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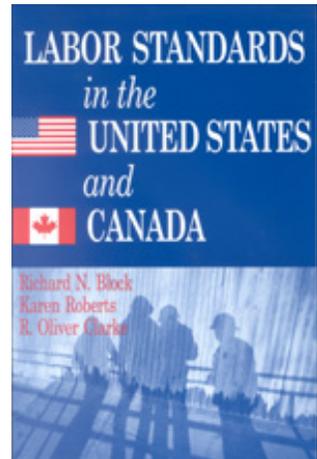
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## Introduction

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**Labor Standards in the United States and Canada**

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# 1

## Introduction

Whereas the League of Nations has for its object the establishment of universal peace, and such a peace can be established only if it is based upon social justice;

And whereas conditions of labour exist involving such injustice, hardship, and privation to large numbers of people as to produce unrest so great that the peace and harmony of the world are imperilled; and an improvement of those conditions is urgently required: as, for example, by the regulation of the hours of work, including the establishment of a maximum working day and week, the regulation of the labour supply, the prevention of unemployment, the provision of an adequate living wage, the protection of the worker against sickness, disease and injury arising out of his employment, the protection of children, young persons and women, provision for old age and injury, protection of the interests of workers when employed in countries other than their own, recognition of the principle of freedom of association, the organisation of vocational and technical education and other measures;

Whereas also the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries; . . .

Treaty of Versailles, 1919

The above quotation, from the provision of the Treaty of Versailles establishing the International Labor Office in 1919, illustrates that the issue of international labor standards has long been on the world stage. During the last two decades, however, rising levels of international trade and a proliferation of large-scale trade agreements have increased the level of attention on cross-country differences in labor standards and on issues associated with setting and enforcing international labor standards. Much of the discussion is on the interrelationship between international trade and labor standards. Despite considerable public attention, relatively little empirical research has studied this relationship. One reason for this empirical void is the difficulty associated with developing reliable measures of labor standards.

This volume has two purposes. The primary purpose is to begin to fill the gap in the research by developing a measure of labor standards that can be applied across countries. A second purpose is to apply that measure to the United States and Canada to test a popular hypothesis that Canada has higher labor standards than those in the United States.<sup>1</sup>

## **OVERVIEW OF THE RECENT DISCUSSION OF LABOR STANDARDS AND INTERNATIONAL TRADE**

As international trade continues to rise, so does the awareness of labor standards at global, regional, and national levels. The debate over the legitimacy of international labor standards and of linking standards to trade agreements has been long and contentious. This debate represents a deeper concern than simply identifying the “winners and losers” in free trade. Rather, it focuses on the role of government policy in protecting citizen welfare. Government policy on employment issues, like most government domestic policy, has traditionally been determined by the domestic values as expressed in the political process. In an insular world with no outside contacts, societies could adopt economic and employment relations policies solely in accordance with their national interests and value systems, with little concern about the consequences of interaction with societies having different economic structures, employment relations, or value systems. In a world of free trade, however, the insularity assumption does not hold. As competition increases, firms are more likely to be under pressure to view human resources as a factor of production affecting their ability to compete in the product market. In their attempts to become more competitive, firms may be tempted to use free trade to escape costly regulatory obligations by moving production to a location with less burdensome and, therefore, less costly labor standards. Labor conditions in different countries are thereby placed into competition. Labor and employment policy, once exclusively a domestic issue, is now affected by outside forces.

Differences in labor standards and labor employment policy among competitors received little attention when the primary competitors were firms in developed countries—the United States, Canada,

Western Europe, and Japan—because all were perceived to be high-wage countries, with high labor standards. When less developed countries began to compete, however, with their lower labor standards and lower wage rates, labor standards in competing countries began to be seen as sources of competitive disadvantage for the developed countries.

Despite the intense public debate and interest that labor standards issues have aroused over the last decade, there has been almost no research on the relationship between trade and labor standards. A primary reason for this empirical gap is the absence of measures of labor standards that can be applied internationally.

The first objective of this book is to begin to close this empirical gap by presenting a new method for comparing labor standards across political jurisdictions; the second is to apply that method to the United States and Canada. In the absence of reliable comparative measures, there is no way of evaluating differences in labor standards among countries. Therefore, there is no way of knowing how such differences affect trade flows or other economic outcomes, such as income distribution and employment levels.

## **THE SOCIAL CONTEXTS: WHY CANADA AND THE UNITED STATES MAY DIVERGE**

When the issue of a free trade arrangement with the United States and Canada was initially raised, one commonly articulated concern was that Canadian labor standards would be forced downward as Canadian and U.S. producers began to compete openly (Langille 1991). Several years before the Free Trade Agreement was signed, the Canadian Minister for International Trade, Gerald Regan, articulated the basis for proceeding with the negotiations by saying, “I am convinced above all that we cannot stand still and must explore new alternatives to preserve and expand market access . . . The status quo is simply not a viable option for Canada’s future.”<sup>2</sup> One basis for the opposition to a free trade agreement was the belief that Canada had higher labor standards than the United States, and that the low labor standards of new U.S. firms would give those firms a competitive advantage vis-à-vis

their Canadian counterparts. It was feared that free trade would result in job losses or a deterioration of standards in Canada.

The second objective of this volume is to compare labor standards in the United States and Canada and to examine the question of whether labor standards are higher in Canada than in the United States. Canada and the United States form a particularly interesting comparison because the two countries are quite similar in both economic and demographic structure, yet differ in employment outcomes in several important ways.

The United States and Canada are neighbors and one another's largest trading partners. Among their similarities, both are developed Western countries that trace their origins to British rule in the 18th century. Neither nation suffered economic infrastructure damage or civilian casualties during World War II. Thus, the industrial structures and labor forces of the two countries are similar.

In terms of industrial structure, the plant, and equipment in the two countries have followed comparable development cycles since World War II. In fact, many firms operate on both sides of the border (Lipset 1989; Rugman 1991). The employment distribution across industries differs in several ways, however. While both economies employ approximately 15 percent of the workforce in manufacturing and 17 to 18 percent in trade, the service sector in Canada constitutes 38 percent of employment, compared with about 24 percent in the United States. Another difference is that Canadian employment is somewhat more concentrated in primary industries, including logging and forestry, fishing and trapping, and mining. Primary industries employ 2.1 percent of the Canadian workforce, compared with 0.5 percent in the United States (CANSIM 1998; U.S. Department of Commerce 1998e).

In general, the compositions of both the populations and the labor forces of the two countries are fairly similar. First, the populations have similar age distributions. In Canada, 33.2 percent of the population are under 25 and 12.3 percent are age 65 or older (CANSIM 1998). In the United States, 35.5 percent of the population is under 25, and 12.8 percent are 65 or over (U.S. Department of Commerce 1998c). Labor force participation is slightly higher in the United States: 79.3 percent compared with 75.9 percent in Canada, in 1996 (CANSIM 1998). Although these rates are nearly identical for prime-aged males and females (ages 25 to 54) in the two countries (about 91

percent for males and 76 percent for females), labor force attachment for U.S. workers is distinctly higher for those over 55. In Canada, the labor force participation rates of males ages of 55 to 64 and those 65 or over are 59.3 percent and 10.3 percent, respectively. The comparable rates in the United States are 67.0 percent and 16.6 percent. There are similar patterns for females: the rates for Canadian women 55 to 64 and 65 or over are 39.6 percent and 3.5 percent, respectively, compared with 49.6 percent and 8.6 percent in the United States.<sup>3</sup>

Both countries are experiencing an ethnic diversification of their populations, as both have been the destinations of European and more recently Asian immigrants (Borjas 1993). Canada's share of immigrants from Asia is, however, effectively twice that of the United States: over 1995–1996, 65.9 percent of all Canadian immigrants were from Asia, compared with 37.2 percent for the United States in 1995 (CANSIM 1998; U.S. Department of Commerce 1998b). In contrast, a much larger share of U.S. immigrants comes from Mexico and Central America: 30.3 percent of U.S. immigrants compared with 1.5 percent of Canadian immigrants.

The education levels of the two countries' populations are roughly comparable, although tight comparisons are difficult because of differences in the degree structure and because government data are reported for different age categories. In Canada, 17 percent of those aged 20 or over have a university degree, compared with 15.8 percent of those aged 25 and over in the United States, suggesting that the Canadian labor force is better educated. However, only 18 percent of Canadians aged 15 and over have just high school diplomas, compared with 33.6 percent of the U.S. population aged 25 years or older, suggesting that the U.S. labor force may be better educated (Statistics Canada 1998; U.S. Department of Commerce 1998d).

Despite these broad similarities, researchers have noted differences in several labor market outcomes. One difference is in unemployment. Until the recession of the early 1980s, the two countries experienced almost identical unemployment rates (Card and Freeman 1993; Riddell and Sharpe 1998).<sup>4</sup> Since then, Canada has experienced chronically higher unemployment rates relative to the United States. On average, over the 1983–1996 period, the unemployment rate in the United States was 6.5 percent, compared with 9.8 percent in Canada (Nickell 1997). This difference has increased during the 1990s, with short-term unem-

ployment falling in the United States from 6.4 percent between 1983 and 1988 to 5.6 percent between 1989 and 1994, while the comparable Canadian rate remained effectively constant—9 percent in the early period, 8.9 percent in the later period (Nickell 1997). Subgroup unemployment rates in 1996 indicate that unemployment for those just entering the labor market, ages 15 to 24, and those on the verge of leaving, age 65 or over, is nearly identical in the two countries. However, Canada's unemployment rate for prime age workers, 25 to 54, is approximately twice that in the United States.

Economists speculate about reasons for this difference in unemployment rates. One ready explanation is that wages are more flexible in the United States than in most developed countries, implying that the U.S. labor market equilibrates through adjustments in wages rather than employment levels. Time series data do not support this explanation, however; they suggest, in fact, that wages are less flexible in both the U.S. and Canadian labor markets than in other developed economies, and that, comparing the two countries, U.S. wages are slightly less flexible than those in Canada (Nickell 1997). In addition, research comparing Canada, the United States, and France suggests that wage rigidity does not explain employment growth differences, implying that it also will not explain unemployment differences (Card, Kramarz, and Lemieux 1996).

There seems to be some agreement that the reasons for the unemployment rate gap in the 1980s are different from those for the 1990s (Keil and Pantuosco 1998; Riddell and Sharpe 1998). For example, one explanation that has been explored is that the gap is the result of different rates of economic growth, attributable to differing monetary policies in the two countries. Evidence shows that the two countries had comparable rates of growth through the 1980s, but that over the period from 1989 through 1996, the annual growth rate in gross domestic product (GDP) in the United States was 1.9 percent compared with 1.2 percent in Canada. This suggests that, while a macroeconomic explanation is plausible for the 1990s, it is probably not so for the initial gap in the 1980s.

Card and Freeman (1993) empirically decomposed the unemployment rate difference during the 1980s and conclude that it can be attributed to structural features in the two labor markets. They note that the labor force participation for females increased faster in Canada than in

the United States in the early 1980s, and that this increase took the form of longer unemployment durations. They link this behavior change to two aspects of unemployment insurance in Canada: the availability of maternity leave benefits associated with unemployment or employment insurance and the substantially higher take-up rates—approximately 60 percent in Canada compared with 25 percent in the United States (Card and Freeman 1993). Increases in female participation rates in Canada have also been interpreted as having caused increasing unemployment rates in Canada by allowing other household members to extend their job searches (Keil and Pantuosco 1998). This is consistent with other findings showing that the 1981–1993 gap can be explained in part by longer unemployment durations on the part of Canadian males (Tille 1998).

A second difference is in the union density rates in the two countries. Compiling data from the U.S. Current Population Survey and the Canadian Labour Market Activity Survey, Dinardo and Lemieux (1997) found overall union density rates of 21.4 percent and 40.2 percent in 1988 for the United States and Canada, respectively. In the labor force aged 25 and over, there is a consistent difference in the rates of 20 percentage points between the two countries for all age groups, indicating that this difference is not a cohort effect. Although within all educational categories Canadians are more likely than Americans to be union members, the largest difference is for the most educated, those with 16 years of school or more: in 1988, 13.9 percent of such U.S. workers were union members, compared with 35.7 percent of similarly educated Canadians. While there are some differences in industry mix, they do not explain the differences in union density rates. Rather, Canadian workers in every industry are more likely to be union members than are their counterparts in the United States. Current data suggest that the differences in union density rates persist.

A third labor market outcome in which the United States and Canada have diverged is that of income inequality. The increasing inequality of income in the United States has been well documented (Gottschalk and Moffitt 1994; Johnson 1998; Topel 1997), but whereas the Canadian evidence suggests that income inequality increased during the late 1960s and again in the early 1980s, the evidence of rising inequality is ambiguous in Canada since the early 1980s (Blackburn and Bloom 1993). Beach and Slotsve (1996) argued that, contrary to

popular opinion, there is no evidence of income polarization in Canada. They maintained that increases in income inequality in Canada can be accounted for almost entirely by cyclical factors, and that there is a tight correlation between the unemployment rate and income inequality. Further, they found that income inequality for women, while higher than for men, actually declined over the 1971–1992 period.

When the focus shifts to earnings, however, polarization is more evident. Again, there is evidence of gender differences: earnings inequality did increase for males but decreased for females. Beach and Slotsve find different underlying patterns for men and women. There appears to be a long-term trend toward decreased inequality for women; however, male inequality seems to be more a function of economic growth and unemployment rates. These differences combined with Canadian income transfer policies have meant that there have been no real long-term changes in family income inequality, unlike the situation in the United States.

These observations are supported by another study, which finds that increased hours of work by families mitigated against factors that increased inequality in Canada (Morissette, Myles, and Picot 1995). That study did find evidence of increased income inequality in Canada but attributes it to differences in the hours worked, with more people working part time, and those working full time working more than 40 hours. This contrasts with the explanation commonly given for inequality in the United States—that is, that widening gaps in the number of years of education and in the quality of education lead to differences in earnings.

Unlike Beach and Slotsve, however, Morissette et al. argued that there are underlying trends in the rise of income inequality that cannot be entirely explained by the business cycle. Their interpretation of the shift in hours of work distribution is that firms are adopting a core-contingent workforce strategy, increasing the number of hours worked by core workers and decreasing the number worked by contingent workers.

In a comparative study of how technological change has affected the wage distribution in the United States and Canada, Murphy et al. (1998) also attributed the differences between the two countries to income transfer policies. Their study differs from most in that they examine this relationship in two ways. First, they maintain that differ-

ences in labor supply at relative wage rates can affect inequality and that these are omitted from most studies. Second, they note that usually a technological explanation of wage inequality explains abrupt shifts in the wage distribution and not smooth trends. They argued that the differences in shifts in the income distribution in the two countries can be explained by an “education-race” model, and that differences in social policy between Canada and the United States explain the outcome differences.

The education-race model argues that there are two simultaneous trends, one driven by rates of technological change and the other by changes in the education distribution of the workforce. During the period under study, 1963–1994, Murphy et al. assumed a constant rate of technological change (that is, change due to the introduction of the digital computer) and then examined how the relative supply of high school versus college educated workers has affected the income distribution. They provided evidence that, cumulatively, technological change has increased the demand for more educated workers relative to their supply and has thus increased the earnings inequality. However, the income transfer policies in Canada have mitigated that effect such that income inequality there has not increased as it has in the United States.

One explanation for some of these differences in the various economic outcomes may lie in the fact that the United States and Canada differ in their views of the relationship between the individual and the government and of the role of the state in regulating economic matters. The United States is generally considered antistatist and individualistic (Lipset 1989; Blank 1994; Block 1992). Its entire constitutional and governmental structure is built around limiting the power and role of government. Canada is more statist than the United States, and has traditionally been more willing to accept some governmental control over the lives of its citizens in order to obtain security and order (White 1988; Lipset 1989). Therefore, as a society, Canadians are likely to be more willing than citizens of the United States to use the government as an instrument of wealth redistribution.

This difference in values between the United States and Canada toward the role of the state was manifested most clearly in the debate around the 1988 Canada-U.S. Free Trade Agreement.<sup>5</sup> The FTA generated far more public debate in Canada than in the United States (Mah-

ant 1993). Canadian opponents of the FTA made their arguments in terms of sovereignty, holding that Canada's commitment to a high level of social welfare for all its citizens would be compromised if free trade resulted in pressure to harmonize its policies downward with U.S. policies (Lyon 1987; Doern and Tomlin 1991; Martin 1991; Mahant 1993; Smith 1988).

A key theme in that debate was the perceived Canadian commitment to social welfare in the form of high labor standards.<sup>6</sup> The concern on the part of Canadian FTA opponents seemed to be that, to assure competitiveness in the product market, Canadian firms could use the pressure of free trade as a basis for a political attempt to unburden themselves of labor standards obligations, could reduce compensation to offset the costs of the higher Canadian labor standards, or could move production to a location that was believed to have less burdensome and therefore, less costly labor standards. In all cases, the welfare of workers and citizens would be reduced through a reduction in standards, in compensation, or in employment.

That view is based on the assumption that Canada's labor standards are superior to those of the United States, an assumption that is one component of a more general attitude that Canada is more generous than the United States in all forms of social assistance, in terms of both eligibility and level of benefits (Blank and Hanratty 1993). Empirical comparisons of social assistance programs in the two countries, however, present a mixed picture. Part of this arises from the differing degrees to which these programs are federally controlled in the two countries, with Canadian policies generally emanating from the provinces, and U.S. policies reflecting more of a federal-state mix (Boychuk 1997). As the United States experienced growth during the 1960s and 1970s in federal antipoverty programs, Canadian federal policy took a cost-sharing form of matching provincial benefits that allowed for considerable interprovincial variation (Blank and Hanratty 1993).

More recently, both countries have experienced a backlash against spending on social assistance. In the United States, this has taken the form of some federal retrenchment, leading to more interstate variation. Empirical comparisons of social assistance in the two countries suggest that, on average, both coverage and benefit levels are more generous in Canada than in the United States, but that there is sufficient variation that, depending on the program feature, the least (most) gen-

erous Canadian province is less generous than the least (most) generous U.S. state (Blank and Hanratty 1993; Boychuk 1997).

A second objective of this monograph is to investigate whether the conventional wisdom, that Canadian labor standards are higher than in the United States and that the difference is substantive, is correct. The chief justification for asking such questions is that a finding of substantive and significant differences would allow the investigation of the economic effect of the level of labor standards on various economic outcomes. It is often held that higher labor standards would put domestic firms at a disadvantage relative to their foreign counterparts, other things (such as exchange rates) being equal. It is also plausible that higher governmentally mandated labor standards might induce firms to invest in their workforces (that is, engage in an efficiency wage strategy) and thus raise the productivity of labor relative to foreign competitors. The extent to which Canadian labor standards are actually higher than U.S. standards has never been demonstrated. Our empirical examination of this issue will allow us to test the validity of the assumption—often political—that labor standards are a cost, putting domestic producers at a competitive disadvantage.

## **ORGANIZATION**

This publication is associated with a website that makes available the data used to measure the labor standards in the two countries. This availability will permit researchers throughout the world to use the data to replicate our results, to change the assumptions underlying our results, or to apply specific standards that may interest them and analyze their impact on trade and trade-related phenomena. This website will also permit researchers to easily use or adapt this method to compare labor standards across jurisdictions other than the United States and Canada.

Turning to the organization of this volume, Chapter 2 reviews the literature on the relationship between labor standards and trade, both generally and with specific attention to the United States and Canada. Chapter 3 provides definitions of the labor standards discussed. Chapter 4 discusses the data and methodology used to compare the labor

standards in the two countries. Chapter 5 presents the results of the comparison of labor standards in the two countries, through text and tables. Chapter 6 summarizes the results and presents conclusions.

## Notes

1. Not all work finds that U.S. labor costs are lower than those in Canada. One study (Roberts and Smith 1992) found that U.S. and Canadian labor costs were quite comparable. Expressed in U.S. dollars, in 1993 the average hourly compensation for production workers in manufacturing stood at \$16.79 in the United States and \$16.36 in Canada, further suggesting comparability between the two countries (U.S. Department of Labor 1994a). To the extent that labor standards are reflected in hourly compensation, this research should cause one to question the proposition that Canadian firms are at a disadvantage relative to their counterparts in the United States.
2. Regan 1984, p. 16.
3. It could be argued that higher social welfare benefits in Canada explain some of the differences in labor force participation. However, research on the labor force participation decision in Canada shows that it depends more on personal characteristics than on the level of welfare benefits (Christofides, Stengos, and Swidinsky 1997).
4. Although the gap between Canadian and U.S. unemployment rates has triggered considerable interest among economists, there is some evidence that the relationship between the two rates, including the almost identical patterns up until the early 1980s, is a statistical artifact, and that looking for structural shifts or exogenous shocks to explain the gap is misguided (Lang and Zagorsky 1998).
5. The discussion in this paper focuses on the debate around the 1988 FTA. Although many of the same issues were raised in the debate around the 1993 North American Free Trade Agreement (NAFTA) involving Canada, Mexico, and the United States, the fact that NAFTA involved a third, less-developed country made it more difficult to focus on that debate in discussing Canadian-U.S. differences.
6. There has been some work on specific issues that might be considered labor standards. For comparative studies in collective bargaining, see Weiler (1983), Adams (1993), and Block (1994 and 1996). For comparative studies in workers' compensation, see Burton (1989), Roberts and Madden (1992), and Hyatt and Kralj (1992). For a comparative study in unjust discharge, see Jain (1992). For an overview of social contracts, see Card and Freeman (1994).