

## 4.2 FORMAL MARKETS: UNEMPLOYMENT INSURANCE AND SEVERANCE PAY

### 4.2.1 Unemployment Insurance is not Used, Especially by Women

Unemployment insurance (UI) is not a widely used resource to cope with a negative shock to household income due to high eligibility requirements and uncertainty in the program. The Argentine UI program is structured to reward benefits ranging from \$150 to \$300 pesos monthly to the unemployed who can prove that they held a formal sector job for at least one year of the previous 36 months (Mazza 2000). This requirement necessarily excludes those who worked in the informal sector<sup>1</sup> or public sector and those who are new labor market entrants, all three being the source of most Argentine unemployment. Only 15 percent of the unemployed actually receive benefits, amounting to collection by approximately 125,000 individuals monthly (Arriagada and Hall 2000).

Furthermore, to collect UI, the individual must have been fired without just cause. Interviews with the poor in popular neighborhoods of Greater Buenos Aires reveal that since the *Tequila* Crisis, firms have been less likely to actually fire workers, instead choosing not to pay them such that workers voluntarily leave their jobs (Geldstein 2001). In this case, they are not eligible for UI (Mazza 2000).

Unemployment insurance is not a particularly reliable insurance mechanism due to the uncertainty in benefit levels and insufficient revenues to meet demand. Unemployment insurance works well when unemployment is the result of idiosyncratic shocks, i.e. uncorrelated unemployment spells, since its strength is pooling of resources. Pooling small amounts of resources across a large population will permit periodic withdrawals of income from the system when the random unemployment spell occurs. The value of resources paid into the system, as with any type of insurance program, should be equal to the probability of a withdrawal multiplied by the value withdrawn. In economies where unemployment is caused by individual events, statistically observed as

recipient (Mazza 2000). Even with a variation in benefit values, the National Employment Fund, from which UI and employment programs are funded, has had a negative balance since 1995 (Chebez 2001). With the zero deficit law, it is unclear whether or not this Fund can be supported from money from elsewhere or it will be subject to program cuts.

Although the indigent poor do not have access to the program, nearly half of the beneficiaries are poor. In 1999, for a family of four, only 6.1 percent of beneficiaries are classified as indigent (defined as a per capita income of \$69 pesos monthly), but over 56 percent of beneficiaries are classified as poor, with a household per capita income of \$160 pesos per month. These may be acceptable levels, though, since informal sector workers are excluded from UI, where a large portion of the poor are employed, and those under the *Modalidades Promovidas* were not eligible (Mazza 2000).

The profile of the program suggests that it benefits a specific segment of the population: prime-aged males who do not have household dependents, lost manufacturing or commerce jobs, and were semi-professionals or laborers. The proportion of men with dependent families decreased from 67 percent in 1994 to 48 percent in 1997, indicating that male household heads are less and less likely to use UI as a form of insurance. The reasons for this decline are not clear. The fall in the size of the manufacturing sector may be responsible since unemployment from the manufacturing sector relies heavily on UI (due to the formality of manufacturing sector jobs and the active participation of unions in the creation and continuation of the program), but only one third of payments went to these workers in 1999, down from 45% in 1994 (Mazza 2000).

Women have less access to UI and thus are less likely to depend on it as a form of insurance against a negative shock to their labor income. Although the proportion of female beneficiaries increased from 23.5 percent to 29.1 percent between 1994 and 1997, men are still the primary beneficiaries. Of the 125,000 payments made monthly, women collect only 26,500. The value of the benefit is likely to be lower as well since the

worked in the firm (with a more complicated payment system for those who have been employed for less than a year), a month of *previso*, any other compensation agreed in the collective bargaining, and repayment of any litigation costs. Since the definition of “without just cause” is broad, including economic and production slow-downs, nearly 65 percent of formal sector involuntary job separations fall into this category (World Bank 2000c). Thus, half the working population is excluded since they work in the informal sector and one-third do not have access since they are fired for just cause. Regarding the generosity of the program, as compared to UI, the transfer amount is higher; all severance benefits are transferred as a lump sum upon unemployment, rather than monthly distributions as with UI.<sup>2</sup> Also, the beneficiary receives the full amount, unlike UI when benefits are cut off once the individual becomes re-employed in the formal sector (World Bank 2000c).

From a gender point of view, severance pay laws are neutral. But given women’s labor force participation patterns, especially those of married women, it is less of a source of insurance than for men. The current system works to the benefit of women with very short tenures, as severance pay is very generous for those who have less than one year’s tenure. But for those with more than one year’s tenure, the value of the benefits will be less than men’s, given women’s lower wages and shorter tenure.

Although severance pay may appear to be a dependable source of income to smooth income across periods of employment and unemployment, it is less reliable in practice since it distorts the labor market and creates uncertainty. The benefits of the program are (i) it acts as a type of risk prevention mechanism by discouraging firms from dismissing employees and (ii) it has an element of risk pooling at the firm level. However, neither of these benefits applies in the global economy where firms must keep a flexible and highly productive labor force to remain competitive and firm failure due to global forces increasingly occurs. Other problems also exist:

➤ It is costly and distorts labor demand by keeping the firms’ labor overly stagnant and

term contracts, without any severance pay requirements, which has the effect of not build human capital for future employment of the individuals.<sup>3</sup>

- The severance payment system generates high indirect costs and a high demand on the legal system. The lack of specificity in the “just cause” concept has led to a large number of court cases that decide whether or not the dismissal was due to just cause, also leading to uncertainty (World Bank 2000c). World Bank (2000c) estimates that 75 percent of cases in labor courts are related to severance pay. These cases may take years to resolve and can be quite costly, thus making severance pay unreliable. Furthermore, they increase costs to the firm and harm labor relations, a political economy factor that is important for the state’s relationship with trade unions.
- The severance pay system may pool risk over the employees of a firm, thereby effectively providing insurance against idiosyncratic shocks, but it cannot pool at a higher level, thus leaving the workers without protection if, for example, the firm shuts down. This has particularly been problematic in Argentina in the 1990s since small and medium sized firms (SME) that provide 78 percent of employment have had exit rates that are twice that of entry rates in the 1990s. The transition period has been difficult for SMEs and even more so for their employees. Such a system leaves workers particularly vulnerable to income losses during systemic shocks and increases their level of uncertainty.

Recognizing the negative incentives that severance pay and other benefits may place on employers, the Labor Ministry has been flexibilizing the labor market for new labor force entrants. Some of the recent initiatives have included: (i) the introduction of new types of employment that waive all benefit payments for new hires for one year with extended partial benefits payment periods for new hires who are older than age 45, younger than age 25, or female household heads; (ii) temporary contracts of up to five years without severance pay upon the completion of the contract; (iii) short term