FRASER INSTITUTE

2021

REFORMING EMPLOYMENT INSURANCE FOR THE 21ST CENTURY

Steven Globerman and Jake Fuss

Contents

Executive Summary

Notwithstanding the long history of unemployment insurance programs in Canada, as well as substantial modifications to the programs over time, employers, researchers, and even the current federal government continue to express concerns about the existing Employment Insurance (EI) system. Indeed, in the fall Throne Speech, Prime Minister Trudeau stated that the COVID-19 pandemic has shown the need for a "21st century system," including coverage for the self-employed and those in the "gig economy."

The current EI system is funded through a payroll tax imposed on employers and employees. EI benefits are a function of the magnitude and duration of unemployment. In this regard, the COVID-19 crisis can be expected to increase required benefit payments while also harming the economic base for the payroll tax. Specifically, it is reasonable to expect that unemployment rates in Canada will remain relatively high for the foreseeable future, while businesses in hard-hit sectors such as tourism, hospitality, and transportation will continue to experience financial distress. Hence, the EI system will face financial pressures in the future, especially with the expiration of special funding programs put in place by the federal government to deal with the economic contraction caused by the pandemic.

The anticipated EI funding challenges amplify calls for implementing design changes to the existing EI system. Specifically, they intensify the need for policies that make the EI system both more efficient and more equitable. In this context, greater efficiency means reducing the magnitude and duration of unemployment associated with what economists refer to as moral hazard. Moral hazard encompasses situations in which individuals or organizations that enjoy financial protection against unfavourable outcomes engage more intensively in behaviour that increases the likelihood of those outcomes. In the case of EI, the concern is that incentives to remain employed or to become reemployed will be mitigated by having access to insurance benefits. Simply put, making it easier to qualify for EI benefits and increasing the generosity of those benefits exacerbates the risk of moral hazard with consequent increases in the unemployment rate and the average duration of unemployment.

The empirical evidence for Canada suggests that pre-COVID, the EI system erred on the side of encouraging labour market inefficiencies by encouraging and sustaining seasonal employment and repeated episodes of unemployment, particularly in Atlantic Canada. The system also indirectly subsidizes firms to use inefficient ratios of labour to capital by providing those firms with ready access to a continuing available pool of temporary workers who can afford to work in temporary jobs because they receive unemployment benefits.

By calibrating eligibility for EI benefits and the generosity of those benefits to regional unemployment rates, the EI system also creates significant inequities. In particular, individuals who were formerly employed in the same occupations prior to becoming unemployed are treated differently depending upon where they reside.

Canada's EI system could be made more efficient and arguably more equitable by making it more of an experience-rated system. Moving in this direction would involve calibrating EI premiums paid by employers and employees so as to reflect more closely historical claims made for EI benefits. Any such design change could be supplemented by initiatives to lengthen the working period required to file for EI benefits and to "front load" benefit payments. Such changes would promote reduced unemployment and shorten the average duration of unemployment by discouraging moral hazard in labour markets.

It must be acknowledged, however, that this redesign of the EI system might impose socially unacceptable hardships on lower-income individuals and families who experience unemployment. This latter concern might argue for a separate income-support program funded from general tax revenue that supplements EI benefits. In this regard, arguments can be made that special benefits currently funded by the EI program, such as parental leave, should also be funded by general tax revenues, especially if the EI program is made more of an experience-rated system of insurance.

The implementation of Unemployment Insurance Savings Accounts (UISAs) would be a substantial redesign of the EI program and could address the moral hazard problem confronting the program. UISAs are mandatory personal savings accounts into which employers and employees make payroll tax contributions. The contributions are the personal assets of the account holders. The funds accumulated through payroll taxes and deposited in individual savings accounts are invested in a diversified portfolio with interest and capital gains reinvested in the accounts. The management of savings account portfolios can be delegated to one or more qualified wealth management companies. Employees can withdraw funds from the accounts during periods of unemployment.

Since positive balances in a UISA account are personal assets (even including to the extent that they can be passed on to one's heirs at one's death), individuals should be motivated to remain employed and, if laid off, to engage in efficient search behaviour and thereby avoid extended periods of unemployment. An important issue would arise in the case of unemployed individuals with insufficient balances in their UISAs to support themselves adequately during periods of unemployment. One way to address this issue is to have a parallel program funded by general tax revenues from which benefits are paid to unemployed individuals with insufficient balances in their accounts. An alternative approach is to make low-interest loans to those individuals from the publicly funded program with loans repaid as individuals reaccumulate positive balances in their personal accounts.

Projections using relatively conservative forecasts of future investment returns suggest that the average Canadian worker would accumulate a positive balance in their UISA after five years of employment that would provide essentially the equivalent insurance coverage available under the existing EI program. While there are complicated implementation issues associated with any such substantial redesign of the EI program, Canada could be guided by the experiences of a number of countries that have implemented UISAs. Personal savings accounts would enable most Canadian workers to self-insure against unemployment and represent a feasible and arguably a more efficient alternative to the current EI system.

Introduction

Canada's first unemployment insurance program was enacted 85 years ago in 1935, although it took a 1940 constitutional amendment to add unemployment insurance to the list of exclusive federal powers.[1] Various governments implemented important changes to the program over time that moved it further away from insurance principles while adding coverage for special benefits such as maternity leave that were not previously considered relevant to a program designed to insure against loss of employment due to changing conditions in the job market.

Notwithstanding the long history of unemployment insurance programs in Canada, as well as modifications to the program over time, employers, researchers, and even the Canadian government continue to identify important issues surrounding the current Employment Insurance (EI) program.[2] Several of these issues predate the COVID-19 crisis, while others have been exacerbated by the crisis. Certainly, calls to "modernize" the EI system predate the Throne Speech delivered in September 2020.

This study seeks to advance the debate surrounding a modernization of Canada's EI system by identifying and evaluating steps that might be taken to achieve that objective. Any such analysis clearly requires a discussion of the major issues that underlie calls for reforming the EI system. Hence, the next section briefly summarizes the relevant issues.[3] The third section then sets out some policy options that can address the challenges facing any redesign of the existing EI system. The fourth section proposes and evaluates the implementation of an Unemployment Insurance Savings Account (UISA), also known as a Personal Savings Account (PSA), as a substantial potential reform to the EI system.[4] The final section provides concluding comments.

---

1 For a brief history of unemployment (and, later, employment) insurance programs in Canada, see Courchene and Allan (2009).

2 In his September 2020 Throne Speech, Prime Minister Trudeau stated that the COVID-19 pandemic has shown that Canada needs an EI system for the 21st century, including coverage for the self-employed and those in the "gig economy."

3 For extensive discussions of major issues surrounding Canada's EI system, see McMahon (2020) and Fuss and Globerman (2020).

4 While the two terms are synonymous, we shall mostly refer to UISA throughout for

Issues Relevant to Redesigning the EI System

When discussing the issues that should be considered in redesigning the EI system, it is important to understand how the system is funded and the incentives created by alternative funding and disbursement schemes. Prior to the special funding programs that the federal government put in place to address the unemployment crisis created by the COVID-19 pandemic, the EI program was entirely funded by payroll taxes imposed on employers and employees.[5] We anticipate that payroll taxes will again be the main source of funding[6] for the EI program once the emergency funding programs end and the government makes any ongoing changes to the program.[7]

By way of background, both economic theory and empirical evidence suggest that most, if not all, of the employer's portion of the EI payroll tax is passed on to employees in the form of reduced compensation (Ebrahimi and Vaillancourt, 2016). The bulk of the employers' portion of the tax is passed through to workers in the form of lower wages due to a reduced demand for labour on the part of employers. This, in turn, is likely to be accompanied by downward pressure on wages and total worker compensation. To the extent that reduced compensation leads some workers to partially or fully leave the labour force, increases in the employer's portion of the EI payroll tax can result in a smaller labour force. This effect is likely

---

the sake of convenience.

5 Employees pay a lower EI premium than employers. EI premiums for employees in 2020 are set at $1.58 for every $100 of insured earnings, whereas the premium for employers is $2.21 per $100 of insured earnings (CRA, 2020). This means that employers pay 1.4 times the employee premium rate.

6 Since 2016, the Canada Employment Insurance Commission (CEIC) has been responsible for establishing the annual EI premium rate based on a seven-year break-even mechanism. This means that annual premium rates are estimated to generate enough revenue to cover expenditures over the next seven years and eliminate any existing surplus or deficit in the EI operating account.

7 The recent Throne Speech indicated that the CERB program would be discontinued but that the Canada Emergency Wage Subsidy (CEWS) program would be extended through June 2021.

augmented, at the margin, by the employee's reduced after-tax income that results from their paying a portion of the tax directly.

A smaller labour force is clearly an undesirable consequence of imposing (or increasing) a payroll tax; however, insurance against the possibility of losing one's employment income for reasons outside one's control is certainly valuable, especially to risk-averse employees, and it is something that they should be willing to pay for voluntarily. Well-known problems make private unemployment insurance markets difficult to sustain.[8] Hence, government-administered programs are ubiquitous. The government as insurer sets not only the premiums paid through the payroll tax, but also the eligibility for benefits, the amount of benefits paid, and the length of time they are paid. Just as changing the payroll tax rate can affect overall employment in the economy, changing the terms and conditions regarding eligibility for EI payouts and the amount and timing of the benefit payments can affect the incentives of insured individuals to participate in the workforce. In particular, the easier it is to qualify for benefits, and the more generous the benefits are, the greater is the incentive of those receiving benefits to remain unemployed. This is an example of what is known in the literature as the problem of moral hazard.[9]

Design tradeoffs

While disincentives to work created by higher payroll taxes and more generous insurance benefits can be mitigated by lowering both premiums paid and the magnitude of the benefits received, as well as by modifying the criteria for obtaining those benefits, the offsetting disadvantage is that unemployed workers may suffer undue hardship to the extent they are financially unable to maintain anything close to their standard of living prior to becoming unemployed.[10] Also, while a less generous insurance

[8] The problems associated with relying on private insurers to provide insurance against unemployment are discussed in Hendren (2015). To our knowledge, there are no examples of jurisdictions that rely upon entirely voluntary and private employment insurance.

[9] Rogerson, Shimer, and Wright (2005) analyze a range of economic models in which searching for a job (the "search") is a key feature of labour markets. Search implies that it takes time for unemployed workers and potential employees to make matches. One fairly consistent conclusion of search models is that more generous unemployment benefits lead to longer durations of unemployment.

[10] This hardship will obviously be a function of the prior savings accumulated by unemployed workers, as well as their ability to borrow money from family or financial institutions. To the extent that individuals accumulate savings over time

program would encourage unemployed workers to accelerate their job search in order to maintain their current standard of living, under some circumstances, "allowing" more time for unemployed workers to search for new employment might result in a better match between those workers and employers looking for specific skills.[11] In turn, better matching of workers' skills to employers' requirements should reduce the probabilities of those workers becoming unemployed in the future while also improving the productivity of the economy.

In short, one enduring and major challenge confronting the design of a public unemployment insurance system is to mitigate moral hazard (which can take the forms of employed workers having weakened incentives to remain employed and unemployed workers delaying their search for new jobs or refusing to accept available jobs), while at the same time providing for an adequate standard of living for unemployed workers and enabling temporarily jobless workers to find good matches in the marketplace for their skills.

One way the Canadian EI system attempts to navigate the tradeoff between providing adequate income replacement and inadvertently encouraging more frequent and extended periods of unemployment associated with moral hazard is to calibrate eligibility for EI benefits and the generosity of those benefits to unemployment conditions in different regions of the country. Specifically, it is easier to qualify for benefits if the insured applicant lives in a region with a relatively high unemployment rate. As well, the replacement rate for lost employment income is more generous in regions with relatively high unemployment rates. The justification for this design feature is that it is more difficult to find new employment in regions where unemployment rates are relatively high, with the reverse being true in regions where unemployment rates are relatively low.

As a consequence of this feature, the current design of the Canadian EI program has created significant inequities across regions.[12] For example, unemployed individuals who were previously working in the same occupation and for the same amount of time may receive differ-

---

that are adequate to bridge financial requirements over most expected periods of unemployment, the requirement for a government-financed insurance scheme is mitigated. We shall return to the potential for self-insuring against unemployment in a later section.

11 Rogerson, Shimer and Wright (2005) note that this outcome is particularly likely for risk-averse job seekers. Conversely, longer periods of unemployment increase the risk of an atrophying of job skills, which would reduce employment prospects and possibly encourage some workers to drop out of the labour force entirely.

12 For a more extensive discussion of inequities under the current EI program, see Fuss and Globerman (2020).

ent EI benefit amounts depending upon where they live. Moreover, using regional unemployment rates to calibrate eligibility and reimbursement dampens labour market mobility by effectively discouraging unemployed workers from moving to locations with more abundant job opportunities (Fernandez-Navia, 2019). It also discourages the movement of capital from less efficient to more efficient business activities by effectively subsidizing the availability of people willing to work on a seasonal or part-time basis. In effect, calibrating the EI eligibility period and benefit stream to differences in regional unemployment rates helps perpetuate those differences. McMahon (2020) highlights this feature of Canada's EI program as a major contributor to the perpetuation of unemployment and inefficient businesses in Atlantic Canada.

As Courchene and Allan (2009) note, Canada's EI system involves substantial cross-subsidies across regions, individual recipients, and employers, and as such it deviates markedly from risk-rating insurance principles. This has the effect of moving the EI system away from an efficient design for an insurance function. Any serious effort to reform the system should therefore address the economic inefficiencies that flow from a program design that discourages employment and reduces the mobility of factors of production.

Self-employed workers

As noted earlier, the September 2020 Throne Speech identified the absence of EI coverage for self-employed workers as a major shortcoming of the current EI system.[13] The growth of the so-called "gig" economy has increased the number of self-employed individuals engaged in a range of activities from driving for car-sharing services such as Uber, to managing shared accommodations through Internet platforms such as Airbnb, to undertaking a wide range of temporary physical tasks via platforms such as TaskRabbit. The likelihood that a growing share of the workforce will be self-employed makes a lack of EI coverage for self-employed workers more pressing.

The moral hazard problem surrounding EI coverage for employed workers is even more salient in the context of those who are self-employed. In particular, it is more difficult to monitor whether the loss of employment is "voluntary" or involuntary in the case of the self-employed since they are more likely to work in unsupervised work environments than are salaried employees. The self-employed are also likely to work in newer and more heterogeneous occupational environments where un-

[13] This issue is also discussed by Fuss and Globerman (2020).

employment histories are too short to be able to apply risk rating to set EI insurance premiums for individuals or occupational groups. Hence, designing an efficient EI scheme that captures the self-employed is an even greater challenge than doing so for employed workers.

Special benefits

Special benefit programs were attached to the EI program in the 1970s. They provide a certain level of income security for individuals and their families if those individuals must interrupt work temporarily for reasons covered by the programs, including parental leave and leave to provide home care for an ailing relative. Without denying the net social benefits of providing publicly financed support for the activities covered by special benefit programs, economists have debated whether such benefits should be directly incorporated into a risk-rated unemployment insurance scheme or whether they instead should be administered as envelopes funded by general taxation revenues.[14]

One argument for removing special benefits from the EI program is that the social objectives of those benefits are different from smoothing disruptions to consumption caused by involuntary unemployment. For example, parental leave is motivated by concerns about child development and gender equity rather than about providing financial support to enable temporarily unemployed workers to remain attached to the labour force by searching for new employment. In the latter case, an efficient insurance design would seek to discourage on-the-job behaviour that leads to unemployment, as well as extended periods of unemployment that cannot be justified by searching for optimal matches in the job market. Conversely, it does not make sense to structure the availability of special benefits so as to discourage the activities that are financially supported by those benefits. For example, it is illogical to calibrate EI premiums or parental leave benefits to the number of parental leaves taken by insured individuals, at least in the absence of an explicit notion of an "optimal" family size. It is also illogical to make the eligibility for sick leave benefits contingent on minimizing sick leave claims if a social goal is to minimize the risk of widespread contagious disease.

A second argument for removing special benefits from the EI program is that it is an inequitable way to finance those benefits. As Mintz (2010) notes, due to maximum contribution limits in the EI system, increases in premiums to pay for general social benefits represent a greater

14 For an overview of the arguments, see Turgeon (2011).

Table 1: EI Benefits Paid (in $ millions) by Category and Province in 2018/19

	Regular Benefits	Special Benefits	Total EI Benefits
NL	799.2	106.5	1,022.9
PEI	160.3	42.3	231.1
NS	595.2	192.2	845.1
NB	632.2	205.2	869.6
QC	2,577.5	528.1	3,106.0
ON	2,775.9	2,500.2	5,240.4
MB	371.1	240.0	619.2
SK	393.0	233.8	624.7
AB	1,331.3	847.8	2,171.0
BC	988.5	869.8	1,878.1
Canada	10,673.8	5,792.5	16,685.3

Source: DOESD (2020e).

relative burden on workers with low and modest incomes.[15] Moreover, payroll taxes used to finance special benefits impose a burden solely on workers and employers, while programs covering parental leave and compassionate care indirectly benefit all of society by reducing costs associated with childhood-related behavioural and health problems and the need for professional care providers that would otherwise financially burden the publicly funded health care system. As such, it is appropriate for at least a portion of the relevant "special" benefits to be paid for by the general taxpayer.[16] Similar logic would argue that benefit payments from general taxation for socially valuable behavior, such as providing compassionate care, should not be limited to those who are eligible for EI benefits.

We find the arguments for moving special benefits out of the EI program persuasive, although we acknowledge that new issues would be raised by doing so, including how the relevant benefit packages would be paid for and administered, as well as how to design the governance of the programs to ensure that "inappropriate" claims are minimized. While the latter issue is related to the moral hazard problem linked to unemploy-

15 The maximum annual EI contribution amount in 2020 is $856.36 for workers and $1,198.90 for their employers (DOESD, 2020f).

16 After 1990, the EI program went from being financed from employer and employee premiums plus federal government general revenues to being fully financed from employer and employee premiums.

ment, the distinction between the social goals of the EI program and programs such as parental leave, beyond simply income maintenance, leads us to conclude that it is preferable for special benefits to be separated from the employment insurance component of the EI system.

By way of background, table 1 reports the amount of money paid out among provinces for regular EI benefits and special benefits during the 2018/19 fiscal year (latest year of available data). Although the biggest expense remains regular EI benefits ($10.7 billion or 64 percent of total payouts), special benefits comprise a large share of total expenditures. Indeed, more than one-third (34.7 percent) of all EI payments consist of special benefits claims, with an annual cost of approximately $5.8 billion. Hence, special benefits are important contributors to the overall cost of the EI system.

Recent changes to the EI system

Towards the end of September 2020 the federal government implemented a number of changes to the EI system that will apply for the next 12 months. First, the Canada Emergency Response Benefit (CERB) program was eliminated and recipients were automatically shifted to the regular employment insurance system (Harris, 2020). With the winding up of the CERB, EI recipients are now entitled to receive $500 per week (pre-tax income) in benefits to match the previous payouts under the now dismantled CERB (Harris, 2020).[17]

Eligibility rules were concurrently expanded to ensure that more people could qualify for EI benefits. Presently, an individual's EI benefits are calculated assuming that all regions of the country have an unemployment rate of at least 13.1 percent (DOESD, 2020a)—a high rate that reflects the continued impact of the COVID crisis on the Canadian labour market.[18] This means that all recipients are able to claim at least 26 weeks of regular benefits and a maximum of 45 weeks. Moreover, claimants currently only need 120 insured work hours to qualify for benefits because they get a one-time credit of 300 insured hours to help them meet the required 420 insured hours of work (DOESD, 2020a).

Although these changes allow Canadians to have additional income support for a longer time during the ongoing pandemic, there is a poten-

[17] The Trudeau government originally planned to make the new EI weekly benefit equal to $400, but this was boosted to $500 after negotiations between the Liberals and NDP.

[18] Canadians are eligible to receive benefits for longer periods in regions with unemployment rates above 13.1 percent.

Table 2: EI Eligibility Compared to Previous Year in all Economic Regions

	Oct-Nov 2019	Oct-Nov 2020	Change
Average qualifying hours	640.6	420.0	-34.4%
Average mininimum weeks of benefits	16.8	26.5	58.0%
Average maximum weeks of benefits	38.5	45.0	17.0%

Note: EI Recipients currently only need 120 insured hours to qualify for benefits because they get a one-time credit of 300 insured hours to help them meet the required 420 insured hours of work.

Sources: Service Canada (2020); calculations by authors.

tial drawback to this approach. Providing easier access to EI may increase the moral hazard risk by encouraging some people to be less active in their job search efforts when unemployed. This would impose an increased financial burden on the EI system (increased payouts) and also have undesirable spillover effects on the economy as employers experience greater difficulty finding suitable employees.

These recent changes could lead to deficits for the EI operating account and additional pressure on federal finances once COVID has passed, as general taxes may need to be increased in order to cover EI deficits. Table 2 demonstrates that if October 2020 unemployment levels persist, the average qualifying period for EI will decline by 34 percent compared to October 2019 and Canadians who have the minimum number of qualifying hours will see the length of their benefits increase by about 58 percent. Workers who have the maximum number of qualifying hours will see the length of their benefits increase by 17 percent. More generous benefits along with fewer EI contributors (the employed labour force remains smaller by about 1 million than it was pre-COVID) might well contribute to a fiscal crunch if the current EI structure remains unchanged.

Other changes to EI announced in September 2020 include the creation of three new benefits for Canadians who don't qualify for regular benefits. The Canada Recovery Benefit (CRB) offers income support to self-employed or gig workers (DOESD, 2020b). These individuals are eligible to receive $500 per week over a two-week period before needing to apply again. Eligibility rules stipulate that Canadians can only receive the CRB for a maximum of 26 weeks over the next year (DOESD, 2020b). Further rules state that claimants must have earned a minimum of $5,000 over the last 12 months, cannot have quit their job or voluntarily reduced their hours after September 27th, and must have either lost employment

due to COVID-19 or experienced a 50 percent reduction in their average weekly income compared to the previous year (DOESD, 2020b). Benefits are taxed back at a rate of 50 percent on income above $38,000 (Boadway et al., 2020).

The introduction of the CRB is beneficial for self-employed workers because it provides them with the income support that they were not previously eligible for under the previous EI system. However, this does not appear to be part of a long-term fix to provide coverage to self-employed workers. In fact, the CRB creates significant work disincentives due to the imposition of a high marginal effective tax rate.[19] Indeed, eligibility rules for the CRB mean that marginal effective tax rates could reach between 75 to 85 percent for individuals depending on their family characteristics and income range once all benefit clawbacks are accounted for (Boadway et al., 2020).

Furthermore, the federal government will need to outline a long-term plan for how to fund an EI system for self-employed workers after the pandemic since the self-employed currently do not make any contributions to the regular EI program. As well, the federal government will need to be clear about—and restrictive—regarding the eligibility requirements—while avoiding negative work incentives—given the moral hazard potential for self-employed workers to lay themselves off or under-report their incomes.

The Canada Recovery Sickness Benefit (CRSB) provides income support to Canadians who are unable to work because they are sick, need to self-isolate, or have a higher risk of getting COVID-19 (DOESD, 2020c). These claimants can receive $500 for one week and need to re-apply if their situation persists beyond that time (DOESD, 2020c). CRSB recipients are eligible for a maximum of two weeks of CRSB benefits.

Finally, the Canada Recovery Caregiving Benefit (CRCB) provides income assistance to individuals who cannot work because they are caring for children under the age of 12 or another family member who needs supervised care (DOESD, 2020d). For instance, parents who must care for their child in the event of sickness, or a daycare or school closure, can receive $500 for a 1-week period and can apply for the benefit a maximum of 26 times (DOESD, 2020d).

In summary, recent proposed changes to the overall EI system address the situation of self-employed workers, but the proposed initiative

[19] Once an individual reaches $38,000 in income for the year, the CRB begins to get clawed back at a rate of 50 cents on the dollar. The 50 percent claw-back ends once an individual earns $52,000. This high claw-back acts as an additional tax on recipients as they keep less of the money earned beyond $38,000. Recipients may also lose some level of benefits (i.e., Canada Child Benefit) as their income rises.

is arguably provisional for reasons mentioned earlier. They also expand financial support for specific special benefits, while increasing the financial benefits available to unemployed workers. In doing so, these changes will exacerbate the moral hazard risk discussed above. In short, while the recent proposed changes may well be appropriate in light of conditions created by the pandemic, they do not address long-run fundamental issues facing Canada's employment insurance system.

The next section discusses some possible design changes to the EI system that preserve the basic "pay-as-you-go" approach to funding and administering unemployment benefits. The fourth section introduces the idea of a more substantive redesign of the system, namely the use of personal savings accounts.

Some Potential Steps to Redesign the EI System

The main purpose of the EI system is to provide the best balance between smoothing the consumption of insured workers, while limiting adverse effects on incentives to work (O'Leary and Wandner, 2018) and promoting an efficient labour market. At the same time, an essential element of any EI system is its long-term financial stability, which involves balancing the extent and cost of unemployment benefits against the taxes needed to fund them. As McMahon (2020) outlines, the above-average unemployment trajectory for Canada in the immediate post-COVID period along with the generous income support benefits that are likely to remain mostly in place for some time will put a substantial financial strain on Canada's EI system. One likely consequence is that payroll taxes will need to rise over time to pay for increased EI-related benefits, an increase that will, as discussed earlier, have damaging effects on economic growth. A second possible consequence, which is not mutually exclusive with a scenario of increasing payroll taxes, is that some aspects of the EI system will have to become less generous to maintain overall financial sustainability.

While increasing taxes, reducing benefits, or both, might be necessary in the foreseeable future to ensure the financial solvency of the EI system, a long-run design problem will still exist. Namely, the EI system as currently structured departs significantly from a strictly risk-rated system, even if special benefits are excluded from the regular EI system. Simply put, the system arguably should have stronger incentives in place to discourage employers and employees from engaging in planned and regularly scheduled temporary and seasonal layoffs, and to encourage workers to make appropriate investments of their time and skills to remain gainfully employed while also prompting unemployed workers to search for and accept new employment in a timely manner.

Experience-rated premiums

The main characteristics of the EI system that can be "recalibrated" to try to make the system more efficient at reducing moral hazard are eligibility conditions and the level and maximum duration of benefits. One step that

would make the system more efficient is to make premiums experience-rated. Experienced-rated premiums would adjust the premiums paid by employers and employees based on prior use of the EI system. In theory, fully experience-rated EI premiums would mean that employees who are certain to be unemployed (such as seasonal or contract workers), and firms whose demand fluctuates throughout the year necessitating habitual temporary layoffs, would be excluded from EI, since when there is a certainty of an event, there is no role for insurance to play. Put differently, if the required premium were equal to the present value of the insurance benefits expected to be received, individuals would have no incentive to participate in the insurance scheme.[20]

To be sure, if seasonal and contract workers are primarily low-income people, the income redistribution that is effectively built into the current EI system would be mitigated by full risk-rating of premiums. Likewise, if those individuals who draw on EI disproportionately are also relatively low-income individuals, an experience-rated insurance system might have undesirable socio-economic consequences to the extent that relatively high-risk individuals would be financially unable to purchase insurance and, in fact, would suffer prolonged periods of unemployment. In short, there might be an unavoidable tradeoff between efficiency and distributional equity in a fully risk-rated insurance system. However, this tradeoff could be addressed, in principle, by complementary programs that directly subsidized EI premiums for low-income individuals from general tax revenues.[21]

Setting aside the issue of how to address the problem of premium affordability for certain individuals in an experience-rated insurance system, there are potentially significant administrative costs and other practical difficulties associated with identifying the likelihood and duration of unemployment as they relate to specific employers and individual workers. This is due in part to the heterogeneity of individual employers and employees combined with changes in economic circumstances that alter the likelihood of unemployment and the severity of unemployment over time for specific groups of employers and employees. There are also new employers and employees continually entering the labour market while others are leaving, and any significant differences in characteristics between entrants and exits that influence the likelihood of continued attachment to employment will alter the relevant parameters for calibrating experience-related premiums in ways that may be difficult to predict (Cameron, 2013).

20 For an extensive discussion of experience-rated EI premiums, see Cameron (2013).

21 Similarly, if the government wants to subsidize seasonal or contract industries, it could do so out of general revenues.

Modifying eligibility and benefits

While there are social as well as practical limitations on implementing a full and efficient risk-rated employment insurance scheme, these concerns would be mitigated by implementing an incremental shift toward experience rating that falls short of a fully risk-rated system. However, the imperative to address the moral hazard problem discussed earlier would still exist. Various initiatives have been discussed in the literature that are meant to mitigate moral hazard while stopping short of comprising a full experience-rated insurance scheme. In general, they involve employing incentives and/or imposing obligations to reduce undesirable behaviour including prolonged periods of unemployment that cannot be justified as engaging in an efficient job search.

Several broad issues are frequently part of any set of considerations to address the moral hazard problem associated with conventional unemployment insurance programs: 1) Should benefits be paid at a fixed rate over the period of unemployment? 2) What eligibility rules and benefit programs should be put in place to discourage behavior that directly or indirectly leads to workers being laid off (i.e. inflows into unemployment)? 3) Should benefit recipients be required to participate in skills training or other activities that, in principal, will help them become re-employed? (Fredrickssen and Holmlund, 2003).

With respect to the first issue, the accumulated evidence is fairly consistent. It suggests that increases in the level and duration of benefits leads to longer unemployment durations, although the precise relationship is uncertain and varies across individuals and the severity of economic downturns (Tatsiramos and van Ours, 2012).[22] A general conclusion regarding the sequence of benefits is that a declining stream of benefits provides better incentives for reducing moral hazard than benefits that remain constant throughout the duration or increase in level.

Another method to encourage people away from unemployment is to combine declining benefits with a wage tax once the person is re-employed, whereby the level of the tax depends on the length of time they were unemployed. The wage tax could be negative at the beginning of the period of unemployment—in other words, they could receive a bonus for leaving unemployment quickly.

The empirical evidence on inflows into unemployment is limited. Most relevant studies focus on eligibility rules. They generally have as their main conclusion that the rate at which workers move from employment to unemployment increases substantially as soon as they reach the requisite

[22] For example, studies have shown that the higher the overall unemployment rate, the less impact moral hazard has on job search intensity. See Cameron (2013).

number of weeks worked in order to qualify for unemployment benefits and at the point at which they have qualified for the maximum possible number of weeks of benefits (Tatsiramos and van Ours, 2012). This evidence suggests that increasing the number of weeks worked to qualify for unemployment benefits will reduce the move to unemployment, although it would also make maintaining a stable living standard (consumption smoothing) more difficult for individuals who lose jobs and do not have easy access to borrowing alternatives. Liquidity constraints are also likely to vary across individuals waiting for eligibility.[23]

The empirical literature on search requirements and job search trends tend to show that monitoring matters for search behaviour and that more stringent search requirements are likely to speed up the transition to employment. However, the evidence on this relationship is far from conclusive (Fredriksson and Holmlund, 2003). Furthermore, there are likely to be substantial administrative costs associated with government monitoring. Training and work requirements are likely to induce some non-workers to self-select out of the EI system. Again, the evidence on the effects of work/training requirements on moral hazard is limited. In principle, work placement and skills training programs should enhance the likelihood of unemployed workers finding higher paying jobs than in their previous employment, which should be a positive incentive for some unemployed workers to participate in EI programs with attached workplace and training programs that are seen by unemployed individuals as being effective. Whether the bureaucracy administering the EI system can deliver effective workplace and skills training programs is an open question.

In short, there are potential design modifications to the EI system that would mitigate the moral hazard problem that is the major challenge to designing a more efficient EI system, but which stop short of moving to a fully risk-rated system. However, some, if not all, of the possible design changes involve decisions and actions undertaken by the EI bureaucracy, and the latter can be expected to have, at best, a highly imprecise understanding of the tradeoffs that individuals, or groups of individuals, are prepared to make with regard to work versus leisure, or with regard to the expected values that those individuals or groups of individuals place on more extended job searches, investments in training, and so forth. In this regard, allowing greater scope for individuals to make the tradeoff decisions themselves might be a promising way to redesign the EI system. A

[23] A related change that would have similar incentive effects would be to impose greater national uniformity with regard to eligibility criteria and benefit duration. This change would discourage strategic use of EI to support seasonal and temporary unemployment as discussed in an earlier section of this essay.

broad approach in this direction is to implement unemployment insurance savings accounts.

Unemployment Insurance Savings Accounts (UISA)

Most economists acknowledge that unemployment is a problem because of liquidity constraints. Put simply, if all unemployed workers could borrow funds when needed at a competitive interest rate, workers could smooth their own consumption streams by accumulating voluntary savings when they are employed and, if those savings are inadequate to satisfactorily fund periods of unemployment, borrow against future earnings in order to fund consumption during periods of unemployment.

Several factors militate against the success of voluntary savings (or voluntary self-insuring) to address the risk of unemployment. One is that many unemployed workers are likely to face borrowing constraints, particularly during periods of widespread unemployment, since it is during such periods that financial institutions are likely to tighten conditions surrounding the extension of loans, especially to individuals with limited assets to put up as collateral against those loans. For another, individuals may be reluctant or unwilling to accumulate savings in a prudent manner, if they believe that the government will ultimately provide funding in the form of welfare benefits or if they underestimate the probabilities of becoming unemployed or the duration of the resulting period of unemployment.

Unemployment Insurance Savings Accounts (UISAs) are savings accounts to which individuals are obligated by law to contribute a portion of their incomes and from which they are expected to draw compensation during periods of unemployment. It is beyond the scope of this essay to address all of the complex design issues that surround the construction of an EI system based on UISAs. Hence, we will focus on the main advantages of UISAs, as well as several of the challenges that confront their design.

Addressing moral hazard

In principle, UISAs can provide the same protection to the unemployed as the current EI system but with less of the moral hazard incentives. In one version of this system, every individual (and/or that individual's employer) would be required to contribute a fraction of the individual's wage income to a UISA. The funds would come from pre-tax income and would accumulate tax free. Alternatively, they could be taxed but the benefits

withdrawn would be tax free.[24] Positive balances would be invested in a financially prudent manner, although the details of how the balances would be invested are not material to this discussion.[25] The primary feature of the system is that if an individual loses their job and would be eligible for benefits under current EI rules, they could withdraw money from their account up to a limit set by EI rules. If individuals retire from the workforce or die with positive balances, they can keep those balances for spending in retirement or pass the balance on to their heirs.

The advantage of having withdrawals taken from a UISA is that an individual with a positive account balance would completely internalize the cost of unemployment benefits and therefore would have no incentive to increase in an inefficient way the frequency or duration of unemployment spells. A moral hazard problem would only arise for individuals who expect that they will retire or die with negative balances in their accounts because additional unemployment has no personal cost. But such individuals would face the same moral hazard incentive as they would under the existing EI system.

Safeguards

UISAs raise some concerns similar to those raised by a strict risk-rated system. Namely, there may be unemployed who, in the case of coverage by a UISA, have negative balances at times during which they are unemployed.[26] A version of a UISA scheme that addresses this issue is to have a common fund alongside personal funds. The common fund would hold reserves from which people with negative personal account balances can take withdrawals if and when they qualify for benefits. The amount that can be withdrawn from the common fund would be limited and the eligibility period would also be limited. Both amount and eligibility could be structured to decline as the unemployment period lengthens to strengthen

[24] For discussions of the advantages of UISAs, as well as design issues, see Feldstein and Altman (2007) and Valentini (2008).

[25] For example, an individual's UISA balance could be invested in an index fund that holds a variety of assets, e.g., equities, fixed income, real estate, with the mix of assets adjusted to reflect the individual's anticipated date to retirement.

[26] This is equivalent to having individuals in the work force who have a high risk of unemployment and cannot, or will not, pay risk-rated premiums therefore foregoing insurance coverage. For individuals with above-average employment prospects in relatively high-paying jobs, the common fund might be a source of loans, i.e., those individuals might accumulate temporary negative balances in their personal accounts.

incentives to search for and accept employment.[27] The common fund could be funded through the personal income tax system, which would preserve some degree of redistribution in a new EI system to the extent that those drawing on the common fund are both more likely to experience spells of unemployment and also to earn below-average incomes.

The benefit funding dispersed from the common fund could take the form of a loan or an outright income transfer. The amount loaned could accumulate as a negative balance in the UISA, in which case the borrower would need to pay down the loan before being able to accumulate a positive balance in the account.[28] An argument against the lending option is that it would effectively make the UISA program nothing more than a completely voluntary self-insurance program. However, terms and conditions of loans extended under a UISA program could be made substantially easier for borrowers than the terms and conditions those borrowers would face in the private capital market. Alternatively, for borrowers who earn below a minimum income level over a given period of time, loans could be forgiven. Again, the specific details of how a common fund would address negative UISA balances are beyond the scope of this essay.

A factor that would limit the practical advantages of a system built around UISAs is the extent to which increased unemployment is concentrated in a sub-group of the population. In particular, if those who typically collect unemployment insurance benefits would also typically run negative balances in their personal accounts and, therefore, need to draw regularly on the common fund, there would be limited advantage to the UISA design. In this regard, Feldstein and Altman (2007) simulate outcomes from US tax data to show that the percentage of individuals who would end their lives with a negative UISA balance is modest and would not obviate the efficiency benefits resulting from shorter and less frequent spells of unemployment.[29] Indeed, Valentini (2008) notes that the simulations that Feldstein and Altman carried out assume that employment incentives would not be affected by a switch to an insurance system structured around UISAs. This conservative assumption likely means that Feldstein and Altman overestimate the percentage of individuals who would end their lives with negative balances.

27 The amount people could withdraw from the common fund could also be calibrated by age, so that, for example, younger people would have a greater possibility of building a positive balance in their personal accounts.

28 For a discussion of lending as a feature of UISA accounts, see Hatherly (2017).

29 Whether this would be true for Canada where seasonal and part-time unemployment is possibly more pronounced than in the US, especially in Canada's Atlantic provinces, requires further study.

Other issues

There are other practical issues that would need to be addressed in any substantial redesign of the EI system to move it towards a system that relies upon mandatory personal savings accounts. For example, there are transition issues. Namely, what credit, if any, should be given to older workers who have been paying EI premiums through payroll taxes and who have never collected EI benefits? Should a new EI system be phased in so that older workers can remain covered under the existing system until they retire if they choose to do so? Should self-employed workers who arguably can more easily indulge in moral hazard when it comes to managing their employment status be obliged to contribute more of their declared net incomes to their personal savings accounts than salaried employees? Should training programs aimed at accelerating transition from unemployed to employed status be paid for from the personal savings accounts of individuals or from a common fund? Should workers who quit their jobs to search for better paying jobs be allowed to withdraw money from their UISAs? Should Canadians living in regions currently oriented around seasonal work be grandfathered in under the reforms?

These and other specific design issues are beyond the scope of discussion in this essay. We merely note that the design issues associated with the UISA scheme do not seem intractable. Indeed, once past any transition period, the scheme promises to be less administratively costly than the current EI system since many of the needed activities can be integrated into the existing personal income tax administrative regime. Furthermore, as in the case of Singapore, the UISA account might, over time, be joined to other new mandatory personal savings accounts to acquire life and health insurance, as well as to pay for educational costs and to acquire annuities or other assets to help fund retirement. The same basic notion applies in principle to insuring against other types of risks as it does to insuring against the risk of unemployment. Namely, individuals have stronger incentives to avoid undesirable outcomes when they stand to benefit individually from successfully avoiding such outcomes. In turn, voluntary individual reductions in morally hazardous behaviour benefit all of society by improving the efficiency of broad-based social insurance programs.

Chile's unemployment insurance system

In 2002, Chile transformed its unemployment insurance system from a pay-as-you-go model to a program built upon a combination of compulsory individual UISAs and a common solidarity fund (SF) (Valentini,

2008). All workers aged 18 and over in the private sector must enroll in the program when they begin their careers (Hartley et al., 2010).[30] The system is funded by mandatory contributions from both workers and employers at a fixed percentage of the employees' wage. The accumulated balance in each individual's savings account is their private property and cannot be used by the government for any purpose.

Upon experiencing a spell of unemployment, benefit recipients can withdraw this money from their UISAs according to a predetermined schedule. Benefits are remunerated at a fixed replacement ratio and can be received for a maximum duration of seven months (OECD, 2018). The replacement rate in the first month is 70 percent of the beneficiary's average wages in the past 12 months (ORDP, 2015). For each subsequent month, the replacement rate decreases between five to fifteen percentage points before reaching 30 percent in the final month (ORDP, 2015).

The Solidarity Fund ensures that low-income workers who have insufficient balances in their savings accounts can still receive EI benefits—and for the same duration as those drawing from their own UISA. Benefit recipients are only eligible to receive benefits from the Solidarity Fund[31] when they have depleted the money in their individual account (Hatherly, 2017).[32] Workers must also have made a minimum of 12 contributions over a 24-month period to their UISA (OECD, 2018). Further eligibility conditions stipulate that workers must not be at fault for their dismissal, and they must visit employment offices every month and accept job offers paying at least 50 percent of their previous wages (ORDP, 2015). Access to money from the Solidarity Fund is only provided for a maximum of 10 months of unemployment in a five-year period (ORDP, 2015).

Research from Hartley et al. (2010) on Chile's UISA system found that the greater the sum in an EI savings account prior to an unemployment spell, the higher the probability of the account holder finding employment and quickly terminating the use of their funds. Put differently, workers who relied on their own individual savings accounts during periods of unemployment found employment sooner than Chileans who drew resources from the Solidarity Fund.

The introduction of a Solidarity Fund partially creates a moral hazard problem, but these concerns are mitigated to an extent both by

30 Government sector workers and apprentices do not participate in the system.

31 The Solidary Fund is primarily financed through the contributions made by employees and employers, but the Chilean government also contributes to the fund out of general revenue.

32 Temporary workers are not entitled to any benefit from the Solidarity Fund.

the limited duration of benefits (7 months) and eligibility requirements capping the number of times workers can access the fund during a five-year period. Chile's EI system also does not differentiate benefits based on region of residence and discourages the existence of seasonal work (Hatherly, 2017). For instance, eligibility standards and benefit durations are standard regardless of where recipients live in Chile. Requiring 12 contributions (over a 24-month period) prior to a withdrawal makes it difficult for Chileans to access their savings accounts or the Solidarity Fund if they engage in seasonal work or are frequently unemployed.

Other Latin American countries such as Argentina, Brazil, Colombia, Ecuador, Peru, and Panama also have similar UISA systems in place. System structures are fairly comparable across countries, but there are important differences. Indeed, eligibility requirements, contributions rates, withdrawal rules, and fund management can vary significantly by country. For instance, only construction workers are covered by UISAs in Argentina, and UISA funds are managed by the government in Brazil rather than by financial institutions as they are in Chile and Colombia (Ferrer and Riddell, 2011).

Singapore

Singapore is another country that has implemented a unique social income support system. The Central Provident Fund (CPF) is a compulsory program that requires workers and their employers to contribute a given percentage of their gross income into a personal savings account (Beng, 2012). Each individual savings account is divided into three sub-accounts that are the personal property of the employee. These sub-accounts are the ordinary, special, and Medisave accounts (Beng, 2012). The Singapore CPF system allows for a fair degree of autonomy for citizens over how to use these funds. For instance, contributions can be used to pay for things such as housing, education, health care, unemployment assistance, and retirement income (Tweedy, 2018). Account holders are able to use the money in their CPF account for daily needs once they turn 55 years old, but they must maintain a minimum sum which can be used to buy an annuity, held in a bank account, or remain in the CPF account (Tweedy, 2018). If there are funds remaining in their personal account following their death, the money is passed on to their beneficiaries (Beng, 2012).

Accounts in the CPF earn a legislated minimum of 2.5 percent interest through the issuing of guaranteed government bonds (Special Singapore Government Securities) but each of the three accounts have different interest rates (Tweedy, 2018; CPFB, 2020). As of July 1, 2018, for example,

interest rates for the ordinary account were between 2.5 and 3.5 percent, while the special account and Medisave account earned more than 4.0 percent interest (Singapore, Ministry of Manpower, 2020). Singaporeans are also able to personally invest their savings from the CPF after setting aside $20,000 in their operating account and $40,000 in their special account (CPFB, 2020). The CPF Investment Scheme allows individuals to invest their savings from their operating and special accounts in financial instruments such as bonds, annuities, exchange traded funds, shares, and gold (CPFB, 2020).[33]

Contribution rates are primarily based on the account holder's age and income. Citizens must contribute 20 percent of their monthly wage if they are under the age of 55, 13 percent if they between 55 and 60 years old, 7.5 percent if they are between 60 and 65 years old, and 5 percent if they over 65 years old (Tweedy, 2018). Of course, these contributions rates are relatively high because personal accounts fund a lot more than just employment insurance benefits.

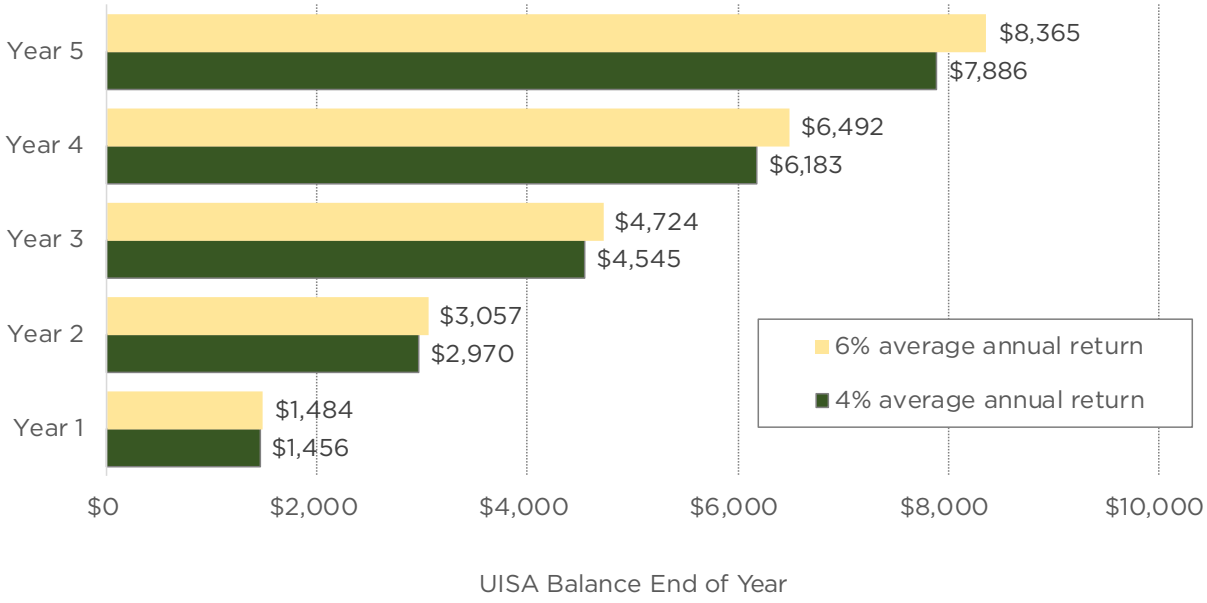
Feasibility

The examples of Chile and Singapore document the feasibility of UISAs or their equivalents. Of course, they do not necessarily demonstrate that a UISA scheme is preferable to a modified EI system for Canadians. As discussed earlier, the greater the reliance on personal savings to pay for insurance benefits, the stronger the safeguards against moral hazard. However, the greater the reliance on personal savings, the more urgent the requirement for financial safeguards to ensure that low-income and other disadvantaged workers do not suffer unduly from unemployment spells that are no fault of their own. Such safeguards, which likely require some ongoing redistribution of income, arguably are socially desirable, but they mitigate the incentive effects associated with self-insurance. Simply put, the larger the required redistribution of income, the smaller the efficiency gain from a UISA program. While Feldstein and Altman (2007) argue that there would be net efficiency gains from implementing a UISA system in the US, and Valentini (2008) makes a similar argument for Chile, similar evidence for Canada does not exist.

Obviously, an important determinant of how robust a UISA system would be as a replacement for the existing EI system is the rate of return that account holders would earn on the positive balances that they accumulate. This issue is especially salient for individuals with below-average

[33] Singaporeans are only permitted to invest up to 35 percent of their investible savings from their operating account in stocks and 10 percent in gold (CPFB, 2020).

Figure 1: Estimated Balance in Unemployment Insurance Savings Accounts in Various Years



Source: Calculations by authors.

incomes and who are more likely to be unemployed and, therefore, more at risk of accumulating negative UISA account balances.

While expected future investment rates of return depend upon a host of factors including the asset mix held in the investment portfolio, recent experience suggests that expecting rates of return of between 4 to 6 percent per year (after inflation) is not unrealistic. By way of illustration, the Ontario Pension Board (OPB) reports earning a simple average annual rate of return of approximately 8.6 percent over the period 2009-2019 (Ontario Pension Board, 2020). In 2019, the OPB reports holding a mix of assets in its investment portfolio including public equities, fixed income, real estate, private equity, and infrastructure. Over the same period, the average annual rate of inflation in Canada was 1.5 percent (Macrotrends, 2020). Hence, the OPB portfolio earned slightly more that 7 percent per annum after inflation from 2009-2019.[34]

Figure 1 reports the positive balances that would hypothetically be in the personal savings accounts of individuals earning $35,000 per year for the five years after initiating the personal savings accounts, making the fol-

[34] The Ontario Teachers' Pension Plan did even better by earning 9.8 percent per year over the past 10-year period. See Ontario Teachers' Pension Plan (2020) for more information. Obviously, future returns to asset holdings can differ from past returns.

lowing simplifying assumptions: 1) Individuals deposit 4 percent of their incomes at the beginning of each year; 2) There is zero inflation so that the income level and the amount deposited do not change over the 5 year period; 3) Investment returns are realized at the end of each year; 4) The assumed returns are 4 and 6 percent per year; 5) No money is withdrawn from the account during the 5-year period.[35]

The main point from Figure 1 is that, given the assumptions made above, individuals earning $35,000 per year would accumulate $7,866 in their accounts at the end of 5 years assuming a 4 percent per annum real rate of return and $8,365 assuming a 6 percent per annum real rate of return.[36] For most people, the basic rate for calculating EI benefits is 55 percent of average insurable earnings up to a maximum annual. For individuals earning $35,000 per year, weekly benefits under EI would therefore equal approximately $370 per week.[37] Given the estimated positive balances at the end of 5 years, accounts that earned 4 percent per annum would be able to pay $370 per week for 21.3 weeks, while accounts that earned 6 percent per annum would be able to pay that amount for 22.6 weeks. Over the period 2015-2019, unemployed Canadian workers in the prime working age category (25-54) were unemployed, on average, for about 18 weeks annually (Statistics Canada, 2020). The main point here is that the average UISA holder earning $35,000 would have sufficient positive balances at the end of 5 uninterrupted years of employment to cover the benefit payout that would be received under the current EI system assuming the average duration of unemployment is 18 weeks per year.

35 The assumption of zero inflation is innocuous since one would otherwise assume that both earnings and the amount required to be invested would increase by the annual rate of inflation.

36 It is useful to note that the reported median income of employed Canadians was $33,683 in 2016, while reported median wages, salaries, and commissions was $35,551 (Statistics Canada, 2019). Hence, the assumed $35,000 income level is representative of the annual compensation of the average Canadian worker.

37 This is calculated by multiplying $35,000 by .55 and dividing by 52.

Concluding Comments

The Canadian EI system has been widely criticized as being both inefficient and unfair. Given the financial pressures brought on by high unemployment related to the COVID-19 health crisis coupled with the Canadian government's recent expansion of EI benefits, the imperative to improve the efficiency of the system will be even stronger in the next several years.

The primary problem facing any EI system is moral hazard, which contributes to increased unemployment and longer durations of unemployment. A number of design modifications to the EI system have been recommended that would move the system in the direction of being more of a national risk-rated insurance program which, in principle, would result in a closer matching of required payments into the system with the benefits expected to be claimed given historical experience. Modifications along such lines would mitigate moral hazard with accompanying higher rates of employment and reduced required payroll tax contributions. We acknowledge that policy changes in this direction would reduce the amount of redistribution that takes place within the EI system, particularly the transfers that go to seasonal workers in Atlantic Canada. In doing so, it would improve the fairness of the system as eligibility conditions and benefit payments would no longer depend upon where one lived.

Another design change that could accompany any move towards a more risk-rated system would remove special benefits from coverage under the EI system and cover those benefits under another program funded from general tax revenues. Programs providing financial support for maternity leave and other "social" justifications for temporarily leaving the workforce should not be governed by risk-rating insurance principles that underlie an experience-rated conventional unemployment insurance system. Furthermore, the associated benefits of social programs are broadly based and, therefore, should be paid for through broad-based taxes such as the personal and corporate income tax and consumption taxes.

A more direct way to address moral hazard is through the creation of UISAs or personal savings accounts in which a portion of pre-tax incomes is withheld and placed in an account that is invested in a pooled

fund, as is the case for pension funds such as the Ontario Teachers' Pension Plan. Accumulated positive balances in UISAs would be used to provide income support during periods of unemployment. Plausible assumptions about future rates of return on pooled UISA accounts suggest that UISAs would provide benefit coverage comparable to EI for workers in Canada after a period as short as five years. While there are numerous implementation issues associated with moving towards a UISA system including how to address negative balances in personal savings accounts, such a system would be more economical administratively and provide greater incentives for unemployed workers to optimize their job searches and for employers and employees to minimize the strategic use of temporary unemployment.

References

Beng, Chew Soon (2012). Employment-Based Social Protection in Singapore: Issues and Prospects. *ASEAN Economic Bulletin* 29, 3: 218-229. <https://www.jstor.org/stable/pdf/43184882.pdf>, as of November 30, 2020.

Boadway, Robin, Luc Godbout, and Michael Smart (2020). Marginal Tax Rates Under the Canada Recovery Benefit. *Finances of the Nation*. <https://financesofthenation.ca/2020/10/30/effective-marginal-tax-rates-under-the-canada-recovery-benefit/>, as of November 30, 2020.

Cameron, Thomas (2013). *Canada's Employment Insurance Program: Design, Effects and Efficiency Costs*. University of Ottawa. <https://ruor.uottawa.ca/handle/10393/30513>, as of November 30, 2020.

Canada (2020). *A Stronger and More Resilient Canada.* Speech from the Throne to open the Second Session of the Forty-Third Parliament of Canada. Government of Canada. <https://www.canada.ca/en/privy-council/campaigns/speech-throne/2020/stronger-resilient-canada.html>, as of November 30, 2020.

Canada, Department of Employment and Social Development [DOESD] (2020a). *EI Regular Benefits: Overview*. Government of Canada. <https://www.canada.ca/en/services/benefits/ei/ei-regular-benefit.html>, as of November 30, 2020.

Canada, Department of Employment and Social Development [DOESD] (2020b). *Canada Recovery Benefit (CRB)*. Government of Canada. <https://www.canada.ca/en/revenue-agency/services/benefits/recovery-benefit.html>, as of November 30, 2020.

Canada, Department of Employment and Social Development [DOESD] (2020c). *Canada Recovery Sickness Benefit (CRSB)*. Government of Canada. <https://www.canada.ca/en/revenue-agency/services/benefits/recovery-sickness-benefit.html>, as of November 30, 2020.

Canada, Department of Employment and Social Development [DOESD] (2020d). *Canada Recovery Caregiving Benefit (CRCB)*. Government of Canada. <https://www.canada.ca/en/revenue-agency/services/benefits/recovery-caregiving-benefit.html>, as of November 30, 2020.

Canada, Department of Employment and Social Development [DOESD] (2020e). *Employment Insurance Monitoring and Assessment Report for the Fiscal Year beginning April 1, 2018 and ending March 31, 2019*. Government of Canada. <https://www.canada.ca/en/employment-social-development/programs/ei/ei-list/reports/monitoring2019.html>, as of November 30, 2020.

Canada, Department of Employment and Social Development [DOESD] (2020f). *2020 Employment Insurance Premium Rate*. Government of Canada. <https://www.canada.ca/en/employment-social-development/programs/ei/ei-list/reports/premium/rates2020.html>, as of November 30, 2020.

Canada Revenue Agency [CRA] (2020). *EI Premium Rates and Maximums*. Government of Canada. <https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/payroll/payroll-deductions-contributions/employment-insurance-ei/ei-premium-rates-maximums.html>, as of November 30, 2020.

Central Provident Fund Board [CPFB] (2020). *CPF Investment Schemes.* Government of Singapore. <https://www.cpf.gov.sg/Members/Schemes/schemes/optimising-my-cpf/cpf-investment-schemes>, as of November 30, 2020.

Courchene, Thomas, and John Allan (2009). A Short History of EI and Look at the Road Ahead. *Policy Option*s. Institute for Research on Public Policy.

Ebrahimi, Pouya, and Francois Vaillancourt (2016). *The Effect of Corporate Income and Payroll Taxes on the Wages of Canadian Workers*. Fraser Institute. <https://www.fraserinstitute.org/studies/the-effect-of-corporate-income-and-payroll-taxes-on-the-wages-of-canadian-workers>, as of November 30, 2020.

Feldstein, Martin, and Daniel Altman (2007). Unemployment Insurance Savings Accounts. *Tax Policy and the Economy* 21, 1: 35-63.

Fernandez-Navia, Tania (2019). *The Effect of Unemployment Insurance on Geographical Mobility.* University of Barcelona, School of Economics. <http://conference.iza.org/conference_files/SUM_2019/28087.pdf>, as of December 15, 2020.

Ferrer, Ana M., and W. Craig Riddell (2011). *Unemployment Insurance Savings Accounts Latin America: Overview and Assessment*. IZA discussion paper number 5577. Institute for the Study of Labor. <http://ftp.iza.org/dp5577.pdf>, as of November 30, 2020.

Fredriksson, Peter, and Bertil Holmlund (2003). *Improving Incentives in Unemployment Insurance: A Review of Recent Research*. Working Paper Series 2003:5. IFAU—Institute for Evaluation of Labour Market and Education Policy. <https://www.econstor.eu/bitstream/10419/82231/1/wp03-05.pdf>, as of November 30, 2020.

Fuss, Jake, and Steven Globerman (2020). *The Issues Facing Canada's Employment Insurance Program*. Fraser Institute. <https://fraserinstitute.org/sites/default/files/issues-facing-canadas-employment-insurance-program.pdf>, as of November 30, 2020.

Harris, Kathleen (2020, September 29). The CERB Benefit is Over—Here's What You Need to Know Now. *CBC News*. <https://www.cbc.ca/news/politics/cerb-ei-benefits-covid19-1.5743537>, as of November 30, 2020.

Hartley, Gonzalo, Jan van Ours, and Milan Vodopivec (2010). *Incentive Effects of Unemployment Insurance Savings Accounts: Evidence from Chile*. IZA discussion paper number 4681. Institute for the Study of Labor. <http://ftp.iza.org/dp4681.pdf>, as of November 30, 2020.

Hatherly, Justin (2017). *An Alternative to Employment Insurance: Perspective for Atlantic Canada*. Atlantic Institute for Market Studies. <https://www.aims.ca/wp-content/uploads/2017/09/Read-the-study.pdf>, as of November 30, 2020.

Hendren, Nathaniel (2015). *Private Information and Unemployment Insurance.* Harvard University. <https://scholar.harvard.edu/files/hendren/files/unemployment_insurance_v150719_0.pdf>, as of November 30, 2020.

Macrotrends (2020). *Canada Inflation Rate 1960-2020*. Macrotrends. <https://www.macrotrends.net/countries/CAN/canada/inflation-rate-cpi>, as of November 30, 2020.

McMahon, Fred (2020). *Extended Employment Insurance Now Open to All: Atlantic Canada's Warning for Other Provinces.* Fraser Institute. <https://fraserinstitute.org/sites/default/files/extended-employment-insurance-now-open-for-all.pdf>, as of November 30, 2020.

Mintz, Jack (2010, August 11). Reform EI Now. *Financial Post*. <https://business.financialpost.com/opinion/jack-mintz-reform-ei-now>, as of November 30, 2020.

OECD (2018). *OECD Economic Surveys: Chile 2018*. Organization for Economic Co-operation and Development. <https://doi.org/10.1787/eco_surveys-chl-2018-en>, as of November 30, 2020 [paywall].

O'Leary, Christopher, and Stephen Wandner (2018). Unemployment Insurance Reform: Evidence-Based Policy Recommendations. In Stephen Wandner (ed.), *Unemployment Reform: Fixing a Broken System* (W.E. Upjohn Institute): 131-210.

Ontario Pension Board (2020). *Rates of Return and Funded Status*. Ontario Pension Board. <https://www.opb.ca/about-opb/investments/rates-of-return-and-funded-status>, as of November 30, 2020.

Ontario Teachers' Pension Plan (2020). *Performance*. Ontario Teacher's Pension Plan. <https://www.otpp.com/investments/performance>, as of November 30, 2020.

Rogerson, Richard, Robert Shimer, and Randall Wright (2005). Search-Theoretic Models of the Labor Market: A Survey. *Journal of Economic Literature* 43, 4: 959-988.

Service Canada (2020). *Unemployment Rates by Employment Insurance (EI) Economic Region, Seasonally Adjusted (3 month moving average)*. Government of Canada. <https://srv129.services.gc.ca/eiregions/eng/rates.aspx?id=2020#data>, as of November 30, 2020.

Statistics Canada (2019). *Employment Income Statistics—Data Tables 2016 Census*. Government of Canada.

Statistics Canada (2020). *Duration of Unemployment, Annual*. Government of Canada.

Singapore, Ministry of Manpower (2020). *What is the Central Provident Fund (CPF)*? Government of Singapore. <https://www.mom.gov.sg/em-

ployment-practices/central-provident-fund/what-is-cpf>, as of November 30, 2020.

Turgeon, Luc (2011). *Reforming EI Special Benefits: Exploring Alternative Financing and Delivery Options*. Mowat Centre. <https://tspace.library.utoronto.ca/bitstream/1807/96950/1/Turgeon_2011_Reforming%20EI%20Special%20Benefits.pdf>, as of November 30, 2020.

Tweedy, Jaclyn (2018). Social Insecurity: A Proposal to Reform the United States Social Security Retirement System. *Indiana International and Comparative Law Review* 28, 129: 129-161.

United States, Office of Retirement and Disability Policy [ORDP] (2015). *Social Security Programs Throughout the World: The Americas, 2015*. Office of Retirement and Disability Policy. <https://www.ssa.gov/policy//progdesc/ssptw/2014-2015/americas/chile.html#:~:text=Unemployment%20Benefits&text=Unemployment%20benefit%20(individual%20severance%20account,the%20sixth%20and%20subsequent%20payment)>, as of November 30, 2020.

Valentini, Francesca (2008). *Unemployment Insurance Savings Accounts: An Overview*. ETLA discussion paper number 1136. Elinkeinoelämän Tutkimuslaitos: The Research Institute of the Finnish Economy. <https://www.etla.fi/wp-content/uploads/2012/09/dp1136.pdf>, as of November 30, 2020.

About the authors

Steven Globerman

Steven Globerman is Resident Scholar and Addington Chair in Measurement at the Fraser Institute as well as Professor Emeritus at Western Washington University. Previously, he held tenured appointments at Simon Fraser University and York University and has been a visiting professor at the University of California, University of British Columbia, Stockholm School of Economics, Copenhagen School of Business, and the Helsinki School of Economics. He has published more than 150 articles and monographs and is the author of the book *The Impacts of 9/11 on Canada-U.S. Trade* as well as a textbook on international business management. In the early 1990s, he was responsible for coordinating Fraser Institute research on the North American Free Trade Agreement. He earned his BA in economics from Brooklyn College, his MA from the University of California, Los Angeles, and his PhD from New York University.

Jake Fuss

Jake Fuss is an Economist at the Fraser Institute. He holds a Bachelor of Commerce and a Master's Degree in Public Policy from the University of Calgary. He has written commentaries appearing in major Canadian newspapers including the *Globe and Mail, Toronto Sun*, and *National Post*. His research covers a wide range of policy issues including government spending, debt, taxation, labour policy, and charitable giving.

Acknowledgments

The authors thank Fred McMahon and the anoymous external reviewers for very helpful comments and suggestions on earlier drafts. Any remaining errors are the sole responsibility of the authors. As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.

Publishing information

Distribution

These publications are available from <http://www.fraserinstitute.org> in Portable Document Format (PDF) and can be read with Adobe Acrobat® or Adobe Reader®, versions 8 or later. Adobe Reader® DC, the most recent version, is available free of charge from Adobe Systems Inc. at <http://get.adobe.com/reader/>. Readers having trouble viewing or printing our PDF files using applications from other manufacturers (e.g., Apple's Preview) should use Reader® or Acrobat®.

Ordering publications

To order printed publications from the Fraser Institute, please contact:

- e-mail: sales@fraserinstitute.org
- telephone: 604.688.0221 ext. 580 or, toll free, 1.800.665.3558 ext. 580
- fax: 604.688.8539.

Media

For media enquiries, please contact our Communications Department:

- 604.714.4582
- e-mail: communications@fraserinstitute.org.

Copyright

Date of issue

March 2021

ISBN

978-0-88975-633-5

Citation

Steven Globerman and Jake Fuss (2021). *Reforming Employment Insurance for the 21st Century.* Fraser Institute. <http://www.fraserinstitute.org>.

Supporting the Fraser Institute

To learn how to support the Fraser Institute, please contact

- Development Department, Fraser Institute
  Fourth Floor, 1770 Burrard Street
  Vancouver, British Columbia, V6J 3G7 Canada
- telephone, toll-free: 1.800.665.3558 ext. 548
- e-mail: development@fraserinstitute.org
- website: <http://www.fraserinstitute.org/donate>

Purpose, funding, and independence

The Fraser Institute provides a useful public service. We report objective information about the economic and social effects of current public policies, and we offer evidence-based research and education about policy options that can improve the quality of life.

The Institute is a non-profit organization. Our activities are funded by charitable donations, unrestricted grants, ticket sales, and sponsorships from events, the licensing of products for public distribution, and the sale of publications.

All research is subject to rigorous review by external experts, and is conducted and published separately from the Institute's Board of Trustees and its donors.

The opinions expressed by authors are their own, and do not necessarily reflect those of the Institute, its Board of Trustees, its donors and supporters, or its staff. This publication in no way implies that the Fraser Institute, its trustees, or staff are in favour of, or oppose the passage of, any bill; or that they support or oppose any particular political party or candidate.

As a healthy part of public discussion among fellow citizens who desire to improve the lives of people through better public policy, the Institute welcomes evidence-focused scrutiny of the research we publish, including verification of data sources, replication of analytical methods, and intelligent debate about the practical effects of policy recommendations.

About the Fraser Institute

Our mission is to improve the quality of life for Canadians, their families, and future generations by studying, measuring, and broadly communicating the effects of government policies, entrepreneurship, and choice on their well-being.

Notre mission consiste à améliorer la qualité de vie des Canadiens et des générations à venir en étudiant, en mesurant et en diffusant les effets des politiques gouvernementales, de l'entrepreneuriat et des choix sur leur bien-être.

Peer review—validating the accuracy of our research

The Fraser Institute maintains a rigorous peer review process for its research. New research, major research projects, and substantively modified research conducted by the Fraser Institute are reviewed by experts with a recognized expertise in the topic area being addressed. Whenever possible, external review is a blind process. Updates to previously reviewed research or new editions of previously reviewed research are not reviewed unless the update includes substantive or material changes in the methodology.

The review process is overseen by the directors of the Institute's research departments who are responsible for ensuring all research published by the Institute passes through the appropriate peer review. If a dispute about the recommendations of the reviewers should arise during the Institute's peer review process, the Institute has an Editorial Advisory Board, a panel of scholars from Canada, the United States, and Europe to whom it can turn for help in resolving the dispute.

Editorial Advisory Board