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Inequality, Intergenerational Fairness, and the Social Contract

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Research Summary

Why was the research done?

This research was conducted as part of a broader forum on the threats to democracy, hosted by the Royal Society of New South Wales.

What were the key findings?

The paper argues that inequality – particularly when it is extreme or seen as unfair – threatens democracy by undermining support for the social contract. In particular, the level of inequality influences: 1) the degree of economic opportunity; 2) notions of fairness; 3) support for redistribution; and 4) the generational divide in social cohesion. A broad perspective on inequality is needed to understand these issues. While there is little evidence of a major shift in economic inequality in Australia, there is a growing perception that intergenerational economic opportunity is lacking. The paper speculates that much of this can be understood through the lens of housing insecurity in Australia.

What does this mean for policy and practice?

Policy makers need to adopt an intergenerational perspective when assessing the likely impact of future policy and ensure that policies mitigate rather than amplify inequality.

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We acknowledge the Traditional Custodians of the lands on which we work and live across Australia.
We pay our respects to Elders past and present and recognise their continued connections
to land, sea and community.

Inequality, Intergenerational Fairness, and the Social Contract

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**Threats to Democracy Forum
Royal Society of NSW Learned Academies Government House
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Introduction

Moral philosophers and social scientists have debated the implications of inequality for the way societies govern themselves for centuries. The concern is that inequality – particularly when it is extreme or seen as unfair – threatens democracy by undermining support for the social contract.

In this paper I will begin by discussing the conceptual links between economic inequality and the support for democracy, focusing on four key issues: i) economic opportunity; ii) notions of fairness; iii) support for redistribution; and iv) the generational divide in social cohesion. I then focus on a particularly salient issue in the current Australian debate – housing security – and consider the potential for better policy to reduce inequality and enhance social cohesion.

Economic Opportunity

There is a direct link between inequality and economic opportunity. Rising inequality pulls the rungs of the socioeconomic ladder further apart, reducing social mobility by making it harder for poor children to avoid becoming poor adults. A lack of social and economic mobility is, in turn, costly for society. Constraints on mobility at the bottom of the distribution mean that many people's talents are squandered, undermining productivity and economic growth (OECD 2017). At the same time, limited mobility at the top of the distribution 'may translate into persistent rents for a few at the expense of many, due to unequal access to educational, economic or financial opportunities' also resulting in inefficiencies (OECD 2018:13).

Perceptions also matter. Some studies suggest that people's beliefs about inequality and where they fit in the distribution are more important for individual wellbeing than are objective measures of how resources are distributed (Buttrick et al. 2017). The prospects for upward mobility have been linked to greater life satisfaction and improved wellbeing, while pessimism about social mobility can undermine social cohesion and the democratic process (OECD 2018). Research has found, for example, that

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economic inequality, measured by the Gini coefficient, drives down people's support for democracy (see Huang 2023 for a review). Currently, 68 percent of people worldwide believe that economic inequality is the biggest threat to democracy at home (Alliance of Democracies, 2024).

It's little wonder that US President Barrack Obama has called restoring economic opportunity "the defining challenge of our time" (Obama 2013).

What's Fair?

Inequality is also linked to the social contract and democratic support through societal perceptions of what is fair inequality and what is not. Martinez et al. (2017, p. 380) describe the distinction in the following way:

"Fair inequality emerges as a result of meritocratic societies rewarding people who are skilled and work harder while unfair inequality is driven by differences in the lottery of birth where the choices available to people are already constrained by the circumstances that they were born into. In the economic literature, the fair kind is called inequality of outcomes, while the unfair type is known as inequality of opportunities."

Promoting equality of opportunity can be thought of as reducing unfair inequality — that is, "seeking to offset differences in outcomes attributable to luck, but not those differences in outcomes for which individuals are responsible" (Roemer and Trannoy 2016 p. 1289).

Greater economic inequality tends to foster democratic beliefs in autocracies and erode democratic support in democratic regimes (Reutzel 2024). Much of this overall association appears to be the result of what is perceived to be unfair inequality, i.e. contexts in which economic opportunity is not shared equally, and inequality is driven by poor governance (Saxton 2021) or other factors beyond people's control (Reutzel 2024). Importantly, there is also evidence that unfair inequality deters economic growth, while fair equality enhances growth (e.g. Marrero and Rodríguez 2013, 2023; Bradbury and Triest, 2016; Aiyar and Ebeke 2020), raising the possibility that the fairness – or not – of inequality is linked to democratic support through overall living standards.

Support for Redistribution

Social and political theorists often argue that that the poor will be relatively more supportive of redistribution policies (e.g. Romer 1975; Meltzer and Richard 1981; Benabou and Ok, 2001; Piketty 1995). Empirical evidence, however, indicates that income is a surprisingly poor predictor of beliefs about redistribution. Those at the bottom of the distribution can be reluctant to support redistribution despite benefiting more from such policies (e.g. Fong 2001; Hoy and Mager 2021; Cavallé 2023). This apparent incongruence is sometimes hypothesized to be the result of the poor being overly optimistic about their own – or their children's – prospects for upward economic mobility (see Benabou and Ok, 2001). Hoy and Mager (2021) also note that this is consistent with the poor using their own situations as a benchmark for what is

acceptable for others. Either way, support for redistribution is difficult to understand using a simple socio-economic status lens.

The evidence is clear, in contrast, that people's support for redistribution is closely related to their beliefs about the relative importance of luck vs. effort in getting ahead – the same yardstick people use when deciding whether inequality is fair. Those who believe that getting ahead in life is largely influenced by hard work and merit are less supportive of redistribution, while those who believe opportunities are unequal are more supportive (Alesina and Angeletos 2005; Alesina and La Ferrara 2005; Alesina and Giuliana 2011; Almås et al. 2020). Researchers have demonstrated that this holds not only in observational data across a number of countries, but also in controlled laboratory experiments designed to uncover causal mechanisms (see Cappelen et al. 2022; Mengel and Weidenholzer 2022; and Lobeck 2023 for comprehensive reviews).

This makes it important to understand how societal views of the importance of luck vs. effort in getting ahead are formed. Researchers studying the issue have found, for example, that people often exhibit attribution bias – attributing their own successes to effort and their failures to luck. Moreover, these beliefs about the relative importance of luck and effort may be “motivated” in the sense that people may distort their beliefs about the true relationship between effort and success so that they can achieve a specific goal or justify a certain behaviour. Studying this issue in an experimental setting, Lobeck (2023) concludes that people's luck-effort beliefs depend on the past or current events that tell them about the true relationship between the two, but also the reward structure they expect to face in the future.

The consequence is that, in many countries, rising inequality does not result in egalitarian policy responses (see Cavaillé 2023 for a review). One explanation for why this might be the case is provided by Alesina and Angelotos (2005, p. 960):

Different beliefs about the fairness of social competition and what determines income inequality influence the redistributive policy chosen in a society. But the composition of income in equilibrium depends on tax policies. ... If a society believes that individual effort determines income, and that all have a right to enjoy the fruits of their effort, it will choose low redistribution and low taxes. In equilibrium, effort will be high and the role of luck will be limited, in which case market outcomes will be relatively fair and social beliefs will be self-fulfilled. If, instead, a society believes that luck, birth, connections, and/or corruption determine wealth, it will levy high taxes, thus distorting allocations and making these beliefs self-sustained as well. These insights may help explain the cross-country variation in perceptions about income inequality and choices of redistributive policies.

Australia's Generational Divide in Social Cohesion

Globally, the nature of inequality has changed over the past four decades. In 1980, more than half of worldwide inequality (57 percent) was attributable to disparities between countries; over the next decade this fell to less than a third (32 percent) (Chancel and Piketty 2021). Inequality is increasingly being felt within, rather than

between societies. What was once a disparity between “us” and “them” is increasingly a disparity between “us” and “us”.

It is also the case, that no single measure can capture all aspects of societal inequality. Often the debate centres on economic inequality – as measured by income or wealth inequality – however, disparities in health, life expectancy, social connections, political influence, and future aspirations are equally important in understanding people’s well-being. Inequality in one domain can bleed into other domains, of course. Importantly, “economic inequality translates into political inequality” (Stiglitz 2014, p. 11) which may directly shape the democratic process.

In Australia, the picture on economic inequality is mixed with estimates of the level of and trend in both income and wealth inequality depending on the data source, measure, and time periods considered. Income inequality today is higher than it was in the 1980s, though there appears to have been little change since the mid-2000s (see ABS 2019; Whiteford 2015; Wilkins 2014, 2015). In the lead-up to the pandemic, income inequality was stable; inequality declined at the start of the COVID-19 pandemic, then subsequently increased as the economy recovered. “It is inconclusive whether post-pandemic income inequality is higher or lower than pre-pandemic levels.” (Productivity Commission 2024, p.11).

The Productivity Commission (2024) has also recently concluded that, since the turn of the 21st Century, Australian wealth inequality has been relatively stable, likely declining in the aftermath of the COVID pandemic (see Figure 1). Property and superannuation are the two most important forms of wealth held by Australian households (ABS 2019), but the Productivity Commission estimates that inequality in both superannuation and housing wealth has declined as well (see Figures 2 and 3).

On balance, there is little evidence of a major shift in economic inequality in Australia.

Despite this, there is a growing perception that intergenerational economic opportunity is lacking. In 2022, 72 percent of Australians reported being pessimistic about the prospects of future generations, saying that they believe that children born today will be worse off than their parents (Clancy et al. 2022). This represented an extraordinary 14 percentage point increase in the degree of pessimism – the largest amongst all 15 countries surveyed – over the previous year. We can only speculate about the possible catalyst for the sudden lack of confidence in intergenerational progress – perhaps it is the result of COVID-19 lockdowns or general economic uncertainty – but whatever the cause, it does not seem to be the result of a dramatic shift in economic inequality.

There also is a growing generational divide in social cohesion. Younger cohorts are now less likely than older cohorts to agree that “Australia is a land of economic opportunity where in the long run, hard work brings a better life” – an age disparity that was not evidence in 2013 (O’Donnell 2023). The sense of belonging in Australia is falling, particularly among young people and those who do not feel financially secure (O’Donnell 2023).

It is hard to escape the conclusion that many people – specifically, many young people – are increasingly feeling left behind despite the stable trend in income and wealth inequality.

If the apparent unravelling of Australia's social fabric is not the result of a major shift in economic inequality, why is it happening? No doubt, there are many complex, nuanced answers to this question. Here I shine a light on one issue – housing – that is at the heart of the current Australian debate around inequality and intergenerational fairness.

International law has recognised adequate housing as a basic human right for nearly three generations.¹ Australia signed and ratified the various treaties that recognise the right to adequate living standards more than half a century ago. Yet today, 40 percent of young Australians feel that they might not have a comfortable place to live in the next 12 months (Walsh et al. 2023). Former President of the Australian Human Rights Commission, Rosalind Croucher, has called on governments at all levels to urgently respond to housing vulnerability not only as a social issue, but also as a social justice issue (Croucher 2024).²

Housing is important for many reasons, not the least of which is that housing is a core social determinant of health. Recent research in the U.K., for example, indicates that there is a link between housing tenure and biological aging.³ Specifically, Clair et al. (2024) concludes that living in a privately rented home is associated with faster biological aging relative to owning one's home outright. Crucially, despite the enormous wealth disparities and potential stigma associated with social housing, biological aging for those living in social housing was found to be the same as for those who owned their homes outright – an outcome which the authors posit may result from the additional security provided to those in social housing.

Addressing the Elephant in the Room: Is Policy the Problem?

Inequality is shaped not only by economic conditions, including the pace of economic growth, but also by social and economic policy (see Rice et al. 2021). This leaves us with some uncomfortable questions. Does the decline in Australia's social cohesion stem not from a belief that inequality itself is increasing, but rather the growing perception that the public policy is exacerbating inequality? Are the policies adopted by Australian governments fuelling a widening generational divide? What is fair in an intergenerational sense? Openly debating these questions – rather than treating them like an elephant in the room – is crucial because the answers go to people's notions of fairness, support for redistribution, and, ultimately, the willingness to support and participate in the democratic process.

¹ Adequate housing was recognised as a component of the right to an adequate standard of living in both the 1948 Universal Declaration of Human Rights and the 1966 International Covenant on Economic, Social and Cultural Rights (UN, 2009). Australia signed the ICESCR in 1973 and ratified it without reservations in 1975 (Croucher 2022).

² The Australian Bureau of Statistics has adopted a broad definition of homelessness that corresponds to being without a home, rather than a narrow definition consistent with being without a roof over one's head. In essence, 'homelessness' is therefore a lack of one or more of the elements that represent 'home' including housing stability (ABS 2012).

³ Biological ageing – measured through DNA methylation – has been proposed as a way of understanding how environmental conditions, such as socioeconomic status and stress, can have lasting biological impacts that influence outcomes, including health (Neu, 2022).

Housing accessibility, stability, and quality, for example, all contribute to the degree of security that people have in their housing. Each is driven by numerous policy decisions at all levels of government and there is ample room for Australia to do better. While the national policy debate has largely focused on strategies to stem the fall in homeownership rates, for many people the more immediate issue is likely to be how to navigate a rental market that is increasingly precarious. One clear policy option would be to increase the availability of social housing. Over the past 20 years, the social housing stock has remained stagnant despite the Australia population growing by a third; the consequence is that between 1991 and 2021 the percentage of social housing in the national housing stock almost halved (Coucher 2022).

Numerous other policies to provide more stability to renters in the private market should – at the very least – be on the table for discussion. These include long-term leases, rent control, limitations on evictions, rights around pet ownership, as well as ‘build-to-rent’ schemes and other policies that incentivise the development of housing that is both stable and affordable. Not all these ideas will pass the pub test. Nor will all attract the political leadership and bipartisanship necessary to turn good ideas into good public policy. But, surely, they must at least be debated.

More generally, there is a need for serious consideration of reforms to the nation’s tax and transfer system. Tax breaks for superannuation and housing investments are at the heart of a gap in wealth that leaves Australians at the top of the distribution owning 90 times the wealth of those at the bottom (Anglecare Australia 2024). Former Treasury Secretary, Ken Henry, believes that Australia’s present tax system “amounts to a conspiracy against future generations” (Henry 2024). Resolving this makes for an excellent starting point.

Looking Forward

Nobel Laureate Joseph Stiglitz reminds us:

“Inequality is not inevitable: it is a result of policies and politics. There are policies that would simultaneously reduce inequality, heal some of the divides in our society, and strengthen our economies.”

Stiglitz (2014, p. 1)

This leaves us with a glass that is at least half full. The good news is that there is a pathway forward. If policy has brought us to where we are today, then surely there are better policies that would reduce inequality, bridge the generational divide, and mend the social fabric. Completely filling the glass, however, requires that our democratic institutions are robust, inclusive, and civil enough to serve up the political leadership necessary to identify and enact those policies. This, of course, remains to be seen; it is not a matter to be taken for granted. Ben Rhodes – Deputy National Security Adviser under President Barack Obama – writing in the New York Times after the 2024 U.S. election puts it this way:

Democrats understandably have a hard time fathoming why Americans would put our democracy at risk, but we miss the reality that our democracy is part of what

angers them. Many voters have come to associate democracy with globalization, corruption, financial capitalism, migration, forever wars and elites (like me) who talk about it as an end in itself rather than a means to redressing inequality, reining in capitalist systems that *are* rigged, responding to global conflict and fostering a sense of shared national identity.

(Rhodes Nov. 8, 2024)

In the end, the greatest threat to democracy is the possibility that our democratic institutions are failing – or are perceived to be failing – a large share of society. Can democracy really survive if it has left people pessimistic about their children's futures? Or if it has left people feeling that hard work is not the pathway to getting ahead? Or if increasing numbers of people feel they are being excluded and left behind?

Tackling inequality – broadly defined and within as well as across generations – is crucial to righting the ship and strengthening the faith in our democratic institutions.

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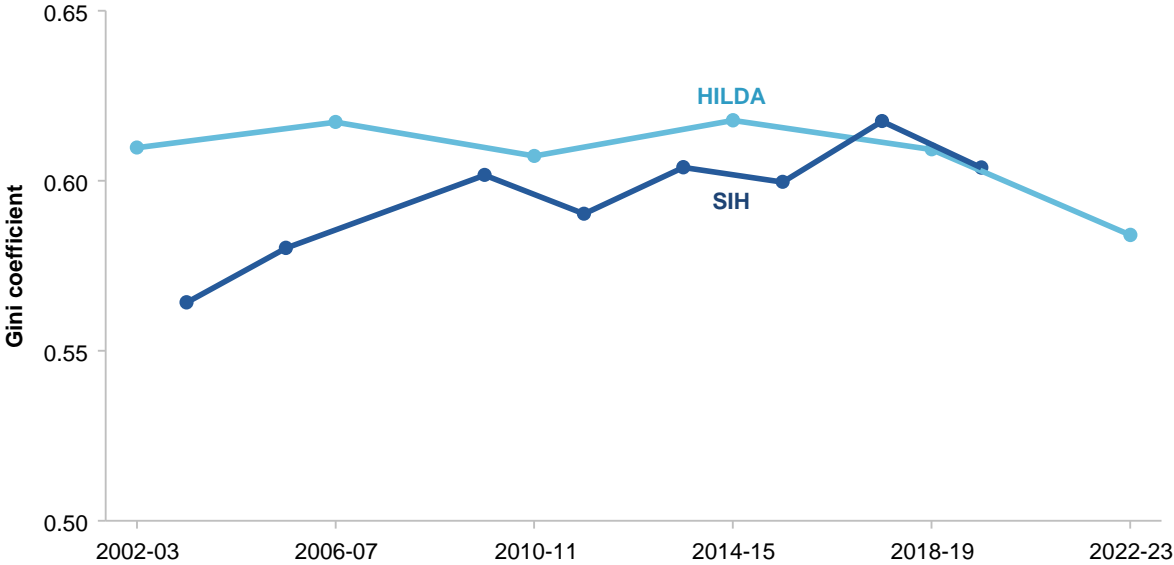
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Figure 1 – Wealth inequality was stable but declined recently

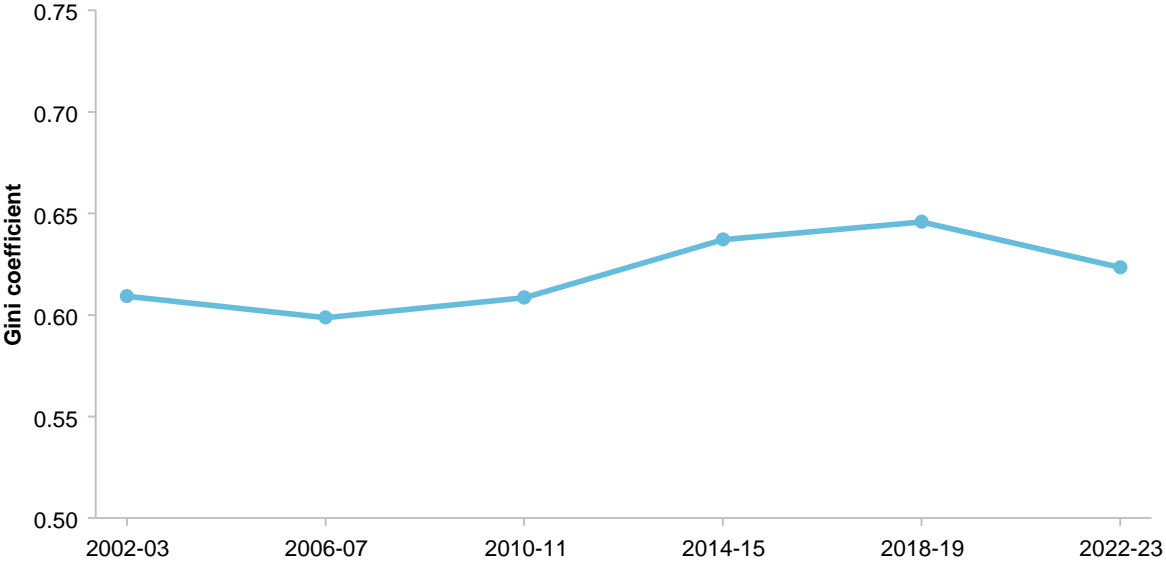
Gini coefficient for equivalised household wealth, 2002-03 to 2022-23



Source: Productivity Commission (2024)

Figure 2 – Housing wealth has become more equally distributed in recent years

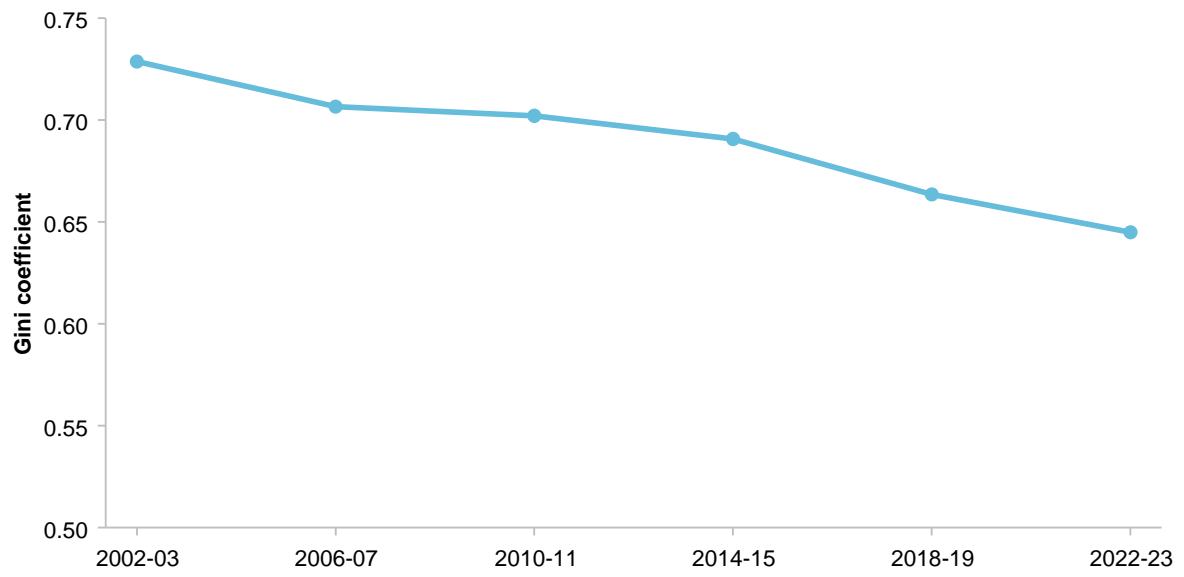
Gini coefficients for equivalised owner-occupied housing wealth, 2002-03 to 2022-23



Source: Productivity Commission (2024)

Figure 3 – Superannuation inequality has been declining

Gini coefficients for equivalised superannuation wealth, 2002-03 to 2022-23



Source: Productivity Commission (2024)