

Skills Research Initiative Initiative de recherche sur les compétences

Adjustment in Labour Markets Internal and External to the Firm

Rafael Gomez (York University)
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Working Paper 2006 C-09

Human Resources and Social Development Canada/Ressources humaines et Développement social Canada
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- B. Employer-Supported Training;
- C. Adjustments in Markets for Skilled Workers;
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Abstract

While labour adjustments issues are generally analysed through adjustments in the external labour markets, the focus of this report is on adjustments within the internal labour markets of firms through their workplace and human resource practices. The internal labour market dimensions include job design, training, employee involvement, alternative forms of employee representation and voice, compensation, work-time arrangements, non-standard employment, diversity management and workplace wellbeing programs. The paper begins by discussing the practical and policy importance of such internal labour market adjustments by linking them to a number of related issues of practical and policy importance. It then outlines the main current and forthcoming factors that are giving rise to adjustment pressures in both external and internal labour markets. The implications for adjustment issues in external labour markets are then discussed, focussing on those issues that have the most important implications for internal labour market adjustments. The implications for internal labour market adjustments in various workplace and human resource practices of firms are then outlined, relating them to the various adjustment pressures as well as the adjustments that are occurring in the external labour markets. Particular attention is paid to the extent to which the external and internal labour market adjustments are substitutes and/or complements (i.e., the extent to which they impede or facilitate each other). Policy implications are then discussed, focussing on the barriers that inhibit internal labour market adjustments including barriers to innovations in this area. As well, the paper analyses the extent to which internal workplace and human resource practices are affected by various policy initiatives, and the extent to which the policy initiatives themselves can be affected by the internal labour market responses of firms. The paper deals with the issue of whether there is an appropriate role for public policy in this area, or whether internal labour market issues are simply “the business of business” with governments having no business in those internal labour markets. An overall message of the paper is that more attention needs to be paid to the inter-relationship between the adjustment process of the external labour market and internal labour markets of firms with their workplace and human resource practices. Effective policy making in the labour adjustment realm requires information on all dimensions of this inter-relationship: theoretical knowledge of the underlying causal relationships; empirical evidence on those relationships and how the various actors respond; and appropriate policy responses based on such information.

Résumé

Tandis que les questions relatives à l'adaptation sur les marchés du travail sont généralement analysées sous l'angle des marchés du travail externes, les auteurs se concentrent sur l'adaptation au sein des marchés du travail internes par l'entremise des pratiques des entreprises dans les domaines du milieu de travail et des ressources humaines. Parmi les dimensions liées aux marchés du travail internes, notons la conception des tâches, la formation, la participation des employés, d'autres formes de représentation des employés et des formules permettant aux employés de se faire entendre, la rémunération, les formules de travail, l'emploi atypique, la gestion de la diversité ainsi que les programmes de bien-être en milieu de travail. Les auteurs

commencent par parler de l'importance sur les plans pratique et stratégique des adaptations sur les marchés du travail internes en les reliant à un certain nombre de questions connexes d'importance pratique et stratégique. Ils exposent ensuite les principaux facteurs actuels et futurs qui font croître les pressions à l'adaptation sur les marchés du travail internes et externes. Ils examinent ensuite les conséquences pour les questions d'adaptation sur les marchés du travail externes, en s'attardant aux questions qui sont les plus importantes pour l'adaptation sur les marchés du travail internes. Puis, les auteurs exposent les conséquences pour l'adaptation sur les marchés du travail internes dans les diverses pratiques en matière de milieu de travail et de ressources humaines des entreprises, et ils relient celles-ci aux diverses pressions à l'adaptation ainsi qu'à l'adaptation qui se produit sur les marchés du travail externes. Ils portent une attention particulière à la mesure dans laquelle les adaptations sur les marchés du travail externes et internes sont des substituts ou des compléments (p. ex. la mesure dans laquelle elles sont bénéfiques ou nuisibles l'une pour l'autre). Les auteurs examinent ensuite les conséquences pour les politiques, plus particulièrement les obstacles qui nuisent aux adaptations sur les marchés du travail internes, notamment les obstacles à l'innovation dans ce domaine. De plus, les auteurs analysent la mesure dans laquelle les diverses initiatives stratégiques touchent les pratiques dans les domaines du milieu de travail et des ressources humaines et la mesure dans laquelle les réactions des entreprises relativement aux marchés du travail internes peuvent toucher, à leur tour, les initiatives stratégiques. Les auteurs se demandent si les politiques publiques ont un rôle à jouer à ce chapitre ou si les questions relatives aux marchés du travail internes ne regardent que les entreprises, les gouvernements n'ayant pas à s'en mêler. Les auteurs affirment qu'il faut tenir davantage compte de l'interdépendance entre les processus d'adaptation des marchés du travail externes et internes des entreprises et les pratiques des entreprises dans les domaines du milieu de travail et des ressources humaines. Pour élaborer des politiques efficaces relativement à l'adaptation des marchés du travail, il faut disposer de renseignements sur tous les aspects de cette interdépendance : des connaissances théoriques des relations causales sous-jacentes; une preuve empirique de ces relations et de la façon dont les divers acteurs réagissent; des mesures d'orientation appropriées fondées sur ces renseignements.

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INTRODUCTION

In discussions of labour market adjustment, the focus is invariably on adjustments in labour markets that are external to the firm. Adjustments occur through such mechanisms as wages, mobility, unemployment and entry and exits to and from the labour market mainly through life-course transitions – the school-to-work transition, work-to-retirement transitions, and transitions in and out of the labour market, many associated with work-family balance. Manifestations of that external labour market adjustment that draw policy attention include unemployment, wage polarization, job displacement, involuntary retirement, a productivity slowdown, income inadequacy and precarious employment often in non-standard jobs. With respect to that external labour market adjustment, there is wide agreement that active labour market policies that facilitate the adjustment from contracting to expanding sectors are preferable to passive income maintenance programs that impede such adjustment, often by encouraging the “stay” option.

Such external labour market adjustments are obviously important as evidenced by the previously discussed manifestations that draw policy attention as well as the emphasis on active labour market adjustment programs. What attracts little policy attention, however, is the parallel adjustments that go on within the internal labour markets of the firm with respect to their workplace and human resource practices. To a certain extent this may reflect a perception that adjustments that occur within the confines of the firm are the firm’s business and not that of the government (subject to adhering to legal standards with respect to areas like employment standards, health and safety and human rights). Nevertheless, such adjustments have implications for external labour market adjustments. They can be substitutes or complements, and firms may effectively undo the intended effect of government policy interventions in the external labour market through changes in their internal labour markets practices.

The focus of this report is on adjustments through the internal labour markets of firms through their workplace and human resource practices. Particular attention is paid to the link between internal and external labour market adjustments, the extent to which they affect each other, and the extent to which they are substitutes or complements to each other.

Internal labour market issues are important in part because the workplace is the unit of analysis where key decisions in this area are made, and it is where workplace strategies and industrial strategies interact. There is increasing emphasis on the importance of the strategic use of human resource management and workplace practices to ensure that labour is “a resource to be utilized and not simply a cost to be minimized.” If prices of goods and financial and physical capital are increasingly determined and fixed in world markets, then the main source of comparative advantage lies in strategic use of human resources via the link between workplace practices and productivity. Internal labour market adjustment issues are linked to a range of other concepts that are increasingly receiving attention, including: social capital; life-long learning; co-op education; the long-run legacy effect of initial labour market experiences; non-standard employment; synergies

and "agglomeration" effects from clustering; effect of work environment on employee health and well being; and the various life-cycle transitions from school-to-work, work-to-household and work-to-retirement.

The policy relevance of the topic is illustrated by the fact that in the 2004 Speech from the Throne, the federal government announced a Workplace Skills Strategy (WSS) to ensure that Canada has the skilled workers it needs for the future, especially to deal with the expected labour shortages and the transformation to a knowledge based economy. The fact that it was announced as a *workplace* skills strategy highlights the importance of workplace practices and human resource policies *within* the internal labour markets of firms. The relationships between these internal labour market practices and issues of adjustment and skill development in the *external* labour market as well as through *institutions* (e.g., educational institutions) and *policies* (e.g., immigration policy) are not well understood or researched. The purpose of this project is to help fill that gap by analysing the internal labour market adjustments of firms through their workplace and human resource practices, and relating them to adjustments and skill development in external labour markets, institutions and policies.

After this introductory material which motivates the analysis, indicating its practical and policy importance and linking it to a number of related policy issues, the paper then (briefly) outlines the main current and forthcoming factors that are giving rise to adjustment pressures in both external and internal labour markets. The implications for adjustment issues in external labour markets will are then discussed, focussing on those issues that have the most important implications for internal labour market adjustments. The implications for internal labour market adjustments in various workplace and human resource practices of firms are then outlined, relating them to the various adjustment pressures as well as the adjustments that are occurring in the external labour markets. Particular attention is paid to the extent to which the external and internal labour market adjustments are substitutes and/or complements (i.e., the extent to which they impede or facilitate each other). Policy implications are then discussed, focusing on the barriers that inhibit internal labour market adjustments including barriers to innovations in this area. As well, the paper analyses the extent to which internal workplace and human resource practices are affected by various policy initiatives, and the extent to which the policy initiatives themselves can be affected by the internal labour market responses of firms. The paper deals with the issue of whether there is an appropriate role for public policy in this area, or whether internal labour market issues are simply "the business of business" with governments having no business in those internal labour markets -- just as they are said to have no business in the bedrooms of the nation.

SOURCES OF PRESSURES ON FIRM'S INTERNAL LABOUR MARKETS

It is important to have an understanding of the underlying causal factors that are affecting the internal workplace and human resource practices of firms for three main reasons. First, causal understanding is necessary to predict future changes as the underlying causal factors may change. Predicting the future based on extending what has happened in the past can work if the underlying causal factors do not change. But if they do, then the predictions invariably will be wrong. Second, a causal understanding is necessary to determine where policy interventions should apply; it is important to treat the cause and not just the symptoms. Third, a causal understanding is necessary to determine how the affected stakeholders may respond to policy interventions, especially in ways that may undo or offset the intended effect of the intervention.

With this importance in mind, a brief discussion is provided of the underlying causal forces that are affecting external labour markets and the internal labour markets of firms. The emphasis is on their implications for adjustment issues.

Demand Pressures

The demand for labour is a derived demand, derived from the demand for the goods and services produced by firms. Firms will alter their demand for labour and the *nature* of that demand in response to the pressures they face in their product markets. If their product markets demand just-in-time delivery, then firms will need a just-in-time workforce that is flexible and adaptable to meet those needs. If their product markets require high-quality niche products to survive under global competition, then firms will require a committed workforce that can deliver those niche products. The various pressures arising from the demand side of the market will be highlighted, emphasising their features that have implications for adjustment issues in both external and internal labour markets. The pressures include: globalisation, trade liberalisation, technological change, industrial restructuring to the knowledge economy, cyclical fluctuations, exchange rate changes, temporary one-off demand shocks, privatisation, de-regulation and replacement demand from retirements.

Globalisation and trade liberalisation have opened world markets on the export side but also subjected domestic markets to more import competition. The import competition has generally been from low-wage countries, displacing workers at the middle and lower end of the skill distribution. Those displaced at the “vanishing middle” have often moved down the job-opportunity chain, putting even more pressure on lower-wage workers. Offshore outsourcing has been common, originally affecting blue-collar workers but increasingly involving higher-skilled white-collar workers as business services are increasingly outsourced. Business services were once thought of as “protected” because services could not be “imported”; with the Internet this is no

longer the case, as the Internet highway has opened such competition on a 24-7 bases. Requests can be sent offshore at the end of the business day with the results back by the start of the next business day, done at a fraction of the costs. The export opportunities have been more at the higher-end of the occupational spectrum involving higher value-added products embedding higher skills and more human capital.

Technological change, especially associated with the computer revolution and the Internet, has also been skill-biased, fostering the information economy and requiring knowledge workers. Technological change has also fostered global competition and outsourcing by linking suppliers, producers and customers through advanced communications and transportations modes. This has facilitated just-in-time delivery which in turn has led to pressure for a just-in-time workforce to meet those needs. The technological change since the mid 1970s appears to have involved a major transformation from an older technology to a newer one based largely on computers and utilizing skilled, educated labour. In fact, the availability of skilled labour embodying considerable human capital may have induced much of the endogenous technological change (Beaudry and Green 2005) thereby fostering the skill premium and higher returns to education.

Industrial restructuring has been away from the old blue-collar often unionized jobs in large fixed worksites and towards jobs at the polar ends of the skill spectrum: high-skilled, knowledge worker jobs in business, financial, professional and administrative services, and low-skilled jobs in the low-wage service sector – typically providing services to those at the higher end of the occupational skill distribution. Business alliances and joint ventures have been formed around particular projects, often requiring a contingent workforce that is needed only for those projects. Businesses (and government departments) have often restructured so that they have a core workforce that handles the subcontracting and outsourcing – their focus is mainly on co-ordinating amongst suppliers, producers and customers (hence the emphasis on “people skills”). “Reinventing government”, typically in the direction of being more market driven and customer oriented, has also placed pressure on governments as employers. Privatization and deregulation have opened product and service markets to more competition and this competitive pressure has been displaced back to the workforce.

Cyclical demand fluctuations have been a common feature of the economy. Some empirical evidence suggests that youths who enter the labour market in such downturns carry a more permanent negative legacy or scarring into their subsequent employment (McDonald and Worswick 1999). This is particularly problematic given the evidence that *recent* cohorts of young males in Canada are also experiencing dramatic declines in their earnings when they enter the labour market and these are not being offset by more rapid earnings growth (Beaudry and Green 2000). As well, there is some evidence of similar negative legacy effects on the labour market assimilation of immigrants who enter at the time of cyclical downturns (Abdurrahman 2003, Abdurrahman and Skuterud 2005). This is a particularly important issue given the increased difficulties of recent cohorts of immigrants in assimilating as well as the fact that we appear to be moving away from a “taps-on, taps-off” immigration policy where the tap is turned off in times of high unemployment. There is also evidence that much of the high structural

unemployment in Europe resulted from demand shocks that could not be accommodated because of labour market rigidities – rigidities that did not matter when unemployment was low and there were few negative demand shocks, but that had negative effects when the shocks were more prominent and unemployment increased (Blanchard and Wolfers, 2000).

The *appreciation of the Canadian dollar* relative to that of our major trading partner – the US – is also placing additional pressure by making our exports more expensive and imports cheaper. To a certain extent, earlier inefficiencies may have been “protected” by the low-value of the Canadian dollar, allowing them to be priced competitively in international markets in spite of high cost. The cost of this was not born by the inefficient producers but rather by all Canadians whose real purchasing power decreased because they had to pay a higher price for their imports given the low value of the Canadian dollar. An appreciating Canadian dollar will expose those sectors (and their workforces) more to the “chill winds of competition.” This will place pressure for a reallocation of labour from the sectors that were previously competitive only because of the low value of the Canadian dollar towards ones that are more competitive and are likely inducing the rise of the dollar because of an increased demand for their output (e.g., oil and resource extraction).

An adjustment pressure that has received increased attention is that of one-off, *temporary, unanticipated, short-term shocks* associated with such events as SARS, mad-cow, terrorist acts and natural disasters. When those shocks hit product or service markets they obviously have important implications for adjustments in both the external labour market as well as the internal labour market of firms. Since they are one-off, unanticipated and temporary it is unlikely that adjustment policies are in place in external or internal labour markets. Since they are temporary shocks, the expectation is that the affected workers will return to their job once the shock is over, but that may take a while. Shocks from natural disasters can affect related sectors, decreasing demand in those that are complementary to the affected sector, or increasing demand in those that are substitutes or that provide repairs to infrastructure or plant and equipment. Disaster relief to the communities often ensue and this can affect labour demand.

Replacement demand from retirements will be an increasingly important pressure as the leading edge of the baby boom population (born between 1946 and 1964, peaking in 1960) retires from the labour force. The loss of older workers is likely to be especially pronounced because a growing proportion of the population is in the older age brackets¹ and they are retiring earlier,² although that trend is changing for men. The loss of older workers can lead to not only possible labour and skill shortages, but also a loss of experience and institutional knowledge as well as mentoring of younger employees by senior employees. Retirees will also be drawing from, rather than contributing to, both public and private employer-sponsored pensions. The

¹ The proportion of the population over the age of 55 is projected to grow from 24% in 2005 to 34% by 2025. Source: <http://www.census.gov/ipc/www/idbsum.html>

² Changing labour force participation rates are documented in Gunderson, Hyatt and Pesando (2000).

ageing and longer-living population will also be altering the nature of demand, especially towards health care services given that over 40% of Canadians over the age of 65 self-report themselves as *disabled* (Cossette and Duclos 2002).

Supply-Side Pressures

A wide range of supply pressure is also affecting both external labour markets and the internal labour markets of firms. In some cases, those supply pressures are exacerbating the effect of the demand pressure, but in other cases they create opportunities for adjustments to the demand pressures. The main supply-side pressures include those associated with various life-course transitions (school-to-work, in-and-out of the workforce often in response to work-family balance issues, and work-to-retirement transitions). As well, they include immigration assimilation issues.

The *school-to-work transition* increasingly involves students working part-time while in school as well as engaging in various forms of non-standard employment (especially limited-term contracts) while making the school-to-work transition. The key issue here is whether such non-standard work is a viable stepping-stone to more permanent employment (perhaps the new form of probationary employment) or whether it sets up a situation of state-dependence whereby they continue to be employed in more precarious employment. As indicated, there is some evidence that a permanent negative effect occurs for youths who enter the labour market in times of depressed economic conditions. Does the same apply to youths who start off with non-standard employment, or is it a viable stepping-stone to more permanent jobs? The empirical evidence from Europe³ and the U.S.⁴ suggests that temporary-help agency jobs and limited-term contracts do improve the subsequent labour market outcomes for low-skilled workers, but much of this evidence is for welfare recipients and the low-skilled, and it deals mainly with temporary-help agencies.

³ For European evidence see Amuedo-Dorantes et. al. (2005), Andersson and Wadensjo (2004), Booth et. al. (2002), Garcia-Perez et. al. (2002), Gerfin et. al. (forthcoming), Ichnio et. al. (2004), Kvasnicka (2005), and Zijl (2004).

⁴ For U.S. evidence see Corcoran and Chen (2002), Ferber and Waldfogel (1998), Heinrich, Mueser and Troske (2005), Lane, Mikelson, Sharkey and Wissoker (2003) and Segal and Sullivan (1997). The lone study that does not find positive effects of temporary-help agencies on subsequent employment outcomes is Autor and Houseman (2005) for welfare recipients. That study, however, is the only one based on random assignment of people to temporary-help agencies vs. direct-hire placements. All of the other studies use non-experimental methodologies including regression selection procedures and propensity score matching, which are generally regarded as less likely to control for unobservable factors compared to random assignment. As such, even though it is an outlier, it should be regarded with more weight.

The rise of the *two-earner family* associated with the increased labour force participation of women (and especially women with children) is also creating adjustment issues in both external labour markets and within the internal labour markets of firms. There is general agreement that women are not “taking the jobs of men” in that such a view is subject to the lump-of-labour fallacy that assumes there is a fixed number of jobs in the economy. But the two-earner family does inhibit external labour market adjustment through geographic mobility to the extent that it would require both parties to move. It places even more pressures on the workplace and human resource practices of firms, especially to accommodate the increasingly diverse needs of employees and especially to balance needs of work and family. The two-earner families are also affecting the nature of demand in the labour market since they often require services in the evening and on weekends – services that cannot be produced during a regular workweek and then inventoried and provided on demand. This in turn increases the demand for part-time and other forms of non-standard work to meet such demands.

Work-to-retirement transitions are also occurring at the other end of the life-cycle, often involving phasing into retirement and often back into the labour force, frequently into non-standard jobs. Such issues will be even more important in the future given the larger numbers of baby-boomers entering the normal retirement ages. That growing number may create some adjustment problems associated with their reduced mobility. While such retirements may create adjustment *challenges* in both external and internal labour markets, they also create *opportunities* for firms to use this growing pool of experienced workers to fill impending labour shortages.

Legislative bans on mandatory retirement (currently now existing only in Quebec and Manitoba) are increasingly being contemplated in other jurisdictions and are likely to have an impact on transitions to retirement. Such bans are not likely to create extensive adjustment problems in external labour markets since the number who will postpone retirement is likely to be small and they are unlikely to continue working much longer⁵. However, the numbers who continue working may increase in the future for a number of reasons: the decline of early-retirement buyouts; improvements in health and longer life expectancy; the shift from blue-collar to white-collar work in the knowledge economy where work is less physically demanding and more intrinsically interesting; increased demands for an experienced workforce to fill impending labour shortages; the shift from defined-benefit pensions which often had penalties to postponed retirement to defined contribution plans which do not have such penalties; a possible erosion of pension wealth from increases in the age of entitlement or reductions in pension generosity or the absence of windfall gains from stock market booms; and the rising labour force participation of older women together with the complementary retirement among couples.

⁵ Gunderson (2004), Gunderson and Hyatt (2005), Reid (1988) and Shannon and Grierson (2004) and references therein.

While the adjustments to legislative bans on mandatory retirement are not likely to be substantial in external labour markets, this is not the case for internal labour markets and their workplace and human resource policies. Adjustment issues include: fewer opportunities for renewal by hiring younger persons, often with updated skills, and fewer promotion opportunities for such persons; more expensive age-related fringe benefits and especially disability related programs; greater need to monitor and evaluate older workers and difficulties in succession planning given the uncertainty as to how long they may remain with the firm; higher costs to the extent that compensation has an element of being seniority-based independent of productivity; and difficulty in sustaining deferred compensation since there is no termination date to such an arrangement.

Adjustment problems emanating from the supply side of the labour market are also arising because of the more recent cohorts of immigrants are having increased *difficulty in assimilating into the labour market* (Abdurrahman and Skuerud 2005 and references cited therein). This may be attributed to a number of factors: increased discrimination given the fact that recent immigrants also tend to be visible minorities; changing source countries giving rise to language barriers as well as difficulties in recognizing foreign education, credentials or experience; rising wage inequality whereby immigrants often come in at the bottom of the occupational distribution, unable to move up given the “declining middle”; and deteriorating labour market conditions at the time of entry that lead to a legacy of more permanent negative effects. Such assimilation problems are generally associated with external labour market adjustments; however, they also have implications for internal labour markets in areas such as credential recognition, prior learning assessment recognition (PLAR), literacy training and challenges of diversity management. There is increasing recognition, however, that diversity creates not only challenges but also opportunities especially under globalisation in dealing with diverse suppliers and customers.

Institutional Pressures and the Regulatory Environment

Adjustment pressures affecting both external and internal labour markets have also emanated from changes in the institutional and legal environment. These relate mainly to unionization and to the legislative/ policy environment.

While unionization in Canada has not plummeted as it has in the US, the UK and many other developed economies, it has declined in recent years and unions appear more on the defensive (Riddell and Riddell 2004). This decline in union power has implications for both external and internal labour market adjustments. With respect to external adjustments, since an avowed purpose of unions is to “take wages out of competition” (meaning to protect it from the vicissitudes of market adjustments) this means that labour is more subject to market pressures. Certainly, unions continue to bargain for restrictions in such areas as layoffs, subcontracting and wage concessions, as well as bargaining for the protection of pension benefits, but they are more circumscribed in that bargaining. With respect to internal labour market adjustments, unions

have had to move away somewhat from pattern bargaining, detailed job rules, narrow job classifications and seniority-based pay. In effect, unions are less able to buffer labour from market forces in either the external or internal labour markets of firms.

Governments are also more constrained in their ability to use laws, regulations and policies to buffer labour from the vicissitudes of market adjustments. This is so because under globalisation and free trade, governments increasingly have to compete for business investment and the jobs associated with that investment⁶. Firms have a more credible threat of locating their plants and investments and to outsource to jurisdictions that have less costly regulations and policies. One way for governments to compete is to reduce their laws, regulations and policies that otherwise impose costs on employers. There is pressure to appear “open for business” that can lead to a “race to the bottom”.

To a certain extent this pressure is mitigated by the fact that not all laws and policies impose costs on employers. Many provide the basic infrastructure that facilitates market transactions and adjustments. This can be the case with many active labour market adjustment programs that are designed to facilitate the reallocation of labour from declining to expanding sectors. By providing a safety net they and other programs may also reduce resistance to otherwise efficient market changes. Requirements for advance notice of layoffs can facilitate efficient job search. Workers’ compensation is a quid pro quo whereby no-fault insurance is provided in return for workers giving up the right to sue their employer. Most of the payroll taxes initially imposed on employers are shifted backwards to workers in the form of lower compensating wages for the benefits from the programs financed by the payroll taxes. Health and safety regulations reduce costs associated with accidents as well as the wage premium that has to be paid for workplace risk. While these adjustments imply that the costs of laws, regulations and policies are offset in part by associated benefits for employers, the fact remains that they likely impose net costs. In such circumstances, governments are under increased pressure to reduce their costly initiatives including those associated with adjustment.

Ironically, these pressures on government are coming at the very time that they may be needed most to deal with the adjustment consequences associated with such factors as globalisation and trade liberalisation. In other words, pressures from factors associated with globalization and trade liberalisation are reducing the ability of governments to *supply* adjustment programs just at the time they are increasing the *demand* for government policies to deal with the adjustment consequences.

The issue is especially severe for programs to assist the more disadvantaged and vulnerable workers since they are the most severely affected by the market adjustments. Yet assisting them likely has little positive efficiency feedback effects on firms. As well, the evaluation literature generally suggests that although there is substantial variation across groups,

⁶ See Gunderson (1998) and Gomez and Gunderson (2005) and references cited therein.

the benefits of assisting the disadvantaged seldom exceed the costs⁷; the assistance has to be rationalized on equity rather than efficiency reasons.

IMPLICATIONS FOR EXTERNAL LABOUR MARKET ADJUSTMENT

The previously discussed pressures have a range of implications for adjustment issues in both external labour markets and the internal labour markets of firms. In this section the implications of those pressures for external labour market adjustment issues are discussed with particular attention paid to how they relate to the internal labour market practices of firms. Emphasis is placed not only on the challenges but also the opportunities that result from the different pressures.

The pressures are giving rise to adjustment issues on both the “downside” (layoffs, plant closings, underemployment, involuntary non-standard work, lack of immigrant assimilation) as well as the “upside” (over-employment and work intensification for core workers, labour and skill shortages and the associated structural bottlenecks). This highlights the importance of active labour market adjustment programs (training, mobility, labour market information, job search) to facilitate the reallocation of labour from declining to expanding sectors, in contrast to passive income maintenance programs that encourage the “stay” option. In essence, active labour market adjustment programs have the potential to simultaneously solve *both* the downside and upside adjustment problems.

Facilitating, rather than inhibiting, adjustment in the external labour market ensures that constant “marginal” adjustment are being made by those for whom the costs of adjusting are lowest and/or the benefits highest. They are the persons most likely to engage in job search or move or retire in response to voluntary retirement incentives. For firms, the constant marginal adjustment is likely to occur through such “flow” mechanisms as voluntary attrition (e.g., quits, retirements) as well as reduced new hiring. In contrast, inhibiting such constant marginal adjustment is likely to inevitably lead to large adjustments in the cumulative “stocks” in such forms as mass layoffs and plant closings involving negative effects on the communities as well as the individuals. This involves infra-marginal workers who value their jobs the most and who have fewer feasible alternatives. It also leads to “congestion” effects in the subsequent job search as large numbers are displaced on the local labour market and whole communities are affected. Again, active adjustment assistance policies have the *potential* of facilitating constant marginal adjustments, while passive income maintenance or the bailing out of failing firms discourage such adjustment by encouraging the “stay” option, leading to more costly and socially disruptive adjustments when they eventually occur.

⁷ See Friedlander, Greenberg and Robins (1997), Gunderson (2003a), Heckman, Lalonde and Smith (1999), Heckman, Roselius and Smith (1994), Lalonde (1995), Leigh (1995), Riddell (1991, 1995) and Warburton and Warburton (2002).

The wide array of adjustment pressures also highlights the importance of having generally usable education or training, including literacy training, so as to be able to cope with the uncertainties associated with the adjustments. Acquiring basic foundation skills that provide the base for subsequent lifelong learning is increasingly important given the ever changing nature of the tasks that will be performed and the adjustment issues that will be faced. This is especially the case given the empirical evidence indicating that higher education tends to foster more subsequent training⁸.

Credential recognition especially for foreign trained individuals can be an important policy especially to facilitate the assimilation of immigrants into the labour market. Credential recognition is especially important since it does not involve the costly procedure of human capital formation to *create* new skills; it simply involves the *recognition* of existing skills that are already produced. This can have benefits for all stakeholders: the groups whose skills are being recognized and hence who are better able to assimilate into the labour market; employers who now can fill skill shortages and alleviate the associated bottlenecks without having to engage in costly training; and governments who have increased taxes and reduced social expenditures if assimilation is fostered. As well, the failure to recognize credentials can lead to a drying up of skilled immigration if potential skilled immigrants are reluctant to come because their credentials are not likely to be recognized.

To a certain extent, the various pressures have led to risk-shifting from employers to employees (Gunderson 2003b). This is obvious in various forms of non-standard employment (e.g., part-time work, part-year seasonal work, limited-term contracts, casual work, self-employment, temporary-help agencies, and home work) that are contingent on the work being available. As well, individuals are more exposed to the risk of skill obsolescence, given the importance of skills and the increased human capital they have acquired. Risk may also be enhanced by the bifurcation into core-periphery jobs. The core of “insiders” may be protected from the risk of wage or job loss, but they may be subject to more stress-related risk associated with the increasing work intensification and long hours. This is especially the case when firms downsize the number of jobs but not the amount of work. The “outsiders”, in contrast may be subject to more risk associated with contingent employment. Compensation is also increasingly “at risk” through wage polarization, pay-for-performance, shifts from defined benefit to defined contribution pensions, breakdowns of old pattern bargaining, and the greater pay flexibility associated with many forms of non-standard employment. Some of this risk shifting may reflect the fact that employees now may be better equipped to absorb the risk given the rise of two-earner families, and firms are less able to diversify against the risk given the growing number of small businesses. In contrast, workers may have difficulty diversifying against risk since their “eggs are often in one

⁸ The positive relationship between education and subsequent training is found, for example, in Altonji and Spletzer (1991), Lowenstein and Spletzer (1997, 1998, 1999), Lynch (1992) and Parent (2003).

basket”; that is, their earnings, pension wealth, and the value of their home and social and community capital may be all tied up in their job.

Voluntary activity and community involvement can be a risk diversification strategy to the extent that it builds social capital that can be “cashed in” if labour market risk comes to fruition. Such activity is not likely to provide a sufficient buffer against labour market risk, however, given that assistance is not “guaranteed” and many in the community may be affected in the same fashion.

Managing labour market risk involves four dimensions: predicting, controlling, diversifying and insuring against such risk. Government policies can facilitate *predicting* risk through improved labour market information systems to forecast shortages and surpluses. This can assist perspective employees, employers, educational and training institutions to make decisions with respect to job search, careers, education, training and mobility. Governments can help in *controlling* labour market risk by providing a stable and predictable macro-economic climate that in turn fosters labour market stability. Some would argue that resisting globalisation and trade liberalisation would also reduce the associated risk – but that would likely simply postpone adjustments that would involve more risk when they inevitably occur.

Diversification is generally regarded as the best way to manage risk, but it is extremely difficult for workers to diversify the risk of their human capital investment, although some diversification may be obtained when there are multiple income earners in the family. Investing in training and education that provides generic, broad-based, skills that are generally usable in a variety of ever changing environments and that provide the foundation upon which to build subsequent lifelong learning may be a sensible diversification strategy. Employee ownership of companies (even small ownership through stock options) is not a good diversification strategy since it ties wages, human capital, social capital, home assets, pension and savings to the fate of that organisation – effectively “putting all your eggs in one basket.” Opting for defined contribution plans that result in stock market risk but are not tied to the performance of the employer as are defined benefit plans may also be a diversification strategy even though defined contribution plans are generally regarded as more risky.

It is difficult if not impossible for individual workers to *insure* against labour market risk given the conventional insurance market failures involving adverse selection (those who have private information that they are high risk will buy more insurance) and moral hazard (individuals can influence the probability of the risk coming to fruition). Hence, the rationale for government involvement in a form of mandatory insurance (although they also face moral hazard problems). The moral hazard problem can be dealt with partially by reduced income-replacement or benefit rates so as to ensure against catastrophic risk and preserve incentives and fiscal solvency. Experience rating can also provide a reasonable balance between providing insurance and preserving incentives.

IMPLICATIONS FOR INTERNAL LABOUR MARKET ADJUSTMENT

Various pressures on labour markets also have important implications for adjustments in the workplace and human resource practices within the internal labour markets of firms. These internal adjustments often have implications for the external labour market adjustments that tend to be the focus of policy. The internal labour market adjustments can be complements or substitutes for the external labour market adjustments, and they can often undo the effect of the policy initiatives that are usually directed at the external labour market. This is illustrated here for a number of workplace and human resource practices that have changed in response to the new pressures. They include, job design, training, employee involvement, alternative forms of employee representation and voice, compensation, work-time arrangements, non-standard employment, diversity management and workplace wellbeing programs. Evidence on the existence and impact of internal labour market practices is given in Gunderson (2002).

Job Design

A number of job design features have changed in ways that have important implications for labour adjustment. Broader-based job classifications have become more prominent with job functions being enlarged so that employees are responsible for a wider array of tasks (i.e., multi-tasking). This is often accompanied by job rotation so that employees know the range of tasks that are involved. It is also often accompanied by reduced supervision and employee teams.

The broader-based job classifications, multi-tasking and job rotation should facilitate adjustment within internal labour markets since employees are better equipped to deal with a wider array of tasks; their work is not so dependent upon one function that could be displaced, for example, by technological change. It should also equip them for tasks in other organisations since they have been exposed to a wider array of job requirements, and this should speed any adjustment if they enter the external labour market to search for jobs.

There does not appear to be a role for government policy in this area (i.e., it is the business of business) except to ensure that public training is geared to such multi-tasking, as discussed subsequently.

Training

Multi-skill training is necessary to prepare for the multi-tasking that is required for the broader-based job classifications and job rotation. Basic foundation and communication skills (e.g., literacy) are also increasingly important so that individuals can absorb mentoring and engage in life-long learning; learning how to learn and re-learn is as important as learning specific tasks. “People

skills” and basic literacy and communication skills are also more important given team production and reduced supervision. For employers, credential recognition and Prior Learning Assessment Recognition (PLAR) are increasingly important, especially for immigrants.

The changing nature of training requirements has a number of implications for government policy in this area. Publicly supported training should obviously be geared to such requirements; this is simply a case to gearing your product to current market demands. Immigration policy should also recognize such requirements, and it is doing so now in part by emphasizing more general education and language skills as opposed to narrow occupation-specific skills. Governments can play an important role in facilitating credential recognition, an especially difficult task given that most of the new immigration is coming from countries where we do not have a history of recognizing credentials and education and training systems can be quite different.

Whether a more pro-active government role is required is a difficult question to answer. The answer depends upon whether there is a well-defined market failure that inhibits the private parties themselves from providing the socially optimal amount of training. The fact that we may not have developed an indigenous training culture because we have been able to “import our training” through skilled immigrants is not a market failure; it is simply taking advantage of a market opportunity. In spite of general statements that “Canada does not have a training culture” or that “employers in Canada seem reluctant to train” such well-defined market failures are not easy to establish either in theory or in practice.

In theory, the poaching problem can inhibit employers from providing generally usable training since they risk losing their trainees to other firms who bid them away in which case the firm providing the training “double-pays”; they pay for the training, and they pay a higher competitive wage to keep them. But this simply displaces the question to one of whether there are well-defined market failures that inhibit employees from paying for the generally usable training since they will reap the benefits in the form of higher wages afterwards. Employees may be inhibited from paying for training because of wage compression due to legislative and institutional factors. At the lower end of the wage distributions wage fixing due to, say, minimum wages may inhibit employees from paying for training by accepting a lower wage in return for the training. But minimum wages and even pay equity legislation often have exemptions in the case of training. As well, minimum wage jobs usually do not have a high training component. Wage fixing at the higher end of the pay distribution (e.g., through unions) can also reduce the incentive for workers to train to the extent that they cannot get the wage premium from training. In effect, wage compression can deter trainees from obtaining general training because they are unable to “buy” it by accepting lower wages or “sell” it by obtaining a skilled wage premium. Workers also may be inhibited from paying for training because those who are credit-constrained cannot use their resulting human capital as collateral for a loan; unlike cars or a house, human capital cannot be repossessed since it is embodied in the individual. Workers may also be inhibited from paying for training because of the uncertainty of its payback given changing markets over which they have little control, although this is a normal risk that proper training may protect them from. In theory, it is also difficult to “purchase” a commodity like training when it is difficult to determine how much of it is being

“produced.” This is especially the case for on-the-job training that is often informally provided and very much a joint-product of the normal production process. Nevertheless, some employers are known to provide a good environment to learn and train, and others are not. In such circumstances, employers may be willing to provide such training for its positive effects on commitment, turnover and perhaps the ability to pay lower wages in return for the training environment.

In Canada, Sector Councils can potentially “internalize some of the externalities or spillovers from poaching” by fostering standards, credential recognition and connections with education and training institutions; nevertheless, they cannot solve the poaching problem since that is between firms within the sector. As well, sector councils focus on adjustment and other issues *within* their own sector; however, much adjustment, especially in external labour markets, occurs across sectors, and especially from declining to expanding ones. By way of policy initiatives, encouraging Sector Councils to co-ordinate more across councils (as is the role of the The Alliance of Sector Councils) may facilitate that important aspect of adjustment.

General assertions to the contrary, the empirical evidence (albeit indirect) does not suggest obvious market failures in the training area. Employers appear to pay for a considerable amount of general training⁹, perhaps because their trained employees are often tied to the firm for a variety of reasons. The evidence tends to suggest that minimum wages inhibit training, but the evidence is not conclusive¹⁰. Such evidence, suggests (indirectly) that general training does get provided in spite of potential market failures; whether it is the optimal amount is not clear.

Employee Involvement

Employee involvement has become more common within workplaces. It has occurred in various forms including quality circles, information sharing, employee suggestions, joint committees, and alternative forms of employee representation and voice. It has arisen in part because of other changes including reduced supervision, the greater use of work teams, and the increased emphasis on quality and commitment. As well, with the move away from assembly-line production procedures and Tayloristic narrow job requirements (where workers “checked their brains” when they came in the door), there is growing realisation that employees embody a wealth of knowledge and experience that can be invaluable if tapped into, especially in the knowledge economy.

⁹ Evidence that employers often pay for general training is provided in Acemoglu and Pischke (1998), Lowenstein and Spletzer (1998), Lynch (1992), Parent (1999) and Steedman (1993),

¹⁰ Grossberg and Sicilian (1999), Hashimoto (1982), Leighton and Mincer (1981) and Neumark and Wascher (2001) find that minimum wages deter training although the effects are often small and statistically insignificant. Acemoglu and Pischke (2001) find no effect while Converse et al. (1981) find a positive effect. For Canada Baker (2005) generally finds negative effects of minimum wages on training, but the results are often imprecisely measured and not robust. He concludes that the data is inadequate to provide a true test of the relationship.

There is not an obvious a role for government policy in this area (again, it is the business of business). An exception may be with respect to mandated joint committees in such areas as health and safety. Such committees appear to be working well and there is little pressure to have them eliminated (O'Grady 2000)

Employee Representation and Voice Including Sector Councils

Stronger forms of employee involvement obviously occur in the form of unions and collective bargaining. Unlike many developed countries where unionization has plummeted, unionization in Canada has fallen only slightly and currently is around 30 percent of the workforce that can potentially be unionized.

A comprehensive analysis of the effect of unions on labour market adjustment as it occurs in both external and internal labour markets is beyond the scope of this analysis. Suffice it to say, that unions have impacts that both hinder and facilitate adjustments in both external and internal labour markets.

With respect to external labour markets, unions may hinder such adjustments by creating rigid wages and being reluctant to engage in wage concessions. They may also reduce such adjustments by bargaining for restrictions in such areas as layoffs and subcontracting, compelling firms to do more adjustments within their own internal labour markets while retaining their employees. Such restrictions, however, also become anticipated quasi-fixed costs at the hiring decision, perhaps deterring new hires because they may ultimately involve termination costs.

With respect to internal labour market adjustments through the workplace and human resource practices of firms, unions in the past imposed rigidities in such forms as pattern bargaining, detailed job rules, narrow job classifications and seniority-based pay. As indicated, however, these have dissipated somewhat as unions have focused more on protection from layoffs and on guaranteeing pensions. Union wage premiums have also declined to be more in the neighbourhood of 8 to 10 percent, down from the 15 percent or more in the 1970s and 1980s¹¹, highlighting some flexibility to retain jobs and reduce layoffs to the external labour market adjustment process. Where they exist at workplaces, union co-operation and support can be a crucial ingredient for the success of workplace practices introduced by employers. The same is the case for a range of organisation outcomes such as reduced conflict, turnover, absenteeism, job insecurity and resistance to change as well as improved morale, innovation, productivity, product quality and customer satisfaction (Wager 1997, 1998).

¹¹ Evidence on the declining union wage premium in Canada is given in Fang and Verma (2002) and Gunderson, Hyatt and Riddell (1999).

While unions are a familiar part of the landscape in Canada, what is less well known is that non-union forms of employee representation are also prominent in such forms as professional staff associations and non-union employee-management committees. Taras (2002), for example, estimates that almost 50 percent of the Canadian workforce has some form of formal employee representation, including the slightly over 30 percent represented by unions. In the U.S. such non-union forms of employee representation are generally banned while in Canada there are no prohibitions against groups of employees dealing directly with management if they are not represented by a union (Kaufman and Taras, 2000, Taras 1997, 2002).

In addition, in Canada Sector Councils can also represent the interests of workers in their sector (Gunderson and Sharpe 1998). Currently somewhat over 40 percent of the Canadian workforce is in jobs where a council exists in their sector. The federal government's recently announced Workplace Skills Strategy (WSS) highlighted their importance in meeting the skill needs of the future, especially to deal with the expected labour shortages and the transformation to a knowledge based economy¹². Specific activities that are related to adjustment issues in external and internal labour markets include or involve: school liaison, career information, Prior Learning Assessment Recognition (PLAR), credential recognition, labour market information, immigration, training in such areas as literacy skills and apprenticeship, setting of training standards, spaces and program content in colleges and universities, lifelong learning, multi-skilling, poaching issues in training, "upside" adjustment issues pertaining to vacancies and skill shortages especially related to impending retirements, "downside" adjustment issues pertaining to layoffs and outplacements, and some workplace design issues pertaining to such factors as teams, working time, non-standard employment, employee well-being and diversity management. Clearly, Sector Councils have the *potential* to deal with a wide range of labour adjustment issues occurring in both the external and internal labour markets of firms. Their actual success in this area is not known since they have not yet been systematically evaluated.

Compensation

Actors in labour markets often seem irrational in that risk-averse workers do not appear willing to engage in small wage concessions in the internal labour market in order to reduce the risk of adjustments through the external labour market in such forms as layoffs or plant closings. Adjustments seem to occur in external labour market in the form of quantities (employment) rather than in the internal labour market in the form of prices (wages) even though wage adjustments would seem less costly. The reluctance to engage in small wage concessions, however, may be perfectly rational for a number of reasons (many of which have important policy implications). Layoffs into the external labour market are supported by unemployment insurance, while wage concessions within the internal labour market are obviously not supported. "Insiders," especially if they are median union voters, may be protected from layoffs by seniority so there is little reason why they should engage in wage concessions to save the jobs of others

¹² See <http://www.rhdcc.gc.ca/en/cs/comm/hrsd/news/2004/040316.shtml>

(unless their own jobs are threatened by a mass layoff or plant closing in which case they may be more willing to engage in concessions). If they know the firm is eventually going to be shut down because it is in a declining industry, employees may rationally engage in an end-game strategy (effectively “milking a dead cow”) by refusing to engage in concession bargaining because they know that there is not the threat of new firms entering and displacing the incumbent high-wage, high-cost producers. In a situation of asymmetric information where employers have private information on their true ability to pay, they will always bluff by saying they cannot afford a wage increase in order to elicit wage concessions. To deter such bluffing, employees may rationally compel the employer to absorb negative demand shocks via employment reductions rather than wage reductions since layoffs are also costly to employers while wage reductions are not costly. From a policy perspective, such adjustments suggest that unemployment insurance may encourage layoffs as opposed to wage concessions and that information disclosure on the part of firms may deter “bluffing” and hence layoffs.

Compensation arrangements within the internal labour markets of firms, however, have become more flexible. This has occurred in such forms as pay-for-performance, individual and groups bonuses, team-based pay, greater salary dispersion, breakdowns in pattern bargaining, and the greater use of pension incentives to encourage voluntary early retirements when downsizing was prominent and to encourage delayed retirement if shortages are impending (although the use of the latter remains to be seen).

Such flexible compensation arrangements within the internal labour markets of firms puts more emphasis on adjusting through prices (wages) rather than quantities (employment) and this should reduce the need for quantity adjustments in external labour markets. Of course, this puts compensation more at risk but it is likely that individuals are able to absorb small wage adjustments more than quantity adjustments that involve layoffs and unemployment.

Pension arrangements within the internal labour markets of firms have also adjusted in ways that have reduced the need for external labour market adjustments. When downsizing was prominent in the 1980s and early 1990s early retirement buyouts were commonly used as an internal labour market adjustment to induce voluntary retirements so as to avoid layoffs into the external labour market. This made sense since retirees generally had viable alternatives in retirement activity, especially when they were given generous pension buyouts to afford such activities. Now that the issue is shifting from one of downsizing to one of skill shortages and lack of mentoring and institutional memory associated with the retiring baby-boom population, such early retirement packages have become less prominent (Conference Board 2005). Whether employers will alter the penalties to postponed retirement¹³ that is contained in most occupational pension plans in order to encourage delayed retirement to fill skill shortages is an interesting and open question. Recent survey evidence from the Conference Board of Canada

¹³ Such penalties in Canadian pension plans are documented in Pesando and Gunderson (1988) and Pesando, Gunderson and Hyatt (1992).

(2005, p. 11) indicates that over half (55%) of companies that have a mandatory retirement policy intended to eliminate that policy in the near future. If this happens, they likely will reduce the penalties to postponed retirement that also characterise most defined-benefit pension plans.

Work-time Arrangements

Work-time arrangements within the internal labour markets of firms are also becoming more flexible. This is occurring in such forms as work-sharing (where all employees reduce their workweek to avoid layoffs for some) job-sharing (where two employees share the same job each working part-time), compressed workweeks, flexitime, unpaid leaves, early retirement and possibly moving away from mandatory retirement as discussed. Many of these arrangements have the common element that they reduce the work-time of incumbent employees. This, in turn, can provide job opportunities for others and hence reduce the need for external labour market adjustments in the form of layoffs or spells of unemployment.

Ironically, some government policies often have the unintended effect of discouraging such work-time reductions. This is so, for example, for payroll taxes (UI, CPP, workers' compensation) that have an annual earnings ceiling beyond which the payroll tax is not paid. This has the unintended consequence of encouraging firms to work their existing employees long hours if they are at that ceiling since no further payroll taxes are paid. It discourages them from hiring new employees since they would then have to pay the payroll tax for them, up until the ceiling. Such policies thereby encourage over-employment within the internal labour markets of firms and discourage work-sharing that would otherwise reduce unemployment and underemployment in the external labour market.

Governments have also often tried to reduce overtime within the internal labour markets of firms in the hope that this would create new jobs and hence reduce unemployment and underemployment in the external labour market (Donner 1987). A number of policy instruments exist for reducing overtime: raising the legislated overtime premium; having the premiums apply after fewer hours of work; and regulating the maximum hours of work. The overtime premiums, however, can be "undone" by employers by simply lowering the straight-time portion of the wage so that the new straight-time portion plus the overtime premium yields the same earnings that workers had voluntarily accepted before (Trejo 1991). Lowering the standard workweek after which overtime premiums will apply can also have perverse effects. This is so because such a policy does not increase the marginal cost of additional hours for employees who are already working beyond the maximum – that marginal cost is still their overtime premium. But the marginal cost of hiring a new worker does increase since they will hit the lower standard workweek and hence overtime premium sooner. This can create the unintended consequence of actually having the existing workforce that already works longer hours having to work even longer hours in the internal labour market, and to not hire new workers from the external labour market. Restrictions on the maximum hours that can be worked has a disproportionately adverse on families that have one person work in the labour market, perhaps at long hours, so as to earn the

income of a two-earner family where each works moderate hours but total family hours are high. As well, as indicated previously, long hours of work are often fostered by government policies like the ceilings in payroll taxes. They can also be fostered by government policies that make it more costly to terminate employees since such expected termination costs become factored in as quasi-fixed costs at the hiring decision. This, in turn, can discourage new hires from the external labour market, where such costs would be incurred again, and they can encourage firms to work their existing employees long hours so as to amortize those and other quasi-fixed hiring costs.

Non-Standard Employment

As part of their internal labour market practices employers have increasingly turned to various forms of non-standard employment including part-time work, part-year seasonal work, limited-term contracts, casual work, self-employment, temporary-help agencies and home work. Much of this has occurred to meet the needs of a more heterogeneous workforce, especially associated with various life-course transitions: the school-to-work transition often involving non-standard jobs while in school and to facilitate the transitions to the workforce; transitions in and out of the labour force to balance work-family needs; and bridge jobs as part of the transition to retirement. Much of the increase in non-standard work has also arisen in response to the needs of employers for flexibility. But much of it has also risen as a response by employers to avoid employment protection regulations that are applied with the intention of reducing external labour market adjustments associated with layoffs or terminations. Ironically, legislation that increased the protection to incumbent workers (“insiders”) provides an incentive for employers to shift to more non-standard employment for “outsiders” who were not protected. The international evidence¹⁴ generally confirms that the employment protection legislation fostered not only more non-standard work but also reduced employment overall (especially for youths) as well as more dropping out of the labour force because of little or no new job creation and increased long-term unemployment. Again, policy initiatives designed to protect workers from external labour market adjustments led to internal labour market adjustments (more non-standard work and reduced hiring) that may have worsened the external labour market adjustment as well as fostering a bifurcation into protected “insiders” and unprotected “outsiders”.

Diversity Management and Human Rights

As part of their workplace and human resource practices within their internal labour

¹⁴ Empirical studies and reviews of the effect of employment protection legislation include Addison and Grosso (1996), Addison and Teixeira (2001, 2003), Addison, Teixeira and Grosso (2000), Bentolila and Bertola (1990), Bertola (1990), Bertola and Ichino (1995), Blanchard and Wolfers (2000), Grubb and Wells (1993), Lazear (1990), Nickell (1997), Nickell and Layard (1999) and OECD (1999a, 1999b).

markets, employers engage in issues pertaining to diversity and human rights. This is the case with respect to areas such as employment equity, pay equity, reasonable accommodation of disabled and injured workers and anti-discrimination issues.

This is an area where their practices are not just the “business of business” but rather they are also the business of governments. Most interventions in this area do involve regulating the workplace practices and sanctioning violations. It is also the case, however, that this is an area where adjustments in external labour markets can have an important impact on those workplace practices. In particular, discrimination is smaller in situations where employers are subject to more competition in their product and service markets.¹⁵ In essence, competition puts pressure on employers to abandon discriminatory practices and hire and promote the groups who are paid less but equally productive to others. Discrimination is not “good business” since it implies bypassing opportunities of hiring or promoting the discriminated against groups who are equally productive but paid less. Competition compels them to follow good business practices.

Similar issues apply to diversity issues at the workplace. Diversity is generally regarded as a challenge to manage. Increasingly, under globalisation it is regarded as a competitive advantage since diverse groups can deal with the diversity of suppliers and customers. Diversity is moving from a challenge to an opportunity under global markets.

Ageing Workforce

The ageing workforce is posing both challenges and opportunities within the internal labour markets of firms. As indicated, the impending retirements can lead to skill shortages as well as the loss of mentoring capabilities and institutional memory. But the retired workforce is also a large potential untapped resource that can likely be attracted back into the workforce, especially on a part-time or reduced work-time basis.

One issue that will have to be overcome is the age stereotyping of the declining productivity of older workers. Empirical evidence¹⁶ suggests no clear relationship between productivity and age. Some skills decline with age but older workers often compensate through other inputs such as diligence and experience. Variation in productivity is greater within age groups than across age groups.

¹⁵ Ashenfelter and Hannan (1986), Black and Brainerd (2004), Black and Strahan (2001) Hellerstein, Neumark and Troske (2002) and Meng (2004).

¹⁶ Reviews of the relationship between age and productivity include Hellerstein, Neumark and Troske (1999), Jablonski, Kunze and Rosenblum (1990), Posner (1995, pp. 66-98, 156-201), Richter (1992) and Sterns, Sterns and Hollis (1996).

Workplace Wellbeing Programs

Increasingly, employers are emphasising workplace well-being programs in their internal workplace and human resource practices. They can involve childcare, family-friendly policies like leaves and work-time flexibility as well as employee assistance programs. Their rationale stems in part from such factors as the needs of two-earner families as well as the fact that if employers want commitment from their employees they should also show commitment to them.

Such practices within the internal labour markets of firms can affect adjustment issues in external labour markets. By accommodating work-family balance, they can reduce the need to leave the labour force for family issues (generally childcare, but increasingly eldercare) and to experience unemployment and adjustment problems if one returns. They can be important practices to attract and retain employees

CONCLUDING OBSERVATIONS AND POLICY DISCUSSION

The previous discussion highlighted that adjustment issues in external and internal labour markets are intricately related. Conventionally we focus on how external labour markets affect internal labour markets either negatively (e.g., retirements of baby-boomers from the labour force lead to internal skill shortages) or positively (e.g., influxes of skilled immigrants can alleviate skill shortages). What is less often emphasised is that changes in the workplace and human resource practices within the internal labour markets of firms can also have positive or negative effects on external labour market adjustments. They can have negative effects whereby internal labour markets practices adversely affect external labour markets (e.g., lack of internal wage flexibility leads to layoffs into the external labour market) or positive effects if they reduce the need for external labour market adjustments to occur (e.g., voluntarily abandoning mandatory retirement or reducing the pension penalties to postponed retirement can alleviate skill shortages; broader-based job classifications can facilitate internal reallocations of labour rather than external reallocations through the external labour market).

In part because of our conventional focus on external labour market adjustments, policy initiatives also tend to focus on external labour markets. This is understandable since this is where the manifestations (e.g., unemployment, wage polarization, productivity) are most visible. But the internal labour markets are the level of aggregation where firms and individual (or their representatives) make decisions. And, as indicated, those decisions can positively or negatively affect external labour market adjustments.

Understandably, policy initiatives often shy away from internal labour markets since they are regarded as the “business of business” with governments having no role in those labour

markets just as they have “no business in the bedrooms of the nation.” In many cases, this is important, and governments have to know when to “get out of the way” and when to selectively intervene. All too often, when a social problem is manifest, the response is to intervene and regulate the manifestation of the social problem rather than to deal with the incentives that caused the problem in the first place. A message of this paper is that more policy attention should be paid to the internal labour markets of firms as underlying causes of adjustment problems in external labour markets, as well as of potential solutions to many of those problems.

Importantly, and as a first-step in policy making, more attention needs to be placed on examining the unintended consequences that government policy initiatives may have on internal labour market adjustments. A number of examples were given by way of illustration: regulations on standard employment that fostered a move to non-standard employment; ceilings in payroll taxes that encouraged long-hours of work of incumbent employees and deterred new hiring; protective laws that protected “insiders” but that reduced the hiring of “outsiders”. Negative unintended consequences do not make policy initiatives bad; they simply highlight that such trade-offs must be delineated theoretically, and empirical evidence mustered before sensible evidence-based policy decisions can be made. Recognition and documentation of such unintended barriers created by policy is a first-step.

As well, it is crucial in labour market policy making to recognize that the private parties may respond to the policy initiatives in behavioural ways within their internal labour markets that may effectively “undo” the effect of the policy initiative. In that vein, it is important to have a theoretical understanding of the expected behavioural response of the private parties as well as evidence on those responses.

Government policy making should also focus on well-defined market failures whereby decisions of the private actors, based on the incentives they face, do not lead to socially optimal outcomes. The failures should not be vague like: “We need more training because Canadian employers do not have a training culture.” Rather, the analysis should precisely delineate the theoretical market failures and empirically document their actual importance. The market should be judged as “innocent until proven guilty” and corrective action not taken until guilt is determined. As well, government policy initiatives to correct market failures will have problems of their own: an imperfect market-based solution must be compared to what is likely to be an imperfect government solution, given that governments will face many of the same issues (e.g., moral hazard problems in providing insurance against income loss). Internal labour market decisions are largely the “business of business” unless they have negative externalities on society at large.

Just as it is important not to see negative externalities everywhere, it is also important not to be blind to their existence. A fundamental one, for example, is that a perfectly functioning market will not guarantee an equitable treatment of the most disadvantaged and vulnerable members of society (i.e., it may achieve efficiency but not equity) and in fact the recent market changes like globalization and trade liberalisation have exacerbated their plight. Market failures

to deal with equity issues imply a legitimate role for governments. A less often discussed market failure is that the market may not provide sufficient incentives for firms to *innovate* with respect to their workplace and human resource practices within the internal labour markets of firms (Gunderson 1986, p. 127). This is so because individual firms cannot appropriate the full benefits of successful workplace innovations since they will spill-over to other firms and be quickly emulated. Innovative firms cannot appropriate those positive externalities since innovative workplace practices cannot be patented unlike conventional innovations in product or service markets. All that the innovative firm can do is to get a slight lead on competitors, but this is not sufficient to generate the socially optimal amount of innovation in this area, just as it would not generate that amount for innovations in product markets without patents. Firms have insufficient incentives to innovate in their workplace practices since they bear the full cost of both successful and unsuccessful innovations and yet cannot capture the full returns from the successful ones – the unsuccessful ones of course not being emulated by competitors.

Government policy making must also be aligned and complementary with the internal workplace practices of firms when those practices are regarded as socially desirable and contributing to positive labour market adjustments within the external labour markets. It is well accepted in the human resource management literature that human resource practices within the organisation must be strategically aligned with the overall goals of the organisation for those practices to be accepted and supported by the organisation. The same principle applies to the link between government policies and workplace and human resource practices within the internal labour markets of firms. This is important in a range of areas discussed in the paper: credential recognition; multi-skilled foundation training to meet the multi-tasking needs of broader-based job classifications; and the provision of labour market information to facilitate the matching of workers and jobs. Many government policies are in this direction: active adjustment assistance programs to facilitate the reallocation of labour from declining to expanding sectors; Sector Council support to the private stakeholders; and labour market information systems that “grease the wheels” of market adjustments. The collaboration between HRSDC (responsible for human resource and skills issues) and Industry Canada (responsible for productivity and competitive issues) also highlights the recognition of the importance of human resource and skill development for productivity and competitiveness and hence the importance of aligning government policy to the internal labour markets of firms where behavioural decisions are made that impact productivity and competitiveness.

The overall message of this paper is that more attention needs to be paid to the inter-relationship between the adjustment process of the external labour market and internal labour markets of firms with their workplace and human resource practices. Effective policy making in the labour adjustment realm requires information on all dimensions of this inter-relationship: theoretical knowledge of the underlying causal relationships; empirical evidence on those relationships and how the various actors respond; and appropriate policy responses based on such information. Recognition of this importance is a first-step in the process.

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