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# THE ISSUES FACING CANADA'S EMPLOYMENT INSURANCE PROGRAM


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# Executive Summary

Is Canada's employment insurance (EI) program designed to ensure fairness, economic efficiency, and financial viability while providing adequate support to all Canadians who involuntarily lose their jobs? The purpose of this paper is to explore this question and to identify some of the primary problems inherent in the design of employment insurance.

Although EI is a federally administered program, eligibility and the duration of benefits differ based on the region in which an individual resides. Canadians in regions of high unemployment receive benefits for longer and have easier access to employment insurance than those living in regions where unemployment is lower. As a result, some Canadians are required to work more hours to qualify for the same benefits as Canadians in other areas of the country. Regionally extended benefits create inequities and distort the national labour market, thereby harming economic prosperity.

Specifically, disincentives to work inherent in the design of EI have sustained high unemployment rates in Atlantic Canada. The current design encourages workers in Atlantic Canada to remain unemployed for an extended period of time because benefits are available for longer than in other regions. The result is longer durations of unemployment and more frequent claims. This reliance on EI has harmed prosperity in the Atlantic provinces.

Changing dynamics in the labour force and the rise of the "gig economy" indicate that more Canadians are pursuing part-time work or self-employment. Although part-timers are eligible to receive EI, their eligibility rate is much lower than that of those working full time, since everyone is required to work a minimum number of hours in the prior 12 months to qualify for benefits. Moreover, self-employed individuals are not eligible to receive regular EI benefits and are left without any temporary income support if, for instance, their business fails. Hence, a significant proportion of the Canadian workforce is not eligible to receive EI regular benefits because they are either self-employed or work part-time. Since this is the case, the EI program is failing to achieve its objective of providing temporary income support to all individuals who face losses as a consequence of involuntary unemployment.

Recent unemployment data and the experience of past recessions suggest that EI is also likely to face financial strain. Higher unemployment means that fewer workers are making EI contributions and premium revenues will fall. Benefit payouts will rise as a consequence of the increase in unemployed workers, it will be easier to qualify for EI, and workers will be eligible for a longer duration of payments. The resulting deficits in the

EI operating account will place additional pressure on federal finances as general taxes may need to cover the EI deficit. This means the federal government will likely need to raise premium rates going forward, but doing so could have serious adverse effects on overall employment and economic growth.

Nearly one third of EI program expenditures are allocated to EI special benefits. Since these benefits are funded through EI premium revenues, this means premium rates are higher than they would be if the program offered only regular benefits. As COVID-19 will place increased financial strain on regular EI benefits, continuing to pay EI special benefits through EI premiums will add to the economic burden of funding the EI system.

Identifying solutions to make the EI system more efficient and less costly to maintain will be the focus of a future study. Nevertheless, this publication points out that employment insurance is a flawed federal program that is in serious need of reform. The current design of EI creates regional disparities, distorts labour markets, provides inadequate coverage for part-time workers and the self-employed, and will impose a financial burden on Canadians for years to come. Federal policymakers should consider the harmful unintended incentives of EI and pursue an overhaul of the program.

# Introduction

There has been renewed discussion about the need to redesign Canada's Employment Insurance (EI) program following recent changes made by the federal government to provide temporary income support during the COVID-19 crisis for individuals through the Canada Emergency Response Benefit (CERB). Prior to the pandemic, a number of Canadian economists had identified and discussed problems in the design of employment insurance but the issues raised were rarely acted upon by federal politicians (Mahboubi, 2019; Hatherly, 2017; Gunderson, 2011). However, the financial burdens on both the private and public sectors associated with the pandemic have renewed concerns about the program's design, including the financial viability of the program in the coming years.

The ultimate rationale for providing employment insurance through a public system is to provide temporary income support to individuals who have involuntarily lost their jobs (Fredriksson and Holmland, 2003). To our knowledge, all unemployment insurance systems are publicly funded and it is beyond the scope of this essay to address the arguments for and against using private insurance (including self-insurance) as the sole or primary mechanism to satisfy this rationale.[1] Suffice it to say that problems related to asymmetric information and moral hazard are relevant to all insurance schemes.[2]

At the same time, it is recognized that the goal of smoothing consumption must be balanced against concerns about limiting incentives to work and creating other labour market distortions (Tatsiramos and van Ours, 2012). In this regard, EI in Canada has often faced criticism because it distorts labour-market decisions and sustains high unemployment rates, thereby harming economic prosperity. It also has been charged with creating an inequitable system that rewards or punishes Canadians based on their region of residence. Changing dynamics in the workforce, particularly the emergence of the "gig economy", are also presenting problems, as EI lacks appropriate measures to support the rise in part-time and self-employed workers (Busby and Muthukumaran, 2016). Further, the pandemic will place financial strain on EI as a consequence of the likely persistence of unemployment claims and associated prolonged periods of unemployment across the country. Simply put, EI will be an increasingly expensive program for the economy to support as it is currently constructed.

1. For a discussion of the issues surrounding private versus public social insurance programs, see O'Leary and Wandner, 2018; Kesselman, 1996; and Rappaport, 1992.
2. In this context, asymmetric information refers to the condition whereby the insured know more about the risks of their becoming unemployed than the insurer, while moral hazard references the incentives that the insured have to risk their employment by shirking on the job, and, if fired, to look for employment less assiduously once they are covered by insurance.

This report aims to identify and discuss several of the problems inherent in the design of Canada's Employment Insurance (EI) program and provides context for some reform options. Solving these issues will act as a critical step forward for Canada as we recover from the COVID-19 crisis, and ensure our income-support system is properly designed to optimize economic incentives and fairness, while helping those who need it. Specific proposals for reforming Canada's EI system will be put forward in a subsequent essay.

## What Is Employment Insurance?

Employment Insurance (EI) is a program offering financial assistance to individuals who involuntarily lose their jobs and are currently looking for work (DOESD, 2020a). There are a few key eligibility requirements that individuals must meet before receiving any income support. For instance, Canadians are not eligible to receive EI if they quit their job or were fired for misconduct. Benefits are also only available to people who have made EI contributions during a specified qualifying period. The recipient is required to have worked a minimum number of hours, typically within a 52-week period prior to receiving EI benefits (DOESD, 2020a). There is also no age limit for collecting benefits as long as the claimant meets these conditions.

Although EI is a federally administered program, eligibility and the duration of benefits differ based on the province and region in which an individual lives. The country is separated into 62 unique EI regions predicated on local unemployment rates (McMahon, 2020).[3] Duration of benefits and the minimum number of hours individuals must work to receive benefits varies significantly from region to region. The program stipulates that people living in regions with higher unemployment rates are required to work fewer hours to receive EI than people living in a region with lower unemployment (Busby, Laurin, and Gray, 2009). Moreover, Canadians in regions with high unemployment are eligible to receive EI for longer durations than those living elsewhere (McMahon, 2020).

The scale of the EI program has expanded over time to provide coverage for things beyond regular EI benefits such as sickness benefits, maternity and parental benefits,

3. Regional unemployment rates are re-calculated each month for EI purposes, but they are calculated based on a seasonally adjusted 3-month moving average.

fishing benefits, and compassionate care. These categories are classified as special benefits (DOESD, 2018). Parental benefits are offered to people who are pregnant, have recently given birth, or caring for a newborn or adopted child. Sickness benefits provide support to those who cannot work as a result of illness, injury, or other medical conditions. EI fishing benefits are given to qualifying self-employed fishers who are looking for work. Finally, compassionate care benefits are provided to people who are caring for someone who is critically ill.

## How Is EI funded and How Much Can Beneficiaries Receive?

Employment insurance is funded through mandatory contributions made by both employees and employers. The federal government establishes the EI premium rate—the percentage of income contributed to EI—each year and assesses payroll taxes to finance benefits. However, employees pay a lower EI premium than employers. EI premiums for employees in 2020 are set at $1.58 for every $100 of insured earnings, whereas the premium for employers equals $2.21 per $100 of insured earnings (CRA, 2020). This means that employers pay 1.4 times the employee premium rate.[4]

It should be noted that some portion of the tax imposed on employers is passed through to employees in the form of lower wages and/or benefits. This is because the tax imposed on employers to pay for their employees' EI coverage reduces employers' demand for labour. Simply put, the employers' portion of the payroll tax makes employees more expensive. Hence, for-profit or budget-constrained organizations will reduce the quantity of labour they employ. The resulting loss in output is part of the cost of the EI system to the Canadian economy, even holding other potential concerns with the system constant. While there is substantial uncertainty about what portion of the employers' tax is passed through to employees, one review of over 50 empirical studies concludes that workers may bear up to two-thirds of the total EI premiums charged in North American and European countries (Melguzo and Gonzalez-Paramo, 2017).

The supply of labour might also be affected by the EI premiums Canadian workers are required to pay both by law and by any indirect pass-through from the employer's EI

4. See Ebrahimi and Vaillancourt, 2016 for more information.

payroll tax. At the margin, some people might drop out of the labour force when their after-tax income drops below a critical level. These are likely to be people who can and are willing to work in a self-employed capacity and/or able to work in the "grey market". We know of no studies that report reliable estimates of this phenomenon. For this reason, we simply acknowledge the possibility of another channel by which higher EI premiums might reduce employment. At the same time, it must also be acknowledged that insurance against unanticipated losses of income makes it more attractive to participate in the labour market. In short, the actual incidence of EI premiums, that is, who pays what portion, as well as the direct consequence of the payroll tax on overall employment is uncertain. However, as is the case with payroll taxes generally, the likely effect of higher EI premiums is less employment than would otherwise be the case.

Since 2016, the Canada Employment Insurance Commission (CEIC) has been responsible for establishing the annual EI premium rate based on a seven-year break-even mechanism (DOESD, 2020h). This means the annual premium rates are estimated to generate enough revenues to cover expenditures over the next seven years and eliminate any existing surplus or deficit in the EI operating account. Changes to the premium rate are also legislated to increase by a maximum of only 5¢ annually per $100 of insurable earnings (DOESD, 2020h).

EI premiums are paid into the Consolidated Revenue Fund (CRF) and the benefits are paid out of it. On an accounting basis, EI program expenses are charged to the CRF and EI premium revenues are credited to it (Leonard, 2014). However, any surplus in the EI operating account is treated as general tax revenue. This means an operating surplus increases the federal government's budgetary balance even though the money is earmarked for EI purposes rather than general program spending. Similarly, a deficit shrinks the balance.

In 2020, Canadians eligible for EI receive a weekly payment equivalent to 55% of their average insurable earnings up to a maximum of $54,200 for the year (CRA, 2020).[5] Put differently, claimants can receive a maximum benefit of $573 per week. There is usually a one-week waiting period before benefits are paid out and EI benefits can last between 14 and 45 weeks depending on the region and minimum insurable hours worked.[6]

5. EI benefits are taxable in Canada.

6. The federal government recently waived the standard one-week waiting period before benefits kick in for new recipients who are quarantined as a result of COVID-19.

# Job Training and Reasonable Job-Search Efforts

Opportunities for job training are offered to EI beneficiaries to help them obtain the skills necessary to find new employment. Provincial governments are responsible for delivering EI training programs, but these services are largely funded from EI premium revenues that the federal government transfers to the provinces through the Labour Market Development Agreements (LMDAs) (DOESD, 2020f). The federal government provides over $2 billion annually to the provinces and territories to help fund skills training and employment assistance (DOESD, 2020f).

EI beneficiaries are allowed to take job training on their own but must declare it and provide proof that they are simultaneously searching for work. Additional criteria also specify that individuals cannot have received more than 36 weeks of EI regular benefits (or fishing benefits) in the last five years or paid less than 30% of the maximum annual EI premium in seven of the last ten years if they wish to receive benefits while enrolling in training (DOESD, 2020c). Claimants are permitted to continue receiving benefits once training has finished if they have not yet used all of their entitled weeks of benefits. However, if training lasts for a longer length of time than the number of weeks of benefits a recipient is entitled to, the recipient is not offered additional weeks of benefits to support the full duration of training (DOESD, 2020c).

While receiving benefits, EI claimants are required to conduct reasonable job searches every day and accept any offers of suitable employment (DOESD, 2020g). Reasonable job-search activities include registering with employment agencies, attending job fairs, networking, submitting job applications, contacting prospective employers, and attending interviews.[7] However, requirements change based on local employment conditions. In regions of high unemployment, claimants are only required to network with members of their community, search for employment in the newspaper or internet, and apply for any suitable employment opportunities (DOESD, 2020g).

The government's broad definition of suitable employment stipulates that claimants are obligated to look for job opportunities where they live or normally work. This means you

7. EI recipients must document their job-search efforts for the entire duration of their claim. They are required to record information such as dates, the type of work looked for, and the name and contact information of employers contacted.

do not have to move elsewhere to pursue job opportunities. In fact, job opportunities are only considered suitable employment if the office or worksite is within an acceptable commuting time, which is determined based on the average commuting time in your region of residence (DOESD, 2020g). Further, job opportunities are not considered suitable employment for several other reasons, including if the nature of work conflicts with your moral or religious beliefs, the work hours are not well suited to family obligations, or the wage is lower than current EI benefits (DOESD, 2020g).

## EI Creates Regional Inequity

Currently, the EI program is designed to allocate benefits according to the unemployment rate across regions. Canadians in high unemployment regions receive benefits for longer and have easier access to employment insurance than those living in lower unemployment regions (Busby, 2008). As a result, some Canadians are required to work more hours to qualify for benefits equivalent to those received by Canadians in other areas of the country. The primary rationale behind this regional disparity is that it is presumably more difficult to find work in regions of high unemployment, so it is also presumably equitable to make it easier for claimants to obtain benefits and for a longer period of time if they live in relatively high-unemployment regions. While seemingly justifiable on the surface, the regional disparities are more reasonably seen as creating inequities. Furthermore, as we shall discuss below, such disparities can distort the national labour market, thereby harming economic prosperity.

The regional design of employment insurance means that two Canadians who were employed in the same or a similar job at two locations operated by the same company and who worked the same number of hours can be treated very differently when applying for benefits. For instance, a worker living in Restigouche-Albert, New Brunswick would only need to work and contribute to EI for 420 hours to qualify for 32 weeks of benefits as of July 2020, and a maximum of 45 weeks with 1,330 hours of work, because the regional unemployment rate is 16.8% (Service Canada, 2020). Meanwhile, a worker living in Abbotsford, British Columbia must contribute to EI for 595 hours for 18 weeks of benefits, with a maximum of 42 weeks of benefits for 1,820 hours, because their regional unemployment rate is only 8.8% (Service Canada, 2020). Furthermore, an individual in Restigouche-Albert contributing to EI for 500 hours, for instance, would receive benefits, whereas an individual in Abbotsford with the same income and an equivalent period of contributions would not receive anything.

These regional discrepancies in eligibility and length of time to collect benefits are likely to discourage unemployed individuals from relocating across geographic markets in order to reduce their likelihood of being unemployed, as well as their duration of unemployment. For example, if a worker moves from Restigouche-Albert to a low unemployment region like Abbotsford to find employment, the individual might be unable to receive EI benefits or would receive benefits for a shorter duration as a consequence of stricter qualification requirements. This acts as a major disincentive for unemployed Canadians to move elsewhere because the costs of moving may outweigh the benefits (where benefits are the expected gain in employment income minus the expected loss of EI benefits) (Gunderson, 2011). Put differently, employment insurance deters individuals from moving from high unemployment regions to low unemployment regions by providing easier access to benefits in the former, thereby fostering a culture of reliance in high unemployment regions.

As most workers in low unemployment regions are net contributors to EI, these individuals essentially subsidize the lifestyle of the person in Restigouche-Albert. This means that workers in Restigouche-Albert can live in a location with a lower cost of living while receiving benefits and avoiding costs associated with relocation to find employment elsewhere. Consequently, labour markets are distorted because differences in regional unemployment rates become entrenched when unemployed workers in specific regions lack incentives to pursue employment elsewhere. The regionally based EI benefits system thereby raises concerns about fair and equitable income support. It also discourages the labour mobility that would otherwise promote increased total employment and increased real national income.[8]

Such cross-subsidies within the EI system can be driven by even relatively small physical distances in location. For example, two workers in the same office building or at the same work site could face different eligibility requirements depending on how far away from work they live. For example, an individual who resides in Abbotsford and works in Vancouver has to contribute to EI for longer (595 hours as of July 2020) than someone working in the next cubicle who lives in Vancouver (455 hours) to be eligible to receive benefits (Service Canada, 2020). Regional unemployment rates drive differences in eligibility requirements for these two workers, even though they have identical employment circumstances.

8. More generally, empirical evidence shows that more generous benefit levels and longer periods of benefits promote longer periods of unemployment. See, for example, Tatsiramos and van Ours (2012), who argue that benefit structure and eligibility criteria are the most important elements for the design of EI systems, where benefit structure encompasses the payment amount, as well as the duration of the benefit receipt.

Cameron (2013) reviews some of the available evidence on the relationship between geographic labour mobility and the structure of EI benefits. He views the evidence as inconclusive with regard to the strength of the relationship. However, he references strong evidence for Canada that seasonal workers in collaboration with employers tailor hiring and employment separation to ensure EI eligibility and maximum receipts of EI benefits. Unemployed workers do not engage in serious job search when they expect to be recalled. Laid-off employees benefit from compensated leisure, while employers benefit by maintaining the attachment of seasonal employees to their firms, thereby allowing employers to economize on searching for new seasonal workers.

To be sure, in situations of episodic and relatively short-run recessions, the ability of employers to reemploy already trained workers quickly during an economic recovery can be a source of efficiency.[9] However, the phenomenon is less easy to defend on grounds of efficiency when it is an ongoing institutional feature of an EI system. Likewise, longer periods of search while unemployed can lead to workers finding better labour-market matches for their skills. However, such efficiency-improving searching is unlikely to be promoted by seasonal unemployment and reemployment arrangements, since the unemployed workers in question expect to be rehired by their previous employers.

The design of employment insurance is also inconsistent with other federal programs like the Canada Child Benefit (CCB) and Old Age Security (OAS) that treat Canadians as members of a national community rather than residents of regions. In fact, the evidence highlights that Canada is the only industrialized country in the world to provide EI benefits based on region (Radmilovic, 2011): Canada is an outlier as other countries (with the exception of the United States) treat workers applying for employment insurance the same regardless of where they live.[10]

9. Some observers highlight the success of Germany in keeping its unemployment rate relatively low during the COVID-19 pandemic through government payments to enable employers to retain workers. This is a continuation of prior German government unemployment policies (see Crimman, Wiefner and Bellmann, 2012).

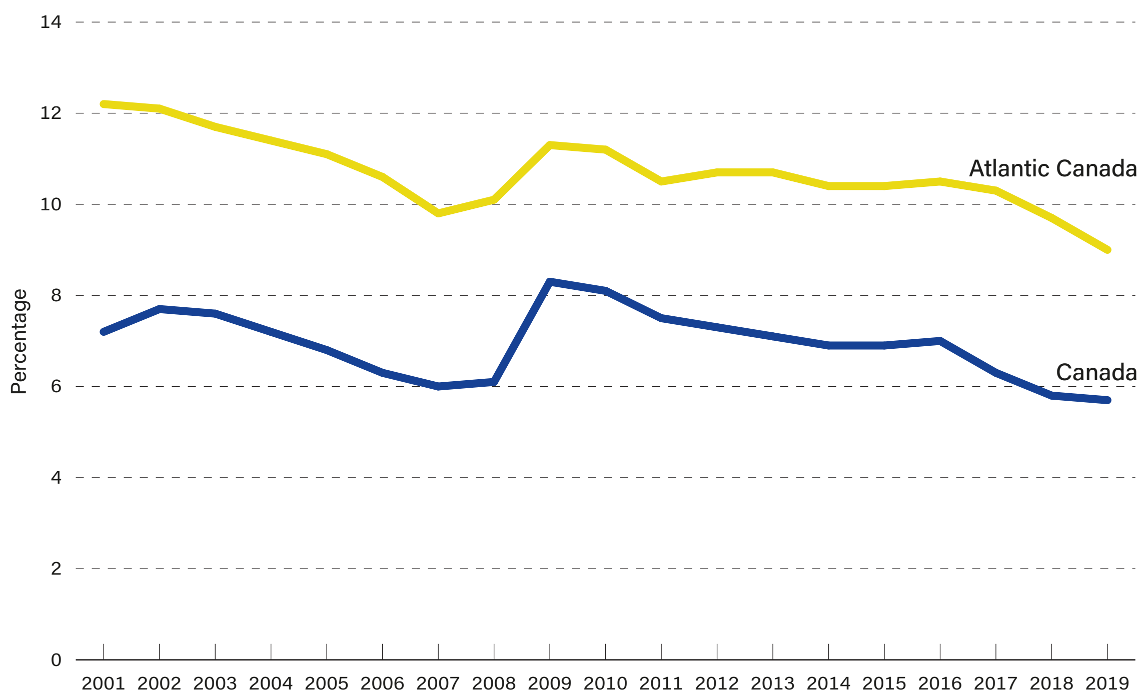
10. While the employment-insurance regime in the United States does vary from region to region, this is a result of different policies adopted by sub-national governments rather than the national government.

# Disproportionate Reliance on Employment Insurance in Atlantic Canada

Disincentives to work inherent in the design of EI have maintained persistent differences in regional unemployment rates and sustained high unemployment rates in Atlantic Canada (Hatherly, 2017; Busby, 2008). The current design perpetuates high unemployment rates in this region by providing lower eligibility requirements and incentives for workers to apply for benefits frequently instead of searching for longer-term employment. This reliance on EI has harmed prosperity in the Atlantic provinces and discouraged improvements in productivity (Hatherly, 2017).

In the Atlantic provinces, the annual unemployment rate has been higher than the national average since 2001 (**figure 1**). From 2001 to 2019, average annual unemployment rates were 9.3% in New Brunswick, 8.6% in Nova Scotia, 10.8% in Prince Edward Island, and 14.0% in Newfoundland & Labrador, while the national rate was comparatively low at 6.9% (Statistics Canada, 2020d). Newfoundland & Labrador also consistently has the highest unemployment rate among the ten provinces and is the only province that always has an annual rate in the double digits.

Figure 1: Unemployment rates (%), annual averages, Canada and Atlantic Canada, 2001–2019




Sources: Statistics Canada, 2020d; calculations by authors.

Regionally based requirements also create adverse economic incentives and distort labour markets by prolonging unemployment and reinforcing dependence on EI in Atlantic Canada. Seasonal work has become engrained in many areas of Canada, while dependence on employment insurance is primarily concentrated in Atlantic Canada (Hatherly, 2017). Specifically, EI encourages workers in Atlantic Canada to remain unemployed for an extended period of time because benefits are available for longer than in other regions. The result is longer periods of unemployment and more frequent claims.

Moreover, EI is creating long-term pockets of regional unemployment. Busby, Laurin, and Gray (2009) find that rural areas in Atlantic Canada have more frequent beneficiaries of EI and seasonal workers than anywhere else. The incentive for some workers in these regions is to work the minimum number of weeks required to qualify for EI and then remain unemployed for an extended period of time while relying on benefits. As a result, employment insurance acts as a permanent income-support system and fosters dependence rather than achieving its goal of providing temporary support for those facing involuntary loss of employment. As noted above, employers in Atlantic Canada also benefit to the extent that they can readily rehire seasonal workers, thereby mitigating the expense of searching for and training new inexperienced employees.

Hatherly notes that "cumulative benefit payments far exceed contributions" (2017: 14) in Atlantic Canada compared to other regions. **Table 1** illustrates the nominal net contribution to EI by province based on the difference between the total EI premiums paid and benefits received between 2007 and 2018. All four Atlantic provinces are net recipients of the EI program, with Newfoundland & Labrador benefiting the most at $7.1 billion.[11] In contrast, each of the six remaining provinces are net contributors to the program. For these reasons, the regional aspects of EI are capable of creating divisions among provinces and damaging the unity of the federation, much as the equalization program does (Eisen, Lafleur, Fuss, and Hill, 2019).

Specifically, the share of total EI payments given to unemployed Ontarians has consistently been below the province's share of Canada's unemployed workers in recent decades (Hartmann, Thirgood, and Thies, 2018). This means that the country not only derives substantial surpluses from EI contributions from Ontarians, but also leaves a significant proportion of unemployed workers in Ontario without access to EI benefits. These developments should not be surprising given that the EI system allows for unequal treatment of claimants based on the region where they live. Canadians respond to incentives and a social-insurance system that provides more generous benefits to some regions will create a disproportionate reliance on it and hinder long-term employment and associated prosperity.

11. These figures are presented on a nominal dollar basis, meaning they are not adjusted for inflation. The gap between Atlantic Canada and other provinces is greater when accounting for inflation.

Table 1: Nominal net contribution ($ billions) to Employment Insurance, by province, 2007–2018

| | Benefits received | Premiums paid | Net contribution |
|---|---|---|---|
| British Columbia | 22.5 | 33.2 | 10.7 |
| Alberta | 21.1 | 33.4 | 12.3 |
| Saskatchewan | 5.3 | 7.9 | 2.6 |
| Manitoba | 5.9 | 9.0 | 3.1 |
| Ontario | 63.6 | 96.9 | 33.4 |
| Quebec | 41.9 | 44.5 | 2.6 |
| New Brunswick | 10.0 | 5.2 | −4.7 |
| Nova Scotia | 9.3 | 6.4 | −2.9 |
| Prince Edward Island | 2.6 | 1.0 | −1.6 |
| Newfoundland & Labrador | 11.1 | 4.0 | −7.1 |

Source: Statistics Canada, 2020f; calculations by authors.

# Eligibility Issues for Workers in Non-Standard Employment

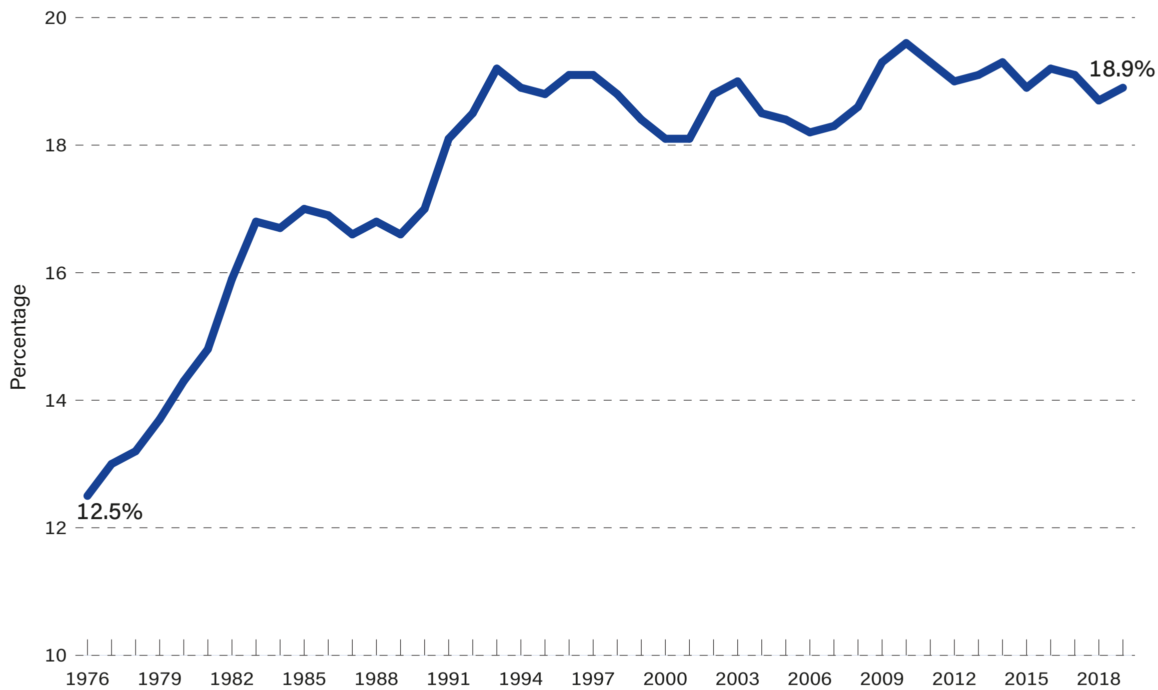
The rise in non-standard employment during the 21st century in Canada has largely been driven by advancements in technology, globalization, and workers' preferences for greater flexibility and better work-life balance (Busby and Muthukumaran, 2016).[12]

## Part-time workers

Part-time work is one of the more common forms of non-standard employment in Canada. Between 1976 and 2019, the proportion of the labour force engaging in part-time work grew from 12.5% to 18.9% (**figure 2**).[13] Generally, part-time workers work fewer hours and face a higher degree of job insecurity than those in full-time employment. Although part-timers are eligible to receive EI, their eligibility rate is much lower than full-timers, since everyone is required to work a minimum number of hours in the prior 12 months

12. By non-standard employment, we mean work by those who do not have full-time and salaried status. There are many types of non-standard employment; part-time and self-employed work are two major categories.
13. Nearly one third of part-time workers (1.1 million) in 2019 were students enrolled in high school or post-secondary institutions. More than two thirds of workers chose to pursue part-time employment for reasons such as illness, caring for children, personal preference, or inability to find full-time employment (Statistics Canada, 2020c).

Figure 2: Percentage of labour force employed part time, Canada, 1976–2019




Sources: Statistics Canada, 2020e; calculations by authors.

to qualify for benefits (Mahboubi, 2019). Furthermore, low-unemployment provinces tend to have a higher proportion of part-time workers, with the result that it is harder for part-time workers to qualify in these regions because they need to accumulate more hours than those living in regions where unemployment is high (Mahboubi, 2019). The result is that a significant portion of the workforce is unable to claim EI benefits despite changing dynamics in the Canadian economy.

There is, however, an interesting provision embedded in the EI system regarding part-time employment. Individuals who are unemployed and receiving EI benefits are allowed to find part-time work and still receive some level of EI benefits, albeit at a reduced rate. These workers are eligible to keep 50¢ of their benefits for every dollar they earn, capped at 90% of their previous weekly earnings. Beyond this threshold, EI benefits are reduced dollar-for-dollar. Canadians on EI are also not eligible to receive benefits if they work a full work week regardless of income (DOESD, 2020e).

## Self-employed workers

Self-employed workers engage in another major type of non-standard employment. Recent data estimates that more than 2.9 million Canadians, or 15.2% of the labour force, were self-employed in 2019 (Statistics Canada, 2020b). These individuals are not

eligible to receive regular EI benefits as a result of the moral hazard that exists because self-employed workers can lay themselves off (Busby and Muthukumaran, 2016). This means that self-employed workers are left without any temporary income support if, for instance, their business fails. However, self-employed workers can now pay optional EI premiums to qualify for EI special benefits.[14]

The federal government allows self-employed workers to register for special benefits if they operate their own business or work for a corporation but do not qualify for EI benefits because they control more than 40% of the corporation's voting shares. People who are self-employed must earn at least $7,279 in 2020 and have made contributions for a minimum of one year before placing a claim to receive EI special benefits. Self-employed Canadians who have opted into the special-benefit program pay the same premium rate as employees but do not pay the employer portion (DOESD, 2020b). These workers have access to special maternity, parental, caregiving, and sickness benefits. As of 2017/18, only 21,240 self-employed individuals had enrolled in the EI special-benefits program (DOESD, 2018).

Hence, a significant proportion of the Canadian workforce is not eligible to receive EI regular benefits because they are either self-employed or work part-time. This being the case, the EI program is failing to achieve its objective of providing temporary income support to all individuals who experience involuntary employment-related income losses. In principle, there is no reason to exclude self-employed or part-time workers from the regular EI program to the extent that they pay EI premiums that are "risk-rated", that is, that reflect the expected claims that those workers will make over time. To be sure, it is arguably more difficult to apply risk-rating for insurance premiums to individual workers than to companies, given the greater heterogeneity of the workers' characteristics, particularly of self-employed workers in the gig economy. However, risk-rating should be easier for classes of self-employed workers such as those who work for ride-sharing services such as Uber. The issue of whether and how the growing share of self-employed workers might be included in an EI program will be addressed in a subsequent publication.

It is also possible that the self-employed and gig workers would prefer to self-insure against future reductions in income because they have a greater tolerance for risk than conventional salaried workers. Nevertheless, there is no compelling conceptual

14. Self-employed workers increasingly include "gig workers", that is individuals who are directly or indirectly working on a contract basis in occupations drawing on computer technology. There is increasing political controversy about whether such workers should be considered employees or contractors for the companies for which they work.

reason to prevent them from "buying" into the public EI program, presuming the program operates on a risk-rated basis.[15] With the rise of the gig economy and continuing shifts in the dynamics of the economy moving forward, it will be important to modify the EI program so it can adapt to the changing nature of employment in the modern economy.

## Financial Burden of COVID-19

Temporary income support has recently been provided to Canadians who have been furloughed or temporarily laid off because of COVID-19 through the Canada Emergency Response Benefit (CERB). Currently, applicants are eligible to receive $500 per week for a maximum of 24 weeks (DOESD, 2020d). As of March 15, 2020, the federal government is automatically processing EI claims for regular benefits through CERB (DOESD, 2020d).[16] This means many unemployed workers will collect benefits from CERB rather than EI, reducing EI payouts while CERB is in place. In fact, as McMahon (2020) notes, the CERB program had processed 8.41 million unique applicants as of June 4. Consequently, it is unclear what the financial impact of COVID-19 will be on the employment insurance system in the foreseeable future, in particular when the CERB program is discontinued.[17] However, recent unemployment data and the experience of past recessions suggest that the EI system is likely to face a significant financial strain.

Between February and April 2020, the national unemployment rate increased by 7.4 percentage points and reached a total of 13.0% (Statistics Canada, 2020a). This marks the highest national unemployment rate recorded since December 1982 and could put significant financial strain on the EI program if unemployment rates do not decline substantially in the years to come. Higher unemployment means fewer workers are making EI contributions and revenues from EI premiums will fall (McMahon, 2020). Benefit payouts will rise as a result of the increase in the number of unemployed workers. It will also be easier to qualify for EI and workers will be eligible for a longer duration of

15. Adjusting EI premiums to reflect the probability of future benefit claims mitigates the aforementioned moral hazard problem associated with insuring the self-employed.
16. Special benefits such as maternity, parental, caregiving, and fishing are still provided through the normal EI application process.
17. The federal government has recently announced that it will transition CERB recipients to the EI program in the fall. It will also create a parallel EI program for contract or gig workers.

payments, exerting further financial strain on the program (McMahon, 2020). The result could be deficits for the EI operating account and additional pressure on federal finances as future general taxes may need to be used to cover the EI deficit.[18]

If levels of unemployment in July 2020 persist it could mean the average qualifying period for EI will decline by 28% compared to July 2019 and Canadians who have the minimum number of qualifying hours will see the length of time benefits are received increase by about 50%. Workers who have the maximum hours will experience a 17% increase. Moreover, the average worker would only require 462.5 hours to qualify for EI and receive between 25.2 weeks and 44.9 weeks of benefits (Service Canada, 2020). More generous benefits with fewer EI contributors will contribute to what could be a fiscal crisis if the current EI structure remains unchanged.

Past recessions indicate Canada could be running operating deficits in the EI account for years to come. The global recession in 2008/09, for instance, saw a substantial increase in the number of Canadians receiving EI benefits. This increased EI expenses and unemployment rates remained relatively high in the years following. In fact, the EI operating account reached a cumulative deficit of $9.2 billion in 2011 (DOESD, 2018). The operating account only began achieving annual surpluses again in 2012 when the employee premium rate was 10¢ higher ($1.83) per $100 of insurable earnings than it was in 2008 ($1.73) (CRA, 2020). Moreover, the premium rate increased again in 2013 and remained at 1.88¢ until 2017 (CRA, 2020). **Table 2** highlights how the EI premium rate and maximum contributions have changed since 2008.

Table 2: EI employee premium rates (%) and maximum contributions ($), 2008–2020

| | Employee premium rate (%) | Maximum employee premium ($) |
|---|---|---|
| 2008 | 1.73 | 711.03 |
| 2009 | 1.73 | 731.79 |
| 2010 | 1.73 | 747.36 |
| 2011 | 1.78 | 786.76 |
| 2012 | 1.83 | 839.97 |
| 2013 | 1.88 | 891.12 |
| 2014 | 1.88 | 913.68 |
| 2015 | 1.88 | 930.60 |
| 2016 | 1.88 | 955.04 |
| 2017 | 1.63 | 836.19 |
| 2018 | 1.66 | 858.22 |
| 2019 | 1.62 | 860.22 |
| 2020 | 1.58 | 856.36 |

Source: CRA, 2020.

18. How best to fund the increased government income-support payments related to the COVID-19 crisis is beyond the scope of this study. Suffice it to say here that the additional government deficits incurred under current programs will need to be paid for by future generations of taxpayers.

The *2020 Actuarial Report on the EI program* (completed before the pandemic) projects the average unemployment rate between 2020 and 2026 to be 5.8% (OSFI, 2020). The report also projects that a one percentage-point increase in the average unemployment rate over this period would result in an increase of about 0.14 percentage points in the seven-year forecast break-even premium rate. A scenario positing low economic growth is also presented to estimate what would happen to premium rates if the economy has a higher average unemployment rate (7.8%), longer durations of unemployment, and slower wage growth than anticipated. In this scenario, the seven-year forecast break-even rate would rise to 1.79%, an increase of 0.21 percentage points (OSFI, 2020). This means the EI premium rate would increase annually by the 0.05 percentage-point maximum between 2020 and 2024, increase slightly to 1.79% in 2025, and then remain there until 2027 (**table 3**) (OSFI, 2020).

Table 3: EI premium rates (%) and national unemployment rates (%) from the Office of the Superintendent of Financial Institutions' low economic growth scenario, 2020–2027

| | EI premium rate (%) | Unemployment rate (%) | | EI premium rate (%) | Unemployment rate (%) |
|---|---|---|---|---|---|
| 2020 | 1.58 | 8.5 | 2024 | 1.78 | 7.5 |
| 2021 | 1.63 | 8.3 | 2025 | 1.79 | 7.3 |
| 2022 | 1.68 | 8.0 | 2026 | 1.79 | 7.0 |
| 2023 | 1.73 | 7.8 | 2027 | 1.79 | 7.0 |

Source: OSFI, 2020.

Of course, the temporary existence of the Canada Emergency Response Benefit makes the extent of the future financial strain on employment insurance *per se* uncertain, although the additional strain on the government's overall fiscal position is quite clear. CERB will remain in place until the fall, thereby shifting most of the burden of employment-insurance payments away from payroll taxes and toward other sources of tax revenue until that time. It is also unclear how CERB is affecting the incentives of those collecting under the program to search for work and to accept employment positions that are available to them. What is known is that workers with longer durations of unemployment find it more difficult to regain employment, in part because of a deterioration of job skills, as well as depreciating knowledge about local labour-market conditions. This consideration suggests that the future unemployment rate in Canada might well be higher than the estimates in the *2020 Actuarial Report on the EI Program*.

Furthermore, CERB payments are often more generous than the maximum benefits afforded to many Canadians under EI. This suggests that there may be pressure on policymakers to increase EI benefits or alter the program after the CERB program is

removed. If CERB is removed and unemployment rates remain high for the foreseeable future, annual deficits in the EI operating account will increase. In short, all signs point to a significant future financial strain on the EI program. This matters importantly for Canadians, since the federal government will either need to modify the EI program to reduce the claims made under the program and/or raise premium rates to cover what will otherwise likely be much higher EI expenses going forward.

## Increasing Payroll Taxes

In a subsequent publication, we shall discuss possible initiatives to reduce the burden of claims under the EI system through structural changes to specific features of the system. We shall argue that, while increasing EI payroll taxes is certainly a policy option, it is likely to have serious adverse effects on overall employment and economic growth. As discussed earlier in this study, higher EI premiums directly imposed on workers, or indirectly shifted onto workers, reduces the net after-tax income of workers who pay into the EI system. At the margin, this reduces incentives of workers to participate in the labour force.[19] This might be particularly the case for workers nearing retirement age, who view the likelihood of their collecting EI benefits in the future to be significantly lower than younger workers might expect.

Higher EI premiums imposed on employers are, as noted earlier, passed on largely, although not completely, as lower wages for employees. This means that employers in competitive markets in Canada will try to pass through their remaining portion of EI premiums to consumers in the form of higher prices. Those Canadian businesses that cannot pass through higher taxes will either reduce production or go out of business entirely. Previous studies have documented a decrease in capital investment rates across a range of Canadian industries in the post-2014 period, which has been interpreted as an indication of declining Canadian competitiveness.[20] Higher EI premiums imposed on employers are therefore likely to exacerbate competitiveness problems facing Canadian businesses, resulting in further reductions in business investment and a slowing rate of productivity and real economic growth.[21]

19. Saez, Schoefer, and Seim (2019), for example, discuss the Swedish experience in which a reduction in employer payroll taxes led to a substantial reduction in youth unemployment. Presumably an increase would have had the reciprocal effect.
20. See, for example, Globerman and Emes, 2019.
21. Since the bulk of increases in payroll taxes are borne by workers, the impact on capital investment is mitigated (see Deslauriers, Gagne and Doste, 2018).

# Should Special Benefits Be Funded through EI?

EI special benefits offer short-term income support to eligible employees who are "unable" to work because they are facing difficult life circumstances. As mentioned previously, EI special benefits apply to circumstances such as sickness, pregnancy, and caregiving. Employees must work a minimum of 600 hours and experience at least a 40% reduction in their weekly employment income to qualify for these benefits (DOESD, 2018). The most recent data suggests 597,090 Canadians received EI special benefits in 2017/18, with more than two thirds (69.0%) of these claims related to sickness benefits. In the same year, the amount of EI special benefits paid totalled $5.7 billion, representing 30.7% of total EI benefit payouts (DOESD, 2018). Put differently, nearly one third of EI program expenditures are allocated to special benefits.

EI special benefits are often criticized as a use of premium revenues on areas unrelated to the original purpose of employment insurance. In particular, the Canadian Chamber of Commerce argues that the EI program "should be operated as a true insurance program … that provides temporary income support to qualified individuals who involuntarily lose their job" rather than use EI funds to pay for other "social-program aspects" (Canadian Chamber of Commerce, 2009). Since EI special benefits are funded through EI premium revenues, this means premium rates are higher than they would be if the program only offered regular benefits, thereby imposing an additional burden on the working population, as the higher premium rates are ultimately largely passed through to employees in the form of lower wages. Furthermore, since COVID-19 will ultimately place increased financial strain on regular EI benefits, continuing to pay EI special benefits through EI premiums exacerbates the economic burden associated with funding the EI system.

An alternative approach that has been suggested is to separate special benefits from EI and fund them exclusively through general taxes rather than EI premiums (Mintz, 2010; Canadian Chamber of Commerce, 2009). Since all taxes impose economic distortions and associated inefficiencies, a basic underlying argument is that the distortions are less severe when broad-based taxes are used to raise revenues (Turgeon, 2011). The notion here is that spreading a tax across a larger number of market participants dampens the economic reaction to the tax. We shall consider the recommendation to fund special benefits through the income tax system rather than through payroll taxes in a subsequent publication.

# Conclusion

Employment insurance is a flawed federal program that is in serious need of reform. While some problems, such as generous subsidization of seasonal unemployment, have long been discussed, the COVID-19 pandemic has elevated existing concerns given heightened worries about the future financial sustainability of the EI system. As well, by using regional unemployment rates to determine eligibility and the benefits paid to recipients, EI treats workers differently depending on where they live. This creates an inequitable system that effectively redistributes income from workers in one region to workers in another. It also distorts labour markets by entrenching high unemployment rates and harming prosperity in specific regions, most notably in Atlantic Canada, by weakening the incentives of workers to find stable employment and by making it effectively cheaper for employers to lay off workers while retaining them in a re-employable pool.

A growing number of Canadians are not eligible to receive EI benefits because they are self-employed or working part-time. As the gig economy continues to grow, the EI system will move further away from providing a full unemployment insurance program. Therefore, addressing the growth of the gig economy is an important issue for future research.

Finally, COVID-19 will place an increased financial strain on EI as a result of increases in unemployment rates and longer durations of unemployment in Canada for the foreseeable future. Either premium rates will have to increase in the near future, or reforms will need to be made that reduce the disbursements made to unemployed workers and/or disbursements associated with special benefits. Possible reforms to the EI system that might make it more efficient and, therefore, less costly to maintain are the focus of a future study.

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