

# Addressing Canada’s Employment Insurance Gap For Self-Employed Workers

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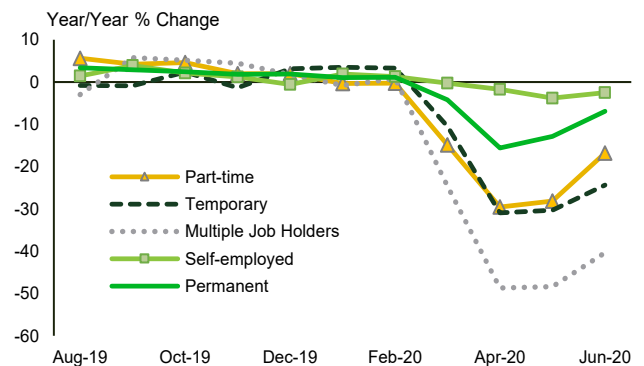
## Highlights

- While the pandemic had devastated the overall labor market, workers in more precarious and non-standard work arrangements have been especially hard-hit.
- Yet, many of these workers do not have access to employment insurance (EI) or run a higher risk than regular workers of not meeting qualification conditions. Only 64% of unemployed Canadians contributed to EI in 2018, meaning that millions would be left without financial assistance in the absence of the Canada Emergency Response Benefit (CERB).
- Extending EI coverage to non-standard workers does have challenges. However, there is a growing understanding among many countries that these workers require social protection. More than two thirds of the OECD countries offer at least partial coverage for the self-employed. Their experience offers valuable lessons if Canada decides to follow suit.
- The labor market recovery is likely to be uneven and protracted. This is especially true for self-employed and other non-standard workers, since their hours and incomes are more volatile and less protected. Having a more inclusive system with a broader contribution base, which accommodates non-standard workers but also includes a larger number of regular employees would help strengthen the recovery and build on economic gains achieved so far through the temporary CERB program.

The COVID-19 pandemic delivered a sudden and devastating blow to the Canadian labor market. Between February and April, millions of people lost their jobs as employment plunged by 16%. Unlike in previous recessions, the impact this time around has been disproportionately felt by workers in more precarious employment arrangements: part-time, temporary and self-employed, who are less likely to have access to unemployment insurance (EI). These types of work arrangement are more prevalent in the service sector industries, many of which have been hard-hit during this downturn. As of June, year-over-year (y/y) employment in part-time and temporary positions was down by 17% and 24%, respectively (Chart 1). For multiple job holders, employment fell by nearly 40%. By comparison, the 7% y/y decline in permanent positions seems relatively modest.

As dramatic as these declines are, they may still underrepresent the pandemic’s toll on employment and incomes. Notably, overall hours worked fell more than employment during the months of lockdown and social distancing. This is especially true for non-standard workers who were more likely to work fewer hours than regular employees. For example, while self-employed workers saw only a 3% drop in employment since February, 43% of self-employed worked less than half of their usual hours in May

**Chart 1: Workers in More Precarious Employment See Steep Job Losses**



Source: Statistics Canada, TD Economics.

**Chart 2: COVID-19 Forced Self-employed to Cut Hours Worked Drastically**



Source: Statistics Canada, TD Economics.

(Chart 2). By comparison, among all employees, only 9% worked less than half of their usual hours. Moreover, self-employed people who were away from work were more hard-hit financially as they were far less likely to still be paid. Among incorporated self-employed workers with zero hours, less than 1 in 10 received pay compared to 1 in 4 for regular employees in the same situation.

As a result of the significant drop in hours worked, a far larger portion of the labor force was underutilized than suggested by the unemployment rate alone. While the official unemployment rate was 12.3% in June (equivalent to 2.45 million people), Statistics Canada noted that nearly 27% of the potential labour force was ‘underutilized’. The significant gap between the drop in the hours worked versus the more modest decline in employment helps to explain why 8.3 million of people have applied the Canada Emergency Response Benefit (CERB) (at any point during this crisis).

### EI Leaves Many Non-Standard Workers Behind

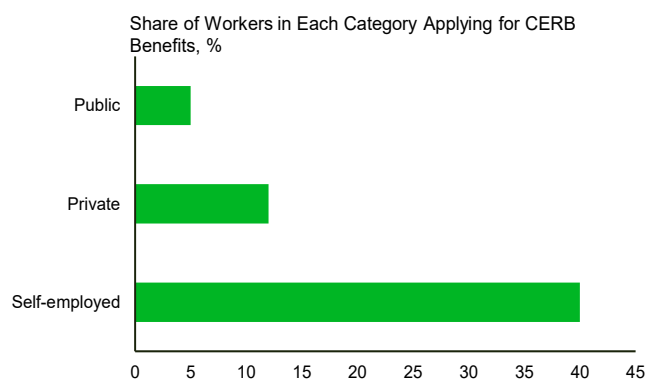
It is clear that self-employed and other non-standard workers were more impacted by the pandemic. Yet these workers usually have the least access to social safety nets, such as EI. Currently, EI unemployment benefits are mostly accessible to employees in the most traditional sense of the word: those that work full-time in a permanent positions for a single employer. By contrast, self-employed workers are not eligible for EI<sup>i</sup>, and, while those in temporary, contract and part-time positions are eligible, they might not have a chance to accumulate enough insurable hours to qualify because their work arrangements are less stable. Due to lack of EI coverage and significant loss of hours,

nearly 40% of self-employed workers applied for CERB benefits, while only 12% and 5% of private and public employees did (Chart 3).

The reasons why some workers, such as self-employed, are excluded are rooted in the design of the EI program. The program is based on insurance principles, with both employers and employees paying into it through mandatory contributions. The corollary is that those workers who have not paid in, as well as those who have left voluntarily without just cause, are disqualified. Contributions are also intended to make the program self-sufficient in the long-run as has been the case in Canada in recent years. In the case of self-employed workers, there’s also an issue of moral hazard when it comes to determining what represents a valid job separation (more on this in the section below: “What Complicates Offering EI Coverage For Non-Standard Workers”). For this and other reasons, many non-standard workers are currently ineligible for unemployment insurance.

These gaps in coverage have been growing as the job market has steadily tilted towards more non-standard work arrangements. In 2018, only 48.2% of unemployed Canadians had contributed to EI and had a valid job separation.<sup>ii</sup> Even among these workers, only 88% had accumulated enough insurable hours to qualify for benefits, which, depending on the regional level of unemployment, ranges between 420-700 hours in the 52-week period. The combined influence implies a relatively low EI coverage ratio for Canadian workers – out of 1.1 million Canadians who were unemployed in 2018, only 42.1% were eligible for EI.<sup>1,2</sup> This is

**Chart 3: Self-employed Workers Much More Likely to Apply for CERB**



Source: LFS supplement (Economic and Fiscal Snapshot 2020), TD Economics.

considerably below the median coverage among developed countries, which is around 60%.<sup>3</sup>

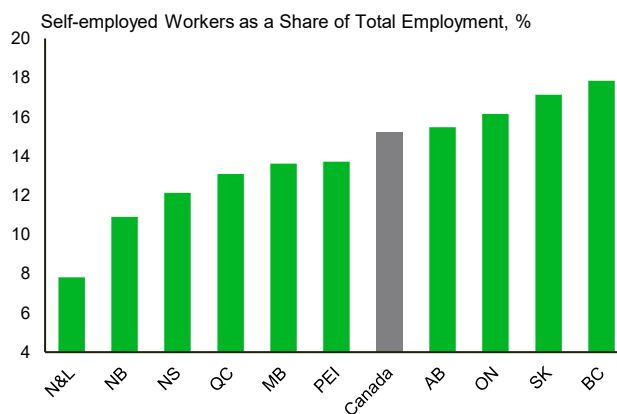
Due to data limitations and because non-standard workers include many different types of employment arrangements which may overlap, it is difficult to know with precision the prevalence of non-standard work in Canada. About 15% of Canadian workers are self-employed, while 17% work part-time. In 2016, Statistics Canada estimated that gig workers (self-employed freelancers, on-demand online workers and day labourers) accounted for roughly 8%-10% of Canadian workers. About half of those workers were relying exclusively on their gig income and had no other employment, making them ineligible for EI benefits.<sup>4</sup>

The low coverage rate and other limitations of the current EI system have been highlighted extensively in other research literature.<sup>5</sup> For example, the fact that benefit eligibility and generosity varies geographically across Canada implies that there's significant variability in coverage rates across provinces. EI coverage ratios are particularly low in Ontario, British Columbia and Alberta – all three provinces which also have above-national prevalence of self-employment (see Charts 4).<sup>6</sup>

In order to mitigate these shortcomings in the near term, the Canadian government rolled out the CERB program. Compared to EI, CERB qualification rules are very straightforward and were a quick means to provide financial assistance to an extremely broad and large number of applicants that included previously uninsured workers. CERB's eligibility replaced the insurable hours threshold with a low and uniform income threshold, with anyone over the age of 15, having earned more than \$5,000 in income in 2019 and who have lost their job or hours due to COVID-19. This had provided a helping hand to millions of non-standard workers in Canada. However, it has come with a steep price tag: in just three months since it was launched the government had already paid out \$55 billions in benefits (as of July 5th) – nearly three times last year's annual spending on EI and \$28 billion more than it had predicted at the conception of the program.

CERB coverage was originally offered for 16 weeks, and was recently extended for an additional 8 weeks. However, it will start expiring in September for the earliest recipients, long before the labour market and certain industries are back to

**Chart 4: Prevalence of Self-employment Varies by Province**



Source: Statistics Canada, TD Economics.

health. Unless adjustments are made to the EI program to accommodate non-standard workers, many of them may suddenly find themselves without unemployment assistance.

### What Complicates Offering EI Coverage For Non-Standard Workers

Limited social protection for self-employed and other non-standard workers is not an issue unique to Canada. In most developed countries, non-standard workers have lower social protection compared to regular employees, with unemployment benefits being the least accessible benefit (Charts 5-8). Why is that and what makes implementation of unemployment insurance coverage for self-employed workers challenging for policymakers?

First of all, providing unemployment insurance for self-employed workers (and other non-standard workers) raises the issue of *moral hazard*. Put another way, presence of EI coverage may change behavior of self-employed workers making them less likely to take on work and more likely to remain unemployed. Non-standard workers tend to have more variable income, and they are far more likely to have lower future earnings than regular employees due, for example, to smaller assignments and contracts, or flexible pricing on various labor platforms (e.g. Uber). Lower expected future earnings could prompt them to quit in favor of EI benefits. More volatile earnings also make it more challenging to determine the appropriate income replacement rate. However, one solution to this could be to use income averaged over a period of time.

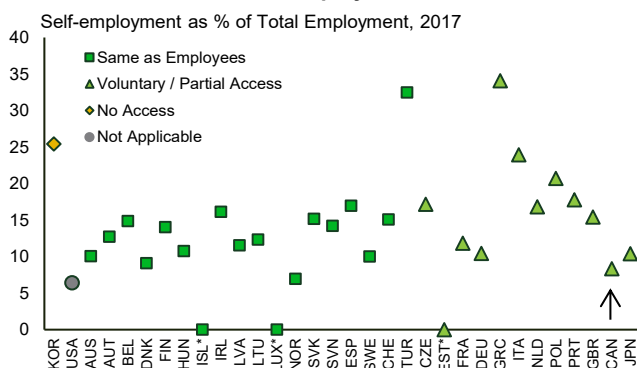
Secondly, for regular workers, reasons for leaving a job are

transparent and can be verified with the employer. This is difficult to achieve in the case of non-standard workers. For example, if they avoid smaller assignments, then they will lose work but this will be impossible for government agencies to determine.

Some countries (e.g. Sweden, Austria, Slovakia, Spain) offer a voluntary option for self-employed workers to enroll into an employment insurance plan. However, a voluntary arrangement raises the issue of *adverse selection*. Workers with the highest risks or those that are most likely to make a claim have the greatest incentive to join, which limits the risk-sharing aspect of the program.

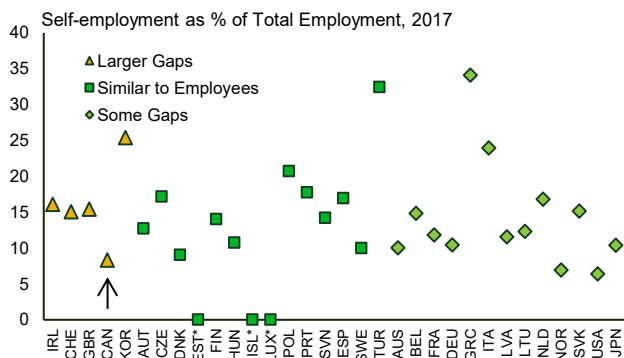
Adverse selection is something that Canada experienced first hand when it introduced the Special Benefits for Self-employed Workers (SBSE) in 2010 through the EI system, which allowed self employed workers to opt-in to gain access to maternity and parental benefits, sickness benefits and

**Chart 5: Maternity and Family Benefits Available to Self-employed**



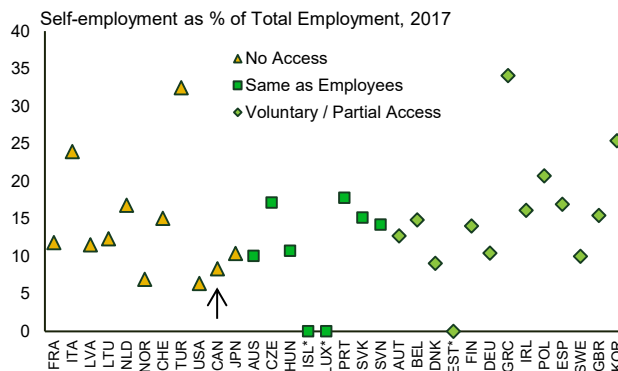
Source: OECD, TD Economics.  
Note: Countries denoted by \* had no self-employment in 2017.

**Chart 6: Sickness, Disability and Work Injury Coverage Available to Self-employed**



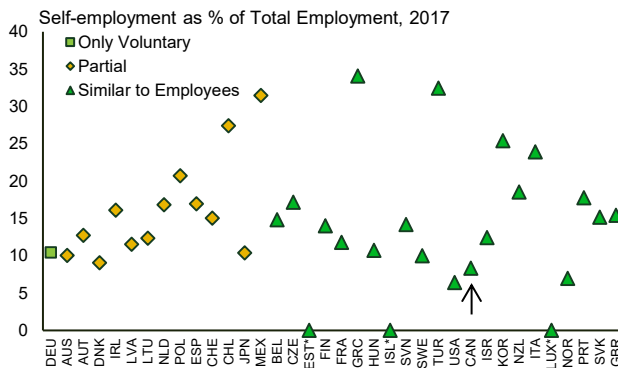
Source: OECD, TD Economics.  
Note: Countries denoted by \* had no self-employment in 2017.

**Chart 7. Unemployment Benefits Coverage Options Available to Self-employed**



Source: OECD, TD Economics.  
Note: Countries denoted by \* had no self-employment in 2017.

**Chart 8. Old-age Pensions Coverage Options Available to Self-employed**



Source: OECD, TD Economics.  
Note: Countries denoted by \* had no self-employment in 2017.

compassionate care and caregiver benefits. A 2016 program review study found that the characteristics, such as gender, age and income, of the self-employed workers who participated in the SBSE program were considerably different from the general sample of self-employed workers. In focus group studies, participants also indicated that the likelihood of making a claim was an important consideration for their decision to register for the benefits.<sup>7</sup> Other issues with the voluntary scheme included a relatively low take-up rate, which in turn led to relatively high administration costs and required significant government subsidies to cover benefit payouts. Longer-run, low coverage is problematic for voluntary, contributions-financed, unemployment insurance schemes, as adverse selection could lead to a vicious cycle of rising insurance premia and falling coverage. Meanwhile, achieving high coverage may require significant public subsidies because individual willingness to voluntarily pay for unemployment protection appears to be low.<sup>8</sup> For those rea-

sons, voluntary coverage schemes do not appear to work well in the case of non-standard workers.

Lastly, the current EI system is based on contributions from both employees and employers. In the case of the self-employed, it is not clear who will pick up the tab for the employer portion of the contribution. If the government subsidizes the employer portion, it could create adverse incentives for employers to hire a self-employed worker to reduce non-wage related labor costs. However, a lack of coverage for non-standard workers could also lead to this outcome, contributing to a rise in non-standard forms of employment. For example, in Italy, *para-subordinate* workers (self-employed but highly depended on one or very few clients) used to pay significantly lower pension contributions and were not eligible for unemployment and sickness benefits, resulting in significantly lower non-wage labor costs and a rising number of para-subordinated workers. In response to this Italy had gradually increased their contribution rates and expanded coverage. Levelling the playing field led to a significant decline in the prevalence of this type of employment. Austria had a similar experience with independent contractors.<sup>9</sup>

## Some Solutions Based on The International Experience

Despite the challenges in expanding unemployment insurance to non-standard workers, there is a growing understanding among many countries that the growing share of non-standard workers need social protection. As a result, more than two thirds of the OECD countries now offer at least partial unemployment benefits to self-employed workers. There's a great variety of schemes, ranging from mandatory to partial and voluntary coverage, and no two are exactly alike. Still, their experience offers valuable lessons for Canada if it wishes to incorporate self-employed (and potentially other non-standard) workers into its EI system.

So what are some of the solutions of dealing with the higher moral hazard issue for non-standard workers? Lower level of EI benefits or a more restrictive access could be imposed in order to incent individuals to search for work or to keep their current job, and to offset higher level of moral hazard. In Sweden, for example, the moral hazard issue is mitigated through more restrictive access, allowing self-employed workers to claim benefits only after 5 years have passed since

the previous claim. There is also a requirement that the firm has been shut down, which acts as an additional deterrent.

To mitigate *adverse selection*, upon starting a business, self-employed individuals in Austria have six months to decide whether they would like to participate in the voluntary unemployment insurance scheme, and that decision is binding for 8 years. In Canada, only half of startups survive to their eight-year anniversary, so there is a high likelihood EI could be used at least once by many self-employed business owners during this time period.<sup>10</sup>

Generally speaking, based on the OECD review,<sup>11</sup> there appears to be a consensus that voluntary coverage schemes, particularly the ones with little or no commitment, such as Canada's EI SBSE for the self-employed, are quite rare and do not work well to accommodate non-standard employment due to prevalent adverse selection, low participation and the significant public subsidies required to operate them.

On the other hand, mandatory EI contributions and coverage, like the one that currently exists for regular employees, would resolve the issue of adverse selection, hold more closely to the principle of risk sharing within their peer groups, and help to lower program costs. However, results from past surveys conducted in Canada found that there was little support among the self-employed for a mandatory contribution scheme.<sup>12</sup> Due to the nature of their work, many self-employed workers indicated a preference to minimize their absence from work (to avoid the risk of losing clients etc.) suggesting that, unless their contribution rates are significantly lower, self-employed workers may get less "value-for-money" from EI programs, such as for example maternity/paternity leave, than traditional employees. The less predictable nature of their income means that they are likely more in need of an income protection program rather than employment insurance.

Indeed, based on surveys, their preferred financing option for temporary work/income disruptions was a tax-sheltered savings account.<sup>13</sup> This is another viable alternative to contributions-funded EI, however, the downside is that individual contribution rates would need to be significantly higher in order to generate sufficient savings because there will be no splitting of contribution between employers and employees. There is also a risk that individuals, particularly those in part-time or low-income jobs, may not be able to

accumulate sufficient savings to weather the unemployment or low-earnings spell.

For other non-standard workers, such as those with flexible hours or doing work for an online platform, one solution would be to introduce a wage premium for employees doing flexible work. This would compensate workers for the added income uncertainty. In Australia, for example, casual workers are entitled to a wage premium or have a minimum hours guarantee.

Lastly, if the goal is to make social protection more universal and harmonized across all forms of employment, a means-tested social protection system financed through general taxation, similar to that of Australia and New Zealand, could be adopted. However, moving to these systems would require a complete overhaul of Canada's current contribution-based EI.

## Concluding Remarks

The labor market recovery is likely to be uneven and protracted. Even those workers that were able to return to work could remain underutilized and continue to face lower earnings due to social distancing restrictions and weaker consumer demand for a considerable period of time. This is

especially true for self-employed and other non-standard workers, since their hours and incomes are more volatile and less protected. The rollout of CERB during the pandemic has been very helpful to address gaps in coverage within the current EI system. However, looking ahead, a more sustainable and permanent solution is required for workers outside the EI system. Having a more inclusive system with a broader contribution base, which accommodates non-standard workers but also includes a larger number of regular employees through more inclusive qualification criteria would help strengthen the recovery and maintain economic gains that were so far accomplished through CERB.

The traditional EI system is based on a binary choice of whether or not someone has a job. It is clear that with non-standard forms of employment becoming more prevalent, fewer people fit into that box. These workers need some form of insurance against joblessness as well as income volatility both during the current economic recovery and in the future to address the changing nature of employment relationships. Many OECD countries now offer various options for non-standard workers to participate in unemployment insurance systems, and their experience offers valuable lessons if Canada decides to follow suit.

## Endnotes

- i. Since 2010 self-employed workers can voluntarily participate in EI Special Benefit for Self-Employed Workers (SBSE) to gain access to many life event-type benefits accessible to regular employees, such as maternity and paternity leave programs, leave due to sickness or to care for an sick family member. In addition to this, current EI system allows certain exceptions for some non-standard workers. For example some individuals who work independently as barbers, hairdressers, taxi drivers, drivers of other passenger vehicles are eligible to receive benefits through the regular EI program. Fishermen are also included as insured persons under the EI Fishing Regulations. In the case of the self-employed fishermen, EI qualification is tied to income. In order to qualify for up to 26 weeks of benefit, they need to have earned between \$2,500 to \$4,200 in the last 31 weeks.
- ii. The two main reasons for not contributing to the EI program were not having worked in the previous 12 months, and non-insurable employment (which includes self-employment).

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11. Ibid.
12. "Government Response To The Fifth Report Of The Standing Committee On The Status of Women. Interim Report on the Maternity and Parental Benefits Under Employment Insurance: the Exclusion of Self-Employed Workers." <https://www.ourcommons.ca/DocumentViewer/en/39-1/FEWO/report-5/response-8512-391-19>
13. "Evaluation of the Employment Insurance Special Benefits for Self-employed Workers". Employment and Social Development Canada. <https://www.canada.ca/en/employment-social-development/corporate/reports/evaluations/2016-ei-special-benefits.html>

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