Journal of Behavioral and Experimental Economics 60 (2016) 23–28

Contents lists available at ScienceDirect

Journal of Behavioral and Experimental Economics

journal homepage: www.elsevier.com/locate/socec

Behavioral biases in the labor market, differences between older and younger individuals

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ARTICLE INFO

Article history:
Received 30 June 2015
Revised 21 November 2015
Accepted 21 November 2015
Available online 11 December 2015

Keywords:
Aging
Employment
Welfare

ABSTRACT

The employed and unemployed who are considering giving up work or seeking employment, respectively, have to consider the pecuniary and non-pecuniary benefits of both positions. What is the minimal allowance that motivates an individual to move from employment to unemployment? What is the minimal salary that motivates an unemployed individual to seek employment? This study examines those questions, specifically with regard to the differences between older and younger individuals. Our findings demonstrate that age has a strong impact on the threshold incomes and behavioral factors. Older people demand more money than younger people for giving up their jobs. Older workers also have a stronger status-quo bias and demonstrate a greater preference for work. However, there is no significant difference between young and old with respect to the income needed to motivate a switch from unemployment to employment.

Unemployment benefits are an important tool for helping people cope with a loss of income as well as other psychological and social stresses. However, at the same time, these benefits may prompt those who are employed to give up their jobs and motivate those who have lost their jobs to remain unemployed. Striking a balance between providing temporary help for the unemployed and encouraging people to seek work is crucial for economic growth as well as for alleviating poverty and the unequal distribution of income.

In every major school of economic thought – mercantilist, classical, and neoclassical – work has been portrayed as an unloved necessity (Spencer 2009). The underlying belief was that work was by its very nature a necessary evil, whereas idleness was associated with pleasure. Work was not recognized as an end in itself, with the classical economists describing it as intrinsically irksome (Spencer 2008).

However, several writers have challenged this notion of work as a necessary evil, demonstrating how the costs of work are socially determined and highlighting the possibility of intrinsically rewarding work under a transformed system of work. Other have argued that despite efforts to extend the analysis of work in mainstream economics, such studies are still lacking compared with similar analysis developed outside the mainstream paradigm (Spencer 2008). Paid employment has a substantial impact on the well-being of most adults (Warr 1999). According to research about happiness, not just income, but also satisfying work and secure employment are important factors that affect happiness (Layard 2006). Maslow's theory of human motivation (1987) clarifies the meaning and significance that people place on work. From Maslow's hierarchy of needs (1943) we can conclude that workers want to feel psychologically safe and secure and have a sense of belonging with others. Workers want to be productive and feel useful.

Both the employed and unemployed consider the pecuniary benefits as well as the non-pecuniary benefits of seeking work. Frey argued that it is inconceivable that people are motivated solely or even mainly by external incentives. We need to move beyond the idea of "economic men" who consider work only in terms of the creation of wealth to "mature economic men" who are more mature in the sense that they have more sophisticated motivations for working (Frey and Stutzer 2010).

The non-pecuniary benefits of work include satisfaction, interest and social status (Jahoda 1982; Mor-Barak 1995, Winkelmann and Winkelmann 1998) as opposed to the strong dependence on the state evident in unemployment (Frijters, Lindeboom, and van den Berg 2009; Mühleisen and Zimmermann 1994). Nakai et al. (2011) identified three clusters of mature job seekers: those who work primarily for monetary and family reasons, those who seek personal satisfaction and learning opportunities from employment, and those who want the benefits of full-time employment including training opportunities, access to benefits, and paid time off.

Furthermore, older adults regard work as a means of teaching, training and sharing skills with the younger generation, thereby leaving a legacy behind them (Mor-Barak 1995). The fact that volunteering increases during retirement, underscores the value that work has

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http://dx.doi.org/10.1016/j.socec.2015.11.003
2214-8043/

for older people. For example, using the lifecycle model Sherman and Shavit (2012) argued that older people substitute paid work for volunteering due to their inherent need to maintain immaterial consumption during retirement. A meta-analysis that investigated the relationship between age and work-related motives established a significant positive relationship between age and intrinsic motives, and a significant negative relationship between age and the strength of growth and extrinsic motivations (Kooij et al. 2011).

With respect to non-employment, the pecuniary benefit is unemployment benefits (if any), and the non-pecuniary benefit is leisure time. However, unemployment also has non-pecuniary and psychological costs. Studies show that the non-pecuniary costs of unemployment are about two times higher than its pecuniary costs (Knabe and Rätzel 2011). Two of the greatest disasters for people are unemployment and the breakup of one's marriage, confirming the important role that work plays in creating a satisfying existence (Knabe and Rätzel 2011). Unemployment has a powerful detrimental effect on one's satisfaction with life, and the non-pecuniary impact is much stronger than the effect that stems from the associated loss of income (Winkelmann and Winkelmann 1998).

Studies in behavioral economics have demonstrated that people do not act according to the classical rational theories of economics. Results from these studies have led to attempts to integrate ideas from behavioral economics into the decision to enter the labor market. Ideas such as the status quo bias, endowment effect, and loss aversion have been applied in various models, particularly in finance. Loss aversion in economics refers to people's tendency to strongly prefer avoiding losses to achieving gains. Some studies suggest that, psychologically, losses are twice as powerful as gains. In the field of labor economics Sherman and Shavit (2009) argue that loss aversion affects the decision to seek employment or go on welfare.

Three of the best-known natural phenomena that have been explained by loss aversion are the status quo bias (Samuelson and Zeckhauser 1988), the endowment effect (Knetsch and Sinden 1984; Thaler 1980), and underinvestment in stocks (Benartzi and Thaler 1995). The leading explanations of all three phenomena assume a general loss aversion bias (Eret and Erev 2013). The status quo bias is an irrational preference for the current state of affairs. The current baseline or status quo is taken as a reference point, so any change from that baseline is perceived as a loss (Kahneman, Thaler, and Knetsch 1991; Samuelson and Zeckhauser 1988). Finally, the endowment effect posits that a person's willingness to accept compensation for a good is greater than their willingness to pay for it once their property right to it has been established. The endowment effect contradicts the Coase theorem, which asserts that a person's willingness to pay for a good should be equal to their willingness to accept compensation to be deprived of the good, a hypothesis that underlies consumer theory and indifference curves (Kahneman, Knetsch, and Thaler 1990). Other studies show that when adding deliberation time constraints to a standard willingness to accept/willingness to pay paradigm, the endowment effect grows (Ashby, Dickert, and Glöckner 2012).

A specific category of research in labor economics deals with the difficulties of older workers (age 45 and above[1]) have finding employment if they lose their jobs. Lahey (2005) found that older job applicants (defined as those aged 50 or older) are treated differently than younger applicants. A younger job applicant is more than 40 percent likely to be called back for an interview than an older applicant. In addition, employers make little effort to recruit older workers despite the benefits of employing them (Van Dalen, Henkens, and Schippers 2009). Therefore, it is very difficult for older workers to re-join the work force after they have exited from it.

[1] The decision to use the age of 45 is consistent with several previous studies (e.g., the National Bureau of Statistics of Australia; Bangali 2004; and others).

Difficulties in integrating older adults into the labor market also stem from biased stereotypes that employers have about them, particularly with regard to their reliability and adaptability. Biased stereotypes might lead to the inefficient allocation of workers in the labor market, resulting in the hiring of younger workers even if their productivity is less than the real productivity of older workers (Axelrad, Luski, and Malul 2013; Luski and Malul 2014).

Our goal in this study is to investigate the role of behavioral effects in the re-employment difficulties of older workers. Our research has several purposes. First, we present a conceptual framework about the decision to seek employment vs. remaining on welfare that incorporates behavioral aspects. Second, we estimate the non-pecuniary benefits of an employed worker as well as the status quo bias effect, and investigate the impact of age on these parameters. Finally, we discuss the policy implications that can be derived from the analysis.

1. Welfare vs. employment: a conceptual framework

The theoretical model refers to the preferences of individuals for either employment or paid unemployment. The model analyzes two transitions: from employment to unemployment (or non-employment) and from unemployment to employment. Our equations demonstrate the individual's willingness to move from one choice to another.

Our model differs from previous ones (for example Sherman and Shavit 2013) in two main regards. First, we compare the behavioral factors and the non-pecuniary value of work for younger and older individuals. Second, we consider the non-economic value of work and the status quo bias. Both affect the amount of money that will satisfy the individual. We argue that personal characteristics such as age, education and whether one is currently working or unemployed rather than the type and quality of one's work affect the non-economic value of work. We also analyze the transition from work to unemployment and vice versa, not just changing work hours.

(a) Moving from Work to Welfare
Let us define I_W^* the level of welfare benefits such that an individual is indifferent about being employed with an income of I_E^0 and being unemployed with welfare benefits of I_W^*.

$$I_W^* = I_E^0 + U_E + SQ \tag{1}$$

Where, U_E- the net non-pecuniary utility from work (the non-pecuniary benefit from work minus the utility from leisure) SQ- status quo bias

(b) Moving from Welfare to Work
The question for unemployed individual is, if you have a given allowance I_W^0, what salary I_E^* would make you indifferent about being employed or being on welfare?

$$I_E^* = I_W^0 - U_E + SQ \tag{2}$$

We assume that U_E when moving from work to welfare (Eq. 1) is the same as U_E- when moving from welfare to work (Eq. 2), because in the former situation the compensation the individual asks for includes the status quo bias and the non-pecuniary value of work. Our model allows us to control for the behavioral factor so only the real value of work, which should be the same in both cases, remains. Indeed, when individuals are employed, they attach greater value to work, but part of this value involves loss aversion for which we control.

Summing Eqs. 1 and 2 allows us to estimate the status quo bias

$$I_W^* + I_E^* = I_E^0 + I_W^0 + 2SQ \tag{3}$$

The gap between Eqs. 1 and 2 allows us to estimate the non-pecuniary benefit of work.

$$I_W^* - I_E^* = I_E^0 - I_W^0 + 2U_E \tag{4}$$