Discussion (in progress) of

Incentive Effects of Unemployment Insurance Savings Accounts:
Evidence from Chile

by *Gonzalo Reyes Hartly, Jan van Ours and Milan Vodopivec*

Very relevant very timely

- In the recession almost 40 million more unemployed people around the world
- Most of them receive UBs (spread well beyond the OECD area)
- How to deal with moral hazard when recovery begins?
- Chile once more innovating (after the 1990 crisis!). What did we learn to date from this experience?

Many countries now have UBs

(dates of first introduction of UBs)

1905-1944	1945-1979	1980-1990	1991-1992	1993-2002
Australia	Austria	Brazil	Argentina	Albania
Belgium	Bangladesh	Bulgaria	Armenia	Algeria
Canada	Croatia	China	Azerbaijan	South Korea
Chile	Ecuador	Colombia	Belarus	Taiwan
Denmark	Egypt	Georgia	Estonia	Tunisia
Finland	Greece	Hungary	Czech Republic	Turkey
France	Hong Kong	Iran	Kazakhstan	
Germany	Iraq	Poland	Kyrgyzstan	
Ireland	Israel	Sri Lanka	Latvia	
Italy	Japan	Uruguay	Lithuania	
New Zealand	Netherlands		Moldova	
Norway	Nigeria		Russia	
Spain	Portugal		Turkmenistan	
Sweden	Serbia		Ukraine	
United Kingdom	Slovenia		Uzbekistan	
USA	South Africa		Romania	
			Slovak Republic	

Source: Social Security Programs Throughout the World and our own research based on administrative sources.

The Chilean scheme

- The Chilean UI system pioneered an innovative design, mixing individual accounts for unemployment (**Régimen de seguro de cesantía,** Individual Severance Account - ISA) and a social insurance component (**Fondo de Cesantía Solidario** Solidarity Severance Fund - SSF). The monthly contribution to the system is equivalent to 3 per cent of covered wages.
- For employees hired under fixed-term contracts, the contribution is levied on the employer alone. For employees with open-ended contracts, the contribution is shared between the employee (0.6 per cent of monthly earnings, which is allocated completely to the ISA) and the employer (2.4 per cent of the employee's monthly earnings, which is split between the SSF and the employee's ISA). The employer's contribution is mostly allocated to the employee's ISA, with a small part paid to the SSF (0.8 and 0.2 percentage points in the case of employees with open-ended contracts and for employees with fixed-term contracts, respectively). The SSF is also partly financed by a monthly fixed amount from general tax revenues; annually, this is equivalent to approximately USD 14.5 million.

Research questions

- Is the Chilean system an effective tool to combat the moral hazard plaguing the traditional UI programs?
- Does the program improve job search incentives and/or reduce reservation wages, and thus increase the exit rate from insured unemployment as theoretical models predict?

Answers

Is the Chilean system an effective tool to combat the moral hazard plaguing the traditional UI programs?

Yes it does notably for those having accumulated a large individual account

Does the program improve job search incentives and/or reduce reservation wages, and thus increase the exit rate from insured unemployment as theoretical models predict?

Yes. Evidence of disincentive effects instead for those relying entirely on collective accounts

Comments

- **Context.** Related literature. Not UB, but also EPL and pensions.
- **Design of the scheme**. Complexity. Many details missing.
- **Empirical strategy**. Selection into eligible and non eligible U spells, choice of SSF.
- **Policy recommendations.** Words of caution

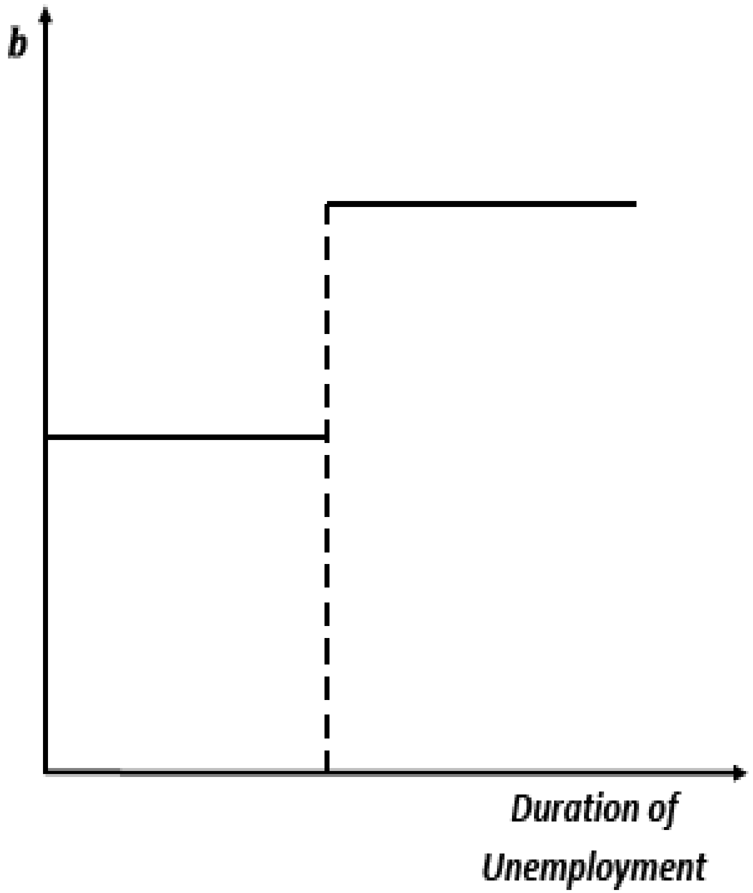
Context

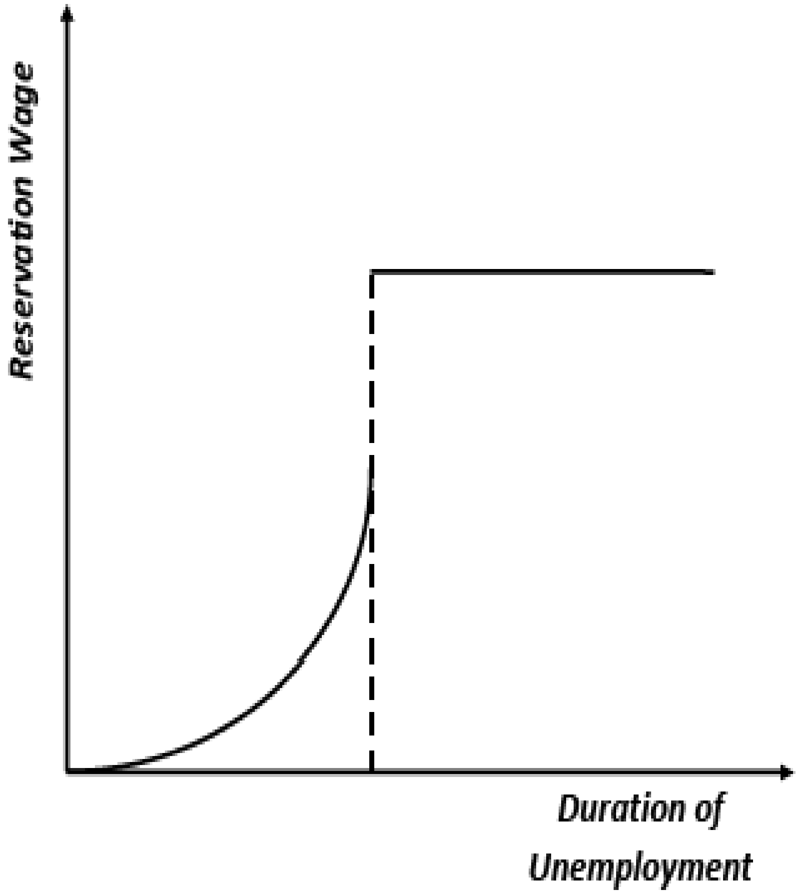
- Literature on severance pay and on pension funds. Italian TFR (trattamento di fine rapporto) transformed into contributions to private pensions.
- Severance pay can be undone by wage reductions if wage flexibility. How is wage setting in Chile? What happened to wages after the introduction of UISA?
- Relationship between UISA and standard severance. Is large UISA (and severance) entitlement a deterrent to layoffs?

Important Design Features

- Relationship with pure severance:
- "Open-ended contract workers laid off because of what is referred to as, "enterprise necessity" and with 12 months or more of employment are entitled to a severance payment equal to one month's salary for every year of work. Currently, the wage contribution made by the employer to the ISA can be discounted against the amount to be paid as a severance payment. This mechanism is considered a positive feature because it allows employers to make provision for future possible financial obligations, something that is especially important in periods of high staff turnover when enterprises must finance severance payments. A remaining policy question is whether further improvement in the coordination between UI and severance payments should be sought, and whether the latter should be partially substituted by a more generous UI benefit. To date, a lack of statistical data regarding the level and coverage of severance payments has not permitted an informed discussion about the pros and cons of these policy options. "
- Relation with other schemes? Is there means-tested social assistance?

A useful chart





Relevant Design features (cont.)

- Relationship with pensions. Complementarity and substitutability. What happens to unused UISA? Is there also risk pooling across individuals or only intertemporally?
- For those eligible to both UISA and SSF when is the decision about use of SSF made? At the beginning of the U spell or every month?

Empirical strategy

- If decision over SSF is made not only ex-ante, but can be made ex-post, then one should jointly estimate hazard and selection.
- Any spillovers from fixed-term contracts?
- Selection also into eligible and non-eligible to SSF: layoffs vs. voluntary quits?
- The scheme is very complex: include some proxies for informed/uninformed unemployed (e.g., exposure to previous UISA withdrawals)?

Policy: some words of caution

- Can we really switch from risk pooling across individuals to intertemporal risk pooling? Is the system sustainable in light of your behavioural estimates? Important also from a pure job finding standpoint if those having exhausted UISA move to SA.
- Sorting and statistical discrimination. Why people eligible to SF do not apply for it? Future eligibility, low levels, hassling or stigmatisation? Selection involved (of the fattests)?
- Effects on savings and consumption