

From Governing to Governance

Seppo Tiihonen

From Governing to Governance

A process of change



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Preface

We can say without exaggeration that governance with its different specifications is a term of the day. It is a new term, which does not have a long history. Even the history of this book is longer than the record of the term.

In this preface I will give a short history of the birth of the concept of governance and good governance through my personal career as a researcher and a civil servant both in Finnish central administration and the World Bank. Governance is a term which is used in national administrations and scientific discourses in Finland as well as in most European administrations in the nineties in a way that makes the discourse from the eighties sound outdated and belonging to the past. In that respect my personal story is presented as an example of encounters with new discourses and the difficulties in institutionalising these and giving them concrete, effective form in daily practices.

For me the term governance is connected to the very long history of governing, rule, authority structures, and domination. In my basic university studies in the University of Tampere in the early seventies I learned a lot about modern public administration, but not about the historical roots of Finnish pub-

lic administration. As a civil servant I was first content with what I had learned, because I managed reasonable well with that knowledge. Terminology and theories from the University had a good resemblance to what I saw in my daily businesses and practices. Professor Kauko Sipponen, my teacher, was familiar with modern theories and administrative practices. In my daily work I found that public administration was keenly connected to traditions, but my knowledge of these connections was not enough. I had to study history. My dissertation was the first intermediate stage in process, where I gained better understanding of the roots of modern administration. The dissertation concerned modern themes in historical connection (decision-making in Finnish Government during the Second World War and immediately after the war). In addition I wrote a book on the history of the Finnish public administration. My teachers were professors Ilkka Heiskanen and Heikki Ylikangas. When the Government of Finland set a committee to study the history of central administration, I was engaged with it ten years from 1985 to 1995. During this time I had to abandon all modern themes of administrative modernization in Finnish central administration. I studied history of law and history of administration in the university of Frankfurt am Main with the direction of professor Michael Stolleis by means of a Humboldt Award. With his advice I was completely absorbed with the long duré of European authority structures and domination practices (history of Herrschaft). Administrative modernization was set up in proportions of slow change and long duré. Administration followed one of the slowest change patterns.

When I, after ten years of historical reflection, returned back to present and to modern administration I was surprised of the nominal changes in Finnish public administration. Administration had adapted a quite new vocabulary. Word public administration was difficult to find. It had disappeared and public

management has stepped in. Decision-making was transformed into management and leadership. Instead of bureaus and offices ministries had flexible units, the budgetary system was transformed to financial management etc. I was even afraid to return back to the corridors of my old Ministry of Finance. The corridors were the same. I wondered how could I manage there after so long a stay in themes and institutions of long durée. Naturally I had already earlier found out from newspapers that globalization has deep effects in Finland. It was a surprise that they would enter even into public administration, which should represent continuity. First I decided to learn the new vocabulary and new theories. It did not take a long time to adapt this new way of speaking. New practices had not even been adapted in full. However, soon I noticed that public management was not the newest discourse any more. OECD had started to introduce quite new terms and ideas. In the mid nineties in the conference of the European Group of Public Administration (EGPA) and International Institute of Administrative Sciences (IIAS) I learned a new term, governance. If you wanted to be modern and follow your time you had to use this vocabulary. Governance was the third layer of discourse of authority structures in the public sector. The first was public administration, the second public management and the third governance.

Discourse of governance raised my interests as a researcher. It was more promising than the vocabulary of public management. Management was adapted from the private sector and did not represent principal change but qualitative improvement and new technologies. Governance was a broad term which did not concern only internal questions of public sector, but referred to quite new authority structures and systems of rule – at least in theory. For me the discourse of governance promised to break many of the traditional up-down authority chains in public administration and in the relations between the state and society.

In the late sixties themes like this were discussed in different anti-authoritarian and libertarian discourses. To turn the authority structures upside down so that the power and influence will be raising from grass root level from citizens in society and from business actors in markets was tremendous change even in my long term perspective, with which I had been acquainted. I could not believe what was happening: can I experience a really big change in my lifetime? I felt that new governance can be a ground-breaking move from authoritarian governing towards a genuine liberal system of rule. Governance was not the only new discourse. I have already referred to globalization. In late nineties the discourse of New Economy tried to bring about a revolution in economy and the markets. The proponents of New Economy were even trying to abandon the traditional laws of economy, which they began to call Old Economy. This fervour did not last long. However, the term governance did not disappear. It transformed into more modest and practical forms.

In the late 1990s I participated in the Ministry of Finance in several practical public management reform projects, which used this new discourse. Along these projects I tried to analyse what is happening in public administration and in the modernization programs from the framework of long-term governing trends and authority structures. In 2001 I presented my first ideas in a discussion paper in Finnish.¹ In early 2001 I had a possibility to work for two years in the World Bank in Washington DC with European and Central Asian (ECA) countries, especially in public sector and governance reforms. From there I received quite a new layer into to my understanding of governance. The Bank had developed a package of tools and reform ideas, with helped the staff of the Bank in reforming the public sector in developing countries. After September 11th I learned

¹ *Tiihonen* 2001

that terrorists and corrupted leaders utilized failed public institutions, bad governing systems and weaknesses of new governance structures, which were based on trust and self-regulation of economy and society. It was clear that the problems in developing countries did not have much in common with the discourses of new governance we had accustomed in developed Nordic and European countries. The practical problems were as if from a different planet. Many of these countries can be regarded as failed states. They do not have even basic administrative machinery, legal framework for public administration, solid budgetary systems or civil service legislations. I became a true believer in classical bureaucracies and their values. Besides, I am convinced that authority structures develop through certain ladders. Developing countries cannot step directly from patrimonial rule to New Public Management and network-based governance. Before that they have to build classical institutions of public administration.

There are a lot of important sources of inspiration in my journey from governing to modern governance. The International Institute of Administrative Sciences has been one of the most important in many ways. First, the permanent working group studying the history of administration has offered me an intellectual inspiration. Comparative studies of past themes, which have modern manifestations – in bad and in good – have helped to understand modern discourses. Two examples can be mentioned here. The study of Napoleonic models is an example of spread of modern administrative ideas in Europe.² They are still a living tradition in many ways. Another example is a com-

² *Les influences du "Modele" Napoleonien d'administration sur l'organisation administrative des autres pays. The influences of the Napoleonic "model" of administration on the administrative organization of other countries* 1995.

parative study of history of corruption in central administration in developed countries.³ The chairman of the group, professor Fabio Rugge has been working actively to keep the truly living spirit amongst us. All members with their personal capacities have supported him. The annual conferences of the IIAS and EGPA have offered forums for debate on modern themes of administrative reforms. Different national and theoretical backgrounds give opposing views and interpretations for practitioners and participants of academia all over the world. Director general Michael Dugget has shown in an excellent way how modern down-up governance ideas can be used in an international organization, which will gain more responsibilities in combining future challenges of global governance and cultural diversity of mankind. IIAS understands the importance of classical public administration, new public management needs and discourse of good governance. The World Bank has offered for me in a similar way intellectual challenges as a researcher of governance. My unit in ECA and the thematic Public Sector Group were networks, which inspired the staff of the Bank in their work in reforming public administration in developing countries. Especially I remember warmly Amit Mukherjee. He is a devoted international civil servant, who is working for the poor. The library of the World Bank and the IMF is an excellent infrastructure, which I had the privilege to use.

From my employer, the Ministry of Finance, I have learned what is real administration, public management and modern governance in practice. Participation in modernization reforms and preparation of the governance strategies for the government have taught how long-term administrative institutions do change and what are the pain points of administrative moderniza-

³ *The History of Corruption in Central government = L'histoire de la corruption au niveau du pouvoir central*

tion. My colleagues have learned rules of the game and silent practices, which are not written in regulations of the Ministry, but which everybody learns in his work and which nowadays is known to be tacit knowledge. Analysis of this and of the principles, which govern changes of tacit knowledge, opens the door to a deeper understanding of the laws governing administrative change processes. As a student of administrative modernisation I am in debt to the Ministry of Finance for these practical experiences in old fashion governing and in new governance. My senior colleagues are living data banks in this respect. I thank all of them for this valuable understanding of the importance of the tacit knowledge in organization development. My visit – even a short one – in the World Bank has taught that only a part of this knowledge is transferable to other cultures. Because administrative cultures are country specific, students of comparative administrative research have to know more about these questions. Knowledge of this silent world under the surface is needed in future studies of good governance.

My university colleagues and friends have been a valuable discussion network, which has offered and transmitted new ideas from academia. My long term thanks go to professors emeritus Kauko Sipponen, Ilkka Heiskanen and Heikki Ylikangas. They have emphasized for me the importance of historical traditions, but at the same time with their own experiment revealed that history does not mean uncritical attitude and does not prevent radicalism in professional field. My ten years in the commission of the central administration of Finland with my young colleagues offered intellectual inspiration for history, politics and life. Professor Markku Temmes, who has a long-term experience with administration is among the first to give me fresh ideas for this study. I am grateful to professor Pertti Ahonen's research program Public Management in the Governance of European Welfare States for the financial support and

framework for the study. Pertti's intellectual agility has forced me to try to keep up and learn new things all the time. Professor Jari Stenvall and docent Jyrki Iivonen have read manuscript and have presented valuable comments, which I have tried to follow with my best capacity. Mr. Marko Oja has corrected English in the manuscript. University Press of Tampere, my alma mater, has accepted the study in their publication program. Ms. Anne Lehto has been my partner there. My warm thanks for all of them for their valuable help, constructive support and kind understanding.

In Helsinki

On Finland's Independence Day, December 6th, 2003

Seppo Tiihonen

1. Different dimensions of governance

1.1. Birth of discussion of political governance

Governance is a term of the day. It is widely used in practical and theoretical discourse. Because it is not a completely new word, everybody understands it, although the understanding of the word varies from one person to another. I do not believe that it is possible to find both an exact and general definition for a word, which is used in several different connections and discourses. Furthermore, because the term can be used in different ways and connections, I do not even try to cover it comprehensively, but will concentrate on its use in the political and administrative fields and use it as a term which describes the main ideas of the present fundamental tendencies of change in national and global governing. The wide use of the word is a clear indication of the need for a change from top-down governing towards more participatory and down-up governance.

Governing and governance can be used as terms with general meanings referring to governing and governance of different phenomena – for example of nerves – but in this study the terms are used in political and administrative contexts. Governance is a term, which refers to the political field and political activity as the major task of every national government. This

way of defining the specific significance for the term limits the study to the national governing system. It is used here as a synonym for governing, but I will develop it as a term expressing a step towards a new governing regime.

Before I go into more detail concerning the term governance, it can be considered the art and practice of running a country. Governing and governance are processes of management and rule.

Even though I am not specifically studying economic activities, definitions of the economic management of a country's resources offer a good starting point for understanding the processes of governance. Recent discussion of governance in the World Bank has produced good general characterizations of governance. In 1989 the World Bank presented an excellent definition of governance: "the exercise of political power to manage a nation's affairs"¹. The fundamental discussions connected with this definition in the Bank have uncovered elements from which we can develop the following definition²: good governance is a process, where rules and well-functioning institutions are applied to manage nation's affairs in a manner that safeguards democracy, human rights, good order and human security, and economy and efficiency are followed in management of country's resources. This definition is suitable for the traditional term governing as well.

¹ World Bank: *Sub-African Africa – From Crisis to Sustainable Growth* 1989, 60.

² Legal counsel of the World Bank Ibrahim F. I. Shihata has made an excellent memorandum "Governance" for the Executive directors of the Bank in 1990, when the Bank was discussing of what is contents of the Bank's mandate. His memorandum specifies the contents of economic management. We owe to Shihata's characterizations and arguments of governance, though our definition does not concern only economic questions. *Shihata* 1991.

In this chapter I will present a general and introductory description of the birth of the concept and highlight broad outlines of this study and its purpose. I will present a general framework for the use of the term in political steering of a state and its dimensions, i.e. public administration, markets and society. Questions of governance will be discussed on the same principal level which is applied in the whole study, by emphasizing that this is not a historical study of traditional governing and politics proper but a study which tries to explore future trends and principles of governance.

Governing a country is a manifold task that covers several dimensions and hierarchical levels. I will analyze it in a sector-specific way. State, markets and society are the most important dimensions. I regard governing and governance as processes of order, which aim at bringing coordination and stability in the world, which is composed of actors of different sizes and diverse resources.³ This causes inequality and is the major reason for hierarchies, which is from the perspective of governance the main structural characteristic of the world. The hierarchical structuring⁴ of the world is reflected in such conceptions as governors and governed and ruler and the ruled. Hierarchy is a principle, which has structured our thinking and world for centuries. It will lead us to a multi-level analysis of governance and focus on interaction between different levels.

I regard governing as a high-level pattern and arrangement of interaction of national socio-political actors, institutions, processes and structures, which produce success and well being for all actors and their constituencies. Governing is basically a process which aims at order. The basic element in this interac-

³ See different interpretations of order *Wrong* 1994, *Wolfe* 1989, *Cooper* 1998 and *Kurzer* 2001,

⁴ Importance of the principle of hierarchy is well presented by *Simon* 1997. See also *Fukuyama* 1999, 212-230.

tion is a politically determined framework for the coordination of activities to produce best possible conditions for economic development, good life for citizens and national success. This process contains two phases. First, interaction rules and institutions are defined in a political process. Rules are either official or unofficial and institutions formal or informal. Both of them define the roles for actors. Second, rules and institutions are implemented into action. In a wide sense, governing of an advanced industrial country is composed of all political and non-political practices that steer, control and co-ordinate social life and markets. A governance system of a country is not a single entity, but rather a set of hierarchical systems. Markets, state, family, networks, and associations are examples of different levels of governance systems.

Governing/governance models belong to the long lasting institutions of every state. Historical traditions are reflected in all national political and economic governing systems⁵, though most countries have built their systems from the same theoretical and ideological frameworks, i.e. political and economic liberalism. Formation of new governing structures and political regimes always takes a long time.⁶ This does not concern only formal governance institutions, for example the constitutional framework of governance, but also informal ones. James N. Rosenau says, "Governance does not just suddenly happen. Circumstances have to be suitable, people have to be amenable to collective decisions being made, tendencies toward organization have to develop, habit of cooperation have to evolve, and readiness not to impede the process of emergence and evaluation has to persist."⁷

⁵ See Jepperson 2000.

⁶ See for example *The Rise and Decline of the Nation State* 1990, van Creveld 1999 and Bendix 1978.

⁷ Rosenau 1995, 15.

When political scientists and students of public administration speak about governance instead of governing⁸ – activities of social, political and administrative actors, i.e. formal institutions of the state that are purposeful efforts to guide, steer, control or manage societies with authority or art of practice at running a country⁹ – they refer specifically to a conscious and a long-standing change tendency that is going on in many developed countries.¹⁰ In the 1990s quite many students of governing and other commentators presented visions of transformation of national up down governing and hierarchical commanding into a more self-organizing interorganizational network of governance arrangement of private and public actors - including government¹¹. At the end of this new governance government does not occupy similar dictating and commanding position as in traditional authoritarian governing but represents a consensual will-formation. When governing refers to constituted policies of state actors backed by formal authority to use monopolized coercive powers, governance suggests more to activities backed by shared goals that may or may not derive from legal and formal authority.¹² However, this change of vocabulary and emphasis of new methods of governing does not diminish the coercive powers of the state in any way. Finally, the purpose of governance is similar to the purpose of governing, i.e. to create optimal conditions for collective action and ordered rule.¹³

⁸ *Pierre and Peters* 2000, 79-83 and *Finer* 1970, 3-4.

⁹ *Kooiman* 1993, 2.

¹⁰ *Peters and Pierre* 1992, 224, say that this change is largely European and has concentrated primarily in the United Kingdom and the Netherlands.

¹¹ See *Osborne and Gaebler* 1992.

¹² See discussion of the difference between governance and governing *Bøås* 1998, 120.

¹³ See *Scott* 2001 140-142.

Until the 1990s the discussion of governing of economic and political systems concentrated on competition between capitalist and socialist economic systems and liberal political democracy and communist political systems. They were the dominant governing systems.¹⁴ After the collapse of the Soviet communist system comparisons have concerned differences between the Japanese, the European and the US models of governance.¹⁵ Present search for national success – or for national wealth, if we use Adam Smith’s expression – from down-up governance is a blueprint for a new regime type, which takes as self-evident present liberal democracy and its development.¹⁶

New governance principles have been developed, because many of the former, old up-down governing practices have lost their lure and capability to meet future challenges. Economic and political competition between states has produced new and better governing methods.¹⁷

The authority structures, legitimation bases and governing mechanisms of states were based until the late nineteenth century more on tradition than continuously tested effectiveness of governing.¹⁸ Tradition has not been sufficient legitimation for modern liberal democracies. Adaptation of general suffrage was the first step towards governing where outputs became the bases of legitimacy for the whole system. Ever-growing competition

¹⁴ *Huntington* 1968.

¹⁵ *Kennedy* 1993, *Fukuyama* 1995.

¹⁶ In the early 1990s Fukuyama presented, that liberal political system had won the competition between different political systems, *Fukuyama* 1992.

¹⁷ See analysis of the reasons for the birth of the present discussion of governance, *Pierre and Peters* 2000, 50-69.

¹⁸ In Max Weber’s terminology a step from patrimonial rule to rational rule. See *Weber* 1947.

of nations has challenged in many ways the legitimacy and capability of traditional governing to safeguard the economic success and well being of its citizens.¹⁹ Merely satisfactory results are not sufficient in the present global world, because investments, capital and skilled labor force can move to countries where they can maximize their outcomes and profits. If the flight of physical and social capital becomes a permanent phenomenon, the country will become downgraded. Because of this, reform of governing is a necessity. Abandonment of the old governing model concerns not just economy but also the governing of economy and society.

One of the main challenges for present national governing systems is the growing interdependence of national and international levels. Present changes in national governing are part of a continuous and increasing interdependence and interaction of international, national and local actors. Closed national governing systems are transforming into multi-level interaction between global, national, sub-national and local actors. International governance changes have been fundamental after the Cold War. Present steps from national governing towards interactive and multi-level governance of states and non-state actors will in the long run change the division of labor between the state, markets and society both on the national and international level. This change will destroy present models of interaction, bring forth new institutions and demand new institutional capacities from the state.²⁰

¹⁹ Porter 1990 and Kotler, *Jatusripitak, Maesincee* 1997 and Akbur, *Muel-ler* 1997, 59-81.

²⁰ See a general short summary of the change *Rosenau* 1995.

1.2. Different sources for discussion of governance

In this study discourse of governance refers to principles of order and a process of interaction and coordination of different actors and systems, i.e. markets, state, society and international level. It is a search for the most effective ways of reaching national success and wealth, and a search for principles of governance, rules of the game and ways to arrange cooperation amongst people in political, economic and social realms and to safeguard the efficient functioning of the state, markets and society.

I can present some examples of characterizations of the term governance from different fields. These examples are taken from politics and public administration, business management (corporate governance), international politics (global governance), development policies (good governance) and society.

In politics and public administration the need for continuous reform has been noticed from the late 1980s in all OECD countries. The UK is one of the forerunners in this field. They created the vocabulary for public sector reforms – a turn from public administration to public management – already in the early 1980s²¹. R.A.W. Rhodes is one of the first researchers who have analyzed this development in the UK from the perspective of governance. He has adopted a network conception of governance.²²

In chapter 2 I will continue the discussion of governance in public administration. In the Netherlands, which has a long,

²¹ See *Hood* 1991.

²² Rhodes has been a director in a comprehensive empirical study project of the effects of the public management reforms on governance practices in the UK. *Rhodes*, 2001, 15 and 46-47, 57 (definition of the term). General presentation and analysis of the Whitehall project see *Transforming British Government*, Vol. I 2000 and Vol. II 2000.

rich and manifold organization history, researchers (Walter Kickert and Jan Kooiman) have developed already from the early 1990s governance as an alternative conception to public management, which is based on an Anglo-tradition. Also the questions of Dutch discourse concern developed democracy.

James March and Johan Olsen have in their book *Democratic Governance* developed a framework for democratic governance from a new-institutionalist perspective of political science. They believe that the enhancement of democracy improves political governance. The task demands developing 1) democratic identities; 2) capabilities for appropriate political action among citizens, groups and institutions; 3) accounts of political events, because they define the options available and the possibilities for action, and 4) an adaptive political system, which copes with changing demands and environment. They believe that it is both possible and necessary to improve the organization of society and thereby the ability of citizens to achieve their purposes and better their lot.²³

Goran Hyden, a political scientist and a leading Africanist, has developed discourse of governance on the level of theoretical generality. In his conception governance concerns mostly the rules of the game of political rule. He regards governance as a conscious management of regime structures with a view to enhancing the legitimacy of the public realm.²⁴ Hyden emphasizes political legitimacy of governance contrary to economists, who give emphasis to economic factors and efficiency. Bratton and Rothchild, who have analyzed Hyden's conceptions, have summarized his conception of governance into the following five interpretations: 1) governance is a conceptual approach that frames a comparative analysis of macro-politics, 2) governance

²³ *March and Olsen* 1995, 45-47 and 241-252.

²⁴ *Hyden* 1992, 6-7.

concerns big questions of a “constitutional” nature that establish the rules of political conduct, 3) governance involves creative intervention of political actors to change structures, 4) governance emphasizes interaction between state and social actors, and among social actors themselves, and 5) governance refers to a particular type of relationships among political actors; that is, those which are socially sanctioned rather than arbitrary.²⁵

The term governance appeared in business discourse in the form of corporate governance already in the 1980s. International competition between nations and companies has forced states and the business community to look for reasons for success or lack of success from different sources. Because corporate governance models are determined culturally and regulated by law, their changes demand thorough public discussion and strong arguments. In the late 1980s corporate governance became a popular theme in academia, especially in institutional economics.²⁶ In the 1990s academic and practice oriented discussion concerned more and more on the advantages of different corporate governance models (especially the stakeholder and shareholder model). The significance of the discussion of corporate governance for the general discourse of governance has been vital, because it has shown that governance matters. Different models bring different results.

My third example for the use of the term comes from international politics and international relations. Students of international politics have been active discussants of governance from the late 1980s. James Rosenau and Ernst-Otto Czempiel together with other prominent scholars elaborated the concept already in 1992.²⁷ Their definition was the first in-depth analysis of modern global governance. For Rosenau governance is a

²⁵ *Bratton and Rothchild* 1992, 267.

²⁶ See for example *Williamson* 1986, *Williamson* 1994 a.

²⁷ *Governance without Government* 1992.

more encompassing phenomenon than government. It covers non-governmental institutions and informal, non-governmental mechanisms and how they move ahead, satisfy their needs, and fulfill their wants. "It is possible to conceive of governance without government...Governance is order plus intentionality."²⁸ In 1995 he emphasized that governance is a process whereby an organization or society steers itself. It includes many channels through which "commands" flow in the form of goals framed, directives issued and policies pursued. It is a process where communication is central.²⁹ I am not going to go deeply into the problems of global governance. However, changes on the global level should be taken into account and be seen as a demand for more effective national governance and a new model of governance. New trends and definitions of global governance support my analysis of a new governance regime.

For Rosenau global governance is a sum of myriad – literary millions of – control mechanisms driven by different histories, goals, structures, and processes. Any effort to trace a hierarchical structure of authority that loosely links disparate sources of governance to each other is bound to fail. Governance is for him – as for Rhodes – more a bottom-up than a top-down hierarchical commanding process.³⁰ Later Rosenau has specified the definition and has emphasized more its nature as steering mechanism and a rule system, through which authority is exercised in order to enable systems to preserve their coherence and move towards desired goals. For him the exercise of authority and the sphere of authority in governance is based on traditional norms and habits, informal agreements, shared premises, and a host of other practices that lead to comply with their directives. The compliance to authority and exercise of authority in governing is gener-

²⁸ *Rosenau* 1992, 4-5.

²⁹ *Rosenau* 1995, 14.

³⁰ *Rosenau* 1995, 14-18.

ated through formal prerogatives such as sovereignty and constitutional legitimacy.³¹

The Commission of Global Governance, established in 1992, was one of the first to analyze the rapid change towards a new kind of global governance after the Cold War. For the Commission governance is "the sum of the many ways individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated and co-operative action may be taken. ... (The process) includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people have agreed to or perceived to be in their interests ... Effective global decision-making thus needs to build upon and influence decisions taken locally, nationally, and regionally, and to draw on the skills and resources of a diversity of people and institutions at many levels ... In some cases, governance will rely primarily on the markets and market instruments"³² In the definition by the Commission of the Global Governance the actors of governance are not only states and public authorities, but spread also outside the government. The actors of society, individuals, public and private institutions, markets and market actors should participate actively in modern governance. The Commission regards governance as a multi-level phenomenon, a process of networking and an increase of self-governing. The Commission's concept of global governance is based on a liberal institutional perspective, and emphasizes the need for new forms of democracy in global governance.

International development and finance organizations (the World Bank, the IMF, the OECD, and the UNDP) have been key actors and discussants of governance, because since the late

³¹ Rosenau 2002, 72.

³² Commission of Global Governance: *Our Global Neighborhood* 1995, 2, 4-5.

1940s they have been the major actors in the development policies of poor countries.³³ They have a many-faced role both in developing terminology and creating governance practices not only on international level but also on national level.

In 1989 the Bank started the discussion of wide development policies and took the first steps towards broad institutional analysis of governance.³⁴ A new interpretation of economic factors of development was based on the notion that macroeconomic policies cannot ensure rapid development.³⁵ The structural adjustment policies, which the Bank had started already in the early 1980s, had not produced the expected results.³⁶ Researchers who have studied the birth of governance discourse in the Bank, emphasized that development in economic theory from pure neo-classical economics to New Institutional Economics was one of the most significant backgrounds for this reorientation. It was not only nor a sufficient factor however. The collapse of communism and fall of socialist eco-

³³ A general presentation of the discussion of governance in international development organizations *Weiss* 2000, 795-814.

³⁴ Before the World Bank published coherent definitions and strategy papers, the Bank's staff published discussion and research papers, which prepared new strategies and tried to find out new discourses. Important contribution towards later conceptualization of governance is Arturo Israel's working paper *The Changing Role of the State (Israel 1990)*. He does not use the term governance, but includes all major elements of modern governance in his analysis.

³⁵ The widening of perspective can be seen from the bank's World Development Reports. Good examples of widening perspectives are reports from 1987 and 1991. (*World Bank: World Development Report 1987* and *World Bank: World Development Report 1991*. An evaluation of the turn of the Bank from macroeconomic emphasis into broader governance see *Williams* 1996, 162-165 and *Leftwich* 2000, 105-126.

³⁶ See evaluation of the results of adjustment policies *Jayarajah and Branson* 1995.

nomies encouraged the Bank to stress the importance of institutions and press the reforms.³⁷

In the discussion of governance we have referred to the field of politics and public administration (March and Olsen, Rhodes and Kooiman), in business organizations and markets (corporate governance), in international relations (global governance), and in development policies (international financial institutions). The term refers to governance of state, markets and international relations. Then how about society? Society is the third pillar of order in addition to the state and the market. For two centuries society has been used to mean the group that is located within the boundaries of a sovereign state.³⁸ Is society under somebody's governance? Are there any new governance models in society? What are the roles of society and state in bringing and preserving order in society? It is true that the term governance is not used in the discourse concerning society and there is not a specific discourse of governance of society. This does not mean, that similar pressures for new bases of order cannot be seen in society.³⁹

Especially in European countries the discussion of an individual citizen's growing responsibility of their own life has increased, because present tasks of the so-called welfare state are unbearable in the long run. Modernization has increased individualization and reflexivity and the abilities of citizens to make educated choices about their own lives. They are forced to make choices, because the state is not making them to the same extent, as we are accustomed. All these changes have created a new field of life politics which is concerned with precisely how people govern themselves and make decisions that affect their own

³⁷ *Williams* 1998, 6-8.

³⁸ See discussion of society *Wallerstein* 1999, 104-111 and see especially 105.

³⁹ See for example *Etzioni* 1996 and *Etzioni* 2001.

lives, and with decisions that fundamentally affect these decisions.⁴⁰ Communitarian discourse in the USA has similar features, because it is putting strong stress on social organizations, individual and social responsibilities in contrast to the official and formal responsibilities of the public institutions. Decrease of trust on government and state has undermined the state's capacity and legitimacy to bring order and stability into society.

1.3. What is new in governance discourse?

So far I have treated governance only from a few perspectives. My introduction to the term governance has shown that it is a term that is used both in national and global contexts. At times there is no clear difference between governing and governance, and in practical terms governance is used mostly in discourse of public sector reforms. However, one thing is clear: governance is connected in all our definitions and discourses with the state and into the government's relations towards markets and society. State and public administration are regarded as the basic actors and arenas of governance. This is true even in the discourses which emphasize the weakening of traditional up-down governing and its transformation towards self-organizing inter-organizational networks. Not even Rhodes' definition is abandoning the government, though the definition is based on the idea that the government is not governing alone. Bob Jessop has called this change a tendency towards heterarchy, which emphasizes self-organization, multilateral negotiations, partnerships and networks.⁴¹ However, his empirical definition is based on the growing autonomy of economy and society from the state.

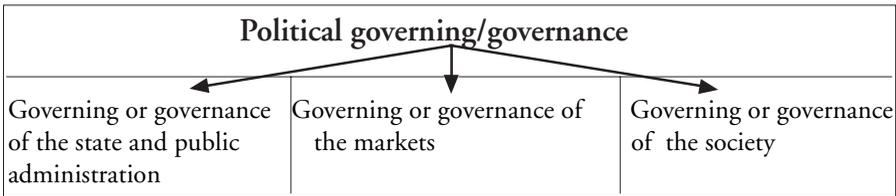
⁴⁰ See of discussion of life policies *Giddens* 1991.

⁴¹ See *Jessop* 1998, 29-45.

For me the discourse of global governance does not accept the proposition of the withering of national state.

In most of the discourses of governance comprehensive interaction of different actors is emphasized. Governance cannot be a separate entity of the markets and society and of their major players. The dimensions of governance are illustrated in picture 1, connecting political governance with the governance of markets, state and society.

Table 1. Framework of political governance



Some definitions emphasize abandonment of authoritarian governing and refer to some kind of a regime change, a step from up-down governing discourse towards public-private partnership and towards blending of private and public resources and trust in social self-steering of social and economic organizations through feedback and voluntary self-correction. Its elements are transparency, accountability, trust, and networking. In its ideal model external authoritative government steering would be abandoned, regulation of the markets and society would be collaborative in nature and state intervention in the management of the nation’s affairs would be based on joint action of the markets and society. This new discourse is a conscious step towards a balanced equilibrium of state, market and society and growing self-governance of economic and social organizations.⁴²

⁴² *Dunshire* 1993, 21-33 and *Dunshire* 1996, 299-334.

Interactive and network based discourse of governance challenges some of the present forms of state centered governing, but not the supremacy of the political sphere in the leadership of governance, and does not abolish the responsibility of the state in establishing optimal conditions for economic development and well-being for the citizens. The government will preserve its unipolar position as a central authority of orchestrating the governance process. New political governance model will create conditions for increased autonomy of the markets and society compared to present governing. It will become a multipolar system of different powers, where several and hostile actors or powers work together to reach agreement in their interests. However, the government has the final responsibility to persuade economic, social and political actors to believe it is in their self-interest to support constructive notions of how they should operate.

The terms political governing and political governance refer to macro level processes and institutions. Here the term political is a necessary specification. First of all, governing and governance are too general terms, As they do not limit the study to the state only. Secondly, I want to emphasize the nature of national governing and governance as a political process in the management of a nation's affairs. According to Pierre and Peters "even if the traditional assumptions are relaxed, we should remember that it is still the state which is the actor."⁴³ Thirdly, the term political specifies the basic nature of governing/governance process. Finally, it separates political governance from governance of markets, society and state or public sector, which are its subcategories.

In my conception political governance is the highest level of rule in a country or authority structure, because most general

⁴³ *Pierre and Peters* 2000, 27.

rules and principles that steer the cooperation of people – in the markets, in society and even in the families – are set in constitution and legislation and their enforcement belongs to the state. Legislation is a political process and enforcement is an administrative and judicial process.

In spite of the straightforward nature of the definition of governance, its application is not easy, because there are different degrees of fulfillment for the criteria of its characterization.

For me the concept of political governance is both constitutional and behavioral in nature. The definition does not take into account attitudinal dimension. It is necessary that a strong majority of public opinion holds the belief that democratic procedures and institutions are the most appropriate way to govern collective life in a society. Linz and Stepan set a condition for consolidated democracy that democracy does require not only constitutional and attitudinal dimension but also behavioral dimension. It means that regime is consolidated when no significant national, social, economic political or institutional actors spend significant resources attempting to achieve their objectives by creating a non-democratic regime or turn to violence or foreign intervention to secede from the state.⁴⁴

Government systems of the world have been built on the national level. Increased dependence of the states on international cooperation has turned the attention of the states towards the regional and global levels. Bilateral trade negotiations have transformed into multilateral. Economic integration has received political components. Incapacity of the nation states to solve traditional national problems has forced them to take common actions. The birth of the concept of global public goods is a good example of this development.⁴⁵

⁴⁴ Linz, Stepan 1996, 5-6.

⁴⁵ *Global Public Goods* 1999.

The global level is the fourth dimension of governing/governance. It has similar features to national political systems, but also clear differences. The system of global governance is not a separate pillar of political governance as are governance of markets, society and the state, but in its nature horizontal, an all sectors encompassing element. There is a global element in market governance as well as in the governance of the state. International cooperation does not concern only states, but encompasses markets and society and voluntary actors also. Thus a global dimension can be formed from all three sectors of governance. Contrary to national governance global governance lacks such clear and well-defined coordinating and steering mechanisms that could orchestrate the global governance and arrange the networks.

Because systems of governing belong to the long-lasting human institutions, present definitions and discussion of new political governance are only the first steps. The discrepancy between these two basic models – on the other hand network-based up-down governance and on the other state-centered authoritarian model – will get a solution in the future. There is no doubt that both models must be based on the proposition of democracy, rule of law and respect for human rights. These are inevitable rights of all human beings in all countries. These principles should be realized before any steps towards the new system can be taken. In most countries there is no doubt of their application.

1.4. The aim and structure of the study

The aim of my study is to foster discourse of good political governance, with good governance standing for a process where rules and well-functioning institutions are applied to manage a

nation's affairs in a manner that safeguards democracy, good order and human security, and economy and efficiency is followed in economic management of country's resources and human rights are respected. Political refers to the role of the state in the governance process.

This study analyzes the arguments of present discourses of governance and through them clarifies the grounds that explain the birth of a new regime of governance, which is qualitatively different from present governing models, if their grounds and arguments solid enough, and whether the discourse of governance is only an example of short-lived continuously emerging new phrases. The examples have shown that many present discourses are practical in the sense that they concern only certain fields (business management, global development, development policies and public sector management). To what extent do present discourses of governance form a uniform family of discourses? Is it possible to find a comprehensive framework, of which different discourses are based on?

My original aim to write this study emerged from my interests to understand the changes in public sector reforms in the OECD-countries in late twentieth century. A few years ago I noticed that there was a change in the vocabulary in administrative sciences from administrative policies and public management reforms to governance. I have recently learned the new terminology of management after traditional administrative vocabulary. Most international development organizations and scientific journals adopted new terms of governance. As a civil servant working with public sector reforms in Finland I had to adapt these new words and terms without more profound discussion of them. Later on I started to wonder about their origin and difference from the discourse of public management, which had been adapted in Finland in the 1990s. What is the difference between public management and governance? This endea-

vor directed me to the use of the term in different fields, because I noticed that the terms were in active use in several connections outside the public sector. Global governance, good governance and corporate governance belonged to the same family of new expressions like public sector governance. When I noticed that the term was a kind of a fashion term, I widened my original interest specifically from public sector reforms to a wider study of the backgrounds for the use of this new terminology. This study of the term governance turned out to be more challenging than I imagined originally. It directed me to theoretical and to practical discourse in different fields, but maintained my original interest in public sector reforms.

My acquaintance with the term showed quickly that there is not a single source for the use of the term, but it is used for countless reasons, and that academic and practical discourse adapt fashion terms in quite similar way without profound consideration, and furthermore that the definitions are derived from different theoretical sources. This discovery did not reduce my interest in the term and its use in government and public sector reforms. Even if the causes for the use of the term are manifold, I noticed that the study of the term was connected in several ways to the changing role of the state, to the relations between the state and society and economy and to political governing.

I attempt to find whether it is necessary and possible to develop a new and comprehensive discourse of governance regime, which is based on the challenges of the future for the present regime of governing. If present regime of governing is incapable if meeting the future challenges, we must concentrate on the challenges and on its new elements for the governance regime? What are the major differences between the new and the old regimes? The themes discussed in this study concern general and short-term temporal change. A long-term temporal perspective

would have lead the study to quite different directions. However, the area of long-term change is reflected unintentionally in the study questions to some extent, even if I cannot continue the discussion of these themes in any greater. I hope that I can later continue the study of the history of governing and authority structures. For that purpose the term governance offers excellent possibilities.

Emphasis of political governing and political themes in the discourse of governance was derived from different sources. It was not only from political science, but also from political economy, international political economy, classical science of public administration and sociology. Institutional discourses of these disciplines emphasized broader themes of order and equilibrium already in the eighties.⁴⁶

The study discusses problems of countries of different political and economic development levels. It is clear that the problems are not similar in developed industrial countries than for example in countries, which are in a process of transformation from communist political and socialist economic system. Developed countries have their own specific problems, which they have inherited from long-lasting colonial rule. In spite of this difference in development, the study discusses good political governance mostly in the form of an idealized type, because all countries irrespective of their development level can find the principles, which they should strive at attaining from this discourse of a well-developed governance model. Discourse of long-term goals can help developing countries to relate their own development goals in a long-term process of regime change.

The interests of the report are mainly practical. It is based on the notion of technical knowledge interests (Habermas)⁴⁷ which enhances general state capacity in governance, i.e., capac-

⁴⁶ See Scott 2001 and *Pierre and Peters* 2000.

⁴⁷ *Habermas* 1987.

ity of a nation to satisfy its national interests in accordance with all national actors. This improves institutional performance of the state as well as all other actors of society and economy.

I use a discourse method⁴⁸ in the study, because discussion of governance is basically discourse in different disciplines and in different practices, most of which are separate and independent from each other. Discourse analysis offers a solid base for this analysis, because at this stage of development of the term, the relation of governance discourses into practical policies is difficult to study on an empirical basis. The perspective of discourse analysis is based on the premises of a knowledge of politics, which emphasizes the connections of discourses into power and regards all discourse as discourse of power.⁴⁹

The study is concerned with the mechanisms and principles of the management of the nation's affairs (capacity to extract and mobilize resources of the nation, regulative capacity to regulate and control the behavior of individuals and groups, distributive capacity to allocate goods, services, status and other kind of opportunities in society, symbolic capacity to command symbolic means of creating support for national political unity and its government, and system responsive capacity to react adequately to inputs⁵⁰) that safeguards democracy, respect of human rights, good order and human security and economy and efficiency in economic management of the country's resources.

I regard good governance as an institutional component of economic, social and political performance. Governance is connected with its concrete manifestation such as public management and public sector reforms. Governance of markets and society is not discussed as widely as political governance and gov-

⁴⁸ See of it *Handbook of Discourse Analysis* 1985.

⁴⁹ See *Exploring the Basis of Politics: Five Essays on the Politics of Experience, Language, Knowledge and History* 1983.

⁵⁰ The definition is from *Martinussen* 1997, 170-171.

ernance of the public sector. Governance of the public sector is used as an example of the different requirements and aspects, which must be taken into account in all governance processes. However, it should not be assumed that the processes are similar.

The study is divided into six chapters. In chapter 2 I discuss the practical and theoretical backgrounds of the conception of governance. I will especially emphasize discourse of governance in administrative sciences and the importance of institutional political science and new institutional economics on the development of present discussion. There is a basic theoretical difference between the concept government and governance. Although this difference is not seen quite clearly in the new reform ideas and reform strategies of development in international development organizations (the World Bank, the IMF, the UNDP and the OECD). Their role in the development of the concept will be discussed at length. Because the goals of this study are more practical than theoretical, I do not make input in theoretical discussion about governance as an official and unofficial institution of the state, administration, economy and society though it would be challenging. I refer to the theoretical determinants of governance only to the extent that is necessary in order to understand the present discussion of the subject. My future goals in the study concern more historical than theoretical interpretations.

In chapter 3 I present the outlines of the general model and characteristics of present discourse of political governance. I will present the basic requirements of capacity and institution building process in good governance. To emphasize the political nature of political governance, I will raise general themes of democracy, trust and networking into central position in every political governance process. This will dispel all doubts from the assumption that governance is a technocratic continuation of the New Public Management ideology. In the end I will define

the conception of regime of governance and present a tentative framework for the steps towards successful political governance.

General characteristics of political governance and its relations to markets and society and its special role in governing of public sector are presented in chapter 4. This chapter culminates in the demands of government strategies for the market, society and the state sector. Drawing of these strategies is regarded as the basic requirement of good governance. Even though in this study governance is seen to imply elements that refer to fundamental transformations in the rule of the country and political authority structures, the government of the country preserves its responsibility for political governing, leadership in governance of the markets, society and public sector. Discourse of political governance unites separate governance strategies and practices of these sectors.

In chapter 5 I will present a short summary of the changing role of the state and the recent management and administrative reforms in the public sector. It is an introduction to the discussion of the new governance model that is presented in the next chapter. This chapter connects present discourse of governance to a short-term historical perspective. It shows that present discussion of governance is connected to empirical changes in the size of public sector and the tasks of the state. The chapter clarifies the background needs for the new model in different countries. Furthermore, I will discuss effects of recent public sector reforms and discourse concerning them for the birth of discourse of governance.

In chapter 6 I will use public sector governance as an example of the use of governance discourse in a concrete sector of politics. I will study governance of public administration, i.e. governance of the public functions, governance of public business functions and governance of public services examine in more detail than governance of markets and society. I empha-

size the analysis of the basic values of different state functions, because values determine the requirements of governing and administration. New discourse of governance has not diminished the need to follow, in administrative functions of the state, classical values of honest administration, legal responsibility of civil servants, impartiality in administrative proceedings, openness in administration, obligation to provide service, procedural equality, objectivity, impartiality, neutrality and other. The chapter points out that even though new public management discourse tried to get rid of the traditional rigidities of bureaucracy, it did not make the basic ideas of classical public administration unnecessary. The discourse of governance helps understand the variety of governance needs.

In Chapter 7 I will evaluate future challenges and discuss implications of the model. Special emphasis is placed on problems of governance in developing countries.

2. Growing interest in governance

In this chapter I will present a short introduction to different ways of using the term governance. It is clear that I cannot go into details with any of these discourses. Even if the term governance is not new, it can be regarded as a fashion term, which has been used more in the 1990s than earlier. I will try to find its major interpretations and causes for its use. Although I'm apt to think that the term is used because it is trendy, I believe that scientific and political communities have justified grounds for using this new term. I will look for these in the deep structures of economy and society.

2.1. Variety of definitions

The roots of the present discussion of governance are manifold. In the first chapter I referred to some sources. First, I referred to a discourse, which emphasized transformation of old up-down hierarchical governing, command and authoritative use of strong executive powers into a network-like governance with down-up negotiation elements. It is a trend towards self-organizing activi-

ties of interorganizational networks, or public steering by networks from bureaucracy. In this discourse new governance was connected to the redefinition discussion of the role of the state in economy and society (or in demand to diminish the active state intervention). R.A.W. Rhodes has raised a fear amongst researchers that the discourse is hiding the fact that "it is still the state, which is the actor."⁵¹ Second, in the first chapter the World Bank and other international development organizations were raised to a leading position in the good governance discourse. They have shown that governance is multifaceted process, where success cannot be reached without the interplay of all actors in political, social and economic field. Third, globalization has challenged nation states traditional governing systems and has stimulated them to endeavor new governing methods. Discourse of global governance is an expression of this. Fourth, competition between companies for profit has forced them to look for new management and governance methods. Discussion of corporate governance has stirred governments, civil servants and academia to look for keys of success from governance.

Discussion of governance in academia has been mostly theoretical in nature. Students of political science, economics and public administration have been most active in the field. Reason for this is understandable: theoretical discussion has tried to interpret the significance of new practices in economy, politics and administration. Practices are so meager that theoretical discussion is a better strategy than involvement into weakly and slowly rooted practices even though their justification discourses may emphasize their fundamental nature. However, researchers hesitate to accept new practices.

Jon Pierre and B. Guy Peters (*Governance, Politics and the State*) have comprehensively analyzed different interpretations

⁵¹ Perre and Peters 2000, 26-27.

of governance, its birth, its connections to administrative practices, its development in economy, administration, and international relations and in different disciplines.⁵² They regard governance as a confusing term, because it is used as an umbrella concept for a wide variety of phenomena. They list several ways of using the term. First, it is used as a structure – as hierarchies, markets, networks, and communities. Second, it can be seen as a dynamic outcome of processes, when it is seen as steering and coordination. Third, governance is used as an analytical framework in intellectual terms.⁵³ Their own interpretation is based on state-centric approach, which criticizes all state-critical approaches to governing.⁵⁴

Though Rhodes' personnel interpretation of governance is based on a network-conception and in recent development practices in European countries, his analysis of the different ways of using the term is not so distant from that of Pierre and Peters. Rhodes found different interpretations for governance; it was used as 1) a minimal state, 2) a corporate governance, 3) a new public management, 4) good governance, 5) a socio-cybernetic system and 6) self-organizing networks.⁵⁵ All these models represent different regime types, which are connected in certain policy regimes. The core question in all of them concerns the role of the state, not only in political field but in all policy sectors as well.

I will continue my analysis of the term in five discourses. First, I will discuss it as a new regime type and an outcome of fundamentally new policies. I will ask whether the arguments to claim that governing is transforming to governance, are strong

⁵² *Pierre and Peters* 2000.

⁵³ *Pierre and Peters* 2000, 14-24.

⁵⁴ *Pierre and Peters* 2000, 194-200.

⁵⁵ *Rhodes* 2001, 46-60. See also *Rhodes* 1998, 17-27 and 1996, 653 of the development of the classification.

and convincing enough. Second, the use of governance is analyzed as a general conception for present public management reforms in most OECD countries.⁵⁶ This way of using the term leaves governance inside the public sector. It does not open the door from public sector into interaction of the state and markets and society.⁵⁷ Third, governance is used in discourse of international systems as a solution for the dramatic change of international relations since late the 1980s as a consequence of globalization. Demand of global governance is regarded as a necessary outcome of the process of globalization.⁵⁸ Fourth, governance is a central term in discourse of institutional economics and institutional political sciences. I will emphasize the practical implications of this theoretical discussion. Fifth, governance will be discussed as a major element of development policies.

Governance in the change of political regime types Most constitutions are flexible enough to allow changes in governing style and in governing regimes. There can be different governing regimes inside the same political system. Regimes of liberal night-watchman state, welfare state and information society are good examples of different regime types. Governing methods of the welfare state differ from governing methods of the limited night-watchman state before the Second World War. Thus the present demand to redefine and reduce the tasks of the state can be interpreted as intentions to create a new regime type, which would change the present predicaments of the political regime of the welfare state. It would mean redefinition of central principles of public policies and production methods of public services. Pri-

⁵⁶ OECD: *Governance in Transition* 1995.

⁵⁷ At present the OECD is using the term in a wide sense. See for example OECD, *PUMA: Governance Outreach Initiative* 2000, 3 and OECD: *Government of the Future* 2001.

⁵⁸ Keohane 2001, 1-12 and Weiss 2000, 795-814. See also Pierre and Peters 2000, 56-60.

vatization, management emphasis, deregulation, and transfer from collective responsibility to private responsibility of citizens express this change towards a new political regime type.

A new political regime is an outcome of fundamental changes in different sectors. If governing methods inside the public sector transform, the whole political regime does not change unless the governing of markets and society undergo similar transformations. The birth of a new political regime demands similar fundamental changes in all sectors of governing.

I have already referred to several discourses which can be seen as addresses in the discourse of political regime change. My discussion has been directed only at the governing of the public sector. Can we find similar addresses from other sectors also? The answer is affirmative.

Sociologists, who have been speaking about a birth of post-modern condition, which has ended modern, have justified a fundamental change in discourse in the end of the twentieth century.⁵⁹ Similarly quite many researchers have interpreted that new information and communication technologies have altered society in such a fundamental way that the deep structures of society have trembled. Discourse of information society after industrial society is an example of the abandonment of the old and the birth of the new.⁶⁰ For political scientists erosion of confidence on democratic institutions and organizations of political regime, parties, government, parliament, administration, courts, army and police, has given elements to the discussion of fundamental reform of the present system of political processes and institutions. If the main conclusion from an international comparative survey that shows that electoral procedures are no

⁵⁹ *Giddens* 1990.

⁶⁰ *Castells* 1996a, *Castells* 1996 b and *Castells* 2000 and *Castells and Himanen* 2002.

longer sufficient for building confidence in representative democracy⁶¹ does not express strongly enough a demand for regime reform, then we must wait until revolutions for this to occur.

I can present an example of discourse of a fundamental change from the historical sciences. Eric Hobsbawm, who has studied the word history in long-term perspective, has called the 1970s and 1980s decades of universal or global crisis. The collapse of communism produced enormous political uncertainty, crisis and chaos and destroyed the system of stability. Nation-states felt that they were pulled away from governing by forces of supranational and transnational economy.⁶² The French revolution was similar, as it destroyed the old absolutism and paved way to the present system of rule based on the ideas of enlightenment.

One of the major questions of the study is to find whether different discourses of a new type of governance represent the first steps towards a new regime type, which expresses similar deep rupture of present governing premises and models? Are the interpretations similar in nature and do they represent discourse of similar governance regime? Are there at present such interpretations? If we are moving towards a new regime of governance, what are their basic premises and bases? Who are the major drivers of such a change?

These questions can be answered on the general level. Demands for change can be connected to the interpretation of external changes in economy, global development trends, technological changes and internal changes in governing practices. Because I have defined political governance as my subject, I will concentrate only on some relevant discourses from the perspective of the state and government. I will not deal with all present

⁶¹ *Dogan* 1997, 3-29.

⁶² *Hobsbawm* 1994, 9-11.

discourses of fundamental change, even if they are interrelated and have connections with the new discourses of governance, but to concentrate to such discourses that have a clear connection to the abandonment of the present model of political governing and the demand for new governance. The internal governance of markets and society are not discussed here. The most important of these discourses demanding fundamental change – demand for a new governance regime – are connected to the changing role of the state from the 1980s onwards and to a change of policy regimes.⁶³ Regime types and policies are connected to each other. I claim that policy reforms are the key reasons for the birth of the discourse of new governing regimes.

The first signs of the present discourse of governance can be dated back to the birth of the regime of big government. The concept of the welfare state (in Europe) or big society (in the USA) was not born in total harmony and without discussion. The adaptation of the new governing methods was accompanied by strong criticism: for example in early seventies Harlan Cleveland used the present terms by saying that the American people want less government and more governance.⁶⁴ He used the term governance without any idea that these terms would be used in a similar way thirty years later. The discourse of reform of governing principles was a natural consequence of the long-lasting growth of public expenditures and tasks of the state that reached its highest peak in late 1980s. Criticism towards an all-encompassing state has been growing for a long time. Critics claim that the distribution of power and balance between markets and state would tremble long-term balance and distribution of power in favor of politics. Pierre and Peters interpret the change of discourse from governing to governance as an ideo-

⁶³ See discussion of this theme *Pierre and Peters* 2000, 550-56.

⁶⁴ Citation from *Fredrickson* 1999, 703. See also of the first sights of the criticism *Nisbet* 1975, 16-20.

logical shift from the state towards the market. They see that the new discourse of governance is based mostly on political goals and only partly on efficiency considerations which are connected to the failures of the state in safeguarding maximum economic growth.⁶⁵

Goran Hyden was amongst the first in the political sciences to analyze governance as a regime change. He analyzed the concept from an analytical perspective. Hyden regards regime as a more permanent form of political organization than a specific government, but less permanent than a state.⁶⁶ He says that it is a set of fundamental rules about the organization of the public realm. Governance regime defines the basic rules of how society conducts its public affairs, or how governor and governed relate to each other. Regime of governance provides the structural framework within which resources are authoritatively allocated. It is related to governance, because governance is “the conscious management of regime structures with the view to enhancing the legitimacy of the public realm.” Regime is also related to decision-making, though these are often confused. The princi-

⁶⁵ *Pierre and Peters* 2000, 61-64.

⁶⁶ Discussion of the regimes has been active in international politics. Stephen D. Krasner (*Krasner* 1983, 2-3) defines regime as sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations. Principles are beliefs of fact, causation and rectitude. Norms are standards of behavior defined in terms of rights and obligations. Rules are specific prescriptions or proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective choice. Krasner emphasizes Keohane's notion that regimes are more permanent than temporary arrangements, which change with every shift of power or interests. Krasner's set of definitions is applicable in national governing as well. International relations should be replaced with national governing.

pal difference is that governance deals with metapolicies.⁶⁷ For him as a political scientist the legitimacy of governance is the central value in governance. Legitimacy defines the nature of quality, acceptance, and goodness of governance.

The objects of governance are markets and society, which the state is governing or steering by giving them an institutional framework. Hyden regards governance as a means to an end by saying that the relation of governance to public space – markets and society – should be seen in the same way as management is to an organization: as a means to an end.⁶⁸ In this sense governance is a regime level concept, because at regime level the rules that constitute the framework within which policies are being made and are implemented are crucial objects of the analysis.

Hyden's conceptions are analytical. They are useful and practical, because they can be used as tools in analyzing different systems of rule and analysis of policies. He has used the framework in the analysis of fundamental economic and political changes in developing countries after the fall of the Berlin Wall in 1989, which he compares with the storming of the Bastille in 1789, as both of them caused fundamental policy and regime changes in the world. Though he does not say explicitly, his conception of governance is a framework for an analysis of change in a governance regime of a developing country. First demands of change came from Africa – where the World Bank launched the governance discourse – and then from Eastern Europe and former Soviet Union republics. The discourse of policy change and regime type in advanced industrial countries was minor compared to changes in former socialist countries. However, a discourse of a new regime of governance was suddenly

⁶⁷ *Hyden* 1992, 7-8 and 15. References in p 7. See also *Hyden* 1997 and *Hyden* 2002.

⁶⁸ *Hyden* 1992, 12.

present in the early 1990s all over the world, with markets, economy, democracy and rule of law as its major elements.

As a political scientist Hyden has raised legitimacy of governance realm into center of the analysis. In normative discourse of political scientists good governance is generally connected to democracy, which is its typical regime type. However, Hyden stresses that the term governance is preferable to democracy, which is more value laden and tends to invoke associations with only its liberal version. Bratton and Rothchild say that in some places prevailing values will be pluralistic, in others corporatist, and in yet others communitarian.⁶⁹

By raising the legitimacy of rule as the basis for the classification of systems of rule Hyden continues the discussion of Max Weber, who developed a classification of systems of domination or authority on similar grounds. Patrimonial, charismatic and rational authority structures had different legitimation bases.⁷⁰

Hyden's discourse has not continued on that level. One reason could be that his framework tried to serve analytical purposes. Political scientists could not see fundamental changes in national governing regimes. Instead they discussed globalization and its practical and incremental effects on present national governing regimes and on the need for global governance. Because governance of globalization has been discussed more than it has been reformed, the discourse has not proceeded.

Discourses that emphasize profound changes have to be searched for from different fields of the practical world of administration, not from traditional scientific discourses. Quite often such discourses are found in, for example, development policies and public management. Even if Hyden's conception of governance is based on political science his studies have clear

⁶⁹ See *Bratton and Rothchild* 1992, 268 and their reference to *Hyden* 1988, 41.

⁷⁰ Weber 1968.

connection to administrative and governing practices in Africa and in development policies. In the late 1990s Hyden has emphasized that discourse of governance is a set of rules and tools, which can be used in management of change in government, such as strategic management in business administration,⁷¹ but not as a legitimation basis of a regime system.

A different example of practical discourse of regime change is R.A.W. Rhodes' definition of governance. Rhodes emphasizes that in the UK old up-down governing is reversing to down-up governance. He does neither define more concretely nor in analytical or theoretical level the importance of this turn of the direction of governing from up-down to down-up governance, but leaves the analysis open and uses the conception as a hypothesis

Even if Rhodes is not discussing the general social, economic and political backgrounds of this change at length, the nature of this transformation subverts the Weberian hierarchical organization principles, but not the legitimation bases of the regime system. In a similar way Bob Jessop has used term heterarchy, self-organization, as a concept, which represents idea of reflexive rationality. Its major forms include self-organizing interpersonal networks, negotiated interorganizational coordination, and decentred, context mediated inter-systemic steering. Its key success factor is a continued commitment to dialogue in order to generate and exchange more information.⁷² Self-organization is a major theme also in Francis Fukuyama's book *The Great Disruption*, even if the book is not about governance but

⁷¹ Hyden 2002, 18.

⁷² Jessop 1998, 29-35. According to Jessop the markets are following the principle procedural rationality (priority on economized pursuit of profit maximizing) and the government is functioning on substantive rationality (goal oriented, prioritizing effective pursuit of successive policy goals)

rather social order. Fukuyama connects the great disruption, i.e. turn from hierarchy to self-organization to some fundamental social, economic, and technological changes. Terms information society, postindustrial era, the Third Wave, networking, trust, and empowering describe the change of social order towards self-organization.⁷³

Fukuyama's describes the present movement towards self-organization in an excellent way.

“We know now, however, that in an information society, neither governments nor corporations will rely on formal, bureaucratic rules to organize the people over whom they have authority. Instead, they will have to decentralize and devolve power, and rely on the people over whom they have nominal authority to be self-organizing. The precondition for such self-organization is internalized rules and norms of behavior, which suggests that the world of the twenty-first century will depend heavily on such informal norms. Thus, while the transition into an information society has disrupted social norms, a modern high-tech society cannot get along without them and will face considerable incentives to produce them.”⁷⁴

So far I have emphasized some practical discourses of regime change – from development policies, democracy and rule of law, and from public sector management, transition from hierarchy to heterarchy. Sociologists' discourse of transformation of modern to postmodern, which means a step from the institutions of modernity towards a new and distinct type of social order, offers the most general and theoretical framework for different discourses of regime change.⁷⁵ For Anthony Giddens the general problem in postmodern discourse has been the identification of

⁷³ *Fukuyama* 1999, 1-5.

⁷⁴ *Fukuyama* 1999, 6-7.

⁷⁵ See for example *Giddens* 1990 and *Liotard* 1985.

discontinuities, which separate modern social institutions from the traditional social orders. He involves in it problems of pace and scope of change, and the nature of modern institutions.⁷⁶ Postmodern discourse places strong stress on discontinuities and analysis of change that has supported all practically oriented analysis of present change tendencies in administration, in politics, society, markets and technology.

I have tried to show with these different examples that governance is discussed on different theoretical levels. Some of the discourse of governance refers to fundamental, long-term change tendencies in governance regimes. For example Giddens's discussion of postmodern conditions and Fukuyama's discussion of great disruption can be regarded as examples of a more fundamental change. However, they are not similar and do not belong to the same interpretation family, despite the fact that they emphasize responsibility of an individual either in the role of a zoon politicoon or as an independent actor, who has a strong responsibility for his/her own affairs.

International politics has been in the drivers set on the new discourse of governance. Economic globalization, new information and communications technologies, political globalization and global environmental change have changed in fundamental ways many of the traditional state centered international relations and given birth to a kind of global governance. Researchers are asking if global governance is a totally new world order, which has replaced – or will replace – the traditional Westphalian international system of national states. Even though researchers are not unanimous on the fundamental nature of the transformation, several observations have been made concerning the institutional architecture of the new global governance system. Held and McGray emphasize its 1) multifaceted charac-

⁷⁶ *Giddens* 1990, 6.

ter, 2) polyarchic or pluralistic nature, 3) variable geometry, 4) structurally complex nature of the system, 5) the role of the states as strategic sites.⁷⁷ Debate of the role and nature of the new global governance mechanisms and arrangements has not found unanimity, but still the birth of new, horizontal forms of authority and governance bear witness to such deep and fundamental changes that we can speak of it as a regime change.⁷⁸

James Rosenau has connected global governance to four major international changes and tensions. These are 1) a technological revolution, which has facilitated the rapid flow of ideas, information, and money across continents, 2) a transportation revolution, which has hastened the boundary-spanning flow of elites, ordinary folk, and whole populations, 3) an organizational revolution, which has shifted the flow of authority, influence, and power beyond traditional boundaries and 4) an economic revolution, which has redirected the flow of goods, services, capital, and ownership among countries. These are major elements in a fundamental transformation process of nationally structured social geography into supraterritorial spaces. This process has eroded boundaries, integrated regions, proliferated networks, diminished territorial attachments, coalesced social movements, weakened states, contracted sovereignty, dispersed authority and expanded citizens skills⁷⁹ in such a way that globalization and governing of globalization belong to the most important qualitative changes of recent decades.

So far my analysis has pointed out that there are several general discourses of regime change in several fields and discourse levels, but as a whole most of them are still incremental in nature. They are not based on a coherent view. Reasons for this are

⁷⁷ *Held, McGrew* 2002, 9.

⁷⁸ See of the discussion *Governing Globalization* 2002.

⁷⁹ *Rosenau* 2001, 137-138.

as natural as can be: governance is not an independent discourse but a means, which serves the needs of general political, economic and social order. Governance is basically a rule and authority system, which is based more on informal agreements and unofficial institutions than traditional governing, which in turn is an authority structure of formal prerogatives. New governance systems do not substitute political governing systems in national and international levels, but supplement official spheres of authority.

Governance as public management In public sector reform discussion the term governance has been regarded as an expression of a fundamental change in the way of managing and ruling a country (Rhodes). However, my analysis of major discourses of political governing has shown that the arguments do not concern the regime of political governing, but the public sector's internal factors. To my view new networking practices and new down-up practices do not have such fundamental effects that would justify interpretation outside public sector governing. However, in the long-term these changes can be reflected in markets and society and then the effects can be fundamental in nature.

Walter Kickert, Jan Kooiman and other Dutch researchers (the so-called Dutch school⁸⁰) have developed alternative conceptions of and models for new public management from the early 1990s on.⁸¹ The roots of the new discourse of network-based governance go back to Germany in late the 1980s, when German researchers launched a discussion of the possibilities of political steering (politische Steuerung⁸²). Compared to private

⁸⁰ *Sibeon* 2000, 292-299.

⁸¹ See *Modern Governance* 1993.

⁸² See *Mayntz* 1993, 9-20, *Dunshire* 1996, 299-334 and of the discussion of the roots of the discourse see *Kooiman, van Vliet* 2000, 361-363 and *Rhodes* 1991, 525-534.

business, public management is more strongly, and especially differently, related to the external socio-political environment. For Kickert governance means firm public steering of social processes with numerous actors and conflicting interests between them. He says that political governance directly influences on political and societal processes of the markets and society.⁸³ In this interpretation political government is not based on business principles. Legitimacy of political governance must be based more on political grounds than on efficiency grounds, i.e. upon management in a narrow sense

Kickert's colleague Jan Kooiman⁸⁴ has a similar network based view of governance, with emphasis on interaction. Kooiman's analysis of governance rises from the state's need to govern dynamic, complex and diverse social, economic and political systems. He asks how dynamic, complex and diverse social-political systems can be governed in a democratic and effective way?⁸⁵ For this purpose he develops different ways to create interaction and coordination between the state and socio-political system. Governance produces changes in complex, dynamic and diverse social and political systems through interaction. Governance is not only an internal function of the public sector but interaction between public and private institutions and authorities.

The term governance represents for Kickert, Koiman and other researchers of the Dutch school an alternative reform strategy to new public management. According to them market models in public management conceptions do not fit into public administration. However, in the late 1990s administrative development organizations took the term governance into ac-

⁸³ *Kickert*1993, 191 -193.

⁸⁴ *Kooiman 1993a* 33-47and *Kooiman 1993b*.

⁸⁵ *Kooiman 1993*, 36.

tive use. For example the OECD replaced the term public management with the term governance.⁸⁶ In this way new public management reforms transform into comprehensive governance reforms. In spite of different interpretations and interests in public sector reforms the term has replaced the term public management, which in turn replaced the term public administration in the 1980s. For students of administrative sciences the terms are not interchangeable. They have different interpretations of the content of the terms and this diversity is connected to their understanding of the need for public sector reforms and of the nature of public administration.⁸⁷

For the Dutch school governance is basically management of networks and interaction, even if researchers have different interpretations of the role of the state in governance, of the possibilities of spontaneous orders in governance, and of the theoretical backgrounds of the conception.⁸⁸ According to Kickert the basic nature of governance is coordination and governing of complex networks of many different participants. "In such a multi-level network there is no single monolithic actor but many various actors, all of which have their own interests, goals and positions. None of the actors is dominant; none has the power to unilaterally force others. Power is dispersed. All actors are

⁸⁶ OECD: *Governance in Transition* 1995. Osborne and Gaebler, well-know inventors of reinventing terminology used the term governance as a better-managed than traditional administration. *Osborne, Gaebler* 1992.

⁸⁷ See for example *Pollitt, Bouckaert* 2000.

⁸⁸ A general presentation of long-term project of network analysis of governing the state, markets and society is book *The Public Sector. Challenge, for Coordination and Learning* 1991. See also *Markets, Hierarchies & Networks* 1991. Of network perspective in governance see *Klijn* 2002, 149-165, *Managing Complex Networks* 1997, *Klijn, Koppenjan* 2000, 135-158, *Comparing Policy Networks* 1998 and *Sibeonm* 2000, 288-309. See also *Rhodes* 1991, 525-534.

more or less autonomous. Decision-making is a negotiation process. In this view it is better to use broader conception of 'governance' than the concept of 'management', which is interpreted more narrowly in business administration."⁸⁹ Governance is thus management of complex networks consisting of many different actors such as parts of national, provincial and local government, political and societal groups, pressure, action and interest groups, societal institutions, private and business organizations et cetera. "Public governance is the directed influencing of societal processes in a public policy network of many other co-directing actors."⁹⁰

The network discourse of governance originally emphasized interconnections, but later also partnerships and alliances of and between the state, business and society. The basic nature of governance is regarded as networking, interdependence, co-steering, self-organizing and co-governance: these go hand in hand in the governance discourse. The term has a wide variety of uses, it is especially useful in multi-level governance problems, (the EU-level, national level, regional level and local level) and in analyzing the role of the state and society (self-governance) in governing the country.⁹¹ Because new public management has been criticized for diminishing the power of the state, researchers have discussed these effects.⁹²

A networking conception of governance is gaining acceptance in different countries. A recent example this is the book *The Tools of Government. A guide to the New Governance*⁹³, which is based on the idea of new conception of governance, which is

⁸⁹ Kickert 1993, 191-192.

⁹⁰ Kickert 1995, 5-6.

⁹¹ See discussion of self governance Kooiman, Van Vliet 2000, 359-377, Sibeon 2000, 291-304 and Huxham 2000, 337-357.

⁹² See for example Sibeon 2000, 305-306 and Klijn, Koppenjan 2000, 151-154.

⁹³ *The Tools of Government. A Guide to the New Governance*, 2002.

regarded as a new paradigm replacing traditional public administration. It is preoccupied with the internal operations of public agencies, their procedures for staff recruitment, budgeting, and task accomplishment. Lester M. Salamon, its main author, defines the new paradigm with the help of five concepts. First, the new governance paradigm is shifting the unit of analysis from agency and program to the distinctive tools or technologies that programs embody. Second, it shifts attention from hierarchic agencies to organizational networks, which create interdependencies between public agencies and a host of third party actors. Third, it is a shift from public vs. private to public and private, where a sharp division between the public and private spheres is blended together. Collaboration replaces competition as the defining feature of sectoral relationships. The fourth concept underlines the need for a new approach to public management, from command and control to negotiation and persuasion. Fifth, governance means a shift from management skills to enablement skills.⁹⁴

Different definitions of governance in public sector management discourses are due to the perspectives of the researchers and discussants. For example Klaus König, who is critical to many interpretations of the New Public Management-reforms⁹⁵, defends legal definition of public administration and political scientist's definition of the nature of the state and of governing.⁹⁶ For König governance of public sector is to be based on a bureaucratic model where the tasks and responsibilities are defined clearly in legislation, the rule of law being its basic principle. The public sector produces services for citizens, not for customers. Market mechanisms and privatization do not belong to public administration and governance. König empha-

⁹⁴ *Salamon* 2002, 1-18.

⁹⁵ See for example *König* 2000 and *König* 1995.

⁹⁶ *König* 1999, 73.

sizes that governance in public sector cannot be based on the managerial theories of business management.

Researchers have adapted new governance conceptions quite actively and used them in different ways without discussing their importance and relation to the traditional governing and public management conceptions. Despite this, the first theoretical and comparative analyses have appeared.⁹⁷ For example P. Guy Peters has analyzed the concept governance in several books and articles from the perspective of steering of the public sector and as a public management model. In his analysis governance includes “a vast array of institutions designed to exercise collective control and influence over the societies and economies for which they have been given responsibility”. He detects four governance models. They are 1) market models for reforming government, 2) the participatory government, 3) flexible government and 4) deregulated government.⁹⁸ Every model uses different organization, steering, recruitment, and management principles. Their relations to private sector are different and they have different political implications for the power structures, which are crucial in evaluating their capacities.

Henry Mintzberg has separated five governance models. They are 1) administrationlike machine-model, which is based upon the idea of control, 2) administration as network-model, where administration coordinates, communicates and cooperates, 3) performance-control-model, where administration differentiates, evaluates and measures, 4) virtual administration-model, where administration privatizes, contracts, and negotiates and 5) normative control-model, where control is rooted

⁹⁷ See for example *Pierre and Peters* 2000 and *Fredrickson* 1997, 78-94 and *Jessop* 1998, 29-45.

⁹⁸ *Peters* 1996, 21-110, citation p. 1 and *Peters* 1995, 288-319 and *Peters* 1996a, *Peters* 1996, 215-46.

into the values of administration.⁹⁹ All models have their own interpretations of implementing the common tasks of the state to carry out its basic functions and of the role of the government in carrying out the public functions.

Peters and Mintzberg have used the term governance in an analytical way and have analyzed different models based on their characteristics. I will not continue the discussion of governance models in management sciences any further. The previous analysis has shown the basic differences between the models and their theoretical variety. The term governance has been used for the most part as an internal term in public sector governing without broader implications to political governing or on its legitimation grounds.

Governance in international relations In the 1990s governance was used actively in discourse of international relations, where it has a long tradition because interaction and coordination of the international system has been described with the term governance.¹⁰⁰ The theme became especially topical after the Second World War, when newly established organizations, like the United Nations, the International Monetary Fund (IMF) and the World Bank began to take a strong position in shaping international relations. The decades after the Second World War witnessed a continuous, although slow, decrease of national barriers for goods, people and information. As national market barriers were opened and information and communications technology developed at a revolutionary speed, states grouped themselves into larger regional units.¹⁰¹

The birth of regional organizations expresses the need of nation states to defend their national interests on the internatio-

⁹⁹ Mintzberg 1996, 75-83.

¹⁰⁰ See *Governance without Governments* 1992

¹⁰¹ Mittelman 1996, 189-213.

nal level with countries sharing similar interests and cultural and economic backgrounds. The European Union is the clearest expression of the need of nation states to defend their national interests together on the international level. Similar transnational groupings have emerged on other continents. NAFTA (North American Free Trade Agreement) in North America, ASEAN (the Association of Southeast Asian Nations), APEC (Asia-Pacific Economic Cooperation) and (EAEC) East Asia Economic Caucus in Asia, MERCOSUR (Southern Common Market Agreement, also known as the Treaty of Asunción) in South America, Southern African Development Community in Africa and CIS (Commonwealth of Independent States) in former Soviet Union countries express this development in various ways and with different degrees success. American countries have started negotiations with the aim of forming a free trade area of Americas (FTAA). In addition to all this, in the 1990s states have established ad hoc international structures with the aim of managing the international community's response to recent ethnic conflicts (for example Kosovo). All these units have changed the division of labor between the nation-state and transnational levels.¹⁰²

New regional and international arrangements and organizations have defined their specific identities and redefined the division of labor between national and international levels. This tendency has weakened and even partly abolished the border between foreign and national policies. International organizations and arrangements of different regional sizes have received more responsibilities in representing the member states on the international level and in international negotiations. This development has brought forth demands of global governance. Ac-

¹⁰² *Held & McGrew & Goldblatt & Perraton* 1999 74-85 and *Mittelman* 1996, 10-201.

tive and growing discussion of global financial architecture and global government of global public goods expresses this discourse.¹⁰³ The European Union has launched a wide discussion of new governance as a result of deepening of integration in the 1990s and the future enlargement of the EU in the next few years.¹⁰⁴

The most fundamental change in international and global level relations concerns the economic sphere. Growth of international trade, foreign direct investments, international financial flows and liberalization of national markets is known as globalization. Even though the process is aiming at the liberalization and deregulation of national markets, economic globalization has given a birth to a new kind of global economic and financial governance. It is not the sole responsibility of the states and multilateral organizations, but also of the companies and other market actors. The rise of global private and public-private networks is a result of this phenomenon.¹⁰⁵

Globalization has changed the boarder between domestic and international politics. This has brought national non-governmental organizations (NGO) and international non-govern-

¹⁰³ *Globalisation and Governance 1999 and Commission on Global Governance 1995, Global Governance 1997, Global Public Goods 1999, Cable 1999, Globalization and Global Governance 1999, The Emergence of Private Authority in Global Governance 2002, International Financial Governance Under Stress: Global Structures versus National Imperatives 2002, Governing Globalization: Issues and Institutions 2002, Global Governance: Critical Perspectives 2002, New directions in Global Political Governance: the G8 and International Order in the Twenty-first Century 2002, Enhancing Global Governance: Towards a New Diplomacy? 2002, Governance in a Global Economy: Political Authority in Transition 2003, Contesting Global Governance: Multilateral Economic Institutions and Global Social Movements 2000.*

¹⁰⁴ Wiener 1998.

¹⁰⁵ See for example Woods 2002, 25-45.

mental organizations (INGO) more actively into global public debate. New information and telecommunications technologies have offered an excellent means for NGO, INGOs, mass public and national elite groups to participate in the international governance discourse. Demand for new global governance structures and democracy in global governance is also an element of the present global governance discourse.¹⁰⁶

The discussion of global governance has not brought concrete results so far. The growing need for global governance has been channeled into the frameworks of present international organizations and negotiation systems. A good indication of the difficulties in creating new systems of global governance can be seen in the discussion of the theme after September 11, 2001. This has shown that terrorists have utilized bad global governance as a means to perform their terrorist attacks. The free transfer of finances, open global communication systems and free movement of people are basic preconditions for global economy, but they have also offered a framework for international terrorism. However, so far no measures have been taken or discussions launched in order to create qualitatively new global governance.

Governance in institutional economics and institutional political science Institutional economists were among the first to launch the present discourse of institutions and governance. The major present contributions in institutional economics are from Nobel-prize winners James M. Buchanan, R. H. Coase and Douglas North, whose studies have influenced discussion of institution in development economics and political economy. The analytic tools that they have developed have focused on incentives and information that shape decision-making by public actors.

New Institutional Economics of North, Oliver Williamson and Mancur Olson emphasize the role of public sector institu-

¹⁰⁶ *Held* 2002, 305-324.

tions in promoting growth. The quality of public and private economic institutions, particularly the structure of governance, institutional infrastructure, the extent of social capital and civil engagement affects economic performance and economic growth.¹⁰⁷ Development is fostered not only by market-institutions and reforms, but also by reinforced property rights and market regulation to promote competition. Reduction of corruption, fostering of political credibility and development of administration to deliver essential public services belong to the reforms stressed by New Institutional Economists. Discussion about shareholder and stakeholder models in corporate governance has direct connections with institutional economics.¹⁰⁸

The growth of interest in institutions and governance has produced a lot of empirical analysis of the effects of political institutions on economic growth.¹⁰⁹ This growing interest in political questions has shortened the distance between economists and political scientists.

Political scientists are also interested in institutions, but they have different emphasis on political institutions, which they study from the perspective of democracy and legitimacy of political systems. They regard polity as a configuration of insti-

¹⁰⁷ *North* 1990, de *Capitani and North* 1994, *Williamson* 1998, 75-79 and *Williamson* 1996 and *Williamson* 1994, 171-197. See also *Scott* 2001, 2-5 and 28-33,

¹⁰⁸ Practical implications of the work institutional economists see *The World Bank: World Development Report* 200, de *Capitani and North* 1994, *Aron* 2000, 99-135 and *Lin, Nugent* 1999, 2303-2363 and *Institutional Change and Public Sector in Transitional Economies* 1994.

¹⁰⁹ Examples of different kind of research problems and perspectives are *Olson, Sarna, Swamy*, 2000, 341-364, *Dethier* 1999, *Isham, Kaufmann, Pritchett* 1997, 219-42, *Beck, Groff, Walsh* 2001, 165-176, *Siermann* 1998, *Rizen, Eastely, Woolcock* 2000 and *Persson, Tabellini* 2001.

tutions, norms, rules, and practices (March and Olsen and Robert Dahl).¹¹⁰ March and Simon have studied (1958)¹¹¹ public administration from the perspective of institutions. The most comprehensive discussion is the recent input of March and Olsen's theory of new political institutionalism, which emphasizes political elements, political institutions and democracy in governance. For them political life is organized around the interaction of a collection of autonomous individual actors who pursue prior preferences by calculating future outcomes. It is necessary to go beyond understanding organizational effects in functional-instrumental terms. They say that institutions cannot be viewed solely as incentives and opportunity structures that regulate behaviors by affecting calculations and transaction costs. The studies of political and administrative reforms have documented the need to go beyond the process of rational adaptation and competitive selection in order to understand the change. Weakly institutionalized processes, such as comprehensive administrative reforms, are according to their studies more likely to have garbage can properties than more institutionalized processes.¹¹²

For March and Olsen “democratic governance is more than the management of efficient political governance and exchange within prior constraints. It also involves influencing the process by which the constraints are established. Governance involves molding social and political life – shaping history, and understanding of it, and an ability to learn from it.” Their book is a

¹¹⁰ Elinor Ostrom presents major recent contributions in institutional analysis and summarizes the state of research. *Ostrom* 1995, 174-178.

¹¹¹ *March, Simon* 1967.

¹¹² A summary of basic ideas of the New Institutionalism is in *March and Olsen* 1995, *March & Olsen* 1989, *Olsen* 2001, 194-197 and *Peters* 1999. See also *Ellwood* 1996, 58-64, *March* 1983, 281-296 and *March and Olsen* 1984, 734-749.

comprehensive and detailed analysis of the four tasks of democratic governance. They ask first what it demands to develop the identities of citizens and groups in the political environment. They answer the question by emphasizing governance of identities, solidarities (civility, citizenship) and conflicts. Second, when governance involves developing capabilities for appropriate political action among citizens, groups and institutions, it demands capacity building, diffusion and transfer of capabilities, mobilization of capabilities and matching capabilities to democratic hopes. Third, when governance involves developing accounts of political events, its major problems are justification, responsibility and accountability. Fourth, when governance involves developing an adaptive political system, it should cope with changing demands and environments.¹¹³

A core question in March and Olsen's institutional approach is the role of the state in the governance of people and markets. They do not represent a minimalist agenda, where the state just sets rules for managing voluntary political exchanges among citizens and where political community is seen as an aggregate of autonomous self-interested individuals. According to them the task of political institutions is 1) to help one group to enhance its resources and capabilities and thereby to secure dominance over other groups; 2) to be a tool for collective problem-solving (for example to secure a more equal distribution of social and economic resources), 3) to help societies reach shared purposes and goals; 4) to regulate and facilitate exchange and help individual citizens to fulfill their private desires; 5) to be a vehicle for constructing meanings and defining appropriate behavior and helping a society to construct individual and collective identities and accounts.¹¹⁴ "Democratic governance involves improving the process by which a society formulates ends,

¹¹³ *March, Olsen* 1995, 44-47.

¹¹⁴ *March, Olsen* 1995, 245-246.

seeks to achieve them efficiently, elaborates and overturns its conceit, and weave an understanding of the good life by experiencing its pursuit.”¹¹⁵

Researchers of political science have not studied as actively the effects of different political institutions on economic development and political outcomes as political economists. Arentd Lijphart has studied patterns of democracy,¹¹⁶ Stepan and Linz have carried out comprehensive comparative studies of political institutions¹¹⁷ and Harrinvirta has found connections between political systems and types of public management reforms.¹¹⁸

Political research on institutions proceeds simultaneously on micro and macro levels. Empirical results from institutional economics are utilized when better grounded empirical theory drawing on a general framework that includes elements from political science and economics is being built. Combination of different levels of analysis and empirical results from different fields is important, because empirical results have been so far modest. For example, the multi-authored volume *Do Institutions Matter? Government Capabilities in the United States and Abroad* found that though institutions affect government capabilities, their effects are contingent, that policy-making capabilities may also differ across policy areas within a single political system, and that institutional effects on government capabilities are challenged through governmental decision-making.¹¹⁹

Discourse of governance in economics and political science, which I have studied, does not give answers to the question of

¹¹⁵ *March, Olsen* 1995, 242-246.

¹¹⁶ *Lijphart* 1999.

¹¹⁷ See for example *Linz, Stepan* 1996, *Stepan, Linz* 1999, 185-209, *Peters* 1999 and *Scott* 2001, 6-8, 33-37.

¹¹⁸ *Harrinvirta* 2000.

¹¹⁹ *Do Institutions Matter?* 1993, 446-449. See discussion of the results *Ostrom* 1995, 177-178.

the nature of recent changes in governing societies, because discussion is analytical. It offers tools for institutional analysis of governance and helps to find the right institutions for the study and to pose right questions for these institutions. Empirical study of long-term changes gives means to change institutions in such a way that leads us to a new regime of governing or to strengthen the institutions, which support present governing regime.

Governance in development policies In chapter 1 I presented a summary of the definitions of good governance by major international development organizations. I neither analyzed the reasons for the definitions nor presented the variety of discussions. In this chapter I will analyze the definitions more broadly by concentrating on the definitions by the World Bank, which has the most thorough and many-sided discussion. Even if this concerns mainly developing countries, it has more general implications.

The discussion started already in the late 1980s. The need for discourse of good governance in the World Bank was an outcome of the Bank's analysis of bad governance in Sub Saharan Africa.¹²⁰ Africa's development gave the World Bank a reason for discussing the reasons for the failures of structural adjustment policies of the Bank in the 1980s. To get better results the Bank analyzed the situation in African countries and noticed that the slow pace of development was connected to personalization of power, patrimonial governing practices, lack of human rights, corruption, weak capacities to manage economic affairs, ineffective and too big civil service, and un-elected and unaccountable governments, i.e. in a word, bad governance and ineffective public institutions. The term governance was used on the level

¹²⁰ The World Bank: *Sub-Saharan Africa. From Crisis to Sustainable Growth* 1989.

of governance regime, not in the framework of policies, though the discussion concerned political questions.¹²¹

The World Bank's first, weakly articulated definition of governance – without any intention that it would be an eternal, because it was not based on comprehensive analysis – was as follows: governance is “exercise of political power to manage a nation's affairs.” This definition was specified in 1991 in *Governance and Economy*¹²² and in 1992 in *Governance and Development form 1992*.¹²³ Governance was one of the major themes in the World Bank's annual conference on development economics in 1991.¹²⁴

In these reports governance encompassed a wide range of concerns from the accountability of leaders to their subjects (for example in financial accountability, accountability of economic performance, macro-level accountability mechanisms as exit mechanisms, voice mechanisms, participation of nongovernmental organizations), the transparency of transactions, formation of rules and institutions, which provide a predicable and transparent framework for the conduct of public and private business and effectiveness of a state's institutional arrangements

¹²¹ The World Bank: *Sub-Saharan Africa. From Crisis to Sustainable Growth* 1989, 22, 55-57, 143, 192, def in 60. The term governance was not in general use earlier. Its use in discourse of business management was increasing. Students raised attention to the outcomes of different corporate models. Goran Hyden, who was in the 1980s a leading student of African development politics, had used the term already in the early 1980s. He emphasized importance of governance reforms for the development. He was professor of political science in University of Dar el Salam.

¹²² Brautigam 1991.

¹²³ The World Bank *Governance and Development*, 1992.

¹²⁴ The World Bank: *Proceedings of the World Bank Annual Conference on Development Economics* in 1991.

(respect of due process, reform of civil service, public expenditure management, effective decision-making process, policy formulation and implementation capacity), and good information flows between rulers and the ruled. The rule of law that rehabilitates the judicial system, ensures independence for the judiciary and ensures scrupulous respect for law and human rights at every level of government. Also independent public auditors responsible to representative legislature not to an executive were mentioned as major elements of good governance.¹²⁵ Accountability, transparency, predictability, openness and rule of law were the major terms of new governance discourse.¹²⁶

The message in these reports was clear: economic progress depended on a government's capability to use authority to establish and maintain both a formal and an informal framework of institutions that regulate social and economic interaction. Discussion of governance was intended to introduce a change in the development regime of the Bank of the 1980s. The reports emphasized that the size of the public sector was not regarded any more as the major problem as in the development policies of the 1980s. The term governance and concepts associated with

¹²⁵ World Bank: *Governance and Development* 1992, 3-5, 12-57. In 1994 the Bank specified the definition of governance to "epitomized by predictable, open, and enlightened policy making (that is transparent process); a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; and a strong society participating in public affairs; and all behaving under the rule of law." The publication gave emphasis to similar themes as two years earlier, i.e. public sector management (civil service reform, financial management, state enterprise sector), reforms of accountability and legal reforms. The Bank wanted to emphasize more participation of the actors of civil society and human rights. (World Bank: *Governance* 1994, 1-29)

¹²⁶ See discussion of governance in the Bank *Shihata* 1991, 53-96, *Landell-Mils and Serageldin* 1991, 14-17. See evaluation of the definition *König* 1999, 73 and *Abrahamsen* 2000, 47-65.

it were developed to foster economic development, well-being and increase the efficiency of markets. Good governance was not a goal as such but rather a means to foster economic development.

The World Bank's first definitions of the conception referred broadly to a wide range of literature, mainly economics, but also political science, institutional economics and development management (i.e. administrative sciences).¹²⁷ Reference to these backgrounds helps us understand that the Bank emphasizes public sector management, accountability, the legal framework, transparency and information, and the civil society as the major elements of good governance. Principles of accountability, legitimacy, openness and transparency, rule of law, predictability and participation were derived from a vast literature of traditional political science. Major authorities and authors were Rousseau, Montesquieu, Mills, Weber, Lipset, Dahl, Lindblom, Huntington, and Cerny. Landell-Mills and Serageldin said that the reforms were Weberian in spirit, if not in letter.¹²⁸

Landell-Mills and Serageldin were major discussants of the terminology in the early 1990s in the Bank. They developed not only general principals of governance, but also defined its sectors and its contents. Landell-Mills and Serageldin raised participation, freedom, accountability and transparency into forefront in good governance. They were the first to raise the Universal Declaration of Human Rights of the United Nations (December 10, 1948) to a position of ideological base of governance.¹²⁹ The authors referred widely to the responsibility of in-

¹²⁷ *Brautigam* 1991, 10-29. At this time the Bank arranged seminars with students of New Institutional Economics, which emphasizes the importance of the state compared to the New Political Economy, which has been regarded as the main discourse in the Bank in the late 1980s.

¹²⁸ *Leftwich* 1994, 378.

¹²⁹ *Landell-Mills and Serageldin* 1991, 6-7. See discussion of the international governance of human rights *Shelton* 2001, 424-468.

ternational organizations – especially of the Bretton Woods organizations – in building a stable world order and their responsibility to express the will of the international community in developing countries. The authors regarded Bretton Wood organizations as key political players capable of exerting considerable influence in promoting good governance in poor countries.¹³⁰ Their conclusion of governance is worth a citation: “good governance depends on the extent to which government is: perceived and accepted by the general citizenry to be legitimate; committed to improve general public welfare and responsive to the needs of its citizenry; competent in assuring law and order and in delivering public services; able to create an enabling policy environment for productive activities; and equitable in its conduct, favouring no special interests or groups.” For these conditions it is necessary to have in place arrangements for political accountability, freedom of association and organization, objective and efficient judiciary, bureaucratic accountability, freedom of information and expression and fostering efficiency within public institutions.¹³¹

There is no doubt that good governance as defined by Landell-Mills and Serageldin was political in nature in many respects. First, new discourse redirected the reform policies of the Bank from neo-liberal discourse of a small state towards a broader conception of an effective state. Second, the discourse referred to Universal Declaration of Human Rights of the United Nations and to the theoretical framework of political liberalism, or more concretely, the pluralist model of liberal democracy. However, the official reports of the Bank referred explicitly neither to the theoretical backgrounds nor to political bases of the model, because the Bank felt that it could not dis-

¹³⁰ *Landell-Mills and Serageldin* 1991, 13.

¹³¹ *Landell-Mills and Serageldin* 1991, 14-15..

cuss themes, which belonged to the political system.¹³² One can say that the major elements of the liberal political system - political equality, open participatory political processes, and a society in which the power of the state is checked and balanced by a private market economy and by a strong civil culture - were so natural propositions in all discussion documents of the Bank, that there was no need for defining them.¹³³

Governance was a sensitive term in the Bank's definition, because it was touching the slippery surface of politics. The Bank's Articles of Agreement explicitly prohibit the Bank from interfering in the political affairs of its members and from being influenced by the political character of its members.¹³⁴ In the

¹³² See discussion of democracy in the World Bank: *World Development Report 1991*, 133-134.

¹³³ Discussion of the basic premises of liberal, plural democracy see *Schmeder and Ingram* 1997, 13-28. In the *World Development Report 1991* discusses of the political pathologies and of political bribery, nepotism and venality, but without defining the basic propositions of liberal, pluralist democracy.

¹³⁴ See *Shihata* 1997, 14 and discussion of political aspects of governance Landell-Mills and Ismail Serageldi. They say that "... governance consists of two distinct but intimately intertwined dimensions: one is political (and relates to the commitment to good governance), and the other is technical (and relates to issues of efficiency and public management). Both must be addressed. Without political commitment little can be achieved, even with an efficient public administration. And without an efficient public administration, no government can be effective, however benevolent. Thus the performance of government depends on the role assigned to the state, the competence of public agencies, and the extent to which there is an enabling environment that facilitates and encourages growth-promoting activities by private citizens and hones behavior by public officials." Landell-Mills and Serageldin 1991a, 307. More discussion about political aspects of governance in the contexts of the Bank's Articles of Agreement see *Shihata* 1991, 67-96. See comments of the unofficial positions of the personnel of the Bank of governance *Williams and Young* 1994, 86 and 88.

late 1980s the field of aid policies was in a state of turbulence and this had an effect on the strategic position of the Bank. Already in the early 1980s many developed countries (the USA, the UK, the Netherlands, Germany, Sweden, France) began to set explicit political criteria for their development aid. The European Bank for Reconstruction and Development (established in 1991) had an explicit purpose to apply the principles of multiparty democracy, pluralism and rule of law in its development policies.¹³⁵ This brought political character to the discourse of governance and development aid. In spite of the growing political considerations the Bank tried not to interfere with this by concentrating on economic management and public sector reforms.¹³⁶ In 1992 the World Bank stated explicitly that political aspects of governance are not discussed, because they are beyond its mandate.¹³⁷

¹³⁵ *Shihata* 1990, 41-42. Agreement Establishing the EBRD states that the contracting parties committed to the fundamental principles of multiparty democracy, the rule of law, pluralism, respect for human rights and market economies shall foster the transition of Central and Eastern European countries towards open market oriented economics and promote private and entrepreneurial initiative, op. cit 109-110.

¹³⁶ For example democracy is one of the major requirements of political scientists of good governance. Because the World Bank's Articles of Agreement prohibit political considerations, democracy was not included in the first discussions of governance in the Bank. Also later discussion is silent of this question.

¹³⁷ World Bank: *Governance and Development* 1992, 5. "Governance may, however, be relevant to the Bank's work if it is addressed in terms of having good order and discipline in the management of a country's resources. Thus, there could well be a need for the Bank to encourage, for example, civil service reform, legal reform, and accountability for public funds and budget discipline". In *Governance. The World Bank's Experience 1994*, the Bank says the form of political regime is deemed outside the Bank's mandate, XIV. See also *Shihata* 1991, 62-96 and *The World Bank: Operations Evaluation Department. IDA Review. Governance – the Critical Factor* 2001.

Because the World Bank had to remain outside political projects¹³⁸, the Bank developed the definition of governance in such a way that it fit its mandate, even if analytical definitions as such do not logically demand the Bank's participation in political governance reforms. The aspiration to develop such a definition that will suit the mandate of the Bank has produced narrow, neutral, empty and vacuous definitions like: "Governance is the manner in which power is exercised in the management of the country's economic and social resources for development".

This strict aspiration for neutrality lasted a couple of years. In 1995 the discussion received a political nature, when the Bank's new president James D. Wolfensohn raised corruption into the agenda.¹³⁹ He wanted to connect macroeconomic and financial considerations with structural, social and human aspects.⁹⁰ The next stage towards more honest discussion of the nature of governance was the World Development Report in 1997 (*The State in a Changing World*), which broadens the political scope of the discussion.¹⁴¹ Stephen Krasner has made a short analysis of the report: "Nothing could be more directly

¹³⁸ In field work this sensitivity of politics could be felt clearly. When different donor organizations with the leadership of the UN were arranging a seminar of urban management program in 1992, the World Bank official denied the use of governance in the title of the program, because it implied involvement with politics, which is denied in the World Bank, as he said. See *McAuslan* 1997, 27.

¹³⁹ *Shihata* 1997, 227-228 and *Krasner* 1999 144. Of the activities of the Bank in the field of anti-corruption see *The World Bank: Curbing Corruption*. 1999 and *The World Bank: Helping Countries Combat Corruption* 2000. See also World Bank's web-sites of anti-corruption (<http://www.worldbank.org/wbi/governance/>) (visited 19.9.2001)

¹⁴⁰ See discussion of the changes in the development agenda of the World Bank *Naim* 2000, 505-528.

¹⁴¹ The development report of 1996 passes political questions, though transition from socialist economy to market economy means in general transformation from socialism to liberal democracy. (*The World Bank: World Development Report* 1996)

political.”¹⁴² The report emphasized old themes of accountability and responsiveness through participation, voice, transparency and decentralization, but raises into the agenda new themes, for example state capacity, improvement in electoral participation, problems of diversity and participation, alternative strategies for voice and participation, mechanisms for informing and consulting, decentralization, corruption and ways of bridging the gap between the state and its citizens.¹⁴³

A World Bank’s strategy for governance and public sector reforms (*Reforming Public Institutions and Strengthening Governance*) from November 2000 discusses governance broadly, though public administration is seen as a major vehicle in governance. The report raises the importance of 1) rules and restraints, 2) mechanisms of citizen voice and participation and 3) mechanisms that promote competition. Rules and restraints are constitutional requirements for a political system. Into mechanisms of voice and participation are included forms of representative decision-making and political oversight, direct involvement of users, nongovernmental organizations and monitoring of public policies, dissemination of information and transparency. Political competition between regions or parties, market competition among public agencies, or between public and private providers of information, goods and services and internal competition within public bureaucracies are regarded as mechanisms that promote competition. Policies of accountability of administration and participation of civil society in public decision-making belong also to the political demands of governance.¹⁴⁴

¹⁴² Kransner 1999, 145.

¹⁴³ World Bank: *World Development Report 1997*, 110-130.

¹⁴⁴ World Bank: *Reforming Public Institutions and Strengthening Governance* 2000, 22-31. Enhance of accountability is not channeled through political society but via civil society.’s Role in Promoting Human Rights and Democratization in Third Countries. 8.5.2001.)

In the late 1990s corruption and the question of political institutions receives more attention in the public discourse of governance in the Bank, though it is only one element of good governance. The Bank developed anti-corruption strategies and the staffers of the Bank published numerous reports on the theme. The governance strategy for Europe and Central Asia stresses the importance of institutions of political accountability (*Anticorruption in Transition. A contribution to the Policy Debate*).¹⁴⁵ The strategy for Africa (*Can Africa Claim the 21st Century*)¹⁴⁶ has the most explicitly political framework in governance reforms. A strategic paper for Latin America and Caribbean (*Beyond the Washington Consensus. Institutions Matter*)¹⁴⁷ discusses institutions from a very broad perspective. In a similar way, the analysis of the first ten years in transition in Eastern Europe and the former Soviet Union (*Transition. The First Ten Years*) countries compares economic outcomes in different political systems and compares the relationship between political institutions and economic outcomes and poverty reduction.¹⁴⁸ Other international donors, both individual countries and international actors have a quite similar trend to increase accentuation of political conditions in their aid policies in the late 1990s.¹⁴⁹

¹⁴⁵ The World Bank: *Anticorruption in Transition* 2000, 3, 9-10, 26-27, 39-41, 44-46.

¹⁴⁶ The World Bank: *Can Africa Claim the 21st Century?* 2000, 50-74.

¹⁴⁷ *The World Bank: Beyond the Washington Consensus* 1998.

¹⁴⁸ The World Bank: *Transition. The First Ten Years*, 2002.

¹⁴⁹ See for example recent strategy of the EU (Commission of the European Union: *The European Union's Role in Promoting Human Rights and Democratization in Third World Countries* 8.5.2001).

2.2. Indicators of governance

The World Bank has been a forerunner in developing governance indicators. These have been developed, because they are useful for showing the importance of governance for economic development. They are used to identify political and social sources of poor governance and to identify which countries have the most severe governance problems. Later on indicators began to be developed in the OECD and in some European countries as well (for example Germany), and in 2002 the EU launched a new indicator program.¹⁵⁰

The first concrete, operationalized definition was made in 1991 by Pierre Landell-Mills and Ismail Serageldin, who presented six minimum characteristics for governance. These are 1) political accountability, 2) freedom of associations, 3) a sound judicial system, 4) bureaucratic accountability, 5) freedom of information and expression and 6) capacity building.¹⁵¹ The indicators emphasize political elements, contrary to the official definition, which limits itself mainly to administrative questions. The definition is neither theoretical, because it is not connected to theoretical discussion of economic or political science, nor empirical, because the framework was not justified with empirical results of governing.

¹⁵⁰ Meeting report: "What statistical indicators for democratic governance: Meeting with statisticians and researchers in order to lay the foundations for an organized network on the "measuring of democracy and good governance" EUROSTAT- Munich, 21-23 January 2002 (http://europa.eu.int/comm/governance/docs/eurostatcon_en.pdf) and Workshop 21.1.-23.1.2002 Measuring Democracy & Good Governance. Fortbildungszentrum München für Wirtschafts-, Umwelt- und Sozialstatistik. <http://www.cdg-fz.de> (visited 5.3.2002)

¹⁵¹ *Landell-Mills and Serageldin* 1991, 15-16.

After the official definitions of the Bank had found established forms in the operations of the Bank and in the development policies, the definition discussion had calmed down until the late 1990s, when definitions were raised on to the agenda.¹⁵² The theme was first discussed in Knack's and Keefer's study of institutions and economic performance (1995),¹⁵³ which concerns the effects of different institutions on economic performance. Its variables resemble the elements of governance of Landell-Mills and Seragelding, though the authors do not refer to it. Even the word governance is not used. For the first time governance indicators are mentioned in Jeff Huther's and Anwar Shah's study of fiscal decentralization. They refer explicitly to the Bank's booklet *Governance and Development (1992)* when they define the dimensions of governance. Their indicators measure the government's ability to 1) ensure political transparency and voice for citizens, 2) provide efficient and effective public services, 3) promote the health and well-being of its citizens, and 4) create a favorable climate for stable economic growth.¹⁵⁴

Kaufmann, Kraay and Zoido-Lobato's¹⁵⁵ two studies from 1999 (*Governance matters* and *Aggregating Governance Indicators*) present a comprehensive database of governance of the Bank. The database contains over 300 governance measures compiled

¹⁵² A good description of governance indicators.
(<http://www1.worldbank.org/publicsector/indicators.htm>)
(Visited 12.03.2001)

¹⁵³ *Knack, Keefer* 1995, 207-227.

¹⁵⁴ *Huther, Shah* 1998, 2 -3.

¹⁵⁵ *Kaufmann, Kraay, Zoido-Lobato* 1999a, *Kaufmann, Kraay, Zoido-Lobato* 1999b. In 1997 Kaufman published with Isham and Pritchett an article of civil liberties, democracy and the performance of government projects. Discussion of governance indicators remained still quite unspecified. *Isham, Kaufmann and Pritchett* 1997.

from a variety of sources.¹⁵⁶ The database is continuously updated,¹⁵⁷ and forms a kind ‘half-official’ operationalization of good governance of the Bank.

Considering the importance of the database, discussion of its theoretical grounds is in practice neglected. Kaufmann, Kraay and Zoido-Lobaton group the indicators into three dimensions without any theoretical reference either to economics or political science. They define “governance broadly as the traditions and institutions by which authority in a country is exercised. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to affectively formulate and implement sound policies, (3) the respect of citizens and the state for the institutions that govern economic and social integration among them.”¹⁵⁸ The authors organize the dimensions into six clusters, which once again resemble clearly the six characteristics of Landell-Mills and Serageldin. The first dimension – the process by which governments are selected, monitored and replaced - defines the political system. It is composed of two clusters, which are a) voice and accountability and b) political instability and violence. The second dimension – capacity of government to manage resources and implement sound policies – includes two clusters, i.e. c) government effectiveness and d) regulatory burden. It contains regulatory institutions that determine how the government is regulating the private sector. The third dimension – respect of citizens and the state for the institutions and society – includes e) rule of law and f) graft.¹⁵⁹ This category also includes

¹⁵⁶ The data is subjective. It is drawn from polls of experts and cross-country surveys of residents carried out by international organizations and other non-governmental organizations

¹⁵⁷ First update appeared in 2002. See Kaufmann, Kraay, Zoido-Lobaton 2002

¹⁵⁸ Kaufmann, Kraay, Zoido-Lobaton 1999a, 1

¹⁵⁹ Kaufmann, Kraay, Zoido-Lobaton 1999a, 7-8.

institutions such as trust and reciprocity, which ensure that social interactions are mutually beneficial and not used for private gain.

The EU has followed the footsteps of the World Bank in launching a project on governance and democracy indicators in 2002. The first discussions of the indicators concern statistical, theoretical and political problems of the endeavor. Emphasis was placed on the need "to share and agree upon the most important principles of good governance, democratization and human rights which are: participation, fairness, accountability, transparency and efficiency. For the avoidance of doubt such principles should include gender equality, and the avoidance of discrimination on any grounds such as race, color, sex, language, religion, ethnicity, political or other opinion, birth or other status" ¹⁶⁰ The EU's governance indicator work has quite strong political emphasis and typical European stress on equity and considerations of fairness.

2.3. Domains of political governance

My original way of defining governance in chapter 1 was based mainly on two assumptions. First, I made note of the fact that public sector reforms adhered to the tasks of the state and to the state's role in the discourse of governance. The redefinition of the tasks of the state and discussion of the basic nature of public management reforms produced a discussion of political governance, which justified the birth of a new regime of political gov-

¹⁶⁰ *Measuring Democracy and Good Governance* Munich, 21-23 01.2002. Conclusions: Broadening, Deepening and Organizing the Approach. (http://europa.eu.int/comm/governance/docs/eurostatcon_en.pdf)

ernance. It was not an unintended outcome, but a result of a long-standing and conscious reform process, which aims to transform traditional up-down governing into down-up governance and into interaction between the state, market and society. New public management reforms were the first step of the reforms and governance belonged to the second-generation reforms of the same process, which referred to a qualitative change in political governance.

Development policies can also be regarded as processes with several steps and similar aims. The present emphasis on institutional questions has broadened the previous economic scope of reforms to a broader discourse of political questions. Economic development requires not only market reforms, but also reforms in public sector management and the governance of society.

Before I continue and broaden the perspective, the first conclusions have to be drawn from the discussion so far, and can be summarized to some points. First, the conception of governance is derived from governing. This background should be respected. It connects political governance as a comprehensive governance regime to the state and especially to the responsibilities of the government in governing markets, society and state. The idea of political governance as a comprehensive set of sub-governance regimes (governance of markets, state and society) is a logical outcome of this. Second, institutions are the key success-factors in good political governance. Third, because political governance is the government's major task and governance concerns markets, society and public administration, the nature of political governance and interplay of political institutions and market and social institutions should receive more discussion than it has so far. When we develop elements of political governance further, political questions cannot be ignored. Discourse of good governance in international development or-

ganizations has confirmed this. All major elements and key factors of political governance should receive more attention and be included in the analysis.¹⁶¹

March and Olsen use the expression "domain of governance". It refers to the forums and sectors of democratic governance, and clarifies the subject of my study. March and Olsen's domains of political governance trace back to implicit or explicit components of the idea of a sovereign nation-state. The first domain is administration, which involves the implementation of rules, principles, and policies adopted by a sovereign state. It is a domain of expertise and problem solving in which there are problems with incomplete information but not with conflict of interests. The second domain is of politics. It involves establishing the rules, principles and policies of a sovereign state. Administration is a domain of constitutional procedures by which diverse interests and beliefs are translated into rules, principles, and policies that are binding within the state. March and Olsen call the third one the domain of international relations. Politics involves dealings among sovereign states. International relations is a domain of war, competition, voluntary cooperation and negotiation among sovereign states pursuing their own rules, principles and policies.¹⁶²

Administration, politics and international relations are also included in my analysis, but I will not discuss governance of international relations. Instead, state, markets and society will be the major domains of this study. Because the state is too big an entity to be handled as one unit, it has to be subdivided into

¹⁶¹ The World Bank is referring in political governance and political institutions in recent studies, but because the Bank it not participating in political reforms, the Bank has not continued the development in this field.

¹⁶² *March Olsen* 1995, 122-123.

smaller parts. March and Olsen had a division between administration and politics, which dichotomy is also used in the current analysis. For governance purposes administration has to be subdivided into more specific parts. I will return to this question in chapter 6.

State, markets and society are the major functional entities in my analysis of governance. They all have special functions, well-developed functional principles and value-structures. Because liberal political theory does not have a uniform model, and in economic theory there is no ideal division of labor between the state, markets and society, different countries have their own national interpretations of their functions and tasks.¹⁶³ Practical interpretations are always dependent on cultural traditions and the economic development of the country. Irrespective of this variety of models, state, markets and society can be regarded without doubt as the major domains of governance. Keeping up and respecting this division of labor is an important principle in governance. More directly: governance is basically a task of developing maximum preconditions for success for all national actors independently and in cooperation.

The relations between different components of governance can be presented as follows.

¹⁶³ See *Jespersen 2000*.

Table 2: Domains of political governance

Political governance			
	Markets	State	Society
Value basis	Values of the market: -profitability, -self-interest	Values of the government: -democracy -equality -public interest -provision of public goods	1. Values of Society: mutual interest, fraternity and solidarity 2. Values of the Individual: self-interest, freedom, survival, equity
Principles	Competition Profit-making Ownership	Coercion Participation Confiscation	Trust; consensus Voluntary collaboration
Politics	Corporate governance	Administrative policies (public sector governance)	Life policies, Life governance Governance of society

2.4. Governance regime in public space

I referred earlier to Goran Hyden's classification of the dimensions of governance regime as a public space, where all major actors are situated. In Hyden's analytical vocabulary regime or realm of governance is displaced in public space, where different actors operate. He connects governance in public space with the help of dimensions, which fix governance into the sphere of 1) power, 2) exchange, 3) compliance and 4) innovation, which are

the major qualities of public space. Power is connected to the governance with authority, compliance is connected with trust, exchange is connected with reciprocity, and innovation with accountability. Trust, authority, accountability and reciprocity are important requirements of good politics and good governance.¹⁶⁴

In Hyden's model the relations between governance and public space are crucial, because they determine its nature, openness, accountability, legitimacy and responsiveness. American sociologist Robert Nisbet, who has studied order in historical perspective, has discussed the same problems, but from his perspective on the analytical level as a theoretical framework, not as an outcome of empirical research.¹⁶⁵ Nisbet is basically studying conditions for success like Hyden. Nisbet's main conclusion for success is based on the principles of political pluralism, which is a system of order, where autonomy and integrity of all actors in the markets and society is respected and common interests are solved in co-operation. The major principles here are 1) functional autonomy, 2) decentralization, 3) hierarchy and 4) tradition. These concern the functions and relations between the major domains of governance, not their internal functioning.

Functional autonomy refers to the ability of each major function (or domain) in social order to work to achieve its own distinctive ends with maximum possible freedom. "It is harmony that our society needs above anything else ..."¹⁶⁶ The second principle is decentralization, which in Nisbet's idea is connected to the functional autonomy of the domain. This supports localism, regionalism, and nurtures the spirit of voluntary participation and activities of the many – workers, professionals,

¹⁶⁴ *Hyden* 1992, 8-14.

¹⁶⁵ See *Nisbet* 1967.

¹⁶⁶ *Nisbet* 1975, 236-237.

entrepreneurs, families and neighborhoods. Decentralization is not an administrative principle, but a principle of large institutions, which supports social diversity and individual autonomy.¹⁶⁷ The third principle is hierarchy. It comes from the functional requirement of social bonds and order. “There is no form of community that is without some form of stratification of function and role.” The fourth principle is tradition, which means here an uncalculated and effective mechanism of social order, custom, folkway, and all uncountable means of adaptation.¹⁶⁸

Nisbet developed these principles in the early 1970’s, when the role of the government was growing and tasks of the state grew over their traditional boundaries. Laws and regulations guided society and markets more than earlier. Nisbet was critical to this development. In my vocabulary, he tried to foster self-government of the markets and society and to guide the government in its political tasks through the principles of pluralism. Dissolution of the centralized governing model started in the UK and New Zealand in the early eighties. Deregulation and privatization are examples of the application of principles of functional autonomy and decentralization. The force of tradition can be seen in the slow adaptation of the most effective management methods in public administrations in such countries that emphasize administration instead of management. Deep-rooted traditions are the carriers of all cultures – including public administration. Nordic countries have neither adapted the privatization ideology nor reduced the role of the state, though most international development organizations supported privatization and the ideology of the small state. Nordic countries have trusted on a different strategy: they have in-

¹⁶⁷ *Nisbet* 1975, 237.

¹⁶⁸ *Nisbet* 1975, 238-239.

creased efficiency in public administration and preserved their collectivist based cultural values and traditions in the present world of growing competition. This is all due to respect for traditions.

Hyden's analysis of politics is analytical in nature. He has presented a hypothesis of four properties of good politics. These differ from Nisbet's properties of good politics, because he emphasizes the importance of the state in governance. For Hyden the basic principles are 1) authority, 2) reciprocity, 3) trust, and 4) accountability. In Hyden's model the governance realm should be seen in relation to the public realm as a means to an end. This means that political governance regime is characterized by the qualities associated with the governance realm.¹⁶⁹ The dissimilarity between Nisbet's and Hyden's properties of governing gives a clear expression that they do not belong to the same governance regime.

Nisbet's principles bear resemblance to Hyden's dimensions of governance, even if they are based on a different conception of the governance regime, and a different interpretation of the role of the state and society and their institutions in the political governance process. For Hyden the interaction between governor and governed is as important as for Nisbet. In spite of Hyden's and Nisbet's different solutions to their problems they both discuss the same themes. Nisbet's hierarchy and order correspond to Hyden's authority and power, and though Hyden's terms do not correspond to Nisbet's terms decentralization, functional autonomy or tradition, Hyden is stressing similar principles. When Nisbet emphasizes functional autonomy, Hyden stresses change and accountability. While Nisbet values tradition, Hyden prefers trust.

¹⁶⁹ *Hyden* 1992, 12-13.

Both of these principles of good politics refer to the relations between the realms of governance and public space. Nisbet's model is based on traditional governing regime and on a liberal conception of the small state, which do not interfere actively in the processes of markets and society. Hyden's model emphasizes relations of the governance realm to public space, i.e., into society and markets. For him the governance regime has to solve the problem of oversight in governance, accountability, and reciprocity.

Nisbet's and Hyden's ideal regime types of governance are systems of power, authority and hierarchy. Authority structures are hierarchical, even though we would personally oppose hierarchies. For Herbert Simon, who is a student of public administration and organizations, hierarchy of authority and division of authority are the basic requirements for unity of command and acceptance of authority, i.e. for order in the system.¹⁷⁰ When we broaden hierarchy to authority we do not abandon it, but increase its content and applicability. Hyden's and Nisbet's governance regimes cannot escape questions of order and authority even though they find different solutions to it.

A recent definition of the principles of governance is done in the *White paper of European Governance*, which the Commission of the European union published in 2001.¹⁷¹ The aim of the White paper is to foster democratic governance. Its principles underline democracy and the rule of law in all levels of government – global, European, national, regional, and local. The

¹⁷⁰ Simon 1997, 191-197.

¹⁷¹ Commission of the European Communities: *European Governance: A White Paper*. The commission has published major contributions of the debate of the European governance and of the future of the governance. See internet page of the debate http://europa.eu.int/comm/governance/contributions/index_en.htm (Visited 5.12.2003)

principles are 1) openness 2) participation, 3) accountability, 4) effectiveness, and 5) coherence.

The principles of the European Commission's correspond to the ideas of Hyden and Nisbet, even if the Commission's paper is in nature political and Nisbet's and Hyden's models are theoretical. The database of governance indicators of the World Bank (chapter 2.2. Indicators of governance) have more practical weighting than these studies, but its basic idea corresponds to the principles raised in this chapter. All these discourses are based on the idea that good political governance is not an internal question of the governance regime, but an outcome of a two-way process between the actors in the governance regime and the actors of public space (market and society). Selection of leaders, participation in decision-making, accountability and control of policies are the major political requirements of good political governance. Openness and transparency are major means to control the policies of the government. Transparency opens the doors for social and economic actors to participate in the policy process and have a real dialogue between the government and other actors. Effectiveness and coherence refer more to the internal goals of the policies.

I have discussed these principles of governance under the heading of governance regime in public space. This shows that governance is related to society and the markets, And that it is not an internal question of the state. When we compare the basic principles of administration/bureaucracy to the principles of democracy, the difference can be seen in full clarity.

Hyden has listed the major principles of democracy as follows: plurality and diversity, dispersion of power, external access, liberty and freedom, elected officials, short term mandate, opportunity to participation and openness. The principles of bureaucracy are unity, hierarchy and authority, command and control, appointed officials, long-term mandate, limited partici-

pation, secrecy and control of information.¹⁷² I do not want to undermine the principles of bureaucracy by presenting the principles of democracy and bureaucracy side by side, but to put stress on the fact that governance is a question, which cannot be separated from public space. The quality of governance cannot be judged on the basis of the efficiency of economic management, but on the political criteria of democracy. Dictatorships may be efficient, but they do not fulfill the requirements of good governance.

The discussion so far has shown that every regime of governing has certain defined characteristic features. This is a very relevant conclusion. Relations between public space and the realm of governing determine the nature of a regime. It determines

- 1) basic principles for the use of power, and structures of authority and hierarchy,
- 2) rules for the conduct of public functions,
- 3) principles for the selection, monitoring and replacement of leaders,
- 4) basic principles for the division of labor between the state, market, society and citizens.

These principles determine

- 1) how citizens and market actors participate in governance and how accountability is arranged
- 2) transparency and openness of the governance system, and
- 3) its legitimacy bases (rational, trust, tradition or force)

The questions are similar to other organization principles developed in business management books and in ruler's handbooks since Macchiavelli. Though management sciences have devel-

¹⁷² *Hyden* 1997, 245.

oped at an enormous speed, classical management principles are still quite similar today. Management gurus are reading military classics (Clausewitz), political scientist read and study principles of Macchiavelli and Max Weber. Ideas of Friedrich Taylor, Chester Barnard, Peter Drucker and Herbert Simon belong to the permanent reading list of all students of management and governance.

2.5. Symptoms of systemic regime change from governing to governance

I do neither discuss in detail the changes in the tasks of the state nor analyze different governing models and regimes of political governing of the late twentieth century. The discourse of present governance is an expression of crisis in the present governing system and a trial to develop a new regime of political governance. The discourse of governance can be regarded as the first step from a *governing regime based on the nation state towards political governance in the pressure of global governance*.

The basic presumptions for a governing regime based on the strong nation state are:

1. National states are the basic actors of governing,
2. Markets are basically national and function inside national borders
3. Tasks of the states and the markets change in a symmetrical way
4. The state regulates and steers the markets and society with a strong hand
5. Governing is based on comprehensive plans and planning efforts
6. Markets are responsible for producing goods and private services

7. The political guidelines and policies are based on ideologies
8. Public welfare systems are based on the legal rights of the citizens
9. The state has a central role in health care and social security
10. Knowledge is centered in big organizations and professions
11. Power in public and private sphere is concentrated in large hierarchies and
12. Homogeneity, order and cohesiveness are its major political goals.

Comprehensive national economic and social development plans, which most Western governments drew after the Second World War until the 1970s, were based on ideas of practice oriented social sciences, which trusted on the possibilities of rational economic and social policies and on the capacity of the welfare state (in Europe) or great society (in the USA) to solve and alleviate social problems and keep order in society.¹⁷³

Many of the propositions of the above-mentioned model led into economic and fiscal crisis. This gave birth to an ideological attack on these propositions especially in the 1980s and the 1990's. Simultaneously citizen's value structures began to change towards individual values, which started to surpass collective values. Active privatization and deregulation policies, which were started in the 1980s in several OECD-countries show that governments emphasized economy and effectiveness more than general good as guiding values in the governing regime and new public management reforms, which formed the basis for the new political governance discourse.

All these change trends in the basic values of people and the national governing practices are weak signals of a new regime of political governance. It is a model that begun to receive support from national governments and the business community. Its basic elements are

¹⁷³ *Schonfield* 1965.

1. State, market and society form the three pillars of governance
2. Markets, states and society are integrated into international and transnational activities
3. Responsibility for the exploitation of the fruits and minimizing of the risks of globalization lies on the national level
4. The state will preserve its dominant position as a source of public power and governance institutions, guarantee of legitimacy of governance and executor of public authority
5. The state is the major mediator for issues concerning national interests and the needs of global governance
6. The state has the responsibility to design, monitor and implement a consistent set of national policies
7. The role of the state in market and society is to provide an enabling environment for success. The state defines their rules and institutions after consultation with the major actors and monitors their effective functioning. The state's role is important, but not the role of an active actor.
8. Economic growth and success is based more and more on knowledge
9. The state supports the building of social capital
10. Growth of knowledge and governance in all levels of society and markets dominate development and success
11. Politics is based more on ethics than on political ideologies
12. Rights and responsibilities are in proportion to each other
13. Protection of privacy and individualism
14. Fostering of manifold social structures
15. Democracy, respect of human rights and rule of law, and gender equality are accepted as the basic principles of good governance.¹⁷⁴

¹⁷⁴ *Declaration of Monterrey* (Monterrey Consensus) in March 18-22, 2002 Included in good governance following principles: sound economic policies, solid democratic institutions responsive to the needs of the people, freedom, peace and security, domestic stability, respect for human rights, including the right to development, and the rule of

This framework will not diminish the importance of political governing and governance of the public sector. On the contrary, though the size of the state – measured with the size of public expenditure of GDP– will diminish, its responsibilities in safeguarding the preconditions for balanced economic growth and well being of its citizens in an open, global world will by no means easier than in a closed economy.

2.6. Concluding comment

The analysis so far has found similar discourse trends in several disciplines and fields of politics and society. The purpose of these discourses is to find more efficient methods to get better results in the use of authority and rule, whether the object is a company, public authority, state, international organization or national economy. Governance is a term that tries to express this endeavor and strive for better results.

When this study finds grounds for the interpretation that governance is a new model of speaking about authority structures or systems of rule, I must remind that the analysis of dis-

law, gender equality, market-oriented policies, and an overall commitment to just and democratic societies (A/CONF.198/3).

<http://www0.un.org/esa/ffd/DocumentsIndex.htm>

(visited 5.12.2002)

In October 2001 the African leaders have in their New Partnership for Africa's Development (NEPAD) declared, that development is impossible in the absence of true democracy, respect for human rights, peace and good governance. The NEPAD defined the core components of democracy as follow: political pluralism, allowing for the existence of several political parties and workers' unions, fair, open, free and democratic elections periodically organized to enable the populace choose their leaders freely. <http://www.uneca.org/nepad/> (visited 28/3/2002).

courses is not empirical research work of social, political and economic issues or historical study using strict criticism of sources. This study focuses on academic and practical discourses, which only have indirect reference to social and economic changes in any country. It is not a surprise that most of the early discourses have been primarily theoretical, having only casual and illustrative evidence from empirical investigations. Theoretical discourses interpret different practices and develop or create new ones. Empirical research testing the use and usefulness of the new discourses will appear in the near future.

In the first chapters of the study I have presented different discourses relevant to governing the country. From these I have combined a new model of discourse, which I call political discourse. This will be developed further in the next chapters of the study.

3. Main elements of political governance

In this chapter I will develop the term political governance so that the concept could be used as a framework in political institution building efforts and evaluation studies. Because the study crosses the border between political science and administrative sciences, it uses their theoretical discussions as its basic building material. The most important concepts in this chapter are institutions and institution-building, capacity and capacity-building, democracy, trust and networking. These are the major elements of a good political governance system. It is self-evident that the list is not complete and comprehensive, but tentative. Emphasis of democracy is important especially after September 11. Before the terrorist attacks for example international development organizations were not convinced of the need of democracy for the economic development. Democracy does not guarantee maximal economic development, but it can safeguard respect for life and civic liberties of citizens. Discussion of the major elements of political governance is not irrelevant either for the developing countries. Discourse of global governance demonstrates this concretely. New instruments of global governance are developed, but without any reference to democracy.

Above-mentioned major elements of modern political governance system are traditional. Because none of these themes are new, how I can say that the model has any innovative nature or novelty value? It is not even tried. Instead I use this model as a general framework for the development of governance strategies of the markets, society and the state. This will remind us of the fundamentals of all governance processes.

3.1. Capacity as the basic requirement of governance

State capacity has been raised to a central discussion theme in political science and in development discourse, because researchers have found that incapacity of the states is one of the major obstacles for achieving the economic and social goals, which the leaders of the country have sought. The governments' capability to implement social policies, to penetrate into society, regulate social relationships, extract resources, and appropriate or use resources in a determined way should be improved.¹⁷⁵ Though researchers have different interpretations of the sources of this incapability, development of such a framework, which could provide adequate tools to analyze the reasons for the weakness and develop tools to increase the strength, is important.

Capacity is often understood as the ability of an organization to act effectively on a sustained basis in pursuit of its objectives.¹⁷⁶ Efficiency of governance can be assessed as the capacity of the government to reach its objectives effectively, efficiently and in a sustainable way. Migdal speaks of state capacity, which

¹⁷⁵ See definition of the major tasks of the state *Migdal* 1988, 4.

¹⁷⁶ *Hilderbrand, and Grindle* 1997, 31-35. *Polidano* 2000, 808. Of discussion of political capacity see *Wallis and Dollery* 2001, 245-263

is the ability of the state to write rules for the game that holds sway throughout society and supersedes any pre-existing rules that are in conflict with its own.¹⁷⁷ Capacity building refers to improvements in the ability of public sector organizations, either singly or in cooperation with other public sector organizations to perform appropriate tasks.¹⁷⁸ For Grindle state capacity is the capacity to set institutional structures conducive to economic growth, to manage macroeconomic policy, and to carry out basic public functions. It includes political representation, conflict resolution, and administrative openness. She has separated four elements in state capacity: institutional, technical, administrative, and political capacity.¹⁷⁹

I will continue the analysis of state capacity with Grindle's conceptions. For her institutional capacity is one of its elements. It is composed of authoritative and effective rules of game to regulate economic and political interactions. It is ability to assert the primacy of national policies, legal conventions, and norms of social and political behavior over those of other groupings. It is ability to set national policies, legislate and implement laws and to hold public officials accountable in terms of these laws. This capacity can be regarded as the nerve center of the government. Its importance has been noticed in recent studies of institutional economics. Keen interplay of different official and unofficial institutions for the success of nations is often more important than mere abundance of resources and factors

¹⁷⁷ *Migdal* 1988, 14.

¹⁷⁸ *Hilderbrand, Grindle* 1997, 34.

¹⁷⁹ *Grindle* 1996, def. 8-10 and broader analysis 11-44. Polidano's definition of state capacity is composed of three elements. They are 1) state's freedom to take decisions unconstrained by special interests 2) ability to take informed decisions on the basis of knowledgeable assessment of a comprehensive range of information and 3) ability to have the decisions implemented and laws are obeyed *Polidano* 2000, 808-809.

of income. The quality of institutions and their management is a crucial source of success.

Peter Evans¹⁸⁰ has analyzed the requirements for state capacity from a different perspective. His main interest in state capacity concerns the position of the state in relation to the market and society, not different capacity structures. It is clear that such an analysis supposes that the state is capable and has capacities to formulate strategies and policies, has efficient administrative structure, civil service and coercive force, and its legitimacy is not questioned. All these requirements belong to the sphere of capacity. However, it is clear that formal capacities are not enough. The state has to have legitimacy in its intervention into the markets and society and in all of its governance activities.

Unlike Migdal, who analyses society and its organizations, Evans concentrates more on the state. The existence of a cohesive and competent bureaucracy, which is recruited on merit, is for Evans a crucial capacity factor. Bureaucracy is a fundamental building block of state capacity, but it is not sufficient. First, bureaucracy has to be cohesive, competent and be based on merit. "There is an abundance of rule-making or administrative organizations, but most have neither the capability of pursuing collective goals in a predictable, coherent way nor an interest in doing so"¹⁸¹ Second, connections and networks to society and to economy are as important as internal capability. "Bureaucracy is not enough. Even the most bureaucratically coherent state cannot effect transformation without a network of ties to social groups and classes with which it shares a project. Connectedness is as important as coherence and cohesion." State-society relations complement autonomy and transform it to embedded autonomy.¹⁸²

¹⁸⁰ *Evans* 1995.

¹⁸¹ *Evans* 1992, 141, 177-179, citation in page 177.

¹⁸² *Evans* 1995, 247-250, citation in page 249.

From the perspective of political governance, the basic requirements for good governance are that there is a sufficient 1) institutional capacity, 2) political capacity, 3) policy capacity and 4) administrative capacity. All of these demand necessary autonomy of state institutions with sufficient connections to markets and society.

It is important to discuss state capacity and its requirements, because through analysis of dimensions of capacity we can specify the elements of governance. Emphasis on institution building is more important in governance of markets and society than in governance of public sector, which belongs to the direct control of the government. Policy capacity is crucial in governance of all sectors. Administrative capacity is more vital in public sector management than for example in the governance of society.

Even if the importance of management capacity has been long well known, only in the late twentieth century systematic management and leadership training for the highest civil servants has been started in the OECD countries¹⁸³ Training of political leaders has been discussed, but still most countries do not have such training. In Finland the Finnish National Fund for Research and Development (Sitra), which is an independent public foundation under the supervision of the Finnish Parliament, has launched in 2000 a program called Finland 2015, which aims to develop the knowledge, skills and networks of decision-makers so that they can handle the challenges facing Finland in the future. Participants of the program include the

¹⁸³ The UN and national development assistance organizations emphasized civil service training in developing countries after the second World War and this trend continued until 1960s. See for example Interregional Seminar on Administration of Management Improvement services 1971. See *Education and training for public Sector Management in Developing Countries* 1977, of similar theme 1977.

top echelons of both the public and private sectors (politics, public administration, business, trade unions, the third sector, the media, research and education). The Prime Minister of Finland chooses the participants. Sitra aims to ensure that Finnish social decision-makers and experts are able to cope successfully in an ever-changing world.¹⁸⁴ The Finnish model of knowledge formation and capacity building is based on strong trust and consensus between different actors of society, economy and the state. It is networking in a practical way.

Because governance is a culturally determined phenomenon, there cannot be such general characteristics, which would suit to all countries. Especially in discussion of governance capacities cultural differences should be emphasized. The analysis of the weaknesses and strengths in every national governance system has to be based on an understanding of the deep structures of the national governance regime and the principles, which determine its practices and changes. However, in this study I speak of governance as if it were a universal model.

I can clarify this discussion of capacities with a short reference to national differences of institutional logics in Western Europe, which is in the global framework a relatively homogenous region. Ronald L. Jepperson has studied different policy frameworks using a simple model, where he separates some dimensions of the structuring of the basic principles of the governance system. He calls the first dimension organization of so-

¹⁸⁴ See <http://www.sitra.fi/eng/index.asp?MM=1&DirID=50> (visited 5.12.2003). The National Defense College have arranged for decades for people in top civilian and military positions so called National Defense Courses with an overall view of Finland's foreign, security and defense policy and to promote co-operation and readiness between national defense and different sectors of the society. The training serves beside its official goals of defense policies the needs of networking and trust supporting amongst the Finnish top leaders.

ciety, which characterizes the nature of official institutional structures. The second dimension is collective agency, which describes the nature of the collectivities. He separates two models in the dimension of organization of society: a corporate model and an associational model. In the dimension of collective agency he finds two main forms of collective agency: a statist and a societal form.¹⁸⁵ There are four basic models. They are social-corporatist (Nordic), state-corporatist (German and Japanese), liberal (Anglo) and state-nation (France; weakly Latin in general) models. His rich discussion of the differences of these models and their change logics shows the importance of understanding the basic regularities and laws governing institutional behavior and policies.

Most Western political systems are basically individualistic. They are characterized by low personnel trust associated with integrated structures in which individuals can shift from one group to another, relatively high levels of general morality, effective legal systems, and the prevalence of reputation mechanisms. The collectivist system, which has strong position especially in Asia, is characterized by informal contract enforcement based mainly on trust. Social structure is segregated in the sense that individuals interact socially and economically mainly with members of specific religious, ethnic and family groups.¹⁸⁶

These two examples of different systems of governance have dissimilar ideas about human cooperation, order, human nature and principles of order. They give a glimpse of the viewpoints, which must be remembered when general models of governance are developed and especially informal institutions and laws governing the practices are defined. All different governance systems can have similar official political and formal market insti-

¹⁸⁵ *Jepperson* 2000, 8-10.

¹⁸⁶ *Dethier* 1999. See criticism towards the Western discussion of the "Asian values" SOJOURN, vol. 14, no 2, October 1999.

tutions, but they are interpreted in a specific way. This interpretation is based on complex historical, cultural, political and social and economic development processes.

3.2. Efficient institutions and institution building

Institutions have been raised to the center in discussion of economic development and governance. They provide a framework for facilitating cooperation within social systems and a framework for controlling access to scarce resources.¹⁸⁷ Both economists and political scientists have been active in the field. Present schools are called “new” institutional economics and “new” political science.

For North “institutions are the rules of the game. In a society, more formally they are the human devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change.”¹⁸⁸ Institutions are made of formal rules (political constitutions, economic laws and regulations, contracts) and informal constraints (conventions, norms of behavior and self-imposed codes of conduct and of their enforcement characteristics). For North the major role of institutions in a society is to reduce uncertainty by establishing a stable basis for human interaction. Hodgson has a slightly different interpretation. He regards institution as a way of thought or action of some prevalence and permanence, which is embedded in the habits of a group or the customs of people. This definition is derived from the 1930s (from Walton Hamilton) and elaborates an old conception, where institutions

¹⁸⁷ *Eggertson* 1999, 52.

¹⁸⁸ *North* 1990, 1.

are seen as settled habits of thought common to the generality of men. The concept of habit played a more important role earlier than it does today.¹⁸⁹

In New Institutional Economics institutions are social constraints: rules that are enforced in some way by public agencies, social groups or private individuals. The methods of enforcement include threats of force, social sanctions, moral codes, and expectations about reciprocity. Public authorities have power to change, ordain and enact only formal rules that originate with political units.¹⁹⁰ Besides, they have strong – often decisive – influence also on informal rules (customs, norms and conventions). Beliefs and worldviews are out of their control, although the political system influences these also in indirect ways. The separation of official and unofficial norms and discussion of responsibilities of different actors in defining the content of the norms is connected to my earlier discussion of the networking nature of governance. Governments cannot be sole and authoritative norm setters. On the contrary, today their role is more multifaced than earlier. Governments cannot act as ultimate and far away high authorities, which inform of new norms without an open and wide discussion with citizens, market actors and political society. The governments have to listen to the interests of economy and society. The present governance regime is connected to the change of the role of norms in governance. Present governing systems, which are based on the rule of law and were born at the beginning of industrialization in the nineteenth century, have recently received soft communal and community driven features, and informal norms have received more influence and importance. As a whole economy and society are more independent and have more responsibilities in managing their own spheres of interest.

¹⁸⁹ *Hamilton* 1998, 179.

¹⁹⁰ See of discussion of this theme *Eggertsson* 1999, 51.

For this study the New Institutional Economy's discussion on rules and norms as determinants of human behavior is important. Official rules – whether political or economic rules – are enforced by agents (police, judges and civil servants). New Institutional Economy regards their enforcement as a cost. In the theory of New Institutional Economy human behavior is affected by norms, which are informal constraints of behavior and are in part derived from formal rules. There are different kinds of norms. They can be codes of conduct, taboos, dogmas, customs and ethical standards of behavior that are in part derived from perceptions that all individuals form both to explain and to evaluate the world around them. Some of these perceptions are shaped and molded by organized ideologies (religion, social and political values), while others are honed by experience, which leads to the re-affirmation or rejections of earlier norms.¹⁹¹

The enforcement of informal norms is more difficult than of official rules. North says that some norms of behavior are externally enforced (mostly by the state) and others are internally enforced codes of conduct, like honesty, integrity, etc. They are followed by the attitudes and behavior of others in the society. North sets hopes for political scientists and sociologists that they would develop a general theory of sociology of knowledge that could help us to understand the way overall ideologies emerge and evolve.¹⁹² Dennis H. Wrong's book *The Problem of Order* is a recent input in the discussion of social order.¹⁹³

North analyzes informal constraints more thoroughly than any economists before him. He shows that constraints are hospitable to the change in the formal rules and he uses the stability of the consequent political-economic system as best evidence of

¹⁹¹ North 1998, 87-89.

¹⁹² North 1998, 91.

¹⁹³ Wrong 1994.

that. “When there is a radical change in the formal rules that makes them inconsistent with the existing informal constraints, there is an unresolved tension between them that will lead to long-run political instability.”¹⁹⁴ Traditions fostered by informal constraints are always reinforced and supported by ideologies that underlie those attitudes. And when we come to ideologies, we are dealing with politics and the state, which has an important responsibility in fostering change in informal norms that support formal rules and regulations, which the state is passing. As a conclusion of the study of institutions North raises discussion of the role of the state in institution building. There is a need to destroy the image of the state as something like Mafia or Leviathan.¹⁹⁵

New institutional Economists’ discussion of institutions is important in many ways. First, it has broadened the sphere of discussion in economics. Second, it has taken steps towards political sciences and sociology. Third, discussion about not only formal institutions and rules but also informal institutions is a challenge even for the sociologists. Their historical arguments are convincing. Fourth, discussion about the state is a straight suggestion for the political scientists. The role of the state in fostering economic development should be analyzed on a broad base.¹⁹⁶

Compared to the new institutional economists political scientists¹⁹⁷ give a different weight for institutions and do not necessarily concentrate on the same institutions as economists. However, students of both disciplines have surprisingly similar opinions of the basic questions of institutions, of their impor-

¹⁹⁴ *North* 1990, 140.

¹⁹⁵ *North* 1990, 138-140.

¹⁹⁶ See evaluation of it *Scott* 2001, 2-5 and 28-33.

¹⁹⁷ See discussion of New Institutionalism in Political Science *Peters* 1996b, 202-220, *Scott* 2001, 6-8 and *Goodin* 1996, 11-16.

tance in change and preserving stability and of their enforcement. Both regard organizations as social constructs of rules, norms and expectations that constrain individual and group choice and behavior. Institutional economists study institutions, rules and norms and their enforcement as ways to reduce uncertainty in human behavior and to secure cooperation. Because economists are interested about economic development and rationality, they study markets, contracts, technology, and disciplines but also bureaucracies (hierarchies). They are interested in efficiency and effectiveness of institutions and their transaction costs. Political scientists study similar institutions but from the perspective of democracy and legitimacy. Both discuss official and unofficial institutions and emphasize long-term perspective in institutional analysis. State, markets and society are interrelated to each other. What are their differences? Is it only the scope of these studies, the state or the market?

New Political Institutionalists James March G. and John P. Olsen describe institutions as the beliefs, paradigms, codes, cultures and knowledge that support rules and routines in a similar way to Douglas North.¹⁹⁸ Both of them stress the importance of following rules in governance. I will give a long quotation from March and Olsen's definition and characterization of rules and of rule-bound behavior, because it illustrates the major problem in an excellent way.

“Much of the behavior we observe in political institutions reflects the routine way in which people do what they are supposed to do. ... Institutions have a repertoire of procedures, and they use rules to select among them. The rules may be imposed by direct coercion and political or organizational authority, or they may be part of a code of appropriate behavior that is learned and internalized through socialization or education. ... Rules can re-

¹⁹⁸ *March, Olsen 1989, 22.*

flect subtle lessons of cumulative experience, and the process by which appropriate rules are determined and applied is a process involving high levels of human intelligence, discourse, and deliberation. ... By "rules" we mean the routines, procedures, conventions, roles, strategies, organizational forms, and technologies around which political activity is constructed. ... Action is often based more on identifying the normatively appropriate behavior than on calculating the return expected from alternative choices. ... Even in extreme situations like war, or in concentration camps, individuals seem to act on the bases of rules of appropriateness rather than rational consequential calculation."¹⁹⁹

In the New Institutional Political Science conception developed by March and Olsen the logic of appropriateness determines the behavior of people. They see that human action is institutionalized through structures of rules and routines. Rules reflect historical experience in a way that ordinarily makes the rules, but not the experience; accessible to individuals who have themselves lived through the experience. Although rules bring order, sets of rules can be potentially rich in conflict, contradiction and ambiguity, and thus produce deviation as well as conformity, variability as well as standardization. The network of rules and rule-bound relations are sustained by trust, a confidence that appropriate behavior can be expected most of the time. "Trust, like the rules it supports, is based on a conception of appropriateness more than a calculation of reciprocity."²⁰⁰

The logic of appropriateness does not only concern individuals but also groups. In this analysis of political governance the behavior of groups – are they states, governments, parliaments, parties, firms, labor unions or other interest groups – can be analyzed and understood from the perspective of appropriateness. This means that periods of change are difficult, because

¹⁹⁹ *March, Olsen 1998, 22.*

²⁰⁰ *March, Olsen 1989, 38.*

present logic of action and behavior loses its power and new rules of the game have not yet formed and received acceptance.

March and Olsen have emphasized the process by which the constraints on political exchange are established. Accountability and responsiveness mechanisms secure socialization and education into the outcomes of governance. They give meaning to governance, which according to them is not only a question of allocative outcomes, but also interpretation. "Outcomes are less significant both behaviorally and ethically than the construction of meaning that is a product of the political process. Politics gives meaning to life and meaning is the core of life."²⁰¹

Frederickson, who has analyzed institutionalists' perspectives in political science, regards Wilson's book *Bureaucracy* (1989) and March and Olsen's book *Rediscovering Institutions* (1989) as important steps in the study of public administration. The books build their theories on consideration of structure, particularly hierarchy, and individual and group behavior in institutional contexts. They recover for institutions and institutional considerations their original high status and say that it is a study of politics and administration. Both books discussed the interaction of individuals and organizations and their wider political, social and economic contexts, and the influence of professional and cultural norms on institutional behavior patterns and institutional longevity and productivity.²⁰²

Excellence and usefulness of institutional theory for public administrative reforms is according to Frederickson based on a practical basis and realism. For example institutionalists remind us that institutions and those associated with them shape meanings, rely on symbols, and seek interpretive order that obscures the objectivity of outcomes. Institutionalism is useful in differentiated state structures, because its assumptions rest on patterns

²⁰¹ March, Olsen 1994, 264-267.

²⁰² Frederickson 1999, 704.

of politics, order, and shared meanings found in both governmental as well as nongovernmental institutions.²⁰³

Students of Institutional Political Science have a different conception of the effectiveness of institutions and governmental performance to economists who stress economic development and growth. Institutional political scientists' assessment criteria are multiple. Traditionally they have evaluated the quality of political institutions from the point of view of legitimacy, democracy and democratic rule. Later on effectiveness has been evaluated on the basis of the production of public services. Weaver and Rockman have developed a set of criteria to evaluate the effectiveness from the perspective of the broad set of tasks of the government. What is the relation between governance and governing in this perspective?

Before we can answer this question we have to see what are the tasks of traditional government conception. Weaver and Rockman have developed a list of ten specific capabilities that all governments need to meet. The governments have 1) to set the main priorities, 2) to target resources, 3) to innovate, 4) to coordinate conflicting objectives, 5) to impose losses to powerful groups, 6) to represent diffuse, unorganized interests in addition to concentrated, well-organized ones, 7) to ensure effective implementation of government policies, 8) to ensure policy stability, 9) to make and maintain international commitments in the realms of trade and national defense to ensure their long-term well-being, and 10) to manage political cleavages.²⁰⁴ As political scientists Weaver and Rockman are interested in the effects of a political system (parliamentary or presidential system) and variations among parliamentary and presidential systems (for example decision-making procedures and policy-making

²⁰³ *Frederickson 1999, 704.*

²⁰⁴ *Weaver Rockman 1993, 6-7.*

capacities) to their performance.²⁰⁵ Arend Lijphart's classical study *Patterns of Democracy* has similar type of variables and a similar perspective in evaluating political systems, when he compared performance in thirty-six countries.²⁰⁶ The goals are in a sense eternal, because democracy is still not accepted universally.

Lijphart discusses the effects of different types of democracies not only from the perspective of quality of democracy, but also for macro-economic management and control of violence. Weaver and Rockman do not have such a detailed and specific discussion of the performance of different models of governing, though they opened a wide discussion of the tasks of the government. It is clear that at present the discussion of governance from the perspective of New Institutional Political Science of March and Olsen has not yet affected the definition of policy performance indicators and governance models of established political science. However, there are interesting possibilities to widen the spectrum of institutional variables outside the classical regime type, government type, decision making structures and processes.

What is the final result of our tour of institutional studies in governance? There is no final result, but a lot of outcomes. Results can be analyzed on different levels and from different perspectives. In development policies institutional analysis has concrete practical effects, because New Institutional Economy has reoriented and widened the practical development policies. Because economists have historically dominated development policies,²⁰⁷ political governance perspectives have received little

²⁰⁵ Weaver, Rockman 1993, 8-41.

²⁰⁶ Lijphart 1999.

²⁰⁷ The World Bank has raised this theme of educational background of the Bank staff in the Bank strategy of public sector reforms. World Bank: *Reforming Public Institutions and Strengthening Governance* 2000, 50-52.

conceptual and practical attention traditionally. They were regarded as a genuine nuisance.²⁰⁸ New discourse accepts that market institutions do not safeguard and determine efficiency alone, but political institutions and broad questions of political governance are just as crucial.

A second answer to the question of institutions could rise from March and Olsen's analysis of an institutional state. They regard institutional state as a political and moral order, and as a collection of long-lasting standard operating procedures, which reflect values, principles, and beliefs that are shared by most of the population. They emphasize that the primary task of the state is to guarantee political order, conditions for development and progress and autonomy of various institutional spheres of society. Constitution and laws are the major constraints on governmental actions. Government agencies are carriers of culture, missions, values, and identities. Decision-making agencies act within clear regulation standards. The public is viewed as consisting of citizens with system-defined rights and duties.²⁰⁹

A third result could be taken from economist Douglas North, who emphasizes the importance of ideology. He says that ideology plays an essential role in political and individual choices that affect economic performance. "Individual perceptions about the fairness and justice of the rules of the game obviously affect performance. ... The importance of ideology is a direct function of the degree to which the measurement and enforcement of contracts is costly. If measurement and enforcing contract performance can be done at low cost, then it makes

²⁰⁸ *Shepsle* 1999, 40-41. Shepsle says, that this is clear in the World Bank's report *The State in a Changing World*, because the authors of the report try to create State institutions that are as much as possible, purged of politics."Politics in this view is something that distorts, even prevents, noble objectives." (p. 40)

²⁰⁹ *March, Olsen* 1989, 113-114.

very little difference whether people believe that rules of the game are fair or unfair. But because measurement and enforcement are costly, ideology matters.”²¹⁰ This emphasis on ideology has direct implications for the study of governance. Ideologies should not be emphasized, but neither neglected, as they channel and redirect change in economy and society.

Ideologies are keenly connected to cultures and thus in the long-term trends, because culture is composed of principles which locate and orient people within their existential realities.²¹¹ New discourses of political governance regime rise from the need for change. In developing countries it emerges from poverty and backwardness. In developed countries it rises from a drive for success and to manage change in growing global competition. Present global economic and technological change is interpreted as demanding fundamental changes in the basic propositions in the governing regime of the late twentieth century. Incremental adjustment is not enough. The discussion, which North has launched institutions and ideologies as the key elements in the reform strategy, should be analyzed carefully.

A fourth lesson for development planning and for economic development could be North's remark of the slow speed of change of institutions. While the formal rules can be changed overnight, the informal norms change only gradually. These words of North are like straight advice for public management reformers: “Since it is the norms that provide ‘legitimacy’ to a set of rules, revolutionary change is never as revolutionary as its supporters desire, and performance will be different than anticipated. And economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. The implication is that transferring the formal

²¹⁰ North 1998a, 97.

²¹¹ Kapferer 1988.

policies and economic rules of successful Western market economies to third-world and Eastern European economies is not a sufficient condition for good economic performance. Privatization is not a panacea for solving poor economic performance.”²¹²

3.3. Democracy

Today democracy is the most common political system in the world, though its history is very short. Present forms of liberal democracy were born in the very late eighteenth century and their wider adaptation started in the late nineteenth century. Even if modern liberal democracy is a Western and Northern conception, only few European countries have an uninterrupted history of democracy longer than 50 years.²¹³ According to Samuel Huntington the democratization of the world has followed certain waves. Birth of new democracies in the 1990s after the collapse of socialist political system represents the third wave of democratization.²¹⁴

Democracy has many meanings and definitions. A short definition is that democracy is a form of governance of life in a polis in which citizens have rights that are guaranteed and protected.²¹⁵ Another short definition is as follows: democracy is about an open contest for state power by means of elections and the oversight and control of state power by representatives of the people.²¹⁶ Because this is not a study of democracy, I use gener-

²¹² *North* 1994, 366.

²¹³ *Huntington* 1991, 13-15.

²¹⁴ *Huntington* 1991.

²¹⁵ *Linz, Stepan* 1996, 10-11.

²¹⁶ *Stepan* 2001, 150.

ally established definitions. Larry Diamond,²¹⁷ Juan J. Linz, Alfred Stepan and Seymour Martin Lipset, who have widely studied democratization processes denote to democracy – or what Dahl terms polyarchy²¹⁸ – as a system that meets three conditions: i) meaningful and extensive competition among individuals and organized groups for all effective positions of governmental power, at regular intervals, and excluding the use of political force, ii) a highly inclusive level of political participation in the selection of leaders for governmental positions, so that no social group is excluded, and iii) a level of civil and political liberties – freedom of expression, freedom of the press, freedom to form and join organizations – sufficient to ensure the integrity of political competition and participation.²¹⁹

In general political discourse basic characteristics of modern liberal democracy are constitutional government, basic rights of the citizens, system of checks and balances, regular elections, party competition and political pluralism, interest groups independent of the government and market economy based on private enterprises. Also the opposition must have influence on the use of power (party competition, human rights, active civil society). There must be effective mechanisms that channel general opinion into decision-making (responsiveness). Most Western democracies have adapted the principles of classical liberalism

²¹⁷ Diamond has published a comprehensive analysis of recent democratization processes around the world. See *Developing Democracy* 1999, *Democracy in developing countries*. 1999, *Consolidating the third wave democracies* 1997

²¹⁸ Dahl (1971, 3) includes following eight attributes to polyarchy: 1) freedom to form and join organizations, 2) freedom of expression, 3) right to vote, 4) eligibility to public offices, 5) right of political leaders to compete for support, 6) alternative sources of information, 7) free and fair elections and 8) institutions for making public policies dependent on votes and other expressions of preference.

²¹⁹ *Diamond, Linz and Lipset* 1999, 6-7.

(individualism, emphasis of choice and competition, suspicion of government).²²⁰

So far I have regarded political governing as a set of rules and principles, which define the steering process and principles of economy, society, and public sector. In democracy political governing is the responsibility of citizens and their organizations. Citizens are the major sources of political power. Its use is trusted to the state organs. Political society and civil society are the major actors in this process of authorization of the use of power, because they are its origin. As the state has no power of its own, but is dependent on citizens, smooth and effective functioning of democracy is the most important precondition for good governing. Though I discuss political society later on in chapter 4, it is important to remind already here that political society is the key player in political governance.

Crucial for the proper functioning of democracy is that the capacity of the political society, which is an arena for the polity to arrange itself for political contest of control over public power, is of high quality. The state apparatus has to be aware of this. It has to take care of the official institutions of political democracy. Major official institutions of political society are constitutional structures, elections, electoral rules, political leadership, intraparty alliances, and legislatures. To achieve a consolidated democracy, necessary degree of autonomy and independence of civil and political society must be furthered and supported by rule of law.²²¹

Official institutions do not guarantee the efficiency of democracy alone. Unofficial institutions and values are even more important. When we approach unofficial institutions and values of democracy, we must stress importance of cultural differences

²²⁰ Discussion about democracy see *Dahl* 2000 and *Dahl* 1971.

²²¹ *Stepan* 2001, 101 and *Linz, Stepan* 1996, 9-10.

and historical traditions. Even if the present globalization process has increased the diffusion of ideas and ideologies, still such values and traditions, which concern political questions, belong to the most permanent, changing at a slow pace.

Government, which is the major actor in all legislation processes, has the right to initiate new legislation, which safeguards the efficient functioning of political democracy. However, political society – parties, civil society organizations and other political actors – has a crucial responsibility to control the government and safeguard effectiveness of accountability mechanisms of political governing.²²² This responsibility does not concern only daily accountability processes, but also permanent monitoring and evaluation of the effectiveness of the accountability and control mechanisms.

I discuss here neither different political systems nor relations of democracy to economic growth. In my perspective democracy is a value system, which cannot be seen as a means of economic development and increase of efficiency. It cannot be seen as a system, which will be adopted after trial of all other political systems as a last change and as a clutch to a straw. No, it is a system, which safeguards the human rights of every human being and the rule of law in governance.

Researchers have discussed widely the connections of democracy and economic liberalization. In most cases it is supposed that political democracy and economic liberalism go hand in hand. This is by far the most common model and combination.²²³ Comparative historical studies show that the level of

²²² Knack and Keefer have studied importance of political parties, trade unions, and professional associations compared to social capital and trust on economic development. *Knack, Keefer* 1997, 112, 1251-88. See also *Voigt* 1998, 200-205.

²²³ See recent literature reviews of democracy and economic development *Martz*, 1997, 104-121 and *Martz* 1996, 96-120.

economic development is causally related to the development of political democracy.²²⁴ However, all researchers are not quite sure of the relation between political institutions and economic growth, whether democracy fosters or hinders growth.²²⁵ Recent studies have identified links between democracy and economic liberalization. According to Jean-Jacques Dethier, Hafez Ghanem and Edda Zoli freedom and market-oriented reform policies are complementary processes. Though political freedom is neither a necessary nor a sufficient condition of liberalization, political freedom facilitates economic liberalization.²²⁶

Toni Rodrik has analyzed the Asian financial crisis and the virtues of democratic institutions to manage the crisis. His conclusion is quite clear. He does not accept the conventional view among economists and many political scientists that economic reforms require isolated, autonomous executives who can act speedily and decisively. He says that systematic evidence from the 1970s and 1980s and from 1990s suggests that democracy facilitates economic reforms.²²⁷ Joel Hellman's study of post-communist systems show that countries, which have a higher level of political participation and competition have adopted more comprehensive economic reforms than countries with lower participation.²²⁸ A recent World Bank study of lessons of the first ten years of transition of Eastern Europe and the former Soviet Union confirms the result.²²⁹ The following discussion of the strategy of market governance is based on the institutional assumption of political democracy.²³⁰

²²⁴ Huber, Rueschmeyer, Stephens 1993, 82-84.

²²⁵ Przeworski and Limongi 1993, 51, 65-66. See also Isham, Kaufmann and Prichett 1997, 219-42.

²²⁶ Dethier, Ghanem and Zoli 1999, 23-25.

²²⁷ Rodrik 1999, 49-50.

²²⁸ Hellmann 1998, 233-234.

²²⁹ The World Bank: *Transition. The First Ten Years*, 2002.

²³⁰ Larry Diamond has studied the consolidation of democracies of the

3.4. Networking and trust

I have emphasized that the present discourse of political governing regime (traditional liberal democracy) and the new discourse of political governance regime have different interpretations of the role of the government in governing, especially in the use of power and authority. In the new discourse of political governance regime the state is not acting as a high authority, which rules its subjects from far away, but as a node of a networking community, which acts in a collaborative way. It has well functioning relations with the markets and society. Basic principles in the new political governance regime are trust, creation of social capital and networking. It is seen that trust creates partnerships, community, creativity, learning, building and synergy. Networking promotes consensus and coherence in society and increases economic prosperity.

Discussion of trust is a recently new phenomenon both in present discourses of governing regime and governance of markets. For example the management literature of the 1930s stressed human factors in the production process. Researchers had found that organizations could be more efficient if they take more care of social and human needs of the workers. The birth of personnel policies and participatory management technologies express this invention.²³¹ In economic literature social aspects of economic behavior were found later than in management literature. Though institutional economics has broadened

world. In 1997 61 % of all countries of the world were democracies.

The increase of the countries has been enormous, because in 1974 the share was 27 % and in 1990 46 %. See *Diamond* 1999 24-31.

²³¹ This discussion was a result of criticism towards a machine model of human behavior of Fredric Taylor's and early classical "machine" school. They treated human participants as machines. See a summary of the criticism *March and Simon* 1967, 34-82 and development of participation 83-111.

traditional conception of the human motives of the economic man, personnel relations were long a neglected area of study. Recent literature of economics and sociology has emphasized personal relations and networks – in Granovetter's terminology embeddedness²³² – in generating trust, establishing expectations and creating and enforcing norms.²³³ Studies have found that trust and civic cooperation have significant impacts on economic growth.²³⁴ This has widened the focus of studies from financial and physical capital to social and on human capital as well. The effects of social capital are channeled through changes in the relations among persons that facilitate action. It exists in the relations among persons. Human capital is embodied in the skills and knowledge acquired by an individual.²³⁵ Research has found that networks facilitate social capital; and that is born in families, schools, and social associations (Putnam).²³⁶ Social capital can also be a political resource,²³⁷ which has significant political consequences. James Coleman regards public goods as a promoter of social capital.²³⁸

Networking is a modern term and a form for trust-based social relations. Francis Fukuyama says that networks are composed of actors that share such unofficial norms or values where normal market exchange and bureaucratic power relations are not in valid. Trust networks produce social capital and promote accumulation of knowledge and transformation it to all participants more effectively than a hierarchical system.²³⁹ Hollings-

²³² *Granovetter* 1985, 481-510.

²³³ *Coleman* 1988, 95-120 and *Knack, Keefer* 1997, 1251-1285.

²³⁴ *Knack, Keefer* 1997, 11, 51-88 and *Zak, Knack* 1998, 1-39. See also *Inkeles* 2000, 245-268.

²³⁵ *Coleman* 1988, 100-101. See also *Putnam* 2000.

²³⁶ See *Putnam* 1993, and *Putnam* 2000.

²³⁷ *Montgomery* 2000, 227-243.

²³⁸ *Coleman* 1988, 116-118.

²³⁹ *Fukuyama* 1999, 199.

worth, Schmitter and Streeck regard networks as loosely joined sets of individuals or organizations in which transactions are conducted on the basis of mutual trust. Confidence is sustained by stable, preferential, particularistic, mutually obliged, and legally nonenforceable relationships. Networks may be kept together either by value consensus or resources dependency, through culture of community.²⁴⁰

Networking as a trust-based form of interaction is not a new invention as such, but its present relatively well-defined forms in business are a new phenomenon. Politicians and civil servants have always had official and unofficial interaction, co-operation and negotiation forms with market and political actors, civil society and the citizens. Interaction and communication with economic and social actors is a central leadership capacity requirement for top-level civil servants in ministries and central agencies. Interlocking directors is a term that is used in politics and economics.²⁴¹

Even if networking and partnerships are old means of coordination of different interests, networking has attracted attention in 1990s in business management and especially in strategic management. Companies have developed networks to increase their competitiveness. All kinds of organizations – not only business companies – try to improve the rigidities of traditional bureaucracy and efficiency by using modern and most effective management and business models. Information exchange between an organization and its customers and clients is one of these modern ideas, which has proved to be effective.²⁴² The public sector has used networking in external co-ordination

²⁴⁰ Hollingsworth, Schmitter and Streeck 1994, 6.

²⁴¹ See for example: Pennings 1980, and *Interlocking directors and officials of 135 large financial companies of the United States*, 1957.

²⁴² See for example Tapscott, Caston 1993, 10-13.

for a long time.²⁴³ As a consequence of discussion of trust and networking many countries have launched development programs and developed methods of networking as a means of internal co-ordination within government. Networking has proved to be an effective means to overcome the rigid and formal nature of public administration. Networking benefits methods of new information technology.²⁴⁴

Networking and trust are basic principles in the governance models, which are known as consensus democracies.²⁴⁵ In Europe, Netherlands and Scandinavian countries are the best known examples of the model. The consensus policies are a European phenomenon, and in Europe they concern especially labor relations, but also relations of the representatives of capital and labor to the state. For example the USA has no such collective bargaining agreements. Originally the employers and labor unions made local labor contracts, but later on labor market organizations concluded a national agreement of collective bargaining. For example in Sweden the purpose of the agreement was to settle conflicts peacefully in order to avoid government intervention into the labor market. They wanted to make government regulations unnecessary by imposing self-regulation. For that purpose labor organizations created a system of centralized collective agreements. After the Second World War in most Western European countries the labor agreement systems widened and the state did not stick only to a role of moral persuasion, but participated actively in the negotiations. This changed the fundamental basis of the collective agreements. Active participation of the state transformed original collective bargaining agreements into a system, which is called corporatism. It is a

²⁴³ See for example *Governing Capitalist Economies* 1994 and *Governance*

²⁴⁴ *Tapscott, Caston* 1993, 13-14.

²⁴⁵ See of consensus politics *Lijphart* 1984 and generally *Lipset* 1985.

formalized administrative cooperation system between private organizations and the state.²⁴⁶ Corporatism has raised strong criticism, because its negative side effects – it has reduced flexibility of labor markets and increased the influence of labor organizations in political and administrative decisions – have surpassed its positive purposes – consensus formation.²⁴⁷

Consensus and networks of trust are important principles for governments, when they have autonomy and enough independence to persuade economic and social actors into policies, which support macroeconomic stability and general good in a fundamental and sustainable way. When the governments allow economic and social actors to dominate the policies for their own advantage, networking is not supporting trust and consensus. Corporatism can produce dysfunctions and problems if its effects are not monitored and evaluated all the time and if its basic principles are not respected. Discussion of consensus policies is bound by the cultural traditions of countries. The problems and remedies cannot be discussed in a general sense. They must be found in the cultural traditions of these countries. Discussion about the difficulty to import American labor market policies into Europe is a good example of this. Flexibility, which is necessary to overcome economic downturns, must be found in the framework of European labor market policy.

Experiences of networking in business have shown that best results will be attained when networks are based on trust and on knowledge of shared interests. The same principle should be accepted in political governing as well. The requirements of trust and knowledge of shared interests are much more difficult, be-

²⁴⁶ See of different negotiation systems *Cooper* 1982 and *Hartog, Teulings* 1998.

²⁴⁷ See discussion of the effects of corporatism in Sweden *Lindbeck* 1997, 1276-1280.

cause people participate in politics based on their personal interests. People's interests are conflicting and the effects of economic change are not similar for all people. The problem comes from the fact that all governments are bound to the promises made to their constituencies and at the same time governments are responsible to promote general good and find solutions conflicting interests.

Government, which is working as a network organization – internally and in external relations – will support the markets and society in its special expertise. A major idea of modern networking in business is that every participant of the network concentrates on its own specialty. For the government this means that it should be responsible to form necessary networks for governance purposes, because it concentrates in political governing, i.e. directing, controlling, monitoring and evaluating and steering development in markets and in society. Other participants of these networks expect that the government shares its expertise in governing. National governing – authoritative power to define official rules of the game – is a task for which other participants of the network – business and civil society – do not have competence and legitimacy.

Networking as a working method in the new political governance regime can be successful only if all participants internalize the requirements of networking. For government this means that it has to abandon its traditional role as an external authority that uses authority as an outside ruler. It must become a member of a network, where its task is to represent the interests of general good. Though I cannot discuss new demands for governance rising from this networking in detail here, its effects can be seen quite clearly. Horizontal interaction and cooperation, trust, low hierarchical levels, delegation of authority, agility to the changes of environment, new kind of knowledge and adherence to the organization are examples of the principles and

qualities that characterize effective networks and networking organizations.²⁴⁸

At the same time as we set demands for and list the qualities of networking in political governance, we must remember, that national governing models and national institutions belong to the very long-lasting institutions of all nations. They are a part of national culture – the aggregation of beliefs, values, and attitudes towards politics. They change quite slowly, and generational replacement is the primary engine of change.²⁴⁹

Basic elements of present up-down hierarchical governing regime – authority structures, organizations, hierarchies and functional divisions of labor – are defined in legislation and supported by traditions. A change over to a new regime of political governance based on trust demands more than a reform of legislation. It requires adaptation of the new principles of governance. Even if the state would adapt informal negotiation and networking methods, delegate some of its powers to the markets and society, and rely on self-regulation of the markets and society, the state preserves its major political social-economic authorities and powers. Any other organization cannot compete with it. The state does not lose its official powers and right to establish executive organizations to fulfill its responsibilities to foster well-being and prosperity of its citizens.

My discussion of networking has emphasized cooperation between business and government – both civil servants and political government. Networking is a very demanding way of cooperation, because it requires that all participants observe the rules of the game and practice high ethical principles. Cooperation, trust, reliance on self-regulation instead of government regulation give possibilities for rent seeking, capture and cor-

²⁴⁸ See *Saarelainen* 2003.

²⁴⁹ *Almond, Verba* 1963 and *Inglehart* 1997.

ruption. Civil servants can demand bribes and business can be willing to pay for such advantages, which favor their business.²⁵⁰ Rent seeking and corruption are weaknesses, which do not belong only to networking between the state and business, but are phenomena, which are inherent in all negotiation and power relations. Corruption is a phenomenon in all countries and it exists in all kinds of administrative cultures irrespective of the size of the government and of the legal tradition.²⁵¹

Kenneth Waltz, who is one of the great international relations theorists of the twentieth century, has emphasized the importance of political functions and political management of the state. This shows that he does not believe in the adaptation of a new governance model. He says that in the future only the state is responsible of essential political management functions of market and society. “The sovereign state with fixed borders has proved to be the best organization for keeping peace and fostering the conditions for economic well being.” The analysis of failed states shows that most important events in international politics are explained by differences in the capabilities of states, not of markets. If the states fail on their political functions, the markets cannot succeed in the task in producing prosperity either. Though markets are integrating and form an economic block, decisions are made on political grounds by the states.²⁵² Misuse of trust on market self-regulation in corporate governance (Enron) and in auditing (Arthur Andersen) in the USA has

²⁵⁰ Collapse of energy company Enron and problems with its auditing company Arthur Andersen in the USA in 2001 are examples of misuse of self-regulation and misuse of trust. The case has forced the government to think anew regulations of energy sector and auditing and models of corporate governance.

²⁵¹ See *The History of Corruption in Central government = L'histoire de la corruption au niveau du pouvoir central 2002*.

²⁵² Waltz 1999, 7.

diminished trust on the self-regulation of business,²⁵³ and increased trust on the state as a neutral authority of general good.

3.5. Steps towards successful political governance

So far I have emphasized the demands of the discourse of political governance on the state and its institutions. Juan H. Linz and Alfred Stepan say that they are not sufficient in addition to a functioning state. In a consolidated democracy there must be, first, conditions for the development of a free and lively civil society. Second, there must be a relatively autonomous political society. Third, all major actors, especially the government and the state apparatus, must be effectively subjected to the rule of law that protects individual freedoms and associational life. Fourth, there must be a state bureaucracy that is usable by the government. Fifth, there must be an institutionalized economic society.²⁵⁴

Linz's and Stepan's list is general, but for our purposes comprehensive. It is easy to forget these because they are self-evident and most countries fulfill these requirements already. However, there are different interpretations of their implementation. For example researchers are discussing the outcomes of different political systems. Arend Lijphart, who compared the performances of thirty six countries, which belonged basically either to the Westminster model of democracy or the consensus model of democracy, was surprised of the enormous variety of formal and informal rules and institutions that he found in the democracies. When studying performance of different models of macr-

²⁵³ *How to Fix Corporate Governance*. In Business Week/ May 6, 2002, 43-49 and *Reform Life*. In: Business Week, April 1, 2002, 30-33.

²⁵⁴ *Linz, Stepan* 1998, 51-58.

oeconomic management and control of violence, Lijphart found that majoritarian democracies do not outperform the consensus democracies. In fact, the consensus democracies had a slightly better record, but the consensus democracies did clearly outperform the majoritarian democracies with regard to the quality of democracy and democratic representation as well with regard to the kindness and gentleness of their public policy orientations.²⁵⁵

The quality of democracy and political governance cannot be regarded as static phenomena. Change of values among citizens requires new forms of political participation. Huge economic and social problems often put hard tests on democracy. Challenges from the international system demand changes in the rules of the political game. Regional economic and political integration in Europe is a good example of a new level of democracy and political governance that has to be integrated into the present political systems. International terrorism, crime and international environmental problems offer another perspective to national political governance. Even technological innovations create possibilities for new accountability and participation mechanisms; for example the Internet can be used as a means to direct democracy and participation.

These examples give a brief flash of the changes that demand continuous and thorough evaluation and monitoring of the performance of political governance. National economic success is a good performance indicator of this. Economic growth is positively correlated with poverty reduction and human development, i.e. in the creation of an environment in which people can develop their full potential and lead full, creative lives in accordance with their needs and interests.²⁵⁶ A reason for the importance of political governance for economic and human

²⁵⁵ Lijphart 1999, 301.

²⁵⁶ Of relations between economic growth and human development see UNDP: *Human Development Report 2001*, 2001, 9-10

development lies in its basic nature, i.e. in its emphasis on the efficient management of national resources. Good political governance is connected with the formal and informal development of institutions of the market, state, society, bureaucracy and the transformation rules of the political governance itself. Markets depend on the formal and informal institutions and legislation and the acceptance of the market system, i.e. its legitimacy to produce welfare and prosperity. People can be active citizens only if the government protects their rights and freedom, and the basic mechanisms of democracy that safeguard the quality of political governance. Good performance in the markets is reflected into society as well. Trust, cohesion and consensus are qualities of a well functioning civil society.

In the discussion on capacity-building two kinds of capacities, institutional capacity and political capacity were separated. Political capacity has traditionally belonged to the special expertise of the political society and political parties, which are responsible for government formation whereas institutional capacity is a more difficult task and does not even belong to the responsibility of political parties alone. Institution building demands a different kind of expertise, because institutions of the market, society and state vary from official rules and regulations to unofficial customs and habits. Before the government can establish new institutions and change existing ones, it has to analyze carefully strategies of institutions and reforms.

Institution building is one of the most difficult tasks of political governance, because definition of new institutions and their regulation and sharp tuning of existing institutions requires keen sense of the political culture of the country. Rules of the game for market institutions are different from those of society and of state. Incautious measures can easily destroy historically established economic, political or social practices, which carry vested interests, shared values and traditions to overcome

difficulties. Traditions must be changed when external pressure demands changes in the institutionalized governance practices by outdated their capacity to produce success. This change process must be based on a careful consideration. Governments should have well-established units, which take care of not only of the political capacity but also the institutional capacity of the country.

To fulfill this requirement, it would be useful if the governments could draw some kinds of plans or strategies to perform successful, efficient and sustainable political governance. The government should

1. build a strategy for the governance of well-ordered markets
2. build a strategy for the governance of well-functioning society
3. maintain and develop political institutions and political processes
4. build a strategy for public sector governance and administrative governance
5. build a strategy for participation in global governance and
6. carry out these strategies

Strategic governance processes should be based on broad discourse with central social and market actors, though the government is responsible for the final decisions. Recent knowledge management literature gives strong evidence for the utilization of silent cumulative tacit knowledge of different participants.²⁵⁷ Requirements set for the strategic processes can be specified in procedural, institutional and cultural terms. Minimal prerequisites for drafting these strategies are well functioning strategic management capacity, competent political advice, and an administrative machinery that implements these strategies effectively. Policy-making arrangements should ensure that policies

²⁵⁷ von Krogh, Ichijo, Nonaka 2002, Baumard 1999 and *The Strategic Management of Intellectual capital and Organizational Knowledge* 2002.

created are not deficient in law or substance, should be economically efficient and sustainable in budgetary terms, do not contradict to each other, and that the policies are implemented and their implementation is monitored.

3.6. Concluding comment

The model of political governance developed in this chapter is a basis for the reform of governance policies and strategies for the markets, society and state. Its purpose is to remind that all governance processes have a political background, even though the institutions are not political or official and do not belong to the public sphere.

Capacity- and institution building requirements in all political governance processes remind of the diversity of the institutions coordinating all human behavior. Institutions are not organizations, but formal and informal rules and social norms that facilitate coordination of human action. They vary from trust, social capital, deeply rooted norms governing social behavior to networks for coordination and to codified laws, constitutions and to procedures and organizations for making (parliament), codifying, interpreting and enforcing the laws (courts and to police). Participants in political processes are parliaments, governments, administrative agencies, firms, civil society organizations and individual citizens. All of them have different possibilities and roles in political processes. The major difference between the traditional governing model and modern governance process concern the role of different participants and players and the tools of governance.

The new governance model emphasizes down-up nature of the process and its inclusive character. Governance capacity is not any more in the chambers of the parliament or in the corri-

dors of power of the government but in the computers of civil society and in the heads of market actors, who have strong responsibilities to invent new governance methods and to participate in the networks of government managed by the government. The new model of governance is moving the emphasis in the system of rule and order from official organizations to non-state actors and from formal rules to informal rules and norms. What it means in market governance, governance of society and governance of the state, will be discussed in the next chapter.

4. Political governance of markets, state and society

In this chapter I will continue to develop the governance model and direct it to the governance of markets, society and state. The model is differentiated. The principles developed in the previous chapter are implemented into national political governing/governance processes. For the sake of simplicity in this chapter national governing tasks are divided into three categories. This naturally does not reflect the diversity that exists in reality, but reflects to some extent well-established practices of thought.

I present the governance strategies as abstractions in an empty table without reference to any empirical realities. However, the readers decode the models from certain national frames and perspectives, which are in all countries different. Even if the EU is steering the market systems of its member states, all of them make their own interpretations of the European directives so that they fit into their national systems of rule, authority structures and official and unofficial institutions, which have been developing for centuries. When abstracted models and schemes or the EU directives are transformed into national implementations, one of the most difficult tasks is their coordina-

tion with national unofficial norm structures, which belong to the behavioral hard core of the nation.

National government that has political accountability to legislative power (parliament) for the executive power of the country bears the main responsibility of political governing of the nation. This does not necessary mean that the government always uses this power concretely and in it's all forms. By delegating executive authority to different state authorities and agencies and to markets and society the government can concentrate on strategic leadership and governance. The government increases efficiency of governance even by linking different actors of society and markets into the political governance process. Especially important this involvement of other actors is in the policy formulation for the governance principles of markets and society. When up-down governing is transforming into a down-up process of governance based on trust and networking, the amount of players increases. It is not only experts of governing and management but also non-state actors who give their input in the governance. Promotion of inclusiveness thus becomes a characteristic trait.

4.1. Governance of well-ordered markets

General considerations The tasks of the state are connected to the markets and their functioning in many ways. However, present discussion in advanced industrial countries can give a false impression of the independence of the markets from the state. Market governance has negative connotations. Recent deregulation policies carried out in most OECD countries do not mean that political order would not rule over market economy. Deregulation is an expression of a new form of political governance, which gives more responsibility to the market and social

actors themselves, according to certain informal rules and standards for mutual tolerance. No state in the world – how ever liberal economic policies it follows – has given up – or has even discussed - its authority to regulate the markets, although market regulation has decreased in most countries in the 1990s.

Emphasis of negative effects of the government's interference in the markets has dominated the political discourse of markets since the 1980s. Adam Smith's image of the invisible hand, which guides the market without the visible hand of the state, has distorted the discussion of relations between the markets and the state. Governance of markets – to safeguard optimal use of all national resources – is one of the most important tasks of the state, because economic progress and growth are major key success factors for all nations. Despite of this comprehensive responsibility, in market economies states do not participate in a direct way in market operations. In socialist countries the state was the major actor. In developing countries the role of state varies enormously, though on general the states' involvement has been dominant and has not been based on any rational and unified framework.

Even though economists have been active participants in defining principles for the role of the state in the governance of markets, the most important decisions of the role of the state in market governance are done via political process. On general one can say that the state's role is connected to the stage of economic and political development of the country, on values of the people and on political traditions and institutions. Political considerations and values of people are often more important factors than economic theories.²⁵⁸

²⁵⁸ See for example discussion of economic role of the state in East Asian countries *Wade* 1990.

A characteristic feature of market governance is continuous change.²⁵⁹ The markets are changing in nature compared to a political system, which in definition is more permanent and represents continuity. Because the institutions of the political system are defined in the constitution, their major characteristics are stability and predictability. Markets are in a state of permanent change, because for example new technologies emerge all the time, new global scale markets are opened and competition in different branches of business forces governments to reform conditions of competition in the markets. The governments have to be aware all the time of the state of this and of the competitiveness of the national business in the global markets. They have to evaluate and monitor the effectiveness of present governance mechanisms and be ready to adapt new ones immediately, when the present mechanisms do not produce good results. This macro level market governance is one of the most important responsibilities of every state, even if the markets are functioning quite freely without government's interference.

The government's responsibilities in market governance are on the macro level. The government sets legal foundations for the markets and enforces the violations of the legal bases of the market, because only the state has legitimate authority to use coercive power (Max Weber). It defines, enforces, and redefines property rights²⁶⁰ and rules, which determine the conditions of

²⁵⁹ See practical guide for the discussion of construction of market institutions and governance of the markets World Bank's *World Development Report 2002: Building Institutions for Markets 2002* and *World Development Report 2003: Sustainable development in a Dynamic World, 2003, 37-52.*

²⁶⁰ Property rights understood in a wide meaning specifying the relations among people, not just between people and things in the process of production, exchange and accumulation. See discussion about property rights from the perspective of governance Lindberg, *Campbell* 1991, 362-367.

ownership and control of the means of production (corporate governance) and provide and allocate information and resources for the market and for the market actors.²⁶¹ The governments establish public authorities, which monitor the functioning of specific market institutions and safeguard the enforcement of government regulations. Basic institutions of the market system are defined in legislation.

A basic question of regulation of the markets concerns the costs of regulation compared to the costs of non-regulation. The costs of operating law-enforcement agencies must be balanced to the costs of unregulated markets. The government has to consider alternative regulation measures as well. Adam Smith and all major economists since him have deliberated this question thoroughly.

Monopoly of legitimate power, which makes markets dependent on the state, has been seen as a major source of problems in market governance, because governments are apt to use their powers too strongly or they cannot find efficient governance methods. Traditional methods rely on regulation, but modern methods are more frameworks for the market actors than rules to be obeyed. Modern methods emphasize actions contributing to the generation of ideas, choice sets, motives, and actions stimulating creativity, innovation and skills, and fostering general trust in the markets and in market economy. In modern economy, which emphasizes information as an important factor of production, the government's role is even more important than in traditional economy, which was dominated by heavy industries. Broad and open dissemination of economic information, which the government produces, collects from markets and receives from the international level, is crucial for the effectiveness of market mechanisms.

²⁶¹ See *Lindberg, Campbell* 1991, 362-367.

It is quite common that governments cannot find tools small enough to interfere in the market mechanisms. A small hammer in the hand of the government can turn into a sledge. The state has to find a proper degree of interference and to find best governance mechanisms at a given time so that the interference does not violate established governance institutions and practices, but take care of the needs of ever changing economic efficiency requirements. There are no general guidelines for this. What suits small countries does not suit big ones or methods made for advanced industrial country do not necessary fit a fragile state of transformation or developing country, which does not have established market traditions and advanced rules of the game. Public cultures and market institutions are tradition bound and they cannot adopt change demands rapidly. People are generally conservative when it comes to moderating basic social beliefs and behavior.

The degree of state interference – market governance - varies extensively in different countries, in different political cultures and in different times. Periods of war are the best examples of situations when all governments, irrespective of their normal responsibilities of market governance, have almost total responsibility of market governance. Regulation, rationing and public enterprises are the most common tools. Experiences show that the return back to the normal situation and into unregulated economy takes a long time. In Europe the period of controlled economy and rationing after the Second World War continued for about ten years. Economic crisis always increases the direct interference of the state on the markets. This concerns all countries irrespective of their market governance models. For example present anti-terror war after September 11 has increased the economic tasks and responsibilities of the state in the USA in many fields.

I have demanded effectiveness of the markets, but not defined what is meant by them. There are a lot of definitions, but most textbooks do not even bother to define the markets.²⁶² Sociologists²⁶³ and political scientists²⁶⁴ show growing interest in markets also.

Markets are the basic arena of market society and an organized and institutionalized arena for the production and commodity exchanges of a specific type. Most important market institutions are those that help to regulate and establish consensus over prices and communicate information of products, prices, quantities, potential buyers and sellers.

Markets are in their fundamental nature a mechanism of order. Order concerns exchange, production and distribution of goods and services. Order of exchange is supposed to emerge from decentralized decisions by a number of actors, buying and selling. The main actors and elements in the markets are buyers, sellers, and goods and services. Transaction in markets is formed through formally interdependent elements, i.e. supply, demand and price. Markets are still behaving like Adam Smith's "invisible hand" that secures coordination without obvious central planning and without a common interest among their members, for each buyer and seller is supposed to be pursuing independently his or her own private interests.

The order in markets is affected by power, which is a by-product of exchange and production processes in the markets. Lindberg, Campbell and Hollingsworth give emphasis to this by saying that "economic activity does not necessarily tend toward equilibrium, equal exchange, or efficiency, but involves intuitionally determined, asymmetrical, and shifting exchange

²⁶² For discussion of the markets see *Hodgson* 1988, 173-194.

²⁶³ *Slater and Tonkiss* 2001 and *Fligstein* 2001.

²⁶⁴ *Lindblom* 2001, *Lindblom* 1988 and *Lindblom* 1977.

advantages. Hence, the institutional distribution of power, not just prices, regulates economic exchange.”²⁶⁵ This is one of the most difficult obstacles of the state in market governance, because all actors are searching in different ways – and not always with cooperative, but conflicting ways – for best solutions for their own interests. The difficulty can be seen in most countries,²⁶⁶ but especially in transition economies, because oligarchs and insiders, who are the losers of market reforms and market liberalization, and the political system is still too weak to resist strong economic powers, can with their enormous power prevent governments from making necessary reforms.²⁶⁷

Competition is a major mechanism of order creation in the markets. What to produce, how to produce and for what price to produce are decisions that are made in the markets through competition. Firms, buyers and sellers make contracts for those decisions. Besides competition, markets are governed through official and informal institutions, for example networking and negotiation mechanisms, associations and systems of monitoring, which supplement competition as a mechanism of order.²⁶⁸ Big firms are huge bureaucracies, which function like all big organizations, irrespective of whether they are public or private.

Markets are not needed only to coordinate the actions of their members but also to diffuse power by preventing public organizations from using their resources as power bases to extend their influence and control into all spheres of human life. Herbert Simon says “A multiplicity of organizations competing vigorously in markets is a strong protection against diversion of

²⁶⁵ Lindberg, Campbell and Hollingsworth 1991, 7-8.

²⁶⁶ Lindberg and Campbell evaluate the effects of power structures on market governance in the USA Lindberg and Campbell 1991, 367-371.

²⁶⁷ World Bank: *Transition. The First Ten Years* 2002, 92-95..

²⁶⁸ Lindberg, Campbell and Hollingsworth 1991, 18-33

resources (by either for-profit organizations) to political objectives.” For him markets are not only a mechanism of allocation of resources, but also a mechanism of distribution of power. Simon refers to lord Acton who says “Power tends to corrupt, and absolute power corrupts absolutely.”²⁶⁹ This concerns both the markets and the state.

In fact, there are a few really existing markets for which the ideal type of free competitive markets is reasonably accurate. Some of these barriers are called market failures, which provide a justification for government intervention (for example public monopolies, public goods, regulation and reduction of transaction costs). However, the major reasons for government involvement in market functions are political and are based on the values of citizens. The state governs markets by allocating resources, through direct intervention and redistributing incomes, because markets cannot carry out political goals and aims. Markets cannot guarantee equal distribution of income, which is an important goal in many countries.

Since Adam Smith the role of generalized morality and ethics in a society has been one of the major themes of the governance of economy. Jean-Philippe Platteau has summarized this discussion as follows: “In fact moral norms act as a substitute for, or a reinforcement of, state-engineered rules or control mechanisms, with the result that enforcement and punishment institutions become of secondary importance. This first function derives from the fact that individuals internalize public good considerations while the second ones arise from their conviction that the law represents the public good. In this perspective, civic consciousness appears as this attitude of respect for law which tends to prevail among citizens who have such a conviction.”²⁷⁰

²⁶⁹ *Simon* 2000, 754.

²⁷⁰ *Platteau* 1994, 756.

In addition to the trust in the official rules – and unofficial norms that support them – markets do not guarantee order without generalized morality and moral norms. These are rules that are at least partially internalized by the agents and prompt them to take other's interests into account. People behave honestly if they have trust in each other's predisposition towards honesty. Their bent to honesty is discouraged by bad and encouraged by good experiences. Because people watch the consequences of their own and other people's behavior towards norms, there must be a state or a rule as a norm reinforcing agency and underlying social consensus that sanctions will be imposed on norm violators. Honest behavior needs support and dishonest behavior has to be banished. Coleman says that obedience of the norms will occur when the sanctions or discomfort are sufficiently great and sufficiently certain to make disobedience less immediately attractive than obedience.²⁷¹ Most important means to moral behavior is internalization of norms and primary socialization. Conformity has to become a motive of its own because it is intrinsically rewarding. The countries with a strong legal tradition trust more on constitutional and judicial methods of order in the markets than on internal individual mechanisms of morality.

There has been a long-lasting discussion of the sources, guarantees, and innovators of moral behavior of men. David Hume was the opinion, that markets – commercial society – can pave way for morality and justice in markets. Adam Smith stressed serious limitations of the self-regulating capacity of the market system. He emphasized that social order of the market must be fabricated within the institutional framework of soci-

²⁷¹ See discussion in *Platteau* 1994, 765-777. Reference to Coleman 1987, *Norms as a Social Capital*, in *Platteau* 1994, 765.

ety, of the body politic, i.e. the state. It has to set norms and activate discussion of the norms of the markets.²⁷² This is the most important task of the state in market governance. The more undeveloped the economy is the more important the norm-setting norm supplier task is.²⁷³

Formal and official mechanisms and institutions, legal and political, do not guarantee efficiency alone. The creation of moral infrastructure is a long-term phenomenon, which cannot be forced and especially it is clear that it cannot be exported. Platteau says: “Unfortunately, generalized morality is not a commodity which can be easily called for as the need arises. It is actually embedded in the historically-determined cultural endowment of a society.”²⁷⁴ This can be seen clearly in literature, which compares different economic and especially capitalistic models.²⁷⁵

Market governance in practice In chapter 3 I emphasized the importance of strategic work in governance. The previous discussion of market governance can be summarized as follows:

²⁷² See a discussion of different models of norm setting *Platteau* 1994, 777-795.

²⁷³ Platteau summarizes this problematic as follow: “Codes of conduct are governed by a limited-group morality which emphasizes the strength of the ties to close social relations; procedural norms, when they exist, are particularistic, professional standards are low; reward and sanction mechanisms (including integration) as well as taxation and subsidies are meted out in a specific ways as to make patronage effective; wealth is currently acquired or redistributed through trafficking, racketeering, plundering, looting, or favoritism, all practices which are almost always accompanied within purview of political power structure” *Platteau* 1994, 799.

²⁷⁴ *Platteau* 1994, 802. See also discussion of it *McAuslan* 1997, 31-33.

²⁷⁵ *Whitley* 1999.

The permanent tasks of the governance in governance of markets are to

- evaluate and monitor the functioning of present market institutions and competition and set rules and institutions that will permit maximum functioning of competitive markets
- evaluate and monitor the demands from the markets to the state for example what regulatory institutions are needed, what are the demands for policies for macroeconomic stability, and is there a need to reform the enforcement mechanisms of property rights
- evaluate the demands from the markets for society (institutions of trust, social cohesion) and coordinate different interests
- analyze future tendencies in international market regulation and deregulation and their effects on national markets and reform the regulation framework
- analyze future development of corporate governance and its regulation or deregulation and make necessary changes
- foster general atmosphere that supports entrepreneurship and risk-taking
- ensure that the legislative and administrative frameworks for the establishment of companies and their functioning are optimal
- support unofficial institutions of the market

The enumerated tasks are permanent in nature. If this kind of analysis is not carried out regularly, markets cannot adjust properly to continuous changes in the business environment, international markets, politics, changing values of the consumers and new technology. The changes in different sectors of industry are not always connected to each other and they are often nonlinear and highly multifaceted. There are peaks of political turmoil and technological inventions. In the 1990's the world experienced a tremendous transformation in most sectors of life. Political and technological revolutions gave new impulses to markets, market institutions and rules of the game.

All countries have their own mechanisms of market governance, which are strongly connected to national power structures and institutional frameworks, which determine and influence these mechanisms. For example in the USA self-regulation of the markets is more common than in European or in East-Asian countries,²⁷⁶ where states have had almost a monopoly of market governance.

Analysis of future trends of international and national markets from a national perspective is the basis in the government's governance strategy for the markets. The analysis demands high policy capacity to foresee future trends, discovery of basic problems in insufficient economic performance of the country, official and especially unofficial market institutions to meet future challenges and – the most important – political power to carry out the necessary reforms. The government must also have power and courage to carry out changes in established power structures. Longevity of industries supports permanence of market institutions, which have connections to political system. Thus the permanence of market institutions is connected with political interests and both of them defend their interests against changes and postpone adaptations in changing conditions, which can rise from technological or global development or from social innovations.

As noted earlier, the 1990s was a decade of fundamental changes in market governance all over the world. The development of regional market integration (in Europe the birth of the EU and in North America the NAFTA for example) and to the collapse of socialist economies are its best examples. Globalization received support from free trade negotiations in WTO.

²⁷⁶ For a general discussion of the role of the state in East-Asian markets governance see for example *Wade* 1990, *The World Bank: The East Asian Miracle*, Economic Growth and Public Policy 1993 and *The World Bank: Rethinking the East Asia Miracle* 2001.

Free trade is fostered on the practical level in all sectors of the markets, but on the general principal level as well. For example the EU and the United States have discussed for years of regulatory cooperation and transparency of regulation.²⁷⁷

Advance of information and telecommunications technology (ICT) has driven more than almost anything else the last decade's economic integration of the markets and change of the markets around the planet. ICT has shrunk geographical distances and increased the speed of communication. It is evaluated that the changes will continue at the same speed in the future.²⁷⁸ ICT is a good example of a driving force, which does not affect only a certain industrial sector, i.e. telecommunications, but all industrial sectors and services, which can get remarkable productivity gains from it. When different industries adopt ICT in their production, marketing and distribution processes, their markets change.

The term New Economy, which was used in the late 1990s, was based on the idea of the fundamental nature of the changes caused by ICT on most sectors of economy.²⁷⁹ Many analysts use new terms such as e-economy, e-business, knowledge economy, and internet-economy/digital economy.²⁸⁰ Even if nobody can estimate exactly the speed and depth of this new phenomenon, every government should evaluate the effects of ICT and draw conclusions of its influence on their national markets

²⁷⁷ See on general *Castels 1996a* and *Castels 1996 b* and *Castels 2000*.

²⁷⁸ General comprehensive analysis of the development *Castells 1996 a*, *Castells 1996 b* and *Castells 2000*.

²⁷⁹ *Leadbeater 2000*, *Digital Economy 2000*, 2000, 43, IMF: *World Economic Outlook 2000*, 70-79. OECD: *A New Economy?* 2000, *Nordhaus 2000*, *Sahlman 1999*, 99.

²⁸⁰ *Tapscott, Ticoll and Lowy 2000*, *Blueprint to the Digital Economy*, 1998, *Tapscott and Caston 1993*, *Schiller 1999*. See the electronic commerce site of the US Department of Commerce (<http://www.ecommerce.gov/>) (visited 29.11.2003)

and market governance. The World Bank is working actively and helping countries in this field. It emphasizes the role of governments in fostering transformation of economies into a knowledge economy, where future growth is based on knowledge.²⁸¹

Adaptation of ICT in business, fall of national borders and deregulation of national markets have produced a new kind of global economy. Characteristic for this is rapprochement, not disappearance of national markets and unification of the markets regulation in industrialized countries, but harmonization. Participation of governments in this harmonization process is based on the view that only this can safeguard long term competitiveness of the firms in the markets. In 1990s the process was going on mostly on the regional level.²⁸²

Harmonization of governance models of the markets is an outcome of the fact that in the present open, borderless markets the firms are already free to look for best locations for their purposes. Globalization has increased the international competition of the companies among nations.²⁸³ This forces states to develop a market governance strategy that is based on their national advantages. The basic premises for this are:

- the government is responsible both for macro economic balance and for the prerequisites of microeconomic competitiveness of the companies

²⁸¹ See a report from China: *Dahlman, Aubert* 2001.

²⁸² In Europe the European Union is the key player in this field. It publishes annual reports of the competition policy in Europe. These reports and the internet-site of the Competition Directorate of the European Commission are a good source of information. See (<http://europa.eu.int/comm/competition/publications/>) and (http://europa.eu.int/comm/competition/annual_reports/) visited 29.11.2003.

²⁸³ See for example *Dunning, Kogut, Blomström* 1990 and *Akbar and Mueller* 1997, 59-81.

- the government has a significant role in creating the platform from which companies compete
- the government does not interfere in the markets by supporting the national bases of the economy but supports competition in the quickly changing markets
- the government is responsible for supporting innovation, entrepreneurship and profitability
- adaptation of uncertainty through flexibility
- fostering national interests through safeguarding the international success of companies in the international markets
- active participation in market regulation on the international level and
- evaluate social effects of market globalization and draw national action plans to minimize the negative effects on the lives of people.

However exactly the governments try to foresee major principles of the new system, there will always be unforeseen outcomes that cause permanent or temporary disturbances. Crises will spread their effects into all sectors of life. A sharp downturn of the businesses will quickly diminish public income and increase unemployment, political instability and cause social unrest. In highly globalized markets the possibilities of the government to counteract and steer the crisis are more limited than in highly national markets. The governance of the deregulated markets in global economy demands new kinds of knowledge and strategies from the governments. There is also need for international co-operation.

4.2. Governance of well-functioning society

Specificity of society Society has been raised to an important theme in governance analysis in the late twentieth century. It is not possible to study all reasons for the emergence of civil society in the discourse of political governance here, but only to refer to some long-term trends in the changing relations between the state and society. It is essential to discuss society because in the 1990s the citizen's trust on the state's capacity to manage economy and social development has diminished in most advanced industrial countries. Recent erosion of confidence on the state has forced governments to find a new, more efficient and legitimate balance between different actors of state, society and economy.²⁸⁴ Civil society plays an important role in the monitoring of the government by improving accountability and voice mechanisms.

However, from the perspective of governance, society is not an easy problem, because society is a broad and many-dimensional conception. This makes it difficult to find coherent solutions for our trial to improve the relations between the state and society, even if we knew that the problem is at the same time an outcome of the growing responsibility of the state in the governance of society, and later deregulation of markets to foster globalization and to improve economic efficiency. Both of these trends have decreased the autonomy of individuals as masters of their own lives in the twentieth century. We cannot just say that we have to transfer tasks of the state to society, because we do not know what is society. What would be the effects of the deregulation of markets and transfer of market governance to the global level? What does it mean, when we say, that the state must not interfere in the functions of society? Or, what it does

²⁸⁴ See discussion of the birth of the discourse of society *Hyden* 1997, 3-30.

mean, when we say that society should control the state more and that citizens should improve the accountability mechanisms of the government?

General characterization of society can refer either to social associations composed of individuals or to a distinct system of social relations. Quite often societies are connected to a nation-state, though at present it is common to see that societies do not limit themselves only to nation-states but widen themselves into global level also. At the level of a nation-state society is normally understood to be composed of those civic communities that belong neither to the markets nor to the state, because in society the mechanisms of order differ from that of markets and bureaucracy.²⁸⁵ The normative order and virtues in society are based on integrity, trust, civility and sympathy.²⁸⁶ In liberal theory society is seen as a self-regulating, uncoerced activity not created by the state and virtually independent of the state.

The structure of society is heterogeneous, because it is composed of individuals, citizens, organized associations and unorganized communities. Society is an arena of formal and informal organizations.²⁸⁷ Expressions and abbreviations like family, clan, tribe, “the third sector”, “NGO”, “civil society” and “free society’ give a hint of the manifold building blocks of society.²⁸⁸

Characteristic for society is that order in society is sustained without centralized, hierarchical forms of governing or without competition, which is the mechanism of markets. Hierarchy and power, which are the mechanisms of the state, are not typi-

²⁸⁵ Aristotle’s *koinonia politike* is often quoted as the classical source of civil society, because its translation (societas civilis).

²⁸⁶ For a discussion of different meanings of civil society see *Cohen and Arato* 1992 and *Civil Society and State* 1988.

²⁸⁷ See discussion of formal and informal organizations *Barnard* 1968, 65-126.

²⁸⁸ See for example *Paradoxes of Civil Society* 2000, *Cohen and Arat* 1992 and *Pierson* 1996, 64-70.

cal features in society, though all formal organizations have hierarchies and power structures. In spite of this network and trust are major bases of order in society, because membership in the organizations of society is voluntary. Networking, trust and voluntary participation are the major operating codes of society.

Rupture is a typical quality of all social organizations of society. It is in opposition to the long lifespan of the institutions of the state.²⁸⁹ This characterization of social organizations and of order in society is naturally a simplification, which does not do justice to the present situation in any country. It is more a general idea of the historical transformation from a traditional community (*Gemeinschaft*) to society (*Gesellschaft*) in Europe in the late nineteenth century.²⁹⁰

When we discuss society from the perspective of governing, it must be seen as one of the major pillars of modern democracy. Jean Cohen and Andrew Arato have defined a catalog of crucial features characterizing society. Families, small group associations, networks and associations cannot function unless freedom of society is protected through legality, i.e. structures, general laws and basic rights needed to demarcate plurality, privacy and publicity. Society cannot function without the principle of publicity, i.e. institutions of culture and communication. Plurality, i.e. autonomy of different informal groups and voluntary association, which allow variety in forms of life, has to be accepted and protected. Privacy, i.e. a domain of self-development and moral choice, safeguards different opinions.²⁹¹

Jürgen Habermas' discussion of democracy and civil society has similar emphasis as Cohen and Arato's. Because he repre-

²⁸⁹ For discussion of order principles of society, markets and state see *Markets, Hierarchies & Networks* 1991 and especially *Streeck and Schmitter* 1991, 227-241.

²⁹⁰ See *Tönnies* 1957.

²⁹¹ *Cohen and Arato* 1992, 346.

sents the discursive theory of democracy, society has an important position in his theory. The interests of people are in society and society is the forum for discussion and debate. His interpretation is more realistic than the typical discourse of networking and small-scale organizations of civil society. According to Habermas society is not only a collection of equal small groups, but is dominated by mass media and large agencies, observed by market and opinion research, and inundated by the public relations work, propaganda and advertising of political parties and groups. However, “freedom of assembly and freedom of association, when linked with freedom of speech, define the scope for various types of associations and societies: for voluntary associations that intervene in the formation of public opinion, push topics of general interest, and act as advocates for neglected issues and underrepresented groups; for groups that are difficult to organize or that pursue cultural, religious, or humanitarian aims; and for ethical communities, religious denominations, and so on. Freedom of the press, radio, and television, as well as the right to engage in these areas, safeguards the media infrastructure of public communication; such liberties are thereby supposed to preserve an openness for competing opinions and representative diversity of voices.”²⁹²

Typical early 21st century discourse of society concentrates not so much on such structural features and preconditions, which safeguard participation of society in political discourse, as on local networking and moral bases of grass-root influence. Both types of discourse are important. The values of citizens are born and nurtured in the lifeworlds of individuals through associational networks. These values are channeled to public opinion-and will-formation through mass media. Freedom of the press and guarantees of plurality are needed to safeguard the free functioning of local associations and networks.

²⁹² Habermas 1999, 367-368.

So far I have discussed the situation in advanced industrial countries and democracies. The governance principles of civil organizations in developing countries are more dispersed, because the organization structure is quite different. The more traditional a nation is the more local, dispersed and unorganized the society is. Division between the state, market organizations and organizations of society is blurred. In some cases the state may still rely on traditional patrimonial governing methods. Society is not composed of formal, but mainly informal organizations, such as families, tribes, clans, language groups, loyalty networks of local and regional warlords and landlords and the like. According to Migdal, the state distinguishes itself from these mainly through seeking predominance over those myriad other organizations.²⁹³ These traditional organizations still follow strongly patrimonial loyalty ties.²⁹⁴

It is natural that both developed and developing countries have small scale and local network based organizations, but besides these, there can also be strong para-military hierarchical organizations, which through their social control – personal loyalties, kinship ties, common regional origin, shared ethnic, tribal, or sectarian backgrounds – can be even more important and effective in local and regional governing than the state. Their strong leaders (Migdal call them strongmen) can mobilize resources more effectively than the government and thus force the state to act under their will.

However, the history of mankind is a history of institutional and organizational establishments and their change. The more developed a society, the more subtle and established its institutional network. This is described (Ferdinand Tönnies) as development from a community (*Gemeinschaft*) to organized society (*Gesellschaft*).²⁹⁵ This development process can be seen

²⁹³ *Migdal* 1988.

²⁹⁴ *Bendix* 1960, 330-381.

²⁹⁵ *Tönnies* 1957.

in the difference between advanced industrial countries and developing countries not only in organizations of society, but also in diverse market organizations and administrative capacity differences.

Individuals are the main actors in all societies (*civitas*). They have different roles. When individuals use their political rights and participate in political processes – vote, hold offices and participate in collective decision-making - they are citizens, *civis* (for Aristotle *zoon politikon*). Citizens form parties and associations, participate in political debate, bear obligations (get drafted, pay taxes, obey laws and otherwise fulfill one's obligations to the state) and enjoy different kinds of rights. People belong to the political society when they organize themselves for political contestation, to gain control over public power and the state apparatus.²⁹⁶ People are alone when they cast their vote in ballot box, but members of an association, a network or a party, when they carry out their ideas and interests.

As individuals people grow and educate their children and form informal networks with their relatives and friends. Families socialize people and teach them moral sentiments, and the system of education familiarizes them with the cultural system. Emotional ties, manners, morals and virtues are socialized in families and in their neighborhoods, where people also participate in religion. People form formal associations and engage through them in the activities of the civil society. Families, newspapers, art, religion and NGO's are examples of official and unofficial forms and institutions of society. People create moral codes through civil engagement as individuals, citizens and collective actors.

²⁹⁶ Stepan 2001, 8. See a brief but informative discussion of the term and its use in historical contexts *Himmelfarb* 2001, 30-44 and *Democracy and Association* 2000.

The difference between civil and political society is principal and important. This difference received special interpretation in former socialist countries, when civil society organized itself as an opposition to the official party system that was part of the official power structure. Opposition towards the former communist state was possible only outside political society and political organizations. Civil society was born as an institution against the state and it was virtually independent of the state. In Poland civil society was formed as an opposition towards foreign controlled state authority (the Moscow dependent party-state). Besides this feature Stepan, who has studied civil society, emphasizes that in Poland civil society was connected to the discourse of truth. Civil society represented truth in opposition to official truth, the party-truth of the state. Civil society organizations represented politics of anti-politics.²⁹⁷

Stepan is critical of a development, where civil society organizes itself as opposition to political society. There should not be a false contradiction between them, as both are needed. "A robust civil society, with the capacity to generate political alternatives and to monitor government and the state, can help transition to their completion, help to consolidate and help to deepen democracy."²⁹⁸ In Scandinavian countries political parties and organizations of society (associations, parties, and labor unions) were born at the same time in the late nineteenth century as the major actors of the modern liberal democratic political system.²⁹⁹

²⁹⁷ Stepan 2001, 173-174.

²⁹⁸ Stepan 2001, 175.

²⁹⁹ See of Scandinavian model *The Scandinavian model: Welfare States and Welfare Research* 1987, *Comparative Welfare Systems: the Scandinavian Model in a Period of Change* 1996 and *Nordic Democracy* 1981.

Diamond's conception of society and of its tasks supports Stepan's stand. The discourse of relations between the state and society is emphasized especially in the USA, where the discourse of autonomous and active associations of society has a long tradition, arising in the late eighteenth century. Tocqueville described it for the first time in an excellent way already 200 years ago (*Democracy in America* 1835). In this tradition society is seen as a forum between political institutions of representation and the individual. According to Diamond the task of society is to strengthen democracy by 1) containing the power of the state through public scrutiny, 2) stimulating political participation by citizens, 3) developing such democratic norms as tolerance and compromise, 4) creating ways of articulating, aggregating and representing interests outside of political parties, 5) mitigating conflict through cross-cutting, or overlapping interests, 6) recruiting and training political leaders, 7) questioning and reforming existing democratic institutions and procedures and 8) disseminating information.³⁰⁰

The discussion so far has shown that society is not a separate sector, but keenly connected to the markets and the state. Organizations and mass media are central mediators between the official systems of power and citizens. Society is a broad concept, composed of single individuals, as citizens, as economic actors, and political and civil associations, mass media and other similar large organizations being the most important. In making business and stepping into the role of an economic man an individual is acting in the markets. He gives will to the companies and the markets. He acts in the role of consumer, employer and employee in the markets. In political elections he has the role of a political man. The authority of the state to steer the markets and society is based on the will of the people as political actors.

³⁰⁰ *Diamond* 1994, 6.

Society and its main actors, individuals, define the values and moral codes for public administration and the markets.³⁰¹

Governance of society The question of governance of society is connected to the multiple nature of society. Who is responsible for developing principles for the functioning of society? Is it a task of the government or society itself? If the task belongs to society, how is it done, because society is not organized for that purpose? How strong a role the state can take in regulating society and its organizations?³⁰² How can citizens' competencies be developed to meet the challenges in giving their input in the democratic process?³⁰³ Though general differences among the nations are enormous, the diversity of models and attitudes is valid especially in models and roles of society in democratic process. One thing is clear, development and governing of a well-functioning society will be based on open and comprehensive discourse.

Although the state is responsible in launching and moderating the discussion and in helping in strategy formulation on professional grounds and from the perspective of general good, the main responsibility of strategy formulation belongs to the society itself.³⁰⁴ The state has to act as a mediating force between the individual and the state, but also as a moralizing force for both the individual and society. Gertrude Himmelfarb says, "If civil society is to become an effective instrument of social mediation and reformation, it will have to reaffirm the moral principles that give it its distinctive purpose." Exercise of authority in

³⁰¹ See discussion of moral obligations *Wolfe* 1989 and *Selznick* 1992, 387-427 of the role of the state in moral regulation and of the importance of communities 355-386.

³⁰² *Yishai* 1998, 153-176.

³⁰³ *Citizen competence and democratic institutions* 1999.

³⁰⁴ Discussion about the state's role as moral agent see *Wolfe* 1989, 107-122 and 212-236.

society according to Himmelfarb should be psychologically and morally coercive, but not physically, as the legal sanctions are imposed by the state.³⁰⁵ The more effective the social sanctions are, the less need there is for legal regulation. But, as the implementation of moral principles demands official regulation, there is a need for government involvement.³⁰⁶

Political and economic traditions are the main reason for different societies and society traditions. I already referred to the USA as a nation of especially strong associations and citizen's own responsibilities. Even Toqueville did not distinguish as sharply the difference between civil and political realms as is generally thought nor does he give the primacy to civil society that is commonly attributed to him.³⁰⁷ In a similar way Europe bears quite strong state traditions and state hegemony over society.³⁰⁸ In continental Europe France and Germany are its main representatives. The Swedish tradition is characterized by weak civil associations and a strong state. Especially after the Second World War most European countries have transferred responsibilities from individuals and families to the state and to the public sphere. In former socialist countries there was no room for civil associations at all.

From the 1980s onwards most OECD-countries have started reforms in the public sector and in market regulation in such an extent, that the long-term division of labor between state and society has changed in a fundamental way. States have launched reforms, which have transferred some of their responsibilities to individuals, markets and society. This tendency is based as much on the fiscal constraints in the state budget as on the results of

³⁰⁵ *Himmelfarb* 2001, 37.

³⁰⁶ Examples of the role of the EU in moral regulation in Europe see *Kurzer* 2001.

³⁰⁷ Discussion about it *Himmelfarb* 2001, 60-61.

³⁰⁸ *Paradoxes of Civil Society* 2000.

the studies of the impacts of strong state responsibility in the field of social services on economic growth.³⁰⁹

Though the discourse of the role of the state has emphasized retrenching perspectives during the two last decades of twentieth century, the state is still a crucial actor and has vital governance tasks. Not even globalization has pushed the state into the background. Researchers have raised the question of relations between the civil society and the state. Recent studies (Robert Putnam) show that a living civil society demands a capable state and civil society needs a competent counterpart. Even if the state does not use its authority in full in governing society, the state is responsible for overseeing and supervising development in society. It cannot leave it to the responsibility of citizens alone. Robert Putnam, who is the most famous student of civic engagement and a proponent of civic vibrancy and social capital, argues, that “civic associations are powerfully associated with effective public institutions ... strong society, strong state.”³¹⁰

Peter Evans emphasizes that studies from the developing world show that on the micro level state agencies have the responsibility to foster sufficient esprit de corps and bureaucratic sophistication. When state agencies work together with local social groups, state-society-synergy will spring up, and this will produce better results than working separately.³¹¹ Joel Migdal has a similar message from the studies of developing countries. From his perspective the situation is critical, because his studies have shown that strong societies with very traditional patrimonial bases of order are major obstacles for the government to

³⁰⁹ See *Tanzi, Schuknecht 2000*

³¹⁰ *Putnam 1993*, 176. Referred in *Evans 1997*, 80. See discussion of the relations between civil society and the state *Evans 1997*, 79-82.

³¹¹ *Evans 1997*, 81.

meet their political goals. Their governance capacity is limited by the social organizations.

The role of the state in civil society is manifold in all countries, whether they are advanced industrial or developing countries. The state is not only a team leader, which produces *esprit de corps*, but above all a sovereign legislator, which has been empowered to protect the civil rights of the people, represent general will and define the rules of the game and the institutions of society. Public authorities have to guarantee the observance of basic rights and liberties and human rights.³¹² Guarantee of these rights serves as the necessary frame for the development of a free society.

Discourse of a new governance regime The division of labour between the state, markets and society/individual is reflected in the role of the government in the political governance of society. The bigger the public expenditures on social services are, the more responsibility the government has in the life of individuals. A part of the long lasting public sector reforms in the OECD countries in the 1980s and the 1990s was a redefinition process of the correct role of the state in steering and regulating society. It was not only a process of internal decentralization of government and deregulation of markets but also an increase of the responsibilities of citizens and society. The full realization of this policy shift requires that people have a new kind of independence in their actions, initiative and entrepreneurship as

³¹² Most important of the rights and freedoms are right to life, personal liberty, integrity and security, freedom of movement, the right to privacy, the secrecy of correspondence, telephone and other confidential communications, freedom of religion and conscience, protection of property, the right to work and the freedom to engage in commercial activity, electoral and participatory rights, freedom of expression and right of access to information and freedom of assembly and freedom of association.

well as co-operation and shared responsibility. As a whole they need the will to help their fellow citizens and social innovations.

It is not possible to get results by encouraging citizens' own initiatives and demanding them to take responsibility of their own life after a long-term regime of public responsibility (discourse of welfare state or great society). In most advanced industrial countries the tasks and responsibilities of the state have increased after the Second World War. The transition from strong public responsibility, collective security, predictability, care and reinsured contracts towards individual responsibility, solidarity, and particularism is not easy. Researchers have described this development with the term life policies or life politics, which concerns the way people make decisions that affect their own lives and also decisions that fundamentally affect these decisions.³¹³ This discourse represents a long-term regime change, and it cannot be based only on short-term fiscal problems. Economic and ideological arguments should support it, because the transformation from an up down governing regime to a network based governance regime concerns deep-rooted national traditions. These are fundamental questions of political culture and changes in them demand unity and action in different fronts. We, at present, only experience the start of the discussion.

In spite of the difficulty to shift the attitudes from collective responsibility towards individual responsibility, discussion of the effects of globalization, dead of socialism and financial crisis of welfare states are first marks of the turn. Anthony Giddens's and Ulrich Beck's analysis of the new forms of future individualism, choice, ethics, reflexivity are inputs of academia in this field. Beck has used the term institutionalized individualism of the change process. It is associated with the retreat of tradition

³¹³ *Roos* 1999.

and customs from our lives. It is not the same as market individualism or atomization, but a phenomenon, where people are invited to constitute themselves as individuals: to understand and design themselves as individuals. In Giddens's new discourse of life policies "we have to make our lives in a more active way than was true of previous generations, and we need more actively to accept responsibilities for consequences of what we do and the lifestyle habit we adopt. The theme of responsibility, or mutual obligation, was there in old-style social democracy, but was largely dormant, since it was submerged within the concept of collective provision. We have to find an new balance between individual and collective responsibilities today."³¹⁴

J.P. Roos has analyzed the use of the term and found its roots in many directions. Changes in the world of consumption, and pressure from the diminishing resources of welfare state and social transfers emphasize individual responsibility, reciprocity, and turn back areas of public responsibility to private individuals. This creates a possibility of new sociability, and new intermediate institutions. On the other hand life politics could be individual in nature. Social decisions and negotiations about the life's course, life chances, relationships, self-realization, happiness and misery and well-being belong to the responsibility of the individual.³¹⁵

Students of social policy and sociology say that the above-mentioned principle *no rights without responsibility*³¹⁶ would demand a reformation of the basic propositions of Western welfare states, especially its Scandinavian model. On the other hand,

³¹⁴ Giddens 1999, 36-35. Citation in p. 36 and reference to Ulrich Beck on p. 35.

³¹⁵ Roos, J.P. Life politics: more than politics and life (style)? In: <http://www.valt.helsinki.fi/staff/jproos/sicinski.html> (visited 29.11.2003.

³¹⁶ Giddens 1999, 65.

stronger individual responsibility – so-called social liberal model - has been a reality in many Western countries, for example in the USA. It had quite strong support in Nordic countries before the collective ideology of the welfare state was adapted as an official ideology. Present analysis of the future threats and trends refers to the growth of responsibilities of an individual and his/her responsibilities to from his/her own life.

International financial and development organizations meet a different situation in most developing countries, which lack most fundamental public services. When people do not have resources for their basic human needs, it is absurd to speak about turning back areas of public responsibility to private individuals. In most developing countries the state has to take responsibility for things that cannot be taken care of in society. When welfare organizations – formal and informal – are not well developed, the state has to develop their capacities and take more responsibility in managing the situation. For this purpose the state needs a governance strategy. On the other hand in quite many developing countries the state's capacity to make and enforce the rules that guide people's social behavior and protect their civil rights are limited when compared to local and regional leaders. In these cases the state is weak compared to strong patrimonial societies, which have not abandoned their traditional power position. The government needs a strategy for this situation as well.

The governance of civil society is one of the most complex political, philosophical and technical tasks of institution building and political governance. The scope of the task is multiple and delicate. The situations in different countries are dissimilar, which could be seen clearly from the previous discussion. One thing is clear: the discussion of the role and the tasks of the state is political in nature, though there are technical considerations, which should be taken into account when discussing it. People

and political actors do neither have unanimity of the role and authority of the state in society nor the position of an individual. Political actors have conflicting views even of the basic propositions. For some people and thinkers society is a free realm, into which the government cannot interfere in any way and for the others it is the realm of the basic human rights.

Most institution building tasks of governance of society demand that government collects signals of the functioning of present governance systems, of quality of life and level of living of people, launches discussion of these questions, uses authority, fosters participation, strengthens institutions, analyzes the effectiveness, efficiency and sustainability of institutions of governance, and from detected material makes choices between different governance methods. In some cases it is feasible to pass laws and establish law enforcement authorities. Sometimes the governance of society demands education and moral awareness campaigns. If the reform of governance principles of society is so comprehensive in nature that public responsibilities are transformed to citizens and their organizations, the government must act on consensus with as many actors as possible.

Public discourse of governance has to be based on the values of society. Question of collective vs. individual responsibility, participation, solidarity, moral discipline and obligations are examples of these themes. Relation between manners, morals, and of both with the laws is also a part of that discussion. An example of this discussion is the question of moral authority. What is the role of law and other authorities in setting moral principles? Today laws have become the only recognized authority in moral obligations and ethos of society.

Solutions to these questions will be found in everyday practices of families, activities of associations, moral infrastructure of society, development of solidarity and moral obligations of the citizens, their public awareness of their responsibilities, and de-

velopment of organization and disorganization of society. A high level of corruption and crimes, violence and collapse of order are expressions of lacking ethos of society and bad governance of society.

Discussion so far has shown that political leadership must be aware of the state of ethical infrastructure of the country and of the key questions of public discourse concerning their reformation. The government has to base its program on the spirit and ideas of citizens. Because the government is accountable of its decisions to citizens as voters, the government is responsible of forming the Soulcraft to Statecraft – using the expression of George Will.³¹⁷ For Himmelfarb this is a mission where the government shapes the character, and hence the soul of a people, not merely of individuals. In our terminology, this is the essence of the governance of civil society.

4.3. Governance of political institutions and processes

The nature of the task The term political governance regime refers to a discourse of fundamental change for the present up-down political governing regime and its principles. In this chapter I will discuss the framework of how such a regime could be constituted and how its principles could be defined. The chapter helps us to relate the discourse of regime change into the framework and propositions of present governing model. The subjects of the chapter are political processes and principles of the present regime of political governing and discussion of the new regime of governance. I ask what it means to step from the

³¹⁷ Will 1983. Referred from Himmelfarb 2001, 83.

governing of political institutions to the governance of political institutions? The expression governing of political institutions and practices refers to the present model and the governance of political institutions is the term for the new discourse.

The subjects in governing or governance of political institutions are not only political institutions, but also political processes, which create frameworks for the governance models of the market and society. Even if this takes place inside the state, it creates general conditions for national success and well-being of citizens, prosperity to economy and society. Governing of political institutions concerns basically the architecture of the state, i.e. building and reforming the constitutional framework of political governing and governance of state. Giovanni Sartori calls this constitutional engineering.³¹⁸ Sometimes it is called a process of institutional designing.³¹⁹

Governing of political institutions is a constitutional theme, because the division of labor between legislative and executive organizations and between government and administration are defined in constitution. There cannot be unclarity amongst citizens and business on what are the decision-making structures, power relations, and political accountability mechanisms in political governance. Regardless of national differences in constitutional structures, the main responsibility of the governing of political institutions – building and reforming the constitutional architecture of the state – belongs to the political government of the country.

Irrespective of its the constitutional nature the governing of political institutions is not only a task of constitutional engineering, because constitutions are interpreted in continuous political practice and interpretations are derived from political

³¹⁸ Sartori 1996. See also Schneider and Ingram 1997.

³¹⁹ *Institutional Design in New Democracies* 1996. See also *The Constitution of Good Societies* 1996

culture. Political culture is a kind of intermediary factor between the long-term written constitution and daily pressures from political society, civil society and the markets.³²⁰ Political actors interpret the demands of current power structures, values of citizens and international pressures at a given time to slowly and incrementally changing political practices. Though political culture and constitution do not necessarily correspond to each other word by word, they cannot be in clear contrast to each other either.

A basic goal in the governing of political institutions is to build such structures, which serve governance of markets and society on a permanent basis and provide an enabling environment for long-term economic, social, fiscal and personal security and create conditions for nurturing institutions and processes of the markets and society. Basic principles in the process of governing of political institutions are to set up institutions and to create frameworks for decision-making in such a way that serves public interests and general will, not partisan needs and goals.

The goals for this work are derived from the principles of good political governing and good political governance. The World Bank has set three goals for good governance. They are (i) empower citizens to hold governments accountable through participation and decentralization, (ii) enable governments to respond to new demands by building capacity and (iii) enforce compliance with rule of law and greater transparency. These aims can be reached only through a durable and inclusive system of political representation.³²¹

After permanent political governance structures and policy processes³²² are formed and established they have to be con-

³²⁰ Of political cultures see *Almond, Verba* 1963.

³²¹ World Bank: *Can Africa Claim the 21st Century* 2000, 64.

³²² *Hill* 1997, *Dror* 1986 and *Dror* 1971

stantly maintained and monitored. Changes in the values of people, transformations in the international system, and even in technology, economic and social institutions outdate political practices and institutions, which demand continuous updating. Even if political governance structures and institutions are long lasting in nature, their efficient functioning demands maintenance and incremental care.

Democracy is only one element in the governance process. Principles of openness, transparency, accountability and control are values and practical principles, which support democracy. They are criteria, which are used when the tasks of the state are defined and the division of labor between political institutions is specified and accountability and control mechanisms and political processes are defined. Preconditions for success in markets and society are violated in a fundamental way, if the actors of political society, market and civil society cannot follow and monitor political governance and keep it accountable. In the same way citizens must have the right to be aware of political processes and have the last word in political guidelines and goals.

The architecture of the state is an outcome of a long-term development, unless revolutions or other similar fundamental upheavals produce a fundamentally new political system. The latest examples of fundamental systemic changes are from the 1990s, when former socialist countries abandoned the socialist system and adopted a political system based on liberal political democracy.³²³ After the collapse of the Soviet Union, the democratization process has spread into many developing countries.

³²³ See analysis of the recent political changes in the 1990s *Developing Democracy* 1999 and *Linz and Stepan* 1996, 235-458.

Because diffusion of good models from abroad in economic and political terms sets pressures to the rapprochement of systems, political systems change by means of evolution. A basic reason for this is the importance of political cultures and traditions, which are filters, which all innovations have to pass. Even if pressures are coming from abroad and from technological changes, traditions transform the innovations into past practices. European integration is a good example. Integration has increased unanimity of politic systems in member states of the EU. The role of national parliaments in legislation has diminished in all countries, because the institutions of the EU (the European Commission and Council of the European Union) have received legislative powers, which formerly belonged to national parliaments. However, national traditions are reflected in the national interpretations of this integration. In the same way increasing international political cooperation has increased the responsibilities of prime ministers at the international level and has strengthened the position of prime ministers – or government leaders – in national governments and in internal politics in all countries.³²⁴

Intensified international cooperation and building of global governance systems³²⁵ in different fields have intensified the diffusion of national governance ideas across borders. The growing tendency towards the harmonization of governing systems does not necessarily destroy national identities and national interpretations of general and international governance models. Studies of economic development have shown that political institutions matter. They must be adjusted to the needs of the day. In a similar way studies of corruption show that political institutions are extremely important in determining the incidence of

³²⁴ See *Cabinets in Western Europe* 2002.

³²⁵ See *Managing Global Issues* 2001.

corruption. New sources of corruption have to taken care of in constitutional design and reform.³²⁶

I cannot discuss constitutional questions and principles of political architecture of state in detail, but only raise some themes that are relevant from my perspective and for the current theme of governance. Democracy, accountability and efficiency of governance are crucial and to somewhat contradictory principles. Their combination raises the relationships between the state and society into an important position. It has been claimed that efficiency demands certain autonomy and independence of the state from markets and society. Democracy and accountability bring the state back from its independence in the hands of the citizens. To what extent the state should and can have autonomy in relation to the interests of citizens, society and markets?

Autonomy of the state is one of the most critical questions of governing of political institutions, because new discourse of governance emphasizes networking and the up-down nature of governance in contrast to traditional hierarchical commanding-type governing.³²⁷ Democracy demands effective government, but not too strong and not too uncontrollable. Experiences of Soviet style government show concretely the need for control of government. The theme of state autonomy concerns directly principles of democracy and accountability.

Democracy and accountability cannot be subdued in the name of efficiency of governing or autonomy of the state and – correspondingly - they cannot be obstacles for the efficient gov-

³²⁶ For example a recent study of corruption showed, that after political institutions are accounted for, variable usually found to be important determinants of corruption

- such as openness, wages in public sector, and legal tradition
- lose virtually all their relevance. *Lederman, Loayza and Soares* 2001.

³²⁷ Discussion of the theme see *Evans* 1995 and *Evans* 1992.

ernance capacity of the state. Relations of one hand political leadership, which represents special interests, values and direct will of citizens, and on the other hand civil servants, who represent general will, professionalism and continuity are examples of these questions. Corporatism is another example of the same problem. If corporations receive too strong a position in political decision-making, the government's freedom of action will be limited. If a government has too close relations to business interests, its legitimacy as driver of general will weakens. In real democracy there cannot be a discussion of what is the best democracy money can buy.

The rules of the game belong to the body of every governing system. For example strategy of regulation is one of these rules, which are never decided, only followed or sometimes changed. Loose regulation and detailed regulation are its opposing poles. The rules of the game of regulation are important when countries discuss governing. How to safeguard democracy, political accountability and control if a country loses its regulation strategy? Deregulation can increase the efficiency of governing, but it can hinder democracy. On the other hand a strictly regulated constitution, which is difficult to change and which protects strongly the rights of minorities, can prevent and block necessary reforms in economic turbulences.

If constitutions are not concrete enough and they do not have practical solutions for governance of markets, society and state necessary interpretations have to be made in political practices and processes. Regardless of how concrete the constitution is, political governance practices are producing all the time interpretations of the principles of democracy, general interest, accountability, control, transparency, and the rule of law, which are the basic questions in the governance of political institutions and practices. The interpretations are born from the pressure of changing markets, values of people, technological development,

foreign political and administrative models, ideological changes and changing global governance practices.

One of the central themes of governing political institutions is the definition of general principles for the implementation of the governing regime in general and especially for the use of state power and division of labor between major public institutions. The rules of interpretation and the basic values of the political system are more permanent than ever changing practices. For example if permanent principles of democracy in political governing are followed, democracy will be one of the major themes in the discussion of globalization. It will be set in democratic frames by integrating it into a national political system. The role of national legislative organs in the globalization process should be defined from the perspective of political democracy. Global governance will receive democratic forms unless globalization does not give rise to a discussion, which will change the rules of the game in a fundamental way and end in the reform of political governing.³²⁸ In the same way present growing involvement of new non-state and non-governmental actors - profit seeking and non-profit actors – in the international and transnational interaction has challenged present national governance systems.³²⁹ The discourse concerning political institutions and practices has to launch a discussion of and find a solution for this problem. It must take care of the considerations of democracy, participation, efficiency and accountability.

³²⁸ In most countries the role of legislative bodies in global governance has already been raised. Present process of globalization and increased internationalization makes it difficult for the governments to safeguard full participation of the national parliaments in the global governance processes between the governments.

³²⁹ See a study of participation of non governmental actors in national and global process of governance, negotiations and knowledge formation *Restructuring World Politics: Transnational Social Movements, Networks, and Norms* 2002

The actors I have discussed the governance process of political governance without defining the principal actors and responsibilities. Who has the responsibility to evaluate the capacity of political institutions and political processes to reach the goals set in elections effectively? Does it belong to government, parliament, political society, civil servants or civil society? Is it a part of political governance or a meta-level responsibility? What evaluation and monitoring methods are used? These questions are at the heart of democracy. There are no simple and unanimous answers. According to March and Olsen's principles the answer can be based only on democracy and should be discussed in government, parliament, academia, political society, civil society and administration. It is the responsibility of all citizens. It cannot be left only to specialists of political science, constitutional lawyers and politicians. If citizens are not integrated into the discussion, lack of trust amongst citizens in politics and politicians and citizen's alienation from politics will grow. Weak participation in elections and political discontinuity indicate a legitimacy crisis.

Think tanks and universities have an important role in producing analyses of the state's governing of political institutions. Their independence of its daily practices gives them political responsibilities and wide horizons to evaluate the problems. They have comparative information of future trends and challenges of governance. Even if they do not know all the facts of present practices of governance as well as governments, they have an important advantage: they are independent from these practices and thus free to raise new challenges and discuss problems from sustainable bases. Governments have similar information, but as participants of governance practices they are too near and too strongly engaged in the practices to see long-term perspectives. They are also too dependent on the special interests of their constituencies. Besides, political and intellectual in-

terest connected to present political structures set obstacles to analyze all future challenges. Even if the governments have willingness to analyze the challenges, self-evaluation has always objectivity limitations. The gap between existent capacities and demands of long term change is in most cases difficult to catch up.

One form of this permanent responsibility of government to update governance of political governance is the maintenance of public discourse. Some countries have arranged permanent evaluation and monitoring systems of the state of democracy in the country. Though governments cannot carry objective evaluations, they should create conditions for that kind of work. For example in Sweden,³³⁰ Norway³³¹ and Denmark³³² governments have occasionally set up broad committees, which evaluate the

³³⁰ The Government of Sweden set up in 1997 a committee to make a study of the state of democracy in Sweden. The report published in 2001. The final report *En uthållig demokrati 2000*.

³³¹ The Government of Norway has started a study project Power and Democracy 1998-2003. Its main theme is the conditions for popular political participation in Norway, and changes in these conditions as a result of internationalization, development of new technology, environmental challenges, privatization, decentralization, gender equality, the mass media, the multi cultural society and the information society.

³³² In 1994, the Danish Parliament formed a special committee "regarding an analysis of democracy and power in Denmark." The committee issued a report in the spring of 1997 in which a majority of the committee members recommended a Danish democracy and power study. Later on it was set up a committee to make a study (*Democracy and Power Study*) of the function of democracy in broad terms, including the influence of power structures in organizations and movements and the economic power structures on society, as well as the consequences of internationalization as far as transparency and visibility of decisions, influence and power in society. (<http://www.ps.au.dk/magtudredningen/Engelsk/frame.htm>) (Visited 29.11.2003). First publication of the Committee is *Den demokratiske udfordring*, 1999. See also *Eriksen*, 1999.

capacity of political institutions and political processes. Some governments have launched discussion amongst civil society and political society. Surveys of citizen's opinions of political governance also belong to the toolkits. Academia has a growing interest in empirical studies of the institutional factors of economic growth and social success. The themes, which have been studied range from the size of the state – share of public expenditure of GNP – to the openness of economy.³³³ Finland has set up a committee – the Committee for the future – in Parliament on permanent basis to discuss of the future challenges. However, so far they have not discussed of democracy and future of governance of political processes.³³⁴

Even if there at present is neither a coherent theory nor a set of representative examples of practical regimes of new governance, there are several challenges for the present governing model. The proper size of the state has been under active discussion in most countries for two decades. Main theme has been “how big is too big”.³³⁵ In some countries the discussion started earlier than in others,³³⁶ but the collapse of the communist system in the late 1980's launched the discussion in latecomers also. Though it is a reality that the size of public expenditure has diminished slightly in most countries in the 1990s, the state's political governance functions have not and will not diminish.³³⁷

³³³ *Rodrik* 1998, 996-1032.

³³⁴ See <http://www.eduskunta.fi> (visited 23.11.2003)

³³⁵ Discussion of the size of public sector see *Tanzi and Schuknecht* 2000, *Light* 1999.

³³⁶ *Pierson* 1994.

³³⁷ Examples of recent contributions in the discussion see articles in a special symposium of the state: *Wilson* 2000,233-234 and the articles published in *Governance* 2000, *Micheletti* 2000, 265-277.

Anthony Giddens is not satisfied with the present state of discourse of governing and democracy in Western countries. He says, “We need a process of democratizing democracy”. For him it means that Western democratic systems should be brought into line with recent structural changes. He refers to political corruption, globalization, global governance and back state deals and fixes, which should be contested. Women should have an egalitarian position in core system of political power, political power should be decentralized, and political processes should be more open and transparent.³³⁸

New information technology (ICT), which has changed the interaction processes and systems especially in business, will affect deeply impact on the interaction modes between the government and society and business. Many countries have already adopted a wide array of new E-governance solutions in administration. Discussions and first experiments of digital democracy and e-democracy are expressions of the effects of ICT in the political field.³³⁹

Internationalization of the economy and new forms of transnational governance are realities, with which the governments are already living.³⁴⁰ In the 1990's these development trends have changed the state's national role as an independent actor.³⁴¹ The upgrade of the political governance from the national level into the international level concerns mostly the gov-

³³⁸ Giddens 2000, 85-100.

³³⁹ Wilhelm 2000 and Sunstein 2001.

³⁴⁰ A comprehensive summary of present management and governance structures of global issues (communications, corruption, crime, money laundering, development assistance, finance, international trade, nature conservation, pollution, health, human rights, refugee protection and assistance, intrastate conflict, conventional weapons and nuclear, biological and chemical weapons) is *Managing Global Issues. Lessons Learned* 2001.

³⁴¹ Strange 1996 and Gilbert 1999.

ernance of the markets, but will widen to governance of the society and governance of political governance.

International cooperation has raised the importance of global and regional organizations. They have become major political players at the international level. Through this process governments have received a new role in national governance. They are mediators of national interpretations of international governance. To fulfill their interests in the international level, governments have established international organizations, which present and coordinate these national interests. The longer these international organizations have lived, the stronger their independence has grown in relation to national interests and needs. This development demands new steering and networking capacities from the national governments. For most citizens these global governance systems are too far to grasp them as mechanisms, which are in their service. However, it is every citizen's basic right to know the basic political mechanisms, political institutions and ways he can participate and influence on political decisions.

4.4. Public sector governance

The task of public sector governance The goal of public sector governance is to safeguard the capacity of the public sector to perform its tasks of general interest effectively, efficiently, and in a sustainable and accountable way. In short the goal is good governance. Even if the principles of good governance change in time and in different countries according to their respective problems and values, there is a general consensus of efficiency, economy and democracy and rule of law as the basic values in all public functions.

I do not go in this section into details of the governance of the public sector, because it is discussed later on in chapter 6. Instead I raise some general themes of the strategic reform process, for example the organization of the strategic formulation process, contents of the reform strategy, its formulation as interaction between political steering and professional expertise and obstacles in administrative reforms.

The main tasks of the government in the public sector governance are (i) to explicate a clear and realistic vision for administrative and management reforms, (ii) to build a strategy for it, and (iii) to implement the strategy. The strategy deals with human resources, public organizations and official and unofficial institutions of the public sector (macrostructures).³⁴² Major goal of the strategy is to improve the capacity of the state to fulfill its tasks in the political governance of the country. The tasks of the state have grown steadily, which has dimmed the discussion of the state's basic functions. In strategic work the basic responsibilities of the state must not be forgotten. Effective governance of public sector is a key requirement for effective markets and efficient society.

Public sector governance is not technical and internal exercise of civil servants, but an outcome of a broad analysis of major future challenges of public sector and wide discussion of the guiding principles of the reforms. The goals of the reform should be imprinted in the realm of citizens. They should deal with coping and adapting to an uncertain and changing environment (political, economic, technological and socio-cultural). The challenges should be analyzed on a broad base in relation to values of the people. Technological development trends and global transformations have deep effects on the governance tasks of the state. Public sector reform strategies have to

³⁴² See a model from *Grindle* 1997, 8-110.

be connected to the public governance regime and to the governance policies of markets and society. The efficiency of the present governance strategy in relation to the future challenges has to be analyzed as well. The governance strategy for the public sector has to look for changes and challenges in a wide context and develop rules of the game and institutions for the changing environment. Examples of such strategic questions are

1. tasks of the state
2. structure of the state (includes for example relationship between the political and career executives and internal decision-making structures in departments,
3. processes of the state and
4. relationship between the state and society (networking, public-private partnership and redefinition of the criteria for flexible use of private services and service providers in public functions)

Comprehensive and intense participation of political actors in the strategic process and analysis of the challenges is more important than the final strategic paper. Governance is more a strategic process, which copes and adapts to an uncertain and changing environment, than a formal document. When the government formulates the strategy so that it reflects the needs and values of citizens, has a realistic and sustainable hold on future challenges, puts the challenges in relation to the big picture and present resources, it creates preconditions for increase of legitimacy for and trust in the public sector.

One of the most difficult questions in the strategic governance process concerns tasks of the state. This has been a major theme in public sector reforms already in the 1980s and in the 1990s, when governments of advanced industrial countries launched privatization programs and adopted market mecha-

nisms in public agencies.³⁴³ Transition countries have carried out even more fundamental privatization programs.³⁴⁴ The most important and crucial questions in public sector governance still concern the strategic advantage of the state and problems of public service provision. Solutions for this question should be based on an analysis of the comparative advantages of public organizations and their effectiveness and efficiency when compared to private organizations.

Public sector governance is one of the most efficient elements of the government's strategic decision-making process, because through public sector organizations and public expenditures the governments have direct influence on the nation's economic and social development. Through public services the governments can directly influence their citizens' well being. In public sector governance strategy the government defines goals for future development of collective goods. For example if the analysis of comparative advantages of public service provision show that their advantages in principle surpass private services and that the quality of public services is low, the strategic process should find mechanisms for increasing efficiency and effectiveness. In the strategic process the government should decide how it adopts market mechanisms inside administration, and how half-markets and networking principles are adapted. Strategic governance should define general principles to be used in different organization, management, service provision, personnel policies and financing principles in the public sector. These will help the government and political decision-makers to decide which are such tasks, from which state should withdraw, when new tasks emerge and budgetary constraints cannot be met without crucial cut-back decisions.

³⁴³ Excellent introduction to the problems is *World Bank World Development Report 1997. The State in a Changing World* 1997.

³⁴⁴ See discussion of it in World Bank: *World Development Report. From Plan to Market* 1996, 110–123.

4.5. Participation in global governance

The two last decades of the nineteenth century testified a fundamental change all over the world. Problems are not seen any more only from a national point of view, because businesses, technology, information, criminality and pollutions cross the borders more freely than earlier. Though political constellations (end of the cold war after collapse of the Soviet Union and regional economic and political integration) were a decisive factor, the importance of ICT cannot be underrated.³⁴⁵

The development of regulation measures of international trade flows, coordination of international development assistance, birth of regional economic and political organizations (the EU) and sector specific international negotiation systems of the governments (for example in health and environment) are concrete examples of present systems of global governance. The proliferation of threats such as environmental degradation, growing inequalities between rich and poor, both between and within countries, the spread of disease and famine, illicit trade in drugs, money laundering, international terrorism, proliferation of arms, and organized criminality are examples of the dark side of globalization. Problems have intensified the governments' efforts to manage them at the global level and as its consequence have raised anti-globalization sentiments amongst citizens. Fears are expressed in demonstrations and in national elections, when an increasing number of votes are cast for extremist parties. Left and right wing extremism and populism feed on globalization fears and resistance to change.

Terrorism and money laundering are examples of lacking global governance. Terrorists and criminals have established and

³⁴⁵ See basic facts of the phenomenon *Managing Global Issues* 2001 and *Held & McGrew & Goldblatt, & Perraton* 1999.

formed global networks, which utilize structures and frameworks for free movement of finances and goods across the borders. When the states created these structures they failed to create global governance systems to handle problems like these. The future threats of globalization have been discussed in different organizations, and from several perspectives, but without concrete conclusions so far. All participants have their own goals of the desirable development. They evaluate and monitor the situations from the perspective of their own national and economic interests. The diversity of interests and their conflicting nature guarantees the slow pace for the process. In spite of this pessimistic appraisal, globalization is an ongoing process, which will continue and will have deep effects on national governance systems.

Globalization has set and will set in the future claims, restrictions and demands for governments to develop capacities to participate in the global negotiation systems and to integrate them into national governance systems.³⁴⁶ The natures of the global and national frames for governance are conflicting. Governments have a better control of the national forces in national governing systems than of global and international actors in global governance processes. Though globalization as a word refers to a unified process, globalization is a differentiated process, which is not in anybody's control. To get better control of the process governments should analyze the process and forces behind it.

To fulfill the demanding tasks of governance the governments have to create a national strategy to influence in all global governance processes, in which it is participating.³⁴⁷ The strat-

³⁴⁶ Of discussion of the changes for the state see for example *Strange 1996*.

³⁴⁷ The Finnish Government has given a report of globalization to Parliament in 2001. *A Report on Globalization for the Foreign Affairs Committee of Parliament* <http://formin.finland.fi/english/>

egy has two different goals. First, it should define the basic national goals and strategies for the national authorities, which represent the government in international negotiations. Second, the government has to interpret the challenges of global economy on the national level and try to help all national actors to adjust to future demands.

The challenges to succeed in the globalizing world of the future are defined in a national strategy. The main elements of this strategy could be for example mobilization of all national resources into action, measures needed to safeguard effective functioning of the markets, measures to safeguard the performance of society and definition of the role of the state and government in national and global governance.

The national strategy should be based on an analysis of the future trends of globalization and analysis of the challenges that globalization will set on the bases of present economic and social policies. Discussion so far has shown that globalization will challenge countries, which are dependent of exports and imports, have high public expenditures of GDP and have heavy future demands on public expenditures for example from the ageing of population without covered pension schemes.

Governments cannot escape globalization even if they wanted to. However, this infirmity does not diminish the accountability of the governments of this global participation to national voters and constituents. Economic globalization, political integration, sector based global and transnational governance systems with national accountability mechanisms should be seen as a major driving force to develop global governance systems and such accountability mechanisms, which will increase trust on it and its legitimacy. National political governance systems have to be integrated into the future transnational system of governance.

The terrorist attacks of September 11, 2001 on New York and Washington have raised awareness all over the world of the threats of terrorism, drugs dealing, organized criminality, transport of weapons of mass destruction and illegal arms and explosives cross the borders so that even the biggest states cannot fight against them alone. The attack has increased the responsibility of nation states not to harbor terrorists. The decisions of the Security Council of the United Nations have made national governments accountable to international mechanisms for global security in this fight against terrorism. However, this accountability to the international level and the international war against terrorism has not abolished the right of states to self-defense. Former state secretary of the United States Charles P. Schultz, who has analyzed governance in the light of terrorist attacks says that international organizations do not work well when they are regarded as rivals or alternatives to states. “International organizations will flourish when healthy sovereign states use them as a vehicle for reaching their common goals.”³⁴⁸ Shultz is not speaking for general global governance, but for the need of global multilateralism in the field of war against terrorism. It is the responsibility of world leaders to evaluate the situation in other policy sectors in the similar way.

4.6 The birth of a new regime of good political governance

In this chapter I have discussed major strategies of political governing. Its major elements were a strategy for market governing, governing of society and governing of public sector or state itself. I have discussed in every section of the future challenges to

³⁴⁸ *Schultz* 2002.

the present governing regime. Now I will give a brief summary of the challenges and specify the characteristics of the new discourse of political governance in the light of the discussion presented in chapters 2 and 3. In chapter 2.5 I presented a summary of the major symptoms and sources of systemic regime change from government to governance. Even if the symptoms of regime change were detected from different sources, most of them supported the interpretation of a birth of a new discourse of political governance.

Systems of governance are not static, but dynamic phenomena that are in a constant state of change. The system of political governance is composed of different sub-systems, which do not have similar change rhythms but follow the change patterns of their own. For example political institutions of political governance are more permanent than governance institutions of markets or even governance institutions of specific business sectors.

Governing models are national, even if nations form cultural families –Anglo-American, Scandinavian, Asian, Mediterranean, Latin-American, Islamic, etc. There are not two completely similar governing models in the world, though many countries have similar governing features, because they belong to the same cultural family of political systems. This coherence allows us to discuss principles of governing and questions of institutional design on the general level, but at the same time it forces us to study them from a comparative perspective.³⁴⁹ Institutional design covers not only national electoral systems and executive-legislative relations, but also general principles of social order, governing of the markets and democracy. What fits an advanced industrial state does not necessarily fit a developing country. They have different traditions, future challenges, and capacities in public and private sectors. This will be reflected in the development needs, concepts, and birth of discourses.

³⁴⁹ Of different political systems see *Lijphard* 1999.

Political governance is a developed version of the traditional term governing, which is a continuous exercise of authority over and the performance of functions of the state. Characteristic for governing has been sovereign authority and use of state powers and ruling. Questions of power, authority, rule, sovereignty and absolute are its qualitative characteristics. Governing is a regime type of the twentieth century.

Discourse of political governance has softer and wider connotations than traditional governing. Discourse of governance tries to get rid of the traditional image of governing as authoritarian use of state power from the top of the official hierarchy. When the term is used as a new specific regime type it is connected to a long history of governing changes. If it succeeds it will belong to the first steps of the reform of present up-down governing towards down-up governance³⁵⁰ The discourse tries to further such macro-level mechanisms, which will increase interaction between the state and market and social actors and develop participatory forms for governing and find more dispersed power structures than the present governing regime. New governance models have received support because the governments' successes depend on the support from the markets and society.³⁵¹ Governments no longer can safeguard preconditions for sustainable development for effective markets, society and public sector alone without functioning relations with the market, citizens and social actors.³⁵²

New discourse of political governance stresses principles of self-regulation (mostly of markets) and growing responsibility of individuals and society of their life changes. It will foster pre-

³⁵⁰ Schmitter is discussing of different democratic regimes in similar way. See *Schmitter* 1998, 28-29.

³⁵¹ *Haufle* 2001.

³⁵² *Wilensky* 1967.

requisites for the organization of the citizens and their activities on their own initiative as well for the development of social responsibilities. Increase of self-regulation should be connected into reforms, which limit the tasks of the state, clarify division of labor between the state, markets and society, and reform the regulatory tools of the government. Discourse of political governance emphasizes voice and accountability mechanisms strongly.

While many researchers share a lot of the aspects of the above-mentioned interpretation of new down-up governance, the views are not accepted unanimously. For example Pierre and Peters stress the importance of the state in governance. They do not accept the general tendency to reduce the role of the state in governing and the idea of letting other regimes to rule. A basic idea in their criticism is that the discussion of new governance has emerged from so many sources. Many of them have originated from the ideological shift towards the market and emphasis of the failure of the state.³⁵³ Many researchers call this development neoliberalism.³⁵⁴ It is regarded as a step towards governance by the most powerful. Even if the criticism has firm bases, I regard the discourse of political governance as a new regime type, which has a sound basis, when it is applied in a manner, which has respect on national traditions. At present it is mostly academic discourse without clear connection to any specific national governance practice.

Minimum requirements for a good political governance regime are that the governance institutions are democratic, the rule of law is respected and governing is predictable and safeguards efficiency and legitimacy of authority. Governance insti-

³⁵³ *Pierre and Peters* 2000, 54-85 and 114-136,

³⁵⁴ See for example *The Rise of Neoliberalism and Institutional Analysis* 2001.

tutions have to guarantee control and accountability of governance, and open participation for all in public decision-making. Institutions must be uncorrupted and they must prevent short-term zeal. They foster citizens' individual responsibility and provide an enabling environment for markets and social development and mutual interaction between the government and citizens and market actors. Basic requirement in good political governance is democracy – majoritarian or consensus³⁵⁵

Besides political governing, governance includes³⁵⁶

- development of principles of political governance and governance institutions
- participation in global governance processes to safeguard national interests
- forecasting the challenges to the success of the nation and its governance (governmental intelligence) and taking care of the long term perspective in economic and social development.
- creation of prerequisites for stable political leadership for political governance
- provision of the basic responsibilities of the state (law and order, judicial system, defense and internal security),

One of the most heated discussions in political economy and political discourse from the early 1980s on has been the role of the state and different actors in the political rule of a country. Market fundamentalist have criticized dominating economic policies for their too strong reliance on state actors (market regulation and public expenditures). Institutional economics has returned trust on the state to a degree. It has shown that throughout history the well-functioning state has played a central role in establishing the institutional framework for the crea-

³⁵⁵ *Lijphart* 1999.

³⁵⁶ *Ranney* 1975, 177.

tion of wealth. However, economic prosperity and the creation of wealth do not necessarily need a strong state, but an effective state.³⁵⁷ Major actors in all countries – even in countries, which have a small public sector and which have strongly criticized the involvement of state in economy and society – admit that in spite of this criticism of state, it has a central role in governance process. It is the supervisor of the governance of markets and society. However, most defenders of the state admit and accept the need to transform hierarchical command-like governing to a new kind of political governance.³⁵⁸

The government has to get impulses from the markets and from the society on different levels and in different ways. It produces the formal rules that are part and parcel of an institutional government. Only the state has the capacity and power to establish formal rules and institutions through political process. The change of the boundaries of the state – privatization, deregulation, contracting out, public-private partnerships - has increased interdependence between state and non-state actors. The need to exchange resources and negotiate shared purposes is connected with this.³⁵⁹

Though I discuss different tendencies in governance, especially from the perspective of networking and institutional emphasize, from the perspective of this study I regard the state as a traditional authority, i.e. administrative, legal, bureaucratic and coercive system that does not only have the right to structure relations between society and public authority in a policy but also to structure crucial relationships within society and markets. Alfred Stepan, who is a major scholar in comparative politics, says that consolidated modern states should be compared

³⁵⁷ *Chhibber* 1998, 36.

³⁵⁸ See for example *Giddens* 1999.

³⁵⁹ *Rhodes* 2000,346.

not in terms of whether they structure such relationships, but in terms of the degree to which, and the means through which, they do so.³⁶⁰

If the government gives up of its responsibility of political governance, it will lose its nature as the government of the country. On the other hand, if the government does not have open relations based on trust with society and markets, it cannot reach the best results. Third, if the government is concentrating too heavily on detailed steering strategy or if it is taking too strong steps from established division of labor between different sectors, the wealth of the nation is in danger. Effective political governance will safeguard the success of the whole nation, of its citizens and the business. It is always based on an analysis of the success factors and on a strategy to increase the wealth of the nation.

Besides the public institutions of political governance (constitutions and public authorities), also market institutions and institutions of social life – moral infrastructure and political culture included – belong to the long-lasting features of every nation. Though only the most important of them are defined in legislation, they belong to the permanent basic institutions of every nation, but not to the political regime. In spite of their permanent nature market institutions and institutions of social life, every-day governance practices are changing constantly. Interpreted needs of the day and situation are driving-forces in all changes.

³⁶⁰ *Stepan* 2001, 7 and *Stepan* 1978.

4.7. Concluding comment

In this study I have discussed governance in a disaggregated way on different levels. Each of these partial governance regimes – or components of political governance – is institutionalized in a particular sequence, according to distinctive principles, and around different sites. When the focus is on the state and political governing, the term governance expresses the present development from traditional structuralist and state centered governing towards trust based and networking type of rule where all three sectors have important roles and responsibilities. When discussing public sector reforms, the term governance describes steps from bureaucracy to new modes of management. Institutional discussion about governance of economy emphasizes the role of the market institutions in economic development.

I have emphasized that present discourse of good governance is mostly academic in nature and so far only a weak, interpretation of some new governing practices. For example principles of transparency, accountability, voice and democracy, which are emphasized in the discourse of governance, are not new principles. They cannot justify an interpretation of a birth of a new regime. However, the discourses analysed in this study have shown firm bases for strong demands to reform the traditional governing model. Many students of political science, economics, administrative sciences and think tanks have been active drivers of the reforms. Some countries have already adopted new practices, which can be regarded as symptoms of a new regime of governance. Civil servants and governments develop and create new governance practises and academia is developing theoretical explanations of their reasons and interpretations of their good quality. Civil servants are not eager to participate in theoretical and academic discussions of the terms and their

backgrounds. For example honour for the invention of the term New Public Management does not belong to any government or to the OECD, but to academia.

My conclusion from the previous discourse is that the term governance and its present practical forms do not yet justify speaking of the birth of a new universal regime of political governance. Present discussion is for that purpose too undeveloped and diffuse and concern mostly practices. It does not have effective manifestations in the level of governing of political institutions, which defines the most important principles of every system of governing. New practices in the governance of markets, society and public sector have not yet been integrated into the governing of political institutions and its established discourse.

The governance of markets, society and the public sector differ a lot, but similar principles of governance discourse can be used in all of them. Reliance on up-down steering and abandonment of authoritarian steering practices are good examples, which can be used in all management problems, but their practical implementation forms vary according to the nature of the problem. Because authority structures are culturally bound and they belong to the long-lasting institutions of all nations, the speed of the adaptation of the new governance principles will vary greatly in different countries. It will take longer in former socialist countries in their transition period from a secretive and reconciled culture to create an up-down culture than in democracies, which have respected civil rights for centuries.

5. From public administration to public management and governance

So far I have discussed discourse of governance in different disciplines and from different perspectives. There some reference has been made to historical development of authority structures and development features, but mostly in public administration in the OECD countries. Because discourse analysis has a general danger to prevail in abstract space without concrete reference to reality, I try to get some connection for the discourse of governance to the relevant discourses, which will explain its birth and major features in time by presenting the basic lines in the discourse of the role of the state after the Second World War. For me all conceptions are bound to a certain place and time, i.e. they have to be anchored to reality or to an interpretation of reality. Because it is impossible to go into history proper in any way, I replace it with the discourse of the role of the state. The chapter will present my interpretation of the major background discourses and arguments, which have affected public sector governance discourse. Even though the interpretation is rough, it serves the needs of the next chapter, where I will go into details of the new governance discourse in the public sector.

In section 5.1 I will present general features of the development of governance regimes in developed industrial countries after the Second World War. In section 5.2 I will continue the discussion and specify the effects of change in the regimes of governance on the public sector and its authority structures and governing models. It is, however, not possible to go into great detail concerning these questions in this study.

5.1. Role of the state as a defining factor in the regime of political governance

All countries have their own governing models, which have received their forms through slow development. Governing models depend on politics, culture, geography, and time. History is reflected both in present tasks of the state and in its role in political governance. For example in Western Europe there are at least four state traditions (Mediterranean, Continental, Anglo-Saxon and Nordic). The roots of the role of the state in the USA are from the late eighteenth century. In Africa the effects of colonial tradition can be seen even today. Geography sets long-term frames for business and peoples' lives. For example in countries where people are scattered around loosely, the state has to provide such services, which in densely populated areas can be provided by private firms. Tasks of the state are time dependent. One hundred years ago the tasks of the state were much smaller than today. Safeguarding of economic progress and stability demands a different kind of government interference in economic processes today than at the beginning of the twentieth century. There is no general classification of the tasks of the state or ideal size of the public sector. However, international comparisons show that in the long-term too big size of

the public sector does not foster economic growth and competitiveness of the economy.³⁶¹

The diversity of definitions of the tasks of the state is a reflection of different theoretical perspectives. The most influential discussants are economists, who emphasize economic reasons. In a typical task catalogue state is said to have responsibility to 1) establish rules and institutions aiming at enforcement of contracts and protection of the property rights to help expand the role of the markets, 2) provide a legal and regulatory framework that reduces transaction costs and promotes market efficiency through strategic market intervention in case of market failure by providing public goods (defense, law and order) and by providing information (for consumer protection), 3) promote macro-economic stability, 4) to address externalities (environment protection), and 5) regulate monopoly (utility regulation and competition policy).

Discourse of welfare economics gives reasons for state interference in market failures. The state has the responsibility to correct them through public intervention and public services. Practical implementation of this economic theory produced the theory of the welfare state,³⁶² which is at present a well-defined regime model of an advanced industrial state. I will present its basic premises in the next section. It is justified to call welfare state a model of governing, because it is based on the ideology of up-down steering and an active role of the state in market regulation and moral economy of the citizens. In most countries implementation of the model has given for the state comprehensive responsibility in social welfare functions, for example in basic level education, health and wealth (and thus an equal opportunity for changing one's level of each). Welfare economics

³⁶¹ *Tanzi, Schuknecht* 2000

³⁶² *Titmuss* 1958, *Myrdal* 1960, *Baumol* 1967 and *Wilson and Wilson* 1982.

has widened the role of the state in macroeconomic regulation and increased public finances have been raised to a central vehicle in economic policies.³⁶³ New ideas in the social field have had similar effects.

Ideological grounds are the second category of discourses. Because markets do not take care of political goals, the responsibility of the state in fulfilling political demands (for example to improve equality) has increased. Political ideologies emphasize fulfillment of collective values and importance of public services.³⁶⁴ Collective ideologies have justified the nationalization of private companies and the establishment of state owned companies. Conception of social citizenship has justified the state's involvement in the protection of citizens against economic and social uncertainties. Collective ideologies and values were the dominant political discourse in all advanced industrial countries after the Second World War until 1980s. After that values of individualism and neo-liberalism have received more acceptance and collectivist values of the welfare state have diminished in influence. The growth of public expenditure has calmed down and in some countries even turned into reduction.³⁶⁵

Discourse of the welfare state as a political governing regime has been dominant in Europe until the late twentieth century. Its adaptation explains the growth of public administration, public consumption expenditures and transfers and increase of the amount of civil servants and public agencies. Because the welfare state model has received more political support from left-wing parties than from the political right, it has produced political discussion of the political and economic implications for example of active state interference in economy and society. Political critics say that big state hampers the functioning of

³⁶³ *Welfare economics*, Vol. I-III, 2001

³⁶⁴ *Tanzi*, *Schuknecht* 2000 and *Stiglitz* 2000 and *Stiglitz* 1989.

³⁶⁵ Discussion about the history of state *Van Creveld* 1999.

markets, causes bureaucracy and increases unnecessary administrative steering of markets and society. Similar arguments can also be heard from economics (public choice theoretic, James Buchanan, Anthony Downs, Mancur Olson, Gordon Tullock, and William Niskanen) and political sciences. Advocates of bureaucratic failures claim that the costs of the model have been bigger than its benefits.³⁶⁶ The discussion has put an end to the general optimism about what the state would be able to accomplish. In the 1990s critics seemed to dominate the discussion. At present the defenders and opponents of the state seem to be finding some kind of a compromise.

So far I have discussed advanced industrial countries. Socialist countries did not have similar discussion because state dominated and governed whole economy. Inside the state the communist party had a leading role. The collapse of communism has launched fundamental reforms in former socialist countries. These were started in political life, and their effects spread into the economic field, but lack of capital, entrepreneurs and skills have set certain limits for the speed of the transformation. In most Asian countries governance models are based on collective values and strong state interference in economics. Even if Japan, Korea, India and China have different political and economic models, all of them they have a strong state, which is the major actor in economic policies.³⁶⁷

All advanced industrial countries have some kind of a welfare state regime.³⁶⁸ Of these, the Nordic model is the most ex-

³⁶⁶ Mitchell, Simmons 1994 and Wallis, Dollery 1999.

³⁶⁷ See for example Wade 1990, World Bank: *The East Asian Miracle, Economic Growth and Public Policy* 1993, and World Bank, *Rethinking the East Asia Miracle* 2001.

³⁶⁸ Esping-Andersen 1990, *European Social Policy* 1995 and European Commission. Directorate-General II Economic and Financial Affairs *The welfare state in Europe* 1997.

tensive. Universality is here a central principle: welfare rights are based on citizenship, and the level of welfare of a person does not primarily depend on his or her income.³⁶⁹ Second, public sector provides most of the services, and social transfers support them. The Nordic welfare state provides free education (no fees from pre-school to university and free school books and meals until high school, plus a student grant for students in further education), inexpensive health services (mainly free health centers, low-paid hospitals, subsidized drugs, home-care support) and insurance and social services. The continental model is more family-centered. Female participation in paid employment has been low particularly among married women, who have taken care of small children at home. Social security is tied to one's labor market position rather than to citizenship. Cash benefits dominate over public services. Social security is organized according to the insurance principle, i.e. it is financed mainly by employer and employee contributions and distributed as social transfers to the insured. In the British model welfare state developed relatively early and is based on tax financing, a large public service sector and women's participation in the labor force. The US model gives support mostly to poor.³⁷⁰

Though the development of the tasks of the state and welfare models is connected to national history and culture,³⁷¹ intensified competition of governments to attract investments in their countries, to attract foreign firms and keep firms and skilled work force has become necessity, a fact which influences

³⁶⁹ *Comparative Welfare Systems* 1996.

³⁷⁰ See discussion about different welfare models or families of nations *Castles and Mitchell* 1993, 93-127 and *Kosonen* 1994.

³⁷¹ *Pierson* 1998. See an analysis of state intervention in Germany and France. *Hall* 1986,

national interpretations of the tasks of the state.³⁷² The pressures are so strong that even the Swedish welfare model is approaching the West European model.³⁷³ Sweden has been a fore runner and model for other countries in building a welfare state. Germany has started its reforms in 2003.

When Western industrial countries from the late 1980s onwards began to withdraw from the regime of comprehensive state intervention on social problems and began to emphasize the responsibility for the deregulation of markets and citizens, national attitude patterns produced different results. For example in the Nordic countries citizens accused governments for not taking responsibility of their legal commitments. The first political reactions to the demand of a regime of a smaller state and to regime change were negative. Later the concept received more acceptances, when financial and economic realities demanded short-cut decisions in public finances. People began to accept a slow transfer from collective responsibility towards individual responsibility.³⁷⁴ However, political turbulences and continuous government changes express that transfer to a new policy regime is not an easy one. Transfer to a new regime takes as long a time as its building.

In the 1990s the discussion of the role the state has received new elements from globalization, which is an outcome of the creation of global markets and the global level, i.e. the WTO. One of the major themes in this discussion is the future of state and its sovereignty. It is emphasized that current globalization entails the eclipse of state and its sovereignty. Even if the fears are exaggerations, question of state and its role cannot be any more regarded as a question, which can be decided on grounds

³⁷² See discussion of the role of the state in promoting growth from 1960s *Maddison* 1964.

³⁷³ *Lindbeck* 1997, 1273-1319 and *Micheletti* 2000, 264-277

³⁷⁴ *Micheletti* 1999, 265-278.

of national political ideologies. For Evans the role of the state is a question of international institutional reality and global ideology.³⁷⁵ However, recent studies have shown, that correlation between economic openness – country is participating in international trade – and the expansion of government is positive. The opening of national markets is complemented by strong government interventions and public services.³⁷⁶ Even though the ideology of market globalization refers to the weakening of the state, in real politics all states transform their traditional diplomacy to serve their national economic interests.

After the terrorist attacks of September 11 the role of the state not only in domestic politics and internal security but also in international level has strengthened dramatically. The role of the state as a regulator and the last safeguard has strengthened in most countries. After the terrorist attacks the Security Council of the UN stressed “that every Member State has the duty to refrain from organizing, instigating, assisting or participating in terrorist acts in another State or acquiescing in organized activities within its territory directed toward the commission of such acts.”³⁷⁷ The decision has confirmed the principle of the states’ accountability for not harboring terrorists. States must be strong enough to prevent the functioning of terrorist organizations in-

³⁷⁵ *Evans* 1997, 64.

³⁷⁶ For discussion of the research results of Rodrik and Cameron see *Evans* 1997, 68-70. Cameron has listed four strategies to shelter their risks of the international economy. First, some states adopt explicitly neomercantilist policies, second, some countries favor certain industries as national champions, third, some adopt a variety of industry-specific protectionist measures and four, open economies use defensive strategies by providing a variety of income supplements, in the form of social security schemes, health insurance, unemployment benefits, job training, employment subsidies to firms and investment capital. *Cameron* 1978, 1260.

³⁷⁷ See *Shultz* 2002.

side their borders. They may not support terrorism directly as a matter of state policy. George P. Shultz has a summary of present conception of globalization and state: “For all the realities of globalization that have drained authority from the state, no other basic entity of international life can replace it. The state is all we have as a means of ordering our international existence and achieving representative government and protecting individual rights. So, if the pendulum has swung against the sovereign state in the past decades, it is time to swing it back. To hold states responsible and to help strengthen them against our common enemy, terrorism.”³⁷⁸

5.2. Major steps in the development of public sector management

From classical administrative regime to welfare state regime The changes in the governing principles and methodologies of the public sector are connected to changes in the size of the state and the governance regimes of economy and society. The wider the tasks of the state and the more strongly the state steers economy and society the more demanding requirements must be set for internal governing of the public sector. The second half of the twentieth century is in this respect a period of growing demands for new technologies and governing practices. Structures, procedures, universal and impersonal rules, arts, skills, and attitudes through which administration applies the rules and regulations, which define the tasks of the state, are developed and reformed when the nature of the tasks of the state change.

The growth of the tasks of the state has increased the hierarchical levels, functional sectors and new co-ordination practices

³⁷⁸ *Shultz* 2002 and *Waldo* 1981.

in administration. Even if the growth of public administration and public expenditure has been continuous in the 20th century and administration has been reformed in the practical level as a continuous process, in most OECD countries fundamental public discussion of the principles of public administration did not start until in the late 1980s. Principles of the classical model of public administration (hierarchy, strict jurisdiction of administration, division of labor, specialization, professional civil service, and formal management principles) dominated the public image of public administration, even if economic and efficiency considerations increased all the time.³⁷⁹

The organization, decision-making and staffing principles and procedures of the classical model of public administration are old. The basic elements of Max Weber's ideal type of state administration from the beginning of the twentieth century are hierarchy of authority, centralized command and control, division of labor and fixed jurisdictions. Weber emphasized the formal qualification of administrative personnel, meritocratic recruitment, and predictable, long-term career rewards, contracts for a long time or even for the whole life span and rational discipline governing behavior of the administrative personnel. Office holding is a vocation. Civil servants have shared norms and values. Administration is based on perfect obedience, imperative working methods and full devotion to do the job properly. A rule centered and top-down approach reflects the government's wish and perceived ability to impose its priorities and values all over the country.³⁸⁰ According to Hood Weber's ideal

³⁷⁹ Raadsbelders 1998.

³⁸⁰ The principles are presented in *From Max Weber* 1958, 196-98, *Weber* 1968 and *Max Weber on Charisma and Institution Building* 1968, 66-77, 66-77. For a general discussion of the bureaucracy and bureaucratization as phenomena see *Reader in Bureaucracy* 1952, *Hall* 1963, 32-40, *Grunow* 1986, 29-59, *Bendix* 2001, 244-246, *Bendix* 1947, 493-507.

type of a perfect administration resembles the economist's model of perfect competition. It is characterized by (i) unitary organization, (ii) shared norms and values, (iii) perfect obedience, (iv) full information and (v) need to do the job properly all the time.³⁸¹

P. Guy Peters has accentuated six characteristics in traditional public administration. These are 1) an apolitical civil service and neutral competence within civil service; 2) hierarchical and rule-bound management within the public service and authority of civil servants to implement and enforce regulations outside it; 3) employment as a public servant is a lifetime commitment, a social contract; 4) an institutionalized civil service that is governed as a corporate body; 5) maximum amount of equality of income and 6) permanence and stability of organizations within government.³⁸²

Public administration and professional bureaucracy are regarded in traditional Weberian tradition as trustees of general will and public good. Bureaucracy's responsibilities surpass the short term. Because public administration represents expertise of governing and governance of the nation, continuity and time-tested wisdom, the state has the responsibility to stimulate debate and to involve citizens in it. Though bureaucracy has been in the service of the ruler and later in the service of political leadership, the ideal model regards a classical bureaucrat as a counterweight to the politician, who represents short-term specific interests and values in decision-making and often opportunism. The positive characteristics of public administration are reliability, predictability, probity, cohesion, continuity and integrity.

The classical model of public administration has preserved its position against more flexible and less strictly regulated ad-

³⁸¹ Hood 1976, 6.

³⁸² Peters 1996. See also Hall 1963, 33-39.

ministrative models, because it safeguards best the rule of law, protects citizens' rights against the state's impertinent interference and is regarded as a guardian of general interests against partisan interests of politics. The European interpretation of the classical model was done in administration on judicial bases and universities trained civil servants in their judicial faculties, In the USA a new science of public administration was born in the 1920s and in the 1930s in departments of political science.³⁸³

All ideal types are always rough descriptions of reality, which is changing all the time and in all countries according to their own traditions. New theories emerge and new practices are developed. This concerns especially the classical Weberian ideal type. Already before the Second World War the new business models had emerged especially in the USA. During the War all governments asked academia and business experts to participate in public administration and create new efficient management and production methods. After the War in reconstruction these new methods were adapted and developed. Experiences from the management of enormous organizations drew attention away from formal organization structures to informal structures and personnel questions. Already in the early 1960s it was clear that the classical Weberian ideal type of bureaucracy did not fit any public administrations any more.

The tasks and responsibilities of the state had constantly expanded in the nineteenth century. Wars are always periods of change. After the Second World War the state in advanced industrial countries was no more the old small night watchman state, whose administration protected the rights of citizen against the state, but an actor, which tried to solve social and economic problems through active state intervention and regulation. The ideology was similar to the original discourses of

³⁸³ See *Waldo* 1955, 20.

public administration in the USA before the War. Dwight Waldo has described the situation as follows: "It (the new philosophy of government, S.T.) sought to attain the values of equity and freedom for citizens by making government strong and efficient, but simultaneously responsible and democratic. To attain these latter objectives, political reforms as well administrative reforms were proposed as a part of single program."³⁸⁴

Because the state after the War was for practical reasons interventionist and relied on regulation, reforms of administrative methods and practices served these purposes. Their aim was to help the government in regulating markets and to interfere in the private life of the citizens and in public business functions. During the Second World War these powers were not justified with the demands of war, but after the war they were justified with the ideology of the Welfare state and great society. Intervention of the state could be accepted if the government emphasized not only the rule of law and legality but also efficiency, effectiveness and economy in all of its functions and reforms.

Until the 1980's the effectiveness of the governing regime of welfare state was not questioned. In the 1980s the criticism was directed towards the principles of the welfare state and its governing regime. Criticism claimed that public administration was inefficient, wasteful, too expensive (public services were more expensive than produced by private service providers), did not care for performance and was poorly managed. Uniformity and the hierarchical nature of administration were one of the main sources of criticism. Defenders of the governing regime said that the model, which combined hierarchical organization structures with rational planning functions, was similar to private business organizations. Defenders said that public administration was not unitary, but a dispersed set of different sub-cultures, which took into account the special needs of that func-

³⁸⁴ *Waldo* 1955, 19-20.

tion. Civil servants did not share the same values of general will, but understood special values in different sectors.³⁸⁵

Reform of the governing regime – New Public Management
Criticism on the welfare state and on its governing regime produced results in the late 1980s, when many advanced industrial countries acknowledged that the growing public sector, bureaucratic mechanisms and civil servants couldn't solve economic and social problems. They accepted the need for regime change. Many governments and politicians admitted that the regime of welfare state had run into difficulties and if the problems cannot be solved, they will lead into a deeper legitimation crisis.³⁸⁶ Critics – from both politics and academia – had demanded unbundling of regulation of markets and society and deconcentration of power and unitary governing. Criticism towards the all encompassing state – too much state – and growing trust in the capacity of markets and society to act and govern their own responsibilities were the basic forces that brought a change in the welfare state governing model created in the 1960s and 1970s.³⁸⁷

Bureaucratic failures and governing failures were an easy goal for critics.³⁸⁸ Dysfunctions of bureaucratic mentality - rule orientation, risk avoidance, dogmatism - the process of societal bureaucratization, increase of bureaucratic organizations and their influence on ever more aspects of people's lives, increase of asymmetry of power and authority between bureaucratic organizations, well-organized interest groups and less organized public at large or the unorganized powerless, processes by which interaction and communication become standardized and for-

³⁸⁵ Hood 1976, Larmour 1997, 385-386.

³⁸⁶ Habermas 1988.

³⁸⁷ Mayntz 1993, 9-18 and Yergin and Stanislaw 1998.

³⁸⁸ Wallis, Dollery 1999, 9-31 and Pierson 1994.

malyzed and standardization of organizational structures of society were recognized and discussed.³⁸⁹ According to Kettl the reformers have tried to root out an authority-driven hierarchical system.³⁹⁰ They believed that we have to get rid of the model of traditional bureaucracy, because all pathologies flow from it.³⁹¹

New Zealand and Denmark started the reforms at the same time in desperate financial straits in public finances.³⁹² The countries could not get quick solutions with technical reforms. Permanent and immediate solutions could be gained only by cutting public expenditures and by starting fundamental reforms. Structural reforms, privatization and private management models offered new tools for this. For example, the principal-agent model replaced bureaucratic model.

New Zealand's reform model produced a well-known name for the reforms (the New Zealand Model).³⁹³ Its idea is government by contract. All reforms have established or strengthened contract-like relationship between the government and ministers as purchasers of goods and services and departments and other entities as suppliers. These contracts replaced the implicit or relational contracts that characterize traditional public administration. Performance agreements displaced the old civil service ethics of trust and responsibility with accountability for results. Minister can purchase services from government departments or from any alternative public or private suppliers. When

³⁸⁹ See *Grunow* 1986, 32-36 and *Strauss* 1971, 75-87 and *Kamarc* 2000, 229-252.

³⁹⁰ *Kettl* 2000, 33.

³⁹¹ *Osborne, Gaebler* 1992 regard privatization, contracting out, decentralization, merit pay, partnership, and management by results and customer orientation as techniques that constitute NPM in practice. See also *Gow and Dufour* 2000, 573-597.

³⁹² *Schwartz* 1994, 546-547 and 550-551.

³⁹³ *Schick* 1996.

appropriations are on an accrual basis, the full cost of the goods and services is incorporated in the purchase price and a capital charge is levied on the net worth of each department.³⁹⁴

The governments of the UK and USA have used public sector reforms as a means to revitalize market institutions.³⁹⁵ The first steps were random and were neither based on a coherent plan nor on a comprehensive analysis of the effects of the reform on markets and the government. Despite this, they showed that there is a real need for new reforms.³⁹⁶ After the collapse of the Soviet system, the market system was celebrated as the winner in the competition between different economic systems. The ideological burden of the market mechanisms as a means to allocate resources disappeared and implementation of market mechanisms in the public sector expanded into new countries

The new contractualism of New Zealand was not a separate reform but a fundamental change in the ideology of classical bureaucracy. Because Anglo-American countries were the most active reformers and they used extensively market mechanisms and contracts, the discourse they created dominated the reform agenda in the whole 1980s. In the 1990s the researchers found a name for the agenda: New Public Management (the NPM).³⁹⁷ The concept and reform agenda spread into the most OECD countries, because the OECD established a special unit to foster the reforms (PUMA, Public Management). Most of the OECD countries have adapted the model as such or some components of it, but not all. For example in Japan and Germany the eco-

³⁹⁴ For a brief summary of the New Zealand Model see *Schick* 1998, 123-131.

³⁹⁵ *Halligan* 1997.

³⁹⁶ A general summary of the reforms see *Pollitt, Bouckaert* 2000, 62-96 and *Pierre and Peters* 2000, 64-65.

³⁹⁷ *Hood* 1991, 3-19. A brief summary of the development *Hood* 1996, 268-287.

conomic development was so good until late 1990s that they postponed the reform. Because Germany's public administration is based on very strong legal tradition and public law, the German government has felt unfamiliarity with market mechanisms and the international reform discussion.³⁹⁸

The first reformers did not have a clear reform conception or a vision of the final stage.³⁹⁹ Concrete outcomes depended on national political and economic situations. Perhaps the most important enforcer for shortcut decisions of public expenditures has been nonpermanent public deficits. Without urgent need for public sector reforms even reluctant countries have launched at least efficiency programs. Some countries wanted to reduce the government's direct role in market regulation and to emphasize the government's macroeconomic management responsibilities by liberalizing domestic and international trade, by privatizing state-owned companies and reducing the fiscal drag of central bureaucracies and deregulating the markets. The economic effects of public sector reforms and shortcut decisions on public services and on the nature of welfare state have been smaller than has been feared or hoped.⁴⁰⁰

All advanced industrial countries used their own models and timetable in reforming their governance systems. However, at present it possible to recognize the following elements in the construction of the new model: a) reduction of government's direct role in economic management, b) raising macroeconomic management to the central economic task of the state, c) pres-

³⁹⁸ Of different national models see *Governance in a Changing Environment* 1995, Peters 1996, Pollitt, and Bouckaert 2000, Kettl 2000, 7-4, Knill 1999, 113-139, Loeffler 1999, Harrinvirta 2000 and *Innovations in Public Management* 1998.

³⁹⁹ See Harrinvirta 2000, 48-185 and Pollitt, Bouckaert 2000 and Schwartz 1994, 527-531.

⁴⁰⁰ See discussion of the effects Pierson 1996, 143-179.

sure to reduce the role of the state in public services to citizens, d) greater trust in markets, civil society organizations and citizens to manage themselves, e) reform of public administration and management to increase efficiency and effectiveness, f) development of a new ideology for reformed governing – step away from welfare state governing towards new kind of governance and increase of efficiency and effectiveness in public administration.⁴⁰¹

The NPM regimes were in most OECD countries a mixture of theoretical backgrounds and practical needs and possibilities. Allen Shick has found four models: 1) the market model, which is based on the assumption of the efficiency of the markets, criticism of the bureaucratic monopolies and idea of generic management – management is management, no matter where it takes place 2) managerial model, which is based on the assumption that the liberation of managers – let the managers manage – from ex ante controls on inputs and operating procedures maintained by central controllers will boost organizational performance, 3) program strategy, which is based on the assumption that the most urgent task in reforming the modern state is ensuring that public resources are effectively allocated to achieve the fundamental objectives of the government, and 4) incremental strategy, which is a cautious approach, where changes are made when opportunities become available.⁴⁰²

New Public Management: a sustainable governing regime for the future? In this chapter I have discussed the challenges for general political governance and for specific governance regimes

⁴⁰¹ See a similar interpretation *Pierre and Peters* 2000, 50-69. For an analysis of the state reforms see World Bank: *World Development Report 1997* and *Harrinvirta* 2000, 18-47.

⁴⁰² *Schick* 2001, 136-139. Especially of the market model see also *Peters*, 1996, 22-31. Of different classification of the models see *Peters* 1996, *Kettl* 2000, 8-29.

of markets and society. All these challenges have to be taken care of in the governing of the public sector, because public administration is responsible for carrying out the policies and reforms. Before the question will be answered, I have to comment on the present dominant governing regime, i.e. the New Public Management regime.

My first observation concerns the principles defining leadership and management responsibilities of the state. The reforms have strengthened the position of the government in the governance of the country. It has the general responsibility for the political leadership of the country and specific responsibility to draw the strategies for the governing of the public sector and to define the management principles. Governments cannot return back to the old model, where leadership and management functions were not clearly separated. The separation of leadership and management functions belongs to the basic reform ideas.⁴⁰³

Second, the present governance model is deregulated to the extent that the most effective and efficient organization structures, management, control and financing principles can be defined based on the substantial needs of the issues and policies. Deregulation has produced differentiation in the public sector. This has concerned organization principles and finance management, budgeting, decision-making and personnel policies. In many countries it has been a step away from a juridical conception of administration towards a new conception, which has its roots in business management.

Third, as a result of the loosening of regulation of administration market mechanisms have been adopted in administrative tasks and administrative agencies subordinated to the government have been transformed into independent public corpo-

⁴⁰³ See especially reforms in New Zealand *Schick* 1996.

rations or into half-public enterprises. Both of these reforms have diminished the size of the core functions of the state. Both strategies have delegated the management responsibilities from the government to lower levels. Regardless how successful the reforms have been in their original goals – reduction of public expenditure, minimization of state in service delivery, modernization of management – they have had immense unintended effects. The old hierarchical and unitary state structure and governance model has been blurred down. Once the old centralized formal hierarchy and market models have challenged the unitary management and governing of the state from the 1980s onwards, we have lived with and tried to get best results with this new model. The effects of the transformation of the state's organization structures, steering mechanisms, financial principles and management practices are manifold. Differentiation and breaking up of the unitary structure and central steering is one of the most important results of this transformation. Uniformity and authoritarian use of power are not any more the only organization and governance principles. Instead, governance is based more and more on principles of market steering, differentiation, devolution and management.

Fourth, privatization, deregulation, outsourcing of tasks and use of the provider-purchaser model have brought new challenges. When public services are not provided only by public agencies and when the state has diminished the traditional regulation of the markets and society and privatized public companies, new forms of interaction have emerged. They do not concern only contractual relations between the ministries and private service providers but a new kind of steering of the national development. Although the state's own public service functions have decreased, coordination of service delivery and national development has to be coordinated. Kettl emphasizes

the spread of networking as a new coordination mechanism, which does not show a sign of fading away though they declarify accountability relationships in administration. He asks: “ How can government ensure accountability in extended service network where administrative responsibility is widely shared and where no one is truly in charge? How can government, structured and staffed for an era when vertical relationships dominated, build the capacity to manage horizontal partnerships effectively?”⁴⁰⁴

On a general level the countries that have carried out wide range of reforms – not only adopted private sector models - and adopted a comprehensive reform strategy have succeeded in their reforms and economy relatively well.⁴⁰⁵ Studies of the effects of public management reforms on economic development encourage continuing the reforms with a differentiated and comprehensive reform strategy.⁴⁰⁶

Measured against its self-proclaimed universal relevance, NPM clearly has not become the predominant public management paradigm in developing countries.⁴⁰⁷ Discussion of the relevance of NPM reforms and reform strategies for Central and Eastern Europe is quite active.⁴⁰⁸ Reviews of public management and capacity building developments in less developed

⁴⁰⁴ *Kettl* 2000a, 495

⁴⁰⁵ See of the evaluation of different reform strategies *Harrinvirta* 2000.

⁴⁰⁶ See for example *Kaufmann, Kraay, Zoido-Lobotón* 1999, *Kaufmann, Kraay, Zoido-Lobotón* 1999b:, *Aron* 2000, 99-135 and *la Porta, Lopez-de-Silanes, Shleifer, Vishny*, 1998.

⁴⁰⁷ Of comparison see *Harrinvirta* 2000 and *Innovations in Public Management* 1998.

⁴⁰⁸ Of discussion see *Verheijen*, 2000, 407- 418, *Coombes* 2000, 418-426, *Schick* 1998, 123-131 and *Bale Dale* 1998, 103-121.

country demonstrate⁴⁰⁹ that hierarchical bureaucracies were not replaced by chains of inter-linked contracts. Some significant reforms have drawn from the NPM menu but most government functions are still performed by vertically integrated bureaucracies functioning pretty much as Weber imagined.

A World Bank study of the changing role of government in adjusting economies in South Asia, Sub-Saharan Africa and South America finds that the effect of NPM reforms have been mixed, at best, with some improvements in efficiency and varying effects on equity. On the downside, the transaction costs of radical reforms to autonomize service delivery agencies tended to outweigh the efficiency gains of unbundling, and reforms that seek to separate purchasers from providers sometimes reduce accountability.⁴¹⁰

The summary has shown that New Public Management has offered a sound foundation for the regime of public sector in developed countries. Its principles emphasize decentralization, self-government and devolution of state power to markets and society, and economy and efficiency. NPM includes major challenges of the future. It offers a base for the government to act as major political leader of the country without interference in the management of implementation, it safeguards political accountability mechanisms, independence for such administra-

⁴⁰⁹ See a summary of studies of capacity building in developing countries in *Hilderbrand, Grindle* 1997, 32, 58. The British Government's Department of International Development has launched a research program concerning feasibility of models of public service reforms generated in rich countries in poor countries. The results of this study program are presented and discussed in *Journal of International Development* 11, 1999. See for example *Batley* 1999, 755-765.

⁴¹⁰ World Bank: *Governance & Public Sector Reform Site*. Administrative & Civil Service Reform. New Public Management and its Legacy. <http://www1.worldbank.org/publicsector/civilservice/debate1.htm> (visited 29/11/2003)

tion, which should be based on the rule of law and legality, offers channels for market mechanisms for such functions, where political leadership wants to implement them, and in the long run it has reduced ideological considerations from the governing of the public sector by emphasizing technical considerations. For developing countries the situation is more difficult. They should be cautious in adapting these measures. It is crucial that they remember the importance of classical features of Weberian bureaucracy. I will return to these questions in the next chapter.

Effects of September 11, 2001 in the USA have been a remarkable test for the strength of NPM regime. The US government has acted on practical grounds. It increased immediately the traditional tasks of the state - law and order- and strengthened its general responsibilities to safeguard continuation of nation and state and to offer a clear framework for markets, society and for citizens. In a word, traditional political governing ideals have been revitalized in the USA to some extent.

The year 2001 brought important cases for the discussion of governing not only from the perspective of September 11, but also from perspective of market self-governance and self-regulation. The collapse of Enron and crisis around Arthur Andersen's accounting practices have raised discussion of the governance regime of self-regulation of the markets. The return of traditional market regulation of the state has been demanded, because the scandals have shown that malpractices emerge if there is no government regulation and oversight. The scandals have connections even to discussion of corruption and state failure, because the same firms have financed political parties' election costs with the purpose of influencing in decision-making by the government. The cases have launched a long-standing discourse of the sustainability of principles of networking and down-up governance.

One of the origins of the term governance was based on the interpretation that the second-generation public sector reforms in the UK had produced a new governance regime. I cannot go into details of the governing practices in the UK, but only suppose that a birth of a totally new governance regime demands more fundamental reforms than just networking. If a new regime of governance does not change the fundamental tasks and nature of the state, basic propositions of transparency of decision, accountability of public policies, predictability of the government officials and the rule of law for all, it cannot be a totally new governance regime.

5.3. Concluding comment

The state in society and economy is a theme that can be discussed in different connections, but it cannot be studied on the general level and receive any relevant conclusions. The states of the world and their histories are too diverse to master, even their basic development features. This comment can be regarded as a apology for the meager results of my endeavor to find some background material for a more detailed discussion of the recent changes in public sector governance, public management or administrative development. This variety of terms and definitions (governance, management administrative development) for the same phenomenon gives a good hint of the manifold development of the subject of the study.

When I relate the discourse of governance in the academic and political discourse of the state and economic development, the discourse of governance receives a location, which emphasizes competition among nations and eternal strive for improvement. Political debate of the role of the state is connected with the interests of non-state actors to push-through their interests

through the political process. The variety of academic discourse is an expression of the birth of practice oriented social sciences, which develop new ways of giving input in national development. However, there are real reasons for the discourse of New Public Management and public sector governance. Changing values and ideologies of the people from authoritative structures to self-realization and from collectivist values to more individual ones, globalizing economy, mergers of companies, collapse of national borders and emergence of new technologies (ICT), which enable new systems of rule and structures of authority outdate traditional management systems and authority structures. There is a need for new ones.

The heated discourse on New Public Management in academia is a good example of the ideological and political nature of public sector reforms. The discourse of governance is a part of this discourse family and represents its next step. So far it has not raised such a debate, even though there are clear marks of similar tendencies.

6. Differentiated public sector governance

6.1. Basic elements of public sector governance

The purpose of this chapter is to present a more detailed analysis of governance processes in the public sector. Special emphasis is on the general principles of differentiated public sector governance. Even if this study has emphasized the importance of the new principles of governance discourse, I want to stress that institution building is always a process, which is composed of different layers, which cannot be omitted. Conflicting arguments in the discussion of the New Public Administration is as an excellent example of this. New ideas are improving and restocking traditional principles of public administration. New ideas may to a certain extent destroy the outmoded methods and practices, but they do not destroy the basic purposes and tasks of the state and public administration. I will emphasize the importance of these classical themes of public administration and give less attention to the new themes of modernization, efficiency and economy. These arguments can be found easily in new books on public management.

Even if New Public Management discourse in the late nineteenth century has not abandoned and changed most of the basic principles of public administration, it has affected some of

them in a fundamental way. Use of market principles in public services is one of the best known examples of these changes. Acceptance of business ideas in public administration is similar example. In this study I would like to raise into a similar position the differentiation of the public sector, which has not been discussed as actively as these two above mentioned changes. The reason for this is simple. It has not been adopted, because it belongs to the next steps of reforms in public administration. However, most industrialized countries do not carry out all public functions and provide services in a uniform way. Differentiation of public sector governance is based on the idea that the political goals for and basic values of different public functions should decide how these functions should be organized, managed, and financed. All public functions should operate in accordance with policy principles, steering models and forms of financing suitable for their basic values.⁴¹¹

In spite of the fear of simplifying the manifold variety of the tasks of public sector, its major tasks can be broken up into three main segments. These are:

- Administrative functions involving the exercise of public power. It belongs to the responsibility of public authorities that provide policy advice to the government. It involves such matters as definition of issues, consultation with interested parties, identification of options, analysis consensus building, consultation with other sources of policy expertise and development of recommendations. General governance of the country, maintenance of public order and safety as well as the maintenance of basic rights of the citizens and the democratic order of society belong to the administrative functions also.

⁴¹¹ Especially in Finland this idea has been accepted widely. The Government defined the principles in the resolution of *High-Quality Services, Good Governance and a Responsible Civic Society* 1998.

- Public service functions that do not involve the exercise of public power. Independent service providers and municipalities are responsible of the services for citizens and the enterprises.
- Public business and production functions. Public enterprises and companies are responsible for the government’s business and commercial tasks. They should be separated from non-commercial activities. In economic literature they are called public goods.

These functions cannot be managed, steered, financed and regulated in a unitary but rather in a differentiated way, because their values are so different. The new model of the governance of the public sector can be visualized thus:

Table 3: Governance of public sector

core functions of the state (public administration)	public business functions (public companies)	public service functions (service providers)
rule of law, economy efficiency, effectiveness transparency	profitability	value for money good service
public management	public corporate governance	service management

Each of these functions has its own organization, steering, financing, controlling and personnel principles.

The role of the government in governing different sectors varies according to the nature of each function. Public administration is the core function of the state. As a legal entity, the leadership of public administration belongs to the government, in accordance with the principles defined in the constitution and administrative legislation, with a special emphasis on legality and the rule of law. The organization of political governance is basically hierarchical. In public services the emphasis is on good customer service values; in public business functions, profitability is the dominant value.

Although public functions will be provided in a differentiated way and there is not a uniform model for public sector, the general policy guidelines that define the general principles for public sector and for the management of the programs should be defined at the top levels of the government. A political consensus not just inside the government but between all major political actors is a prerequisite for a cohesive and coherent approach to governance and for public sector reforms.

The differentiation of the state functions is visualized in the next picture as follows:

Table 4: Differentiation of the state functions

	Core functions of the state (responsibility belongs solely to the state)	Social tasks and functions	Commercial and business functions
Main tasks	<p>Tasks</p> <ul style="list-style-type: none"> -legislation -execution (steering, regulation and supervision) -jurisdiction <p>Authorities</p> <ul style="list-style-type: none"> -ministries and administrative agencies -regulatory agencies -executive agencies and courts 	<p>Administrative authorities</p> <ul style="list-style-type: none"> -service agencies and units 	<p>Public enterprises</p> <p>Public companies</p>
Secondary tasks	<p>Assignments to</p> <ul style="list-style-type: none"> -markets and companies -society -individuals 	<p>Assignments to</p> <ul style="list-style-type: none"> -markets and companies -society -individuals 	<p>Assignments to</p> <ul style="list-style-type: none"> - markets and companies - society

The strategy is based on the idea that the state cannot be governed in a unitary way. When all public sector actors do not adopt a uniform policy model in organization, management, financing and implementation but organize themselves according to the nature of each function, the capacity of the government as a whole in political governance will increase. A minimum prerequisite is that the government launches a policy that is based on a conceptualization of the public sector in a more organized manner. This enables greater flexibility in reacting to changes in the international field and to the needs of citizens and the businesses.

6.2. Governance of public administration

6.2.1. Basic nature of public administration ascends from legality

Public administration is the most important player in the democratic governance of a nation and the backbone of order in society. Public administration forms the core of the executive power. Its importance is not limited only to the public sector but reaches the markets and society also. The performance capacity of the public sector has to be ensured under all circumstances. September 11, 2001 terrorist attacks to New York and Washington have shown clearly that institutions responsible for the external and internal safety of the country safeguard the very existence of a nation.

Researchers are unanimous that administrative action in all political system must fulfill at least two objectives simultaneously. First, political system has to maintain administrative capacity. Second, it must be controllable in order to ensure accountability and responsiveness of administration for both political decision-makers and citizens. Robert Kaufman says that administrative institutions have to serve three values: representativeness, neutral competence and executive leadership.² Researchers have their own emphases, but after a review of the major literature on the subject in the USA Lawrence Lynn drew the following conclusion:

“If there are assumptions that are taken for granted, or a paradigm, in traditional thought, it is that the structures and processes of the administrative state constitute an appropriate frame-

⁴¹² *Kaufman*, 1956, 1057-75. See discussion of the theme *Lynn* 2001, 144-160.

work for achieving balance between administrative capacity and political control on behalf of public purposes defined by electoral and judicial institutions, which are constitutionally authorized means for the expression of the public will. In other words, preserving balance between the capacity to effect the public interest and the democratic accountability of governance was, and arguable still is, the task of democracy.⁴¹³

Quality requirements for basic administrative tasks are very demanding. The governing regime of traditional bureaucracy is built to meet the basic requirements of political accountability, neutral competence and executive leadership. Accountability was built towards political actors, legislature and the government. Already from the late nineteenth century onwards it has been emphasized that administrative functions that involve the exercise of public power have to be organized within state administration in a way that fulfills the above-mentioned requirements.

During the active reform period when private management principles reformed the regime of classical public administration, the merits of traditional public administration were forgotten. Its defenders were regarded as old-fashioned. However, recent comparative studies on economic development and growth have shown that bureaucratic organization has its merits.⁴¹⁴ Evans and Rauch emphasize that countries that receive high scores on Weberianness scale – used meritocratic recruit-

⁴¹³ Lynn 2001, 154.

⁴¹⁴ Oliver E. Williamson, who has analyzed public and private bureaucracies from a transaction economics perspective, has found that in political field and in general affairs of public utility – areas of hazards of probity – public bureau is more efficient than private organizations. See Williamson 1999, 306-342. Stiglitz is towards un-critical, general propositions, that public organizations are less effective than private organizations. Stiglitz 1991, 37-59.

ment, offered predicable, rewarding long-term carriers, competitive salaries, internal promotions, career stability – have significantly enhanced prospects for economic growth.⁴¹⁵ For example Scandinavian countries, which have not been willing to follow the ideology of privatization and have not been forerunners in adopting private sector management models, are getting good results in competitiveness scores and corruption indexes.

A central task of public administration is to guarantee the fulfillment of public interest under political steering and to carry out public functions. There must be strength and independence in the handling of public functions as well as a clear chain of public accountability. The goals and tasks of public administration have to be developed clearly. Significant functions involving exercise of public power are only entrusted to public authorities.

I have not discussed in detail the scope of public administration, because the definition of administration is culture and time related and depends on the scope of the functions of the state. Organization structures have not been even mentioned in this connection, because the exercise of public powers is an exclusive right of the state. Every state decides its public authority functions. In European Union member states from 10 to 40 per cent of public tasks have something to do with the “exercise of public law powers and safeguard the general interests of the state” to use the wording by the European Court of Justice from 1979⁴¹⁶. Things can be organized in different ways. A good example of this difficulty is the question of political advice for the ministers.

⁴¹⁵ *Rauch & Evans* 2000, 49-71, *Evans & Rauch* 1999, 748-765.

⁴¹⁶ See discussion of the case and of the principle *Cardona* 2000, 6-7.

Rule of law as the basic principle of public administration The functions and decisions of public administration have to be based on law. From the late nineteenth century onwards the rule of law has been the fundamental principle in most modern western states and systems of political governing. The idea of the rule of law was born in the late nineteenth century at the same time as the division of labor between the markets and the state were defined and the institutions of the market economy were created. The background for the emergence of the rule of law was the long lasting tradition of uncontrolled powers of hereditary rulers.

The rule of law is not applied all over the world. It is not a basic principle in all political systems, but it is one of the major institutions, which international development organizations have tried to transfer in the 1990s. The characteristics of law in liberal democracy are well known, but they are not always accepted, because the characteristics of the rule of law -principle can be defined in different ways, including ways that raise strong resistance. For example Ellen S. Cohn and Susan O. White, who have studied the implementation of the rule of law principles in Central and Eastern Europe, have defined three general characteristics in the rule of law and found that these principles are not politically neutral and easy to adopt outside Western cultures. The principles are the primacy of law over arbitrary uses of political power, the primacy of the individual through the protection of individual rights claims, and the primacy of universalism over particularism through the abstraction of the individual from social characteristics in front of law. The authors notice that definition of the principles of the rule of law from a strong Western/Anglo-American perspective may restrict their adaptability in less individualistic and more authoritarian and ethnically divided cultural traditions.⁴¹⁷

⁴¹⁷ *Cohn and White* 1997, 153.

The rule of law is a mechanism to maintain social order and foster economic development. Present emphasis on the rule of law and its wide implementation in most capitalist countries make us forget that the rule of law is only one mechanism of social order and governance. However, its importance in economic development has been recognized for centuries (Adam Smith, Thomas Hobbes, Max Weber, Douglas North).⁴¹⁸

In public administration the principle of the rule of law (tradition of *Rechtstaat*, i.e. strong emphasis on legality and the proper fulfillment of regulatory functions) is materialized in administrative law, which has developed into a special discipline in the late nineteenth century. The French theory of administrative law emphasizes the role of administration as a producer of public services, and as an entity, which acts in the public interest. The German theory emphasized control of government as the core of the subject, regards administration as a holder of public authority and emphasizes conformity of administration to law. In this model administrative law is regarded as a mechanism for preventing administrative authorities from making unlawful intrusion into the sphere of private interests. Administrative law defined the legal limits for trespassing on private autonomy when such incursions had been authorized by the legislature.

Administrative activity has been traditionally conceived as the use of power or exercise of public authority. Written administrative decisions have been its concrete form. Administrative law has secured legality in administrative decisions, because it was seen that most administrative acts interfered in the legal status of citizens by defining their rights or by imposing obligations. Besides, the purpose of administrative law was to define

⁴¹⁸ A brief summary of discussion of rule of law and economic development is in *Messick* 1999, 120-123.

and protect the legal status of citizens by defining the required competence of authorities applying the law and by securing adequate legal means of safeguards, which can be resorted to, if authorities exceed their authority or otherwise act illegally.

Moe and Gilmour say that the whole foundation of present administration is in public law.⁴¹⁹ An especially important phase for the present system of administrative law in Europe was the codification of administrative legislation in the late nineteenth century. The old unified science of cameralism dispersed into different disciplines.⁴²⁰ Disciplines of public law and administrative law received dominant positions in administration. They had a leading position in defining what is administration, what are its procedures, and how it functions.

From the 1940s onwards the conception of the rule of law as the sole principle of administration received growing criticism, because the tasks of the state grew outside original responsibilities and the rule of law could not be the only principle that should be followed. This change was not sudden but a slow process. Already in the 1920s flexibility and goal-oriented norms were discussed, as well as the norms of providing a framework or other competent norms, which allow broad discretionary power to the authorities. For example in the USA Leonard White took in 1926 rebuke that public law traditions should start from the basis of management rather than the foundations of law. White said that actors of administration should be consistent not only with the law but equally with the purposes and temper of the mass of citizens.⁴²¹ Changes were slow, but in all countries at least during the Second World War and after the war in reconstruction the strict regulations of public administration were loosened and more freedom was given. Administra-

⁴¹⁹ *Moe, Gilmour* 1995, 135

⁴²⁰ *Small* 1969.

⁴²¹ From *Lynn* 2001, 151-153.

tion could function more on its own initiative than before. The emphasis shifted from legal rules and cases to the formal framework and procedures of the administrative machine. Authorities prepared regulations and implemented legislation in a quite independent way.⁴²²

Establishment of administrative sciences in universities and adoption of the welfare state/great society governing model in the 1960s broadened the scope of administrative principles from the rule of law to economy, effective management and effectiveness.

Since the 1960s competition between the rule of law, i.e. political accountability and effective management, i.e. efficiency has dominated the discussion of administrative development.⁴²³ The basic poles are procedural equality and objectivity vs. economy and managerial discretion. Both of these poles have justified reasons. Discussion of the fundamental nature of public administration and of its principles is always topical, but its perspectives will change and receive new weighting. The long-lasting growth of the tasks of the public sector has uncovered dysfunctions in the bureaucratic administrative model, even though there have been attempts to modernize it. Bureaucratic failures have given direction to different kinds of crises discussions for almost two decades.⁴²⁴ Critics have questioned the existence of special public organization models and special public organization principles, which are separate from private ones.

⁴²² Lynn 2001, 151-157. Interpretation of the development from the Finnish perspective, see *Mäenpää* 1993, 297- 299.

⁴²³ Of discussion about the development of the public administration in Scandinavian countries see *Meyer* 1960, 135-146. See a modern Finnish interpretation of the dichotomy of efficiency and legalism *Temmes* 1997, 7-79.

⁴²⁴ A summary of the intellectual crisis on public administration is *Haque* 1996, 510-536.

Economy, efficiency and effectiveness have even surpassed traditional principles stemming from the rule of law. Adaptation of private management methods and privatization are concrete expressions of this. In many countries privatization has concerned even use of public power.

The heads of the states in the European Union proclaimed the Charter of Fundamental Rights of the European Union at the Nice summit in December 2000. The Charter included as fundamental rights of citizenship the right to good administration and the right to complain to the European Ombudsman in cases of maladministration.

The charter of the Fundamental Rights of the European Union stipulates the principles of good administration (art 42). According to it every person has the right to have his or her affairs handled impartially, fairly and within a reasonable time by the institutions and the bodies of the Union.⁴²⁵

In 2001 The European Parliament adopted a resolution approving a code of *Good Administrative Behaviour*, which is the

⁴²⁵ This right includes 1) the right of every person to be heard before any individual measure which would affect him adversely is taken, 2) the right of every person to have access to his or her file while respecting the legitimate interests of confidentiality and of professional and business secrecy; 3) the obligation of administration to give reasons for its decisions. Every person has the right to have the Community make good any damage caused by its institutions or by its servants in the performance of their duties, in accordance with the general principles common to the laws of the member states. Every person may write to the institutions of the Union in one of the languages of the treaties and must have an answer in the same language. Besides these, every person has right to access documents, right to petition and a right to refer to the Ombudsman of the Union of maladministration. Charter of the Fundamental Rights of the European Union, art 42, 43 and 44. Official Journal of the European Communities 18.12.2000, C364/19.

newest document in the field. Its basic principles are 1) lawfulness 2) absence of discrimination, 3) proportionality, 4) absence of abuse of power, 5) impartiality and independence, 6) objectivity, 7) legitimate expectations, consistency, and advice, 8) fairness, 9) courtesy, 10) reply to letters in the language of the citizen, 11) acknowledgement of receipt and indication of the competent official, 12) obligation to transfer to the competent service of the Institution, 13) right to be heard and to make statements, 14) reasonable time-limit for taking decisions, 15) duty to state the grounds of decisions, 16) indication of possibilities of appeal, 17) notification of decision, 18) data protection, 19) request of information, 20) request for public access to documents, 21) keeping of adequate records, 22) publicity for the code, and 23) right to complain to the European Ombudsman.⁴²⁶

According Moe and Gilmour, notwithstanding apparent national preference for the delivery of government services by private-sector contractors, government officials should always carry out the basic functions of government. Such functions as the making of law binding on citizens, authoritative adjudication of disputes, control over elections for government office, the exercise of coercive force over others, and the denial of private rights on behalf of the state are peculiarly those of the state. Such functions involve an exercise of fundamental powers of the sovereign, which should not be delegated to private parties.¹⁷

The basic manifestations of the principle of the rule of law and political accountability are 1) hierarchical organization structure, 2) professional civil service, 3) high-level policy ca-

⁴²⁶ The code is in the internet-site of the European Ombudsman (<http://www.euro-ombudsman.eu.int/code/en/default.htm>, visited 29.11.20 03).

⁴²⁷ *Moe, Gilmour* 1995, 141-142.

capacity and 4) parliamentary budgetary system. Naturally there are more similar requirements and the classification can be done in different ways, but this serves our purposes.

The European Commission Progress Reports in 1999 for the new accession countries has a list of administrative capacity assessments, which is based on OECD's SIGMA baseline assessments. This is a comprehensive list of necessary administrative institutions, which every good administrative system should fulfill. It has similar elements to the list above, but is more detailed and emphasizes financial questions. On the other hand it does not have an organizational dimension at all. The basic administrative institutions for the EU are: 1) policy-making and coordination, 2) civil service, 3) public expenditure management system, 4) public procurement, 5) internal financial control, and 6) external audit.⁴²⁸ I will comment some of these.

Hierarchical organization Hierarchical order, functional specialization and process control are the basic elements of hierarchical organization structure in public administration.⁴²⁹ It safeguards political accountability. In spite of the criticism, which bureaucratic organization structures have faced, they provide direct, hands-on control of services through rule-based discipline and hierarchical steering and control. Hierarchies and functional specialization are designed more to ensure accountability for managerial actions than to promote control over employees. Political accountability for the implementation of policy and law requires a clear line of authority from the government to the heads of the departments and agencies and from them to their subordinates. The traditional hierarchical model with special emphasis on the responsibility of civil servants to the minister is built to support the political accountability of the

⁴²⁸ See *Verheijen* 2000, 17-20.

⁴²⁹ Of organization structures see *Peters* 1978, 109-136, *Hood* 1986.

minister to the legislator. Through this hierarchical chain citizens and customers have some influence in the activities of administration. The demand to raise accountability to a fundamental value in administration is quite a recent phenomenon.

Professional and permanent civil service Professional and non-political permanent civil service⁴³⁰ is the second central institution of democratic public administration. It is a personnel structure (or more accurately a collection of structures) manifested in a dozen or more statutory laws, in hundreds of executive orders of the government, and thousands of rules and regulations.⁴³¹ The basis of civil service is defined in the constitution of the country. At the same time civil service can be understood to be an idea rather than a body of personnel regulations. This idea is connected with the continuity of governance.

The high competence demands set for the civil service are springing up from the challenging tasks of the state, which demand both political decisions and permanent neutral expertise. Administration is an instrument, which carries important political, economic and social reforms and implements them. It is a task of long-term perspectives, which must not be destroyed by short-term calculations, partisan politics and abuse of power and mismanagement. These high competence and capacity requirements can be safeguarded by the principle of a professional civil service as a profession in its own right and public officials with competence and expertise in their own field. Recent studies (Evans and Rauch) have shown that meritocratic, professional civil service is even more important for economic growth

⁴³⁰ See a general presentation of different civil service systems *Civil Service Systems in Comparative Perspective* 1996, *Public Employment in Western Nation* 1985, *Civil Service Systems in Western Europe* 2000, *Civil Service Systems in Central and Eastern Europe* 1999 *Civil Service Systems in Asia* 2001.

⁴³¹ *Hecló* 1977, 19-20.

than other civil service components and the wage bill. There are differences between countries, but on general most countries emphasize professionalism, competence, permanence, depolarization and responsiveness of civil servants.⁴³² The basic characteristics of civil service are defined in legislation. A special law, a Civil Service Law, is the means to define the scope of civil service, the merit based qualifications, duties, rights and discipline of civil servants, as well as their working conditions, objective, professional grounds of dismissal, personnel participation and training.⁴³³

Effective civil service system functions in most countries under a central institution that is directly responsible to a political authority for the civil service management (definition of the personnel, pay and training policies, implementation of the legislation, management of recruitment and promotion processes) of the country.⁴³⁴ Barbara Nunberg emphasizes that choices about optimal organizational structures for civil service management and assignment of responsibilities to key personnel functions are both critically important to successful administration. Centralized systems of civil service management display a high degree of control and professional standardization especially in developing countries where the capacity of individual agencies to manage the civil service systems is limited. Central systems enhance control, coordination, and capacity for longer-term strategic planning and greater political access for personnel functions. In contrast to these centralized systems, highly developed countries (New Zealand, Sweden and Finland) have gone towards decentralized civil service management.⁴³⁵

⁴³² Rauch, Evans 2000, 49-71 and Evans, Rauch 1999, 748-765.

⁴³³ Basic requirements of civil service legislation are defined in *Civil Service Legislation Content Checklist* 1996.

⁴³⁴ Nunberg 1995, 14-20.

⁴³⁵ Nunberg 1995, 16.

Civil service systems differ in most countries, but there are certain common features in democracies.⁴³⁶ Some of them have been mentioned already. Heclo mentions three such principles: (1) the selection of subordinate government officials should be based on merit – the ability to perform the work rather than any form of personal or political favoritism; (2) since the jobs are to be filled by weighting the merits of applicants, those hired should have tenure regardless of political changes at the top of organizations and (3) the price of job security should be a willing responsiveness to the legitimate political leaders of the day.⁴³⁷ These principles concern all civil service systems regardless of their bases. There are two principal ideal types with real cases falling between them: 1) a career system with closed entry, rigid hierarchical systems with limited inter-class mobility and highly selective entry requirements and 2) a more open position system with lateral entry, greater vertical and horizontal mobility, and more flexible entry mechanisms.⁴³⁸

One of the Robert Kaufman's three basic values of public administration is a quest for executive leadership.⁴³⁹ The traditional Weberian conception did not even use the word management or executive leadership. Instead it concentrated on administration and decision-making. In most countries special leadership requirements and training of management and leadership skills to the public sector managers are recent phenomena.⁴⁴⁰

⁴³⁶ See for example a study of European systems *Civil Services in the Europe of Fifteen* 2001.

⁴³⁷ Heclo 1977, 20.

⁴³⁸ Nunberg 1995, 21-27.

⁴³⁹ Kaufman 1956 1062-64.

⁴⁴⁰ Smith 1983, 14-15. See special reports from Britain (William Plowden), Canada (Colin Campbell, S.J.), Germany (Renate Maynz.), and France (Bernard Gournay) in op cit., and *Bureaucrats and Politicians in Western Democracies* 1981.

The whole theme has not even been actively discussed until the 1980s.⁴⁴¹ One of the basic ideas in public management reforms in the 1980s and 1990s was to reform the management and leadership in the public sector. Allen Schick regards managerial reforms as one of the major reform strategies (managerial strategy). It is predicated on the presumption that “letting managers manage” by liberating them from ex ante controls on inputs and operating procedures maintained by central controllers boosts organizational performance.⁴⁴² Because public management reforms had their intellectual roots in managerialism, private sector ideas of management were brought into the public sector arena. Public managers were sent to school to learn management and leadership skills and were given more authority to manage their organizations. These reforms form only the first step of management reforms, and can be called first-generation reforms.

The reasons for the importance of professional civil service are manifold. First, it represents special expertise in governance and governing. Public administration is the only body in every country that is responsible for governing and has the right to exercise coercive force over others. Second, it represents perspective on policies that may extend beyond immediate political

⁴⁴¹ A good indication of this offers a symposium report of the OECD. The OECD arranged a symposium “*Managing Change in Public Administration*” in Madrid 1979. The report of the symposium do not discuss of management and leadership. Instead it stresses planning systems, personnel policies, fiscal and budgetary instruments and structural reforms. See OECD 1979. Leadership is still missing from OECD’s work in 1988. See OECD: *Administration as Service* 1987. Positive exceptions are *The Job of the Federal Executive* 1958 and *Hecló* 1977.

⁴⁴² Schick 2000, 137.

goals. It has to look at broader public interests and values that state policies may bring to the policy area⁴⁴³

Policy-making capacity Policy-making capacity is the third central requirement set for public administration. The first general discussion of these questions started in the 1970s, when Yehezkel Dror developed principles and models.⁴⁴⁴ The demands for effective policy making capacity in the higher levels of administration is especially important in policy turbulence. As a consequence of privatization, globalization, and search for new governance methods after comprehensive public sector reforms (decentralization, differentiation of public sector and enhance of managerial autonomy) the demands for coherence are crucial. B. Guy Peters has summarized the need for greater capacity in government nicely: “The Issues with which government must contend are becoming increasingly difficult to manage. Governments cannot determine what issues will be presented to them or in what form they will be presented, but they can develop the mechanisms for managing cross-cutting issues and making government work better in a horizontal manner.”⁴⁴⁵

Peters has detected two elements of good policy capacity. They are first, the capacity to translate the wishes of the public, as expressed in the elections into public policy and second, the utilization of knowledge within the policy-making processes.⁴⁴⁶ These elements mean in reality the combination of values and political preferences and analytical judgment of the future prospects and challenges for the present predicaments of policies.

Buckaert, Ormond and Peters have identified six qualities emerging from contemporary experience, which are likely to

⁴⁴³ Peters 1994, 747-748.

⁴⁴⁴ Dror 1986 and Dror 1983.

⁴⁴⁵ Peters 1996a, 37.

⁴⁴⁶ Peters 1996a, 11-12.

contribute to the maintenance of a well-functioning policy process. They are 1) strategic capacity, 2) policy coherence, 3) consensus seeking, 4) informed policy-making, 5) cost-effectiveness and 6) responsiveness.⁴⁴⁷ These requirements aim to ensure a comprehensive perspective in policy decisions through the broad participation of various actors without forgetting the need to make firm and prompt decisions.

Improvement of policy-making capacity in the higher levels of administration is composed of several demands. First, they need to involve both the permanent senior civil servants and top political actors in the highest policy formulation level but make a clear division of labor and a division of competencies between the political level and senior executives in policy advice in central agencies, which have one foot in the administration and the other in the political world.⁴⁴⁸ Policy analysis should not be compensated with political advice and vice versa. There is a real need in decision-making for both values and different kinds of facts. Though a distinction between politically partisan and non-partisan advisers needs to be made, there should be adequate communication between both groups.

Second, to improve communication between the political and senior administrative levels on problems of governance and the content of the challenges of the policies. In addition, the government should have open channels to private sector sources of information and other alternative sources of policy advice,

⁴⁴⁷ Bouckaert, Ormond and Peters 2000, 48-52.

⁴⁴⁸ Definition of the central agencies see the web-site of the World Bank (<http://www1.worldbank.org/publicsector/civilservice/center.htm>). Peters stresses the importance of senior civil servants in the decision-making, because their influence has diminished recently because of emphasize of political nominations and private sources of information Peters 1996a, 32-33.

though political and administrative remain the main sources of information. Third, to evaluate regularly working-methods, decision-making structures, priority-setting mechanisms and implementation systems in strategic questions (especially in general macro management and in budgetary processes). Because decision-making has such a huge amount of uncertainties and unpredictable components, the proposals submitted to the government should meet the highest quality standards. Lines of accountability within the government and public accountability should be clearly defined and in good condition. A similar demand concerns system of policy advice, priority-setting mechanisms and their links to financial and planning system and implementation planning.

Fourth, to adopt some kind of a horizontal strategic management process for the government and all its sectors (ministries). The body responsible for strategic management should change on a regular basis.⁴⁴⁹ The articulation of national vision and development of strategies based on it should be integrated into the economic and financial frameworks. Integration and coordination of national development policies into the economic frameworks is the key prerequisite for all government policies. Policy capacity building is concerned mainly with the organizational arrangements in state chancelleries and the Prime Minister's Offices. Normally ministries of Finance and Treasuries are not included in this discussion.⁴⁵⁰

Fifth, there is no clear organization model⁴⁵¹ for policy-advice. The organization models depend mostly on the political

⁴⁴⁹ *Strategic Decisionmaking in Cabinet Government* 1999, 8-18.

⁴⁵⁰ See for *Manning* 1999 and *Dror* 1986, 285-290.

⁴⁵¹ See for example *Wright & Hayward* 2000, 27-46, *Administering the Summit* 2000 and from the point of view of public sector reform see *Lindquist* 2000, 149-183.

structure of the government – one-party or multi-party government, position of the president in government decision-making –, the role of the prime minister as the leader of the government, general arrangement of political advice for the ministers – French system of *cabinets*, German and Scandinavian system of political state secretaries or British system of junior ministers and non-political permanent secretaries – and historical traditions of the country. Regardless of the system, policy advice of the government should not violate the normal division of labor between the Prime Minister and other ministries.

Sixth, policy capacity's effectiveness is built on trust in professionalism and capacity.⁴⁵² Trust is based on the idea that everybody is working to serve the government's broad policy agenda and public interest and advisers are loyal to the government. Advisers should have the reputation of being the best and brightest public servants, facts and analysis are of high quality and discussions conducted fairly and openly.

Effective budgetary system and public expenditure management
Budgetary system and public expenditure management (PEM) is the fourth important sub-institution of public administration. It is the key means of the government's economic policies. The goal of public expenditure management is to serve overall economic policy goals, which are conventionally growth, equity and stability. As a central instrument of government policies, public expenditure management must pursue all overall economic policy goals. The above-mentioned goals have more specific sub-goals and demand established policy instruments, for example fiscal discipline, and demand efficient and effective use of resources.

⁴⁵² The point is based on the ideas of *Schacter, Haid* 1999.

Chiavo-Campo and Tommasi have emphasized that the three economic goals have to translate into three key objectives of good public expenditure management. They are fiscal discipline (expenditure control), allocation of resources consistent with policy priorities (strategic allocation) and good operational management (which calls for economy, efficiency and effectiveness). OECD has a slightly different wording of those goals. It emphasizes fiscal sustainability, efficient resource allocation and operational efficiency.⁴⁵³ The three objectives correspond to major functions and management responsibilities. Fiscal discipline requires control at aggregate level and it is the responsibility of the ministry of finance and the whole government, strategic allocation requires good programming and entails appropriate government-level and interministerial arrangements and operational management is an interministerial affair.⁴⁵⁴

Though budgetary planning and public expenditure management belong to the competence of the government, it is an accepted principle of democracy that parliament has power over the purse, i.e. that it decides on the state budget, the revenues and the expenditures. The parliament sets the legal framework based on the overlapping requirements in the Constitution, Budget Law, Public Accounting Law, and the Public Reporting and Audit Law.⁴⁵⁵ The legislature ensures that governance regimes are successful and that the budget conveys national, social and economic priorities. To hold the executive branch accountable, the legislature must ensure that the budget is coherent, efficient, effective and reflects the will of the people.

⁴⁵³ OECD: *Managing Public Expenditure* 2001, 17, 21-23.

⁴⁵⁴ Schiavo-Campo and Tommasi 1999, 2-3. See also *Public Expenditure Management Handbook* 1998.

⁴⁵⁵ OECD: *Managing Public Expenditure* 2001, 65-87 and *Public Expenditure Management Handbook* 1998.

6.2.2. Values of public administration

Values form the foundation of public administration. These are the collectively shared principles that guide judgment about what is good or proper. Values provide the normative controls that guide decision-making. The role of values is so critical that the quality of public administration varies in relation to the strengths with which they are held. OECD emphasizes that values stated in public documents provide the basis for an environment where citizens know about the mission and vision of public organizations and they also give overall guidance for daily public service operations. A survey of trust in the government in all OECD countries showed that all countries have a set of stated core values for public administration, which show certain homogeneity. The values are drawn from society, democracy and profession.⁴⁵⁶

Democratic decision-making is responsible for defining and transmitting values and moral codes of society into administration. The starting point in the discussion of values and ethics in administration is that the behavior, interests and values of the civil servants cannot be individual self-interests but the values of democracy stemming from society. The relationship between the values of society and values of administration is central and at the same time difficult, because there are inevitable tensions between some of these values. Fairness to society, responsiveness to citizens and due process and efficiency are examples of the problems that public servants meet. The problem is even bigger when public servants have to be loyal and obedient to a higher authority that does not represent the values of citizens and does not even comply with law. The history of administration is full of examples where the notion of duty as a categorical imperative related to public service is fairly straight-

⁴⁵⁶ OECD: *Trust in Government* 2000, 31.

forward. Louis C. Gawthrop raises this dilemma by saying that “Public servants are those who obey the directives of higher authority with loyal and trusting responses, which is to say, “no questions asked”. However, if this notion of duty is considered in terms of manner in which bureaucracy should be related to democracy, one is confronted with a dilemma of major proportions.”⁴⁵⁷

Guy Braibant has given an excellent definition of general public good and public interest for public administration in a speech in a meeting of public administration experts organized by the United Nations in 1995 to prepare for the resumed session of the General Assembly given. According to him:

“The first and overriding principle, which acts as a kind of matrix for the other principles, is a sense of the state. This is a notion that has evolved over thousands of years, although there is no place on earth where it has been fully and definitively developed. The idea behind this notion is to assert, over and above the individual interests of a country’s rulers and civil servants, as well as certain fractions of population, the supremacy of the general good of the interest of the community and of the public service. The task here is to guarantee the continuity and unity of the country beyond passing events and political divisions. Finally, this notion entails separating completely public property and funds from private capital.”⁴⁵⁸

Though values in public administration belong to the long lasting institutions of administration, the changing needs of society and citizens have to be taken care of. The updating of the values and their communicating to civil servants and to the public is the responsibility of the government and authorities responsible for administrative policies. Awareness of their present state, pressures of changes, and possible collisions and conflicts

⁴⁵⁷ *Gawthrop* 1997, 208.

⁴⁵⁸ *Braibant* 1996, 1167.

requires hard and careful thinking from every government and civil servant.⁴⁵⁹

The values can be classified in many ways. In Canada a deputy minister task force has grouped the core public service values around democratic values, traditional and new professional values, ethical and people's values.⁴⁵⁰ Van Wart has classified five sets of values that are the bases for ethics in public administration. Though his list is based on the US experiences, it is relevant in all administrations. The types of values are 1) individual (for example honesty, consistency, coherence and reciprocity); 2) professional and expertise; 3) one's work or organization (for example fact-based decision-making, centralization, application of technical knowledge); 4) legal (rule of law) and 5) public interest (representative democracy, separation of powers, protection of individualism).⁴⁶¹

Every civil servant should be aware that values form the basis for the ethics of his/her work. He/she will need firm ethical awareness of the conflicting demands of different values which are manifested in different ethical codes and codes of conduct. Most important of them are general, professional and personal ethics and other values. For the professional work of a civil servant crucial values are, besides the traditional democratic values (serving the general interest, legality, impartiality, neutrality, integrity and transparency), new public service values (service principle, effectiveness, efficiency), human rights values and values of environment.

The preservation of high moral and ethical standards cannot be left alone for individual civil servants alone, though they bear final responsibility of their behavior and decisions. Civil service legislation defines in most countries the basic principles

⁴⁵⁹ OECD: *Trust in Government* 2000, 34 - 57.

⁴⁶⁰ OECD: *Trust in Government* 2000, 32.

⁴⁶¹ *Van Wart* 1998

of good behavior, responsibilities and rights of civil servants and disciplinary measures for penalized actions. Besides, governments publish ethical standards and codebooks that define the principles of ethical behavior. Disclosing wrongdoings in public administration has become an evolving concern in many countries.⁴⁶²

6.3. Governance of public market functions

6.3.1. Basic nature of public corporate governance

Birth of the agenda of public corporate governance Public business and market functions are separated from public administration and from normal budgetary systems. In a highly developed public sector governance regime governments have specific organization policies and steering and financing methods for public business functions. Public corporate governance forms an institutional framework for the governance for public business and market functions. All countries have their own development histories, and their public corporate governance models are different. Common to all of them is that most business functions are not included in the government budget. Sometimes enterprises are included into the budget, but on a net basis.

Public business and commercial market functions that cannot be defined in a way that would be based on the contents of the market and commercial functions, because governments change their organization structures and definitions of business

⁴⁶² OECD: *Trust in Government* 2000, 5-68 and OECD: *Public Sector Corruption* 1999, UNDP: *Corruption and Integrity Improvement Initiatives in Developing Countries* 1998, World Bank: *Anticorruption in Transition* 2000.

and commercial functions all the time. Crucial for public market functions is that they are publicly owned and governments refrain from using normal administrative steering and management mechanisms for these tasks by defining specific market-based steering mechanisms. Here market-oriented management and organization methods replace normal administrative and political steering methods. In private companies these methods are called corporate governance.⁴⁶³ A similar term is used in this study (public corporate governance). Public corporate governance is composed of all the measures that the government uses either directly or indirectly to affect the public market and business functions. The basic actors of public corporate governance are ministers and ministries.

Reasons to adopt market mechanisms in certain public (or at least publicly owned) activities are various. Political ideologies, economic premises and financial situations set general frameworks for the concrete decisions to adopt market mechanisms in the public sector. These statements of reason and justification for the use of market mechanisms also define the models and methods used in steering business functions. The variety of market mechanisms used in different countries is enormous. After the Second World War the discussion of market mechanisms had negative connotations, but in the 1990s most countries have increased substantially their use of these. The state has always been a key owner of public companies and enterprises. The state's involvement in the construction of national infrastructure and exploitation of national domestic resources and industry got a special boost in the late nineteenth century, when the process of industrialization gained momentum from new technological innovations.

⁴⁶³ See for example *Harvard business review on corporate governance* 2000, *OECD principles of corporate governance* 1999 and *Comparative corporate governance: the state of the art and emerging research* 1998.

Reasons for the privatization and institutional reforms in ownership policies in the 1990s are manifold. First, collapse of centrally planned economies accelerated the reform process, which had been going on in the first reform-countries already in the 1980s and earlier. Ideological barriers on privatization were diminishing in most countries. Second, the need to increase efficiency in the use of public finances and alleviate their burden government finances. Third, fundamental changes in the markets in the 1990s – internationalization of the markets and growth of national and international capital markets – made it easier for governments to give up their responsibilities to keep state-owned companies in public possession. The capital investments for tasks, which had been covered by state-owned companies, could be allocated through private financial markets. Fourth, when fiscal pressure forced many countries to downsize their public sector, privatization of state-owned companies and an expanded ownership base of the companies was one solution.

Mary Shirley, who has analyzed the reforms of the World Bank and the goals of the Bank in them, has summarized the goals for reforms of state owned companies. The goals are (i) strive to maximize profits, (ii) in a competitive environment, (iii) under managers with autonomy, (iv), motivation, (v) and capacity to respond to competition: (vi) nonviable enterprises will be liquidated and (vii) selectively disinvested.⁴⁶⁴

The reforms in most countries have followed two basic models or are a combination of them. The first of these is the simple privatization model. The second model is based on incremental change via several steps. When the end of the reforms is not privatization and the governments preserve a special category of public business functions, in public ownership, the governments have to develop a specific public corporate governance framework. This is necessary, even if privatization is the

⁴⁶⁴ Shirley 1989, 5-6.

final goal, because countries proceed towards privatization in steps.

Privatization has been the simplest way of enhancing efficiency, profit maximizing, increasing the competitive efficiency of the business and getting rid of the problems, which have been developing under incompetent steering and inappropriate organization forms. Reform of ownership policies loosens public business management from bureaucratic culture, which does not safeguard accountability of results. The reform transforms governance into an entrepreneurial mood. Without reform in ownership policies the definition of public interests in the public business functions would be more difficult and demanding. Quite many countries have faced this problem and tried to find solutions at different times and with different degrees of success.

Mary Shirley has expressed the reform problem of state-owned companies as follows:

“In theory efficiency will be highest when an enterprise - public or private - strives to maximize profits in a competitive market, under managers with the autonomy, capacity, and motivation to respond to competition, and when enterprises that cannot compete go bankrupt. In practice, state enterprises seldom face such conditions. They often have objectives different from, and incompatible with, profit maximization. They operate in non-competitive markets; the absence of competition is often a reason for their creation. Their autonomy is compromised by undue government intervention. Their managers are not held accountable for results and are not given incentives to improve performance, and the way managers are selected and rewarded encourages qualities more appropriate to a central bureaucracy than a competitive enterprise. Finally, non-viable state enterprises are seldom liquidated. Additionally, the proliferation of SOEs’ (State Owned-Companies, ST) diverse activities, some of them of very low priority to any stated development policy, has placed an un-

tenable burden on the government - both on the budget and on its human capital.”⁴⁶⁵

General requirements and conditions in the reform of public corporate governance are similar to any other public sector reform process. The interests of the state in public business activities has to be defined and the role, scope and objectives of the state's business and market functions has to be clarified. The reform process starts with the definition of the nature of public business and non-commercial interests. The government has to find new approaches to accomplish non-commercial social and political roles that historically have been assigned to state-owned companies. In 1993 the Finnish Government defined four basic forms for all outputs other than those under public law. These are

1. a joint-stock company is the usual form of operation on a competitive market
2. a public enterprise is a way of organizing service production which has to be publicly controlled. The unit must be able to operate profitably in open competition. It can also have official functions to perform.
3. net budgeting is a way of organizing the supply of monopoly services under public law, and other services in the nature of by-products; it forms an interim stage on the way to more advanced market control.⁴⁶⁶

Goals of public corporate governance The definition of the models serves as a diagnostic tool for analyzing how present state-owned companies, enterprises and some functions of agencies fit into these models. The next step is to define the interests of the government for the state-owned companies. In Finland the Government's Decision-in-Principle on the State's Corporate Own-

⁴⁶⁵ Shirley 1989, 1

⁴⁶⁶ *Government Decision-in principle on Reforms in Central and Regional Government* 1993, 34.

ership Policies contains provisions on the significance of state-owned companies, operating principles, changes in the ownership base and restructuring of ownership. According to the decision, state-owned companies can be divided into three categories: 1) Companies with the state's special assignment (such as special financing companies), 2) other companies of strategic importance to the state because of their role in society and/or economy, and 3) companies of reduced strategic importance to the state where the state's interest is basically that of an investor.

In most countries public interests are quite similar. A World Bank study lists reasons, which governments have used when they have defended public ownership in state owned-companies. The general arguments are 1) promotion of strategic sectors of economy, 2) generating income for the treasury, 3) offsetting economic dominance by foreign or national interests and 4) regulating monopoly power.⁴⁶⁷ Most countries have long lists of non-commercial objectives. The World Bank's study is very critical to these bases, because they can have perverse effects, including cases where under priced resources are wasted, labor productivity falls at the taxpayer's expense, management tends to become lax and resulting inefficiencies create shortages and bottlenecks throughout the economy.⁴⁶⁸ The specification of different purposes serves the purpose of differentiation of ownership policies. It is clear that in 100 per cent state owned-companies ownership policies are different from publicly quoted state-owned companies.

A diagnostic analysis of the companies is the first and most crucial phase in the all ownership reforms, because the government has to analyze the condition of individual enterprises and companies. It has to decide which of the companies need restructuring and which should be privatized or liquidated. Un-

⁴⁶⁷ Shirley, Nellis 1991, 16-17.

⁴⁶⁸ Shirley, Nellis 1991, 17-18.

like the usual practice, governance reform should occur first and privatization or transfer of ownership second.⁴⁶⁹ The analysis should leave doors open into different directions. Companies and enterprises should be classified not only as strategic and essential but also as nonessential, viable, potentially viable and nonviable.

Institutional framework for public corporate governance After these interests have been defined, the government defines the institutional framework for ownership policies. They include, for example, the government's steering procedures and responsibilities, handling of reporting and monitoring material in government, the planning documents needed for corporate governance for the state-owned companies, operational and financial accountability and liability system for corporate governance, accountability of the executive management and the steering organization. The institutional framework of public corporate governance defines the basic tasks of the principal actors and their roles. They include the role of the government, minister, board of the company, director of the company etc.

Public corporate governance is the task of the government and ministries. The government and ministries cannot interfere either with operative management or strategic management. They are the tasks of the management of the company and its board. Instead, because the government has in all companies the interest of an investor, the government is responsible for participating in institutional management (choice and development of business strategy and changes in ownership structures and other corporate governance questions). This demands active participation in the work of board of directors, where the government should have a representative. The representative has to be appointed by the competent ministry into the board of directors.

⁴⁶⁹ The World Bank recommends vice-versa method. See World Bank: *Corporate Governance*, 2000, 35

He has to work independently and for the company, just like the other board members. The government influences the companies through the shareholders' meeting.⁴⁷⁰

Public corporate governance in its present demanding form is a new task in the ministries. The expertise of steering business functions has not traditionally belonged to the basic requirements of the civil servants. Ministries responsible for steering public business functions should develop their own strategy for public corporate governance in the general framework of the government's strategies. Special attention should be given to capacity questions of the ministry in steering the companies.

In defining the institutional framework for public corporate governance attention should be given to (i) the composition and size of the company boards, (ii) the ownership management at ministries (iii) to the principles of forming boards and the role and possible disqualifications of board members representing the Government or ministries and (iv) how ownership management will work at shareholder's and supervisors meetings.

According to the experiences from reforms of state owned companies the World Bank published in 1989 its first institutional framework for the governance of state owned companies. It did not use the term corporate governance, because the term was not yet in active use in business organizations either. In spite of the traditional terminology the Bank's framework was well developed.⁴⁷¹

⁴⁷⁰ See of Finnish principles: *Kaisanlahti* 2001.

⁴⁷¹ From 1978 to June 1989 the World Bank approved 122 operations with components directed at SOE sector reforms. Most Bank lending in this area has taken the form of components in structural adjustment loans, freestanding technical assistance loans, sectoral adjustment loans and policy-based loans (PELs: public enterprise rationalization loans). *Shirley* 1989, 1 and 7-8 and 45-58. See also World Bank: *Bureaucrats in Business* 1995,

Table 5: Institutional framework.⁴⁷²

Finance ministry	Sector ministry	Central SOE organization	Holding company	Board
<p>The core responsibilities</p> <ol style="list-style-type: none"> 1. Review and approve a. Subventionsb. Investments which affect government financec. Dividend payments 2. Serve on board <p>Other functions</p> <ol style="list-style-type: none"> 1. Approve monopoly prices 2. Approve budgets 3. Approve borrowing 4. Approve sales, liquidation of SOE 	<p>The core responsibilities</p> <ol style="list-style-type: none"> 1. Set sector policy 2. Review and approve corporate plans and investments <p>Other functions</p> <ol style="list-style-type: none"> 1. Serve on board 2. Nominate or appoint management team and much of board 3. Approve budgets 4. Approve borrowing 5. Approve major procurement 6. Recommend creation or, sale or dissolution 7. Evaluate and monitor performance 	<p>The core responsibilities</p> <ol style="list-style-type: none"> 1. Evaluate and monitor performance 2. Suggest follow-up to evaluation 3. Analyze sectoral trends and macro-economic impact 4. Improve coordination, government oversight 5. Safeguard managerial autonomy 6. Standardize reports and maintain central data bank 7. Develop files on candidates for managing slots <p>Other functions</p> <ol style="list-style-type: none"> 1. Approve budget 2. Approve investments 3. Approve personnel actions 4. Set sectoral standards for labor policy and corporate practices 	<p>The core responsibilities</p> <ol style="list-style-type: none"> 1. Appoint board and managing director of subsidiaries 2. Approve budget, investments, accounts, and borrowing of subsidiaries 3. Approve creation or dissolution of subsidiaries 4. Do company corporate plan and approve subsidiary plans <p>Other functions</p> <ol style="list-style-type: none"> 1. Shift funds, inventories, other assets from subsidiary to subsidiary 2. Borrow and distribute funds 3. Provide centralized services 4. Appoint or second key officers 	<p>The core responsibilities</p> <ol style="list-style-type: none"> 1. Approve budgets and corporate plans 2. Approve annual accounts 3. Monitor performance on quarterly basis and advice management 4. Approve investments <p>Approve major procurements</p> <ol style="list-style-type: none"> 5. Nominate or appoint management 6. Approve major changes in corporate policy vis-à-vis internal controls 7. Approve sales of assets

⁴⁷² Shirley 1989, 21.

The researchers of the World Bank have specified and interpreted the institutional requirements. Shirley and Nellis have found two major key goals in the reform of the institutional framework. These are 1) improve the quality of oversight by shifting control in the direction of ex post performance evaluation and away from prior intervention in decisions more efficiently handled by management or the board and 2) create groups in the sector and finance ministries trained in the review of state enterprises.⁴⁷³

In the 1990s international awareness of the importance of corporate governance – whether their ownership structure is private, publicly traded, or state-owned – grew all over the world. The discussion polarized sometimes into two basic models, the stakeholder model and shareholder models although there is no one-size-fits-all blueprint for corporate governance.⁴⁷⁴ Reality is more complicated, because there are several models of corporate governance. Most notable are the US, UK, German, and Japanese systems.⁴⁷⁵ All models are culturally connected. Because of this difficulty in defining the best model, the World Bank has in the late 1990s defined general principles, which should be taken care of in organizing public corporate governance.

The OECD has identified five basic principles of corporate governance. These are based on tenets of fairness, transparency, accountability and responsibility. They are (i) protection of shareholder rights, (ii) equitable treatment of shareholders, (iii) protection of shareholder rights, and (iv) timely and accurate disclosure and transparency and (v) diligent exercise of the

⁴⁷³ *Shiley, Nellis* 1991, 31.

⁴⁷⁴ *Cadbury* 2000.

⁴⁷⁵ The World Bank: *Corporate Governance* 2000, 21, table 1.1. and annex 2, 90-94.

board of directors' responsibilities.⁴⁷⁶ According to the World Bank well governed corporations need to balance the role of three groups of players: shareholders, board of directors, and managers. Shareholders provide capital in return for the opportunity to benefit from profits and increase in corporate value. The board of directors represents the interests of shareholders and may have obligations to other shareholders under various statutory and voluntary provisions. It is the bridge between the management and the owners, other stakeholders and the outside world. Managers report to the board and are responsible for day-to day operations and for implementing the strategy. Also stakeholders influence the corporation.⁴⁷⁷

By defining specific ownership policies the government becomes an active and demanding owner, which can expect a sufficient yield on its share-holdings both in the form of dividends and increase in the value of its holdings. The government tries to attain these aims by clearly defining the general goals relating to state ownership of shares – such as yield goals, goals relating to the capital structure of the companies, etc. – and the principles of state ownership policy as well as by actively participating in the work of the management bodies. In well-defined ownership policies the general goals and principles will be applied in a company-specific way so that market positions and situations of the companies, their status with regard to domestic and foreign competitors, the economic situation of the company as well as goals relating to the strategy, business operations structure and/or ownership base of the company can be taken into account. In company-specific goal setting attention will also be paid to any special interests that the state may have with regard to the company for example for reasons relating to the development of national economy and society.

⁴⁷⁶ Quoted in World Bank: *Corporate Governance* 2000, 10-21.

⁴⁷⁷ World Bank: *Corporate Governance* 2000, 10-21.

A basic idea in public corporate governance reforms is to create optimal conditions for the government to follow a flexible and pragmatic ownership policy and to enable the government as a shareholder to operate, when necessary, on an equal standing on the market together with the other market operators and further the government's interest as efficiently as possible. As an organizing framework public corporate governance is a dynamic interplay of internal and external incentives that affect the performance of all corporations.⁴⁷⁸

Variety of public market functions One of the key questions in the governance of public business functions is to formulate a strategy for different types of organizations. The discussion above has mostly concerned state-owned companies. However, they form only one form of the business functions and market mechanisms in public sector. As mentioned, public companies are the second step and often the last phase before privatization in the process of marketization of public functions or running public entities on commercial principles. The result of this process is a fully privatized company, and the starting point a public agency.⁴⁷⁹ A comprehensive governance strategy of public business functions covers all organization types of public business functions.

Enterprises are normally 100 per cent state owned entities and so are under firmer government control than companies but looser than agencies. They can be regarded as an intermedi-

⁴⁷⁸ See for example *High-Quality Services, Good Governance and a Responsible Civil Society* 1998, 29-31.

⁴⁷⁹ World Bank: *World Development Report 1994*, 40. World Bank lists water, power, and railways and port services as examples of the first step in the process of adopting commercial principles in public entities.

ate station in public business functions and the marketization process of public functions.⁴⁸⁰ State enterprises are organizations that lie between a state agency - or more concretely a net-budgeted agency – and a state-owned company. They are arrangements with increased management autonomy. Administrative agencies can be transformed into enterprises when the markets can, and have to, be taken into account, but when political steering and control is needed because of the social significance of the services or the non-functioning of the markets. The enterprise model is suitable for agencies whose main operations are business operations carried out under competition, but which also have social obligations, such as the production of public services. After a transitory period agreed upon, the unit that has been formed into an enterprise will have to be able to operate profitably in an open competition situation. The establishment of enterprises facilitates the creation of markets.

The enterprise model lets the manager of the enterprise to manage and find solutions for the service and operating goals set by the parliament and the government. As an organization, an enterprise has to find a balance between commercial operating principles and implementation of general socio-political goals. These goals can be mutually opposite. A state enterprise is under parliamentary guidance, which guides its operations by setting the service and operating goals, and the government, under whose authority the enterprises fall, sets the result goals for the enterprises.⁴⁸¹ The enterprises have boards, and the freedom of operation to decide on their own policies and organizational solutions. At the minimum, the activity shall be self-supporting, i.e. the principle is that the income from the activity has to cover

⁴⁸⁰ See for example a Finnish interpretation of the mercerization process
Salminen, Viinamäki, 2001 21-23.

⁴⁸¹ *Salminen, Viinamäki 2001, 40 -47*

the costs. A state enterprise may also have tasks of a public authority. The costs incurred by implementation of the social tasks are reimbursed to the enterprises from the state budget. The status of personnel in enterprises is different from civil servants. They have the status of an employee. Wage formation is changed as well, as it is based on a classification according to the demands of the job and as a result bonus systems have been developed towards a more individual direction. State enterprises operate in restricted competition conditions. Enterprise is a solution when competition does not significantly guide the activities of the organization.

When the market solutions – state-owned companies or enterprises – cannot be used to address corporate governance problems, there are other options as well. The World Bank has recommended ways of structuring the relationship between the government and the service provider. They are (i) performance agreements by clarifying performance expectations and the roles, responsibilities and rewards of all involved; (ii) management contracts that transfer to private providers the responsibility for managing an operation and (iii) service contracts that transfer to private providers the responsibility for delivering the service at lower costs or obtaining special skills or expertise lacking in public sector.⁴⁸² The provider-purchaser model and outsourcing are common models for the service provision in many countries.

Compared to the agency model, the benefits of market-oriented forms of activities are their extensive powers to arrange their operations and production as well as to decide on the pricing and financing of their products and services and on their investments.

⁴⁸² World Bank: *World Development Report 1994*, 1994, 42.

6.3.2. Values of public business functions

The basic nature of public business functions determines the values, which public business units, companies, enterprises or agencies will follow. Thus the question of values of public business functions cannot be discussed in a homogeneous way. The basic nature of businesses and their values are reflected in the form of the organizations.

Public business functions are mostly not organized in agencies, but in enterprises and companies. In most of them the state is the major owner. The ownership bases and operating principles of such companies, which are in the stock exchange - independent of the size of public ownership – do not differ from private companies for the most part. Profitability and yield for the owner are the only criteria that attract capital. On the other hand some public enterprises and companies serve specific goals and pursue public good more than profit. The operating principles of public business and market functions are based on respect for business values. The principles of profitability, long-term sound economic base on business and financial solidity are drawn from economic values that concern both private and public companies. If the government sets other goals for the companies, it has to pay compensation for that.

Public enterprises stand between companies and administrative agencies. Demands for profitability, sound economic base and financial solidity do not have such a dictating position in their principles as in companies. Enterprises have to fulfill some specific public tasks and represent general will. Internal administration in enterprises has to fulfill the same requirements as administrative agencies.

In spite of the differences between all public business functions, the basic values are derived from business requirements of profitability. If the demand of public good dominates and sur-

passes sound economic principles, organization form, financial principles and control and steering arrangements have to transform back to administration.

6.4. Governance of public services

6.4.1. Basic nature of service governance

Quite often all public functions are called public services. In that perspective the police, court, army, taxman, bailiff and ministry of finance are services. For me this definition is too general, because it does not separate different functions of state. Administration and policy planning are not public services. In my conception public services are mainly those that the public sector delivers for citizens to foster human and social capital of the country. Education, health, social welfare, support of cultural activities and infrastructure are the most important of them. Public expenditures grew after the Second World War, because the state increased public services and increased social benefits and public transfers. The growth is not due to growth of overseeing, coordination and management of services proper but of the growth of transfers and services given to citizens. Naturally administrative and management functions have increased too, but their share of the total costs is marginal.

Public sector reforms during two last decades of the twentieth century have introduced a new method to produce public services. In this new conception the state can purchase services from the private sector. The old role of the state as a producer of services is reformed so that the government will be a purchaser of services. The state is ultimately in charge of the availability of services, functioning of society and coordination of the interests of different actors.

The majority of public welfare services have been traditionally produced through state or municipal agencies in a similar fashion to administrative functions i.e. following traditional administrative principles of the rule of law. In this conception the distribution of services and benefits is in its basic nature decision-making of entitlements and rights of citizens and supervision relating to the use of benefits. Reformers of public administration have claimed that it is the major cause for poor quality, high costs and enormous waste. The second traditional principle in administration has been the concept of a public monopoly. Public services were regarded as public monopolies. This has eliminated from service delivery all pressure for better performance. Competition is an effective means for efficiency and monopoly is its enemy.

From the late eighties onwards governments tried to find new institutional mechanisms to improve service delivery and decrease the budgetary burden from public services and achieve cost savings. Use of market mechanisms (marketization or commercialization), contracting out service delivery to private firms or NGOs, introduction of charges, decentralizing services into the local level using performance management mechanisms and providing more managerial flexibility for agencies were adopted. Original free of charge or under valued services were transformed into full cost services.

When reforms have been radical enough they have broken down the old unitary hierarchical organization, steering and financing model, or at least reduced its centralized nature. Different countries have used their own models. Public management reforms have concerned mostly public administration, their organization and production models and methods, management structures, financing principles and relations between the service providers and customers. Later the reform perspective have put more emphasis on services. Reforms have formed a long-

lasting learning process, of which states have collected information so that they can improve their capacities from experiences from different countries and fields.⁴⁸³ In 2004 the World Bank has in its flagship series, World Development Report, raised services for the poor in the central position. The report develops a general governance framework for provision on services. Because the report discusses the problems of developing countries, best practices and benchmarks are not necessarily from developed countries. In spite of this, the major framework in the report is the same all over the world: how to combine the relationships between policymakers, people and service providers. It is crucial that services can be provided by public authorities or private service providers.⁴⁸⁴

Regardless of the nature of the service delivery model used (Scandinavian, Westminster type or French type), all methods to increase efficiency in public services suppose that central government diminishes its role in steering public services.⁴⁸⁵ The reason for this is as simple as can be. All public service systems had been built after the Second World War according to centralized organization, management and financing models.⁴⁸⁶ To increase efficiency, most reformers have been forced to diminish the role of the central government in steering the service delivery so that the central government does not dictate how services

⁴⁸³ Of different national models see *Governance in a Changing Environment* 1995, Peters 1996, Pollitt and Bouckaert 2000, Kettl 2000, 7-4, Knill 1999, 113-139.

⁴⁸⁴ *World Bank: World Development Report: Making Services Work for poor People* 2003

⁴⁸⁵ See information of use of different methods to improve service delivery, especially in developing countries Pradhan 1998, 60-63.

⁴⁸⁶ Of the ideology after the Second World War see Shonfield 1965 and Maddison 1964, 99-157.

are produced, but it pays attention to their quality. Local service providers, whether performance-managed public agencies, private service providers, municipalities or enterprises, are in a better position to take into account the viewpoints of the citizens and the customers when services are arranged. In this context, various systems of participation play a crucial role.

Most countries have emphasized that the production of public services for citizens should serve local needs. It is an undeniable goal, but how to accomplish it? How to know the real needs of citizens? How to allocate the scarce resources for those who are really in need? In general, one can say that in most countries the needs of the citizens are bigger than the resources and the governments have to deliver scarce rather than abundant services. Though the goal is clear, there are no easy answers to succeed in reaching the goal and making reforms in service delivery. All methods have shortages and advantages.

The basic problems in service delivery are limited resources and inefficiency in service delivery. The problem of limited resources is mostly unsolvable by the agencies. But the question of efficiency of the service delivery for the citizens is in their control, especially if the central government has decentralized service delivery. However, there has to be central control to some degree, because most local services are financed through the government budget. Since governments are accountable to the parliament for service delivery and use of public funds, they have to find a way to balance demands of general accountability and decentralization of service delivery to enhance efficiency. Because public services should meet standards of political accountability and support efficiency, governments have to establish efficient control, monitor and evaluation systems for the implementation of service programs. At the same time they have to meet the demands for central control and local autonomy.

Public services have traditionally been monopolistic. Monopoly does not need competition, because it does not have motivation to reform, renew and improve. Opening of monopolistic public services for competition has increased the effectiveness of public services. Increase of effectiveness and user satisfaction does not depend on the way competition is introduced. Crucial is a choice for the citizens or customers. A comparative study of health care services has a clear conclusion: "Improvement of the quality of government health services depends on pressures outside the bureaucracy – citizen voice and consumer choice."⁴⁸⁷

Different service production models do not meet these demands in similar way. The goals in most recent reforms, independent of the reform strategies and production models, have tried to increase efficiency, create competitive pressure and emphasize client focus, transparency and accountability. Governments have created exit options or given choices for alternative suppliers. For example Anglo-Saxon countries use more private service providers and monetary transfers that Scandinavian countries, which emphasize public services. In most Scandinavian countries municipalities, which have wide autonomy, are responsible for public services.⁴⁸⁸ The Scandinavian models differ from other models in its emphasize of democracy and participation. Because municipalities are delivering services, decisions of the quantity, quality and service model are decided upon in municipal councils. The extensive participation of citizens in the decision-making process increases their trust in the services. They feel that they are the owners of the services. Because municipalities have responsibility for the efficiency of the services – they are financing a major part of the services – efficiency considerations are omitted. This is a major reason for the use of private service providers and vouchers.

⁴⁸⁷ *Filmer, Hammer, Pritchett* 2000, 207-208, 213, citation 219.

⁴⁸⁸ *World Bank: World Development Report 1977*, 86-87.

Market models emphasize competitive pressures on suppliers through competitive mechanisms. Demand-side mechanisms are used in a better way than in public municipal services. However, the effects of commercialization on public service delivery have shown similar results as independent self-government municipalities, because they enhance client focus, improve responsiveness of suppliers, improved staff performance and client satisfaction, increased accountability and transparency regarding financial management and service delivery and a clearer notion of costs and return on assets.⁴⁸⁹

The reform of public services – mostly increase of efficiency and service delivery – is a process where different service delivery models are analyzed in a certain situation. It is a choice of reform strategies. Analysis concerns the organization model, financing method and controlling and production models. Because services are different in nature, there cannot be only one strategy to be followed, but several strategies depending on the specific nature of the service. A choice of organization strategy can be an example of the strategic choice situation. The basic models are 1) bureaucracy (public agency), 2) business model (enterprise and company) and 3) outsourcing to NGO.

An analysis of the organization form for a certain service includes an evaluation of

- what effects the organization form has on the service

⁴⁸⁹ *Brown, Ryan, Parker* 2000, 206-221. Several problem areas are also identified. Commercial pressures were managed by downsizing, trading results were poor, conflicts of interest arose when agencies undertook contract oversight, there was a tension between the need for public disclosure of information and the commercial sensitivity of business transaction data. There was also concern that commercialization might compromise ethical standards and reduce public interest considerations.

- how to organize accountability between minister, civil servants in the ministry, and the service unit
- what are the effects of political accountability mechanisms for the service delivery
- how strong political leadership is needed in those particular services

The choice of organization form has to be based on the analysis of the situation and environment where the organization is to function. The expectations and fears of change are a part of this analysis. Irrational fears and false expectations of the environment and customers create a frame for the success or failure of the reform. The analysis should include the whole organization network and its structure – external structure. This has to be taken into account in the reform analysis. Analysis should study possibilities to change the environment and increase the possibilities of success. Evaluation of pros and cons of different organization or production models produces vital information for the choice of the model.

The special nature of public services sets some extra requirements for the analysis of public service provision. The perspectives of economy and efficiency are not sufficient. Political accountability, public interests and financial political considerations are necessary components of the analysis. The choice of organization form/service model has to include 1) analysis of public interest considerations in the service. It has to be clear what role public interest is playing in the service. If public interest has a big importance in the service, is it possible to use any other models than public agency. 2) The analysis of economy and efficiency considerations concerns the relation between economic efficiency and the rule of law and between economic efficiency and political control.

Decentralization, commercialization and the use of performance-based methods in service delivery are correct trends in

public services, but they impose special requirements on the steering of the service functions. When a public service function is organized in the form of a company, the extent to which public-service goals are imposed on the company has to be decided. When the municipalities are responsible for service delivery, the government has to set service standards and evaluate the results.

Information technology creates fresh possibilities for the production and distribution of public services. The states have to participate actively in reforms of information technology structures, adopt new ways of operational policies and to build trust needed therein as well as to enhance the readiness of citizens to use new information technologies. The opportunities to decentralize and rationalize administration offered by information technology have to be utilized. Information technology helps administration and public services in the arrangement of joint services of the authorities. Information technology decreases problems relating to opening hours. Service systems should be such that citizens can use the electronic services offered in the information networks around the clock irrespective of their location.

6.4.2. Values of public services

The value basis of public services depends on the role and responsibility of the state in the service process. Public services have a kind of a hierarchical structure. At the top of the hierarchy are services that are defined in the constitution and that belong to the basic rights of citizens. They form the core of public services. Besides these, public sector produces a huge amount of services for various reasons (lack of competition and private capital, monopoly and political reasons). The divide between core public services and general public services is based on the

legal status of the services: are they either constitutionally guaranteed or not.

Most modern constitutions are based on the idea of a broad responsibility of the state in securing individual civil, political and social rights. The constitutional principle of the right to social security for those who cannot obtain necessary means for a life of dignity guarantees for them indispensable subsistence and care. In most European countries people are guaranteed by an act the right to basic subsistence in the event of unemployment, illness, and disability and during old age as well as at the birth of a child or the loss of a provider. The public authorities are obliged to guarantee for everyone adequate social, health and medical services and to promote the health of the population. The values of services that are guaranteed for the citizens in the constitution and in legislation have to be derived from the constitution. They must be at minimum the same as the principles of good administration.

Delivery of most public services is not defined in the constitution but is dependent on the financial and budgetary situation. Governments are free to decide on their delivery based on budgetary constraints. This affects the basic values of such services. Though the nature of public services is more manifold than this division between constitutionally guaranteed services and other services, the dichotomy helps us clarify the basic idea in the values of public services.

The decision of the scope of different categories of services is political in nature. However, the decision is made in the form of legislation, more concretely in constitution. In that way the divide and division belong to the long-term questions in administration. Because different countries have their own interpretations of the scope of the social rights of citizens, the values of public services are keenly connected to the discussion of the content of public good and the basic nature of the state. Though

the division of different kind of services is constitutionally determined, discussion about the role of the state and public sector reforms has shown that financial considerations have become a more important element in the values of public services. Today production and delivery of public services is more than earlier a practical, not an ideological question. The quality and price of the service and accessibility of the service is essential.

The government is accountable to parliament for all constitutionally guaranteed public services for the citizens. The services are free of charge for citizens and produced through budgetary means. Their value basis is quite similar to the values of public administration. Services are produced emphasizing the principle of the rule of law and good administration, (objectivity, neutrality, equality, impartiality in administrative proceedings, etc.), because the services are basically economic benefits and income transfers to the public. Service providers exercise one-sided public authority. The general principles of legality, equality and good administration will guarantee the respect for human dignity and equality of citizens. Public services should be produced so that they are reliable, confidential, profitable, and safeguard the respectful treatment of citizens and reliable accessibility of the services. The high quality of basic services and a principle of good service have to be safeguarded, though the services must be produced economically and effectively. Basic services should be developed continually using the vehicles of quality management, quality standards and quality criteria.

Compared to the basic public services that are constitutionally safeguarded, the values of other public services are more flexible and depend on the nature of the service. Basically it is not a question of the exercise of public authority but of the provision of services for customers. The core of the values emerge from the needs of the customer/client. The quality of services and satisfaction of the customer are in front. Customer and

good service form the core values. This turns the steering of the services from the political level towards the customer. Sensitivity to the needs of the clients – the customers – and acceptance of competition have enabled a break away from hierarchical organization models and steering systems and adaptation of internal markets and different managerial styles in the public sector. In other than core public services the openness and transparency of service system, accessibility of the services, production of services in the front line, service capacity, user-friendliness, quality and productivity will be emphasized. Different and alternative production methods are developed and favored, user charges and paychecks are used, user participation in the development of the services is encouraged and freedom of choice and self-determination of the customer is emphasized.

The values of general public services are moving away from uniform, politically decided values towards a customer-driven service culture. It is a step way from bureaucratic administrative culture towards the culture of customer service. This will determine the basis for the position of the customer and give basis for forms of service production, management, financing, and control.

6.5. Concluding comment

Public sector management is a manifold task, which demands different kinds of expertise and experience. It cannot be learned in business schools nor in departments of public policy or public management. It is neither a task of politicians alone nor civil servants. It is a combination of different knowledge, expertise and experience, full of conflicting interests, which have to be combined in daily practices and decisions, which often have to be made on ad hoc bases without any possibilities of thinking about long-term perspectives.

My tentative governance model of differentiated public sector is a framework, which at best can give some ideas of the problems in present governance practices. It raises institutional questions and value considerations to front, because they should belong to the permanent infrastructure in all governance reforms and practices. There are no such books that could serve as models or guides in any practical governance reform. Governance problems even in developed industrial countries are not similar, even though they belong to the same international organizations (for example the EU) have been members of international development organizations and think tanks (for example the OECD), and they utilize the advice of the same globally acting consultant firms, which sell them quite similar reform packages. The problems in developing countries are even bigger. Some of them are former socialist countries, which are in a process of transformation into modern market economies with liberal parliamentary democracy or are keeping to authoritarian, semi-democratic political structures. Some countries do not have decent public authorities responsible for public good at all, while some developing countries do not have efficient non-state actors either in markets or in society.

My modest goal in this chapter has been to raise the major themes of public sector governance. The model is a combination of the basic features of traditional Weberian bureaucracy and modern ideas of New Public Management and network-based up-down governance. These ideas do not fit in a unitary way into all public functions. In governing functions and in the use of public authority the classical model should be adapted. This does not mean that economy and efficiency should not be respected. If the core of political governing does not have the trust of citizens, goals of good governance cannot be reached. Governance strategy is always a combination of different management principles, organizational models and behavioral patterns.

7. Conclusions

This study of governing and governance raises institutions into the center of good governing and national success irrespective of the regime. I regard institutions as important in the traditional governing regime as well as in the discourse of the future regime of governance. I do not see governing and governance as separate and specific tasks of leaders, but as activities that demand full participation of market, social and government actors. I have studied them as a huge set of practices and institutions by breaking them up into innumerable amounts of practices, organizations, traditions and institutions. However, political governing/governance can be regarded as an institution as such. In that case I as a social engineer have to pose the same questions for it as I pose for all specific governing institutions. To what purpose is the machinery to be used? How does it fulfill its purpose?

Peter Drucker has said that any social and political analysis of an institution has to proceed on three levels. First, it has to look at the institution as autonomous – governed by the rules of its own structure and determined by the desire for survival – capable of being judged in terms of its own purposes. Second, it

has to be analyzed in terms of the beliefs of and promises made to the society which it serves. Third, the functional requirements of society to political governing have to be analyzed in relation to the autonomous purposes of political governing.⁴⁹⁰

The first level the basic problem concerns the relations between long-term programs, on rules of behavior, and operation and demands of flexibility and receptivity to change. In the political field this is not the most difficult problem, because political governance cannot exist independently. The major actors, viz. political leaders, are selected in elections. They represent fresh ideas and the values of citizens and articulate the changes in tendencies. Still, this danger is not nonexistent, because the mechanisms of political governance belong to the hard core of the political system. They are defined in the constitution, their implementation models are confirmed in long historical traditions and strengthened in daily practices, which form the hard core of political culture. Institutions of political rule – whether constitutionally confirmed or culturally formed practices – cannot be autonomous. All institutions have a tendency to become fossilized.

Second, when political governing is analyzed in terms of the beliefs of and promises made to the society, which it serves, the attention is to be placed on the needs of the society. The needs and interests can be analyzed from different time horizons and from the perspectives of different articulation capacities. The needs are defined in different ways. Elections are the most important forum in a political society. Flora of civil society organizations and their activities – from demonstrations to bowling-clubs and church activities – create social capital. Profits, economic growth and unemployment are indicators of markets. Political actors read the figures and let civil society, market actors and citizens give impulses and advice on how to improve the results.

⁴⁹⁰ *Drucker* 1946, 13-15.

The subject of this study has been political governance, which is the exercise of political, economic and administrative authority to manage the nation's affairs or a set of measures, which aim at creating official and unofficial institutions and processes through which citizens and groups articulate their interests, take care of their rights and responsibilities and participate in the economic, social and political processes. Because all methods that are used in the exercise of power and in allocation of resources belong to political governance, I have discussed in the study not only the maintenance of legal order and the use of the government's power in establishing official and unofficial institutions, which form our life, but all hierarchical interventions to maintain the democratic legitimization of the political system and the institutionalization of the execution of the legal system. New governance is toothless without the hard core of governing, the authority structures of power. The process involves complex sets of decision-making institutions, systems, processes and mechanisms of power of the state, in which the actors of society and market have the right to engage in a democratic and transparent way and according to clearly defined ways and means. Before globalization processes received their present forms governing was confined to the state's borders. Today it implies the development of channels of cooperation, establishment of alliances, coalitions, networks and partnerships networking with global state- and non-state actors, encompassing the market, society and government at all levels. Networks and partnerships are new ways in breaking the barriers between rulers and the ruled. Essential for all of this is a holistic approach and continuous growth and the diversity of governance methods.

A glance at the effects of globalization gives a clear indication that political governance and governing have to be seen in a temporal continuum. When governing systems are studied in a long-term historical perspective, changes are smaller and conti-

nity will become the prevailing feature. Fundamental changes of contemporaries turn into minor ones and they lose their revolutionary nature when they are set in a long-term perspective. Awareness of time dampens our optimistic mood of the fundamental nature of our revolutionary outcomes. However, if we are conscious of the need of change, but – conscious of historical processes – we do not even try to transform ourselves, we will lose our only possibility. At present it is fashionable to stress the fundamental nature of recent changes, but I'm not quite sure if this interpretation will be sustainable in the long run.

Historical perspective in this study has shown that the present discussion of governance is diffused. However, one of the most interesting interpretations of the term is based on the idea of regime change. Discourse of governance and political governance expresses will to reform traditional up-down governing to a network based down-up governance and it omits the traditional functions and responsibilities of the state. The study has shown that the discourse has been implemented to some extent, but it is still mainly theoretical in nature and concerns mostly the development of strategies and principles but not so much the difficult implementation phase. There are a lot of reasons and arguments in favor of that interpretation, but so far they have not been convincing of their sustainability and comprehensiveness.

The discussion of governing and governance as regimes has shown that we must study general principles of governing, the most of which are not changing continuously but are permanent in nature. Time-horizon is a question of generations. The study has shown that political governing systems have to be built so that they prevent political actors from behaving only in their own interests, because political governing serves general interests. The system must be such that it prevents political leaders for example from using public authority so that the benefits

serve their re-election interests, but the costs of the decisions go to the next generation. This consideration is a classical example of governing and constitution drafting.

A step from one system of rule to another is not only a question of constitutional change, but also of the change of mentalities and thus a question of long *durée*. Douglas North, who is interested not only about economic institutions, but of all kind of institutions that affect that the economic behavior of people, has said that “both institutional and belief systems must change for successful reform since it is the mental models of the actors that will shape choices. ... Developing norms of behaviour that will support and legitimize new rules is a lengthy process, and in the absence of such reinforcing mechanisms polities will tend to be unstable. ... It is adoptive rather than allocative efficiency which is the key to long-term growth”⁴⁹¹ Norms have to be implemented and enforced. This a common responsibility of the state and non-state actors, and a typical tasks of new governance.

Question of interests is one of the most difficult problems of governing. The division of labor between political leadership and professional expertise or civil service is a clear expression of this question. In Europe the continental governing model is based on the idea that civil servants represent the general will and common good and politicians represent special interests and changing needs. The Anglo-Saxon tradition does not give administration such a role, because it is seen to be loyal to the government. This basic difference of conceptions has affected the constitutionally defined positions of executive authorities in government. Notwithstanding of this arrangement, it is clear that civil servants are responsible for analyzing and presenting for the political leadership the arguments of general will, general

⁴⁹¹ *North* 1994, 366.

considerations and long-term perspectives in the preparation of decisions. Civil servants have in their use the institutional memory of the administration; they have comprehensive responsibility for all sectors of life, economy and society. The preparation of decisions for political decision-making is in its nature a process of mediation between different interests and perspectives.

Though the role of the civil servants is to represent general will and interests, civil servants in different sectors – agriculture, social welfare, trade and industry – have a tendency to represent the special and short-term interests of their specialty inside the government against more broader interests of government, public finance, the markets or citizens as a whole. This conflict and discrepancy has to be taken into account in organizing governance systems. Transition from traditional governing towards new governance includes new kinds of networking practices, and this change will strengthen this propensity of civil servants to identify with these special interests.

In the discourse of political governance networking as a special characteristic of governance demands even more attention from civil servants to their role as representatives of general interests than traditional governing, because non-articulated interests do not participate in the networking processes. Only well-articulated and organized interests are at present in the negotiations. They have the power of a voice and an exit, but unorganized interests lack both of them.

The discourse of political governance regime carries out many similar features to the governing regime. Conflict of interests between the internal actors of political governance and the external interests of the market actors and citizens is in political governance quite similar as it has been in the traditional governing. The conflicts will be even bigger than in governing. There are different reasons for this. First, the new action model, net-

working and up-down emphasize, is based on the idea of openness, discussion, and confession of broad mutual interests. Second, the new governance model gives more responsibility to individuals, citizens and market actors. To fulfill their responsibility wholly all of them need open information of national and international policies, government's economic and social forecasts, predicaments of the government etc. Because the government has to serve the interests of all actors unbiased, it has to inform of its policies, plans and actions openly. Openness serves national success best.

Not only openness serves the principle of equality but also democracy, which is a key pillar of political governance. Political institutions offer citizens a way to make their interests heard. This function of all institutions of political governance transforms them into the common cause of the whole nation, and not only the interests of those that are in power. Institutions of political governance are the common property of the nation, although the political forces, which received majority in national elections or confidence in the parliament, man all organizations of executive power. Transparency and openness serve the principles of accountability and democracy. They safeguard that all actors in the organizations of political governance put the welfare of the institution above their own and model themselves upon an institutional idea of conduct. Openness and transparency help to develop such an *esprit de corps*. Citizens and economic actors can through openness and transparency control political governance and prosecute their aims and interests and influence in the governance practices. This influence is significant principle, because governance is in nature more participatory than traditional up-down governing.

I have already given in a way answers to the third question that concerns the relationship between the political governance as an autonomous institutional body when compared to the

needs of society. It is difficult to find any autonomous interests in political governance that do not serve the needs of society and markets. Adaptation of democracy dropped kings out of their patrimonial positions. However, the tradition of patrimonial authority has survived up to the twentieth century, but it does not justify its existence any more. Nobody defends the official arguments of pre-democratic systems, but their governing practices have survived in silence long after its abolition.

Justification for the internal purposes of political governance that are different from its external social functions is often sought from national secrecy needs in foreign policy and defense. Secrecy is acceptable in cases like these, but this does not produce own purposes for political governance. It is essential that political governance is organized and institutionalized in such a way as to be able to function and to survive as institution, as to enable society to realize its basic promises and beliefs, and to enable citizens, society and markets to seek success.

Empirical studies of the economic results of governing have shown that governance matters. I will not go deep into the variables that are most favorable to economic growth and success on general. The general message, which is that well ordered governing systems and well-functioning institutions matter, is sufficient for our purposes. In the beginning of the new century the result is already self-evident. We should raise political governing next to land, capital, raw material, labor, and management as a new factor, which must be institutionalized and taken care of to obtain production. Management has already fought for itself a recognized position beside capital, material and labor as a factor of production. Political governance has to fight for this position for itself.

Studies of capacity-building, administrative development, political governing and economic development have shown in their own ways and in their own terminology unanimously that

the establishment of well-functioning institutions and governance systems is a long-term process. Results can not to be seen immediately. My institutional analysis of political governing has put emphasis on a long-term perspective.

Networking, informal interaction, and the transformation of national up down governing and hierarchical commanding to down up governance is a long-term goal, which cannot be reached in a moment. Regime changes take time. As I have emphasized, governing institutions belong to the core of those institutions, which preserve order in all nations and societies. I started my analysis with the notion of Herbert Simon's important principle of hierarchy. I structured the discussion of governing structures by using that as my means. Later on I defined functional autonomy, authority, decentralization and tradition as the major principles in this study. Hierarchy is a sub-component of authority.

Hierarchy is a major principle of human history. It was born before we had organizations where hierarchy is an accepted and natural feature at present. Because governing is crucial for the success of all organizations, be they states, business companies, civil society associations, welfare organizations, armies or churches, the above-mentioned principles have to be observed. This is especially important in political governance.

The discourse of political governance regime developed in this study challenges most of these principles, because it emphasizes mutual understanding, networking, down up influence and self-governing. Unofficial institutions, readiness and willingness to change were principles and attitudes that were raised above official institutions and traditions and habits. Irrespective of these goals the state retains even in the future its official authority as the government of the country, which cannot for example leave the maintenance of the economic equilibrium or market regulation to the invisible hand of the market. It is the

responsibility of the government to make the necessary decisions. This does not decrease the responsibility of the state to listen to markets and their representatives or the representatives of society, citizens. The state is in my political governance model still the major authority and arbitrator between different economic and social interests.

To preserve this authority the state has to respect the major functional principles of governance, i.e. authority and hierarchy, tradition, and decentralization. In the EU's governing model the principle of decentralization is called subsidiarity.⁸² It means that decisions should be made on the lowest possible level. This level should have necessary authority and information for the decision-making.

Authority, functional autonomy and decentralization/subsidiarity are all principles, which refer to organizations. Herbert Simon has said that a history of human civilization can be written, "in terms of progress in the means of human cooperation, that is organization." In that history hierarchical systems would play a central role. In organizations hierarchy safeguarded efficient coordination. "Both private and public organizations have played essential roles in these modern developments (he is referring into the development of markets and the states, S,T.) complementing each others' functions, learning from each other, and at the same time, competing for power to steer and manage the systems that have emerged."⁸³

Functional autonomy, authority, hierarchy and decentralization are established principles of organization, which must be respected in the regime of political governing and in the discourse of political governance as well. Their respect safeguards the traditional efficiency and coordination in human interaction. Networking and trust are new principles, which will com-

⁴⁹² *Inman, Rubinfeld* 1998 and *Kersbergen* 1994, 215-36.

⁴⁹³ *Simon* 2000, 10.

plement the traditional ones. They will be adopted in civil society first. The second step may be the adaptation of these principles in markets and inside administration. It will be the most difficult to adopt the principles into the interaction between the state and the market and between the state and society.

I have tried to list and raise discussion in a systematic way of major institutions of political governance. For me the discourse of political governing has shown itself as a multistage, multivariate and demanding networking process, where negotiation skills, firm determination, democratic spirit and ambition for results are essential qualities. I have built a framework for political governance. Empirical studies of institution-building emphasize not only the importance of formal institutions, but also learning, socialization, respect of historical specificities, culture and incremental adaptation to changing problems.⁴⁹⁴ The development of the regime of political governance is a long-term cultural process. It must start from an analysis of culture, which is the carrier of traditions, institutionalized practices, and vested interests.

Students of both institutional political science and institutional economics taught us patience in waiting for the results from our reforms by raising the discussion of importance of different kind of institutions. Even if they study governance from their own perspectives, they both emphasize a long-term perspective and unofficial institutions. Change in a governance system cannot succeed only by reforming the judicial infrastructure. The generalized morality of the people has to be in congruence with the judicial framework, and this will produce results only in the long run. If the formal judicial framework and institutions do not have support from the generalized morality, the matters can even worsen. When we add a time perspective into governance reforms, we will learn that quick results can not be expected.

⁴⁹⁴ *March, Olsen* 1983, 391-392.

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