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Bouncing back from health shocks: Locus of control and labor supply[☆]

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ABSTRACT

Many studies have demonstrated a causal effect of ill health on labor-supply. In this study, I explore the personality-related heterogeneity – measured by differences in control beliefs – in the labor-supply response to health shocks. To identify such behavioral differences, I follow the labor-supply trajectories of 649 initially full-time employed and healthy men who experience at some point in time an episode of ill health. When compared with men who have positive control beliefs, men with negative control beliefs are on average 100% more likely to drop out of the labor force – a drop out unrelated to early retirement – and work on average 12% less hours per week the year after the health shock. These behavioral differences remain robust to alternative estimation samples and health-shock definitions. They are strongest for men from low socioeconomic backgrounds, who do not have access to private health insurance, or who experience high intensity shocks. Heterogeneous labor-supply responses are also observed for conscientiousness and risk tolerance, traits that have been linked with willingness to invest and treatment compliance. An important conclusion from the findings is that a small set of non-cognitive skills produces long term labor-market benefits in the advent of adversity.

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1. Introduction

During the course of a normal life span, most people will experience at least one traumatic life event. Although such traumatic events can be highly debilitating in the short run, it is now established that not all individuals will respond to life events in the same way. Decades of research conducted by the team of George Bonanno at Columbia University have demonstrated important individual differences in the psychological adjustment and coping strategies to severe life events (see Bonanno, 2004; Bonanno et al., 2011). Psychological distress is a normal response to such events, but some individuals fall into a chronic dysfunction after an adverse life event, while others return to baseline levels after several months. Most of the research studying individual differences in the response to life events has focused on disasters, exposure to warfare, and loss of a loved one. In recent years, subsequent studies have identified similar individual differences in the response to

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health-related adversities, such as emergency surgery, health epidemics, breast cancer and physical trauma (see [Bonanno et al., 2012](#), for an overview of the literature).

The ability to cope with adversity is referred to as resilience in the Positive Psychology literature (see [Seligman, 2011](#)). It is “the capacity to maintain, or regain, psychological well-being in the face of challenge. The definition underscores . . . the capacity to flourish, develop, and function effectively despite difficult circumstances or events” ([Ryff et al., 2012](#), p. 12). An important component of resilience is beliefs around whether one can influence the important outcomes of one’s life. These *positive control beliefs* are often referred to in the literature as *sense of mastery* ([Masten, 2014](#)), self-efficacy ([Bandura, 1990](#)) or internal locus of control ([Rotter, 1966](#)). Economists are increasingly interested in the health and labor-market benefits of positive control beliefs (see [Cobb-Clark, 2015](#), for a review), especially so in the presence of adversity. For instance, [Buddelmeyer and Powdthavee \(2016\)](#) study the psychological benefits of positive control beliefs when dealing with a series of negative life events ranging from the loss of a loved one to the experience of financial distress. [Caliendo et al. \(2015\)](#) and [McGee \(2015\)](#) show that positive control beliefs help workers, who have lost their job, to search more intensively for re-employment, and therefore are more likely to be re-employed.

In this study, I explore whether positive control beliefs can function as an insurance against episodes of ill health. Instead of investigating the psychological wellbeing trajectories following an adverse event, I measure functioning as the ability to stay in the labor market. I hypothesize that among individuals who experience a health shock those who exhibited positive control beliefs prior to the health shock are less likely to drop out of the labor market – or reduce their hours of work – than those who exhibited negative control beliefs. They do so, because their attitude helps them to undercut feelings of hopelessness which in turn allows them to exploit all possible resources to counterbalance the negative impact of the health shock. To test this hypothesis, I follow the labor-supply decisions of initially healthy and full-time employed men who experience an episode of ill health at some point in time using data from the German Socio-Economic Panel (SOEP), a nationally-representative longitudinal survey.¹

Understanding the heterogeneity in coping mechanisms with health shocks is of paramount importance to public policy because ill health has long-term economic consequences for individuals (see [Smith, 2005, 1999](#); [Currie and Madrian, 1999](#), for an overview). Episodes of ill health may force older workers into early retirement ([Disney et al., 2006](#); [Wing Han Au et al., 2005](#); [Bound et al., 1999](#); [Riphahn, 1999](#)) and younger workers out of the labor market ([García-Gómez et al., 2010](#); [García-Gómez and López-Nicolás, 2006](#)). The employment effects of health shocks persist over many years ([Crichton et al., 2011](#); [García-Gómez et al., 2013](#)). Public policy may utilize knowledge on the heterogeneity of coping behavior with health-related adversity to save public taxpayer money on health and social insurance pay-outs.

There are two alternative avenues through which public policy could utilize this knowledge. One avenue is to directly target individuals who experience adversity. For instance, life-coaching sessions that improve positive thinking could be offered alongside standard medical treatment during episodes of ill health. Such training is already provided in large scale to employees of the US American military upon return from traumatizing military interventions ([Seligman, 2011](#)). Another avenue for public policy is to teach positive control beliefs as part of standard school curriculum. Governments in California (United States), Ottawa–Carleton (Canada), and Victoria (Australia) have already or are currently revising their school curricula to formalize resilience education for children. The effectiveness of these initiatives has not been evaluated yet, nor do we know which intervention strategies are most successful in teaching and evaluating these skills (see [Schurer, 2016](#), for evidence and discussion). Some innovative methods to teach positive control beliefs have been proposed and evaluated by [Bernard et al. \(2014\)](#) in a developing country context.²

Theoretically, there are several alternative mechanisms that could explain heterogeneous labor-supply responses to health shocks, which are not caused by, but correlate with, control beliefs. On the one hand, it may be that negative control beliefs measured at some point in time just proxy latent health problems. Thus, instead of identifying true behavioral differences in response to health shocks, control perceptions may just capture more intense health shocks or worse childhood (ex ante) health that also explain labor supply trajectories. On the other hand, positive control tendencies may just proxy higher levels of human capital or socioeconomic advantage. If there is an education gradient in positive control beliefs, then they may just capture an individual’s access to information, private health insurance, and high-quality care. I will present a theoretical model in the next section that describes and justifies these alternative channels.

To identify heterogeneous labor-supply responses to health shocks that are truly linked to differences in control beliefs I will choose an empirical strategy that is able to shut off each of these alternative mechanisms. Using German data has multiple advantages of testing these heterogeneous labor-supply responses. On the one hand, Germany has an almost universal and relatively homogeneous health care system, with a high coverage of health care services, free provider choice, and a high density of physicians and hospitals, factors which ensure access to high-quality health care for all citizens (see [Eibich and Ziebarth, 2014](#)). German labor-protection laws further protect most workers from short-notice lay-offs due to

¹ The analysis is conducted on men only because for women it is difficult to disentangle episodes of ill health and subsequent labor supply responses from pregnancy-related health problems and pregnancy-related labor supply decisions.

² The authors showed videos of successful people in randomly selected Ethiopian villages. They could then demonstrate that in those randomly-selected villages both aspirations and control perceptions changed significantly relative to villages where the videos were not shown, and improved control perceptions were associated with savings and investment behaviors.

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