Unemployment Insurance and Unemployment Dynamics in Europe

Konstantinos Tatsiramos
University of Leicester & IZA
and
Jan C. van Ours
Tilburg University & University of Melbourne

UMD-OECD Conference on Labour Activation
in Times of High Unemployment

OECD, Paris
November 14-15, 2011

Plan of the Talk

1. Overview of UI Design
2. UI Systems in Europe
3. UI and Labor Market Performance
4. Empirical Evidence: inflow, outflow, post-unemployment
5. Final Remarks

The Role of UI

- Unemployment insurance provides unemployed workers with benefits to smooth consumption
- The design of UI needs to consider the *trade-off* between
  - Insurance: consumption smoothing
  - Incentives: search for work
- UI is public and mandatory
  - Private insurance is problematic because of asymmetric information
  - Insurance is attractive for 'bad' risks - adverse selection

Benefits and Costs of UI

- There are four potential benefits of UI:
  1. Enables consumption smoothing and acts as an automatic stabilizer
  2. Stimulates aggregate spending
  3. Improves job matching
  4. Reduces liquidity trap
- The cost is that UI might create disincentives to find a job
- The magnitude of the disincentive effects is not a firmly established parameter and the literature is inconclusive and thin on important aspects

Policy Issues

- There are several incentive mechanisms to stimulate workers to search for a job:
  - sequencing of benefits
  - monitoring and sanctions
  - workfare
- In past decades the focus of policy makers and research was on (dis)incentives
- With the emergence of the *Great Recession* more attention is given to the insurance part of UI systems and whether UI should be more generous in recessions

UI Systems in Europe

- The European UI systems have similarities but also many differences
- **Similarities**:
  1. Eligibility conditions (involuntary unemployed, registered, seeking work)
  2. Qualifying period for eligibility
  3. Benefits are defined by previous earnings (flat in Poland and UK)
  4. Benefit duration is fixed (except for Belgium)
- **Differences**:
  1. Varying qualifying periods (e.g. 6 months in 1 year in Sweden, 52 weeks in 4/5 years in Netherlands)
  2. Declining benefit profile only in some countries
  3. Benefit duration depending on insurance period (most countries) and/or age (some countries)

Table 1. Difference in UI benefit rules across European Countries.

	Contributions conditions	Payment Rate (%)	Declining Profile	Maximum duration (months, weeks, days)	PBD depends on: Insurance period	Age
Austria	28 weeks in 1 year	55		20 to 52 weeks	x	x
Belgium	28 weeks in 1 year	55	x	No limit		
Czech R.	12 months in 3 years	50	x	6 to 12 months		x
Denmark	52 weeks in 3 years	90		48 months		
Estonia	1 year in 3 years	50	x	180 to 360 days	x	
Finland	43 weeks in 28 months	55		500 days		
France	4 months in 28 months	57-75		36 months	x	x
Germany	12 months in 2 years	60-67		6 to 24 months	x	x
Greece	125 days in 14 months	50		5 to 12 months	x	x
Hungary	1 year in 4 years	60	x	270 days	x	
Iceland	10 weeks in 12 months	70		3 years		
Ireland	260 days in 1 year	49		12 months	x	
Italy	52 weeks in 2 years	60	x	6 to 12 months	x	x
Luxembourg	26 weeks in 12 months	80		1 to 2 years		x
Netherlands	52 weeks in 4 of 5 years	75	x	38 months	x	
Norway	Last 12 months	0.24		52 to 104 weeks	x	
Poland	12 months in 18 months	Flat	x	6 to 18 months		
Portugal	365 days in 2 years	65		24 to 72 months	x	x
Slovak Republic	3 years in 4 years	50		6 months		
Slovenia	12 months in 18 months	70	x	3 to 12 months	x	
Spain	360 days in 6 years	70	x	120 to 720 days	x	
Sweden	6 months in 1 year	80	x	300 to 450 days		
Switzerland	12 months in 2 years	80	x	260 to 520 days	x	x
United Kingdom	Last 2 years	Flat		26 weeks		

Sources: OECD and "Social Security Programs Throughout the World" (2010), U.S. Social Security Administration.

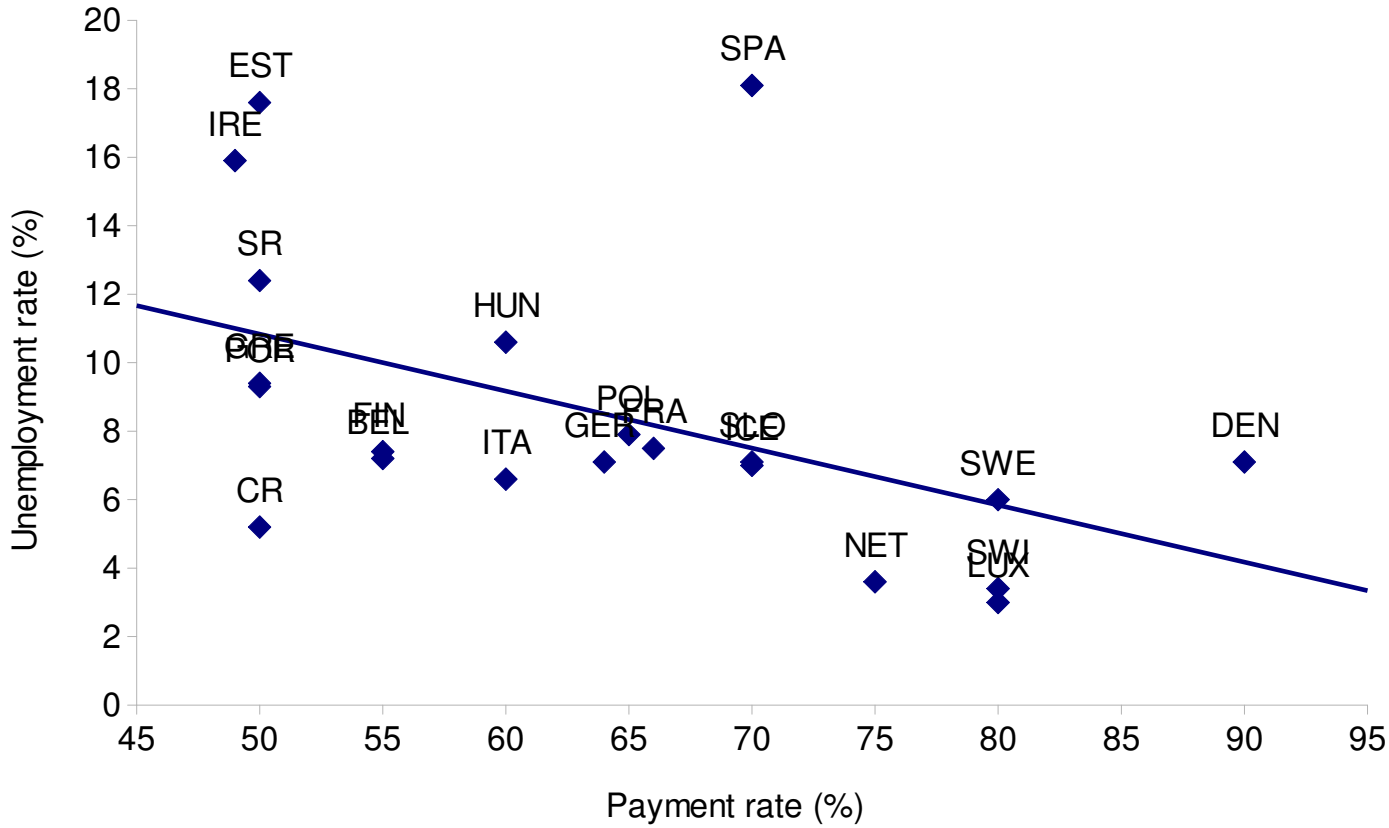
Labor Market Performance

- In 2010 unemployment rates for prime age men ranged from a low 3.0% in Luxembourg to a high 18.1% in Spain
- For prime age women the range in unemployment rates are similar, from a low 2.6% in Norway to 19.2% in Spain
- Unemployment rates are very much the same for older and prime age individuals but older face longer spells
- There is substantial variation in the share of long-term unemployed across countries

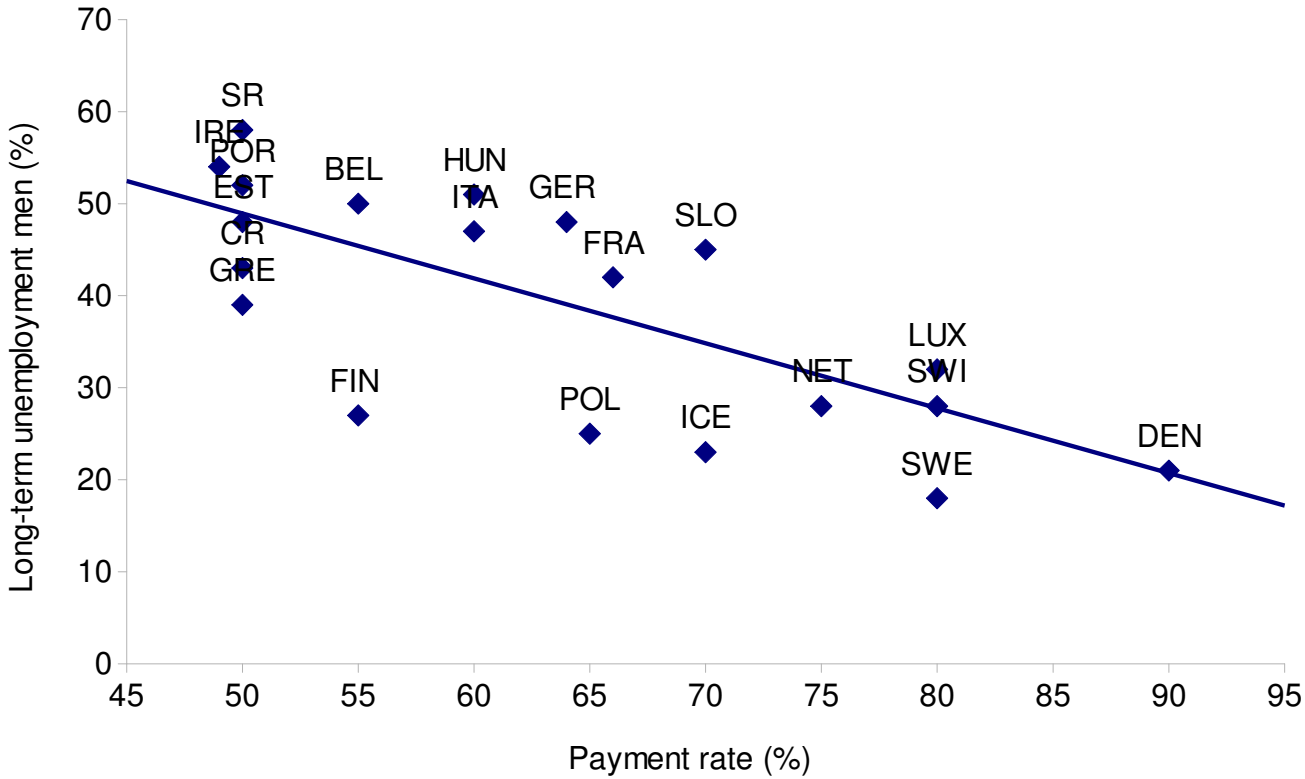
UI and Unemployment Rates

- At the cross-country level there is no direct relationship between UI generosity and the unemployment rate
- We focus on the two main features of UI design: payment rate and maximum benefit duration
- We consider the overall unemployment rate and the share of long-term unemployed
- Other institutional differences such as expenditures on active labor market policies, union density and employment protection legislation are important too

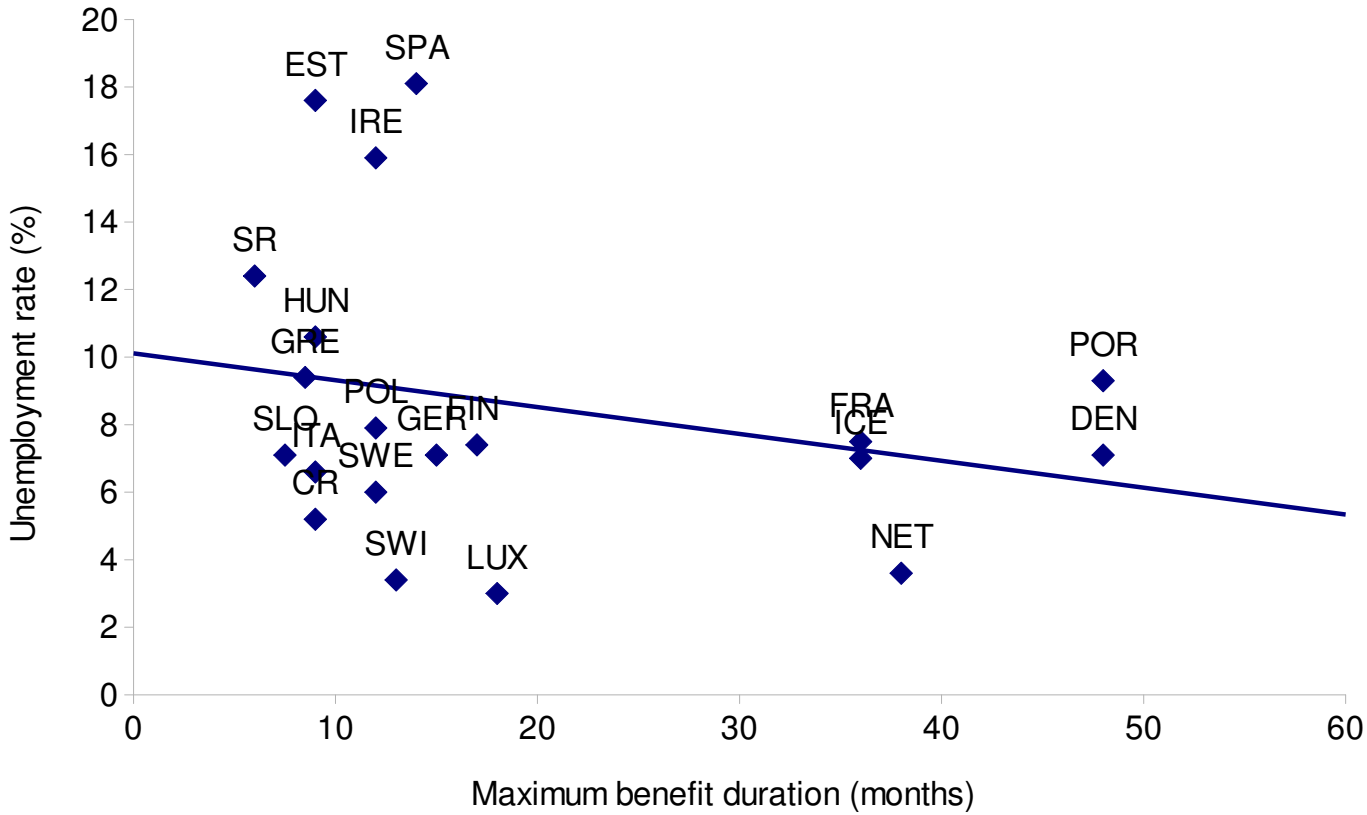
Payment rate and unemployment rate



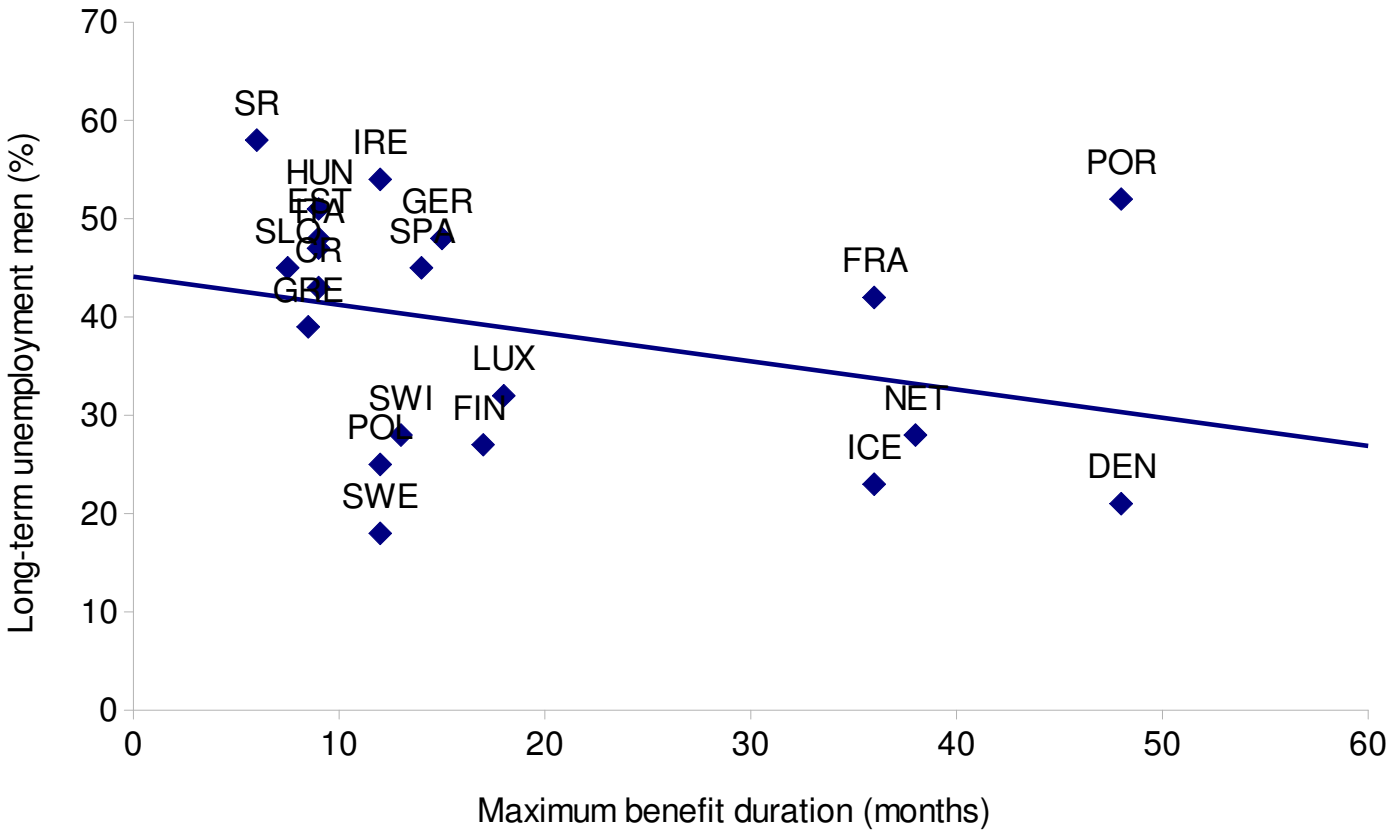
Payment rate and share of long-term unemployed



Maximum benefit duration and unemployment rate



Maximum benefit duration and share of long-term unemployed



Empirical evidence on UI and Unemployment Dynamics

Evidence for the effect of UI on:

- Unemployment outflow
- Unemployment inflow
- Post-unemployment outcomes

Unemployment outflow I

- Evaluation of the effect of **benefit level** is based on a number of policy reforms in several countries (e.g. Austria, Norway, Sweden)
- The evidence suggests that a reduction of the replacement rate increased re-employment probabilities (Sweden, Norway)
- An increase in benefit levels increased the duration of unemployment (Austria)
  - Individuals with access to more generous unemployment benefits tend to leave unemployment less rapidly during the covered period

Unemployment outflow II

- The recent literature has also exploited reforms on the potential **benefit duration**
- A common finding of most studies is a sharp increase in the exit rate close to benefit expiration
- The magnitude of the effect of an extension of the maximum benefit duration on the actual duration of unemployment varies

Overview of Recent Studies - Unemployment Outflow

a. Unemployment outflow

	Country	Period	Measure of effect
Carling et al., 2001	Sweden	1994-1996	Benefit elasticity: 1
Roed and Zhang, 2003	Norway	1990s	Benefit elasticity: 0.95 (M) - 0.35 (F)
Lalive and Zweimüller, 2004	Austria	1984-1998	1 week PBD ↑, 0.7 day U ↑
Van Ours van Vodopivec, 2006	Slovenia	1997-1999	1 week PBD ↓ , 1.6-4.4 days U ↓
Lalive et al., 2006	Austria	1987-1991	1 week PBD ↑, 0.4-0.7 days U ↑
			Benefit elasticity 0.3
Lalive, 2008	Austria	1986-1995	1 week PBD ↑ , 0.6 (M) - 2.2 (F) days U ↑
Uusitalo and Verho, 2010	Finland	2002-2004	Benefit elasticity: 0.8

Unemployment outflow III

Main conclusions:

- Both increases in the generosity of the UI system lead to longer unemployment duration
- Most of the effect of the increase in **benefit levels** takes place early in the unemployment spell
- Most of the effect of an increase in **benefit duration** arises around the dates when benefits expired
- A maximum benefit duration creates incentives to find a job compared to an indefinite benefit duration
- Changes in the duration of benefits lead to stronger effects compared to changes in the level of benefits
- Benefit duration is a more effective tool to influence incentives

Unemployment Inflow

- The empirical evidence on the inflow into unemployment is rather limited
- Both the level and the maximum duration of benefits have a significant positive effect on the inflow into unemployment (Winter-Ebmer, 2003 and Lalive and Zweimuller, 2004)

Post-unemployment outcomes

- Evidence on the effect of UI on post-unemployment outcomes is focused on wages and employment duration
- Wages: extending benefit duration has overall a weak positive effect
- Employment stability:
  1. Jobs which are accepted while still being insured last longer
  2. Jobs accepted close to and after benefit termination are jobs with a higher dissolution rate
- The increasing exit rate from unemployment induced by the declining profile of benefits might be associated with lower quality of jobs

Overview of Recent Studies - Post-Unemployment Outcomes

b. Post-unemployment outcomes

	Country	Period	Effect on earnings	Effect on job stability
Card et al., 2007	Austria	1981-2001	No	No
Centeno and Novo, 2007	Portugal	1998-2004	Yes	–
Van Ours and Vodopivec, 2008	Slovenia	1997-1999	No	No
Caliendo et al., 2009	Germany	2001-2007	Yes (M), No(F)	Yes (M), Yes (F)
Tatsiramos, 2009	Various	1994-2001	–	Yes
Fitzenberger and Wilke, 2010	Germany	1975-2001	No	–

Final Remarks

How to bring unemployed back to work?

- UI benefits:
  - Limited maximum benefit duration
  - Level sufficiently high
- Early activation to avoid benefit expiration and the associated reduced job quality
- Monitoring and sanctions

No silver bullet - no one size fits all