

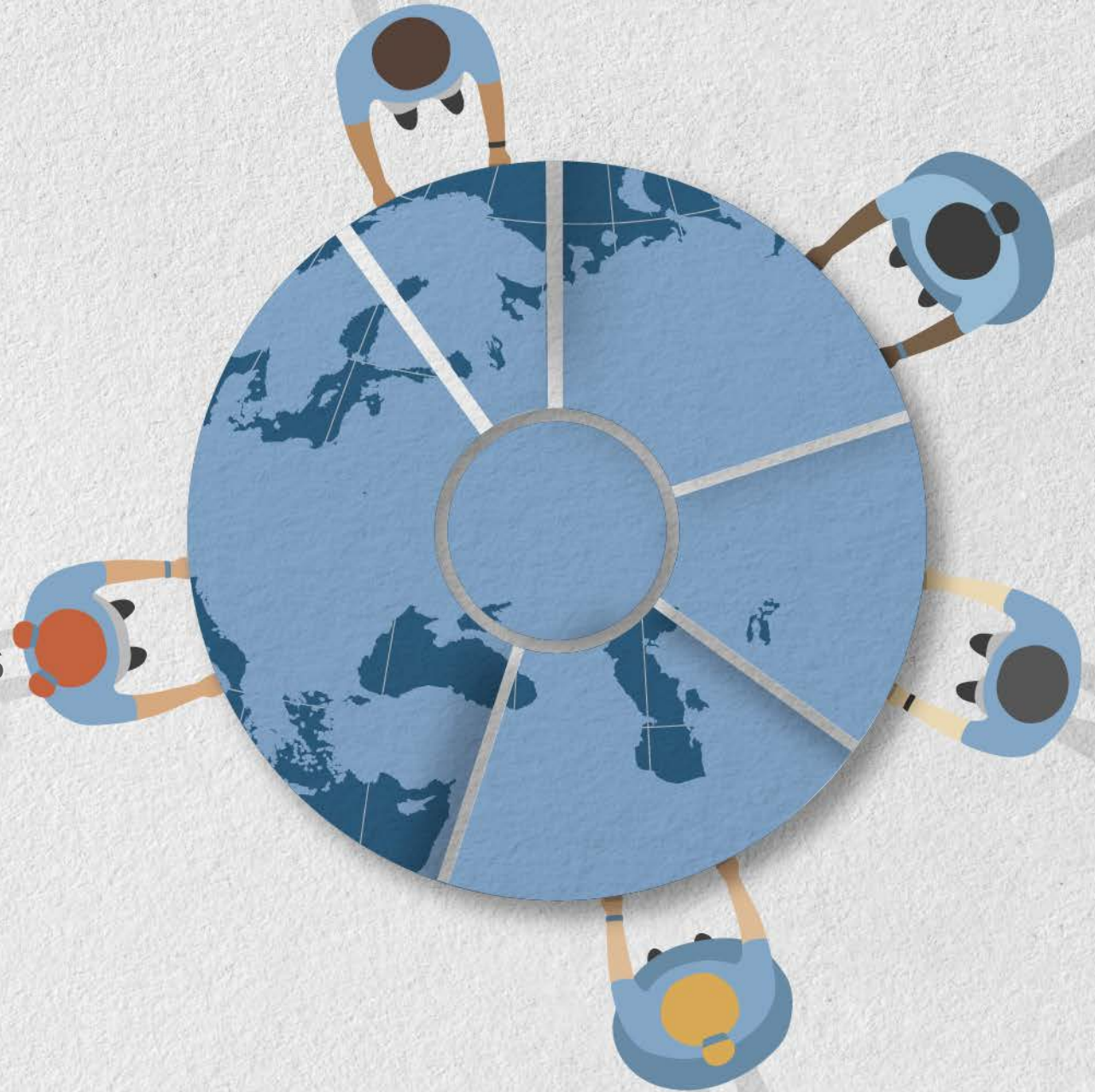
**Bruegel**

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# Toward a New Social Contract:

## Taking on Distributional Tensions in Europe and Central Asia

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# Toward a New Social Contract:

## Taking on Distributional Tensions in Europe and Central Asia

- Globalization, technological change, and aging, have created opportunities, but also intensified cleavages within societies.
- Four main contributions:
  1. Draw attention to the *changing nature of inequality* and provide new evidence that insecurity and risks are not shared equally (beyond income).
    - Rising ‘horizontal’ inequality (disparities among groups); and persistent inequality of opportunity.
  2. Domestic institutions of conflict-management are *not anymore very effective* in reducing emerging distributional tensions.
  3. *Perceptions* of inequality and demand for corrective action are rising;
    - Gap between subjective perceptions of inequality and objective inequality.
  4. Principles for redesigning the social contract: universalism, security, progressivity.

# Why Social Contract?



# Why “Social Contract”?

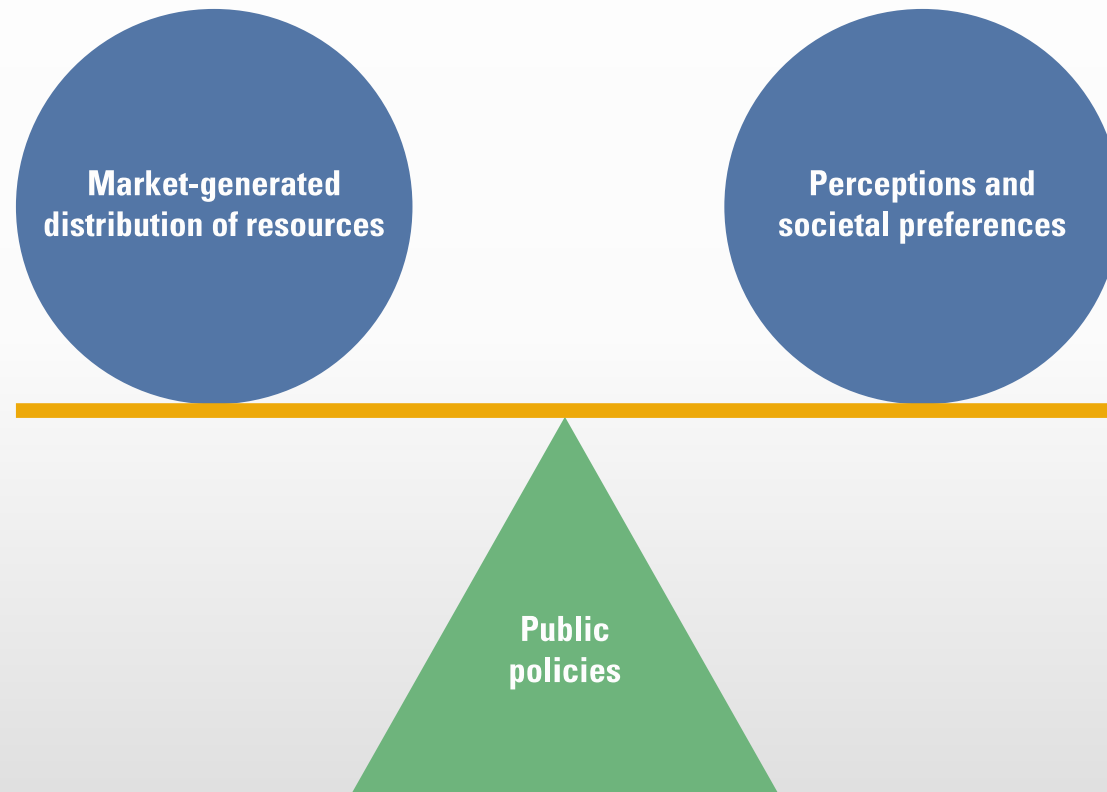
A stable social contract is achieved when there is an dynamic ‘equilibrium’ among:

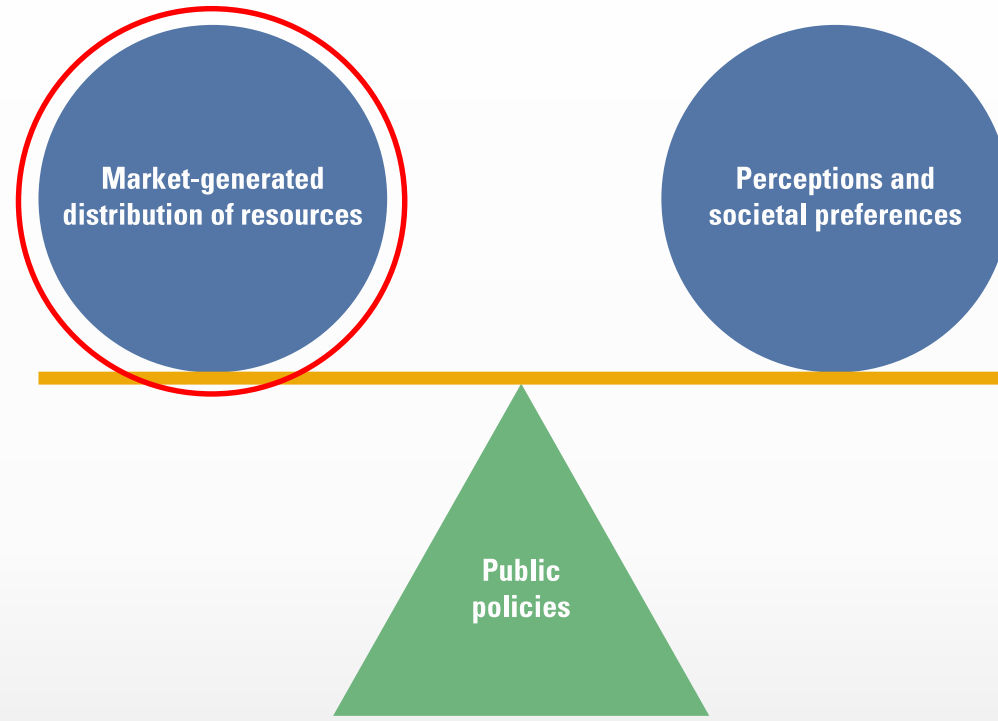
1. Distribution of resources generated by market forces;
2. Public redistribution and social protection against risks;
3. Social preferences for equity-redistribution, which are the complex product of beliefs, perceptions, social values and social norms;

Social contract a la Binmore (1998) as an equilibrium of a game; or Kanbur (1999), in the context of optimal taxation; also see Rodrik (1999): shocks, distributional conflict and growth.

Different from Hobbes, Locke, Rousseau.

# A stable social contract





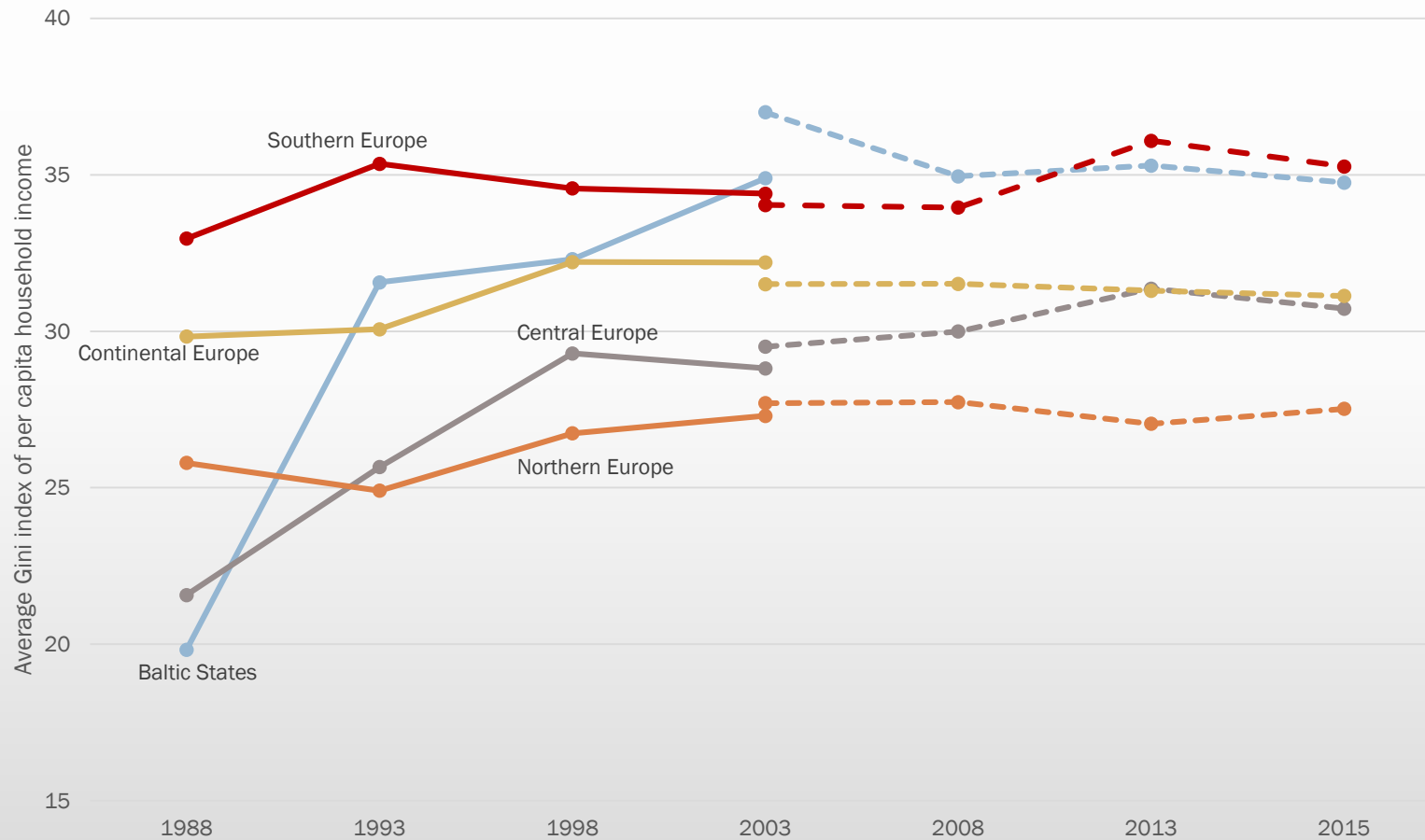
# Market-related Distributional Tensions

## Contribution 1:

Draw attention to the changing nature of inequality and provide new evidence that insecurity and risks are not shared equally.

# Vertical Inequality

Trends in income inequality,  
European Union, 1988–2015



# Distributional tensions

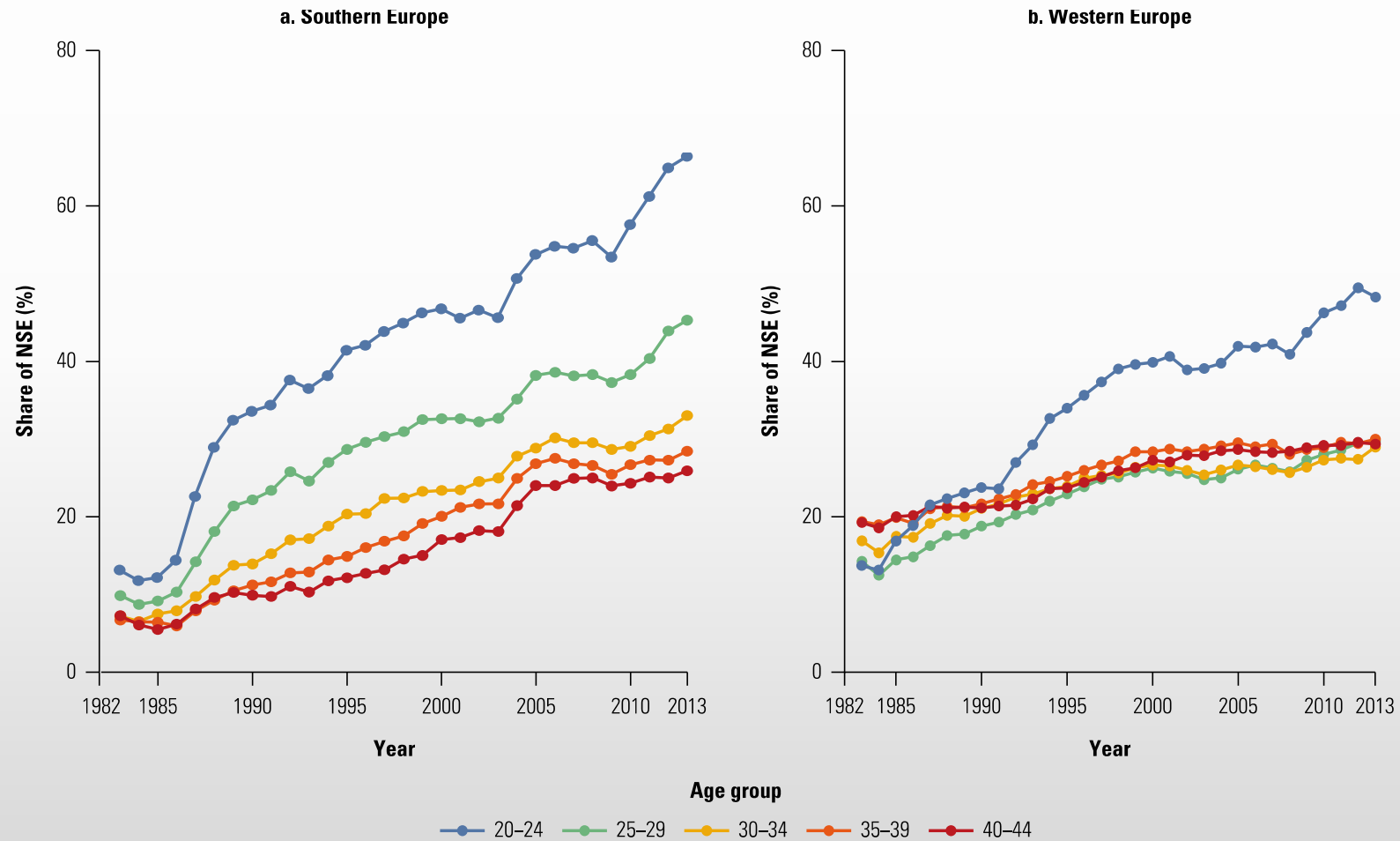
## *Horizontal inequality*

- Disparities across three key groups:
  - Generations (or birth cohorts);
  - Workers;
  - Regions;

## *Inequality of opportunity - Fairness*

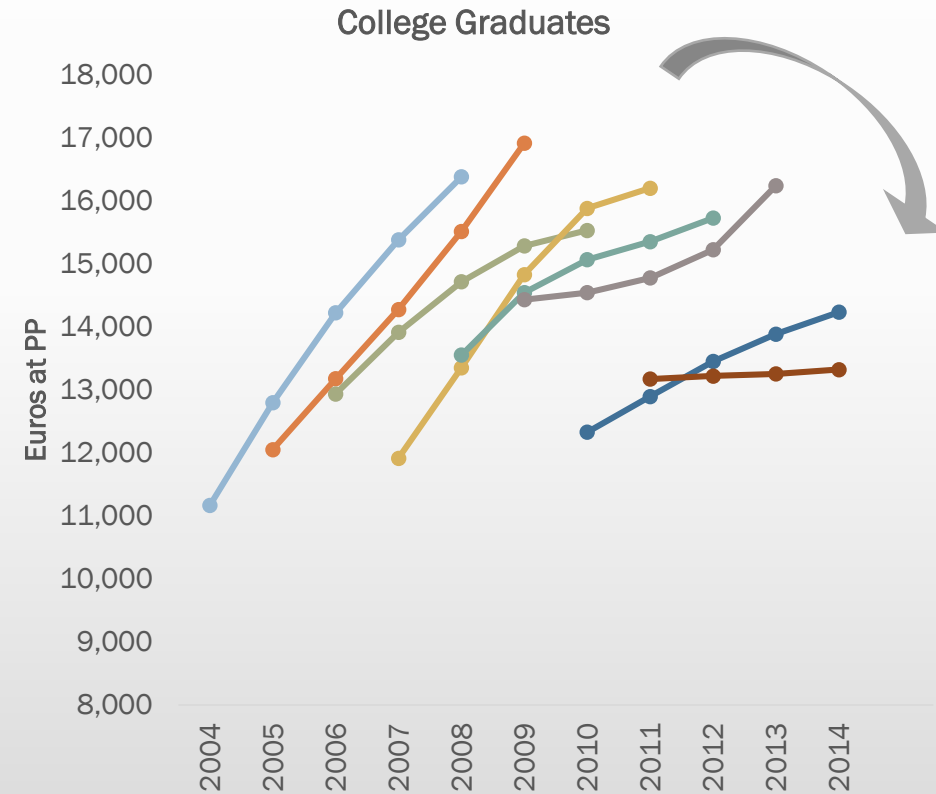
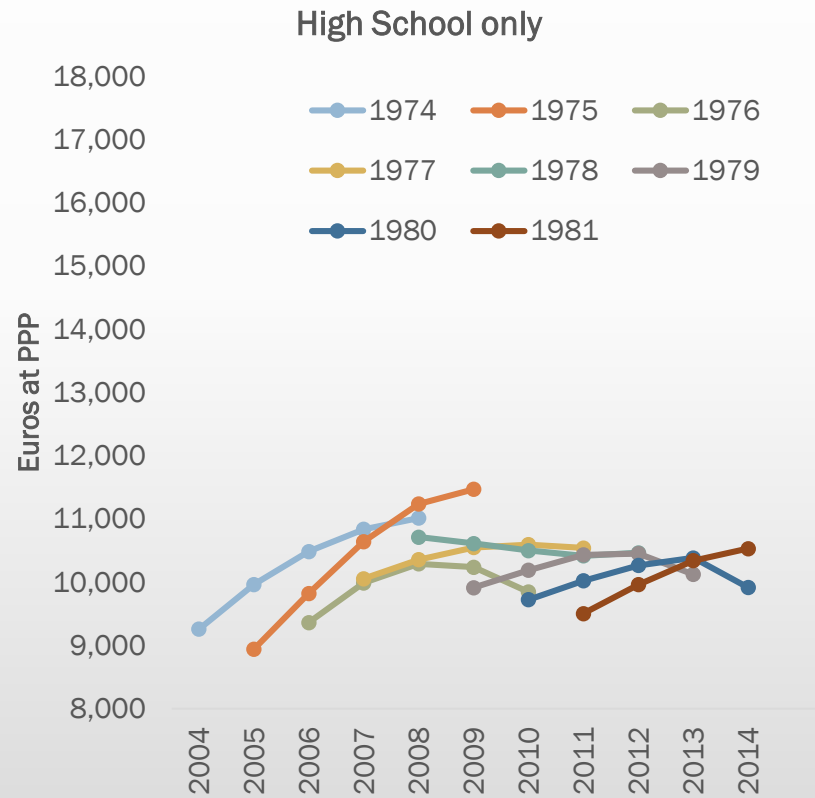


# Intergenerational divide: The incidence of Non Standard Employment



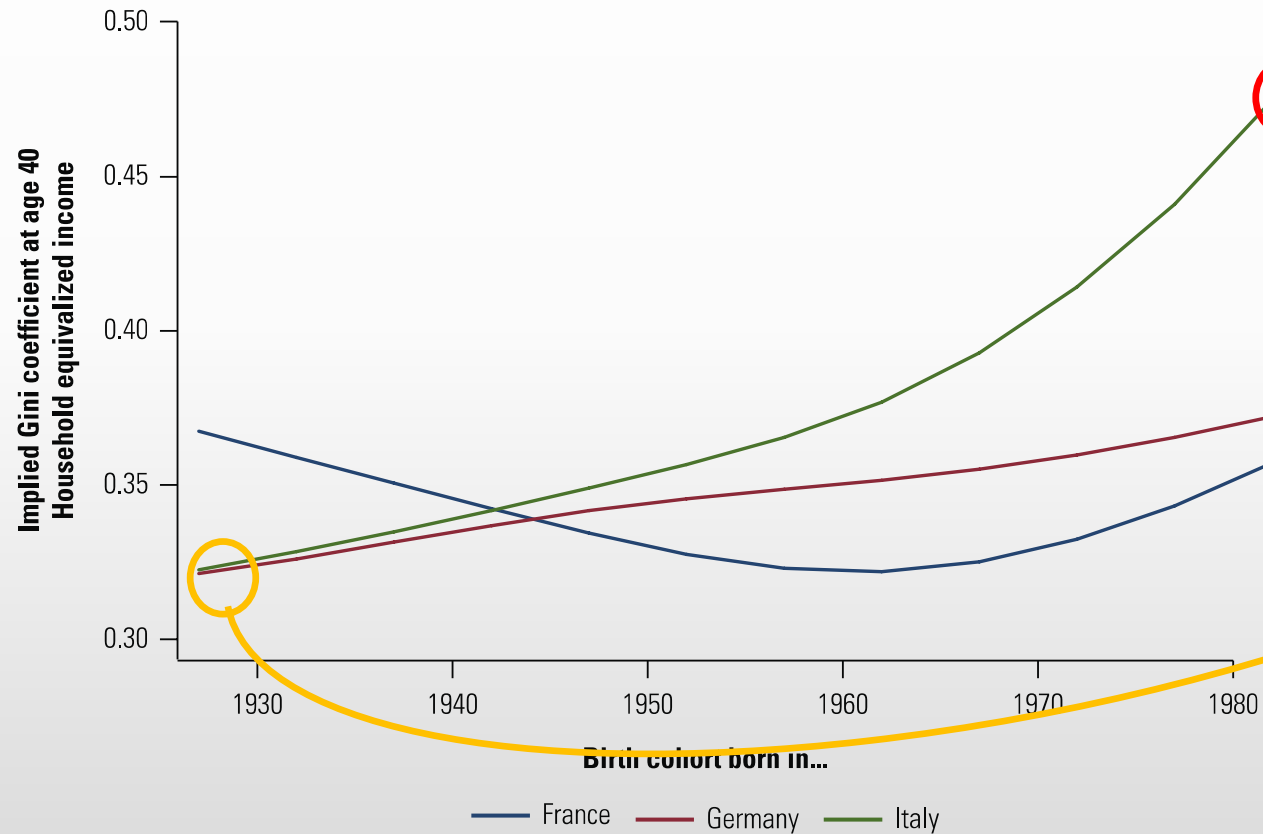
# The declining fortunes of the young

Southern Europe  
Annual income by cohort (30-34 age group)



# An intergenerational divide: within-cohort inequality

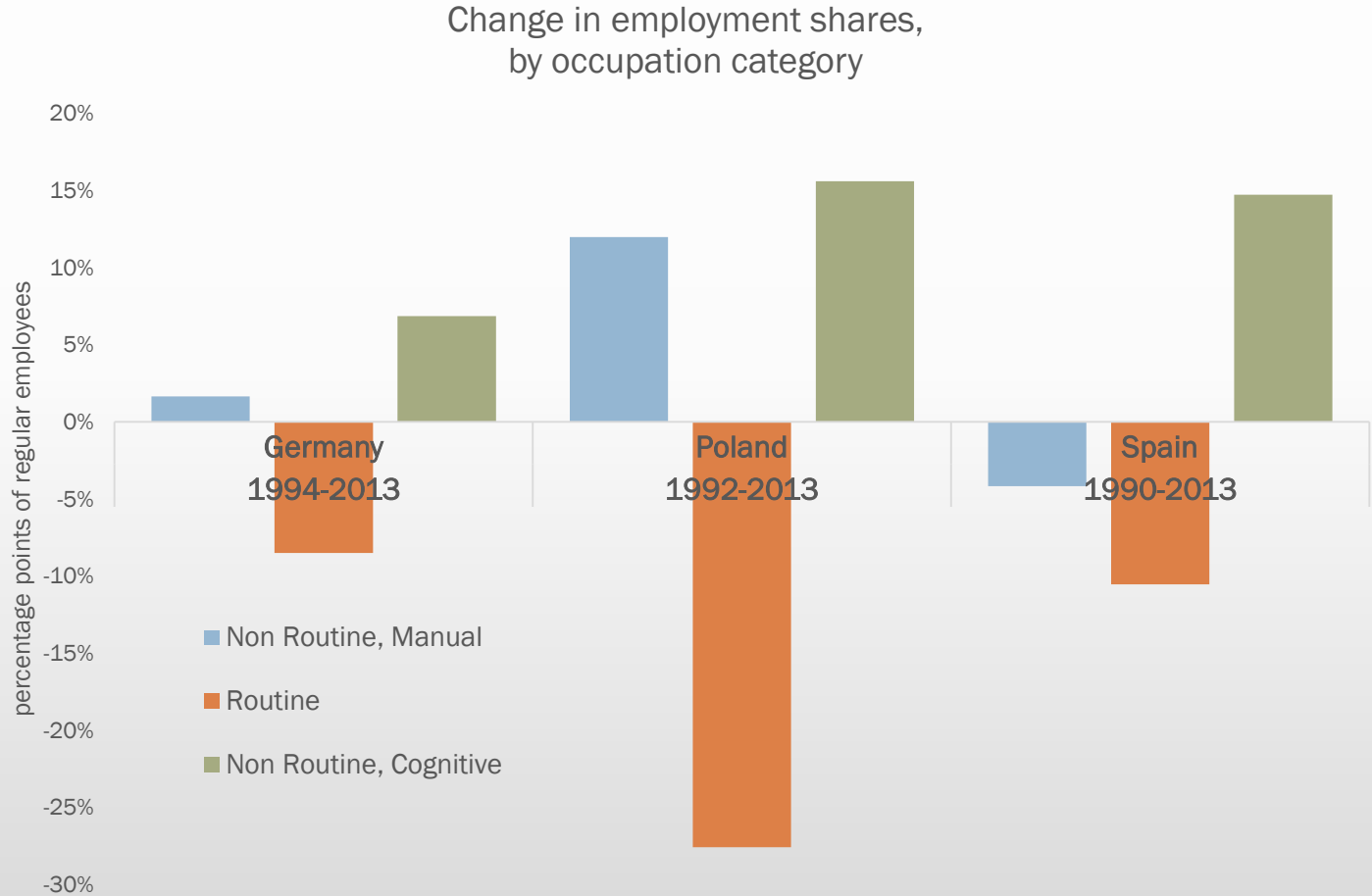
Income inequality by birth cohort



Italy		
Cohort	Gini coefficient	Equivalent to:
1930-35	0.319	Japan
1945-50	0.329	France
1960-65	0.380	UK
1980-84	0.486	Chile

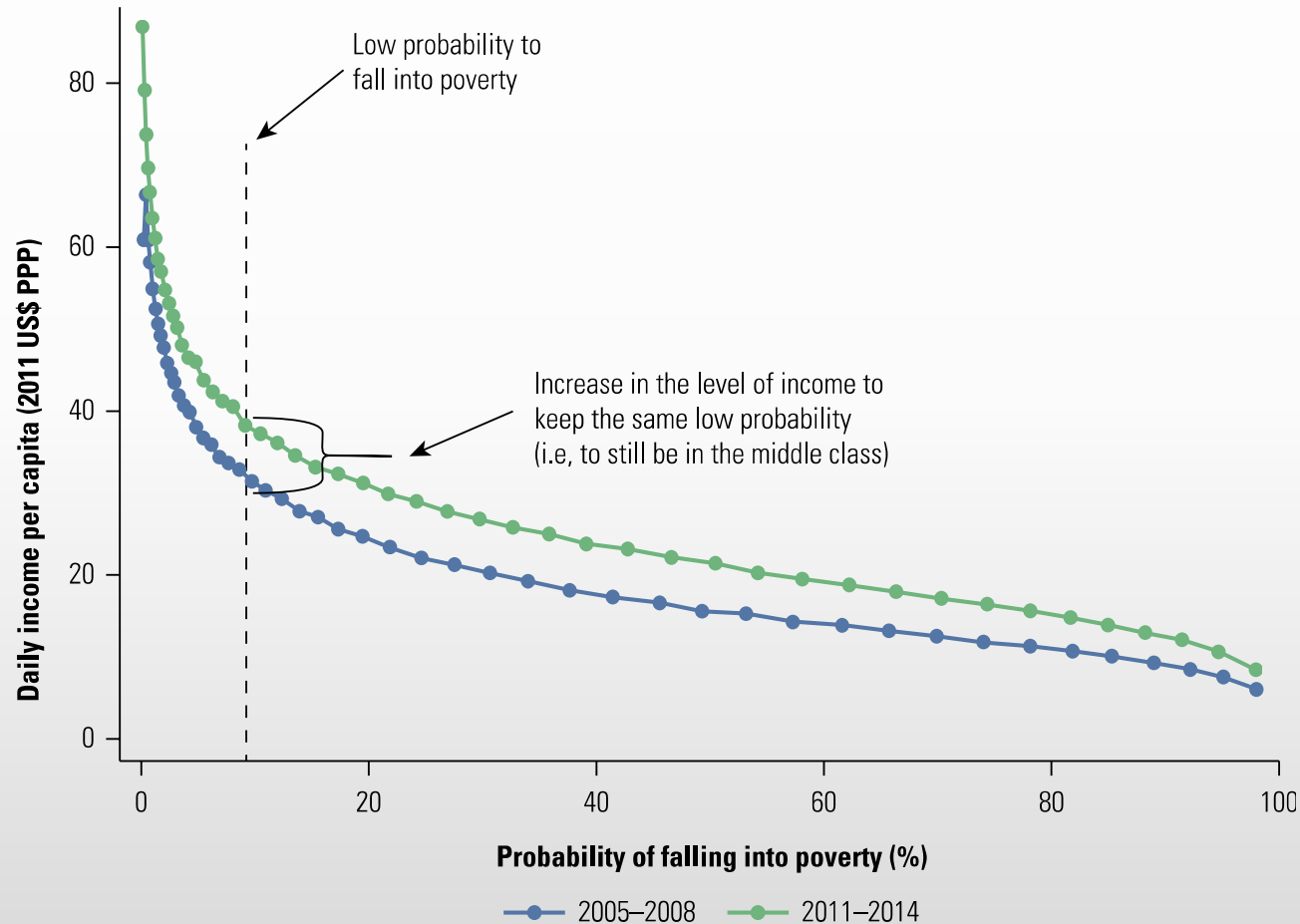
Note: Calculations using a Deaton-Paxson cohort-age-time decomposition regression, and assuming log-normality

# Occupational Polarization



Source: Bussolo, Torre and Winkler (forthcoming background paper)

# An example of insecurity: Vulnerability of the middle class



Source: EU-Silc data. Note: the figure shows the results as averages across EU countries (excl. Germany) and participating non-EU countries (Iceland, Norway Switzerland).

# How has vulnerability increased? Assets required at or near the middle class threshold have shifted

Group	Level	Proportion of those near threshold		Change
		2005-2008	2011-2014	
Education	Primary or less (HH head)	23.6%	18.3%	-23%
	Lower secondary (HH head)	13.8%	12.0%	-13%
	Upper secondary (HH head)	37.2%	35.6%	-4%
	Post-secondary (HH head)	1.7%	3.5%	107%
	Tertiary (HH head)	23.7%	30.6%	29%
Occupation (for HH heads working)	Managers, professionals, technicians (HH head)	41.1%	45.6%	11%
	Support, service, sales workers (HH head)	22.6%	23.1%	2%
	Craft, trades, elementary occupations (HH head)	22.3%	17.5%	-21%
	Plant/machine operators/assemblers (HH head)	9.5%	9.9%	5%
	Skilled and unskilled agricultural/etc. (HH head)	4.4%	3.7%	-16%

Source: EU-Silc data. Note: the figure shows the results as averages across EU countries (excl. Germany) and participating non-EU countries (Iceland, Norway Switzerland).

Near the middle class threshold is defined as those with a predicted income between 35-39 USD PPP

# Inequality of Opportunity (IOp)

- Evolution of IOp over a long period in 5 EU countries (Italy, Germany, France, Great Britain and Switzerland).
- Parametric approach to measure IOp, and a simple theoretical model to decompose IOp into its constituting components:
  - intergenerational persistence in education
  - labor market returns to education
  - networking activity associated to parental background

# Decomposing IOp

- By considering parental education as the only circumstance, we propose an extended mincerian equation:

$$\log(Y_{i\theta}) = \alpha + \beta E_{i\theta} + \gamma E_{i\theta-1} + \omega_{i\theta}$$

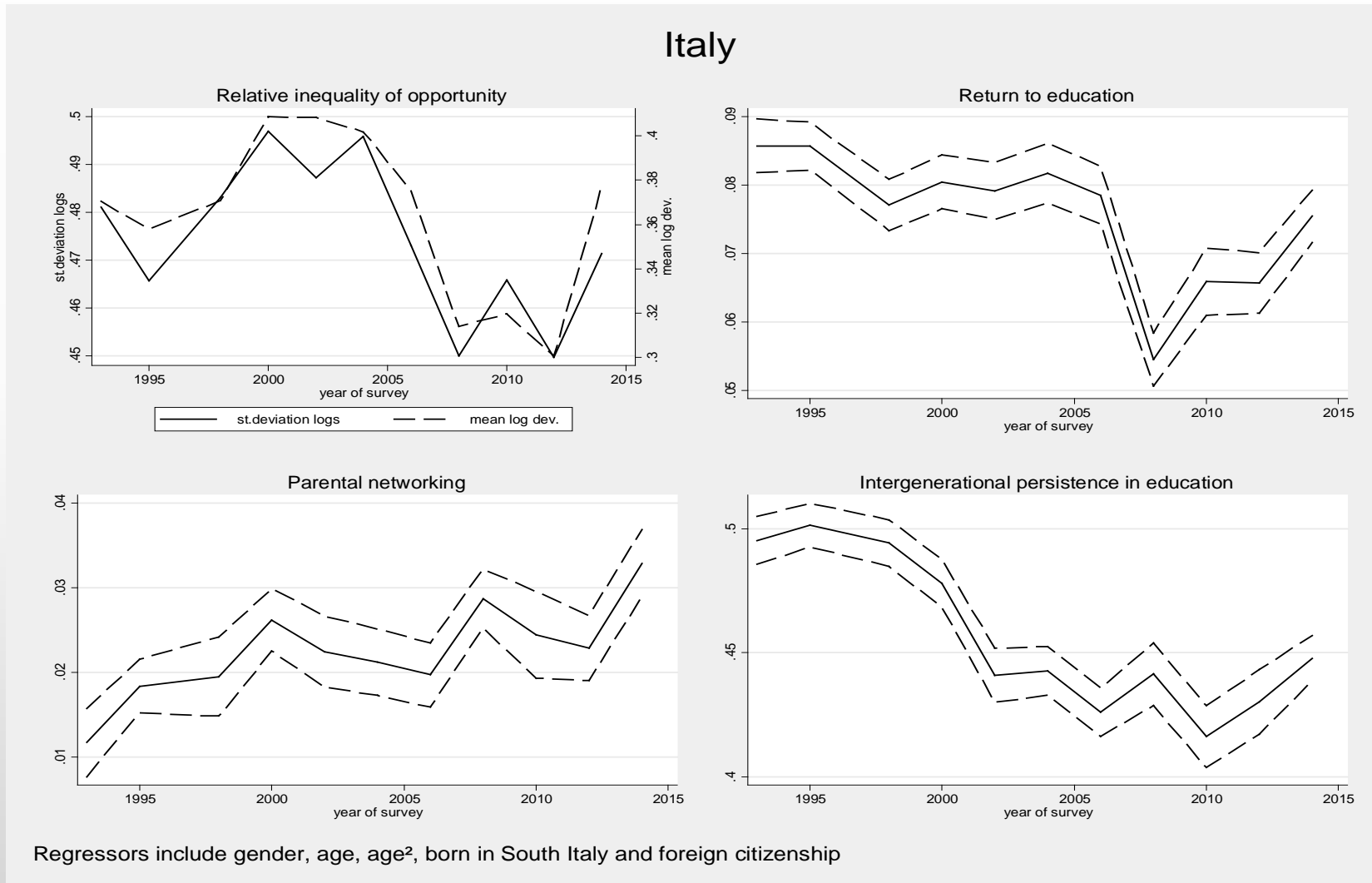
$$E_{i\theta} = \delta + \eta E_{i\theta-1} + \epsilon_{i\theta}$$

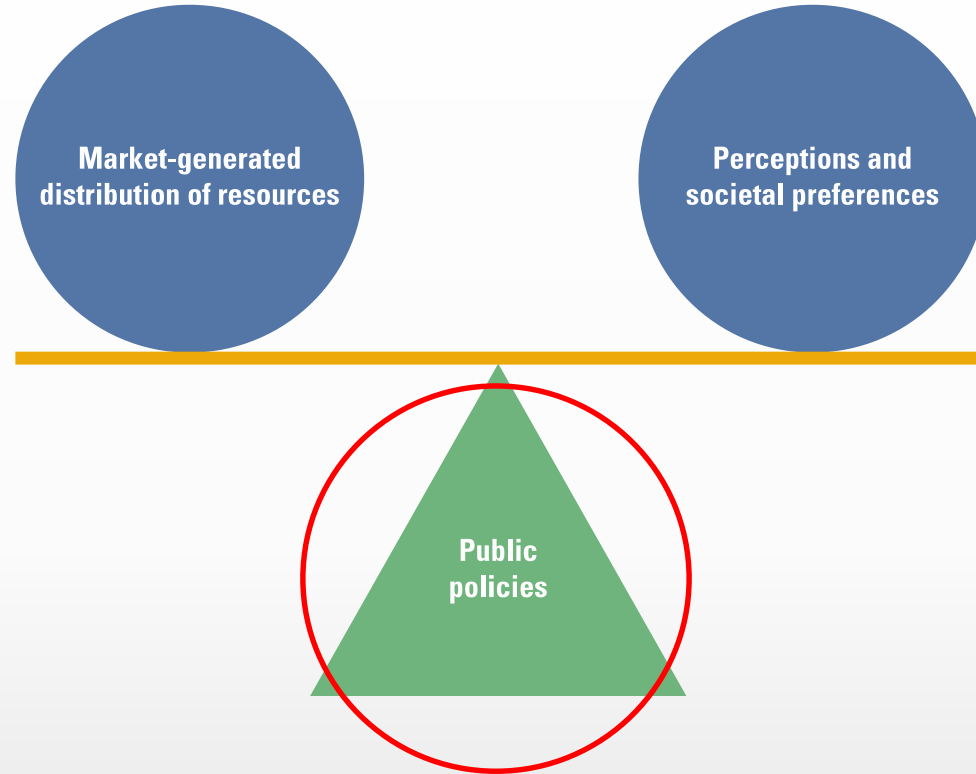
Where:

- $\beta$  is the return to education;
- $\eta$  is a measure of intergenerational persistence;
- $\gamma$  family networking in labor market;



# Inequality of opportunity: results





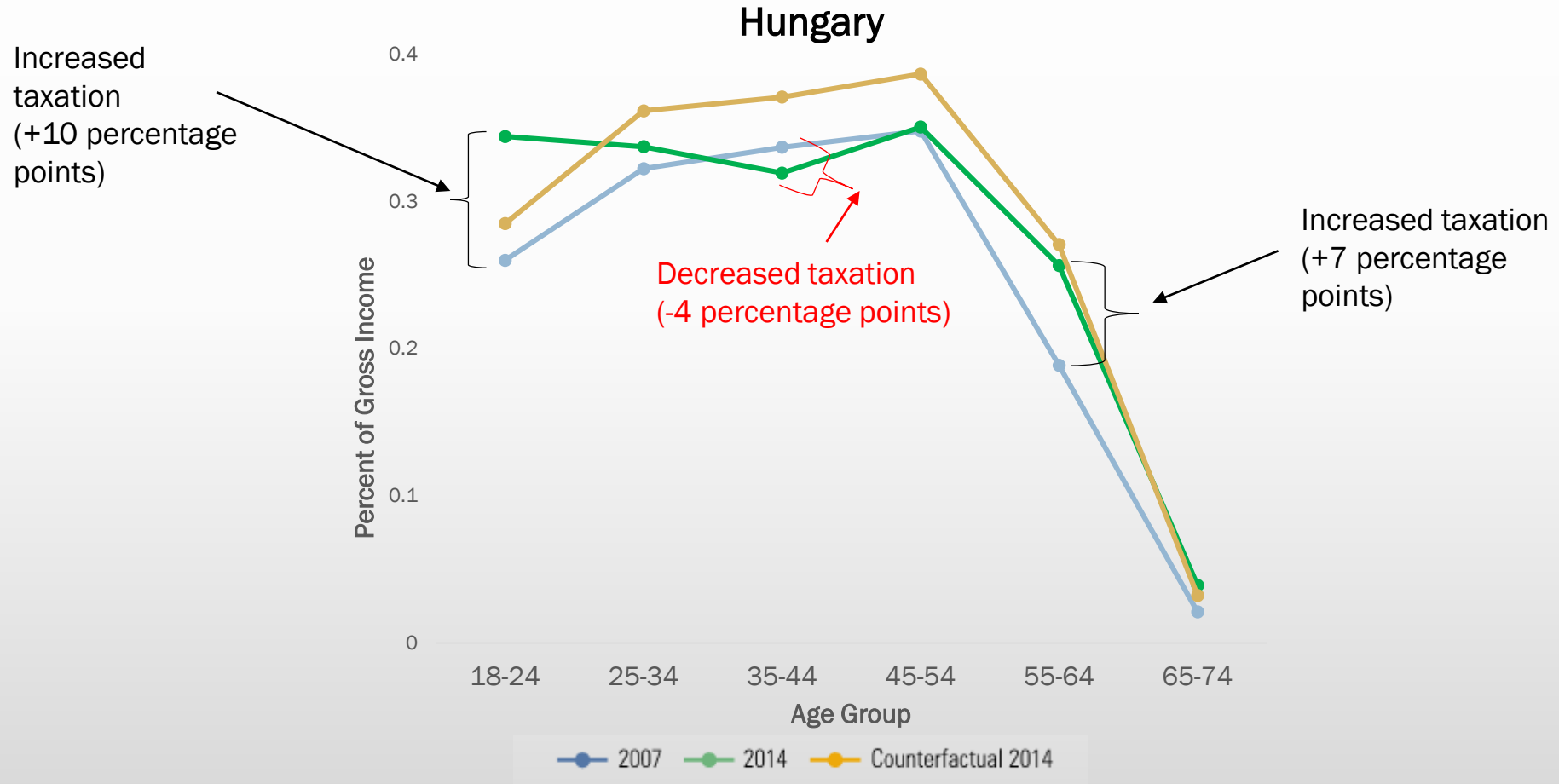
# Public policies

Contribution 2:

Domestic institutions of conflict-management are not anymore very effective

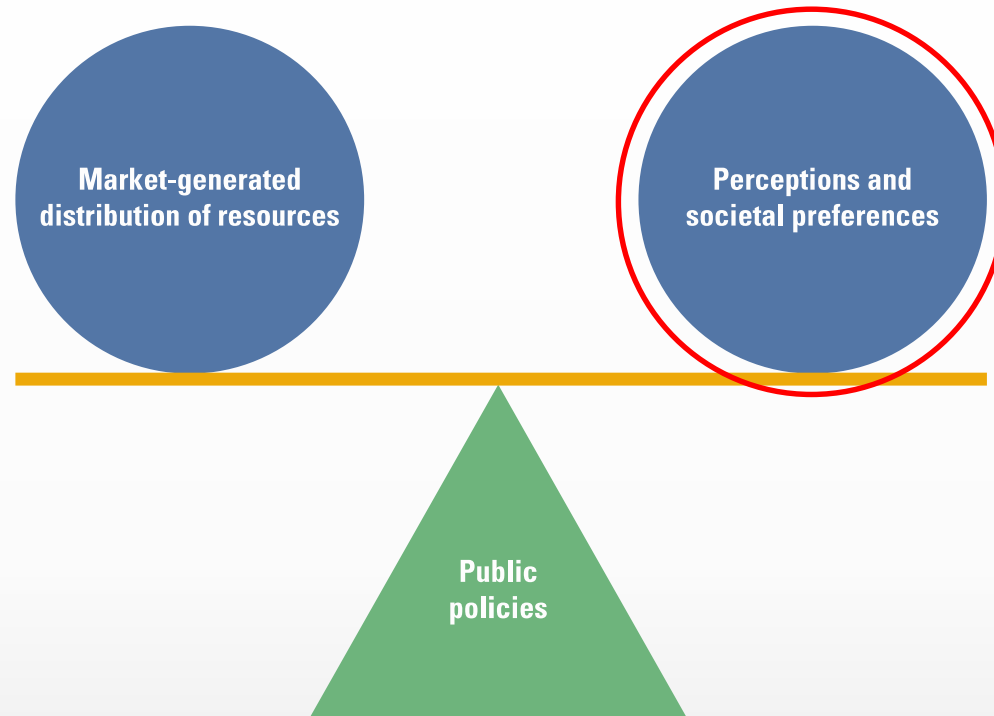
# Horizontal redistribution

Regressive and progressive tax changes across age groups



Note: data and simulations from EUSilc and Euromod microsimulations

Toward a New Social Contract: Taking on Distributional Tensions

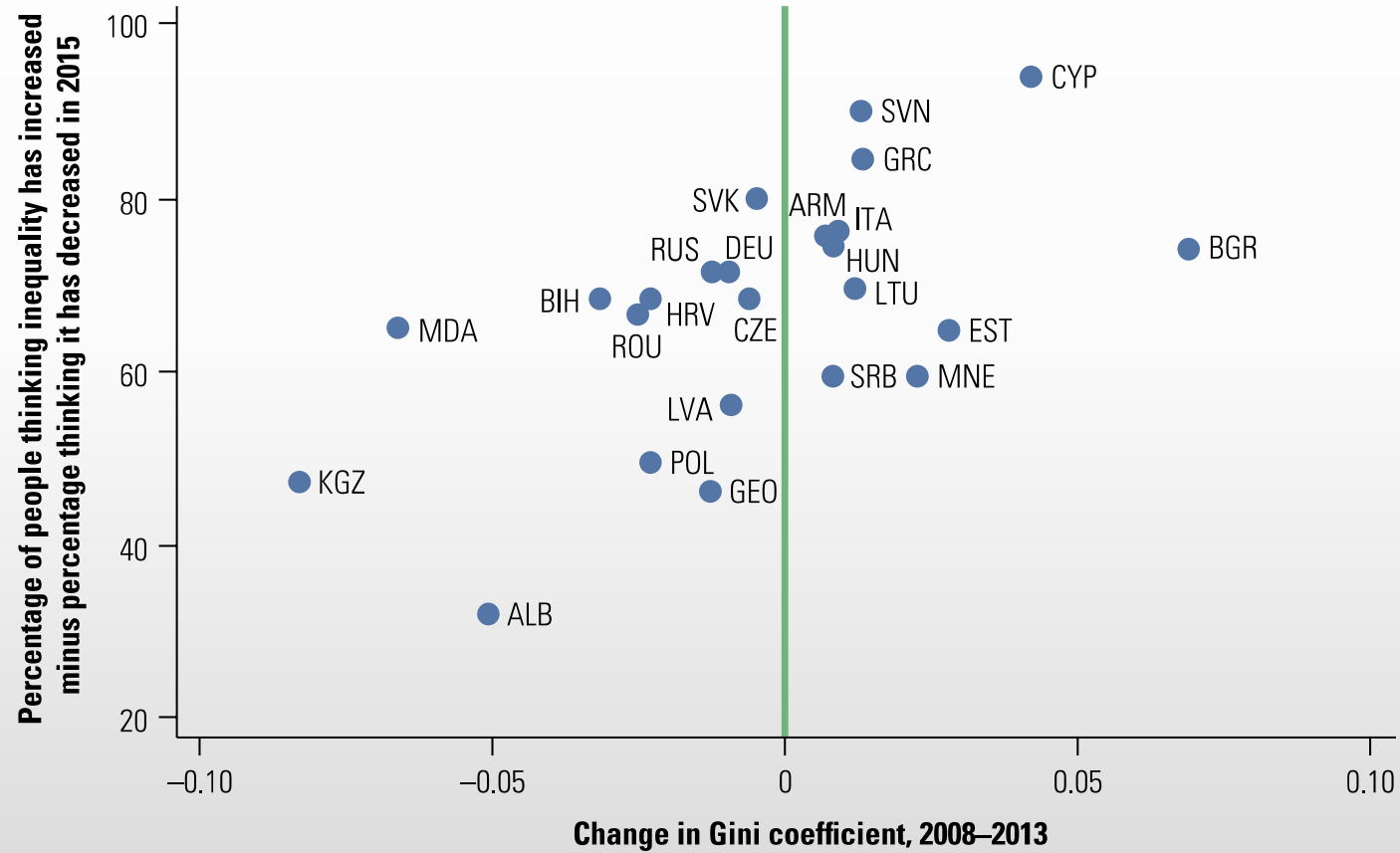


# Preferences and Perceptions

Contribution 3:

*Perceptions of inequality and demand for corrective action are rising*

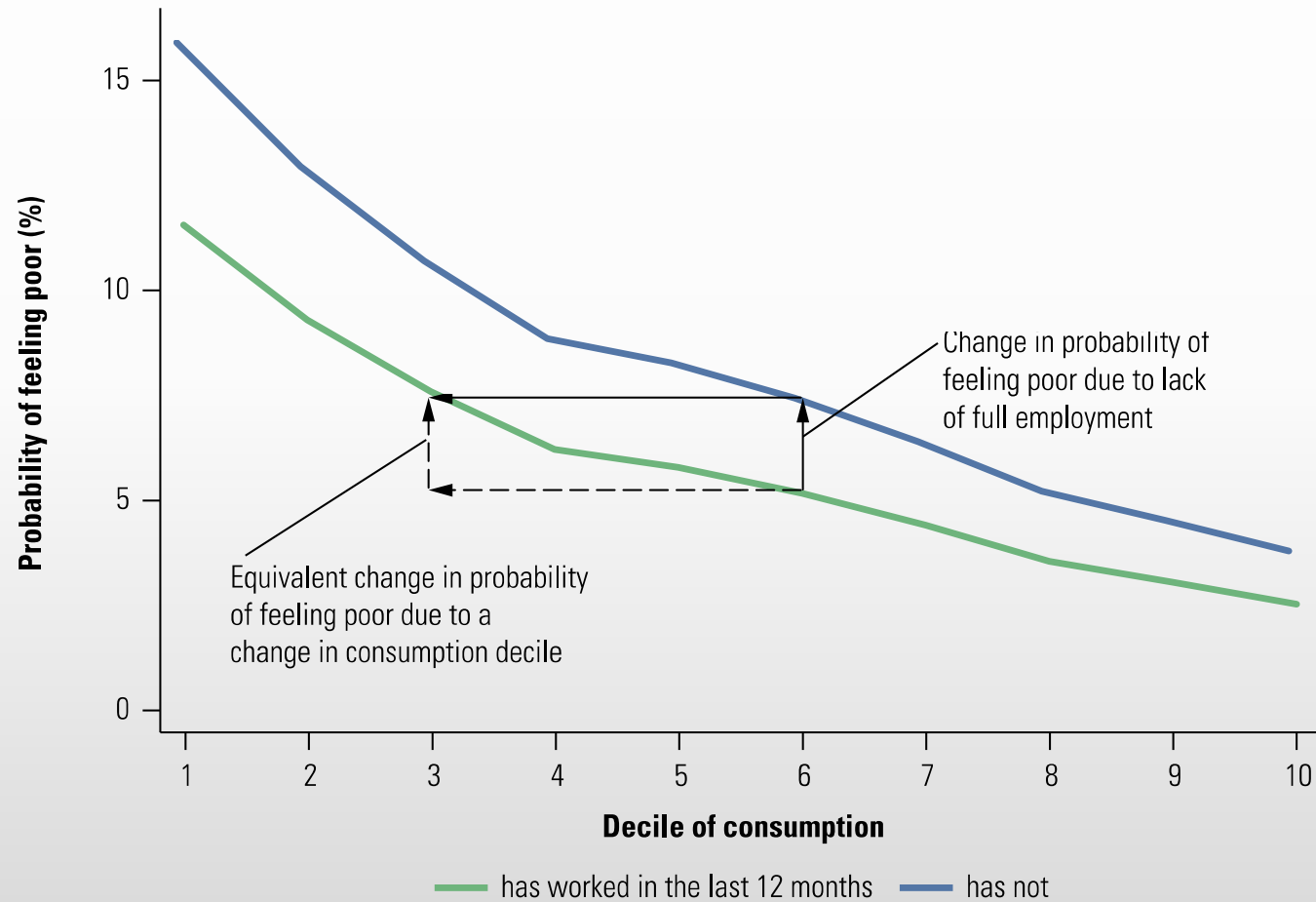
# Perceptions signal rising inequality, even if...



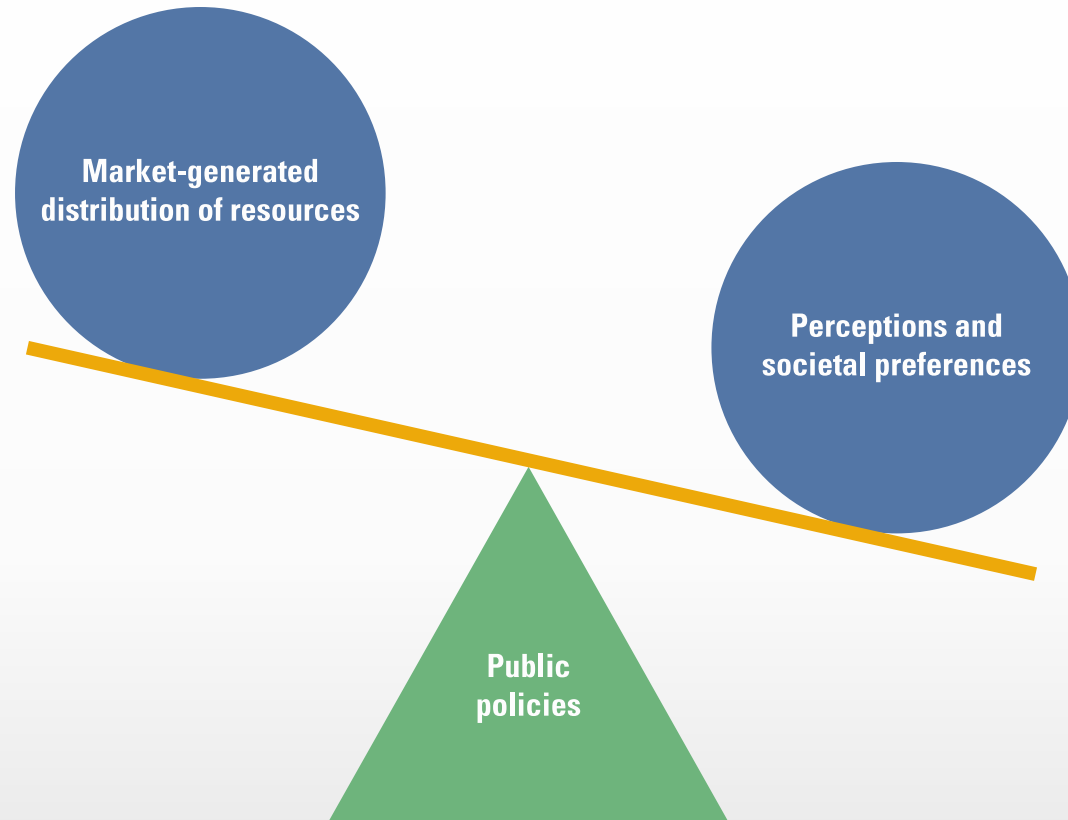
# Equity Preferences

- Abundant experimental and representative surveys evidence on the negative relation between well-being and inequality
  - Clark and D'Ambrosio 2015; Ferrer-i-Carbonell and Ramos 2014
- Yet large variation across and within countries
  - Alesina and Angeletos 2005; Alesina and Glaeser 2004
- Percent of people believing the poor can escape poverty on their own:
  - 70% in the US
  - 40% in Western Europe
  - 24% in Eastern Europe

# Perceptions of inequality (also driven by insecurity)



Source: Life in Transition Survey data. Note: the figure shows the results as averages across all LITS countries.

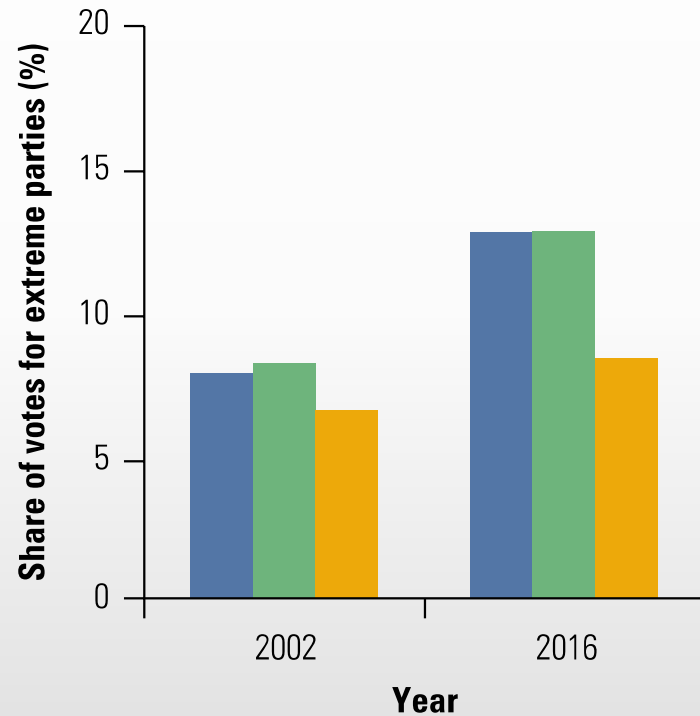


# Imbalance?



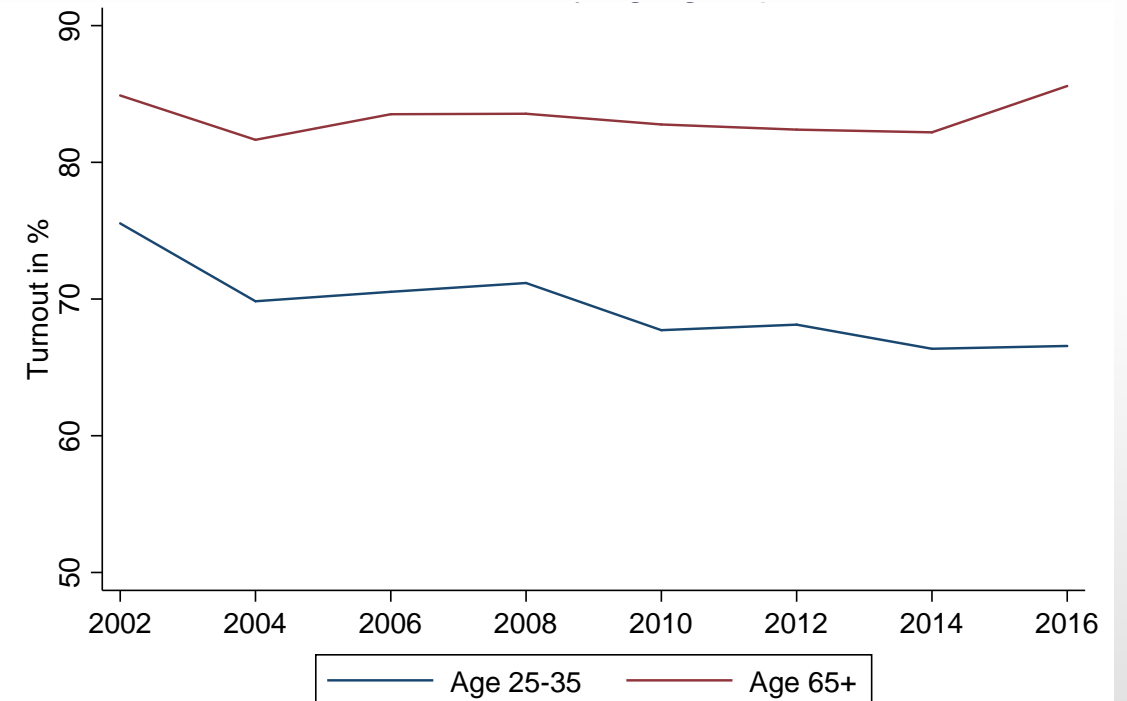
# Cracks in the social contract?

Workers facing less demand for their skills tend to vote for extreme parties



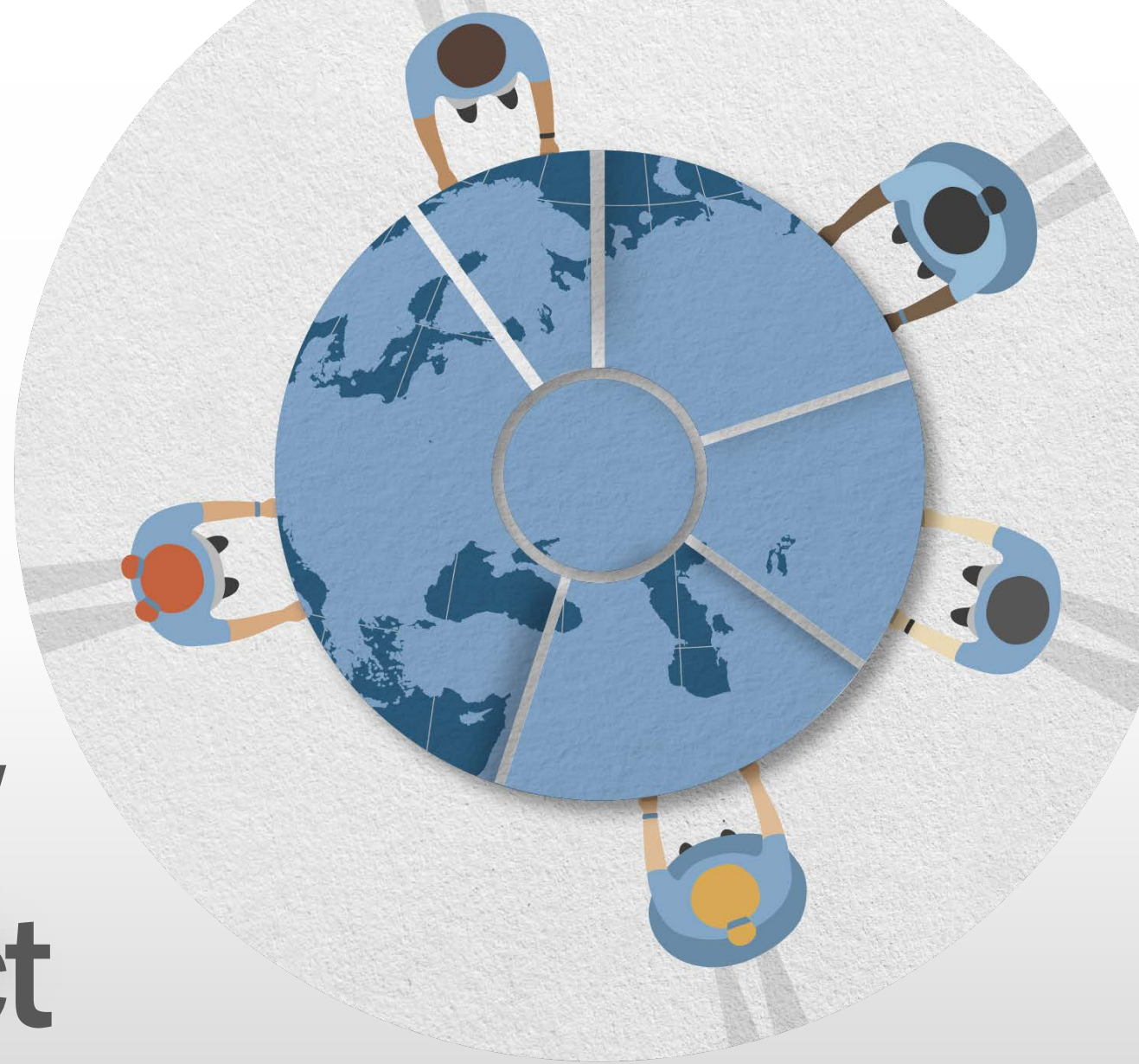
- Intensive non-routine, manual tasks
- Intensive routine tasks
- Intensive non-routine, cognitive tasks

Turn out for the young cohorts is declining



# Toward a New Social contract

Contribution 4: Principles for redesigning the social contract



# Three principles

- 1) Seeking universality in the provision of social assistance, social insurance, as it is for basic public services (education, health); [WDR progressive universalism, UBI]
- 2) Leveling playing field in the labor market; equal protection of all workers, no matter their type of employment, while promoting labor markets' flexibility;
- 3) Supporting progressivity in a broad tax base that complements labor income taxation with the taxation of capital.

# Three principles (the IPSP version)

## 1) Rescue the losers (post-market redistribution)

- Universal programs: better coverage, larger support
- Basic income: =inverting the timing of taxes and subsidies --> more secure
- Respect freedom (low marginal tax rate on low income? Fleurbaey-Maniquet JEL 2018)

## 2) Prepare the players (pre-market predistribution)

- Education:
  - Select, train and reward teachers at their social value (compare with home care)
  - Transition toward lifelong education system due to quick technical change
- Inheritance:
  - (Atkinson) move toward a recipient tax: there is nothing wrong about leaving a large bequest, but it is unfair to receive a large one

## 3) Changing the rules of the game (in-market predistribution)

- Promote competition
- Promote productivity via minimum wage
- Promote democratic organization (esp. firms)
- Directing technological innovation (slow down? Excessive risk and obsolescence)
- Curb/tax social and environmental externalities
- Tax rents (market power, capital gains, CEO pay, legal and banking services, male bonus)
- Reform electoral system and consultation procedures (funding, lobbying, media, voting rules)

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For more details, data and the full report, please visit:

<http://www.worldbank.org/en/region/eca/publication/eca-social-contract>

