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Manifesto for a Competitive Social Democracy

Marcel Boyer (CIRANO and Université de Montréal)

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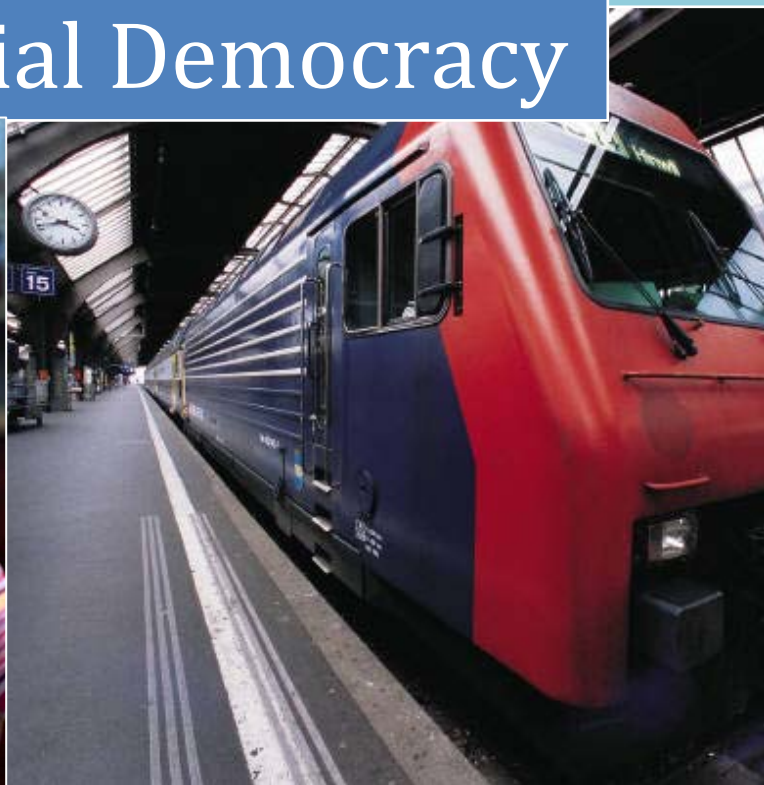
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Marcel
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Manifesto for a Competitive Social Democracy



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Marcel Boyer

Emeritus Professor of Economics, Université de Montréal
Vice-president and Chief Economist, Montreal Economic Institute
Fellow of CIREQ, CIRANO and the C.D. Howe Institute

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FOREWORD

The idea to write this *Manifesto* takes its origin in a deep personal belief that many social, economic and political debates currently taking place in our societies, both developed and developing, are rooted not in a conflict between the left and the right, or between socialists and neo-liberals; but, rather in the confusion between goals / objectives and ways / means.

People may disagree on the goals and objectives that a society or their society should pursue. They may disagree about the relative efforts that should be exerted towards wealth creation and wealth redistribution. They may even argue about the differential efficiency of different ways and means that could be implemented to achieve common goals and objectives. But when there is confusion between goals and objectives on the one hand and ways and means on the other, the debate becomes spurious. Thus, while the debates about goals and objectives are societal by nature, the debates about ways and means are technical, or at least should be.

In extreme cases, there is no confusion. In a sense, a goal must be socially shared, which means we must all agree to pursue it, or we must at least have a way to build a consensus about it as is the case, for instance, through an open and transparent electoral process. Once the goal is set and agreed upon, it must be reached or achieved. How? This is where the discussion about ways and means comes in. The discussion then becomes more technical: What resources and technologies are available? How efficiently can they allow us to reach the goal? How much do they cost? The discussion on ways and means deals essentially with relative efficiency and relative costs. Achieving a consensus on goals and objectives requires an efficient political competitive process with candidates competing to obtain the electoral support (basically democratic election rules and institutions), while achieving a consensus on ways and means requires an efficient economic competitive process (basically competitive markets, competitive processes, and competitive prices).

The concept of a Competitive Social Democracy model and project stems from disentangling the numerous conflicts that occur between goals and objectives on one side, and ways and means on the other. The Competitive Social Democracy model and project radically distinguish between the processes that can lead to the identification of the goals and objectives characterizing a given social democratic society and the

processes that can lead to the identification of the ways and means by which those goals and objectives will be reached or achieved.

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ABOUT THE AUTHOR

www.cirano.qc.ca/~boyerm

Marcel Boyer (Ph.D. economics, Carnegie-Mellon University) has taught economics at York University (1971-1973), UQÀM (1973-1974) and at the University of Montreal (1974-2008). He held the Bell Canada Chair in Industrial Economics in the Department of Economics at the University of Montreal (2000-2008) and the Jarislowsky-SSHRC-NSERC Chair in Technology and International Competition at l'École Polytechnique de Montréal (1993-2000).

He is presently Emeritus Professor of Economics at the Université de Montréal, Vice-president and Chief Economist at the Montreal Economic Institute, Fellow of the C.D. Howe Institute, CIRANO and CIREQ, Academic Affiliate of The Analysis Group, Member of the Executive Board of the Canadian Law and Economics Association, Member of the Board of the Agency for Public-Private Partnerships of Québec, member of the Industry Canada Advisory committee on business strategies and innovation, member of the Governance committee of the "Sustainable Development and Socially Responsible Investment" Chairs (École polytechnique de Paris and Université de Toulouse).

He was President of the Canadian Economics Association (CEA), President of the Société Canadienne de Science Économique (SCSE), CEO of CIRANO, Member of the Board of Directors of the National Bureau of Economic Research (NBER, USA), Member of the National Statistics Council of Canada, Member of the Management Committee of Bell-University Labs, Member of the Board of the Montreal Mathematical Finance Institute, Member of the Board of Directors of the Social Science and Humanities Research Council of Canada, Chairman of the Board of the Network for Computing and Mathematical Modelling, Visiting Senior Research Advisor for industrial economics at Industry Canada, Member of the Editorial Board of the *Canadian Journal of Economics* and the *Journal of Economic Behavior and Organization*, and Chairman of the Board of the Caisse Populaire de St-Jérôme.

Marcel Boyer received numerous prizes for excellence in research: Alexander-Henderson Award (Carnegie-Mellon University 1971), Prix Marcel-Dagenais (Société canadienne de science économique 1985), Endowment-for-the-future Distinguished Scholar Award (University of Alberta 1988), Distinguished Guest Professor Award (Wuhan University of Technology 1995), Fellow of *The International Journal of Industrial Organization* 1997, Fellow of the World Academy of Productivity Science 2001, Prix Marcel-Vincent (Association francophone pour le savoir ACFAS 2002), and Médaille Guillaume-Budé (Collège de France 2005). He is an elected member (1992) of the Royal Society of Canada (RSC - The Academies of Arts, Humanities and Sciences of Canada). According to the prestigious RePEc (*Research Papers in Economics*, University of Connecticut, April 2009) ranking of economists around the globe, Marcel Boyer is among the top 5% (19 700 economists registered and ranked, including all the major names of the profession).

Author or coauthor of over 250 scientific articles and papers and public and private reports, Professor Boyer currently conducts research in the areas of investment valuation (risk, flexibility and real options); efficient organizations, innovation and competition; incentives, incomplete information and uncertainty; and law and economics (environmental issues, Intellectual property rights). Marcel Boyer has acted as expert economist on behalf of several national and international corporations and government organisations, concerning such matters as copyright, competition policy, wage negotiations, evaluation of strategic investment choices, contractual litigation, development policies, municipal institutional reform, cost sharing and pricing of common infrastructures, public-private partnerships, risk management, regulation and

deregulation, etc. In this capacity, he has acted as expert witness before various organizations and tribunals.

Montréal, April 15, 2009.

CHAPTER 1: THE SOCIAL DEMOCRACY CHALLENGE

New opinions are always suspected, and usually opposed, without any other reason but because they are not already common.

(John Locke, Essay Concerning Human Understanding, 1690)

In life, it would be kind of boring if there was no risk. On the other hand if there's too much risk, too much uncertainty, too much chaos, we can't handle it either. We simultaneously want order and disorder, simultaneously want risk and quiescence.

(Myron Scholes, Canadian 1997 Nobel laureate in economic science, in an interview with H.W. Jenkins Jr. of *The Wall Street Journal*, March 5, 2007)

The capacity and willingness to identify, select, adopt, adapt, implement, and commercialize inventions and innovations, whether technological, social or organizational, are the main engines of productivity gains, economic growth and improvements in social well-being. Such capacity and willingness are found rooted in individual attitudes towards change as well as in social, organizational, and political institutions' attitudes towards flexibility, dependability and reliability.

There is significant pressure being exerted on social democratic societies and their institutions to adapt to a more competitive political, economic, social and cultural environment while, at the same time, preserving the nature of their social security programme that has conditioned their economic performances and characterized their high quality of life. These performances have been, by historical standards, very high for well over half a century. At the centre of the current questioning lie the legal, political and social interfaces and interactions between the public sector as a whole and other stakeholders involved in making social democratic societies strong and innovative ones, societies in which justice, equity and entrepreneurship are valued principles. The proposed "Competitive Social Democracy" (CSD) model and project developed in this book aim to contribute significantly to these reflections, and, as such, represent the first, but certainly not the last, tangible comprehensive building block. The CSD model

and project build on five main observations and ideas as well as ten major generic policies and programmes.

FIRST, there is a *creeping inefficiency* in the production, distribution and delivery of public and social goods and services. This inefficiency has many roots, but the most important ones find their derivation in two subsets of factors. The first of these subsets revolves around the omnipresent confusion between goals / objectives and ways / means in many important aspects, sectors, and programmes of social democratic societies. This confusion is the source of fruitless debates. It is time to clarify the goals and objectives to ensure that the most efficient, least costly and least risky ways and means are used and harnessed to reach the goals and objectives that should be pursued.

The second subset of factors in creeping inefficiency proceeds from the capture of large segments and portions of the production, distribution and delivery processes of the public and social goods and services by well-organized, entrenched and highly-protected interest groups and lobbies. Those interest groups and lobbies have, over the years, become capable of imposing hurdles of many kinds, which have impaired sustainable performance and productivity gains.

It is time to reaffirm the preponderance of goals and objectives and give all citizens the right to displace inefficient, in both absolute and relative terms, providers of public and social goods and services. In a sense, the CSD model and project aim at disentangling the following paradox: many social, political, and economic observers claim that our health, education, infrastructure, and environment systems are failing to provide citizens with the level of services that they could once provide, in spite of increasingly important human, material and financial resources being invested into such systems. How could and did we end up with so many problems in the production and distribution of public and social goods and services, considering that we have become richer and richer almost every year over the last half century?

SECOND, if social democratic societies really aim to improve or simply maintain their broadly defined social protection and security programmes developed over the last half century as part of their social landscape (including universal access to high-quality education, training and health services, unemployment benefits, environmental protection and restoration policies, extensive water and sanitation services, recreational activities, etc.), they will have to run those programmes and deliver the associated public and social goods and services they are supposed to provide in a *much more*

efficient and effective way. If not, the increasing economic pressures arising from both the globalization of markets and the internationalization of cultures will lead to a reduction, shrinkage or even abandonment of those programmes one way or another—perhaps not officially, but certainly in practice with lower-quality goods and services and/or slower delivery, in addition to increased uncertainty and lower dependability. This reduced quality of public and social goods and services will occur not because we cannot afford them anymore (we have never been so rich, powerful and, therefore, capable of affording higher quality and quantity of public and social goods and services!), but because these goods and services have become *relatively* more expensive.

The current political debate on the failure of the health system, education system, and infrastructure system to deliver the goods and services they are supposed to produce and distribute is centered on government budget allocation. Different groups call for more money, sometimes under the more acceptable pseudonym of ‘reinvestment’, for health, education, infrastructure, environment, etc. The view taken here in the CSD model and project is that the fundamental problem is not one of money or budget per se, but rather one of organizational or systemic efficiency and effectiveness, efficiency in reaching the goals and objectives set and effectiveness in doing it at the lowest possible cost in terms of socially-valuable resources.

THIRD, social democratic societies have been able to achieve a high level of human and social development first and foremost because of their high performance in achieving significant economic growth rates for sustained periods of time, the *sine qua non* condition of broadly distributed improvements in living standards. The main factor underlying economic growth is the quality of institutions and organizations and their capacity to reach an efficient allocation of resources and to both coordinate and motivate individuals to contribute maximally to the well-being of all. The quality of institutions and organizations, including the resource allocation mechanisms and the incentive schemes, transcends the importance of other factors of growth, such as human capital, technological change and innovations. This occurs because the quality of institutions and organizations fundamentally determines the development of the other factors of growth. Many of the problems social democratic societies are facing today are due to the fact that those institutions and organizations that have characterized their social democratic core have aged and lost their original efficiency and effectiveness.

FOURTH, social democratic societies have become well-educated, highly-skilled societies with significant entrepreneurial capabilities. They have also reached a high level of tolerance for diversity, not regarding fundamental principles and objectives (justice, equity, inclusion, efficiency, effectiveness), but regarding the different ways and means by which those principles and objectives may be achieved or met in practice in different contexts. Hence, competition and modularity in the production, distribution and delivery of public and social goods and services become possible and desirable. The efficient and effective ways and means by which the public and social goods and services will or should be provided in the future, will be different from the efficient and effective ways and means by which they were produced and delivered in the past. Increasingly effective production, distribution and delivery processes are now available or possible thanks to significant changes in education as well as in production and information and communications technologies. The CSD model and project make some of those processes explicit.

FIFTH, human behaviour can be explained and understood mainly from two major fears: the fear of competition and the fear of uncertainty, insecurity and risk. The CSD model and project aim at dealing with these fears at their roots. Both fears could be powerful engines of stagnation and negative growth, but they can also be powerful engines of growth and opportunities to increase the well-being of all, as suggested by the quote of Myron Scholes at the beginning of this chapter. Misunderstanding the role of competition and the reality of uncertainty and risk can lead to years of suboptimal and even wasteful development and deployment or allocation of resources, human, natural and technological. One important goal of the CSD model and project is to harness the natural fears of competition and uncertainty and risk in a way that is compatible with increased efficiency and effectiveness, sustained growth, and improved well-being. In the same vein, negating or misunderstanding the role of competition and improperly assessing the importance of uncertainty, insecurity and risk are the two most important roadblocks towards an improved social democratic society.

The CSD programmes and reforms proposed later in this book are quite ambitious and challenging. They will generate and require significant debates and further developments, regarding their implementation as well and the transition of the current under-performing and wealth-destroying mechanisms and policies towards efficient, wealth-creating and welfare-increasing ones. Although the CSD model and project are totally in line with the social values that have become associated with the social democratic view on life, society and well-being, the significant reforms it requires for

the mechanisms by which those values are concretized into the production, distribution and delivery processes of public and social goods and services will be aggressively opposed by many individuals, groups and organizations who have vested interests in the current under-performing system while claiming their attachment and adherence to social democracy ideals. Implementing the reforms will, therefore, require a strong, dedicated and well-informed political will.

The *traditional* social democracy that dominates the social democratic landscape in these times has now become a socio-economic model of the past that impedes growth opportunities. It does so by relying on non-competitive ways and means of production and delivery of public and social goods and services and emphasizing the (anti social democratic) preservation of acquired rights and privileges, the protection of rents and vested interests, as well as the safeguarding of sacred cows and institutional symbols. Moreover, the associated central planning technocratic and bureaucratic management style has become a burden on the shoulders of citizens. In the so-called social democratic world, the different reforms, implemented over the last fifteen years or so in some regions and countries, have been mainly aimed at reducing, or simply coating, the most evident forms of inefficiencies generated by such a degenerated system. These reforms have, in the most part, avoided any confrontation or tackling of the true underlying causes of system failures. In other regions and countries, significant resources have been harnessed to challenge or negate the existence of failures and to claim that reforms would only generate bad results and worse situations.

The *modern* CSD model envisioned here emphasizes goals and objectives on the one hand and ways and means on the other, stressing the need for social flexibility and modularity, and insists on competence as the source of power and authority. In doing so, it aggressively promotes efficiency, effectiveness and responsibility in the production, distribution and delivery of public and social goods and services. The CSD model is intended to be a truly powerful engine of growth, fuelled by open, competitive, and pro-freedom processes fostering citizenry involvement. It rests on redefined boundaries between responsibilities and activities of different sectors. Indeed, in the CSD model and project, the dichotomy “public versus private” is replaced by the dichotomy “governmental versus competitive”.

The governmental sector and the competitive sector must be understood broadly as follows. The **GOVERNMENTAL SECTOR** is comprised of those officials chosen through democratic processes as well as their close collaborators (senior civil servants), while the

COMPETITIVE SECTOR is comprised of the different coalitions of citizens embedded in different forms of organizations, such as non-governmental organizations, cooperatives, civil society organizations, social economy organizations, business corporations, other corporate entities, etc. The distinction is not simply semantic, but is instead intended to modify and clarify the sectors' boundaries of interventions, responsibilities, and interactions in a more transparent and useful way.

As we just saw in the CSD environment, the distinction between the public sector and the private sector is considered outmoded and no longer relevant. Rather, I distinguish between the governmental sector and the competitive sector. The old separation between public versus private sector led to an associated distinction between public-sector-produced goods and services and private-sector-produced goods and services. In the CSD context, the private-sector-produced goods and services will naturally be produced and delivered as competitive-sector-produced goods and services. What about the previously denominated public-sector-produced goods and services? Those goods and services could remain "public" in the sense that their production and delivery would remain publicly financed. However, they would now be designed, produced and delivered by the competitive sector under a partnership or appropriate contracting agreement with the governmental sector, as I will show in the next paragraphs. I maintain the expression "public and social goods and services", but it must be understood that such terminology does not refer in any way to public-sector-produced goods and services.

The CSD model and project revolve around the following ten major generic policies and programmes, which will be discussed more fully in chapter 5.

I. Clearly define the core competencies of the governmental and competitive sectors.

The core competencies of the **GOVERNMENTAL SECTOR** are first, the identification of citizens' needs in terms of public and social goods and services, both in quantity and quality; second, the design of proper mechanisms through which conflicts between different baskets of goods and services and between different coalitions of citizens will be arbitrated; and third, the management of contracts and partnerships with competitive-sector organizations for the production, distribution and delivery of the chosen basket of public and social goods and services. The core competencies of the **COMPETITIVE SECTOR** are to produce, distribute and deliver the public and social goods and services as well as the private ones by making use of the best forms of organization and the most efficient combinations of factors, human resources and technologies.

II. Promote open and transparent competitive mechanisms in the attribution of contracts for the production, distribution, and delivery of public and social goods and services.

For competitive mechanisms to be broadly accepted, a significant effort must be undertaken to promote the liberalization, dissemination and better understanding of economic laws and rules. The emergence and omnipresence of competitive prices and processes throughout the economy, in the public and social goods and services sectors in particular, constitute significant forces aimed at avoiding waste and at generating and implementing innovative solutions to problems and challenges and, in that regard, must be understood as a significant endeavour of the CSD model and project. To achieve such results, it is important that the attribution of contracts be realized through open and transparent processes, exempt of favouritism and predatory behaviour. Competitive-sector organizations must face a level playing field; if some advantage should be given to particular participating organizations, it should be announced and quantified in a clear way at the outset.

III. Favour the creation and development of efficient competitive-sector organizations with a capacity to bid efficiently for public and social goods and services contracts.

The emergence of competitive markets for the governmental-competitive contracts and partnerships in the production, distribution and delivery of public and social goods and services requires that a sufficient number of organizations be present in the tendering process. It is a fundamental responsibility of the governmental sector to make sure that contract-award processes be exempt of significant expression of market power by competitive-sector organizations. Those competitive-sector organizations must be capable of submitting credible offers in a level playing field contest for governmental contracts. Efficiency in this process requires all competitive-sector organizations face the same requirements (except for some advantages that are intended to be given to some participants that should be announced and quantified at the outset). In order to achieve the highest level of efficiency, it is preferable, if not necessary, for the government to explicitly favour, through an adequate programme of training and counselling, the development of competencies through the creation and development of efficient competitive-sector organizations without interfering directly in the contract-allocation processes. Such a policy would, in the long run, be much more efficient than trying to tilt the balance towards preferred-son organizations.

IV. Promote the emergence of competitive prices and mechanisms (market creation) in all sectors of the economy, including the public and social goods and services sectors.

The competitive mechanisms are the most efficient mechanisms allowing citizens and organizations to make choices based on appropriate information. The manipulation of prices by sending biased signals or indicators of relative costs and scarcity of goods and services has become a major source of social and economic waste in our societies. Such manipulations imply that individuals are induced to make inefficient consumption and investment decisions, while firms and organizations in all sectors, including public and social goods and services sectors, such as health and education for instance, are induced to make production, investment and R&D choices that are oriented more towards the interests, wishes and private objectives of price manipulating political authorities and well-organized interest groups rather than towards the needs and demands of their customers and clients. Confronted to adequate indicators (competitive prices and processes), individuals as well as firms and organizations, can adapt their consumption and production activities, including their investments in human capital (portfolio of competencies), in R&D, and innovation efforts, to the relative social value of those activities, as reflected in competitive prices. In some cases, efficient well-informed decision-making will require the creation and development of competitive markets in lieu of traditional bureaucratic, autocratic, and centralized decision-making by, more often than not, poorly informed social engineering planners whose special interests eventually always dominate those of the people. This is inexorably and most perniciously the case even with well-intentioned political or social leaders playing as gods imposing their own tutelary preferences. This is not to say that it is never appropriate for political or social leaders to convince people of the desirability of better behaviour, but rather that it is always better to proceed through competitive institutions and mechanisms, respecting the autonomy and fostering the responsibility of citizens.

V. Favour modularity, flexibility, experimentation and change through multiple sourcing.

Innovation, not only technological but also organizational, must rely on an explicit process by which experimentation and change become normal if not frequent or continuous events. In order to reduce the costs of innovation generation, selection and implementation, and, therefore, of favouring the emergence of an innovative society,

the governmental sector must explicitly develop a multiple-sourcing policy in the attribution of contracts. Multiple sourcing means that no single competitive-sector organization should be allowed to monopolize or dominate a significant part of the production, distribution and/or delivery of a public or social good or service. In order to favour competition among providers and to identify those capable of higher performance in the production, distribution and delivery of public and social goods and services, it is essential that some level of modularity and experimentation be continuously undertaken under proper safeguards allowing the evaluation of new ways and means so implemented, the objective being to implement real-world best practices as consistently as possible. By explicitly favouring multiple sourcing, the governmental sector must aim to encourage a proper level of modularity and experimentation in the provision of public and social goods and services, and in so doing, favour the research and discovery of better ways and means.

VI. Develop efficient mechanisms and institutions for better adaptation to change by individuals as well as by firms and organizations.

A significant source of opposition to socio-economic change, even when such change appears desirable is the absence of efficient mechanisms or institutions allowing individuals and firms to reduce their own direct cost of adaptation to such changes. The following three factors are equally important for the social well-being: first, the flexibility to adapt to changes and the willingness to take on new challenges posed by exogenous and endogenous changes in a volatile socio-economic environment; second, the capacity of the education sector to respond to industrial and social needs in terms of required skills and competencies of different types; third, the importance and efficiency of R&D investments in generating new ideas and useful products and services. Hence, the flexibility to adapt to a volatile environment must be a characteristic of all sectors producing and distributing private as well as public and social goods and services. Flexibility runs against inertia; inertia grows from fear; fear from change. Unless people are given the reasons for change and the tools to manage such change, they will resist to it in the economic and political arenas. Therefore, the level of social flexibility towards change will depend on the existence of institutions (tools and means; organizations and markets) allowing individuals, firms and different levels of government to efficiently manage risks and opportunities that volatility in the socio-economic environment represents. A proper set of institutions to manage the risk faced in change is a prerequisite for a flexible society, that is, for a society where innovation,

both technological and organizational, thrives. Hence the need for those institutions in the CSD model and project.

VII. Promote direct and transparent policies of income and wealth support in fighting the development of dependence for individuals as well as for firms / organizations.

It is normal and expected that, in any efficient society, a certain number of individuals will end up making or having taken wrong decisions with dire and socially undesirable and even unacceptable consequences. Hence, a public programme of income and wealth support is not only necessary but also conducive to growth enhancement and social well-being improvement for all. But such public programmes must be efficiently designed and implemented. In lieu of the paternalistic control and manipulation of prices that have often been the preferred policy in the past, the CSD model and project propose to implement direct and transparent policies of income and wealth support with strong incentives for the beneficiaries to get out of them. Moreover, it is desirable that those income and wealth support mechanisms not only be integrated, direct, efficient and incentive compatible, but also developed under the responsibility of one single government authority in order to increase governmental accountability in that matter. A CSD policy towards the needy, the unlucky, and the poor must be as empathetic as possible. This objective requires that the policy be aiming strongly at avoiding the development of dependence, for the well-being of the beneficiaries themselves. If properly designed, an income and wealth support programme can be both empathetic and dependence-free. It is imperative that beneficiaries be properly induced to leave public income and wealth-support programmes fruitfully, successfully, and as soon and efficiently as possible, allowing better and more generous programmes to be designed and implemented. It is imperative, for instance, that the implicit tax rates imposed on the unemployed and the social welfare recipients as they find a part-time or full-time employment be adjusted and calibrated to persuade them to find and accept those jobs. Similarly, governmental support and subsidies of all types and forms, including those intended to help and support competitive-sector firms and organizations that are facing particularly sudden difficult times or competitive environments, must be continuously reassessed and made equally as transparent, publicly accountable and incentive compatible as possible. It is desirable that an explicit evaluation of the cost of such supporting contracts (guarantee provisions, conditional subsidy, real options of different kinds) be performed and, on that basis, be in most cases brought to market, that is, be sold to third parties at competitive market prices.

VIII. Foster regular, systematic, transparent, independent and credible evaluations of public programmes and policies.

All government programmes should contain sunset clauses so that their role and efficiency can be reassessed on a regular basis. Independent and credible organizations and bodies, using state-of-the-art and transparent methodologies, while also being open to the scrutiny and criticisms of the public, should be called to perform such evaluation. In many, even in most cases, the current socio-economic evaluation of governmental programmes proceeds from improper, disputable and self-serving methodologies. Programmes aimed at (regional) job creation, fostering investments in specific sectors, as well as programmes intended to favour the reinsertion of the long-term or seasonally-unemployed persons, are all examples of public programmes costing vast sums of money with practically no significant tangible results. It is not the goals and objectives of those programmes that are flawed, but rather their implementation. The current evaluation procedures of such programmes are not only dubious, but are most often reduced to nothing more than a means to justify (ex-post) a bad politically motivated decision. The CSD model and project reject those shabby evaluation procedures and methodologies in favour of systematic, transparent, independent and credible evaluations. By stressing the need for more rigorous and regular evaluation procedures, in addition to requiring that the programmes be subject to competitive processes leading to incentive contracts for those organizations chosen to produce and/or deliver them, the CSD model and project will favour programmes that are better designed and better implemented.

IX. Promote the development of e-government in all forms and manners to ensure a sound and efficient democratic process, both in politics and economics.

An aggressive policy towards the development of e-government processes could favour the implication of the citizenry in governmental affairs. Information gathering and dissemination should be high on the agenda of an e-government policy. But there is more to e-government than simply bi-directional communication with the public. A systematic implementation of e-government procedures can make the call for tender and bidding processes much more efficient and transparent. An e-government infrastructure will make possible a productive recourse to sophisticated combinatorial auctions,¹ in which coalitions of citizens and competitive-sector organizations of all kinds

¹ We will present and discuss the working of those auctions in chapter 6, section 6.8.

can efficiently bid and compete for the right to obtain appropriate contracts to serve the public and produce, distribute and deliver public and social goods and services.

X. Promote strategic alliances with developing countries to get a head start or to catch up in higher value-added competition with developed countries.

The CSD model and project stress the search for social and economic efficiency within one country or region in order to provide the best possible opportunities for productivity gains, growth enhancement and social well-being improvement. Among such opportunities, the free trade policies, across sectors and levels of the commercial and industrial landscape, occupy a special place. The CSD model and project stress the importance of identifying, investing in, and implementing different ways to strike alliances with producers and providers from countries of the South in order to gain, maintain, and consolidate competitive advantages among countries of the North and, in so doing, favour the development of countries of the South. With such a strategy, the latter countries would become prime allies as providers of key inputs (not only intermediary products but also, in due time, new technologies, new products and new services) in the challenges that countries of the North are posing to each other.

CONCLUDING REMARKS

Those ten major and ambitious generic policies and programmes of the CSD model and project will be opposed, criticized, confronted and fought by numerous well-organized self-centered interest groups. Hence, it is important that our institutions and we as a society demonstrate clearly and credibly the intelligence and courage of our ambitions, the **INTELLIGENCE** to design ways and means of implementing the necessary reforms to reach a systematic realization of social democratic goals and values and the **COURAGE** to implement and pursue those reforms in the production, distribution and delivery of public and social goods and services.

It is likely that there exists no single best way to achieve the goals and objectives of a modern competitive social democratic society. Only one thing can be known for sure: if the current providers of the public and social goods and services cannot be challenged in a reasonable and repeated way, rather if the production, distribution and delivery of public and social goods and services are allowed to be captured and monopolized one way or another by particular groups of individuals and organizations, then the quality, reliability, dependability, and timeliness of public and social goods and services will eventually and inexorably decrease towards an unacceptable wasting of social resources. This is unfortunately the current state of many, if not all, social democratic

societies that seem to be facing a stalemate resistance to change, sitting on social and economic time bombs, and, therefore, courting with disaster.

The CSD model is, first and foremost, a vision of Humans as social beings. According to this vision, the first and central objective, improvement in social and individual well-being, goes through the recognition of three fundamental principles: **(I)** Individuals are capable of making rational choices; **(II)** Social integration defines Humans; **(III)** Explicit efficient mechanisms of coordination and motivation are necessary to an optimal use of the available resources. This allows for an immediate comparison of the traditional versus the competitive social democracy models. While both may proceed from the same original point, the former has not only lost its true finality, but also has sunk more and more into what can only be described as magic or wishful thinking, according to which the simple assertion of an objective is seen as sufficient to its reach without being too concerned with the design of appropriate and realistic mechanisms of evaluation, coordination and motivation.

CHAPTER 2: THE COMPETITIVE SOCIAL DEMOCRACY (CSD) MODEL AND PROJECT

*You fritter and waste the hours in an offhand way [...].
Waiting for someone or something to show you the way.
One day closer to death.*

(Pink Floyd, *Time*)

“The Planners have the rhetorical advantage of promising great things: the end of poverty. The only thing the Planners have against them is that poor people die because of ineffective efforts by those who do care.”

(William Easterly, *The White Man’s Burden: Why the West’s Efforts to Aid the Rest Have Done so Much Ill and so Little Good*, Penguin Press, 2006)

Since the sixties and early seventies, the creation of the Welfare State and its numerous reforms have shaped all other public policies. These policies, however, are now being challenged because public programs inherent to this model (such as education, healthcare, public pension plans, and social protection systems in general) put intense pressures on cash-constrained governments in a world of fiscal competition. Hence, a fundamental dilemma: in a society that has become richer and more productive, public and social goods and services have become more costly (opportunity cost), giving rise to important pressures that wish to reduce their level and coverage. What about reducing their cost by improving productivity and fostering innovation?

“Traditional social democracy” and “traditional neo-liberalism” programmes are both challenged. Criticism is anchored in the widespread recognition that markets cannot solve all problems and that efficient governments are as necessary as efficient markets for ensuring maximal growth and an optimal well-being for all. There is a need to find something else, namely a new social-political-economic philosophy, together with an efficient set of policies aimed at the production, distribution and delivery of an appropriate set of public and social goods and services. A model where goals and objectives supersede ways and means, where political and economic rights and freedoms, including the right to challenge and displace the current providers of public and social goods and services are reaffirmed, and where transparent competitive

processes, as the ultimate incarnation of equality of opportunities and efficiency, are promoted. This new agenda is the “CSD.”

This objective is ambitious and may appear utopian, but it is not. The CSD model and project derive from an intellectually coherent model with concrete political implications and applications. The basic building blocks, tools and instruments needed for implementation are already available, but require a significant reorganization of the government activities and priorities. A change of paradigm is long overdue. The CSD model and project pave the way for such change.

I will present in this chapter the basics of the CSD model and project: the ultimate objective, namely the optimized well-being of all citizens through social cohesion, maximal growth, and economic freedom including the right to economic contestation, and the main principles or postulates, namely the rationality of the individuals, the efficiency of incentive mechanisms, the efficiency of competitive mechanisms, and the efficiency of modularity and experimentation.

2.1 THE ULTIMATE OBJECTIVE OF A CSD: THE OPTIMIZED WELL-BEING OF ALL CITIZENS

The ultimate objective of the CSD’s agenda is the optimized improvement of the social well-being. What exactly is well-being? The idea of human well-being embraces civil freedoms, environmental quality and subjective well-being. However, total human well-being is more than the sum of individual levels of well-being. It also reflects societal preferences and values with regard to equality of opportunities, civil liberties, distribution of resources and opportunities for further learning.

This last paragraph gives an indication of the complexity surrounding the concept of well-being. Rather than entering the quasi-philosophical debate on the concept of well-being, let us restrict this concept to a series of relatively short and clearly definable concepts, determinable by the citizens. I define this **WELL-BEING** as comprising the three following concepts: *social cohesion*, *maximum growth* and, finally, *freedom*. I will, however, also be introducing a new right, the **RIGHT TO ECONOMIC CONTESTATION**; rather, the right to challenge and replace the current providers, producers and distributors of public goods and services.

Social cohesion, economic growth and economic contestation will be regarded as specific objectives, while civil and political freedoms can be understood as primary objectives or constraints, which must be satisfied in priority. This last assertion not only

poses the problem of the correlation between the specific objectives and the primary objectives or constraints, but also between the specific objectives themselves. Finally, from the basic management principle “*you can't improve what you can't measure*”, it is important that specific objectives be measurable and measured, at least to some significant degree. Before turning to the problems of the correlation and measurability, let us consider in more details the three specific objectives of the CSD model and project.

THE OBJECTIVE OF SOCIAL COHESION

Recent studies tend to confirm the existence of a positive correlation between measurements of social and economic welfare and an “equitable” distribution of income, as well as the negative repercussions of economic and social inequalities. Cohesion, a key concept in sociology and political science, is today at the centre of the debates on the social and economic policies as it is regarded today as an essential component of the concept of *well-being*. As a recently developed concept, social cohesion is an objective to be reached. The Council of Europe characterized, in 1997, social cohesion as “*one of the vital requirements of an enlarged Europe, an indispensable adjunct to the promotion of human rights and human dignity.*”

The definitions associated with this concept are numerous. The OECD proposes a relatively narrow definition, stressing almost exclusively the economic and material factors. Conversely, the Council of Europe’s definition is broader and more generous. It affirms that social cohesion is an essential condition of democratic safety, since greatly divided and unequal societies are not only unjust, but also unable to guarantee long-term stability. The European Union’s definition can be described as a median between these two definitions, envisioning social cohesion as a central element of the European social model, founded on historical concepts of solidarity and supported by universal systems of social protection.

As variations of the definition exist in abundance, I will quote here only one of them because of its positive appeal for CSD. According to Judith Maxwell (1996),² President of the Canadian Policy Research Network:

“Social cohesion is built on shared values and a common discourse, the narrowing of gaps in wealth and income. Generally speaking, people must feel that they are participating in a common enterprise, that they face the same challenges and belong to the same community.”

² J. Maxwell (1996), “Social Dimensions of Economic Growth”, *Eric John Memorial Lecture Series*, vol. 8, University of Alberta.

This definition, however, deserves to be refined and specified in order to establish clear objectives. On this subject, Jane Jenson (1998)³ proposes to circumscribe social cohesion from a five-coordinate framework: belonging / isolation, insertion / exclusion, participation / passivity, recognition / rejection, and legitimacy / illegitimacy.

I accept the generalization that the policies aimed at ensuring social cohesion will attempt to include each of these facets. I will devote particular attention to the last point since I consider the legitimacy of certain public institutions to be in doubt. In order to optimize the policies necessary to support those five dimensions, it is advisable to divert our attention a few moments to three concepts closely related to the concept of social cohesion: (I) the civil society that constitutes its condition; (II) the social capital that perpetuates it; (III) the exclusion and the defection that threaten it.

CIVIL SOCIETY

In all industrialized countries, civil society as the basis of social cohesion is starting to disintegrate and disaggregate itself. The common definition of the civil society is: all interactions between individuals as well as the family, social, economic, cultural and religious structures that exist in a given society, outside of the framework and intervention of the State. Jean Bethke Elshtain (1999)⁴ defines the civil society as: *“the relationships and institutions that are neither created nor controlled by the State, civil society includes families, neighborhood life, and the web of religious, economic, educational, and civic associations [that] foster competence and character in individuals, build social trust, and help children become good people and good citizens.”*

In short, the civil society is what remains when the State (virtually) withdraws itself. One should not however assimilate power of civil society and anarchy, defined as a world of pure unconstrained freedom with no State. To quote Benjamin Franklin (1783):⁵ *“He that does not like civil Society on these terms, let him retire and live among Savages.”* Questioning the concept of civil society inevitably leads to questioning of the role, place and scope of the State.

Our position in this debate is overall quite similar to what is normally called the subsidiary design of the State. The idea is that the role of the State should basically be that of compensating for the limits and incapacities of the actors of civil society. If the

³ J. Jenson (1998), “Mapping Social Cohesion: The State of Canadian Research”, *Canadian Policy Research Networks Study*, Ottawa.

⁴ J.B. Elshtain (1999), “A Call to Civil Society”, *Society*, July, vol. 36, no. 5, pp. 11-19.

⁵ B. Franklin (1783), “A Century of Lawmaking for a New Nation: U.S. Congressional Documents and Debates, 1774 – 1875”, *The Revolutionary Diplomatic Correspondence*, vol. 6.

State dislodges these actors or reduces them to mere puppets subordinated to its will, it will disrupt the social order and replace the pursuit of well-being by the “**REASON OF STATE**”. The concept of subsidiarity presupposes that neither is the State always necessary, nor it is never necessary. It requires reconsidering its role in a pragmatic way.

SOCIAL CAPITAL

In the last twenty years, a new category of capital has been added to the concepts of financial and human capital. Although disputed, this concept seems crucial if one plans to adopt policies aimed at ensuring social cohesion. This concept of social capital is relatively recent and the definitions differ. It is, however, possible to distinguish three fundamental definitions. They were proposed chronologically by Pierre Bourdieu (1986),⁶ James Coleman (1988, 1990)⁷ and, finally, Robert Putnam (2001).⁸ Bourdieu’s interprets the concept of social capital as a network, while Coleman and Putnam perceive it more as a function.

Bourdieu proposed to define social capital as: *“the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition.”* This first definition insists on the concept of resource in terms of social relation. It should be noted that Bourdieu worries about the use of this social capital by the elites as a means of self-reproduction.

According to Coleman, the social capital is composed of the aspects of a social structure that facilitate the interventions of the actors within this structure. Coleman identified the following types of social capital: obligations and expectations, confidence, potential of information, standards and efficient sanctions, authority structures, social organizations that could possibly be adapted and social networks.

Although Coleman has explicitly conceptualized the social capital as an asset for the people, Putnam was mostly interested in the study of the means by which the social capital represents a collective asset. Thus, for Putnam, *“social capital refers to features of social organization, such as networks, norms, and trust, that facilitate coordination and cooperation for mutual benefit.”*

⁶ P. Bourdieu (1986), “Forms of Capital”, in J. G. Richardson (dir.), *Handbook of Theory and Research for the Sociology of Education*, Greenwood Press.

⁷ J. Coleman (1988), “Social Capital in the Creation of Human Capital”, *American Journal of Sociology*, no. 94, pp. 95-120 and J. Coleman (1990), *Foundations of Social Theory*, Cambridge (Mass.), Harvard University Press.

⁸ R. Putnam (1995), “Bowling Alone: America’s Declining Social Capital”, *Journal of Democracy*, 6:1, pp. 65-78.

Whether one leans towards the direction of the functionalist approach or, on the contrary, towards an approach based on networks, it is generally accepted that social capital allows for greater social cohesion. However, social capital can also generate perverse effects: the bond linking the social capital with cohesion can be broken. For an example of the negative effects related to the existence of social capital, consider: the exclusion of “foreigners” from the resources controlled by the members of the network, excessive requests made to the members who have succeeded by the less assiduous fellow members who seek to benefit from the high level of solidarity, or finally the restriction of personal freedoms in the closely united networks.

The positive effects on prosperity, health and happiness, as perceived by individuals themselves gain importance. It seems that people who have strong networks of relationships tend to be more successful in their careers and live longer. The same seems to be the case for communities and societies in which there are strong and overlapping networks of formal and informal relationships. Individuals in communities and societies with strong social capital tend to be more prosperous, healthier and experiencing less crime.

Putnam has produced an exploratory statistical study on the concept of social capital. His analysis of a large U.S. database has allowed him to draw the following conclusions. It is important to emphasize that this field of research is still very young and evolving; therefore, one must interpret these conclusions with hindsight: (i) in states with higher social capital, school results are better, children’s well-being is higher, the rate of violent crimes is lower, people are not so quarrelsome, people’s health is generally better, tax evasion is lower; (ii) social capital and tolerance go hand in hand; (iii) social capital and civic equality go hand in hand; (iv) social capital and economic equality go hand in hand.

However, Putnam himself reminds us that one must remain cautious: *“In many of my examples, one could reverse the arrow of the effects of social capital, and tell a story where the arrow runs to social capital instead of from social capital. In the end, it is only going to be through detailed empirical research that the relative importance of the two possible directions of causation can be established.”* Perhaps this may be one reason why many economists hesitate to use this vaguely-defined concept that has consequently proven difficult to measure.

From a political point of view, it is not easy to work on social capital. If the State intervenes too much, it could lead to the weakening of human capital. This could

happen if the State reduces inadvertently the obligations and bonds inherent to private initiatives and voluntary work or reduces the level of confidence and commitment.

EXCLUSION AND DEFECTION

There exist two major threats that could jeopardize social cohesion: firstly, exclusion that is regarded as an involuntary phenomenon and, secondly, defection that, unlike the former, can be interpreted as voluntary exclusion. In regards to the social cohesion objective, these two phenomena must be simultaneously fought in order to promote what is generally called **SOCIAL INCLUSION** as defined by Amartya Sen (1999),⁹ the 1998 Nobel laureate in economic science, as follows: *“an inclusive society is characterized by a widely shared social experience and active participation, by a broad equality of opportunities and life chances for individuals and by the achievement of a basic level of well-being for all citizens.”*

The concept of social exclusion is relatively recent. It appeared in the seventies with the rise of new forms of marginality. Social exclusion is a phenomenon of alienation and distance from society. Exclusion is the art of preventing someone from participating in social relationships and participating in the construction of society. One should not confuse exclusion and poverty: poor societies are not necessarily societies that demonstrate high levels of exclusion. Instead, they normally maintain strong bonds between the individuals. Low income is only one of the facets of exclusion. Albert Hirschman (1970)¹⁰ analyzes the concept of **DEFECTION**, which he defines as a behaviour consisting of disengaging oneself from the rules of society, to free oneself from the social organization, to abstain from taking part in any sphere of society. It is clearly a loss of social capital.

What role should the State assume in fighting the problems linked to exclusion and poverty? Is it better to give a fish to the hungry, teach him how to fish, or allow him to learn how to fish?” Should voluntary defection also be fought?

THE OBJECTIVE OF MAXIMAL GROWTH

This second objective is easier to present. The definition is clear and the concept relatively easily measurable, although not without challenge. Simon Kuznets, the 1971 laureate in economic science, writes: *“Distinction must be kept in mind between quantity and quality of growth, between its costs and return, and between the short and*

⁹ A. Sen, *Development as Freedom*, Oxford, 1999.

¹⁰ A.O. Hirschman (1970), *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Harvard University Press.

*the long run. [...] Goals for more growth should specify more growth of what and for what.*¹¹

The CSD answer to the first question (*more growth of what*) is relatively simple: **GROWTH** is defined as an increase over a considerable period of time of a broad indicator of production measured in volume, such as the real gross domestic product (GDP) or the real GDP per capita.¹² Independent from the chosen indicator of volume, the objective will be to maximize this indicator while making sure that we are not threatening the attainments of the other objectives, such as cohesion and freedom. Indeed, when growth is founded on social exclusion and the performances of the economic apparatus are appreciated independently of human resources, one sees appearing the difference between growth and development. The analysis of the bond which links growth and social cohesion is consequently of primary importance.

As for the second interrogation (*more growth for what*), the CSD model and project accept the causal relation between **GROWTH** and **WELL-BEING**. They are aligned with the broad definition, suggested by Sen, of a well-being equally dependent on what we do as on what we possess. Growth is thus not an end in itself, but a way to allow and reach a wider range of choices.

THE OBJECTIVE OF ECONOMIC FREEDOM: THE RIGHT TO ECONOMIC CONTESTATION

What does freedom mean? It would be extremely difficult to answer this question in a few words. As I announced in the introduction of this chapter, the political project developed here is concrete and applicable. Under these conditions, we must adopt a positive way to integrate the concept of the “**RIGHT TO ECONOMIC CONTESTATION**”, which represents a significant and distinctive element of the CSD model and project.

I will refer to Constant’s (1819)¹³ concept of freedom as a reference point. A more positive aspect of the concept of freedom will be presented below, when I examine the definition provided in the 1948 universal declaration of rights and freedoms. The concept of the right to contest economic realities will be added at the end of the present section. Constant suggests that the meaning of the word freedom has greatly evolved over time; it evolved from an ancient definition of freedom to a modern definition of freedom.

¹¹ *The New Republic*, October 20, 1962.

¹² Define GDP

¹³ B. Constant (1819), *De la liberté des anciens comparée à celle des modernes*, Athénée royal de Paris.

The ancient definition of freedom is as follows:

“THE LATTER CONSISTED IN EXERCISING COLLECTIVELY, BUT DIRECTLY, SEVERAL PARTS OF THE COMPLETE SOVEREIGNTY; IN DELIBERATING, IN THE PUBLIC SQUARE, OVER WAR AND PEACE; IN FORMING ALLIANCES WITH FOREIGN GOVERNMENTS; IN VOTING LAWS, IN PRONOUNCING JUDGMENTS; IN EXAMINING THE ACCOUNTS, THE ACTS, THE STEWARDSHIP OF THE MAGISTRATES; IN CALLING THEM TO APPEAR IN FRONT OF THE ASSEMBLED PEOPLE, IN ACCUSING, CONDEMNING OR ABSOLVING THEM. BUT IF THIS WAS WHAT THE ANCIENTS CALLED LIBERTY, THEY ADMITTED AS COMPATIBLE WITH THIS COLLECTIVE FREEDOM THE COMPLETE SUBJECTION OF THE INDIVIDUAL TO THE AUTHORITY OF THE COMMUNITY.”

This ancient definition is thus mainly characterized as a collective freedom *“immense but castrating because it denies individual characteristics by conceiving the individual only as a citizen”*. According to Constant, this ancient definition has been replaced by a more modern definition, described in terms of individual rights:

“FOR EACH OF THEM IT IS THE RIGHT TO BE SUBJECTED ONLY TO THE LAWS, AND TO BE NEITHER ARRESTED, DETAINED, PUT TO DEATH NOR MALTREATED IN ANY WAY BY THE ARBITRARY WILL OF ONE OR MORE INDIVIDUALS. IT IS THE RIGHT OF EVERYONE TO EXPRESS THEIR OPINION, CHOOSE A PROFESSION AND PRACTICE IT, TO DISPOSE OF PROPERTY, AND EVEN TO ABUSE IT; TO COME AND GO WITHOUT PERMISSION, AND WITHOUT HAVING TO ACCOUNT FOR THEIR MOTIVES OR UNDERTAKINGS. IT IS EVERYONE'S RIGHT TO ASSOCIATE WITH OTHER INDIVIDUALS, EITHER TO DISCUSS THEIR INTERESTS, OR TO PROFESS THE RELIGION WHICH THEY AND THEIR ASSOCIATES PREFER, OR EVEN SIMPLY TO OCCUPY THEIR DAYS OR HOURS IN A WAY WHICH IS MOST COMPATIBLE WITH THEIR INCLINATIONS OR WHIMS. FINALLY IT IS EVERYONE'S RIGHT TO EXERCISE SOME INFLUENCE ON THE ADMINISTRATION OF THE GOVERNMENT, EITHER BY ELECTING ALL OR PARTICULAR OFFICIALS, OR THROUGH REPRESENTATIONS, PETITIONS, DEMANDS TO WHICH THE AUTHORITIES ARE MORE OR LESS COMPELLED TO PAY HEED.”

Each of these two perspectives on freedom presents dangers as sensed by Constant. On the one hand, the danger of ancient liberty was that of men who were exclusively

concerned with securing their share of social power, who might attach too little value to individual rights and enjoyments. On the other hand, the danger of modern liberty is that people, when absorbed in the enjoyment of their private independence and also in pursuit of their particular interests, should surrender our right to share in political power too easily.

A better definition would lie somewhere between the ideas of political or collective freedom as defined in the ancient perspective and the idea of civil freedom that relates to a more modern interpretation. Hence, these two interpretations should be combined. This combination was forged successfully within the universal Declaration of 1948. Economic rights will be obtained thanks to **ECONOMIC FREEDOM**: freedom to undertake, freedom to engage, or greater flexibility are all tools that can allow us to ensure economic rights. However, flexibility in this case does not rhyme with precariousness. Instead, this economic freedom must be accompanied by measures that maintain and guarantee social cohesion. For this reason, we must further insist on a right that is omitted from this Declaration: the right of economic contestation. This right would allow individuals to question the production and delivery / distribution structure or organization of public goods and services provided by the State.

Indeed, the production and delivery / distribution of public and social goods and services provided by the State, currently representing a significant share of GDP that is presently provided outside competitive markets and, thus, protected from competition, has quite often become inefficient and, consequently, limits the extent of our economic rights. Thus in many fields directly related to the production, distribution and delivery of public and social goods and services, including healthcare services, social protection and security, social insurance and services to the unemployed, as well as education and training services, individual citizens and organizations must be given the right to challenge, in an open and repeated way, the current providers and operators. As P Calame (2003)¹⁴ states: *“any local innovation which proves better adapted, which increases social capital, which ultimately widens the set of answers while respecting a certain number of common principles is a progress for all.”*

In this section, I have presented and stated the objectives of our CSD model and project. I have underlined the fact that social well-being is obtained in the pursuit of the three objectives of social cohesion, economic growth and economic freedom, including the

¹⁴ P. Calame (2003), *La démocratie en miettes : pour une révolution de la gouvernance*, Editions Descartes.

right to economic contestation. In the next section, I look at the commonality and correlation characteristics of these objectives.

CORRELATION BETWEEN OBJECTIVES

The analysis of the relations between objectives will enable us to answer the following questions: Is freedom an obstacle to social cohesion and economic growth? Is it possible to sustain high growth while supporting social cohesion?

FREEDOM AND SOCIAL COHESION

In light of the previous definitions, is social cohesion foreseeable in an individualistic society where individual autonomy and freedom are very highly valued? Does one necessarily have to arbitrate between social cohesion and personal freedom?

There is no need for arbitration. Social cohesion must rest on a social contract that guarantees the essential freedoms; mainly, safety, equality in front of the law, freedom of conscience and expression, freedom of entrepreneurship in all spheres of human activity, etc. But, this list is incomplete. Indeed, it is also imperative to guarantee a certain number of economic rights to the citizens, including the right to economic contestation, that is, the right to challenge the current organizations responsible for the production and distribution of public goods and services.

The crisis that undermines civil society in the majority of developed countries is due, in a rather paradoxical way to a lack of freedom either in the civil, political or economic domain. Therefore, the State should implement policies aimed at ensuring the respect of economic freedoms and rights. One way to do so would be to integrate more competition and incentive mechanisms into the production and distribution of public goods and services. Such innovations would lead us towards cohesion by, at the same time, limiting exclusion and defection. Having a social security program or an unemployment benefits program is not sufficient to guarantee social rights! It is imperative to have effective and efficient mechanisms to govern these systems. Setting up a new right is easy. Instead, it is more complex to guarantee it. The art of good governance lays both in pairing the maximum level of cohesion with the greatest level of freedom of initiative, and the greatest level of unity with the maximum of diversity.

FREEDOM AND ECONOMIC GROWTH

Let us start with a 1962 quote¹⁵ from Mao Tsé-Toung himself: *“Without democracy, you have no understanding of what is happening down below: the situation will be unclear... you will be unable to collect sufficient opinions on all sides; there can be no communication between top and bottom; top-level organs of leadership will depend on one-sided and incorrect material to decide issues, thus you will find it difficult to avoid being subjectivist.”* This is a very limited vision of the benefits of democracy. However, coming from the creator of a totalitarian regime that was responsible for millions of deaths, it should lead us to the conclusion that growth is not limited or constrained by freedom. Nevertheless, it remains that some relatively authoritarian states continue to have very high growth rates that are significantly larger than those of other countries with less authoritarian regimes. The relationship between economic and political freedom and economic growth is quite complex. In fact, numerous studies have shown that measurement difficulties make attempts to characterize the links between freedom and economic growth very risky and statistically unstable.

GROWTH AND SOCIAL COHESION

While social cohesion can be regarded as an end in itself, it is also a resource that can be mobilized to support economic growth. T Omori (2003)¹⁶ highlights a number of factors inherent to social capital, an essential component of cohesion, that positively influences economic efficiency and growth: **(i)** the way in which individuals coordinate their actions; **(ii)** the degree of confidence among individuals; **(iii)** the way in which workers cooperate within and between firms; **(iv)** the honesty of business people; **(v)** the reliability of the infrastructures; **(vi)** the confidence expressed by the population towards the government, and the level of co-operation between stakeholders.

Social capital is a growth factor while, at the same time, being a direct factor of individual well-being. Omori proposes to classify social capital into three categories. The first two categories have a direct effect on economic growth, while the third affects the well-being of individuals. *“First, some components of social capital are inferior substitutes for markets and institutions.”* Particularly true in the developing economies, those characterized by omnipresent failing market mechanisms and institutions, is that family trust and bonds play a dominating role in sustaining growth. This component of

¹⁵ Talk at an enlarged working conference convened by the Central Committee of the Communist Party of China, January 30, 1962.

¹⁶ T. Omori (2003), “Economic Effects of Social Capital”, *International Forum on Economic Implication of Social Capital*, Tokyo, Japan.

social capital has almost completely disappeared from our developed societies; yet, it would undoubtedly be interesting to rediscover it. *“Second, some components of social capital are complements for markets and institutions.”* Complements for markets and institutions, according to Omori, refer to all not-for-profit institutions such as associations, hospitals, and schools that contribute to economic activities and make it possible to confront market failures. Finally, *“Third, family, friendships, sports or hobby clubs, alumni associations etc. can be a direct foundation for well-being even if they are not producing economic benefits at all.”*

Social capital can also exert positive effects on innovation, (and thus on growth), as recent work by P Maskell (2001)¹⁷ suggests:

“FIRMS IN COMMUNITIES WITH A LARGE STOCK OF SOCIAL CAPITAL WILL (...) ALWAYS HAVE A COMPETITIVE ADVANTAGE TO THE EXTENT THAT SOCIAL CAPITAL HELP REDUCE MALFEASANCE, INDUCE RELIABLE INFORMATION TO BE VOLUNTEERED, CAUSE AGREEMENTS TO BE HONOURED, ENABLE EMPLOYEES TO SHARE TACIT INFORMATION, AND PLACE NEGOTIATORS ON THE SAME WAVELENGTH. THIS ADVANTAGE GETS EVEN BIGGER WHEN THE PROCESS OF GLOBALIZATION DEEPENS THE DIVISION OF LABOR AND THUS AUGMENTS THE NEEDS FOR CO-ORDINATION BETWEEN AND AMONG FIRMS.”

MEASURABILITY OF THE OBJECTIVES

One of the essential ideas of the CSD model and project is that the value of public programs, goods and services be regularly evaluated in a rigorous, independent and credible way. For this purpose, it is imperative to define indicators making it possible to evaluate the efficiency of policies in contributing to meeting the objectives. As mentioned before, *“you can't improve what you can't measure”*. It is thus of primary importance to provide relatively precise measurements of the concept-objectives that characterize the **WELL-BEING** of the individuals.

In the social democracy model, an independent office (governmental or competitive-sector organization) must be in charge of developing and measuring the indicators of global performance in meeting the objectives set. Both the development of and amelioration to the indicators as well as their measurement must be made open to public scrutiny.

¹⁷ P. Maskell (2001), “Social Capital, Innovation and Competitiveness”, in Baron S., J. Field and T. Schuller, *Social capital: critical perspectives*, Oxford, Oxford University Press

2.2 THE MAIN PRINCIPLES UNDERLYING THE CSD MODEL AND PROJECT

The CSD model and project are based on four principles or postulates, which will appear legitimate and undeniable to a vast majority: the rationality of the individuals; the efficiency of incentive mechanisms; the efficiency of competitive mechanisms; the efficiency of modularity and experimentation. This does not mean that they are perfect and, indeed, they could face serious criticisms. Still, I will try to convince even the sceptics that these principles are most appropriate and implementable.

THE RATIONALITY OF THE INDIVIDUALS

What does the concept of rationality entail? Opinions diverge on the proper definition of this concept and its use in economics. I use the following very general concept: rational behaviour is characterized by the pursuit of a coherent set of objectives and the use of appropriate means to reach them. Frank Hahn (1978)¹⁸ proposes the following definition: *“Given a set of possible actions, the agent chooses rationally if there is no other action leading to preferred consequences to those of the action chosen.”* Rationality is an amoral concept that sees saints, criminals, and, of course, ordinary citizens, as highly rational people: rationality can serve the betterment of society as well as its enslavement. When properly understood, rationality presents the greatest advantage by allowing predictions of human behaviour and, in particular, specific changes in behaviour due to altered incentives.

The concept of rationality is an integral element of contemporary economic modeling. The use of this assumption is anchored in mainstream economic reasoning. However, no economist would pretend that everyone is rational in the above sense in all circumstances and at all times. The notion of rationality must be understood in a broad sense, including constrained and bounded rationality. Hence, I do not propose to go as far as some traditionalists who propose a radical separation between economic decisions and the social and historical context. Those traditionalists believe that the economic principle of rationality means, in addition to the above definition, that individuals do make the best use of the resources at their disposal given the constraints they face, but they also point out that the rational individual is fundamentally egoistic: one takes only one's own interest into account and one's behaviour is immune to social practices that may have been acquired consciously or not. I do not share this conception.

¹⁸ F.H. Hahn (1978), “On Non-Walrasian Equilibria”, *Review of Economic Studies*, 45, pp. 1-16.

Instead, I position myself more within the framework of what is generally referred to as systemic rationality. This concept, as suggested by J March (1978),¹⁹ can be summarized as follows: the individual makes decisions in an *open* environment, that is, permeable to the influence of the other agents' behaviour. Current decisions depend on past decisions (*adaptive rationality*), concomitant ones (*contextual rationality*), while preferences evolve within a given community (*social rationality*). Thus, systemic rationality is a different interpretation of rationality, conceived simultaneously as a social, endogenous and evolving phenomenon that does not exclude the possibility of individual actions justified by "computational" rationality.

By adopting the logic behind systemic rationality, we can clearly oppose the narrowly-defined egoistic logic. To give due credit to the traditionalist view, let us not forget that the assumed selfishness of the individual incorporates also the interests and opinions of others insofar as they are part of the individual's preferences. The individual is absolutely not the caricature of the *homo oeconomicus*, the isolated and autonomous cold calculator who is without passion, even if a good part of individual behaviour can be understood and, therefore, predicted with this simple representation in mind.

Behaviour is a function of preferences and incentives. It is difficult to change preferences, but incentives can be used to lead individuals towards contributing not only to one's well-being but also to the well-being of all: a quite demanding but, at the same time, rather exciting agenda.

THE POWER OF CLEAR INCENTIVES

The rationality of the individuals leads quite naturally to the second postulate: incentives are as a powerful tool that favours efficiency in reaching the objectives of the CSD model and project. The importance of incentive mechanisms will initially be presented within the context of the following example. The key concepts of moral hazard and adverse selection will then be presented.

The agricultural crisis of 1959-1961 in continental China is a particularly dramatic example of the consequences that can follow the failure to recognize the impacts of implicit incentives contained in some reforms that change the economic environment of individuals.

Agricultural collectivization in China began around 1952 and was immediately a clear success: the agricultural production increased in an impressive way between 1952 and

¹⁹ J.G. March (1978), "Rationality, Ambiguity and the Engineering of Choice", *The Bell Journal of Economics*, vol. 9, pp. 587-608.

1958. In contexts where information can be manipulated, production cooperatives can be extremely profitable if certain organizational requirements, mainly those that allow for the proper handling of coordination and motivation through adequate mechanisms, are met. It appears that the organizational structure of the Chinese agricultural cooperatives met these requirements in the first few years. In 1959, the production of grain decreased by 15% and did not recover in 1960. Then, in 1961, grain production plummeted more than 30% below the levels reached in 1958. Why? Justin Yifu Lin (1990)²⁰, an economist of the University of Beijing at that time, attributes most of the fall in production to a modification of the organization of the cooperatives. In that case, the modification significantly reduced the possibility of effective coordination and efficient incentives for effort and resulted in a famine that caused an estimated 30 million deaths! What had happened?

Following the success of the first cooperatives, the Chinese government decided in 1958-1959 to extend the collectivization project to the whole agricultural production. The number of cooperatives had grown to more than 735,000 in 1957 with 119,000,000 households as members or an average of 160 households per cooperative. By the autumn of 1958, these cooperatives were gathered in 22,000 communities that covered almost the totality of the Chinese territory and gathering an average of 5,000 households. Before 1959, members of a cooperative had the option of withdrawing their labour or physical capital in order to join another cooperative project if they believed that the productivity or their share of the benefits was insufficient in the first cooperative. Various organizational changes were brought up in 1958-59. The right of withdrawal was abolished *to simplify the administration of the system*. The mode of remuneration was also changed from a redistribution of the benefits based on points of merit, to a system primarily based on the member's needs, independently of his productivity. The control and surveillance of the effort provided by each member was possible when there were 160 households in the cooperative, thanks to the mutual observation of the comrades. However, when this cooperative reached 5,000 households, this task became impossible. Withdrawing the right of the individual to leave a cooperative and join another made the threat from more productive members totally void.

Although there is no consensus on the specific effect of each one of these organizational changes, one could predict that the general effect of these changes on effort and

²⁰ J.Y. Lin (1990), "Collectivisation and China's agricultural crisis in 1959-61," *Journal of Political Economy* 98, 1228-52. See also J.Y. Lin and D.T. Yang (2000), "Food Availability, Entitlements and the Chinese Famine of 1959-61," *The Economic Journal* 110, 136-158.

productivity levels would be disastrous, hence the famine. Intentions were most likely good, but replacing competence and rationality with incompetence and ideology ended up causing 30 million deaths! China had to wait for the de-collectivization of the eighties to recover the productivity levels recorded before 1959!

Not all examples of a misunderstanding of the incentive impacts of reforms lead to such catastrophic situations. Extending those ideas, namely the importance of efficient incentive mechanisms, in particular to sectors where they have almost never been used (the production and distribution of public and social goods and services), will enable us to find more adequate solutions to control many harmful phenomena that afflict our society, such as free-riding, moral hazard or adverse selection. In so doing, important efficiency and productivity gains can be obtained to raise the quality and reduce the cost of those goods and services.

Briefly, there is moral hazard when the effort exerted by an agent to raise the probability of success, the quality, the productivity, or the profitability of some projects cannot be observed by other parties or stakeholders, and is, therefore, private information of the agent. This information can be used strategically either to reduce costly effort levels or to redirect such effort towards other objectives. In the example above, a collection of citizens for whom the production or distribution of public and social goods and services is intended and done, or their representatives, may not be able to observe the effort levels exerted by the providers of those goods and services to make this provision as close as possible to its expected quality, quality/cost ratio, and other characteristics. There is adverse selection each time an agent can benefit and abuse of an informational advantage on some relevant characteristics. This asymmetry of information reduces the efficiency of contracting since both parties are not in full knowledge of the relevant facts. Adverse selection is a pre-contractual problem of opportunism, while moral hazard is a post-contractual problem of opportunism. Other similar problems of asymmetric information leading to some opportunism by one or both parties to a contract exist, such as free-riding behaviour and hold-up behaviour. Efficient contracting in the production or distribution of public and social goods and services must include incentive-compatible clauses that are intended to optimally reduce the impact of such potential sources of inefficiency. Clearly, an efficient incentive mechanism should not require complex computation by individuals or firms.

THE EFFICIENCY OF COMPETITIVE PROCESSES

Our third basic principle or postulate is that competition generates efficiency, growth and consequently well-being. This postulate is quite often subject to ill-informed and biased criticism. The following is a typical statement of leftist speakers; it comes from Bernard Cassen, president of the French section of ATTAC: *“At the pediment of the French Constitution is written Liberté, Égalité, Fraternité. At the pediment of the [proposed] European Constitution is written ‘non-distorted Competition’. This is not the way to create a strong community. If you compete with your neighbour, there will be a winner and a loser. We do not want losers.”*

I do not want losers either. However, the CSD model and project are built on the belief that the absence of competition generates only losers (besides the bureaucratic central-planning illuminated leaders who claim to know better than the citizens themselves what is good for them), while proper, open and transparent competition pushes everyone upwards. The society dreamed up by some anti-competition groups is a society where poverty is generalized by a fear of revealing disparities. The society that the CSD model and project will generate is a society where markets and solidarity are reconciled for the benefit of all. Modern history hardly leaves any space for doubt regarding relevancy and truth in this matter. Critics need only consider what centralism, central planning and the absence of competition have generated, over the last sixty years, in the Soviet Union or China until very recently: reduced productivity, increased likelihood of famine and corruption, realized equality in misery.

The lessons that can be learned from recent social history are brought out in many diverse statistical studies analyzing the links between competition, innovation and growth. To mention only a few: the 2003 report of OECD *“Competition, Innovation and Growth”*; the 2004 Statistics Canada research paper by Baldwin and Gu *“Industrial Competition, Shift in Market Shares and Productivity Growth”*; and finally the 2004 report *“Productivity and Growth”* published by the French Council of Economic Analysis. The first study emphasizes the relation between stronger competition and better productivity gains. An increase in competition pressures stimulates innovation efforts and can be a powerful engine of growth: *“by supporting competition on product markets, one can reinforce the incentives to raise and improve output and therefore facilitate efforts. The result will be productivity gains in some firms, but will also redirect production towards more efficient firms”*. The second study highlights the fact that competition displaces market shares towards the more productive establishments, an important source of productivity gains and growth in most manufacturing industries.

Finally, the last report is unambiguous: “*the deregulation of product markets has multiple positive effects,*” for example the job creation. We are, therefore, quite far from the stereotype slogans conveyed by some parties or organizations claiming, for instance, the following sequences of causes and effects: competition \Rightarrow exploitation; competition \Rightarrow offshoring \Rightarrow unemployment; trade unionism \Rightarrow improvement of working conditions.

Only proper, open and transparent competitive mechanisms (making an optimal use of new information and communication technologies) can guarantee the emergence of a society where the interests of the citizens prevail, where choices of production, consumption and investments, public as well as private, are made efficiently on the basis of the best information available, best competencies available, and best development prospects. Complementary competitive mechanisms, such as benchmarking and competitive tendering, could be particularly efficient as transition mechanisms in the public sector. These ideas will be developed later.

Let us keep in mind the definition of competition as suggested by economist William Baumol *et al.* (1982):²¹ a competitive market is a *contestable market* (low entry and exit costs). It is with this definition in mind that the CSD model and project give a pre-eminent place to the right to economic contestation, that is, the right to challenge and eventually replace the current providers, producers and distributors of public and social goods and services.

THE PRESUMED “SINS” OF COMPETITION

*« C’est dans leur convention
à page quatre-vingt
la compétition
faut t’nir ça ben loin »*

(Richard Desjardins, *Les bonriens*)

It may be useful to address here some misconceptions and fallacies about the role of competition that are particularly pervasive.

COMPETITION AND MARKET REGULATION

First, it is often believed that a competitive market system can operate without government intervention or regulation. Quite the contrary, a competitive market system cannot function efficiently without the necessary strong and appropriate leadership of

²¹ W.J. Baumol, J.C. Panzar and R.D. Willig (1982), *Contestable Markets and the Theory of Industry Structure*, Harcourt Brace Jovanovitch Press.

the State as a market regulator. A competitive market system must rely on an informed and enlightened State to design and implement, among others, property laws and competition laws and regulations respectively to foster freedom of choice and movement, to facilitate investment in better technologies, products and services, to enhance research and development as well as invention and innovation through intellectual property rules (copyrights and patents), and to arbitrate unavoidable conflicts, all for the betterment of social and individual well-being. In particular, competition laws and institutions must be properly designed, calibrated and enforced in order to favour free entry and exit in industries and markets as well as to avoid the development of persistent and durable market power in the hands of individual competitive-sector firms or organizations, including labour unions, without necessarily eradicating transitory market power that is, in fact, a source of growth and development. The CSD model and project rely on such extensive powers of the State to foster and regulate a vibrant competitive sector, in the search for best practices among other objectives.

COMPETITION AND CHEATING

Second, it is often argued in poorly-informed anti-competition milieus that private firms make money by fooling their customers, cheating their suppliers and exploiting their workers! Without negating the existence of cheating in some cases or occasions under particular circumstances (indeed whenever human behaviour under incomplete information is involved), it is clear that generically a competitive-sector firm or organization, whether a private corporation, a cooperative, a social economy organization, a non-governmental organization, or any other form of organization, can be beneficial or profitable if, and only if, it satisfies the needs and demands of its customers, respects its suppliers, and takes good care of its labour force. Otherwise, in a properly-functioning competitive system, customers will cease to support and patronize the firm's products and services, the suppliers will stop contracting with it, and the workers will quit for better opportunities. To be effective and credible, the threat of switching must rely on alternatives open to customers, suppliers and workers. It is an important characteristic of a competitive market system to favour the emergence of those alternatives. To propose that a competitive-sector organization can survive and be profitable by systematically cheating its customers, fooling its suppliers and exploiting its workers simply does not make any sense.

COMPETITION AND PROFITS

Third, it is often claimed that since a private corporation must make profit in addition to covering all its other costs, the prices it must charge for the goods or services it delivers will often be higher than the prices a governmental-sector enterprise, not constrained by the profit requirement, would or must charge. The error here lies in the confusion between accounting profit and economic profit. Accounting profit is the difference between revenues and all costs other than capital costs. Economic profit is the difference between revenues and all costs including the cost of capital, whether it takes the form of debt or equity.

Both notions of profit would coincide for a firm financed by debt only, as it would basically be the case for a governmental-sector enterprise if it is subject to the same taxation as private firms. In a well-functioning competitive market system, the level of economic profit, sometimes called economic rent, would tend to fall or climb towards zero, that is, oscillate around zero. Capital providers, both debt and equity holders, would be normally and fairly (competitive level) compensated, and the pressures of competition, free entry and exit in particular, would make sure that no extra expected profit or rent can be captured or lost. Whether the firm is a governmental-sector firm or not, and whether in the former case it is financed by taxation or by government debt, it must be able to properly compensate all its factors of production, capital and labour, at their respective competitive levels. Otherwise, workers would prefer to turn to other firms where their contributing value is higher, while government-provided capital would be better used elsewhere in other more valuable governmental-sector firms or businesses, including the possibility of lowering taxes.

Governmental capital invested in a governmental-sector firm or organization has an opportunity cost represented by what could have been done in other uses with that capital: the cost of governmental capital is the value of those foregone uses or opportunities. This is exactly what the cost of capital (profit) represents in the private or competitive sector. Hence, the claim that profit-seeking firms would inevitably charge higher prices than government-run firms as a result of their profit requirement is a fallacy; an enduring one, but a fallacy nevertheless.

Indeed, the presence of profit-seeking firms in a competitive market will most likely lead to lower prices because of their stronger incentives to pursue and achieve increased levels of efficiency and effectiveness compared to governmental-sector firms. Governmental firms and organizations should typically operate with a zero-expected

economic profit objective, and hence be able to compensate all factors of production used, including governmental capital at a level equal to the net value lost in forgone activities. Private- or competitive-sector firms and organizations will typically be forced by the intensity of competition to a realized zero-expected *economic* profit in spite of their objective to beat the market, that is, to realize a supra competitive return on capital. If competitive forces are adequate, beating the market must be a transitory phenomenon, as beaten by the market is, even if it is an important motive of competitive-sector managers and owners and an important source of economic growth from increases in both efficiency and effectiveness.

COMPETITION AND RISK TAKING AND SHARING

Fourth, there is a pervasive misconception about the importance and role of risk taking and sharing in society, and about the role of competitive markets in quantifying and pricing risk, that is, in determining competitive risk premiums. As for the other presumed sins of competition, this is a complex issue and it is impossible to cover even only the most important aspects in one single paragraph. An important aspect of risk sharing that is particularly important in the context of the CSD model and project is arguably that of risk sharing and pricing in the context of private-finance initiatives (PFI) or public-private partnerships (PPP). Although PFI and PPP are well-known acronyms, I will refer to **GOVERNMENTAL COMPETITIVE PARTNERSHIPS** (GCP) that is a more appropriate concept in the context of the CSD model.

Risk refers to randomness and probability distribution of outcomes, more precisely to the volatility of outcomes around the average or expected outcome: more volatility means a higher probability that the realized outcome will turn out to be relatively far from the expected outcome, either above (on the good side) or below (on the bad side), and more volatility means more risk. More rigorously, total risk is composed of diversifiable risk, which need not be compensated because it is relatively easy to eliminate through diversification, and systematic risk, which cannot be eliminated and, therefore, will command compensation. Understanding the sources of risk or volatility and managing those risks²² when possible are important but quite challenging endeavours in any society.

It is a fundamental role of financial markets to quantify risks (for example, by the *beta* measures of correlation or covariance with different risk factors) and to price such risks

²² Managing risks is usually understood as taking actions to reduce the probability and/or severity of bad outcomes without jeopardizing good ones.

as a premium over pure time preference or over the risk-free price. In a risk transfer agreement, one party assumes the risk, that is, the possibility that the outcome will be significantly above or below the expected outcome, in exchange for a premium paid with certainty by the other party who can then consider the outcome as certain.

What is meant by (optimal) risk sharing in governmental competitive partnerships (GCP)?²³ Optimal risk sharing in society proceeds from two distinct sources: first, it involves the transfer of risk from people or agents with higher risk aversion to people or agents with lower risk aversion in exchange for a premium and second, it distributes risks to the partner who can better manage them in situations when risk can indeed be reduced through proper risk management. In cases of purely exogenous risks, where probabilities and losses are outside the control of any one of the partners, only the first source of risk sharing is present. In cases where some partners can make decisions, most often difficult to observe or to verify, that can affect the probabilities with which good and bad outcomes occur and the benefits or losses that those outcomes represent, then both sources are present: optimal risk sharing will involve, in part, a transfer of risks from more risk averse to less risk averse agents and, in part, a transfer of risks from less able to more able agents or managers. Managers' ability refers here to both their competency and their incentives either to raise the probabilities of good outcomes and reduce those of bad outcomes or to increase the benefits and reduce the losses incurred in the different outcomes.

In a GCP, the transfer of risk is typically from the governmental sector to the competitive sector, the party that assumes the risk will normally be the competitive-sector firm and the party that sheds risk will be the governmental sector. In other cases, where the governmental sector acts as an insurer (unemployment, education, and health insurance), it assumes risks that individuals do not wish or prefer not to bear. In each transaction, the buyer and the seller share the gain from realizing the transaction, that is, the transfer of risk: the seller who sheds risk avoids the risky outcome in exchange for a premium paid to the buyer who then faces a larger part of the outcome uncertainty or volatility.

In a risk-sharing agreement, both parties to the transaction will support part of the systematic risk and will be compensated accordingly. The important element to

²³ Risk sharing must be distinguished from risk pooling. The latter refers mainly to insurance motives and contracts by which it may, for instance, be known that one percent of a given population of one thousand will suffer a loss of magnitude L in the coming period; the members of that community can get together to pool that risk since, on average, ten members will suffer the loss and therefore, if everyone contributes one percent of L in the pool, there will be enough money to compensate fully the ten members who will suffer a loss. Individuals generically prefer a known contribution of one percent of L to the risky possibility of losing either 0 or L .

understand here is that risks can and are being exchanged at competitive prices, like other goods and services. The efficient competitive transfer or exchange of risks is a major source of welfare gains. Hence the significant innovation efforts and the important resources allotted to risk management, risk transfer and risk sharing in modern society.

COMPETITION AND THE COST OF PUBLIC FUNDS

This brings us one more fallacy that has the characteristic of being often repeated by officials both in the private or competitive sector and in the public or governmental sector. In its simplest form, the fallacy is argued as follows: since the private-sector cost of capital (cost of borrowing or raising equity finance) is higher than the public-sector cost of capital (cost of borrowing), then the cost of a public-sector business must necessarily be less than the cost a private-sector firm would incur for producing, distributing and delivering the same goods and services. Although it is generally admitted and, in fact, observed that governments can borrow at lower rates than private or competitive-sector organizations can, the fallacy of the above argument comes from the fact that part of the cost of government borrowing is hidden from the casual observation of published interest rates or yields.

Let us consider two firms, one in the governmental sector and the other in the competitive sector, producing, distributing and delivering the same goods and/or services. The governmental-sector firm can raise debt or capital at a cost that is lower than the cost the private- or competitive-sector firm must incur to raise the same level of debt or capital. The reason must be that the former is less risky for lenders, hence their request, in equilibrium, of a smaller rate of return. But why is the cost of capital lower for the governmental-sector firm when it is involved in the same activities and using the same technology and the same factors of production and, therefore, subject to similar risk factors? Why then would lending to the governmental firm be less risky for the lenders?

It is so because the governmental-sector organization, through its direct link with the government as the ultimate responsible and liable party, has the right and power to raise additional taxes to reimburse its debt / capital holders if necessary, that is, if its activities and/or projects turn out to be a failure or, more generally, fail to deliver the expected returns. In the case of a private- or competitive-sector firm, no such right or power exists or has been granted, which thereby justifies the requirement by lenders or investors of a higher interest rate or return. However, from the point of view of the

citizens who are the ultimate customers and taxpayers, that is, lenders or investors, the right and power of the government to literally withdraw money from their bank accounts to cover financial distress situations does have a price: it is the option value today of the government right to require and obtain from them additional funds to cover what may turn out to be ex-post bad or non-profitable projects.

The differential in interest rates or returns paid on funds raised by governmental organizations, on the one hand, and private- or competitive-sector organizations, on the other hand, is fundamentally equal to the option value of the government right and power to raise additional funds from taxpayers as lenders and investors even without their “agreement.” In other words, if the citizens were to grant a private- or competitive-sector organization of good financial standing the right and power to “tax” them if it ends up in financial distress, then this organization would be able to raise capital at the same conditions as those faced by the government. Hence, the claim that the governmental sector can produce at lower costs because the government can raise money at lower interest rates is a subtle but a clear although pervasive fallacy.

COMPETITION AND INTERNATIONAL TRADE

Some people fear competitive processes for the production and distribution of public and social goods and services not only in national affairs, but also in international contexts. Globalization of markets and the internationalization of cultures are often considered as responsible for destroying jobs (outsourcing or offshoring jobs) in developed economies and favouring exploitation of labour in developing countries.

However, the significant growth of international trade over the last half century has been a major factor of improvements in social and economic well-being, as well as cultural and scientific developments. As mentioned by Amartya Sen (“If It's Fair, It's Good: 10 Truths About Globalization,” *International Herald Tribune*, July 14, 2001): *« Pervasive poverty and lives that were "nasty, brutish and short," as Thomas Hobbes put it, dominated the world not many centuries ago, with only a few pockets of rare affluence. In overcoming that penury, modern technology as well as economic interrelations have been influential. The predicament of the poor across the world cannot be reversed by withholding from them the great advantages of contemporary technology, the well-established efficiency of international trade and exchange, and the social as well as economic merits of living in open, rather than closed, societies. What is needed is a fairer distribution of the fruits of globalization. »*

Without going into too much detail here, it is clear that negating the phenomenal potential of international trade to improve the well-being of all must come from the misunderstanding or sheer ignorance of one of the most important elements of modern economic theory, namely the theory of comparative advantage. The implications of this theory, originally due to David Ricardo (1817),²⁴ are both implacable and unavoidable but somewhat counter-intuitive. It says that, under the necessary and sufficient condition that there exist differences in *relative* costs of production of different goods and services under autarky in different countries, each country can and will benefit from open trade by specializing in the production and export of goods and services for which it has the best *comparative* or *relative* advantage, while importing the other goods and services. It is important to stress that *all countries* can and will benefit from such trade, independently of their *absolute* competitiveness.

This statement is arguably the most important finding in modern economic theory. It is the foundation of free-trade policies against protectionism, that is, the foundation of policies favouring social well-being, poverty eradication, wealth creation, and social and economic growth against the specific private interests of lobby groups, whatever the grandiloquence of such interest groups.

[Comparative advantage]: That it is logically true need not be argued before a mathematician; that it is not trivial is attested by the thousands of important and intelligent men who have never been able to grasp the doctrine for themselves or to believe it after it was explained to them.

[Paul A. Samuelson, the 1970 Nobel laureate in economic science]²⁵

A recent and dangerous example of anti-free-trade propaganda is the so-called “inalienable right to food sovereignty” to defend, mainly in developed countries but also in developing ones, the private interests of agricultural and livestock producers against the benefits of free trade. To add to their seemingly social-welfare creating arguments, the proponents of food sovereignty are now arguing that it reduces greenhouse gases. In spite of this apparent logic, this argument is also a subtle but dangerous fallacy. In developed countries, such food sovereignty objectives translate into different supply

²⁴ D. Ricardo (1817), *On the Principles of Political Economy and Taxation*, London.

²⁵ Paul Samuelson was answering a challenge from mathematician Stanislaw Ulam to “name one proposition in all of the social sciences which is both true and non-trivial.” In *Understanding the WTO*, World Trade Organization Information and Media Relations Division (2007).

management programmes and/or generous farm subsidies to the detriment of consumers and taxpayers.

Let us briefly present this most important element of modern economic theory, namely the theory of comparative advantages. Suppose that in the current state of their economies, two countries A and B face the following choices. Country A could increase its food production by 1 unit (however it is measured) by allocating more resources (labor, materials, capital) to it that are taken away, in the most efficient manner possible, from its production of cars, thereby reducing its production of cars by 2 units. Hence, in the jargon of economists, its rate of transformation in country A is +1 unit of food for -2 units of cars (or equivalently -1 unit of food for +2 units of cars). As for country B, it could increase its food production by +2 units by allocating more resources (labour, materials, capital) to it that are taken away, in the most efficient manner possible, from its production of cars, thereby reducing its production of cars by 3 units. Hence, the rate of transformation in country B is +2 unit of food for -3 units of cars (or equivalently -2 units of food for +3 units of cars). Because the two countries have different transformation rates, in the current state of their economies, between food and cars, it is possible to increase welfare in both countries by reallocating production in the two countries. Suppose first that country A reduces its food production by 1 unit, thereby increasing its production of cars by 2 units and second that country B reduces its production of cars by 1.5 units, thereby increasing its food production by 1 unit. This reallocation is not only possible given the transformation rates in the two countries, but it also translates globally into the same production of food ($-1+1=0$) but an increased production of cars ($+2-1.5=+0.5$). By sharing this increased production, both countries see their welfare increase.

This very simple example shows that, as long as transformation rates differ across countries, there is a possibility of global welfare gains through a reallocation of production. How can such global welfare gains be achieved? The answer is also simple: through international trade at the same competitive prices. This argument, which again is a fundamental result in modern economic theory, holds for any levels of competitiveness (or absolute advantage) in the two countries: even if one country were more efficient in producing both goods, both countries would gain in opening their internal markets to international trade and allowing their respective economies to adjust to competitive international prices. Only their comparative or relative advantages count.

THE OMNIPRESENT TEMPTATION OF CENTRAL PLANNING: MAGIC THINKING AND THE FAILURE OF FOREIGN AID

Whom the Gods would destroy, They first endow with a central planner. Then to insure that the destruction will be complete, They encourage the central planners to meet in international forums and coordinate their mistakes.

[Paraphrasing H.G. Johnson, 1975]²⁶

Any respectable person is regularly tempted to act as God and draw a Grand Plan. This is true of politicians, entrepreneurs, ordinary citizens, economists, philosophers, gurus, as well as prophets and saints. Not all, but far too many such plans are well-intentioned but nevertheless prone to fail. Misconceptions surrounding the value, efficiency and effectiveness of central planning and/or competition-free bureaucratic hierarchical decision-making to solve intricate and complex socio-economic problems involving a multiplicity of agents and a multitude of decisions indeed make the said Grand Plan doomed to failure right from the start.

The temptation of drawing a Grand Plan to solve the world's socio-economic problems, such as eradicating poverty, stopping unnecessary deaths of children from easily-curable diseases in underdeveloped countries, curing environmental degradation, fostering more efficient education and health systems, and so on, is a first but lasting reaction from, in most cases, well-intentioned and compassionate people with goodwill to sell. But unfortunately, "the road to hell is paved with good intentions": an example of what may be referred to as one-way and magic thinking.

Nowhere is this more dramatic than in foreign aid. The temptation of drawing a Grand Plan is particularly acute and socially costly in multilateral international or global discussions on third world poverty. The drawing of a Grand Plan in this context has three main characteristics. First, it brings to the head table, front stage, and power room all major worldwide communication consortiums controlling TV, radio, and newspapers coverage, together with their star-studded cameo figuring journalists, movie stars, pop singers and performers, and former politicians. Second, it ends, with quasi-perfect regularity and high probability, with failure to meet the objectives, once the implementation of the applauded Grand Plan falls into the hands of bureaucrats. Those bureaucrats are themselves severely constrained by national-content policies ensuring

²⁶ See the review by Jim Johnston of the book *Adjusting to Volatile Energy Prices* by P.K. Verleger Jr. (Institute of International Economics, 1994) published in *Regulation* 17 (3), 1998.

that most of the money and benefits, such as job creation, capability building, and innovation, is grasped by individuals and firms of the developed donor countries. This is often done in a rather subversive way through strong directives and incentives to balance the gains, if any, of the intended population, with distortions in other sectors that impose significant costs on that same population. Of course, politicians and bureaucrats of the donor countries as well as movie stars and pop singers will, in general, make sure that their images are well protected from the highly-probable failure of the Grand Plan, thanks to the inexistence of rigorously operational responsibility and accountability schemes. Third, it eventually provides little beneficial results on the intended populations, once the “langue de bois” of the Grand Plan launching is pierced and deflated. The main reason for such grandiose and repeated failures is not the lack of funds or resources but rather the absence of serious accountability schemes, performance-related incentives, and good-governance constraints on the donor and recipient countries.

Development economist William Easterly (2006)²⁷ writes about the twin tragedies of global poverty. The first tragedy is that vast numbers of individuals worldwide are promised to live difficult if not squarely horrible and miserable lives; *one may find some comfort in the fact that those lives are short!* The second tragedy is even more troubling and compelling: after fifty years and zillions of dollars spent in the accounting category called foreign aid (more precisely, over 2.3 trillion US dollars, or US\$ 2 300 000 000 000), “there is so shockingly little to show for it.” Easterly claims that “*We [the West] take all the credit for the economic success stories of the last fifty years, like Korea and Taiwan, when in fact we deserve very little of it.*” And he adds: “*We deny all accountability for the fact that despite more than half a trillion dollars poured into Africa and other regions, and one ‘big new idea’ after another, the majority of places in which we’ve meddled the most are in fact no better off or are even worse off than they were before.*”

The CSD model and project foster an approach to development and foreign aid based on two major premises. First, the design of clear objectives, which is a prime responsibility of the governmental sector including national donor governments as well as organizations such as the World Bank, the International Monetary Fund, and all the other governmental consortiums of many kinds, must be complemented by an equally-important implementation process through competitive mechanisms and by competitive-sector organizations under high-powered incentive contracts with a strong

²⁷ W. Easterly (2006), *The White Man’s Burden: Why the West’s Efforts to Aid the Rest Have Done so Much Ill and so Little Good*, Penguin Press.

emphasis and focus on performance and results. Second, it must rely necessarily on proper governance in the recipient countries based on the four most important development factors: public accountability, basic human rights, economic freedom, and property rights.

Hence, the first, most important and most urgent worldwide development policy today is to drop the central planning, heavily bureaucratic and hierarchical approach to development and foreign aid in favour of competitive processes, calling on the best possible labour and technological resources from the most competent firms and organizations capable of functioning under high-powered incentive contracts. This is the only way to do more than to pay superficial, publicity-driven, and lip-service tribute to the objectives of development and foreign aid.

As in other fields of human endeavour, underdeveloped regions and countries need well-intentioned people only if they are competitively competent, that is, only if they can show and demonstrate their competence in an open, transparent, competitive environment.

In developed social democratic countries, the temptation of central planning is omnipresent in major socio-economic domains, such as education and health. Whenever a problem arises – usually one of poor coordination, of imbalance between demand and supply, of inefficient production or delivery, or one of poor performance due to misaligned incentives – the immediate quasi-cultural reaction in traditional social democracies is to call on the government to intervene, find a solution, and implement it. It is quite paradoxical that the more the government is responsible for the mess and crisis that is decried by the individuals and the citizen organizations, the more it is asked to intervene to fix it up!

Of course, the result is that the mess grows even worse and the infernal cycle of more messy situations and more extensive government interventions will run for a while until the mess itself becomes the normal state. It then becomes more and more difficult to change the system and its supporting faulty processes, as each faulty part appears essential given its close interaction with other faulty parts: the objective then turns to the perceived better alternative of avoiding a collapse rather than chopping the entire faulty system altogether. Overall pervasive inefficiency is a built-in characteristic of a centrally-controlled system that is fundamentally hostile to modularity and experimentation.

The presence of well-organized interest groups who can take advantage of the centralized faulty system at the expenses of citizens makes things even worse as these groups can and have incentives to block any change towards an open, transparent, competition-based and citizen-centered system with its associated modular and experiment-prone market processes. Society is then left with no other choice but to pour more and more money, resources and capital, into inefficient systems, whether it is foreign aid, health, education, or other production and delivery systems of public and social goods and services.

THE VALUE OF MODULARITY AND EXPERIMENTATION

The modularity concept is relatively old. One can find modular producing organizations in the movements towards industrial standardizations in the automobile and railway industries more than a century ago. What is modularity? What are the advantages related to modularity? What role should modularity play in the production and distribution of public goods and services? I will answer the first two questions here, while the third will be treated in the chapter devoted specifically to policies.

Modularity is a broad concept, which can be applied to many situations: *modularity in conception, production and use*. The original idea is to break down the end product into several subsystems that can be conceived and produced quasi-independently; these subsystems or components are significantly less complex than the end product system as a whole. Modular production has a double dimension: the first dimension refers to the design and production aspects of a given good; the second dimension refers to the organizational aspect. Very often, a modular product generates a modular organization.

With regard to the end products, interfaces define the relational characteristics between components. Architecture is qualified as perfectly modular when the interfaces are perfectly uncoupled (i.e. a modification on one of the modules connected by the interface does not imply a necessary modification in the other modules connected by this interface) and perfectly standardized (i.e. they accept the connection of a large variety of components). At the opposite of the spectrum, we can find the perfectly-integrated end products. In general, a modular architecture is to be preferred on the basis of costs and efficiency.

With regard to the organizational structures, we have modularity when each organizational unit can work independently on the parameters and characteristics of a

subsystem of the end product. As J. Catel and J.C. Monateri (2004)²⁸ note, a modular organization is made up of *“the architect who defines the visible rules of design; organizational modules, which are the suppliers and which work independently according to specific parameters of the module of which they are responsible; organizational interfaces consisting in the procedures of information exchange.”*

I will not further develop my remarks on the concept of modularity in the context of end products and organizations. We must now look at the second question: *What are the advantages related to modularity?* First of all, as Sturgeon (2002)²⁹ has pointed out, modular architectures are formed by groups of actors operating in a parallel and distributed way. Thus direct cooperation between members is not necessary once the modular architecture is in place. Simpler market relations are sufficient: *“the reaffirmed incentive generating power of competitive markets as well as thorough specialization would appear then as the major advantages of a modular network organization”*.

Finally, let us quote C.Y. Baldwin and K.B. Clark (2006):³⁰

“THE ESSENCE OF MODULARITY, WE FELT, LAY IN THE OPTIONS IT GAVE DESIGNERS TO POSTPONE AND THEN REVISE KEY DECISIONS. OBVIOUSLY, HOWEVER, NOT ALL DECISIONS ABOUT THE DESIGN OF AN ARTEFACT CAN BE POSTPONED: SOME EARLY DECISIONS ARE NECESSARY TO PROVIDE A CO-ORDINATING FRAMEWORK FOR THE OTHERS. THOSE EARLY DECISIONS, IN TURN, WOULD SERVE AS RULES – DESIGN RULES. DESIGN RULES WERE NEEDED TO GOVERN THE MODULAR SYSTEM, ENSURING THAT THE RESPECTIVE PARTS DID NOT CLASH, AND IN SO DOING KILL THE SYSTEM AS A WHOLE. SUCH RULES, WHEN WELL-CONSTRUCTED, PROVIDED HARMONY AMONG THE MANY DIFFERENT PARTS OF A MODULAR SYSTEM. (...) MODULAR DESIGNS CREATE OPTIONS AND MODULAR DESIGNS CAN EVOLVE».

In the CSD model and project, the concept of organizational and industrial modularity is omnipresent for the production and distribution of public goods and services. Precisely which role should modularity play in the production and distribution of public and social goods and services? What level of modularity do we wish or need to promote in order

²⁸ F. Catel et J.C. Monatéri (2004), “Modularité : l’émergence de nouvelles compétences organisationnelles dans les industries de biens complexes”, Université de Grenoble.

²⁹ T. Sturgeon (2002), “Modular Production Networks: A New American Model of Industrial Organization”, *Industrial and Corporate Change*, vol. 11, no. 3, pp. 451-496.

³⁰ C.Y. Baldwin and K.B. Clark (1997), “Managing in an Age of Modularity”, *Harvard Business Review*, September-October, pp. 84-93.

to optimize the production and distribution of these goods and services? Once more, the role of the State is crucial: Should this role be limited to the architecture of these organizations? Is there a relation between modularity and the right to economic contestation, as an expression of economic freedom? These questions will be tackled later.

2.3 CSD: DEFINITION

Let us complete this brief presentation of the main building blocks (objectives and principles) of the CSD model and project with a short-hand summarizing definition.

The CSD model and project represent a “new” social democracy philosophy that stresses the importance

- of strictly separating objectives (optimized well-being of all citizens through social cohesion, maximal growth, and economic freedom – contestation) from ways and means (production, distribution, and delivery processes);
- of building, designing and implementing policies from a behavioural realism perspective to attain global efficiency and effectiveness (rationality, incentives, competition, as well as modularity and experimentation);
- of making use of competitive institutions, old and new, to harness the distributed knowledge, innovation capabilities and competencies of citizens for the betterment of all.

Following the presentation set forth in this chapter, we now have a more precise understanding of the most important ideas that constitute the pillars of the Competitive Social Democracy model and project. While the CSD model and project proposed here are built on these pillars, they are also anchored in a profound belief in a modern form of social liberalism. However, CSD is not an ideology in the sense of a philosophy of the world or a philosophy of life. Hence, a number of major macro-sociological, macro-economic or macro-psychological problems discussed above are not tackled in this book, at least not directly.

A competitive social democrat is a social democrat that worries not only about ensuring an optimal level of public and social goods and services, but also ensuring their efficient production, distribution and delivery. These goods and services, when produced in an efficient manner, constitute the basis of a unified, stable and cohesive society. Furthermore, a competitive social democrat opposes reductions in the level and quality

of public and social goods and services under the simple pretext that they are expensive to produce.

To be a competitive social democrat is to regularly question the ways and means by which public and social goods and services are produced, distributed, and delivered. If those ways and means are inefficient (for not attaining the objectives) or ineffective (for not achieving the results at minimum social costs), it becomes possible to increase the production, distribution and delivery of public and social goods and services to increase well-being. It is by ensuring such an efficient implementation of social democracy objectives that the concept and value of competition comes into play.

CHAPTER 3: THE ROOTS AND FOUNDATIONS OF SOCIAL DEMOCRACY

Pray for the government's well-being for without its intimidation people would eat each other alive.

(Rabbi Hananya Segan Ha-Kohanim, *The Babylonian Talmud*, Avot 3:2)

The worth of a state, in the long run, is the worth of the individuals composing it. A state, which dwarfs its men in order that they may be more docile instruments in its hands even for beneficial purposes, will find with small men no great things can really be accomplished.

(John Stuart Mill, *On Liberty*, 1859)

La nature particulière de l'État moderne, la complexité et la délicatesse de ses fonctions, la gravité des problèmes politiques, économiques et sociaux qu'il est appelé à résoudre en font le lieu géométrique des faiblesses et des inquiétudes des peuples.

(Curzio Malaparte, *La technique du coup d'État*, 1931)

Competitive social democracy is not an object without history. On the contrary, as we will see in this book, the new perspective on politics and economics is both a continuation (mainly on fundamental principles) of the already well-established social democratic current, an ideology that has been around for more than a century, as well as a significant departure (mainly on ways and means) from the multiple forms of social democracy that have appeared and been developed over the past 100 or 150 years.

It is important to realize that, in spite of the fact that the CSD model and project proceed from a set of principles and fundamental objectives that are similar to those that broadly define the social democracy movement, the differences are significant. Hence, the CSD model is significantly different from the other forms of contemporary social democracy models that have appeared under such names as the Social State, the Social Market Society, Market Socialism, the Third Way in England, the New Center in Germany, the ALP-led reforms dubbed “economic rationalism” and “national

competition policy” in Australia, the Rogernomics in New Zealand, or even the Blair-Schröder manifesto for a modern social democracy of June 1999.

Most of these social democracy “reforms” have tried to find some equilibrium between the market economy and the social democratic ideals. Their relative failure or mitigated success is most probably due to both a systematic confusion between goals and objectives, on the one hand, and ways and means, on the other, in addition to an incapacity to efficiently plan the needed transformation from a heavily bureaucratic command and control system to a decentralized competitive (market) provision system for the production, distribution and delivery of public and social goods and services.

The CSD model strictly abides by the distinction between “goals and objectives;” that is, the design for the package of public and social goods and services, in both quality and quantity, and “ways and means” by which this package will be produced and delivered. Hence, the CSD model and project rest on the separation between the role of the governmental sector and the role of the competitive sector, as well as the generic policies and programmes that will be characterized below. The long-sought optimal coexistence, complementarity and reinforcement between, on the one hand, the *desirability* of social democratic policies towards the provision of public and social goods and services for the betterment of all citizens, and, on the other hand, the *efficiency* of market mechanisms in the production and distribution spheres. All types of goods and services are considered and actively pursued and achieved in the CSD model and project.

In some sense, the CSD model and project could be qualified through oxymoronic expressions, such as an efficiency-prone rational social democracy or a liberal social democracy, and even through the super-oxymoron “neo-liberal social democracy”! In a more serious sense, it is potentially the ultimate social democracy model.

In order to fully grasp the concept of competitive social democracy, comprehension and knowledge of its roots and foundations are necessary. Thus, I will begin by describing the evolution of this ideology from its birth, on the extreme left of the political spectrum, at the end of the 19th century, and its current position at the centre left of the political spectrum. I will then present the bases and policies that characterize the dominating social democratic movement in its current form. Indeed, for several decades now, the social democratic political parties have been among the most influential groups in a vast majority of democratic countries.

3.1 A BRIEF HISTORY OF SOCIAL DEMOCRACY

The social democracy movement has a tumultuous history of mergers / unions and divestitures / separations from its origins as a particular name of the Second (Socialist) International of 1889 led by Friedrich Engels to current national centre-left political parties, present in one form or another in most countries, advanced or developing. This short chapter on the history of social democracy has clearly no claim to be exhaustive and/or fully accurate in all details. A quick account of some of the roots and foundations will highlight the resemblances and the differences between the CSD model and project presented here, as well as the numerous different factions of the social democracy movement of the last century and a half.

The modern social democratic current came into being through a break within the socialist movement in the early 20th century, between two groups holding different views on the ideas of Karl Marx. Many related movements, including pacifism, anarchism and syndicalism, arose at the same time, (often by splitting from the main socialist movement) often presenting quite different objections to Marxism.

The social democrats, who made up the majority of socialists at that time, did not reject Marxism (they in fact claimed to uphold it), but wanted to reform it in different ways, among them toning down their criticism of capitalism. They argued that socialism should be achieved through evolution rather than revolution. Such views were strongly opposed by the revolutionary socialists, who argued that any attempt to reform capitalism was doomed to fail, because the reformers would be gradually corrupted and eventually turned into capitalists themselves.

Despite their differences, the reformist and revolutionary branches of socialism remained relatively united until the outbreak of World War I. The war proved to be the final straw that pushed the tensions between them to a breaking point. The reformist socialists supported their respective national governments in the war, a fact that was seen by the revolutionary socialists as outright treason against the working class (since it betrayed the principle that the workers of all nations should unite in overthrowing capitalism). Eventually, during and after the Russian Revolution, most of the world's socialist parties fractured. The reformist socialists kept the name **SOCIAL DEMOCRATS**, while the revolutionary socialists began calling themselves **COMMUNISTS**, and soon formed the modern communist movement.

Following the split between social democrats and communists, another split developed within social democracy, between those who still believed it was necessary to abolish

capitalism (without revolution) and replace it with a socialist system through democratic parliamentary means, and those who believed that the capitalist system could be retained but needed adjustments and improvements. Among the necessary changes, were the nationalization of large businesses, the implementation of social programs (public education, universal healthcare, public unemployment insurance, etc.) and, more generally, the partial redistribution of income and wealth through a Welfare State; all this in order to make capitalism more humane.

Eventually, most social democratic parties have come to be dominated by the latter position and, following World War II, have since abandoned any objective or commitment to abolish capitalism. In general, those social democrats that merely want to improve capitalism have kept the name **SOCIAL DEMOCRATS** (by virtue of their majority position), while those wishing to gradually abolish capitalism through democratic means have become **DEMOCRATIC SOCIALISTS**.

Social Democratic parties all over the world have followed a switchback evolution since their creation. The German Social Democratic Party (the SPD, *Sozialdemokratische Partei Deutschlands* was formed by the merger of partisans of Karl Marx and of Ferdinand Lasalle in 1875) became the strongest socialist party in Europe and, between 1900 and 1914, led to the establishment of the shortest workweek, longest vacations and best benefits. As if that were not enough, all this was accomplished in wartime preparation. Labour parties were also created in many other countries and from this social democrat ideal emerged a mass of often well-established parties in the working class but continuing to be autonomous parties. The Australian Labour Party formed a government in 1904, while the British Labour Party elected its first members in 1906 and had to wait till after World War I to form a government.

The post World War I decade proved to be the decade of the social democrats. British Labour Party headed the government in 1924 and the German Social Democratic Party was in power much of the decade. After the Great Depression, Europe soon saw the rise of Fascist States, the Australian and British Labour Parties were defeated, and only Sweden was able to maintain its social democrat government that was first elected in 1932.

During World War II, social democracies reached their lowest point. Because of communists' involvement with the Nazis, much of the ideology associated with socialism was banned. Britain, Sweden, Switzerland, Canada, Australia and New Zealand were the only countries that had "significant" socialist parties allowed to operate. It is

only after 1945 that social democratic parties were re-elected, most notably in Britain. The German SPD was defeated in 1949 in Germany's first free election after the war.

The Great Depression and the economic prosperity after World War II along with John Maynard Keynes' new economic ideas on State intervention allowed social democratic ideas to gain more popularity. Not only were States expected to sustain national demand and economic growth, but they also had to ensure a certain level of social justice. This made it possible for the labour force to accept capitalism, with most of its implications, in exchange for job security and a more active and intervening government. These macroeconomic policies were widely implanted throughout the fifties and the sixties during a time when social democratic parties and Welfare State politics were present in many countries, especially in Europe.

However, the Cold War, in combination with communist advances and the divisions within the social democrat movement, in part due to the Soviet participation in World War II, led to more conservative ruling parties. Only in France and Scandinavian countries did social democrats have notable political importance. During the sixties and seventies, labour parties and social democrats found their original support base, composed primarily of workers and unions, was not sufficient. Thus many of the political reforms were oriented to satisfy middle-class demands.

The economic instability of the seventies and eighties contributed to the decline of social democratic governments in favour of more conservative ones. The recent challenges faced by governments, namely, the globalization of markets, the increased interdependence amongst nations, and the growing concerns for social justice within civil society led to a debate in the nineties on the proper social model that could be developed to reach social democratic objectives within the new economic realities. The debate is ongoing and the solutions proposed within the social democrat movement are numerous. Yet, in a sense, there is a common underlying ground that unites most social democrats. The objective of the next paragraph will be to characterize this common ground.

3.2 PRINCIPLES AND POLICIES OF SOCIAL DEMOCRACY

Currently, the position of the social democracy movement can be found somewhere between the two major political ideologies that have dominated the post World War II period. The first one is socialism, which rests on the belief that the State is the most trusted agent of society as a whole. Therefore, the more the State controls centrally in fine detail (not only economic life but also social life), the better society is and the

higher its well-being. This is the project that the Soviet Union has tried to lead on. This ideology allows little room for capitalism as it is perceived as evil: market forces could be slightly tolerated but are in principle wrongheaded. The second ideology, neo-liberalism, takes the opposite view. It believes that the State, as Ronald Reagan once said, is not part of the solution but part of the problem. It recognizes that there is a need and some room for the State, but it is an overall 'bad' influence and should be tightly controlled. The good is in the free market and the freedom of choice, transactions and exchange that it allows.

Since the seventies, the vision of the social democrats has shown a need to move away from what they see as a sterile debate between left and right; rather, between those who favour either the State or the free market to do everything. Instead, they look towards a new form of political philosophy that focuses on adapting economies and societies to the demands and pressures of globalization. The principles of this renewed ideology are, as put forward by the Blair-Schröder 1999 manifesto, the principles of liberty, equal opportunity, solidarity and responsibility to others, and finally, fairness and social justice (democratic rationality).³¹

The principles of **LIBERTY AND EQUAL OPPORTUNITY** boil down to personal autonomy and self-reliance in the market economy. The principles are formulated in terms of pluralism and meritocracy. Each member of the social or political community should enjoy the basic resources and capabilities that are needed to survive and flourish in an advanced market economy. The emphasis here is on standards for social protection, health, and schooling (qualifications, competencies, employability). Further, there should be equal opportunity from start to finish, as outlined in procedures and plans for anti-discrimination and checks on asymmetric power relations.

The principles of **SOLIDARITY AND RESPONSIBILITY TO OTHERS** entail submission to the civic rules of moral responsibility and social virtue. The market is upgraded as a sphere of peaceful and productive expression of individuality and sociability. Market participants in civil society do much more than occasional bargain hunting. They abide by the legal and conventional rules of local concern (with contracting parties), decent and honest transaction, joint venture in case of collective interest, and social initiative on the basis of ability to pay. The principles of solidarity and responsibility to others translate into reciprocity. Each citizen ought to have access to full community

³¹ For more information about principles of social democracy, see among numerous sources J. De Beus et T. Koelble (2001), "The Third Way Diffusion of Social Democracy: Western Europe and South Africa Compared", *Politikon*, 28(2), pp. 181-194.

participation and social entitlements. This is often connected with a broad concept of work in which family care, volunteering, and public service are seen as sensible and profitable activities on a par basis with conventional formal labour. On the flip side of these advantages is the obligation to work according to fitness, training (in particular free training at the expense of the taxpayer), and expected contribution to public goods, or promotion of social cohesion. The “no right without responsibility” formula means that those willing to share the economic benefits of social co-operation in a wide sense have a corresponding obligation to make, if so able, a personal relevant and proportional productive contribution to the community in return for those benefits.³² Government may moralize here in the name of the community as long as public policy itself is instrumental to “empowerment”; rather, the guiding of each individual citizen towards independence (say teaching everyone to fish and assign a ration of fish to all of those who never get a good command of it).

The principles of **FAIRNESS AND SOCIAL JUSTICE OR DEMOCRATIC RATIONALITY** suggest that the entire pursuit of social democratic objectives is compatible not only with the principles of procedural justice and democratic legitimacy (constitutionalism), but also with the principles of allocative and dynamic efficiency (competitiveness). Social democratic thinkers contend that the trade-off between conflicting political goals must be shaped by permanent public deliberation under the guise of civic dialogue, decentralization, subsidiary and proper democracy in all contemporary forms of groups and organizations.

From these principles follow different variants of centre-left economic policies applied throughout the world, for instance Europe, Canada, Australia, New Zealand, and Brazil. One can identify a certain number of characteristics common to the representation of social democracy emerging from their policies. A non-exhaustive list of those characteristics would include the following, although not always at the same level and with the same credible commitment.

1) Social democracy should welcome globalization as a primary mode of economic growth in a regime of economic freedom and value pluralism. Growth policy has two dimensions. On the one hand, growth comes from new technologies (computing, Internet, biotechnology) and new business and distributive services. On the other hand, growth should be qualitative and minimize ecological degradation, particularly through the invention and adoption (innovation) of better methods of production and

³² See White S. (1999), “Rights and Responsibilities”, in Gamble and Wright (eds.), *The New Social Democracy*, Oxford: Blackwell.

management. The process of growth must strike a balance between private and public goods, toil and leisure, old and new risks, as well as competition and local community bonding. The purpose of economic growth is the widening and deepening of human freedom.

2) Social democracy should restore the weight of full employment and labour ethic. The goal of employment policies is unorthodox in a number of ways. Full employment, for example, concerns men and women as well as young and old, majority and minority citizens. It entails part-time jobs as a device to balance contractual obligations to one's employer and family obligations. It may also include temporary exit (prolonged learning) and frictional unemployment (unemployment benefits with an efficient replacement rate) as the unintended consequences of upward mobility of the employable worker. The quality of jobs, that is work as a source of self-respect and personal development, socialization, income and career concerns (minimum wage, decent labour conditions), is taken into account and is relevant to comparisons between the open sector and the sheltered sector (public services included).

3) Social democracy should create a level playing field for basic opportunities, while also accepting outcome differences in income, wealth, life-style and prestige. The "celebration of creativity, diversity and excellence"³³ is, however, restricted in a dual sense. Social democrats aim at abolishing or controlling extreme differences in *unearned* income and *inherited* wealth. Poverty should be eliminated with a policy-mix of safety nets, fiscal and moral promotion of job acceptance at the proper level of skills, schooling, childcare facilities, sanctions (workfare), urban renewal (against segregation, ghettos, organized crime, and no-go areas), family values, as well as access to social services (no poverty trap). Moreover, the superrich could pay efficient wealth taxes in lieu of contributions to social cohesion, and exit options (transfer pricing and profit export, done to evade taxation) and double dipping (public and social goods and services consumed in the country but earnings declared and taxes paid in a foreign country) should be discouraged.

4) Social democracy should reinforce its commitment to open society and humanitarian missions via a wide range of measures. These include, among other things, hospitality towards political refugees, integration aid for communities of migrants (language courses, special programmes for migrant employment and migrant entrepreneurship), global open and fair trade based on competitive processes and hostile to political

³³ Britain's Blair and Germany's Schröder joint programme (1999).

interventions in favour of national champions as well as to export-oriented aids and trade-distorting grants, development aid under the condition of good governance, and participation to peacekeeping operations and regional stability pacts.

5) Finally, social democracy should promote inclusive citizenship and strong democracy. This reform entails, among other things, social pacts, regional autonomy, interactive policy-making, legal protection of ethnic minorities and women, adequate financing of political parties and non-governmental organizations, institutions and practices of representative and direct democracy (accountability, powers of parliament, referenda), and personal liberties and responsibilities.

CHAPTER 4: THE “FABULOUS FOUR” FACTORS OF GROWTH

The fundamental objective of the CSD model and project is to optimize the well-being of all citizens through social cohesion, maximal growth, and economic freedom, including the right to challenge the current providers of public and social goods and services. This chapter is devoted to the four main factors of growth that underlie social and economic development. The general growth-enhancing and promoting policies that result from this model must find application in most sectors of the economy: health, transport, education, energy, environment, etc. They will be presented and discussed later.

There is a large consensus among economists that the most critical factors explaining the differential performance of countries and regions relative to economic growth, social well-being, and gains in living standards are the following: the per capita quantity and quality of human capital, the capacity to invent and innovate, the quality and intensity of well-designed performance incentives, and finally the quality of private and public resource allocation and coordination mechanisms, the latter two defining the general concept of good governance of organizations and institutions.

The importance of the *fab four* factors of growth, hence social well-being and welfare, is pervasive throughout all sectors of society, all networks of stakeholders, all mechanisms of resource allocation and conflict resolution, and all fields of human activity; hence the importance of presenting them from the outset and giving them pre-eminence. Equally important is the fact that these fabulous four factors are strong complements, exemplifying a significant level of super-modularity. More of one increases the incremental value of (more of) the others and more of the others increase the incremental value of (more of) one.

Hence, although it is useful to present and understand these *fab four* factors quasi-independently, their impacts on growth and hence social well-being and welfare, are quite interdependent and intertwined. For instance, a fundamental belief behind the CSD model and project is that intelligence and creativity are uniformly distributed across time periods, societies, regions and/or countries. The relative performance of those societies and time periods innovation-wise and commercialization-wise may and does differ significantly, not because of a differential endowment in creativity abilities, but because of the different portfolios of acquired skills, incentive schemes and frameworks,

and resource allocation and coordination mechanisms (governance) their members, individuals and organizations, are or were facing.

Growth and gains in productivity and well-being depend mostly on proper governance rules in organizations and institutions, including efficient incentive schemes and efficient resource allocation and coordination mechanisms. Indeed, competencies and human capital, inventions and innovations, as well as natural resources, are all significant determinants of growth and well-being, but it is good governance in private and public affairs that is probably the most important factor. This occurs because, in a sense, it is good governance rules that determine the development, evolution and adaptation of competencies and human capital, the choice of investments and, therefore, the portfolio of advanced technologies, as well as the way natural resources are exploited for the benefit of all. The factor “good governance” has, under these conditions, a dominating place in the policies characterizing the competitive social democracy.

4.1 THE FIRST FACTOR: HUMAN CAPITAL

Education, or more generally the formation of human capital, is defined as the individual and social portfolio of distributed knowledge and higher-level competencies together with cognitive capacity and dexterity, basic skills, soft skills, and specialized skills, and is a major determinant of growth.

Countries and regions must efficiently develop their stock of human capital in order to fully benefit from accelerated growth opportunities offered by the globalization of markets, the new information and communications technologies and the internationalization of cultures. The efficient development of human capital allows a country to make sure that each individual can increase his/her abilities, whatever his/her initial endowment: accessibility to human capital development tools and programmes as well as rationalization of choices and efforts from all stakeholders. To achieve such an objective, the supply of training programs must be diversified in a context of lifelong spells of education / training and work.

Levels of competitiveness and productivity, as well as innovation and commercialization of inventions and, therefore, gains in living standards of a society, country, or region, depend on the following building blocks: **FIRST**, the capacity of its broadly-defined education sector to respond to industrial and social needs in terms of required skills and competencies of different types and levels both in quantity and quality; **SECOND**, the importance and efficiency of its R&D investments and its capacity to transform these R&D investments into successful inventions, innovations and their successful

commercialization, or rather, to transform the new ideas into useful processes, products and services; **THIRD**, the flexibility with which a society can adapt to changes in its social, economic and business environment, in addition to the will and determination it shows in confronting the significant challenges that exogenous and endogenous changes pose.

Reaping the full benefits of such investments in human capital formation is not a straightforward task. In order to reap the full benefits of its investments in human capital, a country or region must successfully address the skills “challenge”: those reaped benefits are greater, most likely by a significant margin, when the skills acquired are properly integrated with the needs expressed by society on labour markets for the near and far future. Hence the importance of revisiting the national and sectorial effort levels of human capital formation and the allocation of those efforts across the different skills and competencies being developed in quantity as well as quality.

OECD defines human capital as *knowledge, skills, competencies and other attributes embodied in individuals that are relevant to economic activity*. In short, human capital can be associated with the economic behaviour of individuals, especially in the way that the sum of knowledge and aptitude allows individuals to increase their productivity and their incomes, thus contributing to the raise in the productivity and wealth of the firms and organizations in which they operate and live. Human capital formation and economic growth feed on each other. Yet, the former in many ways precedes the latter. A recent study by Serge Coulombe *et al.* (2004)³⁴ suggests that differences in average skill levels among OECD countries fully explain 55% of differences in economic growth since 1960. Investment in human capital, such as education and skills training, is three times as important to economic growth over the long run as investment in physical capital.

Human capital brings growth but it can also support the creation and maintenance of social capital. Education and training can encourage practices, aptitudes and values favourable to cooperation and social participation. I may quote here Côté (2001):³⁵ *“Heyneman (1998) stresses the potential role of education in contributing to social cohesion by: providing knowledge about social contracts among individuals and between individuals and the State; reinforcing behaviour expected under social contracts, ‘in part through the socially heterogeneous experiences students have in the schools*

³⁴ S. Coulombe S, J.F. Tremblay and S. Marchand (2004), “Literacy Scores, Human Capital and Growth Across 14 OECD countries”, *Statistics Canada*, 89-552-MIE.

³⁵ S. Côté (2001), “The Contribution of Human and Social Capital”, *ISUMA*, vol. 2, no. 1

themselves;’ providing an understanding of the expected consequences for breaking social contracts; also, respect for the rule of law and an appreciation of society’s obligation toward the economically and socially vulnerable are key values and competencies for democratic societies.”

4.2 THE SECOND FACTOR: INVENTIONS AND INNOVATIONS

As mentioned in the introduction, economists consider the capacity and willingness to identify, select, adopt, adapt, implement, and commercialize inventions and innovations, whether technological, social or organizational, as the source of economic growth. Such capacity and willingness find their roots in individual attitudes towards change as well as in social, organizational, and political institutions towards flexibility, dependability and reliability. The capacity and willingness to accept and promote growth-enhancing changes rest more concretely on the four main factors of growth.

The second main factor is the promotion of inventions and innovations that correspond to the set of improvements in ways and means of producing and delivering goods and services, social, public and private, now and in the future.

Inventions are scientific discoveries and generally new knowledge resulting from fundamental research, appearing quite often as ideas without concrete applications. Innovations sometimes follow inventions. They correspond to the successful application and/or commercialization of inventions. For A. Landry *et alii* (2001),³⁶ *“innovation is a process which focuses on problem-solving rather than technological results, takes place mainly within companies and not government agencies and laboratories, is interactive and involves relationships among companies and various actors in their environment (these relationships are both formal and informal and make the firms part of various networks), is a diversified learning process (learning can take the form of learning-by-using, learning-by-doing or learning-by-sharing; the sources of knowledge can be internal or external to the firm; learning from external sources relates to a firm’s capacity to absorb knowledge), involves the sharing of codified and tacit knowledge (sharing codified knowledge is essential but not enough on its own), is interactive (innovation is a process of learning and sharing in which the actors’ interdependence creates a system, an innovation system, a social innovation system, an ‘innovative environment,’ or an innovation cluster).”*

³⁶ A. Landry, A. Amara et M. Lamari (2001), “Capital social, innovation et politiques publiques”, *Isuma*, vol. 2, no. 1

Inventions and innovations contribute to an increase in productivity. The benefits from these gains can take various coexisting forms: a fall in prices and a corresponding increase in the purchasing power of households, a reduction in working time, an increase in profits and a corresponding increase in real incomes and/or investments suitable for still more increases in productivity and value added, or an increase in wages insofar as pressures develop on the labour markets. This is not an exhaustive list of advantages related to inventions and innovations.

Creating a really efficient **POLICY OF INVENTION AND INNOVATION** requires strong support for both inventions and innovations, but in particular for the innovation element: inventions are numerous, innovations are much less numerous. An effective policy must initially redefine the roles, specific but interdependent and complementary, of various stakeholders in the invention / innovation / commercialization process: individuals, universities, granting agencies, and the State.

Given the complementary and super-modularity relationship between the four main factors of growth, it will appear as no surprise that inventions and innovations, whether technological, social or organizational, are greatly enhanced, for their creation, adoption, and successful implementation, by the level and quality of human capital, the quality of incentives (profitability) directly geared towards inventions and innovations and good governance of intellectual property laws and provisions. Not everyone needs to be or can be involved in research and discoveries or implement sophisticated technologies or discoveries. It is necessary that the individuals be well trained, whether they are in the invention and innovation-generating sectors or in sectors relying for their growth on the adoption and implementation of technological, organizational and social inventions and innovations. Thus, by supporting the accumulation of human capital, a social democratic society government supports inventions and innovations and thus growth.

But in order to induce inventions and innovations, it is important that specific social democratic policies support the emergence of teams integrating researchers and entrepreneurs but also to guarantee a protection against the plundering of discoveries through well-enforced patents and copyrights. According to Hernando De Soto (1989),³⁷ underdevelopment is in good part due to the absence of a legal and social framework supporting the valorization of physical and intellectual capital.

³⁷ H. De Soto (1989), *The Other Path: The Invisible Revolution in the Third World*, New York, USA, Harper & Row.

The prosperity and growth of a society as well as its competitiveness and its capacity to adapt to change mainly depend on the society's capacity to innovate and accumulate human capital. However, the quality of institutions and organizations within that society has a considerable influence on those growth factors. Thus fundamental growth policies that I suggest within the CSD model and project appear under the umbrella of good governance; that is, proper incentives schemes and frameworks and proper resource allocation and coordination mechanisms.

4.3 THE THIRD FACTOR: INCENTIVES (INFORMATION, CONGRUENCE, COMPATIBILITY)

Whenever organizations and individuals make decisions, they have an impact on the use of social resources and, therefore, on the value of those resources. If decisions are made efficiently, they create wealth directly or indirectly either by increasing the level of resources available or by increasing their value. It is therefore important to understand what motivates organizations and individuals to make the decisions they make regarding the allocation of the resources they control one way or another.

One can distinguish two broad sets of factors explaining the decision-making of economic and social agents. One factor is 'preferences', and the other is 'incentives'. Preferences are the deep-rooted factors emerging from the very long-term process of evolution and survival and from the more immediate but still lifelong process of socialization through which every human being learns to adopt social values and proper behaviour from parents, families, teachers, and peers. The first source of preferences can be considered as fixed or impossible to change. As for the second source, it is very difficult to make changes in the short or medium term. Hence, growth factors and policies are better understood as dealing with the second set of factors that explain the decision-making of economic and social agents, namely incentives. Incentives are malleable and powerful tools in shaping the contribution of organizations and individuals to social wealth and well-being. In that sense, growth and gains in productivity and well-being depend directly on the quality and intensity of incentives that organizations and individuals are facing.

Adequately intensive incentive schemes require that compensation for people and profitability for firms be based on their performance. Insofar again as (too) many compensation schemes in social democratic societies, whether at the level of individuals, groups, firms, or organisations, suffer from either low-intensity characteristics or misalignment with social objectives or both, the development of free-

riding, wealth-destroying, and growth-impeding strategies is indirectly encouraged at great social cost. It would be useful to identify the relative importance of low versus high-intensity compensation schemes in different sectors of a given social democratic society and relate them to the relative innovative capacity or commercialization performance of the different sectors.

Incentive pay is for higher-level workers; rather, workers whose productivity characteristics are difficult to evaluate at the start: (i) it is difficult to know who is going to be successful for example in an academic (university) career in research and teaching (adverse selection problem), (ii) effort on job is more difficult to observe (moral hazard problem), (iii) the job is less standardized, hence more individual initiative is desirable and welcome (again a moral hazard problem), (iv) individual or team performance is crucial for the success of the organization in attaining goals or fulfilling its mission.

As we will see, unless there is a major observation or information problem, there is no case for incentive pay. Incentive pay should be understood as a compensation scheme in which the individual is put in a context where the pursuit of individual objectives or interests is canalized towards the achievement of the goals of the organization.

In such contexts, the dangers of not having incentive pay are numerous. The compensation formulas in any organization is a fundamental management tool in coordinating the efforts of the different divisions and individuals towards achieving the highest level of performance possible (measured with respect to the overall objectives and mission of the organization). Failure to realize the importance of this tool would jeopardize the organization's capability to fulfill its mission. Incentive pay is the most efficient way to make the key members of the organization responsible for their own contribution to the success or lack of success of the organization. Moreover, it forces the organization to explicitly state its mission and objectives.

4.4 THE FOURTH FACTOR: EFFICIENT RESOURCE-ALLOCATION AND COORDINATION MECHANISMS

As mentioned above, competencies and human capital, advanced technologies, and natural resources are significant determinants of growth and well-being, but good governance rules in private and public affairs is probably the most important factor. It is important to stress again that in the CSD model and project, good governance rules are seen as significantly affecting the development, evolution and adaptation of competencies and human capital, the choice of investments in social, technological and organizational inventions and innovations and, therefore, the portfolio of advanced

technologies, as well as the way natural resource endowments are exploited for the benefit of all. Good governance covers both the proper performance-related incentive schemes I discussed above and the efficient resource allocation and coordination mechanisms I now turn to.

The term **GOVERNANCE** appeared in 1937 in the article “*The nature of the firm*” by Ronald Coase.³⁸ Applied initially to the context of the management of private corporations, its domain has grown and today includes the political sphere. Although this concept suffers from multiple definitions and covers many subtopics, it can be apprehended in a relatively global way. Good governance, understood in its most abstract and general form but specifically tailored to a CSD approach to the production, distribution and delivery of public and social goods and services, corresponds to a radically-different form of government role, actions and interventions. In this concept of governance, different competitive-sector organizations, both the currently active ones and those that could potentially emerge, and the individual citizens themselves participate in an incentive-compatible framework for the formulation and implementation of policies aiming at meeting the single most important objective of social well-being. To achieve this explicit and organized participation, an extensive use of competitive mechanisms, modularity, transparency and accountability is necessary. Hence, CSD “good governance” calls for a major reform of the State, of its place, role and scope, as well as its operations.

CSD good governance must aim at setting up, creating and supporting efficient resource-allocation and coordination mechanisms not only for the production, distribution and delivery of public and social goods and services, but also throughout the economy. Efficient resource-allocation mechanisms require that proper signals be sent to individuals and firms regarding the relative scarcity of goods and services. In most situations encountered in practice, the most efficient mechanisms are those compatible with the competitive market / open auction mechanisms.

Insofar as too many prices in social democratic societies are administratively set and controlled rather than determined on competitive markets or at competitive market levels, the efficiency of the economy in generating value for citizens is significantly diminished because such administered prices are likely to generate distortions in the overall level of innovative effort and in its allocation across industries or activities. When prices are set too low, there is either an overproduction (if demand must be satisfied,

³⁸ R. Coase (1937), “The Nature of the Firm”, **ECONOMICA**, New Series, vol. 4, no. 16, pp. 386-405.

social welfare is reduced because the last units of the good or service produced are worth less for the consumers than the cost incurred to produce them) or an underproduction (if the freedom to supply is enforced, social welfare is reduced because some units are not produced whose value for the consumers would be larger than the cost to be incurred to produce them).

Whenever such price controls are used, a level of resource misallocation is generated where social cost will vary with the importance of the control or with the discrepancy between the administered price and the competitive equilibrium price. In general, these price controls are used to directly “benefit” consumers or producers, to “induce” consumers to consume more of some product or service than they would otherwise choose to consume, or to “protect” consumers or customers against the exercise of market power by suppliers. Whatever the reason or intended objective for such price controls, there is always a better way to achieve the objective, that is, a way to attain the objective without unduly distorting the allocation of resources. In some situations, such as for network architecture, system design and pure public goods, it is necessary to consider other coordination mechanisms, although most of those other mechanisms follow from the same competitive equilibrium principles.

CHAPTER 5: THE TEN GENERIC CSD POLICIES AND PROGRAMMES

The CSD model and project are based on the fundamental belief that public and social goods and services improve the well-being of citizens by favouring both economic growth and social cohesion. To be a competitive social democrat is to understand that there is a double condition to be met for allowing a clearly positive relation to exist between the provision of public and social goods and services and social well-being. First, the public and social goods and services must correspond with what citizens want, need and expect, and second, they must be produced, distributed and delivered efficiently at the lowest possible cost.

If this double condition is not met, those public and social goods and services will most likely not be as favourable to growth and social cohesion as they could be and, in some cases, could in fact impair both growth and social cohesion. Many social democratic countries are presently running that risk. The cost of providing many traditional public and social goods and services is getting out of control because their production, distribution and delivery is increasingly inefficient and, consequently, provoke severe criticisms by individuals and groups calling for scrapping some of those public and social goods and services. Most reforms to date have aimed at and ended up reducing the general level, either quantitatively, qualitatively or both, of the public and social goods and services. The CSD solution is to directly tackle the ways and means or processes by which those public and social goods and services are produced, distributed and delivered. Indeed, it will be possible to use the reduction in costs achieved from efficiency gains to maintain or raise the production, distribution and delivery levels of public and social goods and services.

Competitive social democrats propose an organisational revolution in the way that public and social goods and services are produced, distributed and delivered. How to obtain a better level (in quality and quantity) of public and social goods and services and how to make sure that they are provided efficiently is at the heart of the CSD model and project. The following ten generic policies and programmes are the cornerstones of the CSD model and project. Those policies and programmes are generic in the sense that they should apply to and be implemented in all sectors and fields.

5.1 PROMOTE THE DEVELOPMENT AND MAINTENANCE OF WELL-DEFINED KEY COMPETENCIES FOR THE GOVERNMENTAL AND COMPETITIVE SECTORS

The CSD model and project have no use for the old dichotomy between the private sector and the public sector. This dichotomy is presently at the center of all discussions on reforming the traditional socio-economic system, whether it is referred to as the Welfare State or Social Democracy State, but such a dichotomy is creating unnecessary conflicts because it is fundamentally misconceived in dramatically confusing the distribution of roles and responsibilities and the processes by which the objectives, in terms of public and social goods and services, will be met. In other words, there is a pervasive confusion between objectives, on the one hand, and ways and means, on the other hand. Hence, in the presentation and discussion of the CSD model and project, the major actors are not in the public sector and private sector, but rather the **GOVERNMENTAL** sector and the **COMPETITIVE** sector.

Indeed, it is a fundamental responsibility of the governmental sector to define baskets of public and social goods and services and to propose them to the community of citizens. It does not follow that the governmental sector should produce, distribute and deliver those goods and services. The Competitive Social Democracy model and project propose a significant organizational revolution insofar as they call for the implementation of a different dichotomy, a dichotomy between the **GOVERNMENTAL** sector and the **COMPETITIVE** sector, both having clear responsibility in making sure that the well-being of citizens is optimized.

The **GOVERNMENTAL** sector is, as its name suggests, the sector under the direct responsibility of the elected Government. The role of this sector is first and foremost to identify the needs for public and social goods and services both in quantity and quality, to design the specificities and characteristics of those public and social goods and services, to make the necessary and numerous arbitrages between the possible baskets of public and social goods and services in light of the available resources, and to manage the contracts and partnerships for the production, distribution and delivery of the public and social goods and services so retained. The identification, design, arbitrage and choice functions related to the baskets of public and social goods and services are closely linked to and realized through the democratic electoral process.

This redefined **GOVERNMENTAL** sector bears little resemblance to the public sector as we know it in most countries. Indeed, the redefined **GOVERNMENTAL** sector will be

composed of the political party in power together with a group of senior properly-qualified civil servants who, for the most part, will be responsible of the overall management of contracts with different **COMPETITIVE**-sector organizations responsible for the production, distribution and delivery of the public and social goods and services. The **GOVERNMENTAL** sector's prime responsibility is neither to be an employer nor producer or distributor of public and social goods and services.

The role of the **COMPETITIVE** sector is to produce, distribute and deliver the public and social goods and services in the most efficient manner possible using the best technologies, human resources, and organizational structures, under properly-defined incentive contracts with the governmental sector. In the CSD model and project, the competitive sector is broadly defined to include the corporate sector, the cooperative sector, the non-governmental organizations (NGO), the not-for-profit organizations (NPO), as well as other organizations such as civil society organizations and social economy organizations. Those organizations of the competitive sector will be called or invited by the governmental sector to enter open bidding processes for the right to produce, distribute and/or deliver, for a properly-defined limited time, specific public and social goods and services, under appropriately defined contracts specifying the rights, responsibilities, commitments and payments or remunerations of the parties.

Design activities consist in a system of different elements that must fit together in a relatively precise, predictable and inflexible manner. In the domain of public and social goods and services, design activities hold a major preponderant place because of the complexity of the public and social goods and services networks. Such design activities must be managed in a centralized fashion in such a way that synchronization and complementarities be maximized when necessary or advantageous. Hence the design of public and social goods and services is fundamentally a domain better suited for the **GOVERNMENTAL** sector. Through the electoral process, the different political parties or entities propose baskets of public and social goods and services to the population, which is then asked to choose among the different baskets.

However, the production, distribution, and delivery of the public and social goods and services in the chosen basket is subject to an open bidding process, through which different **COMPETITIVE**-sector organizations are asked to submit their bids for the right to produce, distribute, and deliver specific elements of the chosen basket of public and social goods and services. The contracts linking the **GOVERNMENTAL**-sector authorities and the **COMPETITIVE**-sector organizations must be designed in such a way that the

retained **COMPETITIVE**-sector organization is induced to deliver on its promises via either a form of warranty bond or a significant bonus to be paid once the realization of objectives and promises has been verified. Moreover, proper pro-competitive policies must make sure that level playing field conditions are strictly enforced.

5.2 PROMOTE OPEN AND TRANSPARENT COMPETITIVE PROCESSES IN THE ATTRIBUTION OF CONTRACTS FOR THE PRODUCTION, DISTRIBUTION, AND DELIVERY OF PUBLIC AND SOCIAL GOODS AND SERVICES

An objective of the Competitive Social Democracy model and project is to transform the **GOVERNMENTAL** sector as well as public markets into true instruments of economic development. To do so, transparency through competition and open bidding are imperative.

Indeed, transparency must play a key role in all the steps of the production, distribution and delivery of the public and social goods and services. From the initial calls to tender to the information provided to the bidders that have not been selected, and even the adjudication process itself, the steps must all be conducted in a transparent manner to ensure efficiency.

Generally, compliance with the rules of competition is a sure way of ensuring transparency in markets, enabling free access to governmental contracts and equal treatment of all candidates. Furthermore, it is essential that all decisions be founded on evaluation criteria stated in advance in the call for tender documents and on the information provided regarding the application of these criteria. Moreover, in order for all to have the assurance that the adjudication process respects this principle, it is necessary for the criteria to be formulated in such a way that they can be applied objectively. It is also necessary to include an internal revision mechanism aimed at ensuring the respect of contractual obligations and at making sure that all international actors intervening in the market conform to the national rules and regulations. Another way of ensuring efficiency would be to translate invitations to tender in internationally-recognized languages in order to help increase competitive pressures and bypass unnecessary intermediaries.

It is of utmost importance that the retained organization in the bidding process be the one offering the best quality/price ratio (effectiveness), with the best probability of success of meeting the objectives pursued (efficiency). Proper usage of public funds is guaranteed by choosing the best offer, which translates in the most economically

advantageous offer. In order to achieve this goal, using competition mechanisms is again of primary importance.

Competitive processes are disturbing and bothering. Hence it is quite normal and natural that individuals and organizations of all types will try to reduce competitive pressures by trying to entrench one way or another some market power advantages. Such strategies must be controlled through the existence of an efficient competition bureau responsible for making sure that competitive processes are protected from abuse by individuals and organizations, whether they are public or private corporations, cooperatives, NGOs, not-for-profit organizations, civil society organizations, social economy or labour organizations, or other forms and names.

In the competitive sector, abuses may take different forms that must be controlled even forbidden, such as the following:³⁹ **(i)** squeezing, by a vertically-integrated competitive-sector supplier, of the margin available to an unintegrated competitive-sector customer who competes with the supplier, for the purpose of impeding or preventing the customer's entry into, or expansion in, a public and social goods and services market; **(ii)** acquisition by a competitive-sector supplier of a competitive-sector customer who would otherwise be available to a competitive-sector competitor of the supplier, or acquisition by a competitive-sector customer of a competitive-sector supplier who would otherwise be available to a competitive-sector competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from a public and social goods and services market; **(iii)** freight equalization on the plant of a competitive-sector competitor for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a public and social goods and services market; **(iv)** use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitive-sector competitor; **(v)** pre-emption of scarce facilities or resources required by a competitive-sector competitor for the operation of a business, with the object of withholding the facilities or resources from a public and social goods and services market; **(vi)** buying up of products to prevent the erosion of existing price levels; **(vii)** adoption of product specifications that are incompatible with products made by any other person and that are designed to prevent his entry into, or to eliminate him from, a public and social goods and services market; **(viii)** requiring or inducing a competitive-sector supplier to sell only or primarily to certain competitive-sector customers, or to refrain from selling to a

³⁹ Adapted in part from the Canadian Competition Act, article 78.

competitive-sector competitor, with the object of preventing a competitor's entry into, or expansion in, a public and social goods and services market; (ix) selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitive-sector competitor (predatory pricing in public and social goods and services contracts); (x) the determination of access prices and conditions to natural monopoly competitive-sector infrastructure for the purpose of preventing the entry of competitive-sector competitors in some public and social goods and services markets. The list could be extended and refined.

In the governmental sector, the requirement of implementing open and transparent processes, such as calls for tender and competitive tendering for contracts to produce, distribute and deliver public and social goods and services, will often be opposed from within because such a requirement imposes constraints on political authorities. These opponents will, more often than not, be politically motivated and will at times try to justify the avoidance of competitive tendering by short-term gains that, in spite of being wrapped in the “langue de bois” of job creation and regional development, of the existence of local competencies and “savoir-faire”, and of the government (bureaucratic) capacity to emulate and be as efficient as competitive processes, will inevitably end up benefiting well-organized businesses, political, and labour union groups at the expense of non-organized, law-abiding, competition-pressed, and taxpaying businesses and citizens.

Of course, an industrial, commercial, or political project that is realized through a contract “de gré à gré” (mutual private agreement contract), thereby avoiding the procedural rigour that a well-designed call for tender imposes, might, and sometimes does, create jobs, contribute to regional development, make use of local competencies and savoir-faire, and cut on delivery time. What is left out of the equation is the negative impact that such a project and procedure will inevitably have on future job creation throughout the economy, on regional development and the fostering of competencies because of reduced competitive pressures, distorted signals, and increased incentives to engage in influence activities and political gaming. Moreover, the often-heard claim by government officials that a contract *de gré à gré* will cut months and even years in delivery time, thereby adding value in a compelling and urgent situation, is more often than not indicative of the incompetence of the same individuals in planning ahead to avoid such urgent situations, which are always synonymous with higher and padded costs.

When a firm's or an organization's political allies become more important and deserve more attention than its suppliers, customers and clients, the firm should start planning first to demand more political favours, second to file for protection against creditors, and third to declare bankruptcy!

The reason why the bypassing of competitive processes by government officials, often acting in congruence with some private corporations, labour unions, cooperatives, and/or social economy organizations, always ends up generating more costs than benefits is that the economy is a complex animal, characterized by distributed and diverse knowledge and interests that are typically not commonly known or public. Only competition and open and transparent competitive processes can unveil and usually master such an animal in a reasonable way most of the times in most situations. Even if, in theory, both competitive markets and bureaucratic planning and controls can or could achieve the same outcome, the former institutional framework has historically outperformed the latter by a significant margin. The reason for this is that the real world is plagued with imperfect and incomplete information, a context under which the competitive-market institutional framework is decisively more efficient.

Indeed, one of the most important modern roles of the governmental sector is to search for and implement innovative forms of market-like institutions when and where standard markets did not emerge, or do not exist for reasons that are, by now, relatively well known. Despite the existence of competition-based solutions, they may not always be clear, making their implementation quite difficult. Among other examples of such developments, without trying to create an all-inclusive list, one may refer to **(i)** the creation of markets for tradable pollution rights according to well-specified and newly-designed exchange rules, **(ii)** the creation of markets for derivative assets that were practically inexistent in the early eighties but now represent billions of transactions a day, **(iii)** the creation of market-like institutions for intellectual property rights such as patent pooling (not really a new form, but a rapidly expanding one), **(iv)** compulsory licensing of patents or copyrights with an associated competitive price-setting process, **(v)** limits to the fair use of and fair dealing with copyrighted published works, **(vi)** the setting of equitable remuneration for creators of original musical works and performances in the context of an increasingly digital world, **(vii)** access pricing and conditions to essential links of an otherwise proprietary network to competitors, and so on. In many such cases, the governmental sector has a very important role to play in making sure that the most socially-efficient (competitive) levels of trade between willing

buyers and willing sellers can be achieved. This implies that the cost of making transactions and enforcing their conditions be minimized and low.

5.3 FAVOUR THE CREATION AND DEVELOPMENT OF EFFICIENT COMPETITIVE-SECTOR ORGANIZATIONS (CSO) WITH A CAPACITY TO BID SUCCESSFULLY FOR PUBLIC AND SOCIAL GOODS AND SERVICES CONTRACTS

If a sound competitive process is to be implemented across public and social goods and services, it is necessary that, for any contract considered, there be a sufficient number of high bidders that create the necessary incentives for the bidding organizations to offer or accept the best possible contract terms from a social point of view. To do so, it is desirable that a government bureau be created with the responsibility of designing a whole set of policies that could encourage and support the creation and development of credible competitive-sector organizations, private corporations, cooperatives, not-for-profit organizations, social economy organizations, labour union collectives, etc., capable of bidding for governmental contracts.

Creating, supporting and promoting the development of efficient CSOs with a capability to bid in open and transparent call-for-tender processes will require a serious and profound understanding of the rules of a competitive-market economy and of the strategies to be developed in order to stand a chance of winning contracts. There are already significant business support resources around in the competitive sector, but a governmental sector policy towards the creation, support, and promotion of efficient CSOs is warranted, at least in the transition period, towards a full-fledged competitive social democracy. Such a policy would ensure a smoother transition, most notably for the necessary restructuring of many current public-sector entities into competitive-sector entities.

The creation and development of CSOs must be supported and encouraged at many different levels within the systems governing the production, distribution and delivery of public and social goods and services. At the present time, the competitive (private) sector is too often called to take responsibility for lower-level jobs in the public sector, such as cafeterias, laundry, and maintenance. But the most important gains are most probably in higher-level jobs and responsibilities, such as executive functions, accounting, legal services, professional services, human management, research and development, etc. I will discuss in chapter 6 some applications of the CSD model and

project with all the above functions undertaken by competitive-sector organizations under incentive contracts with the governmental sector.

5.4 PROMOTE THE EMERGENCE OF COMPETITIVE PRICES AND MECHANISMS (MARKET CREATION) IN ALL SECTORS OF THE ECONOMY, INCLUDING THE PUBLIC AND SOCIAL GOODS AND SERVICES SECTORS

Within our democracies, many organizations work in order to protect competitive mechanisms by making sure that markets function efficiently. The primary obstacle faced by such organizations exists in conceiving the proper framework that includes corrective measures when the pricing behaviour of participating organizations may, in reality, destroy or reduce the efficiency of competition. Generic policy #2 will allow, as shown above, for the strict control of such harmful behaviour. This difficult task proves even more complex when a government wishes to manipulate prices not for efficiency concerns, but in order to protect or favour some groups considered deserving, particularly vulnerable or of a particular interest with regard to some social aspects. For competitive social democrats, such a policy of manipulating prices is not an adequate solution and they will strongly oppose it in favour of more adequate policies.

Competitive prices are signals on relative scarcity of goods and services, in particular of public and social goods and services, on which individuals and organizations can plan not only their consumption and purchases but also their production efforts and investments. Unless such information is available and transparent, it is difficult for the general public to ascertain the value of investments and efforts to provide more value for the citizens. Innovation and creativity rest on the provision of information on relative scarcity to the different stakeholders in the production and distribution of public and social goods and services.

In general, policies to control or manipulate prices, directly or indirectly (through quotas, for example), above or below their competitive levels are always the product of decisions imposed on the poorly-organized general public by a misinformed coalition of legislators, businesses and union leaders exercising inordinate control over society's resources.

In the case of energy prices, for example, the result is always a poorly-oriented resource development policy that, based on price manipulation, benefits mainly the groups directly involved, while squandering the potential gains from a socially-optimal resource exploitation plan. This is a policy that will inevitably and inexorably lead to collective

impoverishment. The policy of low energy prices always ends up being financed by higher public debt and taxes, leading to a deterioration of social services, as well as infrastructures thereby impairing future economic development. It is not only an inefficient subsidy to big energy consumers, including both individuals and corporations, but also a regressive transfer from poor to rich. Commentators often hail the relatively low (manipulated) level of energy prices for helping achieve a high level of economic development. What that hides, however, is the real social cost of the policy. The real price of energy remains its opportunity cost, which could be significantly higher because it equals the maximum competitive price at which energy can be sold. The traditional response of special interest groups who gain from this policy is that everybody benefits from low prices. Nothing could be further from the truth. Distortions in price signals destroy potential wealth and in so doing hurt a majority of citizens, especially the poor.

The case of agricultural support is even more troubling. In most contemporary social democracies, agriculture and agrifood are heavily subsidized sectors, most often to the detriment of better food at lower prices for all citizens. The situation is due to well-organized interest groups whose political influence peddling is abnormally high. The channels through which political support is provided differ across regions and countries: direct financial subsidies, supply management or production quota systems, price floors, import restrictions (tariffs and/or quotas), etc. In all cases, the effect is similar: lower-quality product, less diversity, higher prices. If farmers and breeders were in need of special support for reasons that are absent from other industries facing economic difficulties and changing social and economic environment, then it would be better to explicitly determine the level of support and grant it directly in an incentive-compatible way without manipulating the price system. This way, the social cost of such support would be minimized while assuring its social benefits if any.

Similar analysis could be performed for education and health, which are sectors where the manipulation of prices creates socially costly distortions in the allocation of resources, to the advantage of special interest groups and to the detriment of social well-being. Such distortions benefit the rich and wealthy much more than they benefit the poor and needy. On this basis alone, they should, in fact, be opposed by competitive social democrats in favour of more efficient and equitable direct income and wealth support for the poor and needy, perhaps through the anonymity of income tax system.

5.5 FAVOUR MODULARITY, FLEXIBILITY, EXPERIMENTATION AND CHANGE THROUGH MULTIPLE SOURCING

Competition, modularity and experimentation are the key concepts of a competitive social democracy. They represent a guarantee of efficiency and effectiveness. Under these conditions, the governmental sector must take care not to allocate the totality of a contract or set of contracts to a single supplier, namely, the one proposing to undertake, produce, and/or deliver the good or service at the lowest cost. This policy, while somewhat counter-intuitive, is inspired by the model of procurement used by automaker Toyota. Known under the name of 'multiple-sourcing procurement,' it constitutes a basic process by which Toyota has gained and maintained superior competitiveness.

The underlying idea is as follows: to benefit from the advantages of market incentives even when it is necessary for the suppliers to undertake specific investments (a specific investment is an investment whose value depends in a significant way on the existence of the relationship between a supplier and its client) to reach an efficient production level and schedule. The problem of investment specificity is particularly important in the production and delivery of public goods and social services (specific physical investments as well as specific human capital investment).

The multiple-sourcing procurement applied in the production and delivery of public and social goods and services can be understood and can proceed as follows: during a first stage, the governmental sector has recourse to a competitive call for tenders to award a contract (that of education in the colleges for example). It is probable that, in spite of the explicit policy of encouraging the emergence of firms in the field, relatively few suppliers will be able to bid (let us say ten). An error to avoid would be to allocate the whole contract to the firm making the best bid to provide the service at the lowest price or at the best quality/price ratio. Indeed, this situation would closely resemble that which we know holds true in current public monopoly: competition, modularity and experimentation would be nothing more in such a case than a remote dream. Thus, during the second stage, the governmental sector must allocate and distribute the contracts to a relatively significant number of suppliers (the better tenders obtaining however the larger parts or shares of the contract set). The analysis and inspection, when possible, of the production and delivery methods used by the better suppliers will encourage other suppliers to increase their competitiveness upon observation. The governmental sector will thus give its support to different suppliers even if it does not have, in the short term, the direct financial interest to do so. Incentive mechanisms

could however be used so that the better suppliers would transfer their innovations without fear and with proper compensation.

The system of multiple-sourcing procurement will, in some cases, trade economies of scale for the implementation of a more efficient comparative evaluation (benchmarking) of the suppliers' performances and for the maintenance of a proper level of competition that guarantees, on average, lower prices and higher quality. In short, this system will guarantee that the production and distribution of public and social goods and services remain in movement, a perpetual state of flux if you will, and that it does not sink in the hands of a private monopoly.

The last three pro-competitive policies will foster the development of truly open competitive processes for the betterment of all in society. To achieve the goal of building a more innovative society based on competition, modularity and flexibility, experimentation and change, it is imperative that proper signals be sent to the stakeholders in order to guide their search for more efficient ways of producing and distributing public and social goods and services in energy, health, education and all other sectors. To do so, competitive prices and mechanisms must be promoted at all levels and in all sectors. Thus price controls must be abandoned in favour of market-determined competitive prices.

5.6 DEVELOP EFFICIENT MECHANISMS FOR BETTER ADAPTATION TO CHANGE

Innovations and the commercialization of new technologies, products and services are important causes of significant displacement, sometimes offshore delocalization, of economic activity and of abrupt depreciation, sometimes quick obsolescence, of capital, skills and competencies. A fundamental policy of the CSD model and project towards innovation and commercialization is to foster the creation and implementation of those tools and the means that will allow individuals, firms, and different levels of government, to efficiently manage risks and opportunities that innovation and commercialization-based volatility in the social and economic environment represent. To facilitate financial risk control, market solutions have been found via the introduction of a variety of insurance and derivative products that enable users to manage and trade risks. There is a need for new insurance-like and derivative-like products to help individuals, firms and different levels of government manage the risk of change, both in the displacement and offshore delocalization of activities and jobs, and in the abrupt depreciation and obsolescence of human capital.

A significant source of opposition by important subgroups of citizens to some socio-economic changes, even when such changes appear desirable from a social welfare viewpoint, is the absence of efficient mechanisms or institutions that could assist both individuals and firms / organizations in reducing their own direct cost of adaptation to such changes. When a society is, as a whole or in part, confronted with exogenous and endogenous changes in its socio-economic environment, its capacity to adapt, maintain, or increase its citizens' well-being depends on three factors: first, the capacity of its education sector to respond efficiently to industrial and social changing needs in terms of required skills and competencies of different types; second, the importance and efficiency of its R&D sectors to generate reactive new ideas, products and services; third, its flexibility to adapt to changes and its eagerness to take on new challenges.

This flexibility to adapt to a volatile environment must be a characteristic of all sectors producing and distributing private as well as public and social goods and services. Flexibility runs against inertia; inertia grows from fear; fear from change. Unless people are given the tools to manage such change, they will resist it in the economic and political arenas, at significant social costs. Resistance to change is in most, if not all, circumstances a very poor substitute to adaptation to change. But the level of social attitude and flexibility towards socio-economic changes will depend on the existence of institutions (tools and means; organizations and markets) allowing individuals, firms and different levels of government to efficiently manage risks, control their exposure to downside risks, and foster their exposure to upside opportunities, that volatility in the socio-economic environment represents. A proper set of risk-management mechanisms and institutions is necessary for a flexible society where innovation, both technological and organizational, thrives. Hence the need for a continuous effort to create and develop those institutions in the CSD model and project.

A society that is insufficiently innovative and insufficiently strong on the commercialization of new ideas runs the risk of being systematically and negatively affected by the innovation and commercialization efforts exerted upon it by the other societies with which it competes. To be successful at innovation and commercialization, a society must develop a higher ability to analyze risky prospects (e.g. via a more educated workforce in economics, business and finance) and favour a better exposition to structural factors, such as market size, enhanced competitive processes, and a lower reliance on poorly-designed and inefficiently-produced and distributed social protection programmes. Globalization and increasing free trade can ensure the first and second factors, while the CSD model and project can ensure the second and third factors.

The CSD strategy of developing efficient mechanisms for better adaptation to change must rest on a research and action agenda aimed at fostering a better understanding and better control of free riding, moral hazard and adverse selection, fostering a better understanding of the resistance to change, fostering a better understanding of the exogenous and endogenous depreciation, obsolescence of the human capital that is a significant impediment to innovation, and fostering a better understanding of innovation-prone institutions and organisations in order to favour their implementation throughout the economy and society.

5.7 PROMOTE DIRECT, TRANSPARENT AND INCENTIVE POLICIES OF INCOME AND WEALTH SUPPORT IN FIGHTING THE DEVELOPMENT OF DEPENDENCE BOTH FOR FIRMS AND INDIVIDUALS

The traditional maxim stating that it is better to help someone learn how to fish than to give him fish directly must apply to the programmes aimed to support the development of national firms through governmental subsidies, whether direct or indirect subsidies through tax rebates, sales of some input (energy for instance) at subsidized prices, and/or guarantees (loans, sales, accounts receivable, etc.). Firms must be induced (financially) to eventually become, sooner rather than later, independent of such subsidies as well as other forms of protection. It is imperative that the vicious circle of more subsidies leading to more subsidies be broken.

The same applies to individuals even if it is always much easier to give money to the unemployed than to provide someone with an incentive package for the maintenance or upgrading of one's competency capital so that dependency is avoided or broken early. Similarly, helping a poor person or a beggar by simply giving him/her money is the best way to encourage the development of poverty, which may serve those who, sometimes under the flag of political correctness but with inefficient humanitarian intentions, end up preying on poverty and poor people. What is needed is a good incentive program to induce the persons in need to get out of poverty by efficiently searching for employment and/or by acquiring the skills and competencies that are in demand by their fellow citizens. Such a good and efficient incentive program would include, besides short-term emotional and psychological help, a financing program for skill acquisition as well as the provision of a significant bonus in case of success. One way to achieve these objectives is to design an income-support program through the implementation of a negative income tax within an incentive-compatible income tax system.

In the politico-economic environment, questions are raised regarding governmental aid to private firms. It is not so much the support itself that is questioned, but the way it is offered in practice. A proper comparison of the ways and means used by different governments in different cases requires sophisticated analytical tools capable of determining their relative advantages and costs in volatile markets. Without a rigorous financial evaluation of the cost of government support, the different measures and policies are too often formulated, justified and contested by way of subjective and ill-founded arguments, a major obstacle to the sound quest for efficiency and transparency.

Since the activation of certain assistance measures or instruments often depends on contingent factors that may or may not occur in the future, it is difficult to evaluate the value or the cost of this assistance. The evaluation methodology of contingent claims and options is specifically designed to be applied in situations where uncertainty is important and pervasive and where the actual value depends on future events and on the optimal reactions to these events. I will come back to this later.

There is no policy sector or set of programmes as closely linked with the social democracy ideal as the support for the needy, the underprivileged, the maladapted, and the handicapped. The CSD model and project, based on one grand objective, namely, the optimized well-being of all citizens, and three specific objectives, namely, social cohesion, maximal growth, and economic freedom including the right to contest and challenge, require a specially-designed set of programmes for those disadvantaged citizens. What's in it for them?

As with education and lifelong learning and training aimed at fostering employability and at promoting flexisecurity, as with health, as with the infrastructures, and as with environmental protection, the CSD model and project promote an approach to supporting the needy that is efficient, effective, and establishes clear goals and strong incentives for the performance both from those in charge of the programmes for the needy and from the needy themselves. If the specific objectives of social cohesion, maximal growth and economic freedom are aggressively pursued, then significant resources must be earmarked for programmes intended for the needy. Such programmes are potentially quite profitable for society. Not only do we ensure this way that human resources are fully developed, but we also ensure that they are fully used.

In the CSD model and project, the governmental sector is responsible for answering the demands of citizens for public and social goods and services by designing programmes,

fixing objectives and developing an implementation strategy. This implementation strategy will call for competitive-sector organizations to bid for governmental contracts to put the policy into practice and ensure that the objectives are met at the lowest possible cost. That is, with as much resources as needed but as little resources as possible.

In the CSD model and project, minimum-wage laws would or might be abolished in favour of a direct supplement to earned income through incentive-compatible fiscal programmes. Such programmes would blend negative income tax credits for low-wage earners, progressively reduced towards a break-even point, and positive income tax afterwards up to a maximum. Moreover, to induce proper behaviour, lump-sum fiscal bonuses could be implemented for significant changes in taxable income at the low end of the income scale. This policy will go a long way to eliminate unemployment and to make the value of work, even at the bottom of the wage distribution, higher and socially more rewarding. The social importance of unemployment insurance and social aid programmes will dwindle, making low-skilled individuals and families better integrated in the social fabric and full-fledged contributors to the creation of wealth.

5.8 EVALUATE PUBLIC POLICIES AND PROGRAMMES ON A REGULAR BASIS THROUGH A RIGOROUS, TRANSPARENT, INDEPENDENT, AND CREDIBLE METHODOLOGY

It is common knowledge that all governments have a tendency to repeatedly create new programs that seldom exist long enough to undergo thorough evaluations. The CSD model and project are opposed to this short-term conception of politics and stresses that new programs must be confronted to rigorous and independent evaluations.

A strict policy of systematically evaluating (sunset clauses) all programmes must be put in place and be rather inflexible. The inflexibility of the evaluation timetable is a must if one wants to avoid the significant influence activity that could otherwise emerge in favour of the postponement of the evaluation and, in so doing, consume a non-negligible part of the resources allocated to the programme itself.

Not only must such a strict policy be announced, but the way it will be implemented is also of utmost importance. The methodology by which the programme will be evaluated must be the object of serious scrutiny and always be part of the evaluation itself. In this way, it will be open to criticism and one can expect that evaluation methodologies will improve over time. In order to achieve such a goal, evaluation must be outsourced whenever it is feasible to do so in such a way that the independence of the evaluator be

guaranteed. One such independent body could be a Council of Public Programme Evaluators, whose members would be knowledgeable in programme evaluation and named for a fixed term. But again, a high level of rigour in data collection and analytical methodology and overall transparency of the process must be guaranteed.

5.9 PROMOTE THE DEVELOPMENT OF E-GOVERNMENT IN ALL FORMS AND MANNERS TO ENSURE A SOUND AND EFFICIENT DEMOCRATIC PROCESS, BOTH IN POLITICS AND IN ECONOMICS

A sound strategy towards e-government must revolve around the use of information and communications technologies. The Internet, in particular, can foster better management of public affairs. Better management refers not only to doing usual things in a better more economical way, but also to change in a radical way how governments interact with citizens and how they conduct social and governmental business. Recent studies⁴⁰ show that e-government can contribute to higher efficiency through better (i) dissemination of information, (ii) coordination between policies, (iii) contribution to superior linkages between policies, (iv) implementation through appropriate instruments, and (v) contribution to the reinforcement of citizens' participation in the development of policies.

The use of advanced information and communications technologies in government relations with citizens can go much farther than simply ameliorating the administration of the government. It can make the administration of standard contracts more efficient and allow the use of more sophisticated contract forms for even larger efficiency gains.

One example is, among others, the use of combinatorial auctions procedures for the competitive allocation of contracts when scale, scope and/or network economies are present. **COMBINATORIAL AUCTIONS** allow bidders to bid on packages of items, such as municipal services (snow removal routes, maintenance of parks, water and sanitation systems, building security, trucking and bus routes as well as governmental and industrial procurement for different bundles of complementary items) in jurisdictions that are often adjacent.⁴¹ When there are complementarities between the different goods or services, bidders prefer to bid for contracts that cover not just separate items but rather sets or bundles of items. For this reason, bidders can lower their bids and economic efficiency is enhanced if bidders are allowed to bid on bundles or

⁴⁰ See in particular The E-Government Imperative (OECD 2003).

⁴¹ See, for instance, Peter Cramton, Yoav Shoham, and Richard Steinberg (editors), *Combinatorial Auctions*, MIT Press, 2006. See also multiple papers on such auctions on the website of CIRANO (<http://www.cirano.qc.ca>).

combinations of different services. Such auctions are typically run in multiple rounds as bidders must be able to create their own bundles and submit bids accordingly on the basis on the different current bids submitted at a given round.

Generalizing the use of such procedures could lead to significant cost savings at all levels of government but in particular at the municipal levels. The use of combinatorial auctions could lead to a much more efficient provision of municipal services by favouring a merger-like outcome, service by service. Given that the efficient scale of operation differs for different services, one can expect that such an outcome could achieve economic mergers without political merger; hence favouring higher levels of both economic efficiency and political democracy at the municipal level.

The use of advanced information and communications technologies, such as advanced combinatorial auctions, is also a significant instrument for implementing the right to economic contestation. The proper and efficient information of citizens is the best guarantee of achieving the respect of the right to economic contestation, or the right of citizens to contest the current providers of public and social goods and services and eventually replace them.

In the context of the CSD model and project, it would make sense for governments to promote open-source software in order to foster competition while, at the same time, ensuring the protection of intellectual property in software that is, in many cases, a primary condition for significant R&D developments. In their analysis of a sound government policy regarding open-source software, Boyer and Robert (2006)⁴² make recommendations to increase the efficiency of an e-government policy towards software development. They can be extended to the context of the CSD model and project as follows. **FIRST**, governments should promote open standards for software and avoid adopting proprietary solutions if the latter restrict competition and make them dependent on a single provider. **SECOND**, governments should avoid as much as possible granting exclusive commercialization rights for software developed under governmental contract. **THIRD**, governments should promote the use of open licenses that allow firms to use the open code to develop commercial proprietary applications (e.g. BSD licenses). **FOURTH**, whenever governments bring improvements to some open software, they should put such improvements in the public domain, except if security or confidentiality conditions prevent such action. **FINALLY**, governments should ensure

⁴² M. Boyer and J. Robert (2006), "The Economics of Free and Open Source Software: Contributions to a Government Policy on Open Source Software", CIRANO 2006-RP-03.

that competitive-sector organizations, including business-support organizations, are present in the open-source software field.

The 2002 declaration of the Danish Board of Technology in its report *Open-source software in e-government* is a good overall statement of this software-related aspect of a relevant e-government policy: “A strategy for e-government should not be based on a closed, proprietary standard in a key technology. The first reason for this is that it is unacceptable as a matter of principle for enterprises and citizens not to be able to choose between different suppliers of the software that is necessary to use the services of public authorities that are offered in the form of e-government. The second is that it is vital to the socio-economic cost-effectiveness of far-reaching e-government that a competitive situation can be established that ensures the presence of competing products. A condition that must be met for this to be achieved is that open standards are used.”

5.10 PROMOTE STRATEGIC ALLIANCES WITH DEVELOPING COUNTRIES OR ECONOMIES TO GET A HEAD START OR TO CATCH UP FASTER IN HIGHER VALUE-ADDED COMPETITION WITH ADVANCED ECONOMIES

Social democratic societies must find ways to strike alliances with better producers in developing countries in order to gain competitive advantages in competing with advanced countries and, in so doing, favour the development of emerging countries. With such a strategy, the latter countries will become prime allies as providers of key inputs (not only intermediary products but also new technologies, new products and new services) in the challenges launched by an advanced social democratic society to other advanced developed societies.

Rather than trying to compete, through ways and means that are more often than not opaque, biased and predatory, with the producers of the South for the production of products and services for which those countries can be relatively more efficient, it would be much more efficient for any given CSD of the North, aimed at generating well-being improvement for its citizens, to form alliances with countries and economies of the South, hopefully with competitive social democracies of the South, for the provision of those goods and services for which the latter have a comparative advantage. In so doing, the CSD of the North could compete more aggressively and efficiently with countries of the North in high value-added products and markets for which it may have a comparative advantage. We are told that electronics companies like the Japanese

Sharp and Matsushita are indeed developing industrial strategy in which high-level research is conducted in Japan and lower-level assembly farmed out to China and elsewhere. Several electronics companies have recently stepped up their spending in state-of-the-art factories at home, with the aim of developing hard-to-copy “black box” technology that relies as much on industrial secrecy as on patents.

Similarly, it is crucial to design policies that will strengthen the capacity to benefit from productivity, efficiency and well-being gains that the offshoring of services can offer. Among those, one can identify the following two.

FIRST, the temptation of protectionism must be avoided in spite of strong short-term demands expressed by different interest groups, as the economic reality of comparative advantage remains the best guide. In this vein, the development of countries and regions, such as China and India and soon Africa is a promise of significant world growth and should be welcome because it both raises competitive pressures in developed countries, thereby fostering innovations and growth, and allows a better and more intensive allocation of resources to high value-added products and markets, contributing to higher social well-being both for developed and developing countries.

SECOND, the design of public and social goods and services in the governmental sector must meet the important challenge of making the necessary job changes less burdensome and costly and even a source of satisfaction for most of those concerned. Incentive-compatible programmes of continuous skills development and maintenance are the key policy to implement. The skills challenge that social democracies are facing is not only significant but also rather poorly met as misaligned incentives make it difficult to ensure the continuous match between acquired and needed competencies. Hence the need for a new institutional arrangement to favour more directly and efficiently a better congruence between incentives for individuals to acquire and maintain a valued portfolio of competencies, incentives for higher education and lifelong learning and training institutions to provide the necessary skills development programmes, and incentives for firms and organizations to state their demands and needs in a more efficient and responsible fashion.

CHAPTER 6: ILLUSTRATIONS

The CSD model is ultimately a model of social organization based on the belief that social and public goods and services are essential to ensure economic growth and social cohesion. Among the necessary conditions for these social and public goods and services to generate the most benefits and optimize the well-being of all citizens, two are crucial in the eyes of the competitive social democrats: on the one hand, social and public goods and services must meet the needs of citizens and, on the other hand, they must be produced, distributed and delivered in an efficient and effective manner. The first condition will be met by the democratic electoral process and the second, by the systematic recourse to competitive processes, old and standard ones as well as new and yet to be imagined and created ones.

The objective of the CSD model and project is to foster a profound reorganization of the State's structure in order to meet those challenges. For this purpose, ten generic programmes and policies, which constitute the basis of a competitive social democracy, have been stated. These programmes and policies entail a truly provocative revolution, which can appear utopian and theoretical in the eyes of the sceptics. However, such is not the case and this chapter aims at convincing those sceptics of the feasibility and realism of the CSD model.

By looking in this chapter at eight important challenges, sectors or problems that have a direct impact on the well-being of citizens and in which the State is directly or indirectly a major actor, namely, education, employability, outsourcing and offshoring, innovation, healthcare, infrastructures, environment use and protection, and municipal services including public transit, I will demonstrate why and how competitive social democracy policies constitute a significant part of the solution to most if not all major problems and challenges that both threaten and undermine the future of our societies.

The fundamental challenges we face in the above sectors, problems and policies, if improperly solved, could break and dismantle the social fabric that our successful growth-enhancing and welfare-ensuring policies depend on. On the other hand, a successful solution to those challenges could propel social democratic societies to superior levels of achievements, such as the eradication of poverty and of abuse of all kinds, as well as a renewed sense of security, that is, a better world for all.

It is important to understand that this chapter does not claim to provide turnkey solutions for these sectors. The objective is rather to convince the reader, in very few

words, that the reforms proposed by the CSD model and project are not utopian dreams. Clearly, to make the model and project really operational, it will be necessary to invest significant resources to design the explicit processes in each sector and in each case, based on the four fundamental principles of the CSD model and project – the individual rationality, the power of incentives, the efficiency of competitive processes, the value of modularity and experimentation – and the ten generic policies and programmes discussed above in chapter 5. But the returns on such investments could be tremendous.

The eight domains, sectors or problems presented here are those where the production, distribution and delivery of social and public goods and services are paramount concerns. They are examples of sectors where the organizational microstructure of the design, decision and implementation processes matters quite significantly. There are, of course, other subjects of concern for citizens, the governmental sector, and the competitive sector, which are not discussed here. To name a few of those subjects, let us mention the following: public-finance topics, such as taxation, public-investment criteria, and public-debt management; immigration policy; foreign policy; security-policy topics, such as law, police and the army; etc. Those topics are important for the CSD model and project but they will, for all practical purposes, be left out of this book. However, the reader will be able to imagine, on the basis of the theoretical construct of previous chapters and of the discussion of the eight topics below, what the CSD model and project would imply for the domains, sectors or topics not explicitly covered.

Nevertheless, it may be useful to say a few words about the extension of CSD principles to taxation, public-debt management, and public-investment criteria. Regarding taxation and public-debt management, the CSD model and project require a profound revision of both. More efficient taxation would allow a significant overall reduction in taxation as consumption taxes replace most income taxes, as uniform taxation by broad income classes is implemented, and as the double taxation system of capital gains and dividends as well as the investment and capital taxes are eliminated, both for reasons of equity and reasons of efficiency.

As for public-debt management, the CSD model and project propose that strict and rigorous public-investment evaluation rules should be enough to determine the efficient level (borrowing and repayments) of the public debt. The level of the public debt must also take into consideration the possibility or probability that future generations will be significantly richer than current generations, as the latter are today significantly richer

than past generations. If that is the expected case, then contrary to credos and proposals by many contemporary commentators and observers of economics and politics, it may make sense for current generations to borrow on the higher capacity of future generations to repay the debt currently contracted, as current generations would like, if that were possible, to transfer resources towards past generations. Indeed, most of us today would agree that past generations should have borrowed much more to raise their relatively low living standards and should have, for the same reason, let us repay their debt from our higher incomes and wealth.

Our higher income and wealth levels today are in good part the results of investments by past generations in building production capacities and designing institutions that have increased significantly our own productivity when compared to their own productivity. In a similar manner, we must realize that our own investments in building further production capacities and designing even better institutions will or should increase future generations' productivity. Inter-generational transfers are potential factors of gains in social welfare for the same reasons that intra-generational transfers may be welfare increasing.

6.1 EDUCATION

Countries and regions must efficiently develop their stock of human capital in order to benefit fully from accelerated growth opportunities offered by the globalization of markets, the new information and communication technologies and the internationalization of cultures. This means that formal education, lifelong learning and training, and workers' competencies and employability are parts of an integrated human capital development process, a portfolio of social and public goods and services.

A majority of political parties worldwide have understood the importance of this reality and have begun to devote an increasingly significant part of their programs to education of both children and young citizens as well as to lifelong training of adult workers. Moreover, the quality of the education and lifelong learning systems, both on the demand side and on the supply side, is influenced by the systemic level of flexibility and security in the labour markets. Hence the joint discussion, here, of how those systems interact in the CSD model and project.

In spite of this generalized awakening, most countries are now confronted with multiple crises demonstrating important different faults in their education systems: quasi-illiterate students, graduates poorly prepared for the needs of labour markets, a relatively blocked social ladder, high levels of failure and large number of dropouts, and

relatively high levels of unemployment are only some sad examples of what the state of our current education and lifelong learning and training systems have led and still lead to. Nowhere is it more explicit than in countries where the youngsters dream of a secure job in the public sector!

The recent major conflict in France around the *contrat première embauche* (CPE) was in good part a fundamental criticism of the education system as a whole. Students, at least a significant number of them, declared that they were in favour of a more flexible labour market so that firms can hire more, but that it should be associated with a flexible social system allowing career development (a right to economic contestation?), vigorous investments in R&D, and highly performing education / training programs. Indeed, those programs should be significantly more adapted to modern society and labour markets and not simply deceptive decoys with the official discourse affirming the superior interest of the students while, in practice, the system is designed to favour the private interests of governmental officials and service providers, the latter regrouped in powerful professional and/or labour unions.

The situation is basically the same in many countries and regions, including social democratic ones: a poorly-designed governance system characterized by low-powered if not totally inexistent or counterproductive incentive schemes and inefficient bureaucratized allocation and coordination schemes, leading to a significant waste of resources.

Education and lifelong training have become a sector where the wasting of resources is ubiquitous, in particular in the formal education system as such. Excessive bureaucratic control, both between organizations and within organizations, implies poor reactivity to changes in labour markets and strong hostility to explicit, open, transparent, and credible evaluation of the performance of the system and its subsystems: those are characteristics of sclerosis-prone centralized systems. Competitive mechanisms stand a much better chance of success by making a broad central place to modularity, freedom (right to economic contestation), high-intensity incentives, and more efficient allocation and coordination mechanisms, thereby improving the likelihood of achieving success in improving the overall performance of the system. Education is a service that is too complex and too diversified, both in demand and supply, to be efficiently produced and distributed in a centralized fashion.

In the CSD model and project, the overall design and setting of performance objectives must be a prime responsibility of the State, while the production, distribution and

delivery of education and lifelong learning services are left to competitive-sector firms and organizations, appropriately induced to meet the objectives embedded in incentive-compatible contracts with the State, and in line with the first generic policy of the Competitive Social Democracy model and project.

Many commentators claim that the problems of the education sector could be solved by an injection of additional funds and resources. Competitive social democrats need not share that view as the difficulties of the education systems in our societies are not due, in general, to an overall macro-level lack of resources, but rather to an inefficient system of production, distribution and delivery of educational services. They rather insist that the organizational structure and delivery of the education system must be re-examined. It is necessary to reform existing models, often based on a co-management framework between governments and labour unions, whose interests come first, implicitly if not explicitly, before those of the children and students. A better use of the resources presently dedicated to providing education services to citizens could go a long way in solving the endemic problems of education systems.

In education, as in other social and public goods and services sectors, a better use of resources means and requires a more efficient division of responsibilities between the governmental sector and the competitive sector (policy number 1) and a systematic recourse to competitive processes and prices (policies numbers 2, 3, 4) to guide individual choices and social investments. It is necessary to rebuild the system differently.

In a CSD world, the whole educational-sector structure would be organized in a completely different way. The key words of this important, difficult, but feasible programme are competition, modularity, experimentation, obligation of results and performance, both in terms of efficiency, the measure of how close the outcomes and results are to the objectives, and effectiveness, the measure of how much resources are used to reach or deliver the results.

In the education sector, the objective is to provide, to all children and students, whether of school age or working adults, an education / training of quality. Consequently, students must find their central place within the organizational check-board. A new principle of equality must be applied. Equality in the field of education and lifelong learning does not consist in putting groups of twenty-five pupils in front of a teacher during a fixed number of hours per year. The equality, which must prevail, is not that of treatment but rather that of opportunities. The CSD model and project call for an

education system based on the equality of opportunity, which implies that a lower-quality social or family environment must be compensated by a higher quality of formal education resources. It is therefore necessary for us to rebuild the education system by taking into account the diversity of individual needs in achieving a common set of objectives.

Putting back the child and student at the centre of the debate does not imply that the other actors, such as teachers, will be replaced or downgraded. The CSD model and project recognize the essential role played by teachers as well as parents, medical personnel, psychologists and others in the evolution and education of the children. They also recognize the difficulties those actors face every day: violence, overloaded classes, and low wages among others. By setting up competitive and incentive mechanisms, the CSD model and project will reinforce the nobility of the teaching profession. The “good” well-motivated teachers who represent a significant majority will benefit from this organizational revolution. Those who are not and who haunt our schools, colleges and universities, will be induced to quit the system and to redirect themselves towards other fields. Those who may be victims of a system that has been inadequate for too long will find new opportunities to prove their competency.

The objective of the education and lifelong training system is a two-pronged one. First, to provide all citizens with the necessary knowledge that will enable them to contribute to a better society; second, to continuously prepare and support everyone to adapt to the changing reality of the labour markets. Firms want employees who have not only proper skills but also more basic capacities allowing them over time to acquire and to master new knowledge. Some see a conflict between those two objectives. The competitive social democrats do not. Indeed, firms and organizations do not want the education / training system to provide them with individuals who are simply “ready for employment.” They seek individuals who have knowledge of fundamental principles, allowing them to later acquire and master new knowledge, rather than simply applying the knowledge they have acquired by the time they become eighteen, twenty, or twenty-five years of age.

The existing education model based on a co-administration between the State and trade unions is fundamentally unable to fill these two objectives and many are those who await a reform: the CSD model and project can meet their expectations, not by specifying what the education / training system should be, but rather by identifying the processes by which it will come to life and adapt.

Let us now define the main features of this new organization. As for any CSD programme, the master words are competition, modularity, experimentation, obligation of results and performance. I will discuss mainly, and only scantily, the reorganization of elementary- and high-school education systems. It should however be obvious that the CSD ideas can and must also integrate sectors of higher education (colleges and universities) and lifelong learning institutions. The objective here is not to describe in any detail the full complexity of educational institutions. The model presented in the next few paragraphs is a simple illustration of the main ideas of the CSD model and project as they could be applied in the education sector.

The CSD model and project identify six main agents or actors: the children or students, the governmental sector, the competitive-sector suppliers of educational goods and services, the competitive-sector suppliers of ancillary goods and services (school catering, child-care, recreational activities, construction / upgrading and maintenance of facilities), the competitive-sector suppliers of control and evaluation methodologies and procedures, and the school integrator responsible for managing the interrelated responsibilities of the other actors.

The last four actors would operate under incentive-compatible contracts signed with the governmental sector (municipal, regional, or national) with the explicit objective of meeting the needs of the prime stakeholder, namely, the students. The architecture of such a model can be summarized as follows: the student must be educated or trained, formed, directed and evaluated under the supervision of the governmental sector by competitive-sector firms and organizations operating in open and transparent competitive markets. One could say that the CSD model and project would get rid of public schools as we know them now in favour of a competitive school system where competitive-sector organizations (private corporations, cooperatives, not-for-profit organizations, social economy organizations, organized labour-backed collectives, etc.) would compete to obtain the performance-based education contracts.

Hence, we would move from a system of low-accountability and low-performance public schools towards a system of strictly imputable (to students and parents), high-performance (payments made on the basis of objectives attained), publicly-financed (with possibly complementary private or personal contributions) competitive (private, cooperative, associative, etc.) schools, operating under limited-term incentive contracts with the governmental sector that remains ultimately responsible for the quality of the education system.

Before analyzing more explicitly the role of each actor, let us consider the financing of the education sector. Clearly, the efficient organization of the education sector is in part independent of the financing of the system. It is quite compatible with the CSD model and project that the financing of the system be ensured by the governmental sector. In such a case, the contracts would include the schedule of payments to the different competitive-sector organizations retained by the open competitive-tendering process. Alternatively, part of the financing could come from the users themselves, in particular for more advanced educational services (post secondary or university for instance) and lifelong learning and training services. In the latter case, it would be preferable that the governmental sector remain partly involved and pay the bonus payments for those providers who have attained and surpassed the objectives set. One important characteristic of the education and lifelong learning system under the CSD model and project would be the significant decentralization of the process: no more centralized labour contracts and no more uniform working conditions, but a strong equality of opportunities across all education levels and a full development and finely-tuned adaptation of individual and social human capital and competency potential.

The role of students evolves progressively throughout their schooling. At the beginning, their role is limited to consuming the educational services, which are offered to them by the educational sector under the supervision of their parents and the governmental sector. At a later age, the student's role will evolve from a passive consumer to a more active consumer: free to choose his way and free to criticize the education received. Let us note first that, in order to be free to choose one's way, it is imperative to be well informed of options; and second that, in order to be free to criticize the system, one must be reasonably confident that criticism may be potentially followed by concrete actions. There is no freedom to criticize if one cannot hope to induce changes. The CSD model and project guarantee the full exercise of these two freedoms by making the education sector more responsive to the needs of students through high-powered incentives for all providers of educational services.

The governmental sector has new responsibilities. The first one is to determine the quantity and quality of educational goods and services through the definition of competence thresholds that students must meet at different stages of their instruction or education. Only the objectives need to be given. The methods used to reach these objectives could be specified by competitive-sector firms and organizations in their respective bids, properly induced to deliver on their promises and commitments by incentive-compatible contracts. This will thus ensure an adequate level of modularity

and experimentation in the search for best practices. The second responsibility of the governmental sector is to manage contracts with those competitive-sector organizations within the education system. With these responsibilities, the prerogatives of the governmental sector will be numerous.

First, the government would set the standards for the personnel (teachers and staff), for the safety of the infrastructures, for the quality of the catering services, and for student care and assistance services. Second, the governmental sector will write and attribute contracts to firms. These contracts will integrate incentive mechanisms and their application will be subject to rigorous, transparent and regular control and evaluation. The contracts will be assigned to firms proposing the best services at the lowest costs. If firms outperform the objectives, they will receive important bonuses, but if they do not, they will be subject to special assistance to help them improve their performance or be sanctioned and, in the worst cases, be replaced as soon as possible. The school will then become the meeting place and lieu of exchange for all firms providing different services: teaching, students' supervision, teachers' support, facilities maintenance and upgrading, etc.

The tendering process will be carried out in a clear and transparent way in order to support the development of competition between competitive-sector firms in the education sector in accordance with the ten generic policies described before, in particular the third policy aimed at the promotion of open and transparent competitive mechanisms in the attribution of contracts for the production, distribution, and delivery of social and public goods and services, and the fourth policy aimed at the creation and development of efficient competitive-sector organizations with a capacity to bid efficiently for those contracts. This system will, above all, guarantee the quality of the goods and services offered in the education sector.

Organizations of the competitive sector in educational goods and services will be able to put forward and market their competencies on the vast education market. Let us consider a particular procedure (there could be others obviously) in order to better illustrate these ideas. Three "lines of business" within each school or institution could be assigned to competitive-sector firms on the basis of a competitive tendering procedure: the teaching and supervision services, the ancillary goods and services (school catering, security, recreational), and the construction / upgrading and maintenance of facilities. The competitive-sector organizations in these lines of business will be in competition

and the best will obtain a contract for a limited time of up to say five years. The obligation of results and performance will replace the obligation of means.

In order to ensure coordination within the school and to be able to clearly define the responsibilities of each partner, a single firm will be in charge of each line of business in any given school. The managers of these firms will be under the supervision of a fourth single supervisor or school integrator responsible for the overall coordinated performance of all suppliers. This integrator of services will necessarily be specialized in human resources and education management and will also be subjected to an incentive system of remuneration. This integrator will be responsible for the performance of the school or institution and will be able, in the event of failure by a partner service organization, to call upon other suppliers within a short time and to manage the relations between service providers in the best interest of the students. The integrator firm will be evaluated and compensated on this basis.

Facilities maintenance and upgrading firms as well as suppliers of ancillary goods and services (school catering, child care, sport and transport) already exist in the economy and they only need to be integrated into schools. Other (new) firms will be created from the supporting resources already existing in the education system. The largest sector will obviously be the education and supervision services sector composed of competitive-sector firms mainly made up of teachers but also of supervision and specialized services staff (psychologists, doctors, and other specialists). These firms will answer, as the other two groups of services as well as for the integrator firms, to competitive tendering processes launched by the government and will be subject to incentive contracts. The length of contracts will correspond to the complexity of the services.

The sixth actor will intervene at a more global level and will not be integrated into the schools or institutions. It will consist of firms in charge of three tasks. First, these firms will make sure that the standards, set by the governmental sector, are actually applied, whether they regard the personnel or the curriculum. Second, they will be in charge of conceiving methods and procedures (exams) that will allow an evaluation of the students before, after and throughout the length of the contracts. Third, they will be responsible for guiding the students towards the fields that are the most adapted to their interests and possibilities and that present the best career opportunities.

It is important that the education sector do not fall into the hands of too few competitive-sector organizations. With the objective to maintain competitive pressures,

a particular attention will have to be given to the redaction and the attribution of contracts. The CSD model requires setting up mechanisms that will encourage innovation. With regard to the contents of the contracts, various methods could be employed to support efficiency and effectiveness. Incentive mechanisms in terms of remuneration must be implemented in order to push the service providers to surpass themselves and beat other providers. The use of multiple-sourcing procurement mechanisms, together with an information gathering and sharing system, must be generalized in order to support competitive pressures and induce innovation, modularity and experimentation in the discovery of best practices. The negotiated contracts should not extend too much in time. The attribution of contracts of optimal duration will foster performance and avoid leaving a firm protected from competition during too long a period of time. The competitive-sector firms will understand that a bad evaluation of their services will lead to the cancellation of the contract and their replacement with better, more efficient organizations. With the modular architecture put in place, the threat of contract cancellation or non-renewal will be quite credible.

Let us briefly mention some of the major benefits that will arise from this new structure. The level of student supervision and counselling will not be identical in all schools. In order to properly educate students from underprivileged families and neighbourhood, the competitive-sector firms, subject to the obligation of results, will offer services that, depending on the specific needs of the students, will integrate more qualified and thus generally better paid personnel. In order to learn how to read, a child from an underprivileged family will need more supervision compared to a child whose parents have a high level of resources and education. This obvious fact cannot be denied any more and competitive mechanisms will naturally take this reality into consideration, hence contribute to the equality of opportunities.

The three different modules, which were identified above, are present in each school: each firm is a module that can be removed and replaced quickly, without affecting the two others. It seems likely that firms of various sectors will organize their activities in a modular way in order to reduce their production costs. Even under the general constraints of governmental policies and objectives (set in the contracts), competitive-sector organizations will have a lot of freedom in pursuing the goals they have been assigned and they are committed to. This freedom will undoubtedly result in many experiments as regards to teaching methods. Only diverse and specific locally-adapted methods can be an answer to the diversity of the student population. In summary, the

CSD model and project approach leaves a broad place to modularity and experimentation.

The competitive-sector firms in charge of providing educational and training services will manage the internal problems arising within their own group of professionals. It is unlikely that someone who has been teaching for thirty years the same subject under a wage policy that is based on seniority rather than quality, competence or performance will keep on providing good-quality teaching. Proper career planning and development should call for different contributions at different experience levels. Competitive Social Democracy will free the teachers from the administrative constraints that often prevent them from showing their true teaching capabilities. Experienced teachers will become senior partners of competitive-sector teaching firms. Wages and other contract clauses will no more be necessarily identical for all: the best teachers will be rewarded more, while the worst ones will be induced to leave the school and the firm. Appropriate incentive pay systems will foster updated and improved teaching both in terms of skills and curriculum.

As for instruction / education, the supervision will not be identical in all schools. The evaluations carried out before the tendering process by the responsible competitive-sector firms and the governmental authorities will make it possible for firms to evaluate the optimal level of supervision according to the level of incivility reigning in the establishment and not according to the number of students. In the underprivileged districts where violence is more pervasive, the new organizational system will make it possible to ensure the education and the safety of the students with the help of psychologists, doctors and security personnel necessary to meet the objectives and the obligation of results.

Parents often complain about the absence of teachers and about their mental fatigue. Once more, the rules within the educational contracts will make it possible to mitigate this important problem. The competitive-sector organizations will be required to have a reserve of high-quality teachers able to replace quickly their colleagues if necessary. The contract can set constraints for instance on the maximum number of days of absence without replacement but, more importantly, the obligation of results will make it in the best interest of the competitive-sector organizations to make sure that the development of students is protected from the unavoidable occasional fatigue problems of the teachers.

In short, the application of CSD policies will make it possible to educate our children in a better, more adapted, and more efficient way. Competition, freedom (including the right to economic contestation, that is, to replace if necessary the people and organizations responsible for the production, distribution and delivery of the educational services) and modularity, in line with the systematic application of the relevant generic policies and programmes discussed before, will be the tools which will make it possible to achieve this goal.

A SIMPLE FIRST STEP⁴³

Despite significant increases in public spending on primary and secondary education in OECD countries, concerns linger about both the efficiency and effectiveness of the school sector. In response to these concerns, governments around the world have introduced a range of strategies aimed at improving the financing and delivery of school-level education. These strategies have included reductions in class sizes, increases in teacher salaries, curriculum reforms and market-based reforms that involve the decentralization of education decision-making and encourage choice and competition.

One particular form of market-based education reform compatible with the CSD agenda that has become increasingly popular in recent decades is the decentralization of school management (also called school-based management). Decentralization of school management can take many forms and has appeared in a variety of guises in different countries. Among the most prominent examples of school decentralization have been the charter schools in several US states, the Tomorrow's Schools reforms in New Zealand, and Grant-maintained schools or their post-1998 successors, the Foundation schools, in the UK.

School-based management can be defined as the systematic decentralization to the school level of authority and responsibility to make decisions on significant matters related to school operations within a centrally-determined framework of goals, policies, curriculum, standards, and accountability.⁴⁴ School decision-making is often broken down into different domains, the four most important being personnel management (appointing and dismissing teachers, establishing salaries), financial resources (school budget formulation), student policies (disciplinary and assessment policies) and

⁴³ Adapted from Marcel Boyer and Norman LaRocque (2006), *Decentralization of School Management: Ideas from Abroad*, Montreal Economic Institute, February.

⁴⁴ Caldwell, Brian J. (2005), *School-based Management*, International Institute for Education Planning, UNESCO, Paris.

curriculum and instruction (course content and textbooks). Infrastructure development and maintenance as well as security are other domains of interest.

The main reason put forward to support decentralization is that those closest to teachers and parents are best placed to make decisions about how the school's resources should be organized to meet the needs of students and the wider community. In most countries, schools face a myriad of regulations, covering all facets of school operation – curriculum, enrolments, staffing, school operation and school governance. Such regulation can limit schools' ability to organize in the most effective way to meet students' needs and to offer performance-inducing work environments and incentive packages to teachers and administrators. The improved management and accountability of schools under school-based management can lead to improved education outcomes, such as increased test scores and reduced drop-out rates. Effective organization was found to be second only to student aptitude in determining achievement gains, hence more important than family influence. Moreover, school autonomy had the strongest influence on the overall quality of school organization.⁴⁵

Other potential benefits from decentralization include increased efficiency and innovation in the delivery of education, reduced education bureaucracy, increased responsiveness of schools to the needs of local communities, strengthened accountability and increased engagement with, and financial support for, schools. Increased self-management for schools is also an important part of any strategy for introducing greater choice in education – whether through the abolition of school zoning or the introduction of vouchers – because increased self-management provides public schools with the freedom required to compete amongst them and with more autonomous private schools.

Cross-country evidence from successive Progress in Student Achievement (PISA) studies suggests that education systems that devolve more responsibility to schools in areas concerning budget allocations within schools, the appointment of teachers, course offerings and disciplinary matters get better results. For example, data suggest that in those countries in which principals report, on average, higher degrees of autonomy in certain aspects of school management, the average performance in mathematics tended to be higher.⁴⁶ Similarly, in those countries in which principals report greater school autonomy with regard to choice of courses, the average performance on the

⁴⁵ Chubb, John E. and Terry M. Moe (1990), *Politics, Markets and America's Schools*, The Brookings Institution, Washington DC.

⁴⁶ OECD, *Learning for Tomorrow's World: First Results from PISA 2003*, Programme for International Student Assessment, 2004, p. 236, <http://www.oecd.org/dataoecd/1/60/34002216.pdf>.

combined reading literacy scale tended to be higher.⁴⁷ The OECD is careful to point out that correlation is not causality.

Decentralization in education has many different meanings and has been applied in a wide range of different contexts in both developed and developing countries. The introduction of school-based management or other forms of decentralization in education can be controversial – particularly in the early stages of implementation. However, it gains acceptance after a period of time to the point where few seek a return to a more centralized approach to school operations.⁴⁸ Decentralization is no panacea for improving education outcomes. To many supporters of market-based reforms in education, decentralization is only one of necessary reforms. However, if implemented carefully and with clear objectives, it can provide governments with a vehicle for achieving a number of policy goals, including increasing community ownership of schools, improving student learning outcomes, and providing more streamlined administration of the education system.

Let us reaffirm that, in a significant number of advanced countries, education and lifelong training have become a sector where the wasting of resources is ubiquitous, due to an abusive bureaucratic control, which generates a poor reactivity to changes and a strong hostility to the evaluation of the performance of the system. Competitive mechanisms, built around modularity, freedom, high-intensity incentives, and efficient allocation and coordination, stand a much better chance of success. Education is a service that is too complex and too diversified to be efficiently produced and distributed in a centralized fashion.

The overall design and setting of performance objectives must be a prime responsibility of the State, while the production, distribution and delivery of education and lifelong learning services could be more efficiently achieved by competitive providers, appropriately induced to meet the objectives embedded in properly-designed contracts between the providers and the State. A better use of the resources presently dedicated to education services could go a long way in solving the endemic problems of education systems. A better use of resources means and requires a more efficient division of responsibilities between the State and competitive-sector organizations and a

⁴⁷ OECD, *Knowledge and Skills for Life: First Results from PISA 2000*, Programme for International Student Assessment, 2001, p. 178, <http://www.oecd.org/dataoecd/44/53/33691596.pdf>.

⁴⁸ Caldwell, *op. cit.*, p. 6.

systematic recourse to competitive processes and prices to guide educational choices and investments.

6.2 EMPLOYABILITY

Formal education systems are only part of the system by which individuals acquire competencies that allow them to contribute to the best of their potential to social well-being. The other major part is the lifelong learning and training systems. Here the fundamental objective is to maintain the employability of workers, of all levels, of all ages, and for all trades and professions.

It is impossible to conceive a social project based on cohesion and economic growth without addressing the plague of unemployment and misemployment, a significant waste of society's resources. Indeed, it is safe to say that no country is safe from this phenomenon. Deregulation of labour markets – for example making it easier for firms to increase and decrease their labour force – is at the heart of the employment debate in OECD countries and elsewhere.

The CSD model and project seeks to address directly and reconcile the seemingly contradictory demand by firms for greater flexibility in managing their labour force and the demand by workers for extensive job security. Higher employment protection tends to reduce layoffs during economic downturns and thus increases job stability. This is likely to favour workers' effort and willingness to acquire specific human capital through in-house training. This may have positive implications for aggregate employment and economic efficiency.

However, higher employment protection increases labour-cost risk for firms and diminishes their ability to cope with a rapidly changing and volatile socio-economic environment. Hence, higher employment protection affects hiring decisions in periods of rising demand. Indeed, when deciding whether to hire new workers on permanent contracts, firms take into account the expected costs of possible layoffs in the future. This may make it more difficult for job seekers to find a job, thus favouring long-term unemployment. Stricter employment protection may also be a factor behind the rise in temporary contracts and part-time jobs observed in many OECD countries.

Stricter employment protection legislation reduces the risk of layoff but also makes the edge between non-employment and employment more difficult to jump over. Since employment protection legislation tends to reduce both dismissals and hiring, its overall impact on aggregate unemployment is unclear both in theory and in the empirical

evidence. This notwithstanding, the effects of employment protection legislation are likely to be different for different groups.

There are several dimensions to the concept of labour market security: stability in employment, the opportunity to find a new job quickly after a spell of unemployment or inactivity, and income security for those who are working or are looking for work. Employment protection legislation seems to contribute mainly to the first of these dimensions, namely, the stability of employment relationships. The other side of the coin is that job protection also tends to prolong the average spell of unemployment, thus contributing to one form of labour market insecurity. Second, there is no evidence that workers feel more secure about their job in countries where they are more protected against layoffs. Strikingly, not only does more stringent employment protection make temporary workers feel less secure, but it seems also to have a similar effect on the very workers that it is meant to protect. Unemployment allowances may reassure workers, while employment protection legislation may make them anxious.

The CSD model and project seek to develop, in a harmonious way, the three dimensions of the labour market security. This conception of the labour market is presently applied in some Scandinavian countries and is known under the name of *flexisecurity*. It is a way to foster labour market security while maintaining a sufficiently-mobile labour force. The Scandinavian model is very often regarded as simultaneously efficient and equitable.

Flexisecurity represents a policy strategy that can be defined as follows:⁴⁹ “[*flexisecurity*] attempts, synchronically and in a coordinated way, to enhance the flexibility of labour markets, work organization and labour relations on the one hand, and to enhance security – employment security and social security – notably for weaker groups in and outside the labour market on the other hand.” There exists however many variations of flexisecurity depending on the weight which is allotted to each of the two elements that make up this policy strategy.

Both for reasons of efficiency and social cohesion, and in congruence with its insistence on competitive processes to achieve social democratic objectives, the CSD model and project favour a weak legislation regarding employment protection but, at the same time, a strong policy towards employability and income security. For instance, in a CSD, fully-funded private and public pension plans will not only be favoured over pay-as-you-

⁴⁹ See T. Wilthagen (2002), “Managing Social Risks with Transitional Labour Markets”, in Mosley, H., J. O’Reilly and K. Schönmann, eds., *Labour Markets, Gender and Institutional Change*, Cheltenham: Edward Elgar.

go public ones, but they will be made fully transferable from employer to employer. Moreover, the administration of those plans will be more in the hands of the individual workers and will be managed independently of the firms or employers. This will favour more independence for workers by pushing forward a concept of global remuneration including, besides the wage part, such elements as pensions, holidays, health and social insurance, and days-off.

It is not possible to discuss, in detail, the content of the CSD employment protection system. This legislation must imperatively simplify the formalities associated with hires and layoffs, whether they occur for economic, technical or organizational reasons. With regard to the level of employment security, the CSD model and project favour more flexible labour laws together with important public support for job seekers. In this regard, the mechanisms of competition, modularity and flexibility, which constitute the pillars of the CSD model and project, will make it possible to limit the costs of this important public support. Indeed, the implementation of the policies and programmes of assistance to job seekers, which inevitably will be in strong congruence with lifelong learning and training programmes, will no longer be in the hands of the governmental sector.

The public organizations of assistance in finding employment will be replaced by firms specialized in lifelong learning, training, recycling, and placement of workers. Those competitive-sector organizations will find in their best interest, thanks to incentive-compatible contracting clauses, to provide high-quality services in the short- and long-term. Education and lifelong learning will inevitably be closely linked with this new market for assistance to job seekers. It is possible to imagine that each worker would choose to be affiliated with a lifelong learning and training competitive-sector organization in order to continuously be aware of the desirability of acquiring new competencies and/or maintaining one's competencies, as a self-protection strategy against significant spells of unemployment. Constantly in competition and financially encouraged to obtain high placement and success rates, these lifelong learning and training competitive-sector organizations will find in their best interest to provide services of high quality given the labour markets' demand for workers of different types. Once the financial incentive mechanisms put into place, the governmental sector will let those firms compete for governmental contracts by using and proposing lifelong learning and training methods that seem the most effective to them. The pursuit of generic policies and programmes will ensure an efficient level of modularity and experimentation to identify best practices. No centralized system of bureaucratic

commands and controls can achieve such objectives as efficiently as the competitive system that the CSD model and project would put in place. The main reason for that is by now well known: the quantity of information to be collected, handled and processed is so huge that any centralized system is bound to fail.

The CSD model and project will complement this competition between lifelong learning and training institutions and organizations that would be facing incentive-compatible contracts under which failing would be costly for them, with incentives mechanisms for the employed, job seekers and the unemployed to continuously acquire new skills and/or maintain their current market-valued skills.

With regard to employability and flexisecurity, the governmental sector will specifically carry out two major tasks: **(i)** It will design and set the standards and objectives for lifelong learning and training, will manage the incentive-compatible contracts with lifelong learning and training organizations; **(ii)** It will facilitate the transmission of information regarding employment opportunities, again through contracts with competitive-sector organizations capable to search and find this information and to manage and diffuse it in an efficient user-friendly way.

INCOME AND WEALTH CREATION AND REDISTRIBUTION

It bears repeating that the links between the creation, sharing and redistribution of wealth are complex but need not be in conflict, provided that certain determining factors are well understood. Clearly, the CSD model and project aim to integrate objectives of efficiency, effectiveness, and social cohesion and, in so doing, objectives of properly-understood wealth creation and redistribution.

Wealth creation and productivity growth do not just fall from the sky through divine providence but result from the actions, research and thinking of creators, innovators and entrepreneurs who succeed in producing more goods and services of greater value with the available resources in labour, materials and capital. Moreover, wealth distribution is much more egalitarian in developed countries and has become more egalitarian as the level of development has increased. Here is a reminder of some important facts. First, the share of labour compensation in the gross domestic product (GDP) is relatively stable; in Canada, for instance, it has remained close to 53% for several decades. Second, payment for work is just one of the income sources for individuals and households as they are actually company owners, when all is said and done. For example, the portfolios of corporate shares held by Retirement Funds belong to workers, who receive the dividends from them.

It is important to draw a distinction between the short term and the long term in the dynamics of income and wealth creation and distribution. At times of accelerated wealth creation, its distribution temporarily becomes less egalitarian before again becoming more so. New wealth at first accrues largely to those who are chiefly responsible for its creation. Then, the restructuring and reorganization of economic activities that follow make human resources more productive and result overall in wealth distribution becoming more egalitarian. Added to this, changes in the quality of human resources due to the development and acquisition of new skills raise productivity still further and favour an even more egalitarian sharing.

There exists a level of inequality in the sharing of income or wealth that enhances the well-being of everyone. There are two reasons for this. First, incentives for creativity, innovation and entrepreneurship are a fundamental and essential factor in economic development. They are derived largely from the fact that the fruit of these developments can accrue in the short term to those directly responsible for them, namely, the creators, innovators and entrepreneurs. This is the basis of intellectual property protection, in different forms, such as patents and copyrights. Second, for the results of this creation and innovation to be fruitfully applied and commercialized, highly-trained and highly-skilled human resources are required. At a time of accelerated wealth creation such as we are witnessing now, pressure on these resources pushes up their value compared to that of basic human resources with lower levels of skills and competencies in putting those new production technologies and organizational forms to work. This provides a powerful incentive to acquire such skills.

This phenomenon strongly suggests that wealth can be redistributed in an effective and sustainable way only through the adaptation of the portfolio of skills possessed by individuals, thereby raising their market value, that is, their value to fellow citizens. It is by establishing institutions and mechanisms promoting this continuous, rapid and orderly adaptation of skill portfolios that governments can best foster a proper connection between wealth creation and its responsible and motivating redistribution. The best way to redistribute wealth in a durable way is to promote the participation of each and every one in its creation.

6.3 OUTSOURCING AND OFFSHORING⁵⁰

OFFSHORE OUTSOURCING or **OFFSHORING** refers, in its general meaning, to a business procurement strategy, by which foreign suppliers of goods and services are retained in order to reduce costs and improve competitiveness. More specifically, the **OFFSHORING** phenomenon refers to services rather than goods and to the displacement of professional or business services jobs rather than manufacturing jobs from home-country suppliers or providers (including in-house procurement) to foreign ones. I consider here the latter more specific definition of offshoring. But it should be clear to everyone that there is a continuum of phenomena going from internal or in-house, home-country production or procurement of intermediate goods and services to home-country outsourcing of such procurement, to the displacement of such procurement to in-house offshore (subsidiary) business units, to offshore outsourcing of such procurement to foreign suppliers and providers. However, we must constantly keep in mind the two most important specific characteristics of the offshoring phenomenon, namely, that it deals with services rather than physical goods and that it implies a displacement of jobs from the home country to a foreign country rather than simply the creation of new jobs in a foreign country, although such new jobs created will be considered as offshored if they could have been created in the home country instead.

Because of the importance and significant growth of offshoring as well as the ongoing debate on its different facets, it is important to discuss it in the context of the CSD model and project.

Offshoring, or more precisely offshore outsourcing of business services, is a phenomenon that emerged and appeared on economic and public-policy radar screens with the significant increase in competitive pressures that resulted from mainly two phenomena: first, the rapid dissemination of information and communications technologies and the related movement towards deregulation in telecommunications, and second, the increasing liberalization of international trade and investment.

With the advent of these two phenomena, the globalization of services such as engineering, accounting, business consulting, and finance first appeared, followed by the whole sector of services, including health and education, which is now part of the offshoring phenomenon. This sector, whose products were first seen as quasi-non-

⁵⁰ Adapted from Marcel Boyer (2008), "The Design of Efficient Offshoring Strategy: Some Reflections with Links to SNC-Lavalin." Chapter 7 (50 pages) in *Proceedings of the conference, "Offshoring Outsourcing: Capitalizing on Lessons Learned,"* held at the Rotman School of Management, University of Toronto, Toronto, October 26–27, 2006. Edited by Daniel Trefler. Conference sponsored by Industry Canada and the Rotman School of Management. Available from: www.rotman.utoronto.ca/index.html

tradable, has been transformed by the new technologies and trade liberalization. A new wave of globalization has also recently emerged with a seemingly increasing transfer of white collar and high-skilled occupations offshore. From now on, professions such as engineers, medical doctors, teachers, and others, can be considered as potentially vulnerable to competition from abroad.

A variety of factors have increased the tradability of services over the years: trade and investments liberalization, which increased competitive pressures to minimize costs and improve productivity; technological advances in information and communications technologies, which made competitive pressures even more challenging; shortage of competencies (skills shortage) at the national level. Among those factors, globalization and trade liberalization as well as the expansion (development and adoption) of information and communications technologies (ICT) are probably the most significant factors behind the increase in competitive pressures and the rise in offshoring activity.

Offshore procurement, even in services, is not really a new phenomenon. It has existed for a long time and is only the prolongation of the portfolio of strategies pursued by firms in their continual search for efficiency and competitiveness, in particular those strategies directly linked to the concretization of their effective organizational limits: vertical integration, sourcing within their own internal network (insourcing), sourcing outside their internal network (outsourcing). It is the rate of its development that worries policy-makers. As if one realized suddenly that the “global village” (in services) was no more simply an image and a concept but a reality with which it will be necessary to compose effectively and quickly.

Offshoring results from a diverse set of factors, of which the most important ones seem to be the following. The increase in the intensity of competition in all fields and at all levels is translated into increased pressures and needs to reduce costs. The reduction of costs may be achieved by a more important recourse to offshoring. The cost reductions make it possible for firms to generate free cash flows to increase their capital budgeting for investments in new technologies aimed to increase productivity and raise quality standards. Offshoring makes it possible for firms to better face fluctuations in workloads through multiple technological spheres and offers a solution to skills shortage at the national level. Offshoring provides more expertise and capacity and thus flexibility to firms.

Thus the recourse to offshoring is not a simple question of costs. Other factors, as important and perhaps more important ones, such as the availability of special expertise

and the capacity-flexibility tandem, are often mentioned by firms. It is difficult for firms to innovate when budgets are burdened with maintenance costs of old, possibly obsolete technologies. Offshoring represents, in such a context, a lower cost avenue or opportunity for change and adjustment for quite a number of firms. Offshoring could make it possible for firms to improve the quality of their business (data-processing) applications, to increase productivity through better technologies (foreign providers), to obtain adequate skilled labour at the right time, and thus to transform higher fixed costs into lower variable costs.

Several anticipated potential impacts of large scale offshoring can be identified: increase in efficiency and effectiveness and reduction in production costs; greater economic efficiency and significant welfare gains, triggered by improvements in productivity and competitiveness, both in the country of origin and the host country; creation of new jobs and growth opportunities in the country of origin and the host country.

The offshoring phenomenon brings new problems, as much of economic policy as of political economy. It forces firms and all their stakeholders (employees, managers, shareholders, directors, suppliers, customers, and populations in the cities and areas concerned) to participate fully in the global economy, to be more aware of their overall competitiveness, and to seize the growth opportunities that the offshoring movement represents. At the same time, these developments translate into increasing demands for government interventions at several levels.

In line with the basic principles of the CSD model, public policies must encourage investments to enhance competitiveness by identifying appropriate incentive mechanisms to facilitate the adaptation of displaced employees. But they must be resolutely centered on the promotion of competitiveness and gains in GDP, absolute and per capita. The keystone is the promotion of the capacity to adapt through increased flexibility of workers and employees as well as of firms themselves.

Four growth drivers, adequately supported by CSD public policies, appear particularly important in this new environment: first, inventions, innovations and implementations of new ideas, new ways and means of production, new ways and means of organizing, both at the firm level and at the social and political levels; second, acquisition, maintenance and adaptation of professional competencies through an incentive-compatible protection against an abrupt unforeseen depreciation or obsolescence of competencies to favour a culture of change when needed; third, the key role of good governance of private and public businesses, as well as static and high-powered

dynamic incentive schemes; and fourth, a renewed model combining social democracy and competition through incentive-compatible social protection, maximum openness to trade, continuous search for renewed efficiency and effectiveness, modularity and experimentation in the production and distribution of public and social goods and services.

In order to benefit fully from the opportunities for productivity gains, efficiency enhancements and improvements in well-being that offshoring offers, the following CSD public policies should be enacted. First, avoid protectionism and remain committed to liberalization of trade in services as the economic reality of comparative advantage remains the best guide. In that vein, we should be happy with the arrival of major new trade partners, such as China, India and eventually Africa. Protectionism can certainly save some short-term jobs, but it is extremely likely to reduce later on both innovation and job creation of higher value added. The temptation to design policies aimed to identify and support “winners”, firms or sectors, is not only likely ineffective but especially dangerous considering the serious difficulty to correct errors in the long term. Second, make better use of granting rights of access to our natural resources in trade negotiations insofar as access to the resources becomes an increasingly important and crucial condition of economic growth. Third, promote better education and training of labour, centered on the capacity to take advantage of new employment opportunities. It is less the level of human capital that poses problem than its distribution by type of competencies. The reforms of education in the CSD model will guarantee benefits from such opportunities. Fourth, make changes of jobs, which are becoming a central preoccupation of citizens in all countries, less painful and even attractive for most. CSD public policies can help workers make such transitions through incentive-compatible programs. A possible example would be to implement an investment tax credit for the acquisition and maintenance of human capital.

Policies towards the offshoring phenomenon must first aim at avoiding the value destruction associated with a direct and hasty response to pressures from lobby groups asking various protection measures, which are likely to lead to unjustified delay till problems become insurmountable and require abrupt and expensive reactions. It is necessary to favour the development of policies (institutions, ways and means) that will facilitate continuous adjustments and to remember that small differences can generate significant benefits. Offshoring, if properly supported by CSD policies, can – sustain the virtuous circle: lower costs to increases in investments to increases in the intensity coefficient of capital, cost reduction.

A CSD offshoring policy compact must induce firms and their stakeholders to explicitly consider not only the cost-reduction possibilities (often the igniting factor) to enhance competitiveness but also the risk management imperatives, not simply the financial risks involved but also the organizational risks, in particular the moral hazard and adverse selection risks. Of course, in this matter there is no single solution or strategy to fit all situations or business environments. The designer of public-policy alternatives towards the development of offshoring activities should avoid the micro-management interventionist temptation that different interest groups may strongly demand. Public policy should rather insist on developing and implementing (competitive, real option) market mechanisms and management processes that will ensure that firms and their stakeholders are indeed making decisions towards global competitiveness in full knowledge of the risks but also the opportunities that an offshoring strategy might represent. One important but still largely unknown impact of the offshoring development is in terms of job creation, in the home country and the foreign country. By gaining in competitiveness, national firms can create more (high-valued) jobs locally by offshoring some jobs abroad. Offshoring can be a win-win phenomenon. In fact, unless it is mismanaged, it will be such a win-win situation if the proper risk management tools, both for individuals and firms, are appropriately assessed, designed and implemented in order to favour the necessary adaptation, both at individual and firm levels, to a new world economic environment. Such should be the main if not the only objective of the offshoring-related and relevant public-policy compact: by any standard, this should be a difficult but exciting CSD program.

6.4 INNOVATION

A fundamental difference exists between, on the one hand, adopting a new technology, proposing a “once in a lifetime,” “written in the sky” merger or acquisition, or commercializing a new idea or process, and, on the other hand, successfully implementing those changes and capturing the expected benefits. One cannot overstate the significant risks and uncertainties in the transformation process from one technology to another. Clearly, inventions and innovations are quite unpredictable and, once available, their adoption and implementation are even more intrinsically risky. The fact that many economists consider the processes of selecting, adopting, implementing and/or commercializing inventions and innovations, either technological or social or organizational, as the main engines of economic growth, makes the above observations even more challenging.

Numerous examples abound to illustrate the difficulty in recognizing the value of inventions and innovations, hence of implementing and commercializing them.⁵¹ Consider for example the case of the laser, which, besides its uses in measurement, navigation, chemistry, music, surgery and printing, has revolutionized, together with fibre optics, the telecommunications industry. Yet, after its invention at Bell Labs, it was not at first considered by patent lawyers to be valuable enough for the telephone industry to warrant a patent application. Similar stories exist for other major inventions, such as the telephone, the radio and the transistor. Western Union turned down the possibility of buying for a low price Alexander Graham Bell's 1876 telephone patent, considering that its long-term interest was to concentrate on the market for telegraphy, its core activity and market at the time.⁵² Marconi thought that his invention, radio, would be useful only where wire communication was impossible, such as in ship-to-ship or ship-to-shore communications. IBM considered leaving the computer business in 1949 because it estimated that the world market for computer would level off at around fifteen units. The inventor of the transistor thought that his invention might possibly be useful in improving hearing aids. There are an even larger number of examples where the difficulties of implementing a previously-chosen and adopted invention, innovation or technology have been misunderstood or miscalculated.

The above examples are a testimony of the difficulty of predicting future technological progress, itself an umbrella concept covering the adoption, diffusion, implementation and commercialization of both inventions and innovations, whether technological, social or organizational. There is no reason to believe that government policies aimed at identifying promising avenues and areas, in which we should concentrate our innovation and commercialization efforts, can be better at it and generate more value than simple common sense. But that is not to say that governments have no role in fostering innovation and commercialization. Quite the contrary, the prime role of governments in favouring an innovative, competitive and prosperous society is to make sure that high-powered incentive schemes as well as increasingly efficient coordination and resource-allocation mechanisms are present and fully operational throughout the economy and society.

Remarkably, relatively very little effort has been exerted to foster our understanding of the differences between inventing, adopting, commercializing, and implementing new technologies, products and services at the theoretical or practical levels. The risk and

⁵¹ See *The Economist* of June 18, 1994.

⁵² See http://www.porticus.org/bell/westernelectric_history.html

uncertainty involved in the transformation process from one technology to another and from commercializing new technologies, products and services, are different from and come in addition to the production uncertainty that economists have mostly studied.

There are two strands of the economic literature, which are relevant for a better understanding, and, therefore, a more suitable policy initiative favouring the efficient and profitable commercialization of inventions and innovations. One deals with the identification of the relevant factors underlying the decisions of firms regarding the adoption of new technologies, the other deals with the somewhat more-loosely-defined contributions to organizational inertia, the existence of significant resistance to change in firms, organizations, and society. As mentioned earlier, such resistance factors are basic elements of the adoption / commercialization process and may indeed be the factors which stand between the decision to adopt and the successful implementation / commercialization of the newly adopted technologies and of their associated new products and services.

Without going into too much detail, we can summarize the state of current knowledge on these issues as follows. Adopting the current best technology may turn out to be disastrous if future improvements in the technology make the earlier version obsolete quickly. A slower pace of adoption may be beneficial in volatile technological contexts. Moreover, not only is it important to adopt and commercialize valuable technologies, but it is also equally important to abandon the adoption process as quickly and as efficiently as possible if it turns out to be less profitable or promising than it appeared in an earlier phase. Adopting, diffusing or commercializing an innovation often requires a previous complementary investment in information gathering on the new technology. Typically, innovations are initially unfamiliar and hence characterized by subjective uncertainty, making learning processes quite crucial. The quality (precision) of information available affects significantly the decision to adopt / commercialize or not and the intensity of adoption and commercialization of a new technology when the process is divisible and significant risks are present. Firms face a difficult timing trade-off in their decision regarding the adoption and commercialization of technologies because the more advanced the new technology is relative to the firm's current technology, the greater its productive potential (if successfully implemented), but the smaller the firm's starting level of expertise in that technology as technological expertise is typically (or in good part) a specific organizational capital. The cost of adopting / commercializing a new technology typically declines over time and profit flows depend on the patterns of adoption / commercialization in the industry. Hence, price and entry regulations may

reduce the rate of technology adoption / commercialization by making pre-emption strategies less attractive. Conditional trade protection for national firms, which is bound to remain effective until the domestic firm adopts a new technology, whether in the form of a tariff or quota, always postpones technology adoption / commercialization because it reduces the relative cost of sticking to the current technology.

If firms are sufficiently flexible, for instance because of adequate surrounding institutions, more uncertainty about the market that the commercialization of a new technology could develop will increase the number of innovating firms. A more efficient, less costly and less subsidized, new technology implementation program within the market leading firm will induce lagging firms, in a value-maximizing move, to postpone the adoption / commercialization of some new technology. It may also induce the market leading firm to advance the adoption / commercialization of that technology, if the cost of capital is relatively high, that is, if capital market efficiency is relatively low. Similarly, the market leading firm may postpone the adoption / commercialization of that technology, if the cost of capital is relatively low, that is, if capital market efficiency is relatively high. A more efficient new technology implementation program within the market lagging firms will induce them to advance the adoption / commercialization of some new technology and thereby induce the market leading firm to postpone the adoption / commercialization of that technology. This results from the strategic impact of technology adoption / commercialization by one set of firms, either leaders or followers, on the complementary set of firms.

Much remains to be done to reach a complete understanding of the difficulties organizations and firms are facing in successfully implementing new technologies they have chosen to adopt and/or commercialize. Adopting / commercializing a new technology is often an irreversible decision, at least in good part, taken in environments or markets that are expected to grow but in a volatile way. Insofar as the firm has some flexibility to adapt its adoption / commercialization strategy to changing market and industry configurations, then the value of adopting / commercializing a new technology will be greatly influenced by the level of flexibility of the firm, and the more so, the more irreversible the decision is and the more volatile the environments or markets are. Hence, when firms enjoy more flexibility to adapt their adoption / commercialization strategies as the market and industry situations evolve – including the flexibility to stop the process and abandon the technology chosen or the new products and services offered – then a higher level of adoption and commercialization of new technologies will be observed in the economy.

The evolution of the market and industry situations need not be readily apparent to the firm. Indeed, the firm may have to put in place either an intelligence unit to dig and process the information that changes over time or develop a capacity to process the information that becomes publicly available. Both of these receptivity strategies may involve significant costs and benefits and their respective net value will be an important factor in the firm's attitude towards innovation and commercialization. We can identify this important flexibility-irreversibility-volatility factor as **THE REAL OPTION FACTOR**. The use of investment evaluation methodologies that ignore the potentially important source of value that real options represent or that evaluate them in an improper way could reduce significantly the estimated value of innovation and commercialization strategies and, therefore, reduce their adoption.

Some conclusions can be derived from the above (too quick) presentation of issues and review of the state of our knowledge. The low innovation / commercialization disease is diffuse, has many causes, develops and operates in ways that are still largely unknown. It is therefore essential that the development of a portfolio of micro-economic public policies towards innovation and commercialization be aimed at the underlying roots of the observed phenomena rather than at their symptoms or worse at their resulting or measured effects or observations. But that is easier said than done.

FIRST, the adoption / commercialization decisions and processes appear to be much more complex than suggested by the popular gurus. No single direct cure is available for the lack of innovativeness and/or lack of commercialization entrepreneurship. Beware of popular slogan-like superficial cures!

SECOND, the performance of a country in developing, adopting and commercializing new technologies, products and services is significantly affected by the quality of its skilled workforce in generating and processing the proper information on current best technologies and future ones. In order to properly assess the value-creating potential of new technologies, those currently available (to be implemented if chosen) and those to be developed (through original R&D programmes), firms must rely on a high-quality workforce (in technical, analytical and managerial skills) and on adequate analytical methods to measure the option value (flexibility of firms, irreversibility of choices, expected growth and volatility of markets) of those technologies. In this context, there is a clear need for a reassessment of the way we meet the skills challenge we face in this new worldwide economic environment characterized by the globalization of markets, with the associated increasing level of trade in both goods and services such

globalization permits and favours, the rapidly evolving communications and information technologies, with the increasing level of competitive pressures both in goods and services that such new technologies permit and favour, and the internationalization of cultures, with the increasing level of migration and population fluidity such a phenomenon permits and favours. The location of economic activity is significantly more footloose as a consequence of these developments, which identifies even more than before the quality of the workforce as the most important growth factor. It is imperative that higher education and lifelong learning institutional sectors fully grasp the implications of such movements.

THIRD, the performance of countries in innovation and commercialization depends on the institutional and social fabric that surrounds those activities. Unless innovation is really a promoted characteristic of that institutional and social fabric, it is unlikely that the country will succeed in staying ahead or simply abreast of its competitors. This is not simply a matter of more money poured into “innovation” but rather a matter of quality in incentives as well as in information and coordination mechanisms. Educational and business institutions are responsible for equipping citizens in major social-democratic societies with the skills required to face changing economic realities. As a result, all citizens face institutional risk if these social bodies, educational and business institutions, do not have the capacity, flexibility and incentives to adjust to their environments in a manner that supports the long-range goals of society and its citizens. How can we best manage such institutional risk is a critical challenge. The overall assessment of risk for a corporation or a society goes beyond a careful measurement and integration of the various risk components. Society expresses ethical concerns concerning purely market responses to environmental or biological risks. Firms feel more and more the need for greater social transparency in reporting the internal and external risks associated with their operations. Within the firm, incentive structures create their own sets of risks due to optimizing behaviour of stakeholders. The evolution of market structures through mergers and acquisitions is also a response to a certain risk environment but creates in turn new sets of risks. A good understanding of these complex issues needs careful investigations involving many fields of competence.

Two major elements of such institutional and social fabric can illustrate these ideas: the model of social protection and the regulatory policies, including the related competition policy. The model of social protection is a great asset, a great logo, a great trademark, which is not only improperly valued as a productive asset, as too much protection reduces responsibility and incentives, but also improperly produced and delivered in a

way that does not foster or promote innovations and efficient information and coordination mechanisms.

The pervasiveness of the social-democratic model of social protection is such that this fact, namely, the fact that its production and delivery is not only hostile to innovation but also produced and delivered inefficiently, even more so year after year, generates tremendous negative externalities throughout those economies and societies insofar as innovation and commercialization are concerned. Rather than being a significant source of spillover effects on innovation and commercialization in all sectors, the production and delivery of their model of social protection (not the model itself) operate as depressing factors on innovation and commercialization. Their citizens are invited, within the production and delivery of the model of social protection, to play the “administration and influence” game with its portfolio of influence strategies and activities in the political arena rather than the value-generating “innovation and commercialization” game in competitive markets. This leads to a general and pervasive state of needlessly low innovation and commercialization strategies and activities throughout social-democratic societies and economies.

It is necessary to become more efficient in delivering the social protection model. This can be done only through the introduction and implementation of competitive mechanisms (prices, auctions, contracts, competition policy for public services, competitive procurement system, etc.). The centrally-administered social protection system most social democracies have now is a major source of the innovation gap. Innovative ways to deliver the social protection programmes are discouraged by the centrally-controlled process of “commercialization” of new ways, new technologies, new products and services. Moreover, the significant barriers to competition and innovation that characterize the production and delivery of public and social goods and services in their social protection model send a major signal to their citizens, namely, that the government and its partners will take care of you so that you do not have to worry about the external world: a perfect low-powered incentive recipe for inaction and lack of competitiveness. The CSD model and project are bound to change such a stalemate state.

6.5 HEALTHCARE

Health systems not only represent the largest service sector in many countries but also constitute a crucial factor in the development of social cohesion and inclusion. Their efficiency, their impact on public finances, and their ability to meet the challenges of

medical advances, aging populations and rising life expectancy depend on creative policy approaches, both to control rapidly-increasing costs and to obtain the most out of the resources invested. The CSD model and project provide policy guidance on these matters.

Many observers and commentators, including at the forefront politicians, claim that the problems of the health sector and system could be solved by an injection of additional funds and resources. In many countries, elected officials are under significant pressure to increase the level of resources dedicated to the health sector. Competitive social democrats do not *a priori* share those claims. There are indications that the overall level of resources in the health sector cannot increase significantly as they already represent a major element of public budgets, not to mention private ones. Hence, it is difficult to imagine and credibly state that the level of resources can increase, at least as a percentage of total available resources (GDP).

It is rather the overall organization itself of the health system that must be re-examined. As for education, a significant majority of citizens would probably agree that it is necessary to reform existing models of healthcare delivery. Healthcare delivery is most often based on a co-management model where the interests of politicians, government officials and healthcare workers, both medical personnel professionals and others groups, highly- and strongly-protected by their powerful professional and labour unions, come before those of the patients and citizens.

The difficulties of health systems in our societies are not due in general to an overall macro-level lack of resources invested in health services but rather to an inefficient system of production, distribution and delivery of health goods and services. A better use of the resources presently dedicated to providing health services to citizens could go a long way in solving the endemic problems of health systems. In the health sector, as in other social and public goods and services sectors, a better use of resources means and requires a more efficient division of responsibilities between the governmental sector and the competitive sector (policy number 1) and a systematic recourse to competitive processes and prices (policies numbers 2, 3, 4) to guide individual choices and social investments in healthcare.

It is necessary to rebuild the system differently. In a CSD world, the whole structure would be organized in a completely different way. The keywords of this important, difficult, but feasible programme are competition, modularity, experimentation, obligation of results, and performance, both in terms of efficiency (measuring how close

the outcomes and results are to the objectives) and effectiveness (measuring how much resources were used to reach or deliver the results).

Policy-makers in OECD countries are under increasing pressure to improve different facets of health systems. Patients are demanding healthcare that better responds to their needs and preferences, as illustrated by the fact that waiting lists for surgery are a pressing public-policy issue in most OECD countries. Shortfalls in healthcare quality - such as long waiting lines in emergency rooms, failures to provide needed services, and errors in healthcare delivery - result in unnecessary deaths, disability, and poor health, and add significantly to social costs. Disparities in health and access to care across income groups or other dimensions do persist within many countries in spite of an array of public policies aimed at reducing disparities in access.

Responding to demands for better healthcare can increase cost pressure at a time when health spending is already climbing at a significant rate, steadily increasing the share of total resources dedicated to healthcare. Even so, spending more is not necessarily a problem, particularly if the added benefits exceed the additional costs. Since three-quarters of health spending in OECD countries is publicly financed, rising costs increase the pressure on governments to contain costs and force them to divert resources from other priorities. Modest co-payments can relieve public-financing systems, but are no magic bullet, partly because vulnerable populations must be protected to avoid restrictions and more disparities in access that could be costly in the long run. Competitive health insurance can increase consumer choice and the responsiveness of health systems, but has not provided much help in reducing public spending, due to overwhelmingly complex interactions between the traditional public and private sectors. Well-designed governmental sector guidance and intervention, in part through subsidies and regulation, are critical if equity of access and financing is to be assured. Ultimately, increasing the effectiveness and efficiency of health systems is the most promising response to pressures to contain costs while improving performance. The CSD model is the organizational solution, thanks to the integration of competition, modularity and experimentation that will enable a more effective and efficient use of resources allocated to healthcare.

Let us begin by identifying the principal factors causing the expenditure growth in healthcare. The first one seems to be the aging of the population. The reasons why age and healthcare spending are linked are not hard to fathom. Older people consume far more healthcare resources than the young, particularly at the end of life – various

studies have shown that health costs in a person's final year can be six or seven times higher than just two or three years earlier. The higher cost associated with aging (and dying) is particularly apparent when it comes to drugs: average costs for men aged 65-74 are more than 18 times the average costs of those aged 15-24. Hospital costs show a similar profile.

But, overall, the aging of the population is only expected to account for about half of the anticipated increase in health expenditure. Other factors also play a role. First, medical care is a superior good and, therefore, growth in income or GDP favours an increase in health expenditures at all ages and for all social groups. Second, the increase in the costs of new drugs and treatments is in good part due to advancement in knowledge and new technology that expand the treatment possibilities available to the population rather than simply act as a (better) substitute for older drugs and technology. Such treatment expansion allows the treatment of more people, more problems, for longer periods, thereby allowing for a healthier population but at a significantly higher cost. Therefore, the uptake of new technology in the healthcare sector, unlike in other sectors of the economy, is in part responsible for cost increases rather than decreases. The third factor is of a different type. It relates to the organization of healthcare, which has been designed at a time of different demographic structures, different relative prices for goods and services, and of a relatively larger (less educated, less informed) population in need of social and health protection. But times have changed.

As we have seen before, most governments are facing growing scarcity of resources necessary to meet society's healthcare demand, forcing the public and the non-governmental sectors to review their roles and responsibilities. The CSD model and project solution implies a reorganization of the responsibilities of the different stakeholders in healthcare, which will necessarily lead to a redefinition of the equilibrium between the governmental sector and the competitive-sector organizations including the traditional non-governmental sector, such as NGOs, not-for-profit, as well as social economy and community organizations.

The participation of non-governmental or competitive-sector organizations as healthcare providers is very controversial. This controversy often derives from the fact that the term "privatization", which raises fears in some circles, is sometimes used incorrectly to describe nothing more than delegated management and multiple sourcing. Indeed, privatization can have many meanings and it corresponds sometimes to the auctioning of governmental responsibilities. In other cases, it means

subcontracting certain services or functions to the competitive sector in order to increase productivity or flexibility. In this latter case, the governmental sector maintains ownership and responsibility for the quantity and quality of goods and services offered, even if they are contracted out to for-profit or not-for-profit competitive-sector organizations. In still other cases, the term privatization is interpreted as equivalent to the increase in the financial burden of individual patients.

All of these interpretations have led the debate in the wrong direction. First of all, it is important to underline the fact that there exists no health system that is entirely competitive or public in the world. These expressions are mere shortcuts. For example, in the only system within OECD countries that is defined as being “private”, namely the American system, public funding represents 46% of all expenditures, compared with 74% for OECD countries as a whole. If direct personal expenditures, in currency or in kind, were added to this comparison, the percentage of public spending would be (much) lower. Every health system displays varying degrees of partnerships between the public or governmental sector and the competitive sector. It is also important to keep in mind that public resources are themselves competitive: they come from citizens’ competitive pocket! Therefore, it is preferable to abandon the sclerotic debate leading to a useless confrontation regarding public versus private ownership of facilities and public versus private delivery of healthcare goods and services. What is at stake is the proper understanding of the respective roles of public /governmental and competitive / non-governmental organizations and how they can be adapted as different ways and means harnessed to pursue the ultimate objective of increasing the well-being of all members of society.

Which policies should be implemented in order to improve the accessibility and the quality of healthcare services? The first desirable characteristic of a healthcare system is arguably its capacity to answer, as adequately as possible and at the right time, the healthcare needs of individuals. To achieve these goals of accessibility and quality, the policies to be applied are many: it is necessary **(i)** to maintain integrated primary healthcare services accessible at all times; **(ii)** to ensure a sufficient, adequately qualified and geographically well-distributed workforce; **(iii)** to regularly re-examine, widen or restrict the respective roles of the different healthcare professionals; **(iv)** to intensify the research efforts in the healthcare field, not only on new technology and new drugs but also on new organizational structure; **(v)** to update training programs of all medical personnel; and **(vi)** to widen the accessibility of information to patients and experts.

These policies do and will undoubtedly be unanimously approved not only by the experts but also by the population. The question is: How can we manage to put them in place? The answer of the CSD model and project is as follows: It is necessary to reorganize the healthcare system by integrating more competition, modularity and experimentation. It will not be possible in these few pages to go into any detail. However, some facets of the CSD revolution can be presented.

Before analyzing more explicitly the role of each actor and each group of stakeholders, let us consider the financing of the health sector. Clearly, as for the education and lifelong learning sector, the efficient organization of the health sector is in part independent of the financing of the health system. It is quite compatible with the CSD model and project that the financing of the health system be ensured by the governmental sector. In such a case, the contracts would include the regular schedule of payments to the different competitive-sector agents or organizations retained by the open competitive tendering process. Alternatively, part of the financing of the health system could come from the users themselves, in particular for some basic health services.

It may be efficient to ask patients to cover the costs of their use of primary care services, visits to doctors' offices, and small ambulatory surgery. The costs of such uses of health services could be income-tax deductible, fully for low-income households and partly so for higher-income ones. Standard income- and wealth-support policies would take care of those households in dire financial situations, without having to design the whole health system with those households in mind. Whatever the payment system chosen, it would be preferable that the governmental sector remain partly involved and pay the bonus payments for those providers who have attained and surpassed the objectives set. One important characteristic of the health system under the CSD model and project would be the significant decentralization of the process: no more uniform working conditions, no more centralized labour contracts, and no more governmental officials negotiating or dictating specific salary conditions for health professionals and supporting staff, but a strong equality of access across all income, wealth, and social groups.

As for the education sector, the CSD model and project identify six main actors or agents in the health sector: the patients or the intended population, the governmental sector, the competitive-sector organizations providing healthcare goods and services, the competitive-sector suppliers of ancillary goods and services (catering, patient-

supporting care and counselling, other patient-related activities, and development, maintenance and upgrading of facilities), the competitive-sector suppliers of control and evaluation methodologies and procedures, and the integrator responsible for managing the interrelated responsibilities of the other actors.

The last four actors would operate under incentive-compatible contracts signed with the governmental sector (municipal, regional, or national) with the explicit objective of meeting the needs of the patients or, more generally, the intended population. In the next paragraphs, I consider the case of patients but they could clearly be adapted to other groups of healthcare beneficiaries. The architecture of such a model can be summarized as follows: the patients would be taken care of and cured if possible under the supervision of the governmental sector by competitive-sector firms and organizations operating in an open and transparent competitive market. Let us analyze more explicitly the role of each actor.

The role of patients evolves progressively throughout their cure. At the beginning, their role is limited to consuming the health services, which are offered to them by the health sector under the supervision of custodians, if any, and the governmental sector. Later on, the role of patients becomes more active as they become more and more directly responsible for improving and maintaining their health status and properly induced to do so. But to be able to bear such responsibility, the patients must be well informed of their options. The CSD model and project guarantee the full exercise of this responsibility based on a healthcare-related information and incentive system, which is a basic ingredient of a better health system as a whole.

The governmental sector would accept new responsibilities. The first one is to determine the quantity and quality of health goods and services through the definition of proper health thresholds that patients must meet at different stages of their cure and recovery. Only the objectives need to be given. The methods used to reach these objectives will be specified and chosen by competitive-sector firms and organizations in their respective bids, properly induced to deliver on their promises and commitments by incentive-compatible contracts. This will thus ensure an adequate level of modularity and experimentation in the search for best practices, both for acute care and for recovery activities.

The second responsibility of the governmental sector is to manage contracts with those competitive-sector organizations within the health system. The different institutions (hospitals, health clinics, doctors' offices) will then become the meeting place and lieu of

exchanges for all firms providing different services: healthcare, maintenance, upgrading, patients' supervision, personnel support, etc. With this responsibility, the prerogatives of the governmental sector will be numerous.

First, the governmental sector will set the standards for the personnel (doctors and different staff groups), for the safety of the infrastructures, for the quality of the ancillary services, and for patient assistance services. This system will guarantee the quality of goods and services offered. Second, the governmental sector will write and attribute contracts to firms. These contracts will integrate incentive mechanisms and their application will be subject to rigorous, transparent and regular control and evaluation. If firms outperform the objectives, they will receive important bonuses, but if they do not, they will be subject to special assistance to help them improve their performance and/or be sanctioned and, in the worst cases, be replaced as soon as possible. The contracts will be assigned to firms proposing the best services at the lowest costs. The tendering process will be carried out in a clear and transparent way in order to support the development of competition between competitive-sector firms in the healthcare sector in accordance with the ten generic policies described above in chapter 5, in particular the third policy aimed at the promotion of open and transparent competitive mechanisms in the attribution of contracts for the production, distribution, and delivery of social and public goods and services, and the fourth policy aimed at the creation and development of efficient competitive-sector organizations with a capacity to bid efficiently for those contracts.

Organizations of the competitive sector in healthcare goods and services will be able to put forward and market their competencies on the vast healthcare market. Let us consider a particular procedure (there could be others obviously) in order to better illustrate these ideas. Three "lines of business" within each healthcare institution could be assigned to competitive-sector firms on the basis of a competitive tendering procedure: the healthcare *per se* services, the ancillary goods and services (catering, security, support, administration), and the development, maintenance and upgrading of facilities. The competitive-sector organizations in these lines of business will be in competition and the best will obtain a contract for a limited time of up to say five years. The obligation of results and performance will replace the obligation of means. In order to ensure coordination within the healthcare institution and to be able to clearly define the responsibilities of each partner, a single firm will be in charge of each line of business in any given institution. Each competitive-sector organizations retained within the institution will have a director in charge of its activities.

These directors will be under the supervision of a single competitive-sector organization responsible for the overall healthcare institution supervision and direction, that is, for the integration of all suppliers. This supervisor (firm), as integrator of services, will necessarily be specialized in human resources and healthcare management and will also be subjected to an incentive system of remuneration. This integrator will be responsible for the performance of the institution and will be able, in the event of failure by a partner service organization, to call upon other suppliers within a short time and to manage the relations between service providers in the best interest of the patients. The integrator firm will be evaluated and compensated on this basis.

Maintenance firms and suppliers of other goods and services (catering, patient care, security, and administration) already exist and they only need to be properly integrated into healthcare institutions. Other (new) firms will be created from the human resources already existing in the healthcare sector. The central competitive-sector firm(s) in any institution will obviously be those of healthcare professionals, such as medical doctors, nursing personnel and other professionals. Those competitive-sector firms will be composed mainly of doctors and other medical professionals but also of supervision and specialized services staff (such as psychologists) and some administrative staff. These firms will answer, as the other two groups of service providers as well as the integrator firms, to competitive-tendering processes launched by the government. They will all be subject to incentive contracts. The length of contracts will be positively correlated with the complexity of the services rendered.

The sixth actor will intervene at a more global level and will not be integrated into healthcare institutions. It will consist of firms in charge of two tasks. First, these firms will make sure that the standards, set by the governmental sector, are actually applied, whether in regard to personnel or procedures. Second, they will be in charge of developing methods and procedures (tests) that will allow an evaluation of the services rendered to the patients throughout the length of the contracts.

As for the education sector, it is important that the healthcare sector do not fall into the hands of too few competitive-sector organizations. With the objective to maintain competitive pressures, a particular attention must be given to the redaction and the attribution of contracts. The CSD model requires setting up mechanisms that will encourage innovation. With regard to the contents of the contracts, various methods could be employed to support efficiency and effectiveness. Incentive mechanisms in terms of remuneration must be implemented in order to induce healthcare service

providers to surpass themselves and be better than other providers. The use of multiple-sourcing procurement mechanisms must be generalized in order to support competitive pressures and induce innovation, modularity and experimentation in the discovery of healthcare best practices. The negotiated contracts should not extend too much in time or in space. The attribution of contracts of optimal duration will foster performance and avoid leaving a firm protected from competition during a too long period of time. The competitive-sector firms will understand that a bad evaluation of their services will lead to the cancellation of the contract and their replacement with better, more efficient organizations. With the modular architecture put in place, the threat of contract cancellation or non-renewal can be made quite credible.

6.6 INFRASTRUCTURES

The “common infrastructures” constitute, in several ways, the skeleton of the economic and social body of our societies. They are the virtual or physical networks, on which depend the performance and competitiveness of societies and institutions and, consequently, the well-being of all citizens. They include, among other examples, those networks ensuring the proper information gathering and processing as well as communication and transmission capacity (Internet, telecommunications of all types, broadband capacity, and high-performance software), the transportation and distribution of energy (electricity grid, pipelines), the transportation of persons and goods (road system, public transit systems, railways, airports, seaports), the provision of drinking water and the treatment of used water, as well as the financial system (payments, netting, financing of firms and organizations, financing of investments and consumption by households).

Indeed, infrastructures play two major roles in our economies: on one hand, they provide essential services that are the basis not only of productivity gains but also of poverty reduction (drinking water, electricity, mobility), and they trigger important positive externalities in all sectors of economic activity by facilitating the link between various individuals and various activities and markets, favouring social cohesion and inclusion. These positive externalities are distributed across all sectors of society and the economy through various channels related to the dynamics of demand and supply. High-quality infrastructures are fundamental factors of productivity gains and increases in social well-being as they reduce transaction costs, shrink distances, and facilitate cultural and economic exchange between individuals, as well as trade between regions and countries. They also allow different economic actors to satisfy new demands in new

places and favour the transformation of non-profitable activities into lucrative ones while increasing profit margins of existing activities. Common infrastructures are the genitors of the global village.

In spite of their diversity, infrastructures all share common characteristics. First, they are highly capital intensive. Second, they are in many circumstances partial public goods, not only when they lead to non-rivalry consumption (when the use or consumption by some consumers of the services they provide decreases neither the quantity nor the quality of the services available for other consumers) but also when they are subject to a non-excludability situation (when it is not possible to exclude a consumer who would refuse to pay for the services consumed). Third and most importantly, they have design characteristics that make them particularly well suited for governmental sector regulation, in particular regarding standards. There may be different railway companies whose railcars could run on different railway systems owned by different companies, but significant efficiency gains can be obtained if all railway systems are compatible (same railroad gauge, same resistance). A similar argument can be made for telecommunications systems, road and seaports systems, and financial systems.⁵³ In the case of financial systems, considered as common infrastructures, the mode of intervention and the respective roles of the governmental and competitive sectors must be the subject of a specific analysis that I will not conduct here in order to concentrate on physical infrastructures.

The role of the governmental sector in the design of infrastructure systems is paramount even if, in some cases, industry-level cooperation can and sometimes does achieve similar results. Hence, the CSD model and project call for the governmental sector to be ultimately responsible for the design of common infrastructures and call for the competitive sector to be ultimately responsible for their development/construction, maintenance and operation. Why such a separation of responsibilities? The CSD model and project propose an approach based on an increased reliance on competition processes in order to achieve better quality at lower costs. The model leaves a significant and central role for the governmental sector by striking an optimal combination between the resources and key competencies of the governmental sector and those of the competitive sector. Since common infrastructures constitute key instruments to achieve the goals of a competitive social democracy, since they are

⁵³ In the case of financial systems, the role of the governmental sector is channelled through the central bank whose responsibility is to actively promote safe, sound, and efficient financial systems, both within the country and internationally, by conducting transactions in financial markets in support of these objectives.

highly capital intensive and of vital importance, and since they allow for a redistribution of wealth, for lower level of poverty, and for higher levels of social cohesion and inclusion, a significant effort towards their efficient development is warranted. This efficient development calls for a transparent and incentive-compatible governance based on a division of responsibilities between the governmental sector and the competitive sector: better design under or by the governmental sector and better implementation by the competitive sector.

The range of public infrastructures, going from local and municipal infrastructures to major regional and national, even international infrastructures, is very vast and requires differentiated interventions. Let us consider first municipal public works, such as the construction and servicing of municipal roads and sidewalks and the development and maintenance of water distribution or sanitation systems. The approach suggested by the CSD model and project consists in giving the municipal sector authorities and senior civil servants the responsibilities to determine the design of the works to be carried out as well as to manage not only the call for tender mechanisms regarding the construction and maintenance by the competitive sector of the infrastructure considered but also the writing and administration of the contracts themselves.

For maximum efficiency, it would be better in most cases that each “phase” of the construction and maintenance be awarded to a single competitive-sector organization. On the other hand, the financing of the project could remain within the public sector, even if, in some cases, a contribution by users may be considered (toll roads, water meters, permits, user fees, etc.). A properly-designed incentive contract allows for the transfer of several responsibilities to the competitive sector. Moreover, some level of benchmarking process could be profitably developed by dividing a municipal territory into various districts and awarding district contracts to different competitive firms. The competitive-sector entities will then be encouraged to be more productive in order to obtain a contract in some district, while municipalities will not be dependent on only one provider organization. Finally, contracts should be of limited duration so that various competitive-sector organizations will be called to compete once again to obtain a contract renewal. As a result, efficient and specialized competitive-sector firms should carry out most if not all of municipal works.

An implication of the above is that municipal governments should not be allowed to have municipal employees, except for the two key competencies pertaining to the design of municipal social and public goods and services and the management of

contracts with the competitive sector. All other works, such as roads and buildings construction and maintenance, water system development and maintenance, parks, recreation, security, tax collection, accounting, as well as direct services to residents and other services should be provided by competitive-sector organizations following open, transparent, and efficient bidding and tendering mechanisms.

One might consider that police and firefighting services should be under the direct responsibility of municipalities, that is, performed and provided by municipal or national government employees. But it is quite possible to imagine and define incentive contracts under which a municipal government could outsource those activities at least partially if not totally. Indeed, most police activities could be outsourced, except possibly for those related to the criminal code provisions. As for the firefighting activities, it is not clear if any of them must or should remain under direct control of municipal governments. But even if those activities are outsourced to competent competitive-sector organizations, it is clear that municipal governments must remain ultimately responsible, through the electoral process, for the quantity and quality of services under their jurisdiction.

The same principles can be applied for other levels of governments and other levels of infrastructures. Different contract modalities for infrastructure development are possible and well known. They basically represent a blend of formulas, such as short-term outsourcing contracts, long-term concession contracts, BLT (build-lease-transfer), long-term leasing agreements, risk-sharing agreements, turnkey project with fixed price agreements, BOT (build-operate-transfer), RLT (rehabilitate-lease-transfer), BOOT (build-own-operate-transfer), PPP (public-private partnerships), FDBOMT (finance-design-build-operate-maintain-transfer) and generally GCP arrangements.⁵⁴ It should be clear to the reader by now that the implementation of the CSD model and project would favour the development of better and more intensive and extensive common infrastructures in all fields with significant benefits in terms of more profitable industrial and commercial investments and better services to citizens throughout society. An important complementary result of developing infrastructures through GCP contracts is the fiscal responsibility constraints it imposes on governments at all levels, in particular in terms of the maintenance of the infrastructures.

⁵⁴ For an analysis of these different possibilities and more, see M. Boyer, M. Patry and P.J. Tremblay (2001), "La gestion déléguée de l'eau: les options", CIRANO 2001-RP10 et M. Boyer, M. Patry and P.J. Tremblay (2001), "La gestion déléguée de l'eau: gouvernance et rôle des différents intervenants", CIRANO 2001-RP11.

Thus, notwithstanding the category of infrastructure work considered, competition and competitive processes have an important role to play. The governmental sector is far from being marginalized in this process. Its role remains central insofar as design and contract management activities are concerned and as the ultimate responsibility for the quantity and quality of the common infrastructures are concerned. The CSD model and project call for a better focused role for the governmental sector and in fact a more important role than the role governments typically assume in traditional social democracies.

The CSD model and project thus make use of various contractual solutions to fulfill the various needs of the citizenry in terms of common infrastructures. More and better competition and a better focused governmental sector are strong complements in fostering optimal uses of scarce resources, efficient risk-sharing agreements, as well as substantial gain in efficiency and effectiveness in the development of common infrastructures.

6.7 ENVIRONMENTAL USE AND PROTECTION

"[If] you want to fight for the environment, don't hug a tree; hug an economist. Hug the economist who tells you that fossil fuels are the third most heavily subsidized economic sector after road transportation and agriculture... Hug the economist who tells you that the price system matters; it's potentially the most potent tool of all for creating social change."

Bill Moyer, PBS Commentator, Speech before the Environmental Grantmakers Association, Brainard, MN, October 16, 2001.

Seeking to maximize economic growth in order to increase the well-being of citizens invariably leads to the question of environmental protection. Indeed, in the wake of the Kyoto Protocol adopted in 1998, environmental policy and management have been at the forefront of political debates, but much of these debates have focused on the high cost of compliance towards achieving the required standards. Little has been said about how these standards will be achieved. We shall see how market-based instruments will inevitably be part of the solution due to their cost-effectiveness versus traditional command and control methods. We shall also see why, within the social democracy model, the governmental sector has a fundamental role in environmental policy due to the presence of significant externalities and quasi-public goods, such as air and water

quality. By encouraging competition, modularity and the experimentation, the CSD model and project appear as a particularly well-adapted system to solve the complex problem of proper use, development and protection of environmental capital.

Two questions allow us to grasp the complexity of environmental protection: How do we know which level of pollution or environmental protection is efficient? And why is it so difficult to push an environmental agenda?

Concerning the first question, there is a simple answer from an economic theory viewpoint: the socially efficient level of environmental protection is characterized as that level for which the marginal benefits of environmental protection equal its marginal costs including the costs of control. However, this theoretical answer is obviously difficult to apply in practice. On the one side, benefits of a cleaner or better environment are difficult to quantify, while pollution abatement costs may be more easily known, but unfortunately such information is mainly known only by the polluting firms and agents. The level of environmental protection will be efficiently reached if the marginal costs of pollution abatement are equal across all firms. Evidently, analyzing the cost structures of all firms and then selecting what pollution abatement each firm should be forced to adopt or which pollution level it should be allowed to emit would be extremely costly. Instead, governments have mainly adopted what is known as command and control methods. I will show later how these methods of regulating the environment are as a whole rather ineffective and inefficient.

The implementation of the proper level of environmental protection characterized above can be done in part through competitive pricing of environmental services. If firms and individuals must pay a price for using the environmental services, such as air quality and water quality (the quantity used would vary with the different pollutants released), they will rationally equate marginal value, or what economists call the value of marginal product, to the price. In so doing, firms, as well as individuals, being confronted with the same price, would achieve, in a completely decentralized fashion, the productive efficiency condition demanding that the marginal costs of pollution abatement be equal across all firms. As for the global level of environmental services to be used, the efficiency condition remains that the marginal benefits of environmental protection or use equal its marginal costs including the costs of control.

Ecologists and environmentalists sometimes seem to consider that using and destroying natural ecological systems is per se wrong and immoral. Economists do not. They rather consider that the proper use, whether it is called degradation, destruction or protection,

which are basically all synonyms, of ecological or environmental systems is deemed socially efficient if it results from exchange in a market-based system. Creating and implementing market-based instruments will therefore be the preferred way toward efficient environmental protection. As Joan Roughgarden (2001) puts it:⁵⁵ *“Economists are not about to cede the moral high ground to ecologists just because humanity is contained in a giant ecosystem. In principle, economics deals with ‘ethical efficiency’ — trying to achieve the most good for the most people given a ‘budget constraint’ of either time or money. Of course, matters may not work out so ideally, but it’s important to realize that the ethical starting points for both ecologists and economists are equally noble.”*

Concerning the second question, namely, the difficulty to push for an efficient environmental protection policy agenda, is due to the fact that environmental degradation is basically an externality for firms. In general, no direct environmental degradation costs are directly incurred and supported by firms and, therefore, they tend to overuse the environmental resources. In other words, the true cost of polluting is not captured in the private cost functions of polluting firms because such things as air and water are part of the public domain. This phenomenon is referred to by economists as the tragedy of the commons: when a common resource is unaccounted for in the price system, then agents, whether they are cooperatives, private firms, labour unions, consumers, governments, or religious bodies, tend to overexploit it.

The problem stems from missing markets for the common resources because the environment has been there to use by everyone without compensation for its degradation. However, competitive processes are difficult to implement when it comes to air and water. That is why, on a national scale, the governmental sector has a crucial role in finding ways to protect the population from inefficient present and future environmental degradation. There is another economic problem with the internalization of externalities, namely free riding. Free riding occurs when an agent, whether an individual, a firm or a country, that engages in environmental protection activities cannot capture the benefits of the activity.

For example, if one country decides to reduce its air-polluting emissions, its neighbours and the rest of the world will benefit from cleaner air without contributing to it. In such a case, the cost of pollution abatement is borne only by the first country, whereas the benefits are conveyed to all others. Because pollution abatement is costly and would

⁵⁵ J. Roughgarden (2001), “Guide to Diplomatic Relations with Economists”, *Bull. Ecol. Soc. America*, no. 82, pp.85-88.

typically be financed by taxes, the production costs of firms in the benevolent country will typically go up and these firms risk being at a competitive disadvantage versus the rest of the world. This is why governments have been reluctant to develop unilaterally an environmental protection policy and impose pollution abatement objectives on national firms. The necessary condition of a sustainable pollution abatement policy is that countries come together, as they have done in recent years, to define, implement, and enforce common solutions through legally-binding treaties to address these matters.

In spite of all this activity, environmental policies are seen by many, especially in the private corporate world, as threatening for growth and social well-being. It is certainly one of the biggest fallacies of recent times to claim that proper pricing of environmental goods and services as factors of production may be growth and welfare threatening. Quite the contrary, proper (competitive) pricing of all goods and services, whether they are used for productive or consumption purposes, is a major factor of growth: it allows proper signals to guide decisions related to production, investment and consumption as well as R&D expenditures, education and lifelong learning and training. Maximal growth relies on maximal efficiency and maximal effectiveness in the use of scarce resources, including environmental resources. But maximal growth, maximal efficiency and maximal effectiveness are disruptive and survival threatening for inefficient organizations.

The traditional method of managing the environment at the government level has been through general regulations uniformly applied to all firms to ensure control over emissions. As we have seen above, for this system to be efficient, regulations must be tailored for each firm so that marginal costs of abatement are equal across all firms. Some examples of command and control instruments are: requirements of specific designs, compulsory use of a given technology for production or emission reduction, and determination of a common level of pollution abatement each source, firm, or other entity in a given group must achieve.

Even though these regulations have helped to curb the level of pollution, much can be said about their inefficiencies. The main argument, from an economic standpoint, is the lack of cost-effectiveness. Since all firms must adopt the same standards, firms that have lower marginal costs of abatement will not reduce sufficiently their emissions, while firms with high marginal costs of abatement will cut their emissions too much. Moreover, under command and control regulations, firms have a strong incentive to

send biased information to the regulators. Therefore, regulators must spend more time and money to analyze the information sent by firms. Another negative aspect of command and control is that firms have fewer and weaker incentives to develop and adopt new technologies, since if regulators know that such technologies exist or could exist, their regulations could become more stringent. One more negative aspect of command and control methods is the political game that they lead to. Politicians often use these methods to gain popular support by adopting a hard-line environmental stance. However, since these methods are part of intricate laws, they can often be less stringent in practice in order to appease the political pressures exerted by polluting firms. Information manipulation and political gaming call for a different more efficient way to optimally use and protect environmental resources. That is where competitive prices and competitive markets come into play.

The inefficiencies discussed above put at the forefront the role of economic theory in explaining how markets can foster environmental protection and thus its role in future policy decisions. Note however that markets should only be used when it is cost-efficient to do so. For instance, if there are only a small number of firms in an industry, command and control methods could be efficient since the necessary information may be easier to collect and process.

Concerning market-based instruments, the first point to address is to demystify markets as evil institutions that manipulate the weak in favour of the strong. In essence, market-based instruments are regulatory devices that shape behaviour regarding pollution control levels and methods through price signals rather than explicit instructions. When properly implemented, these market-based instruments encourage firms and individuals to undertake actions that serve both their own financial interest and public policy goals. Another myth that needs to be addressed is what environmentalists have sometimes argued to be a “*license to pollute*” referring to emission trading systems. Their flawed argument can easily be countered by exposing the fact that the government already gives these licenses to pollute to firms for free! Just because a market exists for emission trading does not mean that pollution will increase; on the contrary, it will, in a transparent way, limit pollution by setting a maximum quota of pollution permits or rights, which are defined as the right to emit say one ton of some pollutant in the atmosphere or a water system. For the purpose of making the presentation as simple as possible, market-based environmental protection instruments may be regrouped into four different categories: pollution charges, tradable permit systems, deposit refund systems, reduction of government subsidies and/or market barriers.

POLLUTION CHARGES consist of fees or taxes on the amount of pollution that a firm produces. By internalizing the pollution costs, such charges encourage the firm to reduce its pollution to the point where its marginal cost of abatement equals the per-unit tax. Since firms will have different marginal costs or pollution abatement structures, some firms will be able to abate more than others. As a result, pollution targets will be achieved while minimizing the overall social cost of abatement. The potential savings from such approaches have been shown to be quite significant. By encouraging firms with the lowest costs to provide the bulk of the abatement—as opposed to all firms abating to the same level—substantial savings can be achieved in the overall economy. This is done because pollution charges (or Pigouvian taxes and levies as they are known to economists) cut into firms' profits and, therefore, firms will seek ways to reduce their pollution emissions. Hence, profit-maximizing firms would control rather than emit, when it is cheaper to do so.

TRADABLE PERMIT SYSTEMS are created when the government establishes an allowable or limited level of pollution and then allots the permits or rights to polluting firms through either an auction or grandfathering. Subsequently, firms can choose to buy, sell or lease their permits depending on their relative costs of abatement. In that system, profit-maximizing firms will choose to reduce their emissions when the marginal cost of abatement is lower than permit prices. Therefore, firms with low costs of abatement will sell their excess permits to high-cost-of-abatement firms. This market mechanism achieves cost-effectiveness as competitive markets act to regulate the relative levels of pollution emissions across firms. The key here is that permit prices will signal what the marginal costs of abatement should be across all firms, and thus marginal costs will be made equal across all firms, a characteristic of efficiency. Market-based instruments further induce firms to engage in research and development programmes for pollution control and to implement new innovative pollution control technologies much more efficiently than simple command and control methods can do. This occurs because firms directly benefit, sometimes in a significant way, from these innovations through lower cost of compliance and, therefore, lower cost of production. Thus market-based instruments have the potential to stimulate the emergence of more efficient “green” technologies at a lower social cost.

The third category of market-based instruments is composed of **DEPOSIT REFUND SYSTEMS**, where consumers pay a surcharge over the price of durable goods they buy and then get a refund when they bring them back at the end of their useful life. These systems have proved to be highly effective in promoting recycling programs, such as

deposits on glass bottles and aluminum cans. It was also a precursor of mass recycling programs where the deposit was dropped in exchange for a weekly recycling pick-up.

A fourth category of market-based instruments consists in the elimination of some **GOVERNMENT SUBSIDIES** that turn out to be pollution-inducing. Since subsidies are the equivalent of negative taxes, those pollution-inducing subsidies can be eliminated as a first step towards signalling and reflecting the true cost of a polluting activity or product. Examples of pollution-inducing subsidies are those one can find in coal and fossil fuel energy generation, large-scale agriculture, industrial breeding, forest exploitation, commercial fisheries, and chemical industries.

The CSD model and project are compatible also with regulation by information. In such an approach to regulation, a regulatory body is in charge of a program to inform the public about the extent of pollution each firm is responsible for. Environmental protection can properly benefit from the market power of consumers. By properly informing the public about the risks of a firm's products and operations, the regulation-by-information system affects positively or negatively the reputation of polluters. This mechanism, operating through public access to information, would act both as a self-protection mechanism, since firms would want to reduce their probability of causing a major environmental disaster, and a self-insurance mechanism, since firms would want to design programmes that would result in a smaller loss in human lives and material wealth in case of a major ecological or environmental industrial accident. Consequently, a regulation-by-information system would favour responsibility and accountability of firm executives.

Another important policy dimension to take into account is what is known as the cost of being wrong. To minimize the costly risk of being wrong in matters related to environmental degradation, the governmental sector should use a portfolio of instruments. An important and often neglected dimension of policy instrument choice resides in the relative risks that each different type of instrument represents. In fact, regardless of which instrument is chosen, there exists always a risk of being wrong in its calibration to achieve proper environmental results, even though, theoretically, these instruments, under ideal condition should yield the most favourable outcome. For that reason, any policy objectives and implementation should be achieved through a portfolio of instruments instead of always using the same. So, in order to measure adequately the risk of a given instrument, it must not be taken individually, but within its contribution to the overall risk of the portfolio of instruments chosen. This risk must

properly be measured if we want to maximize the probability of achieving the policy objectives.

Given the relative efficiency of market-based instruments in terms of costs, information, investment in R&D, and risk management, why are these instruments not used on a more regular basis? In fact, these instruments are relatively new and, therefore, it takes time for politicians and the public to understand these systems and abide by them. It also takes time to counteract argument promoting a biased perception of the link between the protection of the environment and the working of competitive markets. However, even though command and control instruments are still the main channel of environmental protection, there is a steady rise in the use of market-based instruments. Better knowledge and understanding of economic theory and analysis among politicians, environmentalists, and social activists will promote the adoption of socially-efficient environmental policies. Continuing and intensifying efforts towards such better knowledge and understanding is particularly important in the CSD model and project given that environmental demands and policies are likely to become more pressing and stringent in the future, thereby making inefficient implementation of environmental policies increasingly more costly. In so doing, competitive social democrats must keep working to convince environmentalist groups to adopt and promote market-based instruments in order to foster efficiency in ecological and environmental protection. Otherwise, a general preference for bureaucratic command and control instruments will lead the way and dominate more efficient and innovative market-based policy implementation instruments.

One often hears industry representatives complaining about environmental protection policies and claiming that those policies will increase costs, reduce investments, and destroy jobs. It may be true that environmental protection policies will increase some firms' costs, reduce some firms' investments, and destroy some firms' jobs. But overall, a proper competitive pricing of environmental resources, goods and services can only make the economy more efficient and better aligned with desirable economic growth and social well-being. A proper competitive pricing of environmental resources, goods and services will also foster the development of R&D programmes in green technologies, products and services. It will also protect markets for more valuable products and services against the unfair competition of environmentally costly goods and services, whose market performance and market shares depend on and are favoured by the improper pricing, sometimes zero pricing, of their intensive use of valuable environmental capital. However, a general movement towards more

competitive pricing of environmental resources will require from those firms that they adapt to the new business environment if they can. Otherwise, it is socially better and efficient that those firms, which cannot survive unless they are allowed to use environmental capital at lower-than-competitive prices, be put to rest.

The main objective of environmental protection remains and must be to foster the CSD ultimate objective of optimized welfare and well-being of citizens through the specific objectives of social cohesion, maximal growth, and economic freedom. The link between environmental protection and the above objectives rests on the main principles or postulates of the CSD model and project, namely, the rationality of individuals, the power of incentives, and the efficiency of competitive processes.

The ten generic policies of the CSD model and project can be adapted to the determination of the proper level of environmental protection as a social and public good or service. In this matter, the master concept is competitive processes. As I argued before, a centralized and regulatory Grand Plan based on command and control instruments will inevitably fail as it is unlikely to deliver the desired results and meet the intended objectives: it is likely to generate more harm than good. It makes a lot more sense to stop subsidizing industries that are detrimental for the environment and simply favour the emergence of competitive prices for environmental services through competitive processes of the kind discussed above. The environment will then be taken care of by the myriad of self-interested decisions by all agents, individuals as well as firms and organizations, facing proper prices, including the competitive prices for environmental services being used, consumed, or produced. Indeed, proper pricing of environmental services will induce everyone to use them in a rational way and will even induce some entrepreneurs to contribute to a healthier environment by cleaning, at the proper price, the mess that others might end up creating.

THE PARTICULAR CASE OF THE NIMBY SYNDROME⁵⁶

The syndrome known as NIMBY (short for *Not In My BackYard*) designates any conflict involving the location of dangerous or nuisance-creating projects in places where local people can be expected to oppose their establishment. In the last few decades we have seen a growth and broadening in this phenomenon of structured opposition, the intensity of which has led many public authorities to get caught in stagnation.

Cases that come to mind include wind farms, liquid natural gas ports, electricity transmission lines, road, rail or marine routes for shipping hazardous materials, and

⁵⁶ Adopted from M. Boyer (2008), "How Can the NIMBY Syndrome Be Avoided?" *Economic Note*, Montreal Economic Institute, March.

even relatively minor projects (a new casino, cross-country or snowmobile trails, etc.). These structured opposition movements, influenced by highly-publicized disasters,⁵⁷ stem from more or less realistic perceptions of the risks involved.

Reactions of opposition, long focused on projects that are especially polluting or risky, currently affect a surprising number of projects, both public and private. NIMBY-type reactions apply only to some of these projects, which generally have three characteristics in common. First, they create nuisances at the local level (noise from airports, odours from incinerators, visual blight and noise from wind farms, fear and insecurity from prisons, or visual blight and health risks from electricity transmission lines, refineries or natural gas ports). Second, they are likely to produce sizable advantages, but on a broad scale rather than a local scale. Third, these are often large projects, and their establishment in a given municipality often requires expropriations as well as long-lasting changes in the environment.

Opposition reactions, when pushed to the limit, can result in three downsides for the general well-being of citizens. In terms of the environment, victories by NIMBY activists in one place may create or worsen problems elsewhere. As regards infrastructure or services, the spread of the NIMBY syndrome can lead to delays in fulfilling important needs.⁵⁸ And with respect to land use, obstruction caused by this syndrome may result in projects being moved to unsuitable zones where there happens to be less opposition.

The use of special laws or regulations, including expropriations, to impose final decisions has too often been the preferred solution. Although some people may see this as necessary, it should be noted that it leads inevitably to tougher opposition from the citizens concerned. Using political force ends up causing feelings of frustration among local people and rarely settles matters.

The pursuit of new types of project that are safer and less harmful may sometimes be envisaged, but there is a risk that this simply shifts the problem elsewhere. For example, “pro-environment” demonstrators often oppose thermal power plants or even hydroelectric plants and look to “clean” alternatives, such as wind farms. It is quite

⁵⁷ As examples, we can mention the derailment of a train carrying hazardous products in Mississauga, Ontario (1979), the chemical plant incident in Bhopal, India (1984), the nuclear plant explosion at Chernobyl, Ukraine (1986), the oil spill in Alaskan waters with the sinking of the Exxon Valdez (1989), and the explosion of the AZF petrochemical plant in Toulouse, France (2001). Most of these accidents caused heavy loss of life and substantial material damage. See also Nicolas Marchetti, *Les conflits de localisation : le syndrome NIMBY*, CIRANO, May 2005.

⁵⁸ This brings to mind the much postponed Hertel-Des-Cantons (Quebec) electricity transmission line. Its conflict-ridden erection following the 1998 ice storm crisis caused deep resentment, which persists even today.

obvious today that these alternatives also pose many problems and are subject to fervent opposition.

Accordingly, the most promising strategy is to set up competitive compensation mechanisms both to respect the citizens concerned and to manage the NIMBY syndrome sustainably. It is the approach proposed in the Competitive Social Democracy model.

MARKET MECHANISMS TO THE RESCUE

Compensation mechanisms developed to overcome opposition from people nearby must take account of the characteristics of the projects at issue. Compensation must be paid by a project's beneficiaries and must go to its real victims. In a private project, the developers will compensate the neighbours. In a public project, the entire population that benefits from it will have to pay. Moreover, people living near a dangerous or risky project should get compensation mainly if an accident occurs, thereby guaranteeing that only those who have suffered direct prejudice receive payment. Furthermore, when a nuisance-creating project is built, compensation should begin as soon as the project is in place and should last as long as the nuisances do.

The response to the NIMBY syndrome from public authorities is a result mainly of centralized decision-making. Decision-makers select a site, announce the choice to the public, defend it and undertake the project by force, if necessary. Awareness of the failures linked to this type of procedure has led gradually to mechanisms allowing a greater role for citizens. The participative aspect is important but insufficient to prevail over the syndrome. The procedure should be competitive and show greater respect towards the preferences of the parties concerned. Both these aspects have been largely cast aside by political leaders. However, economists have developed mechanisms of varying complexity that are participative, competitive and, at the same time, more ethical or respectful of the preferences of those most closely involved.

Economic approaches based on market mechanisms aim to be more "decentralized" and, by definition, allow a greater role for the groups concerned. The innovative idea behind this type of mechanism is as follows: considering that a project is likely to provide significant advantages to the general public or to generate substantial profits, and considering also that the nuisances are essentially local, it is possible to picture the citizens or developers who benefit from the project compensating the likely neighbours. This approach is based on the principle that those subjected to the project are the only ones who really know the costs of its eventual advent. With various sites in competition

to host (or not host) the project in return for compensation, an incentive will arise to disclose these costs and to volunteer (or not volunteer) in a perspective of mutual gain.⁵⁹

The decentralized procedures generally proceed in three stages. First, a socioeconomic analysis assesses the scope of a project's private and public benefits.⁶⁰ Next, with major benefits involved, a multi-criterion technical analysis identifies a limited number of potential sites. Any site under consideration at the end of this stage could, under the traditional approach, have been imposed as the project's location by public authorities. Finally, a "consultation" mechanism is established to enable representatives⁶¹ from the various potential sites to "agree" on a given site and on the size of transfers, compensation and contributions. Potential sites would thus all lie at the heart of the decision-making process and would be used in determining the best location. The first two stages are subject to pitfalls and must be conducted diligently and impartially, but they do not seem to pose serious methodological problems.⁶² I am focusing my remarks here on the third stage.

Three types of decentralized procedure have been suggested: auctions, lotteries and insurance.⁶³ Lotteries and insurance present particular difficulties: lotteries leave too much to chance, and insurance leads too often to endless legal disputes when accidents occur. In contrast, auctions merit particular attention; this is the type of mechanism I will analyze here.

Well-chosen auction rules must be both transparent and efficient and must rely on competition between several groups, municipalities or regions that, despite initial opposition, can come to show interest in hosting the project at issue under certain conditions. In implementing a new project, it is fundamental to retain a limited but adequate number of potential sites, paying particular attention to the conditions of participation to favour the entry of new "competitors" for hosting the project. The issue

⁵⁹ These approaches are not unrelated to the theory devised by Ronald Coase (1991 Nobel Prize in Economics), which states that markets will lead to an efficient solution as long as property rights (to particular sites or to the environment) are well defined and transaction costs are sufficiently low.

⁶⁰ The project may come initially from private or public entities, but the confirmation of the existence and scope of benefits will sometimes be the responsibility of political authorities even in a private project.

⁶¹ Representatives of sites (groups or regions) will usually be elected officials with authority over the territory concerned and over the decision to be made. Devising open and transparent procedures may require that the respective roles, powers and responsibilities of the various parties involved be reaffirmed.

⁶² Some disagreements may persist as to the nature of nuisances, as well as to the costs and the benefits, but these disagreements should focus on empirical measurement of the various elements rather than on the method applied.

⁶³ These potential solutions are not mutually exclusive, and various combinations may be considered.

of mechanism design is delicate:⁶⁴ it can enable the right solution and the correct level of compensation to be identified, with the true costs of hosting the project being disclosed; it must prevent behaviour based on opportunistic strategies from taking advantage of shortcomings in the mechanism, which could lead to the wrong results.

Economists have suggested various auction mechanisms for overcoming the NIMBY syndrome. The simplest mechanism is the so-called Dutch reverse auction: the developer or government offers a level of compensation to representatives of the various potential sites. If there is no taker for the project, the compensation on offer is increased until a taker is found. Airline companies use this process when too many tickets have been sold aboard a certain flight so as to persuade passengers to give up their seats.

A second mechanism is the so-called modified low-bid auction:⁶⁵ each group issues, through its representatives, a bid for compensation for hosting the project on its territory; whichever makes the lowest bid hosts the project and gets the compensation that it sought plus a certain percentage; the other groups each pay a “tax” proportionate to their bid for compensation, with the total being equal to the amount to be paid to the winner. Despite having to pay something, these groups all come out as winners in the auction: to avoid hosting the project, they will pay less than hosting it would have cost, based on their own assessments.

A third mechanism is the so-called modified high-bid auction:⁶⁶ each group issues a bid for compensation, and whichever makes the lowest bid not only hosts the project but receives, in return for the prejudice suffered, compensation equal to the highest bid for compensation; the other groups each pay a tax proportionate to their respective bids, with the total equal to the amount to be paid to the winner. Thus, none of the groups comes out losing in the auction, with the group hosting the project in effect achieving a net gain compared to its assessment of the cost of hosting it.

To illustrate the spirit of these procedures, let us consider the following hypothetical case.⁶⁷ The City of Montreal wishes to select a location for a garbage incinerator on the

⁶⁴ The Nobel Prize in Economics was awarded in 2007 to economists Leonid Hurwicz, Eric Maskin and Roger Myerson specifically for their work on mechanism design.

⁶⁵ Howard Kunreuther and Paul R. Kleindorfer, “A sealed-bid auction mechanism for siting noxious facilities”, *American Economic Review*, Vol. 76 (1986), No. 2, pp. 295-299. The modification makes the proposed auction budget balanced.

⁶⁶ Arthur O’Sullivan, “Voluntary auctions for noxious facilities: incentives to participate and the efficiency of siting decisions”, *Journal of Environmental Economics and Management*, Vol. 25 (1993), No. 1, pp. 12-26. The modification makes the proposed auction budget balanced.

⁶⁷ The application of those processes must also take account of the possibility that the participants may have an interest in overestimating their costs and thus their compensation requests, a problem which is not discussed here.

island. A technical study has identified the desired characteristics (capacity, layout, number of trucks per day, atmospheric discharges, etc.) and has determined five potential sites in five different boroughs. A call for tenders is launched, leading to five bids for compensation with the costs for each borough estimated respectively at \$1 million, \$1.2 million, \$1.8 million, \$2 million and \$2.6 million. In this instance, the incinerator would be located in borough number 1. Under a modified low-bid auction, borough number 1 would receive the compensation it sought plus, for example, 50%, while the other boroughs would have to pay a tax equal to 19.7% of their respective bids (for a total of \$1.5 million). Under a modified high-bid auction, borough number 1 would receive the highest amount of compensation that any of the participants bid for (\$2.6 million), thereby achieving a major gain compared to its original bid, while the other boroughs would have to pay a tax equal to 34.2% of their respective bids for compensation.

These mechanisms ensure, at relatively low cost, true disclosure of a project's costs and location values in the best possible place. Based on context, one of these mechanisms, or a variant, will be most effective in managing the NIMBY syndrome adequately, respecting all parties involved.⁶⁸

TO CONCLUDE

Conflicts related to implementing risky or nuisance-creating projects occur often. In most cases, all players involved may say they are dissatisfied: public developers must face local opponents (in consultation procedures or informal protests); political and administrative decision-makers have trouble reconciling the conflicting interests of their constituents; concerned members of the public are too often excluded from discussions and decisions concerning their daily lives.

The main aim here is to draw attention to a CSD approach that is likely to limit the emergence of this type of conflict. Centralized decision-making procedures, such as a location imposed by expropriation or following the report of a commission or bureau, can be rejected in favour of decentralized market mechanisms such as auctions, which can be seriously considered in many actual situations. It is also possible to consider applying the principles used to devise mechanisms in more complex contexts, such as networks for shipping hazardous or nuisance-creating goods that affect several

⁶⁸ It is possible to adjust the auction to take account of the fact that the sites initially retained may not be of the same quality as regards implementing the project.

municipalities or regions: similar principles and practical details can apply by delineating correctly the various groups concerned and the various options at hand.

Although research on the characterization of such mechanisms is already quite advanced, actual applications remain held back mainly by lack of awareness of these mechanisms. This lets certain pressure groups that benefit from the NIMBY syndrome acquire disproportionate power. Limits to our imagination form the only real constraint to developing effective auction mechanisms for managing the NIMBY syndrome in full respect of the groups directly concerned and of the general public.

6.8 MUNICIPAL MERGERS, PUBLIC TRANSPORT AND OTHER MUNICIPAL SERVICES

The merger of various municipalities into larger metropolitan areas has caused the ink to flow in many countries over the last few years. Do size and efficiency go together? When, and under what conditions? What are the alternatives? How does a CSD approach enable the goals of mergers to be fulfilled, especially regarding economies of scale and scope, while maintaining the high degree of local democracy characteristic of smaller municipal governments?

There exists a simple solution that can be a rallying point: like national governments in a parliamentary or presidential system where the people's representatives are elected in ridings, counties or states, a two-level municipal government can be devised, with the creation of a group of municipal entities (boroughs) covering altogether the whole area to be supplied with municipal services (these entities should be similar in size and responsible for all neighbourhood services), followed by the creation of a citywide structure with a mayor chosen by universal suffrage and city councillors elected by the residents of the member entities to handle duties and responsibilities of broader interest (police, fire protection, water, major roads, public transit, etc.). This would promote the goals of a true reform of municipal administration: democracy, harmonization, inclusion, efficiency, responsibility and accountability.

But how can it be ensured that the benefits of merging local services will materialize properly in a system with only two municipal levels? In the CSD model, municipalities as a government sector must assume their respective roles and responsibilities, in particular in defining the groups or baskets of specific municipal goods and services, in terms of quantity and quality, and providing them to the community of citizens without directly producing, distributing or delivering these goods and services. They must manage and arbitrate conflicts where necessary with respect to the available resources,

and they must manage the contracts and partnerships for supplying the chosen basket. Municipal authorities, whether elected officials or high-level civil servants, can ensure that their citizens are best served by putting these contracts up for bid and by properly overseeing them.

To achieve the economies of scale underlying the efficiency of large cities, local municipalities must set up a system of auctions and bidding procedures that enables suppliers of municipal services, at each level and for each service, to reach the right size for them in order to achieve the bulk of the economies of scale for the service in question, with the correct level of competitive pressure maintained through multiple sourcing in procurement. We know today that these goals can be met through a process of *combinatorial auctions*.⁶⁹ This relatively simple solution, which in all likelihood would be broadly accepted by a large majority of citizens who wish to live together in a municipal territory that is well run for the greater well-being of all residents, is truly within our reach.

The identification, design, arbitrage and choice functions related to the baskets of social and public goods and services are closely linked to and realized through the democratic electoral process. This redesigned **MUNICIPAL GOVERNMENTAL** sector has little resemblance with the municipal public sector, as we know it in most countries. Indeed, the redesigned municipal governmental sector will be composed of the elected officials in power together with a group of properly-qualified civil servants who, for the most part, will be responsible for the overall management of contracts with different **COMPETITIVE**-sector organizations for the production, distribution and delivery of the municipal social and public goods and services. As for other levels of government, the municipal sector's prime responsibility is neither to be an employer nor to be a producer or distributor of municipal goods and services.

The role of the **MUNICIPAL COMPETITIVE** sector is to produce, distribute and deliver the municipal social and public goods and services in the most efficient manner possible using the best technologies, human resources, and organizational structures, under properly-defined incentive contracts with the municipal government. Those organizations of the competitive sector will be called or invited by the governmental sector to enter open bidding processes for the right to produce, distribute and/or deliver, for a properly-defined limited time, specific social and public goods and services, under appropriately-defined contracts specifying the rights, responsibilities,

⁶⁹ See section 5.9 above.

commitments and payments or remunerations of the parties. The contracts linking the governmental-sector authorities and the competitive-sector organizations must be designed in such a way that the competitive-sector organization retained is induced to deliver on its promises through either a form of warranty bond or a significant bonus to be paid once the realization of objectives and promises has been verified. Moreover, proper pro-competitive policies must make sure that level playing field conditions are strictly enforced.

THE PARTICULAR CASE OF PUBLIC TRANSIT

Public transit in many urban areas seems to be in a considerable financial impasse. But just pouring billions a year of new money, as mayors of major cities regularly request, is not the solution. One actually needs more competition and an opening of the current urban public transit monopolies to private operators before handing out such considerable amounts.

The reason is that the fully-public management model which is in use in many large cities has increasingly been abandoned in other large cities around the world because of its inefficiencies and non-stop increasing costs. Public authorities have been leaning, in the latter cases, towards a competitive tendering model and more partnerships with the private sector to provide transit service to their citizens, very much in the spirit of the CSD model.

The idea of such an approach is quite simple. It is based on a distinction between the organizational and financing aspect of transit networks, on the one hand, and network operation, on the other. Thus, while public authorities continue to be responsible for routes, schedules, frequencies, fares paid by users and indicators of quality and customer satisfaction, the provision and production themselves have been turned over to competitive (private and public) operators. These operators must compete to obtain renewable, fixed-length contracts by trying to offer the best quality/price ratio.

Clearly, competitive tendering may require detailed transportation contracts, whose costs would likely be small compared with their advantages. Just as you make competition play among different providers to get the best deal when you go shopping, public authorities are able to benefit from the competition in the bidding process. They can take advantage of the expertise provided by private operators – in terms of managing operating risks – and focus on service improvements, such as greater frequencies, more routes, etc.

Public authorities and ultimately taxpayers benefit because competition in winning and retaining transportation contracts in a given geographic area provides incentives for operators to control their costs while offering more punctual and reliable service. Reduced operating costs allow getting more with the same amount of money. More funding is available to finance service, newer fleet or other infrastructure needs, without further squeezing the taxpayers.

The experience from such reforms is certainly out there. In Europe, for example, competitive tendering is becoming the norm, encouraged by the European Commission. France has applied this model to public transit over a number of years. And other social democratic countries, such as Denmark, Sweden and Great Britain have also succeeded in reforming their urban transit with substantial operating cost reductions.

There is no reason for other large and small cities not to benefit from the same advantages of competitive tendering. The mayors in major metropolitan areas should be requested to open up the urban public transit systems to competition instead of being in line to request more taxpayers' money.

CONCLUSION

Let us recall as conclusion the main elements of the competitive social democracy model.

- The fundamental principle of the CSD model and project: under a strong leadership of the public or governmental sector, the private or competitive sector is called upon to produce, distribute and deliver social and public goods and services.
- The relationship between the governmental and competitive sectors is optimized through incentive-compatible contracts ensuring proper participation and proper effort.
- The incentive contracts between governmental authorities and competitive providers, firms and organizations, are regularly put on the block through transparent and adequate auction and auction-like competitive mechanisms.
- The passage from a traditional social democracy to a competitive social democracy will require strong leadership and wide acceptance, hence extensive discussions and significant convincing efforts.



2020, University Street, Suite 2500, Montreal (Quebec) H3A 2A5

Tel.: 514-985-4000 • Fax: 514-985-4039

www.cirano.qc.ca • info@cirano.qc.ca