

Social protection and job displacement in developing countries



In brief

- Across the development path, social insurance programmes such as job displacement insurance schemes become an increasingly important part of governments' role.
- This brief uses unique administrative data from São Paulo, Brazil, to study displaced workers' need for insurance and the insurance value of the two most common government-mandated job displacement insurance programmes: severance pay (SP) and unemployment insurance (UI).
- The results show the need for job displacement insurance is sizable, even in a context of high informality. Moreover, we find that the insurance value provided by these programmes can be very sensitive to their disbursement policy. This is particularly relevant for SP schemes, which are much more common than UI schemes in developing countries.
- The authors make three policy recommendations relevant to policymakers across the developing world.

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Policy motivation for the research

This project aims to shed new light on the extent to which job displacement insurance schemes in developing countries can mitigate welfare losses for workers after a layoff. Currently, 12% of the labour force in Brazil is unemployed and 40% of the labour force is informally employed. Therefore, government policies to tackle unemployment shocks and informality are a high priority, and likely to be relevant to other developing countries facing similar challenges.

More broadly, this research agenda can be important for growth as social insurance mechanisms can be welfare enhancing, and countries tend to increase expenditures on such schemes across the development path. Using data from 139 countries collected for this project, Figure 1 shows that an increasing set of countries adopted some form of government-mandated job displacement insurance over time, but that the relative prevalence of different policies varies systematically across countries. The most common government-mandated programmes are severance pay (SP) – lump-sum payments at layoff – and unemployment insurance (UI) – periodic payments *contingent* on non-employment.¹ Both programmes are quite prevalent and often coexist, but while UI programmes are mostly found in richer countries, SP programmes exist across levels of development and are thus relatively more common in developing countries (Holzmann 2012). While there is a vast literature on UI, SP programmes have received much less attention. This evidence gap is particularly relevant for developing countries, which rely relatively more on SP. The Sustainable Development Goal 1.3 “*Implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable*” highlights the importance of social insurance schemes, and there is a need for more evidence-based policy discussion using findings from developing country contexts in order to inform the relevant trade-offs across different job displacement insurance policies.

In practice, job displacement insurance can only cover *formal* workers (i.e., who are formally reported to the government) and benefit payout schemes can only be made contingent on non-*formal*-employment in developing countries, which typically have high levels of informality. Much of the existing debate between UI and SP in that context focuses on mitigating the *moral hazard* problem with UI. Displaced workers may have lower incentives to find a new formal job while eligible for UI benefits. This concern exists

1. The study focuses on the benefit payout schemes – lump-sum vs. state-contingent. Job displacement insurance programs also differ in their *financing schemes* – insurance-based vs. savings-based (Parsons, 2016). According to this typology, SP and UI programmes are typically insurance-based. *Severance Savings Accounts* (SSA) – forced savings accounts that workers can withdraw from at separation – are common in Latin American countries. *Unemployment Insurance Savings Accounts* (UISA) – forced savings accounts from which workers can withdraw a fixed amount periodically, contingent on non-employment – are often discussed but remain rare in practice.

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in all countries, but it could be aggravated in developing countries because of the possibility to work informally and the limited state capacity to monitor workers' reemployment status.² SP has the advantage that it does not generate such moral hazard and requires less administrative capacity, as it shifts to firms the mandate to provide payments upon layoff and does not require government offices to monitor workers' reemployment status .

However, we actually know little about the insurance value provided to workers by SP and UI schemes, or about formal workers' need for any type of job displacement insurance in developing countries. The need for insurance may be higher if traditional means of self-insurance (e.g., formal credit) are more limited (Chetty and Looney, 2007); it may also be lower if formal employment is not workers' usual employment status or if informal jobs are easy to find and close substitutes for formal jobs. Moreover, the insurance value of SP relies critically on workers' ability to "dis-save" their lump-sum amount progressively after layoff. Despite a growing body of evidence of excess sensitivity to cash on hand from other contexts, the role of disbursement policies in affecting the insurance value of job displacement insurance schemes has been largely overlooked. At the same time, it is not clear that one should observe the same excess sensitivity in this context as the lump-sum is triggered by a negative shock (i.e., a layoff). Empirical studies, therefore, are relevant to inform policy design.

Overview of the research

Our study aims to shed light on the need for job displacement insurance in a developing country context, and on the relevant policy trade-offs between different job displacement insurance schemes. We follow a standard approach in the UI literature that evaluates workers' need for insurance and the insurance value of various policies by studying workers' ability to smooth consumption after layoff. We take advantage of a rare combination of high-frequency expenditure data and matched employee-employer data for more than 400,000 workers over five years in the state of São Paulo, Brazil. This is a rich empirical setting in which displaced workers are eligible for both UI and SP, with variation in benefits across workers that we can exploit in the analysis.

We find that workers increase consumption at layoff by 35% despite experiencing a long-term consumption loss of 17% when they stop receiving any benefits.

We find that workers *increase* consumption at layoff by 35% *despite* experiencing a long-term consumption loss of 17% when they stop receiving any benefits (Figure 2). We use the word 'consumption' because these patterns are robust across expenditure categories, and are not driven by durable goods. The long-term loss is comparable to estimates from other studies on UI programmes, despite the high labour market informality in our setting. Using administrative data on UI payments, we also find that

2. Gerard and Gonzaga (2016) show that the incentive effect of UI programmes in that context – the disincentive to find a new *formal* job – is not necessarily larger, despite the high informality.

workers spend 20% more in the week they receive their monthly UI paycheck (Figure 3). In addition, they fail to smooth consumption in anticipation of the (expected) drop in income when workers exhaust UI benefits, which is associated with a 10% drop in consumption (Figure 4). These results highlight the importance of the different ‘disbursement’ policy between SP and UI – beyond their different ‘contingency’ policy – when consumption is highly sensitive to the timing of benefit payment. In particular, the ‘trenched’ disbursement of UI benefits due to its contingency policy may help workers better smooth consumption in that case, thus increasing the insurance value of UI compared to SP. The associated welfare gains for workers could partially mitigate concerns related to the moral hazard problem with UI programmes.

Policy recommendations

- **Job displacement insurance programmes can lead to substantial welfare gains for workers, even in a context of high informality**

Many developing countries have large informal labour markets. Job displacement insurance can only cover formal workers (i.e., who are formally reported to the government) and payout schemes can only be made contingent on non-formal-employment. Therefore, the need for job displacement insurance may differ in developing country contexts. Although traditional means of self-insurance (e.g., formal credit) may be more limited, the need for insurance may be smaller if formal employment is not the workers’ usual employment status or if informal jobs are easy to find and close substitutes for formal jobs. In this study, we find evidence that the need for job displacement insurance is sizable: the long-term loss in consumption for displaced workers is comparable to estimates from other studies, despite the high labour market informality in our setting.

- **Disbursement policies matter and should be considered carefully.**

We find that consumption is very sensitive to cash-on-hand, even in the context of a relevant and salient negative shock, i.e., the loss of a formal job. This highlights the importance of the different ‘disbursement’ policy between SP and UI – beyond their different ‘contingency’ policy – when consumption is highly sensitive to the timing of benefit payment. In particular, the trenched disbursement of UI due to its contingency policy may help workers better smooth consumption in that case, thus increasing the insurance value of UI compared to SP. In fact, we find the majority of displaced workers in a survey that we conducted with UI applicants would not prefer to receive their UI benefits as a lump-sum payment upon layoff, despite the clear financial advantages. The associated welfare gains for workers due to the better consumption

smoothing could partially mitigate concerns related to the moral hazard problem with UI programmes.

- **Lump-sum disbursement of benefits can be relevant for other policy objectives.**

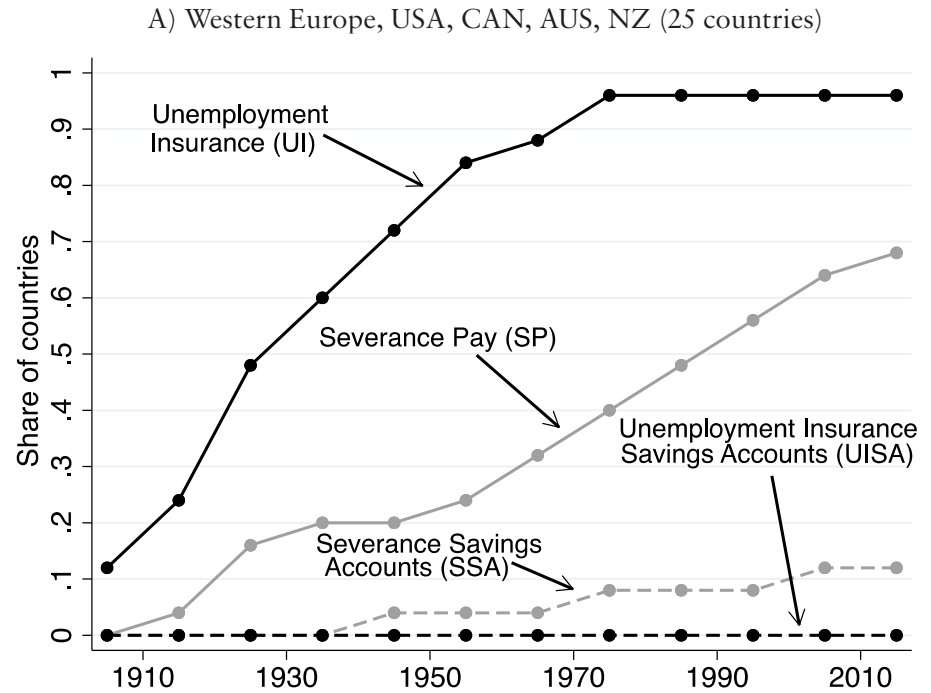
Our results do not imply that the lump-sum disbursement of benefits should generally be avoided. The same reasons that may prevent workers from dissaving their SP amount more slowly may justify the existence of forced savings to mobilise the resources necessary for lumpy investments that workers may not be able to make otherwise. The key implication of our findings is that, if the goal of a policy is to provide insurance to displaced workers, a lump-sum disbursement could undermine this goal. Workers may still benefit from forced savings and occasional access to these financial resources in a lump-sum fashion for other purposes or at other times.

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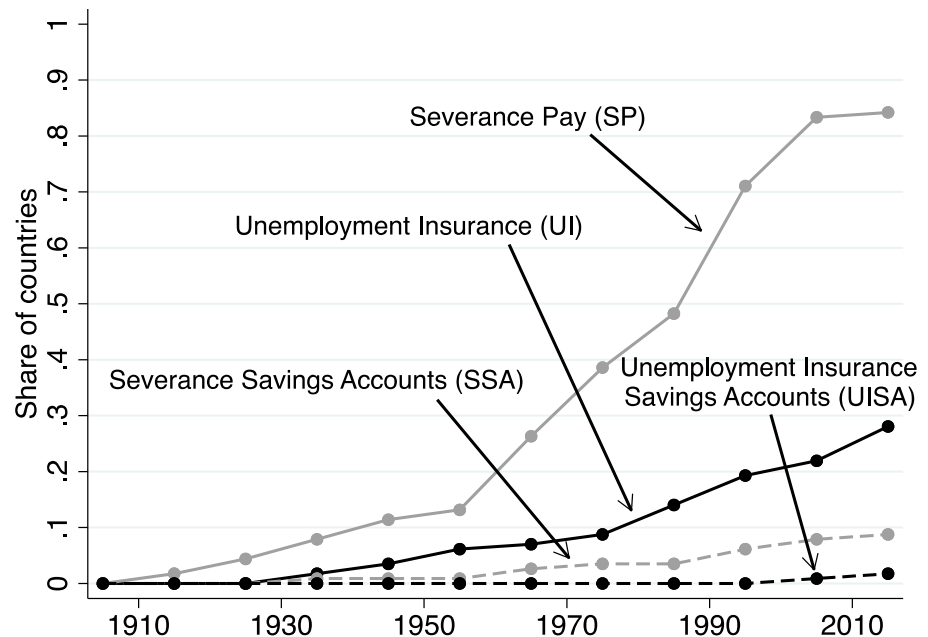
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Figures

Figure 1: Job displacement insurance (government-mandated) around the world

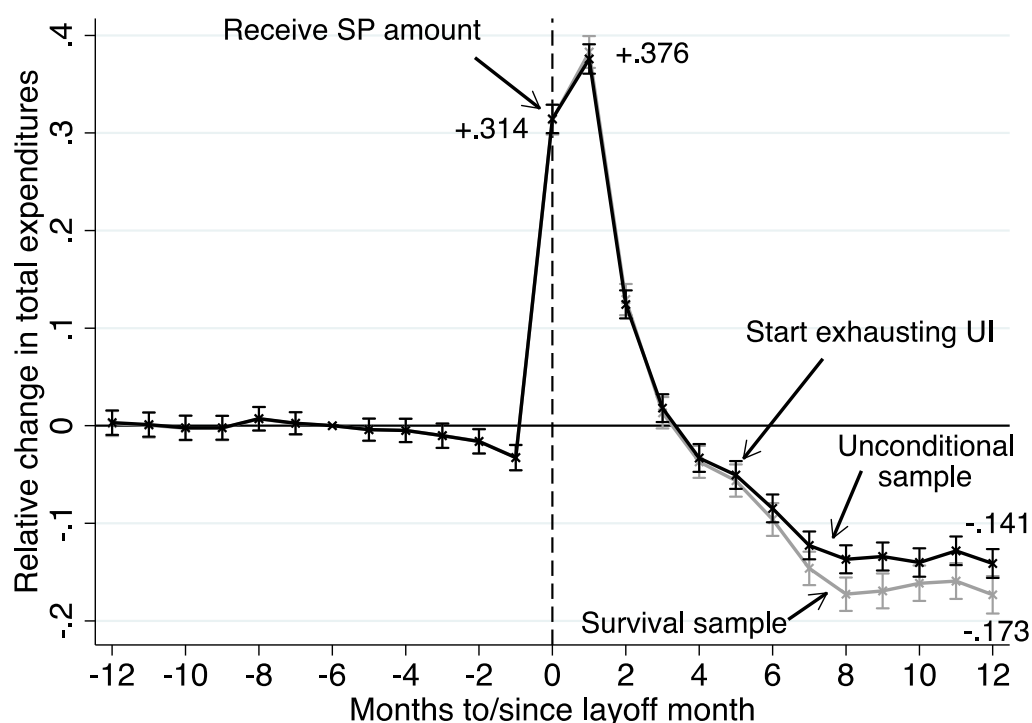


B) Africa, Asia, Rest of Americas (114 countries)



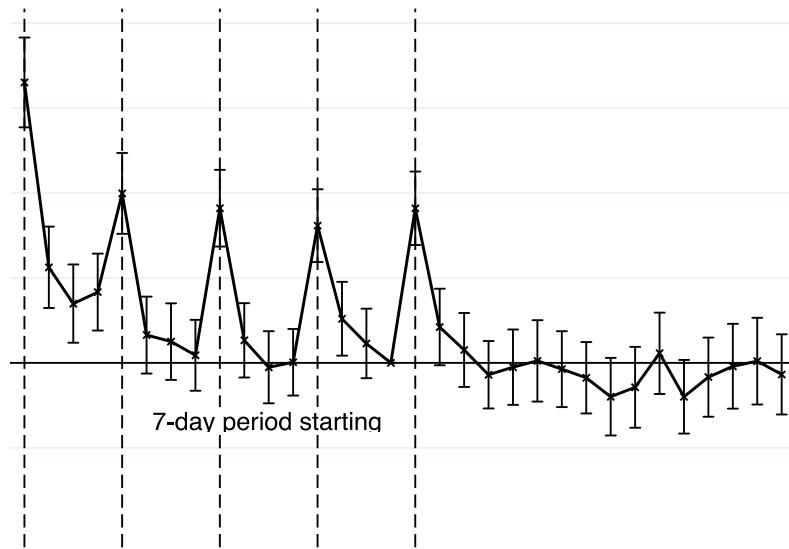
Notes: The figure displays the share of countries with government-mandated job displacement insurance programs by decade. We collected data for 139 countries (see Appendix D for details) in Western Europe, USA, Canada, Australia, New Zealand (panel a), and Africa, Asia, rest of the Americas (panel b). The programs are categorized based on their *benefit payout schemes* -- lump-sum vs. state-contingent -- and *financing schemes* -- insurance-based vs. savings-based, such that we display separate graphs for Unemployment Insurance (UI; state-contingent, insurance), Severance Pay (SP; lump-sum, insurance), Unemployment Insurance Savings Account (UISA; state-contingent, forced savings), Severance Savings Account (SSA; lump-sum, forced savings).

Figure 2: Consumer spending profile before and after the loss of a formal job



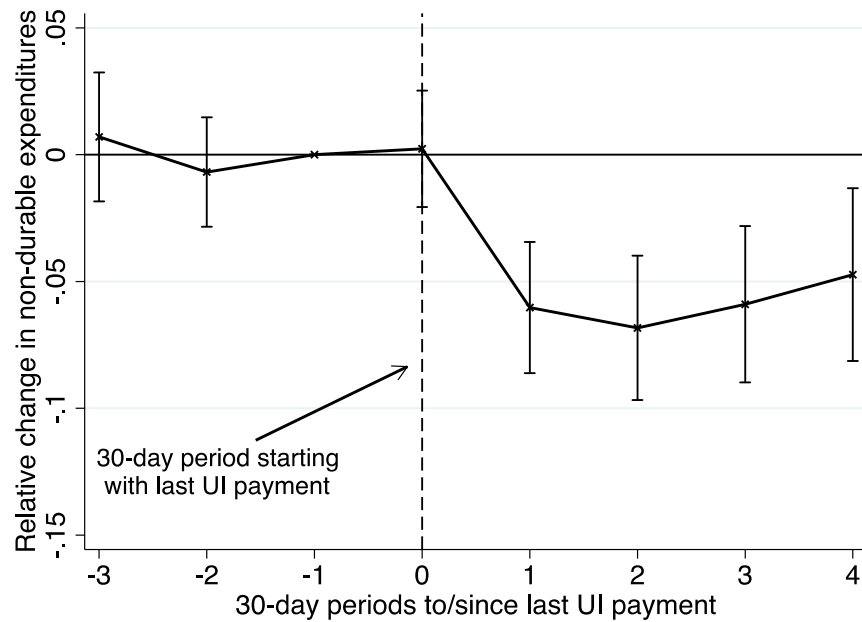
Notes: The figure presents difference-in-differences results (point estimates and 95% confidence intervals) for relative changes in total expenditures before and after the displacement event (the vertical line indicates the displacement month). The black line displays estimates using all displaced workers (“unconditional” sample). The red line displays estimates restricting the sample to displaced workers who remain non-formally-employed in each month after layoff (“survival” sample). The pattern around UI exhaustion is fuzzy because workers exhaust UI benefits between months 5 and 7 after layoff, but we present the results of an event analysis centered around UI exhaustion (rather than displacement) in the paper, showing that workers fail to smooth consumption in anticipation of the drop in income at UI exhaustion.

Figure 3: Consumer spending profile around UI payment dates



Notes: The figure investigates how non-durable expenditures change around UI payment dates within a month by presenting the results (point estimates and 95% confidence intervals) of an event analysis centered around UI payment dates for relative changes in non-durable expenditures. We use the subset of displacement events in our sample for which workers were eligible for 5 months of UI and were observed drawing 5 monthly UI payments. The window of analysis starts at the first UI payment date. We then divide the time between two payment dates into four “quarter-month” periods: three 7-day periods spanning the first 21 days since a UI payment (the first period includes the payment date) and a fourth period including the remaining days until the next UI payment (vertical lines indicate 7-day periods starting with a UI payment date). To investigate how expenditure levels evolve after UI exhaustion in the same analysis, we construct comparable time periods after the last UI payment. The sharp increases in the week of UI benefit receipt are similar if we restrict attention to workers who remain without a formal job until the end of the window of analysis.

Figure 4: Consumer spending profile around UI exhaustion



Notes: The figure presents the results (point estimates and 95% confidence intervals) of an event analysis centered around the date of the last UI payment (i.e., UI exhaustion) for relative changes in non-durable expenditures. As in Figure 3, we use the subset of displacement events in our sample for which workers were eligible for 5 months of UI and were observed drawing 5 monthly UI payments. The figure aggregates the data by 30-day periods centered around UI exhaustion (the vertical line indicates the 30-day period starting with the last UI payment date). The drop at UI exhaustion is even larger (above 10%) if we restrict attention to workers who remain without a formal job until the end of the window of analysis.