

Moving from Severance Pay to Unemployment Insurance: Asian Experiences and Justification

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What is Severance Pay?

also called ...

dismissal compensation,

redundancy compensation,

termination benefits,

and leaving allowances

Example: Cambodia

Article 89: If the worker is dismissed for a reason other than serious misconduct, the employer must pay an indemnity for dismissal. The amount of the indemnity depends upon the employee's length of continuous service: - for employment from 6 to 12 months: 7 days wages and benefits; - for employment over 1 year: 15 days wages and benefits for each year of employment, up to a maximum of six months' wages. This only applies to contracts of an unspecified duration.



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Cambodia - Severance pay and redundancy payment

[\(-\) hide remarks](#)
 2010

 2009

[+ show references](#)

Severance pay:

Remarks:

- *Article 89 LC: If the worker is dismissed for a reason other than serious misconduct, the employer must pay an indemnity for dismissal. The amount of the indemnity depends upon the employee's length of continuous service:*
 - for employment from 6 to 12 months: 7 days wages and benefits;
 - for employment over 1 year: 15 days wages and benefits for each year of employment, up to a maximum of six months' wages.*This only applies to contracts of an unspecified duration.*

Note that art. 73 LC provides that: at the expiration of a fixed-term contract (the end of the term or completion of the task), the employer must pay the employee severance pay which may be fixed by collective agreement but should not in any case be less than 5 per cent of the total wages paid during the length of the contract.

- o tenure ≥ 6 months: **7 day(s)**
- o tenure ≥ 9 months: **7 day(s)**
- o tenure ≥ 1 year: **15 day(s)**
- o tenure ≥ 2 years: **30 day(s)**
- o tenure ≥ 4 years: **60 day(s)**
- o tenure ≥ 5 years: **75 day(s)**
- o tenure ≥ 10 years: **150 day(s)**
- o tenure ≥ 20 years: **6 month(s)**

Moving from Severance Pay to Unemployment Insurance

	Compulsory Severance Pay	Unemployment Insurance
India	Yes, since 1947	No
Indonesia	Yes	No
Korea	Yes, 1961	Yes, since 1995
Malaysia	Yes, since 1955	No
Philippines	Yes, since 1974	No
Sri Lanka	Yes, since 1950	No
Thailand	Yes, since 1956	Yes, since 2004
Vietnam	Yes	Yes, since 2010

Brief Overview

1. Voluntary Severance Pay by some employers predated the promulgation of Compulsory Severance Pay Regulations.
2. Severance Pay Regulations were promulgated in almost all the countries many decades ago.
3. Severance Pay Regulations have not been so strictly enforced in many of Asian countries.
4. The Compulsory Severance Pay does not go away even after the Introduction of UI.

Questions

1. Why did some employers voluntarily provide severance pay even when it wasn't compulsory?
2. What are the rationales for making severance pay compulsory?
3. Why are the severance pay regulations often not strictly enforced?
4. If strictly enforced, what kind of impact compulsory severance pay will have on the economy?
5. Why do we need Unemployment Insurance?
6. Why can't we get away with Severance Pay when UI is introduced?

1. Why did some employers voluntarily provided severance pay, even when it was not compulsory?

It is because some employers, especially in the industries where workers' firm-specific and/or industry-specific knowledge and skills play a very important role, found that severance pay would be an efficiency enhancing human resource instrument, as a device tightening existing bonds between workers and firms, in order to reduce the transaction costs and the loss of firm-specific knowledge and skills due to turnover .

(Holzmann, Pouget, Vodopivec, and Weber 2011: 27)

→ Severance Pay can benefit not only workers but also some employers.

→ If so, why did they make it compulsory?

2. What are the rationales for making severance pay compulsory?

Social Benefits of Severance Pay

1. Promotion of Industrial-Specific Skills
2. Stable Industrial Relations
3. Reduction of Social Unrest

- The benefits of severance pay each employer can enjoy vary, depending on the type of industry.
- Those employers who enjoy the benefits of compulsory severance pay most do not usually coincide with those who bear the cost.

3. Why are the severance pay regulations often not strictly enforced?

1. In the case of bankruptcy and retrenchment, employers often lack resources to provide severance pay to the laid-off workers.
 2. It is difficult for the government to monitor whether the employer has provided severance pay properly. In the case of the employer's breach of conduct, laid-off workers can get severance pay only when they file a complaint to the government agency, which many workers feel reluctant.
- The better organized and vocal workers tend to get severance pay, while the rights of unorganized workers with weak voice are often ignored.

Severance eligibility and receipt by employee and job characteristics

	Employees eligible for severance pay as a proportion of all job separations	Employees who received severance pay as a proportion of all eligible	Employees who received severance pay as a proportion of all separations
Age			
15–18 years	16.1%	12.9%	2.1%
19–24 years	16.2%	13.4%	2.2%
25–34 years	17.3%	39.5%	6.8%
35–49 years	26.1%	56.6%	14.8%
50–64 years	20.8%	36.6%	7.6%
65 years and older	29.7%	66.4%	19.7%
All ages	18.4%	33.4%	6.1%
Gender			
Female	14.9%	26.8%	4.0%
Male	21.3%	37.2%	7.9%

(Brusentsev, Newhouse, Vroman 2012: 21)

Table 2**Severance eligibility and receipt by employee and job characteristics**

	Employees eligible for severance pay as a proportion of all job separations	Employees who received severance pay as a proportion of all eligible	Employees who received severance pay as a proportion of all separations
Firm size			
1–4 employees	10.1%	18.8%	1.9%
5–19 employees	14.0%	26.1%	3.7%
20–99 employees	21.3%	37.6%	8.0%
100+ employees	25.4%	37.5%	9.5%
Firm status			
Government agency	14.0%	11.6%	1.6%
State-owned enterprise	19.5%	31.5%	6.2%
Domestic private firm	22.8%	42.6%	9.7%
Foreign firm	21.9%	22.5%	4.9%
Individually owned	14.2%	26.4%	3.8%
Other	18.6%	28.0%	5.2%

((Sakernas (2008) quoted in Brusentsev, Newhouse, Vroman 2012: 22)

Table 2

Severance eligibility and receipt by employee and job characteristics

	Employees eligible for severance pay as a proportion of all job separations	Employees who received severance pay as a proportion of all eligible	Employees who received severance pay as a proportion of all separations
Wage (IDRs)			
Less than 250,000	9.8%	20.3%	4.0%
250,001–500,000	15.3%	18.3%	2.8%
500,001–1 million	20.2%	32.7%	6.6%
1–1.5 million	21.8%	52.4%	11.4%
More than 1.5 million	11.9%	50.3%	6.0%

(Sakernas (2008) quoted in Brusentsev, Newhouse, Vroman 2012: 22)

4. If strictly enforced, what kind of impact compulsory severance pay will have on the economy?

Positive Impact

1. Promotion of Industry- and firm- Specific Skills
→ Higher productivity in some industries that heavily depend on workers' skills
 2. Stable Industrial Relations
 3. Reduction of Social Unrest
- Better Investment
Climate & Fewer
Production Interruption

4. If strictly enforced, what kind of impact compulsory severance pay will have on the economy?

Negative Impact

- It tends to hamper the structural adjustment of the economy, by making it difficult for employers to close down the production units that lost competitiveness, and set up a new production unit with new workers.
(Lazear 1990)

How to minimize the negative impact? → Question 5

5. Why do we need Unemployment Insurance?

The Difference between UI and Compulsory SP

1. Who bear the cost?

Unemployment Insurance:

Widely and thinly shared by all the employers and the employees (and the government in some countries)

Compulsory Severance Pay:

All the burdens are put exclusively and heavily on employers who fire workers.

- Layoffs are less likely in the growing industries, and more likely in the declining industries.
- Therefore, compulsory severance pay tends to put much burden on the employers in declining industries.
- But its positive social impact such as reduction of social tension and stronger incentives for workers to update and upgrade their skills, tends to be enjoyed more by employers of growing industries than those of declining industries.

The Difference between UI and Compulsory SP

2. Chances for employer's non-compliance

Unemployment Insurance: **low**

Compulsory Severance Pay: **high**

3. Deterrence of Lay-off

Unemployment Insurance: **low**

Compulsory Severance Pay: **high**

- Lay-off Deterrence has both the positive and negative aspects.
Positive Side: It provides better job security for existing workers.
Negative Side: It may hamper job creation by making structural adjustment difficult.

6. Why can't we get away with Severance Pay when UI is introduced?

(1) Workers' Resistance

- Workers' Distrust against Unemployment Insurance (especially in its initial stage)

A New Form of "TAX" under a Beautiful Name?

For the majority of workers, the amount of money they are required to pay as their contribution to UI is likely to far exceed the amount of money they may get from UI.

[Thailand's Case]

Contribution Rate for workers: 0.5% of their salary

UI benefit for the involuntarily laid-off workers:
50% of their salary for six months

Expected Amount of UI benefit for those who believe that their chance of being laid-off is 10%:

6-month salary $\times 0.5 \times 0.1 = 0.3$ -month salary

The amount of workers' contribution in 5 years:

0.005-month salary $\times 12 \times 5 = 0.3$ -month salary

For those who expect that they will not be laid-off in the first four years and that their chance of being laid-off will be less than 10% in the fifth year, the expected amount of the UI benefit is smaller than the amount of their contribution.

6. Why can't we get away with Severance Pay when UI is introduced?

(2) UI's lack of job security enhancement

Workers tend to feel that the abolition of compulsory severance pay in exchange for the introduction of UI will negatively affect their job security.

Metaphorical Comparison of Severance Pay and UI to Car Horn and Safety Belt

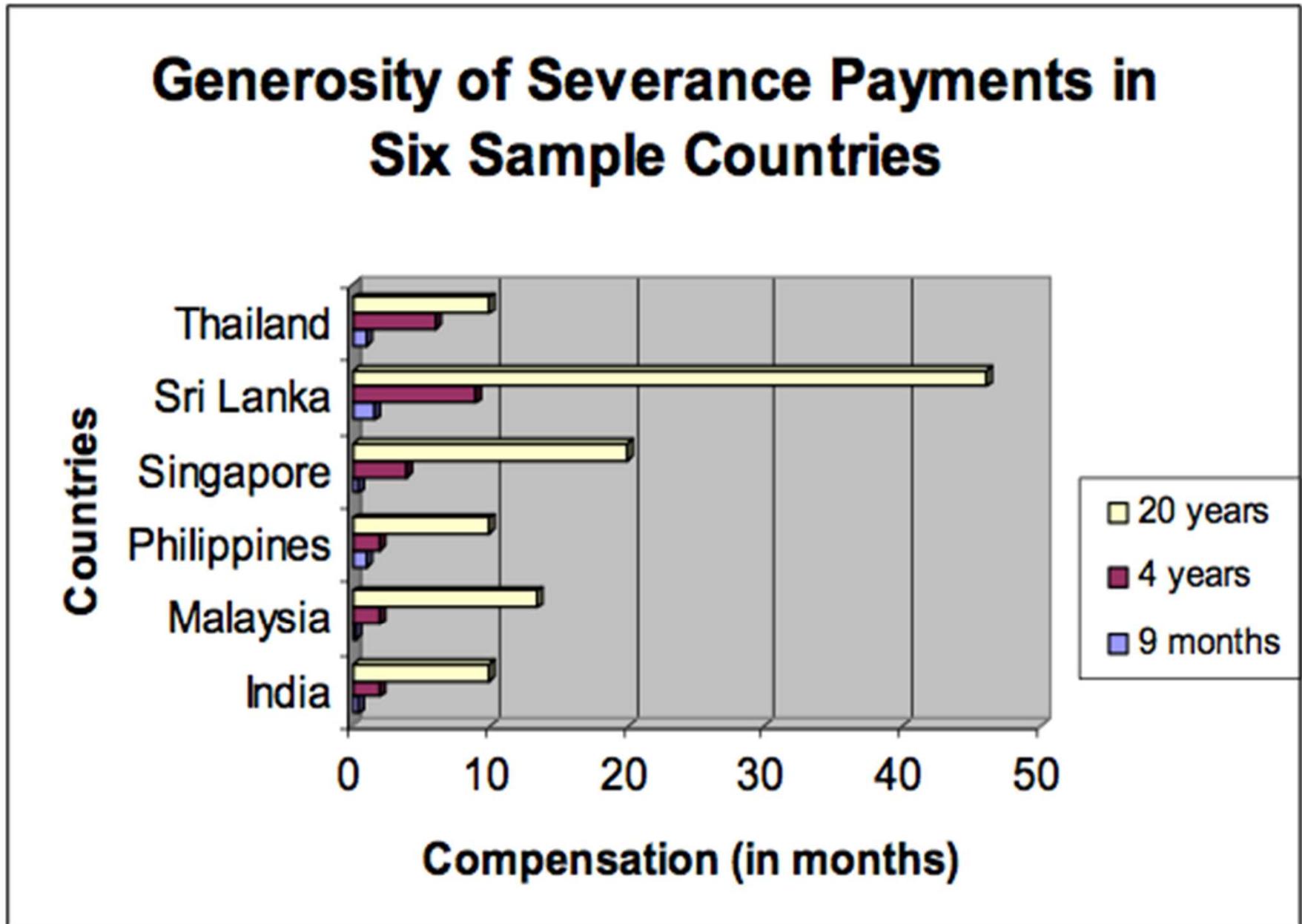


- Reduce the Risk (somewhat)
- (very) limited protection in the case of "accident"



- **No** Risk Reduction
- Better protection in the case of "accident"

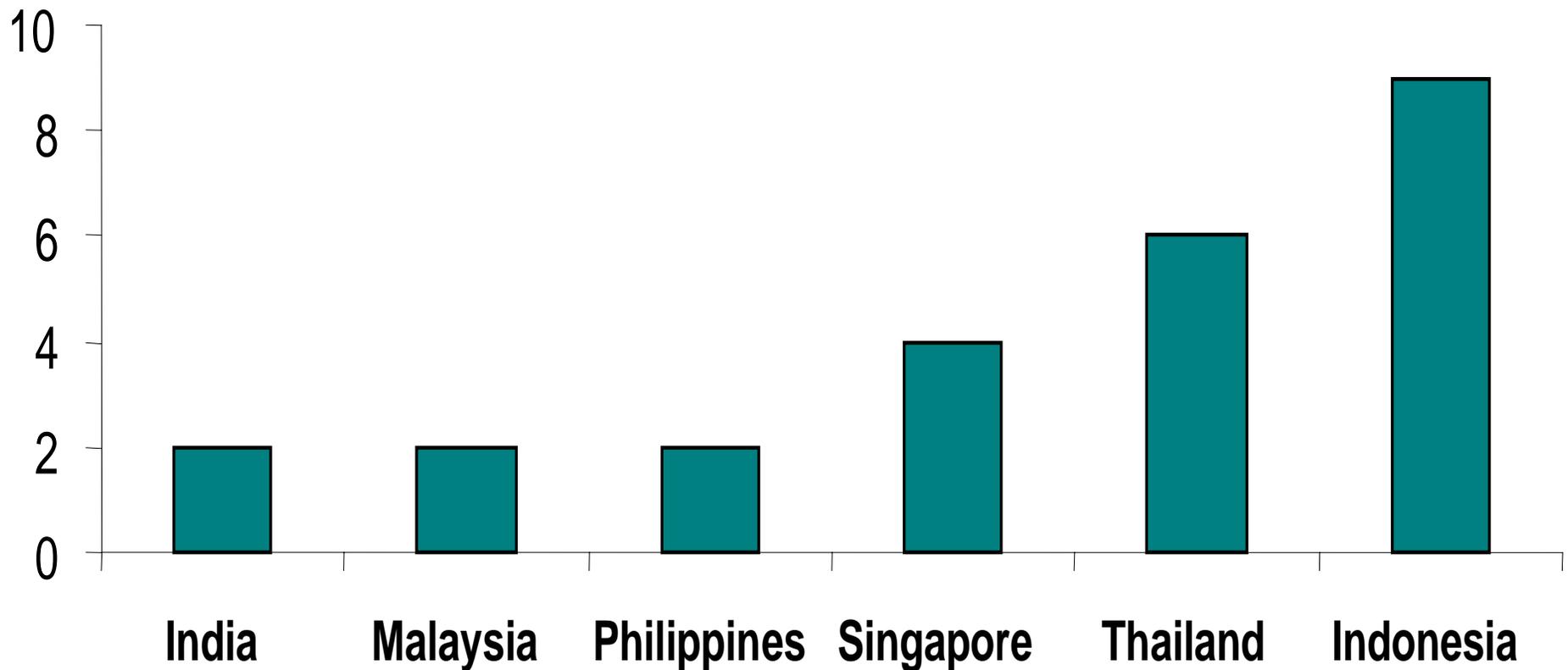
Employers' Anxiety about "Too Generous" Severance Pay



(Source: Asher 2004: 16)

A worker with 4-years experience at the firm and dismissed for economic reasons

Severance pay in no. of monthly wages



(Source: GIAT-UNPAD 2004)

"Too Generous" Compulsory Severance Pay Regulation is likely to hamper economic development.

- For those countries where compulsory severance pay regulation is too generous, it is advisable to reduce the compulsory severance pay in exchange for the introduction of UI. But the total abolition of compulsory severance pay is politically difficult and economically unnecessary, for most of the countries in the region.

Consideration for Workers in the Informal Sector

- It is administratively difficult and unadvisable to extend the coverage of UI to workers in the informal sector.
- Compulsory Severance Pay regulations can cover some portions of workers in the informal sector, but not all of them.
- For the protection of workers in the informal sector, it would be better to set up a separate program from UI.
- Though UI does not protect workers in the informal sector directly, it is likely to benefit them indirectly through its job creation effect.

Tentative Policy Recommendation:

- (1) It is not recommendable to make compulsory severance pay provisions too generous to appease workers. It will make the introduction of UI more difficult.
- (2) As for compulsory severance pay, it is more important and beneficial for workers to make its enforcement more strict than to make the provisions specified in the regulation more generous.
- (3) For those countries that have not yet introduced UI, it is recommendable to start seriously planning its introduction.

Additional Suggestions

- Keep the contribution rate as low as possible (even at the expense of low UI benefits).
- Do not spend UI fund on other purpose than unemployment benefits.
- Job Creation, Enhancement of Employability of Workers, and Provision of Social Protection for Workers in the Informal Sectors are all very important. But the programs for these purposes should not be mixed with the UI scheme. Those programs should be kept financially separate from the UI scheme.

Tentative Policy Recommendation (cont'd):

- (4) Introduction of UI is a necessary condition for a newly industrializing country to survive and thrive in the highly competitive globalized world without suffering avoidable social pains. But it is NOT a sufficient condition.
- (5) In order to have a well-functioning UI, very careful planning, skillful negotiation, strongly determined but behind-the-scene initiative by labor ministry officials, and a certain level of administrative capability and transparency are required. So far as UI is concerned, financial constraint does not pose a serious obstacle.

Tentative Policy Recommendation (cont'd):

"Risk of ending up with having improperly-designed and/or improperly-operated UI is not small in many of developing economies. Once improperly designed UI is introduced, or once the UI scheme is seriously plagued with corruption and inefficiency in the first several years of its operation, the public will lose their confidence in UI, and both employers and employees will start resorting to all means available to evade the payment of their contribution to UI. The morale of the staffs in charge of UI will also deteriorate, and the abuse of the UI scheme by unqualified claimants will also become rampant. In this sense, the introduction of UI is a once-and-for-all chance. If a proper UI scheme is successfully installed, it will do a lot of good things. But if not, it may do more harm than good. To make it worse, once it is installed, it is difficult to uninstall. However, it should also be added that, though the introduction of UI is a risky endeavour, it is more risky for small export-dependent second-tier NIEs to face the volatility of the global market without having UI."

(Asami 2010: 193)

Thank you!

Suggestions, Questions, any Comments,
please contact:

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[Thailand's Case]

Rate of Contribution as Percentage of Wages of Worker

worker: 0.5% of his/her salary

employer: 0.5% of a worker's salary

government: 0.25% of a worker's salary

1.25% vs $50\% \times 2\% = 1.0\%$

Mismanagement of the UI Fund in Japan between 1999 and 2005

A huge surplus for many years at that time in the 1990s
→ Under the strong recommendation of some of the Labor ministry officials, the Japanese government spent about 440 billion Japanese yen (equivalent to about US\$5.5 billion) out of the UI fund on the construction of 2,070 facilities for the purpose of job creation and vocational training between 1999 and 2005. But almost all those facilities and related programs were so badly managed that the government finally abandoned all those 2,070 facilities, and sold them. The amount of the money they got back by selling off those facilities was mere 12.7 billion yen (less than 3 % of the money they spent on the construction).