



How long and how much? Learning about the design of wage subsidies from policy changes and discontinuities[☆]



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HIGHLIGHTS

- The Swedish New Start Jobs-subsidy reduces long term unemployment.
- We explore effects of subsidy rate and duration and sensitivity to the business cycle.
- We find substantial effect on job-finding rates of the long term unemployed.
- Effects are stronger for larger and longer subsidies.
- Employment is higher after expiry of employment subsidies.

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ABSTRACT

Employment and wage subsidies are used to combat long-term unemployment, yet there is little research to guide the design of such programs. Discontinuities and changes in the design and implementation of wage subsidies under the Swedish *New Start Jobs*-policy allow us to study effects of both subsidy rate and subsidy duration. We find that wage subsidies have substantial effect on job-finding rates for those eligible. The effect is stronger for larger subsidies and more than doubles as the length of the subsidy doubles. Although employment drops as subsidies expire, the probability of being employed remains higher for workers finding subsidized employment also after the expiry of the employment subsidies.

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1. Introduction

The persistence of the present economic crisis is pushing long-term unemployment to the fore front of the economic policy agenda in many countries. In the US long term unemployment in the 25–55 age group rose from 20 percent in 2008 to 45 percent in 2013 (Kroft et al.,

2014). In Sweden, the long term unemployed made up 47 percent of the unemployed in the 25–74 age group in 2012 (SCB, 2013).¹ Even as the economy recovers, there is a risk that those who have been out of work for a long time or never held a job, will face difficulties reentering the labor market. Their skills may have depreciated along with their self-confidence, networks and sources of information about job offers and opportunities. This may discourage job search as well as job offers.²

Subsidies or tax credits to reduce labor costs for employers and to increase the take home wage of employees are part of the policy tool

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¹ Long term unemployment are spells over 26 weeks. In a European perspective the Swedish figure is still low. The EU average was 66 percent.

² Experimental evidence also shows that employers' reluctance to call for interviews individuals who have been long-term unemployed is likely to contribute to negative duration dependence (Eriksson and Rooth, 2014 and Kroft et al., 2013).

kit to boost employment in general and combat long term unemployment. While the employment effects of general wage subsidies to sectors, regions of low wage-groups seem to be limited (Neumark, 2013; Card et al, 2010), programs that increase the take home wage of employees increase employment of disadvantaged groups by increasing labor supply (Eissa and Hoynes, 2006).³ In an overview of European studies, Kluge (2010), however, finds that wage subsidies targeted to unemployed individuals can be effective in getting long-term unemployed back into employment.⁴ Recently, Neumark (2013) has argued that hiring credits to stimulate firms' labor demand may be more effective in economic downturns than policies stimulating labor supply since the latter have limited effects when unemployment is high and wages are downward rigid. Neumark and Grijalva (2013) also find that employment subsidies in various US states, targeting the unemployed and conditional on creating new jobs were successful in boosting job-growth during the recent recession.⁵

Although many studies investigate the overall effects of wage subsidies targeted at unemployed there is limited evidence on how wage subsidies are best designed and on the sensitivity of policy response to the business cycle. In particular, the literature does not provide an answer to how sensitive job finding rates and long run employment prospects are to the level of the subsidy, i.e. the subsidy rate and the duration of subsidies.⁶ Both rate and duration obviously effect the total costs of wage subsidy schemes.

The purpose of this paper is to fill these gaps in our knowledge by making use of a new wage subsidy policy, *New Start Jobs (NSJ)*, which was introduced to the Swedish labor market in 2007 at a time when unemployment was low, but when there was a growing concern with persistent long-term unemployment and low labor force participation of disadvantaged groups. The NSJ policy made individuals who had been unemployed or for other reasons absent from the labor market for at least a year eligible for a subsidy covering the payroll tax (31.4 percent) for a duration equal to their time in unemployment or out of the labor force. The NSJ policy was in place when the economic crisis hit Sweden in late 2008 and became more generous in 2009 when unemployment continued to rise.

The eligibility requirement of 12 months of non-work allows us to study the effect of job-finding rates of subsidy eligibility. It is of interest to study the flow into subsidized employment, but of particular interest to study the how the net flow out of long-term unemployment is affected since subsidized jobs are likely to crowd out some unsubsidized job openings, creating a windfall for employers.⁷ We also closely examine the job-finding rates around the 12 month threshold in order to examine the extent to which employment is postponed until the worker is eligible for the subsidy.

Two features of the *New Start Jobs*-policy allow us to study effects of two important dimensions of policy design. In particular, we are able to

³ Pay roll tax reductions for elderly low-wage workers in Finland, analyzed in Huttunen et al. (2013), had no effect on employment on the extensive margin, but affected hours of those already employed. Korkeamäki and Uusitalo (2009) and Benmarker et al. (2009) find that regional reductions in payroll taxes led to faster wage growth rather than more employment. There are exceptions. Goos and Konings (2007), find that pay-roll tax subsidies for manual workers lead to increased employment in Belgium.

⁴ Studies supporting this conclusion are e.g. Gerfin and Lechner (2002), Blundell et al. (2004) and Rosholm and Svarer (2008). Card et al. (2010) reviews the international evidence and finds that subsidized jobs in the private sector are more efficient than subsidized jobs in the public sector. Recently, however, Schünemann et al. (2015) find insignificant employment effects of eligibility of the long term unemployed to generous wage subsidies in Germany.

⁵ Hiring credits targeted at small firms also seem to have stimulated job-growth in France, in particular in areas with many job-seekers (Cahuc et al, 2014).

⁶ The meta-analysis of Card et al. (2010), for instance, finds no clear impact of program duration, but does not report separate estimates for different types of programs. In a related paper Gerfin et al. (2005) compares two subsidized employment programs, and conclude that subsidies for temporary work in the private and public sector are more efficient than a non-profit employment programs.

⁷ Although the subsidy generates net employment for the targeted group of long term unemployed, is possible that this comes at the cost of other groups.

study and compare the relative efficiency of both subsidy rate and subsidy duration. First, we exploit a doubling of the subsidy rate in 2009 compared to the first two years of the policy. Second, we make use of the fact that older workers (55+) were entitled to double-duration subsidies creating an age discontinuity that allows us to identify effects of duration. Furthermore, rapid changes in the overall unemployment rate with the onset of the economic crisis in 2008 and the recovery in 2010 allow us to explore the sensitivity of the response to the policy to the business cycle.

Since the NSJ-policy was not restricted to specific sectors or to low-wage jobs it is also possible to investigate which groups are more likely to benefit from this type of employment subsidy. Such an analysis provides input into a discussion of optimal targeting of employment subsidies but can also be indicative of which types of employers respond to employment subsidies.⁸ A further contribution of this paper is that we are able to follow eligible and non-eligible job-finders and their less lucky peers for several years which allows us to analyze how long term employment prospects are affected.

Our main findings are that wage subsidies have a substantial impact on job finding rates: Subsidies increased re-employment by 16 to 20 percent. The double subsidy rather than single subsidy drives most of the effect. Our estimates are stable over the business cycle, but also suggest that the response of reemployment rates to the subsidy at longer durations is stronger when the business cycle is improving. We also find that employment effects are stronger for individuals with low levels of education, and that there appears to be a complete crowd out of unsubsidized jobs for those with university degrees. We find that wage subsidies have long-run effects on employment on those eligible. In particular, workers who find employment with the subsidy, are more likely to work after subsidy expires, compared to workers who found unsubsidized employment.

For older workers, we find that the doubling of the subsidy duration implies a 65% increase in the job finding rate. We also find that extended subsidy duration affects the probability of staying employed for those who find subsidized employment when we compare with workers who were employed on a short subsidy. The positive employment effect of doubling the subsidy duration persists after the expiry of the employment subsidies. For older workers we compare the relative costs and benefits of subsidy rate increases and length extensions and find that extending the length of the subsidy is a more cost effective strategy.

In Section 2 we provide background information on the Swedish institutional framework and on the wage subsidy policy program studied in this paper. We also provide a description of the uptake of the new wage subsidy and we also describe the population of unemployed and the population of New Start workers. In Section 3 we describe the data used and discuss identification and estimation methods. In Section 4, we analyze effects on job-finding rates of the New Start job subsidy. We then focus on how the subsidy rate and the duration affect the probability of leaving unemployment. Next, in Section 5, we address the issue of long run employment effects and post-subsidy effects before we conclude the analysis in Section 6.

2. New start jobs – the new wage subsidy policy

The wage subsidies considered in this paper, called *New start jobs*, were introduced to the Swedish labor market in January 2007 and replaced previous wage subsidy programs.⁹ In this section we describe the main features of the *New start jobs*.¹⁰ The *New start jobs*-policy made all individuals who had been absent from the labor market for

⁸ Initially subsidies were limited to private sector employers, but this restriction was lifted in 2008.

⁹ Previous programs included general and enhanced employment supports which were both targeted and selective.

¹⁰ Lundin and Liljeberg (2008) and Sibbmark (2010) provide more detailed descriptions of the program. A detailed account of Swedish Unemployment benefits is provided in the online appendix.

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