



APRIL 2019

# LABOUR SHORTAGE: WHAT IS THE EFFECT OF REGULATION?

By Mathieu Bédard

We are constantly told that there is a shortage of labour in Canada. In 2018, the economy added 163,000 full-time jobs, and the unemployment rate fell to 5.6%, a historic low that can be qualified as full employment.<sup>1</sup> The participation rate for people of prime working age, 25 to 54 years, is 87%.<sup>2</sup> The winds are shifting on the labour market. Employers used to have the upper hand; now, it's workers who have it.

A labour shortage should lead to higher wages through the simple application of the law of supply and demand.<sup>3</sup> When there's a potato shortage, their price goes up. Normally, the same thing happens on the labour market, but that's not what is happening right now in Canada. While wages did go up in 2018, the increase was slight: Hourly rates grew by 2.9%. That's more than the inflation rate, which was 2.3%,<sup>4</sup> but a much bigger increase could have been expected, given the crisis described by the media.

Provincial data paint a similar picture. The most severe labour shortage by far is in British Columbia, whether we look at the unemployment rate (4.7%) or the job vacancy rate (4.5%).<sup>5</sup> Ontario, New Brunswick, and Quebec are also places where the lack of workers to fill positions is being felt, to varying degrees of intensity.

The regulation of the labour market undoubtedly plays a significant role. Government-imposed barriers to employment result in a lack of correspondence between the skills sought by employers and those on offer in the market, which reduces the pool of available employees.

If some regulation of professions is not shocking at first glance in certain sectors—for example the health care sector—it seems more difficult to jus-

Table 1

What wage increases?				
Job vacancy rates, unemployment rates, average wage increases, and inflation, 2018				
	Job vacancy rate	Unemployment rate	Increase in the average hourly wage	Inflation
British Columbia	4.5%	4.7%	4.1%	2.7%
Quebec	3.2%	5.5%	1.9%	1.7%
Ontario	3.3%	5.6%	3.5%	2.4%
New Brunswick	2.9%	8.0%	2.2%	2.1%
Canada	<b>3.3%</b>	<b>5.8%</b>	<b>2.9%</b>	<b>2.3%</b>

**Note:** For the job vacancy rate, the data are for the fourth quarter. **Sources:** Statistics Canada, Table 14-10-0326-01: Job vacancies, payroll employees, job vacancy rate, and average offered hourly wage by industry sector, quarterly, unadjusted for seasonality, data for the 4<sup>th</sup> quarter of 2018; Statistics Canada, Table 18-10-0005-01: Consumer Price Index, annual average, not seasonally adjusted; Statistics Canada, Table 14-10-0106-01: Employment and unemployment rate, annual, population centres and rural areas; B.C. Stats, "Earnings and Employment Trends," January 2019.

tify in other fields. In 2010, nearly 13% of Canadian private sector workers aged 18 to 60 were covered by a system of occupational licensing. According to a 2014 study based on the National Occupational Classification, 127 occupations in Canada were regulated in at least one province, by a total of over 400 supervisory bodies.<sup>6</sup> These occupations ranged from tile setter in Quebec to cook in Saskatchewan. Such regulation has the effect of artificially limiting the number of people who can fill such positions.

It is therefore not surprising that the provinces with the biggest labour shortages also tend to be the ones with the most rigid labour laws.<sup>7</sup>

Yet salaries in these provinces did not go up radically in 2018 (see Table 1). Even the increase in the average hourly rate of 4.1% in British Columbia, by far the highest in Canada, seems low given the intensity of the shortage and compared to the inflation rate, which was 2.7%.<sup>8</sup> In Quebec, the increase in the hourly wage in 2018 was even less impressive, at 1.9%. That's far less than the 2016 and 2017 increases, which were respectively 2.8% and 2.9%.<sup>9</sup> It's also barely higher than the increase in the general price level, which was 1.7% in 2018.

Why have salaries not increased more rapidly? Several explanations are regularly suggested. One of these invokes technological innovation, alleging that it limits what workers can demand in terms of wages, since they can be replaced more easily by machines. Another explanation is based on certain fears workers have regarding a possible recession to come, which would keep them from leaving their current jobs. A third hypothesis holds that there are more workers available than the unemployment rate would suggest.<sup>10</sup> Public policies also play a role.

## OBSTACLES TO WAGE INCREASES

We tend to overlook the effect of interprovincial trade barriers and of the tax burden, both of which undermine the productivity of workers.

Productivity and wages improve through better equipment (via investment) or better organization due to more specialization. Both of these allow workers to be more productive by producing more goods and services more quickly, which allows companies to pay higher salaries.

Obstacles to trade between the provinces take the form of rules that make trade more difficult, by limiting it or even by preventing it.<sup>11</sup> They thus hinder the division of labour that would naturally operate between workers located in different provinces, making our economy less efficient.<sup>12</sup>

Indeed, the rules that restrict trade act like a tariff imposed on a country's internal trade. Statistics Canada measured this "border effect" and con-

cluded that it corresponded to the equivalent of a 6.9% tariff imposed on interprovincial trade,<sup>13</sup> which is higher than the average tariff rate as measured by the World Bank, including countries that do not even have free trade agreements between them.<sup>14</sup>

The tax burden, for its part, weighs heavily on investment and slows the accumulation of wealth, for individuals and for companies, thus reducing the amount of capital there is to invest.<sup>15</sup> The provinces where the labour shortage is the worst, and where salaries are the slowest to react, are also provinces where this burden is high.<sup>16</sup>

## CONCLUSION

The regulatory barriers that act like tariffs, as well as the tax burden, keep Canadian workers from earning as much as they should. A less regulated and less taxed economy, with freer trade, would benefit workers by allowing them to be more productive, which would lead in turn to them being better paid.

## REFERENCES

1. Statistics Canada, "Labour Force Survey, December 2018," January 4, 2019; Carolyn Wilkins, "A Look Under the Hood of Canada's Job Market," Bank of Canada, January 31, 2019.
2. Statistics Canada, Table 14-10-0287-01: Labour force characteristics, monthly, seasonally adjusted and trend-cycle.
3. Philip Cross, "Feeling It in Our Wallets: What Surprisingly Poor Wage Figures Tell Us About Canada's Labour Economy," Macdonald-Laurier Institute, MLI Labour Market Report for Q2, 2018.
4. B.C. Stats, "Earnings and Employment Trends," January 2019; Statistics Canada, Table 18-10-0005-01: Consumer Price Index, annual average, not seasonally adjusted.
5. Statistics Canada, Table 14-10-0326-01: Job vacancies, payroll employees, job vacancy rate, and average offered hourly wage by industry sector, quarterly, unadjusted for seasonality; Statistics Canada, Table 14-10-0017-01: Labour force characteristics by sex and detailed age group, monthly, unadjusted for seasonality.
6. Rafael Gomez et al., "Do Immigrants Gain or Lose by Occupational Licensing?" *Canadian Public Policy*, University of Toronto Press, Vol. 41, Supplement 1, August 2015, p. S81 and supplementary material available on the publisher's website.
7. Amela Karabegovic et al., *Measuring the Flexibility of Labour Relations Laws in Canada and the United States*, Fraser Institute, September 2004.
8. BC Stats, *op. cit.*, endnote 4; Statistics Canada, Table 18-10-0005-01: Consumer Price Index, annual average, not seasonally adjusted.
9. BC Stats, *op. cit.*, endnote 4; Institut de la statistique du Québec, *État du marché du travail au Québec : Bilan de l'année 2018*, pp. 31-32.
10. Philip Cross, *op. cit.*, endnote 3; Carolyn Wilkins, *op. cit.*, endnote 1.
11. Standing Senate Committee on Banking, Trade and Commerce, *Tear Down These Walls: Dismantling Canada's Internal Trade Barriers*, June 13, 2016; Michel Kelly-Gagnon and Patrick Déry, "The Comeau Case: The End of Provincial Trade Barriers?" *Viewpoint*, MEI, December 5, 2017.
12. Lukas Albrecht and Trevor Tombe, "Internal Trade, Productivity and Interconnected Industries: A Quantitative Analysis," *Canadian Journal of Economics*, Vol. 49, No. 1, February 2016, pp. 237-263.
13. Robby Bemrose, Mark Brown, and Jesse Tweedle, *Going the Distance: Estimating the Effect of Provincial Borders on Trade when Geography Matters*, Statistics Canada, Research Paper No. 11F0019M, September 14, 2017.
14. World Bank, Tariff rate, applied, simple mean, all products (%), 2017.
15. Mathieu Bédard and Kevin Brookes, *Entrepreneurship and Fiscal Policy – How Taxes Affect Entrepreneurial Activity*, Research Paper, MEI, September 13, 2018, pp. 23-34.
16. Chaire en fiscalité et en finances publiques, *Bilan de la fiscalité au Québec – édition 2019*, January 10, 2019, p. 28.



This Viewpoint was prepared by **Mathieu Bédard**, Economist at the MEI. *The MEI's Regulation Series* aims to examine the often unintended consequences for individuals and businesses of various laws and rules, in contrast with their stated goals.

The MEI is an independent public policy think tank. Through its publications and media appearances, the MEI stimulates debate on public policies in Quebec and across Canada by proposing reforms based on market principles and entrepreneurship. It does not accept any government funding.

MEI 910 Peel Street, Suite 600, Montreal QC H3C 2H8 T 514.273.0969 F 514.273.2581 [iedm.org](http://iedm.org)