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Does choosing jobs based on income risk lead to higher job satisfaction in the long run? Evidence from the natural experiment of German reunification

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ABSTRACT

Workers make job choices based in part on their income risk preferences. But how important is risk matching for long-run job satisfaction? Empirical research has been limited because job choices are endogenous, hindering identification of causal effects. We circumvent these problems by using data from the natural experiment of German Reunification. Pre-reunification East Germans chose jobs in a socialist environment without market income risk. These jobs were then exposed to market risks post-reunification, providing quasi-experimental variation. We find that workers in pre-reunification jobs report relatively higher job satisfaction, despite being less well-matched in terms of risk preferences. This unexpected result is robust to alternate explanations which might affect job satisfaction such as potential differences in job expectations, self-selection into leaving pre-reunification jobs, and past unemployment spells. We conjecture the results are consistent with projection bias: individuals at the start of their careers may over-estimate the extent to which risk matching matters for their future job satisfaction.

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“Choose a job you love, and you will never have to work a day in your life”

– attributed to Confucius

1. Introduction

Workers trade off a bewildering variety of attributes when making job choices. Besides the usual considerations of skills, aptitude and taste, job seekers must also assess whether the job income risks match their present and future risk preferences. While a considerable literature exists on risk preferences and behavior, and on the determinants of job satisfaction, there is little causal evidence on the role that risk preference matching plays in job satisfaction. We examine how risk preference matching affects the subsequent long-run job satisfaction of employees, using the natural experiment of German reunification.

Risk preferences significantly affect job choices (Bonin et al., 2007). More risk-averse workers tend to prefer jobs with greater

security and more predictable earnings, while less risk-averse workers may accept volatility in earnings in exchange for other benefits or higher expected incomes (Bellante and Link, 1981). Accordingly, civil service or unionized positions often attract relatively risk-averse workers. Conversely, workers who tolerate higher risks may be more likely to become entrepreneurs, or to work in private sector, non-unionized jobs, accepting greater variance in income and a higher risk of business failure or unemployment (Bellemare and Shearer, 2010). Risk matching is an important enough dimension of job choice that risk-averse workers may sort into low-risk jobs even if not otherwise well suited, harming on-the-job performance (Böhm and Riedel, 2013).

This paper answers a first-order question: Do workers actually maximize long-run utility – measured as job satisfaction – when they make job choices with risk preferences in mind? Although job satisfaction is just one measure of job quality, optimizing individuals should be weakly more satisfied with their jobs if they consider their own risk preferences when choosing jobs. Whether and to what extent this prediction is empirically confirmed provides insight on the relative importance that income risk matching plays in job satisfaction. This relationship has relevance for understanding the welfare effects of broader labor market phenomena, such

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as the ongoing shift in many countries away from relatively secure permanent employment positions, towards more volatile contract and freelance work.

We start by describing an idealized thought experiment that provides causal estimates of the effect of appropriate risk matching on job satisfaction. This thought experiment is vital because simple estimates based on observational data are biased since existing job choices and compensation schemes are endogenous with respect to risk preferences (Buurman et al., 2012; Dohmen and Falk, 2010; Grund and Sliwka, 2010; Pfeifer, 2011). Our thought experiment begins with a population of workers holding freely-chosen jobs in a standard market economy. Suppose a treatment group is chosen at random from this population. The effect of risk matching on job satisfaction can be determined by randomly assigning income risks to the jobs held by the treatment group, allowing a comparison of their subsequent job satisfaction to that of the control group whose income risks remain unchanged. Note that our thought experiment requires randomization of income risks rather than of jobs, since we are investigating the marginal impact of considering income risks *in addition* to other factors when choosing jobs, relative to choosing jobs freely in all respects except income risks. As actually assigning income risks randomly to workers in the field is impractical for most real-world jobs, we use the natural experiment of German reunification to approximate the experiment using observational data.

Our ideal thought experiment is approximated through comparing, between subjects, the self-reported job satisfaction of East and West Germans who are still holding pre-reunification jobs¹ after the German reunification. East Germans, whose pre-reunification job choices were orthogonal to income risk, form our treatment group. West Germans form our control group. This comparison is suitable for four reasons. First, while the division of Germany into East and West as a result of differences in political ideology lasted for forty-one years, the two states shared extended common cultural and social histories. Despite the separation, East and West Germany continued to share an identical language and some institutional features such as the structure of the education system. Second, prior to reunification, the socialist state in East Germany (the former German Democratic Republic or GDR) restricted income risk variation in the East German labor market through compressing wages and guaranteeing employment (Krueger and Pischke, 1995). On the other hand, West Germany (the former Federal Republic of Germany or FRG) had a market economy long before reunification. Third, the rapid introduction of a modern market economy post-reunification exposed workers in the former GDR to market-based income risk for the first time while leaving West Germans unaffected relative to the pre-reunification era. Finally, West German wage levels, labor market standards and protections, and social welfare entitlements were adopted in East Germany following reunification, resulting in broadly comparable employment conditions for workers across Germany (Snower and Merkl, 2006).²

Our paper's identification strategy draws on a literature establishing the German reunification as an ideal natural experiment for studies on risk matching and job choice. In a seminal paper, Fuchs-Schündeln and Schündeln (2005) used evidence from the

German reunification to show that self-selection into jobs based on risk significantly biases estimates of precautionary savings behavior. While standard life-cycle models predict that precautionary savings *increase* with labor income risks, precautionary savings also *decrease* with greater risk tolerance. These forces offset when workers self-select into jobs based on income risks, leading workers in low-risk jobs to save more than expected, and workers in high-risk jobs to save less than expected. Fuchs-Schündeln and Schündeln (2005) find that these offsetting dynamics are muted amongst East Germans holding pre-reunification jobs, whose precautionary savings vary significantly more with labour income risks than their West German counterparts. Their finding is consistent with East Germans sorting into pre-reunification jobs on the basis of factors other than risk preferences.

While there are concerns on the suitability of comparing (former) East and West Germans, our research design circumvents many of the difficulties of cross-country analyses typical in the literature. As we outline in the Methods section, we employ a pseudo difference-in-differences strategy that allows us to control for the fact that East Germans are exposed to a different working environment from West Germans. Our identifying assumption is that, conditional on our controls, East and West Germans holding pre-reunification jobs are similar enough with respect to employment decisions, conditions, and expectations, to be comparable. We show in robustness tests that our results are substantively unaffected by controlling for potential sources of bias such as differences between East and West Germans in labour mobility, job expectations, and unemployment spells.³ We also test for whether older workers, who have less labour mobility as a group (Mincer and Jovanovic, 1981), are more significantly affected by the lack of income risk matching in their pre-reunification jobs. Accordingly, our empirical strategy relies on East and West Germans effectively forming the treatment and control groups, respectively, to identify the causal impact of risk-based job choice on job satisfaction.

The remainder of Section 1 discusses the prior literature on job satisfaction. Section 2 explains important institutional details of the pre-reunification East German labour market. Section 3 outlines the empirical strategy and our data sample drawn from the German Socio-Economic Panel. Section 4 presents the main results, while Section 5 presents a series of robustness tests. Section 6 concludes.

1.1. Prior literature

Subjective well-being is the subject of a rich literature (Dolan et al., 2008), and even the specialized topic of job satisfaction (rather than generalized life satisfaction) is difficult to cover in a short review. Here, we focus on the most directly related portions of the job satisfaction literature. We are not aware of a study that attempts to provide causal evidence on the relationship between risk-matching and job satisfaction.⁴ Studies do show that self-selection into jobs based on income risks is correlated with higher job satisfaction. Cornelissen et al. (2011) demonstrate that risk seeking workers who sort into performance-pay jobs have higher job satisfaction as a result of capturing the rents provided by such jobs as a compensating differential to attract relatively

¹ Pre-reunification jobs refer to job choices made before the German reunification. Pre-reunification job choice in East Germany is assumed to take place without income risk matching, but pre-reunification job choice in West Germany is assumed to take place with income risk matching. Additional details follow in the next section.

² Rapid convergence in labor market conditions also caused significant unemployment in East Germany, since labor costs rose dramatically as a result (Snower and Merkl, 2006). We address concerns that these disruptions to the East German labor market may bias our estimates through a difference-in-differences strategy, described shortly, and through additional robustness checks reported after the main results.

³ Labour mobility in particular is relatively low in Germany compared to Anglo-Saxon countries due to stricter employment regulations (Dustmann and Pereira, 2008), which suggests job switching costs are an exogenous barrier to leaving pre-reunification jobs.

⁴ A significant literature in job satisfaction similarly involving self-selection issues examines the stylized fact that union members are generally less satisfied than non-members. One central question is whether self-selection affects the job satisfaction of union members and to what extent. Heywood et al. (2002) and Powdthavee (2011) provide recent causal evidence and reviews of the literature on this topic.

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