

# Spell durations with long unemployment insurance periods

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## Abstract

This paper uses data from a natural experiment to investigate the potential incentive effect of a fixed unemployment insurance period. We compare two large groups of Norwegian unemployed persons who registered as unemployed in 1990 and 1991. The last group was affected by a rule change that in practice extended the length of unemployment benefits to more than 3 years. Our data are taken from official records, and we construct unemployment durations by combining information from the unemployment registers with employers' records. We use a proportional hazard model with a flexible baseline. The results suggest that the main effect of benefits running out is to make people drop out of the unemployment register. We find neither clear evidence that the hazard into employment increased when the end of benefits approached in the pre-liberalisation group, nor that behaviour in this part of the spells changed after the reform. On the other hand, our results suggest that the reform had an all over negative effect on the employment hazard. © 2000 Elsevier Science B.V. All rights reserved.

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## 1. Introduction <sup>2</sup>

Standard search theory predicts that the duration of an unemployment spell is increasing in the level of unemployment benefits, because the cost of rejecting a job offer decreases. Furthermore, if benefits are cut after a fixed period, the reservation wage decreases, and the exit rate out of unemployment increases as the time of running out approaches (Mortensen (1977)). Of these two hypotheses, the first one is fairly well established empirically. A number of contributions deal with the connection between benefit size and unemployment duration, <sup>3</sup> even though there are different results as to the magnitude of the effect. The second prediction is less researched, and our purpose with the present paper is to add to the knowledge of the potential incentive effects of a fixed unemployment insurance period. Doing so, we use two large samples of extensive Norwegian register data covering a period including a natural experiment — in 1992 a former rule of 13 weeks benefits withdrawal after 80 weeks was abolished. Thus, we can compare a group of unemployed who were affected by this policy change with another consisting of individuals who were not.

Compared to most other European countries, the Norwegian unemployment rate has been remarkably low through most of the 1980s, mostly staying between 1.5 and 3% until 1988. Then, in 1989, unemployment increased sharply and stayed at approximately 5–6% of the labour force during the early 1990s. Unemployment insurance is universal for all employees with earnings above a minimum level. Until 1991, the maximum entitlement period was 80 weeks, followed by 26 weeks without benefits. One could then receive unemployment benefits (UB) for a second 80-week period. The alternative to UB for those who did not manage to get a job, would be means tested social benefits. In May 1991, as a response to the increasing number of long-term unemployed, the length of the period without UB was reduced to 13 weeks. One year later, it was then decided that if the unemployment agencies had not offered an individual a new job or a labour market programme after 80 weeks, benefits should no longer be withdrawn in the 13 weeks period. Thus, from May 1992, it became possible to receive UB for a continuous period of 186 weeks. <sup>4</sup>

As we have already suggested, the empirical literature concerning the effect of fixed benefits periods is relatively scarce. Meyer (1990) and Katz and Meyer (1990) find that spikes in the hazard out of unemployment may be explained by

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<sup>2</sup> The data used in this paper are provided by The Norwegian Social Science Data Services (NSD). NSD is not responsible for the authors' analyses.

<sup>3</sup> Surveys can be found in, e.g., Atkinson (1987) and Layard et al. (1991).

<sup>4</sup> The benefit level is adjusted after 80 weeks. Before the 1992 rule change, individuals with pre-unemployment earnings close to the minimum level for eligibility might not qualify for a second period. After 1992, the UB level for the second period was set to 90% of the first UB period.

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