Statecraft and Liberal Reform in Advanced Democracies

Nils Karlson

Statecraft and Liberal Reform in Advanced Democracies

‘Most developed democracies and welfare states are in need of liberal reform, and this book is the best guide I know on how to do it. It makes critical contributions to public choice, theories of institutional change and public sector entrepreneurship. Strongly recommended, I read it straight through.’

—**Tyler Cowen**, *Professor of Economics, George Mason University, USA*

‘A comprehensive political economy of reform requires an approach that focuses on how ideas and interest interact both to block beneficial changes and how these blockages can be overcome. Nils Karlson’s *Statecraft* is an excellent example of this approach and is a welcome contribution to ‘new institutional’ political economy in the tradition of Douglass North.’

—**Mark Pennington**, *Professor of Political Economy and Public Policy, King’s College London, UK*

‘Nils Karlson has written an authoritative guide to reforming the welfare state—by giving up its antique socialism and turning it to effective help for the poor. Most effective is a mutually advantageous economy, the enrichment of the poorest among us that comes from increasing the size of the pie. Instead of serving special interests and the seekers of unearned rents, Sweden and Australia have taken to serving the whole. Karlson explains how. Great lessons a provided for other advanced democracies and welfare states.’

—**Deirdre McCloskey**, *Professor of Economics, History, English, and Communication, University of Illinois at Chicago, USA*

‘Here, it is, a much needed book. In very clear and concise language, Karlson shows that, yes, rich democracies can implement necessary reforms. In the last few years, the political economy of reform has been analyzed here and there. Karlson goes further. He develops a theory of modern statecraft in which policy entrepreneurs are key. Mandatory reading for anybody interested in how necessary reforms can be implemented.’

—**Stefan Voigt**, *Professor of Law and Economics, University of Hamburg, Germany*

‘Liberal, but lobby-encrusted democracies in mature economies normally find it hard to adjust their laws and habits flexibly to the requirements of unceasing technical, political and demographic evolution on the global scene. Yet, such adjustment is crucial for sustaining prosperity and happiness. Sweden and Australia have been exceptional over recent decades in managing much-needed legal and economic reforms. By a comparison of these two remarkable cases, this book elucidates how intellectual analysts, strategic actors in- and outside politics, and legislative and administrative agents have interacted to bring about worthwhile reforms. It offers much-needed lessons to all.’

—**Wolfgang Kasper**, *emeritus Professor of Economics, University of New South Wales, Australia*

Nils Karlson

Statecraft and Liberal Reform in Advanced Democracies

palgrave
macmillan

Nils Karlson
Ratio Institute
Stockholm, Sweden

ISBN 978-3-319-64232-1 ISBN 978-3-319-64233-8 (eBook)
DOI 10.1007/978-3-319-64233-8

Library of Congress Control Number: 2017952166

Cover Image: HerminUtomo / iStock / Getty Images Plus
Design by Ran Shauli

Printed on acid-free paper

This Palgrave Macmillan imprint is published by Springer Nature
The registered company is Springer International Publishing AG
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

Preface

In a world with rapidly changing economic and social conditions, and plenty of policy failures, there is a great need for reform. Existing institutions have to be adapted to new circumstances. This book explains how.

Its focus is on how to promote liberal, welfare-enhancing reform in developed or advanced democracies and welfare states. It explains how to govern a country well and how to overcome different barriers to reform. The book develops a general theory of reform, *modern statecraft*, based on the concepts of the *reform cycle*, *reform strategies*, and *polycentric experiential learning*. Policy entrepreneurs, who introduce and develop new ideas, play a key role.

The lack of modern statecraft may be one of the most important reasons for the rise of populism, protectionism, authoritarian nationalism, and similar creeds in recent years. Even the open society, the rule of law and democracy itself may be under threat if welfare-enhancing institutional change do not come about.

However, as the examples of Sweden and Australia show, reform is indeed possible. There are lessons to be learned for other advanced democracies that have the ambition to improve their economies and societies.

The book is written for an academic audience, including students, and also for a wider group of readers such as policy experts and practitioners. It should be of interest for anyone who is concerned about problems such as budget deficits, slow growth, over regulation, social divisions, unemployment, and lack of structural reforms in advanced democracies and welfare states.

I am grateful for comments on the manuscript by Niclas Berggren, José Cordeiro, Nick Cowen, Anton Howes, Wolfgang Kasper, Dan Klein, Henrik Malm Lindberg, Stig-Björn Ljunggren, John Meadowcroft, Mark Pennington, Hans Pitlik, Emily Skarbek, and David Skarbek. Seminars at the School of Social Sciences and Humanities at Tampere University, Finland; the Department of Political Economy at King's College in London; the Mont Pelerin Society Regional Meeting in Seoul, Korea; and the Ratio Institute in Stockholm, Sweden, have been very valuable. While visiting Australia, generous support and insights were given by Greg Lindsay and Wolfgang Kasper. In addition, I am grateful for excellent research assistance by Victoria Nilsson, Jacob Lundberg, Filippa Ronquist, Sofia Lindbom, and Anne-Sophie Larsson. Jane Shaw Stroup did a fantastic job editing an earlier version of the manuscript. Lastly, I thank Jemima Warren, Beth Farrow, and their team at Palgrave Macmillan for excellent support preparing the manuscript for publication. As always, all remaining faults in the text are the result of my own shortcomings.

Stockholm Nils Karlson
May 2017

Contents

List of Abbreviations

ACTU	Australian Council of Trade Unions
ALP	Australian Labor Party
ANU	Australian National University
ANZAC	Australian and New Zealand Army Corps
AUSSAT	Australian Communication Satellite
AWA	Australian Workplace Agreements
EFW	Economic Freedom of the World Index
GST	Goods and Services Tax (Australia)
IAC	Industries Assistance Commission (Australia)
KIS	Parliamentary report on reformed indirect taxation (Sweden)
LO	Swedish Trade Union Confederation
LRF	Federation of Swedish Farmers
RINK	Parliamentary investigation on reformed income taxation (Sweden)
SAF	Swedish Employers' Confederation
SNS	Centre for Business and Policy Studies (Sweden)

List of Figures

List of Tables

CHAPTER 1

Introduction

How did they do it? How could Sweden and Australia reform and modernize their economies and societies from the 1980s and onwards in such successful ways? How did they overcome the procrastination and policy mistakes of many other advanced democracies and welfare states?

Today many of these countries have severe problems, ranging from budget deficits and debt crisis to slow or non-existent growth and high unemployment levels. Many politicians seem to be good at spending, but incapable of providing the conditions needed for the creation of new jobs and resources. This may be one of the most important reasons for the rise of populism in recent years.

Most developed or advanced democracies can be regarded as welfare states. In a classic formulation, Marshall (1950) described the welfare state as a combination of democracy, welfare, and capitalism, indicating that in welfare states the government plays a role in the protection and promotion of the social and economic well-being of its citizens. Social expenditures, for example, amounts to around 20 percentage of GDP in most OECD countries, including the USA (OECD 2016c). However, these systems of welfare look very different in different countries. In particular, the role of the government differs.

Several distinct models of welfare can thus be identified. A famous distinction is Esping-Andersen's (1990) between *liberal, conservative-corporatist* and *social democratic* welfare states. Australia is an example of the liberal version, while Sweden belongs to the social democratic category.

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_1

Germany and many central European countries have conservative-corporatist welfare states.

The main purpose of this book is to—based on a synthesis of previous research about institutional change and reform strategies, and the experiences of Sweden and Australia—develop a general theory of reform in advanced democracies that incorporates what I shall call "modern statecraft." By statecraft I mean the art of governing a country well. Somehow, in some welfare states successful reforms have been implemented despite the challenges involved.

Statecraft, or statesmanship, is thus the skill of developing a country in a beneficial direction. As such, statecraft is distinguished from institutional change—change in a government's policies, taxes, laws, and rules—more broadly, which may go in any direction. ("Institution" in this context means the rules of the game in a society, rules that shape and constrain human interaction.) I have chosen to call it "modern" statecraft because the analysis is confined to advanced democracies and welfare states, where statecraft is likely to be quite different from the governing of less developed, more traditional or autocratic polities.

Sweden and Australia are both examples of what may be called "advanced democracies" (O'Neil 2012). They are well-established pluralist democracies with a belief in civic and political liberties, political competition, and participation. Moreover they have a high level of economic development and prosperity. The institutions present in such advanced democracies are part of what makes these countries "modern," that is, secular, rational, technological, and individualistic. Advanced democracies include not just Western countries, but also Asian, East European, and Latin American countries that share these characteristics. They may differ significantly in other dimensions, for example, electoral systems, interpretations of fairness and equality, size of government, level of economic freedom, and so on.

In such advanced democracies and welfare states, as we shall see, welfare-enhancing reforms may be particularly difficult due to the bias toward keeping earlier institutional changes that led to the overexpansion of public spending and regulation, causing many of the current problems.

Welfare-enhancing institutional change, or for short just "reform," is thus distinguished from institutional changes that decrease welfare. Reform implies that the institutional changes make everyone better off (or at least could make everyone better off if the losers were compensated).

Admittedly, in many situations this is nevertheless not easily determined due to different conceptions of what constitutes a good society, divergent causal beliefs about the world, fundamental measurement problems, and so on. I shall return to this problem on several occasions.

Since I am concerned with explaining the mechanisms behind successful political reform—*why* and *how* beneficial reform can come about in modern welfare states—I have chosen two successful cases to develop a theory of reform. In both Sweden and Australia, the large number of reforms that have been carried out over the last two and three decades required overcoming tremendous barriers. By studying two cases in which reform would seem particularly difficult, and yet has been achieved in far-reaching, systemic ways, the causal processes by which reform can be achieved should become clear.

One may argue that these two countries are two of the least likely cases to have reformed. They both were welfare states with long traditions of interventionism, egalitarian welfare policies, and monopolistic production of welfare services. But for more than two decades both countries managed to push a large number of reforms through the political system during both social democratic or labor and liberal-conservative governments. Major structural institutional changes were implemented, making their economies more dynamic and their societies more flexible (even though major challenges remain in both countries). This makes them especially interesting cases. Their systems of welfare as well as their structures of government were also, as we shall see, different enough to make comparing them very fruitful.

As we shall see, modern statecraft in the context of today's advanced democracies and welfare states is often, if not always, equivalent to liberal statecraft, that is, policies or political developments that increase liberty and make society more free.[1] The welfare-enhancing reforms in fact often involve, perhaps paradoxically to some readers, a reduction of the role of the (welfare) state in society. This is an empirical description that fits the developments in Sweden and Australia very well; even though there are instances where the reform processes involved elements that decreased liberty. My major concern is the overall direction of the process, which clearly was dominated by liberal reforms. I shall return to the possible tension between efficiency and liberty, between modern and liberal statecraft, at the end of the book.

To reform a country in a beneficial direction is not easy. It requires knowledge of, what I shall call, the reform cycle, based on a synthesis of earlier research about institutional change, as an analytical tool to interpret the logic in the process. The sustained reform processes in both countries started with the recognition by some actors that the existing welfare models did not work very well. Various policy failures were identified. This recognition triggered some policy entrepreneurs to search for new ideas. And these new ideas—either completely new policy paradigms or new policy instruments or policy settings—slowly became articulated, aggregated, and advocated by a variety of interests with power resources. That shifted the balance of power in a way that changed the institutions and policies of the two countries.

However, also advanced political skills are needed to enhance welfare in society and to promote liberty in advanced democracies. In the coming chapters, three distinct reform strategies, all central to statecraft, will be presented. The first strategy, which I shall label *Popperian*, is fact based and involves the use of research, rational argumentation, and pragmatism. The second, which I label *Kuhnian*, is idea based and involves the use of shifts of perspectives, narratives, framing, new authorities, and agenda setting. The third, which I label *Machiavellian*, is based on shrewdness and involves the use of obfuscating, blame avoidance, splitting, compensating, and scapegoating.

Modern statecraft—that is, to govern a modern welfare state well—involves the active use of all three types of reform strategies, including Machiavellian strategies, despite their negative standing. But political leaders, different interests, and policy entrepreneurs also need new policy ideas, ideas that actually work in the context they are in. In addition to knowing *how*, they also have to know *what* to do. Analytical skills needed to develop new policy ideas are also essential. Otherwise beneficial institutional change will not come about.

Moreover, sustained reform in advanced democracies is not limited to the activities of a single person or statesman, even though individuals do matter, sometimes decisively. In a democratic society, statecraft rather concerns the broader process of reforming a country in a welfare-enhancing direction, where different actors with different roles contribute to the process. Modern statecraft is a "polycentric" effort where experiential learning plays an important role.

I will use the method of the extended case study to understand in detail the processes that lead to successful political reform. The two reform countries Sweden and Australia will be used in a theoretically structured qualitative and comparative case study of reform in order to develop a general theory of reform in advanced democracies and welfare states. The focus will be on why and how reforms were developed and successfully implemented. How did the reform processes start, what made them persist, and why did they, as it seems, come to a halt?

This book has a long history. It is a synthesis of a large number of research projects, books, papers, and practical experiences in politics and management positions, all dealing with the interaction between politics, markets, and civil society within the context of the modern welfare state.

More than 20 years ago, I analyzed the emergence of modern welfare states in my doctoral thesis, *The State of State: Invisible Hands in Politics and Civil Society* (Karlson 1993, 2002). I showed that the influence of special interests and counterproductive interventions into markets and civil society had produced, more or less unintentionally, a highly inefficient situation where everyone would benefit from a reduction of the size of the government. Social order, prosperity, the position of the weak and unfortunate as well as democratic values could be strengthened.

However, due to rational adaptation and entrenched interests in the status quo, such a welfare state, I argued, was likely to be caught in a *public goods trap* where it would be irrational for any group to give up their subsidies or privileges. Such traps are examples of social dilemmas, such as the *tragedy of the commons*, where individual actions due to the structure of the decision situation lead to suboptimal outcomes. Free-riding behavior will be prevalent. Thus the public good, in this case the reduction of the size of the government, would be difficult, if not impossible, to produce.

The only possibility to escape this trap, I thought,

> would be for a group of well-meaning and benevolent politicians and voters determined to restore civil society to cluster together. And some of these actors must be willing to do so even if they in the short term will lose from the desired changes—they must be unconditional cooperators. To monitor the behavior of others they must also be able to use all their credibility to persuade and convince the general public that the changes are in their own long-term interest. A great deal of deliberate political action and leadership is necessary for this to be realized. There is no invisible-hand process available to handle such a change. The "welfare" state cannot be dismantled through incremental changes. (Karlson 1993, p. 208)

This puzzle on how to promote beneficial policy change has been with me ever since. I have published over 25 academic books on topics related to this question in different fields, dealing with everything from tax policies, property rights, industrial relations, growth policies, constitutional design, and federalism to educational policies, entrepreneurship, virtues, and institutional competition. Also, for a period I was involved in both formulating and implementing new policies. Moreover, I have held leading management positions in different academic organizations over the whole period. The present study draws on these experiences.

In particular, this study relies on the results from several research projects about economic and political change and learning processes at the Ratio Institute in Stockholm, where Swedish and European reform processes have been studied. Other research fellows at Ratio have published a number of books and papers about the Swedish reform process, in the project *Economic-Political Reforms in Welfare States* financed by the Torsten and Ragnar Söderberg Foundation, which I shall draw heavily upon. In addition, I have benefited from the participation in the research project *Work, Welfare and Wealth for Europe*—organized by the Austrian Institute of Economic Research in Vienna WIFO and sponsored by the European Union—where welfare state reform in all European countries was studied.

As for the Australian case, I conducted in-depth interviews with several of the main actors involved in the Australian reform process. In Sweden, colleagues at the Ratio Institute conducted similar interviews. Of course, my firsthand knowledge of and acquaintance with the people involved in the Swedish reform process remains greater. For this reason the section about this country is also somewhat longer. My accounts of both countries further rely on other interview-based studies and memoirs, as well as on numerous secondary sources, investigations, and academic studies.

In Chap. 2, the most important barriers to reforms in modern welfare states are analyzed. In the following chapter, the two countries to be used in the case studies are briefly presented. In Chap. 4, a large number of existing explanations and theories of institutional change are analyzed and discussed in order to develop the analytical framework to be used in the case studies. In Chap. 5, these theories are synthesized into a more general theory, the reform cycle, and extended and combined with a notion of statecraft and the three major reform strategies. This theoretical framework forms the basis for the case studies of the Swedish and Australian reform processes in Chaps. 6 and 7. Finally, Chap. 8 synthesizes the results of my case studies and the characteristics of modern statecraft. The final chapter, Chap. 9, summarizes my main conclusions.

The identified mechanisms behind successful political reform have the potential of being generally applicable to other advanced democracies and modern welfare states, and possibly to other countries, that have the ambition to modernize their economies and societies.

Notes

1. The term "liberal" is a contested concept. It is here used in the European way, simply denoting policies that strengthen the role of markets, the rule of law, individual freedom and choice, pluralism, and limited government compared to policies going in the opposite direction. Alternative terms could be "market liberal" or "economic liberal." For a discussion of different interpretations of liberalism, see for example Gray (1986) and Hudelson (1999).

References

Books and Articles

Esping-Andersen, G. (1990). *The Three Worlds of Welfare Capitalism*. Princeton: Princeton University Press.

Gray, J. (1986). *Liberalism*. Minneapolis: University of Minnesota Press.

Hudelson, R. (1999). *Modern Political Philosophy*. London: Routledge.

Karlson, N. (1993). *The State of State. An Inquiry Concerning the Role of Invisible Hands in Politics and Civil Society*. Stockholm: Almquist & Wiksell International.

Karlson, N. (2002). *The State of State, Invisible Hands in Politics and Civil Society*. New Brunswick: Transaction Publishers.

Marshall, T. H. (1950). *Citizenship and Social Class: And Other Essays*. Cambridge: University Press.

OECD. (2016c). *Social Expenditures*. Retrieved March 2016, from https://stats.oecd.org/Index.aspx?DataSetCode=SOCX_AGG

O'Neil, P. (2012). *Essentials of Comparative Politics* (4th ed.). New York: W.W. Norton & Company.

CHAPTER 2

Barriers to Reform

All actual and potential reformers know that it is difficult to promote beneficial institutional change. In a classic quote from the sixteenth century, Machiavelli (1984, p. 19) formulates the problem elegantly:

> There is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order, this lukewarmness arising partly from fear of their adversaries … and partly from the incredulity of mankind, who do not truly believe in anything new until they have had actual experience of it.

In a similar way, Milton and Rose Friedman (1984) describe how reformist governments, despite their initial ambitions, are caught in an "iron triangle" composed of the direct beneficiaries of existing laws, the bureaucrats who thrive on them, and the politicians who seek votes from maintaining them. Hence, the status quo is preserved, and as a consequence, there are many "big bills left on the sidewalk," as Olson (1996) pointed out. Despite the fact that many or even most politicians realize what they ought to do, or which institutional changes would make everyone better off, many illiberal and welfare-decreasing institutions still exist.

This bias in favor of the status quo, which conserves undesirable, inefficient social states and creates barriers to reform, has a number of

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_2

important causes, some of which are especially severe in modern welfare states:

- Special interests and public goods traps
- Negativity biases and ideational traps
- Public opinion and preference falsification

I will discuss these below.

Special Interests and Public Goods Traps

Special interest groups, such as civil servants, organized labor, coalitions of producers, military establishments, and farmers exist in all polities. Sometimes they are even created and supported by politicians and governmental agencies. But in welfare states, social programs and institutions themselves create their own constituencies over time. Different groups—such as pensioners, parents, and welfare recipients—adapt to the government programs and become dependent on them. In some modern welfare states, a majority of the voters have become dependent on the state for their living (Karlson 1993, 2002; Pierson 1996).

All these groups have a strong interest in upholding the status quo, even if society at large would benefit from reforms. They can also be expected to lobby for the expansion of existing programs and to block welfare-enhancing reforms (Tullock 1967; Krueger 1974). In the words of Tsebelis (2002), many such actors have to ability to act as *veto players* and hinder institutional change.

"Public goods traps" aggravate the problem of special interests. Reform would involve tangible losses to those concentrated groups, while the gains would be diffused and uncertain. Many well-organized groups have strong incentives to protect their existing benefits, and no special interest group has the incentive to promote these reforms for the sake of the larger public. Thus the public goods trap leads to the continuation of the status quo—even if the current beneficiaries realize that the problems are harming their own members.[1]

To make things worse, the same logic applies to inter-temporal decisions. Politicians and others deliberate on whether to act in their long-term interest or to choose a more short-run benefit. There is a strong incentive for many political decision-makers to free-ride on the future (Elster 1987; Rodrik 1996; Weingast 1994). A typical example that has these characteristics is pension reform, which often involves moving away from pay-as-you-go systems, current systems that push the cost of pensions on to future working generations, to a funded system that covers its long-run costs. Other examples are tariff reforms, which end protection of failing industries and reduce tax rates, and budget reforms that pay off governmental debt by cutting benefits. Both of these have short-run costs but long-term benefits.

Finally, it should be emphasized that voters, by the same logic, do not have incentives to inform themselves about welfare-enhancing policy alternatives. Due to the public goods characteristics of such reforms, voters are likely to remain rationally ignorant (Downs 1957; Caplan 2007). And, regrettably, the logic of the media tends to reinforce this ignorance. Media most often focus on sensational stories, spectacular events, and short-term phenomena instead of long-run processes and improvements that may benefit everyone (Hernes 1978; Eide and Hernes 1987).

Negativity Biases and Ideational Traps

These barriers to reform are further aggravated by a number of cognitive biases. In an influential paper, Kahneman and Tversky (1979) present what they call *prospect theory*, which addresses decision-making under risk. According to this theory, widely supported by empirical research, people tend to have a *negativity bias*, meaning that they react disproportionally negatively to losses, as compared to increases, in welfare. The status quo tends to work as a reference point from which they evaluate changes. As a consequence, people tend to be willing to sacrifice more to avoid losses than to make improvements—to hold on tightly to what they have (Baumeister et al. 2001; Rozin and Royzman 2001; Vaish et al. 2008).

More generally, cognitive science has shown that mental or cognitive frames influence behavior to a much greater extent than is implied by the reasoning above. Human behavior is only “boundedly” rational (Simon 1957; Karlson 1993, 2002; Kahneman 2003), in the sense that our intellectual and cognitive capacities are limited. Our judgments and decisions differ depending on how we interpret reality. For example, we tend to draw different conclusions from the same information depending on how that information is presented. Moreover, people exhibit a bias toward confirming their own ways of thinking and a bias toward not believing in their opponents’ (Kunda 1990; Kahneman 2003).[2] Further, normative biases and concepts of fairness influence our interpretations (Kahneman and Sunstein 2005). Note moreover that such cognitive limitations are not confined to voters and ordinary people, but are just as likely to influence the behavior of political decision-makers as well (Berggren 2012;

Kasper et al. 2012). Perhaps such *ideational or cultural traps* are the most fundamental obstacles to change.

The important implication of these biases is that people's negativity and confirmation bias tend to reinforce cognitive frames and belief systems that reflect the status quo in existing welfare states.

Public Opinion and Preference Falsification

A separate problem, which is somewhat related to the problems of rational ignorance, media logic, and negativity biases, is the problem of "preference falsification," discussed in the field of social psychology. According to this perspective, bias in favor of the status quo is also created through the social pressure of public opinion. Noelle-Neumann (1984) defines public opinion in the following way: "[p]ublic opinions are attitudes or behaviors one *must* express in public if one is not to isolate oneself; in areas of controversy or change, public opinions are those attitudes one *can* express without running the danger of isolating oneself" (Noelle-Neumann 1984, p. 178). As a consequence people sometimes speak falsely about their true opinions for fear of being criticized or isolated.

This adaptation to what other people think may also start what Noelle-Neumann calls "the spiral of silence": "To run with the pack is a relatively happy state of affairs; but if you can't, because you won't share publicly in what seems to be a universally acclaimed conviction, you can at least remain silent, as a second choice, so that others can put up with you" (Noelle-Neumann 1984, p. 6).

The same kind of analysis has been developed further by Kuran (1995), who argues that this kind of preference falsification has extensive, often unintended, consequences. The social pressure to favor the established view of the status quo, where one says one thing in public even though one holds another view in private, has huge social and political consequences. Privately unpopular policies may be retained as people reproduce conformist social pressures. In falsifying preferences, people hide their own knowledge and distort, corrupt, and impoverish the knowledge in the public domain.

This leads to widespread ignorance about the advantages of change, since others will lack information about the drawbacks of the status quo and the merits of the alternatives. The argument is further developed in Kuran and Sunstein (1999), where they introduce "availability entrepreneurs-activists" who manipulate the content of public discourse to trigger information or availability "cascades," self-reinforcing processes of collective belief formation, to advance their own agendas. If no one dares to say the emperor is naked, as in the famous H. C. Andersen story, the public lie will prevail.

Difficult Tasks Ahead

The topic of this book is how to promote welfare-enhancing, often liberal, institutional change in welfare states facing problems such as budget deficits, debt crisis, slow or non-existent growth, and high unemployment levels caused by the overexpansion of public spending and various forms of government regulation.

Both existing institutions and established ways of thinking work against such reforms. It is a lot easier to keep on spending and to focus on short-term measures. As I have mentioned, there are numerous rational, cognitive, and social reasons—involving special interests and public goods traps, negativity biases and ideational traps, and preference falsification—to explain why these kinds of reforms are difficult tasks. Different kinds of institutional and cognitive lock-ins favor the status quo, even though it is highly inefficient and undesirable from most perspectives. It should be easy for anyone to think of a number of contemporary cases, in Europe as well as on other continents.

Despite all these difficulties and challenges to welfare-enhancing institutional change, some welfare states have reformed, and quite significantly so in the cases of both Sweden and Australia. The question is: how did they do it?

Notes

1. Formally this can strictly be studied as an n-person, multilateral Prisoners' Dilemma game (Schelling 1979; Taylor 1987). See Karlson (1993, pp. 54, 159–169).
2. Compare Kuhn's (1962) famous analysis of "paradigmatic shifts" in scientific revolutions.

References

Books and Articles

Baumeister, R., Bratslavsky, E., Finkenauer, C., & Vohs, K. (2001). Bad Is Stronger than Good. *Review of General Psychology, 5*(4), 323–370.

Berggren, N. (2012). Time for Behavioral Political Economy? An Analysis of Articles in Behavioral Economics. *The Review of Austrian Economics, 25*(3), 199–221.

Caplan, B. (2007). *The Myth of the Rational Voter: Why Democracies Choose Bad Policies*. Princeton: Princeton University Press.

Downs, A. (1957). *An Economic Theory of Democracy*. New York: Harper.

Eide, M., & Hernes, G. (1987). *Død og pine! Om massemedia og helsepolitik*. Oslo: FAFO.

Elster, J. (1987). The Possibility of Rational Politics. *European Journal of Sociology, 28*(01), 67.

Friedman, M., & Friedman, R. (1984). *Tyranny of the Status Quo*. San Diego: Harcourt Brace Jovanovich.

Hernes, G. (Ed.). (1978). *Det mediavridde samfunn: Forhandlingsøkonomi og blandadministrasjon*. Oslo: Universitetsførlaget.

Kahneman, D. (2003). Maps of Bounded Rationality: Psychology for Behavioral Economics. *American Economic Review, 93*(5), 1449–1475.

Kahneman, D., & Sunstein, C. R. (2005). Cognitive Psychology of Moral Intuitions. In J. Changeuz, A. Damasio, & W. Singer (Eds.), *Neurobiology of Human Values*. Berlin Heidelberg: Springer Verlag.

Kahneman, D., & Tversky, A. (1979). Prospect Theory: An Analysis of Decision Under Risk. *Econometrica, 47*(2), 263.

Karlson, N. (1993). *The State of State. An Inquiry Concerning the Role of Invisible Hands in Politics and Civil Society*. Stockholm: Almqvist & Wiksell International.

Karlson, N. (2002). *The State of State, Invisible Hands in Politics and Civil Society*. New Brunswick: Transaction Publishers.

Kasper, W., Streit, M., & Boettke, P. (2012). *Institutional Economics*. Cheltenham: Edward Elgar.

Krueger, A. O. (1974). The Political Economy of the Rent-Seeking Society. *American Economic Review, 64*(3), 291–303.

Kuhn, T. (1962). *The Structure of Scientific Revolutions*. Chicago: University of Chicago Press.

Kunda, Z. (1990). The Case for Motivated Reasoning. *Psychological Bulletin, 108*(3), 480–498.

Kuran, T. (1995). *Private Truths, Public Lies*. Cambridge, MA: Harvard University Press.

Kuran, T., & Sunstein, C. (1999). Availability Cascades and Risk Regulation. *Stanford Law Review, 51*(4), 683–768.

Machiavelli, N. (1984). *The Prince* (P. Bondanella & M. Musa, Eds.). Oxford: Oxford University Press.
Noelle-Neumann, E. (1984). *The Spiral of Silence*. Chicago: University of Chicago Press.
Olson, M. (1996). Distinguished Lecture on Economics in Government: Big Bills Left on the Sidewalk: Why Some Nations Are Rich, and Others Poor. *Journal of Economic Perspectives, 10*(2), 3–24.
Pierson, P. (1996). The New Politics of the Welfare State. *World Politics, 48*(2), 143–179.
Rodrik, D. (1996). Understanding Economic Policy Reform. *Journal of Economic Literature, 34*(1), 9–41.
Rozin, P., & Royzman, E. (2001). Negativity Bias, Negativity Dominance, and Contagion. *Personality and Social Psychology Review, 5*(4), 296–320.
Schelling, T. (1979). *The Strategy of Conflict*. Cambridge, MA: Harvard University Press.
Simon, H. (1957). *Models of Man*. New York: Wiley.
Taylor, M. (1987). *The Possibility of Cooperation*. Cambridge: Cambridge University Press.
Tsebelis, G. (2002). *Veto Players: How Political Institutions Work*. Princeton: Princeton University Press.
Tullock, G. (1967). The Welfare Costs of Tariffs, Monopolies, and Theft. *Economic Inquiry, 5*(3), 224–232.
Vaish, A., Grossmann, T., & Woodward, A. (2008). Not All Emotions Are Created Equal: The Negativity Bias in Social-Emotional Development. *Psychological Bulletin, 134*(3), 383–403.
Weingast, B. (1994). *The Political Impediments to Economic Reform: Political Risk and Enduring Gridlock* (Institute for Policy Reform Working Papers 68).

CHAPTER 3

Two Reform Countries

In the 1970s and 1980s both the Swedish and Australian welfare states faced severe economic and social problems caused by changing economic and social conditions as well as policy failures. The barriers to reform in these two advanced democracies were similar and indeed monumental. But reform nevertheless took hold. Since the early 1980s, Sweden and Australia have been among the most successful reformers among the advanced democratic welfare states. At least up until the last few years.

For over 25 years, structural reforms over a wide range of policy areas have been implemented, making both countries' economies more dynamic and their societies more flexible and free. Surprisingly, both countries have changed in such a drastic way that one can speak of the creation of two new models of welfare.

Case Selection and Method

I have chosen these two countries for this structured qualitative and comparative case study in order to explore and develop a general theory of welfare state reform. Since I am concerned with explaining the causal mechanisms behind successful political reform—*why* and *how* beneficial institutional change takes place in modern welfare states—I will use the method of the extended case study to examine in detail the processes which lead to successful political reform. As described by Mitchell (1983),

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_3

such a method enables me to "trace how events chain on to one another and how therefore events are necessarily linked to one another through time" (1983, p. 194). The method closely resembles that of process tracing (George and Bennett 2005; Collier 2011), in which detailed evidence from a case or several cases is systematically analyzed in order to develop and refine a theory.

In Chap. 4, I will survey and summarize some of the most important theories of institutional change in previous literature, starting with simple models, with few variables, followed by increasingly more complex models. Then in Chap. 5, these theories will be synthesized into a more general model of institutional change, to be used, together with three different reform strategies, also derived from previous research, as the analytical framework and my hypotheses in the process tracing of the reforms studied in the case studies. But, as we shall see, there are also remaining puzzles requiring theory development.

The two cases have been chosen, in part, for their similarity. In both countries, the reforms that have been carried out required overcoming tremendous barriers to achieve far-reaching political change. Both were welfare states with long traditions of egalitarian welfare policies and monopoly production of welfare services. For this reason, they both seemed unlikely cases of liberal reform, which makes them especially interesting.

Sweden, at the start of the reform process, had one of most expansive welfare states, with extensive systems of redistribution, progressive income and capital taxes, high public expenditures, and a high tax burden. The Swedish "social democratic" model rested on state paternalism, a universal welfare program, public monopoly production of welfare services, and collective bargaining. The Australian welfare model, on the other hand, was based not so much on high-cost welfare services as on selective welfare programs and state involvement in the economy through paternalistic intervention, regulated markets, industry protection, and wage arbitration. Yet, both countries would manage to reform and liberalize in drastic ways, as we shall see.

By studying two cases in which reform would seem particularly difficult, and yet has been achieved in far-reaching, systemic ways, the causal processes by which barriers to reform in modern welfare states can be overcome should be especially clear. Selecting two exceptional cases in this manner is especially useful for theory development (Eisenhardt 1989; van Evera 1997; Yin 2002).

Furthermore, selecting and studying two cases which, apart from their successful reforms, are different in a number of ways may strengthen my results and should make the theory more general. Sweden and Australia, while both welfare states, had, as noted above, very different welfare models when the reform process started. The two countries also differ in that Sweden is a unitary, centralized state with a one-chamber parliament, the Riksdag, and has a proportional electoral system, while Australia is a federal state based on the Westminster model of democracy, with a House of Representatives and a Senate. Moreover, the Swedish economy has mainly been based on manufacturing industries, while Australia has relied on agricultural products and raw materials. Australia is, of course, also much larger, extending over a whole continent with more than twice the number of citizens than Sweden—24 million compared with close to 10 million.

These differences could presumably weaken hypotheses that attribute successful reform to political or economic details specific to either country. As we will see, similar causal processes unfolded in both Sweden and Australia, with a remarkable similarity in how the reform process developed, the reform strategies used and the sequencing of reforms. The countries faced similar barriers to reform, and they overcame these in similar ways. This suggests that the resulting theory of reform may also be applicable to other countries with predicaments comparable to those of Sweden and Australia.

It could be objected that selecting two cases based on the dependent variable (successful reform) is a faulty method of testing a theory about reform (King et al. 1994). However, such a critique is misplaced. I am not primarily looking to *test* (or to *corroborate*) a theory of reform, based on a synthesis of previous research, with my cases. Rather, my main purpose is to use two case studies to *develop* a theory, one that explicates the causal relationships between numerous variables in welfare-enhancing institutional change. As such, the selection of cases must be done based upon their relevance for the phenomenon I am trying to explain, that is, how successful political change is brought about in advanced democracies and welfare states (George and Bennett 2005).

While logical inferences can be drawn from my result, it is obvious that statistical inferences cannot, because my "sample" is much too small for any kind of statistical generalization to be valid (Mitchell 1983; Small 2009). But, as noted above, in so far as other modern welfare states face similar barriers to reform as Sweden and Australia did, the theory of modern statecraft to be developed may nevertheless contribute to the understanding of how reforms can be promoted in these countries as well. More robust empirical testing of my theory of reform would require looking at other cases too. And in particular, it would require looking at control cases that could serve as counterfactuals (countries in which modern statecraft has been lacking) and studying the outcome in such countries too. In this book, I present some evidence from both Sweden and Australia showing that a lack of modern statecraft in recent years is a plausible explanation for why the reform processes have stopped. This may give additional support for my theory. In Chap. 8 I will return to the question of whether my conclusions may hold for other countries as well.

In the coming chapters the reform processes will be analyzed in some detail, but a brief overview is in order before the theoretical framework of the study is presented. Despite the fact that the reforms started a few years earlier in Australia, I shall start with Sweden for the simple reason that I am a lot more familiar with this country.

Sweden

Over 25 years, from the mid-1980s to 2010, the Swedish model, presented above, underwent fundamental change. Individual responsibility and choice were extended while the role of politics was reduced. Taxes and welfare benefits were lowered, markets deregulated, businesses privatized, and publicly financed welfare services opened up to private operators. This new Swedish model is still a welfare state in which everyone is guaranteed social security and welfare services, but the economic performance of Sweden, just as in Australia, has been impressive, largely due to those structural reforms.

While the reform process was initiated by the Social Democrats, after the election of 1991 a center-right government took over and implemented an ambitious liberal reform agenda. In 1994 the Social Democrats came back into power, but the reform process continued. From 2006 a center-right coalition government pushed through more reforms. In all, the reforms included the deregulation of financial markets and service and product markets, the privatization of state-owned companies, the introduction of a school voucher system, tax reforms, a new budget process and a new macroeconomic regime, pension reforms, labor market reforms, and social insurance reforms.

Table 3.1 Some Swedish reforms

Year	*Type of reform*
1985	Deregulation of credit market
1989	Deregulation of foreign exchange market
1990	Start of deregulation of energy, postal, telephone, railways, and airline markets
1991	Agricultural reform, cutting subsidies
1991	Tax reform lowering marginal income and capital gains tax rates
1991	Start of sales of state-owned companies
1992	School voucher system, floating exchange rate
1994	Choice in child care, elderly care, etc.
1995	New budgetary process, required surplus over business cycle
1995	Less generous social insurance and welfare systems
1995	EU membership
1997	Independent central bank and inflation targeting
1998	Pension reform, partly funded and with automatic balancing
2000	Industrial relations reform
2004	Tax reform, inheritance and gift taxes abolished
2006–2010	Wealth tax abolished, earned income tax credits introduced, tax deductions for household services, social insurance and sick leave reforms, etc.

About 2010, however, the reform process came to a halt. Since 2014, the Social Democrats, now in coalition with the Green Party, are back in power while an illiberal anti-immigration party has been rising in the polls.

Table 3.1 lists some of the major reforms in Sweden.

Australia

In Australia the reform process was also shared by different political parties. It started with a Labor government that came into power in 1983 and implemented a comprehensive reform program of economic liberalization. From 1996 to 2007, a coalition government, made up of the Liberal and National parties, continued the process. The reforms included dismantling the barriers to foreign trade, financial deregulation, privatization of government business enterprises, competition reforms including new regulatory arrangements for natural monopoly utilities, and labor market reforms.

Over this quarter of a century Australia was transformed into an open, competitive economy with high productivity, stable public finances, and virtually no public debt. It became a cosmopolitan, multicultural society with an optimistic view of its future and role in the world. Australia is still

Table 3.2 Some Australian reforms

Year	*Type of reform*
1983	Floating of the Australian dollar, abolishing of capital controls
1985	Deregulation of financial markets
1985	Tax reform, lowing marginal taxes, abolishing double taxation, etc.
1988	Tariff reform starts
1990	Competition and microeconomic reforms, privatizations, deregulations
1990	Firm-level bargaining introduced
1992	Liberalized foreign bank entry, foreign investments rules eased
1992	Pension reform, superannuation compulsory
1993	Industrial Relations Reform Act, extends scope of enterprise bargaining
1996	Central bank independence and inflation targeting formalized
1996	Industrial relations reform, Workplace Relations Act
1996	Public sector reforms, competitive tendering and contracting out
1997	Welfare reform work-for-the-dole scheme
1997	Commonwealth award simplification
1998	Privatization of employment services
1999	Tax reform, introducing general sales tax
2002	Fiscal consolidation completed, budget surplus achieved, no public debt
2005–2007	Industrial relations reform, Workplace Relations Amendment Act (work choices)

a welfare state, but the scale of the change nevertheless amounts to no less than a change of social model.

In 2007, when the Labor party came back to power, however, the reform process stopped. The return of a liberal-national coalition in 2013 did not, it seems, change this.

Table 3.2 lists of some of the Australian reforms.

Antipodal Wonders?

It is not an easy task, of course, to determine whether the results of all these reforms really were welfare-enhancing in the sense that they made everyone better off, or at least could have made everyone better off if the winners had compensated the losers for the gains they had received. Different conceptions of what constitutes a good society, divergent causal beliefs about the world, fundamental measurement problems, and so on make such a task fundamentally controversial. Also, of course, many other, often external, factors influenced the economic and social developments. Moreover, we do not know the counterfactual, that is, what the results would have been *without* the reforms.

However, and perhaps most importantly for this study, it should be clear from the list of reforms above that both countries on opposite sides of the globe managed to overcome many of the barriers to reform presented in the last chapter. Somehow they escaped the public goods traps they were in. That in itself is a wonder.

We can also conclude that both countries experienced significant growth in GDP per capita, especially after the early 1990s. In terms of PPP-adjusted GDP per capita rates, which give a good approximation of living standards in different countries, Sweden had dropped from 4th place in 1970 to 13th in 1995. Since then, it has experienced a slight improvement, returning to the 11th place in 2014. Australia's position has changed in a very similar fashion, where the problems faced in the 1980s resulted in a worsened position in 1990, but has since then improved. In 2014, Australia had the 9th highest PPP-adjusted GDP per capita rate among all OECD countries (OECD 2016a).

Now, it is well known that GDP is not an undisputed measure of welfare. So we should look at subjective well-being as a possible supplement to traditional measures of development such as GDP (Stiglitz et al. 2009). Such a measure is multidimensional and may cover aspects of life ranging from civic engagement to housing, from household income to work-life balance, and from skills to health status, as in OECD's latest study. There both Swedes and Australians are more satisfied with their lives than the OECD average. When asked to rate their general satisfaction with life on a scale from 0 to 10, Swedes gave it a 7.2 and Australians a 7.3 grade, higher than the OECD average of 6.6 (OECD 2015b). These measures, however, only cover the last couple of years.

It is also interesting to observe (see Fig. 3.1) that from the early 1990s public debt fell in both countries (even though Australia shows an increase in the last few years).[1] Moreover, there is a dramatic fall in the inflation rate in both countries, as can be seen in Fig. 3.2, especially from the early 1990s on.

When it comes to government share of GDP, as indicated in Fig. 3.3, after a decrease in the 1980s Sweden shows a dramatic increase in the early 1990s, a fact we shall return to later on. From then on the government share of GDP starts dropping again. Australia has a lower level of government expenditure all along, mainly due to a lower level of government consumption, as indicated in Figs. 3.3 and 3.4.

This difference in the government role between the two countries becomes evident when we compare the tax revenue as a percentage of GDP—Sweden lies way above the levels of Australia during the whole

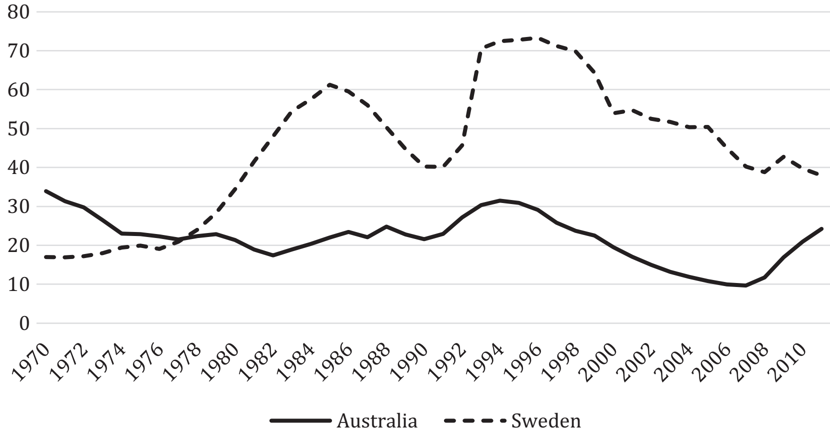

Fig. 3.1 Gross public debt as share of GDP, 1970–2011 (Source: Mauro et al. (2013))

Fig. 3.2 Inflation rate, annual percentage change, 1970–2016 (Source: World Bank (2015b))

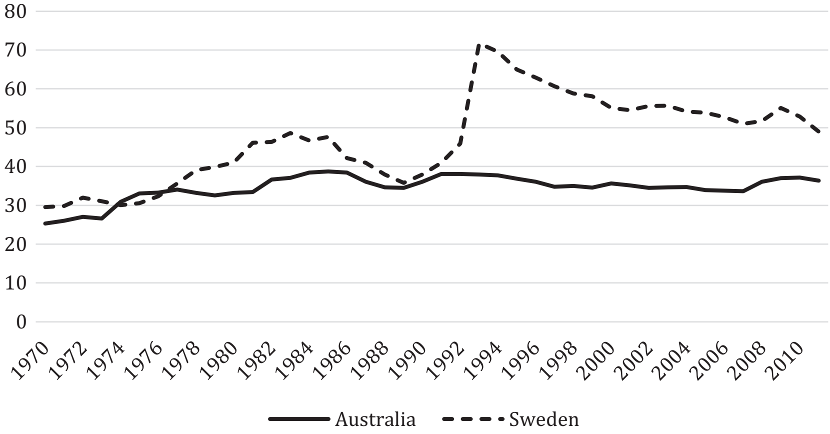

Fig. 3.3 Government expenditure as share of GDP, 1970–2011 (Source: Mauro et al. (2013))

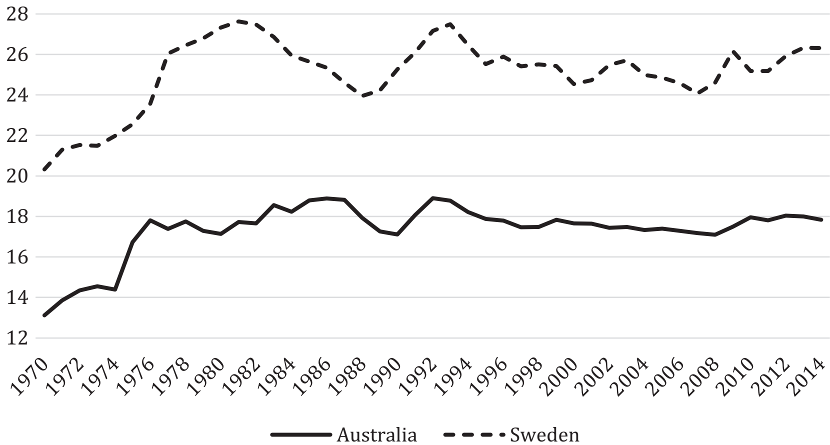

Fig. 3.4 Government consumption as share of GDP, 1970–2015 (Source: World Bank (2015a))

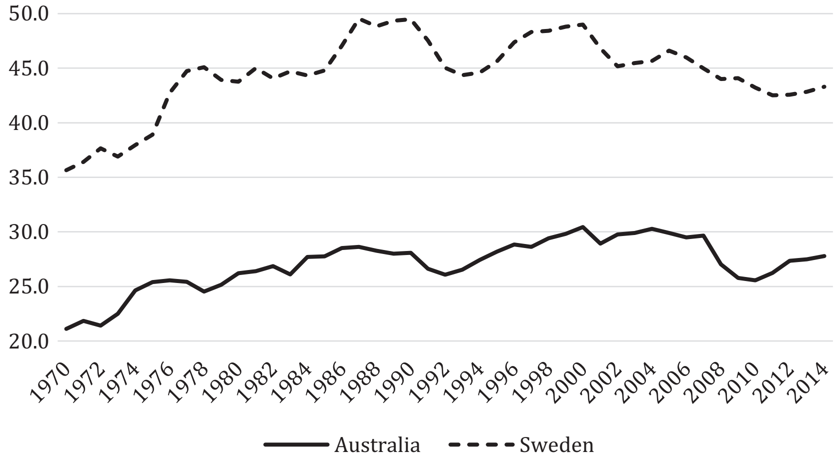

Fig. 3.5 Tax revenue as share of GDP, 1970–2014 (Source: OECD (2016b))

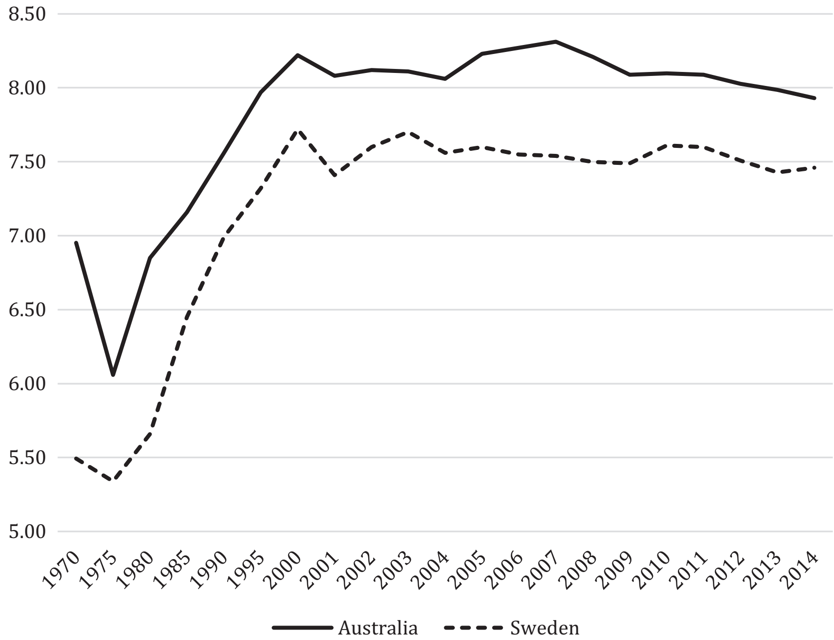

Fig. 3.6 Economic freedom index, 1970–2014 (Source: Gwartney et al. (2015), Fraser Institute)

Fig. 3.7 Unemployment rate, 1980–2016 (Source: ILO (2017))

period, as pictured in Fig. 3.5. However, in both countries the tax revenue as a share of GDP fell beginning about the year 2000. Interestingly, this fall in taxes did not create an increase in public debt.

Another indication of the nature of the changes that have taken place is the increase in economic freedom, as shown in Fig. 3.6. A dramatic increase in economic freedom, measured on a scale from 1 to 10, from the early 1980s up until around the year 2010 is clearly visible. Sweden moved from 5.66 in 1980 to 7.61 in 2010. Australia moved from 6.80 to 8.10 during the same period.

There are of course other criteria that could be used to evaluate policy outcomes. Employment performance for example, is more mixed. As can be seen in Fig. 3.7, in Australia unemployment fell from high levels beginning in the early 1990s.[2] But in Sweden the dramatic increase in unemployment in the early 1990s was followed by only a temporary decrease and a subsequent return to very high levels in the first decade of the 2000s.

Still, I think voters and politicians in many countries would envy the development in our reform countries, even though they might disagree about some issues. In a rapidly changing world most of the consequences are indeed impressive.

In fact, in 2013 the *Economist* called Sweden "The Next Supermodel" and devoted a special section to its reinvention of capitalism and reformed welfare state (Economist 2013, February 2–8). And in 2004 the *Economist* called Australia "A Wonder Down Under," heralding the country's stunning performance due to prudent monetary and fiscal policies and to structural reforms (Economist 2004, March 18).

The question to be analyzed over the coming chapters is how these two countries were able to reform and modernize their economies and societies in such successful ways. We will explain how it was possible to overcome barriers to reform and why the processes finally came to a stop. There may be lessons here for other countries.

Notes

1. The time periods differ somewhat in the figures below due to lack of data for later years in some of the statistical series used.
2. For Sweden there was no available data from ILO for 1981 and 1988, instead we used the averages of the years before and after.

References

Books and Articles

A Wonder Down Under. (2004, March 18). *The Economist*. Retrieved from http://www.economist.com/node/2524281

Collier, D. (2011). Understanding Process Tracing. *PS: Political Science & Politics, 44*(04), 823–830.

Eisenhardt, K. (1989). Building Theories from Case Study Research. *The Academy of Management Review, 14*(4), 532.

George, A., & Bennett, A. (2005). *Case Studies and Theory Development*. Cambridge, MA: MIT Press.

Gwartney, J., Lawson, R., & Hall, J. (2015). *Economic Freedom of the World—2015 Annual Report*. Vancouver: Fraser Institute.

International Labour Organization. (2017). *Labour Force Survey 1980–2016*. Retrieved from http://www.ilo.org/ilostat

King, G., Keohane, R., & Verba, S. (1994). *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton: Princeton University Press.

Mauro, P., Romeu, R., Binder, A., & Zaman, A. (2013). *A Modern History of Fiscal Prudence and Profligacy* (IMF Working Paper No. 13/5). Washington, DC: International Monetary Fund.

Mitchell, J. (1983). Case and Situation Analysis. *Sociological Review, 31*(2), 187–211.

OECD. (2015b). *OECD Better Life Index*. Retrieved March 2016 from http://www.oecdbetterlifeindex.org

OECD. (2016a). *Gross Domestic Product (GDP)*. Retrieved March, 2016, from https://data.oecd.org/gdp/gross-domestic-product-gdp.htm

OECD. (2016b). *Tax Revenue*. Retrieved March, 2016, from https://data.oecd.org/tax/tax-revenue.htm

Small, M. (2009). 'How Many Cases Do I Need?': On Science and the Logic of Case Selection in Field-Based Research. *Ethnography, 10*(1), 5–38.

Stiglitz, J. E., Sen, A., & Fitoussi, J.-P. (2009). *Report by the Commission on the Measurement of Economic Performance and Social Progress*. Paris. Retrieved from http://www.stiglitz-sen-fitoussi.fr/en/index.htm

The Nordic Countries: The Next Supermodel. (2013, February 2). *The Economist*. Retrieved from http://www.economist.com/news/leaders/21571136-politicians-both-right-and-left-could-learn-nordic-countries-next-supermodel

The World Bank. (2015a). *World Development Indicators: General Government Final Consumption Expenditure (% of GDP)*. Retrieved March, 2016, from http://data.worldbank.org/indicator/NE.CON.GOVT.ZS

The World Bank. (2015b). *World Development Indicators: Inflation, Consumer Prices (Annual %)*. Retrieved March, 2016, from http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG

Van Evera, S. (1997). *Guide to Methods for Students of Political Science*. Ithaca: Cornell University Press.

Yin, R. (2002). *Case Study Research: Design and Methods*. Thousand Oaks: Sage.

CHAPTER 4

Explaining Institutional Change

Institutional theory has often been criticized for focusing too much on stability (Peters et al. 2005, pp. 954–5). But there is an abundance of theories of institutional change, all of which may contribute to our understanding of how reform was possible in Sweden and Australia. However, most of them are partial and only address some aspects of the challenges involved in reforming a country. In particular, they most often focus on *why* institutional change may occur, rather than on *how* welfare-enhancing reform can be promoted.

Nevertheless, it is necessary for me to summarize some of the most important theories of institutional change I have come across in the literature of policy change of the last 30 years or so. Not only are we developing a general theory of reform in advanced democracies and welfare states, but we want to develop an analytical framework to be used in the case studies. The presentation starts with simple models, with few variables, followed by increasingly more complex models.

Following North (1990, p. 3), who is a major inspiration, I define institutions as "the rules of the game in a society or, more formally, … humanly devised constraints that shape human interaction." These rules may be of a formal or an informal kind, with the former consisting of legislation and regulations and the latter of conventions, internalized rules, moral systems and practices. The focus in this study is on the formal institutions and policies. Informal institutions, especially in terms of values upholding the formal institutions, is however of significant interest, as we shall see.

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_4

Let me state the problem more plainly. What we want to explain is how institutions and policies in time period 1 (t_1) are reformed into institutions and policies in time period 2 (t_2). In particular, we are interested in how to make society more efficient and free. How can the institutions in t_1 be modernized into the institutions of t_2?

Economic and Social Conditions, Power Resources, and Interests

Most established explanations of institutional change emphasize the importance of economic and social conditions, as well as interests and the allocation of power resources. In its simplest representation, this type of model can be seen in Fig. 4.1.

The model shows that economic and social conditions produce outcomes that affect the power resources of different interests, which, in turn, produce the institutions and policies in society. The arrows indicate a causal relationship.

Marx's theory of historical materialism is an example of this kind of model of institutional change. According to this theory, the productive forces of society, such as machinery, land, and labor, determine the modes of production, which in turn determine the ownership of the means of production and class divisions. The institutional superstructure in society, such as the tax structure and labor laws, is a direct consequence of the relative resources held by these classes. When the productive forces change, so do interests, power resources, and institutions (Marx 1867; Hobsbawn 1968).

A modern version of this Marxist way of thinking is power resource theory, a dominating theory in explanations of welfare state characteristics. Power resource theory explains the emergence of, and changes in, welfare state regimes by considering changes in working class power through labor unions and left-wing parties (Esping-Andersen 1985; Korpi 1978, 1980; O'Connor and Olsen 1998; Korpi and Palme 1998, 2003; Pontusson and Kwon 2006). For example, Korpi and Palme (2003) argue that socio-economic class and class-related parties are central to understanding policy change in modern welfare states.

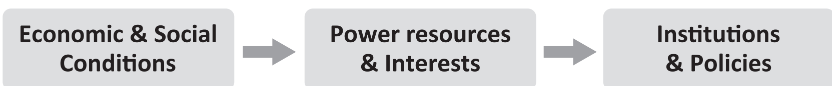

Fig. 4.1 Power resources, interests, and institutional change

In a similar way, without being narrowly class-based, public choice theory is concerned with the relative strength of different interests in society and how their power affects policy-making (Buchanan and Tollison 2009; Mueller 2003; Karlson 1993, 2002; Tullock 1989). A major theme within this field of research is that special interests, seeking privileges and rents, are likely to have a disproportionate influence on policy-making for the reasons given earlier in the chapter on the barriers to reform. For example, Olson (1965, 1982) argues that the formation of networks of collusive and cartelistic special interests, firms, and lobbying organizations spurs excessive regulation and taxation, causing inflation, slow growth, and even economic and social collapse.

North (1981, 1990) also bases his model on the strength and resources of different interests in society. He argues that fundamental changes in relative prices—caused by changes in technologies, trade, climate, demography, social developments, and so on—change the value of different resources and thereby the incentives and resources of rulers. These rulers, in turn, devise property rights and other institutions according to their own interests.

In more advanced explanations of this kind, institutions themselves are added to the basic model in such a way that the institutions and policies in time period 1 (t_1) both shape and interact with economic and social conditions to produce the power resources of different interests, which in turn explain the institutions and policies in time period 2 (t_2), and so on in a continuous process. Figure 4.2 illustrates this process.

Much of the work in the field of political economy and institutional economics, including constitutional economics (e.g., Buchanan 1986), fits into this category. Acemoglu et al. (2005), for example, argue that the distribution of resources combined with the existing economic and political institutions in a given time period determine the de jure and de facto political power of different groups, which in turn determine the economic and political institutions in the next time period, and so on.

There is strong empirical support for these kinds of models (Persson and Tabellini 2000). For example, the strikingly different development of North and South Korea can be explained by their differing institutions.

Fig. 4.2 Institutions, power resources, interests, and institutional change

Those institutions shape economic and social conditions, as well as interests and power resources, in radically different ways, despite many other similarities between the two countries. A more sophisticated example is the long-run economic, political, and institutional effects of Atlantic trade on the countries in Western Europe, in contrast to the economic and institutional developments of Central and Eastern Europe. Successful trade increased the power and resources of merchants and other commercial interests, with enduring effects on the institutional role of the nobility and the monarchs in the countries bordering the Atlantic sea (Rogowski 1989). In Central and Eastern Europe, in contrast, the lack of such social and economic conditions had a conserving effect on the institutional structure.

In the interesting book *Why Nations Fail* by Acemoglu and Robinson (2012), a similar model is applied to a large number of historical cases from all continents. They make a broad distinction between inclusive and extractive institutions. They argue that the former, which support pluralism and creative destruction, can create virtuous circles, where the evolving institutions and policies continuously support new technology, education, commercial activities, and growth, benefiting and including the larger population. Extractive institutions, in contrast, create vicious circles, where fear of creative destruction and conflicts of interests between elites, seeking to benefit only themselves through corruption and exploitation, make nations fail.

A central element in their theory is the role of critical junctures, which they define as "a major event or confluence of factors disrupting the existing economic or political balance in society" (2012, p. 101). These may open up the possibility of breaking the path dependency, that is, the long-term influence of earlier decisions on the set of later decisions, even though circumstances may have changed dramatically. Such critical junctures, however, can be "two-edged swords," shifting the institutions either in the inclusive or extractive direction. I shall return to these critical junctures, formative movements, or focusing events, as some other authors call them, later in this chapter.

Ideas, Beliefs, and Values

An apparent weakness of the theories of institutional change presented so far is that they disregard, or underestimate, the role of ideas, or beliefs, and values. As emphasized in the chapter on barriers to reform, mental and cognitive frames, paradigms, belief systems, but also rational ignorance, media logic, and preference falsification, make institutional change hard to achieve.

To Hayek, ideas were fundamental to institutional change (Hayek 1960, 1978). Also Keynes (1935, p. 383) in a well-known quotation expresses the importance of ideas in political decision-making:

> The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly believed. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist ... I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Soon or late, it is ideas, not vested interests, which are dangerous for good or evil.

Today, an advocate of a similar position is McCloskey (2006, 2010, 2016) in her ambitious project to explain the rise of the Western world by ideas. More broadly we may also speak of culture instead of ideas.

In the last decade there has been an upsurge in research showing how paradigms, cognitive frames, worldviews, principled beliefs, and ideas affect policy-making (Campbell 2002). At the most general level, these theories are about how people make sense of other people, themselves, and the world. As we saw earlier, there are clear limits to human cognition in acquiring and processing information. Moreover, how people think tends to determine how they act (Fiske and Taylor 1991).

The field of economics has not been exempt from this trend. Economists have recognized the important role of cognitive interpretative frameworks, or cognitive paradigms, for understanding institutional change (Denzau and North 1994; Knight and North 1997). What politicians and voters believe is as important as what they want (Vanberg and Buchanan 1989; Thelen and Steinmo 1992).

North himself argues that the path of institutional change is shaped by "(1) the lock-in that comes from the symbiotic relationship between institutions and the organizations that have evolved as a consequence of the incentive structure provided by those institutions and (2) the feedback process by which human beings perceive and react to changes in the opportunity set" (North 1990, p. 7). In other words, how people perceive changed opportunities is as important as their interest in affecting institutional change or stability.

The relationship between ideas and institutional change is, however, far from undisputed (Blyth 1997; Berman 1998; Hall 1989, 1993, 1997; Hay 2001). As put by North (1990, p. 85):

> Changing relative prices are filtered through preexisting mental constructs that shape our understanding of those price changes. Clearly ideas, and the way they take hold, play a role here. The exact mix of price changes and ideas—are still far from clear.

Even those who put ideas at the center of their analysis of institutional change emphasize the complex relationship between ideas, interests, and institutions (Hall 1997; Walsh 2000; Blyth 2002; White 2012). Figure 4.3 illustrates my view of the processes involved.

In my view, ideas in terms of both beliefs and values *condition* how different interests interpret and understand the economic and social conditions, as well as the existing institutions and policies, of their society. But ideas, beliefs, and even values may also *arise or change* due to a need to interpret changes in these conditions. Hence, the arrow goes both ways. Moreover, as argued by Blyth (2002), ideas serve to reduce uncertainty, facilitate collective action, coalition building, and coordination, and are used as weapons for transforming existing institutions. McCloskey (1985) and Majone (1992), among others, point out the importance of rhetoric in arguing for institutional change. Interests and power resources are thus ideationally bound.

When it comes to ideas, it is important to distinguish between beliefs and values (Sartori 1969). Beliefs concern our causal understanding of how the world works, while values denote our preferences or normative ideals. Sometimes the same distinction is termed causal beliefs versus principled beliefs. Goldstein & Keohane (1993) have suggested that cognitive frameworks, combining beliefs and values, should be called "worldviews."

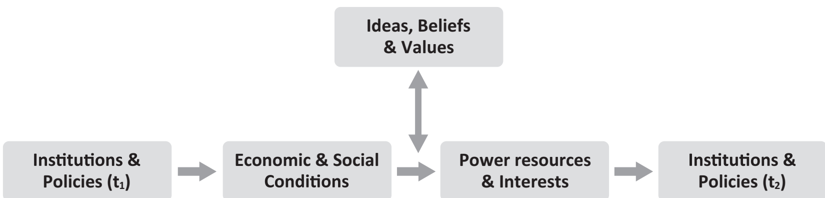

Fig. 4.3 Ideas, beliefs, and values in institutional change

In a more familiar terminology, this is equivalent to what is commonly called ideologies (Karlson 2013). For example, socialist and liberal ideologies combine more or less explicit causal beliefs about how markets, interventions, and state planning work with normative or principled beliefs (such as a commitment to freedom). An important result in earlier research is that it is easier to change causal beliefs than to change normative ideals (Skocpol 1996).

There is empirical support for this extended model. For example, changed economic beliefs have been shown to affect how decision-makers act and how coalitions of interests are formed. When established ways of thinking are reevaluated, policies tend to change (Derthick and Quirk 1985; Thelen and Steinmo 1992).

Peter Hall (1989, 1993, 1997), who has studied the shift from Keynesian to monetarist policies in the UK in the 1970s and 1980s, has developed a theory of institutional change, or social learning as he calls it, in which he distinguishes among three different levels of institutional change:

1. Instrument settings
2. Policy instruments
3. Overarching goals

The first level, the instrument settings, concerns the specific tax rates, levels of subsidies, details of regulation, and so on. The second level, the policy instruments, concerns the broader techniques or means used within an institutional framework. Examples are tariffs, subsidies, regulations, public monopolies, planning, taxes, and so on. The third and most important level, the overarching goals, concerns the principles, values, or standards that are used to evaluate the success or failure of an institutional framework.[1] These values are often a kind of informal institutions. In the terminology of this subsection, the three levels can all be interpreted as dealing with different kinds of ideas.

According to Hall, political actors minimize their cost of learning, that is, the costs involved in institutional change and the adoption of new ideas, by restricting changes to the first and second level. As long as their beliefs, experiences, and knowledge support the established policy paradigm, there is no need to reevaluate or change more fundamental beliefs or values at the third level.

Third-order changes happen rarely, but when they happen the changes are fundamental. Change in ideas cause change at all other institutional levels. Importantly, a change of a policy paradigm is more sociological than scientific, just as Kuhn (1970) argued in the case of scientific revolutions. The change emerges with the appearance of anomalies that seem to contradict accepted facts, realizations of policy failures, and shifts in the groups and individuals who hold authority.

In a similar manner, Argyris and Schön (1978, p. 4) have made a distinction between "single-loop" and "double-loop" learning, which occurs through the correction of errors or mistakes:

> When the error detected and corrected permits the organization to carry on its present policies or achieve its present objectives, then that error-detection-and-correction process is single-loop learning. Double-loop learning occurs when error is detected and corrected in ways, that involve the modification of an organization's underlying norms, policies and objectives.

An important implication is that institutional change most often is incremental and pragmatic, since it usually takes place at the levels of policy instruments and policy settings. This is in line with the above-mentioned finding that it is easier to change beliefs than to change normative ideals. The empirical evidence that institutional change is most often incremental and pragmatic is strong (Lindblom 1959; Wildavsky 1988; North 1990; Jones et al. 1997). However, periods of rigidity are sometimes broken by short periods of more rapid and fundamental policy change (Baumgartner and Jones 1991, 1993, 2002; John and Margetts 2003; Jones and Baumgartner 2005; Béland and Hacker 2004).

A well-established policy paradigm can normally survive for many years despite the gradual accumulation of conflicting data. What triggers paradigmatic shifts are in many cases so-called focusing events (Birkland 1997). These are often dramatic crises, with intense media exposure, which illustrate the shortcomings of the established framework and force actors to rapidly reorient themselves (Baumgartner and Jones 1993). Such events, or critical junctures, open up a window of opportunity that can be exploited by advocates of alternative policy paradigms (Kingdon 1984). There is substantial empirical support from different disciplines that crises may facilitate reforms (Pitlik et al. 2014; Vis 2009; Starke 2008; Vis and van Kersbergen 2007; Mierau et al. 2007; Cox 2001; Pitlik and Wirth 2003; Drazen and Grilli 1993; Alesina and Drazen 1991; Fernandez and Rodrik 1991). Ideas, or new policy paradigms, are likely to be especially important in change stemming from crises.

In the so-called advocacy coalition theory, formulated by Sabatier and Jenkins-Smith (1993), the role of policy paradigms is extended to policy subsystems. They argue that since modern societies are so complex, policies and institutions most often evolve within more specialized and technical subsystems where fundamental beliefs and values are taken for granted (Sabatier and Zafonte 2001). Actors within such policy subsystems tend to group themselves into several "policy coalitions" with different core values, frames of reference, knowledge bases, and so on. Hence, competing policy paradigms, which interpret information differently, may coexist. Most often, however, one such coalition tends to dominate within a specific policy field and thus decides which knowledge, information, and policy options are relevant (Sabatier and Zafonte 2001; Sabatier and Weible 2007).

Policy Entrepreneurs

The theories of institutional change presented so far have either shunned or only indirectly mentioned the role of agency. However, economic and social conditions, interests, and power resources, as well as ideas, beliefs, and values, do not by themselves produce change. This is where theories of policy entrepreneurs come in. Without agency, no change. If institutional change is to take place, some kind of agent must identify contextual changes, aggregate interests into power resources, articulate and communicate ideas, and seize windows of opportunities.

The labor unions, organizations, bureaucrats, and political parties prominent in the theories behind the simplest model of institutional change above are of course actors, but only in a limited sense. Their agency is confined to advancing interests that are predefined by economic and social conditions and existing institutions. In fact, the models which have been presented so far basically explain institutional change through exogenous changes of economic and social conditions, that is, changes in technology, climate, trade, demography, and so on, which in turn produce new outcomes and new relative prices, which then give rise to changed interests, power resources, institutions, and so on.

This somewhat deterministic tendency in explaining change is apparent in, for example, the book by Acemoglu and Robinson (2012) mentioned above. In almost all of the historical examples they discuss, societies are caught in vicious or virtuous path dependencies that can be broken only by critical junctures, which disrupt the existing economic or political balance in society. However, the authors give no explanation of why and how a new path of development is established, only that it is a complex and "contingent" process.

The same is essentially true when ideas, beliefs, and values affect how interest groups, experts, and political parties interpret and understand the economic and social conditions, as well as the existing institutions and policies, of their society. This is where policy entrepreneurs come in. They give ideas the decisive role in the process of institutional change.

Following previous literature, I define policy entrepreneurs as agents who seek to initiate institutional change by actively working to get support for ideas for policy innovation (Mintrom 1997; Baumgartner and Jones 1993; Schneider and Teske 1992; King 1988; Kingdon 1984; Polsby 1984). This is not an easy task. As put by López and Leighton (2013, p. 11):

> political change happens when entrepreneurs notice loose spots in the structure of ideas, institutions, and incentives and then find ways of implementing these new ideas into society's shared institutions

Figure 4.4 illustrates my view of the role of policy entrepreneurs in institutional change.

Policy entrepreneurs have to be able to make *their* beliefs and values (not others' beliefs and values) condition how interests groups and other actors interpret and understand the economic and social conditions, as well as the existing institutions and policies, of society. Moreover, in order to be real agents of change, they have to be able to use their ideas to strengthen their favored interests, build coalitions, and change the power

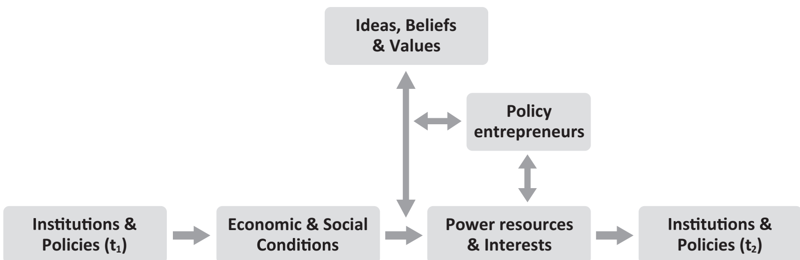

Fig. 4.4 Policy entrepreneurs and institutional change

resources in their favor. They must be successful in the interest-group arena, but also in the arenas of public opinion making, elections, and government. Most importantly, interest groups may also create their own policy entrepreneurs, deliberately advocating ideas that favor their preferred interpretation of the economic and social conditions. Hence, the arrow may go both ways between interests and ideas. As put by Hall (1993, p. 289), "powering" and "puzzling" often go together. North (1990) has a similar view.

Policy entrepreneurs thus articulate and promote new ideas that come from various sources, including international organizations and academic research as well as think tanks, bureaucracies, and interests. A particularly interesting source is so-called epistemic communities. According to Haas (1992), such a community is "a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area." Examples could be medical doctors in the area of health policy or economists in the case of monetary policy. Epistemic communities share both causal and principled beliefs and form a tight-knit community. But new beliefs and values may also emerge as a result of experiential learning processes among policy-makers and policy entrepreneurs themselves (cf. Kolb 1984). In any event, once new ideas have been created they may be imitated and diffused to others. Empirically there is support for this latter view (Pitlik 2007).

Most often, the policy entrepreneurs are concerned with the reformation of policy instruments and settings, in the terminology of Hall (1993) presented above. However, they can also be engaged in the much tougher task of establishing a competing policy paradigm and a new policy-advocacy coalition, with new overarching goals, principles, and standards of success.

Policy entrepreneurs do not have to be central decision-makers or politicians, perhaps better called "political entrepreneurs" in this setting (Kasper et al. 2012). In fact, since policy entrepreneurs are working to change the existing status quo, they are more likely to be located at lower levels of politics, in the bureaucracy, in interest groups, labor unions, the corporate sector, the media, or the academic world. As noted by Mintrom (1997), "[t]he role of business in policy transfer and marketing of ideas should not be under-estimated." Business entrepreneurs may turn into policy entrepreneurs (Henrekson and Sanandaji 2010).

By any account it should be clear that policy entrepreneurs, either individually or in constellations of policy-advocacy coalitions, have a decisive role in the promotion of institutional change in the model above, which by now has become quite complex. As we have seen, institutions and policies in t_1 interact with different economic and social variables to produce policy outcomes, which are conditioned by beliefs and values as well as by the activities of policy entrepreneurs. These, in turn, affect the power resources of different interest groups, which produce the institutions and policies in t_2, and so on.

Notes

1. Willamson's (2000) well-known hierarchical representation of institutions is somewhat similar. He distinguishes between informal, formal, and governance rules plus resource allocation and employment within these institutional rules, where the informal rules take the longest to change.

References

Books and Articles

Acemoglu, D., & Robinson, J. (2012). *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York: Crown Publishers.

Acemoglu, D., Johnson, S., & Robinson, J. (2005). Institutions as the Fundamental Cause of Long-Run Growth. In P. Aghion & S. Durlauf (Eds.), *Handbook of Economic Growth* (Vol. 1B, pp. 385–464). Amsterdam: Elsevier.

Alesina, A., & Drazen, A. (1991). *Why Are Stabilizations Delayed*? Ramat Aviv: Sackler Institute of Economic Studies.

Argyris, C., & Schön, D. (1978). *Organisational Learning: A Theory of Action Perspective*. Reading: Addison-Wesley.

Baumgartner, F., & Jones, B. (1991). Agenda Dynamics and Policy Subsystems. *The Journal of Politics, 53*(4), 1044–1074.

Baumgartner, F., & Jones, B. (1993). *Agendas and Instability in American Politics*. Chicago: University of Chicago Press.

Baumgartner, F., & Jones, B. (2002). *Policy Dynamics*. Chicago: University of Chicago Press.

Béland, D., & Hacker, J. (2004). Ideas, Private Institutions and American Welfare State 'Exceptionalism': The Case of Health and Old-Age Insurance, 1915–1965. *International Journal of Social Welfare, 13*(1), 42–54.

Berman, S. (1998). *The Social Democratic Moment*. Cambridge, MA: Harvard University Press.

Birkland, T. (1997). *After Disaster: Agenda Setting, Public Policy, and Focusing Events*. Washington, DC: Georgetown University Press.
Blyth, M. (1997). Moving the Political Middle: Redefining the Boundaries of State Action. *Political Quarterly, 68*(3), 231–240.
Blyth, M. (2002). *Great Transformations*. New York: Cambridge University Press.
Buchanan, J. (1986). The Constitution of Economic Policy. *American Economic Review, 77*(3), 243–250.
Buchanan, J., & Tollison, R. (2009). *The Theory of Public Choice—II*. Ann Arbor: The University of Michigan Press.
Campbell, J. (2002). Ideas, Politics, and Public Policy. *Annual Review of Sociology, 28*(1), 21–38.
Cox, R. H. (2001). The Social Construction of an Imperative: Why Welfare Reform Happened in Denmark and the Netherlands but Not in Germany. *World Politics, 53*(3), 463–498.
Denzau, A., & North, D. (1994). Shared Mental Models: Ideologies and Institutions. *Kyklos, 47*(1), 3–31.
Derthick, M., & Quirk, P. (1985). *The Politics of Deregulation*. Washington, DC: Brookings Institution.
Drazen, A., & Grilli, V. (1993). The Benefit of Crises for Economic Reforms. *American Economic Review, 83*(3), 598–607.
Esping-Andersen, G. (1985). Power and Distributional Regimes. *Politics & Society, 14*(2), 223–256.
Fernandez, R., & Rodrik, D. (1991). Resistance to Reform: Status quo Bias in the Presence of Individual-Specific Uncertainty. *The American Economic Review, 81*(5), 1146–1155.
Fiske, S., & Taylor, S. (1991). *Social Cognition*. New York: McGraw Hill.
Goldstein, J. & Keohane, R (1993). *Ideas and Foreign Policy: Beliefs, Institutions, and Political Change*. Ithaca: Cornell University Press.
Haas, P. (1992). Introduction: Epistemic Communities and International Policy Coordination. *International Organization, 46*(1), 1–35.
Hall, P. A. (1989). *The Political Power of Economic Ideas*. Princeton: Princeton University Press.
Hall, P. A. (1993). Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain. *Comparative Politics, 25*(3), 275–296.
Hall, P. A. (1997). The Role of Interests, Institutions, and Ideas in the Comparative Political Economy of the Industrialized Nations. In M. Lichbach & A. Zuckerman (Eds.), *Comparative Politics: Rationality, Culture, and Structure*. Cambridge: Cambridge University Press.
Hay, C. (2001). The 'Crisis' of Keynesianism and the Rise of Neoliberalism in Britain: An Ideational Institutionalist Approach. In J. L. Campbell & O. Pedersen (Eds.), *The Rise of Neoliberalism and Institutional Analysis*. Princeton: Princeton University Press.

Hayek, F. A. (1960). *The Constitution of Liberty*. Chicago: University of Chicago Press.

Hayek, F. A. (1978). *New Studies in Philosophy, Politics, Economics and the History of Ideas*. Chicago: University of Chicago Press.

Henrekson, M., & Sanandaji, T. (2010). The Interaction of Entrepreneurship and Institutions. *Journal of Institutional Economics, 7*(1), 47–75.

Hobsbawm, E. (1968). *Industry and Empire*. London: Weidenfeld and Nicolson.

John, P., & Margetts, H. (2003). Policy Punctuations in the UK: Fluctuations and Equilibria in Central Government Expenditure Since 1951. *Public Administration, 81*(3), 411–432.

Jones, B., & Baumgartner, F. (2005). *The Politics of Attention*. Chicago: University of Chicago Press.

Jones, B., True, J., & Baumgartner, F. (1997). Does Incrementalism Stem from Political Consensus or from Institutional Gridlock? *American Journal of Political Science, 41*(4), 1319–1339.

Karlson, N. (1993). *The State of State. An Inquiry Concerning the Role of Invisible Hands in Politics and Civil Society*. Stockholm: Almquist & Wiksell International.

Karlson, N. (2002). *The State of State, Invisible Hands in Politics and Civil Society*. New Brunswick: Transaction Publishers.

Karlson, N. (2013). The Limits of Pragmatism in Institutional Change. In H. Lindberg (Ed.), *Knowledge and Policy Change*. Newcastle: Scholars Publishing.

Kasper, W., Streit, M., & Boettke, P. (2012). *Institutional Economics*. Cheltenham: Edward Elgar.

Keynes, J. (1935). *The General Theory of Employment, Interest and Money*. New York: Harcourt, Brace.

King, P. J. (1988). *Policy Entrepreneurs: Catalysts in the Policy Innovation Process* (Unpublished Ph.D. dissertation), University of Minnesota.

Kingdon, J. W. (1984). *Agendas, Alternatives, and Public Policies*. Boston: Little Brown.

Knight, J., & North, D. (1997). Explaining Economic Change: The Interplay Between Cognition and Institutions. *Legal Theory, 3*(3), 211–226.

Kolb, D. A. (1984). *Experiential Learning*. Englewood Cliffs: Prentice Hall.

Korpi, W. (1978). *The Working Class in Welfare Capitalism: Work, Unions and Politics in Sweden*. London: Routledge & Kegan Paul.

Korpi, W. (1980). Social Policy and Distributional Conflict in the Capitalist Democracies: A Preliminary Comparative Framework. *West European Politics, 3*(3), 296–316.

Korpi, W., & Palme, J. (1998). The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality, and Poverty in the Western Countries. *American Sociological Review, 63*(5), 661–687.

Korpi, W., & Palme, J. (2003). New Politics and Class Politics in the Context of Austerity and Globalization: Welfare State Regress in 18 Countries, 1975–95. *American Political Science Review, 97*(3), 425–446.

Kuhn, T. (1970). *The Structure of Scientific Revolutions* (2nd ed.). Chicago: University of Chicago Press.

Lindblom, C. (1959). The Science of "Muddling Through". *Public Administration Review, 19*(2), 79–88.

López, E., & Leighton, W. (2013). *Madmen, Intellectuals, and Academic Scribblers: The Economic Engine of Political Change*. Stanford: Stanford University Press.

Majone, G. (1992). *Evidence, Argument, and Persuasion in the Policy Process*. New Haven: Yale University Press.

Marx, K. (1867). *Das Kapital*, Erster Band, MEW, Bd, 23, 647. Vol 2. Hegel and Marx. Routledge.

McCloskey, D. (1985). *The Rhetoric of Economics*. Madison: University of Wisconsin Press.

McCloskey, D. (2006). *The Bourgeois Virtues: Ethics for an Age of Commerce*. Chicago: University of Chicago Press.

McCloskey, D. (2010). *Bourgeois Dignity: Why Economics Can't Explain the Modern World*. Chicago: University of Chicago Press.

McCloskey, D. (2016). *Bourgeois Equality: How Ideas, Not Capital or Institutions, Enriched the World*. Chicago: University of Chicago Press.

Mierau, J. O., Jong-A-Pin, R., & de Haan, J. (2007). Do Political Variables Affect Fiscal Policy Adjustment Decisions? New Empirical Evidence. *Public Choice, 133*(3–4), 297–319.

Mintrom, M. (1997). Policy Entrepreneurs and the Diffusion of Innovation. *American Journal of Political Science, 41*(3), 738–770.

Mueller, D. (2003). *Public Choice III*. Cambridge: Cambridge University Press.

North, D. C. (1981). *Structure and Change in Economic History*. New York: Norton Press.

North, D. C. (1990). *Institutions, Institutional Change, and Economic Performance*. Cambridge: Cambridge University Press.

O'Connor, J., & Olsen, G. (Eds.). (1998). *Power Resources Theory and the Welfare State*. Toronto: University of Toronto Press.

Olson, M. (1965). *The Logic of Collective Action*. Cambridge, MA: Harvard University Press.

Olson, M. (1982). *The Rise and Decline of Nations*. Baltimore: Yale University Press.

Persson, T., & Tabellini, G. (2000). *Political Economics*. Cambridge, MA: MIT Press.

Peters, G., Pierre, J., & King, D. S. (2005). The Politics of Path Dependency: Polical Conflict in Historical Institutionalism. *Journal of Politics, 67*(4), 1275–1300.

Pitlik, H. (2007). A Race to Liberalization? Diffusion of Economic Policy Reform Among OECD-Economies. *Public Choice, 132*(1–2), 159–178.

Pitlik, H., & Wirth, S. (2003). Do Crises Promote the Extent of Economic Liberalization? An Empirical Test. *European Journal of Political Economy, 19*(3), 565–581.

Pitlik, H., Heinemann, F., & Schweickert, R. (2014). *Overcoming Reform Resistance and Political Implementation of Large-Scale Welfare State Reforms*. Prepared for WWWforEurope. Retrieved from http://www.foreurope.eu/fileadmin/documents/pdf/Policybriefs/WWWforEurope_PB_no03_D104.1.pdf

Polsby, N. (1984). *Political Innovation in America*. New Haven: Yale University Press.

Pontusson, J., & Kwon, H. (2006). *Power Resource Theory Revisited and Revised*. Paper Presented at Annual *APSA* Meetings.

Rogowski, R. (1989). *Commerce and Coalitions: How Trade Affects Domestic Political Alignments*. Princeton: Princeton University Press.

Sabatier, P., & Jenkins-Smith, H. (1993). *Policy Change and Learning*. Boulder: Westview Press.

Sabatier, P., & Weible, C. (2007). The Advocacy Coalition Framework: Innovations and Clarifications. In P. Sabatier (Ed.), *Theories of the Policy Process* (2nd ed., pp. 189–222). Boulder: Westview Press.

Sabatier, P. A., & Zafonte, M. (2001). Policy Knowledge: Advocacy Organizations. In N. J. Smelser & B. Baltes (Eds.), *International Encyclopedia of the Social and Behavioral Sciences* (Vol. 17, pp. 11563–11568). Amsterdam: Elsevier.

Sartori, G. (1969). Politics, Ideology and Belief Systems. *American Political Science Review, 63*(2), 398–411.

Schneider, M., & Teske, P. (1992). Toward a Theory of the Political Entrepreneur: Evidence from Local Government. *American Political Science Review, 86*(3), 737–747.

Skocpol, T. (1996). *Boomerang*. New York: W.W. Norton & Co.

Starke, P. (2008). Radical Welfare State Retrenchment: A Literature Review. *Social Policy and Administration, 40*(1), 104–120.

Thelen, K., & Steinmo, S. (1992). Historical Institutionalism in Comparative Politics. In S. Steinmo, K. Thelen, & F. Longstreth (Eds.), *Structuring Politics* (pp. 1–32). New York: Cambridge University Press.

Tullock, G. (1989). *The Economics of Special Privilege and Rent Seeking*. Boston: Kluwer Academic Publishers.

Vanberg, V., & Buchanan, J. (1989). Interests and Theories in Constitutional Choice. *Journal of Theoretical Politics, 1*(1), 49–62.

Vis, B. (2009). Governments and Unpopular Social Policy Reform: Biting the Bullet or Steering Clear? *European Journal of Political Research, 48*(1), 31–57.

Vis, B., & Kersbergen, K. (2007). Why and How Do Political Actors Pursue Risky Reforms? *Journal of Theoretical Politics, 19*(2), 153–172.

Walsh, J. (2000). When Do Ideas Matter? Explaining the Successes and Failures of Thatcherite Ideas. *Comparative Political Studies, 33*(4), 483–516.

White, L. (2012). *The Clash of Economic Ideas. The Great Policy Debates and Experiments of the Last Hundred Years*. Cambridge: Cambridge University Press.

Wildavsky, A. (1988). *The New Politics of the Budgetary Process*. Glenview: Scott, Foresman & Co.

Williamson, O. (2000). The New Institutional Economics: Taking Stock, Looking Ahead. *Journal of Economic Literature, 38*(3), 595–613.

CHAPTER 5

Reform Cycles and Reform Strategies

The explanation of institutional change presented above is still insufficient for the creation of an analytical framework to be used in the case studies. Rather than merely being interested in how any kind of institutional change comes about, we are interested in how *welfare-enhancing reform* can be achieved, overcoming the barriers to reform and making society better off.

The Reform Cycle

The synthesis of the theories of institutional change presented in the previous Chap. 4 (in Fig. 4.4) can be viewed as a continuous process, as in Fig. 5.1. This is the model of institutional change that will form the basis for the analytical framework to be used, and work as my hypotheses, in the case studies in Chaps. 6 and 7. For simplicity I shall simply call it the reform cycle.

The reform cycle starts with changing economic and social conditions. These create a demand for new ideas, which need to be articulated by different policy entrepreneurs. They interact with and activate power resources and interests, which influence institutional and policy changes. These changes in turn affect social and economic conditions, and the cycle continues.

Note, however, that the cycle may stop if and when new ideas are lacking, policy entrepreneurs are missing or power resources or interests cannot be mobilized or activated to implement the required changes in

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_5

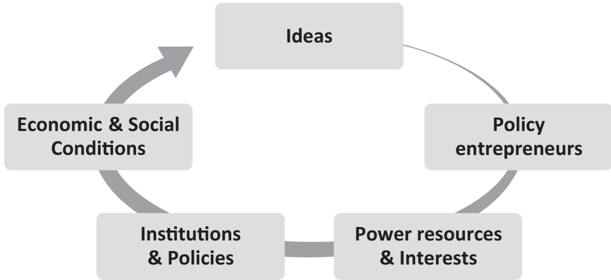

Fig. 5.1 The reform cycle

policies and institutions. Moreover, also note that the actions of governments, parliaments, or parties—the usual focus of political scientists—are only minor parts of the reform cycle.

The conceptual framework provided by the reform cycle may be interpreted on different levels. I expect that it can be used to analyze institutional change in the short run as well as in the long run, and that it can be used to help understand changes in instrument settings, in policy instruments, or in overarching goals of institutional frameworks (to use Hall's terminology above). The latter, paradigmatic reforms, are likely to be rare and most likely to occur as a result of major focusing events or crises. Short-run changes in specific policies and their settings are likely to be more incremental and pragmatic.

However, these reform cycles are still incomplete and insufficient if we want to know how reform in advanced democracies and welfare states can be promoted and what it takes to govern a country well. First, the theory so far does not explain how the barriers to reform can be overcome. Second, the institutional changes, if they occur, may make society worse as well as better off. The change can be either welfare enhancing or welfare diminishing, which does not qualify as reform in my terminology.

The ideas may reinforce an inefficient status quo due to the spiral of silence, preference falsification, and negativity biases that create an ideational trap—making it impossible to overcome existing opinions. Moreover, special interests and the public goods character of many welfare-enhancing reforms may block beneficial reforms. Policy entrepreneurs may even lobby for institutional changes that benefit a few at the expense of the many, promoting ideas and mobilizing resources that change the institutions in a direction which makes welfare lower at t_2 than at t_1. As

Baumol (1990) famously argued, entrepreneurship may be destructive and unproductive as well as productive. Destructive political entrepreneurs may get the edge.

It is thus apparent that something more is needed to explain welfare-enhancing, liberal, reforms that do overcome the barriers to reform. A more general theory of welfare state reform is required.

The Concept of Statecraft

This is the reason why *statecraft* must be added to the theory of the reform cycle synthesized above, since we want to know what it takes to govern a country well by promoting reform. The concept of statecraft has in recent decades largely been limited to the literature of international relations and to historical case studies, sometimes including the role of economic policies (Kaplan 1952; Baldwin 1985; Mastanduno 1998). But there are earlier studies that apply the concept to domestic policies. Usher (1934, p. 8), for example, treats statecraft as a broad liberal process of policy adjustment and adaptation, aiming toward "the greatest measure of social welfare."

There is also a more recent strand of theory, labeled "neo-statecraft" by James (2016), which focuses on how politicians manage government while cultivating electoral appeal. Originally formulated by Bulpitt (1986) to analyze the first Thatcher government, the analytical primacy is given to the governing party's leader and to his or her elite advisors. What matters is winning elections, and winning them again, through party management, a winning electoral strategy, political argument hegemony, and governing competence (Bulpitt 1986, p. 22). The theory is thus not primarily concerned with welfare-enhancing institutional change, or reform in our terminology, but may of course nevertheless be of relevance.

Another potentially significant contribution to our understanding of statecraft is, however, Jacobs' (2011) analysis of governing for the long term, or why governments sometimes are willing and able to impose short-term pain for long-term gain. He does not call it statecraft, but this is clearly equivalent to overcoming the inter-temporal public goods traps mentioned in Chap. 2, an important barrier to reform. He argues that three conditions are necessary for governments to invest in the future: electoral safety, perceived positive long-term social returns of the policy, and institutional capacity, meaning that governments must be committed to reform even when they are opposed by influential interest groups.

Ideas in the sense of mental maps and framing of the policies in question play a key role, especially when it comes to explaining the positive long-term social returns of the policy to the electorate and various interest groups. He also provides a reality check of his framework by studying pension reforms in a number of countries. I shall return this perspective in Chap. 8.

Moreover, there is a related literature, with relevance to statecraft that argues that the barriers to reform and the status quo bias may be overcome in certain situations. In particular, Vis and Kersbergen (2007), Vis (2010), and Giger (2011) have analyzed the electoral risks of welfare reforms. One important result, based on the prospect theory presented in Chap. 2, is that governments are more likely to pursue unpopular but necessary reforms when the current situation, the status quo, is considered unacceptable both by themselves and by the voters. Otherwise the risks are too high. However, also when only the government, and not the voters, considers the current situation to be unacceptable may reforms be pursued if strategies of blame avoidance can be used (Vis and Kersbergen 2007). I will come back to this in the next session.

I shall thus restrict statecraft to institutional changes that are beneficial or welfare enhancing. That is what the art of governing a country well requires. By this, I mean reforms that make everyone better off, or could make everyone better off if the winners compensated the losers with some of their gains. This is equivalent to the Pareto or Kaldor-Hicks criteria (Bergh 2009) and is in line with mainstream definitions such as the one offered by Fernandez and Rodrik (1991), who speak of "efficiency enhancing reforms," as well as definitions proposed by Bresser-Pereira, Maravall, and Przeworski (1993). Often, perhaps always, in the case of modern welfare states such changes are equivalent to liberal reforms, reforms that make society more free, even though there may be a tension between efficiency and liberty.

The concept of statecraft, the art of governing a country well, however, also requires some kind of agency or governance that "crafts" the policies of a country, using a variety of skills to overcome the barriers to reform.

In the reform cycle outlined above, we have given policy entrepreneurs, either individually or in constellations of policy-advocacy coalitions, a decisive role in this process because they use ideas to strengthen their favored interests, build coalitions, and change the power resources in their favor. We also noted that these policy entrepreneurs do not have to be central decision-makers or politicians, as in the theories of Jacobs (2011) and James (2016) mentioned above, since they are working to change the existing status quo. They can be located at lower levels of politics, in the bureaucracy, interest groups, labor unions, think tanks, the corporate sector, the media, or the academic world.

Which potential actors are decisive for modern statecraft, how they interact, and how welfare-enhancing ideas become dominant and advocated, rather than ignored or disparaged, need to be explained. These questions will be addressed in the case studies of our two reform countries.

Reform Strategies

A central question is thus how the barriers to reform are overcome. As we have seen, the task of bringing about beneficial institutional change is not easy. The actors involved in the art of statecraft need strategies to mobilize power resource and interests to push the advocated policies through the political process.

There are three major kinds of reform strategies that I believe, based on my experience and previous research, are central to statecraft:

1. Popperian strategies
2. Kuhnian strategies
3. Machiavellian strategies

The first strategy, which I label *Popperian*, is fact-based and involves the use of research, rational argumentation, and pragmatism. The second, which I label *Kuhnian*, is idea-based and involves the use of paradigmatic shifts of perspectives, narratives, framing, new authorities, and agenda setting. The third, which I label *Machiavellian*, is based on shrewdness and involves the use of obfuscating, blame avoidance, splitting, compensating, and scapegoating. Statecraft, to govern a country well, is likely to involve the active use of all three types of reform strategies.

Popperian Strategies

Karl Popper (1902–1994) is best known for his critical rationalism and vigorous defense of liberal democracy and the open society. He was a leading philosopher of science of the twentieth century and an opponent of all forms of utopianism and totalitarianism. His 1945 book *The Open Society and Its Enemies* has been deeply influential in both academic and popular circles.

Based on his famous belief that we can only advance our knowledge through the empirical falsification of existing scientific theories, he argued that the open, market-liberal, and democratic society can be sustained only if it is possible for individual citizens to evaluate critically the consequences of the implementation of government policies. Hence, only if the voters and other political actors can openly and rationally criticize established policies and institutions will undesirable policies be eliminated. Differences over social policy will be resolved by critical discussion and argument rather than by force (Popper 1934, 1945, 1957).

For the same reasons, Popper was highly critical of all kinds of large-scale social planning. He believed such planning was necessarily based upon unproven, untenable, and incoherent predictions of the future. He advocated "piecemeal social engineering" as a preferable reform method. According to Popper (1945, p. 158), "the piecemeal engineer will adopt the method of searching for, and fighting against, the greatest and most urgent evil of society, rather than searching for, and fighting for, its greatest ultimate good." Moreover, he argues (1957, p. 80) that "we make progress if, and only if, we are prepared to learn from our mistakes: to recognize our errors and to utilize them critically instead of persevering in them dogmatically."

In the light of the research presented in Chap. 4, I shall take the liberty to translate these reformist views of Popper, which are likely to be supported by many social scientists and policy-makers, into the following reform strategies:

1. Use scientific results, empirical research, and experiments in the evaluation of existing, and in the development of new policies and institutions.
2. Focus on feasibility and on pragmatic and incremental, rather than large-scale, institutional changes.
3. Use rational argumentation and open public discussions when seeking support for reform proposals.
4. Do not rely on firm beliefs about how the world works or on strong normative ideals when formulating or implementing reforms.

Kuhnian Strategies

Thomas Kuhn (1922–1996) was a theoretical physicist and philosopher of science, whose book *The Structure of Scientific Revolutions* (1962, 1970) has been enormously influential. He argued that under normal conditions:

> [T]he research scientist is not an innovator but a solver of puzzles, and the puzzles upon which he concentrates are just those which he believes can be both stated and solved within the existing scientific tradition.

However, normal science sometimes undergoes "paradigm shifts" rather than solely progressing in a cumulative way. Such scientific revolutions open up new approaches that would never have been considered valid before. These competing paradigms are frequently incommensurable. They are competing accounts of reality that cannot be coherently reconciled.

As already developed in Chap. 4 in the section about ideas, beliefs, cognitive frameworks, and values, some explanations of institutional change, notably Hall's (1993, 1997), reflect the same kind of reasoning as Kuhn's. Hall pointed out that more fundamental institutional changes require shifts in overarching policy goals or "policy paradigms." Such third-order changes happen rarely and are more sociological than scientific, just as argued by Kuhn (1962, 1970). They are caused by the appearance of anomalies, policy failures, and shifts in the locus of authority.

Thus, strategies based on rational argumentation, public discussions, and scientific results are not sufficient to achieve institutional change beyond pragmatic changes involving only policy instruments and policy settings. For more fundamental or paradigmatic changes, ideas and ideologies are central to policy-making; science is not.

Rational argumentation may serve us well within a given, fairly accurate cognitive framework. However, it cannot address situations wherein an entire interpretative framework must be changed to achieve welfare-enhancing institutional change (Karlson 2013). Paradigmatic change also requires advanced communication skills, rhetoric, and leadership (Kingdon 1984; McCloskey 1985; Hall 1989; Majone 1992; Goldstein 1993; Béland 2005). How policies are presented and discussed, as well as how the agenda is set and the process is sequenced, is essential to institutional change (Snow et al. 1986; Skocpol 1996; Wilson 2000; Armingeon and Giger 2008; Giger and Nelson 2010; Giger 2011).

To change paradigms, the following reform strategies, which I take the liberty to label Kuhnian, can be identified:

1. Use the windows of opportunity created by focusing events, crises, or critical junctures to establish alternative policy paradigms.
2. Focus on policy failures, striking facts and figures, experiments and examples, that can be easily communicated, and try to promote new policy-advocacy coalitions, as well as the establishment of new authorities and alternative experts.
3. Make use of ideas, narratives, and rhetoric to frame and redefine discussions and agendas.
4. Realize that paradigmatic policy shifts are long-term projects, and that it is easier to change beliefs about how the world works than to change preferences and normative ideals.

Machiavellian Strategies

Niccolò Machiavelli (1469–1527) was an Italian historian, politician, diplomat, and political philosopher. He is best known for his book *The Prince* (1532), which reads like a manual on how a new ruler should behave in order to acquire and keep hold of political power. This work is often thought to glorify absolutist rule as well as cunning and duplicity in politics. However, Machiavelli is also the author of the *Discourses* (1531), in which he discusses how a republic should be formed and structured. It explains the advantages of republican rule, while retaining some of the themes found in *The Prince*.

Whether or not beneficial motives, such as the unification of Italy, lay behind Machiavelli's recommendations is a matter of debate. It is clear, however, that his ideas have been enormously influential, both in political theory and in practical politics. For example, many politicians would agree that "no enterprise is more likely to succeed than one concealed from the enemy until it is ripe for execution." More controversial, but nevertheless often practiced, are recommendations such as "it is better to be feared than loved, if you cannot be both," and "a prince never lacks legitimate reasons to break his promise."

Another typical example of a Machiavellian political recommendation is the following (Machiavelli 1984, p. 53):

> A prince must be prudent enough to know how to escape the bad reputation of those vices that would lose the state for him, and must protect himself from those that will not lose it for him, if this is possible; but if he cannot, he need not concern himself unduly if he ignores these less serious vices.

While it is not entirely clear what is considered a vice in politics, studies in what has been called *The New Politics of Welfare* (Pierson 1994, 1996, 2001) have found that similar kinds of strategies are used in the retrenchment of welfare policies. When welfare benefits have to be cut down or scrapped, politicians often engage in *blame avoidance* (Weaver 1986; Starke 2008; Tepe and Vanhuysse 2010). They do this by using various methods to hide or obfuscate the consequences of the policy proposals to the voters, such as making things technically complicated, indexing benefits, postponing consequences, delegating responsibility to administrative bodies, creating broad coalitions to diffuse responsibility for the hardship produced, and so on (Lindbom 2007; Kono 2006). All with the purpose of avoiding critical and open discussion about the institutional changes. For example, instead of making yearly public decisions about the levels of social support, politicians may tie the level to an index, making the adjustment automatic (and in the direction the politician favors but who fears is not popular).

This suggests that reforms will be attempted in areas where such blame-avoidance techniques are possible, such as complicated transfer systems with low transparency (Vis and Kersbergen 2007). Other methods include the deliberate splitting of the interest upholding the current policies through buying off or compensating parts of the opposition interest, a strategy often used in the case of tax reform (Williamson 1994; Pierson 1994; Prince 2010), and the creation of parallel organizations and institutions (Streeck and Thelen 2005; Mahoney and Thelen 2010). Agenda control, strategic voting, and manipulations of dimensions (Riker 1986) belong to the same categories.

The following reform strategies, which I shall label Machiavellian, can thus be identified:

1. Use different techniques to obfuscate and lower the visibility of institutional change through masking, indexing, delaying consequences, and so on.
2. Split the opposition to reform, and play off one group against another by compensating some interests and not others. Create parallel institutions replacing existing ones.

3. Do not show your real intention and reform ambitions, and try to shift the blame for hardship caused by institutional changes on others.
4. Beware that your competitors and partners are likely to use similar strategies.

Remaining Puzzles

The importance and role of these strategies for reform in modern welfare states will be addressed in the coming case studies. While Machiavellian strategies may mainly be available to central political actors involved in the actual power games in government and parliament, a variety of policy entrepreneurs and interests are likely to use Kuhnian and Popperian strategies. In practice these reform strategies may be combined in different ways by different actors at different times.

However, not even the skills involved in using the reform strategies in order to lower the barriers to reform are likely to be enough to achieve welfare-enhancing institutional change. Again, destructive policy entrepreneurs may develop such skills as well. So far the theory developed can explain why countries fail, as well as why they succeed.

In order to present a general theory of reform we also need to understand how and why welfare-enhancing policy ideas emerge, develop, and become implemented, where a multitude of actors may be involved in the process. Moreover, since many of the problems that advanced democracies and welfare states face have the characteristics of public goods, the collective action problem involved in reform has to be solved. The involved actors must both know what to do and how to do it. New and better ideas, causal as well as principled beliefs, need to be found, developed, tried, and implemented. These remaining puzzles require theory development.

With a better understanding of these elements in modern statecraft, the reform cycle and the reform strategies presented above may form the basis of a general theory of welfare-enhancing institutional change. In the coming chapters the cases of Sweden and Australia will be used to explore and develop this analytical framework. The focus will be on why and how reforms were developed and successfully implemented. How did the reform processes start, what made them persist and why did they, as it seems, come to a halt?

References

Books and Articles

Armingeon, K., & Giger, N. (2008). Conditional Punishment: A Comparative Analysis of the Electoral Consequences of Welfare State Retrenchment in OECD Nations, 1980–2003. *West European Politics, 31*(3), 558–580.

Baldwin, D. (1985). *Economic Statecraft*. Princeton: Princeton University Press.

Baumol, W. (1990). Entrepreneurship: Productive, Unproductive, and Destructive. *Journal of Political Economy, 98*(5), 893–921.

Béland, D. (2005). Ideas and Social Policy: An Institutionalist Perspective. *Social Policy & Administration, 39*(1), 1–18.

Bergh, A. (2009). *Den kapitalistiska välfärdsstaten*. Stockholm: Nordstedts akademiska förlag.

Bresser-Pereira, L., Maravall, J., & Przeworski, A. (1993). *Economic Reforms in New Democracies*. Cambridge: Cambridge University Press.

Bulpitt, J. (1986). The Discipline of the New Democracy: Mrs Thatcher's Domestic Statecraft. *Political Studies, 34*(1), 19–39.

Fernandez, R., & Rodrik, D. (1991). Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty. *The American Economic Review, 81*(5), 1146–1155.

Giger, N. (2011). Is Social Policy Retrenchment Unpopular? How Welfare Reforms Affect Government Popularity. *European Sociological Review, 28*(5), 691–700.

Giger, N., & Nelson, M. (2010). The Electoral Consequences of Welfare State Retrenchment: Blame Avoidance or Credit Claiming in the Era of Permanent Austerity? *European Journal of Political Research, 50*(1), 1–23.

Goldstein, J. (1993). *Ideas, Interests, and American Trade Policy*. Ithaca: Cornell University.

Hall, P. A. (1989). *The Political Power of Economic Ideas*. Princeton: Princeton University Press.

Hall, P. A. (1993). Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain. *Comparative Politics, 25*(3), 275–296.

Hall, P. A. (1997). The Role of Interests, Institutions, and Ideas in the Comparative Political Economy of the Industrialized Nations. In M. Lichbach & A. Zuckerman (Eds.), *Comparative Politics: Rationality, Culture, and Structure*. Cambridge: Cambridge University Press.

Jacobs, A. M. (2011). *Governing for the Long Term. Democracy and Politics of Investment*. New York: Cambridge University Press.

James, T. S. (2016). Neo-statecraft Theory, Historical Institutionalism and Institutional Change. *Government and Opposition, 51*(1), 84–110.

Kaplan, M. (1952). An Introduction to the Strategy of Statecraft. *World Politics, 4*(04), 548–576.

Karlson, N. (2013). The Limits of Pragmatism in Institutional Change. In H. Lindberg (Ed.), *Knowledge and Policy Change*. Newcastle: Scholars Publishing.
Kingdon, J. W. (1984). *Agendas, Alternatives, and Public Policies*. Boston: Little Brown.
Kono, D. Y. (2006). Optimal Obfuscation: Democracy and Trade Policy Transparency. *American Political Science Review, 100*(3), 369–384.
Kuhn, T. (1962). *The Structure of Scientific Revolutions*. Chicago: University of Chicago Press.
Kuhn, T. (1970). *The Structure of Scientific Revolutions* (2nd ed.). Chicago: University of Chicago Press.
Lindbom, A. (2007). Obfuscating Retrenchment: Swedish Welfare Policy in the 1990s. *Journal of Public Policy, 27*(02), 129.
Machiavelli, N. (1984). *The Prince* (P. Bondanella & M. Musa, Eds.). Oxford: Oxford University Press.
Mahoney, J., & Thelen, K. (Eds.). (2010). *Explaining Institutional Change: Ambiguity, Agency and Power*. Cambridge: Cambridge University Press.
Majone, G. (1992). *Evidence, Argument, and Persuasion in the Policy Process*. New Haven: Yale University Press.
Mastanduno, M. (1998). Economics and Security in Statecraft and Scholarship. *International Organization, 52*(4), 825–854.
McCloskey, D. (1985). *The Rhetoric of Economics*. Madison: University of Wisconsin Press.
Pierson, P. (1994). *Dismantling the Welfare State?* Cambridge: Cambridge University Press.
Pierson, P. (1996). The New Politics of the Welfare State. *World Politics, 48*(2), 143–179.
Pierson, P. (2001). Post-Industrial Pressure on the Mature Welfare States. In P. Pierson (Ed.), *The New Politics of the Welfare State*. Oxford: Oxford University Press.
Popper, K. (1934). *Logik der Forschung*. Vienna: Verlag von Julius Springer.
Popper, K. (1945). *The Open Society and Its Enemies*. London: Routledge.
Popper, K. (1957). *The Poverty of Historicism*. London: Routledge.
Prince, M. (2010). Avoiding Blame, Doing Good, and Claiming Credit: Reforming Canadian Income Security. *Canadian Public Administration, 53*(3), 293–322.
Riker, W. H. (1986). *The Art of Political Manipulation*. New Haven: Yale University Press.
Skocpol, T. (1996). *Boomerang*. New York: W.W. Norton & Co..
Snow, D., Rochford, B., Worden, S., & Benford, R. (1986). Frame Alignment Processes, Micro Mobilization, and Movement Participation. *American Sociological Review, 51*(4), 464–481.
Starke, P. (2008). Radical Welfare State Retrenchment: A Literature Review. *Social Policy and Administration, 40*(1), 104–120.

Streeck, W., & Thelen, K. (2005). *Beyond Continuity*. Oxford: Oxford University Press.

Tepe, M., & Vanhuysse, P. (2010). Who Cuts Back and When? The Politics of Delays in Social Expenditure Cutbacks, 1980–2005. *West European Politics, 33*(6), 1214–1240.

Usher, A. P. (1934). A Liberal Theory of Constructive Statecraft. *The American Economic Review, 24*(1), 2–10.

Vis, B. (2010). *The Politics of Risk-Taking—Welfare State Reform in Advanced Democracies*. Amsterdam: Amsterdam University Press.

Vis, B., & Kersbergen, K. (2007). Why and How Do Political Actors Pursue Risky Reforms? *Journal of Theoretical Politics, 19*(2), 153–172.

Weaver, R. (1986). The Politics of Blame Avoidance. *Journal of Public Policy, 6*(4), 371–398.

Williamson, J. (Ed.). (1994). *The Political Economy of Policy Reform*. Washington, DC: Institute for International Economics.

Wilson, P. I. (2000). Deficit Reduction as a Causal Story: Strategic Politics and Welfare State Retrenchment. *The Social Science Journal, 37*(1), 97–112.

CHAPTER 6

The Swedish Reform Process

The reform process in Sweden started in the mid-1980s. The then-existing Swedish welfare model had run into serious problems. The period between 1970 and 1990 saw policy failures in almost all areas. Over the next 25 years the Swedish model went through a fundamental change, involving not only new policy instruments and settings, but also a redefinition of its overarching goals. These institutional changes largely explain the relative economic success of Sweden in recent years.

The process of change in Sweden can be divided into several distinct stages: the early social democratic reforms; the crisis and the shift of policy paradigm; debt reduction and structural reforms; and a new model emerging. As we shall see, many different actors, using many different reform strategies, were involved in the reforms that were introduced,[1] some of which were listed in Chap. 2. We shall analyze in detail this successful reform process. But first, let us briefly present the institutional and socio-economic conditions and developments that preceded the institutional changes that are the focus of this study.

The Famous Swedish Model

By 1970 the GDP of Sweden was the fourth highest in the world. Socio-economically, the Swedish society was also one of the most equal in the world, measured in terms of the Gini coefficient (Bergh 2009). This outstanding development partly coincided with the emergence of the social

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_6

democratic welfare state in the early 1930s onwards. However, it is important to understand that both the high growth rates and the increases in equality largely preceded what is commonly known as the Swedish model, with its extensive systems of redistribution, public production of welfare services, progressive income and capital taxes, high public expenditures, and high tax burden.

In fact, it is possible to distinguish between at least two distinct Swedish models preceding the present one (Lindbeck 1997; Bergh 2009; Karlson and Lindberg 2008): one in existence until 1970, largely characterized by what may be called capitalistic institutions, and one, more interventionist, between 1970 and 1990. Today a third, clearly different, model has emerged, as we shall see.

The Capitalist Model

The period from 1870 to 1970, sometimes referred to as "the golden years," was largely the result of a number of liberalizing institutional reforms in the mid-nineteenth century. Preceded by earlier land reforms and increased productivity in farming, the changes included mandatory elementary schools, the abolishment of the guild system, freedom of enterprise and enforcement of property rights, banking reforms, parliamentary reform, inheritance reform, the lowering of tariffs, and investments in infrastructure such as railroads (Myhrman 1994; Magnusson 2010; Bergh 2009, 2014).

Many of the reforms were highly unpopular at the time due to the entrenched interests of various groups, but after a lag of a decade or more, productivity and growth started to pick up. In the following decades Sweden entered the era of industrialization and saw an expansion of new businesses, a vitalization of civil society, rising exports, and rapid economic development. Many of the major global companies of Swedish origin that still exist today, as well as the major cultural institutions and social movements, were founded during this period.

Sweden also succeeded in building a state administration almost free of corruption. According to Rothstein (2008), efforts to build up countrywide networks of railroads, canals, roads, and telegraphs created a need for technological expertise among government officials. This, in turn, paved the way for recruitment based on merit in government, rather than wealth or family connections.

In the first decades of the twentieth century the franchise was extended, first to all men and then to women as well in 1921. Both liberal and conservative governments introduced various systems of social insurance, including a general pension system in 1911. Moreover, at this time the labor unions gained momentum and the Social Democratic Party started its rise to power, transforming itself from a Marxian revolutionary movement to a reformist, parliamentarian party. By the 1930s the Social Democrats had established themselves as the major political force in Sweden, a situation that would last for almost 50 years, with the exception of the period 1976–1982, when a non-socialist government held office.

At about the same time, in 1938, a central agreement, the so-called Saltsjöbad agreement, was made between the blue-collar unions—the Swedish Trade Union Confederation (or LO)—and the major employers' organization, the Swedish Employers' Confederation (SAF), covering virtually the whole private labor market. Through centralization and organizational discipline, collective agreements regulated the bargaining process, the use of industrial action, the protection of third parties, and so on. Essentials of the agreement, however, made it distinct from similar developments in other countries. First, the government was kept out of the agreement, and, second, both parties approved of technological advances, structural change, open borders and creative destruction—that is, they agreed that growth, not failing industries, should be supported (Karlson and Lindberg 2008; Lundh 2010).

In the following decades these developments, together with the fact that Sweden stayed out of the Second World War, resulted in rapid growth and social stability. A division of labor between the social democratic state, which provided social insurance and high-quality education to everyone, and the business sector and labor unions, which jointly minimized industrial conflict, led to economic development and new, better-paid jobs.

In contrast to a common misconception, the role of government was quite limited in this Swedish model, at least in terms of taxes. In 1950, Swedish tax revenues were still only around 21 percent of GDP. By 1955 the tax share of GDP was lower than in the USA and most other OECD countries. However, from the late 1960s onward, Sweden moved toward another social model, which put an end to "the golden years."

The Interventionist Model

In the 1960s the number of public employees started to increase. Women especially started to work in the expanding public monopolies in health, elderly care, and child care. Ambitious new policies in housing, public pay-as-you-go pension schemes, and social security systems added to the expansion of government responsibilities.

Later in the decade the Swedish political culture became radicalized. The Social Democrats, feeling securely established in power, wanted to extend their policy agenda to economic democracy—political and social democracy was not enough. At the same time a youth and student movement heavily influenced by Maoist and other radical ideas of 1968 joined forces with the more radical elements of the party in the wake of the war in Vietnam. The worldviews, beliefs, and values of the elites in the different spheres of society, including the public media monopolies, labor unions, academia, arts and religion, and even the non-socialist parties and parts of the business sector, started to favor interventionist policies.

An important aspect of the change involved a shift in ideas—the meaning of equality and fairness changed and was applied to policies as well as wages (Malm Lindberg 2014). During the era of the more capitalistic welfare state the emphasis had not been on equalizing income, wealth, or outcomes. Rather, the focus had been on creating equal opportunities, providing good schools for everyone, and ensuring a basic social-safety net. In the labor market the famous "solidaristic wage policy" meant equal pay for equal work, even in different sectors and companies. Now all this changed to favoring policies of equal outcomes, pay, and incomes regardless of merit or desert. Equal pay for very different kinds of jobs became the motto. School policies changed to favor equalization of skills, often at a low level. What did not come about through voluntary transactions on the market was to be enforced by politics in the name of the new understanding of equality or fairness.

Within a decade the famous Swedish welfare state emerged, with extensive transfer systems, a large public sector and bureaucracy, public production of welfare services, labor market regulations, progressive income taxes, high capital taxes, and a dramatic increase in the tax burden.

By 1970 the tax share of GDP had risen to 37.8 percent (OECD, SCB). Between 1970 and 1979, the payroll tax rose from 12.5 percent to 36.7 percent (Bergh 2009, p. 49). A value-added tax of 10 percent was introduced in 1967 and was increased until it reached 25 percent (SOU 2005, p. 57). Other indirect taxes increased as well. At the same time, the income tax system became more progressive, with a top marginal tax of 86 percent (Daunfeldt and Wallen 2013, p. 17). The number of government employees increased by 50 percent. In 1987 public expenditures amounted to no less than 52.1 percent of GDP (OECD).

Like many other countries, Sweden was affected by soaring oil prices. However, the problem worsened as a result of unwise economic policies. One of the key factors in Sweden's stalled economy was the switch to Keynesian policies, as politicians tried to balance Sweden's economic cycles by increasing and decreasing public spending. As a consequence, inflation rose to unprecedented levels. Between 1975 and 1976 wage increases amounted to over 40 percent (Bergh 2009, p. 50).

In the 1970s many Swedish industries started to suffer from structural and productivity problems. The government responded by giving extensive subsidies to troubled industries and by constantly devaluing the Swedish currency to keep exports up. However, this strategy did not solve the underlying problems, and uncompetitive businesses were kept alive even though they would not have survived without the help of the state.

Moreover, the earlier policy of non-interference by the government in labor markets was abandoned. A number of labor market regulations were introduced, including employment protection legislation and various forms of labor union participation on company boards. Sweden gradually moved to a system resembling the systems in Continental Europe, with government involvement in wage setting, state ownership of ailing industries, and income policies. Furthermore, the constant currency devaluations affected employees' salaries negatively, despite high nominal increases. Industrial conflicts soared. This pattern was repeated over and over again as the devaluations continued. In two decades, from the mid-1970s to the mid-1990s, nominal wages rose by several hundred percent while real wages did not increase at all (Medlingsinstitutet 2016).

On top of this the Social Democrats, heavily influenced by the Swedish Trade Union Confederation, in 1976 pushed for a gradual socialization of Swedish industry through something called the wage earners' funds. This was a system of union-governed funds created by taxes on the profits of private companies. According to the estimates by the governmental commission making the proposal, within a couple of decades ownership of Swedish industry would be in the hands of labor union officials (Furåker 2016). According to Lindbeck (1997, p. 1277), the proposal could be seen as "a unilateral cancellation of the implicit 'cooperative contract' between labor and capital."

Even the electorate thought this was a bit too much. The proposal, together with broad resistance to government policies regarding nuclear power, led to a temporary loss of government for the Social Democrats between 1976 and 1982. However, the non-socialist, center-right government continued and even extended interventionist welfare state policies in almost all other areas. The beliefs, values, and worldviews of the famous Swedish model held a firm grip on the country. And when the Social Democrats came back to power they continued on the established path and immediately started to implement the wage earners funds.

This transition toward a more extensive and interventionist welfare state reduced entrepreneurship, as taxes and regulation hindered the development of private businesses. It also crowded out private employment. On net, virtually no new jobs were created in the private sector from 1950 onwards. The increases in employment all occurred in tax-paid public jobs (Bjuggren and Johansson 2009).

Furthermore, the high marginal taxes not only weakened the incentives to work, they also encouraged tax avoidance and tax evasion. Since tax-deductible interest allowed some people to pay as little as 13 percent of their interest costs, borrowing for consumption became a popular alternative. High inflation also meant that the value of such debts would decrease rapidly (Bergh 2009, p. 51).

A vast expansion of the public sector may have made the Swedish society look promising from the outside, but in reality things were starting to fall apart. In a final desperate attempt to control the developments in the spring of 1990 the Social Democrats proposed legislation that combined price and wage-fixing and made strikes unlawful. A year later they lost the elections, indicating the start of a new era.

To summarize, the interventionist Swedish model resulted in a large number of policy failures:

- Macroeconomic failures: devaluations, inflation, expanding public expenditures
- Tax failures: tax avoidance, weak incentives to work
- Microeconomic failures: few start-ups and few entrepreneurs, weak industrial transformation, few new jobs created
- Labor market failures: industrial conflicts, stagnating real wages
- Welfare failures: weak incentives to work, welfare dependency

These failures triggered the welfare-enhancing reforms in the coming decades.

New Ideas and Policy Entrepreneurs

By the 1980s Sweden was caught in a highly undesirable, inefficient economic and social situation. The institutions and policies of the interventionist welfare state interacted with the economic and social conditions to produce severe policy failures.

In spite of these failures, the barriers to reform were massive. The status quo was heavily ingrained with special interests protecting their subsidies and privileges. Many potential reforms would involve tangible losses to concentrated groups of welfare recipients and regulated sectors, while the gains were diffuse and uncertain. No organized interest appeared to have the incentive to bear the cost of promoting reforms, while many well-organized groups had strong incentives to oppose them in order to maintain their existing benefits. Moreover, cognitive biases made voters and organized interests react more negatively to potential losses in welfare (compared to increases). The dominating values and beliefs in Sweden embraced the existing welfare model. Sweden seemed to be caught in an ideational trap where public opinion and preference falsification would block any reforms that were attempted.

This is when a number of policy entrepreneurs entered the scene and started to introduce new ideas, which slowly shifted the direction of the policy cycle. Four more or less independent groups stand out: (1) the SAF and the Moderate Party; (2) young social democrats and economists at the Ministry of Finance; (3) The Centre for Business and Policy studies (SNS); and (4) two business entrepreneurs.

Perhaps the most important policy entrepreneurs and advocates of new ideas were within SAF. But the young Social Democratic economists at the Ministry of Finance had crucial roles too (Boreus 1994; Johansson 2000; Malm Lindberg and Ljunggren 2014).

Interestingly, the main focus of SAF was the promotion of new ideas, beliefs, and values, largely using Kuhnian strategies and narratives, rhetoric, and new authorities to frame and redefine discussions, and agendas with the explicit goal of achieving a long-term paradigmatic policy shift. Thus the massive resources of one of the major organized interest groups were combined with new, future-oriented ideas.

When the Social Democrats had started to push for more and more radical proposals in the 1970s, key business representatives had realized that something had to be done, despite the fact that they all were involved in the Swedish model of collective bargaining and at least implicitly had agreed to the division of labor between the social democratic state and the business sector. The new labor market regulations, the rapidly rising tax levels, and the socialist wage earners funds were simply too much for them.

As early as 1971 Sture Eskilsson, then a junior member of the communication department of SAF, had written a short—but today famous—policy paper advocating the active promotion of market-liberal ideas to try to stop the socialist and interventionist policies of the time. Intellectuals and academics, not primarily politicians, should be the main targets of the proposed campaigns, he said. According to Eskilsson, successful policy change could only be achieved through (1) the long-term promotion of ideas; (2) supporting individuals willing to promote ideas; and (3) active interaction with media and public opinion makers. Then, when public opinion had changed, policy-makers would follow and make the appropriate policy changes (Eskilsson 2005).

In 1976 Curt Nicolin, the leading CEO of the Wallenberg business group, the major capitalist family of Sweden, was made chairman of SAF. Along with Eskilsson, Nicolin promoted market-liberal ideas in Sweden. Through their combined efforts, together with other idea-oriented members of SAF such as Olof Ljunggren, Carl-Johan Westholm, and Janerik Larsson, they turned the organization into a staunch defender of individual liberty, free markets, and the open society. That was not an easy task for an organization previously almost exclusively engaged in the administration of corporatist labor market arrangements, and it occurred only after an internal struggle (Ehrenkrona 1991; Johansson 2000; Interview, Westholm 2012).

Over a period of more than 15 years SAF launched major campaigns promoting individual initiative, profit-making, choice in schools and child care, private radio, and so on. Free-market think thanks were set up, in particular Timbro, to introduce new ideas into public discussions, with generous funding from SAF. Popular books explaining the virtues of capitalism were translated and published, also with the highest academic standards within the Ratio Publishing House. Moreover, private child care centers, private radio channels, and even a private university were set up to influence public opinion and to change established worldviews. In addition, concrete policy proposals concerning everything from tax cuts and labor market reforms to constitutional changes were made by different organizations sponsored by SAF (Svanborg-Sjövall 2011). Together these individuals and organizations created an informal coalition for the advocacy of market-liberal policies.

At the same time SAF deliberately cultivated talented politicians who favored market-liberal ideas, especially from the Moderate Party, which in the early 1970s had made a turn away from conservatism to liberalism under the leader Gösta Bohman. But young politicians from the Liberal People's Party and the Centre Party, too, were engaged in a number of projects promoting a new start for Sweden.

The Moderate Party became the leading opposition party and the major parliamentary proponent of institutional changes in a liberal direction during the 1980s, favoring privatization, deregulation, and the depoliticization of society. However, these kinds of ideas were still considered controversial both by the public and by the media. For example, in the election of 1985 the Moderate Party failed to win support for a platform arguing for "a shift of system" (Ljunggren 1992; Tobisson 2009).

These ideational developments in Sweden were also spurred by a global ideological paradigm shift, although the shift would take place later in Sweden than in many other countries. Margaret Thatcher had come into power in 1979, initiating a formidable change in policy perspective in the UK, and Ronald Reagan was elected president in the USA in 1981, making similar reforms, including radical cuts in marginal tax rates and attempts to decrease the role of government in society.

In 1974, in Stockholm, Friedrich Hayek was awarded the Swedish Riksbank's Prize in Economic Sciences to the Memory of Alfred Nobel, to be followed in 1976 by Milton Friedman, both staunch defenders of the market economy. Other prizes with the same orientation would follow the coming years, for example, George Stigler in 1982, James Buchanan in 1986, Ronald Coase in 1991, and Gary Becker in 1992. These awards indicated a shift away from Keynesian to more supply-side and market-liberal ideas among leading economists (Karlson 2009).

In 1980 a regional meeting of the Mont Pelerin Society, attended by Hayek, was organized in Stockholm, sponsored by the SAF. Moreover, yearly conferences and seminars involving leading Swedish academics and business leaders were organized to increase the credibility of the free-market ideas that slowly had begun to penetrate Swedish society.

A significant turning point in public opinion took place in October 1983 when 100,000 business leaders and entrepreneurs, especially from family firms, demonstrated on the streets in Stockholm against the wage earners funds. Slowly but steadily the spiral of silence and preference falsification of public opinion in Sweden began to weaken.

Parallel, but largely unconnected to the developments described above, was an emerging skepticism within the Social Democratic Party about the prevailing policies. This began around 1980, in particular among younger economists in the so-called Economic Club and later on within the Ministry of Finance (Malm Lindberg and Ljunggren 2014).

Largely influenced by the policy failures of the Keynesian policies of the mid-1970s and the catastrophic results of the industrial policies implemented by the non-socialist government in 1976–1982, but perhaps most importantly by the disastrous election result in 1979, a number of younger Social Democratic economists had started to discuss and advocate alternative policies. On the initiative of Carl-Johan Åberg, together with Erik Åsbrink, they joined forces and started the Social Democratic Economic Club in order to convince the party leadership of the necessity of adopting new ideas and worldviews. Economists working in both governmental departments and the party headquarters, as well as Social Democratic economists at university departments, were members.

The leading figures in the group, called the *Sixlings* (they were six in number), were Villy Bergström, Klas Eklund, Harry Flam, Carl B. Hamilton, Nils Lundgren, and Karl-Göran Mähler. They would all play important roles in the early stages of the reform process and all six would make great careers, not only in politics as Social Democrats, but also in banking. They were also known as "Kjell-Olof Feldt's boys," due to their close connection with the Social Democratic minister of finance in the 1980s, Kjell-Olof Feldt (Bergström 1987).

In contrast to SAF and the Moderate Party, their goal was to save the welfare state, to make it more efficient, and to adapt it to a changed world, a world without stable currencies and the Bretton Woods system, and with increased international competition and mobility of capital and labor. According to their analysis, a small open economy such as Sweden was strongly dependent on foreign trade and would have to bring its policies into line with those of its main competitors—or risk the loss of its most productive assets and people. They wanted to adjust the policy instruments and instrument settings of the welfare state, not to change its overarching goals, to use the terminology of Peter Hall. This group would have wide access to the system of government investigations and expertise.

Undoubtedly, they were also influenced by the reforms in other advanced democracies and the new ideas and findings of academic economists. But it was largely the real-world problems of the Swedish economy that triggered their willingness to reconsider the policies of the welfare state (Malm Lindberg and Ljunggren 2014).

These policy entrepreneurs sought reform in a number of areas: the macroeconomic regime of Sweden and in particular the regulation of financial markets, the organization of the public sector, agricultural policies, and the tax system. As we shall see in the next section, this group became very influential during the early Social Democratic reforms.

A third important group of policy entrepreneurs emerged within the SNS. This is an independent think tank, largely financed by private business, but viewing itself as a bridge between the labor movement and the business sector. If SAF attracted the more hard-core market liberals, SNS had a leaning toward social liberalism and more "right-wing" social democracy.

In the early 1980s, during the center-right government, the SNS under Bengt Rydén initiated a "crisis group" consisting of leading Social Democrats. These included the former Social Democratic prime ministers Tage Erlander and Olof Palme, the leader of the metal workers' union, and a number of prominent business representatives. The explicit motive was to re-establish a culture of consensus and compromise in order to take Sweden out of the ongoing crisis. Even the question of the wage earners funds should be open to discussion and compromises, they believed (Ullenhag 1998, p. 110). However, the group dissolved when the Social Democrats returned to power in 1982.

The SNS nevertheless continued its publications and conferences on economic and social policies. In particular, the yearly reports of the Business-cycle Council, written by leading economists of the time, often including one or several of the *Sixlings*, became enormously influential both in public discussions and in university teaching. Under the new leadership of Hans Tson Söderström, which began in 1985, SNS placed particular emphasis on advocating a new macroeconomic policy with a fixed exchange rate and inflation targeting, combined with deregulation of the credit and financial markets. This directly influenced government policy (Söderström 1996). In addition, SNS publications had an impact on institutional reforms in areas such as housing and agricultural policies, as we soon shall see.

A last category of agents, two business entrepreneurs, should be mentioned. They were both primarily entrepreneurs in the standard sense, successful businessmen who created innovative companies in previously unregulated areas. While doing so, however, they also promoted institutional change on a wider scale. Both used opportunities created by the new digital technologies to challenge the existing state monopolies in telecommunications, television, and the stock exchange (Jörnmark 2013).

Jan Stenbeck was the founder of Vodafone, Tele2, and a number of other mobile or cell phone companies. Because regulations and vested interests blocked his innovations in the USA, he moved back to his country of origin, Sweden. There he managed to get hold of an existing license for a "business telephones" company. In the early 1980s he transformed and built it into one of the first mobile phone companies in the world, despite severe resistance from the Swedish state-run telephone monopoly. On this foundation he went on to create a worldwide business. At the same time he invested in a satellite, making it possible to broadcast television from London to a Swedish audience, all commercially financed—and all illegal by Swedish law.

Olof Stenhammar, also with a US background, created the world's first digital market for options and derivatives in Stockholm in 1983, again despite fierce opposition from the stock market establishment, including the main owner, the Swedish state. However, within less than a decade the old stock exchange had been merged with the new entrant, and subsequently merged again with Nasdaq in New York.

In both cases the entrepreneurs actively created, through bargaining with pragmatic Social Democrats, the new institutional frameworks necessary to run their businesses. Moreover, as prominent and controversial public figures, they showed that the so-called natural monopolies—"natural" being the justification for state control—were in fact not all that natural, since private alternatives could be established. This revelation had a huge impact on public perception in other areas as well.

Financial Deregulation and Early Social Democratic Reforms

While the ideational background was slowly changing, the Social Democrats regained power in the election of 1982. The new government, led again by Olof Palme, had to start focusing on the poor performance of the Swedish economy.

Even before winning the 1982 election, leading economists and politicians among the Social Democrats had started to discuss possible solutions to the country's economic problems (Malm Lindberg and Ljunggren 2014), as mentioned above. The economic strategies of other countries were discussed, and it was noted that several leading governments were trying to keep inflation low, partly through harsh economic austerity measures.

The primary example was Great Britain. Even though Margaret Thatcher did not become a role model for the Swedish Social Democratic Party, her success over the British Labour Party was seen as a warning of what could happen in the future. The UK, just like Sweden, suffered from an uncompetitive exports industry and high inflation, and the Labour Party had lost the election after failing to make successful deals with the trade unions. The Social Democrats also looked to the French Socialist Party, which won the French election of 1981. After staging a large Keynesian experiment, which became a huge failure, France, too, started to implement economic austerity measures (Feldt 1991, pp. 56, 64).

Sweden's poor economic performance, in particular the high inflation and increasing budget deficit, in combination with inspiration from other countries, resulted in some early Social Democratic reforms: the deregulation of the credit and foreign exchange markets, the start of a process toward deregulation of other state-regulated markets such as energy and airlines, and the sale of several state-owned companies. The aim was to save the beloved welfare state.

However, before reforming and liberalizing the Swedish economy, the Social Democrats decided to start off with a last devaluation to kick-start the economy. The previous government had devalued the Swedish krona by 10 percent in 1981, a measure heavily criticized by the Social Democratic opposition. During a dinner the coming undersecretary at the Ministry of Finance, Erik Åsbrink, along with his colleague Michael Sohlman, suggested a so-called super-devaluation to Feldt, the minister of finance. They had been inspired by a 30 percent devaluation that took place in Sweden in 1949, which was said to have accounted for the Swedish industrial expansion and the general economic growth through the entire 1950s (Malm Lindberg and Ljunggren 2014).

Both Feldt and Palme realized that the devaluation was a gamble—the record of previous attempts made it less than promising. In one of their last conversations before it was decided, Palme said to Feldt: "I believe in making a killing. It fits my temperament the best" (Feldt 1991, p. 63). The new government chose to devalue the krona by 16 percent in 1982, which for a while boosted Swedish exports, but again led to high inflation and reinforced the underlying economic problems (Jonung 1999, p. 188).

But then the Social Democrats started the era of reforms—including financial deregulation; agricultural reform; the start of deregulation of energy; public sector reform; reform of postal, telephone, railways and airline markets; sales of state-owned companies; and a major tax reform, lowering marginal income and capital gains tax rates. We shall now take a closer look at some of these.

Financial Deregulation

In 1982 the Swedish financial sector was heavily regulated. Banks, insurance companies, and other institutions were subject to lending ceilings, placement requirements, and interest regulations, all designed to finance government budget deficits and various programs for residential investments.

However, in 1983 the Social Democratic government abolished the liquidity ratios for banks (the regulation that sets the minimum reserves each bank must hold), and interest ceilings were lifted in the spring of 1985. In November 1985, the ceilings on loans were eliminated in a move known as the "November revolution." Banks and companies could now offer credit to whomever they liked, without having to follow any restrictions regarding price or quantity (Englund 1999; Svensson 2002a).

The decision to deregulate the financial market was not preceded by any extensive negotiations within the Social Democratic Party, nor a public debate. However, the Swedish Central Bank, the Riksbank, actively promoted the reforms and was responsible for some of the decisions (Bäckström 2003, p. 8). Feldt remembers being contacted by the Riksbank, which suggested the reforms (Feldt 1991, p. 260). Moreover, a couple of public investigations had analyzed the pros and cons of financial deregulation.

In some respects, the reforms should not have come as a surprise. Due to new technology the financial markets were becoming more and more digitalized, a fact that entrepreneurs such as Olof Stenhammar had taken advantage of. Completely new financial products were introduced, also as a result of influences from other financial markets around the world. As mentioned, there were no regulations in place regarding those new financial products, so trading could start without any governmental restrictions.

A so-called gray credit market emerged, a market which was both legal and illegal, where large corporations, unregulated financial actors, and commercial banks found sophisticated ways to avoid the old laws and regulations. In an interview Bengt Dennis, the head of the central bank, remembers the hopeless situation: “They laughed at us. They had developed such effective techniques that they could manage just any restrictions on credits” (Svensson 2002b, p. 201).

The argument in favor of deregulation was thus that the existing regulations had lost their efficiency and created distortions in the market, resulting in a growing gray market. Also, no one expected any substantial increase in lending as a result of deregulation. Instead, it was assumed that the main part of the credit expansion would consist of transfers from the gray to the common market (Svensson 2002a, b).

Moreover, Olof Palme, the prime minister, did not seem to bother much about what happened to the financial sector. When Feldt approached him to discuss the Riksbank’s suggested reforms, Palme simply said: “Do as you wish. I don’t understand it anyway” (Feldt 1991, p. 260). Which Feldt did. The new reforms were adopted and during the coming years more would follow. In 1989, the law allowing only the central bank to trade with foreign currencies was abolished, and the financial market continued to grow (Bergh 2009, p. 63).

It should be obvious that this is a case of what I call a Machiavellian reform strategy. As Feldt (1991, p. 260) notes, the deregulatory steps went against Social Democratic ideology. They could be seen as retreats in favor of market liberalism, an ideology which the Social Democrats had spent much time opposing. Nevertheless, the policy entrepreneurs within the party and the Ministry of Finance, as well as in the Riksbank, pushed the reforms through, doing their best to hide or obfuscate the consequences of the policies to party members, labor unions, and the voters.

It has been suggested that the decision to deregulate the domestic credit market during the 1980s caused the financial crisis in the 1990s. That, however, is misleading. The crisis in the 1990s was the result of the interventionist welfare state of the 1970s and 1980s causing a series of policy failures. However, the deregulation did contribute to the overheating of the Swedish economy (Jonung 1999, p. 281). With the rapid expansion of credit, private sector debt grew from 100 percent to 150 percent of GDP in only five years’ time, and a bubble was created (Bäckström 2003). This was to be the start of the home-made Swedish financial crisis a few years later.

Deregulation and Privatization

During the late 1980s and early 1990s several Swedish product and service markets were deregulated or liberalized. Among them were the energy, postal, telephone, railway, and airline markets. These kinds of reforms are often associated with the political parties of the center-right coalition, which won the election of 1991. However, this transformation of the public sector had started in the 1980s under the Social Democrats.

At the start of the decade these markets were controlled by public monopolies, organizations that can best be described as a cross between a normal public authority and a state-owned company. Public enterprises such as the Post Office Administration (Postverket), the Swedish Telecommunications Administration (Televerket), the Swedish State Railways (Statens Järnvägar), and the State Power Board (Vattenfall) were obliged to fulfill political objectives as well as meet financial targets (Berg 1999, p. 159; Malm Lindberg and Ljunggren 2014).

The Moderate Party had already in the late 1970s proposed that all public enterprises be made into corporations and that either the entire public enterprises or some of their tasks should be privatized. One would have expected the Social Democratic governments of 1982–1991 to take a strong stand against such developments, but during the 1980s they took a more liberal and pragmatic view and started to favor more market-oriented public enterprises (Berg 1999, p. 263).

In fact, according to the Regulatory Reform Commission appointed by the Social Democrats in 2003, it is impossible to tie the liberalizations to a specific government, a sole governmental investigation, or a single parliamentary decision. Instead, the commission describes it as a step-by-step process, which lasted over a long period of time and several different administrations (SOU 2005:5, p. 151).

The first measures were aimed at strengthening the autonomy of the public enterprises, moving regulatory tasks and infrastructure over to other organizations, and opening up the monopolies of public enterprises to competition (Berg 1999, p. 160). Then, at the beginning of the 1990s, several public enterprises were converted to limited liability companies.

In addition, markets were opened up to competition. This included not only telecommunications, electricity generation and distribution, postal services, and the railway, but also the aviation market and taxi services. Now in opposition, the Social Democrats expressed negative attitudes toward the reforms, concerned that the proposed new laws were not sufficient guarantee for the fulfillment of social goals (Berg 1999, p. 264).

Another factor that affected the deregulation and liberalization was the emergence of several private companies, which started to compete with the state monopolies. The examples of the entrepreneurs Jan Stenbeck in telecommunications and television and Olof Stenhammar in the stock exchange have already been mentioned. Another example was the private company City Mail, a mail delivery service, which claimed that its services were not included in the postal monopoly and that they therefore should be allowed to continue with their mail delivery. Shortly after the emergence of City Mail, a proposal to abolish the postal monopoly was put forward to the parliament. The Social Democrats protested, claiming that the center-right coalition supported the proposal only in order to satisfy City Mail (Berg 1999, p. 181). However, the law passed without the support of the Social Democrats or the Left Party, and the postal monopoly was abolished in January 1993.

One significant event in the explanation of the deregulation and privatizations was the change of government in 1991 to a center-right coalition led by the Moderate Party, but according to Berg (1999, p. 247) there are several possible explanations as to why these markets were liberalized in the first place. Berg considers party-strategic reasons and changed parliamentary conditions as the least likely explanations. The conduct of the state-controlled enterprises, which in some cases supported deregulation themselves, and technological innovation are plausible factors, but Berg sees ideological changes, the economic crises, and the international political development as the most likely causes.

This perspective is confirmed by the Regulatory Reform Commission (mentioned above). The commission identified the problematic economic situation of the 1980s, with its high inflation, low growth, low productivity, and a low degree of savings, as the key reason behind the reforms (SOU 2005:4, p. 152).

One notable characteristic is that none of these reforms were preceded by any extensive discussions among economists or the general public. According to Calmfors (2012, p. 20), international influences seem to have been the main drive toward deregulation, especially the earlier developments in the USA and the UK. The need for Sweden to adapt to European Union competition and anti-trust legislation was another factor, with the Swedish membership application being handed in by the Social Democratic government in July 1991.

In conclusion, then, these institutional changes toward privatization took place as a consequence of (1) changed economic conditions causing policy failures, (2) the influence of beliefs and examples from other countries, which opened up the opportunity for new kinds of entrepreneurship, and (3) largely pragmatic Popperian reform strategies. The low level of public discussion also indicates that the Social Democrats used Machiavellian elements to make possible decisions that they thought were economically necessary.

Agricultural Reform

Another early Social Democratic reform was the agricultural policy reform of 1991. Since the 1930s, Sweden had had a policy aimed at self-sufficiency in food production to protect the country from food shortages during a war or other crisis. The *war-preparedness policy* (beredskapsmålet) meant that Sweden should maintain agricultural production capabilities above the level required for peacetime production.

The farmers were subsidized by artificially high consumer prices, which in turn were maintained by various import taxes and export subsidies. The policy resulted in increased production and food surpluses. It was also very expensive; for example, in the late 1980s almost one-third of cereals production had to be supported by state subsidies (Daugbjerg and Studsgaardt 2005, pp. 110–111).

The prices, taxes, and subsidies were decided in negotiations between the government and the Federation of Swedish Farmers (LRF). The system was perceived to be so complex that only a handful of experts could understand and interpret the Swedish agricultural policy. All major political parties, however, defended the policy, as did the bureaucrats, NGOs, and leading politicians (Lindberg 2008, 2012, p. 40).

What sparked the reform process was a 1984 book, *The Power over Food* (Makten över maten), written by two university professors and an official from the Swedish Industrial Association (a sister organization to SAF), and published by the SNS. It analyzed the agricultural policy from a totally new perspective: public choice theory. The conclusion was that the market regulations resulted from the immense powers of the established interests of the "iron triangle" of producers' organizations, politicians, and bureaucrats, at the expense of consumers and taxpayers. (Lindberg 2012, p. 40).

This triggered a public debate about agricultural policy, which, due to the high inflation, was also drawn into broader macroeconomic discussions. Minister of Finance Feldt took the opportunity to redefine the issue of agricultural support from a question of supporting farmers' incomes to a question of conducting sound economic policy (Daugbjerg and Studsgaardt 2005, pp. 112–115). Consequently, he removed agricultural policy-making from its traditional arenas to arenas where he could control the reform process.

Mats Hellström, as minister for agriculture in 1986, was given the task of reforming the agricultural policy (Lindberg 2012, p. 47). He was known as a "free-trader" who supported radical reform, a fact that helped the Ministry of Finance to strengthen its positions within the Department of Agriculture. Moreover, two political officials were transferred from the Ministry of Finance to the Department of Agriculture and assigned to lead the reform process. One of these officials, Michael Sohlman, a close associate to the undersecretary of state at the Ministry of Finance, later appointed chairman of the parliamentary working group, was assigned to draft a reform proposal (Daugbjerg and Studsgaardt 2005, p. 113).

The status of the parliamentary working group was unique. The group allowed the Federation of Swedish Farmers to participate in only a limited number of meetings, and largely excluded it from the preparation of the report. The 1991 agricultural policy reform was set to abolish the internal regulation of prices over a transition period. Guaranteed minimum prices and export subsidies would go, and the transition measures, which included direct payments to the farmers, would be phased out within a three-year period (Daugbjerg and Studsgaardt 2005, p. 111). In the end, all political parties, except the Green Party, supported the reform proposal (Lindberg 2008; Malm Lindberg and Ljunggren 2014).

However, the agricultural deregulation was never fully carried out. Sweden joined the European Union in 1995, which also meant joining the Common Agriculture Policy and re-regulating Swedish agriculture. This coincidence has been discussed to some extent, but there are no indications that the prospect of EU membership had any influence on the decision to deregulate (Daugbjerg 1998, p. 141; Rabinowicz 1999, p. 218).

Again, we have a case where a reform process was initiated by new ideas and beliefs propagated by policy entrepreneurs, in this case directly or indirectly the Swedish Industrial Association and SNS. They interacted with like-minded actors within the Ministry of Finance to form a policy-advocacy coalition, which outmaneuvered the extremely well-organized special interests protecting the established institutions. Kuhnian strategies of framing and shifting the perspective to redefine discussions and agendas played a key role in the process, but there were also elements of

Machiavellianism, such as splitting the opposition within the Ministry of Agriculture by appointing outside experts and keeping the farmers' federation out of the decision process.

A Major Tax Reform

The interventionist Swedish model of the 1970s and 1980s was characterized by a tax system with a high degree of progressivity. In the beginning of the 1980s, the marginal tax on income reached 85 percent. Due to the high inflation and rapidly rising wages more and more people reached levels of marginal tax rates that had been intended only for a few high-income earners. As a consequence employees demanded even higher wages to compensate for the high marginal taxes, with the result that wages rose even faster.

At the same time, while the tax rates were high, the tax base was remarkably small. The tax system might have looked very progressive at first glance, but in reality high-income earners and large industries were compensated through many tax deductions, tax exemptions, and tax-free benefits. The complexity of the tax system made it profitable to hire tax advisors, who knew which loopholes to exploit. All of this meant that the net effect of the tax system in the end differed very much from the formal tax levels (Santesson 2012, p. 128).

Consequently a tax reform was badly needed. The reform process can be dated all the way back to 1981 and the "wonderful night" agreement between the Centre Party, the Liberal People's Party, and the Social Democrats, the latter then in opposition. This agreement substantially lowered marginal tax rates. However, due to the high inflation this soon had little or no effect (Santesson 2012, p. 123). The failure of the 1981 tax reform resulted in calls for a larger reform in order to make the tax system more rational and efficient.

However, such a reform faced enormous resistance not only from different interests protecting the privileges and deductions in the existing system, but also because values and beliefs about fairness and equality, especially within the ruling Social Democratic Party favored a system of high marginal taxes to support the welfare state and high levels of redistribution (Feldt 1991, p. 307)

Despite such opposition, in 1990 a reform humbly called "tax reform of the century" was implemented by the Social Democratic government. It consisted of a reduction of the highest marginal tax rate on earned income from 73 percent to 51 percent, and a lowering of capital gains taxes to 30 percent, creating a dual tax system, which had not existed before. Moreover, corporation taxes were cut to 30 percent. At the same time the tax base was widened by abolishing most of the tax deductions and exceptions, and a uniform VAT of 25 percent was applied to most goods and services.

The reform was not intended to result in a change in the overall tax burden. Rather, it was supposed to be revenue-neutral, with every tax loss being fully compensated by new tax revenues in other areas. The idea was to diminish the negative effects of the tax system on the economy.

The Swedish reform fit the worldwide movement toward income taxes characterized by broader bases and lower rates (Norrman and McLure 1997, p. 146). Those reforms, like the American tax reform of 1986, put pressure on Sweden to question its high tax rates, but much of the Swedish tax reform effort seems independent of the changes in the USA (Norrman and McLure 1997, p. 147). The Swedish reform was also substantially more ambitious, measured in terms of the loss in revenue caused by lowering the tax rates. The Swedish reform involved a loss of revenue of 6 percent of GDP compared to 1–2 percent of GDP in the USA (Birch Sørensen 2010, p. 61). Again, the young economists at the Ministry of Finance played a key role.

A governmental investigation on corporate taxation had begun in 1985, but the real starting point of the reform process was January 1986, when the undersecretary at the Ministry of Finance, Erik Åsbrink, arranged a two-day meeting at the finance department. Two parliamentary investigations, RINK (on reformed income taxation) and KIS (on reformed indirect taxation,) began in June 1987. Åsbrink led the work with both investigations, a process involving so little transparency that not even Finance Minister Feldt was fully informed about the progress (Santesson 2012, p. 132). Normally, both the governing Social Democratic Party and various organizations and labor unions would have been part of an investigation of this size, but this time, the investigation kept a very low profile.

This is understandable, since despite many attempts by Åsbrink and his reform-oriented colleagues to influence public opinion, neither the public nor the Social Democratic Party and its congress favored any radical tax reforms in the 1980s (Steinmo 1993, pp. 157–158). In fact, as late as in the election campaign in 1988 the Social Democrats chose the Liberal Party as their main adversary, fiercely attacking its proposal to lower marginal tax rates. All such policies were portrayed as "unfair" and threatening to the welfare state (Bennett and Åsard 1995, pp. 17–18).

Less than a month later, however, after the Social Democrats won the election, the finance ministry began to mobilize support for much more radical and ambitious reform, first at the top governing board of the party, next among the supporting labor unions, and lastly in negotiations with the Liberal Party. Internally, the main strategy was to show that the present tax system was unsustainable, counterproductive, and in fact unfair because rich people in practice could use loopholes to avoid the high tax rates. Externally, the main strategy was now to deliberately make the Moderate Party the main adversary, painting that party as the defender of the status quo.

In the final phase of the negotiations, the Social Democrats made some changes in order to satisfy the demands of the Liberal Party and to compensate certain groups protected by the Swedish Trade Union Confederation (LO).

Finance Minister Feldt summarizes that successful reform process as a combination of the following factors: external pressure to reform, long-term public opinion work, public investigations isolated from party participation, convincing the party by surprise and force, deliberately framing who is the adversary, and using pragmatic compensations when needed (Santesson 2012, p. 149).

In my terminology, a reform of this magnitude necessitated the extensive use of all three reform strategies. Everything from rational argumentation, to framing, to shrewdness and scapegoating was used. Again Machiavellian strategies clearly dominated the process in this early Social Democratic reform. And again a policy-advocacy coalition of centrally placed economists had a key role.

Crisis and Shift of Policy Paradigm

Despite these early reforms, the Swedish economy was in a more or less constant crisis all through the 1980s. All kinds of macroeconomic, tax, microeconomic, labor market and welfare failures characterized the interventionist Swedish model. The Social Democratic reforms were simply too few and too limited to solve the underlying structural problems. Also they may have been badly sequenced and timed.

The deregulation of the credit market in 1985 resulted in a surge in lending by commercial banks, which led to a real-estate price bubble.

Also, wages and prices rose much faster in Sweden than abroad and the level of unemployment was less than 2 percent during 1989–90. The economy was severely overheated (Jonung 1999).

At the same time the Social Democratic Party experienced a series of internal crises. Following the assassination of Olof Palme, the Deputy Prime Minister Ingvar Carlsson assumed office in 1986. A conflict between the labor union federation and the Social Democratic government started, commonly known as "war of the roses," named after the party symbol of the Social Democrats.

One of the issues that deeply affected the relationship was the wage earners funds, which had been adopted in a watered-down version in 1983. The funds were, as previously mentioned, to be union-controlled and tax-financed, designed as a way of enabling the unions to take over the majority of the ownership of Swedish corporations on the stock market. However, neither the Social Democratic leadership nor the electorate really liked the idea.

A second issue of conflict consisted of a deal that Prime Minister Ingvar Carlsson and the Social Democratic government tried to strike with the labor unions and the employers' confederation. Carlsson had realized that something had to be done about the rapid wage increases and the inflation-wracked economy, and tried to make LO and SAF agree upon a freeze of wages for 1990–91.

When the negotiations failed, Carlsson together with Feldt and Stig Malm, chairman of LO, constructed the so-called stop-package, which was presented by the government in February 1990. The package included a price freeze, a halt in dividend payments, a freeze on municipal tax, and a strike ban—but not a wage freeze.

Although Carlsson had succeeded in making both the chairman of LO and the chairman of SAF support the stop-package, Finance Minister Feldt eventually declared that he did not believe that the package would have any significant effect on the rapidly deteriorating financial situation (Johansson and Magnusson 2012). A few days before the proposal was put to a vote in parliament, Feldt resigned. When the stop-package did not pass in parliament, the Carlsson government also chose to resign. By the time that Carlsson had succeeded in forming a new government, the crisis had deepened.

In this situation many members of the elites in Sweden realized that the current system of policies was unsustainable. The formative moment in which more fundamental changes of the Swedish model would be possible was coming closer. One clear sign was the sudden application for membership in the European Union by the Carlsson government just before the 1991 election, despite the Social Democrats' fierce opposition to do so up until this point. However, the really eye-opening crisis lay more than two years ahead.

An important factor behind these focusing events was foreign exchange policy. For almost two decades, following the breakdown of the Bretton Woods system, Sweden had tried, despite recurrent devaluations, to pursue a policy of fixed exchange rates. This later became known as the *norm policy*, most heavily promoted by SNS and Hans Tson Söderström. It was favored by a small but influential elite of economists and policy-makers in the Social Democratic Party in the late 1980s and in the coalition government that came to power in September 1991 (Blyth 2001, pp. 17–18). The belief was that holding on to the norm of a fixed exchange rate would both make the economy work better and make the government more prudent.

A New Policy Paradigm

The election of 1991 came in the wake of the severe economic crisis, the de-legitimization of the Social Democratic government, the fall of the Berlin Wall in 1989, and the crumbling of the Soviet empire. A center-right coalition, led by the Moderate Party and its leader, Carl Bildt, won the election by promoting a market-liberal agenda. They explicitly wanted a new Swedish model, arguing that "society should be bigger than the state." The new prime minister, echoing Margaret Thatcher's slogan "There is No Alternative," called the policy of reducing the welfare state "The Only Way Policy" (Agius 2007, p. 591). In addition to focusing on deregulation and privatization, the coalition promised to put an end to the wage earners funds, introduce a school voucher system, obtain labor market and higher education reforms, introduce choice in health, elderly and child care, and so on.

Almost all these institutional changes were implemented over the course of the three years (1991–1994) the coalition remained in power. This coalition of the Moderate, Liberal, Centre, and Christian-Democratic parties was well prepared. As far back as 1985 both Bildt and Bengt Westerberg, the leader of the Liberal Party and deputy prime minister, had participated in a project called *The Market Economic Alternative for Sweden*, sponsored by SAF, which outlined the content of several of the reforms to come. Moreover, in a joint election manifesto called *A New Start for Sweden* the Moderate and Liberal parties had laid out the course for the new government. When it came to economic policies, the coalition could count on the support of a new party in parliament, *New Democracy* a small populist right-wing party. That created a majority that facilitated the reform process.

An example of the institutional changes is the school voucher system introduced in 1992. Inspired by the theories developed by Milton Friedman, the government allowed privately operated schools to compete for students with public schools on an equal financial basis (Blomqvist 2004, p. 147). All private schools approved by the National Agency of Education are entitled to full public funding based on the number of students who enroll in the school.

Several other reforms to improve customer choice in the public sector were introduced during the same period. In health care, county councils started to act as purchasers of services, negotiating contracts for the cost and quantity of services to be offered to the public. Public service providers became independent and started to receive funding on the basis of performance rather than through political budgeting. The Primary Doctor Reform of 1993 allowed private primary-care physicians to open their own establishments and receive funding on the basis of the number of patients. The reform also gave patients the right to choose their own primary-care physician, either private or public (Blomqvist 2004, p. 146). A similar system was introduced for elderly care, with county councils purchasing the services from either private or public care home providers. Also in higher education extensive reforms were introduced, transferring two universities into private foundations and making all universities more autonomous, increasing competition and student choice (Karlson 2001).

Another crucial area of institutional change should be mentioned, namely wage bargaining. After the Social Democrats failed to obtain the stop-package of the Carlsson government in 1990, a government commission was established to try to make the social partners agree on wage moderation. This resulted in the so-called Rehnberg agreement between 1991 and 1993, which involved no fewer than 111 partners and was equivalent to a total centralization of wage bargaining, fixing wage increases at 3 percent annually in all sectors. From then onward the bargaining system shifted to the industry level. Moreover, as a consequence of the bad experiences of government interference in the bargaining system in the 1970s and 1980s (SOU 1992, p. 100), it was decided in 1994 that an independent government agency (Arbetsgivarverket) should handle wage negotiations with public employees. From now on, politicians would stay away from the bargaining system (Nycander 2002; Karlson and Lindberg 2008).

The reform processes during the period combined both an explicit Kuhnian element—openly arguing for a new policy paradigm of privatization and deregulation—and more Popperian strategies using rational argumentation and bargaining. However, more acute measures would soon occupy the Bildt ministry.

The Banking Crisis

The center-right government elected in 1991 prioritized inflation control and the defense of the fixed exchange rate, as mandated by the norm policy (Blyth 2001, p. 20). According to this policy, a fixed exchange rate should serve as an anchor for price stability (Calmfors 2012, p. 19). The policy also inherently criticized the Social Democratic labor market policy of "full employment," which pushed employment above the "natural rate," and led to rising wages and prices.

Unfortunately, due to the underlying economic imbalances and badly needed reforms in many other areas, the norm policies instead contributed to the worst crisis in Sweden since the 1930s. Already, in 1990 before the shift of government, a finance company, Nyckeln, had defaulted. The crisis spread when similar companies were refused additional funding from their owners, and a number of them went into bankruptcy (Englund 1999, p. 90).

In 1990, the unemployment rate was 1.7 percent. By 1993, it had reached 8.3 percent. Swedish GDP would fall for three consecutive years in a row, and falling tax incomes meant that Sweden had the largest budget deficit in the OECD in 1993—14 percent of GDP. Moreover, public debt would increase to 72 percent of GDP in 1993 and public expenditures rose to 73 percent of GDP the same year, an extreme level for a democracy.

The crisis quickly spread to the banks, which coincided with a downturn in the real-estate market, partly caused by the removal of deductions in the tax reform of 1990. In central Stockholm prices fell by 35 percent in 1991 and by another 15 percent in 1992. As a consequence widespread bankruptcies hit the banking sector, and all of Sweden's seven largest banks experienced large losses. The banks' total credit losses over the years in crisis amounted to the equivalent of 12 percent of one year's GDP (Bäckström 1998).

Banks with the highest fractions of real-estate loans had large credit losses. One example was Nordbanken bank, where the government (which was the major owner) had to inject new equity to fulfill its capital requirements (Englund 1999, p. 91). Problems with more banks would follow, and after the bankruptcy of another bank, Gota, the government, with the support of the opposition, announced a general guarantee for the entire banking system. The guarantee meant that all creditors, except shareholders, were protected against losses.

According to Englund (1999, p. 92), two things should be emphasized about the government's "emergency treatment" of the banks in 1992 and 1993. The first is the broad political support from all major parties once action was taken. The bank guarantee was implemented months before the formal decision was taken in parliament and allowed the government to act quickly. The second thing to note is that no direct compensation was given to shareholders of the failed banks. The general bank guarantee was of course a valuable asset, and the guarantee probably helped some banks avoid bankruptcy, indirectly saving the shareholders. However, the guiding principle was to rescue the financial system with a minimum of wealth transfer to the shareholders.

The banking crisis had started a year before the currency crisis, which indicates that there may be no strong direct link from the currency losses to the banking crisis. However, one can say that as the situation of the Swedish banking sector became internationally recognized in 1992, the odds of speculation against the krona increased (Englund 1999, p. 93).

The 500 Percent Interest Rate

In the fall of 1992, as a result of speculative attacks on the krona, the central bank was forced to raise the overnight interest rate step by step, in an attempt to defend the fixed exchange rate. In a desperate attempt to hold on to the norm policy, the process continued all the way up to a 500 percent interest rate (Stern and Sundelius 1997). Sweden was portrayed as a banana republic in the media. This crisis, however, became a cognitive turning point in the Swedish reform process.

Prime Minister Bildt contacted Ingvar Carlsson, then the leader of the opposition, to see if the opposition was willing to make a crisis agreement in order to calm the financial markets. The Social Democrats agreed to start the negotiations. In his memoirs, Carlsson points out three factors that he took into account at the time (Carlsson 2003, p. 486). First, how would voters react if they let the crisis spin out of control? Second, whom would they cooperate with in the future? Finally, he asked what would Sweden look like when the Social Democrats came back to power if the crisis were not solved? As Santesson (2012) notes, Carlsson used the word *when*, not *if*. To Carlsson, the return of a Social Democrat administration was only a matter of time—the shadow of the future was no doubt an important factor behind the decision.

The most interesting thing, from the perspective of this study, is that these agreements marked the first time ever that the Social Democrats openly agreed to reduce the expenditures of the welfare state. For example, two unpaid qualifying days were introduced into the health insurance, the pension age was raised, housing subsidies were cut, legislated holidays were shortened, and child allowances were lowered (Carlsson 2003; Möller 2012). Up to this point the idea of reform had always meant increasing public expenditures, at least in the view of the Social Democrats. Not surprisingly, the agreements also involved tax hikes in several areas.

Yet the two crisis agreements did not in fact calm the markets. Thus on 19 November, the head of the central bank, Bengt Dennis, telephoned Prime Minister Bildt, letting him know that the bank's board saw no other solution than to let the krona float freely on the market (Stern and Sundelius 1997). That led to an immediate depreciation by 9 percent, and by 20 percent by the end of the year (Englund 1999, p. 93). Hence, the norm policy was in practice abandoned.

Another consequence of the crisis was that the government in early 1993 appointed an expert commission to come up with proposals for a new fiscal framework. The commission, composed of leading academic experts from Sweden and other Nordic countries, led by Professor Assar Lindbeck, came up with no less than 113 proposals, covering everything from new budgetary rules, inflationary targeting, and an independent central bank to cuts in the number of seats in parliament and longer terms in office. Many of the proposals of the commission would be implemented.

In retrospect, as indicated above, it is clear that the crisis in the early 1990s was a turning point in the reform process of Sweden. It was a critical juncture, which disrupted the existing economic or political balance in society and broke the path dependence that existed. The actors involved probably did not themselves see it this way; they just tried to handle a critical situation by making the best decisions possible. They did what they thought was right.

But they also used the crisis to do things that almost certainly would not have been possible in normal situations. The sense of urgency and the broad coalition involved in the decisions created the opportunity to establish a new path forward. They used blame avoidance and other Machiavellian strategies to diffuse the responsibility for institutional changes they thought to be necessary and right, but perhaps not defendable to their supporters. These techniques should prove to be a way for the future.

At the same time it should also be emphasized that the ideas and beliefs that influenced the decisions made in the crisis were ideas that some policy entrepreneurs had promoted for almost two decades before the arrival of the crisis. Without these ideas the development could have taken another direction. It is also worth noting that the norm policies that were originally supposed to keep Sweden out of a crisis actually did the opposite. The crisis they launched, however, led to more radical and beneficial reforms.

Debt Reduction and Structural Reforms

Despite the austerity measures that were introduced and the liberalizing reforms that had been implemented, the economy continued to plunge deeper into recession in the early 1990s. Public debt skyrocketed to unprecedented levels. In the election of 1994 the Social Democrats regained power in parliament and were able to form a government, again with Ingvar Carlsson as prime minister.

The Social Democrats had presented a traditional platform with a left-wing agenda and won over 45 percent of the popular vote. Wisely, they also had asked for “an open mandate” to do whatever the party believed to be needed, which proved to be highly successful. The new government, with Göran Persson as minister for finance, to the surprise of almost everyone, let the liberal reforms of the Bildt government remain in place and continued the reform agenda laid out by the Lindbeck Commission. Major achievements included joining the European Union, creating a new macroeconomic regime, and reforming pensions and collective bargaining. But the immediate task was to reduce the public debt by cutting spending and raising taxes.

The Challenges of Debt Reduction

The debt reduction process was initiated through cooperation between the Social Democratic minority government and the Left Party (the former communist party). It involved several radical cuts in expenditures, including a reduction in unemployment benefits from 90 percent to 75 percent of the recipient's previous income. However, in spite of this debt reduction plan, interest rates on government debt remained high, which was seen as a sign that the markets did not trust the Left Party to be a long-term credible partner, which was needed for economic recovery. The Centre Party, a former farmers' party with a green social liberal leaning, which had been part of the coalition led by the Moderate Party, made a bold decision to help the Social Democratic government. That cooperation would last up until 1997 (Santesson 2012, p. 92).

In his memoirs, Göran Persson, prime minister from 1996 to 2006, describes the cutbacks: "Literally everything was slimmed down, from the King's appanage [annual support for his family] to single parent grant advances. All institutions received less funding than in the past, from embassies to preschools. All public services were hit, from defense to elderly care" (Persson 2007, p. 83).

The general idea was that if everyone would bear the burden of debt reduction a sense of fairness could be secured. Moreover, this approach avoided the influence and endless arguments of different special interests (Persson 2007, p. 131). At the same time taxes were raised with about the same amounts as the cuts in welfare (Persson 2007, p. 95). According to Thomas Östros (interview 2011), who worked close to Persson during these critical years, first as a political adviser and later as minister for taxes, about half of the reduction in debt came from cuts in expenditures and half from higher taxes.

All kinds of strategies were used to make this possible. For example, Prime Minister Persson rhetorically appealed to the feelings of many voters by stating that "if you are in debt, you are not free" (Persson 2007, p. 131). Also he introduced the "symbolic" raise in the marginal income tax rate by 5 percentage points by calling it a *preserve tax* (värnskatt), indicating that this particular tax "on the rich" would preserve the welfare system. However, the main strategy consisted in blaming the economic problems on the former center-right government "who recklessly had destroyed the country."

Moreover, various methods to obfuscate and lower the visibility of institutional change through hiding, indexing, and delaying the consequences of the measures taken were used. One well-documented example is the radical change in housing policies. In this sector, highly technical and complex in nature, almost all subsidies were taken away, improving the financial situation of the state by more than 50 billion kronor, with virtually no resistance despite the fact that housing costs rose dramatically for ordinary people. According to Lindbom (2001, p. 506), citizens were largely ignorant of what had been done. He shows that "political programs that are difficult for citizens to understand or the effects of which are difficult to observe directly" were the ones most likely to be used and implemented in the politics of debt reduction.

However, it is obvious that a debt reduction process of the magnitude attempted could not take place without serious conflicts with special interests. In particular, the Social Democratic government had problems with the labor union confederation, which was represented on the governing board of the party. As we have seen, during the period 1995–1997 the fighting was fierce, popularly called the "war of the roses," and visible to the public. LO, the union confederation, even attacked the spending cuts of the Social Democratic government on the first of May, a time when demonstrations normally praise union solidarity. According to Persson the relationship did not really improve until 2001 (Persson 2007, p. 167). Still, it seems hard to think that any group other than a Social Democratic government could have managed to control the special interests, especially public employees, and doing so was necessary to succeed in reducing debt.

An additional aspect of the process was that Sweden, which applied for membership in the European Union in 1990, had become a full member in January 1995, following a referendum. In accordance with the criteria for entering the Euro zone, stipulated in the Maastricht Treaty, Sweden agreed to bring its public debt down to less than 60 percent of GDP and the budget deficit down to less than 3 percent of GDP by 1998. Which Sweden actually did!

The EU membership thus contributed positively to the Swedish reform process in this and many other respects (Karlson 2014). However, in 2003 in a new referendum, the electorate said no to join the European Monetary Union despite strong elite support for the yes option, especially by Persson himself. This decision meant that Sweden could keep its own currency rather than adopt the Euro. This gave Sweden and Swedish industry, through the depreciated krona, the advantage of a long period of export-led growth, as well as providing a shield against the coming problems of the Euro zone. Thus, luck may also have helped handle the debt crisis.

A New Macroeconomic Regime

Along with debt reduction, major structural reforms were implemented during the late 1990s. Most importantly, a new macroeconomic regime was established through a consensus between the two political blocs. As mentioned, in 1993 the Lindbeck Commission had recommended a stricter budgetary process (SOU 1993, p. 16) and the year before a government investigation (Molander 1992) had made similar suggestions.

The key elements of the stricter fiscal framework and budget reform, implemented for the first time in 1997, were clear fiscal targets, rules, and restrictions. First, there must be a general government surplus target of 1 percent of GDP. Second, the parliamentary budget decisions are taken in two steps—first on the total level of the budget and its allocation among 27 expenditure areas, then on different expenditure items in these areas. Any spending increases in an area must be met by corresponding cuts in the same area (Blöndal 2001, p. 28; Calmfors 2012, p. 10). Third, it was decided to introduce a ceiling on expenditure in order to limit government spending when further tax increases are not considered possible. The expenditure ceiling is nominal, it covers a three-year period, and it takes cyclical macroeconomic fluctuations into account (Bergh 2009, p. 78; Calmfors 2012).

A second important element in the new macroeconomic regime was the granting of independence to the central bank and the creation of a system of inflation targeting. When the central bank failed to defend the fixed exchange rate of the norm policy in 1992 and the krona was allowed to float freely, the bank on its own decided on an inflation target of 2 percent per year to anchor inflation. The target was later confirmed by parliament (Calmfors 2012, p. 12).

Following the deregulation of the credit market, the government of 1990 had appointed a commission to investigate the goals and functions of the central bank. The commission, which presented its results in 1993, argued that the bank had been relatively independent since the beginning of the 1990s. For example, the governor of the central bank appointed by the Social Democrats was not replaced in 1991 although the center-right coalition won the election. The commission also argued that the central bank needed legal independence to increase its credibility if monetary policy was to be effective in the long run (Bergh 2009, p. 70). The proposal to make the bank independent came in 1997 when Erik Åsbrink, who succeeded Persson as minister for finance in 1996, put forward a bill suggesting independence along with a goal of price stability for the central bank (Bergh 2009, p. 71).

The new law mandating independence for the central bank came into effect on 1 January 1999, although (as the commission reported) the bank had been acting independently since 1993. On the one hand, this may be seen as one of the clearest cases of a Popperian reform strategy, where rational argumentation, public investigations, and open discussions played crucial roles. On the other hand, one may perhaps also view the late formal legislation of a practice that already was in place as somewhat Machiavellian. The central bank acted as a policy entrepreneur and the politicians followed along.

A third important part of this new macroeconomic regime, one that is often ignored, was the reformed system of wage bargaining that emerged during the 1990s. As mentioned in the previous section, with the Rehnberg agreement between 1991 and 1993 and the creation of an independent government agency in 1994 to handle wage negotiations with public employees, important steps had already been taken to break the spiral of ever-increasing nominal wages that dominated the Swedish model during the 1970s and 1980s. From 1997 onward, the *Agreement on Industrial Development and Wage Formation* between the social partners in the manufacturing industry coordinated the bargaining process. This agreement is an industry-level procedural framework for patterned bargaining, where the first wage agreement in the bargaining round establishes a norm for wage increases for others to follow. This system was backed up in 2000 by a law creating a National Mediation Office, which supports the norm-setting role of those industrial sectors "exposed to international competition" (Lundh 2010; Karlson and Lindberg 2008; Medlingsinstitutet 2012).

A New Pension System

A final structural reform of great importance to the institutional renewal of Sweden is the new pension system that was created in two steps in 1994 and 1998. Its origins can be traced back to a governmental investigation appointed in 1984. In 1991, the Bildt government established a working group to start the reform process (SOU 1994, p. 20). This resulted in the first decision, in the wake of the financial crisis and just before the 1994 election, when the general principles of the new system were established. All parties except the Left Party stood behind reform. The final decisions were made in 1998, again just before an election.

The general idea behind the new system was that it should be sustainable in the long run, being based on contributions rather than promised benefits. It also contains a balancing mechanism which automatically reduces pensions if the long-run financial stability of the system is threatened. Moreover, it is public and compulsory, with a high degree of individualized links between pension contributions and payments. In other words, every individual's pension contributions are in principle to cover the pension disbursements later in life, except for a guaranteed minimum. A small part of the system is also made up of individualized funds, which are individually invested stock market funds (Prop. 1997/98, p. 151; Bergh 2009, p. 71; Santesson 2012).

The working group behind the proposal was unusual in many ways. Special interest groups like the National Pensioners' Organization and the labor market parties were not invited to take part, and the Left Party and New Democracy, the small populist right-wing party, could only attend the regular meetings of the group, not the negotiations that preceded them (Santesson 2012, p. 100). Within the working group, the aim was to focus on what was politically possible and to find common ground. As the process continued, members of the working group were drawn closer to each other and further away from their own party loyalties.

Although the reform of the pension system was characterized by cooperation and open public discussion, it was also a complex project driven by experts in the political elite. The reason was that leading Social Democrats, who realized the need for substantial reform of the pension system, feared that the members of the party were not yet aware of the need for reform. The fact that the Social Democrats decided to take part in the working group can be seen as a pragmatic attempt to bring about reforms which they realized were necessary but would be hard to win support for within the party (Santesson 2012, p. 106). Furthermore, none of the parties wanted the question of pension reform to become central in the election of 1994—another reason for both sides to reach an agreement (Lundberg 2001, p. 33).

In fact, all through the process up to the final decision in 1998, and even in the decade following, all the major partners to the deal chose to stick together. Public discussion mainly served the purpose of convincing the public of the virtues of the new system, not to debate its principles or purpose. Again we have a case where Popperian strategies of rational argumentation and open discussions are combined with the Machiavellian strategy of using a broad coalition to diffuse the responsibility for an institutional change thought to be necessary and right, but perhaps not fully supported by the voters.

Abolishing the Inheritance and Gift Taxes

A last and somewhat different case of a reform during the Persson government is the abolition of inheritance and gift taxes in 2005. This was indeed an institutional change that few had expected from a Social Democratic government.

In 2000 the government had asked the Ministry of Finance to launch an extensive investigation of the Swedish tax system, including the effects of the inheritance and gift taxes. The investigation was led by Per-Olof Edin, a former chief economist of the Swedish Trade Union Confederation. He suggested that the inheritance and gift taxes should be abolished between couples and their children (SOU 2002). Prime Minister Persson later indicated that he was open to reform, commenting on Edin's suggestions with the words: "I believe he is right, it is pointless to keep a tax that does not work, it just undermines the trust for the tax system as a whole" (Dagens Industri 2002).

In the fall of 2004, however, as the new budget was being negotiated, a parliamentary committee appointed two years earlier to investigate the inheritance and gift taxes did not recommend abolishing any of these taxes (SOU 2004:66). At the same time the budget negotiators suddenly announced that they had agreed to abolish the inheritance and gift tax by the year of 2005 (Lucas 2004).

According to Professor Sven-Olof Lodin (2009, p. 243), who previously worked at the Ministry for Finance as a political expert on taxes, the reform was the result of personal actions taken by Persson. He would most likely have preferred to remove the wealth tax, a levy on the total value of personal assets, whose negative economic effects were well known. The problems with the inheritance and gift taxes, especially for family businesses when it was time for a generational shift, were indeed grave, but the wealth tax still remained more important, according to Persson.

Lodin claims that Persson simply gave Lars Ohly, the leader of the Left Party, the task of choosing which of the taxes he would rather see disappear. Ohly chose the inheritance and gift taxes, since keeping the wealth tax carried more ideological symbolism to the Left Party. The chief budget negotiator of the Left Party, Marie Engström, later told the press that the decision was part of a larger deal that allowed her to send more money to the local municipalities (Lucas 2004).

It is of course hard to say which story is the most credible, but either way the Machiavellianism involved in this process where the inheritance and gift taxes were abolished by a left-wing government should be clear, even though the actors involved may have had strong rational arguments for doing so.

As we have seen, this is a recurring theme in the reform process of the Persson years—blame avoidance rather than claiming credit in the period from 1994 to 2006. This occurred even while Popperian elements—using scientific results and empirical research, rational argumentation and open public discussions in the development of the new policies and institutions—also had an important role.

A New Model Emerging

Despite signs of economic recovery, in 2006 Persson and the Social Democrats lost the elections to an alliance of center-right parties led by Fredrik Reinfeldt from the Moderate Party, which had taken a sharp ideological turn to bring them into power. This was the first time since 1991, and only the fourth time since the 1930s, that the Social Democrats did not get enough votes to form a government. The Moderates ended up increasing their number of votes by 11 percent and produced their strongest vote since 1928 (Oscarsson and Holmberg 2008, p. 15).

In the election of 2002 the Moderate Party had presented a market-liberal platform, favoring welfare cutbacks, tax cuts for the rich, and deregulation of the labor market. But the election results were catastrophic, with the party only achieving 15.3 percent of the vote, compared to 22.9 percent in the election of 1998 (Agius 2007, p. 592).

The leader of the Moderate Party resigned in 2003 and was succeeded by Fredrik Reinfeldt, who especially with Anders Borg, the new minister of finance, and Per Schlingmann, the party secretary and communication expert, all former market liberals, developed a radically new strategy for the party. It consisted of two main components: an ideological change, moving the party toward the political center, and a change in the relationship with the other non-socialist parties, aiming for closer cooperation (Aylott and Bolin 2007, p. 625).

The party's traditional agenda was changed to focus on tax cuts for only lower- and middle-income groups, with a key message to voters saying that tax cuts would make working more rewarding. Moreover, fiscal responsibility, while also promising fully financed cuts in taxes, was made a top priority. Labor market regulations, such as employment protection laws and the unions' role in wage formation, were left alone. The party rebranded itself as the "New Moderates" and later on also started to call themselves "The New Workers' Party." The party leadership also made it clear that they believed that the welfare state should be defended rather than dismantled, and that they would support the collective bargaining system (Agius 2007, p. 592). No more rhetoric about a shift of system.

This strategy is a case of what is called "triangulation," a term used by US president Bill Clinton's chief political advisor Dick Morris to describe his strategy for getting Clinton reelected in the 1996 presidential election. It is presenting one's own policy proposals as being "above" and "between" the "left" and "right" sides (or "wings") of the political spectrum, and thus adopting some of the ideas, or at least the rhetoric, of the political opposition. The logic behind it is that it both takes credit for the opponent's views and insulates the triangulator from attacks on the same issues. The strategy would prove to be highly successful (Aylott and Bolin 2007, p. 625) in Sweden, just as it was in the UK at least in the short run—with, for example, the "New Labour Party."

In the period preceding the election of 2006, the leaders of the Moderate, Center, Liberal, and Christian-Democratic parties formed what they called the Alliance and produced a joint election manifesto. Such a cooperative venture by four parties had never happened before, and it weakened the position of the Social Democrats who were left to form insecure and unpopular majorities with the Green and Left parties.

Another reason for the failure of the Social Democrats was that although the country showed impressive economic growth, few new jobs were created and welfare dependency remained high. Unemployment, especially among young people and immigrants, was on par with the levels in southern Europe just as the Social Democrats were accused of classifying too many people as too ill to work or offering early retirement (Aylott and Bolin 2007, p. 623). As stated by Erik Åsbrink, a former minister for finance during the Persson governments, "the Social Democrats must radically rethink its policies in a number of areas, and instead of focusing on unemployment targets set goals for employment targets instead. The key is to put as many people in employment as possible" (Åsbrink 2006).

Most likely, however, the Social Democrats lost because of their extensive use of Machiavellian strategies of blame avoidance, or, rather, their decision to avoid claiming credit, which characterized most of the important reforms made by the Persson governments. That made it hard for the voters to understand both why the reforms were implemented and what beneficial effects they had. Moreover, the leadership and personality of a successful debt reducer may not have been the best for more normal times—according to most polls, Persson was not liked as a person.

Persson himself blamed the election failure on the extensive debate regarding the property tax that emerged weeks before the election. The Alliance promised to abolish the tax, which for long had been resented by large groups of middle-class voters. Persson still thought the tax to be a just and rational one, but as he himself put it: “Impossible to defend” (Brors 2007).

More Reforms

After the election of 2006 the new coalition government set out to fulfill its promised reform agenda. During the first four years the reforms included the abolition of the wealth tax, the introduction of earned income tax credits for low and medium income earners, and tax deductions for “household services.” At the same time, unemployment benefits were reduced, and unemployment insurance, which previously had been completely funded by employers’ contributions, was changed to include mandatory individual contributions as well. Several other reforms were made to improve the labor market, such as making short-term contracts more available and cutting employers’ contributions in half for those who employed someone under the age of 26. Moreover, regulatory reforms were made to cut down the administrative burden on firms. In total the tax cuts were larger than the cuts advocated by Bo Lundgren in 2002.

Other reforms included privatizing health care provision and increasing choice in health and elderly care. The criteria for benefits from the health insurance system were made stricter. In addition, reforms were made to improve the academic quality of the school system. Finally, shares in state-owned companies were sold, namely in the Nordea AB banking group, and the public pharmacy monopoly was opened up to competition (Agius 2007, p. 595).

Explicitly this massive wave of institutional changes was based on a Popperian strategy, as references to research in social sciences, reports from the OECD, rational argumentation, and so on played a central role. Finance Minister Borg filled his department with PhDs in economics in order to strengthen the credibility of the proposals. Thanks to these achievements as well as to Borg's successful management of the financial crisis in 2008–2009, the Alliance was reelected in 2009—however, this time not with a majority.

Together with the reforms over the previous 20 years and the new reforms implemented by Fredrik Reinfeldt's government, something like a new Swedish model is emerging. It should be emphasized that it is a model in making; it needs to be completed in various ways. The labor market in particular has not been reformed, which largely explains the remaining high levels of unemployment noted in Chap. 3, especially among "outsiders" such as the young and immigrants. Nonetheless, it is clear that it is a very different and clearly more liberal model especially when compared to the previous interventions model. The following characteristics can be identified:

- Individual responsibility and choice have been extended, while the role of politics has been reduced.
- Taxes and welfare benefits have been lowered, markets deregulated, business privatized, and publicly financed welfare services produced by private actors.
- The social insurance systems have been reformed to become more actuarial and less redistributive.
- A new macroeconomic regime has been credibly established, with a budget surplus and inflation targeting.

It should be emphasized that Sweden is still a welfare state that guarantees everyone social security and welfare services (cf. Lindbom 2001). Interestingly, there seems to be a kind of consensus around this new model, at least among the central decision-makers, if not yet among the members of the more left-wing parties.

In the elections of 2010 the Social Democrats received a historically low 30 percent of the votes. Later they fell even lower in the polls and changed their leadership several times, but under the leadership of Stefan Löfven in 2012 they initially gained support.

There are several remaining problems that this new Swedish model needs to be able to handle. First of all, the tax share of GDP in Sweden is still the second highest in the world, and the high taxes cause weak job creation and distorted incentives. Secondly, the labor market regulations, including employment protection laws, central collective bargaining, and high minimum wages, are still keeping the unemployment level high among young people and immigrants. Finally, housing regulations have resulted in low mobility and very low rates of construction (Bergh 2009). Those factors, together with the restrictions on freedom of enterprise, primarily in services, will result in a continued welfare dependency if left without reform. Also the educational system has severe problems with quality as well as efficiency and the relevance of the education produced (Lindberg 2012). Moreover, Sweden of course also faces the challenges of an aging population as well as pressing environmental issues, just as the rest of the advanced democracies do.

Lately the reform process has come to a halt. In the second term of the Reinfeldt ministry, 2010–2014, very few reforms were implemented. Partly this was due to the fact that it was a minority government. A new anti-immigration party, the *Swedish Democrats*, entered the Swedish parliament, making it impossible to form a majority by either of the traditional blocks. But almost all governments since 1985, when the reform process started, have been in similar minority situations. A more likely explanation for the slowdown of reform is that the political leaders have run out of ideas and are focusing more on defending what has already been achieved than on moving forward.

The alliance of the Moderate, Liberal, Centre, and Christian-Democratic parties came to power through the framing of their preferred policies in a new, more welfare state–embracing fashion. The strategy of "triangulation" is an example of a Kuhnian strategy in which the rhetorical image of the old Swedish model was used to gain power. The Alliance also adopted the Machiavellian strategy of not pushing controversial issues such as changes in employment protection legislation or the lowering of the marginal tax rate.

But the use of this strategy may have blocked the changes needed to complete the new model—instead the mental frames of the old, failing model seemed to reemerge.

In September 2014 a new government led by the Social Democrats in coalition with the Green Party, Miljöpartiet, formed a minority government. This marked the definite end of the Swedish reform era. The new prime minister, Stefan Löfven, started to implement a traditional left-wing agenda, but due to lack of parliamentary support the result, in many areas it can perhaps better be described as a stalemate, even though taxes and regulations have started to increase. There are also signs of a weakening of Sweden's competitiveness (Karlson et al. 2015; Karlson and Larsson 2016). In addition, Sweden is facing new challenges due to the refugee crisis.

Swedish Statecraft

How then should we characterize the statecraft involved in this process of sustained reform that took place in Sweden over the last 25–30 years? Sweden modernized its economy and society, overcoming the procrastination and policy mistakes of many other welfare states, and implemented welfare-enhancing institutional changes. Our goal now is to identify the causal mechanisms behind successful political reform—*why* and *how* the beneficial institutional change took place. We will do this by tracing how events chain on to one another and are necessarily linked to one another through time.

If we are to summarize the lessons from the sections above a first observation is that Swedish statecraft, the art of governing the country well, was not limited to the activities of a single person, that is, a statesman. Rather, a large number of actors with different roles contributed to the process. Individuals as well as policy entrepreneurs, policy-advocacy coalitions, political parties, party leaders, and interest groups took part in the process of increasing liberty and making the Swedish society more free and efficient.

Still, some individuals mattered significantly for Swedish statecraft. An incomplete list would include Sture Eskilsson, Curt Nicolin, Erik Åsbrink, Kjell-Olof Feldt, Carl Bildt, Assar Lindbeck, Göran Persson, Fredrik Reinfeldt, and Anders Borg. Perhaps only two of these had a role of sufficient weight to be praised as statesmen, because of their contribution to the paradigmatic shift of ideas and the important structural reforms, namely Carl Bildt and Goran Persson. But Sture Eskilsson's and Assar Lindbeck's promotion of new policy ideas may have been just as important.

The process of change can be divided into several distinct stages. Let us first recall the reform cycle, presented in Chap. 5, which starts with changing economic and social conditions, creating a demand for new ideas, which need to be articulated by policy entrepreneurs, who interact with and activate power resources and interests, which use their strength to influence institutional and policy change, which in turn affects social and economic conditions, and so on.

In Sweden both individual reforms and the whole reform process largely followed this model of institutional change. The reform cycle started with external changes in economic and social conditions together with the large policy failures of the interventionist Swedish model of the 1970s and 1980s. To more and more people, especially within the elites regardless of party affiliation, it became clear that the model with high taxes, public monopolies, and regulated markets could not deliver what was expected. Recurring budget deficits, inflation, weak growth, cost crises, devaluations, labor disputes, and nonexistent real wage increases gradually eroded the legitimacy of the model.

However, changing economic and social conditions did not alone explain the reforms that followed. For institutional change to take place, what was necessary was that the contextual changes really were identified, ideas became articulated and communicated, interests were aggregated and made into power resources, and windows of opportunities were created.

In Sweden at least four more or less independent groups of policy entrepreneurs who introduced new ideas, beliefs, values, and worldviews and played crucial roles early in the reform process. One of the most important groups were members within the SAF, who over a long period starting in the mid-1970s devoted massive resources to the promotion of market-liberal ideas, beliefs, and values. They used Kuhnian strategies with the explicit goal of achieving a long-term paradigmatic policy shift. Another very important group was the young Social Democratic economists who later worked in the Ministry of Finance. In contrast to SAF, however, their goal was to save the welfare state, to make it more efficient, and to adapt it to a changed world. Other central policy entrepreneurs included economists at the SNS and outstanding business entrepreneurs. Later other policy entrepreneurs would enter the scene.

They were all necessary for Sweden to overcome the status quo bias and barriers to reform in the form of special interests and public goods traps, negativity biases and ideational traps, and public opinion and preference falsification.

In the first stage of the reform process, the early Social Democratic reforms implemented between 1985 and 1991 primarily used Machiavellian strategies. That is, in order to make decisions politically possible, which they thought were economically necessary, they used techniques to obfuscate and lower the visibility of institutional change, to split the opposition to reform by compensating some interests and not others, and to spread the blame for hardship caused by institutional changes on others. However, Popperian strategies of rational argumentation and Kuhnian strategies of reframing issues were also successfully used.

These early Social Democratic reforms were, however, too few and limited to solve the underlying structural problems. The focus on reforming the policy instruments and policy settings of the existing Swedish model, rather than trying to achieve a change of overarching goals and policy paradigm, was not sufficient to achieve what was needed. In fact, partly due to the sequencing and timing of these early reforms the economic situation worsened. Indeed, it would take a series of crises to bring about such a fundamental shift.

The next stage in the reform process occurred in the early 1990s. In the wake of the fall of socialism in 1989 and the crumbling Swedish welfare state, the center-right government, led by Carl Bildt from 1991 to 1994, initiated a series of liberalizing reforms, combining Kuhnian elements, openly arguing for a new policy paradigm, and more Popperian strategies using rational argumentation and bargaining.

However, the serious financial and banking crises and the speculative attack on the krona in the fall of 1992 marked the real turning point in the reform process of Sweden. This was the critical juncture, which disrupted the existing economic or political balance in society and broke the path dependence of the interventionist Swedish model. For the first time the Social Democrats openly agreed to cut down the expenditures of the welfare state. The sense of urgency and the broad coalition involved in the crisis agreement created the opportunity to take a new path forward, a path that had been promoted by some policy entrepreneurs for almost two decades before the crisis. The use of blame avoidance and other Machiavellian strategies to diffuse the responsibility for institutional changes thought to be necessary and right, but perhaps not defendable to one's supporters would prove to be a way for the future.

The third stage in the reform process came with the return to power of the Social Democrats in 1994 and lasted until 2006. Due to the debt crisis and the deep economic problems of Sweden, the Carlsson and especially Persson governments implemented radical cuts in expenditures in virtually all welfare programs, while also raising taxes. However, they also let the liberal reforms of the Bildt government remain in place and continued the reform agenda of the Lindbeck commission, which included structural reforms: the establishment of a new macroeconomic regime with inflation targeting, an independent central bank, and a collective bargaining reform, as well as EU membership and a major pension reform.

Most of the structural reforms had been initiated early on in the reform process, sometimes as early as the 1980s or during the Bildt government and had been thoroughly analyzed and discussed in different investigations and commissions. They could thus be implemented through Popperian strategies, often in consensus with the other major parties. However, blame avoidance rather than credit claiming and other Machiavellian strategies still dominated the Swedish reform process during the pragmatic Persson years.

In the fourth stage of the Swedish reform process, from 2006 to 2010, the center-right Alliance and the Fredrik Reinfeldt government came to power through the framing of their preferred policies in a new, more welfare state–embracing fashion. This Kuhnian strategy was combined with Popperian strategies, largely advocated by Minister of Finance Anders Borg, to implement a cascade of liberal institutional changes in many policy areas, including big tax cuts for working people. During this reform stage a new emerging Swedish model could be identified, a clearly liberalized model but still a welfare state, around which a consensus seemed to have arrived. However, despite the success of this new model the Alliance achieved little in its second term in office and lost the elections in 2014 to a minority government composed of the Social Democrats and the Greens advocating a return to more traditional welfare-state policies.

The timescale itself of the reform process over these four stages should be noted—it took Sweden 25–30 years to change an utterly failing model into a more well-functioning new social model. Both Social Democratic and center-right governments played crucial roles, not least by not changing welfare-enhancing reforms already implemented. The process of sustained liberalization was largely incremental and pragmatic. There is a kind of underlying Popperian tendency involved in the process—using research, commissions, and rational argumentation.

However, many or even most of the actors involved had no intention of changing the underlying policy paradigm; rather, their ambition was to save the old, failing system. And on only one occasion was it possible to gain electoral support for more drastic changes of policies. A severe crisis was necessary to break the existing path dependence and change the overarching goals or policy paradigm. Moreover, Machiavellian strategies actually dominated the process of implementing the new policies.

Still, Kuhnian strategies of introducing new, more liberal ideas and perspectives played a crucial role for the direction of the reform process.

Pragmatism and shrewdness were not enough to achieve welfare-enhancing institutional change. Swedish statecraft involved both advanced political skills and new ideas, ideas that actually could make Sweden a better country.

Hence, in the Swedish case, the reform cycle as well as our three reform strategies clearly fit the processes we have traced. The development and implementation of new policy ideas by policy entrepreneurs played a key role. In Chap. 8 I shall return to some other major lessons—that may contribute to the development of a general theory of reform—of the Swedish reform process that more fully can explain how and why sustained policy reform took place in this advanced democracy and welfare state.

Notes

1. See in particular Santesson (2012), Malm Lindberg (2014), and Malm Lindberg and Ljungren (2014), all of which are based on extensive interviews with a large number of Swedish decision-makers in the relevant periods.

References

Interviews

Östros, Thomas (2011), Swedish Minister of Taxes 1996–1998, Uppsala, December 22.

Westholm, Carl-Johan (2012), PhD, Employed at SAF, the Swedish Employers' Confederation in the 1970s and 1980s, Stockholm, January 9.

Books and Articles

Agius, C. (2007). Sweden's 2006 Parliamentary Election and After: Contesting or Consolidating the Swedish Model? *Parliamentary Affairs, 60*(4), 585–600.

Åsbrink, E. (2006, October 6). Ett obegripligt och svårartat misstag för socialdemokratin. *Dagens Nyheter*. Retrieved from http://www.dn.se/debatt/ett-obegripligt-och-svarartat-misstag-av-socialdemokratin/

Aylott, N., & Bolin, N. (2007). Towards a Two-Party System? The Swedish Parliamentary Election of September 2006. *West European Politics, 30*(3), 621–633.

Bäckström, U. (1998). Finansiella kriser, svenska erfarenheter. *Ekonomisk Debatt, 26*(1), 5–19.

Bäckström, U. (2003). The Road to Price Stability in the 1990s. *Sveriges Riksbank Economic Review, 2003*(3), 5–44.

Bennett, W., & Åsard, E. (1995). The Marketplace of Ideas: The Rhetoric and Politics of Tax Reform in Sweden and the United States. *Polity, 28*(1), 1–23.

Berg, A. (1999). *Staten som kapitalist: marknadsanpassningen av de affärsdrivande verken 1976–1994* (Doctoral dissertation). Sweden: Uppsala University.

Bergh, A. (2009). *Den kapitalistiska välfärdsstaten*. Stockholm: Nordstedts akademiska förlag.

Bergh, A. (2014). *Sweden and the Revival of the Capitalist Welfare State*. Cheltenham: Edward Elgar.

Bergström, H. (1987). *Rivstart*. Stockholm: Tidens förlag.

Birch Sørensen, P. (2010). *Swedish Tax Policy: Recent Trends and Future Challenges* (ESO-rapport 2010: 4). Stockholm: Ministry of Finance.

Bjuggren, C., & Johansson, D. (2009). Privat och offentlig sysselsättning i Sverige 1950–2005. *Ekonomisk Debatt, 37*(1), 41–53.

Blomqvist, P. (2004). The Choice Revolution: Privatization of Swedish Welfare Services in the 1990s. *Social Policy & Administration, 38*(2), 139–155.

Blöndal, J. R. (2001). Budgeting in Sweden. *OECD Journal on Budgeting, 1*(1), 27–57.

Blyth, M. (2001). The Transformation of the Swedish Model: Economic Ideas, Distributional Conflict, and Institutional Change. *World Politics, 54*(1), 1–26.

Boréus, K. (1994). *Högervåg. Nyliberalismen och kampen om språket i svensk debatt 1969–1989*. Stockholm: Tidens förlag.

Brors, H. (2007, March 6). Vi förlorade valet på fastighetsskatten. *Dagens Nyheter*. Retrieved from http://www.dn.se/nyheter/vi-forlorade-valet-pa-fastighetsskatten/

Calmfors, L. (2012). *From Macroeconomic Failure to Macroeconomic Success* (CESifo Working Paper Series No. 3790). Stockholm: Stockholm University.

Carlsson, I. (2003). *Så tänkte jag: politik & dramatik*. Stockholm: Hjalmarsson & Högberg.

Daugbjerg, C. (1998). *Policy Networks Under Pressure: Pollution Control, Policy Reform, and the Power of Farmers*. Aldershot: Ashgate.

Daugbjerg, C., & Studsgaard, J. (2005). Issue Redefinition, Venue Change and Radical Agricultural Policy Reforms in Sweden and New Zealand. *Scandinavian Political Studies, 28*(2), 103–124.

Daunfeldt, S. O., & Wallen, F. (2013). *Svenska citroner: åtta fräscha idéer som lämnade en sur eftersmak*. Falun: Kalla kulor förlag.

Ehrenkrona, O. (1991). *Nicolin—en svensk historia*. Stockholm: Timbro.

Englund, P. (1999). The Swedish Banking Crisis: Roots and Consequences. *Oxford Review of Economic Policy, 15*(3), 80–97.

Eskilsson, S. (2005). *Från folkhem till nytt klassamhälle: ett högerspöke berättar*. Stockholm: Fischer & Co.

Feldt, K. (1991). *Alla dessa dagar…—i regeringen 1982–1990*. Stockholm: Norstedt.
Furåker, B. (2016). The Swedish Wage-Earner Funds and Economic Democracy: Is There Anything to Be Learned from Them? *Transfer: European Review of Labour and Research, 22*(1), 121–132.
Johansson, J. (2000). *SAF och den svenska modellen*. Uppsala: Acta Universitatis Upsaliensis.
Johansson, A. L., & Magnusson, L. (2012). *LO: 1990-talet och ett nytt millennium*. Falun: Bokförlaget Atlas.
Jonung, L. (1999). *Med backspegeln som kompass—om stabiliseringspolitiken som läroprocess* (ESO-rapport, DS 1999:9). Stockholm: Finansdepartementet.
Jörnmark, J. (2013). *Krisen*. Stockholm: Tangent Förlag.
Karlson, N. (2001). *City-universitetet. Det fria universitetet*. Stockholm: City-universitetet.
Karlson, N. (2009). *Eight Prizes that Changed the World. The Sveriges Riksbanks Prize in Economic Sciences in Memory of Alfred Nobel to Members of the Mont Pelerin Society*. Stockholm: Ratio.
Karlson, N. (2014). *Vilket EU vill vi ha?* Stockholm: Ratio [Publit förlag].
Karlson, N., & Larsson, A.-S. (2016). *Kritiska villkor för företagandet*. Stockholm: Ratio [Publit förlag].
Karlson, N., & Lindberg, H. (2008). *En ny svensk modell—Vägval på arbetsmarknaden: Sönderfall, omreglering, avreglering eller modernisering*. Stockholm: Ratio.
Karlson, N., Larsson, A.-S., & Blom, K. (2015). *Företagandets villkor i internationell belysning*. Stockholm: Ratio.
Lindbeck, A. (1997). The Swedish Experiment. *Journal of Economic Literature, 35*(3), 1273–1319.
Lindberg, H. (2008). Politikbyte och idéernas betydelse Reformeringen av den svenska jordbrukspolitiken. *Historisk Tidskrift, 128*(1), 29–54.
Lindberg, H. (2012). 1980-talets avreglering—en kort paus mellan beredskapsplaner och EU. In C. Isaksson (Ed.), *Maten och makten. Hur ska den nya världen mättas?* Stockholm: Ekerlids.
Lindbom, A. (2001). De borgerliga partierna och pensionsreformen. In J. Palme (Ed.), *Hur blev den stora kompromissen möjlig? Politiken bakom den svenska pensionsreformen*. Stockholm: Pensionsforum.
Ljunggren, S. (1992). *Folkhemskapitalismen: högerns programutveckling under efterkrigstiden*. Stockholm: Tidens förlag.
Lodin, S. (2009). *Professorn som blev näringslivstorped*. Stockholm: Ekerlid.
Lucas, D. (2004, October 26). Slopad skatt räddade budgeten. *Dagens Nyheter*. Retrieved from http://www.dn.se/arkiv/ekonomi/slopad-skatt-raddade-budgeten-i-dag-presenteras-regeringens-forslag-om/
Lundberg, U. (2001). Socialdemokratin och 1990-talets pensionsreform. In J. Palme (Ed.), *Hur blev den stora kompromissen möjlig? Politiken bakom den svenska pensionsreformen*. Stockholm: Pensionsforum.

Lundh, C. (2010). *Spelets regler—institutioner och lönebildning på den svenska arbetsmarknaden 1850–2010* (2nd ed.). Stockholm: SNS förlag.
Magnusson, L. (2010). *Sveriges ekonomiska historia*. Stockholm: Norstedts.
Malm Lindberg, H. (2014). *Drömmen om jämlikhet. Socialdemokratins radikalisering och den svenska modellens fall*. Stockholm: Atlantis.
Malm Lindberg, H., & Ljunggren, S. (2014). *Från jämlikhet till effektivitet. Om lärande socialdemokrati under 1980-talet*. Stockholm: Hjalmarson & Högberg.
Medlingsinstitutet. (2012). *Avtalsrörelsen och lönebildningen* (Medlingsinstitutets årsrapport 2011). Retrieved from http://www.mi.se/files/PDF-er/att_bestalla/arsrapporter/arsrapp12.pdf
Medlingsinstitutet. (2016). *Avtalsrörelsen och lönebildningen* (Medlingsinstitutets årsrapport 2015). Retrieved from http://www.mi.se/files/PDF-er/att_bestalla/arsrapporter/AR16_ny.pdf
Molander, P. (1992). *Statsskulden och budgetprocessen* (ESO-rapport. DS 1992:126). Stockholm: Finansdepartementet.
Möller, T. (2012). *Sveriges statsministrar under 100 år. Carl Bildt*. Stockholm: Albert Bonniers förlag.
Myhrman, J. (1994). *Hur Sverige blev rikt*. Lund: Studentlitteratur.
Norrman, E., & McLure, C. E., Jr. (1997). Tax Policy in Sweden. In R. Freeman, R. Topel, & B. Swedenborg (Eds.), *The Welfare State in Transition: Reforming the Swedish Model*. Chicago: University of Chicago Press.
Nycander, S. (2002). *Makten över arbetsmarknaden* (2nd ed.). Stockholm: SNS Förlag.
Oscarsson, H., & Holmberg, S. (2008). *Regeringsskifte: väljarna och valet*. Stockholm: Norstedts juridik.
Persson, G. (2007). *Min väg, mina val*. Stockholm: Albert Bonniers Förlag.
Persson är beredd att slopa arvsskatten.Dagens Industri. (2002, December 30). *Dagens Industri*. Retrieved December 3, 2016, from http://www.di.se/artiklar/2002/12/30/persson-ar-beredd-att-slopa-arvsskatten/
Prop. (1997/98:151). *Inkomstgrundad ålderspension m.m.* Retrieved from: http://www.regeringen.se/rattsdokument/proposition/1998/04/prop.-199798151/
Rabinowicz, E. (1999). Agricultural Policy Reform in Sweden. In K. Frohberg & P. Weingarten (Eds.), *The Significance of Politics and Institutions for the Design and Formation of Agricultural Policies* (pp. 212–229).
Rothstein, B. (2008). Tillit och social kapital. In J. Lindvert & I. Schierenbeck (Eds.), *Jämförande politik*. Malmö: Liber.
Santesson, P. (2012). *Reformpolitikens strategier*. Stockholm: Atlantis.
Söderström, H. T. (1996). *Normer och ekonomisk politik*. Stockholm: SNS.
SOU. (1992:100). *Staten och arbetsgivarorganisationerna*. Slutbetänkande av Arbetsgivarkommittén. Arbetsgivarkommittén: Stockholm.
SOU. (1993:16). *Nya villkor för ekonomi och politik*. Ekonomikommissionens förslag, Ekonomikomissionen: Stockholm.

SOU. (1994:20). *Reformerat pensionssystem*. Pensionsarbetsgruppens betänkande. Pensionsarbetsgruppens: Stockholm.
SOU. (2002:47). *Arvs- och gåvoskatten*. Skattebasutredningen: Stockholm.
SOU. (2004:66). *Egendomsskatter—Reform av arvs- och gåvoskatter*. Egendomsskattekommittén: Stockholm.
SOU. (2005:4). *Liberalisering, regler och marknader.* Regelutredningen, Näringsdepartementet: Stockholm.
Steinmo, S. (1993). *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State*. New Haven: Yale University Press.
Stern, E., & Sundelius, B. (1997). Sweden's Twin Monetary Crises of 1992: Rigidity and Learning in Crises Decision Making. *Journal of Contingencies and Crisis Management, 5*(1), 32–48.
Svanborg-Sjövall, K. (2011). *Kentucky Fried Children, Om den svenska valfrihetens rötter—och dess fiender*. Stockholm: Timbro.
Svensson, T. (2002a). *Novemberrevolutionen—om rationalitet och makt i beslutet att avreglera kreditmarknaden 1985* (ESO-rapport. DS 1996:37). Stockholm: Finansdepartementet.
Svensson, T. (2002b). Globalisation, Marketisation and Power: The Swedish Case of Institutional Change. *Scandinavian Political Studies, 25*(3), 197–229.
Tobisson, L. (2009). *Främling i folkhemmet*. Stockholm: Atlantis.
Ullenhag, K. (1998). *I takt med tiden. SNS åren 1948–1998*. Stockholm: SNS.

CHAPTER 7

The Australian Reform Process

The reform process in Australia started in the early 1980s, a couple of years earlier than in Sweden. The Australian welfare state had run into serious problems in the 1970s and policy failures were seen in almost all sectors. However, the Australian welfare state was very different from the Swedish one, and the economy had been in a steady decline relative to other industrialized nations for a long time.

These failures, which shifted the interests and the allocation of political power, together with new ideas advocated by different policy entrepreneurs triggered the reforms. Just as in Sweden, successive governments from both the left and the right propelled the reform process, using a whole range of reform strategies.

Over 25 years the Australian model went through a fundamental change, involving not only new policy instruments and settings, but also a redefinition of its overarching goals. The institutional changes involved financial reforms, tariff reforms, taxation reforms, industrial relations reform, welfare reform, and fiscal consolidation.[1] These institutional changes largely explain the relative success of the Australian economy in recent years.

Over this quarter of a century Australia was transformed into an open, competitive economy, with high productivity, stable public finances, and virtually no public debt, and into a cosmopolitan, multicultural society with an optimistic view of its future and role in the world. It amounts to no less than a change of social model. However, just as in Sweden, the

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_7

reform process has come to a halt. In the case of Australia, this coincided with the return to power of the Labor Party in 2007.

As in Sweden, the process of change can be divided into several intertwined and partly overlapping stages: financial deregulation and a series of structural reforms; from a banana republic to a new narrative; debt reduction and continued reforms creating a new model; and, finally, the reform process coming to a halt. As we shall see, many different actors, using many different reform strategies, were involved in the large number of reforms that were introduced, some of which are listed in Chap. 3.

Just as in Sweden, a number of different governments were involved in the reform process. For the first 12 years Labor governments implemented a series of structural reforms, led by Prime Minister Bob Hawke and his treasurer, Paul Keating, between 1983 and 1991 and then by Paul Keating as prime minister from 1991 to 1995. From 1996 to 2007 John Howard led a coalition government composed of the Liberal Party and the National Party and continued this process of sustained liberalization. Due to the overlapping stages in the process I shall not follow a strict chronological order in the presentation of the reform areas.

Again, we shall analyze in detail this successful reform processes to try to identify causal mechanisms behind successful policy reform—*why* and *how* beneficial institutional change takes place in modern welfare states. First, we will briefly present the institutional and socio-economic conditions and developments that preceded the institutional changes.

The Australian Settlement

In 1901, the six Australian colonies joined to form the Commonwealth of Australia, a nation of 4 million people. The constitution blended the British system of government with the American model of federalism, while keeping a subject of the British monarchy. The former colonies, now states, assigned specified powers to a bicameral national parliament, consisting of a House of Representatives representing the citizens and a Senate representing the states, roughly with coequal powers. Today there are six states and two territories, each with its own government. The governor-general of the Commonwealth of Australia is the representative of the Australian monarch (currently Queen Elizabeth II).

Journalist Paul Kelly (1994) has famously argued that the first eight decades of the new nation was characterized by what he calls the *Australian Settlement*, a national consensus that the government should play a large role in the economy. The origins of this consensus are as old as European settlement in Australia itself, "rooted in a society shaped by former convicts, military officers and a 'colonial secretary' mentality" (1994, p. 10).

The European settlement, as conceived by Kelly, consisted of five pillars:

1. White Australia
2. Industry protection
3. Wage arbitration
4. State paternalism
5. Imperial benevolence

"White Australia" is the name Kelly gives to Australia's immigration policy during the larger part of the twentieth century—which limited entry to people from Europe, and in particular from Northern Europe and the British Isles. This policy was not just about immigration, however, Kelly says; it also gave the nation a national identity in defining Australia as European and more precisely British. Australia's first prime minister, Edmund Barton, rightly predicted the demise of Western colonialism but saw White Australia as something that would safeguard Australian values in the future. The second prime minister, Alfred Deakin, went even further, stating that "Unity of race is an absolute to the unity of Australia … After all, when the period of confused local politics and temporary political divisions was swept aside it was this real unity which made the Commonwealth possible" (Kelly 1994, p. 3).

White Australia was progressively dismantled during the second half of the twentieth century, largely as a result of decolonization, the decline of Europe, and the transformation of Australian national interests. The Australian Labor Party (ALP) abolished its commitment to White Australia in 1965 and the Whitlam government ended the last remains of official racial discrimination in 1973 (Kelly 1994, p. 4).

The second and third pillars, industry protection and wage arbitration, were two important and related components of the Australian settlement. Industry protection shielded the manufacturing sector from competition while wage arbitration was supposed to ensure that the social surplus presumably created by protectionism was equitably distributed between labor and capital (Kelly 1994, p. 7). In 1929 the government's Brigden Report had concluded that protectionism served Australia well since it transferred wealth from the rural sector to the urban sector—from landowners to workers, which was considered desirable on equity grounds. The government announced that "wherever effective protection is granted, its benefits will be limited to those manufacturers whose employees are allowed to share in them to this extent" (Powell and Snape 1992, p. 3).

Australia did not reduce tariffs to any significant degree as a result of the GATT (the General Agreement on Tariffs and Trade) negotiations starting in the late 1940s, since they only concerned manufactures. Australia's main exports were commodities and its leadership perceived its manufacturing industry to be in an infant state, deserving of protection (Corden 1996, p. 145). As a consequence, for much of the twentieth century tariffs were very high in Australia. By 1970, Australia and New Zealand had the highest tariffs in the industrialized world. It was not until the 1970s and the 1980s that the tariffs began to be questioned.

The wage-arbitration system—a very special Australian institution—was instituted in 1904. According to Kelly (1994, p. 9), the system was an institutional monument to Australian egalitarianism and its quest for social order. It gave a Commonwealth Arbitration Court the right to settle disagreements between employers and unions through a system of compulsory arbitration. The court determined, as a principle, that wages needed to be "fair and reasonable," meaning that they should be at least enough to pay for "the normal needs of the average employee" (Kelly 1994, p. 9), a term that in practice meant a married male responsible for supporting a family.

The arbitration system had both federal and state tribunals, which issued awards—detailed judgments concerning compensation and working conditions. These could cover a particular company, occupation, or industry. The award system covered most workers, but not all. In 1974, 88 percent were covered. Through this system minimum wages and some other working conditions were set. Trade unions and employer associations were granted an assured position within the system in exchange for restrictions on their ability to bargain freely (Campbell and Brosnan 1999).

The fourth pillar of Kelly's Australian settlement, state paternalism, was rooted in the fact that the state, from the start when the British established Australia as a penal colony, was involved in everything—from handling convicts to regulating commercial activity. The rise of democracy in Australia and the relative absence of a property-owning aristocratic or entrenched ruling class resulted in laws and institutions dedicated to advance the individual by way of state power (Kelly 1994, p. 10). In fact, Australia is one of the oldest welfare states and a typical example of a liberal welfare state regime, with fairly limited and selective redistribution (Esping-Andersen 1985). In the early 1980s the tax share of GDP was only a little above 25 percent (half as much as in Sweden).

The fifth pillar of the Australian settlement, a belief in the benevolence of the British Empire, defined Australia's role in the world and underscored the country's European identity. For most politicians, a strong Empire was necessary for a strong Australia, or, as William Hughes (prime minister 1915–1923) put it: "Without the Empire we shall be tossed like a cork in the cross-current of world politics. It is at once our sword and our shield" (Marshall 2001, p. 173).

However, the bond with Britain was never uncomplicated. Even though the creation of a nation in 1901 had been successful, there was no given sense of nationality or purpose. As Kelly (1994, p. 11) puts it: "The Australian psychology was trapped between the aspiration to independence and the comfortable dependence upon Britain." It would be the 1970s before Australia started to bury its inferiority complex and reveal glimpses of national confidence.

Thus imperial benevolence, together with white immigration, industry protection, wage arbitration, and selective state paternalism, formed the ideological underpinning of the Australian welfare state. A central element in this ideology was the loose concept of "fair go," inherent in the wage-arbitration system as well as in state paternalism. The concept implies that everyone (or at least white males) should be treated in an equal way. All major parties contributed to the model, but the "fair-go" system was mainly created and upheld by non-Labor party politicians. From the consolidation of the party system in 1910 to Labor's election victory in 1983, non-Labor parties (chiefly the Liberal Party) ruled Australia for 52 of the 73 years (Kelly 1994, p. 12).

During the Second World War a Labor government implemented a program of wide-ranging intervention in the economy, as did many other industrialized nations at the time. In a reaction against these policies, the Liberal Party came back to power in 1949 and removed the most blatant aspects of the planned economy. Robert Menzies, who had previously served as prime minister (1939–1941), again assumed the nation's most powerful office. The Liberals remained in power until 1972. During this period, sometimes called the golden age, the population almost doubled through massive immigration, unemployment was virtually non-existent, and economic activity increased more than threefold (Macintyre 2004).

In the 1970s, however, there came an economic downturn, partly caused by the sudden rise in the price of oil. The Labor government under Gough Whitlam responded by expansionist reforms, which accelerated inflation, reaching a peak of 16.7 percent in 1974–1975. An across-the-board tariff cut of 25 percent was implemented as an anti-inflation measure. But it was soon replaced by import quotas and partly ditched. A constitutional crisis followed in 1975 when Whitlam could not get his budget approved by the Liberal-controlled Senate. The governor-general, a representative of the Australian monarch Queen Elizabeth II, appointed by her on the advice of the prime minister, intervened by dismissing Whitlam and instead appointing the Liberal leader Malcolm Fraser as prime minister. Fraser won the subsequent election in a landslide.

Fraser would lead the Liberal-National party coalition from 1975 to 1983, with John Howard as treasurer. Fraser was given a strong mandate, and for five-and-a-half years had control over both the House of Representatives and the Senate. While he was in a good position to implement a new reform agenda, instead he sought to restore the status quo as it had been before the Whitlam government. He did this largely through interventionist policies, including restoring the higher tariff levels and harsh credit restrictions hitting protected industries. This occurred even though Australia was experiencing its worst economic downturn since the 1930s—along with a domestic wage explosion.

In 1982, wages rose by 16 percent, resulting in squeezed profits, double-digit inflation, and an unemployment rate of almost 10 percent. Leaning again on Keynesian principles, Fraser sought budgetary expansion to counter the recession, causing a rising budget deficit without solving the underlying problems.

In fact, throughout the long period of the Australian settlement, the Australian economy had had slow growth, measured by both exports and GDP per capita. Exports fell as a proportion of GDP between 1913 and 1973 (Leigh 2002, p. 491). The exception was an unusually high increase in GDP in the 1960s, but apart from that growth rates have kept within the band 1.5–2 percent annually on a five-year basis (Maddison 2008). The interventionist and protectionist policies kept productivity and growth low, imports expensive; worsened the terms of trade; and, in the end, caused inflation, unemployment, and industrial conflict. These policy failures caused the end of the Australian settlement.

New Ideas and Policy Entrepreneurs

In the 1970s and early 1980s Australia was caught in a highly undesirable, inefficient economic and social situation. The institutions and policies of the Australian welfare state interacted with the economic and social conditions to produce severe policy failures.

Special interests protected their subsidies and privileges nevertheless upheld the status quo, since they benefited from industry protection, wage arbitration, and state paternalism, while the gains were diffuse and uncertain. No special group seemed to have the incentive to bear the cost of promoting reforms, while many well-organized groups had strong incentives to oppose the reforms in order to secure their existing benefits. Thus, the barriers to reform, just as in Sweden, were massive. Moreover, the status quo of the Australian settlement worked as a reference point from which changes were evaluated. The dominating values and beliefs in Australia embraced the existing system. Australia seemed to be caught in an ideational trap where public opinion and preference falsification virtually made reforms impossible.

It was around this time that Singapore's president Lee Kuan Yew is said to have said that Australians were on track to become "the poor white trash of Asia," but it has been questioned if he really made this statement. However, by then a number of policy entrepreneurs already had entered the scene and started to shift the political climate in favor of free-market ideas. Five more or less independent groups stand out: (1) the Tariff Board, later to become the Productivity Commission; (2) academic economists and think tanks, especially the Crossroads group; (3) actors within the Australian Council of Trade Unions (ACTU) and the ALP; (4) the Treasury; and (5) the Reserve Bank of Australia.[2]

The Tariff Board was created in the 1920s to monitor and administer the extensive protectionist system. In 1974 it became the Industries Assistance Commission (IAC) and later, in 1989, the Industry Commission. In 1998 the Productivity Commission replaced the Industry Commission.

Somewhat paradoxically, rather than supporting the tariff system, the Tariff Board came to do the opposite. Alf Rattigan, chairman of the board from 1963 and chairman of the new IAC until 1976, early on had begun to publish reviews of the tariff assistance for every industry, largely in order to spark a debate about the costs of protection. This was almost exactly what happened. Together with an alliance of bureaucrats, journalists, and economists, Rattigan started a war against protectionism (Lloyd 2008;

Kelly 1994, p. 44). Later on the board and the ensuing commission would take on a unique and much broader role in the Australian reform process.

The second group of policy entrepreneurs, made up of academic economists and think tanks, was more heterogeneous. There were also external academic influences. For example, Milton Friedman visited Australia in 1975 (and again in 1981, 1994, and 2005). According to Kelly (1994, p. 47) his visits "left a lasting impression that new institutions were needed to promote the cause of freedom" and contributed to the shift in favor of monetarism and market-liberal policies in the Australian discourse (Courvisanos and Millmow 2006). The next year, 1976, Friedrich Hayek visited Australia promoting the intellectual cause of liberal reform further (Berg 2015).

Perhaps even more influential was a 1980 book by Herman Kahn and Thomas Pepper, *Will She Be Right? The Future of Australia*. The authors argued that Australia could have a future of "economic dynamism" in the East-Asian region if it did not remain protectionist and (partly) isolated.

A more radical argumentation along the same lines was made in the book *Australia at the Crossroads*, by the economists Kasper et al. (1980). The publication was sponsored by Shell Australia. The authors presented two scenarios called the "mercantilist trend" and the "libertarian alternative." The first was characterized by "risk-averse, inward-looking attitudes and the efforts of established groups to conserve their power positions in an increasingly insecure world," while the second would "open society up to the challenges of competition from new technological ideas and concepts, new industrial countries and a new generation of young people" (Kasper et al. 1980, p. 92).

According to Berg (2015), the publication sparked organizational development among scattered classical liberal, the so-called Dries, in the Liberal Party, and the Crossroads group was formed to bring together representatives of party politics, industry, media, think tanks and academics. From 1981 onwards it provided a platform for liberal reform discussion (Kasper 2011, 2016).

A number of think tanks supported such market-liberal ideas, in particular the Centre for Independent Studies, with Greg Lindsay; the Institute for Public Affairs; and the Australian Institute for Public Policy, with John Hyde. The last of which was also one of the "Dries" (Hyde 2002). Later on the H.R. Nicholls Society, an organization formed to support the reform of Australian industrial relations, founded in 1986, became influential on issues dealing with reforms of the arbitration system.

It is notable, however, and an important contrast to the Swedish case, that the corporate sector did not have the central role in the promotion of institutional change in Australia. There were several business organizations in the country, but no peak organization such as the Swedish Employers' Confederation (SAF) in Sweden. In 1983 three business organizations at the national level at least partly competed with each other, alongside hundreds of local and sectional ones (Goldfinch 2000, p. 143). Also, part of industry may have been too caught up in the prevailing protectionist policies. Nevertheless, the National Farmers' Association as well as the leading mining companies and some prominent businessmen were active in promoting the above-mentioned think tanks as well as supporting lectures by classical liberal foreign speakers.

There was also a shift in ideas among many academic economists, not least at the Australian National University (ANU). They started to favor more neoclassical, supply side, and market-oriented policies. A leading professor was Ross Garnaut, later to become an economic adviser to Prime Minister Bob Hawke. These ideas were later termed "economic rationalism"—a distinct Australian phrase that had arisen in the 1970s policy discussions to cover a wide range of policies that were meant to make the Australian economy more competitive. According to Pusey's (1991) much quoted (and critical) study, economic rationalism even took a doctrinaire hold on bureaucrats in the federal agencies in Canberra.

Of course these ideational developments were also spurred, just as in Sweden, by the global ideological paradigm shift exemplified by Margaret Thatcher and Ronald Reagan. It is also clear that recommendations from international organizations such as the OECD played an important role (interview Robertson 2011). Moreover, the parallel but still different market-liberal reforms of New Zealand also served as a very important reference point (Goldfinch 2000, Kasper interview).

However, the policy ideas were also changing within the Australian Council of Trade Unions (ACTU) and the ALP. Bill Hayden, who was the party leader from 1977 to 1983, persuaded the party that economic responsibility was the main task of a party in power. He also forged a closer relationship with the unions, as well as the business community, and started to accept the economic prescriptions brought forward by the academic economists as well as by the Treasury, the OECD, the Reserve Bank, and similar organizations (Kelly 1994, p. 23). In a similar way, leading members of ACTU, especially its secretary Bill Kelty, had started to question the protectionist, centralist, and paternalist policies dominating Australia, more from a consumer and union perspective (Goldfinch 2000).

As just mentioned, policy entrepreneurs were also to be found in the Treasury and the Reserve Bank of Australia. Both institutions, staffed by highly trained economists, gradually moved toward more neoclassical and supply side–oriented views. The influential secretary of the Treasury John Stone, as shown in Whitwell's book *The Treasury Line* (Whitwell 1986), largely came to reject Keynesian polices and moved toward more market-oriented ideas. At the same time the Reserve Bank lost faith in its established monetary instruments and sought to reduce its reliance on direct controls by making greater use of market operations. In the process the bank became strongly in favor of market liberalization, a view that was cemented by the appointment of Bob Johnston as governor in 1982 (Interview Cornish 2010, 2011, p. 41; Goldfinch 2000, p. 44).

Together these policy entrepreneurs formed a lose policy-advocacy coalition arguing for change in a more liberal direction. The worldviews, beliefs, and values of the elites in the different spheres of society had started to change. This set the stage for the intertwined and partly overlapping stages of the reform process that would follow. Both major parties agreed that the Australian settlement—which they both previously had administered—was no longer a viable option.

Financial Deregulation and a Series of Structural Reforms

The massive policy failures of the Fraser government, pushing Australia into its worst economic crisis since the 1930s, opened up the opportunity for an election victory by the ALP in 1983. The party won on a traditional Keynesian and interventionist platform with former union leader Bob Hawke as the new prime minister and Paul Keating as treasurer.

However, the government that took office on 11 March 1983 also felt a need to signal economic responsibility, since the previous Labor government of 1972–1975 was generally perceived to have pursued a reckless economic policy. Right after the election the financial markets became very nervous and much capital left the country, forcing the new government to devalue the currency by 10 percent immediately. Moreover, the Treasury officials revealed that the deficit for the coming year was projected to be $9.6 billion, a staggering sum at that time. The new government took this as an argument to abandon some of its election promises in order to trim the deficit to $8 billion, or 4 percent of GDP. Hawke and Keating thus exploited the surprise deficit for political purposes in order to shift the blame for the austerity measures to the previous Liberal government (Kelly 1984, p. 439; Keating and Holmes 1990; Goldfinch 1999).

In effect, they embarked on a reform program that would transform their party, the government, and the Australian economy. Although both Hawke and Keating had criticized the Liberals for supporting "economic rationalism," once in power they themselves started to implement it. According to Macintyre (2004, p. 251), the failure of the Liberal Party to embrace these economic ideas during the 1980s enabled the Labor party to use them instead.

The Labor Party's reform strategy first secured support within the party and then in parliament, where the Liberals were likely to support steps toward a freer economy. According to Hirst (2002, p. 217), the Australian people had never voted to make those paradigmatic changes, but the adoption of the ideas, beliefs, and values of "economic rationalism" by both the Liberal and the Labor party made it possible to implement them anyway.

In order to break the vicious cycle of high inflation and high nominal wage increases, Hawke had made a kind of corporatist agreement, called the Prices and Incomes Accord, with the union ACTU before the election of 1983. In return for wage restraint, the party promised to bring down inflation and increase social spending in line with the "fair-go" tradition. Over the following 12 years, seven more such Accords were negotiated. This strategy paved the way for employment growth and lower inflation (Macintyre 2004, p. 248). However, as in other countries, inflation only came down to the levels we are used to today after the introduction of an inflation-targeting regime by the central bank. An inflation target of 2–3 percent was in place from 1993 onward and the government also recognized the independence of the Reserve Bank in a series of steps during the 1990s and 2000s (Stevens 1999).

While the early Accords may have kept wages under control, subsequent Accords were decreasingly potent as labor market decentralization progressed and wages increasingly were set at the firm level. During the late 1980s, the wage awards became more "simplified and rationalized" (Chapman 1998). The eighth and last Accord spanned the years 1995–1999, but as Labor lost the 1996 election the Accord was not in force for the full period. The Liberals opposed centralized wage fixation altogether so the Accord approach was abandoned.

Financial Reform

Just as in Sweden the liberalization process in Australia started in the financial markets. The Australian dollar (and before 1966 the Australian pound) had been pegged periodically to the British pound, the American dollar, and a trade-weighted basket of currencies. Nevertheless, continuous devaluations followed.

In 1979 the Fraser Liberal-National party coalition government appointed the Campbell Committee, the first public review of the Australian financial system for over 40 years. The process was supported by the treasurer Howard. At the time there were already a number of advocates for financial reform, among them the Reserve Bank itself. As put in a speech by Governor Johnston, they had themselves seen that the regulatory system had broken down and that it needed to be replaced by market-based instruments (Johnston 1989, p. 257).

The committee published its final report in 1981, recommending the floating of the exchange rate, the removal of capital flow regulations, and the abolition of interest rate and lending controls (Kasper and Stevens 1991). The Fraser government, however, implemented very few of the Campbell committee's key recommendations, while taking smaller steps such as introducing a tender system for marketing of Treasury bonds, the abolition of quantitative lending advice, and the lifting of interest rate ceilings on bank deposits (Cornish 2010, p. 47). These measures of financial deregulation, however, were far from sufficient.

On 12 December 1983, however, the Hawke government suddenly decided to let the Australian dollar float and to abolish the capital controls. The immediate trigger was a large capital inflow that could not be accommodated by the central bank. The float, according to Kelly (1994, p. 76) "signaled the demise of the old Australia—regulated, protected, introspective."

In subsequent years financial markets were deregulated, all remaining controls on bank deposits were removed, interest ceilings were abolished, restrictions on foreign ownership of merchant banks were relaxed, distinctions between trading and savings banks were scrapped, and regulation of membership of the stock exchange and brokers' commissions was eliminated (Kasper and Stevens 1991). A national stock exchange was formed in 1987 by merging the regional exchanges. The exchange demutualized in 1996, when its members converted it into a company owned by shareholders and subsequently went public. Finally, a direct ban on mergers between, and foreign takeovers of, the major banks was abolished in 1997 (Industry Commission 1998, p. 169; Goldfinch 2000, p. 158). It should be recognized that this sequence of intertwined reforms continued over the premiership of Hawke, Keating, and Howard during the tenures of both Labor and conservative parties. As we shall see, this is true of many other reform areas.

There were, however, numerous obstacles to this deregulatory process. A first problem was the fact that the initiative came from the Fraser-appointed Campbell Inquiry; thus it was a Liberal document. The earlier Labor government had instead decided to extend regulations to non-bank financial institutions, even though the decision never was implemented. The Labor Party had moreover publicly opposed the Campbell recommendations.

Hawke and Keating solved this political problem by appointing a new organization to conduct an inquiry into the financial system, the Martin Committee (Cornish 2010, p. 48). When the Martin Report finally arrived in early 1984, after the decision to float the dollar, it reached conclusions similar to those of the Campbell Report. The cabinet as a whole played only a limited role in this process, which was dominated by Hawke and Keating and key officials (Goldfinch 2000, p. 160). They moved as much decision-making as possible away from their caucus (Labor members of Parliament), because they were likely to face opposition there. In addition, it was also necessary to overcome opposition by the Treasury, especially its secretary, John Stone, who at this time was against financial deregulation (interview Stone 2011). Keating dealt with this by including the Reserve Bank in the talks, because its officials supported deregulation. Hence, those who favored continued regulation appeared to be the minority. In addition, before the float a compromise had been reached between the different factions within the bureaucracy: the forward exchange rate would be floated, but not the spot rate, hence signaling a future float. This made the float seem more unavoidable.

Just as in Sweden, then, the financial deregulation in Australia required advanced political skills, involving in particular Machiavellian strategies of splitting and obfuscating. In doing so Popperian strategies, for example public inquiries, as well as Kuhnian strategies of framing also played crucial roles. The process can also to a large extent be described as an incremental learning process (interview Cornish 2011).

Financial deregulation nevertheless turned out to be "a popular reform," embraced by business, farmers, and many state governments. In hindsight, it has been claimed that the decision to float the currency was widely supported (Veale 2008, p. 4). And Keating and Howard would later argue over which of them should get the credit for the deregulation (Kelly 1994, p. 89). McCarthy and Taylor (1995) present the thesis that Keating was the driving force and that his motivations were based on his conviction of the soundness of the idea, as he thought financial regulation mainly served established interests. Keating also had personal experiences of financial regulation; his father had been denied bank financing for his firm and was forced to sell the business.

Harper (1986), who has examined the financial reforms from a public choice perspective, also concludes that no group lost much due to deregulation. The banks were compensated for the loss of their protected position by the creation of business opportunities, and since government initially retained the interest ceilings on mortgages, opposition from the homeowner lobby was avoided. The financial sector also grew by 70 percent between 1983 and 1987. Harper fails to explain, however, why the left of the Labor Party did not oppose the change of policy to a significant degree.

Tax Cuts and Income Policies

Financial deregulation was only the first step. During the 1984 election campaign, Bob Hawke and Paul Keating made their famous *trilogy commitment*, promising:

1. Further reductions in the Commonwealth deficit, in money terms in 1985–1986 and as a proportion of GDP over the life of the current Parliament;
2. No increase in tax revenue as a proportion of GDP in 1985–1986 and over the life of Parliament; and
3. A reduction in expenditure as a proportion of GDP in 1985–1986 and over the life of the Parliament. (Hawke 1985)

This was a dramatic Kuhnian policy shift, setting the agenda for coming cuts in taxes and welfare expenditures, with a focus on fiscal discipline.

The initiative for tax reform came from the Treasury. And again, according to John Button, the industry minister, and Hawke's adviser Ross Garnaut, it was not very much discussed in the cabinet (Goldfinch 2000, p. 170). Instead, in line with Hawke's preference for consensus, a national tax summit was convened in mid-1985.

The Treasury prepared a white paper for the summit with three options for tax reform: A, B, and C. This was an attempt at agenda setting and the options were formulated so that the participants would choose C over A or B. The proposal C was carefully crafted to offer compensation to many interest groups while simultaneously increasing economic efficiency by broadening tax bases and lowering rates.

A capital gains tax was introduced, the company tax rate was raised somewhat, and fringe benefits were taxed, but in return the business community got the abolition of double taxation of dividends through full imputation of dividends. By broadening tax bases, the top marginal income tax rate could be reduced from 60 percent to 49 percent. Keating thought that having a tax rate of less than 50 percent had important symbolic connotations (Hawke 1985).

Keating also wanted to introduce a value-added tax, the Goods and Services Tax (GST), to replace existing sales taxes and other consumption taxes. Such a tax has favorable economic efficiency properties by diminishing distortions, but it may also have adverse distributional consequences, since it is a proportional tax affecting all consumers, high- and low-income alike, that are difficult to rectify with changes in the tax and benefit system. For this reason, Hawke could not get the unions and other constituents to back the GST at the tax summit in 1985, so the tax was not implemented until 2000 under Howard's coalition government (Quiggin 1998; Kelly 1994, p. 49).

A key vehicle in the reform strategies used to make the cuts in taxes and public expenditures possible was the above-mentioned Accords, a kind of corporatist arrangement which the party made with the ACTU and some business organizations. The Accords included centralized wage-fixing and wage indexation, but the 1985 second Accord included real wage discounting of 2 percent, traded-off for tax cuts, and increased superannuation—a compulsory tax-advantaged retirement savings plan for employees.

Later Accords continued to combine tax cuts with income policies, but with increased elements of enterprise bargaining, pushed by the ACTU.

Within the bureaucracy as well as among several cabinet ministers there was initial skepticism about the Accords. Treasurer Keating especially disliked them. He himself and his department were not involved in the process, at least not in the first rounds, and they feared the Accords would slow down the reforms. However, later on they would all approve of this corporatist method of gaining support for liberalizing reforms, not the least as a way of obtaining the approval of the general public. It was essential to make the policies adhere to the "fair-go" mentality.

Again we see different Machiavellian strategies such as compensating, blame sharing, and splitting being used to make the tax and expenditure reforms possible. The corporatist arrangements with the leading labor union, ACTU, were essential to success. However, Kuhnian methods of agenda setting and shifts of perspectives, such as the trilogy commitment, which shifted the focus of policy to fiscal discipline, and the deliberate framing of alternatives at the tax summit to narrow the options for reforms also played crucial roles to get the reform cycle rolling. Popperian strategies of rational argumentation of course had a key role once the agenda was agreed upon.

Tariff Reform

A central feature in the early Australian settlement was protectionism. Slowly, insight had been growing among many of the central decision-makers that these policies were in fact destructive to Australia. "Tariff-on demand" tended to work as an open door to industry lobbying and the growth of protectionism (comment by Wolfgang Kasper 2016). But numerous barriers, not least within the business community, blocked reform. As mentioned, in the 1970s the Whitlam government had attempted to lower the protectionist tariffs of Australia, but had failed, despite the support by an alliance of central bureaucrats, journalists, and economists.

And even though both Hawke and Keating were convinced free-traders, Hawke did not reveal himself as a free-trader in the 1983 election campaign. He stated that "[u]ntil this crisis is overcome, there will be no reduction of existing protection levels" (Leigh 2002, p. 500). However, Australia started to liberalize trade substantially after Paul Keating's economic statement in May 1988 (Corden 1996, p. 145). The decision was pushed by members of the center-right and right factions of the Labor Party and heavily influenced by the Industries Assistance Commission, all of whom largely relied on Popperian strategies of rational argumentation based on statistics and research. Also, the opposition tacitly supported trade liberalization. But again, the income policies in the Accords were central to the process. Moreover, subsidies were given to industries that were hurt (Kasper 2000, p. 16). Thus, Machiavellian strategies played a key role.

Industry minister John Button was also influenced by the Swedish experience with structural transformation, as Sweden and Australia had similar macroeconomic experiences, but Sweden had initiated a process of industry restructuring with the reforms in the mid-1980s that Australia had not (Leigh 2002, p. 498). Moreover, the decision had by this time become politically easier to implement due to the depreciation of the Australian dollar, which promoted the competiveness of Australian industry.

After 1988 tariffs above 15 percent were to be reduced to 15 percent over four years, while tariffs between 10 and 15 percent were to be reduced to 10 percent, lowering the average rate from 19 to 14 percent by 1992–1993 (Goldfinch 2000, p. 173). This process, however, would escalate, and tariff receipts decreased from 6 percent of federal revenue in the 1970s to 2 percent in the 2000s. The general tariff rate decreased to 5 percent in 1996 and tariffs on automobiles and textiles reached that level in 2010, down from 40 percent in 1990 (Commonwealth of Australia 2010, p. 477). Even protection surrounding agriculture, which had been subjected to regulation and price support for a long time in Australia, decreased in intensity, and tariffs on major commodities like wheat, wool, and meat were abolished by 1995 (Industry Commission 1998, p. 13). Australia, in fact, turned from one of the most protected to one of the least protected in the world (Berg 2015).

This dramatic policy change was thus made possible by a combination of Popperian strategies relying on research and facts and Machiavellian strategies of compensation, largely through the Accords. Clearly, the framing of the problem that the Tariff Commission had started in the 1970s was essential to the long-run success.

Pension Reform

In 1909 the Commonwealth of Australia had taken over responsibility for government-provided pensions from the states by introducing a flat-rate pension system, with automatic payments to retired or disabled persons, periodically adjusted for inflation and productivity growth. It was means-tested, based on income and assets. There was also a residency requirement. In the 1970s the Whitlam government made these pensions universal for pensioners over 70, but the subsequent Fraser government reversed this change. While about 30 percent of employees were covered by the private superannuation system—the tax-advantaged retirement saving plan for employees, often supported by employers—the rest relied on the national pension system.

The Hawke and Keating governments moved in the opposite direction, targeting the age pension more toward poor elderly people. Already the second Accord in 1985 as part of a deal to gain support from the unions in the reform process had increased the superannuation tax support.

In 1992, the Keating government introduced the Superannuation Guarantee, which made retirement saving compulsory, a forced saving scheme. The government had previously encouraged the unions to demand superannuation contributions from employers. By 1995, superannuation coverage had risen to 90 percent, and had become accepted by the Liberal and National parties, which had earlier opposed the system. It was seen as a way of increasing national saving and decreasing demographic pressures on the age pension (Bateman and Piggott 1997, p. 7; Rosenman 1997, p. 19; Rein and Turner 2001).

The compulsory contribution (paid by the employer) was initially set at 3 percent and has gradually increased to 9 percent. The employer manages the fund scheme, but many workers are allowed to choose in which fund they want to invest their money, as long as it enjoys superannuation tax treatment.

Compulsory superannuation turned Australia into a "shareholder society," where most workers are indirect investors in the stock market. Consequently, a lively personal investment marketplace has developed, and many Australians take an interest in investment topics (Liu 2010, p. 27).

Privatization and Competition Policy Reform

From the mid-1980s, Australia set out on a radical privatization course. It was among the most prolific privatizers in the OECD (Hodge 2003). The policy of privatization was, at least at the federal level, a gradual process that gathered momentum in the final years of the Labor government in the mid-1990s. However, several of the states and in particular New South

Wales had begun the process as early as 1988, based on ideas developed in the Crossroads group and partly inspired by the developments in New Zealand (interview Sturgess 2011; Hyde 2002). Similarly, in Victoria a successful reform movement was initiated, influenced by an agenda set by the Institute for Public Affairs and other think tanks (Berg 2015).

Central agencies had advocated privatization for a number of years, but it took some time for key officials and ministers to find the political opportunities needed to override the opposition within the Australian Labor Party. According to Mike Keating, finance secretary at the prime minister's office, privatization and the necessity of increased microeconomic efficiency had been discussed early in the Labor government. However, it was not until the corporatization and pro-competition policies had been settled that the process of privatization was made possible (Goldfinch 1999, p. 13).

Hawke had tried to gain approval for sales of publicly owned assets at the 1987 Labor conference, but he was unsuccessful. It was not until the collapse of the state bank in the Labor-governed state of Victoria in 1990 that a new opportunity for a privatization policy arose. In order to save the bank and protect the Labor party, the Commonwealth Bank bought the State Bank of Victoria. In order to afford the takeover, the Commonwealth Bank sold some of its shares. The move to save the bank by selling shares silenced the opposition within the Labor Party and opened up the possibility of further asset sales. Once the government had floated shares amounting to 30 percent of the equity of the Commonwealth Bank in 1991, an extensive program of asset sales followed, including the sale of Qantas and Australian Airlines and AUSSAT, a national satellite communications system (Goldfinch 1999, p. 13).

The next step to improve microeconomic efficiency was the National Competition Policy. In 1993, the Keating government established mutual recognition of regulations, meaning that state governments did not require goods or professionals to meet a state's standards, as long as they are approved by another state. This reduced impediments to the flow of goods, particularly food, and provided greater labor market flexibility in, for example, the legal and medical sectors. The Commonwealth used financial incentives to persuade states into accepting the National Competition Policy, partly to compensate states for revenue lost when state monopolies were privatized.

The groundwork that needed to be done before the deregulation and privatization could start dates back to the Tariff Board and the subsequent

Industry Assistance Commission, which published a series of reports arguing for reform. In 1990 the agency was renamed the Industry Commission, and in 1998, the Howard coalition government merged the Commission with some other bodies to form the Productivity Commission. Since the mid-80s this commission has had between 200 and 300 employees (Productivity Commission 2003, p. 24).

According to the Productivity Commission itself, three core principles distinguished the commission: independence, transparency, and a community-wide focus. It operates under the protection and guidelines of its own legislation, meaning, "It has an arm's length relationship with the Government, which can tell it what to do but not what to say." The Commission's advice and the information that it generates are open to public scrutiny and in providing advice it "seeks to advance the interests of the community at large" (Productivity Commission 2003, p. 1, 2005a; interview Banks 2011).

A special government report from 1993, the Hilmer Report, also played an important role for the new policies. It broadened the competition policy to including the role of regulation and government-owned enterprises and public utilities. For example, it proposed the dismantling of public monopolies on electricity, gas, and telecommunications and recommended third-party access to gas pipelines, railways, and airports. The process of producing the report was very transparent, with the committee asking for comments from the public along the way. An Industry Commission report (1995) supported the Hilmer Report recommendations and was important in pointing out the need for competition policy reform (Painter 1998; Kelly 2009, p. 126).

In 2005 the Productivity Commission concluded that the National Competition Policy, the de facto termination of the policy of industry protection, had delivered substantial benefits to the Australian community and greatly outweighed the costs. The report stated that the policy had "contributed to the productivity surge that has underpinned 13 years of continuous economic growth, and associated strong growth in household incomes." It also stated that the policy had directly reduced prices of goods and services such as electricity and milk; stimulated business innovation, customer responsiveness, and choice; and helped meet some environmental goals, including the more efficient use of water (Productivity Commission 2005b).

To conclude, privatization and competition policies were largely implemented through Popperian strategies such as research, rational argumentation, and independent reports. Of particular significance was the role of the Productivity Commission, an independent bureaucratic body, which produced many of the recommendations that later were implemented by the politicians. However, due to the federal structure of Australia, as well as to the resistance to the reforms, Machiavellian strategies were used as well to make the necessary decisions possible. For example, instead of targeting each regulatory measure, a policy of mutual recognition of regulations between the different states was used. The leaders of the Labor Party, moreover, took the failure of an individual bank as an opportunity to push for a much larger reform.

From a Banana Republic to a New Narrative

Most of the reforms described above were implemented through a combination of rational argumentation and shrewdness. However, the Labor Party, or at least its leader Paul Keating, also used Kuhnian strategies to promote a major paradigmatic shift of perspectives. He wanted a new narrative for Australia.

In May 1986, Keating, then finance minister, held a now-famous "Banana Republic" speech, in which he warned that without a reduction of costs and an improved trade performance, Australia would become "a third-rate economy … a banana republic." The reforms he proposed included cuts in public spending, further wage restraint, and greater exposure of Australian businesses to international competition. The Labor government also started to talk about reducing the tariffs that protected local industry as well as relaxing the centralized system of wage fixation (Macintyre 2004, p. 249).

Keating's provocative statement lifted public consciousness and made people aware of Australia's economic dilemma. According to Kelly (1994, p. 196), the statement helped expand the limits of political tolerance, which made it possible for the Labor Party to pursue the reforms presented above. This was the start of the fall of the principle of state paternalism, the idea that a strong state was needed to protect living standards.

In the late 1980s, however, the financial market had started to cause some problems for the Hawke government. In the aftermath of the financial deregulation, the inflow of borrowed capital pushed up the national debt, the Australian dollar, and finally the trade deficit. According to Kelly (1994, p. 77) neither Hawke nor Keating had been able to foresee the full impact of the deregulation, notably the credit expansion and the asset boom (in a very similar way to the Swedish developments). By repeatedly increasing the official interest rate, which reached 18 percent in 1989, they tried to force an end to the process.

The price was paid with the collapse of large companies in the finance industry as well as thousands of small businesses. With a market opened up to global competition, several manufacturing plants in Australia were forced to shut down, since they could not compete with goods shipped in from low-cost factories in Southeast Asia. By 1990 Australia had run into a recession. GDP sank, unemployment rose, revenue collapsed, and welfare payments surged (Macintyre 2004, p. 251).

The problem of unemployment, and especially youth unemployment, haunted Hawke and Keating, but the reform process nevertheless continued. Keating used the same message as Margaret Thatcher when he claimed that there was simply "no alternative" other than confronting a new, globalized world with less state control over the markets (Macintyre 2004, p. 252). The recession was something that Keating stated "Australia had to have." At the same time, Hawke appeared to lose interest in further pursuing the reform agenda, and was eventually overthrown by Paul Keating, who became prime minister in 1991 (Macintyre 2004, p. 259).

The problematic economic situation may have increased chances for the opposition. In 1990, after losing yet another election, the Liberal Party elected the economist John Hewson as party leader. Hewson fully embraced the market-liberal reform agenda and pushed for more far-reaching tax cuts, a smaller public sector, and a speedier removal of tariff protection and labor market regulations.

In 1991 Hewson presented a policy document named *Fightback!* made up of a number of radical proposals, including the abolition of the wage-setting system based on the "awards," the conditions set by the wage-arbitration courts, cuts in Medicare and government expenditures, major cuts in income taxes, sales of government-owned businesses, and the introduction of a value-added goods and services tax (GST) of 15 percent. Arguably, this was the most substantial reform agenda Australia ever had seen (Berg 2015).

Keating, eager to put his own stamp on the prime ministry and despite resistance from the Treasury, responded by presenting his "One Nation" statement in February 1992 (Goldfinch 2000, p. 183; Kelly 2009, p. 59). It was a highly political package that contained a significant fiscal stimulus in the face of the worst recession in ten years. It was a break with the fiscal constraint that had dominated since 1985. Keating's statement promised even larger tax cuts than the *Fightback!* document and combined them with public investments. He also convinced the states to agree to increase their fiscal spending. However, and most importantly, he carefully avoided proposing the unpopular GST.

In the 1993 election, where the opposition in the face of the severe economic situation had a huge lead in the opinion polls, avoiding the GST turned out to be of great significance. In the so-called birthday cake interview before the election, the Liberal Party's Hewson could not explain how much a birthday cake would cost with the Liberals' GST proposal. This contributed to the Liberal Party's losing the "unlosable" federal election. Following the loss, Hewson declared the *Fightback!* policy to be dead and buried. Apparently such a dramatic shift of paradigm did not appeal to the voters.

After winning the election of 1993, Keating, however, continued with reforms such as relaxing the centralized wage setting and introducing competition policies designed to increase the efficiency of public utilities. He also introduced, as mentioned above, the compulsory system of superannuation, saw to it that several national enterprises were sold, and allowed states and local government to commercialize or privatize theirs as well (Macintyre 2004, p. 260).

As we have seen, through a series of structural reforms implemented by Labor governments, the Australian settlement was gradually replaced by fundamentally different, and more liberal, policies. In particular, industry protection was replaced by the deregulation of financial and product markets. Moreover, state paternalism was losing its grip due to tax cuts and the increased importance of a pension system based on individual savings. Also we have seen the first steps taken toward a fundamental change in the wage-arbitration system through increased bargaining on the enterprise level. Many of these changes emerged as the result of an incremental learning process (Edwards 1993). However, remnants of other elements in the previous model still existed in 1993.

Keating, as prime minister, saw as his mission to change this by launching what he called the "New Australian Policy." He set out once and for all to leave the old pillars—the Australian settlement, especially the fifth element, imperial benevolence and Australia's special historical relationship with Britain and the USA.

Keating wanted a new narrative. According to Kelly (2009, p. 65) its "essence lay in nationalism, identity and Australian history … it would touch many aspects of Australian life—the ANZAC, ethos, war history, the Constitution, the head of state, multiculturalism, Aboriginal reconciliation, school curriculum, relations with Asia, racial tolerance and egalitarianism." Keating explicitly wanted to change "the Big Picture," as he called it.

This Kuhnian strategy to complete the paradigm shift, however, turned out to be too much for the electorate. It failed because of lack of support from the people. Keating was instead perceived as being out of touch with ordinary folks. As described by Rodney Cavalier, historian and former New South Wales minister,

> Paul [Keating] was sounding like the National Library and the great institutions of public life had become his own property. The only legitimate sense of Australian identity was the one Paul defined. His ideas agenda based on the republic, native title, engagement with Asia and multiculturalism cut no ice with the electorate at large, especially core Labor voters (Kelly 2009, p. 150).

Debt Reduction and Continued Reforms Creating a New Model

Keating lost the 1996 election to opposition leader John Howard. The political agenda that Keating had been pushing in the year before the election included issues that did not appeal to the Australian middle class. It gave Howard a chance to occupy the middle ground. As put by the opinion poll analyst Rod Cameron: "The Labor agenda in the last 12 months (before the election) was Mabo [The Native Title Act 1993], Carmen Lawrence, an obscure bridge in South Australia, Asian migration and also a republic. It wasn't about anything of interest to the middle ground" (Kelly 2009, p. 240).

Howard had served as treasurer in the Fraser Liberal-National coalition government from 1977 to 1983. He was leader of the Liberal Party from 1985 to 1989, which included the 1987 federal election against Bob Hawke, but was subsequently outcompeted by John Hewson. He was re-elected as leader of the opposition in 1995.

The Howard coalition government was re-elected at the 1998, 2001, and 2004 elections, with Peter Costello as treasurer. During this time real per capita GDP rose by over 32 percent and employment by 27 percent, helped along by favorable terms of trade (Kasper 2011).

In his first term in office Howard sought to expunge Keating's legacy, both at home and abroad (Macintyre 2004, p. 272). Under the Labor Party, the government had taken a multilateral approach to foreign affairs and emphasized the importance of close relations with the Asian countries. Now the focus shifted, and the coalition instead stressed a bilateral approach and national sovereignty. However, in other areas the set of wide-ranging structural reforms would continue.

Howard upheld and developed the reformed regime in capital and products markets. The Howard government, for example, introduced a new competition policy. It consisted of several agreements between the Commonwealth, the states, and the territories—all designed to achieve competitive neutrality between publicly and privately owned enterprises. This, in turn, led to the sale of several public enterprises and a number of government functions being contracted out to private firms (Brennan and Pincus 2002, p. 19).

The state governments agreed to implement reforms in the electricity, gas, water, and road transport sectors. The states also promised to accept a national, uniform competition law, which was extended to non-listed and government-owned enterprises (Productivity Commission 2005b). The agreement also established the National Competition Council, with its main function being to "recommend on the regulation of third party access to services provided by monopoly infrastructure" (National Competition Council 2013).

Howard also continued with the shift in public enterprise management that had begun during the Hawke-Keating era. Furthermore, he started to make attempts to further reform the labor markets and change the debt and tax regime. Howard would greatly benefit from the earlier reforms, which with a lag by now finally paid off in terms of increasing growth and employment (interview Edwards 2011).

Fiscal Consolidation and Welfare Reforms

However, rather than opting for a smaller government and a lower tax burden, Howard, along with Costello, instead wanted a solvent, debt-free government. Keating's push for Keynesian policies had dramatically increased public debt. The first priority of Howard-Costello thus became budget surplus and debt reduction through the establishment of a new rule, a requirement to have the Commonwealth budget balance over each economic cycle (Kelly 2009, p. 278). The move was supported by the

Reserve Bank as well as by the Productivity Commission and the members of the notorious Crossroads group. Among other things, the government published a balance sheet of valued assets and liabilities, a National Commission of Audit, which showed that successive governments had been in the business of value destruction (Kasper 2011). In effect, this was a long-run pledge of budget surpluses.

Moreover, Howard was re-elected after announcing a shift in the tax structure, moving from a traditional heavy reliance on personal and corporate income taxes to a GST (!) at an initial rate of 10 percent (Kasper 2000, p. 25). In order to get the bill through Parliament, however, he had to agree to exempt food (Howard 2010, p. 313). He also halved the capital gains tax and abolished taxes on superannuation payouts (Kelly 2009, p. 301).

The abolition of the debt was one of the most important achievements of Howard and Costello, since it allowed Australia to enter the 2008 global economic crisis debt-free (Kelly 2009, p. 285; Di Marco et al. 2009). Furthermore, the formal agreement on central bank independence in 1996 promoted a low-inflation culture.

Howard, however, also successfully executed important welfare reforms. His so-called tough love reform was a result of his view that welfare payments should be conditional, welfare recipients having obligations to the society and other taxpayers. The Center for Independent Studies played was here a key player in framing the debate (Berg 2015). This was implemented through the Work for the Dole program in 1996 and the Welfare-to-Work bill. The reforms were controversial and opposed by the Labor Party, but successful economically. After job-search requirements were imposed in 2006, the number of families dependent on benefits fell by 120,000, or 20 percent (The Australian 2011).

Furthermore, Howard considered choice as a basic value, which included private schools and private health insurance. He instituted a private health insurance rebate of 30 percent and consequently, the numbers of Australians with private insurance rose from 30 to 44 percent. The school policy included shifting funding proportions to back private schools more generously, with the result that one in three pupils switched from a public to a private school (Kelly 2009, p. 298).

However, Howard would also drastically increase benefits to families, in an attempt to combine economic liberalism and social conservatism. He included a child tax credit aimed to target poverty and benefits to support single-income families, which he considered to be disadvantaged by the tax system as compared to two-income families. His rhetoric also started to change, with attacks on his former pro-market, liberal friends (Kelly 2009, p. 294). By Howard's final budget the scale of family support was larger than the defense budget, but Howard never saw a problem with giving out large benefits to families. Perhaps this was a sign of the beginning of the end of the liberal reform era.

Industrial Relations Reforms

The Howard government initiated new and radically liberal industrial relations reforms. The ambition was to do away with central wage-fixing, quasi-judicial arbitration, and union dominance (Kasper 2011). Two reforms stand out, the Workplace Relations Act of 1996 and the 2006 Workplace Relations Amendment Act (called WorkChoices). In addition, the privatization of the employment service in 1998 was an important liberal reform (Stone 2008).

As mentioned, bargaining between workers and employers had started to be decentralized during the Labor years, beginning in 1990 through the sixth and seventh Accords. In 1985 Hawke had formed a special commission, headed by Professor Keith Hancock, whose report opened up discussion about enterprise bargaining. The Australian Council of Trade Unions actively promoted the development (interview Edwards 2011). Wage negotiations soon started to take place at the firm level, which became known as enterprise bargaining. This signaled the beginning of a gradual dismantling of the award system (interview Sloan 2011). In 1994, with Keating as prime minister, workplace agreements were allowed to be negotiated also in non-union workplaces.

The Howard government, with Peter Reith as the minister for industrial relations between 1996 and 2000, went further however, partly influenced by the H.R. Nicholls Society. The Workplace Relations Act of 1996 encouraged individual contracts in addition to the enterprise agreements, and restricted the scope of the Industrial Relations Commission's awards. The commission no longer determined national wage levels; rather, it provided "safety net" adjustments for those lower-paid workers who were unable to bargain for a better deal (Macintyre 2004, p. 264). The 1996 reform allowed Australian workplace agreements (AWAs), which were individual contracts that could bypass collective bargaining. It also outlawed closed shops, that is, workplaces where only union members could work. This caused union membership to decline, continuing a long-term trend. Union membership decreased from 51 percent in 1976 to 23 percent in 2004 (de Turberville 2007, p. 376).

Another important reform affecting the labor market was the 1998 privatization of the public job service, called Job Network and later Job Service Australia (Dockery and Stromback 2001). Unemployed individuals each get a "job voucher" to be used to purchase the service needed from competing private, for-profit as well as non-profit, job services. The providers are ranked depending on their performance. Despite some initial problems the system has proved to be highly successful in matching individuals and jobs.

Around this time opposition from the ACTU started to rise. However, in 2004 Howard's coalition government got the majority in both houses, which made it possible to push additional labor market reforms through the political system. Howard now saw the chance to do something "big," not just adding to the Hawke-Keating reform agenda (interview Kelly 2011).

In 2006 the Workplace Relations Amendment, WorkChoices, came into effect. Instead of wage awards handed down by arbitration tribunals, the Australian Fair Pay and Conditions Standard now guaranteed a minimum set of working conditions. The changes effectively meant the end of compulsory arbitration. Workplace agreements no longer had to pass a "no disadvantage" test, meaning that conditions no longer needed to equate or exceed those stipulated by awards.

However, the reform met increasing opposition, and not only from the labor unions. The increase of federal power was first challenged by all state and territory governments in the High Court of Australia. The court ruled in favor of the Commonwealth, but in 2007 the Liberal Party lost the election, with WorkChoices being a major issue.

According to Kelly (2009, p. 306) Howard misjudged the trade union movement and the public's mood. Although he was able to push through the policy, he never succeeded in convincing the public of its value. Furthermore, WorkChoices was seen as un-Australian for violating the "fair go," and thus gathered a very powerful coalition against it. That coalition included everyone from the trade unions and the Labor party to media, churches, welfare groups, celebrities, and community leaders. In addition, the state governments, all of whom were controlled by the Labor Party, resisted the change (interview Sloan 2011).

Howard himself has confirmed this analysis. According to his view, winning both houses made the government overconfident (Interview Howard 2011). Another way of putting this would be to say that the barriers to reform, in terms of special interests, negativity biases, public opinion, and the like, were not handled with the appropriate reform strategies. Perhaps Howard was not Machiavellian enough. Moreover, the shift toward more conservative rhetoric and policies may have made the ground for liberal policies less fertile.

The Reform Process Comes to a Halt

From 1983 to 2007, with Labor governments led by Hawke and Keating and Liberal-National coalition governments led by Howard, Australia experienced a process of sustained liberalization. Over this quarter of a century Australia was transformed into an open, competitive economy, with high productivity, stable public finances and virtually no public debt. It was also a cosmopolitan, multicultural society with an optimistic view of its future and role in the world (Kasper 2000). It amounts to no less than a change of social model.

However, the reform process came to a halt when Kevin Rudd, the leader of the Labor opposition since December 2006, became prime minister after the election in 2007. He focused his campaign on abolishing WorkChoices and blamed Australia's other problems on what he called "neoliberal, unregulated market capitalism" (Rootes 2008). At the same time the Labor Party was very careful about not promising any radical changes. It is worth noticing, however, that the economy during the times of Howard as the prime minister did not face any serious problems, and unemployment figures were at their lowest.

Once in power Rudd also implemented a Keynesian stimulus package intended to get Australia through the international financial crisis (Johnson 2011; Kasper 2011). The package mainly consisted of large infrastructure investments, support to the construction sector, financial support to pensioners, workers, families and homeowners, small businesses, and training measures (Wettenhall 2011, p. 82). In doing so, Rudd abandoned the "economic rationalism" of Hawke and Keating, although he did emphasize that "the central tenet of Keynesian economic management: [is] the need to balance budgets over the course of the economic cycle" (Johnson 2011, p. 565).

Rudd also introduced the FairWork Act of 2009, reversing several of Howard's changes toward greater labor market flexibility. And the new Liberal leader, Brendan Nelson, assured voters that "WorkChoices is dead" (Crawshaw and Drape 2007). Rudd did, however, implement Howard's plan for a simplification and reduction in the number of awards, as part of the Labor party's "Forward with Fairness" industrial policy (Philipatos 2012, p. 4). In reality the government thus strengthened arbitration and collective bargaining, reversing not only the Howard scheme, but also the hard-won Hawke-Keating reforms.

Although several reforms, like the reduction of awards, were successful, Rudd faced great problems with the implementation of the stimulus package, particularly the failure of the civil service to execute all new projects fast enough. Other complaints, especially regarding the housing policy, were that the rush to spend was coming at the expense of good planning and proper community consultation (Wettenhall 2011, p. 82). Rudd's personality and his authoritarian style may also have contributed to the failures of his government (Cassidy 2010).

Increasingly his government was described as the one failing to deliver "effective policy outcomes and programmes" (Johnson 2011). *The Economist* (2012) characterized Rudd's rule as "chaotic" and "dysfunctional." This contributed to his deputy prime minister Julia Gillard's successful challenge for leadership in 2010 (Wettenhall 2011, p. 83).

The election of 2010 resulted in the first hung government since 1940. None of the political blocs could form a majority. The opposition had focused its critique on the stimulus package and the rising public debt, but since at 6 percent of GDP Australia's public debt was among the lowest in the world, the opposition could not win with that argument. Gillard was nevertheless able to form a minority government together with the support of one MP from the Green Party and three independents. She announced herself as a "social reformist," but in a pragmatic way in order to get broader support (Johnson 2011).

Nevertheless, her popularity was seriously affected by a carbon pricing legislation, which was part of a broad energy reform package requiring the use of emissions permits labeled as a tax by the opposition, as well as by the introduction of a mining tax. The 2013 election was thus described more as "a vote against the Greens-supported Labor government than an enthusiastic embrace of Abbott's alternative" (a reference to the Liberal Party's leader) (Rootes 2014).

The new Australian Prime Minister Tony Abbott, leader of the Liberal Party since 2009, was characterized by *The Economist* (2013) as "a social conservative in the mold of John Howard." He would "take Australia to the right," *The Economist* said, as he opposes gay marriages, supports the

British monarchy and announces the tough stand against asylum seekers. Moreover, he was aiming at eliminating the mining tax, restoring budget surpluses, ending government waste, protecting the private health system while also improving the public one, restoring work for the dole, and so on. However, in September 2015 Malcolm Turnbull replaced Abbott as prime minister due to an internal coup within the Liberal Party. Turnball was subsequently elected in his own right at the 2016 federal election. When it comes to reforms, not much seems to happen.

Australian Statecraft

How then should we characterize the statecraft involved in this process of sustained liberalization that took place in Australia over a period of 25–30 years? How did they do it? Australia modernized its economy and society, overcame the procrastination and policy mistakes of many other advanced democracies and welfare states, and implemented dramatic welfare-enhancing institutional change. Can we identify causal mechanisms behind successful political reform—*why* and *how* beneficial institutional change took place—by tracing how events chain on to one another and how therefore events are necessarily linked to one another through time?

Again, just as in Sweden, a first important observation is that a large number of actors with different roles contributed to Australian statecraft, the art of governing the country well. Individuals as well as policy entrepreneurs, policy-advocacy coalitions, political parties, party leaders, and interest groups took part in the process of increasing liberty and make the Australian society more free and efficient. Not the least was the fact that different government agencies played important roles.

Clearly, some individuals mattered decidedly more for Australian statecraft. An incomplete list would include Alf Rattigan, Wolfgang Kasper, Bob Hawke, Bill Kelty, Ross Garnaut, Paul Keating, and John Howard. Among these, the three mentioned prime ministers (Hawke, Keating, and Howard) no doubt could qualify as statesmen, due to their importance to the change of the Australian model. But Alf Rattigan's and Wolfgang Kasper's promotion of new policy ideas may have been just as important.

The process of change can be divided into several overlapping stages. In Australia the reform cycle started with external changes in economic and social conditions together with the large policy failures of the protectionist and paternalistic Australian settlement of the twentieth century. To more and more people, including the central bureaucracies, regardless of party affiliation, it became clear that the model of industry protection, centralized wage arbitration, selective state paternalism, imperial benevolence, and heavily restricted immigration could not deliver what was expected. Recurring budget deficits, inflation, weak growth, cost crises, devaluations, labor disputes, and non-existent real wage increases gradually eroded the legitimacy of the model.

However, the changing economic and social conditions cannot alone explain the reforms that followed. As explained in the reform cycle model, new ideas also had to be articulated and communicated and interests aggregated and made into power resources. Also for the institutional change to take place, it was necessary to take advantage of the windows of opportunity created by focusing events.

In Australia at least five more or less independent groups of policy entrepreneurs who introduced new ideas, beliefs, values, and worldviews played crucial roles early in the reform process. Of particular interest is the Tariff Board, an independent government agency constructed to monitor the protectionist measures, which transformed itself into a staunch critic of those policies. Later it was given an extended mandate to do the same in other sectors as it became the Productivity Commission, largely depending on Popperian strategies of rational argumentation and research. Other important groups included academic economists and think tanks, not the least the Crossroads group, as well as actors within the Australian Council of Trade Unions and the ALP. Moreover, economists within the Treasury and the Reserve Bank of Australia were also important for Australia to overcome the bias for the status quo and other barriers to reform.

In the early stages of the process, which were characterized by financial deregulation and a series of structural reforms, including tax cuts, tariff reductions, pension reform, privatizations, and competition policies, the main advocates were an unlikely combination of governmental agencies and departments, the labor union council and the Labor Party. They favored specific market-liberal reforms, loosely defined as "economic rationalism" by their critics. They were, in contrast to the developments in Sweden, most often quite outspoken and open about their intentions to change and liberalize the social model, because they believed these policies would benefit society at large as well as the voters and members of the labor movement. The Liberal and National parties, who later took over, more or less just followed along.

This does not mean that reform was easy. It had to be developed step by step using a combination of different reform strategies. Machiavellian strategies played a major role. That is, in order to make what they viewed as economically necessary decisions politically possible, the reformers used techniques to obfuscate and lower the visibility of institutional change, to split the opposition to reform by compensating some interests and not others, and to spread the blame to others for hardship caused by institutional changes. However, Kuhnian methods of agenda setting and shifts of perspectives, such as the trilogy commitment in 1985, where Hawke and Keating committed the government to cuts in taxes and welfare expenditures, with a focus on fiscal discipline, also played crucial roles to get the reform cycle rolling. Popperian strategies of rational argumentation of course had a key role within the agreed-upon agenda.

In the early stages, corporatist arrangements in the form of Price and Income Accords with the social partners were thus used as a major reform strategy. The Labor Party made deals involving income polices and compensation schemes with the ACTU in order to secure public support for the new policies. The arrangement also made it possible for Hawke and Keating to move the decision-making away from the cabinet as well as from the parliamentary group of the Labor Party, which both tended to oppose the measures taken. These largely Machiavellian arrangements also served to make the new policy mix better known to the public.

In fact, Popperian strategies with different public committees and, in particular, the independent Productivity Commission and its forerunners, produced many of the recommendations that later were implemented by the politicians. For example, the Campbell Committee proposed several of the financial deregulation policies well before the reform process started. The Hilmer Report and the Productivity Commission had similar roles in the case of later changes in pro-competition policies. The same is true in the case of, for example, tariff and labor market reforms.

However, Machiavellian policies were essential to the whole reform process. Many or even most of the elections during the period studied were won by parties presenting traditional platforms. In fact, on the two occasions when more radical reformist views were advocated—by opposition leader John Hewson in 1993 and by Paul Keating in 1996, the advocates lost the elections. Once in power, however, the politicians did their best to implement the liberal policies they thought best would benefit their country, using the full range of strategies.

For example, Hawke and Keating in the first Labor government produced their own Campbell Report, which came to similar policy conclusions as the Martin Committee, which they had vociferously opposed. Other examples are the strategic agenda setting at the tax summit in 1985 and the way the privatization got going after the change of ownership in the State Bank of Victoria.

While some central actors may have envisaged and even longed for a paradigmatic shift of policy, to most others this was clearly unintentional and an unforeseen consequence of the ongoing reform process. Still, the Labor Party kept winning the elections, even though, just as in Sweden, the economic situation worsened, which was partly due to the sequencing and timing of these early reforms.

After winning the election of 1993, Keating, now prime minister, nevertheless explicitly wanted a paradigmatic shift, a new narrative for Australia that would change the "big picture" and finally put an end to the Australian settlement. This Kuhnian strategy, however, turned out to be too much for the electorate. It failed because of lack of support from the people. Keating was perceived as being out of touch with ordinary folks.

Instead, Howard's Liberal-National coalition government was elected and continued the liberal reform process for another 11 years, albeit with a somewhat stronger conservative bent: debt reduction, microeconomic reforms, welfare reforms, and new labor market policies were adopted using a combination of the different reform strategies. At this final stage of reform it is fair to say that a new social model, a clearly liberalized model but still a welfare state, had finally been created.

However, despite the success of this new model, in 2007 Howard lost the election with the labor market reforms being a major issue. The coalition government had won the majority in both houses in 2004, which made it possible to make additional reforms in this area. They were able to push through the policy, but they never succeeded in convincing the public. The labor market reforms, which promoted individual contracts with only a minimum set of working conditions required for the wage-setting process, were seen as un-Australian and violating the "fair-go" ideology.

This marked the end of the Australian reform process. The new Labor government led by Kewin Rudd and later Julia Guillard largely abandoned the ideas of Hawke and Keating, reintroduced Keynesian policies, and their terms were marked by internal conflicts and leadership problems. The leadership stopped pushing a liberal agenda. The same largely seems to be true of the ensuing Liberal-National governments led by Tony Abbott and later by Malcolm Turnball.

If we are to summarize the Australian reform process over these stages, the timescale itself should be noted. Just as in Sweden, it took Australia 25–30 years to change an utterly failing model into a better-functioning new social model. Both Labor and Liberal-National governments played crucial roles, in part because they did not change the welfare-enhancing reforms once they were implemented. The process of sustained liberalization was largely incremental and pragmatic.

A severe crisis was necessary to break the existing path dependence and to start changing the overarching goals or policy paradigm. From then on, however, there was a kind of underlying Popperian tendency involved in the process, using research, commissions, and rational argumentation. However, Machiavellian strategies actually dominated the process of implementation.

Still, Kuhnian strategies of introducing new, more liberal ideas and perspectives also played a crucial role in setting the direction of the reform process in Australia. Pragmatism and shrewdness were not enough to achieve welfare-enhancing institutional change. Australian statecraft involved both advanced political skills and new ideas, ideas that actually could make Australia a better country.

Again, the reform cycle as well as our three reform strategies clearly fit the reform processes we have traced in Australia as well. And again, the development and implementation of new policy ideas by policy entrepreneurs played a key role. In the next chapter I shall return to other major lessons of the Australian case that may contribute to the development of a general theory of reform, a theory that more fully can explain how and why sustained policy reform took place in this advanced democracy and welfare state.

Notes

1. My understanding of the process is based, apart from the references given in text, on the interviews made in Australia in the end of 2011, all listed at the end of the chapter.
2. This section is partly based on Goldfinch (2000), who did a series of 93 interviews with institutional elites in Australia, based on questionnaires with standardized questions, regarding their views of the most important contributors to the ideas that influenced the economic policy changes 1983–1993. My other sources include my own interviews and other literature on the topic.

References

Interviews

Banks, Gary (2011), Head of the Productivity Commission, Canberra, November 28.

Cornish, Selwyn (2011), Professor, Economic History, Australian National University, Canberra, November 29.

Edwards, John (2011), Economic Adviser to Paul Keating 1990–1994, Sydney, November, 24.

Hartwich, Oliver (2011), Research Fellow, the Center for Independent Studies, Sydney, November 22.

Howard, John (2011), Australian Premier Minister 1996–2007, Sydney, November 25.

Kasper, Wolfgang (2011), Professor of Economics emeritus, University of New South Wales, formerly also Australian National University and Reserve Bank of Australia, Tura Beach, November 26–27.

Kelly, Paul (2011), Author and Leading Journalist at the Australian, Sydney, November 24.

Lindsay, Greg (2011), Director for the Center for Independent Studies, Sydney, November 21.

Petterson, Sven-Olof (2011), Swedish Ambassador in Australia, Canberra, November 28.

Robertson, David (2011), Former Professor, Economist, OECD, Treasury, Australian National University, Canberra, November 28.

Sloan, Judith (2011), Former Commissioner, Productivity Commission, Journalist, Telephone, Sydney, November 21.

Stone, John (2011), Secretary of the Treasury under Fraser/Howard and Hawke/Keating, Sydney, November 22.

Sturgess, Gary (2011), Former Cabinet Secretary New South Wales, Sydney, November 26.

Books and Articles

Bateman, H., & Piggott, J. (1997). *Private Pensions in OECD Countries: Australia* (OECD Labour Market and Social Policy Occasional Papers, No. 23). Paris: OECD Publishing.

Berg, C. (2015). Classical Liberalism in Australian Economics. *Econ Journal Watch, 12*(2), 192–220.

Brennan, G., & Pincus, J. (2002). *From the Australian Settlement to Microeconomic Reform: The Change in Twentieth Century Policy Regimes* (Centre for International Economic Studies, Discussion Paper No. 0213). Adelaide: Adelaide University.

Campbell, I., & Brosnan, P. (1999). Labour Market Deregulation in Australia: The Slow Combustion Approach to Workplace Change. *International Review of Applied Economics, 13*(3), 353–394.

Cassidy, B. (2010). *The Party Thieves: The Real Story of the 2010 Election*. Carlton: Melbourne University Press.

Chapman, B. (1998). The Accord: Background Changes and Aggregate Outcomes. *Journal of Industrial Relations, 40*(4), 624–642.

Commonwealth of Australia. (2010). *Australia's Future Tax System: Report to the Treasurer.* Retrieved from http://www.taxreview.treasury.gov.au/content/downloads/final_report_part_2/AFTS_Final_Report_Part_2_Vol_2_Consolidated.pdf

Corden, W. M. (1996). Protection and Liberalisation in Australia and Abroad. *Australian Economic Review, 29*(2), 141–154.

Cornish, S. (2010). *The Evolution of Central Banking in Australia*. Sydney: Reserve Bank of Australia.

Courvisanos, J., & Millmow, A. (2006). How Milton Friedman Came to Australia: A Case Study of Class-Based Political Business Cycles. *Journal of Australian Political Economy, 57*, 112–136.

Crawshaw, D., & Drape, J. (2007, December 19). WorkChoices 'Dead' Says Nelson. *Sydney Morning Herald*. Retrieved from www.smh.com.au.

de Turberville, S. (2007). Union Decline and Renewal in Australia and Britain: Lessons from Closed Shops. *Economic and Industrial Democracy, 28*(3), 374–400.

Di Marco, K., Pirie, M., & Au-Yeung, W. (2009). A History of Public Debt in Australia. *Economic Roundup, 2009*(1), 1–15.

Dockery, A., & Stromback, T. (2001). Devolving Public Employment Services: Preliminary Assessment of the Australian Experiment. *International Labour Review, 140*(4), 429–451.

Edwards, J. (1993). Economic Policy in the 1980s and Its Implications for the 1990s. In I. Marsh (Ed.), *Governing in the 1990s: An Agenda for the Decade* (CEDA Research Study No. P37). Melbourne: Longman Professional Publishing.

Esping-Andersen, G. (1985). Power and Distributional Regimes. *Politics & Society, 14*(2), 223–256.

Goldfinch, S. (1999). Remaking Australia's Economic Policy: Economic Policy Decision-Makers during the Hawke and Keating Labor Governments. *Australian Journal of Public Administration, 58*(2), 3–20.

Goldfinch, S. (2000). *Remaking New Zealand and Australian Economic Policy: Ideas, Policies, and Policy Communities.* Wellington: Victoria University Press.

Harper, I. (1986). Why Financial Deregulation? *The Australian Economic Review, 19*(1), 37–49.

Hawke, B. (1985). Answer to Question Number 420. *House of Representatives*, April 23, 1985.

Hirst, J. (2002). *Australia's Democracy: A Short History*. Crows Nest: Allen & Unwin.

Hodge, G. A. (2003). Privatisation: The Australian Experience. In D. Parker & D. Saal (Eds.), *International Handbook on Privatisation*. Northhampton: Edward Elgar.

Howard, J. (2010). *Lazarus Rising: A Personal and Political Autobiography*. New York: Harper Collins Publishers.

Hyde, J. (2002). *Dry: In Defence of Economic Freedom Extended*. Melbourne: Institute of Public Affairs.

Industry Commission. (1995). *The Growth and Revenue Implications of Hilmer and Related Reports* (Research Paper, AGPS). Canberra: Industry Commission.

Industry Commission. (1998). *Microeconomic Reforms in Australia: A Compendium from the 1970s to 1997* (Research Paper, AGPS). Canberra: Industry Commission.

Johnson, C. (2011). Gillard, Rudd and Labor Tradition. *Australian Journal of Politics & History, 57*(4), 562–579.

Johnston, R. A. (1989). *Collected Speeches 1982–1989*. Sydney: Reserve Bank of Australia.

Kahn, H., & Pepper, T. (1980). *Will She Be Right? The Future of Australia*. Brisbane: University of Queensland Press.

Kasper, W. (2000). *Building Prosperity: Australia's Future as a Global Player*. St Leonards: Centre for Independent Studies.

Kasper, W. (2011). A Generation of Reform—and a Few Years of Backsliding. *Quadrant, 2011*(4), 49–58.

Kasper, W. (2016). *The Role of Entrepreneurs and Government in Australia*. Talk at the Bastiat Forum, Vaucluse Branch, Liberal Party.

Kasper, W., & Stevens, G. (1991). Lessons from the Australian Monetary Reforms of the 1980s: Possible Pointers for Malaysia in the 1990s? *Banker's Journal Malaysia, 65*, 27–38.

Kasper, W., Blandy, R., Freebairn, J., Hocking, D., & O'Neill, R. (1980). *Australia at the Crossroads*. Sydney: Harcourt Brace Jovanovich.

Keating, M., & Holmes, M. (1990). Australia's Budgetary and Financial Management Reforms. *Governance, 3*(2), 168–185.

Kelly, P. (1984). *The Hawke Ascendancy—A Definitive Account of Its Origins and Climax, 1975–1983*. Sydney: Angus & Robertson.

Kelly, P. (1994). *The End of Certainty: Power, Politics and Business in Australia* (Rev. ed.). St Leonards: Allen & Unwin.

Kelly, P. (2009). *The March of Patriots: The Struggle for Modern Australia*. Carlton: Melbourne University Press.

Leigh, A. (2002). Trade Liberalisation and the Australian Labor Party. *Australian Journal of Politics and History, 48*(4), 487–508.

Liu, X. (2010). *Essays on Public Pension Systems, with Special Reference to China* (Doctoral dissertation). University of Birmingham.

Lloyd, P. (2008). 100 Years of Tariff Protection in Australia. *Australian Economic History Review, 48*(2), 99–145.

Macintyre, S. (2004). *A Concise History of Australia* (2nd ed.). Cambridge: Cambridge University Press.

Maddison, A. (2008). *Historical Statistics of the World Economy: 1–2008 AD*. Retrieved from http://www.ggdc.net/Maddison/Historical_Statistics/horizontal-file_02-2010.xls

Marshall, P. J. (2001). *The Cambridge Illustrated History of the British Empire*. Cambridge: Cambridge University Press.

McCarthy, G., & Taylor, D. (1995). The Politics of the Float: Paul Keating and the Deregulation of the Australian Exchange Rate. *Australian Journal of Politics & History, 41*(2), 219–238.

National Competition Council. (2013). *The Role of the National Competition Council*. Retrieved from http://www.ncc.gov.au/index.php/about/about_us

Painter, M. (1998). Public Sector Reform, Intergovernmental Relations and the Future of Australian Federalism. *Australian Journal of Public Administration, 57*(3), 52–63.

Philipatos, A. (2012). Back to the Bad Old Days? Industrial Relations Reform in Australia. *Centre for Independent Studies*. Retrieved from https://www.cis.org.au/publications/policy-monographs/back-to-the-bad-old-days-industrial-relations-reform-in-australia

Powell, A. A., & Snape, R. H. (1992). *The Contribution of Applied General Equilibrium Analysis to Policy Reform in Australia* (Impact Project General Paper G98). Melbourne: Impact Research Centre, Monash University.

Productivity Commission. (2003). *From Industry Assistance to Productivity: 30 Years of 'the Commission'*. Canberra: Productivity Commission.

Productivity Commission. (2005a). *Review of National Competition Policy Reforms* (Inquiry Report, No.33). Canberra: Productivity Commission.

Productivity Commission. (2005b). *Structural Reform Australian-Style: Lessons for Others?* World Bank and OECD, May 2005. Canberra: Productivity Commission.

Pusey, M. (1991). *Economic Rationalism in Canberra: A Nation-Building State Changes Its Mind*. Cambridge: Cambridge University Press.

Quiggin, J. (1998). Social Democracy and Market Reform in Australia and New Zealand. *Oxford Review of Economic Policy, 14*(1), 76–95.

Rein, M., & Turner, J. (2001). Public-Private Interactions: Mandatory Pensions in Australia, the Netherlands and Switzerland. *Review of Population and Social Policy, 10*, 107–153.

Rootes, C. (2008). The First Climate Change Election? The Australian General Election of 24 November 2007. *Environmental Politics, 17*(3), 473–480.

Rootes, C. (2014). A Referendum on the Carbon Tax? The 2013 Australian Election, the Greens, and the Environment. *Environmental Politics, 23*(1), 166–173.

Rosenman, L. (1997). The Social Assistance Approach and Retirement Pensions in Australia. In J. Midgley & M. Sherraden (Eds.), *Alternatives to Social Security: An International Inquiry*. Westport: Auburn House.

Stevens, G. R. (1999, May). Six Years of Inflation Targeting. *Reserve Bank of Australia Bulletin*, 46–61.

Stone, J. (2008). Liberty, Productivity and Jobs. Workplace Relations under the Howard Government. *Quadrant, 52*(7–8), 67–73.

Veale, J. (2008). *Australia's Experience with Capital Flows Under Different Exchange Rate Regimes* (Note for the CGFS Working Group on Capital Flows to Emerging Market Economies). Basel: Bank for International Settlements. Available at: http://www.bis.org/publ/cgfs33rba.pdf

The Australian (2011). *Endorsing Tough-love Reforms.* April 1. Retrieved from http://www.theaustralian.com.au/opinion/editorials/endorsing-tough-love-reforms/news-story/ed7584a45ff7827e69e0ba628a6d40a3

The Economist (2012). *We No Longer Need to Talk About Kevin*. March 3. Retrieved from http://www.economist.com/node/21549004.

The Economist (2013). *Australia's New Government: All Change Down*. September 7. Retrieved from http://www.economist.com/blogs/banyan/2013/09/australias-new-government

Wettenhall, R. (2011). Global Financial Crisis: The Australian Experience in International Perspective. *Public Organization Review, 11*(1), 77–91.

Whitwell, J. (1986). *The Treasury Line*. Sydney: Allen & Unwin.

CHAPTER 8

Modern Statecraft

How then should we characterize the reform processes of Sweden and Australia over the last 25–30 years? Why and how were welfare enhancing and liberalizing reforms developed and successfully implemented, creating "a new super model" and a "wonder down under"? How did they overcome the procrastination and policy mistakes of many other welfare states? And why did the reform processes seem to have come to an end in the last few years? Most importantly, can we identify causal mechanisms behind successful political reform—*why* and *how* beneficial institutional change takes place in advanced democracies and welfare states—and formulate them into a general theory of reform?

In this chapter, I shall identify the causal mechanisms that can be traced in studying how events chained on to one another through time in the reform processes of both Sweden and Australia. How and why did liberal, welfare-enhancing policy ideas emerge, develop, and become implemented? How was the collective action problem typical of many of the reforms solved? And why did the reform processes come to a halt? A number of new theoretical elements will be added to the reform cycle and the three reform strategies in order to formulate a general theory of modern statecraft. Moreover, the generalizability of the results will be discussed.

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_8

Reform Cycles and Reform Strategies

Swedish and Australian statecraft alike involved a combination of knowing *what* and knowing *how*. Governing these countries well involved the active use of different reform strategies. But the actors involved in these respective countries also needed to develop new ideas, ideas that actually worked. They had to know what to do. That is what modern statecraft is about.

The sustained reform processes took place within the reform cycle presented in Chap. 5. In both countries the reform era started with the recognition by some actors that the existing welfare models did not work very well. Various policy failures were identified. This recognition triggered some policy entrepreneurs to search for new ideas. And these new ideas—either completely new policy paradigms or new policy instruments or policy settings—slowly became articulated, aggregated, and advocated by a variety of interests with power resources. That shifted the balance of power in a way that changed the institutions and policies of the two countries. At least in the cases of Sweden and Australia this model of institutional change fits the facts of reality well.

However, the use of advanced political skills was also essential to reform in both countries. The use of reform strategies was necessary in order to overcome the barriers to reform and bring about institutional change. This was fundamental to modern statecraft in both Sweden and Australia.

Due to path dependence, existing institutions, and established ways of thinking, worked against welfare-enhancing institutional change in both countries. There were numerous rational, cognitive, and social reasons—involving special interests and public goods traps, negativity biases and ideational traps, and preference falsification—for why reform of this kind was very difficult. Different institutional and cognitive lock-ins favored the status quo.

In both countries, the actors involved used all our three reform strategies. Popperian strategies, which are fact-based and involve the use of research, rational argumentation, and pragmatism, played important roles all through the reform processes. Kuhnian strategies, which are idea-based and involve the use of shifts of perspectives, narratives, framing, new authorities, and agenda setting, were crucial as well, for specific reforms but especially for major paradigmatic shifts of welfare models. However, just as important in both countries were Machiavellian strategies, which are based on shrewdness and involve the use of obfuscating, blame avoidance, splitting, compensating, and scapegoating. These were largely used by central political actors such as parties and ministers. This gives support to the results in the literature on political risk-taking, mentioned in Chap. 4 (e.g., Vis and Kersbergen 2007). Without such skills the reforms and liberal institutional changes would not have taken place. Also these hypotheses are then supported by our two cases.

The reform cycle worked in both the short run and the long run, fitting the patterns of change in instrument settings and policy instruments, as well as in the change of the overarching goals of an institutional framework. These latter, paradigmatic institutional changes, however, were dramatic and occurred in times of major focusing events or crises, just as the theory predicts. In Sweden the paradigmatic shift occurred in the crisis in the early 1990s, at least among the central actors, while in Australia the shift was more prolonged. Kuhnian strategies played the key roles in these paradigmatic changes.

Short-run or limited changes of specific policies and their settings were often incremental and pragmatic. Governmental investigations and committees, largely relying on Popperian strategies based on research and rational argumentation, were very important for these changes. However, as we have seen, for example, in the case of taxes, reforms of specific policy instruments were most often heavily conflict ridden, with the intense mobilization of special interests and the political opposition. This created a need to actively use more-shrewd reform strategies. The consensus that later developed in both countries around the institutional changes that had been implemented was most often simply non-existent at the time of the reforms themselves.

It is important to emphasize the close relationship between Popperian and Kuhnian strategies in this regard. Facts do not exist independent of ideas in terms of beliefs and values—this was Kuhn's fundamental insight, a view that is strongly supported by modern cognitive research. Fundamental ideas determine what are considered relevant facts, research problems, and even results of research. This implies that the scientific, rational argumentation, and pragmatism characteristic of Popperian strategies were based on a foundation of beliefs and values. In the field of economics Gunnar Myrdal had made this argument already in the 1930s (Myrdal 1953). It is clear in both case studies that the framing of the problems to be investigated was often just as important as the actual rational argumentation put forward.

Consequently, ideas—in the sense of beliefs, values, and worldviews, or causal beliefs and principled beliefs—are thus of fundamental importance to modern statecraft, both through their significance in the reform cycle and through the importance of Kuhnian reform strategies. The development and implementation of such ideas by policy entrepreneurs played a key role in both countries.

However, statecraft, as I have defined it, is the art of governing a country well. As such, statecraft is distinguished from institutional change more broadly, which can include decreases in welfare. While all institutional changes are made difficult by different kind of status quo biases, achieving liberal, welfare-enhancing reform in advanced democracies and welfare states may be particularly difficult because of the prevalent public goods traps that characterize many desirable reforms. The reforms would be beneficial to everyone, but each actor lacks sufficient incentive to bring such reforms about. Do our extended case studies provide an answer to how they may be achieved?

A Polycentric Effort of Experiential Learning

A first observation is that modern statecraft in our two reform countries was not limited to the activities of a single person or statesman, even though individuals did matter, sometimes decisively, for statecraft to be successful. Rather, a variety of actors with different roles contributed to the process.

This means that modern statecraft should be distinguished from political leadership, which is more narrowly concerned with how individual political actors behave in order to be successful in achieving their deliberate intentions and priorities (Nye 2008; Heifetz 1994; Möller 2009). Modern statecraft is also distinct from neo-statecraft, as formulated by Bulpitt (1986) and James (2016), with its emphasis on the party leader, the party elites and their electoral strategies. To win elections is not enough to secure welfare-enhancing institutional change.

The new and better policy ideas that actually promoted the increases in welfare came from many sources. Clearly, international examples of ideational shifts in other countries such as the UK, the USA, and New Zealand played a role in this regard. Also, international organizations such as OECD and the IMF provided new ideas and policy solutions. But even more important were ideas developed by economists and think tanks. Nobel laureates such as Hayek and Friedman, both classical liberals, inspired some of them. But the majority of the involved economists, whether at universities or in government agencies, were neoclassical economists who had realized the shortcomings of Keynesianism and other interventionist policies. The problems that the two welfare states were facing, such as budget deficits, debt crisis, slow or non-existent growth, and high unemployment levels made them promote new, and often market-liberal, ideas and policies. These economists formed "epistemic communities" with shared causal beliefs and principled beliefs, which both turned out to be very important, especially in the times of crisis.

However, a very important explanation of how the reform process became welfare enhancing, rather than neutral or negative, is that the new and better policy ideas emerged as a consequence of experiential learning, with only marginal or indirect influences from outside. Many of the new policy ideas arose by, what I shall call, *a polycentric effort of experiential learning*, involving a critical mass of intrinsically motivated actors.

Kolb's (1984) model of experiential learning is useful in conceptualizing this learning process. This model, slightly adapted to our context, is presented in Fig. 8.1.

In both countries, concrete experiences, often based on policy failures, and large-scale economic crises triggered reflective observation by the involved actors, which in turn led to the search for new ideas and abstract conceptualizations of the problem, which in turn enabled policy experimentation, in turn leading to new experiences that informed the next cycle of learning. The reflective observation often involved intensive internal and public discussions among those involved. This required advanced analytical skills. Characteristic of the learning process in both Sweden and

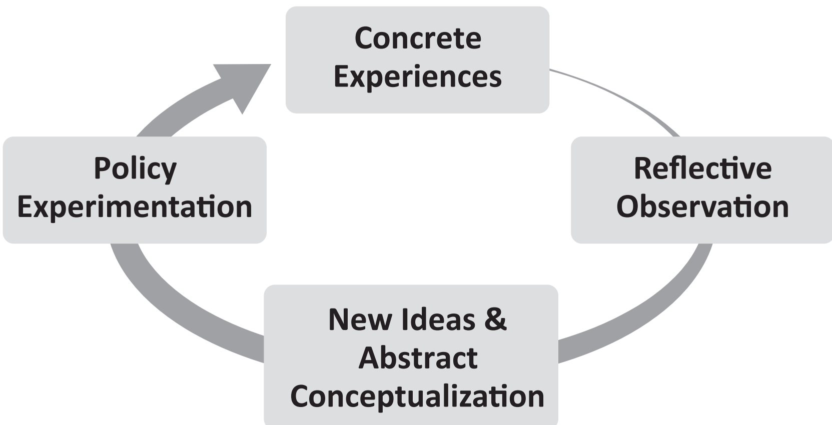

Fig. 8.1 The experiential learning circle

Australia was also that many different groups of policy entrepreneurs learned from each other, sometimes acting on their own, sometimes forming coalitions with others with similar views. A dialectical process, often with sharply conflicting ideas, developed the new ideas, often through the use of Popperian, Kuhnian, and Machiavellian reform strategies that produced new knowledge, new perspectives, and new policy experiments.

The combination of many distinct groups of actors, each with some expertise and decision-making power in partially overlapping areas, helped stimulate policy innovation. In order to break away from ideational traps caused by the spiral of silence, preference falsification, and public opinion cementing the status quo, it was essential for someone to point out that the emperor was naked. Also in both countries, many of the actors belonged to different elites in distinct spheres of society, not only within the government or in the ruling party. The ideas, beliefs, and values of these elites were decisive in making welfare-enhancing reforms. They formed a kind of overarching policy-advocacy coalition. Their values may have differed, but they came to share causal beliefs and to advocate similar policies.

In Sweden and Australia, these different groups of policy entrepreneurs, interests with power resources, and political actors formed what, after Ostrom (1990, 2010), may be called a system of "polycentric governance." Her explanation of how the commons can be governed by a multitude of actors is similar to how experiential learning and the implementation of welfare-enhancing, often liberal, institutional change came about in our two reform countries. She describes how in such systems, a plurality of agents who act without centralized control nevertheless succeed at managing common pool resources, precisely because the plurality of agents enables innovation and learning.

Despite great differences between the empirical cases of polycentric governance that she has studied, there are also a number of common features. One is that all faced uncertain and complex environments. Another is that the actors shared a past and expect to share a future. Moreover, the involved actors cared about their reputation and trustworthiness. Consequently, different norms of "proper," prudent behavior had evolved (Ostrom 1990, pp. 88–89).

By analogy, the polycentric system of groupings of policy entrepreneurs, epistemic communities, advocacy coalitions, and interest groups in Sweden and Australia successfully managed the common good of welfare-enhancing liberal reform.

Combining Kolb's theory of experiential learning and Ostrom's theory of polycentric governance with the reform cycle and the use of Popperian, Kuhnian, and Machiavellian reform strategies provide the explanation of how welfare-enhancing institutional change came about in our two reform countries. The concrete experience of different actors triggered reflective observations, public discussion, and the search for and development of new ideas and abstract conceptualization through research, rational argumentation, and shifts of perspectives. In turn, these led to policy experimentation through a polycentric learning effort.

The sequential development of the reform processes, where different actors and political parties took turns in implementing the policies, also helped overcome different public goods traps, since the shadow of the future was long enough to stimulate cooperative behavior (Karlson 1993, 2002). This result is supported by a large theoretical literature, relying on experimental results (both real-life and computer-simulated) that show how learning can induce cooperation in iterated games, and especially so when some actors take on the role of teachers (e.g., Hyndman et al. 2012; Camerer et al. 2002).

The new ideas produced by experiential learning were used to communicate policy challenges, measures, and solutions. And perhaps just as important, these ideas were used to simplify and mobilize interests and power resources, all of which were crucial in gaining the political power needed to promote institutional change. This result is similar to Jacobs' (2011) observation that governing for the long term requires a framing of the suggested institutional changes to be perceived to give long-term social returns.

There was, moreover, a division of labor involved where some actors specialized in the development of the new ideas, which then were developed by policy strategist into political platforms, which in turn were shaped into legislated reform programs by parliamentarians (comment by Wolfgang Kasper in 2016). In contrast to Jacobs' (2011) theory, modern statecraft is thus not limited to government action alone.

Intrinsically Motivated Actors in the Central Zone

It was important in this process in both countries that a critical mass of intrinsically motivated actors emerged, acting for what they believed to be the common good. In terms of the game theory they were unconditional cooperators. Since the problem these states faced had the characteristics of public goods traps, a group of actors willing to advance reforms that they believed would be beneficial to society as a whole was needed (Karlson 1993, 2002). These groups of actors, including policy-advocacy coalitions and policy entrepreneurs, were crucial to the reform process.

Different explanations as to why such groups of actors emerge are possible. One such explanation is offered by Haas (1992) in his description of epistemic communities. Typical examples of such communities in both Sweden and Australia were, as mentioned, various groups of economists, which is in line with recent results by Christensen (2017). Other intrinsically motivated groups were found among think tanks, organizations, agencies, and political parties in both countries. The Crossroads group in Australia combined many of these characteristics. Because the members of such epistemic communities are held together by strong beliefs, they can show strong group solidarity, and they face lower costs of organizing collective action than do larger groups (Olson 1965). Ideas in terms of beliefs and values indeed served to reduce uncertainty and facilitate collective action and coalition building. In Ostrom's (2000) terminology, "the shared cognitive understanding" facilitated cooperation.

However, the benevolence of these actors shouldn't be overstated. Even if, in the short run, the costs may have outweighed the benefits for the policy entrepreneurs who were trying to introduce new paradigms and policies, in the long run, successful policy entrepreneurs were often rewarded with prestige and positions of power, in addition to the great personal satisfaction of contributing to successful political change.

Another factor that contributed to the ability to overcome the public goods traps of many structural reforms was the fact that the size of the groups of individual and policy entrepreneurs involved was quite small—this increased the ability to monitor and sanction potential free-riders (Karlson 1993, 2002; Ostrom 1990). Such groups were pivotal to starting, as well as maintaining, the reform process.

Some of the most important policy entrepreneurs and policy-advocacy coalitions were located in what Shils (1961, 1982) followed by Zetterberg (2002) have called the *central zone*. According to this theory, every society has a central zone made up of the worldviews, beliefs, and values of the elites in the different spheres of society, including media, politics, business, academia, arts, and religion. This is where the political order, wealth, new knowledge, high culture, and spiritual achievements of society are created and upheld. It was primarily among these actors that the polycentric effort of experiential learning took place.

The concept of the central zone should be distinguished, however, from elite theories of the kind developed by, for example, Pareto, Mosca, and Michels (Dunleavy and O'Leary 1987). The central zone is not the same as the "establishment," a dominant group that already holds power or authority. Nor is it the same as the government or ruling party elites as in James (2016) and Jacobs (2011). It is likely to include competing as well as complementary elites from different spheres of society, with different interests and backgrounds that may form a kind of overlapping consensus, at least on some ideational dimensions.

Admittedly, the concept may imply top-down policymaking in the sense of Dye (2001), but the central zones of Sweden and Australia included not only narrow groups of lobbyists but also those who challenged such groups. As we have seen, the policy entrepreneurs came from many spheres of society. Perhaps most importantly, the theory of the central zone is not a normative theory. Instead, it is an empirical hypothesis about how an institutional change in modern democracies works, a hypothesis that is confirmed in our extended case studies.

Adding this last element, we can now formulate our general theory of reform in advanced democracies and welfare states.

Modern Statecraft Formulated

Modern statecraft, to govern a country well, combines knowing what and knowing how. It takes place within the reform cycle, where advanced political skills and Popperian, Kuhnian, and Machiavellian reform strategies are used, generating new policy ideas in a polycentric effort of experiential learning involving a large number of actors, with a critical mass being intrinsically motivated, located in the central zone of the country. This is summarized in Fig. 8.2:

Modern statecraft, thus, combines polycentric learning, the use of reform strategies and the reform cycle, where the new policy ideas are articulated by policy entrepreneurs, who need to interact with and activate power resources and interests, which can influence institutional and policy changes that are welfare enhancing.

In other words, in order to promote reform one has to take advantage of changing economic and social conditions, become a dedicated policy entrepreneur, and formulate and articulate new policy ideas that activate power resources and interests, which can influence institutional and policy changes. This requires advanced analytical and political skills, but it is also

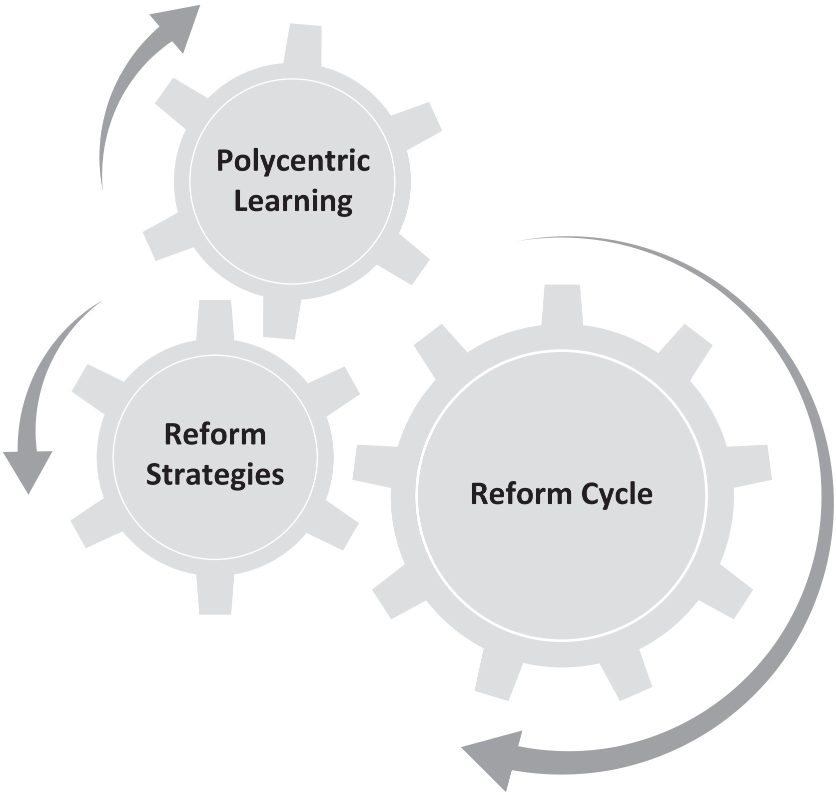

Fig. 8.2 Modern statecraft

necessary to engage in the dialectic process of public discussions, coalition formation and experiential learning with other policy entrepreneurs and other advocates of reform in order to promote the common good of welfare-enhancing institutional change.

Strategic Reforms

Another pattern that emerges from the comparison of our two reform countries is the fact that some reforms were different from others in a fundamental sense. They were what I shall call *strategic reforms*, being strategic in the sense that they created new development paths for the overall reform process. Such reforms change the incentives, but also, after a time lag, the worldviews and beliefs of voters, special interests, and other power holders of a society.

In both countries there is a similar, if not identical, sequencing of reforms. They begin with financial deregulation and floating of the currency, subsequent wage moderation policies, followed by measures to secure macroeconomic stability through inflation targeting, an independent central bank, and budget balancing. Also, the deregulation of some utility markets and the introduction of choice in welfare services came fairly early on. Only in later stages came the tightening of social expenditures, mutual obligation in welfare policies, and the like. This pattern did not arise by chance. (The parallels are not perfect: the superannuation plan for pensions in Australia came early in the process, while the big pension reform in Sweden came later.)

The early reforms were not only strategic in the sense that strategies of obfuscating, blame avoidance, and the like were used in both countries to implement them. They also set their polities on a new path that changed the incentives and the cognitive interpretations of actors involved in other policy areas.

For example, the floating of the Australian dollar together with the financial deregulation triggered a process that made a range of protectionist policies look outdated and destructive to the interest of wage earners and new entrepreneurs alike. A similar scenario occurred in Sweden. Later reforms such as the Swedish pension reform also had long-term consequences for how Swedish voters consider issues like productivity and growth, as well as personal savings for old age. In both countries the introduction of choice in welfare services opened up room for private provision of such services. In fact, strategic reform such as these may trigger information or availability "cascades," self-reinforcing processes of collective belief formation, that facilitate further reform.

The Intentionality of the Processes

Modern statecraft as the combination of using advanced political and analytical skills, and polycentric experiential learning within the reform cycle may seem to produce something of a new puzzle. In both countries, the reform processes were less intentional than one might expect in hindsight, after the results have been seen. Were the reforms merely accidental rather than deliberately promoted?

Consecutive governments of labor or social democrats as well as of liberal-conservatives, in both Sweden and Australia, adopted new ideas and policies during the studied period. They transformed their welfare models in a more liberal direction compared to previous decades. However, these paradigmatic policy shifts were largely unintentional to some or even many of the actors involved. This is in stark contrast to government-centered theories of neo-statecraft and governing for the long run developed by James (2016) and Jacobs (2011), where institutional change is envisioned as a deliberate process with electoral success as a key element.

For example, the early Social Democratic reforms in Sweden that started the actual reform process in the mid-1980s were explicitly implemented in order to save the old, failing welfare model. But as the process gained momentum, together with the severe crisis in the early 1990s, these reforms contributed to the paradigm shift, which later Social Democratic governments furthered with additional reforms in many other areas. Even then, however, Machiavellian reform strategies dominated the process, in particular in times of elections, indicating that the party was not willing to openly defend the reforms they regarded as necessary. Apparently the electoral risks were considered too high, as argued by Vis and Kersbergen (2007).

Actors in the central zone for pragmatic reasons implemented the reforms because these leading Social Democrats believed the reforms were necessary and in the long-run interest of the party. Without delivering policies that created work, wealth, and welfare it would be hard, they believed, to gain voter support in the long run.

In contrast to the example above, several of the policy entrepreneurs and policy-advocacy coalitions, which were essential to start the process, intentionally promoted the change. They may have valued increased liberty itself and wanted to make society more free (typically, pro-market academics and think tanks) or they may have been academic economists, Social Democrats or in the Ministry of Finance, who believed in the results of current policy research. Even small groups of actors like this made a big difference, and especially so if they managed to promote strategic reforms. The *Sixlings* and the Lindbeck Commission in Sweden are typical examples of the latter. In Australia, the Crossroads group, individual economists at universities and governmental agencies and departments, not the least at the Productivity Commission, had similar roles.

The liberal-conservative parties and governments that were part of the reform process may have had an easier task at hand; at least once the policy shift had taken place. Then the new dominating policy ideas fit well with their basic principles, beliefs, and values. But in addition, the liberal-conservative parties and governments changed their ideas in a more liberal direction.

Of specific interest in the Swedish case is the role of the Swedish Employers' Confederation (SAF), which I identified as one of the most important policy entrepreneurs in the early stages of the reform process. The organization itself, as well as most of its major corporate members, had been deeply involved in the former Swedish model, with numerous corporate arrangements, subsidies, and regulations that favored rent-seeking behavior and the status quo. They were short-run pro-business, rather than pro-market.

But due to the severe economic consequences of the radicalization of the welfare policies in the 1970s, the organization transformed itself into a market-liberal, activist policy entrepreneur. This may be internationally unique. Through an internal process of experiential learning the Swedish business sector managed to overcome the public goods and ideational traps it was in. As we have seen earlier, this may partly be explained by the roles of a number of exceptional individuals, supported by a major capitalist family. Hence, even a small number of individuals with a strong reputation and good ideas can make a difference. The fact that SAF was an "encompassing" organization in Olson's sense (1990), covering virtually the whole private sector, is also likely part of the explanation for this transformation.

This development stands in stark contrast to the alignment of ideas, resources, and interests in Australia, even though the reform cycle itself was similar, in terms of both the paradigmatic shift of welfare model and the reform of specific policy instruments and policy settings. There the corporate sector played only a minor role. Major industries and business sectors, with some notable exceptions, did not want to abandon the protectionist and regulated model that characterized the Australian settlement, despite the apparent failure of the model. They also lacked the organization to act collectively.

Instead, it was the unlikely combination of a governmental agency (the Australian Tariff Board, later called the Industry Commission), the Australian Council of Trade Unions (ACTU), and the Australian Labor Party, who in the central zone became the main advocates for market-liberal reforms in the early stages of the process. Together with the Crossroads group and the "Dries" within the Liberal Party they formed an effective policy-advocacy coalition that radically transformed Australia. The liberal-conservative parties, who later took over, more or less just followed along.

In Australia, the early advocates of reform were more outspoken and open about their intentions to deregulate, cut taxes, lower tariffs, decentralize wage bargaining, change the pension system, and so on, because they believed these policies would benefit society at large as well as the voters and members of the labor movement. The reforms were developed step by step, in particular using the corporate Accords with the social partners as a major reform strategy. This is much more in line with Jacobs' (2011) result that governing for the long term requires a good electoral strategy, perceived positive long-term social returns of the policy changes and effective handling of influential interest groups. But even though some central actors, such as Keating, may have envisaged and even longed for a paradigmatic shift in policy, to most others such a shift was, just as in Sweden, clearly unintentional and an unforeseen consequence of the ongoing reform process.

The paradigmatic policy shifts in welfare state models of Australia, and perhaps Sweden, thus did not primarily come about as a deliberate goal-oriented process. But neither were they an accident. Rather they were precisely the result of the use of advanced analytical and political skills as well as polycentric experiential learning within the reform cycle. The Kuhnian shift came about largely as a consequence of the sequential implementation of Popperian and Machiavellian reform strategies. Changes in policy instruments and their settings came before the change in policy goals. Hence, even minor idea-based policy changes created an ideational path dependency with long-term consequences.

However, it should also be clear that when important decisions were about to be taken in the parliaments of both countries, it was crucial that the major decision-makers were clear about their intentions. Advanced analytical skills were essential in developing the needed polices. In Sweden, for example, this was essential to decision-making in the crisis in the early 1990s, as well as to the debt reduction and structural reforms that followed. Without a strong belief in the new policy ideas and the shadow of the future being strongly felt, the reforms would most likely not have been accomplished. The same is true in Australia, especially during the 12-year period of reforms by the Hawke-Keating governments.

It could also be noted that even though some reforms may have been more difficult for one side of politics than the other, once the "other" party won office, it recognized the value of the reforms and most often chose to improve, rather than repeal, them. Hard-won reforms—sometimes resembling the "Nixon goes to China example"—were not to be lightly overturned (Andrews 2011). The Swedish tax reform in the early 1990s is a good example. The Hawke-Keating government, moreover, was able to establish compulsory superannuation for workers, which the Liberal-National coalition ultimately endorsed even though it initially had rejected it. Welfare reform promoting "work for the dole," which the Labor Party opposed when it was out of the government, was accepted once it returned to government.

So even though the overall results of the reform processes may not have been intentional for more than a few policy entrepreneurs, it was not accidental, since each and every policy experiment and its continuation was deliberately decided. This polycentric effort of experiential learning, together with the reform strategies used, explains the success of the two countries.

Why the Reform Processes Stopped

However, the Australian process of sustained reform and liberalization came to an end in 2007, while in Sweden it lasted until 2010, as described in earlier chapters. A real backlash may even be taking place.

Several explanations can be offered for this development.[1] A first possibility is that the economic and social conditions, at least compared to most other countries, became stable and the need for reforms decreased. There may also have been a reform fatigue created by continual institutional change. Moreover, the barriers to reform may have gained renewed influence—special interests and public goods traps, negativity biases and ideational traps, and public opinion and preference falsification may have had a sclerotic effect along the lines of Olson's (1982) arguments. In Sweden, the membership in the European Union may also have made reform more difficult. Moreover, the consequences of the global financial crises starting in 2008 may have made both countries preoccupied with more acute issues.

It could also be that the policy paradigms which became dominant in the early 1990s in both countries were exhausted and did not provide any guidance to new and better policy instruments and settings. There may be long-run *political reform waves* similar to the Kondratiev waves, Kuznets swings, or super cycles said to exist for the economy (Korotayev and Tsirel 2010). Perhaps they could be called *paradigm waves.*

Even though this may have some truth to it, it is hard to see how and why the reform process should stop at these particular moments and not

10 or 15 years before or later. Both countries no doubt have remaining and recurring social and economic problems. And, as shown above, in both countries earlier financial crises had been used as windows of opportunities to promote fundamental reforms, rather than to make reform impossible.

Instead, the theory of modern statecraft provides us with the explanation. The actors involved apparently stopped knowing what to do or how to do it. Not enough, or not good enough, new policy ideas were advocated by policy entrepreneurs. And even if policy entrepreneurs had ideas—about new instrument settings, policy instruments, and even overarching goals—they did not succeed in mobilizing the power or resources needed to transform these ideas into policy proposals and reforms. The experiential learning stopped. It is also possible that some policy entrepreneurs, after the long processes of reform in the two countries, thought they had already won the battle of ideas. As noted in Chap. 3, this lack of modern statecraft causing the reform processes to stop may serve as an additional support for our theory of reform.

In Sweden the Social Democrats had implemented market-liberal policies for pragmatic reasons, without explaining why this was done. In 2006, the center-right alliance came to power by using a strategy of triangulation. Political pragmatism, in both cases, led to a degrading of ideas and ideology. Both the Social Democrats and the Alliance focused too much on *how*, and too little on *what*. Not even signs of failure of some of the earlier reforms, for example, in the quasi-markets created in health and elderly care, caused a search for new policy ideas. Instead, when the Social Democrats came back to power in 2014, they had fallen back to more socialist ideas and ideals and started reversing hard-won reforms implemented by previous governments.

In Australia, the Liberal-National coalition under Howard continued the reform process for 12 years, but then lost power, perhaps due to a too-radical reform, the Work Choices, a decision that showed disregard for the skills needed to stay in power. Moreover, Howard had moved in a more conservative direction, favoring subsidies to families, and so on. The Labor Party and the new government led by Rudd and Gillard had during its long period in opposition lost its fancy for market-liberal ideas and started a reversal of the reform process. The Liberal-National governments of Abbott and Turnball that came to power in the last few years still have to prove in which direction they are going.

In both countries, the economic and social conditions also changed due to different external forces such as falling commodity prices, a change in China's model of economic development, which shifted from an emphasis on export of manufacturing goods to a more consumption-led growth path, and a dramatic increase in asylum seekers, primarily from the Middle East. These changes required policy solutions that did not already exist. Perhaps even a new policy paradigm is needed. Again, to know what to do is fundamental to modern statecraft. The hard work of policy development and polycentric experiential learning is crucial to reform.

Hence, the lack of modern statecraft is the likely explanation to why the reform processes stopped. Without political and analytical skills and new policy ideas generated in a polycentric effort of experiential learning new reforms are not likely.

Liberal Statecraft

Modern statecraft in the context of today's advanced democracies and welfare states is often, as we have seen, equivalent to liberal statecraft, that is, policies or political developments that increase liberty and make society more free. This is an empirical description that fit the developments in Sweden and Australia very well up until some years ago, even though there surely are instances where the reform processes involved elements that decreased liberty. But the overall direction of the change that took place definitely moved our two reform countries in a liberal direction. This said, none of these welfare states are liberal utopias, of course.

Perhaps explicitly "liberal" statecraft is required to keep welfare-enhancing reform processes in advanced democracies and welfare states sustainable for longer periods of time, extending over several paradigm waves. This kind of statecraft would involve a constant upgrading of fundamental liberal ideas, values, beliefs, and worldviews into new policy instruments and settings, adapted to the changes in economic and social conditions.

The existing norms of fairness or equality may create special challenges in this regard. The change of the fundamental values in society is, as shown in previous research, likely to be the most difficult kind of double-loop learning. It is possible that the weak and slow change in this regard was a more fundamental reason why the reform processes stopped.

In Sweden, as we have seen, the Social Democrats as well as the center-right Alliance in the latter phases of the process never really challenged the existing normative views of "equality of outcome" and redistribution established during the famous, but failing, interventionist Swedish model of the 1970s and 1980s. The actual interpretation of equality may have changed slightly, due to the liberal orientation of some of the reforms that were implemented, for example, the major tax reform in the early 1990s. However, this change may be marginal. On the rhetorical level equality was used largely in the same way as before, and taken to mean equal incomes and outcomes.

The same seems true in Australia regarding the concept of "fair go," ingrained in the earlier policies of industry protection, wage arbitration, and state paternalism. During the era of structural policy shifts implemented by the Labor governments, discussions of the normative challenges of reforms were largely controlled and delimited through the Accords. Outside critics were ignored or marginalized. The later National-Liberal reform governments also kept a low profile on normative issues from a liberal perspective and instead moved in a conservative direction.

In both countries, thus, efforts to advance more liberal concepts of fairness were largely missing. As a consequence, fundamental cognitive frames or belief systems may not have changed to a sufficient degree to keep the reform process going.

Liberal statecraft, in contrast to modern statecraft more widely interpreted, may thus require not only policy entrepreneurs with welfare-enhancing ideas and strategic skills but also a firm belief in ideals of liberty as intrinsic values, with liberty viewed as fundamental to human nature and the good life. Notice however that too radical attempts to shift the policy paradigm in a liberal direction, as the example of Hewson in Australia illustrates, can create similar problems.

While this is not a treatise about the normative foundations of liberalism, we may nevertheless note that economists almost by definition are utilitarians, who care about potentially Pareto-sanctioned welfare-enhancing reforms in the sense we have loosely defined the term. As we have seen in both Sweden and Australia, they were important as policy entrepreneurs in the reform processes. However, economists need not be liberals with a firm belief in liberty as intrinsic values. Rather they may be instrumental liberals who favor liberal reforms only when they believe such policies are welfare enhancing. The same is likely to be true of the politicians discussed above who unintentionally promoted the liberal paradigm shift through a polycentric learning process in our two countries. Consequently, they were only instrumental liberals who may have lacked principled beliefs in the policies they promoted.

Liberal statecraft may thus be a way to keep the reform processes sustainable for longer periods of time, extending several paradigm waves. This assumes, of course, that the problems the societies face have the characteristics of public goods traps, with severe ideational and institutional lock-ins that require liberal policies and a sufficient number of intrinsically motivated actors if they are to be solved.

Democratic Dilemmas

In democratic societies such as Sweden and Australia, modern statecraft as developed in this study may create democratic dilemmas. Does not the important role of Machiavellian reform strategies, characterized by the use of obfuscating, blame avoidance, splitting, compensating, and scapegoating, create a democratic problem? And how should we from a democratic perspective view our finding that the reform process was essentially top down, involving the central zone of our two countries?

It was the paradigmatic shift of policy ideas among the elites in the two countries that turned out to be decisive for the long-run success. Moreover, in both Sweden and Australia the political leaders at crucial movements in the reform process used strategies of blame avoidance in order to make the necessary decisions possible. Instead of claiming credit for policy ideas they believed were in the long-run interest of the electorate, they successfully hid the reforms and avoided public discussions about their true content. This is particularly true of the Social Democrats in Sweden. In both countries parties presenting traditional, non-liberal, platforms most often won elections, while parties that explicitly wanted substantial policy change lost. Once in power, however, the former kept the reform process going. Winning elections is one thing, reforming is another. Again, this is a significant difference to the analysis of Jacobs (2011) and James (2016), but more in line with Vis and Kersbergen (2007), Vis (2010), and Giger (2011).

This may however correctly be described as a democratic dilemma, in which the ideal of popular participation and open public discussions, on the one hand, stand in conflict with the wish of enlightened elites to quickly implement policies that are welfare-enhancing and potentially Pareto-improving, on the other.

However, the dilemma should not be overstated. It rests on a fairly narrow view of democracy (Held 2006). In both countries, many different actors took part in public discussions about policy failures and their potential solutions. There were numerous policy entrepreneurs, academics, labor union representatives, and bureaucrats, with different interests and backgrounds, who at least partly replaced earlier elite groups. Together with prime ministers and other ministers, not least in the Treasury, these made up the central zone and promoted welfare-enhancing reforms in both our countries. This was how the polycentric effort of experiential learning was achieved. The major role of the leading politicians, such as Bildt, Persson and Reinfeldt in Sweden, and Hawke, Keating and Howard in Australia, was to secure the political support necessary for the parliament to make decisions about reforms based on ideas and visions often created elsewhere. In a pluralist democracy, as envisaged by leading theorists such as Robert Dahl (1971, 1989), this seems perfectly all right.

Moreover, as our two extended case studies show, taking responsibility for having the appropriate welfare-enhancing decisions being made was in most cases rewarded by reelection. In Australia, the Labor governments of Hawke and Keating remained in power for 12 years, and in Sweden, the Social Democratic governments of Carlsson and Persson were similarly successful. In Australia, Howard as well was re-elected several times, and so was Reinfeldt in Sweden, albeit only once. When Reinfeldt stopped reforming he lost his power.

From a democratic perspective this is in line with the views of Schumpeter (1944), who argued that real-world democracy is characterized by a competition between different elites. The primary function of general elections and popular participation in politics, on this view, is to legitimize governments and keep them accountable for the decisions they make. If voters do not like the policies implemented, they can and will vote for someone else.

It is also important to consider the alternatives to using Machiavellian strategies to implement reforms. If the leading political parties of a country do not use these kinds of strategies, they will not be able to implement the policies necessary to enhance the welfare of the electorate. This could lead to an uprising of populist movements, eventually undermining democracy itself.

Modern statecraft may indeed be necessary to avoid such a development. Without combining strategic skills and new, better ideas, many advanced democracies may not be able to escape the problems they are facing.

Do the Results Hold for Other Countries?

An important question to address is whether this theory of modern statecraft holds for other countries as well. Can the identified causal mechanism found in our two countries be used to promote reform in other advanced democracies and welfare states as well? Or in other countries, excluding more traditional or autocratic polities, such as developing nations?

I think so. The method of the extended case study used to analyze in detail the successful reform processes has enabled us to trace how events chain on to one another and how therefore events are necessarily linked to one another through time. The hypotheses of the reform cycle, a synthesis derived from previous research, and the reform strategies fitted the empirical evidence in our two reform countries well indeed. Moreover, our comparative case study enabled us to develop the theory of modern statecraft, which combines these elements with the generation new policy ideas in a polycentric effort of experiential learning involving a large number of actors, with a critical mass being intrinsically motivated, located in the central zone of the country.

By studying two cases in which reform would seem particularly difficult, and yet has been achieved in particularly far-reaching, systemic ways, the causal processes by which barriers to reform in advanced democracies and welfare states can be overcome should be especially clear. Moreover, the fact that the chosen countries were different in a number of ways, including their models of welfare and democratic institutions, should strengthen my results and should make the theory more general. Also, the explanation of why the reform processes stopped due to a lack of modern statecraft may give additional support to the theory.

However, as with all qualitative studies of a limited number of cases, there are limitations to generalizing the results. All advanced democracies are different, and each has particular challenges due to its historical development, demography, geography, level of economic development, and so on. They also all have different models of welfare; conservative-corporatist as well as the liberal and social democratic versions studied here. But many of these advanced democracies face similar problems caused by changing economic and social conditions. Also the barriers to welfare-enhancing reforms are similar, if not identical (Heineman and Grigoriades 2013). Therefore, the same lessons are likely to be drawn from a study of other reform countries. But this of course remains to be proven. For example, Denmark, Netherlands, Canada, and Israel would be well suited for such a study. However, as mentioned in Chap. 3, robust empirical testing of my theory of reform would also require looking at control cases that may serve as counterfactuals (countries in which modern statecraft has been lacking) and studying the outcome in such countries. Argentina, Greece, Italy, and Portugal, for example, could possibly in future research serve as such counterfactuals.

I may also be objected that there are a number of shared characteristics, or facilitating circumstances, of our two countries that also may contribute to restricting the generalizability of the results. First of all, both Sweden and Australia are high-trust and low-corruption countries (Uslaner 2012). This may have made reform and welfare-enhancing institutional change easier in these two countries. It is easier to cooperate, solve common problems, and engage in polycentric experiential learning processes if people trust each other and their political representatives (Heinemann and Tanz 2008). Culture in this sense matters. However, this point should not be overstated. First of all, the other Nordic welfare states have levels of trust just as high as Sweden, and they have not, except perhaps Denmark, had the same kind of successful processes of sustained liberalization. Finland, in particular, which has a long shared history with Sweden, is a telling example. Despite very high levels of trust and low levels of corruption it has not experienced a welfare-enhancing reform process comparable to the Swedish case.

Therefore, it may be a misconception that high levels of trust are good for reform. A widespread trust in existing institutions, sometimes called vertical trust, is not likely to be good for reform—why engage in the conflict-ridden, hard work of institutional change if the existing institutions are considered well-functioning (Andreasson et al. 2013; Berggren et al. 2016)? Rather, what is required is probably a mix of discontent based on fundamental policy failures and, as I have argued, a number of policy entrepreneurs in the central zone of the country who know both what to do and how to do it. This should be possible in most advanced democracies and welfare states, as well as in other countries, even though it is never an easy task. Some kind of generalized trust may help, but it is not a sufficient condition.

Another, but similar, argument for believing that Sweden and Australia are special cases is the homogeneity of the populations of the two countries. Sweden is often believed to be made of blue-eyed blondes, and Australia of white Anglo-Saxons from the UK and northern Europe. However, even though this may have been true earlier in the twentieth century, this was certainly not true in the 1990s and onwards when most of the reforms studied were implemented. On the contrary, Sweden has become an immigrant society at least since the early 1990s. Today 16 percent of the population was born in another country, higher than most other West European countries and equivalent to the USA. In Australia the same figure is 27 percent (OECD 2015a), with large shares coming from Asia.

Another important observation is that both countries are small, open economies, which may explain their ability and willingness to adapt to the changing conditions of the world economy. Exports of manufacturing goods and commodities, respectively, are important to both countries' economies. As a consequence, they both benefited from the China boom in the second half of the 1990s up until 2008, which led to high growth in exports and productivity. This may have diminished some of the reform barriers, not least resistance from certain special interest groups, including labor unions, since compensating short-term losses of a reform is easier if the economic pie is growing. But again, behind the growth of exports and incomes has been the capacity of Swedish and Australian companies to flexibly meet the demand and respond to the new world-market opportunities. This is certainly possible in other countries as well.

Moreover, as we have seen, the role of the labor unions in the two countries differs dramatically. In Australia the ACTU was an active party pushing for liberal reform, while the Swedish, more encompassing (Olson 1990) LO (the Swedish Trade Union Confederation) actively fought against the Social Democratic Party's reform agenda in the "War of Roses." The same is true, but in the opposite direction, in the case of the business organizations, where the Swedish Employers' Confederation was very important in the early phases of the reform process. This cannot be said for its Australian counterparts. This indicates that corporatist arrangements and the involvement of organized interests fail as a unifying explanation.

The population of both countries is quite small, just around 10 million and a few million above 20 million, respectively, for Sweden and Australia. This indicates that the central zones of the countries may be comparatively small, a potential facilitator in the reform process. Again, however, this is true of many other welfare states and democracies, especially in Europe.

Furthermore, it is important to note that the two countries differ in that Australia has a federal system, while is Sweden is a monistic parliamentary democracy. This difference surely affected the shape of the reform processes, but only marginally so. And in Australia, a number of policy changes that affected the states had to be resolved in the constitutional court. Yet the sequence, pace, and direction of the institutional changes were surprisingly similar. Hence, the developed theory of modern statecraft seems to hold despite very different institutional decision frameworks.

Lastly, it is true that in both Sweden and Australia there were a number of unique individuals, policy entrepreneurs, and politicians (some of which we have identified), who were decisive in the reform process. Many of these were intrinsically motivated. Individuals do matter for how history evolves. But that does not make the theory less relevant for other advanced democracies in need of liberal reform or welfare-enhancing institutional change. Rather, it highlights an essential element of modern statecraft.

Consequently, even though the theory of modern statecraft developed here needs further empirical testing, it has the potential of being generally applicable to other advanced democracies and welfare states, and possibly other countries as well, at least as long as they face similar barriers to reform. The reform cycle, the three reform strategies and the experiential polycentric learning may conceivably be used to promote reform despite divergent models of welfare, cultures, and democratic institutions.

Notes

1. Most of my Australian interviews touched upon this question.

References

Interviews

Kasper, Wolfgang (2011), Professor of Economics emeritus, University of New South Wales, formerly also Australian National University and Reserve Bank of Australia, Tura Beach, November 26–27.

Books and Articles

Andreasson, H., Elert, N., & Karlson, N. (2013). *Does Social Cohesion Really Promote Reforms?* (Ratio Working Paper No. 211). Stockholm: Ratio.

Andrews, K. (2011). Intoxicated by Power. *Quadrant, 55*(11), 32–35.

Berggren, N., Daunfeldt, S.-O., & Hellström, J. (2016). Does Social Trust Speed Up Reforms? The Case of Central-Bank Independence. *Journal of Institutional Economics, 12*(2), 395–415.

Bulpitt, J. (1986). The Discipline of the New Democracy: Mrs Thatcher's Domestic Statecraft. *Political Studies, 34*(1), 19–39.
Camerer, C., Ho, T. H., & Chong, J. K. (2002). Sophisticated Experience-Weighted Attraction Learning and Strategic Teaching in Repeated Games. *Journal of Economic Theory, 104*(1), 137–188.
Christensen, J. (2017). *The Power of Economists Within the State*. Stanford: Stanford University Press.
Dahl, R. (1971). *Polyarchy: Participation and Opposition*. New Haven: Yale University Press.
Dahl, R. (1989). *Democracy and Its Critics*. New Haven: Yale University Press.
Dunleavy, O., & O'Leary, B. (1987). *Theories of the State. The Politics of Liberal Democracy*. London: Macmillan Education.
Dye, T. R. (2001). *Top Down Policymaking*. London: Sage.
Giger, N. (2011). Is Social Policy Retrenchment Unpopular? How Welfare Reforms Affect Government Popularity. *European Sociological Review, 28*(5), 691–700.
Haas, P. (1992). Introduction: Epistemic Communities and International Policy Coordination. *International Organization, 46*(1), 1–35.
Heifetz, R. (1994). *Leadership Without Easy Answers*. Cambridge, MA: Belknap Press.
Heinemann, F., & Grigoriadis, T. (2013). *Origins of Reform Resistance and the Southern European Regime*. WWWforEurope. Retrieved from http://www.foreurope.eu/fileadmin/documents/pdf/Workingpapers/WWWforEurope_WPS_no020_MS20.pdf
Heinemann, F., & Tanz, B. (2008). The Impact of Trust on Reforms. *Journal of Economic Policy Reform, 11*(3), 173–185.
Held, D. (2006). *Models of Democracy*. Stanford: Stanford University Press.
Hyndman, K., Özbay, E., Schotter, A., & Ehrblatt, W. (2012). Convergence: An Experimental Study of Teaching and Learning in Repeated Games. *Journal of the European Economic Association, 10*(3), 573–604.
Jacobs, A. M. (2011). *Governing for the Long Term. Democracy and Politics of Investment*. New York: Cambridge University Press.
James, T. S. (2016). Neo-statecraft Theory, Historical Institutionalism and Institutional Change. *Government and Opposition, 51*(1), 84–110.
Karlson, N. (1993). *The State of State. An Inquiry Concerning the Role of Invisible Hands in Politics and Civil Society*. Stockholm: Almquist & Wiksell International.
Karlson, N. (2002). *The State of State, Invisible Hands in Politics and Civil Society*. New Brunswick: Transaction Publishers.
Kolb, D. A. (1984). *Experiential Learning*. Englewood Cliffs: Prentice Hall.
Korotayev, A. V., & Tsirel, S. V. (2010). A Spectral Analysis of World GDP Dynamics: Kondratiev Waves, Kuznets Swings, Juglar and Kitchin Cycles in Global Economic Development, and the 2008–2009 Economic Crisis. *Structure and Dynamics, 4*(1), 3–57.

Möller, T. (2009). *Poltiskt ledarskap*. Malmö: Liber.
Myrdal, G. (1953). *The Political Element in the Development of Economic Theory*. London: Routledge and Kegan Paul.
Nye, J. (2008). *The Powers to Lead*. Oxford: Oxford University Press.
OECD. (2015a). *Database on Immigrants in OECD Countries (DIOC)*. Retrieved March 2016 from http://www.oecd.org/migration/mig/databaseonimmigrantsinoecdcountriesdioc.htm
Olson, M. (1965). *The Logic of Collective Action*. Cambridge, MA: Harvard University Press.
Olson, M. (1982). *The Rise and Decline of Nations*. Baltimore: Yale University Press.
Olson, M. (1990). *How Bright Are the Northern Lights? Some Questions About Sweden*. Lund: Institute of Economic Research.
Ostrom, E. (1990). *Governing the Commons*. Cambridge: Cambridge University Press.
Ostrom, E. (2000). Social Capital: A Fad or a Fundamental Concept? In P. Dasgupta & I. Serageldin (Eds.), *Social Capital: A Multifaceted Perspective*. Washington, DC: The World Bank.
Ostrom, E. (2010). Beyond Markets and States: Polycentric Governance of Complex Economic Systems. *American Economic Review, 100*, 1–33.
Schumpeter, J. (1944). *Capitalism, Socialism and Democracy*. New York: Kelley.
Shils, E. (1961). *The Intellectual Between Tradition and Modernity*. The Hague: Mouton.
Shils, E. (1982). *The Constitution of Society*. Chicago: University of Chicago Press.
Uslaner, E. M. (2012). *Segregation and Mistrust: Diversity, Isolation, and Social Cohesion*. Cambridge: Cambridge University Press.
Vis, B. (2010). *The Politics of Risk-Taking—Welfare State Reform in Advanced Democracies*. Amsterdam: Amsterdam University Press.
Vis, B., & Kersbergen, K. (2007). Why and How Do Political Actors Pursue Risky Reforms? *Journal of Theoretical Politics, 19*(2), 153–172.
Zetterberg, H. (2002, December 3). Den centrala zonen sätter tonen, Opening remarks at Marknadsekonomiska klubbens diskussion om "Idéer som vinner". Stockholm.

CHAPTER 9

Summary and Conclusions

To govern an advanced democracy and welfare state well is a very difficult task because special interests and public goods traps, negativity biases and ideational traps, and public opinion and preference falsification tend to favor the status quo. Liberal, welfare-enhancing reforms are likely to be especially difficult.

Based on the extended case studies of Sweden and Australia—two advanced democracies that through sustained reform over a period of 25 years made their economies more dynamic and their societies more flexible and free, creating two new models of welfare—the conclusion is that modern statecraft, to govern a country well and to promote reform, requires a combination of knowing *what* and knowing *how*. This involves the active use of different reform strategies, but also the development of new ideas, ideas that actually work. Policy entrepreneurs, who introduce and develop these ideas, play a key role.

Modern statecraft takes place within the reform cycle, where advanced political skills and Popperian, Kuhnian, and Machiavellian reform strategies are used, generating new policy ideas in a polycentric effort of experiential leaning involving a large number of actors, with a critical mass being intrinsically motivated, located in the central zone of the country.

To promote welfare state reform requires political skills , to know how to achieve the desired institutional changes. This is an art that combines the use of three major reform strategies: (1) Popperian strategies, which are fact-based and involve the use of research, rational argumentation, and

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8_9

pragmatism; (2) Kuhnian strategies, which are idea based and involve the use of shifts of perspectives, narratives, framing, new authorities, and agenda setting; and (3) Machiavellian strategies, which are based on shrewdness and involve the use of obfuscating, blame avoidance, splitting, compensating, and scapegoating.

New and better ideas, causal as well as principled beliefs, need to be found, developed, tried, and implemented. This learning process, which is central to modern statecraft, takes place within the reform cycle, which starts with changing economic and social conditions, creating a demand for new ideas, which need to be articulated by policy entrepreneurs, who interact with and activate power resources and interest, which use their strength to influence institutional and policy change, which in turn affects social and economic conditions, and so forth. Concrete experiences trigger reflective observation, which in turn leads to the search for new ideas and abstract conceptualizations of the problem, which then enable policy experimentation, in turn leading to new experiences informing the next cycle of learning. Successful reform requires constant learning through experience.

In the learning processes in the two countries that was used to develop our theory of reform, Sweden and Australia, many different groups of policy entrepreneurs learned from each other, sometimes acting on their own, sometimes colliding with others with similar views. But they were also often in ideational conflict with each other. Intense public discussion was crucial. The combination of many distinct groups of actors, each with distinct ideas and power resources, often in partially overlapping areas, helped stimulate learning and policy innovation over time.

This involves using research and independent inquiries and committees to get the facts right, as well as using crises and large-scale policy failures and other focusing events to shift the policy paradigm, but also, sometimes, either hiding the consequence of reform from the voters or blaming them on one's adversaries. Without such skills welfare-enhancing institutional change may not be possible.

Modern statecraft is thus equivalent to polycentric governance of welfare-enhancing institutional change. In the context of today's advanced democracies and welfare states this often, if not always, means liberal statecraft, that is, policies or political developments that increase liberty and make society more free. Such governance is a collective good. Due to the collective action problem, sustained reform, especially if it is to extend over several paradigm waves, requires a critical mass of intrinsically motivated actors. They must be unconditional cooperators, acting for what they believe to be the common good, even if they in the short term will lose from the desired changes. If not, reform will come to an end, or may never start in the first place.

In the theory of reform developed in this study, statecraft is consequently not limited to the activities of a single person or statesman, even though individuals do matter. Instead it is a polycentric effort involving a large number of actors, often located in the central zone of a country, where the worldviews, beliefs, and values of the elites in different societal spheres are created and upheld. It is essentially a top-down process.

Modern statecraft have the potential of being generally applicable in other advanced democracies and welfare states, and possibly other countries that have the ambition to modernize their economies and societies.

Index

N. Karlson, *Statecraft and Liberal Reform in Advanced Democracies*,
DOI 10.1007/978-3-319-64233-8