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How and Why Do Institutions Change? A Four Phase Framework for the Description of Institutional Development

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Abstract

Proposes a framework to categorise the development of systems of social and economic management, enabling comparative study of institutional change. Drawing on work by the Regulation School, neo-marxist state theory as well as the policy style literature, four phases of institutional development are identified. In the first phase, the existing institutional environment is unchallenged and relatively stable. In the second phase, minor changes in the broader environment prompt small scale adaptation of institutional arrangements. Most institutions will typically be located in one of these two phases. In the third phase, the onset of crisis - broadly defined - challenges the effectiveness of existing institutional arrangements, resulting in their collapse or mounting ineffectiveness. In the fourth phase a new institutional arrangement is established. This paper sketches the main features of these phases.

Introduction

The ongoing restructuring of the Australian economic and social policy framework, and the consequences of this restructuring, has been a central concern for journals such as the Journal of Economic and Social Policy in recent years. In the past two decades, longstanding Australian institutions of economic and social management have undergone fundamental restructuring, typically away from state-based intervention into the operation of the economy and towards a market-based orientation (ACIRRT 1998; Argy 2003; Bell 1997; Capling & Galligan 1992; Frankel 2001; Wooden 2000). How can we understand this ongoing restructuring of state-based social and economic institutions?

The current explanatory literature has relied on several types of argument. For some writers, most famously Michael Pusey, the restructuring process can be traced to the success of specific policy approaches, such as 'economic rationalism' or 'neoliberalism' in winning public policy debates. Others, particularly in parliament, understand the current phase of restructuring in rational, technical terms. A minority of writers, such as Castles, Bell, Capling and Galligan and numerous globalisation writers, downplay ideological and voluntaristic explanations, and instead locate the process of restructuring as a consequence of the changing structural, economic

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1 An earlier version of this paper was published as G. Treuren, 2002. 'A four phase structuralist-functionalist framework for categorising the evolution of systems of employment regulation'; in I. McAndrew (ed.), proceedings of the 16th AIRAANZ Conference, Queenstown, NZ. I am grateful to a seminar group at the Institute of Social Sciences, The Hague, The Netherlands, in April 2000, Paul Martin and the referees of this journal for useful comments on this paper. I remain responsible for the final result.
context of Australian capitalism. For these writers, this process of transition can be understood as the consequence of growing exposure to competitive global financial and product markets, and Australia's changing position within the global division of labour (Castles 1988; Fagan & Webber 1994; Lansbury, Kitay & Wailes 2003; Pusey 1992; Smyth & Cass 1998; Wooden 2000).

The Australian literature has been primarily concerned with the outcomes of this restructuring, either its institutional form or in social consequences, which is typically explained using a structural or voluntaristic logic of institutional restructuring. The interaction between structural and voluntaristic forces has not been significantly explored (Lansbury, Kitay & Wailes 2003, pp. 63-65). This paper is concerned with providing a framework to describe this process of institutional change, recognising the interaction of structural and voluntaristic processes in shaping the development of institutions.

In the typology introduced in this paper, institutions of economic and social management are held to pass through four ideal-typical stages. The first stage can be understood in terms of a 'steady state', enabled by 'institutional momentum', where the prevailing arrangements continue to operate successfully. In the second stage, the circumstances enabling the 'steady state' begin to erode, reducing the effectiveness of the regulatory arrangements. Minor scale adaptation of prevailing institutions occur. Even though it is possible that the prevailing institutional arrangements may be dysfunctional or inefficient, the majority of institutional arrangements will remain in these two phases for the majority of time.

However, the environmental conditions underlying the relative stability of the first two stages may not last, leading to crisis. This process occurs in the third stage of our four stage process. Here, prevailing institutions may be unable to reconcile the emerging pressures on the regulatory system, leading to regulatory failure beyond the capacity of existing institutions to accommodate or by piecemeal modification. The institutional arrangement begins to fail, eventually leading to collapse. Crisis results. The fourth phase concerns the process of establishing a new and viable institutional framework. This process occurs through a form of institutional darwinism, where experimentation and innovation leads to the new institutional forms. Unsuccessful institutional forms and processes, unable to reconcile the host of environmental pressures, will emerge and collapse, prompting the devising of new forms and processes. Eventually a satisfactory institutional ensemble will emerge. Once properly established, this new framework remains stable - in the first phase of this framework - until environmental pressures necessitate change (Figure 1). Thus, in this framework, an institution cycles between stability and collapse, renovation and eventually back to stability.
Figure 1: Four Phases of Institutional Evolution
Necessarily at a high level of generality, this paper merely outlines a theoretical framework, and does not seek to provide a case-by-case explanation of specific institutional developments, or examples to demonstrate the utility of the framework.\(^2\) It does, however, provide a method for conducting comparative studies of institutional change.

This framework will be developed in several stages. The following section will introduce the 'steady state' phase of institutions. Ideal-typical reasons for the collapse of the steady state will be sketched in the second section, and will highlight the more typical process of piecemeal institutional modification. The third section will sketch the factors leading to the collapse of the prevailing regulatory environment. The following sections will outline the trial and error processes and context through which new regulatory systems emerge.

This argument understands an 'institution' to be not only a formal entity such as the 'banking system', the operation of the various Commonwealth, state and local government agencies, 'trade unions' or the 'courts', but also as:

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\text{formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy. They range from the rules of a constitutional order or the standard operating procedures of a bureaucracy to the conventions governing trade union behaviour or bank-firm relations (Hall & Taylor 1996, p. 938).}
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Why a 'Steady State'?

This paper begins from the assumption that the typical situation for a regulatory system is a 'steady state,' where institutions and the practices surrounding those institutions operate with a minimum of disharmony. As will be discussed in the next section, this 'steady state' is not inert or static, but reflects a set of institutional arrangements marked by relative stability and the absence of significant demands for change. This assumption draws on the argument developed by theorists of the Regulationist and Social Structures of Accumulation schools who have identified the existence of regulatory regimes that prevail over extended periods of time (Aglietta 1998; Boyer & Juillard 1998; Frenkel 1988; Hollingsworth & Boyer 1997; Kotz, McDonough, & Reich 1994). For these writers, capitalist social relations are inherently unstable due to the relentless competition between capitalists, and between capital and labour. Orderly reproduction can only occur through the intervention of institutions, as understood in the broad sense given above, mediating between the various economic actors (Aglietta 2000; Boyer 1990). In this literature, the destructive consequences of the contradictory tendencies within a given period of capitalist society are only prevented by the operation of institutional arrangements.

Once established, these institutional arrangements typically demonstrate path dependency and institutional momentum. Although the process of establishment of viable institutional arrangements is the result of a difficult process of institutional

\(^2\) Subsequent papers, looking at the evolution of Australian industrial relations, tourism planning and trade practices policy will demonstrate the usefulness of this framework to provide a linkage between environmental change and institutional development.
experimentation based on trial and error adaptation of existing arrangements and approaches, once established, the essential features of these institutional arrangement remain in place until rendered obsolete. Such a steady state may be ineffective, inefficient or otherwise socially or economically dysfunctional. The key feature of this 'steady state' is that forces that hinder or disrupt the reproduction and continuity of the overall system - which may be social, technical, administrative, political or economic - are somehow contained.3

How can this longevity of institutions be understood? In the theory of embedded autonomy, the capacity of the state to implement policy is a reflection of previously established relationships that have been 'embedded in a concrete set of social ties that binds the state to society and provides institutionalized challenges for the continual negotiation and re-negotiation of goals and policies' (Evans 1995, p. 12).

These embedded relationships reflect the settled linkages between the state, the institutions and other forms of organised interests within a community. These linkages can occur in two ways. This network of institutional arrangements establishes the power and capacity of any one set of actors, including the state, to influence the negotiation process. In addition, the existing institutional arrangements also shape the perception and definition of agent power and influence. Not only does this embeddedness establish the hierarchy of authority and capacity of the state in relation to non-state institutions, it also shapes the procedural rules between the parties.

These embedded social institutions ensure that these arrangements continue to exist over time and can act to limit the range of choices available to policy actors, potentially resulting in sub-optimal outcomes. These institutions - the remains of prior decisions - interact with the current forces for change (Hall & Taylor 1996). Decisions about the nature of change, the choices that are available to the policy actors, and even perceptions about the range of choices, are typically understood and resolved within the confines of that framework. Prior decisions may dominate present and future decisions with the momentum of prior decisions continuing to commit the parties to the path previously set (Hollingsworth 1997; Thelen & Steinmo 1992). Unless circumstances warrant rejection of that path, further decisions will be made in the context of the requirements of the trajectory of that path (Arthur 1989; David 1994; Scott 2001). This organisational momentum may be overcome by events. Krasner (1984) uses the metaphor of 'punctuated equilibrium,' as the previous institutional configuration collapses, another is formed, and continues on under the momentum of daily use.

**Minor Adaptation of Institutional Arrangements**

It cannot be assumed that this 'steady state' phase will be characterised by freedom from difficulty. Economic, political and social fluctuations will continue. The key question for institutional stability is whether existing institutional arrangements are able to absorb and resolve the consequences of these fluctuations. This section will

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3 I am indebted to the participants in a seminar at the Institute of Social Sciences, The Hague, The Netherlands, in April 2000 on this point.
discuss how minor difficulties can be absorbed through institutional adaptation; the next section will discuss the processes through which the institution may respond to challenges beyond small scale adaptation.

In the usual case, during the life of a viable set of institutions, these fluctuations are accommodated. This 'accommodation' can take several forms, perhaps playing a 'cathartic' role, 'purging' temporary disequilibria out of the institutional environment (Boyer 1990). Such periods act to remove emerging mounting disequilibria, for example, through temporary recession, fluctuations in unemployment, an interest rate movement or through stock market correction. These crises are restorative and are short-term; they can be likened to Adam Smith's 'invisible hand', equibrialising the various destabilising tendencies across the economy.

During these periods, the institutions and structures of that economy are not fundamentally challenged. The correction provided by the crisis acts to minimise the accumulation of crisis tendencies, and the previous stability can be regained. Such situations, however, can prompt the modification of existing institutional arrangements. These modifications do not necessarily alter the fundamental processes of the prevailing arrangements.

Usually the adaptation reflects an incremental, marginal change to existing arrangements. Visser and Hemerijck's study of the evolution of the Dutch system of industrial relations and social security provide two explanations of this process. First, existing institutions meet the new circumstances provided by mounting pressures by creating 'additional rules and procedures', which have the effect of 'relieving bottlenecks in the existing institutional format'. Thus, existing institutions are 'patched up' to meet the requirements of the emerging procedures.

In the second case, existing institutions can undergo a process of 'transposition', where institutions established for a specific purpose gradually assume responsibility for more general institutional purposes, extending their existing institutional approach to new areas (Visser & Hemerijck 1997). These processes of modification of institutions reflect the inherent adequacy of the existing institutional arrangements in reconciling the competing interests within the institutional environment.

The Collapse, Dissipation or Fragmentation of Regulatory Systems

The model so far can be understood in terms of institutional arrangements with sufficient momentum to not be significantly affected by contrary influences. Such arrangements eventually end for two intertwined reasons. First, the social, economic and political basis that created and enabled specific institutional forms and processes may be eroded, disappear or become irrelevant to prevailing circumstances. At some point in time, the various actors or marketplace pressures that led to the embeddedness of prevailing arrangements may no longer exist or may have lost relevance. As a direct consequence, challenges to institutional stability are then unable to be absorbed and the regulatory environment becomes inadequate in reconciling competitive pressures.
The second reason for institutional collapse is the emergence of new forms of institutional challenge which overwhelm the amelioratory capacity of the regulatory framework. This may occur through the emergence of new technologies, changing markets and consumer preferences, changes in the orthodoxies about economic, social and political governance for example. In addition to these endogenous origins of change, change may occur for exogenous reasons, such as flooding, war, famine or terrorism, which can also lead to the regulatory collapse.

Endogenous variables can transform the terrain in which institutions are embedded, as the balance of forces within a society evolve. This situation occurs when the existing system of regulation is unable to continue, the prevailing dynamics of capitalist social relations are blocked and a short period of crisis will not restore the conditions of continued growth. Maintaining accumulation then requires the reconfiguration of the norms of social relationships. In this period of reconfiguration, the usual gradual advance through minor technological innovation or the application of market rationality is unable to resolve the imbalance, and the possibilities for future configurations of social relationships seem more explicitly politicised and contested (Boyer 1990).

**Establishing a New Institutional Framework**

The growing institutional inadequacy eventually prompts attempts to find a new form for re-regulation. This can occur in two ways. In the first way, the parties themselves develop a method for regulating their interactions, such as industry self regulation or professional and occupational group standards of conduct for their members. It is beyond the scope of this paper to outline the particular dynamics involved in such processes.

More commonly, the new institutional form will be the result of statutory intervention. This section will sketch the more usual case of state intervention in establishing a regulatory regime, by integrating Block's (1977) framework for state behaviour with innovations drawn from comparative public policy and historical sociology. In this model, the legislature is only likely to effectively legislate on matters within a narrow zone of possibility, satisfying the accumulation and legitimation obligations faced by the state. Why is this?

Block has argued that the central challenge facing state managers - elected government officials and senior bureaucrats - is the need to maintain the confidence of the business sector. Ongoing investment is essential to maintaining community living standards as well as the electoral viability of sets of state managers. While both state managers and the business sector have an interest in the continued expansion and viability of economic activity, there are two essential divisions of labour in achieving this end. The first division concerns the planning horizons of the two groups. While industrialists are quite likely to be keen judges of their short and medium term viability - and the conditions necessary to ensure that viability - it cannot be assumed that this detailed awareness of any one employer or industrialist would extend to the 'management' of the current 'system' of political economy. State managers, however, are comparatively obliged to ensure the medium and long-term viability of the *overall*
economic system and to consider these objectives within the context of the electoral cycle.

The second division of labour concerns the investment decision. State managers cannot compel investment (Lindblom 1977). From this perspective, the key issue for state managers is to provide the circumstances in which capitalists are happy to continue to invest. This has two aspects. First, state managers are constantly aware of the role of expectations - 'business confidence' - in shaping the investment decision. As a result, state managers are obliged to propose capital-friendly policies that will assist in continued accumulation. The second aspect involves avoiding policy that will discourage investment. State managers need to recognise the implications of their actions on the current activities of investors, as well as the effect of actual, perceived and anticipated polices that may be made. The threat of capital not investing is as effective as capital not actually investing, as a corrective to state behaviour. Maintaining the support of capital, or at least the absence of significant capitalist disapproval, is central to the task of state management. Consequently, the intangible and quixotic 'business confidence' variable becomes a major concern for state managers. Block (1977) argues that the need to maintain 'business confidence' prompts state managers to self-censor not only actual policies, but proposed polices.

There is a limit, however, on the accumulation necessity. State managers also need to maintain legitimacy, the support of the community for the prevailing system of regulation. In liberal democratic nations, the legitimation function is most clearly demonstrated through the electoral process. Viable state policy must simultaneously satisfy the accumulation function and the legitimation function. Thus the short-term outer boundaries to state policy are set (Treuren & Lane 2003 (in press)).

**Policy Formation within the 'Policy Space'**

What shapes actual policy within the 'policy space', where both legitimacy and accumulation functions are satisfied? The 'policy style' literature provides a useful way of understanding the capacity for the business sector and the government to shape the policy formation process. This literature attributes the diversity in abilities of state managers as a function of the different configurations and policy networks, of state capacity and organisational structure (Atkinson & Coleman 1989; Smith, 1990; Wilks & Wright 1987). At any point in time, debate and policy on a specific set of policy questions is shaped by the interaction of organised interests, either in a class or interest group sense, and the state.

The state, its structural capacity and the strength of interest groups dependent on the embedded set of surrounding institutions can influence the inclusion or exclusion of interests into the policy domain. At the core of the state's ability to regulate this network is its resources and capacity relative to those of the various interest groups. At some moments and in some configurations, the state is clearly able to determine policy outcomes; at other moments and configurations, the state is clearly constrained by the agenda of organised interests and coalitions of organised interests. The Atkinson and Coleman (1992) typology provides a neat way of conceptualising and categorising distinct configurations of state capacity and societal organisation,
differentiating between corporatist, client or pressure-group pluralism and state-directed processes (Table 1).

### Table 1: Conditioning Factors for Policy Networks

<table>
<thead>
<tr>
<th>Mobilisation of business interests</th>
<th>High autonomy high concentration</th>
<th>Low autonomy high concentration</th>
<th>High autonomy low concentration</th>
<th>Low autonomy low concentration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>State-directed</td>
<td>Pressure pluralism</td>
<td>Pressure pluralism</td>
<td>Pressure pluralism</td>
</tr>
<tr>
<td>High</td>
<td>Concentration</td>
<td>Clientele pluralism</td>
<td>Corporatism</td>
<td>Industry dominant</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Pressure pluralism</td>
</tr>
</tbody>
</table>


The Atkinson and Coleman typology employs three major interdependent variables to characterise a range of ideal-type permutations for policy networks. The first variable is the level of centralisation and concentration of control by the state over business officials and other interest groups, and over policy outcomes. The second variable is the degree of differentiation between state and non-state groups. To what extent is the state autonomous from interest groups? The extent of autonomy will depend on a range of historically grounded factors such as the resources available to state and non-state actors, and the relationship between these agencies and non-state bodies.

The final variable is the degree of mobilisation of non-state and business interests. Atkinson and Coleman's typology focuses on the business sector, which has its own decision making capacity to influence economic and other policy outcomes. This capacity has been simplified into two states: 'high' and 'low' degrees of organisation, able to be deployed in the policy formation process. The variable 'mobilisation' represents the extent to which these interests can organise independently from the state.

Placing these variables together creates an ideal-typical typology of policy networks, according to the extent of state autonomy and centralisation, and the extent of interest group organisation. Used within this study, such an approach locates voluntaristic behaviour within a decision-making space shaped by the structural imperatives of accumulation and legitimation.

While this approach relies on very few variables to characterise different policy-making environments, it does clarify different configurations of organised interests, and the implications of these configurations on the policy formation process. Thus, the approach distinguishes between the different configurations of state capacity to direct policy formation; from contexts where policy determination is the result of interest group bargaining, as suggested by classic pluralist conceptions; or environments where corporatist forms of negotiating between organised interests prevail. The further specification of explanatory variables will assist in developing more nuanced characterisations of embedded policy environments.
The Flexibility of Constraints, Alliances and Boundaries

In practice, these boundaries - within and defining the decision-making space - are not necessarily clearly or firmly fixed. The central concept of Block's (1977) typology - 'business confidence' - as well as the 'legitimation' function, is significantly shaped within the domain of discourse and is subject to the complex interaction between the requirements for accumulation and legitimation, and competition within the realms of practice and ideology. In addition, these boundaries, particularly those of the legitimation function, have a temporal component, with policies moving in and out of acceptability over time.

'Business confidence' as a discourse-constructed concept exists in the minds of investors and state managers, created and modified in the interaction between the domain of discourse and the actual world of social and production relations. Prevailing 'ideas' and theories that constitute 'commonsense' shape the practical meaning of 'business confidence', altering the boundaries of the decision-making space of state managers. Business confidence can be flexible, adjusting to non-market considerations, such as the national interest, for example, during times of war.

A consensus on the outer boundaries of state behaviour may also be shaped by the time lag of policy within the community and the business sector. Some decisions may be misunderstood or ignored for a period, enabling ultimately unacceptable policies to be implemented, only to lead to a later rejection. Policies ultimately deemed acceptable may initially be opposed; policies ultimately to be rejected may at first be enthusiastically received.

The onset of technology-assisted hypermobility of capital, production processes and information has led to these boundaries becoming increasing fluid. In addition to the malleability of the boundaries of acceptable state decision making, the dilemmas of the mobility of capital affect state capacity in another way, as the authority of the state to influence its own affairs may be significantly altered. The expansion of the market from a domestic orientation to the international marketplace adds to the challenges confronted by state managers, and may weaken the capacity of the state to directly regulate the domestic space. At the same time, the growing mobility of factors of production, and thus the factors of domestic economic stability, has added to the difficulties for state managers in 'winning' business confidence.

Not only are the boundaries fluid because of economic, political and temporal reasons, but these boundaries are fluid because of the evolution in 'ideas' that can act, over time, to expand the set of possible activities or prevent other activities. 'Ideas,' conceived as sets of assumptions about appropriate, legitimate and acceptable behaviour, influence the extent of these boundaries The importance of 'ideas' as sources of authority for policy options, variously enabling or preventing policy innovations, has been adopted by some 'new institutionalist' writers, to explain major policy departures, such as the American New Deal, the rise and fall of Keynesian demand management, the trajectories of different welfare systems, the borrowing of institutional arrangements, and the time lag in dissemination of new policy approaches (Weir 1992; Hall 1989; Hall 1992; Katznelson 1996; King 1992; Rabinbach 1996)
Institutional Darwinism

The process of finding the form for a new regulatory system may emerge either intentionally or as a by-product of regulatory intention. This section will look at the more typical case of regulatory intention. Given the perception of a need for a new regulatory regime, legislators may propose a specific form for a regulatory system. If this particular regulatory system is interpreted as leading to outcomes contrary to the imperatives for continued accumulation and legitimation, for example, either proposing the curtailment of managerial prerogative in favour of worker self-management, or proposing for the enslavement of sections of the population, then it is likely that the proposal will be abandoned. Eventually, another proposal will emerge, and proceed through the same process.

If a proposal is implemented, and does not work - that is, does not act to provide a stabilising influence - the ensuing instability will prompt new efforts to find a new regulatory system. The proposed system, it can be expected, will be apparently superior. Unacceptable proposals and institutional forms fall away, either prior to implementation, if outside the existing ideational scope; or after implementation, due to an inherent inadequacy in reconciling competing interests - a form of trial and error experimentation. Over time, new proposals will emerge, for reasons best ascertained through empirical study. Those that reconcile the prevailing competing interests will be able to continue. This process of institutional arrangements rising and falling will continue until an adequate form emerges.

Conclusion

In this framework, the form taken by statute-based institutions is the result of the interactions of state managers in reconciling their legitimation and accumulation obligations, acting upon the terrain of existing organised interests. This terrain develops over time, variously bounded and facilitated by the ideational constructs and the patterns and structure of embedded institutional arrangements.

This paper has sought to make a contribution to the literature, by considering the way in which institutions are formed and develop. The framework developed in this paper categorises the institutional development through four stages. First, the typical situation, an established, adequate regulatory system prevails. The regulation provided by this system is not unchanging; over time, small scale adaptation will occur to absorb or find new solutions to presenting difficulties - the second phase of this framework. Such changes, however, are typically incremental advances, rather than changes in the operation or structure.

In the third stage, unspecified but typologised factors act to derail the momentum of the regulatory system. Endogenous reasons can include changes in innovation,
employment participation rates or consumption levels. Exogenous reasons include war, climatic unpredictability, changes in the international division of labour, local demography and plague.

The instability of the third phase creates the conditions for the exploration of forms of new regulatory systems. This can occur in two ideal-typical ways. In the first instance, the solution to regulatory crisis is generated by the parties. In the second and more typical case, the new regulatory system emerges through a complex process of policy experimentation, itself conducted within the constrained context of contested accumulation and legitimation, and between organised interest groups.

This framework is not a *theory* of the development of institutional arrangements. It does not specify a motive force underlying the process of change. Instead, this paper outlines a typology for the categories of the development, and a means for the orderly classification and comparison of regulatory development.
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