

# ► Social Protection Spotlight

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## Why are unemployment individual savings accounts not an adequate and equitable solution to unemployment protection?

### Key points

The COVID-19 pandemic has thrown into stark relief the reality of social protection gaps and lack of unemployment protection. Globally, only 16.7 per cent of the unemployed receive any kind of benefit in the event of their losing their jobs or earnings.

The myth of ‘moral hazard’ regularly resurfaces, which holds that unemployment benefits stand to create more unemployment. In such discussions, **unemployment individual savings accounts (UISA)** are presented as an alternative replacement for income in the event of job loss; yet, these UISA cannot provide an adequate, equitable and sustainable form of unemployment protection and should only be considered in the last resort as being complementary to unemployment benefits that are provided by social insurance or are tax financed.

While social protection and savings both contribute to securing income and preventing poverty during a period of suspension of earnings, savings mechanisms cannot be considered as social insurance. UISA generally do not provide adequate social protection and do not align with certain of the international principles of social protection enshrined in ILO Social Security (minimum standards) Convention, No. 102 (1952) and the Employment Promotion and Protection against Unemployment Convention, No. 168 (1988). This is for the following reasons:

- UISA do not provide for risk pooling across economic sectors, type of employment and age

and gender. They leave persons in these latter categories more vulnerable to unemployment (for example, workers on short-term contracts, seasonal workers) and without adequate and predictable protection or solidarity mechanisms. Women are particularly represented among those with a higher unemployment risk.

- UISA do not comply with the principle of collective financing, which requires that the cost of benefits and the expenses for their administration are borne collectively by insurance contributions, taxation or both.
- The cost of UISA is higher for two reasons: first, the contribution rate for UISA must be set at a sufficient level to build up individual savings that can adequately replace previous earnings; and second, additional protection financed by tax resources will be necessary to provide replacement income for unemployed workers whose work patterns prevent them from cumulating sufficient savings.
- UISA are perceived as personal savings and provide limited or no conceptual and institutional links with active labour market programmes, or policies, (ALMP) for facilitating return to suitable employment, which is the second objective of an unemployment protection system.
- Because of the absence of such links, UISA are not in a position to support economic transformations and a just transition to environmentally sustainable economies.

## Introduction

During the COVID-19 pandemic, unemployment protection schemes played a crucial role in ensuring income security for workers and their families, providing safeguards against them falling into poverty or being pushed into the informal economy. Unemployment protection schemes also acted as automatic stabilizers and stimulated economic recovery (ILO 2021).

In 2020, in response to the pandemic, 95 countries implemented unemployment protection measures and 110 other countries implemented job or income protection measures.<sup>1</sup> The COVID-19 pandemic and its ensuing job crisis were a reminder that unemployment protection continues to be the least implemented branch of social security, with only 16.7 per cent of those unemployed worldwide receiving a benefit (ILO 2024). This shortfall is attributable to the absence of unemployment protection schemes, the legal exclusion of certain categories of workers, the prevalence of informal employment in many countries, high rates of youth, and long-term, unemployment and restrictive qualifying conditions (ILO 2021; 2024).

In some developing countries that are contemplating the introduction of contributory unemployment protection schemes, mandatory or voluntary UISAs have gained some popularity. UISA can fulfil an important function as a savings product, guaranteed by the state, for a population that usually has limited access to private insurance and savings institutions. Provisions on individual savings accounts may also allow for early withdrawal in exceptional circumstances, such as in Jordan in the case of medical and education expenses.

Firstly, UISA are usually implemented with the argument that they address the 'moral hazard' issues associated with social insurance unemployment schemes. It is presumed that individuals, by having to draw on their own savings, will be more strongly motivated to avoid unemployment or else to return to employment more quickly than they would under a traditional unemployment insurance system (Robalino et al. 2009; Sehnbruch et al. 2020). However, the evidence on the possible negative impact of unemployment insurance on labour market outcomes is mixed. A simulation study in Malaysia in 2009 showed that the introduction of the employment insurance scheme would only have a modest impact on levels of unemployment (Margolis et al. 2012). Furthermore, Tatsiramos (2014) in his study concludes that while unemployment benefits are typically associated with a lower unemployment exit

rate, in particular at the beginning of the unemployment spell, a small positive effect with respect to the duration and level of benefits can also be observed on wage level and duration in new employment (Tatsiramos 2014).

Secondly, UISA are promoted as a mechanism for extending protection to workers in the informal economy, especially in contexts where there is weaker institutional capacity to monitor employment status (Robalino et al. 2009). However, because of the absence of risk pooling through insurance mechanisms, the required contribution rate for UISA will be higher and level of benefits less predictable than with unemployment social insurance, in particular for workers with unstable work histories, short contracts and low income; they are accordingly less adequate and equitable for workers at the edge of formal employment. Experience has shown that governments have had to finance a solidarity component for workers with limited saving capacity (box 2). In a social insurance scheme, solidarity typically operates across insured workers and enterprises.

The nature of the UISA model, being individual savings and not a social insurance mechanism, brings some important implications in terms of i) social security principles, ii) economic cost and iv) employment promotion that are discussed in this note.

For the purpose of this note, and because to date only two countries have implemented unemployment individual savings accounts, the analysis has also included a review of prefunded separation payment schemes to bring to bear further experience and evidence.

## Social insurance is the most commonly applied unemployment protection mechanism

Unemployment protection schemes (either social insurance or tax-financed schemes) can be found in 93 countries and territories. In most cases, unemployment protection is provided through a social insurance mechanism (87 countries), either alone (16 countries), in coordination with a non-contributory mechanism (38 countries) or in parallel with a separation payment (33 countries). More recently, unemployment schemes based on social insurance are also being established

<sup>1</sup> ILO Social Protection Monitor. Available at <https://www.social-protection.org/gimi/ShowWiki.action?id=3426> (accessed on 21.11.2024).

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in middle income-countries, for example, in Grenada, Indonesia, Iraq, Malaysia, the Philippines and Viet Nam (box 1) (ILO 2021; 2024).

### ► Box 1: Viet Nam's unemployment insurance scheme

Viet Nam's Social Insurance Law, adopted in 2006, introduced unemployment insurance provisions, with the collection of contributions commencing in 2009 and the first benefits paid in 2010. Since 2013, these provisions have shifted to the Employment Promotion Law, with the intention of fostering the link with activation measures. In 2020, 13.3 million workers were covered (27 per cent of the employed), with nearly 1.1 million unemployed persons receiving benefits. These figures testify to the attractiveness of the unemployment insurance scheme in Viet Nam, including during the COVID-19 pandemic. The 2024 draft Employment Promotion Law reform proposes to expand coverage from beyond the current three-month contract rule to include workers with at least a one-month employment contract and part-time workers and salaried managers of enterprises and cooperatives, in alignment with the 2014 Social Insurance Law. However, self-employed workers remain excluded from the scope of the unemployment insurance. They are nevertheless legally covered for other social insurance benefits on a voluntary basis. Benefits remain at 60 per cent of the average salary, accessible after 12 months of contribution and for a duration depending on the contribution period. The proposed reform will above all continue to strengthen integration with employment promotion programmes, for example, job placement, vocational training and skills upgrade for the purpose of retaining employment. The reform also aims at enhancing the enforcement, transparency and accountability of the scheme.

Source: Carter et al. (2013); ILO (Forthcoming a).

In a minority of cases, individual savings accounts have been introduced, alone or complementary to social insurance. In Jordan, benefits in the event of unemployment are organized through UISA only,<sup>2</sup> while in Chile, UISA are complemented by a social insurance component. In Ecuador and Gabon, savings accounts constitute a top-up of social insurance benefits. Costa Rica, Dominica, Honduras, Panama and Peru have established a separation payment fund in the form of savings accounts to meet the severance payment and termination regulations. In Colombia and Venezuela, a social insurance mechanism coexists with a separation payment fund organized in the form of a savings account; in Brazil, both mechanisms are complemented by



A young worker at the Nobland garment factory in Ho Chi Minh City, Viet Nam. © ILO/ A. Dow

tax-financed benefits for those uncovered (box 2) (ILO 2024).

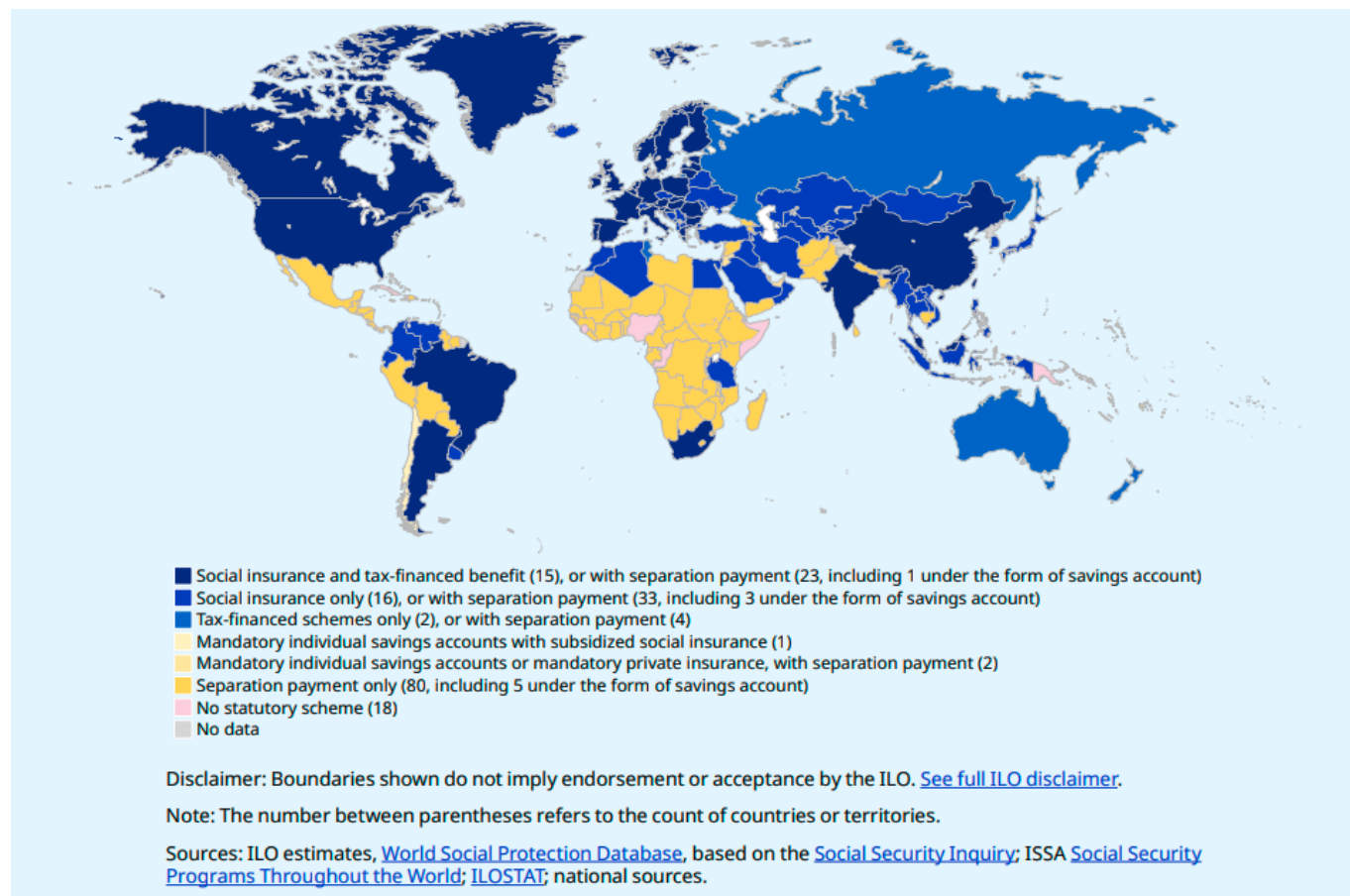
In countries where individual savings accounts already exist, including through severance payment funds, introducing a social insurance mechanism to protect against unemployment remains desirable. However, it must also be acknowledged that individual savings accounts offer a services complementary to social protection, such as savings for purchasing a home, financing children's education or covering cases of temporary financial hardship. This would be particularly appropriate for workers who lack access to commercial saving products. In such circumstances, savings accounts could be envisaged as a top-up of social insurance benefits that must guarantee at least an income replacement of 45 per cent of the reference wage.

<sup>2</sup> At the time of publishing the brief, Jordan was discussing a reform of the UISA to an unemployment insurance schemes based on social insurance mechanism.

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► **Figure 1: Unemployment protection (cash benefits) anchored in law, by type of scheme, 2023 or latest available year**



► **Box 2: Separation payment funds in Central and South America**

In Central and South America, prefunded separation accounts collectively financed by the employer and linked to the worker are common (Costa Rica, Dominica, Honduras, Panama and Peru) and are sometimes complementary to social insurance unemployment schemes (Brazil, Bolivarian Republic of Venezuela, Colombia) or for a specific economic sector only, for example, in Argentina in the construction sector.

They are different from UISA in Chile and Jordan, insofar as they aim to support employers in complying with their responsibilities vis-à-vis labour laws and regulations for separation benefits (ILO Termination of Employment Convention, 1982 (No.158)). Those schemes, while being valuable for securing workers' labour rights, are nevertheless not considered as

social security mechanisms for unemployment compensation schemes per se (see Employment Promotion and Protection against Unemployment Recommendation, 1988 (No. 176), Para. 30). The creation of such funds should be considered as an initial measure to protect workers when countries do not meet the conditions for implementing an effective social security mechanism for unemployment conditions in the areas of employment service, social insurance administrative capacity, labour market information and level of employment formalization (Employment Promotion and Protection against Unemployment Recommendation, 1988 (No. 176), Para. 26).

Source: ILO, 2024.

## UISA do not comply with international social security principles

The risk of losing earnings as a result of unemployment is first and foremost an idiosyncratic one, such as illness or accident, although certain covariant effects during economic downturns also figure prominently as a course of such risk. This is why insurance mechanisms are better adapted than savings to covering such a contingency as unemployment. The provision of unemployment benefits on the basis of social security principles, that is, through social insurance or non-contributory schemes, remains the most common approach internationally. In particular, it is aligned with the international principles of social security and unemployment protection, rooted in the ILO Social Security (Minimum Standards) Convention, 1952 (No. 102), ILO Employment Promotion and Protection against Unemployment Convention, 1988 (No. 168) and its accompanying Recommendation No. 176, and the ILO Social Protection Floors Recommendation, 2012 (No. 202).

Furthermore, UISA implemented on their own would be deficient in light of the following three reasons entailed by fundamental considerations of social security:

- They do not allow for risk pooling, redistribution and solidarity across sectors, size of enterprises, type of contract, geographical regions and age and gender.
- They are not based on collective financing.
- They do not allow for predictability of benefits.

In the case of Jordan, given that the unemployment protection scheme is a savings account mechanism, it is unclear how the benefit will be paid at the prescribed level for the maximum entitlement period if a person's account lacks sufficient funds, as required by ILO Social Security (Minimum Standards) Convention, No. 102 (1952) (ILO, 2022). Generally, UISA have limited links with active labour market programmes, or policies (ALMP), and thus do not fulfil the objective of facilitating return to suitable employment, which is also at the core of unemployment protection schemes consistent with international social security standards.

### ► Box 3: International Social Security Standards on Unemployment Protection

The following fundamental elements of social security, embedded in the ILO Social Security (Minimum Standards) Convention, 1952 (No. 102), are only partially guaranteed through UISA:

- The right to benefits shall be secured upon completion of a qualifying period (Article 23).
- The provision of benefits shall be granted throughout the contingency or for a sufficient period to serve their purpose (Article 24.1).
- The level of benefits shall be sufficient in terms of income replacement or to secure basic needs (Article 66).
- The cost of the risk shall be collectively borne in a way to avoid hardship on persons with low income while accounting for the economic situation of persons protected (Article 71.1).

Other important elements are:

- The general responsibility of the State for the due provision of benefits.
- Equality of treatment between nationals and non-nationals.
- The participation of representatives of protected persons and employers in the administration of the scheme.
- The right to complaint and appeal in case of refusal or suspension of the benefit or with respect to benefit quality or quantity.

ILO Employment Promotion and Protection against Unemployment Convention, 1988 (No. 168) and its accompanying Recommendation No.176 extends the scope of application (for example, to seasonal workers, apprentices and new entrants into employment) and the level of protection. It emphasizes the complementary objectives of:

- ensuring individuals enjoy income security when they lose their earnings owing to inability to obtain suitable employment
- promoting full and productive employment, including through employment services, vocational training and guidance.

Amplifying Convention No. 168, Recommendation No. 202 urges that the design and implementation of social protection floor guarantees combine preventive, promotional and active measures that advance decent employment and productive economic activity, notably through vocational training for productive skills, entrepreneurship and sustainable enterprises.

Source: Peyron Bista and Carter (2017); ILO (Forthcoming b).

## UISA are more costly and provide less protection

### Inadequate levels of protection

The limitations of UISA in providing adequate protection have been recognized by some of the proponents of UISAs. Thus, Holzmann and Vodopivec (2011) observe: “One of the main problems of a pure UISA system is that it forgoes the redistributive effects available in a system that pools the unemployment risks of the entire working population. Because of the concentration of unemployment among certain groups, UISAs may not provide adequate benefits for temporary workers or those with low incomes. This creates the problem of providing alternative sources of income for workers with insufficient funds in their accounts.”

UISA schemes are generally viewed as less conducive to the intended purpose because they provide limited duration of protection to unemployed workers, in particular low-income, short-term and temporary workers (Feldstein and Altman 1998; Vodopivec 2008; Juergens-Grant 2022). The benefits derived from them prove to be inadequate for those who experience frequent or long spells of unemployment as with temporary workers, who are more exposed to the risk of unemployment (Peyron Bista and Carter 2017).

Ultimately, UISA schemes require a significant allocation of governments’ resources to provide protection to those who do not cumulate sufficient savings to protect them throughout the unemployment period.

In Jordan, the government issued a series of ad-hoc emergency measures in response to the COVID-19 pandemic via the Tadamon and Musaned Programmes so as to support unemployed persons insured at the Social Security Corporation, including those covered by the Unemployment Insurance Fund (UNICEF 2020). The measures included an advance on individuals’ savings and a one-off unemployment allowance. The measure amounted to about 94.9 million Jordan Dinars (133 million USD) (Mahmoud 2020; Government of Jordan 2020).

In 2002, Chile launched its unemployment protection scheme, based on a mandatory individual savings account financed by workers and employers’ contributions and complemented by a solidarity component, collectively financed by employers and the government. In 2009, the coverage was extended to temporary workers, benefit levels were increased and the link with activation programmes was consolidated. Thus, under the scheme, unemployment protection is first provided through the

UISA in accordance with mandated replacement rates. If a person has exhausted the funds in the individual account, the solidarity component extends benefits for the remaining entitlement duration for up to five months; however, this comes with a lower replacement rate for temporary workers (Carter et al. 2013; Guillermo et al. 2020). In 2012, the OECD reported that for most workers, the savings represented less than a month of minimum wage (OECD 2012), though replacement rates were subsequently increased and more flexibility was incorporated into the qualifying conditions. In 2023, an automatic provision for extension of benefits in case of catastrophe was introduced into legislation, making the scheme more adaptable when responding to shocks, including those related to climate change (ILO 2024).

Finally, in countries with limited financial products and underdeveloped financial markets, the expected return on savings account assets may be low or even negative when they are considered on a real return basis. In such circumstances, using a pay-as-you-go financing method might ensure better predictability of benefits and thus contribute to building up trust in the scheme among workers and employers.



A quality checker smiles during her shift in a garment factory in Jordan. © Marcel Crozet / ILO

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### Higher contribution rates

Individual savings accounts require higher contributions than a typical social insurance scheme offering a comparable level of benefits (box 4). The higher cost derives from the lack of risk pooling that is characteristic of any insurance and withdraw provision on grounds other than loss of employment. Therefore, the contribution rate for a UISA must be set at a sufficiently high level to build sufficient savings to compensate for the loss of earnings over a period of at least a few months.

#### ► Box 4: Simulations of the cost of the unemployment insurance system of Malaysia

In 2012–2013, the Government of Malaysia and Malaysian workers' and employers' representatives reviewed different options for the introduction of an unemployment insurance system, one integrating an active labour market and savings accounts component.

The preliminary cost assessment, subject to an actuarial validation, that informed the social dialogue is presented below:

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
<b>Pillar 1</b>	UI: 0.5% equally shared by employers and workers	UI: 0.5% equally shared by employers and workers	UI: 0.5% equally shared by employers and workers	UISA: 4% equally shared by employers and workers
<b>Pillar 2</b>		ALMPs: 0.2% of wages shared by employers and government	ALMPs: 0.2% of wages shared by employers and government	UI: 0.3% equally shared by employers and workers
<b>Pillar 3</b>			UISA: 2% equally shared by workers and employers	ALMPs: 0.2% of wages shared by employers and government
<b>Total contribution</b>	0.5%	0.7%	2.7%	4.5%

In 2018, the employment insurance scheme was introduced, financed by a contribution rate of 0.4 per cent equally shared between workers and employers, and including a component of vocation training support.

Note : ALMPs: active labour market programmes; UI: social insurance-based unemployment insurance; SA: savings accounts.

Source: Carter and Bédard (2012); Ponniah Raman (2020); PERKESO (2024).

### Limited links with employment promotion

#### Employment termination reasons, job search requirements and conditions for accessing benefits

UISA are perceived as personal savings, so payments are not attached to termination reasons or job search requirements for continuing to receive benefits. In Chile, UISA can be withdrawn irrespective of the reasons for the termination of employment (Robalino et al. 2009; Montt et al. 2020; Pinto Velasquez 2021). In Jordan, as well as in most countries with individual savings accounts for prefunded severance payment, the scheme allows for withdrawal of savings whenever the workers may so desire. Again in Jordan, following the amendments of 2019 to the Social Security Law, withdrawal of savings became allowed for education and medical treatment, since resulting in the withdrawal of significant cash amounts (ILO 2022). However, the existence of such a facility potentially leaves workers without protection in the event of job loss. Evidence of this situation has been documented in the case of the Brazilian Fundo de Garantia do Tempo de Servico (Barros et al. 2000).

If access to individual savings is not conditional upon the active search of employment as is mandated in Chile, benefits are likely to be paid until accounts are exhausted, resulting in a higher cost of the overall scheme (Bédard 2012).

#### The important link with labour activation, support to enterprises and avenues for extending coverage to all workers

One of the two objectives of an unemployment protection scheme is to support return to suitable employment. Therefore, unemployment benefits are more effective if complemented by active labour market policies or programmes that support workers reinserting into formal employment that matches skills with jobs (Peyron Bista and Carter 2017). Unemployment insurance schemes that complement active labour market programmes, or policies, (ALMP) can play an important role in supporting job search in the formal economy and in turn boost the formalization of employment such as reported in Mexico (Bosch and Esteban-Pretel 2013). In the absence of a tight link between income replacement and active labour market programmes, such opportunities may be missed (Bosch 2016).

Comprehensive unemployment insurance systems or similar employment insurance systems, such as those found in Germany, Japan, the Republic of Korea, Malaysia and Viet Nam, support enterprises and workers in safeguarding jobs during periods of economic downturn through the implementation of job retention schemes (Carter et al. 2013; ILO 2021). UISA, by contrast, do not allow for such an extension of services and support (Peyron Bista and Carter 2017).

Finally, the enhanced link between unemployment protection and active labour market programmes, in particular employment services, offers an avenue for extending protection to those still outside unemployment insurance coverage, including self-employed persons and workers in the informal and rural economy (ILO 2020; ILO and FAO 2021). In Mauritius, for instance, access to transition unemployment benefits is not contingent upon contributions to the unemployment insurance scheme (financed by employees at 1 per cent of the salary and by employers at 2.5 per cent of it); rather, it is conditional upon active labour market measures such as the country's Workfare Programme Fund, which is open to workers in all types of employment, including those who are self-employed or work in the informal economy (Liepmann and Pignatti 2019; ILO and UNDESA 2021).

## Policy orientations

In order to ensure that unemployment protection schemes fulfil their role in ensuring adequate income security for workers in the event of loss of earning or jobs, and in the interests of promoting full and decent employment, the following considerations must be recalled:

- The principles of collective financing for unemployment protection schemes guarantee adequate and predictable benefits at a lower cost and ensure risk pooling across economic sectors, types of employment contracts and gender and ages. In light of these considerations, it is axiomatic that unemployment protection is more effective when provided through insurance mechanisms and not individual savings, in particular for those more likely to be unemployed such as short-term, seasonal and part-time workers.
- In countries where individual savings accounts already exist, including through severance payment funds, introducing a social insurance mechanism to protect against unemployment is recommended. However, savings accounts might complement unemployment insurance that includes defined benefits by being maintained separately and in parallel to the social insurance scheme since they offer a valuable service, in particular to those workers who lack access to commercial saving products.
- When designed with appropriate parameters in place (such as appropriate level of benefits, contribution rates and qualifying conditions) and if complemented with active labour market policies that support placement in a formal and suitable job, unemployment insurance can function as an important instrument for providing income security to workers and also for promoting transitions to the formal economy and to environmentally sustainable economies and societies.
- For extending unemployment protection to all workers, public social security and labour market institutions should be adapted to the circumstances and needs of those self-employed persons and workers and enterprises currently in the informal economy, conditioned by a view to facilitating their transition to the formal economy. This can be achieved through a greater accessibility by workers to a network of institutions, services tailored to their needs, job vacancies matched to their skills and other measures to promote decent work for them. This requires coherent employment, skills development and formalization policies, in tandem with the political will and adequate financing. Such approaches are developed and implemented with the support of the [Global Accelerator for Jobs and Social Protection for Just Transitions](#).



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