

UNEMPLOYMENT INSURANCE IN EUROPE: UNEMPLOYMENT DURATION AND SUBSEQUENT EMPLOYMENT STABILITY

Konstantinos Tatsiramos

IZA

That unemployment insurance (UI) has disincentive effects on job-seeking behavior and on unemployment duration is the conventional wisdom in modern labor economics. Policy recommendations often suggest a reduction in the generosity of UI as a way to remove these disincentives. By focusing only on the disincentives of UI, however, such policy discussions fail to take into account the potential beneficial effects of UI on postunemployment outcomes. By allowing more time and more resources for search, generous unemployment benefits may improve the match between the unemployed and the available job vacancies. Consideration of these positive features of the UI system is very relevant in the European context. This paper contributes to the empirical literature by modeling both unemployment and employment transitions for a number of European countries employing individual level data from the European Community Household Panel (ECHP). The analysis focuses on the effect of benefit receipt on unemployment duration and on subsequent employment duration, which is a measure of employment stability, including job-to-job transitions. The main novelty of the paper is that it considers a number of countries which vary in the generosity of the UI system and belong to different institutional regimes. This allows us to examine to what extent the effect of UI varies across countries. The econometric analysis adopts a reduced-form approach by estimating a multivariate discrete-time hazard model addressing two important issues: (a) the endogeneity of benefit receipt, and (b) the endogeneity of previous unemployment duration on subsequent employment duration. The empirical results suggest that receiving unemployment benefits significantly reduces the hazard of leaving unemployment, leading to longer unemployment duration. Moreover, the effect of receiving benefits on unemployment duration is larger in countries with relatively more generous UI systems, such as Denmark, France, Germany, and Spain compared to countries such as Greece and Italy, in which the UI system is underdeveloped. Despite this, there is a beneficial effect of UI on subsequent employment stability. Specifically, the hazard rate out of employment is lower for previously unemployed benefit recipients relative to non-recipients. This effect is pronounced (a) in those countries with relatively more generous benefit systems, and (b) for recipients who have spent at least 6 months in unemployment. These findings are consistent with the hypothesis that UI may have beneficial effects on post-unemployment outcomes. The magnitude of the effect of UI on employment stability varies by the generosity of the UI system and it is sizeable in countries with relatively

more generous UI, counteracting the disincentive effect of UI. From a policy perspective, these findings suggest that in countries with low benefits—both in terms of level and duration—there is scope for increasing the generosity of UI to levels of more generous welfare regimes. This will lead—*ceteris paribus*—to positive effects in terms of employment stability and productivity due to the matching effect of better insurance. In countries with relatively generous UI systems, the findings suggest that reforms toward reducing its generosity as a way to reduce the disincentive effects might not be the optimal policy as they ignore the matching effect of UI. A better policy might be a system with generous benefits that delivers beneficial postunemployment outcomes coupled with measures that increase the efficiency of the search process as a way to minimize the disincentive effects that generous UI can produce.