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CHILE
UNEMPLOYMENT INSURANCE: MORE PROTECTION IN A CONTEXT OF CRISIS

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Unemployment Insurance began to operate in Chile in October 2002, aiming to provide monetary benefits to wage-earners upon termination of their work relationship. The innovative design combines a pay-as-you-go fund with an individual savings account arrangement linked to the severance pay mechanism, irrespective of the cause of unemployment. After operating for six years, a set of reforms were implemented in 2009 to improve access to benefits, extend coverage, and strengthen the counter-cyclical role of the plan, by means of additional benefits that become available when unemployment levels rise beyond their usual trend. In the framework of a number of measures designed to reduce effects on employment through public expenditure in infrastructure, stimulation of investment, and direct transfers to the poorest homes, together with activation of the Contingency Programme against Unemployment, actual operation shows that protection of unemployed workers has been kept up in spite of a significant decline of economic conditions in Chile.

1. Introduction

The purpose of Unemployment Insurance is to provide monetary benefits to all wage-earners governed by the Chilean Labour Code, at the time of facing unemployment, and support their rehiring in productive jobs via employment and job-training services. Funding is provided by regular payments made by employers and workers, in addition to an annual government contribution. Such contributions and payments are deposited in individual accounts, which are proprietary capital of each worker, and a pay-as-you-go fund applied to finance a variety of benefits, which vary according to the cause of unemployment and the type of contract held by the protected worker.

Accordingly, in the case of a worker under an open-ended work contract, the contribution rate paid into his/her individual account is 2.2% of the worker's wage (1.6% by the employer, 0.6% by the worker), which covers all contingencies stemming from termination of the work relationship. Thus, in the event of resignation or lay-off, the worker becoming unemployed may withdraw all funds accumulated in the account in a period of not more than five months. In the event of retirement or disablement, the unemployed individual may withdraw all the funds in a single transaction and in the event of decease of the worker, the funds will be part of the estate. In the case of a worker under short-term contract, the employer pays in the equivalent of 3% of the worker's taxable wage, and the worker may withdraw all funds accumulated in the account, irrespective of the reason for termination of contract, with the sole requirement of having previously paid in not less than six contributions.

On the other hand, when the cause of unemployment is involuntary and the worker concerned is under an open-ended contract, the insurance guarantees a programme of decreasing benefits, proportional to the wage, in a range within specified limits, for up to five months, as shown in Table 1. Benefits are funded from the resources accumulated in the worker's individual account and, if not sufficient, from the Solidarity Unemployment Fund (*Fondo de Cesantía Solidario – FCS*).

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Table 1
Unemployment Insurance Benefits[a/]

Month of unemployment	Percentage of wage	Upper limit (CLP)[b/]	Lower limit (CLP)[b/]
First	50	190,000	88,000
Second	45	171,000	73,000
Third	40	152,000	64,000
Fourth	35	133,000	56,000
Fifth	30	114,000	48,000

Source: *Superintendencia de Pensiones* (Superintendence of Pensions)
a/ Amounts in effect from May 1, 2009 to January 31, 2010
b/ In October 2009, US$ 1 = Ch$ 550 approx.

FCS funding comes from employers, who pay in the equivalent of 0.8% of the worker's wages, and the Government, which makes contributions provided by law. In addition, beneficiaries have access to subsidies and active employment-policy measures covered by public funds.

Originally, access to such benefits - which were covered by the FCS when the balance of the individual account of the worker concerned was insufficient - was available provided that the worker had made at least 12 consecutive monthly payments prior to lay-off, had been laid-off on grounds not attributable to the worker, was still unemployed at the time of applying for monetary benefits, and was actively seeking employment without having rejected a job offer or attending job-training financed by the Government.

Coverage of beneficiaries of Unemployment Insurance has grown rapidly, totalling 67% of all wage- earners in June of this year.[2] This is mainly because of the compulsory enrolment mechanism which applies automatically upon execution of a new work contract. In a context of extensive use of temporary work contracts and relatively high job turnover, most benefits have been granted to workers under short-term contracts. For similar reasons, the FCS, since its creation, recorded an increasing accumulation of funds, given that in cases of layoffs for business-related reasons the requirement of having previously completed 12 consecutive monthly payments operated as a major design constraint.

2. Reforms

In 2008, following an analysis of plan operation, a set of reforms was designed for the Unemployment Insurance, basically aiming to improve access to benefits, enhance benefit quality, and strengthen the counter-cyclical role of the insurance. The reforms were approved in early 2009 and application thereof became effective as of May. The main features are as follows:

- Access to two Payments charged to the FCS for workers under fixed-term or service contract, at 35% and 30% replacement rates for the first and second payments, respectively. The overall contribution rate under this special regime remains at 3%; however, 0.2 percentage points will be allocated to the FCS.

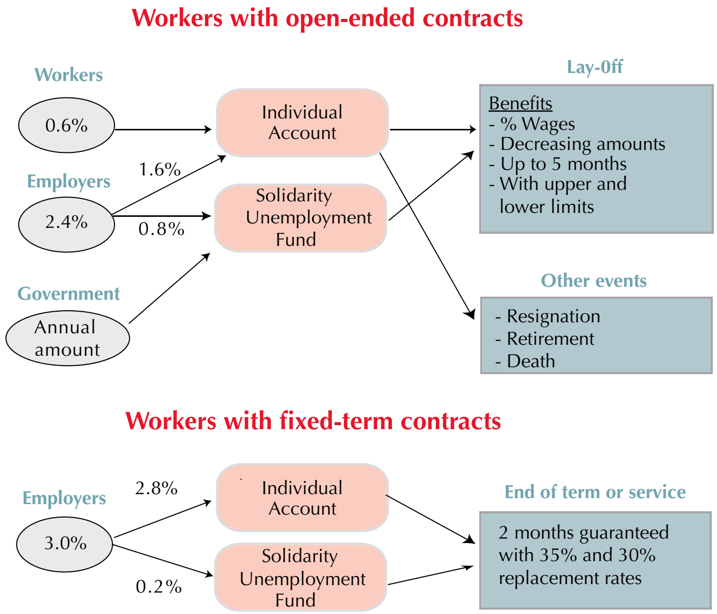
- Access to the FCS was streamlined. For workers with open-ended contracts the requirement of having made 12 consecutive contributions is replaced by having made at least 12 contributions in the last 24 months as of the end of the work relationship, the last three being consecutive under the last employer. For workers under fixed-term contract, right to the FCS is granted under the same new conditions as for workers under open-ended contracts.

- Counter-cyclical adjustment. Two additional withdrawals are granted to FCS beneficiaries when unemployment is higher than the average for the last four years, plus one percentage point. This amount, regardless of the type of contract, will be equivalent to a replacement rate of 25% in each case. In addition, a special adjustment was made to the upper and lower limits of FCS benefits.

- The National Employment Exchange (*Bolsa Nacional del Empleo*) was transferred to the National Employment and Training Agency (*Servicio Nacional de Capacitación y Empleo - SENCE)*; its management will be the object of a call for tenders.

With the reforms described, the current structure of financing and benefits is as shown in the following diagram.

2 Actual coverage is even greater, as the system is designed to protect only wage-earners governed by the Labour Code.



Source: Prepared by the author

3. Supplementary measures

In addition, three measures were adopted including participation of the Unemployment Insurance, in the framework of the "National Agreement on Employment, Training and Labour Protection" (*Acuerdo Nacional por el Empleo, la Capacitación y la Protección Laboral)*, to face the current situation of rising unemployment.

Indeed, a worker and his/her employer may voluntarily agree on Leave for Skills Improvement lasting up to five months, during which time the worker will not provide services and will attend training courses, receiving benefits equivalent to 50% of his/her remuneration for the last six months.[3] The worker retains access to health-care benefits and family allowances, if any, and receives a transportation subsidy to attend the courses. The work contract continues in effect.

Benefits are financed by combining contributions by the employer and the Unemployment Insurance (including social security payments); coverage will be maintained if the contract terminates during or after such leave for workers in compliance with access requirements. This benefit is available to all workers registered with the Unemployment Insurance and holding an open-ended contract, and having made six consecutive payments in effect on the date of application.

The above measure will continue in effect until July 2010 and the employer, while the worker makes use of the benefit, will make an additional contribution to the individual account, amounting to 10%, 20%, 30%, and 40% of the benefit for the second, third, fourth, and fifth month, respectively, together with insurance payments for Work Related Accidents and Occupational Diseases.

Furthermore, workers under fixed-term contracts may benefit from the FCS, and consecutive or non-consecutive contributions paid to the Fund during the 24 months prior to May 1, 2009 will be accepted as requirement for access. This measure, adopted for one time only, is intended to provide access to such workers in the present context of crisis. To retain the right to such benefits, the unemployed worker shall demonstrate his/her situation and be available to accept offers of employment or training. Finally, training grants will be made available for FCS beneficiaries to improve job skills and expedite rehiring in a productive job or activity.

4. The course of unemployment and coverage of the unemployed

At present, certain symptoms suggest that the most negative effects on economic activity are being overcome; however, it is still too early to confirm the consequences on the labour market. In this context, although definitive conclusions regarding the effect of the measures discussed cannot be reached, it is useful to take note of recent trends observed in terms of unemployment and the coverage obtained with the operation of the Unemployment Insurance.

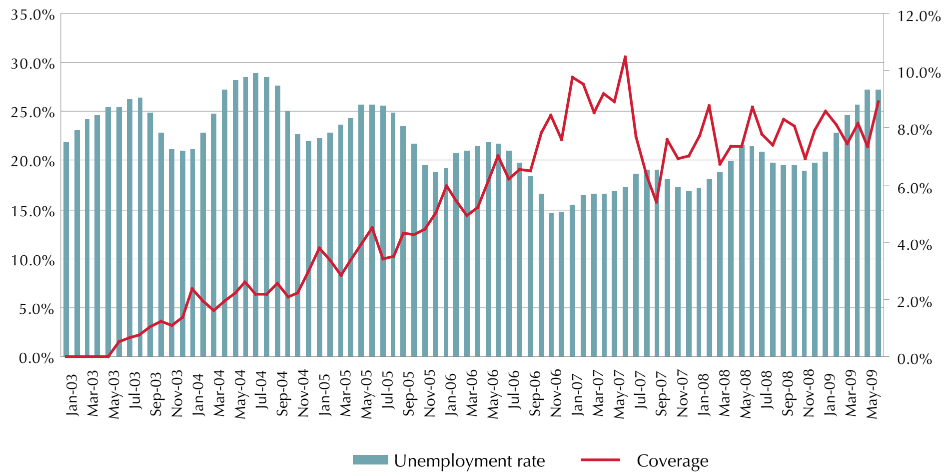
3 With a ceiling of $ 190,000 equal to US$ 532 approx.

Reforms to Unemployment Insurance have basically sought to remove the barriers which unnecessarily restricted access to benefits and extend the potential universe of beneficiaries of the Solidarity Unemployment Fund by including workers with fixed-term contracts. To extended coverage and sufficiency of benefits, linked to the positive effect on the level of benefits obtained by adjusting the upper and lower benefit limits, is added the device which strengthens the counter-cyclical role of the plan by providing additional benefits whenever unemployment rises beyond its trend.[4] Such reforms, ratified by the analysis of their operation since 2003 in a context of decreasing unemployment, were particularly well-timed to face the effects of growing unemployment arising from the current crisis. Thus the country, for the first time, has had an instrument especially designed not only to provide effective protection for the unemployed, but simultaneously to strengthen supplementary measures to attenuate effects on employment and contain unemployment.

Indeed, the most significant effects of the Unemployment Insurance are supplementary to those of the Contingency Programme against Unemployment, which are designed to ensure constant funding for the implementation of active labour market policies in times of crisis, together with application of a significant fiscal package worth approximately US$ 4,000 MM, which includes public expenditure in infrastructure, incentives to investment, and direct transfers to the poorest households.

The information presented in Graph 1 illustrates the behaviour of the unemployment rate and the insurance coverage of workers who have lost their jobs.

Graph 1
Chile: Coverage of beneficiaries and unemployment rate, 2003-2009
(Percentage of total unemployed and percentage of labour force)



Source: Prepared by the author based on data from INE and *Superintendencia de Pensiones*

In a context where the latest information suggests that the rising trend of the national unemployment rate, isolated from seasonal factors, has been arrested, it may be observed that protection of the unemployed has been maintained in spite of a significant impairment of economic conditions, as expressed in successive drops in economic activity from November 2008 to August of the present year.[5]

Ultimately, although the reforms made to the Unemployment Insurance have helped to correct its main shortcomings and were especially well-timed to face the effects of the current crisis, certain challenges derived from its present mode of operation may be identified. The first is to assess the sufficiency of the benefits granted to workers under fixed-term contracts and paid by the FCS, as such benefits are based on relatively low replacement rates. In addition, although benefit duration may be extended at times of high unemployment, it must also be considered that the employment-seeking period also tends to be longer in times of crisis.

Another challenge is to achieve optimum integration between Unemployment Insurance and employment services, the latter having shown scant effectiveness and a persistently low level of development over time. In this context, the Electronic Employment Exchange (*Bolsa Electrónica de Empleo*) is under reformulation with a view to supplying the brokerage process with a more efficient tool. This effort must be supplemented by strengthening the in-the-field structure of Municipal Employment Brokerage Offices to take advantage of employment and job training policies so as to set up an integrated system of employment services.

4 In the three mobile quarters from February to June of the current year, the conditions arose as required to activate the two additional withdrawals, which were charged to the Solidarity Unemployment Fund.
5 According to the Economic Activity Index (*Indice de Actividad Económica - IMACEC*), of Banco Central de Chile.