



Culturally based beliefs and labor market institutions

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ARTICLE INFO

Article history:

Received 23 December 2009
Received in revised form 7 October 2010
Accepted 16 December 2010

JEL classification:

D7
E24
E6
J3

Keywords:

Culture
Fatalism
Trust in others
Labor market institutions
Employment protection legislation

ABSTRACT

This paper has two main goals. The first is to provide empirical evidence that differences in labor market institutions across countries and, specifically, in how they provide protection to workers, can be attributed to underlying differences in culturally based prior beliefs: in particular, people's fatalism and trust in others. The second goal is to single out the socio-economic determinants of these beliefs and the role of education in this regard.

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1. Introduction

The interactions between culture and institutions and the link between institutions and economic performance are at the forefront of economic analysis. In particular, *fatalism* and *trust in others* appear two among the most important culturally based prior beliefs that impact on institutions. But while the connection between *trust* and institutions has been widely investigated, the role of *fatalism*, notwithstanding its importance in people's socio-economic attitudes, is almost neglected. It is surprising that a personality trait so important in characterizing people's expectations concerning the link between actions and results has received so little attention, particularly in regard to analysis of the labor market and its institutions.

The assumption adopted here, and which finds support in the empirical as well as theoretical literature (Guiso et al., 2002, 2006, 2009; Tabellini, 2005), is that culturally based prior beliefs are quite stable and that they can consequently be treated as exogenous factors in the political process leading to the implementation of labor market institutions.

On these premises, the first goal of our paper is to verify whether international differences in the way protection is provided

to workers, and in particular, in the extent of job protection, may reflect underlying differences in culturally based beliefs. Drawing on D'Orlando and Ferrante (2008, 2009), we point out that *fatalism* and *trust in others* have major impacts on the demand for labor market regulation and, in particular, on the demand for job protection, i.e. employment protection legislation. From this it follows that differences in the levels of *fatalism* and *trust in others*, to the extent that people's preferences affect the choices of institutions, might explain the existing differences in labor market regulations among countries and the extent of political opposition to deregulation.

The second goal of our paper is to investigate the socio-economic and demographic traits that appear to be associated with *fatalism* and *trust in others*. Specifically, as to be expected, we find that people's prior beliefs depend, over and above the effects of their innate propensities and socioeconomic backgrounds, on their cognitive skills and on non-cognitive traits acquired through education. On these grounds, we suggest that poorly educated individuals are those most affected by culturally transmitted beliefs such as *fatalism* and *trust in others*.

In order to provide support for these contentions we carry out an empirical investigation based on the World Value Survey (EUROPEAN AND WORLD VALUES SURVEYS, 2006) which expands and strengthens D'Orlando and Ferrante's (2008, 2009) analysis. Like Aghion et al. (2009), we find that *trust in others* is negatively related to the demand for job protection and, like D'Orlando and Ferrante (2008, 2009), we find a positive relation between *fatalism* and the demand for job protection. Moreover, our estimates

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Table 1
EPL rigidity index and average replacement ratio in 20 OECD countries.

| Country | EPL 1982 | EPL 1992 | EPL 2002 | RR 1982 | RR 1992 | RR 2002 |
|---------------|-------------|-------------|-------------|------------|------------|------------|
| Australia | 0.90 | 0.90 | 1.20 | 21.95 | 26.45 | 23.49 |
| Austria | 2.20 | 2.20 | 2.20 | 32.67 | 34.80 | 38.96 |
| Belgium | 3.20 | 3.20 | 2.20 | 51.22 | 47.95 | 45.49 |
| Canada | 0.80 | 0.80 | 0.80 | 55.85 | 57.80 | 45.56 |
| Switzerland | 1.10 | 1.10 | 1.10 | 38.20 | 67.65 | 75.00 |
| Germany | 3.20 | 3.20 | 2.35 | 39.00 | 38.00 | 37.95 |
| Denmark | 2.30 | 2.30 | 1.40 | 79.25 | 75.50 | 64.42 |
| Spain | 3.80 | 3.80 | 3.10 | 77.25 | 67.75 | 63.53 |
| Finland | 2.30 | 2.17 | 2.00 | 31.87 | 59.81 | 53.62 |
| France | 2.78 | 3.00 | 3.00 | 59.50 | 58.40 | 61.30 |
| Great Britain | 0.60 | 0.60 | 0.70 | 29.45 | 23.05 | 18.46 |
| Ireland | 0.90 | 0.90 | 0.90 | 53.06 | 43.56 | 36.93 |
| Italy | 3.60 | 3.60 | 2.13 | 1.81 | 8.81 | 58.31 |
| Japan | 2.69 | 2.12 | 1.80 | 26.20 | 29.80 | 25.35 |
| Netherlands | 2.70 | 2.70 | 2.10 | 65.00 | 70.00 | 70.99 |
| Norway | 2.90 | 2.90 | 2.60 | 48.00 | 61.50 | 63.79 |
| New Zealand | 0.90 | 0.90 | 1.50 | 29.42 | 29.29 | 27.96 |
| Portugal | 4.10 | 3.85 | 3.70 | 23.64 | 65.00 | 69.66 |
| Sweden | 3.50 | 3.50 | 2.20 | 84.10 | 87.25 | 75.77 |
| USA | 0.20 | 0.20 | 0.20 | 32.55 | 25.15 | 29.19 |

Source: Bassanini and Duval (2006).

show that employment protection legislation and unemployment benefits are effective means with which to reduce the workers' perception of insecurity and that, in this regard, the quality of the legal system matters as well.

The paper is organized as follows. Section 1 furnishes evidence of the main differences existing among the levels and modes of protecting workers and their families against unemployment risk in the OECD; Section 2 discusses the influence of culturally based prior beliefs on labor market institutions; Section 3 presents the empirical strategy and results; Section 4 concludes.

1.1. Some empirical evidence: labor market institutions in OECD countries

Workers can be protected against unemployment by means of two main labor market institutions: unemployment benefits (UB) and employment protection legislation (EPL). It is a matter of interest to determine whether different countries have used these two instruments in different ways and, if so, to try to understand why they have done so.

Empirical evidence confirms that the combination of these two forms of protection differs greatly among the 20 OECD countries examined. Table 1 reports EPL, this being the well-known OECD index of labor market rigidity which takes account of a large set of factors regarding labor contract regulations (Nicoletti et al., 2000), and the replacement ratio RR, i.e. an index of generosity of UB, for 20 countries and for three years (1982, 1992, 2002). In particular, RR is given by the average benefit replacement rate¹ during the first year of unemployment.

The 20 countries considered here can be divided into two groups: Australia, Canada, Great Britain, Ireland, New Zealand, Switzerland, USA are characterized by low levels of EPL stringency, while Austria, Belgium, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Norway, Portugal, Spain, Sweden display relatively high levels of stringency. The Scandinavian, Mediterranean (especially in the last decade) and Central European countries (with the exception of Austria and Germany) tend to exhibit more generous replacement ratios than both the English-speaking European countries and the other extra-European countries (with the excep-

tion of Canada). We also created a normalized version of EPL and RR dividing the indicators by the respective sample maximum. In Fig. 1a–c we plot the normalized RR against the normalized EPL for three years (1982, 1992, 2002) in order to gain an immediate picture of different countries' choices between regulation and benefits. The three figures suggest that there have been no major changes over time.

As shown by Table 2, which reports the stringency of EPL for regular (EPL reg) and temporary (EPL temp) contracts, reforms in countries characterized by strict regulation have been implemented principally by giving greater flexibility to temporary contracts while leaving permanent ones unchanged, thereby creating a "dual" labor market.

The economic literature has proposed various explanations for these different attitudes to workers' protection. Here we briefly discuss the most frequent of them.

2. Culturally based beliefs and the demand for job protection

2.1. Why protect workers and how?

The economic literature puts forward two main explanations for the origin of employment protection legislation and unemployment benefits. On the one hand, there is the belief that the existence of these labor market institutions reflects the equilibrium resulting from the interaction between insiders (employed workers) and outsiders (unemployed workers). If the former have more political power, they are able to impose a system of job protection that strengthens their bargaining position at the expense of the unemployed and of society as a whole (Saint-Paul, 1993, 1996, 1997, 2002; Boeri et al., 2004). In this regard, Boeri et al. (2004) have shown the existence of a trade-off between EPL and UB, where the different locations of countries along this continuum stem from heterogeneity in the skills levels of labor force. In particular, they argue that, given the redistributive nature of EPL (from high-skilled to low-skilled workers), countries characterized by a less skilled labor force and a compressed wage structure (with low wage differentials between high- and low-skilled workers) should prefer EPL to UB.

On the other hand, there is the view that employment protection legislation is an instrument that furnishes social insurance to risk-adverse workers in an incomplete market context (Acemoglu and

¹ See Clark and Postel-Vinay (2005) for a brief discussion of the advantages/disadvantages of using indicators of this type.

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