



Don't worry, be happy? Happiness and reemployment[☆]



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ABSTRACT

This study investigates the effect of unemployed individuals' happiness on their future labor market outcomes. It therefore acknowledges the possibility that happiness could also be a driver of behavior and influence life's outcomes. I use rich survey data from 2007 to 2009 of entrants into unemployment in Germany (the IZA Evaluation Dataset S) to calculate residual happiness, which displays higher (or lower) satisfaction levels than would be predicted by a number of demographic and socioeconomic characteristics. I find a statistically significant inverted U-shaped effect of residual happiness on an unemployed individual's future reemployment probability and reentry wage, even after controlling for demographic and socioeconomic characteristics, labor market histories and future job prospects. Further investigation offers three mechanisms that have not been previously shown in this context: (a) happiness is mainly a predictor for exit into self-employment rather than regular employment; (b) only male unemployed experience an effect of happiness on reemployment; and (c) the concept of locus of control and the personality traits of neuroticism and extraversion are main drivers of the baseline effect on regular reemployment and are able to explain the effect on reemployment for males.

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1. Introduction

"Well-being is important because there appears to be an increasing gap between the information contained in aggregate GDP data and what counts for common people's well-being" (Stiglitz et al., 2009, p. 12). This growing attention of policymakers highlighted by the Stiglitz–Sen–Fitoussi Commission follows the surge of academic interest in happiness research after the pioneering work of Easterlin (1974).¹ Yet, to date economic research has primarily focused on subjective well-being as an outcome variable (see Frey and Stutzer, 2002, for an overview) where due to its important social implications the effect of unemployment has received particular attention, with a broad consensus that unemployment leads to a decline in happiness (e.g., Clark and Oswald, 1994; Winkelmann and Winkelmann, 1995, 1998; Gerlach and Stephan, 1996; Korpi,

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¹ I use the terms happiness, subjective well-being and life satisfaction interchangeably in this paper, as with most economists, see, e.g., Graham et al. (2004).

1997; Clark et al., 2001; Di Tella et al., 2001; Böckerman and Ilmakunnas, 2006; Kassenboehmer and Haisken-DeNew, 2009; Winkelmann, 2009; Ohtake, 2012).²

This paper contributes to the literature on unemployment and happiness by adopting a different perspective: it acknowledges the possibility that happiness could also be a driver – and not only a response – of behavior and hence might influence life's outcomes. In fact, while there is no doubt that people do certain things to remain happy or become happier, it is probably as likely that happier people also behave differently *because* they have different well-being levels. Adding to the literature on unemployment and happiness, the paper investigates the following questions: does individual happiness influence an unemployed individual's future reemployment probability? Does individual happiness influence an unemployed individual's future reentry wage? The interest in looking at the relationship between happiness and post-unemployment outcomes is threefold. First, unemployment constantly represents an important topic in terms of academic research and public policy, given that it leads to high psychological distress, it reduces general output, and paternal unemployment exerts a negative effect on children's schooling efforts (Andersen, 2013). Second and related to the previous point, for an effective policy design it is important to understand the factors facilitating reemployment and whether the unemployment–happiness relationship is exclusively a one-way street. Third, given the lack of adaptation in life satisfaction with respect to unemployment compared to other life events (Clark et al., 2008), the relationship between happiness and exit from unemployment appears to be of particular importance.

The paper provides a deeper understanding of the impact of life satisfaction and new insights concerning the determinants of reemployment and reentry wages. To carry the analysis, I use a rather unique and unexplored survey dataset that provides rich information on entrants into unemployment in Germany (the IZA Evaluation Dataset S). I focus on outcomes one year after unemployment entry, which is the standard definition of long-term unemployment and hence, a time-frame of particular interest. In fact, it is important that individuals avoid passing into long-term unemployment for several reasons at the societal and individual level. On the one hand, high long-term unemployment will lead to increasing inequality and higher aggregate unemployment within the whole economy (Machin and Manning, 1999). On the other hand, evidence suggests that individuals suffer from long-term unemployment with respect to their labor market opportunities and physical and mental well-being (Machin and Manning, 1999), and individuals who have been longer unemployed are less likely to find a job (Shimer, 2008). Moreover, and given that I use data on Germany, 12 months is the maximum period during which prime-aged unemployed individuals are entitled to unemployment benefits receipt in Germany.³ Given the panel structure of the dataset, I am able to observe individual happiness and the outcome variables for the same individuals 12 months apart, hence at the border of entering long-term unemployment.

Moreover, the use of the IZA Evaluation Dataset S helps reducing endogeneity bias. A problem of endogeneity can arise due to omitted variable bias and reverse causality. If an unobserved variable influences life satisfaction *and* future employment probabilities, such as the knowledge about a future job, one would falsely interpret an effect from life satisfaction as being causal, despite the other factor actually determining the pattern in the relationship. For a clear causal effect of happiness, one would need a random assignment or experimental data. Given the impossibility to randomly allocate happiness, the IZA Evaluation Dataset S provides an alternative with rich observational data that are particularly suitable for studying this topic. It contains a large number of unemployed compared to surveys of the whole population and moreover, information about labor market histories, search behavior and other variables such as the subjective probability of finding a job. The latter helps to account for a form of self-esteem or own assessment of employability and consequently serves to reduce the reverse causality issue. Related to that, I am able to exclude those individuals who have not been looking for a job, and importantly those who have been looking and report to have already found a job, and thus the sample will only comprise actual job seekers. This also reduces reverse causality bias by minimizing the issue arising from the knowledge about a future job which leads to an increase in happiness *and* future reemployment probability, but is usually unobserved by the researcher. In addition, the data provide information about personality traits such as the locus of control, neuroticism and extraversion. Being able to account for personality traits is important as De Neve and Oswald (2012) show that they can be mediators of effects from happiness on income. A further advantage is that the respondents all have been unemployed for the same amount of time, around two months on average, and thus different unemployment durations do not influence their happiness levels and a discouraged worker effect should be small or non-existent.

Methodologically, the empirical strategy is based on using “residual happiness” rather than absolute happiness as an explanatory variable, much in the spirit of Graham et al. (2004) to capture a sort of constant factor of happiness. The idea is to investigate whether people who had higher (*positive residual*) or lower (*negative residual*) happiness levels than their socioeconomic and demographic characteristics would predict having different labor market outcomes one year later. This residual element of happiness is interpreted as some sort of underlying inner disposition or cognitive bias (e.g., Cummins and Nistico, 2002), and therefore may capture psychological differences between the respondents (and some random noise).

² A study using time use data finds that while the unemployed feel less happy while performing an activity, they compensate this decrease in well-being by the amount of time the employed do not have and therefore, average experienced utility does not differ between the unemployed and employed (Knabe et al., 2010). This finding extends the literature to more detailed evidence on the effect of unemployment on happiness.

³ These rules vary by age in connection with former employment duration. After these 12 months, unemployed individuals are entitled to a form of social insurance.

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