



Time-varying individual risk attitudes over the Great Recession: A comparison of Germany and Ukraine[☆]



Thomas Dohmen^a, Hartmut Lehmann^{b,*}, Norberto Pignatti^c

^a University of Bonn, Maastricht University, IZA and DIW, Berlin

^b University of Bologna, IZA and DIW, Berlin

^c International School of Economics at Tbilisi State University

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ABSTRACT

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We use the panel data of the German Socio-Economic Panel (SOEP) and of the Ukrainian Longitudinal Monitoring Survey (ULMS) to investigate whether risk attitudes have primary (exogenous) determinants that are valid in different stages of economic development and in a different structural context, comparing a mature capitalist economy and a transition economy. We then analyze the stability of the risk measures over time. Between 2007 and 2012 we have the Great Recession, which had a mild impact in the German labor market while it had a more profound impact on the Ukrainian labor market. This enables us to investigate whether and how the crisis impacted on the risk attitudes in the two countries. By focusing on self-employment we also investigate whether the reduced willingness to take risks as a consequence of the Great Recession affects labor market dynamics and outcomes. *Journal of Comparative Economics* **44** (1) (2016) 182–200. University of Bonn, Maastricht University, IZA and DIW, Berlin; University of Bologna, IZA and DIW, Berlin; International School of Economics at Tbilisi State University.

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1. Introduction

Most economic models treat preferences as given and time-invariant. In an early influential paper, [Stigler and Becker \(1977\)](#) are adamant that persons do not change their preferences (for example their tastes) and that change in behavior is linked entirely to changes in their opportunity sets. In recent years, a small but growing empirical literature, which often complements survey data with experimental data, investigates whether economic actors' preferences are indeed time-invariant or whether idiosyncratic life events (e.g., health shocks, death of relatives and friends, financial losses or job loss) and general shocks (e.g., natural catastrophes, violent conflict, or large macroeconomic shocks) experienced by individuals trigger persistent changes in these preferences. The main focus of this literature is risk attitudes.

Of particular interest for our study are those papers that deal with the link between risk attitudes and economic shocks or the economic environment. Our overview of such papers is not meant to be exhaustive; we only consider papers that feed well into

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* Corresponding author.

E-mail address: hartmut.lehmann@unibo.it (H. Lehmann).

our own work as far as the posed research question is concerned. [Guiso et al. \(2014\)](#) survey the investing clients of an Italian bank before and after the 2008 financial crisis. They find that the financial crisis increases average risk aversion of these investors. It is very striking that even those investors who did not experience any losses during the crisis are more risk averse than before it occurred. Hence, the general experience of the financial crisis drives changes in risk attitudes and not individual outcomes in connection with it. With a complementary lab experiment the authors try to establish that it is fear brought on by the crisis that lowers the willingness to take risks. The study by [Cohn et al. \(2015\)](#) is very much in the same spirit. In a lab experiment the authors find evidence for countercyclical risk aversion, having financial professionals as participants in the experiment. Drawing on the priming method from psychology they prime participants of the experiment to be either in a boom or in a bust condition. According to the authors the priming method ensures that the psychological impact of booms and busts on risk preferences is isolated from confounding factors that are potentially many. Their main result says that financial professionals primed in the bust condition have a lower willingness to take financial risks than their counterparts who have been primed in the boom condition. Like [Guiso et al. \(2014\)](#) they also establish that it is fear that triggers more risk aversion. The study by [Malmendier and Nagel \(2011\)](#) takes a more long-term view of the impact of macroeconomic shocks on risk attitudes in the financial sphere. Using data from the U.S. Survey of Consumer Finances between 1960 and 2007 the authors show that individuals who in their lives have experienced low returns on their stock and bond investments are prone to exhibit more risk aversion when it comes to future investment decisions and are more pessimistic about future returns than those individuals who thus far had high returns. They also show that more recent experiences affect risk taking behavior and expectations more than experiences lying in a more distant past.

The last important study that we briefly discuss is by [Sahm \(2012\)](#). The author uses hypothetical gamble responses across the 1992 to 2002 waves of the Health and Retirement Study¹ to investigate whether risk tolerance is time-variant. Modeling risk tolerance with a time-varying and a time constant component and using the panel to separate within-person and between-person variation in risk attitudes, Sahm finds that nearly three quarters of the systematic variation is driven by persistent differences between individuals. The rest of the variation, which Sahm considers the time-variant part, is driven by age and macroeconomic conditions: older individuals are less willing to tolerate risk and an improvement in macroeconomic conditions is linked to increased risk tolerance. It is also striking that changes in income and wealth and major life events like job displacement and the diagnosis of a serious health condition hardly affect risk tolerance. An additional important result is that the unexplained transitory variation is larger than the systematic variation by an order of magnitude.

We use data from the German Socio-Economic Panel (SOEP) and the Ukrainian Longitudinal Monitoring Survey (ULMS). These large and nationally representative household data sets ask identical questions soliciting risk attitudes of respondents across the two countries over a time span that includes the Great Recession. Our study thus contributes to the literature in at least three ways. It is to our knowledge the first paper that compares risk attitudes and their determination in representative samples of two countries that find themselves at very different stages of the development process.² While Germany is a mature capitalist economy we can characterize Ukraine as a “laggard” transition economy. As a first task we study whether primary determinants of risk attitudes are the same across the two countries and whether the link between these determinants and risk attitudes is stable over time. Second, we investigate how a large macroeconomic shock impacts on individual risk attitudes in the two countries, by analyzing data on risk attitudes before and after the Great Recession. In particular, since Ukraine had a more severe recession than Germany and a larger and more persistent increase in unemployment after the financial crisis we can see whether these differences translate into more systematic variation over time in the Ukrainian case. Third, we examine data on the entire working age populations, in contrast to those cited papers that discuss the impact of economic shocks on risk attitudes of particular sub-groups of the labor force.

We find that primary determinants are similar across the two countries, and that rank-order stability of risk attitudes is rather high. At the same time we observe transitory changes in stated risk attitudes, but only a tiny fraction of this variation over time is explained by idiosyncratic life events or changes in socioeconomic conditions. The bulk of the variation is due to measurement error, which is sizable and larger in Ukraine than in Germany. Importantly, we observe shifts in the distribution of risk attitudes that are related to macroeconomic conditions. In particular, we observe that people’s willingness to take risks falls during the Great Recession. We discuss a potential chain of causation that, triggered by the reduced willingness to take risks, affects labor market dynamics and outcomes. For example, since persons who are more willing to take risks are more likely to become self-employed or start their own business (see, e.g., [Caliendo et al., 2009](#)) or are more mobile (see, e.g., [Jaeger et al., 2010](#)) a general increase in risk aversion might lower take-up rates of self-employment, geographic mobility, and job mobility. Hence, the negative effects of the Great Recession on the economy might be prolonged via the channel of risk attitudes. In this paper, we demonstrate this chain of causation by concentrating on self-employment.

While our study predominantly contributes to basic research on the link between risk attitudes and economic shocks, the presented results also have relevant implications for the medium- to long-term modernization and development prospects of the Ukrainian economy. Our results clearly show that Ukrainians are on average far more risk averse than Germans who in turn also have a low average disposition to take risks when compared with the average U.S. citizen for example ([Fehr et al., 2006](#); [Falk et al., 2015](#)). The literature finds willingness to take risks to be positively associated with workers’ mobility across sectors, occupations and jobs, as well as workers’ geographic mobility.³ Since mobility across these dimensions is an important ingredient in the

¹ The Health and Retirement Study is a large biennial panel survey of U.S. residents over the age of 50 and their spouses.

² [Vieider et al. \(2015\)](#) compare data on 2939 students who participated in experiments in 30 countries.

³ We discuss this literature in [Section 5](#) of the paper.

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