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Ideas, Interests & Experience

Some implications for policy advice

Roger L. Kerr

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Foreword

Ross Parish

The relative importance of ideas and interests in shaping the course of politics is a perennial puzzle. Those of us who are in the ideas business clearly think that ideas are important, but how important is a mystery. In black moments we may, like Bernard Levin, be 'troubled ... by the thought that nobody is listening and that nothing would happen even if somebody, or even everybody, were.' Even Keynes's dictum that '... the world is ruled by little else [but ideas]' is less than totally comforting, for the ruling ideas need not be one's own.

The development of public choice theory has greatly undermined the plausibility of the model of government as benevolent guardian of the public interest, and shown more clearly the way in which interests operate. As a result we might incline to a greater scepticism regarding the power of ideas to influence political outcomes. But public choice theory is itself a set of ideas and in so far as it helps us to understand events it also helps us to influence them.

Roger Kerr offers some mature reflection on the roles of, and interactions among, ideas, interests and experience in the formation of public opinion and in the political process. He draws on an easy familiarity with the changing intellectual currents of modern economics, experience as an adviser of governments and as a business spokesman, as well as on the views of others who have thought deeply about these matters. His theme is, of course, close to the hearts of us at the Centre for Independent Studies. We also thoroughly approve of, and hope we follow, his concluding advice, that the economic adviser would 'stick to the high road and avoid the advisery habits of the swamp, even if the journey is frustrating and sometimes very long.'

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Ideas, Interests and Experience: Some Implications for Policy Advice

I. THE ROLE OF ECONOMIC IDEAS

Much has been written in recent years about intellectual influence on members of a science, on public opinion and on the political process. Much has also been written about the incentives and capacity of organised interests to appropriate the instruments of public policies for their own benefit, and about the slow, but sometimes decisive process by which open societies learn from experience, reject former ways of doing things and choose better ones. The major purpose of this paper is to explore some of the interrelationships among these influences. In doing so, it offers some reflections on why economic policies in New Zealand and Australia in particular have often been badly chosen, and on the nature of obstacles to better policy choice. A related theme deals with some aspects of the communication of economic ideas and the market for economic advice.

I begin with the role of ideas. Reflections on the occasion of the Keynesian centenary seldom failed to quote the famous affirmation of the influence of ideas on events with which the *General Theory* ends:

> [T]he ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas ... it is ideas, not vested interests, which are dangerous for good or evil.

For a generation or more after those words were written — the era of macro-supremacy originated by the *General Theory* — Keynes was effectively that influential defunct economist. The ascendancy of Keynesian ideas was pervasive, reaching far beyond the economics profession. Even after they had come under mounting challenge from

other scholars and the evidence of their limitations and dangers was becoming apparent in the 1960s, President Richard Nixon was still expressing a widespread consensus in declaring, 'We are all Keynesians now'.

Most economists have become aware that Keynes's work did not constitute — and did not even purport to constitute — a wholesale revision of accepted economic thought. As the preface to the *General Theory* and the vast literature on 'what Keynes really meant' makes clear, Keynes's writing is more appropriately described as a collection of insights, many of them extremely penetrating, but not a theory (certainly not a 'general' one) in the accepted sense. A good number of the insights related particularly to the circumstances of the 1930s and the policy failures of that time. It is therefore not surprising that simplistic attempts by Keynesians to apply his precepts in different circumstances led to erroneous policy conclusions. For example, we now know that Keynes's adherents erred in diagnosing unemployment as being generally due to inadequate demand for labour; that consequently their support for government-sponsored large-scale investment projects was misguided; that they underestimated the irresistible pressures that expansionary policies would create for the debasement of the currency about which Keynes had earlier warned; that the fear of excessive savings was misplaced; and, more generally, that the arguments for government activism to fine-tune the economy lent respectability to policies that lead to the over-extended public sectors and macroeconomic instability of recent experience.

But if Keynes's contribution did not, with hindsight, constitute a revolution, his legacy includes some important perspectives that mainstream economists have incorporated into their understanding of economic processes. A key one is the reminder that many markets do appear to have rigidities and that price and quantity adjustments do not always occur flexibly and rapidly, factors that help explain the business cycle and non-neutral short-run economic responses to policy changes. A related point is the importance of interactions between markets in influencing the path of the aggregate economy. While the contemporary interest of policy analysts is no longer centred on government attempts to manipulate the macroeconomy in ways that might minimise these effects but rather on the role of legal processes, institutions and contracts (implicit or explicit) in determining the nature of transactions and responses to change, the macroeconomic consequences are ones that Keynes did much to illuminate. Moreover, Keynes's writing gave a large place to many established elements of economic thought such as the relationship between wages and jobs. Those who find selective Keynesian prescriptions congenial are often less comfortable with a quite fundamental aspect of his analysis, namely that, as a modern Keynesian has put it, 'labour's support of price increasing measures and unions'

representation of senior employed workers at the expense of the unemployed worsen the agony of the trade-off and cripple full-employment policies' (Tobin, 1983:11).

In the domain of macroeconomics we have probably all noticed that we have been relearning and reinterpreting much of what we were taught in the 1950s and 1960s, and rediscovering and developing the key ideas of the more established and orthodox tradition of economics that have been found to have a sound microeconomic basis and public policy rationale. These have included the importance of sound money in avoiding inflation and its associated cost; of good housekeeping in public budgets to avoid damage to incentives and intergenerational theft; of stability in institutions in order to reduce unnecessary transaction costs and uncertainty; and of market disciplines on behaviour that are absent when government allocation prevails. What is probably less apparent is that we have been relearning a good deal of the microeconomics that was also shunted up the wrong track around the same time.

For 50 years after Marshall, the dominant model of market behaviour in most centres of learning outside the sphere of influence of the Austrian school was the perfectly competitive version, with its assumptions of full knowledge, zero transaction costs and no market power on the part of firms and individuals. The central interest was in equilibrium properties, with marginal anything being equal to marginal everything else. The vision of this ideal world was essentially a static one; real time did not enter into it.

As intellectual abstractions, the refined versions of the perfect competition model are a tour de force, and even illuminating up to a point. The trouble for policy purposes is that the model leaves out much that is critical in the real world, extending far beyond features such as economies of scale, which were always recognised as qualifications. Confronted with a host of situations in which its 'nirvana' properties do not hold, theorists initially devoted enormous intellectual effort to exploring the so-called economics of imperfect competition. Much of this also originated in Cambridge, and focused in particular on monopoly and oligopoly. The view that monopoly was a pervasive problem attained great influence, further undermining faith in the competitive economy and strengthening interest in anti-trust and planning.

As with the attack on Keynesian macroeconomics, the challenge to the regulatory wave of the 1930s that flowed from perceptions of ubiquitous 'market failures' took time to develop. Initial critiques of intervention on market failure grounds involved two main propositions. One was to draw attention to the 'grass is always greener' fallacy. Critics pointed out that the fact that some market outcomes are not perfect (judged against some abstract ideal, in reality not attainable under any form of economic organisation) did not necessarily mean that

governments can improve on them. 'Government failure' came to be recognised as a problem often at least as severe as market failure — especially given human fallibility and the incentives involved in public decision making. As one writer has put it, the fact that a fish can't fly doesn't mean that a rhinoceros can do any better. The second critique recognised that most interventions involved costs as well as benefits. When the test that the benefits should outweigh the costs was applied, many interventions failed, or should have failed, to pass. Empirical studies also called into question the importance of earlier perspectives; for example Stigler summarises the conclusions of a large amount of quantitative research in noting that 'The evidence that monopoly is important is negligible, and the evidence that it is a quite minor influence on the workings of the economy is large' (Stigler, 1982:24).

However, the development of microeconomic theory has gone far beyond these initial counterattacks on ideas of imperfect competition. A large body of research has stressed the need to incorporate an understanding of incentive mechanisms, principal/agent problems, voting behaviour, uncertainty, and information, transaction and adjustment costs into any useful model of economic behaviour. The 'new' economics of organisation — which goes back at least to Coase's initial work on the theory of the firm — has pointed out that the long-standing preoccupation of economists with the allocation of resources in atomistic markets is an unsound and unbalanced view of social activity. The insight that markets and organisations are alternative economic arrangements, whose relative efficiency depends on transactions costs, broadly defined, has led to a long overdue interest in the systems of incentives that motivate behaviour in organisations, and to the development of modern agency theory. The literature on 'contestable' markets has emerged to supplement the competitive market model by showing that the openness of a market to potential competition may be more important than the structure of an industry — the number of firms in it — in determining production efficiency. What contestability and transaction costs economics has shown is that competition and competitive outcomes are (a) complex, and (b) not dependent on the atomistic assumptions of perfect competition. Finally, a renewed interest in entrepreneurship and the dynamic effects of competition in promoting the search for new knowledge and innovations has further exposed the limitations of static microeconomic theory.

The point to be stressed in surveying these developments in microeconomic thinking is not the problem of abstract models. All models, including those that encompass costs of information, transactions and other complex aspects of business structure and conduct, are abstractions. The problem has been the facts or behaviour that some economists have attempted to explain with over-simplified models, and the policy prescriptions they have adduced. The traditional market

models have simply not provided us with enough microanalytic insights to help us understand individual transactions, which is what we must attempt to do if we want to improve outcomes in some way.

I will touch later on the question of the relative influence of ideas, interests and experience in shaping public decision making, but I will assert at this point that ideas matter (even if they are not decisive) and that the dominant influences in the economics profession over the last generation or two — the confused ideas that entered into both macro and micro analysis — have a lot to answer for in respect of the policy failures that were exposed with a vengeance in most industrial countries in the 1970s and still beset us today. These failures, and particularly the slow recognition of them and the consequent slow adjustment, were more acute in New Zealand and Australia than in most other countries. I agree with the observation of Austin Holmes in his admirable lecture 'The Good Fight' that 'those who have had to face more directly the things which have gone wrong, have learned fastest. This group includes bond-holders and bureaucrats. Other main purveyors of advice (academics and journalists) have, in a good many cases, remained closer to older views' (Holmes, 1981:9).

The first responsibility of an industry is to produce sound, reliable products for its consumers. There is much that the economics industry still needs to do to improve its quality control.

II. COMMUNICATION — AND SOME OBSTACLES TO IT

Ideas require communication. If the economics industry can be indicted for producing some shoddy products, it has also sometimes done a poor job of marketing some good ones. Those (like Holmes) concerned with 'the struggle to get good sense (economic rationality if you like) into our economic affairs' are aware that economic rationality is often an endangered species and care must be taken to sustain and nurture it. I propose to illustrate this point at the apparently trivial level of economic vocabulary, by discussing the labels of some of our most common stock in trade in order to show how important ideas can easily be misinterpreted or misused.

Markets

The language of economics tends to portray markets as impersonal mechanisms, as in 'let the market decide' or 'market forces'. Furthermore, market activities are typically contrasted with activities in which (warm, caring) governments are involved. Such characterisations can undervalue the relevant ideas of the economist and confuse people who understandably find it difficult to 'feel and touch' something called a

'market' and tend to associate markets with some notion of unbridled capitalism, red in tooth and claw. The transactions that economists are speaking about are indeed transactions between people (individually or in organisations). And their main characteristic — the important idea involved — is that they are voluntary and, to take place, they must accordingly benefit at least one party and not injure others (relative to some alternative). Such transactions take place all the time in all facets of all types of economies, regardless of how 'socialist' or 'capitalist' they are. Different economic systems merely imply different constraints affecting transactions.

Similarly, it is normally misleading to speak of a 'free' market in the sense of a market free from government involvement. In anything other than a primitive society, markets — i.e. voluntary exchanges — can function only within a defined set of property rights and contractual rules normally laid down by governments, that is, by collective choice. The important issue for economists is to understand how behaviour and outcomes are modified as the constraints and rules affecting individual decisions are changed.

Intervention

Once it is recognised that public choice — decision making through some representative political system — is involved more or less directly in all important aspects of social activity, it follows that the relevant question is not 'should the government intervene?' to influence private behaviour, but rather 'what set of interventions is most appropriate to promote the attainment of efficiency or equity objectives?' The fact that these objectives may involve value judgments, which are a fair area for debate, is no excuse for sloppiness in analysing the impact of interventions.

When we address the question of the appropriateness of individual interventions in this way, it becomes clear that most people would agree on the need to treat different aspects of society's affairs differently. Most of us, for example, would support the case for maintaining what Okun describes as the 'domain of rights and duties', that area where conceivable voluntary transactions such as buying and selling rights to vote, or putting oneself or one's family into indentured arrangements, are simply not tolerated. Similarly it might be agreed that trading in hard narcotics should be banned. Those are areas of human activity where equality is given a dominant weighting over other social objectives, or where the social costs of allowing individual freedom of choice are considered too great. On the other hand, there is clearly a huge domain where the opportunity to allow relatively unconstrained voluntary exchanges and individual choice is likely to produce greater social benefits. In between, there are areas where the achievement of equity may be regarded as more

important than considerations of efficiency, or where one must be traded off against the other.

Deregulation

Given that some constraints can clearly improve economic efficiency and others (such as systems of income redistribution) may reflect widely shared community preferences — even though they may adversely affect potential national income — it is clear that regulatory reform should not be equated with deregulation. The term deregulation presumes some existing over-supply of rules, or that the prior decision to regulate was wrong or is no longer optimal. Instead, the task of regulatory reform is to examine whether the existing framework of rules (defined in the broadest sense, including issues of property rights, ownership and wealth distribution) creates an environment that is conducive to achieving the greatest net social benefits. The optimal regulatory framework may well change over time, in response to changes occurring in technology, levels of economic development, social values or other factors. Improving the current incentives environment may involve removing regulations, but it may also involve changing the form of regulations or even adding new ones; it is not a simple-minded question of deregulation.

Competition

Competition is another economic concept with a bad or confused press. On the one hand there are those who regard it as a zero sum game, producing as many losers as winners. On the other there are those who cannot get too much of it, since they equate greater economic efficiency with generating more rivalry.

The limitations of the perfect competition model as an intellectual tool have already been mentioned. As Demsetz notes in a recent discussion of the nature of competition, 'it is the price system the model explicates, not competitive activity. Competitive activity itself is difficult to comprehend through a model that assumes away transaction and information costs' (Demsetz, 1982:7).

Competitive activity is first and foremost a discovery procedure — a continuous search for better ways of meeting consumers' needs or using resources. Moreover, it is ubiquitous to all economic systems in which people are striving to improve their lot; different economic policies or laws merely alter, for better or worse, the forms that competition takes. Although there may be some temporary or even permanent losers in the process, and there is a case for social rules and safety nets to mitigate losses, there can be no doubt that a well-constructed competitive system is a positive sum game for society as a whole.

But market activity is not only about arm's length competition. Once information and transaction costs are allowed for, it is clear that cooperation between firms and voluntarily negotiated restraints on competition have a vital role to play in a welfare-maximising economy. Indeed it is hard to imagine a more cooperative process than a well-functioning market. Such notions are foreign to those brought up on simplistic economic models and have inspired, amongst other mischiefs, the excessive growth of anti-trust regulation. As Miller notes, 'A fervent body of crusading rent-seeking regulators invaded the corporate domain in the name of economic efficiency' (Miller, 1984:9).

It is precisely because property rights in information are often hard to enforce that the issue of patent legislation to protect and reward investment in information (so as to reduce free rider problems) arises and the legal system safeguards commercial confidentiality. Competition and efficient outcomes should not be equated with the absence of any barriers to engaging in business. There are always positive economic costs involved in entering an activity. Pejorative terms like entry 'barriers' conceal the fact that these are costs that should be borne by entrants and that artificially lowering these costs to new entrants can be undesirable. The policy problem is to ensure barriers are appropriately scaled, not to manufacture synthetic forms of competition. It is probably the influence of this body of outdated thinking that explains why regulatory authorities persist with proposals to force disclosure of information (for example in the company takeover situation, thus **creating** a free rider problem) or to ban vertical pricing arrangements, virtually all of which benefit consumers in the presence of contestable markets.

Nowhere is the misunderstanding of the role of competition more apparent than with respect to equity goals. The stereotype persists in some quarters that competition yields prizes to the rich and powerful, and crumbs to the underprivileged. Yet mainstream economic writing from the time of the classical economists has demonstrated the effectiveness of competition in dissolving established positions and opening up opportunities for those at the bottom of the income ladder. Noting that one of the most offensive calumnies on the classical economists was the allegation that they stood for the sectional interests of the capitalist class, Shenfield observes that:

> The essence of the matter lay in the understanding of the nature and effect of competition. Competition was the shield and support of the general interest. Being the great benefactor of the poor and the weak in society, it was essentially an egalitarian force, which was one reason it was hated. For the socially just type of egalitarianism is highly irksome to entrenched interests of many kinds, notably those of organised labour. At the same

> time the self-styled egalitarians of socialist parties and propagandists hated competition because, not understanding it, they thought it favored the strong against the weak, the successful against the unsuccessful. They failed to see that its favors were not for the entrenched strong against the hapless weak, but for success against failure in the service of others, especially in the service of the masses. (Shenfield, 1986:91-2)

It follows, for example, that many in the lowest income groups would reap the greatest benefits from a freeing of the labour market in Australia and New Zealand, and that it is protection **against** competition that is at the root of most forms of 'exploitation'.

The Preoccupation with Efficiency

The concept of efficiency is my final example of economic vocabulary with a marketing problem. In part this is because of loose definitions, since many outcomes should be regarded as efficient, subject to the existing set of constraints, and the latter are the relevant issues for policy. But economists also seem to feel a particular need to argue for economic efficiency, as if this objective required the exercise of more persuasion than the pursuit of equity goals, and systems of analysis were better equipped to deal with it. There is something of a puzzle about such an attitude. Efficiency does not seem a particularly hard cause to defend in terms of any political values: even after the revolution, those guilty of waste (as defined by the new masters) are likely to be among the first to be punished. Moreover, we need to be mindful that no strong standard of efficiency can be determined independently of judgments about income distribution. Notions of equity are just as important, and most people would be willing to sacrifice some efficiency for worthwhile gains in equity, partly to achieve the greater degree of social cohesion that may be associated with moderate redistributional policies. In making such decisions, however, it is useful to be informed on the nature of the trade-off involved.

Economics as a discipline has an enormous amount to contribute, both in terms of forcing more rigorous thinking about concepts of equity and in clarifying trade-offs. For example, one problem with equity concepts is the excessively narrow and static framework adopted as in some measures of vertical and horizontal equity. What may often be more meaningful is a concept of dynamic equity that puts the emphasis on fair opportunities for people to develop their abilities and implies seeking policies that lower transaction costs and unjustified entry barriers (e.g. in the labour market) and provide more opportunity. Such perspectives on equity accord well with many efforts to promote greater efficiency. Competition in legal systems bearing on equity issues at

both the national and subnational level may be relevant — people can and do vote with their feet. The private supply of services or resources through philanthropy, charitable activity and voluntary social work, and the incentives affecting it, are important policy issues. Time and again careful analysis can suggest broader dimensions of equity that are important and ways to exploit the wide variety of opportunities that exist in our present arrangements to adopt policies that enhance both equity and efficiency objectives — and indeed other relevant goals such as the maintenance of democratic institutions and individual freedom.

It follows that a major idea that economists should seek to communicate is that it is generally inaccurate to associate the 'market' with inequality, and that intervention does not necessarily promote equity. Market competition is typically an equalising influence over time, while intervention has often served the goals of special groups rather than those of the community as a whole. When resources are distributed through the political system, a great deal of evidence suggests that the interests of the voting majority, the providers of services and the politically active and articulate tend to prevail. Especially in areas such as education, health, housing and employment, those genuinely concerned about the interests of the underprivileged and minority groups can do well to study policy approaches that offer more direct and competitive opportunities to exercise consumer choice and individual preferences.

III. IDEAS, INTERESTS AND LESSONS FROM EXPERIENCE

The thesis so far is that economic ideas are of at least some consequence, so that the first duty of the economist-adviser is to be a seeker of truth or scientific validity and to try to get them right. Some care and finesse in marketing a reputable product is then relevant. But what of the competing views, doubted by Keynes but powerfully argued in the literature on positive theories of the state, that public choices may owe more to the constant pressures of organised interests?

The economic analysis of politics and bureaucracy has offered some penetrating insights into the effects of the pursuit of self-interest in the political market. It has shown how the influence in this market of voters who are organisationally isolated and with no great individual stake in outcomes — such as consumers, taxpayers and the unemployed — is severely constrained. By contrast, both the incentives and the opportunities for profitable political action are far stronger for narrower interests — such as protected industries or occupational groups — since they can organise at low cost and the benefits of effective action may involve significant increases in the incomes of their members. The outcome of this process in which actors in various parts of the economy

seek rents or benefits for themselves may be drastically at variance with the interests of the whole. This analysis has been extended in Olsen's familiar work to shed light on the differential growth rates of a number of countries and to speculate on the likely conditions, particularly long periods of stability and order, in which the entrenchment of group privilege is most likely to be corrosive of the public interest.

There seems a compelling logic in the application of Olsen's thesis to New Zealand and Australian economic history. According to this view, an era of colonisation of new lands by settlers escaping in may cases from the structures of an older society, and in circumstances in which the apparatus of government was relatively undeveloped, produced in both countries by around the turn of the 19th century one of the world's highest standards of living. But a further two or three generations of stable politics and relative isolation from disturbances elsewhere allowed the conjectured effects of group sclerosis to accumulate, through political responses to individual sources of pressure which involved a steady expansion of the government sector and a stultification of competitive market processes.

In both countries this period was also characterised by the widespread absorption into economic policies of the mistaken economic ideas discussed earlier, which finally lead to the stagflationary experience of the 1970s. But these policy directions were virtually universal and, even if they sometimes took more extreme forms in New Zealand and Australia, might not explain the relative deterioration in those countries' economic performance. The explanation for that might lie more fundamentally with the influence of the distributional coalitions discussed by Olsen, particularly in the presence of accessible governments and the absence of institutions or an informed climate of opinion to counteract their effects.

Yet Olsen's explanation of social and economic history is not couched exclusively in terms of group pressures. As one commentator has noted:

> There is a role in his system, albeit an elusive one, for ideas. The growth of government in the 20th century may, he says, also be partly explained in other ways: 'The inter-war depression, World War II and other developments led to profound **ideological changes that increased the scope of government'**. Furthermore, when discussing the trend towards trade protection (a natural aim for groups), he notes that there were strong ideological pressures in Erhard's West Germany which encouraged resistance to it. (Barry, 1985:45; emphasis added)

There are, in fact, plenty of counter-examples to the related proposition that politicians do not lead but just get pushed around by interest groups. A recent one in New Zealand was the present government's decision to introduce a comprehensive goods and services tax. This did not feature in any explicit way in the party's election program, nor was the climate of public opinion on the subject particularly informed or favourable. The decision was taken within weeks of coming into office, and the government had to undertake a long and vigorous defence of it within its own party and to the community at large. At least at this stage, polls and other indications suggest it has enjoyed a fair measure of success in arguing its case.

In the struggle between ideas and interests, there is a further factor that is sometimes overlooked: the role of experience. Friedman (1981:4) has argued that:

> The reaction that has occurred from time to time, the change in tide of opinion and its impact on policy, has not in my opinion come primarily from the success of intellectuals of one kind or another in persuading the people. It has come from the peoples' actual experience with the results of the policies that were adopted.

Friedman and Stigler have differed over the role of the economist as a policy adviser, as I shall come to mention shortly. But I read them as being substantially in accord in postulating that while people can and do err, they also learn to correct their mistakes so that errors do not persist in repetitive circumstances. Stigler (1982:37) presents the hypothesis 'that we live in a world of reasonably well-informed people acting intelligently in pursuit of their self-interests. In this world leaders play only a modest role, acting much more as agents than as instructors or guides of the classes they appear to lead'.

I find the role of experience relevant in explaining the change in opinion on economic policy in New Zealand in recent years, since the level of economic literacy as manifested in the news media or academic contributions, for example, is not high and remains well below that in Australia. Indeed, the reassuring aspect of recent New Zealand experience, at least on a provisional assessment, is that where ideas have been misused or misinterpreted — or the wrong ideas employed — the 'markets' (voters and all) have finally recognised and rectified the situation. The extent of the misuse of ideas may have helped restore the role of sounder ideas in a more vigorous way than might otherwise have been possible or envisaged. Similarly, politicians may be best able to lead and to face down potential opposition from special interests when experience has shown the bankruptcy of the old ways. And the new monitoring mechanisms at work in a freer economy — the financial and

foreign exchange markets in particular — provide strong and informed signals to the community at large about the adequacy and balance of policy settings and may operate as a reinforcing influence for sounder decision making.

In a sense, experience provides a link between ideas and interests. There is a need for alternative ideas to have been formulated and be readily accessible when experience reveals the inadequacy of the old ones. Ideas may be the catalyst of change rather than the cause. Thus the theoretical development of proposals for floating exchange rates permitted their rapid adoption when international monetary pressures caused the Bretton Woods fixed-rate system to be scrapped. A similar perspective on this idea was given by Dicey (1905:23) many years ago:

> Success ... in converting mankind to a new faith, whether religious, or economical, or political, depends but slightly on the strength of the reasoning by which the faith can be defended, or even on the enthusiasm of its adherents. A change of belief arises, in the main, from the occurrence of circumstances which incline the majority of the world to hear with favour theories which, at one time, men of common sense derided as absurdities or distrusted as paradoxes.

There may thus be some relevant evidence that experience matters, and that the electorate is more perceptive and capable of rational assessments than is often assumed. Efforts to inculcate mistaken ideas or to fool people about their own interests can ultimately backfire. But experience may also not be decisive even over long periods, as much Latin American history indicates, and certainly I do not think it is possible to form the strong conclusion that what is, is necessarily efficient or desired. The learning process is continuous, and errors, gaps and lags are always present. Thus like Barry I conclude that ideas and interests (and I would add experience):

> interact in a complex and bewildering way. It is difficult to ascertain directly the relative influences of each in a particular circumstance ... [Although interests matter] ideas about economics and politics must, in some ultimate sense, influence politicians and legislators irrespective of group pressure. Otherwise, how would change occur (except by revolution)? The point is that the permeating of ideas is a longer and more difficult process in modern democracies than in simpler forms of political organisation. (Barry, 1985:48)

IV. TRANSLATING IDEAS INTO BETTER POLICY

Getting the Storyline Straight

Friedman has urged his fellow economists to advocate the adoption of what they consider sound economic policy, regardless of perceived political practicality. Stigler's reservations appear to have had a number of strands, including a conception of society that holds economics and politics to be a seamless web, a view of the economist-advocate as a customer's man, purveying ideas that are in demand with audiences or employers, and a preference for scientific inquiry and the pursuit of new knowledge as a vocation, given his belief in the negligible direct influence of economic ideas.

At the level of scientific knowledge, it would seem uncontroversial that many of the established findings of economics as a discipline provide a basis for information and advice, and Stigler has endorsed the view that increasing knowledge of the political-economic process will (ultimately) improve public policy making. As economists, we have a role in teaching that the laws of supply and demand matter, just as physicists and astronomers had a role in times past in affirming that the world is not flat, and that the earth revolves around the sun, and not vice versa. There is a large body of well-established, orthodox economic principles and findings that offers a surer guide to public policy than what Henderson in his recent Reith lectures has called the 'economics of Everyman' or the 'mutually reinforcing centralist, nationalist and mercantilist assumptions of do-it-yourself-economics', which so often pervade the policy-making arena. The prevalence of pre-economic ideas poses a major informational problem for the public in establishing what is valid economic analysis and what is not, and the problem is compounded by people who call themselves economists but feel no obligation to apply economic principles and methods in examining economic issues. It is therefore all the more important that, while recognising the evolving nature of orthodox economic ideas as knowledge advances, and without making claims for imperialism in economics, competent economists adopt a constructivist role in public discussion and the advisory process.

Similarly there is a duty to expose analysis and viewpoints that do not bear informed scrutiny. There is a need, for example, for the type of rebuttal the Industries Assistance Commission offered in its 1984–85 Annual Report of such nonsense as assistance to high technology industries, the Metal Trades unions' industry policy proposals, and the alleged employment benefits of the Department of Trade's targeted export strategies. There is all too little professional criticism of the contribution of tenured academics whose failure for years to subject their work to the test of refereed journals seems in no way to inhibit them

from making eccentric and insistent policy recommendations. It is easy to sympathise with the special ire that Holmes reserves 'for certain slow learners who fail to realise that the world has changed from the one from which their models were estimated and still believe that those models can tell them how to fiddle a tax rate here and an interest rate there in order to fix both inflation and unemployment' (1981:11).

A highly pertinent issue in this context is the incentives operating upon economists and advisers that help determine the nature and quality of their advice, and in particular how these can be improved. Everything from the Scriptures to Stigler teaches us that men and women are not angels, and 'Yes Minister' appears to confirm that even the Westminster system does not invariably breed paragons of virtue and wisdom. The more sceptical among us may prefer to seek ways of mobilising incentives that can help raise the quality of information and analysis presented to policy makers and the public. Relevant areas for attention are the advantages of open government for increasing the accountability of advisers; the role of professional societies and their literature in providing a monitoring and quality control function; the regulated nature of the education in New Zealand and Australia; and the regulation of the labour market, especially in this context the public sector labour market, in permitting the continuation of poor quality advice. Too often the tenured position of bureaucrats and academics has provided an opportunity for partial retirement on full pay, and notions of political impartiality and academic freedom are distorted beyond recognition in the defence of taxpayer-supported incompetence.

It follows that one of the best mechanisms available to policy makers concerned to satisfy themselves about the performance of their advisers (whether in the bureaucracies, interest groups or universities) is to encourage processes of open government, more efficient terms of employment, professional peer review and free trade in the market for ideas. Such competition will help good ideas drive out bad, expose those who seek to hide behind unpublished models or analysis or protect privileged access to decision makers, and downgrade the market value of ersatz economists retained as consultants or spokespersons for narrow interest lobbies. By such means governments may secure for themselves a larger margin of support for decisions that benefit the whole community.

Telling It Like It Is

There is an obvious argument on the grounds of professional integrity for telling it like it is. In the final analysis this can have consequences like those faced by William Niskanen, recently acting Chairman of the President's Council of Economic Advisers, who was dismissed by the Ford Motor Company some years ago because he refused to accept or

support the company's case for import protection. But there is also some evidence that a willingness to give relatively independent and not unduly compromising advice is both respected and, in the long run, rewarding, despite the fact that messages are often unpalatable and messengers are sometimes at risk of being beheaded. The current Australian Treasurer was reported as saying of his department:

> The Treasury is an important institution in this country. It has not been prepared over the years to offer soft advice to governments. It stands its ground, often in a sea of weakness ... You have to have institutions which stand up and it stands up. I have been very proud to have executive responsibility for the Treasury. (*Australian Financial Review*, 29 October 1985)

Once again Holmes's observations of the conduct of policy advisers seem to me to contain a lot of wisdom:

> Those who become a little impure in order to save a very scarce commodity, a minister's time, have my sympathy; I also feel a little for those who become extra-economic because their ministers require them to. I have less compassion for those who take on a courtier style, become more political than their masters, neglect the verities, or use some reputation for expertise to support positions not warranted by that expertness. (Holmes, 1981:10)

Very often in the bureaucracy the comment is heard that a particular course of action is not advocated because it would not be 'on' politically. Pre-emptive judgments are substituted for careful analysis and an exploration of possible alternatives. A perceptive comment by Charles Schultze (1982:66), reflecting on his own experiences in an article on 'The Role and Responsibilities of the Economist in Government', is that 'many policy advisers who pride themselves on their political acumen in fact do miserably at predicting political reactions or outcomes'.

Two chastening experiences on this point concern international trade. Despite his denunciation of mercantilism, Adam Smith did not believe that free trade could ever be achieved, yet it was adopted as Britain's commercial policy from 1846. By contrast Keynes, who at least at the time was still convinced of the case for liberal international trade, advised the United Kingdom government in the 1930s to impose tariffs because he did not consider a devaluation to be politically feasible.

Shortly thereafter the pound was devalued, but tariffs were also imposed and maintained, thus consolidating the shift away from the open trading policies that had contributed so much to Britain's 19th-century economic strength.

No competent policy adviser can naively operate as though in a political vacuum; nor is there any reason to suppose that economic advisers have comparative advantages in the skills that political management demands. Economists of all people should be conscious that the performance of bureaucrats in trying to pick winners and losers in the policy advice market is likely to be as unimpressive as in the industrial domain — and for much the same reasons, namely the lack of information and incentives. Perceived political constraints are not always immutable — they can be shifted by reasoned analysis and well-constructed strategies for policy change, developed by interaction between political managers and technical advisers. Second-guessing political reactions can lead to a narrowing of policy options and does less than justice, in recent New Zealand circumstances at least, to the intelligence of a number of politicians, on both sides of the political fence, who have been more aware of the gravity of New Zealand's economic problems and prepared to tell the story like it is than many of their advising bureaucrats.

The Dangers of the Quick Fix

There are constant temptations for those, in both the political and the bureaucratic camps, who are frustrated by the seemingly insuperable obstacles to a policy change to seek short cuts or expedient devices for shifting the boundaries of what appears currently possible. A cautionary tale about the dangers of such a strategy was brought out in a recent account by Finger of the evolution of the present world trade rules. He points out (1984:2) that the political momentum behind the 'post World War II movement to create a liberal international trade and payments system did not stem from a technocrat's calculation of the gains from trade'.

While a far-sighted leadership elite were convinced of the political and strategic necessity of turning away from isolation and constructing an open, interdependent trading system, they did not educate the public to a more balanced view of the economic pluses and minuses of trade. Rather, they built on the public's traditional, mercantilist perceptions that exports are the gains to the domestic economy from trade, and imports the costs — 'the canker at the heart of trade', as Flaubert once put it. On these perceptions they built the strategy of reciprocity, involving exchanges of so-called 'concessions'. The process was structured so that the interests that might otherwise have prevented the liberalisation were neutralised by the exporting interests that would gain,

and this tactic, coupled with wider political concerns, was the basis for the public granting the leadership community the authority to implement their policy design.

However, as Finger (1984:4) goes on to observe, 'The GATT's statement of principles is theirs, but its detail and mechanics reflect the compromises the internationalists had to make with the protectionists'. The costs of the compromises with sound economics, as with most such compromises, were bound to emerge over time. In the words of a recent commentary: 'as an agreement based on mercantilist ideas, it was a tactically shrewd device for achieving liberalisation, but it was also strategically dangerous because of its perverse consequences for public education in the principles of international trade' (Omega Report, 1984:51).

These basic flaws in the economics of the GATT constitute what Tumlir and others have described as 'the seeds of its own destruction'. Much effort has been devoted in recent years to lamenting the resurgence of protectionism and the failure of governments to adhere to the GATT rules. It has much less frequently been observed that such tendencies have been motivated or facilitated by the misconstrued basis of the rules themselves and by the failure to develop the kind of climate of public opinion that prevailed in the second half of the 19th century when, in the absence of any world trade body, a liberal international regime was most complete.

Temptations similar to those faced by the founders of the GATT to adopt tactical manoeuvres in the interests of desirable change may still be felt by some participants in the Australian debate on industry policy. It must be a source of enormous frustration to all the individuals and institutions in Australia that have made such outstanding contributions over the past two decades to the case for market liberalisation that, at least in terms of policy change if not community acceptance of the argument, so few runs are yet on the board.

In such circumstances it is not surprising that suggestions have recently been made again in Australia for initiatives that might unblock obstructions to change and accelerate the snail's pace progress of reform. Typical proposals involve long-run forecasts of industry growth to help identify new business opportunities; the provision of 'positive' assistance for modernisation and higher productivity as old forms of protection are removed; adjustment assistance schemes, especially for displaced workers; and a willingness to accelerate or slow down the pace of assistance reductions depending on the economic cycle or the level of general business activity. There has also been a recognition that piecemeal changes in regulatory arrangements will not necessarily result in efficiency gains and a concern to identify in detail the conditions under which policy changes will be efficiency-improving.

The technical and political economy arguments for and against specific government intervention to 'assist' adjustment have been canvassed at length in a number of studies and need not be rehearsed here. A standard conclusion is that the economic arguments for such assistance are weak, that the problems of designing and implementing efficient and equitable schemes are formidable and that the possible political benefits of lubricating the process of change are at best uncertain. In respect of proposals for intervention to hasten the emergence of new competitive activities, Kasper has recently reminded us that 'one can only become competitive by competing' not by changing from old life support systems to new drip-feeds and steroids (Kasper 1985:8). The IAC reviewed the arguments again in its 1985 report on the textile, clothing and footwear industries and, no doubt in the face of considerable pressure to adopt a more 'realistic' stand, reaffirmed the negative conclusions that most of the evidence seems to support.

Beyond the standard analysis, there is a further and more basic criticism of such proposals that is relevant to one of the major themes of this paper. If ideas count, at least to some extent, there seems a danger, akin to that inherent in promoting trade liberalisation on mercantilist grounds, of fostering a public belief that assistance reform involves a special type of adjustment cost that justifies community compensation. The possible longer-run costs of encouraging such a climate of thinking and policy making may not be fully accounted for. The point has been well made by Tumlir and others that economies are subject to a global flow of economic change, originating not just abroad but in changes in technology, consumer tastes, domestic policies, the weather and other factors at home. Adjustment to such continuous disturbances must simply match the rate of change; if it falls below it, maladjustment will begin to cumulate. In respect of policy changes, it is clear that the case for adjustment assistance is no stronger in principle on account of protection reductions than it is for firms or individuals affected by, say, reduced agricultural or export assistance, regulatory reform of the transport and financial sectors, changes in shop trading laws, the introduction of a consumption tax or a whole host of macro or micro policy changes. Nor indeed is it obvious that the case for assistance with policy-induced change is stronger than with other adjustment pressures, some of which are often far greater in magnitude.

The proposition that we should not proceed with regulatory reform, or proceed very far, until we know all the possible effects of regulation is certainly one that would boost the demand for economists or economic agencies (and Stigler would no doubt enjoin us to look for such motives on the part of its supporters). But it surely denies everything we do know from general principles and observed responses to such things as tariffs, quotas and entry restrictions. The argument is a bit like the proposition that we should remain agnostic about the effects of gravity

of sparrows until we are told where every sparrow will fall. The more relevant perspective is surely that, within a medium-term policy framework, we can have a good deal of confidence that a sequence of broadly based and consistent changes derived from sound general principles will reduce distortions and improve efficiency. The political economy arguments for a general strategy are also strong, as Pincus (1983:38) observes: 'piecemeal reform, industry by industry, can create such small advantages that the beneficiaries may not even notice, let alone react to them, whereas a wide correction might promise benefits of sufficient size to spark active political support'. Once a momentum of change has been established, resistance may be lowered by the prospect of even-handed treatment for all, and governments may be spared the necessity of a series of sectoral confrontations.

To make such points is in no way to argue for a passive role for the government in industry restructuring. Many other areas of economic management are highly relevant to a successful liberalisation program. Sound macroeconomic policies are needed to avoid inflation and the loss of industry competitiveness, which have been the main causes of aborted reform initiatives. The relevance of a floating exchange rate regime to the capacity of the economy to reallocate an adequate flow of resources to the tradeable goods sector in the wake of assistance reductions may not yet have been adequately appreciated. The regulatory reform initiatives in the financial market should clearly contribute to improvements in the cost and quality of financial services available to industry, while competition among financial institutions to ensure loan and indirect equity performance will in turn contribute to raising the efficiency of the financial sector. Some existing securities market regulations, on the other hand, may be working in the opposite direction, by reducing the potential for restructuring through merger, takeover and acquisition. Existing trade practices legislation and restrictions on foreign investment are frequently cited by business, with a good deal of justification, as having similar effects. Interactions with the labour market are of special significance: on the one hand a refusal to accommodate unwarranted wage increases by increasing assistance is critical to improving wage determination and employment performance, while on the other the introduction of greater flexibility into wage setting and employment contracts at the industry and firm level would facilitate adjustment to structural changes. Education and training services must be adapted to the changing skill requirements of industry. All these are areas where careful consideration of appropriate public policy is vital.

Nor would I wish to argue that under no circumstances should adjustment assistance policies be contemplated. General safety nets and labour market and training arrangements that facilitate redeployment are important; there may be cases where the wealth consequences for individuals of policy changes are of an extraordinary magnitude and

warrant compensation; and there is often an argument for phased and predictable rather than abrupt change. However, there are strong grounds for believing that attempts to fine-tune assistance changes with movements in the economic cycle are misguided, since they cannot be accurately judged and they fly in the face of the incessant demands of industry for policy certainty and predictability.

Isn't There a Better Way?

To draw an analogy from Keynesian macroeconomics and the rational expectations reaction to it, it is possible that policy-makers could muddy the waters, buy off resistance from a pressure group and make some limited gains for a while with proposals of the type being promoted, but in the longer run people may not be fooled and the risk may be a progressively worse outcome. Are economists and economic agencies best employed in such exercises, or are their efforts better directed towards using their acquired knowledge to help shape the ideas that interact with interests and experience in the community and ultimately have an influence on policy decisions? Tumlir (1984:13), referring to government attempts in the United States to mobilise service industries and consumers to lobby for liberal trade, has remarked:

> What an absurd system it would be where an obviously reasonable policy could be sustained only if these two large masses of citizens could be organised in active support of it ... If the issues of liberal trade and protection were presented to them in their capacity as voters and electors, fully, simply and intelligently, why should any politician doubt that their response would be equally intelligent?

There does seem to be some evidence in Australia and New Zealand of successful experience in altering community perceptions of economic issues and promoting major policy changes. The Campbell Committee inquiry is a premier example of how a generally rigorous, well-argued body of analysis decisively shifted the weight of thinking on financial and foreign exchange market interventions in Australia and facilitated the same process in New Zealand. The acceptance of the result was made easier by the fact that much of the analysis validated the emerging interests of a number of major actors in the financial sector. In Australia, and I think New Zealand as well, it would be reasonable to claim that, partly thanks to solid research and teaching, there is now a better acceptance that the level and structure of real wages matter for employment (though this does not yet extend to a predominant view as to whether centralism is better than a decentralised labour market). New

Zealand's initiatives in regulatory reform can be seen in terms of the same pattern of changing ideas and community dissatisfaction with the experience of control regimes. Although protection reform has proved a tough nut to crack, there are perhaps some signs in New Zealand and maybe Australia that progress in the next ten years will be more satisfactory than over the last decade. Perhaps the best contribution Australian economists and economic agencies can make in this area in the immediate future is to urge the adoption of the type of proposals put forward by the IAC for the textile, clothing and footwear industries rather than canvass alternative and more complicated strategies. Those who see themselves as history's hastening agents in promoting new industries and speeding the adoption of new technology might do best for Australia by standing up for some basic, well-tested ideas.

How things are done is also important, and I referred to some weaknesses in the marketing of economic ideas. Henderson made the point in his lectures that, with some honourable exceptions, economists have often failed to argue their case persuasively, in language that can be understood by intelligent non-specialists. There is a place for ideology in the sense of the summary view needed for public understanding. It can also be fairly argued that real consensus on the basis of rigorous analysis and patient persuasion (such as flowed from the Campbell inquiry) is better than unresolved conflict and the probability of policy reversals with revolving political majorities. The manner of introduction of voluntary unionism in New Zealand in 1984 was such that, regardless of the merits or otherwise of the idea, it was virtually guaranteed to be overturned in the event of a change of government. But there is little value in reaching an 'accord' that it is possible to defy gravity, for example by seeking to maintain the purchasing power of all incomes in the face of currency depreciation.

Experience has also shown that it is naive to believe that psychology or expectations can be manipulated other than by solid policy. Markets and individuals have long since grown sceptical about government behaviour, and policy credibility has to be earned, sometimes over long periods. There is a tendency among advisers to believe that expectations can be successfully manipulated independent of policy content, and that confidence, sustained by rhetoric, will be a self-levitating force for recovery or growth. Such habits can lead, as Schultze notes, to the application of great effort to decide how a series of economic decisions is to be packaged. And he adds: 'Some of this is harmless (though time consuming). But an economic adviser who begins to take these games too seriously is in danger of trading all his acquired knowledge about economic interactions for a mess of psychological pottage' (Schultze, 1982:65). Animal spirits are important, but nowadays at any rate they must be nurtured on a diet of hard fibre.

Finally, those concerned to fight the good fight and to limit or redirect the influence of distributional coalitions might be mindful of the importance of sound institutional structures and policy-making processes. There is an important role for public information, open government, policy transparency and public inquiry processes in order to expose to critical scrutiny the claims of special interest groups and the performance of bureaucrats (including the propensity of some of the latter to operate as taxpayer-funded lobbyists for the former). Such procedures can help assemble a mass of data and argument into a coherent framework, and help forge shared perceptions about the effects of intervention. They can also monitor progress towards goals. At the same time, there are dangers that such institutions, if not properly used by governments, can become an additional forum for special pleading, degenerate into unstructured information-gathering exercises and implode inwards — become a sort of debating society with highly restricted membership.

Other institutional approaches can be helpful in curbing sectional pressures and advancing pro bono ends. Schultze (1982:65) points out that 'Economists interested in minimising protectionist measures, for example, should tenaciously block efforts to shift the locus of decisions on trade matters to the Department of Commerce which is inevitably protectionist minded'.

The broader the responsibilities of an agency, the more likely it is that its perspectives will reflect the interests of the many rather than the few. Particularly at a time of public sector overload and in an environment where neutral, economy-wide approaches to reforming regulation and intervention are being pursued, there is a need to reconsider the role and scale of sectoral agencies. Similarly the emergence of interest groups with broad representation, which are thus forced to take a more economy-wide view, may be a source of influence that is more coincident with the interests of the community at large. There is also a case for greater accountability of government officials for the advice they provide, since it is far from clear that all our economic and social misfortunes should be blamed on incompetent politicians. Finally, it would be worth exploring the potential that legislative or quasi-constitutional rules might offer for more restrained, consistent and stable government action.

V. CONCLUSION

Those whose tastes favour the earlier Keynes over some of the more mature vintages recall his 1922 pronouncement:

> 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... Before Adam Smith this apparatus of thought scarcely existed. Between his time and this it has been steadily enlarged and improved. It is not complete yet, but important improvements in its elements are becoming rare. The main task of the professional economist now consists, either in obtaining a wide knowledge of relevant facts and exercising skill in the application of economic principles to them, or in expounding the elements of his method in a lucid, accurate and illuminating way. (Keynes, 1922:v-vi)

If ideas are of some consequence, if there are some ways in which the influence of organised groups can be curbed and channelled in more constructive directions, and if people learn from experience, then I see no reason why Austin Holmes's troops are necessarily condemned to spend their lives fighting in an economic wasteland. If the climate of public opinion in Sweden and Switzerland has allowed governments to maintain relatively liberal trade policies (at least on industrial goods), and if the electorates in Germany and Japan have shown themselves intolerant of governments that have manufactured inflation, why should one suppose that voters in New Zealand and Australia are somehow not capable of demonstrating the same intelligence? My conclusion is that the economist in government — or indeed in any employment — should stick to the high road and avoid the advisory habits of the swamp, even if the journey is frustrating and sometimes very long. To borrow a sentiment from a former President of the Canberra branch of the Australian Agricultural Economics Society:

> For when the One Great Scorer comes
> To write against your name,
> He marks — not that you won or lost —
> But how you played the game.

For those who would view this sentiment as excessively pious, I offer two other motives that might prompt a similar conclusion. One is that if advisers choose the path through the swamp they may, in an era of more open and informed government, become more accountable for their actions. The other, which I am sure Stigler would approve, is that, by choosing the other route, would-be maximisers of economic rationality might achieve greater gratification of their own self-interests.

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Ideas, Interests & Experience

Some Implications for Policy Advice

Roger L. Kerr

Economists are increasingly called upon by bureaucrats and government officials for policy advice. But economists have not always been able to present their ideas effectively. Many basic concepts of economics such as 'markets', 'competition', 'deregulation', and 'efficiency' are automatically dismissed because they have come to be misunderstood.

Roger Kerr is uniquely qualified to offer his thoughts and conclusions on the proper role of policy advisers. He has worked as an economist and policy adviser in the New Zealand Treasury, and has been a consultant to the Australian Industries Assistance Commission. Mr Kerr is currently the Executive Director of the New Zealand Business Roundtable.

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