



# Making work pay for the indebted? Assessing the effects of debt services on welfare recipients<sup>☆</sup>



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## HIGHLIGHTS

- We investigate an intervention for welfare recipients with unmanageable debts.
- These individuals generally experienced a disincentive to resume work.
- The intervention aimed at restructuring debts to increase work incentives.
- The intervention increased the exit out of welfare, but mainly out of the labor force.

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## ABSTRACT

This paper investigates the effects of an intervention that was targeted at a specific group of Dutch Social Assistance (SA) recipients with debt problems. Since a large share of the income gains of work resumption is earmarked for creditors, these individuals generally experienced a strong a priori disincentive to resume formal work. The intervention had three aims: restructuring personal debts, preventing the occurrence of new debt problems, and increasing the direct incentives to resume work. The paper uses the Timing-of-Events method to identify the effects of debt programs on SA spells. Our main finding is that the debt program substantially increased the exit out of the SA schemes, but this was mainly due to exits out of the labor force. With a large share of assigned individuals who did not participate in the scheme, it appears that individuals perceived or experienced the program as unpleasant and opted to exit without work. Our results suggest the presence of threat effects, particularly for individuals who were assigned by their caseworkers but did not participate in the debt program.

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## 1. Introduction

In many Western countries, an increasing share of unemployed individuals faces unmanageable personal debts. These debts can have substantial consequences for work incentives, particularly when bankruptcy systems are creditor-oriented and a large share of the income gains from work resumption is transferred to the creditors for an

extensive period of time (for a survey, see e.g. White, 2011).<sup>1</sup> Unemployment Insurance (UI) and Social Assistance (SA) benefit administrations thus have an interest in the settlement of their clients' claims. Empirical evidence on the use and usefulness of debt programs for unemployed workers is, to the best of our knowledge, nonexistent. Also scarce, in a broader perspective, are empirical analyses on how household debt restructuring affects labor supply.

This paper attempts to break new ground by studying the effectiveness of an intervention that was targeted at Dutch SA recipients with debt problems. Individuals in this program lived in Amsterdam, the largest city of the Netherlands (about 800,000 inhabitants). This

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<sup>1</sup> In contrast to this, the most common personal bankruptcy procedure in the US exempts all future earnings from the obligation to repay (this is referred to as the 'fresh start').

intervention had three aims: restructuring personal debts, preventing the occurrence of new debt problems and increasing the direct incentives to resume work. Individuals were first assisted with the restructuring of their debts and alerted about their entitlement to income supplements other than SA benefits, so as stabilize or solve debt problems. If clients did not succeed in debt restructuring, they were prepared for their eligibility to a formal, judicial (and more time-consuming) debt-restructuring program. Second, individuals were offered training programs to improve their budgeting- and financial literacy skills. These programs aimed to teach individuals how to become financially well organized and to understand the necessity of paid work.

The key question in this paper is whether the debt program contributed to the exit rates of the targeted group of SA recipients, into both employment and non-employment. Of particular interest throughout the analysis were potential threat effects, as individuals had to provide a full overview of their financial situation and income components. Threat effects may be particularly relevant for the individuals who were assigned but chose not to participate in the debt program – these were indicated as ‘no-shows’. For this group, abstaining from participation in the debt program was not without consequences, as it increased the likelihood of sanctions and intensive monitoring activities by their caseworkers.

Our analysis uses administrative data on SA unemployment spells and the assignment and actual start of debt programs. The identification of program effects relies on the assumption that SA recipients could not anticipate the exact timing of a debt program assignment – one of the key elements in the ‘Timing-of-Events’ method (Abbring and van den Berg, 2003). Using this approach, we start by estimating the overall effect of the program on exit rates into employment and non-employment, regardless of whether or not the individuals who were assigned to the program actually participated. The resulting estimates can thus be regarded as ‘Intention-to-Treat’ effects. This model becomes our ‘baseline model’, which is then extended by allowing for different effects for program participants and the no-shows. We argue that extending the model in this way requires a more careful interpretation than is needed in the baseline model, as program effects may be biased by anticipation effects in the short run. This particularly holds if assigned individuals expected to exit the SA soon and therefore decided not to participate in the program.

This paper connects and supplements various strands of literature. To start with, a continuing stream of papers addresses the effectiveness of active labor market policies (ALMPs; see Kluge, 2010 and Card et al., 2010 for recent surveys). Typically, this literature addresses instruments that directly aim at improving the job opportunities of workers by offering job training, job mediation, wage subsidies or subsidized employment. The idea behind the debt program, however, was to remove the incentive barriers that prevented individuals from accepting jobs and (related to this) improving their ‘soft skills’ – in order to prevent future debts. Although a growing body of research stresses the importance of social capital and financial literacy (see Heckman and Kautz, 2012; Lusardi and Mitchell, 2014 for recent survey studies), there is virtually no evidence on interventions that are targeted at unemployed workers with debt problems.<sup>2</sup>

The second way this paper contributes to the literature is by building upon work on the importance of threat effects of mandatory job programs (for a recent survey, see Andersen, 2013).<sup>3</sup> Threat effects are typically defined as increases in re-employment rates *prior* to the actual start of programs, when workers are already informed as to the starting

date (Graversen and van Ours, 2008; Geerdsen, 2006; Rosholm and Svarer, 2008). The implicit assumption is that mandatory programs are enforced for *all* targeted workers that receive benefits at the time the program starts. In this context, a common finding is that threat effects are substantial in the relevant time interval, particularly when compared to the effects after the start of job programs. Presumably, unemployed workers derive disutility from job programs due a loss of leisure time and more interference by their caseworkers. As a result, they try to avoid program participation by searching more actively for jobs.

In the current analysis, it is likely that threat effects were important as well, but worked in different ways. First, threat effects started from the moment individuals were contacted and assigned to a debt program. Participants had to provide a full overview of their financial situation and their income components. This explains why some individuals were not eager to participate, as this would harm their privacy or – worse – would reveal income fraud. Second, it should be noted that threat effects were likely to lead to increased exits into non-employment (see also Hagglund, 2006; Arni et al., 2013; Frijters and van der Klaauw, 2006), rather than increased work resumption. This particularly holds for individuals who were assigned to the program but did not participate and were registered as ‘no-shows’. The latter bore the risk of increased monitoring and sanctioning by their caseworker. Some individuals may also have left the scheme voluntarily for this reason.

Finally, this paper adds to the empirical literature on personal bankruptcy effects. Typically, this literature focuses on how between-state variation in exemption levels for wealth in the US affects the behavior of debtors and creditors. Evidence on the post-bankruptcy behavior of labor supply and work effort is, however, limited. Although filing for bankruptcy in the US generally reduces the obligations to repay debt from earnings, Han and Li (2007) find no evidence that this increases the labor supply of individuals.

Our main finding is that the debt program increased the exit out of the SA scheme. On average, the assignment to a debt program increased the exit probability by about 8 percentage-points, measured two years after the start of an unemployment spell. More strikingly, however, the effect is almost fully due to increased inflow into non-employment. This suggests the presence of substantial threat effects. We also find evidence that most of these threat effects are confined to the group of ‘no-shows’ that were assigned to the program but did not participate.

The paper proceeds as follows. Section 2 explains the institutional settings of the SA benefit scheme in the Netherlands, as well as the design of the debts program of the city of Amsterdam. We also provide a description of the data in this section. Section 3 explains the empirical strategy we use to assess the impact of the debt program. Section 4 presents estimation results and Section 5 concludes.

## 2. Institutional settings and data

### 2.1. Priority care debt services

In the Netherlands, SA benefits form a safety net that is provided by municipalities to support unemployed workers who are not or are no longer entitled to any other social insurance benefits (such as Unemployment Insurance (UI) or Disability Insurance benefits). In 2014, 22% of all new SA recipients consisted of unemployed workers who exhausted their UI benefits (UWV, 2014).<sup>4</sup> Thus, the vast majority of the inflow consisted of individuals with insufficient work history for UI entitlement. SA benefits are both means- and asset-tested; individuals should not own more than 5765 euro net worth of assets (for households with more persons, this net worth was set at a maximum of 11,895 euro). SA benefits are about 1000 euro per month for single

<sup>2</sup> Related to this literature, Della Vigna and Paserman (2005) investigated the effects of hyperbolic discounting on the return-to-work rates of unemployed individuals. The idea is that impatient workers will search less intensively for work; this effect dominates the effect of lower reservation wages and higher job-acceptance rates that characterizes impatient unemployed workers.

<sup>3</sup> In a broader perspective, this literature complements studies on the effect of sanctions on return-to-work rates (van der Klaauw and van Ours, 2013; Abbring et al., 2005; van den Berg et al., 2004; Lalive et al., 2005; Jensen et al., 2003; Boockman et al., 2009).

<sup>4</sup> Depending on the work history of individual workers, UI benefits may last no longer than 38 months.

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