

The Challenge of Reforming Welfare State Institutions

Viewpoint Paper for the 2020 Public Services Trust

Charlotte Aldritt

Researcher to the Commission on 2020 Public Services

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8 John Adam Street
London WC2N 6EZ**

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Introduction

As we approach the end of the first decade in this new century, the changing nature of the world in which we live is evident. An unprecedented rate of technological innovation – especially in information and communication technology – is accelerating the pace of globalisation, a powerful force narrowing the distance between producers, consumers, cultures and societies. Within the post-industrial welfare states, populations are aging, family structures are shifting and there are increasing international flows of labour (Cabinet Office, 2008). Combined with growing environmental risks, these factors are putting strain on the institutions (structures, norms, organisations and arrangements) that have formed the bedrock of welfare states since their origin in the late nineteenth century.

Between sixty and one hundred years later it is perhaps remarkable that, given the scale and significance of these exogenous (and, to an extent, endogenous) pressures, the institutions of welfare states continue to exhibit many of the same essential features.

However, this essay argues that the persistence of welfare institutions is not 'the most striking feature of policymaking'. Using Hall's (1993) taxonomy of policy change and restricting 'reform' to third order change, I show that the persistence of deeply embedded welfare institutions is not surprising. Although policy change is observed and can take place within established, embedded institutional structures, third order reform is a much rarer phenomenon.

I first define the type of policy change involved when institutional reform takes place. I then consider the nature of welfare state institutions, the extent to which they are typically 'entrenched' and – drawing largely upon the Pierson's comprehensive review of this literature – then set out the primary institutionalist arguments used to explain the resulting difficulty in their reform. Finally, I tackle one of the most forceful challenges to the institutionalist perspective (summarised by Bannick and Hoogenbaum, 2007) and demonstrate that my argument is still valid; the very nature and design of welfare institutions mean that their resistance to reform is not striking, but to be largely expected.

Defining our terms: policy reform and welfare state institutions

Bonoli and Palier (1998) define 'innovative change' as "change which affects the institutional factors that have contributed to structure debates, political preferences and policy choices in the past." In Hall's typology of policy change, 'innovative change' is comparable to third order reform.

Hall describes policymaking as "a process that usually involves three central variables: the overarching goals that guide policy in a particular field, the techniques or policy instruments used to attain those goals, and the precise

settings of these instruments.” (1993: 278) In the case of old age pensions, Hall explains that the policy *goal* might be to alleviate poverty among the elderly, the chosen *instrument* might be a state pension and the *setting* would be the level at which this benefit was given. There are three types of policy change that arise from this underlying analysis, first, second and third order reform.

First order policy change occurs when policy goals and instruments stay the same, but policy settings are modified. This might be due to new information regarding past performance or future projections (about the economy, for example). Second order policy change occurs when the overarching policy goal remains the same, but the instruments used to achieve them are altered. This might happen if it is thought that the type of instrument is proving to be ineffective or is displaying unintended consequences. Third order change takes place when there is a radical shift, which entails “simultaneous changes in all three components of policy” (p279). According to Hall, such “wholesale changes in policy occur relatively rarely” (p279).

Broadly speaking, first and second order policy reform can be described as ‘parametric’ change. Change takes place within the ideas, ideology and structures of the established institutional architecture. On the other hand, third order change is ‘paradigmatic,’ and represents a different sort of process. Instead of incremental change within the existing framework, third order change sees a challenge not only to the goals and instruments of policy, but “also to the very nature of the problems they are meant to be addressing” (p279). The definition of the problem, and the range of ‘acceptable’ solutions have changed. We see a paradigm shift into a new framework of ideas that cannot be sustained within the existing institutional arrangement. It is therefore this form of paradigmatic, third order policy change that we must concern ourselves when looking at institutional reform.

An institutional perspective has come to dominate academic analysis of welfare states – their origin, development and classification. Esping-Andersen’s (1990) seminal typology of welfare regimes is based upon the different social arrangements that give rise to stratification on the basis of decommodification (the capacity to live outside the market) and social status. These social arrangements comprise a complex array of norms, structures, systems and organisations that are systematically interwoven and can be defined as welfare institutions.

The empirical case

Peter Hall (1993) illustrates his definition of third order reform with an account of the transition from Keynesian economic orthodoxy to monetarism in the UK during the late 1970s/early 1980s. He describes how the Keynesian economic policy paradigm ran into theoretical difficulties as stagflation gripped the British economy. After the Government was forced to resort to the IMF in 1976, the Keynesianism was further discredited and gradually lost credibility

in the eyes of policymakers and the public. Within the broad debate that ensued, monetarism became the “principal challenger to Keynesian doctrine, in large part because it was the most coherent and highly developed alternative” (p286).

In conjunction with an affinity with New Right ideology and the doctrine of the Reagan administration within the Conservative Party leadership, the UK experienced a rare third order reform of its economic orthodoxy. In reference to this change, Rhodes (2000:20) suggests that, “Thatcherism...provided a new and rather brutal ‘institutional fix’ that fundamentally altered the logic of the system.” Innovative change was also felt across many Western welfare states as they felt the effects of the second OPEC oil shock and moved into a post-industrial era. It is often argued that here ended the ‘Golden Age’ of welfare; a new, “silver age of permanent austerity” had begun (Pierson, 1998, 2001a; Taylor-Gooby, 2002).

However, across much of Europe, welfare state institutions were not overhauled. Rather they were ‘modernised’ or ‘recalibrated’ to account for the additional set of fiscal constraints and other internal and external challenges that they faced. Although the nature, extent and pace of policy response varied (and continue to do so) by country and policy area, Ferrera (2008) finds that they typically comprised (1) an attempt to *contain costs*, and (2) programmatic and/or institutional *adaptation*. As such, they most frequently experienced first or second order reform. Third order, innovative change has occurred only rarely; “Where welfare state change is concerned...there is good evidence to suggest that welfare institutions do not simply collapse in the face of structural challenges such as global economic pressures and indeed can be highly resilient (Swank, 2002; Rieger and Leibfried, 2003)” (Dwyer and Ellison, 2009:394).

Pensions policy is one area that has seen most substantial reform, but even here cases of paradigmatic structural change (e.g. Sweden or Italy) are rare: “Most countries...have kept within the logic of existing systems” (Ferrera 2008:93). First and second order reforms have included increasing the age of retirement and extending the use of mixed forms of private and public (‘multi-pillar’) forms of funding.

A similar pattern is observed in other aspects of welfare provision. Reform in health care has been focussed primarily on improving the efficiency and effectiveness of existing structures through better use of incentives (Freeman, 2000; Guillen 2002; Steffen, 2005). In a pursuit to cut costs and fund new social demands, *some* countries have seen a reduction of traditional benefits, such as old age, disability and survivor pensions (Armingeon and Bonoli, 2006). However, Kuhnle (2000) highlights that increased use of targeting (another attempt to reduce aggregate costs) has been applied “depending upon national preferences, constraints and opportunities.” (Ferrera, 2008:94)

Finally, it is useful to note that even in the face of radical economic policy change during the 1980s, “it is striking how little the welfare state has been eroded” (King and Waldron, 1988:417). Despite the ideological commitment of the Thatcher and Reagan administrations to reduce welfare dependency and total public spending, “on the whole the main institutions...remain largely intact” (p417). That the Conservative Party acknowledged at this time that it would be ‘political suicide’ to suggest anything other than the NHS would be safe in their hands (Campbell, 2003), might – using King and Waldron’s line of argument – indicate “the extent to which welfare provision is now conceived of as a core element of citizenship in Western society.” (King and Waldron, 1988:417) A challenge to existing welfare organisations, norms and structures might be said to be an affront on our social rights and the very notion of what it means to be a citizen. Coupled with the fact that welfare provision impinges directly upon people’s expectations and management of risk across their lifecycle, it perhaps follows that third order (and even sometimes first and second order) reform is difficult to bring about. It is to these – and other – theoretical explanations of institutional resilience that I now turn.

Why welfare state institutions are intrinsically difficult to reform

Esping-Andersen suggests that welfare regimes are inherently stable since they emerge out of class coalitional power relations which purposefully embed institutional structures, which are then self-reinforcing. Based upon Korpi’s power-resources theory (1980), Esping-Andersen argues that his three ideal welfare state types are the result of power relations between leftist actors and the rest of the political economy. These power relations are reinforced through “institutionalisation” as the welfare regime “becomes a powerful societal mechanism which decisively shapes the future” (p221). As such, welfare state institutions become increasingly embedded and *thus* difficult to reform (at least in any other direction than to the continued benefit of the system’s most powerful political actors).

Korpi and Palme (1998: 664) also use power-resources theory to explain how welfare state institutions are “intervening variables (Lazarsfeld, 1962)” with a strong tendency towards entrenching existing social strata and patterns of poverty and inequality. Positive feedback mechanisms mean that, on the one hand “institutional structures reflect differences in the roles played by markets and politics in distributive processes within countries” *and*, on the other, “[t]he shape of societal institutions is affected by the actions of different interest groups.” (p664) It is this role as both cause and effect that reinforces the outcomes and institutions of welfare states, leading to path dependency over the long run. Path dependency is a major reason behind welfare state institutions becoming increasingly entrenched as agents’ interests and expectations are shaped by, and reinforce existing, norms and structures (Korpi and Palme, 1998: 664).

However, while power-resources theory offers a compelling logic of path dependency, it is perhaps limited in its explanatory capacity, particularly as we

see persisting welfare norms, structures and levels of investment in the face of shifting patterns of social identities and alignments (Taylor-Gooby, 2009). According to Pierson (1994), power resources theory should have led to a much more significant degree of retrenchment in the UK and USA than was the case. Both these welfare states showed a much greater resilience than Pierson expected, a puzzle which led him to develop his idea of a 'new politics' where a new logic of 'restructuring' and 'recalibration' takes place. Kahneman and Tversky's (1979) experimental evidence suggests that people are much more sensitive to losses than to gains. As a result, the politics of 'taking away' is primarily concerned with 'blame avoidance' rather than 'credit claiming' during periods of expansion (Pierson 2000). The 'new' politics of welfare is an important reason behind their institutional entrenchment and subsequent difficulty in enacting third order reform. As evident in the persistence of welfare spending in the UK during the 1980s and Sweden during the 1990s, welfare state institutions create their own expansionary inertia, which – despite the pressures of ideology or fiscal austerity – is difficult to reverse.

There are other reasons that explain entrenchment of welfare state institutions and their subsequent difficulty in reform. One of the most important reasons stems from the application of game theory, which points to institutionalisation as a way of making credible commitment to policy over time; the 'time-inconsistency problem' (formalised by Barro and Gordon (1983) in relation to inflation expectations and monetary policy) is solved by embedding within formal institutions (rules and structures) the roles, responsibilities and expectations of agents in time period one. This locks in reputational risk and thus establishes a credible commitment to a particular policy in time period two.

Pierson (2000:256) also draws upon economic theory to explain how, "once in place, institutions are hard to change (North, 1990a)". Due to increasing returns, the costs of switching from one institutional configuration to another increase over time and, when faced with shocks or pressures to change, individuals and organisations (often first) seek to adapt to existing institutional arrangements rather than pay the price of exit. Furthermore, Pierson (2000) suggests that there is something intrinsic about the welfare state that means its institutions are all the more resistant to innovative reform. He identifies four main factors that "make this a domain of social life that is especially prone to increasing returns processes" (p252): collective activity in politics, the central role of formal institutions, power asymmetries, and uncertainty. These factors, explained in further detail below, highlight several important reasons behind the entrenchment of institutions and the difficulty in implementing third order, path-breaking reform.

Pierson's first reason for the persistence of welfare state institutions stems from the prominence of collective action in politics. Economic theory suggests that where collective action is required, free-riding will be endemic unless behaviours can be incentivised, monitored and enforced through institutions.

Since political activity is a primary mechanism for coordinating collective action in society, these institutions – in accordance with Pierson’s second factor – come to play a central role. Thirdly, institutions then help to establish and reinforce power relations as “they fundamentally shape the incentives and resources of political actors” (Pierson, 2000:259. As described above with regards to power resources theory, rational agents with agenda setting power will seek to maintain the status quo in their favour. Finally, the iterative nature and uncertainty of policy learning means that agents are more likely to adapt their expectations in accordance with the *existing institutional context*. The process of learning brings about its own increasing returns, making it difficult to break from the prevailing policy paradigm.

At this stage it is important to focus on the third of Pierson’s (2000) four factors to show that, almost by their very definition, deeply embedded institutions are resistant to reform. This relationship can be illustrated at a micro and macro level.

At a micro level, rational actors with agenda setting power will design institutions in such a way that makes them (and their subsequent social arrangements and power dynamics) difficult to reverse. Electoral competition and uncertainty might also mean that governments will try to lock-in their successors to policy reforms by purposely embedding institutions. A common way of achieving this is through the use of constitutional legislation that is especially difficult to retract. Furthermore, while rational agent models often encounter considerable criticism when applied in practice, the need for policy makers to make a credible commitment over time (even over the relatively short electoral term) means that institutions must be designed in such a way that they are difficult to reform. As a result, it should not be striking that we rarely see third order, innovative welfare institutional change.

At a macro level, systems of reinforcing individual institutional arrangements heighten increasing returns to scale all the more. Esping-Andersen’s (1990) typology of welfare regimes is based on a complex array of social provision arrangements, which – as an ‘entity’ – are arguably all the more resilient to third order reform of their increasingly entrenched norms and structures. Similarly, Hall and Soskice’s (2000) ‘varieties of capitalism’ approach also emphasises the role of institutional complementarities. According to both accounts, complementary configurations of organisations and institutions entrench reinforcing patterns of arrangements. As a result, third order paradigmatic change is yet more difficult to enact.

A defence of institutionalism

Critics of the institutionalist approach argue, “the main problem with the institutionalists is not only that they do not spot welfare state change, but also that they can hardly explain it as it occurs” (Bannink and Hoogenbaum, 2007:19). Indeed, Bannink and Hoogenbaum say that – contrary to the institutionalist literature – “In the past three decades, Western welfare states

have been overrun by multifarious reforms.” These reforms have also featured third order reform: “In some countries, social arrangements have even been completely eliminated or unrecognisably altered.” Institutionalists, critics suggest, fail to explain or acknowledge the extent of this reform (Bonoli and Palier, 1998). Bannink and Hoogenbaum (2007) go so far as to say that “dynamism” is in actual fact “inherent to modern welfare states” (2007: 20).

At first glance, this most forceful challenge to institutionalism might seem to undermine the central argument of this essay, namely that that entrenched welfare state institutions are difficult to reform. However, Bannink and Hoogenbaum do not consider the role of welfare institutions in giving a long run credible commitment of risk management to citizens. Furthermore, in response to the ‘social residues’ that give rise to “hybridisation” of welfare systems (rather than Esping-Andersen’s coherent and internally consistent regimes) Bannink and Hoogenbaum only deal with the ‘politics of expansion’ (not the ‘new politics’ of retrenchment – see Pierson, 1994). As such, they overemphasise the capacity for third order change to the institutional architecture of welfare states.

While I agree with Bannink and Hoogenbaum’s demand for better theories of welfare state change, their model of system and provision inclusion, and even the inevitable presence of ‘social residues’ and subsequent pressure for reform from certain interest groups, the one example they offer (the Dutch pensions system) only shows that innovate reform and incoherent regimes are *possible*. On this point we also agree; I acknowledge from the outset that institutional change can occur, but it is a rare phenomenon. Most welfare state policy change tends to be parametric, rather than paradigmatic (Hall 1993; Ferrera 2008). This is because, as I argue above, complex systems of welfare state institutions (whether ‘pure’ regimes or ‘hybrids’) are designed to be change-resistant, are subject to increasing returns and deal with citizen entitlements that are difficult to take away through the political process. For these reasons, it means that third order change is still possible (assuming that the relevant groups can mobilise sufficient power resources), but entrenched welfare institutions are nevertheless difficult to reform.

Conclusion

This essay has shown that policy change is not incompatible with historical institutionalism. There are examples of third order, innovative change. However, these are relatively infrequent occurrence, because actors typically adapt within existing norms and structures unless there is cause for a paradigmatic challenge. Using Kuhn’s model of ‘Scientific Revolution,’ Hall (1993) stresses the need for a persistent or sufficiently significant challenge to the prevailing paradigm *and* an alternative, coherent framework to adopt instead. Without these conditions for third order change actors will instead adapt their expectations and behaviours within the existing norms and structures. Moreover, even when welfare states adopt a new paradigmatic approach, they do so by applying new knowledge and policy ideas onto the

institutional framework of the 'old order' (see Dolowitz, 2001 on international policy transfer); historical institutional legacy matters.

The reasons behind the persistence of welfare state institutions can be described in both economic and political terms. However, the most compelling explanation combines insight from both approaches; the need for policy makers to give credible political commitment means that they seek to embed institutions by design. Increasing returns then heighten the cost of exit and entrench the norms, expectations, structures and organisational arrangements all the more. It becomes increasingly difficult to go against the tide of these embedded institutions and enact third order reform. Indeed, inherent difficulty of reform is where institutional arrangements derive their credibility and influence in coordinating actors. Such credibility is all the more important when institutions are tasked with helping individuals and groups to manage complex social risks over generations. As described above, a persistent and/or significant challenge to the overarching paradigm is necessary for innovative change. It is therefore not at all striking that entrenched institutions, particularly welfare state institutions, are difficult to reform.

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