



Work norms, social insurance and the allocation of talent



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ARTICLE INFO

Article history:

Received 17 December 2012
 Received in revised form 2 September 2013
 Accepted 5 September 2013
 Available online 17 September 2013

JEL classification:

H2
 O0
 Z1

Keywords:

Work norms
 Unemployment insurance
 Occupational mobility
 Economic growth

ABSTRACT

This paper challenges the view that weak work norms make generous welfare states economically unsustainable. I develop a dynamic model of family-transmitted values that has a laissez-faire equilibrium with strong work norms coexisting with a social-insurance equilibrium with weak work norms. While the former has better incentives, the latter induces more intergenerational occupational mobility which improves the allocation of talent and fuels growth. Strong work norms arise as a way for parents to protect their children from the risk of lacking talent. I present evidence from microdata showing that generous social insurance correlates with high intergenerational occupational mobility and that more mobile individuals endorse weaker work norms.

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1. Introduction

This paper proposes a novel view of the interaction between the generosity of social insurance towards the unemployed, the strength of work norms, and economic performance. The prevailing view was developed by Lindbeck (1997), Lindbeck and Nyberg (2006) and Lindbeck et al. (1999). It purports that generous social insurance weakens the work norms endorsed by individuals, i.e. the symbolic value they attach to achieving self-supportiveness through own work. A self-destructive dynamics may then set in as weak work norms increase welfare dependency and worsen macroeconomic performance, which in turn endangers the fiscal sustainability of social insurance. Lindbeck and Nyberg (2006) present cross-country evidence of a negative correlation between self-reported work norms and the share of social expenditure to GDP.

The current paper offers a less negative view of weak work norms and generous social insurance. It grounds on a model of endogenous unemployment insurance where individuals choose a career under imperfect information about their occupational talent. Family ties shape the labor-market outcomes of individuals. Ex post, parents can raise the productivity of their untalented children if they chose the same occupation. The model exhibits two types of equilibria: one with generous unemployment benefits and weak work norms and one with meager benefits and strong work norms. While the latter equilibrium features

better incentives to take up jobs, the former one has a better allocation of talent to occupations. Output and growth need not be higher in the equilibrium with strong work norms, and the two equilibria may coexist. This model thus contributes to explain the so called free-lunch puzzle of the welfare state, i.e. the failure to detect any clear overall negative effect of large tax-financed transfers on GDP.²

My model pins down the role of parenting styles in shaping labor market outcomes. If parents expect high unemployment benefits, they push their children to choose careers with a high expected productivity and a high unemployment risk. To this end, they adopt a liberal parenting style that encourages children to cultivate their talents and does not stigmatize the unemployed. If parents expect meager unemployment benefits, they promote safe career choices with lower expected productivity and lower unemployment risk. To this end, they transmit strong occupational pride in their own occupation and stigmatize the unemployed. Since children that follow their parents' occupational footsteps are protected from professional failure, strong work norms are a way of substituting private for social insurance against unemployment risk.

² That puzzle was put forward by Lindert (2004); see Pestieau (2006) for some qualifications and an overview on social insurance and economic efficiency. As stressed by Bénabou (2000), the variety of national tax-transfer systems can be understood as resulting from multiple equilibria such that none of them dominates the others in terms of long-run economic growth. Alesina and Angeletos (2005) and Bénabou and Tirole (2006) offer related models where the laissez-faire equilibrium outperforms the welfare-state equilibrium.

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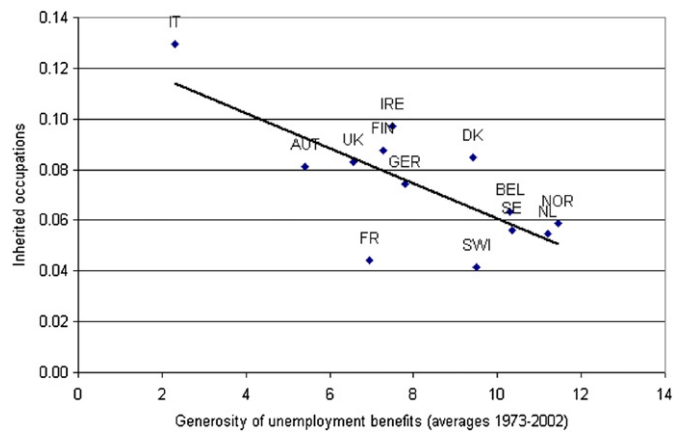


Fig. 1. Generosity of unemployment benefits and intergenerational occupational mobility.

Across equilibria, the generosity of unemployment benefits negatively correlates with the inheritance of occupation along family lines.

Fig. 1 shows that across European countries generous unemployment benefits are indeed correlated with high intergenerational occupational mobility. The generosity index on the horizontal axis captures the ratio of the after-tax unemployment benefit payable to a typical worker to its after-tax wage, as computed by *Scruggs and Allan (2006)*. The vertical axis has the fraction of male adults that follow the occupational footsteps of their fathers. That variable is obtained from the European Values Study of 2008.³ The inheritance of occupations is negatively correlated with the generosity of unemployment benefits and the regression line has a R^2 close to .55.⁴ That negative correlation is robust with respect to controls for individual characteristics of the respondents in the various countries. Taking the country-fixed effects from a regression that explains the probability to inherit the father's occupation yields a scatter plot similar to Fig. 1.

This paper is divided into a theoretical part and an empirical part. After discussing related strands of literature, Sections 3–6 develop a dynamic model of work norms instilled by parents, in which individuals make a career choice with imperfect knowledge of their talent and may become unemployed if they turn out to be unproductive at their chosen occupation. The generosity of social insurance towards the unemployed is determined through voting. The key assumption is that if children are in the same occupation as their parents they are never entirely unproductive, whereas failure is possible if their occupations differ. This captures the idea that when individuals follow their parents' footsteps in the labor market they can profit from both the network of contacts and the occupation-specific human capital that they inherit from their parents, so that unemployment is unlikely even if the individual lacks talent. Using a model of talent-driven endogenous growth, two regimes are obtained as steady states. In one, all children choose their parent's occupation, work norms are strong, and there is neither unemployment nor unemployment insurance. In the alternative regime, children adopt whichever occupation they are likely to be talented for, work norms are weak, and there are both unemployment and unemployment insurance. Even if work norms are weaker, growth can be higher in the welfare-state equilibrium because there are more individuals who are highly productive at their occupation.

The empirical part in Section 7 presents some evidence from individual data that lends support to the main insights of the model. Its key assumption – choosing a parent's occupation protects from unemployment – fits well with the data, as conditional correlations show

³ It refers to the four-digit ISCO code of the occupation of the respondent and his father. All countries for which both sources of information are available have been used.

⁴ A similar negative relationship is obtained when using a general score of generosity of social insurance, which incorporates sickness and pension benefits along with unemployment benefits.

that followers have a lower probability to benefit from unemployment insurance. Moreover, the distinctive predictions of the model are consistent with the data: followers exhibit stronger work norms than individuals who experience intergenerational occupational mobility and the sons of unemployed fathers endorse weaker work norms than other people.

2. Links to the literature

Work norms refer to self-supportiveness: persons who are able to work should work so as to support themselves by their own work and they should not rely on support by others. In *Lindbeck (1997)* the disutility from deviating from such a norm is assumed to decrease with the share of transfer recipients. Since transfer recipients may be individuals who break the norm, his model exhibits a critical-mass effect: the larger the share of the population that violates the norm, the smaller the utility loss from violating it, and the stronger the incentive to live off handouts from the government. There can be both an equilibrium with large norm compliance and ostracism of the unemployed and one where the norm breaks down. *Lindbeck et al. (1999)* show that under endogenous social insurance there can be either a laissez-faire equilibrium, supported by a majority of potential taxpayers, or one with a generous welfare state, supported by a majority of transfer recipients. The laissez-faire equilibrium is the one where the norm is obeyed and the economy thrives. Also in the model of this paper there are equilibria with either weak or strong norms; however, economic performance needs not be better in the equilibrium with strong norms.

Lindbeck and Nyberg (2006) endogenize work norms as the outcome of a purposive socialization process. Parents instill a work norm in their children so as to mitigate children's free-riding on parents' altruism. Social insurance shifts some of the costs of children's free riding from the parents to the government and weakens the incentive for parents to instill a work norm. In a related model, *Gradstein (2010)* allows families to invest in education and shows that education subsidies can prevent work norms from deteriorating. The current paper shares the view that parents purposively influence their children's work norms. However, those norms are modeled as resulting from a broader value system that parents transmit to their children, as in *Corneo and Jeanne (2009, 2010)*.⁵ Values, self-respect and social status depend not only on whether somebody is a transfer recipient or a worker, but also on that person's occupation. This is consistent with the observation that occupational pride and prestige are important ingredients in the choice of careers and occupations (*Arcidiacono, 2004; Dolton et al., 1989; Humlum et al., 2012*).

A few papers have offered models of endogenous work attitudes, as e.g. *Doepke and Zilibotti (2008)* and *Gradstein (2009)*. While work norms refer to self-supportiveness through own work, work attitudes refer to the willingness to substitute leisure for consumption at the margin. Those papers show that the intergenerational transmission of work attitudes can help to explain long-term patterns of income mobility, whereby children of poor parents can overtake children of rich parents. Differently from the current paper, those papers do not deal with social insurance.⁶

Considerable empirical work has been devoted to exploring the relationship between children's and their parents' labor market outcomes. A strand of literature has documented the extent of intergenerational persistence in occupational choice, whereby the father's occupation is found to be an important determinant of the son's occupation. However,

⁵ *Bisin and Verdier (2000)* offer a related approach to the intergenerational transmission of values and attitudes.

⁶ *Algan and Cahuc (2009)* investigate the role of civic virtue in explaining the presence of employment protection rather than unemployment benefits. Civic virtue is endogenized by *Michau (2012)* as a response to unemployment insurance and by *Cervellati and Vanin (2013)* as a response to crime temptation. *Corneo and Grüner (2000)* and *Cervellati et al. (2010)* analyze the role of social stigma and prestige in shaping governmental redistribution in the absence of an insurance motive.

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