

# Review Article

## Policy in an Era of Free Trade: Some Comments on the de Grandpré Report

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During the negotiations for the Canada-United States Free Trade Agreement the most important catchwords bandied about by both those in favor and those against, albeit with different connotations, were 'efficiency and competition'. However, now that the agreement is here and the process of implementing it has actually begun it is interesting that the problems for policy-makers, for business, and for labour are increasingly being summed up by the equally broad and ambiguous terms of 'adjustment and cooperation'. For example, the issues that are posed by the adjustments that must be undertaken and the need to address them through co-operation are the central themes of a recently released report by the government-sponsored Advisory Council on Adjustment, *Adjusting to Win* or the so-called de Grandpré Report.

*Adjusting to Win* is divided into three main sections: the first is concerned with matters of labour supply, 'People Issues'; the second with 'Corporate Issues'; and the third with specific sectoral issues. Throughout the report there is a great deal of rhetoric about the need for an 'export mentality' and a 'training culture,' but fortunately when policy matters are addressed and when specific recommendations are put forward the attention is on the constraints and institutions that condition be-

haviour and not upon 'mentality,' 'culture,' or other such matters. This is as it should be and in certain cases leads to recommendations that will no doubt require serious consideration from all levels of government and the private sector.

### I Corporate Issues

The sections dealing with corporate and sectoral matters read like a list of complaints from the business community. This is not necessarily a bad thing, but it does leave the result vulnerable to errors of omission. These pages offer an early indication of just where the private sector feels the shoe pinch. To begin at the end, the section on sector specific issues addresses matters that range from chicken kiev to the pricing of wheat: pricing and investment in the poultry, dairy, fruits/vegetables, wheat, and wine industries are discussed. Many of the problems that are summarized concern the need to reconcile an entrenched system of supply management with the increased competition from lower cost producers in the United States. The focus is clearly upon the problems of the producer and the Council puts forward its recommendations for a two price system for poultry and dairy raw materials under the assumption that marketing board and supply management systems will not be dismantled. Conspic-

uous by their absence among the associations, organizations, and companies listed as 'participants in the work of the council' are the consumer advocacy groups.

No mention is made of other issues that one would have thought merited some attention. For example, the energy sector will certainly be facing a completely different environment in the free trade era, one that will likely increase pressure for exploration and development in the North. The report makes no mention of this sector nor of the challenges that development will pose for Native Peoples. Is this because of the absence of a highly organized lobby group, or because the changes are too far off into the future to be of concern now, or simply because the shoe doesn't pinch?

While the Council continually speaks of the need for 'cooperation' it is interesting to note that under the section dealing with 'Corporate Issues' the real problems of cooperation concern not labour and management, but co-operation between the different levels of government. In this regard the Council makes some straightforward and important recommendations concerning interprovincial barriers to trade. Government procurement policies and non-tariff barriers to the movement of goods between provinces are rightly lambasted and it is recommended, among other things, that: governments ratify the initial Agreement on the Reduction of Interprovincial Barriers to Trade Related to Government Procurement; that the federal government attempt to extend national training standards for skills; and that skill certification be transferable between provinces. All of this is eminently sensible and lies totally at the doorsteps of the federal and provincial governments, as it has for a long time. There are also a series of recommendations concerning the tax system, some of which address the implications of tax reform for international competitiveness, and others that deal with Research and Development. The main theme that arises is the need for predictability and continuity in the tax system, that is, for an en-

vironment that is conducive to investment. There is no discussion, however, of the role of macro-economic policy in facilitating the adjustment process. The government's exchange rate/interest rate policy is an important influence upon the competitiveness of Canadian firms and has been the subject of some concern recently as the spread between Canadian and US interest rates has increased. Just as the Council urges consistency and predictability in the conduct of tax policy so too should it have given consideration to the conduct of monetary policy. Even so, many of the recommendations of this second section appear to be the most sensible and least controversial of the entire report and they deserve serious thought from the parties concerned.

## **II Issues Related to Labour Supply**

The first section of the report entitled 'People Issues' is the most controversial section, and has already been used by the federal government to rationalize some of its actions, such as the recent paring and reorientation of the Unemployment Insurance system. In this section much is made of the call for a 'training culture,' and it is here that the report is most confusing. Although it is not stated explicitly by the Council, one might reasonably suggest that the recommendations amount to a mixture of policies that promote smooth adjustment and offer payments for compensation of loss due to these changes.

The Report argues against the implementation of special adjustment programs for those adversely affected by free trade because of the informational problems of determining which lay-offs are due specifically to the Free Trade Agreement. Some very worthwhile and interesting proposals are, however, put forward. Three major recommendations may be classified as dealing with the appropriate compensation of workers. These are: 1/ a standard for severance pay legislation that would include as a minimum, for those individuals with at least five years service, 'one week

wages, excluding overtime, for each year of service, plus a credit for each complete month of service to a maximum of 26 weeks; a further one-half week per year of service for workers 55 years and over, to a combined service-plus-age maximum of 39 weeks' [p.xxvii]; 2/ the exclusion of severance payments in the determination of earnings for Unemployment Insurance benefit purposes; 3/ amendments to the *Bankruptcy Act* that would create a national fund to make payments of up to \$4,000 to workers for their claims, or if this fund is not created legislation that would ensure that wage earners have priority over all other claims against the assets of an insolvent employer. The Council in no way states so explicitly but the principle that appears to underlie these suggestions is the classic compensation rule of welfare economics: given that any policy change will create both winners and losers, it should be undertaken only if the winners can compensate the losers. These three recommendations offer, in a limited sense, the basis for institutional reform that promote such payments.

On the side of policies that will smooth adjustment, the Council recommends a minimum standard for advance notification of layoffs, ranging from two weeks for firms laying off one to four individuals to 16 weeks for those laying off 50 or more, and the equal application of such rules across full-time and part-time workers. It also recommends that the government, in conjunction with business/labour co-operation, adopt a more activist policy in the application of the available adjustment programs. The idea here seems to be that resources should be geared towards identification of those plants undertaking layoffs and attention should be focussed on them before the individuals involved actually become unemployed for significant periods of time. The Council does not appear to recognize the trade-offs inherent in such a policy. Such ex ante manoeuvring on the part of the authorities may lead to considerable expenditure of resources upon those individuals who would have been able to find alter-

native employment without assistance. As a result program resources would not be as tightly targeted at the individual level upon those most in need, and therefore a high success rate in re-employing those laid off would be an illusion. What the proper balance is between a passive policy that sets rather broad target groups and requires individuals to be unemployed for some significant period of time before becoming eligible for program participation, and an active policy that seeks ex ante to identify those prone to long-term unemployment remains an open question and is not adequately addressed in *Adjusting to Win*.

Even though there may be debate over specifics, all of these recommendations are laudable. It is, however, the recommendations that the Council directs to the issues surrounding training for which its report will be most remembered. In brief, the Council feels that the rate of technical change is increasing and that the labour force must become better trained in order to adjust to these changes. Therefore, resources should be shifted from income maintenance to 'employment promotion' measures, including the doubling of the moneys allocated under section 39 dealing with training within the Unemployment Insurance program, annual increases of \$200 to \$300 million in the budgets of the Skill Shortages and Skill Investment programs of the Canadian Jobs Strategy, and the implementation of tax-based incentives for firms to undertake greater expenditures on the training of their workforce. The Council also calls for various sorts of federal-provincial and federal-business-labour co-operation on the design and implementation of these initiatives.

This part of the report is the most ambiguous, and in contrast to the other sections, it offers less a blueprint for reform than a sounding of some warning sirens. The focus on educational attainment of the labour force seems to be too narrow and not based on an analytically sound footing. There does not appear to be any recognition of the distinction between so-called 'general' skills, skills that increase an in-

dividual's productivity in all firms, and 'specific' skills that are of value only to the firm providing them. It may well be that the distinction between these two types of skills is not hard and fast, but it can nonetheless be a valuable distinction for policy purposes. For example, the Council is rarely explicit concerning what sort of skill development is needed but when it is precise mention is made only of basic literacy and mathematical knowledge, which are classic examples of general skills. At the same time the Council bemoans the fact that more employers are not like IBM Canada which spent an average of \$2,437 per employee for training during 1987 [p.43]. It would not be unreasonable to suggest that one factor influencing IBM's behaviour is the possibility that much of this training is specific to the tasks that its employees will be performing and is not easily transferable to other firms. Indeed, it is hard to imagine IBM spending a significant fraction of its \$29.6 million training budget on language acquisition! Further, if the Council had made the general-specific distinction it would have been able to make at least partial sense of some facts that it finds puzzling and disturbing: 'Most of the Canadian [training] expenditures are incurred by a small number of firms ... [I]n 1984, three out of four establishments did not provide any formal training ... [T]raining is largely concentrated in capital-intensive rather than labour intensive industries and in expanding rather than declining industrial sectors. Moreover, in firms offering training, evidence shows that it is directed in large part to employees who already have above-average education and pay.' [p.42] Since the bulk of private sector training expenditures are on specific skills the Council's proposal that the government implement a tax liability that would be offset by a firm's training expenditures would do little to increase the type of training that is of value to all firms and that would facilitate the process of adjustment. At best this proposal requires a great deal more thought before it can be made operational.

Furthermore, important errors of omis-

sion are made. The Council does not recognize the possibility that educational attainment – rather than increasing an individual's productivity – may simply serve a screening role that offers employers a signal of his/her innate abilities. If this is the case more expenditure on education is socially wasteful. Absolutely no attention is paid to other characteristics of the workforce that are important for the process of adjustment, most notably the location of economic activity and the mobility of labour. Nor is attention given to the incentives embodied in a less than perfectly experience rated Unemployment Insurance system that encourages adjustment through layoffs. It is also interesting to note that the Free Trade Agreement will increase the ease with which individuals will be able to move between Canada and the United States. Will this increase the pool of highly trained labour available to Canadian firms or decrease it?

### III Conclusion

*Adjusting to Win* seems to suggest that there is a need from all three groups – business, labour, and government – for a mix of policies that on the one hand will serve to smooth the process of change and reallocation of capital and labour, and on the other hand will offer compensation to those individuals and groups that must bear the brunt of the burden associated with these adjustments. It has not made this theme explicit, nor has it examined the implied trade-offs. Further, its focus upon the skill level of the labour force may be too narrow a conception of the adjustment problems ahead. The report is at its best when specific sectoral and corporate issues are addressed, but no doubt all aspects of it will have an influence upon the debate concerning policy in an era of free trade.

### Notes

- \* The views expressed in this article are solely those of the author and should not be attributed to the Economic Council of Canada.