

**Nils Karlson**

The Ratio Institute, P.O. Box 3203 SE 103 64 Stockholm, Sweden. Tel: +46 708 670 351. E-mail: [nils.karlson@ratio.se](mailto:nils.karlson@ratio.se)

## Statecraft and Liberal Reform in Advanced Democracies

### Abstract

This paper is a summary of my book *Statecraft and Liberal Reform in Advanced Democracies*, Palgrave Macmillan, 2018. For further information, free previews etc., see

<https://www.palgrave.com/gb/book/9783319642321>

Most Western democracies and welfare states are in need of liberal, welfare-enhancing reform. This book explains how. Its focus is not on what to do, but how. It explains how to govern a country well and how to overcome different barriers to reform.

The book develops a general theory of reform, based on a synthesis of previous research about institutional change and an extended comparative case study of Sweden and Australia over the last 30 years. It develops the concepts of the *reform cycle*, *reform strategies* and *polycentric experiential learning* to explain successful reform. Policy entrepreneurs, who introduce and develop new ideas, play a key role. Modern statecraft involves a combination of knowing *what* and knowing *how*.

The theory should be applicable to other Western democracies and welfare states, and possibly other countries as well that have the ambition to improve their economies and societies.

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.

## 1. Introduction

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. The problem or puzzle to be analyzed in the book: How to promote welfare-enhancing reform in today's Western democracies and welfare states.

How did Sweden and Australia succeed in reforming their economies and societies? How did the reform processes start, what made them persist and why did they, as it seems, come to a halt?

Can a general theory of reform of how to govern a country well, *Modern Statecraft*, be formulated based on previous research about institutional change and the experiences of these two countries?

## 2. Barriers to Reform

The chapter explains why welfare-enhancing institutional change is a difficult task in Western democracies due to a strong bias in favor of the status quo, which conserves undesirable, inefficient social states and creates barriers to reform, some of which are especially severe in modern welfare states.

This bias has rational, cognitive, and social reasons that can be summarized into:

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

Both existing institutions and established ways of thinking thus work against such reforms. 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?

## 3. Two Reform Countries

I will use the method of the extended case study to examine in detail the processes which lead to successful political reform, a method resembling process tracing. The 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.

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. 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. 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. More robust empirical testing of my theory of reform would of course 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 as well.

Over 25 years, from the mid-1980s to 2010, the Swedish model 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.

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.

The table below lists some of major reforms in Sweden:

Table 1. Some Swedish reforms

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
2006-10	Wealth tax abolished, earned income tax credits introduced, tax deductions for household services, social insurance and sick leave reforms, etc.

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.

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.

In the table below is a list of some of the Australian reforms:

Table 2. Some Australian reforms

1983	Floating of the Australian dollar, abolishing of capital controls
1985	Deregulation of financial markets
1985	Tax reform, lowering marginal taxes, abolishing double taxation, etc.
1988	Tariff reform starts
1990	Competition and micro-economic 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

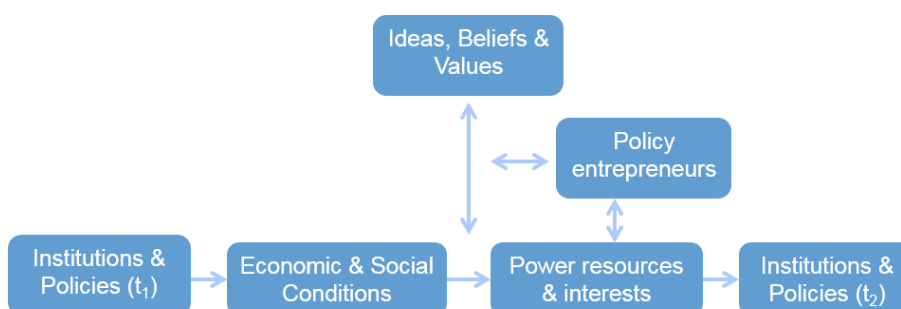
1998	Privatization of employment services
1999	Tax reform, introducing general sales tax
2002	Fiscal consolidation completed, budget surplus achieved, no public debt
2005-2007	Industrial relations reform, Workplace Relations Amendment Act (Work Choices)

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

#### 4. Explaining Institutional Change

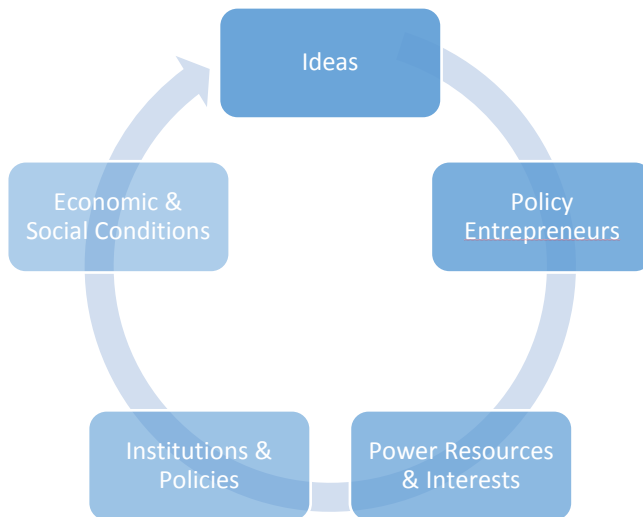
Institutional theory has often been criticized for focusing too much on stability. But there is an abundance of theories of institutional change, all of which may contribute to our understanding of how reform was possible in Sweden and Australia. However, most of them are partial and only address some aspects of the challenges involved in reforming a country. The chapter summarizes some of the most important theories of institutional change in various academic disciplines to be used as an analytical framework in the case studies.

The presentation starts with simple models, with few variables, including theories that use changing economic, social conditions, power resources and interests, followed by increasingly more complex models, which incorporates ideas, beliefs and values, as well as policy entrepreneurs and policy-advocacy coalitions, to explain how institutions and policies in time period 1 ( $t_1$ ) are reformed into institutions and policies in time period 2 ( $t_2$ ). The figure below illustrates the process:



#### 5. Reform Cycles and Reform Strategies

The chapter synthesises the theories of institutional change presented in previous chapter into a continuous process called the *reform cycle*, presented in the figure below.



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.

In order to overcome the barriers to reform the involved actors also need strategies to push the advocated policies through the political process. Three major kinds of reforms strategies are developed:

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.

The reform cycle and the different reform strategies will serve as the analytical framework and my hypotheses in the process tracing of the reforms studied in the case studies. But there are also remaining puzzles requiring theory development.

Since such strategies also may be used to decrease welfare, we also need to understand how and why liberal and welfare-enhancing policy ideas emerge, develop, and become implemented in order to explain how reform comes about. Moreover, since many of the problems that modern welfare

states face has the characteristics of public goods, the collective action problem involved in reform has to be solved. This is where the case studies come in.

## 6. The Swedish Reform Process

The chapter analyzes in detail the successful reform of the Swedish model over the last 30 years. The process is 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.

A large number of actors, using many different reform strategies, were involved in the Swedish statecraft. Different policy entrepreneurs introduced new ideas. 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 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, and that is perhaps a major lesson of the Swedish experience, 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 play a key role. In chapter 8 I 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 Western democracy and welfare state.

## 7. The Australian Reform Process

The chapter analyzes in detail the successful reform of the Australian model. Just as in Sweden, it took Australia 25 to 30 years to change an utterly failing model into a better-functioning new social model. 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 comes to a halt.

Again, many different actors, using many reform strategies, were involved. 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. Both Labor and Liberal-National governments played important roles. And the process of sustained liberalization was again largely incremental and pragmatic. A severe crisis was necessary to break the existing path dependence and 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.

But Kuhnian strategies of introducing new, more liberal ideas and perspectives played a crucial role in setting the direction of the reform process. 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, then, 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.

## 8. Modern Statecraft

The chapter identifies the causal mechanisms that can be traced in the case studies of how events chained on to one another through time in the reform processes of both Sweden and Australia.

Based on these experiences the conclusion is that Modern statecraft requires 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.



The sustained reform processes took place within the reform cycle presented in chapter 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.

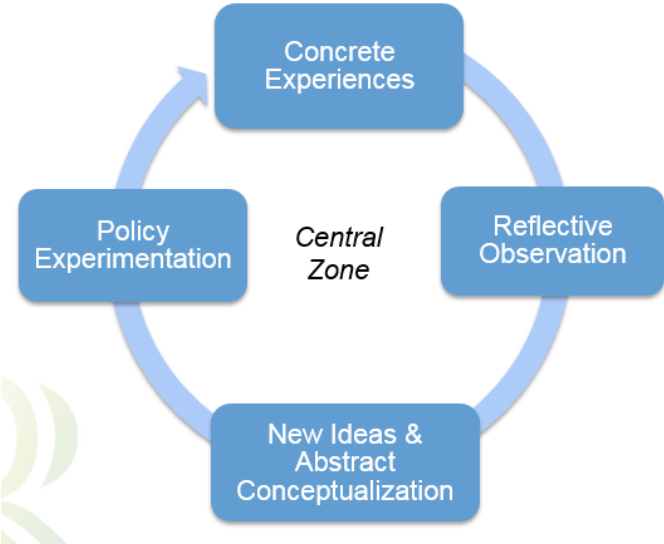
Modern statecraft in our two reform countries was not limited to the activities of a single person or statesman, even though individuals did matter, sometimes decisively, for statecraft to be successful. Rather, a variety of actors with different roles contributed to the process.

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 U.K., the U.S.A., and New Zealand played a role in this regard. 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.

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 combination of many distinct groups of actors, each with some expertise and decision-making power in partially overlapping areas, helped stimulate policy innovation. These different groups of policy entrepreneurs, interests with power resources, and political actors formed what, after Elinor Ostrom, may be called a system of “polycentric governance.” In this process in both countries a critical mass of intrinsically motivated actors emerged, acting for what they believed to be the common good. In terms of game theory, they were unconditional cooperators. These groups of

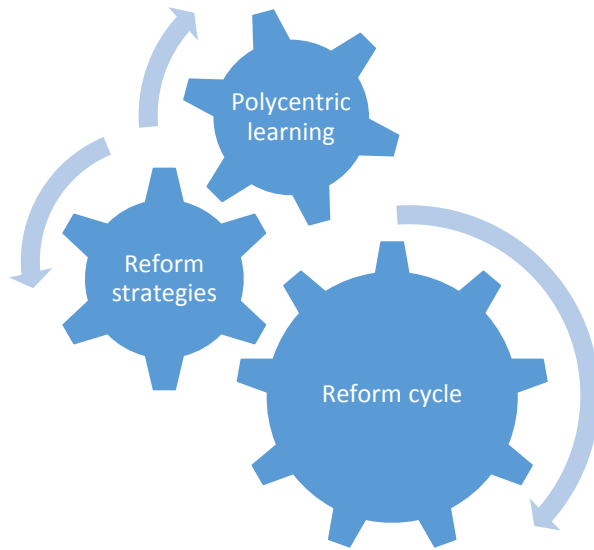
actors, including policy advocacy coalitions and policy entrepreneurs, were crucial to the reform process. Some of the most important policy entrepreneurs and policy-advocacy coalitions was located in what Edvard Shils have called the “central zone”, , where the worldviews, beliefs, and values of the elites in different societal spheres are created and upheld. Hence, policy learning was essentially a top-down process. The figure below illustrates the process:



In addition, the chapter analyses the role of strategic reforms; the intentionality of the process; why the reform processes stopped; democratic dilemmas caused by the use of Machiavellian strategies; whether the results hold for other countries.

9. Summary and Conclusions

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. The figure below summarizes my conclusion:



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. 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.

Modern statecraft, to govern well, is thus equivalent to polycentric governance of welfare enhancing institutional change. In the context of today's Western democracies and welfare states this often, if not always, means liberal statecraft, i.e., 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.

As with all qualitative studies based on a limited number of cases, there are limitations to generalizing the results. All Western democracies are different, and each has particular challenges due to its historical development, demography, geography, level of economic development, etc. But many countries face similar problems caused by changing economic and social conditions. Also, the barriers to welfare-enhancing reforms are similar, if not identical. Therefore, the same, if not identical, lessons could be drawn from a study of other reform countries.

The book is available as hardback, e-book and print on demand, and later a paperback, at

<https://www.palgrave.com/gb/book/9783319642321>