

Employment Insurance in Canada: Recent Trends and Policy Changes

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PRÉCIS

Cet article examine les tendances récentes de l'assurance-emploi (appelée assurance-chômage jusqu'en 1997). Il examine également l'évolution du programme de l'assurance-emploi depuis son introduction en 1940. Voici les principaux résultats de cette étude :

1) Le régime de l'AE était constamment en déficit avant 1993; cette année il réussit presque à équilibrer les comptes, et depuis il a toujours produit des excédents. Ce renversement peut être attribué à plusieurs facteurs. Le total des primes versées par les employés et les employeurs a été stable à un niveau historiquement élevé depuis 1994, en grande partie grâce à la reprise économique. Par ailleurs, le montant des prestations payées a été en recul constant depuis 1993 à la suite de l'importante diminution du nombre des bénéficiaires depuis cette même année et de la diminution dans le taux des prestations qui est passé de 60 pour cent de la rémunération assurable à 57 pour cent en 1993 et 55 pour cent en 1994.

2) À son tour, la diminution du nombre des bénéficiaires peut être attribuée à plusieurs facteurs. Le nombre de personnes sans emploi et le taux de chômage ont tous les deux reculé depuis 1993. Il est possible que les caractéristiques des personnes sans emploi aient changé. Il faut noter également des changements importants depuis 1990 dans les critères d'éligibilité aux prestations.

3) Au cours de ses près de 60 années d'existence, l'assurance-emploi a connu de nombreux changements. La Loi de 1971 sur l'assurance-chômage libéralisa le programme de façon importante par rapport au régime précédent. Les modifications subséquentes à la législation ont eu pour effet de renforcer les restrictions à l'admissibilité et aux prestations, mais aussi d'abolir le minimum applicable aux exigences concernant les primes et les gains (aujourd'hui tous les employés sont couverts).

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ABSTRACT

This article examines recent trends in employment insurance (until 1997, unemployment insurance). It also reviews the evolution of the employment insurance program since its inception in 1940. The following summarizes the main results.

1) The EI system routinely showed deficits before 1993, nearly balanced the books in that year, and has produced surpluses ever since. This turnaround is attributable to several factors. Total premium contributions collected from employees and employers have been stable at a historically high level since 1994, thanks largely to the recovery of the economy. On the other hand, benefit payouts have steadily declined since 1993, owing to a substantial decline in the number of beneficiaries since 1993 and to benefit rate reductions (from 60 to 57 percent of maximum insurable earnings in 1993 and to 55 percent in 1994).

2) The decline in the number of beneficiaries is in turn attributable to many factors. Both the number of unemployed and the unemployment rate have fallen since 1993. Characteristics of the unemployed may have changed. There have also been significant changes in the requirements for benefit eligibility since 1990.

3) Over the course of its nearly 60 years of existence, the EI system has undergone numerous changes. The 1971 UI Act substantially liberalized the pre-1971 system; subsequent legislation has tightened restrictions on eligibility and benefits but abolished minimum hours/earnings coverage requirements (all employees are now covered).

INTRODUCTION

This article describes recent trends and policy changes in the employment insurance (EI) program. EI—unemployment insurance or UI until the end of 1996¹—has attracted increasing public attention lately, mainly because since 1994 the system has been producing surpluses rather than deficits. Since the EI fund is self-financing, it is natural that there should be vigorous public debate about what to do with this surplus. Some argue that benefit levels should be raised. Others argue that premium rates should be reduced. Still others favour using the surplus to reduce unemployment through direct government job-creation action, enhanced training for the unemployed, and financial assistance for those who want to set up businesses.

The fund's turnaround is attributable to both a rise in total premium revenues collected from employees and employers and a decline in benefit payouts. The decline in payouts is largely the result of a reduction in benefits and a decline in the number of recipients of EI benefits. The decline in the number of beneficiaries, in its turn, is the result of several factors, including a decline in both the number of unemployed and the

¹ For consistency, I shall use "EI" throughout the article, except in references to earlier legislation.

unemployment rate, possible changes in the characteristics of the unemployed as a group, and, what is perhaps most important, significant policy changes in the EI program.

The first part of this article examines recent trends in the EI program. Specifically, it considers the extent of the changes in recent years in EI contributions and payouts, and in the number of EI beneficiaries and the proportion of beneficiaries to all of the unemployed. The second part examines the evolution of the EI system, over its nearly 60 years of existence, with a view to explicating the causes of these changes.

RECENT TRENDS IN EMPLOYMENT INSURANCE

Rising Premium Revenues and Declining Benefit Payouts

EI financing has changed significantly over the years. Before 1990, the cost of the program was shared among employees, employers, and the federal government. In 1990, the federal government eliminated its contribution and the fund became self-financing—the entire cost of the system was henceforth to be shared between employers and employees (see the next section for details of financing arrangements). For the sake of consistency over time, our calculations of the gross balance exclude the federal government's contributions to the fund before 1990. The calculations also exclude the operating costs of the system. The inclusion of operating costs would somewhat alter the net balance picture—deficits would be bigger and surpluses smaller.

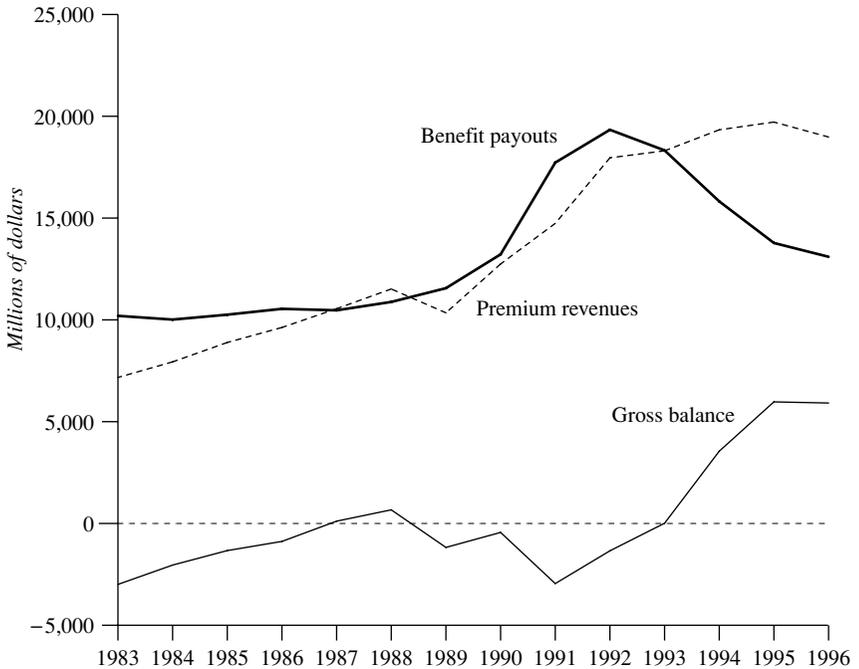
Before 1993, benefit payouts routinely exceeded premium revenues. The fund's gross balance was in the red every year except 1987 and 1988, the peak years of the business cycle of the 1980s. The gross deficit was around \$3 billion in both 1983 and 1991, over \$2 billion in 1984, and close to \$1.4 billion in both 1985 and 1992. In 1993, however, as figure 1 shows, the situation changed: the system just about broke even in that year, and it has enjoyed surpluses ever since. The gross surplus was over \$3.5 billion in 1994 and close to \$6 billion in both 1995 and 1996.

These surpluses have been the result of both a large increase in premium contributions and a substantial decline in payouts. Since 1994, thanks largely to the recovery of the economy, premiums collected from employees and employers have amounted to about \$19 billion per year—an unprecedented figure. Benefits, on the other hand, after peaking at more than \$19 billion in 1992, had by 1996 declined to \$13 billion.

The decline in benefit payouts is attributable to several factors including a significant decline since 1993 in the number of beneficiaries² and

²The unemployed can be divided into those who receive benefits and those who do not. Beneficiaries can further be divided into those who receive regular benefits and those who receive 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 fall into four mutually exclusive (The footnote is continued on the next page.)

Figure 1 EI Premium Revenues, Benefit Payouts, and Gross Balances, 1983 to 1996



Source: Statistics Canada, *Employment Insurance Statistics*, catalogue no. 73-001XPB.

reductions in benefits. The fall in the number of beneficiaries, in turn, has been the result of declines in both the number of unemployed and the unemployment rate (see figure 2), changes in the characteristics of the unemployed, and changes in policy parameters.

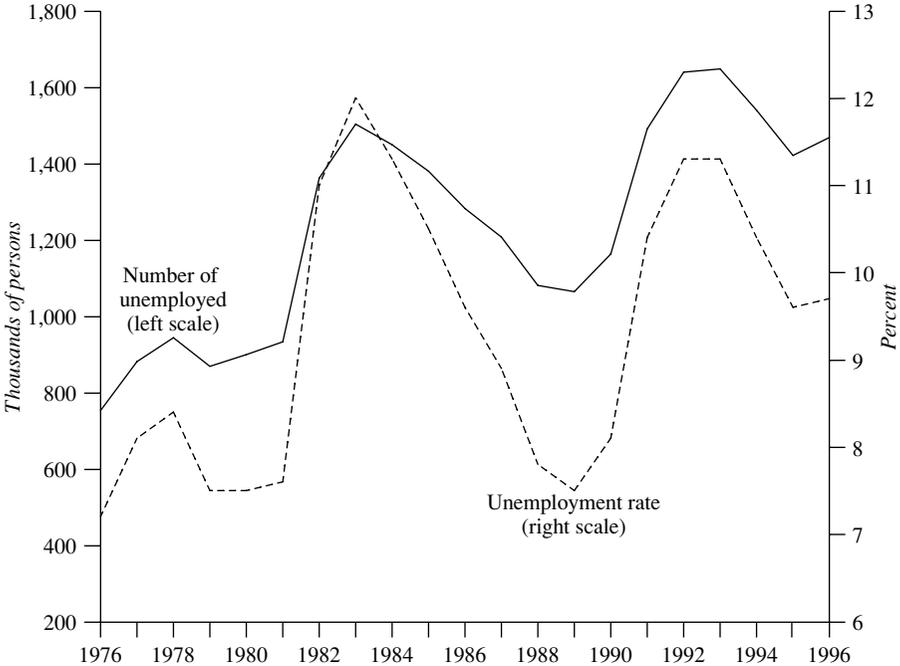
Declining Number of Beneficiaries and Declining B/U Ratio

As figure 3 shows, the number of all beneficiaries under the EI program peaked at 1.39 million in 1992 and by 1996 had fallen to 0.91 million. The number of people receiving regular benefits peaked at 1.16 million in 1991 and by 1996 had fallen to 0.71 million.

² Continued . . .

groups: (1) those who are not covered by the system (that is, those who do not have enough hours or earnings to meet the minimum coverage requirement); (2) those who are covered by the program but ineligible for benefits (that is, insufficient weeks of insurable employment for meeting the VER, quitting without just cause, being dismissed because of misconduct, or refusing to accept suitable employment); (3) those who are eligible for benefits but do not make a claim; and (4) those long-term unemployed who have exhausted their benefit entitlement. Any change in the characteristics of the unemployed 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.

Figure 2 Number of Unemployed and the Unemployment Rate, 1976 to 1996

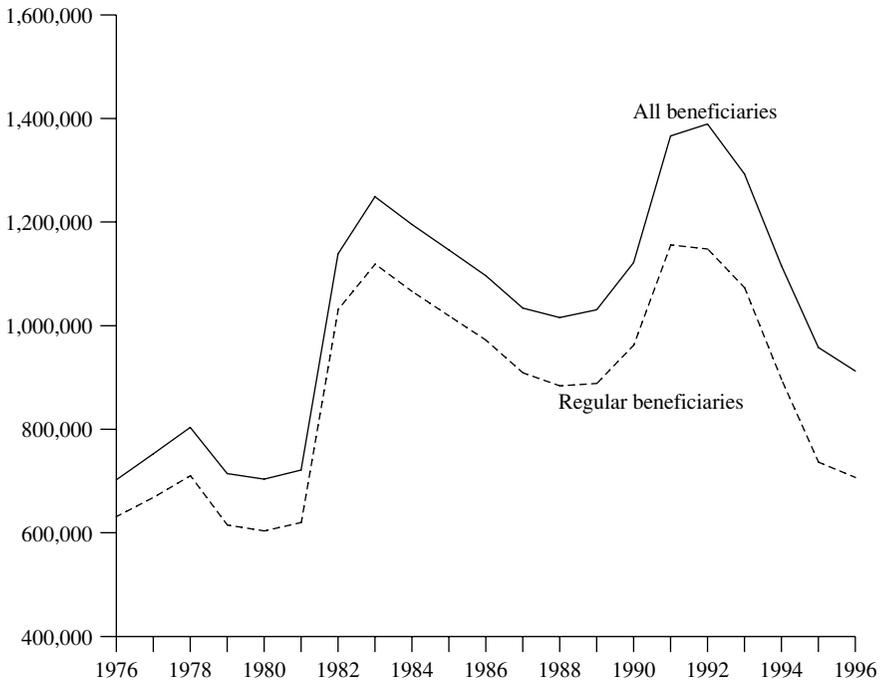


Source: Statistics Canada, *Labour Force Survey*, catalogue no. 71-001XPB.

If the number of beneficiaries is expressed as a ratio of the number of unemployed, the decline begins even earlier. The ratio of all beneficiaries to the unemployed (the B/U ratio) peaked in 1989 at 96.7 percent and has fallen rapidly ever since; in 1996, it was only 62 percent. The ratio of regular beneficiaries to the unemployed also peaked in 1989, at 83.4 percent. It, too, has declined rapidly since 1990, and in 1996 it was 48.1 percent (figure 4).

One possible reason for the decline in both the number of beneficiaries and the B/U ratio is a change in the characteristics of the unemployed as a group. For example, the proportion of workers with short hours or low earnings may have increased, resulting in a higher proportion of the unemployed who are not covered by the EI program. The proportion of workers with employment of short duration or the number of voluntary quitters may have increased and thus increased as well the 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.

Significant changes in EI policy have been another factor in the decline in the number of beneficiaries and in the B/U ratio. The following section

Figure 3 Number of EI Beneficiaries, 1976 to 1996

Source: Statistics Canada, CANSIM database.

discusses the evolution of the EI system and, in particular, the major policy changes introduced in recent years.

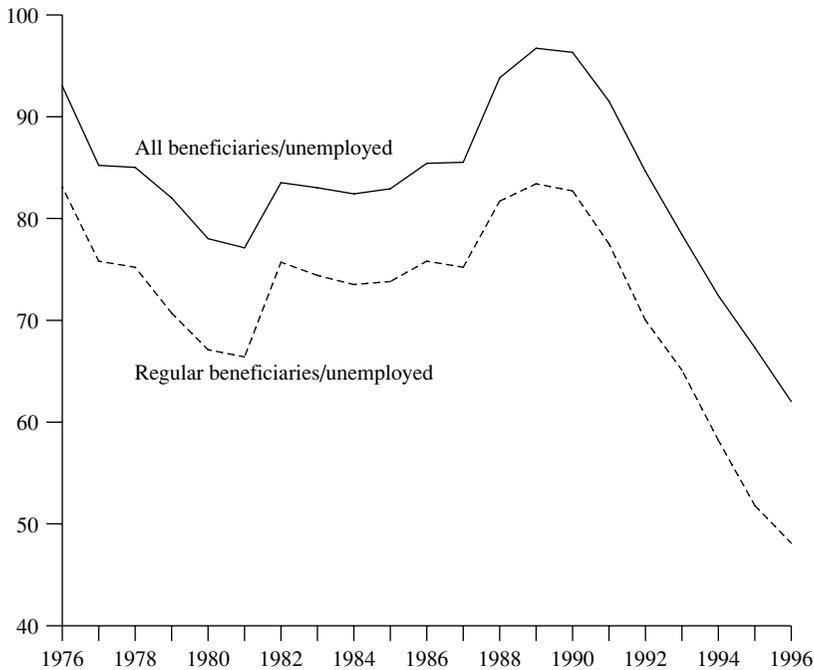
EVOLUTION OF THE EMPLOYMENT INSURANCE SYSTEM

The System Before 1971

After an amendment to the British North America Act that brought matters of unemployment insurance and placement of persons under federal jurisdiction, Parliament passed Canada's first Unemployment Insurance Act on August 7, 1940.³ The main objectives of the act were to provide financial assistance to unemployed persons, to find suitable employment for Canadians, to move people from areas of high unemployment to areas of low unemployment, and to provide aid to the disadvantaged.

The UI Act of 1940 made coverage compulsory but with broad exceptions. Certain industries, professional services, government services, casual employees, and persons with annual earnings over \$2,000 were all excluded from the system. During its first year of operation, the system covered approximately 2.5 million workers, or about 42 percent of the workforce.

³ Unemployment Insurance Act, 1940, SC 1940, c. 44.

Figure 4 Ratio of EI Beneficiaries to the Unemployed, 1976 to 1996

Source: Statistics Canada, CANSIM database and *Labour Force Survey*, catalogue no. 71-001XPB.

The Act was administered by the UI Commission. Contributions into the system's fund began on July 1, 1941. The federal government paid for the administration of the program and contributed an amount to the benefit fund equivalent to 20 percent of the combined employee and employer 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), and capable of employment, and that they had contributed into the fund for at least 180 days during the two years prior to the claim. Persons were disqualified from receiving benefits for up to six weeks if they had left their employment without just cause, had 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.

The most important changes to the system during the 1940s included enactment of provisions to assist persons discharged from the Armed Forces in 1941, transfer of the administration of the Act to the Department of Labour in 1942, an increase in the annual earnings ceiling for coverage to \$2,400 in 1943, and continual expansion in coverage and increase in

benefits. By the end of the 1940s, the system covered about 50 percent of the workforce and the maximum weekly benefit had risen to \$18.30 for claimants with dependants and \$14.40 for claimants without dependants.

The system continued to evolve during the 1950s. Amendments to the Act in February 1950 provided supplementary or seasonal benefits to persons who were ineligible for regular benefits. The special benefits were available at the rate of 80 percent 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 accumulated at least 90 days of insurable employment since that date. In July 1950, the regulations regarding repeat claimants were relaxed somewhat. 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. A new UI Act, passed on October 2, 1955, introduced 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.⁴ In September 1956, the regulations regarding repeat claimants were totally relaxed and the 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, the maximum weekly benefit had advanced to \$36 for claimants with dependants and \$27 for claimants without dependants, maximum weekly insurable earnings had increased to \$69, maximum weekly contributions had risen to \$0.94, the coverage earnings ceiling had gone up to \$5,460, and the maximum benefit entitlement had 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 the equivalent of 50 percent of their weekly benefits without penalty.

The system remained relatively stable during the 1960s. After 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 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, and 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 percent of the workforce.

The System Since 1971

The Unemployment Insurance Act of 1971, passed on June 27, 1971, widely liberalized the system.⁵ One major objective of the new UI Act

⁴ Unemployment Insurance Act, SC 1955, c. 50.

⁵ Unemployment Insurance Act, 1971, SC 1970-71-72, c. 48; given royal assent June 23, 1971.

was to provide “adequate” income support for all persons who were experiencing temporary interruptions in earnings. Among other things, the Act provided nearly universal coverage, eased eligibility, and added a host of new special benefits such as sickness, maternity, and retirement benefits. What has followed since the generous 1971 reforms is a gradual tightening-up of the system in terms of coverage, eligibility, and benefits. In addition, there have been important changes in the financing of the system and in the tax treatment of contributions. This section describes these changes. An appendix to the article provides a chronology of the relevant legislation.

Coverage Requirement

Under the UI Act of 1971, coverage became nearly universal, effective February 2, 1972. The only exclusions were (1) the self-employed (except self-employed fishermen, who were covered for income support during the off season under separate regulatory rules), (2) persons 70 years of age and older (reduced to 65 in January 1, 1976; effective November 18, 1990, workers 65 and over were again covered), and (3) persons who did not meet the minimum weekly earnings requirement, which was set at 20 percent of the maximum weekly insurable earnings. This coverage requirement applied to each job separately. An employee who held several jobs concurrently, none of which separately met the requirement, was not covered by the system even if his total earnings were above the coverage threshold.

In 1979, the minimum coverage requirement acquired another dimension. Claimants were required to have had either 20 percent of the weekly maximum insurable earnings *or* 20 hours of work per week. In 1981, the requirement became 20 percent of the weekly maximum insurable earnings *and* 15 hours per week. In 1987, it became 20 percent of the weekly maximum insurable earnings *or* 15 hours per week. Under the Employment Insurance Act of 1996, effective January 1, 1997, the minimum weekly hours/earnings coverage requirement was abolished and every hour of work became insurable.⁶

Eligibility, the Entrance Requirement, and UI Regions

The UI Act of 1971 required a minimum of 8 weeks of insurable employment during the 52 weeks immediately preceding the claim to qualify for regular benefits and 20 weeks to qualify for special benefits. On December 4, 1977, this eligibility requirement was replaced by the variable entrance requirement (VER). The claimant was now required to have had 10 to 14 weeks of insurable employment during the qualifying period; the number of weeks depended on the unemployment rate prevailing in the claimant’s region of residence. Effective July 1, 1979, new entrants and re-entrants were required to accumulate 20 weeks of insurable employment during the qualifying period. Repeat claimants (those who had made a

⁶ Employment Insurance Act, SC 1996, c. 23; given royal assent June 20, 1996.

claim in the past 52 weeks) in regions with an unemployment rate below 11 percent were required to have up to 6 additional weeks of insurable employment. On February 11, 1990, the recurring legislation that permits the VER failed to pass the Senate, and the entrance requirement reverted to a uniform of 14 weeks nationwide. Bill C-21, which came into force on November 18, 1990, restored the VER and increased it from 10 to 14 weeks to 10 to 20 weeks.⁷ Repeat claimants, however, were no longer required to work up to six additional weeks. Effective July 7, 1994, Bill C-17 raised the VER from 10 to 20 weeks to 12 to 20 weeks.⁸ Effective January 1, 1997, the VER based on weeks of insurable employment was replaced by an entrance requirement based on hours of work.

Table 1 shows the relation between regional unemployment rates and the minimum number of weeks of insurable employment under the successive VER regimes. 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). Bill C-27 increased the number of UI regions to 48, effective November 11, 1978.⁹ Bill C-21 further increased the number of UI regions to 62, effective November 18, 1990.

The Replacement (Benefit) Rate

The UI Act of 1971 set the replacement rate at 75 percent of insurable earnings for claimants with dependants and at 66.67 percent for claimants without dependants. Effective January 1, 1976, Bill C-69 reduced the replacement rate for claimants with dependants to 66.67 percent.¹⁰ Effective January 1, 1979, Bill C-14 further lowered the replacement rate to 60 percent.¹¹ Effective April 4, 1993, Bill C-113 reduced the replacement rate for new claimants to 57 percent.¹² 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) with dependants to 60 percent but lowered it to 55 percent for others. The EI Act of 1996, effective January 1, 1997, changed the base used to calculate the amount of benefit to the average earnings over the 20 weeks preceding the claim, whether the claimant had worked throughout that period or not.

⁷ An Act To Amend the Unemployment Insurance Act and the Employment and Immigration Department and Commission Act, SC 1990, c. 40; given royal assent October 23, 1990.

⁸ Budget Implementation Act, 1994, SC 1994, c. 18; given royal assent June 15, 1994.

⁹ Employment and Immigration Reorganization Act, SC 1976-77, c. 54; given royal assent August 5, 1977.

¹⁰ An Act To Amend the Unemployment Insurance Act, 1971, SC 1974-75-76, c. 80; given royal assent December 20, 1975.

¹¹ An Act To Amend the Unemployment Insurance Act, 1971, SC 1978-79, c. 7; given royal assent December 22, 1978.

¹² Government Expenditures Restraint Act, 1993, No. 2, SC 1993, c. 13; given royal assent April 2, 1993.

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 Maximum Benefit Period and Benefit Phases

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

Under the UI Act of 1971, benefits were paid out in five phases. Phase 1 provided 8 to 15 weeks of benefits. Phase 2 provided 10 weeks. Phase 3 provided up to 18 weeks for claimants with a strong labour-force attachment. Phase 4 (national extended benefits) provided up to 8 weeks; the number of weeks depended upon the national unemployment rate (when the benefit weeks granted in phases 1 to 3 were exhausted). Phase 5 (regional extended benefits) provided up to 18 weeks of benefits; in this case, the benefits depended upon the regional unemployment rate and the difference between the regional and national unemployment rates (when the benefit weeks granted in phases 1 to 4 were exhausted). Table 2 outlines these arrangements.

Effective September 11, 1977, a three-phase structure replaced the five-phase structure. 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) provided a maximum of 13 weeks of benefits—one week for each two weeks of insurable employment beyond 26 weeks. Phase 3 (regional extended benefits) provided up to 32 weeks of benefits—2 weeks of benefits for each 0.5 percentage point increment in the regional unemployment rate in excess of 4 percent.

Effective November 18, 1990, the three-phase benefit period structure was replaced by a single benefit schedule based on the number of weeks of insurable employment and the regional unemployment rate; table 3 shows the weeks of benefit entitlement under this system. Effective April 3, 1994, the benefit duration based on the single benefit schedule would have two components: (1) a work component that provided up to 20 weeks of benefits (1 week of benefits for every 2 weeks of work for the first 40 insured weeks) and up to 12 additional weeks of benefits (1 week of

Table 2 EI Benefit Period During Different Benefit Phases

	Weeks of insurable employment	Weeks of benefit eligibility
Phase 1	8-15	8
	16	9
	17	10
	18	11
	19	12
	20+	15
Phase 2	8+	10
Phase 3	20	2
	21-22	3
	22-23	4
	2 weeks intervals	1 extra week of benefits for each 2 additional weeks of insurable employment
	51-52	18
	National unemployment rate	Weeks of benefit eligibility
Phase 4	Under 4%	0
	4%-5%	4
	5%+	8
	Weeks of benefits	
Phase 5	1-6	Benefits cease if one of the following conditions is satisfied: <ul style="list-style-type: none"> • The regional unemployment rate drops to under 4%. • The difference between the regional and national unemployment rates drops to under 1 percentage point. • At the end of the 6th week, the difference between the regional and national unemployment rates drops to under 2 percentage points.
	7-12	Benefits cease if one of the following conditions is satisfied: <ul style="list-style-type: none"> • The regional unemployment rate drops to under 4%. • The difference between the regional and national unemployment rate drops to under 2 percentage points. • At the end of the 12th week, the difference between the regional and national unemployment rates drops to under 3 percentage points.
	13-18	Benefits cease if one of the following conditions is satisfied: <ul style="list-style-type: none"> • The regional unemployment rate drops to under 4%. • The difference between the regional and national unemployment rates drops to under 3 percentage points.

**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									

benefits for each additional week of work beyond 40); and (2) a regional component that provided up to 26 weeks of benefits (2 weeks of benefits for every percentage point by which the regional unemployment rate exceeded 4 percent). The maximum benefit period continued to be 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. 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 to 12 weeks and the replacement rate for penalized claimants was dropped to 50 percent. Effective April 4, 1993, those who quit without just cause, were fired because of misconduct, or refused to accept suitable employment became ineligible for benefits altogether.

Earnings, Benefit Clawback, and Penalty for Repeat Users

The UI Act of 1971 allowed beneficiaries to earn up to 25 percent of benefits without penalty. Beyond this earnings limit, their benefits were subject to a dollar-for-dollar reduction. On January 1, 1979, a benefit clawback was introduced to retrieve benefits from high-income recipients. Claimants with net incomes of more than 1.5 times the annual maximum insurable earnings were required to pay back 30 percent of the benefits they received.

Under Bill C-12, the replacement rate for repeat users drops by 1 percentage point for each 20 weeks of EI use in the past five years, up to a maximum of 5 percentage points. In addition, repeat users face a benefit clawback of up to 100 percent if their earnings exceed the maximum insurable earnings. The extent of the clawback depends on the number of weeks of EI use in the past five 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 and employees were deemed responsible for the following costs: administration, special benefits, and regular benefits attributable to a national unemployment rate of up to 4 percent. The federal government assumed responsibility for 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 percent.

Effective 1, 1979, Bill C-14 stipulated that the cost of the labour force extended benefits was to be shared among employers, employees, and the federal government. On April 1, 1980, the cost of operating the national

employment service was shifted to employers and employees. Three months later, on July 1, employers and employees also became responsible for all benefits paid during the initial and labour force extended benefits periods. On November 18, 1990, the federal government withdrew its contribution and the fund became self-financing—the entire cost of the system would be shared between employers and employees.

Before the implementation of the 1971 Act in 1972, employers and employees were subject to the same premium rate, which varied with employees' earnings. Since 1972, employers have been assessed at 1.4 times the employee rate, which is set annually, using a statutory rate as a benchmark, on the basis of a three-year average of the program costs. 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 reduced from \$845 to \$750.

Changing Tax Treatment of Premium Contributions

Until 1988, EI premiums and Canada pension plan and Quebec pension plan (CPP/QPP) contributions were treated as deductions from taxable income in calculating an individual's personal income tax. Since 1988, these contributions have instead been used in the calculation of non-refundable tax credits. Since for some individuals non-refundable tax credits and personal income tax are calculated at different rates, this change has resulted in some cases in double taxation—personal income tax on payroll tax. For individuals whose incomes are below the limit for the basic tax bracket, the change has had no impact. For individuals with incomes above that limit, however, the change implies personal income tax on EI premiums and CPP/QPP contributions.

For the second tax bracket, the amount of personal income tax paid on EI premiums is equal to the difference between the rate for the second bracket and the rate for the basic bracket times the difference between income and the bracket limit or premiums, whichever is less. Consider, for example, two employees in 1996. A's income was \$30,500 and B's was \$45,000. For simplicity of calculation, assume that both paid \$1,000 in EI premiums. A's federal personal income tax paid on EI premiums was \$81.90—that is, $(26\% - 17\%) \times (\$30,500 - \$29,590)$. B's federal personal income tax paid on EI premiums was \$90.00—that is, $(26\% - 17\%) \times \$1,000$.¹³

For individuals whose income falls in the top tax bracket, federal personal income tax paid on EI premiums is equal to the difference between the second bracket rate and the basic bracket rate times premiums plus the

¹³ In 1996, the non-refundable tax credit rate was 17 percent. The federal personal income tax rate was 17 percent for taxable income up to \$29,590; 26 percent for the portion of taxable income between \$29,590 and \$59,180; and 29 percent 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.

difference between the top bracket rate and the second bracket rate times the difference between income and the second bracket limit or premiums paid, whichever is less. Consider the example of two employees in 1996 with top-bracket incomes and EI premiums of \$1,000. C's income was \$60,000 and D's \$65,000. C's federal personal income tax paid on EI premiums was \$114.60—that is, $(26\% - 17\%) \times \$1,000 + (29\% - 26\%) \times (\$60,000 - \$59,180)$; D's federal personal income tax paid on EI premiums was \$120—that is, $(26\% - 17\%) \times \$1,000 + (29\% - 26\%) \times \$1,000$.¹⁴

The implications of the change from treating EI premiums and CPP/QPP contributions as deductions to treating them as non-refundable tax credits are even more significant if provincial personal income tax is added to the equation. Any empirical assessment of the impact of the change on the Canadian tax system is, however, beyond the scope of this article, since it would require extensive research on EI premiums and CPP/QPP contributions, and on personal income at the individual level as well.

SUMMARY AND CONCLUSION

The EI system incurred a deficit in almost every year before 1993, just about broke even in that year, and has shown a surplus in every year since. This change is the result of both a substantial rise in contributions collected from employees and employers—a rise largely attributable to the recovery of the economy since the recession of the early 1990s—and a sharp decline since 1993 in benefit payouts.

The decline in payouts is largely a consequence of declines in both the level of benefits and the number of beneficiaries. The decline in the number of beneficiaries, in turn, is attributable to several factors. Both the number of unemployed and the unemployment rate have been falling since 1993. In addition, the characteristics of the unemployed as a group may have changed. For example, take-up rates among the unemployed who are qualified for benefits may have declined, or the proportion of long-term unemployed may have increased. Or there may have been an increase in the proportion of unemployed persons who are not covered by the program, or in the proportion of those who are covered but who would not be eligible for benefits even if eligibility requirements had not been tightened up in recent years.

The tightening-up of eligibility requirements and other significant changes since 1990 in the policy parameters of the EI system have undoubtedly contributed to the turn-around of the EI fund. Most significant, the entrance requirement was raised in 1990 and again in 1994. The benefit rate was reduced from 60 to 57 percent in 1993 and further to 55 percent in 1994 (the rate for low-income claimants—those with weekly

¹⁴The personal income tax paid on CPP/QPP contributions can be calculated in the same fashion. The maximum CPP/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 CPP/QPP contributions.

earnings of less than half the maximum insurable earnings—with dependants went back up to 60 percent). Also, in 1993, those who quit without just cause or were dismissed because of misconduct or refused to accept suitable employment were completely disqualified for benefits.

Given the continued recovery of the economy and the extension of coverage to previously excluded short-hour/low-earnings workers, premium revenues will probably continue to rise. On the other hand, since the number of unemployed and the rate of unemployment continue to decline, benefit payouts will probably continue to fall. It is reasonable, therefore, to project that the EI surplus will continue to grow, at least until the next recession.

The change in 1988 from treating EI premiums and CPP/QPP contributions as deductions to treating them as non-refundable tax credits has had significant implications for the tax system. For people with incomes above the basic tax bracket, the change has resulted in double taxation—personal income tax on payroll tax. Although the effect of this change on the Canadian taxation system has not been examined in the present article, it would be possible in future analysis to measure this effect empirically through the use of income tax data at the individual level.

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

Legislation	Key changes
UI Act (effective June 27, 1971)	<ul style="list-style-type: none"> • Generously liberalized the pre-1971 system: • Provided nearly universal coverage (as of February 2, 1972). • Eased eligibility. • Added a series of special benefits—sickness, maternity, and retirement.
Bill C-69 (effective Jan. 1, 1976)	<ul style="list-style-type: none"> • Disqualification increased from 3 to 6 weeks for those who quit without just cause, were fired because of misconduct, refused to accept suitable employment, failed to attend a placement interview, or refused to follow instructions from personnel handling their claims. • Maximum age for coverage reduced from 70 to 65. • The replacement rate for claimants with dependants reduced from 75% to 66.67%.
Bill C-27 (effective Sept. 11, 1977)	<ul style="list-style-type: none"> • VERs established (effective December 4, 1977) based on 16 UI regions. • Three-phase benefit structure replaced former five-phase benefit structure. • Number of UI regions increased from 16 to 48 (effective November 11, 1978).
Bill C-14 (effective Jan. 1, 1979)	<ul style="list-style-type: none"> • Entrance requirement for new entrants 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 an unemployment rate under 11%. • Replacement rate reduced to 60%. • Benefit clawback introduced to retrieve benefits paid to high-income recipients.
VER legislation	<ul style="list-style-type: none"> • Failed to pass the Senate. Entrance requirements reverted to a uniform of 14 weeks nationwide (February 11, 1990).
Bill C-21 (effective Nov. 18, 1990)	<ul style="list-style-type: none"> • Repeat users no longer required 6 additional weeks. • Retirement benefits eliminated; workers 65-70 covered again. • Penalty increased from 6 to 7-12 weeks for quitting without just cause, dismissal because of misconduct, or refusal to accept suitable employment; replacement rate dropped to 50% for these claimants. • VER raised from 10-14 weeks to 10-20 weeks. • Single benefit schedule replaced former three-phased structure. • Number of UI regions increased to 62.
Bill C-113 (effective April 4, 1993)	<ul style="list-style-type: none"> • Those who quit without just cause, were fired because of misconduct, or refused to accept suitable employment became ineligible for benefits. • Replacement rate dropped to 57% from 60%.

(The appendix is concluded on the following page.)

Appendix Concluded

Legislation	Key changes
Bill C-17 (effective July 7, 1994)	<ul style="list-style-type: none"> • VERs raised to 12-20 weeks. • Entitlement duration changed to work component and regional component. • Replacement rate raised to 60% for low-earnings claimants with dependants, dropped to 55% for others.
Bill C-12 (effective Jan. 1, 1997)	<ul style="list-style-type: none"> • System renamed Employment Insurance (EI). • 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. • Replacement rate for repeat users dropped by 1 percentage point for each 20 weeks of benefits in the past 5 years, up to a maximum of 5 percentage points. • Repeat claimants faced a benefit clawback of up to 100%, depending on earnings and the weeks of benefits in the past 5 years. • Weekly maximum insurable earnings (MIEs) reduced from \$845 to \$750 (effective July 1, 1996).
