ECONOMICS AND POLICY – WORLDS APART?

ISSUES PAPER NO. 14

Edited by

STUART BIRKS

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INTRODUCTION

This collection of papers arises from sessions at the New Zealand Association of Economists 2003 conference, held in Auckland on 25-27 June. The common theme was the nature of policymaking, with special emphasis on the role that economics may or may not be playing.

Similar concerns have been addressed in several of the Issues Papers listed at the end of this publication, and the 2002 NZAE conference produced papers which were adapted for *IPS Policy Newsletter No. 70* (August 2002) on maintaining quality in policy advice.

Checks and balances are an important characteristic of democratic government as they prevent extreme and unrestrained action by any single branch of government. A small country with limited resources and only one house of parliament may have fewer safeguards than countries with larger populations. There is also less scope for public debate and independent advice. For example, on 28 August 2003 Attorney General Margaret Wilson, announcing additional lay appointments to the High Court to assist with matters under the Commerce Act, stated:

> "There needs to be a reasonable pool of experts available because there are relatively few economists with the requisite qualifications and experience in New Zealand…For this reason they tend to be vulnerable to a conflict of interest if called upon to sit as a lay member."

There will always be a tension between politicians and public servants. The Westminster approach is for public servants to assert political neutrality, with a duty to serve the government of the day while providing frank advice, even if it is unwelcome. The US system sees advisors as political appointments, with changes in government being accompanied by changes in personnel. New Zealand has followed the Westminster model, although possibly not entirely successfully, as several contributions in this publication indicate.

David Colander was a keynote speaker at the NZAE conference. Coming from the US, he brought an overseas perspective, while presenting a general problem. The concept of "muddling through" reflects the information gap between theory and policy. Policy issues may not match existing theory due to the latter's simplified nature, and specific data requirements may not be met to permit consideration of theory in a particular context.

In Chapter 2, Robin Johnson looks at the historical traditions which have led to the public service taking its current form, identifying problems with current service delivery. He places particular emphasis on evaluation.

Stuart Birks focuses on the importance of perspective and structure of analysis in specifying issues and shaping views. Groupings for analysis are therefore highly significant politically. For example, given the interactions between men and women, any policies which affect one will have repercussions on the other. It is therefore not possible to properly analyse and recommend policies that ignore these interrelationships. This rules out most feminist work.

In Chapter 4, David Webber considers the increasingly important role of the 'policy analyst". He asks what skills are required and whether analysts can reasonably be expected to perform adequately.

Robin Johnson's introduction to the conference panel session identifies problems of single sector departments and the need for co-ordination.

In Chapter 6, Gary Hawke considers the contribution that economics could make to policymaking, while identifying obstacles such as lack of understanding by others and the relevance of the issues that economists have chosen to consider. He also provides a useful historical perspective on economic thought.

John Yeabsley considers the distinctions between the ideal and the actual situation of economic policy advice and debate in contemporary New Zealand.

Stuart Birks closes the collection with a call for greater quality control at the early stages of policy debate.

Chapter One

MUDDLING THROUGH AND POLICY ANALYSIS[*]

By David Colander

In a variety of books and articles, both published and in process, I've been out pushing the idea of the "economics of muddling through" as the description of the approach to policy that will become standard in economics over the next 20 or 30 years. The argument is both prescriptive—I argue muddling through is what should be done, and descriptive—I argue that muddling through is what is currently being done, although, like Monsieur Jourdain speaking prose in Molière's *Le Bourgeois Gentilhomme*, many economists don't recognize that's what they are doing.[1]

If we've been muddlers for so long, why should we be willing to admit it now? I think there are three reasons.

- First, there is a change occurring in formal theorizing in which the holy trinity – rationality, greed, and equilibrium – is being abandoned as required aspects of any model, and being replaced with a slightly broader trinity – purposeful behavior, enlightened self interest and sustainability.
- Second, the work in the formal general equilibrium model built upon the foundation of the holy trinity has been explored; all the "low hanging fruit" has been picked, and young theoretical researchers are naturally gravitating to less explored areas.
- Third, today's muddling through is not your father's muddling through; it involves the use of a whole range of applied mathematics that is difficult to use unless we admit we are muddling. Today's muddling is technically impressive muddling and is a far cry from the armchair heuristics that characterized early muddling.

The paper is organized as follows. First I consider the history of welfare economics, providing a narrative of how we got to where we are. Second, I briefly outline some important changes that are currently occurring in economics. Third, I expand on my reasons why I believe we are now ready to accept a muddling through characterization of applied policy whereas before we were not.

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[*]Parts of this paper come from early drafts of a book I am currently working on with William Brock entitled The *Economics of Muddling Through* (Colander and Brock, forthcoming). At this point only I am responsible for the arguments presented here.

[1] Actually, though, I suspect most economists do know that we're muddlers; we are just rather hesitant to admit it. In fact, it may be because we know deep down that we are muddlers that we spend so much time structuring our analysis so that it looks like we not.

A BRIEF HISTORY OF WELFARE ECONOMICS

Welfare economics is the study of the policy implications that can formally be drawn from economic theory. It asks the question: What is the relevance of theory for applied policy? The "muddling through" answer to this question is that theory serves as a guide for reasoned judgment, and thus is an input into policy, but that no policy implications follow from theory. The degree to which economists have been willing to accept that answer has varied over time, and thus their willingness to accept that applied policy work is essentially muddling through has varied.

Today, looking at the principles and intermediate texts, which (since welfare economics is no longer actively taught in undergraduate or graduate school) are as close to welfare theory as most economists get today, one gets no inkling that applied policy is muddling through. Instead, the texts convey the impression that policy is guided by what might be called an "economics of control" framework. In that economics of control framework, applied policy is the direct application of economic theory. It is designed to equate marginal social costs with marginal social benefits, eliminate externalities, and undertake other policies to achieve economic efficiency.

Welfare Economics in Micro

To understand how that economics of control approach came to be the textbook model of policy, it is helpful to briefly consider the history of welfare theory that began with A. C. Pigou's attempt to derive policy results from the theoretical model. Before Pigou, policy was generally not presented in specific models, but was part of a broader philosophical and political set of arguments associated with the economics of Adam Smith and John Stuart Mill, which sometimes went under the name "Grand Tradition." For both of these writers applied policy was sophisticated muddling through; they blended together philosophical, psychological, and economic arguments to arrive at reasoned pronouncements about economic policy. They were broad social scientists rather than narrow technical economists.

Around the turn of the century J.N. Keynes (1896) tried to codify the rules of applied policy. In his *Scope and Method of Economics* he classified the applied policy branch of economics as an art, which was separate from both positive and normative economics. Positive economics—economic theory--focused on how the economy functioned; normative economics focused on what the goals of economic policy should be, and the art of economics provided a bridge between the two; it was the branch of economics that considered how to achieve the goals determined in normative economics, given the insights about the way the economy functioned that were developed in positive economics.

Keynes argued that the art of economics involved going outside the realm of economics alone, and that economists, in their role as economists, were best advised to stay out of the business of giving policy advice. They should stick to the study of economic theory—to positive economics--and focus their analysis on how the economy operated, and not draw policy advice from that theory. The reason for this was that, for Keynes, policy was inevitably a muddle that necessarily involved rules of thumb, pragmatism, and good sense. It required a quite different, and looser, methodology than was appropriate for positive economics. To emphasize this point Keynes specifically distinguished economic theorems--implications drawn from economic models, from economic precepts--general rules of applied policy drawn from economic reasoning. While in practice Keynes' methodological approach was not closely followed, it was accepted as being the best prescriptive statement of the correct approach to applied policy. So at the turn of the 19th century the stated approach to applied policy was a muddling through approach.

A first step away from muddling through occurred when Pigou, in his *Economics of Welfare,* (1932) tried to avoid the art of economics and incorporate applied economics into positive economic science. He attempted to make a seamless flow from theory to policy precepts. However, Pigou's policy precepts were not the laissez faire precepts of the earlier Classical tradition, but instead were a set of activist precepts that involved internalizing externalities and subsidizing increasing cost industries in order to equate marginal social benefits with marginal social costs. It was only a first step for two reasons. First, Pigou saw a limited domain for welfare economics; it was only an input into the policy decision-making process, it was not the entire policy process.[2] Thus, he defined welfare economics as "that part of social welfare which can be brought, directly or indirectly, into relation with the measuring-rod of money." Second, he accepted a material welfare concept of utility in which interpersonal comparisons of welfare were possible. This material welfare approach integrated general elements of popular thinking into the goals of the analysis, especially as that analysis related to income distribution. That's why Pigou could support a progressive income tax on the basis of theory.

Lionel Robbins attacked Pigou's material welfare approach. In his "Nature and Significance of Economic Science" (1935) Robbins strongly reiterated J.N. Keynes' argument that "scientific" economists must wear two hats, one as a policy advisor, the other as a theoretician, and that there could be no seamless connection between the two. In making that argument, however, he shifted ground, and interpreted utility within an ordinalist, rather than a material welfare, framework.

The difference between the material welfare and ordinalist approaches can be seen by considering Pareto's distinction between utility and ophelimity.[3] For Pareto, *utility* referred to usefulness, was determinable by introspection, and was comparable across averages of individuals. Marshall and Pigou accepted that interpretation of utility and used it as the basis of their welfare economics. For them, the foundation of the application of theory to policy was introspection. Thus, generally accepted normative views about comparability of welfare were built into applied policy. This view of utility, which is not well known now, was distinguished by Pareto from ophelimity, which referred to satisfaction of desire; it was not determinable, and was not comparable among individuals. Marshall and Pigou took the Pareto-utility approach; for them utility was a rough and ready guide for policy that embodied generally accepted welfare judgments of the society. Ordinalists, such as Robbins, took the Pareto-ophelimity approach; it was a precise statement about individual's welfare and did not allow introspection.

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[2] Pigou's presentation of welfare economics was actually an extension of Marshall's applied policy analysis, although, as was often the case, Marshall had tried to maintain a firm foot in both positions, and thus it was hard to pin down precisely what his position was regarding the relation between theory and policy. Pigou's presentation was much clearer. Because it was he exposed the introspection upon which the material welfare approach to theory that he used, was based, and thereby opened the analysis up to serious criticisms.

[3] See Cooter and Rappaport (1984) for a discussion of the distinction between these two approaches.

Robbins criticized the material welfare aspect of Pigou's work for the interpersonal welfare judgments that it required, and argued that welfare theory must pull out policy precepts from theory without the introspection inherent in the material welfare approach. He argued that there was no scientific basis for making interpersonal welfare judgments. To avoid including such judgments as part of welfare economics he defined economics as "the allocation of scare resources among alternative ends," which nicely fit into a utility optimizing framework. This definition became the standard textbook definition of economics, replacing Marshall's "study of mankind in the normal pursuit of business" definition, and built into economics the ophelimity interpretation of utility, which was broader and had suggested an empirical, introspective, rather than a logical-deductive, approach.

Robbins' arguments won the day and in doing so both expanded and contracted the domain of economics. They expanded it because economics now included all activities and goods, and made no distinction between luxuries and necessities. The materialist welfare approach made a distinction and was applicable only for broad categories—it was a tool of muddling through--a rough and ready concept to talk about policy as it relates to classes of people, not a precise tool to talk about individual welfare. But Robbins simultaneously contracted the domain of economics by limiting the amount of interpersonal comparability that was allowed, since that comparability had no scientific basis.

The result of this change from a materialist welfare to ordinalist interpretation of utility involved a change in the way welfare economics was conceived. Whereas Marshall's and Pigou's welfare economics was a rough guide for economists who were doing actual policy work, and involved making generally accepted interpersonal welfare comparisons, under Robbins's approach, welfare economics became a highly esoteric topic, which asked under what conditions policies theoretically can definitely improve the welfare of society. Welfare economics became a deductive scientific analysis, not a societal tool of muddling through. By the 1950s this ordinalist view came to dominate the profession and set the stage for the modern textbook theory of applied policy that remains today.

The next step in the evolution of modern welfare economics occurred when a student of Robbins's, Abba Lerner, as part of his discussion of the socialist calculation debate, spelled out the welfare conditions necessary to achieve social efficiency in his *Economics of Control*. Lerner argued that planned market economies could achieve all the benefits of the market by following the rules of welfare economics. Lerner's economics of control provided the architectural plans for maximizing social welfare of an economy, and if planners were in possession of them they could do it as well as the market.[4] For Lerner applied policy economics was the application of a scientific set of rules determined by economic theory to be followed by policy makers and by agents in the economy. These rules for both agents and policy makers form the foundation for the current textbook presentation of economic theory.

The economics of control was the final step away from the muddling through approach that was inherent in J.N. Keynes's and earlier Classical economist's applied policy approach. It made

[4] Lerner attempted to include the distribution of income in the analysis with his assumptions about uncertainty and utility maximization, but that was soon dropped, as the scientific foundation for any interpersonal utility judgments, even those based upon uncertainty, were questioned.

economic theory the guiding factor in policy analysis. There was no place for Keynes' art of economics in the economics of control; it was unnecessary since policy was a precise science.[5]

In the economics of control, economic analysis became *the* decision criteria, not an input into a broader decision process, and the results that came out of welfare economics were what "should" be done, not some general results to help economists determine appropriate policy. This, of course, violated Hume's Dictum that you cannot derive a "should" from an "is", but that problem was pushed under the rug by narrowing the goals of economics to a single criteria—ironically called Pareto optimality—that had broad support.[6] Textbook economic theory became the analysis of under what conditions a market economy will lead to policies that improved the welfare of at least one individual, while reducing the welfare of no individual.

The welfare economics associated with Pareto optimality was called the new welfare economics. In the new welfare economics any position that achieved a result in which no one could be made better off without making someone else worse off was an efficient position, and the new welfare economics came to focus on efficiency to the exclusion of other goals. Accepting the Pareto Criteria as the central focus of policy allowed economic models to reach formally clear conclusions about policy, but it severely limited the applicability of new welfare economics to any real-world problems.[7]

This connection between theory and policy on the basis of efficiency significantly influenced the direction of research in economics. Specifically, it led theoretical economists to focus on abstract models rather than concrete problems, and to a separation of applied work from purely theoretical work. The work associated with Arrow/Debreu is the best example of the focus of this formal theoretical work, which was quite separate from what applied economists did or were interested in.

Applied microeconomics followed a different path; it focused on empirical testing; it did not rely on formal theoretical models, but instead on what might be called an educated common sense—exploring the effect of incentives and determines how much they matter. Not much theory was needed for this--the only theory much of this work needs is that incentives matter. It also led to welfare economics no longer being taught. Why teach welfare economics, if it simply came to the conclusion that one cannot apply theory to policy questions?

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[5] This meant that when Milton Friedman wrote his famous essay on methodology (Friedman 1953) although he cited Keynes' tripartite division, he immediately forgot the art branch, and discussed economics as if it only involved positive and normative economics. While there were multiple discussions of Friedman's essay no one objected to the missing art.

[6] This, of course, does not solve the problem. As Sen (1970) pointed out, Pareto optimality cannot be made free of normative judgments.

[7] See, for example, Graff (1967) who argues that welfare economics has little applicability, and that economists should stay out of policy discussions and concentrate on describing how the economy works. The new new welfare economics, which adds back value judgments and interpersonal comparability with a social welfare function framework did not add significant applicability to welfare theory, because it was kept abstract. But it did open up the door to much formal esoteric analysis.

Welfare Economics in Macro

The welfare economics of macroeconomics followed a quite different path. The goal of macro policy was assumed to be full employment and zero inflation, without any connection of those goals to individual welfare. Macro models assumed agent actions that were not necessarily consistent with optimization, but were stable and empirically determinable. In Keynesian macro models economists could use the steering wheel of monetary and fiscal policy to control the economy and direct the economy to the desired goals. Output too high—use contractionary monetary and fiscal policy; output too low--use expansionary policy. This mechanistic approach was also developed by Lerner in the second half of his *Economics of Control* book. He called it functional finance, and it was presented with as much certainty and firmness as were his rules of microeconomics for the socialist planner developed in the first half of his *Economics of Control* book. The 1960s were a time of fine-tuning in macroeconomics.

Lerner's welfare approach to macroeconomics did not last because it involved an inconsistency with the assumptions of microeconomics. As the microeconomic foundations of macroeconomics were explored, and the two approaches integrated, neoKeynesian policy analysis, which was based on Lerner's functional finance welfare approach, was attacked by New Classical economists on consistency grounds. New Classical economists argued that if policy makers had full information, rational individuals should also be assumed to have full information available to them. They further argued that if agents had that information, then much of the benefit of Keynesian policies is eliminated; in fact, most of the Keynesian problems of stabilization and equilibrium at undesirable unemployment levels would not exist.[8] In New Classical models fluctuations in output are simply reflections of shifts in intertemporal choices, or irreducible noise in the stochastic system, and unemployment is simply the result of intertemporal inconsistencies combined with institutional rigidities.

This lack of consistency between agent and policy maker assumptions played an important role in the demise of Keynesian economics and the development of the currently popular dynamic stochastic intertemporal equilibrium approach to macro. Model consistency between agent's information sets and policy maker's information sets seems logically desirable; if policy makers have access to that information, then why shouldn't the agents in the model also have access to it, at least at a cost? So modern intertemporal equilibrium macro is defensible on these consistency grounds. It is simply the extension of the economics of control micro framework to macro. Thus, I see this movement toward New Classical economics as an important step in the development of economic thinking because it brings both micro and macro onto the same footing, and helps clarify the issues. It shows the full implications of taking an economics of control approach to policy.

[8] An example of the implications of the New Classical approach for policy can be seen in Robert Lucas's recent Presidential address (2003) in which he argued that stabilization has little welfare gain, and that the policy focus of macro should be on growth.

THE CHANGING NATURE OF MODERN ECONOMICS

Now that I have completed my brief history of welfare economics, let me turn to what I see as the most important changes occurring in modern economics – the movement away from the holy trinity assumptions that I discussed at the beginning of the paper. In my view modern economics is slowly moving away from the holy trinity toward a broader foundation of economic theory of purposeful behavior, enlightened self-interest and sustainability. The changes that are occurring can be seen in a variety of theoretical work, such as work in behavioral economics, evolutionary game theory, agent based modeling, experimental economics, and new institutional economics – the list could be extended significantly.[9] Indeed, as I have argued elsewhere (Colander, Holt and Rosser, forthcoming), much of the work that is considered cutting edge theoretical work falls into the category of moving away from the holy trinity.

One can see the change in the allocation of recent awards in economics. For example, Daniel Kahneman and Vernon Smith recently won a Nobel Prize for their work in behavioral and experimental economics and Mat Rabin won the John Bates Clark medal for work on behavioral economics. Because of these changes today one would no longer describe modern economics as neoclassical economics. (Colander 2000a)

I do not want to overstate the degree of change that is currently taking place in the profession; one sees only slight change in the work of most existing economists. But I see these small changes as an indicator of much larger future changes. The reason is that the acceptance of behavioral rather than axiomatic foundations to agent's actions involves a major change in the underlying vision of what economists study, and how they study it. Specifically, I see the changes leading from a vision that sees economics *as the study of infinitely bright agents in rich information environments* to a vision of economics *as the study of reasonably bright individuals in information poor environments.* It is this switch that is central to my thesis that economics is moving away from an economics of control framework--*a framework within which infinitely bright economists with full knowledge of the system approach policy*, to an economics of muddling through framework--*a framework within which reasonably bright economists with limited knowledge of the system approach policy.*

Another way of describing my thesis is that the vision of the economy will evolve from its previous vision of highly complex, "simple system" to a highly complex "complex system".[10] Simple systems, no matter how complex, are reducible to a low dimensional set of equations, making it possible to model the system analytically and to conceive of controlling it. A complex system is not, and must be represented in another fashion—through simulation, or through insights gained with replicator dynamics. One never has a full analysis of the entire complex system, and it cannot be controlled.

[9] That is close to happening in behavioral economics in certain fields such as finance. As Richard Thaler has said, once, people asked what was behavioral finance; now people ask what other type of finance is there? A leading indicator of the changes that are occurring, is the hiring priorities of top schools, and the needs their hiring departments see. In the early 2000s behavioral economics is seen as a hiring priority; experimental economics is not yet a totally accepted hiring priority, and agent based modeling is as yet hardly on the horizon.[9]

[10] For a discussion of what is meant my complex system see Auyang (2000).

Simple and complex systems differ in their micro foundations. Simple systems can be studied from micro foundations alone. Complex systems involve emergent properties, and cannot be understood from an analysis of the elements of the components of that system. There can still be micro foundations, but the micro foundations of complex systems are contextual, and can only be understood in reference to the existing system. Such complex systems are built up in path dependent stages, making individual optimization within such systems history and institution specific. This means that its institutional structure is central to understanding complex systems, and that any assumed rationality must involve some boundedness.[11]

The acceptance of this complexity vision of the economy involves a shift in economics far more fundamental than anything associated with the movements away from the holy trinity that the profession has made so far. But by moving away from the holy trinity economics is making the first step toward such a new vision.[12]

UNDERSTANDING THE NATURE OF THE CHANGE

Jokes about the economics profession are often revealing of the vision that the profession has of itself, and one joke that is often told to make fun of economists' deductive and non-practical tendencies is the can opener joke. In it a physicist and a chemists offer practical solutions to a problem of opening a can on a desert island, while the economist offers a useless solution--to assume a can opener.[13] That joke is not very complementary of economists and it provoked a less well-known joke that portrays economics in a better light. The joke is the following:

> A physicist, an engineer, and an economist are given a watch, a string, and a ball and told that the person who can best measure the height of a building will get into a Scientific Hall of Fame. The physicist ties the ball to the string, hangs it down from the roof and, using the stopwatch, calculates the length of time it takes the pendulum to swing from side to side. From that information he estimates the height of the building. The engineer takes the ball and drops it off the top. He then uses the stopwatch to determine how long it takes to fall, and estimates the height of the building accordingly. The economist, however, wins the place in the Hall of Fame by taking the stopwatch, trading it for the building plans with a guard in the building, and simply reading the height of the building from the blueprints.

This joke, obviously made up by an economist, shows both the benefits of trade and the importance of economic theory. That theory provides a blueprint of how the economy operates, and thus, once found, is to be guarded at all costs. It also shows that economist's assumption that the economy is a complex "simple" system, because those are the only systems for which one can find a complete set of blueprints.

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[11] These ideas are developed in Anderson, Philip W., Kenneth J. Arrow, and David Pines, eds., (1988) and Arthur, W. Brian, Steven N. Durlauf, and David A. Lane (1997). See also Colander (2000c).

[12] Of course the simplicity view has not always been the view of economics and thus the movement toward complexity will be a movement back to earlier writers, including Smith, Marshall, and Hayek. See Colander (2000b) for a discussion of the complexity in the history of economic thought.

[13] The joke is so well known that I do not repeat it here, but those who do not know it can find it at www.aeaweb.org/RFE/Neat/JokJokAboEco.html.

The problems with this story from a complexity point of view are the assumptions that a set of blueprints exists, and that the building of the economy actually followed that set of blueprints if they did exist. The complexity vision sees the economy as emergent from a set of simple decisions in a way that no one previously pictured. Thus the complexity addendum to this story, which Robert Bassman suggested to me in private discussions, is that when the building took place, the builders made adjustments to the plans, which they never marked down on the blueprints. The economist reading from the blueprints got the wrong answer.

Each of the changes currently occurring in the holy trinity can be seen as a movement away from a search for the blueprints of the economic system, and toward a search for understanding a system in which the blueprints are missing, nonexistent, or so far beyond our analytic capabilities that we might as well forget about them. Consider rationality. In order to achieve a blueprint of the economy strong rationality must be assumed, where individuals have information about all other's actions, and can determine what they will do given that information. The models one derives given these strong assumptions are justifiable because they provide the blueprint for the economy—once we have that blueprint we can proceed to discussions of practical issues. Behavioral economics is a direct challenge to that belief—it involves a different sense of theory and of rationality; a behavioral economist looks at what people do, and builds in those observations into his or her assumptions about behavior in his or her models. Behavioral economics is designed for economists operating without blueprints.

The "simple" approach relies on theory, uses empirical observation to test the theory, and then builds policy issues around that "empirically tested" theory. The "complexity" approach relies on empirical observation, builds theory around those observations, and then builds policy around the resultant "empirically-determined" theory. The type of rationality assumed is a key difference in the two approaches. Both assume rationality—all models of economics must assume some type of rationality—but there is a difference in the type of rationality and the level of information assumed.

WHY NOW?

Let me now turn to the reasons why I believe the profession is open to a change to muddling through now, and was not previously. One is the developments in macroeconomics. New Classical economics logically follows from assumptions of fully rational agents operating in an information rich environment. But for many economists—Keynesian, monetarists, and eclectic—the results of the analysis do not meet the "aha" factor; they do not make intuitive sense, and the models do not fit the empirical evidence. If the New Classical logic is correct, that means that it is the assumptions that have to be wrong. Thus these economists are now open to behavioral explanations whereas earlier they were not.

You can get a sense of the difference between the behavioral approach and the rational approach by playing what is called the 2/3rds game. In this game you are to estimate a number that is 2/3rds of the average number guessed by a large group of individuals. Thus if people guessed 75, 50, and 25, the average guess would be 50 and you would win if you guessed 33 and 1/3rd. Rationality does not provide an answer to this game. It drives the answer toward zero. But, of course, guessing zero, which is what some game theorists actually do guess, has no chance of winning.

To win the game you have to go beyond rationality and into minds of individuals. You have to have a sense of what people will do when faced with problems that have no unique rational solution. That knowledge comes from introspection, experience, and empirical evidence. The study of such issues is the essence of behavioral economics.[14] J. M. Keynes considered these problems of rationality, as is evidenced in his famous beauty pageant analogy, but the Keynesian economics that developed from his work avoided them and stuck with the holy trinity. By pushing the economics of control framework to its logical conclusion, New Classical economics led many economists to reconsider the foundations of theory, and be willing to abandon the holy trinity.

Accepting that behavioralist view has implications for the way economists picture their role in policy. These implications can be seen by putting the New Classical argument for consistency in reverse. The consistency argument for assuming rational expectations on agent's parts lies in the simple argument that agents can hire economists. If one assumes that economists know the correct model, which might be a stochastic one, then to maintain model consistency one must also assume that agents also can know the correct model at least at some cost. Combining the two arguments led to the rational expectations revolution.

Muddling through achieves consistency the other way around. Rather than achieve the consistency between agent and policy maker by assuming both individuals and policy makers have full rationality and rich information sets, the economics of muddling through approach is to start from the other direction--to assume both policy makers and agents are operating within an information poor environment, and, while bright, are not infinitely bright. Neither agents nor economists know for sure, even stochastically, what is going to happen.

I sometimes picture the difference in the standard and the muddling approach approaches to theory and policy in reference to the building of medieval cathedrals. These cathedrals were built following a muddling through approach. The did not rely on scientific laws to guide the building, but instead on accumulated rules of thumb of what worked and what didn't. The building proceeded by trial and error. Different methods of construction would be pushed to the limit until a cathedral caved in somewhere, and then the rules of thumb would change. As the stored knowledge increased, the cathedrals became more grandiose, even without a specific understanding of the laws underlying them. That came much later.

Muddling through policy follows that same approach. It is conducting policy without a full knowledge of the general laws of the economy, if there are any. What you can find, at best, are general rules of thumb for how things have worked in the past, and possibly some exploitable patterns. Economics of control welfare economics follows a different approach to policy; it is basing policy on the underlying architectural plans of the economy.

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[14] While there is no "correct" solution, some guesses are better than others, although the guesses depend on the group and the framing of the question. With the question framed as I have framed it in groups of economists "11" has often been close to the best guess.

A second reason that I believe the economics profession is ripe to accept a muddling through approach to policy is the technological change that has occurred in the analytic and computing methods available to economists. Developments in non-linear dynamics, chaos theory, and computing technology eliminate the need to make as restrictive assumptions as before. Consider the choice from a graduate student's perspective. Would he or she rather write a dissertation pushing the rationality assumption one degree further, or would he or she rather explore one of the infinite number of new behavioral assumptions that one can make based on findings in psychology? The "low hanging fruit" has already been picked from the first approach, but there is a lot of "low hanging fruit" just waiting to be picked in the behavioral approach. Moreover, the study of those behavioral foundations can now be technically impressive. Whereas before muddling through was primarily heuristic analysis, and difficult to publish, modern muddling through is technically impressive and increasingly publishable.[15] To achieve an analytic solution the full rationality models had to be kept analytically simple. The models used in muddling through do not, because all they are meant to do is to provide guidance, not analytic solutions. This leaves them free to rely on empirical measurements and experiments to provide choices among assumptions, and simulations to provide estimates of solutions to problems that are analytically intractable.

Schumpeter (1954) made the assumption of a unique equilibrium a necessary component of a science of economics. With the higher level of mathematics being taught in graduate school, and with the greater mathematical sophistication of those entering the profession, that restriction is no longer necessary, which is why these more complicated issues are being explored. As students are freed from the requirement of achieving a full analytic solution based on the holy trinity, they can use new tools to study path dependency, non-linear dynamic systems, and many similar complicating features that could well characterize real world processes. By understanding the processes that guide the economy in its evolution one can gain insight into the economy and to the future direction of the economy even if one does not know what it's ultimate equilibrium will be.

As soon as one moves to these more complicated mathematical approaches, neat analytic solutions are far less likely to be forthcoming. Previously, that meant abandoning the approach; today it simply means that one moves from analytics to simulations. Thus, the strongest reason for my belief that the future will involve muddling through is that advances in computing power involve a fundamental change in technology that is reducing the value of deductive theory. If one can gain insight through simulation, one has far less need to gain insight through deductive analytic theory. As long as computing power continues to double every 18 months, eventually a whole new way of doing economics will become the norm: agent-based simulations.

In agent-based models the researcher "grows" an economy, letting simple algorithms describing agent behavior (algorithms developed from work in behavioral work) compete with one another,

[15] I do not want to overstate how these changes are currently affecting economists. Most economists do variations of what they were taught to do, and so have not changed what they do. "Same economist" research changes only slightly. But the economics profession is not a static group, and so the research is also changed by the change in the composition of economists, with younger, newly trained economists coming in, and older economists going out. Thus the evolutionary hiring and retirement process affects research. As time passes, and younger, differently trained, economists replace older economists, the average image of what economics is and of how one does economics changes.

and see which one wins out.[16] Agent-based simulations are fundamentally different than simulations designed to solve equations. In agent-based modeling one analyzes the system without any equations describing the aggregate movement of the economy; one simply defines the range and decision processes of the individual actors. Through multiple simulation runs one can gain insight into the likelihood of certain outcomes, and of the self-organized patterns that emerge from the model. As computing power becomes cheaper and cheaper, such modeling will likely take over the profession. Ultimately, I see virtual economies being created in which policies are tested to determine their effectiveness in the same way that virtual designs are currently tested.

Is such agent based modeling still economics? I believe it is; it keeps much of standard economics—it sees individuals as purposeful, although the precise nature of purposeful behavior is derived from the model rather than assumed. It assumes individuals interact and trade, and that successful individuals continue; unsuccessful individuals do not.

WHAT DOES MUDDLING THROUGH TELL US ABOUT POLICY?

In the muddling through approach that I advocate one begins with a problem to be solved, not a theory. Given that problem, economic reasoning begins with what Tom Schelling has called the "vicarious problem solving" approach. (Schelling 2003) In it one informally models the situation, assuming agents "operate in a purposeful manner, aware of their values and alert to their opportunities." Using this approach the researcher figures out what an agent might do by imagining him or herself in the person's position, as best he understands that position, and decides what that person will likely do given that person's aims, values, objectives, and constraints. It is a type of armchair theorizing that most economists do, and that some, such as Ronald Coase, Gordon Tulluck, or Mancur Olson, are masters of. Thus, in many ways muddling through is advocating that all economists use such an armchair theorizing approach.

But there are two differences. In the muddling through approach that I am advocating such armchair theorizing is only the beginning of the analysis. It is the exploratory work that then will be supplemented by a variety of highly technical work, which will provide a foundation for the workable solution to the problem one works out. This work might include field studies, agent based modeling, statistical data analysis, or a variety of other techniques that might shed light on the issue. The second difference is that the assumptions about the agents will reflect how actual agents operate, and not any predetermined sense of rationality that is separate from introspection. Thus, the agents being modeled will be characterized by introspection--one's understanding of oneself, and insights from psychology.

Initially, the changes in policy analysis associated with muddling through will come slowly and will be appended to existing thinking. Thus, the first set of policy proposal changes that are coming from behavioral economics involve slight addendums to standard economic results. These changes are acquiring the name benign paternalism (Benjamin and Laibson forthcoming) or libertarian paternalism. (Sunnstein and Thaler forthcoming) In this policy work one uses the insights coming from behavioral work in economics to modify the way in which policy is

[16] For a discussion of agent-based modeling see Robert Axtell and Josh Epstein (1996) and Robert Axtell (1977).

implemented. For example, one of the insights of behavioral work is that preferences are often ill formed. This fact means that small, seemingly innocuous, differences in the institutional environment, such as in how a choice is presented to an individual, play important roles in outcomes of policies. Libertarian paternalism involves structuring choices in a way that lead to results that the policy maker believes in best for the individual.

An example that advocates of this policy use is the structure of savings plans in which individuals must choose whether or not they want to automatically save.[17] If the policy maker structures the program with the default option being that the agent saves, approximately 70% choose saving; if he or she structures the default option as one in which the agent does not save only 30% choose to save. (Sunnstein and Thaler forthcoming) If the paternalistic policy maker believes saving is good, he or she structures the program so that the default option is saving. In doing so the individual's consumer sovereignty is not being violated, because he or she is choosing whether he or she wants to save, and may change at will. But by taking advantage of insights from psychology and structuring saving as the default option, the policy maker is guiding that choice to the one that the policy maker believes is best for the person.

THE SLIPPERY SLOPE

Libertarian paternalism seems like it involves only a small change in policy implications, and that it can be added as an addendum to standard welfare arguments of economics. In my view, that is not the case, because accepting the psychological assumptions upon which it is based undermines standard welfare theory, and thus cannot be appended to it. Instead, the implications for future change in policy analysis of accepting the implications of psychological insights are substantial. The reason is that there is no reason for the policy maker to stop at libertarian policies. Accepting psychology's insight and giving up the rationality and greed foundation for policy means accepting that people's actions do not necessarily reflect what they would "really" want.

Psychological research shows that individual's choices are influenced by a variety of factors and can be directed in many ways, an insight that has not gone unnoticed by many real world firms. Thus, based on standard economic theory without the rationality pillar, there is no reason to stop at libertarian policies. If one accepts that policy makers have some insight into what is good for individuals separate from what they actually choose, a premise that is the basis of libertarian paternalism, there is nothing in existing standard economic theory to state that one should not go further. For example, why not design policies that take into account individual's tendency to exhibit hyperbolic discounting, and implement policies to restrict immediate choice, by guiding individuals toward precommitment against immediate gratification? Such policies would likely get significant support among liberal economists.

One can easily go further. Once one accepts that people's actions do not necessarily reflect what they really want, there is no theoretical reason within the economics of control framework to restrict individual behavior to get people to do what is good for them. For example, Robert Frank (1999) argues that a set of goods, which could be called relational goods, are primarily desired

[17] In the U.S. these are called 401k plans.

because others have them, which means that individual's welfare from a variety of luxury goods is determined by what one has relative to others. In that case, a policy of taxing luxuries can bring in revenue to the government and actually improve social welfare. Extending this line of reasoning, and assuming that advances in neuropsychology give us a much better sense of individual psychology, from a society's point of view there may well be a determinable optimal set of tastes, and policy can be devoted to achieving that optimal set of tastes in order to optimize social welfare.

Economists as a group, even liberal ones, would, I suspect, be very much against such paternalistic policies. It is in fundamental opposition to the grand liberalist tradition of economics. The public, however, would probably be far less concerned since economists are usually much more hesitant about paternalistic policies than is the general public. My point is not that economists should support paternalist policies; my point is that, in principle, given that one accepts a behavioral foundation of economics, that hesitancy to accept paternalistic policies that follow from is not based upon deductive theory, since the underlying model that grounded that view has been eliminated when one gave up rationality. Within the new model of endogenous tastes, agents may be made better off, even in their own minds, by government paternalistic actions, because agent's actions do not necessarily reveal their true desires. Thus, the end result of giving up the holy trinity and adopting a behavioral foundation for economics is a much more complicated set of policy arguments, where right and wrong policy will be harder to characterize, and alternative explanations of economists' fear of paternalism will become part of the policy analysis.[18] Policy analysis will require muddling through as best one can using the technical tools available.

CONCLUSION

If the economy is a complex system, which I believe it is, the best we can do in policy analysis is to muddle through. The only question is whether we will do it openly, or pretend to be doing something more than that. If we do it openly, we will, I believe, do a much better job of policy analysis; we will more likely recognize what is, and is not important. We will recognize that technical work is extremely important in arriving at answers to policy questions, but that it is only a step in the chain of reasoning; it is not the entire reasoning process.

Muddling through is primarily a state of mind. It is an approach that sees both theory and empirical work as useful in providing insights and structuring thoughts, but not as providing the final answers on policy issues. Those answers will have to be arrived at through a sophisticated blend of philosophical, psychological, and economic arguments.[19] Adam Smith excelled in the nuances of that blended reasoning, and thus, in many ways the recent developments in economics are bringing the profession back to where it began.

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[18] In the muddling through approach that I have been advocating (Brock and Colander (2000), we argue that an important limitation on policy is policy makers ability to understand the effects of any policy in a complex system. This limitation, more so than inefficiency, lies at the heart of economists' distrust of paternalism.

[19] Amartya Sen's work (eg. Sen, 1999) is an example of such a blend.

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Chapter Two

THE EVALUATION OF ECONOMIC POLICY*

By Robin Johnson

INTRODUCTION

There is an increasing concern that economic policy decisions are taken in a vacuum without adequate investigation and evaluation of past decision making. While it would be normal for policy advisors to review problems with a particular policy, it is not customary (nor efficient) to embark on a large research programme to evaluate the real effectiveness of every policy proposal. This may be due to the myriad of policy programmes in place at any one time (thus making choice of projects for evaluation more difficult), but also to a lack of tradition in requiring systematic evaluation before consideration by decision makers. Not unrelated to this problem, is the problem of finding the necessary skills to do the necessary research at an adequate level.

If standards of presentation and adequate background work on economic policy papers are to be improved, then greater attention needs to be paid to evaluation of past policies and instruments. Good presentations should be based on well-researched analysis and facts from an objective point of view and analysis of alternative options for decision makers. In social policy circles, these objectives are summarised in the phrase `evidence-based policy formation'.

It has to be recognised that decision-making in government is carried out in a political framework and that some issues under discussion derive from previous declarations of intent rather than well-intentioned research. Furthermore, decision-making is in the here and now and there may not be adequate time to prepare analysis in depth. Thus quality may depend on what well-skilled people can do in in a restricted time rather than deep-seated research.

In some cases the sheer volume of evaluation work may require specialist services and groups. Such groups need to have the confidence of CEOs and those who write policy advice papers. This assumes that policy advisors do not have the time to do all their own research or even a significant proportion of it. Those with experience will know that such an approach must *anticipate* the policy issues before they occur and some selectivity shown in prioritizing the resulting research projects.

More broadly, government departments need to more seriously engage in information collection activities and/or support national collection agencies such as Statistics NZ. Such agencies may be able to supply the raw materials of good research on policy issues but not always. Within departments, there is a need to develop information systems alongside policy formation and implementation if feedback for evaluation is to be developed properly.

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This paper is about the benefits of policy evaluation and the range of research and evaluation techniques needed to back up systematic research on policy options in government. Some of the organisational problems that emerge are discussed. The paper takes the political system as a given and examines how better results can be achieved by prioritizing work programmes in departments and using appropriate techniques for the task in hand.

THE WESTMINSTER BACKGROUND

We should never lose sight of the administrative background and origins of our civil service system. Until the early nineteenth century, the affairs of state in the United Kingdom were administered by public officials who owed their positions to political patronage and influence. There was no common system of pay, bribes augmented official salaries, and officeholders, who viewed their positions as property that could be sold, often engaged and paid their own staff. Although the system did not rule out advance by individual ability, it was not a basis for sound administration.

The blueprint for civil service reform was the Northcote-Trevelyan Report of 1854, which advocated the creation of a modern buraucracy based on a career civil service. Drawing on ideas advanced for the Indian civil service by Thomas Macauley, it was proposed to divide the Government's work into two classes – intellectual (policy and administration) and mechanical (clerical) – and creating a career civil service to carry it out. Staff capable of performing the intellectual work would be recruited from the newly reformed universities; the best talent would be selected through tough competitive examinations supervised by a board of civil service commissioners[1].

In New Zealand, the Civil Service Reform Act of 1886 provided for entry into the civil service by a competitive examination. The Public Service Act of 1912 made provision for security of tenure, good behaviour, promotion by merit, pensions on retirement, and abolition of entrance by other than competitive examination[2]. Subsequently, the idea of the bureacracy as a provider of independent and objective policy advice developed slowly and was firmly put in place by some of the well-known civil servants of the day such as Ashwin, McIntosh and Robinson.

This does not mean that the elected officials have to take the advice given by non-elected officials, but it does represent an important distinction derived from the Northcote-Trevelyan reforms in the UK that the civil service has a tradition of independent advice to government which should not be discarded lightly. In an operational sense, the tradition is maintained by non-elected officials always offering alternative courses of action to Ministers so that their neutrality is preserved. (Many Ministers do not want to understand this principle.)

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[1] Adapted from 'Building Institutions for a Capable Public Sector', World Development Report, World Bank 1997, p.80.

[2] NZ Year Book, 1993, p.26.

EVALUATION AND OUTCOMES[3]

The main problem with policy evaluation is the issue of defining the appropriate set of objectives being sought. If serious studies are to measure the *effectiveness* of policy programmes then the focus has to change from departmental *outputs* to policy *outcomes*[4]. As the US authorities put it "The Results Act (the relevant legislation) seeks to improve the management of federal programs by shifting the focus of decision making from staffing and activity levels to the results of federal programs"[5].

The US General Accounting Office (GAO) administers the Government Performance and Results Act of 1993 that *mandates* annual performance plans in the federal system. Congress was seeking to reduce the cost and improve the performance of the federal government, holding agencies more accountable for results and better management. Congress had found that the lack of adequate information on federal agencies' performance was handicapping congressional policy making, spending decisions and oversight and diminishing federal accountability for program results.

The Results Act seeks to improve the management of federal programs by shifting the focus of decision-making from staffing and activity levels to a results basis. Executive agencies are required to prepare five-year strategic plans to set general directions and then prepare annual performance plans that establish the connections between the long-term strategy goals and the day-to-day activities of the program managers and staff. Finally, the Act requires that each agency report annually on the extent to which it is meeting its annual performance goals and the actions needed to achieve or modify those goals that have not been met.

In 1999 GAO reviewed evaluation studies in annual performance reports[6]. Agencies used evaluation studies to both improve their measurement of program performance and understanding *and* how might program performance be improved. Not all evaluations were initiated in response to the Results Act; most were self-initiated in response to concerns about a program's performance or about the availability of outcome data. Commonly agencies all faced challenges in collecting outcome data on an ongoing basis. These challenges included: the time and the expense involved, grantees' concerns about their reporting burden, and substantial variation in states' data collection abilities.

In New Zealand, the State Services Commission has reviewed the issues around the evaluation of outcomes in the context of improving the quality of policy advice[7]. Some other recent New

[3] For a discussion of the role of the Public Finance Act 1989 in New Zealand, see R.Johnson, Improving the policy advice process, *IPS Newsletter 70,* August 2002.

[4] Simply put, efficiency would be measured by some ratio of outputs to inputs, while efectiveness would be measured by some ratio of outcomes to inputs required.

[5] General Accounting Office of the USA (1997), *Guide to Assessing Agency Annual Performance Plans* (www.gao.gov/special.pubs).

[6] GAO (2000), *Evaluations help measure or explain performance* (www.gao.gov/evaluation).

[7] SSC (1999a), Looping the Loop:Evaluating Outcomes and other risky feats: (1999b), Essential Ingredients: Improving the quality of policy advice, (www.ssc.govt.nz).

Zealand research has been focused on refining the meaning given to outcomes[8]. The Strategic Policy Group of the Ministry of Social Policy has been working on the conceptual foundations of cross sectoral social policy and social development[9].

In particular the information needs of ongoing monitoring of policy initiatives has to be identified by departments. Ryan[10] distinguishes between immediate and intermediate outcome monitoring. He also talks about "ultimate policy impacts". The latter are societal-level outcomes and tend to be rather unspecific, unattributable and usually several years after the event. "What staff and providers need for ongoing management is information regarding the immediate and intermediate outcomes of service delivery; what changes client status or their conditions of existence are created as a more-or-less direct result of services delivery? Improvement – or change in the desired directions – will tell them they are doing something right and to keep going".

The problem then becomes, as Ryan recognises, one of devising appropriate indicators and setting up a suitable monitoring framework. He recognises, further, that the time involved and the intellectual difficulty in generating such indicators makes for slow progress. There is thus a fundamental need to address these issues at the policy development stage and the need for enhanced training and recruitment to achieve the follow-up.

PURPOSES OF POLICY EVALUATION

Evaluation of past and present policy programmes is not only about outputs and outcomes. Chelimsky[11] makes the point that the purpose may also differ between end-users. She identifies three general perspectives:

- evaluation for accountability (e.g. the measurement of results or efficiency);
- evaluation for development (e.g. the provision of evaluative help to strengthen institutions);
- evaluation for knowledge (e.g. the aquisition of more profound understanding in some specific area or field).

In evaluation for results the evaluator is faced with answering the question whether a particular intervention *caused* a particular result, or put another way, whether a change observed is attributable to the intervention. This kind of cause-and-effect question usually calls for methods that allow findings or estimates to be linked to interventions as closely and conclusively as possible. On the other hand, purposes such as strengthening institutions, improving agency performance, or helping managers think through their planning, evaluation and reporting tasks call for evaluation methods that will improve *capacity* for better performance. The third category, knowledge seeking evaluations, involve gaining greater understanding of the issues

[8] Proctor, R., *An Inclusive Economy*; Rea, D., *The Social Development Approach*, papers presented at the Institute of Policy Studies 21 August 2001.
[9] D.Rea, Evidence-based Policy and Practice in Social Policy, *IPS Newsletter 70;* August 2002.
[10] Ryan,B., *Death by Evaluation ? Reflections on Monitoring and Evaluation in Australia and New Zealand*, BIIA Conference on Public Sector Performance, Wellington, October 17 2001.
[11] Chelimsky, E. (1997), The coming transformation in evaluation, in *Evaluation for the 21st century ,* eds Chelinsky and Shadish, Sage Publications.

confronting public policy. The effort to gain such explanatory insights requires strong designs and methods, usually involving both quantitative and qualitative approaches, and advanced levels of both substantive and methodological expertise[12].

EVALUATION: INDICATIVE REQUIREMENTS AND ANALYSIS

In this section, I want to discuss statutory and informal requirements for better economic evaluation. Out of this sort of discussion, it is possible to get some idea of the skills and capability required. I start with Treasury requirements for policy papers and regulatory impact statements, and then discuss more informal descriptors of economic and social techniques commonly employed.

Treasury Requirements

Treasury as the budgetary control agency is clearly interested in the outcomes of departmental proposals and their costs. Substantial cost-benefit analysis has not been required for this purpose in the past although in the 1970s Treasury employed zero-based budgeting procedures which necessitated sharper operational categorisation and clear delineation between existing programmes and new proposals. Treasury expects tight reasoning from departments and clear demarcation of options available to reach a given goal. There are clear directives for departments to define what outcome is being sought, whether all the options have been considered (including the status quo), and what assumptions lie behind the declared costs and benefits. The directives ask whether there are clear criteria for analysing the options, and whether the criteria include effectiveness and efficiency considerations. While Treasury is in favour of increased evaluation of efficiency and effectiveness, it is wary of such requirements becoming a compliance activity with no bite. The aim would be appropriate, but not at the cost of excessive resourcing, and effort should be directed to the highest priorities[13].

The Secretary to the Treasury has recently noted (*Dominion Post* April 19), that in 1999 there was insufficient focus on getting results (outcomes), problems in contracting for service delivery, weak links between strategy and spending, reduced departmental ability to provide services (capability) and uneven agency performance. A team of three independent members, with the Heads of the Big Three, expressed concerns about cooperation between public service agencies, too little attention to overall results, legalistic contracting and insufficient training and leadership. The resulting review “The Review of the Centre” found the public management system still provided a reasonable platform for the future. But there was a need for: better-integrated, citizen-focused service delivery, improvements to people management and public sector culture; and to deal with fragmentation between agencies.

This has been followed by new efforts to promote result-based management. “Managing for Outcomes’ is jointly led by the central agencies and TPK and asks all public service departments to define the results they are to achieve, and state the measures they will use to check their

[12] Op cit, p.10.
[13] Personal communication, David Galt, Treasury.

success, how their own services will contribute, the capability they need, and how they will manage risks.

Departments are also being asked to report in a readable form how they are managing for outcomes in a "Statement of Intent" to be published with the Budget. Treasury is heavily engaged with other agencies in developing evaluation – getting evidence for whether policies work, researching how to improve innovation, and improving the governance arrangements for Crown entities.

Regulatory Impact Statements

As of July 1 1998, all policy proposals submitted to cabinet which called for government bills or statutory regulations had to be accompanied by a Regulatory Impact Statement (RIS)(A Ministry of Commerce suggestion). Such Statements were required to consistently examine potential impacts arising from government action and provide an assurance that new or amended regulatory proposals had been subject to proper analysis and scrutiny as to their necessity, efficiency, and net impact on community welfare[14]. The requirements include "a statement of feasible options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s)" and "a statement of the net benefit of the proposal including the total regulatory costs and benefits of the proposal and other feasible options". While these requirements have generally been met over the years since they were introduced, the convention was soon adopted that such Statements needed only outline the problems involved and not provide a full-scale analysis of necessity, efficiency and impact [15]. There is always a danger that such requirements can easily be ticked off at submission time.

Merger Requirements

In the competition field, the Commerce Commission is required by statute to examine policy issues involving acquisitions and mergers. The methodology utilised is very instructive in terms of high level economic analysis of the national interest. In terms of the Commerce Act 1986 the Commission is required to look at any acquisition or merger in terms of increased market dominance (s 67(3)(a)), and failing that test in terms of whether the public benefits that might follow would justify the acquisition or merger in this case (s 67(3)(b)). "The authorisation procedure requires the Commission to identify and weigh the detriments likely to flow from the acquiring of a dominant position in the relevant markets, and to balance those against the identified and weighed public benefits likely to flow from the proposed merger"[16]. This is equivalent to the national point of view or the national interest.

The preciseness of this approach is illustrated by a strict concern for comparing bananas with bananas. Reports and analysis are based on a thorough discussion of what is known as the *status quo scenario*, as compared with any changes brought about by regulatory means or policy

[14] Ministry of Commerce (1998), *A Guide to preparing Regulatory Impact Statements.*
[15] For a full analysis, see B.Wilkinson, The problem of inadequate regulatory impact statements, *IPS Newslettert 70,* August 2002.
[16] Commerce Commission (1999), *Draft Determination….in the matter of an application for authorisation of a business acquisition involving New Zealand Dairy Board…and others, p.84.*

changes. In the case of the Dairy Determination, two base scenarios (counterfactuals) are developed and utilised.

(1) The *status quo* counterfactual is not regarded as a standstill in time. Rather, the Commission asks what events would have taken place *in the absence of the merger* and then puts them in the *status quo* scenario. Thus the Commission assumes a continuation of the current industry structure (pp.90-91) and of the single desk seller for exports, and that efforts at further structural change within that structure and regulatory framework will continue.

(2) The *deregulation counterfactual.* This envisages the deregulation of the Dairy Board export monopoly, and the emergence of two powerful competing cooperative companies, possibly with overseas links, heavily involved in marketing in competition. In such a process, this counterfactual would include the unbundling of payout to suppliers, improvement to the internal pricing systems, and joint venture developments.

The Commission then proceeded to an examination of the *detriments* of the proposed merger and the possible benefits against these *two* counterfactuals. They looked at allocative and productive efficiency changes in the NZ domestic market as a whole[17].

The same approach is evident in the Qantas-Air New Zealand merger proposals. In this case, the definition of the counterfactuals has proved very tricky. On the basis of confidential information provided by the airlines, the Network Economics Consulting Group constructed a counterfactual based on the possible competitive situation without an alliance. Qantas would increase its capacity on both New Zealand domestic and trans-Tasman routes and Air NZ would have to match these increases to maintain market share. Over a five-year period Air NZ would be forced to withdraw its international services, eventually shrinking to a domestic airline. Critics have thus raised the issue whether the strategy of the airlines is to paint a counterfactual so dire for AirNZ that the alliance becomes more acceptable than it would otherwise be[18]. These trends involve serious examination of the possible trends in the air passenger market over a considerable period as well savings derived from cost efficiencies. Thus choice of the counterfactual is fundamental to any analysis of a merger proposal and involves serious consideration of possible future scenarios – perhaps more than one?

Indicative Requirements: The Structure, Conduct, Performance Approach (SCP)

Many policy issues are susceptible to an institutional approach where structural and conduct issues are separated out from performance issues. The Institute of Economic Research has been at the forefront in applying SCP to industry and policy issues. This approach asks three different questions about economic behaviour which complement each other. Structure refers to the institutional environment in which a firm finds itself. This may set a number of constraints on any actions for reform or improvement. Conduct refers to how the management conducts its

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[17] In this particular case the Commission found that the detriments exceeded the benefits of the dairy company merger compared with both counterfactuals and recommended against government approval. This methodology is a good example of sound economic reasoning based on available industry information or that supplied to the Commission. It is an *ex ante* rather than an *ex post* analysis and is a sound basis for examining future government policies.

[18] 'Air cartel's critics counter the counterfactual' *The Independent,* 5 March 2003.

business including governance issues. Performance refers to efficiency in production including returns on shareholders funds. Following this schema in some detail illuminates industry behaviour and can be used to make comparative observations on policy change from a national point of view.

Government has commissioned NZIER and other agencies in a number of policy reviews of this kind, the dominant feature of which was an analytical approach based on the SCP[19]. These reviews include studies of the marketing arrangements for wheat, meat products, dairy products, freight transport and others. Regulatory issues are discussed in terms of their impact on industry from a national point of view. These studies are very thorough and are instructed by the national point of view throughout. One criticism is that there are not enough of them, nor of the people who can carry them out, to make a significant contribution to the formation of government policy on a day-to-day basis.

Investment Requirements

Indicative information on the return on public investment aids decision making. Cost-benefit analysis (CBA) is also based on an appropriate national interest counterfactual and then forecasts of costs and returns (suitably defined for the issue in question) are subject to a discounted cash flow analysis. In the past, much government time was taken with discussions of the appropriate interest rate, when perhaps more focus should have been placed on the counterfactual(s). CBA focusses on the national interest part of government investment – though it can be used in financial analysis just as well – including social as well as economic outcomes. CBA was useful in government adminstrative terms in the past because it compressed a large quantity of numbers down to a few criteria like present value and internal rates of return. This enabled quicker decisions to be made when there was a choice of options and/or investments

It was widely used by the Ministry of Works and the Ministry of Agriculture in the past for soil conservation investment and is still used for roading investment.

Social Returns To Investment

Where time permits or the particular analysis has already been undertaken, econometric modelling may be useful in illuminating possible effects of policy changes. Econometric models are useful in circumstances where time series or cross-section data are available and match the entity which is changed by a given policy. Statistical analysis is time-consuming and its execution must anticipate to a large degree the kind of policy problems which might bear such detailed examination.

As an example, the supplementary minimum prices scheme for farmers in the 1970s is a policy stance which is well suited to econometric analysis. The model concerned was developed at Lincoln University and relates farm exports and production to changes in investment and product

[19] Bollard, A., Gale, S., Harper, D., and Savage, J. (1991), *An Introduction to Industrial Organisation,* Ministry of Commerce, Wellington; Nixon, C. (1993), *The Impact of Wheat Deregulation on the Arable Industry,* Ministry of Agriculture, Wellington; Pickford, J.D. and Bollard, A. (1998), *The Structure and Dynamics of New Zealand Industries,* Dunmore Press.

prices for sheep, beef and dairy farms[20]. From the base year of the model in 1981, investment and outputs were simulated for 1982 to 1985 using product prices *with and without* deficiency payments (the difference between market prices for products and payments actually received). For 1986 actual prices applied to both simulations and continued for the four following years to allow interactions between farm sub-sectors to work themselves out[21].

If deficiency payments had not been paid, sheep number growth would have been less, and dairy and beef cattle numbers would have been higher. In terms of increased export volumes (the aim of the policy) beef volumes would be higher, sheep volumes lower, and dairy volumes higher in the short term without subsidies. The total level of exports would have been two per cent lower. In 1982 dollars the long term difference in exports was $184m per year or 2% less than that which eventuated. Deficiency payments cost up to $1,018m in 1982 dollars over 4 years so the benefits would have to be spread over 6 years or more to show a positive national return (undiscounted). This result has been confirmed by other econometric models[22] though the authors did not feel disposed to draw the same conclusions.

This example demonstrates how an econometric model can be sector-wide, provide for interactions between variables, is subject to statistical tests, and is relatively free of observer bias. On the other hand, national policy initiatives may not always lend themselves to clear uni-sectoral and national interest goals.

Defining Social Outcomes: Poverty Measurement and Socio-Economic Disparity

In the social policy, the measurement of outcomes is particularly difficult. It is one thing to set up programmes of social assistance based on any number of criteria, but quite another to know that the welfare of the individuals concerned has been improved. There is an increasing awareness of these issues and I want to discuss poverty and social disparity measurement of outcomes as opposed to departmental outputs. This is not the final word on a large subject but is indicative of outcomes measurement and its impact on policy.

Bob Stephens has recently summarised the role of poverty measurement in policy development and formulation[23]. He notes "there is considerable academic, technical, and policy-related debate over the appropriate conceptualisation of poverty, the generosity of the poverty measure, how that measure should be adjusted for household size and composition, and how to adjust the measure through time. The different concepts, measures and equivalence scales all identify different people and family types as having a higher incidence and severity of poverty, with different groups identified again depending on whether a cross-section or longitudinal analysis is undertaken. If one objective of government policy is the alleviation and amelioration of poverty, then these conflicting results make policy formulation in this area a nigh-on impossible task. However, a partial resolution is to recognise that the different concepts of poverty can be used

[20] Laing, M.J., and Zwart, A.C. (1983), *The Pastoral Livestock Sector and the Supplementary Minimum Price Policy,*Discussion paper No 70, AERU, Lincoln.

[21] Johnson, R.W.M. (1986), *Livestock and Feed Policy in New Zealand, 1975 to the present,* CAPS, Massey University.

[22] Sandrey, R., and Reynolds, R. (1990), *Farming without Subsidies,* Government Print, p.166.

[23] R Stephens, The Role of Poverty Measurement in Policy Development and Formulation, paper for presentation at the Policy Network Conference, Wellington, 30-31 January 2003.

for different policy objectives. Income-based poverty measures are more appropriate for monitoring the impacts of economic and social aid and determining the level of cash assistance, while outcome or living standard measures provide insights into the role of asset accumulation and whether social assistance should be provided in cash or in-kind. Static measures are more useful for poverty alleviation by assisting in determining the appropriate level of assistance and who should receive it, while dynamic measures provide insights into ultimate causes and thus long-term solutions to poverty".

Stephens provides an overall summary of the poverty measurement work he has undertaken with Waldegrave and Frater in this paper. Most important, to my mind, is the discussion of living standards in policy development. This research looks at negative outcomes or what activities families are forced to restrict purchase or ownership of due to lack of income[24]. Surveys of elderly, working population and Maori ask questions about restrictions on living standards which can be aggregated up into a master score. Such restrictions are classified by age and size of family. The results are presented as the proportion of the sample population indicating enforced lack of an item, eg. % without adequate heating, % without childcare services, % missing doctors visits, % showing dampness in the home etc. Their importance lies in the establishment of social benchmarks which can continue to be measured through time (assuming adequate sampling). These measures are of course the social `outcomes' which social policy should be aiming to improve. It is well known that departments have been happy to pursue departmental objectives (`outputs' in the jargon'), such as meeting Ministers' deadlines, rather than persuading Ministers to agree to policies with long term effects on outcomes.

Measures of socio-economic disparity are concerned with the influence of cultural factors which explain differences in poverty and access to services. It is of some importance to establish the relative importance of different factors because social perception of these differences often varies from the underlying reasons. Simon Chapple has done work on the commitment to addressing Maori socio-economic disparity[25].

Chapple examines known statistical collections such as Census data, the Household Labour Force Survey, population projections, and the Income Supplement of the Household Labour Force Survey, to explore the role of ethnicity in socio-economic disparity. He challenges the conventional wisdom on Maori disparity in public policy circles that takes as axiomatic the key importance of macro ethno-cultural differences between Maori and non-Maori. This view de-emphasises non-ethnic cultural differences and down-plays cultural similarities. Such an approach leads to "Maori for Maori" solutions to perceived problems when appropriate analysis indicates that disparity is not an ethnic problem but a cultural problem based on low literacy, poor education and living in geographical concentrations that have socio-economic problems. For reasons of social justice and efficiency, effective policy to close the gaps needs to focus on those most disadvantaged or at risk.

These conclusions shifted the then policy stance on closing the gaps and moved the disparity programs to a broader base. If such a high level of analysis had been available at an earlier stage of policy development, the policy goals could have been adjusted accordingly (perhaps).

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[24] Ministry of Social Development, 2002.
[25] Chapple, S. (2000), Maori Socio-economic Disparity*, Political Science 52(2)*, 101-15.

SUMMARY AND CONCLUSIONS

(1) Greater encouragement of evaluation work is required from government, both at the Ministerial level and the CEO level. Treasury has a key role to play in its public management role. Departmental coordination is a key issue.

(2) There is a need to organise greater research effort into policy outcomes and find better systems to incorporate research results into policy formation and advice. Disincentives to thorough reporting should be lifted.

(3) Higher levels of training are required for some or all of the policy analyst occupation class. University cooperation is needed to identify suitable courses and class materials. A suitable manual should be developed which showed exactly what standards of analysis can be expected from better and higher training compared with the present.

Chapter Three

AGGREGATION, BIAS AND CONFUSION - DISTORTIONS IN POLICY

By Stuart Birks

ABSTRACT

All analyses involve simplification, frequently through aggregation. As has been seen in debate on "Closing the Gaps", aggregation that groups by ethnicity can be challenged. This paper briefly considers some of the theoretical issues surrounding aggregation, asking under what conditions aggregations might be acceptable. It then looks at possible distortions that can arise from inappropriate aggregation, including both analytical and political perspectives. Some safeguards will also be suggested.

While the criteria are of general relevance, points will be illustrated with examples arising from gendered approaches.

1. THE ISSUES

In this section I consider the underlying factors that might result in distortions in policymaking and policy analysis. In the next section, I shall use criteria identified here to illustrate how the current policy environment is distorted.

1.1. Constrained Optimisation and Decision Hierarchies (Separability)

Policymaking involves trying to do as well as possible in relation to chosen objectives subject to limitations on what can be achieved. In other words, it is a matter of constrained optimisation. Such optimisations need not always involve overall optimisation. It is sometimes possible to break down a problem into several components. The extent to which this can be done without distorting the results depends on the extent to which the components permit independent analyses. If there are interrelationships across components, they cannot be correctly assessed in isolation.

We could consider two extremes.

(1) Complete independence – in which decisions can be made with no regard for other factors.

(2) General linkages – in which optimal decisions are a function of disaggregated measures of circumstances elsewhere.

There is a range of other, intermediate possibilities. For example, there could be aggregate linkages only, in which decisions can be made area by area, while only having regard for some aggregate measure of circumstances elsewhere. This would permit a multi-stage optimisation, optimising over broad areas (as in budget allocations to several sectors, such as health and education), and then optimising within each of those areas.

For (1), optimal solutions can be identified, area by area, as a function of internal variables only. This is a special case. Distortions could arise if it is falsely assumed that the required conditions are met.

With (2), optimal solutions would generally be a function of disaggregated variables across areas.

Intermediate options can permit some independent analysis, but still require consideration of outside linkages at some stage in the policymaking process.

It is common, both on institutional and political grounds, to undertake policy analysis in a segmented way even if this may be problematic. For example, the State Services Commission, looking at the quality of policy advice, identified problems with “insufficient incentives for active co-operation by departmental chief executives on cross-cutting policy issues” and “the counter-productive and debilitating consequences of departmental patch-protection” (State Services Commission, 1999, p.5).

Similarly, microeconomic theory relies on *ceteris paribus* assumptions with respect to numerous omitted variables.

1.2. Simplification Through Aggregation

Policy analysis generally involves simplification through aggregation. Rather than consider each individual unit (individual, household, business), they are commonly grouped. This reduces the number of variables, which makes analysis easier, but can also be misleading unless the aggregation involves grouping units with common characteristics within each group[1], and distinct characteristics between groups. Macroeconomics is an extreme example of the use of aggregation.

One illustration of misleading aggregation is NZDep, a small area index of deprivation. The index is calculated from the proportions of people in each area having specified characteristics. As described in Salmond and Crampton (2002), NZDep96 is very poor as a measure of individual deprivation due to the wide variety of individual deprivation within each area. Hence, “if the three most deprived deciles of NZDep96 were used for targeting, comprising one quarter of the study population, these areas would miss 13.9% - over half of the study population who are individually most multiply deprived” (pp.669-70).

As another example, Wallis (2003) described a blind person in the US who was denied insurance because blind people had a shorter life expectancy. While diseases such as diabetes can result in

[1] For functional relationships, it is enough that the composition of the aggregate stays the same as its magnitude changes. In this case, we could consider a “representative unit”, being a weighted average of the various components.

blindness and shorter life, this person was blind from birth and could expect a normal length of life.

Looked at another way, it could be possible to incorrectly specify a group as deprived simply by including it in an aggregation with a genuinely deprived group, or to conceal a group's deprivation through aggregation with a better endowed group.

1.3. Influence on Perspectives

The nature of the analysis shapes the perspectives taken, and hence can determine the policy issues that are identified, the variables that are monitored, and perceptions of outcomes.

For example, we could consider people on an individual or a household basis. Each would give a different picture. Alternatively, we could attempt to see people on a family basis, where family is defined to include inter-household links, rather than the current definition, where the family is restricted to one household only.

Similarly, we could consider all working women as one group, or distinguish between career women and those whose primary interest is family[2], or working women under and over 30, for example.

An aggregated view can suggest homogeneity within a group that is actually composed of distinct sub-groups. In other words, it can fail to acknowledge discrete differences. Differences can also be continuous, and so breaking down an aggregate may still not result in homogeneity with the resulting sub-groups. As a general point, therefore, in addition to consideration of group averages, variation within groups should also be considered.

1.4. And Then The Politics…

Political factors can influence the choice of approach. To quote Tapp, Geddis and Taylor (in relation to child maltreatment and domestic violence):

> "The present policies in this area in New Zealand are not the end result of logical, coherent evolution, but rather reflect an ad hoc compromise in the face of pressures applied from vested interests" (Tapp, et al, 1992, p.197).

Lobby groups want their specific focus to be highlighted. This will inevitably impact on the choice and definition of variables, the relationships to be emphasized between variables, and the solutions to be promoted. It is to be hoped, but by no means expected, that public sector analyses will compensate for distortions arising from lobbying, and that lobby groups will be sufficiently diverse, so as to cover a range of opinions and prevent an overly-unbalanced understanding.

Incorrect breakdowns or groupings can distort analyses and can be reflected in or arise from political discourse. The next section considers these points in relation to groupings by gender.

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[2] Hakim (2003) suggests three types of women, "work-centred", "home-centred" and "adaptive", where the latter group prefer to combine employment and family work without giving a fixed priority to either (p.6).

2. THE BIASES OF GENDER

2.1 Gender and Separability

How suitable is gender as a category? Can we divide the population on gender lines to consider each group separately? A fundamental requirement is that functional relationships can be separated into those involving men and those involving women, with little or no interaction between them. Ministry of Women's Affairs (2002a) specified the areas of: income, work and family; education; safety and justice; housing; disability; positive aging; and health. Just to take income, work and family as an example, given the extent to which men and women co-habit, share income, and share responsibilities for their children, is it appropriate to consider these issues for women in isolation? Are the underlying relationships for women between policy variables and outcomes independent of the choices made by men, and, given the relevance of these issues to men also, can policies for men be formulated without regard to the aspirations and behaviour of women? If we cannot separate them, what are we trying to optimize when we consider one in isolation?

2.2 Gender, Aggregation and Homogeneity

> "…feminist scholars have increasingly focused on the need to acknowledge differences [between women] associated with ethnicity, class, religion, colonial conquest, sexualities, and disabilities." (du Plessis, 1997, p.221)

Homogeneity within an aggregate is only required in relation to relevant functional relationships. These will vary according to the issues being considered. Similarly, for some issues there may be few differences between common aggregates (such as men and women), in which case there would be little analytical gain from distinguishing between them. As du Plessis says, feminists' internal political debates have stressed certain dimensions of heterogeneity. Many of these could be of similar significance to men.

In addition to the above list, an analyst might also want to consider such variables as age, education level, marital/partnership status, parental status, motivation for work (to supplement household income, for job satisfaction, for social contact, career ambitions, etc.).

Despite current requirements to undertake gender analysis in the New Zealand public sector, a publication on child maltreatment (Ministry of Social Policy, 2000) has expressly warned of the dangers of crude groupings and simple comparisons:

> "There have been some attempts to establish links between child maltreatment and the ascribed characteristics of perpetrators, in particular their age, sex, and ethnicity. In general, however, it has been recognised that any patterns related to these are most likely to be driven by the prevailing conditions that perpetrators face in relation to family, neighbourhood, and culture." (p.13)

And also:

> "A large body of evidence suggests that the incidence of reported child maltreatment is over-represented among single parent families and blended families. Much of that research, however, is based on relatively simple comparisons of the proportion of such families in the general population compared to their representation among families reported in maltreatment statistics. That type of analysis must be treated with considerable caution." (pp.20-21)

"Relatively simple comparisons" are common, so this advice might be more generally applicable. Hopefully it is purely coincidental that, in the above two cases, a gendered analysis would present women in an unfavourable light.

2.3 Gender and Perspectives

The choice of gender as a variable for analysis is not neutral in its effect. Just as using NZDep can result in policies targeting geographic areas rather than deprived individuals, the use of gender as the central defining characteristic may mislead. There are numerous other possible variables that could be chosen as a basis for grouping observations, and some factors may actually be hidden due to the use of gender.

One clear distortion for many issues arises from gender being defined for individuals (naturally), although many aspects of people's circumstances are determined by their participation in groups. One of the most fundamental of these is the family (however defined), and most families include both sexes. Hence an individual's personal income or wealth may be only loosely related to the person's economic circumstances, preferences may exist and decisions may be made with others in mind, and well-being may also depend on relationships with other people. Nevertheless, the current government takes a specifically individualistic approach. The Ministry of Women's Affairs (2002a) specifies economic autonomy for women as a requirement for "New Zealand's success, prosperity and wellbeing" (p.5), and this is included as part of the 2002 Labour-headed government's agenda.

Just as macroeconomic issues such as inflation and growth can only be observed through taking a macroeconomic approach, family-based issues can only be observed through a family, rather than an individual, approach. While individual issues may also be worthy of analysis, it may not be possible to undertake a realistic analysis if family connections are ignored or misrepresented.

Emphasis on gender is likely to result in identification of and relative emphasis on gendered, individual perspectives on issues. Hence we see, to list just a few: "gender wage gap"; "glass ceiling"; battered women's syndrome; the offence of "male assaults female"; possible downplaying of men's perspectives in such issues as parental leave, "work-life balance", "caregiving", "sole parent families"; dominance of the patriarchal power and control approach to domestic violence; downplaying of men's lower life expectancy, higher suicide rates, lower representation among current tertiary students, greater workplace injury and fatality rates; and redistributions from men to women through the tax and benefit systems and state provided goods and services. Similarly, it could be wondered whether feminist writers would have been as accepting of the current household-base definition of family, were fathers to have had first claim on custody of children.

Gendered perspectives can also affect the specific questions that are asked such that they influence the results. For example, the first two sub-questions in Question 36 of Gendall (2002) ask how much respondents agreed or disagreed that, (a) both parents are equally important to children, and (b) mothers are always more important to children than fathers. Although these questions were next to each other in the written questionnaire, from (a) we find that about 96% of men and women agree that both parents are equally important, but from (b) nearly 14% agree that mothers are more important than fathers. Full details are in the Appendix. It should not be assumed, therefore, that gendered studies necessarily give an accurate picture of people's opinions.

Evaluations of impacts, costs and benefits require a specification of the perspective to be taken. Are effects to be measured in relation to government, society as a whole, affected individuals, specific groups? Hence the impact of student debt could be evaluated with respect to society, the taxpayer, industry, the workforce, the skilled workforce, men, women, ethnic groups, students as a whole, students by course, students by age, students by future work plans, etc.. The choice of perspective affects our view of the issues. Current gendered approaches may not be the most useful, and we should be aware that many alternative, legitimate perspectives might be overlooked.

2.4 Gender and Politics

The above discussion indicates that distorted analyses and policies are possible. Political factors make them inevitable. Rosemary du Plessis writes:

> "Claims about women's common interests have been used as a strategy to ensure that international organisations such as the United Nations attend to the political status of women. It has also been vital in developing women-focused structures in particular nation states (such as New Zealand's Ministry of Women's Affairs) and at the level of community organisations, trade unions, churches, workplaces, professional associations, and educational institutions." (du Plessis 1997, p.221)

This is particularly worrying as not only is it an incorrect grouping, but also it results in a focus on the interests of half of the population to the exclusion of the other half. This is clearly seen if we consider the issue of "disadvantage". To show disadvantage, it is necessary first to identify indicators which give different numbers for the specified groups, and second to give an interpretation of those differences whereby the chosen group is worse off. Naturally, therefore, such conclusions can be challenged through questioning the suitability of the indicators and/or presenting alternative interpretations of the results.

For example, in New Zealand the Coalition for Equal Value for Equal Pay has a poster with the caption, "Prepare your daughter for working life. Give her less pocket money than your son."[3] It

[3] http://www.cevep.org.nz/news/news0902.html

is based on the statistic that women's average total weekly earnings are lower than men's. The indicator could be challenged due to being based on data across generations, and differing education, career choices, hours worked and reasons for working[4], for example. An alternative interpretation could be to suggest, "Prepare your son for working life. Make him earn his pocket money, then give some of it to his sister."

We see one-sided research methods built in to the structure of the Ministry of Women's Affairs' version of gender analysis, as discussed in Birks (1999). Other parts of the public sector have undertaken gender-biased research, as in the Law Commission's Women's Access to Justice study, critiqued in Birks (1998), and the then Department of Justice's "Hitting Home" study (Leibrich et al, 1995).

Research elsewhere may also be focused more on achieving political objectives than the pursuit of academic enquiry. According to the web site for the Women's Studies Association 2003 conference (http://www.womenz.org.nz/wsa/conf.htm), the conference "addresses feminist goals". The theme is "Celebrating All Women", but it is not clear how they intend to celebrate non-feminist women. The call for papers includes a suggested area, "economic and social systems which disadvantage women". They are apparently less welcoming of papers which consider advantages experienced by women.

Political self-interest (and the heterogeneity of women) might also be indicated in the following quote:

> "...although equal employment opportunities initiatives have benefited some women, those most advantaged have tended to be the women who most resemble those who fill the equal employment opportunities (EEO) positions in organisations." (du Plessis, 1997, p.222)

and gendered groupings may result in pressure for quite different treatment according to gender:

> "Increasingly, feminist theorists have considered how citizenship implies a male subject and inhibits attention to forms of difference between women and men that might legitimate the two sexes making different claims on the state." (du Plessis, 1997, p.224)

There is a clear danger that treatment would depend on the average characteristics of a chosen group, rather than the underlying individual circumstances. Moreover, separate policy development could result in inconsistent application of principles, such as human rights. The Human Rights Commission has a special section on women based on the International Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW).

[4] Results of a study (Rowntree 1999) for families with teenage children published by the Joseph Rowntree Foundation found men's provider role to be central to fathering, with about 85% of men and 45% of women reporting that they worked out of financial necessity, whereas about 15% of men and 43% of women worked for "a sense of independence". Also, "Women were also much more likely than men to see paid work as a choice and to link it to questions of personal freedom or self-development" (p.2). Hakim (2003) also discusses diverse motivations among women. Some of these motivations require the co-operation of a partner, and so suggest that separate analyses would be misleading.

Might this be the result of lobby groups, as described in 1.4 above, and the initiatives described by du Plessis at the start of this section?

There are aspects of CEDAW that could have implications for men.

Article 4 refers to: "…temporary special measures aimed at accelerating de facto equality between men and women shall not be considered discrimination as defined in the present Convention, but shall in no way entail as a consequence the maintenance of unequal or separate standards; these measures shall be discontinued when the objectives of equality of opportunity and treatment have been achieved." Note that equality is specified in terms of opportunity and treatment, not, for example, equal average pay for men and women in the public sector. This latter is the objective of the recently established taskforce as part of the current government's policy on pay and employment equity[5]. [6]

Article 5 calls on states: "to modify the social and cultural patterns of conduct of men and women, with a view to achieving the elimination of prejudices and customary and all other practices which are based on the idea of the inferiority or the superiority of either of the sexes or on stereotyped roles for men and women." Presumably those who call for preferential treatment for women as "the carers" in society are contravening the spirit of this Article. A Google search for "carers" and "caregivers" commonly finds these terms linked to women. For example, Resolution 9 of 27th Conference of the International Federation of University Women, calls for action on "access to legal services, especially for women caregivers"[7]. It should be noted that gendered approaches can accentuate and even create differences between genders.

Article 16 "shall ensure, on the basis of equality of men and women: …the same rights and responsibilities as parents, irrespective of their marital status, in matters relating to their children… the same rights to decide freely and responsibly on the number and spacing of their children and to have access to the information, education and means to enable them to exercise these rights… the same rights and responsibilities with regard to guardianship, wardship, trusteeship and adoption of children." These aspects are seldom, if ever, mentioned.

We see the effects of gendered stereotyping in policymaking. The 1996 coalition agreement statement on child support talked only of "parents who desert their families"[8]. Margaret Wilson, on 29 February 2000 in the parliamentary debate on the Matrimonial Property Amendment Bill[9], focussed on women who "have been discarded for a newer and younger model". Page 159 of Fleming and Atkinson (1999) talks of policy analysts with "an implicitly punitive attitude towards non-custodial fathers".

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[5] http://www.beehive.govt.nz/ViewDocument.cfm?DocumentID=16893

[6] Hakim (2003) discusses UK policies in this area in the context of women's diverse priorities: *"Did the New Labour government of Tony Blair take any notice of the results of the Listening to Women research programme? Of course not. The studies revealed more diversity of values and complexity of opinion than was politically useful. So the findings were used selectively to support the government's predetermined policy positions - in particular policies promoting paid work as women's central life activity."* (pp.3-4)

[7] http://www.nzfgw.org.nz/news-happen.htm

[8] http://www.executive.govt.nz/96-99/coalition/chsup.htm

[9] http://rangi.knowledge-basket.co.nz/hansard/han/text/2000/02/29_043.html

As Callister (2000) discusses, there is now an accepted principle that women must play a key role in researching women, and Maori in researching Maori. By the same principle, men should play a key part in research on men. On page 43, Callister refers to a research project run by women in the Office of the Commissioner for Children. While finding that almost half the men and a third of women respondents in a random telephone survey thought that the Family Court discriminated against men, this was discounted as a "misperception". This is not the only all-woman research project involving male subjects. Given gender politics, can such researchers be expected to provide balanced assessments?

3. CONCLUSIONS

There are politically defined groupings which are used to define policy issues and approaches, while disregarding the differences within and linkages across groups. They distort our perceptions and result in inappropriate policies. Another way of putting it is that policy is determined by political pressure with little regard for analysis or consideration of possible outcomes.

Gender is not the only significant dimension in current discourse on policy, with ethnicity also being prominent. There is a difference, however. With ethnicity, it is possible, and possibly desirable, to have a degree of diversity and separate development. In comparison to ethnicity, divisions by gender impinge on the living and working arrangements of all or most of society. Gendered analysis does not convey a strong vision of men and women working together. In fact, it could be questioned whether feminist writing displays much empathy for men at all.

The message in this paper is not that the issues are necessarily unimportant, they may merit attention, but that we are looking at them in a way that is harmful. Separation by gender, rather than considering common interests and interdependencies, has the potential to split society down the middle. There is evidence of social engineering, gender politics, and lack of analysis, and signs that a social agenda is being pursued which has not been debated, even less approved.

APPENDIX

			Both parents equally important to kids					Total
			Strongly agree	**Agree**	**Neither agree nor disagree**	**Disagree**	**Cant choose**	
sex	**Male**	**Count**	302	144	10	5	2	463
		% within sex	65.2%	31.1%	2.2%	1.1%	.4%	100.0%
	Female	**Count**	350	119	9	13	2	493
		% within sex	71.0%	24.1%	1.8%	2.6%	.4%	100.0%
Total		**Count**	652	263	19	18	4	956
		%	68.2%	27.5%	2.0%	1.9%	.4%	100.0%

			Mothers always more important to kids than fathers						Total
			Strongly agree	**Agree**	**Neither agree nor disagree**	**Disagree**	**Strongly disagree**	**Cant choose**	
sex	**Male**	**Count**	7	60	68	236	92		463
		% within sex	1.5%	13.0%	14.7%	51.0%	19.9%		100.0%
	Female	**Count**	9	53	86	245	87	8	488
		% within sex	1.8%	10.9%	17.6%	50.2%	17.8%	1.6%	100.0%
Total		**Count**	16	113	154	481	179	8	951
		%	1.7%	11.9%	16.2%	50.6%	18.8%	.8%	100.0%

Source: Gendall (2002)

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Chapter Four

POLICY ANALYSIS AND THE DERMATOLOGIST'S DILEMMA

By David Webber

ABSTRACT

The public sector reforms introduced in New Zealand from 1985 were accompanied by an enthusiasm for the increased importance and effectiveness of "policy analysis". Indeed, an exciting new category of civil service employee – the "policy analyst" - emerged. On the whole, however, the design of policy, and the large numbers of policy analysts who took up this challenge, have settled for less lofty achievements. Innovative new policies, especially in the last seven or eight years, have been rare and rarely complete. As a result, policy analysts seem to have not only begun to doubt themselves, but also the quality and reach of their tools of trade. The problems are examined and some explanations for these disappointments are offered. Some suggestions for more rigorous analysis are proposed.

INTRODUCTION

Comments, and insights, on the demands of policy analysis in the public sector sometimes come from surprising quarters. In a recent discussion, a Wellington dermatologist remarked that a very high proportion of the clients presenting at his clinic described themselves as "policy analysts". Why should this be so?

Of several reasonable explanations offered – the Lambton Quay location of the consulting rooms, a possible pre-disposition to skin problems amongst analysts, their increasing numbers within the civil service, or some kind of localised network recommendation – none seemed to adequately explain his observation. It was eventually agreed, if somewhat unsatisfactorily (and non-expertly from a clinical point of view), that the life of a policy analyst must be particularly frustrating experience.

THE RISE OF POLICY ANALYSTS

"Policy analysts", in name at least, are a relatively new and expanding area of public service employment. Policy advice, however, is nothing new; it is a long-standing function of most public service departments. Over the years, policy analysis has been performed by a variety of officials, in some cases called "policy officers", but more frequently simply by line managers employed on the traditional "executive/clerical" scale. What is new is that since the mid-1980s skills and techniques of policy analysis have been more accurately defined, more explicitly acknowledged, more frequently sought and mostly better rewarded. Training courses in the techniques of policy analysis are increasing. There are "how to" books and guides for practitioners e.g. Hawke (1993) and Mintrom (2002). Papers addressed specifically to improving policy analysis at the Economists' Conference reflect this rising interest in the discipline.

As most policy analysts will attest, good policy analysis is a craft. In many cases, it requires developing a range of credible and viable policy options from a paucity of information: about current needs or problems, the level of resources available, the implementation capacity of institutions, the impacts that policy actions may have on the behaviour and incentives of individuals, the relationships with other policies and services, and not least the views and reactions of senior managers and political masters.

Despite imperfect information, most public policy issues are amenable to analysis using fairly standard tools and techniques: review, research, consultation, data analysis, option building, cost benefit analysis (in its various forms) and the logical development of policy options. Even so, increasing interest, and presumably increasing proficiency, in the work of policy analysts over the last 20 years is not generally perceived to have resulted in consistently better policies. Many of the core policy problems that were confronted in the mid-late 1980s remain equally intractable today. In certain cases, arguably, the position may even be a good deal worse.

Without doubt, many areas of public policy have undergone perplexing shifts over this time. Some obvious examples are governance structures in health and education, de-regulation and re-regulation of industries, asset sales and partial re-nationalisation of transport industries, a proliferation of funding strategies and institutions for business innovation and community employment, separation and re-consolidation of government departments, constantly escalating welfare expenditures and, or course, superannuation arrangements. There are also clear examples of continued policy failure such as student loans and ownership and regulation within the electricity sector.

On reflection, it seems that policy analysts may well suffer more than the average level of public service professional challenges and disappointments. Despite considerable technical developments in the craft of policy analysis, the job has, very possibly, become both more difficult and less satisfying in recent years.

THE ARGUMENT

It is not the purpose of this paper to debate the merits, or otherwise, of these policy flip-flops, much less to attribute them to particular political parties or philosophies. Indeed, significant policy contradictions or reversals have occurred within and between both National- and Labour-led governments at some point. Rather, the key question is whether these inconsistencies can be attributed in any way to the quality and efficacy of policy analysis. Or, even if one were to attribute these policy changes almost entirely to decision-makers, would not the impact still be damaging to the confidence and methods of policy analysts? How should the analysts maintain quality and consistency of advice under such varying political direction?

Public policy analysis covers a wide range of disciplines and subjects, including tax policy, trade policy and public expenditure activities. Each requires a degree of specialist knowledge, not only of the relevant legislation, policies, institutions and behaviours, but also an increasing knowledge and familiarity with the results of policy research and trials in other, especially comparable, jurisdictions.

The arguments in this paper do not necessarily apply to all these potential applications. Nonetheless, policy analysis in each field frequently involves examining the requirement for, and optimal form of, government intervention. The case for intervention may be in response to a perceived social or economic problem, but may also be a part of a constant search to improve economic performance, social equity or, say, the quality of the environment.

In determining optimal interventions, or the case for non-interventions, what the analyst understands about the underlying functioning of the economy is crucial to how the analysis may be managed and hence to the shape of subsequent policy recommendations. It follows that the application of various policy analysis tools[1] can be enhanced by the use of common and coherent analytical frameworks and consistency of assumptions. Conversely, deterioration in the economic and institutional frameworks that underpin good policy analysis – as this paper argues has occurred over the last 10-12 years – has the potential to greatly weaken the quality and consistency of policy advice. The consequences of this process of deterioration are argued to be particularly apparent in the area of social policy, though similar problems apply much more widely and have contributed to many of the problem areas of policy identified above.

THE CHANGING ECONOMIC FRAMEWORK: A "LONG FAREWELL TO PRINCIPLE"?

The "economic framework" that underpins policy analysis is much more than just an understanding of the different sectors, institutions, businesses and other entities that comprise economic activity. It also includes an understanding, and to some degree a belief, about how those institutions and activities may interact and respond under varying conditions. A key element of this understanding concerns the policy environment under which they are most likely to prosper. This implies forming judgements about the role which governments can best play in facilitating economic activity and in ensuring acceptable levels of social justice.

Clearly, there are opportunities for wide divergence of views on this latter issue. Analysts should therefore be equipped to operate effectively under markedly different political views and policy settings. From a technical viewpoint, what matters most in this respect is that these changes in the political environment do not threaten the quality or consistency of the policy analysis process by suggesting, or imposing, untested or unproven changes on the underlying analytical framework.

From 1985 to the early 1990s, successive governments clearly placed much greater faith in the ability of the market to determine optimal (i.e. the most efficient) outcomes. Policy analysis was strengthened by the requirement to focus firstly on determining the conditions, including the role

[1] See the parallel paper by R. Johnson (2003) for a discussion of the evolving use of some of these tools.

of government, which would best facilitate the flexible operation of markets. Existing interventions based on "market failure" rationale were invariably subjected to rigorous re-examination. This analysis set out to establish the cause (if any) of these market failures, the opportunities for enhancing the capacity for market solutions and, as a last resort, the scope and cost of preferably limited government intervention, or improved regulation. Policy analysis therefore took place within a relatively well-defined and coherent analytical framework that consisted primarily of economic efficiency, policy predictability, accountability and transparency.

Since 1993, political compromises and changes of government have worked to dilute this framework. Darwall (2003) refers to this as a "long, drawn-out farewell to principle". Others, however, for example Riddell (1997), have seen this process as restoring balance after a period a of "economic fundamentalism, ...resulting in severe reductionism in policy formation." Either way, there is little doubt that pressures to modify the economic framework underpinning policy analysis and advice by officials have risen markedly during this time.

Some important elements of the pre-1993 policy framework – such as transparency and accountability – remain. However, possibly the most fundamental component of the market model, economic efficiency, has gradually been accorded a less dominant role. As a result, some of the coherence in policy advice has been eroded and the application of tools for determining efficient policy outcomes has become more difficult, technically and politically. As is clear from the earlier examples - policy predictability has become perhaps the most obvious casualty of this process.

Since 1993, there have been several mostly disjointed attempts to establish alternative frameworks for policy development. Most of these – particularly the "Decent Society", the "Third Way", and the "Inclusive Economy" – have emanated from the political level. Each has attempted to establish a guiding concept or principle around which public policies and objectives could be more consistently organised. However, each has lacked the clarity and detail, much less the intellectual rigour, needed to serve as a coherent framework for detailed policy development.

In essence, each has asserted that the economic and social outcomes of market activities may often be unsatisfactory. However, by down-playing the economic efficiency value of market outcomes, and by failing to define adequately where or under what conditions these outcomes are unacceptable, they have encouraged analysts to second-guess politicians on the appropriate scope and criteria for government intervention. In this respect, they have come nowhere near providing the kind of coherence and consistency that the models of economic efficiency and market rationality – however imperfect – could provide in determining the underlying "policy problem" or the range of potentially viable policy responses.

The result has been a tendency to ad hoc, selective and even capricious use or rejection of market principles. This is now reflected, for example, in the conflicting rationale that increasingly underpins the combination of government ownership and regulatory functions within so-called "strategic" industries.

Other attempts, less political in origin, have been made to temper the role of economic efficiency in policy analysis and development. Perhaps the most notable of these has been discussion of the concept of “social capital” and the role which this may play especially in building “social cohesiveness” (Robinson, 1997). However, even this concept has so far proved unsatisfactory. Although the underlying premise may be correct - that effective social linkages, institutions and participation are evident in more vibrant and cohesive societies – it does not follow that public policies can effectively promote these conditions. The relationships within and between individuals, families and communities (including iwi) are invariably much too complex, dynamic and varied to be risked as an objective for public policies. Perhaps the best thing that public policy can do is to avoid harming or reducing existing social capital. However, by holding out a positive description of some of the characteristics of successful communities, the concept of “social capital” may well be useful for encouraging specific communities to address some of these issues themselves.

None of the above concepts has therefore effectively challenged the basic premise that markets generate the most efficient economic outcomes most of the time. Yet they have, to a significant degree, affected many analysts’ thinking about the appropriate concepts and tools for determining optimal efficiency and the case for government intervention. By offering less coherent and rigorous frameworks for analysis, they have shifted and, as this paper would argue, unnecessarily lowered the quality and consistency of policy debate.

CHANGES IN THE INSTITUTIONAL FRAMEWORK: SEPARATING POLICY AND PRACTICE

None of this should suggest that the policy reforms undertaken from 1985-1992 were on the right track in all respects. The adoption of principal/agent theory in particular to the management of public policies and institutions set back significantly both the analysis and implementation of public policies in many areas. The public sector is only beginning to address some of the (declining) “effectiveness” issues that were generated in part by the ownership/purchase, funder/provider and policy/services splits. The difficulty now, in many cases, is that moving forward is not simply a matter of reversing these earlier institutional reforms.

Many of these institutional reforms were largely successful, initially at least, in raising the efficiency of core government operations. For a time, they were perceived internationally as leading-edge public management reforms. This view may have faded significantly in recent years, though the management and achievements of the public sector reform process, if not all aspects of the reforms themselves, remain highly regarded.

The major perceived weaknesses in the public management reforms were in failing to secure better results (i.e. “outcomes”) from policy interventions (Petrie and Webber, 2001) and in leading to “fragmentation and misalignment” of policies and institutions (Review of the Centre, 2002). Much attention is now being focused by central agencies on determining how and where to restore institutional effectiveness. The new emphases on statements of intent, “managing for outcomes” and institutional capability – combined with the re-consolidation of departments (e.g. in the social welfare and justice sectors) are potentially far-reaching. So far, however, the core public sector legislation remains untouched. It would seem only a matter of time before these developments become clearly inconsistent with existing legislation. This time around, it is experimentation and practice that is leading theory and legislation.

The policy analysis process has been significantly affected by these changes. Not only has there been substantial – and in some case on-going – organisational restructuring affecting policy analysts directly, but it has tended to muddy the distinction between policy design problems and institutional (delivery) failures. Reforms to sentencing laws and the delivery of probation services, and policy versus administration in controlling the importation of genetically modified foods and inputs, are two recent high profile examples.

In some cases, for example social policy analysis and the provision of social welfare services, it is quite possible that the consolidation of the respective agencies will improve coordination and alignment. In other sectors, a perceived lack of results may be much less attributable to any existing separation of functions. The Review of the Centre involved primarily a consultative process amongst central agency officials and managers. It did not – at least in its reporting – distinguish between sectors according to their quality of policy advice and their institutional performance. There is a risk, therefore, that re-consolidation of agencies may simply mask these deeper policy (or institutional) problems. Equally, it has the potential to reverse recent efficiency gains in some of the improved service delivery operations – e.g. management of the courts).

A key mechanism for linking analysis, policy advice and performance within this new institutional and managerial framework involves the development of a department's "intervention logic" (IVL). This IVL is essentially a set of policy objectives, or "intermediate outcomes", below the Government's broader set of social and economic goals. These intermediate outcomes now form a crucial component of each department's statement of intent. They are intended to provide a clear focus for the interventions of the department. In time, it is expected that policies, structures and operations will be increasingly aligned to this outcome framework.

To date, IVL has been determined in most departments through interactions between senior managers, with some involvement from divisional staff and even ministers. In most cases, policy managers have played an important, but not necessarily decisive role. Within this process, there is a tendency for the IVL to be developed *down* from the government's goals, rather than *up* from a proper process of problem identification and analysis.

Requiring departments to examine and define their intervention logic is a useful step up. It should help to move departments beyond a rather pure output focus and to question the assumption that they necessarily continue to have a relevant and useful role to play. How that IVL process is conducted, however, will have an important bearing on the policy framework of the department and, hence, on the policies and effectiveness of the department. It is important that they do not overstate what the public policy can realistically achieve. Considerable care will be required in this regard to ensure that the IVL help to shape policy analysis in ways which are consistent with a problem-based approach to any case for intervention.

HITTING THE TARGET, BUT MISSING THE POINT?

The quality and direction of policy analysis has been affected by more than just these pressures on the economic policy and institutional frameworks. Over the last 15 years, social policies in particular have been influenced by increased attention on income distribution issues and, as a result, increased emphasis on "targeting" policies at groups or individuals based on perceptions of "disadvantage".

A key argument in the logic of the economic policy reforms introduced from 1985 was that many of the inequitable outcomes of a more market-oriented economy could be addressed by careful targeting and redistribution policies. This capacity for government policies to compensate individuals and families effectively was crucial to selling, politically, the merits of the new "winners and losers" environment. The primary mechanism for targeting of government assistance was "income support", since winning and losing (an unfortunate characterisation) in a more efficient economy were largely construed in income terms. It also meant that such assistance should be delivered in ways that were most fiscally "transparent". Economic policy, therefore, could pursue increased efficiency and growth through market mechanisms, while social policy would deal ever more effectively with the individuals and families on the lowest incomes. It all seemed perfectly rational at the time.

The main thrust of social policy analysis thus centred on the concept of identifying and reaching the appropriate target groups. Since a key objective of these reforms was to raise economic growth and therefore personal incomes, the principal method for establishing the targets for policy became "income distribution analysis". The longer term consequences and costs of this approach were generally not debated since the environment of policy optimism which dominated much of the public sector at that time did not recognise, much less accept, that these strategies might continue to involve substantial and rising costs in the longer term.[2]

The focus on targeting of social assistance continued well beyond the change of government in 1990. In fact, the targeting of public policies reached their zenith in the 1991 National Government "mother of all budgets" in which the New Zealand households were, for policy analysis purposes, statistically divided into market income deciles.[3] The analysis underpinning the welfare policies within this and the accompanying budget documents reinforced the notion that improved targeting was a desirable way of dealing with the "negative" income distribution consequences of market-oriented policies. It also implied, however, that such groups were clearly definable, measurable and reachable targets for public policies, especially through income-tested transfers.

Confidence in this approach has been considerably dented by subsequent experience. It is one thing – which may be very useful for some analytical purposes – to construct a detailed picture of households' income distribution, including the specific size and average annual incomes of

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[2] In a later discussion of policy reforms, Roger Douglas, the Minister of Finance from that time, argued in "Unfinished Business" for more far reaching solutions to the problem of escalating welfare expenditures. However, it is unlikely that many of these ideas were held as viable strategies in the minds of most politicians or policy analysts during the late 1980s and early 1990s.

[3] Hon. Jenny Shipley, Minister of Social Welfare et al., *Welfare That Works*, 30 July 1991.

various segments or deciles. However, it is quite another to use these segments as legitimate targets for policy analysis and development, programme implementation or service delivery.

As with the social capital approach described above, the key problem here is that the personal circumstances, motivations and opportunities faced by various individuals and households within each segment have turned out to be much more complex than those income distribution analyses suggest. The circumstances and characteristics of households within each decile or target group – and hence the impact of public policies, including benefit programmes and welfare services – are highly uncertain.

Not surprisingly, the precision with which this type of analysis is imbued – aided by increasingly sophisticated demographic data - has led policy analysts into focusing on smaller and more uniquely defined segments of so-called "disadvantage" within the economy. However, the fact that some of the tools of policy analysis may be getting more technically precise in terms of identifying these pockets or categories of disadvantage within the economy does not necessarily mean analysts are getting closer to the design of effective policies.

Identifying polices which effectively address such a wide variety of personal and family circumstances may be turning into a search for the Holy Grail. The view expressed in the 1991 budget that "the (welfare) system fails some people"[4] is surely equally true today despite twelve more years of refining and redefining the policy targets. It is therefore appropriate to ask whether the implied objective – i.e. that the welfare system should be capable of responding to each perceived inequity – was ever realistic.

Clearly, this approach to social policy enables governments from all parts of the political spectrum to promote their brand of policies on the basis that they will leave no perceived disadvantage unattended. Policy analysis and political opportunity have therefore moved hand-in-hand to reinforce the perception that public policies can and should redress disadvantage wherever it occurs, irrespective of the underlying causes of the problem or the real nature of the disadvantage. This approach reached perhaps its silliest level with the concept of "relative poverty" which implied that some proportion of the population would, by definition, almost always qualify as a target for income re-distribution or other social assistance regardless of their need. Similarly, in a recent discussion of policy analysis tools, it was proposed that departments should perhaps be able consider the impacts of policies on "Maori same sex couples". This too indicates the absurd levels to which a preoccupation with defining (presumably potential) categories of disadvantage and/or special needs may be inclined.

This continuing tendency for analysis to focus on developing policies and services which "reach" an expanding range of target groups raises important issues. Firstly, the separation of policy from service delivery institutions referred to above – in the social assistance area in particular – has encouraged the "success" of these policies to be measured too much by the degree to which the service agencies could claim to be "meeting the needs of their clients", rather than releasing them from their dependence. After more than 10 years of this "customer focus" this problem has only recently begun to be redressed through improved performance measures at the front line of some social service agencies. However, there is still a long way to go, and a significant conceptual

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[4] Ibid, page 75.

shift required, to get policy analysis in some departments back to much more of a problem-solving focus.

A second consequence is that far too little analytical attention has been paid to the fact that within almost every "target group" a majority of persons are either gainfully employed or otherwise socially and economically contributing. Mostly, these persons perceive no such disadvantage in their circumstances. However, the positive attributes, characteristics and incentives that define them from their peers are frequently overlooked. Social policy analysis could well focus much more on the role that these *positive* features play for individuals, family and groups in determining the form and level of their economic participation and social inclusion. Similarly, good role models and *positive* financial incentives for beneficiaries – as opposed, for example, to punitive measures in the form of benefit reductions or ineffectual "parental responsibility" charters – warrant much more detailed investigation.

Some groups are, of course, necessary and legitimate targets of government policy. Families and individuals affected by disease, disability, drugs, mental illness etc. face real impediments to full social and economic participation. The design and implementation of effective programmes that address these needs directly – for example through education, treatment, and financial assistance - are essential elements of social policy. What differs here is that the composition of such groups, and hence the recipients of such assistance, are clearly defined by their incapacity or need. This is often not the case with, say, "single parents", "Maori youth" or "rural communities".

Policy analysis and formulation can be much more effective when based on a clearly identified problem rather than on some generalised target group. "Success factors" amongst similar individuals may also be a powerful indicator of how public policies might be effective in prompting change in individual behaviours and attitudes.

CONCLUSION

A recent specification[5] for a Senior Analyst position in a low profile government department called for the appointee to be: "an experienced policy analyst, knowledgeable of the public sector, a brilliant communicator, a strategic and conceptual thinker and an economic analysis guru"! Although exaggerated, these examples raise expectations of what policy analysts, and therefore public policies, can actually achieve. In the current muddled policy environment, it would not be surprising if analysts are feeling uncomfortable.

Nonetheless, skin complaints amongst policy analysts can be reduced. This paper has proposed to start with three basic treatments:

(1) The analysis underpinning good advice should invariably include, as a baseline, the evaluation and specification of the most efficient, market-oriented solution to the perceived problem, irrespective of the political philosophies of the government in office. Not only do most policy analysis tools work best within this framework, but such an approach requires

[5] As advertised in the Dominion Evening Post, Wednesday 7 May 2003.

and enables policy makers to properly consider the costs and benefits of other, more active, interventions.

(2) Current efforts to improve institutional alignment and effectiveness in the public sector through greater emphasis on policy "outcomes" should not distract policy analysts from their logical starting point: clear and accurate problem identification.

(3) Attempts to target pockets of relative disadvantage in the community and population should not overlook the fact that, in most cases, a majority of the persons in those groups or categories are gainfully employed or otherwise actively participating in the economy. The characteristics and attributes of these persons may be a more informative starting point for policy analysis than the perceived constraints or disadvantages of the remainder of the "target group".

Good policy analysis certainly requires an ability and an enthusiasm to find and assemble relevant information, to choose between and apply various analytical tools, to declare one's assumptions, to identify policy options and to formulate and present effective arguments.

Policy analysis also requires analysts to understand the wider picture: that is, to share a broadly consistent understanding of how the economy and society functions and the opportunities, and the limits, for where government policies, and government institutions, might effectively contribute. That understanding is best influenced and amended through professional research and debate, not through political or administrative change.

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Chapter Five

THE ROLE OF ECONOMICS IN POLICY FORMULATION

By Robin Johnson

I welcome the opportunity to introduce this panel discussion on the role of economics in policy formation. I want to touch on the political environment in which policy making takes place; the more accurate identification of the longer term goals we seek to support; the independence of the economic advisor; the thoroughness with which we approach our task, and the dispersion or disassembly of views among departments. Each discussant has been asked to comment on an area of the topic he sees as important.

I think it is important to maintain the independence of the civil service from the political structure of the day. This means supporting the intentions of the 1912 Public Service Act with regard to job protection, promotion by merit and the ability to give free and frank advice. I realise that this puts us in an isolated position with some Ministers but I believe that it is important from the point of view of independent policy advice. By the same score we should welcome alternative sources of advice to Minsters though I don't know if I would support more appointments to Minister's offices from outside!

In recent years, policy analysts have come to recognise the important distinction between outcomes and outputs. Outcomes are the broad goals we seek for society and outputs are what departments can produce in the conventional terms of votes spent, ministerial letters answered, questions to ministers in the House replied to and cabinet papers drafted. It is the broad goals that interest us in this context and how economics can contribute to reaching them. Since such goals involves question of organisation, efficiency (getting best results per dollar spent) and effectiveness (achieving society's goals), it is the economics discipline which can contribute most to their identification.

To carry out such tasks the policy advisor obviously needs to be independent of the legislature. This was the aim of the Northcote-Trevelyan reforms in the UK in the 1850s, and the principle continued to be applied through the various public service reforms in New Zealand in its turn. This principle must extend to the work the policy advisor carries out. The aim should be to prepare position papers for ministerial (and parliamentary) consideration that give the facts and conclusions drawn from them as they really are. If compromise is detected, it should still be possible to present material in such a way that the costs and consequences of alternative courses of action are fully spelled out!

Consistent with this approach I would expect that the conduct of policy research, consultation, and interpretation of sources should also be carried out in an objective manner. There are a large number of steps in these background processes that provide opportunities for misquotation and bias that must be avoided at all costs. I think the policy community has to set a good example in this regard and help and advise, if necessary, those who seek foregone conclusions and short cuts to Ministerial objectives.

Finally there is the structural problem caused by functional (single sector) departments of state often with singular terms of reference as well such as Women's Affairs. One can see that single purpose departments can obtain the benefits of specialisation especially where there are ongoing administrative programmes. Indeed the State Sector Act 1998 contemplated the separation of delivery and policy functions within departments in the name of objective policy making. I think we all now recognise that these ventures weakened the coordination role in policy making, particularly where desirable outcomes involve several agencies. This weakness was exacerbated by the abolition of the Officials' Economic Committee in 1984, again at the behest of the political arm of government. There are now numerous pieces of analysis around that would support stronger coordination functions at the centre in the name of population-wide outcomes. There is a lot of work to be done in this area.

Let me now introduce the panelists.

Chapter Six

ECONOMICS AND POLICY: A CONTRIBUTION TO A PANEL DISCUSSION

By Gary Hawke

The 2003 conference of the NZ Association of Economists included a panel discussion on the role of economics in policy. This reflected a widespread dissatisfaction among economists with the level of economic analysis employed in public and media discussion of policy issues. It is easy to share such dissatisfaction. At times it appears that public discussion of policy issues and economic illiteracy go together.

Recent examples include the way that discussion of the electricity market proceeds on the basis that the problem is adequately defined as rising prices, on alleged "facts" about short-sightedness of markets, and on a solution in terms of a creation of reserve capacity which was treated as thought it were costless. (The response of Comalco to the real costs it faces was reported on p. 1 of *Dominion Post*, 23 July, 2003.) In discussion of railways we find ready resort to "infrastructure" and "strategic assets" in place of any analysis of transport services markets. This shades into simple misuse of economic terminology to evade argument; it is now very common for "investment" to mean nothing more than "costs of which I approve".

The problem is not new. As usual, we can find a passage in Adam Smith which relates to the fundamental issue, the distrust of economics and of the markets which economists study:

> "The popular fear of engrossing and forestalling may be compared to the popular terrors and suspicions of witchcraft." (Smith, 1776, 1937, pp. 500-1.)

"Engrossing and forestalling" were ancient alleged monopolistic market behaviours exploiting supply shortages at the expense of consumers, usually in grain markets, and both executive and common law remedies were sought. The origins of suspicions of markets are deep in our culture.

Numerous examples of similar distrust can be found throughout New Zealand's economic history. Fear of overseas manipulation was influential in generating reliance on government in the nineteenth century and government ownership and operation of railways, government insurance companies and other public institutions owed a good deal to such distrust rather than to economic analysis. After World War I, there was international anxiety about inadequacies of markets given the growth of industrial concentration, especially "trusts" in the US meat and other markets. New Zealanders shared in these suspicions and worries and these feelings contributed to the creation of the Meat Board and Dairy Board. The whole post-Great Depression policy thrust towards "insulationism" was similarly motivated at least in part. Notice that in no case does this necessarily imply that the policy initiative was misconceived; my point is simply that economic illiteracy and distrust of markets has long been a part of the environment in which policy is debated. Nor do I intend to suggest that this is in any way peculiar to New Zealand. If there is a difference between New Zealand and other parts of the international community which we usually use for comparative analysis, it is only that we lack outlets for specialized discussion.

The central issue is a fear of markets. The central achievement of economics is in greater understanding of the circumstances in which, and the manner and extent to which, pursuit of specific interests leads to social optima. Adam Smith developed this understanding as he argued that there was no need for mercantilism. John Stuart Mill added to it as he explored the idea of the limit of freedom being the infringement of the freedom of another. Arrow and Debreu, and modern microeconomics summed up the achievement of two centuries and opened up further exploration of the central theme in the presence of uncertainty and interdependencies. There is a literature which is an impressive intellectual achievement, even if its leading edge gets esoteric and demanding in terms of the preparation needed to participate in its discussion. The leading edge certainly gets remote from policy issues and while Adam Smith and John Stuart Mill were participants in the policy debates of their day, it is now an anachronism to believe that standing as an economist confers knowledge about economic policy debates. The alienation of economics and policy however lies even deeper; the whole central achievement of economic theory is opposed by the "common sense" certainty that that which is directly controlled is more reliable.

Economics provides knowledge which is not acknowledged. Consider the fundamental proposition that incentives matter. It is generally acknowledged in principle, and perhaps treated as too obvious to be worth considering further. But in specific circumstances, the common sense view is very often that people are not selfish and they will not respond to even acknowledged incentives. How can economists persuade the skeptical? Our own beliefs rest on innumerable examples – the literature of economic history is especially valuable - but those we want to convince - especially ministers - have little time, and are surrounded by conflicting noise. They find it much easier to accept arguments for "evidence-based policy advice" when the issue is not whether or not there should be evidence but what counts as evidence - which depends a great deal on prior knowledge. Advice about institutional design which is solidly based in superb empirical observation and impeccable logic will not look "evidence-based" to somebody ignorant of institutional economics. We can find examples in the health area. There are many assertions that reorganisations are decided on the basis of no evidence, when available evidence is simply not recognised. The relevance of a laboratory test to a personal health issue is immediately accepted without reflection on the prior knowledge which is needed to relate the evidence to the problem; more depends on what is familiar than on what is logical. (It is equally true of all professions that the authority of professional competence can be stretched beyond appropriate boundaries.)

The logic of economics creates a distinctive view of the nature of society. Individuals, groups and societies are readily related to beehives, rules and institutions. It is easy to go on to think of different kinds of ordered existence, of occasions when societies are best seen as "clouds" with frequent rearrangements or as "clocks", with ordered machinery. These metaphors are also much used in some of the physical sciences, but they fit easily with the basic economic logic of constrained maximization or "situational logic". They are not universally shared or admired. John McMillan's *Reinventing the Bazaar* shows the value of the basic conception for numerous current issues just as for an earlier generation Lionel Robbins *The Theory of Economic Policy in English Classical Political Economy* rescued the fundamental economic conception from the debased meaning of *laissez faire* in much political rhetoric, while John Hicks *A Theory of Economic History* provided a bridge between the classics and modern writers. But most of the world continues to work with a simplistic framework of government versus the market.

The same kind of fundamental difference of conception applies to the nature of policy. The basic idea underlying much popular and political discussion is a kind of lolly scramble in which teams compete for prizes freely donated from elsewhere; or a boys' sandpit in which a pecking order is established with occasional appeals to outside authority to change the rules and revise an order perceived as unfair. The ideas of conflicting objectives and unintended implications which relate so easily to constrained maximization create a quite different conception. Many people find it genuinely surprising that agreement that something is desirable is not sufficient reason for government to take all steps which are suggested to promote its achievement. The suggested steps may be misconceived. Government may not be the most appropriate vehicle, and the pursuit may have unwanted consequences which outweigh the apparently desirable objective. That is obvious, but its statement is likely to attract allegations of ideological blindness and dogmatic attachment to mere materialism. While the basic conflict is between analysis and instinct, policy debates are usually about reallocation of resources – government is in large part a device for transferring resources from taxpayers to enthusiasts – and it is therefore the economic content of sound policy analysis which attracts dismissal.

The poor quality of economic content in much policy debate is not always the responsibility of those who are not economists. Economists vary greatly. Most are not contributing directly to the great central achievement of the discipline. Most are not contributing directly to policy debates either. Many are teachers whose main contribution will be through improving the capabilities of their students. Those doing so in degree-level courses need to be dealing with new knowledge and that often has policy or at least empirical components. But the link to a policy problem is often partial. Other economists are working in a range of applied areas, and their interest in central policy questions may be no more than incidental. And, of course, the quality of the work of economists varies.

Economists who do want to participate in policy debates can contribute to better economic content in public debate by coming to terms with the problem as perceived by non-economist participants. We can debate the link between interest rates and exchange rates and the trade-offs between exchange rate volatility and output without realizing that this is of little significance to those who believe that exchange rates are manipulated by speculators.

Again, this is not something which is in any way unique to New Zealand. Paul Klemperer (2003) is an interesting account of how economic advisers can pay too much attention to some sophisticated economic results about auction design and miss important points about entry and collusion that would be obvious to anyone relying on undergraduate economics. Klemperer quotes Marshall and Colin Clark as providing similar lessons much earlier. There is intellectual fascination in pursuing logic where it leads, and no reason at all why economists should not exploit that satisfaction – but the novel and stimulating is not necessarily what contributes most to policy debate. As Solow put it nearly 40 years ago (before we became sensitive to the excluding character of sexist language):

> "Economics, like physics or astronomy I imagine, has a body of fairly simple low-powered theory and a body of rather fancy high-powered theory. But there is a subtle difference between economics and physical science. In physics, so far as an outsider can judge, you have to master the simple theory in order to gain access to the fancy theory; and many spectacular practical achievements seem to have come from the fancy theory. In economics, thing are different. I like a man to have mastered the fancy theory before I trust him with the simple theory. The practical utility of economics comes not primarily from its high-powered frontier, but from fairly low-powered reasoning. (I think this occurs not from any intrinsic reason, but because the data are not available to give precision to high-powered reasoning, and in addition, it often turns out that the high-powered theory of today is the low-powered theory of tomorrow.) But the moral is not that we can dispense with high-powered economics, if only because high-powered economics seems to be such an excellent school for the skillful use of low-powered economics." (Solow, 1964, pp. 7-8)

The first part of Solow's parenthesis is not convincing – the difference between economics and social sciences on the one hand and the natural sciences on the other is not likely to be data availability as much as it is that the subjects of the research themselves learn, and they respond to changes which result from increased understanding. But the general message of Solow remains compelling.

As well as dealing with a policy problem rather than an intellectual curiosity, economics should be used as a tool of analysis and as a means of developing recommendations through logic and observation. Economics does not supply ready-made answers. One should always be sceptical of claims that economics per se forecloses a policy debate. Improving the economic content of policy formulation is not a matter of substituting economists opinions for other political preferences. As Keynes put it:

> "The Theory of Economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method rather than a doctrine, an apparatus of the mind, a technique of thinking, which helps its possessor to draw correct conclusions." (Keynes, 1922, p. v)

One should not, indeed conceive the relationship between economics and policy as a one way transmission from the former to the latter. Economic research may provide lessons to policy but more often it provides tools which facilitate analysis relevant to policy formulation. And policy debates often shows the need for extension of available knowledge and perhaps illuminate directions of work which are likely to lead to new knowledge. Endres and Fleming (2002) shows very clearly how intellectual advances came from empirical issues – for the economic understanding of international trade, Condliffe, Hilgerdt and Nurkse probably contributed as much as anybody other than Heckscher-Ohlin in the twentieth century, as least until Samuelson-Stolper became important in analysing income distribution issues in the 1980s. We could say that important theoretical developments take a long time to have an impact, or that most advances come from work on empirical issues.

At the 2003 conference of the N. Z. Association of Economists, David Colander advocated a conception of economics as "muddling through", substituting as the core of economics purposeful behaviour, enlightened self-interest, and sustainability for what is found in conventional text-books, equilibrium, greed and rationality. I would prefer to see this as advice to applied economists of what they are now most likely to find most useful as they draw on the central economics tradition – thinking about in what circumstances individual action leads to collective optima – for the tools with which they approach a world in which complexity and uncertainty are likely to be important. It should not be understood as advice to discard what we have learned. The medieval cathedrals, as David Colander said, were built by learning by doing, and learning by doing remains important, but construction of the great houses in later centuries used the knowledge that was acquired and stored. Blueprints may be wrong or not exist, but when they do exist, we should use them, always of course, with due skepticism about their accuracy as well as their relevance. Advice is an invitation to think, not to acquiesce without reflection and prudence. In another discipline, history, Acton gave the advice, "study problems not periods". It was productive of a great deal of valuable scholarship but it also led to a decline of textbooks paying attention to chronological frameworks and it gave rise to some peculiar learning about specific subjects separated form their historical contexts. We should ensure that economics textbooks are accurately evaluated and their content used appropriately.

The relationship between abstraction and empirical enquiry is complex. When does a gain in precision justify a loss of comprehensibility? If we define a limit in the mathematical sense – given a sequence f(x), it approaches a limit, L, if there is an È>0 such that for all x greater than x' the absolute difference between f(x) and L is less than È - do we really gain much from the everyday sense of a limit? Or would I have a different understanding of "limit" if I did not know the mathematical formulation? Questions like this became more than intellectual games when the notion of a limit plays a role in a policy debate, many of the participants in which remember no elementary mathematical analysis if they ever had contact with any. And economics and economic policy is full of such questions.

Academic researchers and policy analysts diverge; it is not that there is a clear difference between research and policy development, but that individuals concentrate on different parts of the overall process and seek to make their part the whole rather than to reach agreement on specific roles. The whole policy/research dichotomy is probably less important than closed minds versus open minds and this applies to economists who do not recognize the limits of their specific expertise. As George Stigler put it:

> "In general there is no position … which cannot be reached by a competent use of respectable economic theory." (Stigler, 1959, p. 531)

Policy statements and even policy processes are sometimes economically illiterate. Our response should not be to assert authority for different conclusions but to demonstrate commitment to using economic logic to analyse empirical problems which are often different from those encountered in economics texts.

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Chapter Seven

GOING FOR GOALS[1]: COMMENTS ON THE ROLE OF THE ECONOMIST AS A POLICY ADVISOR

By John Yeabsley

This brief note will not be very ‘economic’ except in its broad use of some of the concepts of economic analysis to discuss the issues of interest. I will draw on the general background, but not too much on my particular experiences, of my last nine years as an external economic consultant, and prior to that of about 25 years as an internal economic policy advisor to the successive governments of New Zealand.

My interest in the topic has been sharpened by a series of tasks I have been asked to undertake – specifically those relating to the quality reviews of policy advice, and a joint teaching role with Rob Laking for the Masters of Public Policy at Victoria University on the way policy shops work.

The focus here (taken from the brief we were all given by the indefatigable Robin Johnson) is the notion that somehow ‘experts’ such as economists are not influencing policy the way they should. This broadly reminds some of us older people of the famous (and cutting) remark of Paul Samuelson in the 1950s (I think) that economists then[2] were, “well trained athletes who never run a race.”

I am not completely sure just what Robin’s notion reflected. One economist’s view might be that it was about the strange rejection of the broad truths of the macro-economics underlying the Washington consensus (leaving to one side any questions about the potential false implementation of them by those notorious bandits associated with the international financial institutions.) what seems to have taken their place is a rather oddly connected group of ideas that rest to me on a massively overestimated assessment of the scale of (two way) externalities between business organisations and the communities in which they operate.

WHAT IS THIS PIECE?

To keep this manageable, the idea here is to deal with only a limited number of issues. I have chosen to consider the following broad or “big” areas:

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[1] The title refers to an ironic note struck by the title of a contribution to a published symposium by experienced economist on the role of the US economist as an expert witness, which was called “Going for gold.” See Mandel, MJ (1999) “Going for gold: The economist as expert witness,” Journal of Economic Perspectives.

[2] In retrospect, it is fascinating that Nixon is the president said to have done the most to encourage the use of economists for policy formulation. This stemmed, perhaps, from his exposure to the power of their analysis during his time in price control during the Second World War.

- Background style;
- The process of actually giving advice; and, to close
- Noises off – or the shaping forces that are impacting on the role and the process.

BACKGROUND STYLE

The main environmental point is that New Zealand is a "Westminsterish" democracy. By this I mean that the typical professional advisors that provide technical material to governments are "independent". That is, their selection for the professional roles they fill is not done at the whim of the Ministers[3] that they work with. Indeed, the idea is that there is a category change at the level of the Ministerial advisors. Ministers are political, by being elected, while advisors are professional, by being appointed.

How does this margin operate?

At a recent series of seminars[4] organised by Colin James for the Victoria University Institute of Policy Studies, this question was extensively discussed. My own view was not popular, (especially with former CEs) and did not appear in the final record, but it is that relationship is appropriately represented by thinking of the advisors as "hired help". My point is to emphasise the difference in incentive alignment.

This image is not intended to be demeaning, in fact the image of hired help that often springs to mind when one thinks back to many of the situations I have been involved in, or heard about, is that of the ever unflappable and always resourceful Jeeves assisting Bertie Wooster[5]. Not that Ministers are typically as lacking in common sense as Bertie, but they can well be similarly without the full range of relevant experience. Indeed, the type of advice that we are examining here is that of an "expert". This is not merely a favourable term but one with a very precise technical interpretation – an "expert" is one whose work quality can only be judged by another (similarly qualified) expert. This applies across a wide range of walks of life from medicine or engineering, though to painting or fixing home appliances.

So the relationship is one that is not easy to make work efficiently. It is worth examining in detail.

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[3] There are two qualifications to be made to this, of course. First there are political appointments who work with Ministers, but so far, at least these have been relatively rare. In addition, Ministers can have an impact on the choice of people who work closely with them. There is a formal provision in the State Sector Act for the government to have a veto over the Chief Executive appointments made by the State Services Commissioner. More intriguing, there is asort of informal influence on who is providing briefings and advice, exerted through hints and the like to the Chief Executives by their Ministers.

[4] See James, C (2002) *The tie that binds: Relations between Ministers and Chief Executives*, IPS

[5] See the series of books, and stories produced by PG Wodehouse in the first half of the last century.

PROCESS – TRUST ME

Some years ago an eminent observer and commentator on the New Zealand public Service, John Martin published a slim volume[6] that addressed the vital question, is there a profession of statecraft? He was looking at the relationship we are interested in, from the viewpoint of a wider issue, of the way the New Zealand public service operates. And his answer was entirely correct – as he thought there was such a profession.

But, at least in my view, his reasons were not the most appropriate ones. He was struck by the unique nature of the formal legal constitutional implications of the relationship. I see it more pragmatically – it is about behaviour.

What is the task?

The idea is to influence a series of decisions in a strong but simple way – best analysed in terms I once heard Arrow use in response to an audience question at a public lecture about medical insurance. He suggested that the optimal outcome (in a technical sense) to an uninformed individual searching for the best medical input to a critical clinical choice, was for the decision to consist of the use of the expert's knowledge within the individual's preferences.

This is a general prescription of the best way that an expert can contribute. And we can now reveal the pragmatic response to Mr Martin's question. The "profession" of statecraft consists of those with the skills to organise this type of decision-making on a regular basis. In other words, the statecraft professional is someone who can deftly discover the preferences of the politician and then use appropriate technical knowledge to arrange the most fitting output.

But the question remains: how can this actually be arranged?

And while we are at it, the issue of interest here is slightly different from that of making a one-off decision; it is, how to structure an efficient advice relationship. And given the nature of the Westminster style this will be a 'game' with repeated rounds. So there will be overall (longer term) strategies that will be more efficient, in this situation. Such strategies define a relationship has the qualities that we describe otherwise as "trust".

Trust is a relationship where the advisee is reasonably confident that the advisor has the best interest of the advisee at heart. In other words, there is a confidence that there is a situation that has 'as if' incentive alignment.

It is clear, from the logic of the situation, that we can make some, more or less fairly obvious, statements about such a relationship:

- It will be more or less successful – that is, the influence and attitudes of individuals will affect the way the arrangement actually unfolds;
- It is built up over time, based on experience, and evidence gathered over time, and so will be evolving;

[6] See Martin, J (1990) *Is there a profession of statecraft?* IPS

- It will be hierarchical, in the sense that, the more important the issue to the advisee, the greater the weight associated with the need for proven and committed trust; and
- It is always under revision – so the 'level' of trust is a 'stock' concept, but one that is able to be drawn down.

The issue for anyone seeking to be an effective advisor is how to create and reinforce a trust relation? Both the literature[7] and common sense suggests that one way that trust is established and built up, is by showing **commitment at a real cost**.

In the New Zealand political advice process, the creation of a trust relation seems to be taking significant time to re-establish on every occasion there is a change of government. Indeed, there is a serious history (that has been little investigated as far as I can discern[8]) of rather bitter comments by incoming governments[9] about the presence of a continuing loyalty to the previous incumbents. In the type of idealised thinking that underlies a Westminster system, the ease of re-establishing trust should be little worse between governments than between Ministers within a single government.

As it turns out though, this seems to have been an impossible dream. In the sweep of policy reformulation that takes place when a party loses power it seems lately (at least, at the last two significant alternations of party groups in power – 1990 and 1999) part of the process has included a searching re-appraisal of the approach that the party concerned is taking to economic management[10]. This did not rule out economists from proffering advice that could be acceptable, but it did make the task harder. In fact the statecraft required had moved up a step.

NOISES OFF

Having now filled in the implications of the process, we can also examine several particular situational effects that need to be taken into account as part of the possible reasons why the Johnson thesis has been advanced.

We can treat these relatively briefly in note form:

- The fiscal and accountability environment. Over the last 15 years or so there has been a continued atmosphere of fiscal consolidation, which, coupled with heightened levels of

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[7] See, Morris, S (2001) "Political correctness," Journal of Political Economy. In this analysis, the commitment cost is shown by the advisor making the effort, through the perceptible adjusting of the language selected to discuss the issues; moving to the vocabulary (words and concepts) favoured by the advisee.
[8] It goes back at least to the change of government in 1949, as there was notable comment by the incoming government about the extent to which the public service could be separated from the previous government which had been in power since 1935.
[9] Note, I am neglecting the typically wild remarks made about the attachment of individuals or whole agencies to the government or its supposed ideology by politicians in opposition. These are just part of the normal "political puff" (in RD Muldoon's immortal words) that characterises the process of party differentiation in the political market place.
[10] In 1990 this was not as radical as in 1999, but substantial shifts in economic areas like industrial relations and workplace safety were signalled and implemented. In 1999, an avowed third way was adopted by the incoming party, that included a discernible anti-economist thread.

accountability under the Public Finance Act 1988, have squeezed advisory capacity in many agencies. Perhaps more importantly this has reduced the ability of economists in many shops to absorb the relevant background and develop initiatives.

- Structural effects. The shifts in the New Zealand economy over the last 20 or so years have made the competition for classy economic advisors far more intense than it was. This has meant that public agencies, especially the smaller ones, are struggling to sustain quality and its supporter, critical mass.

- Training and pressure. The atmosphere in the public sector over recent times has been one where many organisations have struggled to have the funds available to allow significant training.

- Support systems – there are missing elements:

  - Adequate supplies and support for potentially complex models, or models that are calibrated and appropriate to New Zealand conditions. This is a scale effect and possibly reflects on the 'silos' that seem to have developed in the economic advice market;

  - Sound data that allows sensible 'what if' questions to be asked and answered. Several years ago, when work was being done to assess the possible impact of alternative responses to Kyoto commitments, the work was hindered by the lack of simple items like the cross-elasticities of energy use and price. We lack long running consistent series relating to input-output coefficients, as we change the definitions of the groupings; and, finally, and possibly most important

  - Thick advice markets. New Zealand is notably short of what are termed 'think tanks.' These are independent sources of sensible and reasoned economic advice outside the public sector. There are several regular contributors to the debate, of which the most notable is the New Zealand Business Roundtable. But their position is typically toward one end of a spectrum, and so much of their work (backed up by an envy-making budget) although it is sound and draws on modern ideas, is not bolstered by being demonstrably widely supported. Otherwise, the contributions broadly can be seen as coming from two sources: the professional analysts paid by those with a commercial interest (mercenaries); and the self-motivated (obsessives).

Thus we have painted a picture of how economic advice is transmitted into the policy process, and provided ourselves with some reasons why the contributions of analysts are not up to expectations.

For all that, it is probably worth remarking that the overall standard of economic advice has improved markedly over the last thirty years. How would I know? Well, that is about the span of my involvement in the system, and while personal experience is not necessarily a sensible basis for assessment, in this case I can point to my early interdepartmental exposure in the early seventies to many of the key issues of the day (including macro-economic advice) to provide a benchmark. More recently I have had the chance to calibrate my experience and impressions in a logical and consistent manner against various samples of work from economically relevant agencies.

So if the standards have improved, why do we think we are missing out?

I can offer two contributions to the possible range of explanations:

(1) The inevitable raising of expectations based on experience. We New Zealanders (via the public decision process) are now grappling with harder and harder problems and still expecting these to yield to the tool kit we have available. This was made worse by the way we were able as a profession to take advantage in the eighties and nineties of accumulated economic and public policy work that had not been brought here. This stockpile of easily mined ideas has been worked over pretty well now and we are close to the frontiers where insights came along more slowly.

(2) The changing political market place has sharpened up the call for improvements. There are now far more relevant parties seeking to provide a differentiated bill of fare before the public. There is always going to be one that refuses to accept the reasonable judgement that there are no easy fixes in some areas. The current (justified, to look at the polls) fascination with 'leadership' means that problems that used to be left to be solved in the technical arenas are now turned into 'issues' with which public servants are expected to grapple.

Chapter Eight

EARLY INTERVENTION IN POLICY FORMULATION

By Stuart Birks

Concerns about policy advice, formulation and monitoring can result in calls for more evaluation. Often this involves attempts to assess outputs or outcomes. There is another area where significant improvements may be possible without any great effort. It would appear that poor quality information and reasoning are allowed, often early in deliberation, to have far more significance than they should. Sometimes "factoids" that are clearly false are given great weight and, through frequent repetition, actually detract from informed debate. A culture that rejects this would act as a strong deterrent to those who would attempt to promote a preferred position through weak argument. Moreover, assessment of the effects of policy, if ever undertaken, commonly occurs long after the distorted information and reasoning have had an effect, and is unlikely even to review these latter.

Here I wish to give two examples, one large and one small, to illustrate the policy distortions that can arise if poor quality inputs to the policy debate are allowed.

The first relates to information on intra-family income.

Sociologist, Rosemary du Plessis, wrote:

> "Claims about women's common interests have been used as a strategy to ensure that international organisations such as the United Nations attend to the political status of women. It has also been vital in developing women-focused structures in particular nation states (such as New Zealand's Ministry of Women's Affairs) and at the level of community organisations, trade unions, churches, workplaces, professional associations, and educational institutions." (du Plessis, 1997, p.221).

In the same publication, she not only acknowledged a great diversity of women's experiences, but also wrote:

> "...although equal employment opportunities initiatives have benefited some women, those most advantaged have tended to be the women who most resemble those who fill the equal employment opportunities (EEO) positions in organisations." (p.222)

In other words, a false picture was presented for political advantage, where the results could favour a privileged sub-group.

We can see this process in operation when we look at the fifth New Zealand report on the International Convention on the Elimination of All Forms of Discrimination Against Women

(CEDAW) (Ministry of Women's Affairs, 2002). It includes a discussion on the distribution of family/household income[1]:

> "Recent research (Fleming & Easting 1994) shows that couple or household income is not necessarily a reliable indicator of access to money by those living in the household…In European families it was found that the more a woman contributes to household income, the more she is **likely to have some say** in household financial decisions…" [my emphasis]

This should result in a response urging the New Zealand government to increase women's economic autonomy through changes in the home, in education and in the workplace. It also reinforces analysis of families based on the dominant "patriarchal power and control" model. Given the policy agenda of both Labour and the Greens, such a response would be most helpful to them.

The claim about the research is misleading, however.

Fleming and Easting (1994) say (p.32), "Sample selection for qualitative studies is not bound by the same constraints as sample selection for quantitative research aimed at generalizing to the wider study population…the requirement for random sampling does not apply". The Fleming and Easting sample included only 59 households. Moreover, comparison with data from the NZ ISSP survey for the same year (Gendall, 1994) indicate that their sample is not representative, at least with respect to the financial arrangements used, and so their results cannot be used to make the claim in the report on CEDAW.

	Fleming & Easting	ISSP ('94)
Pool all	20%	58%
Pool some	42%	17%
Separate	5%	10%
Other	32%	15%

The results do not even show what the report claims.

(1) Fleming and Easting specify categories of management of household finances as "total" and "greater share" for the man or the woman, plus "joint" and "independent". According to their Table 5, men had total management in 3 of the 59 cases, compared to women in 20, and men had the greater share of management in 5, compared to 11 for women. Joint management occurred in 17, with 3 couples having an independent system. Clearly, where one partner has more say in management, that partner is most likely to be the woman.

(2) Fleming and Easting distinguish between "management" and "control" of finances. "While management involves spending the household money, making day to day decisions about what to buy, and making sure there is enough to meet set commitments, control is about

[1] http://www.mwa.govt.nz/women/status/cedaw016.html

deciding whether to spend, what the upper limits are, are where the family's spending priorities lie." (p.55) "Some say" in the Ministry of Women's Affairs quote most probably refers to control. Table 6 of the report shows fairly even numbers of men and women having most control, with somewhat more men than women having full control and somewhat more women than men having main control.

(3) Tables 8 and 12 provide information on the amount of say in relation to share of total couple income. Two groups are defined according to whether the woman earns either less than, or at least, one third of this income. "Table 8 supports the conclusion that women earning more than one-third of the total couple income are more likely to share in the control of money on an equal, or even a dominant basis" (p.72). Table 12 considers only high income households. In no cases where the woman earned a third or more of the couple's income did the man have more control than the woman. In other words, for high income couples, the man had to earn at least twice as much as the woman to have a chance of more say than the woman. Out of all couples, many women in the group earning less than one-third of the income still had more control. Of women who earned over a tenth and less than a third, "the majority were in joint, woman joint, or woman control situations" (p.72).

Rather than using the term "some say", the report on CEDAW should really have said "the more she is likely to have **most say**". Both management and control appear to favour women, balanced to a small extent by the man's chance of a greater say in control if his earnings are markedly greater than his partner's. If we are to consider Fleming and Easting's results at all, despite their small sample and qualitative approach, we should really be concluding that, in European families: (1) the more a woman contributes to household income, the more likely she is to have major control over household finances; and (2) generally, a man has to earn significantly more than a woman in order to get the same amount of say in the use of household income.

The emphasis on control is also of interest in the context of legislation on child support, which relates to families that extend over two or more households. The liable parent makes the payment, but not only does this give that parent no say in the use of the money, but there is no legal specification as to what the money should be used for, and no requirement for the recipient parent to account in any way for the use of that money. Presumably, were women to be a large proportion of liable parents, this would be of concern under CEDAW. Most liable parents are men, and it does not rate a mention.

My second example relates to a recent issue arising out of an unusual, and much publicised court case.

Imagine the following scenario:

> An economist makes a poor investment using his own money.
>
> Senior economists and the media then proclaim: "people should not invest on their own. They should be required to engage an economist."

It might be more realistic to question either the quality of this economist’s reasoning, or the value of economics for determining investments.

Now imagine the following scenario:

> A lawyer represents himself in court, and the case takes two weeks longer than expected.
>
> The judge then (a) suggests that the issue of unrepresented defendants might need reviewing, and that he would be making "certain submissions to relevant authorities ... as a result of this case". He also (b) refers in his written decision to a “problem” of unrepresented defendants. This call is also (c) given media attention and is taken up by the justice spokesman of a major political party. The suggestion is really that, “people should not represent themselves. They should be required to engage a lawyer.”

It might be more realistic to question either the quality of this lawyer’s legal skills, or the value of law for deliberating on issues in a timely fashion.

The scenario with the economist did not happen. The scenario with the lawyer refers to John Burrett. The information is from (a) Editorial, NZ Herald, 17 June 2003, (b) “Judges `lenient to those without lawyers'”, Dominion Post, 17 June 2003, Edition 2, p.8, and (c) Ross T and NZPA, “Defence rights in question”, The Press, 16 June 2003. It seems that a judge and others can, on the basis of the behaviour of an experienced lawyer, make a case against self-representation by inexperienced people who do not know how to “play the system”.

An alternative interpretation of the case might be that lawyers can cause legal proceedings to take longer and cost more than necessary. This may not be an entirely unknown phenomenon. Sometimes this could be deliberate. At other times it could be through inappropriate behaviour. The New Zealand Herald of 28 June 2003 describes (p.A10, “Lawyer rapped over chat with drug-trial jurors”) the abandonment of a major trial after nine weeks due to a lawyer talking to members of the jury. Prosecution costs alone were $250,000. Similarly, incorrect judgments could cause additional proceedings and increase costs. The Dominion Post of 21 June 2003 (p.1, “Lords give Jones another day in court”) reports that the Privy Council supported an appeal by Bob Jones, stating: “the Court of Appeal … treated as uncontradicted, evidence that was in truth very strongly contradicted”.

Rather than the Burrett case being used to challenge the behaviour of lawyers and the efficiency and quality of legal processes, we see attention being devoted only to the possible overturning of the legal right of individuals to defend themselves.

We see from this example that a policy issue can be selected on highly dubious grounds. Meanwhile, no attention is given to an alternative interpretation of the problem that is equally valid, if not more so. Quality policy advice requires not only consideration of outcomes and of the information and reasoning in the analysis, but also to quality of the original questions being posed.

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