



# Partial unemployment insurance benefits and the transition rate to regular work<sup>☆</sup>

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## ARTICLE INFO

### Article history:

Received 9 October 2008  
Accepted 23 February 2010  
Available online 3 March 2010

### JEL classification:

C41  
J65

### Keywords:

Partial unemployment benefits  
Temporary work  
Treatment effect  
Duration analysis

## ABSTRACT

In Finland, unemployed workers who are looking for a full-time job but take up a part-time or very short full-time job may qualify for partial unemployment benefits. In exchange for partial benefits, these applicants must continue their search of regular full-time work. This study analyzes the implications of working on partial benefits for subsequent transitions to regular employment. The timing-of-events approach is applied to distinguish between causal and selectivity effects associated with the receipt of partial benefits. The results suggest that partial unemployment associated with short full-time jobs facilitates transitions to regular employment. Also part-time working on partial benefits may help men (but not women) in finding a regular job afterwards.

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## 1. Introduction

The ultimate goal of most unemployed job seekers is to find a permanent full-time jobs (i.e. a “regular” job). If such jobs are not readily available, a job seeker may also consider part-time jobs or very short full-time jobs as a temporary solution. But wage income from such “irregular” jobs can be relatively low compared to unemployment benefits, making them difficult to accept for some unemployed workers. For this reason, several countries, including all the Nordic countries, many other European countries, and the United States, have made *partial* (or supplementary/adjusted) unemployment benefits available for job seekers who accept an irregular job when no better jobs are available. If short full-time and part-time jobs facilitate subsequent transitions to regular work, subsidizing working in such jobs via the unemployment compensation system can enhance labor market efficiency. The opponents argue that partial benefits discourage workers from finding regular work through high replacement rates and extended benefit durations. The question of obvious policy interest is whether working on partial benefits induces or hinders the unemployed from finding a regular (unsubsidized) job, and hence escaping from compensated unemployment. Given the large literature on other aspects of the unemployment compensation system and on other forms of subsidized employment, surprisingly little effort has gone into studying the role of partial benefits and their implications for subsequent labor market outcomes.<sup>1</sup> This study addresses the issue in the context of the Finnish labor market.

<sup>☆</sup> This study is part of a research project aimed to gather information on partial unemployment and its consequences in Finland.

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<sup>1</sup> Munts (1970), McCall (1996), Gerfin and Lechner (2002), Gerfin et al. (2005) and Lalive et al. (2008) are exceptions.

In Finland, only job seekers who are looking for full-time work can qualify for unemployment insurance (UI) benefits. When no full-time regular work is available, UI recipients who take up a part-time job or a full-time job with the duration of less than one month (two weeks since 2003) may receive partial benefits on top of wage income. The partial benefit can be collected for a limited period of time, which depends on the ratio of the partial benefit to the regular UI benefit. Workers on partial benefits are partially unemployed, and they are expected to continue their search for regular work. The objective of partial benefits is to encourage the unemployed to also take up jobs that are less than suitable, through financial incentives. Although the partial benefits have been available since 1985, very little is known about the recipients and how their behavior and subsequent labor market outcomes are affected.<sup>2</sup> This paper focuses on two main questions: Who among UI recipients go to part-time and short full-time jobs that qualify for partial benefits, and what are the implications of working on partial benefits for the transitions out of unemployment into regular work? Empirical analysis is based on register data on individuals who lost their jobs and entered full-time unemployment in 1999 or 2000.

The main concern in modelling the implications of working on partial benefits is the potential endogeneity of the receipt of partial benefits. For example, it is possible that workers who find regular work more easily also have less trouble finding irregular jobs. As a consequence, they may be overrepresented among partial benefit recipients, which can bias the estimates unless the selection process is appropriately accounted for. A bivariate mixed proportional hazard model is used to deal with the selection problem. The model specifies a transition rate from compensated (partial/full-time) unemployment to regular work, which depends on the past and current experiences of partial unemployment along with other determinants. The timing of the receipt of partial benefits is modelled by specifying a transition rate from full-time unemployment to partial benefits. These transition rates are interrelated by the way of observed and unobserved characteristics. The causal effects of working on partial benefits on the transition rate to regular work is distinguished from the selectivity effects by exploiting random variation in the timing of the receipt of partial benefits. This is known as the timing-of-events approach (Abbring and Van den Berg, 2003).

The effect of working on partial benefits is divided into two parts: the change in the transition rate to regular work while receiving partial benefits (*instant* effect) and the change following the return to full-time unemployment (*delayed* effect). These effects are allowed to vary with the type of partial unemployment (subsidized part-time or short full-time work), the timing and duration of the partial benefit period, and the average wage of the subsidized job. The results indicate a higher transition rate to partial benefits for women than for men. The transition rate to partial benefits also varies with occupation, education, and living region. Subsidized employment associated with short full-time jobs is found to facilitate transitions to regular work during and after a spell of partial benefits. The strong instant effect suggests a possibility that short full-time jobs are used as a probation device by employers, providing a stepping stone to longer employment contracts for some applicants. There is no evidence that subsidized part-time jobs would be used for the same purpose. Nevertheless, for men taking a part-time job that qualifies for partial benefits may still reduce the expected duration until regular work, owing to a positive delayed effect, although this evidence is not conclusive. Subsidized part-time work has no positive effects for women.

The rest of the paper is organized as follows. In the next section, it is argued that the partial benefit scheme differs notably from other wage subsidy schemes. The section also discusses the likely effects of such a policy and gives an overview of some related studies. Section 3 introduces the Finnish unemployment compensation system, with an emphasis of potential incentive effects associated with partial benefits. Differences in the partial benefit schemes between Finland and other countries are also discussed. Section 4 describes the underlying data sources and sample restrictions. Descriptive evidence is presented in Section 5, which is followed by the econometric analysis in Section 6. The final section concludes, with some policy recommendations.

## 2. Background and related literature

### 2.1. Partial benefits as a wage subsidy

Temporary and part-time jobs are often less desirable compared to permanent full-time employment (Booth et al., 2002), and many workers take up such jobs involuntary due to a lack of better jobs. In 2007, over one-fifth of part-timers in Europe would have liked to work full-time, and about 60% of temporary workers would have preferred a permanent job (Employment in Europe, 2008). Job losers, especially, are disproportionately employed in involuntary irregular jobs (Farber, 1999). In many countries, unemployed job seekers are encouraged to accept also irregular jobs via some sort of a wage subsidy. One particular form of such a subsidy include partial unemployment benefits (also known as supplementary or adjusted benefits) directed at otherwise unemployed full-time job seekers who take up a part-time job or a short full-time job. Such benefits are available in almost all European countries and the US. Data from European Social Statistics for 2004 suggest that the partial benefits amounted to 7% of the unemployment benefit expenditure in Finland and Belgium, 14% in Greece and Norway, 16% in Italy and 29% in Sweden (Haataja, 2007). The incidence of the receipt of partial benefits among all the unemployed can be much higher than these figures given that the partial benefit is less than full

<sup>2</sup> As part of the same research project, Haataja and Korkeamäki (2007) and Haataja (2007) consider the incidence of partial unemployment and the livelihood of partial benefit recipients.

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