Unemployment Insurance as a Subsidy to Risky Firms

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Research question: **Does unemployment insurance affect workers' labor supply to risky firms?**

STEP BACK

- Given this question, what is the *ideal experiment*?
  - Randomly assign (otherwise identical) workers to more/less generous UI programs
  - Randomly assign those workers to (otherwise identical) safe/risky firms

	Less generous UI	More generous UI
Firms	a	b
Risky firms	c	**d**

  - Then compare outcomes (employment, wages)

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SUMMARY

- The paper exploits an unexpected change in UI eligibility in Brazil in 2015
- The empirical setting is attractive
  - Key feature of the reform: only *some* workers were affected by the change in UI eligibility
- Identifying assumption: unaffected workers were not differentially influenced by other external changes, compared to affected (but otherwise similar) workers
- The data are also enviable—worker-firm matched data covering formal wages, age, etc. of 50MM workers

Less generous UI reduces labor supply

RESULTS

- The paper examines *equilibrium outcomes* to learn about labor supply: UI reform lead to relatively lower total formal employment and higher wages for affected workers

RISK

- Classifying firms by risk, the negative employment and positive wage effects of UI reform are especially strong at risky firms
  - The authors proxy for employment risk with:
    - Historical layoff rates
    - Credit spreads
    - Default provisions with the Central Bank

    } Falato & Liang 2015; Agrawal & Matsa 2013; Hotchkiss 1995

  - There is some survey evidence that workers do perceive these differences across firms (Brown & Matsa 2016)

The paper exploits other exogenous shocks: this time, shocks to firm performance

EXOGENOUS SHOCKS

- Generous UI might lead to riskier firm choices (Kim 2012; Agrawal & Matsa 2013)

- Authors address the potential endogeneity of firm risk using exogenous, severe weather-related shocks
  - Risky firms have relationships with customers or suppliers affected by large weather events
  - Shock unemployment risk through an aggregate demand channel

Wages at risky firm are higher for workers facing reduced UI eligibility

HIGHER WAGE

- Compensating wage differential studies have often use data in which unobserved worker characteristic (e.g. productivity) may be correlated with unemployment risk
  - Here, we see a cleaner setting, since the shock to the cost of unemployment is exogenous

- How does a back-of-the-envelope (or maybe better) calculation of lost UI payments compare to the increased wage?

Regardless of what the compensating differential is covering, the wage bump isn't sufficient

HIGHER WAGE

- But, is the wage change only about employment risk?
  - Van Doornik, Schoenherr & Skrastins (w.p. 2018) discuss formal and informal labors markets, and same UI reform
  - If reform made the UI system harder to game, then higher wages are compensating for lost benefit of working informally while collecting UI, not unemployment risk *per se*
  - Are riskier firms more likely to have been colluding with workers?
    - How would this affect the historical layoff-related risk measure?
  - Examine only firms/industries that cannot substitutes to informal labor?

How are the affected and unaffected workers different, beyond UI eligibility?

TREATMENT VS CONTROL

- Table 1 provides some comparisons, but it would be helpful to see direct comparisons of workers' age, wealth, education, occupation, industry, location by UI eligibility and firm type

  - Do workers types appear in the same proportion inside risky vs. safe firms?
  - After accounting for worker age, affected workers should have longer tenure?
    - Are affected workers (little prior unemployment) more likely to be professionals with steep wage-tenure profiles?
    - That is, are the unaffected workers (systematically) on a flatter section of a wage-tenure profile?

Heterogeneity in the effect of interest adds depth to the discussion

HETEROGENEITY

- UI reform should have less bite when workers have savings
  - Individual wealth may be hard/impossible to measure
  - College grads may have greater liquid savings and UI benefits typically cover a smaller fraction of lost income (Chetty 2008)
  - So, more educated workers' employment and wage should be less sensitive to UI reform
  - Age and/or tenure interactions with the UI reform might capture similar differences in sensitivity due to accumulated wealth

The performance of risky firms declines after UI reform

FIRM VALUE

- **Why?**
  - Do these firms now face a higher wage bill?
    - Can this (almost mechanical) consequence be observed directly?
  - Did these firms lose their high quality labor because an insufficient compensating wage differential?
    - Is there a productivity measure that can proxy for worker quality?
  - Do these firms undertake a real strategic change?
    - Do they change their approach to value creation in the face of worker attrition or higher labor costs?