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BACKGROUND

SOCIAL POLICY

Mending Canada's Employment Insurance Quilt:

The Case for Restoring Equity

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In this issue...

Reforms to the EI program should focus on removing barriers to mobility by creating uniform, nationwide entrance requirements and benefit entitlement periods.

THE STUDY IN BRIEF

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Under the current Employment Insurance (EI) system, long-lasting EI benefits are more easily accessed in regions with high unemployment rates than in regions with low unemployment rates where workers face tighter restrictions to access short-lived benefits. This complicated screening procedure, intended to better support the various circumstances facing unemployed workers across the country, creates a number of undesirable consequences: the most glaring being pockets of high, chronic unemployment.

This *Backgrounder* argues that Canada's EI program, instead of providing clear and equitable access to benefits for all Canadian workers, supports the preservation of regional labour markets that are dominated by part-year employment. To the extent that variable entrance requirements support persistently high unemployment rates in a few Canadian regions, the program hinders the convergence of wages, prices and unemployment rates across the country.

The goals and intentions of the EI regime should be simplified to better address the needs of Canada's unemployed workers. Reforms are needed to better align the incentives of the EI program with the national interests of a more dynamic, flexible and buoyant labour market. Regionally based criteria for determining eligibility and the length of the benefit period should be replaced by uniform, countrywide EI entrance requirements and benefit entitlement periods. An improved screening mechanism would allow EI parameters to be tightened as the economy recovers and loosened when it enters a downturn.

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The strikingly rapid job losses during the 2008/2009 recession have focused Canadians' attention on the geographic differences that determine Employment Insurance (EI) access and generosity.

Under the current system, EI benefits are more easily accessed for longer periods in regions with high unemployment rates than in regions with low unemployment rates, where the maximum entitlement period is much shorter. As a result of the recession, there has been widespread concern that the eligibility and entitlement parameters of the system were not adjusting appropriately for workers situated in hard-hit, urban regions such as auto-manufacturing centres Windsor and Oshawa, which traditionally have been treated as low-entitlement regions.

Neither workers in high-unemployment, high-entitlement nor low-unemployment, low-entitlement regions benefit in the long run from the system's current design. In high-unemployment regions, the program creates long-term EI dependence that results in concentrated pockets of persistent unemployment, trapping workers in patterns of seasonal labour. Full-time, full-year workers located in regions with lower unemployment rates are the primary funding source for this pattern of part-year work in high-unemployment regions (May and Hollett 1995).

The EI program, therefore, undermines the economic benefits that stem from labour mobility in pursuit of higher wages and more attractive

work, the re-allocation of workers among sectors and geographical regions, and a regional convergence in wages, prices, and unemployment rates.¹ Reforms to the EI program should focus on removing barriers to mobility by creating uniform, nationwide EI entrance requirements and benefit entitlement periods.

Public policy aimed at sustaining rural economies plagued by seasonal unemployment is executed in part through the system of narrowly defined, regional variations in EI provisions and regulations. Variable entrance requirements (VER) stipulate that individuals in a low-unemployment-rate region (less than six percent) are required to have 700 or more insurable hours of employment in the preceding 52 weeks in order to qualify for benefits, whereas a worker in a very high-unemployment-rate region (more than 13 percent) requires only 420 hours in the same qualifying period.² Reinforcing this division among the unemployed is the fact that the latter group is also entitled to longer maximum benefit periods.

Public officials' response to the range of entry requirements is to emphasize that requirements loosen when local unemployment rates increase and tighten when they fall. Thus, they maintain, the system's eligibility criteria respond flexibly to local economic conditions. While the merits of this defence are arguable at best,³ VERs impose real restrictions to accessing EI. In fact, laid-off workers in low-unemployment regions have greater difficulty in qualifying for EI than otherwise similar individuals in high-unemployment regions.⁴ This geography-based policy contributes

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- 1 Labour economists are virtually unanimous in their view that regional labour mobility is a hallmark of an efficient labour market. Nonetheless, the topic of labour migration is notoriously difficult to analyze empirically, and empirical evidence regarding the precise link between EI and labour mobility is mixed (Audas and McDonald 2003).
- 2 See <http://www.servicecanada.gc.ca/eng/sc/ei/benefits/regular.shtml> for the current rules on EI access and duration.
- 3 Indeed, the local unemployment rate is a poor indicator for the ability of a worker to obtain employment in a given geographic region, in part because it reflects the stock of unemployed workers relative to the stock of the labour force and takes no account of flows into or out of unemployment (i.e., it is a snapshot measure). By contrast, the rate of employment growth is a superior measure of the probability that an unemployed worker will find a job, as it captures the dynamic state of the local labour market.
- 4 In his extensive review paper on the unemployment insurance programs of all other OECD countries, Radmilovic (2011, 7) concludes that, "It is only in Canada that regional differentiation forms an integral part of the EI regime."

to incentives against mobility, thereby reinforcing patterns of persistently high unemployment and dependency among groups of seasonal workers who, by definition, are inactive for much of the year. As a result, should there be an increased global demand for commodities, for example, labour shortages are more likely to occur in Western Canada.

Regional EI Coverage – Under-coverage in Some Regions Affected by VER

The recent recession led to public concerns that too few laid-off workers – particularly those in low-unemployment regions facing relatively stringent entrance requirements – are eligible for EI benefits. Across Canada, the range of EI participation is wide and, not surprisingly, varies substantially according to the strictness of the entrance requirements determined by the regional unemployment rate (Figure 1).^{5,6} For instance, based on 2008 employment records, 57.3 percent of job losers in Ottawa would qualify for benefits, whereas 93.5 percent in Restigouche/Albert, N.B. would qualify. Regions in the Atlantic Provinces tend to have a higher percentage of individuals that meet the VER, particularly in rural regions, whereas the opposite applies in many of the region's urbanized areas.⁷

A simple statistical analysis takes the data from regional employment rates and the observed level of access to EI benefits to determine the likelihood of accessing – or the predicted ability to access – EI given one's geographic location. The fitted curved line through the observations in Figure 1 represents the predicted value for access. According to the program's design and stated objective – to modulate EI access conditions in response to local labour market conditions – one would expect to obtain a positive relationship, or correlation, between the local unemployment and EI coverage rates. And this is, indeed, largely the case.

However, an unanticipated statistical result is that the local unemployment rate variable explains only 43 percent of the fluctuations in the EI coverage rate across regions and, therefore, other unspecified (and currently unknown) factors generate 57 percent of those variations. In other words, more than half the degree of coverage is being generated by influences other than the one on which the government relies to assess the neediness of unemployed workers. The graphical interpretation is that the fit of the curve through the data points does not appear to be that tight, suggesting that variable entrance requirements are only partially fulfilling the intended function.⁸ This finding suggests that the local unemployment rate is a blunt indicator for measuring local labour market conditions.

5 The measure of regional EI coverage that we employ in this piece is the ratio of the number of laid-off workers who met the qualification requirements to the total number of job losses that have occurred as the result of involuntary layoffs (reported over the previous 52 weeks). We eschew the oft-cited measure of the beneficiaries to unemployment ratio (B/U) used often by labour market commentators (see Mendelsohn and Medow 2010), which tends to underestimate the true degree of EI coverage (Gray and Sweetman 2004, Bishop and Burleton 2009). Our data are grouped at the relatively low level of the EI administrative region as opposed to the level of the province. The advantage of exploiting regional rather than provincial data is that provinces are characterized by diverse labour market conditions within them. By contrast, the EI administrative regions are purposefully formed in order to group geographical areas with relatively similar labour market conditions, as measured by local unemployment rates.

6 Documentation and a brief presentation appear on pages 74-75 of the *EI Monitoring and Assessment Report 2009*. The source for our data is Table 8.

7 Importantly, the rates of coverage in low-unemployment regions, though generally lower than those in high-unemployment regions, are not as low as the B/U ratio suggests.

8 According to a simple econometric analysis based on fitting a log-linear regression line through the points in Figure 1, for every one percentage point decrease of a region's unemployment rate, EI access conditions tighten, and the qualification ratio in the case of a layoff declines by 1.7 percent. The simple regression equation has a 0.43 determination coefficient, implying that a region's unemployment rate explains only 43 percent of the variation in effective EI coverage – a somewhat loose statistical relationship. On a graphical level, this loose fit is represented by the dispersion of the points away from the line, reflecting the intended relationship between these two variables.

Figure 1: Percent of Laid-off Workers who Qualify for EI, 2005 and 2008



Source: Authors' calculations from HRSDC (2009).

Note: Data points represent the proportion of involuntarily laid-off workers in each region who qualify for EI according to the last 52 weeks on their records of employment paired with the unemployment rate in the EI administrative region.

When one compares the evolution of these values for effective coverage over time *within* a given economic region – as opposed to variations between regions, as in the analysis above – there is also a positive relationship between the coverage rate and the local unemployment rate.⁹ This positive relationship is consistent with program design – as labour market conditions deteriorate (improve) over time within a given region, access is loosened (tightened).

In addition to raising equity issues, these differences in eligibility criteria also lead to more troubling long-term labour market problems,

particularly the way in which regional eligibility and benefit entitlement variations increase economic barriers to geographical mobility. As the VER feature is based in large part on differences in structural unemployment – longer-term unemployment caused by a mismatch in worker skills – as opposed to cyclical unemployment caused by the ebbs and flows in the economy, the VER tends to reinforce economic rigidities. In this way, it contributes to persistent unemployment in high-entitlement regions by reducing incentives to adjust to adverse labour market conditions through migration or wage flexibility.

⁹ This analysis is not shown in the figures.

The Ongoing Dispersion in Canada's Unemployment Rates

In an efficient, flexible labour market where economic conditions in one region are stronger than those in another, some workers in the worse-off region would migrate to the better-off region where the prospects for employment are brighter. This process would continue until the degree of opportunity for employment in each region was roughly the same. In other words, a sort of arbitrage process would occur that would at least reduce, but certainly not eliminate, the imbalance.

We have carried out a crude, empirical analysis in search of evidence that such an adjustment pattern is occurring. We measure the variation among regional unemployment rates in relation to the national average – the dispersion of unemployment – and we relate it to the unemployment rate for all of Canada. In flexible labour markets characterized by few barriers to mobility and other frictions, irrespective of the trend in global labour market conditions, one would expect that degree of variation to diminish over time, reflecting a trend toward partial convergence among regional unemployment rates. Given a climate of overall employment growth and a declining national unemployment rate, this adjustment phenomenon would be associated with a positive relationship between these two variables – if workers are in short supply in one region and abundant in another, the regional variation in unemployment should fall with the national unemployment rate as workers move to where jobs are abundant.

Canada's recent labour market history, however, shows that the opposite is true: as the national labour market improves and the aggregate unemployment rate falls, the degree of unemployment dispersion tends to rise (Figure 2).¹⁰ This suggests that there is a range of factors working to hinder convergence – including both economic and non-economic influences – that conspire to inhibit the mobility of workers from one region to another.¹¹

What is the Source of "Sticky," High Dispersion for the Regional Unemployment Rates?

As mentioned above, the dispersion among regional unemployment rates has continued, even in the backdrop of a sustained, long-standing trend of improving aggregate unemployment. The rising tide has not lifted all boats. In Canada, regional unemployment tends to be persistent, especially for a few historically high-unemployment regions. The scatter plot shown in Figure 3 relates the 1987 unemployment rate in each labour-force-survey region (on the horizontal axis) to its value in 2010 (on the vertical axis). A weak relationship between historical unemployment rates and today's unemployment rates would imply a low degree of correlation, in which case one would expect the statistically-predicted average to be represented by a straight, horizontal line, indicating little persistence. Under this scenario, the unemployment rate in 1987 would be a poor predictor of the rate in 2010. In contrast, a predicted average represented by a positively

10 A simple, linear regression analysis based on monthly data between 1987 and 2010 was estimated from an equation having as its dependent variable the coefficient of variation of the unemployment rates among the economic regions, and the national unemployment rate as the independent variable. The estimated coefficient is negative and statistically significant, but the fit of the estimated coefficient is not overwhelming. Much of the observed increase in the coefficient of variation over this interval is driven by the declining mean level of unemployment, which goes in the denominator as some astute reviewers pointed out. This implies that the unemployment rates in many regions have fallen by a lower proportion than was the case for the national rate of unemployment.

11 We note that many other developed economies also have market disparities in regional unemployment rates. An OECD (2000) study concludes that they rose during the 1980s in a majority of OECD countries. The study attributes this phenomenon to a variety of institutional as well as economic factors such as accessibility (or lack thereof) to product and/or factor markets, unmeasured characteristics of labour supply, the extent of innovative activity, the industrial composition, the lack of opportunities to exploit economies of scale in local production, wage determination mechanisms and unemployment insurance provisions. The study authors recommend policies that aim to reduce the inequality of the distribution of unemployment between regions as a means to improve overall national performance.

Figure 2: Unemployment Dispersion Rates, 1987-2011



Source: CANSIM Table No. 282-0054; authors' calculations.

Note: The method for calculating dispersion is simply the coefficient of variation – the standard deviation of all data points divided by the mean. The data were deseasonalized according to the US Census Bureau's X-12 technique.

sloped line through the points would indicate a fairly high degree of persistence. In other words, a relatively high- (low-) 1987 unemployment rate in a particular region tends correlate with a high- (low-) one 23 years later. The regions with relatively high unemployment rates tend to have persistently high unemployment and vice versa.

Figure 3 uses two lines to show the contrast between the regions with relatively low-unemployment rates on the left with the relatively high rates on the right. While there is some modest persistence

in unemployment rates in most of Canada's economic regions, measured by a fairly flat line for low unemployment regions, the persistence in high-unemployment regions is much stronger, which drives much of the dispersion in unemployment rates.¹² This reflects the phenomenon of chronically unemployed workers, primarily seasonal ones, in these high-unemployment regions making up a disproportionate share of the unemployed, both in their regions and nationally (Brooks 2005). One reason, therefore, for the phenomenon of rising

12 Note that a 45 degree line (with a slope of unity) would denote total persistence.

Figure 3: Persistence in Regional Unemployment Rates, 1987 vs. 2010



Source: CANSIM Table No. 282-0054; authors' calculations.

dispersion rates among the regions is that there is a growing level of unemployment inequality concentrated among a subset of the high-unemployment rate regions in Canada.

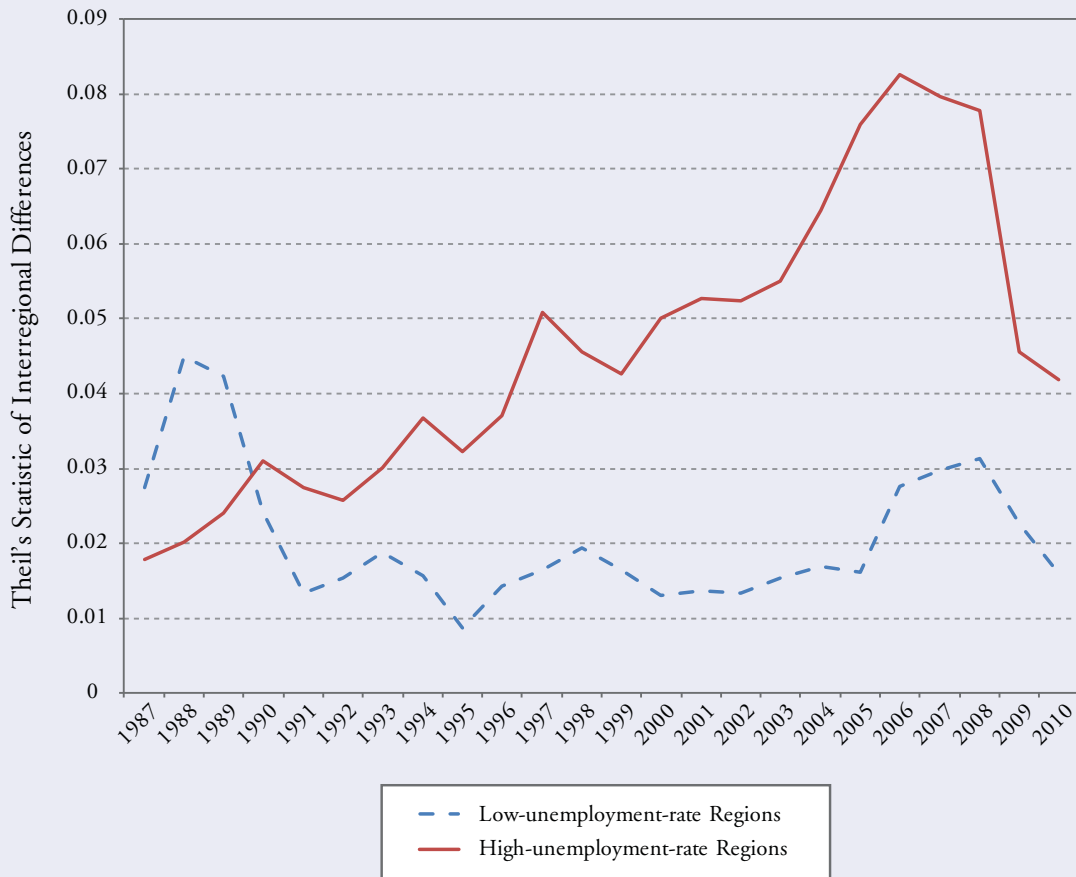
Another empirical measure that bears out this point is derived from splitting Canada's economic regions into high-unemployment and low-unemployment groups. Applying the widely-used Theil statistic in Figure 4 to measure inter-regional disparities in unemployment rates, we commence by dividing the regions into those two broad groups according to their unemployment

rates in 1987.¹³ The question is whether the widening degree of dispersion is due primarily to a) the unemployment rates of individual regions within a group becoming less similar over time, or b) the overall gap between the two broad groups widening over time.

The mostly rising solid line in Figure 4 shows that disparities in unemployment rates have been growing over time within high-unemployment-rate regions while remaining at roughly the same level for low-unemployment-rate regions. This implies that despite the fact that many formerly

13 To compute Theil's statistic for low- (and high-) unemployment regions, we multiply a low- (high-) unemployment region's annual labour force share within all low- (high-) unemployment regions by the ratio of a region's unemployment rate to the average for all low- (high-) unemployment rates and by the natural logarithm of the unemployment rate ratio, and then sum these products for each year.

Figure 4: Concentration of High-unemployment Regions, 1987 to 2010



Source: CANSIM Table No. 282-0054; authors' calculations.

high-unemployment-rate regions have seen their rates drop since 1987, a somewhat small, yet consequential group of economic regions have seen persistently high unemployment over this period, and have thus fallen even further behind the rest of Canada. This phenomenon occurs mainly in rural regions with a high concentration of seasonal workers – the most common repeat users of EI.

This preliminary empirical investigation does not imply that the EI regime is the sole causal

factor of labour market rigidity. Given the current state of data availability, few researchers have been able to rely on solid, rigorous techniques to link labour mobility with the workings of an EI regime.¹⁴ We do suggest, however, that the level of unemployment prevailing in high-entitlement areas has remained persistently high in the context of a 10-year-plus recovery in the aggregate labour market in Canada, and that the EI program incentives work against labour mobility rather than encourage it.

14 One exception of which we are aware is authored by Kuhn and Riddell (2010), who demonstrate that the long-term impact of the EI regime in New Brunswick has been to drastically alter the composition of employment toward more part-year jobs.

Recommendations and Conclusions

The goals and intentions of the EI regime should be simplified to better address the needs of Canada's unemployed workers. The inherent complexities in determining EI eligibility according to local unemployment rates drive a geographic wedge between otherwise similar Canadian workers who live in different parts of the country. While variable EI qualification requirements are intended to deliver generous benefits to seasonal workers, these benefits are extended to all workers in the region, regardless of the type of job for which they are searching.

For instance, unemployed workers who are waiting for the beginning of the next seasonal working cycle are treated in exactly the same way as permanent laid-off workers who are seeking long-term, stable employment in another field. The current geographically driven access-and-benefit period lengths cater to short-term regional concerns and, therefore, contribute to long-term EI dependency for many workers. Pockets of high, chronic unemployment contribute to perpetually depressed local labour markets and to long unemployment spells, whereas a more flexible labour force would respond better to competitive market pressures and attenuate differences in regional incomes and employment conditions. Reforms are needed to better align the incentives of the EI program with the national interests of a more dynamic, flexible and buoyant labour market.

Regionally based criteria for determining eligibility and the length of the benefit period should be replaced by uniform, countrywide, EI entrance requirements and benefit entitlement

periods. This would probably entail shorter qualification periods in some low-unemployment regions, but the uniform entry requirement should not be set at the lowest current level of 420 hours, as that would facilitate the development of part-year, frequent use of EI benefits in (relatively) low-unemployment areas.¹⁵

Modulating the program's parameters to the regional unemployment rate has contributed to both inequities and inefficiencies, and siphoned funds away from other pressing needs of unemployed workers, such as retraining laid-off workers. In this particular policy context, both efficiency and equity can be enhanced simultaneously through program reform. New benefit criteria should be linked to the national unemployment rate, or better yet, the rate of growth or decline in national employment.¹⁶ Such a mechanism would allow the program's parameters and requirements to be tightened as the economy recovers and loosened when it enters a downturn. Using a growth-of-employment measure would better capture the local labour market's degree of fluidity, which is more closely associated with the probability of finding a job.

Essential for a well-functioning national labour market are policies that facilitate and, at a minimum, do not deter labour market mobility. In contrast, the current EI program acts more as a provincial and sub-provincial level program through the geographic variance in access and benefits. Hence, another good reason for eliminating the VER and variable benefit durations is because they work against the purposes of a national program, with unintended consequences including persistent pockets of high unemployment. The bulk of the Canadian labour market, through its EI

15 Even if the entry requirements were lowered from the current maximum level of 20 weeks (700 hours) to an intermediate level such as 16 weeks (560 hours), many of those who are currently ineligible would still not gain access, as this group tends to exhibit very low work levels during the qualifying period.

16 An insightful reviewer raised the question that if the regional unemployment rate is a poor determinant for the appropriate EI system parameters, why would the national unemployment rate be superior in this role? One response we have argued is that the eligibility parameters should not be modulated according to the structural rate of unemployment. A large component of local unemployment rates in high-unemployment regions is structural in nature, while this applies to only a fairly small component of the national rate. Bishop and Burleton (2009) also discuss the benefits of alternative measures that better capture job opportunities.

contributions, redistributes income toward seasonal economies and industries. Variable entrance requirements are the complex, rather opaque screen by which this redistribution takes place (Corak and Chen 2005). As a consequence, the EI program leads to undercoverage for some workers in certain areas of the country, weakening EI's effectiveness as a social safety net.¹⁷

Furthermore, the EI program should not support the preservation of rural labour markets that are dominated by part-year employment. To the extent that VERs support persistently high-

unemployment rates in a few Canadian regions, the program hinders the convergence of wages, prices and unemployment rates across the country.

Reforms to the EI program should remove incentives that deter workers moving from a high- to a low-unemployment region, thus keeping the financial costs of moving as low as possible. As the Canadian economy recovers from the current recession and western Canadian businesses create jobs at pre-recession levels, the need for worker mobility will be of critical importance.

17 Another, somewhat related policy measure that would reduce the subsidy for seasonal employment patterns would be to restore the “intensity rule” for younger workers (who are presumably more mobile) in order to discourage repeat, seasonal dependence on the EI regime – a provision originally implemented in 1997 and repealed in 2000. Such a rule would reduce the weekly benefit amount of workers based on the number of weeks of regular benefits that the claimant has received over the past few years. This would not affect the qualification rules for EI, but apply only to those who do qualify. For a compelling history of the development of these rules in Canada, see Nakamura and Diewert (2000).

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