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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.
     - 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?

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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-generated distribution of resources

Perceptions and societal preferences

Public policies

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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

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Average Gini index of per capita household income


Baltic States

Southern Europe

Continental Europe

Central Europe

Northern Europe
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

a. Southern Europe

b. Western Europe

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The declining fortunes of the young

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

High School only
1974, 1975, 1976
1980, 1981

College Graduates
1974, 1975, 1976
1980, 1981

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An intergenerational divide: within-cohort inequality

Income inequality by birth cohort

<table>
<thead>
<tr>
<th>Cohort</th>
<th>Gini coefficient</th>
<th>Equivalent to</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930-35</td>
<td>0.319</td>
<td>Japan</td>
</tr>
<tr>
<td>1945-50</td>
<td>0.329</td>
<td>France</td>
</tr>
<tr>
<td>1960-65</td>
<td>0.380</td>
<td>UK</td>
</tr>
<tr>
<td>1980-84</td>
<td>0.486</td>
<td>Chile</td>
</tr>
</tbody>
</table>

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

Change in employment shares, by occupation category

- Non Routine, Manual
- Routine
- Non Routine, Cognitive

Source: Bussolo, Torre and Winkler (forthcoming background paper)
An example of insecurity: Vulnerability of the middle class

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How has vulnerability increased? Through a shift in the market resource composition at the middle class threshold

<table>
<thead>
<tr>
<th>Group</th>
<th>Level</th>
<th>Proportion of those near threshold</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2005-2008</td>
<td>2011-2014</td>
</tr>
<tr>
<td>Education</td>
<td>Primary or less (HH head)</td>
<td>23.6%</td>
<td>18.3%</td>
</tr>
<tr>
<td></td>
<td>Lower secondary (HH head)</td>
<td>13.8%</td>
<td>12.0%</td>
</tr>
<tr>
<td></td>
<td>Upper secondary (HH head)</td>
<td>37.2%</td>
<td>35.6%</td>
</tr>
<tr>
<td></td>
<td>Post-secondary (HH head)</td>
<td>1.7%</td>
<td>3.5%</td>
</tr>
<tr>
<td></td>
<td>Tertiary (HH head)</td>
<td>23.7%</td>
<td>30.6%</td>
</tr>
</tbody>
</table>

Note: 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

Regression results:

- **Relative inequality of opportunity**
  - Regression includes gender, age, age², born in South Italy and foreign citizenship
  - Negative impact on status attainment

- **Return to education**
  - Positive impact on education attainment

- **Parental networking**
  - Positive impact on status attainment

- **Intergenerational persistence in education**
  - Positive impact on education attainment

**Italy**
Public policies

Contribution 2:
Domestic institutions of conflict-management are not anymore very effective

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Horizontal redistribution

Regressive and progressive tax changes across age groups

Increased taxation

Decreased taxation
Preferences and Perceptions

Contribution 3:
Perceptions of inequality and demand for corrective action are rising

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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)

Change in probability of feeling poor due to lack of full employment

Equivalent change in probability of feeling poor due to a change in consumption decile

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Imbalance?

Market-generated distribution of resources

Perceptions and societal preferences

Public policies

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Cracks in the social contract?

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

Turn out for the young cohorts is declining

<table>
<thead>
<tr>
<th>Year</th>
<th>Turnout in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>90</td>
</tr>
<tr>
<td>2004</td>
<td>80</td>
</tr>
<tr>
<td>2006</td>
<td>70</td>
</tr>
<tr>
<td>2008</td>
<td>60</td>
</tr>
<tr>
<td>2010</td>
<td>50</td>
</tr>
<tr>
<td>2012</td>
<td>40</td>
</tr>
<tr>
<td>2014</td>
<td>30</td>
</tr>
<tr>
<td>2016</td>
<td>20</td>
</tr>
</tbody>
</table>

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

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Toward a New Social contract

Contribution 4: Principles for redesigning the social contract

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Three principles

1) Moving toward equal protection of all workers, no matter their type of employment, while promoting labor markets' flexibility;

2) Seeking universality in the provision of social assistance, social insurance, and basic quality services; [progressive universalism, UBI]

3) Supporting progressivity in a broad tax base that complements labor income taxation with the taxation of capital.
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For more details, data and the full report, please visit: