

***Unemployment Benefits Systems: the International  
Labour Organization's Recommendations***

***June 2000***

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## EXECUTIVE SUMMARY

1. The International Labour Organization (ILO) has adopted conventions which set international labour standards. Three important conventions on unemployment benefits are: (i) *Ensuring Benefit or Allowances to the Involuntarily Unemployed Convention, 1934 (No. 44)*; (ii) *Social Security (Minimum Standards) Convention, 1952 (No. 102)*; and (iii) *Employment Promotion and Protection (Unemployment) Convention, 1988 (No. 168)*. Hong Kong has not enacted legislation to put in practice any of these three conventions.
2. The ILO has emphasized that each member state should maintain an unemployment benefits system to protect the persons who are involuntarily unemployed. Unemployment insurance (implemented in most of the industrialized countries) and unemployment assistance (implemented in a few industrialized countries such as Australia and New Zealand) systems are the two main types.
3. The unemployment benefits system should be designed to protect persons who are in paid employment. However, the ILO allows some possible exceptions such as self-employed persons; domestic workers; homeworkers; workers whose employment is of a permanent character in the service of the government; seasonal workers; young workers under a prescribed age; and members of the employer's family. Unemployment benefits should be provided in the form of periodical payments.
4. To qualify for receiving unemployment benefits, the unemployed person has to meet certain conditions: (i) should be capable of work, available for work, and willing to work; and (ii) should seek work by registering at a public employment exchange and attend there regularly.
5. A claimant may be disqualified for receiving unemployment benefits if the loss of employment is due to labour dispute, misconduct, fraud, or failure to comply with the instruction of the competent authority. The length of the qualifying period proposed by the ILO is 26 weeks of employment in the past 52 weeks.
6. The unemployment benefits should be fixed at not less than 45% of previous earnings or the statutory minimum wage or of the wage of an ordinary labour, or at a level which provides the minimum essential for basic living expenses, whichever is the highest. The commonly observed rates of unemployment benefits are 50% to 60% of a claimant's previous earnings.

7. The duration of payment of unemployment benefits may be limited to 26 weeks in each spell of unemployment. The ILO allows a waiting period of the first seven days in each case of the claim for unemployment benefits.
8. Unemployment benefits may be paid at the social security office. As claimants have to attend the employment exchange office in order to prove their eligibility for the benefits, a close liaison should be maintained between these two offices.
9. The ILO urged that the introduction of unemployment insurance system would be an important measure in providing a social safety net to the unemployed, especially after the onset of Asian financial crisis in July 1997. The unemployment insurance system proposed by the ILO attaches conditions which are similar to those discussed in the three conventions to reduce the potential negative effects on employment. The ILO further remarked that affordability would not be a problem in Asian economies as per capita incomes are considered high.

# **UNEMPLOYMENT BENEFITS SYSTEMS: THE INTERNATIONAL LABOUR ORGANIZATION'S RECOMMENDATIONS**

## **PART 1 - INTRODUCTION**

### **1. Background**

1.1 In October 1999, the Panel on Manpower and the Panel on Welfare Services requested the Research and Library Services (RLS) Division of the Legislative Council (LegCo) Secretariat to conduct a study on unemployment-related benefits systems.

### **2. Objectives and Scope**

2.1 The objectives of the study are:

- to examine the experience of Mainland China, Taiwan, Malaysia, Singapore, South Korea, the United Kingdom (UK), and the United States (US) in implementing their unemployment-related benefits systems; if any
- to outline the research findings of the Organization for Economic Co-operation and Development (OECD) and the Conventions and Recommendations of the International Labour Organization (ILO) in unemployment benefits systems; and
- to make an overall comparative analysis of the experience in the above places in implementing their unemployment-related benefits systems, and study current provisions in helping the unemployed in Hong Kong.

2.2 The scope of the research, as agreed by the Panels, covers

- historical development;
- main features and components;
- eligibility requirements;
- types of benefits and amounts;
- duration of payment of benefits;
- tax treatment of the benefits;
- source of funds for the benefits; and
- administration of the unemployment-related benefits systems.

2.3 In this report, we outline the international labour conventions on unemployment benefits, Hong Kong's participation in the ILO, the ILO's recommendations on various aspects of unemployment benefits, and a research study published by ILO on a proposal of introducing unemployment insurance system in Asia.

2.4 This report is part of the series of studies discussing unemployment-related benefits systems. There are 11 separate research reports (RP13/99-00 to RP23/99-00) on this subject.

2.5 In this research, "unemployment-related benefits" refer to unemployment benefits and related welfare benefits. Unemployment benefits comprise unemployment insurance and unemployment assistance. Unemployment benefits are available to the unemployed only. In other words, these benefits are not available to people who are not unemployed. The recipient must be currently unemployed, able to work, willing to work and looking for work. Where there are no unemployment benefits or where these benefits are exhausted, welfare benefits may be made available to provide subsistence for those in need. These related welfare benefits, as defined in the 1996 OECD study of *Benefit Systems and Work Incentives*, include family benefits, housing benefits, child-care benefits and social assistance. They are made available to all citizens subject to a means-test, and are not specifically targeted at the unemployed.

### **3. Methodology**

3.1 This report is mainly based on the information available from ILO publications.

## **PART 2 - THE INTERNATIONAL LABOUR ORGANIZATION'S RECOMMENDATIONS ON UNEMPLOYMENT BENEFITS SYSTEMS**

### **4. The International Labour Organization and Its Conventions**

4.1 The International Labour Organization (ILO) was established in 1919, at the end of the First World War, at the Peace Conference at Versailles. In 1945, it was linked as an independent specialised organization to the United Nations. The mission of the ILO is to promote social justice, in particular, to set international labour standards and to promote fundamental rights at work. It was awarded the Nobel Prize for Peace in 1969.

4.2 The ILO carries out its mission through a system of conventions and recommendations. The ILO holds annual International Labour Conferences<sup>1</sup>, which are attended by government delegates, independent representatives of leading employers' and employees' organizations in every member state. The International Labour Conferences pass resolutions, which are then adopted by the ILO as conventions or recommendations.

4.3 A convention is conceived as a set of criteria for the preparation of national legislation. When it has been passed by the annual International Labour Conference and adopted by the ILO, member states of the ILO are required by the ILO Constitution to bring the convention to the notice of their legislative authorities. If the standards that have been set are embodied in national laws, the states concerned will be in a position to ratify the convention. Not every state which follows the convention necessarily proceeds to ratification, but the influence of the ILO in setting standards is significant regardless of the formal procedures involved.

4.4 The ILO's constitution also obliges member states to draw up annual reports, stating what measures have been taken to observe the provisions contained in the ratified conventions. It also provides for a mechanism for organizations in a member state to lodge a complaint, including a right for another member state to prosecute, if the government fails to carry out the conventions which the authorities of that country have ratified. Since 1919, 182 conventions have been adopted by the ILO. While these conventions have not been ratified by all member states, the ILO has certainly made a not insignificant influence on the labour and social welfare legislation of its member states. (See Appendix I for the historical development of unemployment benefits systems outlined by the ILO.)

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<sup>1</sup> The International Labour Conference is an international deliberative body of the ILO in which international labour standards are set and guidelines on the ILO's general policy formulated.

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## **5. The International Labour Organization Conventions on Unemployment Benefits Systems**

5.1 A landmark in unemployment benefits systems was the adoption by the ILO in 1934 of the *Ensuring Benefit or Allowances to the Involuntarily Unemployed Convention, 1934 (No. 44)*. This convention required ratifying states to set up a system for the payments of benefits to the involuntarily unemployed. It laid down minimum requirements as to coverage of the population, conditions of receiving unemployment benefits, and duration of benefits. This convention has been ratified by 14 member states as of end-1997, including the United Kingdom in 1936, but it was not applied to Hong Kong.

5.2 Detailed provisions regarding unemployment benefits were later laid down in the *Social Security (Minimum Standards) Convention, 1952 (No. 102)*, which specified how the periodical payments were to be calculated. As of end-1997, a total of 40 member states have ratified this convention, including the United Kingdom in 1954, but it was not applied to Hong Kong.

5.3 In 1988, the ILO adopted the *Employment Promotion and Protection (Unemployment) Convention No. 168* which provided for benefits in cases of full unemployment and partial unemployment. As of end-1997, six member states have ratified this convention, which did not include the United Kingdom.

5.4 Mainland China has been a member country of the ILO since 1919 but it has not ratified these three conventions.

## **6. Hong Kong and the International Labour Organization**

6.1 There are currently 174 member states in the ILO, including Mainland China. Hong Kong is not a member of the ILO but may attend the International Labour Conference as a member of the delegation of Mainland China.<sup>2</sup> Hence, Hong Kong can participate in the activities of the ILO.

6.2 Hong Kong may decide whether or not to apply a particular convention after considering local conditions. Before enacting legislation to apply a convention, Hong Kong is obliged to give effect through legislative or administrative measures, or a combination of both, to the provisions of the convention. In addition, the Hong Kong Special Administrative Region (HKSAR) Government also submits reports on the application of International Labour Conventions as required by the ILO. These reports are prepared after consultation with the relevant departments and organizations.

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<sup>2</sup> Before July 1997, Hong Kong attended the International Labour Conference as a member of the United Kingdom delegation.

6.3 A total of 45 conventions (out of the ILO's 182 conventions) are currently applied in Hong Kong (see Appendix II for the full list of International Labour Conventions applied in Hong Kong). As of to date, Hong Kong has not enacted legislation to apply the three conventions regarding unemployment benefits systems indicated above.

## **7. The International Labour Organization's Recommendations on Unemployment Benefits Systems**

7.1 The ILO has emphasised that each member state should maintain an unemployment benefits system to protect the persons who are involuntarily unemployed. Each state may determine the method or methods of protection, whether by a contributory or non-contributory system, or by a combination of these two systems.

7.2 However, even if a state protects all residents, whose resources, during the contingency, do not exceed prescribed limits, the protection afforded may be limited, in the light of the resources of the beneficiary and his or her family.

### Variety of Unemployment Benefits Systems

7.3 There are mainly two types of unemployment benefits systems -- (i) unemployment insurance system and (ii) unemployment assistance system. Most of the industrialized countries (e.g. nearly all of the Organization for Economic Co-operation and Development countries) administer unemployment insurance systems. Only a few industrialized countries (e.g. Australia and New Zealand) rely solely on unemployment assistance systems. Some countries operate both systems.

7.4 Countries which have unemployment insurance systems also provide unemployment assistance or social assistance to support workers who fail to qualify for insurance benefits or who have exhausted their insurance rights. While unemployment assistance systems cater for the unemployed only, social assistance programmes are open to all who only need fulfil a means-test requirement. The social assistance programme is mentioned because an unemployed person might exhaust the unemployment insurance or unemployment assistance available and his or her last resort would be social assistance.

### Persons Protected

7.5 The unemployment benefits system (including both the unemployment insurance and unemployment assistance systems) should be designed to protect persons who are in paid employment, since they are exposed to the risk of involuntary unemployment. If it is deemed necessary, member states may make exceptions in respect of --

- (i) self-employed persons;
- (ii) persons employed in domestic service;
- (iii) homeworkers;
- (iv) workers whose employment is of a permanent character in the service of the government, a local authority or a public utility undertaking;
- (v) non-manual workers whose earnings are considered by the competent authority to be sufficiently high for them to ensure their own protection against the risk of unemployment;
- (vi) workers whose employment is of a seasonal character, if the season is normally of less than six months' duration and they are not ordinarily employed during the remainder of the year in other employment;
- (vii) young workers under a prescribed age;
- (viii) workers who exceed a prescribed age and are in receipt of a retirement or old-age pension;
- (ix) persons engaged only occasionally in employment; and
- (x) members of the employer's family.

### Benefits to be Provided

7.6 In cases of unemployment, benefits should be provided in the form of periodical payments calculated in such a way as to provide the beneficiary with partial and transitional wage replacement and, at the same time, to avoid creating disincentives either to work or to employment creation.

7.7 In cases of underemployment<sup>3</sup>, benefits should be payable in a way to be determined by national laws or regulations to unemployed persons whose employment has been reduced.

#### Conditions for Payment of Unemployment Benefits

7.8 The right to receive unemployment benefits may be made subject to compliance by the claimant with the following conditions --

- (i) the unemployed person is capable of work, available for work, and willing to work; and
- (ii) the unemployed person seeks work by registering at a public employment exchange or at some other offices approved by the competent authority, and attends there regularly.

#### Conditions for Disqualifying the Claimants for Unemployment Benefits

7.9 A claimant may be disqualified for the receipt of unemployment benefits for an appropriate period --

- (i) if the claimant has lost employment as a direct result of a stoppage of work due to a labour dispute;
- (ii) if the claimant has lost employment due to misconduct or has left it voluntarily without just cause;
- (iii) if the claimant has tried to obtain fraudulently any unemployment benefits; or
- (iv) if the claimant fails to comply with the instruction of a public employment exchange or other competent authority with regard to applying for employment, or if it is proved by the competent authority that the claimant has failed or neglected to avail himself of a reasonable opportunity of suitable employment.

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<sup>3</sup> On 'underemployment' please see paragraphs 3.19 to 3.22 of the research report *The Measurement of Unemployment and Underemployment* (RP05/98-99 published on 4 February 1999).

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### Qualifying Period

7.10 The right to receive unemployment benefits may be made conditional upon the completion of a qualifying period, involving --

- (i) the payment of a prescribed number of contributions within a prescribed period preceding the lodge of a claim to benefits or preceding the commencement of the period of unemployment;
- (ii) employment for a prescribed period preceding the claim to unemployment benefits; or
- (iii) a combination of the above alternatives.

7.11 The purpose of the qualifying period is to make certain that the claimant is properly within the scope of the system. The length of the qualifying period proposed by the ILO is 26 weeks of employment in the past 52 weeks.

### Benefit Rates

7.12 If the unemployment benefits are based on the contributions of or on behalf of the person protected or on previous earnings, they should be fixed at not less than 45% of previous earnings or the statutory minimum wage or of the wage of an ordinary worker, or at a level which provides the minimum essential for basic living expenses, whichever is the highest.

7.13 The commonly observed rates of unemployment benefits are 50% to 60% of a claimant's previous earnings, within maximum and minimum limits. Most unemployment benefits systems add a supplement for a dependent spouse and children. The ratio of benefits to previous earnings is known as "replacement rate" or "replacement ratio". Please see details in Appendix III.

### Duration of Benefits

7.14 In the case of full unemployment, the initial duration of payment of the unemployment insurance benefits may be limited to 26 weeks in each spell of unemployment, or to 39 weeks over any period of 24 months. In the event of unemployment continuing beyond the initial period of benefits, the duration of payment of benefits, which may be calculated in the light of the resources of the beneficiary and the respective family, may be limited to a prescribed period.

### Waiting Period

7.15 The ILO allows a waiting period of the first seven days in each case of suspension of earnings. This is to reduce the administrative and financial burden caused by short spells of unemployment as the employment exchange office may be able to place the claimant in a suitable job during that time. The waiting period may be waived if a spell of unemployment starts very soon after a previous spell ends. In the case of seasonal workers, the duration of the benefits and the waiting period may be adapted to their conditions of employment.

7.16 Almost all unemployment benefits systems prescribe initial waiting period between the last day of employment and the first day on which benefits are paid. Most waiting periods are three to seven days.

### Administration of Unemployment Benefits Systems

7.17 The ILO recommends a close liaison between the employment exchange office and the social security office since claimants are required to attend the former to prove their eligibility for benefits and to collect their benefits from the latter.

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### **PART 3 - INTRODUCING UNEMPLOYMENT INSURANCE SYSTEM IN ASIA SINCE THE ONSET OF ASIAN FINANCIAL CRISIS IN JULY 1997**

#### **8. The Case of Introducing Unemployment Insurance System**

8.1 The International Labour Organization (ILO) published a research report entitled *The Asian Financial Crisis: The Challenge for Social Policy* in 1998. The author of the report is Eddy LEE, Director of the Cross-Departmental Analyses and Reports Team of the International Labour Office in Geneva. He was responsible in 1995 and 1996 for the first two issues of the ILO's *World Employment Report*. This research report published in 1998 ("the 1998 Research" hereafter) analyses the social impact of the Asian financial crisis and its policy implications. This research report expressed the view that *"the absence of unemployment benefits in the crisis-affected countries has inflicted unnecessary suffering and hardship. Although an unemployment insurance scheme would not have relieved all the social pain induced by the crisis, its contribution would nevertheless have been substantial"*. In this part, we will summarize the findings and arguments of the 1998 Research.

#### What an Unemployment Insurance System Could Have Contributed?

8.2 The 1998 Research showed that the economic slump provoked by the financial crisis had caused widespread social distress in Asian economies, including Thailand, Indonesia, Malaysia, the Philippines, South Korea, Hong Kong and Singapore. A fall in output and incomes caused massive job losses as bankruptcies and cutbacks in production multiply. This led to a sharp rise in unemployment rate.<sup>4</sup> The falling wages and incomes in the context of a weakened labour market might also push large numbers of people into poverty.

8.3 The 1998 Research surmised that had unemployment insurance been extended to workers in the modern sector (i.e. not agricultural or informal), who formed the majority of job losers, these workers would have been eligible for unemployment benefits. This would have alleviated the shock and distress suffered by these workers and would have attenuated social tensions and unrest. In addition, the payment of the unemployment benefits would help to contain the fall in domestic demand. In other words, the unemployment insurance system would also function as an automatic stabiliser to the domestic economy.

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<sup>4</sup> In Hong Kong, the unemployment rate (seasonally adjusted) had increased from 2.2% in 7/97 - 9/97 to 6.3% in 3/99 - 5/99 and decreased to 6% in 10/99 - 12/99. In the 12/99 - 2/00 period, an estimated total of 200 000 persons were unemployed.

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### "Some False Beliefs"

8.4 The 1998 Research questioned why places such as Hong Kong and Singapore where Gross Domestic Product (GDP) per capita was high by international standards did not introduce any form of unemployment insurance. The Research pointed out that there was no direct information on which to base a firm answer to the question of why unemployment insurance was not introduced. The 1998 Research made some guesses as to the possible explanations.

8.5 The first reason advanced might be that, given decades of uninterrupted full employment, the risk of unemployment was perceived as slight, both by governments and workers. In the tight labour markets that prevailed, unemployment was a rare occurrence. When it did occur, spells of unemployment were brief and the need for an unemployment insurance system was thus small. A related reason might be that in some countries with large agricultural and informal sectors there was excessive faith in the capacity of these sectors to absorb retrenched workers.

8.6 The second reason given in the Research was the belief that a system of unemployment benefits would not be feasible in developing countries. This was based on the perceptions that the fiscal costs involved were too high, that the administrative capacity to operate such schemes was lacking, and that the predominance of small enterprises in the industrial structure made these schemes inherently difficult to implement.

8.7 The third reason was ideological hostility to the concept of the welfare state. Champions of "Asian values" decried what they saw as the erosion of the work ethic and the social pathologies caused by generous welfare provision in advanced Western countries. According to this view, unemployment benefits featured as a major part of the problem and were consequently to be avoided.

8.8 Another reason related to the third one above was the standard apprehensions of free market proponents about the negative effects of unemployment benefits on employment. These included the raising of labour costs, and hence the reduction of the willingness of employers to hire, if the system was financed through payroll taxes; the weakening of the incentive to seek work; the raising of the reservation wage (the wage necessary to induce a worker to accept a job); and the reduction in the demand for labour through higher wage costs brought about by the fact that the presence of unemployment benefits made it less costly for workers to quit their jobs more frequently and that, as a consequence, employers had to pay higher wages to counteract this.

8.9 The final reason advanced in the Research was probably the weakness of trade unions and the restraints on freedom of association in several of these countries. In the industrialized countries, trade unions had been the most powerful pressure group demanding the introduction of unemployment benefits. The weakness of the trade union movement in some Southeast Asian countries meant the absence of similar pressure.

### The 1998 Research "Refutes" these "False Beliefs"

8.10 The 1998 Research refutes the above arguments. First, the dramatic rise in unemployment in the wake of the crisis had shattered the assumption about low risk of unemployment hence little need for unemployment insurance. Moreover, there was no room for retreat to the argument that the crisis was a one-off event that would not recur. Economic reforms and better economic management might reduce the future risk of a recurrence but could not eliminate it entirely. Economic volatility and the frequency of financial crises have been increasing in the global economy.

8.11 The 1998 Research remarked that there were grounds for assuming that unemployment would loom as a larger problem over the next few years than in the past in Asian economies. First, the restructuring of enterprises was a process that would need to continue until these economies eliminated excess capacity in some industries and regained competitiveness. Second, when economic recovery was achieved there would be a continual need to adjust the structure of production to ever-changing comparative advantage, especially through upgrading to more skill- and capital-intensive production. Both these processes would imply the relocation of labour and some rise in unemployment unless the extraordinarily high growth rates of the pre-crisis period were regained.

### Can Asian Economies Afford an Unemployment Insurance System?

8.12 The 1998 Research is of the view that an unemployment insurance system is typically self-financing. It is based on the compulsory pooling of risk and is financed by contributions of either workers or employers or a combination of both. The question of affordability in the sense of a fiscal cost need not therefore arise unless the government chooses to subsidise the system. This is a fundamental difference between the insurance system being advocated by the 1998 Research and state-funded systems based on general revenues.

8.13 The basic rationale for an insurance system is that it is a means for overcoming several market failures. One is the tendency for workers to underestimate the risk of becoming unemployed and hence to under-provide for this eventuality through savings. Another is the absence of a private market for unemployment insurance. The probability of becoming unemployed differs among individuals but this is difficult for insurance companies to gauge. It is therefore impossible to run a system that relates the level of the premium individuals are charged to their specific risk of becoming unemployed. A state-run mandatory unemployment insurance system is therefore useful to relief the crisis of the unemployed.

What is the Level of Premium to be Charged?

8.14 The 1998 Research is of the view that all the evidence (please see Table 1 below) points to the fact that the required contribution rate is very low, ranging from 1% to 4% of payroll. Six of these 13 developing countries are shown to have schemes that are entirely self-financing.

8.15 The 1998 Research argues that per capita incomes in Asia are as high, if not higher, than those in countries with unemployment insurance (please see Table 2 below). Wages are also significantly higher than subsistence levels, so the modest payroll tax required can be borne without hardship. A key determinant of the required level of contributions is the ratio of claimants to contributors. A good proxy is the average unemployment rate over the past five or ten years. Here too the 1998 Research regards that the Asian countries are relatively well-placed: their pre-crisis unemployment rates were extremely low.

8.16 The 1998 Research concluded that an average contribution rate of between 0.3% to 0.4% of payroll from 1991 to 2000 would have been sufficient to provide all insured job losers in Thailand, Indonesia and South Korea over this period, with 12 months of benefit at a replacement rate of 50% of previous earnings. *"This would have made a significant contribution to cushioning the harsh impact of the crisis on workers."*

**Table 1 - Features of Unemployment Insurance Systems in Low- and Middle-  
Income Countries**

Country	First and Current Law	Coverage	Contributions			Minimum Contribution	Reference Earnings	Replacement Ratio (%)	Length of Benefits	Depending on:	Waiting Period
			Insured: % Earnings	Employers: % payrolls	State						
Algeria	1994	Non-agriculture employees	1.5	2.5	None	3 years with 6 months prior to unemployment	Average monthly earnings	50 + 1/2 Min. wage	6-36 months	Contributions	None
Argentina	1967,91	Employed persons	1	1.5	None	1 year	Highest wage in the last 6 months	60	12-36 months	Contributions	None
Barbados	1982	Employees aged 16-64	1.5	1.5	None	1 year + 20 weeks prior to unemployment	Average weekly earnings	60	26 weeks	--	3 days
Brazil	1965,90	Employed persons	0	0	Whole Cost	36 months in the last 4 years	Average earnings in the last 3 months	50	4 months	--	60 days
Chile	1937,81	Employed persons	0	0	Whole Cost	52 weeks in the last 2 years	None	Fixed monthly sum	360 days	--	None
Mainland China	1986,93	Employees in state-run enterprises	0	0.6-1	Subsidies	1 year	Public assistance benefit	150-120	12-24 months	Contributions	None
Ecuador	1951,88	Employed persons	2	1	None	24 months	Earnings and length of last employment	Lump sum	Indefinite	--	60 days
Egypt	1959,75	Private sector non-agriculture employees	0	2	Any Deficit	6 months, with 3 of them consecutive	Last monthly wage	60	16-28 weeks	Contributions	7 days
Iran	1987,90	Salaried employees	0	3	Any Deficit	6 consecutive months	Average earnings	80-55	6-50 months	Contributions and family status	None
South Africa	1937,96	Employees earning US\$16,870 a year or less	1	1	None	13 weeks in the last year	Weekly earnings	45	26 weeks	--	7 days
Tunisia	1982	Non-agriculture salaried employees	0	0	Whole Cost	12 quarters	Minimum wage	100	3 months	--	None
Uruguay	1944,81	Employees in industry and commerce	15-16 <sup>1</sup>	12.5-15 <sup>1</sup>	Not specified	6 months in the last year	Average earnings	60-50	n.a	--	None
Venezuela	1989	Employed persons	0.7	1.5	None	52 weeks in the last 2 years	Average weekly salary	60	13-26 weeks	Special circumstances	1 month

n.a. = not available

<sup>1</sup> Overall contributions for social security.Source: Lee, *The Asian Financial Crisis: The Challenge for Social Policy*, International Labour Organization, 1998, p. 80 - 81.

**Table 2 - Economic indicators for Low- and Middle-income Countries<sup>1</sup>  
Operating an Unemployment Insurance Programme, and for Selected  
Asian Countries (1995)**

Country	GNP per capita (US\$)	Non-agriculture GDP per employee (US\$)	Social security expenditure (% of GDP)
Algeria	1,600	--	--
Argentina	8,030	25,448	4.31
Barbados	6,560	14,551	5.23
Brazil	3,640	9,798	--
Chile	4,160	--	22.67
Mainland China	620	1,844	2.55
Ecuador	1,390	5,279	2.08
Egypt	790	4,043	--
Iran	2,200 <sup>2</sup>	--	0.94
South Africa	3,160	--	--
Tunisia	1,820	4,249	5.68
Uruguay	5,170	14,163	--
Venezuela	3,020	9,775	--
Selected Asian Countries			
Indonesia	980	3,164	0.06
South Korea	9,700	15,429	2.18
Malaysia	3,890	10,777	0.15
Philippines	1,050	2,802	3.01
Thailand	2,740	5,962	0.12

Notes:

<sup>1</sup> Low-and middle-income countries are defined as those whose GNP per capita is below US\$10,000.<sup>2</sup> 1992.Source: Lee, *The Asian Financial Crisis: The Challenge for Social Policy*, International Labour Organization, 1998, p. 82.

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What about the Economic Effects of Unemployment Insurance on Labour Costs and on Demand for Labour?

8.17 The 1998 Research argued that since the level of benefits and their proposed duration in which benefits may be paid are modest, the negative impact of payroll taxes and unemployment benefits on the level of employment is not particularly compelling. Where a negative impact has been found, the magnitude involved is very small. On average these estimates imply that a 10% increase in the replacement rate of unemployment benefit would be associated with an increase of only 1.5 weeks in the duration of unemployment.<sup>5</sup> Moreover, the 1998 Research noted that these results are for unemployment benefit systems that are significantly more generous than the scheme proposed. The 1998 Research warned that many of the alleged negative effects of unemployment benefits are most serious for a system based on unconditional payment of a standard flat rate of benefits for the entire period of unemployment.

8.18 The unemployment insurance system proposed by the 1998 Research attaches conditions which are similar to those discussed in the three conventions to reduce the potential negative effects on employment. These conditions are detailed in paragraph 7.5 - paragraph 7.17 above.

Will Mandatory Unemployment Insurance Contributions Have any Negative Impact on Domestic Savings?

8.19 The 1998 Research refers to a study conducted on 65 countries in 1995 which shows that an increase of one percentage point in the ratio of social security taxes to GDP will cause a reduction of half a percentage point in the propensity to save. The Research considers that such effect is hardly a serious obstacle to the introduction of unemployment insurance for countries in all affected Asian places, including Hong Kong, where gross domestic savings have been more than 30% of GDP for a sustained period.

Does Administrative Capacity to Run an Unemployment Insurance Scheme Exist in Developing Countries?

8.20 The 1998 Research is of the view that tertiary education has expanded rapidly and a large pool of skilled labour already exists in all the Asian economies affected, including Hong Kong.

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<sup>5</sup> Meyer, B.D. 1990 "Unemployment insurance and unemployment spells" in *Econometrica*, Vol. 58, No. 4, pp. 757-782.

Is Introducing Unemployment Insurance in the Midst of a Crisis Feasible?

8.21 The 1998 Research refers to the experience of some countries and advises a two-stage strategy. The first stage involves running a deficit that future contributions during the recovery will absorb. The deficit can be kept low if initial benefits are confined to a minimal flat-rate payment applicable to all claimants who have contributed for at least one year. When economic conditions improve, the system can shift to the next stage where the level of benefits can progressively be raised and become more closely linked to past earnings and contributions. At the end of this transitional phase (i.e. when the initial deficit has been eliminated), the system can shift to normal insurance-based operations.

What about New Entrants to the Labour Market and Informal Sector Workers Who Lose their Jobs?

8.22 The 1998 Research concedes that the unemployment insurance will not meet the needs of these two groups. Hence, it recommends parallel action to develop a full-fledged social safety net. The ultimate objective should be to develop a means-tested social assistance that provides minimum income support. The Research recommends that as an interim measure, the government can put in place a system of guaranteed employment in public projects for a subsistence wage.

## Appendix I

### Historical Development of Unemployment Benefits Systems

A.1 The forerunners of present unemployment benefits systems appear to be those run in Europe by trade unions which paid out-of-work allowances to their members. Somewhat later than the trade union unemployment funds, employers in the larger industrialized countries also became involved in unemployment benefits systems. These employers had an interest in promoting a stable workforce and in conserving the acquired skills of their employees. In a typical system the employer would contribute to a joint fund from which payment would be made to dismissed, temporarily unemployed or partially unemployed workers. The principle underlying these systems was that the cost of unemployment benefits had to be passed on to the consumers as part of the cost of production. Such a system, however, spread the risks of unemployment over a single undertaking only and failed, as in the case of trade union funds, to cover the total wage-earning population.

A.2 The weakness of these narrowly based efforts led to public action to strengthen the protection of workers. Some local governments set up unemployment insurance funds which were open to voluntary participation by workers. The first of these was established in Switzerland in 1893. However, while potentially extending their scope beyond trade union membership, these local government funds did not prove very successful because of their voluntary character, which attracted mainly workers who were customarily in unstable employment.

A.3 Some local authorities entered the field of protection indirectly by granting subsidies to private unemployment insurance funds -- mainly those run by trade unions -- for the purpose of increasing the benefits. The subsidies were paid annually on the basis of benefits awarded during the preceding year. This became widely known as the "Ghent System" and its success was followed by similar municipal systems in many European towns. Some countries developed the Ghent system on a national scale, with the financial participation of the central government.

A.4 The experience of the early voluntary unemployment benefits systems is instructive. Their limited success indicates that the risks of unemployment could not be covered by individual establishments, but only by spreading the cost over a wider field of covered persons. And unemployment insurance which operated from the wider base of a local authority area could not be implemented on a wholly voluntary basis because of the inherent danger of adverse selection. Systems run by trade unions were successful up to a point, but often encountered financial difficulties when supported by the members' contributions only. They were inadequate when recession struck a particular industry and were unable to cover unorganised, and unskilled, workers who were most vulnerable to the risk of unemployment. Systems run by municipalities could cover only a limited geographical area and even a moderate setback in a small area could easily exhaust the available funds. The logical development was a nation-wide system.

A.5 The first national legislation on unemployment insurance was adopted by Norway and Denmark in the early-1900s. This legislation set up unemployment insurance funds on the principle of voluntary participation and gave them national subsidies. Similar legislation was also introduced in other European countries during and after the First World War.

A.6 The first national law setting up unemployment insurance on a compulsory basis was passed by the United Kingdom parliament in 1911. Italy was the second country in the world to adopt a compulsory system in 1919. In the 1920s a number of European countries enacted national laws setting up compulsory insurance for unemployment benefits; and Canada and the United States did likewise in the 1930s.

A.7 Cash allowances to unemployed workers whose other means did not exceed prescribed limits -- unemployment assistance -- were first introduced in Luxembourg in 1921. The comprehensive social security system introduced in New Zealand in 1938 also provided unemployment assistance subject to an income test. A similar system was set up in Australia by the federal legislation of 1944. Since then, compulsory unemployment insurance has spread to industrialized countries.

## Appendix II

## List of 45 International Labour Conventions Applied in Hong Kong

Convention No.	Title
2	Unemployment Convention, 1919
3*	Maternity Protection Convention, 1919
5	Minimum Age (Industry) Convention, 1919
7	Minimum Age (Sea) Convention, 1920
8	Unemployment Indemnity (Shipwreck) Convention, 1920
10*	Minimum Age (Agriculture) Convention, 1921
11	Right of Association(Agriculture) Convention, 1921
12	Workmen's Compensation (Agriculture) Convention, 1921
14*	Weekly Rest (Industry) Convention, 1921
15	Minimum Age (Trimmers and Stokers) Convention, 1921
16	Medical Examination of Young Persons (Sea) Convention, 1921
17*	Workmen's Compensation (Accidents) Convention, 1925
19	Equality of Treatment (Accident Compensation) Convention, 1925
22	Seamen's Articles of Agreement Convention, 1926
23	Repatriation of Seamen Convention, 1926
29	Forced Labour Convention, 1930
32	Protection against Accident (Dockers) Convention (Revised), 1932
42	Workmen's Compensation (Occupational Diseases) Convention (Revised), 1934
50	Recruiting of Indigenous Workers Convention, 1936
58	Minimum Age (Sea) Convention (Revised), 1936
59	Minimum Age (Industry) Convention (Revised), 1937
64	Contracts of Employment (Indigenous Workers) Convention, 1939
65	Penal Sanctions (Indigenous Workers) Convention, 1939
74	Certification of Able Seamen Convention, 1946
81	Labour Inspection Convention, 1947
87*	Freedom of Association and Protection of the Right to Organise Convention, 1948
90*	Night Work of Young Persons (Industry) Convention (Revised), 1948
92*	Accommodation of Crews Convention (Revised), 1949
97	Migration for Employment Convention (Revised), 1949
98	Right to Organise and Collective Bargaining Convention, 1949

Convention No.	Title
101	Holidays with Pay (Agriculture) Convention, 1952
105	Abolition of Forced Labour Convention, 1957
108	Seafarers' Identity Documents Convention, 1958
115	Radiation Protection Convention, 1960
122	Employment Policy Convention, 1964
124	Medical Examination of Young Persons (Underground Work) Convention, 1965
133*	Accommodation of Crews (Supplementary Provisions) Convention, 1970
141*	Rural Workers' Organizations Convention, 1975
142*	Human Resources Development Convention, 1975
144*	Tripartite Consultation (International Labour Standards) Convention, 1976
147*	Merchant Shipping (Minimum Standards) Convention, 1976
148*	Working Environment (Air Pollution, Noise and Vibration) Convention, 1977
150*	Labour Administration Convention, 1978
151	Labour Relations (Public Service) Convention, 1978
160*	Labour Statistics Convention, 1985

Note: \* Conventions applied with modifications; the remaining ones are applied without modification.

Source: Labour Department

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**Appendix III****"Replacement Ratio" or "Replacement Rate"**What is "Replacement Ratio" or "Replacement Rate"?

A.1 Replacement ratio or replacement rate is an index which summarizes unemployment benefits entitlements relative to earnings. It can be expressed in brief by the following mathematical expression:

$$\text{Replacement ratio} = \text{Unemployment benefits entitlements} \div \text{Earnings}$$

A.2 This index shows in brief how much of a person's previous earnings is replaced by his or her unemployment benefits entitlements when he or she is unemployed. If 60% is replaced, it means this unemployed person loses 40% of his or her previous earnings through unemployment.

A.3 This index is also an indicator of how generous the unemployment benefits system is. The higher the proportion of previous earnings is replaced, the more generous the system is.

What Determines the Generosity of Unemployment Benefits System?

A.4 The "unemployment benefits entitlements" in the nominator of "replacement ratio" comprises all incomes to which an unemployed person is entitled. It can be mathematically expressed as follows:

$$\text{Unemployment benefits entitlements} = \text{Incomes out of work}$$

A.5 Incomes out of work include: Unemployment Insurance payment until exhaustion of benefit duration where applicable + Unemployment Assistance payment until exhaustion of benefit duration where applicable + Social Assistance (which must be measured with care as Social Assistance is usually of indefinite duration)

A.6 It can be seen that the longer the benefit duration is, the higher the nominator becomes, and in turn, the higher the replacement ratio is. Similarly, the higher the level of benefit payment is, the higher the nominator becomes, and in turn, the higher the replacement ratio is.

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### Is there One Replacement Ratio for One Country?

A.7 It should be noted that replacement ratio differs for different types of household: single individual, couple and couple with children. The aggregate replacement ratio of a country is arrived at only after complicated statistical applications.

A.8 Replacement ratios are commonly used to compare the generosity of the unemployment benefits system of different countries. It is also a commonly used index to determine domestic unemployment benefits.

### Net Replacement Ratio or Net Replacement Rate

A.9 Where the effect of taxation is not included in either the denominator or the nominator, the replacement ratio summarizes gross unemployment benefit entitlements relative to gross earnings.

A.10 Taxation (including Social Security contributions), benefits to children (i.e. Family Benefits), Social Assistance and Housing Benefits can have large impacts on the level of replacement rate. The net replacement ratio can be expressed in brief by the following mathematical expression:

A.11 Net replacement ratio = (Unemployment benefits entitlements – tax – social security contributions + Family Benefits + Social Assistance + Housing Benefits) ÷ (Earnings – tax – social security contributions + Family Benefits + Social Assistance + Housing Benefits)

A.12 It should be noted that net replacement ratio differs for single individual, couple and couple with children. The aggregate net replacement ratio of a country is arrived at only after complicated statistical applications.

### What is the Significance of Net Replacement Ratio?

A.13 As tax and social security contributions lower both the nominator and denominator in the net replacement ratio, it may result in different replacement ratios before and after tax, depending on the taxation structure. In most Organization for Economic Co-operation and Development (OECD) countries, the net replacement ratio is about ten percentage points higher than the gross replacement ratio. This means that the unemployed effectively loses less income if he or she becomes unemployed. In other words, taxation effectively increases the generosity of the unemployment benefits system. Sometimes, taxation may act in the other direction and will penalize the unemployed by resulting in lower unemployment benefits. This index is useful where there is a need to study the relationship between taxation, unemployment benefits system and the level of unemployment.

Is there any Effect of the Replacement Ratio on the Level of Unemployment?

A.14 The unemployment benefit system provides insurance against job loss which individuals would find extremely difficult, if not impossible, to obtain from private insurers. Benefits also allow the unemployed to search for a job which matches their abilities, rather than being forced by financial hardship into accepting the first available job offer. Having the right people in the right jobs raises productivity and reduces the chance of them becoming unemployed in future. In this way, unemployment benefits can help labour markets work more effectively.

A.15 But unemployment benefits can also have negative effects on labour markets and social welfare. By “freeing” the unemployed from having to take less ideal jobs, they increase the duration of unemployment spells. Unemployment benefits also alter incentives in wage bargaining. If the financial consequences of unemployment are harsh, workers will be wary of pushing up wages and so risking their jobs. Furthermore, unemployment benefits can subsidise seasonal employment patterns. Without countervailing factors, the higher benefits are relative to earnings, the higher unemployment will be.<sup>6</sup> Hence, a higher replacement ratio might result in due course in higher unemployment.

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<sup>6</sup> OECD, *Employment Outlook*, July 1996, p. 28.

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