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SOCIAL SAFETY NETS
In the past, middle-income transition was possible without paying due attention to building social safety nets. In the future, this will change. Technology affects how benefits of convergence are distributed across fast-growing economies. Previously, countries were able to pursue successful income convergence strategies with relatively rudimentary social safety nets, as the rising tide of economic growth lifted all boats. The more recent wave of automation, however, may slow and even reverse the offshoring of jobs from advanced economies and simultaneously hollow out the medium-skilled segments of labour markets. Building social safety nets may be costly, yet the trade-off between faster growth and more comprehensive social safety nets may only be short term. In the longer run, social cohesion is key to making sure that growth-promoting economic policies can be sustained in the face of rapid technological change and demographic shifts.
Technological change has had a profound impact on the profile of economic convergence. Technology affects not only the rate at which total factor productivity can increase, but also the way in which the benefits of income convergence are distributed across fast-growing economies. In the past, the rising tide of convergence success used to lift all boats. This enabled countries to pursue successful convergence strategies with relatively rudimentary social safety nets and only strengthen social protection when economies achieved higher levels of per capita income (as in the case of many Asian economies, for instance).

This is likely to change as a result of evolving technology and demographic transformation. In the second half of the 20th century, low- and middle-income economies benefited from the rapid rise of global value chains and job creation that was largely concentrated in medium-skilled occupations, both in manufacturing and services (such as finance, insurance and accounting), which accompanied the rise of manufacturing industries.

**JOB POLARISATION HAS BEEN RISING IN EMERGING MARKETS**

The more recent wave of automation, however, may slow and even reverse the offshoring of jobs from advanced economies and simultaneously hollow out the medium-skilled segments of the labour markets of middle-income economies. Job creation in recent years has been increasingly concentrated in less skilled jobs (such as catering, construction and cleaning) that are harder to automate and in highly skilled jobs (including professional services, and research and development).

In the highly skilled segment, a unit of labour backed by new technologies is often scalable and can be sold an increasingly large number of times (a song or a piece of software can be downloaded millions of times, for instance). At the same time, units of labour in basic occupations that remain hard to automate, such as cleaning or catering, can be sold only once. As a result, technological change is expected to lead to a continued rise in pay inequality.

Highly paid skilled jobs, in turn, raise relative demand for personal services, be they cleaning or personal trainer sessions. This further reinforces the polarisation of occupations into what Goos and Manning (2007) called “lovely” and “lousy” jobs. In addition, in many cases, technological change leads to the deskilling of occupations long before they disappear. In the past, deskilling affected artisans, such as smiths and tailors, as mechanisation split more complex tasks into a large number of relatively simple ones. More recently, navigation systems have deskilled driving, while warehouse automation has deskilled jobs in logistics.

Labour-force surveys point to increasing job polarisation in middle-income economies. In emerging Europe, the share of medium-skilled occupations has been declining, while the shares of low-skilled and high-skilled occupations have been rising. Job polarisation has been increasing, both within sectors and across industries, at a pace similar to that seen in higher-income European countries (see Chart 4.1). Recent evidence also points to job polarisation in Egypt, South Africa and other large emerging markets.

The share of national income accruing to workers in the form of wages and salaries (the so-called labour share of income) in emerging Europe, Central Asia and North Africa has declined by around 4 percentage points since the mid-1990s. Other emerging markets have seen similar developments. The decline in the labour share of income exceeded the average decrease in advanced economies over the same period (see Chart 4.2), as in advanced economies, much of the decline in labour share of income happened before the mid-1990s.

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1 See IDB et al. (2018) for a discussion of the impact on various regions.
2 See also Autor and Dorn (2013).
4 See also OECD (2017a).
6 See IMF (2017a).
The recent experience of rising income inequality in the EBRD regions serves as an example of likely future trends across middle-income economies. Countries in the region experienced rapid growth of per capita incomes from the mid-1990s to 2008. However, inequality has also increased rapidly since the start of the transition from central planning to market economy. Estimates in the Transition Report 2016-17 suggest that in Bulgaria, for instance, only 28 per cent or so of the population saw income growth on a par with or above the average per capita income growth rate of the economy (see Chart 4.3).7

7 See EBRD (2016).
Overall, only 44 per cent of the population of emerging Europe and Central Asia is estimated to have personally experienced long-term income convergence – income growth above the average across the G7 economies (Canada, France, Germany, Italy, Japan, the United Kingdom and the USA). In most countries, those who have experienced income convergence tend to be higher up the income ladder today (see Chart 4.4).

The experience of emerging Europe and Central Asia differs from the typical experience of middle-income economies. Here, the distributional impact of technological change has been compounded by the transition from central planning, with a shift from highly compressed wages to wages determined by a competitive job market.

This growing inequality goes some way towards explaining the rise of populist politicians. Even countries with a consistently strong track record of growth, such as Hungary or Poland, have not been immune to populism. If the feedback loop between inequality and politics is ignored, populism and short-termism in economic policy-setting may undermine countries’ long-term economic growth and weaken their democratic institutions. This may, in turn, lead to greater short-termism, fuelling a vicious spiral, examples of which can be found in middle-income economies in Latin America, both past and present.

**CHANGING DEMOGRAPHICS**

Historically, demographic change tended to create strong tailwinds as economies moved towards middle-income status, only to produce equally strong headwinds at later stages of economic development. As low-income economies develop, the birth rate tends to fall and per capita spending on human capital rises. This boosts productivity growth. In addition, the labour force may initially increase as a percentage of the overall population, as the number of children per working age adult falls. This means that a given rate of productivity growth translates into a higher rate of growth in income per capita.

As economies develop further, however, improvements in the standard of living and better health care translate into higher life expectancy. As a result, populations age and the labour force starts to decline rapidly as a percentage of the total population. Over time, pension obligations necessitate increases in taxation, public debt and/or long-term interest rates. This negatively affects the average rate of growth.

Populations are ageing and birth rates are falling in most emerging markets, but this demographic shift is much further advanced in emerging Europe. The speed of population ageing, as reflected in the rising old-age dependency ratio, is virtually identical to that of advanced European economies. In terms of old-age dependency levels, central Europe and the Baltic states are only about five years behind the eurozone’s advanced economies. In China, ageing is expected to accelerate markedly (see Chart 4.5).
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GETTING OLD BEFORE GETTING RICH
Over time, the ageing phase tends to start earlier on the economies’ development path. In the 1980s and the 1990s, the ratio of people aged 65 and over to working-age adults surpassed 25 per cent when economies (such as Germany, Norway and Sweden) reached per capita incomes of 60 per cent or more of the US level. Today, economies reach the same old-age dependency ratio when their income levels barely exceed 20 to 30 per cent of that of the USA (for instance, Bulgaria, Serbia and Ukraine). This means many middle-income economies may now grow old before they can grow rich. These economies require pension systems that are affordable, yet provide a decent standard of living.

Today’s workers in middle-income economies, therefore, need to stay employed for far longer than they did a generation ago. This is challenging, as rapid technological change makes many specialised skills obsolete within a decade or less (recent studies find that around half of acquired skills lose their relevance within five years in the absence of retraining).8

LIFELONG LEARNING
As workers need to keep upgrading their skills and acquiring new ones, social safety nets need to adapt. More specifically, they need to facilitate lifelong learning through appropriately structured unemployment insurance and contributions to the cost of retraining. Educational systems need to focus more on helping students to learn how to keep learning throughout their careers, in addition to providing school and university graduates with specific skills.

DEMOGRAPHIC TRANSFORMATIONS AND AUTOMATION
Demographic transformations can accelerate technological change. Between 2017 and 2040, the labour force is projected to grow in only half of the world’s economies (based on their contribution to global output today). In the decade prior to the 2008-09 global financial crisis, the labour force was growing in almost every economy. As labour becomes scarcer in middle-income economies, the incentives to automate production grow, as they have in advanced economies.9

The new technologies, in turn, are likely to diminish the importance of companies as employers as self-employment takes hold, creating more jobs across the entire skills spectrum, from pizza delivery to private vehicle hire to software development.10 The rise of the “gig economy” may require a rethink of pension and social-protection provision, as saving for old age has traditionally been viewed as the responsibility of employers.11 While new platforms give workers greater flexibility and foster versatility of skill, in the absence of strong social safety nets, they also create anxiety and can take a toll on individuals’ (subjective) wellbeing.

RETHINKING SOCIAL SAFETY NETS
In future, policymakers in the middle-income economies will need to respond to these technological and demographic shifts with reform. Elements of the solution include the full portability of pensions between employers and self-employment, policies to support greater labour-force participation among older workers, and some degree of universal basic income as a means of counteracting the impact of more flexible labour markets and reduced job security on individual income paths.12 The new schemes also need to prioritise reskilling and upskilling – helping individuals to upgrade and extend their skill sets mid-career.

New technologies can be used to help create additional fiscal space for these policies, for instance, through greater transparency of (cashless) payments,13 stronger tax administration and the seamless exchange of information to fight tax evasion. Building social safety nets may be costly, but any trade-off between faster growth and social safety nets may only be short term. In the longer term, social cohesion is key to making sure that growth-promoting economic policies can be sustained in the face of rapid technological change and demographic transformation.

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8 See Deloitte (2017).
13 Rogoff (2016).