

An aerial, high-angle photograph of a densely packed urban area, likely a city in the Middle East. The buildings are tightly packed and feature a mix of architectural styles, including traditional domes and modern structures. A large, curved stadium or arena is visible in the lower-left quadrant, situated near a body of water. The overall color palette is dominated by warm, golden-brown tones, suggesting a sunset or sunrise. The right side of the image is partially obscured by a bright, hazy light source, creating a soft, ethereal atmosphere.

What We Owe Each Other

**A New
Social
Contract**

**Minouche
Shafik**

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About The Author

Nemat (Minouche) Shafik is Director of the London School of Economics and Political Science. Born in Egypt, she emigrated as a child to the USA, later moving to the UK for post-graduate studies in economics. At 36, she became the youngest ever Vice President of the World Bank and has since held positions as Permanent Secretary of the UK's Department for International Development, Deputy Managing Director of the International Monetary Fund and as Deputy Governor of the Bank of England, working on major policy upheavals across the globe, from the fall of the Berlin Wall, to the Arab Spring, to the financial crash in 2008 and the Eurozone crisis. Following her appointment as Director of the LSE in 2017, she launched a programme of research, 'Beveridge 2.0', to rethink the welfare state for the 21st century. She was made a Dame in the Queen's Birthday Honours list in 2015 and in 2020 was appointed a cross-bench peer in the House of Lords.

*For Adam, Hanna, Hans-Silas, Maissa, Nora, Olivia
and Raffael*

Illustration Notes and Credits

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Acknowledgements

Not surprisingly, I owe many people a great deal in helping me write this book.

The idea of writing a book was planted by Rupert Lancaster after he attended a lecture I gave at the Leverhulme Foundation in 2018. At LSE, I benefited from being surrounded by people who are interesting and interested, starting with my colleagues in the School's Management Committee and Council. Many colleagues shared ideas and provided generous comments on early drafts, and I am particularly grateful to Oriana Bandiera, Nick Barr, Tim Besley, Tania Burchardt, Dilly Fung, John Hills, Emily Jackson, Julian LeGrand, Steve Machin, Nick Stern, Andrew Summers, Andres Velasco and Alex Voorhoeve. Several friends and former colleagues pointed me to relevant literature, provided helpful comments and much-needed encouragement: Patricia Alonso-Gamo, Sonya Branch, Elizabeth Corley, Diana Gerald, Antonio Estache, Hillary Leone, Gus O'Donnell, Sebastian Mallaby, Truman Packard, Michael Sandel and Alison Wolf. I owe them gratitude for their good ideas; any errors are exclusively mine.

Max Kiefel provided outstanding research assistance, finding interesting material and helpful suggestions even though we only managed to meet in person once because of the pandemic. James Pullen, my agent at Wylie, helped me navigate the world of publishing and was a constant source of good advice. Will Hammond, my editor at Penguin Random House, encouraged me to avoid academic jargon and helped make the text far more readable. Joe Jackson at Princeton University Press also gave helpful feedback.

I owe so much to my mother Maissa, who drove me to all those libraries and always supported me, come what may. I am grateful to my sister Nazli, niece Leila and my vast extended family, who provide a wonderful example of a social contract that is generous and enables everyone. To my husband Raffael, I owe thanks for making me braver and encouraging me to take on ever bigger challenges. Our children – Adam, Hanna, Hans-Silas, Nora and Olivia – were uppermost in my mind as I wrote the chapter on the intergenerational social contract. For them, and all our children and future grandchildren, I hope we manage to organise a better social contract for all of you to thrive.

Preface

‘Things fall apart; the centre cannot hold ... Surely some revelation is at hand ...’

So wrote W. B. Yeats in the wake of the horrors of World War I as his pregnant wife lay gravely ill from the 1918–19 flu pandemic. The phrase ‘things fall apart’ was quoted more often in 2016 than at any time in previous years.¹ Yeats’ poem captures a sense of foreboding, when change seems inevitable. Recent years have seen the economic aftermath of the 2008 financial crisis, increasingly divisive politics, environmental protests and the coronavirus pandemic. Periods of great instability can result in a radical reordering of our societies. What that reordering looks like depends on the institutions that are in place, which leaders are in power and what ideas are in the ascendance.²

Over these recent years, I have seen many of the assumptions and increasingly the institutions and norms that have shaped my world fall apart. I spent 25 years working in international development and witnessed first hand how ‘making poverty history’ resulted in huge improvements in people’s daily lives. Humans really have never had it so good. And yet in so many parts of the world, citizens are disappointed, and this has revealed itself in politics, the media and public discourse. Rising levels of anger and anxiety are associated with people feeling more insecure and lacking the means or power to shape their future. Support for the system of international cooperation that has existed since the post-war period, and in which I spent much of my career, is also waning as nationalism and protectionism come to the fore.

The global pandemic of 2020 brought all of this into sharp relief. The risks that the poor, those in precarious work and those without access to health care were exposed to were laid bare. The interdependencies between us were revealed as ‘essential workers’ were largely the lowest paid without whom our societies could not function. We could survive without bankers and lawyers, but grocers, nurses and security guards were invaluable. The pandemic revealed how much we depended on each other for survival but also for behaving in socially responsible ways.

Moments of crisis are also moments of opportunity. Some crises result in decisions that change society for the better – such as the New Deal measures introduced to counter the Great Depression or the rules-based international order that emerged after World War II. Other crises sow the seeds of new problems – such as the inadequate response to World War I or the 2008 financial crisis and the populist backlash it spawned. The impact of the coronavirus crisis remains to be seen. Whether it results in improvements or not depends on what alternative ideas are available and how politics evolves to choose among them.³ After much reading, listening, thinking and talking, I found that the concept of a social contract, the policies and norms that govern how we live together in a society, was a useful construct for understanding and defining alternative solutions to the challenges we face.

Over the years many of the ideas that shaped thinking about social contracts around the world were forged at the London School of Economics and Political Science (LSE), where I currently serve as the Director. There is a long tradition of thinking about the relationship between the economy and society, starting with the founders of the Fabian Society and the LSE, Beatrice and Sidney Webb. Beatrice spent years collecting data in the poorest parts of London and seeing the impact of deprivation first hand. As a member of the 1909 Royal Commission on the Poor Laws, she authored a dissenting minority report that rejected the harsh system of workhouses and Britain’s piece-meal approach to supporting those in

poverty. In it, she argued that a new social contract for the UK would 'secure a national minimum of civilised life ... open to all alike, of both sexes and all classes, by which we meant sufficient nourishment and training when young, a living wage when able-bodied, treatment when sick, and a modest but secure livelihood when disabled or aged'.⁴ More than one hundred years later, that is still an aspiration in most countries in the world.

Her arguments were reflected in the hugely influential report authored by William Beveridge (LSE director 1919–37) that designed the modern welfare state in the UK, including the National Health Service and a comprehensive approach to minimum incomes, unemployment insurance and pensions. The Beveridge Report (1942) was revolutionary, and more copies were sold than any previous government document as the public queued to buy copies to understand this fundamental reordering of the rights and responsibilities of citizens in the UK. Much of its implementation occurred under Prime Minister Clement Attlee, who had previously been a lecturer at the LSE and won the election in part by backing the Beveridge Report. While the focus of the Webbs and Beveridge was on the UK, their ideas had a huge impact across Europe and in much of the post-colonial world, especially in India, Pakistan, East Asia, Africa and the Middle East.⁵

The LSE was also at the heart of the next reordering of societies, when Friedrich Hayek, a recent émigré from Vienna, professor at the school and Nobel prize winner, published *The Road to Serfdom* (1944). Hayek thought the interventionist state advocated by Beveridge would take society down the path of totalitarianism. He laid the foundations for classical economic liberalism with his focus on individual liberty and the efficiency of markets. Hayek left the LSE in 1950 and went to the University of Chicago, where his ideas influenced Milton Friedman and provided the basis for what later became known as the Chicago School, dedicated to liberalism and laissez-faire economics. Both Margaret Thatcher and Ronald Reagan credited Hayek with their political philosophies and their emphasis on individualism and free markets.⁶ Hayek was also hugely influential in central

and eastern Europe, where his books were widely read by dissidents who helped bring about the collapse of the Soviet Union.

The subsequent Third Way was an attempt to define an alternative to the interventionist state of the Fabians and the laissez-faire market liberalism of Hayek. Many ideas on how to use markets to achieve more egalitarian ends emerged at the LSE, with Anthony Giddens (another director of the school, 1997–2003) publishing *The Third Way* in 1998.⁷ These views were embraced by social-democratic politicians around the world, including Bill Clinton in the US, Tony Blair in the UK, Luiz Inácio Lula da Silva in Brazil, Gerhard Schröder in Germany, Thabo Mbeki in South Africa and many more. The Great Recession of 2008 saw the collapse of support for the Third Way, which lost credibility in the wake of the financial crisis as centrist leaders were increasingly replaced by populists around the world.

And so here we are again, in need of a new paradigm. Profound changes in technology and demography are challenging old structures. The climate crisis, the global pandemic and its inevitable economic aftermath have revealed the extent to which our existing social contract is no longer working. This book is an attempt to understand the underlying causes of these challenges and, more importantly, provide an alternative view on what a social contract fit for the twenty-first century might look like. It is not a blueprint, but I am hoping it is a modest contribution to fostering debate and providing a direction of travel for future policy.

I have spread myself thin in this book, trying to cover so many issues from a global perspective, and some readers will be able to identify exceptions to many of the points that I make. I draw heavily on academic research in peer-reviewed journals and meta-analyses – summarised findings of sometimes hundreds of pieces of research. The sources for most of this technical material can be found in the endnotes. I am a strong believer in evidence, the value of expertise and the importance of rigorous debate, but I also express my own judgements about what this

literature teaches us about how different countries have developed solutions to what we owe each other in society.

Those judgements are inevitably rooted in my personal experiences of family, education, work and the impact of society and the state. My interest in economics originated from a desire to understand the architecture of opportunity in society. As a child, I would visit my mother's family's village in Egypt and see girls who looked just like me but who couldn't go to school, worked hard in the fields and had few choices about who they would marry or how many children they would have. It seemed so random and unfair that I had opportunities that they did not – I could have easily been them and they been me. Those opportunities changed radically when most of my family's land and property was nationalised by the Egyptian state in the 1960s and we emigrated to the United States, where my father had studied.

For my father, who had a PhD in chemistry and little else, education was the only path to success. 'They can take everything away from you except your education,' was his oft-repeated adage. But the educational opportunities open to us were mixed in the American south during the turmoil and tensions of desegregation. I was bused to more schools than I can remember, some of which had inspired teachers, some in which the main objective was survival. My salvation was the local libraries, where my mother dutifully took me on the weekends. I had memberships in several to maximise the number of books I could take out each week and spent long hours on the sofa at home discovering the world.

After climbing the ladder of educational quality, that curiosity about the architecture of opportunity led me to a career in economics and development that spanned the World Bank, the UK Department for International Development, the International Monetary Fund and the Bank of England. I love universities and spent eighteen years in them, but most of my career has been in the trenches of policymaking. Perhaps what is unusual is having done it in such a broad array of countries – from some of the poorest in the world like South Sudan and

Bangladesh to some of the richest, such as the UK or the Eurozone. I have also worked with politicians from across the political spectrum – in the UK, I was a permanent secretary for both a Labour government and the coalition of the Conservatives and Liberal Democrats. In my years at the World Bank and IMF, I worked with hundreds of politicians of every imaginable political stripe. That perspective of having been a practitioner of policy as well as a student of policy permeates this book.

After 25 years working in international economic institutions, I saw how much benefit came from sharing experience across countries. Of course, every country has its distinctiveness, especially on issues such as the balance between the individual and the collective in the social contract. Countries like the US put more emphasis on individual freedom; Asian societies tend to prioritise collective interests above individual preferences. Europe is somewhere in the middle, trying to strike a balance between individual freedom and collective interests. Behind each of those generalisations are many exceptions and examples that can teach us how to tailor solutions for different contexts. Rarely is there one right answer, but a set of options and trade-offs that involve various costs and benefits reflecting different value judgements.

In addition to being global and focused on solutions, I have also tried to make this book personal. For me, the terms of the social contract are not some abstract activity reserved for technocrats and policy wonks. Policy decisions on how an education system is organised or how health care is funded or what happens when you lose your job have huge consequences for everyone. They make the difference between the life I have led and that of those little girls in the village. That is why this book is organised around the stages of life that most of us experience – raising children, going to school, getting sick, finding work and growing old. My hope is that this perspective will make these important issues accessible and encourage us all to have opinions on these vital matters.

What Is the Social Contract?

Society is everything. Many of us go through life thinking we are self-made and self-sufficient. Some may credit (or blame) their families for their lot in life, but rarely do we think about the bigger forces that determine our destinies – the country we happen to be born in, the social attitudes prevalent at a particular moment in history, the institutions that govern our economy and politics, and the randomness of just plain luck. These wider factors determine the kind of society in which we live and are the most important determinants of our human experience.

Consider an example of a life in which society plays a very small role. In 2004 I spent time with a family in the Ecuadorian Amazon. Antonia, my host, had twelve children, and her oldest daughter was about to give birth to her first grandchild. They lived on the edge of the rainforest with no road, electricity, running water or sanitation. There was a school, but a considerable distance away, so the children's attendance was patchy. However, Antonia was a community health worker and had access via radio to a doctor in a nearby town who could provide advice to her and others. Apart from this service (arranged by a charity), she and her husband had to be completely self-reliant, gathering food from the forest, educating their children on how to survive in their environment. On the rare occasions when they needed something they could not find or make themselves (like a cooking pot), they panned for flecks of gold in the Amazon, which

they could exchange for goods in a market at the end of a long journey by canoe.

This may seem like a very extreme and distant example, but it serves to remind us how accustomed we are to the things that living collectively in a society gives us – infrastructure, accessible education and health care, laws that enable markets in which we can earn incomes and access goods and services. Antonia and her daughter promised to name the baby they were expecting Minouche, which was a great honour. I often wonder what kind of life that other Minouche will be having as a result of being born in a very different society.

The way a society is structured has profound consequences for the lives of those living in it and the architecture of opportunity they face. It determines not just their material conditions but also their well-being, relationships and life prospects. The structure of society is determined by institutions such as its political and legal systems, the economy, the way in which family and community life are organised.¹ All societies choose to have some things left to individuals and others determined collectively. The norms and rules governing how those collective institutions operate is what I will call the social contract, which I believe is the most important determinant of the kinds of lives we lead. Because it is so important and because most people cannot easily leave their societies, the social contract requires the consent of the majority and periodic renegotiation as circumstances change.

We are living at a time when, in many societies, people feel disappointed by the social contract and the life it offers them. This is despite the huge gains in material progress the world has seen over the last 50 years.² Surveys find that four out of every five people believe ‘the system’ is not working for them in the United States, Europe, China, India and various developing countries.³ In many advanced countries the majority no longer believe their children will be better off than they are. In the developing world, aspirations for education, health care and jobs are often well ahead of a society’s ability to deliver them. And

across the world workers worry about losing their livelihoods because of a lack of skills or the prospect of automation.

This disaffection takes many different forms. Some in rural areas and small towns argue that disproportionate attention and resources go to cities at their expense. Native populations in some countries feel that immigrants are changing their societies and receiving benefits before they have paid their dues. Some members of once-dominant races resent other ethnicities demanding equal treatment. Some men feel threatened by newly empowered women and policies such as quotas and targets that disadvantage them. A proportion of the young are increasingly vocal about the elderly, who they believe consume a growing share of resources in health care and pensions while leaving them with a legacy of debt and environmental destruction. Some older people feel the young are not sufficiently grateful for past sacrifices made on their behalf.

This book tries to get at the root causes of this disappointment through the lens of the social contract: an approach that recognises the primacy of expectations and mutuality, the efficiency and value in collective provision and sharing risks, the importance in adapting to a changed world if we are not to witness a destructive fracturing of the mutual trust on which citizenship and society is based. How much *does* society owe an individual and what does an individual owe in return? And in this time of great change, how might those mutual obligations need to adapt? The answers to these questions would appear to be at the heart of solving many of the political, economic and social challenges facing the world today.

Expectations and the Social Contract

Who is 'we' in the question 'What do we owe each other?' To whom do we feel mutual obligations? This is a complex question that has personal, cultural and historical dimensions. I like to think of mutual obligations as concentric circles. At the core, most of us feel the greatest obligations to our immediate family and friends. Parents will make huge sacrifices for their children;

friends will go to great lengths to support each other. In the next ring of the circle is the community in which we live. This is often the domain of voluntary groups, religious associations, neighbourhood and local government structures. In the next ring is the nation state, in which we owe each other the duties of citizenship – paying taxes, obeying the laws, voting, engaging in public life. In a regional integration project such as the European Union, there has been an attempt to foster a sense of ‘we’ in another ring consisting of citizens of the nation states that are members of the union. The final circle is the world, where the obligations may be weaker but become more apparent when there is a humanitarian crisis or a global challenge like climate change, when international solidarity becomes important.

Every day we navigate mutual obligations and take care of others, not just within our families, but within communities and nation states, far in excess of our narrow self-interest. Most obviously we pay taxes that will benefit people in other parts of the country (and sometimes other parts of the world) who we will never meet. We do this because we believe that living in a fair, well managed society helps us to live a better life and we are willing to contribute our share to achieving that for our own interest and because of solidarity with our fellow citizens. Employers in many countries are required to offer benefits to their employees, such as parental leave and pensions, and many add voluntary benefits on top of those. For the provision of fuel and water, transport and sanitation, we rely on publicly provided infrastructure, which we expect to be universally available. We expect decent schools and health care and safety on our streets in return for which we obey the law. All of these are ways in which we balance our individual desires and the need to live collectively with other people. This collective solidarity extends across generations when we make long-term investments and conversely when we consume resources that take possibilities away from future generations.

Throughout history, people have pooled their resources to varying degrees in order to enjoy the benefits and manage the

political rationale for social solidarity is that, for democracies to function, citizens have to share enough common experience to feel they have a common purpose.¹¹ Finally, the economic rationale is that pooling risks for things like sickness, unemployment and pensions across a large number of citizens is more efficient than individuals trying to insure themselves.

In Smith's vision there are also limits to sympathy, to what the individual can expect, and an unwillingness to share risks when individuals behave 'badly'. And so it is today. Risks that are not the fault of the individual – disability or a job loss resulting from an accident or sudden economic shock – are the ones that most people are willing to share. However, if losses result from smoking or drunk driving or poor performance at work, many believe that individuals should suffer the consequences of their actions. At the same time, others argue that bad behaviour is most often the product of upbringing, deprivation or even mental illness. Moral judgements about individual behaviour and responsibility are often central to questions about how generous the social contract should be.

The most influential twentieth-century philosopher to discuss the social contract as the basis for creating a just society was John Rawls.¹² He argued that we should design our social contract behind a 'veil of ignorance' – meaning without prior knowledge as to what our own status in that society would be. Because we did not know if we would start life privileged or a pauper, we would create a social contract that was just. His principle of equal opportunity states that 'those who are at the same level of talent and ability, and have the same willingness to use them, should have the same prospects of success regardless of their initial place in the social system'.¹³ Today, the notion of equality of opportunity lies at the heart of many citizens' expectations the world over, and the perception of its absence is an important source of anxiety and disaffection.

In modern societies there is an expectation that those who try hard will improve their lot. This was not always the case, and in many traditional societies there was an almost fatalistic acceptance of the prevailing hierarchy, with some arguing it was

essential for social order. But today most countries include enabling social mobility as part of the social contract because it seems more fair, binds society together and enables collective action. The poor need to have the expectation that they or their children will be better off. The rich need to fear their children may be poorer to foster concern about the less well off and create a sense of common interest.

In practice, countries vary enormously in the architecture of opportunity that they offer their citizens. For example, in Denmark it takes on average about two generations for someone to go from being lower income to middle income; in the UK it is five, and in highly unequal countries like Brazil, South Africa and Colombia it takes more than nine generations. These differences in social mobility (Figure 1) are part of the reason we see most frustration with the social contract in precisely those countries where the prospects of improving your lot over time are low or have fallen in the recent period. There is also much evidence that disadvantage, both within families and geographically, is highly persistent across many generations.¹⁴

The Social Contract, the State and the Private Sector

Many people think the social contract is the same as the welfare state, but the concepts are not synonymous. The social contract determines what is to be provided collectively and by whom; the welfare state is one of several possible means of provision. In fact, in every society a huge amount of what falls within the bounds of the social contract continues to be provided by families – for example, through unpaid parental labour educating children, pooling resources in times of ill health or unemployment, or by purchasing private insurance. Communities, charitable and voluntary organisations do a great deal to care for the needy and the elderly, respond to humanitarian crises and support people to get back into work. Employers are often required by law to deliver aspects of the social contract by contributing to unemployment benefits and in some countries to mandatory health insurance, with some

providing additional services such as childcare facilities, educational benefits and well-being and mental health support.

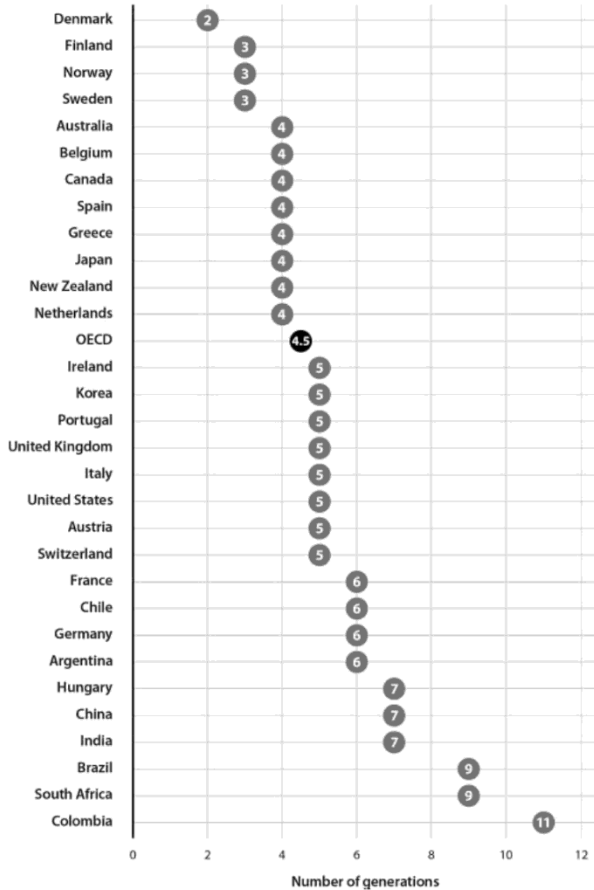


Figure 1. Social mobility: how many generations does it take to go from being low income to middle income in different countries?

When I refer to the social contract, therefore, I mean the partnership between individuals, businesses, civil society and the state to contribute to a system in which there are collective benefits. When I refer to the welfare state, I mean the mechanisms for pooling risks and investing in social benefits mediated through the political process and subsequent state action. This can be directly through taxation and public services

or indirectly by regulations that require the private sector to provide support. The collective benefits can also include the state serving as the insurer of last resort, for example by preventing people starving or being left homeless or destitute when there is a natural disaster or pandemic.

Before we had nation states, the social contract was based on tribes and local loyalties that provided mutual protection and some sharing of basic needs like food or shelter. This evolved in the feudal period into local rulers who delivered law and order and extracted rents in exchange, with an overarching structure of monarchy on top. It was only in the early-modern period that nation states evolved, not just to secure and extract, but also to invest in collective goods like infrastructure financed by limited taxation. As capitalism developed, the social contract became more complex as families became less self-sufficient with a growing division of labour; systems of regulation emerged and public services such as sanitation and electricity had to be coordinated and financed. Providing such collective goods, including having an educated and healthy workforce, became an increasingly important part of the social contract and grew into what we now call the welfare state.

The conservative Prussian Otto von Bismarck is usually credited with bringing in the first legally mandated requirement for social solidarity when as chancellor he introduced a compulsory insurance scheme for pensions and sickness in Germany in 1889. His motives were to make the economy more efficient and to avert more radical proposals, such as the expropriation of property, of his socialist opponents. In a ground-breaking letter to the German parliament, he wrote, 'Those who are disabled from work by age and invalidity have a well-grounded claim to care from the state.' The retirement age was set at 70, which, given life expectancy at retirement in Germany at the time, meant the state would provide a pension for seven years on average.¹⁵

In the UK, the first person to call for collective responsibility for health care was Beatrice Webb in her Royal Commission on the Poor Law in 1909, which recommended the creation of a

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is to make profits, abide by regulations, pay market wages and taxes, and by doing this, the private sector will maximise its contribution to society.²⁹ However, there has been a long tradition of companies that take a more holistic view of their role, sometimes paying higher-than-market wages or providing wider benefits such as pensions and health care, and sharing their profits with their employees. This tradition is now coming to the fore. Increasingly, businesses are under pressure to focus not just on short-term profits but on the wider interests of society – so-called multi-stakeholder capitalism. Proponents argue that this is not charity but a way to maximise companies' long-term value.³⁰

In practice, most countries choose a mix of individual and collective responsibility across different sectors to define their social contracts. Consider traditionally conservative Switzerland. Swiss citizens have relatively low levels of taxation, typical of a small-state approach, but a high proportion of young people go into tertiary education, which is largely free and provided by the state, though about half of those follow a vocational rather than a purely academic track. There is also a complex system of regional redistribution with very high levels of decentralisation and local democracy through referenda. Meanwhile, Singapore, famously organised on free-market rather than big-state principles, also has low levels of taxation and regulation, but over 80 per cent of the population live in public housing socially engineered to achieve racial balance, and all men must do at least two years of compulsory military service as a way to build cohesion in this very multi-ethnic, young country. Meanwhile, nominally communist China until recently had no public health-care provision or unemployment benefits and still does not impose any inheritance tax on the wealthy.

The mix between individual and collective responsibility that countries choose can also vary enormously within any given sector. Consider the approach to financing higher education, which is, in economic terms, both a private good (generating higher income for the individual) and a public good (developing active citizens who are more capable, productive, and commit

fewer crimes).³¹ How do different countries decide how much to invest in the next generation's productivity and who pays for it? At one end is the United States with a more market-based approach whereby individual students take loans on semi-commercial terms that they are expected to repay over the course of their working lives. In the United Kingdom an intermediate solution has evolved whereby students take out loans but only repay them if their income rises to a certain level. Continental Europe and most emerging markets mainly rely on state funding of higher education, but because it is free and resources are limited, high numbers of students often mean that quality suffers. In China, with its one-child-policy legacy and state-funded education system, six adults (two parents and four grandparents) supplement government spending with significant private investments in exchange for the expectation that they will be cared for in old age. Each of these models reflects a very different view of what one generation owes the next.

What Broke the Social Contract? Technology and the Changing Role of Women

In the past, social contracts were redefined at times of great upheaval – the Great Depression brought us the New Deal in the US; the world wars were the backdrop for the Beveridge Report in the UK; decolonisation was followed by activist governments eager to promote economic and social development. A prolonged period of recession and inflation was the context for the ideological shift behind the Thatcher/Reagan revolution that shaped much of current policy thinking. It is my contention in this book that many of today's challenges – the rise of populism, the backlash against globalisation and technology, the economic aftermath of the financial crisis in 2008 and the coronavirus pandemic, the culture wars around race and women's roles in society and the youth protests about climate change – are bellwethers that a new social contract is needed.

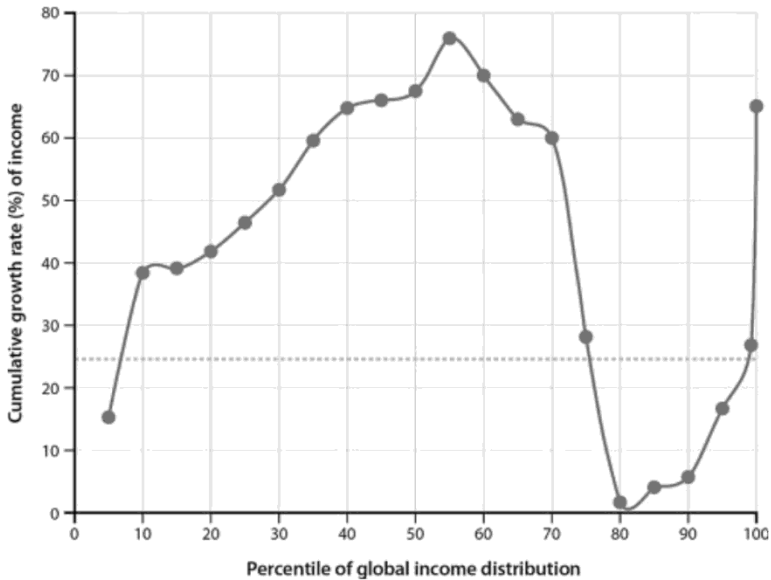


Figure 3. The top 1 per cent and people in developing countries have benefited most from recent economic growth

It need not have been this way. Had policies been in place to help workers adapt to these new circumstances, the negative effects could have been much reduced. For example, in the United States, where the impact of China’s integration into the global economy was huge, a policy called the Trade Adjustment Program was put in place to help workers with training, relocation grants and wage insurance. But it was chronically underfunded and high barriers were put into place for accessing it, so that few workers were able to benefit and find new jobs.³⁴ In the face of the rapid growth of immigration, the UK had a policy to help local government cope called the Migration Impacts Fund, but the money available was too small for the policy to be effective. By contrast, those countries, such as Denmark, that have invested more in what are called active labour market policies, which provide generous support to help all workers adjust to economic shocks, have fared better.

The other major pressure on the social contract has been the massive expansions in girls’ education and the number of women working in the labour market rather than in the home. Almost