Toward a New Social Contract:
Taking on Distributional Tensions in Europe and Central Asia

Maurizio Bussolo
María E. Dávalos
Vito Peragine
Ramya Sundaram
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).
     o Rising ‘horizontal’ inequality (disparities among groups, see Francis Stewart 2001 WIDER lecture “Horizontal Inequality: a neglected dimension of development”); 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;
     o 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;

A stable social contract

- Market-generated distribution of resources
- Perceptions and societal preferences

Public policies
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.

Toward a New Social Contract: Taking on Distributional Tensions
Vertical Inequality


Average Gini index of per capita household income


15 20 25 30 35 40

Southern Europe
Continental Europe
Central Europe
Northern Europe

Baltic States

Toward a New Social Contract: Taking on Distributional Tensions
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**

Toward a New Social Contract: Taking on Distributional Tensions
The declining fortunes of the young

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

High School only
- 1974
- 1975
- 1976
- 1977
- 1978
- 1979
- 1980
- 1981

College Graduates
- 1974
- 1975
- 1976
- 1977
- 1978
- 1979
- 1980
- 1981
An intergenerational divide: within-cohort inequality

Toward a New Social Contract: Taking on Distributional Tensions

<table>
<thead>
<tr>
<th>Country</th>
<th>Cohort</th>
<th>Gini coefficient</th>
<th>Equivalent to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>1930-35</td>
<td>0.319</td>
<td>Japan</td>
</tr>
<tr>
<td></td>
<td>1945-50</td>
<td>0.329</td>
<td>France</td>
</tr>
<tr>
<td></td>
<td>1960-65</td>
<td>0.380</td>
<td>UK</td>
</tr>
<tr>
<td></td>
<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

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

Probability of falling into poverty (%)

- 2005–2008
- 2011–2014

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

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>Primary or less (HH head)</td>
<td>23.6%</td>
<td>18.3%</td>
<td>-23%</td>
</tr>
<tr>
<td></td>
<td>Lower secondary (HH head)</td>
<td>13.8%</td>
<td>12.0%</td>
<td>-13%</td>
</tr>
<tr>
<td></td>
<td>Upper secondary (HH head)</td>
<td>37.2%</td>
<td>35.6%</td>
<td>-4%</td>
</tr>
<tr>
<td></td>
<td>Post-secondary (HH head)</td>
<td>1.7%</td>
<td>3.5%</td>
<td>107%</td>
</tr>
<tr>
<td></td>
<td>Tertiary (HH head)</td>
<td>23.7%</td>
<td>30.6%</td>
<td>29%</td>
</tr>
<tr>
<td>Occupation (for HH heads working)</td>
<td>Managers, professionals, technicians (HH head)</td>
<td>41.1%</td>
<td>45.6%</td>
<td>11%</td>
</tr>
<tr>
<td></td>
<td>Support, service, sales workers (HH head)</td>
<td>22.6%</td>
<td>23.1%</td>
<td>2%</td>
</tr>
<tr>
<td></td>
<td>Craft, trades, elementary occupations (HH head)</td>
<td>22.3%</td>
<td>17.5%</td>
<td>-21%</td>
</tr>
<tr>
<td></td>
<td>Plant/machine operators/assemblers (HH head)</td>
<td>9.5%</td>
<td>9.9%</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>Skilled and unskilled agricultural/etc. (HH head)</td>
<td>4.4%</td>
<td>3.7%</td>
<td>-16%</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 lOp

• 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

Toward a New Social Contract: Taking on Distributional Tensions

Relative inequality of opportunity

Return to education

Parental networking

Intergenerational persistence in education

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

Toward a New Social Contract: Taking on Distributional Tensions

Regressive and progressive tax changes across age groups

Increased taxation (+10 percentage points)

Hungary

Decreased taxation (-4 percentage points)

Increased taxation (+7 percentage points)

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

Toward a New Social Contract: Taking on Distributional Tensions
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)
Toward a New Social Contract: Taking on Distributional Tensions
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
Toward a New Social contract

Contribution 4: Principles for redesigning the 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 with the taxation of capital.
Toward a New Social Contract:
Taking on Distributional Tensions in Europe and Central Asia

Maurizio Bussolo
María E. Dávalos
Vito Peragine
Ramya Sundaram

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