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E-BRIEF

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EMPLOYMENT INSURANCE

# Correcting Course: Employment Insurance Needs a Redesign to Counter Recessions and Achieve Equity

by
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- As a primary pillar of Canada's social safety net, Employment Insurance (EI) has proven itself to be slow to react to downturns, weakening its ability to automatically stabilize the economy. It has also gone off track from its original main goal: to provide insurance against unpredictable job losses.
- EI should be modernized with an eye to making it a more effective counter-cyclical income support tool by making the access criteria more equitable and ensuring that benefit durations respond quickly and effectively to unemployment shocks.
- During the Great Recession of 2008/09, the oil price collapse in 2014/15, and the most recent pandemic, however, the program has proven itself unable to meet in timely fashion the needs of many workers who face job losses. During the commodities shock, unemployment rates in some regions in Alberta rose sharply, but there was no immediate increase in either benefit duration or ease of access. A similar pitfall emerged in low-unemployment regions at the beginning of the COVID-19 pandemic.
- Benefit entitlements should be less oriented to indemnifying chronic unemployment and more responsive to covering unemployment caused by cycles or totally unanticipated shocks like the pandemic.
- The authors make three main policy recommendations: (i) Implement uniform or more universal entrance requirements. (ii) Sharply reduce the number of EI regions. (iii) Improve the responsiveness of the benefit duration formula to labour market downturns and recoveries.

The federal government recently held extensive consultations aimed at modernizing the Employment Insurance (EI) program for the post-pandemic period. In that spirit of reform, this E-Brief proposes options to align EI more closely with its original objective: to respond to the needs of Canadian workers during labour market downturns. The current provisions are

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hardwired to accommodate seasonal and part-year workers situated in high-unemployment regions, and as such are too focussed on structural unemployment issues.[1]

The EI regime determines both access to any benefits at all as well as the length of entitlement durations according to two criteria: hours worked in the last 52 weeks as well as the unemployment rate level in the EI region in which a claimant lives (of the 62 regions). Because unemployment rate levels, whether high or low, tend to be quite persistent over time in each of the EI regions, the responsiveness of the program to address economic shocks is inadequate.[2] In the words of labour economist Miles Corak, "Big shocks matter and need a response in real time," but the current rules determining EI benefits are too slow to kick in.[3]

As we discuss below, our proposed reforms would transform EI by putting in place more flexible, nimble provisions, which would give broader access to benefits that would last for longer durations when labour market conditions deteriorate. To do so, benefit entitlement durations would be based on *changes* in unemployment rates instead of on their levels in given regions, whether high or low. To greatly streamline the structure and reduce the administrative burden, we also recommend that the number of EI regions regions be reduced from 62 to 10 or fewer.

## The EI System's Flaws and History of Ad-hoc Responses

Recent major economic shocks exposed EI's shortcomings in responding to them. Among the problematic features are: 1) variable entrance requirements that are slow to adjust to increases in unemployment; 2) benefit durations that are also slow to respond to increases in unemployment; and 3) finely divided administrative regions with boundaries that reinforce and prolong the inequities in both entrance criteria and potential benefit durations.

*Variable Entrance Requirements:* Eligibility for EI depends on the number of insurable hours that a claimant accumulates during the 52-week period preceding the claim, and that number varies depending on the unemployment rate of the EI administrative region in which the claimant typically resides. For example, to qualify, a worker must have worked only for 420 hours in the last 52 weeks in high-unemployment regions with rates above 13.1 percent, such as in eastern Nova Scotia. Meanwhile, an otherwise similar worker would need to have worked for 700 hours in a region with a lower regional unemployment rate (6 percent or below), such as in Vancouver.[4]

According to the EI Coverage survey for 2019, 90,500 potentially eligible unemployed individuals had not worked enough hours to qualify. The logic underlying these provisions is that workers residing in low-unemployment-rate regions should be able to remain employed longer (until the layoff occurs) and also to find

1 More specifically, this results from the joint impacts of shorter qualifying periods and extended benefit durations in high-unemployment areas.

2 Earlier studies by Guillaumette (2007) and the Mowat Centre (2010) argue the same point.

3 Corak (2020) explains in detail the program delivery mechanism that is responsible for the slow response. The regional unemployment measure that is utilized by program administrators is a three-month moving average of the unemployment rates. When a major shock occurs, there is a lag of four months before it is fully reflected in the regional unemployment rate measure, at which time the program generosity adjusts to the new unemployment rate.

4 In the spring of 2018, the unemployment rates in Eastern N.S. and Vancouver, B.C., were 14.5 percent and 4.2 percent, respectively.

new jobs more easily than those residing in high-unemployment-rate regions. This reasoning ignores the reality of the conditions that workers face when the labour market enters a significant downturn and job opportunities dry up. When a broad-based downturn occurs, displaced workers in low-unemployment regions could be in a comparably worse position than their counterparts in high-unemployment regions, facing a tougher transition to shocks that affect both somewhat equally.

*Benefit Duration Extensions*: Compounding the impact of those entry provisions, those who do qualify in low-unemployment regions also receive shorter-lasting benefits than their counterparts situated in high-unemployment-rate regions. These rules were designed to provide longer-lasting benefits to unemployed workers in regions with fewer job opportunities and to minimize the risk that they would exhaust their benefit entitlement before finding a new job. Yet, here too, adjustments to benefit durations are inadequate during economic downturns.

On seven separate occasions since 2004, federal pilot projects were implemented to extend benefits beyond the durations set by the "EI entitlement matrix." In the same vein, during the pandemic, the federal government ensured that all regular beneficiaries would have access to a minimum of 26 weeks of benefits, which was later extended to 50 weeks for claims established in the period covering September 27, 2020, to September 25, 2021. This amounted to an average of 19 additional weeks. Clearly, standard provisions stipulated in the EI entitlement matrix are insufficiently responsive to sudden and massive job losses. Implementing ad hoc, sometimes retroactive, benefit extensions are arbitrary, entail delays and undermine the intention of automatic stabilization.

One notable pilot project that occurred in the last decade was the "commodities cycle" initiative, which provided benefit extensions to workers in energy-producing regions affected by the steep decline in global commodity prices in 2014-2015. It was unique because in the 15 EI regions that were selected, *changes* in unemployment rates – as opposed to levels of them – were utilized as the basis for making benefit duration more responsive to severe negative labor market shock. As we explain below, the design of this pilot project is the inspiration behind our main reform proposal.

*Finely Divided Administrative Regions*: The 62 EI regions that partition Canada are expressly shaped and demarcated such that their respective labour market conditions are similar within their borders. By design, they are separated and sorted along a continuum ranging from regions with the lowest unemployment rates to those with the highest rates.[5] Given the program's provisions that are embedded in the EI entitlement matrix, this configuration of regions facilitates and reinforces the targeting of longer benefit durations to claimants situated in the highest-rate regions (many of whom are seasonal) and shorter durations to claimants residing in the lowest-rate regions. This low level of aggregation has the impact of sharpening regional inequities. Furthermore, as pointed out by Corak (2020), each of these regions requires a monthly unemployment rate to be calculated, which "stretches the limits of Statistic Canada's workhorse survey, The Labour Force Survey, beyond statistical credibility."

5 We draw an analogy to the process of political gerrymandering by which voters are spatially separated according to political leanings. In this case, potential EI claimants are spatially separated according to labour market patterns and conditions as measured by the local unemployment rate.

## New Solutions Are Required

In the discussion above, we have argued that the design of the EI system's passive benefits does not address the needs of claimants who are unemployed during an economic downturn.[6] A few policy recommendations should help to revamp the entire system to ensure that a broader group of unemployed workers can access it, and that the benefit durations increase more rapidly when the economy enters a recession.

*Implement Uniform or More Universal Entrance Requirements*: We repeat the recommendation that we made in Gray and Busby (2009) that more uniform entry requirements be established across the regions of Canada. Before the pandemic hit in March 2020, there were nine different bands of hours worked requirements that ranged from a low of fewer than 420 to a high of 700 or more hours. As an emergency measure, until September 24th, 2022, these hours worked were temporarily set to a uniform level of 420 hours. For the sake of equity, and to reduce adjustment costs for some claimants who would face shortened benefit durations under our proposed reforms, the temporary threshold of 420 insurable hours should be made quasi-permanent, subject to a subsequent evaluation. Another, more gradual, option along these lines would be, as Miles Corak advocates, to move towards more uniform entrance requirements by reducing the number of unemployment rate bands that determine hours-worked requirements (see Table 2 in Busby, Chejfec and Tambourri 2022). Under either option there would be less need to revise access criteria during economic shocks.

According to the federal budget of 2022, EI premium rates are set to rise from $1.58 per $100 of earnings in 2022 to $1.73 per $100 earnings by 2025, increasing by five-cent increments annually, to help pay off the increase in the accumulated deficit of the EI operating account brought about by higher EI costs during the pandemic.[7] A universal access floor of 420 hours worked would require a small increase in EI premiums, with reasonable estimates seeing premiums increase by around four to seven cents higher than what is already planned (Busby, Chejfec and Tamburri 2022).

*Improve the Responsiveness of EI Benefits Using New Parameters*: The second reform would use the monthly changes in provincial unemployment rates as the indicator for labour market conditions to adjust the durations of benefit entitlements according to shocks to unemployment. Utilizing the changes in unemployment rates nets out the persistent elements of unemployment – its structural and seasonal components – to distill in sharp relief the cyclical and the frictional, idiosyncratic elements that EI was originally designed to address.

As the change in the unemployment rate is highly correlated with labour market shocks (either positive or negative), it is more closely aligned with insurance principles than is the level of the unemployment rate. Most notably, it conforms with the principle that insurance should cover unforeseeable and random losses rather than foreseeable and systematic losses. As jobs are destroyed, benefit durations would be lengthened accordingly; as the labour market strengthens, they would be shortened accordingly. For its part, Employment and Social Development Canada has long pointed out that the current program parameters do adjust to extend durations in the event of a labour market downturn. While true, the speed of the response is inadequate: by combining EI

6 We note that assertion is not at all novel, as it dates back to the Forget and MacDonald Commissions of the late 1980s.

7 Firms pay 1.4 times this rate.

uptake with levels of unemployment in 62 separate EI regions, the current administrative apparatus is much less responsive to negative labour market shocks than it could otherwise be.[8]

Under our proposed reform, variation in the length of the benefit entitlement periods would be driven by *changes* in local unemployment rates. Sudden job loss would trump recurring seasonal layoffs or chronic layoffs in regions with persistently high unemployment.

We conducted a statistical analysis of the variation in the historical levels of the ten provincial unemployment rates. This allows us to assess the degree to which the current program design addresses negative shocks, like an economic downturn or a commodity bust, versus the degree to which it addresses quasi-permanent disparities across regions.[9]

Our analysis over the period from Jan. 2006 until Dec. 2019 (shortly before the pandemic) reveals that across the 10 provinces, approximately 85 percent of the variation in provincial unemployment rates reflect between-province differences, while 15 percent reflects changes in unemployment rates over time. Working through the EI entitlement matrix, this breakdown implies that a very predominate share of the differentials in EI benefit entitlement durations are associated with layoffs and separations occurring in regions characterized by persistently high unemployment rates and chronic employment instability, which includes but is not limited to seasonal layoffs. Only a small share of the differentials is triggered by layoffs caused by cyclical shocks.

The discrepancy stems from both between-province elements and within-province elements. The between-province component captures the *persistent* differences in the levels of unemployment between provinces and reflects factors associated with structural unemployment. The within-province component captures *transitory* differences in the levels of unemployment within provinces over time and reflects factors associated with cyclical unemployment, which, consistent with insurance principles, is what generic unemployment insurance (UI) regimes (and the pre-1971 Canadian regime) are designed to indemnify.

These findings imply that the dominant proportion of the variations in the EI qualification and benefit entitlement parameters, as stipulated in the EI entitlement matrix, is driven by persistent components of unemployment, whether structural or seasonal. The program is thus much more sensitive to the long-standing inter-regional disparities in unemployment rates than to labour market shocks. If those parameters were gauged according to the changes in unemployment rates as opposed to their levels, as we propose, the level of generosity would fluctuate the least in the Atlantic provinces and fluctuate the most in the three western provinces – in sharp contrast to the workings of the current program.

8 In an earlier draft of this paper, we examined what would happen were ESDC to base entitlement on changes in the employment rate (the ratio of employment to the working-age population). It is considered by many economists a more suitable proxy for labour market shocks because changes in the unemployment rate embody changes in labour force participation as well as employment. For the sake of transparency and continuity with program conventions, however, we decided to stick with the unemployment rate because it is a variable that almost all stakeholders and the public can interpret. Statistically, this choice makes little difference, as the monthly provincial employment rates are highly correlated with the unemployment rates over the interval of 2006 to 2019.

9 Note that since there are currently 62 EI administrative regions but 10 provinces, this statistical analysis is executed at a much more aggregated level. The repercussions for the workings of the EI regime of this statistical investigation are robust to this change, however.

We recommend that benefit entitlements should be less oriented to indemnifying chronic unemployment and more responsive to covering unemployment caused by cycles or totally unanticipated shocks like the pandemic. The overall cost of what we propose depends on the choice of new parameters in a redesigned EI entitlement matrix. Only during recessions would our formula trigger longer EI benefit entitlement durations, and they would subsequently be shortened during recoveries. Therefore, we would see cost increases during recessionary periods and cost reductions during economic expansions. This cyclical responsiveness would therefore not necessarily increase EI costs over an economic cycle.

*Reduce the Number of Administrative Regions*: The complex web comprised of 62 EI regions would be aggregated into many fewer regions. An extreme configuration would consist of five large regions,[10] but in our view a regional scheme based on provincial and territorial boundaries would be a major improvement.[11] This would attain some degree of regional parity without splitting up larger provinces and greatly reduces the disparities in labour market conditions between regions by pooling regions with high unemployment rates with those with lower ones. The benefits of such a reform include administrative simplification, greater transparency of boundaries, and a much higher degree of statistical precision in calculating the regional unemployment rates. Importantly, independently of any changes applied to benefit entitlement formulas, it will serve to reduce the wide inequities in benefit duration. This mechanism still allows for some flexibility to address labour market shocks that are felt only in certain geographical regions. For example, if the unemployment rate were to rise sharply in Alberta, as was the case during the commodities cycle, the benefit entitlement durations that apply there would be extended. One drawback would be that this regional aggregation would reduce the degree of modulation of benefit duration to more localised shocks that occur in the large provinces of Ontario and Quebec.

While our suggested reforms do not directly address the question of repeat use, they would complicate the design of EI for seasonal and part-year workers. Although these workers would be able to qualify as easily as ever – and for some of them these requirements would be loosened – depending on how the benefit duration parameter is designed, they could become entitled to shorter benefit periods. This point might need to be weighed versus the other features in considering how best to design a new system.

## An Illustration of a Redesigned EI Entitlement Matrix

To provide greater clarity on what our proposal might look like in practice, we provide an illustration of a new formula for determining the benefit entitlement. The maximum benefit durations would depend on baseline values set for all of Canada but would vary according to changes in the labour market conditions in those respective five regions. The key features of this apparatus would be the following:

- An economic variable according to which benefit entitlement durations are adjusted , for which our preference is the change in the unemployment rate.
- A baseline value for the length of benefit entitlement.

10 These five regions could be the four Atlantic provinces, Quebec, Ontario, the three Prairie provinces, and British Columbia.

11 We note that the 1971 Unemployment Insurance Legislation stipulated 16 regions, so there is precedent for a major reduction in this number.

## Box 1: Illustration of the Proposed Benefit Entitlement Formula

The formula is expressed as follows:

$$\textit{Actual maximum duration} = \textit{Baseline maximum duration} \pm (\Delta_{UR} \times \textit{Duration extension})$$

The first term is the baseline maximum duration, which is a function of the individual worker's number of insurable hours and a baseline value for the unemployment rate. Consider, for illustration, three categories for insurable-hours worked in the last 52 weeks: under 1,000 hours, between 1,000 and 1,500 hours, and more than 1,500 hours.[a] Consistent with the existing provisions, maximum benefit durations increase with the number of insurable hours, and thus claimants still have an incentive to work longer hours. Regarding the baseline number of benefit entitlement weeks, for this illustration we select only one bracket for the unemployment rate that determines the baseline component: 7 -7.9 percent. It is selected because it reflects the typical monthly provincial rates of unemployment that prevailed over the interval from January of 2006 until December of 2019, which covers a bit more than one full business cycle.[b] In the first column of Table 1, we list the values for the baseline benefit durations, which are calculated as the average of all of the values for benefit entitlement contained in the EI entitlement matrix (for that bracket of unemployment rates) across all of the 40 existing brackets for qualifying insurable hours. These figures would be somewhat higher for those with more than 1,500 insurable hours and somewhat lower for those with fewer than 1,000. Values for the baseline duration would apply nationally, and they could still, but to a lesser degree, depend on the levels of the unemployment rates. On the other hand, the benefit extensions or reductions enter into the next term, and they would depend on *changes* in the regional unemployment rate.

The second term of the benefits formula gives the difference in benefit entitlement for each of the five regions reflecting regional changes in labour market conditions. It is the product of two parameters, the first of which is the change in the regional unemployment rate ($\Delta_{UR}$). It is the statistic that measures the magnitude of the regional labour market shock; a rise would increase the generosity of the benefit duration, while a fall would do the opposite. The final parameter is the value of the benefit extension that corresponds to a unit change (i.e., 1 percentage point) in the regional unemployment rate. If we set this value at 3 weeks in the event of a negative shock, the increment to the total entitlement (with respect to the baseline value) is given by the product of the change (in percentage points) in the unemployment rate and

a There are currently 40 brackets of insurable hours, which span from 420 to 1,820 in increments of 35 hours. We have aggregated them into these three categories and selected rounded figures for thresholds.

b Weighting all provinces equally over that interval, the mean and median values were 7.8 and 7.5 percent respectively. The cumulative frequency was 57.6 percent, implying that almost 58 percent of the observations for provincial unemployment rates were below 8 percent. The relative frequency for this 7 to 8 percent bracket was 14 percent.

## Box 1: Continued

three benefit weeks.

For the purposes of comparison, these values for our proposed benefit schedule are more generous than the allocations provided by the *Economic Action* Plan contained in the 2009 budget. It awarded five extra weeks for a national unemployment rate that rose by over 2.3 percentage points from Sept. 2008 to Sept. 2009. According to our formula, six additional weeks would have been awarded. During that major recession, the unemployment rate in Quebec rose 1.6 percentage points from 7.3 to 8.9 percent. Ontario was hit harder, as its unemployment rate increased by 2.6 percentage points from 6.5 to 9.1 percent. During the commodities cycle recession, Alberta's unemployment rate rose from 4.7 percent to a peak of 9 percent for a huge increase of 4.3 percentage points; our formula would have extended benefits for at least 12 weeks.[c]

Table 1 displays a schedule of benefit durations. The first column gives the standard durations in stable labour market conditions; i.e., the baseline values that were explained above. Seasonal workers with fewer than 1,000 insurable hours could receive benefits for 19 weeks, while those with more than 1,500 insurable hours could collect up to 36 weeks. In the mild recession scenario (see the second and third columns), characterized by the regional unemployment rate increasing by 1 percentage point, workers with less than 1,000 insurable hours could collect benefits for up to 22 weeks, while those with more than 1,500 insurable hours could collect up to 39 weeks.

In the severe recessionary scenario (see the fourth and fifth columns), characterized by the regional unemployment rate increasing by 2 percentage points, workers with less than 1,000 insurable hours could collect benefits for up to 25 weeks, while those with more than 1,500 insurable hours could collect up to 42 weeks. Note the built-in symmetry in the responses in the event of recovery in the regional labour market, as the durations of benefit entitlement revert towards their baseline values. The benefit entitlements, however, would never fall below the baseline values of 19, 26, and 36 weeks listed in Table 1, even in the event of full employment.

c To give an idea of the typical value for the change in the provincial unemployment rates between 2006 and 2019, the standard deviations for the provincial unemployment rate variables based on a monthly frequency are slightly above unity. For Quebec: 1.03 with a coefficient of variation of 0.14; for Ontario 1.07 with a coefficient of variation of 0.15; for B.C. 1.24 with a coefficient of variation of 0.21. A rough approximation of the means of the regional unemployment rates is 7.0 percent.

**Table 1: Proposed EI Benefit Duration Under New Rules for Normal Baseline Values**

| Hours worked for claim period (during last 52 weeks) | National baseline for maximum eligible benefit weeks | Change in benefit duration | Actual maximum duration | Deviation from the national baseline | Actual maximum duration |
|---|---|---|---|---|---|
| | | Due to monthly increase (decrease) in provincial unemployment rate of 1 percentage point | | Due to monthly increase (decrease) in provincial unemployment rate of 2 percentage points | |
| Less than 1,000 hours worked | 19 | +3 (-3) | 22 (19) | +6 (-6) | 25 (19) |
| Between 1,000-1,500 hours worked | 26 | +3 (-3) | 29 (26) | +6 (-6) | 32 (26) |
| More than 1,500 hours worked | 36 | +3 (-3) | 39 (36) | +6 (-6) | 42 (36) |

Note: For the calculations, we assumed that the duration of extension is three weeks. Under the proposed new rules, the actual maximum benefit entitlements would only be lowered due to a decline in the unemployment rate if they were higher than the baseline values.
Source: Authors' calculations.

- A variable that, when triggered by a movement in the indicator for the change in labour market conditions, causes increases or decreases in benefit duration.
- A time interval, such as every three or four years, in which it could be evaluated and recalibrated.

To illustrate the mechanics of our proposed benefit entitlement formulas, we show a scenario consisting of baseline values combined with the adjustments to the maximum duration of benefits based on changes in the unemployment rate in Box 1. Our intention for this exercise is to illustrate concretely how we could replace the current mechanism; it is not to suggest that the specific values that we insert be adopted. This framework allows for many permutations of the program parameters that could render it either more or less generous.

## A Recession-Ready EI for the 21st Century

The three policy recommendations that we make are the following:

- Implement uniform or more universal entrance requirements.
- Sharply reduce the number of administrative regions.
- Improve the responsiveness of the benefit duration formula to labour market downturns and recoveries.

These proposed reforms would streamline the regime on a regional basis and render it much more responsive to either national or regional recessions. When the regional unemployment rate increases, maximum benefit durations would be raised immediately. The need to intervene retroactively with pilot programs would be greatly reduced.

The benefit entitlements formula would be consistent with widely accepted insurance principles. Entrance requirements would be simplified and equitable. In stable labour market conditions, eligible unemployed workers would be entitled to reasonably similar benefit durations across Canada. Benefit durations would change alongside changes to regional unemployment rates. The cost of removing the inequity of regional differences in accessing the program with uniform or more universal entrance criteria would likely require a small increase to EI premiums. However, the net cost of what we propose depends on the generosity of the revised program rules and the potential savings from increasing benefit durations in a recession and decreasing them in an economic expansion.

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