Good Governance Gone Bad: Lessons for Ireland

Darius Ornston
Assistant Professor
Department of International Affairs
University of Georgia
(ornston@uga.edu)
The Political Economy of Nordic Europe

- Strong economic performance
- Adopt best practice in many policy domains
- The Nordic countries exemplify ‘good governance’
When Small States Make Big Leaps

Institutional Innovation and High-Tech Competition in Western Europe

Darius Ornston
When Small States Make Big Leaps
Institutional Innovation and High-Tech Competition in Western Europe

Darius Ornston
Puzzle One: Explaining Nordic Success

- **Market competition?** But Finland and Iceland flourished under relatively closed, heavily regulated economic regimes

- **State intervention?** Nordic states have been very laissez-faire and intervene in different ways

- **Labor power resources?** But what about historically weak Finnish trade unions and Icelandic social democrats?

- **Employer coordination?** But patterns vary and Nordic adjustment (rapid restructuring) is inconsistent with this literature
The Nordic countries possess cohesive and encompassing networks (Campbell and Hall 2017; Katzenstein 1985)

- Encompassing: Connect (1) different industries, (2) business and government, (3) capital and labor and (4) masses and elites

- Cohesive: These different individuals get along, it’s easy to strike deals (unlike Greece)
Social Networks and Good Governance

- **Information gathering**: Enables decision-makers to access expert and local knowledge (Bodley 2013; Evans 1995)

- **Consensus building**: Discourages free-riding, shirking and other opportunistic behaviors (Campbell and Hall 2009; Soskice 1990)

- **Coordination**: Can coordinate multiple policies, private–public behavior (Hamalainen and Heiskala 2007; Levy 1999)
Social Networks and “Systemic Change”

- **Politics of persuasion**: Widely distributed networks enable reform-oriented actors to influence others (the “Bjorn Borg” effect, see also Jens Rydstrom’s “Odd Couples”)

- **Politics of compensation**: Can use policy linkages (Wilensky 2002) or intertemporal bargaining (Saari 2001) to reduce opposition (e.g. David Oddsson and Icelandic trade unions)

- **Coordination**: Can reform multiple policies simultaneously and enlist the active support of private sector actors (e.g. Finland’s “systemic” innovation policy)
The Politics of Persuasion: Bad ideas diffuse quickly in dense social networks (Berman 1998). E.g. Pentti Kouri in Finland

The Politics of Compensation: In addition to buying support, the high cost of exclusion from tightknit social networks discourages criticism

The Politics of Coordination: When firing on all cylinders, can scale even the best of ideas to dangerous levels (e.g. Finnish R&D)
It wasn’t good for your health to be questioning. An important aspect of all of this is that the individual becomes visible in the networks of a small country and can feel lonely and exposed. So there is a lot of informal pressure to [embrace those ideas] and to not question it robustly

(Interview with former board member, financial services firm, 4 July 2012, Ireland).
Economic Openness and the Politics of Asymmetric Adjustment

- International markets should discipline small states (Breznitz and Zehavi 2010; Katzenstein 1985)

- But markets are vulnerable to bouts of irrational exuberance (Rogoff and Reinhart 2009)

- Leads to “asymmetric adjustment”
  - Respond effectively to economic crises (we publish articles about how small states are great!)
  - But vulnerable to policy overshooting and overinvestment in good times (we publish articles entitled small states in big trouble!)
Structure of the Book

- The Politics of Planning in Sweden
- The Politics of Innovation in Finland
- The Politics of Liberalization in Iceland
- Generalizing the Argument: Estonia, Iceland
- Contrasting Cases: France, Germany, US, Austria, Switzerland, Portugal and Greece
**Alternative Explanations**

- **Comparative advantage (Schwartz and Becker 2008)?** But happens in low tech, high tech, services and non-tradables

- **Too much market (Rodrik 1998)?** But happened when economies were relatively regulated and closed

- **Blame the state (Steinbock 1998)?** But little state intervention in Iceland

- **Nordic exceptionalism?** Estonia and Ireland
Sweden (I): Manufacturing Sweden, Inc.

- Sweden characterized by cohesive and encompassing social networks (Katzenstein 1985, Rehn 1996)
- Rapid diffusion of German–style universal banking facilitated “big leaps” into capital–intensive industries in late 19th century (Sjögren 2008)
- But still a laissez-faire society in 1933. Lower tax revenue (18.9% of GDP) than Germany (23.0%), the US (23.4%) and the UK (25.2%) (Magnusson 2000)
- How did Sweden become the highest tax state in the OECD by 1975 (46.6% of GDP)?
Sweden (II): The Politics of Planning

- **Politics of Persuasion:** Cross-class cooperation facilitated the development and diffusion of new, economic ideas (Berman 1998; Blyth 2002)

- **Politics of Compensation:** Supported by 1933 “cow trade” and 1938 Saltsjöbaden Agreement between industry and labor (Katzenstein 1985; Pontusson 1992)

- **Politics of Coordination:** Virtually all public policies designed to support to capital-intensive industry (Henrekson and Jakobsson 2001)
  - Taxation
  - Monetary policy
  - Housing policy
  - Labor market policy
  - (Solidaristic) wage bargaining
  - Public procurement
Sweden (III): Manufacturing a Bubble

• Good times! Early postwar growth outpaced Britain, France, Germany (Maddison 2010)

• But exceptionally dependent on large, established firms in low and medium tech heavy industry (Solvell et al 1991).

• Vulnerable to increasing energy prices and cost competition in the 1970s (Pontusson 1992)

• Exacerbated by decision of center–right government to spend 6% of GDP on industrial subsidies (Rehn 1996)
Finland (I): Responding to the Resource Curse

- Even more cohesive, more heavily regulated and more dependent on low tech industry than Sweden (Tainio et al 1997)

- Responded by rapidly liberalizing their financial system. This did not end well. Will discuss later

- And converted capital-intensive industrial policies to reward technological R&D
  - Established a new agency, Tekes, in 1983
  - Budget increases tenfold (in real terms) by 2000
  - And adopted “systemic” approach that included finance, education, etc.
Finland (II): Connecting People: The Politics of Innovation

- **Politics of Persuasion**: Used educational courses and informal roundtables to diffuse new ideas about research among public and private actors (Moen and Lilja 2006)

- **Politics of Compensation**: Compensated low tech industry with research grants and workers with social benefits (Ornston and Rehn 2006)

- **Politics of Coordination**: Used the Science and Technology Policy Council to coordinate research, education, finance, industrial policy (Castells and Himanen 2001)
Finland (III): Too High Tech?

• The share of high tech exports surged from 3.3% in 1980 to 26.8% by 2000 (OECD 2011)

• But dangerously dependent on a single firm, Nokia, which reshaped the Finnish ICT industry and public policy (Sabel and Saxenian et al 2008)

• And narrowly focused on R&D, which was fine for Nokia, but inappropriate for new startups (Ornston 2014)

• Similar shift in Sweden, but innovation policy was less coordinated and developments were more muted
Iceland (I): From Banking on Fish to Fishy Banks

- Historically, even more regulated than either Finland or Sweden (Mjoset 1987)

- No dot com bubble, because responded to negative economic shocks with an extreme form of neoliberalism (Wade 2009)

- Used cohesive, encompassing social networks to *reduce* state intervention
  - Diffused neoliberal ideas via concentrated media (Morgenbladid, etc)
  - Bought off Social Democrats and labor with side payments
  - Coordinated industrial policy, taxation, monetary policy ...

Iceland (II): The Power of Private Politics

- **Politics of Persuasion:** The three commercial banks emulated one another, pursuing the same, highly leveraged financial strategy

- **Politics of Compensation:** Used financial clout to buy support, giving money to universities, municipalities, even artists

- **Politics of Coordination:** Bubble extended into academia, the media and even traditional industry (which also played with foreign exchange)
Iceland (III): Biggest Bubble Ever?

- Inflated bank liabilities from 100% to 800% of GDP in seven years (Wade 2009)

- Led to a devastating economic crisis, although Iceland recovered relatively quickly. Does tourism represent a new bubble?

- Not like other countries: Greater degree of isomorphism than the Finnish banking bubble of the 1980s, the Swedish bubble of the 1980s or any large state (US, UK, Spain...)
[Ireland is] very small. It’s a big village. ... People know each other from different strands of society ... My understanding is that there are often informal parallel structures. Most important people of influence are in them and very few people are not in them.

(Interview with former official, Department of Trade, Industry and Employment, 4 July 2012, Ireland).
Ireland (I): Asymmetric Adjustment in an LME

• Ireland is clearly different from Nordic Europe. Lower levels of coordination and labor incorporation (Campbell and Hall 2017; O’Riain 2014; Ornston and Schulze-Cleven 2015)

• But strong cross-sectoral networks whether measured by formal institutions like the IDA and corporate boards (Clancy et al 2010) or informal ties

• As a result, an unusually strong consensus on developmental strategy relative to other small states (Austria, Greece, Portugal, Switzerland, etc)
There is a huge [consensus] around FDI, to the point that one cannot question whether the pursuit of FDI is compatible with setting up a sustainable model for an open economy .... There is almost a conspiracy of silence that one should not talk about the [low corporate] tax rate.

(Interview with policymaker, 5 July 2012, Ireland).
They treat you like a traitor, like you should be hung. I always find it amusing. These guys like to think they’re great internationalists, but when it comes to Ireland’s corporate tax they wrap the green flag around them and they don the green jumper. We will die in the trenches defending our low corporate tax rate. They like you to conform and put immense pressure on you to conform”

(Interview with trade union representative, 4 July 2012)
Ireland (II): Characterizing Adjustment

- Adopted an extreme form of import–substituting industrialization during the 1930s (O’Grada 1997)

- Complete volte–face to economic openness and FDI after 1958 (could be broken down into different waves of FDI, low tech, high tech and high end)

- Shift to non–tradeables, financial services and housing, particularly after the dot com crash of 2001
Ireland (III): The Housing Bubble

- **Politics of Persuasion:** Like Iceland (unlike the US or Switzerland) all major banks were affected, isomorphism
Virtually all of the banks went bananas, even the cooperative banks. Even our most conservative institution, the Educational Builders Society succumbed and [had to be] acquired by the state

(Interview with employee, Ministry of Finance, 10 July 2012)
Ireland (III): The Housing Bubble

- **Politics of Persuasion:** Like Iceland (unlike the US or Switzerland) all major banks were affected, isomorphism

- **Politics of Compensation:** Benefits of housing bubble were widely distributed (e.g. Irish Social Partnership)

- **Politics of Coordination:** Policymakers reinforced the bubble by lowering real estate taxes and barriers to property development
Conclusion (I): Contrasting Cases

- Nordic cases (plus Ireland) are unique: More reform, restructuring and overshooting than large states like France, Germany and the US.

- Different from other small, open economies. Sectorally coordinated and regionally divided small states of Central Europe (Austria, Switzerland) are more incremental.

- Not the only pathway to crisis. Highly fragmented, polarized societies of Southern Europe (Greece, Portugal) also experience crises, but for different reasons.
Conclusion (II): What About Denmark?

- Denmark as a cohesive, encompassing society: Rapid reform, restructuring and overshooting is alternately presented as a model of efficiency (Campbell et al. 2006) or dysfunction (Schwartz 1994)

- But strong regional identities militate against Swedish–, Finnish– or Icelandic–style national projects (Kristensen 2011)

- Has frustrated reformers from C.F. Tietgen to Anders Fogh Rasmussen, but has also contributed to economic stability
Conclusion (III): Lessons for Ireland?

- Importing Finnish-style coordination may create more problems than it solves

- Internationalization as an asset, particularly when it comes to policy evaluation, decision-making (this is more relevant for Finland)

- Give more space to institutions or regions to develop competing economic strategies