



Reconsidering the effect of welfare stigma on unemployment

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ABSTRACT

Stigma has been modeled in the literature as a cost of welfare participation, providing a disincentive to welfare entry; hence, traditional models predict that stigma leads to higher search effort and higher employment. We develop a more comprehensive model that accounts for the fact that welfare stigma may elicit psychological effects and foster negative attitudes towards welfare recipients, affecting their employment prospects. We find two contrasting effects. The first reinforces the standard prediction: rational individuals foreseeing the reduction in employability defer welfare entry (*deterrence effect*); the second goes in the opposite direction: once assisted, individuals experience less welfare-to-employment transitions, both because of reduced search effectiveness and of reduced search effort (*entrapment effect*). When stigma is not too high, the latter effect prevails: more stigma yields to less employment and more welfare participation. The result is stronger if individuals are not able to foresee their loss of employability.

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1. Introduction

Stigma is acknowledged as one of the determinants of welfare participation and there is wide evidence that it negatively affects take-up rates (Currie, 2004; Hernanz et al., 2004). Keeping stigma low is one of the aims of program design as it is recognized that welfare policies will have a limited impact if a significant share of those who are entitled for the benefit do not claim it.

Yet, there is ample consensus that transfer programs reduce work effort. The effect of income support policies has been the object of extensive theoretical (Rogerson et al., 2005) and empirical research (Moffitt, 1992, 2002; Blank, 2002). The focus is on work disincentives: if the benefit is high enough with respect to wages, individuals choose welfare and stay out of the labor market. Hence, the concern is that anti-poverty programs may indirectly foster unemployment and poverty, triggering the ‘welfare trap’.

Given that (i) stigma reduces welfare programs take-up rates, and (ii) welfare programs reduce labor supply, a positive effect of stigma on employment goes undisputed in the literature. We challenge this view and propose a theoretical model where stigma, in broad regions of the parameter space, plays an unambiguously negative role, decreasing take-up rates while increasing unemployment and welfare participation.

Our analysis ideally applies to social assistance programs, providing cash or in-kind benefits (for example: vouchers to purchase food, subsidized housing). Social assistance is a last resort provision to secure a minimum standard of living for those who do not qualify for unemployment insurance, and is often subject to intrusive means-tests. In-kind programs, having greater public visibility, are particularly exposed to social stigma. Instead, we do not refer to insurance-based unemployment

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benefits: being related to employment or contribution requirements, these benefits are generally perceived as a worker's right and are less subject to stigma.¹

The traditional view of stigma is epitomized in Moffitt (1983), who explicitly introduces stigma in a job-search model, specifying it as a fixed cost of being on welfare. On the other hand, in their influential work on welfare dependence, Bane and Elwood (1994) consider three alternative explanations for long-term welfare participation: the *rational choice*, the *expectancy* and the *cultural* models.² The rational choice model emphasizes the role of choice and incentives. The expectancy model refers to the individuals' sense of control over a desired outcome: if welfare stigma is inflicted upon claimants, self-confidence will be negatively affected, modifying behavior. The cultural model emphasizes the change in values and attitudes that may occur when living in environments with large shares of poor and welfare recipients. Bane and Elwood find little evidence for the cultural model and conclude in favor of a broader perspective that takes into account the mechanisms involved in both the choice and the expectancy models.

We pick up the suggestion and formalize a model in which individuals behave rationally and maximize the utility of the available options, but may be subject to psychological effects of discouragement and loss of self-confidence that may progressively deteriorate their search effectiveness. Accordingly, we extend the traditional model by allowing welfare stigma to have two distinct effects: a fixed utility cost of welfare participation (*à la* Moffitt), and a constant rate of decay in the employment probability.

We expect the negative effects of stigma on search effectiveness to cumulate over time on welfare because discouragement, being nourished by previous failures and experiences of discriminatory treatment, develops gradually. A decreasing employment probability may also depend on the behavior of prospective employers: if the number of people knowing about individuals' welfare participation increases over time, recipients will be increasingly more exposed to negative attitudes and discrimination (Yaniv, 1997).

In our model the unemployed choose whether to search for a job and whether to be on welfare.³ We first prove that, in our setting, the optimal strategy is to enter assistance when the residual employability falls below a critical value, and stop searching when it reaches another threshold. We then simulate the model in order to derive the implications of this behavior on unemployment and welfare participation.⁴

The relationship between welfare stigma and unemployment display a non-monotonic, inverse-U shaped pattern, and the same occurs for welfare participation. The intuition behind this result lies in the following trade-off: the loss of employability component reinforces the effect of the fixed welfare participation cost, as individuals anticipating the decay in employment prospects defer welfare entry and search more intensively (*deterrence effect*); on the other hand, those who eventually enter welfare progressively face lower employability and hence reduce their job-search effort (*entrapment effect*).

Moreover, the deterrence effect crucially depends on the ability of individuals to forecast the future loss in employability. This is highly questionable: although individuals might be able to foresee the negative attitude of potential employers, it is unlikely that they will predict their own psychological reactions. Allowing for weak forecasting ability, the positive relation between stigma and unemployment is further strengthened.

The rest of the paper is organized as follows. Section 2 is devoted to defining welfare stigma and describing its consequences, according to the traditional view. In Section 3 we describe the rationale for decreasing employability and discuss the empirical evidence on it. The model is described in Section 4. Theoretical implications on the behavior of decision makers are derived in Section 5. The simulation design and the results are described in Section 6. In Section 7 we provide some raw country-level empirical evidence on the relation between welfare stigma and relevant economic outcomes. Concluding remarks follow.

2. How is welfare stigma defined and modeled in the literature

In the literature, stigma is defined as «an attribute which is deeply discrediting» (Goffman, 1963); it is ascribed to a personal characteristic that negatively portrays deviants. Those labeled deviant have violated highly accepted rules or norms: the devaluation of deviant individuals and groups entails a negative assessment of personal character. Although not speaking of stigma per se, Paugam and Rachedi (1997) argues that: «It is from the moment they [welfare recipients] are assisted, maybe from the moment their condition might entitle them to social assistance [...], that they become part of a group which is characterized by poverty. This group is not unified through the interaction between its members, but through the collective attitude society as a whole adopts towards it».

¹ Consistently, take-up rates are typically lower for social assistance than for unemployment benefits (Hernanz et al., 2004).

² These models are not formalized in mathematical terms; the authors derive the supposed implications on individual behavior and compare them with the available empirical evidence on a number of related outcomes.

³ Technically speaking, the unemployed who stop searching fall out of the labor force and should be classified as unemployed. However, since we consider individuals that in principle are willing to work and being job-search behavior an outcome of our model, with this caveat in mind throughout the paper we will refer to them as unemployed.

⁴ In some countries social assistance benefits are conditional on being actively searching for a job. Attempts to monitor search effort, however, are often limited to formal actions (like being registered at a public employment center), and may fail to measure the *quality* of the search effort, which is crucial in helping finding a job. We consider a simplified environment with no such requirements.

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