

Unemployment Insurance

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INTRODUCTION

In Thailand, three schemes of the Social Security Act of 1990 (B.E. 2533) were announced in the Royal Gazette in September that year. The first scheme provides persons insured under the Act, with financial assistance in the case of non-work related sickness, non-work related disability, or maternity, and in case of death from non-work related causes, assistance to the next of kin. This scheme came into effect six months after its official announcement. The second scheme which, as specified in the Act, was to become effective before 31 December 1998, is the Child Allowance and Old Age Pension scheme. The third scheme concerns Unemployment Insurance (UI). Unlike the first two schemes, the effective date of the UI program was not specified in the Act, and as such, the program has not yet been implemented.

At present, those insured under the Social Security Act are workers in the 15-60 year age group, who are employed in business establishments with 10 or more employees. Employees and employers contribute equally to the Social Security Fund which provides assistance under the first two schemes of the Act. The employer/employee contribution is 1 percent and 2 percent of the monthly insured earnings (with the maximum monthly insured earnings not exceeding 15,000 baht) for the first and the second scheme, respectively, while the government contributes at the rate of 1 percent for each scheme. Since the UI program has not yet been implemented, no UI premium is collected, at present. However, according to the Act, the UI premium contribution of the insured person should not exceed 5 percent of his/her insurable earnings.

UI should work as a safeguard against uncertainty, business-cycle fluctuations or structural changes in the economy that may adversely affect the labor market. It should provide temporary income support to individuals facing job loss for reasons other than personal incompetence. Individuals who lose a job should have the right to search for a similar job for a reasonable period of time, during which they should be provided income support. UI should ease the cost of job search and help individuals find better jobs suited to their skills and abilities, rather than the ones they are forced to accept due to financial or other difficulties. The usefulness of UI lies mainly in providing support during, and thus cushioning the impacts of, the infrequent economic events that cause jitters in the labor market and create widespread job losses. However, the UI program should not become a panacea for those intending to misuse it by simply living off its benefits as long as possible.

The insurance nature of the UI program may sound reassuring to employees, but probably not as much to employers and the government, since the latter have to support the program.¹ However, one potential ill-effect of the UI program is that it may alter workers' (both employees' and employers') behavior toward the misuse of the program. This article provides theoretical analysis of the possible impacts of the UI program on labor behavior, especially on employment patterns.² The article does not intend to discourage the implementation of the UI program in Thailand; rather, its objective is to provide theoretical considerations that may bring out the weaknesses and strengths inherent in UI and thus, in fact, help in a more effective implementation of the program.

THE THAI UI PROGRAM

Under the Social Security Act (B.E. 2533), an insured person is eligible for UI benefit if he/she has paid the contribution for at least six months during a fifteen-month period prior to the interruption of employment and earnings therefrom. Additional requirements to qualify as a UI claimant are as follows.

(1) The claimant must be employable, ready and willing to work, and cannot refuse to participate in any skill development or job training program. Moreover, he/she must register with a government employment agency and report his/her work status at least once a month.

(2) An interruption of employment must not be a consequence of (a) a job violation, (b) a planned or premeditated criminal act by the insured person against the employer, (c) a serious act against the law, (d) a serious damage to the employer that is caused by the insured person when absenting from work without notice for seven consecutive days or when violating company safety rules, or (e) being imprisoned under court order, except for minor offences.

(3) A claimant must not be receiving the Old Age Pension benefit simultaneously.

According to Article 79 of the Social Security Act (B.E. 2533), the waiting period for receiving the UI benefit is seven days following interruption of employment. The UI premium rate from each of the three contributors, viz., government, employer and employee, should not exceed 5 percent of the insurable earnings (Article 46). However, Article 104 of the Act states that the enforced premium rate of the UI program must be announced in a royal decree. This implies that the UI system will not become a reality until the contribution or premium rates from the three parties are announced.

The Thai UI system is, thus, far from complete, at present. For effective implementation of this system, it is essential that its administration is institutionalized, e.g., through the setting up of a UI commission. In addition, at least the following have to be spelled out in the Social Security Act:

- (1) eligibility requirements,
- (2) types of insurable employment and the minimum/maximum number of work hours,
- (3) types of insurable earnings and maximum insurable earnings,
- (4) the contribution or premium rate for each of the three parties,
- (5) the benefit period and replacement rate (i.e., the proportion of the worker's lost earnings replaced by UI benefits), and
- (6) penalties for misuse or abuse of the system.

THE IMPACT OF THE UI PROGRAM

Since the UI program has not yet been implemented, its possible impacts on employment patterns can, at this juncture, be discussed only theoretically. These impacts are discussed in this section using three theoretical labor economics models—static labor supply model, search model, and implicit contract model. The hypothetical UI system is assumed to have the following characteristics and eligibility criteria.

- A UI-eligible job consists of at least 30 hours per week.
- The claimant must have worked for at least six months in a period of 15 months prior to the job interruption to be eligible for UI benefits.
- The premium rate is 5 percent of the insurable earnings.
- The Replacement rate is 60 percent of the average monthly earnings in the qualifying period, with the maximum monthly earning not exceeding 20,000 Baht.
- The maximum benefit period in a year is six months.
- There is no waiting period for receiving the benefits.

Static labor supply model

In the static labor supply model, an individual makes a decision by maximizing his/her utility subject to a budget constraint. Suppose that the individual faces a decision over his/her preferred combination of the number of months of work and level of consumption in one year. Preferences for the individual are specified as $U(C, l)$, where C is the level of consumption of a composite good, the price of which is normalized to one, l is the number of months of

leisure (or nonemployment), and $U(\cdot)$ is a utility function. In the static model, there is no saving and consumption equals total income. Note that months in a year can be sold as labor or consumed as leisure (l). It is assumed that higher levels of both C and l lead to higher utility.

A budget constraint shows the set of combinations of C and l that the individual can afford given his/her wage (w), non-labor income (BC), and the potential UI benefits the individual is entitled to enjoy. For simplicity, let us consider the budget constraint over a one-year time horizon. Consider an individual who has been in the labor force for at least six months. The budget constraint is given in [Figure 1](#).

In the absence of UI, the individual with non-labor income BC faces a budget constraint ABC . With l months of leisure in the year, the individual works $12 - l$ months. In the figure, months of labor supply are read from right to left. Let H be the minimum number of months the claimant is required to work in order to be eligible for UI. In the present example, $H = 6$. The individual who works 6 months earns wages DE in the absence of UI. However, at H months of work, the individual qualifies for UI and the budget constraint jumps up by the value of the UI benefit. This individual is entitled to 6 months of benefits which equals $DF = 6 \text{ months} \times (0.6 \times w)$, where $w =$ monthly wage. An additional month of work beyond H means UI benefits fewer by one month's. Thus, beyond H , the budget constraint has a slope of $-(1 - 0.6) \times w$. Therefore, with UI, the individual's budget constraint becomes $AFDBC$, as shown in [Figure 1](#).³

To maximize utility, the individual chooses the point on the budget constraint where the indifference curve, $U(C, l)$, touches the budget constraint. Comparing the budget constraint in the absence of UI (line ABC) with the budget constraint in the presence of UI (line $AFDBC$), one can see that UI may change the individual's combination of C and l , since receiving UI benefits improves utility gain. This new labor decision is caused by the incentive inherent in the UI system (Phipps 1990).

The static labor supply model predicts that with the introduction of UI, individuals who work less than 6 months (or less than CH months) in a year may lengthen the number of months worked to exactly 6 months to qualify for UI, while those who work a few months more than H may shorten the number of months worked to exactly H , since at that point all of the remaining non-employment period is compensated, which increases utility.

Search model

The search model provides an alternative viewpoint of the way UI affects labor supply decision. In contrast to the static labor supply model, the search model incorporates an element of uncertainty. Individuals make their decisions each month based on the available information. Suppose that an individual takes a job at a monthly wage, w . With new information about the job each month, the individual must decide whether to remain on the job or to become unemployed. The individual makes this decision by comparing the expected utility from the current job if he/she were to remain in that job for the rest of their life, versus the utility from quitting the current job and undertaking an 'unemployed' search for a new one.

How does the UI system affect the employment duration in this model? Consider an individual making a decision on whether to quit before completing $H (= 6)$ months on the current job. The value of the unemployment option is based on consumption out of whatever savings the individual has built up and the expected value of the unemployed search. If the individual makes a decision to work H months, the value of unemployment includes consumption out of UI benefits. With a higher value for the unemployment option at H , this model predicts more jobs with H months of employment duration than with less than H .

Implicit contract model

In the implicit contract model, the decision to terminate a job is made by the firm. Consider a firm operating in an uncertain environment where demand for its product could rise or fall in a given year. The exact value of its demand in a given year is not known. The firm, thus, draws up a contingency plan for each possible level of realized demand. The capital stock of the firm is taken as fixed, but the firm can adjust to different levels of demand by adjusting the wage, the hours worked per employee, and the number of employees.

It is assumed that given a production technology the firm is indifferent to whether it adjusts to a demand change by changing the hours worked per employee or the number of employees. With a pool of prospective employees, the firm will adjust its decision by taking into account the preferences of these employees. This is because these employees have some opportunity outside this firm's labor pool and that outside opportunity brings them a level of utility, U^* . To keep the workforce it needs for production at a possible level of demand, the firm will set the wage and hours of work

per week that permit employees to have at least U^* utility. The contract is set so that the firm maximizes profit and the employees get at least U^* utility (Green and Riddell 1995).

This model assumes that employees are risk-averse, but the firm is indifferent to risk. The firm is indifferent to adjusting hours of work per employee or the number of employees when there is a demand shock. This is not true for employees. An adjustment in the number of employees (layoffs) leads to a much greater variation in consumption and much greater uncertainty. Thus, the employees would be more willing to have a wage cut and hours of work reduced than be laid off. For a given wage and fixed contract period, the employees' budget constraint and preferences are the same as in the static labor supply model. The firm will set the months of employment such that each employee gets at least U^* of utility.

In the presence of UI, what will be the employment duration for each employee? Suppose that for some level of demand the firm is choosing between hiring employees for H months or $H-1$ months. In either case, the employees must get U^* level of utility. But, in case of H months, the employees can collect UI benefits on top of their labor earnings after job termination. As a result, the firm would have to pay employees hired for $H-1$ months additionally to compensate for the forgone income from UI. Therefore, this model predicts that the firm tends to set the contract such that the employees are employed for H months, or in other words, it is more likely that the job duration ends at H months. When there is a downward variation in demand, the firm may use a combination of employing some individuals for H months and laying off the rest.

Is there any evidence supporting the predictions from these models? The answer to this question is discussed next.

EMPIRICAL EVIDENCE AND POLICY IMPLICATIONS

Card and Riddell (1993) analyzed unemployment in Canada and the United States. They conjectured that the Canadian UI system led some Canadians with low-labor attachment to work just enough to continue collecting UI benefits and to report their non-working time as unemployment. In the United States, the UI eligibility requirement is longer and the benefits are less generous. Thus, its recipiency rate⁴ is low—only about one-quarter of those with unemployment experiences in 1986 reported any UI income. However, in Canada the overall recipiency rate was close to 60 percent in the same year.

What is the empirical evidence on employment durations? Does the evidence support theoretical predictions? Since the UI recipiency rate in Canada is high, it might be worthwhile to study the Canadian experience. In Canada, the minimum work period (measured in weeks) to qualify for UI varies with the regional unemployment rate. For example, the UI system in 1989 allowed workers who had worked at least 12 weeks in a job of at least 15 hours per week in the qualifying period, and who lived in a region with the unemployment rate of 8 percent, to collect UI benefits for 28 weeks. For the same regional unemployment rate, if they worked for 17 weeks, workers could also collect benefits for the rest of the year (33 weeks plus 2 weeks waiting period). In this example, there are two spikes on the budget constraint; the first appearing at the minimum eligibility requirement week (12 weeks) and the second at the week that allowed the UI claimants to collect benefits for the rest of the year (17 weeks). With a UI reform in 1990, the minimum weeks of work to qualify for UI benefits of workers in the same regional unemployment rate were increased from 12 to 18 weeks, but the benefit period was reduced to 21 weeks (Green 1994, 16). To qualify for UI benefits for the rest of the year, the workers had to work 24 weeks. The spikes on the budget constraint are expected to move to 18 and 24 weeks in 1990. In other words, we can expect the average employment duration to be of 12 weeks in 1989 and 18 weeks in 1990 after the reform for the region with 8 percent unemployment rate.

An empirical investigation by Green and Riddell (1995) supports these theoretical predictions. They found significant impact of an increase in entrance requirement on employment durations. That is, employment durations that would have been of between 10 and 13 weeks in 1989 (in the regions with 11 to 12 percent unemployment rate) were extended to at least the new entrance requirement of 14 weeks in 1990. Green and Riddell showed that workers who worked just to qualify for UI in a year were disproportionately low-skill, non-unionized workers in small establishments in the primary and the service sectors. The workers also tended to be paid lower wages but required to work longer hours per week. They increased their worked weeks sufficiently to qualify for UI by moving to jobs in different sectors. As predicted by implicit contract model, employers play an important role in adjusting weeks of work to the eligibility requirement.

Although the impact of UI cannot be studied for Thailand where the system is still not in effect, we may expect a similar adjustment as in the Canadian case in labor behavior when UI benefits are introduced. From the theoretical point of view, UI is expected to encourage seasonal workers who work less than the minimum eligibility requirement

(e.g., less than 6 months, as in Figure 1) to increase their labor supply, and those who work more than the minimum eligibility requirement to reduce theirs, to match the minimum eligibility requirement. One evidence that might support this prediction is the seasonal employment and unemployment patterns in Thailand (Figure 2). The data used here is taken from the Labor Force Surveys (LFSs). Since the Thai LFS is not a longitudinal survey, we cannot analyze employment duration of the Thai labor market.

The employed in Figure 2 include those who work at least one hour a week in establishments with 10 or more employees in the following sectors: manufacturing, construction, commerce, transportation and telecommunication, and services. The unemployed are those who are looking for work as well as those who are not looking for work, but available for work. From the Figure, employment in both medium-sized (10-99 employees) and large establishments (100 or more employees) usually reaches its peak in the first quarter and its trough in the third quarter, except in the third quarter of 1993 and the first quarter of 1998 (where the economy could be characterized as entering the boom and bust periods, respectively). The same patterns are also evident for the national unemployment rate. These patterns could be the result of seasonal mobility of low-skill labor from the formal sector to the informal agriculture sector in quarter three of the year (the rainy season). The patterns lend support to the expectation that, with UI, employees in the medium or large establishments may work up to the minimum eligibility requirement months. Upon the termination of their employment, they could collect UI income while working in the informal agriculture sector. Since UI is not designed to be a tool for income distribution, this expected behavior may not be a desired outcome for the majority taxpayers.

Given these employment and unemployment patterns, we may also expect a higher number of the employed, but a lower average hours of work in the presence of UI. However, the unemployment rate may not be lowered significantly since the UI system may induce individuals, who are not in the labor force, to participate in the labor force to avail UI benefits. At present, the average hours of work per week for employees in the medium and large establishments is around 50 hours. If the UI system requires a minimum of 30 hours of work per week (which is defined as full-time work in Western countries) of insurable employment, one expects employees and employers to alter their behavior as predicted by the implicit contract model. That is, firms that need large unskilled labor in the first quarter may increase the number of employed and hire each employee at a rate equivalent to the minimum eligibility requirement hours of work per week and for a period equivalent to the minimum eligibility requirement months so that the employees qualify for UI income when they are terminated from their formal-sector jobs.

The above employment-sharing pattern may not sound convincing without some evidence from other countries. Therefore, the following “community pressure” model described by Canada’s Newfoundland Royal Commission on Employment and Unemployment is presented below, since it may provide some justification and insight to policy-makers.

‘Since jobs are so scarce, employers come under pressure from the community to qualify as many people as possible for UI. Although not always strictly adhered to, the informal rule is that once someone qualifies, he or she should be laid off and someone else hired until that person in turn qualifies... This pattern of short periods of employment followed by long periods of unemployment... has covertly become the main form of income security in Newfoundland (Green and Riddell (1995), p. 18).’

To introduce UI to the Thai labor market, one needs to understand employment and unemployment patterns as well as the response of labor behavior to the policy changes. One of the UI parameters this article focuses on, is the minimum eligibility requirement months of work. By setting the minimum eligibility requirement months at a low level may induce individuals who are not in the labor force to work for a short period and may alter employees’ and employers’ behavior as explained earlier. On the contrary, by setting the minimum eligibility requirement months at a high level may not benefit the disadvantaged employees who really need UI. Further research on labor behavior, therefore, should be done prior to the settlement of the UI policy.

CONCLUSION

This article has provided theoretical predictions of the effect of UI on employment patterns. The three models presented, viz., the static labor supply model, the search model, and the implicit contract model predict that in the presence of UI it is more likely that employment duration ends when it reaches the minimum eligibility requirement for availing UI benefits. Individuals, thus, can consume out of UI benefits while they are unemployed and then come back to work when UI benefits are exhausted. Given the seasonal employment and unemployment patterns in Thailand, the models predict an increase in the number of employed persons but a decrease in the average hours of work per week to the minimum eligibility requirement in the period of high labor demand. In addition, repeat use of

UI may also be anticipated.

The labor response to changes in one of the UI parameters discussed in this article is an example of misuse of UI. However, the objective of this article is not to discourage implementation of UI, but on the contrary, to provide some insights into the possible changes in labor behavior, and thus stress the need to have a thorough comprehension of the labor market prior to the implementation of the program to make it more effective. It needs not be further stressed that UI should work as insurance to employees, cushioning them from labor market uncertainties and business fluctuations, and not as a mode to distribute income. Jobs that involve seasonal transition of employment and unemployment do not reflect uncertainty. The decision to include them in insurable employment should be taken with care. This is because the UI program may alter employee and employer behavior such that it increases the social cost of the UI system. Moreover, it is suggested that research on Thai labor behavior be undertaken before the UI system is implemented.

One final remark is about the administrative database that should be developed concurrently with the initiation of the Thai UI system. This is important because the data will provide policy makers with information on the use of UI, employment and unemployment durations etc. Therefore, the UI institution should have the record of employment and unemployment. The record of employment should be filed to the UI institution whenever an individual takes on a new job or is laid off. The record of unemployment should be filed to the UI institution whenever a claimant receives the UI benefit. The records should include personal information such as age, gender, marital status, number of children, education, place of birth, and area of residence, and labor market information such as occupation, size and industry of workplace, years of work experience, and number of UI used. The database may not be able to include those among the unemployed who do not claim UI benefits, or record their economic activities during the period of unemployment, but they may be included in the LFSs. Therefore, the LFS of Thailand should be developed into a longitudinal survey so that in future policy makers are able to understand the employment-unemployment transition of the Thai labor.

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