



Neighborhood effects of high unemployment rates: Welfare implications among different social groups[☆]

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ABSTRACT

This study analyzes spillover effects of high unemployment rates on well-being using cross-sectional data for Germany. Context effects among the employed arise due to the informational character of high unemployment rates. Using data on job security perceptions as well as regional unemployment rates the paper shows that high unemployment rates cause negative externalities among the employed. In addition, subjective perceptions of job security depend on local labor market conditions indicating the informational value of employment data. For unemployed persons we cannot find any welfare gains owing to a social norm effect. Thus, the existence of a public bad is not more enjoyable the more people suffer from the public bad.

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1. Introduction

During the last years, economists have devoted much time and research on the study of happiness. Although sometimes criticized that indicators of well-being have their own shortcomings owing to measurement errors and their subjective nature (Deaton, 2008), these studies have provided fresh evidence that relative income concerns are crucial for understanding the well-being of humans (Clark and Oswald, 1996; Ferrer-i-Carbonell, 2005). Another stable result emerging from this literature is that unemployment causes large welfare losses for those being unemployed (among others: Blanchflower and Oswald, 2004; Clark and Oswald, 1996; Frey and Stutzer, 2002). The welfare losses of unemployment exceed by far those directly stemming from a reduced income. Thus, empirical studies on happiness have demonstrated that the psychic costs of unemployment resulting from an implosion of the daily time structure and from a lower social status are much higher than the direct income losses.

What is less well understood are the spillover effects of high unemployment rates, which are at the heart of this paper. Using cross-sectional data for Germany, we show that unemployment induces informational spillovers and creates a negative externality

on those being employed, regardless whether one uses subjective or objective indicators of such contextual effects. When asking respondents whether they are concerned about their job security we see that those who answer positively to this question exhibit a lower welfare level, at least in West Germany. Alternatively, when using objective indicators, i.e. the regional unemployment rate, workers experience lower well-being, too. Finally, the regional unemployment rate is able to explain subjective perceptions about job security indicating that the channels through which regional unemployment rates alter the well-being of the employed works partly through information effects.

With concern to such neighborhood effects, a small body of literature on this topic has recently emerged upon which the present paper builds (Clark et al., 2010; Luechinger et al., 2010; Shields et al., 2009). First, compared to these papers we use an alternative dataset for Germany instead of the widely used Socioeconomic Panel (SOEP). Using different datasets has the advantage to check whether results generated by one data source remain consistent across different individuals. Second, in our analysis subjective as well as objective indicators of neighborhood effects owing to unemployment are analyzed jointly. Moreover, these different indicators are combined and it is shown that the (subjective) perception of workers about their job security can be partly explained by regional unemployment rates.

The paper is organized as follows: Section 2 shortly discusses the different channels through which high unemployment rates might have an effect on well-being and summarizes the results of existing

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studies. Section 3 discusses the data and the variables, whereas Section 4 presents the results. Section 5 gives a brief conclusion.

2. Spillover effects of high unemployment rates

Although individual unemployment is accompanied by large psychic costs, the spillover effects of high unemployment rates are less well understood. Contextual effects of unemployment may exhibit different signs on alternative social groups. Because people are largely concerned with their relative standing, status concerns might work in the opposite way in the case of a public bad. With respect to unemployment, this means that in geographical areas with high unemployment rates the psychic costs owing to a stigmatization of the unemployed might be less pronounced. In areas where many people are unemployed, common explanations like the “laziness” of the unemployed or a lack of ability lose their plausibility. Thus, it should be more difficult to explain the status of the unemployed by factors attributed to their personal characteristics. Moreover, in districts with high unemployment rates, it might be easier for the unemployed to follow their daily life and to keep in contact with other persons. Therefore, from the viewpoint of unemployed persons the local unemployment rate might share characteristics of a public good. An alternative channel, which might alleviate the welfare losses of unemployment over time, is habit formation. Previous research has shown that people adapt to new events like an income increase or – to a lesser extent – marriage (Frey and Stutzer, 2006; Stutzer and Frey, 2004). Although these events may raise well-being for a transitory period, happiness returns to its initial level after some time. If people get used to their new aspiration level, the detrimental effects of unemployment might therefore vanish in the long run. On the other hand, because higher unemployment rates mean that competition for scarce jobs should be more intense the sign of the externality on the unemployed is theoretically ambiguous. If the social norm effect outweighs intensified competition, we would expect a positive sign on the well-being of unemployed persons.

This positive view on the spillover effects of unemployment might be at odd for those being employed. Negative externalities from high unemployment rates can arise from different channels toward the working population. Firstly, if workers see that their colleagues are fired they might feel shame or even guilt. Secondly, since unemployment is positively associated with anti-social behavior like extremism or high crime rates the indirect effects of unemployment might hurt workers as well. Thirdly, more unemployment can implicate that the workload of the remaining workers increases. Fourthly, if unemployment benefits are not cut, the working population has to finance the increasing social expenditures. Finally, if workers attach their future prospects to their local unemployment rate, anxiety that one might be the next on the list of fired persons will grow with rising unemployment rates.

Little empirical work has been done on the spill over effects of unemployment. Besides the direct consequences on the unemployed, macroeconomic work has calculated an “average” effect of unemployment on well-being in a given country (Di Tella et al., 2001, 2003). These papers have shown that in societies with high unemployment rates the average level of happiness is lower even if one controls for personal unemployment. However, macroeconomic studies rely on highly aggregated data. Utilizing data from the British Household Panel Clark (2003) found that in regions with high unemployment rates employed persons enjoy a lower level of happiness. Instead, the effect for unemployed persons is positive, thus suggesting that the social norm effect outweighs the lower chance of getting a new job. This effect is weaker in the study of Shields et al. (2009), especially for females, though it is still present. Clark et al. (2010) using the German SOEP obtain results, which depend on reemployment prospects. For men the

gap in life satisfaction between the employed and unemployed is lowest in regions with high unemployment indicating that a social norm effect as well as negative externalities on the employed may be present. However, differentiating between unemployed with good chances to find a job and those who do not share this prospect their results indicate that a social norm effect is only present when people are very disillusioned about their future labor market prospects. Thus, only the most frustrated gain from the social norm effect. Finally, Luechinger et al. (2010) using the SOEP as well demonstrate that unemployment – measured at the German Laender level – exerts a negative externality on the employed. An interesting point of their study is that they cannot find any effects for public servants, because people whose employee is the government should objectively fear a job loss with a lower probability. Additionally, their study shows that people who subjectively fear a job loss also have a lower level of welfare. Thus, taken together, the existing empirical evidence suggests that high unemployment induces a negative externality on the employed, although it is not for sure through which mechanism this externality might work. Second, the hypothesis that a public bad might be less harmful if many people “join” the public bad remains – owing to the conflicting empirical evidence – contested.

3. Data and variables

The analysis in the next section applies OLS, although an ordered (logit or probit) model may more adequately reflect the ordinal nature of the dependent variable.¹ The dataset used in this study is from the ALLBUS-survey.² The ALLBUS is undertaken every two years in Germany. A cross-sectional analysis with data of the 2004 wave is undertaken. A panel data analysis or a repeated cross-section is not an option because respondents change between the waves and many control variables were asked only in the 2004 survey.

Respondents provide information about their sociodemographic characteristics and their values toward political institutions and society. Some questions of the ALLBUS constitute the basis for the (German part of the) International Social Survey Program (ISSP) which has been used by economists in recent times (for example on redistribution issues: Corneo and Grüner, 2002; on trade protection: Maida and Rodrik, 2005). “Well-being”, the dependent variable, is measured by the following question of the ALLBUS-survey:

Taken all together have you been able to achieve your goals?

Comparing the question with the literature on well-being it refers to cognitive or rational aspects of well-being. Welfare is measured on a scale ranging from 1 to 4, where a “4” means that the respondent was able to more than fulfill her goals. Thus, higher scores indicate a higher level of well-being. Note that this variable does not fully coincide with happiness measures. Though there should be an overlap between “achievement of goals” and “happiness” these variables do not perfectly match with each other, because persons who achieve their goals might be ex post disappointed and even persons who do not realize their goals might feel ex post happy.

¹ Many economists are aware to undertake utility comparisons on a cardinal basis. However, previous work (Ferrer-i-Carbonell and Frijters, 2004; Stutzer and Frey, 2004) has shown, that the differences between OLS and an ordered logit or probit model are negligible. Qualitatively, the results do not change when using an ordered logit model. Results are available upon request.

² ALLBUS is the abbreviation for “Allgemeine Bevölkerungsumfrage Sozialwissenschaften”.

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