



New Horizons in Public Policy

Series editor: Wayne Parsons

**THE DYNAMICS
OF PUBLIC
POLICY**

Theory and Evidence

Adrian Kay

The Dynamics of Public Policy

NEW HORIZONS IN PUBLIC POLICY

Series Editor: Wayne Parsons

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NEW HORIZONS IN PUBLIC POLICY

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Abbreviations

| | |
|------|--|
| ACTU | Australian Council of Trade Unions |
| AFR | annual financial return |
| BBR | balanced budget rule |
| BMA | British Medical Association |
| CAP | Common Agricultural Policy |
| CCT | common customs tariff |
| CE | compulsory expenditure |
| CoAM | Council of Agricultural Ministers |
| CRL | Co-Responsibility Levy |
| DHA | District Health Authority |
| DoH | Department of Health |
| EU | European Union |
| FE | functional explanation |
| GATT | General Agreement on Tariffs and Trade |
| GDP | gross domestic product |
| GNP | gross national product |
| HI | historical institutionalist |
| IIA | inter-institutional agreement |
| NCE | non-compulsory expenditure |
| NGO | non-governmental organization |
| NHS | National Health Service |
| NHSE | National Health Service Executive |
| NICE | National Institute for Clinical Excellence |
| OECD | Organisation for Economic Co-operation and Development |
| OR | own resources |
| PACT | prescription analysis and cost |
| PCGs | primary care groups |
| PCTs | primary care trusts |
| PPRS | Pharmaceutical Price Regulation Scheme |
| R&D | research and development |
| SFP | single farm payment |
| VIL | variable import levy |
| VPRS | Voluntary Price Regulation Scheme |
| WTO | World Trade Organization |

Preface and acknowledgements

During the writing of this book, I moved to a new job in Australia. This slowed down the writing of the book significantly but prompted some new reflections on policy dynamics and the incorporation of references to the situation in Australia to complement the empirical chapters based on my previous work on UK and EU public policy. If the reflective pause in writing ever tried the patience of my publisher, Edward Elgar, it never showed: thank you to Catherine and her colleagues for supporting this project through to completion.

In trying to think about temporality in policy analysis I have benefited greatly from many discussions with former colleagues at the School for Policy Studies at the University of Bristol, as well as my new ones at the Department of Politics and Public Policy at Griffith University.

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My greatest debt is to Siwan and I dedicate this book to her. Dw i'n dy garu di.

Adrian Kay
Brisbane, March 2006

1. Introduction: why we need dynamic perspectives

WHAT IS DYNAMIC ANALYSIS?

This is a book about the dynamics of public policy. Like many well-used and widespread terms in the social sciences the idea of dynamic perspective or analysis, whilst intuitive and appealing, is difficult to define precisely in a manner that will cover all of its different uses. For example, even within the field of economics and its commitment to a positivist science, the Nobel Laureate Paul Samuelson (1947, p. 311) was able to say that: ‘often in the writings of economists the words “dynamic” and “static” are used as nothing more than synonyms for good and bad, realistic and unrealistic, simple and complex’. In his *Essays in Economic Semantics*, the Austrian economist Fritz Machlup (1975, p. 10) offered the view that: ‘Typically, “statics” was what those benighted opponents have been writing; “dynamics” was one’s own vastly superior theory.’

Precise definitions do exist: for example, Samuelson’s own formulation that dynamic analysis refers to models in which time is an independent variable would be recognized by students of economics. However, this limited definition is of little utility outside the formal models of economics and does not capture any substantial sense of the concept of dynamic analysis as it is used variously in the social sciences. Instead this definition is an exemplar of ‘how economics forgot history’, the title of Geoffrey Hodgson’s investigation of the long-standing difficulty of time and historical specificity in the social sciences (Hodgson 2001).

It is precisely the difficulty that economists have had in modelling time that reveals the value and importance of the dynamic perspective to the analysis of public policy. Any policy process is a complex system and dynamic models of complex systems are much more difficult to construct than static ones (which is why dynamic models are also less well developed in biology and physics (Auyang 1998)). The difficulty arises because there are typically several processes with different speeds going on at the same time. This makes separating different time scales such as the short, intermediate or long run as essential to understanding and explanation as distinguishing between different spatial scales, as in the macro, meso, micro and decision levels

common in policy studies (for example, Parsons 1995; Hudson and Lowe 2004).

Most importantly economics, like public policy, depends on human decisions. All decisions are made in historical contexts; they are inevitably influenced by the legacy of the past and the uncertainty of the future. Thus the description of individual decisions requires a sense of memory and expectation; these are subjective, personal and partial and therefore not suited to the formalism of economic models, notwithstanding theoretical advances in game theory on ‘memory’ and ‘expectation’ in repeated games.

One common and essential element in most writers’ use of the term policy is purposiveness of some kind (Parsons 1995, pp. 13–16). Policy expresses a general set of objectives or a desired state of affairs. These are constrained by a sense of possibility driven by legacies and forebodings. In a well-known definition of policy, public policy is: ‘anything a government chooses to do or not to do’ (Dye 1972, p. 2). Policy is about choice: the choice of objectives; the choice of reasons for (in)action; the choice of policy instruments; the choice of how to respond to the consequences of policy outputs. These choices, their consequences and subsequent choices unfold in a temporal process in which uncertainty is a defining feature.

In this book dynamic analysis is not a conceptual framework or theory, nor is it amenable to a precise, pithy definition that allows a succession of theoretical corollaries in terms of policy dynamics. Rather it is a perspective or a way of viewing the world more akin to a methodology – in the sense of prompting a series of questions about methods of inquiry – than a substantive theory. The idea of policy dynamics is not original; it is proclaimed in the titles of Rose (1976), Harrison et al. (1990), and Baumgartner and Jones (2002). However, the intellectual underpinnings of dynamic analysis remain unexplored in the policy theory literature. The case for the importance of understanding policy dynamics in the field of policy studies is put forward in this chapter. This also gives context to the assessment in later chapters of the different frameworks, concepts and theories that might be used for the purpose of dynamic policy analysis.

In exploring the foundations of a social-scientific approach to dynamic analysis, the issue of history in policy studies ineluctably emerges along with the broader epistemological question of the relationship between social-scientific explanations and historical explanations. Indeed, this book aims to make progress on the challenge set out by Pierson (2004, p. 5): ‘The declaration that “history matters” is often invoked, but rarely unpacked.’ Something similar is repeated in Schwartz (2004), Thelen (2003) and Mahoney (2003). In alternative terms, Reynolds (1999, p. 277) observes that, without elaboration, the claim that to be properly understood things must be considered within their historical context amounts to ‘mundane historicism’.

The book addresses the notion of dynamics as a term that is widely, if inconsistently, used within the social sciences, has been applied in the study of policy, but is currently theoretically underdeveloped in policy terms. The nature of what is being studied with a dynamic perspective – temporality and change at different scales – demands notice of history *qua* academic discipline, or more accurately historiography: dynamic analysis is the use of concepts and theories to understand and explain longitudinal data of policy development. I argue in Chapter 2 that there is a deep underlying common structure involved in ‘dynamic policy analysis’ and ‘writing policy history’; however such a formulation faces the constraint that different disciplines have different methods and analytical styles, as well as the acceptance of different modes of explanation as valid. The second chapter establishes the narrative as the appropriate methodology for policy dynamics; I go on to develop specific standards of inquiry to construct and assess policy narratives in Chapter 5.

This chapter has three aims. The first is to set out the intellectual foundations of dynamic analysis from a social science perspective in terms of three notions: temporality, change, and different processes and scales. The second aim is to establish public policy as a unit of dynamic analysis. Finally, the structure of the book is outlined.

TEMPORALITY

There is a distinction between temporality and ordinary, common sense conceptions of time. Broadly there are two categories of answers to Heidegger’s famous question: what is time? The first has time as something which exists independently of things and events; the second sees time as ideal, in the sense that things are not temporal without temporal concepts. It is beyond the scope of this book to investigate this question fully, however for our purposes an answer does help for the understanding of what is meant by a dynamic perspective. The assumption in this book is that ‘time’ is an abstract, imaginary notion; whereas ‘temporality’ refers to how we make events or experiences intelligible in terms of time. Time cannot be separated from things, events, processes and is inherent in all empirical entities.

This allows two things to be set out immediately. First, any policy choice or decision depends on knowledge of options and thus the concept of possibility is fundamental. Next, possibility is inalienably linked to temporality: without sense of a past, present or a future, the notion of possibility – and thus choice – does not make sense. Possibility enters into most social scientific theories, implicitly or explicitly, by the concept of ‘state space’. This is the structured collection of all the possible momentary states of an individual thing. For example: consumption and production sets in microeconomics; or the capacity

of a health system to produce certain health outputs; or the range of predictions in a model of poverty over the life course. The individual thing in this book is policy, so the term ‘policy space’ is used interchangeably with state space throughout the book. The concept of state space is the foundation of dynamics and the use of dynamic perspectives; a dynamic perspective on policy consists of examining successive states of a policy system and the relationship between them.

This distinguishes dynamics from the comparative statics approach that does compare certain states of a system but fails to consider the relationship that links the states through time. Whilst it is possible to have a theory of change within a comparative statics perspective that provides reasons why some states will change to another, two important elements will be missing. First, an account of the process of adjustment between the two states, and some analysis of the connecting path. Second, temporality: the separation of the two states is atemporal, as the snapshots (which may have temporal identifiers to the extent that we can say one occurs before the other) are of two states being compared for reasons other than temporality – they may be salient political events, for example. In a dynamic perspective on the other hand, temporality is central. The purpose is to compare a system as it passes through consecutive temporal states, and these consecutive states may come slowly or quickly; thus a system that changes slowly would have different temporal identifiers to one that changed quickly. And, of course, by making the claim that something changes slowly, we are using some concept of time. This establishes the point that just as we can separate scales of analysis in the policy process, so we can show different rates of change. This is how I understand the frequently cited aphorism that the social sciences should fulfil an ambition for ‘movies and not stills’.

For Pierson (2004, p. 2) the key to temporal analysis is: ‘... *systematically* [italics in the original] situating particular moments (including the present) in a temporal sequence of events and processes stretching over extended periods’. However I argue that temporality involves more than just situating different states; rather the ambition for ‘movies’ is to trace a path between all these different moments or states realized at various times. In principle these paths may be described by deterministic dynamics; in formal social science modelling this is usually in form of a set of functional equations in which time is an independent variable. Alternatively there may be stochastic dynamics, where the probabilistic element is limited by the set of all possible states in the model or theory. However, the crucial point for this book and for policy dynamics is that in the policy process the possibilities are so numerous and heterogeneous, as well as unexpected and unintended, that *they cannot be circumscribed in state spaces*. Therefore, I argue, deterministic or stochastic models of policy dynamics are incapable of prediction, either prospectively or

retrospectively, and thus fail one of the defining standards of social science research.

Unpredictability is not, however, inexplicability; as explanation has the benefit of hindsight. All the concepts, theories and frameworks of policy dynamics covered in this book contribute to ‘narrative’ explanation. Chapter 2 stresses that the notion of possibility, inextricably bound with temporality, is central to narratives of policy dynamics. Most explanations of evolutionary events are narrative and share with policy studies a focus on unique sequences and processes; indeed, the limited applicability of state space indicates the limit of generalization in policy studies. This is one of the reasons why evolutionary approaches to policy dynamics are considered in Chapter 4, and ideas of memory in Chapter 5.

THE NOTION OF CHANGE

There are four ideas involved in the notion of change: an enduring thing; its various possible states; the identification of an initial and a final state by the temporal index; and the characterization of these states. The logical structure of change is of the following form: the thing changes from state S_1 at time T_1 to state S_2 at time T_2 . T_1 and T_2 pinpoint, temporally, the states that S_1 and S_2 characterize. But without some idea of unity that binds the two states, we can only say that they are different. We need the concept of the ‘thing’ to bind the two states, that is something, some element of the entity, must endure for change to occur.

The characterization of the thing involves a type-value duality. A thing’s potential to change is limited by the range of possible states admissible for the type set of which it is a member. If the thing is education policy, for example, only certain policy states are possible for that type; that is, only certain things can be education policy. If the boundary of possibility is overstepped, the thing in question becomes another thing rather than a different value of the same thing. There is a crucial distinction in logical terms between changes in things and changes in kind.

How to make progress on this distinction in practical terms? I start with the proposition that a thing changes *substantively* when its states at different times have different characteristics. The successive states constitute the thing’s history. They can also be interpreted as the stages of the process the thing undergoes, as in policy process where things change form, such as with the generic stages model: from idea, to proposal, to legislation, to implementation plan, to monitoring and evaluation framework. A thing need not change substantively, but an unchanging thing still has a history and undergoes a stationary process.

The endurance of a system is embodied in a path in state space that connects the observed states of a system identified by a unique temporal reference point. The temporal reference point establishes the order of the states in the system and substantive differences between them. The identity of the thing through time, the endurance, raises the troublesome philosophical question: if a changing thing really changes, it cannot literally be one and the same thing before and after the change; however, if a changing thing literally remains one and the same thing (that is, it retains its identity) throughout the change, then it cannot really have changed.

This is not an abstract irrelevance. The debate over public policy toward foetal research, for example, emphasizes that debates about things and values are politically contested: when does the ‘thing’, human life, begin and therefore the legitimacy of scientific experimentation? The identity-through-time difficulty is compounded where the thing is composite and its constituents are in flux, as is the case where the thing is ‘policy’. For example, is social policy under a Keynesian welfare state a different thing from neo-liberal social policy, rather than a different value of the same thing? While the economic policy of *les trente glorieuses* in France is obviously different from that under the Maastricht Treaty process in the 1990s, important continuities remain: it is a different thing with similarities to the previous thing. It will emerge in the book that the notion path-breaking policy change, a change in kind as well as value, forms an important part of debates in the field of policy studies – as in Chapter 8, for example, which looks at policy dynamics following the break up of a well-established policy paradigm in UK health care policy.

A MULTITUDE OF PROCESSES AND TEMPORAL SCALES

Robinson (1979, p. 286) states: ‘Logical time can be traced from left to right on the surface of a blackboard. Historical time moves from the dark past behind it into the unknown future in front.’ As noted, time is the parameter that distinguishes and identifies the various states of an enduring thing and is inherent in the general concepts of endurance and the processes that occur. However, the temporal parameter is defined individually for each thing or process. There are therefore many kinds of time, and this is a characteristic that can distinguish the different states of a system.

The major trend of a system is not the only ongoing process; there are a multitude of processes proceeding together, each with its own pace and temporal structure. So, economists talk about the short term, or intermediate-term adjustment, or the long term or cycles. Policy analysts in government employing cost-benefit techniques examine immediate and medium-term

impacts. Wanna et al. (2000) discuss how the budget-making process at the federal level in Australia includes requirements for 5-year fiscal impact analyses of policy decisions and periodic intergenerational equity reports that use a 30-year time horizon. The relative magnitudes of the different temporal processes help in the understanding of which process dominates over a particular timescale, which can be held stationary, or which might be averaged. Whilst policy theory discusses time horizons, uses notions of time consistency when critiquing policy design and contains discussions of term limits for politicians, there is little systematic analysis of different rhythms, cycles and process speeds in the policy process.

The notion of different temporal scales further limits the utility of static analysis. Once time is 'frozen' then it is impossible to observe different velocities. The idea that what is observed from a snapshot has any relevance at any time in the future is doubtful because the snapshot picture will change very quickly when there are a multitude of temporal processes occurring; in metaphorical terms, taking a snapshot of a kaleidoscope will not have much value in trying to understand what preceded and succeeded the point at which the picture was taken.

Another related limitation of static analysis is that it does not allow for the idea of inertia, a key characteristic of policy change. A static approach assumes away inertia and resistance once a factor driving change has been nominated and an outcome position identified, but the dynamics question is: how do you get from one to the other? What is the resistance involved in terms of countervailing power, institutional inertia, bureaucratic entrenchment or the reassertion of 'old' thinking or analysis?

POLICY AS A TEMPORAL STATE

This brings us to the point that all books about policy must address: what is policy? This is the thing that both changes and endures over time, and arouses an interest in dynamic analysis. Hogwood and Gunn (1984, pp. 11–19) discuss a number of the common uses of the word 'policy': policy as a label for a field of activity (for example, foreign policy); policy as an expression of general purpose or the intended path towards a desired state of affairs; policy as a specific proposal; policy as a decision of government; policy as a formal authorization (for example, legislation); policy as a programme of activity; policy as outputs or what governments actually deliver, as opposed to what it is promised or authorized through legislation; policy as outcomes or what is actually achieved; and policy as a theory or model (the notion that if we do *X* then *Y* will follow').

Such definitional breadth is what attracts scholars to the brevity of Dye's

definition of public policy, or Howlett and Ramesh's (2003, p. 3) offering that 'Public policy is, at its most simple, a choice made by a government to undertake some course of action.' Stone (2001, p. 7) argues that definitions of policy in terms of choice, or an action calculated to achieve a desired objective, or the purposeful connecting of ends with means are premised on a 'classical view' of policy as the result of a rational process: 'the model of policy making in the rationality project is a production model, where policy is created in a fairly ordered sequence of stages, almost as if on an assembly line'.

Of course, most policy textbooks readily acknowledge that this is an oversimplified model: policies usually involve a series of interrelated decisions; rather than a single decision-maker, many different people at different levels and scattered throughout government organizations make public policy decisions; policies are shaped by earlier policy decisions and environmental factors; policies are mediated through their implementation; policies involve both actions and inactions; policies cannot be analysed apart from the policymaking process; policies have outcomes that may or may not have been foreseen; policies are subjectively defined, and may be defined retrospectively; policies extend beyond the formal records of decisions; and policies need resources and action to be differentiated from political rhetoric.

Nevertheless, despite the limitations of the classic view there is an entrenched belief, particularly among policymakers, that policy should achieve a desired change in the wider population. For example, as with the evidence-based policymaking initiative in the UK's Cabinet Office where Professor Ron Amman attempted to introduce something like a stages model to 'improve policy-making' (Centre for Management and Policy Studies 2001). Further, much of the recent policy-learning literature is premised, usually implicitly, on some underlying rationality in the policy cycle where policymakers use trial-and-error procedures in order to find the best solution to a problem. First, policymakers develop a hypothesis about the best way to achieve an objective (the causal model from inputs to outcomes noted previously). They then test their hypothesis, that is, they implement their policies and analyse their impact. From their analysis, policymakers can come to a conclusion about how well their policies work and whether they should be continued, improved, implemented in another way or terminated.

The notion of a policy cycle, prominent in the classical view, has its origin in systems theory and the pioneering work by David Easton on political systems (Easton 1965, 1966). According to Colebatch (1998) the policy cycle imagines the policy process as an endless cycle of policy decisions, implementation and performance assessment. Howlett and Ramesh (2003) conceive of a similar cycle but with more steps: agenda setting (problem recognition); policy formulation (proposal of a solution); decision-making

(choice of a solution); policy implementation (putting the solution into effect); and policy evaluation (monitoring results). Hogwood and Gunn (1984) also envisage a cycle: issue search or agenda setting; issue filtration; issue definition; forecasting; setting objectives and priorities; options analysis; policy implementation; evaluation and review; and policy maintenance, succession or termination.

This generic class of policy cycle models is idealized, but useful here for showing what challenges and demands a dynamic perspective brings: all these models of stages, cycles and learning, and variants thereof, even when they are sophisticated enough to explain why particular decisions are made, do not pinpoint or offer what drives policy from one stage to the next. In our terms here, the notion of a cycle is an exercise of comparative statics rather than dynamic analysis. The 'process' bit of the policy process most often goes un-theorized and is assumed away.

Policy cycle models fail to embrace the complexity of the policymaking process and the reality that policy rarely, if ever, develops in a linear progression. Stages are often skipped or compressed and the idiosyncrasies, interests, preset dispositions, policy paradigms or mental maps of the actors involved often usurp the sense of a smooth process. There are a multitude of different processes at different scales and at different speeds occurring simultaneously.

There is an alternative to the classical view of policy, that Colebatch (1998, p. 102) labels the structured interaction model:

The structured interaction perspective does not assume a single decision-maker, addressing a clear policy problem: it focuses on the range of participants in the game, the diversity of their understandings of the situation and the problem, the ways in which they interact with one another, and the outcomes of this interaction. It does not assume that this pattern of activity is a collective effort to achieve known and shared goals.

The interaction view recognizes that policy is an ongoing process with many participants, most of whom do not have a formal or recognized role in policymaking. They include ministers of state, their advisers, politicians, public servants, party members, 'street level' delivery staff, peak bodies, interested members of the public, the media and academics. According to this view, policy is not about the promulgation of formal statements but the processes of negotiation and influence; indeed, 'much policy work is only distantly connected to authorized statements about goals: it is concerned with relating the activities of different bodies to one another, with stabilizing practice and expectations across organizations, and with responding to challenge, contest and uncertainty' (p. 102).

Stone (2001, p. 208) provides the most memorable description of the

structured interactionist view, and one that emphasizes its corollary in terms of the need for dynamic analysis:

policy is more like an endless game of Monopoly than sewing machine repair. Hence the common complaint that policies never seem to solve anything. The process of choosing and implementing the means of policy is political and contentious. The actions we commonly call 'new policies' are really somebody's next move, and in politics, as in a good game, nobody's move completely determines anybody else's future move.

THE POLICY SYSTEM

One consequence of accepting the complex interaction view of policy over the classical view is that it presents policy as a multi-level phenomenon. There is no unique level or scale but rather several levels that may be examined as 'policy', as Hecló (1972, p. 84) puts it: 'As commonly used, the term policy is usually considered to apply to something "bigger" than particular decisions, but "smaller" than general social movements. Thus, policy, in terms of levels of analysis, is a concept placed roughly in the middle range.'

The first scale in this middle range is that of the policy system. In these terms, policy is a 'whole', or system, as in discussions of health policy, defence policy or housing policy. It is not just journalistic shorthand to talk about policy development; there is a 'whole' or a 'system' at a policy level that can be the subject of active and passive verbs and the object of empirical investigation without stretching the limits of our imagination too far. A policy system is a complex, composite variable consisting of many interrelated elements. Within a policy system there may be several policy subsystems (or elements), each with their set of actors, organizations, goals and instruments (Baumgartner and Jones 2002, Chapter 1). For example, within the health policy system there are *inter alia* the primary care policy subsystem, the hospital policy subsystem and the public health policy subsystem. Using a dynamic perspective, the development of policy subsystems may equally be understood as the policy 'whole' itself.

Rose and Davies (1994) argue the policy programme level should be the basic unit of analysis in policy studies because it is most readily observable. A policy programme refers to a specific combination of laws, commitments, appropriations, organizations and personnel directed towards a more or less clearly defined set of goals. In other terms, this is a policy instrument: an identifiable tool or resource of government used for a specific set of purposes. This is a more finely grained perspective than the policy subsystem and I develop the argument in Chapter 5 that this should be the microfoundation for policy narratives.

One corollary of different policy scales is a lack of precise frameworks for ‘measuring’ policy, or alternatively locating policy continuity and policy change. Judging policy change is difficult because even if at the macroscopic or policy system level there is limited change and policy is considered stable, there may be – concurrently – change observed at the policy subsystem level or programme/policy instrument level. In the context of economic policy, Hall (1993) sets out three orders of policy change: change in the level of policy instruments (first order); change in the instruments actually used (second order change); and change in the overall policy paradigm (third order change, which occurs at the policy system level). Under this categorization, policy change and policy stability may be simultaneously observed. Hall’s work is important because it allows the crucial logical distinction between changes in things and changes in kind to be made in terms of policy. It gives us categories of things (policy instruments and their different levels) and kind (policy paradigm). This allows us to assess whether an existing policy is changing or a new policy is being introduced.

For Hall, a policy paradigm is an interpretative framework that operates in the policymaking process. Specifically, it refers to the framework of ideas and standards that specifies the goals, instruments and the very nature of a policy issue. On this approach, how policymakers interpret and use evidence to construct the notion of a policy, and options for reform, greatly affects policy development. Such an interpretive framework or mental map may be path dependent and ‘sticky’ (Denzau and North 1994). Importantly, just as the Kuhnian model challenges the conception of scientific activity approximating to certain canons of ‘pure’ rationality, so will any parallel model applied to the policy case; thus policy paradigms belong outside the classical view of rational policymaking.

Alternatively, Pritchard (2002) shows how it is possible to generalize away from science by using Wittgenstein’s notion of ‘hinge propositions’. These are the guiding assumptions of a certain activity; assumptions that inform and restrict the choices taken. These guiding assumptions are forms of tacit knowledge; it is not that agents do not know the assumption at issue – this is not a situation of incomplete information – rather they do not recognize that they are making an assumption. They are ingrained in how agents construct their situations, their decisions and their actions. Neither policy paradigms nor hinge propositions are evaluated or directly articulated in the policy process, but they operate to reduce the range of possible alternative courses of action that are scrutinized in the decision-making process. Situated agency in policy studies is discussed in Chapter 5, but note here that I will use the concept of a policy paradigm rather than a hinge proposition throughout the book, on the grounds that this term is commonly used in the policy studies literature; in many ways the latter notion is better however, because the implication of the

label of a policy paradigm is that these are the equivalent of Kuhnian scientific paradigms in their completeness, internal coherence or resistance to disconfirming evidence, whereas in Chapter 8 the argument is presented that this is not always the case.

The emphasis on a multitude of processes at different speeds from a dynamic perspective complements this multi-level view of policy. Throughout the book I will use the terminology of *events* to describe abrupt changes of things; with more gradual change labelled as a *process*. A process is of the form $S(t)$, where t is the temporal identifier or index, and S , the state of a system. Thus, S varies in accordance with the variation in the temporal identifier: a dynamic perspective. Following this notation the derivate, $dS(t)/dt$, can be interpreted at a specific time as an event, the almost instantaneous change in system.

The distinction between an event and a process helps avoid the dualism between policy stability and policy change that sometimes affects policy studies. From a dynamic perspective it is *all* change, because even where the state of the system does not change in type or value, S at t_1 is different from S at t_2 , and so on. This analysis helps to get us 'beyond continuity' (Streeck and Thelen 2005) in our thinking about policy development. Instead the notions of events and processes help decompose sequences of policy development into temporal parts such as periods, stages, phases, movements or epochs. The method of periodization raises questions for narrative explanation and the construction of policy histories: these are dealt with in Chapters 2 and 5.

POLICY AS AN INSTITUTION

Institutions are central to contemporary social science theory. Indeed, an acceptance of the importance of institutions for social and political development is one of the few genuine cross-disciplinary agreements. This has produced a variegated set of institutionalisms (see Hall and Taylor 1996, see also contributions in Goodin 1998). The attraction of institutions, both to policymakers and analysts, is that they help give a structure to a world that is complex and in which there are a multitude of temporal processes underway at different levels. Institutions are collective constraints; organized patterns of socially constructed norms or roles with prescribed behaviours expected by the occupants of these roles, which are created and recreated over time. Institutions help provide a buffer against the uncertainty of interaction among policy actors and perturbations external to the policy process. Institutions are enduring, regular and tend to be difficult to change; as such they provide an important part of the temporal context of policymakers.

As noted earlier, within the policy system 'whole' there are various

structures at different scales that act as institutions in shaping agents' decision-making in the formulation and implementation of policy. These are not reducible to individual level agents or elements in the policy process. Examples of such policy institutions are budget rules, policy networks, standard operating procedures in government departments, and agencies. Most importantly in terms of understanding policy development, past policy decisions *are* institutions in terms of current policy decisions: they act as structures that can limit or shape current policy options. Institutionalism is an important way of thinking about policy legacies, how policies accumulate and gradually institutionalize. The ambition to understand how policy histories affect policy in the present is what drives this project of dynamic policy analysis: as Oakeshott says, we do not have a 'blank sheet of infinite possibility' in a policy area; the options for future policymakers are restricted by past policy paths.

The conceptual distinction between a policy and an institution is significant; to conflate the two would blur the object of analysis in policy studies. Nevertheless, in certain circumstances a policy can act as an institution. As Pierson (1993, p. 596) states: '... major public policies also constitute important rules of the game, influencing the allocation of economic and political resources, modifying the costs and benefits associated with alternative political strategies, and consequently altering ensuing political development.'

In Pierson (2004, pp. 150–51, 165–6) policies are institutions, and although they are less 'foundational' than formal political institutions they can develop in a manner complementary to and interlocking with those formal institutions. Further, the application of the voluminous and important literature on institutional development to the study of public policy represents a 'significant research frontier' (p. 165). I agree, and throughout the book will be using concepts that have been developed for the analysis of institutional dynamics for the purposes of understanding policy development, such as path dependency for example, in Chapter 3.

OUTLINE OF THE BOOK

The book is in two parts. The first part consists of four chapters that take a theoretical perspective on policy dynamics. In Chapter 2 the central role of history in policy dynamics is established, both in terms of the effect on the present of things that happened in the past and its place as an academic discipline. In discussing the different modes of explanations in the social sciences and historical disciplines, the argument is developed that narrative explanations are the most appropriate means for explaining policy dynamics.

Further, the use of narratives in this context, far from being perceived as a weakness or some lack of analytical capability (as some formal social scientists maintain), should be viewed as the valid method of inquiry for answering the questions raised by a dynamic perspective on policy development. Chapters 3 and 4 assess critically two broad concepts as means of organizing or structuring policy narratives. Chapter 3 looks at the increasingly popular notion of path dependency and its application to policy. What advantages and disadvantages does the concept have in understanding or explaining chronicles of policy development? Chapter 4 subjects evolutionary theory to similar scrutiny in a policy development context. On the basis of these theoretical investigations, Chapter 5 sets out how to structure policy narratives to explain policy dynamics. The chapter acts as both a summary of the preceding analysis and a methodological guide for the empirical chapters that follow: what is a narrative? How do you structure a narrative? How do you evaluate a structured narrative? What makes it convincing or valid, successful or true?

Chapters 6–9 constitute Part II of the book. These are all case studies of particular policy dynamics. Theodore Lowi's venerable, but imperfect, four-fold typology of constituent, redistributive, distributive and regulatory policies has been used to select the cases. I make no claim that these are in any sense a representative sample of policy dynamics, only that Lowi's typology allows four different policy contexts to be considered in the book. The EU budget is an example of a constituent policy in Lowi's terms in that it involved the EU adopting a series of decision rules for subsequent policymaking. Chapter 6 will consider the structure and history of the EU budget with particular attention to the development of budget rules and their complex inter-dependency over time, from the mid-1980s onwards. The EU's Common Agricultural Policy (CAP) is described as a redistributive policy in Chapter 7, which will outline the argument that although the CAP has been the subject of five reforms in 18 years these reforms have for the most part been minor, and the key policy dynamic that needs explaining is resistance to reform. Chapter 8 looks at UK primary care between the late 1980s and 1997 as a distributive policy. The GP fundholding scheme was introduced and repealed within seven years in the 1990s and the case illustrates the dynamics triggered by the collapse of a well-established policy paradigm and the subsequent instabilities where a major reform initiative fails to be institutionalized in the policy system. Pharmaceutical policy is considered in Chapter 9 as a regulatory policy in Lowi's terms. UK pharmaceutical policy has changed significantly since the early 1990s, towards an emphasis on controlling NHS demand for medicines. The policy dynamic is of an increasingly complex policy space with new initiatives layered onto existing policies, creating new and potentially contradictory interactions between demand-side and supply-side regulations.

PART I

Theory

2. Policy dynamics and history

In Chapter 1, the path linking successive temporal states of some entity was defined as the history of that entity. When an entity, such as policy, is complex, composite and polyvalent, there can be several different immanent histories. This chapter aims to establish the role of history in policy dynamics, both in terms of the effect of things that have happened in the past and of history as an academic discipline. The first section is epistemological; it discusses what counts as a valid explanation in historical and social-scientific disciplines. The next section develops the argument that a dynamic perspective with social-scientific foundations, as outlined in Chapter 1, can draw on history qua academic discipline to make a genuine and distinct contribution to policy studies; in particular in emphasizing the utility of the narrative in contradistinction to more formal models of dynamics that often fail social science standards of good modelling. The third section illustrates this claim by using a dynamic perspective to problematize the notion of policy ‘choice’, suggesting that the narrative is the appropriate method to render the complexities and conjunctural contingencies in the policy process tractable for analysis.

HISTORY AND THE SOCIAL SCIENCES

Any claim of a ‘historic turn’ in the social sciences, see for example McDonald (1996), should be accompanied by the observation that this is a return rather than a new trend; for example Hodgson (2001) charts the rise and fall of the question of the role and nature of historical specificity in the social sciences. Indeed, an emphasis on history is a defining feature of heterodox traditions in economics, for example in the works of Georgescu-Roegen (1967, 1971) on the possibility of an entropy law and Kaldor (1970) on cumulative causation. Beyond economics and earlier, writers such as Marx, Hegel, Weber and Toynbee all argued for some form of historicism in the sense of general laws, rhythms or patterns to history that allow the social sciences to make predictions, either prospectively or retrospectively.

It is in the ambition for some degree of generalizability that a potential schism between a social-scientific view of society and a historical perspective

can be discerned. To assist exposition, this schism can be simplified and slightly caricatured as follows: social science is essentially a nomothetic exercise: it endeavours to establish laws or mechanisms through the scientific method, based on the premise that social entities, like natural entities, are repeatable and recurrent; in contrast, history does not repeat itself, however. It occurs only once in a certain context and at a certain time. Thus, any examination of history can only be idiographic, that is, a description of events that have already occurred and are unique.

Although this is not a book about the epistemology of the social sciences, in order to develop the place of dynamic analysis in public policy theory it is necessary to consider the longstanding debate about the role of history in the social sciences. This is revealed most clearly in the question of what counts as a valid explanation. Van Parijs (1981, Chapter 1) submits that an explanation of fact x consists of answering the question ‘why x ?’ in an appropriate way. Significant differences exist within and between social-scientific and historical approaches over what counts as appropriate. Progress on this question can be initiated by asserting that the structure of any explanation is governed by two formal conditions: a condition of causality and a condition of intelligibility. The first condition is the assertion of a causal link or production relationship between two facts. The second condition says that explanation requires intelligibility by suggesting the mechanism through which the causal link is produced. As long as the nature of the underlying mechanism is left unspecified, the explanation remains a ‘black box explanation’; and the ‘why’ question is not answered because the fact being explained is not rendered intelligible. In alternative terms, we cannot explain without understanding, where this consists of imagining a plausible mechanism, through which the fact to be explained (x) is brought about, created or produced.

In any given academic field only certain types of mechanisms are considered plausible. Thus it is possible to reformulate the condition of intelligibility in terms of any explanation conforming to one of the accepted patterns of intelligibility, defined by the types of mechanisms recognized as plausible within a particular academic community. At the deep structural level of explanation outlined by Van Parijs, there is no idiographic–nomothetic schism; rather this divide emerges in the strong differences in epistemological and ontological preferences within different social science disciplines about which mechanisms can render phenomena or processes intelligible.

From a nomothetic perspective, one of the pre-eminent contemporary writers on the nature of mechanisms and their role in social science explanation is Jon Elster. For him mechanisms are ‘... frequently occurring and generally recognizable causal patterns that are triggered under generally unknown conditions or with indeterminate consequences’ (Elster 1998, p. 45). The ubiquity of the language of mechanisms owes something to the ambition

for covering law explanations (or deductive-nomological explanations, Hempel 1965) in the social sciences and among some historians (Roberts 1996; Roth 1999); that a phenomenon can be explained by being subsumed under a covering law that is, the particular relationship can be deduced from the general law that covers it. This ambition combines with a persistent failure to uncover generalizations that might be formulated as a law in historical social science to increase the attractiveness of the notion of mechanisms; although not desirable in themselves they allow explanation when law-like generalizations do not appear. To offer an explanation of an outcome or event (the 'explanandum') requires the statement, after the event, of a set of initial conditions and a mechanism that connects these initial conditions to an outcome. This mechanism is more general than the phenomenon that it subsumes and it is the reference to a more general category that renders intelligibility. Goldstone (1998) emphasizes strongly this important point: the adequacy of mechanisms in contributing to explanation relies on their generality rather than their level; reduction to more micro-level phenomena is not necessary for explanation.

Often, and especially in historical disciplines, 'why' questions are answered in a fully satisfactory way without there being any explicit general 'theory' from which the implied (but often unknown) mechanism can be deduced. Instead, there are mechanisms that arise through thick historical description or metaphors that provide reasons. This is often called narrative explanation. The emphasis on a close connection between intelligibility and the asserted mechanism remains in an idiographic perspective but what counts as intelligible is deeply contextual, varying across time and place.

CROSSING THE IDIOGRAPHIC–NOMOTHETIC DIVIDE

One influential way of thinking about the idiographic–nomothetic divide is to imagine a spectrum bounded by two antithetical stances that disagree on the conditions by which intelligibility, the second condition of explanation, is fulfilled. These stances are pure, ideal types that allow the continuum to function as a heuristic device to locate particular scholarly approaches. At one end, the position that human beings are so smart and societies so complex that scientific explanation and prediction by way of general laws is impossible. The only thing that can be done from this perspective is to interpret the meaning of particular historical events or conjunctures in isolation because meaningful generalization across different situations is impossible. This approach records detailed descriptions of settings or events and tries to understand and evoke the mentalities of the participants. The position at the other extreme claims that social science is basically like physics; it is possible to discover a set of

universal laws that explain human behaviour and the nature of all human societies.

Of course, few social scientists or historians occupy either of the extreme stances and the linear continuum acts to allow degrees of separation between different positions. For example, many historians tend to the idiographic stance; for example R.G. Collingwood in *The Idea of History* (1946) argued that explanation in history requires understanding the intentions of agents, their motives and the consequences of their actions for future events; it is a hermeneutic activity. History is a complex and chaotic system. On the other hand, it is usually sociologists, political scientists or anthropologists who are sympathetic to the goals of explanation by reference to general mechanisms.

In practice, most nomological adherents believe, like Elster, that although a fully elaborated (micro-)theory is not necessary for the condition of intelligibility to be fulfilled, it helps. Indeed, it is true that whenever a micro-theory from which the postulated causal link can be derived is available, the explanandum is, *ipso facto*, made intelligible. This is where the drive for generalizations is derived in the social sciences: to establish theories that can articulate a pattern of intelligibility. The theory is not required to be deterministic or stochastic, nor does it have to have any predictive power. Instead, it has to be capable of being used deductively, or more realistically (but more weakly), abductively. The concept of abduction is closely associated with philosophical pragmatism in the philosophy of the social sciences, and of C.S. Peirce in particular. The formal structure of abduction is: D is a collection of data; H (a hypothesis) would, if true, explain D; no other hypothesis can explain D as well as H does; therefore H is probably true.

As will be discussed in subsequent chapters, the historical institutionalist (HI) school is an important and influential body of work about history in the social sciences, and a source of ideas about dynamics in public policy. In terms of the continuum, this school of thought can be located on this spectrum toward, but still some distance from, the nomothetic extreme. For example Hall (2003, p. 395), in his discussion of systematic process analysis, argues that: 'systematic process analysis ... is an effort to elaborate and assess the validity of theories capable of explaining a broad class of events or outcomes. It seeks generalizations that are both more simple and more portable than those at which historians typically aim.' More circumspetly, another leading figure in the HI school, Paul Pierson (2004, p. 6), holds that: 'Although historically orientated scholars are (rightly) sceptical about the prospects for generating anything like a general theory of politics, most social scientists remain interested in developing at least limited generalizations – arguments that can "travel" in some form beyond a specific time and place.'

While the linear continuum imagined between the two antithetical extremes is an appropriate heuristic device for illuminating the idiographic and

nomothetic approaches to understanding and explaining historical development, it has significant limitations as a way of informing how we look at policy histories or policy dynamics. Locating approaches or particular works on a linear scale implies a fixed point; but while scholars may be at the same abstract point on the continuum, they may differ significantly with regard to *which* aspects of social reality they see as more patterned and able to be generalized, versus those that are understood as primarily conjunctural or unpredictable. Further, a position on the continuum may be contingent on a particular descriptive scale. For example, a study may look at new public management reforms at a nation state level and generalize in terms of propositions about Organisation for Economic Co-operation and Development (OECD) convergence; whilst at the same time explaining reforms in the particular part of the civil service that deals with hospital management in terms of a series of case-specific, contextual and unique factors.

Even within the nomothetic disposition of the social sciences, it is not necessary to assert that all human behaviour is equally amenable to explanation via nomothetic mechanisms. There may be whole sectors of human action that are quite conjunctural and in which causality is so complex and interactive that simplifications of the usual sort employed in social-scientific models are incapable of representing reality. The argument in this book is that the complexity of government and the interaction of policy systems are, at one scale of description, examples of these sectors. The observed pattern of development of a particular policy is unique, and one cannot construct generalities about it or build models in the sense of providing explicit and deductively sound statements of theoretical arguments; this is where policy is understood as a composite variable, as in British healthcare policy or EU telecommunications policy.

Some argue that the antinomy in the divide between the idiographic and the nomothetic is entirely false; indeed it is 'logically untenable and methodologically impracticable' (Bryant 2004, p. 452). In particular, to conflate generality per se with explanatory power is to misconceive the function of abstraction, and results in empirical content being sacrificed for the illusory gains of formal parsimony and general scope; yet equally, to develop interpretive frameworks without bracing them against some conceptual and ideal-type heuristics confines analysis to atheoretical descriptions of particular cases.

For Bryant (2004, p. 455) there are negative implications for accepting the idiographic–nomothetic divide:

Assigning separate and distinct epistemic responsibilities to different disciplines – a descriptive-narrational set for the 'temporal' side of human affairs, and an explanatory-theoretical responsibility for the 'structural' side – is to rend aspects of

social life that are mutually implicated and which, *ipso facto*, can be understood and explained only by their relational immanence.

The open question for historical social science, of course, is how to characterize this ‘relational immanence’. Indeed, the desire to achieve a balance between the idiographic and the nomothetic in the analysis of policy dynamics is a theme that runs through the book. Recent historically orientated scholarship in the field of policy studies is sensitive to the need for such a balance. For example, Rose and Davies (1994, p. 11) put it: ‘A model that treated 1790, 1900 and 1990 as equivalent because each could be labelled time *t* would be abstract and academic in the pejorative sense.’ Further, the HI school, while seeking some degree of portability for concepts, metaphors and theories, emphasizes that institutions and their effects can only be understood in particular spatio-temporal contexts.

This is the broad position taken in the book. However, it is far from being uncontroversial in political science; Büthe (2002, p. 481) discusses the use of historical narrative as data to test political science models, and holds that although modelling history is difficult, it is important to remember ‘... the particular strength and source of progress of *American* [italics in original] political science: the explicit modelling of the political phenomena we seek to explain, so as to facilitate scrutiny of the deductive logic of explanation.’ Deductive logic is ineluctably nomothetic logic; the general case must exist in order to deduce the particular one. In Büthe’s terms, historical narratives are data to ‘test’ the general theory. From my point of view, such an approach runs the real danger of producing unverifiable just-so stories; I develop this point in Chapter 5 on the methodology of structuring narratives.

POLICY NARRATIVES

Where does this leave us? The claim is made that policy development is beyond social-scientific modelling and prediction; this does not require us to believe that there are no recurring causal tendencies in the processes of policy development that may be formulated into general mechanisms. The question remains: what aspects of social and political life are repeatable and generalizable, and which are unique? The answer to this question is directly connected with the temporal and spatial perspective adopted for any particular set of explananda. I argue that at the ‘policy’ level we cannot predict, either retrospectively or prospectively, thus we cannot yield mechanisms that provide intelligibility by deduction from models or theories.

Nevertheless it is possible to generalize, however cautiously or contingently, and this contributes to the structuring of narratives as a form of explanation.

A narrative does more than recount events; it recounts events in a way that renders them intelligible, thus conveying not just information but also understanding. They therefore contribute to explanation. The purpose of a narrative is to render various series of events into an intelligible whole; viewing policy as a composite entity that endures over a significant duration is one way of rendering the complex interactions of the policy process intelligible. A narrative can be broken down into a sequence of events, processes and tendencies in order that they may be individually explained. This can sometimes be by reference to general, Elsterian mechanisms deduced from theoretical or empirical frameworks or non-formal models; in other cases, metaphors can be used to structure the social environment in which agents are situated and to provide reasons for action. These may include general, descriptive categories, concepts or frameworks that can be moved across time and space and be applied inductively or abductively for the purpose of narrative explanation.

Any historical narrative must 'simplify' reality to render it intelligible by designating some elements as salient and omitting many more as not significant. They must also posit a causal relationship between factors and events. Even within narrative explanation, models (formal or otherwise) can be used: at certain times they suggest production relationships, which actors in the narrative are important, and what the relationship is between their beliefs, preferences and actions. The point remains that the overall sequence or narrative is unique; at the level of UK pharmaceutical policy there is no general class of UK pharmaceutical policies for the particular case to belong to.

Much of the idiographic–nomothetic balance is contingent on the scale of perspective (both temporal and spatial). It may be valid to run historical regressions of regime change on percentage of gross domestic product (GDP) spent to establish general theories that predict with an acceptable degree of accuracy regime or empire shifts over several centuries. Similarly, general propositions may be uncovered at the level of welfare state regimes (as in the body of work inspired by Esping-Anderson 1990) or the field of security studies (as in Powell and Lake 1999 on UN mobilization of states for peacekeeping). However, a different scale of perspective is involved when looking at UK health policy developments over a 20-year period, or a series of economic policy reforms within a particular government's lifetime. The contextual moves to the foreground in detailed accounts of policy change over time; this is the essence of policy studies. Explananda are therefore rich, detailed and contextual whether they reflect a single case or part-comparative study. Universal mechanisms of change may exist but they are unlikely to yield an intelligible account of specific spatio-temporal contexts. Categories and theories logically cannot take the form of unrestricted universals or of

deductive axioms unqualified by considerations of time and place. In Chapter 5, the epistemological position of the structured narrative as a valid form of explanation is developed into a methodological guide for the study of policy dynamics as a structured narrative.

PROBLEMS WITH POLICY AS CHOICE

The themes of choice, intention and decision suffuse many concepts of policy. For example under a subheading 'Policy as authoritative choice', Bridgman and Davis (2004, p. 4) list *inter alia* the following characteristics of policy: it is intentional, about making decisions, it is political and it is structured. Later they summarize (p. 6): 'Public policy is ultimately about achieving objectives. It is a means to an end. Policy is a course of action by governments designed to achieve certain results.' This is the *locus classicus* of the rationalist view of policy, which as discussed in the previous chapter, remains important in policy analysis and is certainly the prevailing view among policymakers.

It is an easy step from viewing policy as a composite whole to viewing policy as a choice. This is because once you have simplified complex reality to a single, composite variable, it is tempting to simplify the process by which this variable has emerged to a situation where a single agent – the government, say – exercises an authoritative choice over that variable. At a reasonably aggregated level of analysis there is nothing wrong with such abstraction. However, the purpose of this section is to show that a dynamic perspective provides important counsel in analysing policy as a choice. The dynamics of choice requires the tracing of a process from preference formation to intention to action to consequences, and an examination of their interrelationship, rather than simply assuming these are static points that are automatically connected, as in some deterministic stages model of the policy process. Dynamic analysis messes up the notion of choice by insisting that preference, intention, action and consequences have different temporal identifiers, and need linking together.

In terms of action and consequence, the 'sour law of unintended consequences' (Hennessy 1992, p. 453) is well established within the social sciences; indeed Popper (1945) holds it as the defining feature of those disciplines. For example, every economics student learns the paradox of thrift; that saving a greater proportion of income reduces overall income and that overall savings end up being less than they would otherwise have been. The EU's CAP, discussed in Chapter 7, has had the unintended but foreseeable consequence of capitalizing higher land values rather than raising net farm incomes. Alternatively, the emergence of economic development in a region may have the consequence of leading the government to act in a certain way

that can be *ex post facto* rationalized as an economic development policy, but was not a choice in the sense of a path from preference to intention to action; instead economic development caused economic development policy, as is sometimes the case where particular industrial clusters emerge. Equally, sophisticated policy evaluation work recognizes that policy actions can have short-, medium- and long-term consequences; and that it is often difficult to discern transitional from equilibrium-related effects.

Changes in preferences are often invoked to explain changes in action. Indeed, this is the cornerstone of microeconomics and also within game theory; changes in preferences alter the structure of the game and the rational actions and strategies of players therein. The category of preferences refers to the desires, interests and beliefs that allow the rank-ordering of different outcomes. For Büthe (2002, p. 484) preferences must ‘unambiguously yield a rank-ordering of the outcomes that would result from the conceivable actions in that situation’. However, there is no regular law-like connection between having certain preferences on the one hand, and performing a certain action on the other. Indeed, in any kind of strategic reasoning there is a step between holding a preference in terms of the ranking of different outcomes and forming an intention to act. There are beliefs about which actions will lead to which outcomes, and in a complex policy process this inevitably involves strategic thinking about political opportunities and how ‘the political planets are aligned’; in particular how other individuals or groups might respond to any action. The dynamic perspective encourages the view that making the steps preference–intention–action–consequence by assumption is inadequate: these are temporally distinct and it is incumbent on scholars to study and theorize the links. Once we put temporal identifiers on a government action or behaviour, along with preference, intention and review of consequences, and call this ‘policy’ we have a dynamic thing consisting of four parts separated temporally; and we have dynamic perspective of choice.

What is less emphasized in the literature, but of at least equal importance in policy studies, is the relationship between intention and action. Preferences are prior to intentions. The reasons for intending to do an act, A, are the agent’s mental states and beliefs about the world, which rationalize and explain their intentions. Are reasons for intending to do act A the same as the reasons for doing it? Yes, for the most part. The reasons for both are desires for certain ends, E, and include beliefs that doing A would further E, as well as the mental states that provide reasons for holding such desires and beliefs. In these terms, the policy process is simply about determining how to act.

From our dynamic perspective, however, intention and action are distinct events. Thus it is credible to propose that reasons for intending to do A are desires for ends E, and beliefs that now intending to do A would further E, along with the mental states that provide reasons for holding such desires and

beliefs. Thus the policy process is also about what to intend. Such a distinction, based on looking at the notion of choice from a dynamic perspective, has implications for policy studies. Consider the following hypothetical example: imagine a government who has to decide now whether to attempt a controversial policy launch in six months' time. The policy has already been designed but the government has to decide now about attempting the policy launch because now is the time to organize publicity, start playing the political mood music, lay markers, call in favours and so on, for policies that may be launched over the next year. The government needs to coordinate any publicity it organizes now with any later attempt to launch the policy. Timing is one of the great political skills, and affects the extent to which policymakers can influence the external environment into which policy action is launched. The mobilization of support for including a problem on the agenda (prior to launching a policy) is a crucial component of models of agenda setting that have been increasingly useful and sophisticated since Baumgartner and Jones's (1993) *Agendas and Instability in American Politics*.

The government needs, above all, to avoid uncoordinated combinations of actions. It needs to avoid attempting the policy launch without having first organized the grounds for the agenda – a significant political risk – or organizing the agenda for a policy that is not launched, which would make it look foolish. The government will not decide to attempt the policy launch without also deciding to organize the agenda for it; and will not decide to organize the agenda for the policy without deciding to launch it. The government in question is at present risk-averse: having recently had a difficult six months in office, it now prefers that, having first refrained from organizing publicity it will not attempt the policy launch. But in the future, as the memory of the difficulties fades, and this can be quick, the government may well become less risk-averse. There is a possibility that a present decision not to attempt the policy launch might later be abandoned by the government – even if, thanks to that decision, no agenda setting for the launch had been organized beforehand. There is therefore a risk that a present decision not to attempt the policy launch might lead to an unpublicized policy launch in the future – and so to a mis-coordination between policy and agenda setting.

The government will have reasons for intending to do A and a separate set of reasons for doing B. This is not a distinction that I am aware of in the policy studies literature. There may be different reasons in the separate sets that are a function of time; their temporality affects how governments make decisions. In Australia during 2005, there was a protracted and public battle over the introduction of reforms to the industrial relations system. The Howard government announced its intention to launch a reform policy in April but the policy itself was only promulgated in October. The policy dynamics established from announcing the intention for a policy launch ahead of the

policy were manifold, complex and contingent. For example, the absence of any policy proposals allowed the Australian Council of Trade Unions (ACTU) and the federal opposition, the Labor Party, to launch an AUS\$8million 'scare' campaign on the reforms. The campaign was initially successful to the extent that the government's opinion polls were adversely affected, industrial relations reform dominated domestic politics for extended periods (crowding out other agenda), and Prime Minister Howard was forced into a series of public statements and announcements claiming that all the adverse publicity about the reforms rested on unsubstantiated and misleading assertions about the impact of what will be in legislation that was still months away from being written. In December, the government had a reform package enacted because it enjoyed a majority in the Upper House for the first time in 25 years. However, the final reform was affected by the promulgation of the intention to launch a policy well ahead of the policy: the political environment became more hostile, public opinion was successfully mobilized by appeals to insecurity in the absence of any policy details, and as a result the Australian government was forced into a series of concessions to mollify its wavering backbenchers and placate public opinion. This was a case where the step from the intention to launch, to the launch itself, was not a straightforward matter that might be ignored or assumed away in policy analysis.

The dynamic perspective on the policy level of description leads to analysis of contingent conjunctures as opportunities, strategic actions, beliefs about links between action and consequence, as well as preference formation and strategic rationality. To understand and explain the sequence involved in a policy choice in conditions of uncertainty generated by complexity requires a structured narrative; formal models of policy choice that posit a coincidence of self-interest of governments and particular actions are inadequate for dynamic analysis.

Consider monetary policy in the UK in the 1980s. The Thatcher administrations prior to 1985 believed that only by hitting the broad money target could they achieve some further goal that they valued extremely highly (low inflation). The belief and the desire were announced as a set of targets, £M3, a broad money measure. This though had the effect of making this measure of broad money behave quite differently; indeed it seemed that the targeting of this aggregate caused its behaviour to change. Several different broad money targets were tried, but all proved impossible to control once they had been targeted. This was memorably summed up in Charles Goodhardt's 'wallpaper bubble' principle. If the government had cared less about hitting the target, they might have succeeded more easily – that is, they might have been able to act in order to control it. The intention to hit the target had a series of complex consequences for action, consequences and beliefs about the relationship between actions and outcomes. Indeed, even as the professed

monetary targets had been overshot and changed many times, the economy had been tightly – even excessively – squeezed, sterling rose strongly, unemployment soared and inflation plummeted. Inflation was, for the Conservative administrations of the 1980s, their ‘judge and jury’. The targeting of the money supply was formally abandoned in the UK in 1985, to be replaced by Chancellor Lawson’s interest in fixed-exchange-rate regimes as guarantors of low inflation.

It is possible to render this complex series of actions, consequences and conjunctural contingencies intelligible in terms of a concept like ‘monetary policy’, as in Kenway (1993) for example. As social scientists, we wish to add something to the narrative by way of structure using portable and general concepts, theories, metaphors and mechanisms. The methodology of structured narratives is deferred until Chapter 5, for now we note the problems of the general and the universal for issues of portability. This question is highlighted here as the next two chapters look at two broad groups of metaphors, theories and mechanisms that have the potential to be portable across time and place in supporting structured narratives of policy dynamics: path dependency (Chapter 3) and evolutionary theory (Chapter 4).

The general and the universal should be clearly distinguished: to make a generalization is not to claim that the phenomenon or process occurs frequently or in a large or universal range of cases; Goldstone (1998, p. 832) argues that:

A general law is not general because it applies to a wide variety of different kinds of cases and events ... what makes a general law ‘general’ is that it applies to a range of initial conditions and asserts a necessary or probable connection between particular initial conditions and a subsequent event or events.

However, the nomothetic view of mechanisms is that they are a substitute for laws of development when these cannot be uncovered, and returning to the definition offered by Elster, mechanisms are ‘... frequently occurring and generally recognisable’. This raises an epistemological question to which I do not know the answer: how many cases do we need in order to have a general category? This is a variation on the theme of finding a balance between the nomothetic and the idiographic. The more that the cases to which a general mechanism applies are contextualized, described in detail, and contingent and local factors are brought into the foreground, the less portable that general mechanism becomes. Conversely, a mechanism that is specified with less detail is potentially more portable across cases, but is likely to have less analytical purchase in terms of explaining detailed historical phenomena. There is a trade-off between the portability of concepts and their ‘added value’ in terms of a particular structured narrative making sense of a complex series of events or processes.

3. Path dependency

The emergence of a ‘new’ institutionalism across the social sciences has coincided with the increased interest in temporality, change and history in social and political analysis. Institutions are structures that trace a path through state space; they endure, have a history and can be used to link temporally events and processes. The concept of path dependency has been used within political science almost exclusively within a broad institutionalist framework. It is institutions that are path dependent; as Raadschelders (1998, p. 569) states: ‘whatever the discipline ... contemporary neo-institutional analysis has one feature in common: the notion of path dependency’. The widespread and cross-disciplinary use of path dependency for the analysis of institutional ‘stickiness’ makes the concept an obvious starting point for the examination of concepts, metaphors and theories that might be used to structure narratives of policy dynamics.

Indeed, the concept appeals as a label for the simplest of policy dynamics: that past policy decisions act as a constraint on the options available to current policymakers; or to use the language of dynamics from Chapter 1, that past policy decisions act to circumscribe or foreclose parts of policy space. This basic dynamic raises the question of how robust paths are over time and through changes in the policy environment, and supports the interest in evolutionary thinking developed in Chapter 4. Further, the refinement of the concept of path dependency in response to complaints of determinism and an inability to accommodate change introduces the discussion of the methodology of structuring narratives of policy dynamics, which is set out more fully in Chapter 5.

A process is path dependent if initial moves in one direction elicit further moves in that same direction; in other words, the order in which things happen affects how they happen: the trajectory of change up to a certain point constrains the trajectory after that point. As Douglass North (1990, pp. 98–9) puts it, path dependency is a process that constrains future choice sets: ‘At every step along the way there are choices – political and economic – that provide ... real alternatives. Path dependence is a way to narrow conceptually the choice set and link decision-making through time. It is not a story of inevitability in which the past neatly predicts the future.’

The reference to choice sets and decision-making reveals the origins of the concept in economics. Indeed, path dependency is problematic for that

discipline because it implies that decentralized interactions between economically rational actors do not necessarily lead to efficient outcomes; indeed, inefficient equilibria may be recognized as such but still persist.

The concept of path dependency is not a framework or theory or model in the terms of Ostrom (1999, pp. 39–41): it does not provide a general list of variables that can be used to organize ‘diagnostic and prescriptive inquiry’, nor does it provide hypotheses about specific links between variables or particular parameters of those links. Instead, path dependency is an empirical category, an organizing concept or metaphor which can be used to label a certain type of temporal process. As Hall and Taylor (1996, p. 941) put it:

they [historical institutionalists] have been strong proponents of an image of social causation that is path dependent in the sense that it rejects the traditional postulate that the same operative forces will generate the same results everywhere in favour of the view that the effect of such forces will be mediated by the contextual features of a given situation often inherited from the past.

The application of this organizing concept or metaphor to a phenomenon is the beginning of a form of explanation because it asserts a relationship between the sequence of early events and the probability of later events. Importantly, however, the concept of path dependency does not per se provide necessary or sufficient conditions to understand or explain that which it labels: path dependent processes, even when identified, require theorizing; it is the mechanisms that connect decisions or actions across time that explain a path dependent process.

Although both refer to mid-range phenomena, ‘policy’ and ‘institution’ are not synonyms. As noted in Chapter 1, within the policy system there are various structures at different scales that act as institutions in shaping agents’ decision-making in the formulation, enactment and implementation of policy. These are not reducible to individual level agents or single elements in the policy process; the philosopher’s notion of supervenience is used to elucidate the relationship between structure and agency for policy narratives in Chapter 5. Examples of policy institutions are budget rules, policy networks, and standard operating procedures in government departments and agencies. Most importantly in terms of understanding policy development as path dependent, past policy decisions are institutions in terms of current policy decisions: they can act as structures that can limit or shape current policy options.

The question of what about a policy is path dependent does not admit a single, conclusive answer; rather it remains an open question for scholars applying the concept with theoretical and empirical corollaries. If the policy whole or system is path dependent, there may be several potential underlying mechanisms operating, independently or in combinations. This property of ‘multiple realizability’ has theoretical implications in terms of the

microfoundations of path dependency and the spatial and temporal scales of policy analysis. It is necessary when using the concept, either theoretically or empirically, to be clear about the perspective being adopted. The development of a policy may be labelled path dependent over some period, but the various mechanisms that underlie that process remain unclear unless a more fine-grained perspective is adopted. Without microfoundations, the value of the concept in structuring narratives to make sense of policy dynamics is doubtful. Indeed, one of the insights of a dynamic perspective is that path-dependent processes may coexist with other types of processes *within* policy systems. An adequately fine-grained perspective is essential to using path dependency to structure narratives; when policies or elements of policies are seen as strongly interrelated, or where our analytical lens shows policy institutions as deeply interwoven, then a much clearer sense of the mechanisms that underlie path-dependent processes is gained.

The first section of the chapter considers the application of path dependency to the analysis of policy development and its potential advantages in understanding the dynamics of that development. The next section considers several criticisms of the concept: that it lacks a convincing account of decision-making over time, both of the accumulation of constraints and of context-bound rationality; it is incapable of dealing with policy change; and it lacks a clear, normative focus. In the final section I argue that despite its theoretical underdevelopment and relatively limited number of successful empirical applications, the concept of path dependency does have potential utility in the field of policy studies in terms of narrative explanations of why policies might be difficult to reform, and also why they may tend to become more complex over time.

BENEFITS OF PATH DEPENDENCY FOR STRUCTURING POLICY NARRATIVES

Path dependency is an appealing concept for understanding public policy development; it provides a label for the observations and intuitions that policies, once established, can be difficult to change or reform. Recent examples of the use of path dependency for understanding policy development include health care policy in the USA (Hacker 1998, 2002; Wilsford 1994) and the UK (Greener 2002); the reform of housing benefit in the UK (Kemp 2001); UK pension policy (Pemberton 2003); and the CAP of the EU (Kay 2003).

Path dependency encapsulates the insight that policy decisions accumulate over time; a process of accretion can occur in a policy area that restricts options for future policymakers. In this sense, path dependency arguments can 'provide an important caution against a too easy conclusion of the

inevitability, “naturalness”, or functionality of observed outcomes’ (Pierson 2000a, p. 252). For example, Pemberton (2003) argues that the pensions ‘crisis’ in the UK is not primarily demographic but rather due to a low savings rate; further, this low rate is a function of the path dependency and increasing complexity of pension policy. The system of pension provision in the UK has shifted over the last 20 years from one dominated by state provision to one in which the state pension plays a residual welfare role. Despite this large change at the policy system level, there is evidence of path dependency in particular policy subsystems. In the case of UK pensions, policy subsystems exist around specific pension schemes. An individual contract established under a particular pension scheme at a particular time is costly to change: there are large sunk costs; increasing returns associated with rising numbers of contributors and pensioners in a particular scheme; further, there may be significant learning effects. All of these factors contribute to significant switching costs for the abolition of one scheme and the transferring of that set of individual contracts into a superseding scheme. Particular schemes are ‘locked in’ for particular individuals. Nonetheless, pension reform has been possible but change has come in the form of the addition of new schemes or elements to the system. This amounts not to a single, path-dependent policy trajectory but rather to a widening array of ‘locked in’ subsystems over time. This accretion of new subsystems or schemes has led to the increasing complexity of the overall system of pensions and has raised questions of effectiveness at a policy ‘whole’ level. Kemp (2001) reports similar dynamics with regard to housing benefit policy in the UK.

Path dependency can help separate not just different orders of policy change as in Hall (1993), but different rates of policy change. As discussed in Chapter 1, one of the foundations of dynamic analysis is the assumption that there are a multitude of temporal scales immanent in any system. Therefore within a policy system, there may be some elements that are path dependent, and others that are not. Further, there may be a relationship between the different processes at different speeds. Later in the chapter, I develop the point that it is the combinations of institutions and policies that provide the important mechanisms underlying path dependency and also create the potential for strategic action and policy innovation by agents.

The concept of path dependency has the additional advantage of flexibility for policy scholars. In particular, because the concept does not contain within it a fixed temporal or spatial scale of analysis, the insights of path dependency can often complement rather than rival other accounts of policy change. Social housing in the UK is an example of where path dependency can hold at the subsystem level with interesting consequences, but where the policy system as a whole has changed profoundly. Since the mid-1970s there has been a series of failed initiatives by central government to directly control the rents charged

in the social housing sector and ensure equity between local authorities and housing associations. This particular element of social housing policy is path dependent; each local authority has an established policy for rent calculation, often determined by initial decisions made in the immediate post-war era. That these have proved resistant to central control or influence significantly constrains the ability of central government to pursue some of its objectives for social housing. However over the same period as this path-dependent process, there has been a clear shift in the social housing policy paradigm. One of the five ‘pillars’ of the UK welfare state has been, to a large extent, removed. Between 1971 and 2002 home ownership increased from 49 per cent to 69 per cent, with most of the increase occurring in the 1980s. The ‘right to buy’ scheme introduced in the early 1980s contributed to the increase in home ownership, as it allowed local authority tenants to buy their own home. Corresponding to this, the percentage of householders renting council homes increased from 31 per cent in 1971 to 34 per cent in 1981, but then gradually declined during the 1980s to 24 per cent in 1991. This percentage has continued to decrease and in 2002 14 per cent of all householders rented from the council.

PROBLEMS OF PATH DEPENDENCY FOR STRUCTURING POLICY NARRATIVES

Accounts of Decision-Making Over Time

The criticism that the concept of path dependency lacks explanatory power is well expressed by Raadschelders (1998, p. 576): ‘it is only by virtue of retrospect that we are aware of stages or paths of development. “Path dependency” refers to a string of related events: causality in retrospect. The concept does not come even close to pinpointing a mechanism or the mechanisms that propel social change.’

The quotation contains two criticisms. The first is that the concept cannot be used for current or future phenomena. This is, of course, not a singular feature of path dependency but is common to all concepts that are useful for structuring retrospective, ‘thick’ historical descriptions to support narrative explanations in the social sciences. Indeed, as discussed in the previous two chapters, a dynamic perspective reveals that this is not an appropriate standard for considering the utility of different concepts, theories or metaphors.

The more important criticism is that even if one accepts path dependency as a possible candidate for narrative explanation, it is unlikely to be convincing because the notion does not provide any fine-grained mechanisms that might

provide necessary and sufficient conditions for the process observed. The challenge for the use of path dependency in helping to structure narratives of policy dynamics is the uncovering of mechanisms that can help make sense of a path-dependent process. One influential strand of the literature on path dependency has worked on the microfoundations of the concept using insights from new institutional economics. Much of this literature, particularly by US-based scholars, proceeds by analogy from technological development to institutional development. In simple terms, imagine two technologies, A and B, both of which are subject to increasing returns but there is uncertainty over the rate of increasing returns. Initial adoptions of one technology, say B, that may occur for a number of small or chance reasons, beget further adoptions of B in the market because of increasing returns – that is, it becomes cheaper for future firms to adopt technology B rather than A. The interesting results from the models built on these assumptions (for economists at least) are that you might get inefficient technologies adopted by markets. The normative implications of this borrowing from economics are considered in more detail later.

Arthur (1994) states the circumstances in which path dependence as an increasing returns process is likely: the presence of large fixed (and sunk) costs; network effects; learning effects; and adaptive expectations. As noted, these factors have been used at a macro, constitutional level to make arguments about path dependency in institutional development (North 1990; Pierson 2000a, b, c). Within this list of sources of increasing returns, it is useful to distinguish between those factors that relate to the internal efficiency of firms – large fixed costs leading to declining average costs as production increases and learning takes effect – from those that are external to the firm; in particular, network effects. The distinction is important because later in the chapter path dependency is discussed in terms of the increasing returns involved in combinations of institutions and policies, rather than increasing returns as a property of the internal operations of firms. This complements the insistence on a fine-grained perspective of policy systems developed in this chapter.

A focus on increasing returns is only a partial interpretation of the economics of path dependency. Increasing returns are sufficient but not necessary for path dependency. As Arrow (2000) points out, the existence of significant sunk costs along with sequencing arguments can support many of the path dependency narratives of technological change. Although he does not use the concept of path dependency, Arthur Stinchcombe's (1968, Chapter 5) celebrated work on constructing theories of historical causation emphasizes the central importance of sunk costs. I submit that any decision that is difficult to reverse and which has enduring and ongoing effects can be said to have initiated a path-dependent process; and work on path-dependent processes

should not focus exclusively on increasing returns processes; it is moot whether they should privilege this mechanism-type over other sources of path dependency.

Contrarily, Schwartz (2004) argues that the combination of initial, small and contingent steps with increasing returns defines a path-dependent process; if there was a large initial cause that had significant and enduring effects on the subsequent process then this historical cause would be salient in any explanation of the process. The process would no longer be path dependent but rather, as a policy dynamic, would be better characterized as the temporal unravelling of the consequences of some initial event. This point is noteworthy insofar as it highlights the variety of mechanisms that might underpin a path-dependent process, but for the sake of expositional clarity this chapter remains with the definition of path dependency as a general metaphor for sticky policy or institutional processes.

A number of non-increasing returns mechanisms have been suggested as underlying path dependency in policy development: the effect of policy on interest groups, as when policies constrain some groups and enable others (Pierson 2000a); policies that involve investment or disinvestments in administrative infrastructure, which transforms governmental capacity and the set of possible future policies that may be enacted (Skocpol 1992); and policies that involve the establishment of formal or informal contracts with individuals (Pemberton 2003; Kay 2003; Kemp 2001), which are costly to change. Further, there are network effects to *types* of contracts rather than the number of signatories. Once a contract is established, the transaction costs of agreeing another contract of that type in that area of public policy will be considerably lower than any alternative contract.

All these policy-specific mechanisms are based on definite, conscious choices, which have the foreseeable consequence of high future switching costs; none relies on an increasing returns process. Nevertheless, there are examples that suggest that increasing returns processes can occur in policy development. In the structural reforms of the primary care sector in the UK after 1997, a series of primary care models were piloted. By a series of chance factors, a particular primary care trust model quickly became popular. This model subsequently became the government's template for all future combinations of primary care organizations. There was no particular feature to this model to recommend it over any of the others that were piloted between 1997 and 2000, instead it was the case that this model was adopted early in the government's reform process, which made it considerably easier (or cheaper) for subsequent primary care groups to use, and with such a momentum became the template adopted by the government for all primary care agglomerations. At a general level, all metaphors of policy ideas or proposals emerging from the 'policy soup' or 'garbage can' share a notion of a market place of ideas;

analogous to a market system, ideas compete for attention and influence. Where the market structure produces increasing returns, policy ideas can succeed into proposals and eventual enactment by an initial series of small, contingent steps as early adopters of an idea increase the return to future adopters.

Any borrowing from microeconomics, including the idea of increasing returns, inevitably situates the agent in terms of responding to the costs and benefits of different options in a manner consistent with straightforward parametric rationality. The assumption of this type of rationality serves certain purposes in formal economic modelling, but to use it in more informal, intuitive and post-positivist accounts of path dependency in public policy is problematic (Hay 2004). One response is to use the notion of context-bound rationality in an account of decision-making in a path-dependent process. Nooteboom (1997) describes the manner in which markets lock-in to certain technologies in terms similar to how philosophers of science characterize the entrenchment of scientific theories. Both can be path dependent. He cites Kuhn's famous account of how scientific theories develop according to paradigms, a set of tacit and unarticulated guiding assumptions, rather than the standard conceptions of 'pure' rationality at the heart of a scientific approach. Further, just as the Kuhnian model challenges the conception of scientific activity approximating to certain canons of rationality, so will any parallel model applied to the economic case. As discussed in Chapter 1, Hall (1993) invokes the notion of a policy paradigm in a similar vein. A policy paradigm is an interpretative framework that operates in the policymaking process; specifically, it refers to the ideas and standards that specify the goals, instruments and the very nature of a policy issue.

In these terms, the mechanism that underlies path dependency in the policy process is a form of context-bound rationality among policy actors. The current path-dependency literature is mostly developed around the following two claims: (i) that the analogy from economics to institutions can be extended to policy; and (ii) that microeconomics can be borrowed as the microfoundations of path dependency in policy development. Importantly, these claims require a rational choice actor for making the decisions. The assumption of this type of rationality is a strict corollary of claims (i) and (ii). This is problematic for policy studies; Chapter 1 outlined how a dynamic perspective moves analysis away from a simple, atemporal notion of choice, which underlies formal models in economics. Further, public policy theory has begun to move away from a reliance on the simple postulates of instrumental rationality to a more nuanced and contextualized views of rationality. In Chapter 5, this point is developed in more detail and the concept of policy memory is introduced as one way of introducing dynamics into the interpretive tradition in public administration.

Policy Change and Stability

At the heart of any account of path dependency is stability: observations of change challenge the notion. This is a common criticism of the HI school; ‘in its emphasis upon path dependence and historical legacies it is rather better at explaining stability than change’ (Hay 2002, p. 15). Thelen (1999) argues that path dependency is too deterministic in that once the initial choice is made, then the argument for future development becomes mechanical. This sort of claim is usually accompanied with reference to the ‘Polya urn model’ of path dependency: imagine an urn containing ten black balls and ten white balls. A ball is pulled from the urn and then replaced by two balls of the same colour; after a relatively small number of selections, the urn will be almost full of either black or white balls. In terms of exemplifying path dependency, the colour that dominates the urn depends on the random selections early in the sequence.

In terms of policy studies, one possible counter-argument is based on the interpretation of stability in path dependency. Specifically, the notion does allow policy change; policy legacies constrain rather than determine current policy. Policy does change but within a particular set for possibilities; and thus the policy may be said to exhibit stability. There are two main implications of the constrained change argument. The first is that these bounded possibility sets may be large or the paths wide; and the wider they are, the less the notion of path dependency can account for current policy development. The second is that the weaker the ‘echo’ of past policy developments in the present, the more other concepts, framework and theories are required.

The notion of policy direction may assist with constrained change accounts of policy development. A stable policy path when projected into policy space may well imply significant cumulative policy change over time, or in other terms, a significant distance from the initial position in policy space and time. Rose and Davies (1994) show the importance of compounding effects as small, incremental and constrained changes in annual budget allocations can accumulate to significant policy shifts over a period of a decade or more. Further, a change in direction may appear at one distance a small perturbation, but by shifting the direction of the policy may turn out in retrospect to have been a critical juncture and therefore a problem for the validity of path dependency as a description. Chapter 7 presents the argument that the development of the EU’s CAP is an example of this possibility: although considered minor at the time, the reforms of 1988 (rather than 1992), were the critical juncture in shifting the direction of the CAP from a price-support to direct-income-payment system.

Nonetheless, the limitations of path dependency as a conception of policy change have been highlighted in recent empirical applications in public policy:

Kemp (2001) with respect to housing benefit reform in the UK; Pemberton (2003) with regard to pensions; and Greener (2002) on the NHS. Each of these studies finds path dependency in policy development alongside some policy change. They consider change as a reaction to the unintended consequences or side effects of policy, or from pressure for reform due to exogenous shifts in the wider policy environment: for example, where the distribution of power between interested groups has changed. Once a dualism between policy stability and policy change is established, the notion of path dependency is only useful for accounting for the former; indeed the purpose of the concept is to aid understanding of policy stickiness and why actors do not change policy across time.

However, the dualism between stability and change can be avoided by considering the sedimentation of policy decisions or the growing complexity of policy space that is implied by the notion of path dependency. The dynamics of policy subsystem accumulation are theoretically underdeveloped but are important for the use of path dependency in policy narratives. As discussed in Chapter 9, the development of UK pharmaceutical policy since the 1980s provides an example of new policies being added on as a 'patch' or 'fix' to satisfy pressure to mitigate the consequences of the original policy. Relatively high prices for medicines were agreed by the government to reward innovation by the industry under the Pharmaceutical Price Regulation Scheme (PPRS); this contributed to the rapid increases in public expenditure on medicines, observed since the late 1980s. The PPRS remains unchanged and potentially path dependent but its budgetary consequences have precipitated a series of new policies aimed at controlling the demand for medicines in the NHS, such as cash-limited prescribing budgets. The path dependency of a particular policy subsystem is a contributory factor in the explanation of the accumulation of these policy patches and the growing complexity of the policy system, with potential consequences for the overall coherence and effectiveness of policy.

To reprise, a key issue when using the concept of path dependency is the granularity of the perspective. Much of the work within the HI literature uses the concept at a macro-perspective, in which there is a single whole that allows for discussion of an 'institutional setting' or a 'policy'. The path then refers to the trajectory for that composite variable, the direction of which is reinforced after early moves in the sequence. Whilst this is valid for some narratives, from a more fine-grained perspective the issue is which elements of that composite system are fixed or locked-in, and which are capable of being reformed. Further, within the policy space occupied by the composite whole there may be potential for the introduction of new institutions or policy subsystems.

Crucial to my analysis of the development of the EU budget system in Chapter 6 are the incompleteness and limitations of the initial Treaty-based

budgetary institutions working themselves out over time through a series of political and fiscal contexts. This developmental process involved the accumulation of additional and complementary institutions, which has had the net effect of significantly constraining expenditure-generating EU-level policy activism; this is a quite different policy dynamic from a two-speed, change–stability pattern. An incomplete institution is a policy framework or an institutional structure that is not singularly self-sustaining. For example, the constitutional balanced budget rule in the Treaty of Rome has required a series of other institutions in order to ensure that the budget balances – in particular, rules to coordinate spending and revenue decisions. The contingencies for breaches of that budget rule enshrined in the initial design failed to address the key issue in the validation of such a rule: who controls expenditure? The contestation of this incomplete institutional space has led to a growing complexity of budgetary policy, a key policy dynamic in the EU.

In more fine-grained analysis, increasing returns processes operate at the level of sequences of institutional or policy choices: once an initial policy framework is established, there are strong increasing returns involved in the choice of new, supplementary policies within that framework. That is, an increasing returns process explains policy change qua the introduction of new, supplementary policies. As North (1990, p. 95) states, it is ‘the interdependent web of an institutional matrix that produces massive increasing returns’. This view of increasing returns helps avoid too sharp a distinction between stability and change, as seen in on-path versus off-path change, or where stability is followed by a path-breaking juncture and the introduction of a new institutional or policy setting. At a more fine-grained perspective, institutions exist in combinations: they are interdependent, with necessary and contingent relationships. Thelen (2003, p. 233) describes examples where institutional lock-in is combined with elements of institutional innovation that can push the overall trajectory of policy and politics in a different direction; indeed ‘... to understand how institutions evolve, it may be more fruitful to aim for a more fine-grained analysis that seeks to identify what aspects of a specific institutional configuration are (or are not) negotiable and under what conditions’.

In an important recent work pushing the concept of path dependency beyond simply the understanding of continuity, Crouch and Farrell (2004) consider how actors cope with exogenous changes in their environment. At some point, the once reliably successful path no longer works, and even though policy actors know this, they find it extremely difficult to change. Simple path dependency has the actor trapped, in a strict sense the concept does not admit any other possibility; however a more nuanced account would look at how the perceived failure of a habitual path may lead to the search for alternatives, but where that search process is itself path dependent.

The relatively informal models offered by Crouch and Farrell (2004) are designed to address the apparent determinism of path dependency once a path is selected. Change is explicitly modelled as the intentional adaptation of agents to exogenous, environmental shifts. The emphasis is on the ability of agents to reactivate redundant institutions, or convert existing institutions to different purposes, or borrow wholly new institutions from elsewhere to tackle exigencies. These models also prompt thinking about what has been called the 'layering' of institutions; in terms of policy the implication of this notion is that at the level of the composite whole, policy systems cease to embody a simple unique logic, but rather a complex bundle of different policy logics, ideas and interests. Some of these may be dormant, unused or 'forgotten' for periods but are capable of being reactivated by strategic action by agents in response to exogenous environmental shifts. Institutional layering is considered in more detail in Chapter 6 on the EU budget.

The reassertion of the capacity of agents situated within path-dependent processes, with increasing returns acting to change the direction of the path in response to shifts in their environment, is important for how we structure policy narratives; indeed, it contributes to my argument for methodological localism as the appropriate foundation for a methodology of policy dynamics in Chapter 5. Inheritance and policy legacies are not as hard or fixed or as determined as some of the simple path dependency analysis may suggest; for example, increasing returns processes in economics typically assume a static environment, whereas changes in that environment can attenuate (or amplify) feedback processes. In providing a set of mechanisms that may help to structure a narrative in terms of transitions *between* paths, Crouch and Farrell (2004) provide a service to the analysis of policy dynamics. This can complement the emphasis on inter-policy and inter-institutional relationships, in particular combinational effects, which imply that policy development proceeds in a more subtle way than the two-speed view of policy development.

Normative Aspects of the Term

One of the consequences of constructing the explanatory foundations of path dependency in public policy by analogy from the economics of technological development is to 'import' the normative result that inefficiencies can persist in path-dependent processes. This is a powerful result for neo-classical economics: certain historical factors can ensure that inefficiencies occur and markets do not eliminate these over time. Efficiency is understood here as social efficiency, that is, a situation where both technical and allocative efficiency hold. The strength of this normative result depends on the judgement as to whether the inefficiency could have been foreseen at some point in the initial stages in the path-dependent process and corrected; and

second, whether the inefficiency remains remediable, as with a Pareto improvement that can be identified and is achievable from the current situation.

For some writers the question of whether path dependency implies the persistence of inefficient institutions is an open and empirical one (Hay and Wincott 1998, for example); for others path dependency is more clearly something which inhibits the introduction of 'better', or perhaps more rational, policy or organizational form (Greener 2002, for example). Overall, the normative implications of path dependency are less pressing for scholars outside the boundaries of neo-classical economics; it is generally accepted that inefficient policies or institutions may persist. However, it is a much stronger claim that policies in a path-dependent process are *necessarily* inefficient; or alternatively, that contained within the concept is the imputation of inefficiency. The claim is strong at a theoretical level as the concept would require significant elaboration in terms of both policy design and the pressures that sustain path-dependent and inefficient policy. There is also the problem of indeterminism: path dependency emphasizes that policy paths are unique and arrived at by a series of small and contingent moves. As such, it is difficult to say that there exists another path that could have been arrived at that is more efficient, and without such a relevant counter-fact it is difficult to accept the imputation of inefficiency.

At an empirical level the claim that policies are necessarily inefficient is also strong. Developments in performance measurement in the public sector might allow arguments that, for example, health care or education policy are better in one system than another. Despite this it is difficult to assert, within a particular political system, that there exist policy options that represent a welfare improvement over the current policy (the net of switching costs and increased transaction costs) and there is widespread recognition of this by policy actors. Without these two conditions holding, the normative implications of path dependency in terms of public policy are attenuated. Nonetheless recent empirical works on path dependency in policy development seem willing to impute inefficiency to some degree (Pemberton 2003; Kay 2003; Greener 2002; Kemp 2001; Wilsford 1994). This is often not so stark as labelling policies in terms of efficiency, and certainly involves no quantitative analysis; however it is not an over-interpretation of these works to tease out the implicit assumption that a policy would be 'better' without a path-dependent process acting as a barrier to effective reform.

4. Evolutionary perspectives

Although the terms ‘evolution’ and ‘evolutionary’ are widely used in the social sciences, for the most part they are employed as convenient shorthand for slow and gradual change over time. This chapter considers evolution in a more substantive way; investigating the prospects for evolutionary theory contributing to the ambition for more fully developed dynamic perspectives on policy change.

The first section of the chapter will establish the distinction between evolution as a process of change and evolution as a theory of change. This distinction is a necessary start to understanding the terms on which one may judge the ‘added value’ of an evolutionary perspective to existing accounts of the dynamics of public policy. Importantly, the distinction is relevant to the following commonplace and important objection to evolutionary approaches in the social sciences: that biological analogies in the social world are weak, that there are no equivalents of natural selection operating in the social world and that without selection, evolutionary theory has little explanatory power in the social world. This is also known as the missing mechanism argument.

We can employ a two-part strategy to address this problem. The first part is to understand evolutionary theory as a (realist) ontological proposition that is valid for the analysis of the evolution of all open, complex systems including natural ones (Campbell 1965). The next part argues that the correct analogy to consider is not that between the natural and social worlds, but rather the analogy between the problems of evolutionary theory in explaining natural processes of change, and the problems of evolutionary theory in explaining processes of social change in terms of issues such as time, history and differential rates of change. It is from this analogy that policy studies can learn from and adapt evolutionary theory for the purpose of understanding and explaining dynamic processes of policy change. Indeed, the weaknesses of adaptationist models in evolutionary biology provide further intellectual succour for the narrative approach by buttressing the argument that relying on thick, contextual and historical description structured by general concepts or portable metaphors is not a failure of formal modelling, but rather the appropriate response to what cannot be formalized into a model; nor is it amenable to explanation by a general testable theory.

Section two considers the main arguments for scepticism about the value of evolutionary theorizing in public policy. First, the close connection with

functionalism at a time when anti-functionalism is in the ascendant in political science and where functional explanations are seen to have dubious validity; second, the importance of agency and intentionality in social science explanations rather than selection and 'blind' variation; third, the interpretation of 'fitness' and the charge of vacuity that has been levied at evolutionary theory.

In section three, evolutionary theory is considered as a metaphor to advance narrative explanations of policy change. This perspective can provide a framework for: understanding policy development in terms of self-organization, emergence and selection pressures; examining different forms of policy learning; and discerning different and competing rationalities for policy action.

EVOLUTION AS PROCESS, EVOLUTION AS THEORY

Evolution as a Process: Incremental and Radical Change

Any gradual change. Organic evolution, often referred to as evolution for short, is any genetic change in organisms from generation to generation, or more strictly a change in gene frequencies within populations from generation to generation. (Wilson 1975, p. 12)

Evolutionary change generally refers to change that depends heavily on the structure of already existing institutional changes and rationalities. Hence, the choices that actors make today bear heavily on future choices and change occurs incrementally in a path dependent way. (Campbell 1997, p. 31)

We start with these definitions of evolution as a process of gradual change as they capture the loose and more common use of the term 'evolution'. The first definition is from within the biological sciences, the latter from sociology. They serve to highlight that gradualism has often been understood as a defining element of evolution as a process. As Stuart Kaufman (1995, p. 151) puts it: 'One of the most important presuppositions of Darwin's entire thesis is gradualism, the idea that mutations to the genome can cause minor variations in the organism's properties, which can be accumulated piecemeal, bit by bit, over the eons to create the complex order found in the organisms we observe.'

The assumption of gradualism in a process of change is closely connected with reductionism in theories of change. If a composite whole changes only gradually it is easy to view it as the sum of relatively independent parts, with the corollary that these parts may be analysed independently without the need to consider significant interaction effects on the whole. This is the *ceteris*

paribus method in comparative statics, as in the analysis of the effect on the market price of a change in the conditions of demand. However, when every component of an organism is strongly connected to all other components, a minor mutation in one component influences all other components. The density of interconnections among elements is a measure of the complexity of a system. When this is high and the interactions are at a reasonably high speed, it is easy to see that complexity in systems is the antonym of gradualism.

Gradualism's equivalent in policy studies, incrementalism, similarly allows reductionism: macro-scale phenomena like policy, because they change incrementally, can be reduced to the behaviours of independent micro-level units of analysis, such as policymakers. Thus, incremental changes in policy are understood in terms of the bounded rationality of policymakers or institutionally constrained agents.

The assumption of gradualism is problematic for understanding evolution as a process in the natural world because it is difficult to reconcile with the observed stability of many life forms as well as disparate rates of evolution. For instance, embryonic birds and mammals still have gill arches, which are useless; or the case of cave-dwelling fish that have degenerate eyes that do not function. Why are these vestiges not removed by natural selection? Auyang (1998) notes that the banana was introduced into the Hawaiian islands about a thousand years ago and already there are several species of moths feeding exclusively on bananas; at the same time crocodiles in northern Queensland have not changed for hundreds of millions of years. How are these different tempos explained? The controversial and long-standing question in evolutionary biology is whether natural history contains emergent evolutionary changes, or novelties that are not merely the accumulation of small, gradual and adaptive steps. In 1972, Niles Eldredge and Stephen Gould whilst looking at fossil records found that morphological characters stay the same for very long periods, occasionally punctuated by drastic change within a short period of time.

The idea of punctuated change has had a strong grip on thinking about evolution as a process in the political world. For example, recent popular models of the dynamics of public policy by Kingdon (1984) and Baumgartner and Jones (1993, 2002) have used the notion of punctuated change. Although these do not represent a full evolutionary theory nor a detailed and contextualized application of evolutionary concepts in the social sciences, they do acknowledge their borrowings from evolutionary biology.

However the more general point, for our purpose here, is not the difference between gradual or punctuated change, but rather whether interaction between different evolutionary units of analysis can produce evolutionary effects in terms of self-organization rather than the gradual grinding of selection mechanisms. Within any system that has repeated interactions among its

constituent elements with feedback (both positive and negative) and agents capable of innovation, there is the possibility that internal order of a system can increase, or self-organization can occur – typically leading to emergent properties – independent of external selection pressures. If we admit such a possibility then the perspective of evolution as a process moves away from approximating the organism as the sum of independent genes, or policy as the sum of independent actions by policymakers. Kauffman (1995) uses the idea of complexity to doubt gradualism in evolutionary processes in the natural world by establishing that in some complex systems any minor mutation causes significant changes in the system due to interaction effects. The influence of Kauffman's work is manifest in Robert Jervis's (1997) *System Effects: Complexity in Political and Social Life* about international politics (see for example pp. 13, 41, 48, 157).

Much of the recent work in evolutionary economics is also in this vein (Potts 2000; Foster 1997); concerned with self-organization, how patterns of collaboration and cooperation can emerge quickly out of the interactions of agents within certain complex systems. The point for us here is that interaction and relations among agents can make the whole (policy, for example) more than the sum of its parts. The interactions and relationships in a policy system form institutions, generate variety, and produce complexity in the interaction of ideas, interests and material circumstances. This makes composition important: these relations cannot simply be summed; rather they are dynamic, complex and typically have emergent, self-organizing properties.

This challenge to reductionism should be distinguished from the emphasis in much neo-institutional analysis on strategic agency and the need for 'firm microfoundations' for theories of institutional change. This is driven by a proper concern that institutional analysis should not 'overdetermine' behaviour or actions; that the potential for creative, innovative and entrepreneurial agency means institutions cannot explain uniquely, nor can they be assumed to persist indefinitely. I accept this without hesitation; my argument here, developed more fully in Chapter 5 on the methodology of structuring policy narratives, is that this should not be taken as methodological individualism. By always focusing on the individual agent and how their decision-making is affected by institutional structure, evolutionary effects in terms of the emergent properties of composite wholes are liable to be missed. Institutions are collective: it is groups of agents following a rule that constitutes an institution. Significant interaction effects include tipping points, network effects, combinational effects, bandwagon effects, reinforcement, emergence, learning and imitation. These are all concepts from the evolution of complex systems that can be used to structure narratives of policy dynamics.

Further, by acknowledging that there are properties of the whole that are not

reducible to its constituent elements, the analytical possibility of macro-evolutionary effects is raised. This is where the causal mechanism runs from macro-level to macro-level. For policy purposes, this means causal links at a level higher than individual agency; as in situations where policies can cause policy change, or policy institutions can cause institutional change. An example would be policy reform ‘packages’; the Australian government’s decision to introduce a broad-based consumption tax, the Goods and Services Tax (GST), in 1999 after 30 years of protracted and deadlocked political debates over tax reform, caused other policy changes *inter alia* with: intergovernmental fiscal relationships in Australia; small business support schemes; and personal private investment policy.

The purpose of discussing evolution as a process is to establish first that the explanandum of evolutionary theory is not just gradual change; and that looser use of the term evolution misses a substantial part of the process of evolutionary change – that of as rapid bursts followed by periods of stability. There are no analytical advantages to making an a priori assumption that characterizes change as gradual or rapid; cumulative or equilibrating; directional or non-directional; ergodic or nonergodic. Second, that viewing evolution as a complex process with potential system effects renders the gradualism–reductionism analytical strategy invalid in evolutionary theory. There are institution-to-institution causal links and policy-to-policy production effects that cannot be reduced to individual agents and their decisions. Instead the relationship is captured by the philosophers’ concept of supervenience; Chapter 5 takes this point further.

Evolution as Theory

Any evolutionary theory supports a form of consequence explanation; social phenomena are explained through their actual consequences. The central task for an evolutionary theory supporting explanation-by-consequences is to provide a mechanism by which the consequences uphold or maintain the action or structure that one wants to explain. In the absence of some kind of feedback from effect to cause, explanation by consequence remains unclear. A functional explanation (FE) is a special class of consequence explanation where the consequences of an institution or routine of behaviour are favourable, or functional, for some agent or group who maintain that institution or behaviour. Explaining why an institution emerges in terms of its consequences reverses the temporal sequence of causes preceding consequences. Thus it is highly problematic in a obvious sense that it is metaphysically impossible for an event to be explained by another event that occurs at a later time.

Usually the answer is to emphasize historical contingency, accident or

random variation in terms of why an X occurs at some time; then to focus on feedback loops from Y to X that explain why X continues to perform the function (Elster 1983). The separation of analysis between the creation of institutions and what sustains them is a characteristic of recent HI analysis (Streeck and Thelen 2005). In the terms of this chapter, natural selection as a feedback loop successfully supports a functional explanation. Elster (1983) discusses why functionalism is a good strategy in biology by presenting the traditional mutation-and-selection model, which says that functional structures will lead to greater survival and replication of the genes that produce them.

There are examples of FEs in the social sphere. As Cohen (1978, p. 272) notes, the following Marxist argument is a FE: the bourgeois media report industrial conflict in a style that favours the capitalist class because that style of reporting has that tendency. However as Cohen (1978, 1980) and Elster (1980) agreed in their exchange on FEs in the social sciences, successful FEs require mechanisms by which the consequences uphold or maintain the institution or behaviour that one wants to explain. Elster (1980, p. 127) argued that even though an FE remained logically possible, no mechanisms to support one actually exist: this is the missing mechanism argument noted earlier that is often used to deny 'biological analogies' in the social world. That is, there is simply no equivalent of natural selection operating in the social sphere and FEs in the social sciences can only work if supported by evidence of institutional selection, or something of the kind.

In response to this general argument Campbell (1965, 1974) has asserted that Darwinism contained a general theory of the evolution of all complex systems, of which organic evolution was only one. This argument is prevalent in contemporary evolutionary economics. Hodgson (2002, p. 270) argues for a Universal Darwinism that '... upholds that there is a core set of general Darwinian principles that, along with auxiliary explanations specific to each specific domain, may apply to a wide range of phenomena'. For example, Nelson and Winter (1982) applied the principles of variation, inheritance and selection (that underpin Universal Darwinism) to routines in firms. Additionally, a tradition of evolutionary epistemology stretches back to nineteenth-century American pragmatism, for example William James and C.S. Pierce, and has more recently included Popper (1972) and Campbell (1965, 1974), amongst others. This traces the development of scientific, objective knowledge in terms of experimentation, trial-and-error learning and selection. In asserting a general set of principles for the analysis of all complex systems, evolutionary theory amounts to an ontological claim of the existence of processes of variation, retention and selection, irrespective of the particular mechanisms that might be plugged in for specific theoretical strata. For us, the important point of the ontological claim that evolutionary mechanisms are

universal is that their instantiation in the social world need not be directly analogous to genetic variation and selection.

The nature of ontological reasoning is notoriously elusive and, from a policy studies viewpoint, prone to arcane abstraction. Nevertheless, the claim here is problematic: what is the relationship of these general evolutionary principles to some acceptable theoretical presuppositions about the policy world, or empirically based understandings of policymaking? If the principles of Universal Darwinism exist as logical possibilities in complex mathematical models, what is the status of evolutionary theory in the social world? At least formal models in economics are traceable back to assumptions about economic behaviour. What would the patterns and predictions of complex systems models mean in terms of explaining a policy process? In the terms that have been used in this book the question can be rephrased as: does evolutionary theory assist in providing intelligible mechanisms to link steps in a narrative?

I will leave this question open for the moment but note that in accepting the ontological claim that social systems are subject to evolutionary principles, the ground by which to judge the validity or usefulness of evolutionary theory is shifted. This does not of course avoid the missing mechanisms argument, but rather changes its nature. The challenge is no longer to uncover a mechanism of selection that is the equivalent of genetic selection in the natural world, because the argument no longer proceeds by analogy from the natural to the social world; instead the ontological assumption requires a search for mechanisms of variation, retention and selection that are appropriate and contextualized in the social world. The missing mechanism need not be analogous to genetic selection, but it remains missing nevertheless. It is to this challenge that the next section proceeds.

PROBLEMS OF EVOLUTIONARY THEORY IN THE SOCIAL SCIENCES

Functionalism and Explanatory Power

For evolutionary theory to support FEs in the social sciences requires the view that variation, retention and selection mechanisms operate such that dysfunctional entities tend to disappear; alternatively, non-dysfunctional institutions (including functional ones) maintain themselves over time because they are not selected out. With this view, it is on the plausibility of variation, retention and selection mechanisms providing the link from consequence to the persistence of an institution or behaviour that evolutionary explanations rest.

In any given item of functional analysis, there are two groups of individuals involved: those who engage in the practices to be explained and those who benefit from these practices; that is, those for whom they are in some sense functional. The question of intention arises only for the first group; the question of recognition may arise for both. The two groups may coincide, overlap or be totally separate. In the latter case, the possibility arises that the effects are unintended by those who produce them but recognized by those who benefit from them. However, identifying actors and beneficiaries is not sufficient for an explanation of change. For example, in order to see how a 'dysfunction' can explain change, it is necessary that the victims need not only perceive the problem but also correctly identify its cause. If the dysfunction is not recognized, then the victims cannot act as a causal agent in social change. Moreover, when the outcome but not the cause of a dysfunction is perceived, as is often the case if the causal chains are protracted or complex, no pressure for change should be expected; or, if there is pressure for change, it should not be expected to be successful in doing away with the problem. Without the agential link between consequences and future action, or an equivalent of natural selection in the social sciences, then FEs are weak and rightly to be avoided in the social science field. This is our preceding discussion: natural selection supports FEs in the biological sciences, but without an equivalent in the social world evolutionary theory cannot support FEs in the social sciences.

What are the prospects for evolutionary theories having explanatory power without functionalism? This requires the starting assumption that general evolutionary principles operate, but not in a way that 'selects' behaviours or institutions that produce favourable consequences for some group or agent, as that would amount to functionalism. This is the dilemma of wanting evolutionary theory to have some explanatory power whilst avoiding functionalism. Kerr (2002) asserts that institutions, behaviours or ideas that have consequences that are beyond the 'strict limits or "selective" pressures' set by the environment, will not tend to occur; and 'this forces individual actors or groups of agents to negotiate, and "adapt" to, the context in which they are situated' (p. 351).

His basic argument is that because dysfunctional elements tend to disappear, persisting forms can be assumed to be adapted in the sense of not being dysfunctional. It amounts essentially to the assertion that non-dysfunctional institutions maintain themselves over time, because they do not transgress environmental limits or constraints. Some might see this position as vulnerable because there may be many non-dysfunctional alternatives to a given dysfunctional institution. Without the ability to say which of them will emerge and at what time, rather than simply that one of them ultimately will, the predictive capacity of evolutionary theory is limited. This brings us back

to the earlier point that in terms of explanatory power, evolutionary theory is anaemic without functionalism.

However, there is good reason for this lack of explanatory power. The general presumption of this book is that dynamic perspectives introduce a degree of complexity into the analysis that renders the ambition for covering law explanations, manifest in some policy theory and institutionalist research, invalid. The ambition for dynamic theories of public policy is for theories, methods and concepts to structure narratives. In terms of evolutionary theory, there may be different selection pressures operating at different levels and over different time horizons. There is no single uniform and universal mechanism that *uniquely* selects and that can be accounted for by a covering law theory. Instead, there is a multitude of overlapping and potentially conflicting environmental pressures over the short, intermediate and long term.

This notion of selection as environmental pressure, that produces a disposition or a tendency, is closer to contemporary understanding of selection in the field of complex systems and evolutionary economics (Potts 2000 is a good example of this). In these terms, selection mechanisms are not universal fields that operate consistently over time but rather are often local, relative and operate over a specific period. Thus within the environment of the policy system there are dispositions, tendencies and constraints that limit what policy, policy proposal, idea or advocacy coalition (and so on) *may* be successful.

Consequences-based arguments are possible without functionalism; the challenge from the previous discussions is whether such arguments are convincing. Van Parijs (1981, pp. 29–30) suggests that the problem of consequences being used to explain causes can be overcome by saying that it is not Y that causes X but rather the disposition of X has to cause Y that causes X. Dispositions can exist through time, thus they can precede any particular instance of Y. However, this argument is one of potentialities or dispositions: why will X occur at any stage and second, why will it continue to have the disposition to cause Y? One of the arguments of this book is that there is no convincing general theory to answer these questions: selection mechanisms do not select uniquely; so in terms of the narrative explaining what actually occurred at certain times then selection pressures are part of the external circumstances that may softly determine the process of change. The role of historical conjunctures in providing ‘windows of opportunity’ for policy reform is well known to scholars of policy. The notion of a window of opportunity and how it may assist in explaining policy dynamics is unpacked in Chapter 5.

Agency, Intentionality and Evolutionary Theory

In a critical response to John’s (1999) arguments in favour of introducing

evolutionary theories into political science, Dowding (2000) sets a distinction between evolutionary and intentional explanations, and states (p. 75) that ‘specifying any non-intentional selection mechanism by which policies are generated may be called “evolutionary explanation”’. This distinction is too severe for several reasons. First, once parsimony and formalism as features of ‘good’ theory are abandoned to adopt a dynamic perspective, then intentional action as the centrepiece of an analytical strategy becomes more difficult. This does not simply include the general problems of rational choice in public policy theory (Hay 2004) but also the general question of rationality: of connecting particular desires to particular intentions to particular behaviours that was discussed in Chapter 1, and also as set out later, choosing between different reasons for action. Further, intentional actions sit alongside conjunctural contingencies, unintended consequences and environmental selection pressures in terms of mechanisms to make sense of events and processes in policy space.

One way to accommodate selection and intentionality is through the concept of artificial selection, although on the Dowding distinction this is not evolutionary. The essential characteristic of artificial as against natural selection is that humans manipulate the criteria or environment of selection, therefore it is intentional selection. However, the introduction of intentionality in this way raises the question of rationality; the processes of cognitive and cultural evolution that explain why agents come to act in the way that they do.

An example of intentional selection is the evidence-based policymaking initiative in the UK government since 1997. ‘What matters is what works’ is a New Labour mantra and has been the rationale for vastly expanded research staffs and budgets in government departments and agencies, in the NHS and in local authorities. Much of this effort is spent on *ex post facto* evaluation or judgement by consequences; interim and formal evaluation frameworks are routinely built into programme designs and budgets for major programmes such as Sure Start, the New Deals and Neighbourhood Renewal. Evidence-based policymaking in its use of pilots, monitoring, performance measurement, full evaluations and its commitment to act on the feedback of ‘what works’ is, at least in an ideal form, a form of evolutionary epistemology. The search for what works explicitly assumes that policy should be developed in an evolutionary way accepting the insight from Simon (1982) and Braybrooke and Lindblom (1963) that there are strong limits on notions of a universal rationality in policymaking. Indeed, myopia and the importance of random variation or designed experimentation are at the essence of evolutionary theory; this is what distinguishes it from other models of the policy process, or from different models in social science.

Intentional selection mechanisms have been introduced into policy theory; particularly in the voluminous body of work that pushes analysis beyond the stages ideal of policymaking. In Kingdon's (1984) influential policy streams approach, different policy solutions enter at the initiation stage of policy, often taken from the 'garbage can' or 'policy soup', and are fitted by policy entrepreneurs to problems that 'float by'. There are selection pressures that filter out or fail to select certain policies: from backbenchers in the legislature; from different departments; from the electorate; from the media or policy networks. This version of a 'policy window' is a policy environment with a confluence of different policy, political, economic and social trends occurring over different temporal scales. At those times certain ideas and policies 'may have their time' (Kingdon 1984, Chapter 6). He sets out three main categories that enhance the chances of an idea's survival: technical feasibility; value acceptability; and anticipation of future constraints. The first is whether the idea is fully worked out and, crucially, whether there is a practical and achievable implementation plan. The second is concerned with its compatibility with the values of the policy community. This is the equivalent of the notion of a policy paradigm. Third is the anticipation of future constraints, that the idea must be seen to have the potential, to have acceptable budgetary costs and enjoy reasonable prospects of approval from politicians and the public (mass, activist and media). These are all intentional selection mechanisms.

However, for Kingdon these selection criteria only draw up a shortlist. Which particular idea will emerge depends on a series of contingencies in which tipping points and bandwagons can play a part: beyond a certain level of popularity opposition to an idea ceases, or alternatives fade, and everybody joins the bandwagon. This is the internal dynamics emphasized by the self-organization strand of evolutionary theory, which is developed further in the third section of the chapter.

Fitness and the Charge of Vacuity

The technical definition of fitness is the relative rate of change in the number of instances of a certain character within a population. It has no significance itself, but rather only makes sense when compared with the fitness of other organisms; or more correctly, only makes sense in the fitness spectrum for a population of organisms. Why do characters grow at different rates? Natural selection answers this question but raises the further issue: what are the causal mechanisms responsible for the variation in growth rates of different characters? Evolutionary biology as based on the 'survival of the fittest' has often been challenged on this question. Fitness is defined in terms of those units that survive and reproduce successfully; in alternative terms, survival

defines fitness. How to explain survival? According to natural selection, those that are the fittest and most capable of reproducing successfully survive. So fitness explains survival. This invites the criticism that evolutionary theory is vacuous or circular. This is a weakness in evolutionary theory acknowledged by both biologists (such as Wilson 1975; Mayr 1988) and philosophers (for example Popper 1972).

The practical consequence of this circularity is that evolutionary theory may be labelled descriptive in the sense of not allowing any counterfactuals or, in Popperian terms, by being incapable of being falsified. Alternatively, evolutionary theory is incapable of prediction either prospectively or retrospectively, even in the statistical sense (Blaug 1986, p. 274). This is important if you judge theory by its explanatory and predictive powers. It is less of a problem if you view the role of theory as contributing to narrative explanation; with policy dynamics there are never counterfactuals other than those imagined by scholars, and the scale of description is detailed, contextual and fine-grained.

In evolutionary biology, adaptation models are aimed at providing some answers to why some characters reproduce more successfully in certain environments. They seek to explain an organism's ability to cope in a specific environment. A typical model sets out possible behaviours, objective to be optimized and a set of constraints, including environmental conditions. The optimization procedure aims to find the behaviours, strategies or characters that maximize the objective subject to the constraint. Oster and Wilson (1978, p. 292) (quoted in Auyang 1998, p. 146) state that 'Optimization arguments are the foundation upon which a great deal of theoretical biology now rests. Indeed, biologists view natural selection as an optimizing process virtually by definition.' But as Oster and Wilson (1978) go on to discuss, faith is required that equilibrium will be achieved. Optimization models say *how* an organism is adapted (they predict an optimal equilibrium to which the empirically observed behaviours or characters correspond) but not *how come*. These are equilibrium models and suffer the problems of comparative statics set out in earlier chapters. How do organisms approach equilibrium? Analogously, how do market prices approach equilibrium? Some major recent works of evolutionary biology, for example John Maynard Smith's *Evolution and the Theory of Games*, William Hamilton's *Narrow Roads in Gene Land* and Richard Dawkin's *Climbing Mount Improbable*, support the view that most biological models of evolution are of the optimization–equilibrium type and bear strong resemblance to equilibrium and optimization models that are used to underpin much of microeconomics. In these models, it is assumed that equilibrium will be reached – by natural selection or the operation of the free market rather than by revealing the actual dynamics of change.

PROSPECTS FOR EVOLUTIONARY THEORY IN POLICY STUDIES

Evolutionary theory can act as a metaphor in policy studies as it does, for example, in recent political economy work on how political and economic crises often defy understanding: they generate change, but no necessary remedial solutions. To complete this chapter, a general evolutionary metaphor of policy development is developed in order to assess the potential for portable concepts and frameworks: does the metaphor imply or hint at mechanisms that may lend intelligibility to narratives of policy dynamics? Within the social sciences, to label analysis as metaphorical or to claim that frameworks act as a metaphor often implies weakness and a sense of a lack of substance. This is where a metaphor is seen as rhetoric or a literary flourish without the requisite rigour for the purposes of understanding society. This is a mistake. As recent philosophers of social science have noted, metaphors have a deeply constitutive and subterranean presence (Lakoff and Johnson 2003; Lewis 1996; Klamer and Leonard 1994). Indeed, metaphors are prior to any analogy; they establish broad and general mappings across conceptual domains. There is a thin line between metaphor and the structure of thought; metaphor is no longer just a form of expression but a form of conception as well. They help to structure understanding, assist the perception of connections between different things, and are a way of supporting ontological claims (Lakoff and Johnson 2003).

Popper (1972, 1984) developed the pragmatists' idea that knowledge grows by trial and error or, in alternative terms, by conjecture and refutation. The starting point is the formulation of a problem situation confronting the individual or group; the second step is the production of tentative solutions and trial responses to the situation. The third stage is the process of error elimination: weeding out those among the tentative solutions that do not work. The fourth stage is the emergence of new problems, or perhaps the reformulation of the original problem.

Evolutionary epistemology may be used as a metaphor for describing the policymaking process to help develop dynamic policy analysis. The metaphor is not perfect, as Popper discusses evolutionary epistemology in terms of the advancement of objective, scientific knowledge, which is too limiting as a description of the policy process but does serve to establish learning as an evolutionary mechanism, subject to the general principles of variation, retention and selection. Further, this metaphorical structure serves to raise important questions about various forms of learning and competing rationalities in dealing with the uncertain, complex and constantly shifting environments in the policy process.

The evolutionary metaphor is a useful way of organizing thinking about

policy learning by distinguishing adaptation (learning that affects calculations about how to realize interests most effectively aka Bayesian rationality) from more complex learning where interests, identities and institutions are learned or constructed in the interaction of agents in the policy system. In this latter sense of learning, the problem situation itself is constructed in the interactions between agents; policy problems, policy solutions and the criteria of ‘success’, or the intentional selection mechanisms that operate to ‘weed’ out policy failure, are all constructed and it is through this construction that policy paradigms emerge and are institutionalized. As noted, Kauffman argues that analysis of the internal dynamics of self-organization should complement consideration of selection mechanisms in evolutionary theory (1995, p. 644): ‘I have tried to take steps toward characterizing the interaction of selection and self-organization ... Evolution is not just “chance caught on the wing”. It is not just tinkering of the ad hoc, of bricolage, of contraption. It is emergent order honoured and honed by selection.’ One of the important recent insights of the neo-institutionalist research programme is that there is the potential for institutional change in terms of conversion, recombinations, layering and activating redundancy (Crouch and Farrell 2004, Streeck and Thelen 2005; Thelen 2003). These are all examples of evolutionary change as self-organization that may or may not become institutionalized over a period through environmental selection pressures.

In Chapter 1 a dynamics perspective was used to problematize the notion of choice. Preferences, intention, action and consequence were temporally separated. It is possible to appeal to a broad notion of rational decision-making to connect these different temporal states. Over the last 20 years, rationality has been condemned in social theory on several grounds: as a homogenizing force, as a logic of identity, as a mask for power, and as male and modernist. Post-structuralist theorists have attacked its claims to impartiality and universality, while the postmodern turn called for an abandonment of rationality for an endless play of difference. From within the analytical philosophy tradition authors such as John Searle have argued *contra* the classical, scientific model of rationality that rational decision-making is often about choosing between conflicting reasons for action rather than starting from a consistent set of desires or preferences. In fact, humans are distinguished by their ability to be rationally motivated by reasons for action independent of desires or preferences (Searle 2001). Raz (1999) argues that an account of rationality is an account of the capacity to perceive reasons and to conform to them, of judgements of their appropriateness in different contexts and of different modalities of conforming to them.

For some, particularly within the constructivist tradition, these theoretical developments have meant an overturning of rationality; however for our purposes these debates show the the idea of a single, unique and universal

rationality breaking down in favour of different types of rationality. The parametric and generally non-dynamic rationality of rational choice theory has a strong hold in parts of political science and policy studies; while elsewhere the strict informational and cognitive assumptions of rational choice have been attacked (see for example Hay 2004) and relaxed in the renewed growth of interest in Simon's (1957) original idea of bounded rationality (Gigerenzer and Selten 2001). Also influential have been the ideas of Jurgen Habermas on communicative rationality: that rationality comes out of a communicative context but appeals to universal pragmatics and competences in communication (Habermas 1984, 1987). Another version sees rationality as wholly contextual and not just confined to explicit forms of communication in speech, but to all aspects of interaction within social processes (Bridge 2001). This leads to discussions of a possible transition from rationality and certainty to uncertainty, reasonableness and openness to the other (Levinas 1994) that comes from situation and context. Further, the notion of normativity in moral philosophy, built around the concepts of 'ought' and 'a reason', equally supports arguments about the situatedness of particular rationalities: questions of what counts as a reason, and what makes a reason appropriate in certain circumstances and not others allow very different, and spatially and temporally contingent, rationalities.

Importantly for the use of the evolutionary metaphor there are materialities to these situations; rationality is not necessarily just ideational. Indeed, one of the key concepts is appropriateness: how and why agents act in certain situations. This is related to the issue of situational logic that Popper uses: how are policy problems constructed within the interactions of the policy process? This is how narratives are constructed, and the foundation of the interpretive approach in political science advocated in recent work by Bevir and Rhodes (2003, 2005). This insight is developed in detail in the next chapter.

In the evolutionary metaphor of policy development, policies, programmes and projects are recognized as trial solutions to solve a problem. Situational logic assists in understanding decision-making processes; it recognizes that according to the logic of their situation, agents pursue certain goals or act for certain reasons and they do this by assessing which is the 'best' way of achieving these goals within the given situation. In these terms the evolutionary metaphor might be seen as privileging the objective elements of a situation and demanding a formal rationalism whilst ignoring subjective, psychological and non-conscious elements such as folk psychology, rules of thumb and habits or routines. I think such a criticism would be unfair; the evolutionary metaphor draws our attention to the possibility that a person or institution may find that they need to choose between several different options in their pursuit of certain aims, as in the classical view of policy; but also between several different rationalities, as in the interactionist view of policy.

This highlights the potential significance of meanings and emotions in analysing the logic of the situation and understanding why particular decisions are made. This is the basis on which claims to a universal rationality are being disputed and where much of the recent interpretive work may be placed (for example, Orr 2005).

The evolutionary metaphor helps suggest the idea of rationality as contextualized and emerging from the interactions of agents in the policy system. This is an important contribution to policy studies; back in Chapter 1 when discussing broad approaches to conceptualizing policy as a unit of dynamic analysis, I preferred the structured interactionist view of policy in contrast the classical, rational view. This was not a rejection of the importance of rationality in policy; rather a rejection of a singular view of rationality, favouring an emphasis on a plurality of rationalities that compete within the policy system. Different types of rationality have been suggested theoretically above so the empirical questions for policy scholars are: what type of rationality informs policy? Are its assumptions strict and universalizing, or more participative and contextual? Of particular interest will be the temporal and spatial aspects: does policy cohere over different temporal scales and different spatial scales of application? Are rational decisions made at one point in time, or in a certain place, consistent with long-run and wide-reach rationality assumptions?

At first glance, the evidence-based approach to policy advocated by the UK's Cabinet Office seems to assume the neutral and scientific treatment of evidence to inform policy intervention: an impartial and scientific rationality. Yet the evidence base also informs policy in terms of 'what works' (Davies et al. 2000), a pragmatist conception that comes as much from particular context as it does from the application of scientific principles. The significance of particular context has been heightened in the debates in other policy contexts over identity and diversity. The idea of rationality in policy analysis begs the question: are there elements of universality that can be maintained inter-temporally and across policy sectors, or does policy operate with different conceptions of rationality depending on the context? This prompts the core question for structured narratives of policy dynamics: what is the relationship between context and rationality?

Where does the foregoing discussion leave us? In evolutionary biology, the process of natural selection operates at a population level. This has been criticized from within that discipline as 'bean-bag genetics', circular and vacuous arguments about population statistics. In terms of the evolution of individual species, evolutionary biology tends to rely on comparative static models that are unable to account for actual processes of change. This weakness is analogous to how economics, after the Marshallian marginalist revolution, has periodically struggled with how prices adjust to equilibrate

demand and supply; but most economic textbooks assume that prices will adjust, just as most evolutionary biology textbooks assume that evolution has occurred. This may be an appropriate modelling device for certain purposes, but for the dynamic analysis of actual processes of change, evolutionary theory in biology must rely on structured narratives.

The evolutionary approach in policy studies shares this characteristic with evolutionary biology. This is an important element in the 'value-added' of evolutionary theory for understanding policy dynamics by showing that dynamic analysis in different fields favours narratives. In adopting a detailed, contextual scale of description of individual policy development, policy studies rely on narrative for explanation where mechanisms are expressed as tendencies, dispositions and environmental limits combined with an emphasis on conjunctural contingency, memory and history. The evolutionary approach, while not at all ruling out intentional explanation and strategic agency, certainly decentres the agent in the policy process; the metaphor puts self-organization and selection mechanisms alongside intentional action in structuring narratives. Further, the evolutionary metaphor helps to introduce policy learning in a constructivist sense, which is useful for understanding the emergence and institutionalization of policy paradigms.

5. Structured policy narratives

What does a structured narrative consist of? The first section of the chapter considers this question and how its answer contributes to understanding and explaining policy dynamics. Section two is the major section of the chapter and examines methods for the microanalysis of the policy dynamics in a structured narrative. The final section investigates what makes a structured narrative convincing or valid, successful or true. These three sections allow the chapter to act both as a methodological guide for the empirical chapters that follow and as a conclusion to the preceding theoretical chapters.

INGREDIENTS OF NARRATIVE EXPLANATION

The basic material of a narrative is a chronicle: a list of things that happened in a chronological order. This list usually has some minimal organizing principle, such as the fact that the events happened in a particular place or to a particular organisation or person. Crucially, chronicles do not attempt to make sense of what happened whereas narratives, in contrast, are ‘a single coherent story, albeit with subplots’ (Stone 2001, p. 74). Narratives vary in ambition. A minimal narrative charts the sequence of events: how one leads to another with appropriate details of accidents, coincidences, and misapprehensions. The aim is to make the sequence, at some basic level, intelligible or coherent. A structured narrative contains the ambition to make sense of the sequence in terms of some greater interpretive scheme; for example, a normative frame of success or failure; or in terms of the direction and trajectory of policy; or type or value policy changes; or changes in the political environment, and so on.

This interpretive scheme acts as the basic template or structure for the narrative. This structure rests on two premises drawn from the discussion of policy dynamics in previous chapters. First, policy as a concept is either an ideal-type or a cluster concept; both permit us to classify a range of different phenomena (both spatially and temporally) under a single concept. Many social-scientific concepts are cluster concepts because they share some amongst a cluster of properties (Putnam 1975, pp. 50–54); an ideal-type concept is a complex description of a group of social phenomena that emphasizes some features and abstracts from others. Either of these two

allows policy to be used as a heuristic to facilitate empirical enquiry, rather than conceived of as a natural category for investigation. In these terms, the successive states of policy traced through time, a policy path, becomes the basic structure of the narrative; as discussed in Chapter 1, this is the starting point of dynamic policy analysis. Further, this is a non-essentialist ontological claim, which has implications for the microanalysis of policy narratives that are considered in the next section of the chapter.

The second proposition is that policy is a meso-level concept and policy history is somewhere between the macro-scale, such as with accounts of structural changes in the political economy or constitutional change, and particular studies of precise events in deep historical detail, such as the agreement of a particular budget package. This has several important corollaries for the structure of the narrative and its microanalysis. First, historical contingency becomes a guiding theme; at any given juncture there are multiple outcomes that might have occurred. A sense of possibility is essential to any narrative of policy dynamics. The meso-level of analysis is fine-grained and so recognizes the role of agency in influencing the course of development in particular historical contexts and demands analysis of the multiplicity of causes that are at work in any temporal setting. In addition, at the meso-level there are discernible structures, processes and constraints that exist across time and recur in various historical settings; and these play a causal role in the direction and pace of change. Therefore an important part of policy narratives is the identification of these structures and the tracing of the ways in which they constrain and motivate individuals in particular settings, leading to outcomes that can be explained as the contingent results of conjunctural moments. As Pierson (2005, p. 41) sets out:

In part because studies of policy enactment make it possible to examine moments of change in fine detail, the role of particular actors in initiating such movements is likely to be highlighted. Yet these studies have greater difficulty in identifying those features that facilitate, impede or channel entrepreneurial activity. Broad, structural features, as well as long, slow-moving processes, which may be crucial preconditions for policy change, recede from view.

Policy narratives embrace the complexity of different processes of different speeds and at different levels coexisting in the policy path; indeed, it is the aim of the narrative to weave these together into a coherent story. Crucially for explanation by narratives, it is only by virtue of hindsight and the analysis of the conjunction of different processes that we can make any sense of which process is dominant, which structures and constraints may have been operating and the direction of their net effect. A structured policy narrative should specify the institutions, structures and processes that are embodied in a given historical setting; identify the possibilities and constraints that these structures

create for agents within those settings; and construct explanations of outcomes that link the causal properties of those structures to the processes of development that are found in the historical record.

A policy path encompasses a series of steps in the development of policy that are explained individually: there will be different explanations for different steps in the sequence as there is no single causal mechanism to encompass the whole policy narrative, nor is there a teleology or historicist cause from which all else can be traced. These steps may be moments, events, processes, periods, choices that are observed more generally, or are a typical kind for which we might employ portable concepts, models or metaphors; alternatively these may be salient events – these are not necessarily ‘large’ or immediately recognizable, but are capable of being labelled in retrospect as critical junctures in the development of a policy.

Pierson (2004) stresses that causes have their effects over different temporal scales; just as the historian is counselled by the Mao Tse Tung view that the twentieth century was too early to tell about the effects of the French revolution. It is only by virtue of hindsight that one can judge salience; additionally, different events acquire salience over time – that is, our judgement of salience is itself temporally distinct. The judgement of salience relies on questions of potentiality and contingency: if possibilities are foreclosed by a decision or action, or when the costs of reversing a decision or action are high, this is a condition for salience. However it is not sufficient, as there must be a supporting judgement that the decision or action had significant or meaningful consequences in terms of policy development. Unlike closed systems studied in theoretical models based on the ambition for covering law explanations, policy processes sit in an open context. This is what makes theories of the policy process so difficult: they are irreducibly complex. This is a common predicament for professional historians; the crossing of many causal paths drives events. Many of the steps in a structured narrative occur at the nexus of contending forces. John Bury (quoted in Oakeshott 1966, p. 201) argued that this confluence of paths was not governed by laws and stressed the idea of contingency in historical analysis: ‘it was the conflux of coincidence that proved decisive’.

In terms of narrative as a form of explanation, the key for any narrative is to avoid being a *Just So* story. Such stories refer to Kipling’s answer to how the leopard got its spots and the rhino its wrinkled skin; because of the fanciful natural history in these stories, the term came to be used in evolutionary biology to refer to unnecessarily elaborate and speculative evolutionary explanations that lacked any substantial empirical support. The term has come to be used in the social sciences in the same way. In historical narratives, theoretical models are used but they are local or contextual, and sometimes limited to one specific, temporally distinct event within the narrative. Theory

is always subordinate to evidence. The burden of the narrative is to weigh competing models, concepts or metaphors and show that one is the most appropriate in view of the evidence. In discussing how to judge one narrative explanation as being better than any other, the answer always refers back to the evidence. In 'just so' stories, by contrast, the evidence is subordinate to the theory. There is a willingness to extrapolate basic models across whole areas with limited evidential support. Applied rational choice theory has a tendency to produce 'just so' stories; Green and Shapiro (1994) note the poor empirical support for such a widely used theory; and Elster (2000) argues that the Bates et al. (1998) project for 'analytical narratives', aka rational choice history, amounts to a series of 'just so' stories.

'Just so' stories are not usually Kiplingesque in their absurdity; and indeed almost all are the result of a genuine attempt to avoid 'ad hoc-ness' in historical narratives. For example, Goldstone (1998, p. 832) warns against 'Dr Seuss-like explanatory principles', such as logic which suggests that events are wholly contingent and unique and so just happened to happen this way and are not very likely to happen that way again. The ambition to avoid the imputation of ad hoc-ness is worthy but in the context of complex policy systems it can lead to a reliance on general theories that can only ever be idealistic, which approximate only for equilibrium conditions rather than how and why equilibrium is reached, and for which empirical support is not general but rather limited to particular cases. This book argues that 'just so' stories are the inevitable result of adopting the covering law view of explanation as the basis for analysing complex and heterogenous policy dynamics.

For example, in a well-cited article Büthe (2002, p. 487) proposes that structuring a narrative based on a model can allow scholars to treat them as data on which to test the model of a general theory:

Beyond the elements identified in the model, however, additional context-specific information should be minimised. Information that is extraneous to the model should be provided only insofar as it affects salient elements and is needed either to understand the relationship between these elements or to appreciate the contingencies of a particular historical process.

In these terms, the model defines what is important in the narrative and thus avoids the problem of ad hoc-ness that inductive narrative explanations, from a social science perspective, may suffer from. However, the evidence that suits the testing of the model is selected, which raises the possibility that the model is true or correct in terms of confirming evidence, but inadequate in terms of understanding or making sense of the overall phenomenon. In John Godfrey Saxe's fable of the six blind men confronting an elephant and touching different parts of the animal, each of their different models was correct and confirmed by the evidence from touching the elephant: an elephant was like a

wall, a sharp spear, a huge fan, a giant snake, an old rope and an extremely large cow. However, none of these models was remotely adequate for characterizing an elephant.

From a dynamics point of view, the contextual elements of the narrative are essential for making sense of the development of a complex, composite variable over time. The thick, historical description, the emphasis on conjunctural contingencies and strategic agency are the core elements of a narrative; this is what needs to be made sense of rather than being stripped out in the interests of 'lean' modelling. Büthe (2002) is encouraging the analyst to make the overall evidence subordinate to the theory (as expressed in the model). We reject here the notion that narratives should be conceived as 'testing' the model, on the grounds that to do so would inevitably render the narrative a 'just so' story where features of the world that are essential and causal in this context are ignored because they do not have, nor could they have, a place in the general model because of the irreducible complexity that characterizes policy processes.

In place of the goal of assisting the discovery-governing regularities by testing models of general theories, the function of the narrative in policy studies is to provide understanding and explanation of particular dynamics of policy development. Because of contingency and the importance of possibility in policy dynamics, there is no way to tell the trajectory or path of a policy except by following it step by step. There is no covering law to be unveiled here. When the contingent causal factors at one step are understood, then we cannot call upon a dynamic rule to deduce what happens next; no such rule (or theory or model) exists. Many causal factors pull and tug in different directions in a historical process, and the policy analyst must compound them in order to understand the process (it is not possible to strip them away into component parts or use the *ceteris paribus* method). Complex systems textbooks show the vast intellectual effort necessary to compound causes in a theoretical model to deduce the progress of relatively simple systems; this reveals the hopelessness of models aggregating micro-causes in complex and heterogeneous policy systems.

MICROANALYSIS OF STRUCTURED POLICY NARRATIVES

The approach to microanalysis in the book is premised on the claim that policy is an ideal type that supervenes on the structured circumstances of the agents who make up or constitute it. Policy supervenes on a set of properties or individual behaviours when there can be no changes or differences in policy without there being changes or differences in individual behaviours.

Philosophers use this term to describe a relationship between two levels of analysis that is neither logical nor causal. Policy is not the logical identity of the collective actions of agents largely due to considerations of ‘multiple realizability’: policy cannot be the same thing as the behaviour of agents because the same policy may be realized through a large variety of patterns of agents’ behaviours; that is, it is not an identical thing just viewed at a more-or-less grained perspective. Nor is the relationship between levels causal; the behaviour of individually, socially situated agents does not cause the policy or produce the effect of policy; rather it is collective behaviours that constitute the policy.

Agents are situated in a nexus of structures: networks of other agents; institutions; norms; as well as worldviews and paradigms; collective memories; shared folk theorems, and so on. Little (1991) proposes a position of ‘methodological localism’ where individuals, socially situated in their local contexts, constitute the basic unit of analysis of social phenomena. This level of description is particularly relevant to policy studies, which usually stress the relatively small number of elite actors that are involved in most policy decisions. These individuals are regularly interviewed in case study analysis: members of policy networks, occupants of institutional roles such as senior bureaucrats and politicians, leading technical experts, and so on.

To stress, this is not ‘methodological individualism’. It invokes the ‘social’ in the definition of the position of the individual. It refers freely to norms, networks, institutions, belief frameworks, and other supra-individual constructs, such as policy or past policy decisions, or policy frames or paradigms. Importantly, the ‘social’ is ‘local’: individuals acquire their social properties as a result of an actual history of interactions with particular institutions, organizations, networks and other actors. This is what makes methodological localism suitable for the dynamic analysis of the meso-level of policymaking; it provides for the fine-grained, historical study of decision-making consisting of a limited number of agents within both particular institutional roles and a wider policy environment.

The basis of the claim of supervenience between the policy level and individual agents is that there is a complexity and looseness in inter-level relationships that militates strongly against reduction to individuals because it misses key inter-agent relational dynamics. The key to the looseness is the human ability to create/imagine new forms of social interaction; to innovate socially and collectively; and to defect from social expectations. In the terms of Chapter 4, there is the potential for self-organization in the system. As a result there are differential degrees of fit between individual action and structures, institutions and norms. Meso-level structures may morph as agents create policy, support the institutionalization of policy, adjust their behaviour to the incentives and roles created by institutions – but also defy or quietly

defect from norms, act opportunistically or on principle, and forget policy institutions. The relevant question is not whether policy and institutions exercise autonomous and supra-individual causal primacy – a version of reductionism – but rather: to what extent and through what sorts of mechanisms do policy and institutions exert causal influence on individuals and other structures?

Situated Agency

The concept of situated agency brings us back to the discussions in Chapters 1 and 2 about the nature of choice in policy studies. The basic unit of policy analysis consists of agents situated within an institutional environment, where institutions exist as constraints on the choices that may be made by agents. The question of how and why such constraints operate has produced different varieties of institutionalism – rational choice, sociological or organizational, for example. Works such as Hall and Taylor (1996, 1998), Hay and Wincott (1998), Campbell (1997, 2004), Stacey and Rittborger (2003) and Wendt (1999) demonstrate that the role of structure and agency within institutionalism is an open and continuing question, with the interplay over time between institutions as constraints (or enablers) and agents as capable of strategic action, and the remaking or recasting of institutions a central part of dynamic policy analysis.

The narrative form places an emphasis on agents' motivations and intentions; for some, this is what distinguishes the approach from other social-scientific methods. For example, Fischer (2003, p. 163) puts it: 'whereas the scientific mode strives to identify stable, reproducible patterns of actions that can be explained without reference to social intentions or purposes, the special subject matter of the narrative form is "the vicissitudes of human intention".' This is only true up to a point: the longer the narrative, the more complex the conditions for the fulfilment of the intentions and designs of agents, and the less likely it is that ongoing intentions, plans or designs can truly make sense of the sequence. As noted previously, contingencies and conjunctures become relevant in the dynamics of interactions between agents, and so too do structures as buffers against some of the possible perturbations and related complexity in analysis; this is why institutions are given a prominent role within policy narratives.

Interpretivist policy analysis has made a significant recent contribution to the question of how and why agents may act within certain institutional limits or constraints. It should be noted that much of this work either implicitly or explicitly draws on a much longer tradition within historically orientated disciplines. Here a condition of understanding is that the actions we see in a dynamic process make sense to us as analysts; or more accurately, make sense

to us that such actions should make sense to the agents in those circumstances. If an agent acts for certain reasons, observers can be in a position to make sense of that action in terms of those reasons. One way scholars can do this is by thinking himself or herself into the position of the agent (their context, outlook, preconceptions and memory). This deeply contextual form of historical understanding was emphasized most famously in the works of R.G. Collingwood (for example, Collingwood 1946).

This concern for the intentions and beliefs of agents has implications for the research methods of policy dynamics. Direct evidence of mental states in terms of interviews or other documentary evidence is a key aspect of analysing choice; the tendency in some rational choice history (see Elster 2000, p. 693) is to impute intentions and beliefs in order to explain actions. The interpretivist approach holds that it is poor social science to construct a model in which observed behaviour maximizes the interests of agents, and then assume that fit between the interest and the behaviour explains the behaviour. It may just be a coincidence; and this is where the historical form of understanding set out by Collingwood can add such great value to policy narratives.

It is important to note what the interpretivist approach does not imply: it does not mean that the observer identifies themselves with those reasons, or would have acted similarly. Rather this refers to a feigned understanding of the agent. Further, putting oneself in another's shoes may provide an explanation or understanding of the action observed, but it may not provide the complete or adequate explanation. There are important social, psychological and political questions that arise in *why* the agent should act on such reasons. This detailed study of the context in which the agent is situated – including the actions or anticipated actions of others – complements the analysis of the motives and intentions of agents in narratives of policy development.

Neo-institutionalism tends to stress the importance of how agents construct internally institutional constraints, and how they constitute themselves within these institutional structures. This is how institutions constrain: it is only through affecting the *intentions* of agents that institutions have any causal role in explaining behaviour, including those behaviours that result in institutional change. Fisher (2003, p. 28) summarizes the position:

It is not that institutions cause political action; rather, it is their discursive practices that shape the behaviours of actors who do. Supplying them with regularised behavioural rules, standards of assessment, and emotive commitments, institutions influence political actors by structuring or shaping the political and social interpretations of the problems they have to deal with and by limiting the choice of policy solutions that might be implemented.

But what of institutions qua ideational structures, or more particularly, conceptual maps, normative policy frames and policy paradigms? Do these

sorts of institutions enter into the discussion of agent behaviour as conscious, intentional constraints? For Hall (1993), policy paradigms are unconscious and non-intentional in their influence on agents. An important distinction often missing in neo-institutionalist analysis is that between institution-following and institution-described behaviour. This distinction is pertinent in light of the definitional breadth of the term 'institution': habits, norms and routines are institutions for some, as are mental maps, frames and policy paradigms for others, and as are budget rules, tax codes and electoral rules elsewhere. Some institutions may be non-conscious and non-intentional, as when rules have been fully internalized; in this case, institutions describe the behaviour rather than having some effect on the intentions of agents. Other institutions, however, may be interpreted and constructed by agents in a conscious manner as, for example, in the regular and privileged access granted in a formalized policy network to certain social policy groups. Elsewhere institutions are tightly specified, codified and external to the agent, which does not permit much space for individualized interpretive frames; instead there are real penalties associated with certain forms of behaviour and agents may consciously follow such rules, as in budget rules or electoral rules. The general point is that the mechanisms that give causal effect to institutions can be quite different according to different types of institutions and the local context in which they are embedded.

One important dimension of all institutions that poses a problem for the analysis of situated agency in a temporal process is that institutions are collective: there must be sufficient number of agents who act in a certain manner, whether consciously or non-consciously, for that manner to be considered an institution. It is important to repeat the emphasis on methodological localism at this stage; part of the context in which the agent is situated is the behaviour (or expected behaviour) of other agents. This presents a problem for narratives of policy development. First, being particularistic and interpreting all individuals' motivations and beliefs when acting in a certain way introduces an intractable complexity into the analysis once the number of agents goes beyond a small number. Alternatively, there are representative agent models in which all agents act in such a manner that their cumulative actions might as well be the actions of one agent maximizing its expected utility function. These are popular in economics to deal with the issue of aggregation from micro to macro. It is relatively simple to model the behaviour of one person, given some assumptions about preferences and constraints. Indeed, it may well be valid for certain agents in certain circumstances. The problem is composition, as discussed in Chapter 1: how can we aggregate this representative individual's behaviour to a higher-level structure such as an entire economy? In formal modelling terms this is straightforward, however the credibility of the aggregate result must be in

question for policy studies, given our continued emphasis on the complexity of inter-agent dynamics in the policy process.

The notion of situated agency has a strong role in the scheme for policy narratives in allowing agential space to make choices within institutional contexts; and the capacity to innovate to make and remake institutions. But this focus should not be at the expense of acknowledging institutions as collective actions, choices or interpretations. How can groups of agents change their institutional environment? This is a collective choice; and therefore talking about agent's choice within institutions is to miss much of the dynamics at work around bandwagons, tipping points, threshold effects, sufficiency parameters, and so on. Structured narratives of policy dynamics, within a presumption that situated agents are the units of analysis, should be cognisant of these emergent properties of relational dynamics.

Policy Memory

In a general sense, memory refers to the capacity for remembering, recalling, recollecting or recognizing. The extent to which events, behaviours, routines and institutions are remembered is an important, and relatively neglected, part of policy dynamics. Memory is a mechanism that links past events and current intentions, actions and behaviour. It is a function of time: it is always the memory at a given moment in time of an event that occurred at some previous moment in time. This is an important point for any dynamic analysis; policies and institutions are reproduced and have local states at particular places and particular times.

The idea of memory is well established in systems analysis. Cortes et al. (1974, p. 3) define it as '... the impact of some event that happened in the past upon the current response of the system'. Memory is strongly related to the concept of hysteresis that was first introduced into economics by Georgescu-Roegen (1967, 1971) in the study of consumer behaviour: individual utility at a point of time is not simply a function of consumption at that time; rather it is affected by the past consumption of that individual as well. It has subsequently been used in a number of different economic applications, perhaps most prominently in the idea that there is a mechanism whereby a rise in unemployment increases the equilibrium (or natural rate) of unemployment. Elster (1976) uses the notion of hysteresis more generally in the analysis of social and political change, but the term memory is preferred here in order to adumbrate the memory of individual agents as the object of interest.

Brain scientists and philosophers of the mind are a long way off being able to predict what gets remembered and being able to explain why. In light of this, the description of the policy memory mechanism here is appropriately basic and focuses on two different aspects of memory. The first aspect is

memory conceived as something analogous to the operation of computers; while the second relates to how unconscious habits, routines and policy frames are reproduced and 'remembered' over time.

Computer memories store bytes of information and retain that information over time, which can then be retrieved via well-designed algorithms. The analogy to human memory is not perfect. Consider information retrieval, where current experiences of current events produce memories of preceding similar events, or where political actors use symbols and stories to deliberately access agents' memories. The content of such memory can be events or policy decisions, as well as information and opinions and, importantly for the computer analogy, this content becomes more inaccurate with time; it fades or decays, and thus the effect of temporally distant events on current policy processes will change with time. There is also emotional memory, which refers to the intensity of feeling or the vividness and closeness of a particular emotion connected with an object in the propositional memory. For example, when policy has been enacted amid 'crisis' as, for example, in the events that produced the 'foot and mouth' policy in the UK in 2001 (Taylor 2003), the memory of those events will fade with time; both the propositional aspects (as when senior policymakers 'forgot' the lessons of the 1967 foot-and-mouth outbreak) but also the vividness of the imagery of burning animal carcasses. This memory process may affect subsequent development of policy on animal health security in the UK.

One way to consider policy memory at the unconscious level is to use Bourdieu's notion of an agent's 'habitus'; this is the active sediment of their past that functions within their present, shaping their perception, thought and action. It consists in dispositions, schemas, mental maps and competence, all of which function below the threshold of consciousness. Bourdieu (1984, p. 466) puts it: 'the schemes of the habitus, the primary forms of classification, owe their specific efficacy to the fact that they function below the level of consciousness and language, beyond the reach of introspective scrutiny or control by the will'.

Each individual agent's habitus will be different to some degree, as no two biographies are exactly the same. Nevertheless, for Bourdieu individual biographies are just strands in a collective history; individuals belong to a group or variety of groups and develops their habits within these groups. This is useful here for refining the notion of policy memory because it: (i) stresses that is the shared or collective policy habitus that is of interest for policy studies; and (ii) this memory may fade, drift or change through less-than-perfect reproduction over time.

The notion of memory affecting agent behaviour is difficult terrain for any empirical social scientist, for the obvious reason of a lack of immediate opportunities for description and observation (see, for example, the exchange

between Chalmers (1995) and Dennett (1996)). It also poses a substantial theoretical hurdle for us here, in that throughout the book institutions, including past policy decisions, are given a causal role only insofar as they affect the intentions of agents, where agency is defined as the potential for agents to have always acted differently in any given set of circumstances. The intentional part of that formulation refers to agents acting for a reason. This is fine when memory is conceived as something akin to a computer's hard drive with the agent consciously retrieving data, but the problem for unconscious memory is: how do these affect the intentions of agents? If agents are not responding to these unconscious institutions, how can they have a causal role in that agent's behaviour?

The policy memory argument can be developed to include the claim that adherence with institutional rules can occur at a non-conscious level: the following of institutional rules becomes second nature, like a habit rather than an algorithm, and it is this second-nature adherence that helps explain the reproduction of institutions through the actions of agents over time. Searle's (1995) idea of the 'Background' that originates from his work on issues in the philosophy of the mind and the philosophy of language can assist in developing policy memory in terms of the reproduction of non-conscious, underlying policy frames and other policy institutions that serve as background to agents' behaviour. The background is 'the set of non-intentional or pre-intentional capacities that enable intentional states of function' (Searle 1995, p. 129), where non-intentional or pre-intentional capacities consist of abilities, dispositions and other causal structures that ultimately function at some liminal level (pp. 129–30; see also Searle 1999, pp. 107–8). Thus, the background is the set of abilities, dispositions and memories that facilitate intentional human agency; with the corollary that it can act as part of causal explanations.

This is how the notion of a policy paradigm, which is widely used in contemporary policy studies, is understood in this book. Thus, it seems to be a 'rule' that only neo-classical economic analysis is allowed in the Central Budget Agencies of OECD countries. However, this rule is rarely, if ever, explicitly stated in introductory training. Instead, new entrants are simply presented with a series of policy analysis cases and answers. Given this, as time passes, they become more skilled in the application of such economic analysis methods and they develop a natural disposition to think of policy issues in these terms. At this point, adherence to the rule that only neo-classical policy analysis counts as policy analysis becomes widespread. Neo-classical economics becomes second nature; indeed Hall (1993) introduces the notion of a policy paradigm with respect to economic thinking about macroeconomic policy. The key is the propensity to apply this method of thinking, this paradigm, when intentionally directing consciousness at a particular issue: this is Searle's Background.

How then does a change in a policy paradigm come about? Because the following of institutional rules is second nature, the rules themselves are potentially recoverable by consciousness and it is this potential recoverability that explains institutional change. In other words, institutional change results when agents come to have reason to direct their consciousness at what has become second nature. This reason may be shifts in the external policy environment, new ideas, or the accumulation of feedback on the consequences of the policy paradigm.

This notion of change bears a strong resemblance to John Dewey's work on habits and intelligence (Dewey 1922). For Dewey, awareness of the existence of a particular institutional rule emerges, as it were, from the background to the foreground of consciousness. It is at this point that intentional human agency holds out the possibility of innovative and creative institutional change. A strategic and conscious element enters into habitual action; although the habitus or background may predispose agents to act in particular ways, it does not reduce them to 'cultural dopes' or inhibit their strategic capacities.

It is important to point out that for a particular policy paradigm to fade and, hence, for institutional change to occur, it is not enough that a single agent comes to recover into consciousness the rule and stop behaving in accordance with it. Rather, the population of agents to which the rule applies must, collectively, stop behaving in accordance with the rule. Of course, if an agent that is pivotal to the institution, or perhaps society more generally, either declares that people should no longer behave in accordance with a particular institutional rule, or stops herself behaving in accordance with that rule, then this can induce the collective intentionality required for institutional change. However, even in this case, the collective intentionality is a necessary condition for change. Thus, although the potential recoverability into consciousness of institutional rules that have become second nature helps to explain the potential for institutional change, the need for collective intentionality to actually institute that change helps contribute to institutional stability over, possibly long, periods of time.

EVALUATING NARRATIVES

A narrative is a selection of elements such as events, steps and processes from a chronicle; the long sequence of things that happened, which can be organized by some interpretive frame to make sense as an overall story. The narrative has to make sense to at least the person who made the selection, so is not entirely arbitrary in the manner suggested by a strong reading of the Dr Seuss imputation of ad-hocness. Further, just like professional historians, policy scholars are concerned with the discovery, validity and reliability of

evidence. Thus, in terms of selecting items for narratives there can be some agreement on the basic facts of policy development, or in the terms here, the chronicle on which the narrative draws. But crucially, there can be agreement on facts but substantial disagreement on what makes sense of them to different people. Very different narratives are possible, and indeed it may be that whichever group or individual has the power over the writing of the narrative determines what is accepted as making sense. This is what motivates the reluctance of some to use narratives; they are always extemporized and should be regarded as data sets upon which to trial different models of policy change.

Indeed, it is difficult to produce an objective standard or set of criteria against which to assess or 'test' the validity of a narrative explanation. One response is to stress the competition between different narratives, different interpretations and different explanations of the same thing, and argue that this competition may advance the literature toward something that is a 'better' explanation or perhaps closer to the truth. Williams (2002, p. 252) puts it in terms of the marketplace of ideas: 'Continued inquiry ... eliminates earlier interpretations, which become, in the face of further information and more searching questions, indefensible.' This is particularly pertinent for the analysis of policy dynamics, which is history that ends in the present or near past. New evidence of the consequences of policy decisions or of certain actions emerges constantly.

Additionally, the policies themselves are the subject of continued political contestation. For example, subsequent policy development can give new meaning to the preceding policy history: does this policy mark an aberration or permanent shift in direction? Can you see permanent interests in a policy, beyond those produced by specific periods of electoral competition? Has interest group power been realigned? Has a certain policy idea become institutionally embedded, or is its influence more parlous? Is this policy change an ephemeral response to short-term events, or something that is path dependent? New evidence on questions of these types will confront the student of policy dynamics at a rate that alleviates some of the difficulties that confronted historians of the far past – and increase the competition between existing narrative explanations. The constant possibility of new disconfirming evidence will, by one view, intensify the competition among different narratives. This yardstick criteria of a successful narrative – it is better than the alternatives in explaining the evidence – is similar to the abductive reasoning emphasized by Pierce and other American pragmatists.

An alternative response to the challenge for criteria to assess the value of narratives is to accept that there are variations in what makes sense to different people (either at the same or different times). This invites the label 'relativist' and it is important for my argument to explore what this might mean here. The

first point, for philosophers, is that the position is not relative to the truth. There are historical facts in policy development: this legislation was enacted on this date; the budget for 2004 allocated £10 million for this; the leader of the Greens said this on this date, and so on. Relative, rather, refers to the judgement involved in selecting from the chronicle the material to form the narrative and the use of different concepts, metaphors or models to provide intelligible mechanisms in the narrative. Different scholars may argue different interpretations or use different metaphors or concepts, and may contest other scholar's judgements. There are different disciplines with different standards of justification, and different standards for explanations: a belief in causal explanation does not provide a unique or universal method of justifying different causal explanations.

By denying a universal standard, Rorty (1982, p. 166) argues, does not have the corollary that there is no preferred standard of truth: 'Except for the occasional cooperative freshman, one cannot find anybody who says that two incompatible opinions on an important topic are equally good. The philosophers who get called "relativists" are those who say that the grounds for choosing between such opinions are less algorithmic than had been thought.'

This book notes that by accepting relativism we are accepting that different standards of justification of an explanation exist within the social sciences. The standard of this book – understanding and explaining policy dynamics – requires making sense of unique temporal sequences. The chapter has set out the key foundational assumptions of policy narratives and how they allow explanation of policy development:

- 1 Policy is a heuristic concept, which when applied with a dynamic perspective allows a path to be drawn through policy space. This path, which consists of a series of steps between different states of the policy system, acts as structure for a narrative.
- 1 A policy narrative seeks to explain these steps and uses the socially situated agent as its basic unit of analysis.
- 1 The microanalysis of the policy paths requires the investigation of the dynamic interaction of the social situation and agency in the multitude of contemporaneous processes immanent in the transition of policy systems through successive temporal states.
- 1 Policy narratives highlight the conjunctural contingency of these different processes at different speeds as the key driver of policy along the path, step by step. In doing so, explanation in terms of the intentional action of agents is either limited to relatively short temporal horizons; or in some cases dynamic perspectives upset the entire notion of policy as intentional choice.

These key principles act as the foundation of policy narratives; they inform what should be included, which are the key stages, how those stages should be analysed, and they push the analyst toward constructing a coherent narrative, which makes sense of a unique temporal sequence of policy development. By virtue of acting as the foundation of policy narratives, these principles also act as a guide for the evaluation of narratives as explanations of policy dynamics.

PART II

Evidence

6. The development of the EU budget system

The historical development of the EU budget system has involved the accumulation of a set of institutional constraints that limit the scope for EU policy activism in terms of redistributive and distributive policies. This process of EU integration is often underplayed relative to analyses of integration in terms of ‘big step’ Treaty agreements, such as the single market, single currency and enlargements. This chapter provides a structured narrative of the dynamics of institutional change in the EU budget system, where the incompleteness and limitations of the initial Treaty-based budgetary institutions have worked themselves out over time through a series of historical, political and fiscal contexts.

This process of development has seen the accumulation of additional and complementary budgetary institutions that have had the effect of significantly constraining expenditure-generating EU-level policy activism. The granularity of perspective adopted in the narrative helps to reveal the importance of relationships between institutions; in isolation, institutions may be properly labelled as either stable or changing over time, however once institutions are viewed in combinations, or as part of systems of interdependent rules, the question of institutional change is more complex, requiring description of the conflux of interdependent causal relationships and some analysis of how they are compounded into an overall net effect that connects the different temporal states of the EU budget system.

The narrative presented includes an increasing returns process operating at the level of sequences of institutional choice: once an initial institutional framework is established, there are strong increasing returns involved in the choice of new, supplementary institutions within that framework. That is, an increasing returns process explains institutional change qua the introduction of new, supplementary institutions. As North (1990, p. 95) states, it is ‘the interdependent web of an institutional matrix that produces massive increasing returns’ through strong learning effects, coordination effects and adaptive expectations. The analogue of the choice of technological standards in a market – from which the dominant strand of path dependency analysis is derived – is the sequence of institutional choices over time that increase the pay-offs for certain choices further on in the sequence; it is not the

choice of a single institution at one point in time that then persists or is stable.

This has an immediate obvious appeal in terms of explaining the development of the EU budget system where the Balanced Budget Rule (BBR) in the 1957 Treaty of Rome, and the 1970 Luxembourg Treaty distinction between Compulsory Expenditure (CE) and Non-Compulsory Expenditure (NCE), have persisted unchanged, consistent with a path-dependent process. Further, one of the standard micro-mechanisms in an increasing returns process is the existence of significant switching costs. Replacing the existing constitutionally entrenched budgetary framework would be costly politically, as budget reform tends to be a zero-sum game, or where switching costs are significant, a negative-sum game. Since Treaty changes require unanimous agreement by the member states, potential 'losers' possess a veto.

If we adopt the perspective of the budget system as a single whole, this expedites the use of path dependency as a concept that insists on an 'overall' trajectory for an institution and institutional configuration, the direction of which is reinforced after early moves in the sequence. This is fine; however the issue raised in Chapter 3 is that within a path-dependent system some elements may be fixed or locked-in, while others are capable of being reformed. Also within a path-dependent system, space may exist for the introduction of new institutions. This is crucial to my analysis here: the initial budgetary framework set in train path-dependent process in which institutional change has been observed, and as will be shown, new budgetary institutions have been made or remade for various reasons with a variety of effects – but all have been premised on the continuation of the initial budgetary framework; that is, all change has occurred within that framework.

The danger of adopting an institutional configuration – the budget system – as the unit of analysis is the creation of too sharp a distinction between stability and change, as seen in on-path versus off-path change. This is a function of the granularity of perspective and is a general charge against historical institutionalism and path dependency. This unit of analysis leads some to see 1988 as a path-breaking juncture in the EU budget system, with the introduction of a 'new' institutional setting: 'The comparison between the final breakdown of the 1970 institutional setting and the continuous stability of the 1988 institutional setting revealed that the specific combination of reproduction mechanisms present in the 1988 setting was better equipped to sustain stability' (Lindner 2003, p. 932).

In the narrative presented here, institutions exist in combinations: they are interdependent, with necessary and contingent relationships. Thelen (2003) describes examples where institutional lock-in is combined with elements of institutional innovation that can push the overall trajectory of policy and politics in a different direction. This encourages a shift in the ground from a sharp distinction between institutional persistence and institutional change

towards a position where (2003, p. 233) ‘... to understand how institutions evolve, it may be more fruitful to aim for a more fine-grained analysis that seeks to identify what aspects of a specific institutional configuration are (or are not) negotiable and under what conditions’.

While the concept of path dependency is a useful metaphor for the dynamics of the EU budget system, the underlying increasing returns process actually operates here at the level of combinations of institutions, or interrelationships of institutions, rather than at the level of the individual institution. The initial design of the EU’s fiscal constitution did not establish complete institutions; these are institutions that are singularly self-sustaining. Instead, the initial Treaty-based institutions can be defined as a budget framework or an institutional space in which other institutions could develop. For example, the constitutional BBR in the Treaty of Rome has required a series of other institutions in order to ensure that the budget balances – in particular, rules to coordinate spending and revenue decisions. The contingency for breaches in the BBR – that the European Court of Justice declares the budget unconstitutional – was insufficient to exercise direct and immediate control over CE.

The narrative provides microfoundations to the institutional dynamics of the development of the budget system in terms of situated agency: member states as actors in the budget process have, as a minimum, two objectives. First, that the EU avoids bankruptcy, and second that their net budget position remains stable. Each actor would wish to maximize their net transfers but, given national vetoes and the zero-sum nature of the budget game, stable net positions (discussed below) represent the best outcome for the member states collectively. The second objective dominates the politics of budget reform in the EU in the absence of a threat of or an actual budget ‘crisis’. In the event of the EU facing bankruptcy, member states’ preferences with regard to budget share stability and respecting the BBR define a domain of feasible compromise for the development of an additional or supplementary set of EU budgetary institutions to confirm or validate the initial, Treaty-based institutions.

The evolutionary metaphor discussed in Chapter 4 can be used to describe the process of this search for budget institutions in response to the regular budget crises that affected the first decade or so of the EU financial system. The process was akin to a form of trial-and-error ‘learning’ with slow feedback mechanisms. Agreement on institutional reforms was mediated in periods of fiscal crisis at significant political cost, which meant that they were difficult to reverse; however the consequences of the reforms in correcting the tendency of the EU budget system to crisis was only observed at some later point, that is, when the threat of bankruptcy again emerged. The feedback was relatively slow but the next crisis did not lead to the removal of the previous budget

reform; it rather led to the introduction of another budget institution. Thus the process was not classic trial and error, in the sense that budget institutions that had not worked were not dismantled; they were instead added to. The process of accumulation of additional and complementary institutions to avoid the tendency to crisis is the dominant dynamic in the development of the EU budget system.

THE INTERRELATIONSHIPS OF INSTITUTIONS

The notion of state space discussed in Chapter 1 as the foundation of dynamics, implies both a temporal and spatial context to institutional development. An appreciation of both is essential to examine the notion that a multitude of institutional development processes may be simultaneous within an institutional system – in particular, to understand the claim that an institutional setting is path dependent does not require that all institutions contained therein are unchanged.

In spatial terms, the interrelationship between institutions may define a space within which complementary institutions could develop. The most prominent spatial interrelationship is between different levels of institutions. Three levels or layers are regularly distinguished: the macro- or constitutional level; the collective choice or policy decision level; and the operational level of individual decisions. There is no simple structure to the relationship between these three levels: constitutional rules affect the policy decision rules, which in turn affect operational decisions, but some constitutional and collective choice rules are subject to the control of operational-level decisions. This has been a theme running through the theoretical chapters of the book; to understand the layering of EU budgetary institutions requires understanding the relationship between the initial Treaty-based rules and the complementary institutions that have developed subsequently. In the narrative presented here, this relationship is an increasing returns process; the new institutions that have emerged complement and reinforce the initial budgetary framework.

The temporal aspect of inter-institutional relationships is important because it raises questions of inherited legacies and the extent to which institutions, as artefacts of past decisions or actions, circumscribe or condition a particular institutional space in which parallel or related institutions may develop. Whilst agents are situated rather than determined, and remain capable of remaking or reforming these inheritances, institutions tend to endure (almost definitionally). Further, as dynamic analysis emphasizes, institutions are often reproduced across time and may have consequences that bear little relationship to their designers' initial intentions.

Budgetary institutions are necessarily interdependent; they exist as a system and evolve, co-evolve, complement and depend upon each other. Each relationship between a constitutional rule and a policy-level rule cannot accurately be studied independently of the other relationships in a multi-level system, because a change in one affects the other two; that is, *ceteris paribus* does not hold. The EU budget process is an emergent property of the relationship between different actors and different budgetary institutions across time. The challenge for all narratives of a complex system is to balance microanalysis of the interactions of the constituents with a consideration of system-level properties.

THE INCOMPLETE INITIAL DESIGN OF THE EU BUDGET SYSTEM

In order to help structure a narrative of the complex interdependency of budget institutions, I use Buchanan and Musgrave's (1999, p. 118) identification of two types of constraints affecting budgetary institutions: those affecting the rules for reaching collective decisions are procedural constraints; whereas domain constraints affect 'the set of permissible outcomes or solutions that may be allowed under any agreed-on procedures'. The 1957 Treaty of Rome set out the basic framework for EU budget-making, containing the most important domain constraint: 'the revenue and expenditure shown in the budget shall be in balance' each year (Article 199). This Balanced Budget Rule (BBR) was included because the Treaty authors 'did not wish to offer the Communities, and in particular the Commission, any easy solutions' on spending (Strasser 1992, p. 57). The development of a budget system that produced budgets and budgetary outcomes consistent with, or which validated, this constraint is the chapter's narrative, for while the BBR denied 'easy' solutions it never assigned responsibility for 'hard' choices to any individual or organization in the budget process.

The EU's own resources system (OR) came into force in stages during the 1970s as first the Common Customs Tariff (CCT), then the Variable Import Levy (VIL) of the CAP and finally, in 1979, a VAT-based contribution, which passed to the financial authority of the EU. However, there were limits placed on the ability of the EU to exercise control over this revenue base. Importantly, VAT contributions are based on a two-stage calculation. First, the VAT 'base' is determined as the total revenue that would be collected in each country if they adopted a common, hypothetical VAT system designed by the Commission. Payments to the EU budget are then specified as a percentage of the VAT base (the 'call-up rate'). Crucially, this is subject to an annual maximum (initially set at 1 per cent). This, combined with finite VIL and CCT

revenues, imposes a domain constraint on total revenues that limits total EU spending each year.

In terms of procedural constraints, the 1970 Treaty of Luxembourg introduced a distinction between two classes of expenditure, differentiating the powers over each that were granted to the European Parliament. Spending is categorized either as CE – defined in the Treaty as spending ‘necessarily resulting from this Treaty or from acts adopted in accordance herewith’, or NCE – all other spending. The distinction has no administrative or accounting logic but importantly the Parliament was granted greater powers over the latter than the former, which in practice meant it was easier for Parliament to propose changes to NCE than to CE and harder for the Council of Ministers to reverse or otherwise alter changes to NCE.

In addition to limited powers over CE, Parliament faced other limits. First, Article 203 imposed a domain constraint by limiting the annual growth rate of NCE. The Commission fixed this with reference to trends in national GNP; the average variation in member states’ budgets and the previous year’s rise in the cost of living. Second, Parliament’s *de facto* budgetary influence was limited by the fact that, initially, NCE represented less than 5 per cent of total EU spending (although the figure is now much closer to 50 per cent).

During the 1975 budget process, the Council defined CE as ‘all expenditure “in respect of which, by virtue of existing enactments, no budgetary authority, be it the Council or the European Parliament, has the right freely to determine the appropriations”’ (Strasser 1992, p. 176). Thus CE cannot be controlled directly – once the expenditure-generating policies and instruments are agreed, all resulting expenditure obligations must be met. In practice, control over the level of CE is greatest for the institution with the greatest say over the setting of policy; this meant, before 1988, the CoAM (the Council of Agricultural Ministers), which determined CAP ‘Guarantee’ expenditures (amounting in some years to almost 80 per cent of total expenditures).

The CoAM took decisions on the CAP without regard for the overall balance of the budget. This, coupled with the ‘open-ended’ nature of support, discussed here, created this tendency to fiscal crisis. Periodic crises prompted a search for other institutions to validate or enforce the initial BBR domain constraint; I use the evolutionary metaphor of policy development set out in Chapter 4 to describe this process. There was an overall budget system that was path dependent but with the significant design flaw of lacking an EU-level budget authority or anything in the EU budgeting system which required the BBR constraint to be respected: even where the BBR was breached there were no immediate contingencies for balancing the budget in the initial design. In a form of trial-and-error learning, budget reforms were introduced for various reasons at various times of budget crisis; the ‘softer’ or more politically palatable options were tried first, and when these failed to bring discipline to

the budget system (where failure was judged by the emergence of a new crisis), new reforms were tried. The accumulation of these additional budgetary institutions is the salient pattern of the institutional dynamics of the EU budget system.

In understanding the evolution of the EU budgetary institutional matrix, it is important to stress that the BBR, in combination with the OR system, ensured that negotiations between member states in the Council on changes to budget rules, or the introduction of new rules, were a zero-sum game. In response to budget crises, member states had two main preferences for institutional change: first, to optimize their net budgetary position and second, to ensure their budget position was relatively stable across time. Given the zero-sum nature of the negotiations, institutional change that satisfied the first type of preference for all member states was infeasible. However, an institution that achieved the second type of preferences was possible. The data presented in Ackrill and Kay (2006) show a secular decrease in the volatility of annual net budgetary positions for almost all member states. This was the key microfoundation in the agreement of options for budget reform.

THE DEVELOPMENT OF THE EU BUDGET SYSTEM, 1970 TO PRESENT

The incomplete set of initial EU budget rules was exposed by the use of price support instruments in the CAP that stimulated agricultural production and caused surpluses, with the corollary of increased budget spending. The control of CAP expenditure is crucial in the narrative of the development of the EU budget system. The operation of the CAP precipitated regular crises in the budget of the EU, and a series of institutional changes in the budget process that failed to ameliorate the outstanding problem of the incomplete set of initial budgetary institutions: the lack of a ‘hard’ and enduring financial constraint in the CAP decision-making process.

Price support, the dominant form of agricultural support until 1992, operated by maintaining market prices at levels higher than those prevailing in the rest of the world. The associated instruments had various consequences for the EU budget. Cheaper imports below the ‘threshold’ price were prevented from entering the EU by means of the VIL, which then passed to the EU budget. On the other hand, exports to third countries required subsidies (or restitutions) to make them competitive with cheaper third country supplies. These subsidies came from the EU budget.

As production rose, the EU market price was driven down. A system of intervention storage was thus established, so that if the market price fell below the target price set by the CoAM, farmers would receive a guaranteed

minimum price by selling to the government instead. The associated costs again came out of the EU budget. Moreover, intervention was key to farmers having an incentive to produce ever greater quantities: the higher market price would only translate through to higher revenues if farmers could sell their produce. Intervention not only guaranteed a price above world levels, but also offered a guaranteed buyer. Price support drove up production, which drove up surpluses, which drove up budget costs. In addition, higher EU production reduced imports, lowering VIL revenues to the EU budget.

Given the nature of CE, the EU could not stop exporting surpluses and/or buying them into intervention just because spending was rising. The only way to alter the trajectory of CAP spending, therefore, was to change the expenditure-inducing policy instruments: that is, reform the CAP. Chapter 6 presented the dynamics of those reforms; here I examine them in terms of the budget system.

In 1979, the first year the EU's OR system operated in full, spending required a VAT call-up rate of 0.78 per cent. The Commission had already begun discussing options for future financing, given that the CAP was driving total EU spending towards the OR ceiling, as defined by the 1 per cent maximum VAT call-up rate. The institutions governing own resources were 'softer' at this time, in the sense of being flexible in periods of fiscal exigencies to accommodate the consequences of CoAM decision-making. For example, by 1983 a combination of surpluses and low world prices saw claims on the VAT resource rise to the maximum 1 per cent, but this limit was respected only by carrying over ECU825 million of spending (more than 3 per cent of the 1983 total) to the 1984 budget. This was unsustainable and in both 1984 and 1985 the EU budget, technically bankrupt, required additional payments from the member states to keep operating.

THE FONTAINEBLEAU AGREEMENTS, 1984

Amidst this budget crisis, the first significant reform of the CAP was agreed, and concentrated on the dairy sector, which was taking over 40 per cent of CAP spending and 30 per cent of total EU spending. The Fontainebleau European Council Summit of June 1984 also approved three key budgetary measures. First, agreement was reached in principle to raise the VAT call-up rate to 1.4 per cent. This was a budgetary institution that could be changed relatively easily, as opposed to the BBR that was entrenched constitutionally. Second, following years of dispute over the magnitude of the net contribution paid by the UK (and four years of ad hoc compensation payments), a formula was agreed to return back to the UK two-thirds of its net contribution each year (implemented via national VAT contributions). Recognizing that

Germany was the largest net contributor, its contribution to the UK rebate was reduced by one-third (with the additional cost shared among the other member states). Third, in response to concerns over the unrestrained growth in spending, general guidelines were produced for 'Budgetary Discipline', transformed into several rules in December 1984. The most important of which were that the Council of Finance Ministers should set a reference framework for total expenditure, with other Councils asked to ensure that their decisions respected this, and that the growth rate of CAP spending should not exceed the growth rate of own resources.

This was the first public recognition of the design flaws in the initial framework; that the BBR was an incomplete institution without the complementary institutions to control expenditure. There was however no incentive for other Councils, most notably CoAM, to respect the spending guideline. As a domain constraint, Budgetary Discipline remained flawed: there were no institutions proposed or agreed that gave effect to the agreed spending limits. In terms of this development as an example of evolutionary policy learning, this was the first of a series of reforms that failed to institutionalize mechanisms to limit expenditure by Councils and respect the fiscal constitution of the EU.

THE BRUSSELS AGREEMENTS, 1988

By 1987 deep concerns were emerging within the Commission about the budget: 'the Community is at present faced with a budgetary situation which can only be characterised as being on the brink of bankruptcy' (Commission of the European Communities 1987, p. 1). Prominent actors outside the CAP system began to interpret the situation as undermining the ambition to complete the Single European Market, limiting the scope for developing existing, non-CAP policies (notably regional policy) and restricting new measures (such as research and development). President Jacques Delors, supported by an inner circle of the Budget and Agriculture Commissioners, prepared a package of measures, agreement on which was forthcoming in Brussels in February 1988.

Some of the measures addressed directly the shortcomings of the 1984 Budgetary Discipline agreement. The reference framework from 1984 was hardened into a five-year 'Financial Perspective', which set out EU spending in total and was disaggregated by main policy area. These have been agreed subsequently every seven years, on average, and have become a key feature of the EU budget process. Spending was allowed to rise to enable the EU to accommodate its changing policy priorities. In particular, spending on regional policy was to double, to 25 per cent of the total by 1992, whilst CAP spending,

though allowed to rise in absolute terms, would fall as a percentage of the total. This was all negotiated within a controlled rise in the total own resources ceiling. Starting at 1.15 per cent of EU GNP in 1988, it rose to 1.20 per cent in 1992 and continued through the second Financial Perspective, to reach 1.27 per cent of GNP in 1999. It has remained at this level ever since, although a technical change was made recently, with this sum now expressed as 1.24 per cent of Gross National Income. A fourth own resource, based on relative GNP, was introduced and could be used to top total own-resources up to the specified maximum.

Moreover, the Financial Perspective was presented through an Inter-institutional Agreement (IIA), a device that has become an increasingly important element of budgetary planning and that was crucial in completing the institutional matrix of the EU. A key feature of the IIA was that it was binding on all members of the Budgetary Authority (Commission, Parliament and Council). Any changes to the Financial Perspective have to be agreed by all three – other than annual technical adjustments to real-terms spending limits to allow for inflation and GNP growth. Furthermore, the Council and Parliament are bound by the maximum rates of increase for NCE laid down in the IIA.

Monar (1994, p. 698) argues: 'IIAs establish rules and principles which – if effectively complied with – will limit the future freedom of action of the institutions.' The subjunctive is critical; problems remained, most notably with the agricultural guideline, which was left as an incomplete institution after both the 1984 and 1988 agreements on Budgetary Discipline. The 1984 agreement was ineffective as it failed to impose a binding obligation on CoAM to respect the guideline. Even though the 1988 reform reduced the permitted growth rate of agricultural spending to no more than 74 per cent of the growth rate of EU GNP, once again it was not accompanied by the imposition of a direct domain constraint, making its enforcement just as unlikely as the 1984 agreement.

There was also in 1988 a simultaneous attempt to control CAP spending directly via the 'Stabilizers' reform. The initial proposal was for price support levels to be cut should spending exceed a certain 'trigger' level; however, as this proved unacceptable politically, a production trigger was agreed instead. When production activated the trigger, that is, it exceeded a certain level expressed in terms of total EU production, automatic support price cuts would be imposed the following year. There are, however, various reasons why this was inadequate, most notably because CAP support prices were typically 40–60 per cent above world levels, yet the Stabilizer-induced price cut was limited to a maximum of 3 per cent – and for some commodities prices were restored the following year if the production trigger was not reactivated. The fundamental basis of support thus remained unchanged, as did the trajectory of CAP spending. Thus the 1988 CAP reform too failed to impose an effective

domain constraint on CAP spending; in terms of the ‘trial and error’ development of the EU budget system, neither the budgetary nor CAP reforms of the 1980s imposed an effective procedural constraint, nor a domain constraint, on CAP spending. Indeed, the term ‘domain’ is doubly appropriate given that CAP spending remained the unchecked domain of CoAM, despite the terms of the relevant Budgetary Discipline criterion. Thus, by 1992, the EU was facing another budget crisis.

THE ‘MACSHARRY’ CAP REFORM, 1992

This 1992 reform, named after the Agricultural Commissioner of the time, Ray MacSharry, remains the most far-reaching CAP reform. It included a substantial weakening of the production (and spending) incentives of price support. Simultaneously, it imposed domain constraints on CE and the budgetary freedom of CoAM. The timing and direction of reform were also motivated by pressure on the EU through the Uruguay Round of GATT trade talks. Under such pressure the decision was taken, first, to reduce high support prices not by 3 per cent but by about 30 per cent. Second, replacing high prices as the main instrument of farm income support would be direct payments to farmers based on historical production levels. The payments for beef production contained a limit on the total number of animals eligible for support. For the arable area payments there were two limits. First, the yield figure used to convert the per-tonne figure (derived from the initial price cut) into a per-hectare payment was fixed in terms of data from an unchanging reference period; there was also a limit on the area eligible for payments.

It was in the design of these payments that the key budgetary change was made. A direct payment to farmers as compensation for price cuts allowed a spending limit to be defined *ex ante*; this acted as a domain constraint on CAP spending and for the first time in the history of the CAP meant that support payments were closed-ended rather than open-ended. The two alternatives to direct income payments as methods of imposing financial discipline carried significant political costs: agreeing a new definition for CE required a Treaty change and challenging the classification of CAP spending as Compulsory would have ignited Council–Parliament feuds over budget control.

The MacSharry reforms stand out in the history of CAP reforms in finally limiting the discretion of the CoAM to agree expenditure without reference to a wider budget system; the direct income payments were set in the context of the agricultural guideline, itself agreed in terms of the five-year Financial Perspective premised on the BBR. The creation of a link between the BBR and agricultural spending amounts to the completion of the institutions of the initial budgetary framework.

HARD, BINDING CONSTRAINTS?

EU spending (as a percentage of GNP) rose through the first two Financial Perspectives. Since 1999, however, the spending ceiling has remained at 1.27 per cent of GNP (1.24 per cent of GNI). Wallace and Wallace (2000, p. 230) suggest this is because further increases ‘would have required ratification by national parliaments and might have prompted acrimonious domestic debates on future financing’. Indeed, instead of seeking to spread a larger budget over more policies for a given membership, the EU budget debate shifted to how to keep the budget size and policy coverage constant whilst EU membership rises. In agreeing the Financial Perspective for 2000–2006, the European Council reduced the level of spending proposed by the Commission under every heading (Wallace and Wallace 2000, p. 232). Moreover, whilst the own resources ceiling was held at 1.27 per cent of GNP, the margin for unforeseen spending, previously stable at about 0.03 per cent of GNP, ranged in the initial Perspective for the EU15 between 0.08 per cent and 0.15 per cent of GNP. Thus, as a percentage of GNP, planned spending fell significantly.

The 1999 IIA also changed the decision-making procedures to make it harder for spending to be increased, even within the margin for unforeseen expenditure. This limited still further the room for manoeuvre within the EU budget system. For an increase of less than 0.03 per cent of GNP the Council votes by qualified majority voting (QMV), with Parliamentary approval needing a majority of members with three-fifths of votes cast. For spending rises greater than 0.03 per cent of GNP (but still within the permitted margin) Parliament and Council must agree, but with the Council acting unanimously.

Agreed as part of the 2003 CAP reform, and effective from the start of the next Financial Perspective in 2007, a further domain constraint has been imposed on CAP spending: if forecast CAP spending exceeds its guideline by more than €300 million, the Commission must propose cuts to direct payments to ensure the guideline is respected. This serves to harden the constraint on CoAM by making explicit the contingency if the CoAM had agreed a level of expenditure, which remains defined as Compulsory, above the guideline. Under price support, this direct control of CAP spending had been incompatible with the definition of Compulsory Expenditure.

SUMMARY

Institutional reform can have extremely high political costs, in terms of the bargaining of agreement on a new institution, the switching costs from old to new, and the transaction costs of adapting to and learning a new institution. These costs are also subject to an increasing returns process; the more

institutions that are designed and agreed within an institutional framework or configuration, the less costly it is for subsequent and additional institutions to be agreed within that framework. In this chapter, the notion of path dependency has been used to narrate the history of reforms to the EU budget system from its foundational institutions as laid down in the 1957 Treaty of Rome.

I have sought to draw upon theoretical developments in the first five chapters of the book in order to provide a fine-grained analysis of the development EU budgetary institutions. This has emphasized the ‘stresses’ in the initial design of the budget system working themselves out in different fiscal and political contexts as the inter-temporal connection between reforms of EU budgetary institutions. It is only by adopting a dynamic perspective that it is possible to trace the emergence of the political significance of the gaps in the initial institutional structures of the EU budget and how various budget crises precipitated unsuccessful efforts at remedial action. I have characterized this sequence of reforms as a form of evolutionary learning process that lead to the accumulation of layers of institutions that only provided a complete system of budget institutions when the politics of the CAP allowed the agreement of a direct income payment policy instrument that could then be used to impose a financial constraint on CoAM decision-making.

A key point in the narrative is that whilst the 1988 reforms to the EU budgetary process were profound, it was not until the 1992 CAP reform that the significant gap in the institutional framework of the EU budget was plugged: the need to respect one of the original budgetary constraints set out in 1957: a balanced budget for the EU. The new institutional framework has created a much more stable budgetary process than was seen previously. Despite this, the recent agreement on Financial Discipline as part of the 2003 CAP reform indicates that, in an evolving structure such as the EU, new problems can emerge, requiring the introduction of yet more institutions. As noted previously, policy history is history that ends in the present or near past. This makes any narrative explanation presented especially vulnerable to the emergence of disconfirming evidence. Thus, the structured narrative presented here that concludes that the EU has a complete set of budgetary institutions because it has a clear institutional link between the BBR and agricultural spending may be premature.

7. The Common Agricultural Policy 1977–2003

The Common Agricultural Policy (CAP) has been a continuous presence since the inception of the European Economic Community and in key aspects has remained resistant to substantial reform. As a complex policy system, the CAP provides a difficult empirical challenge to dynamic analysis. The preceding chapters have established that viewing policy as a composite whole or system is an appropriate theoretical starting point for a dynamic perspective on policy development. The empirical challenge is that of microanalysis: how to analyse the constituent elements and their interrelationships in the context of an overall identity for the system, marked by a point position in policy space. In other words, how is a multi-commodity, multi-level and multi-national policy ‘whole’ operationalized as a variable? What measures or indicators may be used to trace or map a path through policy space that can be used to structure a narrative?

This chapter aims to address these difficulties through examining a series of CAP reform events, from 1977 to 2003, in terms of the CAP as a composite variable. This structured narrative shows that reforms of the CAP over time, when viewed at a system level, have occurred within a path-dependent process; but simultaneously and within the CAP system over this period a multitude of processes at different temporal scales can be observed. The chapter suggests a microfoundation to the path-dependent process in terms of situated agency: the protection of the net budget position of member states with respect to the CAP as an objective for national governments bargaining within different councils of ministers. The data on distribution of CAP-related budgetary transfers across member states over time as the EU has enlarged and the CAP reformed have shown great stability.

PATH DEPENDENCY AND THE CAP

As noted in Chapter 1, it is possible for a composite system to maintain its identity even where some of its parts are changing or being replaced. Thus, even if we decided that the CAP as a policy system was path dependent, this would not preclude change in the constituents of the system or their

interaction. This reintroduces the philosophical question of changes in kinds and changes in values: at what point do changes in the constituents mark a change in the overall system? This open, and ultimately empirical question, affects how a narrative is structured. I make a start by delineating a policy system from its environment and, following economists, label the environmental parameters as exogenous, distinct from the endogenous variables that are determined by the internal workings of a system. The distinction is pragmatic and synthetic; imposed by the scholar structuring the narrative to facilitate analysis. It points out at least one way of identifying a change at the policy system level, or a change in kind: by establishing a synthetic endogenous/exogenous barrier, any temporal point at which environmental factors that were previously assumed in the analysis to be relatively fixed and external to the policy system become part of the policy system marks a change in that system. In economists' terms, the endogenization of a variable necessarily involves system-level change. The endogenous/exogenous barrier varies temporally and any structured narrative should reflect this, as where the financial actors in the CAP policy system have had an epiphenomenal influence in terms of temporally specific reform episodes but were not institutionalized as a permanent interest in the CAP policy system until much later.

There are several dimensions to the CAP: its objectives; its effects; the different instruments and their levels; the different commodities; and its policy process. There is no straightforward or automatic method for constructing a single, holistic variable – the CAP – from these different dimensions. Indeed, analysts will weight different components of the CAP differently, when forming an overall CAP-level view. This is why, for example, some authors (such as Ackrill 2000a) consider the 1992 reform as radical, whilst others (such as Kay 1998; Daugbjerg 1999) suggest it falls some way short of that.

In understanding the composite variable, the CAP, as path dependent the starting point is to consider how the policy, as initially established, limits future policy options by creating a particular incentive structure that influences political and economic behaviour. I do not detail the establishment of the CAP here, but note that the CAP took shape under various pressures, including post-war food shortages and constitutional foundations laid down in Articles 38 to 43 of the Treaty of Rome, which included three 'pillars' of the CAP: a single market, community preference and financial solidarity. The various reasons why price support emerged as the dominant policy instrument are connected with the problems of the main alternatives, especially direct payments: political (opposition to the CAP offering 'social' payments), administrative (there were many more farmers in the late 1950s) and economic (the EU budget, at the time, could not have coped with the cost).

Chapter 4 provided the insight that narratives of policy development should

focus on the internal dynamics of a policy system as well as the system's interaction with the external environment. The development of the CAP has been driven by the consequences of certain design features of the price support policy, all of which were foreseen at the time (European Commission 1958, p. 70): the direct link between production and support stimulated production and, through high prices, contributed to the suppression of demand growth. As surpluses emerged so the impacts of price support on the EU budget became apparent, in the form of the revenues from variable import levies (later import tariffs) and the costs of dealing with surpluses – export subsidies and intervention storage. Moreover, a certain policy-contingent pattern began to develop in the distribution of these budgetary transfers across member states: net exporters gained from the surplus-related transfers from the EU budget, whilst net importers faced greater transfers to the EU budget (through the levy/tariff). Further, as the underlying basis of support remained unchanged until at least 1992, the consequence was a continual rise in budget costs that have been observed as policy encouraging higher production and (sooner or later) surpluses. Those initially gaining from the budget continued to do so (net exporters did not suddenly become net importers), but more countries joined them in becoming net exporters.

CAP reforms have traditionally been agreed unanimously. The ability of a single member state to veto a reform proposal tends to favour the status quo, whilst the willingness to support change will be influenced, in part, by how EU member states view the CAP transfers they receive from the EU budget. Later in the chapter the view of member states as agents adopting positions in EU negotiations solely in terms of the net transfer they obtain through the EU budget is examined. Net budgetary beneficiaries will often oppose CAP reform, whilst even those seeking reform will not pursue options that see their receipts fall. Total CAP spending will, therefore, tend to be maintained even if some elements of the policy are altered.

SELECTED KEY FEATURES OF CAP REFORMS

Since 1977 CAP reforms have generally been the result of pressures from one or both of two sources – the EU budget and, more recently, international trade negotiations. In these cases, environmental parameters that had been previously fixed and external to the CAP system for the purposes of analysis become crucial influences in the CAP policy process and associated with system-level change. With the former, the problem lies with most CAP spending being defined as 'Compulsory', meaning all CAP expenditure obligations must be met, regardless of the overall situation facing the EU budget. This would not of itself be a problem (ignoring the issue of judging an

‘appropriate’ level of spending) were it not for the presence of a balanced budget rule. The effect of this rule is to mark a point, defined in terms of revenues, beyond which spending cannot rise.

However, price support generated rising export refund and intervention storage costs because the wedge between EU and world prices encourages higher production and, sooner or later, surpluses (an incentive structure that is unaffected by marginal changes to the size of the price wedge). Central to the incentive to produce is the role played by the intervention system in guaranteeing farmers an outlet for surplus production, however much is produced. As spending rises, the BBR imposes an effective limit. Given the nature of CE (and the centrality of high prices and intervention to the execution of Article 39), the necessary response to rising spending is a change in the policy – the ‘tap’ of CE cannot simply be turned off if the revenue limit is reached. Price support thus contained an ‘open-ended’ commitment.

The budget pressure on the CAP therefore arises from a combination of the budgetary consequences of price support and two endogenous budget-related rules agreed by the member states – the definition of CE and the BBR. The second pressure on the CAP comes from other countries through the GATT/WTO where some, but not all, forms of agricultural support policies have been challenged. Policies which distort trade (including price support) are opposed, whilst other policies that support farming incomes but as far as possible de-couple support and production are acceptable. This issue is considered later.

REFORMS BEFORE 1992

The reform options facing the EU were various: leaving price support intact, supplementing it with extra policy instruments; reducing price support levels with larger cuts accompanied by alternative income-support instruments; through to replacing price support totally. In this section we look at CAP reforms in the context of the EU budget reforms of 1984 and 1988, which, as noted in the previous chapter, altered the environment in which CAP-related decisions were taken. This was the first occasion where actors concerned with the budgetary consequences of the CAP entered into the CAP policy system. However, their influence was limited to specific reform episodes and was not permanently institutionalized.

Principles of Support

The basic principle of the CAP, the constitutional commitment to support agriculture set out in Article 39 of the Treaty of Rome, has remained

unchanged since 1958. Moreover, most reforms prior to 1992 left the underlying principles of price support intact. The one notable change to price support (agreed in 1988) was an automatic price cut if production exceeded a 'Maximum Guaranteed Quantity'. Some of the 'reforms' shown in Table 7.1 merely limited the extent of price rises (notably Guarantee Thresholds), whilst even when support prices were cut (for example, through the cereals Co-Responsibility Levy (CRL) and Stabilizers) the reduction was modest. Given that the margin of EU prices over world prices was often in excess of 50 per cent, the fundamental basis of policy and the resulting production incentives remained unchallenged.

Table 7.1 CAP reforms before 1992 – a summary of key features

| Date | Reform | Description | Pressure | Binding? ¹ |
|------|--|---|----------|-----------------------|
| 1977 | Dairy Co-Responsibility Levy (CRL) | Producer levy (max. 3% of target price) | Budget | No |
| 1982 | Guarantee thresholds (multi-commodity) | Negotiated cut (max. 5%) in support prices if production exceeds specified amount – after 'normal' price rise is agreed | Budget | No |
| 1984 | Dairy production quotas | 100% super-levy if production exceeds specified amount | Budget | Yes |
| 1986 | Cereals CRL | Producer levy (3% of intervention price) | Budget | No |
| 1988 | Stabilizers | Automatic cut (max. 3%) in support prices if production exceeds specified amount (plus additional CRL) | Budget | No |

Notes:

¹ A constraint is defined as binding if the need for reform is immediate.

Of the reforms shown in Table 7.1, dairy quotas stand out as the only one to limit spending by building some kind of constraint (production) into CAP policy instruments. In 1988 the original stabilizer proposal had been for a spending-based trigger, but this direct control on spending proved unacceptable politically. Thus, other than for the dairy regime, CAP support has remained open-ended. As set out in Table 7.1, dairy quotas were the only

reform enacted under binding pressure, created by the BBR. Spending had exceeded the revenue ceiling in 1983 but over ECU800 million of CAP spending – and the ensuing crisis – were merely delayed by transferring them to the 1984 budget.

Path dependency can be used to structure a narrative of these changes in terms of the price support system limiting the options for reform. Moreover, the changes that have been introduced have reinforced the development of the CAP along its existing, particular path. Notably, the underlying operating principle of quotas – production in excess of a certain quantity triggering a financial penalty – was the same as Guarantee Thresholds, the difference being the size of the penalty. This also implied continuity in administration, with some tasks also devolved to the member states, or even to individual dairies. Moreover, quotas were chosen over two alternatives, a rise in the CRL and a cut in the intervention price, on the basis that these would have undermined the principle of price support.

Support prices remained high with quotas. Indeed, domestic politics, especially in Germany, meant that retaining high prices was a prerequisite for securing the 1984 reform agreement. By containing spending quotas also targeted the one binding constraint, thus winning support from those countries concerned by rising CAP spending. Quotas thus reconciled member states whose positions were otherwise mutually exclusive. Although spending growth was contained by quotas, spending levels were only reduced subsequently as quota levels were reduced. In the meantime the spending limit was again breached in 1985, the deficit covered by additional payments from the member states. From 1986, a previously agreed rise in the spending limit helped restore budgetary balance.

A feature common to both the 1984 and 1988 reforms was the non-exclusivity of the policy network driving change. Until then, the perception was that the Commission and CoAM worked in a closed system with farmers and agri-business interests to shape policy. Further, as noted in Chapter 6, the financial system of the EU worked in a manner that accommodated the financial consequences of CoAM decisions. As the BBR was threatened then breached, the influence of the Budget Commissioner and national Finance Ministers became prominent in the CAP policy system. Moyer and Josling (1990, p. 70) described an ‘inner circle’ of Commissioners, appointed in 1985, who drove the 1988 reforms – Commission President Jacques Delors, Agriculture Commissioner Frans Andriessen and Budget Commissioner Henning Christophersen (and their cabinets).

Given this composition and the role the budget played in forcing CAP reform, it was no coincidence that 1984 and 1988 also saw changes to the budget and budget process. In 1984 it was agreed to limit annual CAP spending growth to 2 per cent. This formal institution could have represented

a significant change in the direction of the CAP, but without a formal mechanism to enforce this, spending rose by an average of 18 per cent a year between 1984 and 1987. In terms of the narrative, the position of the Budget Commissioner and national finance ministers in the CAP policy process was epiphenomenal. In 1988 a wide-ranging budget reform was agreed, which included the introduction of multi-annual Financial Perspectives. This made spending limits more transparent, but again there was no new institution to help contain CAP spending. A more detailed narrative than the one provided here would explore why the position of budget actors was not institutionalized, but for our purposes the path dependency concept in which the institutionalized price support system drives policy dynamics can make sense of the evidence.

THE 1992 CAP REFORM

The main features of the 1992 reform were substantial cuts in the level of price support, with the negative impact on farmers' incomes offset by direct payments that were partially de-coupled from production. Large arable farmers were also asked to set aside part of their land: they were not obliged to, but if they did not then they would not receive the direct payments. This reform does question the idea of the CAP as path dependent; for the first time there was a significant reduction in prices. However, the option of totally replacing price support in 1992 was opposed by some member states on the grounds that it would represent the ending of one of the three founding pillars of the CAP – Community preference. Although not a formal *de jure* legal requirement for the CAP, it has *de facto* been treated as one by these member states. The alternative of reducing price levels significantly, but accompanied by compensation payments, was the politically feasible option.

In the 1984 reforms, there was one binding pressure (budget costs rising beyond the spending limit) and quotas addressed only that – all other elements of the CAP remained fundamentally unchanged. The 1992 reform can be understood in a similar manner, this time in terms of two binding constraints, the confluence of which created a policy window. Key actors in the policy system agreed that change was required, but a combination of external and internal forces directed that change in one of a limited range of directions. Once again budget costs were threatening the spending limit. In addition, there was pressure through the GATT to address trade-distorting agricultural policies. In terms of the budget constraint, despite the 1988 reforms to budget and CAP, there was nothing explicit in the latter reform to contain CAP spending. Price support cuts of 3 per cent left the basic policy

fundamentally unaltered, maintaining upward pressure on surpluses and expenditure.

However, the international trade constraint was new and focused on the trade-distorting elements of the CAP. The main focus of international pressure for CAP reform was the high level of support prices, and this acted as a constraint that proscribed maintaining the status quo of EU prices significantly above the world price. This set the basic environmental parameters within which reform could be enacted. The response to the budget pressure was the large (30 per cent) cut in support prices and the introduction of compensation payments. Crucially, these payments could build-in both spending limits and a degree of de-coupling of support from production. Indeed, it was the way in which the spending limits were designed that contributed to the (partial) de-coupling of the payments. The arable area payments used a fixed yield figure based on past yields and imposed a limit on the area of land eligible for support. The beef payments were limited in terms of the number of animals eligible for support. In this way, the reform curtailed considerably the degree to which CAP support remained open-ended.

Despite this, the new payments were not without their problems. Replacing price support with direct payments inevitably increases the budget cost of the policy, as the high prices paid by consumers are replaced by taxpayer (budget) costs. However, the shift to direct payments led to a one-off rise in the budget cost of the CAP, but subsequent spending levels have been much more stable (due to the changed basis of support and built-in spending limits) and, moreover, remained within the constraints set out in the Financial Perspectives. As such, support for this reform could be gained from countries concerned about the budget costs of the CAP.

The main trade concern was not the level of spending on the CAP per se, but on the trade-distorting elements of the policy. Even though the new payments broke some of the links with production, the separation was only partial. As a result, it is interesting to note that the new payments did not conform to the then GATT definition of (fully de-coupled) Green Box policies that would automatically shield the payments from reduction. Instead, it required bilateral talks between the EU and USA to develop a completely new definition for partially de-coupled support (the so-called 'Blue Box') to protect new payments.

A further benefit of direct payments was the previous experience of the EU in managing this type of policy instrument. As the reform proposals were being discussed, the EU was required to reform the oilseeds regime, as a result of an adverse GATT ruling on the trade-distorting features of the previous policy under extant GATT rules. The EU replaced this with area-based direct payments to producers. The reformed policy was not entirely to the liking of GATT but the revised version, tweaked slightly and incorporated into the

wider 'arable' regime in 1992, was accepted. The EU was, in effect, able to use the oilseeds reform as a test bed and precedent for the arable sector reform.

The 1992 set-aside provision also developed from pre-existing CAP instruments. A voluntary set-aside scheme was first introduced in 1988. It was then extended by the 1991–92 price package, when (large) cereals farmers could gain exemption from a 5 per cent CRL if they set aside 15 per cent of their land. Both the 1991 and 1992 changes kept set-aside participation voluntary – but they progressively raised the cost of non-participation.

REFORMS SINCE 1992

The 'income support' element of the 1999 reform built upon the 1992 reform to reduce further the level of support prices, and raise higher the level of direct payments. The latter change, however, covered only 50 per cent of the price cut, mitigating some of the budgetary effects of the change. A second element of the 1999 reform drew together the disparate components of agricultural 'Guidance' policy into a new Rural Development 'Pillar II' of the CAP. This was given 10 per cent of the CAP budget and, for the first time, 'Guarantee' money could be used for 'Guidance' policies. For example, member states could opt to top-slice some of the direct income payments and recycle the money into Rural Development ('modulation'). Since Pillar II requires national co-financing, modulation is a way of raising CAP spending without threatening the EU spending limit. The combination of modulation and the partial compensation of price cuts also broke the link between specific price cuts and specific 'Compensation'. As such, the support system introduced in 1992, based on direct payments, was confirmed as a general shift in the way the CAP supported farm incomes.

The main element of the 2003 reform was the introduction of the decoupled Single Farm Payment (SFP). Agreement was not forthcoming to convert all the pre-existing direct payments into SFPs, but initial estimates suggest about three-quarters will be converted. The timing of these reforms is important, occurring during the Doha Round of WTO talks. Whilst other countries in those talks would prefer all payments to be decoupled, this reform, adapting the majority of CAP 'Blue Box' payments, offers the basis for a compromise agreement. On the other hand, one proposal from 2003 that was not accepted was the 'final' 5 per cent cut in cereals support prices, being a step towards the final removal of 'Community Preference'. Given the strength of other countries' opposition to the continued use of price support, it is this element of the CAP that continues to raise serious concerns for agreement in the Doha Round.

MICROFOUNDATIONS OF CAP DEVELOPMENT: THE DISTRIBUTION OF CAP SPENDING

Commitment to the CAP and its principles has remained unaltered since the 1950s. Article 39 is unchanged and two of the three original pillars of the CAP have remained unchallenged. Community Preference has been eroded but it still survives and, for some commodities, at very high levels. The commodity coverage of Guarantee support has also been maintained, with support for sheep production introduced in 1980. Moreover, until 2004 each new country joining the EU had the CAP extended to it in full, in terms of both the support instruments and level of support. With the latest enlargement, ten countries joined but the total EU spending limit has remained unchanged. The new member states have received all CAP instruments but not the full level of support. Price support was extended in full, given its relevance to the Single European Market, but direct payments have been extended initially at reduced levels (to be phased in over ten years) given EU15 budget concerns, whilst Rural Development support is effectively treated as NCE, extended to the new member states at a level that ensures the overall EU25 budget spending limit is respected. As a result, whilst the CAP remains ‘Common’ in terms of support instruments offered, it is not so regarding levels.

Earlier it was noted that the 1992 reform is viewed as ‘radical’ by some observers but not by others. Those in the former group who have so judged this reform have based this opinion largely on two aspects: the huge reduction in the level of the preceding support instrument (price support) and the closing of open-ended support. Although the 1992 reform applied principally to just two sectors (arable and beef), their combined cost represented over 60 per cent of total CAP costs in 2001, with over 90 per cent of those costs being direct payments. The narratives that do not judge the 1992 reform as radical have focused more on the continued level of support under the CAP. Daugbjerg (1999, pp. 415–16) notes, for example, a large share of farming incomes still derived from government policies. Other empirical works show not only how little the level of support changed with the 1992 reform but also the marginal shift in the distribution of support by member state, the extent of the change to support instruments notwithstanding (Ackrill et al. 1997).

The importance of the budget in the narrative encompassing both the occurrence of reforms and the timing of reforms has been highlighted in this chapter; it provides the situational context in which to interpret the actions by member states in the CAP policy process. This prominence is a result of the combination of the BBR, the definition of CAP spending as ‘Compulsory’ and the budgetary impact of certain income support policies. This offers an insight into path dependency as an organizing concept for structuring the narrative of CAP development.

Most of the empirical applications of path dependency to policy or institutional development view changes in kind, where a path breaks or varies significantly in direction, as the result of external shocks where environmental parameters change dramatically. With the CAP, however, change is forced by endogenous factors – the coupling of support and production under price support increasing EU expenditure, that at certain temporal points has threatened the viability of the EU budget process and brought Budget Commissioners and national finance ministers into the CAP policy system. The original CAP thus created periodic bursts of ‘crisis’ almost by design. Even so, whilst the only notable reforms to the CAP have been implemented in times of crisis, defined as times when pressures for reform have been binding, removing the status quo as an option, the policy is sufficiently multi-dimensional that much of the CAP has remained unaltered. For example, the 1984 and 1992 reforms both addressed specific pressures yet left support levels generally unchanged.

Once the CAP was established with price support as the primary tool, a certain pattern of budgetary transfers emerged. Ackrill and Kay (2005) present a simple analysis of the data on the distribution of support across member states. Since then, a working hypothesis is that member states that defend the CAP typically do well financially from the policy. For example, France has consistently received in excess of 20 per cent of total CAP Guarantee expenditures. Per capita transfers are substantial for both France and Ireland. For Spain there are less data to analyse, but by 2001 only France was receiving more money from the CAP, and their per capita transfers were similar.

Among the pro-reform countries both the UK and the Netherlands receive modest sums per capita – from the CAP and the EU budget as a whole. Germany follows the same pattern, although the German pursuit of CAP reform has been less consistent over time, balanced as it sometimes has been against preservation of the Franco-German axis. On the basis of CAP transfers, one outlier amongst pro-reform countries is Denmark, a rich country that does extremely well out of the CAP. If, however, net total budgetary transfers are considered, the set of pro-reform countries (now including Sweden) is somewhat clearer.

Ackrill and Kay (2005) examine in detail the stability of countries’ spending shares. This is a proxy for the dynamics of the CAP policy system. Briefly summarized, countries opposing CAP reform typically receive substantial absolute and/or per capita budgetary transfers. These countries, but especially France and Ireland, have not only defended their shares of CAP spending, but also reduced the variability of transfers over time. Those seeking CAP reform have, however, generally either faced declining shares of CAP spending and/or are significant net contributors to the EU budget and the CAP. In most cases they have also faced rising or unstable variability of transfers. The domestic

politics and history of Germany make for a complex attitude towards CAP reform (Wilson and Wilson 2001).

During the negotiations of the 2003 reform, countries opposing or supporting reform generally matched the foregoing classification closely. Moreover, when presenting the proposals to the European Parliament in 2002, Commissioner Fischler stated that by these measures ‘we intend to give consumers and taxpayers a recognisable service in return for the tax they pay’ (speech 02/330) – thereby seeking to justify the current level of transfers rather than seeking lower spending. Indeed the proposals were drawn up ‘with a view to achieving the objective of *stabilising* agricultural expenditure in *real terms*’ (European Commission 2002, p. 29, emphasis added).

As regards sums received by member states, the SFP is based on actual direct payment receipts over the period 2000–02, a move that will sustain the existing inter-country distribution of expenditures. Moreover one of the concerns expressed by member states over modulation, including pro-reform countries such as the UK, was that the recycling of money could also result in a redistribution between member states. Whilst the final agreement did not rule out redistribution, it did limit it. The first percentage point of the 5 per cent of direct payments to be modulated must remain in the source country and overall a minimum of 80 per cent of total recycled funds must remain ‘at home’.

A STRUCTURED NARRATIVE OF THE CAP

This chapter has presented a structured narrative of CAP dynamics in terms of how its origins have acted to constrain its subsequent development. An examination of several reform events from 1977 to 2003 in terms of the CAP as multi-component policy demonstrates that the fundamental principles of the CAP have remained unchanged, and that many of the reforms amounted to marginal changes in the value of the main policy instruments. In these terms, it is accurate to apply the path dependency label to the CAP as a single, composite variable with a particular direction of development over time.

On the other hand, it has also been noted that the combination of an accumulation of modest changes and the addition of extra elements to the set of policy instruments can create the conditions for a critical juncture, and possibly path-changing policy change. Examples of CAP changes in this regard highlighted in the chapter include: the progression from elements of the CRL and Guarantee Thresholds to the agreement on dairy quotas; the shift from negotiated price ‘cuts’ under Guarantee Thresholds to automatic price cuts under Stabilizers to the pressure for reform in 1992; the move from set-aside exempting farmers from the cereals CRL in 1991 to direct payment

cross-compliance in 1992; and from the reform of oilseeds direct payments to agreement on the new arable regime.

Typically, the literature on path dependence sees changes of kind (those that mark the end of or shift in path-dependent processes) as being driven by external shocks. The notable feature of the CAP policy system is that in the initial stages the EU budget constraint was exogenous to the CAP and the influence of budget actors in the CAP system was epiphenomenal, periodically triggered by budgetary crises caused by the price support, harvest yields and world markets bumping up against the fiscal constitution of the EU. Even after the involvement of the European Council in the reforms of 1984, 1988 and 1992 and the agreement of medium-term financial frameworks, there was no institutionalization of the budget interest in the CAP policy system. Only recently has this design ‘fault’ been corrected with recent CAP reforms that have built in spending limits.

But still a simple analysis of member states’ shares of CAP spending as a measure of path dependency shows they have been very stable over time, despite changes to the CAP. Two countries most closely associated with opposition to CAP reform, France and Ireland, stand out not only in terms of their gains from the CAP (in total and/or in per capita terms) but also in their ability to defend their spending shares even as the EU has enlarged, whilst managing to increase the stability of those shares over time (for example, the year-on-year data on relative shares have been much less volatile). Countries who support CAP reform tend to have more modest spending shares (in total or per capita terms) and also are characterized by shares that are falling or unstable over time. This has by no means precluded reform as the various reform events discussed in this chapter, especially that of 1992, have shown. What it has done, however, has imposed a quite specific and durable constraint upon the parameters within which reform can take place. This is the key situational logic through which member states interpret their roles as agents in the CAP policy process. Moreover, this is consistent with the observation of the breakdown of exclusive agricultural policy networks in several member states. Whilst the newcomers to the reform negotiations are non-agricultural, their interests are often financial and they too have an interest in maintaining CAP receipts.

The greatest threat to the spending shares of the EU15 came with negotiations for the 2004 EU enlargement. The outcome of the negotiations was inconsistent with many previous predictions but entirely consistent with the analysis presented in this chapter. The overall EU budget spending limit was left unaltered, despite ten new entrants. CAP spending in the new member states had, in effect, to be adjusted to fit into the ‘residual’ left once EU15 transfers had been accounted for – and effectively ring-fenced. CAP transfers in the new member states are, *de facto*, being treated as non-compulsory

spending, a move made easier by the switch from price support to direct payments. Some observers viewed EU enlargement as a way of forcing radical CAP reform because of the budgetary pressure that would result. The latest negotiations showed how wrong that view was. Moreover, the analysis here helps explain why the existing member states presented the accession package they did. Maintaining the existing distribution of CAP transfers for the EU15 was more important than maintaining the commonality of the CAP across all member states.

SUMMARY

I have presented a narrative in terms of the price support mechanisms of the CAP, and the financial and international trade consequences structured by the concept of path dependency. This is a single, coherent story that makes sense of the evidence of the budgetary consequences of the CAP and periods of CAP reform. However, the narrative misses other aspects of the development of the CAP, for example the increasing pressure at national and EU levels to take account of the deleterious environmental consequences of the CAP in policy considerations; or NGO campaigns around the disastrous consequences of the CAP for many developing countries reliant on primary commodity exports.

The question not addressed is whether these political discourses around the policy system are having the effect of gradually eroding the CAP policy paradigm. These gaps are in the nature of any structured narrative of the dynamics of a complex, multi-dimensional and multi-national policy such as the CAP; the constituents in the CAP system are in constant flux, its consequences are multi-faceted and spread out over a significant temporal scale. As established in preceding chapters, it is the nature of narratives of dynamics to be backward looking; changes in the CAP policy system are best judged retrospectively; and obviously the emergence of confirming evidence of the effect of environmental or development actors on the CAP policy system will affect the extent to which the structured narrative I have presented here is held as a valid or true explanation of the contemporary policy dynamics of the CAP.

8. The GP fundholding scheme

The Conservative government in the UK introduced a range of reforms in April 1991 to address a number of perceived weaknesses in the National Health Service (NHS) management structure; in particular, an allocation of resources that had been ‘... determined largely by the sum of the individualistic behaviour of individual doctors rather than through a hierarchical process of resource management’ (Wistow 1992, p. 59). The government attempted to compensate for the lack of ‘correct’ economic signals by introducing new incentive structures designed to encourage provider units and NHS staff to meet the ‘limitless demand’ for state-funded health care within a cash-limited, public budget (Thatcher 1993, p. 606). To this end the government introduced an ‘internal market’ for NHS services, which separated the purchasing and provision of health care interventions and allowed general practitioners (GPs) to elect to hold a cash-limited budget for the purchase of a limited range of secondary care, staffing and pharmaceutical services.

This chapter examines the conception, implementation and abolition of the GP fundholding scheme element of these reforms as an example of policy dynamics after the breakdown of a long-established policy community. This exemplifies a more general trend in the 1990s across several OECD countries of the break up of well-developed policy networks dominated by industrial actors, professional elites and bureaucrats, ushering in periods of instability in policy areas such as transport, agriculture, food safety and nuclear power. Health care policymaking between 1948 and the mid-1980s was a worked example of a policy community according to the widely-used typology provided in Marsh and Rhodes (1992, p. 25): there were two policy actors; membership was stable across time; there was a shared ideology expressed in an established policy paradigm around the values of the NHS; and other potential policy actors were excluded. This exclusion occurred institutionally through the Department of Health (DoH) giving formal recognition to the interests of doctors, and through a policy paradigm that stressed clinical autonomy in the implementation of health care policy and the delivery of health care services. Within the health care policy community, ‘... conventional wisdom has emphasized the dominant nature of professional rather than political or managerial influences ...’ (Wistow 1992, p. 51).

A defining characteristic of policy communities is stability over time. They are strongly institutionalized networks that structure the policy process in

terms of the rules of the game, privileging certain interests and supporting a dominant view of the world. Although the enactment of the 1991 NHS reforms, and GP fundholding in particular, is a useful temporal identifier for the end of the policy community in health care, the breakdown of a policy community was not a single event but rather a process of transition from a strongly institutionalized policy system to one that is less structured, more contested and prone to instability. Importantly, after the breakdown of a policy community there is no automatic institutionalization of a new policy community or the establishment of a fresh policy paradigm.

In the structured narrative presented in the chapter, the policy community and its ideational base disintegrated in a conflux of internal and external processes: budgetary pressures in the NHS; a perceived inability to satisfy citizens' rising demands for health care; an intense politicization of health in electoral terms in 1987; waning of trust among members; along with reduced expectations that the institutions of the policy community would be respected. The dynamics of the breakdown of the health policy paradigm in the UK was not a Kuhnian scientific revolution in the sense of an existing paradigm no longer explaining the facts, and where the weight of disconfirming evidence for a particular world view reaches a critical level where the paradigm collapses. Indeed Hall (1993, p. 291), who introduced the term policy paradigm, admitted that the notion of a narrow, cognitive frame that sets strict constraints on policy thinking is not universal: only in some cases is it 'appropriate to speak of a fully elaborated policy paradigm ... In others, the web of ideas ... will be looser and subject to more frequent variation.' Nevertheless, even in this latter sense, the concept of a policy paradigm is useful in structuring the narrative; it is the fragmentation of the policy paradigm after 1987 that triggered some of the key dynamics of policy development in the 1990s; a process of competing problems, ideas and policies.

In Chapter 4, it was suggested that the evolutionary metaphor is a useful way of organizing thinking about policy learning by distinguishing adaptation (learning that affects calculations about how to realize interests within the institutional structure of the policy community) from more complex learning where interests, identities or institutions are learned or constructed in the interaction of agents in the policy system. In the second sense of learning the problem situation is constructed in the interactions between agents, the negotiations of policy problems, policy solutions and criteria of 'success'. In alternative terms, learning is the process of agreeing standards for the intentional selection mechanisms that operate to 'weed' out policy failure; it is through this construction that policy paradigms, however narrow or loose, emerge and are institutionalized. This concept of policy learning is used to structure the description of the process of health care policymaking after 1989

and the introduction, implementation and eventual abolition of the GP fundholding scheme. There was no ready-made replacement for the health care policy paradigm that had underpinned the health policy community from the inception of the NHS in 1948 until the late 1980s. Without the policy community institutions, including the policy paradigm, the policy process was more fluid, more contested politically and ideationally; and the GP fundholding scheme episode resembles a mode of evolutionary learning process in this latter sense, rather than a technical, deliberative and evidence-based process based on shared values of the purpose of health care reform.

The chapter is in three parts. The first charts the fracturing of the health care policy community from the mid-1980s up to the introduction of GP fundholding; in particular how the institutions dissolved along with the trust between the government and the British Medical Association (BMA). The second section highlights the policy process around the GP fundholding scheme post-policy paradigm, emphasizing the ideological and political nature of policy contestation; there was no shift to evidence-based policymaking that might have revealed a coalescing of policy actors around a public management policy paradigm to replace the previous medical–professional one that had fractured in the late 1980s. As Hunter (1998, p. 133) puts it, ‘Health policy has been driven by a mix of ideology, fashion and pragmatism but never by evidence.’ This continued ideological contest was an important factor in why the GP fundholding policy was never institutionalized in its early period and subsequently proved vulnerable to reform and abolition. The third part charts the abolition of the scheme by the Labour government after 1997 and the transition to health care policy process under New Labour.

THE INTRODUCTION OF GP FUNDHOLDING

The ideas of Professor Alain Enthoven from Stanford University Business School and Alan Maynard, Professor of Health Economics at the University of York, were influential in the 1991 reforms. Neither had been part of the previous health care policy community and they viewed the NHS from an economics perspective. As a result of a visit to the UK during the mid-1980s, Enthoven argued that the funding arrangements for NHS hospitals lacked any incentives for them to improve the quality or the efficiency of the services that they provided (Enthoven 1985). Based upon this finding, the Conservative government attempted to improve the incentives for NHS hospitals by introducing an ‘internal market’ into the NHS, as part of the 1991 reforms. At a meeting arranged by the Office of Health Economics in 1985, Professor Maynard argued that NHS general practice also lacked the incentives to encourage GPs to control NHS costs and to make efficient use of public

resources. In response, he suggested that a system of budgets and associated incentives should be introduced into NHS general practice for a range of secondary care and pharmaceutical services. Although Enthoven did not envisage GP budget-holding as part of his internal market plans, Maynard's ideas were championed by Kenneth Clarke, the Secretary of State for Health, and consequently became a late addition to a package of NHS reforms (Lawson 1992; Klein 1995; Webster 1998a).

Details of the fundholding scheme were first published in the NHS White Paper *Working for Patients*, and the accompanying working paper, *Practice Budgets for General Medical Practitioners* (DoH, 1989a; DoH, 1989b). These documents outlined the basic regulations of the scheme and the entry criteria that practices wishing to attain fundholding status had to satisfy. Under the initial regulations, practices that attained fundholding status were allocated a cash-limited budget, which contained an element for: (i) the purchase of a defined group of elective hospital services (including diagnostic tests); (ii) the salaries of non-medical staff; and (iii) prescribing. The scheme allowed participating practices to vire funds between the various elements of the budget and to generate a surplus, which could be spent on improvements to practice services, staffing or premises. However, fundholders that failed to manage their budgets appropriately could be removed from the scheme and become subject to the same regulations as other non-fundholding practices.

Mrs Thatcher led the NHS Review that worked during 1988 to produce *Working for Patients* in January 1989. The Cabinet Committee that steered the Review was small and consisted of a few trusted ministers, advisers and civil servants. There was no representation of either the BMA or Royal Colleges (Klein and Day 1992). Further, there was no Royal Commission, which had been the traditional instrument of ensuring consensus between the government and medical profession. Klein (1995, p. 184) argues that '... in its style, though not in its outcome, the Review marked a brutal break with the past ...' and it was the deliberate exclusion of the medical profession in the policy process that was the 'brutal break'. As Smith (1993, p. 179) puts it, 'Doctors were no longer an essential partner in the development of health policy but a vested interest that had to be challenged.'

The immediate consequence was that the BMA launched a major publicity campaign during the summer of 1989 to discredit general practice fundholding and the opposition (the Labour Party) vowed to dismantle the scheme if elected into power. During the period 1989–91, the Labour Party and BMA worked in a 'curious and unspoken alliance' (Klein 1995, p. 192) in opposition to the proposals. The intensity of this political conflict between the BMA and the government has been compared with that involved in the setting up of the NHS between 1946 and 1948 (Wistow 1992; Klein and Day 1992). Despite the BMA's campaign, the GP fundholding scheme came into being in April 1991.

There was no compromise or negotiation between the government and the BMA over the operational details or implementation of the scheme (in contrast to the battles of 1946–48). The outcome of the political conflict is evidence that the medical profession ‘had lost their ability to veto change in the NHS’ (Klein 1995, p. 199).

The first part of this narrative of the GP fundholding scheme concerns how the policy community of the preceding 40 years had unravelled to the point where one of its foundational institutions – the privileged position of the medical profession – collapsed. The corollary of this was the unvarying political conflict throughout the history of the GP fundholding scheme, explored later in the chapter: its enactment, implementation, evaluation and eventual abolition.

THE POLICY COMMUNITY IN HEALTH CARE UP TO THE MID-1980S

One of the aspects that distinguishes a policy community as a network form is the existence of trust between its members; in particular, each actor trusts all other actors to observe its institutions or the rules of the game. This is a key theme in the policy community literature generally and analyses of the UK health care policy community in particular (Smith 1993; Wistow 1992; Hindmoor 1998). Hindmoor (1998) describes the development of trust between the BMA and the post-war Labour Government. He uses a simple Prisoners’ Dilemma (PD) game to illustrate how this trust supported a bargain between the two actors on the ‘rules of the game’. The 1946 National Health Service Act that set up the up the NHS provided an enabling framework for the establishment of a publicly owned, publicly funded health service. The Labour Government of 1945–50 relied on the medical profession for the implementation of the new NHS, and was required to concede to certain BMA demands because of the political and policy resources they enjoyed. The medical profession was regarded as the custodian of technical and specialist knowledge that was essential for the well-being of society, and the BMA was seen as apolitical (in party-political terms at least), helping to give the views of the BMA a moral authority and make them, potentially, highly influential in public opinion (Klein 1995). There was a clear interdependence between the Labour Government and the BMA in the NHS and the possibility for mutually beneficial political exchange.

In the familiar one-shot PD game, the Nash equilibrium point is (Defect, Defect), which means that neither the government nor the BMA cooperate with one another in terms of establishing the NHS. The problem is that there exists the outcome (Cooperate, Cooperate), which is better for both players

than (D, D). However, there are large transaction costs associated with negotiating, implementing and monitoring the agreement for both actors to cooperate. The emergence of trust between actors helps ameliorate these transaction costs as informal rules and tacit understanding emerge to support a (C, C) equilibrium. Hindmoor (1998) argues that the negotiations between the BMA and the government between 1946 and 1948 were a repeated PD game, in which trust emerged through the development of informal rules and tacit understandings to support a stable (C, C) equilibrium. A stable (C, C) equilibrium can be interpreted, in terms of the health care policy community, as each actor trusting the other actor to observe its emergent institutions over time.

There were two institutions that underpinned the operation of the health care policy community between 1948 and the mid-1980s. The first was that each actor should trust the other on both the process and substance of policymaking. Hindmoor (1998) and Wistow (1992) talk of trust becoming 'embedded' in the health care policy community. This trust supported a consensus on how business was to be conducted, as Jordan and Richardson (1987, p. 101) describe it '... the process by which and the atmosphere within which policymaking is decided'. In particular, this meant the exclusion of other potential interests in health care policy, for example public opinion, Parliament, the rest of Whitehall and hospital managers. Ham (1992), Webster (1988), and Klein (1995) describe how this exclusion became heavily institutionalized after 1948. The BMA had privileged access and a central role at every stage of the policymaking process.

The second 'rule of the game' was an implicit contract between the government and the medical profession. The contract was that the former respected clinical autonomy in how to use resources but the latter accepted that the decision on the overall level of resources, the budgetary constraint, was a matter for the government. The observance of these two rules marked the policy community period in UK health care policy.

Within this well-established policy community, there was policy learning and limited policy change. For example, Royal Commissions were the main conduits for the introduction of ideas and evidence into health care policymaking during the policy community period. They received submissions, interviewed experts and interrogated advice. Their reports, along with the input of 'the comprehensive central expert advisory machinery which was built up between 1948 and 1979' (Webster 1998a, p. 29) constituted the evidence that informed most of the structural changes to the NHS prior to 1991 (Webster 1988, 1996, 1998a).

Policy changes before the late 1980s reflected the policy community that introduced them. They were never radical, they concentrated on the structure of the NHS as a way of influencing the behaviour of staff and they were

introduced incrementally with long lead times after exhaustive consultations within the policy community. The early period of the Thatcher administration was characterized by this type of policy learning in the health care policy community. For example, in July 1979, the Royal Commission on the NHS established by the previous Labour administration and chaired by A.W. Merrison produced its final report (Royal Commission, 1979). Based on the report's recommendations, in 1982 the Conservative government reorganized the administrative structure of the NHS, replacing Area Health Authorities and districts with 192 District Health Authorities (DHAs) and placing Family Practitioner Committees (FPCs) under the direct authority of the Department of Health and Social Security (DHSS).

THE BREAKDOWN OF THE HEALTH CARE POLICY COMMUNITY

A conflux of contingent factors caused the emergence of distrust in relations between the government and the BMA. This emergence was temporally intertwined with the fading of the institutions of the policy community. Two events are salient: the introduction of a limit on the range of drugs that GPs could prescribe on the NHS, and a ferocious and public conflict in 1987 about the level of NHS funding. The plans for the first event were announced in November 1984 and the General Medical Services Committee of the BMA 'came out strongly against the government's intention', with several of its members predicting that a 'two-tier' NHS would be created (Anon. 1984). In response to the BMA's opposition and campaigning by the pharmaceutical industry, the government decided to reduce its plans. In consequence, the 'limited list' that was introduced in April 1985 only restricted the medicines that could be prescribed in seven major therapeutic categories, producing estimated savings of £75 million (rather than the originally estimated £100 million) in the first year (Harris 1996).

Webster (1998, p. 40) argued that the limited list episode was 'an apparent humiliation for a government increasingly renowned for its success in confrontations with corporate interests'. However, it seems to have furnished the Thatcher administration with the conviction that radical policy initiatives could be introduced without prior consultation with the medical profession, or the establishment of a formal investigation or Royal Commission. As Webster (1998b, p. 40) states, the episode 'constituted a firm platform for further and more audacious forays into the primary-care policy field.'

Financial pressure has been an ever-present feature of the history of the NHS, and pre-dated the Thatcher administrations. The desire for macro-level cost containment and fiscal prudence was prominent in the Labour

Government of 1974–79. This had had the corollary of raising policymakers' interest in the efficiency and effectiveness of the use of existing resources. However by 1987, '... it was the willingness of the medical and nursing profession to accept those pressures which appears to have diminished dramatically' (Klein 1995, p. 183). This conflict took both a public and party-political form. Wistow (1992) and Klein (1995) observed a widespread perception, presented by medical professions through the media, that the NHS was on the point of collapse. Health was a prominent and strongly contested issue in the 1987 general election, and despite the Conservatives' comfortable victory had been an issue on which Labour held a substantial lead in the polls. In the six months after the election, Webster (1998a, p. 22) states that, 'It is well known that the government was blown off-course by the financial crisis affecting the health service in the autumn of 1987, with the result that it was forced to address as a matter of urgency the problems of additional resources and cost containment.'

Importantly for the GP fundholding policy process, Mrs Thatcher believed that before and after the 1987 election the BMA had entered the party-political debate over the level of NHS funding (Thatcher 1993). The BMA had abused the medical profession's authority with the public and broken one of the rules of the policy community game, contributing to the fact that '... the public obstinately continued to see the health service as a casualty of the Thatcher administration's parsimony' (Klein 1995, p. 178).

In the repeated PD game, once cooperation breaks down the dominant strategy for each player is to continue to withdraw cooperation. The PD game then reverts to the Nash equilibrium of the one-shot game, (D, D), as Defect becomes the dominant strategy for both parties. In policy community terms this is the non-observance of the 'rules of the game' described above. Both the government and the BMA infringed the rules that had supported a stable (C, C) equilibrium since 1948. In the context of the introduction of GP fundholding, the lack of a policy community meant that the transaction costs of political exchange or negotiation between government and the BMA reached a critical level where the former simply imposed a policy and '... one of the casualties ... was precisely any willingness to discuss the nuts and bolts of implementation' (Klein 1995, p. 195). The imposition of such significant change, as with the GP fundholding scheme, so quickly and without any pilot scheme, appraisal or Royal Commission represented a new period in the development of health care policy in the UK.

POLICY LEARNING WITHOUT A PARADIGM

A defining characteristic of the development of the GP fundholding scheme

between 1989 and 1997, the immediate post-policy community period, was the absence of a shared policy paradigm through which incremental, evidence-based policy learning could take place. The two established mechanisms for introducing evidence into policymaking did not operate. There was no Royal Commission set up, and the central advisory machinery had largely been abolished by the Thatcher administration. Importantly, there was no formal appraisal or evaluation of the effect of GP fundholding on health care or health. This contradicts the view that the reforms of 1991 represented a victory for the 'new' public sector management in the NHS. Instead, the reforms marked the end of the health care policy community and the start of health care policy being driven by political conflict and the struggle to institutionalize guiding assumptions and values about health care policy.

The evidence on which policy development was based under the policy community was undoubtedly biased towards the medical profession's view of the health care system, as this was the policy paradigm. As Webster (1988, 1996 and 1998a) discusses, Royal Commissions collected evidence from the medical profession about how the NHS was working and how any reform proposals might work. The nature of that evidence reflected the professionalized network that controlled its collation and reporting.

Without a policy community, there was no consensus on the introduction of GP fundholding, and therefore there were no common values against which to evaluate the scheme. Both Nigel Lawson (1992) and Mrs Thatcher (1993) expressed the considerable worries that the Conservative government had about the BMA exploiting any policy appraisal or evaluation of the GP fundholding scheme: any formal policy evaluation would not have been evidence to inform rational policy development but instead would have been appropriated for political advantage. As public opinion had become a factor in health care policy there was no time for the government or BMA to wait and see the effects of any pilot scheme or policy assessment. Instead, each interest articulated a public position immediately; policy analysis and public positions were based on folk theorems or common beliefs about the traits, characteristics or dispositions of a policy without any reliable and verified source of evidence.

In the absence of trust, debates about the consequences of the GP fundholding scheme were highly political. For example, in July 1995 the Labour Party restated its criticisms of the scheme (Labour Party 1995): their position was that fundholding had increased NHS management costs, introduced financial pressures into the doctor-patient relationship and had created a two-tier health service. These were claims based on folk theorems, as there was no obvious evidence for any of them. Some politicians may have calculated that vilifying the scheme was the best political response, as any initiative that attempted to introduce financial management into the NHS was

likely to be unpopular with voters. The absence of a formal evaluation of the scheme allowed 'myths' about fundholding and fundholders to remain in the general political discourse, without any independent, formal mechanism for testing their claims.

OFFICIAL AND EMPIRICAL STUDIES OF GP FUNDHOLDING

In June 1995, the House of Commons Committee of Public Accounts published a report on the first three years of the operation of the fundholding scheme in England (Committee of Public Accounts, 1995). Based on evidence provided by the NHS Executive (NHSE), the report detailed the effects of the scheme on the provision of patient services, practice-level prescribing patterns and on the generation and use of budget surpluses. Under the first heading, the NHSE's evidence suggested that fundholders had achieved a faster rate of delivery of secondary care services, whilst securing reductions in waiting times, improvements in access and a widening of the range of services available to their patients. However, the NHSE argued that the scheme had not affected the care given to patients of non-fundholding practices, as fundholders had secured many of these improvements by purchasing previously unused hospital capacity.

Although evidence suggested that fundholding had helped to improve the services that participating practices offered to their patients, the Public Accounts Committee had two main concerns about the operation of the scheme. First, the committee suggested that the scheme had relatively high running costs, with cumulative expenditures on management allowances and computer purchases during the first three years of the scheme being £147 million. Second, the committee noted that between fiscal 1991 and 1993 a significant number of patients had been removed from their practices at the request of their GPs. For example, during fiscal 1992, 78 000 patients had been asked to leave their practices at the request of their doctors. However, according to the Public Accounts Committee there was no clear evidence that this occurred on cost grounds, or that patients were more likely to be expelled from fundholding practices.

Although the government did not commission an independent evaluation of the effects of fundholding, the external auditor for the NHS, the Audit Commission, produced some reports on the initiative. For example, in 1995 the commission published a briefing that described the scope of the fundholding scheme, charted its growth and analysed the budgets that fundholders managed (Audit Commission, 1995). In 1996 the commission published a report on the first five years of the operation of the scheme,

entitled *What the Doctor Ordered: A Study of GP Fundholding in England and Wales* (Audit Commission, 1996a). To accompany its report, the commission published a digest of information from the survey of fundholding practices, which had been undertaken for the main study (Audit Commission, 1996b).

What the Doctor Ordered was one of the most comprehensive reports published on the management, operation and effects of the fundholding scheme. As part of the study, the Audit Commission examined the demographic and organizational characteristics of participating practices. In relation to the former the commission found that, initially, fewer practices in inner-city areas had become fundholders. As a result, participating practices tended to have more affluent and less socially deprived patients. Significant regional variations in fundholding coverage were evident, with the scheme achieving proportionately lower coverage in some inner-city and/or deprived areas. In relation to their organizational characteristics, the Audit Commission reported that fundholding practices tended to be relatively large, often housed in purpose-built premises, with more support staff and equipment, including computers. However, they differed from equally large non-fundholding practices, as they had more of the features normally associated with high standards and better quality in general practice (for example, higher rates of childhood immunization and accreditation to provide minor surgery and/or postgraduate training). Therefore, the Audit Commission's work suggests that the fundholding screening process ensured that only larger, well-organized practices were initially allowed into the scheme.

Following the introduction of the 1991 reforms, a number of independent academics also examined the effects of the fundholding scheme on GP referrals, prescribing and other activities in NHS general practice. Although they varied in terms of years studied, the number of practices examined and the areas analysed, these studies helped compensate for the absence of a government-sponsored evaluation (or piloting) of the schemes. These suggest that evidence on the desirability and effectiveness of the scheme was both limited and equivocal when fundholding was abolished by the new Labour government in March 1999. For example, Coulter (1995, p. 233) concluded that there were 'extensive gaps in current knowledge about the impact of the scheme' and that the claims that 'GP fundholding has resulted in improvements in efficiency, responsiveness and quality of care are in general not supported by the evidence'. In a similar vein, Petchey (1995, p. 1139) argued that 'few reliable conclusions about fundholding, either positive or negative, can be drawn from existing research'. Gosden and Torgenson (1997, p. 103) also concluded that there was a dearth of high quality evidence on many aspects of the fundholding scheme, particularly in relation to referral rates, patient outcomes and service quality.

In a review of the scheme's effects on prescribing, Baines et al. (1997)

found that, in the short term, many early-wave fundholders had managed to secure economies in their prescribing by switching to cheaper, generic drugs. However, in the longer term, such savings may not have been sustainable. In one of the last reviews of the literature before abolition, Smith and Wilton (1998, p. 1253) concluded that 'evidence concerning the success or otherwise of general practice fundholding over the last six years is incomplete and mixed' and, unless further research was undertaken, 'the jury will have to remain out on whether fundholding has secured improved efficiency in the delivery of health care'.

Both the Conservative government and the Labour Party (and subsequently Labour government) had clear public positions on the effect of GP fundholding. These positions did not have a basis in evidence; one of the dynamics set off by the collapse of a policy paradigm is a contestation of the basic values and assumptions that will be used to consider policy development. Without this information, there is no basis on which evidence-based policymaking can take place; instead the benefits and costs of a particular policy is the subject of strong political contestation in which policy analysis is often a case of the assertion of various folk theorems.

THE ABOLITION OF THE FUNDHOLDING SCHEME

Soon after winning the May 1997 general election the new Labour government suspended entry into the fundholding scheme and began a debate on replacement commissioning models for the NHS (NHSE, 1997). After seven months in office, the new administration announced plans to replace the Conservative government's reforms in England in the White Paper, *The New NHS: Modern, Dependable* (DoH, 1997). In keeping with Labour's pre-election promises, the White Paper stated that, at the end of 1998/99, both the NHS internal market and the fundholding scheme would be abolished. In their place an integrated care framework would be introduced, which would separate the planning of hospital services from their provision. Under these arrangements, 500 Primary Care Groups (PCGs), each serving a population of approximately 100 000 people, were established from April 1999 onwards (these subsequently became 300 Primary Care Trusts (PCTs) in April 2003).

Under the new arrangements for the NHS, the Labour government's White Paper announced that each PCG would be allocated a cash-limited budget for hospital and community health services, prescribing and general practice infrastructure for the patients that they serve. Once established, the document stated that the groups would be expected to subdivide their allocations amongst local practices in the form of indicative budgets that cover all of the

aforementioned services. However, in the short-term, the White Paper announced that ‘every practice will have a prescribing budget, as most do now’ (DoH 1997, Chapter 5, p. 8). The practice-level budgets allocated by PCGs were similar to those assigned under the fundholding scheme. Indeed, *The New NHS* White Paper announced that the ‘Government wants to keep what has worked about fundholding, but discard what has not’ (p. 33). As a result, PCGs were left to determine, for themselves, what aspects of the fundholding scheme should be employed when devising their local, practice-level budget schemes.

Although Labour’s plans allowed fundholding to be abolished without, in principle, discarding the effective aspects of the scheme, the absence of an independent evaluation meant that conclusive evidence on what aspects of the initiative actually worked was not available to the government or PCGs. Indeed, little evidence was produced on whether the fundholding budget itself, the extra resources given to participating practices, or the difference in property rights assigned to non-fundholding practices determined the outcomes observed amongst the scheme’s incumbents. Moreover, it was not clear whether the types of practices that elected to join the scheme influenced its effects, or whether fundholding would have been equally effective amongst all practices.

It is possible to interpret *The New NHS* as an attempt to re-establish trust with the medical profession and configure a new policy community. Two aspects stand out, the repeated emphasis on the need for ‘cooperation’ with the medical profession, and second, the commitment that a Labour government would not change the PCG structures for at least ten years. This commitment to policy stability in the primary care sector is a basic requirement for the re-establishment of trust between the government and the BMA after the turbulence of the 1990s. Alongside this commitment to a policy ‘lock-in’ is the signal of a more evidence-based approach to policymaking. For example, the White Paper states that there will be piloting and a proper evaluation of Primary Care Trusts before their universal application.

However, to build trust takes time and other parts of the White Paper explicitly limited clinical autonomy, for example the National Institute for Clinical Excellence (NICE) and the national performance frameworks. The subsequent path of the health care policy system is not the subject of this chapter, but in the 1999 Labour Party conference there was an organized message that the government believed the ‘forces of conservatism’ were hindering the modernization of public services, and that staff in those services were part of the problem. Despite the 2000 NHS Plan and record increases in NHS funding, contemporary health politics have taken place in a context of frequent ministerial frustration, sometimes expressed publicly, at the failure of the health care system to show demonstrable improvements on various output

measures revealing that a high-trust, closed policy community has not coalesced in this policy space.

SUMMARY

This chapter has set out the history of the GP fundholding scheme as an example of policy dynamics after policy communities collapse and where the government has an ambition for substantial policy change. The absence of trust between the major interests means that policy tends to be formulated without valid or reliable evidence on the effects and cost-effectiveness of existing initiatives and any proposed new initiatives. In this sense, the 1991 NHS reforms were not a victory for the new public sector management at the expense of clinical autonomy, but rather marked the beginning of a period of turbulence in health care policy between 1991 and 1997 (and subsequently). The GP fundholding scheme is a case study in how health care policy in the 1990s was driven by folk theorems and political competition; health care problems and policy solutions were learned or constructed in the interaction of agents in the policy system. In this sense of policy learning, the problem situation is constructed in the interactions between agents; policy problems, policy solutions and the criteria of 'success' are bargained and different attempts are made to constitute institutions within the policy system.

The structured narrative in the chapter is inconclusive on the question of whether the period 1991–97 was an aberration in the style of health care policymaking. The existence of a publicly funded and publicly owned NHS had seemed to afford doctors a privileged position relative to other groups. Many of the institutionalized forms of access for the medical profession of the policy community era have remained. However, Ham (1999, p. 1092) notes the Labour government's '... apparent willingness to challenge the power of its traditional support base in the trade unions and entrenched interests of the health professionals, including doctors'. The 15 years since the break up of the post-war health care policy paradigm have been marked by a fluid dynamics of shifting balances and patterns of influence and values within the NHS, without a particular policy paradigm becoming institutionalized.

9. UK pharmaceutical policy

The tendency of doctors to overprescribe medicines because they do not bear the cost of the decision to prescribe, and the monopoly that pharmaceutical companies enjoy in the production of certain medicines under patent, are both long-standing justifications for pharmaceutical public policy to regulate the price of medicines (Bloom and Van Reenen, 1998). All OECD countries have some form of regulation of the pharmaceutical industry and mechanisms to control public expenditure on medicines. These policies have been under budgetary pressure in most countries since the 1980s due to the combination of an ageing population and technological development. NHS expenditure on prescription medicines increased by almost 10 per cent per annum during the 1990s (OHE, 2002). This fiscal pressure has produced a series of policy dynamics that exemplify how policy processes are as much about choosing between different reasons for action or different values, as they are about how to achieve particular values in isolation. This insight complements the point made in the theoretical section of the book: a dynamic perspective raises serious doubts about the instrumental, parametric version of rationality that exists in rational choice theory by challenging the notion of a straightforward policy ‘choice’.

Public policy towards pharmaceuticals can be divided into those aimed at influencing the demand for medicines, chiefly to increase the sensitivity of GPs to the cost of medicines, and those aimed at regulating the supply side, the price paid for medicines by public authorities. In the UK, since the mid 1980s there have been a series of initiatives to influence GP-prescribing behaviour. On the supply side, the Pharmaceutical Price Regulation Scheme (PPRS) is an agreement between the pharmaceutical industry and the government that has been renegotiated roughly every six years since 1957; the latest agreement came into force on 1 January 2005. The PPRS is unique in the EU pharmaceutical policy area in regulating drug company profits rather than prices directly, although relatively small one-off reductions in the average price of the portfolio of drugs supplied by a company to the NHS were agreed in 1993, 1999 and 2005.

The PPRS has a dual identity; it is both an industrial policy to support pharmaceutical companies and the mechanism by which the NHS procures drugs. There is an ineluctable conflict between those two identities. They represent different values or rationalities for public policy that are directly

contradictory: the support of a research and development (R&D) intensive, high value-added successful industry versus maximizing the health benefits of a finite amount of public expenditure in the health care system. It is through policies and policy paradigms that basic values are enacted and institutionalized in the policy system. This chapter provides a structured narrative of the dynamics of this conflict of values since 1957 when the Voluntary Price Regulation Scheme (VPRS), which subsequently became the PPRS in 1978, was first introduced. The narrative reveals how multiple rationalities have become institutionalized in the pharmaceutical policy system and that pharmaceutical policy overall is complex and inconsistent.

THE TRADE-OFF PROBLEM

When values are in conflict, as in the case of pharmaceutical policy, it is common within policy studies to conceptualize the policy process as balancing these values or providing for a trade-off between the values. This is always the case with economic policy analysis; indeed, the whole notion of a social welfare function, the central plank of public sector economics, is premised on the view that different values can be differentially weighted in a common function, and those relative weights represent the result of the trade-off. The notion of a trade-off can be criticized philosophically because it requires the assumption of commensurability: that different values may be converted to a common metric (utility, for example) and thus balanced against each other.

However, for the purposes here the problem of a trade-off is one of dynamics; from a dynamic point of view, policy systems do not remain at some static equilibrium, balancing two conflicting values. Instead, there are sequences of policy decisions: each decision at a particular temporal point may embody particular reasons for action and particular values. Policy decisions may be institutionalized and consequently the values that they embody endure in the policy system. Further, the reasons for action or the values that are being enacted in a policy may vary over time, but they do not vary independently of each other. Rather an initial policy decision may set in train a set of different, often countervailing, effects as policies adopted in pursuit of one value or for a particular reason have unintentional consequences for another interest or value, whose relative importance in the situational context at the time of the initial policy may not have been considered. These consequences may prompt the introduction of another policy as a 'patch' to ameliorate those policy effects. Complex policy systems may contain several different rationalities and different values that have accumulated over time; a key question is the extent to which the system can maintain coherence and stability with such immanent accumulations.

In terms of policy dynamics, there is no definitive and enduring trade-off; there is no reason to expect that the policy process will bring both values together and make a definite political choice between them. Instead policy actors focus on each value sequentially, emphasizing one value until the negative consequences for other values reach a critical level, at which they are asserted contrarily. Thacher and Rein (2004, p. 465) label this as a process of cycling: 'To say that policy responds to conflicting values through cycling means that the attention public institutions pay to each value varies over time, shifting back and forth between opposites – most commonly, subordinating one-half of a dilemma and then the other.' UK pharmaceutical policy is a good example of this policy dynamic: the Department of Health (DoH) has a Pricing and Supply branch that administers the PPRS but is also responsible for the budgets of PCTs and Hospital Trusts that purchase medicines in the NHS. The narrative presented in this chapter shows how the cycling process can lead to the steady accumulation of policy decisions and policy subsystems to mitigate the negative consequences of one policy for another policy value, and the consequences in terms of the overall coherence and effectiveness of policy in an area.

One effect of temporal cycling between values in pharmaceutical policy is a functional separation of different parts of policy. This is where different policies are established for different values at different times. In one sense, a functional separation of parts of policy space is foundational to bureaucracies: a health department, a treasury, a foreign affairs department, and so on. Policies established to mitigate the consequences of other policies may exist as a separate policy subsystem, with different actors, institutions and values. The joined-up government initiative is, of course, an attempt to remedy the adverse consequences of this separation, and indeed in Chapter 7 on the CAP, several spillovers between different parts of policy space were described.

The theme of the narrative presented here is that the functional separation within pharmaceutical policy between the demand and supply side of the regulation of purchasing medicines has become unstable. The cycling process has resulted in the introduction of new, additional policies, which intermesh and interact in an increasingly crowded policy space with original policies, as first the budget of the NHS for medicines is emphasized and then the needs of the pharmaceutical industry. This is a type of policy inheritance process where different parts of policies enacted at different times get institutionalized consecutively. The present mixture of different values and multiple rationalities from different times exacerbates complexity in the policy system. I describe the emerging complexity in the sections below but stress that the immutable conflict of the two values remains. As Wildavsky (1964, pp. 128–9) observed: the fundamentals of any budget problem, which pharmaceutical policy is, always concern value choice.

THE STRUCTURED NARRATIVE OF UK PHARMACEUTICAL POLICY DYNAMICS

The narrative is broken down into two periods. Between 1957 and the mid-1980s, pharmaceutical policy consisted of one instrument, the PPRS, and the mode of regulation was as a gentleman's agreement; since the mid-1980s, however, the objective of the NHS in controlling the level and nature of public expenditure on medicines has been periodically asserted, in a number of policy initiatives, in a process of cycling with the pharmaceutical industry development value.

Thacher and Rein (2004) present a case that, from a practical reasoning point of view, cycling may be effective; it is not a failure of rationality or the triumph of short-term, political interests over longer-term, evidence-based strategic analysis. They concede, however, that it is an open and empirical question whether, in practice, cycling can manage the conflict of values in a consistent and effective manner. The dominant theme of the narrative of UK pharmaceutical policy is the increase in the number of policy instruments within pharmaceutical policy space. Different demand- and supply-side policies have been enacted separately, at different times and for different reasons; yet their material consequences make them strongly intertwined in a manner that has left pharmaceutical policy overall as inconsistent, incoherent and ineffective. In particular, it has proved impossible to isolate particular domains within the pharmaceutical policy area; new policy instruments have had complex spillover effects into other domains of pharmaceutical policy. No institution or policy mechanism has emerged to manage, in a stable and effective manner, the conflict of the two values and the linkages and interconnections between different pharmaceutical policy domains.

The format and rules of the PPRS, and its predecessor the VPRS, have not changed significantly since 1957. The PPRS does not regulate prices directly but is instead a form of rate-of-return regulation. There are profit targets, measured in terms of the return on capital that companies can make on their sales to NHS. A company launching a new drug has discretion over the initial price but a second part of the PPRS strictly controls any subsequent price increases. A third part of the scheme regulates the amount of advertising expenditure that is an allowable cost in the profit calculations, and a fourth part controls the amount of R&D expenditure that can be set against sales to the NHS in the same calculation. Pharmaceutical companies provide the DoH with this information in an annual financial return (AFR). The scheme allows UK-based pharmaceutical companies to make a 21 per cent return on capital on their sales of medicines to the NHS. The scheme allows an expense of up to 23 per cent of the total value of sales and 9 per cent of the same figure to be set against the profit calculation for R&D and marketing respectively.

The PPRS is, *de facto*, an industrial policy; it affects the profitability and structure of the UK pharmaceutical industry. Further, the industrial policy element is explicit in the objectives of the scheme. As most recently stated (DoH, 2004), they are to: (i) secure the provision of reasonably priced, safe and effective medicines to the NHS; (ii) promote a strong and profitable pharmaceutical sector capable of such sustained R&D expenditure as should lead to the future availability of new and improved medicines; and (iii) encourage the efficient and competitive supply of medicines to pharmaceutical markets in this and other countries.

As previously indicated, the PPRS as a mode of regulation is akin to a gentleman's agreement. The metaphor is a useful description because it captures the high-trust, personal relationships that have existed between the government and the pharmaceutical industry away from public scrutiny. Common to all regulatory systems is an information problem; the regulator cannot directly observe the cost structure of the regulated company. The PPRS has dealt with this problem by allowing the industry a large degree of self-regulation on a voluntary basis. The branch of the DoH that operates the PPRS consists of only 20 people (DoH, 2004). The majority of these will be in clerical grades and the Branch Head is a Grade 7, a middle-management grade that is not part of the senior civil service structure. Therefore, it is a reasonable assumption that this branch cannot engage in detailed scrutiny of the information provided by companies in the PPRS. Rather, the level of resources that the DoH commits to the scheme is only sufficient to ensure the scheme's routine administrative functioning. The DoH must take on trust the validity of the large majority of the information provided by the pharmaceutical companies in their AFRs. In these terms, the PPRS is a relationship-based rather than a rule-based regulation and the metaphor of a gentleman's agreement expresses the nature of that relationship.

In contrast, UK utility regulators are independent agencies with a large staff and substantial resources. For example, OFTEL has a staff of over 160 (OFTEL, 2004). They play a quasi-judicial role in protecting customers and exist in an adversarial relationship with the regulated company. The approach to the information problem is to pursue detailed analysis and scrutiny of the information revealed by the company, their accounts and forecasts, in order to formulate an optimal price that the company can charge.

The gentleman's agreement mode of regulation seems to have been successful in preventing a 'hold-up' problem in the relationship between the government and the pharmaceutical industry. A hold-up problem occurs in a contract between two parties where one of the parties has to make some kind of investment that is irreversible. In this case, it is R&D expenditures by pharmaceutical companies that are irreversible. The party that makes such an investment becomes vulnerable to the demands of the other party to

renegotiate the contract; in this case, the government imposing drug prices that are close to marginal cost and substantially lower than had been anticipated at the time of the R&D investment. Given the frequent cash crises in the history of the NHS (Webster 1988, 1996) and the continually rising public expenditure on drugs, there always exists an incentive for governments to impose a low price regime on the pharmaceutical industry. In game theory terms, the government's promise to keep prices at a level to reward investment in R&D is not time consistent (Dixit 1996).

This potential threat of government expropriating the returns for investment in future time periods should tend to lead to severe under-investment by pharmaceutical companies. However, there is considerable evidence of the long-run success of the UK pharmaceutical industry (Maynard and Bloor 1997; Martin 1995; Earl-Slater 1997) and in particular, its high rates of R&D expenditure (Bloom and Van Reenen 1998). The gentleman's agreement established a level of trust between the industry and the government that has given credibility to commitments not to cut future prices. The PPRS, in terms of the value of supporting the development of high value-added industry in the UK economy, has been successful. However, as previously noted this conflicts with the value of maximizing the health benefits of a limited public budget for medicines.

VALUE CYCLING AND A MORE CROWDED PHARMACEUTICAL POLICY SPACE

The PPRS remained the sole instrument for regulating expenditure on pharmaceuticals from its inception in 1957 until 1985, when the Conservative government specified, for the first time, a limited list of medicines that could be prescribed in certain therapeutic categories at the expense of the NHS. The list was extended to several further therapeutic categories in 1992. This marked a shift in pharmaceutical policy in the UK towards an emphasis on controlling the demand for medicines. Further demand-side policies followed: the setting of practice-level indicative prescribing budgets using Prescription Analysis and Cost (PACT) data in the late 1980s, the introduction of GP fundholding in 1991 and the successful encouragement of increased rates of generic prescribing. These developments represent the assertion of the value of health policy against that of industrial policy in the purchasing of medicines by the NHS. This sequence of policy developments has been in a synchronized but anti-phase pattern with the sequence of renegotiations of an essentially unchanged PPRS; a policy decision asserting one value produces another policy decision that counter-asserts an alternative value in a process of cycling.

The Conservative government's decision to take generics out of the PPRS

in 1986 (Luce, 1987) marks the beginning of the increase in the number of pharmaceutical policy instruments. Any number of pharmaceutical companies can supply a generic drug because the patent guaranteeing a monopoly in the production of that drug has expired. Generics trade under the British Approved Name of a drug rather than a brand name. They were removed from the PPRS in order to encourage a market with price competition. As generic medicines are usually considerably cheaper than their branded equivalent, it was hoped that GPs would prescribe, where available, a generic drug rather than its branded alternative, thereby securing economies in the NHS pharmaceuticals budget. The various generic prescribing initiatives that followed (see for example Audit Commission 1994) have successfully raised the rate of prescribing generically in England and Wales to close to 70 per cent of items (from 40 per cent prior to 1986), representing around a fifth of the total value of prescription medicines.

The development of a generics market came alongside the introduction of the GP fundholding scheme in 1991 (see Chapter 8). This scheme allowed participating practices to keep any savings they could make on their purchases of drugs. These initiatives provided a financial incentive to GPs to limit the effect of their prescribing on pharmaceutical expenditure. However, any control of NHS expenditure on pharmaceuticals is a control on pharmaceutical companies' revenues. The combination of competition through generic substitution and a system of price regulation in the market for non-branded drugs has had the effect of reducing the life cycle of branded products as the revenues expected by a branded manufacturer post-patent expiry have been reduced. This means that branded manufacturers have been forced to make their return on R&D investment over the period of the patent instead of over a longer period.

The freedom given by the PPRS to companies in the pricing of new drugs means that pharmaceutical policies to control the growth of drug costs will tend to be undone by the ability of the drug companies to increase their revenues (NHS drug expenditure) through the launch price of new drugs. The average price of branded medicines prescribed increased by about 47 per cent in real terms over the period 1988–98, whilst the average price of generic medicines has remained about the same in real terms over the same period (Kay 2002). However, under the PPRS the price of existing medicines can only be increased by application to the DoH. There are very strict criteria for allowing a price increase (DoH 2004) and the industry view is that such applications tend to be unsuccessful (Lawton 1999). It therefore seems reasonable to infer that the major determinant of the steep rise observed in the price of branded medicines is the increased average price of new medicines launched.

The data tend to show that these developments in GP prescribing policy

over the last 20 or so years have been successful in controlling the volume of items prescribed. The growth in volume of items has been roughly half that of the average price of an item. However, the policies to influence GP prescribing had a greater objective than simply influencing the prescribe/not prescribe decision; they were supposed to make GPs more price-sensitive when taking the decision to prescribe a particular drug. The demand-side policies since the 1980s were designed, all other things being equal, to reduce the average price of a prescription item. However, since the mid-1980s all other things have not been equal. As noted, supply-side regulations have operated in a contradictory way to demand-side policies by allowing industry profits on sales to the NHS to remain at historic levels because the initial price of new medicines is not controlled under the PPRS. The introduction of NICE discussed in the following section is the latest attempt to close this persistent gap in the regulatory framework of the PPRS and another stage of value cycling within pharmaceutical policy.

1999 AND 2005 PPRS AGREEMENTS

Unlike previous PPRS agreements, the 1999 negotiations were both contentious and a matter of public debate. The government had publicly stated its intention to save the NHS money (*The Guardian*, 24 September 1998) and industry representatives warned that companies would start to locate production abroad (*Financial Times*, 20 October 1998). Despite this acrimony, the PPRS was renegotiated for another six years. The new scheme had a basic architecture similar to previous agreements; the objectives of the PPRS remained the same with only marginal changes to the mechanics of its operation (Lawton 1999). The headline change was an agreed average price reduction (across all products supplied to the NHS) of 4.5 per cent, compared to 2.5 per cent in 1993.

One part of the agreement with potentially significant longer-term consequences for the future of the PPRS and the nature of the regulatory relationship was the 1999 Health Act. This gave the scheme and its rules a statutory base for the first time. For example, the government had complained that some PPRS companies had abused the spirit of the agreement at best by selling the brand name of some low-cost but essential products to smaller rivals, who then steeply increased the price. The government could now enforce legally the PPRS rules on the selling on of old brands. This change in the legal status of the PPRS had little impact on the regulatory style of the scheme; it still relies on a trust-based relationship between the government and the industry. It remains 'soft' law, in the sense of being a system of self-regulation where the rules that govern behaviour in medicines sales to the

NHS are administered and enforced by the industry itself. There was no increase in the resources available for regulatory scrutiny to the levels usually associated with utility regulation. There are still only 20 officials operating the scheme in the DoH and although the details of the operation of the scheme have been reported to Parliament annually since 1996, the scheme remains opaque from the outside; in particular, there is no evidence of a confrontational, 'hard' law regulatory style with frequent recourse to the statutory courts to enforce the rules of the scheme.

Independently of, but contemporaneous with, the 1999 PPRS negotiations, NICE was established with the objective of producing clinical guidelines on the clinical and cost effectiveness of medical interventions. It replaced a system in which individual health authorities took their own decisions on the funding for new drugs and technologies. This system had resulted in variations in the patterns of commissioning across the country, with varying access to specific treatments and allegations of 'rationing by postcode'. These decisions had generally been taken in response to resource pressures and financial reductions rather than research into the cost-effectiveness of medical interventions.

As stated, the PPRS does not directly regulate prices but instead controls profit, with pricing freedom given to companies when launching branded medicines. NICE, however, is a form of price regulation; it judges the cost effectiveness of a medicine. However, the cost-effectiveness methodology that NICE use to make comparative judgements across diseases and for clinical and technology appraisal benchmarks are opaque and open to dispute (Williams 2004); implicit is the recommendation of a price that provides a benefit to cost ratio that is acceptable for public expenditure on health care. There is therefore an inconsistency between Labour opting to renegotiate the PPRS in 1999 and also introducing NICE. The price of branded drugs is a policy variable performing two potentially contradictory regulatory functions: rewarding innovation and providing cost-effective treatment. Prior to NICE, the price of drugs in the PPRS was the outcome of political negotiations for a 'reasonable' level for the NHS and the industry. The requirement for NICE to reach an opinion on the cost-effectiveness of a drug may lead to a more formal and confrontational regulatory relationship between the government and the industry as public recommendations, with adverse profit consequences. The relationship will be further complicated by the trend in the demand for medicines: this is no longer simply a function of physicians' prescribing habits when acting as agents of patients, but rather is patient-led, where responsibility for health care is increasingly individualized and where certain groups and interests are organizing successfully for public subsidy of 'their' medicines.

The PPRS agreement covering 2005–10 was the subject of far less public debate than in 1999. There have been a few very minor changes, but the

scheme remains essentially the same as that under the 1999 agreement: the objectives remain, its statutory basis under the 1999 Act is untouched, and there was an agreed average price reduction of 7 per cent this time (compared to 4.5 per cent in 1999). In order to limit room for manoeuvre in complying with price cut commitments and increase transparency and competition in the generics market, 'branded' generics have been excluded from the PPRS. These are out-of-patent products to which suppliers, who did not ever hold the patent, have applied a brand name. Any encouragement of the generics as set against the branded industry is an assertion of the objective of securing value for money in public spending on medicines.

THE COMPLEX SPILLOVER EFFECTS IN A CROWDED POLICY SPACE

The previous section described a more crowded pharmaceutical policy area in the 1990s and identified some spillovers between different policy domains. The development of a generics market has affected the expected profitability of new branded medicines, and this seems to be linked with an increase in the average price of branded medicines. In addition, the work of NICE affects the expected sales revenues of companies in the PPRS by insisting that a branded medicine be cost-effective treatment for the NHS. However, the PPRS has recently been renegotiated, with the objectives of supporting innovation in the pharmaceutical industry unchanged and the launch price of medicines to remain at the discretion of companies.

The overall NHS drugs budget increased by almost 10 per cent per annum during the 1990s. This resulted in expenditure on pharmaceuticals accounting for over 15 per cent of total NHS expenditure by 2001; between 1969 and 1989 it had been a relatively stable share that averaged 8.6 per cent per annum (OHE, 2002). In response to the rising drugs budget, successive governments have introduced various measures to control the demand for medicines by NHS (such as GP fundholding, encouraging a generics market and NICE). The overall NHS demand for medicines is regulated by different institutions, as well as separately from the supply of medicines. However, all need to be considered in conjunction in order to control the growth of expenditure on pharmaceuticals, but the spillovers between policy domains are not the responsibility of any policy or institution. As Walley et al. (2000) put it, 'The pharmaceutical arena is now far too complex to be enveloped in the current balkanised approach to policy.' Without policy spillovers being managed or controlled there is a potential instability in pharmaceutical policy. Such instability would affect both the pharmaceutical industry and the NHS: long-term R&D investment in the UK by the pharmaceutical industry would

be threatened and the ability of the NHS to predict and control overall drug expenditure would be diminished (ultimately adversely affecting patients through unplanned and random rationing).

The combination of complex policy spillovers suggests the need for policy or institution to regulate the government–pharmaceutical industry relationship and manage the value conflict that has produced the process of cycling, described in the previous sections, with the adverse consequences for policy coherence. There is no institution or policy independent of the DoH, which takes an overall view of the regulation of the pharmaceutical industry, to in particular take account of the spillovers between different policy instruments. In particular, an ‘OFDRUG’, equivalent of OFTEL or OFWAT, could help to ensure that there is a consistent and stable approach to regulation. One of the rationales for an independent regulatory agency for the privatized utilities was the necessity for a stable regulatory environment to allow for long-term resource planning away from short-term political pressures. In the case of pharmaceutical regulation, both the NHS and the pharmaceutical industry wish to plan resource allocation over a long time horizon.

There are two practical roles an OFDRUG could adopt to ensure this stability. The first would be to ensure that NHS expenditure on pharmaceuticals is cost-effective. The separate and political question of the affordability of a medicine or the overall size of the pharmaceutical budget would remain for the DoH. A second and related role would be for an OFDRUG to control both the recommendation of new medicines for use and the funding for their implementation; currently Health Authorities may ignore NICE guidance on the financial grounds that the introduction of a new medicine would compromise its locally agreed priorities.

The low level of administrative resources dedicated to the PPRS by the DoH was sustainable in the period of relationship-based regulation with high trust between the regulators and the regulated. However, the robust policing of the PPRS, the regulation of the generics market and administration of NICE rules, as well as the required analysis of the extent of spillovers, would require substantial expertise and resources. The question for the future development of UK pharmaceutical policy is: whether any such single body can be designed to manage the unavoidable value conflict; whether the complexities and inconsistencies precipitate a crisis and radical reform; and whether the policy system can self-organize under the selection pressures of fiscal constraints and global industry demands.

SUMMARY

For many years drug price regulation posed few public management problems.

The growth in NHS expenditure on medicines was contained to a relatively stable share of overall NHS expenditure, the pharmaceutical industry was successful, the PPRS was not the subject of significant public scrutiny and the associated transaction costs were relatively low. However, the growth in the number of pharmaceutical policy instruments during the 1980s and 1990s has introduced an element of instability into the regulation of the industry. Instability is a problem that affects NHS financial programming as well as R&D investment decisions by companies.

The narrative of this increased complexity and inconsistency in pharmaceutical policy involves value cycling. The PPRS was introduced as an industrial policy to assist the development of the infant pharmaceutical industry in the UK in the 1950s. However, by the 1980s the consequences of the PPRS for health spending began to attract the attention of health policymakers. The objective of value for money in public expenditure on medicines has been enacted in a series of demand-side policies from the 1986 reform, to PPRS, over generics with the associated prescribing initiatives, to the introduction of NICE. However, the assertion of the health budget value in the pharmaceutical policy system has been concurrent with a periodic agreement of an unchanged PPRS and support by the DoH for the value of supporting an innovative, R&D-intensive, high valued-added sector of the economy.

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