



# Job displacement and the transitions to re-employment and early retirement for non-employed older workers

Konstantinos Tatsiramos

IZA, Schaumburg-Lippe-Str. 5-9, 53113 Bonn, Germany

## ARTICLE INFO

### Article history:

Received 19 September 2007

Accepted 15 October 2009

Available online 6 November 2009

### JEL classification:

J14

J26

J63

J64

### Keywords:

Job displacement

Unemployment duration

Retirement

Institutions

## ABSTRACT

Despite the relatively higher frequency of job displacement among older workers in Europe, little is known about its effect on the work–retirement decision. Employing individual data from the European Community Household Panel for a number of countries with differences in their institutional environments, the effect of job displacement for non-employed workers is identified separately for the transitions into re-employment and retirement. The findings suggest that in countries with relatively more generous unemployment insurance provisions for the older unemployed, which offer a pathway to early retirement, older displaced workers exhibit lower re-employment and higher retirement rates compared to the non-displaced. These results are robust to dynamic selection due to unobserved heterogeneity and to the endogeneity of displacement.

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## 1. Introduction

This paper investigates how job displacement which leads to non-employment affects the transitions into re-employment and retirement in a competing-risks hazard framework for a number of European countries which face different institutional rules. In recent years, there has been evidence of an increase in the frequency of job loss among older workers both in the US (Farber et al., 1997; Farber, 2004) and in Europe (OECD, 1998).<sup>1</sup> Despite this development, which has been associated with demand shifts, restructuring of traditional industries, import competition and out-sourcing of jobs, surprisingly very little is known on how job displacement might affect the labour market transitions of older workers and, in particular, the work–retirement decision. Understanding the link between job displacement and retirement has direct implications for policies promoting longer working lives. These policies are considered in response to the decline in the labour force participation of older workers and the demographic changes occurring in Europe, which put pressure on the sustainability of the social security systems.

In theory, the direction of the effect of job loss towards re-employment or retirement is ambiguous. Experiencing a job loss may have considerable consequences because of the interruption of a long tenure job, which diminishes acquired firm-specific human capital, employment and earning prospects. Indeed, studies focusing on workers of all ages find that job displacement leads to a reduction of future earnings (Jacobson et al., 1993; Ruhm, 1991) and an increase of employment instability (Stevens, 1997) in the sense that the displaced have higher exit rates from subsequent

E-mail address: [tatsiramos@iza.org](mailto:tatsiramos@iza.org)

<sup>1</sup> In what follows, job loss and job displacement will be used interchangeably.

employment.<sup>2</sup> Although the unemployment rate among workers 45 to 64 years old is lower than the overall rate in most OECD countries, the incidence of long-term unemployment is significantly higher (OECD, 1998), which suggests a lower mobility of older workers who experience unemployment. Considering retirement as a distinct labour market state allows for the distinction between two competing explanations for the incidence of long-term unemployment among older workers. That is, unemployment persistence might exist due to (1) difficulties in being re-employed based on poor employment prospects, or (2) disincentives of being re-employed. In a number of countries, the combination of extended unemployment benefit periods with early retirement schemes available for the older workers might affect their decisions by making retirement more attractive (Duval, 2003).<sup>3</sup>

However, job displacement might also affect the work–retirement decision in the opposite direction and reduce wealth and income, which might lead to an extension of the working life. Focusing on the transitions between non-employment and employment following a late-career job loss in the US, Chan and Stevens (1999, 2001) find that job loss for men leads to longer labour force participation, which reflects the need to rebuild diminished savings for retirement. For women, the reduced earnings due to a job loss reduce the incentives to work. Using Austrian administrative data, Ichino et al. (2007) find that after a plant closure the old initially have lower re-employment probabilities compared to prime-age workers, but later they catch-up.

The analysis in this paper has three novel and important features. The *first* is the focus on the distinction between transitions towards re-employment and retirement for older workers in a number of countries (Germany, Italy, Spain and the UK), which differ in their institutions related to older unemployed, based on individual panel data from the European Community Household Panel (ECHP, 1994–2001). In this respect, the paper contributes to relatively recent literature on the incentive effects of unemployment related benefits for older workers. Heyma and van Ours (2005) find that the abolition of the requirement to actively search for a job beyond the age of 57.5 and the entitlement to unemployment benefits until the age of 65 has a large negative effect on the job finding rate in the Netherlands. Other studies have shown that increases in the entitlement period of unemployment benefits for older workers leads to declines in transition rates to employment in Germany (Hunt, 1995) and Austria (Lalive and Zweimüller, 2004), and provide a quantitatively important pathway into early retirement (Lalive, 2008). Kyrrä and Wilke (2007) evaluate the increase in the eligibility age from 53 to 55 of the unemployment insurance system in Finland, which allows unemployed workers to collect benefits up to a certain age limit and then retire. They find evidence of a large decrease in the inflow to unemployment and a large increase in the transition rate out of unemployment to employment.

The *second* novel feature of the paper is the joint estimation of the effects of job displacement on the transitions into and out of subsequent employment, distinguishing between the short and long-run effects of displacement. That is, although displaced workers might be re-employed relatively fast, it is also the stability of the post-displacement employment which is important for the overall employment rate. In addition, dynamic selection is taken into account by allowing unobserved individual characteristics to be correlated across states.

*Finally*, the paper addresses the endogeneity of displacement by extending the econometric model into a joint estimation of the selection process into displacement and the transitions into employment or retirement. Based on the “timing of the events” approach of Abbring and van den Berg (2003), the causal effect of displacement is identified by means of the variation from the multiple non-employment and employment spells which are observed for each individual.

The rest of the paper is organised as follows. Section 2 contains a brief discussion of the institutional features related to unemployment insurance and retirement rules in each of the countries considered in this study. Section 3 describes the data and provides a non-parametric analysis of labour market transitions. Section 4 presents the econometric model and discusses identification and the way to address the endogeneity of displacement. Section 5 discusses the results of the effect of displacement on labour market transitions, and the Section 6 provides a summary of the findings and some policy conclusions.

## 2. Institutional features

The focus of this section is on the institutions which are related to older unemployed in the four countries considered in the analysis. These refer to the unemployment benefit and early retirement schemes based on information obtained from the Mutual Information System on Social Protection (MISSOC, 2001) of the European Commission. Tables A1 and A2 summarise the major policy instruments in each country, distinguishing between provisions that are available to the general public from those which are only available to older workers.

In Germany, the legal retirement age is 60 after 180 contribution months if unemployed at the commencement of the pension and if unemployed for 52 weeks after the age of 58.5. Alternatively, the requirement for older workers is to have worked part time for 24 calendar months. The age limit for early retirement for the unemployed increased in the years 1997–2001 from 60 to 65 years. However, a pension can be claimed after the age of 60 but with pension reductions.

<sup>2</sup> For a survey on the effect of job displacement see Kletzer (1998). Kuhn (2002) contains an analysis of work displacement for prime age workers for a number of European countries.

<sup>3</sup> The literature on retirement focuses on the incentive structure of the pension systems in explaining the observed retirement patterns (e.g. Gruber and Wise, 1998; Meghir and Whitehouse, 1997). Rigidities in the labour market, such as the inability to choose flexible working hours, might also lead to early withdrawal from the labour force even if older workers might prefer to retire gradually (Hurd, 1996).

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