

**Canada's Declining Social Safety Net:  
EI Reform and the 2009 Budget**

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# Canada's declining social safety net: EI reform and the 2009 Budget

Lars Osberg

April 29, 2009

In May of 2008, the unemployment rate in Canada was 6.1%. Talk of looming “labour market shortages” dominated labour market policy discussions and unemployment insurance reform was not on the policy agenda. By March of 2009, the unemployment rate had risen to 8.0% and the OECD was predicting a continuing upward trend – to an annual average of 8.8% in 2009 and 10.5% in 2010<sup>1</sup>. Quite suddenly, the global recession arrived and Canadians looked for a social safety net.

How adequately does Canada's current Employment Insurance system fill that need?

What could or should be done to improve it?

How do the initiatives of the 2009 Federal Budget compare?

Section 1 of this paper documents the fact that Canada's current EI system offers relatively little income protection compared with the unemployment insurance system in place in other OECD nations and compared with Canada's (Un)Employment Insurance systems of previous years. Section 2 discusses briefly the changing literature on unemployment and (un)employment insurance, with its new-found emphasis on the benefits, as well as the costs, of insurance for individuals against employment income risk. Section 3 then discusses the inadequacy of the 2009 Budget's response and Section 4 speculates on implications.

## **1. Canada's current EI system in Comparative Perspective**

Figure 1 plots Canada's seasonally adjusted unemployment rate from 1976 to February, 2009. It documents the recessionary surges in unemployment that dominated the early 1980s and 1990s and the brief period (from 2005 to 2008) of unemployment rates under 7% that started, after a 30 year drought of labour demand, to give Canadians a brief experience of shorter job search and sometimes rising real wages.

If jobs are easily available, the labour market provides the income-earning opportunities that people need, and the characteristics of income-support programmes are relevant only to an unfortunate few. But Figure 2 (taken from the OECD Economic Outlook of March 2009<sup>2</sup>) illustrates that this is not Canada's current and emerging labour market reality.

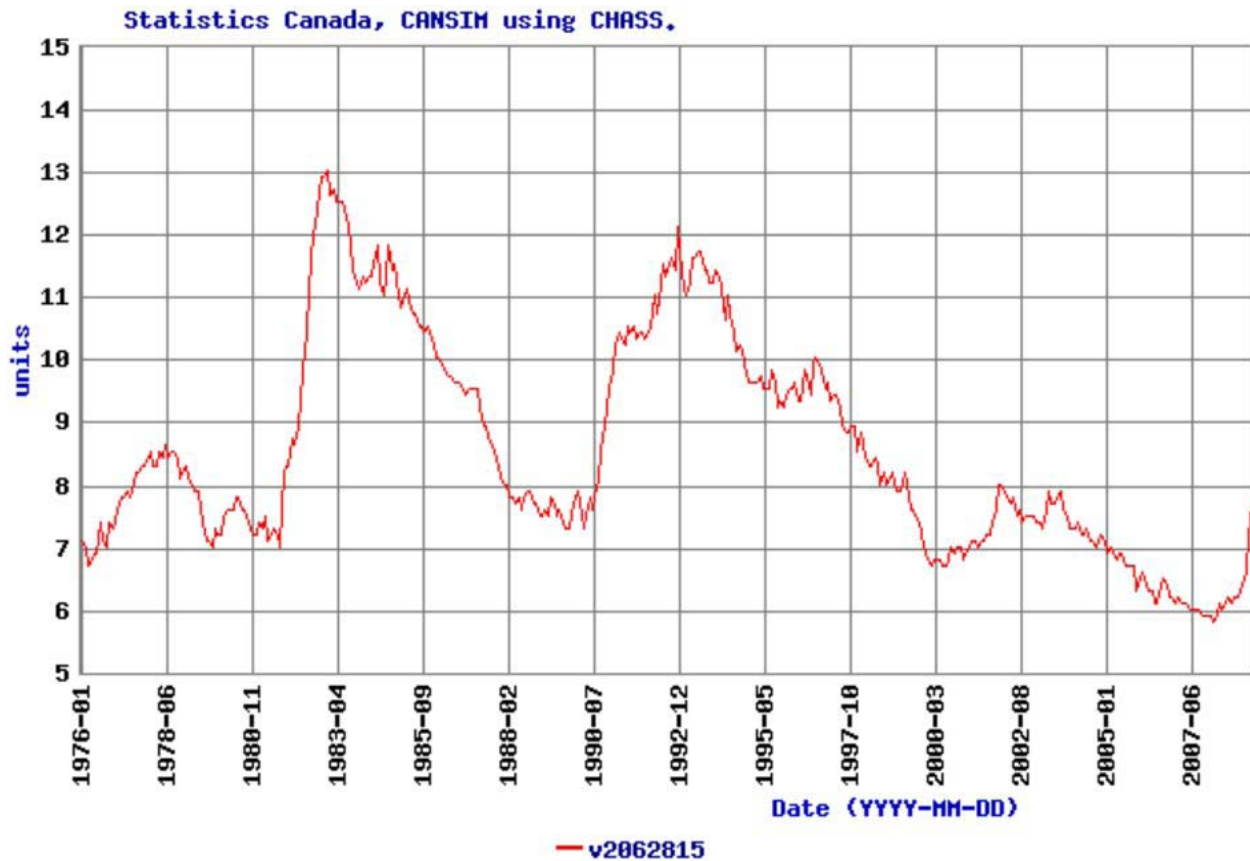
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<sup>1</sup> After peaking in October 2008, employment has fallen each month since, with net losses totalling 357,000 (-2.1%) by March, 2009. In percentage terms, this was the largest decline over a five-month period since the 1982 recession.

<sup>2</sup> OECD Economic Outlook March 2009 <http://www.oecd.org/dataoecd/18/1/42443150.pdf>

Figure 1

The Unemployment Rate in Canada



Compared to the United States, or European nations, Canada was a relative “late-adopter” of Unemployment Insurance. As Perry (1989:681) puts it, the passage of the Unemployment Insurance Act of 1940, well after the Depression of the 1930s, was a belated “recognition of the fact that the historic provincial-municipal relief system was a hopelessly inadequate instrument for dealing with unemployment on a national scale.” Changes over the next few decades were relatively modest in scope, but the 1971 revisions were of a different order of magnitude. Figure 3 illustrates both the size of the 1971 revisions and the fairly relentless decline in the benefit replacement rate that has characterized the 38 years since<sup>3</sup>.

<sup>3</sup> The average of the gross unemployment benefit replacement rates for two earnings levels, three family situations  
Source: OECD, Tax-Benefit Models. See Martin (1996) for details.  
[http://www.oecd.org/document/3/0,3343,en\\_2649\\_34637\\_39617987\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/3/0,3343,en_2649_34637_39617987_1_1_1_1,00.html) ;

Figure 2

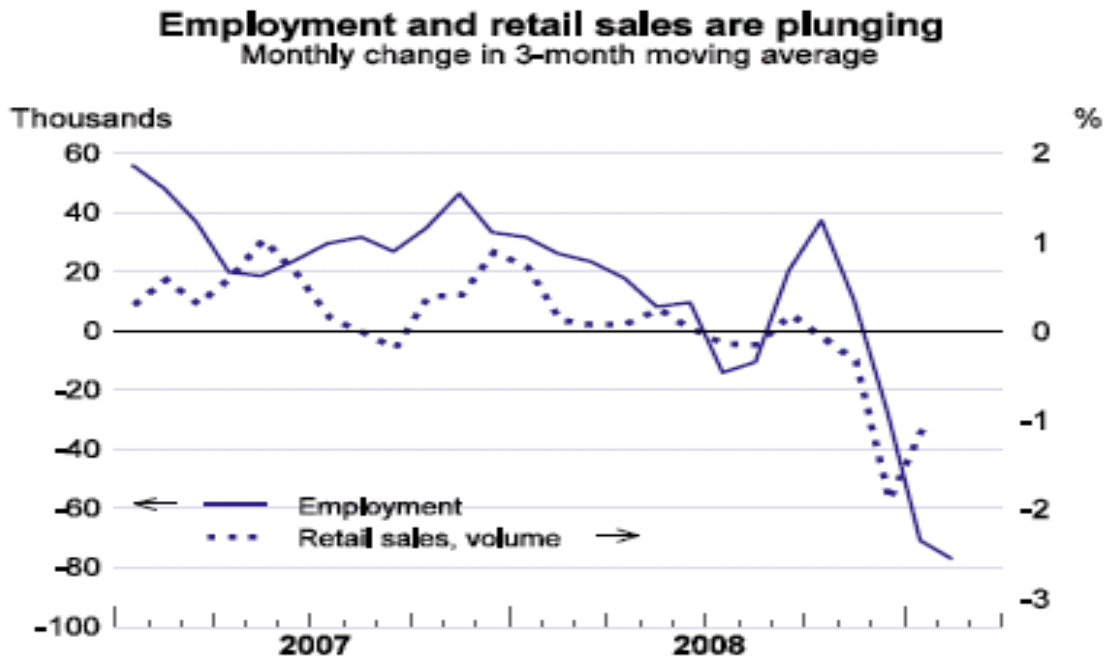


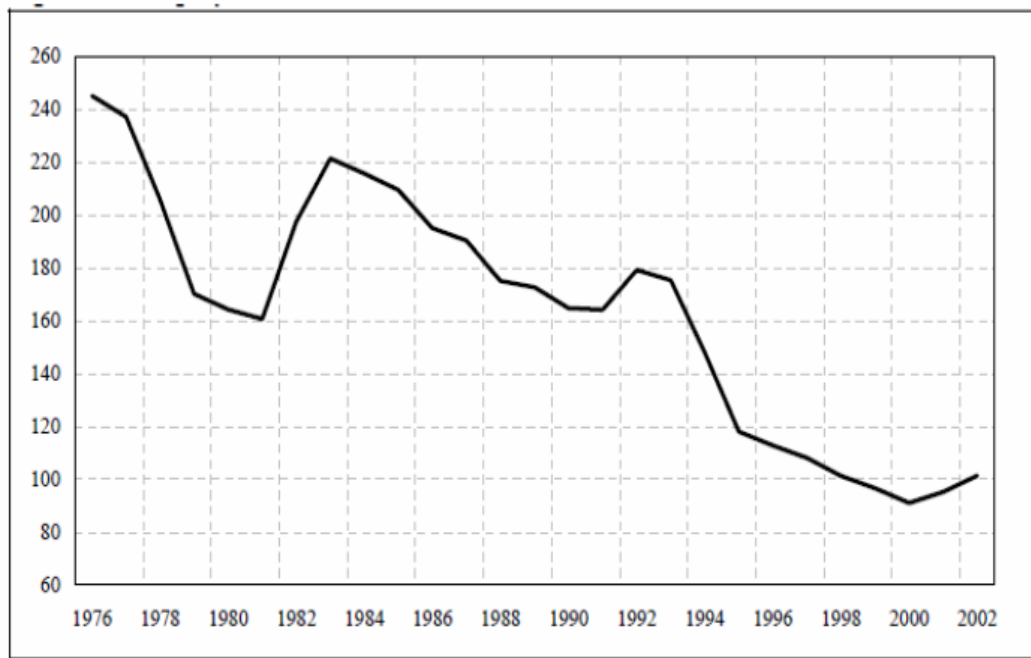
Figure 3



Because the “replacement rate” (i.e. the ratio of unemployment benefits to employment earnings) varies with the situation of individual workers and because the accessibility and duration of benefits are hugely important dimensions of any unemployment scheme, a general moral of the international literature is the complexity of real world unemployment income replacement schemes. In looking for an intellectual framework to simplify this real world complexity, the 1970s and 1980s literature on UI in Canada adopted a “labour/leisure choice” perspective. The disincentive effects of UI were analyzed in terms of the impact of increased weeks of work per year on benefit duration, while presuming that the option of employment at an unchanging wage was always open to individuals and that unemployment was equivalent to (enjoyable) leisure<sup>4</sup>. The “Sargent Index” of UI/EI incentives has kept this supply-side perspective of voluntary ‘leisure’ choice, but amended the early literature’s assumption of an annual accounting framework to reflect the possibility that shorter cycles of work and non-work might be personally optimal – as Figure 4 illustrates, it has declined to a similar degree as the simpler OECD Summary Measure over the last three decades<sup>5</sup>.

Figure 4

### Sargent’s Employment Insurance Index: 1976 - 2002

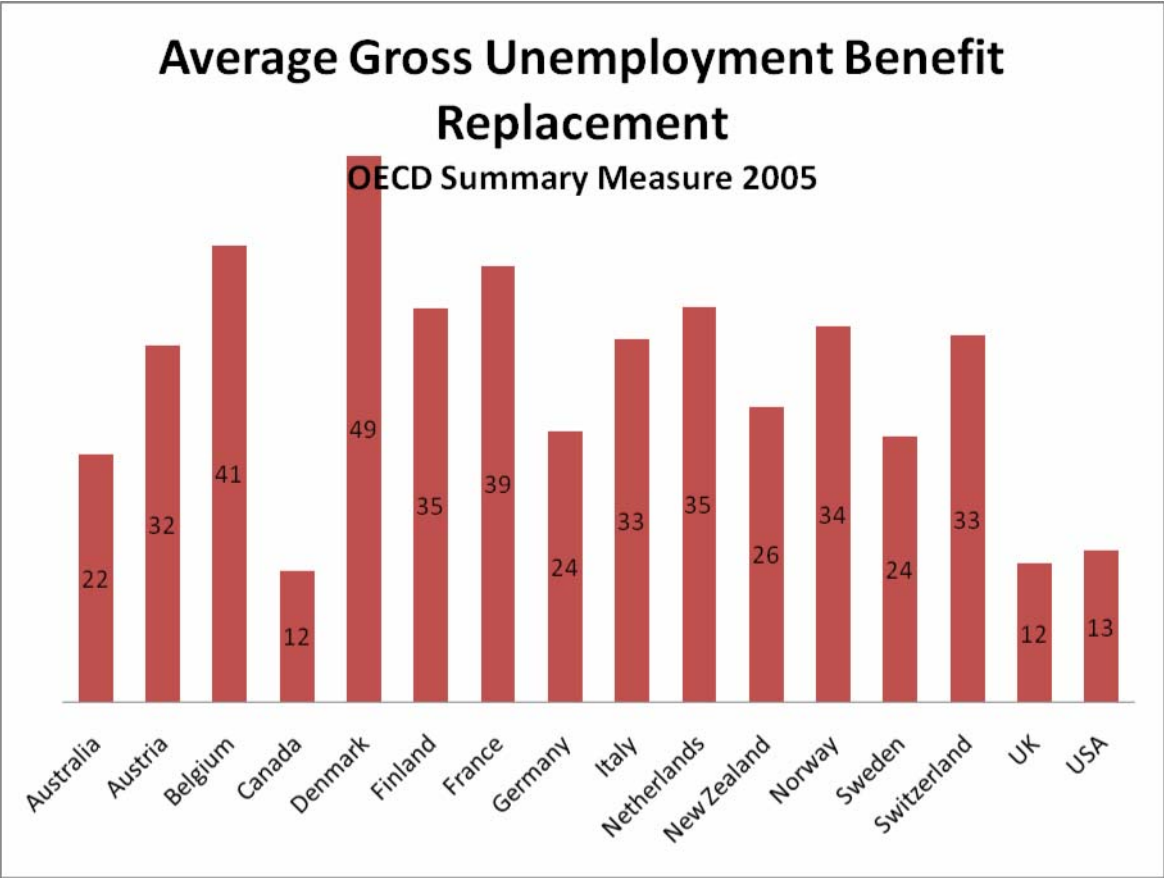


<sup>4</sup> E.g. Green and Cousineau, 1976

<sup>5</sup> James, Sargent, Barnett and Lavoie (2007: 11)

The “replacement rate” can be calculated either as a ‘gross’ ratio (comparing benefits to employment earnings before tax) or as a ‘net’ after-tax and after-transfer concept (i.e. after accounting for any changes in income tax or other social transfers and benefits that would be triggered by unemployment or lower annual income.) As Figures 5 and 6 illustrate, it makes little difference to comparisons between Canada and other OECD nations. Canada is close to lowest by either criterion – as Figure 5 shows, with marginally lower gross replacement than the US average (see also Data Appendix Tables D1 and D2).

Figure 5



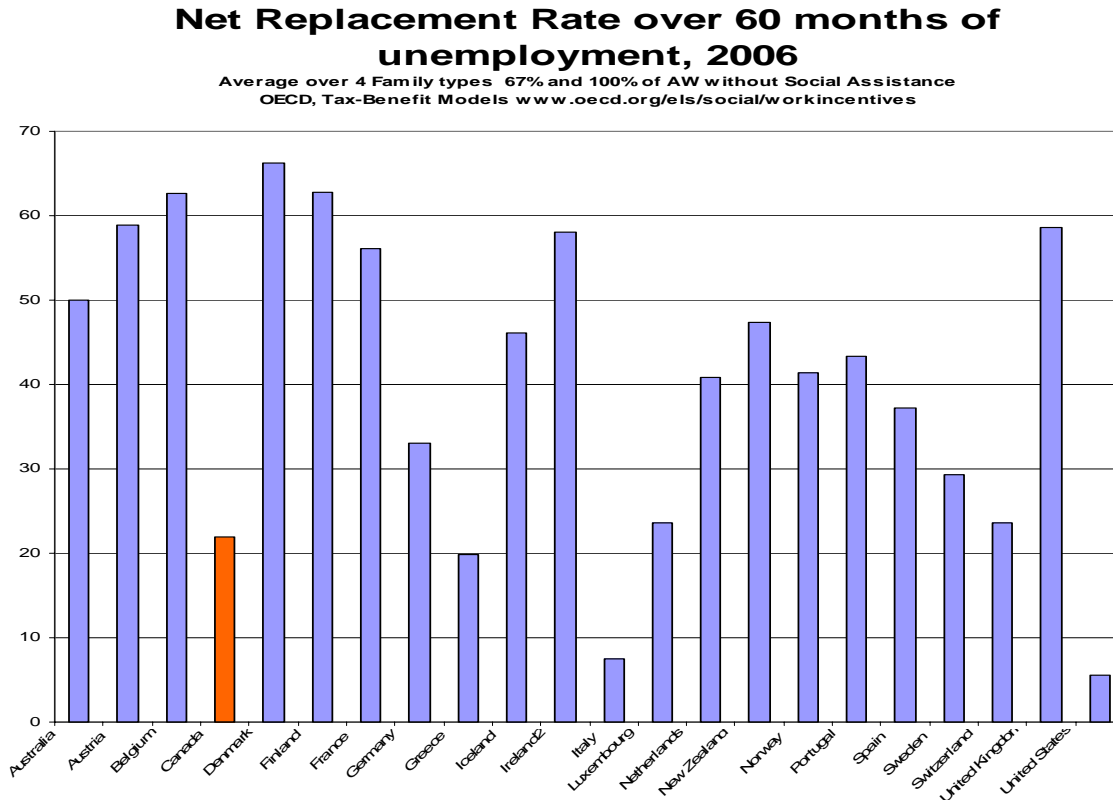
The average of the gross unemployment benefit replacement rates for two earnings levels, three family situations Source: OECD, Tax-Benefit Models.

[http://www.oecd.org/document/3/0,3343,en\\_2649\\_34637\\_39617987\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/3/0,3343,en_2649_34637_39617987_1_1_1_1,00.html)

However, it is not just low wage Canadians who are exposed to unemployment risk. In thinking about income replacement and economic (in)security, it is important to remember that only insurable earnings up to the Maximum Insurable Earnings are covered by Canada’s Employment Insurance Program. The calculations of replacement rates for OECD countries presented in Figures 5 and 6 present an average of the replacement rates for workers at 67% and 100% of average weekly earnings – but because earnings above the MIE (in 2009, \$42,300) are

not insured, in Canada the replacement rate is substantially lower at the upper end of the earnings distribution.<sup>6</sup> Just under half (in 2009, 44%<sup>7</sup>) of claims are at the maximum, implying a lower aggregate replacement rate for all such individuals.

Figure 6



Employment Insurance in Canada in 2009 does not, therefore, replace nearly as much of lost employment income as UI/EI used to in Canada, or as compared to similar unemployed people in the vast majority of OECD nations – even assuming one can get it. But as Figure 7 illustrates, a major problem with Canada’s social safety net in this recession, compared to earlier downturns, is how much rarer it is for the unemployed to get regular EI benefits<sup>8</sup>. In January, 2009 the seasonally adjusted unemployment rate in Canada was 7.7% - as it also was in February

<sup>6</sup> E.g. In the event of unemployment, somebody earning \$85,000 (twice the MIE) would have half their earnings replaced at 55%, and the other half replaced at 0%, for an average replacement rate of 27.5%, even before averaging in the impact of the two week waiting period of zero replacement.

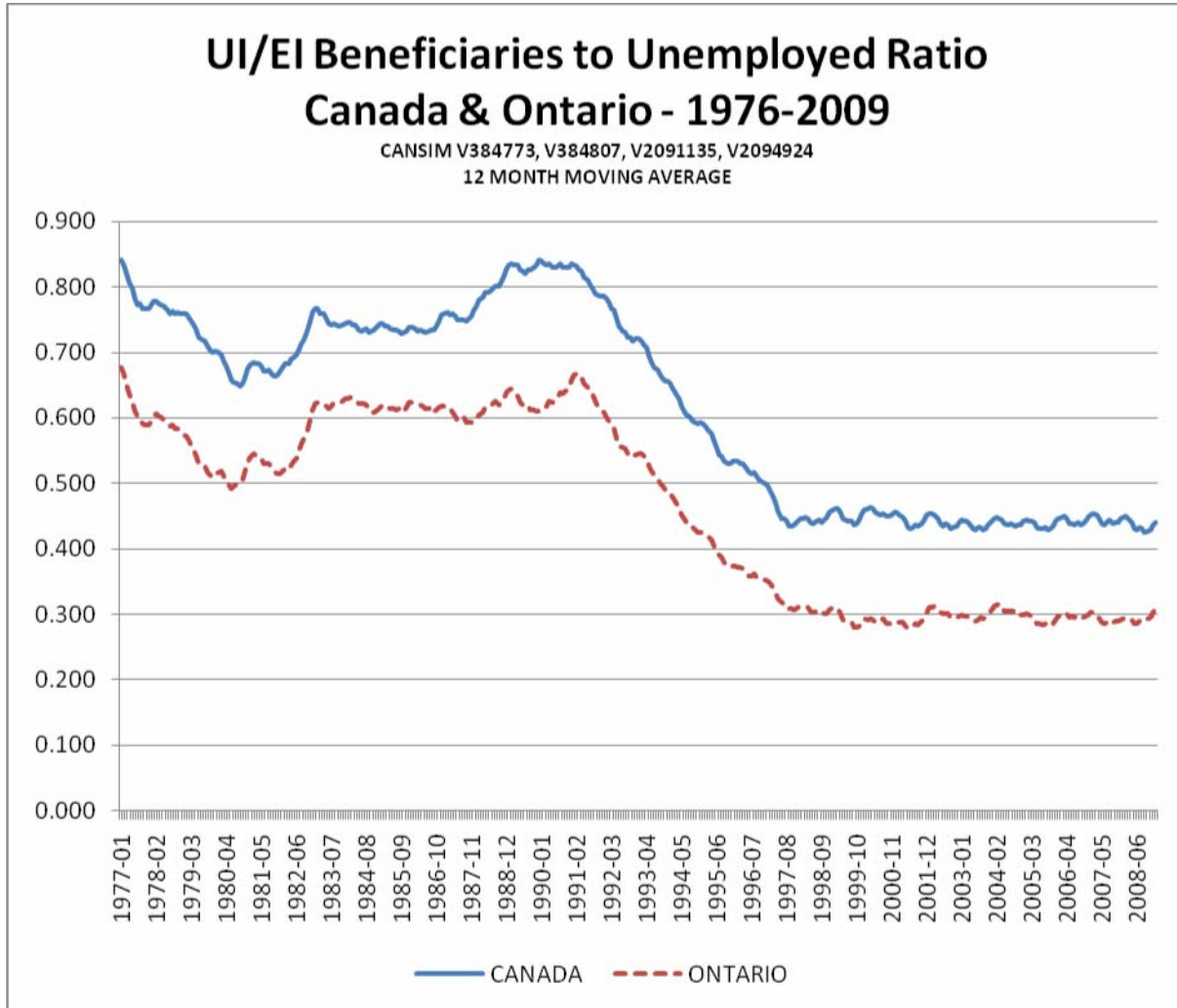
<sup>7</sup> REPORT OF THE CHIEF ACTUARY TO THE EMPLOYMENT INSURANCE COMMISSION ON THE EMPLOYMENT INSURANCE PREMIUM RATE AND MAXIMUM INSURABLE EARNINGS, 2009

<sup>8</sup> Jones (2004:27) examined alternative EI coverage measures, noting that the “B/U ratio can be used to evaluate program targets, rather than just to evaluate the performance of a program relative to an exogenously given target.”



of 1990, near the start of the early 1990s recession – but only a bit over half as many of the unemployed were getting unemployment benefits in 2009, compared to 1990<sup>9</sup>.

Figure 7



A positive feature that Canadian EI has retained from the old UI system is a formula-driven recognition built into program design that the demand side of labour markets does matter. The higher the local unemployment rate is, the greater will be the job search difficulties of the unemployed. EI regulations recognize that reality by automatically adjusting entrance

<sup>9</sup> Both the number of beneficiaries and the number of unemployed are volatile and seasonal, so Figure 7 presents a twelve month moving average – by this calculation the B/U ratio for Canada was 83.7% in February 1990 and 43.9% in February 2009. The unsmoothed B/U ratio was 92.3% in February 1990 compared to 52.7% in February 2009. For Ontario, the comparison is 61.9% to 31.5% (smoothed) and 73.5% to 39.9% (unsmoothed). For the USA the unsmoothed B/U ratio in February 2009 was 38.3%. see <http://www.ows.doleta.gov/unemploy/claims.asp>

requirements and benefit durations – as Table 1 illustrates. In April/May of this year, the minimally qualified EI applicant in Windsor, Ontario had an entrance requirement that was only 60% of the insurable hours required to qualify in Halifax, Nova Scotia – and would be entitled to benefits for 20% longer – because the local unemployment rate was over twice as high.

Table 1  
EI Eligibility and Duration April 12 - May 9, 2009  
Regular Benefits

	Toronto	Montreal	Windsor	Halifax
Unemployment Rate	8.8	8.7	13.2	6.0
Number of Insured Hours Required to Qualify	595	595	420	700
Minimum Weeks Payable	23	23	31	19
Maximum Weeks Payable	47	47	50	41
Unemployed - March 2009	295,300	110,600	42,600	14,100

In its World Economic Outlook of October, 2008, the IMF has recently argued that this design feature of Canada's system should be emulated world-wide. As part of a wider package of counter-recessionary measures, they argue: "the role of fiscal policy as a macroeconomic stabilizer could be enhanced by strengthening the broader fiscal framework. ... First, .. automatic stabilizers could be boosted by making regular tax and transfer programs more cyclically

responsive. For example, the generosity of unemployment insurance systems could be automatically increased when the economy is in a downturn and jobs are harder to find”<sup>10</sup>.

But although the responsiveness of UI/ EI in Canada to local labour market conditions is now recognized internationally as good policy design, it has come at a cost, in political economy terms. Some areas of the country will always have above average local unemployment, and the rural areas of eastern Canada have fit this description. Table 1 (above) includes both the unemployment rate and the number of unemployed in order to make the point that although Halifax has just under half the labour force of Nova Scotia, in aggregate numbers it is still very small relative to other Canadian local labour markets. Despite the fact that urban areas of Atlantic Canada, like Halifax, have throughout the past thirty years had unemployment rates quite similar to comparably sized cities elsewhere in Canada, regional stereotypes of Atlantic Canada’s “dependency” on UI/EI became deeply entrenched in policy discourse in Canada throughout the 1980s and 1990s<sup>11</sup>. The small population base of the rural parts of Atlantic Canada has always implied their quantitative insignificance to Canada’s national unemployment problems, but quantitative importance has rarely impeded the political impact of an evocative stereotype. The inherent politeness of Atlantic Canadians usually restrained them from noting that the unemployed of rural Quebec have always outnumbered the unemployed of rural Atlantic Canada, and the rural labour markets of Quebec and Ontario have also had above average unemployment rates for many years and sometimes similar UI/EI usage patterns. Nevertheless, lasting damage has been done to the sense of national community necessary for Canada’s fiscal federalism.

## **2. Changing Perspectives on Unemployment and (Un)Employment Insurance**

In the period before Canada’s Unemployment Insurance system morphed into Employment Insurance in 1996, a notable feature of the academic literature on UI<sup>12</sup> was its emphasis on supply-side incentives to individual behaviour. Whether the framework of analysis was labour/’leisure’ choice or optimal choice of reservation wage in a search context, the focus was firmly<sup>13</sup> on how individuals’ choices were changed – perhaps ‘distorted’ – by the provisions of the Canadian UI system, and the impact of such distortions on measured unemployment. Part of this emphasis on individual choice was a presumption unemployment was equivalent to voluntary leisure – that jobs were available to the unemployed, and that all non-work time was intrinsically enjoyable.

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<sup>10</sup> IMF World Economic Outlook, October, 2008 Foreword page *xiv*

<sup>11</sup> Between 2001 and 2009, on average 5.8% of Canada’s unemployed lived in rural Atlantic Canada. Even considering the data within rural Atlantic Canada, there was a continuing confusion between the (sometimes) statistical significance of UI/EI variables and empirically important effect magnitudes.

<sup>12</sup> For a survey, see Osberg (1996).

<sup>13</sup> There were some exceptions (e.g. Osberg, Erksøy and Phipps, 1997, 1998),

A large social psychology literature (e.g. Kelvin and Jarrett (1985) has long argued otherwise. As Jahoda (1979:423) has put it:

“There are latent consequences of employment as a social institution which match human needs of an enduring kind. First among them is the fact that employment imposes a time structure on the waking day. Secondly, employment implies regularly shared experiences and contacts with people outside the family. Thirdly, employment links an individual to goals and purposes which transcend his own. Fourthly, employment defines aspects of status and identity. Finally, employment enforces activity.

It is these objective consequences of work in complex industrialised societies which help us to understand the motivation to work beyond earning a living; to understand why work is psychologically supportive, even when conditions are bad, and, by the same token, to understand why unemployment is psychologically destructive.”

Until fairly recently, this literature had little impact on economics, but the explosion of articles on self-assessed ‘happiness’ and ‘life satisfaction’ in the last decade has begun to remind many economists that people typically do not like being unemployed. Winkelmann (2006:1) is representative of a large literature in saying:

“individual unemployment has a large negative effect on subjective well-being. This mirrors the well documented effect of unemployment on physical health and on mental health. This negative effect appears to be causal: we know from panel data estimators that the association persists once we follow the same individuals over time, and thereby control for individual specific fixed effects. Neither is it the case that unemployed people have a completely different personality, or that they anchor their responses on the well-being scale in a way that is systematically differently from the way employed persons anchor theirs. Nor does it seem that there is an instance of reversed causation, i.e., that unhappiness causes unemployment (or, for that matter, that happiness leads to idleness).

It is also clearly understood that the negative effect of unemployment on well-being goes well beyond the effect that the income loss associated with unemployment can bring about. Indeed, the non-pecuniary cost of unemployment seem to exceed the pecuniary cost by far.<sup>14</sup>”

Leuchinger et al (2008), among others, have also noted that higher unemployment decreases the self-reported well-being of the employed, as well as the unemployed, because “increased *economic insecurity* constitutes an important welfare loss associated with high general unemployment”. This accumulation of evidence on the disutility of unemployment has undermined the foundations of perspectives which saw all non-work time as essentially similar, and pleasurable, and the voluntary choice models of unemployment built on those assumptions.

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<sup>14</sup> See also Frey and Stutzer (2002); Di Tella and MacCulloch (2003) and many others

As well, a curious feature of the early academic literature on unemployment insurance also was that it never balanced the budget – the impacts of UI benefits on search and labour supply behaviour were discussed without any simultaneous discussion of the behavioral impacts of the premiums necessary to raise the revenue to pay for those benefits. Had both premiums and benefits been jointly considered, the natural question to ask would have been: “Why would rational individuals vote for an Unemployment Insurance system in the first place, knowing that they must expect to pay for any benefits they may receive through payroll or income taxation?”

By looking just at behavioural impacts of UI benefits, the 1980s and 1990s literature on UI focussed on one aspect of the system’s costs, and it is not entirely surprising that a research agenda that focussed solely on costs should come to negative conclusions on impacts. However, if both benefits and costs are considered, then the socially important question is what individuals think are they getting from a UI/EI system and how much will they rationally want to purchase. In recent years, a revisionist literature (e.g. Shimer and Werning, 2006; Chetty, 2008) has begun to consider the benefits of (un)employment insurance, for risk-averse individuals who face some probability of demand side employment shocks and who may also be liquidity constrained, or otherwise unable to smooth consumption privately, when those shocks occur. Given that rational citizen/workers can expect both costs and benefits to vary with the level of income replacement, this new literature asks: “what is the optimal amount of income replacement?”

### **3. The Federal Budget of 2009.**

As the Red River flood moved north from the US to Manitoba in late March of 2009, a repeated theme of Canadian media reports was the contrast between frantic sand-bag preparation in US towns and the reassuring readiness of dikes and floodway diversion channels in Canada. The moral drawn was clear – risky and unsatisfactory ad hoc emergency measures are what a society has to do if it did not, during good times, put a system in place to deal with potential looming disasters.

Historically, the US has reacted to recessions in a somewhat similar way as to floods. In the current recession, as in previous downturns, Congress has passed special legislation to extend state unemployment benefits – in 2009, by thirteen weeks additional benefits. This ad hoc, but entirely predictable, aspect of the US UI system can be seen as an informal understanding that an inadequate system (see Figure 3) will be liberalized when a severe recession strikes. In contrast to a formula driven system, such as in Canada, ad hoc legislative revisions to unemployment benefits are not necessarily timely, or sensitive to local labour market realities, or directed to areas of greatest need – but at least the Americans know how to build a better sand-bag dike.

In Canada, the 2009 federal budget extended the maximum duration of EI benefits by five weeks. Entrance requirements and the replacement rate remained unchanged. From the perspective of macro-economic stimulus, the \$575 Million which is estimated to be the cost of these five additional weeks of EI benefits amounts to about 1/28<sup>th</sup> of 1% (i.e. 0.037%

%) of Canadian GDP.<sup>15</sup> The increase in benefit duration (which is only temporary, for two years) is easily affordable from program revenue – i.e. projected to cost about 3.42% of EI premium income in 2009-10. The IMF may have been saying since October, 2008 that “*The world economy is now entering a major downturn in the face of the most dangerous shock in mature financial markets since the 1930s.*”<sup>16</sup> but the response of Canada’s federal government has been distinctly tepid.

The inadequacy of the federal government’s response on EI in 2009 has to be seen in the context of the structural reforms of the mid-1990s to the financing and extent of Canada’s social safety net for working age adults and their families. Historically, provincial social assistance (SA) programs – albeit with low benefit levels and highly invasive asset and family income means testing – have been the backstop to a federally funded UI/EI program. As the C.D. Howe Institute has noted (2008:2): “macroeconomic conditions have an extremely strong impact on SA rates, and the decline in the unemployment rate from a high of 12 percent in 1993 to between 6 and 7 percent at the end of the period of analysis (2005) was the single most important factor in reducing the incidence of SA benefits .... The most significant influence on SA rates appears to be the availability of jobs, and it was the substantial strengthening of the economy after 1996 that had the greatest effect in driving SA rates downward.”

But what came down from 1993 to 2005 can now be expected to go back up again, as the unemployment rate rises – and in commenting on the Federal Budget of 2000, Osberg (2000:226) noted:

“the distribution of fiscal risk from business cycle fluctuations has shifted significantly in recent years. During the recessions of the early 1980s and 1990s, the federal government shared in the costs of cyclical downturn through its responsibility for Unemployment Insurance, and the cost sharing of social assistance under the Canada Assistance Plan<sup>17</sup>. In those recessions, the vast majority of the unemployed got Unemployment Insurance (paid for by the federal government) and those who ran out of UI could sometimes go on Social Assistance, for which the federal government paid fifty per cent of the cost.

In the late 1990s, the situation is fundamentally different. A minority of the unemployed are eligible for EI and any increase in social assistance costs produced by a downturn in labour demand will be entirely borne by provincial treasuries. The shift to block funding of transfers to the provinces embodied in the CHST means that the federal government’s participation in increased social assistance payments in a recession is now zero. Demands on the social assistance system are likely to be more sensitive to future business cycle downturns

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<sup>15</sup> See Table 3.5 Page 121, Budget 2009.

<sup>16</sup> IMF (2008a:xx). The IMF has since revised its growth projections significantly downwards in two updates - in November, 2008 and again in January 2009. And by late April of 2009, as flood waters threatened outlying areas of Winnipeg, the self-congratulatory tone of Canadian media reports on flood preparedness had largely disappeared.

<sup>17</sup>In the 1990s recession, federal participation in recessionary costs was greatly limited by the “Cap on CAP” which limited annual increases in Canada Assistance Plan transfers to Ontario, BC and Alberta to 5% - despite the fact that the recession hit Ontario hardest.

because the dramatic decline in eligibility for unemployment insurance payments under EI<sup>18</sup> means that provincial Social Assistance programmes will be called on to carry the burden earlier, and to a far greater degree, than in past recessions.

Furthermore, in addition to “recession proofing” its own fiscal situation at the expense of the provinces, the federal government has backed away from its commitment to the macro economic stabilization of output and employment, preferring a commitment to “price stability”, with concomitant greater likelihood of output and employment fluctuations<sup>19</sup>. Aggregate cyclical risk has grown, and the provinces now have a greater share of that higher risk.”

As the daily newspaper headlines are now reminding us, academic talk of a “Great Moderation” in business cycle fluctuations during the late 1990s was decidedly premature. Although the federal government could, and did, reduce its fiscal exposure to business cycle risk in the mid-1990s, that underlying risk remained, although much of its costs were offloaded to the provinces and to families. Indeed, because both the decline in UI/EI replacement rate on lost earnings and the diminished probability of getting unemployment benefits have worked to weaken the ‘automatic stabilizer’ macro-economic function of (Un)Employment Insurance, we are now experiencing the consequences – an ensuing increase in the depth of cyclical downturns, and accentuated systemic cyclical risk.

The inadequacies of Employment Insurance and Social Assistance mean that most of this increased cyclical risk is uninsured, and will be borne by families. Since low wage individuals are especially likely to experience unemployment, the downloading of recessionary risk will have its biggest impacts on disadvantaged Canadians.<sup>20</sup>

Appendix B of this paper presents the references to “Employment Insurance” in Budget 2009. Enhanced training expenditures financed from the EI fund (\$2 Billion over 2 years) and the freezing of EI premium rates<sup>21</sup> are the main expenditure items listed in Budget 2009. Neither

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<sup>18</sup>In 1997, the percentage of the unemployed receiving EI benefits was 25%. The beneficiary to unemployed ratio was significantly higher (at 42%), largely because a significant fraction of EI recipients work while on claim (and declare their earnings) and are therefore not counted as unemployed. The decline in UI/EI reciprocity in the 1990s has been dramatic - the beneficiary/unemployed ratio in 1989 was 83%. See HRDC (1998: Table 4.1, page 56)

<sup>19</sup>See Federal Reserve Bank of New York (1998)

<sup>20</sup> However, in the 343 pages of Budget 2009 the words ‘poverty’ and ‘inequality’ do not appear, even once. On page 49, ‘Standard and Poor’s Index’ is cited as a source reference for housing values, but otherwise the word “poor” cannot be found either. Budget 2009 does commit to “doubling the tax relief provided by the Working Income Tax Benefit to make work more financially attractive for low-income Canadians”, but this omits the most disadvantaged – Canadians who cannot get work – and also begs the question: are ‘work incentives’ really the big issue, when jobs cannot be found in a recession?

<sup>21</sup> This freezing of the premium rate is described on page 95 as “a projected \$4.5 billion stimulus relative to break-even rates”, but in Table A1.2 on page 241, only part (\$2.449 Billion) is booked under “Action to Help Canadians Stimulate Spending”. Either way, it seems a bit odd to count something that the government is promising not to do in the future as equivalent to, and an addition to, actual spending initiatives. Should one, with similar reasoning, when one has already counted deficit spending as ‘stimulus’, also count as a ‘stimulus’ the revenue that the government is not raising because it is not increasing income tax rates to balance the aggregate budget?

directly address the needs families have for replacement of lost employment income during a recession.

Until the late 1980s, unemployment insurance in Canada – as in most other OECD nations today – was an unemployment benefits program, in the sense that its costs were the UI benefits it paid to unemployed workers and its revenues came from a payroll tax (the premium income collected from employers and employees). Over the last two decades, however, the federal government has shifted training expenditures, employment service and benefit costs from its Consolidated Revenue Fund expenditures to the UI/EI Account. As well, throughout the late 1990s, premium income greatly exceeded expenditures, and the surplus in UI/EI revenues made a major contribution to the reduction of Canada’s general government deficit. In comparing Canada’s “social safety net” with that of other OECD nations, one also has to remember that maternity and sickness benefits in Canada have long been paid from the EI account, unlike the situation anywhere else. Whatever one’s opinions on the optimality of the expenditures on maternity benefits or human capital formation or deficit reduction funded from the EI account, this funding base for these types of expenditures has been a peculiarity of Canadian political economy, compared to other nations.

Only about 60% of Canada’s expenditure on EI account<sup>22</sup> can be currently counted as representing a “social safety net” in the sense of helping families to meet their immediate cash needs by partially replacing earnings lost due to unemployment. The balance represents a social choice to fund deficit reduction, labour market training programs and the costs of maternity and family policy from EI premiums – i.e. from a payroll tax base. Retraining programs may (or may not) help improve future employability, but they do not help meet current income needs – and whether or not jobs will materialize to absorb the newly created skills depends heavily on future business cycle recovery, whenever it may occur. Maternity benefits help offset the financial burden of parenthood, but they do not insure against ‘risk’. Although both programs can be defended as appropriate areas of public expenditure, they are not a “social safety net” for cyclical unemployment risk in any meaningful sense, and both could just as easily be funded from the general tax base (as is normally the case in other OECD nations).

Some of the initiatives of Budget 2009 are eminently sensible. It is entirely reasonable to commit now to not raising a payroll taxes (i.e. EI premiums) in 2010, when the business cycle recovery is likely to be as yet fairly faint. As well, it is an overdue good idea to provide “\$500 million over two years in a Strategic Training and Transition Fund to support the particular needs of individuals who do not qualify for EI training, such as the self-employed or those who have been out of work for a prolonged period of time. (p.94)”. It has long been a dysfunctional weirdness of Canada’s training system that individuals had to get quite a bit of work in order to get the EI eligibility that would enable access to the training which would help them to get work. As unemployment fell in the period prior to 2008, the resulting escalation of EI entrance requirements meant that the marginally employable who did not get quite enough weeks of work

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<sup>22</sup> Canada’s Chief Actuary has estimated that total Regular Benefits for 2009 will be \$9,545 Million, or approximately 54.6% of total EI costs. Maternity, Sickness and Compassionate Benefits are estimated at 22.6% of costs, while Training (Employment Benefits and Support Measures - 12.2%) and Administration costs (9.45%) make up almost all of the remainder. Pro-rating administration costs as proportional to expenditure, Regular Benefits plus their administration costs are 59.8% of total costs. Fishing Benefits (1.58%) and Work-Sharing Benefits (0.08%) blur the picture only slightly. Chief Actuary of Canada, 2009, page 8.



in the reference period were often shut out of training, as well as denied financial benefits – at precisely the time when, if they could have gotten new skills, their productivity would have been most welcomed by employers.

However, whether or not retraining helps economic efficiency much in a labour market with over 10% unemployment is a harder question. Retraining has its biggest social benefits when it provides the means to reduce structural unemployment, by reskilling unemployed workers to enable them to fill job vacancies that would otherwise have stayed empty, costing firms lost sales and production. But 10%+ unemployment signals a generalized cyclical surplus of labour. When workers of all types are unemployed, what exactly is the social benefit of having an even longer queue of qualified potential applicants for any emerging vacancy? Individuals may (or may not) be able to use their shiny new retraining certificate to jump ahead in the job queue, but any such private benefits come at the cost of longer unemployment durations for others. Like digging holes and filling them again, expenditure on training programs can always be counted as a stimulus to consumer expenditure and macro-economic demand – but unless new skills are quickly put to work (i.e. unless the recession is short), the outputs of these programs are likely to rust with disuse.

The underlying strategy of Budget 2009 only makes sense if the problems of the Canadian labour market are fundamentally ‘supply side’ in nature and the current recession is just a short, sharp blip in trend. Its overwhelming emphasis on training and improving labour cost employer incentives at the margin (by freezing EI premiums) is, to be fair, not a set of policies specific to the current government. Retraining, increasing work incentives and decreasing marginal labour cost have long been the dominant themes of Canadian labour market policy – this is the “Same Old Song” that has been coming from Ottawa for many years. Budget 2009 just turns up the volume a bit.

However, is “Same Old” good enough? Does it meet the challenge of the times? Budget2009 may begin Chapter 2 with the statement “The global economy is in the most synchronized recession in the post-war period and the ongoing financial market crisis is the worst since the 1930s” but it is exactly NOT about rebuilding a “social safety net” which can provide Canadians with insurance against unemployment risk in that recession. And as we head deeper into a recession of unknowable length, many Canadians are finding that they need a social safety net more than they ever did before.

#### **4. Implications**

As Anderson and Gascon (2007:1) have noted: “Globalization displaces workers and creates insecurities that increase the demand for social insurance ... As a result, postwar globalization was founded on the principle that the federal government would provide economic security, while free international markets would provide the best aggregate outcomes.” Although their context is the US and their data pre-date the current recession<sup>23</sup>, their motivation is the

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<sup>23</sup> Using 17 waves of the US General Social Survey 1977-2004 to track subjective insecurity and expectations of cost and probability of job loss, they try to explain why: “According to polls from the 2006 congressional elections, globalization and economic insecurity were the primary concerns of many voters.” They conclude: “Our findings verify the economic theory that globalization generates economic volatility leading to worker insecurity.”

observation that “19<sup>th</sup> century globalization sowed the seeds of its own destruction. Political backlash due to economic insecurity, not economic factors, killed globalization.” They feel that although aggregate output may expand if trade increases, those gains are at risk if a majority of voters come to feel themselves to be at risk. Their conclusion – “Globalization, by increasing economic insecurity, amplifies workers demands for social insurance” (2007:17) – is highly relevant to Canada in 2009, given that Canadian EI now arguably provides no more adequate insurance against unemployment risk than US UI now does<sup>24</sup>.

As Green (2009:1) notes: “In general, subjective employment insecurity tracks the unemployment rate.” – with the proviso that the secular trend is for any given unemployment rate to produce a somewhat higher level of subjective insecurity (as one might expect in increasingly more ‘flexible’ OECD labour markets). In this context, as the Canadian unemployment rate spikes upward, Budget 2009 is a curious document. At the same time it was being delivered, the IMF was beginning its update to the World Economic Outlook with the words: “*World growth is projected to fall to ½ percent in 2009, its lowest rate since World War II.*” – but there is little sense in Budget2009 of a recognition that historically bad times are upon us.

(Un)Employment Insurance is the major program by which the Government of Canada has historically helped offset the financial risks of unemployment faced by Canadian families. Unemployment in Canada is now rising at an unprecedented rate and is forecast to stay high for some time to come – so many Canadians are now finding out personally just how little insurance coverage they have. But the response of the Government of Canada has been decidedly meagre. In access, benefit duration and income replacement levels, Employment Insurance in Canada is far below OECD norms and the levels of Canadian UI in past recessions. Budget 2009 did little to change that – eligibility and benefit levels remained unchanged, while benefit duration was increased by only five weeks.

Now that they need a social safety net, many Canadians are discovering that they do not have much of one. As Table 1 noted, in March 2009 the maximum duration of the EI benefits now being received (by the minority who qualify) is less than a year. This implies that current EI recipients will run out of benefits sometime before February 2010. What happens then? The OECD estimates Canadian unemployment in 2010 will be substantially higher (10.5%) than it currently is – a quick rebound in labour demand seems most unlikely.

Reforms to Canada’s EI system need to remedy its inadequacies as a safety net for both short-term unemployment and longer duration unemployment spells. In the current context, Canadians need [1] a plausible expectation that they can get unemployment benefits if laid off – i.e. an easing of entrance requirements and [2] a safety net for the possibility of a longer duration recession – i.e. a ‘second tier’ of unemployment benefits (combined with counselling and retraining) to deal with the problems of the long duration unemployed. The question for

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<sup>24</sup> Because each state administers its own UI system within a federal legislative framework, it is really more accurate to speak of US UI systems. Compared to the average state UI system, Canadian EI provides marginally less adequate initial earnings replacement (see Figure 5 and Table D1), slightly greater probability of entitlement (as measured by the B/U ratio) but shorter average duration of benefits (given the 13 week extension in the US).

Canada's political economy is – if the recession drags on – what happens if that is not forthcoming.

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## Data Appendix

Table D1

### The OECD summary measure of benefit entitlements, 1961-2005

	1961	1971	1981	1991	2001	2003	2005
Australia	17	14	22	26	25	22	22
Austria	20	23	29	31	32	32	32
Belgium	42	41	45	42	38	42	41
Canada	14	13	18	19	15	15	12
Denmark	20	34	54	52	51	50	49
Finland	5	8	24	39	35	36	35
France	25	24	31	38	44	39	39
Germany	30	29	29	29	29	29	24
Italy	4	2	1	3	34	34	33
Netherlands	13	48	48	53	53	53	35
New Zealand	42	26	29	30	28	28	26
Norway	4	5	29	39	43	34	34
Sweden	4	6	25	29	24	24	24
Switzerland	2	1	13	22	38	33	33
UK	24	25	24	18	13	13	12
USA	7	11	15	11	14	14	13

1. The OECD summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations and three durations of unemployment. For further details, see OECD (1994), The OECD Jobs Study (chapter 8) and Martin J. (1996), "Measures of Replacement Rates for the Purpose of International Comparisons: A Note", OECD Economic Studies, No. 26. Pre-2003 data have been revised.

Source: OECD, Tax-Benefit Models.

[www.oecd.org/els/social/workincentives](http://www.oecd.org/els/social/workincentives)

Table D2

Average of net replacement rates over 60 months of unemployment, 2006

For four family types and two earnings levels, in percentage<sup>1</sup>

	Without social assistance				Overall average
	No children		2 children		
	Single person	One-earner married couple	Lone parent	One-earner married couple	
Australia	38	33	59	69	50
Austria	51	53	65	66	59
Belgium	58	58	70	65	63
Canada	11	12	32	33	22
Denmark	60	61	72	71	66
Finland	51	60	72	68	63
France	51	52	61	61	56
Germany	24	25	42	41	33
Greece	16	17	23	24	20
Iceland	39	37	58	51	46
Ireland <sup>2</sup>	40	63	62	67	58
Italy	7	7	8	8	8
Luxembourg	17	17	31	30	24
Netherlands	41	39	40	44	41
New Zealand	45	38	61	45	47
Norway	26	27	69	44	41
Portugal	40	40	48	46	43
Spain	36	35	39	39	37
Sweden	15	15	47	40	29
Switzerland	22	22	25	25	24
United Kingdom	49	49	65	71	59
United States	6	6	5	5	6
<b>Average</b>	<b>34</b>	<b>35</b>	<b>48</b>	<b>46</b>	<b>41</b>

1. Unweighted averages, for earnings levels of 67% and 100% of AW. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (*i.e.* monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months. See Annex A for details. For married couples the percentage of AW relates to one spouse only; the second spouse is assumed to be "inactive" with no earnings. Children are aged four and six and neither childcare benefits nor childcare costs are considered.

Note: Former Eastern bloc and non-European nations excluded

Source: OECD, Tax-Benefit Models. [www.oecd.org/els/social/workincentives](http://www.oecd.org/els/social/workincentives)

## **Appendix B**

### **Excerpts from Budget 2009**

1. Increasing for two years all regular Employment Insurance (EI) benefit entitlements by five extra weeks and increasing the maximum benefit duration to 50 weeks from 45 weeks. (p.94)
2. Providing \$500 million over two years to extend EI income benefits for Canadians participating in longer-term training, benefiting up to 10,000 workers.(p. 94)
3. Increasing funding for training delivered through the Employment Insurance program by \$1 billion over two years. (p. 94)
4. Investing \$500 million over two years in a Strategic Training and Transition Fund to support the particular needs of individuals who do not qualify for EI training, such as the self-employed or those who have been out of work for a prolonged period of time. (p.94)
5. Freezing EI premium rates at \$1.73 per \$100 for both 2009 and 2010—their lowest level since 1982—a projected \$4.5 billion stimulus relative to break-even rates. (p.95).
6. For 2011 and beyond, the Canada Employment Insurance Financing Board (CEIFB)—announced in Budget 2008—will begin setting premium rates on a break-even basis. In order to ensure that premium rate increases are gradual enough to support a strong economic turnaround, the CEIFB will be mandated not to recover any EI deficits as a result of the two-year \$2.9 billion of enhanced EI benefits and training announced in Budget 2009. (p. 106)
7. On the expense side, as the economic slowdown raises unemployment, more people will claim Employment Insurance (EI) benefits. This will support the economy and those most affected by the slowdown. Furthermore, the Government has announced in this budget that the EI premium rate will remain frozen at \$1.73 per \$100 of insurable earnings in 2010, when the economic recovery is expected to remain fragile, rather than rising to the level needed for the program to break even. Together with the below break-even premium rate in 2009, this will provide an additional \$4.5 billion in economic stimulus in 2009 and 2010. (p.208)
8. Transfers to persons are expected to be higher by \$0.9 billion in 2009–10, \$1.0 billion in 2010–11, and \$0.3 billion in 2011–12, as higher projected unemployment rates result in higher Employment Insurance benefits. Transfers to persons are expected to be \$0.4 billion lower in 2013–14, once the economy has recovered. (P.215)
9. Employment Insurance benefits are projected to increase by 9.0 per cent to \$15.6 billion in 2008–09, reflecting higher unemployment, as well as the growth in the maximum weekly benefit, which is indexed to the growth in the average industrial wage. In 2009–10, Employment Insurance benefits are projected to increase by 21.4 per cent to \$18.9 billion, and remain at that level in 2010-11, largely due to the two-year \$2.9 billion of enhanced EI benefits and training proposed in this budget.(p. 226)