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A comparative analysis of the effects of unemployment insurance savings accounts on the labour market

Ana Luiza Neves de Holanda Barbosa,[1] Miguel Nathan Foguel [1] and Charlotte Bilo [2]

The main objectives of passive employment policies are to guarantee a certain level of consumption and well-being and to improve the match between employers and workers. In most countries, the unemployment protection system comprises one or more of the following programmes: (i) unemployment insurance: a general fund which makes a certain number of payments calculated on the basis of the (average) previous salary; ii) severance pay: paid by the company after the dismissal of the employee, usually calculated based on the previous salary and the duration of employment in the company; and iii) unemployment individual savings accounts (UISAs): individual mandatory savings accumulated over the period of employment in the company and accessed by the employee after dismissal.

All three of these instruments have different impacts on labour market indicators. Unemployment insurance, for example, may lead to the employee's premature termination of employment as well as an increase in the duration of unemployment. At the same time, unemployment insurance can provide unemployed people with greater flexibility and create a better match between employers and workers. The severance pay can raise the worker's reservation wage and thereby reduce the outflow from unemployment, increase turnover, decrease productivity and, as a consequence, also reduce wages.

UISAs have the advantage of being financed by the savings of the workers themselves, meaning that they have a greater incentive to seek and/or take jobs. As a form of savings, balances in individual accounts may be used to finance investments, such as in education or when purchasing property, or to increase the value of pensions after retirement. The main criticism of UISAs is that they do not provide workers with sufficient protection. This is particularly the case for low-skilled workers, who tend to have lower contributions and are more frequently unemployed than other workers. In addition, since such benefits are paid as a lump sum, there is a risk that the worker will spend the full benefit before finding a new job. Another criticism is that the below-market interest rates and low liquidity of UISAs generate incentives for workers to bring about their dismissal or agree with their employers to simulate a dismissal. Only a few countries, mainly in Latin America, have UISA programmes.[3]

In Brazil, the Government Severance Indemnity Fund for Employees (*Fundo de Garantia por Tempo de Serviço*—FGTS) is financed by employers and may be withdrawn by workers if they are dismissed without just cause or for health-related expenditures or property purchases. Returns from the FGTS have always been well below inflation. Research has shown that more than two thirds of employees who resigned also withdrew from the FGTS, suggesting simulated dismissals and a high level of interest among workers to have access to their individual funds.

In Chile, unemployment insurance comprises individual accounts, financed by the employee and the employer, and a solidarity fund, financed by the employer and the government. In case of unemployment workers first receive payments from their individual accounts. Those with insufficient funds in their individual accounts receive their benefits from the solidarity fund. Evidence exists that beneficiaries who only use the individual accounts find employment faster than those using the solidarity fund. Others analysing the impact of the Chilean system found that it reduces the risk of unemployment.

In 1990, Colombia replaced its traditional severance pay system with individual accounts financed by the employer. Workers may withdraw from them if they are dismissed, but also for educational expenses or when purchasing property. Research has shown that the system resulted in lower wages, as companies shifted the increased costs largely to their workers.

Although UISA programmes are very recent, and empirical evidence on their effects is scarce, there seems to be growing consensus in the literature that the best unemployment protection system should be a combination of traditional unemployment insurance, which has the main advantage of risk-sharing, together with UISAs, which stimulate savings, soften consumption over time and generate greater incentives for unemployed people to seek employment.

Reference:

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Notes:

1. Institute for Applied Economic Research (Ipea).
2. International Policy Centre for Inclusive Growth (IPC-IG).
3. Countries in Latin America with UISAs include Brazil, Chile, Colombia, Ecuador, Mexico, Peru and Venezuela.

International Policy Centre for Inclusive Growth
SBS, Quadra 1, Bloco J, Ed. BNDES, 13º andar
70076-900 Brasília, DF - Brazil

ipc@ipc-undp.org ■ www.ipcig.org
Telephone: +55 61 2105 5000