



## JOB SEARCH MONITORING AND SANCTIONS

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### Introduction

European labor markets display high proportions of long-term unemployed workers (e.g. Machin and Manning 1999). Being unemployed causes skill loss, and being long-term unemployed leads to discouragement and stigmatization. All of this reduces the re-employment probabilities (e.g. Frijters and Van der Klaauw 2006). In principle, a wide range of policy measures is available to prevent unemployed individuals from becoming long-term dependent on benefits, and to stimulate and assist the long-term unemployed workers in their search for jobs. Examples are subsidized employment for youth and long-term unemployed workers, training and schooling programs. Unfortunately, the evidence on the effectiveness of these policies is not encouraging (see e.g. Heckman, LaLonde and Smith 1999 for an overview).

In this paper we consider the evidence for a rather novel set of policy tools, namely monitoring the job search effort of unemployed workers and punishing them financially if they do not meet the effort requirements.<sup>1</sup> In OECD countries, monitoring has become increasingly important (see OECD 2000 for a survey). Monitoring may be purely administrative. For example, the case worker may double-check whether the unemployed individual has made the applications that (s)he states to have made in the submitted monthly overview of job search activities. However, monitoring also often involves regular meetings at the UI agency or the employment office,

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<sup>1</sup> We restrict attention to monitoring after inflow into unemployment and we ignore effects on the size and composition of the inflow (Black et al. 2003).

at which recent search activities are evaluated and a plan for the next period is made. This may even include a directive to accept a particular open vacancy. If the unemployed worker does not comply with the guidelines, or does not show up at meetings, or does not carry out the monthly plan, then he may be punished with a sanction in the form of a benefits reduction. A typical punishment for insufficient job search is a 15 percent reduction of unemployment benefits for a period of two months.

The key problem for the unemployment agency is that monitoring is costly. Usually the agencies only consider samples of cases, so that individual detection rates are smaller than 100 percent. The costs of monitoring *formal* job search, such as responding to personnel advertisements and registering at the public employment office, are relatively low. However, *informal* job search, such as finding job offers through referral by an employed worker, a friend or a relative, is virtually impossible to monitor. We will discuss under which circumstances monitoring is a useful policy. In this we rely heavily on Van den Berg and Van der Klaauw (2006).

### Theory

This section provides an informal description of some economic-theoretical insights regarding the effects of monitoring and sanctions. Consider unemployed workers who endogenously determine their search effort. Job offers can arrive through formal as well as informal search channels, each with its own specific characteristics. We take monitoring to be concerned with compliance to an explicit lower bound for the amount of formal job search effort. If the unemployed worker does not comply with this requirement, he is at the risk of getting a temporary benefit reduction.

Full compliance to the monitoring requirements can be achieved by a sufficiently high probability of detecting a lack of search effort and a sufficiently severe punishment. In practice, sanctions are not uncommon. Apparently, certain unemployed workers are willing to take the risk of being given a sanction. Field research among case workers shows that mon-

itoring is imperfect (i.e., based on samples), so that indeed it may be optimal for some individuals to deliberately run the risk of being caught.

Monitoring only affects job search behavior if the minimum search requirements are above the optimal formal job search effort in the absence of monitoring. We restrict attention to this case. We assume that unemployed workers know the relation between search behavior and the probability that a sanction will be imposed. Some unemployed workers will be more willing to take the risk of being detected than others. However, monitoring causes unemployed workers to devote more effort to formal job search. Unemployed workers are forced to behave sub-optimally from their private point of view, and therefore they lower their reservation wage. With monitoring, being unemployed is less attractive, which causes unemployed workers to be less selective on jobs.

At the same time, monitoring typically reduces amount of informal job search effort. What is more, the net result of the increase in formal effort and the decrease in informal effort may actually be negative. In particular, if informal job search is more effective than formal job search, then monitoring may easily have a perverse effect on re-employment probabilities. In this case monitoring is clearly an ineffective policy.<sup>2</sup>

Monitoring is more likely to increase re-employment rates if the informal search channel is relatively unimportant compared to the formal search channel. “Unimportant” here means that the informal search channel is not very fertile, or that informal search effort is already very small so that there is not much scope for substitution. The empirical literature is informative on the use of different search channels by different types of workers. There is evidence that workers whose chances to find a job are low, such as long-term unemployed workers, workers in sectors with unfavorable circumstances, and workers in recessions, all rely to a relatively large extent on formal search. Such individuals do not have access to informal search channels, or their informal search channel has dried up. For them, monitoring may have a positive effect on re-employment rates. Conversely, for individuals with favorable characteristics or good eco-

nomical circumstances, the re-employment rate is not likely to increase upon stricter monitoring, and it may even decrease. Here one may think of well-qualified unemployed workers with a short elapsed unemployment duration in good economic circumstances.

An unemployed worker who devotes less effort to formal job search than the minimum requirements may at some point get a sanction. We now turn to the effects of imposition of a sanction. Since unemployed workers do not anticipate the actual moment of imposition of a sanction, the sanction causes a downward jump in the reservation wage at the moment of imposition. At the same time, the unemployed worker increases both formal and informal search effort since the lower benefit level makes it less attractive to be unemployed. Therefore, at the moment at which a sanction is imposed, the transition rate from unemployment to work jumps upward. These effects are temporary. The unemployed worker knows the duration of the sanction and anticipates on the moment at which the sanction period expires.

However, sanctions are more than only a temporary benefit reduction. Once a sanction has been imposed, the unemployment agency often provides the unemployed worker with some assistance on how to improve his behavior to avoid future sanctions and on how to search for jobs more effectively. At the same time the behavior of the unemployed worker is more closely monitored, and the magnitude of a subsequent sanction is often much larger. Data show that recidivism is very rare, which suggests that punished unemployed workers comply to the minimum search requirements. The fact that the individual received a sanction at all suggests that this individual did not have much scope for substituting informal search effort into formal search effort. The sanction and the closer monitoring afterwards then cause a permanent increase in re-employment rates, through higher formal search effort and lower reservation wages.

### Empirical results

In this section we discuss some of the empirical evidence. Linking this with the theoretical insights enables us to extrapolate the empirical results and to draw conclusions about a wider set of labor market policies for job search assistance and monitoring of search effort. In contrast to the previous section, we

<sup>2</sup> See Van den Berg and Van der Klaauw (2006) for a detailed analysis. The results bears an analogy to results in principal-agent models with multi-talking, where the principal incompletely observes the performance of the agent (Milgrom and Roberts 1992). This literature also often concludes that contracts based on the performance in a single task can give rise to dysfunctional behavior and may be less efficient than lump-sum contracts.

start off by considering sanctions and then turn to monitoring.

There is only a limited literature on the effects of punitive benefit reductions on re-employment of unemployed workers. For the Netherlands, Abbring, Van den Berg and Van Ours (2005) and Van den Berg, Van der Klaauw and Van Ours (2004) investigate the effect of imposing sanctions on the re-employment rate of respectively UI recipients and welfare recipients. The empirical analyses use the so-called Timing-of-Events approach. This entails the estimation of a model describing the process at which sanctions are imposed and the process at which individuals move to work. To control for selectivity of the imposition of sanctions, the unobserved heterogeneity terms in both hazard rates are allowed to be correlated with each other. The approach does not require instrumental variation but relies instead on random variation in the timing of treatment (Abbring and Van den Berg 2003).

Both empirical studies find that the actual imposition of a sanction has a positive effect on re-employment. Remarkably, in both cases, the exit rate to work doubles after the sanction.<sup>3</sup> Moreover, the effects on the exit rates are long-lasting, in that they do not disappear after the benefits reduction has expired.

For the welfare recipients one may argue that two times a small number is still a small number. To examine this more closely we translate the effect on the exit rates to work into effects on exit probabilities to work. If no sanctions are applied, then the probability that the average welfare recipient finds work within two years after inflow is equal to 0.66. However, if the same individual had a sanction imposed after 6 months of welfare, then the probability of leaving within two years increases to 0.91. Now consider a 50-year old individual who is otherwise equal. If no sanctions are applied, then his probability of leaving welfare within two years after inflow is equal to 0.29. If he had been given a sanction after 6 months, then this probability increases to 0.54.

Clearly, these effects are substantial and they indicate that the unemployed individuals are responsive to monetary incentives. To put this differently, the re-employment rate can be substantially increased among individuals who are at risk of a sanction, if one tightens the search effort conditions for benefits en-

titlement. Presumably, the threat of severe additional sanctions plays a major role in the magnitude of the effect. Note that the studies do not examine the effect on the characteristics of the job that is accepted. It cannot be ruled out that sanction recipients are so desperate that they accept any job they can get, whereas it could be socially optimal to search longer for a job with a high match-specific productivity. Unfortunately, it is difficult to obtain register data that contain longitudinal individual information on unemployment durations, sanctions, and characteristics of the post-unemployment job, like the hourly wage and the job contract.

Another noteworthy result from the above studies is that the individuals with very unfavorable personal characteristics are not as often sanctioned as one might expect. This might be because they fear the economic consequences of a sanction so much that they behave in an exemplary way. Alternatively, the case worker may feel sorry for them and may use his discretionary power to withhold sanctions for them. Field research supports the latter explanation.

Note that the estimated effect is only the effect of actually imposing the sanction. Given that the data are from a world with sanctions we cannot use these studies to identify the effect of having a benefits system with sanctions as opposed to a benefits system without sanctions. For this we need to compare different monitoring regimes.

There is a relatively large empirical literature on job search monitoring. We summarize the results that are based on social experiments. Van den Berg and Van der Klaauw (2006) examine a monitoring scheme for short-term unemployed workers with good labor market prospects in the Netherlands. They show that monitoring leads to substitution from informal search methods to formal methods. Clearly, this subpopulation of individuals has much scope for job search channel substitution. Within it, sanctions are almost never observed. Also, the monitoring of them has no significant effect on re-employment rates.

Other studies show that the effect of monitoring on the transition rate to work is stronger if the labor market prospects are worse. Also, the more intensive the monitoring, the larger the effect on the transition rate to work (Johnson and Klepinger 1994; Gorter and Kalb 1996; Dolton and O'Neill 1996; Klepinger, Johnson and Joesch 2002; Ashenfelter, Ashmore and Deschênes 2005).

<sup>3</sup> Lalive, Van Ours and Zweimüller (2002) find similar results for UI recipients in Switzerland.

## Discussion

The results from the microeconomic studies on the effects of monitoring and sanctions are in agreement with the theoretical predictions. We can draw a number of conclusions from them. First, stricter monitoring of job search behavior is not always a useful policy to stimulate re-employment. For individuals with very favorable characteristics or in very good economic circumstances, the re-employment rate is not likely to increase upon stricter monitoring, and it may even decrease. Conversely, for individuals whose chances to find a job are lower, such as low-skilled workers, long-term unemployed workers, workers in sectors with unfavorable circumstances, and workers in recessions, monitoring (in combination with the threat of punishment for non-compliance) has a positive effect on re-employment rates. Of course, for monitoring to increase re-employment rates, the search effort requirements should be demanding.

Actual imposition of a sanction has a positive effect on re-employment. Basically, the exit rate to work doubles after the sanction. Moreover, the effect is long-lasting, in that it does not disappear after the benefits reduction has expired. These results indicate that the unemployed individuals are responsive to monetary incentives.

Evidently, monitoring is often a useful policy tool. One may enhance the effectiveness by linking it to a profiling system for unemployed workers. After all, the effect of monitoring depends on characteristics of the individual and his environment. Unemployed individuals will not participate voluntarily in a monitoring scheme, since it reduces their reservation wages, so one needs to assign individuals to the scheme (or not). It is risky to let case workers do this assignment. They tend to use their discretionary power to reduce the intensity of monitoring (and to withhold sanctions) for unemployed individuals who in their view have very bad labor market prospects. This is ironic in the light of the fact that intensive monitoring works best for those individuals.

If a supporting profiling system is unavailable, or if the unemployed have good labor market prospects, then a general decrease of the unemployment benefits level without search requirements is to be preferred even if the unemployment agency has information on formal job search. A reduction in benefits that gives the same reservation wage as monitoring

is then more effective in stimulating re-employment: it is a less expensive policy, while the unemployed workers are indifferent.

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