

**The Centre for European  
and Asian Studies**

**REPORT  
2/2006  
ISSN 1500-2683**

**Public Sector Reform and  
Economic Success: Nordic  
lessons to be learnt?**

**Kåre Hagen and Nick Sitter**

A publication from:

**The Centre for European and Asian Studies at  
Norwegian School of Management  
Nydalsveien 37, 0442 Oslo**

Report prepared for

20th IPSA World Congress  
Explaining Institutional Changes in Public Administrations:  
(RC27) Structure and Organisation of Government  
Monday, July 10, 2006

## Public Sector Reform and Economic Success: Nordic lessons to be learnt?

### I Introduction

The Nordic countries have fared well the last couple of decades. According to the United Nations ranking of Human Development,<sup>1</sup> Norway is the best country to live in, followed by neighbouring Sweden. The Finns, Danes and Icelanders are not doing bad either, and all countries enjoy positions at the top end of the list. The northern lights are still bright,<sup>2</sup> with sustained egalitarian distribution of incomes, high levels of employment, extremely low rates of poverty, and public sector provision of income and health insurance as well as of high levels of social services. This corroborates the (half a century old) and widely spread opinion that an institutionally distinct, exceptionally successful *welfare state model* has been developed in this North-West corner of Europe.

Moreover, the Nordic countries display, in a comparative perspective, a stunning success as *capitalist economies*. On the annual ranking produced by World Economic Forum,<sup>3</sup> all five Nordic countries figure at the top ten most globally competitive economies. Finland is at the top, Sweden third, Denmark fifth and Norway and Iceland as sixth and tenth respectively. The World Bank, in its rankings over the most conducive national institutional environments for private economic actors,<sup>4</sup> place all five Nordic countries among the fourteen best. On The Fund for Peace's index Norway, Sweden and Finland come top as the world's most successful states when scores on social, economic and political characteristics are combined.<sup>5</sup>

Of course, rankings such as these should not be taken too seriously as scientific evidence. On the other hand, the picture they convey is largely consist and suggest a reliable empirical basis for an intriguing concurrence of, in a *comparative* perspective,

---

<sup>1</sup> For the UN ratings see UNDP Human Development Reports (<http://hdr.undp.org/>).

<sup>2</sup> M. Olson, *How Bright Are the Northern Lights*, Institute of Economic Research, Lund University, 1991.

<sup>3</sup> World Economic Forum Global Competitiveness reports (<http://www.weforum.org/>) have rated Norway in the top ten the last four years.

<sup>4</sup> <http://www.doingbusiness.org>

<sup>5</sup> <http://www.fundforpeace.org>

successful accomplishment of social objectives *and* economic efficiency. As such, the ‘Nordic model of society’ enjoys increasing attention from politicians (of a social democratic leaning) as well as from social scientists.<sup>6</sup> Within the EU, the Nordic experience is frequently referred to as possible model, even recipe, for a way out of the present stalemate as to how a Social Dimension and a European Social Model should be developed. This optimism can also be found among academics.<sup>7</sup> But, eventually, what is to be learnt? What exactly *is* the Nordic experience?

In this paper, the ambition is to raise the observed combination of economic success and welfare state sustainability as a research puzzle: to a large body of conventional economic theories, political intervention into the play of market forces only comes at a price: mandatory social insurance, public provision of merit goods, taxation, income transfers, and regulations, etc. is, in sum, bound to create a trade-off between social equality and economic efficiency. Thus, the highest levels of economic efficiency should not occur in the most egalitarian societies. To proponents of the Scandinavian ‘peoples home’ version of the welfare state, the empirical evidence is used to refute the neo-liberal recipe of how economic efficiency is (or should be) produced, - without, however, being able to identify what mechanisms explain better what is observed.

In this debate, primarily between economists and sociologists, political scientists have been sadly absent. Therefore, in this paper, we will try add a political science perspective, by asking: to what extent can the Nordic success be explained by reforms of the public sector? And in more general terms: how do politically created and enforced institutional change, as well as stability, impact upon social and economic outcomes (and vice versa)? From this point of departure we shall, in section two, try to summarize two positions in the present debate; one claiming that the key to the Nordic success lies in its preservation of a specific type of welfare state model, the second asserting that its precisely the opposite, namely that underpinning the success is an extensive reform record. Section three is a survey over the reform efforts in the Nordic countries the last couple of decades, with a special focus on Norway. In the

---

<sup>6</sup> A Giddens, *A Social Model for Europe?* Policy Network, London 2005.

<sup>7</sup> ‘Some countries have been remarkably successful in combining economic growth with high levels of social protection and equality – especially the Nordic countries. Let’s see what the rest of Europe learn from them’ U. Beck and A Giddens, *The Guardian*, Oct. 5, 2005.

fourth and concluding section, we suggest that further research should, on the one hand, focus on the *combination of reforms and stability* in various policy areas, and on the other, be more systematic in specifying how macro-political institutions may or may not *impact on the micro level*, - i.e. within those firms and enterprises which, in sum, makes up a nation's 'global competitiveness'.

## **II Explaining economic success: Welfare state survival or public sector reform?**

The first explanation of Nordic success is the claim that changes in the economic sphere, like the transition to knowledge intensive, ICT-driven production, de-regulated markets, and globalisation, implies that a welfare state regime like the Nordic, unexpectedly and unintentionally, turns out to provide the new economy with a conducive infrastructure. Its distinct social citizenship character, epitomized by universal social rights to tax financed, publicly produced services 'from the cradle to the grave', historically matured in the 1960s and early 1970s. Grand social reforms were introduced for reasons of social justice and equality in status and life chances for all, not to promote economic efficiency. Economic concerns were hardly present, or even regarded relevant, when the new schemes and programmes were introduced in 'the golden age of capitalism'. By resisting elite-driven attempts in the 1980s to reconfigure the welfare state into a more residualist, means-testing public sector that targets only the unfortunate (whilst opening up for market-based provision of social insurance for the well off), defenders of the welfare state today claim that they in fact preserved institutional elements which – because they were maintained, now serves a conducive function for a (necessary) transition to a new, socially acceptable and efficient market economy. The impact of the historical anchoring of social rights in the political institutions of the nation state, and not in the labour market as in the Continental European countries, implies that high levels of labour market mobility and flexibility can coexist, - and not threaten, the social security of workers and families. The Nordic model of welfare protects individuals, not jobs. The socialisation of economic risks by the state has produce a widespread tolerance for a more risky economy (i.e. flexibility and restructuring). Hence, this 'efficiency by coincidence' argument explains the Nordic success by the combination of absence of welfare state reforms and economic imperatives beyond the control of national policies.

The second perspective, not so easily identifiable in the public debate, is, however, the proposition that the particular welfare state regime has little to do with the economic success of the Nordics, but more so with a wave of reforms of the public sector at large. To the extent that a core argument can be identified, it would be an assumption that the cumulative effect of the reforms is on the one hand, increased efficiency in the provision of public services (thus enabling a satisfaction of demand without tax-increases, i.e. ‘welfare state survival’), and on the other hand, elements of market mechanisms introduced by the reforms have provided for private (and former public) companies a new environment with harsh incentives for internal restructuring in order to maintain competitiveness. Therefore, and according to this line of reasoning, the key to explaining Nordic global success is (*not* the preservation of its welfare regime, but) the high capacity to reform the institutions through which political power is exerted, - and in a wide range of policy areas. It is the presence, not to the absence, of reforms that should be our point of departure if we are to understand the Nordic success.

The two above arguments are broad summaries of ongoing debates on the political arena. Different parties compete in claiming the honour for the economic success the last years. And as with all such debates in general, observed correlations between phenomena are claimed to be causal mechanisms deliberately created by the actor. Defenders of the welfare state can claim that the key to success lies in the continued restrictions on privatisation and marketisation of the welfare state model, whereas the ‘modernizers’ contend that without the reforms implemented, economic progress would not have materialized.

Political debates, especially those on ‘big’ macro-level issues, always involve a wide range of counterfactual arguments, and thus, are beyond the possibility of being informed by empirically based insights. No one will ever know how the Nordic economy could have developed with more or less welfare state/public sector reform in the past. On the other hand, when two, logically opposite explanations of the same phenomenon compete, we should – in principle – be able, on empirical grounds, to reject either one – or both. The study of the Nordic model of society is not yet there. In fact, there is a considerable disagreement, both among students of welfare policy

and of public policy, as to what extent the public sector and the welfare state actually has been reformed (see section three, below). Among welfare state researchers, a debate on when an observed institutional change should be classified as a change *of* a system or a change *in* a system (of e.g. health or income insurance), has been unable to reach any conclusion. Where some see radical reform, others see incremental adjustments to changing environments or to new social needs. It follows from this, that as long as there is no agreement on the extent of reform in the Nordic countries, no one should be surprised that political science has little to say about the causal chains between the institutional setup of governance systems and the outcomes in terms of economic efficiency.

The following paragraph reviews the literature on public sector reform in Scandinavia, and in section four we proceed to argue that, in order to advance our knowledge on the relationships between political-institutional reform and economic outcomes, political science should, - and probably contrary to our instincts, focus less on reforms and more on establishing specific hypotheses on the mechanisms that constitute and form the causal links between company-level behaviour and political decisions to change (or preserve) the institutional environment within which they operate.

### **III Public Sector Reform and New Public Management in Scandinavia**

Although much of the literature on public policy reform in the Nordic countries emphasises continuity rather than radical change, a brief overview of the last two decades suggests that a number of relatively radical reforms have been launched. Although the pace of decision making has often been slow, and decisions may have been relatively consensual, many of the reforms have involved quite radical changes along the lines identified in the literature on New Public Management. Although most reforms have been designed to be compatible with long-established welfare state institutions, this does not necessarily preclude NPM-type initiatives. On the contrary, the Nordic welfare states were subject to a series of waves of reform during the second half of the Twentieth Century, and one of the central features of the welfare regimes was (and is) their flexibility when it comes to reform. The main controversies

in the debates on public sector reform in the Nordic states centre on to what extent the changes over the last two decades should be classified as NPM reforms or whether NPM is merely a fad that has had relatively little impact. In Norway in particular, this has developed into a debate as to whether there has been ‘too much’ or ‘too little’ NPM reforms and whether they have had any impact on public policy and administration.

Although the term New Public Management has come to encompass such a wide range of reforms that there is a danger of it capturing everything and nothing, an essential core can be extrapolated from most definitions.<sup>8</sup> Drawing on the quest to introduce economy, efficiency and effectiveness into public administration and efforts to borrow from private sector management, the core of NPM reforms centre on i) disaggregating or splitting up public organisations into functional units and separating policy, oversight and service delivery; ii) introducing competition into the public sector, either directly or through quasi-market mechanisms, with a view to improving efficiency and user choice; and iii) increasing the use of incentives in public sector management. Taking this definition as a starting point, the term ‘governance’ may be seen as a softening up or more advance version of NPM, partly by use of more voluntary mechanisms, and thus as a complement rather than alternative to NPM. Stoker accordingly identifies five key features of governance: i) involvement of actors and institutions beyond formal government; ii) the blurring of boundaries and responsibilities for public policy; iii) horizontal power dependence between institutions; iv) the importance of autonomous networks; all of which results in v) that governments’ capacity to achieve results may depend more on indirect instruments than on command or authority.<sup>9</sup> In this sense, governance entails a combination of radical instruments and inclusive decision making, and the Nordic public policy reforms come somewhat closer to this modified version of NPM. However, particularly the first element of NPM, splitting up and reorganising the public sector,

---

<sup>8</sup> C. Hood, “A Public Management for All Seasons?”, *Public Administration*, 69 (1991), 3-19; . Dunleavy & C. Hood, “From Old Public Administration to New Public Management”, *Public Money and Management*, July-September (1994), 9-16; E. Ferlie, “Quasi Strategy: Strategic Management in the Contemporary Public Sector”, Pettigrew, Thomas & Whittington (eds.), *Handbook of Strategy and Management*, (Sage 2002).

<sup>9</sup> G. Stoker, “Governance as Theory: Five Propositions”, *International Social Science Journal*, 155 (1998), 17-28.

has been prevalent in the Nordic reforms; and user choice is invoked even more frequently than for example in Britain in some sectors.

Perhaps the most influential model of public sector reform in Norway (and this largely hold for the rest of the Nordic states too) is Johan P. Olsen's model of incremental reform.<sup>10</sup> Here public sector reform is a matter of slow and consensual change, with a focus on democratic governance, maintaining the welfare states and on *Rechtsstaat* principles. Although the Nordic states have sought to learn something from the private sector, the focus has been on managerial rather than political change. Comprehensive policy reforms have been avoided, not least because radical reforms do not sit well with the 'culture' of Nordic public administration. Changes in public policy have therefore been a matter of 'experiential learning' (not rational adaptation), and even comprehensive reform programmes have led to little more than modest change. Part of the reason for this also lies in the 'segmented' nature of the public policy regimes: most reforms haven bee specific to a given sector or even organisation. Although Norway has featured a central machinery for public sector reform in the Department for Labour and Administration, this never amounted to the strong centralised machineries that Margaret Thatcher or Tony Blair established to drive through their reforms. British scholars have made similar points in comparative work. For example, R.A.W. Rhodes' comparison of Denmark and Britain emphasises the continuity in Danish reform, and its focus on *Rechtstaat* and democratic accountability rather than 'steering capacity' as the dominant reform narrative.<sup>11</sup> The central point is that the use of independent agencies and management by objectives, which are central elements of NPM, are hardly new in the Scandinavian context (Denmark had also nationalised less than the UK, and there was therefore less to privatise). In short, although Nordic reforms may have something in common with NPM reforms, the region is often seen as exceptional in comparative terms.

---

<sup>10</sup> J. P. Olsen, . P. Olsen, *Organized Democracy: Political Institutions in a Welfare State – the Case of Norway*, (Oslo: Universitetsforlaget, 1994); J. P. Olsen, "Norway: Slow Learner - or yet Another Triumph of the Tortoise?", in J. P. Olsen & B. G. Peters (eds), *Lessons from Experience. Experimental Learning in Administrative Reforms in Eight Democracies* (Oslo: Scandinavian University Press, 1996).

<sup>11</sup> R. A. W. Rhodes, "Traditions and Public Sector Reform: Comparing Denmark and Britain", *Scandinavian Political Studies*, 22:4 (1999), p.341-370.

Nevertheless, neither Olsen's nor Rhodes' analysis precludes the possibility that the Nordic reforms might turn out to be quite radical. Although Olsen remained unimpressed by the results of public policy reform in the Nordic countries by the late 1990s, he was open to the possibility that the Norwegian 'tortoise' might eventually overtake some of the other West European reform 'hares'. Likewise, although Rhodes' analysis points to slow reforms, most of the core elements are equally compatible with radical reforms. Constitutional constraints and protracted negotiations to reach consensus, coupled with considerable professional and ministerial autonomy, make for considerable reform capacity once agreement has been reached. Once consensus has been reached in any given sector, reforms can be both swift and dramatic. Therefore, although the dominant picture has been one of partial, incremental and cautious reform, based on consensual decision making and a pronounced effort to maintain the welfare regimes, this has not precluded ambitious plans. Consensual decision making does not, per se, preclude radical reform.

To be sure, a number of Scandinavian scholars have developed Olsen's model further, and gone on to argue precisely that the Nordic welfare states and public policy regimes do in fact preclude radical reform. Tom Christensen and Per Læg Reid have long argued that the success of public sector reform depends directly on whether reforms 'fit' in with traditional administrative culture.<sup>12</sup> The purported strength of the Nordic systems is that reform is slow, and consistent with long-established welfare state institutions. If the reforms are not, they will "filtered, edited and redefined in a process of pragmatic adaptation."<sup>13</sup> Variation in the success of public sector reforms depends on their 'reception' by the public sector and civil service. Most Norwegian reforms have been a matter of trends and fashion: elites driving through reforms that are resisted by the public sector organisations. In the 1950s it was a matter of relieving ministers of some of their administrative tasks; in the 1970s the order of the day was democratisation of the civil service, and since the 1980s the new fad has been NPM. Many of the core elements of NPM, such as management by objectives, decentralisation and devolution, have long been well established in the Nordic

---

<sup>12</sup> T. Christensen & P. Læg Reid, Christensen & P. Læg Reid, "Public Administration in a Democratic Context: A Review of Norwegian Research", in N. Brunsson & J. P. Olsen (ed.), *Organizing Organizations*, Oslo: Fagbokforlaget, 2001; and "Administrative Reform Policy: The Case of Norway", *International Review of Administrative Sciences*, 64:3 (1998), 457-475.

<sup>13</sup> T. Christensen, "Modern State Reforms", in K. Heidar (ed.), *Nordic Politics Comparative Perspectives*, Oslo: Universitetsforlaget 2004, p.39.

administrative traditions. Other aspects, such as internal competition, are filtered out or adapted beyond recognition.

According to these sceptical analyses, NPM has therefore had a limited or regrettable impact on public administration in the Nordic countries. Lægheid questions the OECD thesis of global convergence and radical change. As far as the Nordic states are concerned, historical traditions and cultural norms have laid the basis for an alternative development. Although these states have a tradition of carrying through radical reforms, the effects of NPM have been more limited due to the “cultural conflict between market and management thinking and the Scandinavian administrative tradition.”<sup>14</sup> As Christensen puts it, “NPM is a one-dimensional reform mostly geared towards efficiency hiking. It spread more easily as ideology and ideas than as practice. There is a lot of variety and inconsistency in the practical implementation of NPM. Its main action appears to render an integrated state into a disintegrated state or government system.”<sup>15</sup> Most importantly, change has not been uniform, but complex. Both authors see Norway as the most reluctant reformer, employing a cautious and incremental strategy; whereas Sweden has gone the furthest in the direction of strengthening employers and independent agencies, and Denmark’s ‘negotiated reforms’ fall somewhere between the other two.<sup>16</sup>

However, a number of scholars working in the very same tradition have come to emphasise the regrettable, rather than the limited, effects of NPM. Summing up the five-year research programme on *Power and Democracy in Norway*, which yielded some fifty publications (many of which are close to the the Lægheid-Christensen school), the authors of the *final report* found that democracy has weakened *with respect to all its aspects* over the last decades. NPM reforms are partly to blame: “the major trend in the administration of public affairs during the last couple of decades has been some privatization of public property, market orientation of state enterprises,

---

<sup>14</sup> P. Lægheid, “Administrative Reforms in Scandinavia – Testing the Cooperative Model”, in B. C. Nolan (ed.), *Public Sector Reform: An International Perspective*, London: Palgrave, 2001, 78.

<sup>15</sup> T. Christensen, “Modern State Reforms”, in K. Heidar (ed.), *Nordic Politics Comparative Perspectives*, Oslo: Universitetsforlaget 2004, p.31.

<sup>16</sup> T. Christensen & P. Lægheid review the Norwegian literature in “Public Administration Research in Norway”, in *Public Administration*, 82:3 (2004), 679-690.

and outsourcing of public services to private tenders”.<sup>17</sup> The Nordic model has become ‘particularly strained’ (in Norway) because of a combination of NPM-style reforms that have brought about a bigger role for the market, the juridification of politics, centralised decision making, the increased role of the EU in Norwegian politics as well as other factors such as the increased influence of the media. NPM reforms are considered particularly detrimental for *local* government, because they entail a shift in focus from the citizen *per se* to the citizen as service user, and a shift in emphasis from democracy to efficiency and value for money. “The introduction of New Public Management reforms within the public sector see little value in the democratic role of local governments, which are increasingly redefined as national policy implementers.”<sup>18</sup> This is not so much a debate with the above-cited ‘NPM-as-a-fad’ literature, but rather an assessment that concludes that, seen in a broader context of Norwegian democracy, NPM-reforms have in fact had a severe and negative effect. However, this analysis is predicated not only on the traditionalist conception of representative democracy mandated by the Norwegian parliament of the *Power and Democracy* project; it is rooted in corporatist theories of the state. Alternative analyses, whether neo-pluralist or rational choice-driven, would yield substantially different interpretations.

It is therefore hardly surprising that a number of Norwegian scholars who have approached public service reform from a rational choice perspective have assessed it more positively both from a positive and a normative perspective. To be sure, several analyses share many of the conclusions of the more NPM-sceptical literature, particularly about the limitations that the Nordic corporatist systems place on the room for NPM reforms because there are many formal veto points in the decision

---

<sup>17</sup> Tranøy, Bent Sofus and Øyvind Østerud (eds.) (2001). *Den fragmenterte staten. Reform, makt og styring*. Oslo: Gyldendal Akademiske. See also special issue of *West European Politics* on Norway: 28:4, September 2005. The citation is from an English-language conference paper on the Commission’s findings, by Ø.Østerud & P. Selle, “Power and Democracy in Norway: The Transformation of Norwegian Politics”, American Political Science Association, September 2-5, 2004, which can be found at <http://www2.hi.is/Apps/WebObjects/Hi.woa/swdocument/1005110/Per+Selle.rtf>. See also Østerud, Selle and Engelstad’s contributions to the special issue of *West European Politics* on Norway: 28:4, September 2005. For a critical review, see critical review, see Stein Ringen’s “Wealth and Democracy”, *Times Literary Supplement*, 13 February 2003.

<sup>18</sup> Ø. Østerud & P. Selle, “Power and Democracy in Norway: The Transformation of Norwegian Politics.”

making systems.<sup>19</sup> Normatively, however, the complaint here is that reform has not gone far enough, both from an efficiency perspective and in terms of the government meeting the voters' demand for (efficient) public services.<sup>20</sup> Political parties offer clearly distinct platforms on public policy reform, and Rune Sørensen finds evidence that, although there is more opposition to NPM-type reforms among public sector employees than among private sector employees, there has been a long term shift in favour of privatisation and public sector reform in Norway.<sup>21</sup> Several authors have documented and analysed Nordic NPM reforms (particularly in the local-language literature), and assessed these reforms as quite radical responses to changing economic conditions.<sup>22</sup> In Norway this includes for example rapid privatisation and extensive liberalisation in the telecommunications and electricity sectors, competitive tendering for local government services, and comprehensive restructuring of health care provision.<sup>23</sup>

The OECD's assessments bear out the assertion that the Nordic states have carried out radical reforms, and, as importantly, that these reforms have contributed significantly to improvements in the Nordic states' economic performance. In accordance with a mandate from OECD ministers in 1997, the OECD has been publishing a series of reviews of regulatory reform including Denmark in 2000 and Norway and Finland in 2003 (but not so far of Sweden). Although the three reviews inevitably recommend further reforms and point to the lack of central reform agendas and mechanisms, they also emphasise how far the consensual Nordic reform programmes have contributed

---

<sup>19</sup> J. E. Lane, "Public Sector reform in the Nordic Countries", in J. E. Lane, *Public Sector Reform: Rationale, Trends and Problems* (London, Sage, 1997); J. Blom-Hansen, "Still Corporatism in Scandinavia? A Survey of Recent Empirical Findings", *Scandinavian Political Studies*, 23:2 (2000), p.157-181.

<sup>20</sup> J. Rattsø & R. J. Sørensen, "Explaining Public Sector Reform: Electoral Interests of political Structures", Nordic Political Science Association, 2002.  
<http://www.socsci.auc.dk/institut2/nopsa/arbejdsgruppe7/runesoerensen.pdf>, J. Rattsø & R. J. Sørensen, "Public Employees as Swing Voters: Empirical Evidence on Opposition to Public Sector Reform", *Public Choice*, 119 (2004) 281-230.

<sup>21</sup> R. Sørensen, "Markedsreformer i offentlig sektor: Elitisk motebølge, velferdskoalisjonens interesser eller partienes konkurranse om velgere?", *Tidsskrift for Samfunnsforskning*, 45 (2004), 509-546.

<sup>22</sup> Busch, T., E. Johnsen, K. K. Klausen & J. O. Vanebo (eds. 2001)., *Modernisering av offentlig sektor: New Public Management i praksis*, (Oslo: Universitetsforlaget); R. J. Sørensen, L. E. Borge & T. P. Hagen (1999), *Effektivitet i offentlig tjenesteyting*, (Oslo: Fagbokforlaget).

<sup>23</sup> A. Midttun & E. Magnus, *The Norwegian Electricity Reform in a Nordic Context*, (London, Macmillan, 2000); R. J. Sørensen & A.H. Bay, "Competitive Tendering in the Welfare State: Perceptions and Preferences among Local Politicians", *Scandinavian Political Studies*, 25:4 (2002), 357-384; T. P. Hagen & O.M. Kaarebøe, "The Norwegian Hospital Reform of 2002: Central Government takes over Ownership of Public Hospitals", Health Organisation Research Norway, Working Paper 2004/1.

to making the economies more competitive and public services more efficient. The report on Denmark praises the country's open economy and pragmatic reform of the system of governance, which is credited with improving the efficiency of government services as well as successful adjustment to changing economic and social conditions (but is critical of sheltered sectors, including service industries, and Denmark's relatively weak competition policy regime).<sup>24</sup>

The OECD report on Finland emphasises the role regulatory reform has played in the successful economic transition (after the loss of Soviet markets), and particularly points to the impact of fast liberalisation in telecommunications, energy and capital markets. The competition policy regime and the competition authority is identified as a central factor in driving reform. The reform of “[public] policy has successfully promoted market openness and international competitiveness for part, but not all, of the economy.”<sup>25</sup> As in the Danish case, however, the need for a coherent overall approach to reform is emphasised: “traditions of gradualism, decentralisation and consensus are not well suited to an overall strategy and a strong central focus.”<sup>26</sup> Parts of the private sector remain protected, as does local level public service provision and many utilities (post, gas, water, sewage, rail; all of which attract OECD criticism. Perhaps more importantly in the present context, the OECD report is critical of labour market regulation that mitigates against return to work.

The OECD report on regulatory reform in Norway emphasises much the same themes: the success of reform and the need for further reform. As in the Danish and Finnish cases the system of consensual decision making is praised, and clearly judged compatible with radical and high-impact reform, and the success of reform is linked to trust between regulators and stakeholders. However, Norway (like the other two) draws criticism for the lack of centralised administration of reform: “a complete and coherent regulatory governance policy cannot be said to exist in Norway. [...] However, the informal, consensus-based approach to regulatory processes is not well

---

<sup>24</sup> “Regulatory Reform in Denmark”, *OECD Reviews of Regulatory Reform*, OECD, Paris, 2000. All the background reports for the main report are listed on the OECD web-pages, [www.oecd.org](http://www.oecd.org).

<sup>25</sup> “Finland: A New Consensus for Change”, *OECD Reviews of Regulatory Reform*, OECD, Paris, 2003, p.15.

<sup>26</sup> “Finland: A New Consensus for Change”, *OECD Reviews of Regulatory Reform*, OECD, Paris, 2003, p.14.

adapted to evidence-based decision-making, and consistency is an issue.”<sup>27</sup> Although the overall picture is one of gradual and ad hoc reform, the OECD report points to several important exceptions: electricity liberalisation is hailed as ‘pioneering’ at the time, and the programme for modernisation of the public sector and reform of state ownership are praised (as are the reforms of regulatory agencies, at least as they were envisaged in 2003). Overall, the OECD’s assessment of Norwegian reforms leaves little doubt as the radical (and NPM-type) nature of reforms in several important sectors, let alone their impact. For example, although the health care reform is criticised for its limited focus on market mechanisms and failure fully to separate the state’s role as purchaser and provider, it is also praised for the high impact in terms of promoting efficiency and patient choice. To be sure, the report calls for further reforms (especially in industrial policy, public services, labour markets and the overall framework for regulatory reform), but the OECD’s positive appraisal of many aspects of Norwegian public policy reform indicate that not only do the reforms feature a number of NPM mechanisms, but they have had a considerable impact in terms improving the conditions for private firms’ competitiveness.

The next section turns to a brief overview of some of these reforms in Norway, their common features and the mechanisms. We have classified reforms into three groups:

- a) Those intended to provide economic actors with a more competitive environment, assuming this will induce innovation and cost cutting,
- b) those intended to reduce the cost of providing goods for the population, assuming this will expand volumes and/or improve quality with less need for tax increases, and
- c) reforms of the health and income insurance schemes, assuming this will maintain the capacity of the schemes to deliver the promises embedded in the systems of social rights.

---

<sup>27</sup> “Norway: Preparing for the Future Now”, *OECD Reviews of Regulatory Reform*, OECD, Paris, 2003, p.5.

### *1. Improving the infrastructure for the market economy*

The most radical changes in Norway, as in the other Nordic countries, over the last two decades have been the liberalisation of telecommunications and electricity markets. Both were driven by a combination of an internal logic and the anticipation of EU-level liberalisation. The electricity sector was liberalised in 1991, before the EUs proposals to liberalise energy markets got off the ground, and the common Nordic pooled market (Nord Pool) established in 1996.<sup>28</sup> However, this process did not involve large-scale privatisation, but rather separation of the production and grid elements of the state utility into two new government owned *statutory enterprises* (statsforetak) – Statkraft and Statnett. The telecommunications market was opened to partial competition, beginning with terminal equipment in 1998, and full competition was brought about in line with the deadline for liberalisation of the EU telecoms market in 1998. Telenor became a state-owned company in 1994.<sup>29</sup> Liberalisation has been slower and less radical in the transport sector, although reforms over the last decade have separated organisations responsible for policy and delivery across the board. The rail services and network were separated in 1996, and the rail operator NSB became an incorporated company in 2002 (and the maintenance division, Mantena, was separated). Competitive tendering for rail-services is at a pilot stage. In the road sector, the production unit became a separate (state-owned) company, Mesta, in 2003; the air traffic and airport management organisation was made into a separate company, Avinor, the same year. The monopoly of the state to provide postal services is also, gradually being replaced by a market with liberalised entry for all. A series of tax and administrative reforms intended to relieve companies from excessive red tape also warrant mentioning in this context. The ‘Simplifying Norway’ project was launched in 1999, and successive plans have sought to map, document and reduce the amount of time spent by the business community on reporting duties. The World Bank Group currently ranks Norway 5<sup>th</sup> in the world in terms of the ease of doing business.<sup>30</sup>

---

<sup>28</sup> T. Bye & E. Hope, “Deregulation of Electricity Markets – the Norwegian Experience”, Discussion Paper 433, Statistics Norway, September 2005.

<sup>29</sup> K. A. Eliassen & J. From (eds), *The Privatization of European Telecommunications*, (Ahsgate, forthcoming), chapter on Norway.

<sup>30</sup> The World Bank Group’s Doing Business database, [www.doingbusiness.org](http://www.doingbusiness.org). The other Nordic countries are all among the top 14 of the 155 states ranked, and the UK and Ireland are the only European economies to score above the lowest ranked Nordic country (Sweden).

These reforms (and more could be mentioned) share, we will argue, three common factors: First, they are top-down, elite driven, and promoted through a depoliticised parlance of modernisation, technological imperatives, efficiency and long-term benefits. Social democratic governments have been in the driver's seat for most of the time. Objections from employees and unions have, programmatically, been voiced but, more surprisingly, eased out after a fairly short time. Second, Norway entered the European Economic Area in 1994, and the EU regime for the internal market therefore applies in full to Norway (except for agriculture and fisheries). The fact that this provided the government and pro-reform elites with a convenient argument that 'EU-law leaves us no room' cannot be ruled out as a catalyst for the erosion of opposition to the reforms. Case-studies, however, show that most reforms in fact were driven by domestic factors, - and in some respects as a deliberate and strategic preparation for entry into the European market. The third factor is a hegemonic idea, - that all reforms of regulatory institutions should strive at establishing a state of 'industrial neutrality', - that all (historically developed) industry-specific attachments to political decision making should be dismantled, as should any other institutional protection against competition.

In sum, we will argue that far from being 'a tortoise', Norway has introduced a series of quite dramatic reforms with one significant common denominator, - that industries historically regarded as 'of vital national importance' should learn to live in a more global marketplace. The use of regulatory authority to deliberately expose industries to competition was at the core of a national elite consensus, implemented by the Labour party.

## *2. Improving efficiency in the provision of public goods and welfare services.*

A characteristic on the Nordic model is the high level of (collectively financed) services provided for the population, through legal rights and administrative discretion. Production of health, education and services for children, the disabled and the elderly occupies close to one third of the total employment. During the 1970s, these services expanded almost entirely through more resources being put into hierarchical, command economy type of industrial organisation, owned and run by the

municipalities. The capacity of the (435) local authorities to produce quantity and quality according to centrally set standards was, and still is, equalised through a comprehensive, state operated, system of indicator-based reallocation of resources from rich to poor regions.

Compared to the above-mentioned reforms of regulatory regimes, this model of producing merit goods and welfare services has proven surprisingly robust to large-scale reforms – surprisingly because the most intense debate over public sector reform on the political arena has been precisely over the need to reform the organisation of the production. There has been no lack of attempts by elites and (centre-right) governments to promote (NPM-)reforms. Legal regimes have been introduced to ease the entry of private producers. But still, and with the benefit of hindsight, we can conclude that despite reform efforts the last two decades, public sector production is totally dominant. Some private alternatives have been established, consumers have been given some rights to transfer to a private producer (taking with them the public subsidy they would alternatively have received), and some municipalities have tried contracting out, - with mixed results. Thus, we will argue that the most interesting question is why the traditional model has been so robust. Three factors are essential to explain this story of non-reform:

First, the configuration of historically determined competencies between the central and local government gave the central state the control over the total income of the municipalities. This, the argument ran, was imperative in order to equalise the access of all citizens to the same services irrespective of where they lived. In combination with a subsequent and successive introduction of individualised social rights, this produced a system of resources determined by the central state and ‘demanding customers’ at the local level. By limiting the aggregate transfers to local authorities (while still legislating more rights for citizens), the central state (deliberately) created a state of austerity. This in turn induced local actors to continuously improve efficiency and performance, - only to discover that without control over the (centrally bargained) wages of employees, in fact little was to be won by organisational reform.

Second, in those cases where contracting out of social services have been tried, market based actors were not able to produce at significantly lower costs. Being

bound by their contracts, cases of eroded quality by the contractors seem to have discredited the idea of competition and market-based producers as a realistic alternative.

Third, in this situation local authorities have, - with the (so far) silent consent of central government, displayed a stunning innovative capacity as to introduce various types of user charges. In fact, the conventional view of Norwegian social services as collectively financed is increasingly inaccurate. During the 1990s, the proportion of production costs actually paid by the users rose significantly, and with surprisingly little protest.

To sum up, the broad picture would be that, when it comes to the production of education and social services, the institutional regime has proven to be very robust. The 'old' regime provided sufficient degrees of freedom to pursue efficiency improvements and service expansion: the central state made the customers more demanding (through the granting of rights), thereby forcing the local authorities to charge the same customers, - making them even more demanding in a situation where 'exit' (i.e. turning to private alternatives) is no realistic option (but for a very tiny minority of the most well off).

### *3 Reforms of the system of health and income insurance*

For four hundred years (!), the health sector operated as a planned economy. Hospitals were owned by the regions, and legally an integral part of the state apparatus. In 2002 a 'big bang' reform was introduced (by the Labour party). The country was divided into five 'health regions', each with its own legally independent, health enterprise, owning and running the local hospitals. The system of financing hospitals was changed from fixed (but in practice negotiable) budgets to a mixed system of (indicator-based) grants and (diagnosis-related) pay per patient. Equally importantly, citizens were given the right to free choice of hospital. The reform carries all the hallmarks of an NPM-inspired reconfiguration of responsibilities, financing and producer-consumer relationships. The reform is too recent to draw any firm conclusion about efficiency outcomes. So far, both production and aggregate national

health expenditure has risen significantly, primarily reflecting the operation of the new income system.

Contrary to health insurance, the system of income insurance (in case of unemployment, maternity, disability and old age) has been virtually unchanged since the last significant reform in 1978 (when full wage continuation from the first day was introduced in the sick pay scheme). This is a significant observation, given the important role that (dis-)incentive arguments play in hypotheses about welfare state impacts on the labour market and economic efficiency. On the other hand, this picture of an extremely rigid system is only partly correct. Compared to other West-European countries, Norway has the highest (and rising) levels of sickness absenteeism and early retirement, - a phenomenon which can be explained neither by health and working conditions (because they have improved) nor by the social insurance schemes (because they have remained unchanged for nearly 30 years). Even though Norway has world record high employment rates and little unemployment, there is a national - across all political parties- consensus that the present level of economic inactivity among people of working age is a problem: socially in terms of social exclusion, economically as a 'waste' of manpower, and demographically in light of the dramatic rise in the number of old people from 2020 onwards. Against this backdrop, the most comprehensive reform since the introduction of the welfare state itself (in the 1930s) is at present being prepared, along three sets of strategies.

- 1) A pension reform is due from 2009, replacing the present eligibility for full pension after 40 years in work with a principle of rewarding all years in employment. Also, contribution rates will be fixed (at 16 per cent of pay). By this Norway copies the Swedish reform, and in fact reforms a fully public 'defined benefit' system into a actuarial, 'defined contribution' system.
- 2) A concerted action (from 2001) by all parties in the labour market (including the government) to improve working opportunities for individuals with health problems. Through a formal agreement on 'An Inclusive Labour Market', the state guarantees not to reform the sick pay scheme if the social partners are able to reduce levels of sickness absenteeism and (early) exit through disability programs. Efforts have been put in effect to adapt jobs to the health status of individuals, and the role of medical doctors have been changed from

certifying the right to the social wage, to verifying (remaining) capacity to work. As a reform effort, this essentially corporatist arrangement is interesting, because its ambition is to maintain stability in the system of social rights by changing the conditions and environment in which the formal institution operate.

- 3) A grand reform, merging the whole system of income insurance with the institutions in charge of (all aspects of) labour market policies into one state organisation. This new ‘Work- and Welfare Institution’ is being set up in order to increase labour force participation, and to provide social security more through participation in (partial) employment, competence-improving programmes and proper activities, and less through (‘passive’) income transfers from the state to individuals.

Thus, to conclude, we find a picture of a Norwegian welfare state that was remarkably stable in the 1980s and 1990s, then, from the turn of the century, quite radical reforms are being implemented. In case of health, the top-down ‘increase efficiency through imposed reorganisation’ formula is obviously significant, whereas the reform agenda of the system of income insurance and labour market policies seems to be driven by other logics, primarily by an anticipation of a new demographic future. In contrast to politically controversial health reform, the social insurance reforms seem to be broadly based in extensive participation by all stakeholders.

The above, by no means systematic, exposition of Norwegian reforms warrants an important conclusion. Even by the somewhat arbitrary classification of public activities in market-creating, goods-producing and insurance functions, a clear picture emerges: it provides us with little insight to try to combine the reform record in the various policy areas into one measure of ‘Norwegian reform activity’. How should one compare and add high levels of market-creating reforms with low levels of reforms in other policy areas? Technically it can be easily done, but we would not know what is actually measured. One important implication is obvious: if we are to make hypotheses about the relationship between the extent of public sector reform/welfare state stability on the one hand and national economic performance on the other, one should specify the possibility that intense reform efforts in one policy

area (or government function) *in combination* with stability in an other area, is the causal factor. Such a model of interaction should then compete with hypotheses that assume that regulation in some areas is more important to economic performance than others.

#### **IV In lieu of a Conclusion: Some Speculations about the Way Forward**

The very notion of a national competitiveness in a global marketplace is of course, a construct. Firms and companies compete (states do not), only they have market shares, take out patents, and generate income. Any hypothesis that assumes a relationship between the macro-political characteristics of a state and the (aggregate) success of individual companies operating on its territory therefore has to specify how these macro-level reforms and institutions actually operate at level of the firm level and across firms operating in the same market, but at different levels of productivity. Conventionally this macro-micro nexus has been captured by the tax-level imposed by the state and characteristics of the supply of labour (price, skills). During the 1980s, more focus was put on understanding regulation and social rights as rigidities, hampering the functioning of market forces. From this grew the neo-liberal and NPM reform agendas: reduce taxes, increase the supply of labour, remove rigidities by re-regulation. The basic idea was that public sector and welfare state reform should and could provide for the single firm a combination of, on the one hand, a more risky and hostile environment (i.e. a more open and competitive marketplace), and on the other hand, a more conducive set of lower production costs (i.e. taxes and labour costs).

The Norwegian (and Nordic) economic success has definitely not followed this (neo-liberal) formula. To be sure, some elements of this neo-liberal strategy can be found, most notably in the reforms of energy and telecommunications. What is not present are the reforms of the welfare state. This in turn suggests that Norwegian success can be explained by the *combination* of market-making reforms in the economic sphere and blocked reform efforts in the provision of public sector services (and social insurance) – figure 1.

<b>Fig. 1 – combinations of public policy reform and stability</b>	Radical public service and social insurance reforms	Modest (or blocked) public service and social insurance reforms
Radical market-making reforms	Neo-liberal/NPM agenda	Nordic states since 1990s
Modest (or blocked) market-making reforms	Czech Republic ca 1995 <sup>31</sup>	Nordic states before 1980 (and the ‘critical’ agenda)

If the success of the Nordic cases owes something to their combination of radical market-making reforms (including utilities liberalisation and EU-style competition policy) with limited moves toward NPM-type regimes for public service provision, the challenge would be to specify what mechanisms, eventually, makes such a combination conducive to economic modernisation.

One working mechanism could be that voters accept more market-oriented reforms in industrial and competition policy if they at the same time feel that the social security provided by stable institutions is not under threat. The causal chain would then be that stable welfare institutions provide conducive political and social conditions for market-oriented restructuring of the export-oriented economy, - which is successful because the changes are so radical. Restructured industries then increase their competitiveness and thus provide the tax base for a (non-reformed) welfare state.

An other possible mechanism could be that high and predictable levels of social services relieve the working population from care obligations towards other family members, and they therefore accept to take more risks in the labour market, for example by moving to another job. The need to find a job compatible with social obligations is reduced, increasing the probability that a company hiring a new employee will find one who is motivated by the content of the job. The welfare state objective of providing high quality services irrespective of geographical location also removes risk otherwise associated with geographical mobility.

<sup>31</sup> The centre-right governments led by Vaclav Klaus in the first half of the 1990s came close to this strategy, as they engaged in considerable public service reform but cushioned market-making reforms (and maintained low unemployment) by helping large firms avoid bankruptcy and by giving some 80 per cent of the electorate a stake in privatisation by 1996 through the use of voucher schemes. B. Slay “The Czech Economic Transition: A Moment of Truth?”, *OMRI Analytical Briefs*, 1:143, 1996; S. Earle, S. Gehlbach, Z. Sakova, J. Vecernik, “Mass Privatisation and Voter Response in the Czech Republic: Will the Klaus Strategy Work?”, *OMRI Analytical Briefs*, 1:137, 1996. Klaus was the only Central European incumbent prime minister to win re-election in the 1990s.

These two mechanisms are based on an assumption that the reform/stability pattern across policy areas affects the distribution of risks for all individual actors, for workers as well as for companies. In order to modernise the economy and make it more competitive in a global economy, companies have to be exposed to increased levels of risk, - of going out of business unless they are innovative and competitive in the marketplace. This is the basic objective of regulatory reforms of market regimes and (formerly) state enterprises. Such a deliberate use of market mechanisms to restructure industries of course increases the levels of risk to employees. They will have to loose old jobs and find new jobs. The key to handle this risk lies in the welfare state: if it is reformed it becomes a source of additional risk, and the individuals and unions will most likely resist both industrial and welfare reform. If, on the other hand, the welfare state is kept stable, it becomes a source of risk reduction, - of security. Insecurity in the economic sphere (i.e. flexibility and mobility) becomes less of a frightening factor.

If these speculations hold some water, three interesting hypotheses can be formulated:

First, if market-making reforms are accompanied by non-reforms of the welfare state, sustained (or increased) national economic competitiveness is more likely to occur than in any of the other three reform effort/policy area combinations set out in figure 1. This, we suggest, may be what has been taking place in the Nordic states (rather than, as some suggest, merely a combination of stability in terms of both types of reform).

Second, if market-making reforms and welfare state reforms go in tandem (the neo-liberal strategy, in figure 1) levels of risk to voters and workers will be too high, - and reforms will be blocked either by industrial action or in democratic bodies. This may be what some German and French centre-left voters fear.

Third: welfare state reforms are most likely to be successful when levels of risk in the labour market are considered low! This has not been a much-used strategy, but it might help explain the success (both political and economic) of the Czech reform strategy in the early 1990s (see footnote 31).

In short, developments in the Nordic states in the last decade or two suggest that the combination of relatively radical reforms in public administration that are geared towards market-making (liberalisation, privatisation, competition policy reform) sit easily together with high levels of social protection. The risks brought about by market-making reforms are offset, or at least mitigated, by high levels of security in the welfare sphere (which in turn is linked to individuals, not individual jobs). In contrast to the neo-liberal agenda, this suggests that aspects of NPM (or ‘new governance’) reforms can well be introduced and combined with public service reform that is less NPM-driven. The Nordic states have seen relatively successful radical reforms, in sectors such as utilities liberalisation. In contrast to the critical agenda, which emphasises the benefits of slow, path-dependent, change, the present reading of Nordic public policy suggests that radical reforms that break with the Nordic traditions are very much part and parcel of the recent economic success stories. This hold not only for the liberalisation of utilities, competition policy reform or changes in the tax regime, but also for the (much less market-oriented) radical reorganisations of public services in health and education, and even the unemployment and pensions regimes. The key clues to any Nordic lessons lie in the mechanisms that link institutional reforms and behaviour at the individual or company level.