

Chinese System and Nordic Exceptionalism: What Explains the Difference in Economic Development as well as Inequality?

Haoya Zheng^{1,a,*}

¹Haoya Zheng, Economics MA (SocSci), Adam Smith Business School, University of Glasgow
a. 2851528Z@studnet.gla.ac.uk

**corresponding author*

Abstract: While traditional economics believes that inequality is an inevitable product of capitalist activities, the outstanding performance in both economic growth and development indicators of Nordic countries, constituting Finland, Denmark, Norway, Sweden and Iceland, draw loads of interest in how they manage to achieve this unique exceptionalism in the globe range. This paper undertakes a comparative analysis of the different development trajectories between China and Nordic countries, trying to uncover the secret to sustain the unparalleled model and to find inspiration to deal with the gradually noticeable issue of inequality in China. The exploration of factors contributing to Nordic's development delves into social, economic and political realms, and presents that policy consistently contributing to the welfare-orientated system is the major drive for economic development. We also look at the possible policies worth referencing for China to sustain its development but also emphasize that it needs to suit China's own national conditions.

Keywords: economic development, Nordic models, China, equality

1. Introduction

Looking back from 2022 to 15 years ago, the five Nordic countries- Finland, Denmark, Norway, Sweden and Iceland is always fixed in the top 15 of the Human Development Index (HDI) ranking, the most commonly used indicator for economic development [1-3]. Based on the newest published report in 2022, the Nordic countries have an average HDI score of 0.951 while China scores 0.768 and ranks 68 places behind Finland whose ranking is the lowest among Nordic countries. Nordic exceptionalism could not only be shown via one indicator: the incredibly small, even gradually narrowing gap between HDI and IHDI shows the trend that Nordic countries perform very well in avoiding the phenomenon that inequality will grow as the process of growth that happens in most capitalist countries (As shown in Figure 1 below). The excellence in economic development performance of these countries sheds light on examples worthy of learning on the way for China to achieve high-quality development. The comparison of policies between the Chinese system and the Nordic one is also an incentive for providing a set of feasible policy improvements that can build towards China's 'common prosperity goal.'

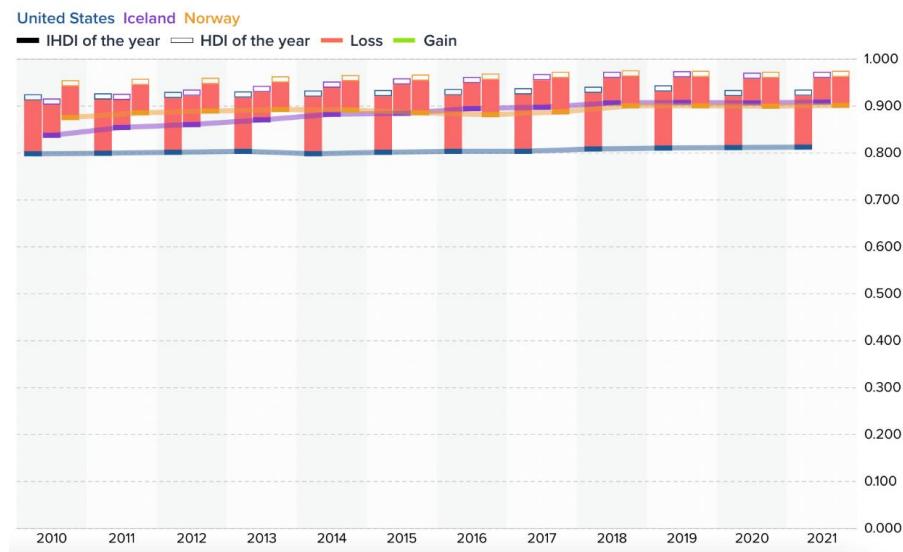


Figure 1: HDI and IHDI gaps in Nordic nations and the illustrative capitalist country Source: UNDP 2021

This paper is organized as follows, Section 2 reviews the related literature and data we referenced. As the next step, we analyse the common factors that existed in the five Nordic countries that might contribute to spectacular development in the main body Sections 3 and 4, Section 5 moves to evaluate why Sweden faces a separate path of development compared to its Nordic neighbours from the aspect of policy reformation. Section 7 is the final conclusion.

2. Literature review

Our study is related to two strands of research. Firstly, this paper contributes to the literature studying how to boost high-quality Chinese economic development. A growing number of papers document the enlightenment on development in China based on experiences from other countries [4][5][6]. However, there is a lack of systematic papers linking Nordic countries as specific examples to examine. Unlike most existing literature always evaluates why it is not reasonable to indiscriminately imitate the Nordic welfare states in China but leaves the issue of which aspects can be learnt selectively to improve policies under Chinese systems, we fill the gap in the literature by analysing factors for development in Nordic countries only and proposing the policy improvement for the case of China at the end of this work.

This paper also contributes to the developing field of linking the study of inequality and economic development. Our study is the few to analyse the role of cultural and historical factors in Nordic countries' low inequality. Consistent with the conclusion presented in the World Happiness Report, we found that cultural and historical factors are key foundations as well, but we specify more of their importance regarding later development in those countries instead of social happiness and well-being.

3. Historical and cultural influence on egalitarianism

The high level of economic development and equality can be largely based on social trust [7]. Nevertheless, one difficulty at the start is trying to explain why all Nordic countries commonly demonstrate a high level of social capital [8-9] within society (Iceland topped the social capital ranking in 2022, followed by Finland, the other three Nordic countries all occupy a place within first ten places). One potential root cause might be originated from their historical and cultural similarities due to the fact of geographical determinations.

There was very little feudalism and no serfdom established in Nordic countries after the medieval era compared to continental Europe due to cultural reasons. Firstly, the Vikings owned dominant power around the Nordic region were primarily seafaring traders and warriors, so they had little interest in establishing such long-term ruling systems. The maritime culture among the countries also plays a key part as the ability to fish enables many people to maintain their independence and the lords would find it difficult to exert power over people by controlling land for agriculture. A rapid rise of a large amount of self-owning farmers did not leave many conditions for the oppression of peasants to be formed after the breakdown of slavery. Therefore, there is no clear separation between the labouring and nobility classes, which is continued into modern times.

In light of the analysis above, less class divide originally in the Nordic countries creates a firm foundation of equality, cohesion and trust between citizens on a cultural level. Hence, it helps the Nordic countries take an advanced step in achieving the UN Sustainable Development Goals [10-12] during the process of economic development. These further generate a supportive environment for governments to provide various social benefits and public services, believing there would be very few people to 'free-ride' or gain profit from it.

4. Factors explaining the well-development

4.1. Innovation

According to the Global Innovation Index (GII) [13], the five Nordic countries always occupied at least three spots in the top 10 places in the past five years despite there being some fluctuations in the ranking. Meanwhile, although China gradually saw rapid improvements in innovative activity [14][15], the trend is not as stable as in Nordic countries. The outcomes in Nordic countries are greatly thanks to the huge expenditure on public education. For instance, Norway spent 6.6% of its GDP on educational institutions according to OECD reports in 2022. More importantly, the country puts a particularly high premium on research and development (R&D) conducted within its tertiary institutions. Iceland, Finland, Denmark and Sweden spent a proportion of 5.6%, 5.3%, 5.9% and 5.9% respectively. Although it is lower than that in Norway, the value is still higher than the 3.6% in China.¹ The public expenditure encourages broad access for students to higher education in Nordic countries, the human capital accumulated from knowledge and skills will generate higher dynamic efficiency when the graduates join the workforce and enable a constant supply of skilled labour.

Additionally, the annual net earnings in Nordic countries are significantly higher than in China- the annual earnings in China is around \$ 8,663 while that of the Nordic average is \$44,053 in the same year. This is likely to hint at higher hourly wages in the Nordic region as well. In that case, the Nordic firms will try their best to place machines and capital as substitutions for high-cost labour due to the profit motivation under the free market, this could inspire lots of innovation so that they could apply technology and minimize costs.

4.2. Welfare system

Nordic countries are renowned for their high-quality welfare and social benefits that are 'covered from the cradle to the grave' for their citizens.

There will be detailed analyses of the three key areas playing roles in the Nordic welfare state respectively: public services, tax system and individual rights - called three pillars as below.

¹ The data used for China is according to the World Bank published in 2020, since there is no later data available, so the year of reference is not the same.

4.2.1. Pillar 1: Public services

Public services in Nordic countries convey the universal principle and idea of all-pervasive. It has specifically ranged from “child benefits, parental leave, health services and hospitals” according to Nordic co-operation. The services provide substantial help to the common people at free delivery or largely reduced price, which ensures access no matter how much the income is.

The following paragraph will select education and healthcare services for more detailed analysis since they are the foundation of human capital and hence determinants for a country’s long-term development.

The education systems among Nordic countries are fairly similar: students aged from six to sixteen enjoy tuition-free education, while the Norwegian educational system is more inclusive of international students and the benefits are well-maintained to universities. The free-of-charge education in Nordic countries could help save money, this encourages more families to send their children to school as there is no opportunity cost for them. In this case, for private, it provides opportunities for inferior individuals to earn higher income and escape from the poverty trap; for public, it expands the talent pool and helps more tax revenue to be collected to finance the welfare services sustainably for future generations.

All Nordic countries have well-operated healthcare systems owned and organised by the central state, coupled with a much smaller private healthcare tier but still regulated by the local councils. For example, in Sweden, private healthcare providers are financed by regional councils and carry out the services councils buy. Their healthcare system provides universal coverage for national residents, although the time of waiting is under-satisfied, such a system ensures the ability of everyone to get secured protection and access effective therapies. Thus, this does not lead to further unequal distribution of health resources that impedes the average improvements of life expectancy and mortality rate which are key indicators for the development of a country.

In light of the two parts above, the public services in Nordic countries emphasise the theme of ‘equity’ and provide equal access to the general population. The services also ensure the sound lives of normal people even though they may not have much disposable income, as the essential expenses needed to be paid are barely only daily necessities. The welfare services are also interactional with the tax system in Nordic countries which will be discussed in the next section.

4.2.2. Pillar 2: tax system

The well-ranged welfare schemes are mainly funded by the taxation revenue collected by the government. Worth mentioning, despite that Nordic countries raise large amounts of tax through the progressive system, their efficiency outcome is maintained strong as mentioned above, which hints taxation does not impede much activity in reinvestment. Therefore, there is clearly something that is done right by the Nordic governments. The following paragraph is going to provide evidence of why Nordic countries can successfully reduce trade-offs from three dimensions.

Firstly, unlike the stereotypical thinking of ‘extremely high tax rates in Nordic countries, the corporation tax burden among Nordic countries is even lower than that of China [16-18] (With Iceland and Finland setting a tax rate at 20%, Norway and Sweden at 20.6% respectively). The key is that, the participation tax rates in Nordic countries are all very low (Kleven, 2014). This means that the taxes paid by firms are largely and effectively subsidized on complementary goods for labour supply and encourage output, therefore, the activity and motivation of workers in the Nordic countries are well-protected.

Worth mentioning that the tax designs and welfare systems in the Nordic countries are the backbone supporting each other. The average standard value-added tax (VAT) in the five Nordic countries is 24.6% whereas the standard rate in China is 13%. Although the VAT is considered a

regressive tax that levied more burden on the poor, who would spend a larger proportion of their income in everyday lives. The design of VAT in Nordic countries has reduced the drawback to quite an extent: for example, there is a special rate for food of 15% in Norway, which has little difference from the 16% of in China. In this case, the tax paid for daily necessities by the poor is not that significant. Plus, decent infrastructure and fair welfare benefits help to control the negative regressive effect of VAT and not fall too much on the low incomes to cause higher inequality [19-24].

Secondly, the taxation policy design in Nordic countries is quite special. Taking Finland as an example from the five Nordic countries, the income tax thresholds in Finland and China don't have many disparities, but Finland's tax is kicked in at a higher rate for low incomers. Differently, the Finnish taxation system is separated into national tax (progressive income tax) and municipal or church purpose at a flat tax rate for all residents' income under municipalities. These designs make the tax base in Finland much wider, so the government are able to collect more tax revenue. In contrast, the financial ministry estimated only 2% of Chinese residents were paying income tax in 2015, the narrow tax base makes the taxation itself hard to support huge expenditures for welfare services. Additionally, the tax elasticity coefficient in China is very inelastic at a value of 0.7 in 2015 [25-28] This means the tax base is hard to be promoted to the proportion that the government wants to achieve even if the tax rate increases.

Finally, there are also other factors concurrently playing a part other than the policies made. The third-party information and database in Nordic countries are excellent, completed information on income report strongly backs authorities to inspect and enforce the tax payment. For instance, the tax evasion rates in Denmark were between 0.2% and 0.9% based on observing Danish taxpayers in 2007 and 2008 by NBER. The law enforcement on tax evasion penalty in Nordic countries are harsher: still taking Denmark as an example, the penalty for the case of gross negligence is 50% to 100% of the tax due, but only 10% to 30% in China when the tax evaded is over RMB 50,000. Hence, the deterrent force of the law in Nordic countries is much more powerful. Moreover, as the content we discussed in Section 3, the cultural influence of greater cohesion in the Nordic societies leads to better awareness and enhances the cooperation for the tax system which further reduces tax avoidance behaviour.

4.2.3. Pillar 3: Individual rights (gender empowerment)

The welfare state in Nordic countries is highly praised also because of their protection and support and individual rights, from everyday life to political representativeness. We are going to emphasise gender empowerment shown by a high level of gender equality and policies targeting to promote greater equality in the Nordic countries in the rest part of this section.

Gender equality, a matter of human rights without distinctions between males and females, is a prerequisite as well as an indicator to determine progress in sustainable development [29]. Taking a look across the world, very few nations can confidently say that they have fully eliminated disparities between genders, but the Nordic countries lead the world in gender equality and pioneeringly drive changes to promote women's rights. The average score of the gender gap index [30-35] of Nordic countries is 0.850 in 2023, contrasting with the score of 0.678 in China. Among these five countries, Iceland has the highest score for 14 consecutive years. Thus, we will use Iceland, the 'paradise of women' as a typical example for further analysis.

The policies applied by the Icelandic government play an irreplaceably important role in achieving gender equality. For example, in order to further guarantee equal pay for men and women, Iceland officially implemented a new legislation on obligatory equal pay certificates in 2018. All companies with 25 or more employees, no matter the ownership and operation, must be reviewed annually by the National Center for Gender Equality and obtain the certificate designed to confirm equal pay for equal-value jobs. Iceland enacted the first legislation for "equal pay for men and women for equal work" as early as 1961. The introduction of the new law further guaranteed equality for about 80%

of women in the Icelandic labour market, showing the expectation of continuing to close the current gender pay gap of 9.1% and hopefully achieving the pledge of eradicating this issue soon. The shared parental leave legislation that came into effect in 2000 in Iceland prevents the disadvantages for mothers in the workplace. The implements have not only promoted equality in the labour market but also gathered momentum to change the social image and expectations for females by osmosis [36].

In the area of education and publicity, Iceland also does a really good job. The first full-women political party - the "Women's Alliance"(or 'Women's list') - was established after the first strike calling for equal pay and started to promote political participation in 1983, and the current share of women in politics is half. Iceland's most valuable experience in promoting gender equality is to teach children a correct gender perspective from an early age. For instance, each of the island's 17 schools has a mission to create a healthy balance of traits between the sexes. Teachers would separate the girls from the boys and cultivate in the girls what are traditionally called "masculine traits. [37]"

In contrast, from the observance of the falling score in GGI after the pandemic in China, there are lots of phenomena showing that China is inadequate in the area of gender equality. Many companies don't provide male and female workers with the same treatment, they tend to recruit males since the profit-oriented firms consider maternity leave of females as costs for companies. Female employees are always thought to be less productive due to time constraints resulting from family responsibilities, so they encounter more difficulties in career promotion to higher-paying positions just because of marital status. Many females experience gender-based violence and harassment (GBVH) in the workplace, but they rarely prosecute since the burden of proof is significant, the charges are always dropped for lack of evidence and the court usually penalizes little compensation for victims since there is a lack of a clear legal definition for such issues. This problem urges to be corrected by government actions, which will be illustrated in Section 7.

5. A relook at equality in Sweden

Sweden, renowned as the 'showcase of welfare states' in China, the egalitarianism theory in the country used to make it an equality paradise. However, its inequality has experienced an unprecedented reverse trend since the late 1990s: the sharp rise in inequality compared to its other Nordic neighbours shows its different development situation in the region as shown in the diagram below.

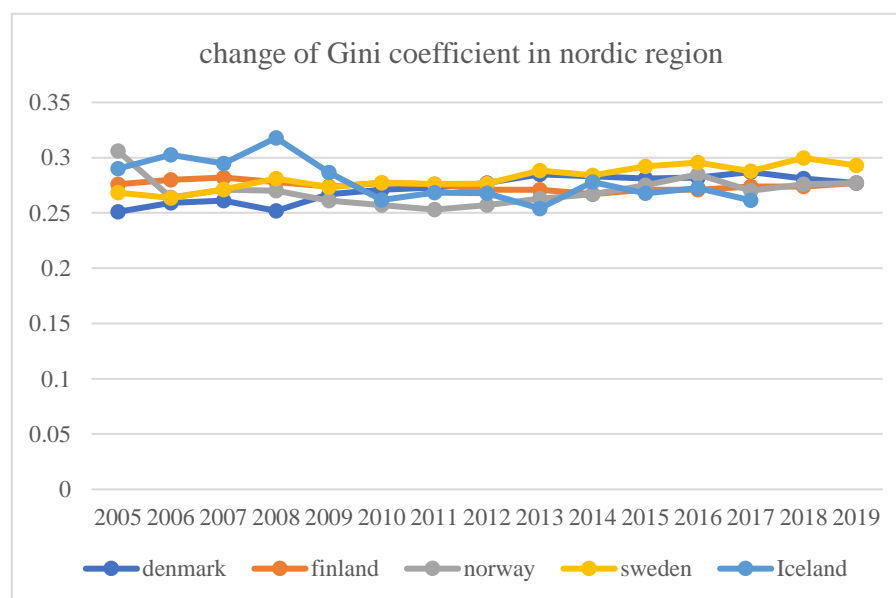


Figure 2: The trend in the change of Gini coefficient in the Nordic region

To let the Swedish situation be more reference for future decision-making for economic development in China, it is essential to evaluate what aspects did the Swedish government acted on that led the country to face the inequality crisis.

5.1. Tax cut helps top earners

The taxation policy changes by Sweden's social Democrat-led government have triggered the rising inequality. Its significant impact on inequality can be via the commitment to reduce inequality index (CRI) [38]– Sweden dropped from 5th place in 2018 to a historically low rank of 20th in 2022, with the 'rank on taxation policies' component reduced dramatically by 91 places.

Firstly, Sweden abolished inheritance and gift tax in 2004, the most redistributive tax helping to reduce wealth inequality; and up till now, there has not been any reintroduction of other kinds of wealth tax since 2007. Secondly, as the most influential part of the tax reform, the Swedish government offers a higher rate of mortgage interest rate deduction than many other countries: 30% of the mortgage is deductible for residence owners. Moreover, 50% of the labour cost for RUT work like cleaning and house maintenance is deductible. The helps the wealthy people who buy such services to save costs while the tax cut allows them to hold more wealth in hand and accumulate. More importantly, the reduction of income tax for top earners will aggravate the concentration of wealth in Sweden [39-42].

In a nutshell, it will exasperate the situation of 'it is cheaper to be the rich'. Hopefully, the income tax cut in the Swedish 2024 budget aimed at low- and middle-income workers could save the situation.

5.2. School reformation expands social segregation

The high-income earners have not only benefitted from the taxation policy changes as mentioned above, but the introduction of a voucher system in Swedish schooling also enhances their lifestyles by generations. This negative impact can be seen via the alarming PISA score [43-46] in Sweden experienced a notable fall compared to the observed data in the early assessments.

The voucher system has greatly diverted public funds into private schools, mostly in affluent communities. According to a report published by Swedish researchers in 2018, the voucher system contributes to greater separation between native, educated and foreign-born, less-educated households, highlighting that students from wealthier and better-educated families are highly educated in private schools. The voucher system and school segregation virtually exacerbate the current extreme intergenerational elasticity of the top 0.1% in Sweden and increase the extent of educational inequality passed down to future generations. Thus it perpetuates different access to opportunities at both economic and societal levels and leads to greater social distance between individuals with distinct socioeconomic backgrounds [47-50].

6. Conclusion

This paper investigates the drivers for Nordic countries to get to the impressive stage of economic development. We document that the excellent economic development of Nordic countries can be characterised by a beneficial cycle; the Nordic economies have a relatively better foundation for sustainable development maintaining equality in the society due to historical and cultural markers of harmonious and mutually trustful. The high level of social capital effectively translates to collective movement towards government policies. The robust social welfare systems that provide the populace access to various kind of services on a universal basis also fosters equality and cohesion, ensuring human capital development and social stability after reducing disparities, which are all important contributor to long-term development.

In conclusion, Nordic exceptionalism in avoiding the trade-off between capitalism and equality is attributed to a combination of factors. Despite that the cultural aspect cannot be overlooked, government policies are the most crucial factor leading the nations to be models of sustainable development since they legitimately balance economic growth and the welfare that it brings. Sweden is facing a different condition in development than the other countries also largely related to policy reforms. This finding inspires us to propose pertinent policies for China adjusting to the country's special national conditions as well as challenges in the next section.

7. Policy proposition

The population size of the Nordic countries is very small. Even if the population of all Nordic regions is added up, the total number is only about 1/50 of China. This means that China cannot directly apply the policies and systems of the Nordic countries, otherwise, the government will highly likely face the issue of a severe government budget deficit sooner. Nevertheless, their welfare systems more or less can bring some enlightenment to China, and let China embark on the road of "common prosperity" and "high-quality economic development" faster.

The common argument for applying for better standard welfare in China is that people will 'eat in the big pot' (the description used in China saying less productive people free ride to get benefits through perfect equality) as in the period of rural people's communes, harming the overall economic efficiency due to low motivation and participation in work. However, not all welfare policies will reduce the labour force participation rate (LFP), the paragraphs below will focus on policies raising LFP to respond to such concerns. The Nordic countries are very worthy of reference for China from this aspect, the governments use high public education investment and several gender-based policies to improve LFP to expand the talent pool to contribute to economic development.

As discussed in 4.2, the public expenditure on education in Nordic countries is high, alongside the huge public investment, the fees to afford higher education are relatively less in Nordic countries compared to China, hence more Nordic people would like to receive higher education. Additionally, when workers joining the labour force with higher education levels earn a premium over those who are less educated, the high hourly wage encourages them to work for longer hours and earn more since the income effect outweighs the substitution effect for leisure. In this case, the expenditure creates a beneficial cycle in which more Nordic people would like to receive higher education to take responsibilities with higher income, so the Labor force participation and education benefits are complementary from such perspective.

There is also a scope of policies aimed at increasing the overall labour participation from the gender aspect that can be learned by China. According to the IMF working paper, the larger difference in labour participation rate between genders emerged after the COVID-19 pandemic, and the gap in LTP has largely resulted from the shutdowns of kindergartens etc. Hence we can see that the gender gap in work and political lives in China, which ought to be solved alongside development, is also related to the inability of women to work as many hours as men could.

In this case, more affordable and accessible caring infrastructure should be built so the barriers or women to enter the labor market can be reduced, new skills can be brought to the workplace and a wider talent pool can facilitate future innovation.

Secondly, strengthening the propagation of female models and enact relevant laws/ legislation to reject gender stereotypes is a good complement for the former suggestion. Public awareness will reshape the minds of the next generations while also encouraging decision-making through a gender lens. In this case, women's ability can be expressed at a social optimum for development. This suggestion is likely to achieve a similar result as the childcare building, but fewer government expenditures are involved. Hence, it could be more practical for the Chinese government, to understand that there must be many other benefits to cover with the limited government budgets.

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