



## Reforming Canada's Employment Insurance (EI) Program

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## Introduction

Canada's economy contracted at an annualized rate of 3.7 percent in the final quarter of 2008, marking the start of the recession, the first in 17 years. The downturn intensified in the first quarter of 2009, with real GDP registering a 5.4 percent annualized drop. For 2009 as whole, Canada's economy is expected to shrink about 2.6 percent.

The recession has enveloped virtually every sector of the economy. The slide continues to be more acute in the goods sector, particularly manufacturing. The previously immune service sector, that encompasses about 70 percent of Canada's economy, has also lost momentum but to a lesser extent.

Unlike the early 1990s recession when the contraction in activity was heavily geared to Central Canada's manufacturing base, this time around all provinces are experiencing a downturn in activity. Statistics Canada reported that Newfoundland and Labrador, Ontario, Alberta, British Columbia and the Northwest Territories experienced negative growth in real GDP last year, while New Brunswick posted no growth. For years, Western Canada had achieved impressive economic growth compared to the rest of the country. Now, the disparity in regional economic performance is behind us. All provinces have succumbed to global recessionary forces.

The recession has taken its toll. The unemployment rate hit 8.6 percent in June. Six of Canada's 10 provinces have an unemployment rate higher than the national average – Ontario and Quebec, and the four Atlantic provinces. Over 370,000 jobs (on net) have been lost from the peak level reached last October. Further job losses in the months ahead are expected to push Canada's unemployment rate above nine percent.

Overall, the number of Canadians drawing regular EI benefits in April (the most recent data available) was up 49.6 percent from a year-ago (+39.3 percent since October). Reflecting economic weakness across the country, and despite unemployment rates remaining relatively low west of Ontario, the number of EI beneficiaries jumped 192.4 percent in Alberta, 109.0 percent in British Columbia, 71.2 percent in Saskatchewan and 48.9 percent in Manitoba compared to a year ago. In central Canada, Ontario and Quebec experienced a 73.0 percent and 25.4 percent increase, respectively. Much smaller year-over-year increases were reported in Atlantic Canada.<sup>1</sup>

Of the more than 1.4 million Canadians unemployed in April, 697,030 or 47.6 percent were collecting regular EI benefits. There is considerable regional variation. In Ontario and Alberta only 37.0 percent and 38.2 percent, respectively, of unemployed workers were collecting EI benefits, despite sharply deteriorating labour market condition. In Newfoundland & Labrador and in New Brunswick over 95 percent of unemployed workers were receiving regular benefits.

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<sup>1</sup> Statistics Canada. "Employment Insurance." *The Daily*. June 22, 2009. Data is seasonally adjusted.

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### Number of people receiving regular benefits continues to rise



Source: Statistics Canada, *The Daily*, June 22, 2009.

There is always a certain proportion of the unemployed who do not qualify for EI benefits. These include:

- Individuals that have not contributed to the EI Program because they have not worked in the past 12 months or their employment is not insurable. This group includes self-employed workers. According to TD Economics, about 30 percent of the unemployed fall in this category.<sup>2</sup>
- Individuals who have contributed to the Program but do not meet the eligibility criteria, such as workers who left their job voluntarily. About 15 percent of total unemployed EI contributors fall in this category.
- Individuals who have contributed to the Program but have not accumulated enough hours of work to qualify for benefits. About 10 percent of total unemployed EI contributors are without coverage because of insufficient hours of work, including part-time, seasonal, and stop-and-go temporary workers as well as recent immigrants. The percentage is significantly higher in regions of the country with relatively lower unemployment rates, like Western Canada.
- Individuals who have contributed to the Program, meet the eligibility criteria, but do not collect EI. Less than five percent of total EI contributors fall in this category.

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<sup>2</sup> TD Bank Financial Group. "Is Canada's Employment Insurance Program Adequate?" TD Economics. April 30, 2009.

The issue of under-coverage is expected to gain increased visibility as the unemployment rate rises and layoffs accelerate.

Preliminary data indicate that 314,190 Canadians filed an initial or renewal Employment Insurance claim in April, up 44.1 percent from a year-ago. Regionally, the sharpest rates of increase were in Alberta (+93.9 percent), British Columbia (+55.1 percent), Saskatchewan (+48.2 percent) and Ontario (+45.6 percent).<sup>3</sup>

Jack Mintz, Palmer Chair in Public Policy at the University of Calgary, said: “Today, the Program is under intense criticism for not helping workers enough and being unfair to workers who rarely need the system but pay premiums anyway.” He added that recent measures to increase funding to help unemployed workers and freeze payroll taxes in the face of Canada’s worsening economic performance “are temporary fixes but do not provide an opportunity to rethink unemployment insurance over the next two year.”<sup>4</sup>

The challenge for the federal government is to determine the best way to “equalize a Program that has regional unfairness built into it and reduce the distortions the Program otherwise induces by offering more generous benefits to people who live where jobs are not.”<sup>5</sup>

Ultimately, in the Canadian Chamber’s view, the desired long-term goals of EI reform are to improve the fairness of the system, reduce work disincentives, promote labour force mobility, and ensure Program costs do not create a drag on economic activity and job creation. After all, EI premiums are a form of taxation – as such, they impact hiring decisions, wages and work incentives. The Program must be affordable in good times and bad times.

#### **Box 1: Federal Budget 2009**

- Temporarily (March 1<sup>st</sup>, 2009 to September 11<sup>th</sup>, 2010) increases nationally all regular EI benefit entitlements by five extra weeks, bringing the maximum benefit duration to 50 weeks, at a cost of \$1.15 billion.
- Provides \$500 million over two years to extend EI benefits for long-tenured workers participating in longer-term training, and allows earlier access to EI regular benefits for eligible individuals investing in their own training using all or part of their severance package.
- Provides targeted two-year funding of \$1 billion to expand the availability of training delivered through the EI Program by provinces and territories.
- Extends over the next two years work-sharing agreements by 14 weeks to a maximum of 52 weeks at a cost of \$200 million. The work-sharing element of the EI Program offers EI benefits to qualifying workers willing to work a reduced work-week while their employer experiences a temporary shutdown caused by factors beyond their control.
- Freezes EI premium rates for employees at \$1.73 per \$100 of insurable earnings (\$2.42 for employers) for 2009 and 2010.
- The Canada Employment Insurance Financing Board will be directed not to recover any EI deficits as a result of the two-year \$2.9 billion of enhanced EI benefits and training announced in Budget 2009.

<sup>3</sup> Statistics Canada. “Employment Insurance.” *The Daily*. June 22, 2009. Data is seasonally adjusted.

<sup>4</sup> Mintz, Jack. “Rethinking EI.” *Canadian Business* magazine. February 27, 2009.

<sup>5</sup> Poschmann, Finn. “Stimulus Week, day 4: Two fine fixes.” *Financial Post*. December 18, 2008.

## Improving Equity and Fairness

“Much of the attention has revolved less around the size of benefits themselves and more on what is widely seen to be EI’s number one-failing – the weak coverage of the Program.”<sup>6</sup>

EI is not neutral across Canada. For EI purposes, Canada is divided into 58 ‘economic regions’. The criteria to qualify for EI benefits ranges from 420 to 700 hours of insured work in the previous 52 weeks, and benefits last from 14 to 45 weeks (19 to 50 weeks for a two-year period as announced in Budget 2009) depending on which economic region an individual worker lives. Both entrance requirements and benefit entitlements are adjusted monthly to reflect the latest unemployment rates in these economic regions (see Table 1). Where benefits are less accessible, Canadians who lose their jobs are unfairly treated. When they are more accessible, they discourage labour market adjustment (i.e. upgrading of one’s skills and relocating to where the jobs may be).

As the unemployment rate rises within an EI economic region, an unemployed worker’s ability to obtain higher benefits for a longer duration increases. As a result, the incentive to look elsewhere for employment diminishes. Granted, this is less of an issue during a recession when jobs are difficult to find across the country. The misallocation of labour reduces overall economic output and hampers productivity.

A measure to improve the equity of the EI system that would be consistent with longer-term smart policy aimed at improving labour mobility and flexibility would be to immediately and permanently make the duration of, and access to, benefits the same where the unemployment rate is 10 percent or less. For all other regions the criteria would be unchanged.<sup>7</sup> In two-to-three years, benefits should be gradually trimmed nationwide to foster a more flexible labour market. More specifically, the Canadian Chamber recommends that the Government:

- Ease the variable entrance requirements from the current 560-700 hours to the lower floor of 560 hours in all economic regions with an unemployment rate of 10 percent or less.
- Standardize benefit duration accordingly in all economic regions where the unemployment rate is 10 percent or less – i.e. provide regular benefit payments for a minimum of 25 weeks and a maximum of 49 weeks until September 11<sup>th</sup>, 2010 when the five week extension is scheduled to expire. After this date, the minimum number of weeks payable for regular benefits would fall to 20 and the maximum to 44.

This measure would cost about \$500 million annually (about \$250 million to expand eligibility and another \$250 million to equalize duration). It would have its greatest effect on coverage in Western Canada at a time when the number of EI beneficiaries and initial claims has risen sharply in recent months.

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<sup>6</sup> TD Bank Financial Group. “Is Canada’s Employment Insurance Program Adequate?” TD Economics. April 30, 2009. In June 2009, the Prime Minister and the Leader of the Official Opposition established a working group to develop proposals aimed at improving EI eligibility requirements to ensure regional fairness. The working group will deliver its recommendations by September 28, 2009.

<sup>7</sup> See Robson, William B. P., Alexandre Laurin, and Finn Poschmann. “Lasting Bang for the Stimulus Buck: Priorities for the 2009 Federal Budget.” C. D. Howe Institute. January 8, 2009. Also, TD Bank Financial Group. “Is Canada’s Employment Insurance Program Adequate?” TD Economics. April 30, 2009.

**Table 1: Employment Insurance Program Characteristics  
for the Period of July 12, 2009 to August 8, 2009  
(Selected Economic Regions)**

<b>Economic Region</b>	<b>Unemployment Rate (%)</b>	<b>Number of Insured Hours Required to Qualify for Regular Benefits</b>	<b>Minimum Number of Weeks Payable for Regular Benefits</b>	<b>Maximum Number of Weeks Payable for Regular Benefits</b>
St. John's	7.7	630	22	45
Halifax	6.0	700	19	41
Prince Edward Island	12.6	455	29	50
Fredericton–Moncton–Saint John	6.4	665	20	43
Montreal	9.6	560	25	49
Quebec City	4.7	700	19	41
Central Quebec	8.8	595	23	47
Ottawa	6.4	665	20	43
Toronto	9.6	560	25	49
London	10.4	525	26	50
Windsor	14.5	420	31	50
Northern Ontario	13.3	420	31	50
Winnipeg	4.9	700	19	41
Saskatoon	4.7	700	19	41
Calgary	6.7	665	20	43
Vancouver	7.0	665	20	43
Yukon	25.0	420	37	50
Northwest Territories	25.0	420	37	50
Nunavut	25.0	420	37	50

Source: Human Resources and Social Development Canada.

A number of other measures have been proposed to counter the regional unfairness of the current system.

- Move to a national standard of 420 hours of work in the previous year as the basis for qualifying for EI (i.e. the current minimum in high unemployment economic regions). This measure would cost about \$800 million per year.
- Implement a national eligibility standard of 360 hours (i.e. a much lower floor than the current minimum). This option would cost about \$1 billion per year.

While a national standard would counter the unfairness of the EI system which favours certain regions of the country over others, the low qualification threshold would promote a cycle of reliance and have substantial adverse impact on Canada's labour market over the longer term – it would discourage work, increase structural unemployment, exacerbate skills and labour shortages, and stifle productivity. It would be detrimental to Canada's long-term economic performance. Either of these measures, if implemented, would add significantly to the cost of the Program.

A number of suggestions have also been put forward to directly enhance benefits such as increasing the earnings-replacement rate from 55 percent to 60 percent or 70 percent.<sup>8</sup> This would cost \$1.2 billion and \$3.7 billion per year, respectively. If implemented, it would have the adverse affect of encouraging the use of EI as a regular income supplement rather than insurance for workers who lose their jobs through no fault of their own. It would also negatively affect the incentive for unemployed workers to seek new employment sooner rather than later, and increase costs for employers, reducing the incentive to hire.

Proposals have also been put forward to increase benefits by eliminating the two-week waiting period (i.e. laid-off workers must wait two weeks after filing a claim before receiving benefits). The cost of this proposal is roughly \$1 billion per year. The federal government must take into account the cost of this measure and whether the money can be better utilized to improve the equity of the system. In Budget 2009, the Government opted to extend the period an unemployed worker can qualify for EI benefits by five weeks (up to a maximum of 50 weeks) at a cost of \$1.2 billion over two years.

The Canadian Chamber recognizes that waiting two weeks to file a claim during the recession is particularly difficult for many Canadians, particularly lower-income individuals with inadequate savings to see them through this difficult time. However, from the viewpoint of the federal government – a view the Canadian Chamber shares – the two-week waiting period acts as "a deductible" on an insurance plan (similar to the deductible portion in private insurance as it eliminates very short claims that individuals could cover on their own). The waiting period also allows for verification of claims since it would otherwise be very difficult to verify whether people had really become unemployed or laid-off temporarily. Additionally, the waiting period is in place to exclude workers who have become unemployed but find work within two weeks. Granted, this last point is less of an issue during a recession than it is during an economic expansion. To summarize, the two-week waiting period serves to enhance the efficiency of the EI Program and should be retained over the long-term.

## **The Self-Employed**

As of June 2009, there were almost 2.7 million Canadians who were self-employed. Currently self-employed Canadians do not pay into the EI system and are not eligible for benefits. The only exception is self-employed fishermen.

During the September 2008 federal election campaign, the Conservative Party promised to give self-employed Canadians the chance to voluntarily opt-in to the EI system for at least six months prior to making a claim, to provide access to maternity and parental benefits. The total annual cost of the benefit was estimated at \$147 million based, in part, on the take-up of a self-employed maternity and paternal benefits plan that is already offered in Quebec (which is not voluntary). Exact premium amounts and required payments post-claim would be set upon implementation following review by the Canada Employment Insurance Financing Board.<sup>9</sup>

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<sup>8</sup> Under the current system, EI benefits replace 55 percent of a claimant's average weekly insurable earnings, up to the Maximum Insurable Earnings of \$42,300 (2009).

<sup>9</sup> Conservative Party of Canada. "Extending Maternity and Parental Benefits to Self-Employed Canadians." *Stand Up For Canada*. September 15, 2008.

In June 2009, Prime Minister Stephen Harper and the Leader of the Official Opposition Michael Ignatieff established a working group to develop proposals that will allow self-employed Canadians to participate voluntarily in the EI Program. The working group will deliver its recommendations by September 28, 2009.

The Canadian Federation of Independent Business (CFIB) stated that it has “some serious questions about whether such a plan can work” because the logistics of being able to administer such a program, and being able to understand if somebody has actually laid themselves off.<sup>10</sup>

Self-employed workers are not insurable under the *Employment Insurance Act* for one key reason - “moral hazard” – the problem that arises from the fact that self-employed workers can control whether they accept work or create the conditions necessary for unemployment. Extending EI benefits to the self-employed appears to contradict the original intent of the EI Program – to provide insurance coverage against temporary unemployment through no fault of the individual worker. Program administrators would face the challenge of distinguishing between involuntary and voluntary unemployment among self-employed workers. The moral hazard problem is considered to be less serious in the case of special benefits (like maternity and paternal) since the conditions triggering these benefits provide Program administrators with greater control over access to them.

### **The Rate-Setting Process**

Under existing rules, EI premium levels are set to ensure the EI Program breaks even on a yearly basis, and potential amounts drawn down from the \$2 billion reserve are replenished. This means raising premiums during economic downturns and reducing them in good times.

The recession will place increased financial strains on the EI system. Coupled with Budget 2009 measures to enhance EI benefits and training provided through EI, and freeze premiums for two years (2009 and 2010), the financial position of the EI Account is expected to go into deficit. TD Economics estimates that the EI Account will have incurred \$19 billion in cumulative deficits over 2009-2012. Consequently, the employee premium rate will have to rise from \$1.73 per \$100 of insurable earnings in 2009/2010, to \$1.88 in 2011 and \$2.03 in 2012 (and for employers, from \$2.42 in 2009/10 to \$2.63 in 2011 and \$2.84 in 2012).<sup>11</sup>

The Canadian Chamber recommends that the present rate-setting formula be amended with a view of balancing the EI Account over the business cycle of up to ten years, rather than on an annual basis. This would imply that the estimated \$19 billion deficit could be recouped by maintaining a \$1.95 premium rate for employees (\$2.73 for employers) until 2019.<sup>12</sup> The smoothing of premium increases over the business cycle would provide greater stability and make the costs more palatable for employers and employees.

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<sup>10</sup> Canadian Federation of Independent Business. “EI working group's mandate concerns small business.” *Press Release*. January 17, 2009.

<sup>11</sup> TD Bank Financial Group. “Is Canada’s Employment Insurance Program Adequate?” TD Economics. April 30, 2009.

<sup>12</sup> *Ibid.*

## **Addressing Longer-Term Structural Issues**

### ***Promoting Fairness and Efficiency in the Tax System***

Both the Technical Committee on Business Taxation (1997) and the OECD (2004) have recommended that Canada design and introduce an employer-based experience rating system. Firms that lay off fewer workers would pay lower premiums. It would render the EI system more efficient and more conducive to job creation and stability, thereby, reducing the unemployment rate over the medium term. As it presently stands, without employer-based experience rating, the EI system levies taxes on firms that minimize layoffs (for example, through smoothing of production and the use of work-sharing arrangements) and subsidizes businesses that readily resort to layoffs. By discouraging the use of EI as a recurrent income supplement, an employer-based rating system would contribute significantly to the goals of promoting employment and growth as well as enhancing fairness.

The Canadian Chamber recommends that the federal government gradually phase in an employer-based experience rating system.

Another issue that must be addressed pertains to the higher premium rate paid by employers compared to employees (i.e. employers pay 1.4 times the employee premium rate, or 58.2 percent of EI premiums). This is a significant cost for businesses, particularly small- and medium-sized businesses.<sup>13</sup> The rationale behind this is that employers have greater control over layoff decisions and, therefore, should bear a higher overall share of Program costs. In recent years, however, EI benefits totally unrelated to layoffs (for example, parental leave benefits) have contributed to higher Program costs. There is little justification for requiring employers to pay more for these benefits than employees do. The federal government must gradually reduce the employer EI premium rate to equal that paid by employees.

Lastly, if employee EI premium payments exceed the maximum contribution limit, employees are refunded the difference between what they have paid in any given year and the maximum annual contribution limit when they file their yearly income taxes. Employers, however, are not afforded the same treatment. Even though an employee has contributed the maximum amount in his/her previous job during a given year, the employee's new employer must also contribute on the basis of current employee earnings. While it is difficult to quantify the exact level of over-contributions by employers, the level is certainly in the several hundred million dollar range. Given the fact that EI premiums represent a barrier to job creation, the Canadian Chamber recommends that the federal government immediately devise and implement a system that allows for over-contributions by employers to be refunded.

### ***Improving Accountability and Transparency***

The original goal of the EI Program was to provide insurance against temporary and unintended periods of unemployment. However, over the last three decades, the social-program aspects of the EI Program and expenditures related to job training have grown in importance. In 2008, for example, workers receiving regular EI benefits accounted for

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<sup>13</sup> In fiscal 2008-09, employers paid almost \$10 billion in EI premiums. For this reason, all businesses have a stake in the EI Program, and demand a voice on how it is structured.

about 65 percent of total EI beneficiaries. Individuals receiving sickness, maternity, fishing, work-sharing, adoption, parental, and training-related benefits accounted for about 35 percent.<sup>14</sup>

Because the EI Program has been used to support government spending in a variety of areas completely unrelated to the original purpose of the EI Program, EI premium rates have been kept at unnecessary high levels. In other words, the break-even level (i.e. the EI premium rate that would generate revenue equal to the cost of funding the entire EI Program on a yearly basis) has been artificially raised.

The Canadian Chamber recommends that the federal government facilitate further reductions in EI premium rates by operating the EI Program as a true insurance program – that is, a program that provides income support to those who are temporarily unemployed through no fault of their own and who qualify for the Program. The social-program aspects of EI should be placed within general program spending. Reducing EI premiums for both employers and employees would reduce real wage costs to employers making it more attractive to hire more workers, and increase real wages received by employees. It would put in place incentives to boost productivity.

There has been some progress in removing the social-program aspects of EI from the regular premium structure. In Quebec, effective January 1, 2006, the provincial government began charging for and delivering maternal, parental and adoption benefits under the Québec Parental Insurance Plan (QPIP). The QPIP replaced maternity and parental benefits previously provided under the EI Program for eligible Quebec residents. EI premiums for employers and employees in Quebec were reduced to reflect the fact that Quebec residents no longer receive maternity and parental benefits under EI. The end result has been greater transparency with respect to payroll taxes collected to fund the Province's parental leave Plan and the federal government's EI Program.

## **In Summary**

The EI system is an important "automatic stabilizer" – it results in an automatic increase in payments (that is, without explicit policy action by the Government) – that mitigates the severity of any economic downturn. In Budget 2009, the Government provided additional fiscal stimulus by temporary extending duration of benefits by five weeks and freezing EI premiums. While the Canadian Chamber welcomes these measures, additional steps can be taken to fundamentally restructure Canada's EI system to address short-term issues and longer-term goals – to improve fairness, provide an incentive for firms to reduce layoffs, encourage reemployment, promote labour force mobility, and ensure program costs do not constrain economic activity and job creation.

More specifically, the Canadian Chamber recommends that the federal government:

1. Immediately and permanently make access to benefits equal in economic regions where the unemployment rate is 10 percent or less by easing the eligibility requirements from the current 560-700 hours to the lower floor of 560. Standardize benefit duration accordingly based on the 560-hour criteria. In two-to-three years

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<sup>14</sup> Statistics Canada. "Number of employment insurance beneficiaries by type of income benefit." CANSIM table 276-0001.

gradually begin trimming benefits nationwide. This measure will help improve regional fairness while enhancing work and job creation incentives over the longer-term.

2. Refrain from implementing a national eligibility standard of 360 hours or 420 hours. A low qualification threshold would have a substantial adverse impact on Canada's labour market.
3. Refrain from directly enhancing benefits by increasing the earnings-replacement rate from 55 percent of insurable earnings to 60 or 70 percent. Not only will the related costs put significant pressure on the EI system, but unemployed workers will have less of an incentive to seek new employment sooner rather than later.
4. Refrain from eliminating the two-week waiting period as it serves to enhance the efficiency of the EI Program.
5. Amend the present rate-setting formula with a view of balancing the EI Account over the business cycle of up to ten years, rather than on an annual basis. This will help smooth out increases in premiums benefiting both employers and employees.
6. Gradually phase in an employer-based experience rating system; gradually reduce the employer EI premium rate to equal that paid by employees; and immediately implement a system that allows for over-contributions by employers to be refunded. The goal of these measures is to promote fairness and enhance the efficiency of the tax system.
7. Operate the EI Program as a true insurance program – one that provides income support to those who are temporarily unemployed through no fault of their own and who qualify for the Program. Remove the social-program aspects of EI from the regular premium structure and fund out of general revenue.
8. Assess whether extending EI benefits to the self-employed is sound public policy. It appears to contradict the original intent of the Program because self-employed workers can control whether they accept work, and create the conditions necessary for unemployment.

If implemented in their entirety, the Canadian Chamber's proposals would streamline the EI Program, rejuvenate its insurance role, and reduce overall employment costs. The competitiveness of our nation and that of Canadian business would be enhanced.

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