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Regulatory Governance

Professor Noralv Veggeland

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Contents

	Preface	**8**
	Acknowledgement	**9**
1	**Economic and Social Stabilization in a Nordic Context**	**10**
1.1	The Nordic Model	10
1.2	Social capital	11
1.3	A comparison of social models	12
1.4	The value of collective state action	16
1.5	Social capital of the Nordic macro type	18
1.6	The threat of non-maintenance	20

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2	**Regulatory Welfare Trade-offs**	**22**
2.1	The emergence of the regulatory state	22
2.2	Regulatory welfare state tradition and models	25
2.3	Welfare-state models and regulatory innovation	28
2.4	Regulatory trade-offs	31
2.5	European regulatory trade-offs	33
3	**Distributed Public Governance: Does democracy work?**	**36**
3.1	Subsidiarity	36
3.2	Vagueness on purpose	37
3.3	Two hypotheses	39
3.4	State formation and administrative traditions	40
3.5	The notions of Distributed Public Governance	45
3.6	Regionalization	51
3.7	Conclusions	56

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4	**Defining Democracy**	**59**
4.1	Democratic models	59
4.2	Subsidiarity; democratic approach or just distributed public governance?	60
4.3	Making the EU competence more democratic through subsidiarity	62
4.4	Confirmation of two hypotheses	65
4.5	State formation and democratic traditions	68
4.6	Territorial size and distributed public governance within the framework of subsidiarity	72
4.7	The New Democracy and its mechanisms	75
5	**Regulatory Petroleum Governance: The Norwegian Case**	**78**
5.1	The emergence of the Norwegian petroleum sector	78
5.2	The arrival of the Norwegian Government Pension Fund – Global	87
5.3	Ethical Guidelines	89
5.4	Vulnerability and risk analysis of the Norwegian Pension Fund – Global	95
5.5	What does Norway get out of the GPF-G? The dilemma; foreign investments versus domestic investments	98
5.6	What does Norway get out of the GPF-G? – The dilemma; negative ethical exclusion versus positive selection	100

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6	**The political-economy background of the contemporary crisis.**	**102**
6.1	Neo-interventionism and neo-Keynesianism of today	103
6.2	Principles of the pre-Keynesian state	106
6.3	The political economy of the interventionist Keynesian state	110
6.4	In the shadow of the international stagflation crisis	114
6.5	Explanation approaches to the Keynesian economics in crisis	119
6.6	The regulatory state and neo-interventionism	122
	References	**126**
	Endnotes	**148**

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Preface

My work is an analysis of the regulatory state in the development. The study focuses on diffusion of privatization and regulatory authority around Europe. The contemporary regulatory state has developed as a result of political struggle that accompanied and increasingly globalized world and was in the beginning a response to the serious international economic crisis that emerged in the 1970s.Two major functions of governance are at stage: *steering* (leading, guiding) and *rowing* (enterprises, service provision). The regulatory state is said to be characterized by 'steering without rowing'. The new order of regulatory capitalism represents a new division of labor between state and society and in particular between state and business: 'Steering by State' and 'Rowing by Business'. However, in my opinion something is missing here. There are arguments for another division of functions: 1) Steering by State, 2) Rowing by Business and 3) *Rowing by Self-regulatory Business-like state Agencies.* The process of regulatory agencification has indeed exploded, and in this process regulation has become a distinct and salient function in the institutions of policy making. Regulatory governance, i.e. heavy involvement of self-regulatory unelected business-like state agencies in government, has become a universal concept. This conclusion might very well be documented clearly through empirical facts.

A central point of departure in my work is the well known postulation from 1994 made by Giandomenico Majone[1]. He suggests that privatization and deregulation have created the conditions for the rise of the regulatory state to replace the dirigiste state of the past…reliance on regulation – rather than public ownership, planning or centralized administration characterizes the methods of the regulatory state. It is followed by the concept of regulatory capitalism defined as a political, economic and social order where regulation, rather than the direct provision of public services, is the expanding part of government. It is these perspectives which in this book are applied on the regulatory state both on the national and European level, and its related type of governance. The EU system of governance is indeed predominantly regulatory. A distinct definition is made to make an empirical study feasible. It is declared that if EUs function was not the direct distribution or provision of goods and services, for the purpose of this particular study. Its agencies and networks were classified as regulatory. Regulatory governance is inclined to eliminate transparency and downgrades the importance of social forces. The democratic deficit of the EU is the outcome. The work is a focused study on the regulatory governance system presented as a volume containing 6 essays. It combines theoretical and empirical perspectives on the evolution of state regulation. It is meant as an appositely analysis of national government and also a contribution to the understanding of the European economic and social crisis.

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Acknowledgement

Over the years many people, nationally and internationally, have contributed to my knowledge and thinking about the arrival of the contemporary regulatory state, and from a political and social perspective, its strengths and vulnerabilities. Thanks to them all. My special thanks go to my colleagues at the University College of Lillehammer, Department of Economics and Organization Science, for very important talks. Also thanks to the University College for making the realization of this work possible.

Noralv Veggeland
Lillehammer, Sept. 2012.

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1 Economic and Social Stabilization in a Nordic Context

Introduction

Europe and the European Union are today swept by an economic and social crisis. The EU is looking for a solution to the crisis, and intends to make worse thing better through state actions and renewed endogenous development, both inside countries and across national borders. Nordic countries are only slightly touched by this crisis. How do Nordic states conduct policies of crisis prevention? How do the interventionist and expensive Nordic welfare states survive in the global age, with demanding and ever changing claims to international competitiveness? The answers seem to be found in their active welfare state and labor marked policy.

1.1 The Nordic Model

This paper addresses these questions. Social capital and partnership building are introduced as terms and policy concepts in order to find answers in the framework of intended or unintended strategic mobilizing endeavors. As a critical approach claims a contextual conceptualization, we shall here view different European social models and administrative traditions in relation to comparative basic contexts in order to arrive at analytical answers. Leaning especially on the Anglo-Saxon model, the traditional Scandinavian universal welfare-state model of the post-war Keynesian order has gradually been transformed into the contemporary Nordic model (Veggeland 2007). Contextual regulatory innovations and path-dependent processes have generated the survival of universal welfare state arrangements and collective action but with the mixed use of market oriented mechanisms of Anglo-Saxon origin in the public sector. In summary, this blending of policies has resulted in the advantageous *social capital of what is called flexicurity*, social security combined with a flexible participatory labor market. We shall discuss both flexicurity policy and participatory subsidiarity defined downwards as contributions to an explanation of why the expensive welfare states of the Nordic type have not only so far been doing well despite the ongoing international financial crisis and the grave economic problems in the Euro zone of the European Union (EU). Due to special reasons the small Nordic state of Iceland[2] represents and exception. Sustained both democratic and social stability characterizes the five countries.

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1.2 Social capital

Since 2008 there is an ongoing crisis in Europe, characterized by being both a private and public credit and a financial crisis. Counteracting measures are needed, which have caused a European policy change. The EU has become active as an interventionist state in the sense of what John Maynard Keynes recommended (1936). However, principally, the framework has change and is new regarding Keynesianism, thereof the introduction of the concept of neo-(state)-interventionism. Interventionism is classical in the sense of state intervention in order to achieve effective demand as an instrument to stabilize the economy. In the neo-interventionism framework an untraditional method is used to construct social and human capital through the arrangement of flexicurity. It means to take the advantage of the welfare state arrangements, i.e. social security, and labor market flexibility, (flexicurity) to achieve sustained economic growth. Neo-interventionism characterizes the five Nordic states (EPC Working Paper 2005). In the end of this paper we will elaborate this concept further.

Several EU states like Greece, Portugal, Spain, Ireland, Italy and others are in an economic situation of recession. In order to help those countries out of this grave situation the EU (together with the European Central Bank (ECB) and the International Monetary Fund (IMF), impose strict regulations claiming savings and reduction of the public outlays. This is a background for why Europe is looking for ideas and concepts of social capital that might constitute and give the integrated global region an impetus to new growth and more sustainable economic activity, employment, and welfare. The EU intends to achieve this through state actions and renewed endogenous development, both inside countries and across national borders (Hayward and Menon (eds.) 2003, Cini and Borragan (eds.) 2010).

Partnership-building that connects private and public actors as well as public actors to other public actors through state arrangements has the intention of strengthening existing social capital and raising new social (and human) capital as strategic concepts for promoting economic renewal and sustainable welfare (Szreter and Woolcock 2004). The concepts draw upon the belief that pooling actors in micro and macro networks (clusters according to Michael Porter (1998) and organized 'institutional thickness' (Amin and Thrift 1995a) in the form of collective action are basic policy strategies when the target of the polity is to achieve and increase competitive development capacity. The strategy goes for organizing existing or new public and private actors for collective actions through contracts and partnership formations, both nationally and locally, as we know recommended by European development programs. Making the labor market more flexible is part of the strategy. Additionally, partnership institutions fit into the mode of arm's-length steering, which characterizes the regulatory state (Keating 1998, Veggeland 2009). The beneficial outcome is the advantages that come with the building of extensive social capital. We may, however, view social capital as a diversified notion. Let us closely focus the concept of social capital.

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The concept of social capital came about in the James C. Coleman's (Sørensen and Spilerman 1993)[3] and Robert D. Putman's (Putman 1993, Putman (ed.) 2002) version in the US in the 1980s. It was part of a major political change that took place in those years in the Anglo-Saxon US and the UK and had wide-ranging consequences. The neo-liberal economic discourse and NPM organizational changes entered the global scene. Social capital became an imperative economic notion. A critical expression became resonant: social capital, social, but still capital (Navarro 2002, 2004). A past president of the American Political Science Association, Theodore Lowi, indicated that 'economic language is the dominant language in social science discourse today…we are witnessing the de-politicization of politics' (1992:86). In other words, it implies that social capital building has become a narrow concept based only on economic values. Contrary to this reductive notion, there also exists a wider concept of social capital that accounts for additional social and sustainable ethical values. Frédéric Lordon express it this way: "…and virtue is going to save the world…. After the financial catastrophe, the salvation comes by ethics". (Lordon 2003: 1)

The term 'social capital' reflects not only the understanding that government uses capital but that the labor force needs safety and earnings in order to compete or survive better in the competitive and microeconomic world as well. As capital, investment in building social capital creates, therefore, expectations first and foremost of economic revenues derived from the social realm and expectations about business growth; if not these do not happen, the investment is deemed a failure.

We may express this notion in the following way. Building social capital within this framework of economics tends to become *an art of social and human engineering* (Beetham et al. 2002, Moran 2003). The target of this art is the creation of competitive macro arrangements and joined-up initiatives. To change the building of social capital from an art of engineering to an art of benefiting collective action may meet resistance in some Western countries. The Nordic state-oriented social model and administrative tradition seems contextual appropriate.

1.3 A comparison of social models

Michael Moran's thesis (2003) is that social capital in the sense of engineered micro-partnerships and institutional changes has been a 'fiasco' with the consequence of generating more innovation in an ever ascending, or more accurately, descending, spiral. He argues that in the Anglo-Saxon UK, the last 30 years have been an era of 'hyper-innovation', displaying 'the frenetic fragmented selection of new institutional modes like partnerships and arm's length bodies, and their equally frenetic replacement by alternatives' (2003:26). Other scholars have supported this thesis (Scharpf 1999, Veggeland 2004, Higdem 2007).

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The implication of Moran's thesis is that partnership-building of fragmented kind encourages collaborative governance and collective action at the micro-level because of 'spill-over' effects but not at the macro level. It becomes a strategy for promoting inefficiency, and increasing transactional costs. Further, its unexpected 'spill-over' effects will manifest as unpredictable actions and sudden dilutions of partnerships, which demand replacements. Individualized interest conflicts and social inequality among the partners devastate partnerships and cause the 'frenetic replacement by alternatives'. Increasing transactional costs becomes another threat because of this 'ascending, or descending, innovation spiral'. We should, however, understand this properly. Of course, the partnership concept as a mode of action and social capital of the engineered, economically valued variety also, in general, encourages weak governance. Theodore Lowi (1992) and Vincent Navarro (2002, 2004) have, however, identified the problem. Their view are that the narrow and economically valued concept of social capital does not only lead to the de-politicization of politics but will contextually, depending on social models, be a barrier for building wider-valued social capital by flexicurity at the societal macro-level. With this in mind, let us study some lessons from Scandinavia (Veggeland 2007).

With regard to the prospect of good governance within the framework national macro-partnership for collective action, for example, Simon Szreter and Michael Woolcock (2004) have concluded that the Swedish welfare state provides social capital of the wider-valued type to its citizens better and more innovatively than do other social models. How have these scholars supported such a statement? Let us test their suggestion in a wider Nordic framework.

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Taking Szreter and Woolcock's statement seriously, we must say that they made such an assertion based on a consideration of what is good or deficient social capital. In other words, they must have drawn the conclusion on the grounds of preferable Swedish welfare norms, social ethics, and valued results, which the actual social model fulfils. They conclude indirectly that social science should be able to say whether or not social capital building has led to 'successes' along a scale of goal achievement. It means we need criteria against which to assess and measure success or failure. Neither Szreter and Woolcock nor Moran with his 'fiasco' statement indicates such criteria. Actually, reviewing the issue of 'good-bad' governance critically from a normative point of view is all too rarely done (Black 2005).

What we do know though is that social models and administrative traditions, which naturally have come into being in a socio-economic framework of values and experiences, do influence the quality and practical outcome of institutional change (Pedersen 2008, March and Olsen 1989), and consequently also the formation of partnership and the provision of social capital. Let us review the Swedish case a little further. Szreter and Woolcock's observations warrant a serious consideration of the Swedish welfare-state model as a major point of reference in order to determine macro social capital in a wider normative framework than the instrumental approach to the concept does.

In what follows, we shall take that approach, but we shall view the Swedish model within the framework of the major Scandinavian-Nordic model, in which the former model represents the core (Veggeland 2007). Szreter and Woolcock refer to 'other societies' in their statement but do not point out which ones. Here we shall address this oversight by making a comparison of macro social capital formation and policy belonging to the Nordic model and its constituent countries, which are though influenced normatively with social-capital policy from the Anglo-Saxon model and the Continental model. Regarding the former model, the focus will be on the social-democratic tradition responsible for the promotion of social capital based on universal welfare and social security, an active labor-market policy, and an interventionist and comparatively expensive state.

Contemporary focus on the building of social capital through various partnership formations is a key part of the debate on both 'reinventing government' (Osborne and Gaebler 1993) and 'rediscovering institutions' (March and Olsen 1989). As such, the focus reflects the pandemic search for ideas of institutional change and innovation in the global age (Cassese 2003). However, the search for and the adoption of ideas do not happen randomly but are linked to contextual 'interpretation' of values and substance (Røvik 2007). Accordingly, this implies that social models and administrative traditions affect the interpretation of concepts of social capital connected to flexicurity, and their attendant policy, which results in diversified implementation (Veggeland 2007).

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In a comparative perspective, there are a number of ways to demonstrate the position of the Nordic-model countries. One way is to look at the size of the public sector measured as general, total governmental outlays as a percentage of the nominal GDP and as total taxes as a percentage of the GDP, see Table 1. This indicates the degree to which governments and countries' citizens are willing to spend money on collective rather than individual goods in society. Welfare and social security issues are part of the collective approach. The figures in Table 1 show that this willingness in the beginning of the 2000s is lowest in the Anglo-Saxon tradition and highest in the Nordic tradition but with the Continental tradition nearby. This is not so strange when we account for the historical roots and framework of the Scandinavian welfare-state model having its origins in the Prussian collective thinking of the late nineteenth century and the performance of the Weberian neutral bureaucracy (Kuhnle 2000). In 2010 the picture is something different, see Table 1. The financial crisis has had its impact especially on the Anglo-Saxon country of Ireland where government interventions have lifted the outlay as per cent of GNP from 45% to 53%. Taxes as per cent of GNP is quite stable, but with Norway as an exception with relatively low share both in 2003 and in 2010. The reason is the dominant petroleum sector which causes the low tax share of the GNP. In the other Nordic countries the tax level is very high especially compared with two Anglo-Saxon countries.

Indicators:	**Social models:**		
	Anglo-Saxon*	Nordic**	Continental***
Government outlays as % of nominal GDP (2004)	45–43%	58–48%	. 54–47%
Taxes as % of GDP (2003)	31–37	45–51	42–46
Unemployment rates (2004)	4.4–4.7	5.4–8.8[5]	9.5–9.7
Government outlays as % of nominal GNP (2010)	53–44	54–44[6]	56–48
Taxes as % of GNP (2010)	35–41	42–55	48–42
Unemployment rates (2010)	13.7–8.1	3.3–9.4[7]	9.8–7.6

*Represented by Ireland and UK, ** The five Nordic countries, *** Represented by France and Germany. *OECD data 2005 and 2011.*

Table 1: The deviant Nordic model: Public outlays, taxes, and employment in the context of other European social models.

Regarding unemployment, Table 1 shows that the Anglo-Saxon countries have been hard hit by the financial crises; the unemployment rate has increased from 4.4–4.7% to 13.7–8.1 in 2010. In the period the unemployment rate is rather stable high in the Continental countries of France and Germany, but as low as 3.3 per cent in Norway. The unemployment rate is stable high in the period, around 9%. The question is what legitimates a high tax level among Nordic people, and what role does social capital play regarding the state-centered social-model?

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1.4 The value of collective state action

Social constructions, like engineered partnership as social capital, are precarious, tending to erode and dissolve over time, especially when short-term economic revenues are expected (Veggeland 2003). These aspects concern the survival of social models and administrative traditions. In contrast, building long-term social capital presupposes basically the existence of values found in national and local networks, identity, mutual consent, social equality, and community life, besides public and private funding access. Some social models may be good fits for these values and comparatively better than others (Iversen 2005, Knill 2001). Accordingly, these social models tend to benefit from administrative traditions that contribute to social equality, universal welfare, and social security (Veggeland 2007), in addition to the stable networking of local and regional communities. Robert D. Putnam (1993) has stressed the latter in his study of the developmental success in Northern Italian communities in the 1980s. Tight collective networking communities provided long-term, 'great' social capital. What is missing in Italy is the building of social capital at the national level which has made Italy very vulnerable vis-à-vis the consequences of the international financial crisis.

In our knowledge-based economy, we are constantly looking for networking partnership and collaborative government principles, i.e., models of collective action. This search aims to find outstanding and innovative policy ideas that organize those socio-economic bodies that make collaborative developments work. Network bodies should involve the public sector and private partners in innovative clusters across all sectors and areas of the polity, among others Michael Porter says (2000).

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As such, we find public innovation measured in the context of a geographical area (state, regions of different scale), or a particular policy domain (welfare, labor market, environment), or some other unit of analysis (an organization, individual), or some combination of the two (social regulation or labor marked in Scandinavia) (see, for example, Pedersen 2008). Actually, public innovation is about intervention and co-ordination of joint activities aimed at social capital through welfare arrangements and partnership formations by territory, by function or even by transcending national and transnational policies. Public innovation defines in the knowledge-based society the building and performance of new accountable and beneficial collective skills and knowledge capabilities, through social as well as human capital, and through fixed strategic processes in order to achieve and realize this capability (Warden, F. van 1995).

Accordingly, public innovation in networks and matters of strategic policy imply, on the one hand, transcending fiscal and regulatory interventions and the territorial and functional creation of new organizations like partnerships as public-public partnerships. On the other hand, such innovations also dispose change in norms, rules, standards, and operating procedures; these changes influence the conceptualization of the reform processes. Basically, path-dependence created by social models and an administrative tradition that makes the changes contextually impacted and deep-rooted circumscribes such interventions (Veggeland 2007, Pierson 2004). Simply put, public innovation means the use of new solutions to address old problem, or old solutions to address 'new' problems of development. Generally, we may see institutional innovation as the pursuit of the modern, all-embracing project of change with regard to rationalization, systematization, and ordering, but this change does not take place a political and ideological vacuum (Meyer 2000).

Yet, if all innovations are change, are all changes innovations? The latter, converse statement cannot be an appropriate and reasonable conclusion. We should approach network innovation contextually and view it as the application of new solutions to old problem, or new solutions to newly 'constructed' problems. This idea has inspired studies that have attempted to determine the criteria for differentiating superficial and short-term policy changes from deep-rooted and long-term innovations. Hall's typology of policy change is germane here (1993: 278–9). He has identified three forms of changes:

- The first-order of change is instrumental, defining changes to the levels and settings of basic instruments like technology and budgetary restrains. Hall does not regard instrumental changes as innovative.

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- Second-order changes are those that refer to modifications in the use and administration of the instruments in relation to current organizational processes. But the art of engineering changes neither the overall goals of policy, norms, and values nor the understanding on which the changes are based. Because these second-based changes occur within existing social models and traditional frameworks of values and norms without disturbing them, they may serve to reinforce the path-dependence of the models. Paradoxically, they may counteract reformatory change and thereof deep-rooted and long-term innovations. The instrumental concept of social capital represents such a second-based change, as we shall see below.
- The third-order changes are transformations of the overall goals of the policy, changes in the cognitive and normative framework of the networking regulatory regime on which it is based, accompanied by first and second-order changes. These changes might lead to deep-rooted and long-term public innovations, for example, moves that remain path-dependent and also aspire to reinvent the state and to rediscover institutions in new settings but.

We shall see below that the traditional Scandinavian model of the welfare state has undergone such a move, and, as a result, has become known as the contemporary Nordic model. This model has combined universal social security and active labor-market policies innovatively, and this combination constitutes a deep-rooted and long-term, path-dependent social capital. This social capital may be objectively experienced by individuals and collectives and is suitable for studies that employ empirical, statistical measurements. Third-order social capital represents substantial public innovation.

1.5 Social capital of the Nordic macro type

In a transnational perspective, we may view social capital in the Nordic countries as a transformation of the traditional Scandinavian welfare-state capacity to what now is named the contemporary social capital of the Nordic model (Veggeland 2007).

The aforementioned term of 'Nordic flexicurity policy' represents contextually collective action and a long-term social capital embracing both economic and social aspects. The driving force is a path-dependent political will to sustain a national partnership between the regulatory authorities, the unions of employees and the employers, and the people. The goal is good governance in the forms of universal social security, institutional stability, and economic and competitive advantages. Universal social security lays the foundation for the development of flexible labor markets that all the partners benefit from in different ways, including benefits irreducible to economic factors.

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The Nordic Active Public Labor Market Policy (ALMP) is another expensive contribution to the social capital of the grand partnership and the flexicurity concept. ALMP is an important part of the state authorities' responsibility for planning, building, restoring, and protecting human capital, and for making human resources the basic element of partnerships and social-capital building. ALMPs compel by regulatory innovations a range of public means and measures in order to function together, and the execution of these means and measures must take place within the framework of the universal welfare-state model. The mechanisms behind the Nordic flexicurity are as follows:

- Universal welfare and social security allow employees to feel free to move and change job and partners – safety and equal access to welfare rule independently of geography, position, employer, and network attachment. The ongoing international financial crisis does not change this fact.
- ALMP performs collaborative governance by complex partnership policies (social capital) and by education, individual training, and life-long learning (human capital). The performance involves not only the public sector but also partners across all sectors – from public services to private actors to NGOs.
- Nordic flexicurity is a nationally implemented policy concept but is basic for partnership-building and regional development capacities domestically and across borders. Flexicurity reproduces long-term welfare, an effective labor market, high labor productivity, high employment rate, and a high level of social and human capital.

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All together, Nordic flexicurity as an important part of the social capital concept is indeed expensive and imposes a high tax burden on the citizens, but even so the policy sustains its legitimacy from its double efficiency with regard to returning economic revenues and social security. The Nordic countries benefit from:

- Economic growth;
- Labor productivity;
- Active Labor Market Policy (ALMP);
- Labor-market flexibility but social security, called 'flexicurity';
- Regional and local development policy;
- Research and development investment;
- Performance in the high-tech and telecom sectors;
- High rates of employment (including among women and older workers).

In this context, social capital as flexicurity turns out to be not only 'capital' but also 'social'. Szreter and Woolcock (2004) were indeed right in their statement about Sweden; countries in the region '(provide) greater social capital to its citizens than do other countries'.

1.6 The threat of non-maintenance

Basically, social-capital building may promote good governance and long-term positive consequences in one polity context, but in another context it may turn out very differently. From the analysis of this article, we learn that social models and administrative tradition do influence the quality and practical outcome of partnership formations.

Professor Vicente Navarro of Johns Hopkins University asks (2004: 2) in a critical commentary: 'Is capital the solution or the problem'? In a response to Theodore Lowi's statement, his answer is that dominant neo-liberal discourse in social science as a consequence of the 1980s, we have seen the appearance of concepts such as social capital and human capital. He writes:

'This dominance by an economic discourse was herald as an indicator of the supposed triumph of capitalism – which had closed any debate about the type of society and economic system we might want and refocused the debate on how to manage the only system we have. Consequently, the purpose of all social actions is reduced to accumulation of capital so that the individual can compete better. The capital might be physical, monetary, human, or social, but it is capital nevertheless'.

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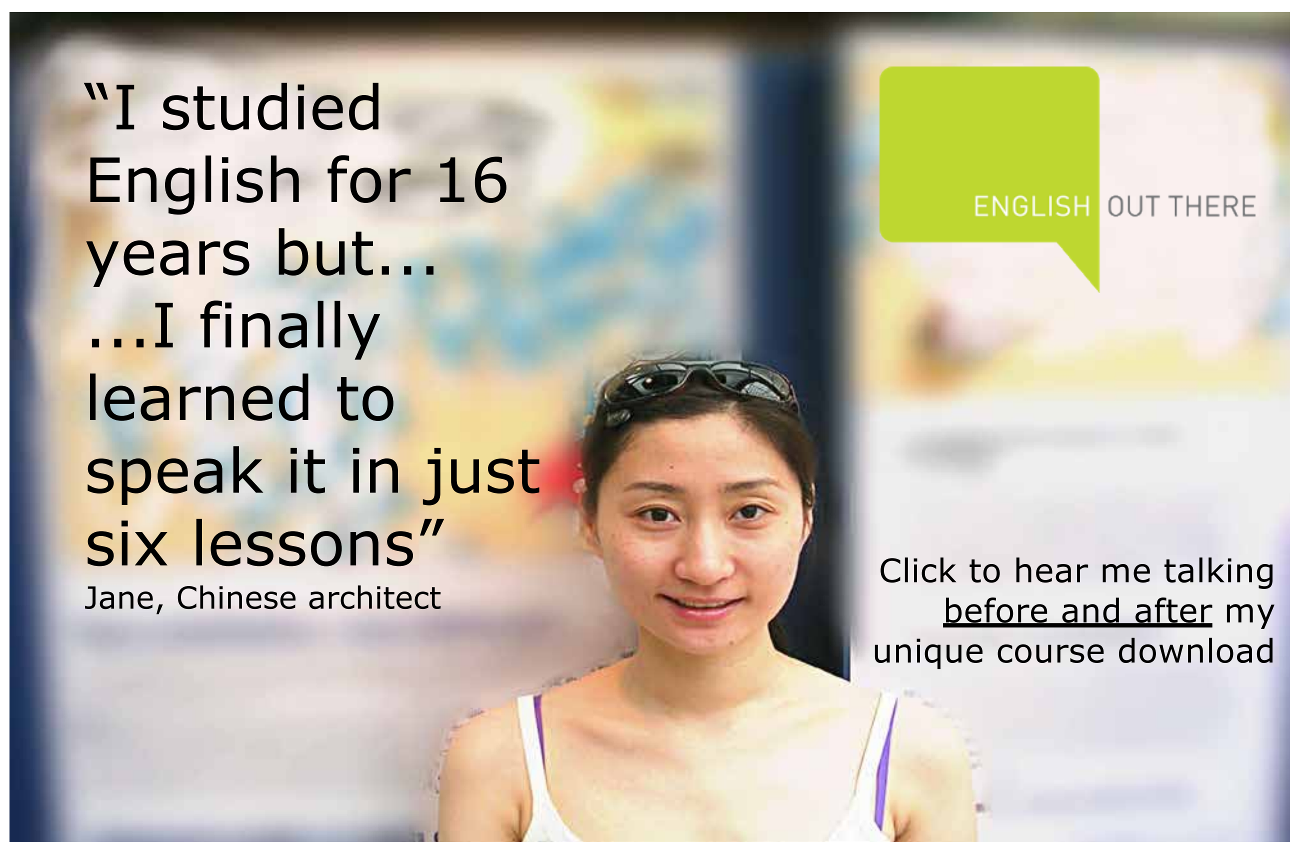
Thus, as 'social capital' has become an economic term in the era of neo-liberalism, it seems that flexicurity will likewise be threatened by the same shift of connotation away from a policy for national social action. In the political debate, even in the Nordic countries, the economic connotation is given superiority as a policy for increasing European and national competitiveness and economic growth rather than for keeping the policy as a steady path to good welfare policy in the global age. The flexicurity policy faces serious challenges today by the embracing of labor immigration from Europe and other, more remote regions. The international financial crisis is stressing the Nordic model despite the protection of the flexicurity principles. The focus tends to change from the social connotation to the economic. The Nordic model is in drift; the maintenance of path-dependence is threatened (Taylor-Gooby (ed.) 2004, Veggeland 2004, 2006, Tranøy 2006, Timonen 2004, Olsen 2005).

Flexicurity policy as social-capital building should remain a path for collective action and for solidarity, for reasons of democracy, social security and welfare, and for keeping the labor market flexible. As academics, we are not really responsible for policy performance, but we do have another responsibility. We are responsible for the definition of the terms and thereby the language in use. With reference to Navarro's statement above, there is a need in social science today to break the trend that supports the dominance of economic language and the considerable reductionism and myopia this dominance generates.



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2 Regulatory Welfare Trade-offs

Introduction

The contemporary regulatory state has developed as a result of political struggles that accompanied an increasingly globalized world and the economic crisis in the 1970–80s. The answer to the development was New Public Management reforms which promoted privatization and market-making of the public sector, and thereby the creation of the new regulatory state. The regulatory state formation was affected by the European administrative traditions and the welfare state models extensively. Path dependent developments influenced the achievements described as innovative. We are talking about regulatory innovation. Socio-economic goals are linked to three distinct policy choices which are characterized by trade-offs. Trade-offs occurs because it is difficult to pursue successfully all three goals simultaneously. In Scandinavia trade-off achieved as a regulatory innovation the appreciated mechanism of 'flexicurity'; flexible marked combined with social security.

2.1 The emergence of the regulatory state

The development of Western welfare states in the 1950s and 1960s until the mid 1970s took place under highly favorable circumstances, aided by continuous growth in the economies, and governments were able to manage national budgetary control (Tinbergen 1965). Political economic analyses, therefore, characteristically emphasized a national, state-centered law perspective bound both to the techno-economic paradigm rooted in Keynesian state intervention and principles of effective-demand and to the socio-institutional paradigm of the Weberian bureaucracy (Olsen 2005).

However, in the wake of the stagflation crisis of the 1970s, there was pressure to modernize government and to reduce government outlays through new structuring (Ferrera 2002). However, there is a counter-pressure which consists of demographic changes such as the growing rate of elderly people, leading to fiscal changes such as the rising cost of health and elderly care, liberalization of national and international markets and the changing nature of the labor market and so on (Pierson 2001). Then the question is how we do acquire fiscal ability vis-à-vis such welfare and workfare challenges without overloading public budgets and creating destructive inflation? How do we achieve flexible market simultaneously with social security?

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Scandinavian political attitudes and economic approaches changed when the fiscal ability became threatened in the late 1970s to the 1980s and the severe worldwide economic recession occurred. Suddenly, increasing unemployment rates, overloaded public budgets and globalization of markets became the focused issues which also challenged the European welfare state models, and the Scandinavian welfare state model as well (Veggeland 2009). To be mentioned, the situation in the Scandinavian country Norway was exceptional because this country had a source of growing income from oil and gas, and this provided a cushion against the development of high unemployment. Nevertheless, the stagflation crisis of the 1970s was noticeable here also, and the crisis represented a fertile ground for new thinking and transformation in the organizations of economic production and the institutional functions of the state (Rosamond 2000).

Market solutions and proposals for less state involvement arose and were legitimized by the neo-liberal ideology of the Anglo-Saxon tradition and New Public Management (NPM) goals (Lane 2000). Paradoxically, this approach also created the condition for the emergence of the regulatory state (Veggeland 2009). Wisely, Giandomenico Majone, in his article 'The Emergence of the Regulatory State in Europe" (1994:77), wrote the following:

> *Privatization and deregulation have created the conditions for the rise of the regulatory state to replace the dirigiste state of the past…reliance on regulation – rather than public ownership, planning or centralized administration characterizes the methods of the regulatory state.*

A background for the privatization and deregulatory achievements, the arrival of the regulatory state, was that politicians, the media and economists started giving attention to the actual and potentially increasing welfare role of the market driven by both public and private actors and agencies. This new attention was often linked to sharp criticism of the allegedly inefficient public bureaucracy and monopoly. The criticism of the costly welfare state emanated not from the heavily burdened OECD welfare states of the Continental and Nordic welfare traditions (Veggeland 2005), but rather from the 'less advanced' or 'less embracing' Western liberal welfare states such as the UK and the USA. The OECD legitimized the criticism and skepticism through the wide-ranging reports on the welfare State in crises. The reports promoted strongly the strategy of deregulation, outsourcing instead of in-house provision of welfare services, market-driven solutions in the public sector, and contracting as a new regulatory tool (Veggeland 2004). Modernizing government in this way and performing the reform along the Anglo-Saxon path and NPM principles were the ultimate recommendation of the OECD. New law-making and innovative re-regulating efforts were needed.

Further, the related neo-liberal ideology stressed the responsibility of individuals for themselves, the freedom to choose services, security through personal and/or employer health and social insurance, etc. From the 1980s on, the international winds of ideological criticism and warnings against universal public welfare and social security measures reached Scandinavia, and so did the regulatory state approach (Veggeland 2010). The OECD neo-liberalism-biased strategy and recommendations still linger on in the documents coming from the organization (OECD 2005).

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The views of neo-liberalism, which were picked up and have been partly followed with very little deviation by the leading Scandinavian right-wing political parties since the 1980s, influenced the social democratic parties. A key word here is the belief in commercialization in order to increase efficiency in the public sector and in the welfare service sector (Iversen 2005). Constituting an ideological front here is the presentation of individual differentiated needs and rights with the liberating message of freedom to go 'shopping' for services of your own, and a message of inclusion by giving everyone the opportunity to be included in this system of freedom. The ideology of neo-liberalism generated its own language, which biased good governance views and values to the market and bad governance views to the state. Ideologically the principle of a necessary dominant regulatory state was un-mention. This list of ideologically blended words, which is inspired by many scholarly sources and dominant in OECD reports of recommendations on modernization issues, tries to clarify the contrasting views in a context of supremacy and inferior absolutism:

Neo-liberal views on

Market qualities	**State qualities**
Freedom	Enforcement
Individualism	Collectivism
Diversification	Uniformity
Open effective economy	Closed ineffective economy
Modernism	Entrapment in the past
Deregulation	Too much state and social security
Cost efficiency	Cost inefficiency
Elasticity	Deficit of flexibility
Mobility	Immobility
Progress	Lack of progress
Innovation	Standstill

The neo-liberal views are partly right and partly wrong but are somewhat realized in the Nordic countries in a transformed mode (OECD 2002). Throughout the last two decades, a new Nordic welfare and social order has risen to some degree. However, regulatory innovations in the field are blended with administrative traditions and should be understood and interpreted as path-dependent innovations arising from the historical Scandinavian welfare state model. Let us look further to compare the actual and basic transformations and trade-offs that challenge the welfare state, and especially the universal welfare state of the contemporary Nordic countries.

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2.2 Regulatory welfare state tradition and models

The regulatory approaches of the European Union (EU) have heavily influenced the welfare state performance of its member state and subsidiaries like Norway. From the launching of the European integration process and the adoption of the Treaty of Rome in the 1950s, and with the inner six Continental states, Germany, France, Italy and the three Benelux countries, as founder states, the Continental model naturally was dominant, and this administrative tradition created path-dependence of state-focused con-federalism and interventionism as a reflection of the Keynesian state (Millward 2000). From the Continental tradition came the policy inspiration to embrace into governing mode of the EU the European social partners, the European umbrella trade union (ETUC) and the private and public employers' interest organizations, respectively Unice (now Businesseurope) and CEEP, to the negotiation table (de Buck 2004). The goal was taming and correcting the integration process by putting regulatory social concerns on the agenda. A sort of a Continental corporatist style was the result. The Maastricht Treaty from 1992 introduced the 'Social dimension' of the Community, with the expressed goal to create arenas for deliberative talks, and thereby to reach consensus instead of conflict on social and labor-market issues. The Anglo-Saxon state, the UK, was exempted from the EU social dimension, and in 2008 the UK still remains outside this facet of EU policy.

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The dominance of the Continental tradition lasted until the end of the 1980s (Urwin 1996). The adoption of the Single European Act in 1987 and the introduction of the Single European Market process one year later marked a fundamental contextual change (Austvik 2002, Wallace, Wallace and Pollack 2004). The strategies of minimizing the state and marketizing the public sector, of Anglo-Saxon origin, became dominant policies (Pollitt and Bouchaert 2004). Further, the member states decided to deregulate – and re-regulate – to create a territorially wider, borderless, single European market. The new regulatory state order of the EU took over. Governance replaced the governing mode of the Union. We might say that this caused the transformation of the social-institutional paradigm, much in accordance with the Anglo-Saxon social model and market-orientated administrative tradition, and expanded the need for innovative re-regulation in this multilevel governance (MLG) system.

How did such a transformation occur? When the United Kingdom had joined the European Community (EC) in 1972 as a major member state, the global recessions, inflation, unemployment and stagflation had reached all the member states' shores. The crises biased and pressed forward change, or at least modification, of the techno-economic and socio-institutional paradigms. The Anglo-Saxon model and the tradition of organizing governance became dominant and changed the Community's method away from state-focused con-federalism and interventionism and moved in the direction of the regulatory-state paradigm based on market-centered policies, modes of New Public Management and supply-side economics. The concept of the Social dimension and the involvement of social partners in negotiations, along with sensitive issues like work conditions and social and labor-market reforms, were temporary taken off the record (Koukiadis 2006).

During the 1990s, both the ability failure of the EU to compete in the global economy and the democratic and legitimacy deficit became central issues, threatening the core identity of the Union (Hayward and Menon (eds) 2003). And when the Soviet Union collapsed, the political situation in Europe changed radically. The poor Eastern Europe states wanted membership status in the 'rich men's club', and the Amsterdam Treaty of 1997 made the opened the door to them (Glenn 2004). Ten new states joined the Union in 2004, and two more in 2007, bringing with them heavy social and economic burdens that were expected and immediately felt. Reforms were necessary, and they were formulated, agreed on and implemented as socio-institutional changes. In our context of studying the social model, the Lisbon Process, launched in 2000, was to be a crossroad (Janssen 2005). The Lisbon Process was targeting the ambitious goal of making the EU the most competitive region globally.

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Hence, there were at least at two important events during the spring of 2006. European political and administrative leaders discussed modes of competitiveness and robust governance in relation to such models. Their explicit focuses was on the Nordic welfare-state model and its regulatory approach to social security and on whether such a successful model that offered low socio-economic risk and vulnerability could be applied to other member states, especially those in distress[8] (EU program 2006). This idea motivated scholars to revisit the Nordic state-focused social model and participatory administrative tradition in a comparative perspective, to find out the essential characteristics of the paths of development coming from this model and to determine why the model is considered successful 'in the global age' (Veggeland 2007, EPC 2005, Timonen 2004).

As mentioned, the EU search for an innovative regulatory social model commenced when the European Council held its meeting 23–24 March 2000 in Lisbon and agreed to set out a new ten-year strategic goal for the European Union. The goal was to make the Union the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion. The Lisbon Process was launched. But right from the start critical voices made themselves heard, like 'Lisbon's single size does not fit all' (Mayhew 2005), meaning that the Lisbon process from the beginning was far too fixated on economic conditions for competitiveness and taming externalities at the expense of considerations of social security and welfare.

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In short, the Nordic model seems to offer more than a 'single-size' method in the pursuit of competitiveness (O'Sullivan 2005). The model seems to offer everything that European decision-makers are looking for: highly competitive economies in conjunction with less social inequalities and the institutionalized taming of risks and innovative regulations for job protection (EPC 2005, Kuhnle 2000). In the 2000s, this rather expensive welfare-state model appears to represent a multi-dimensional method with the potential to generate a successful road for the development of the future EU and for (some of) its member states.

Of course, all these things are extremely complicated. We need European-wide multi-disciplinary comparative research to enhance the knowledge of what happens when social models travel across borders.

2.3 Welfare-state models and regulatory innovation

As elaborated above, we may view innovation in the public sector not as accidental changes but as contextual changes (Pierson 2004). In the European context, it means that path-dependence, owing to different territorial social models, strongly influences such changes (Veggeland 2007). In close connection, another issue arises regarding innovation. New ways of making such changes, and transcending them, also occur when European social models interact across borders and trigger interpretations of new ideas that bias policy and institutional change. Interpretation theory make explicit that there are at least two basic perspectives involved (Røvik 2007: 22–23): the interpretation may be either contextual or out of context. In the former case, innovation is linked to already existing social models and traditions; path-dependence thus determines the norms, principles and values (Knill 2001). In the latter case, there is the simple copying and imitating of first- or second-order changes without taking account of domestic values, management ethics and steering traditions.

In general, regulatory innovation[9] includes strategies for improving the management of risk and the pursuit of state legitimacy in the 'risk society' (Beck 1992). Innovations in the way risk is moderated include threats to welfare, social security, labor market, social and human capital, gender discrimination or otherwise, environment, economy, national security, and so on (see Taylor-Gooby (ed.) (2004)). Re-regulation, a term for new regulation aiming for the reduction of risk and taming purposes is a term often used to express regulatory innovation, for example, providing social capital through market correction or the partnership approach (Scharpf 1999).

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Some researchers have pointed out that the welfare state does not have its basis on 'politics and regulation against the markets', as is commonly assumed in the neo-liberal Anglo-Saxon tradition, but rather on the social-democratic mixed-economy approach, that is, 'politics and regulation *with* markets' (Iversen 2005:73). We may add to this the postulation of 'politics and regulation *by* the market' if we take into consideration how the principles of New Public Management (NPM) and market-type mechanisms have penetrated the traditional Scandinavian welfare-state model and administrative tradition (Pollitt and Bouchaert 2004, Veggeland 2004) and constituted the current Nordic welfare and social model (Veggeland 2007). This change has innovatively formed and adapted a regulatory approach to a new stage of welfare-state performance. The three postulations seem reasonable, but we should qualify them with an answer to this question: which regulatory changes to the welfare state provide greater output to its citizens more than others?

Although, it is popular to point out that the market, including global markets, interferes with the welfare state and vice versa, it is obvious that this interference occurs along different paths, depending on the actual social regulatory model of the states (Beetham et al. 2002). We have at least three general welfare state models in Europe, which link correspondingly to the three administrative and political traditions (Knill 2001). Let us elaborate these somewhat further.

- *The Continental welfare-state regulatory model,* which is dominated by strong trade unions, is said to be of a *corporatist type* with a heavy regulated labor market. As discussed earlier, high job security and protection through industrial relations plays a key role (Koukiadis 2006). For this and other reasons, the corporatist welfare states are, in many ways, based on *politics and regulation against markets* more than other European states. Administrative rigidity and slow process of renewing social apparatus hamper the corporatist Continental welfare-state model. These features are not accidental but due to traditions and developments of institutional path-dependence (Knill 1999).
- *The Anglo-Saxon welfare-state regulatory model,* which is dominated by the adoption of market-centered policies, is said to be of a *liberal type*. The liberal welfare states use market-type-mechanisms and independent agencies to provide welfare services. The labor market is sparsely regulated and has low job security and protection (EPC 2005). This welfare-state model more than others qualifies for the notion of *politics and regulation by markets*. With regard to innovation of social apparatus, the model is restricted by ideological resistance to changes which concern the basic values and principles of neo-liberalism. Again, this occurs not accidentally but is a result of biases historically rooted in the liberal model, and we may best view it as a as institutional path-dependent development.

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- *The Scandinavian/Nordic universal welfare-state regulatory model,* which is dominated by state-centered policies and high welfare expenses, is of the *universal type*. The universal welfare states offer universal social security and job-protection arrangements. Further, it is a governmental responsibility to prioritize such labor-market tasks as life-long learning and the development of skills. From another point of view the Nordic post-war labor market has become rather liberalized and the marketized, such as outsourcing which is often put to use for the provision of welfare services (OECD 2005, Veggeland 2007). This makes the universal welfare-state model qualified for the notion of *politics and regulation with market*[10] in the framework of the regulatory state. The public sector has selectively learned lessons especially from the Anglo-Saxon model, and in some parts of society the third-level of changes is reached, that is, innovative changes. This achievement concerns the concept of social capital, which has been renewed in the contemporary Nordic model. One example is how welfare politics has become connected to labor-market politics in an innovative way. The outcome has been the great social regulatory innovation of '*flexicurity*', i.e., interactive co-play between social security and active labor-market policies, which brings flexibility to the labor market and therewith competitive advantages in the global age (EPC 2005). As with the other models, the contemporary universal Nordic model of the welfare state has also taken its form owing to its historical welfare-state roots and institutional path-dependence (Olsen 2004).

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One main reason why the Nordic regulatory model has been receiving renewed EU attention under the auspices of the Lisbon Process since 2000 is the belief in the social capital of flexicurity and other universal welfare state arrangements of the model (Europe's World 2005). In a time when states and regions are more than ever competing globally and are intensively engaged in political and economical measures to maintain a high employment rate while trying to keep inflation and public expenses low, it is understandable that they are looking for innovative solutions (Iversen 2005, EPC 2005). Records of public budgets confirm over the years, however, that the Nordic welfare and social-security costs consequently represent a high burden on the public budget. Why, then, is this model so attractive? The answer may be very simple: Social capital in the Nordic welfare-state regulatory model creates a high level of labor productivity. The labor productivity is generated through high degree of national employment, which means more than just 'full employment' in the Keynesian sense. It means work, training or education for everybody irrespective of social groups, gender, ages and individual differences. The pay-off of this is ability to afford expensive social security, which in turn results in the taming of social inequality that facilitates the renewal of the social capital of flexicurity in an ascending innovative circle.

The empirically based thesis is that universal job protection and social security shape the incentives workers have both for investing in particular market-attractive skills and life-long learning and for changing work and work-places without personal risk. Labor market flexibility is the innovative outcome of the Nordic active labor-market policies: education, lifelong learning, kindergartens that help women's access to the labor market, and so on. Firms benefit from such flexibility and access to skills because they are critical for competitive advantage in knowledge-intensive economies. 'Firms do not develop competitive advantages *in spite of* systems of social protection but *because of* it' (Iversen 2005: 74).

2.4 Regulatory trade-offs

The welfare goals and regulations of a state need, of course, to be paid for if they are to be realized; social and economic potentials are instruments to accomplish that realization. Analytically, a neo-liberal perspective may view the building of such potentials in modern states as basically directed by three goals: low inequality, low unemployment and low public expenses. These socio-economic goals are linked to three distinct policy choices that are characterized by a 'trilemma'. This trilemma occurs because it is difficult to pursue successfully all three goals simultaneously as long as there are trade-offs between them (Wren 2000). At this point, and before elaborating this statement further, there is a need to define and distinguish the notions of trilemma and trade-offs. For these purposes, I shall follow the work of Pollitt and Bouckaert (2004: 162):

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Regulatory trade-offs: where there is more than one desideratum or more than one problem to be alleviated, there will inevitably be the failure to attain other desiderata or the worsening of different problems. This is a situation, therefore, where decision-makers are obliged to balance between different things that they very much wish to achieve but cannot possibly have them all at the same time – indeed, having more of one desirable thing entails having less of another. In the political world, appropriate choices often are those that essentially make the best out these unavoidable, constrained conditions with the guidance good governance grounded on a pragmatic approach. Yet, norms, values and traditions will affect these choices by making one set of options more preferable than the other. Governments thus tend to compromise the goal that is least ideologically important to them (Weaver 1986) in order to maximize the others in their struggle to retain their position of political superiority. We may take the following as an example. According to the perspective of historical institutionalism (Cini (ed.) 2004), if decision-makers were to engineer the use of social and economic potentialsl as short-term instrumental capital, then the long-term perspectives aiming for sustainability and the supremacy of good governance values will often be insufficiently communicated.

Torben Iversen (2005: 146–147) has highlighted this ideological aspect of the trilemma arising from the challenges of the global age of keeping unemployment, inequalities and public expenses in check, in short, the ideological aspect involved in social-capital tradeoffs. One strategy was to deregulate labor markets to reduce the power of employee unions and to increase wage flexibility. The governments of the Anglo-Saxon tradition, the US, the UK, New Zealand and Australia during the 1980s exemplified these neo-liberal policies. Another strategy was both to accept the consequences for employment resulting from a compressed wage structure and to seek to limit the disruptive effects by discouraging the entry of women into and by facilitating the exiting from the labor market, the latter being primarily affecting the elderly through early retirement. This is the typical pattern of choice we find in some Continental European countries.

The final option was to accept the slow growth of employment in private-service sectors but simultaneously to pursue an expansive employment strategy through expansion of public-sector services in order to balance the effective demand in the framework of Keynes. This strategy also strove to improve the educational resources for younger people as a policy approach towards building social capital. The social-democratic governments in the Nordic countries, where the ideological tenor favored the financing of higher public expenses by full employment and by high tax rates, often chose this option.

As we observe in this process of compromising goals and policies, social regulatory models, administrative traditions and path-dependency play essential roles for what decision-makers consider to be designed appropriate choices and how they implement their strategic thinking on social capital (Sverdrup 2007). We may argue that the trade-offs involved in European social-capital policy have this following inconsistency:

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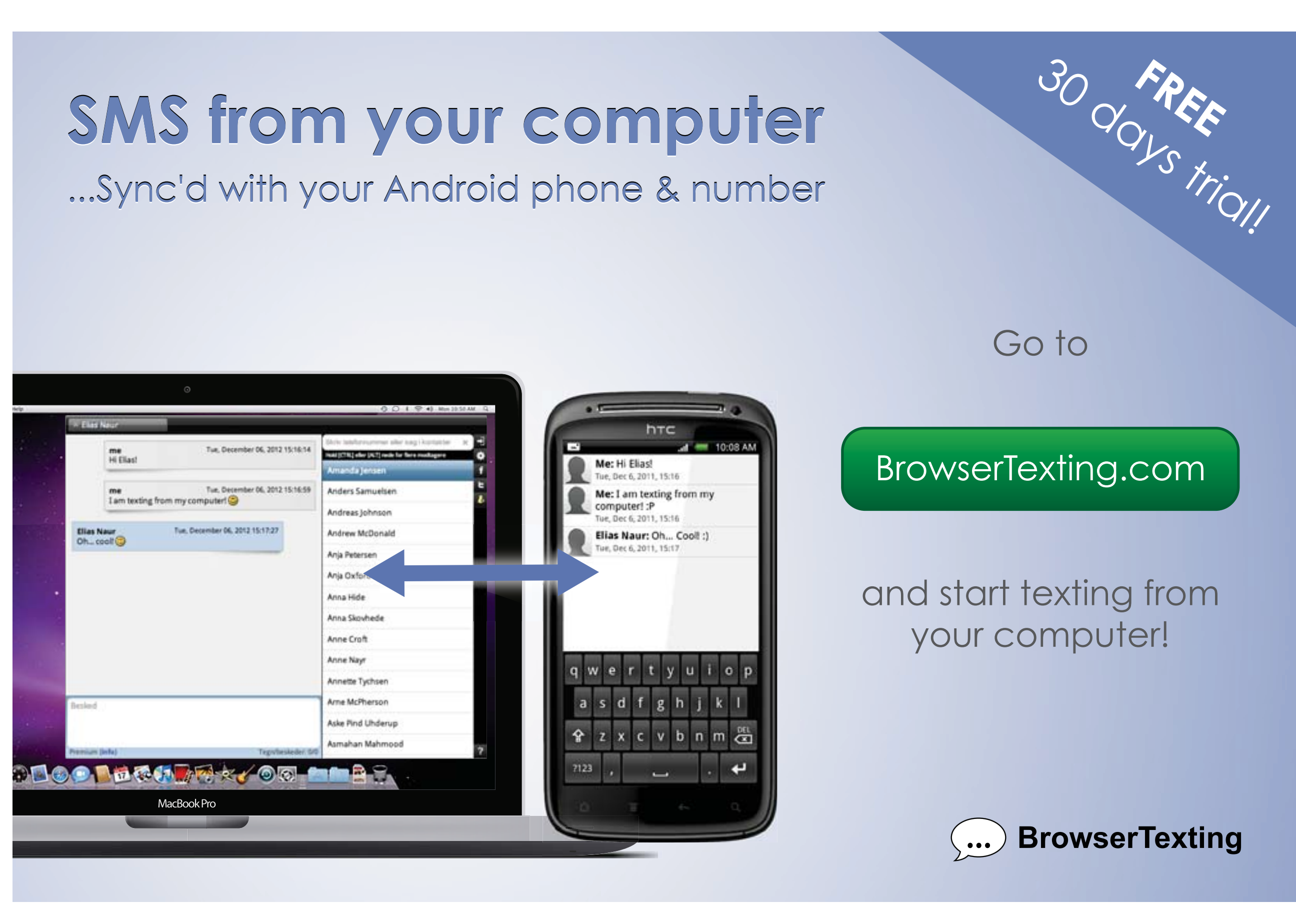
On the one hand, creating jobs and employment in the private-service sector is a positive strategy in that it does not disturb the budgetary balance; however, this strategy has certain trade-offs: lower wages, higher non-wage costs and the inducing of negative inequality in the sense of lowering the degree of employment in the population and thereby reducing work productivity. On the other hand, the strategy of generating service jobs in the public sector also has trade-offs; the strategy indeed pushes the limits of already constrained and overloaded budgets (OECD 2005).

Politicians in charge do have the obligation to make decisions. Concerning social aand economic potentials, they look for a European model to minimize the trade-offs, that is, to find a model for flexible job creation, for social equality and for welfare, but all within a sustainable economy (Janssen 2005, Rasmussen Nyrup 2005).

2.5 European regulatory trade-offs

In our context, we may briefly describe the trade-offs of equality-employment and public expenses of the European welfare-state models and paths in the framework of innovative vs. not innovative regulatory choices as the following (Veggeland 2007):



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- *The trade-offs in the liberal welfare-state regulatory model:* As pointed out before, the Anglo-Saxon regulatory tradition weighs market solutions and regulatory measures and has the lessening of state intervention as an explicitly expressed objective for the service sector. Universal welfare and health coverage are not guaranteed. The employer provides the workers' health and social insurance, while the government covers the health expenses for the poor and the elderly who fall outside this insurance system.
  - In this tradition, the response to the equality-employment tradeoffs was to give job creation and labor-market flexibility priority while it reduced job protection and social security. The use of contracting workers reduced the power of unions and increased wage inequality during the 1980s. The politicians and economists believed in a flexible labor market that would make full the use of economic capacity and promote job creation, innovation and growth through a flexible labor market without fixed tariffs and expensive welfare services; the engineering of short-term social capital was part of this belief. For neo-liberal economists, market flexibility is the ultimate precondition and solution for increasing productivity and revitalizing the European economy in a globally competitive world.

- *The trade-offs in the Corporatist welfare state regulatory model:* The Continental regulatory tradition depends on corporative solutions and state-interventionist measures. Health and social insurance are guaranteed, although the latter is a mixture of public and private institutional arrangements. Traditional welfare services are kept in the public domain as 'services of general interest', i.e. public responsibility. Trade unions are strong, but the problem is that there are too few jobs created. Reaching Hall's third-level institutional change did not, then, come through fast enough.
  - In this tradition, the response to the equality-employment trade-offs was to accept the employment consequences of a formal wage structure and hierarchical and rigid system of professionals, the latter of which also dominated the bargaining area. The labor market remained inflexible and the unemployment rate relatively high. Policies for the liberation of social and economic potentials did not stand up to solutions that obstinately remained 'policies against the market'.

- *The trade-offs in the Universal welfare state regulatory tradition:* The Nordic regulatory tradition relies on public institutional solutions with regard to social equality, interventionist measures, universal welfare services and public health and social insurance arrangements as goals and means for the building of social capital. Institutional changes at Hall's three levels have created public innovations. Owing to the use of the marketizing mechanisms in the public sector, like outsourcing and contracting out arrangements and the selective reorganization of public administration to Public-Law Agencies (PLAs) and Private-Law Bodies (PLBs), indirect governance by regulation has become common, and trade-union power has diminished since the 1980s (OECD 2002, Veggeland 2007, 2004).

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- In this tradition, the response to the equality-employment trade-offs was to accept sluggish employment growth in private services while expanding the public-service sector and public expenses, resulting in high taxes. The influence of professionals in the main bargaining arena was limited because Nordic unions, unlike unions in countries such as Germany and France, were sharply divided between blue- and white-collar workers. In addition, the governments took anticipatory measures for building knowledge capital, such as life-long learning, adult education and continuous training in order to adjust skills to the changing needs in both the private and public sectors. Close to 20 per cent of all adults (those between the ages of 25 and 65) participate in some kind of adult education every year, compared with an average of around 8 per cent for the EU as a whole. A rather flexible labor market has developed as a result of the implementation of this concept. The pay-off from the universal welfare state facilitates the general acceptance of the relatively high tax level.

The Nordic countries have a long shared history and have experienced similar social and economic developments. The most common feature of their systems is a well-developed welfare state characterized by its universalism, which means both that all citizens are entitled to basic social benefits and job protection and that there is high social spending, high taxes and a large public sector. They have succeeded in achieving a high degree of labor-market flexibility and are close to fulfilling one of the goals of the Lisbon Process of an overall employment rate of 70 per cent.

Employment policies lie at the heart of the Nordic countries labor-market regulatory policy, just as social-security policies lie at the heart of their welfare-state policy (Iversen and Wren 1998). The framework of the two policies is innovation and long-term social-capital building, and the innovative achievement of flexicurity. Obviously, these policies pay off only when they are associated with low inequality and high public-welfare expenses and employment.

Even if they did not initiate and end the Lisbon Strategy, the Nordic EU member countries are very much comfortable with it – particularly its initial triple focus on the labor market, employment and social inclusion in a knowledge-based economy and under regulatory governance (Europe's world 2005). Actually, the similarity between the priorities of the Lisbon Process and the past and current actions of social-capital building in the Nordic countries has led some to ask whether or not the Lisbon reform agenda was simply an ambitious attempt by these countries to put their welfare state policy in line '*with the market*,' and the flexicurity model has been firmly imprinted onto Europe's economic and social regulatory model (Janssen 2005).

This interpretation is unlikely the case. The launching of the process of comprehensive renewal by the participants in Lisbon in 2000 represented a collective recognition of the challenges the EU faces and the need for a common response that would be able to draw on the best elements and paths of each member state's social and economic models and regulatory traditions. The challenge was the regulatory trade-offs of the Union. The Nordic approach showed a possible regulatory path.

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3 Distributed Public Governance: Does democracy work?

Introduction

'The Age of Administrative Reforms': Administrative reform programmes have been defined as 'festivals of visions' and 'marketing devices. There have often been complains of 'reform euphoria', which give rise to grand announcements but end up in disaster when it comes to implementation.

Most administrative reforms disappoint. They start off with much fanfare and promise so much (too much, of course) that they are bound to disappoint when the realities set in. (Hayward, J. and Menon (eds) (2003): Governing Europe. Oxford: Oxford University College. pp. 137).

3.1 Subsidiarity

The principle of subsidiarity may be recognised in the EU Constitution draft from European Convention, and presented to the member states for response in 2003, as a somewhat diffuse guiding principle for future distribution of public governance. This observation may well be understood knowing that the intention of the Convention is to integrate all the manifestations of previously signed EU Treaties in one, the Constitution Treaty. The principle of subsidiarity was introduced by the 1991 Maastricht Treaty that ascertained devolution of competence, i.e. 'decision-making to be performed at the lowest possible effective administrative level' in the European multi-level-governance system. In the political rhetoric the subsidiarity became elaborated and design with purpose in the subtle way as the principle of 'nearness', indicating more bottom-up governance and democratic voice options. But 'nearness' in what framework? In the framework of the emancipation of citizens, or devolution of competence to elected assemblies, or just outward devolution to independent government bodies or other actors freely competing in the established Single Market?

Actually, the principle of subsidiarity didn't get a precise definition of status in terms of being a legal or an administrative governance principle, or it being what so ever 'outward' or 'downward' principle inheriting the notion of '*Distributed Public Governance*'. The latter notion defined by the OECD (2002) as *independently organised public agencies, authorities and other government bodies, and each of them regulated by special public law or private law*. – Or may be the only intention of the Maastricht Treaty was to make subsidiarity to become a regulative idea for how decision-making processes in the EU ought to be featured and functioning.

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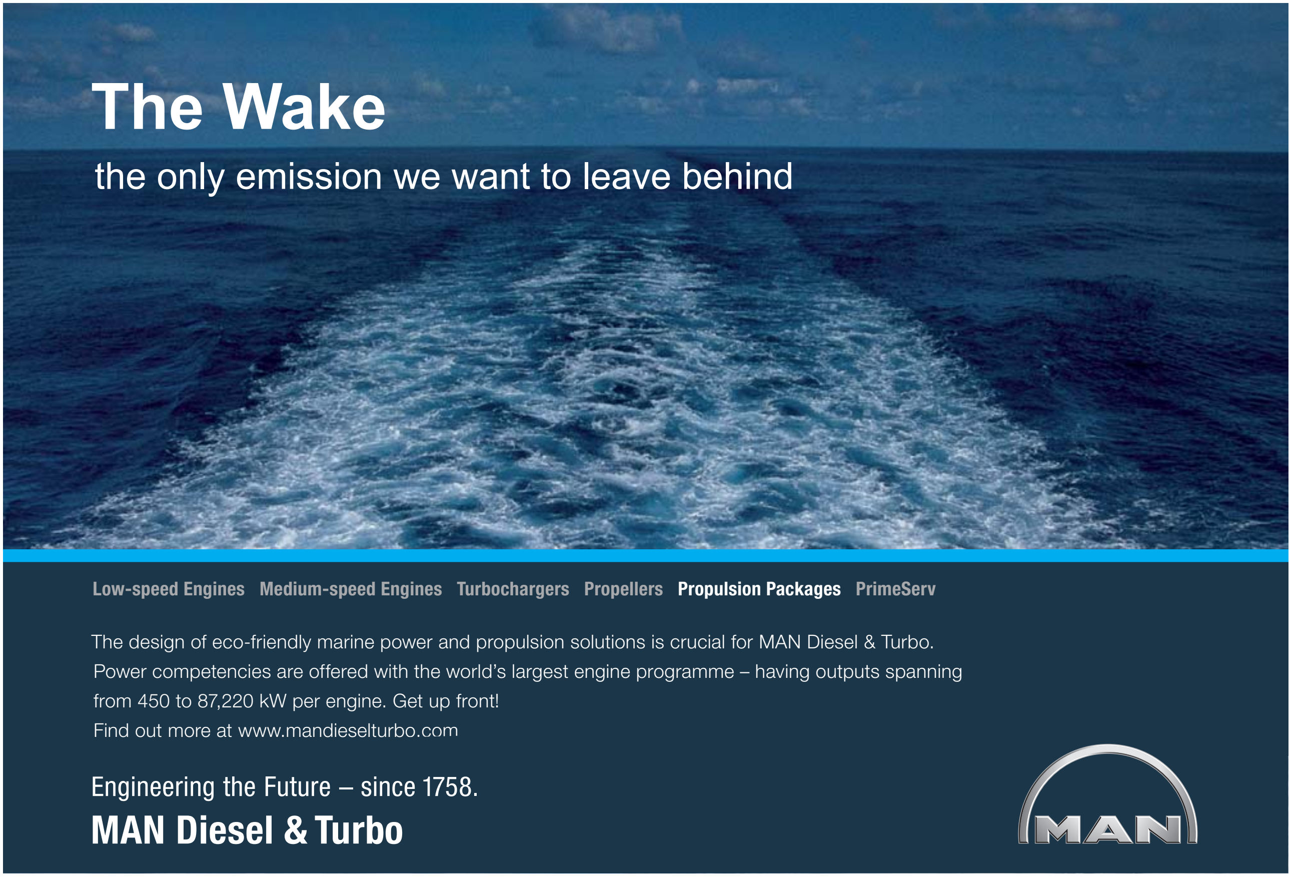
3.2 Vagueness on purpose

Anyway, the principle was acknowledged by the member states at the time. Most likely this happened just because of its diffuse status. Though, concretely the Treaty claimed an institutional sub-national level between the state and the municipality level as compulsory for attaining money allocation from the EU's Structural Funds. We now know that the states had different understanding of the policy implications of as well subsidiarity as regional development institutions, stemming from federalism versus intergovernmentalisme, nationalism versus regionalism, government versus agreement-based governance.

However, they had a common interest in making the increasing supranational EU competence more acceptable and more legitimate for their respective national people. Positively, the notion of subsidarity was all together linked to a political agenda focusing bottom-up governance and the strengthening of national democratic institutions.



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Concerning the Constitution draft, still the status of subsidiarity in the EU governance for the future continues not to be concretely defined, probably for the same reasons as in the Maastricht Treaty, stemming from different national governance traditions. Accordingly, in the Constitution draft the implications of the principle of subsidiarity for democratic and administrative organisation on sub-national levels are vague, if issued at all, while related measures, arrangements and organisational form for reducing the EU deficits of democracy and legitimacy are heavily weighted subjects. Yet, organisational adjustments of local governance to new constitutional condition in the EU are left as an area of competence for each of the member states to decide. But even so, in the Draft subsidiarity is recognised as an important measure for reducing the EU deficit of democracy and legitimacy.

From another point of view, it may seem amazing that national democracy conditions for sub-national bottom-up democracy are not focused and issued in the Constitution draft, considering the fact that in this context it is almost impossible to make a clear distinction between nation-state governance and EU governance. The distinction is as much diffuse as to make a distinction between country's national central state governance and sub-national governance. Tiers' governance structures reflect each other in one or another way, because of democratic and administrative traditions and networking games, which create institutional coherence (Veggeland 2003). Fritz Scharpf calls it 'Politikverflechtung' (Scharpf 1999).

In this article I explore democratic and administrative traditions in two EU member countries, the Continental and the British traditions, the former exemplified by France (and the EEA country Norway) and the latter by Great Britain. In the Continental European democratic tradition credence was given to the idea of the state as an abstract identity, as something different from the society, bearing inherent responsibility for the performance of public functions or as a collective actor representing the society as a whole. Further in this perspective of being a collective actor, even the representative democratic state could preserve its exclusive responsibility for the common best only by introducing certain constitutional modifications. However, the state of authority intervening into societal developments 'from above' should be constrained by the law, and first and foremost by a written national Constitution (in German 'Rechtsstaat').

In this context the British tradition is different, and closely related to the historical evolution of a state identity which is said to reflect 'an aberrant case' (Dyson 1980:36). Rather than ideologically looking upon the state as a top – down authority responsible for the common best, it was conceived as an instrument of mediating between politics and societal interests as for instance market forces (Knill 2001). Probably the mediating function of the state explains why the unitary nation-state of Great Britain was left without a written constitution; political institutions and the civil society were instead perceived as the constraining elements in function, concretely and continuously correcting the state through bargaining processes.

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3.3 Two hypotheses

The first hypothesis of mine is that different administrative state traditions have profound organisational impacts on related sub-national institutions, when subsidiarity is implemented as referable outward or downward Distributed Public Governance in terms of the establishment of independent public agencies and other government bodies. In the paper this hypothesis is confirmed. In France, the 22 elected regional assemblies and their governments have attained governance function and steering capacity in mutual public – public partnership with the central state, regional 'contrat de plan – etat – région', and maintain the political status as principal democratic authorities controlling the state subsidiaries, the independent public agencies. In Great Britain it functions differently. The mediating status of the state is recognised when the state subsidiaries in terms of fragmented independent agencies, here function as the principal regional authorities, performing development policies in public-private partnership. Elected sub-national assemblies have become abandoned. – Despite historically belonging to the Continental tradition, political processes in Norway targeting subsidiarity as outward/downward Distributed Public Governance, seems to be in the beginning of placing the state function somewhere between the Continental and British democratic and administrative tradition. Elected regional assemblies and governments still exist as weak principal authorities, but are for the time being threatened of abandonment. Independent agencies and other institutional public bodies, fragmented or in partnership, are empowered and growing in number especially on the sub-national level.

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The second hypothesis is that state governance traditions to some extent explain different agendas of democratic governance problems, when outward/downward Distributed Public Governance are issued for generating deficit of democracy, legitimacy and accountability. As written in the OECD report (2002:10): "Many government now realise that managing from distance has crated specific accountability and democratic control issues, and have started focusing on improving the governance of these bodies". However, the OECD report also confirms that only in the Continental counties analysed, are Distributed Public Governance as a form of subsidiarity really focused. It happens in terms of creating new policies for more steering capacity to the governments, and for making the independent agencies more transparent and coherent. In this context, for the time being Great Britain is lacking behind, and so is Norway.

In Great Britain it has long been recognised that the doctrine of parliamentary responsibility and steering ability is still a fiction. British scholars conclude "the sheer institutional diversity of government makes the makes the doctrine obsolete and its complexity obscures who is accountable to whom for what? A whole host of official bodies and officials exercise a great variety of powers over the spectrum of government – executive agencies, quangos, public corporations, regulators, czars, ad hoc plenipotentiaries, and inspectors. Many of these are independent 'miniature governments' in their own sphere" (Beetham & Byrne & Ngan &Weir (2002:133).

Good governance depends on bottom-up arrangements creating space for political government and action, involving of the civil society, public discourses and transparent institutions of accountability in order to make democracy work. This contribution goes thoroughly into the OECD report (2002) on 'Distributed Public Governance', and its conclusions on a shift of democratic and administrative trends in Western European countries, away from more governance of independent public agencies and other government bodies. This out of focus issue in the Convention Treaty draft is explored; 'good governance' and democratic subsidiarity, as both 'downward' and 'upward' devolution of competence to effective political levels, but not 'outward' devolution from the nation-states somewhere.

3.4 State formation and administrative traditions

The nation-state of Europe was created at the end of the seventeenth century when the traditional Westphalian state-system was established (Krasner 1988). In France, the 1789 Revolution reversed the absolutist dominance of society by the national state. The state did not lose its monopoly of coercion, but society itself determined the use of state power (Knill 2001). Also the notion of state and the notion of democracy were first expressly linked ideologically. Parliament, the elected representation of society, built the linkage between the citizens and the common interests, i.e. the state, and constituted the input democratic legitimacy (Veggeland 2003). To Europe this new epoch meant emancipation of the people and a new way of governing a bounded territory with its citizens democratically.

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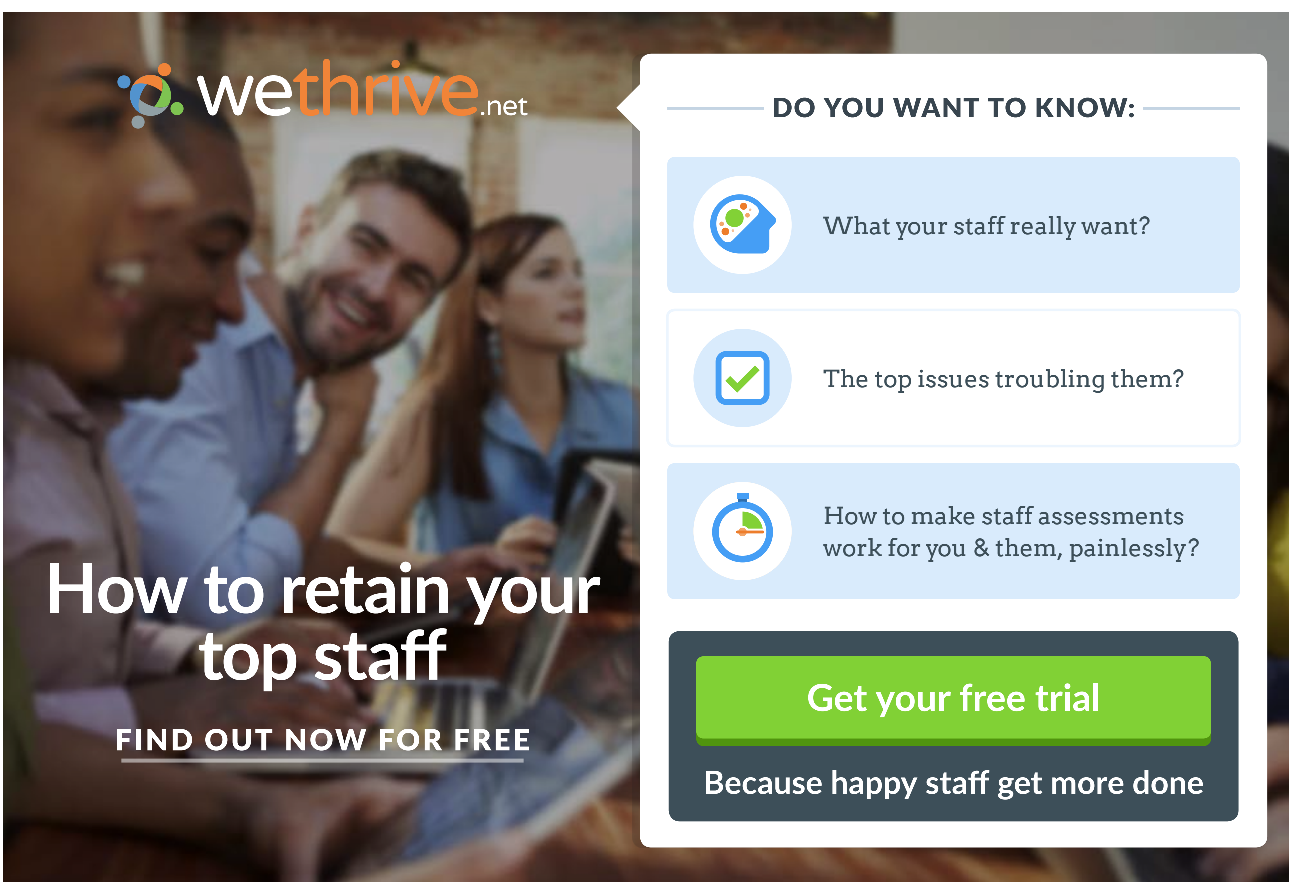
The "people" (*demos*) of a defined national society became the only appropriate foundation for democracy, and the national state made up of government institutions became the only principal authority with internal sovereignty, with power on behalf of that "people". However, two different conceptualisations of the state function should be noted (Knill 2001). In the Continental European democratic tradition credence was given to the idea of the state as an abstract identity, as something different from the society, bearing inherent responsibility for the performance of public functions or as a collective actor representing the society as a whole. Further in this perspective of being a collective actor, even the representative democratic state could preserve its exclusive responsibility for the common best only by introducing certain constitutional modifications. The state of authority intervening into societal developments 'from above' should be constrained by a nation-state constitution and the rule of the law (in German 'Rechtsstaat). In this context the British tradition is different, and closely related to the historical evolution of a state identity which is said to reflect 'an aberrant case' (Dyson 1980:36). Rather than ideologically looking upon the state as a top – down authority responsible for the common best, it was conceived as an instrument of mediating between politics and societal interests as for instance market forces (Knill 2001). Probably the mediating function of the state explains why the unitary nation-state of Great Britain was left without a written constitution; political institutions and the civil society were instead perceived as the constraining elements in function, concretely and continuously correcting the state through bargaining processes.



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The conception of the traditional Continental states (and the Scandinavian states via their historical belongings to this tradition) is shaped by layers, which in part counterbalance each other. As we will elaborate further in this paper, and pointed out by Christoph Krill (2001:62), the ideological conception of a state authority viewing the democratic state institutions as superior to society, today is mediated by several organisational aspects rooted in the historical development of statehood and society. Both constitutional unitary and federal states belong to the concept. Organised as an administrative hierarchy with sub-national local and regional levels, and normally with elected councils governing on behave of central authorities, 'the unitary territorial state' became a notion standing for a 'complete' and fully ended nation-building process. There was just one central state power ruling one nation; the competence of the sub-national elected councils was delimited to decide roadmaps for implementation of state policies. Contrary, in the federal state, the power was shared with the members of the federation as national associates. For that reason, from a unitary state perspective the federal nation-building process was perceived and given a status as 'incomplete', because of lack of unity (Balderheim 2000).

The EU principle of subsidiarity introduced by the Maastricht Treaty in 1991 may be seen as a following-up of the federal idea that layers should counterbalance each other (Keating 1998, Veggeland 2000, Hooghe and Marks 2001). *In accordance with the principle of subsidiarity, devolution of competence upward to the supranational European tier by agreements is recommended when greatest policy outcome and effectiveness is expected on that level. Similarly, downward devolution of competence to regional and local authorities or partnership institutions, ought to be implemented when most effective policy arrangements for regenerating local and regional economy are expected outcome on the lower levels* (Veggeland 2000, Majone 1997, Wallace 1998). Actually, also the concept of the French 1982 regional reform, 'Contrat de Plan – Etat – Régions', i.e. the notion of a negotiated state – region partnership institution that implies contractual sharing of competence between nation state tiers, seems to be anchored in the federal tradition of counterbalancing level authorities. In this modern case conceptualised as subsidiarity performed through bargaining processes and consensus, and legalised as an order of binding regional contracts (Balme and Bonnet 1995).

Often the performance of the OECD defined 'Distributed Public Governance' of the Western Europe states of today (see reference page 1) gets legitimacy from the EU defined principle of subsidiarity. The ideological reference is the value of sharing competence between a plural of public authorities and institutions as an alternative to a hierarchical order of governance (Scharpf 1999, Neyer 2002, Veggeland 2003). However, in the reality it concerns the protection of public interests due to the increasingly wide variety of public organisational forms and a deficit of democracy (Habermas 1999, OECD 2002, Veggeland 2003a). Democratic institutions and their voice channels for communication, and their protection function related to political, social and civil rights, stand against new (more output effective?) technocratic or quasi-technocratic executive authorities providing public services (Majone 1997, Weiler 1999). Therefore, what institutions serve the public interests most properly?

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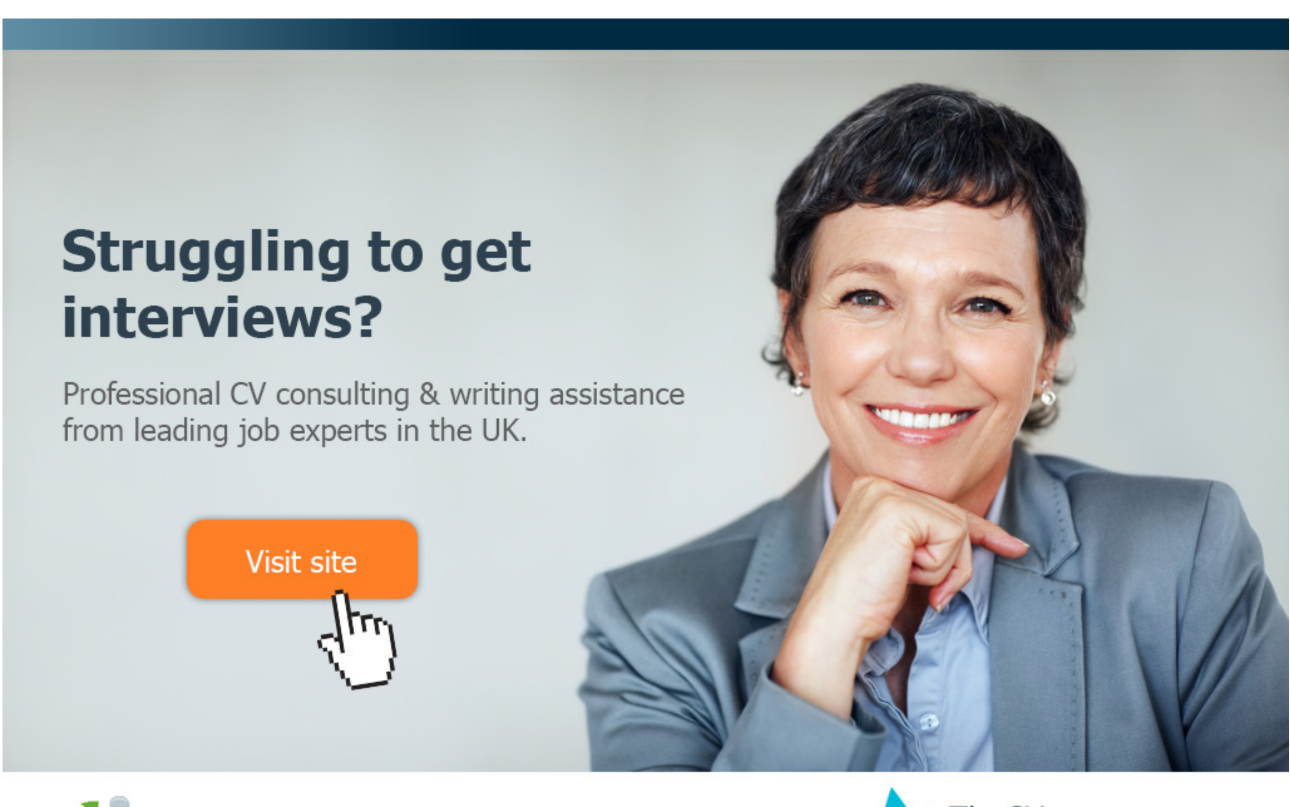
In the Continental Europe tradition it was economic backwardness and the idea of more fair social and regional distribution of the common best that led to the creation of a democratic, but strong state as part of the welfare state building processes (Flora et. al 1999). Today, 'Distributed Public Governance' institutions mean a restructured state hierarchy and public sector in general, and reflect policies for exposing public services for more market competition. In some cases it even means organisation reforms which make public service institutions being regulated by private law as enterprises and not by public law. Even so, the Continental (and the Scandinavian) thinking of the role of the democratic state still seems to be featured by the view that market functionality and competition do not automatically achieve social and regional fairness (OECD 2002, Badie and Birnbaum 1983). There is a widespread concern on the topic; 'Distributed State Governance' anchored in agencies and other authority bodies on arm's length from parliamentary control on all levels creates a democratic deficit if not counteracted (Habermas 1996, 1999, Ferrera 2000, Scharpf 1999, Eriksen and Fossum (eds) 2000, Veggeland 2001). Therefore, in terms of subsidarity, the redistribution of state governance to independent tier agencies and other New Public Mangagement (NPM) authorities is normally delimited in Continental countries. The distribution tends to be more in accordance with a model weighting representative democratic assemblies to be supreme as law makers and regulatory authorities, also on all sub-national levels of governance, in relation to technocratic agencies and public enterprises (Majone 1997, Schmitter 2000, OECD 2002, Veggeland 2003).



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Great Britain tends to be different. The country has been described as a 'stateless society' or in terms of 'government by civil society' (Badie and Birnbaum 1983:121). Here 'it was the very rapid growth of capitalism and the market that resulted in the backwardness of the state, with civil society maintaining its position of dominance…the market reigns supreme, not the state' (Badie and Birnbaum 1983:123–4). The term 'state' was and still is only refereed to at the level of international relations or in terms of "welfare state". 'Government', 'country', or 'nation' became terms of substitutes. Consequently, when the public sector became restructured in the 1980s, the reform thinking was dominated by terms as 'outcome governance', 'institutional competitiveness', 'institutional capacity', 'public-private collaboration', in order to achieve market advantages. Subsidiarity in terms of downward devolution of political power from the central government to sub-national supreme democratic assemblies was not on the political agenda (Jessop 1994, Amin and Thrift 1995, Veggeland 2000, 2003). Also the British thinking is dominated by the origin view on the state as a mediator. Here the Distributed State Governance gets its legitimacy from a constitutional model weighting *functionality* more than parliamentary legitimacy. Thus, in terms of subsidiarity, the growing number of independent state agencies appears as mediators on all sub-national levels of governance, conceptualised as the institution of functional 'public-private partnership' (Amin (ed) 1994). Therefore Bob Jessop makes the conclusion for Great Britain that "in this sense we can talk of a shift from local government to local governance. Thus local unions, local chambers of commerce, local venture capital, local education bodies, local research centres and local states may enter into arrangements to regenerate the local economy" (Jessop1994:272).

But since then, the number of local partnership has been growing to a negative critical number in terms of making democratic control feasible and governance effective. In the separate territorial unit of England distributed public governance in terms of partnership institutions now are causing threatening democratic deficit, raising transaction costs and actually ineffectiveness, because: 'The (central) government has sponsored a bewildering known total of over 2 375 multi-agency partnerships…at local level in England.' – for example, on education, regeneration, neighbourhood renewal, community safety, older people, crime, town centre, management, health, cultural activities, etc. Another 400 local strategic partnerships are being set up to play a key role in local governance, bringing together local councils, local agencies, police and health authorities, etc. (Beetham & Byrne & Ngan & Weir 2002:270.)

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3.5 The notions of Distributed Public Governance

Ideologically, the year "1992" symbolises the anticipated death of the nation-state of Europe, or at least a decisive moment in their expected transcendence (Brubaker 1999). Chosen by the former EU Commission president Jacques Delors as the target date for the completion of the Single Market, ideologically, "1992" came to stand for the abolition of national frontiers and the manifestation of a "borderless" Europe in terms of networking institutions, firms and trade markets. The date came also to stand for the emergence of European citizenship; and – with signing of the Maastricht Treaty in 1991 – the erection of the 'Committee of Regions' and the introduction of the 'principle of subsidiarity'. Together with economic and political theories on growth and democratic advantages of the up coming European new regionalism in the wake of globalisation, the Maastricht Treaty enforced the prospect of an arising "Europe of regions" (Anderson 1994, Keating 1998, Veggeland 2000). It came to be the wide range of Distributed Public Governance institutions that featured and issued this complex prospect during the 1990s.

However, the idea was to make Distributed Public Governance work effectively and democratically by lifting forward subsidiarity as the regulative principle for organising and strengthening the democratic capacity of the political, economic and cultural regions of Europe (Keating and Loughlin (eds) 1997, Keating 1998, Veggeland 2000). So far the main issue in the European integration had been devolution of decision-making competence through negotiations and bargaining processes among member states *upwards* to the EU. The Maastricht Treaty not only challenged the member states by introducing more supranational competence, but also in terms of challenging the national state to perform *downward* devolution to the regions (Neyer 2002).

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Of course, for Jacques Delors the French regional contract model for devolution and decentralisation, as he knew very well as former minister in France, represented both an option and a concept for redistribution of public governance, institutionalised as public-public partnership (Loughling and Mazey 1995). It concerned the establishment of an agreement-based multi-level-governance system functioning in accordance with the principle of subsidiarity. The model conceptualised a sub-national tire with agreement-based political competence, with the necessary capacity to function in the EU intended multi-level-governance system featured by subsidiarity. From that point of time the Union required an organised level with regional authorities and effective executives as actors and responsible negotiators in partnership with other authorities working out development programmes. Without such authorities, the regions and the states were excluded from benefiting from the Structural Funds and other EU Commission regional policies. However, the EU was not given any supranational competence to regulate how the member states should organise and institutionalise the Distributed Public Governance on regional levels; that remained a national state matter of responsibility (Veggeland 2002). Consequently, organisational and administrative traditions come to influence the restructuring processes in the member states when public governance was distributed downwards and new institutions were build. Resent studies show that what OECD (2002) has designed 'Distributed Public Governance' has become an immense issue, because of the wide variety of state authority organisational forms on regional level, such as agencies, service enterprises, partnership and other government bodies. Besides these institutions relation to regional democratic assemblies is very complex in Continental Western countries were such assemblies still exist in accordance with their administrative tradition (Scharpf 1999, Veggeland 2003).

The contributors to the OECD report (2002) has observed that institutions of Distributed Public Governance challenge the democratic order on all administrative levels in three ways (2002):

- Elected tier assemblies and governments have become political weakened, while technocratic executive authorities have gained more dominant power. Accordingly, the abdication of representative political authorities creates a deficit of input democracy, accountability and legitimacy (Scharpf 1999).
- Agreement-based governance and legal partnership institutions are replacing representative government institutions. Negatively expressed by Michael Keating (1998:47) as: 'governance is what exists when government is weak and fragmented', meaning fragmented governance performed by independent authorities replaces holistic government.
- Policies get its legitimacy first and foremost from functionality, effectiveness, i.e. from the output or outcome of executives, and from comparative competitive advantages which benefits from 'locked-in' internal management. That challenges the democratic principles of openness, transparency and a deliberative polity (Eriksen and Fossum (eds) 2000). Let us look at a figure illustrating the principles of both input and output democratic challenges (Veggeland 2003):

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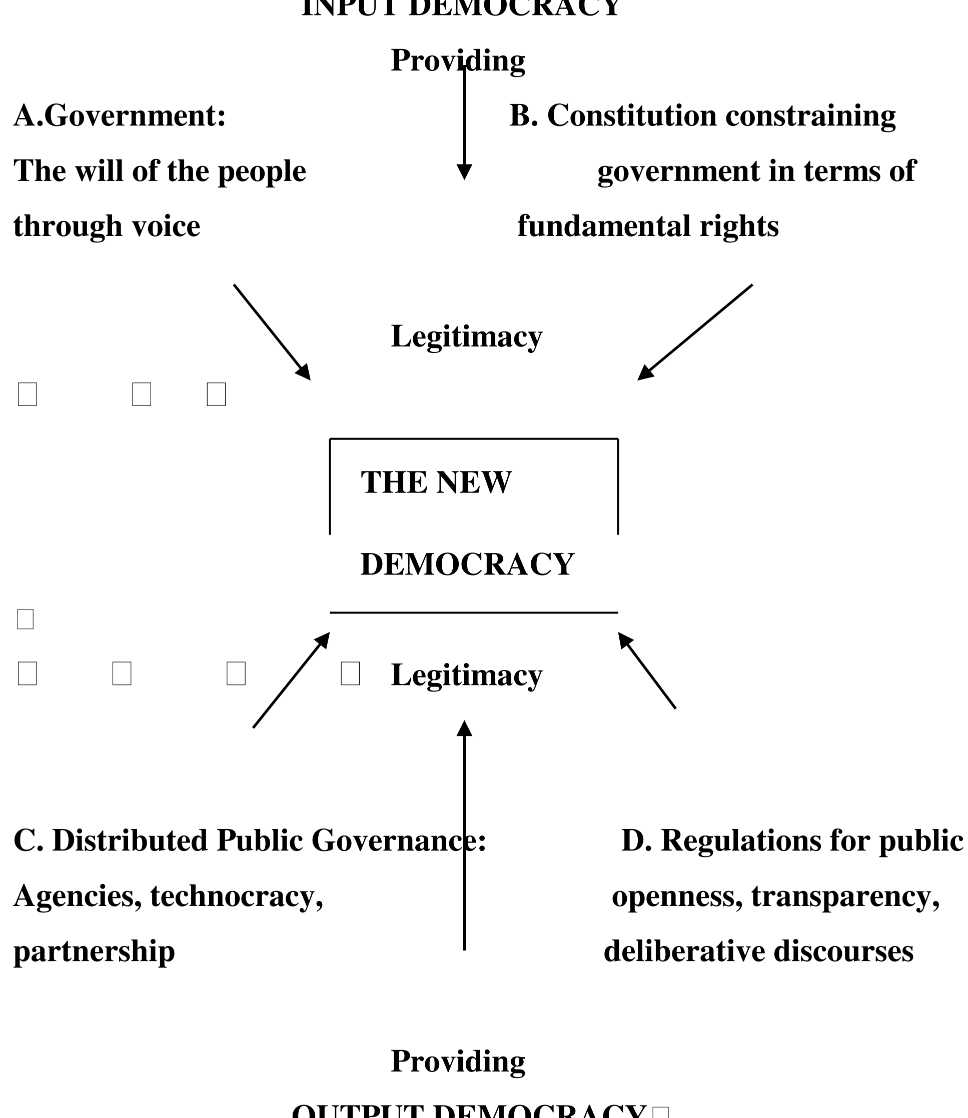

Figure 1: Institutions of the New Democracy:

Fig. 1 with its four basis institutions illustrates the democracy of our time. However, according to the OECD report (2002), the democracy is threatened from two sides: from the Distributed Public Governance type of institutions and from 'locked-in' management undermining the principles of openness, transparency and deliberative discourses. On the one hand elected bodies and governments tend to abdicate from governance and transfer authority to institutions of type C, on the other hand the technocratic executives suffer from transparency and public insight into their agendas and management procedures. Obviously, the reasons for this threatening deficit of democracy are unnumbered, but may altogether be linked to globalisation processes, the 'borderless' network society, and the specific competition policies of each of the Western nation-states (Habermas 1999).

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The EU is in the process of getting a Constitution Treaty in 2004 (Fossum 2003). The member states seem to be very well aware of the challenge of meeting the threat of the democratic deficit by constitutional reforms and restructuring actions (Van den Burg 2002). Even though their historical tradition of state governance is fundamental different in their origin; the state as superior to the society (Continental tradition) or more functional as a societal mediator (British tradition), appropriate solutions must be found. And studies are showing changing priorities. The OECD report (2002) observes 9 countries, including France, Germany, the Netherlands, Spain and Sweden from Europe, on 'Distributed Public Governance'. It is of wide ranging interest when it concludes that there is a change of policies going on, *'from the drive to create agencies, authorities and other government bodies to the challenge of achieving good governance' (2002:21). Further, 'The creation of Specific Public Law agencies and administrations and their twins Private Law Bodies seems to have come to a stand-still in many countries' (2002:22).* This is the new trend in Europe.

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Here are some of the paragraphs from where the OECD report draws its conclusions. The following facts from the studied countries are issued:

- In most countries, and in terms of the new democracy principles, priorities have moved away from the inclination to create new independent and separate bodies. Now the challenge seems to be finding the right balance between accountability, autonomy and management of the existing independent agencies and bodies through more openness and transparency, as well as by strengthening the steering capacity of governments (2002:21).
- The new independent technocratic entities allow governments to avoid taking political decisions or to take decisions guided only by technical expertise on issues that require a political choice and are at the core of political responsibility (2002:22).
- The lack of clarity about the differences between the various types of agencies, authorities, enterprise institutions makes it unclear whether the best organisational forms have been chosen for the various purposes of government (2002:24). Standardisation measures are implemented.
- Governmental monitoring efforts and control of the independent public entities are become more difficult. Despite reporting procedures, and even though using neutral agencies for legal surveillance, the different types of relationships, and the different types of control and accountability mechanisms of the bodies, make accurate control almost impossible (2002:25).
- The lack of clarity of the institutional system potentially undermines citizens' trust in the systems functions (2002:25).
- Need for clearer criteria for establishing different types of boards – advisory, management or governing boards, and their respective responsibilities – are acknowledged. There has been criticism of lack of transparency surrounding the appointments of board members, their salaries and other benefits. Or the criticism has focused the lack of representativity of the members in terms of gender, ethnic and local background (2002:25).
- The independent bodies are seen as functioning outside the political debate with little oversight from ministers and ministries and weak accountability arrangements. The parliaments are neglected, and so are individuals and the institutions of the civil society. Conclusion: Weak accountability mechanisms undermine the legitimacy of governments and parliaments (2002:26).
- Finally: Weak co-ordination mechanisms and coherence failure threaten effective public service production in terms of 'best value' to individuals, social groups and corporate interests, because of fragmented governance (2002:26).

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To explain the last paragraph on weak co-ordination mechanisms we may refer to what has been called Scharpf's Law (Hooghe and Marks (2001:5): 'As the number of affected parties increases…negotiated solutions incur exponentially rising and eventually prohibitive transaction costs' (Scharpf 1997:70). In the system of Distributed Public Governance the problem of technical, communicative or legal co-ordination of the many actors and bodies escalates immensely with numbers, and the transaction costs will at last be excessive, according to Scharpf's Law. In this perspective the weak co-ordination mechanisms of the reporting countries are not a failure adhered to bad performance of public governance, but a *consequence* of the Distributed Public Governance system itself (Veggeland 2003). Therefore, according to the OECD report (2002), there i a growing focus on *good governance and more coherent public services*, i.e. on policy and structural coherence solutions, including making the autonomous bodies work on joint projects and in public-public partnership. Further, the focus of the involved states in the study is reported to be on endeavours: (a) Avoiding the creation of new independent agencies, public service enterprises and autonomous bodies. (b) Involving the civil society and the governments more in governance. (c) Improving the parliamentary control over activities for the reason of more holistic responsibility. And lastly, (d) there is a growing political will to make the overall system more legible and accessible to people, and the accountability mechanisms, activities and performance more easily controllable by parliaments, on all tiers and in accordance with the principle of subsidiarity.

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3.6 Regionalization

A. Regional Distributed Public Governance: the Continental tradition

Continental political regionalization in its origin may be said to be vertical organised with the central state as the superior power. Regions were first and foremost executives of national state's policies. However, as elaborated in this essay, under the umbrella of EU regulations a process of devolution of state competence to regions commenced in the 1980s. Downward devolution became a Treaty regulation i 1991, and was named 'the principle of subsidiarity' (Gidlund and Jerneck 2000). Along with this principle, public governance was not only distributed to regional governments, but even more to independent agencies and other government bodies as we have seen the OECD reports (OECD 2002, Veggeland 2001a, 2003).

As pointed out, the EU structural order of this specific downward devolution process didn't occur by a coincident. The former French minister, Jacques Delors, now from his new position as president of the EU Commission, and in the spirit of subsidiarity, initiated the system of Distributed Public Governance in the context of the idea of an arising new regionalism in Europe (Veggeland 2000, Keating 1998). The administrative method was contractualisation of agreements on shared competence, responsibility and financial obligations between region, central state and the EU (Balme and Bonnet 1995). The background model was the French planning bill, adopted on 29 of July 1982. The bill erected a representative regional parliament, and in accordance with the French constitutional tradition as a superior authority in selected competence areas (Loughlin and Mazey (eds) 1995). The regional government was made the legal basis for contracting support from independent public and private actors when needed in regional development programmes. The bill asserted that the vocation of the region especially was to work out holistic regional plans and co-ordinate public establishments (Établissements publics) and independent administrative authorities (Autorités administratives indépendantes) through state – region partnership (OECD 2002). The reform was founded on the new regional institution named 'Contrat de Plan – Etat-Régions' (Balme and Bonnet 1995). This created a new style of politics based on negotiations and mutual responsibility between regional and central democratic authorities. The decentralisation impact of the reform formally changed the status of the regions. The regional government institutions created a traditional voice option, and the public-public partnership institution, the 'Contrat de Plan', eased the co-ordination problem and reduced the transaction costs (Scharpf 1997). Additionally, instead of being an extended arm of planning and implementation of national policies for the central state, the region became a legally defined territorial level with voice and self-regulatory competence anchored in the negotiated state-region partnership. Thus, the reform restructured co-operation arrangements between the state and regional/local authorities and readjusted their contributions to more effective sector policies. Planning contracts established through the two-tier bargaining process defined common objectives and programmes, and secured financial co-operation on a pluri-annual and legal basis. It may stand as an example of how the principle of subsidiarity was performed in French political praxis, and in accordance with the democratic and administrative tradition of this specific national state (Loughlin and Mazey 1995).

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However, during the 1990s the democratic 'Contrat de Plan' regional institution has undergone a metamorphosis. The purpose of the domestic 'intergovernmental' contractualisation of state – region relations was clearly ambiguous. Thus, may be not too strange, studies show that the emphasis has steadily moved from regional politics to contracting as an institutional technique targeting implementation of national sector policies and competition policies (Balme and Bonnet 1995:69). Distributed Public Governance linked to the many independent agencies and other service and development bodies undermines the steering capacity of the regional governments. The partnership institution, 'Contrat de Plan', tends to become a governance measure for mobilising the regions behind policies of the decentralised independent state authorities, rather than a mechanism to provide support for autonomous regional policies, democratic self-government and local voice. Yet, the OECD report (2002:71–97) indicates that in France there is now a political will to counteract these trends from the 1990s, not only by making regional governments superior to the Distributed Public Governance institutions, but also to strengthening the steering capacity of the representatives elected regional assemblies. Besides, in terms of the new democracy principles, France has taken action to create policy and organisational coherence concerning the structure of independent agencies and other service bodies. The objective is to make them more transparent, legible and accessible for regional planning authorities and the civil society.

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B. Regional Distributed Public Governance: the British tradition

As such, contractualisation and regional partnership formations constitute a new institutional mechanism designed to ensure co-operation of a wide variety of independent public actors. After all, the main policy aim of the regional partnership formations and the purpose of subsidiarity are to achieve competitive regions and economic growth. These objectives imply measures and political endeavours for building strong regional governance structures to actuate economic mobilisation and innovation (Veggeland 2001a, Keating and Loughlin (eds) 1997).

In line with this fact, in Great Britain with its mediating state tradition, independent state agencies (Next Steps Agencies) and 'non-departemental public bodies', often in public-private partnership, have dominated the regional authority configuration (OECD 2002:209–241). The regional agenda emerged through a complex agenda of many different determinants (Webb and Collins 2000). During the 1980s, in the wake of market-liberal ideologies, the region was perceived as the most appropriate level for economic developments, and therefore for new regulatory policies. The question of local democratic accountability was coming as "something of an afterthought" (Anderson and Mann 1997:282). Mainly, the rise of a "me too" regionalist movement in Britain came in response to the perceived success of dedicated development agencies in Scotland and in Wales. Additionally, drawing inspiration from success stories, such as those of the Third Italy and Baden-Würtemberg regions, a general consensus emerged that economic restructuring processes were best organised around strategic public-private partnerships and market effective, decentralised regional development agencies of the central state (RDAs) (Webb and Collis 2000). Elected regional assemblies were perceived to be redundant. The RDAs role as actors in public – private partnership and as the institutional base for programming and contracting has been criticised for two principal grounds. The first criticism relates to the issue of accountability, despite obtained independence though state subsidiaries, too much power and authority is retained at the central state level. Negotiations and bargaining processes between central state and decentralised state agencies imply agreements and contracts, which primarily promote national development interests rather than local interests (Healey 1997). The second criticism relates to the overwhelming business-led interest, which permeates the government's regional agenda for Distributed Public Governance. However, success stories fail to appear in regional Great Britain. The fragmented regional state authorities as mediators in development programme and the absence of holistic government responsibility may be the reasons for the failure. The underlined fear expressed is that the narrowly conceived political focus on fragmented technocratic agencies as instruments for promoting competitiveness, most likely will not achieve economic success. Besides the organisational form undermines and threatens holistic decision-making and democratic legitimacy. The performance of policies seems to suffer from co-ordination failures, large transaction costs, and the absence of local mobilisation of human capital and economic innovation (Gibbs 1998, Scharpf 1997, Veggeland 2003).

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The inhered democratic deficit problem of this criticism, expressed as the missing of regional government and holistic planning authorities, has only recently been really issued by the central government, probably as a political consequence of the offensive Third Way (Giddens 1998). According to the OECD report (2002) there are no signs of organisational changes also in Great Britain. Most likely the latter will happen in some way, of course in accordance with the country's own democratic and administrative tradition.

C. Regional Distributed Public Governance: the Norwegian case

Norway is a none-member country of the EU, though member of the European Economic Area (EEA) and signature country of the Schengen Agreement. The nation-state of Norway belongs historically to the Continental democratic and administrative tradition (Gidlund 2000). The fragmentation process of the national state hierarchy and the shaping of policies for Distributed Public Governance commenced quite late compared to other OECD countries. There are a few examples of special public law and private law bodies from 1992, but it was at the end of the decade the number increased heavily; about 40 in total in 2002 (organisational form narrowly defined) according to ministry (AAD) calculations. Some of the bodies are organised in regional mode and function on arm's length from central government, but totally unlinked from regional authorities and elected assemblies (Veggeland 2003). Well known examples of the latter type are some service institutions, found in the health sector, 'Regional Health Enterprises' organising and drifting the Norwegian hospitals, and in the labour market sector providing vocational aid and mediation of jobs, the Aetat. It is also found in the infrastructure sectors such as road, railway and post, and in the regional policy sectors organised as development agencies, such as SND and SIVA. The reasons for the establishments are well known, and reported in the OECD-report (2002) as policies implemented in order to improve the efficiency, the flexibility and the effectiveness of specialised state functions and services. The policy is targeting improvement of the legitimacy by hoping increased output or outcome from invested taxpayers money in public services (output legitimacy). The measures are the organisation mode of independent institutions made exposed to competition. Specialists, experts and other technocrats have expanded their competence and their steering capacity, on the cost of parliamentary governance. In line with other EU states, Norway has become confronted with the democratic deficit problem (Veggeland 2003, 2003a).

Our point of departure is that Distributed Public Governance threatens the democratic order. Therefore, as the OECD report (2002) describes, many governments now realise that managing from a distance has created specific accountability and control problems, and have started focusing on improving the governance of these bodies, claiming more coherence, openness and transparency. In this paper we have studied some sub-national cases and elaborated how the democracy challenge has been met at the regional level, i.e. how the principle of subsidiarity has been implemented in this context. What features the restructuring processes on the sub-national level in Norway?

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In Norway, the devolution and distribution of public governance seems to be in a process which imply weakening the competence of the existing democratic regional unit, the 19 'fylke' municipalities, or even dismantle them (Veggeland 2002). Since the 1990s the fylke municipality has been criticised on two principal grounds. The first relates to a welfare perspective that a democratic regional unit is redundant, that the state and the municipalities might very well take over its welfare producing functions and its public management responsibility. Accordingly, in 2001 the 'fylke' municipality lost its responsibility for the dominating hospital sector to the mention Regional Health Enterprises, with the central state as the formal owner. The second criticism relates to inefficiency, to its role and function as the principal and responsible authority for regional planning and development. The central government perceives independent regional agencies, service enterprises and other government bodies to be in a better position to take over as regional state authorities. A new role for the democratic regional tire has been defined. The role is to become one of a wide range of other regional developments actors in a fragmented configuration of specialised independent development agencies, service enterprises, and other government bodies. Partnership is the recommended organisational principal. Responsibility for holistic concerns should be adhered to central authorities, and in the long run, let the elected regional assemblies obtain redundancy. The government perceive these governance structures as the new regional authority structure for the future (St.meld. nr 19 (2001–2002). Certainly, it is in accordance with the EU formal demand for a regional level in order to obtain financial support from its Structural Funds and Interreg policy measures, but the thinking deviates from the organisation and regionalisation features of the Continental states.

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Instead, it is in line with what happened in Great Britain where the independent state bodies and the establishment of public-private partnership institutions dominate the restructuring processes. It means linking off the region's development and holistic planning responsibility from the regional democratic assembly (fylkestinget), and redressing the authority to the independent bodies and their local partnership institutions. As we have learned from Great Britain – and France, it will certainly lead to the dominance of national development goals and make planning a narrow sector act. Actually, the empowerment of the regional state technocracy without a holistic responsible and regulating regional government authority, most likely will lead to less efficiency and effective outcome of invested taxpayer money (Veggeland 2003a). As we know from other countries, surely, the failure of co-ordination and the problem of increasing transaction costs will reduce economic competitiveness and the advantages of the new regionalism (OECD 2002, Veggeland 2000). It may seem remarkable, but the new fragmented authority model for exercising Distributed Public Governance and regional development policies in Norway today has all the features from the described British model. The state authorities on all levels function more as mediators than principal and holistic decision-makers. Dominating market liberal competition ideology seems to have determined the choice of regional governance structure, not the Scandinavian (and Continental) democratic and administrative tradition. Formally the principle of subsidiarity may be identified as Distributed Public Governance. However, the devolution of competence happens more as an 'outward' transfer of authority to independent institutions and other markets actors than as a 'downward' principle adhered to mutual transactions between domestic governments. This fact features the deficit of democracy in the Norwegian polity (Veggeland 2003, OECD 2002).

3.7 Conclusions

The EU principle of subsidiarity introduced by the Maastricht Treaty in 1991 may be seen as a following-up of the historical democratic state idea that territorial layers and authorities should counterbalance each other. Accordingly, the EU recommends devolution of competence and steering capacity upward to the supranational European tier by agreements when greatest policy outcome and effectiveness is expected on that level. Similarly, downward devolution to regional and local authorities and partnership ought to be implemented when most effective policy arrangements for regenerating local and regional economy are expected outcome on the lower levels (Veggeland 2000, Majone 1997, Wallace 1998). The EU constitutes an agreement-based multi-level-governance system. For regions and states to achieve benefits from the structural policies of the EU, the EU requires a level for regional authorities as responsible negotiator and actors in partnership, and as effective executives of development programmes.

Implementation of the principle of subsidiartity demands not a specific organisational form of Distributed Public Governance. The latter defined by the OECD report (2002) as a devolution process that today dominates, and is featured by a wide variety of independent authorities, in terms of state agencies, service enterprises and other government bodies. This created a new style of politics and subsidiarity: 'outward' devolution more than downward devolution of competence.

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According to the OECD report this new style of politics is under reconsideration in European countries, because 'governments now realise that managing form distance has created specific accountability and control issue' (2002:10). Especially on sub-national levels elected tier assemblies and governments have become weakened, while technocratic executives authorities have gain more dominant power. That creates a deficit of input democratic, legitimacy and accountability. The new type of policies get its legitimacy first and foremost from output or outcome, from functionality, effectiveness, and competitive advantages, while suffering from missing democratic principles of openness, transparency and deliberative discourses**.**

However, the new style of politics is not uniform, because it is anchored, at least in principle, in two different historical conceptualisations of the state function in Western European states (Knill 2001). In the Continental European democratic tradition credence was given to the idea of the state as an abstract identity, as something different from the society, bearing inherent responsibility for the performance of public functions or as a collective actor representing the society as a whole. The British tradition is different, and closely related to the historical evolution of a state identity which is said to reflect 'an aberrant case' (Dyson 1980:36). Rather than ideologically looking upon the state as a top – down authority responsible for the common best, it was conceived as an instrument of mediating between politics and societal interests like for instance market forces (Knill 2001).

This difference concerning democratic and administrative traditions is especially reflected when it comes to the institutional forms of distributed public governance arrangements on sub-national levels. The French 1982 regional reform introduced the model 'Contrat de Plan – Etat – Région'. The model conceptualised contractual sharing of competence between central and regional governments. The model seems to be anchored in the Continental tradition (Balme and Bonnet 1995). Despite structural policies organising independent state bodies and technocratic authorities, the steering capacity of regional government and parliament institutions were expanded. The objective was to counteract the democratic deficit problem, and the public-public partnership institution was meant to ease the co-ordination problem and reduced the transaction costs caused by many actors (Scharpf 1997).

The British arrangement is different, and obviously reflects this country's tradition. Here the Distributed State Governance gets its legitimacy from a constitutional model weighting *functionality* more than parliamentary legitimacy. Thus, in terms of subsidiarity, the growing number of independent state agencies appears as mediators on all sub-national levels of governance, conceptualised as the institutions of functional 'public-private partnership'. In line with this fact, in Great Britain with its mediating state tradition, independent state agencies (Next Steps Agencies) and 'non-departemental public bodies', often in public-private partnership, have dominated the regional authority configuration (OECD 2002:209–241).

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Of historical reasons also Norway belongs to the Continental democratic and administrative tradition. However, the governmental implementation of the new style politics on the regional level may be said to be aberrant. The model for exercising regional development policies in Norway today reflects mostly the British model of the state as a mediating authority. The principle of subsidiarity is political interpreted as outward distribution of public governance to independent state bodies and technocratic authorities, while downward devolution of the steering capacity of the regional assemblies is greatly weakened. Regional development measures have become the output of national sector policies leaving the polity of the region unable to communicate and evaluate initiatives through deliberative processes. In Norway the distribution of public governance to regional agencies, service enterprises and other bodies has created the deficits of co-ordination and planning authorities, institutional coherence and democracy, for the time being without any counteracting measures (Veggeland 2003, OECD 2002). In contrast to what the OECD-report (2002) reports, the Norwegian central government seems to have not yet discovered the specific democratic, accountability and control issues when public governance is distributed to independent agencies, technocratic authorities and other public bodies. The government policy seems to be lacking behind in relation to trends in other Western European states, if the OECD report (2002) conclusions are chosen as the basis for comparison.

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4 Defining Democracy

Introduction

The principle of subsidiarity was formally introduced as a principle of intention in the 1991 Treaty of Maastricht that recognized the devolution of competence, i.e., 'decision-making to be performed at the lowest possible effective administrative level' in the European multi-level system of governance. The rhetoric deployed on behalf of the principle of subsidiarity elaborated it and strongly suggested that it was, as it were, a principle of 'nearness' to the people, implying a more bottom-up form of governance and a more democratic mean of voicing opinions. But in what kind of framework should 'nearness' take place? Should it take place within the framework of the devolution of competence to elected national assemblies and the emancipation of constituencies? Or should it be applied within the framework of the regulatory stat that makes use of national and international arm's-length agencies and other governmental bodies in its governance approach? The paper gives answers to these questions, and examines how different approaches to the concept of democracy transform governance structures.

4.1 Democratic models

As a point of departure we may examine reforms that have brought regulatory post national authorities into powerful positions. Those authorities are not directly executing 'democratic government by the people'. By contrast their output perspective tends to emphasize 'government for the people' (Scharpf 1999: 6). Not representative in the classical democratic sense supranational authorities dominate political arenas, such as the European Union (EU) in Europe. Contextually Fritz Scharpf adds though (1999: 27): 'It may be an exaggeration to conclude that this implies 'the end of democracy', but the loss of authentic and effective self-determination seems significant and visible enough to explain the present sense of malaise in democratic politics'. Reforms have created the regulatory state and its institutions. Reliance on regulation rather than parliamentary decision-making, public ownership, centralized planning or administration characterizes the methods of the regulatory state (Majone 1997, 1994, Veggeland 2010). It is decisive though that the execution of governance by the institutions of the regulatory state in some way is rooted in the will of the people. Maybe it is this approach Robert Dahl is thinking of when he writes (1989: 350): '[N]ew democracy in a world we can already dimly foresee are certain to be radically unlike the limits and possibilities of democracy in any previous time or space.' We may suggest the following configuration of different models appearing across the modern polity.

	Government consisting of elected assemblies	**Governance consisting of not elected agencies**
Governmental institutions	1. Parliamentary system	3. New democratic system
Regulatory state institutions	2. New democratic system	4. Autocratic system

Table 1: Government and governance systems or models.

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The actual government and governance systems or models of the new democracy are expressed in Table 1. By following Robert Dahl's suggestion, the model 1, the classic democracy of origin, does not exist anymore in the modern world. The rise of the regulatory state has generated model 2 and 3, shown in Table 1. These models are mixed models. In some western states, like the Nordic countries, there is an administrative tradition for subordination regulatory institutions governmental authorities, model 2, while in other countries, like the Anglo-Saxon countries and the EU, there is an administrative tradition for giving preference to regulatory state institutions, named here as model 3 (Knill 2001, Veggeland 2007). What it is all about is giving preference or not to government by the people or New Public Management (NPM) based governance. For example the European community in its very beginning, i.e. from 1952 until its first direct election of representatives to the Parliament in 1979, was essentially based on an autocratic system, as model 4 indicates. The not elected representative of the Council of Ministers decided regulations, regulations which were implemented by the regulatory institution of the Commission of the Community (Kjær 2004, Veggeland 2010). After the Maastricht Treaty of 1992 the EU was transformed by reforms to be characterized by model 3, and a new form of democracy was introduced (Veggeland 2003).

4.2 Subsidiarity; democratic approach or just distributed public governance?

We can recognize the principle of subsidiarity in the Treaty of Lisbon in 2007, or the 'Reform Treaty', (which should not be confused with the Lisbon Process of 2000), which member states signed and ratified in 2008. The Treaty of Lisbon entered into force on 1 December 2009. The Treaty should in our context be look upon as a contribution to more democracy in the EU – The Reform Treaty pursues the statement of the principle of subsidiarity in the Treaty of Maastricht. In the Treaty of Lisbon, the principle of subsidiarity is supposed to become legal in the sense that member states may appeal the decisions of the European Commission to the European Court of Justice if they find reasons for there have been a violation of this principle; supranational decision-making on a certain issue has been unnecessary and un-legal. The decision-making competence is meant to belong to a national level of administration. This treaty proposes certainly, in its context, both an administrative and a democratic reform endorsed by the EU, and promoted within the framework of the regulatory state (Veggeland 2010).

The principle of subsidiarity was formally introduced as a principle of intention in the 1991 Treaty of Maastricht that recognized the devolution of competence, i.e., 'decision-making to be performed at the lowest possible effective administrative level' in the European multi-level system of governance. The rhetoric deployed on behalf of the principle of subsidiarity elaborated it and strongly suggested that it was, as it were, a principle of 'nearness' to the people, implying a more bottom-up form of governance and a more democratic mean of voicing opinions (Weiler 1999).

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But in what kind of framework should 'nearness' take place? Should it take place within the framework of the devolution of competence to elected national assemblies and the emancipation of constituencies? Or should it be applied within the framework of distributed governance that makes use of national arm's-length agencies and other governmental bodies (OECD 2002)? Or could it be that nearness should really be in the framework of public-private-sector business actors meaning more free economic competition in the Single European Market?

Actually, the Maastricht Treaty did not precisely define the status of the principle of subsidiarity. It is clear enough, however, that the principle from its very beginning was not announced as a regulation endowed with judicial status. Despite this, political plaudits and promising panegyrics attended the announcement of this principle, a principle of administrative governance intended to champion the advancement of democracy by authorizing national levels and tiers (Veggeland 1995, Commission of the European Communities 1997). However, this latter goal was not at all clear given. The Treaty has only an evasive answer to the question of which framework is 'nearness' supposed to flourish. Does subsidiarity really indicate the commonly believed 'downwards' devolution of authority to national parliaments and to locally and regionally elected councils? If so, then it clearly indicates an intention to promote democratic practices in the EU through the administrative reform of subsidiarity, and in accordance with model 3 in Table 1.

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Or does the intended democratic reform simply indicate an '*outwards*' distribution of public-governance authority? An 'outwards' distribution, as defined by the OECD (2002), is one that confers governance to independently organized public agencies, unelected authorities, and other regulatory governmental bodies and is a sign of democratic deficit because they are only under indirect democratic control. Outward distribution of governance relates to the model 4 in Table 1.

Another possibility is it that the only intention of the Maastricht Treaty was to make subsidiarity a regulative idea for how decision-making processes in the EU ought to function, and thus its status is really not one of democratic reform in an institutional sense (Weiler 1995). The introduction of this principle could have been, as we shall see, a response to the need to accommodate conflicting administrative traditions, like the Continental and the Anglo-Saxon traditions (Knill 2001); the role of subsidiarity was to prevent the wearing away of the diversified administrative practices within the EU. Consequently, the idea of subsidiarity had to be defined in an equivocal and vague manner. Inter-governmentalists would probably claim that this intended obscurity was aimed at avoiding conflict, while neo-functionalists would perhaps interpret this vagueness as a way of letting 'spill-over' effects determine the progress of the idea in actual practice (Rosamond 2000).

4.3 Making the EU competence more democratic through subsidiarity

Anyway, during the 1990s the EU member states acknowledged the principle of subsidiarity as an official term, which most likely occurred merely because of the diffuse status of the principle. However, in the new EU regional policy framed by the Maastricht Treaty, and seemingly without any connection to the principle of subsidiarity, the member states were enforced to institutionalize and authorize an independent sub-national tier between the state and the local level (Williams 1996). The introduction of this new tier was secured through dictates that made this sub-national involvement in development initiatives a compulsory condition for member states' receiving money allocated by the EU's Structural Funds. This was not really a conflicting reform issue, because there was no talk about the devolution of democratic authority downwards to an elected assembly; it was simply a supranational assertion to participate in the regional administrations.

We have indicated that the member states had different understandings of the policy implications of subsidiarity, but they also had conflicting conceptions about regional institutions and administrations, owing to the competing ideas of federalism versus inter-governmentalism, nationalism versus regionalism, and governance by governments versus governance by unelected arm's-length bodies (Vibert 2007). However, they all shared a common interest in making the increasing supranational EU competence more palatable and more democratic legitimate for their respective populaces. Subsidiarity as a marketing device linked the notion to a political agenda focusing bottom-up governance together with the strengthening of governmental agencies and bodies but also with the administrations for regional development.

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In the signed Treaty of Lisbon, the status of subsidiarity in relation to the future regulatory governance of the EU continues to elude a concrete definition, despite its upgraded status to that of a legal regulation. There is only a suggestion of a new, diffuse mechanism to monitor acts of subsidiarity, accompanied with the stronger encouragement for citizens to bring forward new policy proposals and a clearer categorization of tier competences. What follows is 'a glance', provided by the EU, of these competencies:

- 'A *strengthened role for the European Parliament*: the European Parliament, directly elected by EU citizens, will see important new powers emerge over the EU legislation, the EU budget and international agreements'.
- 'A greater involvement of national parliaments: national parliaments will have greater opportunities to be involved in the work of the EU, in particular thanks to *a new mechanism to monitor that the Union only acts where results can be better attained at EU level (subsidiarity).* Together with the strengthened role for the European Parliament, it will enhance democracy and increase legitimacy in the functioning of the Union'.
- 'A stronger voice for citizens: thanks to the Citizens' Initiative, one million citizens from a number of Member States will have *the possibility to call on the Commission to bring forward new policy proposals*'.
- 'Who does what: the relationship between the Member States and the European Union will become clearer with the *categorization of competences*'.
  (www.europa.eu/lisbon_treaty/glance/index_en.htm – the italics are the author's)

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Probably for the same reasons as was the case regarding the Treaty of Maastricht, we may interpret this vagueness as stemming from different national democratic traditions and fundamental policy disagreements over the issue, see Table 1. Accordingly, the Treaty of Lisbon continues this trend. Thus, the implications of the EU principle of subsidiarity for democratic and administrative organization at the national level are unclear, while related measures, arrangements, and organizational forms for reducing the EU deficits of democracy and legitimacy are heavily biased subjects (see quotation above). Yet, organizational adjustments of national governance to new administrative conditions in the EU are left as an area of competence for each member state to decide.

Moreover, if member states are to be able to determine whether or not subsidiarity is practiced properly, i.e., whether a practice has 'successfully' promoted democracy and legitimacy or has been a 'fiasco' resulting in less efficiency and transparency (Scharpf 1999, Veggeland 2009), say, in relation to the monitoring mechanism, then there is a need for criteria against which they can assess whether a practice has been legal or illegal, successful or deficient, ethically acceptable or unacceptable. Or will these criteria be formed and implemented through ad hoc decisions made by the EU Court of Justice on Law and new regulations? The answer may very well be yes, for it would be a style in keeping with regulatory regimes like the EU, a style marked by democratic deficit (Kuper 2006).

From another point of view, it may seem incredible that the Treaty of Lisbon neither focuses on nor issues any statements on the national conditions for sub-national, bottom-up democracy, if we consider the fact that in this context it is almost impossible to make a clear distinction between member states' internal hierarchical systems and the EU multi-level system of governance (Veggeland 2003). The distinction is so unclear as to make the distinction between a country's central-state governance and sub-national governance difficult. Structures of governance at the tiers reflect each other in one or another way because of democratic and administrative traditions and networking games, which create institutional multi-level coherence with many of the actors' networks, though they are influenced by administrative traditions (Veggeland 2003). Fritz Scharpf calls this 'Politikverflechtung' (Scharpf 1999).

In the context of subsidiarity, let us explore two democratic and administrative traditions, the Continental and the British traditions, in two EU member countries, the former tradition exemplified by France and the latter by Great Britain.

The Continental European democratic tradition, with France as an example, gives credence to the idea of the state as an abstract identity, as something different from society, bearing the inherent responsibility for the performance of public functions or being the collective actor representing the society as a whole. Table 1, model 2, is here a relevant reference. Further, in this perspective of being a collective actor, even the representative democratic state could preserve its exclusive responsibility for the common best only by introducing certain constitutional modifications. The state's intervening into societal developments 'from above' should, however, be constrained by the safeguarding laws and regulations of subsidiarity, and first and foremost by a written national constitution (in German 'Rechtsstaat').

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In this context the British tradition is different and closely related to the historical evolution of state identity, which is said to reflect ‘an aberrant case’ (Dyson 1980:36). Rather than ideologically looking upon the state as a top-down authority responsible for the common best, this tradition conceive it as an instrument of mediating between politics and societal interests, for instance, market forces in a bottom-up order of subsidiarity (Knill 2001). Table 1, model 3, is the relevant reference here. The mediating function of the state probably explains why the unitary nation-state of the United Kingdom (UK) lacks a written constitution; political institutions and civil society are instead perceived as the constraining elements, concretely and continuously correcting the state through bargaining processes.

4.4 Confirmation of two hypotheses

Thus, *the first hypothesis* might be that different state administrative traditions have profound organizational effects on related sub-national institutional order owing to path-dependence (Pierson 2004). The implementation of subsidiarity in the Continental administrative tradition manifests as a downwards devolution of competence to elected assemblies (Pindar 1993), in the Anglo-Saxon tradition it translates into distributed public governance in the form of the outward transfer of competence to arm’s-length public administrations and other governmental bodies (OECD 2002). This hypothesis seems to be confirmed to some extent by the following two cases.

In France, the administrative reform of 1982 fused 100 central state controlled ‘prefectures’ into 22 regions (plus 4 overseas units). The new regions were organized democratically, with elected assemblies in superior political positions, in accordance with the Continental administrative tradition. They became formally responsible for regional economic development and were accorded the necessary legal status to negotiate partnership with state representatives. Their regional governments attained the function of governance and administrative capacity anchored in mutual public-public partnership, with the central state as the partner. Each regional partnership was regulated by an arrangement of ‘contracts de plan État-Régions’ defining the devolution of authority and budgetary allocations from the central state (Balme and Bonnet 1995). The regional authorities on this regulatory foundation attained and still maintain the political status as principal democratic authorities controlling own territorial affaires and the state subsidiaries, the arm’s-length state agencies. This case of French reform illustrates the implementation of the principle of subsidiarity in practice as the downward devolution of democratic authority and power to the sub-national tier. As a case, it indicates so far a confirmation of our hypothesis on the administrative reform of subsidiarity and mode of sharing competence.

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The UK reads and translates the principle of subsidiarity differently. The UK is a liberal democratic state where democracy is exercised in the context of the sovereignty of parliament, but there is no 'state' equivalent of the French état. It is not based on the sharing of power in a hierarchical tier-system of elected assemblies, but is based on the liberal concept of the primacy of the individual, conceived as someone in possession of a bundle of interest and rights, in particular the right to conduct its business of maintaining the security of the realm and international order. The central state has a sort of a mediating constitutional status in the establishment of private-public partnerships and reform activities (Moran 2003). We can clearly recognize this status in the authorization of the state subsidiaries of the UK, in the form of the fragmented unelected arm's-length administrations and bodies, which emerged with the 'Next-Step Reform' of the 1980s, as sub-national principal authorities. Following the Anglo-Saxon administrative tradition, these subsidiaries received a mediating function in development policies and in negotiating forward sub-national, public-private partnerships (Loughlin 2004). Elected sub-national assemblies are in this context non-existent. The British reform case demonstrates the implementation of the principle of subsidiarity in practice as an outward devolution of authority and power and follows the path of democratic deficit entrenched in the regulatory state. Also this case indicates a confirmation of our hypothesis on diversity regarding the administrative reform of subsidiarity and the mode of distributing governance at sub-national levels (Loughlin 2004).

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The first confirmation: Like all modernizing reform activity, the democratic and administrative reform of subsidiarity is also dependent on context. The OECD, therefore, states (2005: 22) that, 'OECD countries' reform demonstrates that the same reform performs differently and produce very diverse results in different country contexts'. This leads to the second hypothesis.

The second confirmation is that state administrative traditions explain to some extent different problems of democratic governance, such as deficits of democracy, legitimacy, accountability, and inefficiency as well as increasing transactional costs, connected to both outward and downward administrative reforms of subsidiarity.

'Many governments' as an OECD report states (2002:10), 'now realize that managing from distance has created specific accountability and democratic control issues, and have started focusing on improving the governance of these bodies'. The OECD report of 2002 also confirms that only in the Continental countries of the nine member states analyzed is the outward form of subsidiarity really considered problematic, and, therefore, these countries have, to a certain degree, avoided implementing them. The OECD report of 2005 goes further and gives the following statement: 'Nevertheless, the reality of reform has not lived up to the rhetoric. In many cases, the changes made to rules, structures and processes have not resulted in the intended changes in behavior and culture. Indeed, in some cases reforms have produced unintended or perverse consequences, and have negatively affected underlying public sector and democratic governance values'. Counteracting measures are put into play in relation to creating new policies that grant greater steering capacity to the governments and for making the arm's-length independent and unelected agencies more transparent and coherent. In the UK it has long been recognized that the doctrine of parliamentary responsibility and steering ability has become a fiction. As mentioned in a previous chapter, some British scholars have concluded that 'the sheer institutional diversity of government makes the doctrine obsolete and its complexity obscures whose is accountable to whom for what? (Beetham & Byrne & Ngan &Weir (2002:133).

Good democratic governance in the framework of subsidiarity depends on bottom-up arrangements, which create the space for governmental planning and action, the involvement of the civil society, and the arenas for public discourses on politics and ethics, and institutions of accountability in order to make democracy work. The Treaty of Lisbon barely mentions this bottom-up issue in the context of subsidiarity, and we know the issue is a conflicting one because of the diversity of national administrative traditions and paths (Veggeland 2007). Therefore, the Treaty still seems to be exploring good governance, democratic governance, and subsidiarity as effective administrative reform as both 'downward' and 'outward' devolutions of competence to both public and market actors and making it thereby a ruling social-institutional paradigm, 'negatively affecting underlying public sector and democratic governance values'.

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4.5 State formation and democratic traditions

The national state in Europe was created at the end of the seventeenth century when the traditional state system was established; the Westphalian order (Krasner 1988). In France, the Revolution of 1789 reversed the absolutist dominance of society by the state order. The state did not lose its monopoly of coercion, but society itself determined the use of state power (Knill 2001). Also the notion of state and the notion of democracy were first expressly linked ideologically. National representative assembly of Parliament, the elected representation of society, built the linkage between the citizens and the common interests, i.e., the state, and constituted the input democratic legitimacy (Veggeland 2003). To Europe, this new epoch meant the emancipation of the people and a new way of governing a bounded territory with its citizens democratically (Rogowski and Turner (eds.) 2006).

The 'people' (*demos*) of a defined national society became the only appropriate foundation for democracy, and the national state comprising governmental institutions became the only principal authority with internal sovereignty, with power on behalf of the 'people'. We should, however, note two different conceptualizations of the state function. We have already seen that the Continental European democratic tradition gives primacy to the idea of the state as an abstract authority, as something different from the society. The state, including its subsidiaries, bears responsibility for the performance of the functions of the welfare state and is a collective actor representing the society as a whole. Being responsible for the common weal, the state authorities receive their legitimacy from the parliament whose power is only restricted certain modifications laid down in the national state constitution. The parliament receives its legitimacy from the 'people', who represent the market of voters and whom politicians must entice.

In this context, the UK democratic tradition is different and somewhat related to the historical evolution of the regulatory state (Loughlin and Mazey 1995, Loughlin 2004). Rather than constitutionally looking upon the state as something different from the society, an authority responsible for the common good, it was conceived as a part of society and as such an instrument of regulating interests, for instance private and public actors competing in the market. State subsidiaries of the arm's-length type have, on one hand, a mediating responsibility, but on the other hand, they are also regulated as Public-Law Administrations (PLAs) or Private-Law Bodies (PLBs).

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The conception of the traditional Continental states, and the Nordic states via their historical connections to this tradition (Gidlund 2000, EPC Working Paper 2005), is shaped by layers, which in part counterbalance each other. As pointed out by Christoph Knill (2001:62), the ideological conception of a state authority's viewing the democratic state institutions as superior to society has social-model background. Today, several organizational aspects, rooted in the historical development of statehood and society are identified as context-dependent. Both constitutional unitary and federal states belong to the concept (Pindar 1993). Organized as administrative hierarchies with sub-national local and regional levels, and normally with elected councils governing on behalf of central authorities, 'the unitary territorial state' became a notion standing for a fully 'complete' and finalized nation-building process (Rokkan and Urwin 1983). There was only one central state power ruling one nation; the competence of the sub-national elected councils was circumscribed to only deciding roadmaps for implementation of state policies. In contrast, in the federal state, the power was shared with the members of the federation as national associates. For that reason, from a unitary-state perspective, the federal nation-building process was perceived and given a status as 'incomplete' because of this lack of unity (Balderheim 2000).

We may see, in this context, the EU principle of subsidiarity as a pursuit of the federal idea that layers should counterbalance each other (Keating 1998, Hooghe and Marks 2001). In accordance with the principle of subsidiarity, the devolution of competence upwards to the supranational European tier through agreements is recommended when greatest policy outcome and effectiveness is expected on that level. This is a federal idea. Similarly, the downward devolution of competence to regional and local authorities as a consequence of subsidiarity is also a federal idea of sharing power and authority between tiers (Veggeland 2000, Wallace 1998).

Actually, we may view the concept of the French regional reform in 1982 made by a unitary state, the aforementioned 'Contrat de plan État-Régions' in this context. The reform is a regulatory one, i.e. a contractual and regulatory sharing of competence between tiers. Seeing the reform as context-dependent, we may see the idea as rooted in the federal tradition of counterbalancing level authorities. There is in this modern case of reform the conceptualization of subsidiarity, performed through bargaining processes and consensus-making and legalized as an order of binding regional contracts (Balme and Bonnet 1995).

Often, the performance of the OECD-defined 'Distributed Public Governance' of the Western Europe states of today gets its legitimacy from the EU-defined principle of subsidiarity. The ideological reference is the value of sharing competences between a plurality of public authorities and institutions as an alternative to a hierarchical order of government (Neyer 2002, Veggeland 2003). However, in reality, it concerns the protection of public interests from both the increasingly wide variety of public organizational forms and a deficit of democracy (Habermas 2006, OECD 2002). Democratic institutions and their channels of communication and their function to protect political, social, and civil rights, stand against the new (more output effective?) technocratic or quasi-technocratic executive authorities that provide public services (Majone 1997, Weiler 1999). What institutions, then, serve the public interests best?

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In the Continental European democratic tradition, it was economic backwardness and the idea of more fair social and regional distribution of the common weal that led to the creation of a democratic but strong state as a part of the welfare-state building processes (Flora et. al 1999). Today, institutions of 'Distributed Public Governance' mean a restructured state hierarchy and public sector in general and reflect policies for exposing public services to more market competition. In some cases, it even means organizational reforms whereby public-service institutions are not regulated by public law but instead by private law as enterprises.

Even so, the Continental (and the Nordic) thinking of the role of the democratic state still seems to emphasize the view that market functionality and competition do not automatically achieve social and regional fairness (OECD 2002, Badie and Birnbaum 1983). There is a widespread concern on the topic; 'distributed state governance', anchored in agencies and other authority bodies at arm's-length from parliamentary control, on all levels creates a democratic deficit if not counteracted (Eriksen and Fossum (eds.) 2000, Veggeland 2001, 2009). Therefore, in relation to subsidiarity, the redistribution of state governance to independent tier agencies and other New Public Management (NPM) authorities is normally delimited in Continental countries. The distribution tends to be more in accordance with a model emphasizing the supremacy of representative democratic assemblies as lawmakers and regulatory authorities, including at all sub-national levels of governance, in relation to technocratic agencies and public enterprises (Majone 1997, Schmitter 2000, OECD 2002).

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The UK tends to be different. The country is described, as we have seen, as a 'stateless society' in a restricted sense, or 'government by civil society' (Badie and Birnbaum 1983:121). Here 'it was the very rapid growth of capitalism and the market that resulted in the backwardness of the state, with civil society maintaining its position of dominance…the market reigns supreme, not the state' (Badie and Birnbaum 1983:123–4). The term 'state' was and still is only referred to at the level of international relations or as the "welfare state". 'Government', 'country' and 'nation' became interchangeable terms.

Consequently, when the public sector became restructured in the 1980s, 'the Next-Step Reform', terms as 'output governance', 'result measuring and financing', 'institutional competitiveness', ' benchmarking', 'institutional capacity', 'public-private partnerships' dominated the thinking on reform, reflecting the wish to achieve market advantages. Subsidiarity as a form of downward devolution of political power from the central government to sub-national tiers and supreme democratic assemblies was not on the political agenda (Jessop 1994, Amin and Thrift 1995a, Veggeland 2003). Also, the original view of the state as a mediator dictated British thinking on administrative reform. Here the Distributed Public Governance style acquired its legitimacy from a constitutional model that emphasizes *functionality* more than parliamentary legitimacy. Thus, with regard to subsidiarity, the growing number of independent arm's-length state agencies appear as mediators on all sub-national levels of governance, conceptualized as the institution of functional 'public-private partnership' (Amin (ed.) 1994). Bob Jessop has, therefore, concluded about the UK that "in this sense we can talk of a shift from local government to local governance. Thus local unions, local chambers of commerce, local venture capital, local education bodies, local research centers and local states may enter into arrangements to regenerate the local economy" (Jessop1994: 272).

But since then, the number of local partnerships has been growing to an undesirable critical number with regard to fragmentation and to making democratic control feasible and governance effective. In the separate territorial unit of England, distributed public governance in the form of partnership institutions now are exacerbating the trend of democratic deficit, raising transactional costs, and actually worsening ineffectiveness because: 'The (central) government has sponsored a bewildering known total of over 2 375 multi-agency partnerships…at the local level in England – for example, on education, regeneration, neighborhood renewal, community safety, older people, crime, town centre, management, health, cultural activities, etc. Another 400 local strategic partnerships are being set up to play a key role in local governance, bringing together local councils, local agencies, police and health authorities, etc.' (Beetham & Byrne & Ngan & Weir 2002:270.

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4.6 Territorial size and distributed public governance within the framework of subsidiarity

Ideologically, the year of 1992 symbolizes the anticipated death of the state in Europe and traditional national democracy, or at least a decisive moment in on their road to expected transcendence (Brubaker 1999). Chosen by the former EU Commission president Jacques Delors as the target date for the completion of the Single Market, ideologically, 1992 came to stand for the abolition of national frontiers and the manifestation of a "borderless" Europe in relation to networking institutions, firms, and trade markets (Kuper 2006).

Periods of time – regimes	*Territorial size*	*Democracy forms*
Ancient Greek	Small urban societies	Direct representative democracy
Roman and Middle Ages	Large empires	Downwards devolution; subsidiarity
Westphalian order 1648–1992	(Nation) states	Indirect representative democracy
European Union	Borderless Europe	Downwards and outwards devolution; subsidiarity

Table 2: Basic historical transformations of the term of 'democracy'

Table 2 connects historical periods with territorial size of predominant regimes and illustrates the actual forms of democracy as occurrences related to the latter, the territorial size of the polity. In the small Greek city societies of the ancient world, it was feasible to have direct representation (of free men) in the democratic assemblies. But when the Roman Empire and later other empires during the Middle Ages took over as the hegemonic entities of European, the downwards devolution of framed regulatory authority to dukes, vassals, and other subsidiaries took over as part of a democratic system of delegation, while the direct democracy ceased. It was rather like what we have elaborated as outward subsidiarity, because elected assemblies were missing.

With the introduction of the Westphalian order of 1648 until 1992, which symbolized the anticipated death of the state, middle-range territorial polity units ascended that were too large for practiced direct democracy and thus indirect representative forms of democracy became the solution. Later on, this indirect form of democracy became to some extent identical with the concept of the national state. The European Union, regulating a borderless Europe, represents a territorial unit of size making the state-level democracy unrealistic. Therefore, the new focus on subsidiarity in the EU has arisen as a strategy for the development of a participatory democracy of Europe. However, as pointed out, this time subsidiarity in the sense of both downward and outward distribution of government and regulatory governance began, and bottom-up capability and responsibility for domestic development were built (Wallace 2005). Not surprisingly, with reference to Tab. 5.1, when the Treaty of Maastricht introduced the principle of subsidiarity in 1992, scholars commented on the term and related it to the parallel concept of the Middle Ages, in particular as a concept of delegation of authority used by the borderless, universal Roman Catholic Church.

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The 1992 came also to stand for the emergence of European citizenship and – with the signing of the Maastricht Treaty in 1991 – the erection of the 'Committee of Regions' and the introduction of the 'principle of subsidiarity'. Together with economic and political theories on growth and democratic advantages of the coming new European regionalism in the wake of globalization, the Maastricht Treaty enforced the prospect of an arising "Europe of regions" (Anderson 1994, Keating 1996, Veggeland 2000). It came to be the wide range of institutions of Distributed Public Governance that featured and issued this complex prospect during the 1990s.

However, the idea was to make distributed public governance work effectively and democratically by bringing to the fore subsidiarity as the regulative principle for organizing and strengthening the democratic capacity of the political, economic, and cultural regions of Europe (Keating and Loughlin (eds.) 1997, Keating 1998). So far, the main issue in European integration had been the devolution of decision-making competence through negotiations and bargaining processes among member states *upwards* to the EU. The Maastricht Treaty not only challenged the member states by introducing more supranational competence but also by challenging the state to perform *downward* devolution to the regions (Neyer 2002).

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Of course, for Jacques Delors, the French regional contract model for devolution and decentralization, as he knew very well as former minister of finance in France, represented both an option and a concept for redistribution of public governance, institutionalized as public-public partnership (Loughlin and Mazey 1995). It concerned the establishment of an agreement-based multi-level system of governance functioning in accordance with the principle of subsidiarity. The model conceptualized a sub-national tier with agreement-based political competence, with the necessary capacity to function in the EU intended multi-level system of governance featured by subsidiarity. From that point of time, the Union required an organized level with regional authorities and effective executives as actors and responsible negotiators in partnership with other authorities working out development programs. Without such authorities, the regions and the states were excluded from benefiting from the Structural Funds and other EU Commission regional policies.

The EU was not, however, given any supranational competence to regulate how the member states ought to organize and institutionalize distributed public governance and to practice democratic government at regional levels. The choice of organizational style remained a national state matter of responsibility (Veggeland 2004). Consequently, organizational and administrative traditions and paths came to influence the restructuring processes in the member states when public governance was distributed downwards and new institutions were built. Recent studies show that what the OECD (2002) designed as 'Distributed Public Governance' has become an immense issue because of the wide variety of state authority organizational forms at the regional level, such as agencies, service enterprises, partnership, and other governmental bodies. Besides these institutions' relations to regional democratic assemblies are very complex in the Continental western countries where such assemblies still exist in accordance with their administrative tradition (Scharpf 1999, Veggeland 2007).

The contributors of the OECD report (2002) have observed that institutions of distributed public governance challenge the democratic order and sustainable development on all administrative levels in three ways (2002):

- Elected tier assemblies and governments have become politically weakened, while technocratic executive authorities have gained more power. Accordingly, the abdication of representative political authorities creates a deficit of input democracy, accountability, and legitimacy (see also Scharpf 1999).
- The regulatory state agreement-based contract governance and partnership institutions are replacing representative governmental institutions. As Michael Keating (1998:47) has negatively and pithily commented, 'governance is what exists when government is weak and fragmented', meaning fragmented governance performed by independent authorities replaces holistic government.

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- Policies acquire their legitimacy first and foremost from functionality, output efficiency, and benchmarking reports, i.e. from the output or outcome of executives, and from comparative competitive advantages, which benefit from 'locked-in' and non-transparent management (Pollitt and Bouckaert 2004: 8). That challenges the liberal democratic principles of openness, transparency, and deliberation (see also Eriksen and Fossum (eds.) 2000). Let us look at a figure illustrating the principles of both input and output democratic challenges (Veggeland 2003).

4.7 The New Democracy and its mechanisms

The EU was in the process of establishing a Constitution Treaty (Habermas 2006) in 2004 but failed. The member states seemed to be very well aware of the challenge of meeting the threat of the democratic deficit by constitutional reforms and restructuring actions (Van Gerven 2005). Even though there are historical traditions of state governance that are fundamentally different in their origins – the state as superior to the society (Continental tradition) or more functional as a societal mediator (British tradition) – the finding of appropriate solutions is imperative. A new trial of compromise has been made in the Treaty of Lisbon, in which more both input-side and output-side democracy stands as pressing issues high up on the agenda.

Not strangely at all, with the collapse of the Constitution Treaty as the background and the research from the OECD, we already have commented about changing priorities. The OECD report (2002) observed nine countries, including the EU member states France, Germany, the Netherlands, Spain, and Sweden on reforms of 'distributed public governance'. It is of wide ranging interest when it concludes that there is a change of policies occurring, which the later report of 2005 confirmed (OECD 2005): 'from the drive to create agencies, authorities and other government bodies to the challenge of achieving *good governance*' (2002:21). Further, as previously concluded, the creation of specific Public-Law Administrations (PLAs) and their twins, Private-Law Bodies (PBLs), seems to have come to a stand-still in many countries. That also implicates a change of the subsidiarity concept, from outward devolution to more downward devolution of politicalk authority in the EU member states. This is the new trend in Europe that the Treaty of Lisbon seems to build upon.

Here are some of the paragraphs from the OECD report (2002:21–26) that draws its conclusions. The following facts from the studied countries are issued, and the facts also mirror the situation of the 2010s:

- The independent bodies are seen as functioning outside the political debate with little oversight from ministers and ministries and weak accountability arrangements. The parliaments are neglected, and so are individuals and the institutions of the civil society. Conclusion: Weak accountability mechanisms undermine the legitimacy of governments and parliaments.
- Weak co-ordination mechanisms and coherence failure are threatening effective public service production in terms of 'best value' to individuals, social groups and corporate interests, because of fragmented governance.

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To explain the last paragraph on 'weak co-ordination mechanisms', we may refer to what we have already referred to as the Scharpf's Law (Hooghe and Marks (2001:5): 'As the number of affected parties increases…negotiated solutions incur exponentially rising and eventually prohibitive transaction costs' (Scharpf 1997:70). In the system of Distributed Public Governance, the problems of technical, communicative or legal co-ordination of the many actors and bodies escalates immensely with the growing numbers, and transactional costs will ultimately be excessive according to Scharpf's Law. It threatens the sustainability of the development of the economies, and today we observe a deep-rooted economic and political crisis arising in Europe. True, the rise of the unelected bodies implies a new separation of public powers, which could theoretically have been advantageous, as argued by Frank Vibert (2007). Empirically it turns out differently, however.

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In this perspective, the costly and failing co-ordination mechanisms of the reporting OECD countries are not a failure directly related to the poor performance of public governance, but they are a *consequence* of the system of distributed public governance and the unelected bodies of the regulatory state itself (Veggeland 2008). Accordingly, there is a growing focus in the OECD member states on bringing governments and administrations closer to the people, and people closer to the state in the sense that they have become and being managed more than being active and participatory citizens (Loughlin 2004). Further, there is focus on *good governance, ethics, sustainability, democracy, and more coherent public services*, i.e., on policy and solutions for structural coherence. Moreover, the focus endeavors to involve civil society and the governments more in governance on all tiers of the European multi-level system of governance. Further to improve parliamentary control over activities for the sake of more holistic responsibility.

On the one hand, there is a growing political intention to make the overall system more legible, accessible, and participatory to people, and the accountability mechanisms, activities, and performance made more easily controllable by parliaments, on all tiers and in accordance with the proper democratic administrative style according to the principle of subsidiarity, i.e., the downward devolution of power and authority. However, in the European multilevel governance system it is a challenging policy with many barriers ahead. The greatest barrier of today is the actual financial and credit crisis that ravage Europe and the EU.

We asked: The Regulatory State: How Democratic? We have elaborated the principle of subsidiarity and found that downwards devolution of government capacity in a multilevel governance system might promote a sustainable new democratic order, if institutions. While outwards devolution of power features independent arm's-length institutions and thereof growing indifference and decreasing participation of the people in elections that undermines the input-side democracy. 'Locked-in' management undermines the liberal principles of openness and transparency, i.e., output-side democracy. The 'locked-in' management triggers social and economic disorder because overall representative government control gets withdrawn from decision-making arenas, and the consequence is growing democratic deficit.

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5 Regulatory Petroleum Governance: The Norwegian Case

Introduction

Petroleum was discovered in the North Sea in 1969. Production began in June 1971, and in the following years a number of major offshore petroleum discoveries were made all the way up along the economic zone to the Barents Sea. Today, there are more than 50 fields in production on the Norwegian continental shelf. But this development began earlier than that.

5.1 The emergence of the Norwegian petroleum sector

In 1962, Philips Petroleum sent an application to the Norwegian Government in order to explore oil opportunities in the North Sea. The international company asked for a license for the part of the North Sea that could possibly be included in the Norwegian shelf. The offer was for $160 000 per month (www.regjeringen.no). The Government interpreted the offer as the company's attempt to secure exclusive rights and thus it did not accept. It was out of question for the authorities, then, to allow a single company to monopolise the shelf. A regulatory policy was formulated; if the areas were to be opened for exploration, then more companies had to be involved. Moreover, Norway was at that time confronted with two main challenges: the lack of test seismic and drilling competence and capacity and the lack of international recognition of its ownership.

In May 1963, the Government proclaimed sovereignty on the Norwegian continental shelf. New regulations determined both that the Norwegian State was the sole owner of any natural resources and that only the Government is authorised to allocate licenses for exploration and production. Soon afterwards, companies were given the opportunities to test the potential for exploration. The licenses only included the rights to perform seismic surveys but not drilling. International agreements on dividing the continental shelf according to the median-line principle were reached in 1965. The first well was drilled in the summer of 1966, but nothing was found. Then, with the discovery of the Ekofisk oil field in 1969, and the Norwegian petroleum adventure really began economically. An adjusted regulatory petroleum regime was properly established and has ever since been crucial for developments and taming processes of a vulnerable sector.

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Norway Oil Production Falls, Gas Production Rises

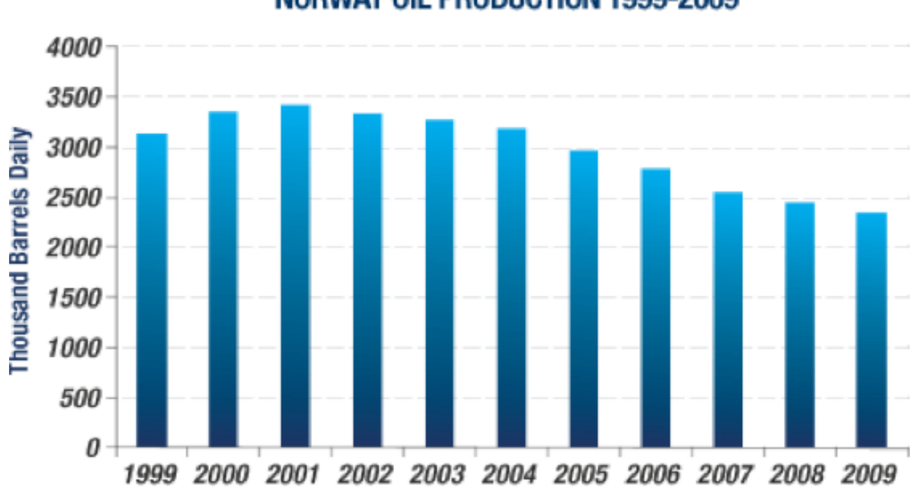

Figure 1: The Norwegian oil production is shrinking.

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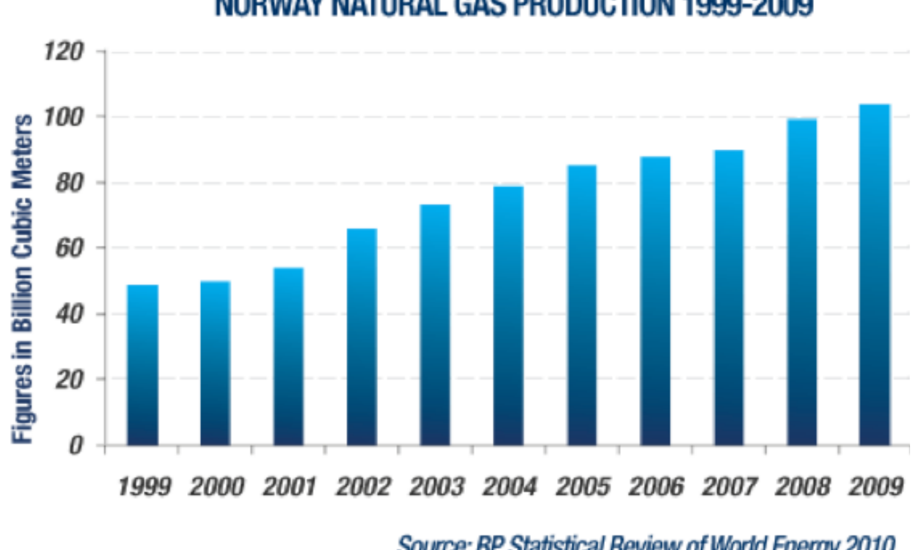

Figure 2: Norwegian gas production is increasing.

Norway ranks as the world's third largest oil exporter and the shrinking seventeenth largest oil producer 2009. In 2004, Norway was the third largest gas exporter, and the seventh largest gas producer. In 2010 it changed to the world's second-biggest gas exporter. Saudi Arabia and Russia are at the top of the lists of exporters and producers.

The Ministry of Petroleum and Energy (MPE) has from the very beginning strongly regulated the production, transport, and sale of oil and gas. Despite that the European market in this economic field has become liberalised in the wake of the Single Market and several EU directives, and Norway as an EEA country has been a part of this liberalisation, the MPE has still maintained extensive control (Austvik 2003). It is the responsibility and duty of the MPE to submit concessions and to appoint delivery fields bound by contracts, as well as to approve commercial agreements. Although the political authorities – the Government and the Parliament (Stortinget) – make the decisions, the Ministry of Petroleum and Energy together with the Ministry of Finance are required to give expert advice before decisions are made and executed. The regulatory body of the Norwegian Petroleum Directorate (Oljedirektoratet) is not really a proper self-regulatory arm's-length governmental agency but an external administration with extended authorisation.

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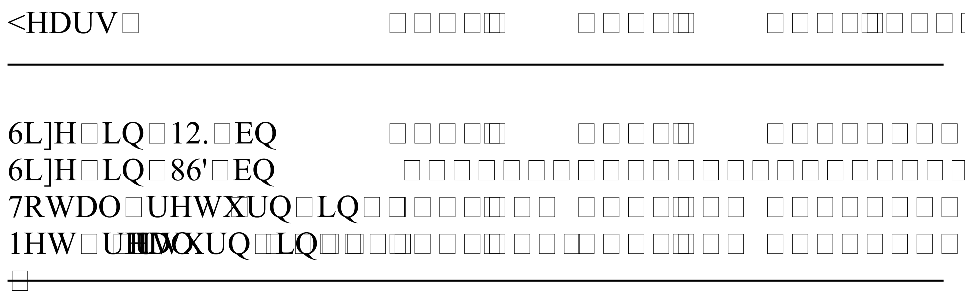
It is easy to understand that petroleum revenues have contributed significantly both to the economic growth in a small country like Norway and to the financing of an expensive welfare state of the Nordic type of universal social benefits (Veggeland 2007). In 30 years of operation, the petroleum industry has created values of about USD 1.3 billion, now probably worth much more due to quickly rising oil and gas prices after that period. The petroleum sector accounts for about 25 per cent of value creation in the country. This is twice the value creation of the domestic manufacturing industry which makes the petroleum industry Norway's largest and most important industry. A high oil price and a sustained high level of activity make the basis for high value creation in the industry. Estimates 2010 show that the industry is contributing with more than NOK 311 billion to the Treasury. This is equivalent to more than 10 transport budgets.

The large petroleum revenues, Tab. 1, have resulted in substantial financial assets in what is now called the *Government Pension Fund*. The total returns on the Government Pension Fund Global (GPFG) in 2010 were good while the net real return will slow down; to a calculated minus – 2.4% in 2030 (see below), due to rising inland welfare costs. The overall results of the last years of production show that the large losses during the financial crisis has been more than compensated by the gains made in the subsequent market upswing, Tab. 1. One important reason is that the Government held on firmly to the long-term investment strategy.



Source: Norwegian Ministry of Finance 2008, 2010

Table 1: The Government Pension Fund – Global; key figures in billion

In fact, according to the Norwegian Ministry of Finance (National budget 2008), the Pension Fund – Global is among the largest and fastest growing funds in the world, rising from the value of USD 373 billion in 2007, Tab. 1, to about USD 584 bn in 2010, and is expected to be continuing growing.

The purpose of the Government Pension Fund is both to facilitate the governmental savings necessary to meet the rapid rise in public pension expenditures, Fig. 3 below, because of an increasing rate of ageing people in the coming years, and to make the long-term management of petroleum revenues effective for Norwegian interests.

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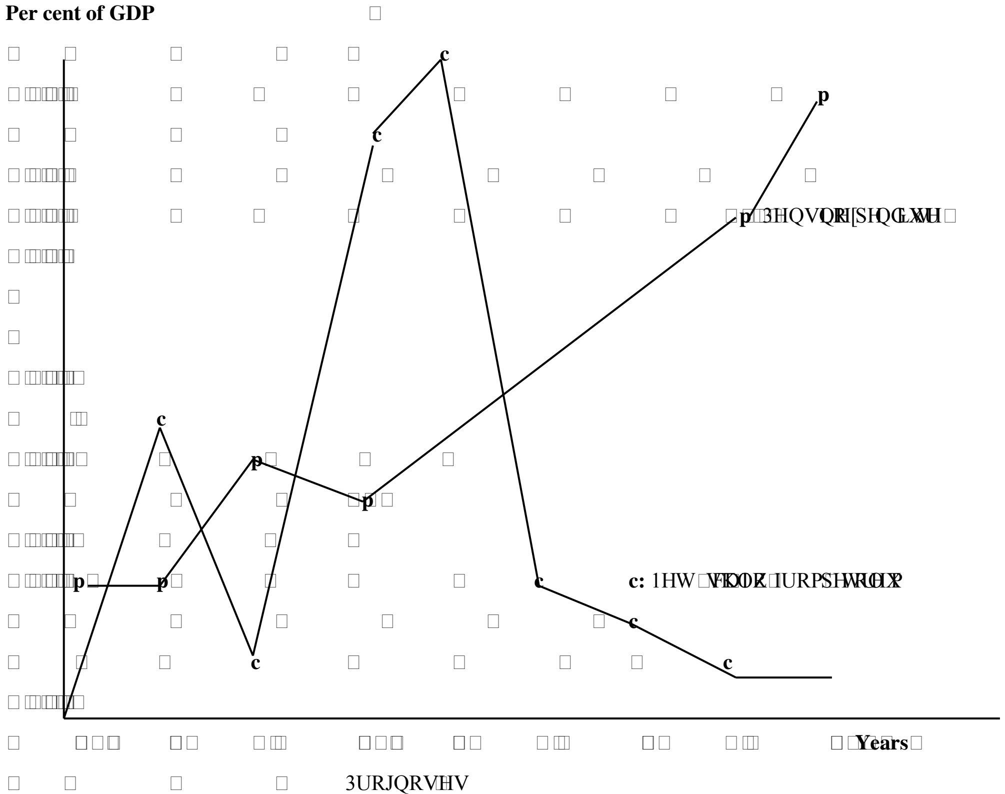

Source: Government of Norway, Long-Term Program, 2002–05, simplified figure.

Figure 3: Net Cash Flow from Norwegian Petroleum and Pension Expenditure (in per cent of GDP).

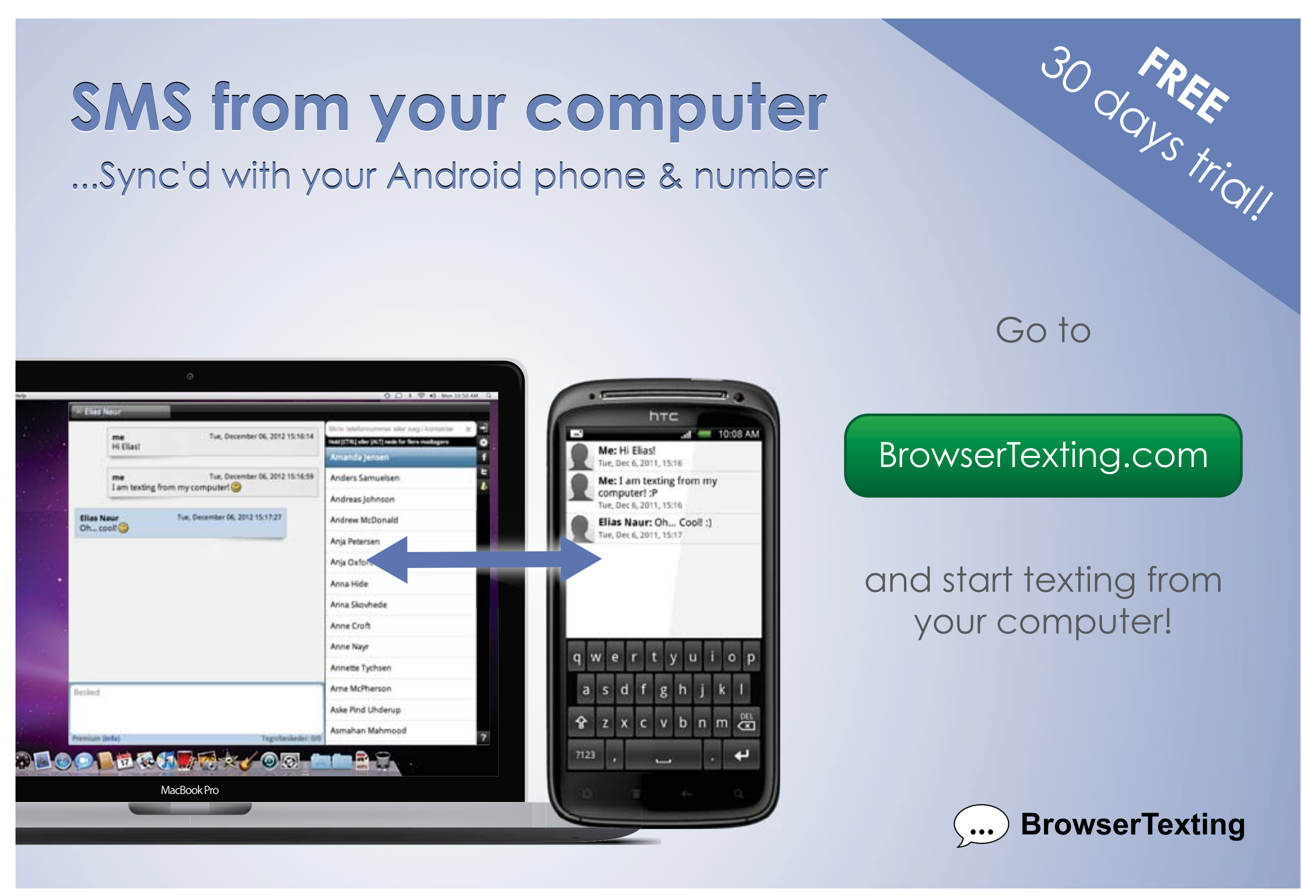

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Fig.3 graphs the growth of revenues from the Norwegian petroleum industries as net cash flow in per cent of the GDP, reaching 25 per cent in 2006. According to prognoses, owing to the aging population and rising pension expenditures, this net cash flow as a per cent of the GDP is supposed to fall sharply after 2010.

The Figure also indicates that the net cash flow to the GPFG is expected to fall during the years ahead. While the share in 2010 was about 5%, Tab. 1, is this figure expected to pass zero in 2020, and become minus 2.4% in 2030. A practical consequence of this fall of the net cash flow is that the Government must withdraw money from the Fund its self, which indicates that GPFG is enforced to reduce its activity as an international shareholder because of liquidity need.

Additionally, Fig. 3 also reveals another fact: the fall of the net cash flow from petroleum in the beginning of the 1990s. Norway has employed Keynesian instruments to implement a policy of general government surplus. Heavy governmental budgets and the short-term recession of the early 1990s created a deficit in the fiscal budget for a period, which is reflected by the net cash flow curve of Fig. 3. Actually, the years it lasted were the only years since World War II when Norway had budget deficits on a general basis. The international financial crisis which came up in USA in 2008, and later on spread to Europe, in fact has so far (2011) had only minor effect on Norwegian economic policy, and petroleum policy in particular. Revenues from oil and gas have been stable high, and the path of the net cash flow indicated in fig. 3 has been followed. The shrinking trend is caused by increasing public welfare service costs, not by deficits caused by the crisis. Table 1 indicates an increase in total return, from 4.1% in 2007 to 5% in 2010.

By the end of the 1990s, surpluses on the central state budgets were statistically predicted to grow substantially owing to increasing petroleum revenues. This prediction convinced the Government that some sort of formal fiscal guidelines were needed to regulate effective demand and in order to restore control over inflation and employment (Ministry of Finance Report 2006–2007). Large surpluses in public finances made the government and parliament to raise the demand-side of the economy, for example, the welfare or infrastructure sectors.

A regulatory regime solution was chosen, see Fig. 5 below. The following fiscal guidelines were introduced in 2001 (Eriksen 2006: 9):

- *'The use of petroleum revenues over the Government budget should be gradually phased into the economy approximately in pace with an estimated 4 percent real return on the assets in the Pension Fund – Global'.*
- *'The actual regulatory implementation of fiscal policy, should, however, also' take into account business cycle fluctuations'*
- *'The automatic stabilizers should have room to work'.*

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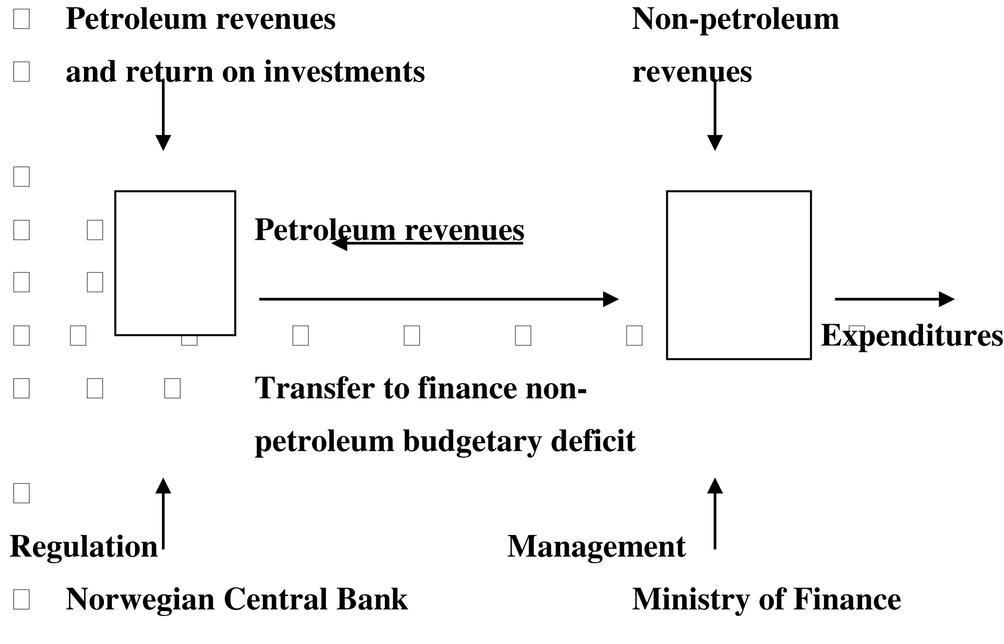
These fiscal guidelines were followed up with formal monetary policy rules targeting stability in the domestic and international economic market. A new regulation for monetary policy was established in 2001 in a white paper to the parliament (Report No. 29 (2000–2001)). The Norwegian Central Bank, which implements the operational monetary policy, was instructed to aim for:

- *Low and stable inflation, defined as an annual increase in consumer prices that remain close to 2½ per cent over time.*

Actually, since 2001 until 2011 the inflation rate has remained stable at 2½ percent annually. The Government Pension Fund was formally established in 2006 and consists of two parts: 'The Government Pension Fund – Global', which is a continuation of the Petroleum Fund, and 'The Government Pension Fund – Norway', which was previously known as the National Insurance Scheme Fund.



Source: www.regjeringen/pensjonsfondet.no

Figure 4: The Norwegian Pension Fund Mechanisms.

The Ministry of Finance is responsible for the management of the Government Pension Fund. The Norwegian Central Bank carries out the operational management of the Pension Fund – Global. The Bank is an arm's-length agency regulated by the government and invests the Fund's capital in bonds and equities outside of Norway in accordance with guidelines issued by the Ministry, Fig. 4. The operational management of the Pension Fund – Norway is carried out by 'Folketrygdfondet' as part of the system of social security.

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Fig. 4 shows the relations and mechanisms integrating the petroleum revenues and the ordinary budget of Norwegian Government, and the separation of governance in a regulatory state order. The Ministry of Finance is 'steering without rowing'; the arm's-length regulatory bodies do the 'rowing'.

In fact, in 1994, with Norwegian approval of the European Economic Agreement (EEA) that gave access to the Single European Market, the State's participation in the petroleum operation began to take place in the deregulated European petroleum market. In 1997, the EU introduced the principle of 'Third Party Access' (TPA) to the transmission pipelines, splitting companies' functions as transporters and wholesalers (Austvik 2003). The TPA directive (often called the 'Gas Directive') was approved for implementation in 2000.

Norway as a participant of the Single Market through the EEA agreement had to reorganise the petroleum apparatus in a regulatory direction i.e., conforming to directives to split companies, extending the exposure to competition, and establishing a wide range of arm's-length control bodies as part of the regulatory regime.

Accordingly, the involvement of the State in the petroleum industry already split into two arm's-length bodies as private-law agencies (PLBs), *Statoil ASA*, the exploration and production corporation but controlled by the State as the main shareholder, and the *State's Direct Financial Interest* (SDFI). The SDFI arrangement was established in 1985, and requires the State to pay a share of all investments and operating costs in projects on the Norwegian continental shelf, which corresponds to its direct financial interest (Austvik 2007).

In the other direction, the government receives accordingly a share of revenues from the sale of production and other income sources. The cash flow from the SDFI will continue to account for a significant proportion of the State's revenues from petroleum activities in the years ahead. One significant consequence of the EU's TPA directive (the Gas Directive) was the establishment of a number of the state-owned arm's-length, 'unelected' bodies. One of those was *Petoro Ltd.*, established in 2001 to serve as an independent manager for the SDFI portfolio.

Petoro Ltd has since managed SDFI on behalf of the State. Petoro is the licensee for production and those pipelines and land-based plants in which the State has a direct interest at any time. Petoro is not the owner of the SDFI shares on the Norwegian continental shelf, however. The value of the SDFI in 2006 was estimated at approximately USD 150 billion. There are other arm's-length regulatory agencies. One of these is *Gassco Ltd.*, a state-owned corporation responsible for the transportation of natural gas from the Norwegian continental shelf. *Gassnova Ltd.*, an administrative agency responsible for promoting and supporting innovation and development of environmentally friendly gas power technology, is another.

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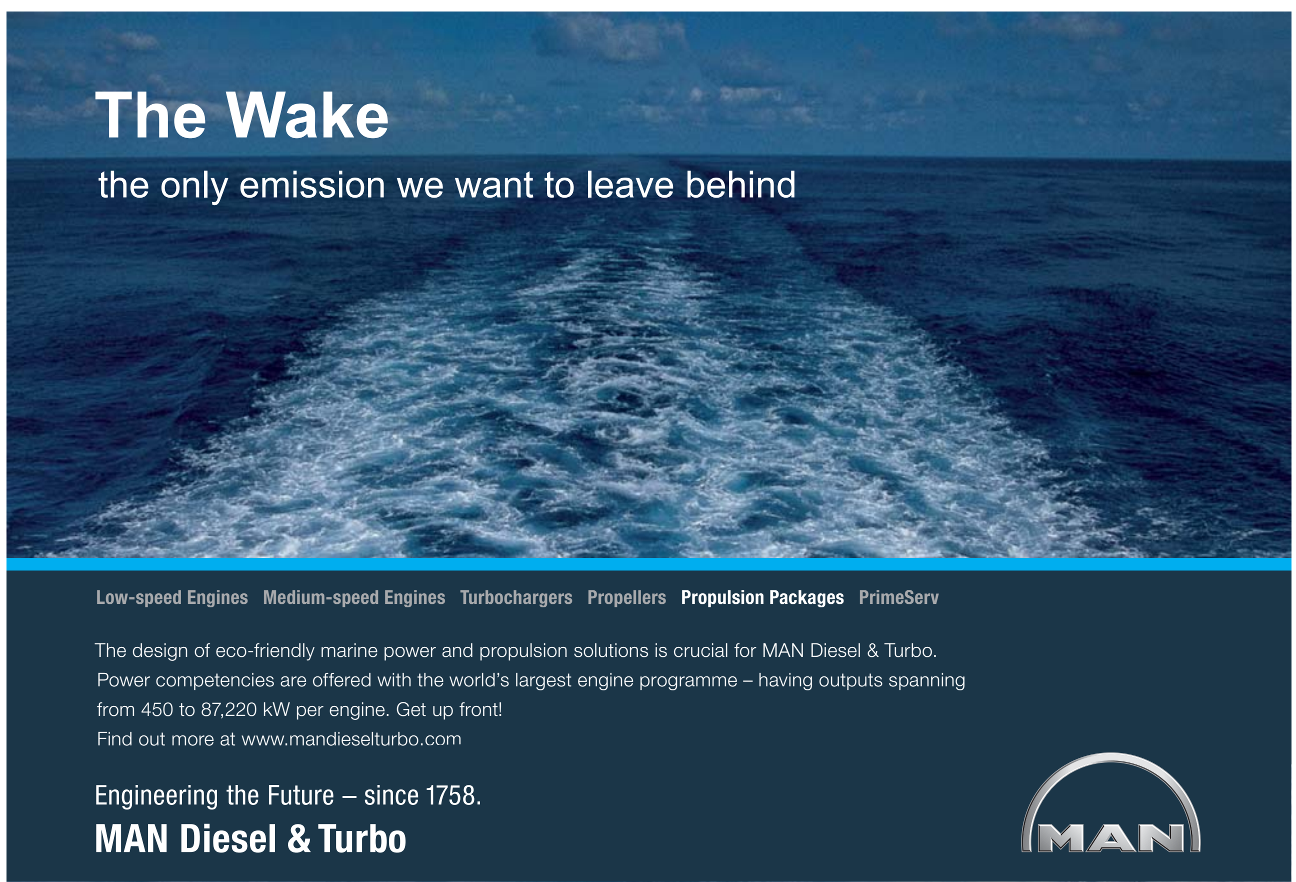
In 2007 Statoil ASA was fused with the limited state controlled corporation Norwegian Hydro, which is now by far the dominant actor on the Norwegian continental shelf but also a significant international actor in the petroleum sector. The State share of Statoil organised as a Private-Law Body diminished because of the merger, but the State is still the major and controlling shareholder. Now Statoil again is listed on both the Oslo and the New York stock exchanges.

As mentioned earlier, *The Norwegian Petroleum Directorate* is not an arm's-length body but a part of the government and as such reflects a petroleum sector with ordinary administration. The Directorate plays a major role in the management of the petroleum resources and is an important advisory body for the Ministry of Petroleum and Energy. It has the authority to issue regulations and control and to make decisions according to the rules and regulations for the petroleum industry.

The supervisory body of the competition system with regard to organisational matters and the surveillance of the liberalised European petroleum market is the regulatory EFTA Surveillance Authority (ESA). This authority functions in accordance with the EEA agreement between Norway and the EU. ESA is a general operating agency of the regulatory state order, mandated to perform the surveillance of legality regarding market competition, including in the petroleum sector.



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5.2 The arrival of the Norwegian Government Pension Fund – Global

Many of the facts about the Government Pension Fund, its organisational features and the policy itself, presented here for descriptive purposes, are to be found in the Report No. 24 (2006–2007) to the Parliament (Stortinget) 'On the Management of the Government Pension Fund in 2006'.

Purpose

The Petroleum Fund was established in 1990 as a tool of fiscal policy in order to support the long-term regulatory management of the petroleum revenues. Typical for the regulatory state mode of governance, the Ministry of Finance is responsible for the management of the Government Pension Fund but has authorised the arm's-length Norwegian Central bank to be responsible for the operational management of the Pension Fund – Global. The Central Bank is accordingly organised as an independent governmental agency, which in this context invests the fund's capital in bonds and equities. Renaming the Petroleum Fund to the Pension Fund – Global in 2006 was actually part of a broader regulatory pension reform highlighting also the Fund's role in facilitating the governmental savings necessary to meet the expected rapid rise in public pension expenditures in the coming years, see Fig. 9.1. The goal of this broader reform has been to slow down the rising expenditures by making it more profitable for people to stay longer in the work-force after reaching ordinary retirement age. This is called the 'work line reform'.

The Pension Fund is not earmarked for pension expenditures but is politically devoted to this social security objective. Politically, the Norwegian welfare state of the Nordic type, with universal social rights, is put into play in the global age, and future economies determine the rules of this game (Veggeland 2007). Certainly, there exist risks to lose the game. However, to make goals about social equity and equality and expensive welfare arrangement realistic at all, the Pension Fund – Global constitutes a necessary and believed guaranty (Veggeland 2009).

The Pension Fund is fully integrated into the budget of the national government. It functions as a tool to strengthen the budgetary process and builds on existing institutions. The Fund is only invested abroad in financial assets in order to bring the accumulated effective demand and inflation in the national economy under regulatory control. Investing abroad also ensures risk diversification in order to increase the chances of good financial returns and helps to protect the domestic non-petroleum economy.

The political intention of maintaining a high degree of transparency and disclosure of information through evaluation reports and public debate is not always realised (Reinertsen 2008). Nevertheless, this openness to some extent helps to build public support and accountability that encourage the wise management of the petroleum revenues and reduce the risks of poor governance that can result in failing investments and of corruption when huge sums of money are in play.

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Key Design Features

The Pension Fund's inflow consists of all state petroleum revenues, the net financial transactions related to petroleum activities, and the return on the Fund's investments. The outflow from the Fund is the sum needed to cover the deficit of the non-petroleum governmental budget. The net cash flow from the petroleum revenues comprises the total inflow minus the outflow, including pension expenditures, from the Fund (see Fig. 3).

This means that the Fund is fully integrated into the state budget and that net allocations to the Fund reflect the total budget surplus (including petroleum revenues). Fiscal policy, which regulates the outflow from the Fund, adheres to the guideline that the non-petroleum budgetary deficit should eventually correspond to a limited return from the Fund, estimated at 4 per cent. It is a responsibility of the Parliament to adopt budgets that do not exceed this limit.

We have already noted that the Ministry of Finance is responsible for the management of the Fund, and in line with the regulatory state mode of steering activities, the Norwegian Central Bank carries out the operational management. The Bank is obliged to invest innovatively and selectively the Fund money in accordance with the guidelines issued by the Ministry, and, as we shall elaborate later, in accordance with ethical guidelines. The Fund might now be named the *Ethical Pension Fund*.

All key changes to the investment guidelines are presented to the Parliament before implemented. The Ministry receives advice on the investment guidelines from Norwegian Central Bank, the Ministry's advisory council on investment strategy and external consultants. The Ministry also uses external consultants for the independent evaluation of performance and the benchmarking of performance and costs (Eriksen 2006).

Investment Guidelines

The investment strategy is to achieve high financial returns subject to moderate risk. The Pension Fund is only invested abroad in financial instruments. The Fund is a financial investor with a diversified portfolio of numerous investments in a range of companies. The Fund's financial results are primarily assessed in the terms of international currency in order to measure the development in the Fund's international purchasing power.

Equities account for 60 per cent of the Fund's strategic benchmark portfolio, comprising equities listed on exchanges in Europe (50 per cent), America and Africa (35 per cent) and Asia/Oceania (15 per cent). Fixed income instruments account for 40 per cent of the strategic benchmark portfolio, consisting of fixed income instruments issued in currencies from Europe (60 per cent), America/Africa (35 per cent) and Asia/Oceania (5 per cent) (Report No. 24 (2006–2007) to the Storting).

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Transparency

The management of petroleum revenues in general and the Fund in particular is characterised, as already pointed out, by transparency and disclosure of information. These features are necessary because a high degree of transparency and openness is essential to be able to build accountability and support for the Government's management of the petroleum wealth. Large budgetary surpluses and substantial and very visible financial assets are in play, and this 'play' is also in need of taming under democratic control, besides being under regulatory control.

The Ministry reports to the Parliament on all important matters relating to the Fund, such as the size of petroleum revenues and the Fund, the outlook for fiscal sustainability, changes to the investment strategy, and the Fund's performance in relation to risk and costs. The Ministry also publishes advice and reports received from Norwegian Central Bank, the Strategy Council, and external consultants. Further, it publishes quarterly reports on the management of the Fund, as well as an annual report and an annual listing of all investments.

5.3 Ethical Guidelines

A regulatory approach:

We have seen earlier the references to the economist Frédéric Lordon (2003) and his statements regarding the actual financial crisis and an anxious stock market. The title of his book is appropriately provocative: *And virtue is going to save the world…After the financial catastrophe, the salvation by "ethics"*? This idea may perhaps also have struck Norwegian politicians and social scientists. Whatever the case may be, in the framework of the regulatory state, the Government Pension Fund gives the option to pursue ethical taming in practical politics.

The Norwegian ethical guidelines were issued in December 2005, and, in accordance to the regulations on the Management of the Government Pension Fund – Global, formal regulations on the Management of the Government Petroleum Fund were issued in 2004. The recommendations of the Graver Commission (NOU 2003:22) form the basis for the guidelines for the Fund. Hans Petter Graver, the leader of the Commission, is not by chance a professor in law and an expert in EU regulations.

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Basis:

The ethical guidelines for the Government Pension Fund – Global are based on two official basic premises in a political and economic regulatory taming perspective:

- *Economic ethical premise*: '*The Government Pension Fund – Global* is an instrument for ensuring that a reasonable portion of the country's petroleum wealth benefits future generations. The financial wealth must be managed so as to generate a sound return of revenues in the long term, which is contingent on sound and sustainable development in the economic, environmental, and social sense. The financial interests of the Fund shall be strengthened by using the Fund's ownership interests to promote such sustainable development'.
- *Political ethical premise*: '*The Government Pension Fund – Global* should not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of social and human rights, gross corruption or severe environmental damages'.

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Mechanisms:

The ethical basis for the Government Pension Fund – Global is to be promoted through the following three measures:

- *Exercise of ownership rights* in order to make sustainable investments globally, involving the diversification and dispersion of the investments both geographically and industrially to reduce risks and to secure stable revenues in the pursuit of long-term financial returns. Promotion of sustainability in every sense should be a goal in itself.
- *Negative screening* of companies from the investment universe that either themselves or through the firms they control violate fundamental social, humanitarian, and environmental principles.
- *Exclusion* of companies from the investment universe when either there have been violations of the aforementioned ethical principles or a risk is deemed unacceptable for the political and economic premises of the Pension Fund.

The overall objective of Norwegian Central Bank's exercise of ownership rights for the Government Pension Fund – Global is to safeguard the Fund's financial interests, because these interests represent the necessary conditions for revenues. And that is how the ownership rights should be exercised, as mentioned, a long-term horizon for the Fund's investments and a broad diversification of investments in the markets that are included in the investment universe. What about the ethical aspect of this regulatory petroleum regime through the perspective of governance?

The exercise of ownership rights is decidedly strongly bound to the UN's Global Compact and the OECD Guidelines for Corporate Governance and for Multinational Enterprises. The Central Bank's internal guidelines for the exercise of ownership rights indicate how these principles should be integrated in the ownership strategy (Austvik 2007). Further, these regulatory bodies are supposed to be in charge of enforcing ethical conduct.

Negative screening and exclusion

Based on recommendations given by the Council on Ethics for the Government Pension Fund – Global, the Ministry of Finance is the authority responsible for making decisions on negative screening and exclusion of companies from the investment universe.

The recommendations and decisions are to be made public. The Ministry may, in certain cases, postpone the timing of public disclosure if this is deemed necessary in order to ensure a financially sustainable implementation of the exclusion of the company concerned.

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The Council on Ethics for the Government Pension Fund – Global comprises five members; in 2008 these are two professors of law, one professor of philosophy, and two managing directors. The Council has its own secretariat. The Council submits an annual report on its activities to the Ministry of Finance. Both the Ministry's decisions and the Council's recommendations are made publicly available on the Council of Ethics website.

Upon request of the Ministry of Finance, the Council issues recommendations on whether or not an investment may constitute a violation of Norway's obligations under international law and may be in conflict with the ethical regulations.

The Council is obliged to issue recommendations for negative screening of one or several companies in cases where the production of weapons through their normal use may violate fundamental humanitarian principles. The Council issues recommendations on the exclusion of one or several companies from the investment universe because of acts or omissions that constitute an unacceptable risk to the Fund (www.regjeringen.no):

Indicators:

- *'Serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other forms of child exploitation'.*
- *'Serious violations of individuals' rights in situations of war or conflict'.*
- *'Severe environmental damages'.*
- *'Gross corruption'.*
- '*Other particularly serious violations of fundamental ethical norms*'.

The Council of Ethics is authorised to raise issues under these indicators on its own initiative or at the request of the Ministry of Finance.

Accordingly, the Council gathers all necessary information in order to ensure that the matter is documented as fully as possible before making a recommendation of negative screening or exclusion from the investment universe. This is, of course, a very complicated act and produces failures first and foremost because information often comes up more or less haphazardly (Reinertsen 2008). The Council may request Norwegian Central Bank to help provide information on how specific companies are dealt with in the exercise of ownership rights. Enquiries to such companies are channelled through Norwegian Central Bank. If the Council is considering the recommendation of exclusion of a company, the company in question will receive the draft recommendation and the reasons for it in order to comment on it.

The Council has the duty to review on a regular basis whether the reasons for exclusion still apply and may recommend that the Ministry of Finance revoke a decision to exclude a company if new relevant information is uncovered.

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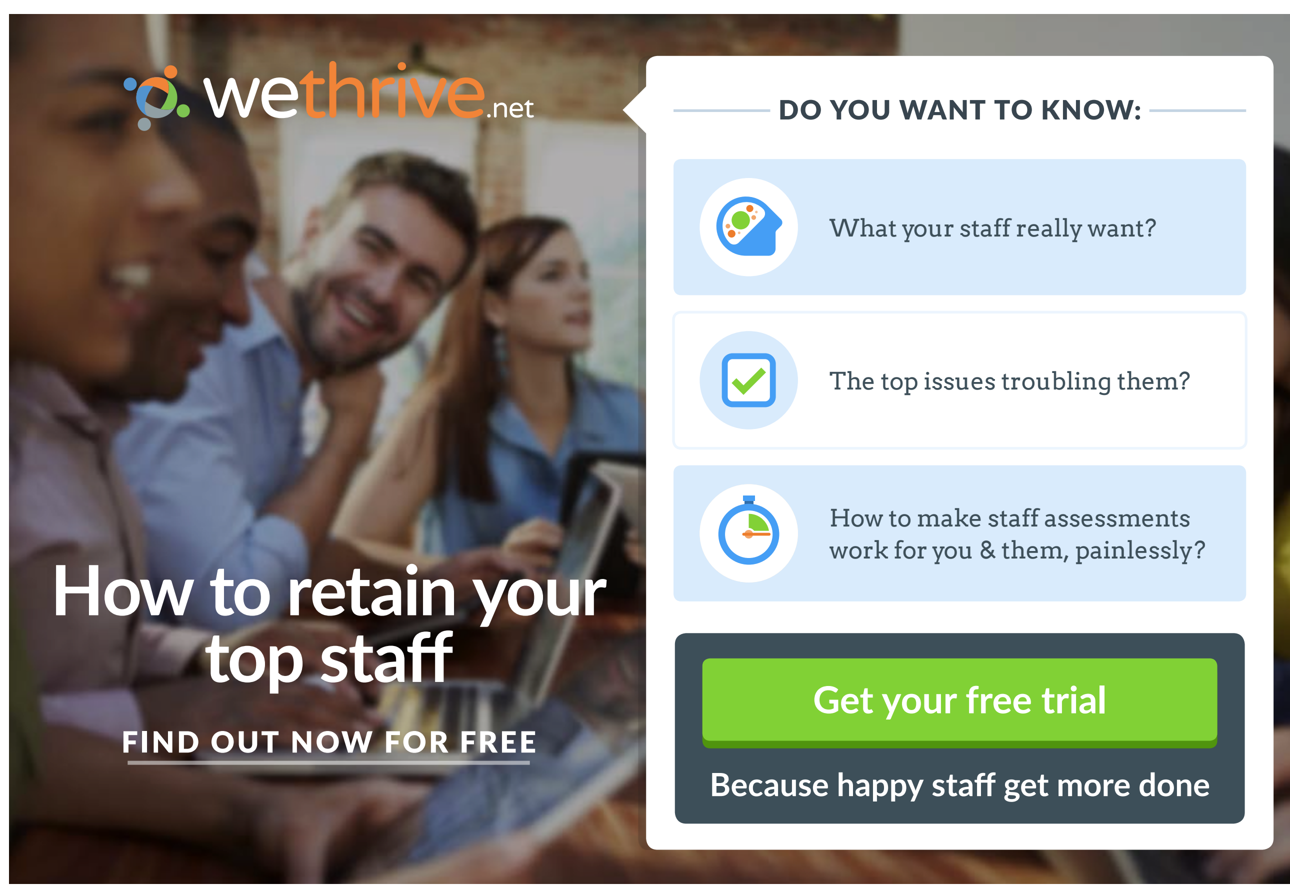
The Norwegian Central Bank is the regulatory agency that receives immediate notification of the decisions made by the Ministry of Finance in connection with the Council's recommendations. The Ministry of Finance may request that the Norwegian Central Bank inform the companies concerned of the decisions taken by the Ministry and the reasons for the decision.

Here follows a presentation of the results from the screening work done by the Council on Ethics for the Government Pension Fund – Global:

Companies considered to have violated the ethical regulations and consequently excluded from the investment universe 2005–2011.

Weapons violating fundamental human right principles

Production of cluster weapons
- Textron Inc. (31 December 2008)
- Hanwha Corporation (31 December 2007)
- Poongsan Corporation (30 November 2006)
- Raytheon Co. (31 August 2005)
- Lockheed Martin Corp (31 August 2005)
- General Dynamics corporation (31 August 2005)
- Alliant Techsystems Inc (31 August 2005)



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Production of nuclear weapon
- Serco Group Plc. (2007)
- Gen Corp Inc. (2007)
- Safran SA. (2005)
- Northrop Grumman Corp (2005)
- Honeywell International Corp (2005)
- Finmeccanica Sp. A. (2005)
- EADS Finance BV (2005)
- EADS Co (2005)
- Boeing Co (2005)
- BAE Systems Plc (2005)

Sale of military materials bound for Burma
- Dongfeng Motor Group Co Ltd (2009)

Production of tobacco
- Grupo Carso SAB de CV (2011)
- Shanghai Industrial Holdings Ltd (2011)
- Alliance Ett International Inc. (2009)
- Altria Group Inc. (2009)
- British American Tobacco BHD (2009)
- British American Tobacco Plc. (2009)
- Gudang Garam TBK pt. (2009)
- Imperial Tobacco Group Plc. (2009)
- ITC Ltd (2009)
- Japan Tobacco Inc. (2009)
- KT & G Corp (2009)
- Lorillard Inc. (2009)
- Philip Morris International Inc. (2009)
- Philip Morris Cr AS. (2009)
- Reynolds American Inc. (2009)
- Souza Cruz SA 2009)
- Svenske Match AB (2009)
- Universal Corp VA (2009)
- Vector Group Ltd (2009)

Actions involving risk for that the Fond contribute to:
Rude or systematic violation of human rights
- Wal-Mart Stores Inc. (31 May 2006)
- Wal-Mart de Mexico SA de CV (31 May 2006)

Grave environmental damages
- Lingui Development Berhad Ltd (2011)
- Samling Global Ltd (2010)
- Norilsk Nickel (2009)
- Barrick Gold Corp (2008)
- Rio Tinto Plc. (2008)
- Rio Tinto Ltd (2008)
- Madras Aluminium Company (2007)
- Sterlite Industries Ltd (2007)
- Vedanta Resources Plc. (2007)
- Freeport McMoRan Copper & Gold Inc. (2006)

Table 2. Companies excluded from the investment universe since 2005

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5.4 Vulnerability and risk analysis of the Norwegian Pension Fund – Global

The vulnerabilities and risks in a political and economic perspective are manifold (Alm 2010). Funding a pension system in the absence of a domestic budgetary surplus certainly has implications of political and economic risk, which is the case with the Norwegian Pension Fund. One implication is that more legal protection set by regulations is given to future pension payments than to other priorities and public outlays. This presents a challenging game in regard to short-term political legitimacy and politicians' re-election cycles. Future pension payments are set against instant investments in roads, schools, hospital services, etc., all of which are vital utilities that have to be set as lower priorities as a result This down-grading of important investments occurs because the pension-funding regime defines the rules of the game, and these rules count until they eventually get changed – and that is a risk.

The Norwegian Pension Fund – Global is also vulnerable in another sense. If future economic growth and governmental revenues turn out to be lower than expected, the negative consequences will fall primarily on public consumption, in accordance with the actual regulatory measures. As pointed out, the Pension Fund is not earmarked for any specific purpose; the intentions are only politically formulated, and the risk is that these might be changed. 'Politics of blame avoidance' (Weaver 1986) may be the outcome for governments when coping with the effects of unexpected decreases in future revenues. Or the governments may feel the political pressure to prioritise greater domestic investment in the cost of the inflow in the Pension Fund or may change the arrangement by letting the petroleum revenues pass into the private sector, away from the goals of universal welfare and collective action.

Another line of argument is bound to the regulatory state's thinking on legitimacy (Veggeland 2009, 2011). The funding of the Pension Fund and the use of petroleum revenues according to laws and regulations, outside direct democratic control and not exposed to short-term political decision-making, is meant to increase the legitimacy and long-term protection of the Fund's assets. An often given example is the high public support for the protection of the assets in the Alaska Permanent Fund. Here, real money from the Fund is handed out directly to the citizens of Alaska. This policy does not, however, reduce vulnerability because it is a short-term perspective that has overrun enduring, long-term considerations regarding welfare and social security (Skancke 2003).

We have previously reviewed the three taming measures that constitute the Norwegian Ethical Pension Fund. These are the *exercise of ownership rights* in order to make sustainable investments globally, diversifying and dispersing the investments geographically, industrially, and financially to reduce risks and secure stable revenues; the *negative screening* of companies from the global investment universe that either themselves or through the corporations they control violate fundamental social, humanitarian, and environmental principles; and the *exclusion* of companies when violations of the principles above have been revealed or when a company is considered to be an unacceptable risk to the political and economic premises for the Pension Fund.

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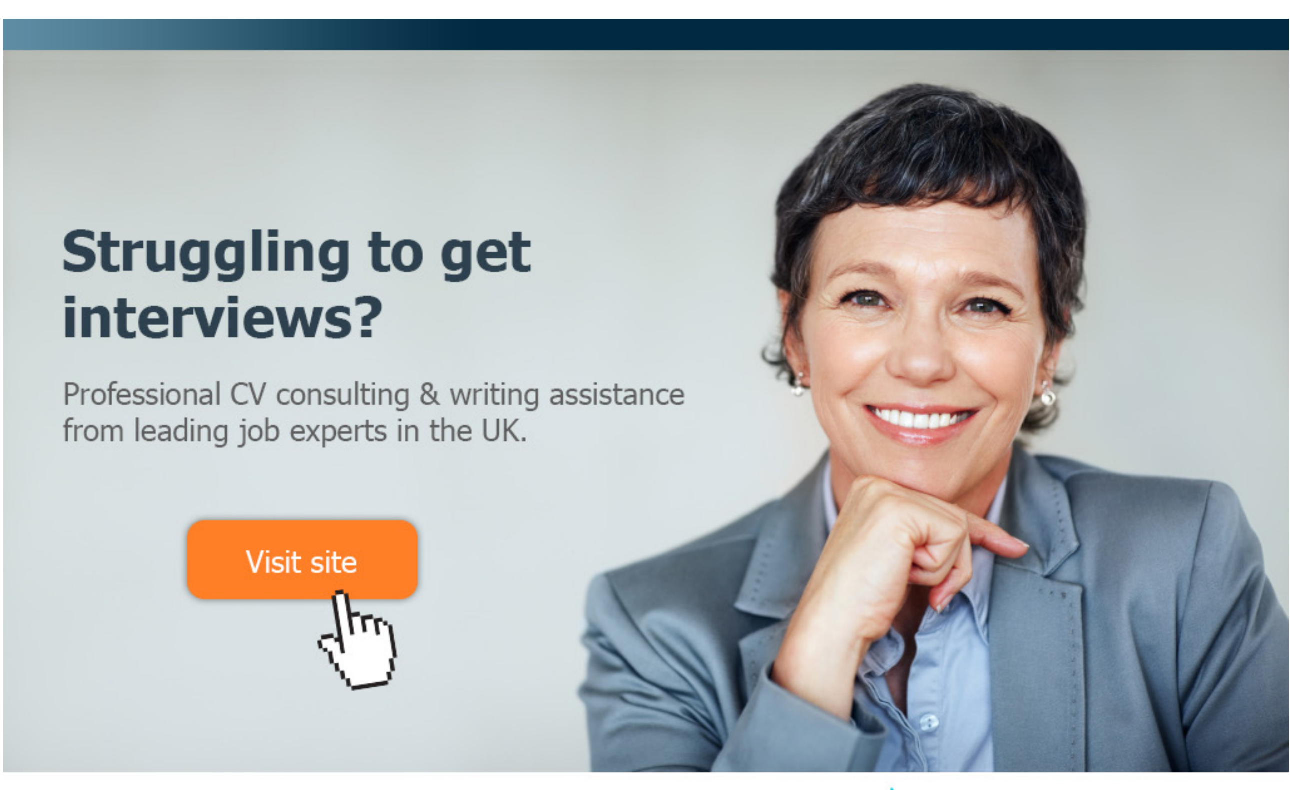
First, there is the exercise of ownership and the strategic measures to reduce investment risks and to secure stable petroleum revenues. Obviously, the strategy of diversity and spreading investments geographically, industrially, and financially is an appropriate strategy. Technically, the Norwegian Central Bank can quite easily implement the strategy. Yet, this strategy does not remove vulnerability and risk (Reinertsen 2008). The whole scheme depends on an international economy and a balanced and growing business cycle. Short-term sector problems and trade disturbances are but normal and acceptable, but an international economy undergoing a deep structural crisis is certainly not. But the history of economics tells us that such crises always have occurred from time to time, with the stagflation crisis from the 1970s and a looming international financial crisis in 2008 as the latest examples. Such crises have been a main subject for most of the classical economists – from Malthus and Marx to Keynes and Schumpeter (Veggeland 2009). A future international structural crisis would probably be a catastrophe for the Norwegian Government Pension Fund.



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Secondly, it is questionable whether the negative screening and exclusion of companies violating the ethical guidelines for Pension Fund investments is sufficiently feasible to affect policy (Alm 2010)? The list of excluded corporations, Tab. 2, shows that implementation of the ethical guidelines and regulations are feasible. The problem is, however, that a fair and accountable screening of corporations in this context is very unreliable, perhaps with a high risk for overlooking the worst cases (Reinertsen 2008). Globally, the transparency of economic networks is very low. Enormous human and technical resources have to be reserved for the task of penetrating these networks and looking for grounds for ethical disqualification regarding investments. One has to be aware of that such use of resources from the Norwegian Pension Fund – Global is not a reality today.

In the future, we may assume that the Norwegian Pension Fund will face huge challenges connected to international agreements on environmental issues, i.e., regulations that intend to restore ecological systems and to secure sustainable development. This is good from a human and ethical development perspective, but it might reduce the expected high revenues from the petroleum industry. Certainly, global agreements on environmental issues imply strong regulations on the exploration, production, and refining of petroleum in the future. In conclusion, the Norwegian Pension Fund is also vulnerable in that environmental threats challenge the petroleum revenues and therefore also the predicted high net inflow of money into the future Fund.

Summing up:

The systematic risk of the type found in the Norwegian Pension Fund – Global is discussed at length in the financial literature. It has over time become common to relate systematic vulnerability and risk to a long range of factors that might cause imbalance and failure. Ulrich Beck (1992) postulates that risks today have a different significance for everyday life from the risks that applied to previous historical eras. He claims that human activity and technology in advanced political and economic modernity produce as a side-effect risks that demand specialised expertise to access and recognise and are collective, global, and irreversible in their impact. The Norwegian petroleum activity under regulatory management and control is an example of that.

The Government Report No. 24 (2006–2007) to the Parliament (Stortinget), 'On the Management of the Government Pension Fund', has presented a very optimistic view on the risks involved. Taking as a point of departure that the risk-return profile of the Pension Fund is largely determined by the governmental investment guidelines, the report continues this way: 'The risk assumed in active management has only to a limited degree increased the actual market risk of the Fund…' (Government Report No. 24 (2006–2007): 82).

There is, however, no simple way of conceiving risk-regulation regimes. No one has ever seen a risk-regulation regime embracing a totality of effects – and side-effects – along all dimensions. Against this background, Christopher Hood, Henry Rothstein, and Robert Baldwin have stated (2001: 179) that, "principles that have been advanced for regulatory assessment typically comprise some mix of "economic rationalist" cost-effectiveness criteria together with rule-of-law criteria – such as proportionality and transparency – and policy evaluation to identify regulatory impacts and alternatives'

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We can recognise the meaning of this quotation in the Norwegian Petroleum industry and the establishment of the Pension Fund. With regard to the optimistic view on risk occurrence and the Pension Fund cited from the Government, as we have seen, there are good reasons to doubt this low assessment of the market risk of the Pension Fund. We should ignore neither the regular cycle of global economic crises nor the connection between global warming and CO2-emissions from petroleum activities, which is kept outside risk assessments.

The notion of 'actual market risks' with regard to the future of the Ethical Pension Fund is far too narrow for a sufficient evaluation in the service of the common good. In a political and ethical perspective, the Pension Fund – Global should not, by definition, and unlike other ordinary international investment funds, represent risk capital in the terms of neo-classical liberal economic thinking. Substantial regulations by law and ethics deviate from regulations by the market.

5.5 What does Norway get out of the GPF-G? The dilemma; foreign investments versus domestic investments

"What does Norway get out of its Oil Fund (Government Pension Fund – Global (GPF-G)), if not More Strategic Infrastructure Investment, is Michael Hudson asking" (Hudson 2011). He keeps on asking: "What do Norwegians get out of these financial savings, besides a modest interest and dividend yield? The export surplus is said to be too large to spend more than a small fraction (a Procrustean 4 percent) at home without causing inflation"? So other countries get not only Norway's petroleum, but also most of the royalties and earnings from its production. Meanwhile, Norway spends little on itself. Even now that its financial managers are beginning to worry about how risky the stock markets are becoming and feel the need to diversify into real estate, the Norwegian government still avoid investing the Pension Fund's wealth to build up the domestic infrastructure. His critical analysis goes further like this.

What seems ironic is that while Norway is sending its savings mainly to European and U.S. financial markets, money managers in these countries are sending their funds to the BRIC economies (Brazil, Russia, India and China). This broad scope invests export earnings directly to make their economies more competitive while raising living standards. This also points to the fact that dealing with the Pension Fund goes beyond the purely financial scope of deciding simply what foreign stocks and bonds to buy. The basic financial scope of question is which securities will achieve the highest rate of return or rise most quickly in price. This is a short-term decision. Little of this financial acrobatic policy adds value to the real capital of the Norwegian economy.

Given this situation, how should Norway best policy look like? As a point of departure, the Norwegian government has a broader option than merely to steer savings into foreign financial markets. The policy should improve the economy by creating tangible means of production to raise productivity by working in tandem with leading national industries, generate innovation by give investment in research priorities, and favor building infrastructure, social as well as physical infrastructure. And rather than being inflationary, public investment enabled economies to minimize their cost of living and doing business.

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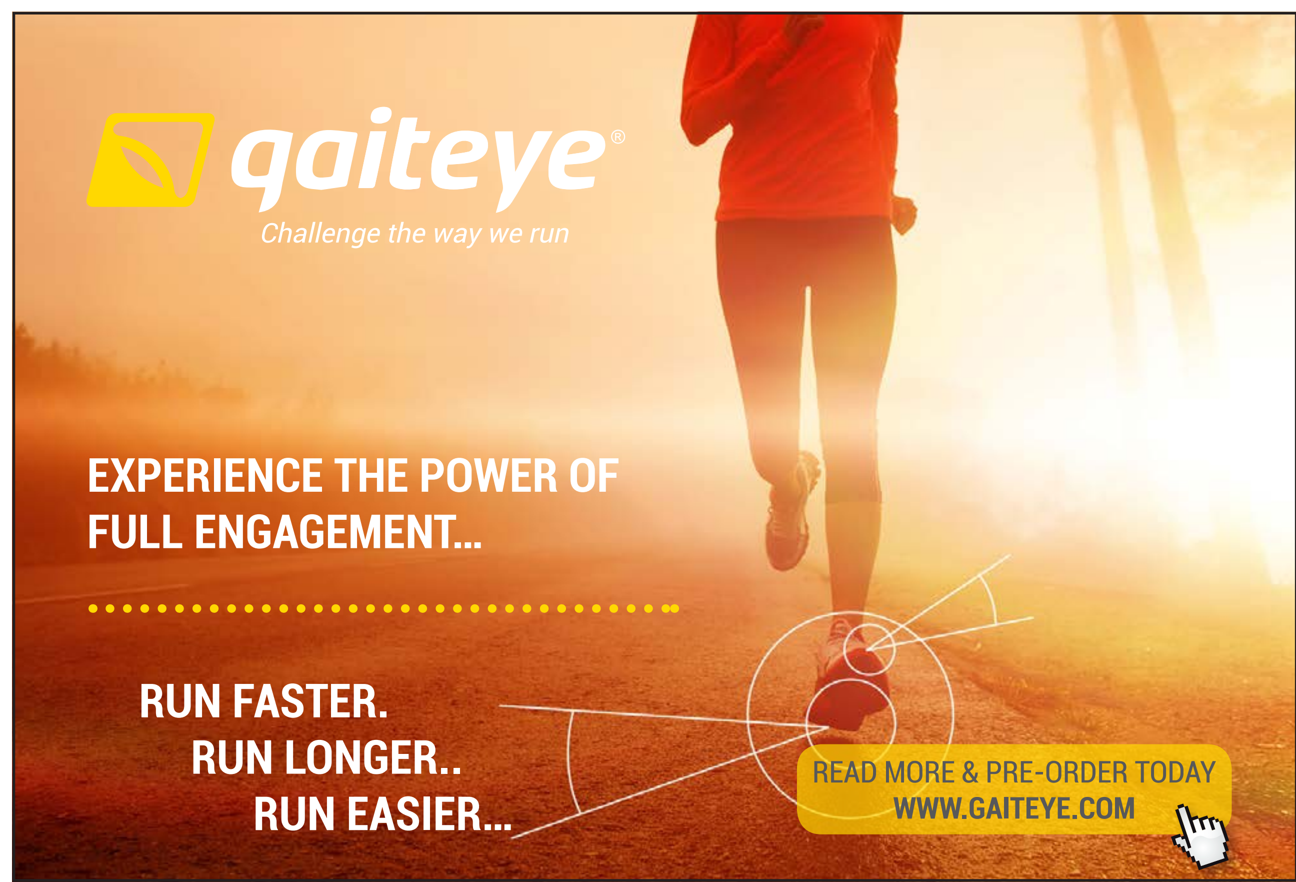
There are two approaches to how the Norwegian government may manage their Pension Fund – Global. For simplicity, these can be called the passive and active approaches. The present approach is passive. Norway consigns its petroleum "earnings to money managers to buy stock or bond ownership abroad without linking these purchases to its own future development – except by receiving a modest foreign exchange return" (Hudson 2011:3). The more active approach considers the government's duty as being to develop the domestic economy to the benefit of its citizens. This is done by initiating infrastructure building, including education and public health care, research and development, and investment in transportation, power generation and distribution, communications and information technology.

Public infrastructure represents the largest capital expenditure in almost every country, yet little trace of its economic role appears in today's Norwegian income and product accounts. Free market ideology wrongly treats public spending as deadweight, and counts infrastructure spending as part of the deficit, not as productive capital investment. Nobel Prize winner 1989, Trygve Haavelmo from Norway, describes the aim of public investment as being different from that of individuals or business. The ultimate aim was not to seek profits, but to create the best economic and social system possible with the resources at hand.



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As the Norwegian Prime Minister (PM) since 2005, Jens Stoltenberg, an economist and former Minister of Finance, actually he is a main architect behind the Norwegian Pension Fund – Global (of US $584 bill) and "the budget rule" of not spending more than "an estimated return" of 4% pro annum. His main argument is that the fund's passive strategy of today is spreading the risk into a multitude of minority positions, and that therefore Hudson's advice of an active strategy and to concentrate investments in national strategic infrastructure and technology will increase the risk rather than reduce the risk. Probably Hudson will respond by arguing that apparently the PM has not understood the industrial motivation of real economic investment (real wealth creation) for Hudson's suggestion as opposed to the financial motivation (monetary profit) that he himself pursues. Monetary profit motivates the Pension Fund's investment in stock and bonds global, while domestic wealth creation is passed over by the PM.

The Norwegian government downgrades the monetary profit motive. Instead the Government argues that the potential threat of increased domestic investments will make the Norwegian currency harder against foreign currencies combined with a growing interest rate. The result of this will be loss of economic competiveness internationally.

5.6 What does Norway get out of the GPF-G? – The dilemma; negative ethical exclusion versus positive selection

Thus far, the Ethical Council which monitors the Government Pension Fund – Global (GPF-G) investments has sought to meet its ethical objectives through so-called negative selection, i.e. exclusion of companies for unethical behavior picked out from the large universe of investments. As we see from tab. 2, these may be companies that violate human rights, use child labor, fail to observe ordinary standards for employee rights, manufacture nuclear weapons or cluster munitions, are responsible for severe environmental damage, etc.

Ethical management of the GPF-G could be exercised in two different manners; by negative exclusion or positive selection. For some years now, in the public debate, it has been proposed that the ethical management should be reoriented from negative screening to *positive* selection. Instead of excluding companies that violate the decided ethical standards, one should invest only in companies and branches that appear to be, in some sense, an active force for the good on ethical issues. Thus, Th. Johnsen and O. Gjølberg (2009:2) write:

> "…positive selection involves a significant narrowing of the investment universe. It is, generally speaking, much more difficult to declare a company to be completely without blame than completely beyond the realm of the ethically acceptable. The potential fallout from error under a pure positive selection strategy may also be much higher than under a negative selection strategy".

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Of course, they are right, and consequently Norway has chosen the easiest way; negative exclusion. Following up their conclusion, Johnsen and Gjølberg suggest a number of more pragmatic approaches that could be realized by decisions in the Ethical Council. One such approach they suggest for Norway is the "popular principle" of selecting positively the best-in-class strategy. This principle, they postulate, entails selecting those companies that are perceived, based on various ethical criteria, to be best in their class of type-production. The class may be defined as an industry (energy, consumer goods, finance, etc.), but it is also possible to define classes as type-production dominant for a particular region. This indicates that a firm may be the best in an ethical poor class, and should be rewarded with investments, and another relatively good ethical firm may be far from the top of the elite ethical and sustainable class of type-production, and investment should be withdrawn. This ranking principle as a pragmatic approach to the political will of realize positive selection more strongly has never been accepted in Norway as a policy for the GPF-G and ethical investments. The reason for that seems to be the problem of ranking. In the jungle of firms and branches it is almost technically impossible to figure out indicators, criteria and measures to make the ranking relevant.

What actually is a more relevant policy approach for Norway in this context is that criteria have been introduced in recent years which are directed investments for stimulating the growth of upcoming of pioneering firms and branches which concentrate on sustainable production for the future. Thus, in line with international trends, the criteria, the Fund favors in particular investment in companies within environmental technology, solar energy, and renewable energy in general, etc. The literature often refers to these criteria as 'pioneer screening'. Such selection strategies are premised on the idea that companies that make a positive contribution to the climate – or to the fight against AIDS and malaria – generate positive ethical externalities. Of course, this pioneering screening policy is not an unproblematic one. Obviously, new ethical conflicts or dilemmas may arise. When eventually the pioneering type-production becomes a commercial success in the global market normally and most likely negative externalities of ethical relevance arise. A randomly chosen example is given by Johnsen and Gjølberg: Pioneering screening can trigger investments in a pharmaceutical company that devotes a large share of R&D resources on developing a low price anti-malaria drug that is affordable for poor people in Africa. NPF-G supports such investments. However, this company may at the same time be conducting large-scale animal testing or producing unhealthy drugs.

In the Norwegian debate on the GPF-G it has also been proposed that the management of the Fund should focus on investments for helping forward economic growth and poverty alleviation in developing countries. This perspective contains interesting views and raise entirely new ethical issues and challenges, in particular as far as positive selection is concerned. It is regrettable, but corruption and poverty do tend to co-exist, making it difficult to combine positive selection based on a company's ethical track-record and investments in developing countries. As observed and for the corruption problem, the NPF-G's positive selection is therefore often biased in favor of well-established, large companies in the rich countries.

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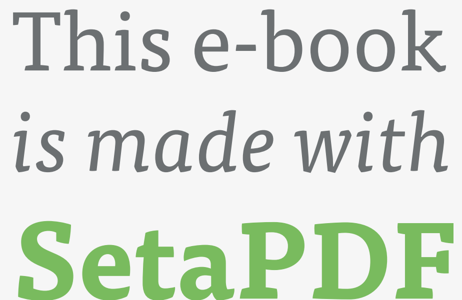
6 The political-economy background of the contemporary crisis.

Introduction

Economics goes back a long way under shifting political conditions. The Keynesian state's macro-economic form of intervention actions, which developed just after the Second World War, was a clear answer to the structural economic crisis of the inter-war period of the 1920s and 1930s. The Keynesian economic theory was in many senses deduced from classical economic theories. Correspondingly, today we see the Keynesian principles being transformed but prolonged, despite change of framework. The ongoing financial and dept crisis needs an answer of solution, and the answer seems to be found in principles which could be traced and identified as neo-Keynesianism and neo-interventionism. This paper is tracing and analyzing the political economy of the historical democratic capitalism.



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6.1 Neo-interventionism and neo-Keynesianism of today

There is an ongoing crisis in Europe, characterized by being both a credit and a financial crisis. Measures are needed, therefore causing the EU to become active as an interventionist state in the sense of what John Maynard Keynes recommended (1936). However, principally the framework has change and is new, thereof the introduction of the concepts of neo-interventionism and neo-Keynesianism.

The EU has made important interventionist steps to counteract the crisis, particular deeply experienced in member states like Greek, Italy, Spain, Portugal, Ireland and Hungary, by claiming firmly reduction in public spending, reducing salaries and lowering pensions. On the other hand the EU established a stability fund near 1000 billion euro to help states in trouble. In December 2011 the European Central Bank (ECB) presented an intermediary but long term solution to heal the actual dept problems of certain states; the Long Term Re-financial Operation (LTRO). The aim of the operation is to support the banks with money by an exchange procedure: Banks sell expensive old bonds and gilts, turned over in the market with 6–9 per cent interest rate, to the ECB and get fresh money in return. The banks agree on paying the money back in three years times at the same price. For the money the banks need only to pay an interest rate of only 1 percent in return. The measure is meant to secure the bank's liquids. The common understanding is that the banks use their money to buy new state bonds and gilts to secure access to financial assets for those countries. In the first round of exchanging money €500 billion were taken over from the ECB by the national banks, and the amount has been more than double since then. The problem with this measure which makes it intermediary is that the dept as such has not disappeared. What is needed is real economic growth and creation of jobs.

The supranational EU interventionism in the wake of the ongoing crisis also aims to lower the degree of devolution and national independence. Europe took a major step towards full fiscal union last year, as every EU member country, except the UK and the Czech Republic, vowed to cut budget deficits and submit themselves to greater scrutiny from the European Commission.

The EU member states, 25 out of 27 states, voted for the so called ”Financial Pact”, which gives the EU and its institutions the authority to control member states ability and political will to keep their national budgets in accordance with EU economic and financial rules and regulations. The agreement is seen as a significant victory for German Chancellor Angela Merkel, who spent months pushing for euro zone members to agree on tighter budgetary constraints. Under the treaty, signatories will agree to cut budget deficits and reduce national debts as a proportion of their economic output or face “automatic” fines, likely to stand at 0.5 per cent of GDP. Sanction will be put in place if the national dept exceeds 3 per cent of the GNP. – National interventionism is losing adequate rendering, and governing democratic authorities are becoming emptied for power.

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The political scientist, Wolfgang Streeck writes in 'Le Monde diplomatique' January 2012 that "Markets dictates what believed sovereign democratic states may and may not do for their citizens. Consequently, the citizens do not respect their elected representatives as their own but identify them as representatives for interests of other states and international organizations. Streeck is right but one word should be replaced by another word. It is not the market but supranational regulation which dictates sovereign states. To be dictated is the price to pay for overcoming the contemporary; the regulations generate new forms of supranational interventionism and adequate ideas. The neo-interventionist and neo-Keynesianism thinking is differently executed though, seen in contrast to Keynes' interventionism which was directed to the promotion of economic stability and national effective demand. The latter interventionism was aiming national market regulation by economic demand interventions (Shonfield 1969), rather than dept reduction, contrary, Keynes recommended the raising of public loan in order to realize effective demand objectives.

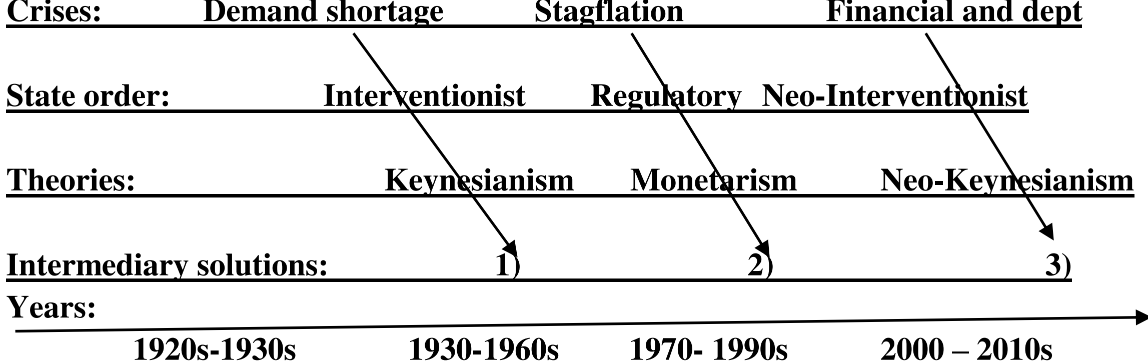

Table 1. Solutions of international economic crises, 1), 2), 3) promote changes in state orders and choices of predominant economic theories. Different theories get transformed to ideology when not valid as solutions any longer.

The Tab. 1 sketches the structure of this paper. International economic crises of our time have their history. Before the Second World War, in the 1920s, there occurred a pre-Keynesian demand crisis causing threatening unemployment in Western states. The state reacted passively, and its policy shaped accordingly relying on classical liberal economy theories. In the paper we will review some of those classical economists; Adam Smith, Davis Ricardo and Thomas Robert Malthus – leading up to Karl Marx and Keynes. In the 1930s John Maynard Keynes wrote his "General Theory of Employment, Interest and Money" (1936), which introduced the principle of the interventionist state. The theory claimed the necessity of an active state to secure effective demand in order to overcome the ongoing pre-war demand crisis.

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The Keynesianism as a political strategy succeeded until the 1970s, when the stagflation crisis undermined the previous enduring economic stability. The intermediary solution to the stagflation crisis was politically to leave Keynesian principles behind, and during the 1980–1990s to establish a monetary, supply side economy. The theory was deducted from ideas promoted by the so called Vienna School of monetary economists which rejected a dominant state function as adequate for the creation of economic growth and stability (Friedman 1980, Veggeland 2009, 2010). The monetary economic policy turned bankruptcy. In the late 2000s the international financial and dept crises occurred and became a grave challenge for Western governments. The contemporary crisis is a double crisis caused by both dysfunctional public and private dept and loans. What is clear is that this double crisis has made the governments and the EU to become active and stick to interventionism in the sense of what John Maynard Keynes recommended (1936). Consequently, we may talk about the occurrence of neo-interventionism as a new state order rooted in neo-Keynesianism theory, see Tab. 1.

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6.2 Principles of the pre-Keynesian state

The interventionist state's macro-economic form of central planning actions, which developed just after the Second World War, was a clear answer to the structural economic crisis of the inter-war period of the 1920s and 1930s, see Tab. 1. The legitimacy, which this form of planning gave the state to intervene in the market, is primarily connected with the work of the John Maynard Keynes, the English economist. In 'The General theory of Employment, Interest and Money', from 1935, where parts of the content had already been published elsewhere, Keynes elaborated a new foundation for the understanding of economic growth and its conditions in the market economy. This entailed studies of the causes behind economic fluctuations, and what determine the level of national income and employment. Even though Keynes was a liberal economist he opposed the laissez-faire perspective and marked the clear need for state intervention to tame the market and to escape and avoid economic crises. For these reasons there has been talk of the 'the Keynesian Revolution'. In this context Andrew Shonfield (1969: 3) puts forward an essential question:

'What was it that converted capitalism from cataclysmic failure which it appeared to be in the 1930s into the great engine of prosperity of the post war Western World? There is no simple answer, which rests on a denial of the validity of the question itself. The economic order under which we now live and the social structure that goes with it are so different from what preceded them that it is misleading – so it is alleged – to use the word "capitalism" to describe them'.

Through his work Shonfield (1969: 3–39) gives answers to the 'conversion' question, which could be summoned up as the following: Keynes' General Theory provided the rationale for state interventions, effective demand, and spending to achieve recovery and full employment. It revolutionized business-cycle theory and established the framework for modern macro-economic analysis including growth economics. In terms of references the effects of this work could aptly be called the 'Keynesian Revolution', Schonfield suggests.

As always happens along lines of ideas, historically they occur before an actual revolution which bias evolution of socio-economic theories and political ideologies. This was also the case regarding the ideas, which shaped the 'Keynesian Revolution'. A number of predecessors contributed as founding fathers of the economic ideas and legitimated the intervention of the market which led up to the Keynesianism. The ideas were all colored of the social setting in which they were innovatively design, and inspired by the political ideas and ideological approaches of the time like liberalism, utilitarism, and socialism. Let us look more closely into some of these 'founding fathers' (Stewart 1972, Schumpeter 1939).

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Adam Smith: Economics goes back a long way under shifting political conditions. Adam Smith, who published 'The Wealth of Nations' in 1776 one can take as the founder of modern economics. Despite his concern with what we call conditions for 'economic growth', the book contains no real discussion of why the level of employment is what it is and how market should be intervened and regulated. At the time agriculture was still by far the most important activity, and in an agricultural society the notions of being employed and being unemployed were not really distinctive: the whole family works, but might seasonally be underemployed. Smith simply assumed that there was always full employment. Regarding regulation, he in line with the liberal political thinking and classic economic theory of time he believed in the 'invisible hand' as the regulatory and taming principle of the market. He just commented one thing though, that of course 'landlords talk together' and they make their decisions and agreements and intervene on prices when they unavoidably meet now and then. This phenomenon he recognised as a negative externality which might disturb the rule and efficiency of the 'invisible hand', and thereby the balance of the economy. It represented a socio-economic risk that should be avoided. He never put forward the idea that such 'decisions and agreements' were indeed a human way of taming the actual markets.

Adam Smith took over the idea that the economic sphere was a sort of nature and therefore stable and structured by 'natural law'. This view he elaborated upon the contributions of the great founders at the time of political liberalism – especially John Locke (1632–1704). For Locke, a state of nature existed before the occurrence of the social contract conducted by the political state. In that pre-organized state each individual was facing nature and free interaction. They had to deal with work, the products and utility of the work, and property rights, therefore each man was a *homo economicus*. The social contract and the state control emerged only in reaction to threats and with the obligation to protect the natural law and the private property. Adam Smith took the idea of the 'natural man' as the 'economic man' and made it basic in his theory. He reaffirmed both the liberal view that the economic sphere should remain free and have historical and ideological precedence over other spheres of societal life.

David Ricardo: The next economist of major founder importance is David Ricardo, who published the first edition of his 'Principles of Political Economy and Taxation' in 1817. Like many other nineteenth century economists his main interest lay in the factors, which are steering the distribution of a nation's income between the major social classes – landowners, capitalists, and workers, i.e. rent, profits and wages in corresponding order. The capitalists must make large profits, accumulate money, he said, because they would invest them in new machinery; and this would create more employment and enable more to be produced. Ricardo operated in the optimism of the dawn of the industrial society. Typically, the issue of state interventions was not in the focus of Ricardo that was instead liberation of potentiality and ability.

Thomas Robert Malthus: Thomas Robert Malthus, another economist at the time, is best known for his theory of population. According to him there is tendency for the population to increase exponentially while the supply of food, only increase linearly. This represented the first socio-economic risk, which Malthus reviewed.

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The theory had its background in the actual population explosion in Europe, and the occurrence of extensive emigration waves to America. Hence, with this part of Malthus' work Ricardo did not disagree. But there was another part he opposed. Against Ricardo's theory of profits and investment in production machinery, Malthus argued on two levels. At one level he pointed out that there was a danger that the investment would raise the production capacity at a faster rate than the ability of the society to consume. Of the wages received by the workers only a part of it will be used to buy goods, which are produced because of the investment. Investment increases the production, but the nation state will find itself with a 'general glut of commodities', which cannot be sold. Will this not lead to unemployment, he asked? This was another risk. And on the second level, he went on asking: Actually, there is a large class of landowners and capitalists that certainly not invest their money; they tend to save their money, producing nothing, but consuming a lot, the third risk Malthus recognised. Malthus pointed out calamities but none principles or means to avoid them or at least for taming them by interventions.

Ricardo seems to some extent to have accepted the logic of Malthus' thinking, but his answer was that an economy might suffer from shortage of what he called 'effective demand' time by time but not in the long run. He eliminated the Malthusian third identified risk. Actually, Ricardo was more or less right at the time when he elaborated his theory. During the early nineteenth century the only way most industrialists could finance new buildings and machinery needed to expand their business was out of their own profits. Keynes said later on that 'Ricardo conquered England as completely as the Holy Inquisition conquered Spain' (quotation from Stewart 1972: 27)[11]. His influence occurs important to day in the shadow of the regulatory state regime belief in supply-side economics, in tax cut and low interest rate in order to increase the inclination of economic investments. This of relevance for the OECD Anglo-Saxon member states in particular (Sachs 2006).

Karl Marx: As an economist Karl Marx was clearly in the debt of Smith and Ricardo. Much of his framework he took over and gave it a new view. Marx published his main work, 'Das Kapital, in 1867. He was the first leading economist to notice that by the middle of the nineteenth century heavy unemployment, like today, was quite common in the developing industrial European states, and tried to find the reasons why. He reasoned that competition forces capitalists to invest their profits in labor-saving machinery, for if they do not their efficiency will fall, and they will be forced out of business. Of self-interest they will continue to do so. But when doing it, there will also be a fall in employment and the unemployment will rise. For those who still have jobs the alternative is to accept lower wages forced upon them by the capitalists.

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According to Marx a fall in employment also meant a fall in profits because only work creates economic values (forgotten in today's focus of financial capital?). The clue in the view of Marx is that when this happened, and contrary to what Ricardo had assumed they would, in the long run have little incentives to invest their profits. And since only a small part of the capitalists' profits can be spent on consumption the general surplus of commodities that Malthus had been afraid of would become a reality. Marx elaborated a theory of crisis: A crisis will occur as a result of that unemployment will get heavier and heavier. The basic reason for that is *the relentless fall of the profits*, which leads before long to a general economic crisis, like our contemporary international crisis. Marx identified an institutional risk inherited in the capitalist system but saw none intervention principle, he saw only the revolution and the breakdown of the capitalist system as the ultimate solution.

Marx theory, certainly, was on the one hand colored by the strong tension between social classes in the developing industrial society in Europe at the time, between the repressed working class and the exploding class of capitalists. On the other hand it was colored by a strong technological belief, a belief in the liberation power of the promising productivity of the new machinery, and the ways of organize it. These production forces in the hand of the working class embedded the ability to free them from the serfdom of wage-work, and would make them economically and politically free as to sides of the same coin. Nevertheless, in spite of the historical fact that his theory about the relentless fall of the profits, the impossibility of balance the trade cycle, and the economic development in general, had limited validity, Marx did represent a significant figure in the evolution of economic theory, and indirectly in state intervention principles by inspiring Keynes. Michael Stewart writes (1972: 33):

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> 'It was much more difficult, after he (Marx) had written, to believe that the capitalist economy, if left to its self, would necessarily function satisfactorily. In particular, it was more difficult to accept Ricardo's view that profits were always invested in new machinery'.

Certainly, Keynes learned from the Marxian lesson. But do have the contemporary monetary economists of the regulatory state learned from this lesson (Veggeland 2009)? And what about Ricardo's effective demand issue approach denying the risk of limited investment might disturb the economies; was his thinking correct? In other paragraphs we are going to give answers by explore occurrence of disturbances in later trade-circles.

6.3 The political economy of the interventionist Keynesian state

Keynes' great contribution to economics, General Theory of Employment, Interest and Money (1936), was to see how the modern economy did not work in the way classical liberalists had supposed, and to provide a new and completely convincing explanation of how it did work. With the interwar economic crisis as background he demonstrated innovatively that heavy unemployment was not a temporary deviation from the normal state of development, but could represent an equilibrium situation, which could go on forever (see Tab. 1 of today's situation of unemployment). If full employment was wanted it was no good doing to follow the recommendation proclaimed by classic liberal economic theory – the government sitting back and hoping for the best, i.e. laissez-faire policy. It must ensure through interventions that there is enough *effective demand* in the national economy to create full employment.

Hence 'effective demand' is a key notion in the Keynesian theory. As already pointed out, this notion was essential also in the dispute between Malthus and Ricardo more than hundred years earlier. Malthus suggested that an economy might suffer from disturbance, namely shortage of what he called 'effective demand', while Ricardo more or less denied this assumption. Michael Stewart (1972: 30) indicates that Keynes was perhaps reading too much into Malthus when he said, in his *Essay on Malthus*:

> 'One cannot rise from a perusal of this correspondence (between Malthus and Ricardo) without a feeling that the almost total obliteration of Malthus' line of approach and the complete domination of Ricardo's for a period of a hundred years has been a disaster to the progress of economics'.

Nevertheless, reading too much or not into what Malthus had grasped rather intuitively, Keynes founded a 'revolutionary' theory on the disputed notion of effective demand. Contrasting a monetary perspective, in his theory effective demand simply means 'demand backed by money' – in other words actual expenditure. The crucial question then is, what determines effective demand? In order to answer Keynes broke down aggregated effective demand into two components, consumption and investment, and claimed it necessary to study each in turn, but also how they could interact in the economy for the purpose of creating full employment.

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According to Keynes:

Consumption: Aggregated consumption in an economy relies on wages and income; the latter represent purchasing power[12]. Purchasing power may give variable expenditures as output depending on the size of the wages. Besides it depends quite a lot on how the National Income is distributed, socially and geographically. Consumption might be more than just private consume, it might also be investment if the consumption is part of running businesses. And further, buying a car might be private consumption, but used by the firm it turns out to be an investment. Increasing consumption of any kind expands the effective demand in the economy.

Investment: Money spent on investment is determined by two things; by the amount the investment will yield, the profit, and by the variable cost of borrowing the money needed to finance the investment. The cost is variable because of changing interest rates[13], though it seems fairly obvious. No one is going to borrow money in order to finance a factory machine or an accommodation facility if the interest payments exceed the profits eventually made by the factory and the facility[14]. But the other way around, if profits exceed the costs, investment will be decided made, resulting in an expansion of the effective demand at an aggregated level.

What challenged Keynes then as being an economist believing basically in liberal economic principles, was how to stabilize consumption and investment on a level of full employment, a thinking almost forgotten by governments today. Full employment and full utilization of the production forces in general, is essential in the theory, neither less nor more than full utilization. 'More' would mean pressure in the aggregated economy with rising prices and increasing inflation as a negative consequence.

What then could be the proper measure, to balance full employment and stable low inflation rate, as part of his effective demand concept of consumption and investment?

Keynes did not believe in Ricardo's view that profits were always invested in new machinery', nor did he believe in Marx's thesis about the relentless fall of the profits. In his theory he introduced an idea with the greatest political implications: the advantage of *state interventions* in the market in order to balance employment and inflation, see Fig. 2 below, through using public consumption and investment as regulatory measures, and planning and centralized administration as steering instruments. This is what Majone (1994: 77) calls the 'dirigiste state of the past', which was replaced by the regulatory state.

The interventionist state as an instrument to counteract risk in a market economy is a theoretical as well as a practical concept. But according to Keynes, the interventions should only be temporary, to overcome the international economic crisis of the 1930s, he promised, as the liberal economist he was. It should turn out differently, we now know, it became the theoretical foundation of the adjusted permanent modern interventionist state – actually the post war social democratic welfare state lasting until the 1970s and 1980s, see Tab. 1, (Veggeland 2007, Flora et al. (eds.) 1999).

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Let us try to illustrate some of the Keynesian principles by formalizing structures.

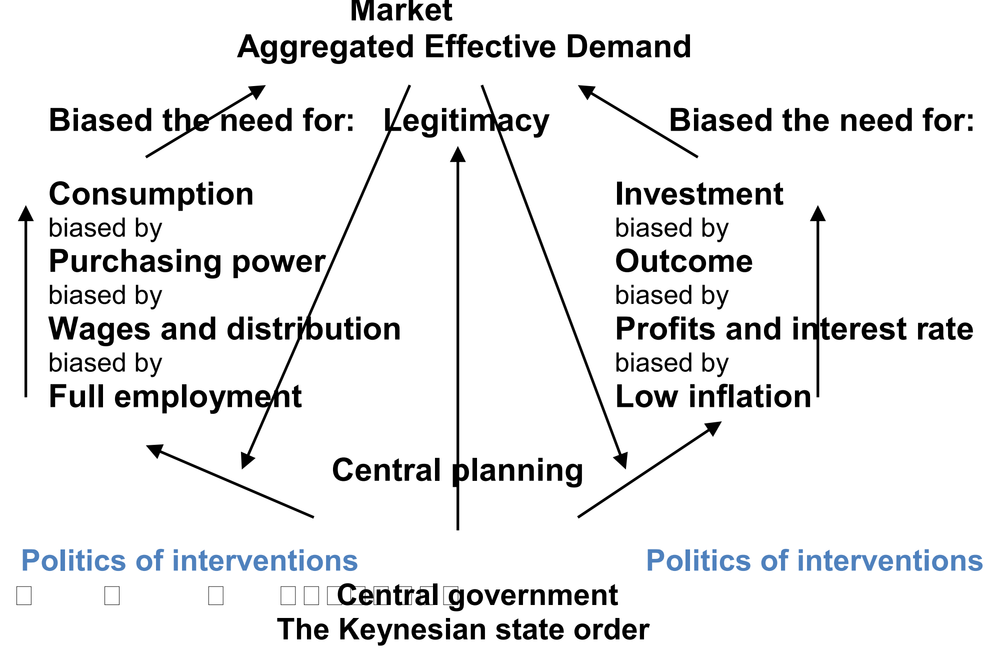

Figure 1 *The structure of the Keynesian political economy*

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What is important here (Fig. 1) is the way Keynes provided legitimacy for the central government to initiate basic central planning, where-after to intervene and make consumption and investment adjustments according to the national Master-plan of economics and to sector plans. This meant to regulate market mechanisms for the purpose of long-term effective demand, and thereby full employment and low inflation. In return, the domain of the politics got legitimacy because of economic stability and growth success as results of the interventions. The advancement of the post war welfare state in this framework might be said to be the top point for convincing Keynesian policies with great legitimacy (Flora et al. (eds.) 1999). Optimistically, some scholars pointed out that probably a new international economic crisis would never occur again because of the balancing effect of the interventionist state (Shonfield 1969). They were wrong.

What measures empowered the interventionist state? The Keynesian approach to macro-economic crises created a new bunch of conceptual tools for economic policy and central planning by the central government. After the Second World War, these conceptual tools were widened to include sector planning, regional planning, environmental planning, and connected extensive social and regional distributive policies. The success of this type of planning and governance rested upon the assumption that the national economy was relatively closed and protected from external impacts. That situation changed during the 1980s. The markets were enlarged globally in order to let businesses get access to new markets, and the Keynesian classical principles as such failed.

As a method and a basis for knowledge Keynesianism represented a top-down rational form of planning, i.e. mean-ends strategies in making both growth developments and distributive policies work (Friedmann 1987, Amdam and Veggeland 1998:26–27). Politically this type of planning fitted the social democratic ideology of the time, and its insistence on market control, state ownership and monopolies and an active income and cost policy. State intervention and a planned society were considered desirable, so were also the Weberian bureaucracy as administrative executive.

Majone (1997: 139–167) has argued that the interventionist state had three main tasks: 1) macro-economic stabilisation, 2) the distribution of income and 3) the regulation of the market. The goal of macro-economic intervention was to achieve economic growth and the principle of full employment. The instruments for this were financial and monetary policy, together with active employment and industrial policy. Public monopolies dominated as executives of the infrastructure service policies.

Income distribution policy included the redistribution of resources from one social group, region and economic sector to another, as well as educational goods, supplementary benefits and health services. The goal was to level-out in-equalities for social reasons but also for the reason of secure full employment and economic growth (Einhorn and Logue 2003, Veggeland 1998).

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Lastly, the interventionist policy of regulation aimed to redress 'market imperfections' such as monopolies, unfair competitive advantages, incomplete market information and incomplete access to public goods. The state distribution policy and the regulation of aggregate demand in society, is what has been called the 'social democratic welfare state', or even the 'Keynesian welfare state' (Ferrera and Rhodes (eds.) 2000). Macro-economic planning to sustain effective demand in the interventionist state was based upon complex mathematical models developed by the Norwegian economist, Ragnar Frisch, who obtained the Nobel Prize. Models used have been known under the terms "Eco-Circ", MSG and MODIS (Amdam and Veggeland 1998: 27).

The mode of governance was democratic in the sense that the Western national parliamentary government system combined the monopoly position of being Lawmaker (the Parliament) with the monopoly position (the Government) as executive of public policy, besides acting as a gatekeeper in international affairs. The state budget, the national accounts, sector policy, welfare policy, distributive policy and other areas became the object of parliamentary policy. Also public planning acts were democratic but only in the sense that political top-down "hearings" were arranged before leading to the formulation of goals for the development of regions, municipalities and sectors. Politically, this was the most popular form of state in the post-war period until the 1970–1980s. From this point in time, doubt crept into the social democratic consensus on the advantages of the interventionist state mode of governance, i.e. the national state monopoly of being an economist, politician, planning actor, producer of infra-structural and social goods and services and employer (Giddens 1998).

6.4 In the shadow of the international stagflation crisis

In the 1970s the international economy entered a crisis, the so-called "stagflation" crisis, SEE Tab. 1 above, and it must be regarded as a fundamental causal factor in subsequent changes of the Keynesian state order (Veggeland 1998, 2009). Unemployment in the western industrial nations rose to 10–15% and more, besides the inflation reached dangerous levels. This represented a fundamental brake in the stable economic development formed on the basis of the Keynesian principles of state intervention. The intervention forms summarized as:

1) Financial interventions.
2) Direct control through laws and regulations.
3) Institutional interventions.
4) Sector interventions.
5) State-run corporations.

(Østerud 1972: 30–31, Majone 1994).

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The stagflation also led to a crisis in the principles of central planning and implementation acts developed under the interventionist state dominance. Actually, the crisis may be viewed as an appearance of the arising globalization and its effects arising of market changes. It hit the national institutions of the interventionist state, which occurred too narrow in the new setting, and made them fail to govern appropriately. On the one hand there was need for more cooperation and regulatory tasks across border, and on the other hand a more decentralized, competitive and task oriented public planning. It became essential to prepare a new institutional framework for cooperation of multi-actors in market defined functional networks, both in the nation-state internally and across international borders (Amin and Thrift 1995, Jessop 1994). Actually, it was the arrival of the post-national modes of international agreement-based multilevel governance that occurred, in Europe with the European Union as a predominant actor. (Hayward and Menon (eds.) 2003).

However, at the time it was difficult to imagine that the balance in economic circulation would once again reach crisis dimensions comparable with those of the interwar great Depression. Symptomatically Andrew Shonfield, the English economist, in a large work from 1969, 'Modern Capitalism', arguing from a Keynesian perspective, wrote the following:

> 'The central thesis of this book is that there is no reason to suppose that the patterns (crises) of the past, which have been ingeniously unraveled by historians of trade cycles, will reassert themselves in the future'. (1969:62)

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But the crisis arrived in the end of the 1960s and into the 1970s. The crisis expresses itself as a stagflation crisis – stagnation and increasing unemployment combined with corresponding increase in inflation. The rate of the profit felt, in the Marxian sense, so to speak.

Using the disputed 'Phillips curve' principle[15] of the empirical relation between inflation and unemployment, worked out under the Keynesian regime, as an adjusted point of departure, the phenomenon could also be illustrated by this simple diagram, Fig. 2.

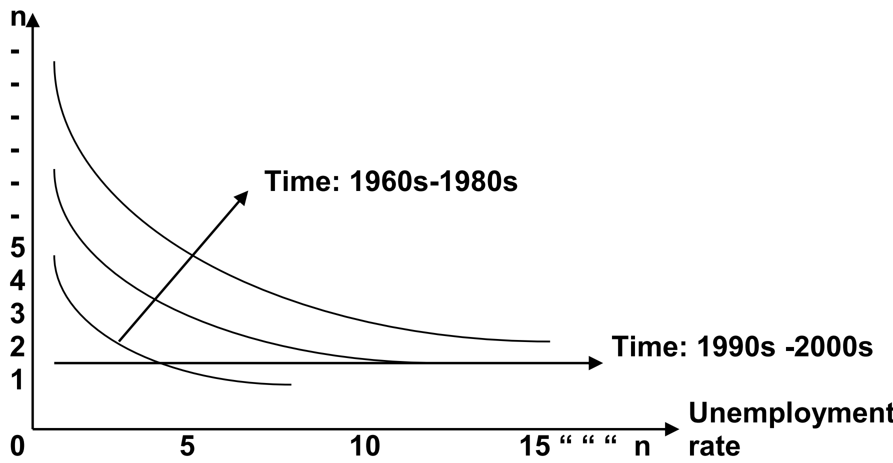

Figure. 2. Curves illustrating the development of crisis tradeoffs affecting the Keynesian state: Changing stability levels for inflation – unemployment relations and growing rates of unemployment since late 1900s–2000s.

In Fig. 2 the rate of inflation is plotted on the vertical axis, the unemployment on the horizontal axis. The arrow illustrates the passing of time. The curves view a development from a trade-cycle of balance in the 1960s with low both inflation and unemployment (the Phillip curve) – actually full employment in terms of Keynesian thinking. Then the economy got into a stage of imbalance at the end of the 1970s and 1980s, with increasing high inflation and unemployment as the normal situation. The curves view the tradeoffs between inflation and employment: Reduced effective demand in order to lessen the pressure in the economy and thereby lower the inflation makes the unemployment rate rise. The opposite around happens when the effective demand is increased, it creates an unwanted race upwards of the inflation rate (Cumes 1984).

What happened at the time was that old methods of dealing with the situation were no longer effective, or to be more correct, they did not work as expected as Fig. 2 views. Theories and models of state interventions built upon the Keynesian General Theory were now found wanting and ineffective in most OECD member states. Measures introduced by governments to reduce rising unemployment only resulted in the level of inflation spiraling upwards. If demand was reduced, production fell with increasing unemployment as a result. Indications of confusion could be found amongst politicians and economists (Veggeland 1998).

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Confusion was also to be found in OECD reports written under the pretence of providing advice to governments. They were unable to decide which remedies that were to be most appropriate (Mc Cracken et al.1977). A quotation (1977:14) may give a picture of the confusion, but also about strong belief in Keynesian measures, and 'avoidable errors' imprint the understanding of the crisis:

> 'To sum up, the immediate causes of the severe problems of 1971–75 can largely be understood in terms of conventional economic analysis. There have been underlying changes in behavior patterns and in power relationships internationally and within countries. But our reading of recent history is that the most important feature was an unusual bunching of unfortunate disturbances unlikely to be repeated on the same scale, the impact of which was compounded by some *avoidable errors in economic policy*. The continuing legacy of 1971–75 makes for unusual difficulties in framing policies for the years immediately ahead. We reject, however, the view that existing market-oriented economic systems and democratic political institutions have failed. What is needed is *better use of existing instruments of economic policy*, and better functioning and management of existing market mechanisms'. (SIC!)

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Later on, in the 1980s and 1990s, OECD got out of its earlier mode of confusion. Now a certain choice between low unemployment versus low inflation was recommended, the latter should be given priority. Consequently, the unemployment rate increased to a high level in many OECD-countries, as Fig. 2 illustrates. Two things ought to be done: economic measures to keep the inflation rate low should be introduced nationally, and to be followed by comprehensive reforms and modernizing tasks in the public sector to make it more competitive (OECD 2002, 2005), and make the sector contribute more to the national income by getting into competing international markets. Great Britain and the United States grasped early the inflation-fighting strategy, and reformed deeply the economic policy – from a Keynesian inspired demand-side economic policy to a so-called supply-side economic policy of neo-liberalism (Storper and Scott (eds.) 1992). Thatcherism and Reageanism have the reforms been named, after their political leaders at the time. Other Anglo-Saxon states followed the same new strategy to get out of the crisis but with a critical rise of unemployment – normal employment rates 10–20% – as tradeoffs. For some OECD countries, such as Norway, had a source of income provided by oil and gas, and this provided a cushion against high unemployment. Nevertheless, stagflation was also noticeable here and in the Nordic countries in general. The economy represented a fertile ground for new thinking and transformations in the organization of economic production and the institutional function of the state and the public sector in general.

Constitutionally, the ground was prepared for the institutionalization of the regulatory state replacing partly the Keynesian interventionist (Majone 2007). The implied commitment to a global free market economy, stressed the virtues of competition and greater efficiencies through specialization and economies of scale was to be balance by acceptance of regulatory dirigisme replacing the old Keynesian method (Egan 2004). Economically, the new regulatory state got founded on the change away from a governmental central planned demand-side economy, to a marked-based monetary supply-side economy with the central government as the regulatory national principal. The National Central Bank services the Government as an independent arm's length body regarding implementation of interest rate and tax policies. Other arm's length bodies serve as legal surveillance agencies. It is this regulatory state that got into a grave financial and debt crisis in the 2007, and restored principles of Keynesianism and state interventionism in another context as neo-Keynesianism and neo-Interventionism, as Tab. 1 above indicates.

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6.5 Explanation approaches to the Keynesian economics in crisis

It has by many been said that the Keynesian policies adopted by the advanced economies in the West carried with them the seeds for their own demise, and created the basic conditions for the regulatory state formation (Cumes 1984, Friedman 1962). The Keynesian state period, 1945–1970s, as we have called the period, was an era of exceptionally persistent economic growth, stability, and the building of the modern welfare state; the latter of course build on the base of different social models and administrative traditions (Knill 2001, Veggeland 2007). When the international economic crisis arrived, therefore, governments applied the widely accepted and well-tried Keynesian remedies and political instruments, which they would have used in the 1950s and 1960s, and believed it to be a short-term incident (OECD 1977). But as we have viewed those remedies and instruments did not work, Fig. 2. When the governments made this experience they initially assumed that the fault lay in their domestic management and in handling international trade, and not in the validity of the Keynesian economic principles.

But as the problems continued and deepened, talk about a short-term fluctuation was heard less and less, and the crisis became more and more recognized as a long-term deep-rooted structural crisis, which claimed new remedies to overcome. People began to say that Keynesian economics had 'failed' as such. The monetarist Milton Friedman (1980) stood up and said that they had all the time been doomed to failure because of too little market and too much state. His view was that policies, which restrict production, productivity, demand and employment, have not worked, nor will it in the future.

As elaborated earlier governments applied Keynesian policies with great success as long as they effectively had the capacity and political will to move consumption and investment up or down in order to control the aggregated effective demand. However, this capacity had passed by some time in around 1970. Actually, the capacity to move the economy *up* remained, i.e. inflation and unemployment, but the capacity to move these factors *down* declined.

Explanation approach 1:

The capacity to calm the economy down with rising inflation as a consequence, Fig. 2, declined because for a variety of reasons –consumption became relatively invariable. One of the main reasons was that the building of the welfare state had come to a mature level, meaning transfer of money to welfare services and social arrangements could not for political and economical reasons be reduced. There could be no question of abolishing allocating of money to social groups and individuals in need, when governments introduced 'deflationary' policies. Consumption and investment in the social more than economic sector became fixed. Attitudes to welfare and social security such as schools, health, social support, care for unemployed, elderly people, disables and other who could look after themselves etc. had become too deeply embedded in the polity (Arter 1999). The capacity and political will to move the economy down abolished. The inflation persisted growing. The impact on the economy of this tendency to hold up the consumption expenditure while stagnation exceeded and unemployment increased was recognized, and stimulated the cry for more market and less state – for the regulatory state.

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Explanation approach 2:

Gender policy also influenced the capacity of the governments. In large measure, women's liberation was made possible by the economic progress of the post-war period. The entry of females into the labor market had in our context two effects (OECD 2005). Firstly, the entry increased enormously the volume of available labor force for employment. The labor market could not offer jobs to them all. The number of people employed might increase but statistically it also contributed to the growing of unemployment, Fig. 2.2. Secondly, the entry of wives into the labor market meant that unemployment was less destructive of individual and family consumption levels than it had been previously. Saving or investment by family units might be reduced as economic activity turned down but a certain level of consumption persisted though. If their incomes were relatively maintained, their consumption was maintained. It influenced the bringing down of the economy through reducing the effective demand (Cumes 1984). It contributed to the failure of the Keynesian remedies.

Explanation approach 3:

Related to international trade, it is a fact that a high-valued currency, leading to high import exposure, is anti-inflationary and low-valued currency increases the export exposure, which leads to greater inflation. During the post-war period free-trade exposure of goods and services dominated intergovernmental negotiations. The European Community (EC) was established, so was the European Free Trade Association (EFTA). In general, globalization of economic transactions had its start, resulting in open-up national economies.

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One of the Keynesian remedies was using revaluation of national currency up or down in order to balance inflation and employment. In an open economy, and in the framework of the free-trade concept of integrated international markets, the economic and political capacity to use this instrument declined (Bratton et al. (eds.) 1996). It contributed little to help adjusting the effective demand. Therefore, in Europe it started the process of creating the Single Europe Marked (SEM) in the 1980s, and the European Monetary Union (EMU) in the 1990s, which introduced supranational surveillance and rules for trade and monetary policy (Woolcock 1996). It is this EMU which 2022 undergoes a very grave crisis. Actually, it was the regulatory state of the European Union (EU) that was founded, contextually in the wake of the Keynesian economics crisis. Goal was to 'create markets' but also to 'correct markets', across borders, including currency exchange, the latter limited to the EURO-zone though (Scharpf 1999).

*Explanation approach 4***:**

Lastly, there is a change of technology explanation, based upon among others the economist W.E.G. Salter. He argued (1969) that an industry may be viewed as a number of plants embodying techniques, ranging between the most modern plants embodying the current best-practice technique, and the oldest plants still in use which embodies the best-practice technique of an earlier date, and which is now outmoded. The consequences of this competition between old techniques, which generate what he terms '*extensive growth*' – growth which merely reproduces a given situation but fails at last – and new techniques which generate '*growth in depth*', the winning situation.

He writes (Salter 1969: 65)

> 'The appearance of a best-practise technique has the following effects: fist, the output of the industry is expanded until price falls to equality with the total costs of plants employing the new technique; secondly, some of the older existing plants are scrapped or replaced until the operating of the oldest plant (or plants) equal the new level of price and best-practice costs. A flow of new best-practice techniques leads to a series of such equilibrium (which combine both short- and long-run elements) and so trace out the path over time of output, costs, prices and productivity'.

In the 1970s, and especially in 1980s, a new technology innovation got introduced in economic production, in manufactory industries and in service production, and in the polity in general, it was the Information and Communication Technology (ICT).

The supply-side economy viewed ICT as a new factor to boost the Keynesian economy in stagnation. In sector after sector and firm by firm, the ICT replaced the old technology and machinery. Investments went to this new sector, and the demand for highly skilled labor forces grew rapidly – and so did the wages and the consumption. Old industries lost competitive capacity and were closed down. Consequences for the Keynesian state economy have been found damaging contextually in this respect, combining impacts of new and old technology.

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On one hand, the closing down of old industries contributed to massive unemployment in most of the Western countries in the actual years. On the other hand, the expansion and pressure created in the new industries based on ICT required investments, highly skilled and paid workers and specialists, which contributed to pressure and high inflation (Cumes 1984). The technological tradeoffs as explanation to the fall of the Keynesian remedies and instruments are viewed clearly by Fig. 2.

As might be expressed by the supply-side monetarists; policies which restrict the marked have never really worked. Well-managed and regulated market growth to stimulate investment, production, productivity and employment, as well as to encourage innovation and a rational use of new technology, is what is needed (Fagerberg, Mowery and Nelson (eds.) 2005). And economy should be approached explicitly in its disaggregated, multi-sector structure, and with steady growth at the micro-economic level, is postulation stemming from Joseph A. Schumpeter. Contrary, the international credit and financial crisis of the 2010s dominates by none growth at the micro-economic and recession at the macro-economic level.

6.6 The regulatory state and neo-interventionism

The emergence of the contemporary financial crisis, as already pointed out, had its beginning in the 1970s. The crisis was named a stagflation crisis. Deindustrialization and diminished economic growth in the wake of globalization processes generated unemployment as a threatening impact. The crisis was met by the national governments by radical change in their monetary policy. Among other things they started printing money to secure piece in the labor market achieved in years after the second, world war. The money was invested in work places, in upheaval of nominal salaries, and in the continued building of the welfare state. Despite such actions the parallel inflation and stagnation problems did not stop though. According to Keynesian theory and policy, as we have seen, this should be impossible, and leading economists did not know to handle the situation and forward advice to the governments.

At last the advices occurred, following an OECD recommendation path (McCracken, OECD 2002). The markets had to be enlarged globally in order to let businesses get access to new markets. It was followed up by unilateral and multilateral agreements and regulations, headed by the European Union (EU) and the World Trade Organization (WTO), to remove trade barriers; free movement of goods, capital, labor and services became the new political spoken slogan. Classical example is the strengthening of the European Commission and the introduction of the Single Marked between the years 1988–1992. It became also an important measure to market orientate and commercialize public sector services to make them contribute to the collecting national income. Organizational liberation of public institutions and agencies as arm's length bodies, dismissing political instruction authority, meant erecting independent agencies, which became embracing political mode of action. The new regulatory state was born and emerged as a form of state organization embedded in the Western democratic capitalism (Veggeland 2009, 2010). The regulatory state was guided by neoliberal ideology, and was basically involving international agreements and regulations. Those agreements and regulations were targeting opening up new markets globally to benefit capitalized industries.

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The emergence of the regulatory state supported internationalization and global processes, but the unemployment rates in the Western capitalist countries remained high through the 1990s, see Fig. 2. What further happened was that the national states started raising loan abroad guaranteed by government bonds. This was done to develop the welfare state and its services further. However, the unemployment rate continued to be kept high in most Western countries. Again the high level of unemployment threatened the stability of the labor market, and the government support of the citizens was declining. Public budget deficit became considered as a practical and functional solution to the problem. Consequently, the state dept arise heavily in countries like the USA and in many EU states in the 1990s and 2000s.

The dept crisis at the time was tried solved by liberalization of the finance sector. This liberalization created an innovative option, namely the option for the people to borrow, from the surplus of financial capital, privatized loans. Low interest rates on privatized loans became a national measure to keep the inflation rate low and stable in accordance with monetary economic theory. The financial institutions traded loan with the only guarantee in expected rising prices in the real estate market. Streeck calls this phenomenon "privatized Keynesianism" (2012), i.e. loan based growth in private sector instead of the Keynesian principle; public loan to stabilize the effective demand in the economy. There could be , democratically spoken, no question of abolishing allocating of money through privatized loans to social groups and individuals in need, when governments introduced 'deflationary' policies. Real estate bubbles showed up and little by little they cracked; that was the situation in the USA in 2008, and it triggered the financial crisis to arise and to hit economies globally. An international double crisis was a fact, consisting of both dysfunctional public and privatized dept.

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The economist, Raghuram G. Rajan, writes about the social 'Fault Lines' (2010), indicating here that the society of our time is in trouble. It is not the historical lines that is threatened to break into pieces but the society along these lines. He sees political impotence together with missing coherence in the democratic capitalism of today. Especially, he analyses the many extreme negative consequences of the catastrophically development of economic and social inequality in many Western countries, and particular in the USA.

Social justice and democratic government as guarantee for economic equality and good governance is a neglected perception. Rajan points out that for every dollar growth of income between 1976 and 2007, 58 per cent went to the one per cent of the most riches in the USA. The income of the lower and middle class people stagnated or became reduced during the same period, while the richest 10 per cent of the citizens doubled their income manifold.

This created a disorder which politically was overseen, and the policy lost legitimacy among ordinary people. Rajan put forward this dilemma in his writing, and postulates that politicians, in order to compensate for rising un-equality, liberalized the financial capital and made easier access to privatized loans for consume as a policy turn. It was an innovative way of level out economic equality seemingly by offer people cheap loans. The banks took the opportunity to make profit out of this policy by offering loan with expected rising real estate prices as guarantee, i.e. subprime loan. Large number of people bought real estate to constant rising prices which were paid by subprime loans. The belief ruled that prices would rise into the heaven. When the US Federal Bank raised the interest rate a bit many families were unable to maintain their loans, i.e. repay interest rate and part payment. This caused the effect that financial institutions broke down and became bankrupt. In the context of neo-interventionism and neo-Keynesianism some of the most important great banks were saved by the US government by supply of huge amounts of fresh money. Now it is told: The bank that exposed the federal government to the greatest potential loss during the government bailout was ***Citigroup***, which received a grand total of $476.2 billion in cash and guarantees, according to a new report of the Congressional Oversight Panel which oversees the TARP program.

The contemporary crisis in the USA, EU and other Western states should be named a *double crisis, because the crisis is intimately bound to both dysfunctional public and privatized dept.* Footprint of neo-interventionist policies derived from neo-Keynesian theory, se Tab. 1, may be observed. On the one hand governments on both national and EU level intervenes the market economies and put money into to save banks from bankruptcy. Further supranational authorities claim reduction of public spending, which is followed by interventions to reduce private consume by forcing forward reduction of salaries together with cuts of pensions. On the other hand the European governments intervened through the EU and established a stability fund of several €100 billion administrated by the European Central Bank, aiming to be raised to reach €1000 billion in the coming years.

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Indirectly but inevitably the government's new approach and attitude to state intervention became achieved as an innovative mechanism. In 2011 the European Central Bank (ECB) presented an intermediary but long term solution to heal the actual dept problems of certain states; the Long Term Re-financial Operation (LTRO). The aim of the operation was, as pointed out before, to support the banks with money by a procedure of money exchange: Banks sell expensive old bonds and gilts which are turned over in the market with 6–9 per cent interest rate. These bonds and gilts are sold, according to the new mechanism, to the ECB with fresh money in return. The banks agree on paying the money back in three years spend of time at the same price. For the money the banks receive they pay an interest of only 1 percent. The surplus of the capital transaction the banks receive is expected to be reinvested in job creating industries.

This is how neo-interventionism and neo-Keynesianism works out today. The principles of the neo-interventionism are in Europe today mainly administrated through the international organization of the EU. EUs 'The Long Term Re-financial Operation' (LTRO) and the 'Financial Pact', is administrated by the ECB and the banks, and in contrast to the original Keynesianism principles, not by national democratic elected governments but by supranational organization; the unelected EU and its judicial agencies.

As in earlier history of political economy theories, the contemporary international economic and political crisis in the democratic capitalism will find its intermediary solution Most probably the solution will not go in the favor of liberalized financial capital which will probably come under hard regulatory international control, in Europe control means the EU. It is expected, in line with what Adam Smith and others feared that industrial monopoly interests will take over because they will be particularly able to create jobs that are needed. In addition, in Europe central EU power will grow on the cost of national democratic sovereignty.

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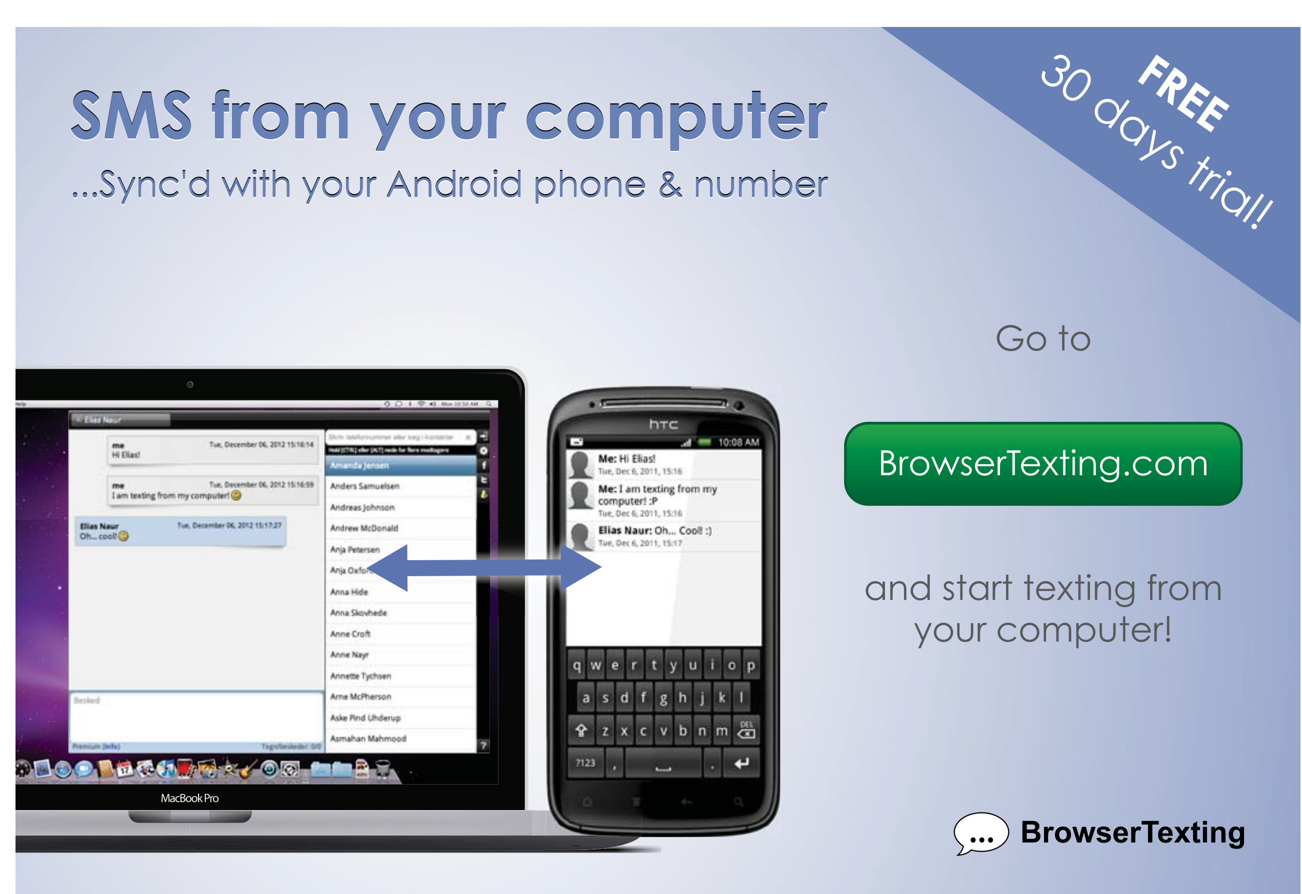

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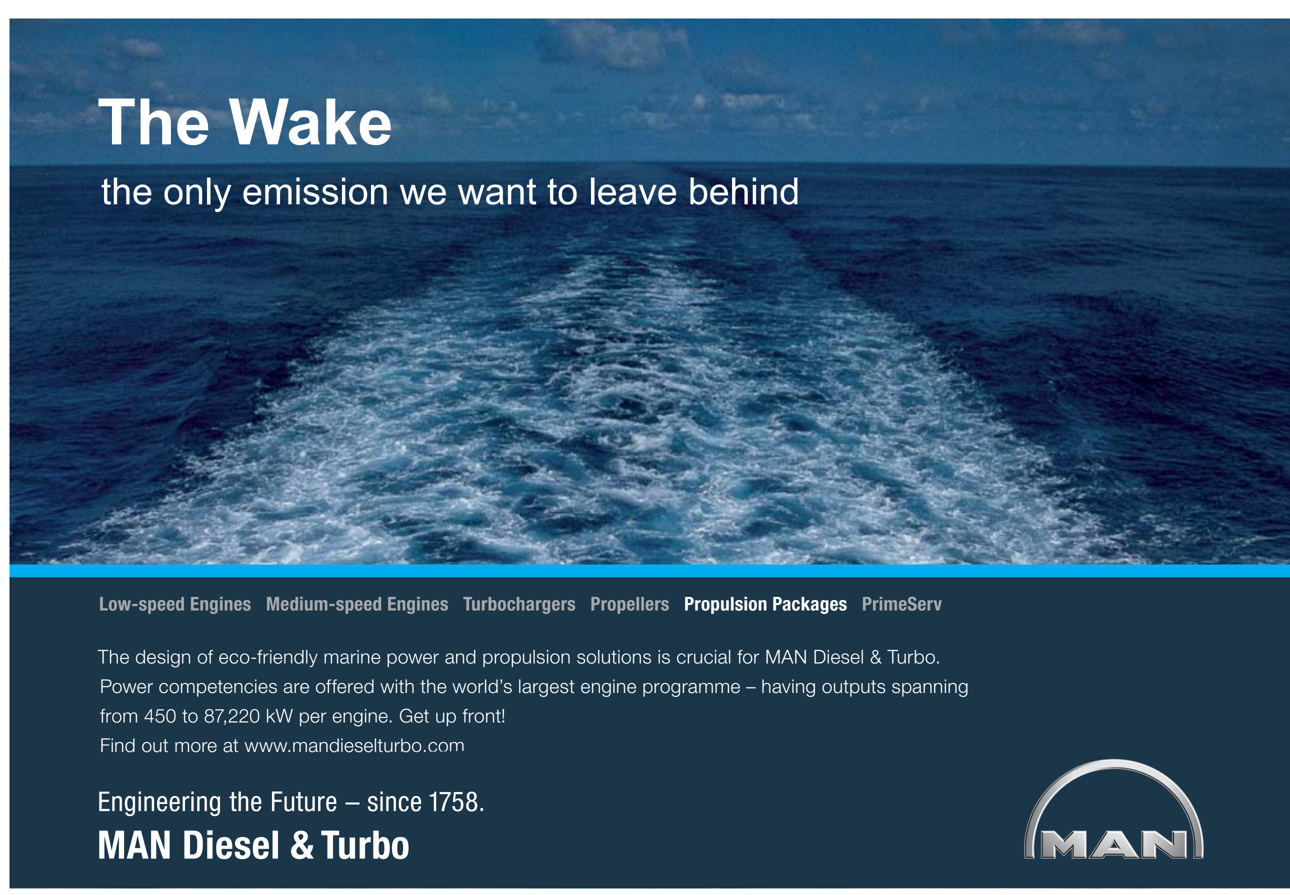

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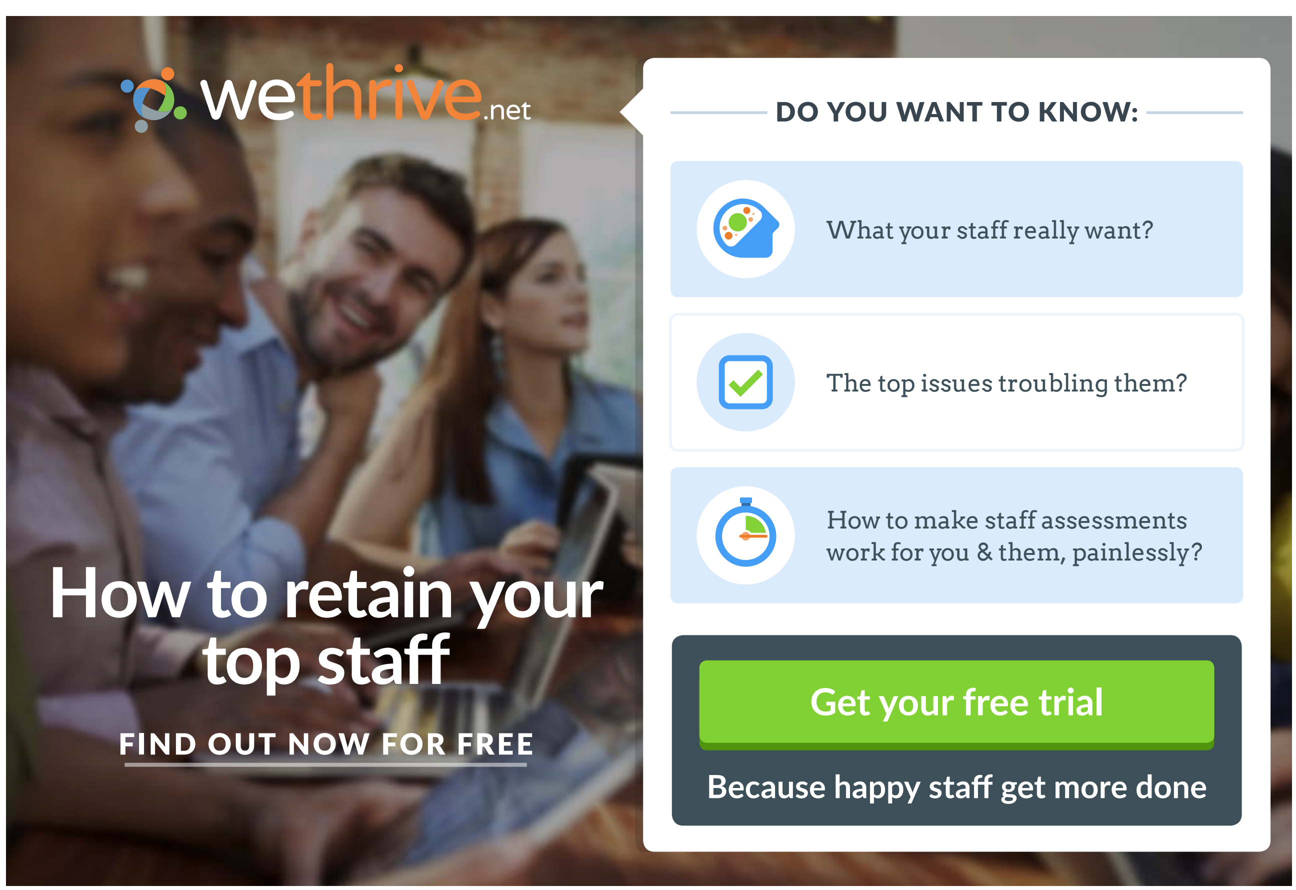

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Endnotes

1. Majone, Giandomenico 1994), 'The rise of the Regulatory State in Europe', West European Politics, 17 (3), 77–101.
2. Iceland and Norway are not members of the EU. Sweden , Finland and Denmark are member states.
3. See Social theory and social policy: essays in honour of James S. Coleman / edited by Aage B. Sørensen and Seymour Spilerman. Westport, Connecticut; London Praeger.
4. Finland's 48 per cent makes an acceptance because of lasting repercussions after the collapse of the Soviet Union.
5. Finland 8.8 per cent, see previous footnote explanation.
6. 44 per cent low because of the large Norwegian petroleum activities are part of the GNP
7. Norway 3.3 per cent, Finland 9.4 per cent, the other states fall in between these figures.
8. Eastern Europe member states.
9. Regulatory innovation is a dynamic part of the 'regulatory state', see G. Majone's (1996, 1997) elaboration about the latter term.
10. Torben Iversen (2005:73) discusses the notion of politics with markets, but explicitly does not link it to the Scandinavian welfare state. He probably also includes the Anglo-Saxon model or perhaps makes it a general notion. If so, I disagree.
11. In terms of reference and in the framework of contemporary neo-liberal economic theory and policies, it might be stated that the profit – investment logic of Ricardo at the end of the nineteenth century conquered the whole of the Western world.
12. Before consumption wages and income are needed.
13. For the monetarists the interest rate is a steering instrument.
14. Well, in the ongoing basically loan-driven international crisis foregoing borrowing behaviour deviate from this normal.
15. Alban William Phillips, an economist, wrote a paper in 1958 titled '*The relationship between unemployment and the rate of change of money wages in the United Kingdom 1861–1957*', which was published in the quarterly journal *Economica.* In the paper Phillips describes how he observed an inverse relationship between money wage changes and unemployment in the British economy over the period examined. Similar patterns were found in other countries and in 1960. Phillips' work made explicit the empirical link between inflation and unemployment: when inflation was high, unemployment was low, and vice-versa. But empirical relations do not necessarily indicate causality, therefore a dispute work.

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