



Transcript of IMF podcast:

Justin Wolfers on the Social Contract

Bruce Edwards:

The last three years have been brutal for many people on many levels, but to what extent are rising prices now threatening social cohesion?

Justin Wolfers:

I mean, there's certainly an inchoate anger. It's not clear that people know particularly who to blame, whether it's the government, the central bank, or just anger at the world. But it certainly causes enormous anger and that anger is absolutely real.

Bruce Edwards:

In today's episode, we look at the current state of the social contract and what a new one might look like.

Justin Wolfers:

I'm Justin Wolfers. I'm a professor of Economics and Public Policy at the University of Michigan.

Bruce Edwards:

Justin Wolfers's work focuses on behavioral economics and social policy among other things, and he was invited to join a panel discussion on social cohesion during the IMF World Bank annual meetings in October.

Tell me a little bit about this panel discussion at the annual meetings a few weeks ago where several high-level people were actually painting a rather grim picture of the current social contract, including the Director General of the ILO, Gilbert Houngbo, who pointed out there are four billion people in the world without any social protections at all, but you were like the optimist in the room. Why are you so optimistic about where we are at this point?

Justin Wolfers:

IMF Podcasts home: <http://www.imf.org/en/News/Podcasts>

Apple podcast page: <https://podcasts.apple.com/us/podcast/imf-podcasts/id1029134681?mt=2>

It may be a deeper point or it may be a more shallow point, actually, about the sociology of economics and about the market for attention. We economists are trained to see what could go wrong and look around the corners at things that might not work out, because our job is to prevent bad things happening. In that sense, we're a lot like firefighters. Now, you've never been to a firefighter's convention and heard people walk around a city and say things like, "Oh, the hydrants are wonderful," and, "I'm glad that the buildings are non-flammable on this block." Instead, they're always looking for what could go wrong. That's one part of it. That's the sociology of the profession. We have a bias towards describing the negative and seeing the negative.

The second is the market for attention. If you want to end up on the front page of a newspaper tomorrow, if you happen to be the director general of a fancy organization or a lobbyist or a think-tanker or an economist trying to make a name, what you want to do is describe something terrible that will happen, because that's much more likely to make the front page than to say things like the year 2023 will probably be the richest year in human history. Now, it turns out that's also true, that 2023 will probably be the richest year in human history.

Bruce Edwards:

That's hard to believe.

Justin Wolfers:

It's not, because all the other ones were terrible (laughter)! I think sometimes when we're talking to a broader audience who are going to go and make decisions like, "Should I spend money this year? Should I search for a job? What sort of wedding should I pay for for my kids?" If all their hearing is negative, then in fact they're getting very biased signal about the state of the world. I think within specialist circles, we're allowed to be miserable with each other because we understand the bias, but when we're talking to a broader audience, we need to tell the truth. The truth is that economists far too often describe the glass as half empty, and the reality is the glass is half full. Almost every year has been better than the previous year through the last many centuries of human existence.

The extent to which we are likely to lose children during childbirth, to lose partners during childbirth, to see people be hungry, to see people die young, the number of murders, all of these things are getting better every year. You might not like the current economic moment. To take the industrialized countries... people will freak out about inflation right now, but by jingo, a lot of them, my native Australia, the United States, have unemployment rates that were unimaginable just a generation ago. There's an enormous amount of good news and sometimes we should tell that story.

Bruce Edwards:

Okay, so it is good, but it can be better, and so before we start into how to make it better, we're talking about social contracts, social cohesion... that was what this panel was all about. What is a social contract? I mean, what does a good social contract look like?

Justin Wolfers:

A social contract is three things. It's social and it's a contract, and the third thing is it's neither a social nor a contract. It's the sort of answer an economist would give. Social means it's something that we all agree among ourselves, we the people. Contract, it's an agreement. What are the ties that bind? What are the obligations we owe each other? We all have a deep and innate sense of it. It's not that we're born with it, it's not biological, but it is the milieu in which we were raised, the values with which our parents and those in the community raised us. Do unto others. Almost every religion has some version of the golden rule, do unto others as you would have them do unto you. That is the social contract. You can think about direct expressions of it during a pandemic, which would be things like don't sneeze on someone during a global pandemic.

It might be even stronger than that, which is if you have a temperature during a pandemic, don't leave the house. Now, I said it's a third thing, it's neither social nor contract. Well, the social contract's not written down. It's not enforced by courts. To the extent that it is enforced, it's socially enforced. If you sneeze on someone at a restaurant during a pandemic, everyone else will look at you funny and maybe even go a step further, throw you out of the restaurant or cast you out of society. But the enforcement of our social contracts is remarkably weak. We end up doing these things not because there's a direct value to us, but because it's a broader sense of understanding and mutual obligation.

Bruce Edwards:

In terms of the social contract that economists speak of, is this a universal concept? Is the social contract we hope for or we hope to achieve in Sydney, Australia, for example, any different from the one that they hope for in Sub-Saharan Africa?

Justin Wolfers:

I think there's probably deep philosophical principles that are similar the world over, as I said, some version of the golden rule, but the exact elements that that gives rise to likely depend on the economic circumstances of the time and the place. To give a very simple example, sneezing in a restaurant, that violated the social contract in 2020 and 2021 during a global pandemic, but not really in 2018. The idea that if you see a kid who's hungry you should stop and help them is easy in a society where food is plentiful and cheap and much harder to uphold in a country where that would mean doing without yourself.

I think the principles may be somewhat universal. You have to be a better philosopher than I am to figure out those principles. But the expression really does and probably should vary by time and place.

You think about some of this as being about behaviors and some of this is also being a little bit like insurance. We look after each other when things go wrong, but the types of insurance that are important in Papua New Guinea are different than the types of insurance that are important in Sydney, Australia.

Bruce Edwards:

I'd just like to stick to sub-Saharan Africa for just for a minute because the director of the African department, Abe Selassie, was part of that panel discussion and at some point he said that given what's going on now in terms of rising prices and food and fuel, the impact of climate change and especially on rising debt levels, that the social programs really need to be strengthened, urgently need to be strengthened, and that may come at the expense of the growth agenda. Would you agree with that, that the social contract sometimes comes at the expense of growth?

Justin Wolfers:

I think I want to draw a distinction. I wouldn't say the social contract. I think what he was describing instead was the welfare state, which is one expression of the social contract. We think we owe each other obligations, so we vote for a set of policies where we look after each other when things go wrong. It's very tempting for economists and people generally just say that there's a trade-off between looking after each other and achieving economic growth, or between social and economic objectives. But I think that that can be ... we can be a little too quick to say that and often there's not. Let me give you an example of policies that could improve both efficiency and equity. Any kind of policy that reduces discrimination by race, by gender, by ethnicity, by religion, by sexuality, by gender and so on, by gender identity, these typically will enhance equity.

Maybe they lead more people to be included in the social contract. If eliminating these isms, the forms of discrimination, lead us to hire the best person for the job rather than the person from a particular demographic group, that's going to improve efficiency as well. I am not confident there's always a trade-off. Then think about what we're trying to do with the social contract. I want to make sure my neighbor can eat. I think that is a really important part of the social contract. One way forward would be to say, "Well, I should share my dinner with him," and that's redistribution. Another is that we go for growth and simply grow twice as much wheat so there's enough food for my neighbor. It's very fashionable, particularly in lefty circles to speak derisively about the growth agenda, which is just saying that very poor countries, people in those poor countries would be enormously better off if they were richer.

That strikes me as actually quite uncontroversial. And the greatest poverty elimination program in the history of economics has been the extraordinary economic growth in China. Any amount of pontificating about social contracts has done less to feed the hungry than economic growth in China. And so maybe we should just think about the growth agenda as being part of the social contract because that's what ensures my neighbor gets fed.

Bruce Edwards:

Just moving on a little bit here, I find it interesting that with all the things that were happening during the pandemic and then at the start of the war in Ukraine, it wasn't long before inflation took the center stage. Inflation is essentially the most talked about product of the pandemic and the war- and to a certain extent, the effects of climate change in some parts of the world. Why so much focus on inflation? I mean, it's high, but it's been higher. Are economists and the general public, do you think, on the same page in terms of how important inflation rates are today?

Justin Wolfers:

It's quite striking. The reasons that the general public express concerns about inflation are very different than the reasons of a standard... when you look up a standard macroeconomics textbook, for the costs of inflation, they're actually remarkably different. I think the reality is that people experience inflation as immense powerlessness. But you hear a lot of discussion right now that "my real income is being stolen by inflation. It's being eaten away by inflation". This would be a view then that inflation determines your real wage. Now, it turns out that's not at all how economists think about it. We tend to think that real wages are determined by labor demand and labor supply and other real factors. Now, the regular public's a little bit right, which is in the short term what happens is prices might rise and wages don't keep up immediately, and so therefore, this year my real income's a little lower.

But we expect, and it's not a question of economic theory, this is actual practice in country after country and every inflation episode I can think of, that wages eventually catch up. Again, because inflation is a generalized rise in prices and that includes the price of labor. In reality, we don't think that people are losing much spending power due to inflation. Now, there's some very interesting psychology going on here. I'll tell you last year I got a very nice annual pay bump. It was a number higher than I was expecting, and I thought to myself, "Crikey, that's because you do a really good job as an economist, Justin, and that's your dean just recognizing how much good work you're doing. You really deserve that, Justin." It was terrific.

Now, the reality is my dean was like, "There's been 8% inflation over the last year. I don't want to lose all my staff and I also think they probably deserve the same wage as they got last year, so I'm just going to give them a cost of living adjustment."

Bruce Edwards:

That doesn't happen often enough.

Justin Wolfers:

Right, and so what happens, though, is I coded that not as a cost of living adjustment, I coded it as a reward for my hard work. And then after that, when the cost of living rose 8%, I felt like it got stolen

from me despite my incredible hard work. So I coded it wrong the first time. The difficult reality is a lot of the stuff that feels like inflation is stealing your purchasing power, it's because you wrongly credited inflation for giving you purchasing power, you wrongly took credit. And that asymmetry means that people blame inflation for a lot of ills that are not in fact inflation's fault.

Bruce Edwards:

Another point that you made in this panel was how the pandemic with all the disruption and the misery that it caused, that it also presented us with a moment of reinvention. What do you mean by that?

Justin Wolfers:

The COVID moment has been and still is an extraordinary moment. The first phase of it through 2020 and 2021 was a moment that forced a degree of reinvention that none of us ever imagined. I suddenly learned that I could work from home. I learned that I could be on the radio and TV from home. I learned I could see my doctor or my therapist from home. My therapist will learn to work from home. Entire newspapers were put out from people's lounge rooms. Just an extraordinary moment of reinvention by necessity. Then we find ourselves, hopefully with COVID risks tailing off and who knows how and when and where things end, still at a moment of extraordinary reinvention where there are many people who haven't been into the office in a long time. It's not just about the shift away from work to home.

During 2020, we saw countries make dramatic fiscal and monetary changes. We saw them offer support and move quickly in a way that has never happened before in my lifetime. Some of those legislative supports are also ending now. In each of these cases, it's leading to the big question of what next? It's what next with a degree of openness that is this is the biggest change moment of our lifetimes. The best analogy might be World War II forced a massive mobilization, including, for instance, the story of Rosie the Riveter, the movement of women into the workplace and factories. The war ended and the troops came home and we had to reinvent society. It was clear that certain things had changed and would forever change. For instance, the role of women in the workplace.

We face, I think in many respects, a very similar moment, which then means normally there are so many things that we think of as deeply embedded, but there are so many cards on the table. There are so many open windows, there's so many opportunities for reinvention. This is the moment for change. Whether it's social, economic, or political, the door's never been wider open for those changes.

Bruce Edwards:

Are you confident that this will in fact benefit more people around the world as opposed to just a select few, as is often the case?

Justin Wolfers:

Let's not go with confident. Let's go with hopeful. If the moment is prime for change and if we have functional political systems and a well-informed populace, one would guess we're going to move in the right direction. If we have- I think lobby groups are a little less powerful and less in a position to resist some of this change, which some of it appears inevitable. One of the enormous changes in the advanced world is, of course, the shift to work from home that dramatically changes the lives of white-collar workers like you and I. It's not yet clear that it has much of an effect on blue-collar workers because a lot of that work is done in person, and it's not at all clear what effects this will have in developing countries.

But that's a form of reinvention that I think leaves open all sorts of questions. How hard should we work? How often should we work? How do we blend work and family life? We know that the old answers weren't great so I'm pretty happy to take another look at ... reinvent these institutions for the first time in decades and perhaps centuries. And it's a pretty good bet that if you invent something today rather than a hundred years ago, today's version's probably a better fit for modern life.

Bruce Edwards:

Justin Wolfers is Professor of Public Policy and Economics at the University of Michigan and visiting Professor of Economics at the University of Sydney. Thanks so much for joining us on the podcast today.

Justin Wolfers:

My great pleasure.

Bruce Edwards:

Justin Wolfers and his partner Betsey Stevenson, who many of our listeners will know, are helping students better understand economics through their new textbook called Principles of Economics. You can also listen to their podcast, Think Like An Economist.

Go to imf.org to watch a webcast of the annual meeting seminar that we talked about today in this podcast. It's called Social Contract in Times of Crises.

Look for more IMF podcasts on Apple Podcasts or wherever you listen. You can also follow us on Twitter at IMF_podcast.

I'm Bruce Edwards, thanks for listening.