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TESTIMONY BEFORE THE  
SENATE STANDING  
COMMITTEE ON  
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Examination of the 2009 Budget  
Implementation Act, with particular  
focus on provisions dealing with  
employment insurance

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TEMOIGNAGE DEVANT LE  
COMITÉ PERMANENT DES  
FINANCES NATIONALES DU  
SÉNAT

LE 5 MAI 2009

Examination de la Loi d'exécution du budget  
2009, en particulier les mesures concernant  
l'assurance-emploi

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Thank you very much, Mr. Chairman, for affording me the opportunity to appear before the committee on the important subject of the 2009 federal budget provisions. My name is Jeremy Leonard, and I am a Senior Fellow at the Institute for Research on Public Policy.

L'Institut de recherche en politiques publiques est un think tank national, indépendant, bilingue et sans but lucratif situé à Montréal. L'indépendance de l'institut est assurée par un fonds de dotation établi au début des années 70.

L'IRPP cherche à améliorer les politiques publiques canadiennes en encourageant la recherche, en mettant de l'avant de nouvelles perspectives et en suscitant des débats qui contribueront au processus décisionnel en matière de politiques publiques et qui rehausseront la qualité des décisions que prennent les gouvernements, les citoyens, les institutions et les organismes canadiens. My role at the Institute is to direct our research projects on economic policy and my remarks today, while not the official view of the Institute, are based on policy research that we have published as well as my own expertise.

The Institute also publishes a monthly magazine *Policy Options*, which is distributed to all MPs and Senators. The February and March issues were devoted to the economic crisis and the budget, and offer useful background information and context for the subject of today's hearing.

The agenda today is to examine various sections of the 2009 Budget Implementation Act, with particular focus on the Employment Insurance provisions, which are obviously of critical importance given the fact that Canada is in the midst of a serious recession. In order to contextualize my remarks, I'd like to take a few minutes to sketch a picture of current economic conditions and where the economy might be headed in the next year or so, and then move on to the budget.

To say we are in uncertain economic waters is to state the obvious. It now seems clear that the US recession will indeed be longer and deeper than any since the Great Depression – though it is misleading and disingenuous to compare the hardship it has wrought to the calamity of the 1930s. The conventional wisdom would say that Canada's recession must of necessity be of a similar magnitude and length as that of our southern neighbours, if not deeper. We all know the reasons, which have been repeated for decades: the vast bulk of Canada exports are destined for the US, that share has been rising in the wake of free trade, and we are therefore chained to the US business cycle.

But are the Canadian and US economies really as joined at the hip as we all seem to think? The answer, in my view is NO. The commodities boom has allowed

Canada to outperform the US and stay out of recession longer, and because of strong underlying demand in China and other emerging markets, the medium-term outlook for commodity prices and demand is bullish. It is for this reason that Canada (as well as other resource-exporting countries such as Australia and Norway) will likely come out of the global recession first and relatively fast. It is important to note that, even after wild spike and downdraft in crude-oil prices last year, they are now over twice as high as their pre-boom average. Similar stories can be told for many other commodities. Because of these dynamics, our share of exports going to the US has drifted downward from a peak of 84 percent in 2001 to 75 percent today – not much above what it was prior to the Canada-US Free Trade Agreement. The slack has been taken up by fast-growing resource-hungry emerging markets.

Si l'on examine le secteur résidentiel, le contraste entre le Canada et les États-Unis est encore une fois plus frappant que les manchettes feraient croire. Les mises en chantier aux E-U sont en baisse de près de 70 p. cent, comparativement à 25 p. cent chez nous. Budget 2009 a d'ailleurs souligné avec raison que nous vivons un léger recul dans le secteur immobilier, et non pas une crise. C'est pour cette raison que j'étais surpris de voir autant d'argent – 7,8 milliards de dollars – consacré aux mesures pour stimuler le secteur résidentiel. Comme je vous dirai tout à l'heure, ces fonds-là auraient eu meilleur effet ailleurs.

The contrast is also evident in the market value of residential assets which (much more so than equities and other financial assets) help drive consumption. In the US, the value of housing wealth is declining at a ten percent year-over-year rate – the first absolute declines since recordkeeping began more than 55 years ago. In addition to being the source of the financial crisis, the evaporation of real estate wealth has decimated household balance sheets south of the border and will put a drag on US consumption, virtually ensuring a sluggish recovery there. Here in Canada, we have seen a *slowdown* in residential wealth growth, but can take comfort in the fact that prudent lending standards have kept most Canadians in houses they can afford and foreclosure rates near historical lows.

I have several slides that illustrate the relevant contrasts between the Canadian and American economies that you can peruse at your leisure. But for the purposes of today's hearing, I'd like to draw your attention to the chart pertaining to employment.

Le contraste avec l'économie américaine est frappant. Aux États-Unis, les emplois sont en baisse depuis janvier 2008, neuf mois avant nous. Nonobstant les chiffres affreux depuis le début de 2009, le nombre d'emplois au Canada est encore plus haut qu'il y a 2 ans. Ceci fait que notre pouvoir d'achat global est beaucoup moins diminué qu'aux E-U. Néanmoins, le fait reste qu'il y a 329 000

de plus de chomeurs aujourd'hui qu'il y a 9 mois, et il y en aura plus dans les mois qui viennent.

Il est donc clair que les défis économiques au Canada sont d'un autre ordre que chez nos voisins. C'est sûr que nous souffrons des difficultés en termes d'accès au crédit, mais nous sommes la victime et non pas la source du problème. Cependant, Budget 2009 contient plusieurs mesures très importantes pour faciliter l'accès au crédit.

The Extraordinary Financing Framework aims to backstop mortgages, provide financial institutions with the capital they need to resume normal lending practices, and provide additional lending authority to Crown corporations such as Export Development Canada and the Business Development Bank. I wholeheartedly endorse these measures, because they reflect in my view an accurate diagnosis of the problem: blowback from the very real and much more catastrophic financial crisis in the United States. In short, our financial system is fundamentally sound, but our economic proximity to the US requires modest (and, in the medium term, likely profitable for the government) infusions of capital into financial markets

Côté cyclique, les défis sont classiques : les baisses de prix de denrées et la perte d'emplois ont réduit le pouvoir d'achat. Même si les Canadiens ont plus d'épargnes que leurs voisins du sud pour soutenir la consommation, elles ne seront pas suffisantes.

To effectively mitigate a cyclical downturn, a budget must counteract some of the negative forces buffeting the economy. With regard to commodity prices, there is very little that can be done; they are determined in global markets and move according to global trends in supply and demand. While the medium term outlook is good, there is virtually nothing that Canadian budgetary policy can do to affect commodity prices.

But with regard to bolstering purchasing power, there is much that can be done, and there are several examples of such measures in Budget 2009: personal income tax cuts, increases in the Canada Child Tax Benefit, and the Working Income Tax Benefit, and more generous employment insurance benefits. The WITB and EI changes are particularly potent, because they put money into the pockets of people most likely to spend it: low-income workers and unemployed individuals. These are exactly the kinds of "automatic stabilizers" that form the basis of sound counter-cyclical fiscal policy

Ceci dit, le budget était beaucoup trop timide en termes des mesures dans ces deux domaines: 1,3 milliards de dollars de plus pour la prestation fiscale pour le revenu de travail et 1,9 milliards de plus pour l'assurance-emploi. Comme j'ai dit

tout à l'heure, ces montants sont minimes comparés au presque 8 milliards consacré au secteur résidentiel.

One concrete measure that should have been in the budget is more generous extended benefit provisions. The United States typically temporarily extends the unemployment insurance benefits by 13 weeks during recessions – and even 26 weeks in the deep 1981-82 recession. The increase of 5 weeks in the budget is not in tune with actual trends in the length of employment spells and, worse, it may be perceived by the public as a permanent measure (even though it isn't), because it merely returns the benefit period to pre-1996 levels.

But so much more needed to be done. The time was right to address some of the longstanding structural inequities in the program, but the budget did virtually nothing in this regard. The most glaring inequity is the fact that the number of hours required to qualify varies according to the local unemployment rate. As a result, the areas of the country hardest hit by the current recession – Alberta and southern Ontario – have the stiffest eligibility requirements, reducing the proportion of unemployed workers who receive benefits. As of January 2009, less than 30 percent of Albertans and Ontarians with no declared labour income were receiving EI benefits, compared to over 70 percent in the Maritimes, which have thus far been spared the worst of the recession. These large implicit regional subsidies mean that EI has strayed far from its core function of providing income maintenance for unforeseen spells of unemployment. Canada may have an interest in maintaining regional development subsidies, but these should be divorced from EI and made more explicit.

EI reform has always been a political hot potato, but the stars may be as well aligned as they can be for fundamental reform.

To move EI back to its core function, and help get money into the pockets of those who need it most during economic downturns, the principle of experience rating must underlie contribution rates and benefit levels. Thus, firms that lay off fewer workers would face a lower EI contribution tax rate on their payroll; and workers who make fewer and less frequent EI claims would receive greater EI benefits when they do claim them. This is analogous to how private insurance is provided, and the method by which unemployment insurance is financed in most of the United States.

In practice, a better EI program would involve reinstating and reinforcing many of the provisions enacted in the *Employment Insurance Act* of 1996, which sought to discourage use of the program as a regular income supplement as opposed to insurance against unpredictable job loss. The Act brought modest experience rating to benefit levels, reducing the replacement rate by 1

percentage point for each group of 20+ weeks of benefits over the prior 5 years – though this measure was rescinded in 2000. Most changes to the EI regime since 2000 have involved increasing the generosity of EI benefits paid to seasonal workers, which has simply encouraged more seasonal employment and long-term dependence on EI.

If EI were operated on a strict insurance basis, it would finance itself over time as contributions equalize benefits. In this sense, it would contrast markedly with the operation of EI in the 1990s, when changes to the program that tightened eligibility requirements and reduced benefit payments led to record surpluses, which the federal government then used to fund other programs. Not only did this cause political difficulties, it also overtaxed labour income as a source of revenue for the federal government.

Experience-based contribution rates and benefit levels would allow EI to improve its coverage and impact. With EI operating on a truer insurance basis, it would create fewer work disincentives and moral hazard problems – by which I mean that firms would think twice about laying off workers because those decisions would have a direct effect on their contribution rates. It would then make sense to raise the earnings replacement ratio above the current level of 55 percent; decrease the eligibility requirements in low-unemployment regions, with a lower minimum work requirement of, for instance, 360 hours everywhere; reduce the current extremely high work requirement for new entrants; and improve access to other benefits and services that are currently accessible only to EI claimants – in particular, employment supports, training services and parental leave benefits.

En terminant, j'ai regardé les propos de Michael Ignatieff à l'égard de l'assurance-emploi lors de la convention libérale avec un grand intérêt. Les thèmes qu'il a évoqués ne sont pas encore assez développés pour porter jugement, mais j'espère que'ils susciteront un débat de fond sur la mission et le fonctionnement du système d'assurance-emploi – une très importante ligne de front dans la bataille contre la recession. Merci de votre attention.