The Copenhagen Consensus

Reading Adam Smith in Denmark

By Robert Kuttner

From *Foreign Affairs* , March/April 2008

Summary: Denmark has forged a social and economic model that couples the best of the free market with the best of the welfare state, transcending tradeoffs between dynamism and security, efficiency and equality. Other countries may not be able to simply copy the Danish model of social democracy, but it nonetheless offers important lessons for governments confronting the dilemmas of globalization.

ROBERT KUTTNER is Co-Editor of The American Prospect, a Senior Fellow at the think tank Demos, and the author of The Squandering of America: How the Failure of Our Politics Undermines Our Prosperity. He conducted the research for this article as a German Marshall Fund Journalism Fellow.

Adam Smith observed in 1776 that economies work best when governments keep their clumsy thumbs off the free market's "invisible hand." Two generations later, in 1817, the British economist David Ricardo extended Smith's insights to global trade. Just as market forces lead to the right price and quantity of products domestically, Ricardo argued, free foreign trade optimizes economic outcomes internationally.

Reading Adam Smith in Copenhagen -- the center of the small, open, and highly successful Danish economy -- is a kind of out-of-body experience. On the one hand, the Danes are passionate free traders. They score well in the ratings constructed by pro-market organizations. The World Economic Forum's Global Competitiveness Index ranks Denmark third, just behind the United States and Switzerland. Denmark's financial markets are clean and transparent, its barriers to imports minimal, its labor markets the most flexible in Europe, its multinational corporations dynamic and largely unmolested by industrial policies, and its unemployment rate of 2.8 percent the second lowest in the OECD (the Organization for Economic Cooperation and Development).

On the other hand, Denmark spends about 50 percent of its GDP on public outlays and has the world's second-highest tax rate, after Sweden; strong trade unions; and one of the world's most equal income distributions. For the half of GDP that they pay in taxes, the Danes get not just universal health insurance but also generous child-care and family-leave arrangements, unemployment compensation that typically covers around 95 percent of lost wages, free higher education, secure pensions in old age, and the world's most creative system of worker retraining.

Does Denmark have some secret formula that combines the best of Adam Smith with the best of the welfare state? Is there something culturally unique about the open-minded Danes? Can a model like the Danish one survive as a social democratic island in a turbulent sea of globalization, where unregulated markets tend to swamp mixed economic systems? What does Denmark have to teach the rest of the industrial world?

These questions brought me to Copenhagen for a series of interviews in 2007 for a book I am writing on globalization and the welfare state. The answers are complex and often counterintuitive. With appropriate caveats, Danish ideas can indeed be instructive for other nations grappling with the enduring dilemma of how to reconcile market dynamism with social and personal security. Yet Denmark's social compact is the result of a century of political conflict and accommodation that produced a consensual style of problem solving that is uniquely Danish. It cannot be understood merely as a technical policy fix to be swallowed whole in a different cultural or political context. Those who would learn from Denmark must first appreciate that social models have to grow in their own political soil.

COMPASSIONATE CAPITALISM

At the center of the current Danish model is a labor-market strategy known as flexicurity. The idea is to reconcile job flexibility with employment security. The welfare state is often associated with rigid job protections: laws and union contracts making it illegal or prohibitively expensive to lay off workers. In much of the rest of Europe, labor-market rigidities have been blamed for high unemployment rates and for a welfare state of "insiders and outsiders," in which the well employed fiercely protect their jobs at the expense of those with little or nothing. It is here that Denmark offers its most ingenious blend of free markets and social democracy: despite heavy unionization, there are no regulations against laying off workers other than the requirement of advance notice.

In fact, Denmark has Europe's highest rate of labor turnover. What is more, much of it is voluntary. A 2005 Eurobarometer poll found that over 70 percent of Danes think it is a good thing to change jobs frequently, compared with less than 30 percent in neighboring Germany. Danish respondents reported that they had changed employers an average of six times, the highest figure in the European Union (EU). One in three Danes changes jobs every year. And with employers free to deploy workers as they wish and all Danes eligible for generous social benefits, there is no inferior "temp" industry, because there is no need for one. As precarious short-term contract employment has grown in most other countries, the number of Danes in temporary contracts has decreased since the mid-1980s. Where most other OECD nations have a knot of middle-aged people stuck in long-term unemployment, in Denmark, the vast majority of the unemployed return to work within six months, and the number of long-term unemployed is vanishingly small.

What makes the flexicurity model both attractive to workers and dynamic for society are five key features: full employment; strong unions recognized as social partners; fairly equal wages among different sectors, so that a shift from manufacturing to service-sector work does not typically entail a pay cut; a comprehensive income floor; and a set of labor-market programs that spend an astonishing 4.5 percent of Danish GDP on initiatives such as transitional unemployment assistance, wage subsidies, and highly customized retraining.

In return for such spending, the unions actively support both employer flexibility and a set of tough rules to weed out welfare chiselers; workers are understood to have duties as well as rights. Professor Per Kongshøj Madsen, director of the Center for Labor Market Research at Aalborg University, observes that the income security guaranteed by the Danish state, as well as the good prospects for reemployment, enables Danes to comfortably take risks with new jobs.

For the United States, 4.5 percent of GDP would be about $600 billion a year. Current U.S. spending on all forms of government labor-market subsidies -- of which meager and strictly time-limited unemployment compensation makes up the most part -- is about 0.3 percent of GDP, less than $50 billion. The dynamic U.S. economy, in other words, has plenty of flexibility but little security. Denmark suggests that a different path is possible.

The Danish model squares another circle by reconciling free trade with economic security. This is not an easy feat. In a global system, corporations can move around in search of low taxes, cheap labor, and scant social regulation. Yet in Denmark, even trade unionists are passionate free traders. One of my more startling interviews was with Marina Hoffmann, chief economist of the Danish Metalworkers Union and former senior economic adviser to the most recent Social Democratic prime minister, Poul Nyrup Rasmussen. "We need to convince Danish industry to do more outsourcing," this trade union leader improbably told me. "We are a small country and we survive by exporting. . . . If a Danish multinational manufacturing corporation can be more competitive by outsourcing components, we will be more competitive as a nation." In other words, hiving off routine production jobs and moving them to China and eastern Europe can help keep higher-end, knowledge-based design and engineering jobs in Denmark. And as manufacturing becomes more automated, a national policy of professionalizing service-sector jobs takes up much of the slack. A nursing-home worker in Denmark, for example, gets far more training, status, and pay than one in the United States.

I encountered an equally surprising set of enthusiasms when I interviewed the director of the Confederation of

Danish Employers, Henrik Bach Mortensen, whose support for union-management partnerships would be most unwelcome at, say, the U.S. Chamber of Commerce. Employers value the system, said Mortensen, both for its absence of industrial conflict and for its supply of good workers. The collaborative vocational training system, he noted, is essential for Danish competitiveness. This view was confirmed in an extensive survey of Danish employers conducted by Professor Cathie Jo Martin, of Boston University. Companies, she found, support the model because it brings them tangible benefits in the form of skilled and adaptive employees.

The productive work force helps both large and specialized Danish export industries thrive. Denmark is a global leader in such niche exports as hearing-aid production (through world-class companies such as Oticon), consumer electronics (Bang & Olufsen), insulin (Novo Nordisk), environmental technology, and finely engineered plumbing fixtures. As a seafaring nation, Denmark has global shipping giants such as Maersk, which ranks 138 on the Fortune Global 500 list. And in the service sector, Danish multinationals, such as the ISS Group, with 220,000 employees worldwide, are among the largest contractors for janitorial and security-guard services for office buildings, airports, and hospitals.

Wages in Denmark are about 70 percent above the OECD average, but the high productivity of the Danish work force justifies them. And because the Danish welfare state is financed primarily by income taxes and not payroll charges, overall labor costs to employers are moderated. But more than anything else, as Jørgen Søndergaard, director general of the Danish National Institute of Social Research, pointed out to me, it is Denmark's culture of collaboration that allows win-win outcomes for corporations and their employees alike.

In another typically Danish bit of ingenuity, a good deal of consumer choice is deliberately built into the social-welfare model, since Denmark is highly libertarian as well as partly socialist. Choices are offered to accommodate individual preferences, so that the model enhances liberty rather than imposing one-size-fits-all regimentation. Consumer choice also allows the discipline of competition to keep social providers on their toes and to retain the support of more affluent Danes for the model. Thus, there is good socialized medical care, but the basic package is complemented by private insurance, now used by about seven percent of the population, and Danes have a broad choice of doctors and hospitals. There is excellent free public education all the way through university and graduate school, but private and religious schools can get 85 percent government financing. In the United States, school vouchers are promoted by the right as a way of undermining the public-school system; in Denmark, state-financed private schools are accepted by the left as a safety valve.

THE GREAT DANES

To fully grasp its dynamics, the foreign observer needs to recognize the Danish model not as a silver bullet of clever public policymaking but as the product of a century of Danish political and cultural history. The modern Danish social system began with the labor compromise of September 1899. The previous decade had seen a bitter struggle between raw industrial capitalism and the rising labor movement. After an increasingly enervating series of strikes and lockouts, the Danish employers association and the central trade union federation, the LO, struck a historic bargain. The employers gave the unions legal recognition, which was soon ratified and reinforced by the state; the unions, in turn, recognized the employers' right to direct work, prefiguring the flexicurity model of a century later. Both agreed to a system of dispute resolution that prohibited both strikes and lockouts.

Denmark never again experienced the type of organized union busting characteristic of the United States and most nations outside northern Europe. Trade unions were empowered to be the bargaining agents of nearly all Danish workers, whether or not the workers chose to pay for individual membership (most did). Their ranks swelled to the point where unions came to consider themselves less an interest group than the stewards of a larger system. Growing union membership also made the closely allied Social Democrats the dominant governing party and the custodians of the social model. But even centrist and center-right parties did not challenge that model's core elements, because they were so highly valued by the populace. Over the course of the twentieth century, the model was continuously refined. The ideal of an egalitarian society with broad economic security took hold as an object of national pride.

This social consensus, however, requires constant tending. In the 1970s, Denmark's then overly generous lifetime social benefits collided with slow growth resulting from the OPEC oil shock. With the unemployment rate rising sharply, a taxpayer revolt broke out; the nationalist, antitax Progress Party became Denmark's second largest. When I visited Denmark in the late 1980s, to write an article on the faltering Scandinavian "third way," it was not clear whether the Danish model would survive. As late as 1993, the unemployment rate remained stuck at 12 percent.

In the early 1990s, a new Social Democratic government, under Prime Minister Poul Nyrup Rasmussen and Finance Minister Mogens Lykketoft, brokered macroeconomic and labor-market improvements in three rounds of reforms. Growth was restored, and the model was refined. They worked through a commission that drew on business, labor, academia, and the other major political parties, striking a series of compromises that were typically Danish.

At the time, some prime-age, able-bodied Danes were using unemployment and disability benefits to stay out of the labor force, often for life -- an embarrassment to the work ethic and a practice that was rendering the system unaffordable and undermining its legitimacy. The unions agreed to support a crackdown on abuses: the eligibility time for unemployment compensation was reduced from nine years to four and individualized reemployment plans were created that required the unemployed to meet regularly with counselors to seek new jobs, often in new occupations. (The labor movement's commitment, after all, is to facilitating and rewarding work, not idleness.) This brand of tough love forced many of Denmark's unemployed to seek and find jobs. And in return, the Danish government increased resources for highly customized training and temporary wage subsidies, with special provisions for workers under the age of 25. An unemployed Dane who reports to a job center can qualify for such opportunities as adult apprenticeships and university-level education. Denmark today has the world's highest percentage of workers, 47 percent, in some form of continuing education. Employer freedoms were also reaffirmed, helping to bring down unemployment. As Lykketoft observed, "When companies are aware of the fact that it is possible to get rid of the manpower when market conditions change, they will not hesitate to hire new people at an upswing."

Despite the coincidence of timing and some superficially similar elements, the Danish reforms of the 1990s were not remotely like welfare reform in the United States. The Danish unemployment benefit for a median-income family of four can be 95 percent of the prior wage. In the United States, it is about 30-35 percent, and many workers do not qualify. Whereas Danes can draw benefits for four years, the typical U.S. limit is six months. With the exception of small pilot programs, neither the U.S. welfare system nor the U.S. unemployment system offers sufficient support to enable people to cover their living expenses while they are undergoing retraining. And in the United States, a shift from a manufacturing job to a service-sector job typically means a significant pay cut.

As the continuing refinements of Denmark's labor-market policy suggest, there is constant debate, self-evaluation, and policy reformulation in order to keep renewing the model's dynamism and the political consensus that underpins it. Success requires continuous social dialogue, on the shop floor as well as on the floor of the Danish parliament. The latest refinements to flexicurity are focused on raising spending on the training of unskilled workers, further limiting the duration of unemployment benefits, and increasing pressure on the unemployed to actively seek new work. At the same time, Denmark is determined not to end up with the kind of low-wage service sector typical of deregulated capitalism, for that would undercut the entire model. For example, there has been an ongoing national debate about housecleaners. Housecleaning is an occupation that cannot be upgraded much by training: at the end of the day, making beds, doing laundry, and vacuuming carpets is pretty basic work. In the 1990s, after considerable debate, the Danish government decided that the only way to prevent housecleaning from becoming a ghetto of low-wage jobs was to subsidize the pay. So the Danish taxpayer got not only employment security, good medical insurance, generous family leave, and a secure pension but subsidized housecleaning as well. In 2002, as a cost-saving measure, these subsidy benefits were limited to less affluent Danes.

THE FUTURE OF FLEXICURITY

Can the Danish system survive? Today, the model is at risk of being eroded by multiple forces. One is fiscal and demographic: as the population ages, it is hard to keep providing high-quality benefits without raising taxes to unacceptably high levels, because the ratio of working people to retired people dwindles. However, thus far the Danes have managed to keep the basic system intact with adjustments around the edges.

The more serious threats to the Danish model have to do with several facets of globalization other than trade. A primary issue is immigration. Denmark, with a population of 5.47 million, now has about 330,000 foreign-born residents (approximately six percent of the population), about half of whom are Muslim. The number of non-European immigrants has tripled since the 1970s. With higher birthrates than native-born Danes, immigrants and their descendants are projected to rise to nearly ten percent of the Danish population by 2020. Reconciling solidarity with diversity is a big challenge, and although the Danes are a fairly tolerant people, immigration undermines the social model in a number of mutually reinforcing ways.

The political system that underpins the Danish model is rooted in social norms that are enforced by subtle peer pressure. People use public spaces in respectful ways. The country is almost preternaturally tidy. A taxi driver is likely to remind you to fasten your seat belt. Denmark's traditional Lutheran heritage, with its concern for community and its distrust of ostentation, reinforces modern social democratic policies. Most immigrants to Denmark come from very poor countries, often with very different traditions and social behaviors. Denmark is historically Lutheran but tolerant and secular. The Danes prize irony. They were a little shocked when the decision by the newspaper Jyllands-Posten to publish satirical cartoons on Islam in 2005 made their small country a lightning rod for Muslim anti-Western feeling. The whole episode reflected Denmark's tolerance of everything but intolerance and underscored a growing backlash against immigrants, some of whom share neither Danish norms nor broader Enlightenment values.

Low-skill immigrants also consume a disproportionate share of public services, and this in a society where much of the middle class already feels overtaxed. Danes get a lot back for their taxes, but there is not much margin for error. Add high unemployment, and the system risks fiscal collapse. Add too many immigrants, and more native-born taxpayers will stop supporting the model.

At a political level, the presence of immigrants increases partisan fragmentation, which undermines the process of national consensus building. The antitax, antiforeign Danish People's Party won 25 parliamentary seats in the November 2007 general election, down only slightly from the peak representation of the predecessor Progress Party in the mid-1970s, when unemployment increased sharply. The DPP wants to restrict some aspects of the Danish social model, including its high taxes and benefits for foreigners, and the current liberal-conservative minority coalition government depends on the party's support for its parliamentary survival. In 2007, the New Alliance Party made its debut, offering a libertarian program of welcoming foreigners and rejecting much of the welfare state. In last November's general election, New Alliance picked up five seats in the parliament. The immigration issue also splits the Social Democratic Party, the traditional champion of the Danish model. Its idealistic leaders tend to be immigrant-friendly, but many of its core working-class voters want a harder line on foreigners.

Immigration also presents a frontal challenge to flexicurity, which is based on the premise that virtually every worker can be trained for a good job. Not surprisingly, the hardest cases are recent immigrants with weak educational backgrounds, few if any skills, and often a reluctance even to learn Danish. The statistics are somewhat better for the second generation, whose members are more likely to have a decent basic education. Yet the children of immigrants continue to lag behind those of native-born Danes in school performance, and according to Peter Birch Sørensen, chair of the Danish Economic Council and a leading economist at the University of Copenhagen, many immigrant children still do not speak fluent Danish, and non-Western immigrant children tend to do far worse on standardized tests. The Danish Economic Council recently recommended that working-age immigrants be required to have at least a bachelor's degree in order to get a work permit in Denmark.

There is a race going on between the social integration of the children of immigrants and the patience of the Danish middle-class taxpayer. All the political leaders I interviewed agreed that Denmark's ability to reconcile its social model with immigration will depend on the success of integration. If immigrants remain an undigested lump of alien cultures in the midst of a generous welfare state, accepting its benefits but rejecting its cultural norms, support for the social system will erode.

A serious defection of the middle class would push the Danish model to a tipping point, as very nearly happened during the recession of the 1970s. Some Danes see this outcome as a deliberate goal of the current center-right government of Prime Minister Anders Fogh Rasmussen. Although it is not acting as crudely as the conservative governments of Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States did, Rasmussen's government sometimes seems to be deliberately nudging the Danish model toward that tipping point. His coalition, which has been in power since 2001, has trimmed health and education benefits, increased social charges, and left citizens to rely more heavily on supplemental private insurance. "They have been very successful at pushing more people to private kindergartens, private hospitals, private old-age care, in a fiscal context of limited public resources," says Lykketoft. This is all done in the name of fiscal discipline and consumer choice, but it pushes affluent citizens toward the conclusion that they would be better off with fewer social benefits and lower taxes. "The risk is that the consensus starts to crack," Sørensen told me. The government has also promoted lower-cost, nonunion unemployment benefit plans, to discourage individual workers from joining unions, accelerating a slow decline in union membership. Still, the government is far from making a frontal assault on the basic model, which continues to enjoy broad support.

GLOBALIZATION'S DISCONTENTS

Beyond bringing more immigrants to Denmark's shores, globalization threatens Denmark's model in other ways. In the late 1980s and early 1990s, when Jacques Delors was president of the European Commission and center-left parties governed several major member nations, the EU served as something of a bulwark for mixed systems such as Denmark's. Today, with the EU in more neoliberal hands, center-left Danes view it as something of a Trojan horse. Commission directives have made it easier for construction contractors based in eastern European member states to bring low-wage workers with them, undercutting local labor standards. New member states, whose development is subsidized by richer members, openly advertise their very low tax rates to lure companies, undermining Denmark's ability to finance its social bargains.

Another face of globalization -- speculative international finance -- poses another potentially serious problem. Private equity companies and hedge funds, the sharp edge of Anglo-Saxon financial capitalism, reject Danish-style social bargaining. Their business model calls for buying and selling corporate entities, slashing costs, and sometimes appropriating assets from operating companies. This trend of short-term financial engineering, imported from abroad as part of the trading system, can be a severe threat to a nation with harmonious labor-management relations rooted in social partnership and long-term company horizons.

In 1994, for example, the Social Democratic government, after extensive internal debate, decided to privatize TDC, the Danish national telephone company. All shares in TDC were sold off by 1998. In December 2005, TDC was resold to a consortium of five private equity groups, including the Blackstone Group and Kohlberg Kravis Roberts. A private equity purchaser is typically buying cash flow and pursuing assets that can be captured; a well-run telephone company, accordingly, is a sitting duck. As former Prime Minister Poul Nyrup Rasmussen explained, "It is hard to imagine a worse match than private equity and a telephone company. The company needs substantial capital to keep investing in technical improvements. Private equity is interested in extracting that capital." The private equity consortium borrowed about 80 percent of the money for its purchase, creating liabilities that weakened TDC's balance sheet. The company's financial condition was further weakened when the new owners voted themselves a cash dividend of 5.6 billion euros. Before it was acquired by private equity, TDC had a healthy balance sheet of about 80 percent equity and 20 percent debt and plenty of money for new technology. Today, the debt-to-total-assets ratio of the company is over 80 percent, its debt-servicing costs are far higher, and its credit rating has been downgraded.

This precedent represents a threat to Danish labor-management relations. Layoffs necessitated by business conditions have traditionally been tolerated by unions as long as owners operate in good faith. But in the case of TDC, layoffs were mostly the result of private equity owners stripping assets for windfall gains. If offshore private equity brings this model to broad sectors of Danish industry, the entire social model will be at risk.

In the aftermath of the TDC affair, former Prime Minister Poul Nyrup Rasmussen, now the head of the Social Democratic bloc in the European Parliament, has emerged as Europe's leading crusader for tighter regulation of hedge funds and private equity. He co-authored an influential report published in March 2007, "Hedge Funds and Private Equity: A Critical Analysis," calling for several mechanisms of tighter regulation in the EU. These include greater transparency and disclosure, a change in the tax laws to discourage highly leveraged buyouts, and prohibitively high taxation of short-term dividend withdrawals of company assets. Rasmussen remains a good free trader. It is the exposure of Denmark to speculative global finance that alarms him.

Despite such threats, the Danish model is partly bolstered against global financial currents, in ways that are historically accidental or incidental to the welfare state. Far less industry in Denmark is in publicly listed and publicly traded companies than in most of the industrial West. Many large firms are either family enterprises or held by trusts. And the large and well-developed pension system, closely allied with the unions, owns a portion of Danish industry. This is not exactly protectionism, but it does protect a big share of the Danish economy from predatory foreign investors.

A final effect of greater globalization is cultural. Younger, cosmopolitan Danes, especially those with advanced degrees and entrepreneurial skills, see their counterparts overseas earning salaries and bonuses that would be considered ostentatious and embarrassing at home. To date, the only erosion of Denmark's income equality has been a slight pulling away at the top. Still, it remains to be seen if the model can remain compelling to Denmark's best and brightest.

EXPORT MODEL?

As a policy buzzword, "flexicurity" is very much in vogue in both Europe and North America. The EU and various Brussels-based think tanks have held conferences and published papers on the concept. Flexicurity is invoked when the French or the Germans seek to make it easier to lay off workers, when the EU adopts a small pilot program of trade adjustment assistance, or when the Hamilton Project, based at the Brookings Institution, promotes its modest program of wage insurance, intended to offer temporary subsidies to workers displaced from industrial jobs. The common message is that if public policy can reduce the pain to individuals of economic transitions -- "compensate the losers" is the usual phrase -- then support for free trade can be rebuilt.

None of these strategies, however, embraces the other key elements that make flexicurity both a political and a policy success. Most seek to buffer the dislocations of trade on the cheap. But the Danish model cannot be understood as a strategy merely of "compensating losers" or even of reinforcing political consent for free trade. It is part of a far broader national commitment to maintaining a highly egalitarian society in which there are no bad jobs and to the use of ongoing labor-market subsidies to create a highly skilled and dynamic work force as the essence of global competitiveness. The other northern European nations have their own successful variants of active labor-market policy, but most of the proposals outside Scandinavia that invoke the Danish model would appropriate the flexibility without the security. None is politically serious about the necessary scale of public outlay or social collaboration. "I am skeptical about how much of the model can be exported," says Lars Rohde, director of the Danish labor-market system, "because it is the product of unique circumstances."

It is possible, however, to learn from Danish flexicurity. For instance, the United States and other industrial nations might grasp the logic of far more systematic investment in the work force as a strategy for attaining greater competitiveness, equality, and security. This could be understood as a way to overcome a well-known market failure: industry's refusal to invest enough in its employees because of a justifiable fear that they will take their newly acquired skills elsewhere. Far from interfering with the rest of the market's efficiency, public investment in the work force actually enhances the market's dynamism. It reduces the resistance of workers to changing jobs and subsidizes a more productive work force over time, just as government compensates for another well-known market failure when it subsidizes basic research.

For example, one could imagine a new U.S. administration embarking on a broad program of upgrading human service work, so that every job tending to the old, the young, or the sick would be a professionalized job on the Nordic model. This would require both government standards and significantly increased government outlays -- on prekindergarten and child care, on better training and career prospects for paraprofessionals caring for the aged, and on workers in the lower tiers of the health-care system. This scale of commitment would produce over ten million middle-class service-sector jobs that could not be exported, replacing vanishing middle-class blue-collar jobs. Such an approach, however, would require a major political shift -- progressive taxation, higher levels of public spending, and a renewed commitment to a far more egalitarian society.

Yet the United States cannot import Danish political or cultural history. Economic historians have a concept known as path dependence. The classic example is the QWERTY keyboard, which was created in 1873 with an oddly inefficient configuration of letters devised to keep typewriters' mechanical keys from sticking. Although more efficient keyboards were invented several decades ago, generations of Americans had grown up learning QWERTY, and we remain stuck with it. Path dependence reflects the dead hand of prior learning and lazy habits, as well as embedded economic and political power. Some would say that the market dominance of Microsoft's products over the technically more elegant Apple products is another case of path dependence and consumer lock-in.

So it is with social policy. Policy paths are heavily dependent on prior history, as Americans are reminded whenever they try to depart from the illogic of employer-provided medical insurance. Because of the unique social and political history behind it, Danish flexicurity policy cannot be imported whole by other countries. There are important differences between the welfare states of Scandinavia and those of Germany and France, whose labor safeguards are more protectionist and less flexible. Even greater are the differences with the United States, where unions try to protect what they have because there is no system for facilitating job transitions or for moderating extreme wage disparities. It is hard to imagine the United States importing Danish industry's embrace of trade union partners, or the Danish labor movement's comfort level with outsourcing, or the Danish taxpayer's tolerance of total tax rates of 50 percent. In an interrelated system, changing one element requires changing others.

Yet a national policy of greater competitiveness and greater equality based on dynamic investment in worker skills is too good an idea to ignore. Denmark breaks through stale notions about the inexorable tradeoff between equality and efficiency, as well as the conventional view shared by the American left and the American right that social justice and free trade are incompatible. If a U.S. administration had the political nerve to propose an active labor-market policy on a serious scale, it could not only narrow income gaps and increase overall productivity; it might also reclaim some of the lost support for a more managed brand of capitalism, revive the idea of a role for government in promoting equality as well as efficiency, reclaim trade unions as social partners, and build more compassion among Americans for those of different social strata.

Adam Smith is best known for his axiom that individual acts of selfishness aggregate to a general good. Even Smith, however, acknowledged that there are some economic necessities that market forces cannot provide, such as education. In 1759, long before he wrote The Wealth of Nations, Smith published the less well-known Theory of Moral Sentiments, a treatise on what a modern Danish social democrat might call social solidarity. "How selfish soever man may be supposed," Smith began, "there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him." Reading those words of Adam Smith in Copenhagen did not feel odd at all.
