Intelligence MEMOS

The federal government is finalizing its long-promised reform of the Employment Insurance system. In this special three-part series, Miles Corak argues that the financing of the program should be part of the reform process, and offers practical changes to EI contributions based on insurance principles.

From: Miles Corak

To: Employment Minister Carla Qualtrough

Date: October 12, 2022

Re: **Reality-based Employer EI Contributions**

Managing risk is an inherent part of running a business, and entrepreneurs must continually adjust production and employment according to their expectations of product demand. There is much variation in how they do this, even among employers within the same region and industry. Yesterday, we discussed how insurance-based principles in the Employment Insurance (EI) system make the case for stable employer and employee contributions, and for the federal government to also contribute to the program. Today, we look at contribution rates for employers and employees.

Economy-wide employment depends not just on individual employer decisions. It also depends on job disruptions initiated by workers, a consequence of the risks they face in balancing work and family as sickness, care-giving, respite and other family risks also lead to spells of unemployment.

A broad interpretation of insurance principles lines up these risks with contributions and suggests employers should contribute to EI at a rate tied to the fraction of benefit expenditures for which they are responsible; employees should contribute at a rate tied to the fraction of benefits for which they are responsible.

Employer contributions should finance Regular Benefits; Individual contributions should finance Special Benefits.

One comprehensive study found that one-fifth of businesses in continuous operation over an 11-year period never had their workers collecting more EI benefits than contributions made. These employers represented almost one-half of all jobs, 60 percent of all EI contributions, but only 28 percent of benefits paid. At the other extreme, the 6 percent of employers associated with more EI benefits paid out than contributions collected in each of these 11 years represented only about 6.5 percent of all jobs, less than 4 percent of all contributions, yet 28 percent of all EI benefits.

Tight adherence to insurance principles would have firm-level "experience-rated" contribution rates, tied to the collection of benefits of laid off employees. This, however, is not a practical policy reform, because it would require a much more considered analysis of tradeoffs associated with EI's regional income support goals, and would add great administrative complexity.

That said, a broader interpretation suggests employers as a whole should contribute at a rate tied to the fraction of benefit expenditures for which they are responsible, and that employees should contribute at a rate tied to the fraction of benefits for which they are responsible.

Conceivably, this was the basis for the rule of $1.40 of employer contributions for every dollar of employee contribution set a half a century ago: the ratio perhaps reflecting the share of unemployment due to involuntary layoffs, job separations at the discretion of the employer, and the share due to resignations or other discretionary employee departures.

Those who quit their jobs without just cause are no longer eligible for EI benefits, so were this logic followed, the contribution share of employers would be higher. Meanwhile, "Special Benefits" have proliferated, reflecting contingencies faced by workers and their families by cover employee-initiated job interruptions. In other words, current realities would suggest that the sharing rule should be based on the ratio between expenditures on Regular and Special Benefits.

The average annual EI expenditure from 2012 to 2019 was $22.9 billion. Regular Benefits account for 55 percent of this total, and Special Benefits 25.5 percent. Part II Benefits and program administration roughly make up the remaining 20 percent. If these latter expenditures are equally attributed to employers and employees, then their shares would roughly be 66 percent, and 34 percent. (Fishing and Work-Sharing Benefits are also attributed to employers.)

This suggests that employer contributions should be almost double employee contributions: about $1.90 for every dollar contributed by employees. This meshes with the ratio of job separations due to employer and to employee reasons. The number of people laid off has on average been twice as high as the number who leave jobs for personal reasons (excluding those returning to school or retiring who would not be eligible for EI).

At the same time, the contribution shares should evolve with the distribution of program expenditures. Special Benefits have been the fastest growing envelope in the program, rising from about $5 billion in 2010 to more than $6 billion in 2020.

If this trend continues, it can be imagined that the employee contribution share should also gradually rise.

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