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Capitalism needs a new social contract

Minouche Shafik*

Abstract: Capitalism needs a new social contract to better manage the consequences of technology and an increasingly diverse and flexible workforce. That social contract should retain the benefits of flexibility but do a better job of providing security in the form of mandatory benefits, putting a floor on incomes, and investing far more in helping workers adapt to economic shocks and rising automation. It also means a new deal with business that would achieve a more level playing field in how capital and labour are taxed.

Keywords: capitalism, social contract, labour markets, taxation of capital

JEL classification: P00, O00, J08, I38, F60, A13, B55

I. Introduction

The failings of modern capitalism have become familiar—inequality, insecurity, and lack of opportunity for those who start with disadvantages. Churchill famously said that 'Democracy is the worst form of Government except for all those other forms that have been tried from time to time'. Perhaps the same can be said of capitalism as an economic model. But over time and across countries, there are many flavours of capitalism that have managed the social consequences of market forces in very different ways. And throughout history, capitalism has evolved as societies act to constrain its worst effects, such as robber barons or child labour, while retaining the unrivalled benefits of efficiency and productivity that market forces can deliver.

I argue that capitalism needs a new social contract to underpin it that preserves the benefits of economic dynamism while creating a better architecture of security and opportunity for all. The current model has been broken by varied forces, including those whose overall impact on society has been positive. These include technological change, which is revolutionizing work, and the entrance of increasingly educated women into the labour market, which interferes with their ability to care for the young and the old

* Director, London School of Economics and Political Science, UK, e-mail: director@lse.ac.uk

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for free. Looking ahead, population ageing means that we will need to find new ways to support the elderly, and climate change compels us to do more to make the world environmentally sustainable.

My arguments draw on my recent book, *What We Owe Each Other: A New Social Contract*, that looks at how the social contract is broken and what needs to change 'from cradle to grave' (Shafik, 2021). In this essay I focus on the social contract at the heart of capitalism—that between firms and their workers. I believe that if we can re-align regulations, change the balance of risks, and provide new opportunities and support to cope with change, there is a possibility of a new consensus around the kind of capitalism that enables everyone to thrive in the future.

II. What has happened to work?

The traditional model of work in advanced economies is that most people are in full-time employment and make mandatory contributions to society via some form of payroll tax. In exchange, they receive unemployment insurance, a pension when they are old, and, in some countries, health insurance. In low-income countries, meanwhile, the majority of the population works in the informal economy without access to legal contracts, unemployment benefits, or other forms of social insurance.[1] Instead, they must rely on their family and community in times of economic distress. But who is working has changed dramatically in recent years, and this in turn has affected the nature of these arrangements.

Traditionally, the workforce was mainly men of 18–60 years of age. Today, women have entered the workforce in large numbers across the world. Fewer young people are in employment as more of them remain in education for longer, in hopes of higher wages later in life. Many young people now do not join the workforce until well into their twenties. More old people are working as retirement ages rise in many countries and since many need to save more to cover their needs in old age. Today's global workforce is older and more diverse in terms of gender and work patterns.

A more diverse workforce has resulted in a growing proportion of workers operating under more flexible work arrangements. Indeed, this has been the primary driver in the growth of jobs in recent decades.[2] Jobs are increasingly characterized by temporary contracts, part-time arrangements, and so-called 'gig' work, serving multiple employers enabled by a technology platform. Benefits like social insurance are often not provided, leaving the risks of dislocation to be borne exclusively by the worker rather than shared with a single employer. Workers increasingly carry the risk of how many hours they will work, keeping their skills relevant, supporting themselves if they get sick, and securing their income for when they are old.

[1] In Sub-Saharan Africa, informal employment exceeds 70 per cent of the labour market; it is 60 per cent in South Asia and 50 per cent in Latin America. See World Bank (2019).

[2] Part-time paid work was the primary driver of the increase in overall employment between 2000 and 2018. Its share rose in 18 out of 21 countries, by an average of 4.1 percentage points, equivalent to 29 million jobs, while that of full-time employment declined by 1.4 percentage points. See McKinsey (2020).

Job stability, measured as the length of time spent in the current job, has fallen across advanced economies.[3] The sharpest falls in job security have been for lower educated workers without an upper secondary qualification (more than 9 years of education). Underemployment, where workers would prefer to work more hours, has also increased, especially for young people, women, and those without any higher education. Young people without higher education have fared particularly poorly, often underemployed or in very low paid work. Young people with higher education have fared better, but on average across the OECD they are still more likely to be in low-paid jobs than in high-paid ones relative to the past.

Interestingly, the pattern is the same everywhere. We tend to associate the informal economy of casual work without benefits with developing countries where only a tiny fraction of the labour force is employed in the formal sector, such as government or large corporations. Yet growing informality is now a feature in both rich and poor countries, as permanent employment in advanced economies is being replaced with more part-time work, self-employment, and 'zero hours' contracts, where employees have to be available but are not guaranteed any hours or income. The pandemic is likely to reinforce this trend as the ability to work from anywhere will increase the shift toward more flexibility.

This phenomenon has been enabled by the trend to reduce labour market regulations since the 1980s and 1990s, in part a response to competitive pressure from the absorption of China into global supply chains, but also because of a shift in political power in favour of capital versus labour. Across the advanced economies, the drive for efficiency meant that employers were given more flexibility in hiring, firing, and in what benefits were required. Even in Europe, usually considered to have the most highly regulated labour markets, about one-third of employees are under what are called 'alternative contracts' where they earn less and usually do not receive benefits such as bonuses, profit sharing, overtime pay, training, and career development opportunities (Eurofound, 2018). Ironically, these alternative arrangements have come into effect largely as a result of employers' efforts to circumvent the strictures of a highly regulated formal sector. The result is a two-tier labour market—one highly regulated and formal, the other less so.

While labour market reforms in many advanced economies have been aimed at liberalizing and deregulating, in many developing countries the tendency has been in the opposite direction. Here, there has been an expansion in labour market regulations for the small proportion of workers in the formal sector. These regulations are to make up for the absence of adequate social protection systems and are often around notification requirements for contract termination, regulation of fixed-term contracts, and requirements for severance pay (Packard *et al.*, 2019, p. 143). In effect, they reduce flexibility to offset the lack of security, while providing protection for only a minority of the labour force. This poor set of policy choices tends to create the same kind of 'two-tier labour market' as in Europe where those workers in the formal sector are protected and

[3] Since 2006, across the OECD, average job stability (as measured by the length of time spent in the current job) has increased in a number of countries. This is, however, a compositional effect due to the increase in the share of older workers who tend to have longer job tenure. Once this change in the composition of the workforce is taken into account, job tenure actually declined in most countries. See OECD (2019).

those outside (often the young and the poor employed in the more informal sector) are unprotected.

III. What has it meant for workers?

These more flexible working arrangements are an important reason why many jobs are being created. Firms are willing to hire because they know they will have flexibility in firing if demand falls. Employers who face cyclical demand in sectors such as agriculture or tourism can increase their work force when they need it and reduce it when they do not. Flexibility enables more efficiency and probably helped companies rehire workers more quickly after the global financial crisis in 2008. For some workers, such as women, greater flexibility has meant they are able to balance work commitments with other dimensions of their lives.

But flexibility also means less security for workers as more of the risks are put on to individuals. The recent coronavirus pandemic revealed the perils of this situation as precarious workers, the self-employed, and those on temporary contracts around the world were most likely to lose their livelihoods. Precarity has significant consequences for workers' physical and mental health. Faced with uncertain income, many modern workers struggle with anxiety about paying their bills and cannot plan their lives. Workers who are laid off are more likely to develop a new illness, have lower life expectancy, earn less later in life, and trust other people less.[4]

In summary, today's workers face a world in which they have less job stability and more individual risk around unemployment, sickness, and old age. If they are educated, highly skilled, and live in a major city, they are likely to do well. If they are not, their prospects are less good and more uncertain. But overlaying this situation is another factor that will dramatically affect the future of work: automation.

IV. What will happen to work in future?

There is much hype about how automation will result in jobs disappearing, mass unemployment, and the need to support those who will be replaced by robots, perhaps with a universal basic income. The most likely scenario is not that jobs will disappear, but that jobs will change. Automation can substitute for labour, but it can also complement labour and create new jobs. Routine and repetitive tasks will be automated,

[4] A study by Columbia University found that employees who were laid off during the 1982 recession in Germany earned 10–15 per cent less 15 years later than their counterparts who had not been laid off. In the United States, the magnitude was 15–20 per cent. A study by the State University of New York found that laid-off employees have an 83 per cent higher chance of developing a new health condition in the year after their termination than workers who were not laid off, while other studies have found that life expectancy declines among those who have lost their jobs. University of Manchester research found that workers in Britain who had been laid off were 4.5 per cent less likely to trust other people than those who had not been laid off, an effect that persisted 10 years later. These studies are cited in McKinsey (2020, p. 59).

machines will augment human capabilities, and those people who have skills that are complementary to robots will fare the best. Those complementary skills may include things like creativity, emotional intelligence, and an ability to work with people. The risk is that those with higher-level skills will race ahead as they benefit from technology, leaving behind those whose jobs were routine and repetitive.

Since the 1980s, much of government policy has been focused on maximizing efficiency through liberalization of trade, privatization, and relaxing regulations of the labour market. Firms have been able to cut costs, reduce benefits, and outsource their supply chains. By and large, consumers have benefited from this, but some workers have seen their incomes stagnate and face greater insecurity in their lives. In theory, those who have lost out from these reforms—the so called 'losers', be they individuals or communities—were supposed to have been compensated and ultimately benefit from more rapid economic growth. In practice, that has rarely happened and certainly not at the scale required. More importantly, who wants to be a 'loser', even if you do get compensation?

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 significant, a policy called the Trade Adjustment Programme was in place to help workers with training, relocation grants, and wage insurance. But it was ineffectual because 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. In the face of the rapid growth of immigration, the UK had a policy to help local governments cope called the Migration Impacts Fund, but it was too small 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 exact balance of flexibility and protection that countries currently provide varies enormously, as can be seen in Figure 1. Some, including most of Europe, provide low flexibility and high protection; others such as the United States provide high flexibility and low protection;[5] most of Asia, Africa, the Middle East, and Latin America, meanwhile, provide low protection and low flexibility in the formal sector and high flexibility to those in the informal sector. Only a few countries, such as Denmark, New Zealand, Japan, and Australia, occupy the 'sweet spot' of providing high flexibility and high protection. Those are the countries that strike a balance between giving employers flexibility to adjust their labour force to economic shocks but also make sure that workers are supported to be able to move to other jobs, while maintaining a reasonable standard of living.

The Nordic countries provide a good example of striking the right balance. Here workers move easily between jobs (Sandbu, 2020). In fact, workers in Sweden, Denmark, and Finland change jobs more often than anywhere else in Europe. This gives employers the flexibility to change their workforces to adapt to market conditions

[5] Data from the US are not in the chart because the 'protection' data are distorted by large health spending in programmes such as Medicare, the Veteran's Administration, and Medicaid that are exclusively for the benefit of the old, former military, and some poor people, but not accessible for the general working population.

Figure 1: Countries strike very different balances between flexibility for employers and security for workers

Notes: 'Flexibility' is defined as the inverse of rigidity of hours, restrictions on hiring, financial costs of dismissals, and procedural requirements for dismissals. 'Protection' is defined as public spending on health, education, income support, and employment services as a share of GDP, using the latest available data for each country. *Source*: Packard *et al.* (2019 p. 151).

in the knowledge that their workers will find other jobs easily. They can have that confidence because their governments spend more on education and labour retraining than most other countries—over ten times more than countries such as the United States and the United Kingdom.

V. How should the social contract change?

A new social contract that successfully balances flexibility and security will need to have several dimensions, since the dislocations people may face will vary. First, a key underpinning to any system will be ensuring that everyone is guaranteed a minimum income to sustain a decent life—shelter, food, and medical care. Second, it will also need to provide security to those working in non-traditional, part-time, and flexible arrangements. Third, when facing economic dislocations, support will need to be tailored to the nature of the shock being faced: in some cases workers may be able to find jobs within the same industry, while in others an entire industry or region may be disrupted, requiring a more comprehensive response that involves helping workers retrain and acquire new skills. Let's consider each of these aspects—a floor on incomes, more security regardless of the type of work, and greater focus on retraining and finding new work—in turn.

VI. Putting a floor on incomes

In traditional societies, those who fall on hard times are reliant on their families and communities for financial support, which may or may not be available. As societies get richer, they find surer ways to protect people from the most catastrophic consequences of unemployment or financial setbacks by putting a floor on income. Countries have found many ways of providing this floor.

Almost every country in the world sets minimum wages, either by legislation or as a product of collective bargaining agreements.[6] They have become more important in many countries where wages of many workers have stagnated. But while minimum wages protect workers from exploitation by employers, they do not guarantee a family an income sufficient for a decent standard of living. Indeed, it is important that minimum wages are not set too high, because some workers who are not productive enough to justify earnings at the minimum level may end up unemployed. For those workers, a negative income tax (or earned income tax credit) is a better mechanism for providing a decent standard of living while preserving their incentive to work.

In addition to minimum wages, most advanced countries have unemployment insurance to support those who lose their jobs. This pays as little as 30 per cent of previous wages in Kazakhstan and Poland to as much as 90 per cent in Mauritius and Israel. Meanwhile, the duration of benefits ranges from 1.2 months' support in Kazakhstan

[6] More than 90 per cent of countries that are members of the International Labour Organization have one or more minimum wages set by law or through negotiations with unions. See International Labour Organization (2016).

to indefinite support in Belgium. In general, those in more advanced economies are more generous and include requirements to be available for work and report regularly to public authorities. For example, Denmark's system of 'workfare' provides very generous unemployment benefits (about 90 per cent of your previous wage) but also mandates training and ultimately mandatory job placement after training is complete. However, as most insurance schemes only support those with formal employment contracts, three-quarters of the world's workers, mostly in the developing world, are not covered since they are employed in the informal sector.

An alternative way to put a floor on incomes is to provide cash transfers to the poorest households. Programmes started in Mexico and Brazil provide regular cash transfers to poor families on the condition that they have enrolled their children in school or participated in public vaccination programmes. In Africa, these cash transfers have tended to be unconditional and designed to supplement very low incomes. More than 130 developing countries have now introduced some form of cash transfer to provide a safety net to the poorest households, whether or not they are employed. This has been made possible by the spread of mobile phones that enables governments to identify the poorest households and transfer funds directly to their bank accounts with minimal administrative costs. The overwhelming evidence is that they have efficiently and effectively prevented destitution, increased nutrition, supported children's education, and improved health of the poorest families in the world (Bastagli *et al.*, 2016; Pega *et al.*, 2017; Independent Commission for Aid Impact, 2017).

More recently, there has been much debate about the provision of a 'universal basic income' (UBI). This increasingly popular concept abandons the idea of targeting and making minimum income payments conditional on participation in work or enrolling children in education or health programmes. Instead, every adult receives the same cash payment unconditionally. Advocates argue that UBI not only empowers workers but is the best safety net against economic shocks and will therefore become increasingly necessary in a world where more people will be displaced by automation (Standing, 2017). There have been many experiments with UBI and they have generated mixed results (Coote and Yazici, 2019).

My view is that most countries can offer a social contract that does much better than UBI. One of the main problems with UBI is that the costs are prohibitive—reaching 20–30 per cent of GDP if UBI is set at a generous level—requiring unsustainably high levels of taxation to pay people who do not need the money.[7] There will be a few cases where UBI may be the best option—such as in very poor countries with no institutional capacity to target benefits or where UBI is a replacement for a worse policy like energy subsidies (as it was in Iran when in 2011 fuel subsidies were replaced with a cash transfer to every household) (Guillaume *et al.*, 2011). But for the vast majority of countries, if the goal is to reduce poverty, then targeted benefits are a better option. Ideally, these should be combined with support to ensure that everyone capable of working is able to do so, since work is perhaps our most important contribution to the social contract.

[7] The International Monetary Fund (IMF) estimates the costs at between 3 and 6 per cent of GDP in selected countries. See IMF (2017).

VII. Providing security to flexible workers

Employers prefer flexible employment because it reduces the amount they pay for social insurance, severance, pensions, and health care. In the Netherlands, for example, the total employment cost for a dependent employee can be 60 per cent higher than for an otherwise similar independent contractor. As a result, flexible workers are especially vulnerable not only to economic dislocation but also in old age, since they make no or very low contributions to pension schemes in most countries. In countries like the US where health insurance is often linked to employment, flexible workers can be excluded from health coverage while those with full-time contracts are locked into their jobs by their fear of losing it.

There are essentially two options for tackling this problem: we can either make employers pay the premium for flexible workers, in proportion to how much they work, or we can move the burden of social insurance away from employers altogether and pay for it instead through general taxation so that its protections are provided to everyone regardless of the nature of their employment contract. By taking a more consistent approach to taxing labour across types of employment, both options would be good for competition, innovation, and fiscal sustainability, as well as providing greater security to flexible workers. And if in addition to this we make social protections earned in this way portable between jobs, sectors, and different types of employment, we will be better able to cope with the major changes that will come with automation. Many countries are experimenting with how to do this.

The Netherlands, for example, has legislated to prevent discrimination against part-time workers and requires that those who employ them provide access to social security and other entitlements in proportion to hours worked. As a result, 77 per cent of women and 27 per cent of men work part time in the Netherlands—the highest rate in the world.[8] Similarly, Denmark has mandated that flexible workers are entitled to the same benefits as more traditional employees.

It is also possible to level the playing field for the self-employed. In most countries, self-employed workers do not contribute as much as employed individuals to social insurance schemes. Consider the UK, where employers pay 13.8 per cent in national insurance contributions for their employees while paying nothing if they engage a self-employed worker. Attempts to reform this have been thwarted, but a system that taxed the hiring of freelancers in an equivalent way to hiring salaried workers would reduce the bias toward flexible forms of employment and would widen the pool of funds contributing to social insurance (Taylor *et al.*, 2018, p. 72).

There are a growing number of governments introducing measures to force employers to provide more security to flexible workers. The UK Supreme Court recently ruled that Uber drivers should be treated as employees and received benefits such as sick pay and pensions. Oregon, New York City, San Francisco, Seattle, and Philadelphia have passed laws requiring businesses to offer workers guaranteed hours and prior notice of schedules to provide more predictable and dependable incomes. There are also partial and voluntary options. New York State created the Black Car Fund as a non-profit insurer that provides an income to limousine and black car drivers in New York if they are

[8] 'Why so Many Dutch People Work Part-time', *The Economist*, 11 May 2015.

injured (McKinsey, 2020). The Fund adds a surcharge of 2.5 per cent on passengers' fares and also reduces risk by providing training in safe driving to its members.

Of course, some argue that many workers are willing to trade off security for the advantages of working when they want. They point particularly to those younger, 'gig' workers who do online work to supplement their incomes. But there is also evidence that flexible workers in the US and the UK would prefer more traditional working arrangements: most would be willing to give up 50 per cent of their hourly wage in the US and the UK for a permanent contract, and 35 per cent of their hourly wage for a 1-year contract relative to a 1-month contract (Datta *et al.*, 2019). A survey of gig workers in the UK, Italy, and the US found that about 80 per cent supported the idea of creating 'shared security accounts' with their employers to stabilize their incomes. After that, their priorities for work-related benefits were pensions in Italy and the UK and health insurance in the US (Boeri *et al.*, 2020).

Unions could have an important role to play in pressing for greater security for flexible workers, who are an important potential new constituency for them. There are some examples of 'flexible unionization' happening. In Italy, a charter was agreed between the association of delivery workers, trade unions, and the local council in Bologna to set minimum standards for pay, hours, and insurance for home food delivery services such as Deliveroo and Uber-eats. When some of the platforms refused to sign the charter, the mayor organized a boycott, which proved effective (Vandaele, 2018). In India, meanwhile, the Self-Employed Women's Association has been supporting more than 2 million women to realize their civil, social, and economic rights by working as both a trade union and a cooperative. The same digital technologies that have led to a rise in flexible work can also be used by flexible workers to organize themselves in response to it.

VIII. Helping workers adapt

Supporting workers with minimum levels of income and benefits, whatever form their employment takes, is an essential piece of a new social contract. In return, those who have lost their employment have an obligation, if they are physically and mentally able to do so, to retool and return to work as soon as possible. How should society support those who are unemployed to return to productive work? What happens when large numbers of workers lose their jobs because their skills have become obsolete? Is it possible to retrain low-skill workers or those in declining regions to find new opportunities?

There have been hundreds of academic studies on the effectiveness of worker retraining programmes in both advanced and developing countries (Dar amd Tsannatos, 1999; Betcherman *et al.*, 2004; Martin, 2014; Card *et al.*, 2018). The track record is mixed, but the lessons on what works are clear. Interventions focused on job placement—such as help with searching for a new job and monitoring the behaviour of job-seekers—are effective at getting people, especially lower-skill workers, back to work in the short run and are not costly to run. Training programmes designed to satisfy the specific needs of local employers, combined with work experience, have bigger impacts and are more effective than classroom training unconnected to the private sector. Although training of this sort can be costly, the benefits are significant when measured over several years, especially for the long-term unemployed. It also helps if training leads to some form of accreditation or formal qualification. For lower-skill workers, programmes that provide administrative support to the participants also tend to result in better employment outcomes (Escudero, 2018).

We also know what does not work. Simply sending workers for classroom training at colleges or vocational training institutes is usually a poor investment. Subsidies that encourage firms to hire displaced workers can increase employment but also result in waste since employers often recruit people they would have hired anyway. Schemes where the public sector job creates artificial jobs for the unemployed invariably do not work. Training workers who are already at risk of displacement works less well than training them in anticipation of technological change (Kochan and Kimball, 2019).

IX. A new deal with business

There are three broad principles that I believe can guide us in designing a new social contract that underpins modern capitalism. First, that everyone should be guaranteed a minimum to a live a decent life. This minimum should include basic health care, benefits associated with work, education, and a pension that protects against poverty in old age, with the level depending on how much society can afford. Second, the provision of minimum protections around some risks, such as sickness, unemployment, and old age, are better shared by society, rather than asking individuals, families, or employers to carry them. Third, part of the social contract should be that everyone should contribute as much as they can through work and be given the maximum opportunities to do so with training throughout life, later retirement ages, and public support for childcare so women can stay in the labour market.

At the core of this new deal are the minimum protections against catastrophic losses and they are provided to all and paid for through general taxation. These include public funding to help workers adjust to massive job losses because of major economic shocks and support for the transition to new jobs. Parental leave benefits and support for parents in flexible work could also be covered by government to reap the benefits from equalizing labour market opportunities between men and women and ease the burden on smaller firms. The next tier includes those measures that would be achieved through mandatory regulations: minimum wages, limitations on and guarantees of hours of work, giving workers voice, and unemployment insurance. After that would come voluntary measures such as enhanced pensions, additional training, and profit sharing schemes, whereby the workers in a company received not just a salary but also a share of the profits—an especially powerful way of incentivizing them to be productive and bring the interests of owners and their employees into better alignment.

The burden of taxation also needs to shift to create a more level playing field between capital and workers (Summers, 2020). Between 2000 and 2015, corporate tax rates in advanced economies declined from 32 per cent on average to 25 per cent, benefiting owners and investors (OECD, 2016). Meanwhile, taxes on labour, which fall on both the employer and the employee, have grown. These increased taxes have been used to fund unemployment insurance, pensions, and sometimes health insurance. This arrangement had its origins in the idea that employers would be the providers of social insurance, paid for by them and their employees. But in many countries (such as Japan and much of Latin America) the revenues generated from payroll taxes already do not cover the costs of pension obligations, for example.

The bias in our tax systems may also mean that firms are under-investing in training their workers and over-investing in automation. One estimate for the US shows that the current system taxes labour at a rate of 25.5–33.5 per cent, while the effective tax rate on capital is about 5 per cent (down from 10 per cent in the 2010s and 20 per cent in the 1990s and early 2000s) (Acemoglu *et al.*, 2020). Bringing the tax rates of labour and capital closer into alignment would result in better decisions by firms on how much labour they employ. Reducing the taxation of labour relative to capital would also increase overall employment, especially important giving rising automation, and labour's share of income.

A better model would tax business differently. In many countries it should be possible to reverse the falls in corporate tax rates in recent decades to require owners of capital to contribute more to the social contract. After the pandemic, many in society feel that business needs to contribute more, given the extent of support many firms received during the crisis. There has also been a shift in thinking about the need for a fairer system of global taxation to reduce the use of tax havens and have companies contribute to the communities in which they operate. Every year, 40 per cent of the global profits of multinationals are shifted into low tax jurisdictions. In the UK, more than 50 per cent of the subsidiaries of foreign multinational companies currently report no taxable profits (Bilicka, 2019). In the US, 91 companies on the Fortune 500 index, including Amazon, Chevron, and IBM, paid an effective federal tax rate of zero in 2018 (Kinder and Agyemang, 2020).

This situation is unfair to domestic companies who cannot avoid national taxation and to the citizens of the countries in which these multinational firms operate who are deprived of the revenues. The current situation is a relic of the twentieth century that gave countries the right to tax a company based on where the legal entity is physically based. This is outdated in a digital world of globalized supply chains where companies can manage their books to legally 'base' themselves in any number of places to reduce their tax burden. The IMF estimates that $500–600 billion of income from corporate tax is lost every year as a result (Crivelli *et al.*, 2015). Developing countries are especially hard hit in relative terms, given their smaller tax bases.

A fairer solution is possible based on proposals developed at the OECD and now gaining support owing to recent endorsement by the United States. First, countries would be given the right to tax companies based on sales in their territory, regardless of where the legal entity is located. Second, there would be a minimum level of tax that all multinationals would have to pay, thus reducing the scope for countries to compete for their presence by lowering their corporate tax rates. The OECD estimates that the two reforms would raise corporate tax revenues by 4 per cent worldwide, which is worth $100–240 billion annually (OECD, 2015).

Meanwhile, there are many taxes on labour that could be lifted from the shoulders of employers. Taxation of labour could be reduced by funding core unemployment benefits, minimum pensions, some training costs, and parental leave from general taxation. Australia and New Zealand, for example, have already chosen to shift away from payroll taxes and fund the core of their pension system from general taxation, and many developing countries—such as Bangladesh, Lesotho, Namibia, Somalia, and Sudan—are now adopting this model of a basic social pension for the elderly funded out of general taxation (Packard *et al.*, 2019). Severance payments, which reduce flexibility, could be replaced by more generous unemployment benefits, reskilling support, or a lifetime educational endowment to enable lifelong learning.

Regulations that mandate the provision of benefits for all kinds of employees—full-time, part-time, and self-employed freelancers—would provide security that does not discriminate by type of work or type of worker and reduce the incentive to create jobs under informal working arrangements as a way to avoid paying for social insurance. It is also possible to give extra incentives to firms to train their workers, as many countries do when they want to promote research and innovation (Costa *et al.*, 2018). Countries such as Austria provide generous tax credits to firms and to individuals for training costs. Such tax credits can also be targeted to low- and middle-skilled workers or to smaller firms who find it harder to afford training. Several states in the US—such as Connecticut, Georgia, Kentucky, Mississippi, Rhode Island, and Virginia—are experimenting with such an approach.

The politics of such reforms to taxation of labour depends on who bears the costs and who receives the benefits. In terms of the costs, increasing general taxation is controversial, income taxes tend to fall disproportionately on the better off, value added taxes are usually more regressive. In terms of the benefits, the constituency for change would be those who are employed (who will get more security and support as the job market evolves) and particularly benefit those who are on flexible contracts. They are a large, although not necessarily powerful, constituency who would have to be mobilized to demand a new social contract around work.

X. Conclusion

Capitalism needs a new social contract. Business leaders increasingly acknowledge that the narrow focus on short-term shareholder value has resulted in inequality, stagnant productivity, poor innovation, and environmental degradation.[9] But too much of the focus has been on changing the objectives of business rather than changing the rules under which business operates. A new social contract would change the rules so that firms pay a fair share of corporate taxes and provide all workers with benefits while society at large would share more of the risks around minimum incomes, parental leave, minimum pensions, and the development of new skills. Workers would benefit from greater security and support to cope with economic change and take advantage of new opportunities.

A new social contract would also be good for business. Being able to rely on the availability of skilled workers and a good safety net would reduce costs and allow firms to optimize their use of both capital and labour. Less time and money could be spent on elaborate legal arrangements to minimize payment of tax and benefits and more could be spent on reskilling and innovation. A better social contract based on concrete changes to taxation and regulations may be the only way to preserve the benefits of

[9] See for example the statement on corporate governance from the Business Roundtable, a group of CEOs of major US companies, in August 2019.

capitalism while mitigating its most adverse effects. This would enable democracy, rather than individual CEOs, to decide the mutual obligations among stakeholders and thereby sustain political support for (to paraphrase) 'the worst economic model except for all those other forms that have been tried from time to time'. It is time for a new version of capitalism that has a better social contract to underpin it.

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