C.D. Howe Institute
Institut C.D. Howe
e-brief

Misplaced Talent: The Rising Dispersion of Unemployment Rates in Canada

By Yvan Guillemette

July 19, 2006

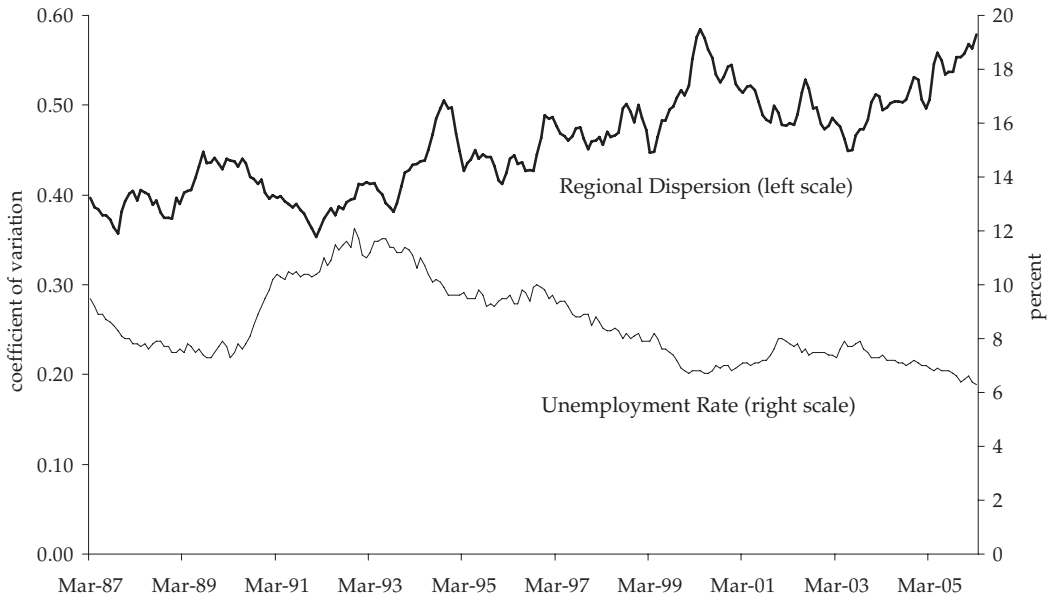
Canada's labour market is doing remarkably well, judging by the nationwide numbers. In June 2006, the employment rate stood at a near-record 63.1 percent, and the unemployment rate was at a 32-year low of 6.1 percent. Wages continue to rise faster than inflation. For the 12-month period ended in June, the average hourly wage was up 3.5 percent, well in excess of the most recent 2.8 percent increase in the consumer price index. The red-hot labour market is a result of sustained economic growth in Canada that has outpaced all other G-7 countries since 1997.

However, the rosy nationwide numbers hide severe local disparities in labour market performance. While the unemployment rate in south-central Manitoba, for example, stood at an impressive 2.2 percent in March 2006, not far away in northwest Ontario, unemployment was much higher at 8.3 percent. In Quebec's Gaspésie region, the rate remained a discouraging 22.7 percent! In a well-functioning labour market, we would expect to see limited variation among regions as people move to where the jobs are.

Not only are there permanent gaps between regional unemployment rates and the national average, but these gaps have also widened as overall countrywide unemployment came down during the past decade. This seems contrary to what one might expect to see during an economic boom, and it suggests that the boom has been milder than it could have been if Canada were realizing its full economic potential. In this e-brief we examine both the extent of the problem and its primary cause, which can be traced to policy flaws in the Employment Insurance (EI) system.

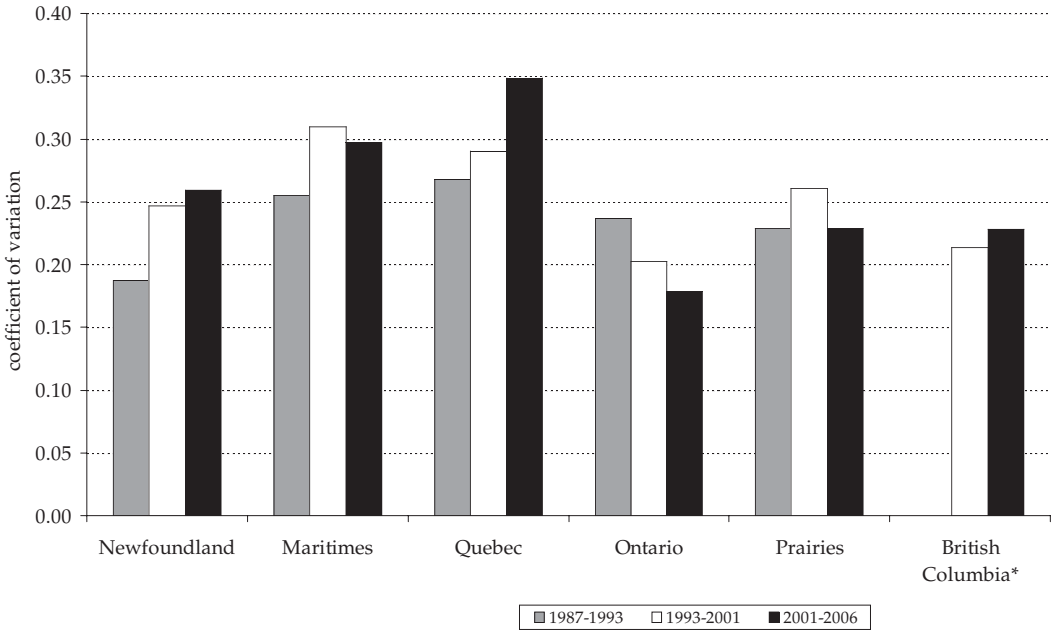
I am grateful to David Gray, Kevin Kerr, Jack Mintz, Finn Poschmann and Bill Robson for comments on earlier drafts.

Figure 1: *Unemployment Rate in Canada and Dispersion of Unemployment Rates Across Economic Regions, 1987 to 2006*



Source: CANSIM tables 282-0054 and 282-0087, author's calculations.

Figure 2: *Dispersion of Unemployment Rates by Region, 1987 to 2006*



Source: CANSIM table 282-0054, author's calculations.
* There are no regional data for Bristish Columbia before 1995.

The dispersion of regional unemployment in Canada has been on the rise ever since the end of the early-1990s recession (Figure 1).[1] The inverse correlation between overall unemployment and regional dispersion means that when the Canadian labour market tightens, it does not tighten everywhere at the same rate. Unemployment falls substantially in some regions but less, or not at all, in others. Better-performing regions pull the average unemployment rate down but also end up farther from the country mean, which raises the dispersion measure. Such statistics reflect the extent to which the unemployed do not move to where there are more work opportunities.

How Much Do People Move Over Time?

It is more reasonable to expect people to move within their province of residence than to another province — according to census data, mobility within provinces is about 3.3 times more likely than inter-provincial mobility. Figure 2 shows the dispersion of regional unemployment rates around the average for a province and, in the case of the Maritimes and the Prairie provinces, a group of provinces. The bars show the average dispersion of regional unemployment over successive periods. While unemployment rate dispersion has gone up significantly in eastern Canada and Quebec and risen slightly in British Columbia over the past decade or two, it has gone down in Ontario and remained stable in the Prairies.

So not only is there a lack of movement of the job seekers between regions nation-wide, but also within certain provinces or sub-national regions, where the unemployed are reluctant to change locales in search of work.

Why don't people in regions of high unemployment move to find work in other regions?

In deciding whether to move, individuals of all ages weigh the benefits and costs of moving, for themselves and their family. They consider factors like expected employment opportunities and earnings, differences in the cost of living and quality of life, as well as financial and psychological costs of moving. The accessibility of government services and benefits also plays an important role in migration decisions. In the case of the unemployed, access to Employment Insurance (EI) benefits is, of course, an important factor. The EI program has lower eligibility requirements and provides benefits of longer duration in regions of high unemployment. Such regionally tilted EI provisions give the unemployed some reason to stay put rather than move to areas where employment possibilities are better.

According to a recent study of the link between EI and individual mobility between economic regions, receipt of EI benefits inhibits migration for individuals who are moderately attached to the labour market; that is, those who work from

1 Statistics Canada divides the country into 73 distinct economic regions to reflect the notion of a local labour market. The dispersion measure the author looks at is the coefficient of variation of unemployment rates across all economic regions, defined as the standard deviation of regional unemployment rates divided by the average unemployment rate for a given period. To remove seasonal fluctuations, each underlying regional unemployment rate series is a three-month moving average that was further smoothed using the X-11 seasonal adjustment procedure. The unemployment rate series is also a seasonally adjusted monthly series.

20 to 49 weeks (full-time or part-time) during the year (Audas and McDonald 2003). For individuals with a strong attachment to the labour market, however, the study found that EI does not have a significant effect on mobility decisions, which is not surprising given that these individuals are relatively unlikely to rely on EI. Because workers in eastern Canada and B.C. generally have weaker labour market attachment and higher levels of EI receipt,[2] it is not surprising to see a rising dispersion of unemployment rates in these regions in contrast to the rest of Canada.

During the 1990s, a series of changes to UI/EI somewhat diminished the impact of the program's regionally differentiated structure by tightening access to, and receipts of, unemployment benefits. Much of these reforms were later undone, however, with the introduction of a series of initiatives targeted at regions of high unemployment.

For instance, in early 1997, the small weeks initiative was introduced as a pilot project in 29 (of the 54) EI administrative regions that had the highest unemployment rates. The initiative was a response to the disincentives created by the new divisor rule implemented in 1996 as part of the new *EI Act*.[3] It was felt that for workers with variable employment patterns, the inclusion of small weeks (short workweeks with correspondingly low levels of earnings) could significantly lower the amount of weekly unemployment benefits by raising the divisor (in proportionate terms) by more than the level of insurable earnings. This could provide a strong disincentive to work extra weeks with short hours. The small weeks initiative was created to enable claimants to exclude weeks in which earnings were under $150 from the calculation of their benefit amount.

The main effect of the initiative was to give an incentive to EI claimants to accept all work, even small workweeks, and enable them to receive higher total income, from both benefits and earnings, than would otherwise be the case within the time horizon of one claim. However, the long-term effects of this initiative were unknown. As Gray (2006) points out, the ability to work small weeks without reducing EI payments may have reduced the incentive to make major adjustments through occupational or geographic mobility. Take-up rates for the initiative were highest in eligible regions located in the Atlantic provinces and Quebec, and lowest in the Prairies and in Ontario. The two regions where take-up was highest are the same identified on Figure 2 as having experienced rising unemployment rate dispersion.

2 In 2003, for example, residents of Ontario and the three Prairie provinces on average worked more weeks than the average Canadian and received less EI benefits. The inverse was true of Atlantic provinces. B.C. had slightly less weeks worked and EI benefits than the Canadian average. These figures were obtained using the 2003 Survey of Income and Labour Dynamics and looking only at non-student survey respondents between age 19 and 59.

3 The 1996 EI reform introduced the "divisor rule" as part of calculating qualification for benefits. With this change, the weekly benefit amount is based on the total insurable earnings over the 26-week qualifying period; divided by the divisor, which is equal to the greater of a) the number of weeks that were actually worked, or b) the minimal entry requirements plus two weeks. The minimum divisor ranges from 14 weeks in maximum entitlement regions to 22 weeks in regions with the lowest unemployment rates.

Adding to the effect of the small weeks initiative, which in 2001 was extended to all regions of the country, the following recently introduced pilot projects all apply to economic regions with an unemployment rate of 10 percent or more:[4]

- a two-year initiative (effective June 6, 2004) that provides claimants with five extra weeks of benefits (up to the maximum entitlement of 45 weeks);
- a three-year initiative (effective December 11, 2005) that increases the earnings exemption from the greater of $50 or 25 percent of the benefit rate to the greater of $75 or 40 percent of the benefit rate;
- a three-year initiative (effective December 11, 2005) that reduces the qualification requirement for new entrants and re-entrants from 910 hours to 840 hours of insurable employment; and
- a three-year initiative (effective October 30, 2005) that allows weekly benefits to be calculated on the basis of the best 14 weeks of earnings (i.e., it eliminates the regionally differentiated minimum divisor).

The effect of these provisions is to inhibit the intra- and inter-regional mobility of workers. By raising the total income associated with seasonal and sporadic work patterns, they encourage workers with precarious labour market attachment to stay put.

Despite good recent economic performance and a generally healthy labour market, there is evidence that Canada could be doing even better if talent moved more fluidly between and within regions. The EI program hinders such fluidity by tying eligibility and generosity to local unemployment rates, in effect discouraging the recurrently unemployed from seeking more stable employment elsewhere. Regionally neutral eligibility and benefit rules would remove this labour market distortion and help promote a more efficient Canadian labour market.

References

Audas, Rick, and James Ted McDonald. 2003. "Employment Insurance and Geographic Mobility: Evidence from the SLID." SRDC Working Paper Series 03-03. Social Research and Demonstration Corporation.

Gray, David. 2006. "Recent Changes to the Employment Insurance Regime: Encouraging Work On-Claim and Off-Claim." *Canadian Public Policy* XXXII(1): 99-108.

———. forthcoming. "Has EI Reform Unravelled? Canada's EI Regime in the 2000s." C.D. Howe Institute *Backgrounder*. Toronto: C.D. Howe Institute.

4 See Gray (forthcoming) for an examination of these provisions and their effects in more details.

This *e-brief* is a publication of the C.D. Howe Institute. For more information contact *Yvan Guillemette*, Policy Analyst, C.D. Howe Institute, 416-865-1904, e-mail cdhowe@cdhowe.org. The *e-brief* is available at www.cdhowe.org.