The ‘Open Method of Coordination and ist Effects:’

Policy Learning or Harmonisation?

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The ‚Open Method of Coordination' and its Effects: Policy Learning or Harmonization?*

1. Introduction: The OMC as a Policy Innovation

The EU 25 is in transition: One the one hand, with the 2004 enlargement, the MEEC joined the Union as new members and 'traditional' transition countries. One the other hand, and perhaps more important, also the 'old' member states became 'new' transition countries, i.e. they realized the necessity of policy reforms and political innovations in order to adapt to the intensifying systems competition in the EU and beyond. Realizing the necessity of transforming the western European welfare states was not only a matter of national political perception, but became an important topic in European Public Policy. The EU 15, in 2000, launched the Lisbon Strategy, setting "the new strategic goal: *to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth* (…)".[1] The Lisbon Strategy assumes an interdependence of (sub-optimal) market dynamics and (lacking) political innovations and wants to resolve this two-fold innovation crisis simultaneously.

The most important *European* policy innovation in connection with the Lisbon strategy is the Open Method of Coordination. In contrast to former political innovations on the European level, mostly consisting of new policy fields, the OMC is a *procedural* innovation. Instead of adding (the substance of) a specific policy field to the supranational level and thereby influencing or determining *directly* the policy measures by the EU, the OMC is meant to

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support the national political processes, thereby being of only *indirect* influence on the political measures taken by the member states. The OMC is applied in a wide range of policies, in which the competences for policy making rest on the national level. However, the national political "experiments" are evaluated on the European level ('benchmarking'), "best practices" are identified, and policy recommendations are given to the member states. The OMC, in short, wants to establish a system of mutual policy learning, which promotes policy innovations of and within member states and accelerates the diffusion of successful ones among the member states. Note, once again, the nexus of economy and politics: Policies for a knowledge-based economy must be 'knowledge-based' themselves.

Critics argue that even the described indirect influence would lead to a creeping harmonization, i.e. the OMC, although seemingly purely procedural, would result in substantial and substantive harmonization. They plead for systems competition as a superior way to ensure policy learning within the EU. Sharing the "Schumpeterian" approach of the Lisbon Strategy and, thus, being in favour of policy innovations and learning, those critics assume that an institutionally safeguarded but otherwise *un*-coordinated systems competition would be the best way for the "Use of Knowledge in Society" (Hayek).

With its focus on innovations and learning, the Lisbon Strategy is an apt example for an evolutionary analysis of Economic Policy, and the controversy described is indeed taking place among evolutionary economists that have different views on the generation and use of knowledge in political competition. The remainder is organized as follows: First, the evolutionary approach to Economic Policy and Political Economy is briefly characterized, then the crucial question of the use of knowledge in politics is addressed, finally, the conclusions with regard to the OMC are presented.

2. Evolutionary Analysis of Economic Policy

> "Economic theory is static; and in the world of dynamic change in which we live a static body of theory

> consistently and persistently yields the wrong policy prescriptions. (…) The recent interest in evolutionary economics is, however, a heartening development“[2]

Ironically, evolutionary economics is not too well prepared to give policy prescriptions. Most of evolutionary economists' energy has been directed toward positive economics.[3] Their analyses, emphasizing processes and dynamics instead of final states and the fragmentarity of knowledge instead of certainty, only touch implicitly on the difficulties an evolutionary political economy may face. Most contributions that explicitly address the problems of policy implementation and policy advice from an evolutionary point of view do so in accordance with Hayek's special kind of evolutionary *and* institutional economics ("Ordnungstheorie"). His scepticism towards economic policy is still the point of departure for most evolutionary analyses of economic policy.

2.1 The Hayekian legacy

Without going into details,[4] Hayek basically claims that a "spontaneous" market order needs universal "rules of just conduct" or that, the other way round, only the enforcement and cautious modification of those rules can guarantee the spontaneity and workability of a market order. Any attempt to govern the economic system more directly is impossible, as it requires the use of "commands" for a specific purpose and would ultimately transform the economic order into an "organization". It is important to note that Hayek uses a formal criterion, i.e. the legal characteristics of institutional policy, in order to evaluate the expected effects.

This "impossibility-theorem" of governance, however, underrates the creative potential of the addressees of any political measure.[5] Even if economic policy does only operate with general and abstract rules, it is not guaranteed that the economic actors react in a way that supports the spontaneity of a market order. Universal rules can be, in other words, so strict that they ultimately destroy a spontaneous order. This leads to the conclusion that the beneficial or detrimental effect of a political modification of the institutional arrangement cannot be qualified along formal criteria, but only on the basis of an economic analysis that must – from an evolutionary perspective – take into account the creativity of actors.

Such an analysis[6] has to differentiate, first, whether either the actors can expand the set of potential actions creatively or whether they lack the innovative potential to do so. It is clear that, secondly, it should be analysed, whether the addressees' action ultimately help reaching the goal of the measures taken. This two-dimensional analysis results in a classification of four possible cases, and it appears that Hayek's impossibility theorem describes only one of them. This case is characterized by the failure to reach the political goal, because the creative actors do not find ways to substitute the prohibited action by an innovative option that is conform to the goal. This consequence crucially depends on the lacking ability to innovatively expand the set of possible actions. As far as actors are endowed with creativity there is, in other words, a potential for the political governance of the economic system. Summarizing, Hayek's normative statement about beneficial institutional policy in a spontaneous order is connected with a positive analysis that astonishingly underrates the spontaneity of the actors.

The potential success of institutional policy can only be assessed for a specific situation and has to estimate the innovative potential *vis-à-vis* the considered measure. Given the creativity of the addressees and the possibility of unanticipated novelty, an optimal measure can never be determined. Institutional policy therefore is always a venture that political entrepreneurs have to answer for. As the knowledge about the reaction on a political measure can never be certain but is necessarily fallible and subject to future learning, an "evolutionary policy maker adapts rather than optimises", his attention "shifts away from efficiency towards creativity".[7] As there is, in other words, "a strong case for experimentation and policy learning"[8] in order to improve the knowledge about governance, it should be asked how the experimental and learning process is to be designed so that most knowledge can be used for institutional policy.

With respect to an evolutionary *normative* economics it is important to analyze the role of knowledge for (different kinds of) legitimation which ultimately allow for normative statements.

2.2 Input-legitimation and knowledge

Constitutional Economics consider institutions as legitimate if and when the institutional choice is explicitly based on a decision of those who will be affected by the institutional arrangement.[9] Hence institutional choice is seen as a social contract that reflects the preferences of all people concerned. As it is important that each contractor voluntarily assents to the contract, the institutional choice has to be taken unanimously. Unanimity is a central requirement of the contractarian approach and can be interpreted as analogous to the Pareto-criterion.[10] In order to avoid the difficulties of the potential nirvana approach the principle of unanimity represents, a comparative institutional approach is to be taken. Below perfect consensus it can be asked to what extent preferences flow into the "production" of the institutional framework. Therefore this kind of legitimation can be dubbed "input-legitimation" as "government by the people".[11]

Following the argument of Vanberg and Buchanan concerning constitutional preferences, two dimensions can be distinguished, namely constitutional interests and constitutional theories.[12] Theories in this context mean "predictions (embodying assumptions and beliefs) about what the factual outcomes of alternative rules will be".[13] Vanberg and Buchanan argue that a consensus on theories could be approached by discourse and deliberation, whereas the conflict of interests would persist. From an evolutionary point of view, at least two interesting features of this approach should be stressed:

- The theory dimension in institutional choice introduces knowledge as an important factor.[14] Note that theory does not mean to make a scientific statement about the best of all possible worlds, but theories consist of the fallible knowledge of people involved (what comprises, of course, scientific advisors).

- Secondly, mechanisms of using knowledge are described, that is mechanisms of mutual learning about theories. This procedural view is able to perceive democracy not only as the application of the majority principle but as a "process of forming opinions"[15]

Vanberg and Buchanan[16] point to two difficulties the consensus about theories may face: First, the incentive to acquire the necessary constitutional knowledge may be too weak ("rational ignorance"), secondly, the effects of institutional policy cannot be assessed with certainty, what may lead to persistent dissent in the rational discourse ("limits of reason"). One may argue that the individual knowledge about outcomes of institutions is partly "knowing that", partly "knowing how".[17] These two kinds of knowledge differ in the way they can be communicated. While knowing that can be expressed by means of language, so that it can be exchanged in a discourse, knowing how cannot be expressed in words and is best acquired by imitation, that is learning by doing or learning by using. If an individual has acquired such practical knowledge about the working properties of a specific institutional arrangement, it is not at all certain that she is convinced by theoretical (that is knowing that) arguments about the superior quality of another institutional setting. Thus, it will be difficult to reach an agreement, if the participants' theories also embody knowing how.

Learning by discourse, that is the theoretical examinations of different options in institutional choice, is only one learning mechanism. Beside these 'thought experiments' there might be a need for real world experiments, in order to give the opportunity for learning by using. This is, of course, already an argument related to output-legitimation.

2.3 Output-legitimation, systems competition, and knowledge

Input-legitimation focuses on the collective institutional choice in a "constitutional moment". A change of the institutional arrangement is possible – no institutional setting could be qualified as the end-state – but has to wait until the next constitutional moment. This also means, that an individual that is discontented by the institutional arrangement, cannot make an individual institutional choice that would express her preferences, as long as only input-legitimation prevails. Introducing the possibility of individual choice among different orders according to the “output” the relevant institutions “produce” for the individual, can be seen as a mechanism of “output-legitimation”,[18] i.e. „government for the people” that derives legitimacy from its capacity to solve problems requiring collective solutions.

This means that the individual can chose among different international orders (institutional/systems competition)[19], among different intranational orders (federalism) or among different functional equivalents (functional federalism). In any case there is no longer a monopoly for the institutional supply, but different suppliers make their institutional offers in a competitive process. This implies competitive control but also the incentive to generate and use new knowledge. Institutional competition, too, is a discovery procedure, a “constitutional exploration, for the inventing of and experimenting with new solutions to constitutional problems”.[20]

Although the limits to these different forms of institutional competition must not be overlooked, the very idea of competitive supply of institutions should not be rejected a priori. Such fundamental criticism would, as Oates (1999) pointed out, imply the pretence of knowledge about a desirable end-state. With respect to the economic theory of (fiscal) federalism he points to a neglected dimension dubbed “laboratory federalism”: “In a setting of imperfect information with learning-by-doing, there are potential gains from experimentation with a variety of policies for addressing social and economic problems. And a federal system may offer some real opportunities for encouraging such experimentation and thereby promoting ‘technical progress’ in public policy”.[21]

3. Systems competition and the OMC: The Hayekian legacy once again

Against this background, critics of the OMC, although recognizing the importance of policy learning, argue that 'pure' systems competition would be the best way to generate and use political knowledge, to bring about policy innovations and to give incentives for policy diffusion. Recognizing as well the potential problems with the workability of systems competition they claim for an institutional framework that delineates the scope of beneficial systems competition and prohibits it if detrimental effects are expected. Beside this framework of general rules, i.e. an Anti-trust law for systems competition, they see no need for any intervention into the competitive process, especially 'open coordination'.[22] This argument exactly reflects the Hayekian position towards institutional policy, conceiving the OMC as a 'constructivist' attempt to 'improve' the outcomes of a competitive process, consequently evaluating the OMC as a meaningless and dangerous endeavour.

This plea for a framework of general rules for systems competition and against any further 'intervention' is highly plausible, very elegant, but at the same time as purely formal as the underlying Hayekian position. The main argument with respect to the OMC is that its effects cannot be evaluated by the formal criterion of 'generality'. Criticizing the OMC because it does not only set a framework for competition, but implements mechanisms within competition, like benchmarking etc., implies that either the undesirable effects of those mechanisms were evident, or that it would be 'given' what the framework should be. With respect to the latter, the crucial problem lies in the delineation of beneficial vs. harmful systems competition. Setting an input-legitimized framework requires knowledge of the effects of system competition – exactly the knowledge that is often deficient ex ante and can only be generated ex post. With respect to the former, the critics of the OMC are apparently – and somewhat paradoxically – unable to perceive the OMC as an approach to promote systems competition (in its "Yardstick" version) in policy fields where other mechanisms of systems competition are only of minor importance (i.e. mobility of goods, production factors or laws). Their formalist critique implies that competition policy could only mean setting a general framework of prohibitions and could never comprise active measures.

Competition policy on markets, in contrast, consists also in enabling co-operations, in organizing the competitive process. This is especially true for innovative endeavours, when research co-operations and networks are supportive to innovations. This points to another important difficulty in the Hayekian legacy: His rather reduced analysis of market competition may also explain the misperception of systems competition (and the role of the OMC therein). Having next to nothing to say about firms and organizations in competition,[23] reducing his analysis to the dichotomy of the "order of actions" and the "system of rules", Hayek overlooks the intermediate level – the "order of actors". Conceiving the OMC as an innovative "order of political actors" in the EU, thereby potentially promoting political innovations, would be an appropriate approach.

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[18] Scharpf, *Governing in Europe,* 10 ff.

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