Intelligence MEMOS

From: David Gray

To: The Honourable Carla Qualtrough, Minister of Employment, Workforce Development and Disability Inclusion

Date: November 23, 2020

Re: **WHAT DOES THE PANDEMIC TEACH US ABOUT EI?**

The COVID-19 pandemic brought labour market conditions to Depression-era levels during the months of April and May, and as of October, the unemployment rate of 8.9 percent was still 3.3 percentage points above February's pre-pandemic trough. In addition employment growth appears to have slowed, leaving Canada with 635,000 fewer jobs in October than in February.

The federal government has indicated that it views this on-going labour market crisis as an ideal opportunity to thoroughly overhaul the Employment Insurance (EI) regimes – perhaps even going so far as accommodating the needs of the self-employed and those working in the gig economy.

I would assert, however, that given the unique nature and the (thankfully) low frequency of terrible events like pandemics, that reforms should aim at better addressing the unemployment risks that are concomitant with more frequently occurring shocks.

Although there is a case for improving the administration of the EI and tax system, the pandemic does not teach us that the normal EI should be redesigned to meet the stress test for a shock of that virtually unprecedented magnitude. Despite their much-discussed drawbacks, the creation of new, temporary regimes such as the Canadian Emergency Response Benefit is the best approach in these circumstances.

The pandemic did, however, place in sharp relief some EI shortcomings and makes many potential EI reforms more germane. For example, one of the key observations from policy analyst Miles Corak is that the EI program responds to regional shocks with a long delay because EI eligibility is tied to the *levels* of past regional unemployment rates.

The EI program only slowly responded to the recession of 2008-2009. Similarly, the normal EI eligibility rules were so unresponsive to the oil price shock of 2014 – 2015 that the government implemented a pilot project to improve coverage. Ottawa has frequently resorted to pilot programs as a response to instances when the standard provisions of the EI system are deemed to be inadequate. The failure of the EI system to address the challenges posed by the pandemic should not be a surprise, but given the scale and nature of that shock, I argue that one cannot expect it to do so.

However, one specific policy recommendation that can help address future recessions more on the scale of what has occurred in the past comes from a suggestion that policy analyst Colin Busby and I made in 2011. Access conditions and benefit entitlement should be modulated according to provincial *changes* in the employment rate as opposed to being determined entirely by the unemployment rate prevailing in each of the specific EI administrative regions. This reform involves consolidating those 62 regions into much more highly aggregated regions and changing the labour market indicator to one that is more indicative of labour market shocks.

One advantage of the change in employment indicator is that it is easy to observe. Statistical measurement of the unemployment rate is more difficult because of the ambiguity that is inherent to gauging labour force participation. Another advantage is that it is a sharp indicator of the existence and the magnitude of the shock buffeting the labour market, of which the conditions determine the availability of jobs, which is not the case with the currently utilized measure

To the extent that it does proxy for the magnitude of downturns, it is consistent with the basic insurance principle that low-probability, unforeseeable losses should be indemnified. When employment rebounds – signaling tighter labour market conditions – losses suffered by workers are attenuated, and accordingly the EI provisions are tightened. Furthermore, as an indicator of cyclical unemployment, it also reflects the role of EI as an automatic fiscal stabilizer. By way of contrast, the level of unemployment measure reflects some element of structural unemployment (in certain regions of Canada) that the EI system was not originally designed to cover.

A third advantage of this indicator is that it allows for the access and entitlement provisions to adjust much more quickly to labour market downturns. The current three-month lag to calculate the regional unemployment rate only serves to generate inertia in the responsiveness of the EI regime and can be jettisoned in favour of a one-month data value arriving almost in real time. Because such a reform would work against the interests of 'high entitlement' regions with perpetually high unemployment rates, it would probably require involving a blend of changes in the regional employment rate and the levels of regional unemployment rates in order to be politically feasible.

With a large-scale EI reform on the agenda, policymakers should keep in mind the kinds of reforms that will best address the most probable future economic downturns. These are more likely to look like downturns the country has faced in the past than the COVID-19-induced downturn, for which broader tools are necessary.

David Gray is a professor of economics at the University of Ottawa.

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