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Unemployment duration and economic incentives—a quasi random-assignment approach

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Abstract

We investigate how economic incentives and spell duration affect hazard rates out of insured unemployment. We take into account that insured unemployment not always ends in employment, but also in disability, training programs, or benefit sanctions. Our empirical basis is Norwegian register data containing variation in economic incentives and spell duration similar to that of random-assignment experiments. We find that the employment and benefit-sanction hazards are negatively affected by the unemployment insurance replacement ratio, but that the effects vary considerably among individuals. There is negative duration dependence in the employment hazard and positive duration dependence in the disability hazard.

JEL classification: C41; J64

Keywords: Competing risks; Unemployment duration; Random assignment

1. Introduction

This paper addresses two themes that have attracted a great deal of attention within public economics and labor market research; (i) the extent to which the level

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and the duration of unemployment insurance (UI) benefits affect individual hazard rates out of unemployment, and (ii) the shape of structural (genuine) duration dependence governing these hazards. Reliable knowledge regarding these issues is of great value to policy makers trying to strike the right balance between poverty prevention and social security on the one hand, and provision of adequate job search incentives on the other. Yet, due to the fundamentally difficult empirical problem of disentangling causal effects of interest from spurious effects associated with uncontrolled heterogeneity, the existing evidence is often disputed, particularly in European countries. Given the important role that UI systems play in European labor markets and the large amount of public money that are thrown into them (see e.g. OECD, 2003, pp. 328–336), this lack of undisputed knowledge is unfortunate. This paper adds to the existing knowledge base by exploiting novel sources of exogenous variation in economic incentives and spell duration to isolate causality from selection. To ensure that our inference is guided by these exogenous sources, we apply an extraordinarily flexible competing risks hazard rate model without restrictions on the multinomial distribution of unobserved heterogeneity. The paper also provides new evidence regarding the mechanisms that terminate more than half of the insured job search periods without a direct transition to a job, such as training programs, disability, and benefit sanctions.

The literature addressing the effects of UI benefits and spell duration on exits out of unemployment is vast and advanced.[1] Recent surveys are provided by Devine and Kiefer (1991), Atkinson and Micklewright (1991), Pedersen and Westergård-Nielsen (1998), Holmlund (1998), and Meyer (2002). The existence of disincentive effects associated with unemployment insurance is, in general, well established. But, as stressed by Meyer (2002), empirical evidence from the United States appears more convincing than evidence from Europe, as there are more sources of exogenous variation in benefits in the United States due to differences in benefit schedules from state to state (Moffitt, 1985; Meyer, 1990; Katz and Meyer, 1990). A number of more recent European studies have attempted to circumvent the lack of exogenous variation by utilizing quasi-experimental properties of policy reforms (Hunt, 1995; Winter-Ebmer, 1998; Carling et al., 2001). However, due to the substantial variation in key results, this approach has yet to deliver a consensus view on the size of disincentive effects in European UI systems. As far as we know, genuine social experiments in which unemployment benefits have been randomly differentiated across individuals, have never been implemented neither in the United States nor in Europe. This is probably due to the fact that such experiments would be considered unethical, thus politically unfeasible.[2]In the present paper we make use of certain particular features of the UI system in Norway that, from the viewpoint of individuals, bear a close resemblance to random differentiation of benefits. The most

[1]Important contributions to this literature include Lancaster (1979), Moffitt (1985), Narendranathan et al. (1985), Katz and Meyer (1990), Meyer (1990) and Card and Levine (2000).

[2]In the United States there have been many social experiments (with true random assignment) regarding other elements of the unemployment insurance system, such as job finding bonuses and job search assistance; see Meyer (1995).