

ECONOMICS FOR POLICY: EXPANDING THE BOUNDARIES, ESSAYS BY PETER GORRINGE EDITED BY A GRIMES, A JONES, R PROCTER AND G SCOBIE

*Reviewed by Matthew S R Palmer**

Arthur Grimes, Alan Jones, Roger Procter and Grant Scobie (eds) *Economics for Policy: Expanding the Boundaries, Essays by Peter Gorringe* (Institute of Policy Studies, Wellington, 2001) 265 pages.

This book is a collection of essays by the late Peter Gorringe. Peter was a lovely, gentle man who made a career in the New Zealand Treasury out of intellectual inquiry. I shared an office with him in the Treasury in the mid 1980s and worked with him on a number of issues. We worked together with some others to found the Law and Economics Association of New Zealand in the mid 1990s. Peter stood out in the Treasury culture as always open to different views and willing to assess all arguments. It is a fitting tribute to Peter's continuous spirit of inquiry that the Institute of Policy Studies has published this edited collection of 10 of his essays following Peter's untimely death in 1999. There is a list of 51 published and unpublished pieces by Peter at the end of the book - illustrating the wide range of his interests, from "Establishing that Fairness Matters" to "An Economic Perspective on Trademark Law". These are also on the web at <www.treasury.govt.nz/gorringe/>.¹

The editors of this volume have done well in choosing ten papers that are true to the core tools of analysis that Peter Gorringe employed and to the variety of subjects that he analysed. Of the ten essays:

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1 (Page last accessed 17 August 2001).

- (1) three concern relatively abstract considerations of aspects of policy analysis;
 - 1 On Coase and Policy;
 - 3 Background to the Policy Implications of Limited Rationality; and
 - 10 Methodology of Policy Advice;
- (2) two examine the organisation and regulation of specific sectors of the economy
 - 2 A Contracting Theory View of Industrial Relations; and
 - 9 Secondary Health Care: Contracting, People and Politics;
- (3) two examine macro-views of the interplay between social and economic factors
 - 4 Institutions, Fairness, Social Cohesion and Economic Growth; and
 - 5 Does Economic Growth Lead to Growth in Welfare? If Not What of New Zealand Economic Reform Since 1984?; and
- (4) three examine the functioning of government and the state sector
 - 6 Reform of the Core Public Sector: The New Zealand Experience;
 - 7 Commitment Perspectives on Public Sector Governance; and
 - 8 Government and Institutions.

The title of the collection *Economics for Policy: Expanding the Boundaries* hints at, but does not fully capture two salient characteristics of Peter's essays. First, while Peter's analysis is rooted in economic tools and concepts, it transcends the simplifying assumptions of that discipline. This is the value of the "new institutional economics" which is the label that Peter most often employs for his analysis, or "law, economics and organisation". This stream of interdisciplinary thinking works from the basis of the assumptions of economic methodology but stresses the importance of examining those messy aspects of reality that traditional economics prefers to assume away. It stresses the nature and size of transaction costs, agency costs, information costs, the value of institutions and reputations, and the effects of bounded rationality. These all lie at the heart of intuitions about what happens in the real world that make the mechanical application of economic theory so irritating to those who seek insights on which to base real policy decisions.

So the essay on the relationship between economic growth and welfare delves into the psychological literature about the nature of human behaviour to examine adaptive preferences,

asymmetric preferences and adaptive commitments – labels for ways human beings act that don't seem quite logical to a Vulcan economist. In some ways, this piece is the least convincing but most revealing essay in the volume.² The essay examines some of the theoretical psychological literature and empirical data to find that people care about their relative incomes. It also notes psychological effects relevant to economic change: at least a temporary commitment to the defence of the status quo against change, especially if change is to our disadvantage; and that we feel more intensely about losses than equivalent gains; and that the "grieving process" over losses can mean a relatively slow adjustment to new circumstances. These lead Peter to find in theory that increasing growth may reduce welfare. Against this are assembled a range of counter-arguments as to the positive effects of New Zealand's economic reforms of the 1980s which Peter clearly believes in - to the effect that "My overall conclusion, albeit as an interested party, is that the reforms were broadly worthwhile and that we should not be trying to unwind them".³ But the force of his examination of the psychological difficulties of economic adjustment lead him to an honest and uncomfortable qualifier to this: "That said, these arguments have led me to question whether the pain reform inflicted on many people was always worth the gain."

The journey traced in the last paragraph demonstrates the second salient feature of Peter's approach to issues that is made clear in these essays. Peter worked in a culture at the Treasury that was, especially in the late 1980s, sure of its prevailing paradigm and believed in the necessity of the outcomes it generated when acted on. Peter consistently adhered to the part of that paradigm that held that nothing was sacred and everything must be analysed on the basis of first principles. He applied that spirit of honest inquiry to the conclusions of the Treasury paradigm itself and was always ready to re-examine his earlier conclusions. The three essays on public sector governance demonstrate that and are well worth re-reading now in light of the present swirling uncertainty in key aspects of public sector governance.

The sixth essay was written and published jointly with Graham Scott in 1989 after the main features of public sector reform had been decided on – most notably encapsulated in the State-Owned Enterprises Act 1986, State Sector Act 1988 and Public Finance Act 1989. The first

2 In it can also be identified seeds of the work that has been published by the Treasury this year on the "Inclusive Economy". See <www.treasury.govt.nz/workingpapers/2001/> (page last accessed 17 August 2001).

3 A Grimes, A Jones, R Procter and G Scobie (eds) *Economics for Policy: Expanding the Boundaries, Essays by Peter Gorringer* (Institute of Policy Studies, Wellington, 2001) 94.

footnote to this piece notes that "It was meant to be an account of the conceptual changes, rather than a blueprint for them".⁴ Certainly this article has been widely referred to by those seeking the intellectual framework behind the reforms. The fascinating aspect of the reproduction of the article in this volume lies in comparing it with Peter Gorrings's subsequent reflections in 1994 on the same topic in the next essay.

The 1989 paper identifies as core to the reform of the public sector the need to control "agency" problems in the public sector – a core concept of the new institutional economics literature. In tackling agency problems the paper examines four key aspects to making government departments more efficient and responsive:⁵

- a change in the relationship between ministers of the Crown and chief executives (CEs) to make CEs more accountable for the output and efficiency of their departments;
- CEs to have much greater discretion in the management of their departments;
- to make a distinction between the outputs of services a department produces and their outcomes, in order to better assess performance by both bureaucrats and politicians; and
- a system of financial accountability that is based on accrual accounting of inputs and on output measures.

The 1994 paper examines these issues from another perspective that lies within the new institutional economics literature: the governance of long-term relationships. This "commitment model" examines degrees of attachment or commitment between parties to a relationship when dealings are ill-specified in terms of formal contracts and are based on cultural factors of good-will and mutual trust. This perspective is applied to re-examine key aspects of the reformed system of public sector management. The essay concludes that "the accountability reforms have provided a richer information base on which politicians can make decisions" and "have been the impetus for all the players thinking more about the role of government and the detailed goals of the public sector and how these goals might best be met." But it also suggests that changes in emphasis are necessary, in particular, that:⁶

4 *Economics for Policy: Expanding the Boundaries, Essays by Peter Gorrings*, above n 3, 107.

5 *Economics for Policy: Expanding the Boundaries, Essays by Peter Gorrings*, above n 3, 96-97.

6 *Economics for Policy: Expanding the Boundaries, Essays by Peter Gorrings*, above n 3, 124.

- there should be move from an "explicit contracting" model to a "relational contracting" model due to the special relationship between ministers and CEs, the difficulties of measuring and pricing outputs and the existence of bilateral monopolies and specific assets in the sector;
- the interests of ministers as a collective need more stress;
- the limited time, knowledge and abilities of ministers and the complexity of their management task need to be considered more explicitly; and
- the issue of continuity in government, especially in an MMP environment, needs addressing.

These conclusions from 7 years ago still stand today. Attention to them would serve to inform and contribute to the current debate as to the appropriate nature of public sector management.

This review has identified two salient characteristics of Peter Gorrings work as exemplified in this volume: that Peter's use of new institutional economics transcended many of the limits of conventional economic analysis; and that he was always ready to re-examine any conclusion from first principles in the spirit of open, honest intellectual inquiry. Peter's last essay in this volume, on the methodology of The Treasury's policy advice, sums this up. It is relevant to the Secretary to the Treasury's current efforts to reinvigorate that institution with open intellectual inquiry. It is also relevant to those, whether politicians or others with responsibility for decision-making, who believe they are right:

In all that we do, and in the way in which we operate, we need to have in mind Popper's criterion of encouraging the optimal amount of criticism. While there is already a tradition of internal and external review of the work we do, it is likely that our work would benefit from an even greater emphasis on focused, careful and constructive criticism. Institutional changes are necessary to bring this about.

