Investing in Health during Good and Bad Times: An Application to the China Shock^{*}

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October 18, 2024

Abstract

Many economic shocks affect not only workers' wages and employment but also health. We study their mechanism, welfare effects, and policy implications in a dynamic quantitative model with endogenous health investment. The health production technology is flexible, allowing workers to optimally choose to forego or partially treat sickness, or incur non-medical health investment. Applying this model to the China shock, we estimate its causal effects on health and calibrate the model to the pre-China shock economy. Our simulations suggest that, first, the health investment mechanism is economically significant, with the model elasticity accounting for between 40-50% of the empirical estimates. Second, the workers' steady-state welfare loss is equivalent to an annual drop of 8.4% in consumption, and both endogenous health investment and health itself play important roles. Finally, while universal health insurance is effective in reducing partial or foregone treatment, it offers little protection for non-medical investment. Therefore, its overall efficacy would be nuanced.

JEL CODES: E20, I30, I10, F10

KEYWORDS: dynamic quantitative model; heterogeneous agents; health; under-investment; over-investment; the China shock

^{*}The paper was previously circulated under the title "Care for the China Syndrome: Trade Shock, Sick Workers, and Access to Healthcare." We thank R. Anton Braun, Yongsung Chang, Roozbeh Hosseini, Karen Kopecky, Dirk Krueger, José-Víctor Ríos-Rull, Richard Rogerson, and participants at various conferences and seminars for their feedback. All errors are our own.

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1 Introduction

Economic shocks, such as mass layoffs, business cycles, and international trade, affect not only wages and employment but also health.¹ What is the *mechanism* through which these economic shocks affect health? What are the *welfare* effects of these shocks, incorporating their health effects? What *policies* may help mitigate these adverse health effects?

There are several challenges in studying these questions. The change of health is inherently a dynamic process and it is affected by both exogenous sickness shocks and endogenous health investment. The angle of health investment is especially relevant for the U.S., because many in the U.S. may limit their healthcare utilization when they are sick due to the lack of health insurance coverage. According to the National Health Interview Survey (NHIS), 18.6% of working-age adults report not receiving medical care in 2011-2012 due to financial constraints.² On the other hand, there are many ways to invest in one's health beyond receiving medical care, such as consuming healthy foods and investing in exercise equipment.

In this study, we take the first step in addressing these challenges. We develop a model of endogenous health dynamics and apply the model to analyze the effects of the China shock, a large increase in import penetration from China between 1990 and 2007 in the U.S. manufacturing sector. Our quantitative analysis starts first by estimating the causal effects of the China shock on workers' health. We then calibrate the model to understand the economic importance of the health investment mechanism, measure the welfare losses from the China shock, and evaluate the effectiveness of health insurance.

In terms of methodology, we develop a quantitative dynamic model with heterogeneous agents whose good health probability evolves endogenously. The workers in the model are incentivized to invest in health as bad health incurs utility costs à la Low and Pistaferri (2015), and has adverse labor market consequences such as lower probabilities of employment and lower earnings when employed. In every period, after a sickness shock is realized, workers optimally choose health investments to improve the probability of future good health. A key innovation of our model relative to the literature is that workers may *optimally* choose to *under*-invest in health relative to sickness, where the health investment is insufficient for full treatment. They may also choose to *over*-invest relative to sickness, above and beyond the

¹Empirical studies include Sullivan and von Wachter (2009) for mass layoffs, Ruhm (2000) for business cycles, and Adda and Fawaz (2020) and Pierce and Schott (2020) for international trade shocks.

²This was more prevalent before the major provisions of the Affordable Care Act (ACA) were implemented in 2014, which subsequently expanded insurance coverage in the U.S. population.



Figure 1: The China Shock and Health

full treatment through, e.g., massages or therapies.³ In other words, the health transition depends on initial health, the sickness shock the worker experiences, and his choice of health investment. We specify a flexible health transition function that depends on both the size of the sickness shock and health investment. It also features minimum investment, so that

workers may optimally choose to not invest in health at all.

We apply this model to the China shock because previous studies (e.g. Autor et al., 2013; Autor et al., 2014) have established econometric method for its causal inference and shown its adverse effects in wages and employment. In addition, the China shock has clear effects on health. To show their correlation in health, we organize the commuting zones in the U.S. into quartiles of import penetration per worker (IPW) using data from Autor et al. (2013). Then, combining it with restricted commuting-zone data from the Panel Study of Income Dynamics (PSID), we construct Figure 1. It shows that the population share of good-health workers is monotonically decreasing across the IPW quartiles. In our empirical analysis, we move beyond the correlation in Figure 1 to estimate the causal health effects of the China shock, following the empirical strategy of Autor et al. (2013). Our estimates imply a statistically significant health effect and the elasticity of future good health probability with respect to IPW is around -0.05, with larger effects among those with good initial health.

Having measured the health effect of the China shock, our next step is to calibrate the model to the pre-China shock economy. We embed our worker-level model of health dynamics into a sector-level model of international trade. We use the Medical Expenditure

³In our model, the workers always *optimally* choose their health investment. We say that a worker "*under*-invests" in health if his health investment is smaller than what is required to fully treat his sickness, and vice versa when he "*over*-invests" in health.

Panel Survey (MEPS) data to obtain the exogenous parameters and targeted moments related to health transitions, medical expenditures, and the shares of workers without medical utilizations by worker demographics. The medical utilization shares, which are overlooked in previous studies, are indicative of under-investment in health. In the data, they range from 0.07 to 0.10 for the insured workers, but reach 0.28 to 0.34 for the uninsured ones, a difference by a factor of more than three. Our model captures such empirical features and endogenously generates heterogeneous health outcomes across workers.

The calibrated model has good fits with targeted moments. For example, the model predicts that 27% of uninsured workers with bad health choose to forego health investment, versus 28% in the MEPS data. It also generates reasonable predictions about the value of health and workers' health investment decisions relative to the corresponding non-targeted data moments.

In the model, workers find it optimal to over-invest in health relative to sickness as a means to self-insure against the future risks of transitioning to the bad health state. As a result, over-investment is a common choice among the individuals with good health in the model. On the other hand, individuals with limited resources, like the uninsured, often choose to sacrifice their sickness treatment for consumption, sometimes by foregoing all treatment. Together, the novel features of over- and under-investment imply that health investment provides an additional channel for consumption smoothing in our model, a novel feature relative to studies that assume exogenous health dynamics or that health investment is equal to medical expenditures. In addition, given the model's ability to capture such heterogeneity and non-linearity in workers' health investment decisions, it serves as a suitable laboratory for studying the mechanism, welfare consequences, and policy implications for the workers facing adverse economic shocks, which, in our application, is the China shock.

We simulate the China shock following the trade literature that models it as an exogenous decrease in the domestic share of the U.S. manufacturing sector. In the simulation, we solve for the change in manufacturing wage that balances the sector-level labor demand and obtain a 5.8% drop in wage, in line with the estimates in Autor et al. (2014) of 2.3%-7.2%.⁴

We now present our quantitative findings for the *mechanism* through which the China shock affects health. Qualitatively, our model suggests that health deteriorates after the

⁴We also conduct a second simulation, where we assume instead, that the wage drop is 2.3%, the low end of the range reported in Autor et al. (2014), and solve for the change in the job destruction rate that balances labor demand. The qualitative effects from the second simulation are similar to that of the first.

China shock because the loss of economic resources decreases the over-investment in health and induces more workers to choose under-investment. Quantitatively, our model-generated IPW elasticity of future good-health probability ranges from -0.02 to -0.03, accounting for a sizeable portion of our empirical estimate of -0.05. As a result, we see that the mechanism through optimal health investment is economically important. Putting the model predicted elasticity into perspective, we show that the China shock led nearly half a million individuals in the U.S. manufacturing sector into bad health, resulting in approximately 100,000 more Emergency Room visits and 200,000 more inpatient hospital days per year. This health implication of the China shock (or any adverse economic shock) is a novel feature of our structural model, that cannot be captured in models that abstract away from health or those with exogenous health transitions.

The adverse health effect of the China shock has considerable heterogeneity across worker types. For example, the loss of economic resources leads to but small changes in future health outcomes for workers with bad initial health, because their calibrated health transition function is fairly flat in the region around their optimal health investment. In contrast, the health transition function of workers with good initial health is steeper with respect to health investment, and so these workers experience substantial reductions in their future good-health probability. These model predictions are consistent with our empirical estimates.

In terms of *welfare*, our simulations suggest that the average worker's welfare loss from the China shock is equivalent to an annual drop in consumption of \$1,721 (8.6%) when we compare the pre- and post-China shock steady states. To measure the contribution of endogenous health investment in shaping welfare, we first shut down endogenous health investment in our model. The resulting economy with exogenous health evolution over-estimates the welfare losses from the China shock, with its magnitude varying across worker types. The welfare loss is 10% higher for the average worker, but 30% higher for the unemployed worker with bad health. We then completely remove health from our model to measure the significance of health in welfare effects. In this economy, the welfare cost is lower by almost one-quarter for the average worker. These counterfactual experiments showcase the significance of both endogenous health investment and health itself in quantifying the welfare costs of an economic shock. A model that abstracts away from the former would over-estimate it.

Finally, we explore the potential *policy* responses by simulating a post-China economy in

which all individuals are covered by health insurance. Universal health insurance substantially reduces under-investment, relative to the benchmark post-China economy, leaving very few workers to forego treatment when facing a sickness shock.⁵ On the other hand, universal health insurance has little effect on the over-investment in health, because non-medical expenditures are not covered by health insurance. Therefore, the overall effectiveness of universal health insurance is nuanced and hinges upon the extent to which access to health insurance can compensate for wage losses and the types of sickness shocks workers face.

Related Literature Our study is most closely related to the quantitative dynamic models in which health evolves endogenously. For example, Hall and Jones (2007) and Fonseca et al. (2021) focus on mortality, and Cole et al. (2019) and Lukas and Yum (2024) incorporate health investment through efforts (e.g., exercise). Relative to this literature, we focus on sickness and monetary health investment, and our flexible health transition function implies that workers may optimally choose to invest less (*under*-investment) or more (*over*-investment) than the size of the sickness shock. By using the China shock as an application, we show that over- and under-investments play important roles in both the mechanism and policy implications of the adverse health effects of economic shocks.

Another line of work studies the interactions of disability and healthcare policies, health and welfare, assuming that health evolves exogenously (e.g. Low and Pistaferri, 2015; Aizawa and Fang, 2020; Kim and Rhee, 2022; De Nardi et al., 2023; Chen et al., 2024; Hosseini et al., 2024).⁶ Relative to this literature, workers' health transition probabilities in our model are impacted by endogenous health investment decisions, and thus economic shocks. In addition, endogenous health investment serves as an additional channel for consumption smoothing.

A number of recent studies have used structural models to study how specific mechanisms, such as migration, labor force participation, and college education, contribute to the effects of the China shock on earnings, employment, and welfare (e.g., Lyon and Waugh, 2018; Caliendo et al., 2019; Carroll and Hur, 2020; Ferriere et al., 2021). We focus on the health investment mechanism, and our results suggest that the estimated welfare loss from the China shock is likely larger if its adverse health effect is taken into account.

Lastly, our study has been motivated by the applied micro studies of the health effects

⁵This result is consistent with the empirical finding that under-investment in health is far more common in the U.S. than in high-income countries with universal health insurance (e.g. Davis and Ballreich, 2014).

 $^{^{6}}$ In Aizawa and Fang (2020) and Chen et al. (2024), health insurance status directly affects health transition. In our model, health insurance affects health through the health investment choice of workers.

of economic shocks, as in, for example, Schaller and Stevens (2015), Ruhm (2000), and Hummels et al. (2023). Additionally, Adda and Fawaz (2020) and Pierce and Schott (2020) show using cross-sectional data, the effects of the China shock on workers' health statuses. Our empirical analysis complements theirs by measuring the health elasticity with respect to IPW using a panel data set that allows us to control for unobserved worker heterogeneity.

The rest of the paper is organized as follows. Section 2 presents our model of heterogeneous agents with endogenous health evolution. In Section 3, we estimate the causal effects of the China shock on health and embed our worker-level model into a sector-level model of international trade. The calibration strategy is detailed in Section 4 and its results are presented in Section 5. Our quantitative analyses, evaluating the mechanism, welfare and policy implications of the China shock, are presented in Section 6.

2 A Model with Endogenous Health Dynamics

In this section, we develop a heterogeneous agent model with endogenous health dynamics. The key features of the health transition process in our model are first, that health investment is determined after the realization of sickness shocks; and second, that the amount of health investment is not restricted to equal the magnitude of the sickness shock. That is, workers may decide to forego or partially treat their sicknesses (*under*-investment) or invest more resources beyond treating the sickness (*over*-investment). Our model also specifies rich heterogeneity in worker characteristics and various roles of health in line with empirical observations that we further detail in Section 4, incorporating multiples ways in which health dynamics impact workers' labor market outcomes and welfare.

2.1 Endowments and Preferences

There are infinitely-lived workers of measure one. These workers are endowed with health status x, where x = G denotes Good health and x = B, Bad health. The workers' utility function follows that in the literature (e.g., Low and Pistaferri, 2015):

$$U(c;x) = \frac{\left[c \cdot \exp(\iota(x))\right]^{1-\rho}}{1-\rho},$$

where c denotes consumption and ρ , the relative risk-aversion parameter. The parameter $\iota(x)$ captures how health affects both the utility level and marginal utility of consumption. If $\iota(B) < \iota(G)$, being in the unhealthy state incurs utility cost, providing incentives for health investment.

The health status impacts workers in three ways. First, each period, a worker receives a sickness shock $\varepsilon(x)$ with probability $f(\varepsilon; x)$. Good health implies mild sickness shocks, i.e., $\varepsilon(G) < \varepsilon(B)$. Second, the worker may be either unemployed l = U or employed l = E, and his transition probability to employment $1-\delta(l, x)$ is health-dependent. Good health workers have higher job continuation rate and lower job separation rate. Finally, an employed worker earns income of $w \cdot v(x) \cdot z$, where w is the market wage and v(x) captures the productivity effect of health with $\nu(G) > \nu(B)$. The last term z is his idiosyncratic productivity shock, which follows an AR(1) process in logs with persistence ρ_z and standard deviation σ_z .

Lastly, workers have access to risk-free savings with an exogenous rate of return, r.

2.2 Health Production

Having clarified the central role of health status in our model, we now specify how health evolves over time. The health production in our model specifies the probability of being in good health in the next period. Relative to the literature with endogenous health dynamics (e.g., Cole et al., 2019, Fonseca et al., 2021), our health production is unique in its dependence on the sickness shock ε . The sickness shock impacts the health production directly through parameters, and indirectly through the health investment choice of an individual because he makes the choice after the realization of the sickness shock.

Specifically, the probability of being in good health in the next period is a function of the current health status, x, sickness shock, ε , and health investment, H, which we parameterize using the following flexible Weibull function:

$$F(H; x, \varepsilon) = \begin{cases} 1 - \alpha(x, \varepsilon) & \text{if } H \le H_{min}(x, \varepsilon) \\ 1 - \alpha(x, \varepsilon) \exp\left[-\frac{(H - H_{min}(x, \varepsilon))^{\gamma(x)}}{\lambda(x)}\right] & \text{if } H > H_{min}(x, \varepsilon) . \end{cases}$$
(1)

The health production function has the following properties. First, all the parameters of $F(\cdot)$ depend on initial health status x, capturing the heterogeneity in future health outcomes by x that we empirically document in Section 4. In Figure 2(a), we plot the health production for a low (mild) sickness shock ε_L and a high (severe) sickness shock ε_H by health investment H in the x-axis, given initial health x. The second feature of the health production function, as seen in Figure 2(a), is that it is non-decreasing in H, with a minimum health investment



required for its marginal effects to be strictly positive and concave. That is, when health investment exceeds the minimum $H_{min}(x,\varepsilon)$, $F(\cdot)$ is increasing in H, $\partial F(\cdot)/\partial H > 0$ approaches $+\infty$ as H approaches $H_{min}(x,\varepsilon)$ from above, and $F(\cdot)$ is concave with respect to H, as long as $\gamma(x) < 1$. We incorporate $H_{min}(x,\varepsilon)$ as many individuals report zero medical utilization in the data. Further, the minimum investment increases with ε (the flat portion is longer under a more severe shock ε_H), as when one is severely ill (e.g. cancer), a large(r) amount of investment is needed for treatment to be effective. Lastly, there is a baseline probability of good health represented by $1 - \alpha(x,\varepsilon) > 0$: even if H = 0, the probability of future good health is $1 - \alpha(x,\varepsilon) > 0$. As illustrated in Figure 2(a), a large sickness shock may lower one's baseline probability of being in good health implying the $\alpha(x,\varepsilon)$ is increasing in ε .

It is important to note that, given ε , the worker is free to choose whatever amount of H he wants. While we do not impose any restrictions on the amount of health investment relative to the size of the sickness shock, we assume that the health investment smaller than the sickness shock is medical expenditures used to treat that sickness. This is an assumption that helps us map the model to the data. Then, any investment beyond sickness shock, max $\{0, H - \varepsilon\}$, is considered non-medical health investments (e.g., massage or healthy food). Thus, implicitly, we assume that non-medical health investments are only useful after the sickness has been fully treated, and they enter the production function additively with medical expenditures. On the other hand, the non-medical investments do not enter into consumption, and so do not directly contribute to utility.⁷

In summary, given the health production function, the worker chooses the optimal health

⁷This assumption represents a conservative modeling choice, because without it, the workers would have even stronger incentives for non-medical health investment.

investment after sickness shock, ε is realized. The above-discussed features of $F(\cdot)$ imply that this optimum may be (i) $H^* = 0$; (ii) $H_{min}(x,\varepsilon) < H^* < \varepsilon$; (iii) $H^* = \varepsilon$; or (iv) $H^* > \varepsilon$, but never $0 < H^* < \varepsilon$. We denote (i) or (ii) when $\varepsilon > 0$, an *under*-investment; (iii), a *full*-treatment; and (iv), an *over*-investment. Figure 2(b) illustrates *under*-investment by showing case (ii) and the associated medical expenditure of $H^* = \min\{H^*, \varepsilon\}$. Figure 2(c) illustrates *over*-investment by showing case (iv) and the associated medical expenditure of ε as well as the non-medical health investment of $H^* - \varepsilon = \max\{0, H^* - \varepsilon\} > 0$.

2.3 Health Insurance

In our model, the worker has the exogenous probability of $\zeta(l)$ to have health insurance in each period, where l denotes employment status. The employed have a higher probability of getting health insurance (i.e. $\zeta(l = E) > \zeta(l = U) > 0$), reflecting the prevalence of Employer-Sponsored Health Insurance (ESHI) in the US, but still allowing the possibility of unemployed individuals to have (some form of) health insurance. With the premium of π , health insurance covers a $\chi(\varepsilon; x) < 1$ share of medical expenditures. However, health insurance does not cover non-medical health investment. Thus, for insured individuals, the marginal cost of health investment is $1 - \chi(\varepsilon; x)$ for medical expenditures, min $\{H, \varepsilon\}$, but 1 for the non-medical health investment beyond ε , max $\{0, H - \varepsilon\}$.

Note that the health production technology is independent of insurance statuses. That is, health insurance affects health dynamics endogenously through the choice of health investment H in our model, distinct from the approach in papers where health transitions exogenously differ by insurance statuses (e.g., Aizawa and Fang, 2020).

2.4 Government

The government does not consume final goods. Instead, it collects taxes on labor income T(y), and uses the tax revenue to finance the unemployment benefit of b and the consumption floor of \underline{c} . The consumption floor, \underline{c} , captures various means-tested government programs, in a similar manner as in previous studies with medical expenditure risks, such as De Nardi et al. (2023). We denote the transfers made for \underline{c} as tr, and assume that the individuals for whom tr > 0 are unable to save or invest in health. The government also ensures that the health insurance sector makes zero profits through lump-sum subsidies. Note health insurance companies collect premium π and pay the insured at coinsurance rate of $\chi(\varepsilon; x)$

up to ε . We assume that premium is exogenous and that the government makes transfers to insurance companies to ensure zero profit.⁸

2.5The Workers' Optimization Problem

We now state the optimization problem of a worker with the state $\tilde{\mathbf{s}} \equiv \{x, a, in, \varepsilon, z\}$ that includes the health status, financial asset, insurance status, sickness shock, and labor productivity shock. The worker of status $l \in \{E, U\}$ solves

$$V^{l}(\tilde{\mathbf{s}}) = \max_{\substack{c \ge 0, a' \ge 0, H \ge 0}} U(c + tr; x)$$

$$+\beta \sum_{\substack{x' \in \{B,G\}}} \Pr(x') \left[\delta(l, x') \mathbb{E} V^{U}(\tilde{\mathbf{s}}') + (1 - \delta(l, x')) \mathbb{E} V^{E}(\tilde{\mathbf{s}}') \right]$$
s.t. $c + a' + \tilde{H} = I(l, x) + (1 + r) a + tr$
(3)

s.t.

$$I(E, x) = w \cdot \nu(x) \cdot z - T(w \cdot \nu(x) \cdot z); \quad I(U, x) = b$$
(4)

$$tr = \max\{0, \underline{c} - (I(l, x) + (1 + r)a)\}$$
(5)

$$\Pr\left(x'=G\right) = F\left(H; x, \varepsilon\right); \quad \Pr\left(x'=B\right) = 1 - F\left(H; x, \varepsilon\right) \tag{6}$$

$$\tilde{H} = \begin{cases} H & \text{if uninsured} \\ \pi + (1 - \chi(\varepsilon; x)) \min\{\varepsilon, H\} + \max\{H - \varepsilon, 0\} & \text{if insured.} \end{cases}$$
(7)

The worker maximizes his utility (2) in the current period $U(\cdot)$ plus his discounted utility in the next period. If he is unemployed, the expectation is over insurance and sickness shock status; and if employed, he additionally takes expectation over labor productivity shock.

In the budget constraint (3), the worker's expenses are consumption c, tomorrow's asset a', and out-of-pocket health investment expenditures H. The worker's resources on the right-hand side of the budget constraint (3) are his income, I(l, x), asset value, (1 + r)a, and government transfer, tr. Equation (4) spells out the worker's income. If employed, he receives the wage $w \cdot v(x) \cdot z$ and pays the tax $T(\cdot)$. Otherwise, he collects the unemployment benefit b. Equation (5) specifies the amount of transfers from the government that guarantees consumption floor \underline{c} . As discussed in Equation (1), health transition probabilities in (6) depend on health status x, sickness shock ε , and health investment H. Finally, Equation (7) summarizes our earlier discussions about medical expenditures and non-medical health

⁸Employer-paid premiums for health insurance are excluded from federal income and payroll taxes, and employee-paid premium is deducted from pre-tax income. Effectively, there is a tax subsidy to ESHI from the government that we may be capturing here.

investment. If the worker is uninsured, his total out-of-pocket health expenditure, \tilde{H} , equals his total health investment of H. For the uninsured, his out-of-pocket health expenditure consists of three components: the insurance premium π , the copayment of medical expenditures $(1 - \chi(\varepsilon; x)) \min \{\varepsilon, H\}$, and the non-medical health investment max $\{H - \varepsilon, 0\}$.

In summary, workers are heterogeneous in health status, and receive sickness and labor market shocks in each period. In this dynamic setting, workers optimally choose consumption, savings, and health investment, recognizing the benefits of good health.

3 Application: The China Shock

We now apply our model to the China shock, a large increase in U.S. import from China in the manufacturing sector. We first clarify why we choose the China shock as our application and then embed our worker's problem into a sector-level model of international trade to map the trade shock into our full model for counterfactual analysis.

3.1 Why the China Shock?: Empirical Motivation

Many empirical studies, including Autor et al. (2013) and Autor et al. (2014), have shown that the China shock caused adverse labor market outcomes to manufacturing workers in the U.S. Therefore, it can be a good laboratory for studying how changes in economic resources can impact workers' health and evaluating the role of health investment. Further, given the well-established empirical approach to estimating its causal effects from previous studies, we can validate its effects on workers' health. While there are previous studies that used cross-sectional data to estimate the negative health effects of the China shock (e.g., Adda and Fawaz, 2020), in this section, we further corroborate its effects utilizing panel data and controlling for unobserved heterogeneity across workers. Additionally, these empirical results provide both quantitative and qualitative validations for the predictions of our model.

3.1.1 Data

In this subsection, we outline our data and the construction of main variables, and illustrate the salient features of our data.

Import Penetration per Worker We measure the size of the China shock as import penetration per worker (IPW) following Autor et al. (2013):

$$IPW_{cz,t} = \sum_{j} \frac{L_{cz,j,t}}{L_{cz,t}} \times \frac{M_{j,t}^{CHN}}{L_{j,t}}.$$
(8)

In Equation (8), $M_{j,t}^{\text{CHN}}$ and $L_{j,t}$ are, respectively, the US imports from China and employment in industry j in year t, $L_{cz,j,t}$ is the employment in commuting zone cz in industry jand year t, and $L_{cz,t}$ is the employment in commuting zone cz in year t. Intuitively, IPW_{cz,t} measures the weighted average of Chinese imports per worker, across industries, in commuting zone cz in year t, where the weights are the industries' employment shares in cz in t. In order to control for potential endogeneity in US imports, we follow Autor et al. (2013) and use the following instrument for IPW_{cz,t}:

$$IPW_{cz,t}^{IV} = \sum_{j} \frac{L_{cz,j,t-10}}{L_{cz,t-10}} \times \frac{M_{j,t}^{OTH}}{L_{j,t-10}}.$$
(9)

As compared with the IPW measure of (8), its instrument, (9), uses U.S. imports from eight other high-income countries and 10-year-lagged labor employments.⁹

Panel Study of Income Dynamics The rest of our data come from the PSID. We restrict our sample to those between the ages of 18 and 64 (working-age population) who work full-time (1,600 annual hours) in their initial year of entry into the PSID sample.

We use self-reported health as our measure of health status, which is common in both the structural estimation literature (e.g. Cole et al. 2019; De Nardi et al. 2023) and applied micro studies of health (e.g. Currie and Madrian, 1999). Recent studies show that self-reported health is also a good predictor of future health events, such as hospitalization (e.g. Nielsen, 2016). It also fits well with our inquiry, because the PSID data for self-reported health span the years of the China shock, 1991 through 2011.¹⁰ In PSID, each respondent is asked to rate his health into five levels (from excellent to poor). We combine the top two levels into the single category of *good* health, and combine the other three levels into *bad* health. PSID also includes detailed demographic information such as age, gender, income, and industry affiliation. In addition, we obtain the restricted commuting-zone identifiers, to combine the worker-characteristics data with the IPW data discussed above.

Merged IPW-PSID Data The merged data set includes 508 unique commuting zones and about 33,000 worker-year observations.¹¹ We list the detailed summary statistics in Appendix A.1, and outline their main features. The average IPW is \$1,440 per worker and

 $[\]overline{{}^{9}M_{j,t}^{\text{OTH}}}$ is U.S. imports from Australia, Denmark, Switzerland, Finland, Japan, Germany, New Zealand, and Spain.

¹⁰The objective health measures in PSID (e.g., indicator variables of diabetes, asthma, etc.) start in 2003, which makes it impossible for us to exploit the IPW variations before 2003.

¹¹The number of all commuting zones is 722, implying that PSID covers around 70% of them.

the IPW distribution features a large variation with quartiles ranging from \$220 per worker to \$3430. Most of the workers in our sample are male and about two-thirds of them are in good health. Importantly, the mean value of the good-health dummy, our measure of health status, monotonically decreases across the quartiles of IPW, as we showed earlier in Figure 1. In the rest of this section, we establish the causality of the effects of IPW.

3.1.2 Effects of Import Penetration on Worker Health

We exploit the rich worker-level panel data to estimate the causal effects of IPW and their heterogeneity across worker characteristics. The econometric specification is:

$$GH_{i,cz,t} = \beta_i + \beta_t + \sum_k \gamma_k \cdot \mathbb{I}_{k,t_0} \cdot IPW_{i,cz,t-1} + \alpha \cdot Z_{i,t} + \varepsilon_{i,cz,t}.$$
 (10)

In Equation (10), the indicator variable $GH_{i,cz,t}$ takes the value of 1 if worker *i*, living in commuting zone *cz*, has Good Health in year *t*. The coefficients β_i and β_t are, respectively, worker- and year-fixed effects, and $Z_{i,t}$ is a vector of time-varying worker-characteristic controls (e.g., education). Given the annual frequency of the data, we include IPW in year t-1, to ensure that exposure to import competition had happened before the realization of the health status, $GH_{i,cz,t}$. The coefficient of interest is γ_k , where $\mathbb{I}_{k,t_0} = 1$ if a worker has a certain characteristic *k* (e.g., works in manufacturing sector) in his initial year t_0 . Thus, the coefficient γ_k allows us to measure the group-specific effects of the IPW.

The following features of the estimation of Equation (10) allow us to interpret γ_k as the causal effect of import penetration. First, both the IPW measure and the worker characteristic are lagged relative to the dependent variable. Second, we instrument $IPW_{cz,t-1,k}$ using the exogenous variations in $IPW_{cz,t-1,k}^{IV}$ as in Equation (9). Third, the worker fixed effects, β_i , control for the idiosyncratic and time-invariant factors that could be important for workers' health, such as early life experiences and genetic differences, some of which have been emphasized in previous studies.¹² While the first two features have been used in previous studies, the use of worker-fixed effects is novel. It implies that regression (10) asks the following: as import penetration increases in a commuting zone for exogenous reasons, relative to the sample mean, do workers in the commuting zone suffer lower probabilities of being in good health in the following year, relative to the sample mean? Because the error term might be correlated across workers within cz by year, we cluster standard errors by cz.

 $^{^{12}}$ See, e.g. Maccini and Yang (2009) and De Nardi et al. (2023).

γ_k	Dependent variable: Probability of good health Elasticity				
	(1)	(2)	(3)	(4)	$(\Delta 75 - 25\%)$
All	-0.019				-0.042
	(-1.60)				$(-2.8 \ pp)$
Manufacturing		-0.025***			-0.054
		(-2.10)			(-3.7 pp)
Non-Manufacturing		-0.012			-0.026
		(-1.13)			$(-1.8 \ pp)$
Income Q1			-0.050***		-0.110
			(-2.81)		$(-7.3 \ pp)$
Income Q2			-0.026		-0.056
			(-1.44)		$(-3.7 \ pp)$
Income Q3			-0.023^{*}		-0.050
			(-1.84)		$(-3.3 \ pp)$
Income Q4			-0.012		-0.026
			(-0.98)		$(-1.8 \ pp)$
Initial Good				-0.031**	-0.068
				(-2.51)	$(-4.6 \ pp)$
Initial Bad				0.019	0.042
				(1.62)	$(2.8 \ pp)$
First-Stage F	12.92	52.71	15.10	58.06	
Number of Obs.		33	,376		

Table 1: Import Penetration and Future Health

Note: The table reports regression coefficients γ_k from Equation (10). The first-stage *F*-statistics are for the first endogenous variables. The standard errors are clustered by commuting zone and *t*-statistics are in parentheses. * p < 0.10, ** p < 0.05, *** p < 0.01

Table 1 reports the results from our analysis. In column (1), we pool across all workers. While the coefficient on import penetration is negative, this effect is not statistically significant. In columns (2) through (4), we divide the workers into their initial year characteristics, and report the coefficient estimates by subgroup. Column (2) shows that the effect of import penetration on manufacturing workers is negative and statistically significant, and about twice as large in magnitude as compared to the effect on non-manufacturing workers. This result is reassuring because during the China shock, import penetration primarily impacted the U.S. manufacturing sector. Our coefficient estimates in column (2) imply that the elasticity of IPW on the Good health probability is -0.054 for manufacturing workers and -0.026 for non-manufacturing workers (although the latter is statistically insignificant), and that the commuting zone at the 75th percentile of the IPW distribution has 3.7 pp lower probability of future good health for manufacturing workers relative to the commuting zone at the 25th percentile. These findings corroborate, and add to, the findings from prior

studies by Adda and Fawaz (2020) and Pierce and Schott (2020), which investigate different dependent variables (e.g. incidences of hospitalization and mortality). Column (3) of Table 1 indicates a particularly pronounced effect of import penetration on workers whose initial-year income is in the first quartile, consistent with the results from Autor et al. (2014) indicating that the China shock had a larger effect on the earnings of low-income workers. Lastly, in Column (4), we see that the IPW had more adverse health effects on workers with good initial health than on those with bad initial health. We will show, in Section 5, that this result is consistent with qualitative predictions of our model.

We have conducted the following additional empirical analyses, the details of which are in Appendix B. First, we aggregate our data into the region level and then follow the longdifferencing specification of Autor et al. (2013). Our dependent variable is the long-term change in the good-health population share, and we exploit the regional variations in longterm changes in IPW exposure. This alternative approach complements the estimation of Equation (10) by capturing the overall effects of the China shock over long periods. We obtain similar results as in Table 1, with the elasticity of the good-health population share with respect to IPW ranging between -0.048 and -0.078, with the mid-point of -0.060. In addition, we estimate Equation (10) with manufacturing-by-year fixed effects to address concerns that workers in manufacturing and non-manufacturing sectors could have experienced different trends in health status during our sample period. The results are robust to the specification. Finally, using subsamples of male and manufacturing workers yield similar results.

In summary, we have shown that the increase in import penetration from the China shock caused statistically and economically significant adverse impacts on workers' health, with IPW elasticities ranging around -0.054. We embed our worker-level model into a sector-level model of international trade, and then use it as a laboratory to study the mechanism, welfare effects, and policy implications of the adverse effects of the China shock.

3.2 Closing the Model at the Sector Level

Production and Trade We close our model in Section 2 with the production and trade sides of the economy, where all markets are competitive. We assume a small-open economy and use the specific-factors model from the trade literature for the manufacturing sector.

We start from goods demand. The price and quantity of the final good are P and Y, respectively, and we normalize P = 1. The production technology of the final good is Cobb-

Douglas with respect to the manufacturing good, whose price and quantity are P_m and x_m , respectively, where m indexes the manufacturing sector. Let ϕ_m denote the manufacturing sector's share in final good production and thus, $x_m = \phi_m \cdot Y/P_m$ represents the demand for the manufacturing good from the final good production. Both the final good and the manufacturing good are non-tradable, and we are agnostic about the rest of the economy, outside of the manufacturing sector.¹³

The manufacturing good, in turn, is assembled from domestic and imported inputs via the following constant elasticity of substitution (CES) technology

$$x_{mS} = \left[\omega_m^{\frac{1}{\sigma}} n_m^{\frac{\sigma-1}{\sigma}} + (1-\omega_m)^{\frac{1}{\sigma}} \left(n_m^*\right)^{\frac{\sigma-1}{\sigma}}\right]^{\frac{\sigma}{\sigma-1}},$$

where ω_m is the weight of the domestic input, n_m and n_m^* are quantities of domestic and imported inputs, and $\sigma > 1$ is the elasticity of substitution. Let p_m denote the price of the domestic input. Meanwhile, the price of the imported input is $\tau^* p_m^*$, where $\tau^* \ge 1$ is the trade cost of manufacturing inputs. The demand for these manufacturing sector inputs are

$$n_m = \omega_m (p_m)^{-\sigma} X_{mS} P_m^{\sigma-1}, \qquad n_m^* = (1 - \omega_m) (\tau_m^* p_m^*)^{-\sigma} X_{mS} P_m^{\sigma-1},$$

where $X_{mS} = P_m x_{mS}$ is the total expenditure for the manufacturing sector, and

$$P_m = \left[\omega_m \left(p_m\right)^{1-\sigma} + \left(1-\omega_m\right) \left(\tau_m^* p_m^*\right)^{1-\sigma}\right]^{\frac{1}{1-\sigma}}$$

relates the prices of the manufacturing good to the those of domestic and imported inputs.

Turning to goods supply, the domestic input is produced with labor according to the linear technology, $z_{mS} = \psi_m L_m$, where ψ_m is productivity, and L_m is the labor supply (in efficiency equivalent units) of the manufacturing sector. Our use of the specific factors model implies that manufacturing labor is immobile to the rest of the economy. The price of the domestic input is thus proportional to the wage rate w_m : $p_m = w_m/\psi_m$. The domestic input is tradable. When it is exported, it faces the foreign demand of $D_m^* (p_m) \equiv D_m^* \cdot (p_m)^{-\sigma}$, where D_m^* incorporates demand shifters as foreign expenditure and export costs. Finally, because we assume that our economy is a small open economy with respect to the rest of

¹³Our model can be extended to incorporate a general equilibrium with multiple sectors. Such model requires more assumptions (e.g., production technology in other sectors). As we focus on the outcomes of manufacturing workers, we choose to abstract away from production in other sectors. However, as we describe in Section 4.4, we impose equilibrium conditions in the manufacturing sector, endogenizing the equilibrium wage effect in the manufacturing sector in response to the China shock.

the world, the supply of imported manufacturing inputs n_m^* , is elastic.

Market Clearing When we simulate the China shock in our quantitative model, we impose market clearing conditions in the economy. Therefore, in response to the shock in the import cost, the wage in the manufacturing sector in the post-China economy is determined endogenously. Here, we outline the key equilibrium conditions, leaving the rest and the formal equilibrium definition to Appendix C.

Let the distribution of workers in the manufacturing sector over state space $\mathbf{s} \equiv (l, \tilde{\mathbf{s}})$ be $\mu(\mathbf{s})$. First, the aggregate labor supply, L_m , depends on workers' health (x) and productivity (z) and the stationary distribution of $\mu(\mathbf{s})$:

$$L_{m} = \sum_{\mathbf{s}} \nu(x) \cdot z \cdot \mathbb{I}_{l=E} \cdot \mu(\mathbf{s}).$$
(11)

On the other hand, the market clearing conditions for the manufactured good and for the domestic inputs imply that when the labor market clears,

$$w_m L_m = \pi_m^D \phi_m Y + D_m^* p_m^{1-\sigma}, \quad \pi_m^D = \frac{\omega_m (p_m)^{1-\sigma}}{\omega_m (p_m)^{1-\sigma} + (1-\omega_m) (\tau_m^* p_m^*)^{1-\sigma}}, \tag{12}$$

where π_m^D is the domestic share of the manufacturing sector. On the right-hand side of Equation (12), $\pi_m^D \phi_m Y$ represents the labor demand from domestic production, and $D_m^* p_m^{1-\sigma}$ represents the labor demand from exports. Equation (12) says that the aggregate labor demand and labor supply, L_m , jointly determine the wage, w_m , for the manufacturing sector.

Thus, our sector-level model ensures that the wage and labor supply are consistent with the labor demand, through Equation (12). These two pieces of our model allow us to quantify the China shock using the standard practice in the trade literature, and to endogenously determine workers' wage, w_m , in the post-China economy, which we discuss in Section 4.4.

4 Calibration

In this section, we map our model to the data to quantify the effects of the China shock on workers' health and welfare. In addition to PSID, we use the Medical Expenditure Panel Survey (MEPS), Current Population Survey (CPS), STructual ANalysis Database (STAN), and World Development Indicators (WDI), to set parameter values and generate target moments. We first lay out the predetermined parameters and discuss the key empirical facts concerning medical expenditures and health transitions. Then, we present calibrations within the worker model (inner loop) and the sector model.

4.1 Predetermined Parameters

The left panel of Table 2 lists the household parameters whose values we take from outside the model, with one model period corresponding to one year in the data. The coefficient of relative risk aversion ρ , discount factor β , and interest rate r are set to 1.5, 0.95, and 0.02, respectively, which are standard values in the literature.

Then, we use the PSID data in pre-China years (1991–1996) to obtain the average income of workers in the manufacturing sector. One of the important components in our quantitative analysis is the health gradient of income. Due to selection into employment, using the observed incomes across health status may be biased. To correct for the bias, we follow Low and Pistaferri (2015) and conduct a two-step wage estimation using the amount of "potential" government transfers as an instrument variable to obtain $\nu(B)$, after normalizing $\nu(G)$ to one.¹⁴ Given this procedure, the average labor income of a worker with Good health is \$50,211 and the health gradient of income, $\nu(B) = 0.81$. The productivity shock process has the persistence and standard deviation parameters of 0.95 and 0.15, and we discretize the process following Tauchen (1986). The job continuation and job finding rates by health status are from the Annual Social and Economic Supplement of the CPS in years 1996-1999.¹⁵

We set the unemployment benefit to 20% of average wage income across health statuses, which amount to \$9,086. Additionally, the consumption floor is \$3,000, similar to one estimated in De Nardi et al. (2023), and the income tax rate is 20%.

Note that these parameter values point to substantial economic benefits of being in good

Parameter	Description	Values	Parameter	Description	Values
Household a	nd Labor Market		Government	t Policies	
ho	Risk aversion	1.5	b	UI benefit	\$9,086
β	Discount factor	0.9	<u>c</u>	Cons. floor	\$3,000
r	Interest rate	0.02	au	Income tax rate	20%
w_m	Pre-China wage	\$50,211	Production		
$ u\left(B ight)$	Health effect on wage	0.81	ω_m	Home bias	0.5
(ho_z,σ_z)	Inc. shock: pers.; st.dev.	0.95; 0.15	$\sigma - 1$	Trade elasticity	3
$1 - \delta\left(E, x\right)$	Job continuation: $B; G$	0.87; 0.93	ϕ_m	Manuf. share	0.17
$1 - \delta\left(U, x\right)$	Job finding rate: $B; G$	0.18; 0.32	$\pi^{D}_{m,pre;post}$	Domestic share	0.85; 0.71

 Table 2: Predetermined Parameters

¹⁴The "potential" government transfers refer to the amount of benefits from welfare programs (e.g., SNAP, TANF) that a representative individual worker would have received in his residential state. The details regarding the first-stage and the second-stage estimation results are relegated to Appendix D.1.

¹⁵The CPS allows us to track workers' employment statuses for a larger sample of individuals than PSID.

health. Employed workers earn 20% more if in good health, and job continuation and finding rates are 0.6pp and 0.14pp higher, incentivizing workers to invest in health.

4.2 Key Empirical Facts

As we showed in Section 2, a key element of our model is the workers' optimal choice of medical expenditures. Individual-level data on medical expenditures are available from MEPS, which we use to establish the stylized facts in two areas: firstly, medical expenditures and medical utilizations, and secondly, transition probabilities to good health, by worker characteristics.¹⁶ These stylized facts provide the starting point of our calibration process.

In Table 3, we document average medical expenditures and the shares of individuals with zero medical utilization by health and insurance statuses. For the latter, we use the Household Component Event files of the Medical Conditions data to identify those who never reported medical events or utilizations, such as outpatient visits and prescribed medicine.¹⁷

Next, to better understand the relationship between medical expenditures, insurance status, and health transitions, we run the following regression:

$$\text{Health}_{i,t+1} = \beta_0 + \beta_1 \cdot \text{Health}_{i,t} + \sum_{k=1}^{10} \beta_{2,k} \cdot D_{i,t,k}^{med} + \Gamma \cdot X_{i,t} + \varepsilon$$

The variable $\text{Health}_{i,t(t+1)}$ takes a value of one if the individual is in Good health, and 0 otherwise in year t (t + 1). We then construct deciles of medical expenditures among insured

		Insured	Uninsured
Average Medical Expenditures	Bad	\$3,297	\$1,755
(positive only)	Good	\$2,246	\$1,294
Share of Individuals	Bad	0.07	0.28
without medical utilizations	Good	0.10	0.34

Table 3: Medical Expenditures and Medical Utilizations

Note: For medical expenditures, we document group-level average expenditures among those who have positive spending, after controlling for age, sex, race, education, Census region, marital status, and survey panel dummies. An individual is considered to have utilized medical service if one had prescribed medicine, dental visit, outpatient event, home health provider event, office-based medical provider visit, emergency room visit, or other medical expenses.

¹⁶For parameters governing health production, we calculate moments using all workers in the sample without restricting the sample to those in the manufacturing sector (as we do for wage moments) for a larger sample size. The underlying assumption is that all individuals face the same health production technology regardless of the sector they are employed in.

¹⁷Event level data is a better measure than zero medical expenditure shares, because some individuals might receive medical treatment free of charge, e.g., in emergency rooms or through charity care.



individuals with positive expenditures, and assign each individual i with a dummy variable $D_{i,t,k}^{med}$ where k indicates either a zero expenditure or the decile of medical expenditure (total of 11 groups) in year t. The individual-level controls $X_{i,t}$ include the number of reported medical conditions, employment, and insurance status. Figure 3 plots the predicted values of Health_{i,t(t+1)} against the medical-expenditure deciles. Figure 3(a) is for the individuals with bad initial health, and Figure 3(b) for those with good initial health. Both subplots distinguish the insured (circles) from the uninsured (crosses).

The salient features in Table 3 and Figure 3 are as follows. First, Figure 3 shows that the future good-health probabilities are monotonically decreasing in current medical expenditure deciles for all groups, after controlling for various medical conditions. It implies that a large expenditure this period reflects the severity of the sickness shock a worker experienced.

Second, initial health status matters. From Table 3, we note that individuals with good health incur lower medical expenditures and are less likely to utilize medical services compared to those with bad health. From Figure 3(a), we note that for the individuals with bad initial health, the predicted future good-health probabilities range from 0.15 to 0.42, while in Figure 3(b), they range from 0.60 and 0.84 for those with good initial health. These patterns suggest that individuals with good health experience milder sickness shocks and have higher probabilities of future good health; i.e. the health status is persistent.

Finally, insurance status also matters. From Table 3, we see that 7%-10% of insured individuals report zero medical utilization but 28%-34% of uninsured ones do, and the insured individuals' mean medical expenditure (conditional on positive) is almost twice as large as the uninsured individuals'. Meanwhile, Figure 3 shows that the uninsured have lower probability

of being in good health in the future than the insured in every single medical-expenditure decile, regardless of initial health status. These suggest that the variations across insurance status in Table 3 are not because the uninsured are healthier, but potentially because they are not able to receive sufficient medical care due to their lack of resources and access.

We summarize these patterns as the following empirical facts and utilize them to calibrate worker-level parameters.

Empirical Fact 1. Initial Health, expenditures, and future health

- (a) Individuals with good health have lower medical expenditures and are less likely to utilize medical services than those with bad health (Table 3).
- (b) Conditional on characteristics, individuals with good initial health have higher probabilities of being in good health than those with bad initial health (Figure 3).

Empirical Fact 2. Insurance, expenditures, and future health

- (a) Insured individuals incur higher medical expenditures and are more likely to utilize medical services than uninsured individuals (Table 3).
- (b) Conditional on medical expenditures and characteristics, insured individuals have higher probabilities of being in good health than uninsured individuals (Figure 3).

4.3 The Worker-Level Model (Inner Loop)

On the household side, the remaining parameters are those governing (i) the sickness shock process $\{\varepsilon(x), f(\varepsilon; x)\}$; (ii) the health insurance $\{\chi(\varepsilon, x), \zeta(l), \pi\}$; (iii) the health production $F(H; x, \varepsilon)$; and (iv) the preferences $\{\iota(x)\}$. We obtain the parameter values in (i) and (ii) from the data, outside the model, and calibrate the remaining ones of (iii) and (iv) within.

Sickness Shocks and Health Insurance Qualitatively, high medical expenditures in MEPS imply severe sickness shocks, ε , in our model, as shown in Figure 3. Quantitatively, however, there are two additional issues related to data availability. First, although in the model, ε is distinct from medical expenditures, min $\{H, \varepsilon\}$, we only observe medical expenditures in the data.¹⁸ Second, although we observe whether an individual utilized medical services or not (lower panel of Table 3), it does not perfectly coincide with whether an individual experienced a sickness shock this period. To address these issues, we assume that individuals who are insured and employed (those most likely to have sufficient resources)

¹⁸Although MEPS asks respondents their medical diagnosis akin to sickness shocks in our model, it is difficult, if not impossible, to translate the diagnosis into a numerical value.

Parameter	Description	Description Values					
			ε_0	ε_1	ε_2	ε_3	ε_4
$\varepsilon\left(x ight)$	Sickness shocks	Bad	\$0	\$370	\$1,454	\$3,599	\$9,446
		Good	\$0	\$220	\$769	\$1,877	\$6,453
$f\left(arepsilon;x ight)$	Probability	Bad	0.07	0.23	0.23	0.23	0.23
		Good	0.10	0.23	0.23	0.23	0.23
$1 - \chi(\varepsilon; x)$	Coinsurance rate	Bad	-	0.38	0.33	0.28	0.20
		Good	-	0.39	0.39	0.34	0.23
$\zeta \left(l \right)$	Insurance prob.	Emp.			0.82		
		Unemp.			0.63		
π	Insurance premium				\$1,889	9	

Table 4: Predetermined Parameters Regarding Sickness Shocks and Health Insurance

Note: All statistics are from the MEPS data (1996-2014). The values of sickness shocks $\varepsilon(x)$ are constructed from the predicted values of medical expenditures among the insured population after controlling for age, sex, race, education, Census region, marital status, and survey panel dummies. We use fourth quantiles conditional on positive spending for values $\varepsilon_1 - \varepsilon_4$ by health status. The probabilities of not experiencing a sickness shock $f(\varepsilon_0; x)$ are those of the insured individuals from MEPS-HC data as described in Table 3. The coinsurance rate is calculated from MEPS using out-of-pocket expenditures and total medical expenditures, and the insurance premium is defined as a weighted average of sickness shocks, using $f(\varepsilon; x)$ as weights.

choose full treatment of sicknesses, and that the uninsured face the same distribution of sickness shocks as the insured.¹⁹ These assumptions are consistent with *Empirical Fact 2*.

Given these assumptions, we are able to use the medical expenditures for the insured and employed from MEPS to parameterize the sickness shock process in our model, $\{\varepsilon(x), f(\varepsilon; x)\}$. As reported in Table 4 below, we discretize $\varepsilon(x)$ into five events. We refer ε_0 to the event of being sickness free (i.e. $\varepsilon_0 = 0$), and its frequency is given by the shares of the insured and employed with no medical events as reported in the lower panel of Table 3 above. Then we construct the values and frequencies of the remaining four sickness events, ε_1 through ε_4 , by health status using within-quartile averages of medical expenditures conditional on positive values. Table 4 shows that the individuals with bad initial health have more severe sickness shocks ($\varepsilon(B) > \varepsilon(G)$) and a lower probability of not getting sick ($f(\varepsilon_0; B) < f(\varepsilon_0; G)$), as consistent with *Empirical Fact 1*.

The parameters for the health insurance are straightforward to obtain from MEPS and are reported in Table 4. We note that first, the expenditure-dependent coinsurance rates, $1-\chi(\varepsilon; x)$, help us parsimoniously capture such components of insurance plans as deductibles and out-of-pocket maximum. Second, the coinsurance rate decreases with the severity of the sickness, implying that health insurance is more useful for severe sickness shocks than for mild ones. Lastly, although we do not directly model insurance for low-income people, such

¹⁹Implicitly, we abstract away from adverse selection in insurance status.

as Medicaid, the unemployed in our model have a positive probability of having health insurance.²⁰ These features help our model predictions match the pattern in the upper panel of Table 3 that the mean medical expenditure is higher for the insured, and generate, endogenously, the heterogeneous effects of the China shock across workers (see Section 6).

Target Moments and Identification We are now ready to use our worker-level model to calibrate the remaining parameters for the health production function and preferences. This is the inner loop of our computation. In order to limit the number of parameters to calibrate, we parameterize $H_{min}(x,\varepsilon) = s(x) \cdot \varepsilon$, with $s(x) \leq 1$; i.e., within health status x, the level of minimum health investment increases as ε increases, but its share relative to ε is constant. Further, we normalize $\iota(G) = 0$, leaving us with 17 parameters to be calibrated: $\alpha(x,\varepsilon)$, s(x), $\gamma(x)$, $\lambda(x)$, and $\iota(B)$. Meanwhile, our data targets are group-specific averages of (i) the sickness shock-dependent probabilities of tomorrow's good health (analogous to Figure 3 but with five sickness shocks, 20 moments); (ii) the share of population with zero medical utilizations (Table 3, 4 moments); and (iii) the average medical expenditures (Table 3, 4 moments). We jointly calibrate the 17 model parameters to target the 28 data moments.

In order to develop the intuition for how the parameters are identified, we first describe the most salient effects of these parameters on targeted model moments. First, from Figure 2(a), we see that an increase in $\alpha(x,\varepsilon)$ lowers the baseline probability of future good health, and so $\alpha(x,\varepsilon)$ are identified from the variation of the good health probabilities across sickness sock ε and health status x. Second, both $\lambda(x)$ and $\gamma(x)$ impact the marginal benefits of investment, but differentially. An increase in $\lambda(x)$ compresses the effective health spending, $H - H_{min}(x,\varepsilon)$, and drags down the concave portion of $F(\cdot)$. On the other hand, for $\gamma(x) < 1$, an increase in $\gamma(x)$ changes the curvature of the concave portion of $F(\cdot)$ by rotating this portion counter-clockwise around the point $(H_{min}(x,\varepsilon) + \lambda(x), 1 - \alpha(x,\varepsilon)/e)$. Thus, $\lambda(x)$ and $\gamma(x)$ are identified from the variation in the mean medical expenditures and probabilities of future good health across current health status. Lastly, an increase in the minimum share, s(x), directly impacts the share of workers who choose zero utilization. It also decreases the probability of future good health for large sickness shocks, but has more limited effects on those of small sickness shocks. On the preference side, $\iota(B) < 0$ affects the utility loss of being in bad health. An increase in $\iota(B)$, or a decrease in its magnitude. increases the zero shares for the uninsured. As a result, s(x) and $\iota(B)$ are identified from

²⁰The consumption floor in our model proxies for other social insurance policies for low-income individuals.

the population shares of zero medical utilizations across health statuses.

4.4 The Sector-Level Model (Outer Loop)

We now relate the worker-side decisions to the market clearing condition in the manufacturing sector, Equation (12), and clarify how we introduce the China shock into our model.

First, we normalize the manufacturing sector productivity ψ_m to one, and as described in the right panel of Table 2, set the sectoral home bias, ω_m , to 0.5, and the trade elasticity, $\sigma - 1$, to 3, following Simonovska and Waugh (2014).

Next, consider the pre-China-shock economy, where we take w_m as exogenous (Table 2). The labor supply, L_m , is pinned down by the workers' optimal choices and their distribution, as expressed in Equation (11). Our remaining task is to ensure that the right-hand side of Equation (12) stays in balance. As listed in Table 2, ϕ_m is set to 0.17, the mean of manufacturing value added as a share of U.S. GDP for 1990-1992 (WDI), and $\pi_m^D = 0.85$ is the average for the years 1990-1992 (STAN). This means that we are left with two unknowns, the export-demand shifter D_m^* , and the total output in the economy Y, in Equation (12).

We thus bring in the extra equation of the model-implied ratio of manufacturing export to Gross National Expenditure (GNE),

$$\frac{\text{Manufacturing Export}}{GNE} = \frac{D_m^* \cdot p_m^{1-\sigma}}{Y}.$$
(13)

From STAN, we obtain that this ratio is 0.057 (the average for 1990-1992). We then use equations (12) and (13) to back out the values of D_m^* and Y that are consistent with the solutions from the inner loop.

For the post-China-shock economy, we follow the sufficient-statistics approach in the trade literature, and model the China shock as an exogenous drop in π_m^D to 0.71 (the average value for the post-China-shock years of 2010-2012). This approach allows us to be agnostic about the specific sources of this shock, because the shock reduces labor demand for the manufacturing sector by the same degree, whether it is caused by a drop in p_m^* (which may result from an increase in foreign productivity), a drop in import cost τ_m^* , or combinations of the two. On the other hand, because we have remained agnostic about the non-manufacturing part of the economy, our model is unable to predict how the China shock affects total output, Y. We expect such effects to be small, however, because the trade literature estimates limited output gains from trade relative to autarky, a much larger change than the China shock we model (e.g. Costinot and Rodriguez-Clare, 2014).²¹ Therefore, we assume that there is no change in Y, as an approximation, and that D_m^* remains unchanged.

Under these assumptions, there are two endogenously determined outcomes in Equation (12), the wage rate w_m and the total labor supply L_m . We use two approaches to simulate the effects of the China shock, keeping the parameter values for the health production and worker utility functions at the pre-China-shock levels. In the first approach, we assume that the job continuation rates remain unchanged. Equation (12) allows us to solve for the post-China-shock wage that clears the labor market in Equation (11), using the labor supply, L_m , from workers' problems and that $p_m = w_m$. In the second approach, we allow both w_m and job continuation rates to change. In order to contrast with the first approach, we set the wage decline to be 2.3%, the lower end of the estimates from Autor et al. (2014), and search for the change in $1 - \delta(E, x)$ that balances equation (12).

5 Calibration Results

In this section, we focus on our calibration results of worker-side parameters. We report and discuss the calibrated parameter values and model fit, show model validation, and clarify the key model features.

5.1 Parameter Values and Model Fit

Table 5 reports the values of our calibrated parameters. In order to illustrate their intuition, we plot the health production function, $F(\cdot)$, as implied by these parameters by sickness shock in Figure 4 by initial health.

First, the ten baseline probability parameters, $1-\alpha(x,\varepsilon)$, determine the vertical intercept of the health production function, $F(\cdot)$. We see that the vertical intercept is always above 0.5 in Figure 4(b) but always below 0.5 in Figure 4(a): the baseline probability of future good health is high when current health is good. We also see that the vertical intercept shifts down from ε_0 through ε_4 in both Figures 4(a) and (b), that is, the baseline probability of future good health is low when sickness is severe.

Second, the remaining six parameters of the health production function determine its shape, which differs substantially across initial health status. This happens for two reasons. One, the production function is more concave for bad initial health, because $\gamma(B)$ is smaller

²¹This literature examines the change in real GDP, which is closely related to Y, the real GNE.



and $\lambda(B)$ is larger than their counterparts for good health. Two, the ratio of minimum health investment to ε for bad health, s(B), is smaller than that for good health, s(G), making the kink point of $F(\cdot)$ under bad initial health farther away from ε . The calibrated production function implies that for bad health individuals, it is important to alleviate the sickness through medical expenditures, whereas for good health individuals, there is more scope for forgoing treatment or doing over-investment.

Lastly, $\iota(B)$ implies that bad health is associated with a utility loss of about 60% of consumption, which is within the range of those in Low and Pistaferri (2015).²² We further confirm the validity of $\iota(B)$ in Section 5.2 by comparing the model-implied value of a statistical injury with empirical estimates from the literature.

Table 6 shows that our model generates reasonable fits on the target moments reported in Table 3. For example, for the uninsured workers with bad initial health, the model

Parameter	Description Values						
Health prod	uction						
			ε_0	ε_1	ε_2	ε_3	ε_4
$1 - \alpha \left(x, \varepsilon \right)$	Baseline probability	Bad	0.244	0.193	0.142	0.107	0.107
		Good	0.658	0.587	0.532	0.524	0.523
$\lambda\left(x ight)$	Scale: Bad; Good			2.	411; 0.8	39	
$\gamma\left(x ight)$	Concavity: Bad; Good	0.167; 0.757					
$s\left(x ight)$	Min. inv. share: Bad; Good	0.467; 0.797					
Worker Utility							
$\iota(x)$	Marginal utility: Bad; Good	-0.931; 0 (normalization))		

Table 5: Parameters Calibrated in the Model

 $^{^{22}}$ Low and Pistaferri (2015) estimates disutility effects from health and employment. Their estimates imply between 36% and 66% loss in utility depending on the employment and health statuses.

predicted share of zero medical utilization is 0.27 versus 0.28 in the data.²³ On medical expenditure side, the model-predicted patterns of expenditures across worker characteristics are qualitatively consistent with those of the data: conditional on health (insurance) statuses, uninsured (good health) workers' average expenditures are lower than those of insured (bad health) workers. Figure 5 plots the future good health probabilities by initial health status, by insurance status, by sickness shock. We see that the model predictions (\circ) track the data targets (\times) fairly well.²⁴

	0			
	Insured		Uninsu	ıred
_	Model	Data	Model	Data
Bad	\$3,134	\$3,297	\$1,802	\$1,755
Good	\$2,155	\$2,246	\$1,545	\$1,294
Bad	0.07	0.07	0.27	0.28
Good	0.12	0.10	0.34	0.34
	- Bad Food Bad Food	Insur Model Bad \$3,134 Food \$2,155 Bad 0.07 Good 0.12	$\begin{tabular}{ c c c c c c } \hline Insured \\ \hline Model & Data \\ \hline Bad & \$3,134 & \$3,297 \\ \hline Bood & \$2,155 & \$2,246 \\ \hline Bad & 0.07 & 0.07 \\ \hline Bood & 0.12 & 0.10 \\ \hline \end{tabular}$	$\begin{tabular}{ c c c c c c c c c c c c c c c c c c c$

Table 6: Model Fit on Targeted Moments





5.2 Validation of the Model

Having established the model's good fit with targeted moments, we now test the empirical validity of the calibrated model by comparing its predictions on the value of health and workers' health investment decisions with the corresponding untargeted data moments.

Value of Health We first aim to confirm whether the value of the calibrated parameter $\iota(B)$, the utility loss from bad health, is plausible. Motivated by Hall and Jones (2007), who

²³It is the sum of the probability of not being sick (i.e. $\varepsilon_0 = 0$) and the share of endogenously chosen zero treatment $(H^* = 0 < \varepsilon)$.

²⁴Given the workers' choices and coinsurance rates, the actuarially fair health insurance premium in the equilibrium is \$2,260, close to the exogenously set premium of \$1,889 (Table 4) from the MEPS data. In counterfactual analyses, we use transfers to ensure budget neutrality of the government, incorporating the gap between the health insurance premium and endogenously determined medical expenditures.

use the estimates of value of a statistical life (VSL) to calibrate the flow utility parameter in their model, we compare our model's prediction of value of a statistical injury (VSI) to the empirical estimates. We combine the CPS data with the BLS data on non-fatal injuries, and find that a 1% increase in the industry injury risk is associated with a 0.37% reduction in the workers' probability of self-reported good health, conditional on worker characteristics. The empirical estimate of VSI obtained from our data is around 3.3 times the average wage, or \$153,000, which is comparable to those in the literature; e.g., Biddle and Zarkin (1988) report VSI of 3.7 times the average wage and the corresponding estimate in Hersch and Viscusi (1990) ranges between 3.3 and 5.4. Meanwhile, our model-predicted VSI is 3.8 times the mean wage, or \$176,000, given the conditional correlation between self-reported health and injury risk discussed above. This prediction is similar to our estimate and within the range of the literature's estimates.²⁵

Income Elasticity of Health Investment We compare the model-predicted income elasticity of health investment with the estimates from previous empirical studies. To do so, we use our model to simulate a temporary increase in income and evaluate their effects on health investment. The average elasticity in our model is 0.47, in line with the range of estimates from previous studies (e.g. Acemoglu et al., 2013) of 0.3 to 1.1.²⁶ Thus, the workers' quantitative responsiveness of health investment in response to income changes in the model is in line with empirical studies.

Prevalence of *Under***-Investment** An important model prediction is that workers may endogenously choose to under-invest (partially treat or forego their sickness) in health. To measure the prevalence of under-investment in the data, we utilize survey questions from the NHIS data in 2011-2012 that ask whether the respondent missed or reduced medical care or medicine doses due to cost.²⁷ If an individual's answer to any of these questions is "Yes," our indicator variable for under-investment in health turns on the value of one. We obtain that, among the working-age adults (18-64) in the U.S., 18.6% under-invest in health. In

 $^{^{25}}$ See also Viscusi and Aldy (2003) for estimates. The detailed description is contained in Appendix D.3.

²⁶Acemoglu et al. (2013) obtains the range of 0.3-1.1 for the income elasticity of hospital expenditure at the U.S. Economic Subregion level, by instrumenting local income by global oil price and ESR-level importance of oil in the economy. Other papers that estimate the elasticity are Moscone and Tosetti (2010),Baltagi and Moscone (2010), and Baltagi et al. (2017) and their estimates vary between 0.35 and 0.9.

²⁷These questions are not available for earlier years, and we stop in 2012 because the ACA went into effect in 2014. We use questions that ask whether, due to affordability, the person restricted medical care (PNMED12M), prescription medicine (AHCAFYR1), a specialist visit (AHCAFYR5), follow-up care (AH-CAFYR6), skipped medication (ARXPR1), or took less medicine (ARXPR2).

comparison, our model predicted share of under-investment (those with $\varepsilon > 0$ and $H^* < \varepsilon$) is 18.9% in the pre-China economy, close to the empirical share from the NHIS.

Magnitude of *Over*-Investment The model also predicts that workers may endogenously choose to over-invest in health, in the amount of max $\{H^* - \varepsilon, 0\}$. From the data, it is difficult to disentangle non-medical expenditures that help improve health (e.g., healthy foods) from ordinary consumption expenditures. As a result, we compute the total nonmedical consumption of $c + \max\{0, H^* - \varepsilon\}$ in the model, which would be measured as the total consumption expenditures net of medical expenditures in the data. Using the recent surveys of the PSID (1999-2013) that include consumption data, we show that among the employed, the ratio of non-medical consumption to income is 70% for those with bad health and 60% for those with good health.²⁸ In the model, these ratios are 83% and 73%, respectively for bad and good health individuals, both in line with the data in terms of levels and the differences across health statuses. That is, our model generates a reasonable non-medical consumption to income ratio, even though this ratio is not directly targeted.

In summary, our model can replicate several untargeted moments about the value of health and health investment. We provide additional validation for the post-China economy in Section 6, but before doing so, we discuss the key features of our model.

5.3 Key Model Features

Our main model mechanisms revolve around the optimal health investment, H^* , which consists of both medical expenditures, min $\{H^*, \varepsilon\}$, and non-medical expenditures beyond the treatment of sickness, or over-investment, max $\{H^* - \varepsilon, 0\}$. We illustrate the key model features using Figures 6(a) through 6(d), which summarize health investment choices for employed workers by health and insurance statuses.²⁹ In the plot, we demonstrate, for each sickness shock, the size of the sickness shock ε , the average medical expenditures min $\{H^*, \varepsilon\}$, and the average health investment H^* . The unit of the vertical axis is \$10K.

Over-Investment as a Channel for Self-Insurance In our model, bad health individuals experience a direct utility loss $(\iota(B))$, lower probabilities of employment $(1 - \delta(l, B))$, and lower wages $(\nu(B))$. As a result, workers have incentives to self-insure against the future

 $^{^{28}}$ As the PSID data records consumption at the household level, we use equivalent scale (0.7 for an additional adult and 0.5 for an additional child) to adjust for family size. Our sample includes those who are employed with positive labor income and we drop those with ratios in top and bottom 1% of the distribution.

 $^{^{29}}$ We relegate the discussion of unemployed workers to Appendix D.2 as they are qualitatively similar.





risk of landing in a bad-health state. Individuals with good initial health do so by investing in health beyond the full treatment of sicknesses (*over*-investment), which is the first novel feature of our model relative to the literature. As illustrated in Figures 6(c) and 6(d), the average health investment exceeds the size of the sickness shock $(H^* - \varepsilon > 0)$ regardless of sickness severity and regardless of insurance status.

The quantitative magnitude of the over-investment depends on their marginal benefits. As seen in Figure 4, the marginal benefit of health investment for good-health individuals remains substantial even when the investment is large. As a result, the average amount of over-investment in Figures 6(c) and 6(d) is typically large, exceeding \$5K, except for the uninsured workers with the most severe sickness of ε_4 . For individuals with bad health, the shocks of severe sickness are especially large (Table 4). As a result, the bad-health workers are incentivized to over-invest when they are not sick or when they have mild sickness, as illustrated in Figures 6(a) and (b). However, the amount of the average over-investment is much smaller than for good-health workers, because the marginal benefits to investment decrease sharply in the health production function for bad-health workers.

Under-Investment and the Role of Health Insurance Another novel feature of our model relative to the literature is that workers may choose to under-invest in health relative to sickness, sacrificing treatment for consumption, especially when the cost of treatment is high. In our model, the cost of treatment is closely related to health insurance status and minimum investment for health.

First, health insurance has no direct effect on health in our model. Instead, it lowers the marginal cost of medical expenditures, allowing covered workers to leverage more resources for treatment. Figures 6(a) and 6(b) illustrate this channel by showing the bad-health workers' optimal choices of medical spending. The insured (Figure 6(a)) tends to fully treat their sicknesses (average medical expenditure is very similar to the sickness shock), while the uninsured (Figure 6(b)) under-invests ($H^* < \varepsilon$). The amount of the average under-investment is modest, but becomes large for the most severe sickness ε_4 , approaching \$6K.

In addition, the health production function in our model has a flat segment, which says that a minimum investment is required before the benefits of health investment materialize. For the good-health individuals, the minimum health investment is large relative to sickness (Table 5), and so many of them choose not to invest in health at all (Table 6). Figure 6(d) illustrates this channel for the uninsured workers when they face the severe sickness of ε_4 . We see that the average medical expenditure is lower than ε , because many choose zero treatment ($H^* = 0$), due to the lack of resources and high minimum investment.

In summary, the flexibly parameterized health production function is a unique element of our model, and it generates the novel features of over-investment and under-investment in health relative to sickness, providing an additional channel for self-insurance. These features also help our model match the health dynamics, shares of individuals without medical utilization, and average medical expenditures, as summarized in *Empirical Facts 1* and 2.

6 Quantitative Analysis

In the previous section, we discussed the fit and key features of our calibrated model in the pre-China shock economy. Now, we use the model as a laboratory to quantify the effects of the China shock on workers' health through the optimal health investment mechanism, to compute the effects of the China shock on workers' welfare, taking this mechanism into account, and to evaluate the effectiveness of potential policy responses.

6.1 The Post-China Economy

As discussed in Section 4.4, we simulate two versions of the China shock. In the first, wage adjusts to clear the labor market in response to the China shock, and in the second, both wage and job destruction rates adjust. Table 7 describes the main aggregate outcomes of the post-China economies in the manufacturing sector.

The first panel of Table 7 recaps the wage, employment rate, and export-GNE ratio of the pre-China economy. The second panel shows that in our first simulation, the model predicts a 5.78% drop in the wage rate of manufacturing workers. This is because the increase in import competition from the China shock reduces demand for manufacturing labor, as can be seen from Equation (12). The magnitude of the wage decline falls within the range of the estimates from Autor et al. (2014), 2.3% to 7.2%. We also see that the export-GNE ratio for the U.S. manufacturing sector increases from 0.057 to 0.068. as the lower manufacturing wage reduces the production cost of the domestic input. The value of the post-China export-GNE ratio is comparable to the mean value for the years of 2010-2012 in the data, 0.077.

The last panel of Table 7 shows the results of our second simulation. We fix the wage drop at 2.3%, the lower end of the estimates in Autor et al. (2014), and find that an increase of 1.12pp in the job destruction rate balances the labor market clearing condition of (12). Relative to the pre-China economy, the manufacturing sector employment rate drops by 2.8pp. With the manufacturing sector employment share of 15%, this implies that the ratio of manufacturing employment to population declines by 0.42pp, accounting for a substantial portion of the effect of the China shock, 0.88pp, as reported by Autor et al. (2013).

Overall, the macroeconomic predictions of our model for the effects of the China shock are consistent with both data and estimates from previous studies. These results provide further validation of our model on post-China economy simulations and therefore, its suitability as

	Wage	Employment	Export-GNE
Pre-China economy	\$50,211	72.5%	0.057
Post-China I: Wage ↓	\$47,308	72.2%	0.068
Change from Pre-China	-5.78%	-0.30 pp	+19.65%
Post-China II: Wage \Downarrow & Job destruction \uparrow	\$49,056	69.8%	0.061
Change from Pre-China	-2.30%	-2.76 pp	+7.28%

Table 7: Manufacturing Sector Outcomes in the Post-China Economy

a laboratory for analyzing its effects.

6.2 Mechanism: The China Shock and Health Investment

We now discuss the health effects of the China shock as predicted by our model. We start with the aggregate effects and uncover the heterogeneity in its effects across worker characteristics.

6.2.1 Aggregate Effects

Table 8 summarizes the aggregate effects of the China shock. The second column summarizes the key metrics about health and health investment in the pre-China economy, and the next two columns show how these metrics change in the simulated post-China economies.

The top panel of Table 8 focuses on changes in the shares of workers with good health. We see that, in the first post-China simulation, the good health share decreases by 1.2pp. This means that the model-predicted elasticity of good-health share with respect to import penetration per worker (IPW) is -0.0203. In Section 3.1, we have shown that the empirical estimate of this elasticity is -0.054. That is, the mechanism of optimal health investment, the only mechanism at work in our stylized model, accounts for around 38% of the estimated empirical elasticity. In the second post-China simulation, the model-predicted elasticity is larger in magnitude, at -0.0282, accounting for 52.2% of the empirical estimate. These results imply that the optimal health investment mechanism is economically significant in explaining the health effect of the China shock, and that it might be important for understanding the health effects of other negative economic shocks. In comparison, the models that abstract away from health or treat health transition as exogenous would be unable to shed light on the health effect of the China shock (or other economic shocks in general).

The second panel of Table 8 clarifies the economic intuition of the results in the first

		Δ from Pre-China Economy		
	Pre-China	Post-China I	Post-China II	
Good health share	58.9%	-1.2pp	-1.7pp	
Implied elasticity		-0.0203	-0.0282	
(% of empirical elasticity, -0.054)		(37.6%)	(52.2%)	
Total health investment, H^*	\$5,140	-6.8%	-9.5%	
Medical expenditure, min $\{H^*, \varepsilon\}$	\$2,359	-11.6%	-11.8%	
Partial treatment share	12.7%	-0.0pp	+0.9pp	
No treatment share	6.2%	+1.3pp	+0.9pp	
Over-investment, max $\{H^* - \varepsilon, 0\}$	\$3,024	-10.6%	-14.9%	

Table 8: The Effects of the China Shock on Health and Health Investment

panel, by showing the workers' choices regarding the optimal health investment in the pre-China economy, and how these choices change in the post-China simulations. We see that the amount of total investment, H^* drops significantly, by 6.8% and 9.5%, because both medical expenditures and non-medical (over-) investment decrease substantially.³⁰ The decrease of medical expenditures, in turn, is closely related to the increase in the share of workers who choose to under-invest relative to their sickness ($H^* < \varepsilon$). In particular, more sick workers choose to forego all treatment ($H^* = 0$), increasing its share by 1.3pp and 0.9pp. Intuitively, due to the minimum health investment, more workers who are on the fence between H^* of zero and a slightly higher value than H_{min} in the pre-China economy are pushed into choosing $H^* = 0$ when the China shock hits. As a result, these workers' medical expenditures change substantially, from higher than H_{min} to 0, contributing to the decrease in overall medical expenditures. Additionally, over-investment in health decreases considerably, as the workers who have fewer economic resources after the China shock cut back on the amount of nonmedical health investment.

We now place the aggregate health effect of our model into context. In the first post-China economy, the share of workers with good health decreases from 58.9% to 57.7%. This translates into nearly half a million, or 460,000 individuals, being pushed into bad health, assuming that the manufacturing sector accounts for 15% of the U.S. population (251.6 million) in 1990-1992. According to MEPS, individuals with bad health have more frequent visits to the emergency room (ER) than their good health counterparts—0.44 per person per year versus 0.21—and also longer hospital stays—0.67 inpatient days per person per year, versus 0.26. As a result, our model predicts that, in response to the China shock, the U.S. manufacturing workers experience 103,000 more ER visits and spend 189,000 more inpatient days in hospitals *per year*, causing economically significant aggregate health impacts.

6.2.2 Individual Heterogeneity

The aggregate effect analysis above masks substantial heterogeneity in individuals' responses to the China shock, which we discuss now. Given the qualitatively similar patterns in the two post-China simulations, we focus on the first simulation in the remaining analyses.

In Table 9, we show the change in good-health probabilities between the pre- and the

³⁰Although the wage drop is mild in the second post-China simulation, the increase in the probability of unemployment implies that the loss of overall economic resources is substantial.

post-China economy by worker characteristics.³¹ The left panel of Table 9 shows that the health effects of the China shock are more pronounced for workers with good initial health, both overall and within employment status. For example, employed workers with good initial health suffer a drop of 1.33% in good health transition probabilities, but those with bad initial health suffer a drop of only one-third as much, about 0.46%. As seen in Figure 6, those with good initial health often choose to over-invest in health as self-insurance, and they have a larger margin of response to the China shock. These predictions suggest that the decrease in the mean non-medical investment in Table 8 is largely driven by workers with good initial health. This feature is also qualitatively consistent with our empirical finding from Table 1, where the coefficient estimate for the effect of the China shock is large in magnitude and statistically significant for workers with good initial health, but small in magnitude and statistically insignificant for those with bad initial health.

The right panel of Table 9 shows that the health effects of the China shock are more pronounced for those who experience severe sickness, and conditional on sickness, those who are uninsured. For example, while those with the severe sickness of ε_4 see their goodhealth probability decrease by 2.22% on average, those who are sickness-free (ε_0) experience a mild decline of 1.48%. Among the former group, the decrease in good-health probability is larger for the uninsured than the insured, 2.94% versus 2.04%. Intuitively, in our model, the workers may optimally choose to over-invest in health relative to their sickness, and such over-investment decreases in response to the China shock. Thus, even the sickness-free workers (ε_0) face a lower probability of good health. In addition, the drop in over-investment is higher for those with severe sicknesses and for those without health insurance.

	-	-					
% Change in Transition to Good Health (from Pre-China)							
l Health	n and Employn	nent	By Sickness Shock and Insurance			ance	
All	Unemployed	Employed	Sickness	All	Uninsured	Insured	
-2.03	-2.04	-1.92	All	-2.03	-2.30	-1.95	
-0.47	-0.49	-0.46	ε_0	-1.48	-1.46	-1.48	
-1.47	-1.93	-1.33	ε_1	-1.87	-2.22	-1.78	
			ε_2	-2.11	-2.07	-2.22	
			ε_3	-2.15	-2.45	-2.06	
			ε_4	-2.22	-2.94	-2.04	
	% C Health All -2.03 -0.47 -1.47	% Change in TransHealth and EmploynAllUnemployed-2.03-2.04-0.47-0.49-1.47-1.93	% Change in Transition to GodHealth and EmploymentAllUnemployed-2.03-2.04-1.92-0.47-0.49-1.47-1.93-1.33				

Table 9: Heterogeneity in Health Effects of the China Shock

³¹With π_m^D of 0.71 and 0.85 in pre- and post-China economies, the elasticity is the percent change in good health share divided by 93. The aggregate health effects in Table 8 reflect the intensive-margin effect from group-specific elasticities, $\Delta Pr(G; s)$, and the extensive-margin effect from compositional changes, $\Delta \mu(s)$.

6.3 Welfare: The China Shock and Welfare Cost

Having established the health effects of the China shock, we discuss the steady-state welfare effects. We first present the benchmark welfare cost, where we compare the pre-China economy with the first post-China simulation. Then, we present the welfare costs from two counterfactuals, the exogenous health economy and the no-health economy, to understand and quantify the role of health investment and health in forming the welfare costs.

In the second column of Table 10, we summarize the benchmark welfare cost of the China shock as a compensating consumption equivalent, the amount of consumption such that the worker's lifetime utility in the post-China economy is the same as that in the pre-China economy. The steady-state welfare loss amounts to 8.4% of average annual consumption in the pre-China economy, or \$1,721. There is also heterogeneity by worker characteristics. As the China shock directly impacts the wages of employed workers, the welfare loss is higher for the employed, at \$1,989 of annual consumption, whereas for the unemployed, the welfare loss is \$966. Within employment status, the welfare loss is similar across health status.

The benchmark welfare cost captures both health and health investment featured in our model. Health matters because the state of bad health carries both direct utility losses and economic consequences such as lower probability of employment and lower earnings when employed. Meanwhile, health investment serves as an additional channel for consumption smoothing; e.g. sick workers who are already in bad health may have an incentive to sacrifice sickness treatment for consumption.

To further understand the roles of these two model features in shaping the welfare effects, we first consider the counterfactual economy in which the workers are not allowed to choose their health investment. We refer to this counterfactual as the "exogenous health

		Counterfactual Economy, C	hange from BM Cost
	Benchmark	Exogenous Health Economy	No Health Economy
	Economy	USD ($\%$ of BM Cost)	USD ($\%$ of BM Cost)
Aggregate	\$1,721	+\$173 (10%)	-\$452 (24%)
Unemployed	\$966	+\$196 (20%)	-\$205~(18%)
Bad health	\$919	+\$281 (30%)	-
Good health	\$974	+\$138 (14%)	-
Employed	\$1,989	+\$157 (8%)	-\$512 (24%)
Bad health	\$1,818	+\$298 (16%)	-
Good health	\$1,978	+\$181(9%)	_

Table 10: Welfare Cost of the China Shock



Figure 7: The "Value" of Health Investment Channel (USD) by Worker Characteristics

economy." To be specific, we assume that all workers experiencing a sickness shock of ε are forced to spend ε . That is, sickness shocks are equivalent to income shocks in the form of medical expenses. This assumption implies that the exogenous health economy is consistent with models with exogenous health evolution. We further assume that the workers' health transition probabilities are equal to the model-predicted values in the pre-China economy.

The welfare effects from the exogenous health economy are summarized in the third column of Table 10, expressed as changes from the benchmark welfare effects in the previous column. In the aggregate, the welfare cost of the China shock is equivalent to an annual loss in consumption of \$1,895, which is \$173 higher than the benchmark welfare cost. That is, because we have deprived the workers of a consumption-smoothing channel when facing a negative economic shock, the welfare losses are higher, and this difference is about 10% of the benchmark welfare cost. Table 10 also shows that the *additional* welfare loss in the exogenous health economy varies substantially across workers. For example, it is \$281, or 30% of the benchmark welfare loss, for the unemployed with bad health, over twice as high as the additional loss of \$138, or 14%, for the unemployed with good health. These additional welfare losses gauge how much the workers in our benchmark model value the consumption-smoothing channel via endogenous health investment.

Figure 7 further highlights the heterogeneity in this value of health investment by plotting the additional welfare costs in dollar values by health, employment, and insurance statuses. It shows that the additional welfare losses are positive for all worker groups, implying that for all the workers in our benchmark model, endogenous health investment provides an important buffer in the face of an adverse shock, even for employed and insured individuals. Figure 7 also shows that the value of endogenous health investment is especially high for workers with bad health, as they have relatively fewer resources. As a result, abstracting away from endogenous health investment would likely overstate the welfare losses, especially for workers with bad health or with scarce resources. Overall, the results for the counterfactual of the exogenous health economy suggest that modeling endogenous health investment is significant for measuring the welfare effects of the China shock, and may also be useful for studying negative economic shocks in general.

We now move on to clarify how the second model feature, health itself, contributes to the welfare losses from the China shock. To do so, we consider the counterfactual economy in which health does not have any roles, the "no health economy." To be specific, we set the labor income and job transition rates to be averages across health status, and set the utility loss from bad health and probability of sickness shocks to zero.

The results for the no health economy are presented in the fourth column of Table 10. In the aggregate, the welfare cost of the China shock would be \$1,270, substantially lower than the benchmark cost of \$1,721, by 24%. For the unemployed workers, the no-health economy underestimates the welfare loss by \$205, or 18% of the benchmark loss, and for the employed workers, the underestimation is \$512, or 24%. The welfare losses are lower in the no-health economy because the model does not capture the direct utility loss and the adverse labor market outcomes associated with bad health. Therefore, abstracting away from health is likely to substantially underestimate the welfare losses from the China shock and potentially from other economic shocks.

6.4 Policy: Universal Health Insurance

In this section, we highlight the policy implications of our model. Specifically, we simulate a post-China economy in which all individuals are covered by health insurance with premium and coinsurance rates specified in Table 4.³² This is a pertinent counterfactual to consider, as the increase in import penetration from China was most pronounced between 1990 and 2007, before the implementation of the major provisions of the ACA that subsequently expanded insurance coverage. We report the results in the last column of Table 11, as changes relative to the pre-China economy. The rest of Table 11 recap the results from Table 8, to place the

³²We also impose budget neutrality, i.e., individuals receive lump-sum transfers so that the government's aggregate expenditure in the counterfactual economy is equal to that in the benchmark post-China economy.

results of the counterfactual into context.

In the aggregate, the population share of good-health workers would increase by 1.1pp with universal health insurance (UHI), in contrast to the 1.2pp drop under the benchmark post-China economy, i.e., UHI would fully remedy the adverse health effect of the China shock. The economic intuition of this result is as follows. First, medical expenditure would only drop by 0.2% under UHI, in sharp contrast to the 11.6% drop under the benchmark. This reversal, in turn, is closely related to the large decrease in the share of workers choosing no treatment, because for the workers who switch out of no treatment, medical expenditures increase sharply, from 0 to above the minimum investment of H_{min} . This effect through medical expenditures the efficacy of UHI. On the other hand, the drop in the average over-investment is similar to that in the benchmark at around 10%, as health insurance does not cover non-medical investments in our model. This effect through non-medical investment in health diminishes the efficacy of UHI. In the aggregate, with a relatively modest 5.8% decrease in the wage, the first effect dominates making UHI an effective policy for mediating adverse health effects.

Summarizing, we see that, because health insurance affects health through the investment choice of workers, the overall efficacy of UHI is nuanced, and hinges upon the importance of the loss in non-medical investments due to wage losses and the extent to which health insurance can compensate for such losses. To further clarify this, we study how the efficacy of UHI varies across commuting zones experiencing different exposures to the China shock.

We start by multiplying the percentiles of the distribution of the change in import penetration per worker, Δ IPW (e.g. \$4,500 per worker, or 4.5 units, at the 75th percentile) by the estimate of 2.14% per unit of Δ IPW (Table 9 of Autor et al., 2013), to obtain the percentiles of the distribution of empirically estimated wage changes (e.g. $4.5 \times 2.14\% = 9.7\%$ at the 75th percentile). We list these percentiles and wage changes in the first two columns

		Post-China, Δ from Pre-China Economy		
	Pre-China	Benchmark Economy	Universal Insurance	
Good health share	58.9%	-1.2pp	+1.1pp	
Total health investment	\$5,140	-6.8%	-1.2%	
Medical expenditure	\$2,359	-11.6%	-0.2%	
Partial treatment share	12.7%	-0.0pp	-0.51 pp	
No treatment share	6.2%	+1.3pp	-4.0 pp	
Over-investment	\$3,024	-10.6%	-10.0%	

Table 11: Effects of Universal Health Insurance

		% Population with Good Health			
		(pp change from)	n Pre-China)		
Δ IPW Percentile	Wage Drop (%)	Benchmark Insurance	Universal Insurance		
5^{th}	0.2	58.9(-0.00)	60.2 (+1.26)		
10^{th}	0.4	58.8(-0.05)	$60.1 \ (+1.21)$		
25^{th}	2	58.6(-0.35)	59.8 (+0.90)		
50^{th}	5.5	57.8(-1.13)	59.2 (+0.24)		
Mean $(53^{\rm rd})$	7.3	57.4(-1.53)	58.8 (-0.11)		
75^{th}	9.7	56.9(-2.00)	58.3(-0.60)		
90^{th}	15.8	55.6(-3.31)	57.1(-1.85)		
95^{th}	21.7	54.3(-4.58)	55.9(-3.07)		

Table 12: Effects of Universal Health Insurance by IPW Exposure

of Table 12. We interpret each percentile as a single commuting zone and simulate the effect of the China shock by feeding in the commuting zone specific wage drops exogenously. We report the results of these simulations in the third column of Table 12 and perform the same counterfactual UHI and present the results of these counterfactuals in the last column.

From Table 12, we see that the commuting zones with large drops in wages experience large deterioration of health. For example, although the median commuting zone experiences a drop of 1.1pp in the population share of good health, the 95th percentile commuting zone has a sharp decline of 4.6pp, more than 8%. We also see that while UHI helps mitigate these negative health effects, the efficacy of the mitigation varies substantially across commuting zones. For a commuting zone with a small wage decline (e.g. those below the median), UHI delivers higher population shares with good health than the pre-China economy, more than fully reversing the adverse health effect of the China shock. In contrast, for the commuting zone at the 95th percentile, even with UHI, the good health share would still drop by 3.1pp. This means that UHI would only remedy around 33% ((4.6-3.1)/4.6) of the health deterioration from the China shock. The intuition of these results is similar to that for Table 11. Relative to the benchmark post-China economy, UHI has little effect on the change in over-investment, but increases medical expenditure substantially. When the wage decline is small, the increase in medical expenditure dominates. With large wage declines, however, the drop in over-investment dominates, limiting the overall efficacy of UHI.

In Figure 8, we investigate how the efficacy of UHI would vary by sickness shock. Figure 8(a) plots the change in the good health probability relative to the pre-China economy under benchmark insurance and under UHI by percentiles of Δ IPW among those with the



Figure 8: Effects of Universal Health Insurance by IPW Exposure and Sickness (a) Moderate Sickness Shocks (ε_2) (b) Severe Sickness Shocks (ε_4)

moderate sickness of ε_2 , and Figure 8(b) plots this change for the severe sickness of ε_4 .³³ In both plots, the gap between the two bars measures the effectiveness of UHI. We see from Figure 8(a), that among those mildly sick, the gap between the bars is small across the Δ IPW distribution, in contrast to those with severe sicknesses in Figure 8(b). In other words, Figure 8 shows that for severely (mildly) sick individuals, UHI is (not) very effective in mitigating the adverse health effects of the China shock.

7 Conclusion

In this paper, we develop a model with endogenous health dynamics to study the mechanism, welfare consequences, and policy implications of the impacts of economic shocks on health. A key innovation of our model is that workers may optimally choose to partially treat or forego treatment (*under*-invest), or invest beyond the full treatment of sickness itself (*over*-invest). We use the China shock as our application and estimate its causal effect on workers' probabilities of being in good health using micro-level panel data. Our estimates show that the elasticity of future good health probability with respect to IPW is around -0.05. We then embed our worker-level model of health transition dynamics into a sector-level model of international trade.

Our simulation shows that the health investment mechanism is quantitatively important, capturing about 40% of our empirical elasticity estimates. It generates an economically significant aggregate health effect, pushing nearly half a million manufacturing workers into bad health. In addition, the health effects of the China shock are heterogeneous across

³³The graphs for ε_0 and ε_1 are similar to Figure 8(a), and the graph for ε_3 is similar to Figure 8(b).

worker characteristics, with larger effects among those with good initial health, consistent with our empirical estimates.

In terms of welfare, our simulations suggest that the average worker's loss is equivalent to a drop in annual consumption of \$1,721. Importantly, the welfare losses would be over-estimated in an economy with exogenous health dynamics, and under-estimated in an economy that abstracts away from health. Our evaluations show the significance of capturing both endogenous health investment and health itself in measuring the welfare costs from negative economic shocks.

Moving on to policy implications, we find that universal health insurance, if implemented after the China shock, would provide a useful remedy for the adverse health effects, primarily through the substantial reduction in the under-investment of health. However, since health insurance does not cover over-investment (non-medical expenditures in health), the efficacy of universal health insurance would be fairly limited for workers with large exposure to the China shock who suffer large wage losses, with the silver lining that it would still be highly effective for the individuals with the most severe sicknesses. Our results speak to the recent discussions about whether some form of universal health insurance would be beneficial for the U.S. (e.g. Baicker et al., 2023; Einav and Finkelstein, 2023; Chen et al., 2024). These analyses may also be relevant for the second China shock on the horizon, as the impacts of China's excess industrial capacity may be felt around the globe, including in many middle-income countries with evolving healthcare systems.³⁴

Finally, for future research, our modeling framework is more general than our application of the China shock, and so it is useful for studying other economic questions. For example, it may be interesting to explore whether under-investment and over-investment in health may contribute to the evolution of health inequalities and earnings, complementing recent works by Hosseini et al. (2024) and De Nardi et al. (2023).

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 $^{^{34}}$ Quoting Janet Yellen, the U.S. Treasury Secretary, "China's industrial policy may seem remote as we sit here in this room, but if we do not respond strategically and in a united way, the viability of businesses in both our countries and around the world could be at risk." (Lawder, 2024)

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