

**The new Chilean Unemployment Insurance:  
To what extent does it protect the unemployed?**

**First draft, please do not quote. Comments welcome!  
April 2005**

**JEL Classifications: J32 Non-wage labour costs and benefits, J64 Unemployment, J65 Unemployment insurance, J68 Public Policy**

**Christopher Neilson  
Departamento de Economía  
Universidad de Chile  
christopher.neilson@gmail.com**

**Kirsten Sehnbruch, PhD  
Centre for Latin American Studies  
University of California, Berkeley  
ksehnbruch@yahoo.com**

# **The new Chilean Unemployment Insurance: To what extent does it protect the unemployed?**

## **Abstract**

In 2002 the Chilean government implemented new legislation for an unemployment insurance scheme which has been presented both at a national and international level as a model for other developing countries, because it provides protection against unemployment, avoids issues of moral hazard associated with traditional unemployment insurance systems, and has a relatively low public finance requirement.

The insurance is truly innovative and combines a system of individual savings accounts with a publicly financed contingency fund. As the insurance has only been functioning for a short period of time, it is as yet impossible to use real data to estimate its practical effect. This paper therefore uses existing historical data (from a survey that was specifically designed to gather data on the unemployed) to simulate how the unemployment insurance will apply to both the employed and the unemployed. Based on this simulation, this article examines how this unemployment insurance will work in practice, and whether it will adequately protect Chilean workers who become unemployed.

It concludes that the unemployment insurance system will protect those workers best who have formal written contracts and stable jobs, i.e. those with good quality jobs. It will protect workers with the lowest quality jobs (i.e. those facing the greatest likelihood of becoming unemployed) the least.

# The new Chilean Unemployment Insurance: To what extent does it protect the unemployed?<sup>1</sup>

## 1. Introduction

In October 2002 the Chilean government implemented new legislation for an unemployment insurance scheme which it claimed was the first genuine alternative to traditional systems of unemployment benefit and assistance<sup>2</sup>. The scheme provides unemployment insurance based on each worker's individual level of savings accumulated in a personal account in the same way that a private pension system would pay pensions according to the level of savings accumulated during a person's working life. Contributions to these personal savings accounts are made by both employers and individual workers, and the government provides a contingency fund from which a worker can draw under certain conditions should individual funds be insufficient. It is the mechanism through which this contingency fund is combined with individual savings accounts in one single institutional structure that makes this system innovative.

The Chilean unemployment insurance has been presented both at a national and international level as a model for other countries, as it provides protection against unemployment but has a relatively low public finance requirement. The insurance scheme was also specifically designed to minimise issues of moral hazard associated with traditional unemployment insurance systems, which would unduly stress the limited financial resources of a developing country.

Thus, the ILO has described the Chilean unemployment insurance as a "new legislation that could lead to a new generation of reforms in unemployment insurance matters" (Panorama Laboral 2001: 50). Given how frequently Chile is touted as a model for other Latin American and developing countries, this innovative scheme is likely to be copied elsewhere, as it constitutes an example of how a developing country that does not dispose of the same level of resources for social benefits as a high income country can address the issue of unemployment. The Chilean government has already advised other Latin American countries on setting up unemployment insurance based on this model<sup>3</sup>.

This paper examines how this unemployment insurance will work in practice. It briefly explains the mechanisms of the system, before going on to examine empirical evidence and assessing the extent to which the scheme will cover the employed and the unemployed. It also examines which factors are likely to contribute to a worker receiving benefits from the insurance. To the best of our knowledge, such an analysis of this unemployment insurance scheme has not yet been presented in the literature. This is partly because there is not yet enough real data to calculate its coverage, given the short period of time that the unemployment insurance has been operating. But it is also because there are no official statistics on the characteristics of the jobs that workers held prior to becoming unemployed. This paper is based on the results of a survey that was designed specifically to include this information<sup>4</sup>. The paper concludes that wage-

---

<sup>1</sup> The authors would like to thank the Center for Latin American Studies at the University of California at Berkeley for their generous support and provision of resources without which the completion of this paper would not have been possible.

We would also like to thank Carol Graham, Marcio Holland, David Levine, Gerhard Reinecke, Rodrigo Sabbatini and Jürgen Weller for their very helpful comments on previous drafts of this paper. The usual caveats apply.

<sup>2</sup> Ministerio del Trabajo, 2000c. Law N°19.728, Código del Trabajo.

<sup>3</sup> Advisors from the Chilean Ministry of Labour have travelled to Argentina, Paraguay, Peru, Ecuador and the Dominican Republic in order to advise local governments on the design of unemployment insurance schemes (Source: Interview with an official of the Ministry of Labour).

<sup>4</sup> This paper is based on a survey of the quality of employment conducted in Greater Santiago in 1999. It was the first survey undertaken in Chile to interview the unemployed about their previous employment situations, which means that it can be used to assess the practical effect of this unemployment insurance scheme. The universe of the survey consisted of all households in Greater Santiago, and the sample was fully representative with a margin of error of 3.5% at a 95% confidence level. The survey was carried out by the survey department of the *Facultad de Ciencias Económicas y*

earners in the formal sector with good quality jobs will be those best covered by this insurance scheme. The more precarious a job is, however, the less it will be covered by this insurance. Since workers with low quality jobs face a far higher probability of becoming unemployed, this means that the vast majority of the unemployed will not benefit from this insurance system.

## **1. The New Unemployment Insurance System in Chile**

---

The new Chilean unemployment insurance is a mixed scheme, financed by all social actors (government, employers and employees), and it creates two types of funding mechanisms: an individual savings account for each worker and a contingency fund, called 'Solidarity Fund' (*Fondo Solidario*). Upon becoming unemployed, workers may withdraw the accumulated savings in their individual accounts. If these are insufficient to cover a five month period of unemployment they have the right to receive a subsidy from the Solidarity Fund – provided they did not resign or lose their job due to misconduct.

Employers pay 1.6% of their payroll into the individual accounts of their workers, which are set up like a pension account. Workers contribute 0.6% of their monthly wage to these accounts. In total, 2.2% of a worker's monthly wage is paid into these individual accounts, which over the course of a year will accumulate an amount equivalent to one quarter of the worker's monthly wage<sup>5</sup>. Employers also contribute 0.8% of their payroll to the Solidarity Fund, which receives additional funding from of the fiscal budget.

All of these payments are limited to a maximum period of 11 years. If a worker stays with the same employer for longer than 11 years, these payments cease, as it is assumed that enough savings have been accumulated in the individual savings accounts to cover any period of unemployment<sup>6</sup>.

Slightly different conditions apply to workers who have fixed term contracts. In their case, the employer must pay 3% of their monthly wage into their individual savings accounts during the duration of their contract, which amounts to approximately a third of a monthly wage over the course of a year.

To withdraw funds from the individual accounts, the worker must have had a formal written contract, must have contributed (not necessarily continuously) for 12 months prior to becoming unemployed<sup>7</sup>, must be aged between 18-65 years, and have been unemployed for at least 30 days. The latter condition means that the unemployed have to finance the first month of their unemployment themselves<sup>8</sup>. The structure of the insurance is based on a calculation that during periods of normal economic growth the average duration of unemployment in Chile is approximately 5 months. Hence the number of withdrawals that can be made from the individual account is 5, regardless of the amount accumulated in the account. Only workers with fixed-term contracts have the right to access their entire savings in one single withdrawal.

If a worker changes jobs without becoming unemployed, the clock is reset, and the worker is free to either withdraw the accumulated funds or to leave them in the account, without this having any impact on the payment obligations of the new employer.

---

*Administrativas of the Universidad de Chile, Santiago.* For more detail on the survey's methodology and its results, see Sehnbruch 2004b and 2006.

<sup>5</sup> This is much less than other individual savings account schemes in the region. In Brazil, the contributions to the individual savings accounts is 8%, in Argentina it is 8-12%, and in Colombia 9%. For a comparative study of these schemes, see Mazza (1999), Islas (2002) and Ferrer and Riddell (2004).

<sup>6</sup> The 11 year ceiling also ties in with the severance pay legislation, which requires employers to pay workers dismissed through no fault of their own one month's wage per year of tenure, with a maximum limit of 11 months.

<sup>7</sup> 6 months in the case of workers with short term contracts.

<sup>8</sup> This condition is similar to a deductible that most insurance policies require their clients to pay.

The conditions described so far apply to all wage-earners regardless of the reason for their unemployment<sup>9</sup>. In addition, workers who had formal open-ended contracts, were made redundant for economic reasons, and who have accumulated less than two month's wages in their account, are entitled to top up funds from the Solidarity Fund<sup>10</sup>. The amount and number of withdrawals that can be made are calculated according to a specified method<sup>11</sup>. On the other hand, if more than 2 month's wages have been accumulated in the account, the total sum, regardless of its amount, is divided by 5 and paid out in monthly instalments. It is the inclusion of this Solidarity Fund which distinguishes this insurance scheme from other such schemes in Latin America and the rest of the world.

Beneficiaries from the unemployment insurance will also be registered at municipal employment agencies by the administrating body of this insurance. This means that they will automatically be registered with employment mediation services. Unemployed workers benefiting from the scheme and dismissed for business reasons will have a preferential right of access to professional training programmes offered by the National Training Office.

The new unemployment insurance, which was introduced in 2002, will gradually replace the previous benefit programme as all new contracts have to contribute to the new insurance. Workers with contracts that pre-date October 2002, could join the scheme voluntarily. It will operate in addition to existing severance pay legislation, which entitles workers with open-ended contracts who are dismissed for economic reasons to receive one month's wage per year of tenure with their employer with a maximum limit of 11 years. The new unemployment insurance will not affect severance pay entitlements in any way, except that the funds accumulated in the individual savings accounts are considered as a provision against potential future redundancies, and are thus deducted from the full amount of severance pay due<sup>12</sup>.

The conditions mentioned above mean that the self-employed, employers and wage-earners without a written contract are excluded from this insurance scheme, as are workers under the age of 18, and over the age of 65. Workers who have not contributed to the scheme for at least 12 months (6 months in the case of fixed term contracts) or been unemployed for at least 30 days also do not have the right to withdraw funds. The amount of the funds that unemployed workers are entitled to depends on the reasons for their unemployment and their previous wage. And the period of unemployment for which workers are covered by this insurance scheme depends largely on the duration of their previous employment, but in any case, this period is limited to a maximum of five months. It is these conditions that we need to bear in mind when analysing the data relevant to the unemployed.

## **2. Empirical Analysis of the Unemployment Insurance**

---

Coverage of social security systems in Chile is generally measured in terms of the labour force in general. For instance, the coverage of the pension system is measured in terms of the proportion of the labour force affiliated or contributing to the pension system. Although these figures are very important in terms of allowing us to estimate the future beneficiaries of a social security system, they do not tell the whole story. Statistics on contribution coverage do not allow us to analyse whether future beneficiaries of a system will receive adequate benefits. In the case

---

<sup>9</sup> Except the domestic service sector, to which a different unemployment insurance scheme applies (See the Diario Oficial de la República de Chile, 2002: Labor Code, Article 163,a). However, since domestic workers are among the most informal jobs in Latin American economies, the coverage of this scheme must be very limited. To the author's knowledge, no data exists so far on this scheme.

<sup>10</sup> See section 2.4 of this paper for a more detailed discussion of the importance of a worker's reason for unemployment.

<sup>11</sup> See the website of the unemployment insurance for detail on receivable benefits and the mechanisms of the Solidarity Fund. It contains a model that simulates the conditions of the insurance according to the conditions that one puts into it. [www.afchile.cl](http://www.afchile.cl).

<sup>12</sup> The linkages between the new unemployment insurance, the previous unemployment benefits programme and the existing severance pay legislation have been discussed in more detail in Sehnbruch (2004b).

of unemployment insurance, we should ask what percentage of the unemployed is receiving adequate benefits from the insurance programme, in addition to looking at the scheme's general coverage. The data discussed below therefore compares the employment situations of workers who become unemployed to the employment situations of the rest of the work force to determine what proportion of the unemployed will be covered by this insurance.

As we will see in the course of this section, the characteristics of the jobs that the unemployed held prior to becoming unemployed were of a significantly inferior quality than those of the rest of the labour force.

This discussion is limited to the unemployed as they are generally defined by employment surveys, i.e. a worker had to be actively looking for work and not be engaged in any remunerative activity at all, no matter how minor, in order to be considered unemployed<sup>13</sup>. Workers who lost their jobs and switched into the informal sector are not included in this data, as they would not be considered 'unemployed' according to this definition. In practice, they would, however, form part of the group of potential beneficiaries from the unemployment insurance as the scheme's entitlements are based on job loss as opposed to any particular definition of unemployment. This means that it is perfectly possible to claim unemployment insurance payments while working informally.

## 2.1 Type of Contract and Employment Status

The most important variable that we must consider first of all is the employment status of a worker, i.e. whether they are wage-earners or self-employed. And if they are wage-earners, we must consider what type of contract they had in their previous job. Having had a formal contract is a prerequisite for being able to withdraw funds from the individual savings account, and an open-ended contract is a prerequisite for receiving additional subsidies from the Solidarity Fund if a worker was made redundant for economic reasons.

As Table 1 below shows, over 95% of the unemployed are from the dependent categories of the work force, i.e. blue and white collar workers and domestic service, reflecting the fact that unemployment rarely occurs as a visible phenomenon within the independent sector. This compares with 77% of the work force in general and shows that the self-employed absorb an economic crisis more through lower incomes rather than the loss of employment as a result of the cessation of business.

In the wage-earning sector, an important discrepancy between the characteristics of the unemployed and the employed is related to the type of contract. The proportion of the unemployed who previously had some form of an atypical contract (30.1%) or no contract at all (33.3%) is significantly higher than the proportion of these contracts among the total work force. The reasons for this discrepancy are relatively obvious: it is in the nature of fixed term contracts that they terminate, so that the worker then has to find a new job, generally passing through a spell of unemployment in the between time. It is also in the nature of informal jobs, i.e. jobs, where no contract was signed at all, that they are more transitory than formal work.

Workers who had no formal written contract prior to becoming unemployed receive no benefits under this insurance scheme. Nor do workers who received a fee for their services (*honorarios*<sup>14</sup>), as Chilean labour market legislation basically considers the latter as self-employed. The 21.8% of the unemployed who had either a short-term or project based contracts are entitled to benefits under this scheme, which amount to the contributions made to their

---

<sup>13</sup> This standard definition is based on the ILO's definition of unemployment. As a measure of what is going on in a labour market, this definition is highly inadequate. See Sehnbruch (2004a and 2006) for a discussion of its inadequacies.

<sup>14</sup> The term '*honorario*' in Chile refers to somebody who receives a fee for a particular service provided. Normally, this kind of arrangement is used for employing the services of professionals on a one-off basis, and is based on a civil law contract, not the labour code. However, the arrangement is increasingly being used by employers in order to circumvent labour legislation as it allows them to avoid giving workers formal open-ended contracts with all the rights and benefits associated to these. We can thus find even manual labourers working on a fee basis.

individual savings accounts during the duration of their contracts. As mentioned above, these accumulate to approximately a third of a worker's monthly wage over the course of a year.

Table 1 shows that only 31.7% of the unemployed had formal open-ended contracts, which, as explained in the previous section, are a prerequisite for receiving the full benefits available from this unemployment insurance.

**Table 1**

**Distribution of the Employed and Unemployed by Type of Contract and Level of Formality, Sept 1999**

		Employed		Unemployed	
		% Sub-Total	% Total	% Sub-Total	% Total
<b>Waged Workers</b>	Open-ended Contracts	65.7	50.6	33.3	31.7
	Total Atypical Contracts (1+2+3)	15.6	12.0	31.6	30.1
	Fixed Term (1)	10.3	7.9	16.7	15.8
	Project/Service (2)	2.2	1.7	6.3	6.0
	Fee Paid (Honorarios) (3)	3.1	2.4	8.6	8.2
	No Contract	18.7	14.4	35.1	33.3
<b>Sub-Total Waged Workers</b>		<b>100.0</b>	<b>77.0</b>	<b>100.0</b>	<b>95.1</b>
<b>Independent</b>	Employers / Prof Self-employed	17.7	4.1	22.2	1.1
	Self-employed	82.3	18.9	77.8	3.8
	<b>Sub-Total Independent</b>	<b>100.0</b>	<b>23.0</b>	<b>100.0</b>	<b>4.9</b>
<b>Total</b>			<b>100.0</b>		<b>100.0</b>

*Note: Excluding all cases who did not know what type of contract they have or had. Number of employed: 1008, number of unemployed: 185. Source: Database of the household survey described in footnote 4.*

## 2.2 Duration of Unemployment

The next variable we must consider is the duration of unemployment so that we can determine whether the unemployed would be adequately covered by the 5 withdrawals they can make from their individual savings accounts. Table 2 confirms that the majority of the unemployed (59%) find a new job within 6 months, during which time they would be covered by the five instalments that the unemployment insurance pays, either through their accumulated savings or from payments from the Solidarity Fund should these savings be insufficient. The remaining 41% would not be covered for the entire duration of their unemployment, 20% of whom must be considered long term unemployed. Table 2 shows that the average duration of unemployment well exceeds the average of 5 months assumed by policy makers<sup>15</sup>. However, if we exclude the long term unemployed, the average does fit well into the 6 month period of benefit coverage,

<sup>15</sup> As discussed above, the first month of unemployment is not covered by this insurance. The five instalments that can be paid begin after this initial month. So the entitlement to benefits ends after a total of 6 months of unemployment.

which also fits with the intentions of the policy makers who intended this insurance to be a solution for short-term (i.e. cyclical), not long-term unemployment<sup>16</sup>.

It should also be added that these figures refer to a time of unemployment crisis, during which one would normally assume a longer duration of unemployment than during periods of normal economic growth.

**Table 2**

**Distribution of the Unemployed by the duration of their Unemployment, Sept 1998 – Sept 1999**

Duration	% of total	% Cum.
< = 1 month	17.13	17.13
> 1 – 6 months	41.44	58.56
> 6 – 12 months	20.99	79.56
> 12 months	20.44	100.0
Total	100.0	
<b>Average Duration of Unemployment</b>		
All cases	9 months	
Excluding the long-term unemployed	4.3 months	

*Note: n= 181. The cases are based on all the incidences of employment and unemployment that occurred during a twelve month period, from Sept 1998 – Sept 1999. The long-term unemployed are defined as those who have an unemployment duration that exceeds 12 months. Source: Database of the household survey described in footnote 4.*

### 2.3 Duration of Previous Employment

The next factor that we need to consider is the duration of the previous job that the unemployed had, as this determines the amount of savings that workers are able to accumulate in their individual accounts. The longer they stay in any job, the more savings they accumulate (up to a ceiling of 11 years), and the higher the benefits they receive from this insurance.

It is evident from Table 3 below that the unemployed on average have spent significantly less time in their previous jobs than the general labour force. A worrisome result is that 61.5% of the unemployed did not remain in their job for a minimum period of one year. This means that they are less likely to be covered by this insurance scheme, as the regulations of the insurance scheme stipulate that workers have to have contributed to the scheme for a minimum of twelve months (or 6 months in the case of workers with short-term contracts) before being able to receive benefits. In fact, 45% of the unemployed did not even remain in their previous job for 6 months. So unless they have funds accumulated in their account from a previous job or previous jobs, they will not be covered by this insurance.

<sup>16</sup> See Acevedo and Eskenasi (2004), Ministerio del Trabajo (2000c), and SAPF (2002).

**Table 3****Distribution of the Unemployed and Employed by Tenure, Sept 1998 – Sept 1999**

Duration of Employment	Employed		Unemployed	
	%	% Cumulative	%	% Cumulative
Less than 6 months	27.64	27.64	45.18	45.18
7 - 12 months	10.57	38.21	16.27	61.45
> 1 – 3 years	18.5	56.71	18.37	79.82
> 3 – 5 years	10.71	67.43	9.04	88.86
More than 5 years	32.57	100	11.14	100
Total	100.0		100.0	

Note: Number of employed: 1400, number of unemployed: 332. The data refers to the tenure of their previous job in the case of the unemployed and to their current job in the case of the employed. The cases are based on all the incidences of employment and unemployment that occurred during a twelve month period, from Sept 1998 – Sept 1999. Source: Database of the household survey described in footnote 4.

**2.4 Reason for Loss of Employment**

As discussed above, the reason for a worker's loss of employment is also an important factor in determining how much a worker will benefit from this insurance and whether he or she will be covered by the Solidarity Fund. Latin American Labour Codes generally distinguish between 'just' or 'unjust' causes for loss of employment. 'Just' causes include reasons attributable to the worker (e.g. some form of misconduct), voluntary resignation, and expiration of contract. 'Unjust' causes for dismissal refers to economic reasons (translated from the Spanish *necesidad de la empresa*), and mainly includes downsizing and firm closures. This distinction is crucial in the context of unemployment insurance because different reasons for unemployment lead to different levels of benefits and entitlements for the worker.

Workers who become unemployed for 'just' reasons are not entitled to additional payments from the Solidarity Fund. They may just withdraw the savings they have accumulated. However, workers who had open-ended contracts and were made redundant for economic (so-called 'unjust' reasons) are entitled to additional funds from the Solidarity Fund should their own savings not suffice to cover a 5 month period of unemployment.

Table 1 of this paper showed that less than a third of the unemployed had open-ended contracts in their previous jobs. Of this third, Table 4 shows that 55.5% were dismissed for unjust reasons, which amounts to 17.6% of the total unemployed. These are therefore the unemployed who would be entitled to the full insurance benefits, i.e. the accumulated savings in their accounts and additional funding from the Solidarity Fund should they need it.

**Table 4****Distribution of former Wage-earners with open-ended contracts by Reason for Loss of Employment, Sept 1998 – Sept 1999**

Reason for Loss of Employment		Open-ended Contract
Necessity of the Firm	'Unjust' reasons	48.76
Closure of the Firm		6.61
Voluntary Change		25.62

Expiry of Contract	'Just' reasons	6.61
Other		12.4
Total		100.0

*Note: n=121. The cases are based on all the incidences of employment and unemployment that occurred during a twelve month period, from Sept 1998 – Sept 1999. Source: Database of the household survey described in footnote 4.*

## 2.5 Level of Income

Another important characteristic of the unemployed to look at in this section is the level of income the unemployed had in their previous job, as this determines the amount of unemployment benefit to which they would be entitled under the new insurance scheme. The data in Table 5 shows that unemployment is far more likely among the lowest income categories, especially among workers who earn less than the minimum wage. The lowest income categories (workers earning 2 x the minimum wage or less) constitute 83.7% of the unemployed. Since employers are not allowed to employ workers at less than the minimum wage, the 45.2% of the unemployed who earned less than the minimum wage are most likely workers who worked informally. This corresponds to the proportion of the unemployed who in Table 1 showed up as not having had a formal written contract in their previous job. So in addition to having received an extremely low wage, they would also not be entitled to any benefits from this unemployment insurance. Check precise inc cats.

**Table 5**  
**Distribution of the Employed and Unemployed by Level of Income, Sept 1998 – Sept 1999**

Income	% Employed	% Unemployed
1 minimum wage (mw) or less	31.53	45.18
Between 1 - 2 mws	37.75	38.55
Between 2 - 3 mws	11.23	9.34
Between 3 - 4 mws	4.19	2.41
More than 4 mws	15.29	4.52
<b>Total</b>	100.0	100.0

*Note: n=332. n=1478 employed The income categories were calculated based on multiples of the minimum wage effective in September 1999, which was \$90,500, roughly US\$ 200 at the time.*

*Source: Author's own database of the household survey described in footnote 4.*

The overall conclusion that we can draw from this comparison of the characteristics of the unemployed and the employed is that the former generally held jobs of a far lower quality than the latter. The data shows that most of the workers, who are formally employed, will be covered by this insurance. However, this is not the same as those who actually become unemployed receiving appropriate benefits. The comparison has shown that the unemployed are generally more likely to have been wage-earners with atypical contracts or none at all, with significantly lower levels of income, and a high likelihood of not having worked for long enough in their previous jobs in order to be covered by this insurance scheme.

## 5. Characteristics of the Insured and the Unemployed

Before bringing all of these different variables together in a simulation of this insurance, this paper will take a brief look at the characteristics that are correlated with qualifying for the unemployment insurance. We use a logistic regression to identify these characteristics and find that the variables that are associated with qualifying for unemployment insurance are precisely those that we found above are correlated with not being unemployed.

The regression simply shows what variables are associated with satisfying the different requirements needed to qualify for unemployment insurance. This way the dependant variable corresponds to a 1 if the worker is entitled to unemployment insurance and a 0 if she is not. The independent variables correspond to the characteristics of employment, the level of education of workers, and to their potential experience. The purpose of this regression is to establish what variables are associated with coverage which are not directly associated with being insured by definition, as are type of contract and duration of employment, but the characteristics that determine the probability of satisfying the established requirements.

**Table 6**  
**Qualifying for unemployment insurance**

Variable	Model 1	Model 2	Model 3
Head of Household	-0.0091346 <i>0.948</i>	0.0514411 <i>0.717</i>	0.0717859 <i>0.615</i>
Age	0.2496109 <i>0.00</i>	0.2443241 <i>0.000</i>	0.2443699 <i>0.000</i>
Age Squared	-0.0029506 <i>0.00</i>	-0.0028638 <i>0.00</i>	-0.0028682 <i>0.00</i>
Male	0.1128334 <i>0.356</i>	0.1498955 <i>0.241</i>	0.1940559 <i>0.133</i>
Secondary Education	0.4792721 <i>0.00</i>	0.3498799 <i>0.011</i>	0.3354633 <i>0.015</i>
Technical Education	0.7184958 <i>0.00</i>	0.3519155 <i>0.102</i>	0.248407 <i>0.256</i>
Higher Education	0.9697752 <i>0.00</i>	0.8804665 <i>0.00</i>	0.3514575 <i>0.159</i>
Manufacturing Sector	-	0.6203548 <i>0.003</i>	0.7529756 <i>0.001</i>
Energy Sector	-	0.9455434 <i>0.00</i>	1.011489 <i>0.00</i>
Construction Sector	-	-0.2950235 <i>0.046</i>	-0.2425783 <i>0.159</i>
Mining Sector	-	-	0.9104256 <i>0.003</i>

Transport Sector	-	-	-0.0644681
			0.7
Financial Sector	-	-	-0.0678573
			0.721
Constant	-5.330493	-5.331965	-5.360369
	0.00	0.00	0.00
Pseudo R2	0.066	0.088	0.092
N	1651	1651	1651

\*P- values under coefficients

We can see that the higher the level of education and age (potential experience), the more likely a worker will be covered by the unemployment insurance scheme. In addition we find, as expected, that more formal economic sectors, such as manufacturing, are more likely to be covered, while less formal sectors, such as construction, are not. This suggests that lower quality jobs are less likely to be covered by unemployment insurance as was suggested by the evidence presented above. This adds to the argument which indicates that although a large part of the employed work force would eventually be covered by the insurance, those who constitute the effective unemployed will not necessarily be covered in the same magnitude. In the following section a simulation of the insurance provides more insight on this topic, illustrating the argument with empirical data.

## 6. Simulation of the Unemployment Insurance

As discussed in the introduction to this paper and as shown by the empirical results presented in section 2, it is not enough to simply consider this insurance in the light of its coverage of the total work force or of wage-earners. The most useful assessment of its coverage occurs if we look at the proportion of unemployed who will actually be adequately protected by this insurance. The tables that follow will assess the insurance scheme's different levels of coverage in turn. All of the tables that follow exclude domestic service workers as they are covered by a different savings scheme. They also exclude any self-employed or employers as these workers are excluded from the unemployment insurance *ex ante*.

Table 7 illustrates what the coverage of this unemployment insurance would be for all wage-earners, if the unemployment insurance had been fully functioning at the time when the survey was undertaken. It shows that **46.3% of all wage-earners would not be covered by this insurance**. The two main reasons why so many wage-earners are not covered by the insurance is either because they do not have a formal written contract or because they would not have accumulated the contributions required to benefit from the insurance, if they became unemployed. Together, these two categories amount to 40% of wage-earners or 87% of wage-earners not covered by the insurance. There is also a smaller number of wage-earners (4.9%) who are working on a fee paid basis (*honorarios*), who also would not be covered by the insurance as they are excluded *ex ante*<sup>17</sup>. The remaining proportion of wage-earners not covered, mainly for reasons of age limits.

Table 7 also shows that **53.7% of wage-earners would be covered by the insurance**. 8.5% of the total wage-earners have atypical contracts and would be entitled to a one-off payment equivalent to approximately a third of their previous monthly wage. Only a small

<sup>17</sup> As discussed above, *honorarios* are normally not considered part of the wage-earning labour force, as their contracts are based on civil not labour law. That is why they are excluded from this unemployment insurance scheme *ex ante*. The *honorarios* included in this simulation, however, are effectively working as wage-earners, and should therefore be considered as wage-earners without formal written contracts.

proportion of all wage-earners would actually have the right to receive benefits from the Solidarity Fund (3.5%), the remainder (41.8%) would have accumulated more than two months' wages in their savings accounts, and would therefore not qualify for additional funding from the Solidarity Fund.

**Table 7**  
**Coverage of Wage-earners**

Categories of Wage-earners		%	%
<b>Not Covered</b>	No Contract	44.6	20.6
	Open-ended contract with insufficient contributions, < 12 mths)	22.6	10.4
	Atypical contract with insufficient contributions, < 6 mths)	19.8	9.1
	<i>Honorarios</i> working as wage-earners	10.7	4.9
	Other reasons	2.4	1.1
	<b>Sub-total unemployed not covered by insurance</b>	100.0	46.3
<b>Wage-earners</b>	Atypical contracts covered by a single payment	15.8	8.5
	Right to Solidarity Fund	6.4	3.5
	Enough savings, no right to Solidarity Fund	77.8	41.8
	<b>Sub-total wage-earners covered by insurance</b>	100.0	53.7
<b>Total Wage-earners</b>			100.0

*Note: Calculation based on 1072 cases that were employed as wage-earners during the year preceding the date of the survey.*

From Table 8 we can see that **62.6% of the unemployed would not be covered by this insurance at all**. Of this proportion the majority (58%) would not benefit because they did not have a formal written contract prior to becoming unemployed. Approximately 40% would not benefit because although they had either open-ended or atypical contracts, they did not contribute for the requisite amount of time. Only a very small proportion of those not covered by the insurance (2.7%) are disqualified from the insurance for age reasons.

Table 8 also shows that **37.4% of the unemployed would be covered by the insurance**. Of these, almost a third (31.5%) held atypical contracts prior to becoming unemployed and would therefore generally be entitled to a one-off payment equivalent to approximately a third of their previous monthly wage. One quarter (7.2%+18.9%) of the unemployed covered by this insurance either resigned voluntarily or lost their job for reasons that justified dismissal. The majority of these cases would find that their accumulated savings are not enough to cover their period of unemployment, as their tenure in years is not at least equivalent to their period of unemployment in months.

Almost 10% (4%+5.4%) of the total unemployed or a quarter (10.8%+14.4%) of those covered by the insurance would have the right to receive payments from the Solidarity Fund. Of this proportion the majority would find that the payments from the Solidarity Fund would cover their period of unemployment, while slightly less than half would find that their period of unemployment exceeds the period of time that they would be covered by the Solidarity Fund. And finally, 6.4% of the unemployed (or 17.1% of those covered by the insurance) would find that they have accumulated more than two months' wages in their savings accounts, and would therefore not qualify for additional funding from the Solidarity Fund.

**Table 8**

### Coverage of the Unemployed

Categories of Unemployed		%	%	
<b>Not Covered</b>	No Contract	58.1	13.1	
	Open-ended contract with insufficient contributions, < 12 mths)	21.0	36.4	
	Atypical contract with insufficient contributions, < 6 mths)	18.3	11.4	
	Other reasons	2.7	1.7	
	<b>Sub-total unemployed not covered by insurance</b>	<b>100.0</b>	<b>62.6</b>	
<b>Covered</b>	Atypical contracts covered by a single payment	31.5	11.8	
	Just dismissal or voluntary resignation	yrs tenure $\geq$ 6 mths unemployed	7.2	2.7
		yrs tenure < 6 mths unemployed	18.9	7.1
	Right to Solidarity Fund	$\geq$ 6 mths unemployed	10.8	4.0
		< 6 mths unemployed	14.4	5.4
	Enough savings, no right to Solidarity Fund	17.1	6.4	
	<b>Sub-total unemployed covered by insurance</b>	<b>100.0</b>	<b>37.4</b>	
<b>Total Unemployed</b>			<b>100.0</b>	

*Note: Calculation based on 297 cases that were unemployed during the year preceding the date of the survey.*

Three results that stand out from these simulations should be highlighted. The first is the generally low coverage of this insurance scheme, both as regards employed and unemployed workers. This low coverage can be attributed to the precarious working conditions of many workers, and particularly of those who become unemployed. The low coverage of social security systems in general in Latin America is often attributed to the large informal sectors (as defined by the ILO) that operate in these countries. However, the ILO's definition of the informal sector includes the self-employed and domestic service workers, both of which are categories of workers that have been excluded from these simulations. The low coverage of this unemployment insurance must therefore be attributed to the precariousness of jobs in the formal sector (e.g. workers employed without formal written contracts), and to the high levels of rotation of these jobs. It cannot be attributed to a large informal sector.

The second important result is that the coverage of this unemployment insurance is further reduced if we consider who is fully covered by it. For example, atypical workers who receive a one-off payment equivalent to a third of their monthly wage, will generally not find this payment sufficient to alleviate any situation of unemployment. Thus, the proportion of workers who are either fully covered by their own accumulated savings or by payments from the Solidarity Fund is low indeed, only 15.8%. And the insurance element of this scheme, which is provided by the Solidarity Fund, covers an even smaller minority of the unemployed, only 9.4%. Most workers, therefore, if they are covered at all by this scheme, are therefore covered through its mandatory savings mechanism, not through its insurance component.

The third results that we must emphasise is the inferior quality of jobs held by those workers who become unemployed compared to the work force in general. This result has been demonstrated by all the empirical evidence presented in this paper, but particularly by the simulations of the unemployment insurance. This issue merits further investigation in order to determine whether this means that it is the same proportion of workers with precarious jobs that rotates in and out of unemployment. Further study of this issue would throw up important results on issue of exclusion from quality jobs, probably due to inferior skill sets.

On a slightly more positive note, the total number of workers covered by this scheme once it is fully functioning will be slightly higher than this simulation suggests, as workers will be able to draw on savings from previous jobs. Workers who have had two short-term jobs, for example, that have not amounted to a total contribution period of 12 months, may only be able to withdraw savings after a third job, if that job takes them over the 12 month savings minimum. This will slightly increase the proportion of workers with short-term jobs that will be covered by this insurance. However, this does mean that between these three jobs, workers may be unemployed without any benefits whatsoever.

Equally, workers who find a job before their savings are exhausted and decide to leave the surplus in their accounts may be able to use them in the case of future redundancies. However, since these possibilities partly depend on individual choice and partly on detailed knowledge of employment histories, this simulation has not been able to take them into account.

## **7. Evaluation of the Chilean Unemployment Insurance Scheme and Conclusions**

---

With workers of the formal sector, the main questions relating to this scheme are whether the contributions to the scheme are high enough to constitute adequate protection, and whether it is a good idea to base unemployment insurance on a principle of as little risk sharing as possible.

As regards the first point, previous versions of the scheme contemplated higher contributions (that were subsequently reduced for political reasons). If we compare the system to its forerunner *Protrac* (*Proteccion al Trabajador Cesante*), which provided for a 4% contribution, or to the Brazilian individual savings account scheme *FGTS* (*Fundo de Garantia por Tempo de Serviço*) to which employers contribute 8% of a workers wage, the contributions to this unemployment insurance are indeed low. It is interesting to note that government officials who instituted this scheme recognise that the contribution from employers to the scheme is probably too low. However, they take the view that it is better to implement a basic insurance, and then improve it over time (Acevedo and Eskenazi, 2004). However, the amount of employers' contributions to the scheme is an issue that is closely related to the existing severance pay legislation in Chile, and further reform of the former is also likely to require reform of the latter<sup>19</sup>.

As for the second point, one of the main problems with the insurance scheme is that it is called an 'insurance', and that it is presented to the public as a scheme which will protect the most vulnerable workers and the unemployed<sup>20</sup>. The term 'insurance' is misleading as only a limited proportion of beneficiaries will be covered by the scheme's insurance element, the Solidarity Fund. For most workers, the scheme bears more resemblance to a mandatory savings scheme with an insurance component, similar to Chile's privatised pension system, which also has an insurance component in that a part of members' contributions pay for disability insurance. Again, the way in which the Chilean unemployment insurance system has been presented to the public contrasts with the Brazilian case, where the *FGTS* is regarded as a mandatory savings scheme, and where a separate unemployment insurance system exists in addition to the *FGTS*<sup>21</sup>.

This paper has not entered into a discussion of whether the unemployed who do receive benefits from this scheme are appropriately covered in terms of the amount and the duration of benefits. It has merely tried to establish as a first step how many of the unemployed will be

---

<sup>18</sup> For a discussion about how the previous proposal for unemployment in Chile, *Protrac*, would have worked, see Velásquez (1996 and 1998), and Ministerio del Trabajo (1997).

<sup>19</sup> The linkages between the unemployment insurance and severance pay legislation have been discussed extensively in Sehnbruch 2004b and 2006.

<sup>20</sup> See Sehnbruch 2004b for a discussion of how this unemployment insurance has been presented to the public through the official political discourse.

<sup>21</sup> See Carvalho and Pinheiro, 1998.

covered at all. We are not, therefore, arguing at this point that the conditions under which the unemployed can claim benefits are unduly restrictive in this scheme. We merely conclude that the inadequate protection of the unemployed under this scheme derives from the discrepancy between its theoretical stipulations and the reality of the Chilean labour market. Despite its innovations, the scheme is modelled on traditional forms of unemployment insurance and existing legislation in the Latin American region<sup>22</sup>. For example, it is not unusual for unemployment insurance systems to stipulate that a worker must have contributed for at least 12 months before being entitled to unemployment benefit. The problem is that in the rather more precarious labour markets of developing economies, a large proportion of the workers rotate among highly precarious jobs and will thus never be able to comply with such a condition.

It has been widely noted in the literature that Latin American unemployment insurance systems are inequitable, precisely because they channel scarce resources to a segment of the labour force that is not necessarily the poorest<sup>23</sup>. Cortázar, for example, argues that the previous system of unemployment provisions in Chile created a strong segmentation of the labour markets between insiders in the formal sector who enjoyed strong job security and informal workers who have access to limited and very unsatisfactory unemployment protection (Cortázar, 1997). However, this new unemployment insurance is no different: it will also protect the most precarious jobs the least. As such, it will not be able to function as a safety net for the poor either<sup>24</sup>.

We should also consider that this unemployment insurance is neither means tested nor does it take into account whether the subsidy received will be sufficient to maintain the people who will depend on it, as the circumstances of the unemployed individual are not considered (e.g. other sources of income or number of dependents). Since a very basic welfare system does exist in Chile, it would make sense to establish the institutional linkages that can combine unemployment insurance with other welfare measures. This should be possible without too much additional cost since both employment and welfare offices are supposed to exist in every municipality in Chile. As Márquez writes: “unemployment insurance has a role as part of the safety net, but there is a need for complementary mechanisms that protect the poor who do not have protected employment contracts” (Márquez, 1999: 7). So at the very least, unemployment benefits and other social security mechanisms should be linked.

In Conclusion, we can say that this insurance system can serve as a model for other middle income developing countries who wish to protect their formal labour force in circumstances of unemployment, without incurring significant fiscal costs. However, they should undertake a comprehensive assessment of the types of jobs that operate in their labour markets, and particularly study the jobs that lead to unemployment before implementing such a system. We should also refrain from referring to this scheme as ‘unemployment insurance’ and call it an ‘individual savings scheme’, as its insurance component is minimal. And it is certainly misleading to present this scheme as a safety net for the poor or as a programme that will cover the unemployed. Such a scheme should never be considered as more than a component of a more comprehensive social security system.

---

<sup>22</sup> See Sehnbruch 2004b for a discussion of how this scheme compares to others in the region.

<sup>23</sup> See for example Márquez, 1999.

<sup>24</sup> The political discourse has presented this savings scheme to the public precisely as a measure that would protect the most vulnerable workers. See Sehnbruch 2004b for a discussion of the political discourse on unemployment insurance in Chile.

## BIBLIOGRAPHY

---

- Acevedo, G.; Eskenazi, P. 2004. *The Chilean Unemployment Insurance: A New Model of Income Support Available for Unemployed Workers?* Washington D.C., World Bank.
- Carvalho, C.E.; Pinheiro, M.M.S. 1998. *FGTS: Avaliação das Propostas de Reforma e Extinção*, Texto para Discussão No. 671, IPEA
- Cortázar, R. 1997. Chile: the Evolution and Reform of the Labor Market, in S. Edwards and N. Lustig (eds.) (1997) *Labour Markets in Latin America: Combining Social Protection with Market Flexibility*, Washington D.C., Brookings Institution Press.
- Diario Oficial de la República de Chile 2002. Código del Trabajo, Santiago, Editorial Lexis Nexis.
- Ferrer, A.; Riddell, C. 2004. *Unemployment Insurance Savings Accounts in Latin America: Overview and Assessment*, Working Paper, University of British Columbia.
- ILO 2001. *Panorama Laboral*, Lima, ILO.
- Islas, G. 2002. *Sistemas de Protección a Desempleados en los países de la OEA*, Lima, ILO.
- Jaramillo, M.; Saavedra, J. 2004. *Severance Payment Programmes in Latin America*, Washington D.C., World Bank.
- Márquez, G. 1999. *Unemployment Insurance and Emergency Employment Programs in Latin America and the Caribbean: An Overview*, Paper prepared for the Conference on Social Protection and Poverty, Washington D.C., Inter-American Development Bank.
- Mazza, J. 1999. *Unemployment Insurance: Case Studies and Lessons for Latin America and the Caribbean*, Technical Study, Washington D.C., Inter-American Development Bank.
- Ministerio del Trabajo 1997. *Sistema de Protección al Trabajador Cesante*, Santiago.
- Ministerio del Trabajo 2000a. *Proyecto de Ley: Del Regimen de Seguro de Cesantía*, Santiago.
- Ministerio del Trabajo 2000b. *Seguro de Cesantía: Informe Complementario*, Santiago.
- Ministerio del Trabajo 2000c. *Seguro de Cesantía: Informe Técnico*, Santiago.
- Sehnbruch, K. 2004a. *From the Quantity of Employment to the Quality of Employment: An Application of the Capability Approach to the case of the Chilean Labour Market*, Working Paper No. 9, Center for Latin American Studies, University of California at Berkeley.
- Sehnbruch, K. 2004b. *The Politics of Unemployment Insurance in Chile*, Working Paper No. 12, Center for Latin American Studies, University of California at Berkeley, forthcoming.
- Sehnbruch, K. 2006. *The Chilean Labour Market*, Macmillan, New York and London, forthcoming
- Superintendencia de Administradoras de Fondos de Pensiones (SAFP) 2002. *El Seguro de Cesantía Chileno: Informe Técnico*, Santiago.
- Velázquez, M. 1996. *Reforma al Sistema de Protección a los Cesantes: Chile: un Debate en curso*, Santiago.
- Velázquez, M. 1998. *Protección al Trabajador Cesante: Proyecto de Ley propuesto por el Gobierno de Chile*, Serie Documentos de Trabajo No 6, CIEDESS May 1998, Santiago.