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I Z A
World of Labor
Evidence-based policy making

Compensating displaced workers

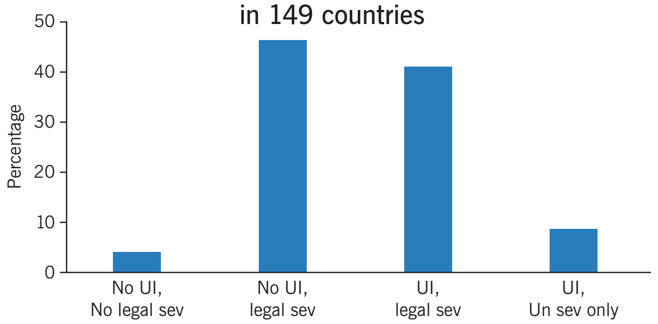
Job displacement is a serious earnings risk and the displaced are typically poorly insured

Keywords: job displacement, unemployment insurance, severance pay, wage insurance, UI savings accounts

ELEVATOR PITCH

Job displacement is a serious earnings risk to long-tenured workers, both through spells of unemployment and through reduced wages on subsequent jobs. Less developed countries often rely exclusively on government mandated employer-provided severance pay to protect displaced workers. Higher income countries usually rely on public unemployment insurance and mandated severance pay. Beyond these options, more administratively demanding plans have been proposed, including UI savings accounts and "actual loss" wage insurance, though real-world experience on either model is lacking.

Distribution of job displacement insurance (JDI) systems in 149 countries



Note: UI: Public unemployment insurance; Legal sev: Legally mandated severance pay; Union sev only: Severance pay by union contract only.
Source: Author's own calculations from [1].

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KEY FINDINGS

Pros

- Job displacement of long tenured workers is a major risk to lifetime earnings, both from unemployment spells and reduced earnings upon reemployment.
- An integrated system of unemployment insurance and severance pay could offset much of job displacement-related earnings losses.
- The larger part of job displacement losses are reemployment wage losses, which are persistent and strongly linked to job tenure at the displaced job, making scheduled benefits feasible.
- The incidence of job displacement of long tenured workers is relatively small, and expected costs to the firm at the time of hire modest.

Cons

- Unemployment spells are less well defined in more informal labor markets.
- The wage loss data required for designing an ideal system are not available for many countries.
- Job displacement losses near retirement are especially difficult to estimate robustly because of the availability of alternative disability and retirement support and voluntary withdrawal from work.
- The ideal wage rate protection, wage insurance, is administratively expensive, forcing protection programs to rely on "scheduled benefits," which is essentially severance pay.

AUTHOR'S MAIN MESSAGE

It is important to recognize job displacement as a serious risk and to design programs to insure against it. The risk is two-fold: earnings losses from unemployment spells and wage losses upon reemployment. Informal labor markets limit displacement benefits to fixed sum amounts at displacement, i.e., severance pay. Formal markets additionally enable actual loss unemployment insurance. Severance pay, whether mandated or voluntarily provided, only crudely targets reemployment wage losses. Programs have been proposed to improve the situation, including unemployment insurance savings accounts and (actual loss) wage insurance, although neither has been fully tested at the operational level.

doi: 10.15185/izawol.444.v2 | Donald O. Parsons © | February 2024 [Previous version September 2018] | wol.iza.org