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RULES, DISCRETION, AND INSTITUTIONAL SUSTAINABILITY: A SOCIAL-DEMOCRATIC PERSPECTIVE ON ECONOMIC GOVERNANCE

Daniel BULIN

Institute for World Economy – Romanian Academy
Bucharest University of Economic Studies

Abstract: *In the context of globalization, recurring economic shocks, and pressures on the welfare state, the issue of the institutional sustainability of economic governance has become topical again. In this context, the debate between rules-based and discretionary policies provides important analytical tools for understanding how states can combine stability with adaptive capacity. However, the literature on rules and discretion and the literature on social democracy are rarely integrated into a common analytical framework. This article develops a conceptual synthesis that links the rules–discretion debate to social democratic governance in the context of institutional sustainability. The study uses doctrinal analysis and an interpretive review of the literature to clarify the conceptual foundations of rules-based and discretionary policies and to examine the main economic instruments associated with social democracy. The analysis shows that social democracy can be interpreted as a hybrid institutional architecture in which stable rules and limited discretion function as complementary mechanisms. Rules ensure credibility, predictability, and long-term commitments, while discretion allows for policy adaptation, resilience, and crisis response. This has direct implications for social sustainability: redistributive and social protection commitments produce sustainable gains in welfare and equity only when the institutional architecture supports them across electoral cycles and economic shocks. Institutional sustainability depends on the balance between stability and adaptability, rather than the exclusive predominance of either principle.*

Keywords: *rules-based policies; discretionary policies; social democracy; institutional sustainability;*

Contact details of the author(s): daniel.bulin@yahoo.com

INTRODUCTION

Debates in economic policy are closely linked to how decisions are institutionally structured and to the capacity of these arrangements to maintain economic and social stability over the long term. In this context, a central distinction in the literature is between rules-based policies, characterized by stability and predictability, and discretionary policies, characterized by flexibility and adaptation to contextual circumstances. The literature highlights the structural tension between these two approaches, discussing their advantages, limitations, and institutional and macroeconomic implications. In parallel, the social democratic tradition provides a complex example of how a political regime combines rules and discretion to shape the economy, promote equality and social cohesion, and stabilize the economy in a context marked by globalization and capital mobility.

Although the literature on rules-based and discretionary policies is extensive, and the literature on social democracy has analyzed welfare state institutions and redistributive mechanisms in detail, the intersection between these two domains remains relatively unexplored at the conceptual level. Interpreting social democratic doctrine through the rules-discretion debate and analyzing the extent to which the combination of these two logics can contribute to the institutional sustainability of economic governance represents a significant theoretical gap.

In this article, institutional sustainability is understood as the capacity of governance architectures to maintain economic stability, social cohesion, and democratic legitimacy over the long term, under conditions of uncertainty and change. From this perspective, the central issue is not the choice between rules or discretion, but the configuration of institutional arrangements that allow for the combination of stability and adaptability. The main argument of the article is that social democracy can be interpreted as a hybrid institutional architecture, in which rules and discretion function as complementary mechanisms for ensuring economic and social sustainability. Rules provide the stable framework necessary for the credibility and protection of social rights, while discretion allows for the adaptation of policies to economic shocks, structural transformations, and constraints generated by globalization.

The article begins with the debate on rules and discretion and integrates a systematic analysis of the main economic instruments associated with social democracy, highlighting how they combine stable commitments with adaptation mechanisms. As a contribution to address the aforementioned research gap, the article also formulates implications for the literature on economic governance, suggesting that institutional sustainability depends on the balance between stability and flexibility, rather than the exclusive predominance of one of these principles.

The methodology used is specific to theoretical research and doctrinal analysis. The article does not aim to empirically test statistical hypotheses, but to clarify concepts, compare intellectual traditions, and integrate two bodies of literature that are usually treated separately: the economic debate on rules and discretion, and the literature on social democracy and state intervention in the economy.

Formulated in this way, the argument links the rules–discretion debate to a concern that has become central to the sustainability literature: social sustainability. Welfare states rely on commitments that go far beyond a single electoral cycle—pension rights, universal health coverage, educational provision—and their value depends on whether they are believed. At the same time, the conditions in which they operate change: demographic shifts, labor market restructuring, and economic crises all require adjustment. The institutional architecture that governs this tension determines whether social protection remains credible over time and can be expanded when circumstances require it. Progress towards more inclusive societies therefore depends not only on the content of policies, but also on the way economic governance is designed.

The structure of the article is as follows. The second section presents the relevant literature and formulates the conceptual framework used in the analysis. The third section describes the methodology. The fourth section contains the research results – a rule versus discretion analysis of social democratic doctrine in different areas of economic policy – and discusses the implications for institutional sustainability. The final section summarizes the conclusions and indicates directions for future research.

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LITERATURE REVIEW

Rules-based policies vs. discretionary policies

The debate between rules-based and discretionary policies concerns monetary policy, fiscal policy, and, more broadly, the institutional design of public policies. The literature shows that the difference between the two approaches stems mainly from how decisions change over time and the role played by the expectations of economic agents.

Taylor (1993) shows that a rules-based policy does not imply an automatic mechanism, but rather a systematic approach defined by a stable plan for how instruments respond to economic developments. McCallum (2003) clarifies an essential conceptual distinction between discretion and rules: while discretion represents a series of decisions made in isolation, rules-based policies assume a continuous strategy, maintained over time and known to economic agents. Buol and Vaughan (2003) show that rules-based policies require a pre-established plan, with responses defined in advance for specific situations. In contrast, discretionary policies allow decision-makers to determine in each period the response they consider appropriate, adapted to current circumstances.

Discretionary policy involves the free assessment of the current and future economic situation, without pre-established normative constraints, while rules-based policies impose explicit limits, such as capping the budget deficit or public debt (Grabia, 2016). According to Kocherlakota (2016), in a rules-based regime, instruments are adjusted according to a previously established function, while in a discretionary regime, the decision-maker freely chooses the action considered appropriate at that moment.

A well-known author on the subject, Taylor (2011, 2012) highlights the contrast between predictable policies governed by stable reaction rules and discretionary, unpredictable policies oriented toward short-term fine-tuning. In a later paper, he emphasizes the gradual nature of the distinction, showing that rules are frameworks that reduce arbitrariness without imposing rigid automatism Taylor (2017).

In more recent work, Dellas and Tavlas (2022) interpret rules-based policy as a situation in which the monetary authority keeps its promises regarding how it will react to economic developments, while discretion occurs when the central bank changes its decisions from one period to another. Similarly, Webster (2025) describes discretionary policy as short-term oriented and reactive, and rules-based policy as long-term oriented and relatively passive.

Social democratic doctrine

Historically, socialist doctrines emerged as a response to the inequalities produced by capitalism. Utopian socialism (Saint-Simon, Fourier, Owen) envisioned harmonious communities and equal resource distribution but, as Engels (1880) notes, did not explain how capitalism could actually be transformed. Marx (1867) demonstrates that the capitalist system is based on the exploitation of surplus value and a permanent conflict between capital and labor. Similarly, Kautsky (1892) argues that the development of capitalism inevitably leads to the concentration of wealth, economic crises, and social polarization. In response to the social changes of the late 19th century, Bernstein in 1899 reconsiders the revolutionary perspective, arguing that with rising living standards and the expansion of the middle class, socialism can be achieved gradually through democratic reforms Bernstein (1961).

In recent theoretical developments, social democracy is described in the literature as a political tradition that combines constitutional democracy with the goals of social justice, equality, and solidarity. Social democracy is based on the idea that real freedom requires adequate material conditions and public interventions to reduce structural inequalities, not just the guarantee of formal freedoms (Petring et al., 2012). The welfare state is considered essential for effective democratic participation, tasked with preventing and correcting structural disadvantages through education, social protection, and active policies.

Social democracy has undergone a transformation – parliamentary reformism, rejection of the inevitable collapse of capitalism, and adoption of an ethically inspired socialism – becoming an ideology in which politics shapes the economy to produce moral outcomes such as equality and solidarity (Jackson, 2013).

In the postwar period, social democracy followed a model characterized by a regulated market economy, high employment, large social expenditures, and reduced inequalities, but without destabilizing capital (Glyn, 1995; Sawyer, 2021). Nordic models have exemplified a universalist regime of social protection, centralized collective bargaining, and strong administrative capacity (Huber and Stephens, 2002). The universalist state is seen as supporting solidarity and social capital, not hindering them (Rothstein, 2001).

As an economic doctrine, social democracy has been associated with Keynesianism, demand stimulation, labor protection, unionism, and redistribution (Piazza, 2001; Bremer, 2019). Social democratic economics holds that the free market requires regulation to prevent its destructive effects on moral norms, social cohesion, and equality of opportunity (Meadowcroft and Pennington, 2007). State intervention goes beyond correcting market failures, including mechanisms such as minimum wages, social insurance, and environmental regulations (Rothstein and Steinmo, 2013).

Globalization, capital mobility, and structural changes have eroded the conditions that made the classical social democratic model possible: low capital mobility, high fiscal autonomy, and strong national economies (Schwartz, 1998; Pierson, 2001). In this context, social democratic parties have undergone ideological changes: adopting pro-business and pro-globalization policies (Piazza, 2001) or adapting to the knowledge economy by focusing on human capital, innovation, and social investment (Andersson, 2007). The literature distinguishes between modernized social democracy, which maintains egalitarian objectives and adapts them through social investment policies, and liberalized variants that rely mainly on market-oriented instruments (Merkel and Petring, 2007).

Normatively, social democracy views freedom as dependent on resources, education, and social protection; understands solidarity as mutual responsibility within a universal framework; and defines equality as equality of opportunity and capabilities, not merely material distribution (Petring et al, 2012; Carlsson and Lindgren, 2008).

Rules, discretion and institutional sustainability

The debate over rules-based versus discretionary policies offers important analytical tools for understanding the institutional design of economic policies, while the analysis of social democratic doctrine provides insight into how the state uses eco-nomic, fiscal, social, and regulatory instruments to promote stability and social cohesion. However, these two bodies of literature are rarely integrated into a common conceptual framework capable of explaining how institutional architectures can generate long-term economic and social sustainability.

For this study, institutional sustainability refers to the capacity of governance architecture to maintain long-term public objectives – such as macroeconomic stability, social cohesion, the protection of social rights, and democratic legitimacy – despite economic shocks, structural changes, and short-term political pressures. The literature on the institutionalization of sustainability shows that integrating sustainable development objectives into stable mechanisms of public governance and state decision-making processes is essential for the long-term implementation of policies and for reducing their vulnerability to short-term political pressures (OECD, 2007). The literature on institutional resilience shows that sustainability does not imply rigidity, but rather the capacity of governance systems to adapt, learn, and respond to shocks without losing their essential functions (Duit et al., 2010).

Analytically, an institutional architecture can be considered sustainable if it reduces arbitrariness and instability through relatively stable rules and commitments, preserves the capacity to react to shocks through adaptation mechanisms and limited discretion, and maintains its legitimacy and social cohesion over time.

Rules are understood as relatively stable ex-ante commitments – such as social rights, labor standards, fiscal procedures, or collective bargaining institutions – that enhance the credibility of public policies, reduce uncertainty, and stabilize the expectations of economic and social actors. Discretion is understood as ex-post adaptation, exercised within normative and institutional boundaries, that allows for responses to economic shocks, the use of contextual information, and the adjustment of policies to structural transformations. The relationship between these two mechanisms can be interpreted as a balance between stability and adaptability: rules provide the necessary anchors for continuity and credibility, while discretion ensures the flexibility necessary for resilience. From this perspective, institutional sustainability does not result from the exclusive predominance of one of these instruments, but from an arrangement in which discretion operates within the boundaries set by the rules, and the rules are flexible enough to allow for adjustments in exceptional circumstances.

Figure 1 illustrates how rule-based and discretionary instruments work through institutional mechanisms – such as anticipation formation, actor coordination, and adaptive capacity – to generate economically, socially, and institutionally sustainable outcomes.

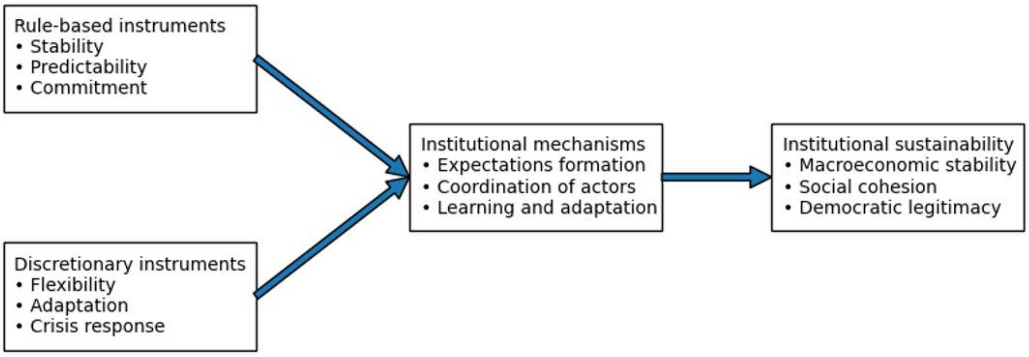

Figure 1. Conceptual framework for the relationship between rules, discretion, and institutional sustainability in economic governance.
Source: own elaboration.

METHODOLOGY

The methodology is specific to theoretical research and doctrinal analysis. The study does not aim to empirically test statistical hypotheses, but rather to clarify concepts, compare intellectual traditions, and integrate two bodies of literature that are usually treated separately: the debate between rules and discretion in economic policymaking and the social democratic doctrine on the structure of state intervention. Methodologically, the article can be characterized as a conceptual synthesis, based on an interpretative literature review and doctrinal analysis. The central methodology is integrative, bringing into dialogue two perspectives – the economic debate about rules and discretion and the doctrinal analysis of social democracy – to show how they can be understood within a common framework. The article systematically examines the concepts of "rules-based policies" and "discretionary policies" as they appear in the economic literature, aiming to identify the main definitions, theoretical arguments, advantages, and limitations of each approach. For the section on social democracy, the methodology consists of a comparative interpretation of the historical and contemporary literature on the principles of equality, solidarity, and public intervention.

The literature reviewed was selected based on several criteria, including theoretical relevance to the research questions and the contribution of the papers to the debates analyzed. Fundamental works from the economic literature on the rules-discretion debate were included, mainly from the fields of monetary and fiscal policy, as well as from the literature on the institutional design of public policies. The analysis uses classic and contemporary works from the literature on social democracy, political economy, and the welfare state, which examine redistributive institutions, labor market regulation, globalization, welfare state transformations, and industrial policies.

The main objective of the article is to analyze how economic theory regarding rules-based and discretionary policies can be brought into dialogue with social democratic doctrine to understand the extent to which social democracy functions as a hybrid model that combines the stability of rules with the flexibility of discretion.

The secondary objectives and research questions support the achievement of the general objective, as follows (Table 1):

Table 1. Secondary objectives and research questions

#O	Secondary objectives	#RQ	Research questions
O1.	Clarifying the conceptual boundaries between rule-based policies and discretionary policies, as defined in the economic literature	**RQ1.**	How are rule-based and discretionary policies defined in the economic literature, and what are the advantages and limitations of each approach?
O2.	Identifying the central economic principles and mechanisms of social democracy, including taxation, redistribution, regulation, and labor market policies	**RQ2.**	What are the doctrinal principles and essential economic mechanisms of social democracy in public policy?
O3.	Analyzing how social democratic instruments combine rules and discretion within the logic of a sustainable model of economic governance	**RQ3.**	How does the combination of rules and discretion in social democratic policies contribute to a sustainable model of economic governance?

Source: own elaboration.

RESULTS AND DISCUSSION

This section presents the results of the theoretical analysis based on the literature discussed above and examines how the relationship between rules and discretion appears in the economic instruments associated with social democracy. The analysis highlights the mechanisms through which the combination of stable institutional commitments and discretionary adaptation contributes to the institutional sustainability of economic governance. The structure of the section follows the logic of the research questions. First, the main arguments from the literature on the advantages and limitations of rules-based and discretionary policies are synthesized. Next, the main economic instruments associated with social democracy are analyzed. Finally, these elements are integrated to discuss how social democracy can be interpreted as a hybrid institutional model in which rules and discretion function complementarily.

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Rules-based public policies

Advantages and justification.

A central argument in favor of rule-based policies concerns credibility and the avoidance of temporal inconsistency. Stokey (2002) shows that a credible commitment from authorities protects the private sector from surprises and enables more efficient decision-making, as expectations can be formed within a stable and predictable framework. McCallum (2003) highlights the importance of communication among decision-makers, which, in a rule-based regime, facilitates the formation of coherent expectations. Taylor's contributions emphasize the transparency and systematic nature of rule-based policies (Taylor, 2011; Taylor, 2012). Taylor (2017) also demonstrates that instances of temporal inconsistency justify the use of rules, as they reduce the risk of abandoning the initial plan after private expectations have been formed. According to Buol and Vaughan (2003) rules increase credibility by constraining the actions of decision-makers and preventing the abandonment of commitments. Therefore, only a binding rule that does not allow for the renunciation of commitments can generate credible expectations and prevent strategic behaviors incompatible with long-term objectives. Derfler-Rozin (2012) argues that rules increase the legitimacy of decisions because similar cases should be treated the same, and clear criteria reduce perceptions of arbitrariness.

In the fiscal sphere, Grabia (2016) shows that rules increase the responsibility and credibility of decision-makers, reducing uncertainty. Bianchi and Menegatti (2007) show that, under a discretionary regime, governments are tempted to increase the deficit to stimulate output beyond its equilibrium level. From the perspective of macroeconomic performance, Webster (2025) argues that rule-based monetary policy leads to slower monetary growth and lower inflation.

Dellas and Tavlas (2022) note that, in previous literature, the main attribute of a rule was considered its ability to minimize policy uncertainty. McCallum (2003) argues that a rule-based framework can eliminate systematic biases associated with discretion and ensure more consistent and predictable conduct of monetary policy.

Disadvantages and limitations

A major criticism of rule-based policies is their rigidity. Lamfalussy (1981) argues that effective policies require both discipline to ensure credibility and flexibility to adapt to circumstances. Similarly, Guitián (1992) notes that rules applied too rigidly are inevitably violated.

Taylor (1993) warns that rules cannot and should not be followed mechanically, given the complexity and variability of economic reality. He also argues that the line between rules and discretion is difficult to establish in practice, and applying rules requires a certain degree of interpretation (Taylor, 2017). In some situations, the costs of strict adherence to rules may outweigh the long-term gains, making discretion preferable, as Sauer (2007) also shows.

Kocherlakota (2016) demonstrates that the performance of a rule can deteriorate significantly when economic conditions change, which is an important limitation of strictly rule-based regimes. Heise (2025) supports this, arguing that rules generate significant costs when the economic model on which they are based is wrong or when unanticipated changes occur.

McCallum (2003) points out that if rules are revised frequently, the adjustment process becomes a form of disguised discretion, weakening the firm commitment that rules are intended to guarantee. Similarly, Gailmard (2009) shows that the legislature cannot credibly commit to a predetermined set of policies for every state of the economy. Under these conditions, completely rigid rules can no longer work effectively in practice, and delegating limited discretion becomes the preferable control instrument.

Grabia (2016) shows that rule-based policies are less flexible, especially in exceptional contexts such as wars, financial crises, or severe recessions. In such situations, strict adherence to rules can hinder the state's rapid and appropriate response. Heise (2025) emphasizes that rules can generate costs when the underlying model is erroneous or when unanticipated economic changes occur. In these cases, Sauer (2007) shows that rules formulated from a timeless perspective can generate significant losses in the initial period, and when these costs exceed the long-term benefits, discretion becomes the superior option. Bianchi and Menegatti (2007) show that in the presence of uncertainty, the relative advantage of discretion increases because it allows policy to adjust to unforeseen shocks.

Discretionary policies

Advantages and justification

Guitián (1992) shows that discretion provides flexibility and allows adaptation to changing domestic or international economic conditions, especially when these conditions become dominant; however, this flexibility comes at the cost of reduced predictability. Taylor (1993) also recognizes that applying a rule is not and cannot be mechanical: decision-makers must exercise judgment, particularly when facing un-foreseen shocks.

Buol and Vaughan (2003) note that discretion enables decision-makers to respond innovatively to unforeseen problems, which can be valuable in uncertain environments. Derfler-Rozin (2012) shows that discretion allows consideration of specific circumstances in each case, leading to solutions perceived as more equitable when rigid rules would yield inadequate results.

At the institutional level, Gailmard (2009) shows that the legislature can impose limits on the agent's actions, and this controlled discretion is optimal when strict rules are not feasible, as it leverages the agent's superior information without requiring unsustainable commitments. In the fiscal sphere, Heise (2025) shows that discretion is justified only in exceptional circumstances, such as severe depressions, when existing stabilization mechanisms and rules are insufficient. Sauer's (2007) analysis shows that discretion can result in lower social losses than a rule formulated from an atemporal perspective in economies affected by large shocks. Kocherlakota (2016) notes that discretion allows responses to information and shocks that cannot be addressed by a fixed rule, as well as to inflation developments driven by unpredictable factors. Grabia (2016) confirms that discretion is more useful in dramatic contexts where rules fail to account for exceptional conditions. Lassa et al. (2022) argue that discretion may be preferable in crisis situations, giving authorities the ability to act in response to urgent problems when rules are absent or incomplete.

Disadvantages and limitations

Although discretion offers flexibility, it carries significant structural risks. Guitián (1992) notes that discretionary regimes gain greater national adaptability at the cost of lower predictability, which can increase uncertainty and the risk of conflicts between different economic policy objectives. Stokey (2002) explains this risk: without commitment, discretion is susceptible to opportunistic behavior, as decision-makers may be incentivized to change policy after private sector expectations have formed. Grabia (2016) demonstrates that the lack of clear rules increases the likelihood that decision-makers will favor certain interests, resulting in less optimal outcomes for the economy in the long term.

At the level of expectation formation, the disadvantages of discretion are considerable. McCallum (2003) shows that in a discretionary regime, the absence of rules hinders communication, and the authorities' timely statements lose effectiveness with rational agents.

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The limitations of the discretionary approach are also highlighted in other studies that point to specific risks. Webster (2025) finds that discretionary regimes are associated with faster money supply growth and higher inflation rates. Grabia (2016) observes that discretionary fiscal policy is often procyclical, amplifying economic fluctuations by increasing government spending during expansions.

Lassa et al. (2022) stress that discretion must be exercised within moral and legal boundaries and be subject to clear control criteria to prevent abuse in emergency situations, when existing rules are inadequate and authorities have broad powers.

For analytical clarity, the main positions in the literature on rules-based and discretionary policies are summarized in Table 2.

Table 2. The role of rules and discretion in institutional sustainability

Dimension	The role of rules	The role of discretion
Economical	Macroeconomic stability, credibility	Countercyclical adjustments, reaction to shocks
Social	Social rights, universal standards	Temporary extension of protection
Institutional	Legitimacy, predictability	Institutional adaptation and learning

Source: own elaboration.

Economic instruments specific to social democratic doctrines

Fiscal policy in social democracy

Taxation. The social democratic approach to taxation is based on the principles of ability to pay, equity, and solidarity. Progressive income and wealth taxes are justified both by the idea that those with greater resources can contribute more and by the fact that high-income earners benefit disproportionately from the legal system and public infrastructure. Indirect taxes, such as VAT, are considered problematically regressive, affecting low incomes more strongly (Petring et al, 2012). The post-war social democratic model combined progressive taxation with deductions for the reinvestment of profits, ensuring that the taxation of profits was compatible with industrial development (Huber and Stephens, 1998). In this model, taxation finances universal services such as education, health, and social protection (Carlsson and Lindgren, 2008). Contemporary social investment models use taxation strategically: they accept the constraints of globalization and avoid aggressive taxation of capital, but direct resources toward education, health, social assistance, and family policies (Kerstenetzky, 2022). Globalization has generated competitive pressures on tax regimes, but social democratic states have maintained high levels of taxation and a redistributive orientation, even though social democratic parties have sometimes adopted tax-cutting or privatization policies (Pierson, 2001; Merkel and Petring, 2007). A current social democratic agenda includes, among other things, taxing the financial economy, combating tax evasion, and rebalancing the tax burden (Mavrozacharakis and Tzagkarakis, 2018).

Redistribution. Fiscal redistribution is a structural component of social democratic doctrine, achieved through progressive taxes, social transfers, and universal public services. Redistribution is not viewed as charitable assistance, but as a mechanism for realizing social rights (Petring et al., 2012). In the perspective of socialist ethics, taxation is a means by which society corrects the inequalities generated by the capitalist market (Jackson, 2013). Social democratic regimes reduce inequality through a combination of taxes, transfers, and universal services, contradicting the thesis that the welfare state is incompatible with economic performance (Petring et al., 2012). In some Nordic models, redistribution is achieved mainly through public services, not only through cash transfers, because education and health care accessible to all reduce inequalities (Rothstein and Steinmo, 2013). Callaghan (2002) notes that redistributive policies have often been limited by financial market reactions, the risk of capital flight, and currency constraints.

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Public spending and social programs. As shown, social democratic public spending focuses on education, health, family policies, and social protection, and is conceived both as an investment in human capital and as a means of promoting social cohesion. Social democratic governments tend to allocate more resources to education, viewing it as the primary tool for reducing inequality of opportunity. According to Carlsson and Lindgren (2008), universal services are considered basic rights of citizens, while collective pension systems have accumulated public resources used to finance major social projects, such as housing development.

Fiscal policy as an economic stabilizer. Social democratic fiscal policy is strongly influenced by Keynesianism and is used as a tool for macroeconomic stabilization: reducing taxes for low-income groups and increasing spending on infrastructure, education, and public services during recessions (Vaut, 2011). Glyn (1995) shows that deficits can compensate for a lack of private investment but also create risks related to debt and financial market reactions. Therefore, increases in public spending are financed through taxes, stimulating employment without worsening public finances. The experience of crises indicates that states with developed social protection systems and regulated labor markets have managed economic shocks better, confirming the stabilizing function of the welfare state (Petring et al, 2012; Pierson, 2001).

Regulatory policy: labor market and business environment

Labor market regulation. The labor market is a central area of intervention for social democracy, both in terms of social protection and the redistribution of economic power. In social democracy, support is particularly directed toward people with reduced opportunities in the labor market, especially those with low levels of education (Petring et al, 2012). In the social investment model, the focus is on supporting participation: continuous training, retraining, work-family reconciliation policies, paid leave, and unemployment insurance that facilitate professional transitions (Petring et al., 2012; Andersson, 2007). The model of over-coming capitalism emphasizes the democratization of power within firms, through codetermination and social ownership, so that workers participate in decisions related to investment and management remuneration (Kerstenetzky, 2022). Labor market regulation is closely linked to corporatist institutions. In the Swedish model, unions and employers are integrated into the decision-making process: co-decision, shared state-organization responsibilities, corporate representation in public agencies, and union control over unemployment funds (Rothstein, 2001). In post-war Western Europe, social democracy developed centralized wage bargaining systems and solidaristic, but also coordinated, wage policies designed to reduce income differences between sectors and maintain external competitiveness (Huber et Stephens, 2002; Huber et Stephens, 1998; Boyer, 2026). Glyn (1995) shows that in contexts of near-full employment, pressures for wage increases above productivity can generate inflation and reduce profits, making coordination of wage negotiations essential. Callaghan (2002) and Pierson (2001) highlight, however, the fragility of these arrangements in the face of capital mobility, currency crises, and periods of extreme unemployment. Doctrinal transformations led some social democratic parties to support the flexibilization of hiring and firing, the decentralization of collective bargaining, and wage moderation, all against the backdrop of globalization (Piazza, 2001; Merkel and Petring, 2007). At the same time, the Nordic model develops formulas of flexicurity: moderate deregulation combined with high social security and investments in retraining (Andersson, 2007; Merkel and Petring, 2007). Sawyer (2021) and Boyer (2008) recall ideals such as decent work (strengthening collective bargaining, decent wages, reducing precariousness) and industrial democracy (worker participation in decision-making).

Business and market regulation. In the business environment, social democracy does not reject the market economy but insists on a robust regulatory framework in response to the fragility of

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capitalism, with the state intervening to protect workers, prevent crises, and maintain social cohesion (Vaut, 2011). Regulation includes limiting employer abuses, establishing health and safety standards, protecting against arbitrary dismissals, and supporting institutions of collective bargaining and co-determination (Carlsson and Lindgren, 2008; Boyer, 2008; Jackson, 2013). Financial markets and ownership structures are priority areas for intervention. Sawyer (2021) argues that the real economy is dominated by large corporations, which justifies anti-monopoly policies, stricter financial controls, and a shift in emphasis from maximizing shareholder value to pursuing social objectives. Mavrozacharakis and Tzagkarakis (2018) similarly highlight the state's role in ensuring fair competition, regulating financial markets, and protecting public goods. The debate on antitrust policies demonstrates the flexibility of social democratic instruments. Although social democracy has traditionally favored nationalizations and direct sectoral regulations, some within this tradition reinterpret antitrust as a means of limiting corporate power and protecting consumers, consistent with egalitarian principles (Sawyer, 2021). Holtham (1999) shows that privatization in sectors with natural monopolies – such as transport, water, and railways – often produces poor results, justifying continued public control or strict regulation. Other authors note that the state's ability to direct the economy through regulations and industrial policies has always been constrained by capital mobility, currency crises, and debt, but regulation remains a defining feature of social democracy (Callaghan, 2002; Pierson, 2001; Schwartz, 1998; Jackson, 2013).

Regulatory policy: labor market and business environment

Globalization, integration and capital mobility. Trade and financial globalization have redefined the space for social democracy, as increased trade, liberalization of financial flows, and the expansion of foreign direct investment (FDI) have heightened dependence on the profitability of private investment and market responses. Glyn (1995) identifies three main channels through which globalization limits the autonomy of national economic policies: international competition, the mobility of financial capital, and the sensitivity of investment to profitability. The author shows that, under financial liberalization, markets can quickly sanction expansionist policies through devaluations and increased debt costs, thus reducing the state's room for maneuver. Pierson (2001) shows that trade integration and capital mobility increase the political costs of inflation and deficits, but do not automatically require the withdrawal of the state, as capital seeks not only low costs but also institutional stability. Gobeyn (2016) emphasizes, however, that FDI and trade liberalization have been associated with increasing inequality and pressures on the welfare state. Petring et al. (2012) argue that capital mobility generates tax competition, in which tax cuts can trigger a gradual decline in taxation levels, threatening the financing of the welfare state.

Domestic capital and foreign direct investment. Regarding social democratic approaches to capital, Kerstenetzky (2022) distinguishes between the social investment model, which focuses on labor and human capital without seeking to transform property, and the over-capitalism model, which aims to democratize capital through the redistribution of property and equal access to economic resources. Foreign direct investment (FDI) is analyzed as a major factor eroding the capacity of social democracy to maintain traditional protective structures. Piazza (2001) shows that FDI can undermine social democratic regimes, as transnational capital can threaten relocation to weaken unions and reduce social standards. Gobeyn (2016) reaches similar conclusions, highlighting the link between FDI, domestic capital mobility, and rising inequality.

International trade and external competitiveness. International trade stimulates economic growth but can harm the external position and balance of payments when high employment and wage growth exceed competitiveness, requiring devaluations or wage adjustments (Glyn, 1995). Huber and Stephens (1998) show that the Nordic model is structurally dependent on competitive

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exports and high-productivity industrial sectors, noting that openness imposes wage discipline and fiscal policies that encourage the reinvestment of profits. Gobeyn (2016) emphasizes that trade liberalization reduces state autonomy but does not completely eliminate the space for industrial and redistributive policies if there is political will and coordination.

Industrial policies and investments. The role of the state as an investor and industrial actor is central to the social democratic ideal. Sawyer proposes, within a post-neoliberal paradigm, a state that directs investments toward the green transition, restricts polluting sectors, prioritizes social infrastructure, and develops coherent industrial policies (Sawyer, 2021). Within the logic of the social investment model, Andersson (2007) describes a social democratic state that invests in education, human capital, and innovation, reforms personnel training systems, and creates networks among firms, universities, and public institutions, transforming citizens into productive resources for the knowledge economy. Other studies show that social democratic states have historically used active industrial policies, including public investment in education, infrastructure, research, asset ownership, and state participation in the development of strategic sectors (Huber and Stephens, 2002; Huber and Stephens, 1998). Carlsson and Lindgren (2008) discuss public investment in housing, education, and social infrastructure as an expression of the ambition to combine economic development and social cohesion.

Other aspects specific to social democracy

Doctrinal configurations. As previously noted in the analysis, recent literature identifies two doctrinal configurations that group social democratic economic instruments: the social investment model and the proposal to overcome capitalism (Kerstenetzky, 2022). The first model describes a state that organizes taxation, employment policies, and regulation around the concept of social investment: the universal provision of education, training, care, and family policies designed to increase human, social, and cultural capital and reduce dependence on monetary redistribution (Kerstenetzky, 2022; Andersson, 2007; Deeming, 2014). Within the logic of the knowledge economy, education, trust, and social cohesion are reinterpreted as forms of productive capital, and equality is also justified by its benefits for economic efficiency (Andersson, 2007). In contrast, the model of overcoming capitalism emphasizes restructuring property and limiting the concentration of capital through progressive taxation of wealth and inheritance, as well as democratizing capital via the development of collective funds (Kerstenetzky, 2002; Glyn, 1995; Boyer, 2026; Carlsson and Lindgren, 2008).

The austerity approach. After 1970, the scope for social democratic fiscal policy was constrained by capital mobility, financial liberalization, and public indebtedness. Schwartz (1998) shows that as debt increases, debt service tends to take priority over social spending, reducing fiscal space for universal policies. The rising costs of public services, especially in education and health, push labor taxation to its limits, which is why Holtham (1999) proposes creating public funds financed by capital taxation. Bremer (2019) notes that, despite the Keynesian tradition, many social democratic parties have advocated austerity – fiscal consolidation through spending cuts and tax increases during recessions – to address public concerns about fiscal responsibility and debt.

Mobility and citizenship. Weber (2012) highlights the national-territorial character of classical social democracy: social rights are anchored in citizenship within a defined demos, with the state controlling membership and access to social protection. In the context of globalization, mobility becomes a fundamental economic resource: those excluded from mobility – undocumented migrants, refugees, vulnerable people – are portrayed as victims (Weber, 2012). From this perspective, social democracy offers equality and protection within borders but indirectly contributes to maintaining transnational inequalities by limiting its instruments to the national level. The issue is not a failure to

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respect egalitarian principles, but their application: fiscal redistribution, social protection, investment, and regulation remain largely tied to the nation-state, raising questions about the possibility of a transnational extension of social democratic instruments.

To highlight the link between social democratic economic instruments and institutional sustainability, Table 3 illustrates the contributions of the main policy areas to the economic, social, and institutional dimensions of sustainability.

Table 3. Contribution of social democratic instruments to institutional sustainability

Category	Economic dimension	Social dimension	Institutional dimension
Fiscal policy	stable funding + countercyclical stabilizer	reducing inequalities through taxes/transfers/services	legitimacy through fiscal equity and predictability
Public spending & social programs	investments in human capital, long-term growth	universalism: access to education/health/protection	trust in the state, continuity of social rights
Labor market	high employment, productivity, structural adaptation	reducing precariousness, decent work	state-social partner coordination; stability of rules
Market/business environment regulation	limiting systemic risks, stability	protection of workers and consumers	credibility, impartial application, reduction of arbitrariness
Trade, capital, industrial/investment policies	competitiveness + adaptation to globalization	"just" transition (socially distributed costs)	institutional resilience through adjustment capacity

Source: own elaboration.

Social democracy between rules and discretion: implications for institutional sustainability

Social democratic policies can be seen as a hybrid form of economic governance that combines stability and adaptability. Social democracy can thus be understood as an institutional framework in which rules and discretion are complementary mechanisms serving economic and social sustainability. Rules provide the stable and predictable framework necessary for credibility, trust, and the long-term protection of social rights; discretion allows policies to adapt to economic shocks, structural transformations, and constraints generated by globalization.

In fiscal and social terms, social democratic regimes establish robust rules – progressive taxation, universal social rights, labor standards, and collective bargaining institutions – that serve as anchors of institutional sustainability. These rules reduce uncertainty, stabilize expectations, and protect investments in human capital, all essential for the long-term sustainability of the welfare state. At the same time, through their redistributive function and focus on universal services, these frameworks contribute to social sustainability by reducing inequalities and strengthening social cohesion.

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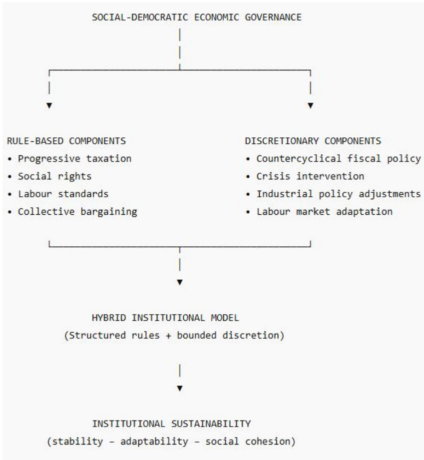

Figure 2. Social-democratic economic governance in terms of rule-based and discretionary components
Source: own elaboration.

The use of discretion is also central to the adaptive capacity of the social democratic model. Countercyclical fiscal policies, discretionary interventions during crises, and adjustments in labor market regulation or capital flows are examples of controlled flexibility. This discretion enables the state to respond to external shocks, financial crises, global competitiveness pressures, or structural transitions without abandoning the model’s normative core. Discretion thus becomes an instrument of resilience, complementing the stabilizing role of rules.

From a sustainability perspective, the combination of rules and discretion in social democracy can be understood on three levels. At the economic level, fiscal and regulatory rules limit slippages and reduce the risk of macroeconomic instability, while discretion allows for countercyclical adjustments and industrial policies focused on long-term investment. At the social level, universal rights and labor standards guarantee protection and inclusion, while discretionary interventions during crises, such as temporary extensions of social protection or active employment programs, mitigate negative effects on vulnerable groups. At the institutional level, the balance between discipline and flexibility maintains both democratic legitimacy and the state’s capacity to respond to change.

In this light, social democracy can be seen as a model of institutional sustainability: rules provide a relatively stable basic structure, and discretion allows for contextual adjustments without eroding the principles of equality, solidarity, and democracy. The issue is not choosing between rules and discretion, but configuring an arrangement in which rules set general limits and objectives, and discretion operates within these limits to ensure the model’s continuity and adaptability in the face of shocks and long-term transformations. Thus, the analysis suggests that institutional sustainability depends essentially on how these two mechanisms are integrated, rather than on the exclusive predominance of one over the other.

CONCLUSION

The results of the analysis allow for several conclusions to be drawn in relation to the research questions presented in the introduction.

Regarding the first secondary objective or research question, the specialized literature generally indicates that the best solution is a framework combining rules and discretion. Clear and transparent rules establish limits, objectives, and general principles, while well-defined areas of discretion enable adaptation to unforeseen shocks and the use of agents' information and expertise.

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This balance between stability and flexibility, between commitment and adaptation, is central to current debates about the differences between rules-based and discretionary policies. The strict opposition of rules versus discretion is somewhat artificial; what is essential is their coherent combination, as the optimal choice between rules and discretion depends on the context. Efficient regimes are those in which rules provide the basic structure, and discretion allows for marginal, transparent, and justified adjustments. Rules-based policies are preferable in situations requiring strong credibility, while discretion is valuable in contexts characterized by high uncertainty or the need for a rapid response to shocks.

Regarding the second secondary objective or research question, Social Democratic Fiscal and Social Policy combines redistribution with social investment, using progressive and capital taxation to finance universal services and human capital development. At the same time, labor market and business environment regulations aim to strengthen workers' power and limit corporate power through collective bargaining, labor standards, codetermination, and anti-monopoly policies, adapted to the pressures of globalization and capital mobility.

Table 4. Key Elements of Social Democratic Economic Policy

Domain	Objectives	Instruments
Taxation	Reducing inequality, financing the welfare state	Progressive income tax; taxes on wealth and capital; fair taxation of the financial sector; limiting regressive taxes
Redistribution & Social Spending	Universal social rights	Social transfers; universal services; social investments; commercialization of certain areas
Macro Stabilization	High employment, recession mitigation	Expansionary fiscal policies in crisis; temporary deficits; countercyclical public investment
Labor Market	Bargaining power for workers; decent work	Collective bargaining; strong unions; minimum wage; protection against dismissal; active policies
Business Environment & Markets	Limiting corporate power	Financial regulation; anti-monopoly policies; strict rules in natural monopolies
Trade, FDI, Capital	Opening up with social protection and industrial policies	Trade acceptance; active industrial policies; investor state; FDI conditionalities

Source: own elaboration.

Overall, social democracy remains an adaptive doctrine: it retains its egalitarian and universalist core but adjusts its instruments to changes brought by globalization, capital mobility, and the knowledge economy. The result is a model capable of combining social protection with economic openness without abandoning the goals of equality and democratic participation.

Regarding the third secondary objective or research question, the analysis indicates that social democracy can be understood as a model of institutional sustainability, as it combines stable rules with discretionary flexibility, providing both economic predictability and adaptive capacity. Institutional sustainability thus emerges from a balance between stability and adaptability, rather than from the exclusive dominance of either principle.

There are theoretical implications for economic governance as well. From a theoretical standpoint, the results contribute to the literature on economic governance and institutional sustainability by showing that the strict opposition between rules and discretion is largely artificial. The findings also have implications for analyzing contemporary economic policies. In the context of globalization, structural transitions, and recurring economic shocks, the ability of states to combine

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credible rules with adaptation mechanisms becomes a central element of economic and social sustainability.

Limitations and directions for future research: As a theoretical study, this article does not empirically test the mechanisms discussed or examine variations across states or specific institutional configurations. The conclusions reflect the coherence of the literature and the internal logic of the arguments. The analysis offers a conceptual framework for future research, including case studies, comparative analyses, or quantitative assessments of the relationship between rules, discretion, and institutional sustainability in different economic and political contexts.

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