

Social Democratic Capitalism

The Nordic Experience and Beyond

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To this point in history, the most successful societies have been those that feature capitalism, a democratic political system, good elementary and secondary (K-12) schooling, a big welfare state, employment-conducive public services, and moderate regulation of product and labor markets. I call this set of policies and institutions “social democratic capitalism.” All rich longstanding-democratic nations have the first three of these—capitalist economies, democratic political systems, and good-quality K-12 education. The distinguishing feature of social democratic capitalism is its addition of expansive and generous public insurance programs along with aggressive promotion of high employment via public services and modest rather than stringent regulation of product and labor markets.¹

The aims of a good society include community, democracy, economic equality, economic opportunity, economic prosperity, economic security, economic stability, education, employment, environmental quality and sustainability, family, finance, freedom, good government, happiness, health, housing, knowledge, law and order, openness and support for other peoples, privacy, and safety. Social democratic capitalist countries have done better than others at achieving economic security (decent living standards for the least well-off and stability of income and expenses) and equality of opportunity. And they have done so without sacrificing the many other things we want in a good society, from liberty to economic growth to health and happiness and much more. Social democratic capitalism has proved more effective than existing alternatives at helping the least well-off and just as effective as those alternatives at achieving other aims.

The chief practitioners of social democratic capitalism have been the Nordic countries—Denmark, Finland, Norway, and Sweden. Contrary to what some presume, there is no good reason to think social democratic capitalism will work well only in these countries. Its success almost certainly is transferable to other affluent democratic nations. Indeed, all of those nations already are partial adopters of social democratic capitalism.

The American Way Forward

What changes are needed in the current system to achieve social democracy? In the contemporary United States, the chief changes needed lie in the realm of social policy. The United States has many public insurance programs and government services already. For the most part, they work very well. We should adjust and expand some of them and add others because the experience of other rich democratic nations shows us that there are other policies and programs that would be good for Americans and because we face new economic and social challenges that didn't exist or were less consequential in earlier eras.

What exactly should we do? We should add or improve the following:

- Health insurance
- Paid parental leave
- Child allowance
- Unemployment insurance and wage insurance
- Sickness insurance
- Disability insurance
- Social assistance
- Criminal justice
- Pensions
- Elder care
- Housing assistance
- Early education
- Apprenticeships
- College
- Affirmative action
- Full employment
- Minimum wage
- Earned income tax credit
- Profit sharing
- Infrastructure and public spaces
- Paid vacation days and holidays

Why rely on government programs rather than such intermediary institutions as families, civic organizations, and labor unions? One reason is that these institutions don't cover everyone. There has never been a society in which all children grow up in stable two-parent families, all workers enjoy union-negotiated wages and benefits, and civic associations serve the needs of all the disadvantaged. Moreover, these institutions have been steadily weakening for half a century. Americans marry later and divorce more frequently. Fewer children grow up in a home with both of their original parents. Participation in voluntary organizations has been declining.

And barely one in ten employed Americans is a union member. Even more problematic, these changes have a class tilt: families, community organizations, and union membership have weakened most among those with less education and income. Advocates for revitalizing these institutions offer lots of hope, but little evidence here or from other rich nations that revival is possible.

On a spectrum from imminently practicable to purely speculative, social democracy lies at the imminently practicable end. It exists to varying degrees in the four Nordic countries. Many other rich nations have some of the policies in force already, and some of those countries have been changing or adding policies to move closer to social democratic ones. Since the United States has perhaps the longest road to travel among the world's rich longstanding democracies, it might take half a century to put in place the full array of policies used in today's Nordic nations.

The notion of a social democratic United States will strike some observers of US politics as a pipe dream. But in the realm of public social policy, the distance between the United States today and Denmark or Sweden today is smaller than the distance between the United States a century ago and the United States today. In the past 100 years, we've put in place a host of public programs that contribute to economic security, opportunity, and shared prosperity. Getting closer to the good society doesn't require a radical break from our historical path; it simply requires continuing along that path.

Progress will be incremental, coming in fits and starts. But steps forward will have staying power. New programs and expansions of existing ones will mostly persist, as they have in the past, because programs that work well become popular and because the array of veto points in the US political system makes policy changes difficult. Small steps and the occasional big leap, even coupled with some backsliding, will cumulatively increase the breadth and generosity of government social programs.

This isn't a prediction about the timing or conditions under which specific policy advances will occur. It's a hypothesis about a probabilistic process. Over the long run, new programs occasionally will be created and existing ones intermittently expanded, and these additions and expansions are unlikely to be reversed. This pattern, in fact, aptly describes the history of US social policy over the past century.

Good Society Economics

Much remains unknown about how best to run an economy. We have virtually no evidence, for instance, about whether a large-scale democratically planned economy could function effectively. The same is true of a basic income grant at a level high enough to make employment genuinely optional. One of the strongest arguments for social democratic

capitalism is that we have real-life experience with this model and that experience offers reason for optimism that the model can achieve a host of goals.

Here are some specifics, as they exist in the contemporary Nordic countries:

A significant share of all productive assets and businesses are privately owned, though in some sectors, such as health care, most or all may be state-owned. Most investment decisions are made by firms. Private firms keep profits, but are taxed at a fairly high rate, as are the income and consumption of individuals.

Markets play the leading role in allocating not only investment but also labor, goods, and services. Government regulates these markets, extensively in some sectors. And government may be a large employer; in some Nordic countries, nearly a third of employment is public. Planning of the national economy is limited mainly to steering resources toward certain sectors (“industrial policy”).²

Social democracy is compatible with a range of firm sizes and corporate governance arrangements. Firm ownership might be dominated by larger shareholders who provide patient capital or by small shareholders favoring shorter time horizons. Firm boards could be elected entirely by shareholders or by a mix of shareholders and employees (“codetermination”).

Labor unions play an important role in determining wage levels and wage differences in social democratic countries. Unionization rates in the Nordic nations remain among the world’s highest. If unions were to continue to weaken significantly, as they have in many other rich democratic nations, government would need to take a more active role in wage determination, via a statutory minimum wage (which none of the Nordic countries currently has) or Australia-style wage tribunals. Most medium-sized and large firms are required to have an employee-elected workers council, which negotiates with management about working conditions, hours, and other non-pay matters.

Consistent with their embrace of competition and their concern for the least well-off, social democratic countries typically favor economic globalization—particularly trade of goods and services. They have been more ambivalent about immigration, though in recent decades Sweden has been a world leader in accepting refugees and its foreign-born population share is now higher than in the United States.

Social democracy constricts economic freedom in one respect: government takes money from us and spends it to ensure economic security, expand opportunity, and enhance living standards. This isn’t especially objectionable. Only diehard libertarians believe individual liberty should trump all other considerations, and virtually everyone supports government paternalism in the form of property protection, traffic lights, and

food safety regulations, to mention just a few examples. Beyond that, many people support public social programs. When basic needs are met, we tend to prefer more security, broader opportunity, greater fairness, and confidence that living standards will improve over time. We are willing to allocate some of our present and future income to guarantee these desirable outcomes and to allow government to take on that task. That's why public social programs tend to expand in size and scope as nations grow richer.

At the same time, a social democratic government can have a relatively light regulatory touch. In the Nordic nations, government sets basic standards for employee and consumer protections, but it seldom tells economic actors how to comply. The aim is to maximize individual opportunity and provide security for those who fail while impinging as little as possible on competition and flexibility.

An expansion of public insurance and public services in the United States will come with a price tag. Roughly, adding or extending the various programs listed earlier would require a rise in government spending of 10 percent of GDP. If that sounds beyond the pale, note that if our government expenditures rise from today's 38 percent of GDP to around 48 percent we will be only a little above the current norm among the world's rich nations. And an increase of 10 percent of GDP would be much smaller than the increase that occurred in the United States between 1920 and today.

Raising the Floor

The Nordic countries have so far kept inequality at a modest level, ensuring a high and rising income floor for the least well-off and boosting opportunity for persons from less advantaged families and neighborhoods. How?

First, in keeping poverty and income inequality in check, government transfers rather than taxes do most of the work. All rich nations, including the Nordic countries, have tax systems that are roughly proportional: households up and down the income ladder pay approximately the same share of their pretax income in taxes. Consequently, taxes don't much alter the distribution of income. But government transfers do. Countries that provide larger income transfers to low- and middle-income households typically reduce poverty and income inequality more. In fact, pre-transfer income for households on the bottom fifth of the income ladder is about the same in Sweden and Denmark as in the United States. But transfers make the income of these households higher in Denmark and Sweden than in the United States. If we were to count the value of free or low-cost public services, the difference between the Nordic countries and the United States would be even greater.

Taxes play a role in redistributing income mainly by providing the funds for transfers. The key difference between America's tax system and those of highly redistributive countries, such as Denmark and Sweden, isn't that US taxes are less progressive. It's that US tax rates are lower, so that tax system raises less revenue. While making America's tax system more progressive is a good idea, we can't get the revenues we need—another 10 percent of GDP—solely from households at the top. Doing that would require increasing the effective tax rate paid by the top 1 or 5 percent of households to a level far exceeding that at any point in the past half century. An American social democracy will require larger tax payments from both the rich and the middle class.

Second, government transfers do more than secure a high income floor for the least well-off. They also raise that floor over time so economic growth is broadly shared. We often think of the trickle-down process as economic growth raising earnings via more work hours and higher wages. But in almost every affluent nation, the earnings of low-end households have increased little, if at all, since the late 1970s. Instead, increases in net government transfers—transfers received minus taxes paid—have driven most increases in incomes. Sometimes increasing transfers requires no policy change because benefit levels rise automatically as the economy grows. This happens when, for instance, pensions, unemployment compensation, and related benefits are indexed to average wages. Increases in other transfers, such as social assistance, require periodic policy updates.

What's the right level for the federal minimum wage? Fifteen dollars per hour, the goal of the "Fight for \$15" movement, might be too high. A \$15 minimum wage isn't likely to reduce employment much or at all in such cities as New York or San Francisco, but in Mississippi and Arkansas there's a good chance it would. A federal minimum of \$12 per hour, indexed to prices to accommodate inflation over time, seems more likely to work. States and cities could still set their own minimum higher than the federal level, as many currently do. And people in low-end service jobs need not have a low income even if they are paid a low wage. A subsidy such as the Earned Income Tax Credit can boost household incomes while encouraging employment.

Should we try to minimize low-end service jobs? One way to do that is to make the wage floor very high, perhaps supplemented by heavy payroll taxes, to reduce employer demand for low-end positions. But why not welcome low-end service jobs? High-end services can't employ everyone. Imagine a high-skill, high-employment economy of the future with 85 percent of the working-age population in paid work. Suppose 65 percent finish college and end up in high- or middle-paying service jobs. That optimistic scenario still leaves 20 percent in other jobs. A few will work in manufacturing or farming, but for the rest we'll need low-end service jobs.

As we get richer, most of us happily outsource more tasks that we don't have the time, expertise, or desire to do ourselves—changing the oil in the car, mowing the lawn, cleaning, cooking, caring for children and other family members, advising, educating, organizing, managing, coaching, transporting. And improved productivity and lower costs abroad will reduce the price we pay for food, manufactured goods, and some services, leaving us with more disposable income. So we'll want more people teaching preschool children, coaching and mentoring teenagers, helping adults navigate the labor market or a midlife career transition, caring for the elderly, preparing and serving food, cleaning public spaces, delivering packages, and so on.

Should we instead pay out a basic income grant—an annual transfer of, say, \$15,000 to every adult, not conditional on employment? This would significantly enhance people's economic freedom. And if it replaced social assistance programs like Temporary Assistance to Needy Families and Supplemental Nutritional Assistance Program ("food stamps"), it would reduce both government administrative costs and the stigma attached to receiving benefits. The hitch is that a grant large enough to allow adults to live without earnings almost certainly would reduce employment, and we need high employment to keep the tax base large enough to pay for generous social programs and government's other functions. Moreover, a program that reduces employment might further widen the political divide, endangering other public social protections.

For some, a low-end service job might be a career. Others will want a service position to be merely a stepping stone. Such jobs can be especially valuable for the young and immigrants. Besides organizing formal job ladders, government can help ensure that people move themselves up by providing health care, early education, elementary and secondary schooling, lifelong learning opportunities, retraining, job placement assistance, special services for the mentally or physically disabled, language assistance for immigrants, targeted programs for the young and the elderly, and assistance with transportation.

Mobility between jobs need not be confined to upward moves. It's difficult to predict at age 18 or even 22 what kinds of interests and capabilities you will have at age 35 or 50. Policy should help people change their job, occupation, or entire line of work at various points in life, even if the switch is simply to something different, rather than something better. This calls for counseling, mentoring, and perhaps several year-long paid sabbaticals. It also means eligibility for pensions, unemployment insurance, sickness insurance, parental leave, and holidays, and other nonwage benefits should be contingent on employment, but not on a particular job or employer.

If most people are expected to be employed, policy also ought to improve the quality of work-life. Low-end service jobs may offer limited mental stimulation or opportunity to participate in decision-making, and

some are stressful. Some of these jobs will never provide more than limited stimulation, but we should push firms to do what's possible. More generally, we should aim to improve working conditions in all jobs and not assume that only higher-skilled, better-paying positions automatically come with decent work quality. Consider here an auditing procedure whereby government sets outcome standards for work conditions, leaves it up to firms to decide how to meet the standards, and monitors efforts to do so.

Policy also ought to limit the degree to which job inequality spills over into social inequality and segregation. In a good society, inequalities are modest, not severe. Jobs inevitably come with inequalities of status. If pay differences are large too, social segregation and inequality of respect might result. Policy should push against this. Neighborhoods should be designed or redesigned to encourage class mixing. Parks, beaches, libraries, and public transport ought to be attractive to all. And we might consider a mandatory year of national service to ensure that everyone gets an experience of genuine social mixing as they embark on adulthood.

So far I've focused on the distribution of wages, jobs, and incomes. What is the best way to reduce inequality of opportunity? Many institutions and policies can help, but evidence increasingly points to a key role for universal high-quality affordable early education. Schools help to offset the massive differences among families.³ Having children enter school earlier in life could reduce disparities among kindergarteners. Indeed, some analysts conclude that the impact of schooling is larger before kindergarten than after.

Social Democracy's Political Road Ahead

Social democracy in the United States is compatible with varying degrees of political centralization, with some use of direct democracy (referendums), and with varying foreign policies. Although the shift wouldn't require any constitutional changes, two would be helpful. One is switching from our winner-take-all presidential-parliamentary system of elections and government to a single parliament with proportional representation elections. The other is taxing wealth directly while wealth holders are alive (wealth tax) rather than only when they die (estate tax).

An important question is whether a strong union movement and a well-organized social movement are needed. True, differences in union strength help account for why the United States lags behind the Nordic countries in public insurance programs and public services. But over the past century, the United States has nevertheless added a host of valuable programs, and unions and social movements weren't always critical to their creation. Even so, organized labor resurgence would help, as would better organized and more persistent social movements. The "Fight for \$15" movement may signal a shift in this direction.

The Nordic countries haven't gotten everything right. Each has at one time or another gone too far with social policy generosity and made mistakes in macroeconomic management, and each has struggled to embrace and successfully manage large-scale immigration. Even so, their experience shows that adding public insurance and public services to a capitalist economy can enhance economic security and equality of opportunity without sacrificing liberty, economic dynamism, health, happiness, or the many other things we want in a good society.

Notes

- 1 For details, evidence, and references, see Lane Kenworthy, *Social Democratic Capitalism* (New York: Oxford University Press, 2019); Lane Kenworthy, *Social Democratic America* (New York: Oxford University Press, 2014).
- 2 Bernie Sanders proposed essentially this in his 2016 presidential bid. Sanders calls himself a “democratic socialist,” but he doesn’t want to nationalize firms or industries or shift from private to public ownership. His chief proposals are to create some new public insurance programs (paid parental leave, sickness insurance) and expand some others (Social Security, Medicare), to create some new publicly funded services (early education) and expand some others (health care, training, job placement), to reduce user fees for some services (public colleges), and to increase the minimum wage. This is social democracy, not socialism.
- 3 We know this from two pieces of evidence. First, at kindergarten entry, children from poor homes tend to have much lower measurable skills than children from affluent homes. Given the huge variation in home and neighborhood circumstances, we would expect that gap to continue to widen throughout childhood. But it doesn’t; it’s about the same size at the end of high school as at the start of kindergarten. This tells us that schools have an equalizing effect. Second, during summer vacations, when children are out of school, those from lower-income families tend to fall farther behind compared to those from higher-income families.

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