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Backgrounder

October 17, 2000

Make EI Fairer:
Don't Open the Coffers to Well-Off Repeaters

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The minister of Human Resources Development Canada (HRDC) recently tabled proposed amendments to the employment insurance (EI) program (see Box 1). Some of the proposals are good, including the easing of the benefit qualification threshold for re-entrant parents and the decision to continue monitoring the effects of EI. But other proposals — to eliminate the EI intensity rule and the experience rating of the EI clawback — urgently need to be dropped or at least changed.

The Primary Purpose of the Intensity Rule and the Experience-Rated Clawback

Social policy decisions are, of course, made for a variety of reasons. The only essential program purpose of the *intensity rule*, however, is to reduce the benefit amounts paid out to repeat users of EI — those who have already received all the insurance-type help their premium payments justify (EI is paid for solely out of workers' and employers' premiums). Currently, *repeaters* are defined as those who have collected 20 or more weeks of benefits over the previous five years.

If HRDC has evidence that the intensity rule is causing unwarranted hardship, then it should be amended by relaxing the cutoff for classifying a beneficiary as a repeater.

Likewise, the only essential program purpose of the *clawback* is to take back some of what was paid out in EI benefits to high-earning repeaters. Currently, this provision applies to payments to all beneficiaries with annual earnings in excess of $48,750, a threshold that is 1.25 times the Maximum

Insurable Earnings (MIE) for EI, and the experience rating applies to repeaters with earnings above the MIE. A person who works about 40 hours a week must earn a wage of $20 per hour to enjoy such earnings for the year. Many working Canadians — including many who pay the EI payroll tax on every hour they work — make less than $20 per hour.

If HRDC has evidence that the experience-rated clawback is too harsh, then it should be amended by raising the income threshold above which the higher clawback rates take effect or, again, by raising the cutoff for classifying a beneficiary as a repeater. It is not, however, appropriate to raise these cutoffs to infinity, which is what eliminating the experience rating of the clawback would do, thereby opening the EI coffers wide to well-off, well-organized repeaters.

A Rundown on the Proposed Amendments to the Intensity Rule and Clawback

The intensity rule and the experience rating of the clawback should perhaps be relaxed, but not removed.

To see why the intensity rule and the experience rating of the clawback should perhaps be relaxed, but not removed, requires an understanding of some of the basics of those features.

The Intensity Rule

As it stands, the *Employment Insurance Act* contains the following intensity rule:

> The benefit rate is reduced by up to five percentage points based on the number of weeks of regular benefits a claimant has received in the past five years.

The rule reduces the benefit replacement rate by 1 percentage point for each additional 20 weeks of past EI use for those who have already collected more than 20 weeks of benefits in the previous five years. This rule has no role in determining who can qualify for EI. It applies only to those who *do* qualify. It affects *no* first-time claimants. It also exempts low-income families with dependent children.

The Clawback Provisions

In the *EI Act*, the clawback concept is described as follows:

> For claimants who have higher incomes and have received benefits in the past five years, their previous weeks of benefits increase the amount of benefits they must repay through the tax system.

The clawback is intended to recoup some of the benefits paid out to higher-income recipients. It applies to nonrepeaters who earn (with their EI benefits) more than 1.25 times the MIE. Since the MIE continues to be set at $39,000, a nonrepeater must have earnings of over $48,750 for the clawback

Box 1: *Proposed Changes to EI Legislation*

The proposed changes to EI legislation were announced in an HRDC press release dated September 28, 2000. The changes, and the reasons for them, were outlined as follows:

> The Honourable Jane Stewart, Minister of Human Resources Development Canada, today introduced legislation in the House of Commons to amend the *Employment Insurance Act*.
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> "Overall, our on-going monitoring shows that the reforms undertaken in 1996 are working well; we have a fairer program and we are helping people find work," said the Minister. "We do, however, need to adjust some measures which have proven to be less effective than we had anticipated and in some cases punitive, particularly to seasonal workers and women. Other changes are consistent with our efforts to support families and children," the Minister continued.
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> The proposed legislative amendments would:
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> - Eliminate the *Intensity Rule* which was designed to reduce dependency and discourage the use of EI as a regular income supplement. The Intensity Rule has not worked as planned.
>
> This measure would be effective retroactively to October 1, 2000.
>
> - Adjust the *Benefit Repayment (Clawback) Provision* as follows:
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> ¤ To ensure that the EI program is there for Canadians who seek temporary income support for the first time, all first-time claimants would be exempted from benefit repayment.
> ¤ To ensure that the benefit repayment threshold is directed at higher-income Canadians, it would be set at one level ($48,750 of net income) with the repayment rate fixed at 30% — the payment would be limited to 30% of a person's net income in excess of $48,750; and
> ¤ To ensure that Canadians are not required to repay benefits when they claim EI special benefits for sickness, maternity or parental reasons, they would be exempt from benefit repayment.
>
> These measures would apply to the 2000 taxation year.

Source: Human Resources Development Canada, News Release, September 28, 2000.

provision to apply. Most workers — certainly most women and most seasonal workers — earn less than that amount.

The clawback consists of two parts, however: rules for EI recipients who have collected less than 20 weeks of benefits over the previous five years, and rules for repeaters who have already collected 20 or more weeks of benefits over the previous five years. For those in the first category, the clawback is a flat 30 percent of the *lesser* of (a) the total benefits paid to the claimant in the taxation year, and (b) the amount by which the claimant's income for the taxation year exceeds 1.25 times the MIE. For those in the second category, the clawback applies to income above the MIE, and benefits are clawed back according to the rising schedule of rates shown in Table 1. The amount clawed back is, however, limited to 30 percent of the recipient's income in excess of $39,000.

Table 1: ***EI Benefit Clawbacks***
(for recipients of more than 20 weeks of benefits in the previous 5 years)

Weeks of Regular Benefits Received over Previous 5 years	Percentage Repayable above Maximum Insurable Earnings
(number)	*(percent)*
21–40	50
41–60	60
61–80	70
81–100	80
101–120	90
More than 120	100

Source: *Employment Insurance Act*.

Thus, nothing is clawed back from workers who earned less than $48,750, unless they are classified as repeaters because they have already received 20 or more weeks of benefits over the previous five years, in which case benefit repayment is subject to the 30 percent cap. For example, a repeater with wage income of $39,000 and regular EI benefits of $10,000 would never repay more than $3,000, irrespective of his or her claims history.

As noted above, the intensity rule and the experience-rated clawback were intended primarily to lower program costs by reducing the amount of benefits paid out to repeaters and recouping some of the funds paid out to high-income beneficiaries. It was also hoped that the experience-rating features of the intensity rule and the clawback eventually would reduce the incidence of repeat use of EI. These behavioral changes likely will appear only after the program has been in effect for some time, partly because, when EI became law in 1996 (replacing unemployment insurance, or UI), everyone's record of benefit collection over the previous five years was reset to zero. Thus, the intensity rule and clawback experience-rating effects will come into full force only in 2001. And it will be another year after that before sufficient data are available to permit analysts to determine the effects of these rule changes on claimants' behavior.[1]

Some of the effects of the intensity and clawback rules are, however, already evident. For instance, it is clear simply from the specification of these rules that neither of them had anything to do with barring anyone from qualifying to receive EI. These features affect only the amounts received and retained by those who claim benefits.[2]

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1 If lower returns to repeaters do not result in an eventual reduction in the number of such claimants (controlling for economic conditions), economists will need to re-examine their theories about how people are motivated by money!

2 This is in contrast, for example, to the hours-of-work cutoff thresholds for qualifying for benefits, which were set too high, in my judgment, for new workers and those re-entering the workforce. These thresholds deny access to EI benefits to a significant number of women who wish to re-enter the workforce after child-related periods of absence and to workers who have had lengthy breaks in their workforce participation due to illness, plant closures, and other circumstances beyond their control. With the intensity rule and experience-rated clawback in place to deal with claimants who begin to use EI repeatedly, the thresholds could be reduced.

Employer Experience Rating Will Not Work as a Replacement

Some analysts may welcome, or at least be unconcerned about, proposals to eliminate the intensity rule and the experience-rated clawback because they believe that it would be better to experience rate employers, rather than employees. This is, in my view, an error in judgment rooted in the observation that some form of employer experience rating exists in the unemployment insurance programs of all 50 US states. In that country, employer experience rating operates in the same way as car insurance: more claims, and more expensive claims, result in higher premium payments. Thus, those employers whose workers cost the system more must pay more into the system.

Employer experience rating is politically feasible in the United States partly because *only* employers pay the costs of unemployment insurance there. In Canada, however, the costs are shared between employers and workers, and I have yet to meet the politician who would be willing to advocate raising premium rates for workers who have endured more unemployment and thus collected benefits repeatedly.

Employer experience rating is a political nonstarter in Canada for another reason. Since a significant percentage of total employment in this country is in intrinsically seasonal industries, it is widely believed that many of the firms in such industries would no longer be economically viable if they were forced to pay the cost of the unemployment of the workers they hire, which would simply result in fewer jobs and more unemployment in some parts of the country.

Moreover, employer experience rating has some problems. For instance, employers who face increased premiums if their workers collect unemployment insurance have a strong monetary incentive to lay off workers for poor performance, even if this is not really the case, rather than for lack of work. There are many more complaints in the United States than in Canada about such behavior on the part of employers. And workers who are unjustly fired are likely to be harmed by such action even if they manage to bring successful grievance charges against their former employers.

A better way to experience rate an unemployment insurance program is to reduce the coverage for those with more weeks of prior claims, rather than to raise premium rates.

A better way to experience rate an unemployment insurance program is to reduce the coverage for those with more weeks of prior claims, rather than to raise premium rates.[3] Also, experience rating workers in the new EI program *will* help to curb abuses of the programs' intent by employers as well as workers, since employers can shift their labor costs onto an unemployment relief program only to the extent that their workers are *eligible* to collect premiums.

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3 In Canada, all those in need without other means of support can apply for help through the means-tested income assistance programs. Means testing is essential in charitable programs, as opposed to user-funded insurance programs such as EI, to ensure that the money goes only to those in need.

For further discussion of these important issues in the context of the innovative Canadian EI reform, see OECD (1999, 297–337).

Why Those Who Oppose the Intensity Rule and Experience-Rated Clawback Are Wrong

Only high-income repeat users of EI stand to gain from the proposed dramatic reduction in the EI clawback.

It is important to note that only high-income repeat users of EI stand to gain from the proposed dramatic reduction in the EI clawback. This explains why, even back in 1996, some of the most vigorous behind-the-scenes opponents of experience rating the EI clawback were certain large manufacturers and unions representing workers in relatively high-wage jobs who had built what were then UI benefits into their budgets. These lobby groups are in Ontario, too, not just the Atlantic provinces. And they are male as well as female. Those workers and companies will continue to use EI benefits in a planned way as long as the system makes it possible for them to access those benefits. It is almost impossible to devise rules that would avoid such misuse while allowing those with unplanned bouts of unemployment to collect. That is why the experience-rated EI clawback is needed. It ensures that an increasing amount of the money paid out to higher-income repeat beneficiaries will be recouped at tax time.

How can politically motivated pressures to amend EI be distinguished from sincere efforts to create a fairer system? Norine Smith, the senior HRDC official responsible for drafting the 1996 reforms, thought that the answer lay in the quality of the factual evidence brought forward:

> [E]valuation results helped shape and support the policy process....The significance of these evaluations lay in the ability to counter social policy mythology with the closest thing to hard facts that anyone could find. In areas as emotional and opinion-laden as the bread and butter issues which lie at the heart of social policy, the ability to lay a fact on the table can go a long way.[4]

To illustrate her point, Smith called attention to a group of applied econometric studies:

> The...evaluation was a wide ranging set of about 22 studies undertaken by a team of academics [and some nonacademic researchers] from across North America....They mined existing administrative data and broadened the information base both through new surveys and through the creation of a massive integrated research data base. The result was truly impressive and had the added authority of having been conducted at arm's length. The perceived objectivity and credibility of academics gave the evaluation results much more weight in the policy debate.[5]

An example of the sort of evidence Smith referred to and that led me, as a member of the Social Security Reform Task Force, to advocate the intensity

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4 Smith 1996; at the time of her remarks, she was the assistant deputy minister of the Insurance Group at HRDC and, as such, effectively headed up the entire insurance benefits component of EI in Canada during the phase-in period for this program.

5 Ibid. The studies Smith referred to were initiated and contracted for by HRDC's Ging Wong well before the start of the reform process that started under former minister Lloyd Axworthy. Drafts became available within the department in early 1994 and greatly shaped the reform deliberations.

rule is contained in a Statistics Canada report (Corak and Pyper 1995).[6] The report documents that, in all industries and all regions of the country, it is only a minority of employers whose workers are responsible for most of the repeat use of what was then UI. Thus, the majority of employers in all industries and all parts of the country would reap savings from having repeat usage reduced:

> The transfers imposed through UI are heavily concentrated at the firm level. Only 12 per cent of firms consistently receive a net positive transfer in each year….Over 40 per cent of firms never receive a positive transfer….While "always subsidized" firms tend to be concentrated in "always subsidized" industries (particularly in construction), a significant fraction of the firms in most industries are of this sort. (Corak and Pyper 1995.)

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The proof of a person of substance versus the vote buyer lies in whether the person wants the facts no matter how inconvenient or how late they arrive, and whether the messenger who delivers them is shot or heeded.

If HRDC has evidence that either the intensity rule or the clawback is not working as hoped or is punitively and unfairly harming some groups of workers, that evidence deserves to be carefully studied, preferably by those at arm's length from HRDC officials who are responsible for the administration of EI. If there are serious problems, careful documentation of those problems based on administrative data for EI beneficiaries should be tabled. All of this is in line with the minister's announced decision to continue monitoring EI. If either the intensity rule or the clawback can be shown to cause harm or to be ineffective as currently defined, the rules should be modified in accordance with the empirical evidence. They should *not*, however, be eliminated, since both rules are essential for a fair, affordable EI. Without them, Canada would soon face the unpleasant reality of a repeat of headline stories about the growth of EI expenditures — the kinds of stories that led to the design and implementation of the intensity rule and clawback in the first place.

While in an amending mood, the minister should also introduce legislation to harmonize the punitively high hours-of-work threshold for new and re-entering workers to qualify for EI benefits with the threshold for other workers. Parents are not the only ones who need a bigger helping hand to re-enter the workforce. As long as Canada keeps the intensity rule and the experience rating of the clawback, it can afford to have more generous EI qualification rules for both new and re-entering workers.

The minister's amending mood should also extend to eliminating the overly lax special EI qualification rules for fishermen, which, tragically, are attracting young people into an industry that is still in need of downsizing. In

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6 For the reasons I proposed this innovation to the Task Force, see Bassi and Woodbury (2000). The editors of the volume are, respectively, vice president of the American Society for Training and Development, and a senior researcher at the W.E. Upjohn Institute for Employment Research who has headed up several recent investigations of the US unemployment unsurance system. In their preface, they explain that the book consists of ten papers commissioned by the US Advisory Council on Unemployment Compensation and one paper that "offers a remarkable account of the Canadian reforms of the 1990s and the adoption in Canada of worker-side experience rating of UI benefits."

short, a simpler EI system, in which everyone faces the same qualifying rules for benefits that can be constrained by the intensity rule and experience-rated clawback provisions, would be fairer and more supportive of economic growth as well.

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