Tokyo morning seminar series

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-generated distribution of resources
- Perceptions and societal preferences
- Public policies

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Market-related Distributional Tensions

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Vertical Inequality

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Average Gini index of per capita household income

- Southern Europe
- Continental Europe
- Central Europe
- Northern Europe
- Baltic States


WORLD BANK GROUP
Distributional tensions

Horizontal inequality

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

Inequality of opportunity - Fairness
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
An example of insecurity: Vulnerability of the middle class

Probability of falling into poverty (%)

Daily income per capita (2011 US$ PPP)

- Low probability to fall into poverty
- Increase in the level of income to keep the same low probability (i.e., to still be in the middle class)

Public policies

Market-generated distribution of resources

Perceptions and societal preferences

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Preferences and Perceptions

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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)

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Imbalance?

Market-generated distribution of resources

Perceptions and societal preferences

Public policies
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

![Chart showing share of votes for extreme parties and turnout in % over years for Age 25-35 and Age 65+](chart.png)
Toward a New Social contract
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.
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For more details, data and the full report, please visit: