

Risk Attitudes, Informal Employment and Wages: Evidence from a Transition Country *

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1 Long Abstract

In our research we relate demographic characteristics to risk attitudes that in turn are linked to the incidence of informal or formal employment. Using the 2007 wave of the Ukrainian longitudinal monitoring survey (ULMS) to study the Ukrainian labor market, we first show that the determination of our measures of risk attitudes by carefully chosen predetermined demographic variables in Germany in 2004 can be replicated with the ULMS data. The measures employed thus seem to catch persistent patterns of risk attitudes across time and space. The ULMS allows the distinction between voluntary and involuntary informal employment. Our findings show that those workers who are willing to take more risks engage in voluntary informal employment relationships or are in formal or informal self-employment, both of which states we consider voluntary.

Including informality history from the ULMS waves 2003 and 2004, we test whether these results hold when accounting for previous informality and find risk attitudes remain an important determinant of informal employment, in particular voluntary employment and self-employment.

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Wages for informal workers exhibit the traditional wage gap found in the literature at first. We distinguish the particular dimensions of informality in terms of voluntary and involuntary employment and find that involuntary informal waged work still carries a significant wage penalty while voluntary informal waged work does not, in particular in the services, unskilled and manual occupations. Our findings of the residual earnings analysis suggest that risk attitudes are significant and positively related to the difference from mean residual earnings. This implies that a higher willingness to take risks increases the residual earnings or risk premium of wages.

The persistence of the risk attitudes measure can be tested with the ULMS waves of 2007 and 2012. Preliminary results point towards the stability of the risk measure over time in our data. We also test for the reverse causality of the effect of informality on risk attitudes: we find that being in an informal employment relationship in 2007 does not have a significant effect on the risk attitudes index in 2012. Moreover, moving into informality from 2007 to 2012 is not a significant determinant of changes in the risk attitudes index.

These results provide additional evidence to support the hypothesis that the labor market in Ukraine is segmented in three ways: a formal sector co-exists with an informal sector which in turn has a voluntary “upper tier”, where a minority of informally employed workers is located, and an involuntary “lower tier”, where the majority of informally employed workers finds itself.

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