

OECD ECONOMIC SURVEY OF CANADA 2004:

EMPLOYMENT INSURANCE

*This is an excerpt of the OECD Economic Survey of Canada, 2004,
from the section on employment insurance in Chapter 3 and the Annex 3.2*

1. Canada's unemployment rate is currently around 7 per cent, which points to one potential source of additional labour utilisation and leads to questions about the incentives embodied in the Employment Insurance (EI) programme. In fact, the overlap between EI and unemployment is surprisingly limited: the ratio¹ of those receiving benefits to those who are unemployed has been stable at about 45 per cent since the late 1990s (Canadian Employment Insurance Commission, 2004). Around 35 to 40 per cent of claims at any time come from frequent claimants (on average between 1995 and 2002), but the dynamics of persistent use are more complex. Much attention has been paid to the use of EI by seasonal workers, but not all long-term seasonal workers end up claiming EI, and not all seasonal jobs result in subsequent EI claims (de Raaf *et al.*, 2004). Long-term seasonal workers' reliance on EI turns out to depend on the characteristics of those frequent users, especially education and age, as well as the conditions of the local labour market (Table 3.2). Repeated use is far more frequent in the Atlantic Provinces and Quebec than elsewhere in the country.

2. The unemployment insurance system has undergone major improvements since 1990, improving work incentives by tightening eligibility criteria and shortening the duration of benefits.² Nevertheless, the programme continues to contain some rules that discourage seasonal and intermittent workers in the high-unemployment areas from working more steadily through the year (see Annex 3.2). Although the rules were designed to ensure equitable access to the EI programme across the country, they can result in some unfortunate incentive effects for those who work only just enough hours to qualify for benefits. For example, someone who has worked only 12 weeks (full-time) in a high-unemployment area (*i.e.* with joblessness of more than 16 per cent) can receive up to 32 weeks of benefits whereas a claimant who has worked 20 weeks in a low-unemployment area could receive only 14 weeks of benefits. As qualifying hours continue to accumulate, in low-unemployment regions the additional weeks of benefit coverage obtained per hour worked is broadly constant until the maximum is reached, whereas in high-unemployment areas the additional coverage per hour worked declines significantly. These diminishing returns may act to discourage efforts to pursue work opportunities (de Raaf *et al.*, 2004). Furthermore, there is some evidence to indicate that both employers and employees who are experienced with the system can be adept at organising work patterns so as to maximise the EI benefits that are received (Gray and de Raaf, 2002).

Table 3.2. **Selected characteristics of long-term seasonal workers**
1993-98, per cent

Demographic characteristics	Degree of reliance on EI following all three seasonal losses				
	Entire sample	Never	Once	Twice	Three times
Proportion relying on EI	-	17.3	20.2	24.9	37.6
Age					
Under 30 years	37.1	45.4	48.9	36.8	27.1
30-39 years	32.3	33.5	30.3	31.3	33.6
40 years and older	30.6	21.2	20.8	31.9	39.3
Gender					
Male	63.7	50.8	53.3	68.4	72.0
Female	36.3	49.2	46.7	31.6	28.0
Education					
High school or less	59.8	54.8	53.5	55.7	67.9
More than high school	40.2	45.2	46.5	44.3	32.1
Regional unemployment rate					
7 per cent or less	28.8	49.3	42.5	24.5	14.9
7 to 9 per cent	20.3	17.0	27.2	21.9	17.0
Over 9 per cent	50.9	33.7	30.2	53.6	68.1
Marital status					
Without partner	30.4	40.0	33.4	31.3	23.8
With partner	69.6	60.0	66.6	68.7	76.2
Region					
Atlantic and Quebec	47.6	28.4	25.2	44.8	70.2
Ontario and West	52.4	71.6	74.8	55.2	29.6
Family Income					
Under C\$35 000	34.8	32.4	26.6	42.7	35.0
Between C\$35 000 and C\$60 000	37.9	40.6	33.6	34.1	41.4
C\$60 000 and over	27.4	27.0	39.8	23.3	23.6

Note: "Long-term" seasonal workers are workers who experienced a job loss in the same three-month "off season" in at least three of the five years from 1993 to 1998.

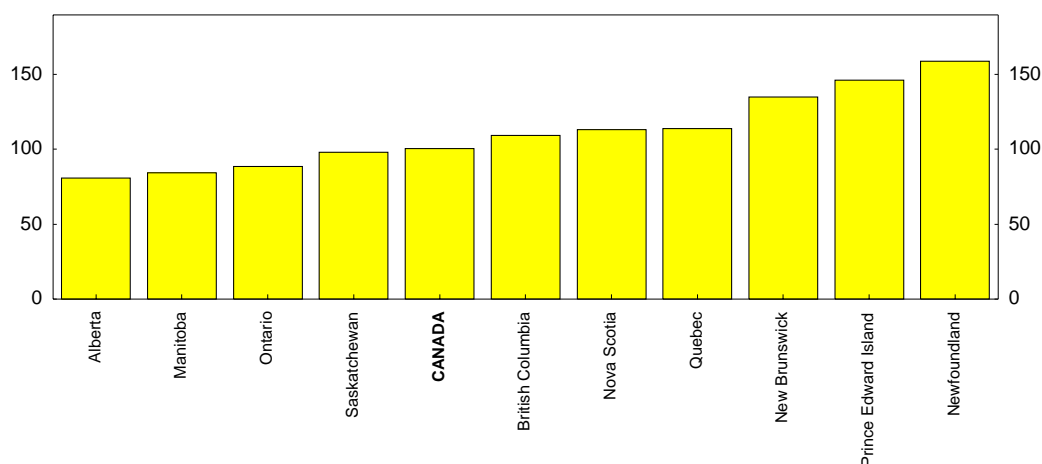
Source: De Raaf, Kapsalis and Vincent (2003).

3. The various measures can be combined together to provide an EI disincentives index, which shows major variations across the country (Figure 3.5). This suggests that in some areas, high unemployment may to some extent be self-perpetuating and may need to be addressed *via* a combination of more vigorous case management and job-activation measures (especially involving efforts to overcome skills weaknesses) and revised benefit rules that provide stronger incentives for job search and acceptance of work offers. (Gray, 2003). However, on benefit rules, a pilot project announced earlier this year has increased benefits in high unemployment areas, potentially weakening work incentives, all else equal, by extending the maximum benefit period by an additional five weeks.³

4. A key feature that emerges from detailed examination of unemployment benefits is the clear evidence of cross-subsidisation among industries and firms. Indeed, the relative benefit-to-tax (RBT) ratio indicates that firms in the fishing, forestry, construction and agriculture sectors were consistently (and heavily) subsidised by those in other industries from 1986 to 1996 inclusive⁴ (Corak and Chen, 2003). In forestry, construction and agriculture, the claim rate was higher due to temporary separations than to permanent separations, while for fishing the claims were split roughly equally. Furthermore, the firms that were subsidised in every year of the 11-year period were more likely to be middle-sized (between 20 and 499 employees), to have a higher rate of temporary job separations and to be located in Quebec (Table 3.3). At a more detailed level, it becomes clear that cross-subsidisation occurred not only among

Figure 3.5. Regional variations in the EI disincentives index

As at mid-2003



Note: The index is compiled using the parameters of the regular (unemployment) benefits of the Employment Insurance scheme on the assumption that individuals who choose intermittent employment and unemployment use the rules to optimise their choice of duration of employment and unemployment. The average disincentive across Canada in 1970 was set to equal 100. The methodology is presented in Sargent (1995).
Source: Department of Finance Canada.

Table 3.3. Subsidisation status and characteristics
Annual averages, 1986-96
Percentages

Characteristics	Always subsidised firms	Never subsidised firms	All firms ¹
Firm size (per cent of jobs)			
Less than 20 employees	11.3	3.2	11.0
Between 20 and 99 employees	27.4	5.0	16.8
Between 100 and 499 employees	28.4	12.7	18.4
500 employees or more	32.9	79.7	53.8
Reasons for layoff leading to a UI claim (per cent of claims)			
Temporary job separation	71.5	43.2	47.8
Permanent job separation	21.1	40.4	37.0
Unknown reason for job separation	7.4	16.4	15.2
Province² (per cent of firms)			
Ontario	15.0	38.5	33.1
Quebec	37.8	14.7	23.5
British Columbia	-	-	13.2
Alberta	-	14.6	-
New Brunswick	9.7	-	-
Industry² (per cent of firms)			
Services	23.8	41.4	36.5
Trade	10.7	19.1	23.2
Construction	30.7	-	10.8
Finance	-	14.1	-

1. Figures are based on the 318 217 firms that were in operation for all 11 years from 1986 to 1996.

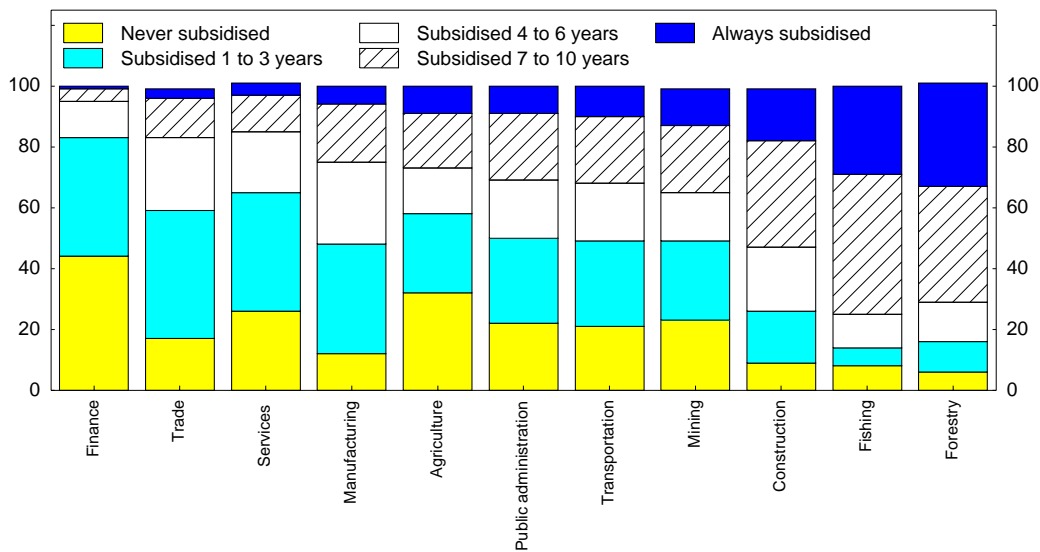
2. Figures by industry and province only indicate percentages for the three top categories.

Source: Corak and Chen (2003).

industry groups but also among firms within each industry group⁵ (Figure 3.6). Altogether, this suggests that certain firms may have been taking advantage of the existence of EI to keep an experienced workforce available on demand while shifting the cost onto other firms. To further reduce this cross-subsidisation, one instrument would be to adjust firms' EI premiums to take account of firms' record of previous layoffs leading to EI claims, *i.e.* enterprise experience rating. Doing this implies that the social costs of the lay-offs would be internalised and employers would have to think more carefully about repeatedly using temporary layoffs as they would bear the costs. Experience rating has been in place in the United States for many years for exactly this reason (see Box 3.1).

Figure 3.6. Firms by industry and subsidisation status

Per cent, 1986-1996



Source: Corak and Chen (2003).

Box 3.1 Enterprise experience rating

Experience rating of employers has been a permitted feature of the US Unemployment Insurance system since its inception, although it has been left to individual states to decide whether they wished to put it into place (Baicker *et al.*, 1997).

The key principle is that those firms with a higher rate of lay-offs pay a higher premium than those who make little use of the system, and its introduction was based on the belief that employers had a significant degree of control over the use of seasonal and temporary layoffs. An insurance system in this situation would introduce moral hazard, because those firms would be able to keep their workforce available when needed again, without having to bear the costs of maintaining attachment. Effectively, employers and workers in firms with variable production enter into an implicit contract to shift costs onto other enterprises.

In the United States, unemployment insurance is funded through payroll taxes, and experience rating means that firms whose workers draw more heavily on unemployment benefits pay a higher tax rate. In practice, there is a variety of systems applied in different states. Perhaps the most common is the "reserve ratio", which is the difference for each firm between payroll taxes paid and unemployment benefits disbursed, relative to the firm's payroll, accumulated over time. There is a maximum and a minimum tax rate (although the minimum rate could be zero). A higher reserve ratio will bring about a lower tax rate and *vice versa* (although some systems have "flat" parts where the relation between tax changes and the reserve ratio is not linear). With the use of maximum and minimum rates, experience rating is incomplete, but it can still provide an effective response to moral hazard.

Empirical evidence of the impact of experience rating on seasonal unemployment is relatively difficult to obtain, but it suggests a reduction in moral hazard in the United States (Baicker *et al.*, 1997). Instead, much of the debate has turned on the outcomes of different theoretical models on employment as a whole. For example, a standard implicit-contracts model produces opposite results depending on whether or not a budget constraint on the unemployment insurance system is imposed. With a budget constraint on the system as a whole, experience rating allows for a lower average payroll tax rate, which at the margin boosts employment overall (Fath and Fuest, 2002).

The effectiveness of enterprise experience rating depends heavily on the extent to which lay-offs are temporary (OECD, 2004a). This suggests that Canada would be more likely to benefit from its introduction than many other OECD countries, where temporary lay-offs are less significant.

NOTES

1. This result reflects two factors: just over half the unemployed were potentially eligible, while the rest either quit their jobs, were engaged in non-covered work, such as self employment, or had not worked in the previous 12 months. Of those potentially eligible, 16 per cent had not accumulated enough hours of paid work to qualify for benefits.
2. The reforms in 1996 were designed to reinforce the insurance principle: the work disincentives in the system were reduced further; eligibility was tightened again, albeit by less than in the earlier reforms; and some income redistribution measures became better targeted.
3. During the pilot project, the government will evaluate its effect on the project participants, the labour market and the existing incentives to work embodied in the EI programme.
4. RBT ratios were 14.8 for fishing, 5.1 for forestry, 3.3 for construction and 3.2 for agriculture for the 11-year period 1986 to 1996. All other sectors of the economy had a RBT ratio of less than one, which means they were net payers.
5. This can be illustrated by the fact that three industries (defined at the three-digit SIC level) appear among both the industries with the highest proportion of always-subsidised firms and the industries with the highest proportion of never-subsidised firms.

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ANNEX 3.2

REGULAR BENEFITS UNDER EMPLOYMENT INSURANCE

1. This annex sets out the principal parameters of the regular benefits that are available to the unemployed within the Employment Insurance programme. Regular benefits can be paid to claimants who lose their job through no fault of their own (for example, due to shortage of work, seasonal or mass lay-offs), and who are available for and able to work, but cannot find a job.

Qualifying for benefits

2. To be eligible for regular benefits, the claimant must have been without work and without pay for at least seven consecutive days and have worked the required number of insurable hours during the qualifying period, which is the previous 52 weeks or the period since the last claim, whichever is shorter. The insurable hours are based on where the claimant lives and the unemployment rate in that economic region at the time of filing a claim for benefits. Only the insurable hours that fall within the qualifying period are used to start a benefit period. However, the qualifying period may be extended up to 104 weeks for people who were not employed in insurable employment and not receiving EI because they were incapable of work by reason of illness, injury, quarantine or pregnancy; or because they were attending a course of instruction or other related employment activity on referral from an Human Resources and Skills Development Canada (HRSDC) designated authority.

3. Most people will need between 420 and 700 insurable hours of work in their qualifying period, depending on the unemployment rate in their region at the time of filing their claim for benefits. In some instances, a minimum of 910 hours in the qualifying period may be needed to qualify, for example, those in the work force for the first time or re-entering the work force after an absence of two years (with special provisions for those who have received maternity or parental benefits).

4. The “labour force attachment period” is the 52-week period immediately prior to the qualifying period. If less than 490 hours have been worked in the labour force attachment period, then a minimum of 910 hours must be worked during the qualifying period to gain entitlement to regular benefits. The calculation of hours takes into account: any hours of insurable employment; any hours for which benefits have been paid or payable (calculated on the basis of 35 hours per week for each week of benefits paid); any hours that relate to a situation arising out of insurable employment or a situation which prevents the payment of benefits.

Benefits calculations

5. There is a two-week unpaid waiting period before EI benefits start being paid. Generally, this period is the first two weeks of the claim. But if a benefit claim is re-opened and the waiting period already served, it is not required again. Earnings made (for example, vacation pay, severance pay, ...) or allocated during the two-week waiting period will be deducted in the first three weeks for which benefit is otherwise payable following the waiting period. Earnings allocated to any week of the waiting period result in a dollar-for-dollar deduction equal to the weekly benefit rate. This means that the maximum deduction for the two-week waiting period is twice the weekly benefit rate.

6. Regular benefits can be paid from a minimum of 14 weeks to a maximum of 45 weeks usually over a period of 52 weeks.¹ The number of weeks of benefit is determined at the starting date of the benefit period, based on the unemployment rate in each region and the amount of insurable hours accumulated (Table 3.A2.1) This table does not include the additional weeks of EI benefits in the pilot project that started on 6 June 2004.

Table 3.A2.1 Number of weeks of benefits payable

Insured hours worked during qualifying period	Unemployment rate in claimant's region											
	6% and under	Over 6% to 7%	Over 7% to 8%	Over 8% to 9%	Over 9% to 10%	Over 10% to 11%	Over 11% to 12%	Over 12% to 13%	Over 13% to 14%	Over 14% to 15%	Over 15% to 16%	Over 16%
420-454									26	28	30	32
455-489								24	26	28	30	32
490-524							23	25	27	29	31	33
525-559						21	23	25	27	29	31	33
560-594					20	22	24	26	28	30	32	34
595-629				18	20	22	24	26	28	30	32	34
60-664			17	19	21	23	25	27	29	31	33	35
665-699		15	17	19	21	23	25	27	29	31	33	35
700-769	14	16	18	20	22	24	26	28	30	32	34	36
770-839	15	17	19	21	23	25	27	29	31	33	35	37
840-909	16	18	20	22	24	26	28	30	32	34	36	38
910-979	17	19	21	23	25	27	29	31	33	35	37	39
980-1049	18	20	22	24	26	28	30	32	34	36	38	40
1050-1084	19	21	23	25	27	29	31	33	35	37	39	41
1085-1154	20	22	24	26	28	30	32	34	36	38	40	42
1190-1259	21	23	25	27	29	31	33	35	37	39	41	43
1260-1329	22	24	26	28	30	32	34	36	38	40	42	44
1330-1399	23	25	27	29	31	33	35	37	39	41	43	45
1400-1434	24	26	28	30	32	34	36	38	40	42	44	45
1435-1469	25	27	29	31	33	35	37	39	41	43	45	45
1470-1504	26	28	30	32	34	36	38	40	42	44	45	45
1505-1539	27	29	31	33	35	37	39	41	43	45	45	45
1540-1574	28	30	32	34	36	38	40	42	44	45	45	45
1575-1609	29	31	33	35	37	39	41	43	45	45	45	45
1610-1644	30	32	34	36	38	40	42	44	45	45	45	45
1645-1679	31	33	35	37	39	41	43	45	45	45	45	45
1680-1714	32	34	36	38	40	42	44	45	45	45	45	45
1715-1749	33	35	37	39	41	43	45	45	45	45	45	45
1750-1784	34	36	38	40	42	44	45	45	45	45	45	45
1785-1819	35	37	39	41	43	45	45	45	45	45	45	45
1820+	36	38	40	42	44	45	45	45	45	45	45	45

Note: This table does not include the additional weeks of EI benefits in the pilot project that started on 6 June 2004.

Source: Human Resources and Skills Development Canada.

7. The basic benefit rate is 55 per cent of average insured earnings up to a maximum amount of C\$413 per week. EI payments are taxable income, and federal and provincial or territorial (if it applies) taxes are deducted at source. A higher benefit rate (the family supplement) applies to low-income families (with an income of less than C\$25 921 a year) with children if they receive the Canada Child Tax Benefit.

8. If the claimant has earned less than C\$225 a week (“small weeks”), any time during the last 26 weeks of work, earnings in those “small weeks” may be excluded from the calculation of the benefit rate. The number of small weeks that can be excluded depends on the “minimum divisor”, which establishes the minimum number of weeks’ earnings that will be counted for determining weekly benefits and is dependent on the regional unemployment rate: in regions with 0-6 per cent unemployment, a minimum of 22 weeks’ earnings are counted, whereas if unemployment is above 13.1 per cent, then only 14 weeks are counted, unless the claimant has worked a higher number of regular weeks.

9. Claimants can work part-time while receiving regular benefits. The first C\$50 or 25 per cent of weekly benefits, whichever is higher, can be earned without changing the amount of benefits received that week. Any monies earned above that amount will be deducted dollar for dollar from benefits.

EI premiums

10. EI premiums are paid on all earnings up to the annual maximum salary of C\$39 000. This means that deductions for the year 2004 are C\$1.98 for every C\$100 of salary until C\$39 000 has been reached. The maximum contribution amount is therefore C\$772.20 for 2004.

Repayment of benefits at income tax time

11. There is a provision clawing back EI regular benefits (including regular fishing benefits) through the income tax system from those with annual net income exceeding C\$48 750. The repayments required are 30 per cent of the lesser of net income in excess of C\$48 750 or the total regular benefits (including regular fishing benefits) received in the taxation year.

NOTE

1. The duration of the benefit period may be extended up to 104 weeks, but the number of weeks of benefits which may be paid will remain unchanged.