Financial incentives and job choice

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Chapter 5

Summary

This thesis examines various ways in which labour market institutions can influence the willingness of an individual to accept a(nother) job offer. The first and second essay consider unemployed individuals and their search for jobs, whereas the third essays considers the job transition decision of employees. All essays are mainly empirical in nature, although the first essay also contributes to the theoretical literature on search models.

The first essay studies the effect of wealth on reservation wages and search effort of unemployed individuals. Intuitively, when an individual with high wealth holdings becomes unemployed, he can use his assets as an addition to his income until a good job offer arrives. For a wealthy individual it is therefore less urgent to put a lot of costly effort into the search for a new job. Moreover, when a job offer is made an individual with high wealth holdings can decide to decline the offer until a more attractive job offer arrives. Indeed, the theoretical model in this essay predicts wealth to influence reservation wages positively and search effort negatively. The theoretical results are empirically tested by estimating reduced form equations for reservation wages and search intensity using Dutch survey data. The main results show that wealth has a significantly positive effect on reservation wages. In particular, a 100% increase in wealth at the mean of the wealth distribution raises the reservation wage by 2.9% for household heads, and 3.7% for spouses. Moreover, wealth has a significantly negative impact on the search effort of household heads. At the 10th percentile of the wealth distribution household heads (spouses) on average apply for 4.95 (2.09) jobs in two months, whereas at the 90th percentile heads (spouses) on average apply for 4.33 (1.71) jobs in two months.

The second essay focuses on the effect of UI regulations on unemployment duration. Specifically, it shows how imposition of job search requirements for older unemployed increases their probability to find a job within 24 months of unemployment. The Netherlands used to exempt their older unemployed (defined as being at least 57.5 years old) from the requirement to actively search for a job in order to receive full UI benefits. This situation changed on January 1^{st} 2004. From that date, the 57.5+ year olds needed to apply for 4 jobs every 4 weeks just like all other UI benefit recipients. Three groups of individuals were affected by this policy change: (1) individuals aged 57.5+ and entering unemployment in 2004. After the policy change they needed to (formally) search for jobs or risk a cut in UI benefit payment (2) individuals aged 57.5- and entering unemployment in 2004. After the policy change they needed to continue searching even when they turned 57.5 (3) individuals aged 57.5 and over at the time they entered unemployment in 2003 needed to start searching on the 1^{st} of January 2004. The essay shows that the outflow to employment and sickness benefits increased for all three groups of individuals. The main finding is that due to the imposition of search requirements, the number of 57.5-59.5 year old males (females) that find a job in the first 24 months of unemployment increases by 6 (11) percentage points. However, this strong effect on labour market participation is accompanied by a 4 (9) percentage point increase in the number of 57.5-59.5 year old males (females) who take up sickness benefits after a maximum of 24 months in unemployment.

The last essay in this thesis makes use of a natural experiment to examine the effects of potential capital losses and general attractiveness of pension schemes on employees' willingness to accept another job. On January 1^{st} 2004, the two largest pension funds in the Netherlands, for civil servants and for the health care sector, changed their pension scheme from DB-final salary to DB-average salary. Theory predicts that a (backloaded) DB-final salary pension scheme can keep individuals locked in their job, since they will suffer a loss in pension wealth when switching to another job. The potential loss in pension wealth is increasing in the (expected) future salary increases of the individual. The main empirical results indeed show that the onset of the DB-average salary pension scheme in 2004 coincided with an increase in the percentage of yearly job switches of 0.08 (0.61) percentage points for employees working as health professionals (civil servants).

However, the estimates could not confirm that job mobility especially increased for career-making employees who made a promotion at the time of the switch, and for those with a high subsequent wage growth in the new job. Observed behaviour can therefore not be explained by the theoretical incentives embedded in the pension system. Our results can be interpreted in two ways. First, it can be that individual workers do react on a major change in their pension system, but do not pay much attention to the details of their pension scheme. Second, it can be that individual workers are interested in their pension scheme, but have a hard time understanding the impact of rules and regulations embedded in the pension system on their (future) income.