

Welfare Benefits and Labor Supply: Evidence from a Natural Experiment in Japan

Kazufumi Yugami[†], Atsushi Morimoto[‡], Yoshiyuki Tanaka^{*},

Abstract

In this study, we use municipal amalgamations implemented in Japan between 2000 and 2005 as a natural experiment to identify the impact of welfare benefits on labor supply. In Japan's Public Assistance (PA) program, maximum benefit levels to those with zero income depend on recipients' resident area. Each municipality is rank at one of six area classes with different benefit levels. In case of amalgamations among municipalities rank at different area class, the highest class among them must be applied to the amalgamated municipality according to government notification. Japanese government strongly promoted municipal amalgamations to reduce the number of municipalities in the era of the Great Heisei Amalgamations, and this is only source of the change in regional variations of benefit levels during the period. Exploiting the event, we use both difference-in-differences and instrumental variable approach to identify the effects of amalgamations with increase in PA benefits on employment. The results show that the increase in PA benefit levels caused by municipal amalgamations in the early 2000s raise the recipient rates by 0.4-0.6% points and lower the employment rate of working population by 0.1-0.2% points on average. The magnitude of the estimated effects is not negligible compared with average change of recipient rate (+3.3 % points) and employment rate (-0.7 % points) during the same period. The results of the examination by demographic group show that these effects are substantial and strongly significant for those who are prime-age men and bereaved or divorced young women.

JEL Classification: H53; J22

Key words: Public assistance; Labor supply; Natural experiment; Difference in Differences

[†] Graduate School of Economics, Kobe University. yugami@econ.kobe-u.ac.jp.

[‡] Graduate School of Economics, Kobe University.

^{*} Graduate School of Economics, Kobe University.