

Benefit shifting: The case of sickness insurance for the unemployed[☆]

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Abstract

This study describes the probability of transition from unemployment with unemployment insurance (UI) to sickness insurance (SI), using a proportional hazard duration model and a large register-based dataset. The combination of limited UI duration and the fact that SI rights do not depend on remaining UI, creates an incentive to use SI to effectively extend UI. The separate effects of elapsed unemployment duration and of UI duration on hazard rates are identified through a reform of the UI system. The estimated hazard rate for transition from unemployment to SI increases sharply the last months before UI exhaustion. The spikes are larger for diagnosis for mental illness, and vary across individuals, but are present for all groups and all diagnoses.

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1. Introduction

The income support programmes of welfare states imply well-known moral hazard problems, and may interact to distort employment and labor market participation decisions. A particular problem is that sickness is often unverifiable, such that economic incentives to apply for benefits related to sickness or disability may result in unwarranted benefits for some persons. In this paper

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I analyze a specific example of benefit shifting, the shift from unemployment insurance (UI) to sickness insurance (SI), using a database with information from a range of administrative registers on the entire Norwegian population for the period 1992–2001. In Norway, membership of the UI and SI schemes is compulsory but eligibility for SI requires that you are either employed or unemployed with UI entitlement. The rules imply that an unemployed person effectively can prolong UI duration if he can convince a general practitioner (GP) that she should grant SI. I focus on how the duration limit on UI affects the rate of transition to SI over the spell of unemployment, with emphasis on behavior in the last months before UI ends.

An unemployed person who receives SI is not required to search for work, and may therefore be more likely to leave the labor force permanently than if he had been denied SI. In fact, SI may be seen as the first step towards disability insurance that can be regarded as a final destination. Studies of displaced workers in Norway have found that being displaced increases the risk of leaving the labor force (Huutunen et al., 2006) and of becoming a recipient of disability insurance (Rege et al., 2007). Part of these effects arise through reduced earnings potential and via unemployment. It is therefore of interest to analyse shifts from UI to SI, and more generally, to study potential paths of benefit shifting that reduce labor force participation. This appears particularly important in light of the surge in expenditure on programs related to sickness and disability in Norway during the 1990s, see Table 1. It is well-known that the demand for sickness-related benefits not only depends on the health and number of eligible persons, but also on the compensation rate relative to alternative income support programs and labor income. This has been confirmed for the use of SI among the employed in reform-based studies for Sweden (Johansson and Palme 2005, 2002), and Askildsen, Bratberg and Nilsen (2005) and Lindbeck, Palme and Persson (2006) conclude that there is a disciplining effect of increased risk of job loss on sickness absence. In addition, the strictness of screening is important for the demand for benefits and the rate of acceptance of applications. Autor and Duggan (2006) conclude that less strict screening and improved compensation explain a large share of the increase in disability insurance take-up in the US after 1984, especially for the low-skilled who are more prone to unemployment and who therefore find disability relatively more attractive (Autor and Duggan, 2003). The importance of screening procedures is confirmed by De Jong, Lindeboom and van der Klaauw (2006) who conduct an experiment where case workers at a selection of Dutch disability insurance offices were instructed to screen employed disability applicants/recipients more carefully. This resulted in less long-term absence and fewer applications for disability insurance.

The key question in this paper is whether the probability of shifting from UI to SI depends on the incentive that arises from the duration limit on UI and loss of eligibility for SI after UI expires. We know from economic theory that the rate of transition to employment increases as the end of UI approaches, due to a decline in the reservation wage (Mortensen, 1977). In addition, workers will spend more time and effort on job search towards the end of the UI period, further raising the rate of transition to work. This theory is supported by the data, as it has been established that the hazard rate for transition to employment increases in the months preceding UI exhaustion. Card, Chetty and Weber (2007) survey the literature for estimates of such spikes in the hazards for leaving unemployment and in the hazard for exit to work. Some US studies report a clear effect, of around a 50% increase in the hazard, although Card and Levine (2000), find no effect of an extension of total UI period on the timing of this spike. Some unemployment compensation systems have “soft” limits in the sense of UI becoming conditional on participation in job training or job search assistance after the limit. Even such soft limits have been found to have an effect on escape rates out of unemployment. Black et al. (2003) (US), Geerdsen (2006) (Denmark) and Carling et al. (1996) (Sweden) found a spike in the job hazard just before continuation of benefits

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