



Assessing the effects of reemployment bonuses on job search: A regression discontinuity approach

Taehyun Ahn

School of Economics, Sogang University, 35 Baekbeom-ro, Mapo-gu, Seoul, 04107, Republic of Korea



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ABSTRACT

This study examines the impacts of reemployment bonuses, that is, the incentive payments to unemployment insurance (UI) recipients who find a job within a specified period, using Korean data. A sharp discontinuity in treatment assignment at age 55 identifies the effect of increased reemployment bonuses on unemployment duration and on subsequent job duration. The results indicate that increases in the reemployment bonus boost the job-finding hazards of UI claimants early in their unemployment spells during the bonus qualification period and significantly shorten the duration of UI spells by 0.16 to 0.42 months (0.68 to 1.82 weeks). In addition, employment stability is not significantly affected by an increased bonus, which implies no negative influence of the bonus on subsequent job match quality. The simulated estimates show that the increase in tax revenue and the decrease in UI benefit payment caused by the behavioral response of UI recipients are large enough to offset the increased cost of the reemployment bonus.

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1. Introduction

The unemployment insurance (UI) systems in many countries intend to provide short-run income support for involuntarily unemployed workers while they search for work. The UI benefits enhance the welfare of risk-averse individuals affected by adverse employment shocks by smoothing consumption. However, at the same time, UI may induce moral hazard and create disincentives to rapid reemployment. The payment of UI benefits may cause unemployed individuals to search less intensively for new jobs than they would in the absence of UI, which increases the duration of unemployment.¹ The balance between incentives to job search and consumption smoothing through insurance is an important concern in designing UI programs. In response to search disincentives, many countries have traditionally imposed various job-search requirements. More recently, policymakers have considered and introduced additional services for UI claimants, including job-search assistance, job-search monitoring, and financial incentives in addition to changing the generosity and time profile of UI benefits (OECD, 2013).

In this study, I specify a simple model that illustrates how reemployment bonuses, (the incentive payments to UI recipients who find a job within a specified period) affect the intensity of their job search. I then

empirically investigate the effects of the reemployment bonus on the job-finding rate and on subsequent job duration, using Korean data. The reemployment bonus in the UI system is often considered as a way to increase job-search efforts among unemployed workers. It is well recognized that the optimal UI is determined by balancing the consumption insurance value and the cost of moral hazard (Baily, 1978; Chetty, 2006, 2008; Shimer and Werning, 2008). Bearing in mind this principle, we can consider the reemployment bonus to be a useful complement to the existing UI benefit because the bonus can stimulate job searching only by reducing moral hazard while preserving the insurance value of the UI.

Reemployment bonuses have been tested mostly by field experiments conducted in the United States (Wandner, 2010). Results from the US cash bonus experiments are mixed and, hence, show no conclusive evidence on the effectiveness of the bonuses (Woodbury and Spiegelman, 1987; Decker, 1994). Based on outcomes from the field experiments, Meyer (1995, 1996) argued that while monetary bonus affects the speed with which unemployed workers find a job, a permanent bonus program may increase incentives to file for UI benefits, the extent of which cannot be assessed by experimental studies.

Korea is one of the few countries that administer a nationwide reemployment bonus program within the UI system. Recently, Korea introduced an age-based payment structure in which a higher bonus rate is applied to individuals aged 55 or older, which provides a rare opportunity to identify the causal effects of the reemployment bonus. In the estimation, I examine the differences in the job-finding hazard and

E-mail address: ahn83@sogang.ac.kr.

¹ See Chetty and Finkelstein (2013) and Tatsiramos and van Ours (2014) for recent overviews of theoretical and empirical studies.

reemployment duration between individuals just below and above age 55 before and after the bonus policy change by combining a regression discontinuity design (RDD) and the difference-in-differences (DID) framework.

A key feature of my analysis is that the identification strategy relies on a sharp discontinuity in the reemployment bonus rate, which increases from half of residual UI benefits to two-thirds of the benefits at the age of 55. Comparing individuals who are unemployed and just below age 55 with those who are just above this threshold is the idea behind the RDD framework. This strategy is intuitively appealing because both the groups of unemployed workers are virtually of the same age.

Another important feature is that the analysis uses comprehensive data from administrative sources that cover the universe of unemployment spells, including information for the period before the age-based bonus policy was introduced. Using this information is helpful, first, in implementing a convincing RDD strategy. Although the treated individuals are barely older than the non-treated ones, an important concern is that the treated individuals may have an inherently different job-finding rate, because they may face a different labor market environment and are potentially eligible for other retirement and benefit arrangements in Korea. Comparing the differences in outcomes of the treated and non-treated individuals prior to the policy change and then contrasting them to the corresponding differences after the policy change, which is an idea of the DID framework, is effective in making the RDD framework persuasive. Second, the data are useful in assessing a potential *entry effect* suggested by Meyer (1995, 1996). The possibility of increased incentives to file for UI benefits, which cannot be assessed by experimental studies, can be verified by examining the pattern of the inflow into unemployment around the age threshold before and after the introduction of the age-based bonus policy, using the administrative records.

In an attempt to examine potential influences of an increased reemployment bonus on job match quality, I also estimate a discrete duration model for the subsequent job spell. I extend the existing empirical research in this dimension because of the concern that the treated individuals are less selective during the eligibility period for the reemployment bonus, which may negatively influence the match quality of the subsequent job. A low match quality potentially leads to a higher probability of leaving a post-unemployment job and ultimately undermines the effectiveness of the reemployment bonus program. While the assignment to treatment is based on an age-based discontinuity, it is possible that unobserved individual factors affecting the transition from unemployment to employment have an additional influence on subsequent job stability. To address this issue, I estimate a discrete-time duration model for the subsequent job duration *jointly* with the model for the transition from unemployment to employment and allow for potentially correlated unobserved heterogeneity.

The data display a significant discontinuity in the job-finding rate at the age 55 threshold after the bonus policy change: the treated individuals, who are just above age 55, are substantially more likely to find a job before exhausting their UI benefits than non-treated individuals, who are slightly below this threshold. The data, however, reveal no significant discontinuity around the age threshold in the old bonus scheme. In addition, I find no evidence of manipulation of timing of entry into unemployment, which supports the validity of the identification strategy.

In light of these patterns found in the data, I estimate discrete-time duration models for the transition from unemployment to employment and the models for subsequent job duration. The estimates from the hazard models indicate that increases in the reemployment bonus significantly shorten the duration of UI spell by 0.16 to 0.42 months (0.68 to 1.82 weeks). In addition, the estimates show that employment stability is not significantly affected by increased bonus, which implies no negative influence of the bonus on subsequent job match quality.

While the reemployment bonus is a tool for alleviating the moral hazard for job seekers without reducing the insurance value of UI benefits, the potential downside of the reemployment bonus is that the expenditure of government might increase, which may eventually increase taxes and make taxpayers worse off. To examine this concern, I investigate the consequences of reemployment bonuses on the government's net spending using the estimates from the hazard models. The simulated estimates show that an increased reemployment bonus reduces the government's net spending per claimant; the increase in tax revenue and the decrease in UI benefit payment caused by behavioral response of UI recipients are large enough to offset the cost increase in reemployment bonus. These findings provide positive evidence for the reemployment bonus program that can be used as a viable tool to shorten unemployment spells without worsening the government's budget balance.

The remainder of this paper is organized as follows. In Section 2, I present a review of related literature and institutional details regarding UI system and reemployment bonus in Korea. Section 3 specifies a theoretical framework that relates the reemployment bonus and job-search efforts. Sections 4 and 5 describe the empirical approach and the data used in the analysis. In Section 6, I report the estimation results and assess the consequences of reemployment bonuses on government's budget to discuss the welfare implications. Section 7 concludes the paper.

2. Background

2.1. Literature review

It is well-understood that the optimal UI system is designed by balancing the consumption insurance value with the cost of moral hazard (Baily, 1978; Chetty, 2006). In that context, reemployment bonus can be viewed as a complement to the UI benefits that correct the moral hazard cost of the UI. Previous studies on the effectiveness of reemployment bonuses have been mostly based on field experiments conducted in the US. The first pilot experiment was conducted in Illinois in 1984. In the experiment, randomly selected UI recipients were offered a \$500 bonus if they found a job within 11 weeks (qualification period) and remained in the new job for at least four months. Results suggest that this experiment reduced the spell of unemployment benefits, averaged over all assigned recipients, by more than one week and that the state UI offices appear to save money even after accounting for the cost of bonuses (Woodbury and Spiegelman, 1987; Spiegelman and Woodbury, 1987). These positive findings induced the government to test the employment bonuses further in New Jersey (1985–1987), Pennsylvania (1988–1989), and Washington (1988).

Unlike the case of Illinois, where the bonus offered a fixed amount during the qualification period, the New Jersey experiment had a payment structure in which the bonus payment declined over the duration of unemployment, so that the bonus received was greater the earlier that reemployment occurred. In addition, job-search assistance (JSA) services were combined with a bonus payment for the treated claimants. The findings suggest that while estimated influences are moderate, a declining bonus structure has a greater impact on short-term claimants than on long-term claimants who are likely to exhaust their benefits (Decker, 1994; Anderson, 1992).

The experiments conducted in Pennsylvania and Washington tested several different combinations of bonus amounts and qualification periods. The outcomes from these experiments reveal that while the impacts are the largest for the most generous bonus with the longest qualification period, the average reduction in the amount of time spent on UI is modest—about half a week per claimant—suggesting that the bonus program is not a cost-effective method of speeding reemployment (Decker and O'Leary, 1995). Evaluating the Pennsylvania and Washington experiments, O'Leary et al. (2005) argued that adopting a low bonus amount with a long qualification period, targeted

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