IS CANADA'S EMPLOYMENT INSURANCE PROGRAM ADEQUATE?

Executive Summary

As debate about how to stimulate the economy intensified in the weeks leading up to the January 2009 federal budget, a number of changes to Canada's Employment Insurance (EI) program were put forward by various groups. In response to these calls, the federal government unveiled almost $3 billion in EI spending measures over two years, with the centerpiece being a 5-week extension of benefits. In addition, the government introduced a temporary freeze on premiums.

While these enhancements were lauded as helpful and positive steps, many observers believe they are inadequate. There have been calls on the federal government to revisit some of the alternative proposals that relate to additional direct increases in EI benefits, such as boosting the replacement rate from the current level of 55% of insurable earnings and eliminating the two-week waiting period. Approximate annual costs for these measures range from $400 million to as high as $4 billion per year.

Still, much of the attention has revolved less around the size of the benefits themselves and more on what is widely seen to be EI's number one-failing – the weak "coverage" of the program. In particular, it is frequently cited that some 60% of unemployed in Canada aren't covered by benefits. Such a striking statistic has, in turn, cast attention on the system's variable entrance requirements (VER), which effectively link qualifying criteria to a region's rate of unemployment. Currently, workers in low unemployment areas require as many as 700 hours in order to qualify – and receive fewer benefits – compared to as few as 420 hours in high unemployment areas.

EI under-coverage often over-stated but still significant

In actuality, this number – which is drawn from a 2007 EI survey – overstates the degree of under-coverage of the system. For one, about 30% were ineligible because they did not contribute to the program (i.e., the long-term unemployed and self-employed). Moreover, another 16% of the unemployed did not qualify due to invalid job loss (i.e., voluntary quits). In fact, about four fifths of those potentially eligible for EI received benefits.

Nonetheless, this still leaves about one in five of those potentially eligible individuals who weren't receiving benefits. Moreover, a majority of these – about 15% of total unemployed EI contributors or at least 50,000 Canadians – have historically remained without coverage because of insufficient hours on the job. As nation-wide unemployment rises and the previously employed are laid-off, this element of under-coverage may well increase. Not surprisingly, rates of under-coverage attributable to inadequate qualifying hours were twice as high, on average, in the relatively low unemployment areas of western and central Canada as in Atlantic Canada.

A flattening in the VER structure urged

The federal government could accomplish the double aim of improving the equity of the system and increasing coverage rates by reducing the regional discrepancy in eligibility criteria and benefit duration. More specifically, we urge the government to immediately ease the VER (and extend benefit duration accordingly) in regions with unemployment rates of less than 10% from the current 560-700 hours to the lower floor of 560 hours. For all other regions, criteria would be unchanged. This measure would cost approximately $500 million per year.

Alternatively, the government could standardize the criteria for all EI contributors at 420 hours, which is the current minimum, or even reduce the bar for all, to 360 hours. Cost estimates for these options are $800 million and $1 billion, respectively.

Our preference for an immediate flattening of the system (rather than standardization) is based on assessment of benefits and costs. One important benefit that flows is increased fairness. The truth of the matter is that during an economic downturn, it is no easier to find a job in a

region with lower prevailing unemployment than in one with a higher unemployment rate. But while such a case is less compelling during periods of expansion, we still believe that such a sizeable discrepancy in the prevailing entrance requirements could be struck down based on the fairness argument. These benefits, however, must be balanced against the undesirable effects of the changes, including increasing long-term EI dependency and the added costs to the program. It is under these two tests in which the standardization option does not perform as well. The federal government could opt to standardize the VER on a temporary basis. However, Canadian governments have a poor track record allowing short-term measures to lapse.

The cost issue of EI program enhancements is a very important consideration. If EI is to remain a self-funding system, which we believe it should, increases in benefit outlays will require either higher premium rates or trimming of other program costs.

Altering the VER criteria

The flattening of the structure is only an intermediate step. Over the longer term, the unemployment rate as the primary benchmark of VER should be looked at due to its significant pitfalls. Most importantly, the unemployment rate is notoriously backward-looking, doesn't capture the direction of unemployment, and ignores the relative number of job vacancies. A new gauge should be considered to which the VER might be linked, such as the seasonally-adjusted change in employment, the job vacancy rate or the rate of employee turnover adjusted for the unemployment rate. These measures would work to better equalize eligibility and benefits on the basis of a worker's probability of employment.

Rate-setting formula

Lastly, the study also recommends changes to EI funding. Indeed, the recent ad-hoc premium freeze announced by the government in January, while laudable, highlights some of the inherent problems with the current framework. In particular, the present rate-setting formula needs to be amended to fund deficits in the EI program over a business cycle (say 7-10 years) rather than in the year for which they are anticipated. The greatest strike against the current requirement of targeting an annual balance is that it introduces a dangerous amount of pro-cyclicality to the system. In addition, we urge the government to consider removing the $2-billion odd in job training measures from EI and place them within general government spending for the primary reason that these expenditures should be open to all members of the labour force.

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