

Instituto Futuro Brasil

Working Conditions and Quality of
Life in Latin America

Research Proposal

Inter-American Development Bank
June 2007

Research Team

Instituto Futuro Brasil (IFB)

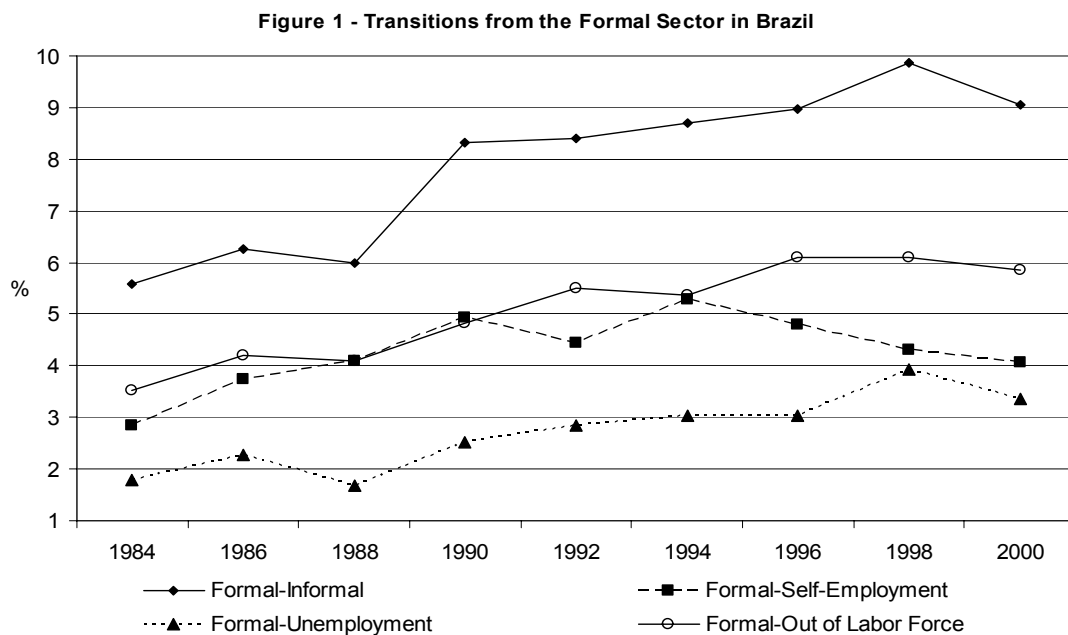
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1) Introduction

Labor market transitions in Latin American countries in general, and in Brazil in particular, are very high. Figure 1, taken from Curi and Menezes-Filho (2006), for example, describe labor market transitions from the formal sector over time in the Brazilian metropolitan regions in a period of twelve months. They show that the transitions from the formal to the informal sector increased from about 5.5% in 1984 to about 9% in 2000. Moreover, about 6% of workers that were in the formal sector in 2000 moved out of the labor force, and the transitions to self-employment and to unemployment reached 4% and 3.2%, respectively, in that year. This means that about 22% of all formal workers transited out of the formal sector in a given point of time.



The transitions within the formal sector are also very high. Menezes-Filho (2003) shows that about 20% of workers changed jobs within the formal sector in the 1990s in Brazil, which accords with Pontual *et al* (2004) that show that job reallocation in Brazil

was in the range of 30% in that period. Taken as a whole, these statistics show that roughly 40% of all Brazil formal sector workers leave their jobs in a given year, which means that job insecurity must be very high in Brazil.

Job satisfaction seems to be related to life satisfaction as well. Corbi and Menezes-Filho (2006) used the World Value Surveys to examine the determinants of subjective wellbeing in Brazil and showed that individuals that were employed are much more likely to consider themselves very happy than individuals which were unemployed. Using the same data (World Value Surveys, 2002) we can compare job satisfaction in a range of countries and also associate life satisfaction with job satisfaction. Figure 2 compares job satisfaction in some Latin American countries, USA and Canada. It shows that the percentage of people who report high job satisfaction (higher than 7 in a 1 to 10 scale) tends to be higher in USA and specially in Canada than in Brazil, Argentine and Chile.

Figure 2- Percentage of people with Job Satisfaction higher than 7

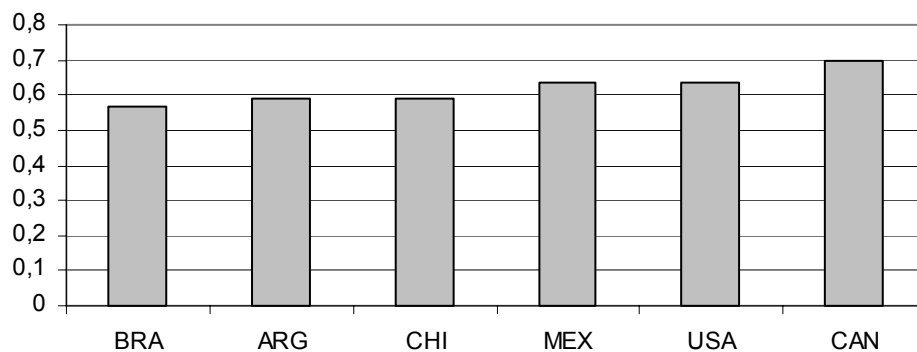


Figure 3 shows that life satisfaction and job satisfaction are highly correlated across countries. It shows that countries with a large share of people with high job

satisfaction also have large shares of people with high life satisfaction. This also occurs within countries.



The aim of this proposal is to examine the determinants and consequences of job insecurity in several Latin American countries and also carry out an in-depth investigation of the Brazilian case. The proposal is structured in the following way: in the next section we will briefly review the literature life satisfaction, paying particular attention to measurement issues. We then present the main hypotheses that will be examined in the proposal, together with the methodology we intend to use to carry out the investigation. Section 4 describes the data to be used in the analysis and in the appendix we present the budget and the vitae of the main researchers.

2) Objective utility, subjective utility and life satisfaction

In this section we briefly review the main approaches used to measure individual wellbeing, their main strengths and weaknesses, to gain insights about the validity of

using *perceived* measures of job insecurity and life satisfaction. We also describe the main surveys used to measure perceived wellbeing.

The objectivist approach of economic theory is based on observable choices made by individuals. Individual utility, dependant only on tangible goods and services and leisure, is recovered from behavior (revealed preferences) and can be used to explain the choices made. This modern view of utility has been largely influenced by positivism. The subjective experience, captured by surveys, is sometimes rejected because it cannot be objectively measured.

Many scholars challenge the classical economic theory from different angles, incorporating self-esteem (Loewenstein 1999), status (Frank 1985) or emotions (Elster 1998). In order to explain human behavior, interdependent utility functions are also considered (Clark and Oswald 1998), which challenges the classical propositions of welfare (Richard Layard 1980). Besides utilitarianism, procedural utility¹ has also been described as a relevant aspect of behavior and, therefore, should also be considered in the analysis (Sen 1995, Frey and Stutzer 2002b, Frey, Benz and Stutzer 2004). The exclusive dependence on the objectivist approach restricts our possibility to understand and influence human well-being, while the subjective approach of utility offers a fruitful way to study the reality, creating a basis for explicit hypothesis testing.

Recently, the concept of experienced utility² has been brought to light again. The utilitarian philosophers, including Bentham and Mill, suggested that people ought to desire those things that maximise their utility, where positive utility is defined as the tendency

¹ While traditional economic theory states that individuals derive utility from outcomes only, procedural utility theory argues that people also care about the processes and conditions which lead to these results, such as political processes and institutions.

to bring pleasure, and negative utility is defined as the tendency to bring pain. This utilitarian viewpoint, especially as advocated by Jeremy Bentham, had a significant impact on 19th century economics. But Bentham's utilitarian project was eventually abandoned in favour of structural accounts of rationality and formal definitions of utility such as rational choice theory. A major reason for this abandonment was that Benthamite utility was deemed impossible to measure. Such change, however, did not come at no cost. It excluded many important issues from the reach of empirical economic research. Since Bentham's time, however, the social sciences have developed greatly, and armed with more sophisticated methods, Daniel Kahneman and his co-workers have proposed that we go 'Back to Bentham' (Kahneman, Wakker and Sarin, 1997). The result is an economic psychology based on the measurement of *experienced utility*. As Di Tella et al. (2003), we assume that subjective well-being measures are closer to the concept of experienced utility than to decision utility from standard economic theory.

A subjective vision of utility recognizes that individuals can better judge their own level of satisfaction with life and that revealed behavior is an incomplete indicator of individual well-being (Frey and Stutzer 2002a). In fact, individual life satisfaction life can be captured directly by surveys. Behind answers, there is a cognitive evaluation of the life as a whole based on circumstances, comparison with other people, past and expected future experiences. One prominent example is the question from the *Euro-Barometer Survey Series*: "On the whole, are you satisfied, fairly satisfied, not very satisfied or not at all satisfied with the life you lead?". The *World Values Survey* (for over 80 countries on all continents) and *General Social Survey* (for the US) present similar

² Nomenclatura proposta por Kahneman, Wakker e Sarin (1997), referindo-se ao conceito de utilidade tal qual proposto por Bentham, em oposição a utilidade de decisão, que se refere à utilização moderna do

questions³. As this data kind of data is based on individual judgements, they are subject to some types of systematic and non-systematic bias. Certainly, they raise legitimate methodological questions which are hard to be resolved. The relevance of these errors, however, depends on the use of the data. If the aim is to identify the determinants of well-being, and not to compare well-being on a absolute level, it is not necessary to assume cardinality so that ordinal comparability between individuals is sufficient for a ordinal approach on the econometric tests. Moreover, there is strong evidence that assuming cardinality does not have qualitative influence on the results (Ferrer-i-Carbonell and Frijters 2004).

Many of the questions posed on the capacity and willingness of people to give meaningful answers about their well-being are discussed by the literature. Eight in every ten citizens think about their happiness at least once a week in the US and the percentage of people which do not know how to answer life satisfaction question are under 1% (Veenhoven 1997). Different measures of subjective well-being present high levels of correlation (Fordyce 1988). Reliability tests indicate that subjective well-being measures are reasonably stable, sensitive to changes in life and present serial correlation of 0.60 when evaluated within a two-week interval⁴ (Ehrhardt, Saris, and Veenhoven 2000; Headey and Wearing 1991). Consistency testes reveal that more satisfied people smile more frequently during social interaction (Fernández-Dols and Ruiz-Belda 1995), commit less suicide (Koivumaa et al. 2001) and that changes on brain activity and heart beat levels can be associated with negative chances in well-being. (Davidson et al. 2000).

termo utilidade, que se refere às escolhas (preferências reveladas).

³ For a survey of many types of well-being measures, see Andrews and Robinson 1991.

Thus, Diener (1984) in an early survey concluded that “[the] measures seem to contain substantial amounts of valid variance”.

Economists have shown a growing interest on self-reported subjective wellbeing research in the last few years. There is much evidence on the association between life satisfaction and personal characteristics. Usually, young married rich women with jobs and good health tend to be happier with their lives (Ng 1996, Oswald 1997, Frey and Stutzer 2000, Easterlin 2000). Most of this evidence is based on data from developed countries. Exceptions are Graham and Pettinato (2001) and Corbi and Menezes-Filho (2006). The latter show that unemployment is one of the main sources of life dissatisfaction in Brazil and Argentina. The analysis of the effect of education on subjective well-being has been intensively performed in the literature and still produces conflicting results. Early studies suggested a great and positive impact of education on life satisfaction (Wilson 1967). After the introduction of more sophisticated methods and the creation of more reliable databases, evidence on such a positive association became confusing. Helliwell (2002) shows that previous positive effects disappear when other controls are introduced. Presumably, the benefits of education are given through indirect channels such as income growth, better health status, etc. Blanchflower and Oswald (2004) and Schwarze and Winkelmann (2005) find similar results for the UK and Germany. Frey and Stutzer (2002b) and Di Tella *et al.* (2002) do find a positive correlation, even after controlling for income and health. On the other hand, Clark e Oswald (1996) find that job satisfaction is diminishing on education, perhaps because

⁴ Serial correlation typically found for education and income are higher (Bound, Brown and Mathiowet, 2001, and Angrist and Krueger, 1999), but 0.60 seems high enough to support the current studies on subjective well-being. (Krueger and Schkade 2007).

education can cause aspiration levels to rise. They also find that satisfaction is negatively associated to their comparison earning levels, showing evidence on rivalry.

3) Research Objectives and Empirical Strategy

In this section, we present our main research objectives and how we intend to approach them. The main aim of the project will be to investigate the determinants and consequences of job insecurity in Latin American countries with an in-depth analysis of the Brazilian case.

In the cross-country approach we intend to estimate an econometric model relating life satisfaction to perceived job quality and social security, after controlling for other potential determinants of life satisfaction. Job quality here means the perceived risk of loosing the job and other feelings at work regarding encouragement, oportunity to do their best, being useful and whether their opinion seem to count. Social security consists on the medical care services used by the individuals and how they are financed – by a public healthcare system, a social secutiry system or privately. Social security also includes the affilation to a retirement plan for income maintenance. With a sample of individuals (i) living in Latin-American countries (j), the equation we propose to estimate is:

$$LIFESAT_{ij} = \alpha_j + \beta_j JOBQUALITY_{ij} + \gamma_j SOCIALSEC_{ij} + \lambda X_{ij} + \lambda W_{ij} + \varepsilon_{ij} \quad (1)$$

with the α_j being the country-specific fixed effects, X_{ij} the demographic characteristics (such as age, education, gender, marital status) and W_{ij} the measures of household assets. Besides allowing for country-specific coefficients, we also intend to replace, in some specifications, the country fixed-effects with country specific indicators of labor market

volatility, such as change in unemployment rate, change in informality, etc, using the household surveys available for several countries.

We also intend to investigate, in the cross-country framework, the determinants of job insecurity and social security. In order to do that, we will regress these measures on a series of individual level (i) and country level (j) objective indicators of working conditions, controlling for individual specific demographic characteristics:

$$JOBINSEC_{ij} = \alpha_j + \beta_j Z_{ij} + \theta X_{ij} + \lambda W_{ij} + SOCSEC + \varepsilon_{ij} \quad (2a)$$

$$SOCSEC_{ij} = \alpha_j + \beta_j Z_{ij} + \theta X_{ij} + \lambda W_{ij} + \varepsilon_{ij} \quad (2b)$$

where Z_{ij} represents objective indicators of the labor market, such as occupation and sector of activity, $JOBINSEC_i$ is a dummy variable which equals 1 if individual i reports joblessness as a likely event in the following six months and $SOCSEC_i$ is a variable indicating whether there is contribution to any form of social security.

In the Brazilian analysis, we would like to examine the impact of the risk of becoming unemployed on individual wellbeing, that is, we want to test the hypothesis that the perceived job insecurity is associated with the actual probability of becoming unemployed. The first step will be to thoroughly describe the labor market conditions and the quality of jobs in Brazil, such as type of occupation and economic activity, wage rates, formal/informal sector, severe unemployment, schooling, overtime work and the characteristics of individuals who pay social security contributions. We will use Brazil's Household Surveys – *PNAD (Pesquisa Nacional por Amostra de Domicílios)* to complement the information available in the Gallup Survey.

In terms of the econometric methodology, we propose a two-step methodology. Firstly, using *PNADs*, we can estimate the determinants of unemployment through regression (2):

$$EMPSTATUS_i = \alpha + \beta X_i + \gamma W_i + \varepsilon_i \quad (3)$$

The dependent variable $EMPSTATUS_i$ is a dummy variable which associates 0 with *employed* and 1 with *unemployed* for individual I , X_i is a vector of individual characteristics such as gender, age, race, marital status, education, wage, occupation and sector of activity and W_i are measures of household assets. We need to use an external dataset (*PNAD*) because the Gallup survey does not contain detailed information on labor market status, that is, we do not know if the individual is currently a student, retired, working part-time or full-time. Therefore, we cannot separate the unemployed from other voluntary out of labor force status.

After estimating equation (3) we can apply the estimated parameters β and γ to the data from the Gallup Survey in order to predict the probability of being unemployed, which will be our predicted measure of job insecurity. Finally, we can input the predicted job insecurity $\hat{EMPSTATUS}_i$ as an explanatory variable to explain the perceived job insecurity:

$$JOBINSEC_i = \alpha \hat{EMPSTATUS}_i + \varepsilon_i \quad (4)$$

The coefficient of interest is α , which will give us evidence on the relationship between perceived and predicted job insecurity. Moreover, we can examine the role of each specific variable on perceived job insecurity via its effect on predicted job insecurity.

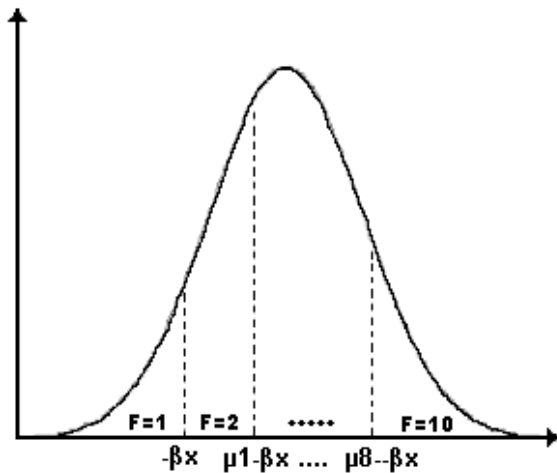
Since the life satisfaction measure is ordinal, equation (1) can be estimated with multinomial Ordered Probit models. This model consists on an efficient tool to model cases where the dependent variable is discrete and whose values establish some sort of non-linear ranking of the possible outcomes. An ordinary OLS regression in this case could not be applied due to the ordinal nature of the data. The model is built from a latent regression just like a traditional binomial Probit model. As we cannot observe the actual continuous variable F^* from $F^*_{jit} = \alpha + \beta' X_{jit} + \varepsilon_{jit}$, we can observe $F =$

$$\begin{array}{ll}
 1, \text{ if } F^* \leq 0 & 6, \text{ if } \mu_4 < F^* \leq \mu_5 \\
 2, \text{ if } 0 < F^* \leq \mu_1 & 7, \text{ if } \mu_5 < F^* \leq \mu_6 \\
 3, \text{ if } \mu_1 < F^* \leq \mu_2 & 8, \text{ if } \mu_6 < F^* \leq \mu_7 \\
 4, \text{ if } \mu_2 < F^* \leq \mu_3 & 9, \text{ if } \mu_7 < F^* \leq \mu_8 \\
 5, \text{ if } \mu_3 < F^* \leq \mu_4 & 10, \text{ if } \mu_8 \leq F^*
 \end{array}$$

The μ s are unknown parameters to be estimated along with β . Individuals have their own intensit of feelings which depende on certain factors of measurement, the explanatory variables X and the unobserved factor ε . In principle, they could answer the questionnaire with their own F^* . However, they are led to choose the answer that most closely reflects their own true opinion, among ten possible answers (from 1 for dissatisfied until 10 for satisfied). We assume that ε is normally distributed in our sample, and by bringing the distribution to zero mean and unitary variance, we have the following probabilities (where Φ and ϕ represent the a.d.f. and p.d.f. of the normal distribution):

$$\begin{aligned}
\text{Prob}(F=1) &= \Phi(-\beta'X) \\
\text{Prob}(F=2) &= \Phi(\mu_1 - \beta'X) - \Phi(-\beta'X) \\
\text{Prob}(F=3) &= \Phi(\mu_2 - \beta'X) - \Phi(\mu_1 - \beta'X) \\
&\vdots \\
&\vdots \\
&\vdots \\
\text{Prob}(F=9) &= \Phi(\mu_8 - \beta'X) - \Phi(\mu_7 - \beta'X) \\
\text{Prob}(F=10) &= 1 - \Phi(\mu_8 - \beta'X)
\end{aligned}$$

Above we can see the implications on the structure of the model. The *log-likelihood* can be obtained and its derivatives are the marginal effects of changes in the regressors:



$$\begin{aligned}
\frac{\partial \text{Prob}(F=1)}{\partial x} &= -\Phi(-\beta'X)\beta \\
\frac{\partial \text{Prob}(F=2)}{\partial x} &= \{\Phi(-\beta'X) - \Phi(\mu_1 - \beta'X)\}\beta \\
\frac{\partial \text{Prob}(F=3)}{\partial x} &= \{\Phi(\mu_1 - \beta'X) - \Phi(\mu_2 - \beta'X)\}\beta \\
&\vdots \\
&\vdots \\
\frac{\partial \text{Prob}(F=10)}{\partial x} &= \Phi(\mu_8 - \beta'X)\beta
\end{aligned}$$

4) Data

One of the database we shall use in our empirical strategy, as described above, is Brazil's Annual Household Survey, the *Pesquisa Nacional por Amostra de Domicilios* (PNAD). This survey is collected monthly by Brazil's national statistical agency, the *Instituto Brasileiro de Geografia e Estatística* (IBGE); the PNAD is the country's

primary source of information on household and individual social, labor market and demographic characteristics.

The first and second waves of the Gallup Surveys (2006 and 2007) consist on an extensive source of information on the Quality of Life of individuals from over 130 countries in the world, 23 of them from Latin America and the Caribbean. These surveys are conducted through the application of questionnaires to representative samples (minimum 1000 observations) of each population. Life satisfaction is captured by the following question: “All things considered, how satisfied are you with your life as a whole these days? Use a 0 to 10 scale, where 0 is dissatisfied and 10 is satisfied”. Other questions capture the perceived risk of loosing your job, people’s feelings toward encouragement, oportunity to do their best, and whether their opinion seem to count at work. Also, individuals are asked to inform they can count on public medical care and if they are affiliated to a retirement plan.

Besides the Gallup Surveys, the *World Values Survey* (WVS) is another potential valuable source of wellbeing data. According to Inglehart et al. (2000), it is one of the best available sources for life satisfaction international comparisons. The *WVS* is a worldwide investigation of social, economical and political change composed by uniting national surveys reflecting people’s convictions and values in more than 80 societies from all continents, representing around 80% of the total world population. It includes samples of societies with very high and very low levels of economic development, ,with long democratic tradition or authoritarian states, and even societies with the most diverse existing religions. It includes variables which capture some dimensions of personal characteristics in more detail than the Gallup Surveys, such as professional status

(employed, unemployed, retired, housewife, student), perceived health status and relative income. On the other hand, it does not bring data on job insecurity or absolute income.

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Annex 1 – Budget

Inter-American Development Bank

- Research Team Honoraria US\$ 10,000
 - Research AssistanceUS\$ 6,000
 - OverheadUS\$ 4,000
- Total*..... **US\$ 20,000**

Counterpart of Instituto Futuro Brasil

- Research Team Honoraria US\$ 10,000
 - Research AssistanceUS\$ 6,000
 - Administrative SupportUS\$ 4,000
- Total*..... **US\$ 20,000**

Annex 2 – Short Curricula Vitae of Researchers

NAÉRCIO AQUINO MENEZES FILHO

ACADEMIC BACKGROUND

- Ph.D in Economics , *University College London*, 1997
- M.A. in Economics, *University of São Paulo*, 1992
- B.A. in Economics, *University of São Paulo*, 1986

CURRENT POSITIONS:

- Professor of Economics, IBMEC São Paulo
- Associate Professor of Economics, *University of São Paulo* (Part-time)
- Research Director – Instituto Futuro Brasil

PUBLISHED PAPERS

- Menezes-Filho, N., Muendler, M. and Ramey, G. (forthcoming) “The Structure of Workers Compensation in Brazil, with a Comparison to France and the United States”, *Review of Economics and Statistics*.
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Coordinator: Santiago Cueto - Preal

London Business School

- *Technical Change in Emerging Markets: Factors Driving the Diffusion of ICT and the Implications for Productivity in Brazil and India* (2004)

Coordinator: Simon Commander

The World Bank

- *Understanding Pro-Poor Growth* (2003)

Coordinator: Louise Cord – Poverty Assessment Unit

- *Household Income Growth in Brazil and its Distribution* (2001).

Coordinator: Mark Thomas – Brazil Unit

- *The Effects of Minimum Wages on Inequality* (2003).

Coordinator: Wendy Cunningham – Policy Unit

Inter-American Development Bank - Research Network

- *Labor Market Dynamics and Reallocation in Latin America* (2002). Coordinators: Carmen Pages and Alexandro Micco. Consultant: John Haltinwanger

- *Unions and Economic Performance in Brazil* (2001). Coordinator: Gustavo Marques, Consultant: Peter Kuhn

- *Adolescents and Young Adults in LAC: Critical Decisions at a Critical Age* (2000). Coordinator: Suzanne Dureya, Consultants: Alexandra Cox-Edwards and Manuelita Uretra

- *Geography and Development* (1999). Coordinators: Alejandro Gaviria and Eduardo Lora, Consultant: John Gallup

PRIZES

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PUBLISHED PAPERS

- Corbi, Raphael (2007) “*The components of economic freedom, income and growth: an empirical analysis*” Estudos Econômicos. Instituto de Pesquisas Econômicas
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INTERNATIONAL CONSULTANCIES

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- *Institutional Factors and City Competitiveness* (2007)

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PUBLISHED PAPERS

- Curi, Andréa Z and Menezes-Filho, N., (2006) “*O Mercado de Trabalho Brasileiro é Segmentado? Alteração no Perfil da Informalidade e nos Diferenciais de Salários nas Décadas de 1980 e 1990*”. Estudos Econômicos. Instituto de Pesquisas Econômicas, Vol. 36 No 4.

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- Teaching Assistant at the IBMEC São Paulo since Aug 2005.
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