Journal of Public Economics 95 (2011) 1096–1110

Contents lists available at ScienceDirect

Journal of Public Economics

journal homepage: www.elsevier.com/locate/jpube

Caught in the trap? Welfare's disincentive and the labor supply of single men ☆

Olivier Bargain *, Karina Doorley

ARTICLE INFO

Article history:
Received 12 August 2009
Received in revised form 11 May 2011
Accepted 11 May 2011
Available online 26 May 2011

JEL classification:
H52
J21

Keywords:
Regression discontinuity
Welfare
Social assistance
Labor supply

ABSTRACT

Youth unemployment is particularly large in many industrialized countries and has dramatic consequences in both the short and long-term. While there is abundant evidence about the labor supply of married women and single mothers, little is known about how young (childless) singles react to financial incentives. The French minimum income (*Revenu Minimum d'Insertion*, RMI), often accused of generating strong disincentives to work, offers a natural setting to study this question since childless single individuals, primarily males, constitute the core group of recipients. Exploiting the fact that childless adults under age 25 are not eligible for this program, we conduct a regression discontinuity analysis using French Census data. We find that the RMI reduces the participation of uneducated single men by 7–10% at age 25. We conduct an extensive robustness check and discuss the implications of our results for youth unemployment and current policy developments.

1. Introduction

There has been an on-going debate in policy and academic circles about the nature and generosity of social transfers that should be put in place. Countries have made obviously different choices in this respect. For instance, in the US and the UK, transfers to the working poor play a major role, through programs such as the US Earned Income Tax Credit (EITC) and the UK Working Family Tax Credit (WFTC). In the US in particular, the perception that traditional welfare programs, like the Aid to Families with Dependent Children (AFDC), encouraged inactivity and fostered dependency on public assistance culminated with the 1996 Personal Responsibility and Work Opportunity Act (PRWORA) and the repeal of the AFDC. The latter has been replaced by the Temporary Assistance to Needy Families (TANF), which imposes work requirements, tightened eligibility conditions and time limits (Scholz and Levine, 2001). In contrast, continental European welfare states still rely by and large on traditional social assistance programs, which are time-unlimited, practically unconditional on work, training or job search, and not specifically targeted at families with children. Like in the US before 1996, these programs have been accused of creating strong work disincentives. This is particularly true for the French guaranteed minimum income (*Revenu Minimum d'Insertion*, RMI), which imposes very high implicit taxation on earnings (Gurgand and Margolis, 2008). As we learn from the applications of optimal tax theory (e.g., Saez, 2002), different institutions across countries may not only reflect profound differences in social preferences but also different labor market conditions and degrees of response to tax-benefit incentives. Labor supply is therefore a key issue that has received enormous attention. Mainly for the US and the UK, a variety of methods have been used to estimate labor supply behavior, including structural approaches (Hoynes, 1996; Meyer and Rosenbaum, 2001), experiments (e.g., Robins, 1985) or natural experiments that have precisely exploited the important US/UK tax-benefit reforms to identify behavioral parameters (e.g., Eissa and Liebman, 1996; Blundell et al., 1998). Much less evidence is available for continental Europe and, in particular, for France. Due to the lack of major tax-benefit reforms in this country, most of the evidence comes from estimates of structural models (e.g., Laroque and Salanié, 2001) which necessarily rely on particular distributional assumptions and have not often been validated against natural experiments (the situation is therefore similar to the pre-1996 US literature). Another important observation is that most of the evidence available in the US and the UK concerns married women and single mothers, two groups known to be the most responsive to financial incentives. Indeed, the aforementioned welfare policies in these countries, and their reforms, were essentially targeted at these groups. In contrast, much less is known about the participation elasticity of childless single individuals, as these are excluded from most welfare programs in the US. Even if the traditional literature points to very small elasticities among singles, it is suspected that the response of low-skilled single individuals is significant, at least

☆ Bargain and Doorley are affiliated to University College Dublin (UCD) and CEPS/INSTEAD. Bargain is also affiliated to IZA, the Geary Institute, the ESRI and CHILD. Doorley is grateful to the Irish Research Council for the Humanities and Social Sciences and to the *Fonds national de la Recherche* (Luxembourg) for financial support. The authors are indebted to participants at seminars at IZA, UCD and CEPS-INSTEAD for invaluable advice and comments. The usual disclaimers apply.

* Corresponding author at: UCD, Newman Building, Dublin 4, Ireland. Tel.: +353 17168357.
E-mail address: olivier.bargain@ucd.ie (O. Bargain).

0047-2727/$ – see front matter
doi:10.1016/j.jpubeco.2011.05.007

compared to higher education singles or married men, and deserves to be quantified.

Interestingly, childless single individuals, primarily males, constitute the core group of recipients of the RMI program in France. The main reason for this is that young workers' contribution spells are too short for them to be eligible for unemployment benefits. It turns out that the RMI program offers an interesting setting to study the labor supply response of this demographic group. In this paper, we exploit a specific feature of the program, namely the fact that childless adults under age 25 are not eligible for the RMI. A regression discontinuity (RD) approach is particularly suited to establish whether the RMI generates a significant drop in labor market participation at age 25, as a static labor supply model would predict. Hahn et al. (2001) argue that studying specific policy discontinuities provides a more clear-cut assessment than natural experiments based on policy changes over time, which must control for simultaneous changes in the economic environment.[1] Using this approach with the 1999 French Census data, we find compelling evidence that the RMI reduces labor market participation among uneducated childless single men at age 25. Our estimates point to a drop of 7–10% in men's participation. As a falsification test, we verify that groups not affected by the age threshold do not show any response, in particular lone parents (for whom no age restriction applies) and uneducated men observed prior to the introduction of the RMI (i.e., using the 1982 Census). We also find that the RMI has no effect on single men with more education. We provide an extensive robustness analysis and check in particular (i) that no other policy could generate a similar discontinuity in 1999, and (ii) that agents cannot manipulate the 'forcing variable', at least not in a discontinuous way. Under these conditions, RD estimates offer a credible alternative to randomized experiments since, according to Lee and Lemieux (2010), assignment to treatment is 'as good as random' in the neighborhood of the discontinuity.

The paper brings the literature forward in several ways. Firstly, we examine a group – single individuals without children – whose labor supply behavior has received very little attention in the empirical literature on transfer programs. We focus on men because their labor supply decisions, and potential eligibility for the RMI around the discontinuity, are less affected by early fertility and marriage decisions compared to single women. The evidence we provide is based on large variations in budget constraints. In 1999, unemployed singles aged 25 and over could receive welfare payments of up to EUR 539 per month, i.e., 162% more than those aged under 25. Variations of this magnitude help us to estimate behavioral effects with better precision. Another advantage of the RD analysis in the present context is that we can evaluate the effect of the whole welfare program on labor supply, and not just an extension of it.[2] For uneducated singles, the participation elasticity to welfare payments derived from our results is relatively modest, yet in line with past estimates for the US and strikingly similar in magnitude to the results of Lemieux and Milligan (2008).[3]

Secondly, the finding that only uneducated men respond to the transfer is important. It corroborates the idea that participation responses may be strongest for those with the lowest potential earnings (see suggestive evidence in Eissa and Liebman, 1996). Our results add to the limited evidence currently available that supports this assumption. Heterogeneous elasticity across different earnings groups is crucial for welfare analysis. Eissa et al. (2008) show that relaxing the opposite assumption (uniform participation elasticity) across the income distribution – and putting largest elasticities at the bottom – completely changes the conclusions of a normative assessment of four major reforms in the US.

Thirdly, we provide one of the first estimations of participation responses to transfers in France which is based on a quasi-experimental approach. Even if a specific group is examined, our results tend to support findings in Gurgand and Margolis (2008) concerning the RMI and the fact that inactivity traps may be confined only to certain household types.

Fourthly, our results add to the aforementioned policy debate on the design of optimal redistributive programs. In fact, the RMI has recently been extended to incorporate an EITC-type of earnings subsidy aimed at correcting (some of the) disincentive effects. Importantly, the 25-year-old discontinuity was maintained in the first years of application. While future research should extend the present approach to evaluate the labor supply response of this new program in a precise way, we provide tentative comments on what can be expected for the core group of RMI recipients. More generally, we also discuss its essential difference of scope to the EITC (or the UK WFTC before 2003), namely that the new program, just like the RMI, targets all household types and not only those with children.

Finally, even if our results are difficult to generalize to a broader population, the particular age group we focus on is extremely important. Indeed, youth unemployment is a recurrent problem in many OECD countries and appears even more acute during recessions (Bell and Blanchflower, 2010).[4] It is structurally very large in France – around 27% in 1999, our main year of analysis – which explains the numerous government interventions over the past 30 years, including state-subsidized employment and training programs discussed in the paper. Among its dramatic consequences, youth unemployment leads to very high poverty rates in this population and has been shown to have a causal effect on crime in France (Fougère et al., 2009). In this context, it is particularly important to evaluate how social transfers may affect the labor supply of young workers, and we discuss the risks of extending the RMI eligibility to 16–24 year olds.

The paper is structured as follows. In Section 2, we provide a brief review of the scant evidence on the single individuals' labor supply, a short overview of the literature on France and institutional background information. In Section 3, we use the French Labor Force Survey (LFS) to examine suggestive evidence of an inactivity trap at age 25 for uneducated singles. Section 4 reports the core RD results based on Census data and Section 5 provides additional results and extensive robustness checks. Section 6 concludes.

[1] In particular, the period following the enactment of PRWORA in the US coincided with a historic economic boom, making it difficult to determine how much of the decline in caseloads was due to the economic upturn or to the reform (Schoeni and Blank, 2000). Lemieux and Milligan (2008) actually find that commonly used difference-in-differences estimators may perform poorly with inappropriately chosen control groups (notably groups not placed in the same labor market as the treated). RD analyses provide an advantageous alternative, when available, yet they must address a similar difficulty pertaining to the existence of confounding policy reforms. That is, double difference approaches must disentangle the policy effect under study from other policy changes possibly occurring at the same time, while RD analyses must verify if other policies can possibly generate similar discontinuities. We discuss the latter issue in much detail in this study.

[2] According to Moffitt (2002), the major methodological problem with estimates of the labor supply impact of the AFDC is that they are not based on any data in which AFDC was literally absent. They are obtained from cross-state variation in maximum benefit levels, and the total impact is a mere extrapolation based on these estimates. As for time variation, the repeal of the AFDC was also accompanied by many other policy changes. There are few attempts to disentangle their relative effects, and Meyer and Rosenbaum (2001) are a notable exception.

[3] These authors exploit the fact that prior to 1989, in Quebec, childless recipients under 30 received much lower benefits than older recipients. They find strong evidence that more generous transfers reduce employment.

[4] During the period of transition from school to work, young entrants into the labor market go through a sequence of temporary jobs, unemployment spells or training periods. This period is particularly long in France, and there is evidence that it is only at the end of their twenties that most workers have stable employment relationships (Magnac, 2000).