INCOME SUPPORT SYSTEMS FOR THE UNEMPLOYED: ISSUES AND OPTIONS

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Executive summary

In recent decades, unemployment has become a serious problem in many parts of the world, and the task of helping the unemployed has gained increased importance and the interest of policymakers. The purpose of this report is to provide guidelines for developing and transition countries wishing to improve their income support systems for the unemployed, or introduce new systems.

The report builds on the fact that public income support systems for the unemployed are a subset of formal and informal mechanisms of social risk management. Participation in a public income support program, for example, may reduce the amount of private transfers received by participants and/or their incentives to save and to take training. Viewing the system in its entirety and considering links among various components brings an important advantage, as it enables to strike the right balance between publicly provided programs and private mechanisms of risk management.

To derive guidelines about income support programs for the unemployed, the report relies on two sets of criteria. One set consists of the following *performance criteria* of the programs:

- how they affect distribution of income;
- how they affect efficiency;
- how suitable they are to confront different types of economic shocks, and
- how resistant they are to political interference.

To "find what fits" developing and transition countries, their specific features have to be appropriately recognized. In obtaining the guidelines, besides performance criteria the report therefore uses also the following *design and implementation criteria:*

- interactions of income programs with labor market institutions and shocks,
- administrative capacity for program implementation,
- the characteristics of the unemployed,
- the size of the informal sector,
- inter-household transfers,
- insurance and self-protection,
- the nature of shocks, and
- cultural and political factors.

Based on the above criteria, the report evaluates the strengths and weaknesses of alternative income support programs for the unemployed, as well as their suitability for developing and transition countries. This procedure produced the following guidelines:

- *Unemployment insurance*, thanks to its wide risk-pooling, enables a high degree of consumption smoothing for all categories of workers, performs well under idiosyncratic, sectoral, and regional shocks, and acts as an automatic macroeconomic stabilizer. But it also creates reemployment disincentives and wage pressures which increase the equilibrium unemployment rate, and it contributes to the persistence of unemployment. Because its

smooth and successful performance relies on strong administrative capacity to monitor program eligibility, conducive labor market conditions, modest size of the informal sector, and an environment of low political risk – the conditions which are typically lacking in developing and transition countries – the case for the introduction of unemployment insurance in these countries is less compelling than it is in developed countries. Its existence may also reduce incentives for self-protection and break down the habit of self-help among local communities, which may be welfare-reducing. Introducing unemployment insurance is thus viewed as a longer-term goal for many of these countries.

- *Unemployment assistance*, while enabling more effective targeting, may not bring savings in comparison to unemployment insurance – and in fact may prove fiscally unsustainable, due to the increased pool of potential applicants created by the programs failure to base eligibility on contribution payments. In addition, in comparison to unemployment insurance, it offers a lower level of protection for high income workers, imposes larger administrative costs, and suffers from similar employment disincentives. Its applicability is thus limited, perhaps to countries with relatively developed administrative capacity and a small informal sector – a rare breed among developing and transition countries.
- *Unemployment insurance savings accounts* (UISAs) are recognized as a promising option for developing and transition countries. By internalizing the costs of unemployment benefits, the program avoids the moral hazard inherent in the traditional unemployment insurance program and thus improves reemployment incentives – given the weak monitoring capacity of developing countries, an important advantage. In its integrated version with public insurance – thus avoiding its main weakness of not pooling the risk among individuals – the program promises to yield both superior protection and improved incentives, and also has the potential to attract informal sector workers. Because the system has been largely untested, further investigation of its effects and design parameters, including piloting of the program, is needed.
- *Public works* program is effective in reaching the poor, has good targeting properties and substantial capacity to redistribute income from the rich to the poor, is able to attract informal sector workers and provide flexible and fast response to shocks, and is administratively less demanding than other public income support programs. Despite its weaknesses – high non-wage costs, the likely counter-cyclical pattern of funding, and, in some countries, stigmatization of participants – it is found suitable for developing countries, particularly as a complementary program.
- *Severance pay* offers few advantages. Because it adversely affects efficiency, produces high litigation costs and offers limited risk-pooling, severance pay is recognized as one of the least appropriate options.

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1. INTRODUCTION

In recent decades, unemployment has become a serious problem in many parts of the world. Macroeconomic crises and increased globalization have put more workers at risk of job loss in Latin America and, more recently, in East Asia as well. In an effort to transform themselves into market economies, former socialist countries have faced the enormous task of efficiently reallocating workers and jobs across sectors and firms, which has led to the emergence of unemployment and poverty of large proportions. Moreover, since the 1970s, Europe has witnessed a reduction in economic growth and an increase in unemployment, especially disturbing of which has been the increase of the share of long-term unemployed.

Given the above trends, the task of helping the unemployed has gained importance and the interest of policymakers. Several aspects of this task must be emphasized. Because job loss entails the loss of income, providing effective income support is obviously a prime concern and a necessary component of assistance to the unemployed (be it in a form of a pure transfer, or through jobs created by public programs). But other aspects must also be considered. In conjunction with income support, it is important to consider how to increase the "employability" of the unemployed, that is, the capacity of the unemployed to search for a job and to match skills with existing vacancies. Moreover, adverse labor supply incentives created by income transfers need to be carefully studied and addressed. And last but not least, reducing the risk of unemployment, both by designing appropriate income support schemes as well as by increasing employment opportunities, should also be considered.

While the task of increasing employment opportunities reaches far beyond labor market policies and programs, important links between job creation capacities of the economy and income support programs – and social protection systems in general – should not be overlooked. Indeed, income support systems for the unemployed should be developed in line with a broader conceptual framework that lays out complex interlinkages of institutions and policies in the area of social protection and labor markets in a systematic and comprehensive way. This report relies on such a comprehensive framework developed at the World Bank (World Bank, 2001). By formulating various strategies to manage social risk, the framework sets analytical foundations for the formulation of social protection approaches and policies.

The purpose of this report is to provide guidelines for developing countries wishing to introduce or improve income support systems for the unemployed. To arrive at such guidelines, the report summarizes the results in literature about the performance of various income support systems viewed from four aspects: how desirable are their distributive effects; how they affect efficiency; how suitable they are to confront different types of shocks; and how resistant they are to political interference. Based on this evaluation, and taking account of countries' specific circumstances – chief among being labor market and other institutions, administrative capacity, the prevalence of private transfers and other cultural factors, the types of shocks typically faced, and the size of informal sector – the suitability of individual schemes for different countries is then evaluated.

The main conclusions can be summarized as follows. *Unemployment insurance* (UI*)* is found to perform relatively well under conducive labor market institutions, in an economy with a low share of the informal sector and strong administrative capacity, in the absence of persistent structural shocks, and if the scheme's exposure to political risk is low. *Unemployment assistance*

(UA), while enabling more effective targeting, may not bring significant savings in comparison to unemployment insurance; because it imposes more demanding administrative constraints – and may suffer similar employment disincentive effects as unemployment insurance, unemployment assistance as a self-standing program may be suitable only to a subset of developing countries. In contrast, *unemployment insurance savings accounts* (UISAs) are recognized as a promising option for many developing countries. By internalizing the costs of unemployment benefits, the scheme avoids the moral hazard inherent in the traditional unemployment insurance scheme and thus radically changes workers' incentives and, if appropriately structured, offers the same protection to the unemployed as the traditional UI system (but the system has been largely untested, so further investigation of the schemes likely effects and its design parameters is needed). Similarly, *public works* are recognized as being effective in reaching the poor, and in general suitable for countries with a large informal sector and lacking administrative capacity. Because of creating strong negative efficiency effects, *severance pay* (SP) is recognized as one the least appropriate income support schemes.

The report proceeds as follows. We first discuss the conceptual issues that arise in evaluating and designing income support systems for the unemployed (Chapter 2). The need to evaluate these systems in a broader framework and allowing for various interactions (with the labor market, for example) is particularly emphasized. We than present the stylized facts about the design of income support schemes in different parts of the world (Chapter 3). The presentation emphasizes the richness of the approaches and the complexity of the schemes, highlighting important features that should be considered when improving such systems or introducing new ones. In Chapter 4, we summarize the performance of various income support systems, based on the review of theoretical predictions and empirical evidence. Distributive and efficiency effects are taken into account, as well as how well are different systems suited to confront different types of economic shock and resist the political risk. The concluding chapter presents tentative guidelines about choosing among alternative incomes support systems in developing and transition economies.

2. CONCEPTUAL ISSUES

Faced with the risk of unemployment, individuals choose among a variety of risk management mechanisms. Some try to get a good education or enter jobs that are known to be stable, so as to reduce the risk of becoming unemployed; others may accumulate real or financial assets, or participate in unemployment insurance programs, so as to have financial means at hand if unemployment occurs; yet others may rely on private transfers of cash, food, and clothing, draw down financial and real assets, participate in public works or public training, or receive social assistance, so as to cushion the loss of earnings associated with job loss.

How to judge the desirability of such mechanisms from the viewpoint of society? Successful smoothing of consumption is important, but there are other considerations. Do public systems displace other mechanisms, formal or informal? Do they affect job search effort and the type of post-unemployment job? How successful are they in reaching the most hard-hit segments of the population and the very poor? What are the tradeoffs between pure income transfers compared with programs which combine transfers with other requirements – and opportunities – such as public works or training? How to prevent the loss of human capital associated with prolonged unemployment spells?

In this chapter, we present conceptual issues in evaluating various mechanisms available to workers in dealing with the risk of unemployment. The starting point – and the recurrent theme of this report – is the recognition that public income support programs available to the unemployed are just a subset of risk management mechanisms. It is of utmost importance, therefore, to look at the system of social risk management in its entirety, so as to consider links among its various components, and the repercussions of introducing new public programs on other mechanisms. The richness of mechanisms and strategies available to individuals, families and communities is staggering – implying, among others, that theoretical models of necessity focus on specific aspects of income support, and therefore the validity of their conclusions has to be checked against the circumstances prevailing in a specific country. The same is true for empirical findings obtained from the experience of developed countries when applied to developing and transition countries.

The complexity of interactions and the lack of generality of theoretical results, coupled with the dearth of empirical studies on income support programs in developing and transition countries, led us to develop the following two sets of criteria to judge the desirability of income support programs in a particular country. The first set consists of performance criteria, and the second set of design and implementation criteria. Performance criteria relate to various effects of income support programs and their other features as established by theoretical models and validated by empirical studies. This set includes programs' effects on distribution of income and efficiency, as well as their suitability to confront different types of shocks and resiliency to political risk. But when transferring the experience of other countries, the "initial conditions" – particular features of the country in question – also have to be taken into account, both to check the implications of the lack of generality of theoretical models as well as to address the gap in empirical studies on developing countries. Therefore, we also propose a second set of criteria, which we call design and implementation criteria. They include country-specific features such as the nature of labor market institutions, the administrative capacity of the country to deliver specific programs, the characteristics of the unemployed, the prevalence and pattern of inter-

household transfers, the ability of individuals to self-protect, the nature of shocks typically faced by the country, and cultural and political factors. For example, the degree of informality of the economy determines how many individuals can take advantage of formal sector programs (such as unemployment insurance and severance pay), and the administrative capacity of the economy is a strong predictor of the success of programs which require strong monitoring or information capacity.

In the continuation of this chapter, we first place income support programs in the context of social risk management. The interaction with other formal and informal mechanisms has an important bearing on the successfulness of these programs and hence on their desirability. We also discuss the arguments that speak in favor of the public nature of programs to help the unemployed. We then develop criteria that we use for the evaluation of the suitability of alternative income support programs. As mentioned, we propose performance evaluation criteria (stressing distributive and efficiency aspects, as well as suitability to confront shocks and resistance to political interference), and design and implementation criteria (stressing a country's specific conditions as factors for selection). Using the above analytical instruments, in subsequent chapters we evaluate various income support programs and judge their desirability for developing and transition countries. We conclude the chapter by discussing the weaknesses of the standard ILO definition of the unemployed when applied to developing countries.

2.1 Public income support in the context of social risk management

Public income support programs for the unemployed are just a subset of risk management mechanisms available to them. These mechanisms can be divided into three categories: (i) those that reduce the risk of unemployment (that is, reduce the probability of becoming unemployed and/or increase the probability of leaving unemployment if unemployed); (ii) those that mitigate that risk (reduce the impact of a future unemployment spell if it happens), and (iii) those applied in response to the undesirable event – coping mechanisms.[1] Within all three categories, both informal and formal mechanisms are usually available, with formal ones further divided into market-based and public (see table 2.1).

The interaction of risk management mechanisms. The above risk management framework enables one to position income support systems for the unemployed in the context of other – informal and formal – mechanisms which may also be used to manage the risk of unemployment. Viewing the system in its entirety and considering links among various components brings an important advantage when evaluating the effects of individual programs or assessing the effects of introducing public programs on other mechanisms. For example, the introduction of unemployment insurance may encourage the emergence or expansion of more risky industries – which may or may not increase efficiency. Similarly, participation in a public income support program may reduce the amount of private transfers received by participants, and their incentives to save and to take training.

But links are even more complicated. The financing of social insurance typically requires contributions of both employers and employees, thus creating a wedge between the wage received and the labor costs and possibly reducing labor demand. Similarly, increasing the generosity of severance pay may slow down labor market flows – from employment to

[1] For a comprehensive framework of social protection based on social risk management, see World Bank (2001).

unemployment, and from unemployment and inactivity to employment. Thus, the introduction of a risk mitigation mechanism (such as social insurance) or a risk reduction mechanism (such as severance pay) may increase the unemployment rate or negatively affect the job creation capacity of an economy – and thus worsens the effectiveness of other risk reducing mechanisms. Income support programs may also have dynamic effects, for example, they may interact with adverse shocks to the economy, typically slowing down the reduction of unemployment to the shock and thus contributing to the persistence of unemployment.

The social risk management framework thus makes clear not only that there are multiple mechanisms for dealing with the risk of unemployment, but also that there are complex links and interactions among them. Recognizing – and appropriately accounting for – such interactions is a must for the successful choice and design of public income support programs. For example, when a low-income country is trying to improve its income support systems for the unemployed, diverse and far-reaching implications of public actions should be taken into account. These implications range from the impact on self-protection mechanisms of individuals (for example, changes in the intensity of job search and propensity to take training), to the effects on labor market outcomes (for example, on the unemployment rate and the intensity of labor market flows), to the appropriateness of a certain program from the standpoint of the existing capacity to administer the program (see box 2.1).

Box 2.1: Recognizing interactions among different risk management mechanisms

In dealing with the risk of unemployment, Filipino workers employed in the formal sector rely on severance pay, although it may be difficult to obtain. Even then, such workers are better off than the informal sector workers for whom there is little or no protection. It is therefore not surprising that Filipino workers have relied greatly on informal mechanisms to manage the unemployment risk – many of which are costly, inefficient, and above all, inadequate.

How to improve public policy to better assist Filipino workers to deal with unemployment? The social risk management framework suggests that the answer should rest, among others, on the following considerations:

- How well does the program fit into existing mechanisms of risk management? For example, would its introduction disrupt existing self-protection mechanisms, or displace existing coping mechanisms (such as an existing system of private transfers, especially for the non-poor population) that may have superior efficiency properties to public programs? Is the program well attuned to the prevailing norms and culture? Are there existing institutions that can be "upgraded" to provide better protection and increased coverage?
- How do the likely beneficiaries compare with other population groups? What are the likely effects of the program on income redistribution and poverty reduction?
- Is the program compatible with other public support mechanisms and policies? Above all, does it promote labor reallocation and job creation as sources of productivity growth?
- How well does the program respond to a country's income shocks, such as economic recessions, structural imbalances caused by liberalization and globalization, and shocks arising from natural calamities?
- And last and certainly not least, is the program well attuned to local circumstances so that the program itself functions well? For example, can it be supported with the existing administrative capacity of the country? Are there mechanisms that allow effective ways of program selection?

Source: Esguerra et al (2001).

Theoretical models offer increasingly complex insights into the working of income support systems and their implications for economic policies. For example, by using a comprehensive insurance approach pioneered by Ehrlic and Becker (1972), important implications about the relative use of different risk management instruments are obtained by Gill and Ilahi (2000). Their results are summarized in box 2.2. Furthermore, pursuing the optimal unemployment insurance approach, Hopenhayn and Nicolini (1997) model the tradeoff between insurance and incentives, created by the moral hazard problem which is present in social insurance when it is difficult to monitor job-search effort of benefit recipients, and derive implications for the time pattern of the optimal replacement rate.

Box 2.2: A theory of "comprehensive insurance"

A conceptual framework for dealing with unemployment risk in a comprehensive way is provided by Gill and Ilahi (2000). It is based on a utility maximization model where the individual decides how much to spend on three different risk management instruments: market insurance, self-insurance and self-protection (individuals insure by transferring income from the good to the bad state, and self-protect by taking actions which reduce the probability of the bad state).

Among the important insights produced by the study are the following ones:

- Market insurance and self-insurance are substitutes, and so are self-insurance and self-protection; market insurance and self-protection may be substitutes or complements. An important implication of the latter finding is that the existence of market or social insurance may not necessarily reduce self-protection and thus produce a moral hazard problem. For example, if more intense job search is rewarded by subsequent lowering of the unemployment insurance premium, moral hazard is not inevitable (note that this assumes that self-protection behavior is detectable).
- Relatively rare and large losses are better insured through market insurance, and relatively frequent and moderate losses though self-insurance. This follows from the fact that while the price of market insurance is lower if the probability of loss is lower, the (shadow) price of self-insurance (for example, the cost of precautionary saving) does not vary with the likelihood of loss.
- Individuals enjoy higher welfare when all three instruments are available than when one of them is missing.
- Introducing a social safety net will reduce self-protection, but not necessarily self-insurance measures.

Gill and Ilahi also offer important insights about the rationale for social policies:

- One rationale for publicly provided insurance is the non-existence of market insurance. An important example is public unemployment insurance.
- Private agents may self-insure using "bad" instruments (for example, using cattle or land as a medium of precautionary saving) because "good" instruments (such as diversified financial assets) are not available.
- The government can step in to foster the development of insurance and financial markets. In particular, financial market strengthening should be a central component of social policy, because it can foster self-insurance, market insurance, and self-protection (for example, through prudential regulation of capital markets).
- One of the best ways of self-protection is investment in human capital, but this investment offers poor collateral. By subsidizing the acquisition of human capital, the government can mitigate the resulting tendency to underinvest.

Source: Gill and Ilahi (2000).

However, one implication of the richness and complexity of the issues that arise in the context of social risk management is the limited ability of formal modeling to capture all relevant aspects. Thus theoretical modeling often fails to include all relevant labor market features, and/or

disregards important features of programs themselves. While advances in theoretical modeling offer increasingly complex insights into the working of public income support systems, often models cannot be solved analytically. For example, theoretical models of labor reallocation which explicitly treat job creation and destruction processes are often analytically nontractable, forcing researchers to use calibration models which yield solutions under less general conditions. Similarly, as Atkinson and Micklewright (1991, p.1706) complain, "the great generality of research reaching conclusions about unemployment compensation has paid scant attention to the institutional details, and some elements have been almost totally ignored. … The importance of the institutional features aspects is a matter on which we would like to insist."

To summarize, the above considerations suggest that there is a host of issues which countries should take into account when changing public income support programs or considering the introduction of new ones. Besides considering direct effects of programs, they should also worry about the interactions of proposed income support programs with many other mechanisms and institutions. In a more comprehensive version of this study, we have therefore devoted a lot of attention to country-specific conditions which influence the functioning of public income support programs and thus affect their choice and design (see Vodopivec and Raju, 2002). This is even more important because theoretical modeling, while producing increasingly complex insights, fail to provide general solutions.

Why public income support programs? The above social risk management framework is also useful when considering whether or not there should be formal, public income support programs for the unemployed. Indeed, some studies cast doubt on the welfare benefits of public programs, because such programs may displace old mechanisms of dealing with unemployment risk. For example, Cox and Jimenez (1995) estimate that the introduction of unemployment insurance in the Philippines would displace a striking 91 percent of private transfers to the unemployed, and Attanasio and Rios-Rull (2000) show that such an introduction can be welfare reducing.

While precise conditions for the introduction of formal programs are difficult to pinpoint, experience shows that these can offer important advantages. Informal insurance mechanisms may often be ineffective, because the loss of employment is too large a shock – and may occur too frequently. As Murdoch (1999) points out, informal insurance (for example, reciprocal transfers, but also other forms) tends to be least effective when insurance is most needed. Moreover, he shows that in poor countries the beneficiaries of private transfers are the elderly, and keeping more income for themselves would enable the young – who are often also poor – to obtain more education. Another advantage of formal systems is the ability to pool resources across larger groups and across time. Providing formal income support may also improve fairness; for example, many informal insurance mechanisms militate against women.

If informal insurance mechanisms are not satisfactory and unemployment insurance is a desirable benefit, why cannot the market itself provide insurance against the risk of unemployment? There are compelling arguments for public programs:

- There are strong informational problems (leading to adverse selection) as well as incentive problems (leading to moral hazard) involved in the provision of unemployment insurance (Barr, 1992). Market insurance may fail if low risk individuals are allowed to opt out; compulsory membership enables widespread membership and thus a wide pooling of resources. Moreover, the state has an advantage in providing mechanisms to deal with the

moral hazard problem as well; that is, it can more effectively monitor and penalize behavior that aggravates the risk of unemployment.
- Unemployment risks are covariant and thus cannot be diversified by private insurance. A severe recession may dramatically increase the number of claimants and jeopardize the existence of private insurers.

2.2 Performance evaluation criteria

In judging the desirability of income support programs for the unemployed, one important measuring rod is how successful are the programs in achieving their objectives – and what are their other intended and unintended effects and features. From the standpoint of individuals, the most important effects relate to the replacement of income in the case of job loss, thereby contributing to consumption smoothing and possibly to the prevention of poverty. Moreover, countering psychological effects of unemployment and maintaining and acquiring human capital may also be important individual level objectives. From the standpoint of society, the objectives are wider and also include promoting distributive justice (reducing income inequalities, helping the poor and long-term unemployed), as well as efficiency aspects.

We therefore propose four subsets of criteria which we use in Chapter 4 to evaluate income support programs for the unemployed:
- distributive criteria,
- efficiency criteria,
- suitability to confront shocks, and
- resistance to political risk.

Distributive and efficiency effects are natural measuring rods, the ones that follow closely from the objectives of income support programs for the unemployed. To determine distributive effects, we will look at the coverage and the adequacy of support as well as the redistribution of income implied by the program. To determine efficiency effects, a multitude of aspects will be examined, including the intensity of job-search effort, post-unemployment wages, equilibrium labor market outcomes, and effects on programs on output and growth.

Besides distributive and efficiency criteria, we will apply two other performance criteria. The first is the programs' *suitability to confront economic shocks*: for example, how suitable are different programs for a country which is frequently plagued by sudden, regionally concentrated shocks due to natural disasters? Or with long-lasting, covariant shocks? The other criterion is the programs' *resistance to political risk*, the criterion which emphasizes political economy considerations in providing income support – that is, what particular circumstances are conducive to the introduction of programs that benefit the unemployed, and how to raise support for reforms to improve such systems. (These last two evaluation criteria of income support programs could also be considered under the rubric of efficiency, but we discuss them separately to emphasize their importance.)

2.3 Design and implementation criteria

Programs do not operate in a vacuum – country specific circumstances affect their performance. They also determine suitability of alternative programs to meet the specific needs of a country. Beside performance criteria, which evaluate income support programs based on their

performance under typical conditions (at that, due to the bias in empirical research, conditions that usually prevail in developed economies), we therefore also introduce another set of criteria – design and implementation criteria – which reflect specific features of the country under investigation.

To illustrate: in a country where certain regions are often affected by natural disasters, it is important to have income support programs in store which are flexible and can be quickly deployed in affected areas. Moreover, a large informal sector calls for a stronger representation of programs which are also accessible to the self-employed and other informal sector workers. Furthermore, when choosing a program, a country's *administrative capacity* has to be taken into account. For example, unemployment insurance/assistance requires monitoring of recipients (to ensure compliance to continuing eligibility rules); in addition, unemployment assistance relies on means testing. The performance of such programs depends crucially on the administrative capacity to provide quality monitoring and testing. And *interactions* with other programs and policies are also important. For example, to avoid incentive incompatibility, unemployment insurance savings accounts need to be harmonized with old-age income support programs to preclude scenarios where unemployment insurance savings accounts are depleted in anticipation of forbearance and generosity on the part of the pension system. Moreover, introducing or increasing the generosity of unemployment benefits may have different effects in an economy with different levels of centralization and coordination of wage bargaining – under uncoordinated and fragmented bargaining, unemployment benefits are more likely to increase wage pressures and hence the equilibrium unemployment rate than under alternative arrangements (see Chapter 4).

Because we believe that the above aspects have to be taken very seriously, we devote one chapter in Vodopivec and Raju (2002) to specific features of countries which – coupled with the performance criteria – are important when considering policy changes in the area of income support for the unemployed. There we discuss the following features:

- interactions with labor market institutions and shocks,
- administrative capacity for program implementation,
- the characteristics of the unemployed,
- the size of the informal sector,
- inter-household transfers,
- ability of individuals to self-insure and self-protect,
- the nature of shocks, and
- cultural and political factors.

2.4 Who is unemployed: definitional problems

According to the International Labor Organization (ILO) definition of unemployment (Resolution I of the 13th International Conference of Labour Statisticians, Geneva, October 1982), the "unemployed" comprise all persons above a specified age who, over a specified reference period, are:

(a) "without work," that is, are not in paid employment or self-employment,
(b) "currently available for work," that is, are available for paid employment or self-employment during the reference period; and
(c) "seeking work," that is, are taking specific steps in a specified recent period to seek paid employment or self-employment. The specified steps may include registration at a public or

private employment exchange; application to employers; checking at work sites, farms, factory gates, market or other assembly places; placing or answering newspaper advertisements; seeking assistance of friends or relatives; looking for land, building, machinery or equipment to establish own enterprise; arranging for financial resources; applying for permits and licenses, etc.

The above definitions have severe limitations when applied to developing countries. First, many workers in developing countries who qualify as employed under the ILO definition are in fact not fully employed or "underemployed" (especially in rural areas).[2] These workers may work less hours that they would like or work in low productivity jobs, and earn low wages. But they are so poor that they cannot afford to be without a job, and so open unemployment is rare. Edwards and Manning (2000) note that "the transition from underemployment to open employment can be partly explained as an income effect: as economies grow and household incomes rise, it becomes possible to go through periods without work while waiting for a job to open."

Second, some unemployed may be classified as inactive. Individuals who have a marginal attachment to the labor force, that is, those who are available for and desire work, but are not actively seeking work because they perceive, rightly or wrongly, that no jobs are available, are often considered economically inactive when they should be more appropriately classified as unemployed (sometimes they are called discouraged workers). Moreover, the conventional application of the term "actively seeking work" also falters in light of a fair share of economic activity occurring through informal employment arrangements or where self-employment is the norm.

Third, some employed workers may be classified as inactive. Per ILO guidelines, an individual who works at least one hour in a week, or who is temporarily absent from work (for example, on vacation or due to illness) is in employment. Those who are out of work but do not meet the criteria of ILO unemployment are classified as economically inactive. However, some forms of informal economic activity may escape this definition of employment (for example, home-based work, typically undertaken by women). And because such workers are not available for work, they do not qualify as unemployed either.

As a consequence, it is sometimes advisable to complement the unemployment rate with other measures of labor market slack (for example, with measures of underemployment). The ILO acknowledges the possible restrictiveness and "industrialized country" bias of the definition, advising the relaxation of these clauses and the formulation of criteria suitable to the labor market characteristics of the particular developing country. For the purpose at hand, the above discussion implies, among other, that besides those counted as unemployed, unemployment support programs may also include the underemployed – and that the unemployed may not be the most unprivileged group in the labor market.

[2] According to the ILO, "underemployment exists when a person's employment is inadequate in relation to specified norms of alternative employment account being taken of his or her occupational skill" (Resolution I of the 13th International Conference of Labour Statisticians, Geneva, October 1982).

2.5 Summary of conceptual issues

The above discussion pointed out that there is a multitude of mechanisms available to individuals, families, and communities in dealing with the risk of unemployment. When changing public income support programs or considering the introduction of new ones, countries should worry about the interactions of these programs with other mechanisms and institutions. Theoretical models offer increasingly refined and in-depth insights into the working of income support programs for the unemployed; numerous aspects, however, do not lend themselves to formal modeling as the underlying theoretical models cannot be solved analytically. Empirical evidence to test the generality of the theoretical models, as well as to determine the effects which are theoretically ambiguous, is therefore called for.

Realizing a need for a holistic approach and given the state of theoretical and empirical research of the field, our approach to evaluate alternative income support programs for the unemployed thus relies on two sets of criteria. One set evaluates the performance of these programs, stressing, among others, distributive and efficiency effects. The other set – design and implementation criteria – recognizes the wide differences among countries and builds on their specific features to arrive at the desirability of alternative programs in a specific developing or transition country. We also used this introductory chapter to point out weaknesses in the standard ILO definition of unemployment when applied to developing countries, and describe the arguments that speak in favor of a public nature for income support programs for the unemployed.

3. REVIEW OF INCOME SUPPORT SYSTEMS FOR THE UNEMPLOYED

Countries differ widely in the way they provide income support for the unemployed. For example, the social insurance program for the unemployed with the richest tradition – unemployment insurance – exists predominately in developed countries. In developing countries, aside from transition countries where it was introduced widely about a decade ago, unemployment insurance is very rare. The incidence of unemployment assistance programs across the world follows a similar pattern. Legislated severance pay as well as voluntary indemnity provisions as part of collective agreements are also most common in developed countries. However, breaking this pattern, severance pay is also quite prevalent in East Asia and Latin America, but this is often the sole form of income support for unemployed workers. Again, as for UI and UA, there is an evident paucity of severance pay programs in Africa. Indeed, developing countries seem to rely more on other types of income support programs, such as public works, training, and other types of active labor market programs – but the proportion of the labor force covered by these programs is much lower than in developed economies.

Besides presenting the typology, the motivation for this chapter is that the review of income support programs will bring to the forefront the factors that contributed to their emergence. For example, why does there exist such a diversity of approaches? Why is it that in developed countries most of the labor force is covered by formal income support programs, while in developing countries coverage is often limited to a small minority? How much does it have to do with the country's stage of development, the nature of shocks experienced, the relative degree of income redistribution associated with a different program, and/or labor market legislation and other institutions? These questions will be reflected upon in the discussion that follows the review of existing programs. Of course, the existence of many of the programs is related to their – purported and real – effects in terms of efficiency and equity; and the following chapter is completely devoted to these effects.

In continuation of this chapter, we first describe the most important income support systems for the unemployed. To see what kind of factors contribute to the existence of income support programs, we examine determinants of the incidence of unemployment benefit systems. We conclude the chapter with the discussion of reasons for a diversity of approaches in income support, and its consequences for further evolution of these systems.

3.1 Typology and description of main income support programs

The description focuses on formal income support programs available to the unemployed, and does not consider implicit systems such employment provided through state or public enterprises. While most of these programs are available only to workers employed in the formal sector, eligibility to participate in some programs – notably public works – includes also workers engaged in the informal sector.

Table 3.1 lays out a typology of income support systems for the unemployed We distinguish two main types: income maintenance programs and active programs. The first group of programs are based on certain program participation rules (which includes the payment of a

premium in the case of unemployment insurance) which entitle the qualifying individuals to the benefits. There are no offsetting services to be performed in exchange for these transfers, although certain actions on the part of recipients may be required such as job search. According to the nature of the link between contributions and benefits, we further distinguish this group into three subgroups: defined benefit, defined contribution, and means-tested programs. The second broad type of income support programs are active programs, which require certain services or activities to be performed by the unemployed in exchange for income support or subsidy (for example, public works and training). Both groups of programs differ further in regards to their benefit levels and durations, eligibility conditions, financing, and sometimes also their main objectives (see table 3.1). The stylized features of the most important programs are detailed below.

Unemployment insurance. Unemployment insurance is typically mandatory. The few voluntary programs that exist (e.g., Finland, Sweden, Denmark) are subsidized by the government, but essentially resemble the compulsory systems of developed economies in both function and form (Holmlund, 1998). Most mandatory programs cover the majority of employed persons, irrespective of occupation or industry. Non-insured persons such as university graduates and the self-employed are sometimes eligible, while casual workers and domestics are most often not (see table 3.2 for stylized features of unemployment insurance by groups of countries). A few programs, particularly in developing countries, only cover workers in industry and commerce. In order to qualify for unemployment insurance, the individual must satisfy the minimum covered employment or contribution requirement, the most common length being 6 months in the past year. The cause of dismissal may affect if and when the individual is entitled to benefits, especially in developing countries. A usual condition for maintaining entitlement to unemployment benefits is that applicants be capable of and available for work. Non-compliance with other labor market requirements can also result in the permanent or temporary suspension of benefits.

Benefits are usually a proportion of average earnings over some stipulated period of the most recent employment spell. Generally, the initial replacement rate is between 40 and 75 percent of average earnings. In some countries, particularly transition countries, the benefit level may be some function of official minimum wage rather than the individual's past earnings. Wage or benefit ceilings are used to limit the range of the benefits; benefit floors, typically at minimum wage, are also sometimes present. In addition to the basic benefit, dependent supplements (either flat-rate benefits or an extra percentage of average earnings) are sometimes provided. Benefits commonly decline over time and are limited in duration. However, extensions are sometimes given to those with long, continuous employment records or to those near early or regular retirement age. It is also possible in many countries to move into means-tested unemployment assistance after exhaustion of unemployment insurance benefits.

Programs are typically financed through regular contributions based on wages by employers and/or employees. The contribution rates are often commensurate for employers and employees or higher for the former group. Sometimes, employees are altogether excluded from this obligation. The converse (employee contributions only), however, is very rare. In many countries, the government provides subsidies or finances any program deficits that arise.

Unemployment assistance. Unemployment assistance is means-tested minimum income granted to working age individuals who are unemployed and do not have the necessary financial resources to maintain a minimum standard of living for themselves and their families. Benefits are usually in cash, but can be in kind as well (see table 3.3). Cash benefits are typically flat-rate at some officially stipulated level (usually guaranteed minimum income at uniform rates). Means or income-testing is conducted not only on the personal financial resources of the applicant but also on that of his/her spouse and other adult members within the household. Aside from incomes, the level of benefits can vary according to factors such as marital status, the presence or number of dependents, and the age(s) of children. Benefits are periodically adjusted for inflation. Unemployment assistance benefits are sometimes offered indefinitely, so long as the recipient satisfies the eligibility conditions. Benefit duration is sometimes limited for recent graduates and other groups while extended for claimants near early or regular retirement age.

Like unemployment insurance, unemployment assistance programs require applicants to be capable and available for work. Claims are reviewed at regular intervals to assess job-seeking intensity and to determine changes in household circumstances, economic and other, that may require a change in the benefit level. In some countries, eligibility for unemployment assistance is not conditional on previous employment or contribution history. However, in most countries, particularly those with dual unemployment insurance/assistance schemes, unemployment assistance is an extension to unemployment insurance offered to the long-term unemployed who have satisfied some minimum length of employment and do not have the economic means to support their households. The two primary groups that enter unemployment assistance are: (1) those that have exhausted their unemployment insurance entitlement and (2) those that are ineligible for unemployment insurance due to insufficient employment records. Some countries penalize applicants whose unemployment was voluntary by limiting the length of unemployment assistance entitlement or extending the waiting period.

Unemployment assistance is financed by governments through general tax revenues, except in countries with dual unemployment insurance/assistance schemes, where source of financing is the same as for unemployment insurance.

Severance pay. Severance pay are lump-sum payments made to discharged workers either voluntarily by employers (through collective agreements or as part of firm policy) or as mandated by governments. They are offered for both individual and collective dismissals, usually with no special dispensations for the latter. Coverage is generally broad, encompassing both white- and blue-collar workers across the entire spectrum of economic activity (see table 3.4). However, in some countries, severance pay is provided only in some sectors, industries, or firms above certain sizes (these practices are more common in developing countries). Severance pay is typically provided to individuals who voluntarily depart due to personal reasons or who are discharged due to redundancy; those who are dismissed due to gross misconduct are not entitled to severance benefits. Minimum years of service requirements are also sometimes used to limit eligibility.

As a rule, severance benefits are some function of the years of past service and relatedly, the individual's age. The standard formula is one month's pay for each year of service. Obviously more complex formulae exist wherein compensation is adjusted according to years of service and/or age tiers; under such structures, individuals with long records of service and/or older age

are usually entitled to more generous severance pay per year of service. In some countries, the generosity of severance benefits may differ based on whether the individual was a white- or blue-collar worker, permanent or fixed-term, and whether s/he was covered by a collective agreement or not.

In general, severance pay is financed by employers. However, in some countries, the government provides financial assistance, particularly for large-scale restructuring operations which involve worker retrenchment *en masse*.

Unemployment insurance savings accounts. Unemployment insurance savings accounts (UISA) system is still very much a new idea, although in Brazil such a system has been in place for several decades, and has been introduced by several other Latin American countries in recent times.

The systems functions as follows. Firms deposit for each worker a fraction of his or her earnings into a special individual savings account each month (see table 3.5). Upon separation and regardless of the reason for separation, workers receive the amount accumulated in their UISA. Some programs allow access to these accounts for other reasons too (for example, health and education expenditures). In Uruguay, which has a dual public / private insurance system which covers, among others, old age and unemployment insurance, both employees and employers contribute. In several Latin American countries, all formal sector workers are covered, while in others coverage is limited to certain sectors.

According to some proposals (see, for example, Cortazar, 1996, and Feldstein and Altman, 1998), the unemployed would be able draw benefits monthly (as under the traditional unemployment insurance), and the government would lend money to accounts where the balance falls below zero. At retirement, positive balances would be added to the individual's retirement income, and negative balances would be forgiven.

Social assistance. Social assistance scheme are targeted at the most impoverished segments of society. They provide a range of benefits on a means-tested basis to applicants with insufficient resources to maintain a minimum standard of living as officially determined. Because of its heavy fiscal burden (in 1990, the social assistance expenditures of OECD countries ranged from 0.3% in Finland to 4.3% in Ireland), they are available mostly in developed and affluent developing countries.

Social assistance is typically provided indefinitely, subject to periodic checks to determine continuation in the eligibility status of the claimant. Review stringency varies across countries, but claims for social assistance from unemployed individuals are usually subject to greater scrutiny. In countries where unemployment assistance is non-existent, social assistance schemes provide exit from unemployment benefits (for example, Denmark, the United Kingdom, and the Netherlands).

In most countries, social assistance is in the form of flat-rate benefits at a low level so as to encourage employment (for example, below the average earnings of unskilled industrial workers). The composition and type of household, the number of income-earners in the household, and housing costs are also sometimes taken into account in the determination of

benefit amounts. In countries where social assistance is limited, social welfare agencies provide cash payments and services in kind.

The majority of social assistance schemes require that able-bodied individuals seek employment. Individuals who do not comply with the labor market requirements of the social assistance program encounter a schedule of penalties of increasing severity. For example, in the UK, first time delinquents are penalized with a reduction in their benefits, while serial delinquents face harsher sanctions including cessation in benefits. These schemes also often require a contract committing the claimant to certain job-seeking actions, such as participating in training or further education, or applying for work with penalties for non-compliance. In Nordic countries, social assistance is linked with social employment and able-bodied recipients are employed directly by municipal administrations for public works schemes or community service. In some countries such as France, the Netherlands, and the United Kingdom, social assistance recipients can supplement their income by participating in employment or training programs.

The administration and financing of social assistance schemes varies, but both national and local governments are usually involved. For example, in France and Ireland, the nationally administered social assistance scheme is supplemented with programs funded and administered at the local level.

Early retirement programs. In contrast to programs which compensate the unemployed for temporary income loss, these programs facilitate the withdrawal of older workers – either employed or unemployed – from the labor force. Typically, in order to be deemed eligible for early retirement pensions, workers must possess a long history of contributions into the pension insurance fund, and in case of unemployed workers, be registered as unemployed for a specified minimum period. These programs were introduced in developed economies in the late 1960s in response to increase of unemployment and the deterioration of reemployment prospects of older unemployed. They were also introduced by transition countries on a limited scale.

There are several types of early retirement programs. Under some programs, *older unemployed* are entitled to early pension benefits (usually, three to five years before the normal retirement age) at full, or more often, reduced value -- although the value is often reduced and less than actuarially fair. These schemes have been introduced within the standard retirement pension system (e.g., Germany and Sweden), the unemployment compensation system (e.g., France and Denmark), or independently of both benefit systems. Other programs instituted in Europe allow older workers to avoid the intervening period of unemployment altogether – under these programs, *workers with sufficiently long periods of pension contributions* can choose to retire early and receive public pensions at full or reduced value. In countries such as the U.S. and Canada, individuals can retire early, but with their pensions actuarially reduced. In many countries, early retirement pensions at full value are offered to those employed in hazardous workplaces or arduous work.

There are also "*job release schemes*" – special early retirement schemes which allow individuals to withdraw from the labor force early and receive pension benefits at full value (or receive a special allowance), conditional on employers to replace the "early retiree" with a younger unemployed individual. Such schemes were instituted in Belgium, France, Germany, the U.K., and the U.S. A variant of this scheme is partial voluntary early retirement, in which older

workers accept reduced work hours, enabling the employer to hire unemployed individuals into new part-time jobs created from the released time.

Some countries also used *disability pensions* to encourage early retirement for the *older unemployed*. Older individuals with even minor infirmities were entitled to full disability pensions if suitable part-time jobs were unavailable in the local labor market (e.g., Germany, Denmark, Netherlands). However, To reduce financial burden on this program, in the 1980s and 1990s, a number of countries reformed their eligibility criteria so that labor market conditions no longer influenced entitlement to disability benefits.

In several OECD countries, older individuals can also take advantage of a *"bridging" mechanism* which allowed them to draw unemployment benefits at relaxed conditions until they reached the minimum age for early retirement pensions. In some countries, older unemployed are also provided unemployment benefits for longer than the standard entitlement period, and sometimes even up to the normal retirement age. During the early 1980s in Germany, for example, after the age of 54 an individual could draw unemployment benefits for a maximum of 32 months. Since early retirement pensions were available at age 60, firms often dismissed those aged 57 or older cognizant of the fact that generous unemployment benefits would be provided until they retire.

In addition to public schemes, firms use *private pension plans* to facilitate early retirement. Moreover, in the Netherlands and Germany, under negotiated "social" plans, firms are required to *top up* the unemployment benefits received by older redundant workers up to the level of previous net earnings until they reach the eligibility age for unemployment-related early retirement pensions.

Public works. These programs provide a way to maintain income and generate employment at the same time. Programs may have multiple objectives, such as providing income to the poor, improving living standards by developing social infrastructure, maintaining and acquiring human capital, countering psychological effects of unemployment, promoting work opportunities to long-term unemployed and discouraged workers, creating capacity for self-help (empowering of communities), and improving community-based services. Nonetheless, public works usually emphasize their income support function. They also allow for significant control of program participation. For example, program rules may favor certain groups of population (such as discouraged workers or long-term unemployed). Programs may also perform as a work test for recipients of unemployment benefits.

Public works are usually geared toward labor intensive projects. Projects typically implemented include improvements in community social infrastructure, such as repairing of schools, hospitals, and local roads. Participation is open to anyone, but duration is usually limited. However, setting low wages makes the limited duration feature less necessary, at least early on in program participation. The earnings of participants are set slightly below the market wage, since low wage triggers a self-selection mechanism through which only those in need participate. It also stimulates the participants to search for a regular job, and to take it if offered. The program is usually financed through central government, with local governments covering the non-wage costs.

3.2 Concluding remarks

The above review shows that countries use widely different approaches when providing income support to the unemployed. While developed countries have multiple programs, many developing countries do not have any special programs for the unemployed. Moreover, parameters of a particular income support scheme differ strongly across countries, contributing to differences in coverage and the degree of protection provided. And even countries which are geographically proximate and at a similar level of economic development may choose quite different welfare regimes, as the diversity of regimes across European countries suggests (see Gough (2000), for example).

How can we explain such a diversity of approaches? There are many possible explanations why the "one size fits all" rule does not apply. Countries have chosen and designed programs to fit their specific circumstances and needs (cultural, administrative, nature of shocks). Appeasing special interest groups and other political economy considerations also play an important role (see Box 3.1: Reasons for introduction of the UI system in Brazil). And different schemes have different distributive and efficiency objectives – and effects. For example, reaching the chronic poor requires different programs than providing income smoothing for skilled workers.

Box 3.1: Reasons for introduction of the UI system in Brazil

In 1986, a universal unemployment insurance scheme was finally incorporated into law (Law # 2.284 Article 25) with the 1986 Cruzado Plan. A consensus regarding the reasons behind the development of a modern UI scheme cannot be found in the literature. One theory states that increased union activity in late 1979 lead to popular demand for strengthened worker rights which had been guaranteed but not enforced by the government. To address the populace, a UI system was implemented as a cheap, politically safe program. An alternative theory identifies as the primary motivating factor the growing public dissatisfaction due to urban population pressures, a new labor arrangement, and economic instability rather than unfulfilled promises on the part of government. Yet a third theory suggests that UI was included in the Cruzado Plan merely as a trade-off for less favorable labor clauses.

Source: Cunningham (2000).

One implication of the above findings is that in reforming their systems, countries may well follow different transition paths – and that these systems may never converge. For example, as claimed by Edwards and Manning (1999), Latin American countries may be amenable to replacing their severance pay systems with the UISAs, while such an introduction may be just a remote possibility in transition economies.

4. PERFORMANCE OF INCOME SUPPORT SYSTEMS

This chapter reviews the evidence about the performance of various income support systems for the unemployed. It evaluates the distributive and efficiency effects of these systems, as well as examine how desirable these systems are when viewed from the angle of susceptibility to various types of shocks and political sustainability. The discussion focuses on programs whose main objective is to provide compensation for the loss of earnings due to unemployment: unemployment insurance (UI), unemployment assistance (UA), severance pay (SP), and unemployment insurance savings accounts (UISAs). Selective outcomes of some other programs (social assistance, early retirement, and public works) are also reviewed. Since these programs combine other objectives with income support, they sometimes cannot be easily evaluated in parallel with the programs which are the main focus of this report.

Before proceeding with the evaluation, three caveats about the pitfalls of such a task should be mentioned. First, as the above review of existing income support schemes shows, many of the schemes tend to be very complex, because they rely on many design parameters that interact in numerous ways. In evaluating the performance of these schemes, **it is of utmost importance to appropriately account for their design parameters (the scheme's "architecture"), as well as for the degree of enforcement of the schemes' rules**, that is, whether or not laws on the books are actually implemented (Atkinson and Micklewright, 1991). Differences in the design of income support schemes may help to explain not only variations in their coverage, but also other effects these schemes have on different labor market outcomes (the incidence of part-time workers, the share of women and long-term unemployed among the unemployed, the duration of unemployment, to name just a few). For example, long periods of insured unemployment may be attributable not only to low labor demand, but also to a generous replacement rate, long maximum duration periods for UI collection, lax monitoring of a job search, ineffective job-search assistance, as well as UI eligibility rules that attract workers with weak labor-force attachment and poor motivation (when Poland introduced its UI scheme in early 1990s, for example, no prior work experience was needed to qualify for benefits). Similarly, a high share of women among UB recipients may be attributable to low relative demand for women's labor, but it may also reflect program rules that extend the benefits for mothers until children reach a certain age (Estonia is an example).

The second caveat relates to the fact that the **working of such schemes cannot be evaluated in isolation, that is, separately from other important institutional features of the economy.** In conjunction with structural parameters of income support systems, a host of institutional and other features – primarily those affecting the performance of the labor market, such as labor legislation and collective bargaining arrangements – as well as labor market conditions have to be considered so as to more accurately determine and attribute the effects of income support schemes. For example, an increase in the intensity of job-search monitoring may well produce different results depending on the extent of unemployment. Similarly, the effects of experience rating on layoffs depend largely on the strictness of employment protection legislation – if the latter is in place, additional effects of experience rating may be small. The UI system is also affected by wage setting arrangements: under flexible wage arrangements, more adjustment is likely to be achieved via real wage reductions as opposed to employment reductions. In contrast, more rigid wage determination may prompt more employment adjustment and larger inflows to

insured unemployment; in turn, higher costs of UB stifle job creation and contribute to higher unemployment on its own (particularly for marginal groups of workers). (For a modeling of reasoning along these lines, see Aghion and Blanchard, 1994).

Various **simultaneous programs and policies can also have offsetting effects, or can reinforce each other**. For example, the employment effects of liberalization of fixed-term work depends not only on job protection of regular jobs but also on whether or not fixed-term workers qualify for unemployment benefits. Or the effects of generosity of UI program may well depend on a host of labor market policies (from wage setting behavior and minimum wage regulations to employment protection legislation) that influence the job creation capacity of the economy and thus the demand side of the market. Or increasing monitoring of job search may not help if the inspection of black employment remains loose. Changing only one program may not produce the desired effects. In other words, one should judge the effects of a particular program in the context of the whole economic system rather than in isolation. Examining the adjustment of the system in its entirety allows one, among others, to set appropriately the counterfactual, for example, by taking into account existing distortions which prevent the economy from being perfectly competitive.

4.1 Summary of distributive effects

The main objective of income support systems for unemployed workers is to provide for a lost job, that is, to compensate workers for a loss of income when they become unemployed. When evaluating these systems, distributive effects of unemployment benefits obviously figure prominently. A natural and legitimate task is therefore to examine how widespread different support systems are, and to what extent these systems succeed in helping to smooth consumption, reduce poverty, and redistribute income from the rich to the poor. Below we summarize the evidence on these issues.

Coverage: In comparison to their counterparts in developed economies, formal sector workers in developing countries have much more limited choice of participation in income support systems which provide insurance against unemployment risk (see table 4.1). For example, the most prevalent form of insurance against unemployment in Latin America is severance pay; however, not all formal sector workers are legally entitled to that benefit, and if dismissed, even those who are entitled often do not receive the benefit. Workers in the informal sector are the least protected. They are excluded from all programs where eligibility is conditional on social security contributions. Their options are thus limited to a subset of formal programs (such as public works), and, increasingly, to innovative programs offered by self-help organizations.

Adequacy of support: In developing and transition countries, replacement rates and entitlement periods of UI do not deviate much from those in developed economies. As for the effects on consumption smoothing, there is abundant evidence of the effectiveness of UI in doing so for developed economies; but there is little evidence of either UI or other income support schemes in developing and transition countries. Most effective in reducing poverty in developing countries seems to be public works; unemployment insurance also contributes to the reduction of poverty, but its scope seems to be limited.

Income redistribution. By far the most progressive programs are public works and training. Unemployment insurance in transition countries also helped to redistribute income from the rich to the poor. By design, the UISA offers little redistribution. Note that this is precisely the advantage of the UISAs. The scheme differentiates between those individuals with savings and those without them – only the latter ones may be entitled to transfers from the public purse – and thus limits the scope of redistribution.

4.2 Summary of efficiency effects

The main findings about efficiency effects of income support programs are summarized in table 4.2. As it is evident from the table, it seems that a consensus is emerging in some areas, but in others researchers are still far from agreement. As for unemployment insurance, there is mounting evidence that the generosity of unemployment insurance reduces the probability of exit from unemployment to employment, a result that is fairly robust across countries and labor market regimes. Another significant agreement, although less unanimous, is that the generosity of UI increases the equilibrium unemployment rate. But there are also important areas of disagreement: the evidence is inconclusive on the effects of UI on post-unemployment wage and thus on the quality of job matches; whether UI enhances entry into regular jobs; and whether the existence of UI helps the economy achieve higher efficiency and output.

There is also a remarkable agreement on the strong negative effects of severance pay on labor market flows, particularly into and from unemployment, and there is strong evidence that severance pay reduces employment. No evidence, however, exists about the effects of severance pay on job matches and on employment in regular jobs as opposed to informal ones.

As for other income support programs of prime interest, there is little evidence on the effects of unemployment assistance as a self-standing program. The most significant gap in understanding the working of income support systems, however, relates to the effects of unemployment insurance savings accounts. Because only few such programs exist, and because most of them have only recently been introduced, such a gap is understandable – but it should figure prominently on a research agenda in the near future.

The above review shows that different income support programs for the unemployed produce quite different efficiency effects. Nonetheless, there is a common thread among these results: none of the programs seem to be without negative effects on efficiency. This is just another confirmation that income security does come – and can only come – with significant costs to the economy. The challenge is, of course, to choose programs which minimize negative effects while providing adequate income security to the unemployed – we tackle this challenge in the last chapter.

4.3 Suitability to confront different shocks

When countries are adversely affected by strong and lasting macroeconomic shocks, do they try to adjust their income support systems for the unemployed and introduce new ones? How suitable are different schemes to deal with different types of shocks? Are income support programs for the unemployed counter-cyclical, that is, do they get increased funding when an economy suffers from a recession and needs income support the most? Moreover, what is the

destiny of marginal groups during the crisis? Below we examine these issues by summarizing the experiences of different regions in dealing with crises, focusing on the ability of various schemes to confront shocks. We review the responses of three groups of countries – European transition, Latin American, and East Asian countries – to their recent severe declines of outputs associated with the systemic transformation and financial crisis (transition and East Asian countries) and with the increase of instability (Latin American countries).

To provide income support to the unemployed, crisis situations and transition reforms invoked a similar response by the three groups of countries – they introduced active labor market programs: public works, training programs targeted at the unemployed, wage subsidies for private sector employment, and schemes to assist self-employment. But in contrast to the other two groups of countries, transition countries also introduced new cash benefit systems, chief among them, unemployment insurance and social assistance. This difference can be linked to a more profound contraction in the size of transition economies, but also to the dearth of informal risk management mechanisms at the start of the transition.
The following is a tentative evaluation of different income support systems regarding their suitability in dealing with different types of shocks:

- *Unemployment insurance.* The experience of transition countries shows that UI/UA can effectively insure against individual (idiosyncratic) shocks, it may not be equally effective against structural shocks. When unemployment is large, many unemployed exhaust their benefits before they find a job. Moreover, in highly inflationary environments of some transition economies, the real value of benefits was quickly eroded (Scarpetta and Reutersward, 1994). The experience in South Korea also shows that unemployment insurance failed to reach many unemployed workers.
- *Unemployment assistance*. The experience of transition economies shows that unemployment assistance can provide effective, less expensive – and thus more sustainable – support to the unemployed than unemployment insurance.
- *Severance pay.* Effective in smoothing consumption regardless of the nature of the shock, but it may require public guarantee fund/pre-funding arrangement to enhance availability.
- *UISA.* Effective in smoothing consumption regardless of the nature of the shock.
- *Early retirement programs*. Effective in dealing with sector/branch risk (meso-level) – but they entail high efficiency and equity costs.
- *Retrenchment programs*. They may be utilized to improve the effectiveness of other income support programs in dealing with meso-risks (on the level of branches) – but they are expensive, which limits their suitability for wider scale operations.
- *Public works.* Large-scale, labor-intensive public works schemes proved to be the most popular emergency measures, providing both income support and employment generation. But evidence shows that funding per poor person declines during crises, showing vulnerability to covariant shocks.
- *Training*. Effective as income support, but ineffective in providing skills demanded by the labor market.

A preliminary assessment of various income support schemes is presented in table 4.3.

4.4 Resistance to political risk

By design or by default, income support programs typically involve income redistribution from the rich to the poor. It follows that the rich would normally oppose such programs – so a natural question arises on the particular circumstances that are conducive to the introduction of such programs, particularly those that benefit the unemployed. Similarly, once introduced, these programs develop their own constituencies, making reforms or their removal difficult.

While it may be difficult to pinpoint exact circumstances that are conducive to introducing/changing income support system from political economy point of view, some principles can nonetheless be arrived at. First, under stable conditions, government programs may favor the middle class, thus failing to reach the poor. Second, the prospects of welfare changes, not only the current position in income distribution, may be important determinant of the support for income redistribution programs. This speaks of crisis as a more likely time of introduction of income support systems with significant built-in redistribution (unfortunately, as discussed above, often that means that programs are introduced too late and not effectively). And third, reducing income support programs may be more effective if scaling back is implemented as a part of a wider, far-reaching reform.[3]

Although it is not necessarily firmly couched in theoretical and empirical findings, in table 4.4 we also offer a tentative evaluation of alternative programs from the aspect of resistance to political risk (that is, ability of the program to remain independent of the influence of special interest groups through lobbying etc.) and ability to sustain budgetary funding. As a pay-as-you-go scheme, unemployment insurance is subject to high degree of political interference. The experience of transition countries supports that conclusion. Initial beneficiaries received quite generous benefits, but the systems proved unsustainable and the benefits had to be reduced in the early 1990s (Vodopivec, Woergoetter and Raju, 2001). On the other extreme and the most resistant to political interference is the UISAs system, where the link between the benefits and contributions is the most direct. The system also introduces policing of its own by providing checking of the accounts by the beneficiaries themselves.

As for the ability to sustain budgetary support, the above summary of the literature indicate that neutral programs in distributive sense (such as unemployment insurance) have better prospects for sustained funding than more redistributive programs (such as public works). Moreover, as Ravallion (1999b) shows, "leakage" of benefits to non-poor participants may be instrumental to obtain sustained budgetary support for programs such as public works.

[3] Van Ours and Belot (2000) investigated the reasons behind the success of some OECD countries in lowering the unemployment. They find that successful countries implemented a comprehensive set of labor market reforms and point to strong complementarities among institutions affecting unemployment.

5. CHOOSING THE RIGHT SYSTEM OF INCOME SUPPORT IN DEVELOPING COUNTRIES

The purpose of this concluding chapter is to provide guidelines for developing countries when improving or introducing income support systems for the unemployed. Although the knowledge about the working of these systems and other mechanisms for social risk management is increasing, we still cannot offer specific recommendations and precise criteria for the introduction of individual programs. Nonetheless, based on the material presented in the previous chapters, we offer some tentative guidelines about the suitability of individual schemes for different countries, focusing on unemployment insurance, unemployment assistance, unemployment insurance savings accounts, and public works.

The basis of discussion are two sets of criteria which we developed and discussed in previous chapters. To repeat, one set consists of performance criteria and is based on the effects of alternative systems reviewed earlier. It has to be emphasized that the established effects of various programs apply under typical conditions prevailing in separate groups of countries, and that particular circumstances of individual countries may exacerbate or ameliorate these effects. The other set of criteria judge alternative schemes by how they fit a specific country from the viewpoint of design and implementation; that is, how countries' "initial conditions" – for example, labor market and other institutions, administrative capacity, the prevalence of private transfers and other cultural factors, the types of shocks typically faced, and the size of informal sector – affect the choice of the income support system for the unemployed.

Before presenting guidelines, let us provide some general principles which should be followed when building income support for the unemployed. The principles are taken from "The Social Protection Sector Strategy" (World Bank, 2001) and have been adapted to the discussion of unemployment support programs.

Adopt holistic view. As discussed in the chapter on conceptual issues, income support systems for the unemployed must be seen in the wider context of other formal and informal mechanisms of social risk management. In this connection, particular attention should be devoted to the interconnection between unemployment support systems and the labor market, the latter being of utmost importance for the ability of individuals for self-protection (compare de Ferranti, Perry, Gill, and Serven, 2000, Ch. 6). This principle has been faithfully followed also by this report. In more general terms, one should not forget that risk coping and risk mitigation mechanisms form only a subset of available mechanisms; economic growth, financial markets, investment in human capital etc. are all powerful mechanisms that contribute to providing income security in fundamental ways.

Strike the right balance. In the present context, this means striking the right balance among publicly provided programs and private mechanisms – self insurance and private transfers. Another important balance is also the balance between public cash benefits and programs providing in-kind benefits, notably public investment in basic education and health, is also important.

Be prepared for the risk. Safety net programs are investments (Ravallion, 1999a). Recent economic crisis in East Asia and recurrent crises in Latin America show the advantages of

having income support programs in place before the crisis develops. If that is not the case, the program quality suffers, because it is difficult to get the programs approved and build information and monitoring mechanisms.

5.1 What conditions are conducive to good performance of the UI system?

The above evaluation of the unemployment insurance system suggests the following strengths of the program (together with weaknesses and key country specific features conducive to the successful performance of the program, they are summarized in table 5.1):

- Above all, thanks to the pooling of resources across a wide base, it provides good protection by enabling a high degree of consumption smoothing for all categories of workers who are covered under the system.
- It performs well under idiosyncratic, sectoral, and regional shocks.
- By automatically injecting additional resources – and reducing taxes – in times of recessions, unemployment insurance acts as an automatic stabilizer and thus moderates the magnitude of the downturn.

The above strengths have to be weighed against the following main weaknesses of the program:

- The program creates reemployment disincentives and wage pressures, which increase the equilibrium unemployment rate of the economy.
- By interacting with adverse shocks, the program contributes to the persistence of unemployment.
- Because the program is non-transparent, may creates large unfunded liabilities, and the funds are held by the government, it is susceptible to political risk.
- The protection is limited to formal sector workers only.

Moreover, there is a host of country specific considerations that influence the choice of the program. Let us mention some key institutional and labor market features which are conducive to its introduction and successful performance:

- Strong administrative capacity to monitor initial and particularly continuing eligibility. The stricter the monitoring of the behavior of the recipients, the lesser the disincentives created by the provision of insurance.
- Modest size of the informal sector. The higher the informality of the economy, the more abundant are opportunities for undeclared paid work, and thus the higher the costs of monitoring.
- Environment not conducive to political risk (see above).
- Decentralized or encompassing wage bargaining structure. Unemployment insurance in conjunction with fragmented and uncoordinated collective bargaining is likely to generate strong pressures on wages. In contrast, decentralized and encompassing wage bargaining structure are conducive to wage moderation.
- Low payroll taxes. The higher the payroll taxes, the stronger the impact of benefits on the equilibrium unemployment rate.
- Low share of underemployed workers. The existence of benefits may attract the underemployed into insured unemployment and thus reduce their incentives for self-protection.

- Low incidence of private transfers. If the introduction of public insurance breaks down the habit of self-help among local communities ("extended families"), replacing private transfers by social insurance is welfare-reducing (Attanasio and Rios-Rull, 2000).

If the above circumstances are not fulfilled, the system does not perform all that well, increasing the costs in terms of efficiency and lowering welfare gains due to the reduction of income security. For example, reemployment incentives depend crucially on the monitoring capacity of a country. This capacity determines how strictly the conditions of initial eligibility and, perhaps even more importantly, of continuing eligibility are imposed. As the experience with Argentinean unemployment insurance suggests (see above), the capacity for screening the initial eligibility has not been a problem (the existing capacity of other social protection programs has been used) – but the country has still to acquire effective capacity to monitor continuing eligibility. While it is difficult to evaluate the consequences of deficient monitoring, it is clear that (i) it creates leakages and thus adds to overall costs (and thus may have also indirect effects on unemployment), and (ii) it undermines the legitimacy of the program, as the system *de facto* ignores its own rules.

How do such "child diseases" affect the decision to introduce unemployment insurance? For example, prompted by increased exposure to foreign markets and fearing future international crises, some developing countries (Thailand and the Philippines among them) are contemplating introducing unemployment insurance. According to some assessments, its immediate introduction to a country like the Philippines would be premature, but the system should be seriously considered in the medium term, once some preconditions are fulfilled (see box 5.1).

Box 5.1: Feasibility of unemployment insurance introduction to the Philippines

In a recent paper commissioned by the ILO, Yoo (2001) examines the applicability of unemployment insurance to the Philippines. For the following reasons, he recommends against its immediate introduction:

- the lack of consensus either nationally or by social partners that unemployment insurance is a top policy priority;
- concerns on the part of employers and employees about its affordability; and
- concerns about the financial stability of a system, given the low level of industrialization and per capita income in the Philippines.

Yoo proposes the introduction of unemployment insurance in the medium-term, and cites a number of pre-conditions (in fact, he proposes a more comprehensive insurance which would also provide some active measures, as it does in South Korea). His main points include:

- an immediate social protection priority of developing social assistance programs for the poor;
- an immediate economic priority on creating the conditions for sound and continuous growth;
- national dialogue among the social partners to determine the best unemployment benefits system for the future; and
- capacity building both in terms of (i) employment and training systems, and (ii) record-keeping and fee-collection within the social security administration.

Source: Betcherman (2001).

Similar is the assessment of Gill and Ilahi (2000) for Latin American countries. Noting that many countries lack the capacity to run an efficient unemployment insurance system, they argue

that although introducing unemployment insurance should be a long-term goal of these countries, it is either infeasible or too costly a strategy for the medium term. They propose that the government should augment other instruments such as self-insurance to overcome the lack of market insurance in the medium term.

In box 5.2, we look at the introduction of unemployment insurance, this time emphasizing welfare and efficiency properties. Undoubtedly, many workers would benefit from such an introduction – but in a low income country, the likely beneficiaries tend to be concentrated among already better off segments of the population, and its introduction would likely bring efficiency losses, with further negative distributive consequences. Note, however, that the magnitudes of both the benefits and costs of introducing the program depend strongly on specific circumstances of individual countries, the fact that we emphasize throughout the report.

To summarize: in light of the above, how suitable candidates are developing countries for the introduction of unemployment insurance? Typically, the administrative capacity of developing countries (even in upper-middle income group, as is the case with Argentina) lags behind the capacity of developed countries. This means that the system may not perform well from an efficiency viewpoint, particularly if low quality of administration is coupled with unfavorable labor market conditions (such as high payroll taxation and a wage mechanism not conducive to containing pressures). High informality contributes to negative effects both from an efficiency and distribution viewpoint, and high political risk (which is often the case) from a political economy viewpoint. The case for the introduction of unemployment insurance in developing countries is thus less compelling than it is in developed countries. Transition countries, having

Box 5.2: Benefits and costs of introducing unemployment insurance

On the benefit side, the introduction of unemployment insurance provides welfare gains in terms of smoothened consumption patterns. This increase of security is certainly valued: for example, Bird (1995) estimates that individuals are willing to pay 5-9 percent of their disposable income for insurance that would smoothen their incomes (estimates for the U.S. and Germany).

These positive, direct effects on welfare have to be qualified in several ways. First, because the program is limited to the formal sector, the beneficiaries are limited to a subset of workers who, by and large, belong to better-off segments of the population. Indeed, as shown above, the likely effect of unemployment insurance on the reduction of income inequality is small. Second, unemployment insurance brings little reduction of poverty, as the likely beneficiaries – particularly in a low-income country – are concentrated in the non-poor segments of the population. And third, the net effect of benefits on individuals' welfare depends, among others, on the displacement of private transfers by the public program; it can happen that this displacement effect prevails (Attanasio and Rios-Rull, 2000).

The welfare benefits of introducing unemployment insurance have to be weighed against the likely efficiency costs, above all:

- disincentives for leaving unemployment and thus higher overall unemployment, and
- more persistent unemployment.

Note that these efficiency effects also have negative distributive consequences. Any increase of unemployment due to the introduction of the program would most likely affect the worse-off workers in society: marginal workers in the formal sector (such as young workers and workers on fixed-term contracts) and informal sector workers, hindering their access to jobs.

relatively better administrative capacity, a more limited informal sector, and lower private transfers, were undoubtedly right to introduce this system, but they still need to improve the implementation of the system (see Vodopivec et al, 2001).

As shown above, the case for introducing unemployment insurance system in developing countries is less compelling than it is in developed ones. How appealing are, then, alternative systems? Below we discuss two of them: unemployment assistance and unemployment insurance savings accounts.

5.2 Unemployment assistance: how attractive is means-tested targeting?

The distinguishing feature of unemployment assistance is that it screens potential benefit recipients with a means test, instead of granting the benefit to all workers with sufficient employment histories and paid contributions as under the unemployment insurance system. Does such targeting of the benefits to the most "needy" improve incentives and produce savings, and thus makes the system more desirable than unemployment insurance?

Other things equal, the elimination of potential claimants by means testing is bound to produce savings. But the experience of Australia and New Zealand – two of very few countries that have a self-standing unemployment assistance program – apparently contradicts this claim. Measured by the average cost of unemployment benefits per percentage point of unemployment, the costs of both systems exceed the comparable average cost of unemployment insurance systems in 12 OECD countries (see Vroman, 2001). As box 5.4 explains for Australia, this counterintuitive result is produced by two factors. Above all, the number of benefit recipients compared to the number of unemployed is very high – in recent years, the former even exceeds the latter, one of the reasons being that about 20 percent of recipients are full-time workers with low wages. Note also that workers without substantial prior work history are eligible for benefits, that is, that the potential pool of applicants is larger than under unemployment insurance. Moreover, because the Australian system offers a high income guarantee, it generates a relatively high replacement rate. As result, the unemployment assistance system fails to produce savings – but undoubtedly, the system effectively reaches all those whose income is below some the stipulated income guarantee, and smoothens consumption. One other feature of the Australian system is worth noting: it is a very progressive system. Roughly 60 percent of cash benefits are paid to those in the three bottom deciles of the income distribution.[4]

While the above findings show that the unemployment assistance system does not necessarily produce savings, they also suggest that the costs of the system depend on the level of income guarantee – as well as on the effectiveness of monitoring benefit eligibility. Indeed, the experience of two other countries which also have unemployment assistance programs – Hong Kong and Estonia – confirms that the generosity of unemployment assistance system (in terms of the costs per percentage point of unemployment) can be much lower, significantly below the average generosity of benefit systems in OECD countries (Vroman, 2001). Moreover, Vroman

[4] Comparative data for 13 OECD countries in 1995 show the overall share of transfers going to the bottom three deciles ranged from 20.8 percent in Italy to Australia's 58.0 percent with the second highest percentage being 53.5 percent in France. Conversely the top three deciles in Australia received 7.4 percent of transfers, the lowest percentage across the same 13 countries (see Vroman, 2001).

suggests that the Australian system has serious problems with labor supply incentives created by high effective marginal tax rates, which also adds to the costs of the system.

As argued by Atkinson (1995), although income- or means-testing may seem attractive, there are several elements that have to be seriously considered. First, administrative costs associated with identifying and monitoring individuals or families over their terms of recipiency can be costly. Second, there are serious problems with the program's take-up. Experience in Western countries suggests that a third or more of potential claimants never receive the benefits (reasons include information problems, administrative complexities, and stigmatization of recipients). And third, incentives problems with programs that condition benefits with low current income tend to be particularly important.

Box 5.4: Costs under the Australian unemployment assistance system

Using "costs per percentage point of unemployment" as a metric, the Australian unemployment assistance system does not outperform unemployment insurance systems in OECD countries (the metric is defined as the percentage of unemployment benefits in total wages, divided by the prevailing unemployment rate). The average cost for 12 OECD countries was 0.25 in 1992 (ranging from 0.697 in Sweden to 0.032 in Greece); the average costs of the Australian system in the 1990s were about 0.28.

Why are the costs under the Australian system so high? First, the basic income guarantee (25 percent of the average wage) is high, producing replacement rates that typically fall into the 0.60-0.90 range. Because of the high income guarantee, most of the unemployed are benefit claimants despite the income test. In fact, since 1995, the number of recipients has exceeded the number of unemployed. Second, employed workers are also eligible to unemployment assistance, and about 20 percent of claimants are employed.

Moreover, it seems that the *administrative costs* under unemployment assistance are higher than those under unemployment insurance. Additional costs under unemployment assistance are associated with the costs of monitoring income (initial income assessments for new claims and income monitoring for ongoing claims). These costs typically exceed the costs of initial eligibility determination under unemployment insurance, which are incurred once per claim. The costs of monitoring availability for work and job search are similar in the two systems.

Source: Vroman (2001).

To summarize: the potential for providing benefits to workers with little prior work experience and informal sector workers, together with a more effective targeting, is a strong point of unemployment assistance (see table 5.1). But in comparison to unemployment insurance programs, the program does not necessarily generate savings, it offers a lower level of protection for high income workers, and imposes larger administrative costs. It also reduces labor supply of family members and may stigmatize recipients. In addition, it suffers from similar weaknesses as unemployment insurance (above all, it creates reemployment disincentives, increases the equilibrium unemployment rate, and contributes to the persistence of unemployment).

In the light of above, what are the implications for the use of this program in developing and transition countries? First, under the typical circumstances in developing countries, one potential advantage of unemployment assistance – the fact that eligibility does not require prior contributions – in fact renders the program non-viable. With large segments of the labor force either underemployed and unemployed, providing an income support program which fails to

exclude persons without prior work in the formal sector (that is, persons who have not paid program contributions) would be untenable on a regular basis: it would be fiscally unsustainable. Unemployment assistance programs in developing countries would therefore have to condition benefit eligibility on the prior payment of program contributions, as is done under unemployment insurance. Second, due to administrative constraints typically faced by low-income countries, few, if any, may be able to carry out the required level of monitoring. Third, because of abundant informal sector employment opportunities, the problem of employment disincentives for other members of the household would be more pronounced than in developed countries. Ineffective monitoring would produce large leakages – on the other hand, effective monitoring would not only impose large administrative costs, but also create large forgone earnings. To conclude, the applicability of unemployment assistance program seems to be limited to countries with relatively developed administrative capacity, a small informal sector, and large fiscal pressures, perhaps as a transition system to unemployment insurance (possible candidates being transition countries).

5.3. The promise of unemployment insurance savings accounts

Spurred by adverse incentives created by traditional income support systems, new approaches to improve these systems have been embarked upon. The system of unemployment insurance savings accounts (UISA) is the most radical and perhaps also promising one. Among its strengths, one should mention:

- By internalizing the costs of unemployment benefits, the system avoids the moral hazard inherent in the traditional unemployment insurance program. This is arguably the most important advantage of the system.
- Being payable also in cases of voluntary separations, the system encourages labor reallocation and cuts down on the litigation costs incurred under severance pay.
- In comparison to public insurance, the program reduces political risk.
- Particularly if backed by government subsidies, the program has the potential of attracting informal sector workers.

The above strengths of the UISA system have to be weighed against its shortcomings:

- By its very design, the program – in its pure form – does not "pool risk among individuals, and thus may be less efficient than those that do so explicitly (such as formal unemployment insurance) or implicitly (such as income support programs financed from general tax revenues)," as stated by de Ferranti et al (2000, p. 89). This is the system's most serious shortcoming. For example, young workers may not be able to accumulate enough savings at the time of separation to be able to self-finance their unemployment.
- In comparison to alternative programs, the program imposes larger administrative costs (this is partly related to new services, such as account updates).

Note that under certain circumstances, the absence of pooling across individuals may not be critical. Under modest and frequent shocks, as the analytical framework of Gill and Ilahi (2000) suggests, self-insurance through savings may provide adequate smoothing of consumption. Moreover, being aware of the limitations of the absence of cross-section pooling, some proposals combine UISAs with public insurance so as to better address large and persistent shocks (Feldstein and Altman, 1998). For example, under the proposal of Feldstein and Altman, unemployed workers are able draw benefits monthly as under the traditional unemployment

insurance, and the government lends money to accounts where the balance falls below zero. Under such as a proposal, the consumption smoothing properties of the UISA system would be no worse than under the traditional unemployment insurance system, because individuals with negative balances would still receive benefits, as rules of withdrawal would be the same as under the unemployment insurance system – yet the UISA system would reduce labor market disincentives.

According to some proposals, the efficiency properties of an integrated private-public system can be further improved by combining several risks under one program. Orszag et al (1999) and Yun (2001) propose an integrated unemployment insurance system, which would combine unemployment insurance not only with the pension system, but also with other programs such as health, disability, and life insurance. Such a program would thus integrate intertemporal pooling of various risks of the individual with cross-section pooling. By doing so, the system is expected to offer not only superior provision of insurance, but also significant reduction of disincentives as compared to the traditional unemployment insurance system (see box 5.5).

There are also some "design and implementation" considerations that by and large speak in favor of the introduction of this system in middle- and upper-middle-income developing countries and transition countries:

- Weak monitoring capacity of these countries accentuates the moral hazard problem inherent in the traditional unemployment insurance program and encourages other misuses of the system. Hence the self-policing nature of the UISA system represents a bigger advantage.
- In developing countries exist various income support programs, and their conversion into an UISA-type program could greatly facilitate its introduction. For example, in the Philippines there are several mandatory forced-savings schemes, which could, together with severance pay, be merged and transformed into an UISA system (see Esguerra et al, 2001).
- Under the traditional unemployment insurance system, employers in developing countries sometimes fail to pay program contributions. By introducing personal accounts, workers themselves monitor such payments. In addition, the same feature makes the UISA system less susceptible to the political risk.
- Moreover, it has to be noted that the administrative complexities of introducing UISAs do not stand out as prohibitive; for example, old-age insurance systems introduced in many Latin American countries require similar information systems. [5]

In sum, the UISA system – and its variant Integrated Unemployment Insurance System – seem to be promising options, particularly for countries where initial conditions seem to be especially suitable (this relates to East Asia and Latin America, where the existence of severance pay programs may ease the transition to an UISA system). There is a need, however, for further investigation – and piloting – of the program. Too little is known about the working of the UISA system to know for which groups of workers, and under what conditions, the above favorable

[5] Smetters (2000) assesses the risk of having high administrative costs of private pension accounts in the U.S. as low to medium – and a similar assessment is valid also for UISA accounts, and for other countries as well. To keep the costs of private accounts low, Smetters proposes that investment funds are approved and regulated by the government, and subject to standard auditing controls to reduce fraud. He also proposes limits on investment charges as well as on free movements of money between funds. In such a case, most of the administrative costs would come from collecting contributions from individual workers, that is, at few extra costs in comparison to the public system.

evaluation of the system actually holds true.[6] And important design parameters of the system (regarding contribution rates and rules for withdrawal, for example) also need to be examined.

Box 5.5: Advantages of "The Integrated Unemployment Insurance System"

Recent proposals to improve both the welfare and efficiency effects of income support systems for the unemployed include also the "Integrated Unemployment Insurance System." Under this system, unemployment insurance is provided via integrating unemployment insurance with the pension system. Benefits are financed via a combination of withdrawals from an individual savings account – on which a worker accumulates his/her contributions for unemployment as well as for old-age pensions – and, under certain circumstances, also from a public unemployment insurance (which operates on a pay-as-you-go basis). Such a program thus combines inter-temporal pooling of risk of an individual with wide-base pooling under the traditional unemployment insurance system, and therefore offers a combination of self-insurance through savings and public insurance. In addition, it combines several risks under one program, thus pooling the self-insurance component and reducing the amount of savings necessary for providing the same insurance under separate programs (indeed, there are also proposals to include other social insurance systems, such as disability and health-care, under the same roof, which – under certain conditions – is again welfare improving – see Orszag et al, 1999).

By doing so, the system is expected to offer not only superior provision of insurance and thus consumption smoothing, but also to significantly reduce disincentives as compared to the traditional unemployment insurance system. In addition, the government could subsidize low wage workers, which would improve the distributive properties of the system. Moreover, because of the direct link between contributions and benefits, the system has the potential to attract informal sector workers. While details of the system still need to be determined, theoretical modeling suggests that the more risk averse is the individual and the lower is the job-search elasticity (that is, the less sensitive is the reemployment probability to job search), the higher is the level of optimal borrowing from the public part of the system (Yun, 2001).

5.4 Public works

As with other programs, we present below the key strengths and weaknesses of public works, and discuss its applicability to developing and transition countries. We also discuss the design features of the program.

The program has several strengths:

- It is effective in reaching the poor, and has good targeting properties and a substantial capacity to redistribute income from the rich to the poor.
- It can attract informal sector workers.
- It allows flexible and fast response to shocks.
- Is administratively less demanding than other public income support programs for the unemployed.

[6] There has been just one serious attempt at analyzing the working of the UISA: Kugler's (2000) study on Columbia.

There are also several weaknesses of the program, mostly affecting its capacity to reduce poverty:

- High non-wage costs reduce the effectiveness of public works in reaching the poor. For example, Ravallion (1999a) estimates that for $1 of additional earnings of the poor, $5 of public transfers are needed, partly because of the leakage of the spending on the non-poor.
- The countercyclical pattern of funding shows that it is difficult to raise funding during crises, when the support is needed most (Wodon, 2000).
- Because of its highly redistributive character, it may be difficult to gain political support, so some leakage to the non-poor may be necessary.
- There may be problems with the maintenance of the infrastructure built by public works.
- Participants may be stigmatized.

Many **conditions prevailing in developing countries** make public works especially suitable for these countries:

- The informal sector is large and pervasive. Informal sector workers do not have access to public income support programs which require social security contributions, and thus remain vulnerable to even small income shocks.
- Due to a strong seasonal farm workload, particularly in mono-crop areas, public works can be cheaply deployed in non-farm activities in non-peak periods. The program thus provides an opportunity to productively engage temporary "surplus" labor while minimizing forgone earnings and maximizing poverty reduction effects.
- The existence of large mono-crop areas make large segments of the population vulnerable to cyclical and structural shocks. Similar exposure is caused by geographic and climatic shocks. In the absence of market insurance, public works can provide effective insurance in such cases (see box 5.6 on vulnerability of coconut farmers in the Philippines).
- In comparison to other programs, public works do not require complex administration, and may be quickly set up in areas affected with various shocks.
- Obtaining support for public works can benefit from traditions and values which emphasize cooperation and collective support, particularly in rural areas.

The experience reviewed above also shows that public works in transition countries do not increase employability and may stigmatize participants, so the program seems to be less desirable for these countries.

In designing public works programs, several general principles should therefore be followed. First, forgone earnings should be minimized by attracting workers who have low alternative earnings opportunities (Ravallion, 1999a). Second, displacement effects should be avoided, among others by the careful selection of areas of activities. Third, while the program should in principle be open to anyone, wages should be set low enough so as to trigger a self-selection mechanism through which only those in need participate. Low wages also encourage participants to search for a regular job. And fourth, to maximize the "bang for the buck," projects that require heavy non-labor costs should be avoided, particularly during crises (Maloney, 2000). In general, as noted by Ravallion (1999a), public works programs should be more labor intensive than required by pure maximization of present value of the assets created. He suggests that, in order to enhance their poverty impact, the design of the program should stress cost-recovery form the non-poor, labor intensity, and provision of indirect benefits to the poor. Key design elements of a successful public works program are presented in box 5.7.

Ravallion also argues that a public guarantee program with the above features should become a permanent program. That would enable the program to address both covariant risks during crises as well as idiosyncratic risks during non-crisis times. Making the program permanent would also reduce political pressures to increase wages.

Box 5.6: Helping mono-crop coconut farmers weathering El Niño droughts

A recent disastrous drought brought severe hardship to Filipino coconut farmers – suppliers of 60 percent of the world's production of coconut oil – and exposed their extreme vulnerability to risk. The risks facing the sector are both cyclical (caused by drought) and structural (caused by emerging substitutes to coconut oil). Despite the risks, inter-cropping is rarely practiced and over half of coconut farms are mono-crop plantations.

Coconut farmers have little access to market insurance, and their ability to self-insure and self-protect is limited. There are few opportunities for generating non-farm income that do not co-vary with activity in the coconut farms. As a consequence, inter-family transfers and other community-based modes of informal insurance and collective savings provide inadequate insurance. Moreover, farmers face severe barriers for production diversification, including: (i) the limited size of the local market for non-food products, (ii) the high transaction costs of selling non-coconut products to urban markets (losses due to spoilage and difficult access to urban centers), and (iii) the lack of capital for starting new ventures.

Without discounting the possible use of other policy instruments (such as commodity price stabilization programs), an obvious program to reduce the exposure to risks of coconut growers is labor-intensive public works. The program would not only smooth income streams of the very poor workers during the lean seasons, but also put in place the infrastructure needed to improve the linkages to product and labor markets in urban areas. This can go a long way towards reducing the barriers to income and risk diversification (such as inter-cropping). Households and community organizations with more diversified income sources will also acquire an enhanced ability to tap bank credit for their investment needs. The fact that adverse shocks to the coconut sector do not necessarily coincide with those in the rest of the economy may also increase the funding possibilities of such a program.

Source: Esguerra et al (2001).

5.5 Complementarity of the programs

There are reasons to expect that – rather than relying on just one program – countries will rely on several programs simultaneously, and be flexibility in their use:

- *Different programs have different objectives.* While the primary goal of some programs is compensation for the loss of earnings, other programs and policies may emphasize human resource development (training, severance pay). In some stages, the labor reallocation goal may deserve special attention (transition economies). Complementary programs should also be flexible and adaptable to changing circumstances so as to provide help when needed.
- *Workers in the informal sector are ineligible for certain programs*. Workers in the formal sector may be covered by public programs such as unemployment insurance or severance pay – but workers in the informal sector are ineligible for these. So it is important that the government also provides programs where anybody can participate – for example, public works and training programs.
- *Different programs follow different eligibility rules* **(**different participation criteria). In contrast to programs where participation is limited, some others are open to anyone – and

individuals themselves decide whether to participate or not. Self-selection can be a very powerful targeting mechanism (Ravallion, 1999a).

Box 5.7: Key design elements of a successful workfare: Argentina's Trabajar program

Trabajar allocates funds across provinces based on the distribution of the unemployed poor. Proposals to use the funds are made by municipalities and non-government organizations. These proposals are approved at the regional level, based on a system of points related to poverty in the area and the merits of the proposed project. The government pays for the costs of unskilled labor and the sponsoring units pay for the equipment, materials, and the skilled labor. The wages for unskilled labor is set at two-thirds of the average wage for the poorest decile in the capital city. In principle there are no restrictions on the eligibility of beneficiaries to participate in the program, but in practice there is rationing. The financing of the Trabajar program as a matching grant scheme not only induces local governments to commit to the project, but it also induces local governments to make use of more labor. The use of labor intensive approaches is thus enhanced through incentives to local governments rather than through instructions to contractors and engineers.

Source: de Ferranti et al (2000).

Among complementary programs, those usually labeled as "active labor market programs" (training, employment subsidies, job-search assistance, promotion of self-employment, youth programs) should be specifically singled out. Depending on the country's fiscal position, objectives, and conditions, they may be used to promote employment opportunities of the unemployed. While the discussion of these policies is beyond the scope of this report, two aspects where "active" and "passive" policies interact are worth mentioning. First, these two types of policies should be carefully coordinated. For example, if participation in an active program qualifies individuals for benefit receipt upon completion, this may create perverse incentives for enrollment in such programs, as well as weaken incentives for reemployment.

Second, active labor market programs may be used as a screening device for participants of income support programs. As discussed above, some of unemployment benefit recipients may not be searching for jobs. One way to test recipients' willingness to work is through requiring a proof of job search (for example, regular job offers). But especially when unemployment is high, this kind of test does not serve the purpose and may impose undue costs on claimants – and employers. Placement in active labor market programs provides a suitable alternative. Those who are not genuinely looking for a job may rather lose the benefit than participate in a program. Calmfors (1994) reports that more intense counseling of the unemployed led to 5-10 percent decline in the registration of the target population.

Complementarity issues arise also from the fact that the locus of distress is often *the household*, rather than the individual. To discourage counterproductive coping mechanisms such as taking children out of school and reduced healthcare, income support programs could also be targeted at vulnerable family members of the unemployed in the form of, for example, schooling and health subsidies. A successful example is Mexico's *Progresa* program, which gives grants to poor families provided that their children attend school and visit health centers regularly. As de Ferranti et al (2000) note, however, the ability to use such programs beyond that of just a crisis-related intervention and employ them as an instrument of social insurance may be limited.

Important complementarities exist also between income support programs and government policies, particularly labor market and financial policies. A well functioning labor market can substantially increase chances for self-protection (by reducing the risk of unemployment), as well as for self-insurance (by contributing to short unemployment spells). Moreover, as emphasized by Gill and Ilahi (2000), to ensure balanced, market-augmented social risk management, the government should not only pay attention to income support programs, but it should also foster the development of insurance and financial markets, as they can greatly improve self-protection and self-insurance mechanisms.

5. 6 Summary evaluation of programs

We have seen that alternative income support programs for the unemployed have their strengths, but also weaknesses. Below we summarize the evaluation of the programs, having in mind their applicability to developing and transition economies (see also the summary in table 5.1):

- *Unemployment insurance*, thanks to its wide risk-pooling, enables a high degree of consumption smoothing for all categories of workers and performs well under various types of risks; it also acts as an automatic stabilizer. On the negative side, it creates reemployment disincentives and wage pressures and thus increases the equilibrium unemployment rate; in addition, it contributes to the persistence of unemployment and is prone to political risk. Because its smooth and successful performance relies on strong administrative capacity to monitor program eligibility, conducive labor market conditions, modest size of the informal sector, and environment of low political risk – the conditions which are typically lacking in developing and transition countries, the case for the introduction of unemployment insurance in these countries is less compelling than it is in developed countries. Its existence may also reduce incentives for self-protection and break down the habit of self-help among local communities, which may be welfare-reducing. Introducing of unemployment insurance is thus viewed as a longer-term goal for many of these countries.

- *Unemployment assistance*, while enabling more effective targeting, may not bring savings in comparison to unemployment insurance – and in fact may prove fiscally unsustainable, due to the increased pool of potential applicants created by the program's failure to base eligibility on contribution payments deriving from prior work history. In addition, in comparison to unemployment insurance, it offers a lower level of protection for high income workers, imposes larger administrative costs, and may suffer from similar employment disincentives. Its applicability is thus limited, perhaps to countries with relatively developed administrative capacity and a small informal sector – a rare breed among developing and transition countries.

- In contrast, *unemployment insurance savings accounts* (UISAs) are recognized as a promising option for developing and transition countries. By internalizing the costs of unemployment benefits, the program avoids the moral hazard inherent in the traditional unemployment insurance program and thus improves reemployment incentives – given the weak monitoring capacity of developing countries, an important advantage. In its integrated version with public insurance – thus avoiding its main weakness of the absence of risk-pooling among individuals – the program promises to yield both superior protection and improved incentives, and has also the potential to attract informal sector workers. Because

the system has been largely untested, a further investigation of its effects and design parameters, including piloting of the program, is needed.

- *Public works* program is effective in reaching the poor, has good targeting properties and a substantial capacity to redistribute income from the rich to the poor, is able to attract informal sector workers and provide flexible and fast response to shocks, ands is administratively less demanding than other public income support programs. Despite its weaknesses – high non-wage costs, the likely countercyclical pattern of funding, and, in some countries, stigmatization of participants – it is found as suitable for developing countries, particularly as a complementary program.

- *Severance pay* offers few advantages. Because it adversely affects efficiency, produces high litigation costs and offers limited risk-pooling ability, severance pay is recognized as one of the least appropriate options (a similar assessment is arrived at by de Ferranti et al, 2000).

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Table 2.1: Income support systems for unemployed workers in the context of other mechanisms for managing risk*

Arrangement Strategies	Informal	Formal	
		Market Based	Public
Risk reduction	Less risky production. Migration. Proper feeding and weaning practices. Maintaining good health.	Training. Financial market literacy. Company-based and market-driven labor standards.	Sound macroeconomic policies. Public health policy. **Labor market policies** (including employment protection policies – **severance pay**, for example).
Risk mitigation			
(a) Portfolio diversification	Multiple jobs. Investment in human, physical and real assets. Investment in social capital (rituals, reciprocal gift-giving).	Investment in multiple financial assets. Microfinance schemes.	Multi-pillar pension systems. Asset transfers. Protection of property rights. Support for extending financial markets to the poor.
(b) Insurance	Marriage/family. Community arrangements. Sharecrop tenancy.	Old-age annuities. Disability, accident and other personal insurance. Crop, fire and other damage insurance.	**Unemployment insurance/assistance.** **Individual savings accounts.** Pensions (including **early retirement**), disability, and sickness insurance.
Risk coping	Selling of real assets. Borrowing from neighbors. Intra-community transfers/charity. Child labor. Dis-saving in human capital.	Sale of financial assets. Commercial loans.	Social assistance. General subsidies. **Active labor market programs (job-search assistance, training, employment subsidies, public works).** Social funds.

Source: Adapted from World Bank (2001).
*Major mechanisms used to manage the risk of unemployment are shown in bold.

Table 3.1: Typology of income support programs for the unemployed

	Benefit level	Duration	Eligibility	Financing	Main objective
I. Income maintenance programs					
A. Defined benefit programs					
Unemployment insurance	Benefits are usually a percentage of past wage, sometimes declining over period.	Limited.	Conditional on past contributions, no-fault dismissal, availability and willingness to work, and job search.	Contributions of employers and/or employees, often additional financing from general tax revenues.	Social insurance for the unemployed – consumption smoothing.
Severance pay	Lump-sum payment, generally based on years of service.	One-time payment.	Laid-off workers.	Paid by the employer (could be either unfunded or funded via book reserves or insurance contracts).	Links income support with human resource management objectives of the employer
Early retirement	Special program that grants retirement rights several years earlier as stipulated by law. Pensions are reduced, but typically at less-than-actuarially-fair rate.	Not applicable.	Any worker.	Paid by other social security contributors (sometimes partly financed also by the employer and state revenues, if pension credits have to be purchased).	Human resource/political objectives – reducing overstaffing without directly increasing unemployment.
Public sector retrenchment (may include some type of active involvement of workers)	Special program that sheds redundant labor in the public sector through mass layoffs.	Limited.	Any worker.	Employer/government subsidy.	Reducing overstaffing: human resource /efficiency/political objectives.
B. Defined contribution programs					
Unemployment insurance savings accounts	Replacement rate as under UI.	Limited.	Conditional on the availability of funds in the individual's savings account (with optional, limited borrowing).	Contributions of employers and/or employees deposited on individual accounts (funded scheme).	Providing insurance without distorting incentives (strong link between benefits and contributions).

Table 3.1: Typology of income support programs for the unemployed (continued)

	Benefit level	Duration	Eligibility	Financing	Main objective
C. Means tested programs					
Unemployment assistance (UA)	Topping the income to reach a specific threshold in terms of average family income, or flat.	Unlimited (if instead of UI) or limited (or after UI has expired).	Means-tested.	From general revenues (or contributions, if after the expiration of UI).	Social insurance for the unemployed – consumption smoothing.
Social assistance (SA)	Topping the income to reach a specific threshold in terms of average family income, or flat.	Unlimited.	Means-tested.	General revenues.	General means-tested income support scheme for population.
II. Active programs					
Public works (PW)	Typically a below-market wage.	Typically limited.	Anyone (self-selection based on the wage).	General revenues.	Links the benefit receipt with labor supply, typically for community.
Training	A stipend (and a service).	Limited.	If deemed appropriate by program officials.	General revenues.	Links income support with investment in human resources.
Wage subsidies	Wage-related or flat.	Typically limited.	Selected categories of unemployed.	General revenues.	Links income support with job creation.

Table 3.2: Stylized features of unemployment insurance programs, by groups of countries

Coverage	Benefits	Duration	Eligibility conditions	Conditions for keeping benefits	Financing
OECD Countries					
Most countries offer UI. Majority of programs cover all employed individuals irrespective of type of industry or sector. Austria, Germany, and Luxembourg: coverage extended to apprentices and training graduates. Many exclude the self-employed, whether generally, special occupation groups, or based on other conditions. Public sector employees excluded in Austria and Canada (voluntary provisions exist for provincial government employees). Few exclude domestic and/or casual workers (e.g., Ireland, Japan, Portugal, Spain, U.S.). Denmark, Finland, and Sweden: voluntary UI.	Generally, initial replacements rates vary between 40 and 75% of recent average earnings. Exceptions on high side include Sweden (80%) and Denmark (90%). However, ceilings on wages and maximum benefit provisions limit range. Flat rate benefits, independent or in combination, offered in Ireland, France, and the U.K. Waiting period: between 3 to 7 days. In some countries, in cases of voluntary quit or dismissal due to misconduct, waiting period is extended (range: 6 weeks to 6 months). Additional flat rate benefits or additional percentage of average earnings for workers with spouses or children (e.g., Belgium, Germany, U.K.). Most countries tax benefits (e.g., Belgium, Canada, Netherlands, U.S., U.K., Denmark, France). In some countries, long-term UI recipients transit into unemployment assistance.	Most countries limit length of UI entitlement. Belgium: benefit duration is indefinite. Maximum entitlement period usually is between 8 to 36 weeks. UI entitlement duration is also sometimes related to length of the most recent period of contributions, employment and/or age.	General minimum employment requirement: 6 months in the past year. Range: 10 weeks in last 52 weeks in Iceland to 540 days in last 24 months in Portugal. All countries require registration at the employment office. Residency required in Iceland and France. Benefits denied in cases of voluntary quit, misconduct, work stoppage, or refusal of suitable offer in almost all countries.	Almost all programs require the recipient to be capable, available, and willing to work. Exceptions are Finland, Iceland, and Spain. Disqualification if failure to undergo training, unjustified refusal of suitable job offer, or non-compliance with job search requirements. Degree of offense determines period of disqualification; however usually between 1-4 months. Regularly reporting to employment office is required in a number of countries.	Most UI programs financed by contributions from employers and employees; in cases where both employees and employers contribute to the UI fund, the rates are equal or higher for the latter. There are only a few cases where only employers or employees contribute (Employer: Iceland, Italy, U.S.A; employee: Luxembourg) Typically the state covers any deficits that arise. In both Italy and Spain, the state provides subsidies. In the U.S., Japan, and Italy the state covers administrative costs. Although, very atypical, the State also contributes to UI. Contribution rates vary significantly between countries. The majority of countries however have contribution rates below 3%. Most of the remainder, have contributions rates in the range of 3-8%.

Table 3.2: Stylized features of unemployment insurance programs, by groups of countries (cont.)

Coverage	Benefits	Duration	Eligibility conditions	Conditions for keeping benefits	Financing
Transition countries of East Europe and Central Asia					
Majority of programs cover employed workers (citizenship or residency required). Coverage by age: usually 16-59 for men and 16-54 for women. Croatia, Romania: discharged military personnel eligible for UI. University or training graduates eligible. Usually domestic and casual workers are excluded.	Initial income replacement rates generally vary between 50 and 75%. Level range limited by wage floors (usually the min. wage) and ceilings (usually the local, regional, or national avg. wage, or double the min. wage). Benefits level can sometimes be dependent on cause of job loss. Some countries provide flat rate benefits (usually f(minimum wage or average wage)) instead or in addition to the earnings-related benefits (e.g., Albania, Croatia, Estonia, Georgia). Earnings-related or flat-rate benefits can be graduated over time. Typically, new unemployed labor market entrants receive flat-rate benefits ≤ min. wage. Albania, Azerbaijan, Kyrgyz Republic, Russia, Ukraine, Uzbekistan: provide dependent supplements; usually a percentage of the minimum wage or benefit level for each dependent (ceiling present).	In most countries, the maximum entitlement duration is 6 months (26 weeks). High end: Hungary, 2 years. In some countries, entitlement duration varies depending on length of employment, contribution period, and/or age (Azerbaijan, Bulgaria, Croatia, Poland, Russia, Slovenia, Slovak Republic). University and training graduates usually have shorter entitlement periods. Some countries provide extensions for those near early retirement age.	Minimum past employment requirement ranges from 4 months (Armenia, Russia) to 4 years (Bulgaria). Commonly, countries require employment between 6 months in the last year to 12 months in the last 2 years. Registration at employment offices required by all countries. Income level in Latvia, Romania and Ukraine must be below minimum wage. In Serbia and Montenegro, household income must be below stipulated income. In few countries (e.g., Armenia, Belarus, Bulgaria, Georgia, Moldova), workers not eligible if dismissal due to misconduct. In Bulgaria and Hungary, workers not eligible if unemployment due to refusal of suitable offer.	About half, require the recipient to be able and willingness to work. Benefits are reduced, postponed, or terminated if recipient does not comply with labor market requirements (job search, training, etc.) or files fraudulent claim.	Almost all countries require employer contributions. 9 (out of 21) require employee contributions. Only exception: Estonia, UI state financed entirely. Employee contribution rates generally vary between 0.06% (Slovenia) and 1% (Slovak Republic). Employer contributions vary between 0.06% (Slovenia) and 6% (Albania). State subsidies (when needed) or deficit financing is common, Latvia: state finances UI for special groups. Slovak Republic: state finances special programs.

Table 3.2: Stylized features of unemployment insurance programs, by groups of countries (cont.)

Coverage	Benefits	Duration	Eligibility conditions	Conditions for keeping benefits	Financing
Latin America and the Caribbean					
Countries with UI: Argentina, Barbados, Chile, Ecuador, Uruguay, and Venezuela. Most provide coverage to all employed workers. Exceptions: Uruguay (excludes workers outside industry and commerce), Venezuela (excludes domestics and casual workers), and Barbados (excludes public sector employees and the self-employed).	Income replacement rate varies between 50 and 60% of average earnings. Chile: graduated flat-rate benefits. Ecuador: lump-sum benefits (based on earnings and service length). Argentina, Uruguay: minimum and maximum benefit limits are proportional functions of the minimum wage. Uruguay: 20% dependent supplement Waiting period: Barbados (3 days), Venezuela (30 days).	All countries, maximum entitlement period ≤ 1 year (range: 3-12 months). Argentina: entitlement period dependent on employment length.	Generally, must have been employed for 6-12 months in some stipulated period of recent employment. Argentina and Chile require registration at employment offices. Chile, Uruguay: applicants ineligible if dismissal due to misconduct. Argentina: applicants cannot be recipients of other social security benefits.	In Argentina, Chile, and Venezuela, recipients must be able and willing to work.	Contribution rates vary between 0.75-2%. In 5/7 countries both employers and employees contribute. Except for Ecuador (employees, 2%; employers, 1%), employers contribute an equal or higher percentage of payroll (N=4). Uruguay: contributions (employees, 15%; employers, 12.5%) split between social insurance and individual accounts (state finances deficits). Chile: state assumes total cost
Asia					
Countries with UI: Bangladesh, China, Iran Taiwan. Coverage differs significantly. Iran: excludes the self-employed, voluntarily insured persons, and those covered under other provisions; Bangladesh: only commerce and industry; China: permanent and contract workers in state-run enterprises, and some collective enterprises; and Taiwan: excludes the self-employed and workers in operations workforces of less than 5.	Iran, Taiwan: initial replacement rate is 55% of average earnings. Bangladesh: 50% of basic wages + lump sum benefits based on length of service and nature of employment (permanent/casual). China: flat rate below minimum wage. Iran: 10% benefit supplement per dependent up to 4 dependents. Waiting period: Taiwan, 14 days.	Maximum entitlement duration varies. Bangladesh: 30-120 days, based on type of employment; China: 1-2 years and Taiwan: 3-16 months, based on employment length; and Iran: 6-50 months, based on employment length and marital status.	Employment requirement: Iran: 6 months; China: 1 year; and Taiwan: 2 years. Unemployment cannot be due to voluntary quit. In Iran, unemployment also cannot be due to misconduct or refusal to accept suitable offer. Registration at employment office required.	China, Iran, and Taiwan: must be capable, available, and willing to work.	Bangladesh, employers: total cost. China, employers: 0.6-1% (rate dependent on local govt. provisions); state: subsidies. Iran, employers: 3%; state: finances deficit. Taiwan, employees: 0.2%; employers: 0.7%; state: cost of administration, 0.1% of employee wages, and allocations from other social insurance funds.

Table 3.2: Stylized features of unemployment insurance programs, by groups of countries (cont.)

Coverage	Benefits	Duration	Eligibility conditions	Conditions for keeping benefits	Financing
Africa					
Countries with UI: Algeria, Egypt, South Africa, and Tunisia. Coverage differs between nations. Algeria: laid-off salaried workers from economic sector; Egypt: excludes public sector employees, casual and agricultural workers; South Africa: excludes domestics and highly paid employees (>76,752 Rand/year). Tunisia: excludes agricultural workers.	Egypt: 60%; South Africa, 45%. Tunisia: minimum wage of industrial and commerce sectors. Algeria: mean of average earnings and national minimum earnings with a floor of 75% of the latter; graduated benefits; spousal allowances provided. Waiting period: South Africa and Egypt: 7 days.	Algeria: duration varies based on length of employment (12-36 months). Egypt: maximum entitlement duration varies between 16-28, based on contribution length. Tunisia: 3 months. South Africa: 26 weeks.	Algeria: 3 years of covered employment; employer must be current with contributions. Egypt: 6 months; Tunisia: 12 quarters; South Africa: 13 weeks in last 52 weeks. Algeria and Tunisia require that applicants have no other sources of income. Algeria also requires 3 months of active search prior to application. Tunisia: applicants must have dependents. Unemployment cannot be due to voluntary quit (Egypt, Tunisia) misconduct (Egypt), refusal of suitable job offer (Egypt, South Africa) or participation in strike (South Africa).	Egypt, Tunisia, and South Africa: must be able, available, and willing to work.	Algeria, employees: 1.5%; employers: 2.5%. Egypt, employees: 2.%, state: finances deficit. South Africa, employees: 1%; employers: 1%. Tunisia, state: total cost.

Sources: Tzannatos, Zafiris, and Suzanne Roddis. *Unemployment Benefits*. Social Protection Discussion Paper No. 9813. Washington, D.C.: World Bank, 1998.
United States. Social Security Administration. *Social Security Programs Throughout the World 1999*. Washington, D.C.: Social Security Administration, 1999.

Table 3.3: Stylized features of unemployment assistance programs, by groups of countries

Coverage	Level of benefit	Benefit duration	Eligibility conditions	Conditions for keeping benefits	Sources of financing
OECD countries					
Present in about half of member countries (complement UI systems) Available for all unemployed workers, irrespective of sector, industry, or occupation.	Generally, means-tested minimum income at uniform rates to meet the basic needs of unemployed individuals and their families. Typically, benefit level depends on marital status and presence or number of dependents. Benefits are flat-rate over time. Some countries have threshold income levels, above which benefits are reduced and/or completely eliminated. Usually, special provisions exist for the older unemployed. Sometimes, special provisions also granted to younger persons. Generally no waiting periods. However, waiting period sometimes applied to applicants not transiting from UI (e.g., Ireland, 3 days; Sweden, 5 days).	Indefinite, as long as conditions are fulfilled. Exceptions include Netherlands (1 year); Spain (6 months, 30 months for those with dependents); Sweden (150 days; 5 day week basis). In Portugal, duration depends on age and if claimant is UI exhaustee or not (longer duration for the latter).	Typically, must satisfy means-test (household income and assets test; excludes state assistance such as family and housing benefits). Generally, offered irrespective of employment or contribution history. Some exceptions: Netherlands (4 years of employment in 5 years preceding unemployment); Portugal (6 months of contributory employment in the year preceding unemployment); France (5 years of employment in 10 years preceding unemployment). In some countries, employment or contribution conditions only applicable for UA applicants ineligible for UI (e.g., Germany, 6 months). In some countries: UA only available for UI exhaustees (e.g., Austria). In Australia: if unemployment is voluntary, due to labor dispute, or refusal of suitable job offer, then benefits are reduced and limited or waiting period is extended to 8 weeks.	Many programs require the claimant to be fully unemployed, capable and available for work; and actively seeking work. Eligibility conditions must be satisfied throughout the period of receipt (periodic checks conducted).	Government financed through general tax revenues.

Table 3.3: Stylized features of unemployment assistance programs, by groups of countries (cont.)

Coverage	Level of benefit	Benefit duration	Eligibility conditions	Conditions for keeping benefits	Sources of financing
Transition countries of East Europe and Central Asia					
Bulgaria, Czech Republic, Hungary, Poland, Romania, Russian Federation, Slovak Republic, Slovenia All salaried workers. Special provisions for recent graduates and discharged military officers. Dual systems of unemployment insurance and assistance in most countries.	Means-tested minimum assistance at flat rates. Generally, benefit level depends on marital status, number of dependents, household size, and age of children. Usually, the receipt of other social assistance does not affect benefit level. However, any earnings, either full or above a certain stipulated amount are fully deducted from UA benefits (e.g., Czech Republic, Hungary). Poland: benefits can be in cash or in kind.	In some countries, UA entitlement length is indefinite, so long as eligibility conditions are fulfilled. Exceptions include Hungary (2 years), Romania (18 months, renewal possible), Russia (6 months for the unemployed; 12 months for dependents of unemployed), Slovenia (6 months). Entitlement is sometimes limited for certain groups such as recent graduates (e.g., Bulgaria, 3 months). In Poland, entitlement duration decided by social workers.	Provided irrespective of employment or contribution history. Must be registered as unemployed. Regular visits to the Labor/Employment office required. Generally, must satisfy household income (and assets) test. Capable and willing to work.	Most programs require the claimant to be capable, available, and willing to work. Refusal of training or acceptable job offer results in benefit cancellation. Eligibility conditions must be satisfied throughout the period of UA receipt.	Government financed through general tax revenues.
Latin America and the Caribbean					
Brazil: all employed persons	Brazil: means tested; 50% of average earnings in last 3 months of employment; range: min. wage to 3 times min. wage. 60 day waiting period	4 months in any 16 month period.	Unemployment not due to misconduct. Claimant must possess no alternative source of income.		Government financed through general tax revenues.
Asia					
Hong Kong (China)	Means-tested, flat rate benefits based on marital status and presence of dependents.				Government financed through general tax revenues.

Table 3.3: Stylized features of unemployment assistance programs, by groups of countries (cont.)

Coverage	Benefits	Duration	Eligibility conditions	Conditions for keeping benefits	Financing
Africa					
Countries: Tunisia, Mauritius Tunisia: all non-agricultural salaried workers covered under National Social Security Fund.	Mauritius: means-tested income to households after 30 days of registered unemployment. Tunisia: minimum wage in industry and commerce.	Tunisia: 3 months	Tunisia: 12 quarters of contributions to the Fund; registered as unemployed, and capable of work. Worker must be involuntarily unemployed, have dependents, and be without any other source of income.		Government financed through general tax revenues.

Sources: United States. Social Security Administration. *Social Security Programs Around the World 1999*. Washington, D.C.: Social Security Administration, 1999.
Boeri, Tito and Scott Edwards. *Unemployment and Social Assistance Benefit Schemes in Central and East European Countries*. (incomplete ref.)
OECD. *Benefit Systems and Work Incentives in OECD Countries: Country Chapters 1995*. http://www.oecd.org/els/socpol/BenefitsCompendium/index.htm.

Table 3.4: Stylized features of severance pay programs, by groups of countries

Coverage	Level of benefit	Eligibility Conditions	Sources of financing
OECD Countries			
Scandinavia			
(Denmark, Finland, Norway, Sweden) Except for white collar workers in Denmark and long-serving, older employees affected by restructuring in Finland, no legislated severance pay for individual or collective dismissal. Severance pay sometimes provided through collective agreements in private sector.	Denmark (white collar): 12+ years of service: 1 month pay 15+ years: 2 months pay 18+ years: 3 months pay Finland: (age: 45+; years of service: 5+): 1-2 months pay.	Separation due to personal reasons or economic redundancy. Minimum years of service: Denmark: 12; Finland: 5.	Employer financed. Firms sometimes receive state assistance.
Western Europe			
(Austria, Belgium, France, Germany, Ireland, Netherlands, Switzerland, U.K.) All workers covered. Germany, Netherlands, and Switzerland: no legislated severance pay for individual or collective dismissals (exceptions for special cases), but severance pay often part collective agreements or social compensation plans. Except for Belgium, where severance pay only for collective dismissal, no special regulations for collective dismissals.	Benefit formula varies significantly. Belgium: ½(net earnings-UI benefits) over 4 months; France: 0.10 month's pay per year of service + an additional 0.067 month's pay after 10 years. Ireland: 1 week pay + half week pay per year of service under age 41 + week pay per year of service over age 41 (maximum amount: Ir£ 15,600). U.K: 0.5 week's pay/year of service (age: 18-21) 1.0 week's pay/year (age 22-44) 1.5 week's pay/year (age 41-65).	Separation due to personal reasons or economic redundancy. Minimum years of service: Austria: 3; Ireland: 2; U.K.: 2.	Employer financed. Firms sometimes receive state assistance
Southern Europe			
(Greece, Italy, Portugal, Spain, Turkey) All countries: legislated severance pay for both individual and collective dismissals; no special regulations for collective dismissal. All workers covered.	Standard formula: 1 month per year of service. Collective agreements in Italy and Turkey can increase generosity. Greece: severance pay reduced if notice given. Greece: more generous for white collar workers. Spain: less generous for fixed-term contract workers.	Minimum years of service: Greece: 5; Turkey: 1. Separation not due to own fault.	Employer financed. Firms sometimes receive state assistance.

Coverage	Level of benefit	Eligibility Conditions	Sources of financing
Non-Europe			
(Australia, Canada, Japan, New Zealand, United States) Australia (only for redundant workers) and certain areas of Canada possess legislated severance pay for individual and collective dismissals; no special regulations for collective dismissal. However, in some countries more than others, severance pay provided as part of collective agreements or as firm practice.	Benefits vary significantly across Australia (for redundant workers): 4 weeks for less than 2 years of services to 8 weeks for more than 4 years of service. Japan (common firm practice): 1 month's pay per year of service; lower for voluntary quits and higher for lay-offs. New-Zealand (for redundant workers; common firm practice): 6 weeks for first year of service then 2 weeks for each additional year. Canada (federal): 2 days per year of service with minimum of 5 days.	Separation due to personal reasons or economic redundancy. Minimum years of service: Australia & Canada (federal): 1.	Employer financed. State assistance possible.
East Europe and Central Asia (Transition Economies)			
(Czech Republic, Hungary, Poland) All workers covered. Czech Republic, Hungary: legislated benefits for individual and collective dismissal; no special regulations for collective dismissal. Poland: legislated benefits only for collective dismissal.	Czech Republic: redundant workers obtain 3 months pay. Hungary: 1 month pay for less than 5 years of service to 6 months for 25+ years of service. Poland: 1 month pay for less than 10 years of service to 3 months for 20+ years of service.	Dismissal due to personal reasons or economic redundancy. Minimum years of service: Hungary: 3.	Employer financed. Firms sometimes receive state assistance.
Latin America and the Caribbean			
(Argentina, Belize, Bolivia, Chile, Colombia, Ecuador, Mexico, Nicaragua, Panama, Peru, Venezuela, Uruguay) Legislated severance pay. Argentina: construction workers Coverage is usually all workers (public and private).	Argentina: 1 month's pay per year of service. Colombia: 1 month's pay per year of service Mexico: 3 months' pay + 20 days' pay per year of service. Peru: 1.5 month's pay per year of service. Belize: 1 month's pay per year of service after 5 years of service. In some countries, employers are required to make an additional payment, known as a seniority premium, regardless of the cause of termination. In Ecuador, Colombia, Panama, Peru, and Venezuela, this benefit is provided to the worker in the case of unjustified dismissal (in addition to the regular indemnity) and or voluntary quit. Upper limits are sometimes placed on compensation packages: Chile: 11 months of wages; Peru: 12; Nicaragua, Panama, and Venezuela: 5; Uruguay: 6.	Venezuela: only for dismissal without due notice, for unjustified dismissal, or retirement for justified cause. In Latin America, only in Argentina and Chile are dismissals for economic causes are allowed. In the Caribbean, severance pay is offered to workers made redundant due to labor adjustment. Belize, Bolivia, Chile, and Nicaragua: severance pay offered for voluntary quits.	Employer financed.

Coverage	Level of benefit	Eligibility Conditions	Sources of financing
Asia			
(Bangladesh, India, Pakistan) Legislated severance pay: covers formal sector workers. Pakistan: firms must have more than 20 employees.	Bangladesh: casual workers: 14 days' pay per year of service; permanent workers: 1 month's pay per year of service. :India: 15 days' avg. pay per year of service. Pakistan: 30 days' pay per year of service.		Employer financed.
Africa			
(Botswana, Libya, Solomon Islands, Tanzania) Legislated severance pay.	Libya: 100% of earnings up to 6 months. Solomon Islands: 2 weeks' pay per year of service.	Minimum months of continuous service: Botswana: 60; Tanzania: 3.	Employer financed.

Sources: Organization for Economic Cooperation and Development. *Employment Outlook 1999*. Paris: OECD, 1999.
United States. Social Security Administration. Social Security Programs Throughout the World 1999. Washington, D.C.: SSA, 1999

Table 3.5: Stylized features of unemployment insurance savings accounts programs, Latin America

Coverage	Level of benefit	Eligibility Conditions	Sources of financing
In Brazil (Fundo de Garantia de Tempo do Servicio – FGTS, established in 1967), Colombia, Equador, Columbia, and Peru, Uruguay, all formal sector workers. In Argentina, construction workers. In Chile, domestic workers.	Amount accumulated on the individual savings account (deposits plus interest earned). In Brazil, if dismissed without a cause, the employer must pay an additional 40 percent.	Upon separation (regardless of the reason of separation). Some programs allow access also for other reasons (for example, health and education expenditures).	Brazil, Equador, Columbia: 8 % contribution rate; Peru: one half of a monthly salary each six months; contributions are paid by employers in workers' individual savings accounts. In Uruguay employees contribute 15 percent of earnings: the first 7.47 new pesos goes to social insurance and the balance, less a 3 percent administrative fee, goes to an individual account. Employers contribute a further 12.5 percent of payroll to the system and the government, if necessary, finances deficits (this is a dual social/ private insurance system which covers old age, disability, death, sickness and maternity benefits, family allowances and unemployment).

Sources: Lipsett (1999), Heckman and Pages (2000), Mazza (2000)

Table 4.1: Summary of distributive effects of income support programs for the unemployed

	Coverage	Adequacy	Effects on income redistribution
Unemployment insurance	In developing countries, limited to (segments) of formal sector workers.	Consumption smoothing: In developed economies, consumption level of UI claimants fairly well preserved. Private transfers important. Poverty reduction: in transition economies, mildly reduces poverty.	Positive/neutral effects on redistribution.
Severance pay	Available to a subset of formal sector workers, not de-facto provided in spite of legal entitlement.	Consumption per head of those unemployed who received severance pay is higher than otherwise similar workers who are employed (Peru).	Benefits concentrated on the rich (Peru).
Unemployment insurance savings accounts	Available to a subset of formal sector workers.	Inconclusive evidence.	Negligible redistributive effects by design (but redistributive effects of its introduction to the U.S. are likely to be small).
Early retirement	Small.	Pensions of participants often reduced at a less-than-actuarially fair rate.	No evidence.
Public works	In principle, available to all (participation rates in some developing countries reach double digits; in transition economies, they have been typically kept below 1 percent).	Strong effects on poverty reduction.	Strongly progressive.

Source: Vodopivec and Raju (2002).

Table 4.2: Summary of efficiency effects of income support programs for the unemployed*

	Job-search effort and post-unemployment wages	Equilibrium labor market outcomes	Enhancing restructuring of enterprises and overall adjustment	Labor supply of other family members	Encouragement of taking regular vs. informal jobs	Output and growth
Unemployment insurance (UI)	**Significant disincentives for leaving unemployment (moral hazard problem). Evidence on improved job matching (via post-unemployment wages) inconclusive.**	**Increase in benefits increases unemployment rate. For some groups positive effect on labor force participation, but reductions of inactivity primarily show as increases of unemployment.** UI slows down adjustment to shocks.	**Attractiveness of restructuring increases; in U.S. strong evidence on increase of temporary layoffs (partial analysis).** Because job creation hindered, overall adjustment not assisted (Blanchard, 1997).	**Labor supply of spouses of unemployed workers strongly reduced.**	**Effects on entry into precarious jobs inconclusive. In Brazil, UI payments increase probability to enter self-employment.**	**By increasing unemployment, reduces output and growth. Modest effect as an automatic stabilizer**. Theoretical predictions about the effect on output inconclusive.
Unemployment assistance (UA)	**Significant disincentives for leaving unemployment, particularly for low-wage earners.**	Similar, but milder effects as under UI.	Similar, but milder effects as under UI.	**Strong disincentive for other family members to taking a job.**	Similar, but milder effects as under UI.	Similar, but milder effects as under UI.
Severance pay (SP)	No moral hazard problem.	**Strongly reduces employment, particularly of the young. Increases participation in the informal sector and self-employment. Effects on unemployment inconclusive.**	**Negative effects on labor reallocation -- economy's "sclerosis" increased: Inflow into unemployment reduced, but so is job creation.**	Similar effects as under UI (income effect).	Reduced incentives to enter informal jobs – but employers reduce demand, particularly for marginal workers.	Strongly reduces employment rates and hence output.

Table 4.2: Summary of efficiency effects of income support programs for the unemployed (cont.)*

Unemployment insurance savings accounts (UISA)	No moral hazard problem.	**Introduction of the scheme in Columbia had little effects on reducing labor demand and employment.**	**Conversion of severance pay into UISA increased both firing and hiring by firms (Columbia).**	Similar effects as under UI (income effect).	Similar effects as under UI.	Increase of output due to reduction of disincentives regarding job search and job creation (in comparison to UI).
Early retirement (government sponsored)	Incentives for reemployment significantly reduced.	Strong reduction of labor supply and employment, ambiguous effect on unemployment.	Attractiveness of restructuring increases, but ability for job creation is diminished.	Mild disincentive for other family members taking a job (pure income effect).	Encourages participation in informal economy.	Fiscally expensive, may reduce growth.
Public works	If wages kept sufficiently low, little effects on job-search efforts.	**Mildly reduce unemployment and increase employment.**	Negligible effects.	Negligible effects.	**Experience shows that participants are stigmatized – more likely to take informal jobs or leave labor force after the completion of public works.**	Negligible effects.

Source: Vodopivec and Raju (2002).
*Conclusions based on empirical evidence are printed in bold.

Table 4.3: Suitability of income support programs for the unemployed to confront different type of shocks

	Suitability	Remarks
Unemployment insurance	Effectively insure against idiosyncratic shocks, less effective against covariant shocks.	Problematic with large informal sector and low administrative capacity.
Unemployment assistance	Suitable for all types.	Requires means-testing capacity.
Severance pay	Suitable for all types.	May require public guarantee fund/pre-funding arrangement.
Unemployment insurance savings accounts	Suitable for all types.	Requires appropriate financial sector (instruments, regulations, supervision).
Early retirement	Effective for sector/branch risk.	Produces heavy financial burden.
Public works	Suitable for idiosyncratic, catastrophic shocks. Vulnerable to covariant shocks.	More effective if strong self-selection; may have "low bang for a buck."

Source: Vodopivec and Raju (2002).

Table 4.4: Resistance to political risk and ability to sustain budgetary support of income support systems for the unemployed

	Resistance to political risk	Ability to sustain budgetary support
Unemployment insurance	Low (as other pay-as-you-go schemes, they can be easily manipulated)	Medium/high (median voter considerations)
Unemployment assistance	Medium (less room for maneuver than with UI)	High
Severance pay	Medium/high (largely outside the domain of the government, except in public retrenchment programs)	Not applicable
Unemployment insurance savings accounts	High (once introduced, the accounts are safe from political interference)	Not applicable
Early retirement	Low (one of the key programs used for political expediency reasons)	Low
Public works	Medium (funding pattern countercyclical, leakage to the better off makes the program more resistant to budget cuts)	Medium (easier to mobilize in the times of crisis)

Source: Vodopivec and Raju (2002).

Table 5.1: Summary of factors affecting the choice of income support system for the unemployed

	Strengths	Weaknesses	Key country specific features conducive to introduction and successful performance
Unemployment insurance	• Provides good protection (wide pooling) • Performs well under idiosyncratic, sectoral, and regional shocks • Acts as an automatic stabilizer and thus moderates the severity of contractions	• Creates reemployment disincentives • Increases the equilibrium unemployment rate • Contributes to the persistence of unemployment • Susceptible to political risk • Does not cover informal sector workers	• Strong administrative capacity to monitor continuing eligibility • Modest informal sector (lower costs of monitoring, less sensitive reemployment probability to job search) • Low political risk • Decentralized or encompassing wage bargaining structure – wage moderation effects • Low payroll taxes • Low share of underemployed workers • Low incidence of private transfers (unemployment insurance may be welfare-reducing if it breaks down social fabric that maintains private transfers)
Unemployment assistance	In comparison to unemployment insurance: • allows for the participation of workers with little prior work experience and informal sector workers • more progressive (other strengths similar)	• The failure to exclude persons without prior work experience (and hence without payments of program contributions) may undermine the program's fiscal sustainability • In comparison to unemployment insurance: • offers lower protection for high income workers than unemployment insurance • imposes larger administrative costs • Reduces the labor supply of family members • May stigmatize participants	Similar as under unemployment insurance, additional capacity needed for means-testing

Table 5.1: Summary of factors affecting the choice of the income support system for the unemployed (cont.)

	Strengths	Weaknesses	Key country specific features conducive to introduction and successful performance
Unemployment insurance savings accounts (UISAs)	• Improved labor market incentives • Good protection, if combined with public insurance • Potential to attract informal sector workers • Being payable also in cases of voluntary separations, the system encourages labor reallocation and cuts on the litigation costs • Low political risk *Remark*: Largely unexplored and insufficiently tested system	• Only intertemporal risk pooling of an individual (no cross-section pooling) • Larger administrative costs	• Modest, non-persistent shocks (if this is not the case, a combination with cross-section pooling via public insurance desirable) • Self-policing (of reemployment incentives) imposed by the UISA is a bigger advantage given the weak monitoring capacity of developing countries • The conversion of mandatory forced-savings type of schemes existing in developing countries to the UISA system would facilitate its introduction • The introduction of personal accounts would reduce non-payments of employers of social security contributions
Public works	• Effective in reaching the poor • Good targeting properties • Substantial capacity to redistribute income from the rich to the poor • Potential to attract informal sector workers • Allow flexible and fast response • Administratively less demanding	• High proportion of material costs • Possible stigmatization of participants • Difficult to raise funding during crises • Because of the program's redistributive character, it is difficult to gain political support, so some leakage to the non-poor may be necessary • Possible problems with the maintenance of infrastructure built through public works	• Public works can attract informal sector workers, an important consideration given that the informal sector is large and pervasive • Ability to attract workers with low forgone earnings • Undeveloped insurance and financial markets prevent market and self-insurance, and self-protection • The existence of large mono-crop areas make large segments of the population vulnerable to cyclical and structural shocks, and similar exposure is caused by geographic and climatic shocks • Require less complex administration, and may be quickly set up in areas affected by various shocks. • Can benefit from traditions and values which emphasize cooperation and collective support
Severance pay	• Does not require sophisticated administration	• Does not cover informal sector workers • Reduces employment rates • Hinders access to jobs by marginal groups. • Reduces labor market dynamics • Creates significant litigation costs	

Source: Vodopivec and Raju (2002).