

## INDUSTRIAL POLICIES AND EMPLOYMENT

NOTES FOR A SPEECH TO THE CONFERENCE BOARD OF CANADA

MAY 15, 1985

by

Rodney Dobell  
President

Institute for Research on Public Policy

### A. Introduction

Given the persistently high levels of unemployment in Canada, it is not surprising that one of the key public policy debates relates to possible measures to alleviate unemployment problems. In this Conference the organizers have asked me to address the role which industrial policies can play in generating employment, and they have placed this topic in the context of a session entitled "Employment Policies and Institutional Rigidities".

In taking on this assignment, it is not my intention to rehearse the standard debate with respect to the relative strengths and weaknesses of various approaches to defining a national industrial strategy. This is not because I do not consider that debate interesting. Rather, it is because I do not consider traditional approaches to industrial policy as the key policy instruments if the objective is to generate employment per se.

"Industrial policy" has been defined in many ways, but for purposes of this paper I will assume that industrial policies involve purposeful intervention by government to influence the allocation of resources directed to industrial production. The purpose, presumably, is to improve economic performance, some-how measured, beyond what would have prevailed in the absence of government action. Traditionally, the focus has seemed to be on the manufacturing sector, and on large industries rather than on small firms.

I will argue that such policies cannot be designed to deal effectively with employment problems, at least in any sustained way.

While certain industrial policy approaches -- such as trade protection -- might save jobs in certain industries for a time, the long term result is frequently uncompetitive sectors which do not create long term employment.

If the objective is to generate long-term employment, the emphasis must be on longer term strategies than those normally espoused in traditional industrial policies. Specifically, I will develop the hypothesis that the government has a four-fold role to play. First, it should facilitate adjustment by providing a general framework of policies which create a suitable

environment for change. Second, it has a crucial role to play in providing support to the labour-intensive public service sector which generates the basic social infrastructure for all other economic activities. Third, it should focus financial and other assistance on a range of community development activities, particularly to stimulate the birth of enterprises, whether fully viable on conventional commercial criteria or not. Finally, a more comprehensive tax-transfer mechanism - or alternatively (with apologies to Premier Bennett and his experience with BCRIC) a thoroughgoing "peoples' capitalism" - must be contemplated to sustain an emerging dual structure within the economy.

The plan of my remarks is this. After fleeting recognition that the employment problem does seem to be more than cyclical, I argue that traditional industrial policy represents an inadequate response, and should be rejected as an instrument for dealing with that problem.

I suggest that the first element of an appropriate policy is an orientation toward the dynamic processes of innovation, change, and growth. Accompanying this must be the necessary lubricant in the form of policies to soften the personal costs of adjustment and encourage the redeployment of labour in a way which recognizes the importance of individual investments in jobs, roles, and social networks.

These policies seem likely to lead to increased productivity and improved competitive positions. But given apparent trends in technology and in the international economy, it seems unlikely that such policies by themselves will make much of a dent in the unemployment problem itself. I therefore argue that we must rethink current attitudes militating against public expenditures, and recognize the importance of public investments and public services in establishing a basic infrastructure and the essential human capital to support the dynamic economy promoted by the earlier policies of positive adjustment.

Further, I argue for being willing to shadow price local labour for purposes of investment in community development, thus being prepared to invest resources in enterprises not viable on short-term commercial criteria. But the likely effect of all this is to create a dual economy with a technology-and-capital-intensive, high-productivity, high wage competitive sector (including a growing dynamic tertiary, or business services sector) coexisting with a labour-intensive publicly-financed service sector which cannot justify comparable wages. I argue that this outcome -- which I see as an essential concomitant of the positive adjustment strategies advocated earlier -- will only be sustainable with the introduction of some form of integrated GAI/NIT scheme for redistribution, or a comparable redistribution of wealth through a "peoples' capitalism" which

spreads the ownership of the capital in the high wage competitive sector.

Thus I argue that some form of social consensus on fair groundrules for sharing the burden of adjustment costs and appropriate redistribution is an essential prerequisite to an efficient, flexible, adaptive economy. Only when this basic support is in place will we be able to achieve an adequate degree of mobility and reallocation without encountering political opposition sufficient to block the adjustment process.

Obviously what I have outlined here is more a speculative agenda for research than a documented thesis. While the first part of this argument is pretty conventional stuff, the latter part may be thought controversial -- if not crazy. I should perhaps emphasize therefore that the views I express here are, of course, my own. They are not necessarily endorsed by any of my colleagues, or my employer. However, as the President of the Institute for Research on Public Policy, I obviously will not resist altogether the temptation to refer to current research activities of the Institute as they touch on this topic. Also, as I have already implied, the ideas I will propose for new approaches to dealing with employment are somewhat speculative. They need further testing. As such, they perhaps point to needs for further research which organizations such as IRPP should pursue in the future.

B. Nature of the Employment Problem

The nature and importance of the problem of unemployment have already been extensively considered in yesterday's discussion. There is little debate that current unemployment levels pose one of the most serious economic and social challenges facing Canada today. Moreover, this is a problem which we share with many European countries and with certain parts of the labour market in the U.S.

In this respect, recent trends in the Canadian economy carry important implications not only for current unemployment but also for longer run employment prospects. On balance, investment embodying new technology appears to have moved in the direction of labour-saving developments, with the bulk of business investment designed to increase productivity and reduce labour costs rather than expand capacity. Many factors might account for this shift, including growing international pressures, the diffusion of technological developments which occur in some sectors and are then transferred to others, and pressures exerted by increasing wage rates relative to capital costs (although this latter trend has certainly reversed itself since the mid-1970's).

At the same time, there are fundamental sectoral shifts which have been occurring over recent decades. In terms of both production and employment, the service sector of the economy is continuing to grow in relative importance. And, within the service sector, those activities which are most highly labour intensive and which have accounted for most of the postwar growth in employment -- health, education and social welfare -- fall primarily in the domain of the public sector, or at least are publicly financed. Where such labour intensive service activities arise in the private sector, they do so -- it appears -- mostly in the small business category, not in large industrial corporations or extractive activities.

The major implication of these patterns is that it will be difficult to solve the unemployment problem through private sector initiatives alone or through traditional approaches to industrial policy which emphasize incentive grants, regulatory screens and trade protection to large enterprises in the manufacturing sector. These may protect some jobs and some industries, but do not promote employment overall. (Nor is the argument for export-led growth particularly helpful.) Before moving beyond these issues, however, it may be useful to sketch briefly the rationale for such arguments.

The strongest proponents of the need for an industrial strategy in Canada point to the fact that the Canadian industrial structure is dominated primarily by mature and uncompetitive industries. Given such a structure, and given the new challenges which international competition and potential trade liberalization are posing, there is general agreement that there is a role to be played by government in assisting in the necessary structural adjustment and rationalization of industry. It is now generally accepted that protection is not the answer. It is also generally agreed that the alphabet soup of incentive grants favouring "program junkies" or "corporate welfare bums" (to use the older terminology) is not likely to promote either job creation or industrial health in the longer run. Work by IRPP staff and other analysts demonstrates that the costs of these sorts of protection are very high, while the costs of the alternative adjustment to trade liberalization or laissez faire may be surprisingly low.

(Close observers of the business scene will note that all this general agreement in principle does not extend throughout the business community. Beyond notable exceptions like Petromont and Domtar, I was struck personally by the message which seemed to me to be left with the Ministers attending the National Economic Conference. This, in my view, seemed clearly to be that free trade, deregulation, and reductions in

government intervention in aid of industry all must be pursued very gently just now, with a great many exceptions, deferrals, and exemptions. A fair number of people seemed to dissociate themselves from universal application of the proposal that business should now back right away from the public trough.)

Nor does the promise of export-led growth seem likely to extend to a solution for our unemployment problems. Firstly, even with successful structural adaptation it seems unlikely that the international competitive environment will evolve in such a way as to result in a surge of manufacturing or industrial activity in Canada. Secondly, trade-led growth assumes a world-wide expansion of purchasing power. However, in a global sense, we are operating in a "closed" system. Not every country can be a net exporter, although all of us can benefit from the expansion of a more liberal trading regime in a growing world economy. Thirdly, and related to this issue, we already have a sizeable export surplus, and there are limits to how far Canada can expect to continue in this direction. Thus, while debate regarding industrial policy in general and trade-led growth in particular are important from the perspective of overall economic policy, neither should be viewed particularly as a strategy for generating employment. Expansion will be met to a considerable extent through increasing productivity, not new jobs. What, then, are the

policy instruments which can make a difference directly to the unemployment problem, particularly in the longer run?

There is, of course, the possibility that the problem of sustained unemployment could be relieved through population movement. Massive immigration has been urged as one means by which demand could be sufficiently stimulated without increasing government deficits and violating financing constraints. Or, on the contrary, substantial emigration has been offered as the safety valve to relieve the excess supply of labour. Indeed, one has to recognize that economic adjustment mechanisms create their own safety valves, quite independently of any industrial policies and emigration may prove to be one. Unfortunately, one suspects that from Canada emigration is likely to be more concentrated amongst the higher-skilled, higher income segments of the labour force.

In any case, I leave aside either development as a likely solution, and I therefore confront still the problem that no plausible degree of success in restoring competitive position and balance sheets in western resource sectors, prairie agriculture, Ontario and Quebec manufacturing, or East Coast fisheries (or even off-shore oil) is likely to deliver us from a situation of serious unemployment over a protracted period.

D. Alternative Approaches to Employment Generation

It is easier to criticize existing approaches to industrial policy than to suggest different strategies to generate longer term and sustained employment. I do not pretend that I have any clear answers. I would, however, like to suggest -- in a tentative way and in the form of a hypothesis -- that the government has a critical function to play in at least four respects. As I mentioned earlier in my introductory remarks, the government should provide a general framework of policies to facilitate adjustment. Second, it should play a direct role in providing public support to the service sector. Thirdly, the government should give priority to financial and other assistance to community level initiatives, including small business. And finally, sustainable solution to the challenge of achieving adequate flexibility and adaptability in an internationally competitive economy demands some form of guaranteed annual income integrated with the tax system.

Let us deal first with the issue of adjustment. A considerable amount of research and a range of public policy initiatives have been devoted to adjustment problems both in Canada and internationally. In fact, the International Economics Program of my own Institute has made important contributions in this regard.

Beginning with the 1983 monograph by Charles Pearson and Gerry Salembier, and continuing through a range of current discussion papers, the IEP has attempted to untangle the linkages between structural change, trade and industrial policy, and adjustment in labour and factor markets. The general conclusion which seems to me to emerge is that the costs to the economy of protection may vastly exceed the social and private costs that might be incurred as a result of trade liberalization, so that we pay a high price indeed to sustain employment levels by this route. Nevertheless, it is also recognized that there are real social costs associated with adjustment, and that part of the burden of these costs should be borne publicly, a point to which I shall return later.

The conclusion from this body of work is that government policies should be directed so far as possible to facilitate geographic, occupational, and sectoral mobility, and hence improve Canada's competitive position within the international economy.

A particularly powerful expression of this view is to be found in a document just released by the Institute, the book Canada can Compete by Jim Fleck and Joe D'Cruz.

Other work of the Institute on the contribution of service activities to trade performance suggests that an important determinant of competitive position is the package of ancillary attributes arising in the design, quality, and marketing of goods exported. The thesis is that innovation, flexibility, and imagination in design may be more important determinant of export success than price margins achieved by standardization and large scale.

I interpret these results to suggest that competition policy should be designed to lean against any industrial combinations or associations for export advantage which carry a risk of adverse impacts on competition in domestic markets.

Similar reasoning underlies the suggestion that the economy might benefit if industrial subsidies were shifted away from large established industrial enterprise toward small firms.

According to the Canadian Federation of Independent Business, small businesses (fewer than 19 employees)-- particularly young small businesses -- produced most of the new jobs between 1975 and 1982. This birth of new firms, and their growth into medium-sized enterprise, provides much of the mechanism by which structural adjustment is achieved. Moreover, a very high proportion of small businesses are

Canadian-owned and usually reinvest back into their own communities.

At the same time, small businesses face serious operational problems including undercapitalization and high interest rates. The removal of such constraints could potentially increase the job creating capacity of this sector.

The area of small and medium sized businesses is an important one for my Institute, and constitutes a special program administered at the University of Laval.

The upshot of all this is a strategy including policies to promote structural adjustment, trade liberalization, strengthened competition policy, and measures to assist small business. The package is evidently premised on a predisposition to favour openness, flexibility, the reduction of barriers -- public or private -- to trade, to entry, to the general contest for markets. It reflects, if you like, the pursuit of maximum efficiency without fear of the unemployment consequences.

#### Lubricating the adjustment process

A process of adjustment such as that just sketched is feasible only if a package of supporting policies, including the

provision of career development opportunities, investment in training and retraining, compensation for dismissal, and the like, can be developed.

The deployment of labour demanded by positive adjustment policies demands in turn provisions which offer so far as possible a degree of security within a firm or a sector, if not in a job; to ask employees to give up rigid work rules or job tenure provisions without some corresponding assurances of opportunities to compete on a reasonable basis for new jobs is asking them voluntarily to slit their economic throat. Investment in the human resource management systems which treat employees as valued participants in a joint enterprise is increasingly recognized not only as sound investment in a long term productive capacity, but also as the quid pro quo for flexibility in the deployment of labour.

A package of such measures is thus a part of an industrial policy designed to achieve an appropriate sharing of the costs of adjustment.

But even with successful policies along these lines, leading to successful adaptation and the maintenance of an internationally competitive economy, it seems unlikely that the problem of sustained unemployment will be resolved. More is

likely to be needed, and it seems to me it is likely to be found in publicly-financed activities.

Public services for employment creation

The third strand of the overall strategy I am proposing would therefore involve the direct provision of support for public social services. At this point, it is useful to pause to confront the problems which conventional labelling and definitions create. There is much debate concerning the role of the public as opposed to the private sector in solving problems of economic growth and employment. Furthermore, there is an underlying tension regarding the relative attention which should be paid to economic and social goals. For example, Jim Fleck and Joe D'Cruz, in their book just released by the Institute, argue that there should be a complete separation between social policy and economic policy. Economic policy should focus on growth and development, in their view, and should be left to the private sector. Social policy should deal with redistribution of wealth, if this is considered politically desirable, and should remain separate from economic policy, following along after the problem of improved competitive position has been resolved.

While I have recommended this book as very worthwhile reading from a number of perspectives, I strongly disagree with the authors in their attempt to separate social and economic policy, and to define the concepts so rigidly. Rather, I would argue that public support for services such as education, health and social welfare -- and indeed public provisions for career development and job transition -- are not forms of social policy which are non-productive consumption but are indeed investments in human capital which contribute directly and significantly to growth, development and productivity. If we were able to see beyond the limits of current labels, we would not waste intellectual energy arguing about whether social or economic goals are more important, but would emphasize instead the positive interrelationship between the two.

When viewed in this light there should be little hesitation about additional public funds for the social investments which generate and maintain the human capital which must be -- I would argue -- the basis for the competitive position of the Canadian economy.

A somewhat different argument would go further, to embrace a willingness to invest in some community activities which employ labour even though these activities cannot afford to pay the going supply price of labour (which reflects existing unemployment insurance provisions).

The need for support to communities attempting to mobilize their own resources to meet local needs may call, in effect, for shadow-pricing employed local labour in the evaluation of community investment projects. The concept of support for community development initiatives is not a new one, but it has only recently been given serious attention as a policy option aimed at generating employment.

#### Redistribution to sustain a dual economy

The final element of this package of policies -- which you may no longer wish to call industrial policies -- is a thorough going tax/transfer mechanism leading to a guaranteed annual income. The argument, again, is that such a provision is the logical support to a system of flexible wages encouraging the reallocation of labour in line with the needs of a changing economic structure. By separating the basic distributional goals of the community in this way from the operations of the labour market and participation in production, we reduce resistance to the reallocations of resources demanded in a changing economy. (An alternative, as noted above, is a mechanism to assure broader distribution of the claims on the returns to capital generated within the high wage capital intensive competing sector which I foresee emerging.)

We thus make possible a separation of industrial policy, with its goal of increasing productivity and improved competitive position, from employment policy, with its goal of a role in production for all who seek it.

### Conclusion

Let me now conclude. In this speech, I have argued that we must move beyond traditional approaches to industrial policy - those which focus on the manufacturing sector, on saving large sunset enterprises, on promoting new sunrise industries, on trade protection - if we are to achieve the goal of long term employment.

I have hypothesized that a different strategy is needed - one which provides a general framework for adjustment which will facilitate change, one which provides support to social infrastructure, and one which focusses on the dynamic small business sector.

To reiterate, my line of argument has been as follows.

1. One should not talk about industrial policies as a solution to the unemployment problems we face. Work by IRPP staff and other

analysts suggests quite compellingly that the costs of protection are very high, and the costs of adjustment may be surprisingly low. Industrial policies have been used to protect jobs, through trade barriers, subsidy programs, or other ingenious devices. They should not be. Industrial policies should be designed to bring about increased productivity and improved competitive positions, and for that purpose the best industrial policy may well be the least industrial policy. Industrial policy is the wrong instrument for dealing with unemployment. Industrial policies should promote and facilitate openness, innovation, and industrial adjustment.

2. Further industrial policies directed toward employment ought perhaps to encourage a shift of government support and subsidies away from large enterprises towards new small business. This emphasis on the dynamics of birth and entry calls for programs to overcome barriers which small businesses encounter with respect to access to capital, implantation of new technology, introduction of office automation, and so on.
3. But the unemployment problem is unlikely to go quickly away with the success of such structural adaptation programs, nor even with a successful strategy of export-led growth. And it has to be recognized that many of the costs of adjustment fall on those least able to bear them.

4. So a major feature of a suitable policy response in this context is a program to encourage redeployment of labour, within firms as well as between sectors. In part this entails programs to support the movement of labour out of some activities in accord with market signals, not to encourage firms to stay in those activities in defiance of them. It involves reducing the rigidities due to work rules and job classifications.
5. Such a policy of positive adjustment, even with all these lubricating mechanisms, seems likely to leave a serious unemployment problem behind. But I argue that substantial public investment in human capital and in community development remains a good investment in economic terms, and an important contributor to improved industrial performance.
6. But such activities, labour intensive services, cannot command wages at the level of the high-measured-productivity sector of the economy. The resulting dual structure can be sustained, with flexibility in the deployment of resources, only with the adoption of a comprehensive guaranteed annual income.

To work out fully the implications and the parameters of the necessary redistributive scheme is obviously a nice task. It seems to me, however, - and I emphasize again that all this is my own speculation - that it is one of the few promising

directions to work on in a search for a solution to the unemployment problem we face.

It may be argued that these last are all social policies which we cannot afford in the present difficult period of restraint. I would argue, on the contrary, that these are economic policies which we cannot afford to neglect if we are to succeed economically in a more challenging world environment.