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Université de Montréal

**Outsourcing the Nation-State:  
A Rational Choice Framework  
for the Provision of Public Goods**

par  
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Mémoire présenté à la Faculté des études supérieures  
en vue de l'obtention du grade de Maîtrise en Sciences (M.Sc.)  
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Faculté des études supérieures

Ce mémoire intitulé:  
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# Résumé

Le rôle de l'État-nation comme fournisseur de biens publics a été mis à l'épreuve et transformé par une série de phénomènes politiques, économiques, sociaux, et technologiques. Parmi ceux-ci on retrouve la décentralisation, la globalisation, et les changements démographiques. Afin d'y faire face, les États se sont tournés vers des organisations supranationales, des gouvernements sous-nationaux, ainsi que des acteurs privés. Cependant, le consensus parmi les observateurs intéressés est que l'État n'a pas agi en tenant compte de l'impact à long terme de ses actions.

La raison d'être de cet essai, c'est de mieux comprendre l'opportunité pour l'État-nation de gérer cette transformation de manière moins opportuniste. Celui-ci traite de la possibilité d'une approche plus stratégique envers la fourniture des biens publics, en rétablissant la prise de décision via la théorie du choix rationnel. Afin de permettre une telle approche, nous avons cherché à développer un modèle qui pourrait qualifier jusqu'à quel point un État-nation pourrait assurer la fourniture des biens publics. Ce modèle tient compte des choix entre les types d'acteurs, ainsi que les différents acteurs à travers d'un type donné qui leur sont disponibles.

À la fin de cette démarche, nous sommes arrivés à trois conclusions qui, selon nous, permettront une approche plus stratégique envers la fourniture des biens publics. Dans un premier temps, nous avons démontré qu'il était possible de créer un modèle qui réunit les différentes alternatives pour la fourniture des biens publics à travers les différents types d'acteurs (modèle que nous appellerons marché de la gouvernance.) Deuxièmement, à quelques exceptions près, pour un bien public donné, il existe de multiples alternatives de fourniture pour chaque type d'acteur. Troisièmement, une série de critères non-financiers peut être appliqué afin de permettre une production plus optimale de ces biens publics.

Mots-clés: fourniture, état-nation, gouvernance, biens publics, décentralisation, Tiebout, fédéralisme fiscal.

# Abstract

The role of the nation-state as a provider of public goods has been challenged and transformed by a range of political, economic, social, and technological phenomena, including decentralization, globalization, and demographic change, among many others. In attempting to address these challenges, states have turned toward supranational organizations, sub-national governments, and private actors. However the consensus among observers is that the State has not acted with regard to the long-term strategic impact of its actions. In fact, it has left itself open to dual loyalties, expanding financial commitments, and empire-building by the actors to which it has delegated public goods provision.

It is the opportunity to manage the transformation of the nation-state less opportunistically by re-establishing rational-choice decision-making that provides the rationale for this essay, which deals with the scope for a strategic approach to the outsourcing of public goods. To enable such an approach, we have sought to develop a framework that evaluates the extent to which nation-states can outsource responsibility for the provision of public goods as well as the choices—among actor types and actors of a given type—available to them.

At the conclusion of this effort, we have three findings that we believe go a long way towards enabling a more strategic approach to public goods outsourcing. First, that it is possible to create a coherent framework that captures the options for outsourcing public goods provision across actor types. (We call this a market for governance.) Second, with few exceptions, for any given public good, there are multiple alternatives for outsourcing within a given actor type. Third, a series of non-financial criteria can be applied to enable a more optimal outsourcing of public goods provision.

Keywords: outsourcing, nation-state, governance, public goods, decentralization, Tiebout, fiscal federalism

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This work is dedicated to my Mom and my Dad, without whom I would have never developed the inquisitive nature I have today.

It is also dedicated to Marie-Claude, who has helped me to realize so many of my dreams, including this one.

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# Table of Abbreviations

## Organizations / Entities / Programs

AMF	Autorité des marchés financiers (Quebec)
AUC	Autodefensas Unidas de Colombia
ASEAN	Association of Southeast Asian Nations
BIS	Bank for International Settlements
CAP	Common Agricultural Policy
CARB	California Air Resources Board
ECSC	European Coal and Steel Community
EU	European Union
FARC	Fuerzas Armadas Revolucionarias de Colombia
G77	Group of 77 Developing Countries
GATT	General Agreement on Tariffs and Trade
HMO	Health Management (or Health Maintenance) Organization
IFC	International Finance Corporation
IMF	International Monetary Fund
IPU	International Postal Union
ITU	International Telecommunication Union
Mercosur	Mercado Común del Sur (Southern Common Market)
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NHS	National Health System (in the United Kingdom)
OECD	Organization for Economic Co-operation and Development
OSC	Ontario Securities Commission
UN	United Nations
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNHCR	United Nations High Commissioner for Refugees
WHO	World Health Organization
WTO	World Trade Organization

## Other terms

Quango	Quasi-autonomous non-governmental organization
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# Quotes

“Modern technology has rendered the nation state obsolete as a principle of political organization; for the nation state is no longer able to perform what is the elementary function of any political organization: to protect the lives of its members and their way of life.”

— Hans Morgenthau, 1966 <sup>i</sup>

“The report of my death was an exaggeration.”

— *Mark Twain, New York Journal, 1897* <sup>ii</sup>

# Chapter 1: Introduction

During the East-Asian financial crisis of 1997 and the Russian sovereign debt default of 1998, nation-states watched helplessly as a process of market-borne contagion threatened the economies and financial systems of developed and developing countries around the world.

As the European Union continued to integrate new candidate countries (in 1995, 2004 and 2007) and further subsume existing member countries, there was a parallel push (starting in 1992) known as subsidiarity that led many to wonder what future remained for a member state left to its own devices: would Europe eventually be simply the European Commission, the European Parliament and a series of regions such as Catalonia, Bretagne, Lombardy, and Scotland?

Finally, the events of September 11, 2001 saw stateless actors lay low—for a time—the world's only superpower, further calling into question the continued ability of the nation-state to execute on its most basic of responsibilities, the provision of public goods such as security.

The vulnerability of the nation-state can certainly be traced as far back as the Treaty of Rome, which laid the groundwork for the European Union, if not earlier. In fact, Morgenthau and others would surely argue that a world of nuclear weapons, starting with the bombing of Hiroshima and Nagasaki, compromised the nation-state even before that.

This vulnerability is in large measure the result of a hollowing out of the state, largely due to the mantra of decentralization, which has seen responsibility for the production and delivery of public goods shifted away from central governments and closer to the actual consumers of those goods. (However, other forces have played a role—in compounding the vulnerability of the state—even accelerating it in recent times—something we will explore in depth in Chapter 2.) This delegation of the provision of public goods has mostly been to the benefit of sub-national entities such as regional and local governments, though delegation

to supranational and private actors, not to mention state-level, arms-length entities called 'quangos', has also occurred.

Decentralization, while appearing to solve a perceived need to bring public goods provision closer to consumers—the better to align with local tastes and preferences—has created other issues. Not the least of which are dual loyalties, expanding financial commitments, and empire-building, all of which favour local government at the expense of central government.

If we assume, as Kenneth Waltz (1979) or Robert Gilpin (1981) do, that the nation-state is a rational actor, we can assume that it would not deliberately work to undermine its long-term interests and put itself in a position of vulnerability. That the nation-state is in just such a situation of vulnerability implies either that it didn't act rationally or that, at a minimum, it didn't act with regard to the long-term strategic impact of its actions. In fact, observers claim that the nation-state has been distinctly lacking in this regard.

## Historical background

It is generally agreed that the nation-state came into being as a result of the 1648 Peace of Westphalia. The resulting 'Westphalian system' defined the state—a unique autonomous entity with complete sovereignty over the land, resources, people and activities that occur on its territory—as the basic unit of analysis in international relations.

The nation-state was active externally, where it had the power to make war and initiate treaties with other states, and internally, where its activities consisted of the production and delivery of public goods, essentially the public services such as healthcare, education and infrastructure that we know today.

The earliest public good to be provided by the State was most probably the provision of public security, more accurately public order, the subject of Thomas Hobbes' 1651 treatise on government, "Leviathan"<sup>iii</sup>. As far back as the Greek *polis*, in return for a monopoly on the use of force, the State agreed to protect its citizens, promising to take action against those—both inside and outside the

State—who would threaten it. Looking back to the time of the Roman Empire, we see the emergence of other public goods, such as infrastructure, specifically, the development of roadways and waterworks for the benefit of the population at large.

In more contemporary times, we find Louis XIV in 1676 providing a home for elderly and sick soldiers at Paris' *Hôpital des Invalides*. Between 1883–1888, we see the beginnings of the welfare state resulting from Prussian chancellor Bismarck's decision to provide national health insurance and compulsory old-age insurance in return for employer and worker contributions<sup>iv</sup>. While modern income tax was initially the result of the need to pay for war efforts (the Napoleonic Wars, the United States Civil War<sup>v</sup>), it continued to be levied after those conflicts, in return for which the state provided additional services to citizens.

Following the great stock market crash of 1929, and the worldwide recession that ensued, states were compelled to introduce new public goods, such as unemployment insurance and welfare benefit payments, to the most downtrodden. Emblematic of these is Franklin D. Roosevelt's package of programs from 1933 through to 1938 known as the New Deal, which was designed to provide relief to the American population in the wake of the Great Depression.

Notwithstanding the increasing role of the State during this time, it is important to note the role played by non-state actors in public goods provision. Oliver Volckart (2000:267) reminds us of the development of private organizations in the Middle Ages designed to provide public goods. These included corporations, which were created to provide a measure of public and legal security for their members, and guilds, which were designed to ensure a minimum level of welfare for members by regulating economic activity. As the European colonial powers began to expand outside of the Old Continent and into the New World, the Roman Catholic Church played an important role in providing education, healthcare and other social services to the newly migrated and their families, as well as the

indigent peoples and, in the centuries that followed, the descendants of both groups.

That the State would eventually take over responsibility for these public goods, while adding new ones, could only occur via the development of its own capabilities to centralize public goods production. Michael Mann (1997:476) provides some perspective on this dynamic over time:

“The regulatory powers of such states expanded through several centuries. First, from the end of the Middle Ages they increasingly plausibly claimed a monopoly of judicial regulation and military force. Then, in the eighteenth and especially the nineteenth centuries they sponsored integrating communications infrastructures and basic control of the poor. The twentieth century saw welfare states, macroeconomic planning and the mobilization of mass citizen nationalism.”

## Relevance

While a long process of centralization resulted in public goods being largely, if not exclusively, provided by the State in the hundred years following the Peace of Westphalia, the role of the nation-state as the principal provider of public goods has since been challenged by a range of political, economic, social, and technological phenomena<sup>vi</sup>, relegating it in many cases to a role of public goods coordinator.

The signing of the International Telegraph Convention<sup>vii</sup> by twenty countries in May 1865 created the first of a series of international organizations and supranational institutions favouring collaboration between states on matters such as the coordination of technical norms or the definition of condoned inter-state behaviours. More than 140 years later, a wide number of ‘traditional’ responsibilities and policy domains of the state—trade, health, defence, justice, fiscal policy, currency, and monetary policy, among many others—are covered by such organizations and institutions, transforming what were essentially national ‘public goods’ into a series of global ‘collective goods’ in the process. While each individual signatory state maintains overall domestic accountability for the public good in question, the day-to-day development, coordination, and in many cases,



execution of that good are the domain of the particular supranational organization.

The phenomenon of delegating responsibility for the design, production and delivery of public goods to a supranational organization has been joined by a second more powerful one: delegation to sub-national entities. This is captured under the broad term of 'decentralization', but is sometimes known as devolution. Though decentralization has an even longer history than that of centralization to supranational organizations—Flinders (2004:884) notes the creation of independent agencies in the UK starting as far back as the 17<sup>th</sup> century<sup>viii</sup>—its intensity has increased significantly over the last fifty years as states have sought to better align the provision of public goods with the preferences of consumers by moving their production and delivery closer to the local level. This movement was influenced in large part by the work of Charles Tiebout, who in 1956 made the case that devolution of responsibilities and associated resources to lower levels of government could significantly improve the quality of services provided. **Annex I** provides some idea of the potential scope for sub-national delegation with a list of sub-national entities created in Britain between 1997 and 2004.

However, the dynamic of *pushing* from the centre outwards that decentralization represents has been replaced by a more powerful one: *pulling* in the form of active pressure from sub-national governments in the context of separatist or nationalist movements. Examples of this range from the piece-meal, negotiated approaches taken by the Canadian province of Quebec or the Spanish state of Catalonia over a period of decades to the outright one-off devolution of a wide range of responsibilities to the assemblies of Scotland and Wales by the British government of Tony Blair in 1997.

A third source of change has been a combination of economic, technological and societal phenomena that have further expanded the scope for delegation of responsibility for public goods to private, non-state actors. Information and communication technologies, including cheap computing power and computer networks, as well as business phenomena such as outsourcing have

demonstrated their awesome power to transform the delivery of public goods both in times of war and in times of peace. In fact, this ability became a major political issue in the 2004 United States presidential election.

In the aggregate, though the means by which public goods provision has been delegated have been mostly happenstance, driven more by political expediency than any conscious, well-thought out, strategic, long-term design. As Bache and Flinders (2004:36) note, "In the context of these developments, there has been little long-term strategic thinking regarding the steering capacity of the centre."

## Project

The impetus for this project was brought about by two newspaper articles as well as an element specific to the United States' ongoing occupation of Iraq. The first article, dated November 13th, 2003, was an editorial in *The Economist* titled, "Europe's rebellious regions", on the occasion of the retirement of Jordi Pujol, the man responsible for much of the success of Catalonia in its push for self-government. The article stated however that,

"What happens in Catalonia is of more than local interest. Europe's nation-states are being challenged from above, by the growing powers of the supranational European Union, but also from below, by increasingly assertive regions. Some theorists talk of a new layering of power in Europe.... This symmetrical squeeze on the nation-state sounds appealingly neat in theory. But, as the controversies in Catalonia show, the reality can be a lot messier. Across Europe, governments and regions still squabble over how power should be distributed."<sup>ix</sup>

The second was a March 2006 article in *The Economist* entitled "Self-replicating", which dealt with a proposal by Singapore to 'manage' one of the thousands of islands that make up Indonesia. In discussing the desire by Singaporean authorities to essentially 'clone' their city-state, providing administration expertise and a proven legal system in return for land and the opportunities it afforded for economic growth, it became apparent that this pushed the logic of outsourcing public goods to its logical extreme. What was left was essentially an expertise that could be implanted anywhere—something *The Economist* called

the “Singaporean operating system”<sup>x</sup>—with ‘investors’ providing the land, people, and resources.

The third impetus was the explosion in the number of Private Military Contractors (PMCs) on the ground in Iraq and the role that these private actors played in relieving the United States’ military of a number of its responsibilities on the ground. The US military had essentially outsourced activities historically associated with national army-driven war fighting to these PMCs. The employees of these military contractors, in return for working with less stringent rules of engagement and less formal recourse for assistance, found themselves making much more money than if they had been there as soldiers under the flag. While military contractors equipped with dark sunglasses and automatic weapons had mostly been seen protecting American diplomats, the May 5<sup>th</sup>, 2004, killings of four employees of Blackwater USA, an American PMC, in the Iraqi town of Fallujah brought home just how close to the action these PMCs actually were.

## Theoretical framework

John Lewis Gaddis (1999) asks, “States are not likely to disappear in the near future, and it is reasonable to expect that they will still be around in some form when the twenty-first century ends. The question is, ‘In what form?’”

Attempting to answer Gaddis’ question, ‘in what form’, we will take the continued existence of the nation-state as a given as well as the continued delegation of some form of public goods provision. Instead, it is the challenges that the nation-state continues to face and the ability to manage the transformation less opportunistically that provide the backdrop for this essay, which deals with the scope for a strategic approach to the outsourcing of public goods. This is something that is currently lacking in the literature, and that we believe provides tremendous value going forward.

To enable such an approach, we seek to develop a framework that will evaluate the extent to which nation-states can outsource responsibility for the provision of public goods as well as the choices—among actor types and actors of a given

type—available to them. To encourage the re-establishment of rational-choice decision-making, this framework will also propose a series of criteria for evaluating the relative attractiveness and potential consequences of a given course of action.

We expect that the eventual transformation of this organizing perspective into a more formal model or eventually a theory would be the subject of future study.

### Units of analysis

When considering the decision to delegate the design, production and delivery of public goods, we would normally assume the operation of some level of rational choice decision-making in the form of a financially-based opportunity cost analysis or a cost-benefit analysis. However, as indicated earlier, the piece-meal approach to public goods delegation seen to date has left the nation-state more vulnerable than ever, and has been described by observers as lacking in strategic approach, causing us to question the level of rationality in operation.<sup>xi</sup>

While public goods may ultimately have other benefits, they are essentially economic services by nature. They are produced by financial means and thus have a notion of intrinsic value. This should simplify the ability to compare them with other public goods and their methods of provision on at least one level. However, in formulating criteria for evaluating the respective options for outsourcing public goods provision, we will also consider goods in terms of their utility, a second approach that favours comparison between one or more heterogeneous goods whose benefits cannot so easily be measured in monetary terms. In this case, we will provide criteria for determining utility based on the potential impact from spillovers, usually conceived in terms of positive externalities, and the potential dynamics resulting from the principal-agent relationship between the State and the non-state actor(s) providing the outsourced goods.

## Findings

We have three findings. **First**, that it is possible to create a coherent framework that captures the options for outsourcing public goods provision across actor types: the nation–state (including quangos); supranational organizations; sub-national entities, and private actors. (We call this a market for governance.) **Second**, with few exceptions, for any given public good, there are multiple alternatives for outsourcing within a given actor type. **Third**, a series of non-financial criteria can be applied to enable a more strategic approach to the question of delegation of public goods provision.

## Demonstration

In Chapter 2, we will consider the forces transforming the provision of public goods, as well as the new forms of governance driven by them. In Chapter 3, we will put forward our proposed framework for the provision of public goods. We will then apply it to three states in Chapter 4 before concluding and considering future avenues for study in Chapter 5.

## Terminology

Before proceeding, we shall provide clarification on the terms we shall use in the course of this document.

When referring to a collection of citizens at the sub-national level sharing a common language, culture or otherwise separate from the majority, we will use the term ‘people’, as in the Catalan people, when not simply using their respective collective nomenclature such as we find for the Scots or the Quebecois. To avoid any misinterpretation with our source material, we will reserve the term ‘nation’ for use as described in the next paragraph.

We shall use the terms ‘nation’, ‘state’, ‘State’, and ‘country’ interchangeably when referring to the nation–state. Mann (1997:476) defines the nation–state as “claiming formal political sovereignty over ‘its’ territories and a legitimacy based on the ‘people’ or ‘nation’ [people] inhabiting them.” We will consider in

particular those states that have voting rights at the top level of world bodies such as the United Nations or the World Trade Organization, which enables us to occasionally include entities such as Taiwan, but not necessarily Scotland, Quebec or Catalonia, to name but a few. We shall also use the terms 'supranational' and 'supernational' interchangeably when referring to international governmental organizations.

When discussing public goods, we shall defer to Paul Samuelson (1954:387) who describes them as "[goods] which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good..." Alternatively known as 'collective consumption goods' or 'pure' public goods, Johnson (2005) adds that they are,

"A very special class of goods which cannot practically be withheld from one individual consumer without withholding them from all (the 'nonexcludability criterion') and for which the marginal cost of an additional person consuming them, once they have been produced, is zero (the 'nonrivalrous consumption' criterion)".<sup>xii</sup>

Further clarifying the notion, Charles Tiebout (1956:417) adds that, "A definition alternative to Samuelson's might be simply that a public good is one which should be produced, but for which there is no feasible method of charging the consumers."

We are specifically interested in those public goods that benefit the citizens or businesses located within the territory of the State. These range from physical goods and services that can be directly consumed by citizens or businesses, to more abstract legal and administrative frameworks that govern specific economic activities or geographical areas (e.g., waterways and resource extraction, among others).

We shall also refer to goods that possess public good-like qualities. For as we shall see, many of the goods in question can be more fairly described as collective goods, global public goods, or quasi-public goods when delivered by a non-state actor though distributed over a large population and meeting the criteria of nonexcludability and nonrivalrous consumption.

We define ‘congestible’ goods as those goods that become congested as more citizens or households make use of them (Inman and Rubinfeld 1997). These can also be thought of as impure goods that are rivalrous in nature. Wilcoxon (2003) explains the dynamic behind congestible goods as, “Once [a] good becomes congested, ... each additional user imposes external costs on all the other users. Since each additional user does not pay the full marginal cost of his or her decision, the resource becomes overused.”

We shall use Alberto Alesina’s (2003:307) definition of government as “a term meant to capture a bundle of public goods and policies.” As for the notion of governance, we shall start with its definition by Bache and Flinders (2004:35), for whom,

“In broad terms, ‘governance’ describes the increased participation of nongovernmental actors in public policy-making and delivery. The term is used to imply an appreciation of an increasingly complex state-society relationship in which network actors are prominent in policy-making and the state’s primary role is policy co-ordination rather than direct policy control.”

To the notion of policy-coordination, which we shall interpret as strategy and execution, we shall add that of the actual production and delivery of public goods to generate what we call governance. To provide additional perspective on this idea, Allen Schick (2003:94-95) writes that governance “has supplanted “government” in many discussions of political institutions and public policy”. Eva Sorensen (2003:6) describes the transition from government to governance as “the spreading of governing capacity to relatively autonomous public institutions and to networks of public and private actors.” Hill and Lynn (2005:1) write that,

“The growing acceptance of ‘governance’ as an organizing concept for public management reform reflects a widespread, though not universal, belief that the focus of administrative practice is shifting from hierarchical government toward greater reliance on horizontal, hybridized, and associational forms of governance.”

Commenting on the notion of governance, a word that has become much more commonplace in day-to-day discussions of accountability in general, and government in particular, Schick (2003:94-95) adds that it suggests, “that

tinkering with the machinery of government through civil service reform, budget practices and administrative re-organisation—the stuff of public management during the past century—does not offer sufficient improvement in performance.” Lester H. Salamon uses the terms “third-party government” (1997) and R.A.W. Rhodes (1996) uses the term “the new governance” to essentially capture the same dynamic.

When discussing “utility”, we mean to use it in the tradition of the field of economics where it is understood as, “a measure of the relative satisfaction or desiredness from consumption of goods. Given this measure, one may speak meaningfully of increasing or decreasing utility, and thereby explain economic behavior in terms of attempts to increase one's utility.”<sup>xiii</sup> We will specifically focus on the notion of ‘desiredness’ to be exact. Though it is citizens who are the ultimate consumers of the goods, it is the State that is ultimately accountable to the population for their delivery. Therefore a qualitative, utility-friendly dynamic is at work.

Finally, we define outsourcing as “utilizing experts from outside the entity to perform specific tasks that the entity once performed itself.”<sup>xiv</sup> Outsourcing has been pursued in the private sector essentially for strategic reasons. It is widely considered a valid, cost-effective means of enhancing value for money and so we use the term here dispassionately. We call the ability to delegate the provision of public goods ‘outsourcing’ as well since, political opportunism aside, this is essentially what is going on: someone other than the State is responsible for the design, production and delivery of a good formerly produced by the State. Referring to outsourcing in security matters, Krahnann (2003:4) uses the term ‘public private partnerships’, which can range from,

“... The outsourcing of single functions or entire service sectors to joint ventures and fully government-owned private companies. Each type of public private partnership is associated with different forms and levels of governmental control. Whereas outsourcing provides supervision through commercial contracts, joint ventures and shareholding directly involve governments in the provision of public services.”



The term outsourcing has been used most frequently in a political science context at the level of individual public goods. For example, Krahnmann (2003), in the context of the UK and German militaries, and Singer (2005) both talk about the 'outsourcing' of defence or active combat by parties to conflicts as varied as the wars of the 1990s in the Balkans and the Congo and the 2003 war in and continuing occupation of Iraq.

## Chapter 2: Literature

The concept of outsourcing the nation-state—the term we propose to describe the *strategic* delegation of the provision of public goods—takes place in the context of a long-standing debate on the future of the nation-state itself. As Peter Drucker (1997:159) noted, for a variety of reasons, “... The best and the brightest have been predicting the nation-state’s demise for 200 years, beginning with Immanuel Kant in his 1795 essay, ‘Perpetual Peace’.” It is a debate that has nonetheless intensified in recent years. However, taking the continued existence of the nation-state as a given, let us now turn our attention to the forces that are converging to transform the State and public goods provision, as well as the new forms of governance driven by them.

### Forces transforming the nation-state

Writing in 1966, Hans Morgenthau stated, “the modern technologies of transportation, communications, and warfare, and the resultant feasibility of all-out atomic war, have completely destroyed [the] protective function of the nation state.”<sup>xv</sup> Echoing Morgenthau nearly thirty years later, in the context of the end of the Cold War, Michael Mann (1997:473) writes that four theses, many leveraging the power, availability and affordability of communications technologies and international travel, have been put forward to justify the (continued) weakening of the nation-state. To paraphrase Mann, they are:

- 1) Globalization, which is undermining the nation-state’s ability to plan, protect or provide for its citizens;
- 2) Global threats, such as terrorism, environmental or population-based, which do not respect borders;
- 3) Identity politics and new social movements; and
- 4) Post-nuclearism, which undermines state sovereignty and other forms of hard politics.

As John Ikenberry (2008:31) writes, “In the age of nuclear deterrence, great power war is, thankfully, no longer a mechanism of historical change. War-driven change has been abolished as a historical process.” Consequently, we shall ignore

point #4. Instead, building on Mann's first three points<sup>xvi</sup>, we will consider the following forces that are transforming the nation-state:

- Decentralization
- Globalization of the economy;
- Demographic change;
- Management theory;
- Accelerated technological change;
- The increase in the number and scope of supranational organizations;
- The trend towards the delegation of powers to sub-national governments; and
- The continued growth in the number, size and scope of private actors.

## Decentralization

Among the many forces transforming the nation-state, one could argue that it is decentralization that has played the most important role. The basic idea behind decentralization was effectively captured in Charles Tiebout's landmark 1956 treatise, 'A Pure Theory of Local Expenditures'. Building on Friedrich Hayek's idea that "local governments and consumers have better information than the national government about local conditions and preferences" (Qian and Wiengast 1997:83), Tiebout argued that the quality of government services would be improved as responsibility for the production and delivery of public goods—and associated financial resources—was moved closer to the ultimate consumers of those goods. The level of government closest to the consumer—whether state, provincial or local government—was perceived as best placed to both understand and arbitrate between consumer preferences.

By moving the provisioning of public goods down to a lower level where multiple potential providers existed, it also created the possibility of competition between providers, which if the market analogy held, would result in more 'bang for the buck'. According to Donahue (1997:74),

"Diverse policy regimes can cater to heterogeneous preferences and accommodate varying conditions. Collective choices are less error-prone, and public administration less plagued by agency problems, with a smaller polity and simpler policy agenda. Interstate competition can discipline government, augmenting the 'voice' of the ballot box with the 'exit' of mobility."

And like with any competitive market for goods or services, unsatisfied 'consumers' could vote with their feet and take their 'business' to the next best provider. As Donahue (1997:73) writes forty years after Tiebout's landmark article,

"Decentralization and interjurisdictional mobility gives the individual power over government that can be exercised on the citizens' terms, at the citizens' own initiative, at any time. If public authority is pushed down to levels where choice and competition can operate, every citizen can stage a personal revolution armed with only a moving van."

However, decentralization was not without its critics. Inman and Rubinfeld (1997:46) write that,

"In the Tiebout economy, most public services are assumed to be congestible and efficiently provided by small communities. However, when there are significant intercommunity interdependencies (like pure public goods or spillovers), Tiebout's competition among small governments may result in economically inefficient public policies.... The principle of economic federalism assigns the central government the task of correcting such misallocations."

In his 1972 book of the same name, Wallace Oates introduced the term 'fiscal federalism' to describe a vision of decentralization that maintained a role for the central government not only as the entity tasked with collecting taxes and redistributing them to the regions. In essence, fiscal federalism says that responsibilities—and funds—should be transferred to the level of government where the externalities can best be generated and captured, even if this remains the central government. Also known as economic federalism, fiscal federalism has had considerable impact on subsequent thinking about the merits of decentralization and its effects. For Inman and Rubinfeld (1997:53), economic federalism embraces "the logic of the Tiebout model and the use of lower-tier governments to provide congestible public services." Inman and Rubinfeld (1997:47) provide some context:

"For most economists, the principle of economic federalism, with its recommended institutions of competitive decentralized local governments and a strong central government to provide pure

public goods and control intercommunity externalities, essentially defines what federalism is about.”

Another way of understanding the drive to decentralize is to shift the discussion away from the question of local tastes, to instead focus on the notion of externalities. As Inman and Rubinfeld note above, this is captured by the discussion of pure public goods—which respect the criteria of ‘nonexcludability’ and ‘nonrivalrous consumption’—and impure public goods, which do not. Inman and Rubinfeld (1997:45) provide some perspective on the recommended separation of responsibilities:

“When public services are pure public goods for which the marginal cost of adding another user will be zero (national defense, basic research), or when there are inefficiencies arising from externalities across jurisdictions, then under economic federalism the central government will be assigned responsibility for those services. However, for public services that become congested as more households use the service—that is, to accommodate additional households at current service levels, additional public facilities must be provided—then relatively small communities are more likely to provide the service efficiently.”

As we have seen, and will discuss further in depth later in this chapter, decentralization has mostly been in the direction of sub-national governments, with its attendant costs in terms of dual loyalties, expanding fiscal commitments and hubris, all characteristic of principal-agent relationships. As a result, decentralization for the sake of decentralization alone had become problematic. Donahue (1997:75) writes,

“In principle, a custom-tailored government should be matched to each collective purpose. But the cost of forming, maintaining, and restructuring polities is often high, and governmental mergers, spin-offs, and liquidations tend to be more traumatic transactions than their private sector analogues. Thus the number and configuration of public sector entities have more to do with the accidents of a capricious history than with the shifting dictates of economic rationality.”

In addition, by creating enhanced responsibilities and visibility for specific sub-regions of a country, potentially enhancing independence movements in the process, decentralization is antithetical to the long-term interests of the State.

Consequently, a separate type of decentralization has also occurred, in the form of state-sponsored, quasi-autonomous non-governmental organizations (known as *quangos* in government jargon). These initially promised to bring some of the benefits of decentralization—a focus on the specific needs of a constituency or geography (something that is difficult at the central level)—while avoiding or minimizing challenges specific to principal-agent relationships and preserving the overall prerogative of the State.

However, as Flinders (2004a:884) writes, the principal drawback of quangos is that they “are neither responsible nor directly responsive to the vote of the people.” (Thus irrespective of the intentions of their designers, quangos exhibit some of the challenges inherent with principal-agent relationships.) Regarding the British experience with quangos, Flinders (2004a:883) writes that, “[the] process has been largely devoid of an underpinning rationale and this may have significant implications for successful policy delivery, the public’s trust in government and the future trajectory of the British state.” This echoes Bache and Flinders’ critique of the lack of a strategic approach that we saw earlier.

While a powerful force unto itself, decentralization has gotten only so far on the strength of its rationale. That decentralization—seen in the broadest sense possible as the delegation of responsibility for the provision of public goods—has continued to expand over time in scope is due to other forces, such as economies of scale due to new technologies, globalization, demographic change, and others that have carried it forward. We shall now proceed to examine those forces.

## Globalization of the economy

Globalization in the early twenty-first century is characterized by relatively liberal flows of people, goods and capital, at least when compared with the 100 years between the end of the nineteenth century and the beginning of the twenty-first. Niall Ferguson (2006:7) writes, “The world of 1900 was in many ways as globalized as our own. Markets for goods, labor, and capital were as integrated as never before. Men and women had never mingled so freely as they did in cities like London, Berlin and Shanghai.” This level of globalization was to be

compromised for at least the next fifty years, starting with the first Sino-Japanese war of 1895 and the Russo-Japanese war of 1904<sup>xvii</sup> and extending into the early years of the Cold War.

According to Mann (1997:478-79), two great geopolitical events eventually set globalization back on its path: "First, decolonization largely ended the segmentation of the world economy into separate imperial zones. Second, the collapse of Soviet autarchy opened up most of Eurasia to capitalist penetration." Globalization in 2007 is symbolized by corporations with operations on all continents except Antarctica and annual revenues surpassing the combined gross domestic product (GDP) of most African countries; 24-hour, largely control-free, worldwide capital markets; and a growing cadre of white collar and blue collar workers crossing borders to ply their trade for a few years before returning home (and starting their own businesses).

Globalization has been perceived for a number of years as the most potent threat to the ability of the nation-state to pursue its policies on the domestic front and to react to external events in line with the wishes of its citizens. Casella and Weingast (1995:13) would say that this challenge to the nation-state by globalization makes perfect sense. In fact, as they see it, "the 'nested,' hierarchical structure of the nation-state has no obvious economic rationale and is opposed by economic forces." Alesina *et al* (2001:3) attribute to globalization a major responsibility for the changes to the form and viability of the nation-state as we knew it. They write that "the increasing integration of the world economy is (at least in part) responsible" for both the growing clout and responsibilities of supra-national unions and the push by sub-national actors for additional powers and resources. These parallel to a certain extent Mann's first and third theses. Alesina *et al*. (2001:41) go on to qualify these as centrifugal and centripetal forces, with centrifugal forces as pushes for "regional autonomy in most West European countries and the break-up of some Eastern European nations)" and centripetal forces as "the tendency to delegate policies to supernational entities like the European Union."

## Demographic change

Going forward, one of the challenges facing most Western countries is that a significant portion of their active population will be leaving the workforce. Tens of millions of members of the baby boom generation—a generation that was significantly outsized relative to both its predecessor and successor generations—are expected to retire in the next ten to fifteen years. The inability to replace them in equal numbers will put additional pressure on a system being asked to look after retirees as they enter the most costly phase of their lives (e.g., old age pensions, healthcare, etc.).

While automation technology and more competitive compensation and recruiting from the private sector can be expected to pick up some of the slack, it is quite likely that the ability of Western governments to return to business as usual is forever compromised. This puts additional impetus behind the drive to outsource many of the tasks performed today by the public service, but with a catch. It is worth noting that this trend of outsourcing towards private actors by pure logistical necessity is over and above the trend towards outsourcing them on the basis of their economic (*read* technological) merits alone, something we will discuss later in this section.

## Management theory

A third force for change in the organization of the nation–state comes from the world of management theory. Two notions—focus at the firm level and specialization at the portfolio level—have had an outsized impact on management practice in the private sector. As Alan Schick (2003:94–95) writes, it started almost a generation ago:

“Decentralisation is part of a broader strategy to divest national governments of direct responsibility for delivering services. The main roots of this strategy can be traced to an influential [1969] article “The Sickness of Government” by management guru Peter Drucker a generation ago. Arguing that national governments are inherently inept providers of services, Drucker urged that they should focus on policy rather than services—they should steer and leave the rowing to others.”



Writing over twenty years after Drucker's article and echoing his line of thinking, C.K. Prahalad and Gary Hamel introduced the business world to the notion of core competencies. As Prahalad and Hamel (1990:81) saw it, competitiveness depended on "management's ability to consolidate corporatewide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities."

By focusing on the essential or the 'core', organizations were ensuring their ability to adapt to, to react to and to take advantage of change. The core competencies concept invited organizations to essentially re-evaluate the 'how' and the 'why' they were in business by asking themselves, "what are we good at?" and "what exactly is it that we do?". We see the evolution of this line of thinking in the political realm at the level of the European Union in a 2001 white paper on governance, which discusses the notion of a 'core mission'.

"Reforming European governance implies that the Commission must refocus on its core mission. The proposals in this paper will improve the quality of the way it initiates policy. They will ensure more clarity and effectiveness in policy execution, and maximise the impact of the Commission's actions as guardian of the Treaty [of Rome]." (CEC 2001:8)

The second powerful idea that transformed management practice came from the world of (financial) portfolio management theory. The push in the 1980s and 1990s to undo the business conglomerates that were so prevalent through the 1960s and 1970s—organizations such as ITT, Gulf & Western Industries, and Hanson PLC come to mind—was due in large part to a re-evaluation of assumptions concerning potential gains from the diversification of risk. Conventional wisdom prior to that time was that an organization could hedge against or reduce risk in one part of its operations by purchasing a second organization that was subject to a different business cycle or different geographical risk. However this eventually came at a price: the shares of conglomerates were historically undervalued when compared to those of their stock market peers. This meant that the desired diversification of risk was coming at the expense of investor returns.

In a highly cited article, Bettis (1983) explained that individual investors could create their own hedges by investing in different companies on their own, with none of the discounts associated with conglomerates. Following this line of thinking, many conglomerates would eventually seek to break up their operations in order to eliminate this discount, essentially becoming specialized 'pure play' providers in the process—best of breed organizations focused on a single line of business.

Over and above the worldwide wave of privatizations in the 1980s and 1990s, this approach of firm-level focus and portfolio-level specialization—backed by management and financial theory—finds its public sector equal in a re-evaluation of those activities in which the nation-state should be present and those that it could conceivably delegate to others. This is captured in the notion of 'The Performing State'. According to Allen Schick (2003:75), the prototypical performing state,

“... continuously reads its environment and adjusts how and what it does in response to new information. In the same way that a successful firm thrives by monitoring its market and changing its product mix, prices and other policies in response to changes in consumer preferences, technological developments and the entrance (or exit) of competitors, an effective government transforms itself in response to changes in family patterns, income distribution, technological advances and other opportunities. Of course, government has a more difficult time adapting because it lacks the pressure provided by markets and the signals supplied by prices. Yet, performing governments do change, even when they profess to be staying the same.”

The performing state is inherently a private sector management concept—notice Schick's reference to the 'successful firm'—in that it is uniquely focused on the notion of outputs or 'desired outcomes'. This last term somewhat dryly strips away the qualitative aspects of public goods delivery to focus attention on more quantifiable 'yes/no' type questions such as “did we do what we said we would do?” or “did we achieve what we set out to do?”. Schick (2003:73) notes that,

“The basic idea is that government should deliver efficient services and operate efficient programmes. In the burgeoning literature on

performance, efficiency generally is associated with outputs—the goods and services produced by government—and effectiveness with outcomes—the impacts of government programmes on society.

One of the initial responses to the need to become a performing state was via the transformation of the civil service, captured under the catchall term 'New Public Management' (NPM), initially developed in the 1980s and much refined since then. Schick (2003:86) writes that NPM,

“... favours ‘shock therapy’, stripping away operations and service delivery from integrated departments and entrusting them to free-standing agencies that have broad operating freedom, privatising government activities or introducing market-type arrangements within governments such as competition, prices and internal contracts.”

According to Bache and Flinders (2004:46), “A central goal of NPM was to move to a situation in which ministers 'steered but did not row' and therefore moved from direct governing to indirect governance.” Shamsul Haque (2001:65) provides some perspective on the worldwide scope of this phenomenon:

“The examples of such business-like reforms in public service include initiatives such as Public Service 2000 in Canada, Next Steps in the United Kingdom, Renewal of the Public Service in France, Financial Management Improvement Program in Australia, Administrative Management Program in Austria, Modernization Program for the Public Sector in Denmark, and Major Options Plan in Portugal (OECD 1993). This new genre of administrative reforms, often generalized as New Public Management, can also be found under various titles in countries such as Belgium, Brazil, Finland, Germany, Italy, Jamaica, Japan, Malaysia, Mexico, the Netherlands, New Zealand, Norway, the Philippines, Singapore, Sweden, Switzerland, Turkey, and Zambia.”

The need to re-evaluate previous assumptions and means of doing found an echo at the supranational level as well, particularly in the case of the EU, a organization that is almost state-like in the range and the depth of its activities. The EU undertook just such an effort with its 2001 governance white paper.

At the level of the EU, the effort to re-imagine governance is captured by 'subsidiarity'—to borrow EU terminology—which aims to push responsibilities

down to the lowest level of government possible, eventually as far down as individual regions. (This form of devolution<sup>xviii</sup> is over and above the question of identity politics and new social movements that Mann described earlier and which we will investigate later in the section on sub-national governments.) In the case of the EU, the goal of governance reform is actually more pragmatic than that. It is more concerned with the Union's ability to both remain relevant and to secure the necessary buy-in over time to continue its efforts.

The line of thinking underlying the performance state, and by extension portfolio specialization, is reflected at the sub-national level as well where it is known as 'unbundling'. Denton and Flinders (2006:1-2) describe the dynamic behind it:

"The relationship between national governments and the regions within that nation-state are both dynamic and complex. In recent years this complexity has been augmented by the centrifugal pressures of new public management, which have encouraged the creation of increasingly fragmented state structures, at the national, regional, and local level..."

However, devolution in the name of the performing state is like decentralization in that it is not without its critics who question the long-term impact of the reforms, thus calling into question the level of strategic thinking involved in its deployment. Describing the situation in the United Kingdom following the 1997 devolution of a series of powers to Scotland and Wales, Bache and Flinders (2004:43) write,

"... It is clear that devolution has led to the *de facto* creation of an increasingly disaggregated (sic) state, a quasi-judicial constitution in which inter-governmental disputes are decided by the judicial committee of the Privy Council and soon the Supreme Court, multiple and confused lines of accountability, shared or negotiated sovereignty within the European context, a fragmented civil service and increasingly distinct and explicit Welsh and Scottish foreign policies."

Taken together, the notions of core competencies and the performing state, as well as the thinking behind modern portfolio theory, effectively provide *impetii* for the disaggregation of the nation-state. Indeed, the notion of the performing state essentially strips away the 'missionary' or nationalistic-emotional aspect

historically found behind the provision of public goods and heretofore used to justify their continued provision by the nation-state. In its place is left a dyad of ‘public goods producer’ (the State) and ‘public goods consumers’ (the citizens).

The generalized acceptance of this dyad is a key stepping-stone on the way to eventually relieving the State of its role as goods producer, thus transforming the dyad into a triad, with the State as monitor—or to echo Drucker’s approach, the entity charged with steering—in collaboration with citizens as public goods consumers and non-state actors as public goods producers.

By putting forth the notion of outcomes as being quantifiable, essentially binary in nature, the performing state concept facilitates the comparison of outcomes between goods providers. Of course, the next logical step after comparison—particularly when one’s provider has been found wanting—is to shop around. Schick (2003:73) writes,

“Performance is a demanding test. When the state fails to meet the test, its legitimacy and competence may be called into question, and policy-makers and interest groups may seek substitutes that promise the results they want. To put the matter bluntly, in the performing state, performance is more important than the state. The modern state has primacy only to the extent that it performs. Inasmuch as the state still has first claim on national loyalty and tax revenues, the initial *tranche* of performance enhancing reforms strives to empower the state. But when this fails to produce results, alternatives to the state may be favoured.”

### Accelerated technological change

In discussing his model for determining the optimal size of countries on the basis of the ability to collect tax revenues net of collection costs, Friedman (1977:60) suggested that, “in most places at most times, [there were] net diseconomies of scale in collection costs. This seems plausible, especially prior to the invention of such aids to bureaucracy as the printing press and the telegraph.” Following Friedman’s line of reasoning, the advent of communications technology initially served to increase the size of the State through reduced collection and

coordination costs, thus enabling the centralization of the provision of public goods.

However, beyond a certain point of technological development (and associated economies of scale), those same technologies have the ability to reduce the required scope of the nation-state as well. The advent of cheap international long distance rates and Internet connectivity, combined with the commoditization of information technology, has enabled the growth of a worldwide outsourcing industry. While the outsourcing industry had initially focused on serving organizations in the private sector, it has since turned its attention to servicing the public sector as well.

That states have not outsourced more on the basis of technology costs alone is essentially the result of political resistance, focusing on the perceived limited *electability* of politicians who support the matter. On the domestic front, efforts to outsource consistently run up against entrenched government unions and populist opportunism. Looking only at the situation in the United States, from 2003 until September 2005, Lee *et al* (2005:2-3) counted a total of 46 states that had proposed some form of anti-offshoring<sup>xix</sup> legislation, with 11 states having adopted formal laws and 9 others subject to decrees by their respective governors. New Jersey adopted the most stringent requirement at the time, specifying that only American citizens could perform contracts for that state.

## Supranational organizations

Donald Wittman (1991:127) describes one of the principal dynamics underlying the desirability of outsourcing the provision of public goods: "In the economic sector, sometimes the best way for a firm to gain access to the unique skills associated with another firm is to become part of the more successful firm." The state equivalent of this is to join a supranational organization, thereby getting access 'on the cheap' to the best practices and the brightest minds.

This trend towards supranational organizations as a means of outsourcing the provision of public goods is the result of both 'push' and 'pull'. In Alberto Alesina

and Enrico Spolaore's 2003 book, *The Size of Nations*, the authors put forth a theory for the development of countries that can be extended to address the rationale behind the 'push' by states to become members of international organizations. Their theory focused on the trade-off between "the benefits of country size versus the costs of heterogeneity of preferences, culture, attitudes of the population." In their book, the authors consider factors that speak to the benefits of being part of a larger country, specifically:

- 1) The per capita costs of public goods;
- 2) The ability to address foreign aggression;
- 3) Internal market size;
- 4) The ability of larger countries to isolate or buffer one region from economic difficulties in another;
- 5) The ability to spread externalities over the population base; and
- 6) The ability to implement redistribution schemes.

Membership in a supranational organization addresses each of the factors identified by Alesina and Spolaore that would have historically favoured a larger country size. For example, membership of the EU enables member states to spread the per capita costs of public goods (factor #1) over a much larger population, one frequently larger than that of most nation-states. In fact, the EU was explicitly designed to create a much bigger internal market (factor #3) over time for the goods and services of its members.<sup>xx</sup>

In addition, membership of a supranational organization such as the EU also enables member states to effectively internalize the many additional externalities created by the organization itself (factor #5). Take defence as an example. Through the sheer combined size of its membership, an organization like the EU—initially focused on economic issues—can also provide an effective counterweight to most attempts at foreign aggression (factor #2); in essence, to pick a fight with one EU member is to pick a fight with the whole organization. In this case, the ability of smaller member countries to not only free-ride, but to actually gain access to incremental war fighting capability, is just one more of the attractions of membership of a supranational organization such as the EU. At the member state level, funds saved on defence or the provision of public goods by the Union can be affected to issues like redistribution (#6) or shoring up a region in times of economic difficulties (factor #4), though it is important to note that

the EU also offers its own dedicated redistribution schemes (e.g., Common Agricultural Policy, EU Infrastructure Fund).

States have also seen the provision of public goods transferred to supranational organizations by means of a process of 'pulling'. In effect, they have delegated additional responsibility for the provision of public goods through a process known as political entrepreneurship, driven by the officials and bureaucrats that represent these same supranational organizations. Andrew Moravcsik (1999:268), a prominent critic of the concept of supranational entrepreneurship, nonetheless describes the dynamic as follows:

“Constructivists contend that international regimes should be viewed not as passive sets of rules, but as active sites of bureaucratic politics that empower international officials to wield transnational influence—the critical question, they assert, is to explain this power and autonomy. In such cases the supranational officials and institutions in question have no formal voting rights, financial resources, or coercive means at their disposal. Instead, they are said to influence international negotiations through the persuasive manipulation of information and ideas. They exercise "leadership" rather than formal power. In short, they are "informal" political entrepreneurs.”

The classic case of supranational entrepreneurship is of course the European Union. Moravcsik (1999:268) describes that organization's unique capability for such entrepreneurship:

“A substantial bureaucracy in the EC Commission, numbering around fifteen thousand, has a primary mandate to oversee daily passage and implementation of EC legislation. For this it is granted formal powers almost unique in international life, including a unique right of legislative proposal, limited control over administrative implementation, and, in some places, the right to launch legal processes of regulatory or judicial enforcement. The European Court of Justice (ECJ) and the European Parliament also have substantial formal roles.”

This “self-sustaining and path-dependent process of unintended consequences — ‘spillover’—that powers regional integration” (Moravcsik 1999:268) has resulted in more and more national prerogatives coming under the purview of the EU, including justice, social policy, environmental law and other domains. Specifically



in the case of the European Union, the process of transferring responsibility for public goods provision—measured at times in degrees—has been aided by the European Court of Justice’s at times generous interpretation of the responsibilities of the EU and the regulatory conditions required in member states for the Union to achieve its core treaty obligation to provide a common market. Whether the motivations that have ultimately led to expansion in scope and financial costs can be qualified as hubris or empire-building is beyond the scope of this effort. However it is fair to say that this supranational entrepreneurship demonstrates a number of the drawbacks associated with principal-agent relationships if left unattended.

In sum, in their ability to transform the nation-state, supranational organizations provide three main benefits, while offering little of the drawbacks associated with decentralization or fiscal federalism in their original forms. First, they are an effective means of mitigating many of the pressures that would have historically caused states to grow through conquest to achieve “critical mass”.

Second, being a member of an supranational organization not only provides for the like-for-like exchange of a public good produced at home for one produced outside the country, it also enables a member country to achieve a higher level of utility for the same overall expenditure or less, due to the presence of spillover effects.

Thirdly, the ability to outsource the provision of public goods and to do so selectively, through targeted membership of supranational organizations, provides an effective means of addressing the potential negative externalities resulting from the historical trade-off between size and heterogeneity of preferences. The additional ability to opt out of specific treaty clauses or programs—at least in the case of the EU—also acts as a release valve for preserving desired state-level specificities.

In fact, at a certain level, the ability to effectively ‘venue shop’ among supranational organizations enables states to essentially fine-tune the net utility—a factor of spillovers and principal-agent costs—which they receive. However, while a given member country is able to both shop among

supranational organizations—as highlighted above—and in some cases, to pick and choose the clauses or conditions that apply to it, that is not to say that a given supranational organization will always be willing to accept new members.

### Sub-national entities

The trend of outsourcing the provision of public goods in the direction of supranational organizations has been complemented by a parallel effort in the direction of sub-national governments, one that is not without its challenges.<sup>xxi</sup> As with supranational organizations, outsourced public goods provision is both the result of pushing and pulling on behalf of state and sub-national actors respectively.

The notion of ‘pushing’ is captured by decentralization, which we examined earlier in this chapter. Hooghe and Marks (2003:237–38) illustrate the extent of delegation of responsibilities to sub-national levels of government with a look at the situations in Switzerland and the US.

“[Switzerland features] six types of functional, overlapping, competitive jurisdictions that complement or compete with general-purpose local governments. These communes, of which there are about 5,000, perform specialized tasks, such as providing local schooling, electricity, gas, water, or street lighting. In addition, hundreds of intercommunal associations provide specialized public goods on a larger scale, including, for example, hospitals, nursing homes, or garbage collection ... The closest functional equivalent in the United States consists of “special districts,” which, as in Switzerland, have intersecting territorial boundaries and perform specific tasks. ... Overall, the number of special districts [in the US] has seen a threefold rise, from 12,340 in 1952 to 35,356 in 2002. Ninety-one percent of these are single-function districts, dealing with one of the following: natural resources, fire protection, water supply, housing, sewerage, cemeteries, libraries, parks and recreation, highways, hospitals, airports, electric power or gas supply, or public transit.”

One example of what we would call ‘pulling’ is the desire by local or regional governments to move at a faster pace or with a level of attention to local or regional specificities than the central government is capable of offering. It is often the case that some sub-national governments want to put in place higher

levels of regulation than the central government is willing to allow. An example of this comes from the state of California, which is effectively exempted from the rules of the federal Environmental Protection Agency in order to more aggressively address the air quality needs specific to that state. In fact, the California Air Resources Board (CARB), founded in 1967, is unique among the fifty American states in its ability to set its own emissions standards.

However, notwithstanding the economic and coordination benefits of moving the provision of services closer to the citizens receiving them, the delegation of responsibilities towards regional and local governments has been driven in large part by what Mann (1997) calls identity politics and regional movements. These movements claim such rights as territorial autonomy, self-government, and even the ability to veto or opt-out of centrally planned programs or legislation. Axtmann (2004:264) writes that their, “demands are premised upon the belief that only by possessing and exercising these rights, powers, and immunities will it be possible for these communities to ensure the full and free development of their culture.”

Addressing this same dynamic, Sambanis and Milanovic (2004:4) speak of a demand for sovereignty, which they define as,

“... an organized effort to increase political power and representation at the center of political authority or, alternatively, to attain greater administrative and legislative independence from the center and greater control over the territory in which a group demanding sovereignty lives.”

Sambanis and Milanovic qualify this demand for sovereignty as a form of political decentralization, whereas Tiebout’s decentralization can be thought of as fiscal decentralization. In the words of Sambanis and Milanovic (2004:6), political decentralization “... takes cultural or political divisions as given and works around them to create a system of quasi-independence, reducing the level and depth of interaction between the center of power and peripheral regions.”

Whether these demands are reasonable or not—at a minimum, they exhibit many of the drawbacks of principal-agent relationships—and whether or not their long

term impact is fully understood, many nation-states have acquiesced to them in a bid to maintain national unity. However this has been shown to be a slippery slope over time as evidenced by continuing demands for powers in Quebec and Catalonia once previously existing demands have been satisfied. In effect, this 'slippery slope' constitutes the principal challenge and drawback of sub-national outsourcing. Axtmann (2004:264-65) speaks to the danger of such efforts, specifically on how they contribute to the phenomenon of identity politics:

“These demands raise the question of the very nature, authority, and permanence of the ‘multicultural,’ or rather ‘multicommunal,’ state of which these various cultural communities are part .... The question has arisen as to how these communities can coordinate their actions in areas of common concern or common interest, for example, with regard to the environment, the economy, or military security ... The net effect would appear to be a state that is limited to act as the coordinator of these political and cultural networks that are formed by a plethora of ‘cultural’ communities.”

### Private actors

Private actors, whether non-governmental organizations (NGOs), publicly listed companies or private enterprises, are the last of the primary forces transforming the nation-state that we shall examine here. Like supranational organizations and sub-national entities, the growing role of private actors in the provision of public goods is the result of both ‘pushing’ and ‘pulling’. And as with supranational organizations and sub-national entities, outsourcing to private actors is not without its challenges.

One of the first public goods to be actively outsourced to the private sector was public security in the form of a time- and context-specific monopoly of violence. Founded in 1850, the Pinkerton National Detective Agency frequently played the role of private military contractor as the United States expanded westward and even that of secret service during the American Civil War<sup>xxii</sup>. At its height, the agency was said to command more personnel than the federal army. (This would eventually lead the state of Ohio to outlaw the agency for fear it could be hired out as a private army or militia.<sup>xxiii</sup>) As the writ of the American government

expanded westwards, the need for the Pinkertons would eventually disappear with first the US army then local law enforcement taking its place.

Following the decolonization of much of Africa and southern Asia in the 1950s and 1960s, and the civil and inter-state wars that ensued, there was a resurgence of private military activity in the form of mercenaries. Brayton (2002:309) writes that, “[the] increasing inability of weak governments to counter internal violence has created a ready market for private military forces.” Avant (2004:153) describes this as a “transnational market for force” with states actively calling on—or ‘pushing’ to use our terminology—PMCs as active participants.

However, in recent years the role of private military activity has taken on entirely new importance, as Brayton (2002:303) describes here:

“For nearly three centuries the accepted international norm was that only nation-states fought wars. Today, however, organizing units unrelated to the nation-state, from terrorists, mercenaries, guerrillas and warlords to non-state militias and private military corporations [PMCs], conduct war worldwide. Although the form of non-state force varies from one society to the next, the collective effect is the erosion of the state’s monopoly on the use of violence.”

While the use of private military contractors had historically been associated with combat operations only—in the form of mercenaries—their role has since changed profoundly. This is highlighted by the two Gulf wars of recent memory. Whereas the US military had essentially handled all aspects of equipping, arming, deploying, supplying, and feeding military personnel on its own in the 1991 conflict, the prosecution of the 2003 conflict would be carried out much differently. There private military contractors such as Kellogg Brown & Root and Dyncorp International were intimately involved in the transport, shelter, feeding, and equipping of US troops. In addition to such support roles, PMCs were also on the ground providing primary security operations, following the cessation of major hostilities, as well as training to indigenous government forces. According to The Economist newspaper (2007c), “The privatisation of military functions, from logistics to maintaining weapons, has reached the point that the Pentagon now regards contractors as an integral part of its ‘total force’. America could not go to war without them.”<sup>xxiv</sup>

This increase in private military activity in recent years, particularly its use by Western governments, is also due to other factors. The Cold War, and the policy of containment, provided politicians and the electorate with a ready-made excuse for the sustained deployment of resources and the need to accept a given level of casualties to protect a certain way of life. The end of the Cold War took away this rationale as philosophical crutch. As Brayton (2002:309) writes, “Fuelled by a post-Cold War shift away from the strategic confrontation of major powers ... politicians are disinclined to explain casualties to their electorates.”

Following the end of the Cold War, there was pressure to cash in the ‘peace dividend’ and as a result many countries saw their national armies dwindle in size and the quality of their kit. This effectively reduced their ability to respond to external threats. That armies have since stayed smaller in spite of heightened geopolitical tensions is in many cases due to budget choices; funds saved on defence expenditures can be used to care for aging societies.

However, in many cases, the push towards using PMCs is for less straightforward reasons. PMCs have often been called upon to sidestep the usual systems of checks and balances—whether for reasons of budget allocations, separation of powers (the ability to declare war or deploy forces; see the Iran-Contra scandal), or to respect client nation concerns about the presence of troops under another flag—while still maintaining the ability to project power.<sup>xxv</sup> As Brayton (2002:309) notes, “... Private military companies can help policymakers achieve their goals free from the need to secure public approval and safe in the knowledge that, should the situation deteriorate, official participation can be denied.”

There is also a determination, specifically in the case of the US, to avoid imperial overstretch. For former colonial powers such as Great Britain and France, there is the challenge of not appearing to re-stoke imperial ambitions in the hearts and minds of their own citizens while also appeasing fears in former colonies. PMCs provide a convenient end-run around both of these issues.

There are also logistical and tactical challenges involved with the smaller-scale “asymmetrical” war fighting of today that leave traditional military forces at a disadvantage. As Brayton (2002:309) notes,

“Most Western armies are designed to fight the sophisticated international conflicts envisioned by Cold War strategists. The armies are neither trained nor equipped for low-intensity civil wars, which involve complicated ethical agendas, blurred boundaries between combatants and civilians and loose military hierarchies.”

Echoing the advantages of other private actors, PMCs provide access to potentially more modern techniques (e.g., military doctrines), looser rules of engagement, and lower overhead in terms of the support personnel necessary for sustained deployment that may make them better suited to these conflicts. However, the trend towards outsourcing defence and security matters, while offering a range of benefits, is not without its consequences. Avant (2004:154) writes,

“Along with this market [for force] has come speculation about its consequences for states and global governance. Optimists have argued that privatization is likely to yield benefits for states— [private security contractors] will deliver new security services cheaply and flexibly in ways that will enhance state security—and thus global governance. Pessimists have argued that privatization will be costly to states—eroding accountability and enhancing conflict and thus challenging global governance.”

According to Brayton (2002:303-04), the privatization of security calls into question the notion of “‘trinitarian warfare’—the rule born at Westphalia that has guided modern conflict with the principle that in war ‘it is the government that directs, the army that fights, and the people who suffer.’”

Private actors have also been ‘pushed’ into the provision of public goods by broad social forces transforming much of the Western World. These are the twin forces of declining birth rates—many of which have fallen below the natural population replacement rate—and an expected mass exodus of the workforce by the Baby Boom generation. In the context of plugging just the baby boomer gap alone, Javers (2007) writes about the expected growth in the breadth and the depth of private sector offerings to the public sector in the USA:

“Government contractors are betting the [government] agencies’ recruitment efforts will go only so far. Where are they most likely to replace retiring boomers? They are loath to say for competitive and political reasons.... And while contractors typically take over back-

office and IT positions, they're vying for some unusual jobs these days. For example, the Army Contracting Agency, which supplies troops in the field, is looking to outsource the writing of quarterly reports to Congress on behalf of the special inspector general for Iraq reconstruction.”

Private actors have been ‘pulling’ to take over the provision of public goods particularly following the worldwide wave of privatizations of state-owned enterprises in the 1990s. Privatization was in itself an indirect form of outsourcing the provision of public goods. Those same organizations, driven by a common market-based imperative—the desire to increase shareholder value—are now looking to increase the range of services they provide and the number of ‘customers’ (i.e., nation-states) to which they provide them.<sup>xxvi</sup> We will address this dynamic further in Chapter 3.

Many of the factors that led states to delegate matters of defence to PMCs (e.g., access to new skills, the ability to provide political cover and its corollary ability to blame, the ability to avoid normal checks and balances) have led states to want to outsource other public goods provision to the private sector. However, there are downsides as well to delegating the provision of public goods, principally due to the agency problem. This is created by a misalignment of interests and information between the principal (i.e., the State) that pays the bills and is ultimately responsible to the citizenry and the agent (i.e., the private actor) that is not responsible to the same constituency.

Returning specifically to the case of outsourcing defence, there is the risk that the activities of PMCs will spill over beyond their original mandate. The very nature of their activities—their *raison d’être*—is conflict. Doing their job too successfully means that there is no more conflict and that they are effectively out of a job. In countries with weak governance, the potential for PMCs to become active protagonists in the conflict is non-negligible and is eerily reminiscent of Eisenhower’s 1961 warnings about the military industrial complex<sup>xxvii</sup>.

Another example of hubris or empire building introduced by the agency problem is the potential for agents to expand the scope of their activities. In the case of PMCs, this has meant the addition of commercial activities alongside and under



the cover of military operations. Many conflicts have their origins in the fight for control of natural resource wealth. Brayton (2002:305) talks of a “troubling link between low-intensity conflicts and strategic minerals”. Even where the conflict is not about natural resources, there is scope for mission creep. Originally launched to combat the rebel soldiers of the FARC, the Colombian paramilitary forces known as the AUC eventually became involved with the production and sale of cocaine just like the FARC. The conflict thus took on its own logic with both the FARC and the AUC wreaking havoc, eventually attacking the general population as well as government soldiers, in order to protect their booming trade. Part of the irony of Plan Colombia, which sees the Government of Colombia accept US financial and military aid in the shape of Special Forces ‘advisers’, is that it is in effect calling in a third party to deal with an existing third party—calling in an outsourcer to manage an outsourcing relationship that had gone sour.

In principal-agent relationships, the principal is ultimately responsible for the agent's performance; this is no different with State-private actor relationships than it is between the management and shareholders of a publicly traded firm. In the case of defence as a good outsourced by the private sector, the extent to which private military activity really is private is open to some debate. Historically, states could be counted on to intervene in the affairs of another country should the citizens of the first country be unreasonable inconvenienced (detained, attacked, killed) by the second. Responses to such incidents are the stuff of military legend and international arbitration as well. The early years of the projection of US power, known as ‘Small Wars’ (Boot 2002), are littered with such cases. The intervention by the United States off of the coast of Malta on February 16, 1804, to rescue the surviving members of the navy frigate Philadelphia—sent out the year before to put down attacks by the Pasha of Tripoli on American merchantmen—is one of the most well known. Exactly 200 years (and 2 months later), US Marines entered the city of Fallujah, Iraq, to avenge the killings of 4 private military contractors, sealing off the entire city in the process, at additional cost in blood and treasure.

## New forms of governance

Now that we have examined those forces transforming the nation-state, let us know our turn attention to the resulting forms of governance.

When considering the nation-state during the three centuries following the treaty of Westphalia, we must consider both the governance model as well as the actual arrangement of powers. In formulating our framework for the delegation of public goods provision, we took into consideration the following concepts for describing these new forms: interdependence, distributed public governance, and multi-level governance. However, before examining them, we will briefly review the models and early forms of state organization that they are considered to have replaced.

### Early forms of state organization

As the nation-state grew in territory and population, it took on new forms to address the scope and complexity of providing public goods to ever-greater numbers of citizens and ever-greater demands by them. For the purposes of demonstration, we will oversimplify the earliest forms of the nation-state as well as timeframes in order to focus our attention on the State's more recent incarnations.

The states that existed around the time of the Peace of Westphalia were characterized by a generally straightforward relationship between the producers and the consumers of public goods. The producer—the State—was led by a King or other executive power of a similar nature, who acted via a handful of handpicked operatives that oversaw other state employees (army, constabulary, tax collectors) to provide public goods to the general populace. The transmission mechanism for decisions was simple and frequently one-way: only the King decided; his operatives acted on his decisions; and the people received their public goods in due time. The King was the executive power, the legislative power, and the judiciary all rolled into one. His operatives served at his—and only

his—pleasure and could be (literally) terminated at will, the threat of which could simplify most coordination challenges.

Some states at that time operated under a primitive form of constitutional monarchy. This inserted a legislative body into the mix, which needed to be consulted with to achieve the royal objectives. Appointed and not elected, the legislative body was responsible only to itself and to the King. However, there was still no complete, formal feedback loop—another way of understanding a transmission mechanism—between the executive power, the legislative body, the operatives tasked with putting decisions into practice, or the people, and so the challenges of coordination increased correspondingly.

As the model of a constitutional monarchy evolved, the right of initiative was completely transferred to the legislative body. This body acquired a leader, who shared some measure of executive power with others—ministers or secretaries—who were responsible to him first and foremost, as well as to the legislature itself. The King was essentially left with the ability to approve or reject legislation and not much more. As well as additional coordination issues, the need to bargain with others simply to develop as well as implement legislation resulted in increased structural complexity and diminished flexibility.

Minus a good number of sitting kings and other royals, and the introduction of the popular vote—in varying degrees by country and time—it is at this point that we renew with the literature. The dominant governance model from this point on, and up until quite recently, is known as the Westminster model. The Westminster model is notable for the notion of ministerial responsibility to Parliament. It assumed that a given minister was ultimately responsible for all activities carried out under his/her purview. Failing that capability, a minister was expected to resign, to be replaced by someone else. Bache and Flinders (2004:33) write that, “the [Westminster model] contained a strong normative dimension, describing not just how government was thought to work but how it should work.” With the Westminster model, the feedback loop was effectively complete: the people receiving public goods were able to vote for the members of the legislature who made the laws that affected the provision of public goods.

Prior to the forces described earlier in this document, the two principal forms of state organization that leveraged the Westminster model were the centralized state (e.g., France (1789), the United Kingdom (1707 with Scotland; 1801 with Ireland) and the state as federation (e.g., Canada (1867), USA (1789), Australia (1901)). As Hooghe and Marks (2003:233) write, the federation approach consisted of a “coherent system of nested governments”, while centralized states featured policies, priorities, and funding dictated from the centre. Hirst (2002) dates the turning point in the dominant models of governance to the start of World War I, focusing specifically on decentralization and globalization, two of the main forces discussed earlier.

Let us now consider three modified forms of governance as studied by the academic community; interdependence, distributed public governance, and multi-level governance. These forms of governance can be understood to a certain extent as a continuum of thinking, an evolution of ideas that has occurred in parallel with some more recent changes to the nation-state over the last thirty years. **Annex II** shows the evolution of these forms of governance over time.

## Interdependence

One of the earliest terms used to describe this new form of state organization is that of interdependence. According to Hanrieder (1978:1278),

“... There has developed on the global level an interconnected and intensified flow of national-vertical, international-horizontal, transnational-lateral and supranational-integrative processes—a complex of relationships, usually described as interdependence, in which demands are articulated and processed through formal as well as informal channels, governmental as well as non-governmental organizations, national as well as international and supranational institutions.”

Though he considers that this interdependence was originally enabled by a “permissive context” of liberal trade and money flows, the absence of protectionism and the presence of other liberal institutions and ideologies, Hanrieder (1978:1286) puts forward the idea that politics has subsequently maintained it as such:

“Interdependence is sustained because these interest calculations do not allow the disintegration of interdependence toward a more fragmented and contentious international system but neither propel it toward more integration and supranationality. Interdependence, and the coordination required for its operation, is a halfway house between disintegration and integration of political and economic processes. Interdependence is the prototypical phenomenon of an international system that derives its dynamics from the pursuit of the national interest as well as of interests that are narrower and larger than the national interest.”

## Distributed Public Governance

The second major form of governance that we shall consider is ‘distributed public governance’, a term the OECD (2001:6) uses to refer to the wider state sector, which includes,

“... all bodies that are part of local or national government and have been given some autonomy and/or some independence from the ministries to which they report and/or are subject to a completely or partially different set of management and financial rules from traditional vertically integrated ministries.”

Distributed public governance has been driven in large part by the mantra of decentralization, a powerful force we examined earlier in this chapter, that has fundamentally transformed the provision of public goods, inserting sub-national entities into all phases of public goods design, conception and delivery. According to Flinders (2004a:884), distributed public governance, “widens the focus of analysis to encompass the growing number of independent bodies that operate at the supra-national and global level.” Whereas the notion of interdependence was essentially concentrated on relationships between nation-states or between the nation-state and one or more supranational organizations, distributed public governance adds governance at the sub-national level. As shorthand for distributed public governance, Veggeland (2003) uses the notion of downward and outwards to describe this dispersion of responsibilities. Bache and Flinders (2004:45) add,

“Whereas devolution signifies the movement of functions downward to the sub-national level, the Government's public sector reforms

have propelled functions sideways. The outcome of these processes is arguably the creation of complex matrices in which functions have been re-distributed both vertically and horizontally.”

In the context of the EU, distributed public governance takes the shape of formal mechanisms such as quasi-autonomous agencies created by Union treaties, as well as subsidiarity, which seeks to push responsibility down to the lowest level possible, potentially even the sub-national regional level, where it is captured by the Euro-speak notion of '*l'Europe des régions*'. This development goes back to the Maastricht Treaty of 1992, which Veggeland (2003:12) says “not only challenged the member states by introducing more supranational competence, but also in terms of challenging the national state to perform downward devolution to the regions.”

As Veggeland (2003:10) writes, distributed public governance takes “its legitimacy from a constitutional model weighting functionality more than parliamentary legitimacy.” Referring to the case of Norway specifically, Veggeland (2003:29) indicates this has come at the cost “deficits of co-ordination and planning authorities, institutional coherence and democracy.”

### Multi-level governance

Gary Marks coined the term 'multi-level governance' (MLG) in 1993. Bache (2004:35) writes that he defined it as “a system of continuous negotiation among nested governments at several territorial tiers— supranational, national, regional and local—as the result of a broad process of institutional creation and decisional reallocation.” According to Bache (2004:35), “For Marks, 'multi-level' referred to the increased vertical interdependence of actors operating at different territorial levels, while 'governance' signalled the growing horizontal interdependence between governments and nongovernmental actors.”

Hooghe and Marks (2003:234) propose two models, or 'types' as they label them, of multi-level governance. (See Table I on page 43)

**Table I: Types of Multi-Level Governance**

<b>Types of Multi-level Governance</b>	
<i>Type I</i>	<i>Type II</i>
General-purpose jurisdictions	Task-specific jurisdictions
Nonintersecting memberships	Intersecting memberships
Jurisdictions at a limited number of levels	No limit to the number of jurisdictional levels
System-wide architecture	Flexible design

**Source:** (Hooghe and Marks 2003:236)

### **Type I Multi-Level Governance**

Type I multi-level governance is based on an approach of federalism with non-overlapping entities, each responsible for a given activity. With this type of governance,

“Decision-making powers are dispersed across jurisdictions but bundled in a small number of packages.... Membership is usually territorial, as in national states, regional, and local governments, but it can also be communal, as in consociational polities. Such jurisdictions are defined by durable boundaries that are nonintersecting at any particular level. Moreover, the memberships of jurisdictions at higher and lower tiers do not intersect.” (Hooghe and Marks 2003:237)

### **Type II Multi-Level Governance**

As for Type II multi-level governance, it is characterized by a situation,

“... in which the number of jurisdictions is potentially vast rather than limited, in which jurisdictions are not aligned on just a few levels but operate at numerous territorial scales, in which jurisdictions are task-specific rather than general-purpose, and where jurisdictions are intended to be flexible rather than durable.” (Hooghe and Marks, 2003:237)

Comparing the two types of MLG, Bache and Flinders (2004:39) write,

“Type I MLG echoes federalist thought, conceiving the dispersion of authority as being restricted to a 'limited number of non-overlapping jurisdictional boundaries at a limited number of levels'.

In this view, authority is relatively stable and analysis is focused on individual levels of government rather than specific policies. Type II MLG provides a vision of governance that is 'a complex, fluid, patchwork of innumerable, overlapping jurisdictions'. Here, governance locates around particular functions and jurisdictions tend to be flexible as demands for governance change."

Describing the situation in Britain, Bache and Flinders (2004:32) contrast multi-level governance with the Westminster model seen earlier. As they see it, "MLG directs attention to a complexity, cross-sectoral engagement and contestation of legitimate authority between actors organized at different territorial levels that increasingly speaks to the nature of British governance." Table II provides a more comprehensive overview of the differences between the two model types.

**Table II: Contrasting organising perspectives of governance: Westminster model and Multi-level polity**

<b>Contrasting Organising Perspectives: Westminster Model and Multi-level Polity</b>	
<b>Westminster Model</b>	<b>Multi-level polity</b>
Centralised state	Disaggregated state
<i>General Principles</i>	
Hierarchy	Heterarchy
Control	Steering
Clear lines of accountability	Multiple lines of accountability
<i>External Dimensions</i>	
Absolute sovereignty	Relative sovereignty
British foreign policy	Multiple foreign policies
<i>Internal Dimensions</i>	
Unitary State	Quasi-federal state
Parliamentary sovereignty	Inter-institutional bargaining
Strong executive	Segmented executive
Direct Governance	Delegated Governance
Unified civil service	Fragmented civil service
Political constitution	Quasi-judicial constitution
British foreign policy	Multiple foreign policies

**Source:** Adapted from Rhodes (1997) and Bache and Flinders (2004), in Bache and Flinders (2004:38).

As Bache and FINDER (2004:36-7) note, "it is increasingly common for sub-national actors and supra-national actors to communicate directly without



working through the national level.” This idea of communication among non-state actors is one that distinguishes multi-level governance from simple decentralization or distributed public governance as discussed earlier.

In 2001, MLG was advanced by the European Union in an attempt to describe the dispersion of authoritative decision-making across multiple territorial levels (Bache and Flinders, 2004). Hooghe and Marks (2003:234) write that in its 2001 whitepaper on governance, the EU saw its internal organization as being “based on multi-level governance in which each actor contributes in line with his or her capabilities or knowledge to the success of the overall exercise.”<sup>xxviii</sup> When applied to the EU, which we can consider as a Type I model—though a case could be made for a trend towards Type II—the MLG model comprises three central tenets:

“**First**, that while nation states remain central actors in policy-making, decision-making competencies are shared and contested by actors organised at different territorial levels rather than monopolised by national governments. **Second**, collective decision-making among states in the EU involves a significant loss of control for individual national governments. **Third**, political arenas are inter-connected, both formally and informally, rather than nested. Sub-national actors operate in both national and supra-national arenas, creating trans-national networks in the process. The ‘gatekeeper’ role of national executives is therefore increasingly challenged: the effectiveness of the response varies considerably, in large part according to domestic territorial structures of governance.” (Hooghe and Marks 2001:3-4)

The major benefit of MLG is that jurisdictions can be “custom designed” to reflect heterogeneity in needs. As Hooghe and Marks (2003:235-6) write, MLG “allows decision makers to adjust the scale of governance...” The chief cost of MLG comes from the transaction costs associated with coordinating decision-making and actions across multiple jurisdictions. Hooghe and Marks, (2003:239) write,

“To the extent that policies of one jurisdiction have spillovers (i.e., negative or positive externalities) for other jurisdictions, so coordination is necessary to avoid socially perverse outcomes. We conceive this as a second-order coordination problem because it involves coordination among institutions whose primary function is to coordinate human activity. Second-order coordination costs increase exponentially as the number of relevant jurisdictions increases.”

Hooghe and Marks (2003) describe this capability as one of pliability. As they see it,

“Many Type II jurisdictions facilitate entry and exit to create a market for the production and consumption of a public good. Most do not seek to resolve fundamental disagreements by deliberation but, instead, avoid them altogether by allowing individuals to choose among competing jurisdictions. Proponents of competing arrangements like to say that Type I jurisdictions choose citizens, while citizens choose Type II jurisdictions.” (Hooghe and Marks, 2003:240–41).

## Conclusion

The resulting evolution of the nation–state from somewhat isolated, self-contained entity interacting with a handful of immediate neighbours—as captured by the concept of interdependence—to open, disaggregated political unit acting as focal point for relations between supranational organizations, sub-national governments, private actors, and its citizens—as captured by the idea of multi-level governance—paves the way for the next logical step. The qualitative shift brought about by the philosophy of new public management and the performing state, with its focus on outcomes at the expense of the ‘missionary’ or nationalistic-emotional aspect of public goods provision, provides the necessary unhitching or disconnect from the previous ways of thinking. Together, they go a long way towards achieving Drucker’s vision of the State as the entity charged with steering while others row.

The ultimate expression of this is of course what *The Economist* described as the ‘Singaporean operating system’, as we saw in the introduction to this text. According to this perspective, the State brings a holistic expertise at tying together the necessary inputs (land, natural resources, and people) and providers of outputs (public goods) to satisfy the needs of citizens and businesses.

Before moving on to the next chapter where we will develop our framework, some final words on the nation–state itself. Notwithstanding these forces transforming the nation–state, Allen Schick (2003:94–95) concludes that not only will it be with

us for a very long time to come, but that it will also continue to retain its central role:

“The nation–state played a critical role in the rise of political democracy and markets.... But like other hoary institutions, the nation–state is fraying at the edges, and the demand for good performance has focused attention on its real or imagined inadequacies. The bill of particulars against the nation–state qua performer is formidable: it is alleged to be too distant from citizens, too uniformist in the design and delivery of public services, encumbered by rigid, aloof bureaucracies and by cumbersome, performance–draining procedures, insensitive to the diverse needs and interests of citizens, more beholden to compliance and control than to performance and results, more responsive to the powerful and affluent who have less need for their services than to the poor and weak who are utterly dependent on the state, unable to cope with global forces that spill beyond national boundaries. These allegations notwithstanding, the nation–state has not withered away, nor will it in the decades immediately ahead. It still is the main financial engine and rule maker for public services.”

Indeed, as Drucker (1997) notes at the end of his essay, “whenever in the last 200 years political passions and nation–state politics have collided with economic rationality, political passions and the nation–state have won.” In fact, the new forms that we have seen in this chapter can be understood as a natural adjustment of the nation–state to the forces at work. Those who see in this a sign of weakness mistake what is instead a sign of strength, an institutional survival mechanism of sorts.

In fact, it may be premature to concede victory on behalf of those forces looking to transform the nation–state. Inman (1997:50) points to the role of the nation–state as umpire or arbiter of last-resort when sub-national entities can’t agree and concludes that,

“Our reading of the historical and contemporary evidence does not provide much support for the claim that lower–tier governments can solve their important collective action problems on their own through unanimous Coasian agreements. If economic federalism seems too biased in favor of centralization, cooperative federalism seems to bias the fiscal constitution too far in the other direction.”

At the end of the day, in spite of the challenges facing it, there is nothing else able to replace the nation-state. It is at once the base unit of the international system and the linchpin regulating interactions between the international system and other non-state actors. In spite of all the challenges to its continued existence and good functioning, the nation-state continues to be the reference point for all actors. As Paquet (2001:183) writes, "While governance capabilities are not necessarily as tightly packaged in national territorial niches as they were in earlier times, the territorial nation still plays a role of echo box through which much must be arbitrated." Those who want to take power away from the nation-state must first recognize the nation-state to do so. Those peoples seeking independence from existing nation-states want to become nation-states in their own right. States pay the bills for supranational-organizations and collect much of the revenues that are distributed to sub-national entities and private actors alike.

## Chapter 3: Theoretical Framework

The principal goal of this effort is to provoke new thinking about the ways that public services can be provided. Indeed, we wish to bring to the decision to outsource a much more strategic approach based on the rational evaluation of alternatives for providing public goods, calculated upon the immediate and long-term benefits and costs of choosing a particular non-state actor or category of non-state actor over another. To achieve that, we seek to provide a means of **quantifying** both the potential scope and extent of a state's outsourcing capability as well as to provide the ability to evaluate those efforts on a **qualitative** basis.

### Caveats

As discussed earlier, it must be noted that this framework is not designed to provide an all-encompassing theory as such. Instead we seek an approach that charts a middle ground of pragmatism. Consequently, we will offer a number of caveats before proceeding. The **first caveat** of this framework is that it is not normative in nature. It assumes that a given level of delegation of provision of public goods will occur for a given state—based on a desire to align with the rationale of Tiebout, among other impetii for decentralization—and does not seek to propose outsourcing as such for those not philosophically in agreement with it.

The **second caveat** of this framework is that it takes the issue of coordination costs as a given. As Hooghe and Marks (2003:239) indicate, “the chief benefit of multi-level governance lies in its scale flexibility. Its chief cost lies in the transaction costs of coordinating multiple jurisdictions.” For our purposes, we will assume that the leaders of a nation-state are prepared—*ceteris paribus*—to accept a given level of coordination-related financial costs and that, for that level, they will want to optimize all other costs and benefits. However, we will consider any and all costs specifically related to the principal-agent relationship over and above any formally contracted costs.

Hooghe and Marks (2003:240) provide some useful insight into the interaction between coordination costs and the development of Type II governance models like the one we propose to develop here:

“The alternative approach is to limit coordination costs by constraining interaction across jurisdictions. Type II governance sets no ceiling on the number of jurisdictions but spawns new ones along functionally differentiated lines. As a result, externalities across jurisdictions are minimized.”

To paraphrase Alfred Sloan, the legendary chairman of General Motors, who described the number and variety of vehicles GM had to offer, there is a non-state actor for “every purse and purpose.”<sup>xxix</sup>

The **third caveat** is that we shall not consider quasi-autonomous non-governmental organizations (also known as quangos) put in place by the nation-state as a separate type of goods provider. For our purposes—essentially to keep the model simple—we shall consider them to be part and parcel of the nation-state itself. When we write of the potential desirability of keeping the provision of a given public good with the nation-state, we allow for it to be provisioned by a state-level quango, thus respecting to some extent Tiebout’s rationale as well as the other forces behind decentralization described earlier, where and when it makes the most strategic sense.

The fourth and **final caveat** is that we will abstract for any and all political and geographical considerations. Though one could make the case that geography is the only variable that cannot be changed, and thus cannot realistically be abstracted, it would only take a change of regime in a given nation-state—or one of its neighbours—for the suggested applicability of this model and the choices and recommendations it makes to change. For example, the political situations of Turkey, the Ukraine, and Georgia—all of which sit on or near fault lines dividing the Arab World, the liberal-democratic Western World, and the autocratic Russian zone of influence—could conceivably change dramatically following an election or coup, with the usual consequences particular to that part of the world. Abstracting for geography enables us to position certain supranational organization as competitors for a given type of public good.

## Framework for the provision of public goods

Our proposed framework for the provision of public goods is comprised of two principal elements. The first is a market for governance, which we shall define in a moment. The second is a series of criteria for evaluating the various outsourcing options available, with an eye to capturing and maximizing utility; we shall define those criteria after first defining the market for governance and describing its constituent parts.

### Market for governance

The ability to outsource responsibility for the provision of public goods is conditional on the presence of what we call a 'market for governance'. The usage and meaning of the term 'market for governance' has not been fully settled and so we have developed our own definition.<sup>xxx</sup> In fact, the term has only been used on three prior occasions, two of them by J. O. McGinnis. First in 2004 when he wrote, "Federalism, in turn, creates a market for governance...", and in July 2006 when he wrote, "Decentralization creates a market for governance by allowing different jurisdictions to compete to attract people and investment. It also permits the formulation of diverse policies that meet peoples' diverse preferences." While McGinnis originally developed the concept of a 'market for governance', it was Pranab Bardhan and Tsung-Tao Yang that expanded on the notion and gave it the general sense we will use in the context of our framework. Bardhan and Yang (2004:6) wrote:

"Let us turn now to a second interpretation of political competition, which focuses less on the process of political turnover and more on the extent to which *political authority* is decentralized. ... The potential benefits of this second form of political competition are indeed largely akin to the potential benefits of competition between firms in a market for goods or services: in this case, political decentralization creates competition on the supply side of a 'market for governance', generating equilibrium outcomes that favor the demand side of that market, or the public at large."

In the context of our framework, which leverages the notion of a market in the true economic sense, we define a 'market for governance' characterized by the

presence of two types of actors: state actors that are willing to demand or 'purchase' public goods for later provision to citizens, and non-state actors that are willing to supply or 'sell' public goods.

Ostrom and Ostrom (1999:16) introduce a similar market-like perspective with their notion of 'public service industries', where they see actors arrayed as either consumption units or production units.

"Each citizen, in such circumstances, is served not by 'the' government, but by a variety of different public service industries. Each public service industry is composed of the collective consumption units serving as providers and production units serving as suppliers of some types of closely related public goods or services that are jointly consumed by discrete communities of individuals."

Following Ostrom and Ostrom's approach, for any given public good, we can assume an associated industry: the fire protection industry, the transportation industry, the welfare industry, the health services industry, etc. Ostrom and Ostrom (1999:16) also make room in their model for non-state actors:

"The governmental component in some industries, such as the police industry, will be proportionately larger than other industries, such as the health services or the transportation industry. But most public service industries will have important private components."

Referring to Hooghe and Marks' typology seen in the previous chapter, our market for governance is compatible with a Type II state model of multi-level governance with its multiple jurisdictions, overlapping memberships, etc.

Before continuing, let us pause to consider the role of markets in general. Markets, which bring multiple participants together, are particularly adept at facilitating a superior, if not always optimal, distribution of goods and services in a more timely fashion than would otherwise be possible. This is achieved by enabling participants to exchange—and more importantly, to compare—both implicit and explicit information regarding the price or range of prices buyers would prefer to pay and the price or range of prices sellers would prefer to receive for a given outcome, in this case, the outsourcing of a public good.



However, while markets provide an immediate solution to information asymmetry in the very short term, they do not necessarily always provide a completely effective solution in the long term. As a result, additional mechanisms are required to ensure long-term alignment of the interests of market participants, something we address later in the section on evaluation criteria.

### Demand side

The number of actors willing to demand public goods is equivalent to the number of nation-states that exist—currently listed as 192<sup>xxxi</sup> by the United-Nations—without counting special cases like Taiwan. Based on trends in Europe since the end of the Cold War and in light of current events in the Middle East and Africa, this number should continue to grow in coming years. For a non-state actor, particularly a private entity, interested in satisfying a new demand for public goods, a positive change in the number of new nation-states is equivalent to a growth market; for actors on the demand side, this should serve to increase the overall supply of public goods over time.

### Supply side

The supply side, while more diverse, can be divided into the three categories that we examined earlier: (1) supranational organizations; (2) sub-national/ regional government entities; and (3) private actors, whether they are non-governmental organizations (NGOs), or publicly-listed or private enterprises with a mandate to deliver shareholder value in the form of growing profits or an increasing share price. It is important to note that our framework also reserves a role for the State, in the more traditional Westminster-model sense as well via quangos though the latter are not explicitly considered as such here.

An example of growth in the supply side—in sheer numbers and scope of offer—is the former state-owned postal service of the Netherlands, formerly known as KPN. Founded in 1752 and nationalized in 1799, it would be spun-off nearly two hundred years later in 1994. In 1996, it merged with an Australian enterprise (Thomas Nationwide Transport), only to later separate the domestic Dutch

operations from the international courier company and become TNT Postal Group (TPG). In 2000, TPG, Britain's Royal Mail Group, a publicly regulated private provider of mail services in the British Isles, and Singapore Post, another market-listed mail operator, signed heads of agreement to commence establishing a global joint venture in cross border mail.<sup>xxxii</sup> As this example demonstrates, the market imperative that led to the initial privatization of those operators continues to provide its own powerful logic that drives operations—the supply side in our jargon—outside of initial home markets.

## Competition

The existence of a market also implies a certain level of competition between providers, each seeking to secure 'customers' for reasons such as economies of scale, geographical coverage or critical mass, among others. Our market for governance is characterized by competition on two levels. First, there is competition among the three different types of non-state actors. There are public goods (e.g., health care standards or infrastructure) for which supra-national, sub-national and private actors can conceivably all compete on head-to-head to some degree.

Second, there is competition between non-state actors of a given type. There are in fact multiple competing providers of public goods at all levels of our framework. While these are most likely to be found for private actors across states and sub-national government entities within states, we may also consider that there are competing providers of public goods at the supranational level as well, though just not as many.

Third, this market for governance is fluid across actor types, with the most growth in supranational organizations and private actors, particularly in the wake of the worldwide wave of privatizations in the 1980s and 1990s. Hooghe and Marks (2003:238) provide some perspective on the growth, evolution and volatility in supranational organizations alone:

"A recent count of international governmental organizations shows steep growth over the past 50 years, from 70 in 1940 to more than

one thousand in the 1980s. However, of 1,063 organizations existing in 1981, only 723 survived a decade later, while an additional 400 or so came into being.”

Abstracting for political and geographical considerations as discussed in the section on caveats, Table III (see next page) provides a list of the various competing providers of public goods available between actor types including the nation-state, while Table IV (see page 56) provides the same table but with a list of individual actors for each type of non-state actor and public good.

Table III: Ability to provide public goods

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	X	X	X	X
Auditor general	X	X	X	X
Citizenship (passports, etc.)	X	X		X
Civil service	X		X	X
Culture and communications	X	X	X	X
Customs and Revenue	X	X		X
Defense	X	X		X
Education / Research	X		X	X
Employment Insurance	X		X	X
Employment / labour force policy / training	X		X	X
Energy policy	X		X	X
Environment	X	X	X	X
Financial Oversight (Banks, stock markets, insurance companies)	X	X	X	X
Foreign Affairs	X	X	X	
Health	X	X	X	X
Homeland Security	X		X	X
Housing & Urban Development	X		X	X
Human Rights	X	X		X
Immigration	X	X	X	X
Industrial Development (Export development / Farm Credit)	X	X	X	X
Infrastructure	X	X	X	X
Interior	X	X	X	X
Lawmaking / justice / Tribunals	X	X	X	X
Management & Budget	X	X	X	X
Monetary policy	X	X		X
Natural Resource management	X		X	X
Postal Services	X	X		X
Public utilities (Energy, Water)	X		X	X
Regional Development	X	X	X	X
Social Programs	X	X	X	X
Sport / youth	X		X	X
Telecommunications	X	X	X	X
Trade / commerce	X	X	X	
Transportation	X	X	X	X
Veteran Affairs	X		X	X

At first glance, Table III contains a number of public goods that one would not think susceptible to being outsourced. There are two main reasons for this. The first is that, in many countries, a number of public goods are outsourced to non-state actors on the basis of constitutional arrangements. In the case of Canada, a federation of sub-national governments, the British North America Act (BNA),

“established the division of powers between the central Parliament and the provincial legislatures. The federal government was responsible for, among other things, banking business, criminal law, the post office, the armed forces; the provinces could legislate, among other things, property law, contracts and local work.”<sup>xxxiii</sup>

While the BNA and the Canadian Constitution of 1982 formally spell out the respective allocation of competencies for the production of public goods, the United States Constitution of 1789 authorized that country’s federal government “to exercise powers deemed necessary to rule over the nation as a whole, with a vague boundary between the two co-existing “levels” of government.”<sup>xxxiv</sup> Those powers that are not explicitly reserved for the federal government were initially the domain of the individual states. However, over time, a number of those same powers have since become the preserve of the federal government through judicial rulings on the basis of the Supremacy Clause (Article VI, Clause 2 of the Constitution)<sup>xxxv</sup>. Thus the constitutional arrangements in place are an important, though not absolute, determinant of the potential of public goods outsourcing.

The second reason is a shift towards focusing on outcomes, at the expense of the ‘missionary’ or nationalistic-emotional aspect of public goods provision. This was discussed earlier in the section on management theory, more specifically via the concepts of NPM and the performing state. (As a result, public goods such as regional development or veterans affairs can be outsourced to the private sector and other non-state actors.) The qualitative shift brought about by those two concepts provides the necessary unhitching, or disconnect, from previous ways of thinking, thus facilitating the provision of public goods by non-state actors. They also simplify the eventual comparison among actors and their ability to deliver ‘as promised’. Let us now turn to Table IV.

Table IV: Competing providers of public goods

Public good	Supra-national	Sub-national	Private actor	Notes
Agriculture / Fisheries and Oceans	EU	X	X	
Auditor general	X	X	KPMG, Deloitte	
Citizenship (passports, etc.)	X		IBM, Accenture	
Civil service		X	IBM, Accenture	
Culture and communications	X	X	Paramount,, Canal+, Fox/News Corp.	Hollywood studios
Customs and Revenue	EU (Schengen)	X	IBM, Accenture	
Defense	NATO, Shanghai Cooperation Organization, EU Rapid Reaction Force	n/a	PMC (Blackwater USA, Dyncorp, Triple Canopy, Aegis Defense, etc)	Definitely not desirable at the sub-national level; a country like Ukraine or Georgia could make the switch following a change in leadership
Education / Research	OECD	UC, & SUNY systems	Harvard, Stanford,	Private universities; SUNY, UQ system
Employment Insurance		X	x	Private providers like Desjardins, etc. over and above core benefits
Employment / labour force policy / training		X	IBM, Accenture	See Germany following Hartz reforms
Energy policy	UN, EU	X	X	
Environment	UN, EU	CARB (vs. EPA)		
Financial Oversight (Banks, stock markets, insurance companies)	X	OSC, AMF	X	
Foreign Affairs	EU, G77	X		
Health	WTO	Provincial governments	US HMOs	NHS in the UK is state-level
Homeland Security		X	Garda, Blackwater USA	
Housing & Urban Development		X	Pulte Homes, KB Homes	
Human Rights	UNHCR, UNHRC		IBM, Accenture	Assuming objective criteria

				can be developed and enforced
Immigration		X	IBM, Accenture	Assuming objective criteria can be developed and enforced
Industrial Development (Export development / Farm Credit)	OECD / CAP	X	X	
Infrastructure	EU Infrastructure Fund	X	Bechtel, Lavalin, Alstom,	
Interior	EU (Maastricht)	X	X	
Lawmaking / justice / Tribunals	X	X	X	
Management & Budget	EU	X	X	
Monetary policy	ECB		X	
Natural Resource management		X	X	
Postal Services	IPU		TNT, DeutschePost, RoyalMail	
Public utilities (Energy, Water)		TVA, Southern Company	Suez, Vivendi, United Water (div. of Suez)	
Regional Development	EU, ASEAN	X		
Social Programs	X	X	X	
Sport / youth		X	X	
Telecommunications	ITU	X	AT&T, France Telecom	
Trade / commerce	WTO, G77, G8, Mercosur, EU, ASEAN,	X		
Transportation	EU (Open Skies)	X	Veolia, DB, SNCF, Private airlines (not flag carriers)	
Veteran Affairs		X	HMOs	

## Evaluation criteria

Competition between providers means that the decision to delegate is not strictly defined on the basis of a purely dollar-driven economic dimension. In fact, aside from financial considerations, a multitude of other criteria come into play when evaluating a potential provider of public goods. They are:

- Technical expertise (spillover)
- Economies of scale (spillover)
- Hubris / empire building (principal-agent theory)
- Financial costs (principal-agent theory)
- Ability to blame (principal-agent theory)
- Dual loyalties (principal-agent theory)
- Ability to control (principal-agent theory)

These can be broadly grouped into two categories: spillovers and the criteria used for evaluating the performance of principal-agent relationships. We have chosen these two broad categories of criteria for their ability to highlight the underlying drivers of the desire to outsource as well as the dynamics at play once a relationship is in place.

The decision to centralize or decentralize is largely determined by the dynamic surrounding the generation of externalities, or spillovers, and the ability to capture or internalize them. (We examined this dynamic in Chapter 2's discussion of Oates and fiscal federalism, as well as Alesina and Spoloare's treatise on the size of nations.) As spillovers increase, there is a tendency towards centralization, first at the level of the State, and then afterwards, at the level of supranational organizations in order to capture them. A good example of this is defence, a blunt instrument of sorts whose success is contingent upon timely access to manpower and military kit, where there truly is strength in numbers. Where there is an opportunity to internalize spillovers at a lower level, there is a tendency to decentralize. An example of this is labour market policy, including employment insurance and training, where there are enough local specificities that a state-level approach introduces more issues than it solves.

At the heart of principal-agent theory is the notion of information asymmetry. This is the possibility that one party, the agent, by right of involvement or presence in the day-to-day activities of the firm or organization, has access to information—more timely or just more—than the principal (or owner) of the organization or the firm. This puts the agent at an advantage, and the principal at a disadvantage, in regards to decisions that must be made. As a result, without the proper mechanisms in place, the agent has a tendency to take decisions (e.g.,



increasing financial exposure, empire building, etc.) at the expense of the principal.

The results of these criteria combine to generate an overall measure that we call utility and which expands on the notions presented earlier during our discussion on the terminology that would be used in this document.

## Characteristics of public-goods providers

Starting with supranational organizations, then moving on to sub-national entities and private actors, we will now discuss in more detail each of the components of utility—spillovers and criteria relating to principal-agent relationships—as they apply to the different actor types, outlining the pros and cons of each criteria to paint a picture of a preferable outcome for each criteria.

In addition, whenever practical, we shall provide examples of these criteria at work. We will then summarize with a comparative table (Table V) at the end of this section.

### Supranational organizations

#### **Technical expertise**

Supranational organizations are frequently characterized by a high level of technical / technocratic expertise. It goes to the heart of what most supranational organizations are about, which is creating a common technical platform or a series of shared ways of doing. Inevitably, over time, this means that best practices usually find their way to the top and become encoded in the organization's policies and procedures. The sheer weight of their presence on the international scene means that supranational organizations also usually attract the scrutiny of academic researchers as well as non-governmental organizations, which seek to lobby them and must understand their inner workings to do so effectively. This helps to create a positive feedback loop that generally serves to improve the supranational organization in the long run. Two excellent examples

of this are the World Bank and the IMF, both of which provide professional expertise to client countries in addition to loans.

### **Economies of scale**

Supranational organizations often benefit from economies of scale, whereas for nation-states there is usually no direct link between public goods and population size. Donald Wittman (1991:126) writes, "Economies of scale and scope are two basic explanations for the size and scope of nations. The costs of administration and policy coordination are unlikely to be proportional to the size of the polity." When supranational organizations focus on one or a handful of items, it allows them to leverage those economies of scale to provide a public good for less cost, and at a higher quality, than what any individual member could afford or achieve on its own. An example of this is the EU with its large internal market and directives designed to spur common markets in various goods and services, the most recent of which is the Markets in Financial Instruments Directive (MiFID).

### **Hubris / empire building**

However, when they do not restrict themselves to a pre-defined set of public good provision activities, supranational organizations can become prone to hubris or empire building leading to a form of 'agency problem'. (Earlier, we described this as supranational entrepreneurship.) An important consideration is voting rules, which impact the extent to which an organization's scope can change over time and how dissenting member countries will respond to it, whether by deciding to walk away or to stick around—assuming that the whole is worth more than the parts.

As an example of empire-building, one need only look at the scale and scope of the activities of the European Union after 50 years of operations to see that the sectors where it is active today are quite different than those originally envisioned by the Treaty of Rome. Subsequent EU treaty efforts, in particular the failed 2004 constitutional treaty, represented in some ways an effort to catch up with the 'facts on the ground', many of which resulted from an especially wide interpretation of the EU's role by members of the European Commission or by various judgments handed down from the European Court of Justice.

### **Financial costs**

We distinguish two situations regarding potential growth over time in the financial costs associated with a supranational organization. The first one is when a member's annual contributions are based on factors such as national GDP as a percentage of world GDP<sup>xxxvi</sup> in which case annual contributions would grow in relation to economic growth, inflation, or some other factor that affects the organization's operating costs, but at the same rate as those of other members. The second situation, and the one that we are focusing on here, is the possibility that membership contributions increase as a result of 'scope creep', essentially the result of an agency problem. This is in some ways what caused the United States to hold off on contributions to the United Nations in the 1980s and 1990s on the premise that the UN was exceeding its mandate (a form of the 'I didn't vote for that, so why should I pay for it' argument.) Another example is the famous 'rebate' negotiated by Margaret Thatcher in April 1980, which saw a portion of Britain's EU membership contribution (based on a percentage of GDP) refunded on the basis that to do otherwise would have left Britain as a net contributor<sup>xxxvii</sup> to the Union during a period when it could theoretically least-afford it.

### **Ability to blame**

Supranational organizations play two very important political roles relative to the domestic political scene of a nation-state. On the one hand, they provide a convenient outlet to blame when they undertake policies that go directly against the populist prerogatives of a state's ruling government or the policies of the party / parties in opposition. A EU white paper on governance highlights this issue:

“Where the Union does act effectively, it rarely gets proper credit for its actions. People do not see that improvements in their rights and quality of life actually come from European rather than national decisions. But at the same time, they expect the Union to act as effectively and visibly as their national governments.” (CEC 2001:7)

One example is the always-unpopular requirement to cut expenditures or raise taxes to comply with the EU Stability Pact's requirement for fiscal responsibility or the need to change work rules in the face of directives from the European

Commission or a decision handed down by the European Court of Justice. On the other side of the Atlantic, the politically costly 2002 decision by the US government to suspend a series of protectionist measures that were in clear violation of WTO rules was justified on the basis that the US had no choice but to suspend the protections or face a punitive trade war with the EU.

Supranational organizations also act as agents of change providing a measure of political cover for policies that, while in the long-term interest of the State and recognized as such by the central government, are too politically unpalatable to be pursued by the party in power or the opposition. The process of passing into national law the *acquis communautaire* of the European Union by candidate countries, thus overriding longstanding domestic policy preferences, is one example of this.

### **Dual loyalties**

In general, supranational organizations are not explicitly designed to dual loyalties among their constituents' citizens. They are usually only active on one or a handful of levels, and so are limited in the ways in which they influence the day-to-day lives of citizens. The clear exception to this though is the EU, which has sought to some degree to develop a second, parallel loyalty among its citizens. There are two reasons for this. The first is to address the perceived democratic deficit associated with the EU, which has given itself broad powers to affect the lives of all citizens at work, at home and on the move. The EU did so in large part without consulting citizens, through a process of growth by stealth (see the earlier discussion on supranational entrepreneurship). There is a fear that one day the citizens of the EU will 'wake up' and seriously question the arrangement. The second reason the EU seeks to foster a sense of belonging on the European level among the citizens of EU member states is to provide political cover for it in its dealings with member states, providing it with a legitimacy that it otherwise lacks.

As an example of this desire to foster a dual loyalty, in its 2001 White Paper on Governance, the European Commission put forth the following rationale for reforming its governance mechanisms:

“There is a perceived inability of the Union to act effectively where a clear case exists, for instance, unemployment, food safety scares, crime, the conflicts on the EU’s borders and its role in the world.”  
(CEC 2001:7)

“Where the Union does act effectively, it rarely gets proper credit for its actions. People do not see that improvements in their rights and quality of life actually come from European rather than national decisions. But at the same time, they expect the Union to act as effectively and visibly as their national governments.” (CEC 2001:7)

“By the same token, Member States do not communicate well about what the Union is doing and what they are doing in the Union. “Brussels” is too easily blamed by Member States for difficult decisions that they themselves have agreed or even requested.”  
(CEC 2001:7)

### **Ability to control**

The ability to control the actions and outcomes of a supranational organization are determined by two factors. The first factor, and the only formal one, is the type of voting rules in effect. Depending on the organization and the question to be determined, voting rules can range from simple majority to various forms of qualified majority to unanimity. However, it is the informal unwritten rules—the geopolitical realities—that often determine how those formal rules are applied. The threat of retaliation outside of the organization on other matters of importance to a given nation-state, or conversely, the ability to make side payments provide an indirect measure of control over an organization’s member states and thus the organization itself. Depending upon the organization and the nation-state (e.g., the UN and the US), the threat to quite simply leave the organization may be enough for a nation-state to have its way. However the overall ability to control the actions of a supranational organization will most always depend on the dyad of nation-state and organization. Venezuela’s threat in the fall 2007 to leave the World Bank and the IMF has not impaired the ability of either of those organizations to continue with their mandates.

## Sub-national entities

### **Technical expertise**

On the question of technical expertise, what sub-national entities lack in pure theoretical expertise, they usually make up for in terms of local, on-the-ground knowledge. They can harness relationships and shared histories, which can ultimately make them more effective in the execution of the provision of public goods (if not the initial quality of their conception). The fact that sub-national entities are even closer—relative to national governments—to the ultimate consumers of public goods may give them a qualitative edge in the ways that matter most, at least that is the argument behind Tiebout and decentralization.

### **Economies of scale**

However on the question of economies of scale, the shift to sub-national entities likely removes any economies of scale. In fact, a sub-national government such as a province or an American state must often manage a series of competing—if not outright conflicting—priorities, without a corresponding increase in resources available. One exception to this is if the provision of the public good is shifted to a specialized public agency that may be in a position to focus all of its efforts to the provision of that public good.

### **Hubris / empire building**

Regarding the possibility of hubris or scope creep, it is definitely more likely at the level of sub-national entities. Lacking the geographical distance between the people who conceive of and deliver public goods and those who consume them, there is significantly more potential for hubris or empire building to occur, a key risk common to principal-agent relationships.

### **Financial costs**

On the question of financial costs, the option of turning to a sub-national entity is the one alternative most likely to result in an increasing financial commitment over time, even to the point of becoming a bottomless hole. This is due in part to an agency problem created by the fact that the actor that pays for the provision of public goods (the State) is not the same as the actor that provides them (the sub-national entity). The sub-national entity, already benefiting in the mind of

the public from the positive association created from delivering the goods to the population has an incentive to essentially 'gold plate' the offering, then turn to the State to ask for more resources. When the State initially refuses, it is the State—and not the sub-national entity—that is portrayed as the bad guy in the minds of the local population. On the contrary, the sub-national entity comes off as the 'only' one that has the needs of the local population at heart. Recent years have seen this scenario play over and over again in Canada where, once the 'fiscal imbalance'—a potentially spurious concept—was corrected, the provinces found additional reasons to demand federal monies for activities that, under the Canadian constitution, were officially theirs and theirs alone to manage (e.g., healthcare, education).

### **Ability to blame**

Among non-state actors, sub-national entities are the most difficult to work with when the situation sours. Inasmuch as they employ members of the same national population and—at least on paper—share the same motives as the State (i.e., to provide public goods to the benefit of citizenry), they do not make an easy target for blame. Indeed, because they are closer to the local population and by the same token, they provide the public goods—meaning they are more easily identified with any benefits—sub-national entities hold the upper hand in terms of any public debate between them and the State. The ability to play the population off against a sub-national entity can be particularly problematic when that sub-national entity, such as a provincial government, represents a specific ethnic or cultural group, as in Québec or Catalonia. The situation can quickly become explosive as any accusation can rapidly take on an 'us versus them' angle to the usual detriment of the State.

### **Dual loyalties**

It is on the question of dual loyalties that the most scope for trouble exists, particularly if it is a sub-national government of the next level down representing a culturally, linguistically or ethnically distinct region. Again, due to the nature of the devolution of provision of public goods—the sub-national entity is front and center in the minds of the consumers of those goods—the population is more likely to view the sub-national government as relevant to their lives. As with the

question of the ability to blame or play one actor off against another, providing additional visibility to a sub-national government that represents a cultural or ethnic group can lead to the creation or reinforcement of dual loyalties. This is particularly the case in independence-minded regions like Québec or Catalonia that have already secured some measure of autonomy. Each additional public good that they are tasked with providing further contributes to their 'critical mass' in the minds of their constituents. The ability to demonstrate that they can successfully provision a series of goods over time provides a powerful argument for those forces wanting to take the final remaining steps along the path of self-determination.

### **Ability to control**

One could think that control of the purse strings is a sufficient condition for maintaining control over a party to whom public goods provision has been delegated. However, the ability to control sub-national actors is made difficult by the issues of blame and dual loyalties described above, irrespective of whether the state is providing the funding or not. Inasmuch as the actor in question is a task- or domain-specific agency as opposed to a local or regional government representing a specific cultural or ethnic group, the ability to control will be enhanced, though still not as straightforward as with a private actor or a supranational organization.

## **Private actors**

### **Technical expertise**

As they gain in scale and scope, private actors may come to resemble supranational organizations over time in their level of technical expertise, with professional managers from multi-national backgrounds focused on one or more public goods that will then be provisioned across multiple countries. Discussing the case of water services and waste management providers that were initially focused on domestic needs in their native France, Marc L'Aimé (2005) discusses the potential for growth in private actor scope in *Le Monde Diplomatique*.

“THREE of the four leading world water companies are French: Veolia,



formerly Vivendi, is an offshoot of the Générale des Eaux, founded in 1853; Ondeo is a subsidiary of Suez–Lyonnaise, founded in 1880; and Saur belonged to the Bouygues group until November 2004. These are the ‘three sisters’.

“In less than 20 years they have become top players. Ondeo is the global No 1 in numbers of people served (125 million worldwide). Veolia Water, with 110 million clients, comes in second globally and first in France, where it provides 26 million people with drinking water and 19 million with sanitation...

“The three sisters control 40% of the global private–sector water market in more than 100 countries. Their only real competitor holds third position globally: RWE, the German energy giant, and its British subsidiary Thames Water, have managed to gain a foothold in the US market through their acquisition of the national leader, American Water Works.”<sup>xxxviii</sup>

As they grow over time, private actors usually develop a high–level of domain–specific expertise, though it is usually put to the task of ensuring profitability as opposed to the more philosophical ends one may find with some supranational organizations (e.g., UNHRC, UNESCO). This is due in part to the nature of their operations, which are often regulated through formal mechanisms that limit the prices that can be charged or the profits that can be made. The ability of private actors to pay greater than the market rate for talent, while providing the international opportunities commensurate with working for supranational organizations, may actually leave them in a better position to attract expertise than some supranational bodies can. However, this development of technical expertise may, over time, become problematic as well. Describing the challenges facing municipal officials in France in their relations with the three large water services companies, Laimé (2005) writes that local water authorities,

“... are faced with the exponential growth of the big firms’ knowledge in technical matters—exploitation of water resources, research, administration, management, finances and client relations. An isolated local authority, without the necessary technical and human resources, is faced with an oligopoly—an unequal balance of power.”<sup>xxxix</sup>

**Economies of scale**

As we saw with the three French water services companies, the ability of private actors to grow outside of their original geography over time, or to take on the provision of additional public goods for a given area, enables them to develop additional economies of scale. Private actors, while profit-oriented, are potentially more focused on the long term than their more political cousins—sub-national governments—which are more likely concerned with issues of political expediency, a function of the electoral cycle and its often perverse incentives.

**Hubris / empire building**

The profit motive also limits the scope for pure hubris or empire building on behalf of private actors, at least for those publicly-traded companies<sup>xi</sup> operating in developed countries with strong institutions that protect against corruption, as well as mature capital markets where shareholder rights are enforced. Market discipline of this nature eventually forces private actors such as publicly listed companies to focus on opportunities that will help to grow profits as opposed to just growth for its own sake. One need only look back to the disappearance of many of the conglomerates built during the 1960s and 1970s as described in Chapter 2 to appreciate that the market is quite happy and able to diversify on its own. However, the need for profit means that private actors are much more sensitive to political risk, as demonstrated during the 2001 Argentinean debt crisis<sup>xii</sup>, which eventually saw the end of parity with the US dollar, freezes in the prices for most goods, and the forced conversion of all outstanding dollar debt to denomination in pesos.

Recourse is essentially a choice between walking away or pursuing the matter via the legal system, which in many developing countries is highly exposed to the same political logic that led to the dispute. As an example, in 2003, Veolia announced that it was considering abandoning its water management concession in the Argentinean state of Catamarca in the face of massive refusal by citizens to pay their water bills<sup>xiii</sup>. In August 2007, Vivendi won a \$105M award<sup>xiiii</sup> from the International Centre for Settlement of Investment Disputes against the Argentinean state of Tucuman after a 10-year battle following Tucuman's unilateral modification of the terms of a 30-year concession.

**Financial costs**

The profit motive that drives many private actors can also lead to potential cost creep. However, as indicated above, private actors are often limited in the prices that they can charge or the profits that can be made, which can provide an effective cap on the relative cost of the public good. The profit motive also favours the search for productivity and innovation to reduce expenses, which should result in improved outcomes for citizens and the other entities paying the bills. Public opinion also provides an often-effective counterweight as witnessed by the travails of European and North American public utilities firms in South America.

**Ability to blame**

Like supranational organizations, private actors can be easily blamed in times of relative or general difficulty, with accusations of betrayal of the nation and its interests a particularly powerful means of modifying behaviours. This becomes even easier when the private actor in question is a multinational corporation, like one of the French water service companies described earlier.

**Dual loyalties**

At the level of the citizenry, the issue of dual loyalties is definitely not as pronounced with private actors as it is with supranational organizations—the European Union being the extreme example—or with sub-national entities such as provincial or state governments. Though there is the possibility of an agency problem—citizens as shareholders—the dispersion of shareholdings and the relative size of any given individual shareholder compared to the rest means that this is not normally problematic in the long run. Outsourcing the provision of a public good to a private actor has the advantage of marrying a public political need with an actor that is essentially economic in nature.

**Ability to control**

One of the downsides of delegation to a private actor is the lack of direct control available to the same extent as when activities are managed internally. However, there are a number of measures available to the State to compensate for this. In the first place, measures to ensure minimum service levels as well as maximum pricing and profitability can be put in place to provide a minimum of oversight.

(Many countries beefed up their national regulatory frameworks and enforcement in the wake of privatizations to compensate for this lack of direct control; in fact, it was often part of the political price to be paid for privatizations to go forward.) Failing a satisfactory outcome through the application of regulatory prerogatives, the State can in most cases revoke the delegation of public goods provision—though most often some form of compensation for owners is required in return, often as the result of arbitration.

However, in the absence of performance measures and enforced guidelines, a private actor can pursue destructive behaviours that leave the nation-state on the hook. A particularly telling example of this comes from Iraq where the US government had pursued a policy of extensive outsourcing of security to private military contractors. John Broder (2007) reports in a New York Times article on the implications to the State when things go wrong:

“The State Department, seeking to retain its relationship with Blackwater USA while trying to bring the company’s armed guards under tighter control, said Friday that it would now send its own personnel as monitors on all Blackwater security convoys in and around Baghdad.... Blackwater is one of three private companies providing security services to the State Department in Iraq, running heavily-armed escorts every time a prominent American civilian leaves the protected Green Zone.... The State Department measures announced on Friday are the first concrete response by the American government to the violent episode on Sept. 16 in central Baghdad involving several Blackwater teams that left as many as 17 Iraqis dead.”

## Optimizing utility

The potential to call on multiple providers and types of providers as well as the ability to compare and analyze them both quantitatively and qualitatively together provide the ability to evaluate the benefits of a given course of outsourcing on a rational choice basis. While the specific financial costs associated with a given course of action are beyond the scope of this document, Table V lists the criteria that can be used to determine the qualitative desirability of engaging a non-state actor for the provision of public goods.

A rational choice evaluation of the set of public goods to be provisioned would be based on a simple cost-benefit analysis to achieve maximum utility. This utility is the net difference between the benefits of outsourcing the provision of a public good (access to technical expertise, economies of scale, ability to blame, geographical scope, ability to control) and the potential costs (empire-building by the non-state actor, increasing financial cost, and dual loyalties) of doing so.

Maximum utility can be achieved via one of two ways. Assuming a given level of economic expenditure, a rational state actor would first choose a combination of public goods provided by non-state actors that allowed it to maximize its utility—the greatest positive difference (or smallest negative difference) between benefits and costs. The alternative approach is to choose a given level of utility and then select the combination of non-state actors and the requisite economic expenditures that would enable the State to achieve that utility.

Based on the discussion in the previous section, the actor-type choices that should maximize utility from the perspective of the nation-state (again taking coordination costs as a given and according to the evaluation criteria and discussion in the previous section) are highlighted with a grey background.

**Table V: Maximum utility for outsourcing public goods provision**

Criteria	Supra-national	Sub-national	Private actor
Technical expertise	Yes	No	Depends
Economies of scale	Yes	No	Yes
Hubris / empire building	Depends	Yes	No
Increasing financial cost	Depends	Yes	No
Ability to blame / provide cover	Yes	No	Yes
Dual loyalties	Yes	Yes	No
Ability to control	Depends	Depends	Yes
Ranked order of preference	2 <sup>nd</sup>	3 <sup>rd</sup>	1 <sup>st</sup>

A simple analysis of the preferred choices for the provision of goods—achieved by calculating the total number of optimal criteria per actor type (indicated by the shaded cells)—suggests that private actors would be the preferred vectors for

outsourcing public goods provision, followed by supra-national organizations. Delegation to sub-national government entities would appear to be fraught with challenges or negative externalities particularly when outsourcing to a sub-national entity representing a distinct regional, ethnic or cultural group.

## Conclusion

Combining the information provided in Tables III, IV, and V gives us a list of the public goods that can be provided, the various potential providers that combine to form a market for governance, the criteria with which to evaluate these providers, as well as normative suggestions on preferred alternatives. Taken together, these form a rational choice-based framework for the provision of public goods.

Our analysis suggests that for a given state considering a Tiebout-style decentralization, private actors are the preferred vectors for outsourcing public goods provision. In effect, while not calling into question the collective qualities of these goods (e.g., non-rivalrous consumption, etc.), our analysis shows that certain public goods respond better to market imperatives such as price or profitability and are best delivered by the marketplace, even if they contain properties of collective goods.

In the next chapter, we shall examine the cases of three nation-states—Canada, the United Kingdom and France—on the assumption that rational choice was operated during the process of delegating public goods provision. We will use our framework to determine the level of current optimality of outsourcing in those three countries as well as make some suggestions regarding possible future decisions to outsource, as well as potential improvements to current arrangements.

## Chapter 4: Applying the framework

With our framework for outsourcing the provision of public goods firmly in hand, we now move to the task of applying it to the real world.

Our framework allows us to do a number of things. **First** it enables us to quantify current outsourcing efforts. To do so, we developed a table listing public goods and the different actor types, including the State (see Table III on page 65). By checking off the intersections between public good and actor type, we can rapidly understand the scope and nature of public goods outsourcing for a given country. We then reprise the table with the names of the actors in question.

**Second**, leveraging the baseline set by the preferred choices of actor type as identified in Table V, our framework enables us to comment on the qualitative optimality or sub-optimality of current outsourcing arrangements for a given state. We do so by superimposing the choices for a given nation-state overtop of those choices we designated as optimal in Table V. The intersection of a given state's choice of actor with our own preferred result suggests optimality—in the context of our framework alone—in that area. The absence of a state's choice for a given preferred result suggests the opposite: sub-optimality.

**Finally**, this framework enables us to more easily compare outsourcing efforts across countries. This is possible both with an eye to the scope and nature of a given nation-state's outsourcing efforts, as described in our first finding. It also possible with respect to the optimality or sub-optimality as described in finding #2 in the previous paragraph.

To that effect, we will first explore the case of Canada before moving on to consider the United Kingdom and then France. Though both members of the European Union, these last two countries are of particular interest because they differ in their adoption of the various foundational agreements of the Union in very important ways. In addition, they were both more than nominally centralized states as recently as ten years ago. We shall elaborate more on both points later in this section. We seek to compare Canada to the UK to bring out the differences

between two countries that practice Anglo-Saxon style capitalism and share other institutional similarities.

## Current outsourcing efforts

### Canada

Table VI provides an overview of the current situation for public goods outsourcing in Canada, grouping any state-level quangos and departments into the category of Nation-State. Table VII reprises the same information but with the names of the respective actors, including quangos where applicable. The names indicated there are for illustrative purposes and should not be considered an exhaustive list. For the sake of brevity, in some cases, we have been obliged to limit the number of actors mentioned, particularly in the case of sub-national entities and private actors.

**Table VI: Provision of public goods in Canada**

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	X		X	
Auditor general	X		X	
Citizenship (passports, etc.)	X			
Civil service	X		X	
Culture and communications	X		X	
Customs and Revenue	X		X	
Defence	X	X		
Education / Research			X	X
Employment Insurance	X		X	X
Employment / labour force policy / training	X		X	
Energy policy	X			
Environment	X		X	
Financial Oversight (Banks, stock markets, insurance companies)	X		X	
Foreign Affairs	X			
Health	X	X	X	
Homeland Security	X			
Housing & Urban Development			X	
Human Rights	X		X	
Immigration	X		X	



Industrial Development (Export development / Farm Credit)	X		X	
Infrastructure	X		X	X
Interior	X			
Lawmaking / justice / Tribunals	X		X	
Management & Budget	X		X	
Monetary policy	X			
Natural Resource management	X		X	
Postal Services	X			X
Public utilities (Energy, Water)			X	X
Regional Development	X		X	
Social Programs	X		X	
Sport / youth	X		X	
Telecommunications			X	X
Trade / commerce	X	X	X	
Transportation	X		X	X
Veteran Affairs	X			

**Source:** Government of Canada web site ([www.canada.gc.ca](http://www.canada.gc.ca)), various provincial web sites.

**Table VII: Provision of public goods in Canada with actor names**

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	Agriculture and Agri-food Canada; Canadian Food Inspection Agency		Agriculture only; each province	
Auditor general	Office of the Auditor General of Canada		Provinces	
Citizenship (passports, etc.)	Citizenship and Immigration Canada			
Civil service	Canada Public Service Agency		Provinces	
Culture and communications	Canadian Heritage, CBC		Provinces	Globemedia, Rogers Media, Quebecor
Customs and Revenue	CCRA		Provinces	
Defence	Department of	NATO,		

	Defence	NORAD		
Education / Research	Human Resources and Social Development (HRSD) (loans and grants)		Provinces	Various technical colleges
Employment Insurance	HRSD		Emploi Québec	Assurances Desjardins
Employment / labour force policy / training	HRSD		Quebec*	
Energy policy	National Energy Board			
Environment	Environment Canada		Provinces	
Financial Oversight (Banks, stock markets, insurance companies)	Bank of Canada, Office of the Superintendent of Financial Institutions		Ontario Securities Commission, Autorité des marchés financiers (Québec), etc.	
Foreign Affairs	Department of Foreign Affairs and International Trade (DFAIT)			
Health	Health Canada	WHO	Provinces	
Homeland Security	RCMP, CSIS			
Housing & Urban Development	Canada Mortgage and Housing Corporation, Infrastructure Canada		Provinces	
Human Rights	Canadian Charter of Rights		Quebec Charter of Rights	
Immigration	Citizenship and Immigration Canada		Quebec*	
Industrial Development (Export development / Farm Credit)	Industry Canada, Agriculture Canada, Farm Credit Canada		Provinces	
Infrastructure	Infrastructure Canada		Provinces	Highway 407 Int'l, Greater Toronto Airports

				Authority
Interior	RCMP		Ontario Provincial Police, Sûreté du Québec	
Lawmaking / justice / Tribunals	Department of Justice		Provinces	
Management & Budget	Treasury Board of Canada		Provinces	
Monetary policy	Bank of Canada			
Natural Resource management	Natural Resources Canada		Provinces	
Postal Services	Canada Post	IPU		UPS, FedEx
Public utilities (Energy, Water)			Hydro- Quebec	EPCOR, Nova Scotia Power
Regional Development	Atlantic Canada Opportunities Agency		Provinces	
Social Programs	HRSD		Provinces	
Sport / youth	Canadian Heritage		Provinces	
Telecommunications			SaskTel	Bell, TELUS, MTS
Trade / commerce	DFAIT	WTO, NAFTA	Provinces	
Transportation	Canadian Transportation Agency, Canadian Air Transport Security Authority		Provinces	CN, CP Rail, Air Canada, WestJet
Veteran Affairs	Veterans Affairs Canada			

Note: \* = deal specifically negotiated with Quebec

**Source:** Government of Canada web site ([www.canada.gc.ca](http://www.canada.gc.ca)), various provincial web sites.

In the case of Canada, it quickly becomes apparent that the vector of choice is sub-national governments, specifically the ten provinces. This is essentially due to the country's constitutional arrangement as a confederation of constituent governments—four provinces initially, now ten in all, as well as three territories—

and not to any recent effort to decentralize the country on the lines of fiscal or economic federalism. In fact, the political organization of the country preceded Tiebout's rationale for decentralization by almost a century.

That Canada has outsourced any goods beyond sub-national actors is the result of its membership in various supranational organizations such as the WTO, NATO, and NAFTA to name but the most significant. After witnessing a long period of centralization following the country's founding in 1867—specifically in the case of monetary policy, utilities (such as power generation and transmission), rail transport, air transport, and telecommunications—an effort to decentralize was undertaken in the 1980s and 1990s in the context of important fiscal imbalances. These included the privatization of the national flag carrier, Air Canada; the privatization of the Canadian National railway; the sale of Telesat Canada to a private company; and the transfer of responsibility for airport services to community groups such as the Greater Toronto Airports Authority and the Calgary Airport Authority. There was additional privatization at the sub-national level with provincially-owned telecommunications firms (Manitoba Telecom, Alberta Government Telephones) and electrical utilities (Nova Scotia Power and the former municipally-owned Edmonton Power (now EPCOR)) becoming publicly-listed companies in the process.)

However, there were some additional responsibilities delegated to the provinces over the past thirty years, ostensibly in the context of fiscal federalism, but in many cases the result of the province of Quebec<sup>xliiv</sup>, motivated by nationalist / self-determination forces, pushing for a special deal. The responsibilities that were transferred include the right to provide labour force training as well as the selection of immigrants according to criteria specific to Quebec. In practice, transfers of responsibilities are often in the form of an opt-out from a federal program with corresponding monies provided in their place to support the provincial version.

## United Kingdom

Table VIII provides an overview of the situation of public goods outsourcing in the United Kingdom, grouping any state-level quangos and departments into the

category of Nation-State. Table IX (see page 80) reprises this same information but with the names of the respective actors, including quangos where applicable. Similar to the previous section on Canada, the names indicated here are for illustrative purposes and should not be considered an exhaustive list.

**Table VIII: Provision of public goods in the UK**

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	X	X	X	
Auditor general	X		X	
Citizenship (passports, etc.)	X	X		
Civil service			X	
Culture and communications	X	X	X	
Customs and Revenue			X	
Defence	X	X		
Education / Research	X		X	X
Employment Insurance	X		X	
Employment / labour force policy / training	X		X	
Energy policy	X	X		
Environment	X	X	X	
Financial Oversight (Banks, stock markets, insurance companies)	X			
Foreign Affairs	X			
Health	X	X	X	
Homeland Security	X			
Housing & Urban Development	X		X	
Human Rights	X	X		
Immigration	X	X	X	
Industrial Development (Export development / Farm Credit)	X	X	X	
Infrastructure	X	X	X	X
Interior	X		X	
Lawmaking / justice / Tribunals	X	X	X	
Management & Budget	X		X	
Monetary policy	X			
Natural Resource management	X	X	X	
Postal Services				X
Public utilities (Energy, Water)	X			X
Regional Development	X	X	X	

Social Programs	X	X	X	
Sport / youth	X		X	
Telecommunications	X			X
Trade / commerce	X	X	X	
Transportation	X		X	X
Veteran Affairs	X			

**Source:** Government of United Kingdom ([www.direct.gov.uk](http://www.direct.gov.uk)); The Scottish Government ([www.scotland.gov.uk](http://www.scotland.gov.uk)); Welsh Assembly Government ([new.wales.gov.uk](http://new.wales.gov.uk)); Northern Ireland Executive ([www.northernireland.gov.uk](http://www.northernireland.gov.uk))

**Table IX: Provision of public goods in the UK with actor names**

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	Department for Environment, Food and Rural Affairs, British Waterways Board	EU	X	
Auditor general	Audit Commission for Local Authorities and the National Health Service in England and Wales		X	
Citizenship (passports, etc.)	Home Office, Identity and Passport Service	EU		
Civil service	UK Civil Service		X	
Culture and communications	Department for Culture, Media and Sport, BBC	EU	X	
Customs and Revenue	HM Revenue & Customs (HMRC)		X	
Defence	Ministry of Defence	NATO, EU		
Education / Research	Department for Children, Schools and Families		X	X
Employment Insurance	Department for Work and Pensions (DWP)		X	
Employment / labour force policy / training	Department for Work and Pensions (DWP)		X	
Energy policy	X	EU		
Environment	Department for	EU	X	

	Environment, Food and Rural Affairs			
Financial Oversight (Banks, stock markets, insurance companies)	Bank of England, Financial Services Authority			
Foreign Affairs	Foreign Office		In the case of Northern Ireland and North- South cooperation on the island. <sup>xiv</sup>	
Health	Department of Health, National Health Service	X	X	
Homeland Security	Home Office, MI5, MI6			
Housing & Urban Development	X		X	
Human Rights	Equality and Human Rights Commission	X		
Immigration	Border and Immigration Agency	X	X	
Industrial Development (Export development / Farm Credit)	X	X	X	
Infrastructure	X	X	X	X
Interior	Home Office		X	
Lawmaking / justice / Tribunals	X	EU	X	
Management & Budget	X		X	
Monetary policy	Bank of England			
Natural Resource management	X	X	X	
Postal Services				X
Public utilities (Energy, Water)	X			X
Regional Development	Department for Environment, Food and Rural Affairs	EU (European Regional Development Fund)	X	
Social Programs	X	X	X	
Sport / youth	Department for Culture, Media and Sport		X	

Telecommunications	Office of Communications			X
Trade / commerce	Department for Business, Enterprise and Regulatory Reform	EU, WTO	Scottish Executive	
Transportation	Department for Transport, British Waterways Board		Transport Scotland	Virgin Rail, British Airways
Veteran Affairs	X			

**Source:** Government of United Kingdom ([www.direct.gov.uk](http://www.direct.gov.uk)); The Scottish Government ([www.scotland.gov.uk](http://www.scotland.gov.uk)); Welsh Assembly Government ([new.wales.gov.uk](http://new.wales.gov.uk)); Northern Ireland Executive ([www.northernireland.gov.uk](http://www.northernireland.gov.uk))

In a largely unitary state with a traditional weariness towards foreign entanglements—see Lord Salisbury’s quip about Britain’s “splendid isolation”<sup>xlvi</sup> in the 1890s—the governance of the United Kingdom has been seriously transformed within the past half-century. A quick glance at the results for the UK shows much more outsourcing of public goods at the supranational as well as at the sub-national level, specifically at the level of the home countries. (In the context of England itself, the home country remains highly centralized, lacking in local representation and initiative to the same extent as in Canada or France). This transformation can be largely traced to two events: the country’s membership in the European Economic Community in 1973 and the pro-active devolution<sup>xlvii</sup> of a range of powers to Scotland, Wales and Northern Ireland in the late 1990s.

While the United Kingdom is a signatory to the Maastricht treaty of 1992, which would lead to the creation of a common European currency, the UK secured an opt-out that allowed it to keep the British Pound as its currency. As a result, the UK maintained control of its monetary policy following the formal introduction of the euro as a currency for transactions in 1999. In addition, the UK does not participate in the Schengen Agreement, which enables passport-free travel between member countries such as France, Germany, Belgium, etc., while also



largely eliminating customs controls specifically among EU member countries. As such it retains its prerogative in its decisions about customs.

On the domestic front, home rule, as devolution is called in the UK, took effect in Scotland and Wales in 1998, following referendums in 1997. (It was originally set for 1998 for Northern Ireland but only became fully operational in 2007 following a power-sharing agreement between the principal protagonists on the ground.) The range of powers devolved in the UK depends on the home country. The Scottish Parliament and the Northern Ireland Assembly, have primary legislative powers over many areas. This means that they can pass their own laws on topics such as education, which have been devolved from Westminster. However, the Welsh Assembly is limited to secondary legislative powers. It is only able to vary some laws set by the Houses of Parliament and only on those issues that have been devolved to Cardiff, the Welsh capital city.

## France

Table X provides an overview of the situation of public goods outsourcing in France, grouping any state-level quangos and departments into the category of Nation-State. Table XI (see next page) reprises this same information but with the names of the respective actors, including quangos where applicable. Similar to the previous sections on Canada and the UK, the names indicated here are for illustrative purposes and should not be considered an exhaustive list.

**Table X: Provision of public goods in France**

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	X	X		
Auditor general	X			
Citizenship (passports, etc.)	X	X		
Civil service	X		X	
Culture and communications	X			
Customs and Revenue	X	X		
Defence	X	X		
Education / Research	X		X	X
Employment Insurance	X		X	
Employment / labour force	X			

policy / training				
Energy policy	X	X		
Environment	X	X		
Financial Oversight (Banks, stock markets, insurance companies)	X	X		
Foreign Affairs	X	X		
Health	X	X		
Homeland Security	X	X		
Housing & Urban Development	X			
Human Rights	X	X		
Immigration	X	X		
Industrial Development (Export development / Farm Credit)	X	X		
Infrastructure	X	X	X	
Interior	X	X		
Lawmaking / justice / Tribunals	X	X		
Management & Budget	X			
Monetary policy		X		
Natural Resource management	X	X		
Postal Services	X			
Public utilities (Energy, Water)				X
Regional Development	X	X	X	
Social Programs	X		X	
Sport / youth	X		X	
Telecommunications				X
Trade / commerce	X	X		
Transportation	X	X	X	
Veteran Affairs	X			

Source: Government of France ([www.premier-ministre.gouv.fr](http://www.premier-ministre.gouv.fr))

Table XI: Provision of public goods in France with actor names

Public good	Nation-State	Supra-national	Sub-national	Private actor
Agriculture / Fisheries and Oceans	Ministère de l'Agriculture et de la Pêche	EU (Common Agricultural Policy)		
Auditor general	X			
Citizenship (passports, etc.)	Ministère de l'Immigration, de l'Intégration, de l'Identité	EU (Schengen)		

	nationale et du Codéveloppement			
Civil service	Ministère du Budget, des Comptes publics et de la Fonction publique		22 Regions; 96 'départements'	
Culture and communications	Ministère de la Culture et de la Communication			
Customs and Revenue	Ministère du Budget, des Comptes publics et de la Fonction publique	X		
Defence	Ministère de la Défense	NATO, EU		
Education / Research	Ministère de l'Éducation nationale; Ministère de l'Enseignement supérieur et de la Recherche		22 Regions, 96 'départements'	Private Schools (elementary to graduate degree)
Employment Insurance	Ministère du Travail, des Relations sociales, et de la Solidarité		96 'départements' (RMI)	
Employment / labour force policy / training	Ministère du Travail, des Relations sociales, et de la Solidarité			
Energy policy	X	EU		
Environment	X	EU		
Financial Oversight (Banks, stock markets, insurance companies)	X	European Central Bank		
Foreign Affairs	Ministère des affaires étrangères et européennes	EU		
Health	Ministère de la Santé, de la Jeunesse et des Sports	WTO		
Homeland Security	X	EU (Schengen)		
Housing & Urban Development	Ministère du Logement et de la Ville			
Human Rights	X	EU		

Immigration	Ministère de l'Immigration, de l'Intégration, de l'Identité nationale et du Codéveloppement	EU (Schengen)		
Industrial Development (Export development / Farm Credit)	X	X		
Infrastructure	X	EU	22 Regions	
Interior	Ministère de l'Intérieur, de l'Outre-mer et des Collectivités territoriales	EU (Schengen, Europol)		
Lawmaking / justice / Tribunaux	Ministère de la Justice; Gendarmerie	EU		
Management & Budget	Ministère du Budget, des Comptes publics et de la Fonction publique			
Monetary policy		European Central Bank		
Natural Resource management	Ministère de l'Ecologie, du Développement et de l'Aménagement durables	X		
Postal Services	X			
Public utilities (Energy, Water)				Veolia, Ondeo, Saur, Electricité de France, Gaz de France
Regional Development	X	EU (European Regional Development Fund)	X	
Social Programs	X		X	
Sport / youth	Ministère de la Santé, de la Jeunesse et des Sports		X	
Telecommunications				France Telecom, SFR

Trade / commerce	X	EU, WTO		
Transportation	SNCF	X	22 Regions	
Veteran Affairs	X			

**Source:** Government of France ([www.premier-ministre.gouv.fr](http://www.premier-ministre.gouv.fr))

A quick glance at the results for France shows that outsourcing of public goods has essentially occurred at the supranational level, with some delegation—less than in Canada but more than in the UK—to the country’s component regions or the private sector. At the supranational level, these changes can be largely traced to the country’s role as a founding member European Coal and Steel Community of 1951 and the European Economic Community in 1957 as a signatory to the Treaty of Rome. France has since acted as a proponent for increased integration of members into the Union and as a consequence, has been a principal motor for the transfer of public goods provision to that entity.

At the sub-national level, not much outsourcing has occurred to date in France’s 22 metropolitan regions, grouping 96 departments. Currently the regions are responsible for activities such as education, transportation, and infrastructure<sup>xlviii</sup>. They also levy their own distinct taxes, separate from the federal ones, and receive a portion of the federal budget.

With respect to non-state actors, the situation is not clear-cut. With the exception of services like water distribution and local transportation, France has often been hostile to outsourcing to the private sector. In fact, until the election of French president Nicholas Sarkozy in 2007, the word privatization itself was somewhat taboo, lest the ‘social contract’ be upset. While some firms have been fully privatized, in many cases, the French state today either continues to control a majority of the share capital of a company or a large enough percentage, known as a “golden share”, which enables it to continue to exert an outsized level of control relative to its holding. The line between quango, state-owned enterprise, and private actor in France is a fine one; one could have included many of these nominally private actors in the category of nation-state.

## Quality of effort

We will now use our framework to determine the optimality of current outsourcing efforts in the three countries by leveraging the baseline set in Table V of the last chapter. As we demonstrated in that table, according to our criteria, the preferred vectors for outsourcing the provision of public goods are private actors followed by supranational organizations, with sub-national entities firmly ensconced in third place in terms of desirability.

Our qualification of the outsourcing situation of a given state is based on an initial high-level appreciation of the dominant quality of the outsourcing dynamic. In the following three tables (#XII, XIII, XIV), with one table corresponding to each country we have discussed, we have put an 'X' in the cell for each actor where we believe a given criteria is most dominant. We have also highlighted the preferred choices from Table V in light gray in order to quickly bring attention to those areas where outsourcing for the country in question could be considered optimal or not. It is the intersection of an 'X' and a gray cell that indicates optimality for a given criteria. Sub-optimality is indicated where an 'X' occurs but the cell is not shaded.

### Canada

**Table XII: Evaluating arrangements for public goods provision in Canada**

Criteria	Supra-national	Sub-national	Private actor	Notes
Technical expertise	X		X	WTO, BIS
Economies of scale	X		X	
Hubris / empire building		X		Opt-outs for Quebec
Increasing financial cost		X		Discussion about the 'fiscal imbalance'
Ability to blame / provide cover		X		Opt-outs for Quebec
Dual loyalties		X		Quebec separatism, Western

				Separatism.
Ability to control		X		Becomes too political, see inability to blame

In the case of Canada, with the exception of access to technical expertise and economies of scale brought about by that country's participation in various supranational organizations and the important role of non-state private actors, the outsourcing of public goods provision can be classified as sub-optimal. In fact only 3 out of a possible 9 areas can be described as optimal, with 6 items that are pointedly sub-optimal. With the exception of any activities managed by the central government or quangos, the country is essentially dependent on outsourcing to sub-national entities. As indicated earlier, this is largely due to the federal nature of the country, though some additional delegation has since occurred as a result of 'pulling' by provincial governments, with Quebec foremost among those doing the pulling. This reliance on sub-national entities has left the state exposed to hubris, scope creep and increasing financial costs. The particularly charged political dynamic, especially between Quebec and the federal government, precludes most attempts to lay the blame at the feet of the provinces, and obviates most opportunities for control, essentially leaving the federal government on the permanent defensive.

## United Kingdom

**Table XIII: Evaluating arrangements for public goods provision in the UK**

Criteria	Supra-national	Sub-national	Private actor	Notes
Technical expertise	X		X	EU; privatized utilities
Economies of scale	X		X	EU; privatized utilities
Hubris / empire building	X	X		EU; home countries post-devolution

Increasing financial cost	X	X		EU; home countries post-devolution
Ability to blame / provide cover	X			EU
Dual loyalties		X		Driven by devolution to Scotland, Wales; the West Lothian question
Ability to control	X	X		Uncertainty about further EU integration; see Scottish nationalism

Overall, we consider the UK to be essentially sub-optimal, judging by the limited number of optimal areas (4 out of a possible 9) that overlap with our preferred choices from Table V. This is largely due to the high number of sub-optimal areas, specifically the strong presence of dual loyalties brought about by home rule for Scotland, Wales and Northern Ireland, which has harmed the long-term position of the Union.

Indeed the current situation in the UK is judged by many to be untenable, specifically as a result of the way that public goods provision has been outsourced. It has led to multiple resentments among the different home countries, over and above any historical grievances. A case in point is the availability of free university education and much more generous social programs in Scotland than are available in England. This is made possible by a higher expenditure per person in Scotland than in England, even though all funds are provided by Westminster. The Economist describes the issue succinctly:

“South of the border, English voters have started to notice that, though they continue to subsidise Scotland, they no longer have any say—through their MPs—over most of its affairs, even though Scottish MPs can, and sometimes do, provide the parliamentary majority for controversial measures that apply only in England. They notice, too, that Edinburgh has abolished tuition fees for Scottish university students, brought in free personal care for the elderly and soon, if [Scottish first minister Alex] Salmond gets his way (read, money), will provide free prescriptions and free school meals.”<sup>xlix</sup>



It has given rise to a second more important challenge known as the 'West Lothian' question, "the constitutional anomaly that allows Scottish MPs to vote on laws affecting only England but, since devolution in 1999, denies English MPs a say on a wide array of matters that pertain only to Scotland."<sup>1</sup> At a minimum, the West Lothian question has led many to call for home rule for England. Were that to occur, the role of Westminster and the future of the Union itself would be called into question. It is worth noting that the 'home countries' already have a certain amount of visibility on the international scene. A case in point is the football (soccer) World Cup where England, Scotland, Wales and Northern Ireland compete against each other much as do France, Spain and Italy, for qualification and for victory.<sup>2</sup>

## France

**Table XIV: Evaluating arrangements for public goods provision in France**

Criteria	Supra-national	Sub-national	Private actor	Notes
Technical expertise	X		X	See local difficulties with water services firms
Economies of scale	X		X	EU, water services firms
Hubris / empire building	X			EU
Increasing financial cost	X			EU (new entrants), etc.)
Ability to blame / provide cover	X		X	EU; Water services firms
Dual loyalties	X	X		Driven by the EU; some regional loyalties
Ability to control	X	X	X	EU w/ France as a motor of integration

Overall, the French situation is somewhat mixed, though better than in the UK, with optimality in six out of 9 possible areas. In terms of access to economies of scale and technical expertise. France benefits from its membership in the European Union in particular. On the other hand, it is France's membership of the EU that is also the source of hubris, dual loyalties (cultivated in part by the Union itself in a bid to address the perceived lack of legitimacy), and (relatively) increasing financial costs.

The use of private actors such as the water services firms (Veolia et al) discussed earlier allows France to reap some of the benefits of outsourcing public goods provision, such as the ability to blame and the ability to provide political cover, with minimal downside. As indicated earlier, the geographical scope and scale of some actors, such as the three French water services firms with their worldwide operations, have left some managers of municipalities feeling that they are at a disadvantage.

## Comparison of outsourcing efforts across states

Of the three countries we have surveyed here, it is France—traditionally a very centralized state—that has outsourced the most public goods in the most desirable manner, according to our evaluation criteria. The UK has outsourced a relatively similar number of goods, but they have for the most part been done in a sub-optimal way, leading to structural tensions in the Union. Finally, Canada has outsourced the least number of public goods and has been essentially sub-optimal in the way that it has done so. The result is also structural tensions in the Canadian federation.

### Supranational organizations

It is France's membership of the Schengen zone as well as the Euro currency that provide the quantitative difference in supranational outsourcing when compared to that observed in the United Kingdom, a fellow member of the EU that has chosen to opt out of both efforts for now. Canada's membership of NAFTA does not compare to the quality of public goods outsourcing undertaken by either

France or the UK in that NAFTA is limited uniquely to commercial activities and has not demonstrated the same sort of scope creep as witnessed with the EU.

### Sub-national entities

Compared to the situation of France's 22 regions, the UK's devolution of powers to Scotland, Wales and Northern Ireland is much more important in scope with sizeable autonomy—both primary and secondary powers—in certain matters. However, when compared to Canada where such devolution of powers is enshrined in the constitution, with additional responsibilities and monies continuing to be transferred over time, the UK's approach largely pales in comparison.

### Private actors

With respect to the role of non-state actors, their importance in France is uneven when compared to the situations in the UK and Canada. In fact, until as recently as the early 1980s, the trend had been towards the centralization, or nationalization, of key industries. This effort was outlined in French President Mitterrand's '110 Propositions for France' and implemented in the law of nationalization<sup>lii</sup> of 1982. Watkins (2007) provides some insight on the scope of the undertaking:

“The nationalizations of 1981–82 involved seven of the largest twenty conglomerate industrial companies in France plus another five industrial companies. Thirty six banks and two finance companies were also nationalized to be sure of the State having capital sources for the nationalized sectors.”<sup>liii</sup>

When privatization efforts did begin in France, they proceeded in fits and starts, often falling short of outright privatization for many companies. In many cases, the French state today either continues to control a majority of the share capital of a company or a large enough percentage, known as a 'golden share', which enables it to continue to exert an outsized level of control relative to its holding. As indicated earlier, there is a fine line between quangos and privatized firms in France.

In contrast, privatizations of state-owned firms in Canada and the UK proceeded much more smoothly. In Canada, the state has largely relinquished its golden shares in state-owned firms such as Air Canada and Canadian National. The situation in the UK is even more fluid. There the government sees no issues with foreign firms purchasing domestic providers of water services and energy, preferring to let the market determine the best allocation of resources while ensuring desirable outcomes for consumers with a deft touch of regulation.

## Conclusion

When applied to the workplace one approach of organizational management theory is to first define what 'success' would like and to then work backwards, determining the strategic choices and tactical actions required to achieve it. In the case of the nation-state, keeping coordination costs constant, success would look like a situation whereby public goods provision was outsourced to the greatest extent possible—enabling the state to steer while leaving the rowing to others—while maximizing the capture of all positive externalities and minimizing any negative ones.

Based on Table V from Chapter 3 and on our evaluation of the outsourcing situations in Canada, the UK, and France in Chapter 4, it would appear that where possible, aside from pursuing the option of quangos—they are outside of the scope of this discussion—states looking to achieve the benefits of fiscal federalism would find it advantageous to outsource public goods provision either to private actors or supranational organizations (in that order), avoiding sub-national entities when possible.

The first two actor types appear to offer relatively easier avenues for control and can make for convenient scapegoats in times of difficulty—being easily positioned as against national interests, which is a sure vote-getter—while avoiding issues such as dual loyalties in the process. The ability to control private actors (more) and supranational organizations (less) also addresses to a certain extent issues such as empire building and increasing financial cost.

Sub-national outsourcing is inherently political (i.e., the decision to provide which kind of public good), as it opens the debate on to more emotional and qualitative issues, and should likely be avoided wherever possible or practical. If the sub-national entity, such as a regional government, corresponds to a specific cultural identity like the Scots or the Quebecois, then public disputes become nasty and can create future troubles, possibly even accelerating any existing drive towards separation.

For those states inclined to pursue the outsourcing of public goods provision, a principal advantage of outsourcing is that it offers the central government the ability to lock in, to a certain extent, a specific vision of the country. This is particularly the case when outsourcing to certain kinds of supranational organizations, which offer the ability to subjugate national and sub-national institutions to the rules of the organization in question. This is something that the EU does very well, and that NAFTA and the WTO do to a lesser extent. Hirst (2002:3) writes that,

"States are increasingly embedded in larger entities to which they have ceded certain sovereign powers; for example, members of the WTO accept its adjudication over a wide range of trade-related matters that impinge on the scope of national policy, and the EU member states under the Single European Act accept EU legislation in matters facilitating the single market as superior to those of their national legislatures and enforceable (sic) as such in their courts."

## Chapter 5: Conclusion and future study

### Conclusion

The role of the nation-state as the sole provider of public goods has been challenged and transformed by a range of political, economic, social, and technological phenomena. In attempting to address these challenges, states have turned toward supranational organizations, sub-national governments, and private actors.

However the consensus among observers is that the State has not acted with regard to the long-term strategic impact of its actions. In the aggregate, the outsourcing of public goods provision has been mostly happenstance, driven more by political expediency than any long-term design. As we noted earlier, Bache and Flinders (2004:36) write that, "In the context of these developments, there has been little long-term strategic thinking regarding the steering capacity of the centre."

It is the opportunity to establish a strategic approach to the outsourcing of public goods that provided the backdrop for this essay. To enable such an approach, we have sought to develop a framework that evaluates the extent to which nation-states can outsource responsibility for the provision of public goods while bringing a qualitative dimension as well.

At the conclusion of this effort, we have three findings that we believe go a long way towards enabling a more strategic approach to public goods outsourcing.

**First**, that it is possible to create a coherent framework that captures the various options for outsourcing public goods provision. In the course of this document we identified three actor types: the nation-state (including quangos); supranational organizations; sub-national entities, and private actors. When combined with the State as public goods consumer on behalf of citizens, we call this a market for governance.

**Second**, with few exceptions, for any given public good—keeping in mind our caveat regarding geographical location as a filter for certain types of organization—we showed that there are multiple alternatives for outsourcing within a given actor type.

**Third**, we demonstrated that a series of non-economic, non-financial criteria could be applied to enable a more strategic approach to the question of delegation of public goods provision. These are based on the notion of spillovers as well as criteria from the world of principal-agent theory to generate a notion of utility, which, keeping coordination costs constant, can be maximized by either increasing the positive externalities of a given course of outsourcing or by reducing the negative externalities associated with it.

## Future study

In the course of undertaking this effort, a number of additional avenues for future study appeared. Some of them are due to the necessarily more limited scope and nature of an essay like this one. Others are the result of new questions thrown up by the work itself. None of them modify our initial hypothesis as such; instead they expand the qualitative applicability of the framework.

### Broader sample

The first effort would be to expand the sample of countries to which we apply the framework. This should include countries that have not yet started down the path of outsourcing to any significant degree. For example, Serbia, a country that sits on the geographical and philosophical fault-line between the European Union, NATO, and the Russian sphere of influence comes to mind. (In this case, we could make immediate recommendations on the best paths for moving forward.) It should also look at those countries that are actively considering new outsourcing opportunities, to complement existing arrangements. This brings to mind countries that are being asked to join Mercosur or ASEAN. Finally, it should also be applied to countries that enjoy high degrees of outsourcing already such as the United States and Switzerland.

## Optimality and utility

A second effort would be to further transform the criteria for evaluating the desirability of a given course of outsourcing action from a qualitative into a quantitative measure. The approach covered in Chapter 4, while highly subjective, represents a starting point nonetheless. In addition, it could be desirable to develop something along the lines of an optimal score. This would help us understand which countries are close enough to the optimal. Furthermore, the development of an outsourcing index, which would enable the ranking and comparison of countries' efforts, would further facilitate discussion and recommendations for the future. These suggestions would be further nuanced based on the level of centralization and ethnic make-up of a given nation-state.

## Role of quangos

A third avenue would be to expand the framework to explore the question of quangos. As indicated earlier, for the purposes of this effort, we considered them to be part and parcel of the nation-state. However, in conceiving of the criteria for evaluating outsourcing efforts, and in examining the cases of the three countries studied here, it became apparent that quangos share a number of the benefits of other actors. In particular, that they can provide possibly an even better solution to the need to address the dynamic of decentralization and fiscal federalism, while potentially avoiding many of the downsides of outsourcing, particularly those associated with sub-national actors. By integrating quangos into our framework, we can expand the discussion about the opportunities for steering and rowing, and their advantages, to the maximum possible. We expect that the ranked order of preferred actor-types—essentially vectors for outsourcing—would likely change with the introduction of quangos.

## Impact on self-determination movements

Finally, the development of this framework took place in the context of an overall effort to understand the dynamics behind self-determination movements, specifically those in the West where inter-ethnic violence and post-colonial re-



distributions of power are not the rule of the day. By understanding how the forces (described in Chapter 2) were affecting, indeed transforming, existing nation-states, we hoped to understand how they could also affect the creation of new states through a mechanism known as the secession calculus.

It is our hypothesis, to be proven in a future effort, that the existence of this market for governance and the outsourcing of the nation-state that it makes possible, have modified the secession calculus significantly. Whereas many independence movements, have effectively hit a ceiling on the strength of appeals to nationalist logic alone—witness the declining support for separation in Quebec since the original referendum in 1980, not to mention the impact that a barely veiled threat to take away pensions had on popular support for independence—the existence of a dynamic that could effectively modify the cost-benefit analysis associated with separatism could significantly change separatist outcomes in the future.

By potentially lowering the perceived costs of independence, outsourcing the provision of public goods—in particular to supranational organizations and private actors with limited required growth in the non-physical infrastructure—should modify the secession calculus for a given people. As a result, it should lead to more attempts at independence, and logically, assuming a given rate of success, more new nation-states. (The heart of this dynamic is demonstrated by the far right column in **Annex III**.)

At its most extreme version, the market for governance and the outsourcing of the nation-state enabled by it, would correspond to a vision of the Singaporean operating system where one just adds people, land and national resources.

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Third Annual Meeting of the American Economic Association". *The American Economic Review*. Volume 81(2):126-129.

# Annexes

## Annex I: Growth in sub-national public entities in the United Kingdom

**Table XV: Quasi-autonomous public bodies created [in the UK] since May 1997**

Policy area	Quasi-autonomous organization
Regional Policy	Regional Development Agencies, Regional Cultural Consortia, Regional Flood Defence Committees
Local Government	Standards Board for England
Northern Ireland	Parades Commission (N.I.), Sentence Review Commissioners (N.I.), Commission for Racial Equality (N.I.), Human Rights Commission (N.I.)
Regulation	Postal Services Commission (POSTCOMM), Office of Communications (OFCOM), Gas and Electricity Markets Authority, Consumer Council for Postal Services, Gas and Electricity Consumer Council, Statistics Commission, Gangmasters Licensing Authority
Food Policy	Food Standards Agency
Constitutional Policy	House of Lords Appointments Commission, Electoral Commission, Commission for Judicial Appointments, Office of the Information Commissioner, Human Rights Commission
Criminal/Legal Policy	Civil Justice Council, Sentencing Advisory Panel, Sentencing Guidelines Council, Local Probation Boards, Legal Services Complaints Commissioner, Youth Justice Board, Criminal Records Bureau, Independent Police Complaints Commission, National Police Training and Development Authority (CENTREX), Assets Recovery Agency, Security Industry Authority, Serious Organised Crime Agency, Civil Nuclear Police Authority
Industrial/Business Policy	Low Pay Commission, Better Regulation Task Force, Fair Trading Authority, Small Business Service, Ethnic Minority Business Forum, Nuclear Decommissioning Authority, Fuel Poverty Advisory Group, Independent Commission on Community Interest Companies, British Trade International, Insolvency Practices Council, Partnerships UK, Financial Reporting Council, Valuation Tribunal Service
National Lottery	National Lottery Commission, Big Lottery Fund

Transport	Strategic Railway Authority, Commission for Integrated Transport, Independent Railway Industry Safety Body, Office of Rail Regulation
Rural/Agriculture	British Potato Council, Countryside Agency, Rural Payments Agency
Economic Policy	Competition Commission, Financial Services Authority, Monetary Policy Committee, Statistics Commission, Independent Complaints Commissioner for the Financial Services Authority, Competition Service, Competition Commission Appeal Tribunal
Social Policy	New Deal Task Force, New Opportunities Fund, Race Relations Forum, Disability Rights Commission, Youth Justice Board, Pensions Compensation Board, Independent Pensions Commission, Community Forum, Children and Family Court Advisory and Support Service, Pensions Regulator, Office of the Children's Commissioner for England
Education	Qualifications and Curriculum Authority, General Teaching Council for England, Learning and Skills Council, Medical Education Standards Board, Schools Funding Agency, University for Industry, Office of Fair Access, National College for School Leadership, Adult Learning Inspectorate, Office of the Independent Adjudicator, Sector Skills Development Agency, Independent Complaints Adjudicator for OFSTED, Partnerships for Schools
Health	Commission for Health Improvement, National Institute of Clinical Excellence, Independent Reconfiguration Panel, National Care Standards Commission, Health Development Agency, Foundation Trusts, Primary Care Groups/Trusts, Commission for HealthCare Audit and Inspection, Commission for Patient and Public Involvement in Health, General Social Care Council, Air Quality Expert Group, Patient Information Advisory Group, NHS Information Authority, National Patient Safety Agency, National Treatment Agency, Retained Organs Commission, National Clinical Assessment Authority, Council for the Regulation of Health Professionals, Council for the Quality of Health Care, NHS Information Standards Board, Medical Education Standards Board, Nursing and Midwifery

	Council, Health Professions Council, Social Care Institute of Excellence, National Shared Standards Initiative, NHS University, NHS Bank, Commission for Social Care Inspection, Health Protection Agency, NHS Appointments Commission, Family Health Services Appeals Authority, Counter Fraud and Security Management Service, Office of the Independent Regulator for NHS Foundation Trusts, National Care Standards Commission, Commissioner for Social Care Inspection for England
Security	Office of Surveillance Commissioners, Security Vetting Appeals Panel, Interception of Communications Commissioner, Intelligence Services Commissioner, Investigatory Powers Tribunal Special Immigration Appeals Commission
Genetics	Human Genetics Commission, Agriculture and Environment Biotechnology Commission, Genetics and Insurance Committee, Committee on Novel Foods and Processes, Sustainable Development Commission, Distributed Generation Coordination Group
Miscellaneous	Statistics Commission, National Archives, Hunting Commission, Independent Football Commission, Spoilation Advisory Panel, Committee for Monitoring Agreements on Tobacco Advertising and Sponsorship, Consumer Council for Postal Services, Brownfield Land Assembly Trust Co., Commission for Architecture and the Built Environment (CABE), National Endowment for Science, Technology and the Arts (NESTA), Land Registration Rule Committee, Office of the PPP Arbiter UK Film Council, Arm's Length Management Organisations (ALMOs), Local Improvement Finance Trusts (LIFTs), Public Interest Companies (CICs)

**Source:** Flinders (2004:888–89)

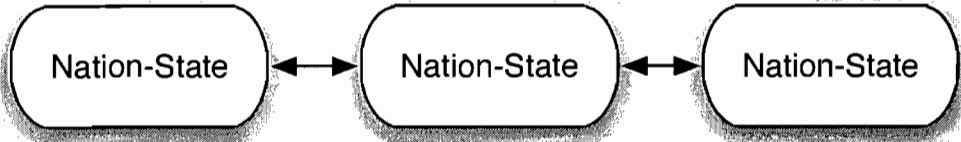
*Sources:* Better Regulation Task Force *Independent Regulators* (London: Cabinet Office, 2003); C. Skelcher and S. Weir, *Advance of the Quango State* (London: LGIU, 2001); HC 209 *Quangos* Sixth Report by the Public Administration Committee, Session 1998/99, London: HMSO; HC 367 *Mapping the Quango State* Fifth Report of the Select Committee on Public Administration, Session 2000–2001 (London: HMSO); Public Records Office (PROCAT); National Digital Archive of Datasets (NDAD); British Official Publications Collaborative Reader Information

Service (BOPCRIS); Social Science Information Gateway (SOSIG), *Public Bodies* 1997-2003, [www.polis.parliament.uk](http://www.polis.parliament.uk).

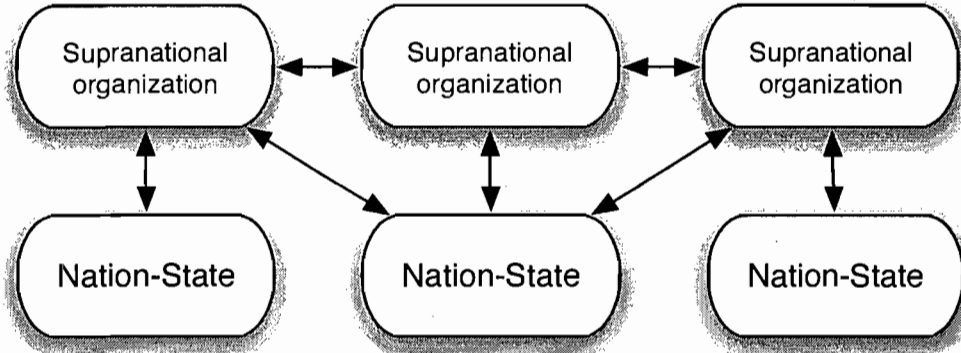
# Annex II: Evolution of forms of governance

Table XVI: Evolution of forms of governance over time

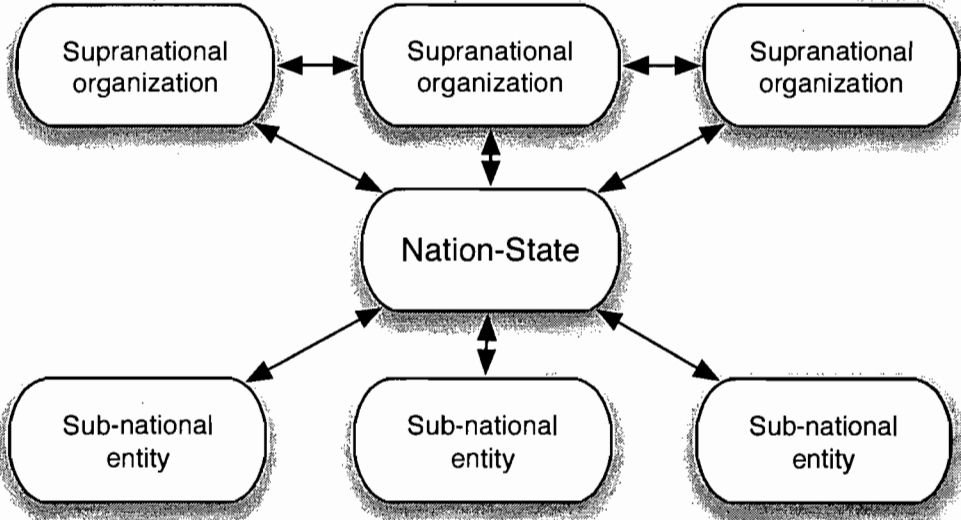
**Peace of Westphalia**



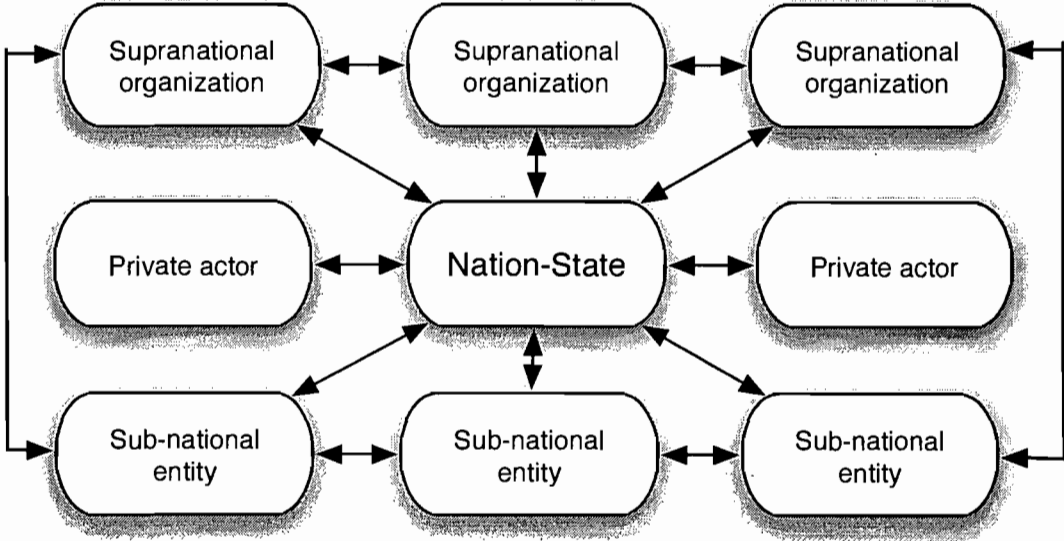
**Interdependence**



**Distributed Public Governance**



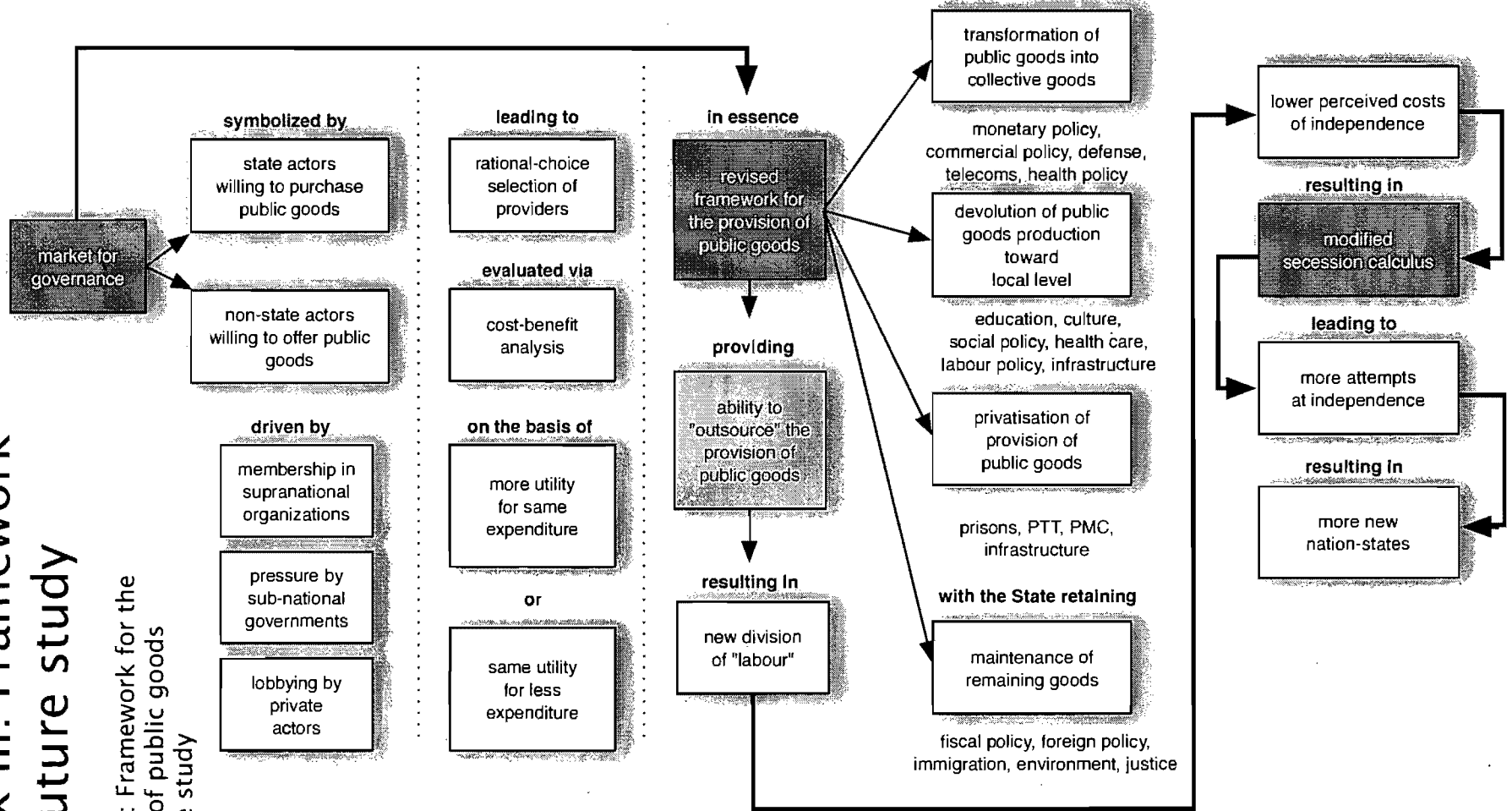
**Multi-Level Governance**





# Annex III: Framework and future study

Table XVII: Framework for the provision of public goods and future study



# Endnotes

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<sup>i</sup> In a speech by Jayantha Dhanapala, United Nations Under-Secretary-General for Disarmament Affairs, at the University of Colorado Law School, Boulder, Colorado, April 7<sup>th</sup>, 2001 (see <http://disarmament.un.org/speech/07apr2001.htm>)

<sup>ii</sup> See [http://www.quotationspage.com/quotes/Mark\\_Twain/91](http://www.quotationspage.com/quotes/Mark_Twain/91)

<sup>iii</sup> The full title is “Leviathan, or The Matter, Forme and Power of a Common Wealth Ecclesiasticall and Civil”

<sup>iv</sup> See Otto von Bismarck

<sup>v</sup> See Wikipedia article on Taxation History of the United States

<sup>vi</sup> In the context of our discussion of the delegation of public goods production, it would be more precise to see centralization and decentralization as the end points of a continuum, with the inevitable ebb and flow between extremes as various societal, technological or economic phenomena appear or disappear.

<sup>vii</sup> This is the future International Telecommunications Union (ITU).

<sup>viii</sup> The Board of Excise and the Northern Lighthouse Board, created in 1643 and 1786 respectively.

<sup>ix</sup> See “Europe’s rebellious regions”. Charlemagne, *The Economist*, November 13, 2003,

<sup>x</sup> See “Self-replicating” in *The Economist*, March 26<sup>th</sup>, 2006.

<sup>xi</sup> If such rationality was in fact operated, it was likely at the level of political expediency as opposed to a selection among the best choices available over time.

<sup>xii</sup> See Johnson (2005) web site.

<sup>xiii</sup> See Wikipedia article on Utility.

<sup>xiv</sup> See Wikipedia article on Outsourcing

<sup>xv</sup> See Dhanapala (2001).

<sup>xvi</sup> For our purposes however, we shall ignore Mann’s point #4, which is quite a different discussion with its own set of dynamics and is beyond the scope of this paper.

<sup>xvii</sup> See Wikipedia article on Russo-Japanese War

<sup>xviii</sup> Note that NPM also saw public goods move outwards towards quangos and private actors and not just downwards in the form of decentralization or devolution.

<sup>xix</sup> Offshoring is the term used to describe outsourcing activities to a location outside of the home country.

<sup>xx</sup> Alesina (2003:309) notes that the issue of appropriate market size is also a factor of the international trade regime in place and that free trade relieves some of the pressure for countries to be bigger.

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<sup>xxi</sup> We shall ignore those cases where certain public goods are the constitutionally mandated domain of those same sub-national governments.

<sup>xxii</sup> See <http://www.ci-pinkerton.com/history.html>

<sup>xxiii</sup> See Wikipedia article on Pinkerton National Detective Agency.

<sup>xxiv</sup> See “Privateers under fire”, *The Economist*, September 20<sup>th</sup>, 2007.

<sup>xxv</sup> Even the secondment of troops to other countries in a non-combat role is a form of outsourcing of expertise by the host country (e.g., US Special Forces involved in Plan Colombia and Operation Enduring Freedom-Philippines).

<sup>xxvi</sup> As they gain in scale and scope, private actors may come to resemble supranational organizations over time, with professional managers from multiple national backgrounds, focused on one or more public goods that will then be provisioned across multiple countries.

<sup>xxvii</sup> See Wikipedia article on Military-Industrial Complex.

<sup>xxviii</sup> Commission of the European Communities, “European Governance: A White Paper”, Brussels, 25.7.2001, document # COM(2001) 428.

<sup>xxix</sup> See <http://www.brainyquote.com/quotes/quotes/a/alfredpsl194030.html>

<sup>xxx</sup> Robert Keohane used a similar market-oriented approach, borrowing from the field of microeconomics as seen in the title of his 1982 book, “The Demand for International Regimes”.

<sup>xxxi</sup> See <http://www.un.org/members/list.shtml>

<sup>xxxii</sup> See <http://group.tnt.com/aboutus/historyofourcompany/index.asp#1752>

<sup>xxxiii</sup> See British North America Act.

<sup>xxxiv</sup> See Wikipedia article on States' rights.

<sup>xxxv</sup> See Wikipedia article on the supremacy clause.

<sup>xxxvi</sup> See the IMF as an example. The notion of a ‘quote-part’.

<sup>xxxvii</sup> This is essentially the result of the EU’s Common Agricultural Policy, which sees community funds transferred to countries that have important agricultural sectors. Since Britain’s agricultural sector was much smaller than those of France, Spain, or Italy, it could never hope to benefit to the same extent from CAP funds.

<sup>xxxviii</sup> See L’aimé (2005b).

<sup>xxxix</sup> See L’aimé (2005a).

<sup>xl</sup> Here we draw a distinction between gross profits and profitability, which is a relative measure that takes into account the capital deployed to achieve the results. The market rewards profitability more than gross profits.

<sup>xli</sup> See Wikipedia article on Argentine Economic Crisis (1999-2002).

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- xlii See [www.polarisinstitute.org/files/veoliapdf.pdf](http://www.polarisinstitute.org/files/veoliapdf.pdf)
- xliii <http://www.reuters.com/article/technology-media-telco-SP/idUSL2181989720070821>
- xliv Many other provinces have been content to essentially free ride, letting Quebec do the heavy lifting while alienating many non-Quebeckers in the process, and sharing in the benefits of this decentralization by stealth.
- xlv See BBC article "A guide to devolved powers", December 2, 1999.
- xlvi See Kissinger (1994:178).
- xlvii See Wikipedia article on devolution.
- xlviii See Wikipedia article on Regions of France.
- xlix See The Economist article, "Tax and Mend".
- <sup>i</sup> See The Economist article, "The England Question".
- <sup>ii</sup> A recent phenomenon of Scots cheering for any team playing against England has broken what was until now solidarity among 'home' countries, including the now independent Republic of Ireland, irrespective of day-to-day concerns.
- <sup>iii</sup> See Wikipedia article on 110 Propositions for France.
- <sup>iiii</sup> See Watkins' web site on Socialism in France.