TEMPORARY FOREIGN WORKERS IN CANADA: DOES A POLICY WITH SHORT-TERM PURPOSE HAVE A LONG-TERM IMPACT ON UNEMPLOYMENT?

ABSTRACT

Provisions in the Canadian Temporary Foreign Worker Program such as comparable wages and working conditions with working Canadians are meant to protect the employment of local workers. However, they appear to be insufficient to ensure that the program does not have adverse effects on unemployment. By not allowing wage increases, incentives to migrate across provinces and convergence in provincial unemployment rates are therefore decreased.

DOMINIQUE M. GROSS

Dominique M. Gross is a professor at the Graduate Public Policy Program, Simon Fraser University. She can be reached at <dgross@sfu.ca>.

Temporary Foreign Worker Programs (TFWPs) were typically developed to help employers accommodate excess demand for labour without undue delays, thereby avoiding economic slowdowns. In the past, they were developed in countries that had no permanent settlement policies, and that experienced generalized acute shortages of unskilled labour. For example, in the 1960s, the average unemployment rates in many European countries with TFWPs was below the 2% mark,[1] and so-called "guest workers" were a complement to other labour force adjustments, such as increased female participation, returns from the colonies and inflows of refugees. In countries where investment in physical capital was booming, partly because of reconstruction, productivity and wages grew simultaneously; temporary foreign workers ensured that economic growth was not slowed down and sometimes allowed the reallocation of native workers to more attractive sectors (OECD 2001). However, in some cases, large flows of temporary workers also delayed structural changes or investment in new technologies (Castles 1986). Nevertheless, the combination of design flaws and severe recession following the first oil shock in the early 1970s led to the elimination of those programs.

Over time, TFWPs have also been used by countries that, like Canada, had developed permanent settlement policies to attract highly skilled workers. They are seen as an efficient tool allowing the country to compete in the worldwide market for brains and to ensure long-term growth. Recently, however, TFWPs for unskilled workers have garnered renewed interest as the long period of economic growth experienced since the mid-1990s was seemingly creating labour shortages in regions and sectors across Canada. In 2002, Canada extended its TFWPs to unskilled labour beyond the two traditional categories of seasonal agricultural workers and live-in caregivers. The basis for such expansion was the standard argument that the country was experiencing local shortages of labour that might slow down growth either because of a lack of availability of suitable workers or because of the ensuing rise in wages. As shown in Figure 1, overall unemployment in Canada has indeed fallen since the mid-1990s, dropping from 11.4% to 6.0% between 1993 and 2007.[2] Concurrently, the number of annual entries of temporary foreign workers (TFWs) rose substantially, reaching 165,200 in 2007, a 63.6% increase since 1993.

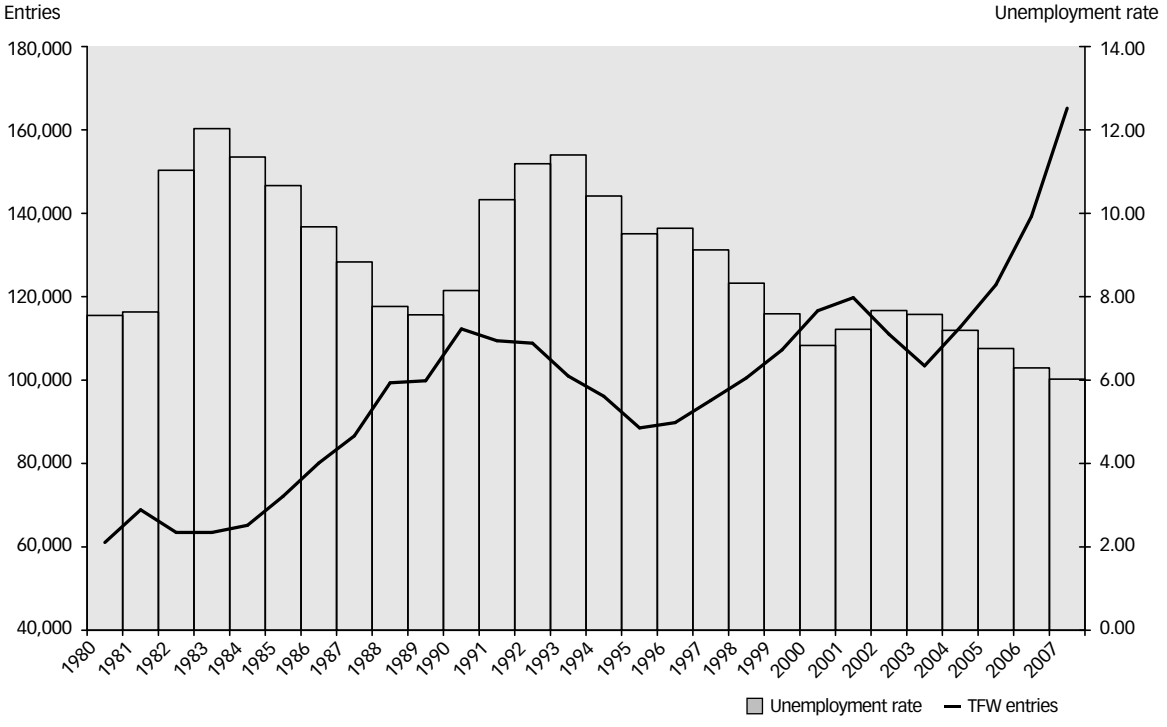
The clear advantage of the program is that employers who meet the required conditions are given access to a large pool of workers with adequate skills. The labour problem is assumed to be temporary, as is the solution; however, as described below, conditions for hiring skilled and unskilled TFWs are somewhat different and the unskilled portion of the program includes a stronger demand-management component than its skilled portion. Generally speaking, demand-management components such as the labour market test are introduced in program design to minimize the substitution by employers of local workers with TFWs simply to lower costs. One of the questions that arise is whether a policy designed for temporary labour can have permanent adverse effects. In other words,

Table 1
Provincial unemployment distribution

	Unemployment					Ranking			
	1983	1989	1993	2006		1983	1989	1993	2006
British Columbia	13.9	9.1	9.7	4.8	British Columbia	7	5	4	4
Alberta	11.0	7.2	9.6	3.4	Alberta	4	2	3	1
Saskatchewan	7.7	7.4	8.3	4.7	Saskatchewan	1	3	1	3
Manitoba	9.5	7.5	9.3	4.3	Manitoba	2	4	2	2
Ontario	10.5	5.0	7.2	4.9	Ontario	3	1	5	5
Quebec	14.2	9.6	13.2	8.0	Quebec	8	6	7	7
New Brunswick	15.0	12.1	12.6	7.6	New Brunswick	9	8	6	8
Nova Scotia	13.5	9.9	14.3	8.0	Nova Scotia	6	7	8	6
PEI	12.4	13.8	16.9	10.4	PEI	5	9	9	9
Newfoundland	18.2	15.6	20.1	13.6	Newfoundland	10	10	10	10
Correlation	0.778	0.972							
Canada	**12.0**	**7.6**	**11.4**	**6.3**					

Source: Statistics Canada, 2008.

Figure 1
Inflow of temporary foreign workers in Canada (1980-2007)



Sources: Entry data provided by CIC; Statistics Canada (2008).

does increasing access to TFWs, even in the presence of demand-management by the government, as is the case in Canada, have medium- to long-term adverse effects on unemployment?

Temporary foreign workers and regional unemployment

Standard economic theory provides a pretty straightforward description of labour market adjustment. In the absence of access to TFWs, employers who experience regional shortages and have difficulty recruiting needed workers must increase the wages they offer. Higher wages would then attract new participants to the labour force as well as workers from regions not experiencing the same economic growth. Hence, the rising gap between wages would create internal migration flows by people living in lower wage areas or labour force participation changes. This labour reallocation mechanism would eliminate regional differences in labour market conditions, and in a perfectly frictionless world, all regions would exhibit identical unemployment rates. Therefore, giving employers access to TFWs by attempting to recruit workers in a tight

Table 2
Average annual provincial in- and out-migration

	In-migration		Out-migration		Total movement	
	1983-1989	1993-2006	1983-1989	1993-2006	1983-1989	1993-2006
British Columbia	57,152	54,754	42,689	48,900	99,841	103,654
Alberta	51,094	70,960	65,599	49,108	116,693	120,068
Saskatchewan	15,908	15,699	24,726	20,713	40,634	36,412
Manitoba	17,242	13,769	21,806	18,258	39,047	32,027
Ontario	92,084	66,968	66,110	66,671	158,194	133,640
Quebec	26,349	21,933	34,512	31,477	60,861	53,409
New Brunswick	12,814	10,944	13,622	12,464	26,436	23,407
Nova Scotia	18,068	15,660	17,689	17,345	35,757	33,005
PEI	3,055	2,610	2,930	2,571	5,985	5,181
Newfoundland	8,045	7,824	11,436	12,868	19,482	20,692
Canada	**307,355**	**285,995**	-	-	**614,711**	**571,989**

Source: Statistics Canada (2008).

local labour market can eliminate or decrease the need for relative changes in wages and the subsequent reallocation of labour across regions. Consequently, it can contribute to persistent differences in regional unemployment rates. So, in Canada, where unemployment rates vary considerably, two questions arise: Are these regional unemployment differences persistent (i.e., is labour force adjustment not occurring)? And, if they are, can the persistence in divergences be attributed to the growing use of TFWs in some provinces?

Table 1 presents the distributions of provincial unemployment rates for the two most recent periods of economic growth: 1983-1989 and 1993-2006.[3] It also provides the ranking of provinces in terms of unemployment performance for each year. The second period of growth is much longer than the first (13 as opposed to 6 years), thereby potentially allowing for more convergence. Yet in 2006, as in 1989, there were still vast differences in unemployment rates across provinces. In 1989, when the overall unemployment rate was 7.6%, Ontario was registering the lowest rate at 5.0%, and Newfoundland, the highest at 15.6%. In 2006, when the overall unemployment rate was 6.3%, Alberta's unemployment rate was 4.8% while Newfoundland's was the highest at 13.6%. Hence, in 2006, both extremes were lower, but there clearly remained important discrepancies. Furthermore, provincial unemployment rates, and thus persistence in the distribution of rates, seem to have increased over time. At the end of the first expansion period, the ranking of the provinces had changed, yet only drastically in the case of PEI. Newfoundland was the sole province that held its spot. At the end of the second expansion period, six provinces (Manitoba, B.C., Ontario, Quebec, PEI and Newfoundland) were ranked the same as at the outset and the other four hardly moved across ranks. There has been little change in the distribution of regional unemployment during the latest 13-year expansion period, and there appears to be a much stronger inertia in the distribution of provincial unemployment in recent times.[4] Having established that there has been little convergence in provincial unemployment rates since the mid-1990s, it must now be shown that the expansion of the TFWP played a role in maintaining these differences.

Temporary foreign workers and inter-regional mobility

The crucial component in the adjustment mechanism for unemployment convergence is inter-provincial mobility following unequal wage variations. Thus, it is expected that higher persistence in unemployment dispersion in the 1990s than in the 1980s will correspond to lower mobility. There is indeed ample statistical and analytical evidence that inter-provincial migration has decreased over time in Canada. Starting with the statistics, Table 2 shows the average annual in- and out-migration as well as total migration during these two expansionary periods (1983-1989 and 1993-2006) for provinces and for Canada. Total movements across Canada have decreased by about 7% between the two periods. Only one province experienced an increase in in-migration (Alberta) while two others (BC and Newfoundland) experienced a significant increase in out-migration. Overall, the movement of people has increased only in three provinces, namely British Columbia, Alberta and Newfoundland. Analytically, both Grenier (2008) and Cousineau and Vaillancourt (2001) argue that mobility of working age populations across Canada has decreased between the mid-1970s and the mid-1990s. There are many reasons other than the availability of TFWs that might explain persistent discrepancies in regional unemployment. Among the most important are differences in institutions and policies that affect mobility. There are particularly compelling argument in explaining international differences in unemployment rates as labour market policies can greatly vary from one country to another. These policies, however, tend to be much more homogenous within countries. Yet, in Canada, province-specific public policies have been shown to contribute to unemployment differences across provinces. Among them, minimum wage legislations, income taxes, provincial per capita spending and regional provisions in the employment insurance legislation are particularly relevant (Day and Winer 2001). There are also other factors that explain why mobility has decreased.

Inter-provincial migration may respond to fundamental changes, such as rural/urban structure or long-term differences in unemployment (Coulombe 2006) or to relocation costs such as age, education, and language (Dickie and Gerking 1998). Increasing persistence in unemployment rates differences across Canada would appear to have resulted from the increasing cost of moving, which results in the fact that employers find it difficult to find workers when regional shocks hit. Under these circumstances, calling upon TFWs to fill labour gaps may appear to be the ideal short-term solution. However, not allowing wages to rise locally through the scarcity mechanism is likely to decrease further incentives to move from other regions. If TFWs further contribute to limiting inter-provincial mobility, the program may have unintended long-term consequences for the employment of Canadian workers. One way of alleviating this adverse effect is to make TFWs as costly to access as workers from another region.

Unemployment in Canada has indeed fallen since the mid-1990s, dropping from 11.4% to 6.0% between 1993 and 2007. Concurrently, the number of annual entries of temporary foreign workers rose substantially, reaching 165,200 in 2007, a 40% increase since 1993.

The relative cost of hiring TFWs

The Canadian TFWP, and especially since its extension in 2002, contains a number of provisions that are consistent with demand management, and those provisions are more numerous for unskilled than skilled workers. They consist of costs to be borne by employers and the labour market test requirements. Direct monetary costs specify that employers must pay for return travel to the home country and health coverage until provincial coverage applies. The labour market test is linked to compulsory recruiting procedures that employers must follow, as "HRSDC and CIC will expect you [the employer] to show efforts to hire unemployed Canadians" (HRSDC 2008) in order to obtain a Labour Market Opinion (LMO), which opens the door to hiring a foreign worker. HRSDC also requires that "wages and working conditions are comparable to those offered to Canadians working in the occupation" (HRSDC 2008). Overall, the demand-management related costs create a gap between the employers' costs of hiring a TFW and a local worker: hiring of a temporary foreign worker was more expensive than hiring a local worker.

However, in early 2007, the introduction of the accelerated LMO Pilot Project substantially decreased employers' recruiting costs. Since then, a list of priority occupations is regularly established for each province and the compulsory advertising requirements have been reduced from two or three weeks to one week (OECD 2008: Annex Table II.A.1.2.). Also, the length of work contracts was extended from one to two years, which basically halves recruiting and travel costs. As a consequence, the differential in hiring costs between a local and a temporary foreign worker has decreased. If this differential is not great enough to induce employers to raise wages to attract resident workers from other regions, and if it also decreased, it is possible that the TFWP would contribute to maintaining important regional differences in unemployment. 1991 to 2007 in Gross and Schmitt (2009) show that hiring costs of TFWs are indeed related to persistence in regional unemployment when other factors that slow down inter-provincial migration are taken into account. It is worth noting that one major component of these costs is travel cost borne by employers who must pay for the return trip from the source country. Between 1993 and 2007, the real cost of one mile travelled by passengers decreased by about 30%, lowering quite substantially the cost of hiring a TFW. In addition, employers further saved on monetary costs with the introduction of accelerated hiring procedures. Since the mid-1990s, persistence in the distribution of regional unemployment differences is likely to have been enhanced by more intensive use of TFWs as the costs related to their hiring was decreasing. Intuitively, if TFWs were more expensive to hire, employers might be more inclined to consider raising wages to attract workers already residing in Canada. For this mechanism to work, the "penalty" for hiring TFWs must clearly be relatively hefty.

Canada has designed a temporary foreign worker policy that involves managing the demand for labour. Such an approach is meant to ensure that employers' excess demands for labour are satisfied while the employment of resident workers is protected. It is clear that employers will always "need" TFWs if they are cheaper than resident workers and some steps have been taken to ensure that there is no displacement of resident workers. However, there is evidence that the policy is inefficient at avoiding the potential displacement of Canadian workers from other regions or provinces. So, even though Canadian policy has established provisions through the LMO to avoid the employment of TFWs below the minimum standards to limit adverse effects on the local market, it seems that they are ineffectual in preventing a permanent rise in regional unemployment differences.

As long as TFWs remain substantially cheaper to hire than resident workers – because wages and hiring costs are substantially lower than what they would be for resident workers from other provinces – employers will hire TFWs. In the absence of quotas like in Canada, the inflow of TFWs depends solely on securing an LMO based on the evaluation of the state of the local market by government officials, a very difficult exercise by all accounts (Abella 2006). An alternative policy tool would be to make the cost

of hiring a TFW more in line with the cost of attracting out-of-province workers. In demand-management, one innovative way of maintaining the cost of hiring TFWs higher is Singapore' foreign worker levy: "The foreign worker levy is a pricing control mechanism designed to regulate the demand of foreign workers in Singapore" (Singapore Government 2009). The levy is industry-specific and rises with the employers' dependency level on TFWs. For example, in services, the monthly levy for unskilled workers is S$240 per foreign worker when they make up less than 30% of the labour force; S$280, between 30% and 40%; and, S$450, between 40% and 50%.[5] Whether such a policy would be efficient in Canada remains to be evaluated, as it is likely to be most efficient in markets where the levy cannot be passed on to TFWs, such as sectors with unions. Nevertheless it seems that the growing gap between the cost of TFWs and the cost of resident workers under the seemingly strict LMO conditions (i.e., same wage paid) have contributed to maintaining high unemployment in some regions by slowing down inter-provincial migration.

Conclusion

Demand-management provisions have several purposes, one of which is to make sure there is no substitution between resident and TFWs by maintaining similar hiring costs. To be efficient, hiring conditions for TFWs must go beyond paying the going wage. Inter-provincial migration depends on the cost of moving, and in Canada, with its existing diversity of provincial labour market institutions, these costs may be quite high. Hence, lowering additional hiring costs for TFWs when local shortages occur can have unintended long-term adverse effects on the regional distribution of unemployment.

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Notes

[1] Average unemployment in the 1960s was 1.8% in Austria, 2,2% in Belgium, 1.5% in France, 0.8% in Germany and 0.1% in Switzerland (OECD 2008).

[2] Even though the magnitude of the flows is much smaller, it is interesting to note that the expansion of the TFWP to unskilled workers occurred in Canada at a time when the overall unemployment rate was 3 to 4 times higher than that of European countries in the 1960s.

[3] Unemployment rate for both sexes, people aged 15 years and over. Annual values are averages of monthly observation (Statistics Canada 2008).

[4] Another illustration is given by the simple correlation among provincial rates, which were 0.778 between 1983 and 1989, and 0.972 between 1993 and 2007.

[5] The benchmarks for the foreign labour force and the size of the levy vary across industries and time (Singapore Government 2009). One Singapore dollar was equivalent to C$0.82 on January 14, 2009.