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Measuring the response of the private safety net to job loss

Motivation

The private safety net is not well documented in the economics literature. This is partly due to the wide range of financial and in-kind transfers that comprise the private safety net and the difficulty in identifying these transfers in existing data sets. They range from sending an individual cash, buying her groceries, and paying her bills or rent to letting her move in and co-reside for a period of time, driving her to work, or watching her kids while she is away. One estimate of financial transfers from parents to adult children is $65 billion in 2012 dollars (Scholz, 1994; McGarry 2012), and this ignores the value of any time, residential, or in-kind transfers.

Yet, the private safety net could play an important role in consumption smoothing, alter the incentives to accumulate precautionary savings, influence labor force participation, and change the take up rate and effectiveness of the public safety net. In this paper, I use longitudinal data from the Panel Study of Income Dynamics (PSID) to examine one specific form of the private safety net in one circumstance—the response of cash transfers from family members after a job loss.

Identification Strategy

The PSID is a panel data set that includes 37 waves of annual and biannual data and surveys roughly 18,000 individuals in 5,000 families. I limit my sample to heads

of household because they are asked for a more detailed employment history, as well as the amount of financial assistance they received from relatives outside the household. I observe 3,200 individuals becoming unemployed.

The paper proceeds analytically in two steps. First, I establish the relationship between financial transfers from family members and unemployment.

$$y_{it} = X_{it}\beta + \psi UNEMP_{it} + year_t + \theta_i + \epsilon_{it} \tag{1}$$

Where X_{it} is a vector of individual and job-related covariates, $UNEMP$ is a dummy indicating that an individual has become unemployed, and θ are individual fixed effects, accounting for all observed and unobserved constant characteristics of the individual. The dependent variable, y, is a dummy for receipt of transfer of any kind.

The analysis represented in equation (1) establishes the existence of a relationship between financial transfers and unemployment. A clear result for the estimate of ψ indicates that transfers respond directly to changes in employment status. However, this says nothing about the size or variation in transfers. The second step of the paper is to measure the sensitivity of the financial transfer to the size of the income shock.

$$y_i = X_i\beta + \gamma UI_i + \epsilon_i \tag{2}$$

Here, y again captures the receipt of transfers, but is tested in a number of forms, including a dummy for any receipt of transfers, the amount (or log amount) received, and the amount received as a share of pre-job separation wage income. The key difference,

however, is that rather than regressing on unemployment status, equation (2)'s independent variable of interest is UI, the potential unemployment insurance (UI) benefit that an individual is eligible for. UI can be measured as the replacement rate of benefits compared to prior wages, or the total value of benefits (weekly benefits amount*number of weeks elgibile).

The advantage to using potential UI benefit is that there is considerable variation in eligibility and benefit calculation across states and over time, as well as differences in maximum and minimum benefit amounts and dependent allowances. This means that individuals with similar wages and work histories could have different benefits, creating variation in the replacement rate in the UI vector. The γ coefficient has two interpretations. It can either be thought of as the effect of the size of the income shock, or the effect of the public safety nets, since they are substitutable definitions in this analysis.

Results and Discussion

Although the literature on the *receiving* of private safety net financial transfers is limited, studies of elderly households in the Health and Retirement Survey (HRS) have provided extensive knowledge on the *giving* of financial transfers from parents to adult children. They are not regular or predictably repeating gifts, and are often negatively correlated to income of the child (McGarry, 2012). This and similar findings from the literature indicate that financial transfers will respond to job loss, and that my study will yield results.

Together, the results of the two parts of this paper will help establish the existence

of the financial private safety net and begin the characterization of how it responds to the depth of the income shock. It cannot be considered a full characterization, since other important safety net programs are not included. Large results from equation (2) would motivate future work that includes a more complete representation of the private safety net after job loss.

Other avenues for future research are varied, and further studies of financial transfers after job separation could examine the effect on consumption, the post-unemployment wage, or the duration of the unemployment spell. Moreover, significant findings from this paper could motivate the search for non-cash financial transfers in other data sets, to further flesh out the size of the private safety net. The aim of all of these, however, is to further understand this vital source of support and how it affects economic behavior in ways current research has not accounted for.