



## BRIEF ANALYSIS

No. 424

For immediate release:

Tuesday, November 12, 2002

## Chile Leads the Way with Individual Unemployment Accounts

by William B. Conerly, Ph.D.

Chile was the first country in the western hemisphere to set up a social security system, and the first country in the world to reform it using individual investment accounts. It has again broken new ground by becoming the first country to use individual accounts in an unemployment insurance (UI) system. Chile's move should prod the United States to rethink the way it provides a safety net for unemployed workers.

**Expanding the Social Safety Net.** Chile previously had only a limited system of unemployment assistance. Some of the unemployed received a very small public benefit — \$14 to \$30 a month, and a few companies paid severance to displaced workers.

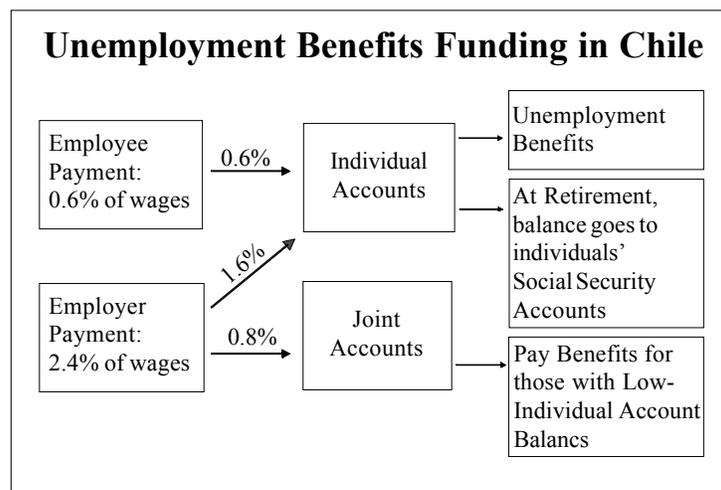
The system now being implemented builds on Chile's success with individually-owned retirement accounts:

- Workers will pay 0.6 percent of their wages into individual accounts, while employers will pay a 2.4 percent payroll tax divided between individual accounts and a "joint account." [See Figure I.]
- The accounts will be administered by the same private pension funds that manage Chilean workers' retirement accounts, and the funds will invest conservatively in a variety of securities.
- The individual account will be in the worker's name and will not be paid out until the worker becomes unemployed or retires.

Unemployed individuals will be able to draw 30 percent to 50 percent of their previous wages for up to five months. The joint account will provide benefits to unemployed people who exhaust the balances in their individual accounts.

**Advantages of Unemployment Accounts.** Unlike the U.S. unemployment system, Chileans will be able draw the funds out even if they quit or were fired from their last jobs. This will allow workers more flexibility in changing jobs. [See Figure II.]

The Chilean approach avoids the need for an adjudication system. In the United States, benefits often are not paid to workers who quit voluntarily or are fired "for cause." In one state, for example, the cost of determining whether a worker's job separation qualified for benefits and adjudicating the disputed claims adds up



to 22 percent of the total administrative cost.

Chileans with money left in their UI accounts at retirement will roll the money into their individual social security accounts. This greatly changes job search incentives. Workers who find jobs more rapidly will build up a larger retirement nest egg. With the UI account appearing on the same statement as the social security account, workers will clearly see the connection between rapid reemployment and retirement funds.

A major problem with the UI system in the United States and other developed countries is that it gives workers an incentive to remain unemployed. Numerous academic studies have found that the system leads people to take longer to find new jobs. The more generous the benefits, the longer the unemployed take to find new work, on average. The Chilean approach solves this problem.

There is concern in Chile that the additional payroll tax will raise businesses' costs. However, based on the results of econometric studies conducted in the United States and Canada, it is likely that Chilean workers will bear 80 percent to 100 percent of the tax burden in the form of lower wages.

The new system in Chile is actually a compulsory saving plan in which workers finance their own benefits. The U.S. unemployment system is also payroll tax funded, and it is also a compulsory saving plan, but for workers as a group rather than individually. Unlike the U.S. system, Chilean workers will benefit even if they are never unemployed.

**Option for the USA: Adopt the Chilean System.**

Americans may want to consider individual accounts, which have been proposed by economist Martin Feldstein and by the John Locke Foundation. Other approaches are also worth considering. For example:

**Option for the USA: Adopt The "JOBS Plus" System.** Oregon diverted some unemployment insurance taxes to pay wage subsidies to companies hiring unemployed workers. The plan focused mostly on low-skilled, less-experienced workers in need of mentoring and on-the-job training. The approach has not yet been extended to all of the state's unemployed, although a universal system is worth considering.

**Option for the USA: Allow Self-Insurance.** Instead of paying unemployment insurance taxes, government and nonprofit employers are allowed to self-insure. They simply reimburse the state employment department for any claims paid. The option of self-insuring unemployment benefits could

be extended to businesses willing to post a bond to guarantee they will make the reimbursements. (A self-insurance option for workers' compensation is available to employers in 42 states.)

**Option for the USA: Allow State Experimentation.** More broadly, the nation should allow the states to experiment with unemployment insurance reform, as it has with some other programs. The greatest achievements in welfare reform came not from the 1996 federal welfare reform law, but from state experiments with alternative welfare systems under waivers from the federal government.

The results from these state experiments strongly influenced the welfare reform legislation Congress later passed.

States also control the way workers' compensation for work-related injuries is structured. Many states have improved incentives for workplace safety, reducing accident rates and employers' costs. States should be granted similar discretion

with respect to the structure of their unemployment insurance programs.

**Conclusion.** Our unemployment safety net has changed little since the 1930s, when most workers were in industrial occupations, most workers were men, and part-time work was not common. It's time we considered alternatives. It's time we mirrored Chile's willingness to weave the social safety net in imaginative new ways.

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**Advantages of the Chilean System**

- Workers can withdraw funds even if they quit or are fired.
- Avoids the cost of adjudicating whether termination was voluntary or "for cause."
- Workers have no economic incentive to delay re-employment.
- Workers can access unspent funds during retirement.

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