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Summary

Chile continues to lead the way in innovative approaches to social safety net reform. Using personal accounts for unemployment insurance, Chile has succeeded in creating a system that financially supports the unemployed while offering greater incentives to seek employment. Oregon and the rest of the country should follow Chile's lead.

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Chile's unemployment insurance model

By William B. Conerly, Ph.D.

Chile is leading the way in social safety net reform—again. In 1924, Chile became the first country in the western hemisphere to have a social security system. In 1981, it became the first country in the world to have personal accounts for social security. Last October Chile again led the way by becoming the first country to use personal accounts for unemployment insurance. Chile's move should prod Oregon and the rest of the country to rethink the way we provide a safety net to unemployed workers.

Chile's workers pay 0.6 percent of their wages into the accounts, while employers pay 2.4 percent. Most of that hefty funding stays in an account in the individual worker's name until the worker becomes unemployed. At that time, he or she can draw 30 to 50 percent of the previous wage, for up to five months. In contrast to the U.S. system, the worker receives benefits regardless of whether he or she quit or was fired. After all, it is the worker's own money. A portion of the funds go into a general account. This helps people whose own accounts have insufficient balances, such as young workers who have not yet built up substantial assets in their individual accounts.

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Chilean workers who don't use up all of their unemployment insurance funds will roll the money into their retirement accounts. This greatly changes the job search incentives. Workers who find work more rapidly build up a larger retirement nest egg. With the unemployment insurance account appearing on the same statement as their private social security account, the worker clearly see the connection between rapid reemployment and retirement funds.

The Chilean approach solves what is, in the United States, one of the major problems of the unemployment insurance system: an incentive toward unemployment. Numerous academic studies have found that the system leads people to take longer to find new jobs. The more generous the benefits are, the longer workers spend, on average, finding a new job.

The United States should see Chile's action as a sign that we don't have to keep doing things the way we did in 1935, when our unemployment insurance system

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was created. We may want to consider individual accounts, which have been proposed by economist Martin Feldstein and the John Locke Foundation. There are other approaches also worth considering.

The JOBS Plus system in Oregon diverted some of the unemployment insurance taxes to a fund from which wage subsidies were paid to companies hiring unemployed workers. The idea is that it's better to pay a wage than a dole, especially for low-skilled workers in need of mentoring and on-the-job training. This approach should be considered as a universal system for all unemployed workers.

Allowing employers more opportunity for self-insurance is another idea worth considering. Currently, government agencies and many non-profit organizations self-insure. Their workers collect benefits like anyone else, and then the employers reimburse the state. This system could be optional for businesses willing to post a bond to guarantee their ability to make the reimbursements.

More broadly, the United States should allow states to experiment with unemployment insurance reform. The greatest achievements in welfare reform came not from federal law, but from state experiments before national reform occurred. States should be allowed to try innovative approaches to helping the unemployed. The workers' compensation system operates in exactly this fashion, with states having total control over the structure of their systems. The result is that many states have been successful at improving incentives for workplace safety. Accidents are down and employer costs are down.

In contrast, unemployment insurance works pretty much as it did in the 1930s, when most workers were in industrial occupations. Layoffs were temporary, with most workers being recalled to their old employers. Most workers were men, and part-time work was not common. Our unemployment safety net still operates as if we lived in the 1930s. It's time we considered a change and caught up with Chile's innovative attitude toward the social safety net.

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