## IS EMPLOYMENT INSURANCE ADEQUATE? TD ECONOMICS

TORONTO -- The sizeable discrepancy of Employment Insurance (EI) eligibility requirements between regions must be addressed, according to a new report by TD Economics (www.td.com/economics). But its authors, Derek Burleton and Grant Bishop, warn that any reform must be balanced against undesirable effects such as the potential for increased dependency on EI and longer-term costs.

Canada's surging unemployment rate has prompted a growing focus on EI reform. An underlying concern relates to the "coverage" of the EI program. This case can be overstated. It is commonly cited that 40 percent of unemployed don't receive EI benefits. However, one quarter of the unemployed didn't contribute to EI. Of those that did contribute, a smaller but still significant share of 15 percent were ineligible due to insufficient hours.

Currently the eligibility for and duration of EI benefits depends on the unemployment rate in the region in which the unemployed worker resides. The number of hours required to qualify for EI – known as the Variable Entrance Requirement (VER) -- increases if the regional unemployment rate is in a lower range. If the regional unemployment rate is above 13 percent, only 420 hours in the last 52 weeks are required to qualify, while 700 hours are required in a region with under 6 percent unemployment.

"As nation-wide unemployment rises and the previously employed are laid off, the under-coverage may well increase and the lowest income workers will be most affected," write Burleton and Bishop. "Moreover, given the tying of benefit duration to the regional unemployment rate, even long-standing EI contributors may exhaust their unemployment benefits before they can obtain a new job."

In the immediate term, the report recommends "flattening" the eligibility structure whereby individuals qualify with 560 hours in all regions with less than 10 percent unemployment. Such a move would represent a cost of $500 million per year to the program. This approach would be more cost effective than proposals to "standardize" eligibility at 360 hours or 420 hours, which would add $1 billion or $800 million respectively in EI outlays. "While government could introduce standardization on a temporary basis, they have a poor track record for allowing short term measures to lapse" states the report.

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*Don’t pin it on the unemployment rate*

During periods of expansion, some regional differentiation in entrance requirements is warranted,given that, in stable times, there are more job opportunities in some areas than others. However, in the longer term, the use of the unemployment rate as the primary benchmark of VER has significant pitfalls and should be looked at.

For instance, the report cites, VER is not necessarily proportional to job prospects in a region. If employment is contracting and firms are not hiring, newly unemployed workers in a region with a current unemployment rate of 7 percent do not have any more access to jobs than do workers in a region with 14 percent unemployment.

As well, during a period of increasing unemployment, tying benefit duration to the unemployment rate at the time of claim creates inequality between workers. For example, consider a worker who is laid off on the 1st of January, after accumulating 700 insurable hours, when the unemployment rate in his region 6.9 percent. He receives 21 weeks of benefits. By February, the unemployment rate has risen to 7.1 percent. The second worker is laid off on the 1st of February, after accumulating 700 insurable hours. She qualifies for 23 weeks of EI benefits.

*The waiting is the costly part*

The TD Economics report also provides a cost analysis of a number of recommendations made by various groups to improve the direct benefits of EI, such as eliminating the two-week waiting period. Presently, a laid-off worker must wait two weeks after filing a claim before benefits commence. From the view of the EI program’s administrators, this waiting period acts as a “deductible”: A potential claimant has an incentive to find a new job since they are initially without income for two weeks.

During normal economic times, it may desirable to exclude such “turnover” from the EI system. However, during a downturn, the proportion of unemployed “in transition” decreases. Rather, the newly unemployed will tend to stay unemployed. With employment presently in rapid contraction, the cost the elimination of the two-week waiting period would be less than during a period of rapid turnover. The authors note that turnover does decrease significantly during economic downturns since fewer unemployed find work within 2 weeks. Even so, elimination of the waiting period would increase EI outlays by approximately $1 billion over each 2009 and 2010.

*Ottawa acts*

In response to EI reform, the federal government recently increased spending measures by $3 billion over the next two years, including a temporarily extension of benefits by five weeks. The report considers Ottawa’s move “a good compromise between putting more money into the pockets of the unemployed in the short term while not over-extending the system in the long term.”

However the authors do identify areas for further improvement. For instance, it calls on the government to remove job training from the EI fold and pay for this from general revenues. Burleton and Bishop write: “Job training should be open to all unemployed and not just those covered by EI and should be funded from an appropriate tax base.”

Another recommendation is to amend the present rate-setting formula to fund EI over a business cycle rather than in the year for which they are anticipated. Substantial deficits will be incurred in the EI account over the next years and a viable business cycle funding framework would also return EI funding to balance over a seven to ten year horizon.

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Derek Burleton
Director of Economic Analysis
TD Economics
416-982-2514

Grant Bishop
Economist
TD Economics
416-982-8063