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e-brief

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EI REFORM: PART II

Back to Basics: Restoring Equity and Efficiency in the EI Program

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- Regionally based entry requirements and benefit durations, which are intended to supplement the income of workers in regions affected by structural unemployment, prolong the persistence of unemployment and reduce economic incentives to adjust to labour-market conditions.
- Reforms aimed at equity are overdue. Regionally based criteria should be replaced by uniform, countrywide, employment insurance entrance requirements and benefit durations.
- To the extent that entry requirements are loosened, it is imperative that the problem of seasonal unemployment not be exacerbated. Linking new benefit criteria to the national unemployment rate would allow program requirements to tighten as the economy recovers.

INDEPENDENT • REASONED • RELEVANT

As the 2009 summer break slowed activity on Parliament Hill, potential reforms to the Employment Insurance (EI) program remained on the political calendar. Recession and rising unemployment had laid the foundations for opposition demands for an immediate and temporary reduction in the number of hours of work required to qualify for EI benefits – to 360 hours – and countrywide application of the standard. Subsequently, a bipartisan "Blue Ribbon" panel set about studying reforms to the current system, in which qualifying times range between 420 and 700 hours of work and benefit durations vary widely depending on the regional unemployment rate.[1] EI reform has become a hot button issue on the Hill and across Canada.

In this *e-brief*, we argue that, indeed, reforms aimed at equity for all unemployed Canadians are overdue. And the direction for reform is simple: equalize terms of access across regions, and similarly equalize benefit generosity nationwide (Robson et al., 2009). Specifically, we propose to equalize both the eligibility for, and duration of, benefits near the mid-points of the current program's scales, which are 560 hours to qualify and between 22 to 45 weeks of benefits,[2] with a longer work record resulting in a longer duration.

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1 One notable exception to the sliding hourly qualification levels currently exists for first-time entrants to the workforce, and workers re-entering the labour force after a period of two years. Such individuals must accumulate a minimum of 910 hours in any region. Yet special pilot regions – of which there are 25 at present, typically with double-digit unemployment rates – have relaxed EI entrance requirements for labour-force entrants by 70 hours to 840 hours.

2 Not including 2009 budget temporary five-week extension.

The objective behind these reforms is to make the system fairer while reducing barriers to labour mobility between low and high unemployment regions. Enhancing such mobility is a vital piece of the puzzle. To the extent that entry requirements are loosened, it is imperative that this does not exacerbate seasonal patterns of employment and unemployment in certain regions.

The Background: Adding Regional Benefits to Insurance Principles

Currently, EI benefit eligibility and duration vary according to the unemployment rate in each of Canada's 58 EI regions (see Appendix Table A1).[3] The higher the regional unemployment rate, the easier it is to access the program and the longer the benefit periods; correspondingly, the lower the regional unemployment rate, the harder it is to access the program, and the shorter the benefit periods.

Defining eligibility and benefit duration on the basis of regional unemployment rates has been a feature of the EI program only since the 1970s. From the program's outset in 1940, Unemployment Insurance (UI), as it was then called, was intended to cover the risks of income loss from normal – frictional and cyclical – unemployment, and applied only to people covered under employment contracts. People employed for fewer than 20 weeks a year, say in seasonal jobs, typically were not eligible for benefits, and their employers did not pay premiums on their behalves.

The social reform movement of the 1960s persuaded the Trudeau government to dramatically expand the program in 1971, by way of sweeping legislative change that introduced broader social support measures. Access was set at eight weeks for all, and the initial phases of benefit entitlement were generous and equal. Extended weeks of benefits, however, were based on the length of a claimant's previous employment, the national unemployment rate and the regional unemployment rate.

Regionally extended benefits were introduced on the grounds that the additional costs related to the presence of structural unemployment in some regions should be shared with other regions and taken on by the government (HRDC 1994). At the time, a sizable portion of EI funding came from the federal government's general revenues, not from employee and employer contributions.[4] Therefore, regionally extended benefits were originally akin to income support, financed through general revenues, on the belief that employment might be more difficult to find in a region where unemployment is high.

Problems with Regionally Extended Benefits

EI has since undergone numerous reforms, and despite the fact that the program is now entirely financed by employer and employee contributions, benefits are still linked to regional unemployment (Box 1) mainly on the basis that more generous benefits are needed in regions where employment is presumably harder to find. Some also maintain that the responsiveness of the EI program to cyclical downturns is improved when benefits are linked to macroeconomic conditions, augmenting the program's ability to perform its automatic stabilization function (Osberg 2009). However, regionally extended benefits tied to local job market conditions hardly contribute to automatic stabilization; in fact, they help to perpetuate seasonal and structural unemployment, and thereby cannot be regarded as fiscally stimulative.

Regionally extended benefits depend on one factor: the regional unemployment rate. However, the unemployment rate of a region is a poor indicator of job prospects. For instance:

3 Regional unemployment rates can also affect the calculation of EI benefit levels – the average weekly level of insured earnings – through the program's minimum divisor rule. This rule stipulates that total earnings of individuals over the last 26 weeks are divided by the greater of: i) the number of weeks worked in the last 26 weeks; or ii) the minimum divisor number. The minimum divisor ranges from a high of 22 in low unemployment regions to a low of 14 in high unemployment regions. Also, a "best 14 weeks" rule exists in pilot regions permitting claimants to choose the 14 weeks of earnings that count toward benefit calculations.

4 See Busby and Laurin (2009) for a more complete history on EI financing.

Box 1: A Brief History of Regionally Extended Benefits

Regionally linked benefit criteria, both duration and access, can be broadly broken up into three major timeframes: 1977-1990; 1990-1996; and, 1996-present.

Access requirements were first introduced into the UI program in 1977, based on 16 UI regions, and then regional maps were redrawn to create 48 regions in 1978, 62 in 1990, 54 in 1996 and 58 in 2000.

Originally, access criteria ranged from 10 to 14 weeks of insurable employment depending on regional unemployment rates. In 1990, entrance requirements ranged from 10 to 20 weeks and in 1994 the bottom qualification threshold increased from 10 to 12 weeks. In 1996, reforms made hours worked – not weeks worked – the unit of account for the renamed EI program. EI entrance requirements now range from 420 to 700 hours worked in the last 52 weeks.

In the beginning, benefit durations increased by two weeks for every half percentage point over a 4 percent benchmark unemployment rate, up to a maximum of 32 weeks of extra benefits. Later, in 1990, the minimum and maximum duration of benefits was tied to regional unemployment rates and hours worked in the qualification period (52 weeks prior to claim), and ranged from 39 to 50 weeks in high unemployment regions, and 17 to 35 weeks in low unemployment regions. EI benefit duration now fluctuates between 32 to 45 weeks in high unemployment regions, and 14 to 36 weeks in low unemployment regions. In Budget 2009, benefits were temporarily extended an extra five weeks in each region for a period of two years.

- The unemployment rate is a lagging indicator of economic conditions. At the onset of a recession, employment prospects can seriously deteriorate before new labour market conditions are reflected in the unemployment rate. Ironically, those first caught up in the wave of lay-offs responsible for the rise of unemployment will likely not benefit from regional adjustments.[5]
- In regions where discouraged workers leave the workforce, the unemployment rate, through a low aggregate participation rate, can significantly understate employment struggles.
- Demographic factors can arbitrarily depress unemployment rates over time. This is especially true in regions composed of a large proportion of workers aged 40 to 50 since these workers are associated with low unemployment levels.
- Finally, local unemployment rates are dependent upon rather arbitrarily drawn EI regions.[6] We sometimes see cities located in the same EI region but with distinct industrial and employment makeup, and distinct job prospects.

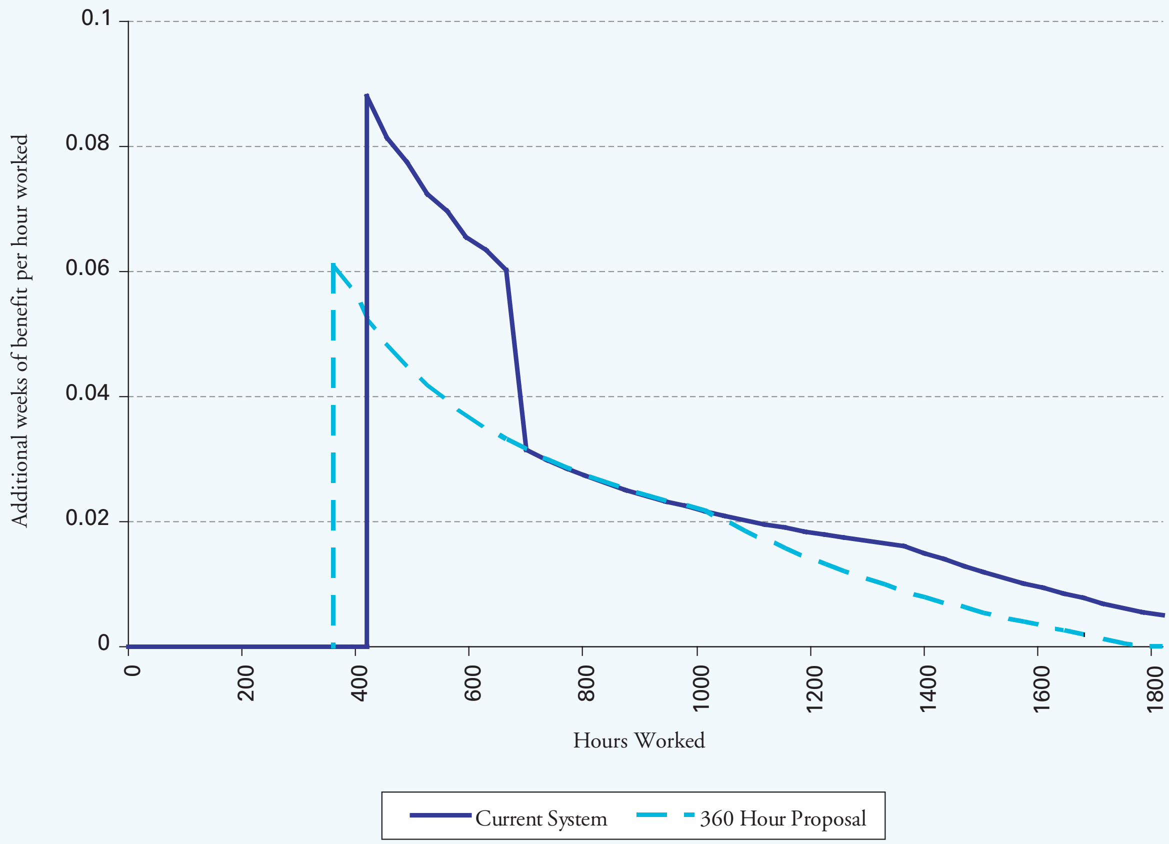
Therefore, where benefits are less generous and less accessible, Canadians who lose their jobs are treated unfairly. This is especially true in the current recessionary environment, when one may argue that job prospects are depressed in almost every region of the country.

What is further troubling about regionally extended benefits is the persistence of regional variations in unemployment rates. While the national unemployment rate decreased over the 1990s, dispersion among regions has increased and persistent pockets of unemployment remain (Busby 2008).

5 See Bishop and Burleton (2009) for a lengthy discussion of the unemployment rate as a poor labour market indicator, as well as other, potentially more useful indicators, such as the employment rate.

6 Though subsection 18(2) of the Employment Insurance Regulations requires EI regional boundaries be reviewed every five years to ensure that they reflect current labour market conditions and geographic representation of communities across Canada, such terms are not clearly defined. Map redraws inevitably lead to lower benefits for some workers. When this happens, political pressure can arise for so-called transitional measures, which can last a long time. Such measures were put in place for Bas-St-Laurent-Cote Nord and Madawaska-Charlotte regions after 2000 redraws and remain in place today. Thus, boundaries are sometimes not redrawn because of political interference, and as a result more generous benefits are spread over all constituents in a region.

Figure 1: Longer-Lasting Benefits in High-Unemployment Regions, Even with Equal Entrance Requirements*



*Additional weeks of benefit entitlements per hour worked obtained by residing in a high unemployment rate region as opposed to low unemployment rate region: current system compared to a uniform 360-hour entrance requirement.

Source: Authors' calculations; de Raff et al. (2004).

Regionally extended benefits provide incentives that work against labour mobility among high and low unemployment regions, and may in fact help sustain the persistence of unemployment in affected regions (Forget Commission 1986).[7] The implication is that regionally differentiated income support contributes to a vicious circle of subsidized seasonal employment patterns and is the source of most EI inequities. One resolution is to take regional differentiation out of the EI program, with social supports instead to be made available through other types of targeted income transfers, financed through general revenues.

How to Fix It

Restoring regional equity and improving economic efficiency could be achieved by making the duration of and access to benefits equal across all regions, i.e., removing the regional component of benefit provision. Figure 1 demonstrates why both regional elements are important. Lowering regionally linked entrance requirements – by adopting, for example, a uniform 360-hour standard – without equalizing benefit durations across regions would continue to provide regional supports, leave

7 See Kuhn and Riddell (2006) for an empirical demonstration of EI induced seasonal unemployment patterns via a comparison of geographic regions in New Brunswick with similar regions in Maine.

incentives to work in short-term jobs, maintain unfairness, and act largely to enrich the current system. Further, a low hourly entrance requirement would raise incentives to structure labour arrangements around EI access requirements. In other words, both parties – firms and workers – tend to adjust start and end dates of employment with the EI system (Corak and Chen 2003).

One option would be to set benefit durations at levels that currently apply to an 11 percent unemployment rate, which falls exactly in the middle of current bounds. Entrance requirements could be equalized at perhaps 560 hours, which again falls right in the middle of the current scale.

These changes would dramatically simplify EI rules, perhaps making it a little harder for employers and employees to take advantage of an otherwise intricate system.[8] At the outset of reforms, some laid-off workers in low unemployment regions would gain in terms of access and benefit generosity, while others in high unemployment regions would lose (Appendix Table A1). Over time, when the national labour market improves, the entrance threshold and duration periods should tighten to avoid generating more seasonal work in some regions. This could be accomplished by linking benefit requirements to the national unemployment rate, which would further add a macro countercyclical element to the program (Appendix Table A2).

How Much Would it Cost to Eliminate Regionally Extended Benefits?

We estimate that our proposal would have cost about $475 million more in 2008, or less than 5 percent of regular benefits paid out.[9] But this cost is a static estimate; the true costs of this reform will not be immediately known, but would become clear over time as key agents respond. It is the authors' opinion that over the long run, the fiscal costs of this reform should be close to nil because more generous benefits in some regions should be offset by falling costs of seasonal claimants in others.

We have previously argued for a new EI financing framework where EI contribution rates would be kept relatively stable over the business cycle, and with EI contributions exclusively dedicated for EI purposes (Busby and Laurin 2009). Ultimately, it would be up to the Chief Actuary to evaluate whether our proposal would be affordable at the current premium rate.[10]

Conclusion

Today's EI program is built around a multitude of policy goals. Regional income support objectives are blended into the regular benefit program, significantly weakening the program's ability to perform its original function: insurance against involuntary, temporary and unanticipated loss of income.

Adopting uniform entrance requirements and uniform benefit durations would eliminate the unfairness inherent in the provision of benefits based on regional unemployment rates. Reforms must also not encourage the further development of seasonal employment patterns that tend to couple with EI benefits. Modulating the new, universal benefit standards with the national unemployment rate should help remedy this problem.

Regionally extended benefits, intended to supplement the income of workers in regions affected by structural unemployment, reinforce the persistence of unemployment and reduce economic incentives to adjust to labour-market conditions. They should be left outside of the EI program, and dealt with by other means, such as federal or provincial transfers funded by general revenue.

8 See de Raff et al. (2004) for more on how frequent claimants best take advantage of EI system design.

9 Estimated using Statistics Canada's Social Policy and Simulation Database and Model (SPSD/M) and our own estimate of the labour force in each EI region for 2008.

10 One should note that under the current financing framework, the EI total premium rate is, without additional reforms, projected to increase by 1.80 percentage points over the next six years (Busby and Laurin 2009).

Appendix

Table A1: Regionally Linked EI Program Criteria, Not Including Temporary Five-Week Extension(1)

Regional Unemployment Rate	Hours Needed to Qualify(2)	Minimum Weeks Payable	Maximum Weeks Payable	Minimum Divisor(3)
0% to 6%	700	14	36	22
6.1% to 7%	665	15	38	21
7.1% to 8%	630	17	40	20
8.1% to 9%	595	18	42	19
9.1% to 10%	560	20	44	18
10.1% to 11%	525	21	45	17
11.1% to 12%	490	23	45	16
12.1% to 13%	455	24	45	15
13.1% to 14%	420	26	45	14
14.1% to 15%	420	28	45	14
15.1% to 16%	420	30	45	14
16.1% and up	420	32	45	14
Our Proposal(4)	560	22	45	17

Notes:

(1) The 2009 federal budget temporarily extended benefit durations by 5 additional weeks for a period of two years.

(2) Qualifying period is the 52 weeks prior to EI claim. Weeks of benefits payable fluctuate depending on insurable hours worked.

(3) The minimum divisor is used to calculate the average weekly insured earnings. Total earnings in the last 26 weeks are divided by the greater of: a) the number of weeks you have worked in the last 26 weeks; or b) the minimum divisor number.

(4) Our proposal for uniform entrance requirements and benefit durations could be extended by linking EI program's criteria to the national unemployment rate, which was 8.3 percent at the time of writing – see Appendix Table A2 for a stylized example.

Table A2: A Stylized Example of Nationally Linked EI Program Criteria

National Unemployment Rate	Hours Needed to Qualify	Minimum Weeks Payable	Maximum Weeks Payable	Minimum Divisor
0% to 6%	700	14	36	22
6.1% to 7%	700	15	38	22
7.1% to 8%	630	18	42	20
8.1% to 9%	560	22	45	17
9.1% to 10%	525	22	45	16
10.1% and up	525	22	45	15

Note: This example is shown for illustrative purposes only. Calibrating program criteria correctly would require more elaborate work than the scope of this study permits.

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