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Book review: Nils Karlson, Statecraft and liberal reforms in advanced democracies[1]

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In this short volume, Nils Karlson makes an important contribution to the economics of institutions by providing stimulating theoretical insights and two interesting case studies. His narrative unfolds in three steps. After having acknowledged that good institutions are a key ingredient of sustainable growth, he draws attention to the lack of satisfactory and comprehensive explanations of their dynamics; he details his views about the components of successful institutional change; and he provides evidence by examining policymaking in Sweden and Australia during the 1980-2010 period.

In the first part of the book, Karlson joins the classical-liberal tradition initiated by Adam Smith and more recently reformulated by Douglass North. Institutions are virtuous when they include light government and the rule of law (no privileges): free trade, moderate taxation, restrained public expenditure, and judicious regulation.

Yet, free-market institutions are the exception, rather than the rule. Sometimes, they replace harmful or ossified laws. More frequently, bad lawmaking and poor growth performance persist, and reforms fail to take place.

Karlson examines the components that make it possible to move from a poor institutional context to growth-enhancing legislation. In particular, the author underscores the role of four necessary conditions. First, economic performance must be disappointing. The country must experience a negative shock (e.g., the oil shock that took place in the early 70s), or intolerably low growth, or structural problems and impending troubles (e.g., a large public debt or high unemployment). In other words, the public must realise that the status quo is undesirable and unsustainable, and that reforms are in order. Second, institutional changes need ideas and a fertile cultural environment. Thus, reforms cannot take off unless influential opinion makers (Karlson calls them "policy entrepreneurs", a label that includes eminent scholars, respected think tanks, influential journalists and junior politicians) succeed in persuading the political elites and the general public to consider abandoning the status quo and moving towards (free-market) alternatives. Third, the creation of new institutional features needs informed debate and flexibility. New fiscal and regulatory measures should be analyzed in detail before they are introduced, they should be monitored after they become operational, and they should be modified if they fail to function as originally predicted. The fourth ingredient relates to what Karlson identifies as Machiavellian politics. This element is the ability to circumvent opposition by interest groups that would lose from downsizing the welfare state, deregulating, cutting trade barriers and, more generally, eliminating privileges. Of course, these interest groups include large layers of the electorate, producers and workers in selected industries, bureaucrats and professional politicians across the entire political spectrum.

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When an advanced country fails to meet Karlson's requirements, the outcome is persistent stagnation and possibly crisis. However, success is not impossible. In this light, the author presents two case studies – Sweden and Australia. He analyses them in detail and documents the existence of all the four requirements that make free-market reforms come true.

In the central chapters of the book, Karlson shows that both countries experienced disappointingly low growth in the 1970s, and engaged in major free market reforms since the early 1980s. During those years, Sweden brought about significant cuts in taxes and public expenditure, introduced stringent budgetary rules, extensive deregulation, privatizations, pension reform and outsourced welfare services to private providers. Australia engaged in a similar process: it dismantled the high trade barriers in place, liberalized financial markets, lowered taxation, introduced free-market elements in the pension system and competition in the public sector, and eliminated public debt. In both cases, the results were fast growth, low unemployment, a healthy competitive environment and solid public finances.

The similarities between the Swedish and Australian stories are striking. Before reform efforts took off, Sweden and Australia experienced low growth, rising unemployment and major shocks: the 1992 attack on the Swedish crown and, in Australia, the 1993 recession accompanied by soaring welfare payments. As a result, in both cases public opinion became ready to question the virtues of government intervention and the traditional notion of social justice. Moreover, in both cases, the political elites included sets of trained neoclassical economists who felt more loyal to what they had learnt in graduate school than to the ideology championed by the political parties to which they belonged. Finally, Machiavelli turned out to be alive and kicking in Stockholm as well as in Canberra, where the political leaders strived to ensure that reforms would not be in the limelight, and actually made things happen well before the rank and file of their parties and most members of parliament had realized that change was under way.

Yet, there was also one important difference, which regarded the nature of the policy entrepreneurs who triggered the reform process and kept it going until about 2010. In the Swedish case, the major driver was the Swedish Employers Association, both directly and through a number of think tanks it generously funded. The Central Bank and enlightened top politicians did the rest. In Australia, the leading actors were academia and one influential governmental body (the Tariff Board).

To summarise, this is a thought-provoking book, which I recommend to a wide audience of readers – including non-economists – and which opens new research agendas in at least three different respects. First, it would be interesting to study what stopped (or is stopping) reforms in a number of troubled countries. Growth remains disappointing and trained economists are ubiquitous. Yet, something is missing: is it because intelligent and cultured people do not make it to the control rooms? Or because the academic environment is inadequate and prioritizes constructivism at the expense of the classical-liberal vision? Or because of a deficient entrepreneurial culture that fears competition? Second, one cannot help observing that even in Sweden and Australia, "the reform processes were less intentional than one might expect in hindsight" (p. 163). Put differently, accidents still play a major role – if not the major role – even in Karlson's account of institutional change. In particular, accidents (having the right people at the right places) ignite the demand for change and make reform possible, while adverse conditions bring reform to a halt and possibly to backtracking. More work on these political mechanisms and on how political elites emerge is needed. Finally, it would be interesting to know how political philosophers regard Machiavellian policymaking in advanced democracies. Karlson's account shows that cheating plays an important role: politicians delivered growth enhancing policymaking by keeping a low profile, taking credit for what their predecessors did, and blaming the others when opposition intensified. Of course, tactical skirmishing is part of the game and in most cases acceptable. Yet, reneging on electoral promises or violating the preferences of the electorate is a different story. Engaging in free-market reforms because it is good for the people despite the people's will is paternalism and electoral treason, and goes against the very principles of classical liberalism. Hopes to see one's own name in history books do not necessarily justify holding on to political posts and ignoring how and who put him/her there.