Worker’s unemployment protection systems in the OAS countries

Gonzalo Islas
REGIONAL OFFICE FOR THE AMERICAS
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Gonzalo Islas

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PROLOG

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In this document, the expert Gonzalo Islas carries out a revision and analysis of the main theoretical aspects as well as the current discussion regarding under which grounds Unemployment Insurance should be implemented. Islas, at the same time, shows how this discussion relates to the OAS countries.

The paper outlines that unemployment is an intrinsic characteristic of the operation of modern economies and, at the same time it is both a problem of economic order as well as a problem of social order. Indeed, affected families see their quality of life, their consumption patterns and those of the rest of the population immensely reduced, as the insecurity perception of their source of income increases. On the other hand, inefficiencies take place in the use of the work factor and if unemployment lingers on there is a human capital deterioration of the economy resulting in a considerable impact on potential productive levels.

By analyzing the characteristics of typical insurance it can be concluded that in the contingency of unemployment such insurance faces the same problems that are common in the typical insurance market. Risk of abuse (Moral Hazard) and adverse selection appear, and in the case of unemployment insurance, they are even stronger. International experience shows us that in most countries protection for unemployed workers comes from public policy funds and that in developed countries the protection comes fundamentally from unemployment insurance.

Unemployment Insurance has effects on the operation of the Labor Market, by generating new incentives as much as for employers as for workers (Job-search intensity by insured workers). The challenge is, therefore, to design mechanisms that give unemployed workers adequate protection without generating distortions on the decisions of the labor market members. However, when analyzing the Latin American experience, the author concludes that such mechanisms are much less than those in developed countries, since in these countries there are other influential factors such as: labor market informality, high youth unemployment and fundamentally due to the fact that many countries opt for the use of protection mechanisms based on compensation for years of service.

Notwithstanding the facts mentioned above, the paper identifies a series of recent developments in the labor markets of the Region that, on the one hand, favor the advantages of having Unemployment Insurance and on the other, facilitate its installation and operation process.
It would be worthy to see if the reforms done to the Pension System replacing the distribution system by and individual savings system (Argentina, Colombia, Chile, Bolivia, El Salvador, Mexico, Peru, and Uruguay), has had positive results and if the Unemployment Insurance System can take advantage of them by developing better collection systems, administration of accounts, billing and far better customer service nets. It is also necessary analyze if these systems have positive effects on the formalization of the Labor Market, since there is a greater link between payment fees and benefits. At the same time, if the development of the capital market linked to social security reform, allows a deeper and greater transparency of the financial markets, it could also be used in the administration of the necessary reserve funds to have an adequately running insurance system.

Economic globalization and the flexibilization of markets have rendered reforms such as the privatization of public companies, reducing the relative importance of public employment. This, therefore, creates a higher labor mobility and a greater commercial openness generating pressures for a greater economic and labor market flexibility. Unemployment Insurance could in this perspective be utilized as protection, without incurring in such costs as labor market flexibility. It could, at the same time, be used as a facilitating element for the transition towards more open economies by protecting the adaptation time of those who are affected by productive reconversion processes.

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Introduction

Unemployment belongs to the essential nature of modern economies. It is due to a variety of factors: i.e. the effects of economic cycles, capital shortage, real salaries higher than the balance level or persistent maladjustments between the pattern of labour demand and the structure of labour supply. Yet, empirical evidence shows that market economies generally operate with a permanent unemployment rate, which although it may vary according to changing circumstances, it never really does disappear at all.

Unemployment is an economic problem, as much as a social one. In fact, affected families experience a substantial decline in their quality of life. At the same time unemployment has adverse macroeconomic consequences not only on the patterns of consumption of families that are directly affected, but on the rest of the population as well, by heightening a perception of insecurity with regards to their sources of income. On the other hand, unemployment impairs an efficient use of the work factor and produces, in the long run, the deterioration of human labour capacity, negatively affecting the economy’s potential product.

Unemployment protection based on private insurance systems (such as fire or accident insurance) must deal with the problems that are characteristic of the insurance market. Problems such as abuse of the system and adverse selection, appear highly magnified when it comes to unemployment insurance. Thus, international experience tells us that in the vast majority of the developing countries worker protection against unemployment is based on public policy. Therefore, in developed countries, protection against unemployment is essentially provided through unemployment insurance.

This institution affects the labour market by generating new incentives for employers and workers alike. The most frequently quoted effect is the job search intensity that insured workers have. Hence, the challenge faced by public policy makers is designing mechanisms capable of providing adequate protection to the unemployed without distorting the decisions of labour market parties.

Latin America has a limited experience in the unemployment insurance area with respects to developed countries. This is mainly due to, among other things: labour market informality, high levels of youth unemployment and, basically, because a large number of countries, have protection mechanisms based on severance pay per years of service. Nevertheless, recent labour markets development in the region have increased the advantages of counting with unemployment insurance, facilitating its implementation and its putting in force.

This paper is structured as follows:

Section A provides a discussion over the principal theoretical foundations and characteristics of unemployment insurance, along with a review of the principal empirical results regarding the effects of insurance on the labour market.

Section B contains an analysis devoted to a series of features common to Latin American labour markets and their influence on the efficient operation of unemployment insurance. Section C illustrates current legislation on severance pay and unemployment insurance in the region, examining the principal changes that took place throughout the last 10 years.

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Lastly, Section D provides a detailed analysis of the principal aspects of current unemployment insurance in Latin America.

A. Theoretical background

Unemployment belongs to the essential nature of modern economies. It is caused by a variety of factors: i.e. the effects of economic cycles, capital shortage, real salaries higher than the balance level or persistent maladjustments between the pattern of labour demand and the structure of labour supply. Yet empirical evidence shows that market economies generally operate with a permanent unemployment rate, which, although it may vary according to changing circumstances, it never really does disappear at all.

1. A public policy solution

The essential role of unemployment benefits is to provide income in the event of involuntary unemployment. Theoretically, these benefits help to stabilize consumption both on an individual basis and at the macroeconomic level, facilitating the quest for new employment and promoting higher labour market efficiency. Consequently, unemployment benefits are a public policy response aimed at correcting the inability of the market to offer suitable insurance possibilities on account of the following reasons:

Risk of abuse (moral hazard). Once they can count on unemployment protection, insured parties (workers) devote little efforts to avoid the recurrence of unemployment, thus increasing the odds of unemployment and intensifying the use of the system. Under these circumstances, the likelihood of unemployment stops being exogenous with respect to workers decisions. The problem may get worse in the event of a collusion between employers and workers to fake redundancies or other actions aimed at overusing the system (sharing the benefits). These effects are usually counteracted by the establishment of a series of requisites that must be met in order to gain access to the benefits, along with restricting the amount and duration of the same, along with other institutional aspects that may strongly condition the final effects on the labour market.

Adverse selection. This problem arises when insured workers are subject to a handful of different unemployment risks whose nature are not accurately known by the insurance entities. Therefore, workers who might have greater incentives to join an insurance system should be those who are more at risk of losing their jobs. Hence private insurance system entities would concentrate in covering higher risk workers; thus, insurance premiums would tend to rise, leading to a situation where only a very marginal proportion of the work force would be covered. This effect explains both the absence of a private unemployment insurance market and the reason why it must operate on an mandatory basis. Under these conditions, the system allows the incorporation of every single individual and makes away with the problems of adverse selection.

Capital market imperfections. As long as the unemployed are not eligible to credit against their future labour income, the length for employment search will not achieve its optimum level. Therefore, the benefits provide the purchasing power that the beneficiaries need to seek work in a more efficient manner (see Section B.3). This approach would lead to recommend a generous benefit distribution for a fix term. Although, such a posture, does not take into account that the unemployed can devote just a few hours per week to job hunting, or the modest correlation shown by empirical studies between job search intensity and unemployment duration.

Massive unemployment risk. This problem alludes to a systemic component associated with the economic cycle, which manifests itself under recessive conditions, implying that there is no independence between the adverse effects of unemployment. Hence, the contra cyclical character of the system causes it to lose money under recessive conditions and to accumulate surpluses throughout expansive phases. Theoretically, this problem could be resolved by determining an unemployment rate that would enable the system to balance its income and expenditures on a long term basis. Therefore, during periods of expansion, the mechanism would generate the necessary surpluses to finance benefits when the system plunges into a deficit mode. However, even
ignoring the difficulties involved with determining a “normal” or long-term unemployment rate capable of generating balanced financial conditions in the face of high unemployment rates, this would mean having to start with relatively high premiums, or contributions with possible negative repercussions in the labour market. (N.B.: unlike population aging, economic cycle can not be forecasted).

Besides, available empirical evidence indicates that as a result of the pressure exercised by recessive conditions in terms of extending the system’s coverage, these regimes end up by committing huge public resources in order to finance chronic shortfalls.

2. Principal characteristics

The traditional version of worker’s unemployment protection systems, known as unemployment insurance or unemployment assistance, were introduced in Western Europe after WW II. Their main feature was that they provided generous benefits without asking for exacting access requisites and coexisted with important protection measures in the face of individual and collective lay-offs. These systems were also established in the United States and Canada, where unemployment protection is relatively less than those in Europe. In the last few years, unemployment protection became the object of a series of controversies in Latin America, where this institution has been frequently considered as a possible total or partial alternative to severance compensation.

Fiscal deficit and unemployment have increased since the 1980’s. Since then, the role of these regimes have been questioned alongside other components of the social protection machinery. This was due not only for the need to reduce fiscal liabilities, but also because unemployment benefits allegedly decrease labour motivation and performance, amongst waged workers. At the same time it also had a negative repercussions on the level and duration of unemployment (the so-called moral risk problem).

The most common features of unemployment protection services are as follows:

\[ \text{a) Protection tools} \]

Mandatory insurance within or alongside social security systems to a lesser extent, there are also voluntary insurance systems that are specially applicable to certain groups of individual workers. Such are the cases of Denmark and Sweden, where organized labour established a voluntary system with strong public financial support. Lastly, social assistance systems that transfer public fundings to those who need it.

Most of the regimes established in the European Union are organized on both a contributory insurance basis and an assistance level covering those workers who do not meet certain criterion covered by insurance. Unemployment programs in Latin America even though they are usually financed through the payroll, tend to take a subsidy shape due to the structural characteristics of unemployment in this region. Unemployment protection systems are created by law or through collective bargaining, and generally provide coverage only to workers in the formal sector of the economy.

\[ \text{b) Contingency} \]

Unlike other branches of social security that cover contingencies of workers and their families, unemployment is a contingency generated by economic situations imposed upon the workers by factors such as the employer, the market place, technology or other changes in the labour market. These systems were born to provide unemployed workers with income, when they were faced with temporary unemployment. In all cases, these workers belonged to economies operating under conditions that were close to full employment. Yet, in the last few years, unemployment protection systems started to be tightly linked with labour market active policies, productive reinsertion; labour training and development of independent activities. Thus, the benefits role not only consist on providing income to the unemployed, but also support their employment search or reward their reinsertion into the labour market.

\[ \text{c) Coverage} \]

Unemployment protection systems seek workers protection. However, even in the case
of assistance regimes, the coverage goal will depend on the purpose of the assistance. The treatment that beneficiaries will get may vary. For example, public servants are generally excluded from the system on account of the sector’s stability where unemployment is a rare occurrence. Such is also the case for agricultural workers, domestic services workers, or workers hired to perform a specific work or task, due to their cyclic and/or unstable character. Unemployed workers who are entering the labour market for the first time or after a long absence are rarely compensated. In other words, protection is specifically aimed at unemployed workers.

d) **Benefit amount and duration**

In general, empirical evidence provides two principal ways of determining the amount of the benefit: a) same fix amount to all beneficiaries; and b) variable amounts on the basis of previous remuneration. What is more, these systems generally establish minimum and maximum cash amounts.

The average benefit rate represents between 40% to 75% of the worker’s previous remuneration. Experience and theoretical models alike agree that the incentives to engage once more on a quest for employment are seriously affected in systems where benefits are over 60% - 70% of the average net remuneration of the workers. Consequently, many countries establish decreasing rates tied to the duration of the coverage; decreasing rates are also adopted with respect to fix benefits.

Benefits dry down after a certain number of monthly contributions, being replaced by a single minimum assistance payment subject to a different set of conditions.

Finally, systems may establish a brief initial period when no benefits are provided, seeking to eliminate the coverage of very short periods of unemployment that do not generate income problems to the worker. The goal is to discourage applications for very short periods, in order to reduce the administrative burden, and controlling possible abuses on the part of voluntary unemployed workers.

e) **Eligibility**

These benefits are open to the risk that the beneficiaries may earn undeclared income while enjoying the coverage of the system. As a result of this vulnerability, a series of conditions must be laid down in order to ensure the financial balance of the system. First of all, the cause of unemployment must be involuntary. This means if the worker quit on his/her own behalf, or the cause for dismissal was the worker’s fault, he/she is not eligible for benefits. Moreover, the worker must prove that he/she worked for at least one year, and that he/she lived off that income that, which now, must be compensated.

Generally, benefit payments are conditioned to the willingness of the unemployed worker to go back to work. To this end, workers must register at national or local employment agencies. If a worker refuses adequate employment offers, he/she is no longer recognized as being under involuntary unemployment and is refused benefits. The notion of “adequate employment” rests on the administrative assessment of his/her reason to refuse employment offers.

On the other hand, there are assistance regimes that normally authorize the extension of protection after the expiration of the benefits, or coverage of those who do not meet requirements. However, in this case, workers must prove that they have no sufficient means of subsistence to have access to benefits (means test).

f) **Financing**

Alternatives in this area span from insurance based on contributions from employers, workers and the State (tripartite financing), to assistance systems financed with public revenue collection. Insurance schemes are rarely seen as a solution to unemployment. Their goal consists rather in providing means of subsistence to workers who lose their source of income temporarily and fail to find adequate employment.

Governments provide a variety of subsidies to finance the regular payment of benefits and deficits generated by the systems or to cover related administrative services such as employment agencies.

As far as the financial regimes are concerned, the distributive system usually prevails, although it is always necessary to establish reserves, specially to face unforeseen changes in the labour market, particularly under recessionary conditions that require the
implementation of extraordinary measures. Unlike pension systems, monitoring the financial balance of these regimes is not only influenced by demographic variables, but also conditioned by labour market variables registered in shorter periods. This conditions calls for timely deficit correction financing measures.

Recent experience shows that increasing unemployment rates have raised the issue of having higher contributions. Yet, since enterprises have requested a cut down on social security taxes, it has been the State who has increased its share in the financial scheme, generating a larger public role in the management of the various systems.

g) Administration

In general, these schemes need the support of administrative services to register the beneficiaries, collect contributions, establish access requisites, pay the benefits and verify the willingness of the unemployed to resume working. They usually complement their services with State or local employment services to promote workers occupational and geographic mobility, specially in those industries that are going through restructuring or reconverting processes.

The functions assigned to these services are hardly homogeneous. Private services are frequently circumscribed to placement activities, while public services complement labour training and other activities that are a characteristic of unemployment insurance. In developed countries, these services have experienced important changes through the use of computer technology and decentralization. Cooperation between different private and public services, sharing information or responsibilities with respect to different segments of the labour market, has been explored recently.

3. Theoretical basis and empirical evidence

The theoretical discussion around unemployment insurance usually emphasizes on the effect that its benefits have on the cost of remaining unemployed. This usually tends to prolong unemployment periods among those who seek employment. These effects may be explained from the perspective of some of the principal theoretical models, such as: Employment Search, Idle-Work and Adverse Risk Individuals’. In order to concentrate the analysis around the fundamental consequences, only the employment search model will be examined.

a) Employment search models

This approach holds that: a) salaries are associated with the characteristics of the occupations, rather than those of the individuals who occupy them, and b) employers differ with respect to the stipulation of minimum hiring standards, which may include educational requisites, labour experience, training, performance tests, etc. Since available information related to employment opportunities and workers characteristics is deficient, convergence of unemployed workers and potential employers takes time.

For each available job there is a given wage. Starting from a given minimum, such a wage increases depending on the required level of skills needed. Thus, two employers with the same hiring standards will offer the same wage. Since different employers have different hiring standards, a distribution of expected wages will take place in association with each vacancy available. Such distribution will have 100% of the probabilities of offered wages found in the current labour market.

Since the available information is deficient, the job seeker knows the form of the distribution function of offered wages, but not the wages offered by each individual enterprise or the hiring standard assessment. Therefore, employment search is seen as the process where the worker seeks hiring standard that will match his/her skills.

How does an unemployed worker know when he/she should accept a given offer? The strategy consists in making a decision on the basis of an accepted minimum wage $W_r$ (reserve wage), in order to accept (or reject) any offer over (below) that level.

Let us start with an individual whose reserve wage has a $K^*$ rating. This candidate will be rejected by any enterprise offering wages over $W^*(K^*)$, since he/she will not meet the minimum hiring standard. Likewise, this individual will reject any offer involving a wage below the reserve wage.
A relatively high reserve wage would have two effects: a) Since the individual might reject lower paid jobs, his/her average expected wage might increase once employed; b) by rejecting more offers, his/her probabilities of accepting a job in a short period of time will decrease, resulting in a longer than expected unemployment duration. In other words, high reserve wages entail higher costs derived from a longer unemployment period, but also higher benefits for a higher expected wage if the individual manages to land a job.

Therefore, each unemployed individual chooses his/her reserve wages. These individuals expect to match their costs of a longer period of unemployment with the expected benefits from a higher post-unemployment wage.

The decision rule associated to this model entails the following:
- Since reserve wages differ from the market’s minimum wage, the probabilities of finding a job will be bellow 1, generating unemployment because of job search, and thus proving that a rate of unemployment equal to 0 is not the optimum. When an individual does not necessarily accept the first job offered to him/her, he/she is simply following a rational market strategy in a market that provides deficient information.
- Any element reducing a persons’ unemployment costs should increase his/her reserve wages, causing longer unemployment periods and higher post-unemployment wages.
- The need to count on current income with respect to future income (or a greater rate of discount on the part of the unemployed), would cut down reserve wages, leading to shorter periods of unemployment and lower post-unemployment wages. This means that unemployed individuals who belong to poor families might find occupations with relatively low wages more frequently than equally qualified individuals who belong to high income families.
- The shorter the time that an individual expects to be employed, the shorter his/her quest for employment and the lower his/her reserve wages. Lower reserve wages will shorten the duration of unemployment and generate even lower post-employment wages.
- Lastly, increasing qualification ratings will have the following effects on the unemployed: on the one hand their W* will grow; therefore, with everything else constant, the proportion of jobs for which they are eligible will increase, reducing their expectations of the length of their unemployment period and increasing the expected post-unemployment wages. On the other hand, increasing qualification ratings entails a growth in their reserve wages, which will increase both their expected unemployment length and their expected post-unemployment wage. Increasing qualification ratings have ambiguous repercussions on the duration of unemployment.

\[ b) \text{ Main issues of discussion}^{4} \]

The effects of unemployment insurance and public direct assistance to the unemployed have been closely followed with respect to the impact of labour protection on the behavior of the labour market.

- **Labour discipline and performance**

Some authors argue that these systems are an obstacle to productive growth and encourage unemployment. The notion that these regimes have a negative effect on labour productivity derives from the assumption that protection moderates the effect of unemployment upon workers, having a negative impact on labour performance and effort and collective discipline. The higher the rate of unemployment, the higher the fear of losing one’s job (Green and Weisskopf, 1987), and higher the disposition of a worker to yield to the demands of the employer, including a better performance at the work place. Hence, providing an alternative income to that of a regular salary, the fear of losing one’s job will diminish affecting individual labour intensity.

A similar effect may be observed when enterprises use wages to attract and keep their workers, or persuade them to stay (Snower, 1995). A tax increase complemented with an equivalent reduction of net remuneration, without changing employers labour costs, would reduce the net remuneration with respect to non wage income, affecting performance and encouraging workers to quit. On the other part, enterprises would seek to encourage productivity and reduce rotation costs by increasing wages, which would affect employment and increase unemployment.
However, the smaller the benefits with respect to wages, the higher the cost of losing one’s job; besides, this could erode collective discipline, triggering conflicts at the work site (strikes, concerted resistance) in the face of organizational and technological changes that would affect the number of jobs, labour and employment conditions and productivity.

- About unemployment

In general, the attention of current literature has been focused on unemployment effects. At times providing somewhat contradictory arguments. These rest on notions on how labour incentives work, starting, most of the time, from the implicit assumption that it is possible to make a voluntary option between employment and unemployment.

While there is abundant fragmentary evidence regarding some of the above mentioned effects, there is no clarity at all about their relative importance; nor what is its end result; nor the net balance of any opposed effects. For example, if unemployment coverage discourages work, what proportion of the beneficiaries chooses unemployment? The opposite posture holds that the problem does not appear in terms of polar alternatives such as employment/wages and unemployment/benefits, arguing that the option of unemployment may have two types of monetary benefits: unemployment benefits and additional non declared income that the worker would compare with the wages that he/she would earn at the time of going back to work. This situation is relatively more important in economies that have a high degree of informality, such as in the case of Latin American economies.

Besides, those effects may differ as a result of recessionary conditions or a strong decline of labour demand, since they would have little importance under conditions of growing unemployment whenever benefits are provided for a relatively short period of time or there is a low substitution rate.

Most of the studies carried out since the early 1980s were conducted on the assumption that the average period covered by unemployment benefits has a positive impact on substitution rates and the maximum period of coverage. These assumptions were examined through a study conducted by Layard, Nickell and Jackman (1991), which explains the average rate of unemployment in 20 OECD countries in respects to labour market institutions and the variables of unemployment insurance benefits. Their conclusions indicate that a 10 percentage point substitution rate reduction would cut down the average rate of unemployment by 1.7 percentage point, while a one year reduction of the maximum duration of unemployment benefits would cut down unemployment rate by 0.9 percentage points. Those results show that social protection may not only have an impact on employment balance levels, but also on the ability to react in the face of external shocks. Lindbeck (1997), emphasizes that the European Welfare State has deepened unemployment persistence.

From a series of transnational and macroeconomic studies, Graafland (1996) concluded that the influence of the substitution rate and the duration of the benefits are not big or insignificant. Repercussions on unemployment protection level appears to be partially due to the consequences that substitution rate produce on wages, and partly also to the impact of the level and duration of unemployment benefits in the employment search strategies of the unemployed. Nickell (1997) provided a new element by holding that transnational data does not show a connection between unemployment benefits and total employment. He also stated that high unemployment goes hand in hand with the lack of a direct complementary intervention in the labour market.

Several observers argue that there is sound information about the repercussion that the variations of unemployment benefits level have on leaving unemployment. With studies done with have U.S. micro-data, Danziger, Haveman and Plotnick (1981) concluded that there is a positive relationship between unemployment insurance and the duration of unemployment. Moffitt and Nicholson (1982), show that a 10 percentage points increase of the substitution rate would prolong the average duration of unemployment in approximately one week.

On the other hand, Carling, Edin, Harkman and Holmlund (1996) state that the beneficiaries of unemployment insurance have more probabilities of finding a job than those who have no benefits, as it so happens in
Sweden. Yet, elasticity is estimated under 0.1. In the Netherlands, only one out of nine studies reached the unequivocal conclusion that there is a significant duration elasticity of unemployment with respect to benefit level. (Hartog and Theeuwes, 1993).

A recent study conducted in Latin America by Rama and Maloney (2000) shows the results of a series of specific studies for different unemployment assistance programs, including civil servants in Argentina, training in Mexico, unemployment insurance in Brazil, individual accounts in Colombia and severance compensation in Peru. An assessment of the effects of these programs shows a longer duration of unemployment in Peru (severance compensation), attributable to a series of changes carried out in the last few years. Meanwhile, in the context of the Colombian system of individual accounts, the duration of unemployment drops by 3 weeks for workers who receive benefits, with respect to those who receive severance compensation.

Results for the United States indicate that the proportion of unemployed workers drops drastically when the period of eligibility to unemployment benefit lapses. Katz and Meyer (1990) recorded that after 26 and 30 weeks, there was a strong increase of those dropping their names from the benefit registrars. This corresponded to worker’s eligibility period for receiving unemployment insurance. This was not seen with workers who have no benefits. Thus, the distinction between the duration of compensated unemployment and total unemployment is an important one. Katz and Meyer concluded that the duration of the benefits is more influential than any level change.

It has also been argued that the existence of unemployment insurance increases the worker’s participation rates of such systems, so they can use the benefits later on. By doing this they are encouraging unemployment growth. In the 1960s, Canada and the United States showed almost the same rates of unemployment. Twenty years later, the average Canadian rate increased by 2 percentage points. Card and Riddell (1993) sought to find out whether it is possible to attribute that difference to the implementation in Canada, in 1971, of a generous unemployment insurance system. They concluded that Canadian workers adjusted their labour supply to the insurance benefits. Therefore, a considerable part of the difference between U.S. and Canadian rates of unemployment may be attributed to idleness.

However, this case may suggest that the main effect is rather an incentive to employment, at least during the period of eligibility. Thus, unemployment coverage would join the package of incentives to waged labour incorporated into all the legal systems of labour protection, since waged labour is the sole mean to gain access to most social benefits. Yet, the opposite has been emphasized, arguing that these regimes allegedly discourage employment, specially in countries where voluntary idleness is subsidized.

Analyzing this problem in the European context, Snower (1995) states that these systems have direct effects on employment. First, because they discourage job hunting, since finding a job means losing insurance benefits and having to resume contributions. This is the so-called “unemployment ambush”, which works specially for those individuals whose main way of shaking unemployment consists in accepting a temporary or part-time job. The benefits they obtain are very modest vis-à-vis the cost of opportunity for renouncing to unemployment benefits.

Lastly, another expected effect would be raising wages, since the existence of an insurance system improves workers leverage. Usually, at the bottom of the scale of remuneration there is a minimum limit to the net remuneration (while most unemployment insurance systems establish a minimum floor to their benefits). Increasing lower wages cause benefits to push wages up. In the short term this increase of net wages raises labour costs reinforcing the effect of growing unemployment.

A recent study conducted by Spiezia (2000) to determine under what circumstances the rate of unemployment is not affected by insurance protection, provides different conclusions. The author’s main argumentation is aimed at distinguishing unemployment assistance from unemployment insurance, an issue that many studies conducted so far failed to examine.

Spiezia attributes the contradiction between experimental data and theoretical projections to assumptions that do not incorporate the actual features of existing unemployment protection systems in force in
many countries, specially with respect to the assumption that all the unemployed are entitled to a subsidy on a permanent basis. He also points out that scholars fail to realize that insurance or assistance benefits are financed by insured workers and their employers.

In the employment search model, the chances of unemployed worker landing a job are equal to the chances of receiving a work offer multiplied by the chance of accepting the job. The chance of receiving an offer depends on the workers efforts to find employment and a suitable job is one that provides the worker with a wage over his/her reserve wage. In this model, unemployment benefits increase the usefulness of unemployment with respect to employment, in a manner that it increases the wages requested by the worker and decreases the intensity of the search for employment. These effects reduce the probability of the worker finding a job and increase his/her unemployment time. Yet, these results are correct as long as the benefits are granted unconditionally to all unemployed workers. But this does not occur in the real world, since there are at least four categories of unemployed workers who are not entitled to any benefits: a) those who are voluntarily unemployed or have been dismissed on grounds of negligence or grave fault; b) those who have not enough seniority; c) those who can not prove having been engaged in a search for employment or have repeatedly rejected job offers; and d) those who are no longer entitled because of time to unemployment benefits. In Latin America there is a fifth category that may be even more important than the other four. Informal sector workers who are not entitled to unemployment benefits because they have never made any contributions into employment protection systems.

To these categories of unemployed the existence of a protection system makes a work offer more enticing, because being employed is the only way to become eligible to future benefits (“entitlement effect”) (Mortensen, 1977). This effect reveals that the regime itself is a form of insurance: in the event of the risk of becoming unemployed, the best way to become insured against such a contingency is to go back to work, since this is the necessary requisite to being entitled once again. Thus, workers who do not match the requisites will reduce their reserve wages and will have to make additional efforts to find employment. As a result of the “entitlement effect”, unemployment insurance will increase the rhythm of transition from unemployment to employment and reduce the unemployment period of workers that are not eligible for benefits. Besides, the reserve wages of these workers would gradually diminish as the right to benefits expires. This effect is reinforced by many regimes where the amount of the benefits is not constant and decreases over time.

The incorporation of eligibility requisites and a structure of decreasing payments that are a characteristic of unemployment insurance systems, supports the theory that job searching entails different effects on benefits. These have an adverse effect on reserve wages and the efforts to land employment by those who are entitled to benefits, while encouraging those who do not meet the necessary conditions to seek employment. Thus, unemployment insurance has, overall, ambiguous consequences on the duration of unemployment and the rate of exit. These indeterminations are confirmed by experimental data supporting the opinion that the effect of benefits on the rate of unemployment depends on the characteristics of a given system. Spiezia holds that the requisites designed for the majority of the regimes are enough to prevent benefits from increasing the duration of unemployment.

With regard to the consequences of the number of unemployed workers, the same author suggests to consider a case in which benefits are financed through tax revenue, just like in an unemployment assistance regime, where employed workers must renounce to a portion of their income in order to provide benefits to the unemployed. The resulting loss of income would be compensated with the same level of benefits in the event of future unemployment. However, the uselessness of having lower earnings after taxes will be greater than the usefulness of being entitled to benefits, since most people would prefer to earn here and now a given amount of money, rather than having to wait (unless they were accruing interest). Since the uselessness of today’s taxes is greater than tomorrow’s usefulness, employers must pay higher salaries to avoid declining performance.
However, when benefits are financed by means of insured workers contributions, the regime works like a mandatory savings system: every worker saves a portion of his/her current wages to secure a certain level of income in the event of unemployment. Since the interest rate matches the cost of saving, workers may choose not to make contributions or rather join in, which implies lower earnings, in order to secure the expected level of benefits in the future. In other words, in this kind of system the adverse effects of both benefits and contributions on wage levels balance each other. As a result, unemployment insurance does not affect wage levels or labour demand (in fact, several Latin American countries have implemented individual account systems fully matching these characteristics).

Spiezia says that, unlike the assistance regime, the duration of benefits in the contributory system does not affect the magnitude of unemployment. While the benefits are financed through the contributions of employers and workers, their effects on wages and labour demand will be null. What counts is that the system has the two features that are essential to an insurance regime. In fact, eligibility requirements are not enough to guarantee the neutrality of unemployment insurance with respect to salaries and labour demand. To this end, it is equally necessary to finance the subsidies through the contributions of employers and workers alike.

Spiezia’s conclusion is that the examination of the effects of both systems (Assistance and Insurance) shows that while the former increases the duration and magnitude of unemployment, chances are that the latter fails to have any influence on the unemployment rate at all. This is due to the specific features of unemployment insurance regimes: eligibility requisites and self-financing. Combined with financing based on contributions, requisites designed to avoid extending the duration of unemployment, might also have the effect of neutralizing the possible negative consequences of the benefits on wages and employment.

- Long term unemployment

It may be argued that an unemployment protection system would deepen long term unemployment by avoiding the need to accept employment under any circumstances (specially when the amount of the benefits is high with respect to wages and the duration of the entitlement). However, long term unemployment might have a positive aspect, whenever a longer quest for employment allows for a better adjustment between the qualification of the workers and the requirements of the employers, resulting in a lower rate of voluntary employment exit and lower future rotation.

This approach may have the advantage of promoting economic effectiveness by allowing the unemployed to readjust in accordance with the nature of available vacancies; but this argumentation would not fit in the framework of long term European unemployment. Gaining employment in the EU area requires workers to undergo professional retraining and radically changing their life-styles. Unemployment benefits reduce the economic need of doing that (Snower, 1995).

Other authors agree, (Coloma, 1996) that: a) In Europe, increasing unemployment rate is associated with a longer stay under unemployment due to available benefits; b) longer and more generous benefits increase the average duration of unemployment. However, this tends to decrease when faced with programs that grant allowances for rehiring or services that improve the quest for work and supervise the beneficiaries; c) unemployment benefits have almost insignificant effects on post-unemployment wages, mainly because insured workers on long-term unemployment are less attractive to potential employers; d) with respect to the level and duration of the benefits, the most significant negative effects take place between the length and transition to employment; the benefits level that takes place during the transition to retraining and finally the effects that both have on the transition to unemployment; and e) higher benefits reduce mobility between employment and unemployment, and encourage, in particular, the incorporation of women to the work force.

- On employment

Financing unemployment benefits by means of tax revenue helps increase unemployment. Determining contributions on the basis of payroll increases the labour factor and reduces employment, thus deepening the
problem. Financing unemployment benefits with workers’ contributions reduces net wages; that encourages wage pressure and triggers undesirable effects. Financing unemployment benefits through consumer taxes affects employment by reducing consumer demand.

Other authors argue that these programs favor informality through agreements between employers who seek to avoid paying social security contributions and workers who prefer higher purchasing power today against their access to future benefits, in particular in countries where oversight on social security legislation is poor. On the other hand, some sources argue that formal employment with an assured number of contributions is the sole road to unemployment insurance and other benefits. This becomes an incentive to the ends of formalizing the economy.\(^6\)

Meanwhile, other authors suggest that these systems help to encourage dependency on unemployment protection systems, by means of creating seasonal preferential employment instead of stable employment, because the rest of the time the State would subsidize a pool of unemployed putting pressure on the costs of the system. However, there is no clarity on the notion that the absence of these benefits would promote the creation of stable employment. Some hold that the U.S. experience might provide evidence to the effect that these programs might influence employers, encouraging temporary dismissals.

- **On mobility**

Lastly, with respect to the issue of the effects of unemployment protection on worker mobility, some have argued, on the one hand, that this feature prevents mobility from declining sectors or areas to expanding ones, resulting in the retention of the unemployed in high unemployment areas. On the other hand, it may be hold that mobility *per se* does not necessarily cause positive effects; mobility might entail pressure on surplus work force in other areas with a higher level of employment, which can not incorporate additional workers.\(^7\)

**c) Other evidence and recent changes**

The ILO World Labour Report (2000) provides updated information with respect to the evolution of these systems. The Report indicates that almost all OECD nations cut down protection levels with regard to previous periods, adding that in countries that show balanced fiscal accounts, such as the U.S., this tendency has not been reversed. According to the Report, Germany, Austria, Belgium, Denmark, Spain, Finland, France, Iceland, Luxembourg, Norway, The Netherlands, Portugal, Sweden and Switzerland provide the most generous unemployment protection systems, characterized by prolonged high level benefits, extended coverage and a legislative frame aimed at increasing employment security. Their average substitution rates are over 60% of labour income and, in general, they also provide an additional level of assistance to the unemployed.

Countries such as Australia, Canada, the United States, New Zealand, and the United Kingdom, which show a medium-level of protection against unemployment, also register lower levels of benefits, with net substitution rates that go from 23% (New Zealand) to 58% (Canada and the United States). In Australia and New Zealand, where unemployment benefits are not linked to the insurance principle, depending rather on a means test, have a fix amount and unlimited duration.

In Central and Eastern European countries, the average levels of benefit substitution may be compared to those in the EU: Average gross rates of substitution registered 59% in transition countries and 54% in the former. Yet, in the 1990s, governments cut down the duration of both benefits and coverage. Between December 1991 and December 1995, the proportion of beneficiaries dropped from 80% to less than 40% in Hungary, 75% to 55% in Poland, and 82% to 27% in Slovakia. Lately, only one third of registered unemployed were receiving benefits in Poland.

In 1998, in Southern and South-Eastern Asia only 4 countries provided (modest) unemployment benefits (Republic of Korea, China, Hong Kong and Mongolia). Full coverage is provided in Hong Kong, while approximately half of the work force in the Republic of Korea was quickly extended in response to increasing unemployment. In other Asian countries, unemployment coverage protects only a small number of workers in the structured sector.
Countries such as Bangladesh, India and Pakistan have a system that mandates employers to pay severance compensation according to seniority at the termination of the labour relation, which benefits a small proportion of the workforce; i.e. the staff of major enterprises in the structured sector. Workers who have little seniority are granted subsistence benefits covering a short period of unemployment.

Meanwhile, Latin American and Caribbean countries are characterized by the great importance granted to regulations aimed at ensuring employment stability by protecting workers against arbitrary dismissals. In many cases, workers receive severance compensation in accordance to seniority, that provide fix benefits paid by the employer. This issue will be discussed further in Sections A.4 and B.2.

At the same time, most industrialized countries have reinforced their standards regarding benefit eligibility and proof of job seeking. In the case of the unemployed and those who are at risk of being dismissed, this approach tends to reduce the chances of increasing the level and duration of unemployment, as a result of the generosity of employment benefits (i.e., mechanisms to reduce the moral risk problem). However, this step could lead to a further reduction of the coverage, since those who go into the labour market for the first time or wish to go back to it from idleness could be excluded. It is interesting to examine a recent Canadian reform seeking to combine greater insurance discipline with a greater coverage of part-time workers. In Austria, generous agreements on unemployment protection have been turned into job seeking and professional training programs while the workers maintain their contracts. Germany is seeking to establish tight links between employment protection and unemployment insurance, partially considering the possibility of turning severance compensation into unemployment benefits, and in particular early part-time retirement.

Changes in this direction are also taking place in Latin America and the Caribbean on account of the greater importance granted lately to the development of employment services for the unemployed. (Conte-Grand, 1997). In the 1990s, Argentina, Barbados, Mexico, Peru and Uruguay adopted measures to intensify interventions in the labour market by consolidating intermediate services, disseminating information on vacancies and the dearth of qualified personnel, organizing training programs for the unemployed and encouraging public sector workers to move into the structured private sector and micro-enterprises.

From this angle, fired workers become eligible to join pro-active programs such as those devoted to professional training, or active programs related to unemployment compensation and assistance subsidies. Therefore, traditional passive policy systems such as covering unemployed workers may play also an active role, incorporating into their design appropriate incentives to job seeking and productive placement, without weakening employment generation or encouraging unemployment.

Hence, it is now possible to distinguish at least two big groups of proposals to reform unemployment protection systems: those aimed at perfecting distribution systems and establish close ties with labour market active policies, as well as those that rise as alternatives, such as the creation of individual saving accounts.

4. Unemployment insurance and severance compensation

Regulations and institutions of the labour market should aim at guaranteeing productive efficiency as an adequate protection to workers. In general, Labour legislation in Latin America is characterized by its inclination towards labour stability and workers protection, mainly for the purpose of preserving jobs instead of protecting workers income in the event of unemployment (Lora and Pagés, 1996).

The obligation of paying severance compensation should not necessarily have a negative effect on the operations of labour markets. In fact, on the assumption that workers prefer to count on stable income over time, any amount determined by law may be considered as a deferred remuneration for work done that may be compensated with lower wages while they are still employed. Thus, it would represent a benefit to the workers with no effects on the employer.

Lora and Pagés suggest that this perfect relationship between present and future
income takes place only if, (i) the worker and the employer are certain about the amount of the transference, (ii) a transparent relationship between contributions and payments is in place, and (iii) the employer’s savings do no exceed of the amount that the worker wishes to accumulate for the purpose of protecting himself/herself against unemployment (otherwise, an overcompensation would result). However, the same authors say that current valid legislation in Latin America shows several deficiencies that constitute an obstacle to the efficiency of this mechanism, impairing its transparency and neutrality when it comes to resource allocation.

Thus, the first condition (certitude of both worker and employer on the amount of the transference) does not materialize, since the law generally does not establish a clear distinction between an "arbitrary" dismissal and layoff caused by slack in demand or other exigencies of the enterprise. Another source of uncertainty is associated with the formula used to calculate compensation on the basis of the last wages, since the enterprises make contributions on the basis of current wages, while the compensation is calculated as a multiple of the latest wage (or on the basis of an average of the salary corresponding to the last few months).

The second condition (a transparent relationship between contributions and payments) does not materialize either, since workers consider severance compensation as an acquired right, while the employers consider it imposed upon them. Thus, workers have no clear notion over the issue of making contributions to a severance scheme. To the extent that by attempting to induce employers to minimize work force mobility additional costs are generated.

On the other hand, in many countries dismissal costs are covered by the companies liabilities since there is no collective fund to that purpose. Hence, when the enterprise faces adverse conditions, this policy may generate an undesired relationship between low resources and the need to rationalize the work force.

Lastly, the third condition (namely, that the savings of the employer should not exceed the amount that the worker wishes to accumulate for the purpose of protecting himself/herself against unemployment) does not take place either. In fact, even in those cases where severance compensation may be conceived and administered as unemployment insurance, small businesses have little chances of diversifying risks among their few workers, which entails a higher insurance premium for the same severance compensation. Likewise, small businesses have little access to credit in order to face multiple severance compensation claims under conditions of low labour demand.

On the other hand, those enterprises whose activities are subject to strong seasonal or cyclic fluctuations will have to pay severance more frequently; as a result, their premiums should be higher. Yet, when labour law clearly stipulates the amount of the contributions to severance funds, these are exactly the same for all the enterprises and equal to a proportion of the salary.

In these conditions, severance costs have no neutrality, since they interfere with the decisions and the costs of labour mobility. Consequently, both workers and employers alter their behavior in a variety of ways to minimize these costs and interference.

In Latin America, the evidence tends to show undesired effects with regard to their consequences on the labour market. In fact, severance benefits usually tend to become potential sources of conflict, since they encourage early dismissal or forced resignation to avoid associated expenses. Besides, workers also behave in a manner to instigate severance since this is their only available way to collect those benefits. This situation generates an unjustified additional cost and has undesired effects on labour mobility.

If severance costs are perceived as adjustment costs, the enterprises may react by minimizing the mobility of the work force. This approach implies that in the face of transitory adverse economic circumstances, enterprises will tend to maintain more occupied workers than those that they should normally keep if severance compensation costs were lower. Such a reaction is hardly surprising and corresponds to the original motivation of the legislators: Preserving labour stability. For the same reasons, the response of employment to economic expansion, especially if this is of a temporary nature-, will be smaller in the face or greater adjustment costs, restricting employment growth. Moreover, under crisis conditions, their negative
consequences on employment tend to deepen, since the restrictions imposed by severance compensation increase the risk of bankruptcy and unemployment for a great number of workers. Another important related aspect has been pointed out by Rama and Maloney (2000) about the way in which severance compensation disputes have become the greatest case load in Latin American Labour Courts, which would show that, in many cases, unemployment benefits have not been honored (or are untimely honored).

On the other hand, increasing liabilities associated with the severance contingency, the incentive to keep a bigger staff with higher relative seniority decreases (Higher rotation of the work force). In extreme conditions such as in Colombia and Ecuador, where severance compensation grows more proportionally with seniority, employers may see an advantage in preventing workers from accumulating seniority. Thus, legislation aimed at preserving labour stability may end by inducing the opposite effect, impairing the adjustment capacity of the enterprises by way of investing in human capital or higher productivity.

Temporary contracts may become a mechanism to evade high severance costs. In many countries, deregulation of these hiring arrangements has entailed marginal flexibilization that applies only to new workers, without affecting those who have indefinite contracts. Another alternatives for cutting down the costs of labour adjustment is by subcontracting parts of the activities from the informal sector.

Finally, it is important to analyze the degree of protection granted by current legislation to workers who lose their jobs. Generally, the risk and duration of unemployment depend on the personal characteristics of the single worker, as well as the macroeconomic conditions that determine the level of aggregated unemployment. Assuming that the risk and duration of unemployment increase along with the worker’s seniority and the specific nature or his/her labour experience, legislation offers a protection that grows according to the worker’s seniority in the enterprise. Yet, severance compensation is not related to the risk associated with economic conditions.

The effects of the superposition of unemployment benefits and severance compensation in the labour market increase labour costs and have negative repercussions on the creation of employment and at the same time it increases unemployment. Labour reforms carried out in Latin America suggest the existence of an incipient tendency towards readjusting regulations in order to reduce these costs. At the same time, the reforms look for a greater coherence between unemployment protection institutions and other similar schemes.

B. General background on unemployment insurance in Latin America

So far, very few Latin American countries have incorporated unemployment insurance into their social security systems. The Social Security Programs Throughout the World Report, published by the U.S. Social Security Administration, recorded in 1999 the existence of Unemployment Insurance or Subsidies in 6 countries (Argentina, Brazil, Chile, Ecuador, Uruguay and Venezuela), while reporting the existence of unemployment insurance in almost all EU nations; among OECD countries, only Mexico and Turkey have no such kind of insurance.

Although ever since the 1990s, a series of Latin American countries undertook reforms in the labour and social security areas (Lora y Pagés, 1996, Marín and Vega, 2000, Solís 1999), specially with regard to pensions, we only found one case where unemployment insurance was incorporated into those reforms. This situation reveals that labour reforms aimed at other issues, such as extending available contracts, reducing the cost of severance compensation and more conservative policies with regard to the minimum wage and public employment growth (Weller, 1998). The main objective in the social security area was reforming the pension systems.

The reasons for the poor development of unemployment insurance systems in Latin America will be examined in the following Section.

1. Labour market informality

According to ILO (2000) figures, urban labour market informality in the region
reached 46.4% in 1999, against 42.8% in 1990. In the first half of the 1990s, 6 out of each 10 employment opportunities created in urban areas of the region belonged to the informal sector (ILO, 1999); the percentage of informality is even higher taking into consideration the region’s rural areas.

Table 1

INFORMALITY IN URBAN AREAS IN LATIN AMERICAN COUNTRIES - 1999

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Informality (%)</th>
<th>Total Informality Men (%)</th>
<th>Total Informality Women (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina a/</td>
<td>49.3</td>
<td>48.0</td>
<td>51.4</td>
</tr>
<tr>
<td>Brazil</td>
<td>47.1</td>
<td>43.8</td>
<td>51.6</td>
</tr>
<tr>
<td>Chile a/</td>
<td>37.5</td>
<td>32.9</td>
<td>44.8</td>
</tr>
<tr>
<td>Colombia</td>
<td>49.0</td>
<td>49.2</td>
<td>48.8</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>46.8</td>
<td>43.2</td>
<td>52.6</td>
</tr>
<tr>
<td>Ecuador a/</td>
<td>58.6</td>
<td>54.5</td>
<td>64.1</td>
</tr>
<tr>
<td>Honduras</td>
<td>60.7</td>
<td>53.3</td>
<td>67.6</td>
</tr>
<tr>
<td>Mexico</td>
<td>40.1</td>
<td>39.5</td>
<td>41.1</td>
</tr>
<tr>
<td>Panama</td>
<td>38.9</td>
<td>36.7</td>
<td>42.2</td>
</tr>
<tr>
<td>Peru a/</td>
<td>53.7</td>
<td>45.3</td>
<td>64.6</td>
</tr>
<tr>
<td>Uruguay</td>
<td>43.1</td>
<td>39.4</td>
<td>47.9</td>
</tr>
<tr>
<td>Venezuela</td>
<td>49.1</td>
<td>47.5</td>
<td>51.4</td>
</tr>
</tbody>
</table>


a/ 1998 data.

Increased labour market informality is an obstacle to the operation of unemployment protection systems, due to the following reasons:

*Low rate of coverage:* Contributory unemployment insurance can only cover workers in the formal sector. Therefore, the levels of coverage in countries with high levels of informality would be low with respect to the total number of the unemployed, reducing the impact of the insurance scheme as a protection tool. Available evidence for countries where unemployment insurance systems are in force, show a small number of beneficiaries with respect to the total number of unemployed workers (under 10% in some cases).

*Higher moral risk problem:* The Risk of Abuse, or Moral Risk, increases to the extent that unemployed workers may move to the informal sector, find a job and continue to enjoy unemployment benefits. This type of behavior is not easy to detect by the insurance system and may become a huge financial burden due to higher rates of contributions or a greater commitment of public funds, besides an inefficient resource allocation.

*Distributive considerations:* One of the possible functions that the economic theory
assigns to unemployment insurance systems is to provide a social assistance network (Mazza, 1999). Yet, in a highly informal labour market setting, insurance benefits will rarely get to poor workers, since they would hardly meet the requisite of making a minimum number of contributions due to the high degree of informality prevailing among low income workers (ILO, 1999). Therefore, an insurance system that incorporates a strong component of State contributions would entail a regressive use of public resources, in exchange for a limited impact on the protection of low income workers.

As it was previously reviewed in Section B-3, a discussion still unresolved by economic theory involves the possible consequences of unemployment insurance on labour informality. As a matter of fact, two counterpoised effects may be found: a) on the one hand, the possibility of having access to additional benefits might attract new workers to the formal sector (specially those whose rotation rates allow them to gain more frequent access to insurance benefits); and b) on the other hand the incorporation of a contribution rate raises the costs of the labour factor, increasing the benefit of informality if such contributions were perceived by the workers as a tax, or in the event of a strong preference for present consumption among workers.

2. Protection through severance compensation mechanisms

Another important feature in this region is the existence of severance compensation mechanisms that are generally characterized by the provision of important benefits. Márquez and Pagés (1998) indicate that these schemes are generally more demanding in Latin America than in other regions of the world. Labour legislation stipulates that these benefits, which may be circumscribed to unjustified dismissals or incorporate also a lump sum, must be paid in full at the termination of the labour relation. These benefits also provide compensation for the contribution of the worker to the enterprise’s human capital, by offering a tool to guarantee greater employment stability, acting as a mechanism to prevent arbitrary or anti-labour practices on the part of the employer. The amount of the compensation is determined by the seniority and wages of the beneficiary. While it is true that severance compensation mechanisms, specially those associated to unjustified dismissals, may not have the same purposes of unemployment insurance systems, and the form and conditions of benefit distribution are also different (lump-sum compensation versus monthly payments in the case of insurance schemes, benefits linked to seniority versus benefits tied to unemployment), in practical terms the way workers use the benefits from unemployment insurance schemes or from severance compensation is the same: i.e., financing their needs while they seek employment.

Therefore, countries whose labour legislation establish high compensation amounts and have a high degree of compliance with regulations, are providing protection to unemployed workers without having to implement an insurance system, even when the explicit objective of the legislation on severance compensation is a different one.

Even in the countries that are equipped with unemployment insurance systems, the amount of the benefits against severance compensation on the basis of seniority is substantially lower. What is more severance compensation benefits will continue to increase with seniority, while the benefits provided by unemployment insurance are independent from employment seniority as it is shown on Table 2:

<table>
<thead>
<tr>
<th>Country</th>
<th>Benefit of Severance Compensation</th>
<th>Benefit of Unemployment Insurance</th>
</tr>
</thead>
</table>

Table 2

UNEMPLOYMENT INSURANCE BENEFITS AND SEVERANCE COMPENSATION a/ (percentage)
Notwithstanding what has been stated before and given the problems associated with protection based on Seniority Severance compensation the introduction of Unemployment Insurance Systems may contribute to improve the operations of the labour market without putting at risk the benefits due to the workers.

Thus, it should be highlighted that any reform or implementation processes in the area of unemployment insurance must necessarily take into account the relationship between insurance systems and severance compensation mechanisms. Otherwise, there is the risk of creating conditions of overprotection accompanied by a strong rise of the cost of the labour factor, with the resulting incentive to move towards informality and non compliance of labour obligations.

Table 3

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate of Unemployment</th>
<th>Unemployed % between 15 and 29 years with respect to total unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>26.4 a/</td>
<td>38.0 (1)</td>
</tr>
<tr>
<td>Bahamas</td>
<td>---</td>
<td>45.3 (3)</td>
</tr>
<tr>
<td>Barbados</td>
<td>21.8 b/</td>
<td>39.4 (4)</td>
</tr>
<tr>
<td>Bolivia</td>
<td>---</td>
<td>38.7 (3)</td>
</tr>
<tr>
<td>Brazil</td>
<td>14.5 b/</td>
<td>53.2 1</td>
</tr>
<tr>
<td>Chile</td>
<td>19.8 c/</td>
<td>57.9 a/ (1)</td>
</tr>
<tr>
<td>Colombia</td>
<td>35.8 b/</td>
<td>55.7 g/</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>12.8 d/ (1)</td>
<td>33.1 a/</td>
</tr>
<tr>
<td>Ecuador</td>
<td>22.6 a/ (1)</td>
<td>46.0</td>
</tr>
<tr>
<td>El Salvador</td>
<td>15.0 a/ (1)</td>
<td>49.3</td>
</tr>
<tr>
<td>Honduras</td>
<td>10.0 c/ (1)</td>
<td>68.4 (2)</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.5 c/</td>
<td>43.4 (2)</td>
</tr>
<tr>
<td>Panama</td>
<td>29.5 a/</td>
<td>47.0</td>
</tr>
<tr>
<td>Paraguay</td>
<td>12.7 c/ (2)</td>
<td>50.6</td>
</tr>
<tr>
<td>Peru</td>
<td>14.2 f</td>
<td>42.4</td>
</tr>
<tr>
<td>Uruguay</td>
<td>27.1 f</td>
<td>46.9</td>
</tr>
<tr>
<td>Venezuela</td>
<td>26.6 a/</td>
<td>42.6 (4)</td>
</tr>
</tbody>
</table>

Source: Author’s own elaboration based on ILO (1999) data.

a/ 15-24 years
b/ 18-24 years
c/ 20-24 years
3. Youth unemployment

According to ILO data, the rate of youth unemployment in Latin America, which is 2.1 times higher than the average rate, climbed from 7.9% in 1990 to 16% in 1999, affecting mainly poor youths and women. Besides, data for the majority of the countries show that both groups tend to increase even in a recovery scenario (ILO, 2000). Table 3 provides youth unemployment figures for a sample of countries in the region, including the rate of unemployment and the proportion of unemployed youths (15 to 24 years) with respect to total unemployment in each country.

Available data shows an average 2.1 ratio between the rate of youth unemployment and the overall rate of unemployment. This ratio is 2.9 times more in Argentina and 1.8 times more in Peru. In Honduras, Chile and Colombia, unemployed youths represent a higher proportion of the unemployed, with 68.4%, 57% and 55% of the total, respectively.

It is generally expected that young workers will have a somewhat difficult time accessing to the benefits of Unemployment Insurance Systems, since these require a certain minimum number of contributions. As a matter of fact, the last few years have seen a growing number of first time young job seekers, as a proportion of total unemployment, reaffirming the idea that the problem is essentially a matter of access to the labour market. Moreover, informality is higher among younger workers. In fact, the informality rate for this group of workers climbed from 42% in 1990 to 47% in 1999, and almost all employment generation for youth was carried out in the informal sector (with the inevitable drop of the coverage rates of social security) (Labour Outlook, ILO).

Consequently, the problem of youth unemployment requires other solutions besides the protection provided by unemployment insurance. In fact, youth unemployment is associated to poor skills and not enough knowledge and must be dealt with specific policies. Indeed, unemployment insurance may even deepen the problem by discouraging job seeking, according to the European experience with youth unemployment.

4. Public employment

Public servants are rarely included into unemployment insurance schemes on account of their higher degree of labour stability. This
shows that in economies where public employment represents a high percentage of total employment there are less incentives to develop unemployment insurance systems.

According to ILO figures, public employment reaches 24.3% of total formal employment in Latin America. The following Table shows the proportion of employment in the public sector, as a percentage of the formal sector.

Table 4
PUBLIC EMPLOYMENT AS A PERCENTAGE OF FORMAL EMPLOYMENT BY COUNTRY, 1999

<table>
<thead>
<tr>
<th>Country</th>
<th>Public Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>25.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>26.8</td>
</tr>
<tr>
<td>Chile</td>
<td>11.5</td>
</tr>
<tr>
<td>Colombia</td>
<td>16.1</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>28.6</td>
</tr>
<tr>
<td>Ecuador</td>
<td>35.7</td>
</tr>
<tr>
<td>Honduras</td>
<td>25.7</td>
</tr>
<tr>
<td>Mexico</td>
<td>24.2</td>
</tr>
<tr>
<td>Panama</td>
<td>33.9</td>
</tr>
<tr>
<td>Peru</td>
<td>15.6</td>
</tr>
<tr>
<td>Uruguay</td>
<td>30.1</td>
</tr>
<tr>
<td>Venezuela</td>
<td>33.2</td>
</tr>
</tbody>
</table>

Source: Labour Outlook 2000 (ILO).

Table 4 indicates that public employment as a percentage of the formal sector fluctuates in the region from 11.5% in Chile to 35.7% in Ecuador, reaching a 24.3% average of total formal employment. Adding the importance of the informal sector in the region it can be concluded that a potential effective coverage of an insurance system would reach, on average, only 40.6% of total employment (without taking cheating into account. That is workers from the formal sector whose contributions are not counted).

5. Recent development of the labour market and unemployment insurance

Notwithstanding previous background information there are a series of features that lead us to believe that the conditions for creating unemployment insurance systems in Latin America are currently more favorable than some years ago. Labour market changes carried out in the last few years show that the development of protection systems based on unemployment insurance have a series of comparative advantages with respect to protection mechanisms based on compensation.

a) Improving pension systems

Reforms introduced to Pension Systems in order to replace the old distributive system (pay-as-you-go) with individual capitalization accounts in several Latin American countries (Argentina, Colombia, Chile, Bolivia, El Salvador, Mexico, Peru and Uruguay) generate positive externalities that may be taken advantage of by a contributory unemployment insurance based on a distributive system or on individual accounts. In fact, the reforms done in the pension systems like: better collection systems, improved administration of individual accounts and customer service networks generate economies of scope that could be taken advantage of by the unemployment insurance, regardless of its administrative structure. For example, the data
bases of the affiliates to pension systems may be used to detect in a timely fashion any possible fraudulent operation against the insurance on the part of workers (Moral Risk) or cheating by employers (Compensation Payment Evasion).

Other potentially important aspect is the effect that social security reforms may have on the formalization of the labour market. Schmidt-Hebbel (1999) says that pension systems based on individual capitalization may generate increasing market formality through greater links between contributions and benefits and the decline of the contribution rate, which decreases the gap between gross and net remuneration, favoring the effectiveness of unemployment insurance. Empirical evidence for the Chilean case, which is the only one that has been operating long enough to validate the assumption, provides positive evidence in this respect.

Moreover, the development of capital markets, which is usually associated with compensation reforms, increases financial savings and allows to deepen the transparency of the financial market. This may be taken advantage of when there are the necessary reserves to run a successful insurance system.

b) Global economy integration and market flexibility

Trade liberalization is one of the most important economic reforms implemented in Latin America in the 1980s (Edwards, 1995). The main objective of these processes was to move from an inward looking development model with strong public intervention to an outward looking development model that encourages exports and competitiveness and assigns a greater role to the market in the area of resource allocation.

These changes led to reforms such as: the privatization of public enterprises, which reduced the relative importance of public employment, increasing labour mobility; trade liberalization, that added to the growing globalization process demands a growing economic flexibility in general and a growing labor market flexibility in particular.

From this perspective, (Mazza, 1999; Velasquez, 1996) various authors emphasize that unemployment insurance may be used as a tool to accomplish the goal of protecting workers without incurring, in terms of labour market flexibility, in the growing costs of severance compensation based on seniority.

On the other hand, unemployment insurance may facilitate the transition from an inward looking economy to an economy open to the global market that provides labour protection and allows the adjustment of workers affected by restructuring productive processes (Mazza, 1999).

Another important change experienced by labour markets in Latin America and the Caribbean in the last few years, was the decline of the relative importance of public employment. Although public servants still represent 1 out of each 4 formal employed workers, after the economic reforms (basically the privatization of public enterprises) public employment is lower than 10 years ago (27% in 1990). The proportion of public employment declined mostly in Argentina, where the percentage of public employment against the formal sector dropped from 40% to 25%, and Costa Rica, where it decreased from 37% to 28%. A growing share of private employment in total employment translates into greater unemployment insurance benefits.

C. Per country analysis and principal changes during 1990-2000 period

The purpose of this Section is to examine main regional regulations related to severance compensation for the termination of labour relations, against unemployment insurance systems. Emphasis is placed on major changes carried out in the 1990-2000 period, in order to identify common tendencies in the reform process.

One of the main problems involved in this kind of analysis rests in the fact that each country uses different legal terminologies, and in some cases identical terms are applied to describe different situations. Thus, this section will take advantage of the following definitions offered by Lora and Pagés (1996).

Unemployment compensation: Payment due to workers at the termination of the labour relation, regardless of the cause argued by the employer (lump-sum).

Dismissal compensation: Payment due to the worker upon dismissal. In general terms, dismissals recognize 3 main causes: Cause
attributable to the worker (usually called dismissal with just cause); unjustified cause (a common legal tool used in most countries in the region); or dismissal due to economic exigencies of the employer (which is used in a small number of countries). In countries where dismissals due to economic exigencies of the employer have no legal existence, any dismissal on those grounds would be considered unjustified.

Unemployment assistance: Subsidy provided by the State to unemployed workers in a non contributory system.

Unemployment insurance: Benefits granted by a contributory system.

I. Severance compensation development during 1990-2000 period

In the 1990s, many Latin American countries reformed their labour legislations. These reforms, among others, included: Changes related to regulations on protection against dismissal, contract termination and unemployment insurance.

The following are some common tendencies of the reform processes implemented throughout the region.

Reduced compensation amounts based on seniority: Argentina, Nicaragua, Panama and Peru made reforms to reduce employer liabilities associated to the costs of dismissals. In 1991, Argentina amended the law on the termination of labour contracts, establishing a ceiling to compensation amounts and reducing to one month the advance notice due to the workers, regardless of their seniority.

Nicaragua lowered compensation amounts in the case of unjustified dismissals from 2 months of salary per each year of work, to 2 months per year for the first 3 years of work and 20 days salary for each year starting at the fourth year.

The 1995 labour reform carried out in Panama changed previous calculations related to severance compensation, in order to reduce incentives to labour rotation. It also mandated enterprises to generate a collective fund managed by a private concern and cut down the payment of salaries due between the date of the dismissal and the day of the judicial ruling, if any.

In Peru, the Employment Promotion Law of 1991 allowed to replace mandatory worker reinstatement rules with a monetary compensation, in the event of unjustified dismissals. In 1995, Peru abolished absolute stability or the right to reinstatement, and cut down severance compensation to high seniority workers from three monthly salaries to one month salary per each year of work, and established a maximum of 12 years.

In Chile, where the military regime cut down severance compensation substantially, the latest reform increased from 5 to 11 the maximum number of years of work to be taken into account for the purpose of severance compensation. El Salvador raised the ceiling of severance compensation in 1994, keeping the previous calculation formula.

Introduction of mandatory provisioning systems and lump-sum payments: In the cases of Colombia and Guatemala mandatory provisioning systems were introduced by means of individual accounts or annual bonuses. These mechanisms seek to make sure that workers will receive what is due to them, while preventing, at the same time, that too many liabilities may impair the ability of enterprises to face critical economic situations.

In Colombia, the 1990 reform changed some of the conditions related to the termination of the labour relation. It was established on the one hand that unemployment funds be deposited in financial institutions on behalf of the workers. It eliminated on the other hand, the right to reinstatement for workers with over 10 years of seniority. It also changed the scale of seniority compensation and increased the number of salaries due by employers in the event of unjustified dismissals. The purpose of these changes was to reduce uncertainty.

In November 1990, the Guatemalan Congress passed the Annual Bonification Law, in order to replace an economic compensation amounting to 1 monthly salary per year of work, with a lump-sum at the termination of employment with an annual bonus that is paid once a year.

In 1992, Peru also changed the law on seniority compensation or accumulation of capital (CTS) constituted by one monthly salary per each year of service, to be cashed at the termination of the labour relation or by means of periodic withdrawals. Thus CTS are
accumulated in a individual, interest earning account on behalf of the worker, where 50% of the wages are deposited in the months of May and November.

2. Unemployment insurance development during 1990-2000 period

Very few Latin American countries have implemented unemployment protection systems based on Unemployment Insurance. Each of these programs have different characteristics and scope (See Section D) and only Argentina and Venezuela are close to the traditional version of Unemployment Insurance; i.e. a bipartite contributory system that usually is complemented with direct or indirect public subsidies, which provide decreasing monthly benefits for a definite period of time, in accordance with the earnings of the workers.

Brazil has an insurance system financed through the fiscal budget, which works jointly with a compensation provisioning system called Seniority Guarantee Fund (FGTS) created in 1996, making it the oldest system in the region.

In Chile, before the creation of the new Employment Insurance, the system was fully financed with public funds and the benefits had a fix amount regardless of the workers’ previous income. In other words, it was a clear example of an unemployment subsidy. The new Unemployment Insurance, which was recently passed by Congress and should go into force in 2002, combines a scheme of individual accounts with a distributive fund.

In Ecuador, benefits are paid in a lump sum, instead of monthly installments, which is one of the characteristics of severance compensation per year of service programs. However, workers receive benefits only if they remain unemployed for 60 days following dismissal.

In Uruguay there is no contribution rate to unemployment insurance as such, since the system is financed from a single contribution rate that goes to social security. This social security fund also finances old age benefits, disability, widowhood, maternity leave and family allowances, among others. All of the above does not help determine with certitude the relationship between benefits and insurance costs and their effects on the labour market.

As far as Unemployment Insurance systems are concerned, very few reforms were carried out. The following table illustrates the comparative situation between 1990 and 2000.
### Table 5

**COMPARING UNEMPLOYMENT INSURANCE IN LATIN AMERICA. 1990-2000**

<table>
<thead>
<tr>
<th>Country</th>
<th>Financing</th>
<th>Substitution Rate</th>
<th>Benefit Duration</th>
<th>Min.-Max. Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Worker 1.5%</td>
<td>Employer 1.5%</td>
<td>Worker 1.5%</td>
<td>Employer 1.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Barbados</td>
<td>Worker 1.5%</td>
<td>Employer 1.5%</td>
<td>Worker 1.5%</td>
<td>Employer 1.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>Taxes</td>
<td>Taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile a/</td>
<td>Government</td>
<td>Worker: 0.6%</td>
<td>Employer: 2.4%</td>
<td>Government: fix contribution</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Worker 2%</td>
<td>Employer 1%</td>
<td>Worker 2%</td>
<td>Employer 1%</td>
</tr>
<tr>
<td>Uruguay</td>
<td>Social Security</td>
<td>Social Security</td>
<td>up to 50%</td>
<td>up to 50%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Worker 0.7%</td>
<td>Employer 1.5%</td>
<td>Worker 0.7%</td>
<td>Employer 1.5%</td>
</tr>
</tbody>
</table>


*a/ The New Unemployment Insurance Regulations were taken into account.*
Table 5 shows that the processes of reform conducted in the 1995-2000 period were hardly significant.

Argentina made no general reforms to Unemployment Insurance (Law 24.013 of 1991 is still in force),\(^1\) only minor administrative changes were made. Like: modifying the formula used to calculate reference wages for the purpose of calculating benefits (Decree 51/99)) and extending the measurement time up to 36 months in the event that the worker failed to receive his/her remuneration on a regular basis for the last six months previous to the termination of the contract.

Barbados did not undertake important reforms, although a surplus accumulated in the last few years (see Section D.2) raised the possibility of cutting down the contribution rate and make an alternative use of the reserves accumulated in the Unemployment Fund.

In Brazil, the principal reform was carried out in 1994 (Law 8900/94) to increase from 4 to 5 the maximum number of payments to the beneficiaries.

Chile made an important change with the adoption of Law 19.728 of 4/2001, to create an Unemployment Insurance System which has not been implemented yet. The reform consists in replacing unemployment subsidies fully financed with public funds, with a Unemployment Insurance combining individual accounts with a collective insurance through a distributive fund that accumulates tripartite contributions.

Ecuador made no significant reforms during the period under review; just administrative changes regarding the formula used to calculate basic remuneration were undertaken.

Uruguay made no significant reforms.

Venezuela made no reforms in the last few years, but worked on a series of proposals to improve the operations of unemployment insurance on the basis of a model that combines individual accounts with a distributive fund, such as in Chile. Yet, the implementation of these proposals is still pending.

D. Unemployment insurance in Latin America: Case studies

This Section offers a detailed analysis of the principal characteristics of contributory Unemployment Insurance systems and Unemployment Subsidies in the region.

1. Argentina

- Regulatory frame


- Coverage

Dependent employees; excludes domestic service and construction workers, who have a separate system, and those who retire from public service as a result of the implementation of rationalization measures.

- Financial sources

Workers Contribution: 1.5%
Employers Contribution: 1.5%

Besides, the government provides financing through extraordinary allocations of public resources.

- Eligibility

Being in a situation of legal unemployment after a no fault dismissal, and available to perform an adequate job.

Having done contributions to the National Employment Fund during a minimum period of 12 months throughout the previous three years, and 90 days in the last 12 months in the case of workers hired by enterprises that provide temporary services.

Non being entitled to social security or assistance benefits.
- Benefits

60% of the highest salary in the last six months. The total time of the benefits is related to the contributions made in the last three years, according to the following scale: 4 months for contributions between 12 and 24; 8 months for contributions between 24 and 35 and 12 months for workers who contributed 36 months or more. Initial benefits decrease to 85% of the first received benefit starting at the fifth month and 70% starting at the ninth month. Besides a monetary benefit, the worker continues to enjoy health benefits, family allowances and the calculation of the unemployment benefits for social security purposes.

Benefits are subject to a maximum ceiling of US$300 and a minimum of US$150. Under certain conditions (i.e. using benefits to join a work cooperative or other similar organization), the benefits may be provided in a lump-sum.

Benefits are suspended if the worker; does not accept job offers, fails to attend professional training activities offered by the Ministry of Labour and Social Security, is called to mandatory military service, or if sentenced to a jail term.

- System administration

The National Employment Fund is managed by the Ministry of Labour and Social security. Unemployment benefits are granted by the National Social Security Administration (ANSES).

- Principal features

The principal features of Unemployment Insurance in Argentina are as follows:

Low coverage: The following Table shows the average number of monthly beneficiaries of the Insurance between 1995 and 2000.

<table>
<thead>
<tr>
<th>Year</th>
<th>N° of Average Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>122,347</td>
</tr>
<tr>
<td>1996</td>
<td>128,672</td>
</tr>
<tr>
<td>1997</td>
<td>95,379</td>
</tr>
<tr>
<td>1998</td>
<td>90,711</td>
</tr>
<tr>
<td>1999</td>
<td>114,177</td>
</tr>
<tr>
<td>2000</td>
<td>125,537</td>
</tr>
</tbody>
</table>

Source: Labour Ministry of Argentina.

In the same period, total unemployment grew over 1,500,000; this means that, the coverage of the Argentine Unemployment Insurance system is under 10%. Galiani (1999) highlights that, since its creation in 1991, the system’s coverage has never gone over 15% of the unemployed. Some of the reasons for this situation include a high degree of labour market informality (49.3%), which excludes a great number of people from the possibility of enjoying benefits; the fact that a great number of unemployed workers come from a waged job (potential beneficiaries) after leaving a temporary job, thus failing to meet the requisites. Available information indicates that the proportion of waged workers who become unemployed with one or more years of seniority has decreased over the years. What is more, when unemployment starts to become a long term problem, a greater number of workers reach the maximum number of payments and stop being eligible.

Low coverage among low income workers: Mazza (1999) emphasizes the fact that the coverage problem deepens among low income workers as a result of the correlation between informality and remuneration levels. He also points out that in spite of the maximum benefit ceiling, some 16% of the
beneficiaries have previous income over US$1,000 per month (February 1998 figures).

Lack of integration to other programs and benefits: Just like the majority of the countries in the region, the Argentine Unemployment Insurance system works totally unrelated to Seniority Severance Compensation mechanisms. Therefore, a dismissed worker has the right to cash his/her severance payment and enjoy unemployment benefits, provided that he/she stays unemployed. Mazza, (1999) underlines that this may discourage workers to cash their Insurance benefits, which would help explain the current low coverage, specially if, as was explained in Section C.1, the severance benefit represents over 70% of the total benefits enjoyed by the worker. Besides, access requisites with respect to severance compensation are less restrictive than those of the insurance system.

Moreover, there is no relationship between unemployment insurance and other types of programs, such as training. Mazza (1999) says that workers who apply for unemployment insurance benefits find no support regarding job search in other words there is no active intermediary labour component.

2. Barbados
- Regulatory frame

Barbados Unemployment Insurance was created in 1982.

- Coverage

16 to 64 year-old employees, excluding independent employees, family workers and permanent civil servants.

- Financial sources

Workers Contribution: 1.5%
Employers Contribution: 1.5%

- Eligibility

Under 65 years of age with 52 weeks of contributions; 20 weeks of contributions in the last three consecutive quarters with the second last quarter before unemployment; 7 weeks of contributions in the second quarter preceding unemployment.

- Benefits

60% average of insurable income for the first 10 weeks and 40% of the average income for the remaining 16 weeks.

- System administration

The system is managed by the National Insurance Office (NIS), which depends on the Ministry of Labour and Social Security, and also manages other benefits such as maternity leave, professional disease, old age and widowhood.

- Principal features

Barbados is the only country in the Caribbean equipped with Unemployment Insurance System. It was established in 1982 to respond to the country’s 1981 economic crisis (Mazza, 1999).

Black numbers: A remarkable characteristic of Barbados’ system is that unlike the developed countries, the Unemployment Insurance has generated a surplus of financial resources (Mazza, 1999). In fact, the Insurance might work with a significantly lower contribution rate. In this context, it is hardly surprising that Barbados is one of the Caribbean countries that asks only a few access requisites.

In the last few years, Barbados’ authorities have discussed the possibility of cutting down the amount of the contributions or devote accumulated reserves to other purposes.

Lack of integration to other programs and benefits: Just like in Argentina, the Unemployment Insurance operates separately from severance compensation schemes, with no links between the benefits of the respective regimes. However, in this particular case, the proportion of Insurance benefits is higher than that of severance compensation schemes. Following a common practice in the English-speaking Caribbean nations, benefits are determined by means of private contracts, rather than labour legislation. Mazza (1999) says that in spite of the fact that law mandates Insurance beneficiaries to register at the
National Employment Office, compliance with this rule is rather low, essentially because the user service facilities of this agency are relatively small. Unemployment Insurance has no ties at all to training services.

3. Brazil

- Regulatory frame

The Brazilian Unemployment Insurance is a benefit guaranteed by Art. 7th of the Constitution devoted to Social Rights. The current system was established by Law Decree Nº 2284 of 1986 and its statute was established through Decree N° 92608. The latest amendment to Law Decree 2284 was made in 1994, date in which Law N° 8900 entered into force.

- Coverage

Unemployment Insurance covers dependent workers, including rural workers and, under certain circumstances, workers under term contracts or temporary jobs. Domestic service workers, autonomous workers, public servants, workers enjoying scholarships and beneficiaries of the social security regime, are excluded from the system.

- Financial sources

Workers and employers make no contributions. The Unemployment Insurance Program is financed both through a Worker Protection Fund (FAT) and a so-called Salary Voucher created for that purpose.

The Fund’s resources are constituted by funds allocated to a Social Integration Program and a Program for the Development of the Heritage of Public Servants; taxes paid by public enterprises (1% of their revenue) and private enterprises (0.65% or their revenue); interest and penalties and other resources specially allocated to that effect.

The financial management of the Protection Fund is regulated by Law N° 8352 of December 1991. Cunningham (2000) indicates that since its creation, FAT which also provides benefits such as the 13th salary and finances the National Development Bank, has produced surplus resources in spite of having to face critical situations in 1995 and 1998.

- Eligibility

Unemployment benefits are provided to unemployed workers dismissed without just cause, who can prove having earned wages during six consecutive months before the dismissal. Besides, they must have been employed by a physical or legal entity for at least 6 months in the course of the last 36 months preceding the date of dismissal, and have no income to maintain their families.

- Benefits

Benefits, known as “parcelas”, are paid on a monthly basis according to the wages earned in the 3 months preceding unemployment. Benefits are determined using a range of reference salaries \((p,q)\) where \(p\) is the smaller reference salary and \(q\) the higher reference salary. Therefore, the benefit due to a worker with \(W\) remuneration will be:

- Maximum between (minimum \(W\), \(0.8*W\)) if \(W<q\)
- \(0.8*p + 0.5*(W – p)\) if \(p<W<q\)
- \(2*\) minimum \(W\) if \(W>q\)

Thus, benefits are subject to a minimum amount equivalent to a minimum salary and a maximum amount equivalent to twice the minimum salary. The number of payments depend on years of seniority and go from 3 years for workers with 6 to 11 months of formal work in the last 36 months, to 5 years for workers with more than 24 months of formal work in the last 36 months. Before the 1994 reform, only four payments were made (Cunningham, 2000).

- System administration

The Ministry of Labour and Social Security is in charge of unemployment benefits. There is an Advisory Council for FAT called CODEFAT, formed by representatives of the Ministry of Labour, Trade Unions, BANDES (National Development Bank), entrepreneurs and the Social Security Administration. Their roles include expanding unemployment benefits in
those regions where employment problems are more severe.

- **Additional background**

The Brazilian Unemployment Insurance system was originated in 1986, in the frame of a macroeconomic crisis and under the effects of the adjustment process known as Plan Cruzado (Mazza, 1999). At the beginning, conditions to have access to benefits were more restrictive, but the situation changed following the creation of FAT (1998), when the system started to accumulate surplus resources and relaxed access to benefits.

Other interesting features of the Brazilian Unemployment System are as follows:

**Low coverage:** Even after the adoption of flexible standards, high labour informality and the fact that maximum and minimum amounts led to a certain level of self-selection, generated a low 13% beneficiaries/unemployed ratio (Cunningham, 2000). The following table shows the number of benefits paid and the Brazilian beneficiaries-unemployed ratio.

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Beneficiaries</th>
<th>Coverage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>394,593</td>
<td>13.3</td>
</tr>
<tr>
<td>1996</td>
<td>363,250</td>
<td>12.4</td>
</tr>
<tr>
<td>1997</td>
<td>368,750</td>
<td>11.8</td>
</tr>
<tr>
<td>1998</td>
<td>396,833</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Cunningham (2000) based on information provided by CAGED and PNAD.*

**Lack of integration to other programs and benefits:** An important aspect of the Brazilian Protection System is the role played by a Seniority Guarantee Fund (FGTS), as a compensation provisioning system based on individual accounts opened by employers for their workers, to deposit, on a monthly basis, 8% of the remuneration. In the event of dismissal without cause, the employer must pay a 40% penalty over the funds accumulated in the individual account of the dismissed worker. A comparison between the benefits of Unemployment Insurance with those of the Fund, indicated that, in general terms, among high income or high seniority workers, FGTS benefits are much better than those provided by the Unemployment Insurance system. Both benefits are provided separately.

The Unemployment Insurance system has no significant ties to placement services (National Employment System) or training services, even when Mazza (1999) emphasizes the development of a pilot plan to be implemented in Brasilia and Rio de Janeiro.

4. **Chile**

- **Regulatory frame**


- **Coverage**

  **Unemployment subsidy:** Private workers (dependent workers whose activities are regulated by Labour Code Statutes).

  **Unemployment insurance:** Private workers (independent workers whose activities are regulated by Labour Code Statutes), except for domestic service workers (who have a separate protection system). Once the new Unemployment Insurance enters into force, already contracted workers may choose to incorporate themselves into it or not. For newly contracted workers, affiliation to the new system will become mandatory.
- Financial sources

*Unemployment subsidy:* Public funds provide a Single Family Allowance Fund and Unemployment Subsidy

*Unemployment insurance:* Tripartite financing: 0.8% Workers contribution, 2.2% employers contribution, and a public contribution of approximately US$12,000,000 per year.

- Eligibility

*Unemployment subsidy:* Being unemployed and having at least 12 months (constant or not) of consecutive contributions in any social security system.

*Unemployment insurance:* To have access to the resources of the individual account, workers must go through the termination of their labour relation and have 12 months (constant or not) of consecutive contributions to the Insurance System (six months in the case of temporary workers or workers under term contracts). To have access to the Solidarity Fund: 12 months of consecutive contributions, dismissal without cause, having exhausted the funds deposited in the Unemployment Individual Account and not having been benefited by the Insurance more than twice within the last five years.

- Benefits

*Unemployment subsidy:* Fix monthly amount for a maximum of 12 months, according to a decreasing scale (Ch$17,388 per month during the first 3 months, Ch$11,560 between the fourth and sixth months and Ch$8,669 from the seventh month, up to completing 12 months of benefits).

*Unemployment insurance:* Lump-sum benefit for the withdrawal of funds accumulated in the Individual Account in 5 installments, depending on seniority. Dismissal benefit consisting in 5 contributions, 50% of the remuneration for the first month, 45%, 40%, 35% and 30% in the following months (whenever the resources accumulated in the individual account are not enough, funds are provided by the Solidarity Fund). Benefits provided through this fund are subject to maximum and minimum amounts (the maximum benefit amounts to Ch$125,000 for the first month and the minimum amounts to Ch$65,000 for the first month; maximum and minimum amounts decrease on a monthly basis, according to the same scale of percentages).

There are differentiated requisites for term or temporary workers (less time required to get the lump-sum benefit but without access to the benefits of the solidarity fund).

- System administration

*Unemployment subsidy:* Institute for Formalizing Compensation (Instituto de Normalización Previsional) (INP), Family Allowance Fund.

*Unemployment insurance:* Administration of Unemployment Funds, a private entity chosen through a public bidding process.

- Principal background

Following the adoption of Law No 19,728 to create an Unemployment Insurance System, Chile carried out fundamental changes in its social security system, by substituting Unemployment subsidy financed with public funds with an Insurance system financed on a tripartite basis. The structure of the Insurance is an innovative one, since it combines a system of individual accounts that finance lump-sum benefits along with common fund benefits known as the Solidarity Fund.

In a few words, the system accumulates contributions (both, workers contributions and 1.6% of employers contributions) in workers individual accounts. In the event of unemployment, workers may use the funds accumulated in their individual accounts. If they meet other requisites, workers receive a contribution from the Solidarity Fund as well. Such fund is created with an employer’s 0.8% monthly contribution (the resources of the Solidarity Fund are used only when individual funds run out).

Another distinctive feature of the Chilean Insurance System is that, unlike most countries in the region, and even worldwide, the system will be managed by a single private enterprise chosen through a public bidding process, in order to take advantage of management scale economies and avoid high commercials costs. (This scheme is similar to the Bolivian Pension System).
In the last few years, Unemployment subsidy showed a low rate of coverage. (In the year 2000, the service paid an average of 35,874 subsidies per month, against an average of 539,000 unemployed workers per month). These situations derive essentially from the low amounts of the subsidies. Current amounts have not been readjusted since November 1995, resulting in a loss of approximately 30% of their value in the last few years. Presently, the average subsidy is under 15% of the minimum salary.

It should be expected that the coverage of the new Insurance System will be somewhat higher (in particular with respect to the number of affiliates). If the contribution to the new Insurance reached levels similar to those of the Pension System, the coverage of the new system with respect to the total number of employed workers should come close to 50%.

With regard to the issue of links between the system and other labour market programs, the Unemployment Insurance Law mandates the system’s beneficiaries to register at Municipal Labour Information Offices (OMIL).

5. Ecuador

- **Regulatory frame**


- **Type of system**

  Fix social security benefits

- **Coverage**

  Dependent workers in the private and public sectors. Excludes voluntary workers.

- **Financial sources**

  Workers contribution: 2%
  Employers contribution: 1%
  There are no direct public contributions

- **Eligibility**

  Workers must have accumulated 24 monthly contributions and remain unemployed for 60 days.

- **Benefits**

  A fix amount determined in accordance with income and seniority. Survival Benefits are provided in the event of the death of a beneficiary.

- **System administration**

  The general supervision of the system is the responsibility of an advisory Council headed by the Minister of Social Welfare. The Ecuadorian Institute of Social Security is in charge of managing the system.

- **Principal background**

  *Fix benefits*: One of the main characteristics of the Ecuadorian Unemployment Insurance System consists in providing fix benefits. While this procedure is similar to the compensation provisioning system, two fundamental differences may be recorded: lump-sum compensation, (including workers dismissed without cause), and a 60-day waiting period to request unemployment benefits. Hence, workers who desert their jobs and find employment within the waiting period are non entitled to benefits.

6. Uruguay

- **Legal frame**

  The current system was established by Law N° 15,180 of August 20, 1981; its Statute was adopted by means of Decree 14/82 of January 19, 1982.

- **Coverage**

  Dependent workers in the private sector (commerce, industry, construction and services
that are not covered by the social security system; bank employees and domestic service workers are excluded.

- Financial sources

Contributions to the Social Security system (15% on the workers and 12.5% on the employers) to finance old age benefits, disability, widowhood, occupational accidents, maternity leave, family allowances and unemployment). The system’s deficits are financed with public money.¹⁹

- Eligibility

Unemployment benefits consist in a monthly cash payment to workers dismissed for reasons unrelated to their will or labour capacities (except in the event of a dismissal for disciplinary reasons). Unemployed workers must prove having worked at least 180 days in the last 12 months (150 day’s wage for workers who are remunerated by the day or by the hour). Workers who have variable remuneration must have earned at least six minimum monthly salaries.

Article 10° of Law 15.180 refers to special unemployment in the case of highly specialized professional and empowers the Executive Branch to establish, for reasons of general interest, a total or partial unemployment subsidy for this kind of workers. The subsidy granted on these grounds may not exceed 80% of the monthly average of computable remuneration and its duration may not exceed of one year.

- Benefits

Fix or variable monthly remuneration equivalent to 50% of the average monthly nominal remuneration earned in the six months preceding unemployment. A minimum limit is established corresponding to 50% of the minimum wage, along with a 20% supplement for workers who are head of a household. The maximum amount of the benefits consists in 8 minimum national salaries; the minimum floor amounts to 50% of the national minimum salary.

Workers who receive unemployment benefits continue to be entitled to other social security benefits, such as family allowances, and remain affiliated to the health insurance system.

Unemployment benefits elapse after six months; by virtue of the reentry of the worker into the labour market; due to his/her refusal to accept a convenient employment without a legitimate reason; and because the worker reached retirement.

- System administration

The system is administrated by the Social Insurance Bank (BPS), whose Board of directors is formed by 4 representatives of the Executive Branch, as well as representatives of workers, employers and retired workers.

- Additional background

Unemployment Insurance was first established in Uruguay in 1934, which makes it one of the pioneering institutions of this kind in the whole region. Its present regulatory set up was implemented in 1981.

Low coverage: Just like other countries in the region, the Uruguayan ratio between beneficiaries and unemployed workers is a low one, but nevertheless higher than in other countries. In fact, in the April-June period of 2001, unemployment reached 224,000 in Uruguay, while the number of benefits provided in June by the Social Insurance Bank topped 32,881, or a coverage ratio of 14.7%.

7. Venezuela

- Regulatory frame

Unemployment Insurance was established in Venezuela in 1989 (Decree N° 449, of September 2) and is regulated by the Statute of Social Insurance for the Contingency of Forced Unemployment; Decree N° 1086, August 23, 1990.

- Coverage

Employees in the public and private sectors. Excludes workers who enjoy old age pensions, disabled or retired workers; temporary, occasional and casual workers; domestic service workers and workers who make house-calls.
- **Financial sources**
  
  Workers Contribution: 0.5%
  Employers Contribution: 1.7%

  The limit of the maximum salary to contribute to the system is 5 minimum salaries.
  
  The government finances management expenses and provides additional resources in the event of any shortfalls.

- **Eligibility**

  Being unemployed against one’s will and having contributed to the Insurance System for 52 weeks for the last 18 month preceding the date of the termination of the labour relation.

- **Benefits**

  Weekly compensation equivalent to 60% of the reference salary for a period of 18 weeks that may be prolonged up to 26 weeks if the worker is under training. Includes a transport bonus. Both the unemployed worker and his/her family are entitled to 26 weeks of health care under the same conditions of active workers.

  A minimum benefit amounting to 60% of the current minimum salary applies.

- **System administration**

  The administration of the Unemployment Insurance is in the hands of the Venezuelan Institute of Social Insurance and the Ministry of Labour.

- **Principal background**

  Just like the rest of the evidence presented in this report, the Venezuelan Unemployment Insurance is also characterized by a low level of coverage. According to the Venezuelan Institute of Social Insurance, in 1999 the beneficiaries of the Insurance represented 7.2% of the unemployed. Due to this and other problems detected in the system (evasion and delay of contributions and poor development of the training and intermediary labour components), a reform of the system has been proposed, but no measures to this end have been implemented so far.

- **Notes**

  1. The correct term should be Unemployment Assistance instead of Unemployment Insurance. However, since the latter is most commonly used both in the legislative field and among scholars, it will be used throughout this document.
  2. Tzannatos and Roddis (1998) analyzed the financial sources of 66 unemployment insurance systems throughout the world, finding out that 4 countries have a financial scheme based exclusively on the contributions of employers; 6 that chose a fully public scheme; 13 that use a bipartite system (employer/worker); 38 countries that combined the contributions of employers, workers and the State. In this set up, 21 governments provide fix contributions and other 17 take care of the systems’ liabilities.
  5. Under the assumption that the interest rate equals the personal discount rate.
  7. See also Gunderson and Riddell (1995).
  8. This is a non contributory subsidy that will be replaced in the next few years, following the implementation of a new Unemployment Insurance system (see Section D).
  9. Mexico has a very limited unemployment protection system that covers unemployed workers between 60 and 64 years; therefore, it will not be reviewed in this analysis.
  10. Even considering the labour and social security areas as a whole, the number of countries that have implemented reforms is smaller than in other sectors of the economy, such as financing, trade, liberalization of capital accounts and privatization (Lora y and Pagés, 1996).
  11. The only exception occurs in the english speaking Carribean nations, where private arrangements are prevalent rather than legislation which, comparatively, imposes limited duties (Márquez and Pagés, 1998; Lora and Pagés, 1996).
  12. See Section D for a detailed analysis of benefits and requisites by country.
  14. Other aspects changed in the last 10 years are the introduction of new hiring arrangements, collective bargaining, minimum wage, flexible
hours and the introduction of conflict resolution mechanisms.
16 See Section E-3.
17 Later on (August 2001) a significant reform was carried out in order to establish a single 16% contribution rate on the part of the employers, such as in the Uruguayan system.
18 Up to 1987, employers provided a 2% contribution to the Fund.
19 Up to 1979, the system was financed through bipartite contributions (OAS, 1999).
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