Session: Rethinking the State for the 21st Century

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

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• Rising inequality is among the most serious problems of our times.
• Technological change, globalization, aging, and policy reforms have created opportunities, but also increased risks and volatility. The risk sharing systems do not work effectively anymore.
• Instead of a quick fix, a long-term, productive, and stable solution requires:
  (1) understanding better how distributional tensions are evolving.
  (2) rethinking the social contract—the shared principles used to regulate markets, define responsibilities and benefits, and redistribute incomes.
What are distributional tensions?
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• Stewart (2001): “Horizontal Inequality: A Neglected Dimension of Development”:
  • “an intrinsic part of human life is group membership, in fact it is this that makes up the identity of individuals [...] and these identities are a fundamental influence on behavior [...] and on wellbeing”


• Fukuyama (2018) “Identity: The Demand for Dignity and the Politics of Resentment”

• Gaps between subjective and objective inequality – Identity and Fairness (IOP)

• Europe is a region with one of the oldest and most developed welfare states in the world, but many of its mechanisms were not designed to deal with the new distributional tensions.
Why Social Contract?
Why “Social Contract”?

A stable social contract is achieved when there is a 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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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

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

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Preferences and Perceptions

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Perceptions of inequality (driven also by insecurity)
Imbalance?

Market-generated distribution of resources

Perceptions and societal preferences

Public policies

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Three principles

1) Moving toward equal protection of all workers, no matter their type of employment;

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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