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# Does past unemployment experience explain the transition happiness gap?

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## ABSTRACT

The profound economic and political changes of the 1990s had detrimental social effects in many domains of life in post-socialist countries, including diminishing life expectancy and growing unhappiness. Despite economic improvements in the second decade of transition, research has documented that happiness lagged behind. We test whether past unemployment experience can explain this “transition happiness gap in the context of Ukraine”, a country with a painful delayed transition from planned to market economy. We analyze unique longitudinal data for the period 2003–2012. Current unemployment substantially reduces subjective wellbeing, and the effect is roughly 50% larger for men than for women. The effect of past unemployment is significant, but small in magnitude compared to the effect of current unemployment. However, it does correspond to around 8% of the “transition happiness gap” found by Guriev and Melnikov (2017), suggesting that past unemployment experience can be considered as a partial explanation.

## 1. Introduction

For post-communist countries, the profound economic and political changes of the early 1990s led to significant social changes. A stable system of guaranteed employment gave way to labor markets governed by the laws of supply and demand. Many enterprises, whose products were no longer desired, closed down. Others remained open but still had to downsize their operations significantly. Inflation wiped out many people’s financial resources, limiting the scope of private investment and entrepreneurial activities, which might have absorbed excess labor supply.

These developments resulted in an unprecedented high level of registered and hidden unemployment, wage arrears, and the reduction of non-wage benefits traditionally provided by employers. Furthermore, government authorities, faced with hyperinflation and weak institutions, were unable to maintain the system of universal social benefits, which existed during the socialist times. Hence, welfare support for the unemployed and needy was insignificant to provide meaningful protection.

However, by the early 2000s, most post-communist countries had seen a steady improvement in real GDP per capita and a rise in demand for consumer goods. Despite the economic improvement, happiness lagged behind: (Guriev and Zhuravskaya, 2009) documented the existence of a “transition happiness gap” of more than one point on a ten point scale (statistically significant at the one percent level), even after adjusting for income and current unemployment status. A more recent analysis, however, shows that the transition happiness gap shrank during the recovery period after the Great Recession (Guriev and Melnikov, 2017).

It remains unknown why people in transition countries have been less happy (for reviews, see Guriev and Zhuravskaya, 2009 and

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Guriev and Melnikov, 2017). Several theories have been proposed, including increasing economic inequality, the decline of public goods, greater economic uncertainty, and depreciation of pre-transition human capital. While all of these theories have some merit, none seems to provide a full explanation. We explore another set of possible mechanisms involving unemployment experiences during the most turbulent times. In doing so, this paper bridges the gap between the literature on happiness in transition countries compared to the rest of the world and the general economic literature on the effect of unemployment on wellbeing.

The negative effect of unemployment on wellbeing is well documented in developed countries. The economic literature suggests that unemployment experience has long-lasting negative consequences (known as “scarring”). However, it is not known if unemployment has a similar negative effect on wellbeing in transition countries. If unemployment lowers wellbeing in transition countries, then the turbulent transition period with high levels of unemployment may partially account for the “transition happiness gap” in the 1990s. It may also explain the narrowing of the transition happiness gap in recent years, as the negative effect of past unemployment in transition countries dissipates while unemployment in Western countries peaked more recently during the Great Recession. Alternatively, if there is no scarring effect in transition countries, then the turbulent 1990s cannot be considered as part of the explanation for the transition happiness gap.

The economic literature has explored three main mechanisms for how individual happiness relates to unemployment. The first mechanism, known as “scarring”, implies that some undesirable condition experienced in the past permanently scars the person, even if the condition is no longer being experienced. The second, known as the “adaptation mechanism”, is fueled by the observation that people adapt to their circumstances. This mechanism implies that the effect of unemployment diminishes as more time is spent unemployed. The third mechanism is known as “social comparison”, and refers to individuals comparing themselves to external reference groups, such as people in their neighborhood, region, or country, which alters their reaction to own unemployment status.

The economic literature has persistently found that unemployment lowers life satisfaction. This damaging effect of unemployment has been confirmed across countries and time periods studied. See, for example, Guriev and Melnikov (2017), Wulfgramm (2014), Knattab and Fenton (2009), Guriev and Zhuravskaya (2009), Blanchflower and Oswald (2004), Clark (2003), Tella et al. (2001), Clark and Maurel (2001), Namazie and Sanfey (2001), Winkelmann and Winkelmann (1998), and Clark and Oswald (1994). More specifically, Guriev and Melnikov (2017) consider two most recent data sets — the third wave of the Life in Transition Survey (LiTS) (administered in 2015–2016) and the 2000–2016 waves of the annual Gallup World Poll (GWP). The LiTS covers 29 former communist countries (excluding Turkmenistan) and 5 comparator countries. The GWP covers 31 post-communist countries and territories (including Nagorno-Karabakh) and 133 comparator countries. The European Social Survey data for 21 European countries for the period of 2002–2008 are examined in Wulfgramm (2014), and Tella et al. (2001) study 12 European countries between 1975 and 1991 as well as the USA between 1972 and 1994. Waves 3 and 4 of the World Values Survey covering 84 countries are explored in Guriev and Zhuravskaya (2009). Furthermore, (Clark, 2003) and (Clark and Oswald, 1994) use the British Household Panel Survey (BHPS) data for 1991–1997 and for 1991, respectively. The Great Britain data from the Eurobarometer Surveys between 1973 and 1998 are analysed in Blanchflower and Oswald (2004), who also study the General Social Surveys (GSSs) data for the USA between 1972 and 1998. Germany has been studied by Winkelmann and Winkelmann (1998) using the German Socio-Economic Panel (GSOEP) data for 1984–1990.

Happiness research rarely focuses on transition economies. A few exceptions, in addition to Guriev and Zhuravskaya (2009) and Guriev and Melnikov (2017), Clark and Maurel (2001) use the Russian Longitudinal Monitoring Survey (RLMS) data between 1995 and 1999 (as well as the BHPS data for 1996–1997), and (Namazie and Sanfey, 2001) utilize the Kyrgyzstan Multipurpose Poverty Survey (KMPS) data for 1993.

In terms of the three mechanisms, scarring is concerned with whether any past unemployment influences human happiness. More specifically, research on the scarring mechanism (see, for example, Clark et al., 2001 and Knabe and Ratzel, 2011) shows that unemployment experienced in the past reduces a person’s current life satisfaction — even after they become re-employed. Both (Clark et al., 2001) and (Knabe and Ratzel, 2011) study Germany and use the GSOEP data for 1984–1994 and 1984–2003, respectively. Clark et al. (2001) (p. 221) conclude “life satisfaction is lower not only for the current unemployed (relative to the employed), but also for those with higher levels of past unemployment.” Furthermore, (Knabe and Ratzel, 2011) (p. 283) suggest that “the scar from past unemployment operates via worsened expectations of becoming unemployed in the future, and that it is future insecurity that makes people unhappy.”

While the scarring mechanism studies whether past unemployment affects life satisfaction, the adaptation mechanism maintains that people get used to their unemployment status the longer they experience it. In particular, (Clark et al., 2008b) and (Kimball and Willis, 2006) provide extensive reviews of studies on the economics and psychology of adaptation, respectively. Using the British data (BHPS) for 1991 and German data (GSOEP) for 1984–1994, (Clark and Oswald, 1994) and (Clark et al., 2001) find that those who have a shorter duration of unemployment are less happy than those with a longer duration of unemployment; suggesting that people get used to their situation in the long run. Furthermore, consistent with the adaptation hypothesis, (Clark et al., 2001) conclude that current unemployment ‘hurts’ less for those who have been unemployed more often in the past. In contrast, having examined the GSOEP data for Germany between 1984 and 2003, (Clark et al., 2008a) conclude that there is little evidence of adaptation to unemployment. Additionally, men are more affected by negative labor market events than women, and past job loss distresses men for longer than it does women.

The social comparison mechanism argues that unemployment hurts individuals less if there is more unemployment in the area. In particular, using the British Household Panel Survey data from the 1990s, both (Clark and Oswald, 1994) and (Clark, 2003) show that the unemployed’s wellbeing is strongly correlated with reference group unemployment at different levels. Furthermore, both studies find that unemployed people who live in areas with high unemployment are less dissatisfied with their lives than those who live in areas with low unemployment levels. Additionally, (Clark, 2003) shows that, in Great Britain, the effect of current unemployment on

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