

The Limits to Policy Transfer in the EU: the Impact of Culture on Female Labour Supply in Europe.

The case of childcare policy reform in Germany

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Note: This is work in progress towards one of the three papers of my thesis. At the moment I am about to start the empirical analysis. As a result, this paper is not a stand-alone piece, but only an introduction to the research question of my thesis and the argument and methodology of my first paper.

Abstract

The idea that social and family values - or in more general terms, culture - influence economic outcomes has gradually gained acceptance amongst economists. Beyond this claim there is, however, a lack of consensus on the level of “determinism” posed by the statement, and particularly, on the role of policy on bringing about – or not – a cultural change. My thesis attempts to cast light onto this matter. Particularly, I am interested in answering the following research question. In the case in which a certain policy change does not complement – to borrow the Varieties of Capitalism (VoC) terminology – the existing cultural framework, will this policy change crowd out culture and deliver the expected outcome or, on the contrary, will it experience a clash with the cultural framework and deliver a different outcome?

In section I I introduce the topic of my research and review the existing literature on culture and policy. In section II I introduce the argument and the methodology of my first case study.

I. Introduction

The idea that culture¹ influences economic outcomes is not a new one. Max Weber already developed it in his seminal work *The Protestant Ethic and the Spirit of Capitalism* (1905:2002), and by the 1990s economists had already started considering culture as a variable of interest for their studies. La Porta, Lopez de Silanes, Shleifer & Vishny(1997), Knack and Keefer (1997) and Greif (1989) among others claimed the existence of a connection between culture and economic development, testing the hypothesis about the importance of the former, previously highlighted by some political scientists such as Francis Fukuyama (1995) or David Landes (1998).

The number of studies dealing with culture and economics has experienced an increase in the twenty-first century. The works of Barro and McCleary (2003), Tabellini (2010), Guiso, Sapienza and Zingales (2004, 2009), Ichino and Maggi (2000) among others have cast light on the multiple ways culture can affect economic outcomes.

At the same time, the cultural argument has been put forward in several other fields within economics, such as labour economics, which is the one my thesis is concerned with. Within this field there is a wide consensus on the relevance of culture in shaping labour market outcomes. Freeman and Schettkat (2001) have argued that culture and preferences have partially accounted for differential marketization of traditional services between the US and Europe. Giavazzi, Schiantarelli and Serafinelli (2009) have thrown light on the social attitudes towards women and young people and the impact of the former on employment rates and hours worked. In the same vein, Raquel Fernandez has dedicated several papers on fertility and female employment outcomes (see inter alia Fernandez & Fogli, 2009; Fernandez, Fogli, & Olivetti, 2004) stating that preferences and beliefs with regard to women's roles in the labour market have considerably shaped fertility and employment decisions. Concurrently, there has been a group of scholars (see for instance Aghion, Algan&Cahuc(2011); Algan and Cahuc(2007); Aghion, Algan, Cahuc & Schleifer(2010); Alesina, Algan, Cahuc & Giuliano (2010)) who have examined the impact of culture on labour market institutions and policies. One common focus has been to look at the co-evolution between culture, demand for regulation (behaviour) and policy design. Culture, it is argued, influences the demand for certain type of regulation, which, at the same time reinforces certain attitudes. In this context two possible equilibria emerge; one 'good' equilibrium with low levels of regulation and high levels of civic virtue and a 'bad' equilibrium with the opposite results.

The consensus of most of the literature focusing on the impact of culture on both labour market policies and outcomes is that culture matters. Beyond this claim there is, however, a

¹ In this paper, following the existing literature on culture and economics, the word 'culture' is understood as a set of beliefs and values which shape economic outcomes and policies. Later on I provide a more thorough explanation of the use of the concept 'culture' in my thesis.

lack of consensus on the level of “determinism” posed by the statement. One strand of literature attributes a limited role to policy when it comes to shape values. Those are perceived as rather static and difficult to change. Policy and culture feed back into each other forming a spiral from which is difficult to get out. Aghion, Algan, Cahuc & Schleifer (2010) suggest in a paper that even when one tries to break the spiral by applying an exogenous policy to a certain cultural context, the attempt may well fail and deliver unexpected results. The example they use is the liberalization challenge experienced by communist countries after communism, which, they argue, did not result in a more liberalized economy but rather in an increase in corruption and in the demand for regulation. In the same vein, Algan and Cahuc (2007) look at how an exogenous shock – namely the decrease in price of household durable goods – has an impact on employment rates of different demographic groups across countries. Their results suggest that the impact of the exogenous events differ depending on the cultural framework, which remains fairly unchanged. Conversely, another strand of literature rejects the notion of slow-changing values and attributes a larger role to policy on shaping values, placing emphasis on the feasibility of exogenous events – be it shocks or policies – leading to cultural change. Authors such as Raquel Fernandez (2010) argue that cultural change “depends on the environment broadly speaking, including the opportunities which determine individual’s learning pace, their interactions with others, and particular historical experiences” (p. 4). She explicitly rejects the vision that culture is “irrational, static or slow changing” (p. 4), and she mentions examples from historical experiences such as Communism or the current crisis which have shaped and changed certain attitudes.

Therefore, while there is a broad consensus on the fact that culture affects policy and outcomes, it is not entirely clear *in which situations* cultural change is – or is not -caused.

My thesis attempts to cast light onto this matter. Particularly, I am interested in exploring the role of policy change on bringing about – or not – cultural change. **That is, in the case in which a certain policy change does not complement – to borrow the Varieties of Capitalism (VoC) terminology – the existing cultural framework, will this policy change crowd out culture and deliver the expected outcome or, on the contrary, will it experience a clash with the cultural framework and deliver a different outcome?** In my view, three outcomes may arise. After a policy is introduced in places with different cultural frameworks, we can observe three possible scenarios:

- *Scenario 1:* Culture does not matter, i.e. the cultural filter does not affect the result of the new policy, and therefore the outcome is the same regardless of the cultural framework in place.
- *Scenario 2:* Culture matters and therefore different cultural frameworks lead to different final outcomes. However, the introduction of the policy eventually induces a cultural change (crowding out of the cultural framework).

- *Scenario 3*: Culture matters and therefore different cultural frameworks lead to different final outcomes. Moreover, the introduction of the policy does not induce cultural change and the different outcomes are preserved (a clash between culture and policy is produced).

Female labour supply is one field within the labour market framework in which testing my scenarios could lead to interesting results. Although female employment has generally increased across Europe in the last decade, differences among countries are still salient. As Pissarides and colleagues pointed out in a book (Del Boca, Pissarides, Boeri, & Fondazione Rodolfo De Benedetti, 2005), after accounting for institutional differences, *“there are still big gaps in our knowledge of the reasons for the large differences in employment patterns, which are most pronounced when we compare northern European countries with the Mediterranean south”* (p. 10). This statement invites not only the inclusion of cultural aspects in the analysis of female labour supply - as several authors have already done - but also the analysis of policies related to female labour supply and the interrelation of the former with certain cultural aspects.

Three social policies which are very likely to exert an impact on female employment patterns are the formalization of childcare, formalization of long-term care and active labour market policies. Moreover, these three policies are prone to be interrelated with cultural aspects, especially family values. At the same time, they are of special relevance in a European context and for the European integration process. Policy-wise, the European Union is encouraging convergence of certain policies and outcomes (e.g. childcare, long term care), and labour market policies are no exception. Although the choice of policy is ultimately left to the state, there is little doubt that these recommendations have an effect on the policy direction adopted by each state. These policies, however, and following the argument stated above, may have different results depending not only on the existing institutional framework of the country but also on its cultural framework. This one presents variations across countries stemming on the one hand from different patterns of co-evolution of the institutional and cultural framework and on the other hand from different patterns of migration. The latter has been an increasing phenomenon which has implications for the cultural framework and therefore cannot be ignored at the time of designing labour market policies.

What is culture?

Before introducing my first case study, the word “culture”, central to my work, should be clarified. In the literature culture is understood as ‘a system of collective constructions of meaning by which human beings define reality’ (Neidhard et al. 1986, p.11 cited in Pfau-Effinger, 2005). Culture is, as it can be seen, a very broad concept with different meanings

and interpretations. In order to study its interaction with policy, it needs to be narrowed down. In my analysis I focus on family values – that is, the relevance given to the family as a nuclear group - and how they interact with childcare policy.

II. Childcare policy reform and culture

The argument

According to labour economic theory (Borjas, 2010; Ehrenberg & Smith, 2009) the effect of a childcare policy on labour supply and hours worked will be different depending on the policy instruments used, those usually being child and childcare benefits, tax credits or childcare subsidies. In the literature there is consensus that for mothers who are already in the labour market, child benefits will reduce the number of hours worked (Borjas, 2010; Ehrenberg & Smith, 2009). The result of an increase in tax credit and childcare subsidies is not clear though, since it will depend on which effect – the income or substitution effect – dominates. The rationale is that given an increase in, say, childcare subsidies, the effective wage rate increases and therefore the individual's demand for leisure (or housework) also increases. Nonetheless, at the same time, a wage increase makes leisure (or housework) more expensive and incentivizes the individual to work more.

Policy instruments will not be the only factors influencing the result of the policy. Individual preferences, represented by the indifference curves, will also shape the policy outcomes. However, labour economic theory usually treats them as given, for obvious reasons. Every individual may have different preferences and it is difficult to determine its shape. In this paper I argue that, while the common overlook of preferences is justified, taking into account one aspect of preferences to the model – i.e family values - can help clarify the impact of the policy. Family values are likely to be very influential in labour market matters, and especially with those related to childcare, and therefore, should be taken into account.

In the case of a tax credit or childcare subsidy policy, cultural values may shed light on which one of the two effects –the income or substitution effect - dominates. That is, the income effect will tend to dominate over the substitution effect for mothers with high family-values, other things being equal. Instead, for mothers with low family-values, the substitution effect will tend to dominate, again other things being equal. This does not have to be necessarily the case if family-values are only slightly dissimilar. However, if the income effect is sufficiently large in the long-term, thus supporting the theoretical predictions, relevant policy implications on the limits to policy transfer would arise. In the case of child and childcare benefits, adding cultural values will not change the direction of the effect, but it might influence its intensity, leading to weak policy outcomes.

This theoretical framework and the consequent predictions are therefore directly related with the research question stated above, shedding light on to whether values are effectively

crowded out or, on the contrary, they experience a clash with the policy and render the policy unsuccessful.

Germany is a good country case study (in the next section I explain the reasons for not doing a comparative case study). The country has passed several childcare reforms in 1979, 1986, 2000 and 2007, slowly shifting from a breadwinner model – in which it is assumed that one parent stays at home and the other parent works- to a “dual-earner household model” (Leitner (2010), Spiess and Wrohlich (2008)) . The shift has been most notable from 2000 on, and especially in the 2007 reform, when the parental leave benefit was increased but the period for which the benefit would be in place was reduced from two to one years.

Methodology

Following Fernandez (2007) my analysis will be based on an epidemiological approach, thus studying the impact of a family policy reform - which decreased the paid parental leave period from two to one year in Germany - on labour supply across different female migrants groups and between these groups and native German groups, using the GSOEP micro-panel database. This approach allows me to separate the effects of culture from the economic and institutional environment of the country, something that a comparative analysis between two different countries on the same childcare reform would not allow me to do. The basis for clustering the individuals in different groups will be family values. That is, I will cluster them according to whether they hold high or low family values. In order to avoid problems of reverse causality (i.e. current attitudes may have been influenced by previous economic outcomes), I will use an instrumental variable for current values, which are values expressed by individuals in the migrant’s country of ancestry in previous years. To do so, I will rely on the World Value Survey (WVS) and pick up one or more questions which reveal attitudes towards women’s work. I will then compare it across countries and elaborate the clusters, which will be used for my policy analysis.

The analysis of the policy reform will have two parts. Firstly, I will analyse the impact of the policy reform in order to see whether culture matters (i.e. testing scenario 1). I will perform an econometric analysis where my dependent variable will be return-to-work rate or, alternatively, number of hours worked. The choice of my dependent variable is linked to the econometric approach chosen. One option is to do a *regression discontinuity analysis* (RD analysis). This approach analyses the outcome – say, return-to-work rates – of two groups of people which experience the same event – in this case, giving birth to a child – but only part of this group is eligible for a treatment – in my case, the treatment is the reduced years of paid parental leave which happens from January 2007 onwards. The eligibility is arbitrary and does not depend nor can be influenced by the personal characteristics of the individuals. In my analysis this would entail taking individuals who have given birth just before January 2007 and just after this date, observe their choice of parental leave and compare the

differences in choices for each cluster of individuals. What I expect to see is, for the high-family values cluster, an insignificant effect of the reform on the return-to-work rate, i.e. I expect mothers to stay at home more than one year regardless of the decrease in their income. Instead, for the low family values cluster I expect to see a significant impact of the reform in the return-to-work rate, increasing it. It has to be noted that in order for this approach to work, the only thing that has to change discontinuously is the treatment. One main drawback of the RD analysis is that, in order to infer causality, only the subjects close to the cut-off point can be included in the regression, and therefore, the size of the sample might be a too small to get good estimates.

An alternative to this approach is to pursue a difference-in-difference analysis (DiD) for each cluster of individuals. In this case, my dependent variable would be the number of hours worked, which would be examined before and after the policy between a treatment and a control group for the different clusters of individuals (that is, one DiD analysis for each cluster). My treatment group would be these female individuals who receive the childcare benefit and the control group will be the ones who have not received it (in theory childless women). I would then compare the impact of the policy (i.e. I would look at the interaction coefficient of each regression) for each cluster. As in the RD analysis, I expect that the impact of the policy is lower in the cluster including families with high family values. One key assumption in the DiD approach is that the treatment and control group would have developed in similar ways in the absence of the treatment. This assumption is crucial in order to control for any omitted variable that does not vary differentially between the treatment and control group, and therefore it has to be checked when doing the DiD analysis. The second part of my empirical analysis will aim at testing scenarios 2 and 3 (I expect – based on previous studies about the relevance of culture to labour market outcomes – that scenario 1 will suggest that culture matters). The difference between the two scenarios is the existence of a cultural change. I assume that if this is happening, it will not happen right after the policy is implemented, and therefore I will have to look at the impact of the same policy on labour market outcomes between different “cultural” clusters beyond the short term. In order to do so, I will reproduce a similar DiD analysis in a later year (say 2011) with a different sample of mothers. In this case, however, there “treatment” applied will not be the policy but the fact of “giving birth”. That is, I will look at the difference in number of hours worked between the treatment and control group and between the different clusters of individuals. I will then compare the interaction coefficient (i.e. the coefficient which tells me the impact of the policy) of the two clusters with the interaction coefficient of the samples in 2007, to see if there is any significant difference in the outcomes. If the interaction coefficient in 2011 corresponding to the high-family values cluster is lower than the one from the same cluster in 2007, it can be claimed that the policy has had more effect on the long-term, which suggests that there is a cultural change taking place. In other words,

it is suggested that there is a process of cultural (family-values) crowding out. If instead, the coefficient corresponding to 2011 is similar (or higher) to the one from 2007, it can be claimed that the impact of the policy has not increased with time, and therefore, this suggests that policy keeps clashing with certain family-values even after a certain period of time.

Data

Data on country of origin, parents' country of birth (to see whether they are first or second generation migrants), employment status, hours worked and childcare benefits information are some of the relevant variables which are available at the German Socio-Economic Panel (GSOEP), a longitudinal database running from 1984 to 2011. The database's sample has been gradually increasing since its creation, and since the last addition of individuals – which took place in 2000 - it accounts for approximately 15.000 households interviewed every year. From these, 7.000 are first or second generation migrants.

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