

Does reducing unemployment insurance generosity reduce job match quality?[☆]

Jan C. van Ours^{a,b,c,d,*}, Milan Vodopivec^{c,e}

^a Tilburg University, CentER, The Netherlands

^b University of Melbourne, Australia

^c IZA, Germany

^d CEPR, United Kingdom

^e World Bank, United States

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Abstract

This paper analyzes how a change in Slovenia's unemployment insurance law affected the quality of jobs workers found after periods of unemployment. Taking advantage the "natural experiment" we show through difference-in-differences estimation results that reducing the potential duration of unemployment benefits had no detectable effect on wages, on the probability of securing a permanent rather than a temporary job, or on the duration of the post-unemployment job.

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The impact of unemployment benefits on the quality of post-unemployment jobs is theoretically ambiguous and insufficiently researched empirically. According to job search theory, an increase in the level of benefits raises the reservation wage at the beginning of the covered spell of unemployment, leading to post-unemployment wage gains (and gains in stability and other aspects of newly found jobs). According to another line of reasoning, which also suggests that unemployment benefits increase the probability of finding a job and/or the probability of finding a better job, such payments increase the resources available for a job search, thereby facilitating more efficient job matching. According to the moral hazard argument, however, longer-lasting benefits may depress the intensity of the job search

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* Corresponding author. Department of Economics, Tilburg University, The Netherlands and Department of Economics, University of Melbourne, Australia. Tel.: +31 13 4662880; fax: +31 13 4663042.

E-mail addresses: vanours@uvt.nl (J.C. van Ours), Mvodopivec@worldbank.org (M. Vodopivec).

and may just prolong unemployment without improving the quality of post-unemployment jobs.¹ Longer spells of unemployment may also worsen post-unemployment outcomes through loss of human capital, as workers' skills become obsolete.

To shed light on these opposing views, we analyzed the impact of unemployment benefits on the quality of job matches by taking advantage of a "natural experiment": the reform in 1998 of Slovenia's unemployment insurance law. The reform radically shortened the potential duration of benefits for most – but not all – groups of workers, which allowed us to use a difference-in-differences estimation strategy to compare pre- and post-reform outcomes. Exceptionally rich administrative datasets on both unemployed and employed workers permitted us to examine not only post-unemployment wages, but also the duration and type of employment in the post-unemployment job.

We find that shortening the duration of benefits did not affect the quality of post-unemployment job matches. None of the quality indicators was negatively affected by the reform: the pre-reform wage increases in new jobs stayed unchanged, as did the duration of the newly found jobs and the distribution between fixed-term and permanent jobs. These findings are particularly important combined with the findings of our companion paper (Van Ours and Vodopivec, 2006a), which showed that the same benefit reform strongly shortened the spell of beneficiaries' unemployment. Taken together, the results show that once the potential duration of benefits was shortened, benefit recipients found a job more quickly with no loss in the quality of the post-unemployment job match — an indication that reducing benefits reduced the moral hazard created by unemployment insurance.

How do our results compare with the findings of other studies? Ehrenberg and Oaxaca (1976), Burgess and Kingston (1976), Hoelen (1977), and Barron and Mellow (1979) find a statistically significant and positive relationship between benefit levels and post-unemployment wages.² But Classen (1977), Blau and Robins (1986), Kiefer and Neumann (1989), and Addison and Blackburn (2000) find a weak or negligible effect on post-unemployment wages. Meyer (1995) finds that re-employment bonuses shortened the duration of compensated unemployment without affecting post-unemployment wages. There is also mixed evidence about the effects of unemployment benefits on the duration of post-unemployment jobs. Using U.S. data, Centeno (2004) finds that a more generous unemployment insurance (UI) system is positively related to post-unemployment job tenure, and Tatsiramos (2006) reaches the same conclusion using data for ten European countries. Similarly, Böheim and Taylor (2002) find that longer spells of unemployment are rewarded by longer job tenure. But Portugal and Addison (2003) find no evidence that unemployment benefits facilitated entry into stable jobs in Portugal, and Belzil (2001) finds a negative correlation between unemployment duration and subsequent job duration for Canada. Moreover, Card et al. (2006), using Austrian data, find that extending the duration of potential benefits lengthens the spell of unemployment but has little or no effect on the quality of subsequent job matches.

Our paper is set up as follows. In Section 1 we describe the 1998 change in Slovenia's unemployment insurance system. In Section 2 we explain our research strategy and present data. In Section 3 we present the results of our analysis of post-unemployment wages, of the probability of obtaining a permanent rather than a temporary job, and of the duration of the post-unemployment job. We present our conclusions in Section 4.

1. The reform in Slovenia's unemployment insurance system

Like most OECD countries, Slovenia provides unemployment benefits through a social insurance program covering all formal sector workers.³ To qualify for benefits, a worker must be enrolled in the program and the job loss must have been involuntary (disciplinary dismissals are excluded). To maintain the entitlement, applicants must be capable of, available for, and looking for work. The level of benefits depends on the earnings on the previous job, and the replacement rate is 70% in the first three months and 60% thereafter, subject to a minimum and maximum. Benefits may last from 3 to 24 months, depending on the individual's work experience. After exhausting earnings-related

¹ Particularly credible evidence on the effects of unemployment insurance on duration of recipients' spell is provided by micro-studies (for a recent summary, see Vodopivec, 2004a).

² Ehrenberg and Oaxaca (1976) estimate that a 10-percentage-point increase in the benefit replacement rate increases post-unemployment wages by 7% for older men and 1.5% for older women. Using New Zealand data, Maani (1993) finds that a 10-percentage-point increase in the benefit replacement rate is associated with a 4.5% increase in post-unemployment wages.

³ Formerly a part of Yugoslavia, Slovenia – a country with population of only 2 million – became independent in 1991 and joined the European Union in 2004.

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