

Call for Research Proposals

Protecting Workers against Unemployment in Latin America and the Caribbean

Research Department (RES) & Labor Markets Unit (SCL/LMK)

1. Background

1.1 Unemployment Risk in Latin America and the Caribbean (LAC)

Over sixty years ago, Latin America and Caribbean countries began to enact a series of labor laws designed to protect workers from arbitrary dismissal and provide severance compensation for dismissal. Few countries, however, enacted unemployment insurance schemes. In the context of large inequalities, employment instability, and poor labor conditions that characterizes most LAC countries, governments used hiring and firing regulations to protect workers against the risk of unemployment by making dismissal more difficult or by mandating a high financial compensation in case of dismissal (Pagés, Pierre, and Scarpetta, 2009). However, protecting jobs rather than workers can have important adverse social and productivity effects. By impeding the efficiency of job reallocation, job protection has a negative effect on the level of productivity across time, industries, and countries (Bartelsman, Scarpetta, and Haltiwanger, 2004; Foster, Haltiwanger, and Krizan, 2002). In addition, because employment protection legislation raises the cost of workforce reorganization, it reduces firms' capacity to exploit technological opportunities or reallocate internal personnel, particularly in the context of open economies where adopting technologies and quickly readapting the labor force is critical to capturing or retaining markets.

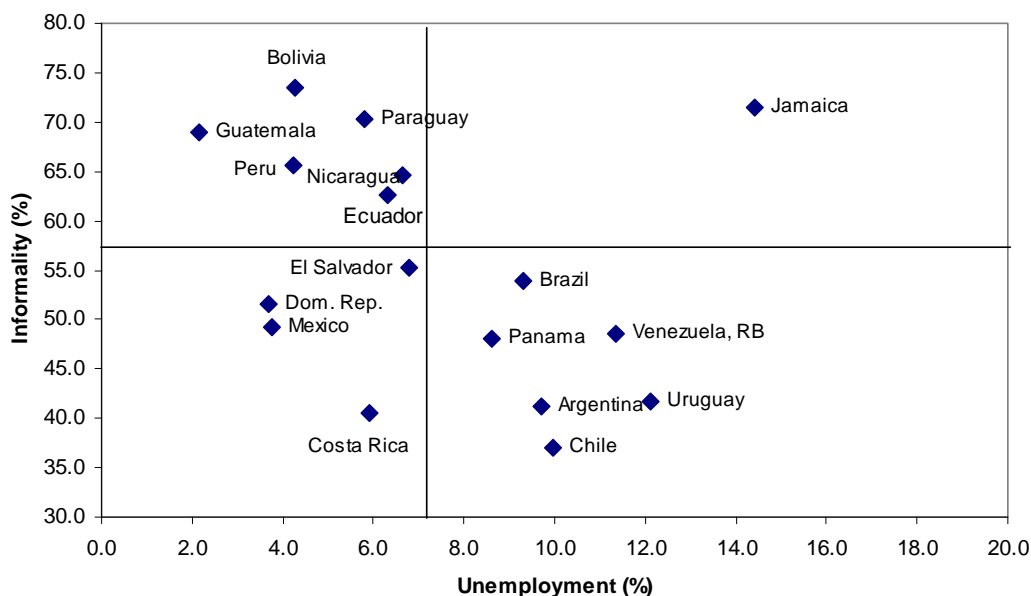
Job protection also affects the structure of employment. Extensive job security regulations tend to reduce the share of workers in wage employment and increase self-employment in developing country contexts; they also tend to promote job stability for prime-age males, while reducing job opportunities for youth, women lacking work experience, and those with low skills (Montenegro and Pagés, 2004).

On addition to the adverse effects described above, severance payments have proven inadequate instruments to shield workers from unemployment risks, for a number of reasons: they only cover formal workers; they are generally linked to tenure (providing low benefits to workers with short employment spells); and they tend to be either poorly enforced or difficult to access (for example, temporary workers are not covered)

Unemployment risk is related with the probability of involuntary job loss, the duration of unemployment, and the income loss associated with obtaining a job with lower wages. But beyond unemployment, workers face other labor market risks that are poorly addressed with available instruments as currently designed. Labor markets in the region are characterized by

high job rotation, high informality (more than 50%) and poor job quality. The high job rotation is observed not only among informal jobs, but also between formal and informal jobs. Pagés and Stampini (2009) find a high level of mobility between formal and informal salaried jobs, both for skilled and unskilled labor in a study for three LAC countries and three transition economies. In addition, because labor income is the main source of household income, many people cannot afford to be unemployed; they need any type of paid job, even if it means a precarious one.¹ This implies that many workers may not be able to search long enough to get a good job. Figure 1 shows a negative correlation between informality (proxy for precarious job) and unemployment, which may be explained by this phenomenon.

Figure 1. Unemployment and Informality
Latest year available for each country (2002-2006)



Notes: Unemployment rate = Unemployed/labor force, Informality = Share of adults in informal jobs (Informal=salaried workers in small firms, non-professional self-employed and zero-income workers). Argentina EPHC 2006-II, Bolivia National 2003-04, Brazil New PNAD 2005, Chile 2003, Costa Rica 2006, Dominican Republic 2006, Ecuador ENEMDU 2006, El Salvador 2004, Guatemala ENEI 2004, Mexico 2005, Nicaragua 2005, Panama 2004, Paraguay National 2005, Peru ENAHO3 2006, Uruguay 2005, Venezuela 2005, Jamaica 2002. Source: Own calculations based on CEDLAS – SEDLAC statistics

Since 2002, the region has experienced economic growth and reduction of poverty rates. This trend has been followed by the creation of new jobs. According to official estimates, the regional unemployment rate fell from 11% to 8% between 2002 and 2007. However, labor markets in the region still show structural inequalities, such as the higher unemployment rate for the poor,

¹ According to CEPAL (2008), 79% of total income of LAC households in urban areas is the result of participation in the labor market. Two-thirds of this labor market income comes from wages, which represents 52% of total income.

women, youth, and other groups. Although the unemployment rate of the poorest decile fell from 30.2% to 23.8% between 2002 and 2006 (CEPAL 2008), the gap with the richest decile's rate still surpasses 20% points. The distance between men and women and between youth and adults also persists over time. In countries such as Ecuador, Chile, Uruguay and Brazil, the unemployment rate for Afro-descendants and indigenous populations are significantly higher than for the rest of the population (OIT, 2007).

In addition, the quality of jobs created tends to be very low. For example, the shares of employment in all types of informal nonagricultural work (independent workers, including the self-employed; domestic workers; and workers employed in microenterprises) continue to be high and have increased from an average of 42.8% in 1990 to 45.6% in 2006 (Perry et al., 2007). These poor labor market outcomes carry a substantial social and political cost. In particular, opinion polls (the annual Latinobarómetro survey) confirm that employment is people's primary concern in almost all countries of the region, and a large majority of respondents are "worried" or "very worried" about losing their jobs (Pagés, Pierre, and Scarpetta, 2009).

More recently, the international financial crisis has affected labor markets in the region. Although the crisis began in the developed countries and it was transmitted to the rest of the world through various channels (credit contraction, lower demand for export products, and fewer remittances, among others), the lack of a system of protection against unemployment in the Region puts pressure on governments to act in the short run, providing income support through instruments such as temporary employment and public works.

1.2 Labor Market Policies and Unemployment Risks

Around the world, the mechanisms to protect people from unemployment and other labor markets risks include active and passive policies. In general, policymakers in LAC have relied more on passive instruments such as severance payments and individual savings accounts, than on active policy instruments such as training, labor intermediation and employment services directed at the unemployed. Only in very few cases have countries instituted unemployment support systems broadly defined, comprising both passive and active instruments to deal with unemployment risk.

Each of the components of the unemployment support system has strengths and weaknesses. Country-specific conditions, such as labor market regulations and other institutions, the capacity to administer each type of instrument, and the size of the informal sector, among others, determine which instrument or set of instruments is best suited to developing countries (Vodopivec, 2006).

Although in most countries, contributory and non-contributory programs co-exist (the latter financed through public funds), there is evidence to suggest that the coexistence of both types of programs provide an incentive for informality (Levy, 2008).² Indeed, labor markets that operate with relatively high rates of unemployment, or with significant proportions of the labor

² Willingness to pay for programs via wage contributions is reduced if some benefits are available free of direct cost to workers and funded with general revenues, which increases workers' incentives to work in unofficial, non registered jobs.

force in conditions of informality, will strongly condition the effectiveness of the social protection system, in particular if these programs rely on contributory financing schemes paid only by a minority of workers.

It is therefore important to consider country-specific characteristics that affect the success of unemployment insurance or other policy instruments. For unemployment insurance, in the few countries where such instruments exist, Mazza (2000) identifies four key factors: (i) the presence of large informal sectors (already discussed above); (ii) the level of payroll and other labor taxes; (iii) the extent of severance pay or other instruments already in place; and (iv) whether or how to cover unemployed youth. The latter is important because experts are concerned that income benefits for unemployment, delivered without training or other employment assistance, can have corrosive effects on the young who have not yet established initial work skills and habits.

In other words, it is necessary to understand the design characteristics of these programs, such as sources of financing and eligibility conditions, as well as their relationship with other protection instruments, to understand how well they protect workers against risk as well as whether they generate unintended problems in the labor market.

2. Objectives

The purpose of this Research Network project is to evaluate the system of institutions, laws and regulations designed to protect workers from unemployment risks.

The studies will be country-specific and will be divided into three parts:

Part I:

- Diagnostic of existing instruments, the incentives they create, and how do they cover (or not) risks.
- Diagnostic of workers' risk patterns and labor market transitions.

Part II:

- Impact evaluation of selected instruments.

Part III:

- Policy recommendations.

3. Research Areas and Methodology

Research will be sequenced in three parts. The first part is a comprehensive diagnosis of both the labor market and its unemployment characteristics and current policy coverage. The second part is an impact evaluation of selected policies or programs of the unemployment system

support. The third part will explore possible policy recommendations to address the problems identified in the first two parts of the study.

Part I: Country Diagnostics

As explained above, the country diagnostic will be divided into two parts (Parts I.1 and I.2)

Part I.1 Diagnostic of Existing Instruments

This section should provide a critical review of existing mechanisms to protect workers from unemployment and other labor market risks, providing evidence on how these mechanisms work in practice. More specifically, the researchers should describe and analyze the existing mechanisms to protect workers from unemployment and other risks. These would include passive labor market policies such as: unemployment insurance, severance pay, and regulations regarding involuntary dismissal. Active labor market policies could be included only to the extent that eligibility is limited to the unemployed, e.g., the instrument is intended to impart either skills or income to the unemployed, Mexico's BECATE training program for the unemployed is an example. Employment services and job search assistance are also instruments aimed at helping the unemployed to find better jobs.

The analysis should determine the actual coverage of these instruments (by size, type of beneficiary and nature of payment). The description would include information on coverage of each instrument, amount and nature of benefits, number of beneficiaries and overlap between instruments (i.e., some (formal) workers may have access to both severance payment and unemployment insurance, while others (informal) may not be covered by any instrument). It would also include data on the size of the programs (executed budget). Overall, it is expected that researchers will be able to assess the difference between the potential pool of workers covered by existing programs, policies and regulations and the actual pool of workers receiving benefits. Assessing this "gap" in coverage would lay the foundation for proposing new ways to improve and extend coverage.

Part I.2 Diagnostic of Labor Markets' Risk Patterns and Transitions

Unemployment risk depends on three factors: the probability of involuntary job loss, the duration and nature of unemployment (e.g., affected by reemployment prospects), and the possible loss of income associated with obtaining a job with a lower wage than the job before unemployment. These factors will depend on the type of worker, the type of previous job (in small/big company, registered/unregistered, temporary/indefinite contract, industry, profession), the length of job tenure, and the point in the economic cycle, among other considerations (Escobar, 2008). They can also be affected by the policy instruments in place (e.g., severance pay) or the introduction of new instruments (unemployment insurance or others).

To estimate these factors, individual and longitudinal data are required. Therefore, proposals that use panel data will be preferred.³

³ See Escobar (2008), for further details on the methodology used to estimate these three factors.

- Probability of involuntary job loss: the researchers will estimate the probability of losing a job as a function of worker and firm characteristics, type of contract, tenure and point in the economic cycle. If there were policy changes during the period of analysis (introduction of unemployment insurance or other instruments), the researchers will estimate any changes in probability associated with policy changes.
- Duration and nature of unemployment: the researchers will estimate the duration of unemployment and the probability of reemployment by worker type, tenure, and point in the economic cycle. As above, the researchers will estimate any changes associated with policy changes.
- Wage risk: The researchers will also estimate the wage loss associated with a period of unemployment, and how it depends on workers' characteristics, the type of job before and after, and the economic cycle. There exists evidence that significant earning losses may occur after displacement. Jacobson, LaLonde, and Sullivan. (1993) find for the United States that high-tenure workers separating from distressed firms suffer long-term losses averaging 25% of their pre-displacement earnings. However, more recent studies have indicated the importance of local economic conditions rather than worker characteristics in affecting the sign and size of displacement effects. For example, Kaplan, Martinez and Robertson (2003, 2005) analyze this issue for Mexico exploiting variation in economic conditions (but not institutions) to compare local labor market conditions and post-displacement wages over time and space. They find that different external conditions can cause wages to go up, go down, or stay constant after displacement.

The analysis will quantify these factors, as well as other transitions such as formal-formal, formal-informal (and vice versa), in-and-out of the labor force, etc. The number of transitions within a period is also relevant, since job rotation appears to be higher among low-skilled informal workers and higher in the Latin American and Caribbean region relative to other regions. For example, Menezes-Filho (2003) focuses on a sample of formal male workers, living in the metropolitan area of São Paulo and finds that around 30% of the workers move out of the formal sector after a year, and that about 20% change jobs in the same period. Among those workers that leave the formal sector, about 15% enter the informal sector and 15% become unemployed or leave the labor force. Menezes-Filho argues that these transitions are strongly associated with individual characteristics, especially education and tenure.

The researchers will also examine how these components vary with the business cycle. The researchers should propose an alternative methodology to address these issues if panel data are not available for a specific country.

Part II: Impact Evaluation of some programs or policies

This part should evaluate the impact of some existing instruments (programs, policies or regulations) described in Part I.1, taking into account the nature of unemployment in the country (country-wide, sector specific, related to dependency on exports to one country, etc.) and the risks that should try to mitigate (as described in Part I.II). Researchers are expected to identify ways to estimate the impact of such instruments on a given set of outcomes, such as consumption or life satisfaction of the unemployed, probability of job

loss, probability of reemployment, or reemployment wages, relative to a control group, using suitable and up-to-date impact evaluation techniques. Preference will be given to proposals that provide better identification techniques to address selection and endogeneity issues which could potentially bias the estimates.

Part III: Policy recommendations

Lastly, researchers should explore possible answers to the question of what can be done to improve worker protections against labor market risks in the country of study. The analysis may reveal that reforms beyond passive or active labor policies may be needed, such as tax reforms or pension system reforms, among others.

The researchers should address both broader policy recommendations (e.g., do the risks merit coverage?) as well as programmatic recommendations regarding which types of instruments might best serve the particular national context.

The researchers should propose reforms to existing programs and/or the creation of new programs, indicating how these reforms or new programs could better cover the unemployed and/or be implemented more efficiently or effectively;

4. Selection Criteria

To participate in this project, **research institutions** should submit a proposal including the following:

- a. A description of the data to be used in the study.
 - Primary data from beneficiary records
 - In the case of secondary sources (administrative data, household surveys and/or other establishment-level surveys), year(s) available should be included as well. In each case researchers should describe the main characteristics of the information available (types of employment questions, feasibility of linking data across multiple surveys if they exist, etc.).
- b. A summary of data availability (maximum 2 pages) and supplementary surveys to be conducted or used.
- c. A summary of the institutions, programs, policies and regulations that constitute the unemployment support system in the country of analysis (maximum 2 pages)
- d. A detailed Plan of Analysis. This section should demonstrate awareness of the state of the art of the quantitative analysis of unemployment risks and active and passive labor policy evaluations in the country under consideration (in the form of a short literature review) and explicitly build on it by both reviewing or corroborating previous analysis and moving forward the exploration of issues not previously addressed, including but not limited to those in the discussion above (4 pages). The proposals should specify in a clear and succinct form:
 - i. The variables to be examined and the methodology to address part I.2,

- ii. The outcomes to be examined and the methodology to address part II, as well as a description of how i. and ii. improve on existing studies in their countries.

5. Proposal Submission

- **Research institutions** interested in submitting a proposal should pre-register before **November 20, 2009** by [clicking here](#). If unable to pre-register before the due date for proposals, please send an email to red@iadb.org
- **Proposals are due Friday, January 8, 2010.**
- Proposals should be submitted using the **Web Submission Form**.

The following information will be required for submitting your proposal:

- The proposal with all the technical aspects involved in the development of the study, based on the Terms of Reference outlined in this Call for Proposals.
- A budget indicating the time and resources that will be used within the context of the research work plan. The budget is requested as a separate file and should not be included in the proposal. The budget proposed should disaggregate items financed by the IDB contribution and those financed by the research institution. The budget should distinguish among amounts assigned to professional honoraria, “overhead” and other major categories of research expenditures.
- The name and curricula vitae (two pages maximum) of the technical coordinator and other researchers involved. The research team should demonstrate its ability to meet the objectives of the project, including relevant experience. Please note that subsequent substitutions for researchers originally specified in the proposal may be made with prior approval from the project coordinators, but the research leader (of each subject) should lead the entire project until its full completion.
- Name and contact information of the legal representative, with authority to sign contracts with the IDB, if selected to conduct the study.
- **Institutions** may present proposals individually or jointly with other institutions in the same country or in the region. For administrative purposes, the Bank will request that each institution sign a letter of agreement with the Bank, which will require a separate budget for each institution.

6. Coordination and Schedule

The IDB project team consists of Verónica Alaimo, Jacqueline Mazza, and Carmen Pagés-Serra (SCL/LM). Robert Lalonde, of the University of Chicago will act as external advisor for the research project.

The tentative schedule of activities is as follows:

- **November 4, 2009:** Call for research proposals.
- **November 20, 2009:** Due date for pre-registration by [clicking here](#).
- **January 8, 2010:** Due date for **receiving proposals**. Institutions should ensure that complete documentation is submitted through the Web Submission Form, available on January 8, 2010.
- **January 22, 2010:** Announcement of **selected research proposals**.
- **February 4-5, 2010: Videoconferences** with selected research teams for the purposes of discussing the outline of the research paper, data sources, and the methodology to be used in the study.
- **February 26, 2010:** Due date for receiving a **preliminary report with an annotated outline** of the research paper, data sources, and the methodology to be used in the study.
- **June 18, 2010:** Due date for receiving a **first draft (Part 1)** of research papers.
- **July 8-9, 2010: First Discussion Seminar** in Washington, DC, to discuss the draft papers and exchange ideas for the second part of the project. At this seminar, non-regional cases may also be included to stimulate discussion.
- **October 13, 2010:** Due date for receiving a **second draft** (Parts I, II, and III) of research papers.
- **October 28-29, 2010: Second Discussion Seminar** (location to be determined) for the purpose of discussing the second draft of research papers. The completed drafts—Parts 1 and 2—will be presented and discussed at this seminar.
- **December 22, 2010:** Deadline for **final version** of the research papers, including a summary that discusses policy lessons and the datasets utilized by the study.

Research proposals should be submitted in English. Also, the initial and final seminar will be held in English.

7. Financial Aspects

The IDB contribution will be up to **\$35,000** per study, depending on the scope of the work proposed.

- 25 percent within 30 days of signing the formal agreement between the IDB and the respective institution.
- 25 percent within 30 days of presenting and approving the first draft of the research paper

- 30 percent within 30 days of presenting and approving the second draft of the research paper.
- 20 percent within 30 days upon approval by the Bank of the final research paper delivery and the datasets utilized by the study to the IDB.

8. References

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