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# Toward human-centered capitalism

## Exploring a new social contract

Dennis J. Snower

BRIEF

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**Dennis J. Snower** is a nonresident Senior Fellow in the Global Economy and Development program at the Brookings Institution and Senior Professor of Macroeconomics and Sustainability at the Hertie School, Berlin.

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# Toward human-centered capitalism: Exploring a new social contract

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**Abstract**

The traditional social contract underlying the free market economy has run its course and needs to be replaced by a new contract, based on a new conception of the “empowering economy.” Whereas different social contracts are relevant to different societies, all such contracts aim to address certain shared human needs that every successful society must satisfy. In the presence of current global problems—such as climate change and financial crises—satisfying these needs can generate popular approval for multilateral agreements to tackle them. This paper identifies three inconvenient truths for the existing social contract: (i) economic performance involves more than material prosperity, (ii) free markets naturally generate inequality, and (iii) human progress rests primarily on cooperation. In response, the paper proposes a new social contract that can be promoted through three policy pillars that focus on: (1) personal empowerment and social solidarity, not just material prosperity; (2) automatic stabilizers that reduce inequalities of economic power; and (3) interventions that develop the human capabilities of cooperation.

Underlying every economic system is a social contract setting people's norms, values, and beliefs, thereby determining how people are expected to behave within the economy, what their reciprocal obligations are, and how the economy is to be run. Many market economies around the world—in both advanced and emerging countries—rest on a materialistic social contract that is increasingly failing to address basic needs of many citizens.

This materialistic social contract rests on philosopher and economist Adam Smith's principle of the invisible hand, whereby people pursuing their own self-interest in free markets are led—as if by an invisible hand—to make everyone in society as well off as possible. The popular appeal of capitalist economies relies heavily on this principle, since people usually support capitalism because it is alleged to deliver higher living standards and more economic freedom than alternative economic systems. The underlying assumption is that human needs can be satisfied through material prosperity and that decentralized, self-interested market decisions tend to generate such material prosperity more efficiently than more centralized, coordinated approaches. Political parties differ in terms of the degree of government intervention deemed necessary to redistribute the economic pie, but there is broad agreement that the Invisible Hand is an effective tool to enhance the overall size of the pie.

In many countries, however, this economic model has generated rising inequality in one or more of various dimensions—income, wealth, education, health, skills, and social esteem. The approach has also generated falling social mobility, rising social fragmentation, a widespread sense of disempowerment in response to the vagaries of globalization and automation, and resentment among many people that their hopes for a good life are being ignored. These phenomena are apparent in the political and social divisions within the U.S. and in many countries across Europe, Asia, and Latin America. These divisions undermine the foundation of trust that is essential for well-functioning market economies and the sense of common purpose that is necessary for democracies to work, thereby threatening the future peace and prosperity of nations.

Changing this economic model requires not just technocratic reforms, but a new social contract. Whereas different social contracts are relevant to different societies, all such contracts share certain features aimed at addressing common human needs. The norms, values and beliefs that are implicit in any particular social contract must be appropriate to satisfy these needs.

Focusing on these commonalities among social contracts has become increasingly important, since the integration of the global economy and the massive increase in the world's human population have generated problems—from climate change to cybersecurity to financial crises—that are global in scope. Tackling these problems requires the countries of the world to cooperate. For such cooperation to achieve political legitimacy, popular approval of multilateral agreements is required. Such approval, coming from diverse countries and cultures, must draw on the commonalities of the underlying social contracts.

Such commonalities are highly relevant to international policymaking, such as that conducted by the Group of 20 (G-20). Though the G-20 has traditionally focused on economic and financial affairs, its ultimate purpose must be the fulfillment of basic human needs. Today's nexus of interrelated problems—social fragmentation, personal disempowerment, environmental disruption, and the retreat from multilateralism toward the pursuit of inward-looking national goals—suggests a new social contract is required. That contract in turn provides a foundation for popular approval of the multilateral cooperation required to tackle global problems.

The broad features of a new social contract—specifying a new division of responsibilities between households, firms, and governments—are becoming increasingly clear. They involve moving to a new conception of the relationship between the economy and society, based on the following:

- a reevaluation of the relative importance of material prosperity, social solidarity, and empowerment for wellbeing;
- a broader understanding of inequality.
- a reconsideration of the role of competition versus cooperation in generating economic progress.

This new conception provides insights into how economic prosperity (in terms of GDP and shareholder value) became decoupled from social prosperity (in terms of the wellbeing of individuals in their communities) and how economic and social prosperity may become recoupled.[1]

# Division of responsibilities

The current social contract has rested on a clear division of responsibilities between households, firms, and governments. Households were viewed as "consumers" and "workers." The job of consumers was to maximize their self-interested utility (payoffs accruing directly to themselves) and the job of workers was to work as little as possible for the greatest possible consumption gratification. Firms were to maximize their profits. For companies, this meant focusing exclusively on shareholder value. In the words of Milton Friedman, "the business of business is business." Governments were to set the "rules of the game" for the economy, so that the Invisible Hand could do its magic. With regard to supranational problems, such as cyber threats and climate change, it was the job of supranational institutions to permit mutually beneficial negotiations among selfish governments, in the hope that an Invisible Hand could also become operative at the state level.

This division of responsibilities is implicit in the dominant versions of the current social contract—from neoliberalism in the U.S. and UK, to the social market economies in central Europe, to the welfare states of the Scandinavian countries, to state capitalism in China and India, to the Latin American emerging economies, and so on. The major differences among these variants lie in their emphasis on market failures versus government failures. The greater is the sensitivity to market failures, the greater is the perceived need for government interventions to reduce externalities and inequalities. The greater is the sensitivity to government failures, the greater is the reliance of free market enterprise. Such variants of the social contract place significant emphasis on material prosperity, manifested primarily through the consumption of goods and services, as central drivers of human well-being. These differences of emphasis set the stage for the debate between left- and right-wing political parties in most countries over the postwar period. This debate was focused primarily

[1] The new conception is central to the OECD initiative on "New Approaches to Economic Challenges" (https://www.oecd.org/naec/) as well as the visions underlying the Global Solutions Initiative (https://www.global-solutions.international/initiative). The conception is also implicit in the UN's Sustainable Development Goals.

on how to create material prosperity and how such prosperity is to be distributed. GDP became the primary measure of economic success, relevant for the evaluation of government economic policy; profit and shareholder value became the primary measure of business success.

In advanced economies, the primacy of material prosperity led to increasing consumerism and financialization, mirrored in the rising share of the financial sector in GDP. It was accompanied by the growth of shareholder capitalism and increasing attention to short-term profits. The expansion of the welfare state in advanced economies over the early postwar decades—involving primarily an expansion of government involvement in education, health, pensions and social welfare—led to increased awareness of government failures, through disincentives to work, bureaucratic inefficiencies, and unresponsiveness to changing human needs. Such awareness led to the neoliberal movement initiated through the Reagan-Thatcher reforms in the 1980s. In many advanced economies, this movement promoted falling income tax rates, especially for the top earners, and a widespread fall in social expenditures as proportion of GDP.

From the late 1970s onwards, the forces of IT-driven technological change and globalization raised the demand for skilled labor relative to unskilled labor and turned a rising number of economic markets into global "tournaments," with high rewards for "superstars" relative to the rest.[2] As machines became increasingly competitive in the performance of routine tasks, the demand for routine white-collar work declined, reducing employment in the middle income occupations.[3]

These forces of technology and globalization raised incomes in the emerging economies, leading to a dramatic reduction in global poverty (driven primarily by China and India). Consequently, global inequality fell over the past 30 years, while within-country inequality has risen. Although inequalities in some dimensions (such as income, wealth, employment opportunity, or skills) have risen in most parts of the world, it has proceeded at different speeds in different countries.[4]

In advanced economies, inequalities have risen across generations (with the youth falling behind their ageing counterparts) and across the metropolitan-rural divide. These divergences have undermined social cohesion, leading to declining trust in government, declining civic engagement, declining political participation, and rising support for populism. Those in the bottom 90 percent of the U.S. income distribution experienced stagnant real wage incomes for the past four decades.[5] Financial deregulation led to hidden fragilities that erupted with overwhelming force in the financial crisis of 2008.[6] Deregulation in product markets, particularly those associated with digital networks, led to the rise of "superstar firms" accompanied by rising product market concentration and the inefficiencies associated with monopoly power.[7] Corporate tax reductions and reduced welfare provision promoted the economic fortunes of the few, who used their newly found economic power to influence the political process and the discourse in the media to their own advantage.[8]

[2] For a recent assessment of this development, see Autor et al. (2019).
[3] See, for example, Autor, et al. (2006).
[4] For the development of income inequality, see for example OECD (2016) and Atkinson et al. (2017).
[5] For example, Krause and Sawhill (2018).
[6] For example, Huwart and Verdier (2013).
[7] As noted, Autor et al. (2017).
[8] For example, Stiglitz (2019).

The self-reinforcing interactions between successful business leaders, politicians and journalists helped promote the cycle of inequality, deregulation, and the gradual dismantling of social safety nets. The underlying social contract was kept alive through the myths of "trickle-down prosperity" and the "equity-efficiency tradeoff" (whereby more material prosperity can be achieved only at the cost of less material equality). In the process, more and more of GDP growth was channeled to the top 1 percent of the income distribution.

Though these developments were particularly pronounced in the U.S. and UK, many other advanced and emerging economies experienced rising inequalities of income and wealth.[9] Nevertheless, the fact that inequality has risen at significantly different speeds in different countries indicates that the global forces technological change and globalization are not the necessarily the primary drivers of inequality. Differences in public policies, labor, and product market institutions, and education and training systems are important determinants as well.

Although income inequality may reduce the wellbeing of the disadvantaged on account of social comparisons, status anxiety, and a sense of relative deprivation,[10] this is certainly not inevitable. In many developing countries, income inequality raises the subjective sense of wellbeing of the disadvantaged by giving them hope of a better future. This phenomenon occurs when unequal incomes are associated with relatively high economic mobility. On this account, inequality of opportunity tends to be more reliably detrimental to wellbeing than inequality of income.

# Three inconvenient truths

As the materialistic social contract delivered higher aggregate income together with greater social fragmentation and conflicts, the public discourse lost sight of three inconvenient truths.

### Economic performance involves more than material prosperity

Material prosperity and its distribution is not the only basic human need affected by economic activity. Two other basic human needs are empowerment and social solidarity.

Empowerment involves the ability to influence one's own fortunes through one's own efforts. In the economic sphere, it concerns the responsiveness of one's economic rewards to one's skills and work efforts. In the political sphere, it pertains to active participation in the governance relevant to one's social allegiances, with respect to both entitlements and obligations. Social solidarity involves conducting meaningful personal relationships within social communities, generating a sense of identity, belonging, and mutual responsibility. Empowerment and solidarity need not be closely linked to material prosperity. Universal basic income can guarantee that one's basic material needs are satisfied, but cannot guarantee empowerment or solidarity. Economic performance and economic policy should be evaluated not just in terms material prosperity, but also with regard to empowerment and social solidarity.

Recent waves of globalization and automation have threatened empowerment, particularly among economically, socially, and politically disadvantaged groups. Shifting global value

[9] For example, Piketty (2014).
[10] An overview of these social forces is given by Kelly and Evans (2017).

chains and the proliferation of robots in production process have also disrupted local communities. Thus the economic performance of countries should be evaluated by more than GDP; economic policy by more than its influence on the magnitude and distribution of national income; company performance by more than shareholder value; and civil performance by more than the satisfaction of current consumption demands.

This is an inconvenient truth since it undermines the myth that economic success consists merely in the satisfaction of maximum consumption with minimum resources and that economic success can be measured through material living standards and the stock markets.

### Free markets naturally generate inequality

Unfettered markets lead, as if by an invisible hand, to growing inequalities of economic power, leading to inequalities of income, wealth, education, skills, health, and employment opportunities. The reason is simple. Free markets generate heterogeneous economic outcomes for market participants. The successful participants in labor, product, and financial markets (the "insiders") use their economic power to erect market entry barriers and to acquire political power relative to the "outsiders."[11] Rising barriers to entry give these winners rising market power; this political power gives them privileged influence over taxes, subsidies, and regulations. These developments reinforce the initial inequalities, thereby gradually undermining countries' social cohesion and the legitimacy of their governance institutions.

It is commonly assumed that the vicious cycle must be checked by governments, but this public sector function is systematically undermined through the economic and political power generated by the inequalities. This is an inconvenient truth since it undermines the myth that free markets are self-equilibrating.

### Human progress rests primarily on cooperation

Global economic progress over the past 300 years rests on two foundations: cooperation and innovation. Innovation, in turn, is generated primarily by cooperation.

In the absence of cooperation, humans can achieve little. The growth of knowledge, the management of the commons, the provision of vital public goods, and the suppression of inequalities all require us to cooperate with one another.[12] This cooperation stems from social and political institutions that prevented people from pursuing their selfish ends to the detriment of others.

Innovation requires curiosity, openness to change, willingness to challenge established truths, adherence to the scientific method and, most importantly, cooperation. All innovations are built on previous innovations. Knowledge sharing is crucial. This is an inconvenient truth since it undermines the myth that economic progress arises primarily through free market competition.

[11] For example, Lindbeck and Snower (1989) and Olson (1984).
[12] See, for example, Henrich (2016).

# A new social contract

A new social contract must be built in recognition of these three inconvenient truths. It must promote human flourishing, elucidated through the principles of multilevel selection.[13] In the evolution of human societies, the process of selection acts not only on individuals, but also on groups, since individuals may gain a competitive advantage by cooperating with others rather than by pursuing selfish ends. As societies evolve, people change their physical environment, giving rise to social changes, which lead to further changes in their physical environment, and so on.[14] For example, the rising social fragmentation, disempowerment, and environmental degradation are the product of social changes favoring individualism and competition, among other things. A new social contract is meant to generate social changes that are better adapted to our current environment. In response to the three inconvenient truths, a new social contract must involve three policy pillars, with far-reaching implications for the responsibilities of government, firms, and households.

### Pillar 1: Empowerment- and solidarity-oriented policies

First, the new social contract must go beyond our current policy focus on material prosperity and distribution of wealth. It must also include the objectives of personal empowerment and social solidarity.

The traditional debate between the left- and right-wing politics focuses on material prosperity, largely ignoring empowerment and social solidarity. Left-wing parties favor more redistribution in exchange for reduced economic efficiency; while right-wing ones favor less redistribution for the sake of greater efficiency. The underlying equity-efficiency tradeoff often is a myth, since the insecurity, social fragmentation, and health problems that accompany severe inequality are all inimical to economic efficiency.

But even when this tradeoff exists (for example, when passive unemployment benefits generate disincentives to work and train), the inefficiencies can largely be overcome by moving from a *welfare state* that redistributes money to an *empowering state* that redistributes incentives and creates requisite skills.[15] In the new social contract, the unemployed and unskilled should automatically receive employment and training incentives, financed through taxes on the employed and skilled. Similarly, an *empowering firm* provides employment and training opportunities to promote upward mobility in the workplace. Such empowering redistribution transcends the traditional controversy between left- and right-wing politics, since empowerment is a goal that both sides share.

Whereas redistributing incentives to become employed and skilled can address economic empowerment, political empowerment requires opportunities to participate in the governance of social groups to which one belongs, within political processes in which individual behaviors are monitored, violations of rules are punished, and conflict resolution mechanisms permit disagreements to be resolved quickly and fairly.[16]

Furthermore, social solidarity can be addressed by giving broken communities—particularly ones that have suffered from disruptions driven by globalization and automation—privileged access to education and quality infrastructure investment. Empowerment and solidarity, in

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[13] See, for example, Wilson (2015), Wilson and Wilson (2007), Richerson & Boyd (2006), Henrich (2017)
[14] In other words, niche construction plays an important role in social evolution. See Odling-Smee (2013).
[15] See Snower (1993, 2018).
[16] For further elaboration, see Wilson, Ostrom and Cox (2013), for example.

addition to environmental impacts, should become a standard ingredient in the evaluation of economic performance, in addition to GDP and shareholder value. It should also become an integral part of cost-benefit analyses for education and infrastructure investment.

In the new digital age, however, smart machines are increasingly taking over routine work from humans, first in a variety of low-skilled tasks (leading to “skill-biased technological change”) and then in a widening range of routine skilled tasks (leading to the “polarization of work”). Thus, traditional employment and training incentives may not be sufficient to ensure economic empowerment. What is increasingly required to secure satisfying, empowering jobs is education and training in areas where humans cannot be displaced in the foreseeable future, namely, in tasks involving social skills, non-codifiable creativity and skills of assuming legitimate human responsibility—all combined with the technical skills to make machines complementary to people. Social skills—such as empathy, compassion,[17] mentalizing, and perspective taking can be trained and measured.[18] The relevant training can promote human-centered productivity in a wide variety of jobs that are currently under threat from automation. These occupations range from low-skilled jobs in health care, elder care, retail sales and cleaning, to higher-skilled jobs in banking, finance, and medicine. Targeted training for people across these job categories could empower many in the new digital age. Government policy can also promote such empowerment by giving users more property rights over their digital identities and the information they generate.[19]

On this account, “empowering states” and “empowering firms” must become involved not just in the redistribution of incentives, but also in the creation of skills that strengthen how humans interact with machines. The new social skills may also be expected to strengthen social solidarities within civil communities, thereby enabling people to cooperate in social groups at multiple levels. These developments once again involve a departure from the traditional division of responsibilities among governments, firms, and households.

### Pillar 2: Automatic stabilizers for economic power

Since the Great Depression, consensus has grown around the need for automatic stabilizers in macroeconomic policy: In a business downturn, governments raise their expenditures, reduce taxes and pursue expansionary monetary policy; when the economy overheats, the opposite is called for. Similarly, a new social contract must provide market economies with automatic stabilizers that reduce inequalities of economic power whenever they arise and whatever form they take. At the national level, this function is currently fulfilled through antitrust and competition authorities. Certain organizations are attempting to fulfill this function at the supra-national level, ranging from the Directorate-General for Competition in the EU Commission to voluntary networks such as the International Competition Network and the OECD Competition Forum. However, this regulatory framework generates inefficiencies of its own, is vulnerable to political interference driven by economic power, and is inadequate for the new digital age. Digital network monopolies (such as Google, Apple, Amazon, Facebook, YouTube, and Microsoft) gain large shares of global markets and can thus often evade national antitrust and competition authorities; they wield immense market power that is often used to gain political influence; and they frequently avoid taxation, erode privacy and create addictive products. They are natural monopolies, whose market value grows in relation to their user numbers.

[17] See, for example, Weng, Fox and Shackman (2013).
[18] See Schleicher (2018).
[19] See, for example, Snower (2018).

There is a broad consensus in the economics, business, and law professions that monopolies, including natural monopolies, need to be regulated and there is a large literature providing guidelines on how to do so.[20] However these guidelines—ranging from price regulation to market entry regulation to market share regulation—are all blunt instruments, many of which are not relevant to digital network monopolies and all of which generate new inefficiencies themselves. Furthermore, the regulation of global digital monopolies would require international coordination on a scale that has proved unachievable so far.

To make progress, it is important to recognize that the social problems generated by monopolies (including natural monopolies) are closely tied to the objectives of these companies, namely, the maximization of shareholder value. It is this objective that makes the companies unresponsive to the public interest whenever it diverges from that of the shareholders. On this account, company law must be reformed. Mayer (2018) suggests that companies be required to define their social purposes, to make boards of directors responsible for delivering on these purposes, to measure company performance in terms of these them, and to implement remuneration schemes reflecting delivery on them.[21] Such a reform would provide new automatic stabilizers that mitigate the adverse social consequences of monopoly power. It would also initiate a potentially important exchange of ideas between businesses, customers, and employees concerning the content of businesses' social purposes.

On this basis, the regulation of global monopolies would become more manageable, since competition authorities would no longer be locked into the traditional principal-agent problem of promoting consumer welfare by constraining the actions of self-interested firms. Instead, the competition authorities could evaluate the social purposes of companies in relation to the wider public interest and design regulations to bring these into greater consonance with one another. These regulations could, in turn, affect the companies' defined social purposes, and so forth in a virtuous cycle that is driven by our understandings of human needs rather than by shareholder value alone.

The implicit social contract underlying such reform departs from the traditional division of responsibilities between firms, households, and governments. Instead of governments bearing the sole responsibility for designing rules that make self-interested firms serve the public interest, a new legal and institutional framework makes governments and firms jointly responsible. This development may be expected to make citizens more aware of potential abuses of economic power and consequently make voters more supportive of the new framework and customers more supportive of companies serving the wider public interest. It would thereby help prevent human cooperation from being disrupted through self-interested behavior by economically powerful actors.

### Pillar 3: Cooperation

Finally, the new social contract must recognize the central role of cooperation in generating economic progress. The contract should promote economic policies that do not simply promote competition for its own sake, but give more emphasis to the development of our cooperative capabilities. The implications are far-reaching and profound.
Recognizing the importance of cooperation—not only in providing public goods (such as basic education, greenhouse gas abatement, and cybersecurity) and preventing problems of the

[20] For example, Joskow (2007).
[21] See Mayer (2018).

commons (such as overfishing, overgrazing, and rainforest destruction), but also in providing a vital sense of social belonging in living communities—decisively invalidates the myth of the invisible hand, whereby selfish private enterprise alone works in the public interest.[22] Furthermore, since human cooperation generally takes place in social groups of limited size, which are nested into larger groups (such as nations), the design of economic policy must move beyond the debate between centralized planning and free enterprise.[23] Instead, the organization of economic activities should follow the organization of social activities, so that people's natural social drives for social cooperation may be brought into the service of material prosperity.

Finally, economic policy must focus innovation on creating wealth and empowerment creation, rather than leaving privileged elites to extract wealth and empowerment at the expense of the under-privileged. The measurement of economic activity—both GDP and shareholder value—must be changed to reflect the distinction between creation and extraction. This distinction should also be observed with regard to manufactured capital and natural capital. A rise of manufactured capital at the expense of empowerment, social solidarity or natural capital should not count as a net gain.

# Conclusion

Recognizing a new social contract that is built on these foundations can help recouple economic activity to the satisfaction of fundamental human needs. This new contract is based on a fresh understanding of the responsibilities to be borne by firms, households and governments. Instead of the traditional division of responsibilities—whereby the government is left with the impossible task of setting rules to ensure that the self-interested activities of the private sector reflect the public interest—each of the participants in the market economy is embedded in a network of reciprocal rights and responsibilities that serve the wider public interest. This recognition can provide values and norms on which popular acceptance of multilateral agreements to address multilateral problems can be built.

Addressing our major global problems—such as climate change, financial crises, pandemics, technological unemployment, overfishing, and so on—requires the cooperation not only of governments, but also private sector decisionmakers, working across national boundaries. Furthermore, government policies generally require citizen approval to become legitimate and effective. On these accounts, the implicit social contract underlying the activities of firms, households, and government has overarching significance. The new social contract can thereby help generate a human-centered capitalism that serves the evolving public interest.

[22] This argument is made powerfully by Hanauer (2018).

[23] See Wilson (2019) for a wide-ranging rationale for this revolutionary insight.

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