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Employment Insurance in Canada: Recent Trends and Policy Changes

by

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Aussi disponible en français

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Abstract

This paper highlights recent trends in employment insurance (formerly unemployment insurance). It also provides a review of the historic evolution of the employment insurance program. The following summarizes the main results.

1. The EI system has turned from large deficits prior to 1993, to nearly balancing the books in that year, and further to substantial surpluses ever since. This is attributable to many factors. Premium contributions collected from employees and employers have been stable at a historically high level since 1994 largely thanks to the recovery of the economy. On the other hand, benefit payouts have steadily declined since 1993 mainly due to a falling number of beneficiaries since 1993, benefit rate reduction from 60% to 57% in 1993 and further to 55% in 1994 except for low income claimants with dependents (back up 60%).

2. The declining number of beneficiaries is in turn attributable to many factors. Unemployment as well as the unemployment rate has been falling since 1993 (there was a slight increase in 1996). Characteristics of the unemployed may have changed. There has also been a series of significant changes in policy parameters regarding benefit eligibility since 1990.

3. Over the course of its nearly sixty years of existence, the EI system has undergone numerous changes. Most significantly, the 1971 UI Act which widely liberalized the pre-1971 system; a series of subsequent fine-tuning and tightening-up; and the abolishment of minimum hours/earnings coverage requirements (all employees are now covered), as well as the name change to “employment insurance” from “unemployment insurance”.

Keywords: Employment insurance; benefits; premiums
JEL classification: J65; H71

I. Introduction

The objective of this paper is to highlight recent trends in the employment insurance (EI) program. EI (formerly unemployment insurance or UI) has again attracted increasing public attention lately mainly because the system has turned around from substantial deficits to large surpluses since 1994. Given that the EI fund is self-financing, it is natural that there is vigorous public debate regarding what to do with this large sum of surplus. Some argue that the benefit level be raised. Others prefer premium rate reduction to stimulate job creation by providing businesses and their employees with relief from payroll tax burden. Still others favour the use of this surplus to reduce unemployment through direct government job-creation action, to enhance training for the unemployed, and to provide financial assistance to those who want to set up businesses.

The fund's substantial surplus is attributable to many factors. Premium revenues collected from employees and employers rose to around $19 billion per year since 1994 largely thanks to the recovery of the economy. On the other hand, benefit payouts have steadily declined since 1993 mainly due to the falling number of beneficiaries since 1993 and a benefit rate reduction in 1993 and 1994. The declining number of beneficiaries is again the result of many factors. The number of unemployed as well as the unemployment rate has been falling since 1993, at least up to 1996. Characteristics of the unemployed may have changed, resulting in a higher proportion of the unemployed who were not covered by the program or a higher proportion of the unemployed who are covered but not eligible for benefits. Take-up rates among the eligible unemployed may have declined. The proportion of long-term unemployed may have increased.

A series of changes in policy parameters regarding benefit eligibility since 1990 have also contributed to the falling number of beneficiaries. For instance, the entrance requirement was raised first in 1990 and again in 1994. Those who quit without just cause or are dismissed because of misconduct or refuse to accept suitable employment were completely disqualified for benefits since 1993. Therefore, the paper also attempts to highlight, in a comprehensive manner, policy changes in the EI program over its 60 years of existence.

2. Recent Trends in Employment Insurance

This section reports some of the recent trends in the EI system, including turning from large deficits to substantial surpluses and falling number of beneficiaries.

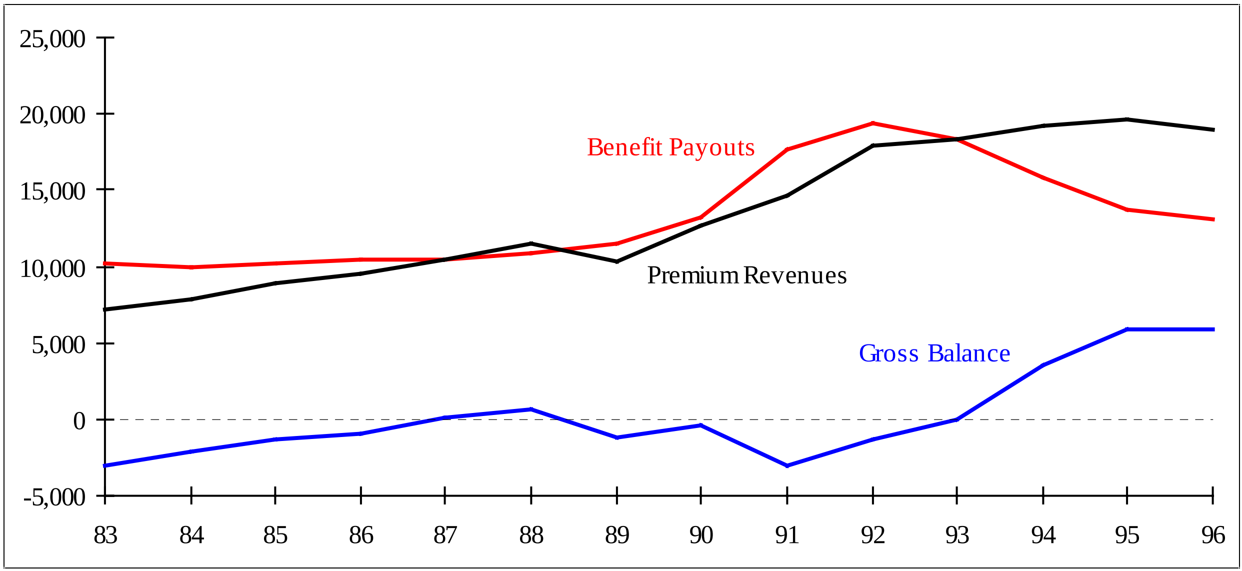
EI Fund Running Substantial Surplus since 1994

The employment insurance (EI) system has turned from large deficits prior to 1993, to nearly balancing the books in that year, and further to substantial surpluses ever since. Prior to 1993, benefit payouts exceeded premium revenues, substantially in some cases, and the fund's gross balance[1] was in red for every year except 1987 and 1988. For example, the gross deficit was

[1] EI financing has changed very significantly over the years. The cost of the program was shared between employees, employers and the federal government prior to 1990. Since 1990, federal government's responsibilities were eliminated and the Fund became self-financing --- the entire cost of the system was shared between employers and employees (see next section for details). In order for the time series to be consistent over time, federal government's contributions to the fund prior to 1990 are thus excluded in calculating the gross balance, i.e., only premiums collected from employees and employers are included as revenues throughout the entire study period. Operating costs

around $3 billion in both 1983 and 1991, over $2 billion in 1984, and close to $1.4 billion in both 1985 and 1992. However, the system turned around in 1993 — nearly balanced the books in that year and has enjoyed substantial surpluses ever since. The gross surplus was over $3.5 billion in 1994 and close to $6 billion in both 1995 and 1996 (Figure 1).

Figure 1: EI Premium Revenues, Benefit Payouts and Gross Balance (millions of dollars), 1983 – 1996



Source: Employment Insurance Statistics, Statistics Canada.

These large amounts of surplus are attributable to many factors. On the revenue side, premium revenues collected from employees and employers rose to around $19 billion per year since 1994 largely thanks to the recovery of the economy. On the cost side, after reaching the peak of over $19 billion in 1992, benefit payouts steadily declined to $13 billion by 1996.

Declining benefit payouts are in turn attributable to many factors. The number of beneficiaries has significantly declined since 1993.[2] The replacement rate was reduced from 60% to 57% in 1993, and further to 55% in 1994 except for low-income claimants with dependents (back up to

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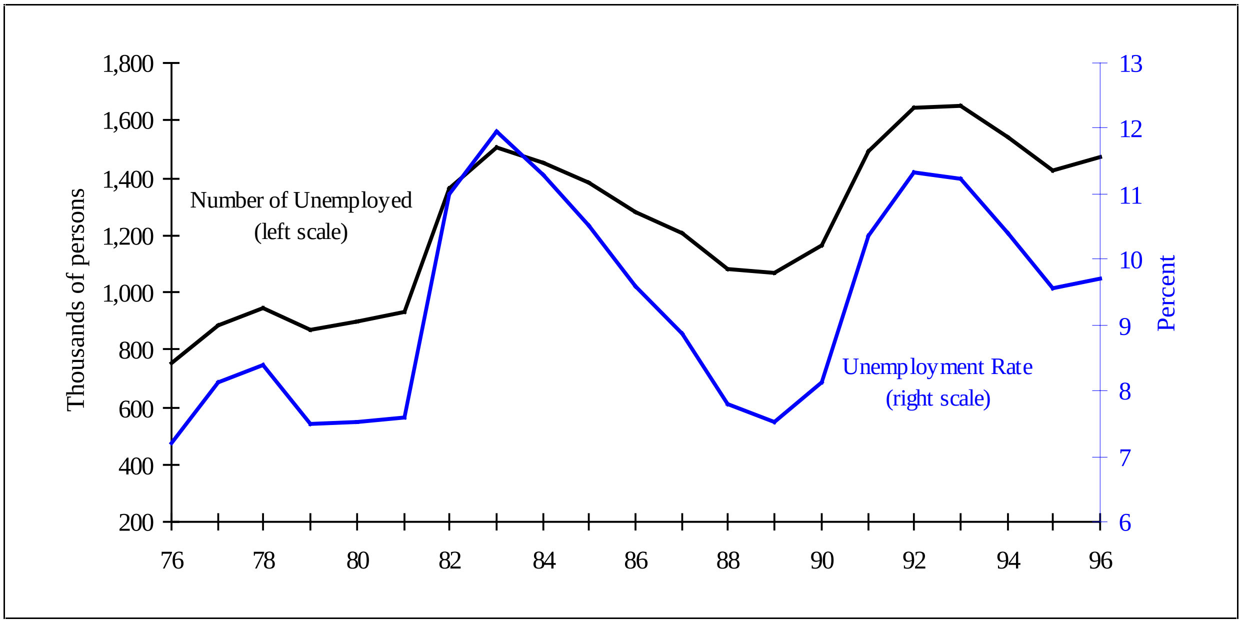
of the system are also not included in calculating the gross balance. Inclusion of operating costs would somewhat alter the net balance picture --- bigger deficits and smaller surpluses.

2 The unemployed population can be divided into those who receive benefits and those who do not. Beneficiaries can further be divided into those receiving regular benefits and those receiving special benefits (sickness, maternity, parental, adoption, retirement, fishing, work sharing, job creation, training and self-employment assistance). Note that special beneficiaries are not necessarily unemployed. Non-beneficiaries can further be classified into 4 mutually exclusive groups: i) those who are not covered by the system (i.e., insufficient hours/earnings for meeting the minimum coverage requirement); ii) those who are covered by the program but ineligible for benefits (i.e., insufficient weeks of insurable employment for meeting the VER or quitting without just cause or being dismissed because of misconduct or refusing to accept suitable employment); iii) those who are eligible for benefits but do not make a claim; and iv) those long-term unemployed who have exhausted their benefit entitlement. Any change in the characteristics of the unemployed and/or policy parameters will affect some or all of these components, and thus result in change in the number of beneficiaries and the ratio of beneficiaries to the unemployed.

60%). The falling number of beneficiaries is again the result of many factors such as falling unemployment and the unemployment rate (Figure 2), changes in the characteristics of the unemployed, and/or changes in policy parameters to which we will turn in the next section.

Figure 2: Number of Unemployed and Unemployment Rate, 1976 – 1996



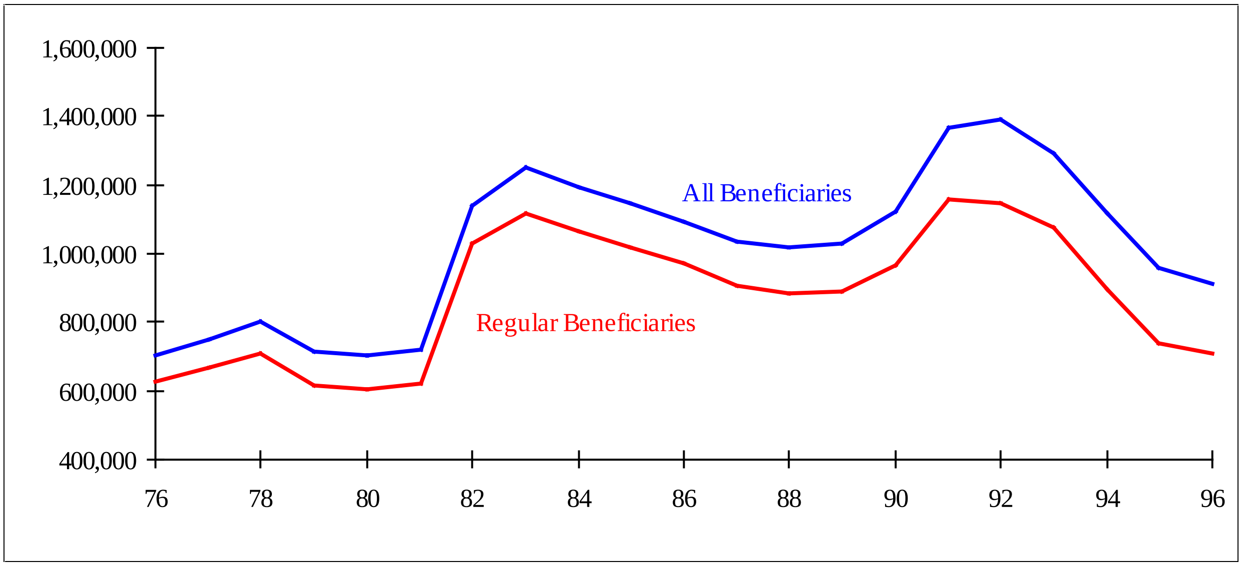
Source: Labour Force Survey, Statistics Canada.

Declining Number of Beneficiaries

As noted earlier, one of the direct factors contributing to the turn-around of the EI fund is that the number of beneficiaries has been in decline since the early 1990s. The number of all beneficiaries reached the peak of 1.39 million in 1992, and has been falling ever since to 0.91 million by 1996. And the number of beneficiaries receiving regular benefits reached the peak of 1.16 million in 1991. It has also been in steady decline to 0.71 million by 1996 (Figure 3).

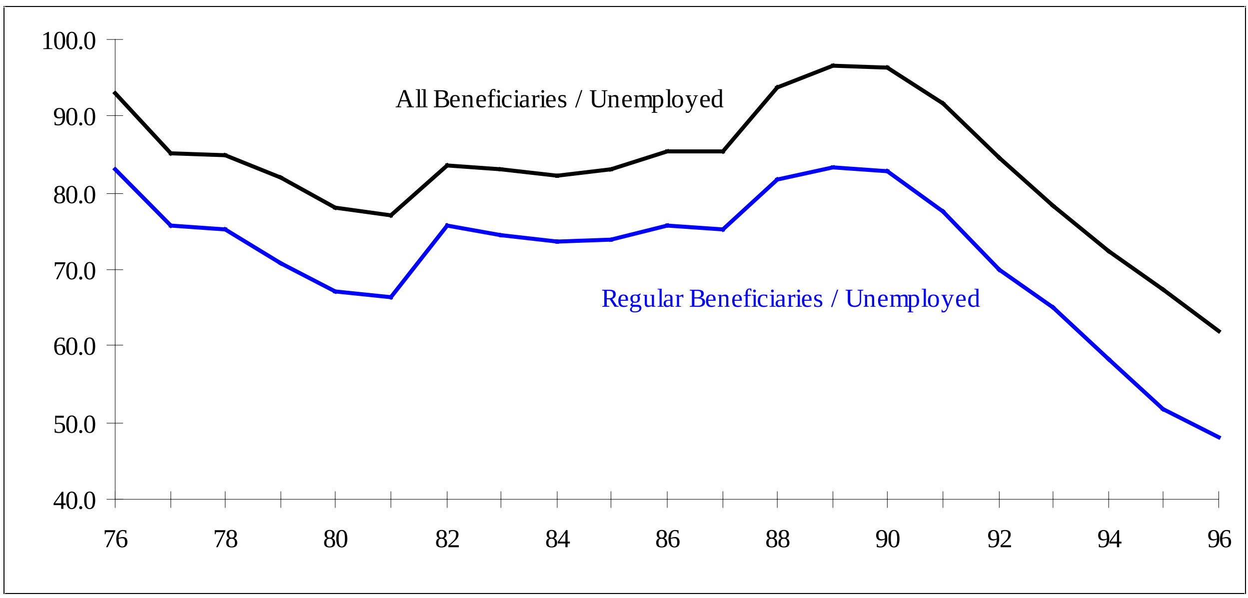
The decline happened even earlier when the number of beneficiaries is expressed as the ratio to the number of the unemployed. The ratio of all beneficiaries to the unemployed peaked in 1989 at 96.7%, and has ever since been rapidly falling to only 62.0% by 1996. The ratio of regular beneficiaries to the unemployed also peaked in 1989 at 83.4%. It has also been rapidly declining since 1990 and reached 48.1% by 1996 (Figure 4).

Figure 3: Number of EI Beneficiaries, 1976 – 1996



Source: CANSIM, Statistics Canada.

Figure 4: Ratio of EI Beneficiaries to Unemployed, 1976 – 1996



Source: CANSIM and Labour Force Survey, Statistics Canada.

There are many reasons why the number of beneficiaries has been steadily falling. There may have been changes in the characteristics of the unemployed. For example, the proportion of workers with short hours/low earnings may have increased, resulting in a higher proportion of the unemployed who are not covered by the program. The proportion of workers with short employment duration or the number of voluntary quitters (dismissals) may have increased, leading to a higher proportion of the unemployed who are not eligible for benefits. Take-up rates among the unemployed who are eligible for benefits may have declined. And the proportion of long-term unemployed may have increased.

There have also been significant changes in policy parameters that can substantially affect the number of beneficiaries. For instance, the variable entrance requirement (VER) was raised from 10-14 weeks to 10-20 weeks in 1990, and further to 12-20 weeks in 1994. Those who quit without just cause or are dismissed because of misconduct or refused to accept suitable employment were completely disqualified for benefits since 1993.

Assessing the significance of each of these changes and their impacts on the system is beyond the scope of this paper, we now turn to policy changes in the EI program.

3. Evolution of the Employment Insurance System

Employment insurance (formerly unemployment insurance) was first enacted in Canada in 1940. Over the course of its nearly sixty years of existence, the system has undergone numerous changes. Most significantly, the 1971 UI Act which widely liberalized the pre-1971 system; a series of subsequent fine-tuning and tightening-up; and the abolishment of minimum hours/earnings coverage requirements as well as the name change to “employment insurance”.

The System Prior to 1971

After an amendment to the British North America Act, bringing matters of unemployment insurance and placement of persons under the federal jurisdiction, Parliament passed Canada’s first Unemployment Insurance Act on August 7, 1940. The main objectives were to provide financial assistance to unemployed persons, to find suitable employment for Canadians, to move people from areas of high to low unemployment, and to provide aid to the disadvantaged.

The UI Act of 1940 made coverage compulsory except certain industries, professional services, government services, casual employees, and persons with annual earnings over $2,000. During the first year of operation the system covered approximately 2.5 million workers, representing about 42% of the workforce.

The Act was administered by the UI Commission. Contributions into the UI Fund commenced on July 1, 1941. The federal government paid for the administration of the program plus 20% of the employee and employer combined contributions. The first date on which claimants could qualify for benefits was January 27, 1942.

In order to be eligible for benefits, claimants had to furnish proof that they were unemployed, available for work (except for attendance in approved training), capable of employment, and had contributed into the Fund for at least 180 days during a two-year period prior to the claim. Persons were disqualified from receiving benefits for up to six weeks if they had left their employment without just cause, refused to accept suitable employment, or were dismissed for misconduct. In addition, persons who were directly involved in labour disputes were disqualified from receiving benefits.

Main changes to the system in the 1940s included enactment of provisions to assist persons discharged from the Armed Forces in 1941; transferring the administration of the Act to the Department of Labour in 1942; raising the annual earnings ceiling to $2,400 in 1943; and continual expansion in coverage and increase in benefits. By the end of the 1940s, the system covered approximately 50% of the workforce, and the maximum weekly benefits rose to $18.30 for claimants with dependents and $14.40 for claimants without dependents.

The system continued to evolve throughout the 1950s. The amendments of February 1950 provided supplementary or seasonal benefits to persons ineligible for regular benefits. The special benefits were available at the rate of 80% of regular benefits between January 1 and March 31, to individuals who had exhausted their benefit rights since the preceding March 31, or to persons who had at least 90 days of insurable employment since that date. In July 1950, regulations regarding repeat claimants were somewhat relaxed. In 1952, the waiting period was reduced to 5 days, and the supplementary benefits period was extended to April 15. In August 1953, the Act was amended to provide for the continuation of benefit payments in case the claimant became ill after the claim had started. The new UI Act was passed on October 2, 1955, introducing a series of changes to benefit rates, contributions, duration of benefit payments, allowable earnings while on claim, seasonal benefits (the benefit rate was increased to that of regular benefits), and coverage. In September 1956, regulations regarding repeat claimants were totally relaxed, and eligibility requirement was reduced from 30 weeks to 24 weeks of insurable employment in the past year or since the last claim. By the end of the 1950s, maximum weekly benefits advanced to $36.00 for claimants with dependents, and $27.00 for claimants without dependents; maximum weekly insurable earnings increased to $69.00; maximum weekly contributions rose to $0.94; the coverage earnings ceiling went up to $5,460; the maximum benefit entitlement increased to 52 weeks. In addition, coverage was extended to self-employed fishermen. To encourage claimants to seek employment they were now permitted to earn up to 50% of their weekly benefits without penalty.

The system remained relatively stable during the 1960s. No major legislative amendments were made except some administrative changes. Following the release of the "Report of the Committee of Inquiry into the Unemployment Insurance Act" (the "Gill Report") in 1962, the government undertook some administrative changes. In April 1965, the duties and functions of the employment service became the responsibility of the Minister of Labour. Further integration of manpower policies and programs resulted in the creation of the Department of Manpower and Immigration. On October 1, 1966, the employment service was transferred to this new department. By the end of the 1960s, the system's coverage had expanded to about 68% of the workforce.

The System Since 1971

Major institutional changes to the system were enacted by the Unemployment Insurance Act of 1971. Passed on June 27, 1971, one major objective of this new UI Act was to provide "adequate" income support for all persons experiencing temporary earnings interruptions. This new legislation widely liberalized the pre-1971 system. Among other things, it provided nearly universal coverage, eased eligibility, and added a host of new special benefits such as sickness, maternity and retirement benefits. Since the 1971 generous reforms, the system has experienced a series of subsequent fine-tuning and tightening-up. What follows highlights these main legislative changes in terms of key coverage, benefit and contribution parameters, while the Appendix provides a chronology of main legislation.

Coverage Requirement

Under the UI Act of 1971, the coverage was nearly universal, effective February 2, 1972. The only exclusions were i) the self-employed except self-employed fishermen who were covered for income support during the off season under separate regulatory rules; ii) employees who did not meet the minimum weekly earnings requirement, which was set at 20% of the maximum weekly insurable earnings. This coverage requirement applied to each job separately. Earnings could not be summed up across different jobs to meet this requirement. For example, an employee who held many different jobs, none of which separately met the requirement but well above the earnings threshold if taken together, was not covered by the system.

A weekly hours of work dimension was added to the minimum coverage requirement since 1979. It was set at 20 hours a week <u>or</u> 20% of the weekly maximum insurable earnings for 1979 and 1980; 15 hours a week <u>and</u> 20% of the weekly maximum insurable earnings between 1981 and 1986; and 15 hours a week <u>or</u> 20% of the weekly maximum insurable earnings since 1987. Effective January 1, 1997, this minimum weekly hours/earnings coverage requirement was abolished and every hour of work is insured.

Eligibility, Entrance Requirement and UI Regions

Under the UI Act of 1971, a minimum of 8 weeks of insurable employment during the 52 weeks immediately preceding the claim (qualifying period) was required for regular benefits, and 20 weeks for special benefits. On December 4, 1977, the minimum of 8 weeks of insurable employment eligibility requirement was replaced by the Variable Entrance Requirement (VER). Depending on the unemployment rate prevailing in the region of residence, the claimant was now required to have 10 to 14 weeks of insurable employment during the qualifying period to become eligible for benefits. Effective July 1, 1979, new- and re-entrants were required to accumulate 20 weeks of insurable employment during the qualifying period to qualify for benefits. Repeat claimants (those who had a claim in the past 52 weeks) in regions with the unemployment rate below 11% were required to have up to 6 weeks of insurable employment in addition to the VER. On February 11, 1990, the recurring legislation that permits the VER failed to pass the Senate. The entrance requirement reverted to a uniform of 14 weeks nation-wide. Bill C-21 came into force on November 18, 1990. Repeat claimants were no longer required to work up to 6 additional weeks. The VER rose from 10-14 weeks to 10-20 weeks depending on the regional unemployment rate. Effective July 7, 1994, Bill C-17 raised the VER from 10-20 weeks to 12-20 weeks, depending on the regional unemployment rate (see Table 1). Effective January 1, 1997, the VER based on weeks of insurable employment was replaced by an entrance requirement based on hours of work.

When the VER was first implemented in 1977, the regional unemployment rate was based on 16 UI economic regions (established under the UI Act of 1971). Under Bill C-27, the number of UI regions was raised to 48, effective November 11, 1978. Bill C-21 further raised the number of UI regions to 62, effective November 18, 1990.

Table 1: Employment Insurance Variable Entrance Requirement

Regional Unemployment Rate	Minimum Weeks of Insurable Employment		
	Bill C-27 (Effective Dec. 4, 1977)	Bill C-21 (Effective Nov. 18, 1990)	Bill C-17 (Effective July 7, 1994)
Under 6%	14	20	20
6% - 7%	13	19	19
7% - 8%	12	18	18
8% - 9%	11	17	17
9% - 10%	10	16	16
10% - 11%		15	15
11% - 12%		14	14
12% - 13%		13	13
13% - 14%		12	12
14% - 15%		11	
15%+		10	

The Replacement (Benefit) Rate

The UI Act of 1971 set the replacement rate at 75% of insurable earnings for claimants with dependents, and at 66.67% for claimants without dependents. Effective January 1, 1976, Bill C-69 reduced the replacement rate for claimants with dependents to 66.67%. Effective January 1, 1979, Bill C-14 further lowered the replacement rate to 60%. Effective April 4, 1993, Bill C-113 reduced the replacement rate for new claimants to 57%. And effective July 7, 1994, Bill C-17 raised the replacement rate for low income claimants (those with weekly earnings less than half of the maximum insurable earnings) and claimants with dependents to 60%, but lowered it to 55% for others. Effective January 1, 1997, the base used to calculate the amount of benefit was changed to the average earnings over the 20 weeks preceding the claim, regardless the claimant was working or not.

The Maximum Benefit Period and Benefit Phases

Under the UI Act of 1971, the maximum benefit period could not exceed 51 weeks (except for persons participating in approved training). Bill C-27 reduced it to 50 weeks, effective September 11, 1977.

Under the UI Act of 1971, benefits were paid out in five phases: The 1st phase provided 8-15 weeks of benefits; the 2nd phase 10 weeks; the 3rd phase up to 18 weeks for claimants with a strong labour force attachment; the 4th phase (National Extended Benefits) up to 8 weeks depending upon the national unemployment rate (evaluated once benefit weeks granted in phases 1-3 were exhausted); and the 5th phase (Regional Extended Benefits) up to 18 weeks depending upon the regional unemployment rate and the difference between the regional and national unemployment rate (evaluated once benefit weeks granted in phases 1-4 were exhausted) (see Table 2).

Table 2: EI Benefit Period during Different Benefit Phases

Phase	Weeks of Insurable Employment	Weeks of Benefit Eligibility
1^{st}	8 - 15	8
	16	9
	17	10
	18	11
	19	12
	20+	15
2^{nd}	8+	10
3^{rd}	20	2
	21 - 22	3
	23 – 24	4
	2 weeks intervals	1 extra week of benefits for each 2 additional weeks of insurable employment
	51 – 52	18
4^{th}	National Unemployment Rate	Weeks of Benefit Eligibility
	Under 4%	0
	4% - 5%	4
	5%+	8
5^{th}	Weeks of Benefits	Benefits cease if one of the conditions is satisfied
	1 – 6	1) The regional unemployment rate drops to under 4%; 2) The difference between the regional and national unemployment rate drops to under 1 percentage point; 3) At the end of the 6th week, the difference between the regional and national unemployment rate drops to under 2 percentage points.
	7 - 12	1) The regional unemployment rate drops to under 4%; 2) The difference between the regional and national unemployment rate drops to under 2 percentage points; 3) At the end of the 12th week, the difference between the regional and national unemployment rate drops to under 3 percentage points.
	13 – 18	1) The regional unemployment rate drops to under 4%; 2) The difference between the regional and national unemployment rate drops to under 3 percentage point;

Effective September 11, 1977, a 3-phased structure replaced the 5-phased benefits: Phase 1 provided up to 25 weeks of benefits --- one week of benefits for each week of insurable employment; Phase 2 (Labour Force Extended Benefits) a maximum of 13 weeks of benefits for each two weeks of insurable employment beyond 26 weeks; Phase 3 (Regional Extended Benefits) up to a maximum of 32 weeks of benefits --- 2 weeks of benefits for each 0.5 percentage point increment in the regional unemployment rate in excess of 4%.

Effective November 18, 1990, the 3-phased benefit period structure was replaced by a single benefit schedule based on the number of weeks of insurable employment and the regional unemployment rate (see Table 3). Effective April 3, 1994, the benefit duration based on the single benefit schedule changed to a two-component system: 1) the work component --- providing up to 20 weeks of benefits (1 week of benefits for every two weeks of work for the first 40 insured weeks) and up to 12 additional weeks of benefits (1 week of benefits for each additional week of work beyond 40); 2) the regional component --- up to 26 weeks of benefits (2 weeks of benefits for every percentage point by which the regional unemployment rate in excess of 4%). The maximum benefit entitlement remained at 50 weeks.

Disqualification and Penalty

Under the UI Act of 1971, claimants could be disqualified for a maximum of 3 weeks of benefits for quitting without just cause, dismissals because of misconduct, refusal to accept suitable employment, failure to attend a placement interview, or refusal to follow instructions from personnel handling their claims. And weeks of disqualification counted as weeks of benefit in calculating the maximum weeks of entitlement. Effective January 1, 1976, the penalty was raised to 6 weeks. Effective November 18, 1990, the penalty was further raised to 7-12 weeks and the replacement rate dropped to 50% for these claimants. Effective April 4, 1993, those who quit without just cause, are fired because of misconduct, or refuse to accept suitable employment became ineligible for benefits altogether.

Earnings, Benefit Claw-Back and Penalty for Repeat Users

Under the UI Act of 1971, a beneficiary could earn up to 25% of benefits without penalty. Effective January 1, 1979, a benefit claw-back was introduced to retrieve benefits for high-income recipients. Claimants with net income in excess of 1.5 times the annual maximum insurable earnings were required to repay 30% of the benefits received.

Effective January 1, 1997, the replacement rate for repeat users dropped by 1 percentage point for each 20 weeks of EI use in the past 5 years, up to the maximum of 5 percentage points. In addition, repeat claimants faced a benefit claw-back of up to 100% if their earnings were in excess of the maximum insurable earnings. The extent of the claw-back depends on the number of weeks of EI use in the past 5 years.

Financing and Contributions

Under the UI Act of 1971, the costs of the system were shared between employers, employees and the federal government. Employers, being assessed at 1.4 times the employee premium rate since 1972 (equal premium rate prior to 1972 which varied with employees' levels of earnings), and their employees were deemed responsible for the following costs: administration, special benefits, regular benefits attributable to a level of national unemployment rate of up to 4%. The federal government assumed responsibility for costs relating to benefits paid to self-employed fishermen, payments to persons who had been granted extensions after training, benefits received by claimants in phases 4 and 5, and benefits associated with the first three phases if the national unemployment rate exceeded 4%.

Table 3: Weeks of EI Benefit Entitlement (Effective November 18, 1990)

Weeks of Work	Regional Unemployment Rate											
	< 6%	6 - 7%	7 - 8%	8 – 9%	9 - 10%	10 - 11%	11 - 12%	12 - 13%	13 - 14%	14 - 15%	15 - 16%	16%+
10											37	39
11										36	38	40
12									35	37	39	41
13								34	36	38	40	42
14							33	35	37	39	41	43
15						30	34	36	38	40	42	44
16					27	31	35	37	39	41	43	45
17				24	28	32	36	38	40	42	44	46
18			21	25	29	33	37	39	41	43	45	47
19		19	22	26	30	34	38	40	42	44	46	48
20	17	20	23	27	31	35	39	41	43	45	47	49
21	18	21	24	28	32	36	40	42	44	46	48	50
22	19	22	25	29	33	37	41	43	45	47	49	
23	20	23	26	30	34	38	42	44	46	48	50	
24	21	24	27	31	35	39	43	45	47	49		
25	22	25	28	32	36	40	44	46	48	50		
26	22	25	28	32	36	40	44	46	48			
27	23	26	29	33	37	41	45	47	49			
28	23	26	29	33	37	41	45	47	49			
29	24	27	30	34	38	42	46	48	50			
30	24	27	30	34	38	42	46	48				
31	25	28	31	35	39	43	47	49				
32	25	28	31	35	39	43	47	49				
33	26	29	32	36	40	44	48	50				
34	26	29	32	36	40	44	48					
35	27	30	33	37	41	45	49					
36	27	30	33	37	41	45	49					
37	28	31	34	38	42	46	50					
38	28	31	34	38	42	46						
39	29	32	35	39	43	47						
40	29	32	35	39	43	47						
41	30	33	36	40	44	48						
42	30	33	36	40	44	48						
43	31	34	37	41	45	49						
44	31	34	37	41	45	49						
45	32	35	38	42	46	50						
46	32	35	38	42	46							
47	33	36	39	43	47							
48	33	36	39	43	47							
49	34	37	40	44	48							
50	34	37	40	44	48							
51	35	38	41	45	49							
52	35	38	41	45	49							

Effective 1, 1979, Bill C-14 stipulated that the cost of the Labour Force Extended Benefits was shared among employers, employees and the federal government. The cost of operating the National Employment Service was shifted to employers and employees on April 1, 1980. Later that year (July 1), employers and employees also became responsible for costs relating to all benefits paid during the initial and Labour Force Extended Benefits periods. Effective November 18, 1990, federal government's responsibilities were eliminated and the UI Fund became self-financing --- the entire cost of the system was shared between employers and employees.

The premium rate was set annually using a statutory rate as a benchmark, based on a three-year average of the program costs. The weekly maximum insurable earnings (MIEs) were set according to the industrial average wage over an eight-year period. Effective July 1, 1996, the weekly MIEs were revised to $750 instead of $845.

Changing Treatment of Premium Contributions

Prior to 1988, EI premiums and Canada/Quebec Pension Plan (C/QPP) contributions were treated as deductions from taxable income in calculating an individual's personal income tax. Since 1988, this treatment has been changed to the calculation of one's non-refundable tax credits. Because of different rates at which non-refundable tax credits and personal income tax are calculated, this change effected a double-taxation --- personal income tax on payroll tax. For individuals whose income is below the basic tax bracket, this change has no impact. For individuals with income above the basic bracket, however, this change implies personal income tax on EI premiums and C/QPP contributions.

For the second tax bracket, the amount of personal income tax paid on EI premiums is equal to the rate differential between the second bracket and the basic bracket times the differential between income and the bracket limit or premiums, whichever is lesser. To illustrate, consider the following two employees in 1996. A's income was $30,500 and B's $45,000. For simplicity of calculation, assume both paid $1,000 in EI premiums. A's federal personal income tax paid on EI premiums was $81.90 [i.e., = (26%-17%)*($30,500-$29,590)]; B's federal personal income tax paid on EI premiums was $90.00 [i.e., = (26%-17%)*$1,000].[3]

For individuals with income falling in the top tax bracket, federal personal income tax paid on EI premiums is equal to the rate differential between the second bracket and the basic bracket times premiums plus the rate differential between the top bracket and the second bracket times the differential between income and the second bracket limit or premiums paid, whichever is lesser. Consider the example of two employees in 1996 with $1,000 of EI premiums again. C's income was $60,000 and D's $65,000. C's federal personal income tax paid on EI premiums was $114.60 [i.e., =

[3] In 1996, the non-refundable tax credit rate was 17%. The federal personal income tax rate was 17% for taxable income up to $29,590; 26% for the portion of taxable income between $29,590 and $59,180; and 29% for the portion of taxable income above $59,180. Maximum EI premiums were $1,150.76 for 52 weekly pay periods, based on insurable earnings up to $39,000; $1,172.89 for 53 weekly pay periods, based on insurable earnings up to $39,750; and $1,194.75 for 27 bi-weekly pay periods, based on insurable earnings up to $40,500.

(26%-17%)*$1,000 + (29%-26%)*($60,000-$59,180)]; D's federal personal income tax paid on EI premiums was $120.00 [i.e., = (26%-17%)*$1,000 + (29%-26%)*$1,000].[4]

The implication of changing treatment of EI premiums and C/QPP contributions from deductions to non-refundable tax credits is even more significant for the tax system when provincial personal income tax is added into the equation. Empirically assessing this impact on the Canadian tax system is beyond the scope of this paper, which requires research on EI premiums and C/QPP contributions as well as personal income at the individual level.

4. Summary and Conclusion

The EI system has turned from large deficits prior to 1993, to nearly balancing the books in that year, and further to substantial surpluses ever since. This is attributable to many factors. Premium contributions collected from employees and employers have been stable at a high level since 1994 largely thanks to the recovery of the economy and expansion of employment. On the other hand, benefit payouts have steadily declined since 1993 mainly due to falling number of beneficiaries and benefit rate reduction.

Cross-province subsidization persists in the program. Despite the large amount of surplus nation-wide, all four Atlantic provinces were subsidized in 1996; the remaining six were net contributors. The degree of subsidization/contribution varies substantially across the provinces. The extent to which a province is a net recipient or net contributor can be explained to a large degree by its ratio of beneficiaries to the number of employees covered by the program relative to the national average. Cross-province variations in per-beneficiary benefits or per-employee contributions are far less significant.

Declining number of beneficiaries is attributable to many factors. Unemployment as well as the unemployment rate has been falling since 1993. Characteristics of the unemployed may have changed, resulting in a higher proportion of the unemployed who are not covered by the program or a higher proportion of the unemployed who are covered but not eligible for benefits. Take-up rates among the unemployed who are qualified for benefits may have declined. The proportion of long-term unemployed may have increased. There have also been a series of significant changes in policy parameters since 1990, which undoubtedly have contributed to the turn-around of the EI fund. Most significantly, the entrance requirement was raised first in 1990 and again in 1994. The benefit rate was reduced from 60% to 57% in 1993. And those who quit without just cause or are dismissed because of misconduct or refuse to accept suitable employment were completely disqualified for benefits in the same year.

With the continued recovery of the economy and expansion of employment as well as coverage extension to previously excluded short-hour/low-earnings workers, it is expected that premium revenues will continue to rise. On the other hand, with declining number and rate of unemployment, benefit payouts are expected to continue to fall. On the balance, it is reasonable

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[4] The personal income tax paid on C/QPP contributions can be calculated in the same fashion. The maximum C/QPP contribution was $893.20 for employees in 1996. Self-employed individuals are not covered by the EI system and do not pay EI premiums, but they pay both the employee and employer portion of C/QPP contributions.

to project that the already-large magnitude of EI surplus will continue to grow, until the next recession at least.

Changing treatment of EI premiums and C/QPP contributions from deductions to non-refundable tax credits in 1988 has significant implications for the tax system. For people with income above the basic tax bracket, this change effected a double taxation --- personal income tax on payroll tax. While the extent to which this change has impacted the Canadian taxation system is not examined in the present paper, it can be empirically assessed through the use of income tax data at the individual level in future analysis.

Appendix: A Chronology of Unemployment (Employment) Insurance Legislation Since 1971

Legislation	Key Parameters
UI Act	Effective June 27, 1971 Generously liberalized the pre-1971 system: Provided nearly universal coverage (commending Feb. 2, 1972) Eased eligibility Added a series of special benefits --- sickness, maternity and retirement
Bill C-69	Effective Jan. 1, 1976 Disqualification increased from 3 to 6 weeks for those who quit without just cause, being fired because of misconduct, refused to accept suitable employment, failed to attend a placement interview, and refused to follow instructions from personnel handling their claims Maximum age for coverage reduced from 70 to 65 The replacement rate reduced from 75% to 66.67% for claimants with dependents
Bill C-27	Effective Sept. 11, 1977 VERs established (effective Dec. 4, 1977) based on 16 UI regions 3-phased benefit structure replaced former 5-phased benefit structure Effective Nov. 11, 1978 48 new UI regions replaced former 16 UI regions
Bill C-14	Effective Jan. 1, 1979 Entrance requirement for new- and re-entrants set at 20 weeks (effective July 1, 1979) Entrance requirement for repeat users set at VER + up to 6 weeks in regions with the unemployment rate under 11% Replacement rate reduced to 60% Benefit claw-back introduced to retrieve benefits paid to high income recipients
Bill C-156	Effective Jan. 1, 1984 Seasonal fishermen benefits modified Maternity benefits modified Adoption benefits introduced
VER Legislation	Feb. 11, 1990 Failed to pass the Senate, entrance requirements reverted to a uniform of 14 weeks nation-wide

Legislation	Key Parameters
Bill C-21	Effective Nov. 18, 1990 Repeat users no longer required 6 additional weeks Penalty increased from 6 to 7-12 weeks for quitting without just cause, dismissals because of misconduct and refusal to accept suitable employment; and replacement rate dropped to 50% for these claimants VER rose from 10-14 weeks to 10-20 weeks Single benefit schedule replaced former 3-phased structure Number of UI regions revised to 62
Bill C-113	Effective April 4, 1993 Those who quit without just cause, were fired because of misconduct and refused to accept suitable employment became ineligible for benefits Replacement rate dropped to 57% from 60%
Bill C-17	Effective July 7, 1994 VERs raised to 12-20 weeks Entitlement duration changed to work component and regional component Replacement rate raised to 60% for low earnings claimants and claimants with dependents; dropped to 55% for others
Bill C-12	Effective July 1, 1996 System renamed to Employment Insurance (EI) Replacement rate for repeat users dropped by one percentage point for each 20 weeks of use in the past 5 years, up to the maximum of 5 percentage points Repeat claimants faced a benefit claw-back of up to 100%, depending on earnings and the weeks of benefits in the last 5 years Weekly maximum insurable earnings (MIEs) revised to $750
	Effective Jan. 1, 1997 Hours/earnings coverage requirement abolished, every hour of work insurable Entrance requirement and benefit entitlement based on hours of work instead of weeks Average earnings over the last 20 weeks used to calculate amount of benefits

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