INSTITUTIONAL ECONOMICS, SOCIAL CAPITAL AND THE NEGOTIATED ECONOMY – A SCANDINAVIAN APPROACH TO ECONOMIC THEORY

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Mental modes are formed by historical and geographical contexts. No doubt, the locations of the upbringing and adult life of an individual strongly influence his or her perceptions and ideas. Although neoclassical economics has an obvious homogenizing effect this is also the case for the identity of an individual trained as a social scientist and economist. For my part, growing up and living for most of my life in the economic and political context of a Scandinavian social democratic welfare state has strongly influenced my views and ideas as an economist. The comparative perspective developed through comparative studies and the experience of living for periods abroad has supplemented and further strengthened the identity forming role of the Scandinavian context of my social life experience.

Scandinavia, or in my case Denmark, is hardly heaven on earth. It is not difficult to identify areas in need of improvement and there are good reasons to be critical at many aspects of actual phenomena as well as current trends of development. Even so, it is a fact that does not escape any Scandinavian with a view on your own society enlightened by a comparative perspective that Scandinavia scores favourably on a lot of indicators. The Scandinavian countries consistently figure among the countries with the highest GDP per capita as well as the highest Human Development Index. Scandinavians, and especially the Danes, most often come out on top in happiness rankings, especially when this is measured through self-registration. In addition, Denmark has for many years been the most egalitarian country in the world in terms of income distribution as measured by Gini coefficients. All the Scandinavian countries are comparatively highly egalitarian and especially the income share of the part of the population with the lowest incomes is relatively much higher than elsewhere. Capabilities, as measured by indicators such as education, internet access and innovative capability, are at a high level and well distributed. Public expenditures and taxes are higher than elsewhere as a share of GDP. The Scandinavian countries are among the world leaders in terms of environmental attitudes and policies and in terms of development assistance. The stock of social capital is very high. The Scandinavian countries consistently rank in the top in measurements of social trust such the World Value Survey. Trust in the state is extraordinarily high. People expect that the public sector generally performs its tasks efficiently and reliably, and its actual performance seldom provokes distrust. Corruption is low or non-existing. Civil society is highly developed and strongly organized. Individuals are members of more voluntary organizations than in any other country in the world. Furthermore, all the Scandinavian countries seem to cope well with the challenges of globalization in ways that contradict the neo-liberal consensus (Nielsen and Kesting 2003). Adaptability and flexibility are achieved without compromising the core characteristics of the Scandinavian countries such as equality, high public expenditures, high taxes and a highly developed welfare state. The Danish ‘flexicurity’ policy is an example of such an approach to globalization that has recently received much international attention (Madsen 2007). As everywhere else, labour and other social forces has been weakened in relation to capital as an effect of globalization. However, this is probably less so than elsewhere. Membership of unions has certainly not decreased as much as in other countries, and most institutions of social cooperation and negotiation are intact and are still going strong. Finally, the political support behind the specific Scandinavian characteristics is strong and undiluted. Opinion polls show strong popular support, and mostly the views of the major political parties differ only marginally, unified as they are by a broad consensus around the welfare state. In Denmark, for instance, a centre-right government is now in its second term, and it is still explicitly basing its position on being more social

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democratic than the social democrats in relation to the maintenance and extension of the popular welfare services and transfer incomes.

Such figures on a comparative scoreboard may seem enviable from the perspective of a less fortunate context. Anyway, problems and disadvantageous features are not hard to find in Scandinavia, even if one leaves out the climate. Employment rates are high and social life is highly institutionalized in the Scandinavian countries, end even sympathetic foreign observers are often understandably critical towards some of the effects on social life, not the least the way old people are institutionalized rather than cared for by family. The high level of adaptability and flexibility on global markets combined with the high level of social benefits and the high wage level has several unfortunate effects, such as widespread stress and exclusion of potential employees with relatively modest human capital. In Denmark, mortality is high because of the lifestyle not least widespread smoking. Furthermore, integration of immigrants is difficult and a highly divisive issue in an otherwise consensual context. Cracks in the welfare state are visible, and the long-term effects of globalization may be less beneficial than in the short term.

Some Scandinavian economists react to the Scandinavian experience through the adoption of a highly critical stance informed by neoclassical economics and neo-liberal ideology. Taxes are seen as far too high. There is too much equality and too little freedom. Incentives, entrepreneurship and individual responsibility must be strengthened. The preferred means are the traditional neo-liberal ones and in case of implementation the effects would be the dismantling of the welfare state and the gradual erosion of the Scandinavian specificities. Luckily, this remains a minority position without any significant impact. Most economists respond differently to the experience of being trained as neoclassical economists in the context of the Scandinavian welfare states. They do not discard their neoclassical training but try to take account of the rationality of the specific Scandinavian societal feature within a rather loose application of the theoretical framework.

Others such as myself find it necessary to adopt a different framework in order to fully understand this rationality and as a guidance for intervention, policy recommendation and elaboration of future scenarios. In my case, the alternative to neoclassical economics is a theoretical framework that spans three levels of abstraction. At the generic level, I subscribe to institutional economics and more specifically to original institutional economics. At an intermediate level of application, I find it useful to relate to systemic approaches such as the '(national) systems of innovation' approach, the 'business systems' approach, and the 'Varieties of Capitalism' approach. Also social capital theory may be seen as an intermediate theory in this context. At the concrete level of application, I relate to theories of the Scandinavian model and more specifically I have been part of an effort to develop a new such approach, the 'negotiated economy'. I do not find it meaningful to try to understand a specific societal context by means of direct application of general theories such as neoclassical economics or institutional economics. There are limits to the applicability of such theories in relation to the historical and geographical specificity of the concrete context of study (Hodgson 2001). General theories may provide useful analytical tools such as supply and demand curves, transaction costs, path dependence and cumulative causation. However, the specific context include emergent properties that are not taken into account if general theories are applied by means of merely inserting the contextual features as parameters in general models. This is the reason why a stratified theoretical approach is needed. General theories and theories about the specific context are necessary, and in my view intermediate theories such as (national) systems of innovation and social capital are useful as well. In the next paragraphs I shall briefly outline the relevant theories and explain how they are relevant.

At the generic theoretical level I find it fruitful to relate to institutional economics and to institutional theories more generally. The focus on institutions is a useful methodological entry point for understanding social reality that escapes the classical dilemmas in social theory such as the agency-structure relationship and the relationship between nomothetical and ideographic theories (Jessop 2001). Generally, institutional theories focus on the role of institutions as enabling as well as constraining social devices, and as such they are important in relation to efforts to understand the effects of the specific institutional contexts of the Scandinavian welfare states.

Generally, it is useful to distinguish three new institutionalisms: Rational-Action Institutionalism, Social-Constructivist Institutionalism, and Mediated-Conflict Institutionalism (DiMaggio 1998). The typology transcends the disciplinary boundaries although the three institutionalisms can be seen as originating from economics, sociology and political science, respectively. *Rational-Action Institutionalism* emphasizes the way in which individual rational action is channeled by the ‘rules of the game’, including laws, inherited organizational forms, and norms. Actors are seen as stable and exogenous. All kinds of institutions are studied within this framework but most of the focus is on economic rules or formal political institutions. Institutional change is conceived as an effect of strategic action of individuals or as a result of (invisible or visible) selection mechanisms. *Social-Constructivist Institutionalism* argues that all elements of rational-action models – actors, interests and preferences – are ‘socially constructed’ and therefore endogenous. Research is focussed on informal institutions such as schemata, roles and scripts, or – in general – all that is ‘taken-for-granted’. Institutional change is seen as a process of isomorphism or diffusion through mechanisms such as legitimacy pressures and normative schemes embedded in training and practice. *Mediated-Conflict Institutionalism* focuses on how states and other institutions structure and mediate conflict among groups with distinctive interests. They study stability and change of the institutional set-up (formal and informal organizational forms) in various contexts as a result of institutionally mediated political conflicts.

The differences and similarities of the three main types of institutionalism are presented in the figure 1 below (Nielsen 2007). The three institutionalisms are positioned in a diagram composed of two dimensions. The horizontal dimension illustrates different conceptions of the relationship between institutions and individual behaviour: calculus versus culture. The vertical dimension illustrates how genesis and change of institutions is conceptualized: coordination versus conflict. In relation to the first dimension, rational-action institutionalism stresses calculus, that is, behaviour is seen as instrumental or strategic within institutionally defined constraints, whereas social-constructivist institutionalism, however, sees behaviour as routinized and stresses the role of interpretation of the decision-making situations as a function of the outlook of the institutionalized individual. In this respect, mediated-conflict institutionalism is in an intermediate position. It sees individuals and groups as actors who are self-seeking and calculating based on their interests. However, these interests are seen as partly constituted by institutions. In relation to the second dimension, both rational-action institutionalism and social-constructivist institutionalism emphasize the role of institutions in relation to problems of coordinating economic action, but they differ in their conceptions of the cognitive repertoire of individuals. Mediated-conflict institutionalism, on the other hand, stresses conflicts of interests rather than coordination problems as the ultimate cause of institutionalization and institutional change. In addition, power resources rather than cognitive resources are seen as important in explaining how institutions are generated and change.

Figure 1: Three institutionalisms: conflict versus coordination; calculation versus culture

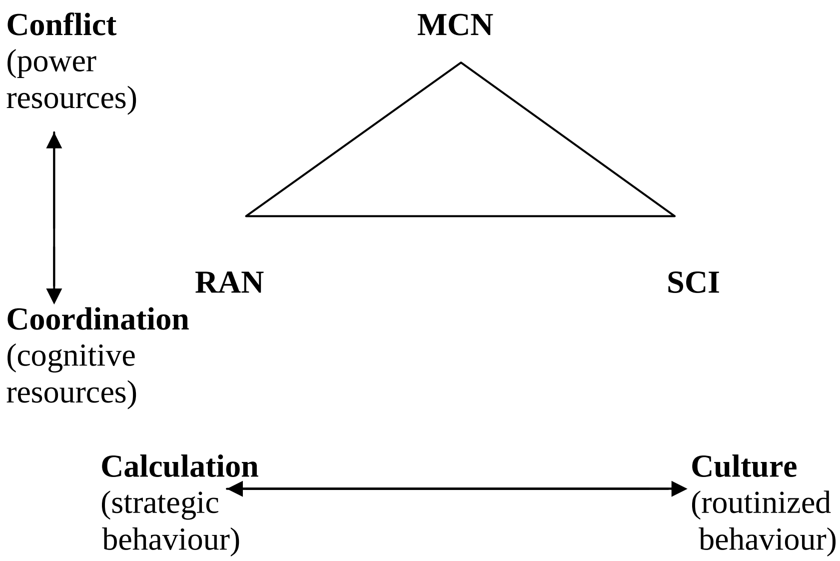

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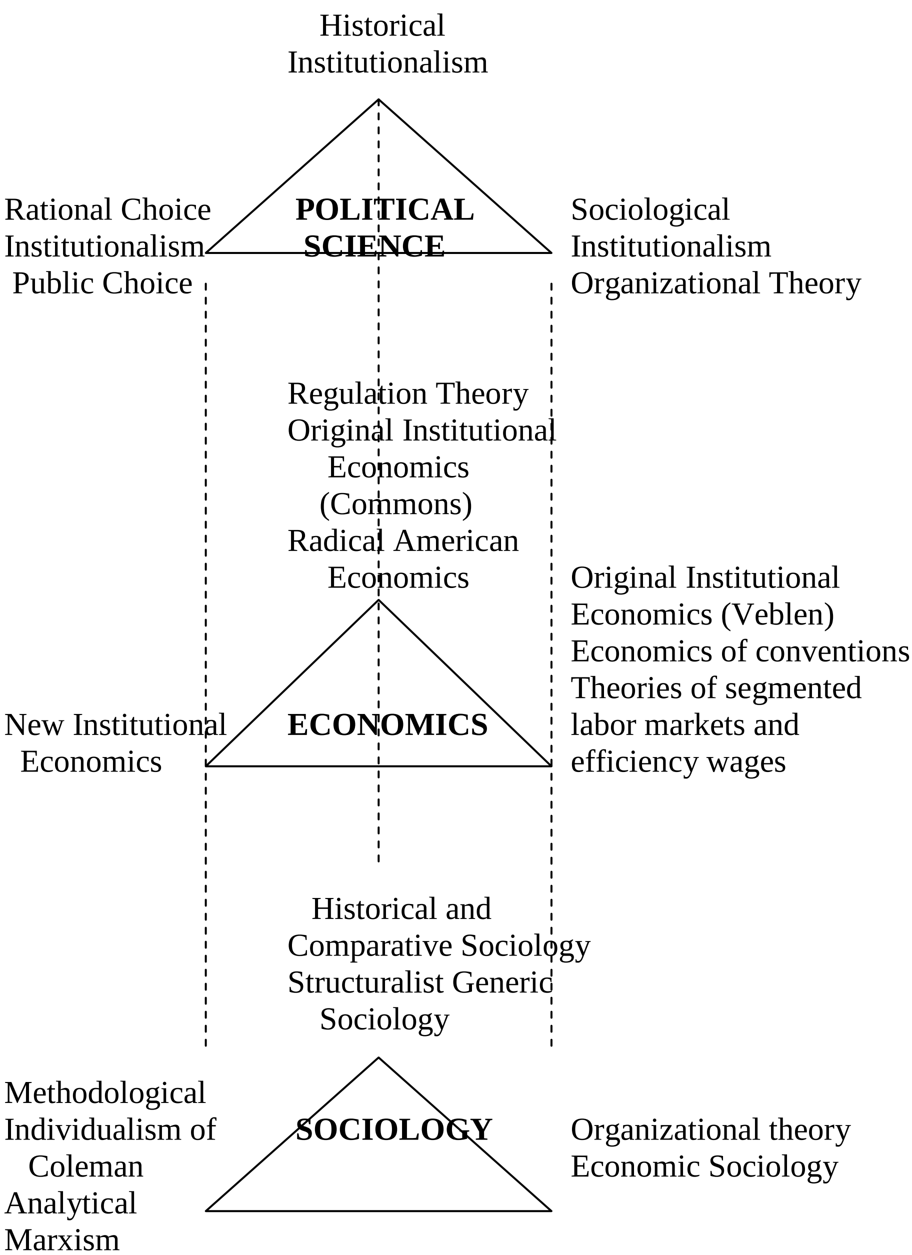
Figure 2 is a modified version of Théret (2000) that identifies contributions from all three social sciences within each of the three main types of institutionalism. All strands of institutional theory has something to offer in relation to the understanding of the Scandinavian context but personally I find original institutional economics most useful. In figure 2, this tradition is split into two theoretical strands associated with Commons and Veblen respectively. The Commons strand focuses on institutions for problem-solving and conflict solution among social partners and is obviously relevant in the Danish context. This is so as well for the Veblenian strand of institutional economics that stresses enculturation of economic behaviour.

Figure 2: Institutionalisms in political science, economics and sociology



The intermediate level of analysis encompasses theories that are not, in principle, generally applicable, but rather focus on specific aspects (or systemic outcomes) such as innovation performance, forms of business organization, industrial relations and corporate governance and social capital. In the Danish context, important studies have been made applying the '(national) systems of innovations' approach (Lundvall 2002), 'the business systems' approach (Kristensen 1996) and the Varieties of Capitalism' approach (Campbell et al 2006; Campbell and Pedersen 2007). Furthermore, it is obviously relevant to apply theories of social capital in the Danish context in order to better understand the glue that holds the complex framework of institutions together. Many studies end up with a missing link or an unexplained factor in a similar way as the X-factor in Leibenstein's classical study of economic growth.

For instance, in a study of the Danish innovation system, Lundvall (2002) introduces social capital as a kind of joker in the conclusion in order to explain the paradoxical competitive success of Danish industry. Trade openness and free capital movements increase international competition and impose huge pressures for industrial restructuring of the OECD countries. The challenge of continuous structural upgrading is even more pressuring for small high-wage countries. In the case of Denmark this is particularly imminent because of the specialisation pattern of Danish industry with its strength in rather traditional low- and medium-tech branches of production. However Denmark has succeeded to maintain and even improve its relative position among the developed countries (as measured by GDP per capita) in spite of this apparent handicap. The explanation is a high degree of change and flexibility in firms' use of resources, including rapid diffusion of new technologies in those low tech and medium tech industrial sectors where Denmark maintains its competitive advantage. The production equipment and manufacturing methods in the production of foodstuffs, furniture and clothing is highly advanced, often combined with high expertise in design and marketing. These experienced-based knowledge assets in traditional industries have little to do with R&D and more with 'a close social interaction across the boundaries of organizations, departments and management levels. Such interaction is supported by a system of education and a labor market with its own national idiosyncrasies' (Lundvall 2002, p. 74). In this context it is also important to stress that the Danish society is characterised by strong social cohesion. Danish firms have the advantages of a relatively high stock of social capital, that is a multitude of voluntary associations, cross-cutting social networks, and a high degree of mutual trust, which not only reduces costs of inter firm transactions but also makes easier adaptation, learning and cooperation between business firms, state and civil society in local contexts as well as at a national level. The major Danish competitive asset is characterised as 'localized learning' based on 'shared trust' (Maskell et al. 1999). The recent initiatives to strengthen life-time learning make Denmark a world leader in this field and further improve these capabilities.

Both generic institutional economics and the intermediate theories are highly useful in efforts to understand the Danish case and more generally the Scandinavian countries. However, they do not fully capture the specificity of the context. More contextual theories are necessary. The 'negotiated economy' approach (Nielsen and Pedersen 1991; Nielsen 1992; Pedersen 2007) is an attempt to develop such a theory. The theory takes as its point of departure the specific institutional set-up that characterizes the generalized political system of negotiations in Denmark and the specific historical process with its path dependent features that explains the emergence and dynamics of this structure. The negotiated economy is defined as a structuring of society whereby an essential part of the allocation of resources is conducted through organized negotiations between independent decision-making centres in the public sector, private interest associations and private firms. This is significantly different from autonomous decision-making in the public and private sector respectively, and also different from the decision making in a mixed economy such as this is traditionally understood. Unlike decisions made by public authorities, negotiation-based economic decisions are reached on the basis of interaction between independent actors, and the relevant public authority is only one of several participants. Unlike market decisions, which are made by individual agents acting on the basis of given preferences and resources, negotiation-based economic decisions are made through a process characterized by the deliberate shaping of preferences of the actors. Unlike the traditional perception of mixed economies, in which the actions of sovereign market actors are supplemented or corrected by the state, in a negotiation-based economy decisions are taken in a system of negotiations in which the deliberate shaping of preferences and the mutual understanding of socioeconomic problems put limits to and sets targets for the interaction of a multitude of actors.

The negotiated economy "is characterized by a combination of institutionalized learning and organized negotiation and … the learning capacity of the system is influenced by the articulation of a shared and mutual understanding of Denmark's socioeconomic problems" (Pedersen 2006: 246). Central in the approach is a focus on the role of institutions in facilitating the elaboration and dissemination of socioeconomic discourses as the framework for actual decision-making by means of institutionalized negotiations. The classical field of application is the labour market but all major markets and policy areas have become integrated in the negotiated economy. Pedersen (2006) outlines Danish structural policy as an example of a policy field that has gradually become institutionalized as a negotiation-based area.

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