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Re-employment Expectations and Realisations: Prediction Errors and Behavioural Responses^{☆,☆☆}

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Abstract

Using a nationally representative panel dataset, this study investigates the extent and impact of systematic misconceptions that the currently unemployed have about their prospect of re-employment. Such biased expectations are of interest because of their capacity to drive sub-optimal labour market behaviour. Specifically, people with unemployment experience of three to five years significantly underestimate their probability of re-employment. Simply having information about the individuals' previous unemployment experience is sufficient to produce more accurate predictions than those of the individuals themselves. People who underestimate their re-employment probability are less likely to search actively for a job and more likely to exit the labour force. If re-employed, they are more likely to accept lower wages, work fewer hours, work part-time and experience lower levels of life and job satisfaction. By improving the accuracy of re-employment expectations, employment agency caseworkers may use this information to enhance their clients' labour market decision-making and prevent adverse job-seeking behaviours.

Keywords: Job Insecurity, Re-employment Expectations, Prediction Errors

JEL: J64, J01, D84

1. Introduction

One primary goal of labour economics is to understand and predict individual choices with respect to labour force participation, occupation, consumption, saving and education. Choices in the labour market are often intertemporal and usually made under uncertainty; thus, analysing subjective expectations is crucial for understanding otherwise unexplained heterogeneity in revealed preferences. The incorporation of subjective expectations into empirical economic models is likely to contribute to our understanding of observed behaviour that is otherwise unexplained. Drawing conclusions about decision processes from revealed preference data may be difficult if the decision maker is not rational and has only partial information about all possible outcomes. In this case, data on self-reported expectations

may be useful for understanding revealed choices and to validate assumptions about expectations (Manski, 2004).

Research beginning with the work of Tversky and Kahneman (1974) has provided broad insights into the systematic biases that are inherent in intuitive probability assessments made under uncertainty. Contrary to traditional assumptions underlying standard economic decision-making models, people are not rational agents; rather, they employ heuristic rules that—while indeed useful—can result in probability assessments that are severely misconceived. In some circumstances, such biases can lead to decision-making processes and behaviours that are sub-optimal relative to those that may have arisen given exposure to more accurate, unbiased information. These understandings have motivated the exploration of how such biases may be incorporated into models of labour market decision-making and the development of more effective policies (Babcock et al., 2012).

Job security and employability represent significant sources of uncertainty in the labour market, and expectations about these can influence the labour market choices of individuals.³ Interestingly, the research in this area is rather scarce, despite suggestions from the psychological literature that the observed rise in perceived job insecurity in recent years has detrimental effects on health (physical and mental), employees' job attitudes and consequently job satisfaction (Sverke et al. 2002;

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³Perception of job security is usually defined in the literature as the expected probability that an employee will lose a job, whereas perceptions of employability refer to the subjective probability of obtaining employment within a certain time frame once unemployed.

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