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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?





Why “Social Contract”?

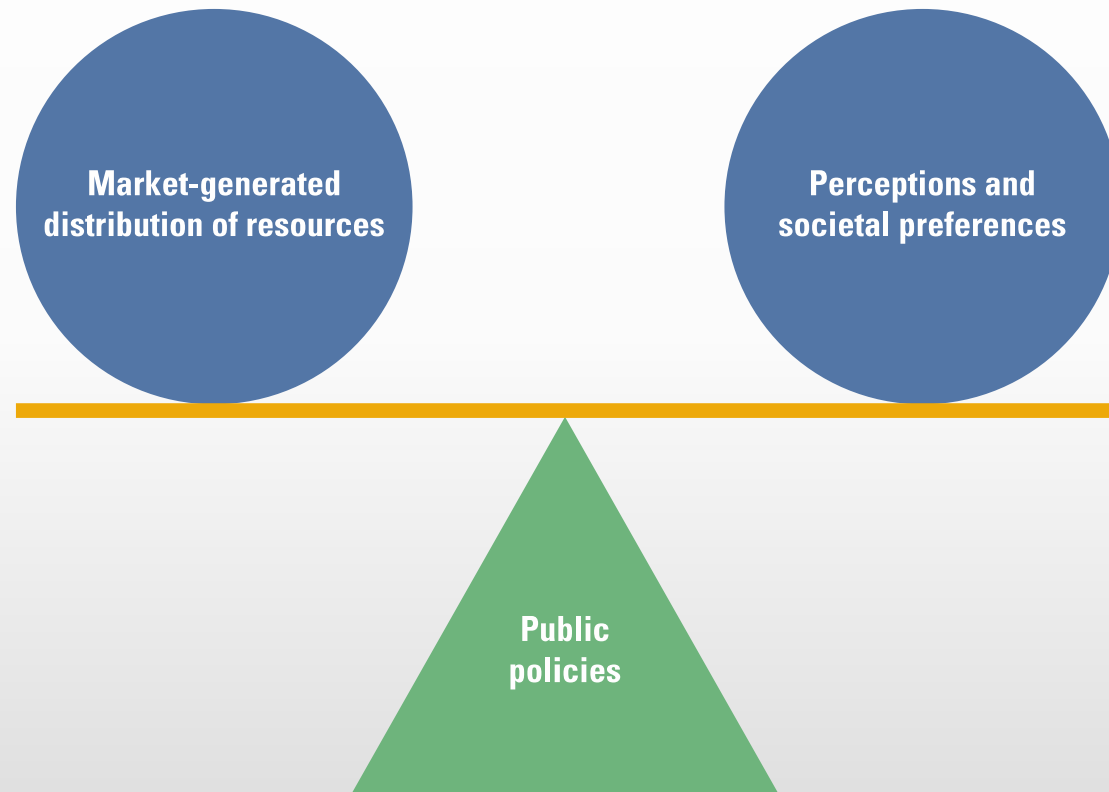
A stable social contract is achieved when there is an dynamic ‘equilibrium’ among:

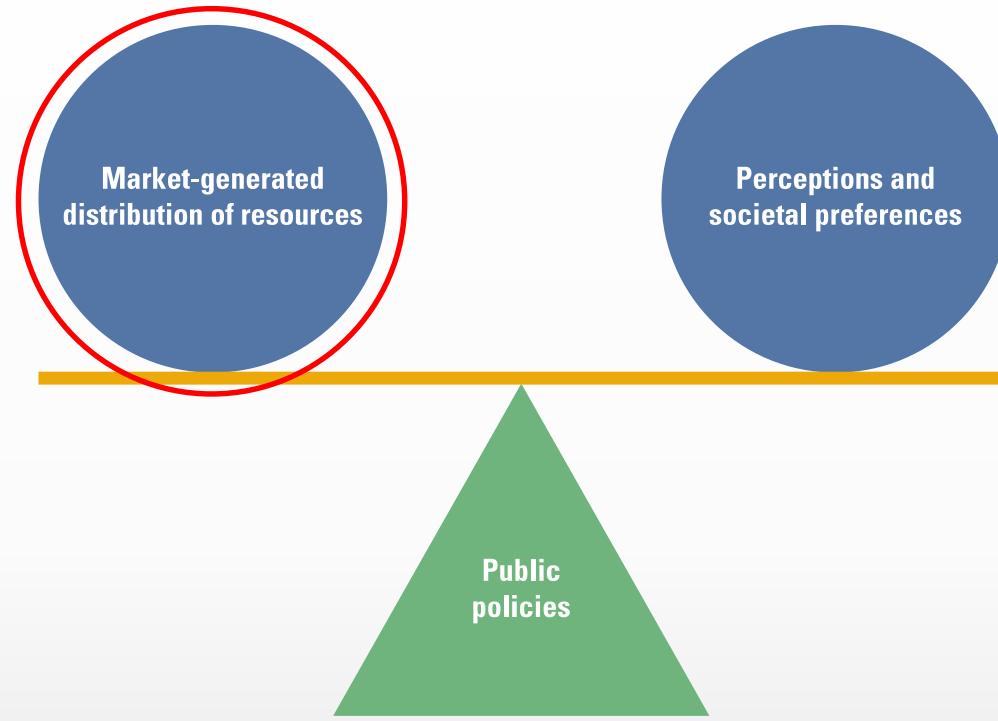
1. Distribution of resources generated by market forces;
2. Public redistribution and social protection against risks;
3. Social preferences for equity-redistribution, which are the complex product of beliefs, perceptions, social values and social norms;

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





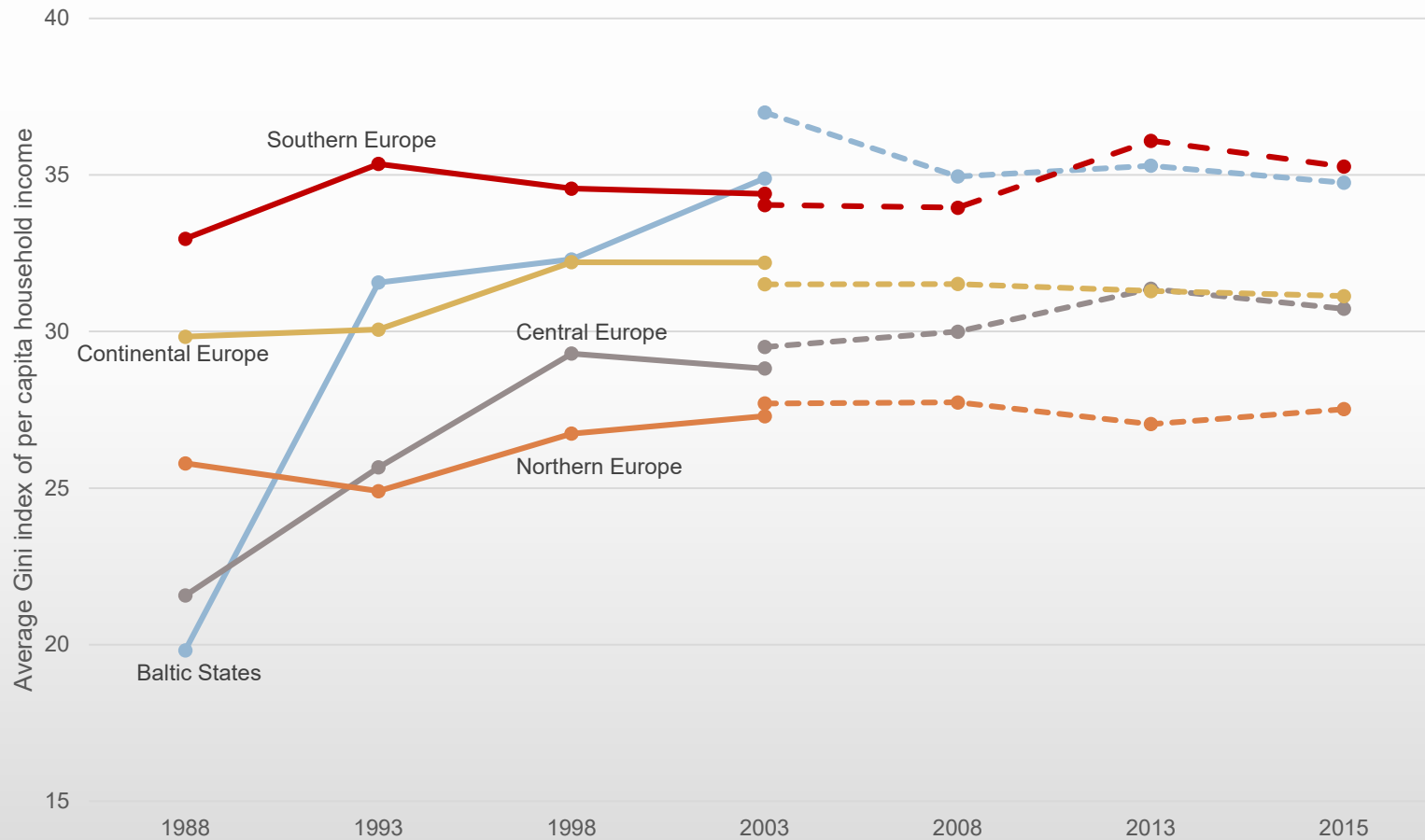
Market-related Distributional Tensions

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



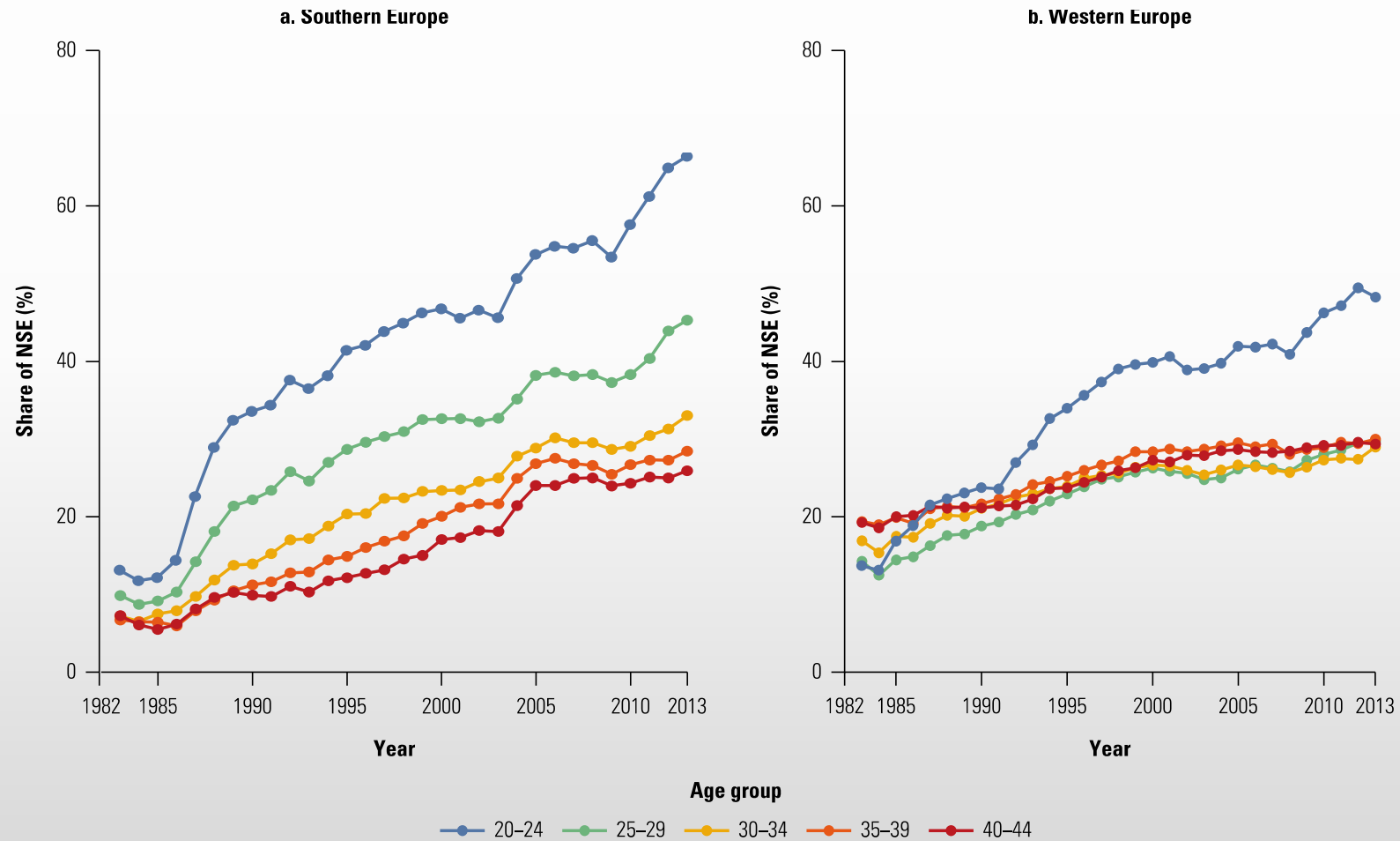
Distributional tensions

Horizontal inequality

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

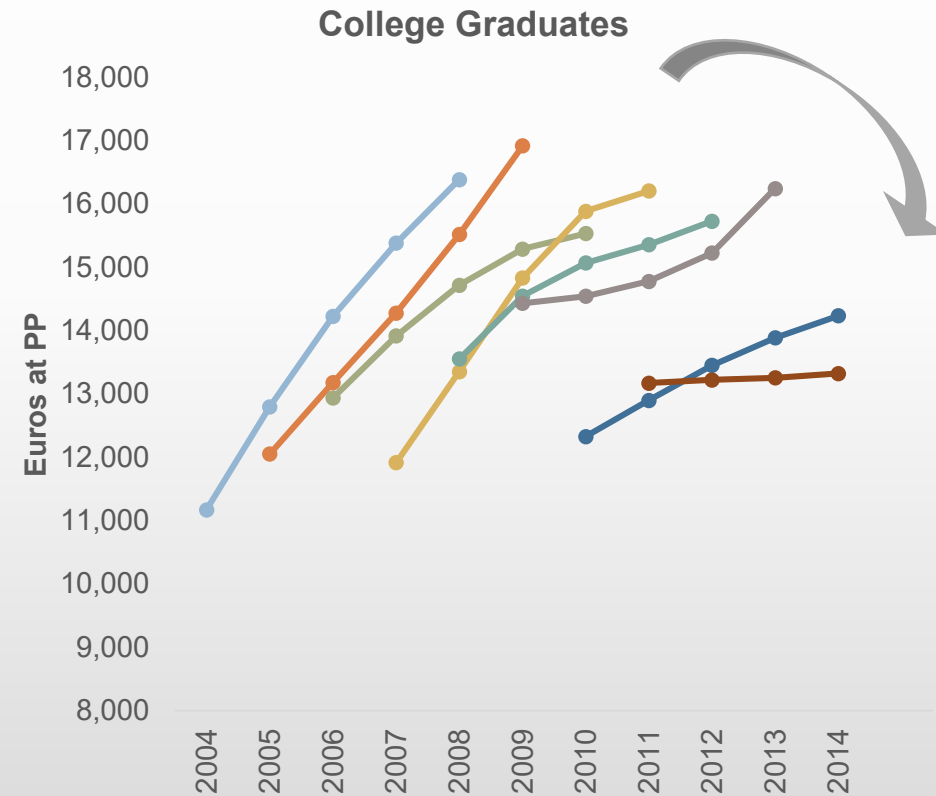
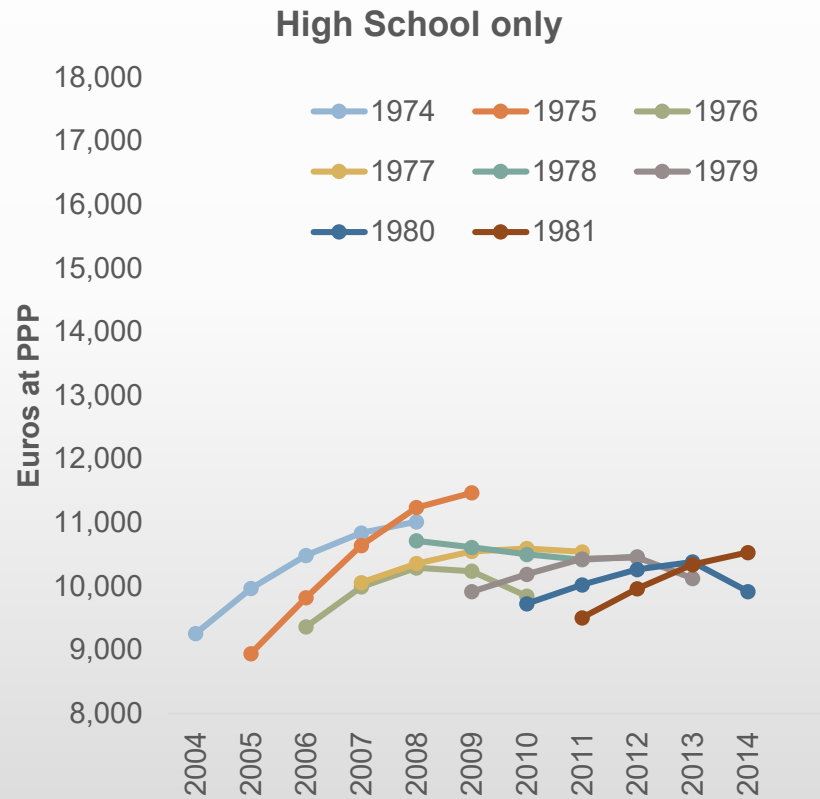
Inequality of opportunity - Fairness

Intergenerational divide: The incidence of Non Standard Employment



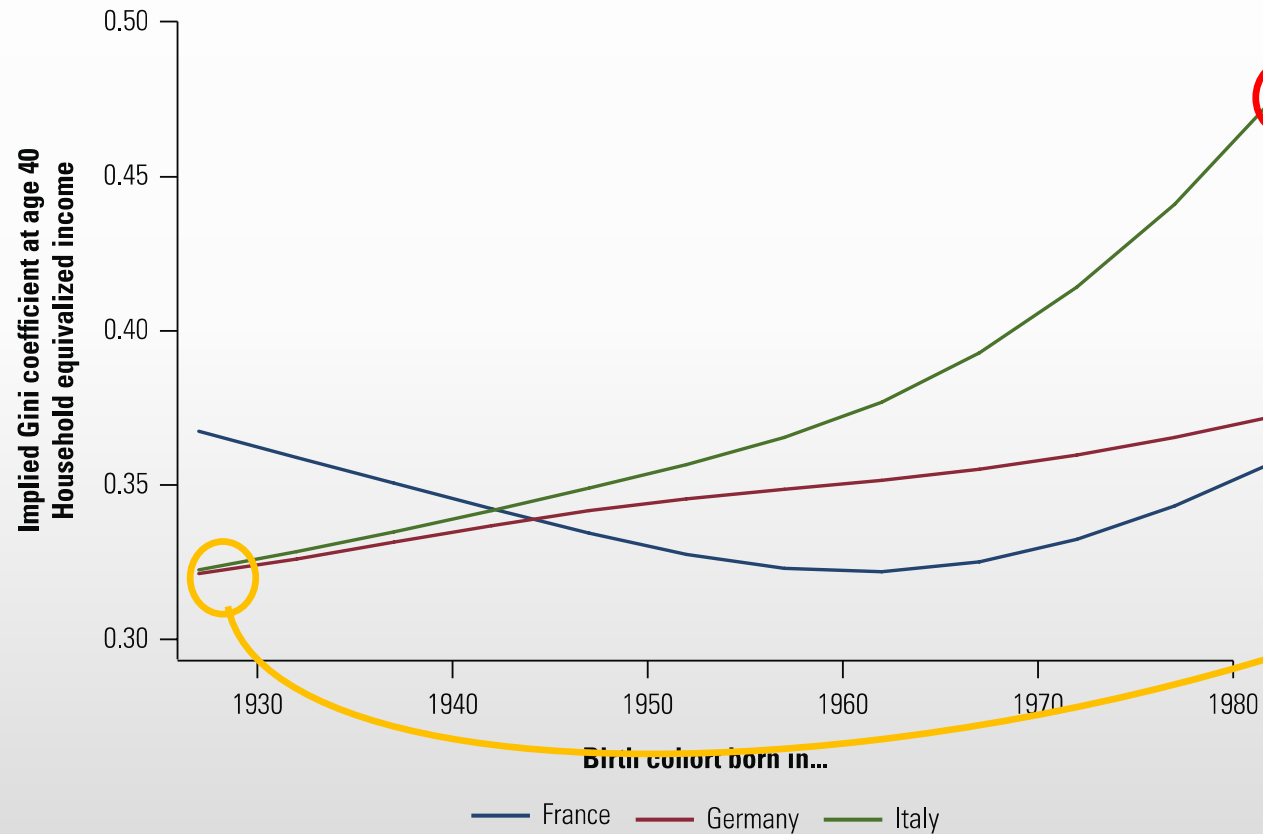
The declining fortunes of the young

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

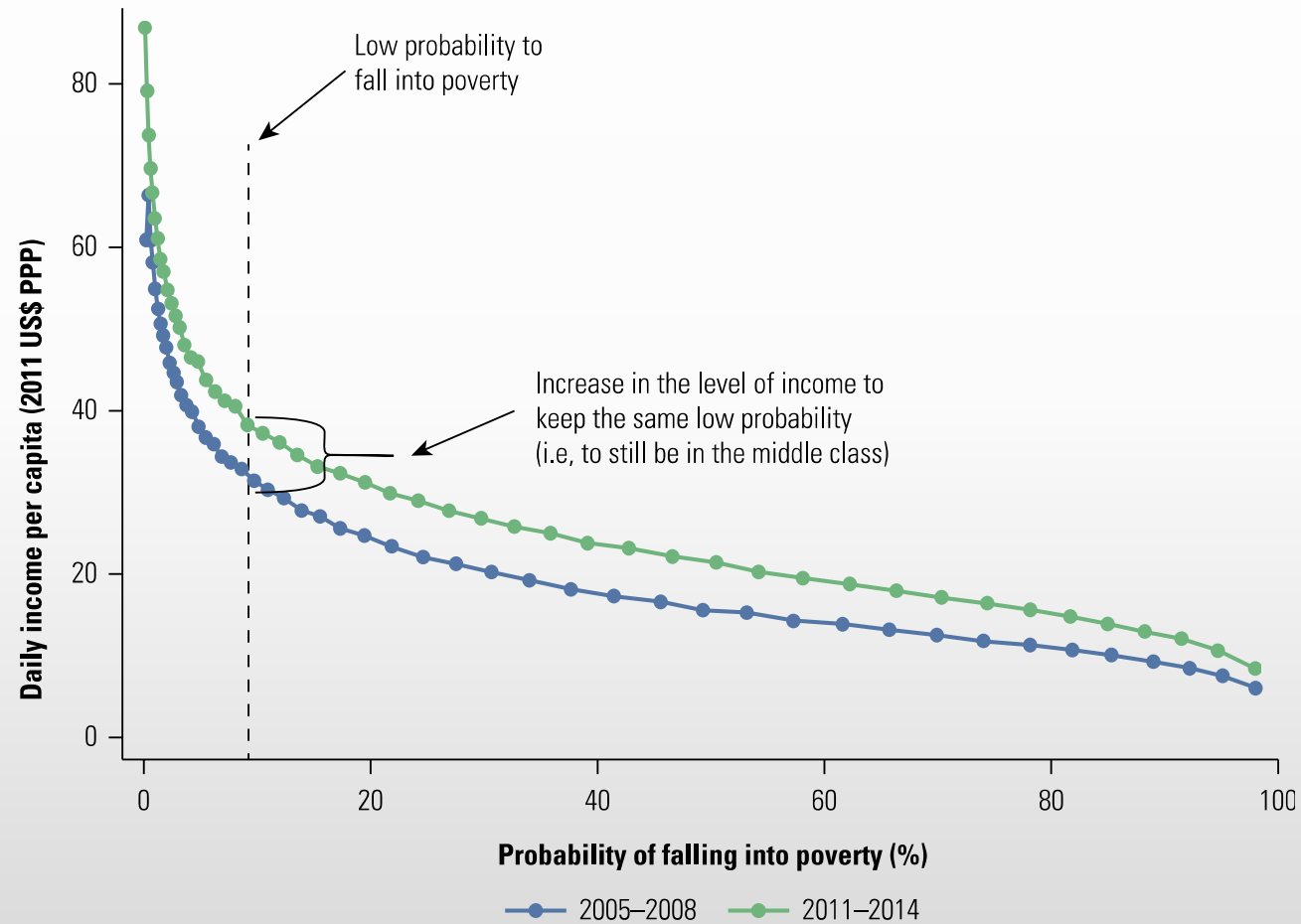
Note: Calculations using a Deaton-Paxson cohort-age-time decomposition regression, and assuming log-normality

Occupational Polarization



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

An example of insecurity: Vulnerability of the middle class



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

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%

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:

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

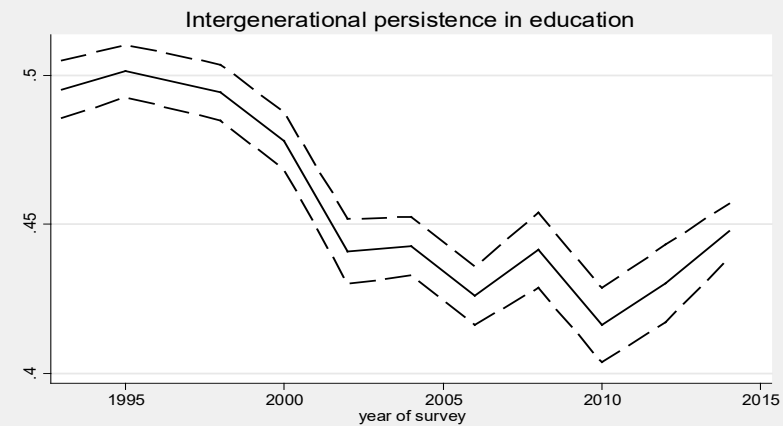
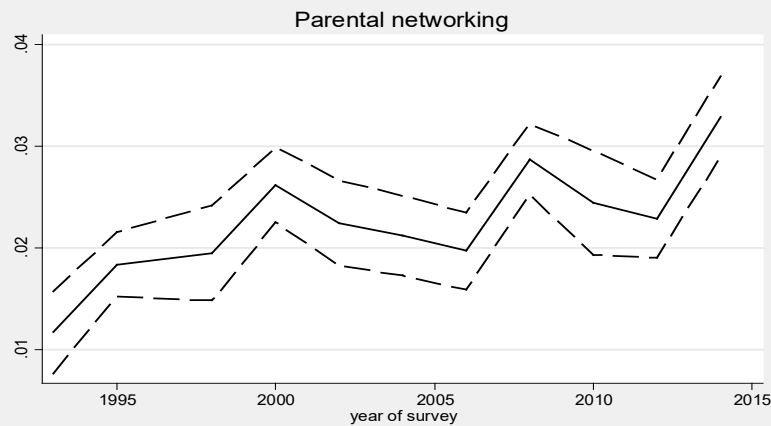
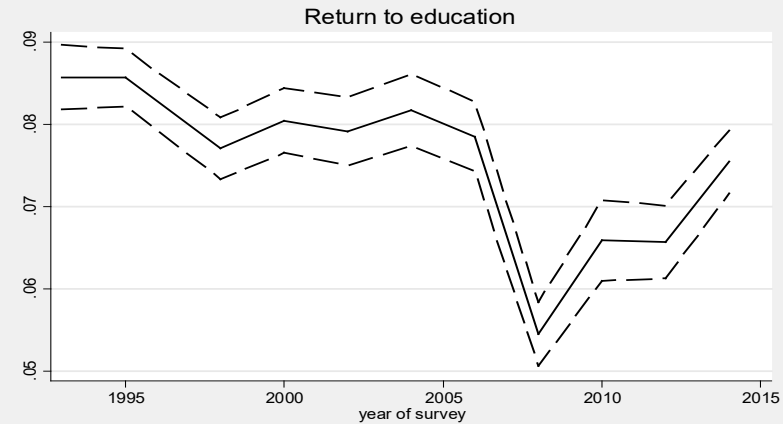
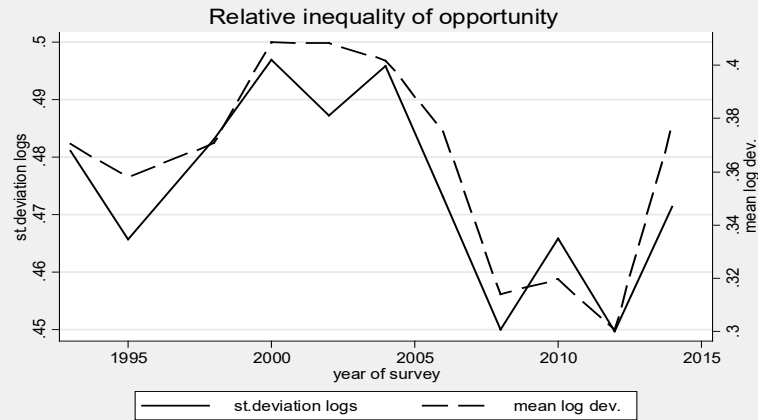
$$E_{i\theta} = \delta + \eta E_{i\theta-1} + \epsilon_{i\theta}$$

Where:

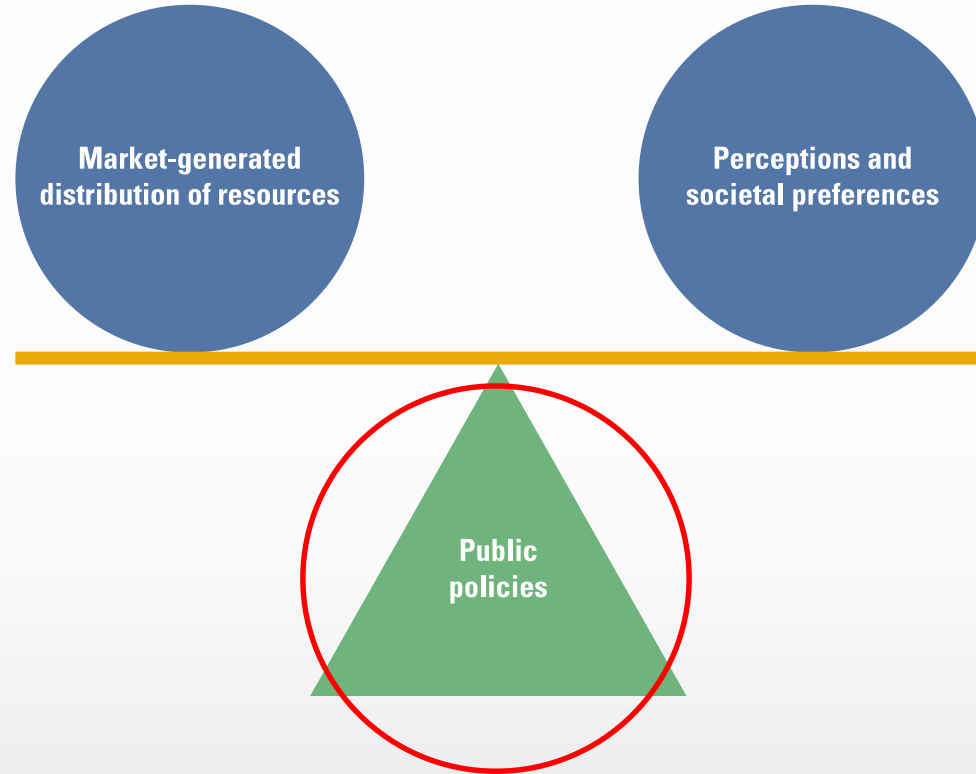
- β is the return to education;
- η is a measure of intergenerational persistence;
- γ family networking in labor market;

Inequality of opportunity: results

Italy



Regressors include gender, age, age², born in South Italy and foreign citizenship



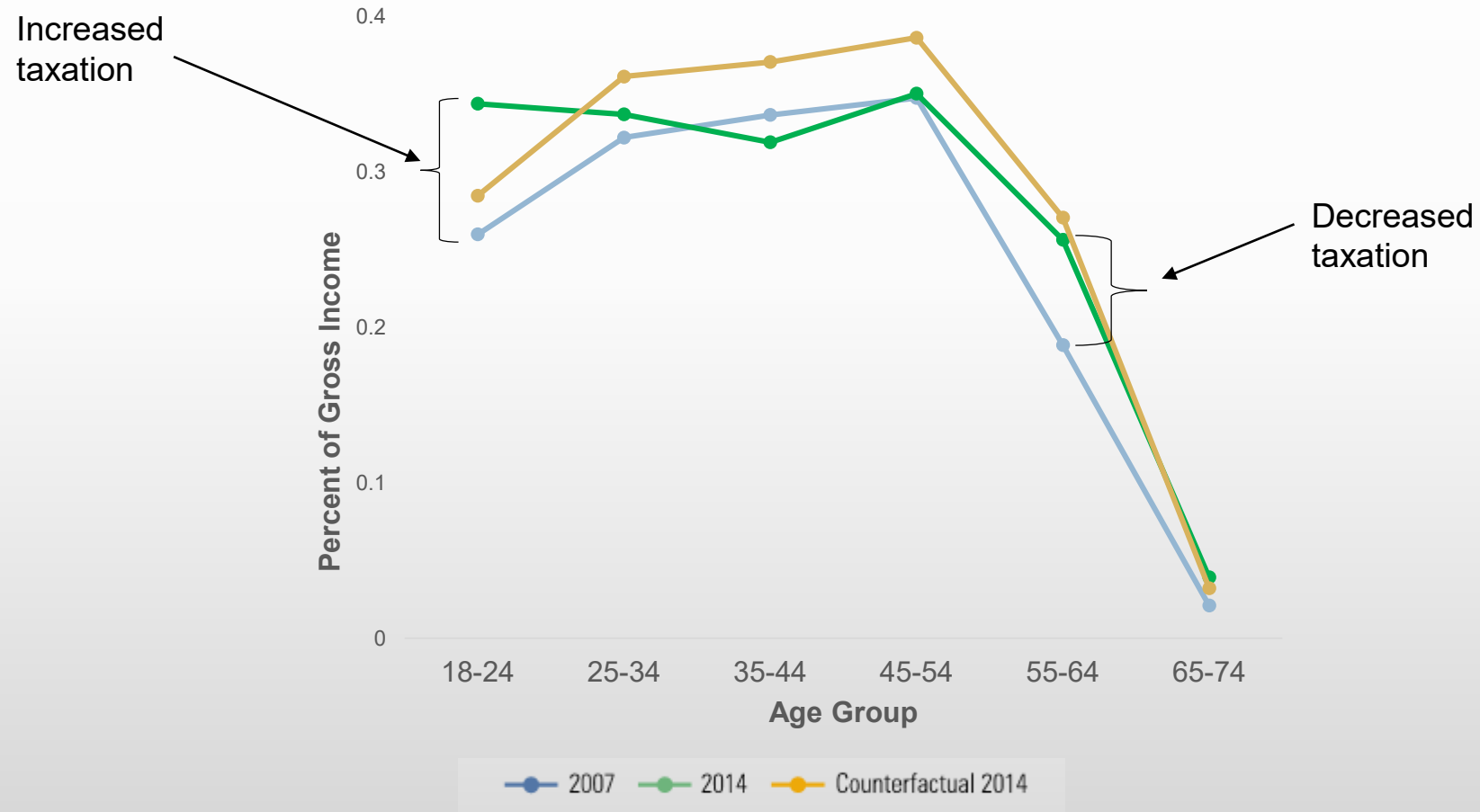
Public policies

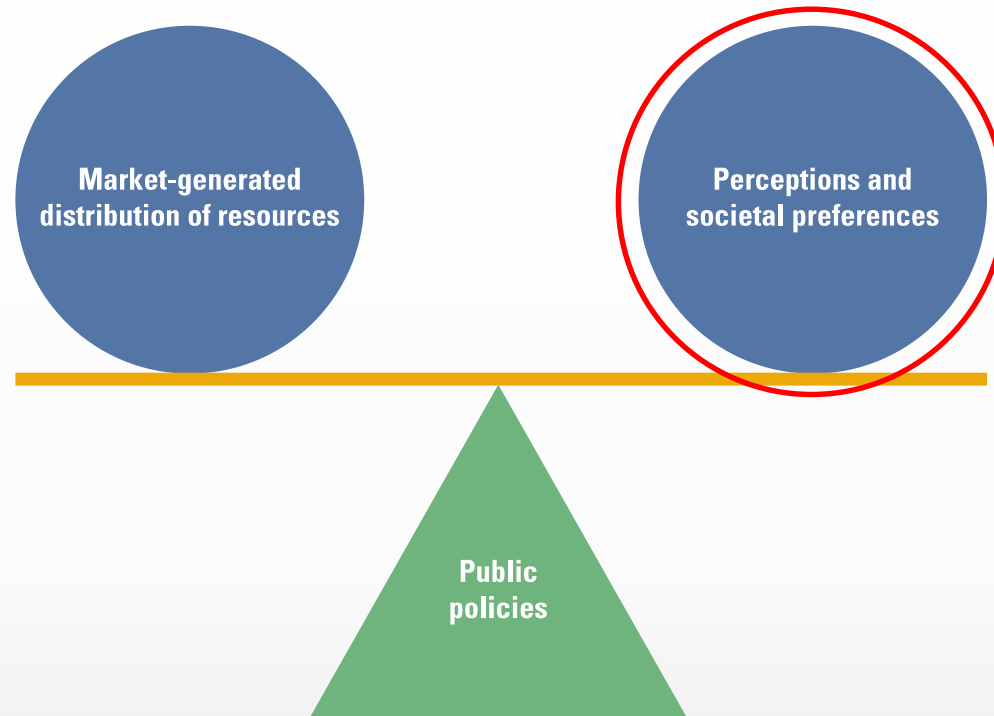
Contribution 2:

Domestic institutions of conflict-management are not anymore very effective

Horizontal redistribution

Regressive and progressive tax changes across age groups



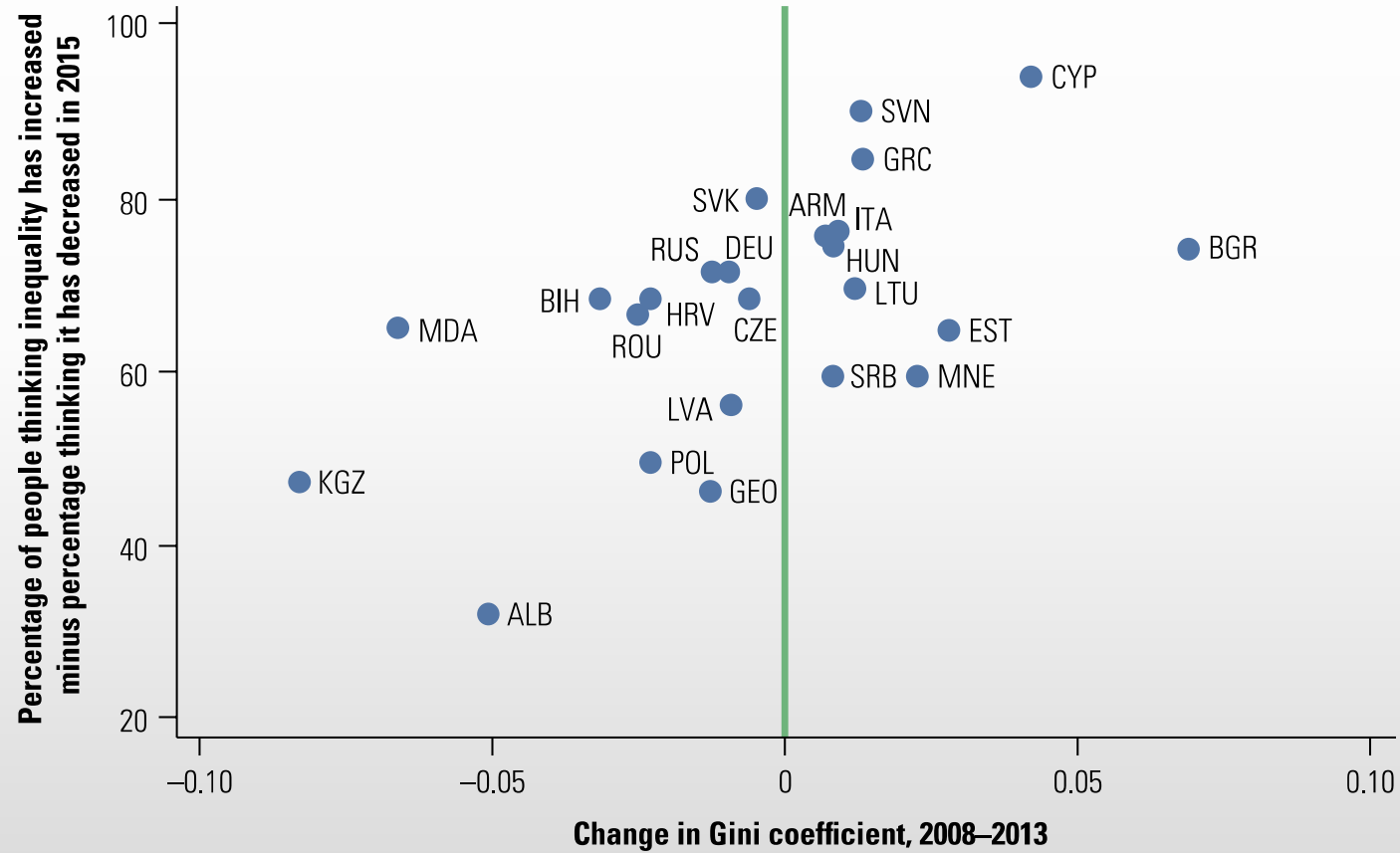


Preferences and Perceptions

Contribution 3:

Perceptions of inequality and demand for corrective action are rising

Perceptions signal rising inequality, even if...

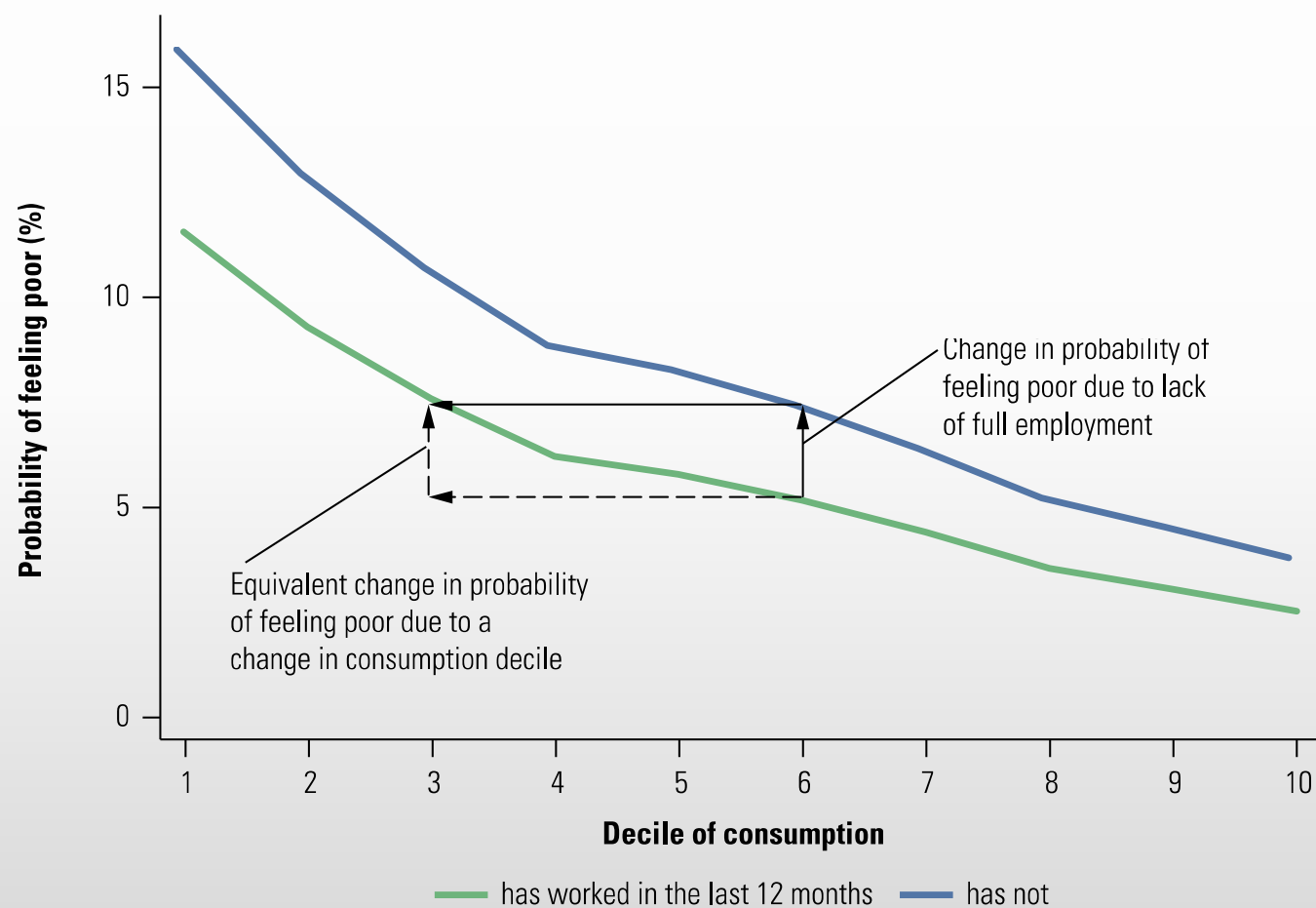


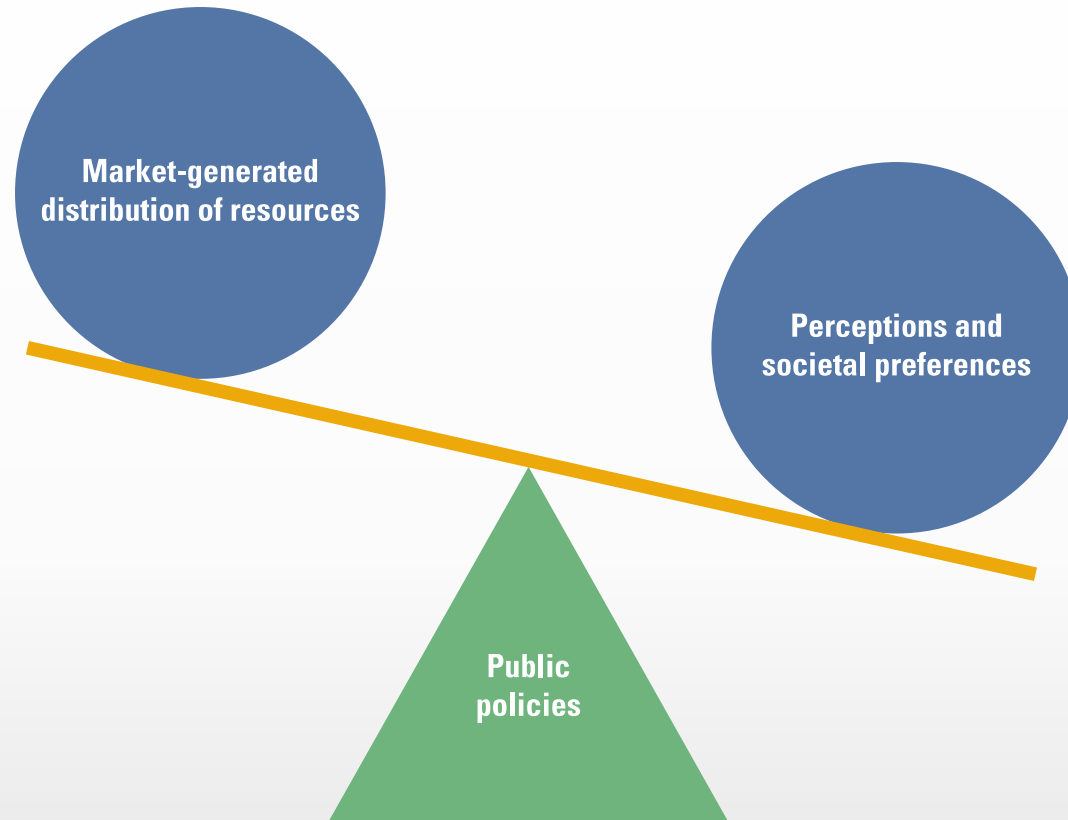


Equity Preferences

- 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)

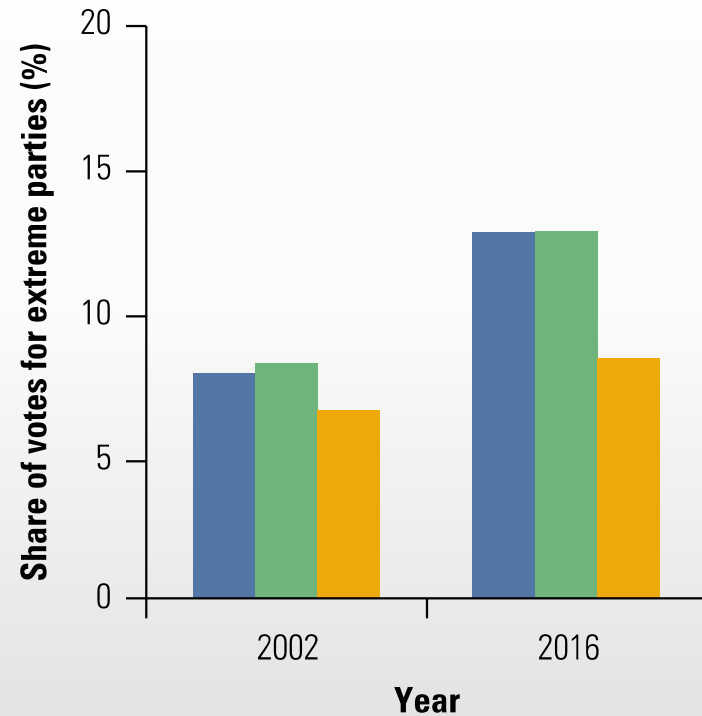




Imbalance?

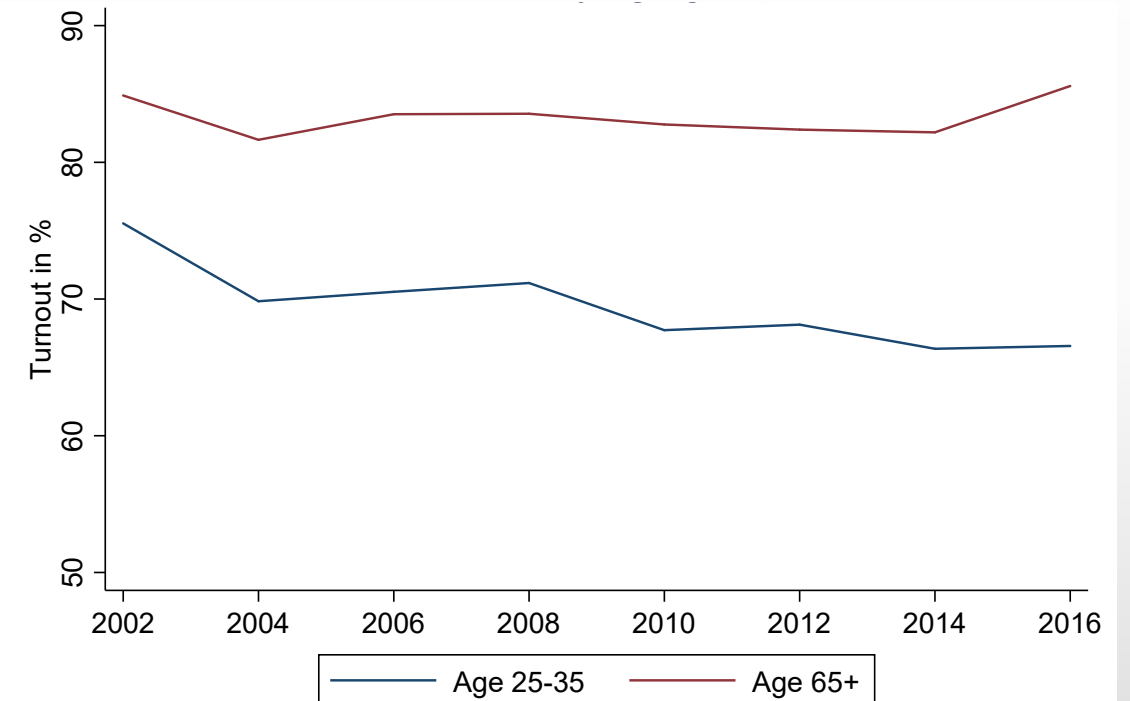
Cracks in the social contract?

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) Moving towards a new type of employment
- 2) Seeking universal social insurance and universalism
- 3) Supporting complementary capital.



Stuck in the past

Overhaul tax for the 21st century

Today's tax systems are unforgivably cack-handed



David Parkins

Print edition | Leaders
Aug 9th 2018



IF YOU are a high earner in a rich country and you lack a good accountant, you probably spend about half the year working for the state. If you are an average earner, not even an accountant can spare you taxes on your payroll and spending.

Most of the fuss about taxation is over how much the government takes and how often it is wasted. Too little is about how taxes are raised. Today's tax systems are not only marred by the bewildering complexity and loopholes that have always afflicted taxation; they are also outdated. That makes them less efficient, more unfair and more likely to conflict with a government's priorities. The world needs to remake tax systems so that they are fit for the 21st century.

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

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

