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A Social Compact for Long Term Inclusive Economic Growth

The notion of a social compact between government, business and civil society as a basis for long term economic development and growth underpins economic models in many industrialised countries. The social democracies of Northern Europe most closely encapsulate this notion and have performed extraordinarily for close on a century with higher levels of economic growth and social stability. Even during the current European debt crisis these economies have held up better than their Southern European counterparts and the social compact has remained largely intact¹.

Social compacts exist in various forms and can be explicit or implicit. An example of the latter is encapsulated in the so-called 'American Dream', of the opportunity for social mobility for all individuals who persevere and work hard.² Even though many Americans struggle at the bottom of the economic ladder, the possibility to prosper is an essential component of the American compact. The European welfare state, on the other hand, represents a more explicit outcome of this social contract.³ The dearth of research about social compacts in developing countries is concerning because they are the presumed engines of future growth and because they have generally much higher levels of social and political instability.

Since the mid 1990s Sub Saharan Africa (SSA) has seen high economic growth rates, second only to Asia. This has been accompanied by a move towards greater democratisation and liberalisation. However, the relationship between business, government and civil society remains fractious, and social and political instability continue to emerge. The lack of a long term social compact is evident and more tellingly, is not in the process of being fashioned. In this paper we explore the consequences for development of the absence of a social compact. We examine the origins and success of social compacts elsewhere and ask whether a social pact is possible given our fractured polity and fraught history.

The Idea of a Social Compact

Political philosophers have toiled with the principles of political authority and legitimacy at least since the days of Aristotle. These themes formed the basis of European political thought in the seventeenth and eighteenth century through philosophers such as Hobbes, Locke and Rousseau. A social contract that defines the rights and responsibilities of the various stakeholders in the political process was considered necessary for the effective and legitimate functioning of the state. O'Brien et al.⁴ argue that social contracts normally offer some form of mutual benefit and impose some reciprocal obligations or constraints. Citizens who are party to these agreements explicitly or implicitly accept obligations (such as paying taxes and obeying laws) in return for the protection afforded by the state (including maintaining order and providing a minimum standard of social wellbeing).

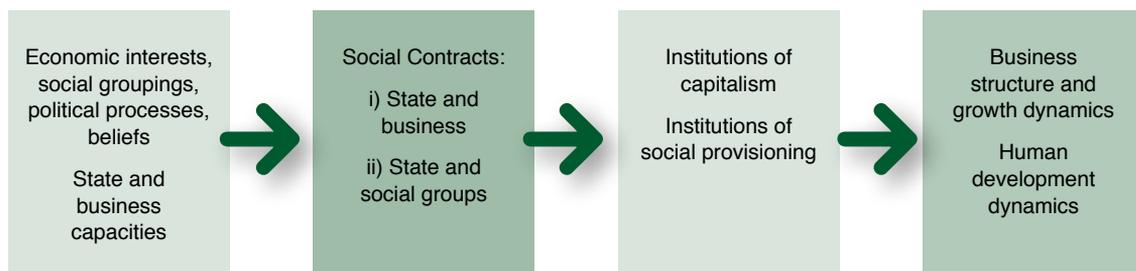
These social compacts provide legitimacy to political and economic systems in various forms. The East Asian authoritarian historical experience saw political legitimacy arise from high economic growth rates. Domestic consumption, social protection and political participation were suppressed. The state had to keep delivering the high economic rents and, in return, labour focused on productive activities and long hours of work. In Europe a very different social compact emerged which saw a more collaborative, corporatist framework which focused not only on production but also on the general wellbeing of the populace. Despite these differences, what ties them together is the implicit or explicit compact which exists between business, government and labour as to the future direction of the socio-political economy. This political equilibrium can change over time and indeed we have seen it do so in various East Asian countries.

Whilst the concept of inclusive development has been explored for developing countries⁵ the notion of a social compact extends beyond that into the realm of a deep political economy. Inclusive development highlights the importance of the needs of the poor and marginalised, but a social compact extends this into an institutionalised arrangement which we, as a society, accept as the basis for our future development. It means that business, government, labour and civil society in some form ‘contract’ (it need not be explicit) as to the accepted parameters governing future change. This can manifest in accepted forms of fiscal policy and the extent of its redistributive focus, and the maximum level of deprivation that is appropriate for this social compact. This still leaves broad room for disputes and political contestation but within these strictures.

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The nature of these compacts reflects the relative initial strength of various economic, social and political interest groups, as well as the capacity to deliver. Walton⁶ provides a schematic representation of how these interact to result in a social contract – see figure 1. The competition between these groups results in a political equilibrium, with contracts between state, business and society emerging. These, in turn, shape the nature of the institutions of governance and socio-economic provision, which affect long run development possibilities. Of course, this loop itself is endogenous, as it then influences the future capacity of state and business and the relative strength of various interest groups.

Figure 1: A simplified schematic of casual processes of social contract transitions



Source: Walton, 2010: 38

This process of the construction of social contracts and institutions is an evolutionary one. They reflect outcomes of past conditions, some thrive, others weaken, and through a process of survival of the fittest they evolve. This, in turn, sets the conditions for new interest groupings and sources of power which further affects the process of social compacts and institution building. Fukuyama⁷ reminds us that

Institutions initially appear for what in retrospect were historically contingent reasons. But certain ones survive and spread because they meet needs that are in some sense universal. ... If the institutions fail to adapt, the society will face crisis or collapse, and may be forced to adopt another one.

He warns that with the onset of industrialization, economic growth and social mobilization progress at a vastly faster rate changing the possibilities for development and the institutions required. This process is not necessarily deterministic as institutions are routinely copied and improved by others. There is therefore much to be learnt by developing countries as to how to provide an enabling environment for social and political equilibria and sound institutions.

Cooperation of the corporatist variety was facilitated by the exceptionally rapid economic growth after the war, the relatively homogenous labour force with strong, politically unified trade unions and employer organisations, and finally government policies which supported cooperative bargaining by alleviating economic insecurity, addressing the distributive concerns and penalizing non-cooperative behaviour.

The European Social Compact and the Welfare State

Social compacts of the European variety are framed in corporatism that recognises the need to harmonise the economic and the social within governance structures. Distributive issues are inalienable from those concerning production. Whilst employers recognise full employment as a social objective, workers accept the need for wage moderation and higher productivity as a prerequisite for economic growth and social welfare⁸. Iversen⁹ discusses corporatism within a framework which includes a) the capacity of interest groups to aggregate and articulate demands on behalf of their constituencies and to implement policy commitments ('intermediation'), and b) the extent to which there is coordination of demands between groups and political parties ('concertation').

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The European social compact developed over time and has taken on the particular characteristics of the underlying social and economic interests. Steinmo¹⁰ discusses the grand breakthrough in Sweden between 1936 and 1938 which led to a historical compromise and brought to an end one of the most conflictual labour markets worldwide. This was constructed on the basis of a new relationship where 'capital and labour came to understand that they had common interests in increasing productivity and employment levels.... Government policy soon came to be used to help facilitate the Historical Compromise.' The European political parties were compacted to supply jobs, decent incomes, lower income differentials, and economic growth so as to sustain the welfare state and preserve social stability. This they have done remarkably well for most of the twentieth century. The agreement resulted

in higher tax rates but with the state delivering a very comprehensive set of social deliverables. During the current financial predicament, this model is facing severe challenges and its sustainability is being questioned in the face of rising debt levels and a rapidly aging demography.

The point is that pure philosophies of social rights need to be embedded in local realities and the result might be what White¹¹ refers to as ‘some messy combination...refined according to local circumstances’ that ‘advances the interests of the most disadvantaged and affirms the duties of all citizens to make a fair contribution to the common good.’ The long term development of social policy needs political support from all actors and involves an acceptance of restraint in some areas (often wages) in return for social protection in other areas. Such a social contract underpins the modern state:

‘By being responsive to citizens’ needs, the state effectively provides a guarantee of its legitimacy, and potentially the legitimacy of the tax system. Conversely, when the state does not provide for these needs, its relevance and legitimacy are undermined.

The recent transition to democracy in many African countries, accompanied by higher economic growth raises the question of how to consolidate this process within a modern state, accountable to its citizenry.

The Post-Colonial African State-Society Relations and Welfare Provision

The post-colonial state in Africa was essentially derived from the colonial state. Moreover, the post-colonial state possessed all the formal powers and attributes of the colonial state but that it was not subject to the constraints of colonial political accountability¹²: In the fight for independence, nationalist movements did not question the nature of the colonial state but rather fought to gain control over it and attempted to gain power over civil society through cooptation, clientelism, patrimonialism, and mass coercion.¹³

This reflects a lack of imagination on the part of both the state and society about a long term social compact for post-colonial African countries. For Africa it raises an interesting conundrum. Historically, Africa has not had a well-developed formal social net and the state has suffered from a lack of legitimacy. The recent transition to democracy in many African countries, accompanied by higher economic growth raises the question of how to consolidate this process within a modern state, accountable to its citizenry. Many African countries look enviously upon the European welfare state as a model but, what are the consequences of growing social security in Africa without an explicit social compact? In Latin America under various populist regimes (most famously Peron in Argentine) we saw macroeconomic constraints being ignored, a lack of wage restraint, public debt rising and being financed by easy monetary policy resulting in hyperinflation. The lack of a national consensus or social compact resulted in short term gains for workers but, long term negative consequences for economic progress. There is a danger in Africa that states are overwhelmed by the socio-economic expectations that society develops as to the probable outcomes of the recent processes of democratisation. This makes the adoption of a social compact, which formalises a process for inclusive development, all the more important to ensure that these fledgling states have an opportunity to consolidate.

The South African Case

South Africa is an interesting case because it has developed a very comprehensive approach to social security given its level of development. Its pension scheme is tax-funded, reaches almost 2.5 million people, covers almost 100% of elderly blacks and costs around 1.3% of GDP. Almost a third of the South African population receives some form of social grant – a sixfold increase on the number of beneficiaries in 1998. The overall cost of these social grants amounts to 3.5% of South African GDP¹⁴. It can be argued that the development of a fairly elaborate system of social security was an attempt by the post-apartheid government to buy political stability in the face of high inequality, unemployment and the lack of service delivery by various tiers of government. The problem with this is that it is not addressing the root causes of unemployment and inequality in South Africa and instead is putting an increasingly unsustainable pressure on the fiscus to support an ever-growing number of welfare recipients with a static and limited taxpayer base. This issue has become increasingly politicized both within and outside government with some pointing to its positive effects on poverty alleviation and others pointing to an increasing culture of dependency.

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The South African post apartheid dispensation was a negotiated settlement between elite groups that left the majority of the population without ‘voice’. Those previously disadvantaged were given the opportunity to vote but in the presence of a dominant single party they have few means by which to express their dissatisfaction. They were pacified through the introduction of an elaborate welfare system which does not seek to address their dispossession but rather seeks their silence. The black establishment was bought through the promise of black economic empowerment (BEE) which gave a small black elite the chance for rapid economic mobility, and big white capital was co-opted in return for the

drop of nationalisation and radical redistribution as a policy option. In September 2012 the frustration with the South African political economic model spilt over into the worst massacre since the end of apartheid when 34 mining workers were gunned down by police for protesting their economic plight through a massive, prolonged strike. There is growing frustration that the rate of improvement in people’s lives does not measure up to their expectation of what the post-apartheid scenario would deliver. However, the larger issue is that business is going to find itself increasingly dealing with the frustration and often unrealistic demands of its workers which may actually reflect something much larger than their immediate work circumstances. This places business in a difficult position as labour relations will need to be understood in the national context of a broader social consensus. Recently there have been calls for a ‘white or wealthy’ supertax to compensate for past advantage. But this is only a viable option if there is confidence in the South African government’s ability to deliver social progress with any fiscal windfall and that it will not be used to further the system of patronage for a small elite. The importance of trustworthy, reliable, impartial and reasonably uncorrupted government institutions is a precondition for citizens’ willingness to support policies of redistribution¹⁵. Thus in South Africa, the nature of a higher tax would need to be positioned within a broader social compact with the state recognising the significant burden that it would be faced with to deliver on the basis of that temporary revenue windfall.



South Africa's economic inequality shows up repeatedly as amongst the worst in the world. In addition, it has actually worsened in the past decade under the post-apartheid dispensation. This is not sustainable and will increasingly put pressure on government, labour and business to come up with a long term social compact for South Africa. It is not an issue that can only be addressed by government and requires all stakeholders to put aside narrow interests and focus on a more sustainable socio-economic model. For business and labour, it cannot be business as usual and requires a very different mindset. This has had an impact on the questioning of government legitimacy and led to populist tirades from an assortment of leaders for wholesale nationalisation and an economic revolution. The ideal outcome is a long term social compact which brings business, government and labour together in an attempt to address the structural deficiencies in South Africa's political economy.

As President Mandela remarked at its launch, 'our democratic gains will be shallow and persistently threatened if they do not find expression in food and shelter, in well-paying jobs, and rising living standards'

Some effort has been made to institutionalise a social dialogue between the main economic interest groups but with questionable results. On 18 February 1995, the National Economic Development and Labour Council (Nedlac) was launched. The motivation behind Nedlac was for major decisions to be taken in a more inclusive and transparent manner. It emerged out of a recognition of the importance of seeking consensus on major economic, social and development policies and ensuring their success, through awareness. As President Mandela remarked at its launch, 'our democratic gains will be shallow and persistently threatened if they do not find expression in food and shelter, in well-paying jobs, and rising living standards'¹⁶. The Nedlac Act, passed in 1994 after being agreed to unanimously by all political parties, says Nedlac shall:

- Strive to promote the goals of economic growth, participation in economic decision-making and social equity.
- Seek to reach consensus and conclude agreements pertaining to social and economic policy.
- Consider all proposed labour legislation relating to labour-market policy before it is introduced in Parliament.
- Consider all significant changes to social and economic policy before it is implemented or introduced in Parliament.
- Encourage and promote the formulation of coordinated policy on social and economic matters.

Nedlac has had very limited success in the broader context of a national developmental vision and has rather been used to push particular interest group agendas. Arguably, the fragmented nature of these relations is partly due to the highly racialised suspicion amongst the parties of the interventions and competence of the various groupings¹⁷. Furthermore, the complex nature of the relationship between the ruling ANC government and its alliance partners – which includes the largest trade union federation – has made labour market reforms difficult to implement. The outcome of Black Economic Empowerment has been the emergence of a new black elite which has had a conflicted position in relation to ‘old’ business and their historical comrades in the ruling party and the trade union movements from which many emerged. Furthermore, a culture of patronage has taken hold in the form of rent-seeking contestation.

Conclusion: The Way Forward

The recent rapid growth, combined with high inequality, in many developing countries has exposed the soft underbelly of these economies. Whilst investors have celebrated the high returns, we have nonetheless seen the rise of protests around the provision of basic needs, growing unemployment and inequality. The lack of inclusiveness of this growth model has led to populist backlash in many parts of the world. This reflects a growing dissatisfaction in developing countries about the lack of a social compact around an inclusive model of development¹⁸.

Governments have reacted to this restlessness by increasing social spending, but in the absence of a clear understanding about the rights and obligations of the various stakeholders this will create a rising fiscal problem and, in time, a problem in competitiveness. A social compact in the developing world needs to:

- Compel governments to be accountable to its:
 - Citizens by delivering the public goods and services that are appropriate given its ‘contract’.
 - Business community by providing a predictable business environment with clear, coherent rules and policies.
- Encourage business to recognise its larger role within society and that its responsibilities extend further than its immediate shareholders and include all stakeholders including its workers and consumers. It needs to pay its fair share not only to its shareholders as dividends, but also in taxes and wages.
- Ensure civil society acts in a manner which not only focuses on its benefits but also its obligations. Citizens need to obey the laws, participate in processes of governance and pay their taxes. Trade unions need to become active participants in the long term national development of the economy and not merely an extractive representative for a narrow constituency.

Such a social compact relies on reciprocal obligations. There is increasingly no substitute to social compacts because the alternative will see rising instability and policy vacillations as governments reflect the underlying tension. This search for a new social order is pressing in developing countries where high levels of economic growth expose the growing gaps between those who participate in this new economy and those who are left behind. This creates new interest groups and alliances and sees old social orders collapse. Finding ways to bring about more inclusive development and ways to compensate those who are not making the transition successfully to this new economy is a function of a social compact and will see a more stable social order arise.

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