

Abstract for “Labor Supply Effects of Wealth Shocks: Evidence for Germany”

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This paper examines the effect of wealth shocks on labor supply behavior in Germany using rich micro data on households and individuals. Providing convincing evidence on this relationship is challenging since wealth and labor supply may be endogenously determined. Therefore, we consider several channels of how labor supply is affected by (exogenous) shocks to wealth, such as lotteries, inheritance and gifts as well as shocks to asset prices.

First, the gain in wealth may serve as an additional source of non-labor income. Substantial wealth gains can be expected to have a significant income effect and, hence, affect a worker’s marginal rate of substitution between leisure and consumption. Economic theory predicts that an increase in non-labor income reduces the number of working hours supplied on the labor market in the short run. Second, households of working-age can use their (gains in) wealth to increase their future streams of retirement income by dissaving after retirement and/or by consuming the additional income from their assets.

Therefore, similar to the decision on current labor supply, wealth can be expected to have an income effect on the intertemporal labor supply decision, which is particularly concerned with the timing of retirement. This means that a gain in household wealth may affect labor supply decisions in various ways, both at the extensive margin, through early retirement and participation and the intensive margin through hours worked. Moreover, windfall income could serve to finance the start-up of a business and, hence, increase the likelihood of becoming self-employed, which is another margin by which individuals and households can optimize their labor market behavior. In a similar way, wealth shocks may change the composition of household wealth portfolios and savings behavior and thus, as mentioned before, we might expect differential effects of particular types of assets on labor market behavior.

We focus on Germany, a country that is characterized by a strongly ageing society, a high level of wealth inequality as well as a sharply increasing aggregate value of assets, which implies a growing importance of future inheritances. Hence, the behavioral effects of inheritance will become more and more relevant as a determinant of employment structure. This might imply sizeable effects, especially on retirement decisions, given the exceptionally strong dependence on statutory public pensions.

The German Socio-Economic Panel Study (GSOEP) with its long-ranging panel micro data (1984-2012) provides detailed information on the labor market histories of individuals, information relating to past inheritances as well as expectations about future inheritances (in 2001), information on household wealth (in 2002 and 2007), information on windfall incomes of households (from 2001 onwards) as well as a rich set of individual and household characteristics.

Using household windfall income, both in its own right, and as an instrument for total wealth, we look at the labor market behavior of individuals in response to wealth (shocks), distinguishing between those who expected an inheritance and those who did not. In the first instance, we will model transition probabilities in the years after the inheritance, focusing on the probability of becoming self-employed, of

becoming inactive and of changing job, varying the timeframe from between one and five years post-inheritance. We use the long-ranging panel aspect of the GSOEP to control for the employment status of individuals in previous periods. Moreover, this data allows us to apply panel regression techniques, to complement our IV analysis and, hence, control for unobservable characteristics that may affect labor market behavior. To examine the intensive margin, we will also model hours worked and labor income between one and five years post-inheritance. We will examine the behavior of men and women separately, expecting that women, who have traditionally been found to be more risk-averse, will change their labor market behavior less than men.

To attempt to disentangle the effect of wealth on labor market behavior into the separate effects of liquid and illiquid assets, we will use the special inheritance questionnaire in the 2001 GSOEP wave. This asks about the timing, type and amount of retrospective inheritances. Matching the timing of the inheritance to the individual's labor market (and other) information in previous waves of the GSOEP will allow us to make inferences about the type of wealth (shock) that induces a bigger response in the labor market.