



Sanctions and the exit from unemployment in two different benefit schemes

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HIGHLIGHTS

- We examine the effect of benefit sanctions on the exit rate from unemployment using the timing-of-events approach.
- The effect of sanctions differs according to the benefits received.
- Sanctions increase the exit rate from unemployment to work among flat-rate labour market support receivers.
- Sanctions increase the exit rate from unemployment to outside the labour force among earnings-related benefit receivers.

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ABSTRACT

This paper investigates the effect of benefit sanctions on the exit rate from unemployment using a unique set of rich register data on unemployed Finnish individuals. The timing-of-events approach is applied to distinguish between the selection and causal effects of sanctioning. The results imply that the effect of sanctions differs according to the benefits received. Sanctions encourage unemployed individuals receiving flat-rate labour market support (LMS) to find jobs, whereas unemployed individuals receiving earnings-related (UI) allowances to leave the labour force. The encouraging effect of sanctions on active labour market policy programmes is relatively small and statistically significant only among LMS recipients.

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1. Introduction

There is a wide range of literature relating to unemployment duration and benefits (e.g., Meyer, 1990; Ham and Rea, 1987; Moffitt and Nicholson, 1982). Nonetheless, little is known about the effect of benefit sanctions. A small body of empirical literature indicates that even moderate benefit sanctions increase the job-finding rates of the unemployed (e.g., Abbring et al., 2005; Lalive et al., 2005; Van den Berg et al., 2004). Recent studies also suggest that the effect of sanctions decreases over their elapsed duration and that the effects differ for various types of unemployed individuals (Svarer, 2011). For example, male immigrants are more sensitive to sanctions than male natives. Few previous studies have examined the *ex ante* effects of sanctions, in which the mere threat of sanctions is assumed to affect the job search efforts of the unemployed. The results in this field of study are

inconclusive. Both Lalive et al. (2005) and Boone et al. (2009) find that the *ex ante* effect is significant because it stimulates the outflow from unemployment. Conversely, Van den Berg and Vikström (2014) find that the *ex ante* effect does not have a strong influence on the re-employment rate.

This paper investigates the effect of sanctions on the exit rate from unemployment. Sanctions, which are temporary benefit exclusions, are imposed on the unemployed when suitable job offers or active labour market policy (ALMP) programmes are rejected and when job search efforts are deemed inappropriate. We use large register data from the 2003 to 2009 period to perform a separate analysis for earnings-related (UI) and flat-rate labour market support (LMS) benefit recipients. This study represents the first attempt to conduct such an analysis. We also perform a diverse set of sensitivity analyses. We examine the strictness of sanctions, whether sanctions influence the exit rate

from unemployment to work and whether the influence of sanctions varies over time. To determine whether some individuals react to sanctions more strongly than others, we allow sanctions to interact with the characteristics of the unemployed.

The contribution of this paper is to provide new evidence to the sparse existing literature on benefit sanctions. Most previous studies have examined the effect of sanctions on unemployment duration for individuals receiving unemployment insurance benefits. An exception is the work of Van den Berg et al. (2004), who analyse the effect of sanctions on the transition from welfare (social assistance) to work. Our study is the first to provide a comparison of two different benefit schemes. It is important to investigate the effect of sanctions for different types of benefits because individuals receiving UI benefits differ from individuals receiving LMS benefits in terms of their employment opportunities and background, and because UI benefits exceed flat-rate LMS. Compared to LMS, UI recipients should have a larger incentive to reduce the reservation wage and increase the search intensity after imposition of a sanction due to the larger reduction in the value of being unemployed.

The data set that we use is large and diverse, whereas most previous studies have used relatively small samples that were often restricted to small geographic areas (see, e.g., Van den Berg et al., 2004; Lalive et al., 2005). In this paper, we also analyse the effect of sanctions on the exit rate from unemployment to ALMP programmes and outside the labour force. Recently, a number of papers report that sanctions increase not only the exit rate from unemployment to work but also the exit to non-employment (Arni et al., 2012; Røed and Westlie, 2012; Hillmann and Hohenleitner, 2012).

The remainder of this paper is organised as follows. In Section 2, we present a brief introduction to the Finnish unemployment benefit system and sanctions. The theoretical framework and econometric methods that are used in this study are discussed in Section 3. Section 4 describes the data that are used. The empirical findings of this study are presented in Section 5, and Section 6 concludes the paper.

2. Unemployment benefits and sanctions in Finland

In this section, the structure of the Finnish unemployment benefit system and sanctions is introduced. This description highlights the aspects of the system that are relevant to our study. The information given applies to the period from 2003 to 2009, which is the observation period in our study.

There were no significant changes to the benefit system between the years 2003 and 2009. However, one change was made to the sanction system during the observation period. In a policy reform in 2006 the monitoring and sanctions of long-term unemployed were tightened in Finland.¹ The main purpose of the reform was to activate long-term unemployed, that is, individuals who had been on flat-rate LMS for over 500 days or on UI allowance for the maximum 500 days and on LMS for over 180 days thereafter. For these individuals, ALMP measures were offered more frequently. Refusal of ALMP measures and/or work offers as well as neglecting job search plan implied exclusion of unemployment benefits until five months of work, education or ALMP measures was performed.

2.1. Unemployment benefits in Finland

There are two types of unemployment benefits: an UI allowance and a LMS.² Eligibility for UI benefits requires membership in an

¹ The reform is available in Finnish at <<http://www.finlex.fi/fi/laki/alkup/2002/20051217>> (accessed 15 March 2016).

² A third unemployment benefit, basic allowance (UA), is granted to unemployed individuals who do not belong to an insurance fund but who fulfil the employment condition. The UA is paid by the KELA for 500 days, and the level equals the LMS. UA recipients (7% of the unemployed) were not included in this analysis because they are few in number.

unemployment insurance fund (either an independent fund or a fund that is specific to a trade union) and an employment history of at least 10 months during the last 28 months prior to unemployment ('the employment condition'). Both membership in a union and membership in an unemployment insurance fund are voluntary. The maximum duration of UI is 500 business days, i.e., approximately two years.³ If a person does not fulfil the employment condition or is unemployed for more than 500 days, then he is entitled to LMS paid by the Social Insurance Institution (*Kansaneläkelaitos* KELA). The LMS is always means tested but the duration is essentially unlimited.

The UI benefit is based on prior earnings of the unemployed and is at the maximum 90% of the previous income level. By contrast, the LMS is paid at a flat daily rate that was 25.63€ (551€/month) in 2009. During the same year, the average daily UI allowance was 55.20€ (1187€/month). The LMS is means-tested whereas the UI benefit is not, which means that the spouse's income affects the eligibility for the LMS but not for the UI benefits. Table 1 summarises the information on unemployment benefits.

Unemployed individuals who receive a sanction may apply for other benefits such as basic social assistance (SA) and/or general housing allowance (HA), although the SA can be reduced by 20% or 40% depending on the sanction (40% for repeated violations).⁴ Because the SA is means tested, the reduction is not always used (the decision is made by a caseworker). Individuals can receive unemployment benefits and SA/HA simultaneously if their incomes are sufficiently low.

2.2. Sanctions in Finland

In Finland, the eligibility conditions for an unemployed individual to receive benefits and to avoid sanctions are: a) register with the public employment service (PES) as an unemployed person, b) actively search for a full-time job, c) apply to jobs suggested by the PES, d) accept ALMPs arranged by PES, e) participate in making a job search plan and f) report to the PES on a regular basis and discuss the job search plan. A compulsory job search plan is created at the beginning of unemployment and specifies how the unemployed will seek work (e.g., which jobs to apply to) and whether ALMP measures are needed to promote employment. Violations of criteria b–f or inadequate search efforts, as evaluated by the PES via interviews,⁵ result in sanctions. Sanctions do not reduce the number of benefit entitlement days; benefits are merely postponed by the period of the sanction. In addition, receiving a sanction does not exclude benefits from the time spent in an ALMP measure. Thus, sanctions are intended to encourage unemployed individuals either to find a job or to participate in an ALMP programme.

Most of the sanctions are temporary and have fixed duration of 60 days. In some cases, conditional sanctions (henceforth, 'exclusion of benefits') are imposed, rendering an individual ineligible for unemployment benefits until 90 days of work, education or ALMP measures have been completed. For the long-term unemployed (those unemployed for more than 500 days) and for the young unemployed (those under 25 years of age), the sanctions are stricter: the exclusion of benefits for 150 days.

Table 2 summarises the reasons for and the duration of benefit sanctions. All sanctions entail a 100% reduction in benefits. Refusal of work leads to 60 days of benefit cessation, but if the duration of the job in

³ Older unemployed individuals (those over 55) who receive UI allowances are eligible for extended benefits until they reach retirement age (62 years old).

⁴ In 2009, the average SA and HA for a single person were 417€/month and 254€/month, respectively. The SA can be applied from the municipality and HA from the KELA.

⁵ The interviewing interval is case-specific; the interval is typically short (two to four weeks) at the beginning of unemployment and increases as unemployment duration increases (three to six months). The search effort is deemed inadequate, for example, if a jobseeker has not been applying to jobs or has not participated in the ALMP measures recorded in the job search plan.

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