

## Unemployment and happiness

### Successful policies for helping the unemployed need to confront the adverse effects of unemployment on feelings of life satisfaction

Keywords: unemployment, happiness, social capital, social norms, psychological scarcity

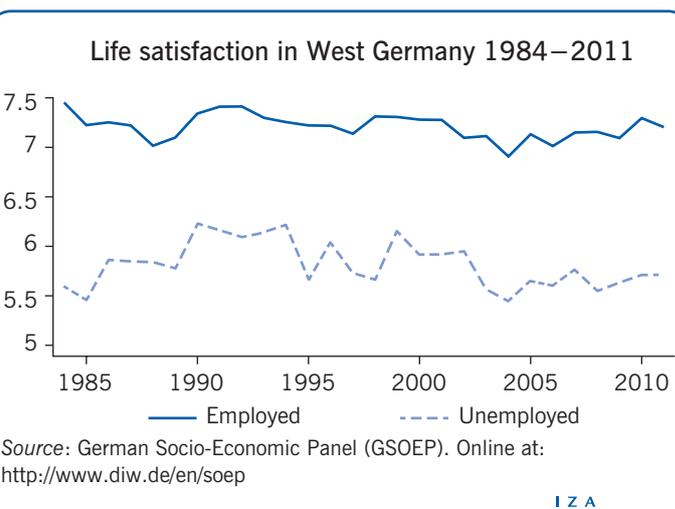
#### ELEVATOR PITCH

Many studies document a large negative effect of unemployment on happiness. Recent research has looked into factors related to impacts on happiness, such as adaptation, social work norms, social capital, religious beliefs, and psychological resources. Getting unemployed people back to work can do more for their happiness than compensating them for doing nothing. But not all unemployed people are equally unhappy. Understanding the differences holds the key to designing effective policies, for helping the unemployed back into work, and for more evenly distributing the burden of unemployment resulting from economic restructuring.

#### KEY FINDINGS

##### Pros

- ⊕ Getting the unemployed back to work does more for their happiness than compensating them.
- ⊕ Because not all people who are unemployed are equally unhappy, good policies should identify and target those who are most unhappy.
- ⊕ Unemployment can deplete mental resources, leading to bad decision making.
- ⊕ Often, the most unhappy unemployed are the least effective in their job search strategies; properly designed support programs can help.
- ⊕ There is no evidence that unemployed workers become less unhappy over time, so support policies should target unemployed persons regardless of the duration of their unemployment.



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##### Cons

- ⊖ A more generous unemployment insurance system does not really improve the situation of the unemployed, as the income replacement has only a minor effect on happiness.
- ⊖ Re-employment policies may fail if onerous application procedures or undue emphasis on discipline exceeds the psychological resources of people already burdened by their unemployment.
- ⊖ There is little scope for affecting social norms, a key determinant of the nonpecuniary cost of unemployment: Unemployment hurts more where work norms are strong, for example due to low aggregate unemployment rates or strong Protestant values.

#### AUTHOR'S MAIN MESSAGE

There is overwhelming evidence that unemployment takes a heavy toll on life satisfaction. The nonpecuniary cost of unemployment exceeds the pecuniary cost, and not conforming to the social work norm is one of the main drivers of loss of life satisfaction. Cost–benefit analyses of employment policies need to account for the intrinsic value of employment in generating happiness. Moreover, recent work on psychological feelings of scarcity can explain why people who are unemployed may engage in ineffective job search behaviors even though their nonpecuniary incentives for finding a job are very high. This mechanism underlines the need for more flexible active employment programs.

## MOTIVATION

The 2007–2009 recession pushed unemployment to new highs in many industrialized countries, and a recovery is not yet in sight. According to the OECD Employment Outlook the unemployment rate rose from 8.4% in 2007 to 10.3% in 2012 in France, from 8.3% to 25.1% in Spain, and from 5.3% to 7.9% in the UK (<http://www.oecd-ilibrary.org/employment>). While a high unemployment rate can be an indicator of a failing economic system and a call for policy action, it is important to realize that a country's loss of welfare from unemployment goes well beyond the associated income loss. As Nobel laureate George Akerlof has put it: "I have always thought of unemployment as a terrible thing. A person without a job loses not just his income but often the sense that he is fulfilling the duties expected of him as a human being" [1].

Many studies have tried to quantify the adverse effect of unemployment on well-being using survey data on life satisfaction. For example, the raw difference in average life satisfaction between unemployed and employed workers aged 20–60 years in the German Socio-Economic Panel for 1984–2011 amounts to 1.3 points on a 0–10 scale. Unemployed workers in all 21 participating European countries in the European Social Survey for 2002–2009 show a life satisfaction gap with employed workers ranging from a low of 0.5 points to a high of around 2.5 points [2]. A study of the subjective well-being of 3.3 million Americans finds a gap of 0.4 on a four-point life satisfaction scale [3]. While surveys like the European Social Survey use repeated cross-section samples and thus cannot be used to track individuals over time, the German Socio-Economic Panel collects data on the same individuals over time. Those data reveal that happiness begins to decline a year or two before unemployment, drops substantially in the year of unemployment, and recovers in the following years, although it never fully regains its former level.

An important finding from the more recent literature is that there are large differences in the effect of unemployment among people—not all people are equally unhappy. This article assesses some of the potential explanations for larger or smaller effects, including social norms, labor market institutions, social capital, and psychological factors. The recently introduced conceptual framework of "psychological scarcity" (a feeling of having less than one believes one needs) [4] helps to explain why most unemployed people are unhappy, with diminished ability to make good decisions, and reveals how support programs for unemployed workers can be made more effective.

## DISCUSSION OF PROS AND CONS

### **German panel data and the association of unhappiness with unemployment—on average**

Research on Germany occupies a prominent place in the happiness literature, mainly because of the pioneering role of the German Socio-Economic Panel, the first large household panel survey to include an evaluative question (see **Evaluative and emotional components of well-being**) on overall satisfaction with life ("How satisfied are you at present with your life as a whole?"), rated on a 0–10 response scale, where 0 means "completely dissatisfied" and 10 means "completely satisfied." The panel provides consistent information on this measure from 1984 onwards. (Most of this article follows the established practice in the economic happiness literature and does not distinguish between happiness, satisfaction, and well-being.)

### Evaluative and emotional components of well-being

Feelings of well-being can encompass both evaluative and emotional components. Evaluative components are concerned with evaluating one's satisfaction with areas of one's life, both current and anticipated. Emotional or affective components concern daily feelings and moods or the affective dimension of happiness (such as the balance between positive and negative feelings). The German Socio-Economic Panel survey captures the notion of evaluative well-being in the question: "How satisfied are you at present with your life as a whole?" and the notion of emotional well-being in the question: "How often have you felt happy during the previous weeks?"

The illustration on page 1 shows the development of average life satisfaction in West Germany from 1984 to 2011 for employed and unemployed residents (see **Analysis of German Socio-Economic Panel survey data** for details on the analysis of the German Socio-Economic Panel survey data). For both groups, mean happiness is almost as high at the end of the period as it was at the beginning. In between, the influence of historical events and the state of the economy is evident. The decline in 1986, for example, follows the Chernobyl nuclear power plant catastrophe, while the hump after 1990 coincides with German unification.

### Analysis of German Socio-Economic Panel survey data

The German Socio-Economic Panel survey distinguishes between employed residents (those in paid work for at least one hour during the week prior to the interview) and unemployed residents (individuals who have not been working during the week prior to the interview and are registered at the unemployment office) of West Germany. Trends are based on regressions with control variables for the number of times an individual has participated in the survey, the survey mode (computer assisted, oral, or written), and the month of the interview. The estimates adjust for potential measurement effects related to the circumstances of the interview. Thus the reported trends are calibrated to a first-time participant completing a paper-and-pencil questionnaire in March. Sampling weights are used.

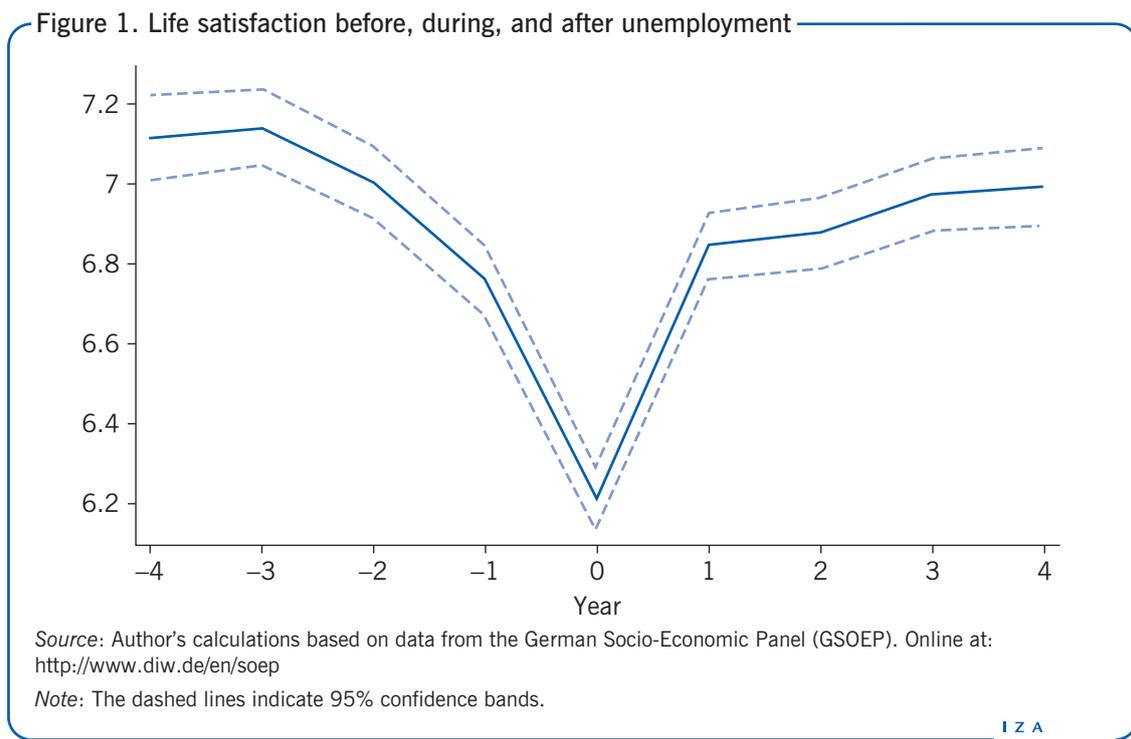
In addition to the influence of wider contextual factors, such as historical events and the state of the economy, there is a strong association between an individual's own unemployment and happiness. Average life satisfaction for unemployed workers, at 5.5–6.2 on the 0–10 scale, is always at least a full point below that of employed workers. There is also a strong association between the aggregate unemployment rate and average happiness even for employed workers (correlation of  $-0.47$ ). For employed workers, a one percentage point increase in the unemployment rate is associated with a 0.04 point (or 0.6%) reduction in average life satisfaction. An important channel for this association is perceived job security, which declines during economic downturns and negatively affects workers' happiness [3]. This means that both employed and unemployed workers living in countries or regions with high unemployment tend to have substantially lower average life satisfaction than others [3].

Despite the strong association between an individual's own unemployment and his or her happiness, a comparison of employed and unemployed workers at a single point in time cannot rule out the possibility that unemployed people are less happy to start with, even

before they lose their job. Also, the comparison cannot indicate how much of the effect is transitory and how much is permanent—whether it goes away quickly after a person gets a new job or whether unemployment leaves permanent scars.

A longitudinal perspective, made possible by the German panel data, follows the life satisfaction trajectories of individuals before and after unemployment, as they transition in and out of unemployment. It allows for more robust causal inferences, as all stable individual characteristics are eliminated as a source of bias. These include, for example, early childhood experiences and personality factors. Because other concurrent major life events that are systematically related to life satisfaction and to the propensity for becoming unemployed (such as the onset of a mental illness) are controlled for, we are then left with the assumption of comparability for the same person over time.

Figure 1 shows the average life satisfaction profile for 3,053 individuals in the German Socio-Economic Panel data over 1984–2011 who were unemployed in one survey year but continuously employed in the four years before and after the unemployment event. The other 2,958 of the 6,011 people in the panel data with any unemployment episode were repeatedly unemployed. The figure shows some anticipation effect, as mean life satisfaction starts to decline a few years before unemployment, but the biggest drop occurs at the time of unemployment. The large negative shock to life satisfaction at the time of unemployment using longitudinal data provides strong evidence for a causal effect.



Afterwards, as people are re-employed, satisfaction rebounds, but four years after the unemployment episode, people’s mean life satisfaction does not reach its early pre-unemployment level of satisfaction. This lingering effect of unemployment has been observed in other studies after controlling for other potential influences, such as age or period effects. Such scarring may reflect a heightened sense of insecurity that persists over time. It is also

possible that some people who were unemployed accepted new jobs that are less satisfying than the ones they held before becoming unemployed.

But not everyone who is unemployed is unhappy. The average effect described here masks considerable differences across individuals. Nearly half the people covered in the German Socio-Economic Panel who were employed in the previous period and unemployed in the current period experienced no reduction in life satisfaction [6], [7], and only about 5% of them experienced a loss in life satisfaction of five or more points on the 0–10 scale. So why are some unemployed people so unhappy while others are not? It is not because those who are unemployed are inherently less satisfied than those who are employed (selection bias), as Figure 1 suggests and fixed effects panel data analysis confirms [5]. It is also not due to the substantial income loss associated with unemployment, as the effect remains very large even after controlling for income.

Understanding the origins of such differences can provide clues about why the effect exists in the first place. Also, a better understanding of the personal and contextual risk factors can be useful for designing effective policy responses. Five groups of potential moderators of unhappiness are considered below: unemployment duration, social norms, labor market policies, social capital, and psychological resources.

### **Length of unemployment**

Since interviews in the German Socio-Economic Panel and comparable surveys are conducted annually, some people who are unemployed report their current life satisfaction while having been unemployed for just one day, while others have been unemployed for 12 months or longer. In theory, the fact that some unemployed people are happier than other unemployed people, relative to their pre-unemployment benchmark, could be related to the different duration of their unemployment spells. If people adapt to their unemployment, life satisfaction should increase over time and unemployment should become less painful. The same pattern would prevail without adaptation if those whose life satisfaction dropped the most initially are the first to find jobs again and leave unemployment.

Evidence on duration effects can be obtained by comparing the life satisfaction of those who are unemployed for a short while with the life satisfaction of those who have been unemployed for a longer period. Based on the few studies that have examined this issue, such as [5], duration appears to have no impact on the life satisfaction of people who are unemployed, indicating that habituation seems not to be an important force.

### **Social norms**

There is plenty of evidence in support of the hypothesis that the evaluative component of well-being depends on how much one conforms to or deviates from the norms of the social group one associates with. For unemployment, this means that the harmful effect of unemployment on life satisfaction is larger the stronger the prevailing norm toward work is. One study reports that the subjective well-being of unemployed workers is higher the higher the unemployment rate in their reference group is (at the regional, partner, or household level) [8]. In this interpretation, higher local unemployment weakens the work norm, so that unemployment is less of a deviation from the norm and therefore hurts less. A Swiss study uses the outcomes of plebiscites on employment topics to proxy the strength of the work norm in

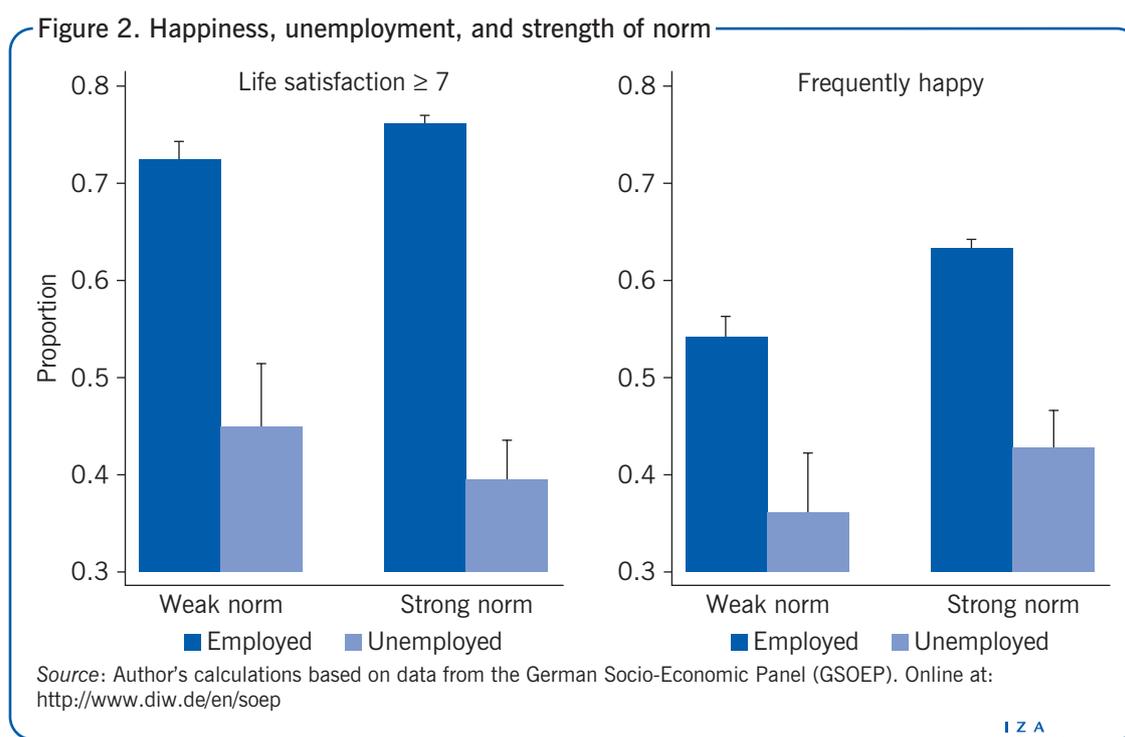
the municipality in which an unemployed person lives [9]. The study finds that unemployed people experience a larger reduction in life satisfaction and find a new job more quickly when they live in municipalities with strong social norms for employment than when they live in municipalities with weaker social work norms.

There is additional evidence in support of the importance of social norms to the degree of life satisfaction of people who are unemployed. A German study finds that unemployed people report a substantial increase in life satisfaction when they retire, although other life circumstances remain largely unchanged [10]. The study interprets retirement as a switch in the social group with which one identifies, from the working-age population to retirees, and thus to a change in the social work norm. Once an individual has retired, not working no longer violates the social work norm, and life satisfaction consequently increases.

Another study pools data from the World Values Survey on 82 countries and finds that the life satisfaction gap between employed individuals and unemployed individuals is larger in predominantly Protestant countries than in other countries [11]. In addition, within a country, self-declared Protestants suffer more from unemployment than others do. These results are presented as evidence of Weber's idea that the work ethic is stronger for Protestants than for others.

In addition, the finding that unemployed women tend to report greater life satisfaction than do unemployed men can also be viewed as a social norm effect, in particular in more traditionally oriented societies where men are seen as the breadwinners of the household.

All this evidence on the importance of social norms is indirect, as it does not measure the degree to which people internalize social norms—that is, the value individuals ascribe to social norms. The 2012 edition of the German Socio-Economic Panel comes close to providing such information. It includes the question: “How important is it for you to have a successful career?” The left panel of Figure 2 shows the proportion of unemployed and employed people with



high life satisfaction (a value of seven or above on the 0–10 scale) and distinguishes between those who have a strong work norm (those who respond to the questions with “important” or “very important”) and those who have a weak work norm (those who respond with “totally unimportant” or “not very important”). A stronger work norm is associated with a larger reduction in life satisfaction among people who are unemployed, confirming the findings based on various indirect evidence of the importance of social norms.

There has also been some discussion in the literature of whether unemployment influences the emotional, or affective, dimension of happiness (such as the balance between positive and negative feelings) in the same way that it does the evaluative dimension. The social norm hypothesis implies that this should not be the case, that unemployment should matter less for affective happiness than for evaluative happiness. One study collecting diary information on activities and associated emotions found that long-term unemployed people experienced similar levels of positive and negative emotions over the course of a day as people who were employed [12], while other studies report higher levels of sadness among the unemployed, which decrease after re-employment. The difference in results may stem in part from different study populations and differences in the duration of unemployment.

In recent years, the German Socio-Economic Panel has included a question on emotional happiness in its survey: “How often have you felt happy during the previous weeks?” The right panel of Figure 2 shows the share of respondents in 2012 who stated that they felt happy “often” or “very often.” Again, the figure shows that unemployment has a substantial negative effect on happiness, suggesting that the distinction between affective and evaluative measures of happiness may not be clear-cut (see [3] for consistently large negative well-being effects using a number of different happiness concepts). However, there is no social norm effect for the affective measure, supporting the view that recognizing a norm violation requires an evaluation of one’s position in life. Moreover, the lack of a social norm effect also suggests that part of the explanation for the negative effect of unemployment on happiness is related to factors other than social norms.

### **Labor market institutions**

A small number of studies, among them [2], have used cross-country comparisons to estimate the effect of the generosity of the unemployment insurance system (usually an index based on replacement rates and benefit duration) on life satisfaction of the unemployed or on differences in life satisfaction between people who are employed and those who are unemployed. Less generous benefits are associated with larger reductions in life satisfaction for the unemployed. It is difficult to know why this happens. One interpretation comes back to social norms: stronger work norms can be expressed through the political process as less generous benefits. Other policies, such as the German jobs program “One-Euro-Job,” have been shown to be associated with increased life satisfaction.

### **Social capital**

Social capital refers to the links in society that enable individuals and groups to share values and work together. There are different ways of measuring social capital. Some of them relate to trust, others to activities that people engage in together and that lead to social interactions. One study measured social capital before the start of an unemployment episode using data

from the German Socio-Economic Panel for 1984–2004 [6]. It defined social capital in terms of cultural events, entertainment events, active participation in sports, visits with friends and relatives, volunteer work in political or social organizations, and church services. Thus defined, social capital was an important predictor of well-being, but there was no evidence that it moderated the effect of unemployment on well-being. The results might have been different had an emotional measure of happiness been used instead of an evaluative measure.

## The psychology of unemployment

Psychological studies have emphasized the emotionally destructive consequences of unemployment. Commonly identified mechanisms relate to loss of economic identity and a sense of insecurity and personal failure. Unemployment has also been related to a diminished locus of control: people who are unemployed tend to believe more often than others that their life is controlled by outside forces and that they therefore bear little responsibility for what happens to them. Little is known yet on how psychological factors can moderate the effect of unemployment on happiness. One study found that conscientiousness is associated with a larger effect of unemployment on happiness [13].

A recent study develops the concept of “psychological scarcity,” a subjective sense of having less than one believes one needs (in contrast to economic scarcity, which involves objective trade-offs) [4]. The study argues that psychological scarcity leads to excessive attention to what one feels is lacking and thereby impairs executive control and reduces the amount of mental capacity that is available for other tasks at a given time (“mental bandwidth”). For example, the same subsistence farmers in India performed much worse on an IQ test before harvest, when they were poor, than after harvest, when they did not need to worry as much about making ends meet [4].

The potential felt scarcities and worries associated with unemployment are manifold. They include fewer social contacts, less social recognition, less money, a less structured day, less control of one’s life, and less certainty about what the future will bring. Indeed, although the effect on happiness of temporary income reductions during unemployment is not very large, people who are unemployed worry about their future economic uncertainty. In the 2012 wave of the German Socio-Economic Panel, 51.3% of unemployed respondents stated that they had “great worries” about their financial and economic situation, compared with only 17.3% of people who were employed. Obviously, this worry puts a great strain on respondents’ sense of well-being.

In addition, the pressure of psychological scarcity from unemployment can result in bad decision-making, as it reduces mental bandwidth [4]. For example, the paperwork and formal procedures required to file for unemployment insurance benefits may require too much effort and attention for some, who are preoccupied by thoughts about what they feel they are lacking. As a consequence, not everyone who is eligible for unemployment benefits applies for them. Similarly, unemployment has been associated with poor parenting, in part because unemployment reduces a parent’s ability to exercise self-control. A recent study finds that the least happy unemployed people search more actively for a job but that effort does not speed up their job finding rate [7]. In other words, they seem to be ineffective at conducting their job search. Of course, ineffective search can arise from a combination of factors, not only from a sense of psychological scarcity. For example, the most unhappy unemployed people might also be the least employable individuals.

## LIMITATIONS AND GAPS

In the absence of randomized controlled trials, there is always the challenge of credibly establishing a causal relationship when selection into unemployment can be nonrandom. In particular, other factors that might increase the risk of unemployment, such as mental health, might also cause lower life satisfaction. One strategy for dealing with this issue is to rely on longitudinal information. Another strategy is to use natural experiments to study the effect of “quasi-random” unemployment events. Along this line, a number of studies have looked at the effect of unemployment resulting from plant closures and mass layoffs, largely confirming the evidence of large negative effects based on standard cross-section or panel regression models.

Also, this review has focused on evidence for heterogeneity in the immediate impact of unemployment on life satisfaction. Much less is known about differences in the way people adjust to unemployment, leaving ample space for future research.

## SUMMARY AND POLICY ADVICE

There is now persuasive evidence that unemployment, on average, is associated with large and lasting reductions in happiness. A review of the recent literature yields some important policy implications. First, the often expressed worry that generous insurance benefits discourage those who are unemployed from looking for work seems unfounded, at least for the average individual and as long as the social work norm is sufficiently strong. The unhappy unemployed have in any case large incentives to act on their unhappiness.

Second, helping the unemployed by implementing policies aimed at changing work norms may be feasible in some marginal cases, such as for early retirement regulations, but could otherwise work only in the long term, and changing work norms is likely to have other unwanted side-effects for society.

Third, the most unhappy unemployed people, generally those who are the least employable or who suffer most from feelings of psychological scarcity, have more difficulty finding a job on their own, although they would have the most to gain from a new job. Thus, there is an important role for active labor market policies and job search support programs. To be effective, such programs should take into account psychological scarcity, along the lines suggested in [4]. For example, job training programs should not progress linearly but should allow for some “slack” or slippage, offering catch-up sessions for participants who miss a session, as some of them inevitably will because of the attention-distracting effects of unemployment.

## Acknowledgments

The author thanks two anonymous referees, the IZA World of Labor editors, and Liliana Winkelmann for many helpful suggestions on an earlier draft, and the German Institute for Economic Research (DIW Berlin) for providing access to the German Socio-Economic Panel data.

## Competing interests

The IZA World of Labor project is committed to the *IZA Guiding Principles of Research Integrity*. The author declares to have observed these principles.

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### Further reading

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