



*Inter-American Development Bank
Banco Interamericano de Desarrollo (BID)
Research department
Departamento de investigación
Working Paper # 411*

UNEMPLOYMENT INSURANCE: CASE STUDIES AND LESSONS FOR LATIN AMERICA AND THE CARIBBEAN

by

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March 2000

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Executive Summary

Latin American and Caribbean nations are giving greater attention to the kinds of labor market programs and policies that might best support the region's transition and integration into a more global marketplace. The labor force of the future will need to be both more highly skilled and more flexible to changing employment. Would unemployment insurance (UI), which provides workers with transitional income until they find new work, be an appropriate and useful instrument in Latin America and the Caribbean? The region and the developing world as a whole have had very limited experience with UI; it has largely been conceived of as an industrial country program.

This study examines unemployment insurance (UI) for its potential application and implications for Latin American and Caribbean economies. It surveys current experience with unemployment insurance programs through case studies and draws lessons learned in particular for the Latin American and Caribbean region. Seven case studies are examined: three within the region (Argentina, Barbados, and Brazil) and four outside (Japan, Germany, Poland, and the United States). The study also examines a specific sub-issue regarding the financing of training through unemployment insurance revenues.

From a distance, unemployment insurance appears to be a similar instrument in every country. It provides income support in the form of weekly or monthly payments to recently laid-off workers to enable them to seek new employment. Yet from this common structure, UI programs can vary substantially in the eligibility of workers, the level and length of benefits, and the type of administration. Most important, while UI may have a similar form across countries, the national objectives sought by instituting the program can be quite different. The issue of the specific objective of a UI program is particularly relevant to whether it makes sense for a Latin American or Caribbean economy.

Overall, the study concludes that unemployment insurance is not *a priori* broadly applicable to the region. Rather, a decision for each individual country within the region should be made based on national labor market needs and conditions and the desired national objective of unemployment insurance. There are likely, the study concludes, countries in the region where unemployment insurance would be appropriate but great attention is required to the details of design, objectives, and execution. The most likely profile of a country where UI should be considered is one undergoing substantial volatility of formal sector employment, where the informal sector is not large, and where administrative capabilities are sufficient to carry out the program. It can also be useful to countries with high rates of seasonal unemployment such as Caribbean economies.

A. Clarity of Objectives of UI Critical for Latin America and the Caribbean

The study reviews four principal objectives sought in current unemployment insurance systems: 1) income replacement/reward labor force attachment; 2) social safety net; 3) macroeconomic stabilization; and, 4) labor market restructuring and transition.

Given regional concerns regarding high levels of poverty and income inequality, one might assume that the social safety net goal would be the most appropriate and applicable one to the region. The study concludes instead that unemployment insurance is most applicable to the region as a labor market transition tool for the formal sector and least applicable as either a wide social safety net or tool for macroeconomic stabilization. Using information from the case studies, the study demonstrates that unemployment insurance typically does not serve the poor, but rather middle-income workers. The low participation of the poor in unemployment insurance would be further accentuated in many countries in the region with large informal sectors. The study stresses the importance for the region of clarifying specific national objectives sought for UI within a national labor market system, rather than seeing UI as a short-term response to an economic crisis as has been the case in a number of countries.

B. Key Regional Factors for Considering UI Systems

The report identifies a number of key regional characteristics that are important to deciding whether and what kind of unemployment insurance system might best fit a country in the region. These regional characteristics exist in varying degrees among countries in the region. In a number of cases, the study recommends design features that can compensate for these factors.

The *first factor* to be considered is the presence of a large informal sector. The report emphasizes that little study has been conducted about the interaction of UI in dual labor markets (informal/formal). The preliminary evidence gathered from Latin American and Eastern European cases is that the presence of a large informal sector may undermine the utility of UI, by making it impossible to insure that recipients are looking for new work, and may provide perverse incentives to increase further the informal sector. The presence of a large informal sector greatly weakens the ability of UI to serve either as a social safety net or a macroeconomic stabilization tool.

A *second factor* to be considered in designing a UI system in the region is the level of payroll and other labor taxes. In some cases in the region, UI would need to be part of an overall restructuring and labor market reform to insure that additional UI taxes did not unduly disadvantage labor and discourage business investment. A *third factor* to be considered is the extent of severance pay or other termination benefits already in place and how they would potentially interact with UI. In many OECD countries where the first UI programs were created, there were fewer nationally-mandated termination benefits. The study recommends that countries in the region with nationally-mandated benefits review these benefits simultaneously with consideration of UI, so that one benefit does not contradict, dwarf, or undermine the other as is seen in some of the case studies.

The *fourth factor* identified in the study of particular importance to the Latin American and Caribbean region is whether and how to cover unemployed youth. Youth unemployment rates are typically high in the region, and depending on how UI eligibility is set, the bulk of the UI program could, inadvertently, end up serving a youth population. Experts are concerned that income benefits from UI, delivered without training or other employment

assistance, can have corrosive effects on the young who have not yet established initial work skills and habits. In Latin American and Caribbean countries with high youth unemployment, the study recommends particular attention to the eligibility criteria of UI and the use of youth-oriented employment programs rather than UI to address the problem of youth unemployment.

C. UI and the Financing of Training

A large number of the existing UI systems permit recipients to obtain training/retraining while receiving unemployment insurance benefits. It is far rarer that unemployment insurance revenues are specifically used to finance training programs; typically unemployment insurance and training have distinct revenue sources. Unemployment insurance payouts are usually so large and cyclical that there is little surplus to fund other types of programs.

While no system finances training through UI revenues, the study identifies two existing types of models that relate the financing of training with UI. One is the "large pool" model in which UI payroll taxes are pooled with other sources (including government tax revenues) into one fund which finances UI, training, and other initiatives. Germany and to a lesser extent Argentina fit this model. The second is the "small pool" or "developmental uses of UI" model in which a small portion of UI revenues is used to fund limited training or employment creation initiatives. Japan fits this model.

While there are some interesting features to the small pool model, in neither the large nor small pool cases do UI funds finance the bulk of a nation's training system. Quite simply, the demands on UI revenues are too substantial and increase countercyclically during economic downturns just when you would want to spend more on training. This makes UI an unreliable source for financing training. UI revenues to fund a nation's principal training programs would be both fiscally and programmatically unsound.

I. Unemployment Insurance: An Overview and Introduction

Unemployment insurance (UI) provides short-term financial support to workers who are laid off from their jobs, typically through no fault of their own. It has become a common program in the advanced industrialized countries, but to date relatively rare in the developing world. Reflecting this trend, unemployment insurance is rare in Latin America and the Caribbean. Currently, seven countries in the region have some form of unemployment insurance¹ and even within this group a number of programs are extremely limited or under revision.

As many countries in the region are beginning to examine potential areas for labor market changes and reform, one question is whether unemployment insurance is an appropriate and useful instrument in the Latin American and Caribbean context. Many Eastern European countries, for example, have adopted unemployment insurance systems within the last 5-10 years to cushion the shock of major job layoffs and market reforms. But is unemployment insurance suitable for Latin American and Caribbean labor markets? What sorts of roles does UI play in other economies and are those priorities in the region? What lessons are learned from past experience that may be relevant to Latin America and the Caribbean?

This study explores seven diverse cases of unemployment insurance around the world: three within the region (Argentina, Brazil, and Barbados) and four outside (Germany, Japan, Poland, and the United States). In each case, it strives to understand the origins of the program, its key attributes (eligibility, benefits, requirements), and how it operates. The intention of surveying a diversity of experience is to draw potential lessons for Latin American and Caribbean countries in considering whether UI, or what form of UI, might be appropriate within the particular regional/national policy context.

The study also reviews a related question relevant to UI prospects in the region. Specifically it examines the financial relationship between unemployment insurance revenues and labor market training initiatives. Are UI revenues a vehicle for funding other labor market programs? Chapter 3 discusses international experience with UI and the financing of training and related labor market programs.

This first chapter provides an overview and introduction to unemployment insurance systems as a foundation for more detailed examination of country cases in Chapter II. It surveys the incidence and occurrence of UI worldwide, its principal purposes, and types of programs and benefits. The final chapter provides recommendations and lessons learned for Latin American and Caribbean countries.

¹ The IDB report identifies: Argentina, Brazil, Barbados, Chile, Ecuador, Uruguay, and Venezuela. It also cites Mexico; however, the Mexican program is only for pre-retirees from ages 60-65. *Economic and Social Progress in Latin America: 1996* (Washington, DC: Inter-American Development Bank, 1996).

A. Unemployment Insurance: Purposes and Objectives

Unemployment insurance provides cash benefits to workers who have had some work history and have become recently unemployed. It is intended to replace lost income and provide a cushion until workers can find new employment; once a new job is secured, benefits are to be terminated. While having a similar basic function across countries, there are actually different objectives that may motivate and determine the kind of unemployment insurance program a country pursues. Unemployment insurance systems have typically tended to meet some, or many of the following objectives for a country:

- **Income replacement/reward labor force attachment:** A very common aim for unemployment insurance is to cushion workers in the short-term transition to new employment. The intention is to reward not every unemployed worker, but only those who have typically paid into the unemployment scheme and demonstrated significant labor force attachment and investment by time spent in employment. An important motivation in OECD countries is that UI would enable workers to hold out for higher paying work more suited to their skill level.
- **Social safety net:** Many programs also contain the objective of preventing a segment of the workforce from slipping into poverty due to unemployment. This objective has great variability among programs, as, depending on the country, only a segment of eligible unemployed workers would likely be near the poverty line. Programs that emphasize a social safety net objective typically provide a low-level of benefits, rather than seek to replace a high percentage of previous income.
- **Macroeconomic stabilization:** UI can be intended to serve a broader function of stabilizing the economy during downturns or depression, providing the means to maintain consumer spending and improve welfare. This macroeconomic impact has been difficult to measure to date. But in principle, to meet this objective, a UI system would need to be comprehensive, seek to cover a large percentage of the unemployed workforce, and have enough reserves to finance payments in economic downturns. Some of the earliest UI systems such as that of the United States grew out of the experience of the 1930s depression and sought to cushion downward cyclical trends.
- **Promote restructuring/efficiency:** In countries undergoing large layoffs and adjustments to market changes, unemployment insurance can be seen as a way to reduce workers' resistance to such changes and facilitate the transition. This was an important motivation behind the enactment of UI systems in Eastern Europe.

It is important to keep these differences in objectives in mind in reviewing the variations in country programs in place today as the objectives sought influence greatly the actual program design.

B. Differentiation between UI and Other Job Termination Assistance

This study deals specifically and exclusively with unemployment insurance, but, depending on the nature of the layoff, there may be other cash benefits that a worker may receive upon job termination. This is particularly true in Latin American and Caribbean countries that have enacted national requirements for the payment of severance payments and/or compensation for unjust dismissal.² It is important to understand what compensation is available and its purpose in each country before deciding on the appropriate policy mix. In principle, severance payments and compensation for unjust dismissal have different objectives than unemployment insurance, but in practice they seem to act similarly in that they all provide cash benefits to workers when laid off from employment.

Compensation for unjust dismissal is intended to discourage employers from firing workers arbitrarily, such as for organizing a trade union. It is intended to serve as a penalty to employers as well as compensation to workers who have unfairly lost employment. In some countries, economic and market factors may not be considered grounds for unjust dismissal and thus eligibility for benefits can be fairly broad. Severance payments are more specific and usually not as broadly legislated on a national basis. **Severance payments** seek to reward a worker's long-term investment and commitment to a firm and vary with the amount of years a worker has been employed. They typically vary with number of years on the job -- the longer the longevity, the greater the payment for investment in the firm. Severance payments are typically made in one lump sum, while unemployment insurance is received periodically (weekly/biweekly) as it mirrors a worker's former paycheck and continues only until a worker finds a new job.

While distinct in objectives served, job termination payments and unemployment insurance occur together in practice. Because they are funds received upon firing, severance payments do help cushion a worker's loss of income in the immediate period following unemployment even if that is not their primary purpose.

Countries vary as to whether they have all, some, or none of any other type of termination compensation. In countries like the United States, unemployment insurance is the more widely received benefit, and only through collective bargaining agreements may workers also be eligible for severance or unjust dismissal pay. Conversely, most countries in Latin America and the Caribbean have requirements for payments due to unjustified dismissal and a more limited number have severance payments, some quite generous. In some Latin American countries (e.g., Argentina, Brazil), severance payments may far exceed what a worker might receive in unemployment insurance. Thus, while not the subject of this study, it is important to understand the availability of other job termination benefits and their policy

²In some countries, largely OECD countries, these may be provided through collective bargaining agreements.

role, to frame and understand the most appropriate policy mix for any one country. This study discusses severance pay/job termination benefits in select case studies as relevant. It then incorporates lessons from these cases in the concluding chapter.

C. UI: International Trends

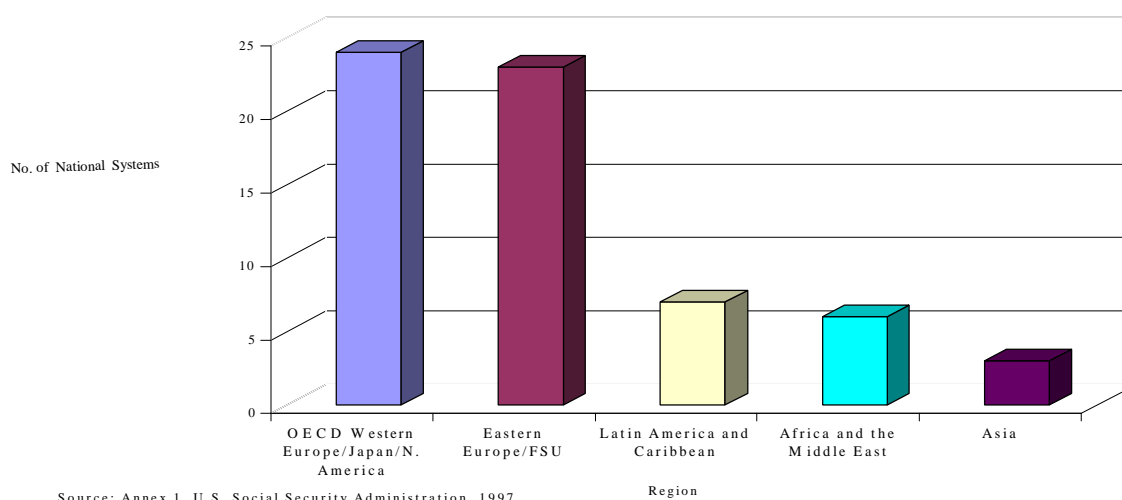
This data confirms the general perception that unemployment insurance is a common feature of the industrialized nations of the OECD. These countries have the majority and longest standing programs in the world, with the first programs developed in Great Britain, Germany, and the United States at the turn of the century.

Since the end of WWII, there has been a growth of unemployment programs, spreading more to the higher income developing countries. There were only 21 such programs in 1940, but 34 in 1967, 40 in 1987, and 68 in 1997.³ Figure 1 summarizes the geographic distribution of UI programs by region. The largest recent growth of UI programs has been in Eastern Europe and among the states of the former Soviet Union (FSU). Figure 1 confirms that, outside of Eastern Europe and the FSU, (23 programs), that UI programs are extremely rare in the developing world with only six programs in Africa and the Middle East, three in Asia and, seven programs in Latin America and the Caribbean.

There are many reasons why unemployment insurance has been less prevalent in the developing world. Even though these systems are principally self-financed by contributions of employers and workers, UI programs particularly can be among the most costly of labor market programs and target a population, that in a developing country context, is not the neediest. Proportionately the very poor have less stable job histories, are in informal (unprotected) employment, and thus are often ineligible for UI. While a segment of UI recipients may be poor, in most OECD countries, UI recipients are at the median income level. In most OECD countries, there are both social welfare/assistance programs for the poor and unemployment benefits, and UI is perceived to address a different and distinct set of economic needs, not those of the poorest. UI systems require as well an extensive administrative apparatus both to collect contributions and distribute benefits and much of this depends on extensive and well-working government services.

³Zafiris Tzannatos and Suzanne Roddis, *Unemployment Benefits: Draft 1* (Washington, DC: The World Bank, Social Protection Unit, May 5, 1998), 3.

Figure I
UNEMPLOYMENT INSURANCE SYSTEM BY REGION



Source: Annex I, U.S. Social Security Administration, 1997.

D. Unemployment Insurance and Unemployment in Latin America and the Caribbean

The need to look beyond the region for experience and lessons on unemployment insurance is important because the more extensive and longer-term experience is outside the region. Nearly all of the seven programs in the region currently were designed in the 1980s or 1990s, a number resulting as a response to an economic crisis. A few of these programs were too small (e.g., Chile) or too unlike traditional unemployment insurance (e.g., Ecuador which makes a single payment) to be appropriate for drawing broader lessons. Other systems, like those of Venezuela and Chile, are being reconsidered nationally. Latin America/Caribbean experience is highly concentrated as well: Barbados has the only UI program in the Caribbean; there are no programs in Central America; and, the few existing programs are predominantly in the Southern Cone. Rarely has unemployment insurance in the region been a large program on the scale of an OECD-type system. Brazil, with the largest program in the region, would be an exception to this, largely by the sheer size of its workforce.

As unemployment has become a greater concern within the region, and considered a more permanent feature of market-led economies, there has been interest in considering alternative approaches to protecting workers from unemployment. In Chile, there is much discussion around a proposal to create individual savings accounts for use during unemployment. The region has some experience in the individual account approach in the Brazilian FGTS (*Fundo de Garantia do Tempo de Serviço*) as well as in a smaller UI program in Argentina for the construction sector. In Argentina, to protect against the high rotation in the construction sector, employers pay into individual accounts for each

worker, which the worker receives on termination. These systems have the advantage of greater transparency (workers can invest in or see contributions placed in their name) and greater predictability in availability of funds.

The IDB supported the design of a comprehensive reform of the Venezuelan social security system that included a proposed reform of the unemployment insurance system. The UI system as designed under the IDB loan provided two accounts: one of individual accounts for each worker and the other a common solidarity fund from which recently unemployed workers, without much accumulated in their individual accounts, can "borrow" on their future account. Its design features draw on current discussions within Chile regarding individual account models. The Venezuelan reform would require a greater commitment of resources from both employers and workers (4% combined of payroll/wages). The redesigned system is pending with the current Venezuelan Congress and new government. These trends in the region suggest an important moment in time to evaluate international experience for its lessons and applicability to the Latin American context.

The region's dramatic opening to international competition and deregulation of domestic markets has raised the specter that workers more and more will be exposed to higher rates of unemployment and labor instability. Public sector employment is falling throughout the region and this has been traditionally an area of great employment stability. Official unemployment rates, in fact, have not dropped in the region which might have been expected given higher economic growth rates and a slowing down of the increase in the labor supply from the latter half of the 1980s. The average rate of official unemployment (formal sector) has fluctuated around 10%. However, this does not account for the greater perceived problems of unstable informal sector employment (in some Latin nations up to 50% of the workforce) and under or sub-employment.

While poverty, income inequality, and low wages have been persistent concerns within the region, unemployment is now rising to become one of the region's top concerns. In recent surveys, seven out of ten Latin Americans are concerned or very concerned they will lose their jobs or become unemployed within the next year; 19 out of every 100 think Latin America's biggest problem is unemployment, exceeding those of low wages, poverty and inflation. Latin American employers, in contrast, see greater problems with the quality of labor supply (e.g., the level of education and training), than unemployment.⁴ Concern about unemployment is greater in the region where there is a higher level of informal sector employment and greater employment in more volatile non-tradable goods (e.g., construction and services).

⁴As quoted in Eduardo Lora and Gustavo Márquez, "The Employment Problems in Latin America: Perceptions and Stylized Facts?" in *Employment in Latin America: What is the Problem and How to Address It?* (Washington, DC: Proceedings of seminar at the Inter-American Development Bank, May 14, 1998), 3.

E. UI Programs: Financing, Types, and Design Features

Whether in an industrialized or developing country, unemployment insurance exhibits variation along a range of similar, key attributes. There is substantial variability in terms of who benefits and how generously, how programs are financed, and what function unemployment insurance serves in the countries' labor market and macroeconomic policy mix. Variability continues further in how unemployment insurance -- a so-called passive labor market policy -- is integrated or linked to active policies such as job training, job search assistance, and wage subsidies which seek to directly connect workers to new jobs or upgrade their skills.

Below is a brief review of some key attributes of UI programs as a foundation for examining the specific country case studies in Chapter II.

1. Financing

Broadly, unemployment insurance is run by pooling funds that are then paid out periodically to beneficiaries as they become unemployed. There are three principal ways that funds are financed: employer/employee contributions (or just employer contributions); government financing from general revenues; or, a mixed system of part contributions, part government revenues. Funds are either "forward financed" -- that is funds are accumulated in good years to pay for years when unemployment is high -- or "pay-as-you-go" in which funds are accumulated to pay for current demands. Under a pay-as-you-go system, contributions may need to be increased or benefits curtailed in times of high unemployment in order not to go into deficit. This countercyclical effect must be taken into consideration in designing the most appropriate system for a country, particularly if macroeconomic stabilization is an objective sought through UI. Annex I summarizes the financing type for each UI system worldwide, with the larger number of systems paid through employer and employee contributions.

The insurance feature of UI comes via its self-financing mechanism. In the majority of countries, employers and workers contribute, or pay premiums into, a system which only the unemployed worker draws on should they lose their job. Like auto insurance, not every contributor draws benefits, only a percentage who incur misfortune. There are a minority of systems which are financed through general government revenues, but they retain at least the insurance feature that only the unemployed under specified conditions receive benefits. Nonetheless, it is more appropriate to call government-financed programs "unemployment benefit" rather than insurance programs as the self-insurance feature is removed.

In mixed systems, government revenues play very different roles. In some, government revenues are used periodically only when the insurance program runs into deficit or additional benefits are to be provided (e.g., United States for extended benefits). In others, government revenues finance a particular component of the UI program (e.g., Japan). In a

number of cases, government financing can be up to two-thirds of program costs. Most cases of unemployment insurance are compulsory -- companies and workers are legally required to pay into the program. There are a number of cases of non-compulsory systems where UI is organized on an industry/union basis; this is more typical for Nordic countries.

2. Types of Unemployment Benefits

Unemployment benefits can typically be apportioned in three generic ways, by:

- a) **Earnings-related benefits.** Benefit levels are tied to some percentage of the recipient's previous earnings; thus, higher income individuals earn higher UI benefits to compensate for lost income. Typically a system might set a minimum and maximum level of benefits using this method. Country examples: United States, most European/OECD systems.
- b) **Flat-rate benefits.** Benefit levels are set at one low level and do not vary with a recipient's previous income. There may be some variation for family size or other trait. Country examples: Poland, generally developing country systems.
- c) **Income-tested benefits.** Benefits depend on **current** individual, and (more likely) family income. This means, for example, that spousal and investment income are taken into account for eligibility. This type of means test is more typical for welfare-social assistance programs, in Germany, for example, unemployment assistance using income-tested benefits as distinct from German unemployment insurance that uses the earnings-related model. Means testing requires more complicated administration and oversight.

The Latin American and Caribbean cases profiled in this study typically use earningsrelated benefits, but in some cases constrain the maximum rate available, so that the effect is closer to a flat rate benefit (e.g., see case study for Argentina).

3. Amount and Length of Benefits

The amount that UI replaces a worker's former income, the replacement rate, varies markedly even among the OECD countries. Its variability is due to differences in the percent of income initially covered, how income is calculated, whether such benefits are taxed, and what ceilings or other restrictions may be in place.

Unemployment insurance varies markedly as well as to how long workers are covered in their transitional job search. Workers can be covered as short as 3-5 months in Brazil to indefinite periods in some Western European countries such as Belgium. Some European countries set defined periods for receiving unemployment insurance, but have longer, or even indefinite periods, for unemployment assistance that functions more like welfare payments (e.g., Germany).

Gross unemployment benefits typically range from 40-75% of average earnings, though most are capped at the higher income levels. More important for international comparison are the actual net replacement rates, taking into account different country level benefits, restrictions, and weights for length of benefits. The OECD has struggled to develop increasingly more accurate measures of gross replacement rates. Recent data shows a remarkable range in gross replacement rates among OECD nations. These rates range from the high end of 81% (Denmark)/69% (Netherlands) to the low end of 20% for the United States⁵ and Italy.⁶ The low end of replacement rates call into question whether UI truly represents an instrument for maintenance of workers' current living standards.

4. Dilemmas of Work Incentives

One key question continually raised with unemployment insurance is the danger that too generous benefits may discourage workers from returning to work, or at least to wait out the period of benefits before doing so. This is often termed "moral hazard." Some portion of this disincentive to return to work is typically controlled through benefits levels, duration of benefits, and work search requirements. Research on the adverse effects on work incentives has found a very small positive relationship, but it is not typically considered to be very significant and seems more dependent on overall macroeconomic conditions than on the UI program itself.⁷ The effect on work patterns has been found to be more troublesome for new entrants, who in some European systems are eligible for UI with little work history.⁸

5. Administration

Efficient administration is extremely important in meeting most of the key objectives of unemployment insurance. Without an efficient administrative structure to provide workers timely and appropriate payments, objectives for immediate income replacement and reduction of poverty rates, or macroeconomic stabilization cannot be met.

While UI may be more commonly paid for by taxes on employers and workers, it is typically administered by government, not private agencies. There is the case of union administration of UI in Sweden, and some countries have sector or employer-managed systems but these are less common. Administration typically requires the provision of weekly to monthly benefits in a network of offices throughout the country. Some offices are strictly used for unemployment insurance payments; many combine UI within another government agency or Labor Ministry office.

With this brief overview in mind, the following chapters look in more detail at each of seven different unemployment systems worldwide. It examines the policy context for the

⁵This is a U.S. average; replacement rates vary markedly among U.S. states.

⁶John Martin, "Measures of Replacement Rates for the Purpose of International Comparisons: A Note," OECD Economic Studies No. 26, 1996/I, 107.

⁷Tzannatos and Roddis, *Unemployment Benefits*.

⁸Joan Wills, telephone interview.

origins of each program as well as the benefit levels and coverage of the program, and highlights key features of program operation.

II. Case Studies Of Unemployment Insurance Programs

This chapter surveys a diverse range of national unemployment insurance (UI) programs to better understand how such programs operate in their national contexts and how they serve the target populations. These different national experiences will be drawn on to identify potential lessons learned of relevance to Latin American and Caribbean economies. Each case study will review the origins of the specific national unemployment system; analyze key program characteristics, including: the level and type of benefits and the nature of the beneficiaries receiving funds; review the financing of the system; examine its administration; and, discuss the broader labor market context in which the UI program operates. While key observations are listed with each case study, the final chapter (IV) will specifically bring together the lessons learned and conclusions from these cases for Latin American and Caribbean countries.

Of the case studies examined in this section, three are within the Latin American and Caribbean region, Argentina, Brazil, and Barbados, and four are outside, the United States, Japan, Germany and Poland. These case studies were selected based on a memorandum to the sponsors of the study that sought to identify a diverse pool of case studies which could provide a range of inputs and lessons learned for Latin America. In particular, these case studies offer some interesting distinctions:

- **Argentina.** A more recent (1992) Latin American unemployment insurance system directed towards a comparatively small beneficiary pool.
- **Barbados.** The only unemployment insurance system operating in the Caribbean with eligibility features adapted to an island economy.
- **Brazil.** The largest UI system in Latin America (in terms of beneficiaries) with relatively short benefits (3-5 months) funded via a worker fund (employer/employee contributions).
- **Germany.** An industrial country, integrated system that combines unemployment insurance, unemployment assistance with job training and placement for the unemployed.
- **Japan.** A relatively unique combination of unemployment benefits and smaller "services" intended to prevent unemployment and retain workers in place.
- **Poland.** An unemployment insurance system instituted in the midst of dramatic economic transition to ease large anticipated unemployment.

- **United States.** A program of long standing, but relatively unique in its operation at the state, rather than national level. The U.S. system has another relatively rare feature in that it calculates employer contributions on "experience rating": the more an employer generates unemployment, the higher their rate of contribution to unemployment insurance.

Following are seven case studies in alphabetical order. These case studies are not intended to be exhaustive or uniform in content. Rather the intention is to summarize national experience and draw out particular salient characteristics that are instructive to other nations. Chapter three explores the particular question of financing training and unemployment insurance, drawing on the case study experience. It should be emphasized that these case studies were largely conducted based on literature reviews and phone interviews. Only the three Latin American and Caribbean case studies benefit from on-site research.

A. ARGENTINA

1. Origins of the System

Argentina's UI system is comparatively recent. It was enacted in 1992 in the wake of a macroeconomic crisis that raised the prospect of large-scale, official unemployment. Ex-Labor Minister Armando Caro Figueroa explains that in 1991-92, unions and the country were just beginning to shift from the image of full employment to a recognition of official, sometimes large-scale unemployment that accompanied economic crisis.⁹ As one trade union official explained it, UI was a benefit that the unions accepted as part of a package of responses to the crisis: "...it was a time of shock, inflation was very high."¹⁰

To administrate the program, government officials turned to the social security system, in particular the *Asignaciones Familiares* program, a family assistance program, since it had in place a national network of offices and was used to managing monthly checks and processing beneficiaries. The program continues to remain under the administration of the social security system, ANSES (Administración Nacional de la Seguridad Nacional). ANSES is a decentralized agency reporting to the Ministry of Labor and Social Security.

2. Financing

The program is financed by a 1.5% tax on employers and a 1% salary contribution by workers.

3. Current Labor Market Demands

The Argentine UI system serves a relatively small population -- roughly 100-125,000/workers per month, an estimated 300,000 workers per year. This represents only

⁹ Armando Caro Figueroa, interview with the author, 5 May 1998.

¹⁰ Alberto Tomassone, Argentine Federation of Commercial and Service Workers (FAECYS), interview with the author, 6 May 1998.

about 15% of the officially unemployed workforce of two million. Table 2.1 shows that from 1994 on, after the initial establishment of the program, the number of workers served per month varied by only 30,000 workers from 98,513 workers/month in 1994 to a high of 128,672 in 1997.

4. Program Characteristics: Benefit Levels, Eligibility, and Analysis of Beneficiaries

Eligibility. From the outset, the Argentine UI system was intended to apply to only a segment of the labor force. Public sector workers, domestics, and the self-employed were explicitly excluded. There is a separate program for construction workers instituted in 1967. As construction is a sector that typically draws heavily on unemployment insurance, this further keeps the level of beneficiaries down. As in all UI systems, informal sector workers are not eligible. This came to be an increasingly important characteristic that limited the applicability of the program, as over the time period from 1992 to today, the informal sector in Argentina has grown from approximately 25% to 40% in 1998.¹¹ For those who qualify in terms of the sector, they must have worked at least 12 months out of the last 36 months and must have been laid off from their jobs due to no fault of their own (*sin justa causa*).

Benefit Levels. Workers are eligible for four to twelve months of assistance, depending on how many years they have been working before the layoff. The minimum benefit of four months goes to those with only a year of employment in their former job; there are eight months of benefits for those who have between two-three years at their former job. The maximum benefit of one year of insurance payments goes to those with three or more years on their former job.

Technically, workers can receive anywhere from \$150 pesos/month to \$300 pesos per month plus a small additional stipend for family support, depending on their former salary. In practice, though, there are very few applicants at this lower salary level. The median monthly UI benefit, including family payments, is currently 284 pesos/month, near the maximum. The median level of benefit as shown in Table 2.1 has not varied greatly in the past three years, from 255 pesos/month to 284 (1998). Median levels of benefits were lower after 1995 as the government officially lowered the maximum amount of benefits a worker was eligible for.

The Argentine benefit schedule has an additional characteristic, considered an important trait of "optimal unemployment insurance" in economic modeling -- benefit levels that decline over time. This design feature is intended to try to encourage workers to return to work as benefits become less valuable. After the fourth month, benefit levels reduce to 85% of the level calculated in the first period; after nine months, the amount reduces to 70%. It must be remembered, however, that these declining percentages apply to only the segment of the beneficiaries eligible for a year of benefits, the rest of beneficiaries receive a flat percentage for their shorter-term benefits.

¹¹Labor Minister Antonio Erman González as reported in La Nación, 5 May 1998.

Analysis of Beneficiaries. The "typical" or average beneficiary of Argentine unemployment insurance is a male (71% are male), between 24-49 years of age (70% fit this category), without family responsibilities (52%). Table 2.2 shows some of the changes over time in the type of beneficiary receiving unemployment insurance. The most significant change overtime has been in the decrease in those who are heads of households (*con carga de familia*), from 67% in 1994 to 48% in 1997.

Table 2.1
ARGENTINA:
UI BENEFICIARIES AND EXPENDITURES
(1992-1998)

Year	Number of Benefit Payments	Expenditures (in pesos)	Benefit (per person, in pesos)
1992	128.062	25.834.000	202
Monthly average	12.806	2.583.000	
1993	880.479	325.193.000	369
Monthly average	72.373	27.009.000	
1994	1.182.154	378.839.000	320
Monthly average	98.513	31.570.000	
1995	1.468.160	374.992.000	255
Monthly average	122.347	31.249.000	
1996	1.544.064	398.000.000	285
Monthly average	128.672	41.388.000	
1997	1.144.548	313.800.000	274
Monthly average	95.379	26.160.000	
1998 <u>1/</u>	174.999	23.606	284
Monthly average	87.500	26.046	

Source: Dirección Nacional de Regulación del Mercado de Trabajo, using data from ANSeS.

1/ For two months only

While the age categories are not differentiated enough to see this clearly, this fits the impression that over time those drawing on unemployment insurance are increasingly younger with less work experience. The average length of benefits has dropped in the last two years from 10.3 months to 8.27.¹²

¹²"Seguro de Desempleo," Data from the Dirección Nacional de Regulación del Mercado de Trabajo, 1998.

Table 2.2
ARGENTINA:
CHARACTERISTICS OF UI BENEFICIARIES
(1994-1997)

Characteristic	1994	1995	1996	1997
Sex				
Female	23.50	26.40	27.50	29.10
Male	76.50	73.60	72.50	70.90
Age Group				
Up to 24 years	7.40	9.60	9.90	9.60
25-49 years	71.30	68.90	70.00	70.40
50 years and over	21.30	21.50	20.00	20.00
Family Status				
w/o dependents	33.00	38.70	41.30	51.90
w/dependents	67.00	61.30	58.70	48.10
Previous Occupation				
Professional/technical	18.20	15.00	21.40	2.90
Directors and executives	0.40	0.50	0.60	4.50
Administrative personnel	17.50	19.40	19.40	34.40
Commercial and sales	6.10	9.10	10.20	3.70
Private service sector	5.10	6.00	5.20	16.80
Forestry and fishing	10.90	12.00	7.80	0.80
Non-farm laborers and drivers	41.70	38.10	35.50	36.90
Line of Work in Previous Occupation				
Primary activities	6.50	3.90	3.50	3.70
Manufacturing industry	45.10	45.10	42.30	37.20
Commerce	18.30	23.40	24.00	25.00
Financial and managerial services	20.40	16.10	14.10	13.30
Social and personal services	8.70	10.00	14.00	18.00
Other	1.00	1.40	2.00	2.80

Source: Dirección Nacional de Regulación del Mercado de Trabajo, using data from ANSES

While often there is the impression that a program such as unemployment insurance plays a social safety net role in protecting incomes for low-income workers, the population served is typically not the lowest income levels, and this is true in the Argentine case. Table 2.3 shows that only 6% of beneficiaries made 300 pesos/month or less (February 1998). The majority of applicants (51%) are in the range from 300 - 600 pesos per month, but surprisingly 17% of recipients had salaries in excess of 1,000/pesos a month, more than three times the maximum benefit level they receive from unemployment insurance. This trend to serve middle-income recipients is reinforced by data on the occupational

profile of beneficiaries (Table 2.2). Non-agricultural workers and chauffeurs comprise a third of recipients, but another third is represented by administrative personnel.

Table 2.3
ARGENTINA
INCOME DISTRIBUTION OF UI BENEFICIARIES
(February 1998)

Income Intervals	Total	Percentage of Beneficiaries	
0 to 100	56	0.1%	} → 6.1%
101 to 200	951	1.1%	
201 to 300	4,216	4.9%	
301 to 400	12,645	14.6%	
401 to 500	19,371	22.4%	} → 16.6%
501 to 600	11,787	13.6%	
601 to 700	8,315		
701 to 800	6,640	7.7%	
801 to 900	4,523	5.2%	
901 to 1.000	3,545	4.1%	
1.001 to 1.500	9,373	10.8%	
1.501 to 2.000	2,986	3.3%	
2.001 to 2.500	1,066	1.2%	} → 16.6%
2.501 to 3.000	485	0.6%	
3.000 to 4.000	368	0.4%	
4.001 and More	229	0.3%	
Total	86,466	100.0%	

Source: Dirección Nacional de Regulación del Mercado de Trabajo, using data from ANSeS

One factor to remember in the Latin American context is that low-income workers are disproportionately represented in the informal sector. Since unemployment insurance covers only formal sector workers, and then within the formal sector those with significant tenure in one job, it rarely could fulfill a social safety net function for low-income workers. What is interesting in the Argentine context is that even though benefit levels are kept relatively low (300 peso/month maximum), the program attracts workers of far higher income levels. In this way, UI plays a role more like a short-term income subsidy -- which is how it is commonly referred to in Argentina (*subsidio al desempleo*) -- than a program which replaces/protects incomes for a period of job-hunting.

5. Administration

As explained above, the program is administered through the social security system. Workers go to one of 150 local ANSES offices to register and receive their checks; there are no other labor market functions or job hunting services provided.

Trade union leaders and other observers of the system interviewed detected few significant administrative problems with the system. Workers who are eligible for UI were generally informed of their eligibility and received their payments on a timely basis. There were some problems with workers not receiving their termination notices, or termination notices being a matter of "negotiation" with some employers, but this does not appear to be an all-pervasive problem.

What is less controlled are the administrative mechanisms and procedures to exclude from unemployment benefits those workers who have found new jobs. Numbers to identify workers (a CUIL, akin to the a Social Security number in the United States) were not instituted until 1994, and only very recently has the government been cross-checking the CUILs of UI recipients with the social security payments rolls to see if the UI recipient is actually working in formal sector employment and paying into the social security system. In doing so, the government has been able to detect significant numbers of UI recipients who were actually working in the formal sector while receiving unemployment benefits. Far greater numbers of UI beneficiaries are likely to be working in the informal sector, but this is nearly impossible to identify. The low level of benefits -- near the minimum wage - - reduces much incentive to go after this type of fraud.

Interviewees noted there is not a lot of urgency to expand or change the current UI system beyond its 100-125,000 beneficiary level. Proposals to change the system have been floated in the past, but are not in active consideration at this time. Trade union and business officials indicated that other labor market programs and trends have a more prominent place in the national agenda, in particular, severance pay and temporary contracts. With the institution of temporary work contracts, approximately 80% of new jobs are temporary in nature.

6. Key Observations: Argentina

- **Small Program Dimensioning.** A striking feature of the Argentine system is its **relatively small size and small variability in number of beneficiaries (@100,000-125,000/month), even as unemployment levels increase.** Across the board, interviewees attributed this first to the number of groups explicitly excluded from receiving UI (e.g., domestic workers, construction, public sector) and the growing informal sector that is not covered by UI. But they also pointed out that another factor is the willingness of the government to intervene and reduce benefits when the costs/number of beneficiaries are likely to exceed incoming revenues from the private sector. The government has reduced, on at least two occasions, the maximum amount of pesos a worker can receive in unemployment benefits, most recently in 1995, when the "tequila effect" forced up unemployment levels. While not typical of other UI programs, Argentina's operates with a broad, informal understanding of the constrained parameters of the program. The 1.5% tax on payroll contributed by the private sector is considered the limit of what they will contribute. As a result, the program must be adjusted to more or less match the incoming revenues.

- **Lack of Integration with Labor Market Operations/Current Role and Purpose.** The Argentine UI system is run through the social security system and has no linkage to training or other labor market programs. Once eligibility is determined, it is a straightforward process to receive cash benefits. Workers apply for benefits in a social security/social assistance office and are not required, directed, or provided with information on finding new employment or training opportunities. Formally, the law says a UI recipient must accept a job offered by the Labor Ministry, but observers indicated that there is no actual labor intermediation performed. The constrained size of the program (limited number of beneficiaries), coupled with the lack of integration with labor market operations led a number of interviewees to maintain that the program had little impact and, for others, to question what role it performed in the economy. Does it protect income during a period of unemployment and reward labor market attachment? Is the program intended to help workers reenter the labor market?
- **Interplay/Function with Severance Payments.** Unemployment insurance's relatively minor role in the Argentine labor market can be understood, in large part, when compared against severance payments which workers receive upon job termination. Under current Argentine law, a worker receives one month of salary for every year worked, with a minimum of two months severance pay after working only three months. In principle, severance pay is distinct from self-insured UI in that workers and employers pay into the pool of funds. Severance pay is paid only by employers and is designed to serve as a disincentive to employers to layoff workers as well as to compensate workers for long-term job investment. While their purpose may be different, both pay cash benefits upon a worker's termination. In practical terms in Argentina, the amounts received by workers are typically much larger and less restrictive for severance pay than for unemployment insurance. UI pays near the minimum wage for a maximum of a year and is received once a month. Severance pay is paid in one lump sum. For higher income workers, just a few months of severance pay would be equivalent to all their UI benefits. Further, fewer workers are eligible for UI -- with UI a worker must have a year's worth of service, with severance only two months. With unemployment insurance being a solely cash benefit, that is, having no conditions or provision to look for a job or receive training to get the benefit, UI and severance pay in Argentina have similar attributes.
- **Potential Distorting Role of the Informal Sector.** Since the UI program was first created in Argentina in 1992, the labor market has shifted dramatically to greater informality, roughly doubling from 25% to 40% in 1998. There are many factors influencing this trend; economists prominently cite the avoidance of high levels of taxation/benefits on formal sector work, which can comprise 50% of labor costs.

Given this looming role of the informal sector, many believe -- from the government, private sector, and trade unions -- that there is a high number of Argentine workers receiving UI who are also working in the informal sector. This would undermine one of the fundamental precepts of UI -- that beneficiaries be available to work and are actively seeking new employment. The Argentine UI system has only recently begun to investigate and exclude those workers who are receiving UI and working in the formal sector. This is accomplished by checking the employees' number to insure they are not receiving UI and also paying into the social security system. But no UI system has an effective way to screen out beneficiaries who are working "off the books." The incentive to seek work in the informal sector is reinforced by the relatively low level of benefits for UI in Argentina. Indeed, in Spanish, many referred to the program as an unemployment subsidy (*subsidio de desempleo*) rather than benefit. More disturbing was a trend, noted by a range of officials, that employers may be entering into informal agreements to layoff employees but then rehire them as contractors off the books. Unemployment insurance then serves as a short-term cushion against the loss of income in the transition from formal to informal sector work.¹³ It is not known how significant is this trend in Argentina, but it is noteworthy that it was mentioned by so many interviewees across the business, trade union, government and academic communities. With a program as small as the one in Argentina, this trend is not likely to have been a significant factor in the sharp rise in informality in the Argentine labor market. The question for Latin American and Caribbean economies with large informal sectors is whether UI is able to effectively serve its intended purpose and whether the program contributes to, or at least reinforces, trends towards greater informal employment. The concluding chapter (IV) presents a fuller discussion of UI in the informal sector drawing on information from a number of case studies in this report.

B. BARBADOS

1. Origins of the System

Unemployment insurance in the Caribbean is unique; Barbados has the only program. Its program arises out of a longer tradition of social insurance advocated by trade union leaders on the island beginning in the 1960s. Unemployment insurance, part of this social insurance tradition, specifically came into being in 1982, following the 1981 economic crisis. Large layoffs at the time (in the 1000s) prompted consideration to providing a greater safety net to workers through self-insurance. A parliamentary dialogue over unemployment insurance grew and included efforts to look at other international systems -- Germany, the United States, and England, in particular -- to craft a scheme for Barbados. As Prime Minister Adams described the UI program's purpose in 1981, it was to provide the temporarily unemployed with "some source of funds to permit those unfortunate

¹³ This can be seen as akin to a short-term preferred interest rate on a credit card or loan which might induce, or at least reinforce, a particular purchase.

persons to meet essential expenses and so maintain their purchasing power and cushion their families against hardships."¹⁴

Workers and employers paid into the new UI system for one year to build up its reserves; workers were then eligible to receive benefits the following year in 1983. Initially workers received 40% of their former salary for up to thirteen weeks a year. This was raised to 60% and 26 weeks in 1985.

This new system of unemployment insurance was considered distinct from severance pay, which was enacted in 1967. Severance pay was intended to compensate for a worker's human resources investment in the firm. Nonetheless, some linkage was recognized, for an agreement was made with business leaders that as UI came into being a cap was put on the maximum amount and number of years of eligibility for severance pay.

2. Program Characteristics: Benefit Levels, Eligibility, and Analysis of Beneficiaries

For the Latin America/Caribbean region, the Barbadian UI system provides a relatively generous stipend -- 60% of a workers' former salary -- over a moderate period for a maximum of 26 weeks per year. The Barbadian system has a number of features which ease eligibility and make it adaptable to a cyclical, island economy, including allowing workers to receive their 26 weeks non-continuously.

Eligibility and Benefit Levels. The program is open to salaried workers from the ages of 16 to 64 who pay into the system. The self-employed are not covered nor are permanent government workers because they have lifelong contracts (temporary government workers are eligible.) A person must be insured (i.e., have made payments into the system) for 52 weeks, and must have at least seven contributions paid or credited in the quarter preceding the quarter in which unemployment is paid. A person can receive a "credit" for a contribution to UI when they are receiving another insurance benefit, such as maternity leave, or injury claim. If a worker is fired due to his or her own negligence, they are still eligible for UI but are disqualified for a specific period. Germany and a number of other OECD countries permit such eligibility; in other systems, such as many state programs in the United States, workers cannot quit their job and collect unemployment insurance. Qualifying workers are provided up to 26 weeks a year (non-continuous) of benefits at 60% of their original salary, up to a maximum salary of B\$715/week. The average claim period is about 10 weeks and has remained so over the last five years.¹⁵

Analysis of Beneficiaries/Demand by Industry. The Barbadian UI system is unusual in the region in its relatively even distribution of male and female recipients. Table 2.4 shows figures for 1996 with 49% female to 51% male recipients, which has been relatively consistent over time. While a specific analysis has not been done in Barbados regarding

¹⁴Prime Minister Adams, Financial Statement and Budgetary Proposals, Barbados, 1981 as quoted in Mr. Grantley Smith and Mrs. Averille White, "The Experience in the Establishment and Administration of Unemployment Insurance and Severance Payment Schemes in Barbados", The National Insurance Office, Barbados, 1991.

¹⁵Averille White, interview with author, 17 August 1998.

the type of beneficiaries, some explanatory factors for the less skewed sex ratios might include: the inclusion of part-time work (minimum of \$21 weekly) and private household employees (yet only 5% of total recipients) in the system; and, the high representation of the service/hotel/retail sector in both the economy and the UI program. Table 2.5 shows the industry breakdown of UI claims in terms of days paid for three time periods, one of which (1992) was the height of demand for the program. These data shows the principal demands on the program have been for employees in the hotel/retail sector (40%) and the manufacturing sector (18% in 1996). The distribution among employment sectors has undergone only a few shifts, as government temporary employees and the transport/communications sector drew on the system particularly during the structural adjustment period, 14% and 8.8% respectively in 1992, but fell back to 2% and 4.3% respectively by 1996.

Beyond data on recipient's sex and industry classification, there is not much more detailed analysis on the beneficiary pool conducted on a yearly basis. Table 2.4 provides additional data on recipients in 1996 in terms of their original earnings. It shows that 54% are in the band from B\$101-350/week, (69.5% from B\$101-450), 10% earned more than B\$651. While men and women receive UI benefits in roughly equal numbers, the women are more concentrated at lower income levels. A third of female recipients earned less than B\$200, while only 15% of men did.

Table 2.4
BARBADOS
INCOME/SEX PROFILE OF UI RECIPIENTS: 1996
(in B\$)

Mean Weekly Earnings	Female	Male	Total	% of Total	
\$21 - \$50	386	247	633	0.7%	
\$51 - \$100	1,946	767	2,716	2.8%	
\$101 - \$200	13,458	6,491	19,949	20.1%	} → 69.50%
\$201 - \$250	5,316	5,183	10,499	10.9%	
\$251 - \$350	9,889	12,522	22,411	23.3%	
\$351 - \$450	5,963	8,704	14,667	15.2%	
\$451 - \$550	3,496	5,560	9,056	9.4%	
\$551 - \$600	1,569	2,112	3,681	3.8%	
\$601 - \$650	1,241	1,704	2,945	3.2%	
\$651 - \$714	3,740	5,506	9,246	9.6%	
\$715	197	419	616	0.6%	
Total	47,204	49,215	96,419		

Source: National Insurance Office, Barbados

Table 2.5
BARBADOS:
UI CLAIMS BY INDUSTRY
(in days paid)

	Year					
	1992	% of total	1994	% of total	1996	% of Total
Sector						
Agriculture	22,261	2.7	19,923	3.9	14,189	3.5
Fishing	2,092	0.3	2,701	0.5	1,353	0.3
Mining and Well Digging	7,840	0.9	5,589	1.1	2,707	0.7
Manufacturing	168,120	20.3	111,556	22.0	74,595	18.2
Electricity, Gas and Water	728	0.1	1,105	0.2	2,378	0.6
Construction and Installation	88,643	10.7	34,791	6.9	38,712	9.4
Hotel and Restaurant Wholesale/Retail	231,540	27.9	203,814	40.2	163,460	39.9
Transport and Communication	73,606	8.9	20,190	4.0	17,429	4.3
Financial Services	38,339	4.6	40,468	8.0	39,532	9.6
Government and Defense	115,417	13.9	8,517	1.7	7,997	2.0
Community Services	42,605	5.1	23,519	4.6	23,621	5.8
Private Household and Other	36,937	4.5	27,192	5.4	20,504	5.0
International and Territorial Bodies	684	0.1	7,512	1.5	3,609	0.9
Total	828,812	100	506,877	100	410,086	100

Source: National Insurance Office, Barbados

3. Financing

The program is currently financed through a 3% levy -- 1.5% (of total payroll) paid by employers, 1.5% (of wages) paid by workers.

4. Administration

UI is administrated under the National Insurance program, which administers all the principal forms of social insurance: pensions, health, maternity, sickness, and, employment injury. Within two weeks of losing their job, a worker should report to the unemployment benefit branch office to initiate a claim. Every two weeks, a worker must return to the office and certify that they have been out of work but available to work in order to receive the next payment. These certificates and applications are sent back to the main National Insurance office where they are reviewed and processed manually. Without the aid of computers, the process is very labor-intensive. In some cases it can take 4-6 weeks to receive payment.¹⁶ Overall, trade unionists did not detect major complaints by workers on the administration of the program.¹⁷

5. Current Labor Market Demands

Barbados is experiencing relatively positive growth and lower unemployment following a difficult period of structural adjustment in the early 1990s. Demand for unemployment insurance was highest in 1992 with over 20,000 claims received and B\$27 million in benefits paid.¹⁸ The number of claims has declined steadily since then along with unemployment, with a small increase in 1996. The total registered claims in 1997 were 12,105. This shows demand for the UI program being fairly cyclical. Current official unemployment rates for Barbados are approximately 14%,¹⁹ with proportionately higher rates for women and youth. Barbados' unemployment rate is not easily comparable to other nations as it includes more people in its definition. In particular, the "reference period" for counting the unemployed -- those who are without work but looked for work in the past three months -- is longer than in many other countries and thus includes those who other systems define as out of the workforce. Nonetheless, unemployment is a persistent problem in Barbados, particularly for women and youth. The unemployment insurance system can be seen to perform a compensating effect in economic downturns. As the Director of the National Insurance Office described the system, "It's not that important until you need it."²⁰

¹⁶Mr. Cecil Henry, interview with author, 17 August 1998.

¹⁷Senator Leroy Trotman and Robert Morris, Deputy General Secretary, Barbados Workers Union, interview with author, 18 August 1998.

¹⁸Central Bank of Barbados, *Economic and Financial Statistics*, ISSN 0378-178X, Central Bank of Barbados, April 1998, Table D5. Recall that number of claims likely exceeds number of beneficiaries as some beneficiaries can file more than one claim in a year. In 1996, the difference was about 1,000.

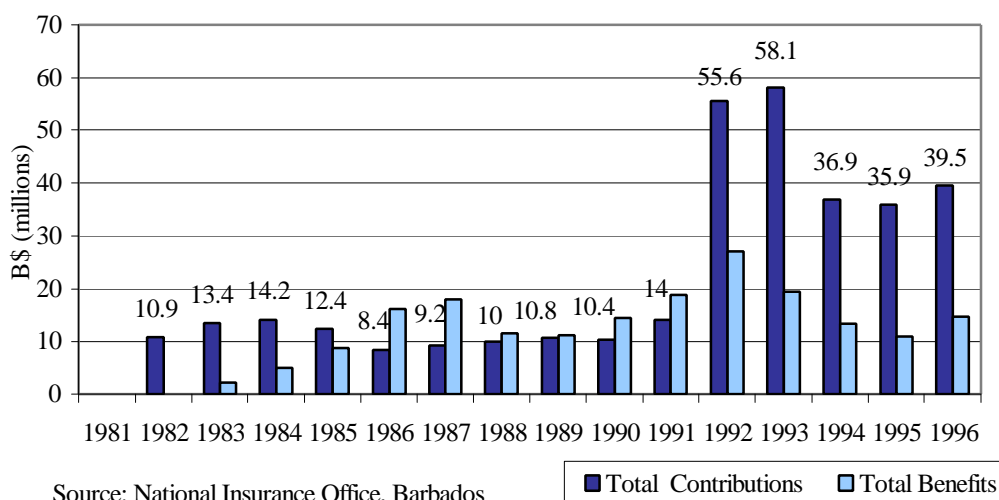
¹⁹ Basic Socio-Economic Data for 19 April 1999, Statistics and Quantitative Analysis Unit, Integration and Regional Programs Department, Inter-American Development Bank.

²⁰Lloyd Bradshaw, interview, 18 August 1998.

6. Key Observations: Barbados

- Unusual and Large Surplus.** The most striking and unusual feature of the Barbadian system is that it is running a very large surplus. It is hard to think of another system like this. The accumulated surplus is currently \$108 million, while only \$14 million or so is needed each year to pay out benefits (roughly 9,000 recipients/12,000 claims in 1996). This surplus is in addition to a one-time transfer of \$50 million from UI to the National Insurance fund made in January 1997 when the unemployment insurance fund was formally separated from the rest of National Insurance. For a system that was originally designed as a "pay as you go", how did the surplus get so large? The principal reason is that the government raised the contribution rate quite dramatically to 5.5% (total) during the structural adjustment years,²¹ left it at this higher level too long, then reduced it to a total of 3% and that was still too high for the demand for the program. Figure 2 displays the annual contributions vs. benefit expenditures of the Barbadian UI system since 1982, showing unusually large surpluses of contributions over expenditures in 1992 (B\$28.6 million) and 1993 (B\$38.6 million) which has continued steadily to today.

Figure 2
BARBADOS UNEMPLOYMENT FUND:
CONTRIBUTIONS Vs. BENEFITS EXPENDITURES 1982-96
 (in million B\$)



The program is still running surpluses far in excess of what is needed to cover demand even in a recession. A recent Actuarial Report for the National Insurance Scheme recommended that contributions to the

²¹The combined rates for workers and firms were increased from 1% to 2.75% in October 1991, and then in December 1991 from 2.75% to 5.5% (2.75% workers/firms).

unemployment fund be reduced from 3% to 1.5% and the balance switched to the National Insurance Fund, which sorely needs the funds. They estimated the "break even" contribution rate to be 1.1% assuming unemployment remained at current levels.²² This recommendation has been raised in preliminary discussions of members of the National Insurance Board, but no formal action to change the UI contribution rate has yet been made.

- **Reduced Incentives for Cost Savings.** The existence of this large surplus generates few immediate pressures to constrain the numbers of people receiving UI or constrain costs through administrative efficiencies or greater restrictions on eligibility. In terms of eligibility, Barbadian UI has a number of features that make it easier to qualify for than in other nations. For example, a worker does not need to be fully employed for the period preceding qualification of unemployment. He or she may be "credited" time if they were receiving other benefits, such as disability or maternity benefit. As well, workers who were dismissed "with cause" (i.e., they quit or didn't show up for the job and were fired) can receive a reduced level of UI in Barbados whereas in some other systems they would be totally ineligible for any benefit. Despite this more generous eligibility, there has not been surging demand for UI benefits. UI benefits reached a height of 20,396 claims during the 1992 economic crisis and in the last two years (1996-97) have averaged about 12,000 claims filed.

The benefits administration is highly labor-intensive as it is yet to be computerized. Bi-monthly payments are recorded by hand for each recipient in a cumbersome filing system. Interviewees indicate that computerization of the UI system has been promised and anticipated for some time. Doing so would allow for much greater efficiencies and free up administrative time to more closely monitor fraud and eligibility. Further administrative improvements would speed the delivery of UI checks to recipients as the current time lag can range from 4-6 weeks.

- **Features Adapted to Cyclical, Island Economy.** The Barbadian system has a number of features/eligibility criteria that reflect its use in a cyclical island economy where key sectors have highly seasonal demands for labor. The UI system is intended to adapt to this. While the tourist season covers more months of the year than in the past, there is still higher differential demand for certain occupations because of tourism trends. Workers are eligible for a total of 26 weeks of benefits in any 52-week period. This permits some workers to go on and off unemployment insurance for seasonal work. Workers are eligible to receive UI payments if they are laid off every other week (i.e., they work one-week on, then one-week on unemployment) as long as they don't

²²*Ninth Actuarial Report of the Operation of the Barbados National Insurance Scheme as at 31 December 1996* (Bridgetown: Barbados National Insurance Board, February 1998), 3.

exceed the maximum of 26 weeks of yearly UI benefits. This permits key employers in the hotel sector, for example, to keep a larger workforce at their disposal by relying on UI to supplement workers incomes every other week. Other systems bar the return to unemployment insurance with a longer disqualifying period to discourage such seasonal use. Like most systems that do not have an experience rating, certain sectors/firms benefit disproportionately from having a UI system as they make greater demands on it.

To insure that workers do not leave the island and continue to receive unemployment insurance the Barbadian system requires that workers physically appear at the UI office once every two weeks, present their photo ID and certify that they have not worked. In other systems, checks are issued on a monthly basis. This requirement for physical presentation to the National Office would be much more difficult to achieve in larger countries.

- **Poor Connections to Labor Market Intermediation and Training.** While legally all workers receiving UI are supposed to register with the national employment service, in practice they are not compelled to and many do not. The National Employment Bureau (NEB) office (run by the Labor Ministry) was located right next to the unemployment office (run by the National Insurance Office) in 1987 to facilitate interaction. Still, most find the service not worth the time, particularly after a long wait to register every two weeks for their UI benefit check. There is also not the staff (3 persons in the main office) or job registry at the Service to service the roughly 1,800 claims a month for UI. The NEB's job listings include a few special overseas programs (e.g., Canada, U.S. cruise ships), low and semi-skilled work and fewer professional listings. The main office for the National Employment Service had a registry of 327 persons registered as of March 1998, an accumulated total of just 780 persons.²³ A number of interviewees believed some workers simply waited until their unemployment ran out before looking for a job.

There is even less linkage with the training system. A national training levy is assessed on employers and pooled into a consolidated fund managed by the Ministry of Finance. The fund finances a number of training initiatives, including the Barbados Vocational Training Board and an employment and training fund of the Labor Ministry for training within firms. Workers, though, as in many systems are not eligible to be receiving UI and training, unless they can demonstrate that they are still available to work. There is no central information for workers and firms about available training programs on the island.

²³Wendy Maclean, interview with author, 17 August 1998.

- **Function with Severance Payments.** As in most systems in the region that have both UI and severance pay, there are questions raised as to the interaction/potential duplication of unemployment insurance benefits with mandated severance payments.²⁴ Both provide cash benefits on termination of employment. Severance pay is typically intended to both discourage termination and reward a worker for the human capital investment made in the firm. UI was considered to be a self-insurance system, contributed equally by workers and business owners, to protect against short-term income loss from short periods of unemployment. Severance pay currently provides workers who have two years working for the same firm with 2.5 weeks of salary each year for up to 10 years service; 3 weeks from 10-20 years service; and 3.5 weeks for 20-33 years service. With between one and two year's service, a worker is only eligible for unemployment insurance.

There was consideration given in Barbados in the 1980s to merging the two systems. Colis Blackman, President of the Barbados Employers Federation, maintains that the private sector was largely unresponsive of UI in the 1980s as they considered it too similar to severance. However, severance was cut back from 4 weeks/year to 2.5 weeks, and UI moved up to play a more important supplemental role in easing employment transitions. "If it wasn't for UI, we'd be in trouble," he explains.²⁵ Overall, the private sector in Barbados relies on the social insurance system to provide benefits that, in other nations, are financed directly by private companies. This includes health benefits, maternity, and injury and sickness claims. Mr. Blackman did not find a high concern among the private sector for revising UI and severance pay,²⁶ even though Barbados has the only UI program in the Caribbean and could be seen as having a competitive disadvantage in terms of labor costs. A more worrisome trend noted is the rise in the employment injury claims whose benefits are more generous than UI. Injury claims increased nearly 30% from 1996 to 97 to 7,347 claims.²⁷ The important evolution over time for UI, if two systems (severance + UI) were to be maintained, is to use UI more proactively in linking workers with jobs and training so that it truly becomes a vehicle for transitioning from one job to the another.

²⁴See Inter-American Development Bank, *Labor Markets and Competitiveness in Barbados*, Inter-American Development Bank, Economic and Sector Study Series, RE3-97-003, October 1997.

²⁵Colis Blackman, interview with author, 18 August 1998.

²⁶A similar conclusion about lack of private sector interest in reforming severance pay was reached in interviews for the IDB study, *Labor Markets and Competitiveness in Barbados*.

²⁷New Insight: Magazine of the National Insurance Office, Barbados (Bridgetown: National Insurance Office, Barbados, January-April 1993), 3.

C. BRAZIL

1. Origins of the System

The current unemployment insurance system was created in 1986 in response to the macroeconomic crisis and its shock therapy, the *cruzado plan*. One key participant at the time recalls that the decision to implement the program was made relatively quickly in a crisis atmosphere of rising unemployment without much time for planning on the specific program or its administration.²⁸ UI was seen as one way to help stabilize unemployment amidst heterodox economic shock; it was thus seen initially, as a "pure benefit" in times of need rather than a labor market transition tool.²⁹ Owing to these origins, unemployment benefits in Brazil were conceived of as a very short-term measure -- three to five months -- and have remained a highly short-term instrument today.

Because UI was needed to respond to an imminent crisis, the original managers felt they had few administrative options for getting the program up and running. For the initial years, unemployment benefit checks were issued through local post offices, which reinforced the benefit image of the program. This initial delivery mechanism did not work all that well, with some workers initially waiting as much as a year for their checks.

It was in 1990, when a larger development fund called the *Fundo do Amparo ao Trabalhador (FAT)* was created, that the program was placed on a more secure financial basis, underwent broader administrative and operational changes, and eligibility was expanded to a wider range of workers. The FAT serves as a major financing mechanism for employment, development, and training initiatives. Its major programs include: unemployment insurance, the Brazilian National Development Bank BNDES (*Banco Nacional de Desenvolvimento Econômico e Social-BNDES* which gets 40% of the FAT), a 13th month salary bonus for workers (*bono salarial*), a fiscal stabilization fund, and training initiatives apart from SENAI/SENAC. Employers and employees contribute to the fund which is managed by the Labor Ministry with a tri-partite (business-government-labor) governing board called the CODEFAT. In the change, the program was moved out of the postal system and into a mixed administrative system via the Ministry of Labor, which uses an amalgam of local state banks and different municipal offices to register recipients and deliver checks.

2. Program Characteristics: Eligibility, Benefit Levels, and Beneficiaries

Eligibility. The Brazilian UI program is open to workers with a formal labor contract who meet the criteria for amount of time worked and were laid off involuntarily. The worker cannot be fired or leave voluntarily to receive benefits; the layoff must be the result of an employer decision not the result of the worker's actions. Brazil has a separate special

²⁸José Paulo Chahad, meeting with author, May 13, 1998.

²⁹Chahad, interview, May 13, 1998.

unemployment insurance program for those working in fisheries in artisan (small scale) forms (*Pescador Artesanal*).

When the UI program first started a worker had to have been working three out of the previous four years to be eligible for benefits. Today, a worker only has to have worked six months out of the last three years to receive the minimum benefit -- a significant change in the "labor force attachment" needed to qualify for insurance. A worker must wait 16 months after receiving unemployment benefits before being eligible again.

Benefit Levels. Brazilian UI is short-term and provided at relatively low benefit levels. Typically, benefits are provided for 3-5 months depending on the length of time in employment. The government has expanded the length of time for benefits during special periods from 4-6 months.³⁰ The length of benefits are determined thusly: workers with a minimum of six and maximum of 11 months of prior employment earn three monthly payments (*parcelas*); four *parcelas* for 12-23 months of service; and five *parcelas* for more than 24 months of service. One can see that, as constructed, the benefit structure does not scale up significantly for workers who have greater labor force experience (many years of employment).

The amount of unemployment insurance received depends on the worker's former income within a specific band. The benefit varies from the minimum wage (\$120 reales/month) to a maximum of twice the minimum wage (R\$224.54); the higher amounts are for workers having a previous salary over \$330.21 reales/month.³¹ Table 2.6 displays the beneficiary levels, expenditures, and median benefit levels of the Brazilian UI system. It demonstrates that the average beneficiary earns a bit more than 1.5 times the minimum wage. This average is down slightly from the early 1990s.

³⁰At the end of 1997, the maximum period of benefits was extended to six months, and in January 1998 returned to five months. The governing board of the FAT (the CODEFAT) is also authorized to extend the benefit period to 12 months for certain groups on an exceptional basis.

³¹Seguro esemprego-Informativo, overnment of Brazil, 6. Found on <http://www.mtb.gov.br/spes/segdp/infv/sdinter.htm>.

Table 2.6
BRAZIL
UI BENEFICIARIES AND BENEFIT LEVELS
(1986-1998)

Year	Beneficiaries	Total Program Expenditures (in thousands US\$)	Median Benefit (1 = wage)
1986	204.324	16.006.745	-
1987	999.967	166.289.225	1.15
1988	1.322.432	198.767.074	1.22
1989	1.912.185	398.393.493	1.7
1990	3.099.910	1.236.731.294	1.75
1991	3.724.840	1.412.893.566	1.83
1992	4.015.225	1.440.626.233	1.69
1993	3.830.420	1.559.105.700	1.41
1994	4.091.318	1.846.798.526	1.55
1995	4.789.307	3.146.551.407	1.54
1996	4.395.977	3.289.268.149	1.56
1997	4.428.757	3.200.247.989	1.57
1998	739.091	547.898.179	1.58
TOTAL	37.553.753	18.459.587.587	1.55

Source: Brazilian Ministry of Labor

Analysis of Beneficiaries. In absolute terms, the Brazilian UI system is the largest in Latin America. It currently serves an average of 300,000-400,000 beneficiaries per month, over four million beneficiaries a year. The average recipient is male, in the services or industrial sector, 35 or younger with an eighth grade education.

As the Brazilian program has expanded over time, statistics published by the Brazilian Ministry of Labor³² indicate that recipients have continued to be relatively young, but increasingly at relatively higher former incomes. Male recipients have heavily dominated the beneficiary pool, with women typically comprising approximately 20-30% of all beneficiaries, 30% in the most recent calendar year (1997). **Fully one-half of recipients are only 30 years old or less**, which is particularly striking in comparison to other UI systems that emphasize rewarding long-term commitment to the labor force. More than one-quarter of these are 18-24 years old. Fewer and fewer low-income people benefit from the program. As Table 2.7 demonstrates, in 1992, 11% of recipients had previous incomes of the minimum wage or below. By 1997, this percentage has been cut in half, with only 5.9% at this income level. Nearly 12% earn more than five times the minimum wage. There have been less striking shifts overtime in the educational level of recipients. Nearly one-half (45%) of recipients have an eighth grade education or better. Since 1992, the educational level of recipients has shifted upward slightly. In 1992, 39% of recipients had a fourth grade education or less; in 1997, this figure was 31%.

³²The following figures come from tables provided by the Brazilian Ministry of Labor, Secretariat of Employment and Salary Policy, General Coordinator of Unemployment Insurance to the IDB. They are published regularly in various series.

Table 2.7
BRAZIL:
UI BENEFICIARIES BY FORMER SALARY: 1992 and 1997
(in increments of the minimum wage)

Former salary	1992	% of total	1997	% of total	% change
Less than .5	20,845	0.5	9,337	0.2	-0.3
.51 – 1.0	423,995	10.9	248,308	5.7	-5.2
1.01 – 1.5	820,355	21.1	657,899	15.0	-6.1
1.51 – 2.0	726,260	18.7	751,277	17.1	-1.5
2.01 – 3.0	851,534	21.9	1,298,416	29.6	7.7
3.01 – 5.0	600,996	15.5	895,354	20.4	5
5.01 – 10.0	285,477	7.3	385,978	8.8	1.5
More than 10	87,436	2.2	128,932	2.9	0.7
Unknown	69,780	1.8	6,848	0.2	-1.6
TOTAL	3,886,678	100.0	4,382,349	100.0	0.2

Source: Brazilian Ministry of Finance

3. Financing

Employers pay into the "FAT" (*Fundo do Amparo ao Trabalhador*) which funds a series of labor market and development programs. There are a number of different taxes on employers that finance the FAT, but largely a .65% tax on total business sales goes to finance UI.

4. Administration

If a worker is dismissed, the employer is required to give them a form that they can then use to apply for unemployment insurance. The Brazilian worker has three different types of offices they could bring their application to: the state-supported banks, the *caixas economicas federales* (there is an office in every municipality), an office of the Ministry of Labor (there are four separate types),³³ or a local employment service office (SINE). Once the application is made and approved, the worker receives his benefit checks through the CEF local bank. With eligibility fairly clear, there is currently a high rate of acceptance of original applications (rate of habilitation), well over 90%.

The centralized, yet three-alternative delivery system, plus the contracting out of data processing to DATAMEC, who subcontracts further to Método, contributes to multi-agency montage used to administer the program. While there are three options available, the most preferred option of workers is to register and receive their checks from the state

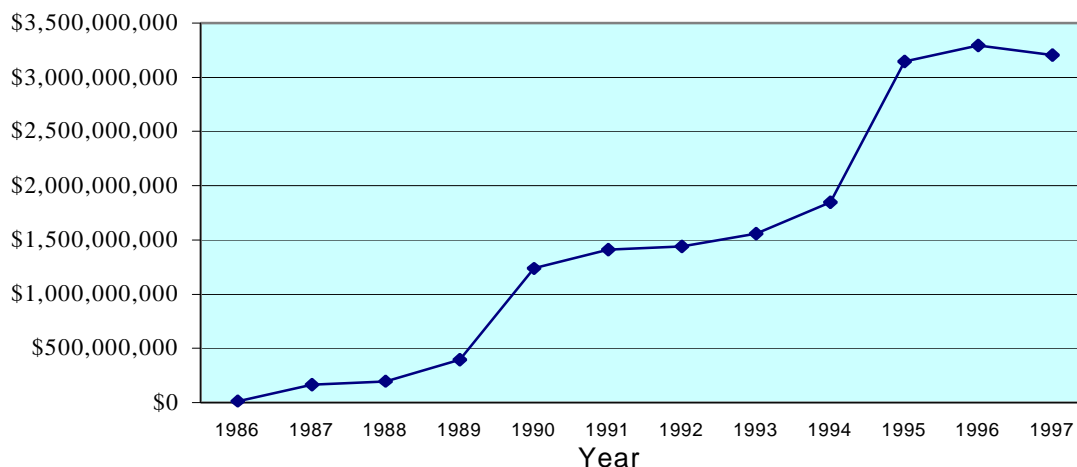
³³Delegacias Regionais do Trabalho (DRT), Subdelegacias do Trabalho (SDT), Postos Regionais do Trabalho (PRT), and Postos Locais do Trabalho (PLT).

banks (the CEFs). These function like typical neighborhood or commercial banks and there is little stigma attached to going there.

5. Key Observations: Brazil

- **Weakening Connection Between Unemployment and UI Demand.** Despite Brazilian UI being short-term and at relatively low income levels (1.5 times the minimum wage), the demand for the program is relatively high with substantial budgetary costs to the country. Figure 3 shows annual costs reaching near US\$3.5 billion. Demand, though, seems to rise less in response to economic cycles than to eligibility for the program. In the Brazilian case, other factors continue to push costs and the number of beneficiaries up. Growth of the labor force is one factor, but importantly, so is the easing of criteria for eligibility and temporary expansions of the length of benefits. An increase can be seen particularly in 1990 where the first expansion of eligibility occurs. In 1994, there was a further easing of eligibility and a temporary extension in the length of monthly payments; another bulge can be noted in contrast to the official unemployment rate. While the easing of eligibility typically is intended to respond to worsening economic circumstances, the unemployment rate does not appear to rise as sharply. Some observers believe that some of the disconnect between demand for UI and unemployment rates might also be related to fraudulent claims. The size of the program also puts stresses on an administrative structure that was originally intended to serve only 100,000 workers a month; currently the rate is triple that.³⁴

Figure 3
BRAZIL: ANNUAL UI EXPENDITURES: 1986-97
(in US\$ millions)



³⁴Beatriz Azeredo and José Paulo Chahad, *O Programa Brasileiro de Seguro-Desemprego: Diagnostico e Proposições de Aperfeiçoamento*, Rio de Janeiro, Centro de Estudos de Políticas Públicas, December, 1992, 78.

- **Increasing Use by Young and Better Off.** Demand for the program will likely continue to be strong in a young labor force where eligibility for unemployment insurance is so generous as to require only six months of work in a three-year period. As the analysis of beneficiaries above demonstrates, the system increasingly is being utilized by the young (30 years or less) as well as by the relatively better off. Nearly 12% of recipients earn more than five times the minimum wage, while only 6% earn the minimum wage or less. This trend away from poor recipients is reinforced by the concentration of the poor in informal employment, where they are ineligible for UI. The question in each national context is whether the resulting beneficiary pool of UI is the one policy makers want to serve. In Latin America, UI is often talked of as one of a number of potential "safety net" programs, because of the region's large, poor populations. However, the concluding chapter will raise questions about UI's utility as a social safety net for the region based on the case experiences in this study.
- **Poor Integration with Labor Market Programs.** Brazilian UI is an isolated instrument: it has very weak connections to the national employment service (SINE) and virtually none to the extensive Brazilian training system. While workers have a choice whether to register for UI at a state employment agency, few typically do. In the case of Sao Paulo, for example, only 2% did so, with the others going to the *Caixas Economicas Federales* (CEFs), (56%) or offices of the Ministry of Labor (41%).³⁵ National figures for 1997 show that the reliance on the employment service offices for insuring beneficiaries was 23%, ranging from 9% in the Southeast (including Sao Paulo, Rio, Minas Gerais), where the most beneficiaries are, to 57% in the South (Paraná, Rio Grande do Sul, Santa Catarina) where SINE has its largest number of offices. In some parts of the country, the SINEs have the reputation of being very politicized and much of the private sector does not register their available jobs with them. The benefit-only focus to the UI system is reinforced by the ability of workers to use the state banks (the *caixas*) to register for UI and receive their checks. Without any requisites for job-hunting, a number of interviewees sensed that many workers, particularly younger ones, were waiting out the period of UI benefits before looking for work.³⁶

There is an even weaker connection between unemployment benefits and retraining programs. This is a particular shame in the case of Brazil as it has a wide variety of high-quality worker training that could be utilized more effectively to reskill the unemployed, and, with better labor market intermediation, channel them into new jobs. The disadvantages of the current poor linkage of UI with training and job placement are being recognized; currently there are two pilot programs, in Brasilia and Rio, which are testing ways to better link UI with initiatives in training and new job creation. Any

³⁵Francisco Marseglia, Secretary of Labor for the State of Sao Paolo, meeting with the author, May 12, 1998.

³⁶Ivan Gonçalves Ribeiro Guimaraes, interview, May 14, 1998.

future integration of UI benefits with either training, job placement, or new job creation will be made more difficult by the multi-agency administrative structure in which the program operates.

- **Centralized and Multi-Administrative Structure.** The system was conceived of as a centralized program, yet because of Brazil's size and regional diversity, there result quite different regional demands and an uneven quality of implementation and service based on varying local capacity. In terms of size of the labor force, the Brazilian system compares, for example, with the United States, which runs state-level programs under federal guidelines. As explained, Brazilian UI beneficiaries can register at one of three different local offices (SINE, CEF, and Labor ministry), which have different regional quality and representation. Almost by definition and certainly in practice, this means the beneficiary can receive varying levels of quality of service. The number of SINE-national employment service, CEF, and Labor Ministry offices, for example are within a similar range nationally³⁷, but at the regional level their distribution varies more markedly. There are 300 SINE offices in the South (Paraná, Santa Catarina, and Rio Grande do Sul) where only 18% of UI recipients are located, while only 139 offices in the Southeast (Sao Paulo, Rio, Minas Gerais) where 57% of the UI beneficiaries live.³⁸ This multi-agency structure contributes as well to a varying range of services and type of staff serving the unemployed. In a study of the system, Paulo Chahad points out as well additional administrative problems and notes that many local offices are in precarious physical condition with poorly trained staff.³⁹
- **Dual Termination Payments.** In addition to unemployment insurance, workers who are laid off in Brazil receive a form of severance pay from the *Fundo de Garantiado Tempos do Servico* (FGTS). The *Fundo* works like a series of individual workers savings accounts.⁴⁰ A portion of a workers' wages are placed each year in an individual account and earn interest. The worker can monitor the amount accumulating in their account. Upon termination, the worker receives the balance of this account, and if the firing was unjustified, the employer must pay a 40% penalty on top of this. The FTGS is a benefit whose origins stretch back to 1967 when, in return for giving up the guarantee of permanent employment, worker savings accounts were created.⁴¹ Today if a

³⁷They range from 550 to 700 offices nationally.

³⁸*Seguro-Desemprego*, síntese mensal, Ministério do Trabalho, February 1998, 2 and 13.

³⁹Azeredo and Chahad, 35.

⁴⁰A number of countries in the Latin American and Caribbean region have similar type funds. See *Economic and Social Progress in Latin America: 1996* (Washington, DC: Inter-American Development Bank, 1996), 189-197).

⁴¹Capital from the FTGS has been invested in housing and sanitation projects, and, with different governmental policies and hyperinflation has accumulated significant financial problems. Beatriz Azeredo da Silva, *Políticas Públicas de Emprego no Brasil: A Experiência Recente*, dissertation presented to the Federal University of Rio de Janeiro, 1997, 305

worker has been working just a few years, it is likely that his/her FTGS account will exceed any UI benefit. Since Brazilian UI is largely a cash benefit program with only limited ties to efforts at job placement and connections to retraining, questions arise, as in many other programs, as to what specific role unemployment insurance is supposed to play. Sorting out the objectives of UI and other termination benefits is discussed, more broadly, in the concluding chapter.

- **Potential Distorting Effect of Informal Sector.** Even in the initial years of the UI program, the informal sector was already a significant factor in the Brazilian labor market. Estimates on the size of the informal sector see a growth from approximately 45% of the labor force in 1988 to 57% today (1998). As in the case of Argentina, interviewees across all three sectors -- business, labor, and government -- felt that the existence of this large, informal sector and a UI program for the formal sector interacted in a negative way. Since Brazilian UI is relatively short-term (three-five months) it would only provide an equally short-term income supplement for moving from formal to informal work. More fundamental was the perspective of program administrators in Brazil, one of whom felt that it was becoming very difficult to place older, unemployed workers (more than 33 years old) in formal sector work. Ivan Gonçalves Ribeiro Guimaraes, who runs the state employment and job service in Brasilia, says only about 2-3% of those receiving UI in this age group are able to go back to formal sector work.⁴² These trends toward increasing informality are influenced by broader labor market factors (e.g., cost to hire or fire workers in formal jobs, ability to evade labor laws), but it appears that UI can play a reinforcing role in these trends. This is distinct from a more classical economic approach which argues that the existence of UI provides an incentive to workers to seek formal sector work.

D. GERMANY

1. Origins of the System

Germany has one of the longest histories of social legislation mirroring the wave of industrialization in the early 20th century. Despite being the first country to establish social insurance (1889), Germany was relatively late in Europe to establish unemployment insurance. As a German government publication describes it: "Before 1914 the opinion prevailed that anyone failing to find work only had himself to blame."⁴³ As a consequence of the First World War, though, a system of state unemployment welfare was introduced for those displaced by the war and of economic need. This evolved into a broader program of unemployment insurance in 1923-24 for those affected by economic circumstances and was formally institutionalized into an independent institution, the *Reichsanstalt* for Job Placement and Unemployment, with employer and employee participation in the German

⁴²Ivan Gonçalves Ribeiro Guimaraes, interview, 14 May 1998.

⁴³*The Bundesanstalt für Arbeit Introduces Itself* (Nuremberg: Bundesanstalt Für Arbeit, 1993), 8.

law of 1927. Important in the German case is the early integration of job placement and unemployment insurance benefits in one system with one institutional administration. The system provided up to 26 weeks of benefits with contribution rates varied for different wage classes. Coverage was nearly universal.

Before significant reserves could be built up, Germany faced massive unemployment stemming from the global depression of 1929-32. Unlike the British, who tried to incorporate most of the unemployed under UI and ran into massive deficits, the Germans progressively restricted their unemployment insurance system and changed it more and more into a relief (welfare) type system.⁴⁴ Contribution rates were sharply increased, waiting periods were extended, benefit levels cuts, and eligibility tightened. Further changes were instituted beginning in November of 1929, all aimed at keeping the insurance scheme solvent. The proportion of unemployed covered by UI peaked at 80% in January 1929 and fell to 30% by January 1932, with the largest decreases likely attributable to those who had exhausted their benefits.⁴⁵ Administratively, under Hitler's National-Socialist regime, the *Reichsanstalt* lost all its independence and was heavily politicized.

Slowly following the end of WWII, Germany moved to create again an independent institution, now called the *Bundesanstalt*, with equal employer and worker participation, which was charged with carrying out unemployment insurance, public job placement and vocational guidance. The program's structure, based on a 1969 law, is similar to that of 1927. Administratively, the system has undergone further evolution and today the *Bundesanstalt für Arbeit* handles UI, vocational guidance, job counseling and placement, and promotion of vocational training. The following chapter, which considers UI and training, discusses further the German case with respect to training.

2. Program Characteristics: Benefit Levels, Eligibility, and Analysis of Beneficiaries

Eligibility. To be eligible for unemployment **benefits** a worker must have been in insurable employment (e.g., formal sector work paying into the social security system) for at least 12 months of the last three years. Workers are eligible if their employment was part-time, but it must have been for a minimum of 18 hours/week. Exempt from making insurance contributions, and thus exempt from receiving unemployment insurance are civil servants, students, and those on disability pay.

Once unemployment benefits expire, workers are eligible for unemployment **assistance** at slightly lower benefit levels but with a stronger means test insuring that workers do not have access to other income (e.g., spousal earnings or investment assets).

If a person becomes unemployed due to their own behavior or even gross negligence without good reason, they are still eligible for assistance but are disqualified for benefits

⁴⁴Saul J. Blaustein with Wilbur J. Cohen and William Haber, *Unemployment Insurance in the United States: the First Half Century*, (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1993), 96.

⁴⁵Blaustein, 99.

for 12 weeks. They can be disqualified for 8 weeks if they refuse to accept offered, suitable employment or a place in vocational training or retraining. These periods can be reduced in cases of particular hardship.

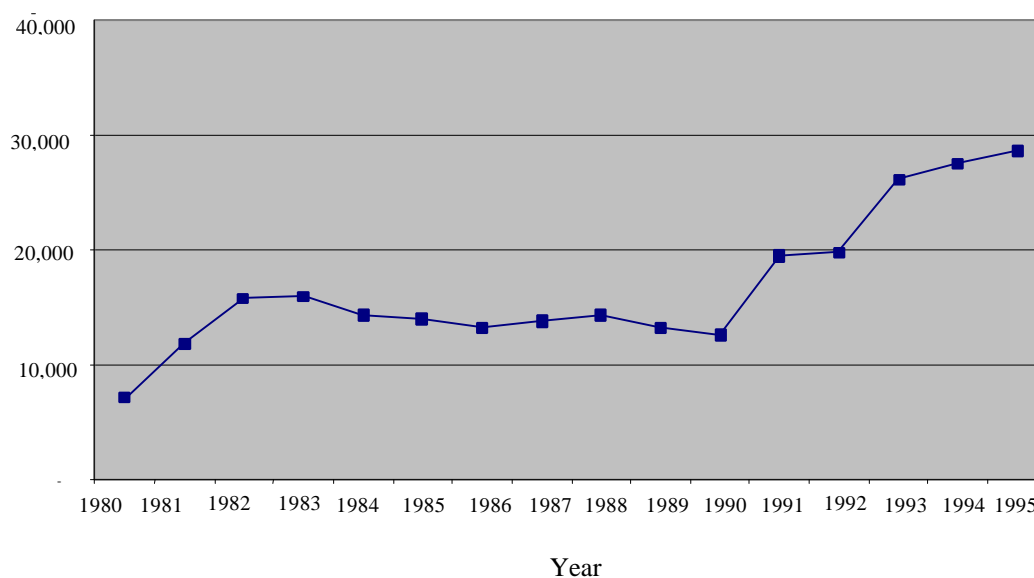
Benefit Levels. Workers receive 67% of their former salary in unemployment **benefits**, 60% if they have no children, for a period from 12 months to 32 months depending on their age. Workers under the age of 42 receive the minimum 12 months for at least two years of previous work. This increases to 18 months of benefits for those over 42 (at least three years of work experience); 22 months over 44 years of age; 26 months over 49; and 32 months for those over 54 who have been employed at least 5 years and four months. Unemployment **assistance** which can follow the expiration of unemployment **benefits** is at 10% lower benefit levels: 57% of the workers' former salary, 50% if the worker has no children. There are a series of additional benefits for seasonal workers, particularly those in the building trades. For the building trades, workers can receive additional bad-weather and winter allowances to smooth out the temporary losses of income.

There is also short-term assistance for workers who are temporarily laid off due to a work shortage but will be returning to the same job. This could be due to a temporary or seasonal downturn of work or corporate restructuring. The short-term assistance is paid for up to six months. The company or employer must report the temporary work stoppage to the employment office and it is they who would make the payment of the short-term assistance.

3. Financing

Employers and employees pay into insurance funds at a 3.15% rate on wages taxable to a specified ceiling. The rate was raised in the early 1990s. Employers, though, pay the worker share of contributions for employees earning less than 10% of the ceiling. Unemployment assistance is financed by government funds. Figure 4 provides a summary of German expenditures for UI from 1980 – 1995, showing a significant rise in demand in the mid-1990s.

Figure 4
GERMANY
UNEMPLOYMENT COMPENSATION EXPENDITURES: 1980-1995
(in constant US\$ 1990)



Source: OECD Social Expenditure Data Bank, December, 1998

4. Administration

Program administration is relatively autonomous and conducted by the *Bundesanstalt für Arbeit*, whose main office is in Nuremberg, with offices throughout the country. The *Bundesanstalt für Arbeit* administers UI as well as gives vocational guidance, job counseling and placement services, and promotes vocational training.

Once unemployed, workers must report in person to the local employment office in the district in which they reside to register for benefits and insure they meet eligibility criteria. Unemployment benefits are then transferred by accounts: a beneficiary does not need to report regularly to the benefits office.

5. Key Observations: Germany

- **Integration of UI, Job Placement, Training, and Employment Creation Functions.** From nearly its inception, the 1920s, the German system has sought to connect its UI program with training and job placement functions in a single executing institution. Its social program contains a relatively diverse range of

instruments which permit the combination of UI with training, UI benefits or assistance with a job creation measure (e.g., a wage subsidy to employers), and training/retraining with a part-time job subsidy. Due to the high cost of this combination of benefits, special regulations were created when East Germany was integrated into the West, which limit the job creation subsidies to those unemployed who are the most difficult to place.

- **Combined UI to Social Welfare Assistance.** The German system provides unemployment benefits to unemployed workers who pay into the system on a contributory basis. Once these benefits are exhausted, a worker may still be eligible for a lower, but longer-term unemployment assistance, which is more akin to a welfare system. The German system provides benefits, thus, of nearly an infinite duration. This open length of benefit eligibility would be hard to maintain in a developing country economy.

E. JAPAN

1. Origins and Overview of Insurance/Services System

Unemployment insurance in Japan was first introduced following the end of the Second World War. There was a system of general unemployment insurance and a separate program for temporary day workers which each exist today. The Japanese unemployment insurance system itself remained financially sound as the country underwent dramatic shifts in employment and unemployment in converting to a modernized, peacetime economy. The program often ran in surplus and employer/employee contribution rates were lowered on a number of occasions. Demands on Japanese unemployment insurance were constrained by two major factors. First, the bulk of the insured population in Japan were salaried workers in large firms who did not draw heavily on UI due to traditions of "lifetime employment" and retraining and reemployment within firms. Second, only 60% of the workforce were insured; the more marginal workers were not in stable, insurable occupations.⁴⁶

The most significant changes to the program came in 1974-75 in the wake of oil price shocks which led to an employment crisis as well. The changes expanded and refined benefits in a number of ways and introduced three specific programs or services to help prevent unemployment and improve working conditions. These services, coupled with the provision of integrated job placement services to all UI recipients, help define the Japanese approach to what they term "employment insurance" rather than unemployment insurance. These employment-related services and training within the framework of an unemployment insurance program are discussed further in Chapter III. The description in this chapter is oriented specifically towards the unemployment insurance benefit itself. Briefly, employers in Japan pay an additional 3% to cover the costs of the following three employment services:

⁴⁶Akira Takanashi et al., *Employment Insurance Law*, Japanese Economy and Labour Series, no. 3 (Tokyo: The Japan Institute of Labour, 1997), 7.

1. **Employment Stabilization.** Employers can receive a subsidy up to 100% for a variety of initiatives to stabilize employment. For example, employers can be paid to hold open a position while the occupant goes on training or is transferred to another facility during a reduction in business activity or changes in industrial structure. Stabilization measures also include subsidies for the wages of older (61+) workers, regional incentives (in areas designated for employment expansion), or family care leave. The grants or subsidies cover the employee's wages and temporary leave allowances. This is the most widely used of the three services.
2. **Assistance for Developing Worker Capacities in Business Restructuring.** Employers who are restructuring their business operations to provide more stable employment in the medium to long-term can receive subsidies for a number of initiatives: for education and training of workers assigned to new posts; vocational training undertaken by small and medium-sized businesses; assistance for skill evaluation; and, for setup and maintenance of facilities and equipment for reassigned personnel.
3. **Services to Improve Worker Welfare.** This is principally for programs to improve the workplace for health, safety, and environmental reasons.

2. Program Characteristics: Benefit Levels, Eligibility, and Analysis of Beneficiaries

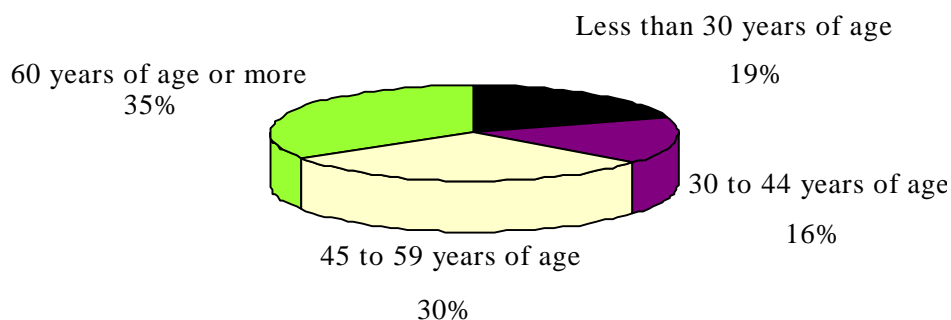
Eligibility. The program is open to all insured workers who have paid into the system for at least six months out of the last year. Domestic workers, students, directors and officers of corporations, and those working less than 20 hours per week are not covered. Certain sectors can join the insurance scheme on a voluntary basis -- agriculture, fishing, and forestry -- and thus coverage in these sectors is variable. There are separate eligibility criteria for "specially insured" categories (as opposed to the regularly insured) such as short-term workers (e.g., construction) and day laborers. As in Germany and Barbados, a worker can receive UI if they have quit or lost their jobs due to their own actions but they are subject to an initial waiting period before receiving any benefits. Workers can still receive UI while in training programs.

Benefit Levels. The length and amount of benefits varies proportionately to a worker's age and length of service, providing substantially longer benefits at greater amounts for older, more experienced workers. For regularly insured workers, they can receive from 60-80% of their former salary within limits established for their age group. For example, the upper limit for daily basic benefits is 8,830 yen for those 29 and under, while it is 18% higher for those in the 45-59 age category, 10,790 yen. Benefits decrease somewhat between ages 60 to 64, where other programs supplement income until retirement at age 65.

Japanese benefits are of relatively shorter duration compared to other OECD countries, particularly Europe. The duration of benefits varies from 90 days (for those younger than 30 with less than a year in their current employment) to 300 days for those age 45 and older with over 20 years of experience. A 45-year old worker receives 180 days of UI if their period of employment is from five to nine years. The Japanese system has an important feature called a **re-employment bonus**. This is paid to workers who are re-employed with up to one-third of their eligible benefit period remaining. For workers who are eligible for the full 300 days of benefits, if they are re-employed within 100 days, they receive an additional lump sum of 120 days of benefits.⁴⁷ The bonus can range from 30 to 120 days of benefit. The intention of the re-employment allowance is to provide an additional incentive for workers to become re-employed more quickly. Figures for 1995 show about 40% of UI recipients receiving some form of re-employment bonus.

Analysis of Beneficiaries. Japanese UI recipients are relatively evenly distributed among age categories. As shown in Figure 5, 18% were under 30 years of age, 18% from 30-44 years of age, 23% from 45-59 years of age, and 20% over 60 years old for the financial year of 1995. Considering the reduced level of benefits for younger workers, participation of youth is relatively high.

Figure 5
JAPAN: UI BENEFITS BY AGE GROUP
(1995)

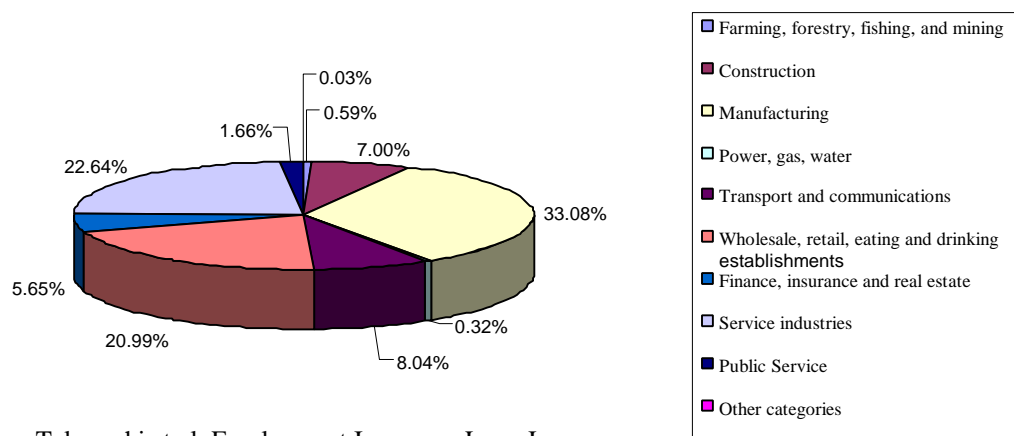


Source: Takanashi et al, Employment Insurance Law, Japan Institute of Labor

Figure 6 shows the industry classification of those who received benefits in 1995. They show that the predominant users of the UI system are workers in the manufacturing and services sectors. Remember again, that these workers are primarily in the small and medium-sized industries.

⁴⁷As a temporary measure to March 1999, the government has provided an additional 20 days of re-employment bonus for those re-employed by the mid-point of the duration of benefits, (except those only eligible for 90 days of benefits.)

Figure 6
JAPAN: UI RECIPIENTS BY INDUSTRY
(1995)



Source: Takanashi et al, Employment Insurance Law, Japan Institute of Labor

3. Financing

The Japanese UI system is a mixed system financed by both employer and employee contributions and a smaller amount of government tax revenues. Costs for unemployment insurance are paid equally by employers and employees; but employers pay solely for the three employment service programs. The combined rates for employers/employees vary somewhat per sector: 1.15% of wages for general establishments, 1.35% for farming, forestry, fisheries, and breweries, and 1.45% for construction. These figures include the .35% supplemental for the employment services, so for example, employers of general establishments each pays .75% and employees .4% of wages.

Table 2.8
JAPAN: UI BUDGET 1991-97
(in billions of yen)

	Year						
	1991	1992	1993	1994	1995	1996	1997
Total Revenue	20,514	19,254	18,187	17,797	18,593	18,413	19,462
Employer/ee Contribution	15,662	13,713	12,266	12,270	12,457	12,650	13,104
Government	2,492	2,614	2,810	2,672	3,374	3,273	4,202
UI Expenditures	11,514	13,475	16,126	17,996	20,221	21,358	23,011
Surplus or Deficit	9,000	5,779	2,061	(199)	(1,628)	(2,945)	(3,549)

Source: Ministry of Labor, Japan

The Japanese government contributes specific proportions to specific UI programs, typically in the one-third to one-quarter of total expenses range. Table 2.8, for example,

shows for 1997 UI expenditures, employer/employee contributions constituted two-thirds of revenues to the government's one-third.

4. Administration

Once unemployed, the candidate reports in person to a local Public Employment Security (PES) Office where they must submit the required separation form and make applications for jobs and UI. There are over 600 PES offices in the country. The Employment Security Bureau under the Ministry of Labor is in charge of the planning and implementation of all aspects of employment policy except for vocational training, which is under the Human Resources Development Bureau of the Labor Ministry. The majority of the staff of the Labor Ministry (15,284 out of 24, 897) work in the front-line offices dealing with the public.⁴⁸

5. Key Observations: Japan

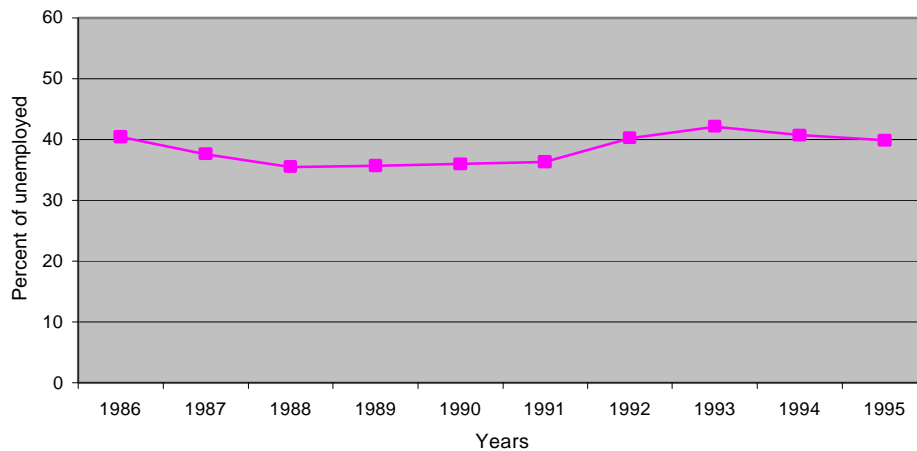
- **System Reflects Particular Japanese Context That Is Now Changing.** The relatively "good fit" to date of the Japanese unemployment insurance program to the Japanese macroeconomic context and industrial structure reflects at least three characteristics distinctive to Japan that have kept demand for the program relatively constrained and manageable. One, demand in terms of number of users has been largely concentrated in small and medium-sized firms. Owing to Japanese traditions, larger firms have tended to reemploy workers within the firm under conditions of lifetime employment. To put it bluntly, large firms in Japan have been willing to subsidize employment/unemployment programs for smaller firms for social and economic reasons. Two, official unemployment levels have been traditionally low in Japan, and within that the UI system finances only roughly 40% of the officially unemployed over the last few years.⁴⁹ The percent of unemployed covered by UI is shown in Figure 7. Those excluded encompass those who do not qualify for UI as well as those who don't wish to accept it; the stigma attached to unemployment is relatively strong in Japan. Three, the employment services financed under the Japanese program also constrain the number of people seeking or needing unemployment insurance, although it is not known by how much.

⁴⁸Organization for Economic Cooperation and Development, *The Public Employment Service in Japan, Norway, Spain and the United Kingdom*, Paris: Organization for Economic Cooperation and Development, 1994, 129.

⁴⁹Takanashi et al, 174.

- The economic, social and cultural conditions that have kept the Japanese UI program relatively solvent and contained since its inception, though, may be shifting. Official unemployment, after decades of low levels, is on the rise. Previously only small firms laid off workers, but now every type of firm is doing so. Japanese firms are using contingent workers more along the U.S. model. Job service centers in Japan are becoming inundated with workers.⁵⁰ The program, as shown in Table 2.8, has begun to run a small annual deficit since 1994. Under conditions of increasing loss of profit margins and the impact of the Asian financial crisis, it will likely be harder for large Japanese firms to either continue paying the employment tax or not to make great demands on it themselves. What may be more instructive in the Latin American and Caribbean context is less the special inter-firm relationship and macroeconomic context under which the program has functioned, but rather the emphasis on employment and training in the context of UI and special program features like the re-employment bonus.
- **System Incorporates Employment Initiatives and Training Support with UI.** The Japanese system actively incorporates employment initiatives and job-finding/placement into its unemployment insurance system, first by funding

Figure 7
JAPAN:
UI RECIPIENTS AS A PERCENTAGE OF TOTAL UNEMPLOYED
(1986-1995)



Source: Takanashi et al, Employment Insurance Law, Japan Institute of Labor

alternative activities or "services" within the insurance system, and second, by

⁵⁰Takasaki, Labor Attache, Japanese Embassy, meeting with author, 31 March 1998.

trying to integrate training, job placement and UI on-site through the public employment service.

While the employment services generally represent only one-quarter of the expenditures for UI,⁵¹ their purpose is targeted to preventing further unemployment, for example, through retraining workers or seconding workers to another firm temporarily. The combination of specific subsidies for retraining under the employment initiatives plus other training initiatives for the unemployed permits a fair amount of opportunity to get workers into training. UI recipients can receive job placement and training referral services within the public employment service system. Without field research, it is beyond the scope of this study to assess how effective both the smaller employment services and the integrated system are. Anecdotal information, for example, indicates that some Japanese feel the work centers do not offer a wide enough array of job opportunities. In principle, though, they represent a more comprehensive approach to delivering unemployment insurance while practical application requires a separate investigation.

⁵¹Figures from Japanese Ministry of Labour for 1997 budget.

F. POLAND

1. Origins of the System/Eastern European Context

In the early 1990s, as Eastern Europe and the former Soviet Union (FSU) underwent dramatic, and often radical transitions from state to market-led economies, unemployment insurance was frequently initiated to protect incomes and lessen the shock of impending unemployment. The path taken and recommended for many Eastern European and FSU countries was a relatively radical transition to a market economy, with a rapid transition to competitive prices, reduction/elimination of production subsidies, and large scale layoffs in state industry.

The fear of widescale unemployment from this transition was particularly great, as unemployment had been both theoretically and socially inconceivable in the former communist bloc. Projected layoffs in Poland were very high, over one million new unemployed within a year or two of market reform. An unemployment insurance system was designed not just as an emergency measure to facilitate the market transition but to be integrated in the labor market policy of the country. Polish officials perceived that the free market economy would continually generate unemployment and a system was needed over the long term.

In retrospect, many analysts are now beginning to question whether the Eastern European transitions really needed to lay off workers on such a wide scale in order to stimulate private sector growth. Studies, instead, have found that the rate of new job creation and the rate of layoffs in the state sector had no correlation. Labor economists Richard Jackman and Catalina Paean write:

The belief that unemployment is needed in the particular circumstances of the transition, because it would facilitate the movement of workers into growth sectors, seems to us mistaken -- private firms appear to recruit almost exclusively from those with jobs in the state sector or new entrants to the labor force rather than from the unemployed.⁵²

2. Early Program Design

The original design of the Polish UI system in 1989 was open-ended with broad eligibility, reflecting the deep apprehension and concern about the potential impact unemployment would have. Under the initial design, anyone who was without a job was eligible for unemployment insurance and benefits could be continued indefinitely. Thus, a worker who had not been in the labor force before could still receive unemployment insurance.

⁵²Richard Jackman and Catalin Paana, "Labour Market Policy and the Reallocation of Labor Across Sectors," in *Lessons from the Economic Transition: Central And Eastern Europe in the 1990s*, ed. Salvatore Zecchini (Dordrecht, Netherlands: Organization for Economic Cooperation and Development and Kluwer Academic Publishers, 1997), 387.

From 10-20% of the initial recipients, it was found, fit this category. Benefit levels varied with previous income or were set at a minimum level.

As the levels of unemployment exploded in the early 1990s this structure became untenable. Demand for the program far outstripped administrative capacity and costs were escalating. In the 1991-92 period three important changes were made to restrict eligibility: a work test was imposed (recipients had to have worked at least 180 days in the previous 12 months); an eligibility period was defined (12 months); and, the benefits level was largely changed to one flat rate, 36% of the minimum wage, for all recipients. It is the changes in 1991-92 period which largely constitute the current structure of benefits in the Polish system described below.

3. Financing

Polish unemployment and related benefits are financed out of a Labor Fund. This fund has two sources of income: a 2% employer payroll tax and transfers from the central government budget. It was originally conceived that payroll contributions would fund the whole Labor Fund; this concept was soon abandoned, as contributions could not keep pace with the huge increase in unemployment over a short period. Government funds by far became the principal financiers of unemployment insurance. In 1990 and 91, government financing accounted for 73% and 61%, respectively, of UI.⁵³ The Labor Fund, a concept similar to the *Fondo de Empleo* in Argentina, also finances smaller programs for the unemployed, training/retraining, assistance for self-employment, and subsidies for job creation. However, the vast majority of funds go to UI.

4. Program Characteristics: Eligibility, Benefit Levels, and Analysis of Beneficiaries

Eligibility. Workers must have worked at least 180 days in the previous 12 months. School leavers must wait three months before claiming benefits and then they can claim only the remaining nine months of benefits.

Benefit Levels. Under the original system, benefit levels varied according to previous income with a floor of 95% of the minimum wage. For the first three months, benefits were paid at 70% of a recipient's former wage, 60% for the next six months, and 40% thereafter.

⁵³Poland: *Income Support and the Social Safety Net During the Transition*, Washington, DC: World Bank, 1993.

CATEGORY		DURATION OF UNEMPLOYMENT (MONTHS)		
		4	6	12
New entrants		95% minimum wage (mw)		
School leavers	University	125%mw	95%mw	
	Others	110% mw	95% mw	
Individual Lay-Off		35% average wage (aw)		
Training	New Entrants			
	Others	125% mw	Eligibility exhausted	
		41.1% mw	Eligibility exhausted	

Source: Poland: Income Support and the Social Safety Net during the Transition, The World Bank, 1993,25.

With changes in 1991 and 1992, the Polish system moved to a flat rate of benefits -- 36% of the average wage for the previous quarter with an additional 15% if the recipient is in training. Workers are eligible for up to 12 months of benefits. The only exceptions are for workers close to retirement and in some regions of high unemployment. For these workers, the benefit period can be extended to 18 months. Table 2.9 shows the benefit levels under the flat rate system with variability by class of recipient with additional benefits to those in training.

By calculating the wage based on the previous quarter, so-called "backward indexation," real benefit levels were actually even lower as rising inflation continually eroded the real value of benefits. The flat-rate system uses a different calculation for school leavers, 75% of the minimum wage, and shortens their eligibility to 9 months. Originally, higher benefits were granted to those near retirement with long-term job experience, but this benefit category was eliminated in 1994 and had few users (around 20,000).

Beneficiaries. As benefit levels are kept relatively low (36% of the average wage) and income levels of workers under the former communist regime had less variability than for other nations, the program is continued to be perceived as serving lower-income populations. The unemployed in general in Poland have very low levels of educational attainment: 22% had only primary or lower education; 58% had less than secondary education.⁵⁴ The largest group of unemployed are the young, 15-24 years old, constituting around 40% of the unemployed pool.⁵⁵

5. Administration

Unemployment insurance is administered by regional and local labor offices (LLO) that were originally set up under the communist government to assist workers moving to jobs in different parts of the country. Each of the 49 *voivodships* (local areas) has a number of local offices under it (335 in total). The local offices have the most direct contact with UI

⁵⁴Marek Góra, "Employment Policies and Programmes in Poland," in Martin Godfrey and Peter Richards, editors, *Employment Policies and Programmes in Central and Eastern Europe*, Geneva: International Labour Office, 1995.

⁵⁵Alain de Crombrughe, "Wage and Pension Pressure on the Polish Budget," Washington, DC: World Bank Working Paper Series, June 1997.

beneficiaries. Beneficiaries must register at these offices and their eligibility is determined there. Benefits are distributed in cash at these offices and recipients must report monthly to receive their benefits. The staffs at the offices are first supposed to find a suitable job or training for the unemployed person, and then if not, register them for unemployment benefits. In practice, these offices are heavily understaffed and ill equipped for such functions. As the program began in 1990, only one office in the country had an old computer and others did not even have calculators for calculating benefits. Conditions apparently have improved substantially since the first years of the program but, as one analysis put it, "The unemployed have to queue in most of LLOs [local labor offices] in order to register or get their benefits and have limited chances of being offered a job."⁵⁶

6. Linkages with the Training and Placement System

Through the local labor offices an unemployed person can be connected with a training/retraining program or offered a job listed in the employment service. The labor offices themselves offer training programs or the unemployed person can take a course offered by a private contractor. The labor office pays the full costs of training, which typically varies from two weeks to six months but is on average 2.5 months.⁵⁷ The unemployed person may also be eligible for subsidized work or a public works job. All of these programs are paid through the Labor Fund but are funded at much lower levels than unemployment insurance. Table 2.10 shows the breakdown in expenditures between UI and early retirement (another passive labor market program) and active measures such as the employment service, training programs, and subsidized employment. As a percentage of GDP they are both small, but UI consumes more than five times the resources of active labor market programs.

7. Key Observations: Poland

- **Lessons of Administration: Advantages of Flat Rate Benefits/Need for reparation.** The administration of the Polish UI system was overwhelmed in a short period with the huge influx of demand for benefits. The case clearly demonstrates the need to have developed systems and trained staff prior to initiating a program. In addition, the administration of the system was improved as well by moving to a flat rate system. Local administrators didn't have to make case-by-case calculations of 60%, 40%, etc. percent of a worker's former salary before distributing benefits; cash disbursements were greatly speeded up. It was also found that the flat rate system induced more males to leave unemployment for regular work, although not females.⁵⁸ It is believed that the males had more possibilities of job offers and higher reservation wages than women did. This is an interesting lesson for Latin American systems which more typically provide benefits similarly at lower rates, near or at some multiple of the minimum wage. If a country is to provide a generally lower

⁵⁶Góra, "Employment Policies," 124.

⁵⁷Góra, "Employment Policies," 128.

⁵⁸*Lessons from Labour Market Policies in the Transition Countries* (Paris: Organization for Economic Cooperation and Development, 1996), 157.

level of benefits (i.e., it is not seeking to replace former incomes), it is worth considering whether the advantages of simpler administration of flat rate benefits and potential inducements to re-enter the labor force outweigh the preference to give some varied level of benefits to high former wage earners.

- **Informal Economy Effects.** The Polish economy has a significant amount of informality, although not at the levels experienced in many Latin American countries (closer to 20%-30%). The informality as well is of a different type than Latin America in that bartering for goods is common as well as home production. Workers may engage in a mixed form of commerce, some informal, some formal. One survey found that 46% of unemployed people had some form of work, generally only part-time or casual; another found that 35% of employers were hiring people informally who were registered as unemployed.⁵⁹ It is perceived that the program is helping to reinforce lower incomes in the informal sector and contribute to the informal sector's growth.
- **Ease of Eligibility Initially Increased Unemployment.** Polish officials soon realized that their initial design with unlimited benefits, no prior work experience needed, and free health care actually induced people not actively engaged in the labor force to register as unemployed. An OECD study concludes:

Poland can serve as an example where the existing structure of incentives combined with a poor performance of the monitoring system allowed unemployment to rise substantially above the level required to facilitate the necessary reallocation of labour during transition.⁶⁰

In Poland, it was the combination of generous eligibility plus lax enforcement which provided a significant inducement to registered unemployment. Researchers in this study found that, in contrast, the Czech Republic case demonstrates that the rapid rise in unemployment can be controlled through a better institutional and regulatory framework.⁶¹

⁵⁹Jackman and Pauna, 387.

⁶⁰*Lessons from Labour Market Policies*, 152.

⁶¹*Ibid.*

G. UNITED STATES

1. Origins of the System

From the outset, the U.S. system was intended to permit broad flexibility to individual states to set their own guidelines. President Franklin D. Roosevelt's Committee on Economic Security recommended that "States shall have broad freedom to set up the type of unemployment compensation system they wish. We believe that all matters in which uniformity is not absolutely essential should be left to the States."⁶² Despite the fact that equivalent individuals may be eligible for UI in some states and not others and eligible for different amounts of benefits, the emphasis on state-level programs has persisted in the United States. In 1966, for example, Congress considered imposing uniform benefit standards, setting minimum levels of earnings for entitlement and bills were passed in each house of Congress. These versions were never reconciled and thus no change in law was enacted.

As the UI program began, benefits were relatively short, particularly as the system's financial viability was still in question. By 1950, only 13 States had a maximum duration of 26 weeks; by 1960, 42 States had this level of benefit or higher; and, by 1970, all states had reached this minimum standard. Beginning in 1958, the U.S. UI program has undergone specific "temporary" expansion periods when longer-term benefits are permitted. In the early 70s, a permanent extended benefits program was enacted permitting extensions for an additional 13 weeks (up to 20 in some States), typically using a trigger for higher state level unemployment rates. As the United States underwent a deeper recession in the late 70s and early 80s, UI benefits were extended further, again on a temporary basis. The initial financing of extended benefits have typically been split 50% state/50% federal, but further extensions have been 100% federally financed from either general revenue or the federal UI fund.

2. Financing

The U.S. UI system is based on a self-financing principle, although general federal revenues have been used to pay for specific extended benefits. Currently, the U.S. system is funded almost entirely by a payroll tax on employers; only four states have provisions for worker payment through a small payroll tax.

Employers are taxed by both their resident state and, a smaller amount, by the federal government which goes to the respective state and federal UI funds. State funds are used to pay out the bulk of UI benefits. Federal UI taxes are built up to increase the balances available for the federal share of extended benefits and to provide re-payable loans to States with low balances. Federal UI taxes also pay for administrative funding of the UI program and 97% of the funding for the federal Employment Service offices that administer UI.

⁶²*Technical Supplement: UI Program Mission and Principles* (Washington: U.S. Department of Labor, 1998), 1.

Experience Rating. The U.S. system is unique in that, rather than a flat rate, it charges employers a variable rate depending on how much unemployment they have generated, a so-called "experience rating." Employers who lay off few employees receive a discounted contribution rate, while employers causing large layoffs pay a higher rate.

There are important trade-offs in developing an experience-rated system. Some pool must be reserved for shared risks: for example, bankrupt firms who no longer pay into the system, start-up firms which have not yet established a track record, or unemployment that is not the fault of the employer.⁶³ The U.S. system allows each state to set the experience rating for firms within the state; new firms are charged a standard rate until they establish a track record. There is great variability among the states in how they calculate experience, and how much of the rate is experience rated.

Current index figures indicate that, on average, about 61% of state level benefits are paid by the employers actually causing unemployment, and the rest is paid by shared risk.⁶⁴ The index level for the nation has fluctuated in the 60% range since it was developed in 1988. However, within this average, there is still a great deal of variability among the states. For example, in 1996, 86% of New York's UI benefits were paid by employers causing the layoffs, while only 42% did so in Wyoming.⁶⁵

Maximum and minimum UI tax rates for employers can thus vary substantially by state. For example, for the 1993 tax year, the minimum tax rate varied from 0% (in 7 states) to a high of 2.5% in New York. The maximum tax rate varied from 5.4% (in 13 states) to 10.5% in Pennsylvania.⁶⁶

The U.S. system was developed on the forward financing principle. State and federal surpluses are supposed to be built up during years of economic prosperity to pay for the downturns that require greater UI disbursements. There has, however, been great variability over time in states' UI fund solvency, with some needing to borrow frequently from the federal government to cover greater demands. This has called into question the long-term viability of the forward financing principle.

3. Program Characteristics: Eligibility, Benefit Levels, and Analysis of Beneficiaries

Eligibility. The basic requirement for all U.S. programs is that UI recipients be able to work and available to accept and offer of work. Beyond this, states are able to set a wide range of eligibility conditions for their specific programs. Workers must, though, demonstrate significant prior workforce attachment; new entrants are not eligible. The self-employed are also not covered in the United States. Typically, States tend to disqualify individuals who leave jobs without good cause, carry out misconduct on the job, or refuse suitable work.

⁶³Some states in the United States pay benefits to those who quit work voluntarily.

⁶⁴*Ibid.*, 8.

⁶⁵*Technical Supplement: Benefit Funding* (Washington, DC: U.S. Department of Labor, 1998), 5-6.

⁶⁶Advisory Council on Unemployment Compensation, 75.

The Federal government does set a few additional guidelines which require states to deny benefits to some or permit them for others. Federal law, for example, requires workers in approved training to receive benefits if they are otherwise qualified. States are required to deny benefits to teachers between terms and certain athletes between seasons.

Benefit Levels. As with eligibility, benefit levels are determined at the state level. All States provide a maximum duration of 26 weeks during the 12 months following the filing of the claim; two provide longer-term benefits. This makes the United States a relatively shorter-term benefit program in comparison with Western Europe, which typically exceeds one year, often many more. Even with that, the percentage of claimants exhausting their full benefits has varied from the 1980s from 30-40%.⁶⁷

A permanent program of extended benefits, required since the early 1970s by Federal law, provides an additional 13 weeks of benefits and an option of a further seven weeks beyond the 13. Congress has provided even further extensions in periods of recession by special supplemental legislation.

Benefits are not means-tested; they are available to any worker who qualifies. Benefit levels are intended to replace a given level of previous income, so the beneficiaries' former salary is key to their level of benefits. The majority of states replaced one-half or less of pre-tax weekly earnings. In 1997, the national average pre-tax wage replacement was 47%, with the national range spanning from 32.2% to 57.3%.⁶⁸ All states cap benefit levels in some form. The lowest State cap is \$180 per week; the highest (without dependents) is \$390. Thirteen states provide additional benefits if the recipient has dependents; the highest dependency allowance would bring weekly benefits to \$573.

Analysis of Beneficiaries. In line with overall unemployment trends, the U.S. UI system has increasingly served older, more professional workers, although the majority of claimants make less than \$25,000/year. The average American UI recipient is a white male earning less than \$25,000/year. From 1988 to 1997, the average age of UI claimants rose from 38.2 to 40.1, following national trends in which the average age of job losers rose.⁶⁹ The greatest age increase among the unemployment was for professionals whose average age rose from 39.9 in 1988 to 42.1 in 1997. The majority of recipients continue to be male (56% in 1996), although female rates have been increasing. Over two-thirds of UI recipients (77% in 1996) made less than \$25,000, and 48% earned below the poverty level for a family of five.⁷⁰ Figure 8 demonstrates the current racial breakdown of recipients who are predominately white. Black and Hispanic recipients make up a little over one-quarter of recipients.

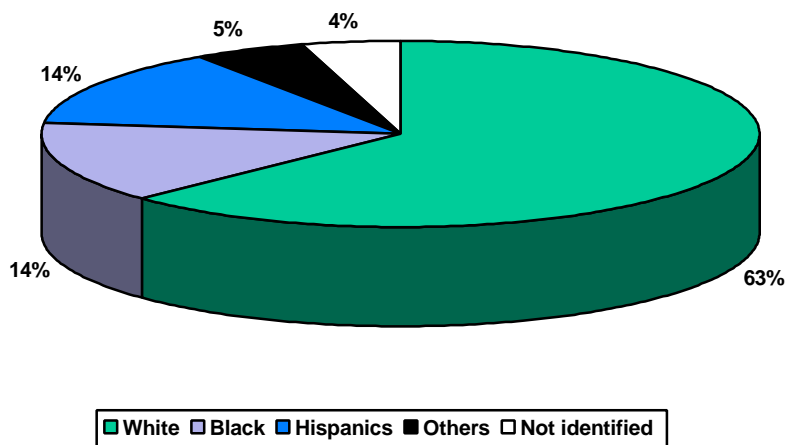
⁶⁷Advisory Council, 21.

⁶⁸*A Dialogue: Unemployment Insurance and Employment Service Programs* (Washington: U.S. Department of Labor, 1998), 5.

⁶⁹Beneficiary characteristics are from State data submitted to the Characteristics of the Insured Unemployed (ETA 203) as shown in *Technical Supplement: Current Environment* (Washington: U.S. Department of Labor, 1998), 3.

⁷⁰Family level data, however, was not included.

Figure 8
U.S. UNEMPLOYMENT INSURANCE RECIPIENTS BY RACE
(1996)



Source: US Department of Labor

4. Administration

Federal law requires that UI be paid through public employment offices or other such offices approved by the Secretary of Labor. At the same time, the UI system is becoming increasingly automated. In many states, workers need only report in person to make an initial claim; thereafter they can mail in weekly claims or use a telephone voice response unit. This has been a more convenient process for workers, and in many instances was motivated by cost savings, as states could no longer afford to keep many local offices open. Some states have even started taking initial claims over the phone, and others are considering letting workers use the Internet to make claims.

Benefit administration itself is considered relatively responsive. Timeliness of benefit payment has gone down considerably over the life of the program. While in the early 1970s, between 75%-85% of payments were made within 14-21 days, currently that figure is over 90%.⁷¹ Employer payments and record keeping is also being simplified and better automated with new methods being tested as of 1995 to integrate federal reporting and tax requirements of all federal agencies (e.g., Treasury, Labor-UI, Social Security).

A key problem related to administration of the U.S. system is in the funding. In principle, the federal government is to provide funds to the states for the administration of the UI system.

⁷¹*Technical Supplement: Additional Information on the UI Program* (Washington: U.S. Department of Labor, 1998), 7.

In practice, through complicated budget regulations, UI administration funds actually compete with other discretionary budget programs for funds and savings from UI administration are not necessarily turned back to the UI program. States also complain about the formulas used to calculate how much administrative money each State receives, with different adjustments made for case load and cost of living. To date, there has been no agreement between Federal and state officials on how to change allocation for administrative expenses. Change to current formulas is no easy task, as many states oppose changes that would decrease the funding for their program administration. In sum, it is harder under the vagaries of the U.S. system to equitably equilibrate administration costs to actual costs and this can provide unequal incentives for administrative savings and reform.

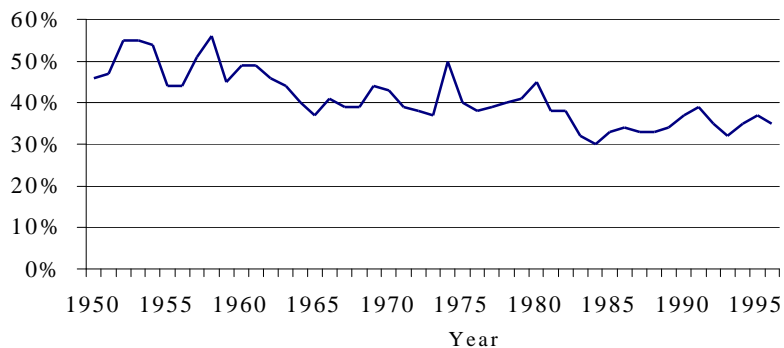
5. Key Observations: United States

- **Diverging Trends in Integrating UI and Re-Employment Services.** In principle, the U.S. system seeks to facilitate the transition of workers into new employment by connecting UI recipients with reemployment services (national employment service, job banks, job-finding services, and training). The national data bank, America's Job Bank, and the national resume service, America's Talent Bank, use Internet services to provide job finding and search services on-line. Simultaneous, there has been a trend to increase automation of the system and reduce the need for expensive physical office space. In some states, workers can apply by phone and never need to visit a caseworker or office. Concern has been raised that these two trends are running counter to each other and that, as automation increases, it will be harder and harder to link reemployment and training services. This is particularly true for the hard-to-reemploy. This could be reinforced as well by the continued perception that the national employment service is not widely used by the private sector and thus represents only a narrow segment of available employment. The effects of such automation on service delivery, cost, and system integration have not been fully studied, but have been duly identified by the U.S. Secretary of Labor for future investigation.⁷²
- **Decreasing Coverage of the Unemployed.** The United States has been successful in covering increasing percentages of wage and salary employment under the UI program. Coverage is near universal of the civilian workforce with the exception of the self-employed and workers on small farms. Nonetheless, while coverage has expanded, a greater proportion of the unemployed do not collect unemployment insurance. Figure 9 shows this change over time in the percent on unemployment insurance of the total unemployed. There are a multitude of explanations behind this trend; no single one provides the full explanation. One, federal and state policy changes have restricted eligibility and benefits overtime and taxed benefits. Two, there has been a decline in employment in the manufacturing sectors typically drawing on unemployment insurance. Three, there has been a decline in the unionized

⁷²Technical Supplement: Additional Information, 8.

workforce and rise in the number of self-employed and independent workers who do not participate in UI. Four, there have been population shifts out of the industrial states to states with traditionally low UI claims.

Figure 9
UNITED STATES: INSURED UNEMPLOYMENT AS A
PERCENT OF TOTAL UNEMPLOYMENT
(1950-1996)

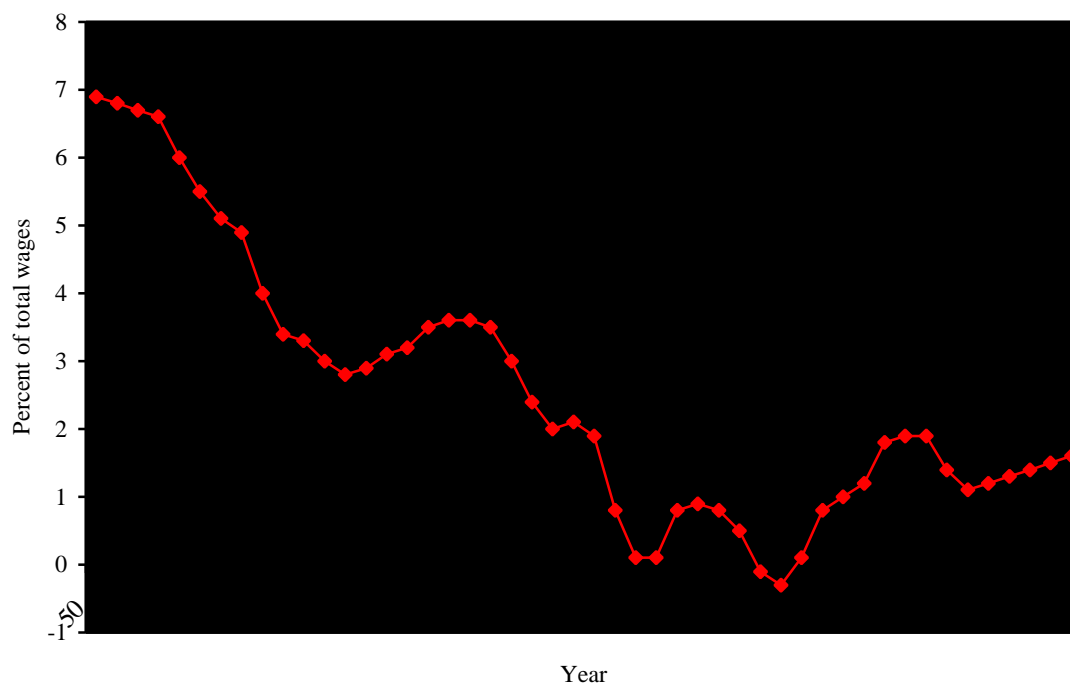


Source: U.S. Department of Labor

- **Financial Solvency of Continued Concern.** The great variability in state-level UI demands, in eligibility criteria and benefits, and differences in fiscal administration contribute to very different conditions of financial soundness and sustainability of state UI funds. By default, rather than design, many state-level systems are functioning more on a "pay-as-you-go" fashion, rather than as intended by forward funding funds in prosperous years to save for lean ones. Following the severe recession of the early 1980s, 33 States did not have enough funds to pay UI benefits and had to take loans from the Federal Government. Figure 10 below shows the decline over time of state UI trust funds as a percent of total wages. The return to forward funding is a goal advocated both in the Secretary of Labor's current dialogue and in the findings of the Advisory Council on Unemployment Compensation appointed by the President.⁷³

⁷³Advisory Council, 13.

Figure 10
UNITED STATES: UI TRUST FUND BALANCES
(1950 - 1996)



- **State-Level Systems: Fits U.S. Context.** As noted above, the U.S. system, by definition, permits a great deal of flexibility and variation at the state level, in what it charges employers for UI, what benefits are received, and who is eligible. This approach fits appropriately the U.S. context in which state administrative capacity is relatively strong and traditions for state management of social benefits are long-standing. This capacity and social tradition for state-directed benefits, as well as tolerance for differing levels of benefits, may not fit appropriately many other nations, Latin America and the Caribbean included. The United States is one of very few nations which has a decentralized, state-UI benefit system; the vast majority have uniform benefit and eligibility criteria and are run by federal agencies.⁷⁴

III. UNEMPLOYMENT INSURANCE AND THE FINANCING OF TRAINING

In the terminology of the field, unemployment insurance is considered a "passive" labor market program in that it transfers income to a recipient without actively engaging them in reemployment. Early retirement programs, too, are considered passive labor market

⁷⁴Canada is recently moving to devolve UI responsibilities to the provinces.

policies as there is no intention of workers returning to active employment. Passive policies are contrasted to so-called "active" labor market policies that more directly seek to integrate workers into the marketplace. The principal forms of active labor market policies are: training and retraining, job search assistance, employment services, employment subsidies, and measures for the disabled. Active labor market policies are exclusively for the unemployed. Many policies seek to improve the skills match or upgrade the productivity of workers who are already in jobs.

The table below (3.1) demonstrates the current balance between active and passive labor market policies in a range of OECD nations as a percent of Gross Domestic Products (GDP). One can observe the large proportion of funding devoted to passive measures relative to active measures.

As a separate subquestion of this study, the sponsors requested a brief inquiry into whether countries were using revenues from passive unemployment insurance to fund training programs. Can and do countries use unemployment insurance to fund their national training systems? For this study not only were the seven cases studied reviewed, but also a much wider range of literature and cases were surveyed.

Table 3.1
ACTIVE VS. PASSIVE
LABOR MARKET POLICIES
(Select OECD Countries) 1996-1997
(as % of GDP)

Programs	Countries						
	France (1996)	Germany (1997)	Netherlands (1997)	Norway (1997)	Poland (1996)	United Kingdom (1996/97)	United States (1996/97)
Passive Measures							
1. Unemployment Compensation	1.44	2.49	3.33	0.70	1.77	1.05	0.26
2. Early Retirement for Labor	0.36	0.05	NA	NA	0.05	NA	NA
Market Reasons							
Active Measures							
3. Public Employment Service	0.16	0.21	0.35	0.16	0.02	0.18	0.06
4. Labor Market Training	0.36	0.36	0.13	0.17	0.02	0.09	0.04
5. Youth Training	0.24	0.07	0.10	0.04	0.10	0.13	0.03
6. Subsidized Employment	0.48	0.34	0.42	0.07	0.16	NA	0.01
7. Measures for the Disabled	0.08	0.28	0.54	0.47	0.01	0.02	0.03
Total							
Passive Measures (1-2)	1.80	2.54	3.33	0.70	1.82	1.05	0.26
Active Measures (3-7)	1.32	1.26	1.54	0.91	0.31	0.42	0.17

Source: OECD Social Expenditure Data Bank

The question asked in this chapter is a very narrow one: the use of UI monies to fund training on a significant scale. By any account, if one examines the literature on the financing of training, using unemployment revenues is rarely mentioned. The vast majority of training around the world is financed by: (1) direct government tax revenues (or rebates); (2) contributions by employers; and, (3) fees/contributions by beneficiaries (workers). Most systems contain a mix of financing by all three parties in very different

forms. Unemployment insurance revenues come from either government taxes or contributions of employers/employees, or again, a combination of these sources. Thus, rather than a distinct new area of financing, using unemployment insurance revenues to finance training simply means redirecting government revenues or employer/ee contributions from their intended purpose -- paying UI claims -- to a broader purpose.

A. Training and Unemployment Insurance

A review of current experience of the financing of national training systems through unemployment insurance revenues yields a very simple answer. It does not happen. **No country surveyed uses UI revenues to directly and exclusively finance training on any substantial scale.** There are many reasons for this.

First, training and UI have different cyclical funding demands and linking the two creates greater instability in funding for both. The financial demands on unemployment insurance are very cyclical; training is more an investment function that is needed in a down cycle but has a more fixed, long-term demand. Depending on UI revenues to fund training typically has meant that funds for training are cut back when unemployment is high. This, unfortunately, is just when training programs are likely to be the most desirable. This is precisely what happened in Poland even without formal linkage between UI and training. As unemployment rose sharply in the early 1990s, the Polish government had to cut back drastically on the funds from its Labor Fund going to training and other active labor market policies in order to channel it into UI benefits. The percentage share of expenditures from the Labor fund going to active labor market policies declined from 32.1% in 1990 to 7% in 1991 and fell even further to 4.7% in 1992.⁷⁵

Second, drawing training monies out of UI funds risks greater insolvency in the UI program. Countries typically want to maintain the solvency of their UI funds for the periods when they really need them, so they often require the accounts to be kept separate. Insolvency is of great concern because UI is a form of insurance that pays out frequently. It is not, for example, like high end, flood or disaster insurance that can pay out infrequently. It is rare to see a case of the long-term accumulation of surpluses. Even with separation of UI funds from other labor market initiatives, funding crises still result where training monies are cut to pay for UI.

Third, if unemployment insurance generates significant surplus revenues it is likely because the contribution rate is set too high relative to demand. This was the case of Barbados, discussed in Chapter II, which was one of the rare cases of a UI program generating significant surplus revenue. The Barbadian government significantly raised the contribution rate quite dramatically to 5.5% (total) during the structural adjustment years of the early 1990s,⁷⁶ left it at this higher level too long, then reduced it to a total of 3% and

⁷⁵Hartmut Lehmann, *Labour Market Flows and the Evaluation of Labour Market Policies in Poland*, Discussion Paper No. 161 (London: Center for Economic Performance, London School of Economics, July 1993), 7.

⁷⁶The combined rates for workers and firms were increased from 1 to 2.75% in October 1991, and then in December 1991 from 2.75% to 5.5% (2.75% workers/firms).

that was still too high for the demand for the program. Graph 1 in Chapter II displays the annual creation of net surpluses beginning in 1992. The Barbadian government does not, however, intend for its UI program to generate such large surpluses forever. One problem that results in setting contribution rates above anticipated demand is to undermine long-term support within the business community. More typically, countries would seek multiple uses for a high contribution rate. Below is described the "large pool" model where a portion of the resources are devoted to UI, others to active labor market activities.

A fourth factor keeping training and UI apart is a bureaucratic one. In some countries, the agencies handling UI and training are distinct; they require different skills and a different bureaucratic set-up. UI is sometimes handled as a form of social insurance with a more social-oriented agency, although in a number of countries it is affiliated with the Labor Ministry. Distinct from training, UI requires a system of local offices and accounting procedures to handle weekly/monthly disbursements.

Finally, limited experience with utilizing UI revenues for the financing of training indicates that combining the two programs may make it harder to direct training funds to the most disadvantaged groups. If UI monies come from paying employer and employee contributors, then they have a right to expect that the training funds be returned to them. This was what was found by the OECD in the case of Austria, which previously had funded a small amount of training from the residual of UI contributions over benefits paid:

..the financing of programs through the UI system seems also to have impeded the broadening of the spectrum of activities to include disadvantaged marginal groups (who, as a rule, have not been regular contributors to UI).⁷⁷

B. Models for Funding UI and Training

Although no country uses UI revenues to exclusively fund training on any substantial scale, there were a number of systems noted in the research for this study which link, in part, the financing of the two. For the purposes of analysis, most systems can be categorized as one of two types of models. The first is the **large pool** model. In these cases, a larger contribution rate is assessed on business (and workers) and funds are pooled into a fund or institute that finances a range of passive and active measures. Germany is a primary example of this model. In such a case, there is typically not a specific contribution rate destined just for UI. There are variations of this model in which UI funds are channeled into a larger pool, but one can still identify the UI revenue stream.

The second group of cases can be called the **small pool** model. In these cases, a portion of UI revenues goes to fund specific training initiatives related to unemployment. These do

⁷⁷ *Unemployment Insurance and Active Labour Market Policies* (Paris: Organization of Economic Cooperation and Development, 1993), 188.

not represent the bulk of training financed by the country, but rather a method of financing a few discrete programs.

1. Large Pool Model

In the large pool model, contributions destined for paying unemployment benefits are pooled in a large pot that finances a range of active and passive training programs. It is not that UI "surpluses" are used for training; UI is considered part of an integrated mix. In Germany, the payroll tax on employers and employees funds an Institute (the Federal Employment Institute), which uses the money to fund a host of programs including: UI, unemployment assistance, and training. The government makes up any deficit. It should be emphasized, though, that even in this case the German system relies heavily on employer involvement and employer voluntary financing of training, particularly apprenticeships. So even in this case, the large pool does not encompass all. The German case, though, is still instructive in how UI and training funding interact in a large pool model:

- It shows that drawing training and UI monies from the same pot runs into fiscal difficulties, particularly in economic downturns when so much money is needed for UI; and,
- That the mixing of the funds, also contributed to programmatic difficulties: when surpluses were large in the 60s -70s this led to generous design of programs, and time consuming changes in terms and conditions of programs.

A variation of the large pool model can be seen in the case of Argentina where UI funds are pooled with other revenues, including financing from multilateral institutions in the National Employment Fund, the *Fondo de Empleo*. The National Employment Fund finances the youth program (*Programa Joven*), infrastructure investments, and limited employment subsidies. UI is by far the biggest consumer of the fund, comprising just over the majority of its expenditures.⁷⁸ In the Argentine case, though, the business contribution to UI is fairly explicit. The 1.5% tax on employers is considered the limit the business sector will sustain and as the case study in Chapter II laid out efforts have been made over time to adjust program eligibility to meet anticipated revenues from this contribution. Thus, it cannot be argued that UI revenues are being utilized to fund active labor market programs; these programs have different sources of financing.

One might argue that the large pool model has some parallels to the payroll training taxes in many Latin American countries. In the case of the payroll training tax, though, the fund pool all goes to one state institution. If the government chooses to fund additional programs, it does so outside the training tax.

⁷⁸In 1995, UI comprised 54% of the *Fundo de Empleo*, from *Estimating the Benefits of Labor Reform in Argentina* (Washington DC: World Bank, Annexes, 1992), 34.

2. Small Pool Model

In contrast to the large pool model, the funds destined for unemployment insurance are clearly demarcated for UI. In the small pool model, a portion of these designated funds go to fund specific training or other active labor market policies. In the language of the field this is called "developmental uses of UI." This means that a portion of the UI funds are directed to activities to reduce or ameliorate the effects of unemployment.

There are a number of different variations and cases in the small pool model. The most prominent case is Japan. Austria and Canada used to use UI funds for some training but have both recently changed their systems for different reasons. One might even argue the United States fits the small developmental uses model, since it funds exclusively its small national employment service from UI monies.

While unemployment insurance does exist in Japan, it does not have the central role it does in the OECD countries because of the importance of "lifetime employment," in-company training, regional development, and other measures that keep formal sector workers from the unemployment rolls. Nonetheless, Japanese UI has a number of unusual features and employs the "developmental uses of UI" in interesting ways.

The Japanese system is financed by a payroll tax on employers and employees (1.15% of wages) which is supplemented by the government, sometimes to one-third the costs. The Japanese system is called "employment insurance" for an appropriate reason, because it uses the extra financing to prevent unemployment, promote worker training, and correct "improper employment situations." Three services are funded from UI monies. These services are funded from an explicit levy just on employers. These services are:

- **Stabilization of employment.** Programs to prevent unemployment in insured workers, rectify improper employment situations, and increase employment opportunities in firms. Includes subsidies for employment development for specific job applications and human resource capacity building within firms.
- **Services for Developing Workers' Abilities.** Includes establishment and operation of workers' education and training facilities, assistance for workers' receiving education and training, other training upgrades.
- **Services for Promoting Workers' Welfare.** Includes funds for improving working environments, job finding assistance, and promoting worker welfare.

It is important to remember that these are relatively small initiatives, as Japanese firms, then other government programs, provide the lion's share of training done in the country. Nonetheless, these initiatives have an intellectual consistency in the use of UI revenues and provide an interesting case of a "developmental uses" model.

C. Conclusions on Financing UI and Training

This review has argued that the proposition that unemployment insurance revenues could be used to finance training is not only unrealistic but also not in the best interests of stable funding for either UI or training. Supporting this argument is the fact that no UI system surveyed attempts to fund all its training programs through surplus UI revenues. Instead, the chapter showed that there are broadly two groups of models in relating UI financing with training. One is the large group model in which UI funds are pooled with other funds to finance both active and passive labor market programs. The second group is the small group model in which some UI funds are utilized for specific training initiatives or employment initiatives related to unemployment. But these are not the bulk of training or active labor market policies conducted in the country.

It must be kept in mind that most OECD countries, with far greater resources than Latin America and the Caribbean, are struggling with how to devote more resources to active labor market policies and in doing so cut back benefits or control costs to fund the heavy existing demands on their unemployment insurance systems. This does not provide a workable environment for financing training. In the case of the large pool model, there are risks during periods of high unemployment that training programs may need to be scaled back. In the small pool model, the expenditures for training out of UI funds are limited so there is typically little such risk. Broadly, though, current realities must be emphasized. In contrast to one program financing the other, there has been a trend in OECD countries that the rise in unemployment has increasingly "crowded out" resources for active labor market policies in favor of unemployment benefits, rather than create conditions for ample financing.⁷⁹

IV. Lessons and Recommendations for Latin America and the Caribbean

Given the limited experience in Latin America and the Caribbean with unemployment insurance systems, this study has sought to survey a broader range of experience in order to draw potential lessons for countries in the region considering whether UI makes sense for their nation. The lessons drawn from this study constitute only a preliminary input into an emerging national dialogue within each country on labor market policies. Would unemployment insurance be a useful instrument in a specific country in the region? Does it fit a country's national objectives, labor market characteristics and needs, and resource constraints?

The experience surveyed in this study shows that unemployment insurance is in no way a "one size fits all" program. Unemployment insurance exhibits some basic, common features across countries: it is largely a short-term income replacement program for the unemployed of the formal sector who have demonstrated labor force attachment. But within this general framework, there is a notable diversity in terms of length/type of

⁷⁹Harmut Lehmann, *Active Labour Market Policies in the OECD and in Selected Transition Economies* (Washington, DC: World Bank, Policy Research Working Paper, August 1995), 2.

benefits, eligibility, design features, and national objectives. This diversity is significant enough that unemployment insurance can range from the largest labor market program run by a country, as in most OECD countries (in dollar terms) or, in a smaller number of cases, it can be a circumscribed program applying to a small segment of the workforce (e.g., Argentina) or single sector (e.g., construction in Argentina or artisan fishermen in Brazil). Importantly, there is interest in the Latin American region in moving away from traditional tax-based unemployment insurance programs to ones where workers accrue individual savings accounts to use during unemployment.

This study reveals the need for a great deal of caution in broadly applying unemployment insurance models to Latin America and the Caribbean. First, because unemployment insurance has a mixed record in many countries in terms of policy effectiveness and financial viability. Secure funding for UI has been a challenge and a number of countries have run into funding crises just when demand is highest. There is concern as well that UI has not been used effectively to channel workers into new employment. Many OECD countries are struggling to reorient their labor policies away from reliance on primarily "passive" labor market policies -- UI and early retirement programs -- in favor of more active labor market policies -- job placement assistance, retraining and education, and employment creation. The Latin American and Caribbean region should not be quick to embrace existing models which themselves are under scrutiny.

Second, caution is required in applying UI models to the region because there are a number of traits of Latin American and Caribbean labor markets which would likely make UI narrower in scope and effectiveness, depending on the labor market objective sought for UI. Through the case study research, it became clear that a number of Latin American and Caribbean regional characteristics might distinctly affect the application of UI to the region. These regional characteristics include large informal sectors, high youth unemployment and young working populations, and the existence of nationally-mandated job termination benefits.

The conclusions of this study are presented in two parts. Using the case study research, the first part discusses specific regional traits and their relevance to unemployment insurance, providing an initial screen to whether and what type of unemployment insurance might be applicable to countries in the region. The second section presents broader conclusions and lessons learned about consideration of unemployment insurance models in the region, by the type of objective sought, again drawing on the case study research.

Broadly, the paper concludes that unemployment insurance in the Latin American and Caribbean context is not universally applicable to the region. Rather, its application depends on specific country labor market conditions and how these fit with the desired purpose of unemployment insurance. Is unemployment insurance to be intended for macroeconomic stabilization, a labor market transition and restructuring tool, or a social safety net for the poor? The difference in objectives yields a very different answer in each country about whether and what form of unemployment insurance is applicable. This chapter organizes its recommendations in terms of the potential objectives sought for UI:

macroeconomic stabilization, social safety net, income replacement/labor force attachment reward, labor market transition tool.

Overall, the study concludes that unemployment insurance is most applicable to the region as a labor market transition tool, and least applicable as a wide social safety net or tool for macroeconomic stabilization. There are other policy instruments which are likely more effective for the latter two goals.⁸⁰ Before these more generalized conclusions about how UI might be applied in the Latin American and Caribbean context, there are a number of factors regarding the region's labor market that are worth considering in both assessing and tailoring a UI program to the Latin American context.

A. Labor Market Characteristics in Latin America and the Caribbean Important to Assessing/Designing UI Systems: Lessons and Considerations

There are many factors which affect how unemployment insurance might interact in a specific national labor market. Would a large segment of the unemployed be ineligible for assistance because they work in the informal sector? Would unemployment insurance benefits be significant enough given other termination benefits available?

This section reviews four important regional labor market characteristics which have come out during the case study research of other systems. This section discusses how these characteristics might interact with unemployment insurance, affecting its impact and utility. In some instances, the paper suggests design features that can compensate for these traits. The four regional characteristics discussed are: high rates of informal sector employment; high payroll and other labor taxes; existence of severance pay and other job termination benefits; and large youth populations. It must be emphasized that this is a descriptive analysis as there has been simply little labor market research and survey work done in the region on labor market traits relevant to UI. It is important to stress as well that these four characteristics, while common in the region, vary markedly between countries and their relevance depends thus on the particular Latin American or Caribbean nation.

1. Large Informal Sector

In the vast majority of cases of unemployment insurance worldwide (e.g., OECD) informality is not a predominant feature of the labor market. Neither was it a feature of the industrial economies which first developed and implemented UI. Informality, or dual labor markets (mixed informal and formal), have arisen predominantly in developing economies, but not universally. It is a predominant feature of Latin American labor markets, but is much less prevalent in the Caribbean.

⁸⁰See Gustavo Márquez, "Unemployment Insurance and Emergency Employment Programs in Latin America and the Caribbean: An Overview", Office of the Chief Economist, Inter-American Development Bank, February 1999.

But where informal sector is large in Latin America, it is quite large. Informal sector employment for the Latin America and Caribbean region as a whole is notably high and has continued to grow, increasing on average from 51.6% in 1990 to 57.4% in 1996.⁸¹ Every Latin American country in the region has shown increased rates of informality, with countries like Paraguay, Bolivia and Mexico showing urban informality rates over 60%.⁸²

Logically, unemployment insurance is a system that applies only to the formal sector. Informal sector work is not recorded; there are no consistent records about start and end dates and salary levels. There is no way to consistently and fairly document unemployment and salary on the same basis for all workers for the informal sector.⁸³ Nor is it easy to imagine how one could collect UI contributions in the way that they are deducted from formal sector workers' paychecks. In light of these challenges, no UI system in the world tries to incorporate informal sector workers and only a handful even incorporate formal sector workers who are self-employed.⁸⁴

At first glance, though, it wouldn't seem to matter much whether UI applied just to the formal sector. As UI is typically "self-financed" -- contributions are paid for out of contributions from formal sector workers and employers -- it constitutes a form of "self-taxation." Thus, it is up to the formal sector whether it wishes to insure itself against unemployment and trends in one sector would not seem to necessarily affect the other. The only direct inequity would come in the use of general government revenues to finance UI, rather than taxation, as this might mean government revenues supporting formal sector workers at the expense of alternatives for informal workers.

This section looks a little closer at what relevance a large informal sector might have to achieving the objectives of and executing well an unemployment insurance program. To date, there has been limited study of the interactions of unemployment insurance in dual labor markets, largely studies and surveys in Eastern Europe which have smaller informal sectors than Latin America. There has been no systematic study in Latin America among the limited UI systems as to how they function in relation to the informal sector. Short-term field research conducted in Argentina and Brazil for this study and the experience of Eastern Europe indicate a few potential implications from the introduction of UI into economies with informal sectors, **trends which may likely weaken the impact of unemployment insurance for certain objectives and give perverse incentives to**

⁸¹ Lora and Márquez, 9.

⁸² *Ibid.*, 10.

⁸³ Informal sector workers could save for the possibility of unemployment or contribute to some individual savings account (although unlikely for low-income informal sector workers). Yet, because the period of unemployment would be impossible to uniformly document, access to the savings account would have to be so open as to be used for purposes well beyond unemployment.

⁸⁴ Individual savings accounts could be generated by informal sector workers, but since workers could not certify when they began and ended jobs using similar criteria, the accounts would have to be available on demand, that is, they would be essential the same as any other savings account.

increase further the informal sector. It must be stressed that these are only potential implications; much more systematic study is needed and recommended by this study before firmer conclusions can be drawn. The implications fall into two generally categories: how UI might affect the interaction and mix between the formal and informal sectors; and, how a large informal sector affects which objectives of a UI program are achievable.

a. Potential Interaction of UI in Informal/Formal Labor Mix

Following are some potential implications of the interaction of UI with informal labor markets in the Latin American context:

- **Undermine Utility of UI:** If a large proportion of workers receiving UI benefits are also working on the side in the informal sector this undermines some of the key rationales for providing workers with unemployment insurance benefits. As it exists in the OECD countries, UI beneficiaries are to be available for work and utilizing the time to find work roughly equivalent to their former skill and income level. Because workers are less available to look for work if engaged in the informal sector, the transition to new employment may take longer or a worker may simply continue to work in the informal sector once benefits expire, likely at lower levels of remuneration. UI for many workers then functions as a "short-term salary supplement," rather than income support as a transition tool to finding new, skill-appropriate work. As well, a perverse penalty would be set up: lose your UI benefits if you obtain formal sector work, keep them if you work informally. This disincentive is not necessarily decisive; there are many more benefits to long-term work in the formal sector. It might, though, provide incentives for workers to prolong entry into the formal sector, undermining the rationale for UI as a transition tool, and making it less likely that the worker ever returns to formal sector work.
- **Reinforce Greater Informality:** qualitative evidence indicates that with the existence of UI, a segment of workers are entering into informal sector arrangements -- sometimes with the employer who just laid them off -- and are able to use UI as a cushion against the reduction of income and loss of benefits from the transition from formal to informal work. Without more intensive survey research it is difficult to determine to what extent this is occurring in the few UI systems in Latin America. It is significant, though, that this short-term cushion for informal sector employment was mentioned by all types of participants in Brazil and Argentina in interviews for this study -- unions, government administrators, and business leaders. The incentive to undertake informal sector work and collect UI benefits as well is reinforced in systems where the level of UI benefits are kept near the minimum wage, as in many developing countries.

It is important to stress that in economies with large informal sectors, there already exists incentives for employers to hire informally given the cost savings

and limited fear of detection/sanctions. It is not known what further incentive UI might add. At a minimum, though, the existence of UI makes it easier for employers to convert formal to informal sector jobs and convince workers to go along with it.

- **Reinforce Job Insecurity in the Informal Sector As Formal Sector Employment Becomes More Protected.** Job insecurity is very high and of concern to workers throughout Latin America. Countries with higher levels of job insecurity are also the ones with greater informal sectors.⁸⁵ Unemployment insurance has been viewed as one policy tool that would help reduce job insecurity among workers in the region. It is important to stress, however, that enacting a UI system in countries with large informal sectors would **not** help lessen insecurity in the larger informal sector. Indeed, such insecurity would likely worsen as the formal sector would become proportionately more safe and secure.

b. UI Objectives Critical in Large Informal Sector Economies: Poor Instrument for Social Safety Net

Beyond the implications for the interaction between UI and the informal and formal sectors, the existence of a large pool of informal sector workers in a Latin American or Caribbean country **affects the national utility and purpose of enacting a UI system**. Simply put, the existence of a large pool of informal sector workers in a given country **renders UI decidedly less useful as a social safety net or macroeconomic stabilization instrument**. UI could not be useful on a broad basis to stabilize incomes in the economy when less than half of the working population was eligible for assistance. It would be unable to protect incomes at the lower end of the scale when the vast majority of the poor would also be ineligible.

This does not mean UI should be abandoned as a policy option in countries with large informal sectors. Rather, **countries would have to be much more careful about which objective was sought by UI and tailor program design accordingly**. Countries with large informal sectors should understand that it will be **impossible to insure that UI recipients meet the criteria of available to work by being 100% unemployed**. It is important to decide whether there is a national interest in still providing some income protection to unemployed formal sector workers (labor attachment reward objective) or facilitating the labor market transition of formal sector workers (labor market transition objective). Rather, it means that UI is better used for the objective of a labor market transition tool for formal sector workers. If so, countries should consider **providing greater job search requirements and assistance** as way to reinforce the use of UI

⁸⁵Lora and Márquez, 16.

as a market transition tool, rather than reinforce supplementary work in the informal sector. A second consideration would be to **means-test benefits** as a way not to reinforce informality at higher wage levels. Finally, countries in the region would benefit from greater study on the interaction of UI and dual labor markets before major policy changes as suggested by this study.

2. Payroll and Other Labor Taxes

One of the factors contributing to the rise in informal labor markets in the region is the avoidance of the payment of heavy taxes on labor. Effective tax rates for labor vary markedly across the region. Costs of social security are lowest in the Caribbean while highest in Uruguay, Argentina, Colombia and Brazil.⁸⁶ An estimate of the total cost of labor benefits and social programs⁸⁷ among Mercosur countries finds a variance in total costs from 102% of a workers' salary in Brazil, to 70% in Argentina, and 41% in Paraguay.⁸⁸

High tax requirements on labor can provide a disincentive to hire labor over investing in capital and may discourage investment in a high-tax country at the expense of a low-tax one. There has also been a strong positive link between high labor costs and increasing informality.⁸⁹ This, of course, does not mean that taxes on labor are not important to providing for basic social security and other labor market programs; it is the comparative burden of taxation and how the funds are used that is most relevant.

In considering whether to impose additional taxes for contributions to a UI program, Latin American and Caribbean countries with high effective labor taxes need to consider that **UI may need to be part of an overall restructuring and labor market reform**. OECD nations largely had the advantage of creating UI systems at earlier stages with lower effective tax rates or with greater ability to sustain higher effective rates. Latin American and Caribbean nations will need to be more creative in how they might incorporate UI systems within their current labor market mix. Perhaps **a portion of current payroll training taxes could be devoted to a UI system**; or, as discussed below, a UI system could be part of a reform of the gamut of severance and termination benefits. This is not to imply that key benefits must be reduced for labor, but rather that to incorporate a new benefit in Latin America, other benefits may need to be better structured so as not to

⁸⁶*Economic and Social Progress in Latin America*, Washington, DC: Inter-American Development Bank, 1996, 188.

⁸⁷This includes contributions to social security, training and social programs (e.g., SENAI, SESI), holiday and vacation pay, and 13th month salary.

⁸⁸José Pastore, *Encargos Sociais: Implicações para o Salário, Emprego e Competitividade* (Sao Paulo: Editora LTr, 1997), 91.

⁸⁹*Economic and Social Progress in Latin America: 1996*, 205.

disadvantage labor by discouraging employment and feeding the growth of the informal sector.

3. Existence of Severance Pay and other Termination Benefits

A third factor that needs to be considered in proposing or designing UI systems for Latin America is the extent of severance and other termination benefits already in place, the objectives and amount of benefits, and the potential interaction with UI. Here again, Latin American and Caribbean labor market characteristics can vary with the OECD countries where UI originated. In many of the OECD countries, there were few nationally-mandated termination benefits before UI was created. In contrast, the Latin America and Caribbean tradition has been to rely on nationally-mandated requirements rather than create specific benefit programs or rely on collective bargaining mechanisms.

Most countries in the region require an employer to provide termination benefits to workers fired without just cause. This is meant to protect workers against arbitrary dismissal as well as provide a penalty to employers who do so. Countries vary as to how substantial unjust dismissal benefits are, and importantly, whether economic circumstances are defined as an "unjust cause". In countries where economic or market changes are not a reason to fire a worker, the requirement provides additional disincentives to restructuring.

Fewer countries in the region have legislated severance benefits. Severance pay requires employers to pay workers upon termination -- for any reason -- an amount prorated with their years of service. In some countries in the region, severance pay can be quite generous. Colombia and Ecuador require as much as 25 months pay after 10 years or more of seniority⁹⁰; Argentina provides one month for every year worked, with a minimum of two months provided for a minimum of three months worked.

These types of benefits -- unjust termination and severance pay -- are intended to discourage firings and reward employment stability. Unemployment insurance has a different function in that it is not aimed at changing the incentives of the firing decision, but rather assisting the unemployed once terminated. Even though they have different objectives they can serve similar secondary purposes in providing income to workers once terminated. Depending on the labor market context, all three types of benefits can co-exist in one country, but this may not be the best alternative. For UI to be effective it must be seen to be a reward for labor market attachment and aid a worker in cushioning the transition to new employment, ideally utilizing their long-acquired skills. **Severance and other termination benefits may be so substantial in some countries as to dwarf, and make irrelevant, any UI program.**

It is important in Latin America and the Caribbean that **unemployment insurance programs be considered in the context of the entire mix of termination and severance benefits.** The existence of termination benefits was not necessarily a factor in other

⁹⁰*Economic and Social Progress in Latin America: 1996.*

countries that enacted unemployment insurance. In the United States, for example, severance pay agreements are made through collective bargaining agreements; there are no national standards or requirements. When UI was enacted in the United States following the Depression, it was seen as the only support mechanism for a large portion of the labor force. In a certain way, one could argue that many of the severance and termination benefits legislated in the developing world needed to compensate for the absence of any other form of a social safety net like UI. In Barbados, a UI system was enacted in 1982, after a severance pay requirement had been on the books since 1967. The Barbadian legislature, in order to garner support for the new UI program, agreed to place a cap on the maximum amount and number of years available for severance pay.

It is important to consider whether in Latin American and Caribbean countries **enacting unemployment insurance will not duplicate existing benefits, nor will UI be so minor as to be irrelevant in employers or employees employment decisions.** Important questions are: what percent of the unemployed received termination benefits, and how do these benefits compare with proposed UI (i.e., could UI serve its function of replacing lost income?) Is a new program of unemployment insurance needed or would workers be equally served with a reform of severance packages?

4. Youth Labor Market

A fourth and final factor in considering and designing unemployment insurance programs in the region regards whether and how much to cover unemployed youths. Depending on how eligibility is defined and the level of youth unemployment in a particular nation, the UI program could end up -- perhaps unintentionally -- principally serving very young populations. Many European systems allow youths to collect unemployment if they do not find employment immediately after leaving school (typically at lower remuneration levels than adults). Other UI systems, such as in the United States, place a length of work requirement of two years or more in a single establishment which effectively limits the number of youths who are eligible; other programs are intended to cover the more specialized problem of youth employment. The concern over providing unemployment insurance to youth who have not yet developed an initial labor force attachment is that it can corrode the development of early workplace skills and undermine their attitudes to the workplace.

For Latin American and Caribbean economies this can be a particular issue because of the large cohort of young people among the population and high levels of youth unemployment in many nations. While there has been some aging over time of the region's population, comparatively Latin America and the Caribbean is still the second youngest region of the world with an average age of 27 years to Africa's 22 years.⁹¹ There is great variability within the region, with particularly young populations in Central America and higher average age populations in the Southern Cone and parts of the Caribbean. Despite differences in the relative proportions of the youth populations, youth

⁹¹United Nations, *World Population Prospects: The 1996 Revision* (New York: the United Nations, 1997).

unemployment is typically high in the region. For example, among 12 countries throughout the region, urban unemployment rates were highest in every country for the 15-24 age group. This includes the highest rates of 31% in Panama, 24% in Uruguay, and 22% in Argentina, of which the latter two have relatively smaller youth populations.⁹²

The region has already begun experimenting with specific labor market programs targeted to youth such as in Chile, Argentina, and Venezuela and pilot efforts in Panama and other nations. These youth programs aim at addressing specific barriers to youth entry into the workplace through short-term internships and training. This type of youth-specific intervention address problems that unemployment insurance cannot, such as employer attitudes, basic work skills and readiness training for youth. **In considering unemployment insurance programs, Latin American and Caribbean nations should examine closely their youth unemployment problem and make policy decisions about whether and how much youth should be covered by UI, and/or whether youth unemployment is better addressed with a more specific intervention.**

Latin American and Caribbean countries with high youth unemployment rates need to give consideration to the large number of young recipients that would result from more open eligibility and more limited work requirements. In Brazil, where recipients are eligible after working only six months in the last three years, fully one-half of all UI recipients are under 30 years of age, and more than one-quarter are under 24 years of age.

Latin American and Caribbean nations with high rates of youth unemployment should give particular consideration to two key issues: (1) the eligibility and work requirement criteria for UI and how broadly this would encompass youth populations; and, (2) whether the application of UI to youth populations would best serve national labor market needs or whether other forms of more active measures -- training and workforce development programs would better address early new job entrants.

B. Lessons and Conclusions for Latin America and the Caribbean in Implementing UI Systems

There is no such thing as an ideal unemployment insurance system. The record of unemployment insurance is a mixed one: while providing important income replacement for many laid-off workers, many programs have had significant fiscal difficulties and/or been accused of being overly generous with benefits and have generally been less effective as vehicles to get workers into new employment. A key difficulty over time within OECD countries has been that while unemployment insurance is designed to **address temporary, short-term unemployment** it has overlapped and provided benefits to the growing problem of the **long-term unemployed**. The long-term unemployed have much greater barriers to reentering the labor force. Some programs have tried to compensate by

⁹²Suzanne Duryea and Miguel Székely, "Labor Markets in Latin America: A Supply-Side Story" in *Employment in Latin America*, 26.

permitting UI beneficiaries to receive retraining, but all told, **UI is an inappropriate instrument for addressing the larger problem of long-term unemployment.**

Many OECD countries are striving to redress an imbalance they see between passive (UI) vs. active labor market policies. Passive policies have consumed the lion's share of resources, but active measures, while their record is not totally proven, offer the prospect of more directly retooling workers for a rapidly changing workplace. **Latin American and Caribbean economies should not repeat OECD mistakes by rapidly installing unemployment insurance systems at the expense of active labor market policies.**

Nonetheless, unemployment insurance can be an important instrument for assisting and facilitating workers through temporary periods of unemployment, in helping make labor markets more flexible, if countries are careful to tailor the benefit system to their country circumstances, labor market needs, and administrative capabilities. In considering the implementation of an unemployment insurance system, this study has revealed the need for assessment in a number of areas: important pre-conditions for program success; consideration of objectives sought and design adaptations for these objectives.

1. Important pre-conditions for UI success

- **Short-term unemployment should be of particular concern.** In some countries in the region, long-term unemployment and poverty far outweigh the concerns of protecting against short-term unemployment which, as yet, does not play a significant labor market role. UI should be considered an important policy tool when the issue of concern is dealing with short-term unemployment flows.
- **Job creation should be sufficient to support worker transitions.** The unstated assumption of an unemployment insurance program is that there is sufficient job creation and mobility in the economy to handle the transition of workers from one job to another; UI is just needed just to bridge that transition. If job creation is extremely limited in a particular Latin American or Caribbean nation, UI would have little chance of being effective. It would merely serve as a short-term income supplement.
- **Sufficient administrative capabilities needed.** If a large segment of the labor force is to be potentially eligible, unemployment insurance requires an extensive and efficient administrative structure. It requires a network of regional offices, mechanisms for transferring weekly or monthly substantial sums, and the ability to verify income and eligibility. An exception would be for small economies that could do with just a few offices to serve the population. This administrative apparatus is not cheap, and depending on the length and amount of benefits a Latin American/Caribbean country is willing to provide there may be less costly alternatives. In particular, a Latin American or Caribbean country could choose to:

- a. **develop a form of unemployment insurance that is in bulk payments (1-3) that does not require an extensive administrative apparatus.**
- b. **use a flat-rate level of benefits.** Poland found an important ease in administration by simplifying its system to one rate for all, eliminating the need for income verification and clerk calculations. This reflects, though, the type of UI that provides a minimum social safety net rather than substantial income replacement.
- c. **combine UI delivery within an existing service delivery network.** Argentina runs its unemployment insurance program through its social security offices; Brazil uses a combination of its Labor Ministry offices and state-supported banks. While this is a logical response to the administrative demands of the program, it has its trade-offs in terms of linking workers to job search, training, and other services.

2. Clarity of Objectives and Design Features to Achieve Objectives

Many UI systems in both developing and industrial countries were created in the midst or in the wake of a major employment crisis. This is often one of the more difficult times to assess what role UI is to play in the long-term labor market mix when the principal impulse is simply to protect against the current or another crisis.

Chapter I laid out four objectives typical of modern-day UI systems. They are:

- Social Safety Net;
- Macroeconomic Stabilization
- Promote Restructuring/Labor Market Efficiency; and
- Income Replacement/Reward Labor Force Attachment.

One of the principal conclusions of this report is that clarifying the objective sought by unemployment insurance and squaring this with the national context and needs is the critical variable in deciding whether and what form of unemployment insurance is appropriate for a given country in the region. Below is summarized the report's conclusions that the most applicable objectives to the region is utilizing UI as a labor market transition tool. The social safety net objective for UI, while it is the more intuitively appealing objective given the region's high levels of poverty are least applicable.

3. Social Safety Net Objective: Less Applicable to the Region

On the surface, one might assume that Latin American and Caribbean countries would tend towards utilizing UI as a social safety net for the unemployed poor. The case study analysis of this report has revealed that UI systems, even in the

absence of a large informal sector, tend to serve the middle-income range of beneficiary, not the poorest. With a little examination, this makes intuitive sense. The poor have a more unstable employment profile and are less likely to have the years of job tenure needed to qualify for UI. This is much worse in economies with large informal sectors as the poor are disproportionately represented in this sector. Lowering the requirements for length of time in employment, as was the case in Brazil, still doesn't necessarily reach the poor. By reducing work test requirements, one also brings in a younger population and in those cases UI might not be the best labor market instrument, as discussed above.

Other developing country systems, such as Poland, have reached the poor by putting benefit levels so low (at one-third the minimum wage) that only lower income levels are likely to participate. But even this change might not be sufficient for the region, where a large proportion of the poor are in the informal sector. The Argentine case, for example, showed that even as benefit levels were kept close to the minimum wage to 1.5 times the minimum wage this did not prevent the average income of beneficiaries from continuing to increase. In recent data, only 6% of beneficiaries in Argentina earned less than the minimum wage (300 pesos/month) and more than 17% of recipients earned three times the minimum wage before UI, over 1,000 pesos/month (Chart 2.3, Chapter II). Higher income workers were likely viewing UI more as a salary supplement than income replacement.

Latin American/Caribbean programs that have a greater interest in using UI as a social safety net should seek programs that subject beneficiaries to a means-test. One way would be to bar recipients whose former incomes are above a certain level from participating in UI. For higher income workers, providing job search assistance could be the primary form of assistance.

4. Macroeconomic Stabilization Objective: Requires Specific Country Circumstances and Program Design Features.

Using UI as a macroeconomic stabilization tool is becoming less relevant even to industrial country economies. Chapter II demonstrated, for example, that in both the United States and Japan, UI is continuing to cover a smaller percentage of the employed labor force. This downward trend is largely because of the greater diversity in part-time employment, self-employment, and other forms of non-covered employment. Further, study on the U.S. system has had a harder time verifying, if indeed, UI has provided this stabilization function in the U.S. economy. It, has, for certain, provided an instrument for extended benefits during economic downturns in the U.S. in key regions such as the Midwest. One key problem in using UI to meet macroeconomic stabilization goals is whether the system is financially able to do this. A number of countries, including the cases of Argentina and Germany in this study, sought to cut benefit levels as demand increased to prevent the UI program from exceeding fiscal constraints.

The objective of macroeconomic stabilization should thus be subject to caution in any country context, with serious study employed on the target population to be reached in macroeconomic crisis and the country's labor market profile. A system would need to be designed that had sufficient reserves to cover a crisis period. In the Barbados case, the country substantially increased the unemployment insurance tax on business during an economic crisis to cover greater UI claims. The program was able to meet stabilization needs but this action of raising rates, of course, has a countercyclical economic effect. The United States extends benefits only for regions of higher unemployment.

For the Latin American and Caribbean region, this study recommends that macroeconomic stabilization be carefully considered before being employed as the objective of a UI program. Consideration must be given to the financial ability of the system to provide funding in an economic downturn. For countries with large informal sectors, this study argues that macroeconomic stabilization is an inappropriate goal for a UI program as it would reach too small a percentage of the population.

5. Income Replacement/Labor Force Attachment Objective: Achievable in the Region but Requires Policy Decision

Providing workers with income following a layoff for those who have demonstrated a significant attachment to the labor force is one of the most common objectives of unemployment insurance systems worldwide. The intention of UI programs, as described in Chapter I, is typically to provide sufficient income so that workers have time to seek new work at appropriate skill and income levels.

No UI system seeks to completely replace lost income. Gross unemployment benefits in the OECD countries typically range from 40-75% of average earnings; most are capped at the higher income levels. When taxes and other factors are considered, net replacement rates are much lower and very variable among OECD nations. Net replacement rates vary from the high end of 81% (Denmark)/69% (Netherlands) to the low end of 20% for the United States⁹³ and Italy.⁹⁴

For developing countries, the fiscal burden of replacing large percentages of former income must be considered. It is important to note that of the developing economy case studies in this study, only Barbados seeks to replace a percentage of lost income. In the other cases -- Argentina, Brazil, and Poland -- benefit levels more typically are calculated as a multiple of the minimum wage based on the worker's former salary.

⁹³This is a U.S. average; replacement rates vary markedly among U.S. states.

⁹⁴John Martin, "Measures of Replacement Rates for the Purpose of International Comparisons: A Note," OECD Economic Studies No. 26, 1996/I, 107.

For developing countries, maintenance of a minimum standard of income is a more feasible policy goal.

6. Labor Force Restructuring Objective: Most Applicable to the Region

Using unemployment insurance as a vehicle for transitioning workers from one job to the next is not a typical, primary goal of UI as it exists in the industrial economies, although many systems are moving in this direction. To use UI as a transition tool requires countries to design and implement "passive" unemployment insurance as part of a package of active labor market measures delivered to the unemployed. This package could include job search assistance, placement, skills assessment and training. UI thus serves as an income supplement to encourage and enable workers to effectively transition to new employment, helping reduce the initial resistance to job change.

Latin American and Caribbean countries are continuing to undergo dramatic changes in how their labor markets operate. We see in the region greater volatility in employment and greater numbers of job changes. If we accept that UI is an instrument only for the formal sector, facilitating labor market transitions might be an appropriate goal for this segment of the labor force and one fitting growing regional needs.

The real challenge to making UI more of a transition tool is how to do this in any particular national context. OECD nations are experimenting with incorporating training and self-employment in UI delivery and linking UI with national job placement programs. As discussed in the UI case study, the United States is grappling with the contradictory trends of linking UI better to training and placement while at the same time trying to reduce administrative costs -- which has encouraged the closing of regional offices and less human contact through mail/phone systems for checking in with UI officers. Latin American and Caribbean countries would have an initial advantage in trying to create systems from the start which sought to achieve job transition goals. Such UI systems, however, would require a number of key elements, including: efficient administrative apparatus, support and participation of the private sector, and diversified training systems. This echoes previous recommendations that any UI system in the region be conceptualized within the framework of an overall labor market reform and restructuring to enable all the components to more successively meet national labor market goals.

ANNEX II

Interviews/Consultations Conducted For Study

Azeredo, Beatriz	Directora da Area de Desenvolvimento Regional e Social do BNDES, Rio de Janeiro, Brazil
Barr, Nicholas	Economist, Eastern European Economies Specialist, London School of Economics, London
Blackman, Colis	General Secretary, Barbados Employers' Confederation, Barbados
Bour, Juan Luis	Economista, Fundación Investigaciones Económicas Latinoamericanas (FIEL), Buenos Aires, Argentina
Bradshaw, Lloyd	Acting Director, National Insurance Scheme (NIS), Barbados
Braitwaite, Kathleen	Ministry of Labor official, Barbados, 18 August 1998
Cavalieri, Armando	Sindicato de Empleados de Comercio, Buenos Aires, Argentina
Chaddad, José Paulo	Assessor Especial, Ministério do Trabalho, Gabinete do Ministro, Brasília-D.F., Brazil
Correia, Alexandre	Dpto. de Economia, Federação das Indústrias do Estado de São Paulo (FIESP), São Paulo, Brazil
Diaz, Ricardo Dario	Ex-gerente, Programa de Seguro de Desempleo y Asignaciones Familiares, Ministerio de Trabajo, Gerente General de SADEM-OSDEM, Sindicato Argentino de Musicos, Buenos Aires, Argentina
Dixon, Lionel	President, World Association of Public Employment Services, Canada
Edwards, Alejandra Cox	Professor of Labor Economics, University of California at Long Beach, Long Beach, California
Ferraiuolo, Roberto	Diretor Titular do Dpto. De Relações Intersindicais e do Trabalho, Federação das Indústrias do Estado de São Paulo (FIESP), São Paulo, Brazil

Figueroa, Armando Caro	Ex-Ministro, Ministerio de Trabajo, Director, Human Capital, Buenos Aires, Argentina
Funes de Rioja, Daniel	Presidente, Departamento de Política Social, Unión Industrial Argentina, Buenos Aires, Argentina
Gill, Indermit	Labor Economist, World Bank, Brasilia Office, Brasilia, Brazil
Goldin, Adrian O.	Abogado laboral, Buenos Aires, Argentina
Henry, Cecil	Senior Executive Officer, Acting Assistant Director for Short-Term Benefits, National Insurance Office, Barbados
Jackman, Richard	Labor Economist, London School of Economics
Licorish, St. Elmo	Deputy Permanent Secretary, Ministry of Labour, Community Development & Sports, Barbados
Ludwig, Larry	U.S. Department of Labor, Washington, DC
Marsiglia, Francisco	Secretario Adjunto, Governo do Estado de Sao Paulo, Secretaria do Emprego e Relações do Trabalho, Sao Paulo, Brazil
MacLean, Wendy	Office Director, National Employment Bureau, Barbados
Montenegro, Fernando	Chefe para Assuntos Técnicos Administrativos de Relações Intersindicais e do Trabalho, Federação das Indústrias do Estado de Sao Paulo (FIESP), Sao Paulo, Brazil
Morris, Robert	Deputy General Secretary, Barbados Workers Union, Barbados
Nelson, Joan	Overseas Development Council, Washington, DC
Templeman, Sheryl	Interstate Conference for Employment Security Agencies, Washington, DC
Tomassoni, Alberto	Asesor, Sindicato de Empleados de Comercio, Buenos Aires, Argentina
Torelly, Rodolfo Péres	Coordenador, Ministério do Trabalho, Secretaria de Políticas de Emprego e Salario, Coorenação-geral do Seguro-Desemprego e Abono Salarial, Brasília-D.F., Brazil
Paes de Barros, Ricardo	Professor, IPEA, Rio de Janeiro, Brazil

Pastore, José	Consultant, Confederação Nacional da Indústria e professor, Univ. do Sao Paulo, Brasília-D.F., Brazil
Pitz, Carl	German Embassy, Washington, DC
Prado, Dr. Antonio	Member, Technical Board of Directors, Departamento Intersindical de Estatística e Estudos Sócio-Economicos, (DIESSE), Sao Paulo, Brazil
Takasaki, Shinichi	First Secretary, Economic Section, Japanese Embassy, Washington, DC
Trotman, LeRoy	Senator, Barbados Workers Union, Barbados
Urani, Andrés	Secretary of Labor, State of Rio de Janeiro, Brazil
White, Averille	Senior Research Officer, National Insurance Office, Barbados
Wills, Joan	Center for Educational Leadership, Washington, D.C

ANNEX III

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