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Canada

An Institutional Interpretation of Unemployment:
the Case of Postwar Canada

Chi Fai LI

A Thesis

in

The Department

of

Political Science

Presented in Partial Fulfilment of the Requirements
for the Degree of Master of Arts at
Concordia University
Montreal, Quebec, Canada

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ABSTRACT

An Institutional Interpretation of Unemployment: the Case of Postwar Canada

Chi Fai LI

Today, chronic and massive unemployment, especially in advanced industrialized countries such as Canada, provokes serious discussion. Macroeconomic persuasions have different interpretations of the unemployment problem. This thesis argues that the Institutional interpretation is superior to either Keynesian or Classical interpretation because it allows the closest understanding of the complex economic reality and provides the best explanation of the nature of and prescriptions for the current unemployment problem. For Institutionalists, the current structural unemployment results from a mismatch between a new techno-economic paradigm and the socio-institutional climate. The case of postwar Canada illustrates the inadequacy of both a watered-down version of Keynesian and Monetarist macroeconomic policy in balancing inflation and unemployment. Institutional prescriptions with emphasis on economic, social, and political institutional changes are necessary for Canada to alleviate the current unemployment problem, and adjust for future economic fluctuation.

PREFACE

Understanding ideological development is one of my aims in studying abroad. My involvement in social movements and politics in Hong Kong in the 1980's taught me the importance of ideology in public policy. By ideology, I mean the way in which an individual looks at oneself, and his/her relationship with others, society, and the universe which has developed from a unique cultural context. The ideological background of politicians, and bureaucrats influence the orientation of policy formulation, and policy implementation. Similarly, the ideological background of interest group leaders also influences their reaction to public policy. Therefore, it is important for politicians, bureaucrats, and interest group leaders to understand their own ideological position.

Acquiring knowledge in economic policy is one of my goals in studying public policy and public administration. At the time I was actively participating in public affairs in Hong Kong, I found myself well aware of the cultural context, and interested in a social and political analysis of public policy. I was, however, weak in economic analysis. I had a tendency to reject some of the capitalist ways of economic analysis especially the all powerful concept of the market mechanism. But, I found

it difficult to accept the feasibility of a Communist utopia and the upheaval of a Proletariat revolution. Perhaps this is why I tend to accept the Fabian ideal of achieving a Socialist society by reform. Still, I found myself short of knowledge in economic analysis. Therefore, I took many courses relating to economics.

There are several courses which gave me inspiration in writing this thesis. Professor Harold C'horney's courses on business cycles, and Keynesian economics stimulated me to examine different perspectives on the ebbs and flows of economies and how Keynesian economics differed from Classical economics. Professor Maben Poirier's course on methodology in political science introduced to me to three theories of knowledge which include radical empiricism, Kuhnian relativism and Polanyian realism. Professor Marguerite Mendell's course on economics for public policy introduced me to an institutional perspective on unemployment. My thesis is an attempt to integrate the knowlege that I have learned and apply it to the Canadian situation.

There are people who deserve my deep gratitude. My family's financial and emotional support encouraged me to complete this thesis. Professor Marguerite Mendell's guidance helped me through the process of writing. Ms. Michèle Turner helped eliminate mistakes in the manuscript.

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CHAPTER 1

INTRODUCTION

Brain Mulroney announced his resignation as the leader of the Progressive Conservative Party in February 1993. Four months later in June 1993, Kim Campbell won a marginal victory in the leadership race and became the first female Prime Minister in Canadian history. Will Kim Campbell lead her party to win the third term of office? To be precise, can the performance of the Mulroney government convince voters to vote for the Progressive Conservative Party again?

In the 1992 Budget, the Minister of Finance announced that "A total of 46 separate government entities are directly affected by these streamlining measures... i.e. wind up, defer, merge/ consolidate and privatize." (Canada 1992:86-87) The 1993 Budget proposed further streamlining of more than 12 government entities. (Canada 1993:58-59) In the private sector, job cutting, the closing and restructuring of business is not news at all. The result of these government and private sector decisions is massive unemployment.

In April 1993, the unemployment rate in Canada reached 11.4% which means that there are more than 1.6 million Canadians out of work. The impact of such massive unemployment is enormous. Different studies reveal that there are economic, social, and political impacts of unemployment. Economic impacts of unemployment include lost production, the depletion of Unemployment Insurance funds, a depreciation of human capital, and an increase in welfare assistance. Social impacts include an increase in the suicide rate, crime rate, family break-up, alcoholism, drugs, poor physical health, and mental illness, among others. (Eileen and Bernardine 1971:41-46; Peitchinis 1975:166-168; McGiveny and Sims 1986:2; Sinclair 1987, 34-37; White 1991:228-231; McBride 1992:3-11)

The ill-handling of the unemployment problem by the government may lead to political instability. Lorne Brown (1987) gives a historical account of the Great Depression. During the Conservative Bennett government in the 1930's, thousands of jobless young men were drawn into work camps, a place which provided them with employment. They were offered poor food, mass shelters, and a few pennies a day in exchange for heavy work on major government projects. As those young men organized themselves to seek improvement, the government used repressive and shameful tactics to keep the situation under control. Lorne Brown worries that the history of the 1930's may repeat itself in the 1990s. (Brown 1987:13-15)

The complex economic, social, and political consequences has made unemployment a thorny issue for Canadian as well as other governments in the world.

In order to deal with the problem of mass unemployment, government has to resolve two fundamental questions: Why does massive unemployment exist? How can it be alleviated?

To explain the cause of massive unemployment is basically the subject matter of macroeconomics. In simple terms, macroeconomics concerns the aggregate performance of an economy. Dornbusch, Fischer, and Sparks identify Gross Domestic Product, inflation, economic growth, employment and unemployment, the business cycle, balance of payments, and the exchange rate as key variables in the study of macroeconomics. (Dornbusch, Fischer and Sparks 1989: 5-14) Robert Gordon adds the unemployment rate, inflation rate, productivity, interest rate, government budget deficits, and foreign trade deficits as six major issues in the study of macroeconomics. (Gordon 1990:2-4) In short, employment, price stability, and economic growth are the basic issues in macroeconomics.

Macroeconomic policies are instruments that governments use to deal with macroeconomic issues. There are two main types of macroeconomic policy: monetary and fiscal. Monetary policy is the manipulation of monetary variables such as the quantity of money and the rate of interest to influence the economy. Fiscal policy is the use of government spending and taxation to influence the economy. According to Lipsey, "macroeconomic policy suggests goals for full employment, stable prices, and a satisfactory growth rate." (Lipsey et al 1987: 846) In other words, macroeconomic policy aims to deal with employment\unemployment, deflation\inflation, and

inadequate\excess economic growth issues.

Even though there is common understanding of the variables of macroeconomics and the tools of macroeconomic policy, there are different interpretations of the operations of an economy. This thesis presents three macroeconomic schools of thought: Classical, Keynesian and Institutional. The Classical School's interpretation of macroeconomic policy, as stated in Milton Friedman's writings, is that the money supply affects the economy by the fluctuation of prices. Therefore, the prime aim of macroeconomic policy is to deal with inflation. Government takes a non-interventionist approach, and lets the market mechanism regulate the economy. The Keynesian School's interpretation of macroeconomic policy is that there is involuntary unemployment. Government, therefore, has to intervene by adopting countercyclical policies in order to sustain aggregate demand. Institutional economics is strongly influenced by cultural anthropology, pragmatism and Darwinism. Institutional economics adopts a holistic view of economics. The economic system is not isolated from a society; rather, it is part of society, influenced by and interacting with societal phenomena. Economics is a science of social provisioning in which a society uses its organized intelligence to enhance the betterment of life of its members.

Why are there different interpretations of macroeconomic policy? The answer lies with the different philosophical foundations they rest upon. As Allan Gruchy pointed out, the philosophical position or intellectual orientation determines the

economist's view of economics. In his words:

[S]ocial scientists' accumulated life experiences in a cultural setting form their preliminary intellectual outlook which influences social scientists' view on the real economic world, the problem they will select to study and the methodology they will use.
(Gruchy 1987: 41-42)

This thesis examines two opposite philosophical orientations upon which many interpretations of macroeconomics rest. The Babylonian mode of thought allows different lines of inquiry, and methods of study to understand the complex reality. The Cartesian/Eculidean mode of thought attempts to establish universal truths through self-evident axioms or with the use of deductive logic. *This thesis argues that the Institutional interpretation which follows the Babylonian mode of thought is superior to either the Classical or Keynesian interpretation because it considers the complexity of macroeconomic reality. Its superiority is even more evident on the unemployment issue in that it asserts technology as the prime factor determining the structural change of an economy.*

An economy does not operate in an vacuum. The global as well as domestic political, and social conditions certainly have an impact on macroeconomic issues and policy. Similarly, macroeconomic issues and policy influence political, and social conditions. For instance, the experience of World War II and the Great Depression influenced many industrialized countries to pursue employment as their principal macroeconomic goal. Political business cycle theories e.g. M. Kalecki (1977) attempt to illustrate the ways that the political system influences the ebbs and flows of an

economy. The level of technology is also an important factor affecting political, economic, and social conditions. Christopher Freeman and others have pointed out that technology is, indeed, the prime factor determining economic growth. For example, the advancement of computer technology has made the international production of goods possible. In addition, the global interdependence of financial markets is possible because of telecommunications and computer technology. These economic issues have strong political implications. For example, Douglas Hibbs has done an empirical study on the relationship between political parties and macroeconomic policy. His research reveals that different political parties in advanced industrial societies have different preferences regarding economic goals. Price stability is the top economic goal for conservative parties while full employment is the top economic goal for socialist-labour parties. (Hibbs 1977:1467) Philip Klein (1989) has studied the role of power in the study of economics. Barry Clark argues that the distinction between economics and politics is unsatisfactory because it is very difficult to separate politics and economics. (Clark 1991:1-6)

With respect to unemployment, it is commonly agreed that there are four types of unemployment: structural, frictional, cyclical, and seasonal. However, even this seemingly common language does not mean that all macroeconomists agree on unemployment issues. In fact, the debates arise precisely because of different interpretations. Classical economists view unemployment as voluntary. Workers become unemployed because they are not satisfied with the current wage and,

therefore, drop out of the labour market voluntarily. Thus, the way to force workers back to the labour market is to decrease the supply of job opportunity. As the demand for jobs increase, workers will be forced to accept the current wage.

Keynesian economists view unemployment as involuntary. In the downturn of the trade cycle, there is not sufficient investment and spending to maintain employment opportunities. Workers are willing to work at the current wage, but there are no available jobs. Thus, government has to intervene in order to maintain aggregate demand.

For institutionalists, technological changes affect the economic structure profoundly. These structural changes cause a mismatch between the labour supply and labour demand, and thus create unemployment. Under the guidance of the state, the collective effort of different sectors in society seek solutions to the unemployment problem. If government adopts a restrictive aggregate demand policy, it will create persistent unemployment and initiate institutional changes.

The above discussion points out that different political-economic interpretations assume different causes of unemployment. In general, monetary and fiscal policy are the instruments used by government to deal with unemployment. Yet, the policy prescription for different countries differs according to the unique situation of the country, to the dominant views concerning the causes of unemployment, and the appropriate policy mix to deal with the problem. The current massive unemployment problem in Canada is a complex issue within a particular socio-cultural and political

context. This particular context also operates in, and is constrained by, a greater global context.

The economic history of the postwar period shows that unemployment, inflation, and growth have been the concerns of many governments throughout this period. Before the mid-1970's, many governments in advanced industrialized societies believed in the Phillips Curve. The understanding during that period was that the unemployment rate and the inflation rate were inversely related. Thus, part of their macroeconomic policy was to determine the trade-off between inflation and unemployment. Most governments of advanced industrialized societies tended to create more employment opportunities through stimulating aggregate demand. The stagflation in the mid-1970's proved that the original Phillip's Curve was not sufficient to explain what appeared to be a new relationship between inflation and unemployment; the trade-off disappeared. Different governments in advanced societies adopted different macroeconomic policies to deal with stagflation. Many adopted a tight monetary policy to curb inflation. Macroeconomic policy orientation leaned increasingly towards the Classical school. Massive unemployment is the consequence of this "Monetarist Experiment."

Unlike Canada and many advanced industrialized countries, some advanced industrial countries such as Japan and Sweden, and the Newly Industrialized Countries such as Hong Kong, Taiwan, Singapore and South Korea did succeed in keeping comparatively low unemployment and inflation rates even in the stagflation period.

Their macroeconomic policy orientation throughout the postwar period has been closer to institutional economics. Because they did not experience the severe unemployment problem of the major industrialized countries, this reveals the superiority of Institutional economics over Monetarist and Keynesian approaches.

Keynesian and Monetarist economics have been the dominant macroeconomic policy orientations for the postwar Canadian governments. A watered-down version of Keynesian economics, as suggested by Harold Chorney, dominated from 1945 to 1975 while Monetarism has dominated from 1975 onwards. At the end of the 1960's, during the height of Keynesian economics, however, high inflation emerged. Since the reversal of Keynesianism and the wholesale adoption of Monetarism, massive unemployment has emerged. It seems that neither the watered-down Keynesianism nor Monetarism can strike a balance between inflation and unemployment. The philosophical superiority of Institutional economics, and the success of Japan and the Scandinavian countries in keeping the balance between unemployment and inflation without adopting monetarist policy provokes us to contemplate the following questions: Are Keynesianism and Monetarism inadequate in the current economic environment? Is institutional economics an appropriate orientation for Canadian macroeconomic policy, especially in tackling the massive unemployment problem?

In Chapter 2, I shall outline the philosophical foundations of Institutional, Keynesian, and Monetarist interpretations of macroeconomic policy, and demonstrate the theoretical superiority of the institutional interpretation. In Chapter 3, I shall

compare and contrast these approaches with respect to the problem of unemployment and again demonstrate the superiority of the institutional interpretation. In Chapter 4, I shall provide an overview of macroeconomic performance in postwar Canada. In Chapter 5, I shall examine the causes and prescriptions of the current massive and persistent unemployment in the context of postwar Canada. Chapter 6 is the conclusion of this thesis.

PART I

An Institutional Interpretation of Unemployment

CHAPTER 2

PHILOSOPHICAL FOUNDATIONS OF THE INSTITUTIONAL, KEYNESIAN AND MONETARIST INTERPRETATIONS OF MACROECONOMIC POLICY

Introduction

As Gruchy's writings have suggested, the philosophical foundations of a school of thought influence the way economists understand macroeconomic issues and formulate policy to deal with those issues. This chapter discusses two modes of thought on which most macroeconomic approaches are based. On one hand, the Cartesian/Euclidean mode of thought emphasizes that we may approach absolute truth by using deductive reasoning. On the other hand, the Babylonian mode of thought emphasizes that reality is so complex that we can never achieve the truth. (Dow 1985) These two divergent modes of thought do affect the economists' view of reality. Thus, there are different interpretations of macroeconomic issues and policies. In this chapter, Keynesian, Monetarist, and Institutional interpretation will be examined.

Cartesian/Euclidean Versus the Babylonian Mode of Thought

A mode of thought is a way of constructing one's thinking. This is a broader concept than macroeconomic theory. It is important to understand what the mode of thought is behind a macroeconomic theory because it gives us a wider perspective. The following example provides the reader a useful understanding of the concept. Let us assume that a type of tree in a forest represents a macroeconomic theory. Different botanists specialize in different types of trees. Yet, if botanists neglect that they are in the Rain Forest when they are studying a particular type of tree, they may miss a very important factor which explains why the tree survives in the forest. Similarly, if macroeconomists only focus on the theory they purport without an understanding of the mode of thinking that governs the construction and presentation of their theory, or the social, institutional, and cultural context, they may miss the philosophical foundation that their theory rests upon.

As Sheila Dow has pointed out, Cartesian/Euclidean and Babylonian modes of thought are two philosophical bases that govern the generation of macroeconomic thought. The Cartesian / Euclidean mode originates from two mathematicians, Euclid and Descartes. This mode of thought favours the application of the mathematical method to generate knowledge. It is only mathematics that can possibly establish incontestable axioms, because only mathematics is a definitional system which can be used independent of any observations of reality. In the case of observable reality, deductive logic is used to develop axioms which tend to be self-evident.

There are two principal characteristics of this mode of thought. The first characteristic is reductionism. Because the entire logical structure depends on basic axioms, it is important to make them as widely acceptable as possible, that is, as close as possible to an approximation being 'self-evident'. As a result, propositions are broken down into their smallest components, such that one set of axioms can be identified from which all propositions can be derived by means of deduction. The second characteristic is dualism. Dualism is the propensity to classify concepts, statements, and events according to duals, as belonging to only one of two all-encompassing categories: true or false, logical or illogical, positive or normative, fact or opinion and so on. In short, the Cartesian/Euclidean thought uses a linear system of logical deduction from basic axioms. (Dow 1985:11-14) For Allan Gruchy, this is an idealist philosophical orientation which regards "the ultimate reality as a static, unchanging social world that is most readily grasped through the use of the power of abstract reasoning." (Gruchy 1987: 2)

The origin of the Babylonian mode of thought has been described variously as Babylonian as well as Stoic, and Roman. This style of reasoning is found typically in theological, and legal argument. It includes the non-axiomatic style of mathematical reasoning as well as the rabbinical tradition represented by the Babylonian Talmud. The Babylonian mode of thought starts from the view that it is impossible in general to establish watertight axioms to describe the reality. Different lines and levels of inquiry of contemporary problems can, therefore use various methods. Each line of

inquiry has its own limitations. Logic, in the Babylonian mode of thought is applied within partial systems. Two lines of argument may have conflicting assumptions or conclusions. But the conflict is not a logical one if it simply reflects different choices as to which part of the system is chosen for inquiry. Since Babylonian reasoning depends on which part of a system is singled out for particular attention, it is necessary to understand the nature of the system as a whole before studying its parts. Thus, this mode of thought is 'holistic', unlike the Cartesian/Euclidean style of reasoning. (Dow 1985:14-17)

Philosophical Foundation of Institutional¹ and Keynesian Macroeconomics

Institutional and Keynesian macroeconomics rest upon the Babylonian tradition while the "bastardized" Keynesian and Monetarist approaches tend towards the Cartesian/Euclidean mode of thought.

Cultural anthropology, Darwinism, and Pragmatism have strong influences on Institutional economics. Culture is a complex of ideas, attitudes, and beliefs that is played out by individuals in a habitual manner through institutional arrangements. The primary aim of all cultures is to meet the fundamental needs of human beings which consist of food, sex, shelter, safety, justice, artistic expression, and religious

¹ Sources of the section on Institutional economics include: Gruchy A. The Reconstruction of Economics: An Analysis of the Fundamentals of Institutional Economics. (Connecticut: Greenwood Press Inc., 1987), 2-17 & 21-23; Philip Mirowski, "The Philosophical Bases of Institutional Economics," in Evolutionary Economics: Foundations of Institutional Thought, ed Marc R. Tool (New York: M.E. Sharpe, Inc., 1988), 51-71

speculation. Moreover, institutionalists adopt the concept of "cultural man" which means one whose conduct is largely determined by the culture in which the individual is situated. Darwinism influences the institutionalists' view on the evolutionary nature of economics. The evolution of the economy arises, in this framework, from technological changes.

Philosophically, because Institutional economics has its roots in the Babylonian mode of thought it is especially persuasive. The following are characteristics of Institutional economics: Firstly, it is holistic. The economic system is not isolated but is part of a cultural context. Thus, the study of economics should be interdisciplinary. Secondly, it adopts a "processual" paradigm in economics. An economic system, as part of a culture, is an ongoing process in which structure, and function change over historical time. Thirdly, there are many factors affecting the evolution of an economic system such as population movements, and political developments, amongst others. Yet, the prime mover is technological change. Fourthly, institutionalists believe that there is no final end to this ongoing process. Lastly, the institutionalist view is that organized intelligence is important in the process of economic development.

To summarize, "Economics is the study of the ongoing economic process that provides the flow of goods and services required by society to meet the needs of those who participate in its activities." (Gruchy 1987:21)

The resemblance of Institutional economics and Keynesian economics leads some scholars to study their compatibility and complementarity. (Keller 1983; Whalen

1988) From my point of view, their resemblance lies with their basis in the Babylonian mode of thought. Keynes's view on the methodology of economics is based on the Babylonian mode of thought.

Keynes viewed economics as an art rather than a science. In The General Theory of Employment, Interest, and Money (The General Theory), Keynes clearly stated his position:

The object of our analysis is, not to provide a machine, or method of blind manipulation, which will furnish an infallible answer, but to provide ourselves with an organised and orderly method of thinking out of particular problems; and after we have reached a provisional conclusion by isolating the complicating factors one by one, we then have to go back on ourselves and allow, as well as we can, for the probable interactions of the factors amongst themselves. This is the nature of economic thinking.
(Keynes 1956:297)

This quotation reflects that Keynes did not think that economic analysis must seek the "infallible answer", or the truth in Cartesian/Euclidean terms. Furthermore, Keynes thought that economic analysis was a method of action in which an individual has to make decisions in the midst of uncertainty. Uncertainty is the pivot of the actual economic system, as Fitzgibbons interprets Keynes. Fitzgibbons maintains:

Expectations of the future determine investment, which in turn determines aggregate demand and employment through a spending multiplier. The economy is volatile because expectations and investment are volatile. However, uncertainty was not a vague background context, but was at the heart of a moral as well as a probabilistic philosophy which implied a different way of understanding the economy... The reason why investment is unstable is that the reaction of the average investor to uncertainty is radically irrational, in a way that economics had not recognized as meaningful. (Fitzgibbons 1990:80)

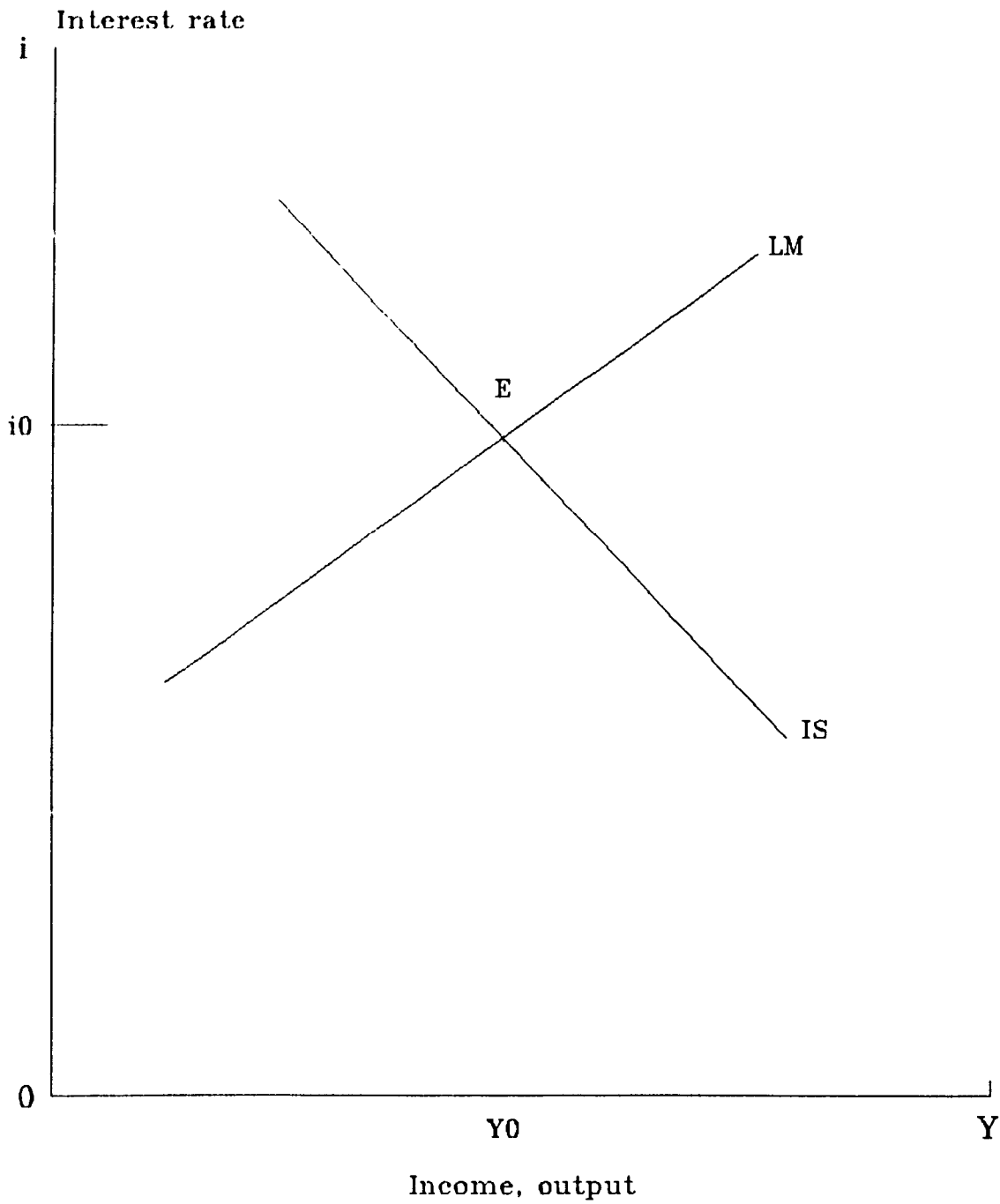
Keynes's idea of uncertainty of economy certainly will not be accepted in the Cartesian/Euclidean approach as this approach assumes perfect predicability. Keynes's support of a common-sense interpretation of probability which allows for direct judgement or intuition to reach a probabilistic conclusion contravenes the predicability principle of the Cartesian/Euclidean mode of thought.

Philosophical Foundation of Bastardized Keynesian and Monetarist Macroeconomics

Keynes's ideas were "bastardized", a term coined by Joan Robinson. The IS-LM model which is included in almost every macroeconomic textbook is a typical example of the bastardization of Keynes's ideas. Figure 1 presents the IS-LM model. On the X axis is the national income Y and on the Y axis is the rate of interest. The IS curve represents various equilibria between investment plus government expenditure and savings plus taxes. The LM curve presents various equilibria between the demand for and the supply of money. Any change in the components of IS and LM curves will result in a new equilibrium level of income, output and the rate of interest. This equilibrium hypothesis contradicts Keynes's idea of the unpredictability of an economy as a result of uncertainty.

This "bastardized" Keynesian idea as well as Classical economics rest on the Cartesian/Euclidean mode of thought. The IS-LM model assumes the economy will always revert to equilibrium. But, is this true in reality? Another example of Classical economics which illustrates the Cartesian/Euclidean roots is Say's Law. Say's Law

FIGURE 1
IS-LM MODEL



Source: Dornbusch, Fischer & Sparks (1989) p.130

points out:

As output increases, increased quantities of some goods exchanged against increased quantities of other goods; increased supply creates correspondingly increased demand. (Sowell 1974:15)

Supply creates its own demand is an axiom which should be true in every situation. Milton Friedman's quantity theory of money which I shall discuss later also assumes universal truths. Friedman's belief in Cartesian/Euclidean principles is reflected in his works. He points out that "Economics as a positive science is a body of tentatively accepted generalizations about economic phenomena that can be used to predict the consequences of changes in circumstances." (Friedman 1953:39) In another statement, Friedman clearly spells out his effort to grasp reality with abstract reasoning:

The ultimate goal of a positive science is the development of a "theory" or "hypothesis" that yields valid and meaningful (i.e., not truistic) predictions about phenomena not yet observed. Such a theory is, in general, a complex intermixture of two elements. In part, it is a "language" designed to promote "systematic and organized methods of reasoning." In part, it is a body of substantive hypotheses designed to abstract essential features of complex reality. (Friedman 1953:7)

Philosophical Superiority of the Institutional Approach

Philosophically, the Keynesian interpretation is superior to "bastardized" Keynesianism and Classical economics because it admits the instability of the economy and the psychological factor, in investment and consumption behaviours in making investment and spending decisions.

The fatal weakness of Classical economics and "bastardized" Keynesianism is their attempt to establish a universal truth of economic behaviour. Their methodology follows the physical sciences. Can social science in general, and economics in particular, model physical science methodology? The answer is no. Unlike physical phenomena, experiments in economic phenomena are extremely limited. Data used in physical experiment, may be observed in an isolated environment while economic behaviour cannot be sliced into particular features, and observed in the absence of a social environment. As the social environment is not static, it is difficult to apply economic axioms and test the predictions in the real world. The predicability of economic axioms is further hampered by the fact that the historical context of economic theory formulation ought to reflect the changes in institutions and in behaviour which occur over time. On the other hand, human beings are different from physical objects in that they have their own will. Economic behaviour of an individual cannot be predicted by a few axioms as this changes according to the will of the individual. Similarly, economists who have introspective power should have an innate understanding of the subject-matter of economics. An economist is not like a physicist who can have a clear cut relationship with the subject-matter. (Dow 1985:32-38)

Keynesian and Institutional economics are superior to Classical and "bastardized" Keynesianism because they do not follow physical science methodology. Institutional interpretation is superior to Keynesianism because it accounts for numerous psychological, social, political and cultural factors which influence the

economic system. Institutionalists admit that the true picture of the economic world is imprecise and often messy, and that rational and non-rational motivations compete with each other in the efforts of individuals and groups to acquire power, and to direct the "thrust of the total economy" in their favour.

To conclude, the Institutional interpretation is superior, in my view, to Keynesianism, "bastardized" Keynesianism and Monetarism because it provides a holistic, and realistic analysis of economics.

CHAPTER 3

INSTITUTIONAL, KEYNESIAN AND MONETARIST INTERPRETATIONS OF UNEMPLOYMENT

Introduction

As mentioned in the previous chapters, the core issues of macroeconomics are economic growth, inflation, and unemployment. These issues are interrelated. Based on different philosophical foundations, Institutionalism, Keynesianism, and Monetarism have different interpretations of those macroeconomic issues. To understand their interpretations on unemployment, we have to understand their views on the cause of unemployment and the relationship between unemployment and inflation.

Keynesian View of Unemployment

Keynes's views revolutionized the Classical economic perspective on unemployment. According to Say's Law, the economy will always be close to full

employment; that is, the economy will regulate itself and return to equilibrium without any intervention from government. In this scenario, prolonged unemployment is impossible because supply creates its own demand, which means that as firms produce goods, they also create income. This income (to workers and to other factories) will then be spent in the economy. So all payments to factors of production will go to consumption or investment--thus equating aggregate supply and aggregate demand at a full employment level of aggregate output, and a stable price level.

Thomas Sowell summarized the seven major propositions of Say's Law:

1. Production necessarily generates purchasing power of equal value, in the form of factor payments, so that it is always objectively possible to sell any given level of output at cost-covering prices. (James Mill)
2. People's behaviour patterns are such that they will not desire to save more than they desire to invest, nor do they generally desire to hold money balances beyond that needed for transactions in the immediate period. (Adam Smith)
3. Investment does not reduce aggregate demand, but merely transfers it from one group of potential consumers (capitalists) to another (workers in the investment goods sector). (Adam Smith)
4. As output increases, increased quantities of some goods exchanged against increased quantities of other goods; increased supply creates correspondingly increased demand. (J.B. Say)
5. Each individual works only in anticipation of consumption equal to his own output, of that the aggregate quantity supplied equals the aggregate quantity demanded ex ante (are always equal) as well as ex post. (James Mill)
6. Increased savings (quantity or function not distinguished) increases the rate of growth. (Adam Smith)
7. Periods of unsold goods are due to internally disproportionate production, which can be eliminated by increasing the output of some other goods which will be traded for the goods currently in excess. (J.B. Say) (Sowell 1974:32-33)

Say's law, therefore implies that there are only two types of unemployment:

frictional, and voluntary unemployment. Frictional unemployment is the result of the normal turnover of labour, that is, people choose to quit their job or are fired. People are unemployed during the time they move from one job to another. It is assumed that the structure of jobs is unchanged. Voluntary unemployment results from the fact that there are job offers in the labour market, and workers choose not to work because they are not satisfied with the current wage.

Keynes in the General Theory argues that there is involuntary unemployment which is a feature of capitalist economies. Keynes points out that there are two postulates of classical theory, namely:

I. The wage is equal to the marginal product of labour. II. The utility of the wage when a given volume of labour is employed is equal to the marginal disutility of that amount of employment.
(Keynes 1936:5)

Keynes maintains that the second postulate is compatible with "frictional" and "voluntary" unemployment. Yet the second postulate does not admit that there is "involuntary" unemployment. Keynes rejected the second postulate for two reasons: Firstly, the Great Depression did not support the supposition that "all those who are now unemployed though willing to work at the current wage will withdraw the offer of their labour in the event of even a small rise in the cost of living." (Keynes 1936:12) Secondly, the assumption that the general level of real wages is directly determined by wage bargaining between labour and entrepreneurs is disputable. Keynes thinks that there are other forces which influence the general level of real wages. (Keynes 1936:12-13) What are they?

Michael Stewart's succinct summary of Keynes's views on the operation of an economic system illustrates those forces at play. The level of employment is affected by certain causal forces, mainly the level of output which equals total consumer goods and services plus capital goods. If output runs at a high level, firms will employ more workers and vice versa. Output depends on effective demand, that is, actual expenditure. Keynes breaks effective demand into two components: consumption, and investment.

By consumption, Keynes referred to the money spent by individuals on goods and services in order to satisfy their own needs. An individual's consumption is determined mainly by his/her income. There are two factors which affect income and in turn affect consumption. The first factor is the distribution of national income. Rich people save their profits while poor people spend their wages. Thus, if wages represent a larger portion of national income, consumption will rise. The second factor is that the proportion of income spent on consumption may change as income changes. This relates to the concept of the Marginal Propensity to Consume i.e. the proportion of any increase in income that is spent on consumption.

Investment is the money spent by firms on capital goods e.g. buildings and machinery in order to produce goods and services in the future. The relationship between profitability (investment demand-schedule) and the interest rate determines the level of investment. One must assesses the probable returns from capital goods over the whole of its life, that is, the marginal efficiency of capital. In Keynes's

definition, the marginal efficiency of capital means "as being equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price." (Keynes 1936:135)

A business person's assessment of investment depends on the outlook of the economy as a whole and the goods to be produced, in particular. Psychological expectations, that is, optimism or pessimism, will affect the market. The rate of interest, essentially a price which is determined by the demand and supply of money, also affects investment.

Keynes's liquidity preference theory explains that people hold money based on the transactions motive; the precautionary motive; and the speculative motive. The demand for money to satisfy the speculative motive will be high at low interest rates and low at high interest rates. There is a rentier class which receives fixed income from investments in land, stocks and bonds. (Stewart 1987:66-97)

Keynes's view of the trade cycle or business cycle is contained in his *General Theory*. He points out that the marginal efficiency of capital is the cause of economic fluctuations. In other words, investment in capital equipment is the main factor which explains economic fluctuations. Economic fluctuation occurs in some "recognisable degree of regularity in the time-sequence and duration of the upward and downward movements." The phenomenon of the crisis characterizes Keynes's explanation of the business cycle. In the downturn of the cycle, there are sudden and violent changes in

investment in capital goods. As there are precarious expectations of the future expected yield of capital goods, investment will decrease sharply. The collapse of the marginal efficiency of capital precipitates a sharp increase in liquidity-preference which aggravates the decline in investment, as the interest rate increases. The economy will grow only when consumer and investor's confidence returns. Only then, will the investor make capital purchases and will consumers be willing to spend. (Keynes 1936:313-332)

Based on his analysis of the operation of an economic system, Keynes purports that there is a type of unemployment called involuntary unemployment which means:

Men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods relatively to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment.

(Keynes 1936:15)

In the Keynesian tradition, involuntary unemployment results from the deficiency of aggregate demand. Thus, this type of unemployment is called cyclical unemployment or demand deficient unemployment that is temporary unemployment resulting from the lack of aggregate demand, i.e. consumption, investment, government expenditure and net export in a downturn of a business cycle or trade cycle.

In the Keynesian tradition, government intervention is necessary in order to keep the economy going. Fiscal policy such as taxation and government spending, as well as monetary policy such as the money supply and the rate of interest, are used

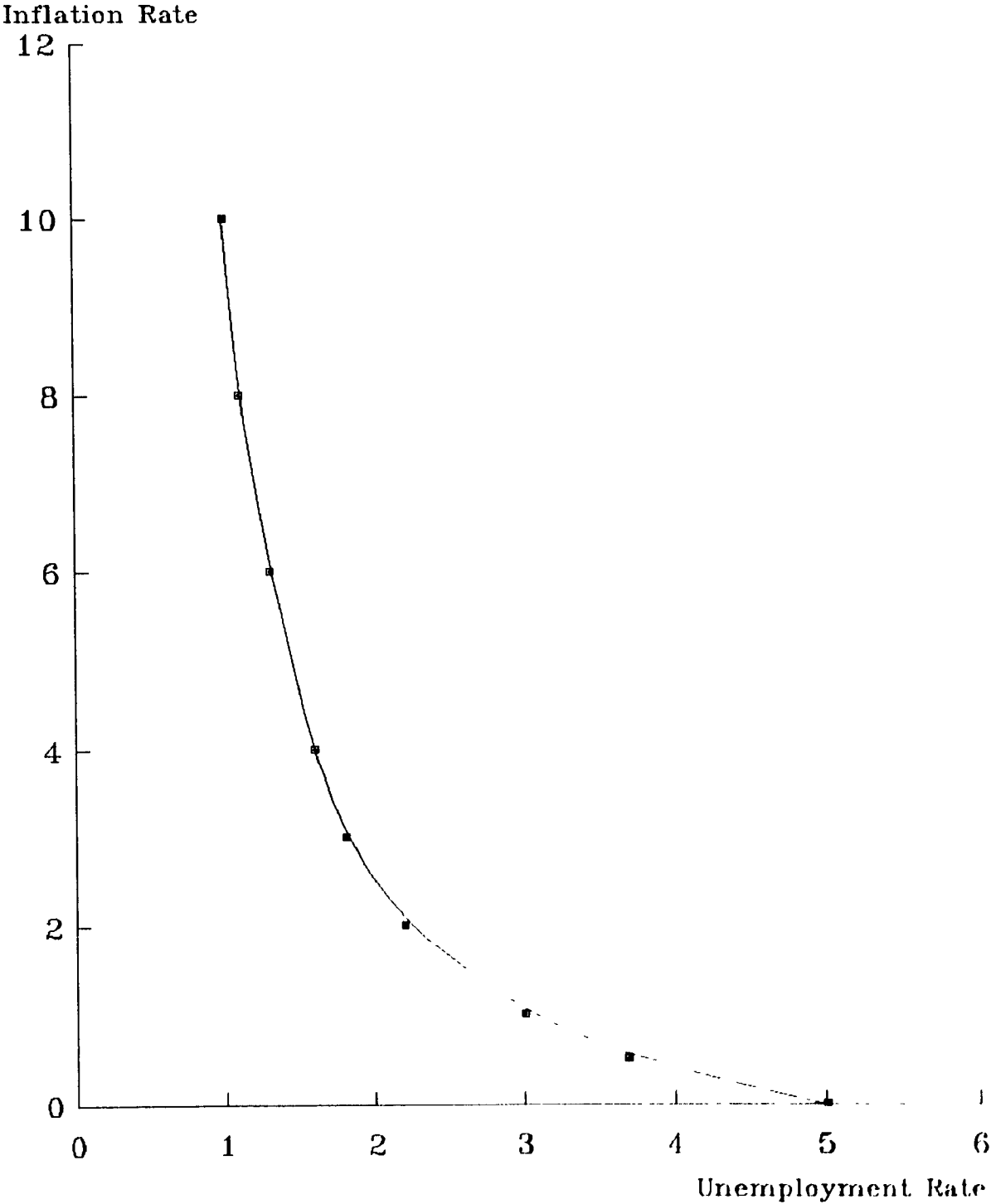
to stimulate and sustain aggregate demand. But how do governments determine the level of aggregate demand which sustains employment and the level of price increase? This question was solved by A.W. Phillips, a professor at the London School of Economics, in 1958.

A.W. Phillips (1958) studied the wage behaviour in the United Kingdom for the years 1861 to 1957, and he found that there is an inverse relationship between unemployment and the rate of change of money wages. His findings gave rise to the Phillips Curve which denotes a trade-off between inflation and unemployment. Figure 2 shows the Phillips Curve. On the X axis is the percentage of unemployment, and on the Y axis is the rate of inflation. The curve shows that the higher the rate of unemployment, the lower the rate of inflation and vice versa. Thus, it was a common understanding of governments in the 1960's that policy making with regard to unemployment and inflation is a trade-off. This theoretical understanding came under Monetarist attack in 1970's as it showed the difficulty this analysis had in explaining the phenomenon of stagflation.

Monetarist View of Unemployment

Milton Friedman (1975) rejects the Phillips curve. He compares Irving Fisher with Phillips on the relationship between rate of change of prices and employment. Friedman points out that the difference between Fisher and Phillips was the direction of causation. Fisher viewed the rate of change of prices as the independent variable

FIGURE 2
PHILLIPS CURVE



Source: Dornbusch, Fischer & Sparks (1989) p.457

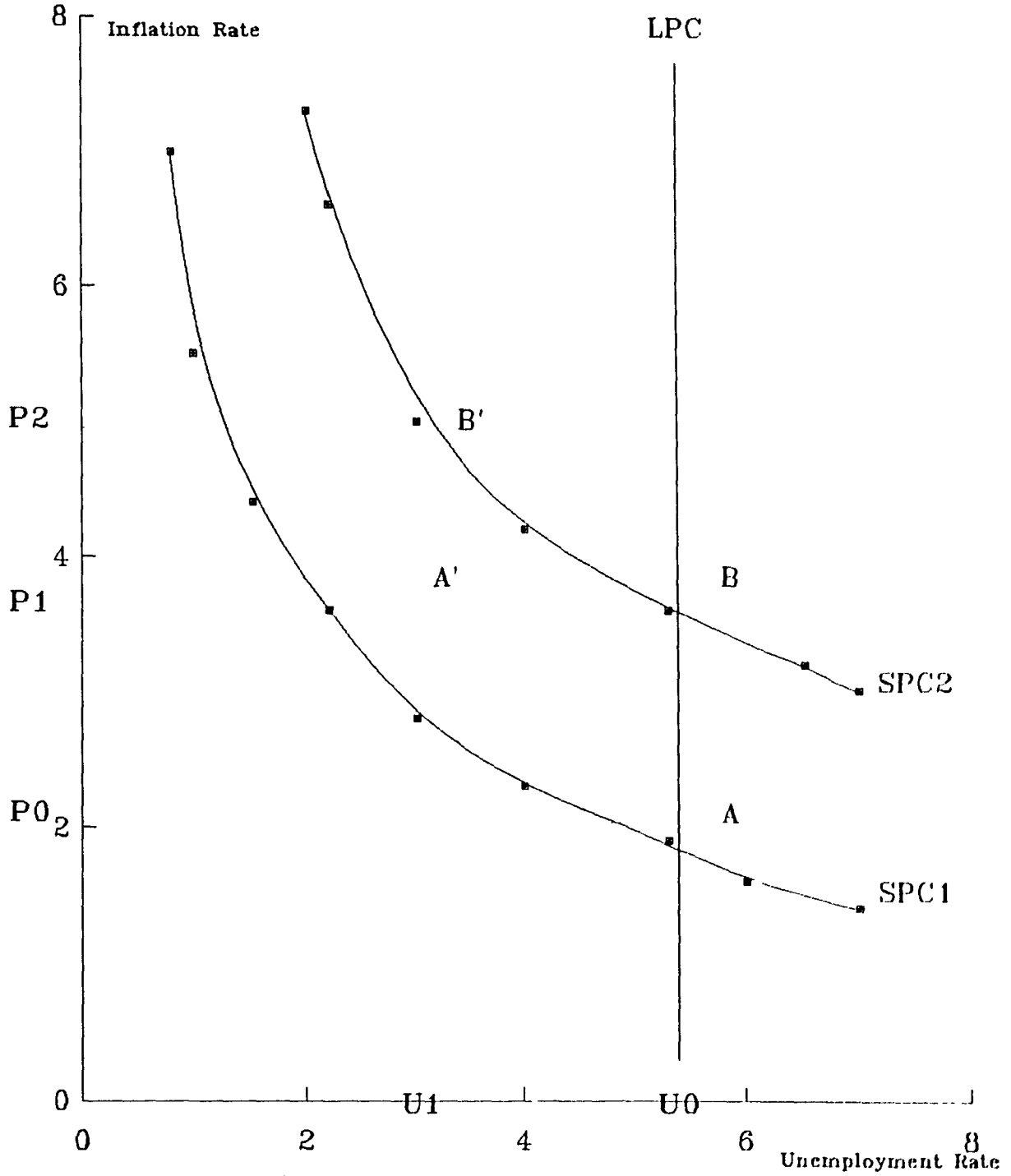
while Phillips views it the other way round. Friedman stands on Fisher's side. He suggests a long-run Phillips curve in which there is no trade-off between inflation, and unemployment.

Figure 3 shows the expectations-augmented Phillips curve which is a reformulated Phillips curve including the effects of price expectations on money wage increases. On the X axis is the percentage of unemployment and on the Y axis is the inflation rate. The equilibrium is at point A of the short-run Phillips curve SPC1 with U_0 unemployment and P_0 inflation. Suppose aggregate demand is stimulated. The new equilibrium will move along to point A' of the SPC1 with U_1 unemployment and P_1 inflation. The increase of employment results in a fall in real wages; yet, workers' expectation on real wage rise to A'. As productivity has not changed, without this fall in real wages, employers would not have hired more workers. the unemployment will revert to U_0 . In the next period, the SPC shift from SPC1 to SPC2 with an equilibrium at point B with unemployment back to U_0 and inflation at P_1 . If aggregate demand is stimulated again, the unemployment will drop to U_1 again but inflation will move up to P_2 . If this aggregate demand measure is used repeatedly, in the long run there will be no trade-off of unemployment and inflation. This is indicated by the long-run Phillips curve LPC. (Friedman 1991:63-86)

For proponents of natural rate hypothesis, policy makers should reduce workers' expectations about the expected rate of inflation rather than increase aggregate demand. Although this will increase unemployment from U_1 to U_0 , the

FIGURE 3

EXPECTATIONS-AUGMENTED PHILLIPS CURVE



Source: Cornwall John (1990) p.50

prices will drop from P2 to P1.

Friedman's natural rate of unemployment hypothesis later became the nonaccelerating inflation rate of unemployment (NAIRU) which means that at the rate of unemployment, inflation is neither accelerating nor decelerating. (Lipsey 1987, G-12) Rooted in the Classical school, the Monetarist's natural rate of unemployment is based on an equilibrium framework, in which there is a tendency for the economy to revert back to the natural rate, if any deviation has occurred. This equilibrium notion can be understood in two situations. On one hand, if the actual rate of unemployment is above the natural rate, the greater risk of redundancy will encourage workers to moderate their wage demands and employment possibilities will increase. On the other hand, if the unemployment rate falls below the natural rate, workers will bargain for higher wages and employment possibilities will decline. In short, the labour market will clear itself.

The above Monetarist view of unemployment grows out of their view on the business cycle. Milton Friedman and Anne Schwartz studied of money stock fluctuations in relation to the business cycle of the United States between 1867-1960. Their findings show that "the stock of money displays a consistent cyclical behaviour which is closely related to the cyclical behaviour of the economy at large." (Friedman & Schwartz 1963:48) They concluded that money plays an important role in the business cycle and proposed a kind of transmission mechanism to explain how monetary changes can produce cyclical fluctuations in income. Disturbances in the

rate of change in the money stock set in train a cyclical adjustment mechanism including a feedback in the rate of change in money itself. Additional disturbances from time to time would prevent the fluctuations from dying out. (Friedman & Schwartz 1963:64) Friedman's quantity theory of money aims to prove the importance of money supply in affecting the fluctuations in the economy. The quantity theory of money is expressed in the quantity equation $MV=PQ$ where M is the money supply, P is the price level, Q is the real output and V is the velocity of money. As the real output is assumed fixed and the velocity of money is a constant, therefore the change in money supply has a direct effect on the change in price. (Gordon 1990:494)

Institutional View of Unemployment

According to Monetarists, there is no trade-off between unemployment, and inflation. But the current chronic unemployment disputes this Monetarist assertion. The 'Monetarist Experiment' attempted to curb inflation with an effort to restrain the money supply. The result is chronic unemployment. Institutional view is that the cause of unemployment is more than deficiency in demand and the natural level of unemployment. Their emphasis focuses on the economic structural change caused by technology and government policy.

John Cornwall demonstrates how restrictive aggregate demand policy

institutionalizes chronic unemployment. Figure 4 shows the hysteresis¹ effect on the Phillips Curve. Suppose an economy is at point A ($U_1;P_1$). An increase in the price of imports will shift the LPC (the original LPC at point A is not drawn) to LPC1 and lead to an increase of wages/prices from P_1 to P_2 . If authorities suppress the price from P_2 back to P_1 , unemployment will increase from U_1 to U_2 . Hysteresis effect results in LPC shifting again to LPC2. If authorities suppress the price again, unemployment increases from U_0 to U_2 , and stays there. This indicates that the authorities attempts to curb inflation brings this hysteresis about. The fixation of unemployment at U_2 is then policy determined. The impact of such policy determined unemployment is mass unemployment, and the prolonged mass unemployment will induce structural, and institutional changes. (Cornwall 1990:182-185)

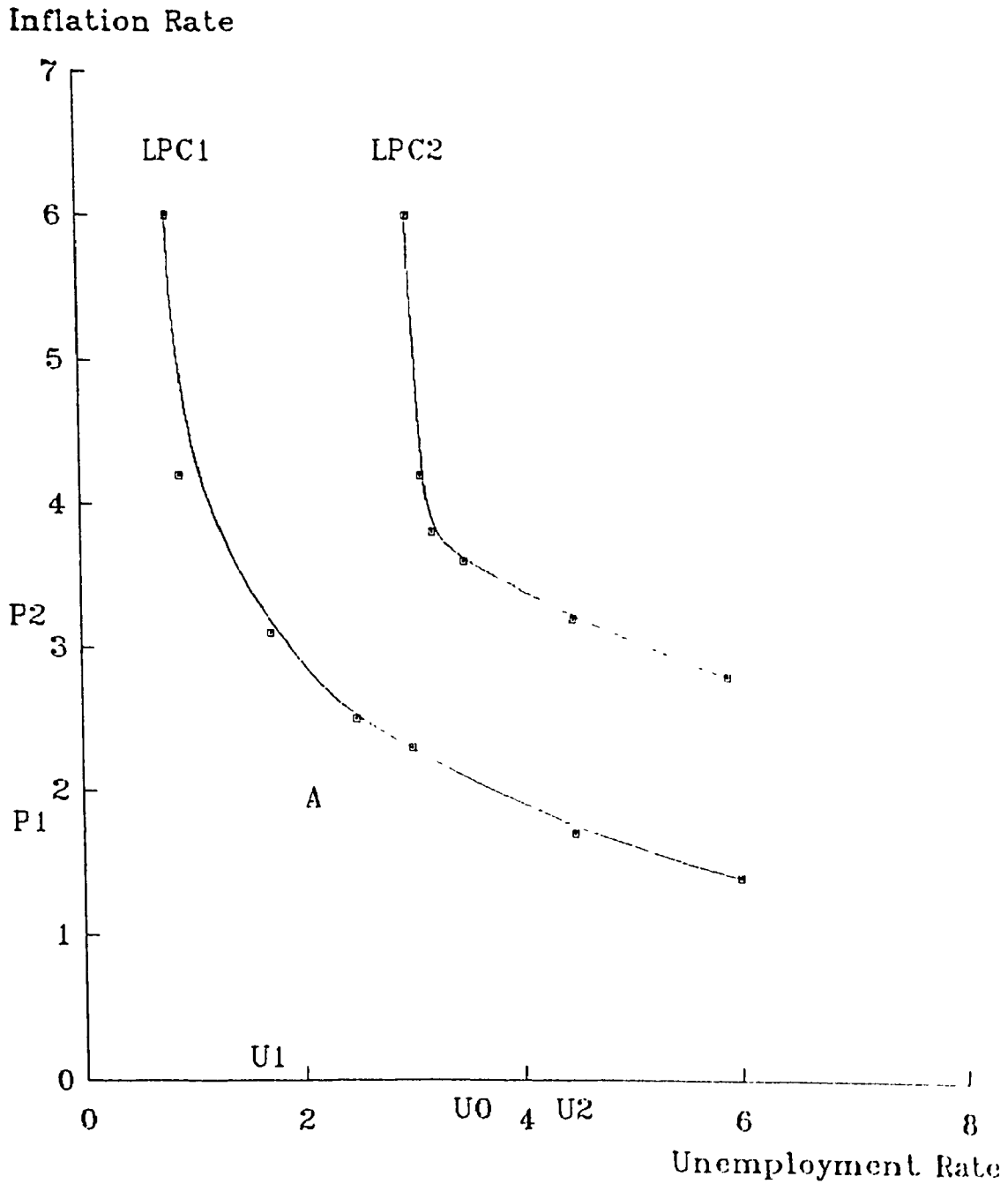
In other words, the hysteresis theory argues that the economy is capable of fixing at one of many different equilibria. Thus, the natural rate is not fixed but flexible.

Besides the hysteresis explanation of unemployment, the most pronounced institutional view of unemployment is from the perspective of technological change. From the Institutional viewpoint, structural changes in the economy produce structural unemployment which means a mismatch between the structure of the labour force, that is, skills, occupations, geographic location of industry, and the structure of the

¹ The term hysteresis is a Greek word which means 'which comes after, or is behind.' In the context of unemployment, Gera defines hysteresis as '(a phenomenon) that shocks the actual rate of unemployment which also brings about changes in the natural rate of unemployment.' (Gera and McMullen 1991:10)

FIGURE 4

HYSTERSIS AND THE VARIABLE-COEFFICIENT PHILLIPS CURVE



Source: Cornwall John (1990) p.184

demand for labour.

The institutionalist view of economic growth focuses on the long wave or Kondratieff cycle. There are various identified causes of long wave fluctuation: technological innovations and revolutions, new resources and territories, population movements, consumer psychology, and socio-political environment. (Lamontagne 1984, 106-132) Institutionalists regard technology as the prime moving force for economic development. Freeman's techno-economic paradigm fully illustrates how structural unemployment occurs.

By classifying and analyzing thousands of innovations in the postwar United Kingdom economy, Freeman distinguishes four different categories of innovation: incremental innovations, radical innovations, changes in the "technology system" and change in the "techno-economic paradigm". For changes in the "techno-economic paradigm", he writes:

Some changes in technology systems are so far-reaching in their effects that they have a major influence on the behaviour of the entire economy... The expression "techno-economic paradigm" implies a process of economic selection from the range of the technically feasible combinations of innovations, and indeed it takes a relatively long time (a decade or more) for a new paradigm to crystallise and much longer for it to diffuse right through the system. This diffusion involves a complex interplay between technological, economic and political factors... A new techno-economic paradigm is one that affects the structure and the conditions of production and distribution for almost every branch of the economy, and creates widespread new opportunities for profitable investment both in the provision of new consumer goods and services and in new types of capital goods. (Freeman 1989, 429)

Freeman identifies five Kondratieff cycles in the past two hundred years: early mechanisation Kondratieff, steam power and railway Kondratieff, electrical and heavy engineering Kondratieff, Fordist mass production Kondratieff, and information and communication Kondratieff. In the fifth Kondratieff, information and communication technology emerge as the leading industries to enhance economic growth. Freeman further illustrates that information and communication technology diffuse into the national and international economic system making significant changes in production and trade processes. (Freeman 1989: 431-435)

These changes envisaged in the restructuring of the world macroeconomic framework include: Firstly, the decline of U.S. hegemony and the emergence of regional trading blocs with the United States, Germany and Japan as the new foci. (Bergsten 1990; Hettne 1991; Wilkinson 1991) Secondly, the globalization of production, and finance. Production processes are taken from OECD countries to those regions where production cost is lower. (Cox 1991) Lastly, economies are transforming from production of goods to service provision. Workers need new skills and actually fewer workers are needed. Aging workers and those less educated are expelled from the labour force. A new class of symbolic analysts have emerged who are engaging in problem-solving, problem-identifying, and strategic-brokering by manipulating symbols. (Rowthorn & Glyn 1990; Reich 1991)

Freeman's interpretation of the business cycle is that the big boom periods of expansion occur only when there is a "good match" between a new "techno-economic

paradigm" and the socio-institutional climate. When such a good match is achieved, there is a tendency towards explosive growth of the system as new investment opportunities and markets are opening up everywhere. Such headlong expansion must however ultimately encounter limits to further growth of productivity, scale economies and profitability. As these limits are encountered, there is a search for a new combination of technical and organisational change. Depressions represent periods of mismatch between the emerging new paradigm and the old institutional framework. The widespread generalization of the new paradigm, not only in the "leading" branches, but also in many other branches of the economy, is possible only after a period of change and adaptation of many social institutions, buttressed by the political power of established interest groups. Yet another factor to consider is the slow response time of many individuals and groups. (Freeman 1989: 440)

The Superiority of the Institutional Interpretation of Unemployment

The superiority of the Institutional interpretation of unemployment lies with its emphasis on technology as the prime mover of an economy. Christopher Freeman maintains "that a weakness of almost all neo-classical and neo-Keynesian theories of technical change and economic growth is that they fail to take account of the specifics of changing technology in each historical period." (Freeman 1989:427)

For the Keynesian school, the insufficiency of aggregate demand, especially the investment of capital goods, causes the fluctuation of intermediate cycles and

results in involuntary unemployment. Government has to sustain aggregate demand. The Monetarist school views price change as the reason for economic fluctuation. In the long run, keeping the price stable, rather than enhancing employment through stimulating aggregate demand, will give real benefit to the people. Therefore, inflation instead of unemployment is the prime concern of the government in power. Neither Monetarists nor Keynesians place emphasis on the importance of technology. The Institutional stand takes a holistic view of the economic system with focus on institutional arrangements which ensure economic growth and balance inflation, and unemployment.

The Institutional interpretation of long wave business cycles provides a fundamental explanation of change of the economic structure. And, the change of economic structure can be through a set of institutional arrangements. In Freeman's terms, the set of institutional arrangements is called a national system of innovation. He defines the national system of innovation as "the network of institutions in the public and private sectors whose activities and interactions initiate, import, modify and diffuse new technologies." (Freeman 1988a:1)

Japan's success in leading the fifth Kondratieff cycle proves the achievement of such a national system of innovation. In my previous study on the "Japanese economic miracle", I found that state intervention and the Japanese ethos are the two crucial reasons for Japan's leadership in the fifth Kondratieff. The Ministry of International Trade and Industry (MITI) along with industrial and technological

policies such as encouraging research and development give clear direction to changes in the structure of industry and to the fostering of leading industries. The Japanese ethos of loyalty to one's lord and the Emperor as well as nationalism and paternalism make the Japanese keen in assimilating western technology and transforming it for economic growth purposes. However, they develop a unique social structure which allows government's direct intervention in technological and industrial sectors and develop a tightly kneaded consumer-oriented society which facilitates the diffusion of technology. (Li 1991:13-24)

Japanese institutional arrangements, not only encourage technological development, but also help to balance inflation and unemployment. This institutional balancing of inflation, and unemployment is also found in other countries such as Sweden and Austria. Campbell finds that Japan, Sweden and Austria developed unique policy institutions and procedures to translate socio-economic demands into effective policies, for example, the Labour Market Board in Sweden, and the Social Partnership in Austria. Thus, when the economic problems of the 1970's and 1980's emerged, those institutional arrangements prevented governments from facing a sharp trade-off between unemployment and inflation. (Campbell 1991)

Conclusion

This conclusion attempts to recapitulate the theoretical discussion of Keynesian, Monetarist, and Institutional interpretations of macroeconomics and this recapitulation

forms the basis for our case study of postwar Canada.

Table 1 summarizes Keynesian, Monetarist and Institutional Interpretations of macroeconomics. When we compare and contrast these three interpretations, we find that the Institutional interpretation of macroeconomics is superior than either the Keynesian or Monetarist interpretations. First of all, the institutional interpretation is closer to the reality of economic issues. It takes into account various factors which affect the economic system. Secondly, it sees economic development in a longer perspective and pays special attention to technology. Thus, it identifies structural changes in the economy and suggests national guidance to resolve the problem of unemployment and inflation.

The discussion in Chapter 2 and Chapter 3 provide a theoretical basis for the next part of this thesis, that is, a case study of postwar Canada.

TABLE 1

KEYNESIAN, MONETARIST AND INSTITUTIONAL
INTERPRETATIONS OF MACROECONOMICS

	Keynesian	Monetarist	Institutional
Mode of thought	Babylonian	Cartesian / Euclidean	Babylonian
View on economics	economics as an art	economics as a science	economics as a science of provisioning
Macroeconomic priority	full employment	stable prices	full employment and stable prices
Role of state	intervention	non-intervention	intervention
Cause of unemployment	deficiency in aggregate demand	frictional and voluntary	a mis-match between a new techno-economic paradigm and the socio-institutional climate
Prescriptions for unemployment	sustained aggregate demand by fiscal and monetary policies	restricted aggregate demand by controlling money supply	institutional arrangements to reduce structural unemployment and maintain a balance between inflation and deficient demand unemployment

PART II

The Case of Postwar Canada

CHAPTER 4

AN INSTITUTIONAL INTERPRETATION OF THE MACROECONOMIC POLICY IN POSTWAR CANADA

Introduction

The previous chapters maintained that different philosophical foundations will lead to different interpretations of macroeconomic behaviour and to different policy prescriptions to deal with macroeconomic issues. In postwar Canada, both Keynesian and Monetarist macroeconomic policies have been adopted. In certain period of time, inflation and unemployment seem untamed. This chapter formulates an institutional interpretation of such macroeconomic development in postwar Canada.

From an institutional perspective, the macroeconomic performance of postwar Canada is a product of her cultural, social, political and economic systems. There are two periods of macroeconomic development in postwar Canada. The first period, known as the "Golden Age of Capitalism", extends from 1945 to the mid-1970's. In this period, Canada experienced economic growth and manageable inflation and

unemployment. The macroeconomic policy orientation was focused on increasing employment; the prevailing macroeconomic approach was Keynesian. The second period, known as "Stagflation", extends from the mid-1970's to the end of the 1980's. In this period, high inflation plus high unemployment elicited new concerns. The prevailing macroeconomic thought was Monetarist; tight monetary policy was adopted to bring down inflation. Before turning to those two distinct periods, an overview of the context is necessary.

Context of The Canadian Economic System

Geographic, demographic and political factors shape the economic system of Canada. Canada is a vast land, now ranked the first among nations. There are rich natural resources on this land, which include fur, agricultural products, fish, minerals, oil, trees, and hydro-electric power. The location of these natural resources affects the economic structure of individual regions. For example, the fishing industry is prosperous in the Atlantic provinces and in British Columbia. Furthermore, cold weather certainly affects economic activity in Canada. For instance, construction work is almost impossible in winter. The geographical proximity of the United States has a great impact on the Canadian economy. The imbalance of economic power between the United States and Canada creates a dependent situation. The Macdonald Commission points out that "In historical terms, the United States constitutes a central problem for Canada because it provides such a strong engine of growth for our

exports, and yet, on account of its strength, may pose a threat to our Canadian identity." (Canada 1985 vol I: 217)

In colonial Canada, the British and French exploited resources useful for their countries. In addition, the influx of British and French immigrants made them the majority of the population. With the decline of the birth rate of Canadian and the constant increase of immigrants from other than the United Kingdom and France, Canada has become a multi-racial and multi-cultural country. As Robert Bothwell and others points out: "In the late forties, half of all Canadians were of British and Irish descent and 31 percent of more distant French descent. By 1981 these proportions had fallen to 40 percent and 27 percent respectively." (Bothwell et al 1989:14) The demographic composition of Canadian society influences the economic life of people in this country. The British and French cultures are mutually adjusting and conflicting. For example, Canada adopts both English and French as official languages; the co-existence of common law, and the continental law traditions within Canada. The increase of Asian immigrants makes the food market accommodate Asian food needs.

In 1867, the British North American Act (BNA Act) created a new country called Canada. In the BNA Act, economic power is divided between the federal and provincial governments. The federal government regulates the financial structure of the country such as the issuing of money, the incorporation of banks, as well as the regulation of trade and commerce. Provincial governments have power to deal with

natural resources. (BNA Act Clause 91, 92 and 92A) The division of economic power enables provinces to bargain with the Federal government.

To conclude, the interweaving of geographic, demographic and political factors shaped the development of Canadian economy. As Pomfret points out:

Canadian economic development since the 1850s has followed a well-trodden path: long-term intensive growth has been rapid and stable, manufacturing has grown in relative importance and has been accompanied by urbanization, the business cycle has become endemic and the geographical concentration of industry initially increased regional inequality. Resource endowment explains much of the particular structure of the Canadian economy, including the continuing importance of natural resources which makes the economy more responsive to external demand changes and more unstable than most industrial nations' economies. The salient differentiating features of Canadian industrial development, high concentration levels and the ubiquitous branches of U.S. corporations, can be accounted for by Canada's relative lateness in industrializing and by her proximity to the United States... In sum, after taking account of resource endowment, geography and the timing of the industrial revolution, Canada's post-industrial economic experience has been similar to that of other countries.(Pomfret 1989:202)

The context illustrated above provides a background to understand the development of the postwar Canadian economy. Canada, as one of the capitalist economies, has experienced both "The Golden Age of Capitalism" and "The Stagflation" period in the postwar era.

Canada's "Golden Age of Capitalism"

The "Golden Age of Capitalism" in postwar Canada, from an institutionalist viewpoint, is a product of Keynesian macroeconomic strategies, the upturn of a long

wave cycle and the hegemony of the United States. There are different opinions on whether Keynesianism was fully applied in the postwar era.

After the Second World War, the Canadian government began to rebuild the economy. Two months after the Budget Speech of 1945, The Minister of Reconstruction presented the White Paper on Employment and Income: with Special Reference to the Initial Period of Reconstruction (White Paper) to Parliament. Since this policy paper clearly presented the government's macroeconomic orientation, it is worth close study.

The White Paper is Keynesian in its emphasis on the need to stimulate aggregate demand for economic growth. The objective of the White Paper is stated in the Foreword:

The central task of reconstruction, in the interest of the armed services and civilians alike, must be to accomplish a smooth, orderly transition from the economic conditions of war to those of peace and to maintain a high and stable level of employment and income. The Government adopts this as a primary object of policy. (Canada 1945:1)

In the process of the transition to peace, how to create employment was a key objective. The White Paper points out that:

In maintaining a high and stable level of employment and income, the Government proposes to use appropriate means to influence expenditures in all these channels (i.e. export trade, private investment, consumption expenditures and public investment)... (Canada 1954:4)

In addition, the White Paper also points out the importance of scientific training and research for the maintenance of high levels of employment.

Specific policy directions were set in the White Paper to stimulate aggregate

demand. For export trade, the policy direction was to secure a stable world environment and re-constitute multilateral trade. For private investment, the government was prepared to reduce taxes in order to minimize production costs. In addition, the government wished to keep interest rates low. Furthermore, the government agreed to provide credit and loans to farms and to encourage housing development projects. For consumption, the government would develop social security measures such as old age pensions and health insurance in order to supplement income and to increase consumption expenditures. For public investment, the government would undertake advance planning of all necessary and desirable projects and carry them out when prospective employment conditions made it desirable to increase public investment expenditures. Furthermore, the government would implement, in co-operation with the provinces, a new federal policy of expenditures on the development and conservation of natural resources. (Canada 1945, 7-8; 11-12; 14; 16-17)

Whether or not Keynesianism was the guidepost for Canadian macroeconomic policy is a subject for debate. David Wolfe, Robert Campbell and Harold Chorney present different interpretations of Keynesianism in postwar Canadian economic development. The differences between them concern the implementation of Keynesian policy and the demise of Keynesianism in Canada. On the one hand, Campbell argues that Keynesianism in Canada was an illusion which means that the postwar Canadian government never used Keynesian ideas as the sole guide to economic policies. On

the other hand, Chorney suggests a stronger Keynesian orientation in Canada even if it was a somewhat watered-down version. In other words, Keynesian ideas did diffuse in the upper echelons of Ottawa and, to a certain extent, did guide the implementation of government policies. Wolfe stands in the middle arguing that Canadian Keynesianism was a unique synthesis of Keynes's general ideas and the staples approach. (Wolfe 1984; Campbell 1987; Chorney undated)

From my point of view, the international and domestic atmosphere in the postwar era favoured the diffusion of Keynesianism in Canada. The Great Depression and World War II left the world population with traumatic experiences of economic hardship and human suffering. The mood of the people at that time called for government assistance in order to avoid precarious experiences. Keynesian ideas provided political, economic and social justification for the government to create a welfare state. Within this international context, the Canadian government finally adopted the White Paper to show her commitment to Keynesian policy. The White Paper is solid evidence that Keynesianism had its place firmly in Canadian government policies. The enactment of certain laws such as the Family Allowance in 1945, and old age pensions in 1952, supported Keynesian objectives.

Even though I do not agree with Campbell's "grand illusion" thesis, his idea of institutionalized Keynesianism is worth attention. Campbell points out that "The historical experiences of Canada and countries such as Sweden suggest that a full-employment commitment cannot be effective or realized unless it is institutionalized."

(Campbell 1991a:36) From the institutionalist viewpoint, the Canadian government was not whole-heartedly committed to Keynesian ideas; thus creeping inflation in the late 1960's and early 1970's could not be blamed on Keynes's ideas.

The second factor which contributed to the "Golden Age of Capitalism" in Canada is the upturn of the fourth long wave cycle based on Fordist mass production. In this long wave cycle, energy, especially oil, was the key factor, offering abundant supplies at descending prices. In this techno-economic paradigm, flow processes and assembly-line production techniques prevail. Mass production and mass consumption is characteristic of this period. (Freeman 1988:Table 15) The last factor behind the prosperity of postwar Canada, as noted above, was the hegemony of the United States. After World War II, the United States emerged as the leader among capitalist countries. The creation of the United Nations and other international organizations such as the International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade facilitated a set of rules for the operations of the international economy. The United States, through her dominant influence on those international organizations, led the world. The prosperity of the United States provided economic development opportunity for Canada. The synchronization of the peaks and troughs of the United States and Canadian business cycles demonstrated the mutual influence of these economies on each other. (Lamontagne 1984:6; Glyn et al 1990:41 ; Hettne 1991:133)

Figures 5 to 7² show the macroeconomic performance in postwar Canada which include Gross Domestic Product, unemployment rate and inflation rate. The Gross Domestic Product is an indicator of economic growth, while the unemployment rate denotes the percentage of the labour force not at work but actively seeking jobs in the period of interview, and Consumer Price Index is an indicator of inflation. Generally speaking, in the "Golden Age of Capitalism" period, economic growth was sustained with periodic recessions. At the beginning of the 1970s, inflation began to creep upward. The monetarists maintain that this was the result of Keynesian policy. Cornwall explains that the rise of inflation is not due to Keynesianism. He argues that:

...prolonged periods of full employment and the rise of the welfare state significantly altered the manner in which labour markets function. These changes reinforced the redistribution of economic and political power initiated by the rising power of organized labour. As a result, potentially strong inflationary pressures developed at full employment. (Cornwall 1990, 236)

The mid-1970's represents a distinct period in which both the unemployment rate and the inflation rate were rising simultaneously. This is called "Stagflation".

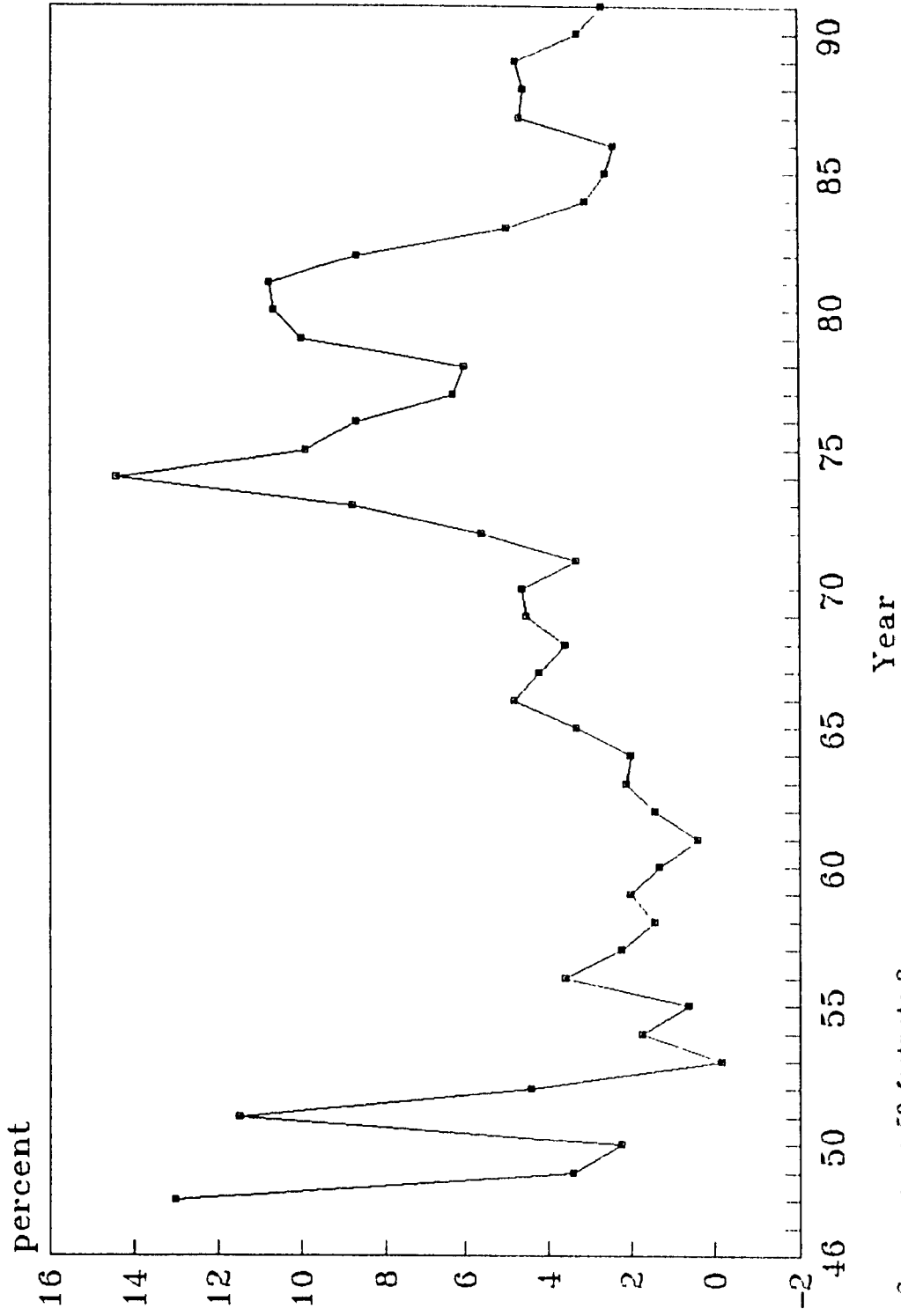
² The data of the macroeconomic performance in postwar Canada comes from Statistics Canada.

For figure 5, Gross Domestic Product, data comes from StatCan CANSIM Disc data series 6836 D 205567: Impl. price index GDP(86=100)SAAR by QTR.

For figure 6, unemployment rate, data comes from several sources: 1946-1975 Historical Statistics of Canada 2nd ed. PD223-247; 1976-1985 Canada Year Book 1980-81 p.269, 1985 p.172 and 1988 p.5-20; 1986-1993 Canadian Economic Observer catalogue 11-010 monthly various issues and The Labour Force April 1993 catalogue 71-001 monthly.

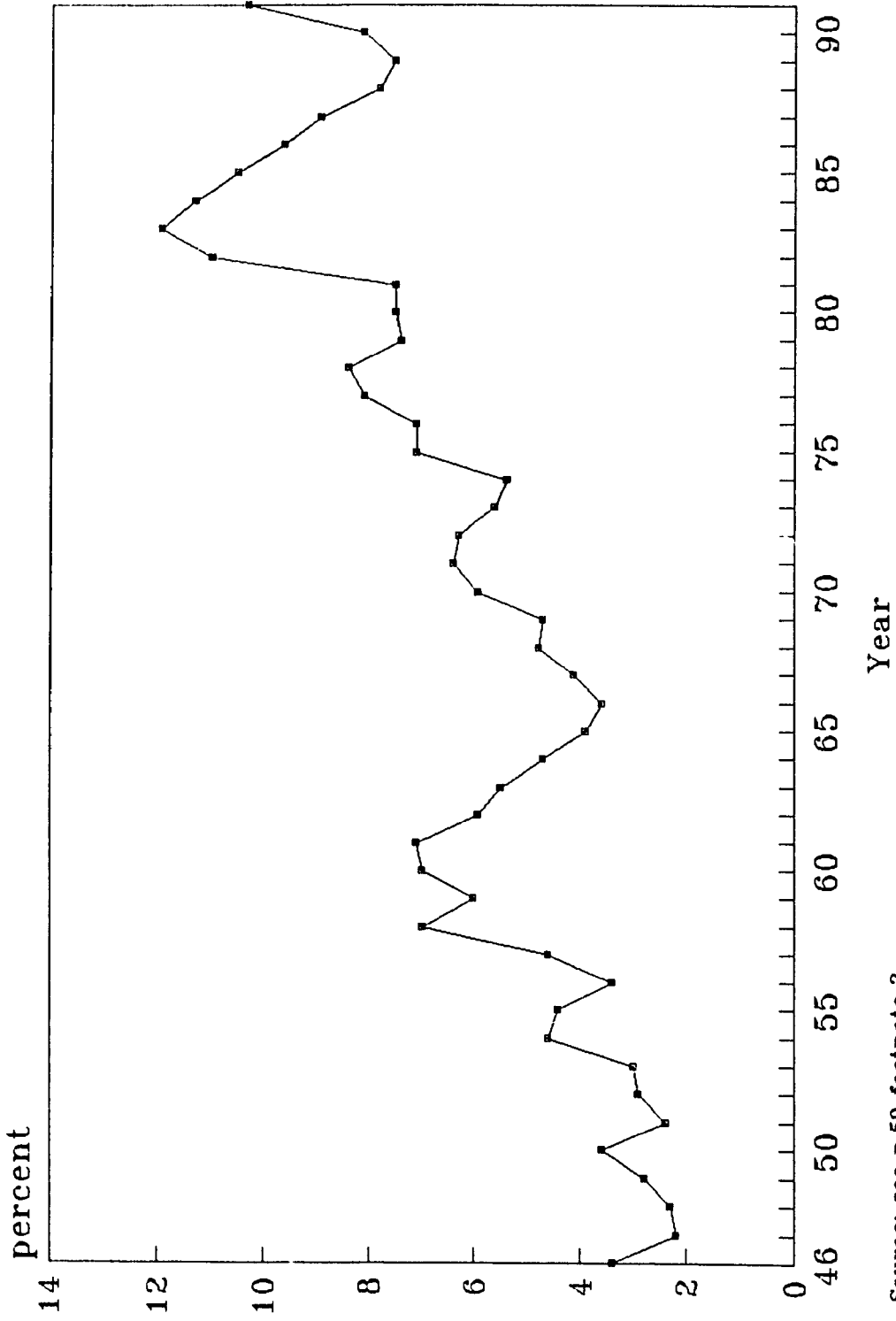
For figure 7, inflation rate, data comes from StatCan CANSIM Disc data series 2231 P 490000: C.P.I. Canada Annual Averages, all-items(1986=100).

FIGURE 5
 MACROECONOMIC PERFORMANCE OF POSTWAR CANADA
 GROSS DOMESTIC PRODUCT



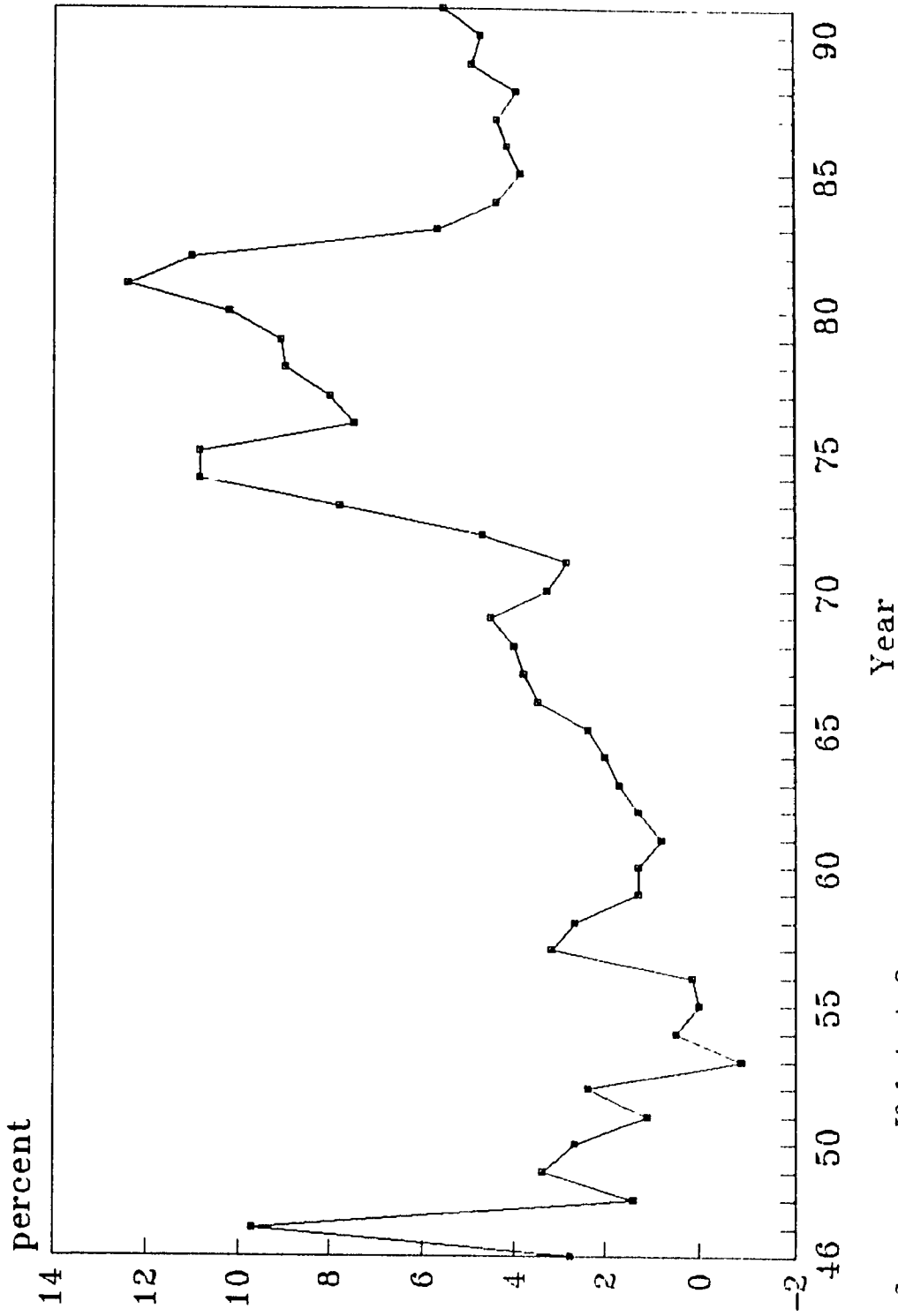
Source: see p.50 footnote 2

FIGURE 6
 MACROECONOMIC PERFORMANCE OF POSTWAR CANADA
 UNEMPLOYMENT RATE



Source: see p.50 footnote 2

FIGURE 7
 MACROECONOMIC PERFORMANCE OF POSTWAR CANADA
 CONSUMER PRICE INDEX



Source: see p.50 footnote 2

"Stagflation"

The 1973 and 1979 oil price shocks marked the end of the period of prosperity in industrialized countries and replaced it with "stagflation". "Stagflation" is a term which denotes the coexistence of high unemployment and inflation rates. In Canada, the unemployment rate rose sharply from 5.4% in 1974 to 7.1% in 1975 and climbed to 8.4% in 1978. This high rate of unemployment was accompanied by a high inflation rate. The inflation rate rose four times between 1971-1974. In 1974, inflation hit 10.8%, the highest level during the 1970's. "Stagflation" resulted in a 30% decrease of GDP between 1974 and 1975.

The "stagflation" of the 1970's persuaded the Canadian government to adopt a tighter fiscal and monetary policy to curb inflation. In 1975, the Anti-Inflation Program was introduced by the government. Furthermore, the Governor of the Bank of Canada announced explicit targets for the growth of the money supply. Monetarist macroeconomic thought was firmly in place during the Mulroney government. Two months after the Conservative government was elected in September 1984, they put forward an economic policy paper called A New Direction for Canada: An Agenda for Economic Renewal. In this paper, they stated that they will try to reduce the deficit and the debt, to redefine the role of government in the economic arena, and to foster a positive climate for private investment. (Canada 1984, 2-3) This economic policy agenda paper was simply an outline without much substance. It is the Royal Commission on the Economic Union and Development Prospects for Canada known

as the Macdonald Commission which substantially reveals the government's economic policy agenda.

The Macdonald Commission was established under the Liberal government by Order in Council (PC 1982-3438) and made known to the public on November 5, 1982. The Commission was designated the task to investigate:

the long-term economic potential, prospects and challenges facing the Canadian federation and its respective regions, as well as the implications that such prospects and challenges have for Canada's economic and governmental institutions, and for the management of Canada's economic affairs. (Canada Vol.I 1985:xvii)

After three year, the Progressive Conservative government selected data from the various studies and formulated their economic policy for future implementation.

The Macdonald Commission Report recognized the new global interdependence of countries and situated Canada within this global environment, thereby making Canada's economic growth subject to global forces.

The Macdonald Commission Report adopted the Monetarist stand with regard to the unemployment and economic growth issues. Unemployment is a serious policy concern because it is well above the rate consistent with stable inflation (6.5 to 8 %). The non-accelerating inflation of unemployment rate (NAIRU) was used to measure unemployment. In the Macdonald Commission Report, they maintain that expansionary monetary and fiscal policies cannot sustain levels of unemployment below the range of the natural rate over the longer term without causing inflation. A permanent reduction in such structural unemployment would require structural

changes such as freer trade, labour-market adjustments and new mechanisms for labour-management relations. The report suggested that industrial policy rely on market forces and private-sector enterprise because they are the engines of economic growth. In elaborating, the report continues:

Industrial policy should fortify incentives for excellence, for the efficient allocation of resources, and for adjustment to new economic realities. Such a policy would produce increases in real income, fuller employment and the means to address income distribution. (Canada Vol.III 1985:426)

There are framework policies to encourage the private sector to adapt to change and for the efficient allocation of Canada's human, capital and natural resources. These framework policies include tax policy, competition policy, general regulatory policy, foreign investment and adjustment policy.

This Monetarist ideology is further revealed in the recent publication on competitiveness in Canada. The study Canada at the Crossroads: the Reality of a New Competitive Environment was conducted by Michael Porter, a professor at Harvard Business School. It includes "an in-depth analysis of Canada's patterns of trade and shifts in Canada's relative competitive position over time; a detailed historical and current analysis of 25 industries...; an audit of the institutional and public policy environment in Canada and its impact on the way Canadian firms compete." (Porter 1991:1) In his report, Michael Porter has proposed an economic vision for a more competitive Canada in the world economy which includes the need to: i) become an innovation-driven economy, ii) increase the sophistication of the natural resource

sector, iii) tackle structural barriers, so as to upgrade the economy, iv) build on Canada's regional strengths, v) move quickly and decisively to achieve complete free trade within Canada, vi) transform foreign subsidiaries into home bases and, vii) create and maintain a supportive and stable macroeconomic climate. (Porter 1991:72-74)

The promise of Monetarist policy has been achieved. The inflation rate was brought down to 3.9% in 1985. Yet, the price of such low inflation is massive and persistent unemployment.

To conclude, in postwar Canada, a watered-down version of Keynesianism and Monetarism dominated the macroeconomic policy orientation. Their domination created institutional changes. In the "Golden Age of Capitalism" period, the rise of labour power as one of the factors contributed to the rise of inflation. Since the "Stagflation" period, the restrictive aggregate demand policy of the Canadian government resulted in prolonged unemployment. Will an Institutional perspective for Canada in the 1990's be helpful in resolving the unemployment problem and keeping inflation at a manageable level?

CHAPTER 5

AN INSTITUTIONAL PRESCRIPTION FOR THE CANADIAN UNEMPLOYMENT PROBLEM

Introduction

The last chapter analyzed postwar Canadian macroeconomic performance from an institutional viewpoint. This chapter further discusses the postwar unemployment situation in Canada. From an institutional viewpoint, the unemployment situation is a socio-historical product. Different economic, political, and social factors are interwoven to produce a specific economic result and operate in a cultural context. Throughout the past four decades, the Canadian unemployment rate has demonstrated an overall upward trend. There are specific high unemployment periods in the 1950's, 1970's and 1980's. The upward trend of unemployment in the 1990's is obvious. The current massive and persistent unemployment has become one of the platforms of all three major parties in the coming election.

The next section presents a retrospection of the fluctuations of postwar

unemployment. A detailed analysis of the nature of unemployment follows. Finally, institutional prescriptions for the current massive and persistent unemployment are suggested.

Unemployment in Postwar Canada

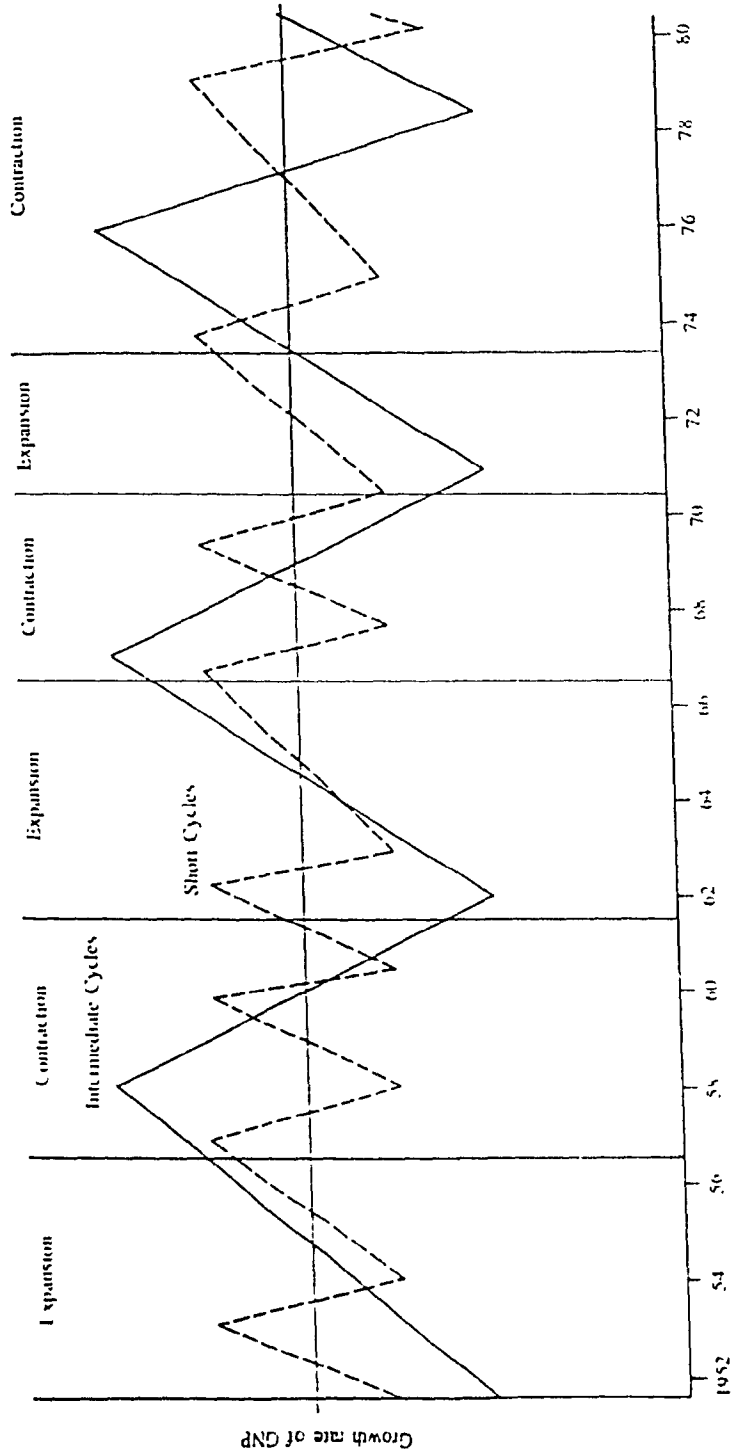
Figure 6 illustrates the overall trend of unemployment in the postwar era. Among those 32 years during the "Golden Age of Capitalism", for only five years did the unemployment rate exceed the postwar average of 6.2%. Among those five years, the highest unemployment rate was 7.1% in 1961. The second highest unemployment rate was 7% in 1958 and again in 1960. The two other above average unemployment rates were 6.4% in 1971 and 6.3% in 1972. In the "Stagflation" period, the highest unemployment rate was 11.9% in 1983. The sharpest increase was 7.5% in 1981 to 11% in 1982 which is a 46.6% increase within one year. The second sharp increase is from 5.4% in 1974 to 7.1% in 1975, which represents a 31.5% increase within one year. In the 1980's, although unemployment dropped gradually, it remained above average. The lowest unemployment rate in 1989, 7.5%, was still 21% higher than the postwar average. According to Statistics Canada's Labour Force survey, the trend of unemployment in Canada is going up in the 1990's. The unemployment rate in 1990, 1991 and 1992 are 8.1%, 10.3% and 11.3% respectively. In April 1993, the unemployment rate hit 11.4% which means that 1.6 million Canadian are out of work.

Nature of Postwar Canadian Unemployment

The above section describes the changes in postwar unemployment; this section examines why such changes occurred. It is very difficult to distinguish the exact cause of every change in the unemployment rate. The intention here is to follow the history and to explore the reasons why some distinct periods emerged. Generally speaking, there are several reasons which account for the marked changes in unemployment. These include demographic and policy changes, technology and the business cycle.

The nature of unemployment before 1975 was basically demand-deficient. In terms of the long wave, there were fluctuations of inventory and capital investment which brought about short and intermediate cycles. Maurice Lamontagne discussed the short and intermediate cycle in the "Golden Age of Capitalism" in Canada (figure 8). The downturn of short and intermediate cycles denotes high unemployment. This demand-deficient unemployment was also supported by Frank Denton and Sylvia Ostry's analysis of postwar unemployment in Canada. They maintained that there are two categories of unemployment: demand-deficient and non-demand deficient unemployment. In the demand-deficient category, there are two types of unemployment. Short-term inadequate demand unemployment is usually associated with business recession; long-term inadequate demand unemployment is caused by a more persistent deficiency of demand. With respect to non-demand deficient unemployment, there are three types of unemployment: frictional, structural, and seasonal unemployment. Denton and Ostry then broke down the unemployment rate

FIGURE 8
A SIMPLIFIED MODEL OF THE SHORT & INTERMEDIATE CYCLES



Source: Lamontagne, Maurice (1984) p.39

into five components: minimum frictional and structural (age-sex composition and growth of the non-agricultural labour force), minimum seasonal, short-cycle, irregular, and residual. Furthermore, they estimated the rate of each component from 1946 to 1963. They found that there was a significant increase in the residual component that is, the remainder after the other four components were subtracted. They tried to find out whether the increase of the residual component was caused by long-term inadequate demand, or by structural unemployment through regression analysis and Lorenz Curves. They stated in their conclusion that:

On the basis of the foregoing analysis, it would appear that most of the increase in 'residual' unemployment in the latter 1950's and early 1960's stemmed from growing slack in the economy, i.e., a growth of demand-deficient unemployment. This type of unemployment may be dealt with by means of general policies designed to stimulate the overall level of demand.

(Denton and Ostry 1965:18)

The Keynesian interpretation of the cause and remedy of unemployment is clear in the above study. Government policies used to deal with unemployment in this period were also Keynesian. For example, the Liberal government proposed an emergency Budget in December 1957 to deduct tax in order to sustain aggregate demand.

Unemployment after 1975 was mainly structural in nature. The structural nature implies more than merely demographic changes as indicated by Denton and Ostry. The Economic Council of Canada published a study in 1982 which analyzed the nature of unemployment in the 1960's and 1970's. Their study found that the

portion of non-cyclical unemployment, that is, frictional and structural unemployment increased substantially in the 1970's. In the 1960's, average non-cyclical unemployment was 55.2% of the unemployment rate, while in the 1970's, the percentage went up to 64.3%. (Economic Council of Canada 1982:9)

Andrew Burns concludes that the noncyclical rates of unemployment shifted upward throughout Canada in the 1980's. The increase in unemployment was caused by several factors. First are the structural factors which include the entry of women and the baby boom generation into the labour market, the oil price shock which induced the restructuring of industry towards a service-producing economy, union bargaining power, and the persistence/ hysteresis effects of unemployment. Second are policy factors which include the generosity of the Unemployment Insurance system, minimum wage legislation, and tax wedges. Last are the changes in terms of trade, for example, international price fluctuations. (Burns 1991a:39-51)

Burns further points out that the disparity of unemployment among provinces is due to the different economic structure of individual provinces. Economic structure includes both a structural component, that is, industrial organization and workers, and a non-structural component, that is, resources, geographic location, history, culture, and provincial legislation. Thus, the Atlantic provinces are expected to have a higher unemployment rate than other provinces because of their seasonally dependent industries. Economic structure is subject to change. And, when change occurs, an adjustment process is expected. (Burns 1991b:79-86)

The change from a manufacturing to a service oriented industrial structure induces structural unemployment. Michael Piore proposed a dual labour market hypothesis to explain the high unemployment of the 1970's. He suggested that the labour market is composed of a primary and a secondary sector. Secondary sector jobs, when compared with primary sector jobs, tend to be unskilled, insecure, with little advancement opportunity, and low pay. Employers who do not expand productive facilities cause an increase in unemployment in the secondary sector. (Piore 1979:xii-xxix)

The Economic Council of Canada's study also shows that there is shift of job creation from industrial to service production. Employment shares of the service sector rose from 59.4% in 1967 to 70.9% in 1988, with an annual growth rate of 3.4%. The goods sector, on the other hand, dropped from 40.6% in 1967 to 29.1% in 1988. The manufacturing industries within the goods sector dropped sharply from 23.9% to 17.2% in the same period. (Economic Council of Canada 1990:5)

Surendra Gera and others examined the relationship between unemployment and job vacancies in the past two decades. They found that both unemployment and job vacancies rose during this period. This suggests that there is a structural imbalance in the Canadian labour market. This structural imbalance implies that the skills of the unemployed do not match the job vacancies. The increase of long-term unemployment (LTU) is attributed to this structural imbalance in this analysis. The long-term unemployed are those who have been unemployed for 12 months or more.

(Gera, Rahman & Arcand 1991, 53-63)

A restrictive aggregate demand policy will also induce structural unemployment. As the government adopts a restrictive aggregate demand policy, unemployment is policy determined in order to curb inflation. (Cornwall 1990:167-187)

Who are the unemployed in such structural change? Syed Sajjadur Rahman and Surendra Gera found that the older worker has the highest probability to be LTU as their skills no longer fit the new economic structure and they cannot retrain and equip themselves with new skills so as to reenter the labour force. (Rahman & Gera 1991:99-110) In addition to the old workers, the unemployed in Canada include single young women, people who have seasonal occupations, production workers in high volume industries, workers with lower education, and workers who leave their jobs involuntarily. (Gera & McMullen 1991; Reich 1991; Rowthorn & Glyn 1990; Burns 1991b)

The restructuring of the world economy has affected other countries as well. One estimate shows that by the end of 1993, there will be 36 million unemployed in the Organization for Economic Co-operation and Development member countries. (Elliott 1993:B6) Various studies explore the massive unemployment phenomenon and try to discover why some countries can attain a relatively low unemployment rate. The answer lies in the institutional arrangements of a country.

As various studies have shown, the fundamental difference between high

unemployment countries such as Canada and the United States, low-high unemployment countries such as the United Kingdom and France and low unemployment countries such as Japan and Sweden, is the way in which governments intervene in the economy. Low unemployment countries have a strong corporatist tendency. Their economies have strong integration between finance and industry, more state intervention and a less independent central bank. These 'star performers' pursue highly interventionist economic policies, and their governments have played a vigorous role in guiding the economy and moulding its future. These strong corporatist economies demonstrate that the success of an economy is a matter of political will. (Rowthorn & Glyn 1991; Cornwall 1990; Campbell 1991a&b; Epstein & Schor 1990)

As Canada has not yet developed an institutional orientation to adjust to the restructuring of the economy, the economy will further deteriorate when the short and intermediate cycle downturn coincides with the present long wave cycle downturn. Maurice Lamontagne issued such a warning almost a decade ago. He said "...the possibility of another major depression cannot be ruled out if the downward phases of the three cycles were to coincide at any time." (Lamontagne 1984: xxxv)

Institutional Prescriptions for Unemployment

Our current unemployment is largely caused by structural factors and is threatened by the coming downturn of the short and intermediate business cycle.

Prescriptions must be found to cure the current unemployment problem.

Based on neo-conservative ideology, the Conservative government's prescriptions for the current unemployment still depend entirely on the market mechanism. The government's role is to facilitate the private sector to bring about job opportunities. Furthermore, the government must facilitate training of workers to re-enter the workforce. The Canadian Labour Force Development Board was formed in 1991 to:

provide broad strategic direction to ensure the development of a skilled Canadian workforce by:

- i) serving as an advocate for more, higher quality and accessible training;
- ii) advising the Government of Canada on all aspects of training and related employment and adjustment programs and policies; and
- iii) making firm recommendations on a number of training issues including the links between income support and training. (CLFDB 1991, cover)

The formation of the Board is evidence that the government recognizes the structural problems of the economy. Yet, it does not indicate that the government is heading toward any corporatist direction as the Board's mandate is just to give advice and recommendations.

There must be political, economic, and social institutional changes in order to tackle current and future economic problems. Political will is the key here. As Robert Campbell points out, the achievement of full employment is a matter of political will. The governments of Canada did have a Keynesian policy paper i.e. the White Paper. But, when critical economic problems emerged, the government would not follow

through with the Keynesian strategies. Today, government should be joined by business and labour to formulate a national policy plan for Parliament's consideration. With respect to a labour and business relationship, Cornwall suggests that one of the keys to the success of economic recovery is "... working with unions. The thrust of this program is that an improvement in labour-management relations as part of a social bargain not only works to increase the chances of moving to full-employment with acceptable inflation but also increases productivity." (Cornwall 1990, 233)

With respect to economic policy, there are many general and specific proposals suggested by the institutional and/or Keynesian approaches to deal with current economic problems. The first is to develop a flexible labour market to adjust to the structural changes of the economy. Specific proposals to improve the flexibility of the Canadian labour market include: i) early identification of the long-term unemployed to minimize skill erosion; ii) policies to reintegrate older workers into the labour market; iii) reducing the mismatch between labour demand and supply by promoting sectoral/regional mobility through training and information; and iv) policies to help the cyclically unemployed, for example, advance laid-off notice, employment sharing and use of Unemployment Insurance benefits for work sharing. (Ingerman 1985; Gera & McMullen 1991 ; Cornwall 1990)

With regard to the Long Term Unemployed, specific policies should be developed either to increase their competitiveness on the job market or to expand the job opportunities for them. The federal Job Development Program and the Program

for Older Worker Adjustment are two examples of these policies. Moreover, reintegration and preventive orientation programs are more desirable than compensatory programs to facilitate older workers to re-enter the labour market. (Rahman & Gera 1991, 110-115)

For Chorney, the role of the provinces in the stabilization process is very important if Keynesian policy is to succeed. Although this issue has been discussed in the past decades, there was no progress in institution formation. Chorney points out that the Keynesian inspired model of stabilization policy relied on the co-operation between the central bank and the government, and the co-operation of all spending authorities. In Canada, the federal-provincial relationship and the right of access to the central bank might impede those two pre-conditions of stabilization policy. Thus, in solving current economic hardships, the suggestion that provinces can have access to the Bank of Canada for debt management is worth considering. (Chorney undated:1-5)

With regard to the social aspect, reform of the education system is also important. Robert Reich argues that the American educational system has to change in order to face the new era of the emerging symbolic analyst. Symbolic analysts are people who work with symbols in analyzing, articulating, and suggesting methods to resolve problems. He suggests that formal education has to equip people with four basic skills:abstraction, system thinking, experimentation and collaboration. (Reich 1991,229-233)

In the context of Canada, the adoption of an institutional approach has to take into account certain unique Canadian factors: growing regional disparities, Quebec's nationalist aspirations, adjustment of federal and provincial governments to the Free Trade Agreement, weak business, liberal political culture, labour organizations, lack of political will of the government for a full employment objective, and the erosion of Canada's social welfare system. (Drache & Gertler 1991:11-19; Donner 1991: 47; Campbell 1991b:40)

Conclusion

In postwar Canada, the nature of unemployment changes from mainly deficient demand unemployment to structural unemployment. The crucial factor for such change is the downturn of the Fordist Kondratieff cycle and the emergence of the new information technology. As Christopher Freeman points out:

The structural crisis of the 1980's and 1990's involving the transition of the world economy to a new technology is based on information-intensive products and processes which give rise to a period of instability and a prolonged period of social adaptation to the new "information technology" paradigm. (Freeman 1989:431 & 440)

In order to adjust successfully in the new techno-economic paradigm, Canada has to introduce political, economic and social institutional changes. It is essential that the Canadian government has the political will to institutionalize a full employment objective, to foster a flexible labour market, and to help unemployed re-enter the labour force if the unemployment problem is to be resolved.

CHAPTER 6

CONCLUSION

Unemployment is not simply an economic phenomenon but a complex mixture of economic, political, and social factors, operating in a cultural context. Classical economists view the operation of an economy based on certain axioms: rational choice of individuals, equilibrium state of economic variables, and the market principle. Unemployment, from the Classical school viewpoint, is that workers choose not to work at the current wage, and shift from one job to another. Monetarists such as Milton Friedman maintain that stimulating aggregate demand will, in the long run, create high inflation but no concrete improvement in employment. Thus, government does not need to put unemployment on the top priority as the labour market will clear itself, and stable prices will lead to substantial benefits for the people. For Classical and Monetarist economists, unemployment is basically an economic phenomenon which is governed by economic axioms, and can be solved by economic measures.

Unlike Classical and Monetarist economists, Keynes maintains that an

economic system operates in uncertainty. The psychology of consumers and investors affects their consumption and investment decisions which, in turn, will affect the level of employment. Thus, being unemployed may not be the will of workers. Government has the responsibility to sustain aggregate demand which will decrease involuntary unemployment. Keynes's view on economics reflects a philosophical revolution away from Classical and Monetarist economics. Classical and Monetarist economics which are based on the Euclidean/Cartesian mode of thought seek to establish universal truths of economic behaviour through deductive reasoning. For Keynes, economic phenomena cannot be explained by axioms. Human beings who make decisions can easily rebel against economic axioms as they have their own will and value judgement. The Babylonian mode of thought, the philosophical foundation of Keynesianism, recognises that it is impossible to develop a universal truth of reality. One must realize that there are various ways to study reality. However, even though Keynes's economic philosophy is different from Classical and Monetarist economics, he still looks at the unemployment issue mainly from an economic perspective.

Institutional economics fully recognizes the complexity of economic reality and the importance of technology in changing economic structure. From an institutional viewpoint, economic reality is not an isolated segment of a society. Rather, it is an integrating part of the whole. Economic institutions interact with political, and social institutions to influence economic conditions. The current unemployment problems explain this. It is not an isolated situation. The precarious experiences of the Great

Depression and World War II created political pressure for many governments to take care of citizens. Keynesian ideas and the Phillips Curve provided a theoretical foundation for government intervention in economics. The Keynesian orientation was supported by various institutions which included welfare legislation, and the growing power of the labour movement. The macroeconomic orientation of government to sustain aggregate demand helped the "Golden Age of Capitalism" maintain low unemployment.

The oil price shocks in 1973 and 1979 initiated the "Stagflation". In choosing between high unemployment and high inflation, many industrialized countries chose to curb high inflation at the expense of high unemployment. The change of macroeconomic orientation created new institutional changes. For example, labour union power was suppressed, and Central Banks controlled the money supply. Such restrictive aggregate demand policy induced more than economic changes. For example, people who are unemployed for a long time are discouraged in seeking employment and an "unemployed life style" may be the result.

The interaction of political, economic, and social factors creates the direction of economic growth. In the postwar era, the upturn of the Fordist mass production Kondratieff cycle was possible because appropriate institutions were developed to carry out assembly line production and encourage mass consumption. The oil crisis triggered the downturn of the Fordist mass production Kondratieff cycle. The emergence of the Communication and information Kondratieff cycle induced

structural change in economy. Thus, the institutional arrangements in the last Kondratieff cycle have to be changed or modified in order to fit the existing Kondratieff cycle. A more progressive way to deal with economic development is not to adjust, but to embark on a new Kondratieff cycle. Japan provides a good example of how a "national system of innovation" helps the country to lead a communication and information Kondratieff cycle.

The nature of Canadian unemployment in the "Golden Age of Capitalism" is mainly demand deficient in nature. Starting from the "Stagflation" period, Canadian unemployment changed to become mainly structural in nature. Such structural unemployment originated from the downturn of the Fordist mass production Kondratieff cycle and the government's restrictive aggregate demand policy.

In order to alleviate the current unemployment problem, Canadian politicians have to re-examine their neo-conservative ideological position on which the current policies are based. Without a change in ideology, there will not be a breakthrough in policy mix. Policies are, after all, the result of ideological persuasion. Furthermore, political instability created by recurrent constitutional debates and the promotion of the independence of Quebec has to be minimized in order to attract investment.

Finally, the Canadian government needs to think of how to channel the resources and intellectual ability of immigrants to economic development. For example, the network of immigrants in their country of origin may help Canada to create more investment. In the process writing this thesis, I find that there is little

discussion on the utilization of immigrant's network in their place of origin. Canada absorbs roughly a quarter of million immigrants from all over the world every year. Many of them are selected because of their occupation or investment which is needed in Canada. Yet, from my experiences in Montreal, there are a lot of well educated Chinese who cannot find jobs related to their training. In addition, in my recent study on the needs of Chinese business immigrants in Greater Montreal, I discovered that many business immigrants have money to invest and they have good network in their place of origin, but there seems inadequate institutionalized arrangements to help them to invest and channel the resources from the networks of business immigrants. Future study of the unemployment problem of Canada ought to pay attention to the contribution of immigrants in the economic development.

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