates could be a problem for several reasons (IMF 2003):

- They are evidence of inefficiency in the labour and capital markets because resources that are in excess supply in some regions are not productively used in other regions.
- They increase the social cost of unemployment. When unemployment is concentrated in a specific area, informal support networks can break down, asset prices drop sharply, and economic distress can become more acute.
- They are often associated with a large shadow economy. Research suggests that participation in the underground economy in Canada is greater in poor rural areas with low labour-force participation and high unemployment (Reimer 2000).

Across OECD countries, high regional unemployment disparities generally coincide with high national unemployment and low employment, suggesting that reducing regional disparities is important to improve overall labour market performance (OECD 2006). In the US, a country recognized for its very flexible labour market, dispersion of unemployment rates across states is positively correlated with average

unemployment (Wall and Zoega 2003; Jarrett 2005) and persistence of unemployment disparities is much lower, with a six-year correlation of around 0.3 (IMF 2003). Not surprisingly, then, the US has long enjoyed lower structural unemployment than Canada.

The sources of regional differences in unemployment rates are numerous. Some disparities are a natural feature of an open economy because different regions have different economic circumstances. In addition, industry composition seems to play an important role; for instance, long-term unemployment is particularly high in traditionally fishing-intensive regions such as eastern Canada. Whatever the initial cause, persistent regional unemployment suggests that there are insufficient incentives for either labour to move out or private capital to move in.

This assessment means that both the federal and provincial governments in the East have a role to play in encouraging greater labour market flexibility. Provincial governments can make their regions more attractive to mobile workers and industries by providing an attractive business climate with a low tax and regulatory burden. On the labour side, two important factors explain why market flexibility is lower in the East than in the central and western parts of the country. Migration there is hindered by (i) a dwindling pool of young, educated and mobile workers, as well as by (ii) more generous and easily accessed unemployment benefits (Audas and McDonald 2003; Kaufman, Swagel and Dunaway 2003; Bayoumi, Sutton and Swiston 2006; Orr 2006; Guillemette 2006).

What to Do?

The federal government should re-examine the Employment Insurance (EI) program with a view to stimulating greater mobility among regions. Gray (2006) reviews a number of changes to the EI program since 2000 that have partly undone the progress made in the 1996 reforms. Together, these changes have had the effect of facilitating casual and seasonal attachment to the labour market. They act as a disincentive to move.

Because many of these changes targeted regions of high unemployment, they affect the eastern part of the country disproportionately. To take just one example, the EI enhancements of February 2005 that, among other things, made it easier for new labour force entrants and re-entrants to qualify for EI benefits, apply only in areas where the unemployment rate exceeds 10 percent. As of September 2007, five of the six areas in the country where this provision applied were in the Atlantic region (the only other area being the Gaspésie in eastern Quebec). Gray's (2006) suggestions to rehabilitate the EI regime include:

- Tightening the relevant eligibility criteria to limit EI access to seasonal and temporary workers; for example, by shortening benefit entitlement periods and lengthening qualifying contribution periods for repeat users under age 35, who presumably have greater occupational and geographic mobility. The government could channel some of the realized savings into financial inducements for geographic mobility.
- Targeting the aid for truly immobile seasonal workers more narrowly than the current practice of directing it to all EI claimants situated in all high-unemployment areas.

- Scientifically evaluating EI pilot projects using random assignments to determine their real effectiveness.

These recommendations remain just as relevant today. They are also especially timely, for there is no better time to reform labour-market programs than when the economy is strong and displaced workers can most easily find jobs.

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