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An economic perspective on the law:
Is there “legal failure”?

A thesis presented in partial fulfilment of
the requirements for the degree of

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in
Economics

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New Zealand.

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Abstract

The law fulfils important functions in society, contributing to its institutional structure, its policies and resolution of disputes. Workers employed in the law are providing a service, and economics can be applied to analyse the nature of this service. Such analysis must recognise the characteristics of law, including the costs and nature of deliberation. This requires more than the use of theoretical approaches which assume exogenous preferences and no transaction costs.

Rhetoric is important in law, and there may be a rhetorical dimension to economics itself. This theme has led to the thesis having two components. The first considers methodological issues in the application of theories and techniques. The second then assesses aspects of the law.

Groups and group cultures are considered as influences on academic disciplines including economics, and professions such as the law, as well as shaping political activity and social beliefs. The interpretation of theory as analogy is developed to evaluate the application of theory and empirical analysis to real world issues. Cross-disciplinary material is then used to provide alternative perspectives on democracy. These aspects assist in identifying possible failures in the formulation and implementation of law.

From this foundation, and using selected criteria to assess policy development, parliamentary debate leading to changed legislation is investigated and limitations identified. Characteristics are then identified for the services provided to consumers by the legal sector. Provision involves a mix of participants, including lawyers, court staff and other professions. Process and persuasion are important, and there can be game playing between opposing parties. The result may be misleading signals to others operating “in the shadow of the law”.

Overall, concerns are identified about research methods, the quality of laws, the cost and quality of legal deliberation, and implications for behaviour by others. This a relatively untapped area with much potential for further research.

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List of Abbreviations

New Zealand Parliamentary Debates citations will follow the legal citation method as in Chapter 5 of the New Zealand Law Style Guide (McLay, Murray, & Orpin, 2009): [Date of debate, volume, NZPD, page number], for example [14 November 2000, 588, NZPD, 6530]. The same format will be followed for citations of Parliamentary Questions for Written Answer to the end of 2002, with the source being *New Zealand Parliamentary Debates Question Supplement* (NZPDQS) , and for which the date refers to the date on which the question was lodged. All other citations, including Questions for Written Answer from 2003 (available online) and case law, follow APA 5th.

CDA	Critical discourse analysis
CEDAW	The Convention on the Elimination of All Forms of Discrimination against Women
IDF	Ideological-discursive formation
INUS	INUS condition – insufficient but necessary part of an unnecessary but sufficient set of conditions
MMP	Mixed Member Proportional (voting system)
MSD	Ministry of Social Development
MWA	Ministry of Women’s Affairs
NCWNZ	National Council of Women of New Zealand
NGO	Non-government organisation
NZCTU	New Zealand Council of Trade Unions
NZFLR	New Zealand Family Law Reports
NZLR	New Zealand Law Reports
NZPD	New Zealand Parliamentary Debates
NZPDQS	New Zealand Parliamentary Debates Question Supplement
QALYs	Quality Adjusted Life Years
RIA	Regulatory Impact Assessment
RMA	Resource Management Act

Chapter 1 Introduction

This thesis is based on a very simple premise. People are employed as solicitors, barristers, judges and in numerous other roles in relation to the law. From an economics perspective, they are producing something, which is then being purchased either by the state or by individuals and organisations in the private sector. They are not producing goods, so they are providing services. There are several questions that economists could ask so as to better understand this activity. For example:

- What are the characteristics of the services?
- How can the services be viewed from an economic perspective?
- How are the services developed?
- How well are services delivered?

In part, the motivation to select this topic resulted from some questions that had come to mind over several years:

- Legislation is a major policy tool for MPs and political parties. How is it that laws can be passed and implemented on the basis of assumptions that are not supported by the information available? Why might there be no response when such anomalies are demonstrated?
- Should lawyers be entrusted with the implementation of policies on such diverse areas as the economy, social problems, and the environment when they are not required to have any training in the issues that the laws address?
- Has enough consideration been given to the financial and time costs that can accrue in the process of legal action, given that these can have significant impacts on behaviour and outcomes?

Having considered that these and other issues merited attention, it soon became apparent that the application of economics would not be straight forward. Echoing Carr (2008), the historian Arnold Toynbee wrote:

“Any account of anything is bound to be selective. The human intellect does not have the capacity for comprehending the sum of things in a single panoramic view. Selection is unavoidable, but it is also inevitably arbitrary; and, the greater the mass of information from which a selection has to be made, the more disputable will be the investigator's choice.” (Toynbee, 1976, p. x)

The analysis of one area, the law, in terms of another, economics, requires selective assessment from a vast amount of information. The choice here has been based on key economic questions such as the nature of the services provided, and the efficiency and equity of that provision.

An economics perspective alone is likely to generate heavy criticism from non-economists with an interest in this area. Erwin Shrodinger, Austrian physicist and Nobel prizewinner, said, “the isolated knowledge obtained by a group of specialists in a narrow field has in itself no value whatsoever, but only in its synthesis with all the rest of knowledge ...” (Goleman, 1997, p. 6).

Even within economics, certain approaches might be expected, in particular those based on the currently mainstream, neoclassical perspective. Well known economics principles textbooks present an economics view based on rational choice and concepts such as opportunity cost, marginality, static analysis, profit and utility maximisation, and equilibrium (Mankiw, 2007; Stiglitz, 1993).¹ These are the building blocks for a perspective on, or “framing” of economic issues. Marginality assumes divisibility, and static analysis focuses on optima or equilibria, rather than on dynamics and the processes of adjustment. Assumptions of exogenous preferences, and rationality are common (McCain, 1992, Chapter 1; Royo, 2007, pp. 153-155), although the latter has been a point of contention with critics of economics (Considine, 2005; Grofman, 1993).

A neo-classical economic analysis of aspects of the law is unlikely to be convincing to those in the law, or to those concerned with making the law, or those in other fields to which the law relates (such as politics, sociology, social policy). It is necessary to consider criticisms of economics and weaknesses in economic methodologies. It is also

¹ More advanced microeconomics texts also build on this foundation (Varian, 1992).

necessary to consider the nature of the subject on which an economic perspective is to be taken. Some synthesis is then required with relevant information carefully selected from these areas. This thinking, along with feedback from specialists in these other fields, has shaped the development of this thesis.

There are methodological issues to be addressed. An early stage involved a search for criteria on which to base an assessment of policy debate, or, alternatively, for support in the literature for the choice of criteria. There is no generally accepted paradigm across disciplines that includes economic aspects. Outside economics, there are several theories that address aspects of the process of policy making, but they do not indicate “good” or “bad” processes. Without some means of assessment, it is not possible to determine whether the existing situation is satisfactory, or whether changes may be made to improve matters.

In contrast, neo-classical economic theory has a concept of market failure (McTaggart, Findlay, & Parkin, 2003), where an observed situation can be considered to fall short of a theoretical “ideal”. This is widely used as a basis for policy interventions, commonly specified as responses to perceived market failures. The analytical tools are potentially very powerful, but it is important to be aware of the underlying assumptions and potential limitations of the approach. For example, can an ideal be specified, and, if so, is the economics ideal the one to use? The concept is based on theories that fall under the umbrella of static analysis. Hence, the focus is on the end result with little attention paid to processes, and time paths such as growth trends and adjustments to “shocks” are also sidelined.

Not only are the policy process and economics approaches distinct, but also the policy process literature contains some scathing criticisms of economics. In particular, there is opposition to the assumption of rational behaviour. There is also doubt about the real world relevance of theoretical and statistical techniques. Some writers present these techniques as means of persuasion, or “modes of argumentation”, rather than legitimate forms of analysis giving accurate information (Dunn, 2004). Noted law and economics scholar Richard Posner also suggests that some have a fundamental dislike of the economic approach:

“Economic analysis of law has aroused considerable antagonism, and not only among academic lawyers who dislike the thought that the logic of the law might be economics. A recurrent criticism is that the normative underpinnings of the economic approach are so repulsive that it is inconceivable that the legal system would embrace them, since law reflects and enforces fundamental social norms.” (Posner, 2007a, p. 26)

While many of the problems are indicated by a range of different literatures, there is a unifying theme that emerges, namely the importance of rhetoric. Law involves deliberation, both in law making and in implementation. Adam Smith referred to deliberative eloquence and judicial eloquence as branches of rhetoric. The former considers persuasion in the selection of policies (such as laws), and the latter refers to the persuasion of a judge or jury.² Early thinking on rhetoric focused on interactions between individuals. Some more recent approaches do not always use the label “rhetoric”, but could be classified as “macro-rhetoric” in that they consider the issue of broadly held perceptions and the factors that can influence these perceptions. It is a useful classification as it groups together diverse theoretical perspectives with outcomes in common.

Rhetoric is to be contrasted with logic in that the former concerns itself with persuasion, whereas the latter relates to proof. This raises two issues. First, mainstream economic theory with its assumption of rational behaviour (Baumol & Blinder, 1991) is based on logic and the absence of rhetoric, so how can it be used to analyse the making and implementation of laws, for both of which rhetoric is an important factor? Second, is economics so “clean” in its own reasoning, or does it have its own rhetoric, as suggested in some of the policy process literature, or is it building on “repulsive” underpinnings as mentioned by Posner? It may be a worthwhile test of the analysis in this thesis that it is credible not only to economists, but also to those who are critical of economics. This requires an acknowledgement of the limitations of economics. Failing that, the conclusions could simply be dismissed as economic rhetoric.

² Such ideas have a long history. See, for example, Plato (1998, pp. 35, 41), which contains a general discussion of demand for training in rhetoric, especially in the courts, suggesting that rhetoric is more effective as persuasion than is knowledge.

Economics is relevant for this thesis in two ways. First, it proposes methods to be used when assessing the quality of law making and implementation (evaluating the law). Second, it may be applied directly to real world issues as information to be used in law, influencing people's understanding of the environment in which laws are developed and implemented (affecting legal outcomes). This can be seen in terms of policies and laws to address various forms of market failure. If so, it will have an impact on the choice of laws and on their effects. Careful consideration of economic thinking is important for both these dimensions.

While the aim here is to consider law from an economics perspective, the focus and approach differ somewhat from much of the literature that falls under the heading of "law and economics", a relatively new, but fast-growing field. Much of the existing law and economics literature focuses on the contribution economics can make to improve decision making in law. This can be seen in some key law and economics texts. Hence, "Until the 1960s, economic analysis of law was virtually synonymous with antitrust economics..." (Posner, 2007a, p. 23), and, "Until recently, law confined the use of economics to the areas of anti-trust law, regulated industries, tax, and the determination of monetary damages" (Cooter & Ulen, 2008, p. 1). Then, from the early 1960s, "the economic analysis of law expanded into the more traditional areas of the law, such as property, contracts, torts, criminal law and procedure, and constitutional law" (Cooter & Ulen, 2008, p. 2).

This is still a narrow perspective, however. Posner sees law and economics as the analysis of legal doctrine, with "the positive role of economic analysis of law – the attempt to explain **legal rules and outcomes**..." (Posner, 2007a, p. 25). A similar position is taken by other writers (D. D. Friedman, 2000; Varuhas, 2005). There is little recognition of the legal sector as a provider of services, with its own products that may have unique characteristics, that are produced at a cost and for which demand may be expressed through markets or in other ways. There are important economic questions as to the nature of the product, methods of production, expressions of demand, and possible (market or other) failures and reasons for intervention. Here a context is given as a basis for analysis, and then some of these issues are addressed.

Given the importance of methodological issues in this thesis, a broad explanation of the underlying thinking and hence choice of approaches is warranted. Several writers have made the point that innovation comes from new combinations of ideas.³ Katila (2002) found that innovation can be effectively achieved both from original combinations of new knowledge within an industry, and original combinations of old knowledge from outside an industry. He contends that one advantage of the latter approach is that the old knowledge has withstood the test of time. Katila also suggests that uniqueness is more likely from the use of external knowledge, in contrast to the more common approach to innovation which is to concentrate on the latest, “cutting edge” developments within an area.

There may be similarities between innovation within industries and innovation in terms of academic research. A research methodology to generate new understanding can involve novel combinations of existing ideas and findings from outside the immediate discipline. Originality and novelty is important. Recent years has seen the development of new information technologies and a resulting growth in, and increased access to, information. Consequently the number of possible combinations of ideas, and hence the likelihood of finding useful new combinations, is greatly increased. Efficient research is likely to draw on this potential. Conversely, the efficiency of economics research could be questioned if it is observed to disregard much of the (newly accessible) available information.

There are some peculiarities to this approach to research. In particular, much of the data will be in the form of ideas, concepts or findings from a broad range of sources. Others besides economists have looked at issues from their own perspectives, and this can give new insights compared to those of economists using their standard tools. The analysis here will then comprise consideration of alternative combinations of these ideas,

³ Schumpeter defines development as “carrying out *new combinations*” (emphasis added) of materials and forces (Schumpeter, 1934, p. 66). For a more recent example:

“...every new innovation consists of a new combination of existing ideas, capabilities, skills, resources etc. It follows logically from this that the greater the variety in these factors within a given system, the greater the scope for new combinations of these factors, that is, new innovations...”
(Fagerberg, 2003, p. 7)

See also the concept of “recombinant growth” in Weitzman (1998).

concepts and findings. An analogy can be made with innovative recipes using commonly available ingredients. In that many combinations of ideas/ingredients are considered, it causes some problems in terms of demarcation between literature review and analysis. Recipe books generally present the ingredients in association with each particular recipe, rather than listing them all in a separate section of the book.

Michael Perelman has suggested that one could:

“[do] a service to economists by opening up more social science literature to economists...Very few economists do so, but we could benefit from learning about the richer parts of other social scientists’ work.” (Perelman, 2009)

Oliver Williamson made the point to Coase that ideas will not have much impact unless they are developed to the point where they can be “operational”.⁴ This thesis provides an opportunity to pull together a large number of small observations so as to construct a more general overview. While this mitigates against a clear linear development of ideas, and the end result may not be comprehensive, it provides useful insights and points to future productive areas of research.

In the early chapters there is discussion of economists’ use of theory and empirical techniques. This is presented in a context which highlights the link between theory, empirical analysis and the real world. Such aspects are commonly given only cursory coverage in standard economics and econometrics texts. The context provides a framework for assessing the role of theory and empirical evidence, and for incorporating information from other areas. The result is a toolkit of points and concepts, and an illustration of problems in reasoning which may also arise elsewhere. Later chapters consider information from political science and law. In part, this involves modifying or extending existing theory, as with Downs on democracy.

In the second half of the thesis, evidence is gathered and interpreted on the nature and reasoning observed in the making of and application of the law. Here the approach is more one of drawing conclusions about observed practice and reasoning than of

⁴ See the quote on p.25.

drawing conclusions within models with restrictive assumptions. Phenomena and practices can be observed which give strong support to the view that there is much scope for “failure” in law in terms of the effects differing from those which might be considered desirable. This includes failure to develop laws with adequate deliberation in a suitably informed manner, and failure to apply laws as intended in an economical way. Such analysis requires consideration of a range of concepts, including the role of rhetoric, agenda setting, framing, and the shadow of the law. This process can result in the identification of relevant questions, along with problems and possible side effects of the law.

A case study on the parliamentary debate leading to the passage of legislative changes seeks to identify and evaluate limitations in a key part of the political deliberative process. There are then further repercussions at the implementation stage. The elaboration of these phenomena from a critical, multi-disciplinary perspective is a useful contribution to knowledge.

The structure of this thesis is as follows. Chapter 2 looks at some of the criticisms of economics, covering some of the additional factors which might be thought relevant in a consideration of law making and wider attitude formation. Chapters 3 and 4 present three “paths”, or areas where errors may arise, in the application of economics to real-world issues. Chapter 5 incorporates alternative concepts and criticisms of economics to present some alternative propositions to Downs for the operation of democratic political processes. Chapter 6 considers the parliamentary debates between 1998 and 2001 that led to the current Property Relationships Act 1976 as a means of assessing aspects of the policy/law making process. Chapters 7 and 8 then discuss the operation of the law, presenting concepts to assist in understanding the nature of legal deliberation and its wider effects. Overall conclusions are then drawn in Chapter 9.

Chapter 2 Economics and policy debate

2.1 Introduction

This chapter outlines the reasons why it was considered necessary for the analysis of law to incorporate information and concepts from other disciplines. In particular, literature from the policy area takes a very different approach and contains criticisms of economics perspectives. If alternative perspectives on the same issues are so different, it may be that economics is failing to consider important aspects which are addressed elsewhere.

The central idea of this thesis originated in work done some years ago. At that time some papers were presented which looked at the law, and those working in the law, as if it were a service industry (Birks & Buurman, 1997a, 1997b). From an economic perspective, this is true, even though some with careers in the law may prefer to view it otherwise. Nevertheless, the law is relied on as a mechanism through which politicians can introduce policies⁵, as an important component of policy implementation, and as a method of dispute resolution.

There are wide-ranging questions that economists could ask about the efficiency of the industry, the specific characteristics of its transactions and the nature of its products. Also, the law could be considered as a means of specifying the allocation of property rights in general through legislation and in individual instances through legal deliberation.

One set of questions could relate to the processes whereby innovation occurs. To shed some light on these, one component of this thesis involves an assessment of the parliamentary debates between 1998 and 2001 that culminated in the passing of the Property (Relationships) Amendment Act. The aim was to see if anything could be said about the consideration of relevant information. In particular, what were the issues that

⁵ But note also: (i) “delegated law making”, whereby bureaucrats are empowered to make regulations or “secondary legislation”; and (ii) “judicial activism” where judges take a broad approach to the interpretation of statutes.

were considered, and were they well understood? Might the outcome of the resulting legislation be satisfactory and as anticipated?

The selected debates on relationship property began with the introduction of the De Facto Relationships (Property) Bill and the Matrimonial Property Amendment Bill in 1998 under a National-led government and ended with the passing of the Property Relationships (Amendment) Act in 2001 under a Labour-led government. A basic assessment of the debate could involve seeking a demonstration by participants of an understanding of the underlying economic aspects of the legislation. It could also include consideration of whether the debate incorporated available information on those issues. These alone turned out to be overly optimistic requirements, as discovered in a preliminary investigation (Birks, 2007d). In particular, there may have been little background research on which to determine the desirability of the proposed legislation, and claims were made based on assertions about legislation on human rights which may have been far removed from the intention as understood by MPs at the time. More generally, the focus was on the possible needs of a subset of the population without regard for others or for the effects the legislation might have on behaviour.

Criteria are required on which to base an assessment of the debate. Some general criteria were selected for an initial investigation, with the intention of setting more demanding requirements at a later stage in the analysis. The general criteria fit within the broad umbrella of economic policy assessment. They were that there should be consideration of:

1. the future environment, as that is where the effects will be felt;
2. the impacts on all the various sub-groups who may be affected; and
3. the effects of behavioural changes by various groups as a consequence of the law change.

To give some basis for this selection, or to find some alternatives, various bodies of literature were consulted. The Ministry of Economic Development's documents for regulatory impact assessment (Regulatory Impact Analysis Unit, 2007a, 2007b) could be interpreted as support for the choice, especially when set alongside a document they

produced on behavioural economics (Ministry of Economic Development, 2006)⁶. This is discussed further in Section 6.2 below.

Searching for a stronger justification, some of the literature on policy, policy making, and the policy process was considered. This did not provide the required information, but proved to be very significant for another reason. Noting the possible value of ideas from social scientists other than economists, it was apparent that there exist widespread and strong criticisms of economics, even to the point of being dismissive of the entire body of thought. There was also a heavy focus on factors that are commonly overlooked in economics. It is surprising to see two such disparate approaches from disciplinary areas addressing issues of common interest, suggesting scope for valuable synthesis or cross-fertilisation of ideas.

2.2 General criticisms of economics

A common concern is the rationality assumption that is central to much economic thinking. As Considine (2005, pp. 4-5) states, “Some [policy] text books can also provide a version of rational choice theory (or economic choice theory) to contrast with these other types, although interestingly there are few texts which recommend rational choice as a method”. Considine explains why the rational choice model may be unsuitable. As a model, it is based on assumptions, and this framing could result in bias. In particular (my emphasis)⁷:

⁶ The key focus of the document is described as follows:

“Most decisions in the world are made under uncertainty (including policy decisions). Making decisions under uncertainty means they are not made with perfect information, and so things irrelevant to decision-making in traditional economics (because they are not needed once you assume perfect information and perfect rationality) become important: beliefs, the actual information people possess, culture, peers, learning, and the many other things studied within behavioural economics, psychology and other relevant fields.” (Ministry of Economic Development, 2006, p. iii)

⁷ For a discussion of rationality by an economist, see Grofman (1993). He describes the strong objections to rationality and gives a qualified defence of this assumption [“only an idiot (or an economist) would claim that rational choice models can explain all of human behaviour” (Grofman, 1993, p. 240)].

“...the foundation principle of the schema [is] the idea that all actors have goals which can be turned into explicit preferences. **In many cases we find that goals emerge from the decision-making encounters between actors, and do not precede them, as would be required by the model.**” (Considine, 2005, p. 78)

The highlighted sentence is important. At the level of individuals, preferences can change with deliberation (Akunne, Bridges, Sanon, & Sauerborn, 2006). Also at the level of political parties, especially since the change to Mixed Member Proportional (MMP) representation in New Zealand, negotiation between parties can affect the final preferences as expressed through the political process. Rationality and exogenous preferences are simplifying assumptions. To the extent that other factors such as heuristics and rhetoric are important, much of economic theory can only give a qualified explanation of behaviour.

Another aspect of Considine’s criticism merits further comment (my emphasis again below):

“These criticisms of the alleged virtues of rational deliberation do not require us to abandon the model altogether, but merely to recognize that it depends upon its own unique cultural context made up of specific assumptions about the identity of ‘consumers’, of human behaviour, needs and capacities. The contextual framework may be limiting, but it does not follow that it automatically leads us to jettison the approach as false. **What might apply easily to the choice made at a supermarket is just not so helpful in the context of many political decisions.**” (Considine, 2005, p. 79)

This could be taken as a comment (i) on utility as incorporated in the theory of consumer behaviour, or (ii) as a more general comment on individual thinking overall. On the former, the concept of utility functions and indifference curves has intuitive appeal when considering decisions in a static context. It could easily be thought that preferences cannot change without the passage of time. However, this conclusion should not be too readily drawn. For example, if preferences depend on the decisions of

others, endogenous preferences are plausible.⁸ Note that exogeneity and endogeneity in preferences are not characteristics of the preferences themselves. They relate to the nature of the analysis. Either the preferences are determined outside the analysis, or they are explained, at least in part, by factors that vary within the analysis or model. Nevertheless, economists seem to have taken the step of assuming that people have absolute, given preferences that can simply be observed or measured (as with willingness to pay, or contingent valuation⁹). This is an extension of an assumption from theoretical analysis to a belief applied to analysis of real world phenomena. The assumption has also been made in theories on collective choice.

On the second possibility, that people's preferences may actually be given, it may not be possible to make the same assumptions for narrow (individual) and broader (policy) choices. It is plausible to assume that people will generally focus on matters over which they have some influence. There is some value to them in investing time and effort to build up the required knowledge¹⁰, and they may have a body of knowledge resulting from their past decisions. This point was highlighted in this writer's personal experience many years ago when working in strategic planning in West Glamorgan. This involved the development of the first "Structure Plan" for the county, the aim being to set out a plan with a twenty-year time horizon. The process included public participation exercises. For many people it was the first time they had been asked about several of the aspects of development that were under the control of the County Council. Their responses were commonly based on narrow, personal aspects that were familiar to them, such as shopkeepers being concerned about foot-traffic outside their shops.

Political decisions relate to broader dimensions, and many people are relatively unaware of these at first. There are also reasons why in the long term they may not find it worthwhile to develop a greater understanding. In particular, their impact on any result

⁸ Note also Walras' *tâtonnement* process whereby adjustment and iterations are assumed to occur within one time period. See Section 3.3 of Jan van Daal's introduction to Walras (2005).

⁹ Exogeneity is crucial for the applicability of evaluations using these techniques, although this qualification is seldom mentioned. See also p.65.

¹⁰ In relation to people's decisions, this could be considered as a component of transactions costs. Coase emphasised the importance of transactions costs as a constraint for all forms of transactions including those via markets, internally within organisations, or through the law or government. (Coase, 1960, 1991)

would be small. The issue of choice of doctors or schools is similar, but with one difference, namely the direct benefits of information to them in situations of choice may be larger. When they have no choice, people could be ill-informed, but there are incentives to learn if there is a change of regime giving them more discretion over the decision.

Note that “choice” may be broader than the standard economic view of available alternatives. Consider schooling when schools are zoned, compared to when there is free choice, for example. In this example, it could mean that people gather different information under zoning, rather than less information. With zoning, the response to dissatisfaction is likely to be voice (what changes do you seek in the school?), whereas with free choice exit is more of an option (what alternative school should you choose?) (Hirschman, 1992, Chapter 4). In either case, people are likely to learn more about the things they believe they can influence. Hirschman (1970) saw “exit” as being considered in the realm of economics, and “voice” within politics. In brief, Hirschman (1970, p. 17) suggests that withdrawal or “exit” is presented by economists as “the ‘direct’ way of expressing one’s unfavourable views of an organisation”. In contrast, “A person less well trained in economics might naively suggest that the direct way of expressing views is to express them!” This is what is meant by “voice”. He contends, “In a whole gamut of human institutions, from the state to the family, voice...is all their members have to work with”. Exit is not always an option, nor is it the only option. Economic theories of competition and markets tend to ignore this.

Similarly in a highly regulated economy the incentive is for investment in lobbying, rather than understanding the markets, but this is reversed in a less regulated environment. If the laws and legal structure are amenable, this encourages competition by means of litigation or, in other words, by means of “voice”.

There is a further important distinction between consumers’ choices and policy issues. The former is generally an individual matter, whereas the latter is usually the result of collective action, for which preference issues are more complex, with greater interdependencies between people.

Overall, theories of consumer behaviour should be applied with care when considering wider political decisions. To stress these points, for political decisions:

1. People start with little direct experience of the issues;
2. It is costly to gather information;
3. Individuals have little direct influence; and
4. Responses frequently require co-ordinated actions by many people.

Consequently, consideration should be given to issues of relative ignorance, and the costs and benefits of becoming informed, along with the distinction between individual and collective decision making.

There is another important aspect of the policy process that is mentioned by several writers. Namely, what issues get on the agenda? Considine (2005, p. 30) states, “Problems are usually defined by interests, and often by the most powerful and persistent among them”. The issue of problem definition and policies designed to benefit target populations is described in a broader context by another writer who perceived limitations in an economic approach (Bosso, 1994). For example:

“A sharpened focus on problem definition may also have roots within social science itself, as part of a broader rebellion against the seductive but simplistic determinism embodied in the more economics-based theories of policymaking that have dominated academic and political discourse over the past three decades...it isn’t too much of a stretch to suggest that a focus on problem definition is part of a broader effort within the social sciences to revisit concepts and factors (e.g. culture, societal values, formal institutions) that may have been undervalued in, for example, the literature on rational choice.” (Bosso, 1994, p. 183)

Bosso’s emphasis is on the way individuals’ and society’s values and perspectives are shaped, contrasting sharply with the common economic starting point where preferences are “given”.¹¹ It should be noted that, “If problem definition hinges on the social

¹¹ In a New Zealand context, McCarthy presents an analysis of the changing representation of Maori in museums to argue that the displays are essentially an expression of, and a mechanism for change in

construction of reality, then culture, commonly held values, ideology, political socialization, and ideas all matter” (Bosso, 1994, p. 183).

To summarise, there are some valid criticisms of aspects of economic thinking. Given that all analysis involves simplification, this does not mean that economics should be disregarded. However, it does mean that economic analyses could possibly be enriched by incorporating aspects of these additional dimensions (although perhaps with some loss of mathematical elegance). This is likely to be particularly relevant for issues of policy making and implementation, including the use of law.

2.3 Dunn, and Hudson and Lowe on reasoning and process

Dunn (2004) includes two aspects of the policy making process that are of particular interest. These are, (i) “Modes of policy argumentation and characteristic reasoning patterns” (Dunn, 2004, pp. 394-418), and (ii) “models of policy change” (Dunn, 2004, pp. 47-55).

2.3.1 Modes of policy argumentation

Dunn lists eleven of these modes:

- 1) Authority (status of individuals)
- 2) Method (status of techniques)
- 3) Generalization (from a sample)
- 4) Classification (group characteristic assumed for each group member)
- 5) Cause (cause and effect relationships)
- 6) Sign (associated phenomena, not necessarily causal, e.g. leading indicators)
- 7) Motivation (assumed support because of shared interest)

prevailing political positions. This is “a reminder that social institutions are not impermeable [and] that power is fluid and contestable” (McCarthy, 2007, p. 202). The representation/reinterpretation of history for current political purposes is also described by Myers (1995). These suggest also that prevailing views of the past may indicate current political power structures.

- 8) Intuition (“tacit knowledge”)
- 9) Analogy-Metaphor (it works for one situation, so will work for another)
- 10) Parallel Case (copying somewhere else)
- 11) Ethics (right or wrong – “In public policy, many arguments about economic benefits and costs involve unstated or implicit moral and ethical reasoning”)

Of the eleven, only the second and the fifth might be considered to refer directly to the approaches used in econometrics and economics (emphasis added):

“**2. Method:** Reasoning from method is based on warrants about the approved status of methods or techniques used to produce information. The focus is on the achieved or ascribed status or “power” of procedures, rather than persons. Examples include approved statistical, **econometric**...methods and techniques.” (Dunn, 2004, p. 395)

“**5. Cause:** Reasoning from cause is about the activity of generative powers (“causes”) and their consequences (“effects”). For example, a claim may be made based on **general propositions, or laws, of economics that state invariant relations between cause and effect...**” (Dunn, 2004, p. 395)

Dunn is arguing against making too much of the results of economic analyses. However, his comments could be taken as reasons for dismissing such work due to it being based on overstated claims about the value of the techniques and the generality of the findings. An alternative approach would be to assess individual analyses on their merits and to see what reservations there might be about the application of specific results. The claim of “invariant relations” is dubious, as there is much debate among economists and econometricians on directions of causality and the timing and magnitude of impacts. Moreover, the “ascribed status” of techniques such as econometrics might refer more to the reluctance or inability of the uninitiated to critically assess their results, rather than a failing of the techniques themselves.¹²

¹² This is not to say that economists or econometricians are incapable of overstating the significance of their findings. More detailed discussion of the limitations and possible misuse of economic and econometric analyses is included in the next two chapters.

Dunn does not attempt to rank the alternative modes of argumentation on their accuracy, legitimacy, or desirability. However, there is questionable merit in reliance on someone's authority as an alleged expert (number one)¹³, or the confidence that might be placed in someone's gut instinct or intuition (number eight).

The categorisation of a range of methods of argumentation is not new. Schopenhauer listed thirty eight stratagems that could be used to win arguments, and referred back to Aristotle for his discussion of logic, dialectic, eristic and sophistic (Schopenhauer, c1851)¹⁴. The use of authority is described in a medical context by Hutchison (1925), along with repeated assertion and confident presentation, and the use of ridicule to counter fads and fashions. The existence of an extensive literature on these matters suggests that they should at least receive some consideration in an analysis of decision making on matters beyond people's direct personal experience.

2.3.2 Models of policy change

Law making is not the result of a static optimisation exercise. The process of making laws is important. Dunn (2004, pp. 47-55) describes eight "models of policy change". His first is called "**comprehensive economic rationality**". While he includes a brief mention of modifications for transaction costs, imperfect information, and so on, nevertheless his general discussion, including reference to "homo economicus", seems to present economics as an extreme and unrealistic option.

He continues with "**second best rationality**", which is loosely related to the Lipsey-Lancaster Theory of Second-Best (Lipsey & Lancaster, 1956). Other approaches include

¹³ Authority may be considered as a heuristic approach to decision making, where reliance is placed on the judgment of someone else more qualified in the area, although authority and celebrity are sometimes confused.

¹⁴ The four are explained as follows: "(1) *Logic*, or Analytic, as the theory or method of arriving at true or apodeictic conclusions; and (2) *Dialectic* as the method of arriving at conclusions that are accepted or pass current as true, (3) *Eristic* is the method by which the form of the conclusion is correct, but the premisses, the materials from which it is drawn, are not true, but only appear to be true. Finally (4) *Sophistic* is the method in which the form of the conclusion is false, although it seems correct."

“disjointed incrementalism” with numerous small changes taken after narrow, partial analysis. “The disjointed-incrementalism model of policy change holds that policy choices seldom conform to the requirements of the economic rationality model.” (Dunn, 2004, p. 50). This approach is important both as a description of much actual decision making and for its links to historical institutionalism, discussed in sections 2.4 and 6.3.3 below. Consideration of a limited number of options is also described by Bosso (emphasis added), “The cases in this volume...reinforce the impression that for any problem at the regime or macro-level of discussion and analysis **there are remarkably few alternatives actually under debate.**” (Bosso, 1994, p. 184)

Dunn also outlined **“mixed scanning”**, a combination of broad strategy and other incremental (“operational”) choices, and **“erotetic rationality”** or rationality in the face of ignorance, where the information required is not available. Limited knowledge is used as a reason for open-minded searching rather than routine application of standard techniques. Hence (emphasis added) “Albert has stated the major principle of erotetic rationality succinctly in his critique of the use of **benefit-cost analysis in judicial settings...**” (Dunn, 2004, p. 53). An additional approach was described, **“critical convergence”**, where “individuals and groups combine to set agendas and formulate policies [but success] depends on the ability to recognise critical moments” (Dunn, 2004, p. 54).¹⁵ This could fit the post-1984 reforms in New Zealand, as the need for change had long been recognised, but it took until that time for the changes to be widely acceptable. Alternatively, that could be an illustration of the last approach that Dunn mentions, **“punctuated equilibrium”**, which is incremental with occasional large jumps.

“The fundamental proposition of the punctuated equilibrium model is that external shocks are a necessary but not sufficient condition of major policy change. The sufficient condition is that new political images and understandings of the political world suddenly arise in response to these shocks.” (Dunn, 2004, p. 55)

¹⁵ An academic parallel to critical convergence or punctuated equilibrium is described by Kuhn, “When...the profession can no longer evade anomalies that subvert the existing tradition of scientific practice – then begin the extraordinary investigations that lead the profession at last to a new set of commitments, a new basis for the practice of science” (T. S. Kuhn, 1970, p. 6). See also the discussion on accepting or rejecting theories in Section 3.2.3 below.

Dunn also refers to Lindblom, who described the practice of policy making as “muddling through”¹⁶ (Lindblom, 1959, 1979), which has similarities to incrementalism. A similar perspective and terminology has been taken by Colander focusing specifically on economics (Colander, 2003a).

Collectively, all but the first of these approaches involve partial, gradual, or piecemeal change. This ties in with the institutional approach presented by Hudson and Lowe (2004, Chapter 9) and outlined below.

2.4 Institutions

As the name suggests, institutionalist perspectives centre on the role of institutions and their impact on (or constraints on) change. While there is a broad literature on institutions (Hodgson, 1998; North, 1990; Williamson, 2000), this section will focus on a subset, that of historical institutionalism. “We believe that the historical institutionalists have produced the most powerful work to emerge from the new institutionalist school, not least because they have emphasised the role of history in shaping policy outcomes” (Hudson & Lowe, 2004, p. 149). Hence:

“Policy tends to evolve quite slowly and in an incremental manner...in part...because policies tend to create sticky institutions...that are difficult to reform and so act as barriers to change.” (Hudson & Lowe, 2004, p. 150)

Historical institutionalism¹⁷ is linked to “path dependency” and “policy feedback”. Hence, “...policies, rather than merely being the *outcome* of the policy process, can and

¹⁶ The term is also used by Popper (1961, pp. 74-75)

¹⁷ It has been suggested that there are three alternative new institutionalist approaches in political science, historical, rational choice and sociological (Hall & Taylor, 1996). Hay and Wincott (1998, p. 952) say that individuals in the rational choice approach are considered as “calculating automatons”. Niskanen (1973, p. 20) also uses this term. Historical institutionalism is discussed further in Footnote 136, and in terms of New Zealand parliamentary debate in Section 6.3.3 below. A connection might be expected between institutional change and structural change.

do become a central part of the policy process itself...creating large communities of interest that seek to defend the existing settlement” (Hudson & Lowe, 2004, p. 152). Considine makes a similar point, “The act of deciding a new policy is both a decision about a particular outcome and a laying down of precedent for the next decision that comes along.” (Considine, 2005, p. 15)

The emphasis on process and dynamics is important as a contrast to static economic analysis. This is significant because the latter provides the basis for many fundamental economic propositions including those in welfare economics such as the desirability of perfect competition. It would be wrong to generalise too much about economics, however. The literature is very broad, with numerous aspects addressed in specialist areas even if the core (or introductory) theory is more restrictive.^{18 19}

For example, while economics might be criticised for ignoring institutional aspects, another perspective could also be taken. Depending on the analysis, economics could take institutions as given, or it could shape institutions. While often a structure is assumed, there is also consideration of institutions in relation to, for example: available policy instruments (as with broadening the tax base); objectives (policies for regions, ethnic groups, or women); accountability and supervision (purchaser-provider splits); and inefficiencies (monopolies, or public versus private provision). Alternative structures are sometimes suggested, using economic theories to demonstrate why, under given assumptions, they would give improved outcomes. Even under static analysis, there is some indirect acknowledgement of path dependency. The general rule that “sunk costs” (costs incurred to date) should be ignored is not saying that the past is

¹⁸ Eighty years ago, Schumpeter suggested that economic change should be viewed in terms of the “total situation”, not just economic conditions. (Schumpeter, 1934, p. 58). See also Bryce (1929a, p. 64).

¹⁹ Process is also being considered in some recent economics research through reference to “procedural justice”. For an outline of the concepts, see Tyler (2000). For a legal recognition, law changes are “unlikely to gain broad acceptance unless they have been developed through an adequate *process*, including appropriate consultation” (Legislation Advisory Committee, 2007, p. 9). In addition, “process utility” (the term commonly used in health economics) or “procedural utility” is described in Frey and Stutzer (2001). These are of interest because, within their own schema, they provide a basis for assessing the desirability of alternative processes.

irrelevant. Rather, it is saying that past decisions cannot be changed, and current decisions should be made building on the net result of those past decisions.²⁰

There is another illustration of historical institutionalism which can be very significant for policy. This is contained in the argument that existing institutions may justify their existence by the promoting additional issues:

“...in many cases solutions go looking for problems to attach themselves to, not the reverse. A policy system which is practiced at running tribunals to resolve disputes will look for ways to attach this solution to any new issue coming within its purview.” (Considine, 2005, p. 78)

“...success at group identity politics tends to expand the list of grievances and ‘enemies’ necessary to keep the movement viable and its leaders powerful...What a movement needs for its own survival is...an inventory of demands still outstanding, grievances still unassuaged, and ‘enemies’ still to be dealt with.” (Sowell, 2004, pp. 180-181)

An economic interpretation could be that organisations have their own policy variables, and their aim is to use these variables to achieve their objectives. Consequently, they are motivated to find relevant applications for their available instruments. It is not their role to constrain their own activity.²¹

An additional institutional example could be the process of reporting on the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW) to the United Nations CEDAW Monitoring Committee. This includes, in particular, the periodic report collectively provided by non-government organisations (NGOs), all of which are advocating for women with no attempt at balance from alternative interests. Hence, a New Zealand Council of Trade Unions (NZCTU) media release of 27 February 2003 states, “The Status of Women - NGO CEDAW Report, a collaborative

²⁰ Two other economic phenomena indicating ongoing importance of past events are hysteresis and agglomeration economies.

²¹ Niskanen (1973) made a similar point in his description of the behaviour of bureaucrats.

effort involving over 100 New Zealand women's organisations, including groups representing migrant women, was formally launched by the National Council of Women of New Zealand (NCWNZ) National President, Beryl Anderson at a function in Parliament" (NZCTU, 2003).

In summary, institutional changes and structures have broad implications, paths through time are important, and current decisions and policies have additional effects in the future. Some areas of economics underplay the significance of this process. Consequently, important aspects of policy making and implementation may be overlooked when a purely economics-based approach is taken.

2.5 A role for economics?

It would be wrong for economists to disregard the processes of policy making and the impact these have on policies considered and decisions reached. However, this is an area that has not generally received much attention from economists. At the same time, economists do sometimes ask important questions about the effects of and desirability of alternative structures and policies. Similarly, policy literature on the process of policy making is valuable, but it appears to overlook some of the questions on the initial choice of options and the (indirect) implications of final policy decisions that economists do attempt to address.

As a sweeping generalisation, it could probably be said that the policy texts focus on the policy making process, whereas economics concentrates on systems (markets, etc.) and outcomes. Alternatively, economics starts with a situation or set of preferences and asks where to from there. In contrast, politics/policy takes the perspective of building up from individual/group agendas to the resulting situation/preferences in society as a whole (how they are formed, how to influence them). This focuses on competition between groups in the promotion of selected agendas and the denial of others, but does not consider all the implications. In addition, economics attempts to specify not just what is, but also what is desirable. There is no clear equivalent to this in the

policy/process literature²², but it is potentially important. It can assist in addressing questions such as how to improve outcomes, and perhaps what are desirable processes. Paradoxically, some policy texts tend, despite their often valid criticisms of economics, to refer back to economics for methods of evaluation, borrowing concepts such as utility and cost-benefit analysis (Colebatch, 1998; Dunn, 2004).

Colebatch suggests an order of events in policy starting with a decision on action (taking the analysis as given), then gaining acceptance for the action:

“Determining policy goals is...not a matter of a context-free group of ‘policy-makers’ determining what the goal will be for all the participants: there is a range of interested parties who will have their own analysis of the problem, and will be seeking wider support for what they see as the most appropriate course of action.”
(Colebatch, 1998, p. 45)

This is the reverse of the standard economics approach, which starts with preferences as given and then determining the desirable action (doing the analysis). The process as described later by Colebatch (1998, pp. 53-54) involves shaping and manipulating preferences.

There is also a difference between the world according to economic theory and the world in which policies are being applied. There are some economists who openly acknowledge the limitations of economic theory and the need to recognize the specific circumstances relating to individual cases. For example, Commerce Commission guidelines on mergers state:

“These merger outcomes with high barriers to entry can be simulated quantitatively using economic models. Such models are at best imperfect representations both of actual markets and of the behaviour of participants. Judgements need to be made about the assumptions that are built into such models, and the strength of the results that they can produce. Nevertheless, the Commission considers that quantitative

²² See Appendix 1 for further discussion of this point.

modelling may be a useful complement in some cases to qualitative analysis...”
(Commerce Commission, 2004, p. 32)

Nevertheless, there is arguably a weakness in the process of development of economics as a discipline. It could be considered that there exists a large central body of knowledge/theory that holds a dominant position. Consequently, other contributions that highlight limitations have limited impact. One explanation that has been suggested for this is that criticisms and alternative suggestions, while highlighting weaknesses, do not provide an alternative of equivalent stature. For example, Nobel Prize winner Ronald Coase has said:

“Oliver Williamson has ascribed the non-use or limited use of my thesis in *The Nature of the Firm* to the fact that it has not been made "operational", by which he means that the concept of transaction costs has not been incorporated into a general theory.” (Coase, 1991)

The same could be said of Colander with “muddling through”. In policy terms, they have not, to date, achieved “traction”. Perhaps there are similarities between the process of policy making and that of development for academic disciplines. Terms such as historical institutionalism and path dependency might even be used to describe the pattern of discipline development.

In conclusion, there are limitations to both bodies of thought. Each could benefit by giving some attention to areas of interest central to the other. To give a label to this point, perhaps this is the effect of “déformation professionnelle” — “the tendency to look at things according to the conventions of one's own profession, forgetting any broader point of view” (Anon.).

The concern here is primarily with economics and its application. Economics has been critically viewed by academics focusing on policy issues on the basis of its assumptions and its disregard for the policy process. In particular, criticism has been levelled at assumptions of rationality and exogenous preferences, which are integral components of many economic models and associated applied techniques even at the advanced level. Insights into the policy process are also overlooked by economists. Economics has its

strengths, including its concepts of systems working well and failing, but these are not complete on their own, given their omissions and simplifying assumptions. The following two chapters explore some of the issues that may be encountered when applying economics for the analysis of real world phenomena.

Chapter 3 Logical gaps in economics – using theory

3.1 Introduction: setting the scene

As described in Chapter 2, economists have been criticised for their unrealistic representation of the real world as incorporated in assumptions of exogenous preferences and rational behaviour, as well as the disregard for processes of deliberation and political decision making. This Chapter presents a framework for considering the use of theory to understand real world phenomena, suggesting that there are aspects of the application of theory which merit particular attention. This involves investigating the nature and role of theories, and the possible misuse of theory. Three areas of potential error are identified, relating to (i) the link between theory and the real world, (ii) the relationship between theory and empirical analysis, and (iii) the application of empirical results in decision making (including the determination of and implementation of laws). The first area is discussed in this Chapter, with the second and third addressed in Chapter 4.

As a first step, it is important to be able to distinguish between logic and rhetoric, or proof and persuasion. This is central to the issue of preferences and rationality. People's views and beliefs result from numerous influences, including persuasion. While people may be persuaded by proof, this is not a necessary requirement, hence the existence of rhetoric as distinct from logic, and of Dunn's modes of argumentation. In common terminology, it could be considered that persuasion dominates over proof, perception over reality, or image over substance. Put simply, if people were purely logical, there would not be a distinct area of study called rhetoric. People would only be persuaded by logical argument.

It is perhaps paradoxical that, while economic theories based on rational behaviour assume that people are logical (Varian, 1992), it can be shown that economics has its own rhetoric. This has to be understood in order to see what can be said with economic analyses, and perhaps even to see how economists can persuade others to accept the relevance of economic findings. Rhetoric is based on persuading a particular audience,

and the rhetoric of economics persuades economists and econometricians, but probably not others.

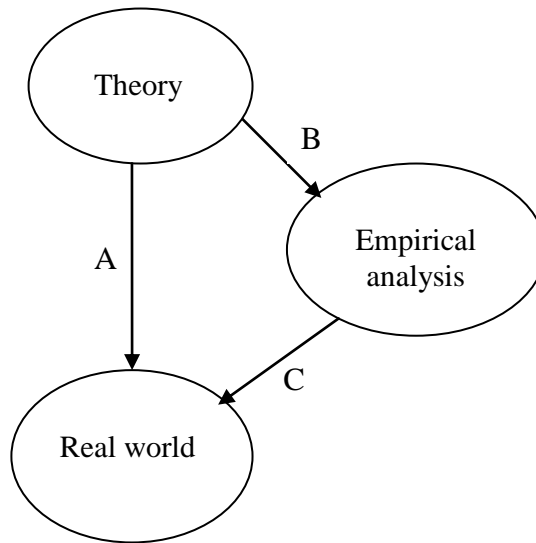
There is a problem with the use of economics to analyse law. Modern economic theory is based on logic and proof. Policy making and the application of law are based on rhetoric and persuasion. Hence a straight application of economics to this area involves the use of approaches which deny the existence of a fundamental component of the area under analysis. There is an additional problem. Although it may be desirable to consider economics as being entirely logical, there is a body of literature about the rhetoric of economics which has some validity. A longstanding advocate of this perspective is Deirdre McCloskey (1998), and support has been given by others including Arjo Klamer (2007). In a discussion on the structure of argumentation in economics, Klamer refers to gaps in the reasoning:

“Gaps between the theoretical and empirical arguments have not been bridged, policy implications do not necessarily follow and methodological arguments are, for the most part, seriously flawed.” (Klamer, 2007, p. 106)

Dunn’s modes of argumentation do not translate into any particular approach being universally effective. People are only likely to be persuaded to support a particular position if the methods used are suitably tailored to appeal to them (Whitehead, 2008, p. 26).²³ Someone reading Klamer’s book might briefly note the point and move on. More likely, its significance may simply be overlooked unless it has already achieved some prominence. The following diagram makes broadly similar points, but perhaps in a more persuasive manner. In particular, it should be noted there are potential difficulties in the translation of results from one area of analysis to another, and in these moves across areas unrecognised errors are likely to arise:

²³ Over 150 years ago Schopenhauer (c1851) listed 38 stratagems which could be used to win an argument His Stratagem No.28 consists of using an invalid argument which will appear plausible to the audience.

Figure 3-1 Logical errors, Types A, B and C



It is to be hoped that any theory is internally logically consistent. Similarly, empirical analysis should be based on sound methodology. However, these two requirements are not sufficient for the use of these approaches to be meaningful for real world issues. There are problems with A, B and C. Theoretical findings, being based on specific assumptions, may not translate directly to the real world (path A). The relationships or findings may also not be accurately or uniquely described in empirical formulations (path B). The results of empirical analyses may not support the claims made about real world implications (path C). In each of these cases, the paths may not be based on logic, in which case they rely on rhetoric. People, often unaware, are prepared to accept flawed reasoning. Consequently, three types of error are highlighted through this structure:

Type-A errors arise when theoretical results are assumed to be directly applicable to the real world.

Type-B errors arise when empirical formulations do not accurately reflect the underlying theory. This can be due to data problems, or difficulties specifying relationships and functional forms that match the theory.

Type-C errors occur when incorrect conclusions are drawn from statistical results, either through a misinterpretation of the meaning of the results, or a failure to consider additional, relevant policy dimensions.

Cooter and Ulen, in a major law and economics text, describe economic theory and its methods of analysis:

“Why has the economic analysis of law succeeded so spectacularly...?...Economics provided a scientific theory to predict the effects of legal sanctions on behavior...Economics has mathematically precise theories (price theory and game theory) and empirically sound methods (statistics and econometrics) of analyzing the effects of prices on behaviour.”

(Cooter & Ulen, 2008, p. 3)

They write as if economics accurately reflects the real world, and that the statistical methods show what they claim. The law may err if it disregards relevant economic aspects of cases, but even when it does rely heavily on economics, it may still be failing if economics does not accurately reflect the real world.

Harrod (1938, p. 387) made this point, “[E]conomists, even the most theoretical, have been prone to give advice on the basis of theory”. But when they do this...

“They must say good-bye for ever to the claims to certainty which they could make so long as they remained within the confines of their geometrical system. From being one of the most exact, albeit narrowly circumscribed, sciences, economics of necessity becomes one of the most conjectural.” (Harrod, 1938, p. 388)

To overcome the problems in analyses, it is necessary to recognise rhetoric and to limit the resulting distortions (including those in economics and econometrics). It is important to be able to distinguish between logic and rhetoric, proof and persuasion, substance and image. Hence the focus here is on methodological issues. Path A, relating to theory, is covered here, and Paths B and C on empirical issues in Chapter 4.

3.2 Path A – theory to the real world

In October 2008 there was a coordinated international response to what had been recognised as a global financial crisis. On 23 October in the US, the former chairman of the Federal Reserve, Alan Greenspan, appeared before the House Oversight and Government Affairs Committee, where he read a statement (Greenspan, 2008) and answered questions. In the statement he described his understanding of the reasons for the “once-in-a century credit tsunami” arising from the sub-prime mortgage crisis. Here is an extract from an exchange between him and the chairman of the committee, Rep. Henry Waxman:

“WAXMAN: The question I have for you is, you had an ideology...[T]his is your statement, 'I do have an ideology that free, competitive markets are by far the unrivalled way to organize economies. We tried regulation. None meaningfully worked.' That was your quote. You had the authority to prevent irresponsible lending practices that led to the subprime mortgage crisis. You were advised to do so by many others. And now the whole economy is paying the price. Do you feel that your ideology pushed you to make decisions that you wish you had not made?

GREENSPAN: Well remember that what an ideology is is a conceptual framework with the way people deal with reality. Everyone has one. To exist, you need an ideology. The question is whether it is accurate or not. And what I'm saying to you is yes, I've found a flaw, I don't know how significant or permanent it is, but I've been very distressed by that fact...

WAXMAN: You found a flaw in the reality...

GREENSPAN: Flaw in the model that I perceived as the critical functioning structure that defines how the world works.

WAXMAN: In other words, you found that your view of the world, your ideology was not right.

GREENSPAN: Precisely.” (F. James, 2008)

Greenspan was treating his chosen theoretical perspective as if it were representative of the real world. There was a rhetorical leap, and a leap of faith at that, given that he considered it his ideology. There is a link with the law. James writes, “Rep. Barney

Frank who chairs the House Financial Services Committee has blamed Greenspan for not regulating mortgages under the Homeowners Equity Protection Act which Congress passed in 1994 which would have allowed mortgage markets to be regulated across the board” (F. James, 2008). In other words, a law had been passed giving him the required powers, but it was not implemented because it did not fit his perception of the world. This is one way that legal failure can arise; even if the laws are there, those responsible for implementation may misread the situation. In this instance, it happened because of Greenspan’s view of theory. In general, people’s perceptions of their environment can be shaped by their education, the views of their discipline, beliefs within a discipline, commonly promoted views in the news media, concepts of acceptable reasoning, and numerous other sources. Issues are not analysed simply on the evidence presented for that particular issue. The analysis is shaped by numerous other influences that individuals bring with them to interpret that evidence, with theories being an important component.

Similar rhetoric, suggesting that theoretical findings can be assumed to apply directly to the real world, can be seen in the following quote. It is in information prepared for the public on the award to Paul Krugman of the Prize in Economic Sciences in Memory of Alfred Nobel 2008 (emphasis added). Note that models are claimed to show what **will** happen:

“Such a model can be used to show that foreign trade **will arise** not only between countries which are *different*...it can be demonstrated that extensive intra-industry trade **will occur**... This allows each country to take effective advantage of economies of scale, thereby implying that consumers worldwide **will benefit**...”
(The Royal Swedish Academy of Sciences, 2008, p. 2)

Becker cautioned against such thinking (but note that he still suggests that a finding has been “demonstrated”):

“...the recommendation of government intervention does not follow from the demonstration that government intervention could improve matters. Demonstrating that a set of government decisions would improve matters is not the same as demonstrating that actual government decisions would do so. This kind of inference

is logically equivalent to identifying the actual workings of the market sector with its ideal workings.” (Becker, 1958, p. 105)²⁴

Theory plays an important role in shaping our understanding, but its influence can be misplaced. This suggests a need to investigate the nature and function of theory as a means of understanding real world events.

3.2.1 What is theory?²⁵

Section 3.2 considers theory, and in particular economic theory, as a tool for analysing issues and presenting criteria for evaluation of alternatives. While theory serves as a tool for analysis, it has limitations, so the nature of theory that should be recognised. Any theory involves simplification, giving a partial view based on a particular perspective. It is at best an approximation of reality. Alternative theories highlight different aspects and give differing results. This difference in emphasis can be most apparent when comparing theories across disciplines, as illustrated by the discussion in Chapter 2, but differences are more commonly identified and debated between competing schools of the same discipline. A possible outcome of these differences is described in the poem about the blind men and the elephant, where each man felt a different part of the elephant, drawing their own conclusions as to the appearance of the animal. The final two verses read:

“And so these men of Indostan
Disputed loud and long,
Each in his own opinion
Exceeding stiff and strong,

²⁴ While Becker is saying that theory cannot be applied directly to the real world, his point is actually that there is potential for political failure, rather than the economic theory not fitting the real world. Nevertheless, it shows that there are aspects (in this instance political) that the theory does not consider.

²⁵ Methodological note: This section draws on a range of literature, much of it outside the discipline of economics, identifying alternative concepts which are then used in an interpretation of theory in general and economic theory in particular. The concepts are also relevant for understanding people’s perceptions and how they can be shaped. This is important for material in later chapters.

Though each was partly in the right,
And all were in the wrong!

Moral:

So oft in theologic wars,
The disputants, I ween,
Rail on in utter ignorance
Of what each other mean,
And prate about an Elephant
Not one of them has seen!”
(Saxe, 1878)

The term “theologic” could easily be replaced by “academic”.²⁶ The image conveyed by this poem is significant. Similar issues can be considered by several disciplines and professions. Hence, social policy issues may be analysed by economists, sociologists, political scientists, psychologists and lawyers, to name a few. Each applies its own existing body of knowledge, perspectives and tools of analysis to draw conclusions, commonly related to the application of their own policy instruments. They are looking at the same thing, but in different ways and with differing conclusions.

According to Lipsey:

“A theory consists of (1) set of definitions that clearly define the **variables** to be used, (2) a set of **assumptions** that outline the conditions under which the theory is to apply, (3) one or more **hypotheses** about the relationships among the variables,

²⁶ Albert Waterston of the International Bank for Reconstruction and Development may have been making an reference to this poem when he wrote, on the back cover of Ilchman and Uphoff (1969) (emphasis added):

“I am attracted to their conception of the human environment as an integral one which embodies political, social and economic values. These must be explained within a common analytical framework. This we have all been told in elementary courses in political science, sociology and economics, but only in one sentence. Thereafter, the matter rarely arises as each of the social sciences proceeds to concentrate exclusively **on the part of the elephant it has taken hold of.**”

(4) **predictions** that are deduced from the assumptions of the theory, and that (5) can be tested against actual data.” (Lipsey, 1989, p. 22)

This description focuses on the structure of a theory. With the use of variables and the relationships between them, at its core there is a model. This would fit a conventional view of theory in economics, although point (5) would not apply to pure theory. However, models are not unique to economics. A model is a simplified representation that is intended to highlight the main elements of a phenomenon under consideration. Except for possible differences in the level of formalisation, it is not unlike the approach that a person might take on any issue, as in adopting a stylised or simplified representation of the real world.

Alternative perspectives on theory and models might consider not their structure, but instead their function or use. First, theory can be used to specify the functional relationships in a model that relates policy instruments to target/objective variables.²⁷ The variables are selected according to the objectives and the available instruments. This affects what we see and what is, possibly by default, excluded from the analysis.

Second, the use of theoretical findings might be considered as merely a “mode of argumentation”.²⁸ The following discussions of models illustrate this alternative, considering them as forms of **analogy**, **metaphor**, and **attribute agenda setting**, or **framing**.^{29 30}

²⁷ Note also a link between models and planning: “We take the term 'planning' to refer to a purposive, means-ends process and we may define it as a deliberative manipulation of the parameters of a system in order to bring about a desired and specified alternation in the operation of the system.” (R. A. Bowles & Whyne, 1979, pp. 1-2)

²⁸ Mode no.5, reasoning from cause (Dunn, 2004, p. 395).

²⁹ Note that the analysis of these issues themselves has been subject to alternative framing over time. Writing in 1942, with his experiences shaped by the 1930s, Friedrich places an emphasis on **propaganda** as a major determinant of public attitudes (Friedrich, 1942). Similar themes are developed in his later work (Friedrich, 1968). This has since moved through “bias” to “framing”, see p.38.

³⁰ Adam Smith, in paragraph IV.76 of his *History of Astronomy*, stressed that theory is imagination, not reality, with “philosophical systems as mere inventions of the imagination” (A. Smith, 1980, p. 105). Note, therefore, that the structure applied here and providing errors A, B and C is also an invention of the imagination, and is only presenting a framework which may be analogous to reality.

Klamer, in an economics context, describes a model as, “an explicitly, and in economics often formally, articulated **analogy**. A model is typically characterised by ‘as if’ reasoning.” (Klamer, 2007, p. 123) It was not by accident that the blind men each interpreted their impression of the elephant by means of analogy. The origins of theories may also be based on analogies, as described by Gilbert (1896) in terms of formulating hypotheses in science. Note also Leatherdale (1974) on the role of analogy, models and metaphor in science. He describes extensive debates between those favouring a literal view of science and those taking a metaphorical view. In his Chapter 5 he presents rebuttals of fifteen arguments raised against a metaphorical view. In the social sciences it is likely to be even harder to argue that theories are other than metaphors.³¹

Lakoff and Johnson, from a linguistic perspective, focus on the use of **metaphor**, where, “The essence of metaphor is understanding and experiencing one kind of thing in terms of another.” (Lakoff & Johnson, 2003, p. 5)³² With economic models, we generally see economic phenomena in terms of mathematical/mechanical systems. Lakoff and Johnson speak more generally:

“In all aspects of life...we define our reality in terms of metaphors and then proceed to act on the basis of the metaphors. We draw inferences, set goals, make commitments, and execute plans, all on the basis of how we in part structure our experience, consciously and unconsciously, by means of metaphor.” (Lakoff & Johnson, 2003, p. 158)

³¹ The point that theories are a form of metaphor is particularly clear when theories and models are understood to be simplified representations of the main elements of the phenomena under investigation. A literal view of science suggests that theories can be definitive, but this is unlikely to be the case when simplifications are made. Arguments against a metaphorical view tend to emphasise inappropriate metaphors, or where no justification is provided for the choice of the metaphor.

³² For an economics example, “The best way to view the theory of consumer choice is as a metaphor for how consumers make decisions” (Gans, 2009, p. 510). Swann (2006) devotes a whole chapter to metaphor. A legal academic has used the perspective of models as metaphors in the context of law and education (Mackinnon, 2007).

They distinguish between direct and indirect experience, where indirect experience involves some additional processing or interpretation of information. As such, even consumption activity, such as say watching a comedy film, can include indirect components, but broader policy issues can be entirely indirect. This is particularly relevant for the analysis here, because, “[M]ost of our indirect understanding involves understanding *one kind* of entity or experience in terms of *another kind* – that is, understanding via metaphor.” (Lakoff & Johnson, 2003, p. 178) It should be noted that the metaphor highlights certain aspects, “and what is not highlighted is downplayed or hidden” (Lakoff & Johnson, 2003, p. 179). So models and theories could be considered as metaphors which shape our perceptions and understanding.

Communication literature refers to **frames**. Hence Severin, discussing the news media and quoting a conference paper, writes (emphasis added), “A frame can be defined as ‘a central organising idea for news content that supplies a context and suggests what the issue is through the use of **selection, emphasis, exclusion, and elaboration**’” (Severin, 1997, p. 320). As with analogy and metaphor, framing can be widely observed.³³ However, the approach of selection, etc., could also be used to describe theories and model building. Weaver, also in the communication literature, makes a connection between framing and agenda setting. He describes first-level agenda setting, where issues are selected (giving “what”), and second-level agenda setting, where attributes of the issues are determined (giving “how”). The first level could be called simply agenda setting, with the second level being framing (Weaver, 2007, p. 142).³⁴ The New Zealand Treasury is also aware of framing and agenda setting, as well as the importance of

³³ Cherry, a social psychologist, gives an interesting example both of framing and the way frames can change, partly as dominant issues and perspectives (or perhaps the conventional wisdom) change. She describes the case of a woman, Kitty Genovese, stabbed to death in public in 1964, when none of 38 witnesses did anything to help her:

“Intervening or turning away behaviours are best understood in historical and cultural context. The circumstances of Genovese's murder that I originally understood in individual behavioural terms became, during the 1970s, an instance of the general failure to intervene in the prevention of violence towards women. Now I use that incident as a springboard to understand how whole communities can be seen as vulnerable to unchecked violence.” (Cherry, 1995, p. 29)

³⁴ Weaver also refers to a concept with links to traction, “priming”, which occurs through the media, “making certain issues or attributes more salient and more likely to be accessed in forming opinions” (Weaver, 2007, p. 145).

persuasion, as components of the process of giving policy advice. It is not clear whether the framing implicit in the theories is also recognised, however:

“We frame issues and help set the agenda...Advice is compellingly presented...[Advice] pitched to suit the target audience – uses appropriate language, style and level of detail.” (Whitehead, 2008, p. 26)

To summarise, various bodies of literature have their own terms for very similar phenomena. They all suggest that our understanding is influenced by the perspectives taken, and theories and models perform this function also. Gitlin makes the connection with theories explicit: “Frames are principles of selection, emphasis, and presentation composed of little tacit theories about what exists, what happens, and what matters” (Gitlin, 2003, p. 6). As they affect our perceptions, they may result in distorted understanding. While this could be considered to be bias, Schudson, referring to the news media, gives an alternative, more benign interpretation:

“In the social sciences, the idea of bias has largely been replaced by that of ‘framing’...Framing is as central a concept as there is in the study of news. It moves the analysis away from the idea of intentional bias. That is, to acknowledge that news stories frame reality is also to acknowledge that it would be humanly impossible to avoid framing. Every narrative account necessarily presents some things and not others; consciously or unconsciously, every narrative makes assumptions about how the world works, what is important, what makes sense, and what should be.” (Schudson, 2003, pp. 35-36)

Lastly, here is a quote (and caution) from Richard Feynman, who was awarded the Nobel Prize for physics in 1965:

“I would like to talk about one more thing, and that is, how do you get new ideas?...That you do by analogy, mostly, and in working with analogy you often make very great errors.” (Feynman, 1998, p. 114)

In summary, it is inevitable that theories and models will be used to assist in our understanding, but they are not accurate representations of the real world. They are

partial, they may distort, and they may mislead. It is important that the nature of theories and, in particular, their limitations be understood. Otherwise the theories might be considered as definitive descriptions of real world situations.

3.2.2 Limits of theory

This section considers two aspects of the use of economic theory to draw conclusions about the real world. First, mainstream microeconomic theory focuses heavily on the concept of “market failure”, describing phenomena such as monopoly, oligopoly, externalities and public goods (Gwartney, Stroup, & Sobel, 2000; Varian, 1992). By providing a theoretical basis for contending that a policy change will result in a better outcome, the concept plays an important role in economic arguments for policy selection. As the underlying assumptions and theory are questioned by some non-economists (as described in Chapter 2), the issue is considered further here. Second, given that there may be several possible explanations of observed phenomena, we should note the reservations that should be made about conclusions based on evidence being “consistent with” theory. This is a very important and often overlooked aspect of explanations of observed phenomena. It can result in inflated claims being made about the value of a theory. Two examples are given to illustrate this point.

3.2.2.a Perfect competition and counterfactuals

Mainstream economic theory describes an economy with perfect competition everywhere as a form of ideal (McTaggart, et al., 2003). Consequently market failure is defined in comparison to this ideal. An alternative is needed for comparison, and value judgements must be applied to justify one situation being considered superior to another. The lack of such a comparator was mentioned in Chapter 2 as a relative weakness of political science. Its existence in economics raises two questions. First, is perfect competition the right “ideal”? Second, should economic analyses involve comparing a real situation with an ideal such as perfect competition, given that this ideal that is unattainable? The counterfactual is not a feasible situation. Hence Buchanan, in reference to the ideal society, referred to “the equivalence between the hopeless and the ideal” (Buchanan, 1975, p. 92). However, the specification of a counterfactual is an important aspect of any policy analysis.

First, a fundamental problem is the choice of perfect competition as the starting point for analysis. Theory is, in essence, an intellectual exercise whereby structures are presented and implications drawn. There is no a priori reason to assume that they in any way accurately reflect, or even closely approximate, the real world. Amartya Sen summarised the situation in his paper on “Rational Fools”:

“I am concerned here with the view of man which forms part of Edgeworth's analysis and survives more or less intact in much of modern economic theory. The view is, of course, a stylized one and geared specifically to tackling a relatively abstract dispute with which Spencer, Sidgwick, and several other leading contemporary thinkers were much concerned - namely, in what sense and to what extent would egoistic behavior achieve general good? Whether or not egoistic behavior is an accurate assumption in reality does not, of course, have any bearing on the accuracy of Edgeworth's answer to the question posed. Within the structure of a limited economic model it provided a clear-cut response to the abstract query about egoism and general good.” (Sen, 1977, pp. 320-321)

So economists have taken something that was intended as an intellectual exercise, extending it to become a combined answer to questions of “how people actually behave” and “how people should behave”.³⁵

Second, consider the issue of counterfactuals. Aristotle discussed the value of unattainable and attainable optima, “[T]he best is often unattainable, and therefore the true legislator and statesman ought to be acquainted, not only with (1) that which is best

³⁵ This is a paradoxical combination. If economists have worthwhile advice to impart, then some of the people without that advice are not making the best decisions. Consequently models depicting the economy based on “rational” decisions will be flawed. Conversely, if people are making the assumed decisions without assistance from economists, do economists have anything of value to offer? One solution to the paradox could be to argue that *market* decisions are correct, but *policy* advice from economists is required. However, that raises an alternative problem. An additional explanation is required for the selective ignorance whereby full understanding is observed in the market sphere, but limited understanding in the policy sphere. One suggestion, made on p.13 above, is that people may be familiar with market decisions, but not familiar with policy issues. If the paradox cannot be resolved, then the relevance of economic theory is in question.

in the abstract, but also with (2) that which is best relatively to circumstances”(Aristotle, 350 B.C E., Part 1). Demsetz makes a similar point, using the term “nirvana approach”³⁶:

“The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing "imperfect" institutional arrangement. This *nirvana* approach differs considerably from a comparative institution approach in which the relevant choice is between alternative real institutional arrangements.” (Demsetz, 1969, p. 1)

In epidemiology, four alternatives have been suggested as counterfactuals in relation to risk of disease. These are *theoretical minimum risk*, *plausible minimum risk*, *feasible minimum risk*, and *cost-effective minimum risk* (Murray & Lopez, 1999). These represent, in turn, the lowest risk imaginable, even if highly unrealistic; the lowest risk that might be considered possible, even if not currently realistic; the lowest risk that has been achieved somewhere, and thus is known to be attainable; and the lowest risk that could be achieved using all cost-effective means available. The economic “ideal” counterfactual would roughly parallel the theoretical minimum, while the others reflect the best we might ever expect to achieve, or the best that has been observed elsewhere, or the best that could be currently achieved using approaches that are known to be cost-effective.³⁷

Additional dimensions could be considered in a policy setting when selecting counterfactuals. For example, the timing of the alternatives, political acceptability, distribution of costs and benefits, and certainty of outcome may be relevant.

If the theoretical ideal considered a valid ideal, it can be interpreted as giving a measure of the extent to which imperfections lead to sub-optimal outcomes. There may be some value in this. However, for policy purposes we should not forget the Theory of Second

³⁶ Demsetz bases his criticisms in part on imperfect information and indivisibilities, which tie in to the Theory of Second Best, and also on issues of public sector failure.

³⁷ While economic theory is based on an equivalent of theoretical minimum risk, the econometric approach of frontier analysis is analogous to feasible minimum risk. This is one of several cases where economics and econometrics are based on different criteria, as discussed in relation to path B.

Best (Lipsey & Lancaster, 1956). An interpretation of this theory is that, if it is not possible to create all the conditions required for the optimal position, then it may not be beneficial to come closer to achieving some of them. In other words, perhaps we should be aiming for some other goal, as suggested by the alternative counterfactuals, although there may be significant information requirements that would have to be met.³⁸

The relevance, or the great significance, of the Theory of Second Best can be seen if we consider that any application of theory to the real world assumes that the conditions of the theory hold in reality. Whenever the theory does not accurately describe reality, second best conditions apply. As theory is based on simplification, second best applies.³⁹

For the purpose of this thesis, there is a possibility that economics is using an optimal that would not be meaningful, desirable, or widely accepted. Even if the optimal is chosen optimal is suitable as an ideal, that may not be a useful criterion for judging failures and interventions. Given the rhetoric of economics, it is necessary to explain these potential weaknesses. A recognition of them then opens up the possibility of other criteria and consideration of other aspects to be considered. Also, to avoid Type A errors, it is necessary to investigate issues beyond those assumed within particular theoretical models. The latter chapters of this thesis make a start on this process by looking at a broad range of evidence using a range of types and sources of data, many of which are only recently relatively accessible, coming from literature or qualitative

³⁸ Allan Rae has suggested that one reason for failure to reach agreement in international trade negotiations may be that the parties do not have a common interpretation of the situation. They are not all aiming for the theoretical ideal of free trade, but rather they each have their own alternative counterfactual in mind. This raises another point, namely that, where coordinated action is required, it may be better to have a common view that is incorrect, rather than individuals holding diverse views, each of which more accurately reflects the circumstances that they individually face. If so, it may be preferable that participants only have a vague (but common) understanding of the issues.

One challenge to the free trade argument is based on the differential treatment through sales taxes of exports and goods sold domestically. If countries differ in the emphasis they place on such taxes, it could be argued that high-taxing countries are effectively subsidising their exports (Birks, 2009a).

³⁹ This does not mean that the theoretical findings do not apply, but only that they might not apply. However, in practice there are many situations where they do not apply, as shown in several places in this thesis.

information available and searchable through electronic information technology. The chapters aim to identify and explore characteristics of law making and implementation as a basis for selecting models and concepts which may be relevant.

3.2.2.b Evidence consistent with theory

i) Dishonesty and commitment

There are several findings from economic theory that have been awarded great significance, purportedly being directly applicable to real world situations. Sometimes this is questioned, as by Sen (1977) on the desirability of a perfectly competitive economy as discussed above, and by Tullock (1992) on the paradox of voting.⁴⁰ Theory is based on simplification, and there may well be overlooked aspects that would result in a different interpretation.

This point may be illustrated in Sen's paper above. Sen gives an example of a one-off situation in which self-interested utility-maximising players would be dishonest:

“‘Where is the railway station?’ he asks me. ‘There,’ I say, pointing at the post office, ‘and would you please post this letter for me on the way?’ ‘Yes,’ he says, determined to open the envelope and check whether it contains something valuable.”
(Sen, 1977, p. 332)

In practice, many people would not behave in this way. Sen quotes Leif Johansen:

⁴⁰ Tullock suggested that competition over votes is generally determined in negotiations before the vote takes place. “Pork barrel politics” can also be a factor, in which case the result of votes by elected representatives may be based on factors other than the issue in question. This was illustrated in the passing by the US Senate of President Obama's health reform in the early hours of 21st December 2009. The last required vote was gained by Nebraska Senator Ben Nelson in exchange for a large amount of extra spending in his state. US correspondent Jack Hitt said:

“Most bills that are close often end up with just that one person. Everybody tries to hold out to be the last vote because you know that the goodies for your constituents will be lovely indeed.” (Hitt, 2009)
This also suggests that in such cases there is a disincentive to reveal true preferences.

“Economic theory...tends to suggest that people are honest only to the extent that they have economic incentives for being so. This is a homo oeconomicus assumption which is far from being obviously true, and which needs confrontation with observed realities.” (Sen, 1977, p. 332)

Sen then contends, “The presence of non-gains-maximizing answers, including truthful ones, immediately brings in commitment as a part of behavior” (Sen, 1977, p. 332). The suggestion is that real world behaviour differing from that indicated within a theoretical gains-maximising model suggests a particular alternative, non-gains-maximising interpretation. Instead of this interpretation, it could mean that the model’s specification overlooks real world phenomena that could explain the contradiction and show that the behaviour may still be gains maximising. Sen’s case for commitment relies on assumptions implicit in the model, and these may not reflect real-world conditions. In other words, rather than the evidence supporting the claim, it may result from the characteristics of the test. As Desai has pointed out, “...in confronting theories with facts, the method of testing does not play a neutral role” (M. Desai, 1981, p. 96). A method of testing may be inappropriate for the hypothesis and the available information,⁴¹ or there could be false positives and false negatives (Type I and Type II errors). In Friedman’s terms, there could be alternative hypotheses that are also consistent with the observations.

Hence, a key question to raise is whether the same results might be observed for another reason. Are there alternative explanations, or can the same result be achieved under other circumstances? Theories specify artificial environments based on a few variables, where other factors do not exist.

The simple models used by economists to consider behaviour may not be suitable for handling issues of honesty and accuracy of information. Sen’s example assumes that

⁴¹ Making a similar point, Dunn argues against the automatic application of accepted problem-solving techniques, describing the possibility of Type III errors. “Policy analysts...are often faced with the probability of a Type III error: incorrectly accepting the false hypothesis that there is no difference between the boundaries of a problem, as we have defined them, and the actual boundaries of that problem” (Dunn, 1997, p. 282). Type III errors could be considered as a statistical parallel of Type A errors.

people only learn from direct experience, so they are ignorant of all other things. If this applies in the real world, the resulting imperfect information would mean that markets are inefficient for all but the most mundane, routine transactions. In reality, information is spread by other means also.⁴² The significance of the simplifying assumptions of the game should be recognised. Consider the following four potential confounding factors. Signals can be given i) through reputation, or ii) through appearance (a “Dorian Gray” effect), or iii) there can be social conventions (“rules of the game”), or iv) there could be “potentially repeated” games:

First, a person’s *reputation* can be affected by past actions, and the information spread to people with whom future interactions may occur. In this sense, any game may be with someone in the informed and/or informing community. Similar significance could be attached to a person’s credit rating or criminal record, and as a reason for name suppression and charges of defamation. The essence of human society and development is that information can be gained and shared without requiring direct personal experience. People’s behaviour can affect their reputations, and this can be important for them.

Second, even without interpersonal transmission of information, signals may be given to others through what could be termed a “*Dorian Gray*” effect. According to the story, “The Picture of Dorian Gray” by Oscar Wilde, Dorian got his wish that he be able to live life as he chose, with his appearance untarnished by his experiences, while instead, “the face on the canvas bear[s] the burden of his passions and his sins” (Wilde, 1993, p. 78).⁴³ For the purposes of the point here, a person’s past actions may be reflected in their appearance. Others will perceive this according to the extent that they are able to read character traits such as honesty, consideration, or selfishness.⁴⁴

⁴² Note, for example, Hardin’s “street-level epistemology” as described below (p.116).

⁴³ Oscar Wilde made an alternative suggestion (quoted in a letter dated 17 April 1898 from Robert Ross to Leonard Smithers), “A man’s face is his autobiography. A woman’s face is her work of fiction.” (Wilde, 1962, p. 730n)

⁴⁴ One US text for attorneys discusses in some detail the importance of appearance for the credibility of witnesses (Social Psychology Resource Library, 2002, Chapter 10).

The information conveyed by these means may be inaccurate, or may not be a good predictor of future behaviour. Therefore there is still scope for players to misread a situation or to mislead others through trickery or deceit, for example. Consequently some may place particular emphasis on presenting a clear signal of honesty.

Third, there is an additional dimension in terms of there being generally accepted *rules of the game*. In other words, by some informal collective agreement or convention, it may be determined that people should behave honestly in such exchanges. The gain for all is an increased level of trust, reduced risk, and improved exchanges between members of society. A parallel in economics is common acceptance of money as a medium of exchange. Without trust, levels of co-operation would be much lower. This would cost everyone, including those who breach the trust. Society may also wish to stigmatise those who behave contrary to the rules, giving an additional incentive for compliance.

Fourth, there may be a difference in the optimal strategy in repeated games, as compared to one-off games. Possible reasoning is described for the prisoner's dilemma in Luce and Raiffa (1957, pp. 94-102). Unlike the theory, real world situations can take the form of repeat games, or *potentially repeated* games (there could be uncertainty as to whether one might have an additional encounter with a particular party).

These four possibilities could explain why some people might behave honestly out of self-interest even though it is contrary to the prediction of a game such as that considered by Sen.⁴⁵ This suggests that, while simple models may indicate some possibilities, they will ignore many aspects. Some of these aspects may be central to real world behaviour. Consequently, it should not be claimed that understanding of the world immediately follows from basic theoretical findings in pared-down environments. In the context of this example, it may be that the issue of honesty and behaviour cannot be resolved through recourse to simple models.

ii) Theoretical rationality

⁴⁵ The importance of trust, identity and beliefs have been explored in an economic history context by several writers (Greif, 2009).

Tversky and Kahneman are well known for a celebrated finding in behavioural economics which is considered to show that a basic assumption in economics does not hold. They suggest that people violate rational choice requirements of consistency and coherence due to “psychological principles that govern the perception of decision problems and the evaluation of options”, such that, “We have obtained systematic reversals of preference by variations in the framing of acts, contingencies, or outcomes” (Tversky & Kahneman, 1981, p. 453).⁴⁶ The use of the term “framing” is worth noting. In their summary, they suggest that, “The dependence of preferences on the formulation of decision problems is a significant concern for the theory of rational choice” (Tversky & Kahneman, 1981, p. 453).

Their finding is illustrated by their now classic example (with numbers and percentages of respondents in brackets):

“Problem 1 [N = 152]: Imagine that the U.S. is preparing for the outbreak of an unusual Asian disease, which is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimate of the consequences of the programs are as follows:

If Program A is adopted, 200 people will be saved. [72 percent]

If Program B is adopted, there is 1/3 probability that 600 people will be saved, and 2/3 probability that no people will be saved. [28 percent]

Which of the two programs would you favor?

The majority choice in this problem is risk averse: the prospect of certainly saving 200 lives is more attractive than a risky prospect of equal expected value, that is, a one-in-three chance of saving 600 lives.

A second group of respondents was given the cover story of problem 1 with a different formulation of the alternative programs, as follows:

Problem 2 [N = 155]: If Program C is adopted 400 people will die. [22 percent]

If Program D is adopted there is 1/3 probability that nobody will die, and 2/3 probability that 600 people will die. [78 percent]

⁴⁶ This finding has also been used in advice to attorneys on how to frame an issue to get the support of a jury. (Social Psychology Resource Library, 2002, Chapter 17)

Which of the two programs would you favor?

The majority choice in problem 2 is risk taking: the certain death of 400 people is less acceptable than the two-in-three chance that 600 will die.”

(Tversky & Kahneman, 1981, p. 453)

They give one explanation for their findings. Here is an alternative hypothesis. Tversky and Kahneman suggest that the outcomes in the two problems are actually identical because the numbers living and dying in each option are the same. Hence they assume that the framing is distorting because it shapes perceptions differently.

Consider, as a basis for alternative hypotheses, that the payoffs to the decision maker may not be specified in terms of lives saved or lost (under which the two problems are identical), but are linked to perceptions of the choices. These may differ over the two problems. To illustrate, in problem 1, the focus is on the 200 who could be saved with certainty, in which event option B would involve risking the lives of these people. In problem 2, by contrast, the focus is on the 400 who would face certain death under program C, but who might be saved under program D. The choice of the risky option is then one of possibly saving these 400 from otherwise certain death.

For one hypothesis, Tyler (2000, p. 123) has suggested that people may accept different treatment of people according to group membership.⁴⁷ In this case, two groups are defined, with one group emphasized in the first formulation and the other emphasized in the second. If the decision makers are led to identify with the first group, the certain survivors, they may not wish to risk their lives. If they identify with the second group, the certain fatalities, they may choose the risky option in an attempt to save them.

For a second hypothesis, participants may interpret the difference in the framing of the options as reflecting society's preferences, and hence the payoffs they would face. Payoffs depend on other people's perceptions, and are measured in terms of these other

⁴⁷ Similar thinking on an individual level is the basis for Rawls' requirements of a "veil of ignorance" and an "original position" in his theory of justice. Note also, "...we judge less harshly those malefactors who are most like us and with whom we can therefore empathise most easily" (Posner, 2007b, pp. 89-90). The issue of group identity and its implications arises in several areas. It is discussed further below in section 3.2.4.b.

people's responses. A choice of the risky option could then result in being seen by others (their superiors, or public opinion, say) as risking the lives of the 200, and possibly being blamed for causing their deaths. Alternatively, it could be seen as trying to save 400 from certain death, and being praised if the gamble pays off. Should they risk the lives of 200, or take a risk to try to save 400? There could be a difference in terms of praise or blame in the perceived payoffs for the two problems.

Tversky and Kahneman write of the importance of the "reference outcome" against which other outcomes are "perceived as positive or negative". "The reference outcome is usually a state to which one has adapted; it is sometimes set by social norms and expectations..." (Tversky & Kahneman, 1981, p. 456). It is only a short step from there to suggest that the decision makers will also be judged, and rewarded or penalized, according to those norms or expectations. Consideration of rationality should then focus not on the decision maker, but on the society and the institutions. It should be defined not within the simplified world of the theory, but in the actual context in which the decision makers are operating.

Differing incentive structures affecting payoffs and hence willingness to take risk are not unknown in economics. For example, William Niskanen has discussed the incentives faced by bureaucrats, suggesting that they would be risk averse due to asymmetry in rewards and penalties for good or bad outcomes (Niskanen, 1973, p. 23).

In summary, we should not be too quick to assume irrational behaviour simply because observed decisions do not match those hypothesised within the simplified environment of a model.⁴⁸ The real world may be more complex. More generally, while a theory may be consistent with our observations, there could be other theories that fit just as well. Hence, as a general point, when it is found that evidence "supports" a theory, it should be considered as indicating that the theory is one possible explanation of the evidence, but the analysis should not stop there. There may be numerous alternative explanations also.

⁴⁸ Posner describes such examples as "common cognitive limitations", mentioning what he calls the "sunk cost" fallacy, the "endowment effect", "mirror imaging", "hyperbolic discounting", and so on (Posner, 2007a, pp. 17-18). As he then points out, such behaviour may seem irrational according to a simple structure, but there may be more complex, rational explanations.

Both the examples in this section could have implications for the operation of the law and the strategies and decisions of litigants. Taking the first example, signals about trustworthiness, or stubbornness, or a track record of winning in court, can have implications for a party in the event of subsequent legal issues. On the second example, if there are parallels to gains and losses effects in terms of winning and losing, a particular outcome seen as a win would not be viewed as equal to the same outcome if it is perceived as a loss. Care should therefore be taken when considering the real-world significance of results drawn in the context of theoretical structures.

3.2.3 Accepting or rejecting a theory

Theories serve as tools that may aid us in our attempts to understand our environment and to make decisions. They are widely used in economics, with many courses at different levels focusing heavily on theoretical representations (Baumol & Blinder, 1991; Varian, 1992, 2006). As with any tools, care must be taken in their use. There are alternative views on how those who favour a theory can or should react to criticisms of that theory. Three arguments that are sometimes used in response to such criticisms are described below. They all have flaws and can lead to problems. A fourth option is then discussed. The options are:

- 1) Accept current theory as a matter of faith;
- 2) Do not look outside current theory as long as it can give **SOME** explanation of an observed phenomenon;
- 3) Do not reject a theory, even if flawed, unless the challenger can present a superior alternative;
- 4) Take a more pragmatic approach.

The first three views could be considered as being logically flawed. Alternatively, they could be described as rhetorical arguments that are persuasive for the target audiences and are used by people who want to maintain a particular position. The four views are discussed in turn.

3.2.3.a Accept current theory as a matter of faith

Several writers have voiced concern at a perceived debasement of academic standards. Mark Bauerlein (2001), referring to social constructionism⁴⁹, is one:

“When someone holds a belief philosophically, he or she exposes it to arguments and evidence against it, and tries to mount arguments and evidence for it in return. But in academic contexts, constructionist ideas are not open for debate. They stand as community wisdom, articles of faith.”

E J Mishan’s similar but more general assertion, eight years earlier, bears repeating:

“Over the last three decades ideological doctrines have infiltrated the curricula of many of the larger universities. Spurious academic subjects ... putatively designed to 'raise consciousness' and strengthen commitment to credos of 'emancipation', manifestly fail to meet the stringent requirements of scholarship. Certainly the doctrines of these ideologically inspired 'studies' are not regarded by their proponents as provisional and refutable hypotheses. Clearly arrangements being made for their systematic propagation in these circumstances do not comport well with the idea of a university as a forum for open-minded enquiry and impartial scholarship.” (Mishan, 1993, p. 202)

Mishan’s assertions would be supported in a chapter on feminist research (B. Smith & Noble-Spruell, 1986).⁵⁰ Similar points have been made in relation to the academic

⁴⁹ “...a simple belief system, founded upon the basic proposition that knowledge is never true per se, but true relative to a culture, a situation, a language, an ideology, or some other social condition” to be contrasted with the alternative position that “at least some knowledge is independent of social conditions” (Bauerlein, 2001).

⁵⁰ On feminist research, the writers discern:

“...a number of themes and assumptions about its nature, from which various attempts at practice have been developed.

1. Feminist research should be for women, to improve their daily lives... 2. Feminist research should be based on feminist theory... 3. Feminist research is premised on the oppression of women and is committed to changing it... 7. Feminist research attempts to develop a specific methodology congruent with feminist ideology.” (B. Smith & Noble-Spruell, 1986, p. 139)

environment in New Zealand with particular reference to requirements based on ethnic dimensions (Openshaw & Rata, 2008).

Nevertheless, similar criticisms could also be made against many academics, although without such a clear political motivation.⁵¹ Economics may also fit this description. Greenspan is not alone when he takes an ideological stance. Of course, we could echo Schudson and say that this is not a matter of bias, but rather an effect of the framing of economic theory. The suggestion in this context would be that, while economic theory may be based on “provisional and refutable hypotheses”, the basis may seldom be questioned, and it may even be considered that the issues have been fully debated and resolved, or, at least, so well entrenched as to be accepted as a starting point for any analysis.⁵² Kuhn writes:

“Normal science, the activity in which most scientists inevitably spend almost all their time, is predicated on the assumption that the scientific community knows what the world is like. Much of the success of the enterprise derives from the

⁵¹ This observation was made in a less serious, but perceptive, book where Harper wrote:

“To you and me, a paradigm crack-up would appear to be the most exciting thing imaginable in an academic career...To an academic it’s pure poison, and that’s because he has a mortgage to pay. Including, of course, an intellectual mortgage – an academic has invested his whole life in the learning and exposition of a certain set of facts and it’s too much to ask that he retrain at his time of life.” (Harper, 2006, p. 76)

Mende suggests that academic disciplines have “research processes and knowledge products” which have become fashionable, and so supervisors insist on their use by students, who then become supervisors, and so on (Mende, 2005, p. 199). Accepted practices within disciplines may mean that peer review, while a method of quality control, may also mean instead that the work has conformed to the established conventions, even if these are questionable.

⁵² There may be institutional biases favouring this approach. One text on undertaking research states of the literature search phase, “Where there is a copious literature the researcher may never have to go beyond this initial subject to amass sufficient references” (Sharp, Peters, & Howard, 2002, p. 87). Consequently, research may only be undertaken within the dominant frame (building on and accepting the general foundations outlined in a literature review). The alternative is recognised by Saville-Smith, who writes in a Ministry of Social Policy report, “Because certain factors and/or certain dimensions have been extensively researched does not mean that those factors or dimensions are more important...than those that have not been extensively researched” (Saville-Smith, 2000, pp. 9-10).

community's willingness to defend that assumption, if necessary at considerable cost." (T. S. Kuhn, 1970, p. 5)

It is interesting to note a paper by Joan Robinson in which she said the following:

"Professor Ferguson, in *The Neoclassical Theory of Production and Distribution*, asserts that belief in neo-classical theory is a matter of faith. 'I personally have the faith', he declares..." (Robinson, 1970, p. 309)

In this instance, the topic was a problem of the indivisibility of capital, which then causes difficulties in relation to marginal analysis. Robinson concludes:

"No doubt Professor Ferguson's restatement of 'capital' theory will be used to train new generations of students to erect elegant-seeming arguments in terms which they cannot define and will confirm econometricians in the search for answers to unanswerable questions. Criticism can have no effect." (Robinson, 1970, p. 317)

At least according to Robinson, students could be persuaded to accept such a view, although it is not based on logic. Dunn's modes of argumentation could be consulted to consider why this may be possible, with argumentation by authority being a contender.

About the same time, Sumner Rosen made a similar point to that made by Robinson:

"Long ago economists opted for a separation of their studies from fundamentals. In so doing they adopted a prevailing American view that the fundamentals are not in question. The older fashion of joining economic and political concerns into political economy passed from the scene." (Rosen, 1972, p. 417)

For an alternative explanation, Edward de Bono, in his book, *The Happiness Purpose* (de Bono, 1979), referred to religions as examples of meta-systems. It would seem that the body of economic thinking could serve some of the same functions.

"Decision is easy when a powerful meta-system provides the values...It is in this area of simplifying decisions that meta-systems tend to be most powerful in action.

And it is this practical power in action that gives meta-systems their appeal. People tend to take up a belief or meta-system because it reduces the confusion of their lives by making decisions so much easier.” (de Bono, 1979, p. 23)

From a very different source, the following was written by Pope John Paul II (original emphasis):

“[T]here are in the life of a human being many more truths which are simply believed than truths which are acquired by way of personal verification...This means that the human being—the one who seeks the truth—is also *the one who lives by belief*.” (Pope John Paul II, 1998, para.31)

In summary, and to use an alternative terminology, it could be said that economic theory provides frames that have come to be widely accepted among economists to shape perceptions of economic phenomena. They are accepted ways to perceive the phenomena, and consequently they both enlighten and restrict the aspects that are observed.⁵³ Given the link between frames and agendas, taking a step back one could consider whether economic theory has tended to set the agenda itself. In other words, has economics specified not only the approaches to issues, but the selection of issues and questions to be considered (and those to be overlooked) by economists?

3.2.3.b Do not look outside current theory as long as it can give SOME explanation of an observed phenomenon

“When examining normal science...we shall want finally to describe that research as a strenuous and devoted attempt to force nature into the conceptual boxes supplied by a professional education.” (T. S. Kuhn, 1970, p. 5)

⁵³ See also Latour (1987) for a similar approach to science. He presents a critique of the framing whereby a science is seen as consisting of knowledge, as compared to irrational beliefs held by those outside the science. Knowledge may be based on the particular perspective, and “irrational belief” may be rational if seen in the right context.

“The conventionalist view stresses the organizational function of theories: theory construction is undertaken to organize a complex of facts into a coherent whole. In the words of philosopher Joseph Agassi, theories are "mathematical systems which serve as pigeon-holes within which to store empirical information". In this view, theories are again neither true or [sic] false, but are posited for a time as being true by convention, given consensus within a community of scholars. The primary conventionalist criterion of theory choice is simplicity: the simpler theory organizes the facts better. But only revolutionary conventionalists try to find ever simpler theories; **conservative conventionalists attempt to preserve existent theories by building onto them ever more elaborate (critics would label them ad hoc) peripheral systems.**” (Caldwell, 1980, p. 367)

In the first chapter of his economics textbook, Eugene Silberberg attempted to show “the powerful nature of the economic paradigm” (Silberberg, 1990, p. 9). He took as an example the rise in women’s labour force participation in the generation up to 1990, seeking an economic explanation. He referred to constancy of tastes as a simplifying assumption in the neoclassical economic paradigm. Moreover, “to accept (changed tastes) as an explanation of observed events is to abandon the search for an explanation based on systematic, and therefore testable, behavior” (Silberberg, 1990, p. 7). Hence, “We reject out-of-hand any explanation based on changes in tastes” (Silberberg, 1990, p. 7).⁵⁴

He identified, as a “wide ranging constraint that changed during the 1960s”, the ratio of young women to men a few years older. The post-WWII baby boom meant that there was a shortage of marriageable men for these women due to lower birth rates in the war years. Marriage was not an option for many young women, and so they pursued careers.

This is plausible, assuming low rates of divorce and no change in the relative ages of marriage partners. Silberberg goes further, predicting a return to more traditional lifestyles during the 1990s as the gender imbalance disappears. The economic paradigm may be powerful, but events in the 1990s did not support his prediction. There was a

⁵⁴ Note, however, Bowles (1998) on endogenous preferences.

levelling off of female labour force participation, but no sharp drop in the 1990s, and there was increased participation by mothers.⁵⁵

It could be asked why he found it so objectionable to consider the possibility of changes in tastes. They may not be unobservable, and even if they are difficult to identify, it could be wrong to disregard them simply because there is an alternative plausible explanation. The existence of one possible explanation does not exclude the possibility of others. If each generation has its own perceptions (possibly distorted⁵⁶), why shouldn't tastes change?

Silberberg illustrates what could be called “paradigm-based reasoning”, whereby it is important to explain events within a particular paradigm (or frame, or analogy). The result is then considered to be sufficient, even though there may be alternative explanations. This is similar to the idea of “consistent” results. For example, someone could present a hypothesis and find it supported by the data. The data could also be consistent with a wide range of alternative hypotheses, but these are not explored.^{57 58} Not only is the presence of alternative consistent hypotheses possible, but, according to Milton Friedman, it is inevitable⁵⁹:

⁵⁵ See Davis (2002).

⁵⁶ see Birks (2005).

⁵⁷ This point can be important in law, in that evidence can be “consistent with” a proposed interpretation. While it may therefore be persuasive, there could be numerous alternative explanations of the same evidence that are not presented. An example of this point from case law is given by Robertson (B. Robertson, 2003). He explains why it was meaningless for an expert witness' to claim evidence of post-traumatic stress disorder (PTSD) as demonstrating sexual abuse. Although PTSD is consistent with sexual abuse, “there is no behaviour that is inconsistent with sexual abuse”.

⁵⁸ Posner is well aware of the possibility of evidence being consistent with alternative explanations, giving three alternatives for evidence of possible “internal inefficiency” of administrative agencies (where they fail to minimise the costs of pursuing their goals). The evidence was: i) pursuit of seemingly trivial cases; ii) lower pay for agency personnel; and iii) personnel frequently leaving for better paying jobs in the industry being regulated. Alternative explanations of points (ii) and (iii) are based on an assumed improvement in skills and experience as a result of employment by the agency.

⁵⁹ Also note:

“[A] hypothesis is rejected if its predictions are contradicted (‘frequently’ or more often than predictions from an alternative hypothesis); it is accepted if its predictions are not contradicted; great confidence is attached to it if it has survived many opportunities for contradiction. Factual evidence

“Observed facts are necessarily finite in number; possible hypotheses, infinite. If there is one hypothesis that is consistent with the available evidence, there are always an infinite number that are.”⁶⁰

(M. Friedman, 1953, p. 9)

In terms of reasoning, Silberberg’s approach allows people to cling to a paradigm (or analogy without considering alternatives until it fails so badly that it has to be rejected. This may hinder, rather than assist, understanding. It raises the bar to a level at which many theories would be virtually non-falsifiable.⁶¹ Equally dangerously, it could lead us to have an inflated view of our level of understanding.

At an extreme, it may be that a theory will never fail to the extent that it is rejected by its adherents. Lakatos, criticising scientific methodology, constructs an example to illustrate his contention that “the most admired scientific theories simply fail to forbid any observational state of affairs” (Lakatos, 1970, p. 100), so they cannot be disproved. Any contrary evidence can be explained in some way that allows continued acceptance of the theory. If a planet does not follow the expected orbit, there in an unobserved planet causing the deviation, for example (Lakatos, 1970, pp. 100-101). Desai describes the difficulties in resolving disputes about theories, suggesting that the techniques available are such that it may be very difficult to conclusively show that a theory fails to fit our observations.⁶²

can never ‘prove’ a hypothesis; it can only fail to disprove it, which is what we generally mean when we say, somewhat inexactly, that the hypothesis has been ‘confirmed’ by experience.” (M. Friedman, 1953, p. 9)

⁶⁰ Despite the major increase in availability of information through new information technology, the information is finite, especially in relation to specific events or phenomena, and some necessary information may be unobservable or “non-verifiable” (see p.173).

⁶¹ For many entertaining and graphic examples in a historical context, see Harper (2006), who makes this specific point on evolution, with any new species being a branch from some unknown source (Harper, 2006, p. 92). Darwin made the same point himself (Darwin, 2003, p. 159). Harper’s point is even more strongly made if an additional requirement applies as in section 3.2.3.c, namely the alternative must be superior to the existing theory in terms of claimed (not necessarily actual) performance.

⁶² See Desai (1981, Chapter 3) on “The methodology of testing economic theories”.

For an additional illustration, Pierson argues that supporters of intergovernmentalism⁶³ can find some consistent explanation for various events that at first appear to contradict their theory. Consequently, “absent a theoretically based explanation...these detailed investigations will not persuade proponents of intergovernmentalism” (Pierson, 1996, p. 125). That they are not persuaded without an alternative theory to adopt does not mean that they would switch were such a theory to exist. It is a possibility, however, as discussed next.

3.2.3.c Do not reject a theory, even if flawed, unless the challenger can present a superior alternative

This approach involves the use of something that is known to be misleading in preference to admitting ignorance. Writing on econometrics in *The Economic Journal*, Peter Phillips quotes Hoover, who makes a claim about scientists: “even accumulated falsifications or anomalies do not cause scientists to abandon an approach unless there is the prospect of a better approach on offer” (Phillips, 2003, p. C27).

In law and economics, Harkrider (2005, p. 7) describes judges accepting flawed econometric evidence because the other side failed to provide alternative analyses. Also, Swanson, writes:

“To contest the good judgement of judges and juries does not seem constructive criticism to me, unless there is some alternative decision-making device that is shown to perform more acceptably.” (Swanson, 2002, p.540)

Swanson is supported by Grofman who is defending economics, “...you can’t beat something with nothing, and so it is not enough to show that some given rational choice model does not fit the data, it is necessary to show that some other perspective leads to a model with better fit and predictive power” (Grofman, 1993, p. 240).

⁶³ Intergovernmentalism considers international organisations as playing a passive role in negotiations between participating states. (Pierson, 1996, p. 130)

McCain(McCain, 1992, p. 28) and Ormorod (2001) make a similar point, and the failure to present an alternative body of theory has been given as an explanation for the low level of attention given to Coase's point on transaction costs (p.25 above). There are problems with this viewpoint. Should people use something that is known to be harmful rather than admit ignorance? Is it unacceptable to identify a problem unless a solution can also be offered? Is it not also important to acknowledge the errors and limitations of accepted approaches?

The alternative position also has its supporters. Lakatos, discussing Popper, says, "He still construes 'falsification' as the result of a duel between theory and observation, without another, better theory *necessarily* being involved" (Lakatos, 1970, p. 181). Similarly, Sowell said of Stigler, "When shattering theories with gusto, Stigler seemed utterly uninhibited by the question, 'But what would you put in its place?' Nor should he have been" (Sowell, 1993, p. 787). Nevertheless, as has been shown, on several occasions criticisms of a theory or the presentation of contrary evidence have been dismissed on the basis that a superior alternative has not been presented. This is not a valid reason for ignoring flaws in a theory.

3.2.3.d Take a more pragmatic approach

The ways of thinking about theory described above are not uncommon. They may be a product of the way in which economic theory is commonly taught, with little or no attention to the importance of theory as analogy rather than as a description of the real world. Each of the three approaches results in an understatement of weaknesses in understanding, downplays the fact that support for a theory only requires consistency with the considered evidence, and reduces the search for and receptiveness to alternative explanations. This limits the opportunities for expanded understanding through consideration of alternative perspectives and alternative information that is not amenable to incorporation into the accepted theoretical approaches (such as when contrary to the assumptions made in the theory)..

At the AWH Phillips symposium held in Wellington, New Zealand, in July 2008, keynote speaker Sir Clive Granger reiterated the point that the best forecast is a mix of forecasts. His 1969 paper with Bates contended, in particular, that this is likely to be the

case where different variables or information are used for the alternative forecasts (Bates & Granger, 1969). A similar point could be made about theories. If, as for the blind men of Indostan, each theory is a simplified, partial perspective on an issue, a superior understanding may be gained from a combination of theories.

The information for the public on the 2008 award of the Nobel Prize to Paul Krugman includes the statement:

“Today, the general view is that the basic mechanisms specified by Krugman constitute an important complement to the traditional Heckscher-Ohlin theory. The truth, as in so many other instances, is that reality encompasses features of both theories.” (The Royal Swedish Academy of Sciences, 2008, p. 2)

Similarly, Gordon Tullock writes, “I have given you a number of theories on how regulatory agencies act and I regret to say that instead of telling you now which one of them is true, I think all of them are partly true” (Tullock et al., 1983, p. 10).

Gitlin, after outlining Gans’ classification of theories on the selection of items for the news, writes, “As Gans points out, each of these theories has something to recommend it, and each falls short of completeness” (Gitlin, 2003, p. 251). Together, they give a more complete picture.

Socrates would contend that it is better to acknowledge what we do not know rather than to cling tenaciously to unsupported and contradicted beliefs.⁶⁴ In other words, it is wise to acknowledge the limitations of our understanding, rather than to proceed on the basis of false confidence. This can sometimes be of great practical importance, as with the acknowledgement that it was unrealistic to expect to “fine tune” an economy with the policy instruments available. Occam’s razor is used to describe the point that simpler explanations are better, *ceteris paribus*. However, there is a danger that, by focusing on simple explanations, automatically assuming they are valid, not looking

⁶⁴ See paragraphs 7-9 of (Plato). Note also Mill (1956, p. 49) on being open-minded. While Mill’s open-mindedness is helpful for someone seeking to undertake quality analysis, it may not be advisable for someone active in a political environment based on agenda setting and denial, with groups competing for their ideas to dominate.

beyond a narrow, accepted perspective, or rejecting valid criticisms unless alternative superior solutions are presented, results an inflated sense of the extent to which issues are understood.

A pragmatic approach would result in a qualified use of theory-based understanding. Alternative evidence can result in two key qualifications that should be recognised:

- a) Valid criticisms should be recognised as limitations of current understanding (and hence on our ability to intervene);
- b) All theories should be recognised as being partial, and they are analogies for, rather than representations of, the real world. They result in the framing of issues, so it is prudent to use a mix of theories.

These points can be stated in another way. A good theory is judged on the two possibly conflicting objectives of simplicity and of breadth of explanatory power. However, rather than considering that there are “theories” that may “explain” the evidence of the real world, it should be recognised that there are “analogies” that may be “consistent with” the evidence of the real world (and may then in addition possess some explanatory power). To take the latter to be the former is to overstate the level and value of our understanding. For that reason, the later chapters of this thesis are not based on a single theoretical approach. Rather, they draw on a range of sources and apply a variety of concepts to a wide range of data, including qualitative data, in an attempt to identify diverse characteristics of the law making and implementation process in the real world. As described in Chapter 7, there are parallels with the approach taken in health economics. In future research, further analyses can build on such a base.

3.2.4 Two additional considerations

“In the critically important discussion about the actual solutions to real-world problems, no set of theoretical tools is likely to be fully adequate. Such problems are, almost by definition, too complex to allow theory to be applied simply and straightforwardly.” (Buchanan, 1967, p. 196)

The economic theory that underpins many policy recommendations addresses only some of the issues associated with policy making. This subsection contains a brief discussion of some additional aspects that have to be considered for a comprehensive assessment.⁶⁵

As shown on p.24 above, according to the New Zealand Commerce Commission theoretical structures may provide only poor representations of economic phenomena in the real world. Theoretical analyses are based on simplified structures. While it is hoped that they identify key aspects of a problem, there are additional factors to consider in relation to real world issues. Some of these are referred to in a New Zealand Treasury document (Whitehead, 2008). Hence, on analysis using relevant frameworks, there are requirements that:

“[A]ssumptions behind the frameworks used are explicit and consideration has been given to how they will be expected to play out in the real world (a world which includes information and transaction costs, market failure, government failure, etc)... Advice considers the long-term implications of decisions and provides a perspective that goes beyond immediate impacts... Issues of implementation, technical feasibility, practicality and timing are considered and advice accurately identifies compliance, transitional, legislative, revenue and administrative implications and costs.” (Whitehead, 2008, p. 26)

Two factors to consider in the context of such frameworks are i) the use of static analysis and ii) the treatment of individuals as autonomous units.

3.2.4.a Static analysis

The basic approach of economic theory takes economic factors in isolation, frequently framing the issue as one of reliance on markets or on government. The resulting viewpoint could be viewed as a simplification. Avinash Dixit, considering traditional views on markets and market failure suggested:

⁶⁵ Further aspects on evaluation are discussed in section 4.2.

“...the traditional dichotomy of markets versus governments, and the question of which system performs better, largely lose their relevance. Markets and governments are both facts of economic life, and they interact in complex ways. We cannot find feasible improvements by wishing away one of the components.” (Dixit, 1996, p. xv)

Even within economics approaches, application may not be straight forward due to the emphasis in theory on static and comparative static analyses. There are other, real-world, aspects which must be considered. Two in particular are dynamics and timing.

i) Dynamics

Static and comparative static analyses focus on equilibria and optima. The issue of behaviour when not in these positions, essentially the processes of adjustment, if and how they occur, are not included in the theory.⁶⁶ If adjustment to equilibrium is slow, then the real world experience is likely to be one of disequilibrium. This also means that policy or law changes which alter equilibria will result in adjustment patterns which take time and could have significant implications. Consequently, when considering a law change it may not be enough to think only of behaviour when everyone has fully adjusted to the new law. There can be efficiency, equity and incentive effects arising from the change. For example, a change in some subsidies or taxes can be capitalised, as with changed land values, due to altered expectations of future income/benefit streams.⁶⁷

The limited consideration of adjustment in a static analysis framework highlights a broader limitation of the approach. One alternative perspective is to take a historical

⁶⁶ Marshallian and Walrasian market adjustments describe simplified processes to support claims that there are forces which lead to change when a market is not at equilibrium. While this can mean that a particular equilibrium may be either stable or unstable, the concepts have generally been used to justify the focus on equilibrium positions. The cobweb model goes a step further in showing possible patterns over time, subject to its own behavioural assumptions.

⁶⁷ There can also be implications arising from uncertainty about change, as with neighbourhoods earmarked for potential redevelopment.

view in which the course of events through time is central.⁶⁸ In contrast to historical institutionalism, for example, economic theory commonly takes a “blank sheet of paper” approach, just considering the before and after situations without regard for path dependence.

ii) Timing

When the limitations of static analysis are recognised, additional concerns emerge. In particular, the importance of timing becomes apparent. Policy changes affect the future, and so it is necessary to identify future circumstances. This comes under the broad heading of forecasting, with forecasts being required both on the problems and on the effects of the policy options being considered. While theory can suggest directions of responses to a policy change, for practical purposes it is also necessary to identify possible magnitudes of responses. Common economic measures include elasticities of demand and multipliers. Future values of such measures are not easy to predict. It can be harder to estimate important legal measures, such as response of crime rates to changes in length of prison sentences. As a basic constraint, the only available information relates to the past, and so there has to be a stable underlying structure observable in the past and applicable to the future. Some quantitative estimation problems are discussed in section 4.1 below.

The timing issue is linked to delays in the policy making and implementation process, commonly referred to as lags. A good basic description can be found in Vane and Thompson (1993, pp. 195-198), and key points are summarised in Birks (2007c). These timing issues affect the information requirements for, shape the adjustment processes of, and are relevant for the feasibility and desirability of policy interventions.

There are other approaches, more commonly given attention outside economics, which rely on history, as with historical institutionalism, and on consideration of path dependence or process. By definition, static analysis is not well suited to these, tending instead to see each change in isolation rather than being one of several steps to be taken

⁶⁸ Consider also time series analysis as compared to econometric modelling.

over time. As these aspects may be important in law making and implementation, they are given consideration in the later chapters of this thesis.

3.2.4.b Individuals or groups?

Mainstream microeconomic theory assumes individuals with exogenous preferences (McTaggart, et al., 2003; Sloman & Norris, 2008) . This simplifying assumption is important. If relaxed, doubts would arise as to the meaning of wellbeing and of preferences expressed through markets, the political process, or economic evaluation methods (McCain, 1992, p. 153). However, the persuasive influence of some over others by virtue of authority has already been mentioned, and the exogeneity assumption is also put in doubt by evidence on group perceptions and behaviour. Group cultures exist.⁶⁹ They are an inherent part of any organisation, with its hierarchies, procedures and processes, and its framing of issues. They apply within academic disciplines, professions, institutions and elsewhere. Different group cultures can co-exist in the same society. They may be benign, beneficial or harmful.

Consider the differing approaches that various social sciences may take to the analysis of the same phenomena. Discussion above on theories and disciplines suggests that members of a discipline (economists included) are likely to be subscribing to partial assessments that are inconsistent with those of other disciplines. In relation to this thesis, politicians are grouped by party, lawyers by profession and common training, and those working in a court by institution. Group cultures, understandings and accepted reasoning and behaviours may be significant influences on outcomes. They may also be important when considering what should be thought of as rational behaviour.

This call has been taken up to some extent within the discipline, with attention being given to the work of Tversky and Kahneman (1981) and the growth of behavioural economics. However, there are other well-known phenomena that could also be considered. Here are three examples that are well known because they are extreme. If

⁶⁹ Mayo has given mainstream economics assumptions about individuals the label the “rabble hypothesis”, objecting to the representation of society as unorganised individuals (Perrow, 1986, pp. 59-60).

extreme outcomes such as these can occur, it can be expected that numerous less dramatic instances also arise under more normal circumstances.

1. The Stanford prison experiment

This was first conducted at Stanford in 1971, and involved subjects being allocated the roles of either prison guard or prisoner (Zimbardo, 1999). The subjects were ordinary college students. As described on the web site:

“Our planned two-week investigation into the psychology of prison life had to be ended prematurely after only six days because of what the situation was doing to the college students who participated. In only a few days, our guards became sadistic and our prisoners became depressed and showed signs of extreme stress.”

2. The Milgram experiment

This was conducted at Yale by Stanley Milgram and described in an article published in 1963. Subjects were instructed to apply what they believed were electric shocks of increasing severity. The intention was to see if extreme behaviours, such as those by concentration camp guards, were due to the people being sadistic or just ordinary people obeying orders. They found that many subjects were prepared to follow instructions to administer severe shocks:

“Ordinary people, simply doing their jobs, and without any particular hostility on their part, can become agents in a terrible destructive process. Moreover, even when the destructive effects of their work become patently clear, and they are asked to carry out actions incompatible with fundamental standards of morality, relatively few people have the resources needed to resist authority.” (Milgram, 1974, p. 6)

3 The Stockholm syndrome

This is based on the well-known story of hostages in a Stockholm bank robbery who sided with the hostage takers, with the heiress Pattie Hearst being considered a later example. The concept has been extended further to describe a “societal Stockholm syndrome” whereby women became willing participants in their patriarchal oppression

(Graham, 1994). The existence of the syndrome has been questioned (Namnyak et al., 2008), and a description of the original hostage taking (Bejerot, 1974) does not mention the claimed behaviour. Nevertheless, the syndrome's acceptance indicates its plausibility (such that people can be persuaded to believe in it).

All three of these suggest that people may find themselves in environments in which they behave in unexpected ways.⁷⁰ However, economists still tend to focus on people as individuals, so the full importance of the social context may be overlooked. There are a few exceptions. Williamson (1975) notes the importance of "atmosphere"⁷¹ and "informal group influences"⁷², and Laffont and Martimort refer to interactions between private incentives and cultural norms of behaviour.

"How private incentives interact with cultural norms of behavior might be the next important step of research needed to offer sensible advice on the design of institutions." (Laffont & Martimort, 2001, p. 3)

The usual examples that are presented of these three phenomena relate to extreme behaviour, but related responses may be expected in less dramatic situations.⁷³ Each organisation or social grouping has its own culture, rules and norms. The experiments

⁷⁰ The first two approaches were used in an attempt to understand the behaviour of American soldiers in Iraq (Montgomery & Phillips, 2009; Sommers, 2009)

⁷¹ Described as follows (italics in the original):

"...*technological separability does not imply attitudinal separability*. Reference to atmosphere is intended to make allowance for attitudinal interactions and the systems consequences that are associated therewith." (Williamson, 1975, p. 37)

He uses the Titmuss blood donor example to illustrate his point. Note the mention of process:

"It may be more accurate to regard the exchange process itself as an object of value...supplying a *satisfying exchange relation* is made part of the economic problem." (Williamson, 1975, p. 38)

⁷² When a contractor becomes an employee:

"He becomes a member of a team, and, as a member of a team becomes subject to a different set of expectations regarding his relations to the whole...Informal group influences...are brought more systematically to bear when behaviour contrary to the interests of the firm occurs." (Williamson, 1975, p. 99)

⁷³ For dramatic effects on an entire country, see Haffner (2002) for observations of Germany prior to World War II.

simply suggest that these may be formed, and conformed to, in ways that we might not have anticipated.⁷⁴ Goleman describes this possibility in terms of frames and schemas and self-deception by groups:

“Self-deception operates both at the level of the individual mind, and in the collective awareness of the group. To belong to a group of any sort, the tacit price of membership is to agree not to notice one's own feelings of unease and misgiving, and certainly not to question anything that challenges the group's way of doing things.” (Goleman, 1997, p. 12)

And:

“...shared schemas guide group dynamics...the social construction of reality. Shared schemas are at work in the social realm, creating a consensual reality. This social reality is pocked with zones of tacitly denied information. The ease with which such social blind spots arise is due to the structure of the individual mind. Their social cost is shared illusions.” (Goleman, 1997, p. 23)

While economics recognises the significance of perverse incentives, it has paid relatively little if any attention to group culture and its impact on perceptions and behaviour. It may be an important aspect of policy making and implementation. In relation to the implementation of law, consider the reported words of a U.S. Senator:

“Nothing ‘did more to damage America's place in the world than the revelation that our great nation stretched the law and the bounds of executive power to authorize torture and cruel treatment,’ Sen. Patrick Leahy said at the start of a committee hearing.” (“Leahy calls for 'truth commission' on torture," 2009)

On this same policy issue, internal memos advocating such actions are described by Frieden (2009). The internal culture allowed the actions, and others were then prepared

⁷⁴ Consider, for example, the willingness of the public to favour an incumbent prime minister and the views of an incumbent government, or people's acceptance of the culture in an organisation. This has been described as “system justification” (Jost, Banaji, & Nosek, 2004).

to carry them out even though they were arguably contrary to fundamental principles of the society.

There may be numerous areas where theorising on the basis of the above phenomena could yield plausible explanations of behaviour. In New Zealand, Rodney Hide has contended that the Inland Revenue Department had “a tactic of engaging in protracted audits of taxpayers, in order to delay GST refunds to drive certain taxpayers broke” (Hide, 2003). Similarly, in 2000 he claimed that a “taxpayer had been harassed and bullied by the IRD to the point of a breakdown” (Bruce, 2000). Recently hitting the headlines, we also hear of Immigration’s Pacific “fiefdom” (Trevett, 2009):

“The Ernst and Young report said that since being set up in 2005 to deal with applications from people in Pacific nations and fill the Pacific quota, the division...had become isolated from the rest of the Immigration Service as its leadership created an ‘us and them’ approach.”

There may be group dynamics active in determining collective views and behaviour. Numerous examples were given by Mackay over 150 years ago in his book, *Extraordinary popular delusions and the madness of crowds* (Mackay, 1995). Even among economists, and for economics as a discipline, there may be common acceptance of our conventions despite cause for unease. Kuhn, describing scientists, writes:

“[T]he members of a scientific community see themselves and are seen by others as the men uniquely responsible for the pursuit of a set of shared goals, including the training of their successors. Within such groups communication is relatively full and professional judgment relatively unanimous. Because the attention of different scientific communities is, on the other hand, focused on different matters, professional communication across group lines is sometimes arduous, often results in misunderstanding, and may, if pursued, evoke significant and previously unsuspected disagreement.” (T. S. Kuhn, 1970, p. 177)

There are commonly held perspectives on, and a collective understanding of, the economy. These are held by the mass of people within the discipline, despite internal dissension on some finer points. Might they be as much the result of a collective group

dynamic as a logical, reasoned, and regularly reviewed and revised, assessment of theory and evidence? New entrants are educated as to the established conventions and their acceptance into the group depends on a demonstrated competence according to those conventions. Similarly, the global financial and economic situation that arose with the sub-prime crisis in the United States may have been in part due to the culture within financial institutions. If this dimension of behaviour is important, then economic models that overlook it may be omitting a relevant variable, with all the associated consequences.

Rhetoric and groups are inevitable aspects of societies. Many economic models treat preferences as exogenous, and people as individuals. In this context, rhetoric and groups would have to be considered as causing “failures”, deviations from the theoretical ideal. This means that second best problems arise when applying the theories to the real world.⁷⁵ In addition, understanding of issues, attitudes towards groups, the effectiveness of rhetoric, and the development, evolution and implementation of laws may depend on the perspectives of dominant groups and influences on their understanding. Consequently, these aspects are expressly considered in later chapters of this thesis.

3.3 Conclusion

This Chapter has considered aspects of economic analysis. Starting with a simple structure, it is shown that theory alone and empirical analysis alone do not address all the issues to be considered when drawing conclusions about real world issues. Consequently, the direct application of theory to real world issues requires more than just the use of logic within a theoretical structure. There is a rhetorical dimension, as there are additional questions to be addressed when applying theoretical findings to real world problems. Central to the application of theory to the real world is the recognition that theoretical representations serve only as analogies of the real world. These are simplified and incomplete, and different approaches or perspectives may see the “elephant” quite differently. The nature of “theory as analogy” should be

⁷⁵ This raises the question whether the “ideal” that is used as a basis for identifying failure is one in which these phenomena are assumed not to exist. Note the possibility of alternative sources of happiness or satisfaction, including meaning through attachment (Seligman, 2004).

acknowledged. This raises several concerns. One, specific to economics, is the use of a theoretical “ideal” as a basis for real world policy recommendations. Such an ideal is defined within the bounds of the theory, and may not result in realistic decision making if the theory does not match the real world, if it is based on a poor measure of society’s objectives, or if it is an unattainable position. Another is the recognition that theories may be merely “consistent with” the evidence. A theory that appears to explain some evidence may simply give one of numerous possible explanations, and so should not be thought sufficient to definitively resolve an issue. Given numerous possible perspectives, all of them partial, a combination or synthesis of theories and concepts may yield a superior understanding than one theory alone. At the least, it could indicate the contradictions in and limitations of our diverse attempts to understand issues.

There are several observed positions that may be taken when faced with evidence that appears to conflict with a theory. Three that were described are that a theory could be accepted as a matter of faith, it could be accepted as sufficient as long as it can be adapted to give some explanation of the evidence, or it could be retained unless an alternative explanation is provided that is considered superior. Each of these overlooks the nature of theory as an analogy, and results in limiting the investigation and probably presenting an inflated impression of the prevailing level of understanding provided by the theory. A recognition of the limitations of the theoretical approach in general would be helpful. Any particular theory considers a limited range of factors and interactions, overlooking much of the available evidence and the thinking and analysis that exists elsewhere. The best that can be done with a theory is to demonstrate consistency with the selected observations. There may be numerous possible alternative explanations, and relaxed or changed assumptions or consideration of alternative evidence may suggest very different conclusions. It is for this reason that the later chapters of this thesis look at the making and implementation of laws in a more pragmatic way, considering a range of alternative sources of information more readily accessible as a result of new information technologies, seeing to find or apply concepts which may enhance our understanding.

A further step in considering methodology involves addressing issues about some of the data and methodologies commonly used by economists.⁷⁶ This is the subject of Paths B and C, which are considered in the next Chapter.

⁷⁶ As economists have tended to emphasise the quantitative, the same is done here. Qualitative data and analyses also give valuable insights and should not be forgotten, especially in the light of points raised by Lindblom and Dunn in Footnote 80 below. New information technologies have greatly expanded their ease of access and reduced the cost of access. Efficiency in research would suggest that such sources be increasingly used. These sources are drawn on in later chapters in the thesis.

Chapter 4 Logical gaps in economics – empirical aspects

Numerous textbooks for economists focus on econometrics (Gujarati, 2006; R. C. Hill, Griffiths, & Lim, 2008; Kennedy, 2008; Ramanathan, 1998), and economists' research techniques have focused heavily on quantitative methods of analysis. In any such analysis, there are steps to be taken before the quantitative analysis, and further steps once the quantitative results have been found. These aspects generally receive scant attention in the textbooks. However, they are important determinants of the practical value of the results of the analysis. Without due consideration, as Dunn has suggested (see Section 2.3.1), the value of conclusions on practical application may be more rhetorical than actual. This Chapter considers the two paths involving empirical analysis. Path B considers the transition from theory to empirical formulation, and Path C focuses on the steps from empirical results to application to policy in the real world.

4.1 Path B – theory to empirical

Consider the link between a theoretical formulation and an empirical formulation. To reiterate Meghnad Desai's point at p.44, the result of a statistical test of a theory depends on the validity of both the theory and the test. This section considers whether formulations used for testing theories are likely to result in reliable tests. In particular, it focuses on i) data problems, and ii) problems of functional form.

4.1.1 Data problems

Where established data sources exist, there may be commonly accepted applications of those data. This can be dangerous in that, by habit or convention, definitional or measurement problems may be overlooked, or the suitability of data for particular uses may not be questioned. Some examples can be found later in this thesis, such as outcomes after separation on p.142. For numerous reasons, the variables used in theories may not match the data gathered.

Many economic theories relate to either short-run or long-run structures with a focus on equilibria or optima. The same data have to be used to estimate both short-run and long-run models⁷⁷, and the observations may not be of equilibria or optima.

Even if data are accurate, their use may be inappropriate. For example, health outcome measures such as QALYs⁷⁸ are commonly discounted in health care evaluations in the same way as is done for monetary measures, but it is not clear that the same approach can be taken or how it should be interpreted (Birks, 2006, 2009c). Also, some index measures are ordinal in nature, but they are frequently used in regression analyses as if they were cardinal (Birks, 2007f).

Two issues will be given particular attention here, aggregation and proxies. The first sub-section identifies spatial and temporal aggregation, using the latter to illustrate the possible problems. Patterns of aggregation influence the groupings used in an analysis and hence the results. As a general issue, this can shape perceptions as described for artificially engineered social groupings (Hargreaves-Heap & Varoufakis, 2002), or social justice (Tyler, 2000). Aggregation is more widespread and more of a problem for analysis than is commonly understood, however. This is followed by a subsection that considers what numbers in an analysis might actually represent. Sometimes they are assumed to represent the given variable, while at other times they are taken to be acting as a proxy for something else. This possibility opens the door to several problems of interpretation.

4.1.1.a Aggregation

There are generally unstated aggregation problems, such as i) over time, which has implications for the timing of impacts of one variable on another, and ii) over space, as

⁷⁷ The distinction in economics, being based on the assumption of values of certain elements being fixed or variable, is conceptual, not temporal. If, at the microeconomic level, there are short-run and long-run responses to a change in circumstances, and if the short run is not a fixed length of time for all situations, then according to economic theory there will presumably be complex and variable patterns of lagged effects from any change.

⁷⁸ Quality-adjusted life years.

with disregard for distance, required assumptions about market boundaries, or cross-country regressions which disregard differences in country size and hence weights by country and within-country averaging. The problems arising from spatial aggregation are more complex than those arising from aggregation over time. This is because time is uni-dimensional whereas space is in two (or three) dimensions, and because spatially aggregated units can be of widely varying size.

Aggregation reduces the number of variables to be included, and hence the number of relationships between variables to be considered. If aggregates are to provide valid simplifications, then it is necessary to have homogeneity of the components of an aggregate in terms of their relationships with the other variables under consideration (except in the presumably unusual situation of constant composition of the aggregate as its size changes). A further requirement for simplicity of analysis would be heterogeneity between aggregates, as otherwise the number of variables could be reduced by combining further.

Aggregates are far more common than is commonly stated. One distinction between macroeconomics and microeconomics is that the former is based on aggregate variables. However, even in microeconomics there is aggregation over space and time, not to mention aggregation over suppliers of goods and heterogeneous units of factors of production such as labour.

The example here focuses on the issue of aggregation over time. While the economy operates in continuous time, the data are aggregated into discrete time intervals, as with daily, monthly, quarterly or annual data. Analysis then considers simultaneous, lead, or lagged relationships with these aggregate data.

Consider quarterly money supply and price level data. A simultaneous relationship running from money to prices could be interpreted as a change in money supply in this quarter having an effect on the price level also in this quarter. The aggregation issue results in an assumption that a money supply change will have the same effect on this quarter's price level whether it occurs on the first or last day of the quarter. Similarly, it is assumed that an effect on the next quarter's price level will be quite different if a

money supply change occurs on the last day of this quarter rather than the first day of the next.

Aggregation also influences the interpretation of results. Consider a distributed lag model with a series of estimated coefficients. The coefficient of the one period lag on quarterly data should not be interpreted as the impact to be expected 4-6 months after a money supply change. For a change on the last day of the previous quarter, the next quarter reflects the impact in the first three months following the change. To treat the lag coefficients as the effects to be expected in the current, next and subsequent quarters is to assume that all the money supply changes occur on the first day of their quarter.

Even if there is in reality a fixed temporal relationship between cause and effect, aggregation problems can result in highly uncertain and imprecise estimates of the relationship. To illustrate this, consider the following simple problem.

First, two series, X and Y, are generated by the following steps (the data are in Appendix 2):

- i. Let X be the value of a throw of a die. Take 50 observations, 1-50.
- ii. Toss a coin 50 times, one for each X observation.
- iii. If it comes up heads, the X value contributes to its matching Y.
- iv. If it comes up tails, the X value contributes to the next period Y.

One interpretation (A) of this structure is that there is one occurrence of X each period, either at the start or the end of the period. There is a deterministic relationship between X and Y such that $Y_t = X_{t-1/2}$. If X happens at the start of a period, the full impact on Y is felt in that period. If it happens at the end of a period, the full impact is felt in the next period. Which of these occurs is determined by the throw of a die. As an alternative interpretation (B), it could be considered as a model with variable lags, having a 50 percent chance that the effect is felt in either of the current or the next period. In either event both X and Y actually occur at a particular instant, not spread over time. This differs from the more complicated effect of a change such as a tax cut, where the effect on disposable income (X) and any resulting impact on consumption (Y), say, can take some time.

In generating Y , it happened that 23 of the 50 X observations resulted in lagged impacts on Y . Pairwise correlations were as follows: $(X_t, Y_t) = 0.565516$; $(X_{t-1}, Y_t) = 0.06752$; $(X_t, X_{t-1}) = -0.01865$.

A regression, $Y_t = \beta_0 + \beta_1 X_t + \beta_2 X_{t-1} + \varepsilon$, was estimated. Despite interpretation A being based on a deterministic relationship between X and Y , the specification of time periods resulted in an R^2 of only 0.3259. A standard interpretation might be that variations in X explain only 33 percent of variations in Y . It could then be suggested that other variables and random error are responsible for the remaining variation. In other words, X is a poor predictor of Y .

Table 4.1: Lagged impact regression results

	β_0	β_1	β_2
Coefficient	-0.29101	0.961213	0.135912
Standard error	0.982915	0.205265	0.210735

Coefficients for the β s, plus standard errors, are given in Table 4.1. Note that the coefficient on the lagged variable is small and not statistically significant. It would be concluded that there is no lagged effect with this particular sample, despite 23 of the 50 observations actually having a lagged impact. With the estimate of β_1 being significant and near to unity, it would be concluded that the magnitude of the effect is as in the underlying model, but that all the impact occurs in the same period as X .

This example illustrates two points. First, results can be consistent with alternative interpretations, but only one may be considered. Second, the tests/techniques may not be as solid as is sometimes assumed, in this example giving a false negative.

The problem is not one of misspecification through an incorrect functional form (it is linear), nor one of an omitted variable⁷⁹. Rather, it arises from incorrect aggregation over time. It shows the potential for econometrics to give false negatives simply because of aggregation within discrete time periods. Models with quarterly data do not merely require that the effects be felt within a quarter. They actually require the effects to be felt instantaneously if all the effects are to be observed within the same quarter as the cause. Lagged impacts inevitably result in impacts being spread inconsistently over time periods, resulting in imprecise estimates of the underlying relationships.

This presents a problem for economists. Not only are economic effects not instantaneous, but also microeconomic theory suggests distinct short-run and long-run adjustments so the effect of a change in a variable is likely to have a complex temporal structure. Are lags likely to be of fixed length? Consider a few economic examples. There can be lags between an event occurring and a decision being made on a response. Petrol prices change, and people decide to get more economical cars. Some new equipment might be needed, but a decision has to be made at an infrequent committee meeting. There can then be lags between the decision and resulting action. How long does it take to sell a house, or find a new job, or to get a tradesperson to do some work? There can be a lot of variation in the time between an event that can cause the initiation of an action and the end result.

In summary, time, and aggregation over time, are not trivial matters for economists. Given the potential problems as illustrated by the numerical example here, care must be taken when interpreting estimates of lag structures and their significance or otherwise. There are alternative interpretations of the same results, and the conventionally accepted conclusions may not be universally valid. Cross-section data do not eliminate these problems. Rather, they are likely to exacerbate them. Given the importance of population groupings in much policy analysis, this raises serious questions about interpretation of evidence. If the limitations are not recognised, then the accuracy of the

⁷⁹ Although omitted variable bias is a paradoxical problem. Theories about the economy are simplified representations of the real world. When testing or applying any theory, the aim is to include only the few most important variables, to the exclusion of others.

evidence is overstated and any resulting deliberation based on those findings may be flawed.

4.1.1.b Proxies

Statistical models only “explain” in terms of finding statistical associations between strings of numbers. The results depend on the numbers alone, with no regard to the specific variables underlying the numbers. Two distinct variables with identical data series would give identical statistical results. The identified variable may be acting as a proxy for one or more other variables which are, individually or collectively, correlated with it. The interpretation of statistical results as referring to specific variables depends heavily on this issue of proxies, especially in situations where related variables are “controlled for”.

Sometimes an index is used as a variable in regression so as to reduce the number of variables being considered. This is based on the concept of several variables moving together, so that a variable can be constructed that will represent them all and pick up their combined effects. An extreme approach would involve using a single indicator variable instead of a composite index. In other words, a single variable can be used to pick up the effects of several variables that are individually or in some linear combination correlated with that variable.

If a variable can be used that way, can it ever be said with any certainty that any explanatory variable in a regression is not serving that function? In other words, whenever an equation is estimated, the results may represent the impact not of the individual explanatory variables included in the equation, but of all the correlated variables and combinations of variables for which the included variables can act as a proxy.

This point can be illustrated by the use of a variable, “mother’s education”. Several documents present results about the effects of education levels of mothers along with consequential policy recommendations. For example, from the World Bank Living

Standards Measurement Study, Working Paper No.123, *The Demand for Medical Care: Evidence from Urban Areas in Bolivia*:

“Our results also show that income and education are also important determinants of demand for medical care. For children, mother's education is far more influential than father's.” (Ii, 1995, p. ix)

Similar reasoning is found in Working Paper No.128, *How Does Schooling of Mothers Improve Child Health? Evidence from Morocco* (Glewwe, 1997, p. viii) and Working Paper No.132, *The Role of the Private Sector in Education in Vietnam: Evidence from the Vietnam Living Standards Survey* (Glewwe & Patrinos, 1998, p. ix). Elsewhere numerous examples can be found, including: an OECD report (Morrison, 2002, p. 30); a UK Treasury document (Doney & Wroe, 2006, p. 5); and a Joseph Roundtree Foundation document (Machin & McNally, 2006, p. 13).

All these studies are making claims that could be used to support policy decisions. However, a Google Scholar search on [“mother’s education” +proxy] provided over 2,500 results. Hence, from *Demography*:

“[W]e argue that maternal education may be a proxy for the socioeconomic status of the household as well as for characteristics of the community of residence. Hence, we consider the possibility that the observed correlation between maternal education and various markers of child health may be spurious...we demonstrate that controls for a few socioeconomic variables and for community of residence substantially attenuate the maternal education/child health link. Based on these results, we argue that the relationship between maternal education and child health is considerably weaker than is commonly believed.” (S. Desai & Alva, 1998, p. 71)

As far as the computations are concerned, any variable that is included in a regression is considered as a string of numbers. Whatever the numbers actually represent is irrelevant for those processes, but it is essential for interpretation of the results. However, there is good reason to expect a variable to pick up the effects of other (at least numerically) related variables, which allows for the use of proxy variables and can also yield spurious results. As they rely solely on the numbers, there is nothing in the statistical

techniques to allow an analyst to deduce whether the results represent the effects of the variable, of some other variable(s) for which it is a proxy, or pure chance. It would seem that some policy recommendations are claiming to be based on a stronger evidence base than is justified.

4.1.2 Functional forms

Theory generally does not give the specific form of relationship to be estimated.⁸⁰ This is particularly so with static models, as timing and lagged effects are not considered. One simple, but powerful description of the functional form problem was presented in a seminar at Massey University several years ago by a visiting geography professor. He used the concepts of an input wave and an output wave. In a single equation model, an independent variable provides an input wave, a particular pattern of impact over time. There is then a resulting effect on the dependent variable, which can be described as an output wave, a particular pattern of effect over time. In a model, the pattern and timing of impact are fixed by the functional form. With a linear relationship, the output wave matches the pattern of the input wave. All the regression does is estimate sign and the magnitude of the effect. This is highly restrictive, but it is a starting assumption in most estimated relationships. It is not the only strong restriction imposed by linear models, another being additive separability. Two additional concerns, controlling for other factors and causality, are described here.

⁸⁰ Even when it does, the approach has been criticised. For example, Mende (2005) suggests that researchers are too quick to move into estimation and application of quantitative techniques, thereby possibly missing numerous other possible perspectives. Similarly, Lindblom (1990) and Dunn see much standard social science policy research as being locked in to established frameworks and “little more than a ratification of conformity” (Dunn, 1997, p. 277). For a broader criticism of the requirement of a stable underlying structure, “The most telling point against [econometrics is that] significant invariant event regularities...have yet to be uncovered in economics” (Lawson, 1997, p. 70), and Carr (2008, p. 171) talks of history being concerned with processes of change (i.e. changing structures) while economists “take cover” in econometrics.

4.1.2.a Controlling for other factors

A Google Scholar search for “vector of control variables” conducted on 27 February 2009 produced “about 4,140” results. Repeated on 2 January 2010 the number had grown to “about 4,980”. It has become common practice to convert basic models with a few variables into ostensibly more complex and realistic models simply by adding “control variables”. It is then claimed that the effects of those variables have been taken into account, with the results for the variables under investigation being those observed having made full allowance for the other effects.

Without further explanation of the functional form, this is pure rhetoric. Consider what it means. It has to be assumed that, for a unit change in a control variable, when the dependent variable is:

- A number - the control variable has a fixed numerical effect;
- A log - the control variable has a fixed proportionate effect;
- A total value (such as GDP) - the control variable has a fixed total effect;
- A per capita value - the control variable has a fixed per capita effect;
- A nominal value - the control variable has a fixed nominal effect;
- A real value - the control variable has a fixed real effect;
- A first difference - the control variable has a fixed effect on the first difference.

Should it be simply assumed that, whichever of these is used, it results in the relationship being correctly specified? As alternative specifications are chosen for the dependent variable, can it be expected that the functional form for the control variable will always be correct? These would appear to be highly implausible.

As an alternative explanation, consider standard approaches to the use of data in different currencies (adjusting for exchange rate differences by converting to a common currency) or different price levels (adjusting for inflation by converting from nominal to real values). Instead of these adjustments, would it be considered acceptable to add an exchange rate or a price index as an additional variable in a linear regression? The implication would be that the effect of say a price level change is independent of the

magnitudes of all other variables. If such an approach is unacceptable, why should it be assumed sufficient when controlling for any other influences?

Interpretation of results is also problematic. Control variables may sometimes be considered as a means of adjusting (in a restricted way) for aggregation problems in the data. For examples, dummy variables can do this by allowing for some difference in overall affect according to category. In other cases, their use lends itself to an interpretation such as, “if policies were introduced **to successfully eliminate the effects of the control variables**, then the relationship between the other variables may be as estimated”. An additional rejoinder is then needed, “however, the policies do not have to be introduced”, which bears a close similarity to the reasoning underpinning the Kaldor-Hicks compensation principle.

Similar issues have been identified in psychology, especially building on the work of Urie Brofenbrenner, who recognized the impact of wider social factors on individual behaviour. As one illustration, Brofenbrenner challenged the idea that the effects of certain factors can be taken out so as to analyse interactions between others:

“[Brofenbrenner] went on to explain that it made no sense at all to control for ethnicity, social class, or household composition in an attempt to isolate "pure" process. No processes occur outside of a context. And if we want to understand context, we need to take it into account, not pretend to control it away.” (Steinberg, Darling, & Fletcher, 1995, p. 424)

This suggests a major problem with much of the quantitative work in economics. Unstated and untested assumptions are being made right at the specification stage. This will generally have an impact on the results, but not in any predictable or meaningful way.

4.1.2.b Causality

There are well-recognised causality issues, such as:

- The distinction between correlation and causation and whether a statistical relationship is actually causal at all;

- If it is causal, whether it is between two identified variables or involving some additional variable(s);
- The direction of causality between variables (one way from A to B or B to A) or two way);
- The timing of the impact.

As indicated in several examples above, these matters may be glossed over in many studies.⁸¹ Economic analysis relies heavily on econometrics to estimate relationships between variables. The results may then used to influence policy decisions. The recommendations are based on simplified assumptions about causality. The existence of more complex relationships is indicated by some recommendations that do not seem to fit very well within this framework. In Israel, a comprehensive stabilization programme was effective using a range of policies working together whereas traditional approaches relying on fewer policy instruments had failed (Cukierman, 1988, p. 48). A combination of measures was required to achieve a health objective in African countries (C. D. James et al., 2006, p. 148). In youth smoking prevention, Ross et al. (2006) describe a range of policies used to change the whole environment, considering that their success depended on the multidimensional approach. An OECD Policy Brief mentioned above, (Morrison, 2002), refers to mothers' education and poverty. While it mentions the statistical link between mother's education and child health, and talks of a relationship between mother's education and the demand for education for children, it also talks of "clusters of factors" and "combinations of disadvantages".

The common feature of these examples is that individual policies might be ineffective. For successful outcomes, a package of policies is required. This is consistent with an

⁸¹ Granger causality uses statistical tests based on a presumption of *post hoc ergo propter hoc*. Some treat this as a test of causality, but it is really a case of Schopenhauer's second stratagem, "the homonymy", where "[the] trick is to extend a proposition to something which has little or nothing in common with the matter in question but the similarity of the word; then to refute it triumphantly, and so claim credit for having refuted the original statement" (Schopenhauer, c1851, 3.II). The problem can be seen by consideration of an increase in retail spending followed by Christmas. The former is a response to the latter, despite it occurring first. (This highlights an additional problem for economists, in that behaviour is based on perceptions of the environment. These may differ in substance and timing from events in the environment themselves, however most data series are attempts to measure real rather than perceived phenomena.)

INUS approach to causality, whereby outcomes require the coincident occurrence of a specific combination of factors, and there may be several alternative combinations that can achieve the same outcome (Addison, Burton, & Torrance, 1984).⁸² Policies in isolation may be ineffective, but in the right combination they can work, and there may be several alternative approaches to choose from. To rephrase this, a policy might be effective in some situations but ineffective in others as a combination of (policy and other) circumstances are required.⁸³

This does not fit well within an econometric modelling approach because econometric models have difficulty including conditional multivariate components. Even in the relatively simple situation of binary variables (a policy is “on” or “off”) a complex mix of dummy variables and interactive terms would be required. Take a simplified version of the first example, consider a dummy variable, D_1 , equal to 1 when there is a tight monetary policy, another, D_2 , for tight fiscal policy, and D_3 for a prices and incomes policy. It would then be necessary to include a variable $D_1 \times D_2 \times D_3$.

If INUS conditions are included, there may be several possible combinations to consider. If so, for the structure to be correctly specified, it would be necessary to include all the combinations that occurred in the sample period, set out as combinations rather than just individual variables. This raises an additional problem. If the combinations of policies that can give the desired outcome are not already known, are there ways that they can be identified and/or tests undertaken to find them? This is important in a general policy dimension. A basic point is that it may be desirable to consider broad-based, multi-dimensional, multifaceted policy. Instead, regression approaches tend to be based on the assumption that there are individual policy variables with a fixed marginal impact on the target variables.

⁸² An INUS condition is Insufficient on its own, but is a Necessary component of a set of conditions that are Unnecessary but Sufficient for an outcome to arise. For example, there are several reasons why a house might burn down (cooking fire, electrical fault, candle), but each reason is contingent on other factors (proximity of flammable material, lack of oversight, no smoke alarm, etc.).

⁸³ This point is central to Rodrik (2007).

4.1.2.c Structural stability

Alan Greenspan's statement to the House Oversight and Government Affairs Committee on 23 October 2008 included the following:

“In recent decades, a vast risk management and pricing system has evolved, combining the best insights of mathematicians and finance experts supported by major advances in computer and communications technology. A Nobel Prize was awarded for the discovery of the pricing model that underpins much of the advance in derivatives markets. This modern risk management paradigm held sway for decades. The whole intellectual edifice, however, collapsed in the summer of last year because the data inputted into the risk management models generally covered only the past two decades, a period of euphoria. Had instead the models been fitted more appropriately to historic periods of stress, capital requirements would have been much higher and the financial world would be in far better shape today, in my judgment.” (Greenspan, 2008)

This indicates a problem that can arise in understanding situations that may occur infrequently, as with some shocks⁸⁴, or long cycles or structural changes, when people are drawing on experience only of the recent past.

A broader point is that generations each have their own experiences of the world. An older generation may make decisions in reaction to their experience of earlier issues or problems. A younger generation, observing these decisions, will not have experienced the context on which they are based. Therefore, their interpretation of their current experiences can differ from that of the older generation. A certain behaviour (or policy) could be seen as “the way things are done”, as with consumption of fast foods. Alternatively, it could be rejected as misguided or outdated behaviour of older people. This could possibly help to explain differing attitudes to debt of those who lived through the depression of the 1930s, those born after the Second World War, and those born in the 1980s.

⁸⁴ Taleb refers to these as “black swans” (Taleb, 2005, 2007). Winston (2005) distinguishes between perspective and analytic time, pointing out the problem for economics of unique events.

A further potential problem that Greenspan did not mention is that, depending on the complexity of the estimation of risk of default on mortgages, the calculation may be giving the average risk of default, whereas the important measure, at least in an expanding market, would be the marginal case. As more loans are given to people within a category, risks may be rising as the marginal and average are not the same. A similar point can be observed in an example by Musgrave and Musgrave. They present results on returns to education, after which they state, "...since there is considerable slack in student input (only about 50 percent of students complete high school and only one-third of high school graduates proceed through college), it appears that considerable scope for increased investment in higher education still exists" (Richard A Musgrave & Musgrave, 1973, p. 196). However, the statistical result is the average return, and additional (marginal) students may have other characteristics and outcomes (even if only through changing pay by qualification as numbers of qualified change).

The average versus marginal issue has similarities with that of outliers. Should such observations be discarded as aberrations which distort statistical results, or are they valuable sources of information. A classic example of the value of outliers is that of the Broad Street pump (Hempel, 2007). In 1854 a cholera outbreak produced numerous cases clustered around a pump in Broad Street, London. Dr John Snow noticed this when he plotted the deaths on a map. The connection with the pump was demonstrated more conclusively by the lack of deaths in a factory close by which did not use that water, and the death of a woman some distance away who was regularly supplied with water from the pump.⁸⁵

The value of reliance on a common structure has also been questioned, as in cases where only low R^2 s are produced. Action research, often applied to education issues, aims to bring change through consideration of issues at a micro level. This is because the individual influences may be more important than the more generalised ones found through quantitative research. Egon Guba, in a foreword to Stringer's book on action research, writes:

⁸⁵ The existence of relevant factors besides proximity to the pump suggests the existence of INUS conditions.

“We have witnessed, over the past half-century or so, determined efforts to find general solutions to social problems...The cost to national economies has been prodigious, and there is precious little to show for it...It ought to be apparent by now that generalized, one-size-fits-all solutions do not work...Without intimate knowledge of local context, one cannot hope to devise solutions to local problems. *All problems are de facto local; inquiry must be decentralized to the local context.*” (Stringer, 2007, p. ix)

Parallels might be considered with the law, giving generalised solutions, and its implementation, through which individual circumstances may be considered. If the specific are more important than the general, there is limited scope for laws themselves to address the problems. There are also lessons for the value of much economics and econometrics research in that this commonly seeks to obtain generaliseable findings.

There is an additional consideration also. Of all the available information, only a small component is in the form of large, quantitative data series. This is particularly true with the growth of new information technologies, providing large quantities of readily accessible textual and other data along with means to quickly search and analyse them. Consequently, other approaches to research and the use of alternative types of data may give additional valuable insights into phenomena of interest to economists.

In summary, data problems and limited functional forms can place significant constraints on empirical analyses. This is not entirely surprising for two reasons. First, as has been indicated, econometrics is constrained by the restrictive nature of relationships it is used to estimate, with many potential alternatives assumed away at the initial specification stage. Second, econometric results focus on the average, or the common features, which may tell only a small part of the whole story. Nevertheless, as Dunn has suggested, as a mode of argumentation, these techniques may be persuasive. This may result in decisions being based on misinformation and undue confidence in quantitative research results. A less tightly structured investigation making use of a broader range of data may provide additional, alternative insights. This approach is taken in the later chapters of this thesis.

4.2 Path C – Empirical to the real world

The third step, and potential area for error, is when research results are used as a basis for policy. There is often a tenuous relationship between research and policy, with research sometimes playing little or no part. There are several other components in the process of policy making, including political and media debate, response to pressure groups, and shaping or reacting to public opinion. Research is not necessarily directly focused on policy, and the approaches taken by researchers do not necessarily directly address policy questions. Nevertheless researchers sometimes describe policy implications arising from their findings, and research findings are sometimes used in policymaking and implementation. Consequently, the role of research in the policy process is worth exploring.⁸⁶

There are several forces at work that result in a tendency to favour simplified views of issues.⁸⁷ They can be observed at each of the three “levels of discourse” described by Desai, namely theory, data analysis, and policy (M. Desai, 1981, p. 93). At the theoretical level, there is the value judgment associated with Occam’s razor whereby simpler theories are preferred over more complex ones, *ceteris paribus*.⁸⁸ At the level of data analysis there are constraints of available data, limitations of techniques and problems with degrees of freedom.⁸⁹ At the policy level, a simple message is often required in order to obtain public acceptance. This can arise in part as a result of constraints on transmitting and acquiring information, including the costs of such investments and their limited benefits to individuals. Implications can be observed in the importance of interest groups and in the limited range of options presented for consideration.

⁸⁶ For a recent contribution, see Wolf (2007).

⁸⁷ See also Birks (2007e)

⁸⁸ While theoretical simplicity is commonly lauded, sometimes this is merely paying lip-service to the principle. More complex analyses with longer equations, more advanced mathematics and/or larger data bases can be awarded a higher status than simpler, more readily understood expositions.

⁸⁹ Concerns about techniques used by economists, especially econometrics, have been raised by various writers, including Swann (2006) and Thurow (1983). Alternative techniques are described in Swann (2006) and Allen (1978).

One aspect of simplification that is apparent at the level of public debate is the way that policy conclusions are frequently drawn from limited statistical evidence. While economists and econometricians are generally cautious about specifying policy implications arising from econometric analyses, at the level of broader debate and media coverage there are fewer reservations. This section explores some of the limitations and potential opportunities for policy-relevant findings from econometrics. In particular, it considers what can and cannot be deduced as a result of an explanatory variable being found to be statistically significant. In addition, it indicates what aspects to address or questions to raise if econometricians and economists are to extend this work to the point where it may be directly applicable in policy debate.

Subsection 1 briefly considers the link between statistical findings and policy recommendations by academic and public sector researchers and through media coverage of research. Subsection 2 outlines some basic statistical considerations, while subsections 3 and 4 consider issues associated with the step from statistically meaningful findings to more comprehensive policy analysis.

4.2.1 Using statistics for policy

One channel for statistical analysis to influence policy is through public presentation of research findings. This may affect general understanding of issues, shaping public opinion and influencing political priorities. This can happen even if the research was not intended for that purpose and if the results are misinterpreted at the public reporting stage. Where attention is created for political purposes the focus may be on a specific finding, probably associated with a visiting expert deliberately invited to promote a preferred perspective (as with agenda setting and framing). This is unlikely to result in high-level debate on alternative, possibly contradictory research findings.

4.2.1.a The research phase

McCloskey and Ziliak have identified problems in academic papers in the interpretation of statistical findings as being of significance for policy (McCloskey, 1998; Ziliak &

McCloskey, 2004)⁹⁰. One of their central points is that policy decisions should not be determined on the basis of statistical significance alone.⁹¹

Looking at recent issues of such economic journals as *Applied Economics*⁹², *The Review of Economic Studies*, *Economic Record* and *Southern Economic Journal*, few articles actually refer to policy implications. This may reflect a difference in focus between academic economists and economists working as policy analysts.⁹³ Some of the discussion papers from the Reserve Bank of New Zealand use econometric models of the macroeconomy and relate the results to policy decisions.⁹⁴ The Department of Labour research publications tend to rely heavily on more discursive forms of analysis with graphical representation of data.⁹⁵ The Ministry of Economic Development has papers outlining econometric analyses on microeconomic issues using disaggregated data.⁹⁶ The policy conclusions tend to be tentative, however, as in Maré and Timmins (2007, p. 53). Given the range of industries and firms and the number of geographically related factors that can affect productivity, this study's findings are not entirely surprising. A strong statistical association would only arise if there is a fixed underlying

⁹⁰ Note also a newer publication on this topic (Ziliak & McCloskey, 2008). This has been critically reviewed (Spanos, 2008). However, the criticisms relate to proposed solutions to the problem. If anything, Spanos suggests that the problems themselves are more severe than suggested by Ziliak and McCloskey.

⁹¹ This point has been made also in relation to policy in education:

“Most research articles, after finding a set of things that is correlated with student performance, immediately go to a section on policy conclusions. The steps between the statistical analysis and the section on policy conclusions are seldom discussed.” (Hanushek, 1997, p. 303)

⁹² Based on their abstracts, econometrics was central to 10 of 11 articles in *Applied Economics* 39(21), December 2007. Of these, three drew some possible implications for decisions/policy.

⁹³ As a separate exercise, it may be interesting to see to what extent academic research impacts on policy decisions, and, if considered, whether the findings are correctly interpreted. Example 2 below is a case in point.

⁹⁴ <http://www.rbnz.govt.nz/research/discusspapers/>. Approximately 7 of the 15 papers in 2007 would fit into this category. The greater emphasis on policy implications from econometric analysis may be due to the Reserve Bank having defined objectives and a limited number of policy instruments. It therefore has less need to consider a wide range of alternatives or associated costs and benefits.

⁹⁵ <http://www.dol.govt.nz/publications-browse.asp?BrowseBy=Date&Year=2007>, None of the 11 listed publications relied on econometric methods.

⁹⁶ http://www.med.govt.nz/templates/StandardSummary_22733.aspx. 3 of 5 papers for 2007 had significant econometric components and drew tentative policy-relevant conclusions.

structure that applies to highly heterogeneous units. This is unlikely to be the case. The same point could be made for many other studies using similar methodology.

4.2.1.b *The media phase*

Tentative conclusions are less commonly observed at Desai's third level, that of the media and policy discourse. Politicians are expected to appear clear and decisive, despite all the actual uncertainties surrounding policy issues. The public want information that has a clear point to make, or, for personal interest, that relates to a need to change behaviour, presented without many complicating qualifications. Journalists may also lack the specialist knowledge required to handle complex issues, and they are constrained by the nature of their media to be concise and entertaining (Birks, 2008). Consequently, recommendations may be based on limited evidence and analysis, perhaps merely on a statistical association or ascribed to some designated "expert"⁹⁷. To give three examples⁹⁸:

Example 1: alcohol and brain damage

A *Dominion Post* article suggested that binge drinking 'damages brains' (R. Hill, 2007, 5 November). Arbias (Acquired Brain Injury Service) chief executive Sonia Burton suggested that "[e]ven so-called "social drinking" could cause permanent brain damage". On the basis of this association, she called for an education programme and screening by health professionals that "should be as routine as a cholesterol check".

Example 2: Single parenthood and childhood risk

⁹⁷ Note that one of Dunn's "modes of argumentation" in policy debate is "reasoning from authority" based on the achieved or ascribed status of the person presenting the information. (Dunn, 2004, p. 395)

⁹⁸ See also NZPA and Reuters (2007, 1 November) on obesity and cancer, (R. Palmer, 2007, 30 November) on job cancer risks, Perry (2008, 18 January) and Medical update (2002). It may not be coincidental that so many examples are health related. The media considers reader interest and this often requires a personal angle (Hamilton, 2004). The recommendations in the articles may shape perceptions, behaviour and policy.

This is an example in a policy context where lack of statistical significance was used to draw policy conclusions. In paragraph 616 and footnote 299 of the Law Commission's *Preliminary Paper 47: Family Court Dispute Resolution* (Law Commission, 2002) there is reference to Fergusson (1998).⁹⁹ The paper is quoted in the footnote, "Collectively, the findings suggest that single parenthood, in the absence of social or family disadvantage, is not a factor that makes a major contribution to childhood risk".

This statement refers to a statistical finding on the significance of a variable. It is used to suggest that single parenthood may not be a concern as associated childhood problems are not observed when the study controls for certain factors. The interpretation of this finding is a more complex matter. It must recognise the interconnectedness of many determining factors, such that the factors that are controlled for may be closely associated with single parenthood. It is therefore not realistic to simply treat single-parenthood as being independent of these determinants. This is made clear in the published study. Hence Fergusson states:

"The implications of these conclusions are clearly that social programmes and policies that are likely to be most effective in addressing the needs of at-risk families and their children are likely to involve multi-compartmental approaches that have sufficient breadth and flexibility to address the wide range of social, economic, family, individual and related factors that contribute to the development of childhood problems." (Fergusson, 1998, p. 172)

This example illustrates the use of lack of statistical significance to suggest that a factor is not important. It is also a case where a journal article presents its results with great care, but at the policy level it is selectively quoted to provide apparent support for a specific position. In fact, the impact of the factor may well be felt through other, related variables. This can happen due to more complex causal relationships, or because some variables are acting as a proxies for others.

⁹⁹ This example is discussed further in (Birks, 2002).

Example 3: TV watching and attention problems

A research paper published in *Pediatrics* found a link between children's television watching and attention problems some years later (Landhuis, Poulton, Welch, & Hancox, 2007). On this basis, despite voicing reservations, the researchers recommended restricting children to no more than two hours watching per day. This example is discussed in more detail in section 4.2.3.a below.

As a general point to draw from these examples, the information that is presented in reports of research contributes to the shaping of opinions and views on alternative issues and policies. At the very least, the news media do not always apply due caution in presenting these results. This is in part a consequence of inadequate specialist training and expertise.

The distortions may be widespread. Quite apart from statistical estimation and functional form problems, the information deduced from these findings may be flawed. This raises a fundamental question, what can be said about policy from statistical findings?¹⁰⁰ In addition, given the answer to this first question, what additional questions should be asked to more effectively address the requirements for good policy decisions?

4.2.2 Consideration of the problems

A paper at a health economics conference in Auckland in November 2005 illustrates a common problem with the use of statistical results for policy purposes. To give fictitious data, imagine a prevalence of 18 percent for some negative health measure for low income groups, compared to 16 percent for high income groups. This indicates a possible relationship between income and the prevalence of this problem. Does this justify policies to improve the income of low income groups? Quite aside from causality and the issue of the costs of the problem and the costs of alleviating the problem, income may be the wrong measure to look at. Changing income may not be effective,

¹⁰⁰ For a discussion of the use of econometrics in law specifically, including reservations and qualifications, see Harkrider (2005).

and even if it is, the best that could be achieved is a two percent improvement for those on low income, and no gain for those on high income. This might be considered fairly minimal in terms of addressing the problem, even though it is the type of policy inference commonly made.¹⁰¹

The following discussion will be based on a simple regression equation as it provides a useful structure for explanation. Consider a basic single equation multiple regression model where Y is a target variable of policy interest and X₁ can be affected by policy:

$$Y = b_0 + b_1X_1 + b_2X_2 + \dots + b_nX_n + u$$

Statistical analysis can give results such as a finding based on whether or not X₁ is statistically significant as a determinant of Y.¹⁰² With a superficial assessment, it might be concluded that:

- If it is not significant, there is no relationship, so the variable can be ignored.
- If it is significant, there is a relationship, so there can be a policy recommendation to change X₁.

In other words, there is heavy emphasis on the statistical significance of the estimate of b₁. Such reasoning is flawed. Statistical significance cannot be interpreted as answering all the questions required for deciding on policy intervention. Even if the relationship is one between a policy variable and a target variable, many aspects remain to be considered. For policy, it is important to know the magnitudes of impact, the variability of impact, the costs and possible side-effects of intervention, and, ideally, alternative policy options should also be considered. The first two of these are basic but often overlooked. They are briefly discussed here. A more fundamental issue relating to statistical hypothesis testing is then considered, followed by an issue of option

¹⁰¹ Stringer's justification for action research is based on the limited value of studies seeking generalised patterns such as these (see page 87).

¹⁰² There is scope to debate the criteria for determining whether results are "statistically significant". This discussion takes statistical findings as given, looking at the subsequent stage of interpretation of results for policy purposes.

identification from statistical results. The second two points are addressed in subsection 4.2.3.

i) Magnitude of policy impact – if X is changed, how much change is there in Y?

Harkrider gives a good legal example of this point when he distinguishes between “practical significance” and statistical significance:

Practical significance means that the magnitude of the effect being studied is not de minimis – it is sufficiently important substantively for the court to be concerned. For example, econometric evidence in the context of a publishing merger may reveal that titles published by new entrants are .0001 percent less profitable than titles published by existing entrants. That result may be statistically significant, but not substantively important. (Harkrider, 2005, p. 15)

Similarly for policy, it could be asked whether the relationship between the variables and the available options for change in X_1 result in realistic and effective policy options. In addition to magnitudes and costs, the answer could depend on formulation problems as discussed in relation to Path B.

ii) Variability of policy impact

Often relatively little attention is given to the overall R-squared for an equation. Sometimes a relationship may be only poorly specified by the equation. A statistically significant explanatory variable may then be a small factor in the overall determination of the value of the dependent variable.

Also, even though the significance of a coefficient is commonly discussed (as with the t-test results), this may not be carried over to consider the possible variability of response to a policy of changing X_1 . The estimated coefficient may be significantly different from zero, but the true value may still be quite different from the estimated value, and the effect of a change in X_1 on Y may also be variable across individual cases.

4.2.2.a McCloskey and Ziliak on interpretation of statistical significance

McCloskey and Ziliak have identified problems in academic papers in the way that policy inferences are drawn from statistical findings. Subsequently, they have given a detailed exposition (Ziliak & McCloskey, 2008). Thomas Schelling is quoted on the back cover:

“McCloskey and Ziliak have been pushing this very elementary, very correct, very important argument through several articles over several years and for reasons I cannot fathom it is still resisted.”

The reason for the resistance may be found by noting the focus of logic on proof, and rhetoric on persuasion. McCloskey’s *The rhetoric of economics* is now in its second edition (McCloskey, 1998). It may have proved its point (their arguments are logical), but it has not persuaded many economists (their rhetoric is weak).

In economic theory, little attention is generally paid to processes and persuasion. This is perhaps inevitable, given the focus on static analysis and assumptions of exogenous preferences and rationality. However, persuasion may be important in terms of both our understanding of economic phenomena and the development of economics as a discipline.

There is other literature that incorporates concepts such as traction, agenda setting, and framing. This shows clearly that it is not enough simply to present a correct argument. One reference that addresses these issues in a political context is Cobb and Ross (1997b). The title, *Cultural strategies of agenda denial: Avoidance, attack, and redefinition*, suggests that there are reasons why people with a heavy investment in established positions may be unwilling to change.^{103 104}

¹⁰³ Consider the discussion on accepting or rejecting a theory in Section 3.2.3 above.

¹⁰⁴ To quote Simon, “Legitimacy may sometimes be achieved (and even attention secured) by the usual credentials of science...[b]ut many an impeccable report is ignored, and many a report without proper credentials gains a high place on the agenda” (Simon, 1971, p. 50). Note also:

In relation to challenges to statistical significance, economists may still be involved in avoidance. Cobb and Ross talk of “identification groups”, people who raise an issue in the first place, and “attention groups” who then promote the issues more widely (Cobb & Ross, 1997b, p. 7). Without the latter, the issue will not get off the ground.¹⁰⁵

As Schelling states, McCloskey and Ziliak’s points are elementary. Two of their central points are outlined here. They can both be simply illustrated.

On the first point, the impact of sample size on statistical results, consider the gender pay gap:

“Science can destroy religion by ignoring it as well as by disproving its tenets. No one ever demonstrated, so far as I am aware, the nonexistence of Zeus or Thor, but they have few followers now.” (Clarke, 1953, p. 21)

Also, “[M]ost papers are never read at all. No matter what a paper did to the former literature, if no one else does anything else with it, then it is as if it had never existed at all.” (Latour, 1987, p. 40) Reasoned assessment may prove more complex than this, as indicated in the quote from Pope John Paul II on p.54. Political motivation on gender issues is also suggested by Margaret Mayman when she said: “Stereotypical notions of femininity have tended to obscure women’s violence or alternatively, it has been actively denied by feminists, both first and second-wave, because it complicates the interpretation of women’s ‘innocence’ and non-culpability in intimate violence” (Mayman, 2003). Durie on ethnicity also cautioned that it is, “important that the researcher should not to be captured by current ideologies that manicure a perception of the past to suit a current purpose” (Durie, 1999). This may also help to explain why the figures from one New Zealand study on the economic costs of family violence (Snively, 1994) continue to be used despite the study having serious flaws (Birks, 2000a), whereas a PhD thesis identifying gender biases in sentencing (Jeffries, 2001) has had little impact.

¹⁰⁵ Cobb and Ross’s more detailed formulation (identification groups, the attentive public and attention groups, and the mass public) has parallels with an earlier description by Bryce of:

“...three classes of person who have to do with the making of public opinion...the men who seriously occupy themselves with public affairs...those who, though comparatively passive, take an interest in politics...[and] all that large residue of the citizens which is indifferent to public affairs, reading little and thinking less about them.” (Bryce, 1929a, pp. 176-177)

The need for a small pressure group to gain wider support is also stated in, “...this kind of group is wholly dependent on the socialization of conflict...this is a trigger organisation which may start a chain reaction...” (Schattschneider, 1960, pp. 47-48)

1. With earnings data for one man and one woman, nothing can be said about the significance of any difference between them as nothing is known about the distribution of male and female earnings. More than one observation for each is required.
2. With a larger sample, assumptions can be made and tests undertaken for a difference in average incomes.
3. At the other extreme, if observations are available for every man and every woman in the population, the average male and female earnings can be calculated precisely. The estimate equals the true population value, the variance of the estimate is therefore zero. A difference as low as 1c is therefore statistically significant.

In other words, a finding that a gender pay gap does or does not exist depends on the sample size. However, this has **nothing** to do with significance for policy. Consequently, policy decisions should not be determined on the basis of statistical significance alone.

There is a second criticism of the interpretation of statistical significance. It involves a problem with the conventional interpretation of null hypothesis significance tests. It has been illustrated through a class of examples that have been presented in several places (such as J. Cohen, 1994, pp. 998-999; Taleb, 2005, pp. 206-207). The examples have tended to take the following form. There is a test for some illness that picks up say 95 per cent of true cases. Someone gets a positive result. What is the likelihood that the person has the illness. Through giving additional data on false negatives, it is shown that the answer is quite different from the 95 percent that many assume.

The explanation involves computing tables, and/or equations of conditional probabilities. These present the underlying logic, but have done little to change behaviour. Apparently, logical arguments are not necessarily very persuasive. It may be helpful to illustrate the point in the example by taking an extreme case. This reduces the detail required.

Consider a society that has such advanced technology that all coins are so well made that none of them are ever biased. Someone tosses a coin 6 times. Whatever side came up on the first toss is repeated for the next 5 tosses. The chance of such a result with an unbiased coin is $(\frac{1}{2})^5$ or about 3%. An analyst is likely to reason that the chance of this occurring with an unbiased coin is so low that the null hypothesis of unbiasedness would be rejected, concluding that there is a high likelihood that the coin is biased. For this example, **this would be wrong every single time** that the reasoning is followed. It is known that false positives can occur, but, it cannot be determined if a positive result is a false or a true positive (e.g. biased coins in this example) without using additional information.

There is a difference between a statement that the outcome is unlikely if the coin is unbiased and a statement that, given the outcome has been observed, the coin is likely to be biased. The reasoning uses the former to claim the latter. Ziliak and McCloskey refer to this as the “fallacy of the transposed conditional” (Ziliak & McCloskey, 2008, p. 17).¹⁰⁶

David Hendry also demonstrates the importance of an awareness of the fallacy, “If, say, 1000 possibly lagged, non-linear functions of a set of candidate exogenous variables in

¹⁰⁶ Consider the following table where A-D are the four possible outcomes of a hypothesis test:

	Null Hypothesis True	Null Hypothesis False
Reject Null Hypothesis	A (false positive)	B
Accept Null Hypothesis	C	D (false negative)

The 5 percent significance level means that $19 \times P(A|H_0) = P(C|H_0)$. In other words, there is a 5 percent probability of rejecting the null hypothesis, given that the first **column** applies. It is then often assumed to mean that there is a 5 percent chance of being wrong, when the null hypothesis is rejected. This is relating A to B and is conditional on being in the first **row**. The reject criterion is unlikely to be met if the null hypothesis is true (column 1). If the reject criterion is met (row 1), it is then commonly assumed that the null hypothesis is unlikely to be true. The condition has been transposed from the column to the row. This assumption is wrong because it considers no information about the situation when the null hypothesis is false. It is based solely on probabilities assuming the null hypothesis to be true. Hence the fallacy. Note also that Type I errors (A) and Type II errors (D) are both conditional in their respective columns. When an analyst has a test result the concern is for the row-conditional probability. See also Schmidt (1996) for misinformation from significance tests in a paper written for psychologists.

a model with many breaks are checked for relevance at a significance level of 0.1%, and all are indeed irrelevant, then on average **one** will be retained adventitiously...” (Hendry, 2009, p. 41)

It also appears in Gorard, Prandy and Roberts (2002, p. 11), who then describe the “prosecutor fallacy”, giving an example of a fingerprint or DNA test:

“Prosecutors tend to use the probability of such a match (e.g. 1 in 10,000) as though it were the reverse of a probability of guilt (9,999 in 10,000). However, they have to argue also that there is no human error in the matching process, that the match signifies presence of the suspect at the crime scene, that presence at the scene necessarily entails guilt, and so on. Above all, they have to demonstrate that the number of potential suspects is so small that a 1 in 10,000 chance is the equivalent of ‘beyond reasonable doubt’.” (Gorard, et al., 2002, p. 12)

A legal example is also given by Volokh. He describes how a claim that few women make false rape claims can be misinterpreted as meaning that claims of rape are unlikely to be false (Volokh, 2005).¹⁰⁷ In an example based on case law, Robertson points out that it is wrong to use the point that “36 per cent of adult survivors of abuse suffered from PTSD”, to assert that the presence of PTSD is evidence of this abuse (B. Robertson, 2003). As Robertson states, “Its value as evidence cannot be assessed without a figure for similarly placed non-abused people...”

4.2.2.b Interpretation: change X_1 or change b_1 ?

There is a fundamental point that is often overlooked. Even when the policy options under consideration are restricted to the relationship between X_1 and Y , the outcome depends on both the value of X_1 and the relationship between X_1 and Y . Researchers tend to pick one of these, most commonly a change in X . For example, more education is statistically associated with higher earnings, and so a recommendation aimed at increased earnings could be to provide more education (a change in X). For some

¹⁰⁷ Douglas Adams, in *The hitchhiker’s guide to the galaxy* used the same flawed reasoning in his “proof” of the non-existence of God (Adams, Moore, Jones, Jones, & Moore, 1981, p. 60).

variables, such an option is not available. Consider a statistical relationship between gender and earnings. As a general rule, a person's gender cannot be changed, so a policy recommendation might be for a change in the relationship between gender and earnings through regulation or market intervention such as affirmative action on pay and/or employment. These amount to policy changes to alter b_1 rather than X_1 . For many policy questions, both X_1 and b_1 may be variable, so both options should be available for consideration.

A common economics textbook illustration of this point can be seen with the treatment of externalities. Consider a market for a product with external costs of production. The standard treatment involves the addition of a "social cost" curve which comprises marginal private cost plus marginal external cost. A tax can be imposed to move the supply curve in recognition of this external cost (Doyle, 2005, p. 148; Stiglitz, 1993, p. 180). Some texts describe such an equilibrium point as the social optimum or the efficient point (Gwartney, et al., 2000, p. 128; Mankiw, 2007, p. 206; McTaggart, et al., 2003, p. 353; Sloman & Norris, 2008, p. 162). The assumption for this latter claim to be true is that there is a fixed relationship between the marginal cost of the externality and the output of the good (or b_1 is fixed).¹⁰⁸ An alternative, if the option is available, would be to target the externality directly. This would acknowledge the possibility of varying the external cost at any given level of output, which is analogous to a variation of b_1 (Mankiw, 2007, p. 217; McTaggart, et al., 2003, p. 352; Stiglitz, 1993, p. 589). Again, losers are not compensated.

The approach of targeting the externality directly can be taken further. In the supply and demand diagram, the externality is measured not in terms of the volume, but in terms of the value of the externality associated with an additional unit of output. Policies that target the externality directly and vary the volume of the externality assume a fixed value (cost) per unit of externality. Instead, it may be possible to alter this value.

Coase (1960) gives the example where people who are affected by an externality could move away so as to avoid the effects, thereby reducing the costs of the externality. In other words, a reduction in an external cost can be achieved through altering output,

¹⁰⁸ Even that is not enough as there is no compensation paid to the losers.

altering the production process, or altering the behaviour of those affected by the externality. In general, there may be many options available to alter the relationship between a variable, X_1 and another variable, Y .

There is an additional stage that could be added to Coase's assessment. His starting point is where the activities are in place. The courts then allocate property rights, after which the parties can then negotiate a mutually beneficial agreement.¹⁰⁹ As this discussion illustrates, an issue can be considered in increasing detail by allowing changes in additional variables. Instead of starting with activities in place as in Coase's farming example, consider a set of rules, or possible rules, on allocation of property rights and people considering strategies on location of an activity. The rules open up the possibility of game playing, or one party threatening or actually imposing costs on another. Coase writes of a cattle raiser expanding his activity when he would have to compensate a neighbouring crop farmer for any damage caused. He rightly suggests that this would not result in the neighbour expanding production to benefit from the compensation (assuming the crop farmer is a price taker). However, consider two cattle raisers as neighbours. If a crop farmer were to consider buying the land from one of the cattle raisers, this would impose costs on the remaining cattle raiser not directly involved in the purchase transaction. Consequently, existing rules can be used strategically (just as they can in sport, as with forcing or conceding penalties). In other words, economic analysis can become more complex, but also possibly, more realistic, through increased relaxation of *ceteris paribus* conditions. The role of law in Coase's example should be noted. A further step could relate to the determination of the rules. Beyond this, there are additional aspects to consider, including process and development over time with path-dependent changes in institutions and expectations, phenomena discussed further below. This illustrates the limited extent of the explanation contained in the initial supply and demand depiction of the effects of externalities. It also indicates that estimated models are bounded in their assumptions as to what can be changed, thereby limiting the range of policy options considered.

¹⁰⁹ Coase recognised the significance of transaction costs and suggested that this might limit the negotiation. Consequently he considered it important for efficient activity that the courts make the right allocation in the first place. This point has often been missed, as he indicated in his Nobel Prize lecture (Coase, 1991).

4.2.3 There are standard policy questions not covered by the econometrics

The examples in subsection 4.2.1.b above indicate that policy conclusions may be drawn or behaviour changes suggested on the basis of statistically significant relationships between variables. This can lead to poor decisions, as there are additional aspects that must be considered for a proper assessment. To illustrate, Example 3 is discussed here in more detail. While laws are unlikely to be drafted on the basis of this analysis, it illustrates the sort of thinking that may be used to justify policy interventions, and in some instances these involve legislative measures or decisions.

4.2.3.a An example – TV watching and attention problems

In September 2007 there was media coverage of a study on childhood television viewing and attention problems (Landhuis, et al., 2007). It serves as a useful illustration of the potential problems that can arise if policy recommendations are made on statistical association alone. One report in *The Press* (Hann, 2007) included the sort of information contained in a media release by the researchers (Hancox, 2007), together with further information from one of the researchers and a personal angle from a Christchurch mother. The main finding of the study was that “children who watched at least two hours of television a day were more likely to have short attention spans, and have difficulty concentrating on tasks”.

Hann quoted Hancox, “Although teachers and parents have been concerned that television may be shortening the attention span of children, this is the first time that watching television has been linked to attention problems in adolescence”. To put this in other words, people had suspected a causal relationship, but until now there had not even been any observed statistical relationship. Readers might be excused for thinking that a causal relationship had been found, although that is not what was said. The published study says, “As with any observational study, we were unable to prove that childhood television causes attention problems in adolescence”. It also presents possible alternative explanations for the observed relationship, but reasonably suggests that there may be some causal link, and that some limiting of viewing may be prudent for heavy viewers. The study includes a recommendation, “It, therefore, seems prudent to observe

the recommendation of the American Academy of Pediatrics to limit children's television viewing to a maximum of 2 hours per day" (Landhuis, et al., 2007, p. 536).¹¹⁰

There are several additional questions that could have been asked. On the statistical findings, it was found that childhood television viewing was associated with adolescent attention problems with a standardised regression coefficient of 0.12 and p of 0.0001. When adolescent television viewing was added to the equation, the coefficient fell to 0.06 and p rose to 0.0515, with results for adolescent television viewing being 0.16 and $p < 0.0001$ (Landhuis, et al., 2007, p. 534). If television viewing hours when young are correlated with viewing hours when older as this suggests, care should be taken in concluding that younger viewing causes problems later. It may not be possible to separately identify the effects of earlier viewing as suggested.

Questions could also be asked on the interpretation of the results in terms of recommended actions. Should the matter be a concern? What are "attention problems"? Are they really problems, and how serious are they? How many children have these problems, and what is the actual difference associated with extra hours of television viewing? What magnitude of benefits might be expected from reducing younger children's viewing? If viewing is reduced, what would the affected children be doing otherwise (do the average results apply to all)? If there are benefits from improved attention, what other ways might there be to bring about this change? Might any of these alternatives be easier to achieve or more effective? It would appear that there are a number of additional questions that should be considered before deciding on policy responses.

4.2.3.b Policy questions

As indicated by the example above, not only are there statistical issues to consider when drawing policy conclusions, but there are also a number of specific policy questions to

¹¹⁰ Figure 1 of the study (Landhuis, et al., 2007, p. 535) indicated fewer attention problems among those watching for 1-2 hours per day compared to those watching less than 1 hour per day, which suggests first that the relationship may be non-linear, and second that increased viewing may be beneficial for low watchers (if the relationship is causal).

ask. An “ideal” economic approach to policy decisions (assuming perfect information and zero costs of analysis) involves identifying all the available policy options, determining their effects, valuing them to calculate costs and benefits, and then applying a decision rule to select the best option. A statistically significant relationship in a regression equation tells nothing about alternative options. Nor does it address the question of costs and benefits. All it demonstrates is that it **may** be possible to alter the value of Y by changing the value of X_1 . Outstanding questions¹¹¹ include:

- a. Can you change X?
- b. At what cost?
- c. How much control is there over this change (how precise are the changes in X)?
- d. How variable are the effects on Y?
- e. What lags are there?
- f. What is the **value** of the resulting change in Y (what is the benefit, does it outweigh the cost)?¹¹²
- g. Are there any distributional effects (gainers, losers)?
- h. Are there any side-effects?
- i. Are there other policy options available (including changing the relationship)?

In summary, it is important to consider the ability to change the target variable, and the costs and benefits of such a change, along with those of alternative policy options to address the same problem. This information is not provided through a t-test.

¹¹¹ While these questions are raised in relation to econometric studies, they apply to all policy options where one (policy) variable is altered so as to bring about a change in another (target) variable.

¹¹² This is one of the key concerns raised in Ziliak and McCloskey (2008). Note that effects on Y, and the policy significance of the resulting Y, may not always be continuous. This can cause particular problems, especially where variability of outcome assumes particular significance. Consider the difference, for a non-swimmer standing in a tank of water, between a situation where the water level is exactly at shoulder height and one where the water level is, on average, at shoulder height. Econometric estimation gives average impacts only.

4.3 Conclusions

This chapter has shown that there is a large rhetorical component in the use of data and the specification and estimation of econometric models, as also there is in the application of results to real world issues. While econometrics may be useful for analysis and identifying relationships between variables, it is important to recognise the limitations of the approach. Type B errors can arise from incorrect assumptions at the specification stage. There are various types of assumptions to consider. It could be incorrectly assumed that data accurately represent the desired variables (including the required short-run or long-run equilibrium positions, for example). Properties of the data, such as cardinality, are assumed even for many index variables which do not meet this requirement. It is commonly assumed there are no problems arising from aggregation in various forms, including over time and space. As has been shown, aggregation over time can cause serious problems when trying to estimate relationships between variables.

In obtaining results, further type B errors can arise. It is not always recognised that statistical results merely consider relationships between numbers, and are not dependent on what the numbers represent. Consequently results are interpreted as specifying relationships between particular variables. Not only are statistical relationships treated as relationships between variables, but, paradoxically, a variable can be specified as representing itself, or acting as a proxy for something else, as convenient for the analysis.

Econometric estimation allows for a limited range of functional relationships between variables, searching only for solutions within this limited range to the exclusion of other possibilities. “Controlling for” other variables can give results which are claimed to be economically meaningful, although the control variables may be causing arbitrary distortions. Also, many relationships may be based on the co-existence of a set of required conditions, as with INUS conditions. These are unlikely to be considered in econometric estimation.

The assumption of structural stability is required in order to have a structure to estimate and a large enough number of observations for the estimation method. This assumption may not be realistic, especially given a historical view of changes over time. Other concerns can be raised about the relevance of results for policy. Econometrics tends to give results based on average effects, whereas important results for policy may be marginal impacts. Outliers can be important and, more generally, a large amount of the available information is not suitable for econometric analysis, but this does not mean that it should be ignored. Later chapters of this thesis draw on some of these alternative information sources.

At the policy stage, type C errors may arise. In part, this is due to problems in the nature of statistical tests and the interpretation of the results. The criterion commonly used in statistical tests has been questioned, especially in terms of misinterpretation of results due to the fallacy of the transposed conditional. A bigger difficulty is the limited value of econometric results for addressing many of the questions which economists might wish to ask when considering choice of policy options. The results from regression models provide estimates of specified relationships between the chosen variables. This provides part of the information required for a subset of policy options. It is part of the information because it does not consider aspects such as the changes that can be achieved, the cost and value of those changes, and alternative policy options. It is a subset of policy options because the focus is on changing variables, not relationships, to achieve the outcomes, and the search is for common determinants that might be widely effective, while policies more closely focused on individual circumstances are not considered. Economic analysis is commonly tightly structured within a theoretical framework. While that can be very helpful, it means that certain aspects have been excluded, or assumed away.

While many analysts may present their findings carefully, there is also the danger that others, including the media and the public, will draw false inferences from their results. They could also be misused in a political environment, as suggested by Dunn's argumentation by method (see section 2.3.1 above). Consideration of these factors and attention to the additional issues could increase the value of econometric analyses by placing them in a wider analytical context. Recognitions of the issues also results in an additional range of research questions, types of data to consider, and associated research

methods, that economists could profitably consider. This is a major reason for the approaches taken in the following chapters in this thesis.

There are two additional points to be taken from this chapter. First, economic thinking is used both as an input into the law (its formulation and implementation), and for an evaluation of the law. As with Chapter 3 and theory, where empirical analyses are used, rhetoric, overstatement and incorrect conclusions may be found in legal deliberation. Second, the chapter gives an illustration of a group having its own perspectives, techniques and conventions. The same could apply to other disciplines and to professions, including lawyers and others associated with the law. Each may have its own perspectives, techniques and conventions, and these may not be regularly re-evaluated. Group cultures and group beliefs that may not match those of other groups, and which may not stand up to careful scrutiny, are to be expected within disciplines, professions, and political and social groups.

Chapter 5 Downs with traction

5.1 Introduction: “macro-rhetoric”

Chapter 2 demonstrated that academics focusing on the process of policy making have been critical of economics. There appears to be some validity in their criticisms, especially in the assumptions of rationality and knowledge which, while probably reasonable for many consumption activities, may not be suitable for consideration of policy issues. Conversely, economics also has some strengths in its attempts to determine the effects of interactions and the desirability of outcomes. Chapters 3 and 4 have indicated that the reality of economic analysis may itself involve distorted perceptions and misinterpretation of results where there is a failure to recognise limiting assumptions in the reasoning. This in part arises from the concepts and approaches used, so it may be beneficial to consider alternative possibilities by going outside these methods. In part, this can involve using additional information beyond the types of data considered in economic theory and quantitative analysis.

All forms of analysis have limitations, if only because explanations are based on simplified analogies and there are issues in the selection and interpretation of data. Nevertheless, novel insights may be obtained through the alternative perspectives. As indicated in Chapter 2, and discussed further below, attitudes and public opinion can be shaped, and are important in the determination of policies, including those realised through the law. They can also be important in the implementation of the law. Downs addresses issues in policy making, but subject to restrictive assumptions. This chapter sets the context, and then provides some alternative propositions to Downs, taking into account other literature and concepts, beginning with a discussion on rhetoric.

Downs (1957) presented a theory of political behaviour, aspects of which have come to be widely acknowledged, even among political scientists.¹¹³ This is paradoxical in that his theory is based on assumptions that he recognises as unrealistic. These assumptions are standard in economics, and have been a source of criticism from other disciplines.

¹¹³ Including comments from the floor at the 2007 New Zealand Political Studies Association conference in response to a paper forming the basis of Chapter 2.

An attempt is made in this Chapter to produce a set of propositions along the lines of Downs, but reflecting a broader range of literature from other disciplines. The results are likely to be more consistent with established and accepted thinking in those areas. They may also be more realistic.

This introduction presents the concept of “macro-rhetoric”. It summarises, synthesises and discusses several literature sources which, collectively, contribute to that concept. It is therefore in part a literature review, but it also develops the literature as a basis for critiquing common economics assumptions.

Anthony Downs presented 25 “specific testable propositions” in *An Economic Theory of Democracy* (Downs, 1957). These were based on assumptions about the political system, including the motives of politicians and voters. In his description he includes detailed consideration of uncertainty and the implications of there being costs associated with information gathering. Nevertheless, he states, “Throughout this thesis, we assume that no false (i.e. factually incorrect) information exists...” (Downs, 1957, p. 46) He also states, “Our model in particular ignores all forms of irrationality and subconscious behavior even though they play a vital role in real world politics.” (Downs, 1957, p. 34)¹¹⁴

These are extreme assumptions and may give a distorted view, although they are implied in modern mainstream economics texts (Baumol & Blinder, 1991; McTaggart, et al., 2003). This reflects a significant narrowing of perspective since the early days of economics. Adam Smith, sometimes referred to as the “father” of modern economics, gave a series of lectures on rhetoric in 1762 and 1763 (A. Smith, 1963). This was not remarkable at the time. Smith reflected a long tradition (dating back to classical Greece) where both logic and rhetoric were considered central to a good education. Briefly, we could consider logic to be concerned with proof, whereas rhetoric is concerned with persuasion. When describing the rhetoric of political debate, whereby policy decisions

¹¹⁴ Downs also considers politicians to be vote maximisers. Riker is critical of this and suggests an alternative “size principle: that parties seek to increase votes only up to the size of the minimum winning coalition” (Riker, 1962, p. 100).

are made, Smith used the term “deliberative eloquence”.¹¹⁵ People are not necessarily swayed by detailed, technical, logical arguments (A. Smith, 1963, p. 139). It is more likely that they would be persuaded by simple points and rhetorical techniques such as humour, the use of analogy, or appeals to authority or to emotion.

Some more recent analyses could be considered as “macro” approaches to rhetoric, as compared to traditional rhetoric, which is “micro” in focus, looking at individuals in debate.¹¹⁶ For example, literature on the processes of policy making can be seen to draw on the scholarship of rhetoric. Hence, consider Dunn’s eleven “modes of argumentation” (see section 2.3.1), describing ways in which positions can be presented so as to persuade people to a particular viewpoint. Logic is not mentioned¹¹⁷, and the presentation of logical arguments may not be very effective in comparison to other approaches, as indicated by advertising and celebrity endorsement. Consequently the results of studies may be convincing, although this is not necessarily related to the quality of the studies themselves.¹¹⁸ Persuasive methods include “authority”, the use of a source or personality that people trust¹¹⁹, and “analogy”, applying an approach in one context that people already accept in another (even though it may not, in fact, be suitable). Some of the research techniques that analysts apply may have achieved acceptance on such grounds also. Dunn’s “modes of argumentation” suggest that Downs is making overly strong assumptions about the correctness of information and

¹¹⁵ He also described “judicial eloquence”, or methods of persuasion in court.

¹¹⁶ A term such as “macro-rhetoric” draws, by analogy, on the economic distinction between microeconomics and macroeconomics, but it also serves as a unifying concept to bring together traditional rhetoric and a range of current perspectives on the formation and shaping of social attitudes.

¹¹⁷ Dunn’s listing of “method” (techniques such as econometrics) and “cause” (such as economic “laws” based on theory) relates to their use for rhetorical purposes, in that people may be swayed by arguments couched in those terms, even if the logic is questionable. This issue in economics is addressed, with strong support for claims of rhetoric, in McCloskey (1998).

¹¹⁸ McCloskey (1998) devotes much attention, in her book and elsewhere, to the distinction between statistical significance and economic or policy significance. She stresses that many refereed studies fail to note the difference, resulting in questionable policy conclusions.

¹¹⁹ The use of celebrities to endorse finance companies, many of which ran into difficulties, is discussed by Taylor (2008). “Celebrity” influence is sometimes considered as “authority”.

the rationality of individuals. At the very least, selective presentation of information will give a distorted picture which would not be incorporated into Downs' model.¹²⁰

Other fields are also relevant. Literature on critical discourse analysis focuses on the use of selected words to emphasise a particular perspective, and on broader approaches to "frame" issues in desirable ways. This perspective has been adopted by others also, hence:

"The formal, structural dimension is only one dimension of control over the decision-making process. There is also the more substantive side: policy-makers who take the initiative in **framing** the problem and proposing solutions improve the chances of these solutions being accepted. To this end, the decision-makers may not simply use the force of argument; they may also resort to more manipulative tactics, such as using their monopoly on certain types of policy-relevant information to present their colleagues in the relevant decision units with a highly stylized picture of the issues involved." (Goldfinch & Hart, 2003, p. 242)

Fairclough (1995) refers to "ideological-discursive formations" (IDFs) which groups may use to define debate in a way that favours their perspective.¹²¹ If a particular IDF dominates to the exclusion of others, it may be seen as the norm, rather than as a particular perspective.¹²² Public perceptions and media presentation of issues will be

¹²⁰ Richard Prebble MP's speech at NZPSA 2008 conference dinner included entertaining examples of the way someone can be labelled to undermine their support. For a fictional account with more than a grain of truth, note *Yes Prime Minister* (Lynn & Jay, 1989, pp. 363-364).

¹²¹ Note, "Gramsci's 'war of position' is in fact a war of competing narratives, competing constructions of crisis, increasingly fought out in the media between conflicting political elites." (Hay, 1996, p. 274)

¹²² Note also Gramsci's concept of hegemony: "hegemony is a ruling class's (or alliance's) domination of subordinate classes and groups through the elaboration and penetration of ideology (ideas and assumptions) into their common sense and everyday practice; it is the systematic (but not necessarily or even usually deliberate) engineering of mass consent to the established order." (Gitlin, 2003, p. 253) Others have suggested that this may be due to passive compliance rather than engineered dominance, and may be inevitable. Viscount Bryce, in a book first published in 1921, stressed the small number of people who actually make the decisions of government, even in a democracy (Bryce, 1929b, p. 597). He contended that those who can influence decisions comprise an "infinitely small" proportion of the

heavily influenced by dominant terminology and frames.¹²³ Considine (2005) describes policy as the result of competition between groups, each trying to create the dominant perspective. In a similar vein, and as also described by Goldfinch and Hart above, other literature emphasises the setting and denial of agendas (Cobb & Ross, 1997b; Hilgartner & Bosk, 1988; Rochefort & Cobb, 1994).¹²⁴

Public perceptions are shaped by the information that is transmitted in these processes. It might be hoped that debate in the media would result in an informed public. Bourdieu doubts this. He suggests that television favours people whom he terms “fast thinkers” (Bourdieu, 1998). He does not mean that they actually think quickly. Rather, they are able to give quick answers that will be accepted. Far from thinking, they are simply tapping into currently held beliefs, thereby getting instant audience acceptance and giving the appearance of being knowledgeable.¹²⁵ His point could apply to much of the

population (Bryce, 1929b, p. 596). He referred to Rousseau, who wrote on control by a few (Rousseau, 1968, pp. 112-113). Consider also the quote from Bastiat on p.196 below on slaves accepting the law.

¹²³ Bertrand Russell made a related point in his essay, “On being open-minded”. He was writing in the 1930s (the essay was first published in *The Nation* in 1937) and so he framed his points in the perspective of an earlier generation. Presenting a possible reason why certain language and views may dominate, and why people may choose to conform to these conventions, he wrote:

“The belief that fashion alone should dominate opinion has great advantages. It makes thought unnecessary and puts the highest intelligence within the reach of everyone. It is not difficult to learn the correct use of such words as 'complex', 'sadism', 'Oedipus', 'bourgeois', 'deviation', 'left'; and nothing more is needed to make a brilliant writer or talker...Quite deliberately [the modern-minded man] suppresses what is individual in himself for the sake of the admiration of the herd.”

(Russell, 1950, pp. 66-67)

Russell also described the lack of incentive or reward for those who might consider a more independent path.

¹²⁴ Richard Prebble MP has said:

“In the days of first-past-the-post elections, the two parties held many ritualistic debates. What was most interesting though was what we did not debate. If the two parties did not want to discuss an issue, no matter how important it might be, it simply was not discussed on the floor of this House.”
[24 May 2004, 617, NZPD, 13187]

Chapter 6 below gives some indication on whether there has been much change since the introduction of a mixed-member-proportional system.

¹²⁵ A similar point was made by Galbraith in relation to what he termed “conventional wisdom” when he wrote, “Individuals, most notably the great television and radio commentators, make a profession of knowing and saying with elegance and uncton what their audience will find most acceptable” (Galbraith,

mass media. Consequently, dominant frames are emphasised, prior beliefs reinforced, and false perceptions perpetuated. This can have a significant impact on people's understanding of issues and priorities, at least those for which they have little or no direct personal experience.

On 17 November 2008 there was a public discussion by three editorial cartoonists in the Palmerston North City Library. It was a spin-off from a "cartoonists for peace" conference that was held in Wellington. One revealing comment was provided by Grant Buist, who said that it took him about two hours to do a cartoon. Garrick Tremain voiced a preference for doing a cartoon a day. The clear impression given by all three cartoonists (the third was Pierre Wiazemsky from France) was that they did not research the issues, but they used the cartoons to make a point. If political cartoons are likely to be influential, it is worth noting that they may simply be reflecting current, or idiosyncratic, viewpoints, rather than revealing additional, informed insights.¹²⁶

Hardin (2002) uses the term "street-level epistemology" to describe the way people's "knowledge" on many issues is simply what they have heard and accepted from others, who have in turn heard the information from elsewhere. He describes it as follows:

"...the bulk of our knowledge...depends on others in various ways. We take most knowledge on authority from others who presumably are in a position to know it. Indeed, we take it from others who themselves take it from others and so forth all the way down. There are finally no or at best vague and weak foundations for most of an individual's knowledge." (Hardin, 2002, p. 216)

1999, p. 10). Mark Twain made a similar point in a letter to Mrs Mary Hallock Foote dated 2 December 1887, reprinted in DeCasseres (1934), "All you need in life is ignorance and confidence; then success is sure". Note also that someone with a more open and questioning attitude is less likely to sound confident when presenting opinions.

¹²⁶ It may be hard to identify any influence on opinions by statistical means. Young, attempting to assess the importance on attitudes of late-night comedy states, "political comedians argued that since jokes are based on what the public already believes, their influence on public opinion was inconsequential" (D. G. Young, 2004, p. 2). The three cartoonists also, in answer to a question whether cartoons had an impact, were adamant in their denial, although this might not have been their honest opinion. From a perspective of framing, dominant IDFs and agenda setting and denial, the influence may be less benign.

Such information is not checked out. Hence, it is easy for misinformation to spread and false beliefs to be widely accepted.^{127 128}

The implications of these processes and phenomena have long been recognised. Over 150 years ago, Charles Mackay wrote *Extraordinary popular delusions and the madness of crowds* (Mackay, 1995). The introduction to the 1995 publication of the text was written by Norman Stone, Professor of Modern History at the University of Oxford. In it he wrote:

“Throughout the world people have tended to focus on individual issues rather than on the good of society as a whole...frequently the zeal with which campaigns are conducted damages the causes they are meant to promote...The examples are numerous...Surely they managed things better in the past? Well no, they didn't. Of necessity, the oddities of our age are peculiar to it, but...human folly changes only in detail and not in scale.” (Mackay, 1995, pp. v-vi)

And in the Preface to the 1852 edition, author Charles Mackay wrote:

“In reading the history of nations, we find that...whole communities suddenly fix their minds upon one object, and go mad in its pursuit; that millions of people become simultaneously impressed with one delusion, and run after it, till their attention is caught by some new folly more captivating than the first.” (Mackay, 1995, p. xv)

¹²⁷ Note “proof by repeated assertion”, the “availability heuristic” (Tversky & Kahneman, 1973), or the concept of “communal reinforcement” (Carroll, 2009). Note also, a principle of advertising by Claude Hopkins that he first published in 1927:

“People are like sheep...We judge things largely by others' impressions, by popular favor...when we see the crowds taking any certain direction, we are much inclined to go with them.” (Hopkins, 1998, p. 119)

¹²⁸ Such phenomena are not restricted to the street. University students absorb received wisdom from academics who, in the main, are conveying an accepted body of knowledge. Displacement of dominant bodies of knowledge can be a slow process, even when the body has numerous identified flaws (M. Desai, 1981; Gellner, 1964; T. S. Kuhn, 1970; Lakatos & Musgrave, 1970).

This is not to say that Stone and Mackay are necessarily correct, but Mackay describes numerous examples that illustrate his point. Current discussion of moral panics¹²⁹ supports Stone's contention that every generation has its own popular delusions. Goleman's description of frames and schema further support the view that societies see their world through particular lenses that shape what they see (Goleman, 1997).

5.2 Economics and logic

Mainstream economic theory is based on people having preferences that are fixed, or determined "outside the system/model" (exogenous, rather than endogenous, preferences) (S. Bowles, 1998).¹³⁰ There is then no need to explain preference formation. This is convenient as a means of simplifying the analysis, but it is not very realistic. There is also an assumption that people are "rational". In this context, this means that, given their preferences and available information, they will act in such a way as to do the best they can according to those preferences. There is a presumption that logic dominates.

There is no place for rhetoric or persuasion in such a view of the world. At the most fundamental level, rhetoric is unlikely to have even developed as a separate field of study if people were only persuaded by logical arguments. Schopenhauer, in his Stratagem No.28 for winning arguments, makes the point that a logic-based response to rhetorical criticism would not be effective. Such a defence, "would require a long explanation...and a reference to the principles of the branch of knowledge in question,

¹²⁹ Cohen, for example, states, "Sociologists such as Becker and Gusfield have taken...cases...to show how public concern about a particular condition is generated, a 'symbolic campaign' mounted, which with publicity and the actions of certain interest groups, results in what Becker calls *moral enterprise*: '...the creation of a new fragment of the moral constitution of society'" (S. Cohen, 1980, p. 11). For a New Zealand case study, see Hood (2001). Note also the more extreme "risk society crises" (Krinsky, 2008; Ungar, 2001). Even Garber's challenge to the tulipmania story does not discredit the case for delusions, in that the story has been believed for a century and a half (Garber, 1989).

¹³⁰ Economists are not the only ones to make this assumption. "Intergovernmentalism itself generally takes member-state preferences as given, focusing instead on how member states seek to pursue those preferences" (Pierson, 1996, p. 128)

or to the elements of the matter which you are discussing; and people are not disposed to listen to it" (Schopenhauer, c1851).

Abraham Lincoln recognised this and understood the need for simply presented messages. He explained his wish to use the expression, "The house divided against itself cannot stand", in a major speech in June 1858, "I want to use some universally known figure expressed in simple language as universally well-known, that may strike home to the minds of men..." (Herndon & Weik, 1961, p. 322).

Given Adam Smith's familiarity with rhetoric, economics appears to have taken a backward step by disregarding this major aspect of policy making and implementation. Downs was well aware of the simplification, and the consequences in terms of a lack of realism. Nevertheless, he based his exposition on two such assumptions (see p.112). This approach is understandable on one level. It is relatively easy to model and analyse a purely logical world. Consideration of rhetoric and endogenous preferences presents major problems for the use of many commonly applied economic methods of evaluation. How are economists to determine costs and benefits if the values that are observed through either actual behaviour or elicitation through surveys, etc., can be influenced by rhetoric and false or misleading information?¹³¹

These aspects are likely to be of particular relevance for issues where individuals have little or no direct involvement, so their opinions are not shaped by first-hand experience, and for issues which require collective action, so that there is little benefit to an individual from acquiring an accurate understanding.¹³² These conditions apply for many policy issues, and for areas of policy implementation such as jury service. Cobb and Ross (1997a, p. 7) describe "attention groups", whose support is necessary for an issue to gain a place on the policy agenda. They also describe mechanisms whereby the

¹³¹ For an example, see Birks (2007b).

¹³² The frequency of similar events can also be important. Taleb describes what he refers to as "the inverse skills problem" (Taleb, 2005, p. 254). He argues that the competence of senior executives may be lower than those of middle-tier executives because the latter can be monitored on numerous repeat decisions whereas the former only do one-off big decisions. Established monitoring systems for repeat events also lower costs of information gathering.

agendas of less powerful groups can be denied. These dimensions suggest a dynamics to political processes that cannot be addressed by assuming fixed preferences.

Lakoff and Johnson suggest that our perceptions can be distorted because much of our information is obtained indirectly. Hence:

“...many aspects of our experience cannot be clearly delineated in terms of the naturally emergent dimensions of our experience. This is typically the case for human emotions, abstract concepts, mental activity, time, work, human institutions, social practices, etc....Though most of these can be *experienced* directly, none of them can be fully comprehended on their own terms. Instead, we must understand them in terms of other entities and experiences, typically other *kinds* of entities and experiences.” (Lakoff & Johnson, 2003, p. 177)

The discussion in Chapter 25 of their book is on the myths of objectivism and subjectivism, and is worth noting. In particular, “In terms of real power in our society – in science, law, government, business, and the media – the myth of objectivism reigns supreme.” (Lakoff & Johnson, 2003, p. 192) The above quote from p.177 suggests that our actual perceptions are a synthesis of objective and subjective aspects. This is subsequently described by the writers. They make the point that objectivism misses the fact that understanding depends on how the world is framed, and subjectivism misses the fact that framing, or a “conceptual system” “is grounded in our successful functioning in our physical and cultural environments” (Lakoff & Johnson, 2003, p. 194). This last point may explain why there can be greater problems with policy and implementation issues, as they are less closely associated with our individual functioning.

Downs’ approach was to present several propositions that were plausible, given his assumptions. The following section takes a similar approach, but relaxes Downs’ assumptions on rationality and the absence of false information, hence assuming a “macro-rhetoric” environment.

5.3 Downs with traction

Traction is a term frequently used in politics to indicate that an issue has attention. It is not a precisely defined term, although it has acquired widespread usage and acceptance. Its applicability in particular instances arises from a perception or belief by decision makers that the issue has assumed sufficient prominence in terms of concern by relevant people. It could be considered to indicate that an issue has been placed on an agenda, as in agenda setting and denial (Cobb & Ross, 1997a). While a precise definition would be preferable, loose recognition of a characteristic in this way is not unknown.¹³³

Points can be made, and evidence presented, but without traction there is unlikely to be the interest or support for an issue to gain a prominent position on a policy agenda. Even if an issue is important to a dominant political party, the party risks unpopularity and resistance if it proceeds without popular acceptance. There is a close association with rhetoric, both micro and macro, in that these latter consider how people can be persuaded to see issues in particular ways. The need for traction is a constraint on political activity, and it also suggests an arena in which political contests take place. The following general points and associated propositions are not comprehensive. Rather, they are an attempt to indicate, in a Downs-like framework, some of the important implications of this activity.

5.3.1 A limited number of issues

The operation of the media and the importance of “traction” suggest that Downs’ approach could be modified to consider agenda-setting and the shaping of observed preferences. For the purposes of an exploratory investigation, consider the possibility that there can only be a limited number of policy issues on the agenda at any one time. There are broad reasons for this. Simon, on “attention scarcity”, writes, “...a wealth of information creates a poverty of attention and a need to allocate that attention efficiently among the overabundance of information sources that might consume it” (Simon, 1971,

¹³³ Consider Rawls’ approach in *Justice as fairness: a restatement*:

“The terms ‘reasonable’ and ‘rational’ will not be explicitly defined. We gather their meaning by how they are used and by attending to the contrast between them.” (Rawls, 2001, p. 82)

pp. 40-41). From a basic economic assessment, there are costs of gathering and processing information, and there are, at least initially, economies of scale in gathering information on specific issues. The media are important for the transmission of this information, and they influence the number of issues addressed and the quality and nature of information presented. This point is discussed further in Birks (2008). Also, Hardin's concept of "street-level epistemology" suggests that people take their knowledge from others without much individual critical assessment (Hardin, 2002). This is closely linked to critical discourse analysis (CDA), whereby the form of presentation of information shapes people's perceptions. As items on the political agenda require co-ordinated action, it is generally not enough for interested individuals to develop a degree of understanding on their own. However, it is easy to "overload" the system:

"Large public problems...periodically require a synchrony of public attention. This is more than enough to crowd the agenda to the point of unworkability or inaction."
(Simon, 1971, p. 47)

The general public may only be willing or able to consider a few options at a time, but politicians who wish to set agendas will also seek to limit the options available for discussion. Whatever the reason, it has been observed that "...for any problem at the regime or macro-level of discussion and analysis **there are remarkably few alternatives actually under debate**" (Bosso, 1994, p. 184). Similarly (original emphasis), "There are billions of potential conflicts in any modern society, but *only a few become significant*" (Schattschneider, 1960, p. 66).

Consequently it is plausible to suggest that issues are not set by individuals, as might be assumed in economic theory based on individuals each with their own exogenous preferences. Rather, it may be more realistic to consider them set by politicians, pressure groups and the media, after which individuals form their opinions. This may be a large adjustment for formal models as commonly used in economics. However, in a general description it is only a small step. The result is that it opens up the possibility of a synthesis of the approaches. This gives a first proposition under a traction approach:

Proposition 1: There is a limited number of issues with traction at any one time.

5.3.2 Parties competing for traction

Parties select issues either because they fit their policy agenda or because they believe that they will win votes. If an issue has traction, it has public attention. Consequently, voters are likely to believe that something should be done about it. Hence there will be voter support for policies that are perceived to be addressing issues with traction. As parties are competing against each other, their aim is to achieve traction on their issues, but not on those of other parties. This is central to the themes of agenda setting and denial.¹³⁴ Hence the claim, “the definition of the alternatives is the supreme instrument of power” (Schattschneider, 1960, p. 68).¹³⁵ This gives a second proposition:

Proposition 2: Parties aim to achieve traction on their issues and prevent traction on others.

5.3.3 Parties’ reaction to issues with traction

If an issue already has traction, either through the action of other parties or pressure groups, or through the media, or via international transmission of policy issues¹³⁶, parties will feel obliged to have policies on those issues. This is because they are backing issues with popular support, and because failure to address the issues would suggest indecision and lack of an agenda.

Proposition 3: Parties back issues with traction.

¹³⁴ For a description of some of the mechanisms that may be applied to this end, see Cobb and Ross (1997b).

¹³⁵ Discussed further, along with the influence of such actions on groups, by Barbalet (1991).

¹³⁶ Pierson (1996) uses a historical institutionalist structure to consider international transmission of policy. One mechanism whereby this occurs is through reporting to and by international bodies, such as the UN Committee on the Rights of the Child, the UN Committee on the Elimination of Racial Discrimination, and the UN CEDAW Monitoring Committee. International action on climate change also illustrates this point. It can also occur country to country. New Zealand’s system of family group conferences which has received much attention and been adopted overseas (Wiffin, 2006).

5.3.4 Creation of new issues

It is harder to generate traction for a new issue than to present policies for an issue that already has traction. Also, there are a limited number of issues with traction, but numerous other issues which are not receiving attention. It can be difficult to focus attention on a new issue at the expense of prevailing recognised concerns.¹³⁷

Proposition 4a: Parties are more likely to invest in an issue with traction than to generate traction for a new issue.

Besides agenda denial strategies, there can be conspiracies of silence to overcome, “...a conspiracy of silence, whereby people tacitly agree to publicly ignore something of which they are all personally aware” (Zerubavel, 2007, p. 181)¹³⁸. This could extend to the entire realm of political matters, which, as Eliasoph described, can become a taboo subject within a social network due to the social riskiness of voicing political opinions (Eliasoph, 1998). So society, or groups in society, may fail to discuss significant policy issues. In general, this is unlikely to be rectified through the news media, which aim to appeal to the public and therefore focus on issues that are known to be of interest, as discussed further below.

Proposition 4b: The media tend to reinforce the prevailing pattern of issues with traction.

¹³⁷ This can explain why more attention may be given to the process of achieving and maintaining awareness than to debate on the details of policy issues, options and responses (rhetorical matters rather than analysis).

¹³⁸ This is further illustrated:

“Watching Peter disregard a distinctly audible comment...may lead Paul to consider it irrelevant and thereby disregard it as well, yet watching Paul also ignore it may in turn reinforce Peter’s initial impression that it was indeed irrelevant. We basically have here a vicious cycle...increasingly reverberating [as others] join the conspiracy, which is how an entire society may come to collectively deny its leaders’ incompetence, glaring atrocities, and impending environmental disasters.” (Zerubavel, 2007, p. 187)

As described in section 2.4, Sowell suggests that organisations initially established to promote affirmative action face inbuilt pressures to grow. Such organisations can be expected to find new dimensions for their issues so as to have a continuing reason to exist. Similar points are made in literature on historical institutionalism.¹³⁹

Proposition 4c: Institutions that have been established due to an issue with traction aim to maintain that traction through expansion of the issue.

5.3.5 Shifting public opinion

Many policy issues are beyond the scope of individual action, and therefore have received little individual attention. Concern for such issues depends in part on the concern expressed by others. If something is considered by many to be important, more people will invest time and emotional energy into being concerned. Cobb and Ross would say that an issue has successfully spread beyond the “identification group” , being understood by the “attentive public” and adopted by some of the “attention groups” (Cobb & Ross, 1997a, pp. 7, 21). Hardin (2002) might suggest that the position is spread through street-level epistemology. Downs (1972) hypothesised that many issues are subject to an “issue attention cycle”, whereby interest and support can be generated for a time among members of the wider community.

Proposition 5a: As an issue generates traction, public opinion will swing further in its favour.

When the government promotes a particular issue or position, there is a greater belief that something can be done about it. Also, there is perhaps a natural tendency for people to align themselves with the prevailing authority (as suggested by the Stockholm

¹³⁹ Schattschneider made a similar point with groups formed in support of an issue:

“A successful alignment accumulates a tremendous body of hangers-on. The question is: What other uses can be made of the power won by the dominant cleavage?” (Schattschneider, 1960)

By cleavage he means the division that split other groupings to create this particular one to support some chosen issue.

syndrome¹⁴⁰)¹⁴¹. In part, these effects may arise because issues closely related to the government are more newsworthy, especially if fronted by official spokespeople who thereby lend their authority to the positions they take. “Officialness makes the news statist, that is, it contributes to a tendency to cover state voices rather than civil ones...” (Schudson, 2003, p. 54).

Proposition 5b: The public will tend to move in favour of policies promoted by the current government.

5.3.6 The use of traction

If the key to policy acceptance is traction, then the aim for political parties is to exploit this so as to get their preferred policies accepted. Rhetorical strategies will be used to achieve traction. Reasoned analysis and argument may not be required. In fact, this can be counter-productive if it is less likely to attract public attention than other approaches more suited to the prevailing media, such as careful choice of language, or framing.¹⁴²

Proposition 6a: It is easier to generate traction through authority, celebrity support or framing than through detailed, informed presentation of information.

If an issue has traction, then it may be more effective than valid, reasoned argument as a basis for a policy change. For example, the New Zealand government raised nurses’ pay in 2006 on the basis that, as a woman-dominated occupation, there must have been

¹⁴⁰ See section 3.2.4.b.

¹⁴¹ See also, for example, Chapter 22 of Strentz, describing, “the common occurrence of people adopting the values and beliefs of a new government to avoid social retaliation and punishment” (Strentz, 2005, p. 247). A possible example from the Czech Republic is given by Newman (2009).

¹⁴² Note, for example, the New Zealand Labour Party’s emphasis on language (Curran, 2006). Hence, “Use language to create identity...Create an identity for Labour that mirrors positive core values of decent New Zealanders – so that people know what Labour is without having to talk about issues.” (Curran, 2006, p. 9) A similar approach towards the climate change debate is described by Broder (2009). Also indicative of political preferences and process, “There is nothing a government hates more than to be well-informed; for it makes the process of arriving at decisions much more complicated and difficult” (Keynes, 1937, p. 18).

discrimination against them resulting in low pay. This argument was used in preference to a probably sounder (economics/market-forces based) case that the prevailing rates of pay were insufficient to overcome a nursing shortage. The discrimination argument suited and reinforced the position presented in Department of Labour and Human Rights Commission documents (Crossan, 2004; Mintrom & True, 2004). This may be an easier way to obtain a desired result than trying to generate traction through honest presentation of information, and it serves to reinforce the issue.

Proposition 6b: An issue with traction may be used as a false justification for a policy rather than a more logically-based alternative.

5.3.7 The importance of process¹⁴³

A major focus of politicians' attention is on obtaining and maintaining public support, publicly measured by relative performance in the polls. This is necessary, if only for political survival. Downs describes his model as being "based on the assumption that every government seeks to maximise political support" (Downs, 1957, p. 11). This is then interpreted as vote-maximisation (Downs, 1957, p. 31). Given the importance of rhetoric, and arguably a need for apparently decisive government, there is little scope for logical policy development with detailed consideration of and evaluation of the options. Instead, the actual policy direction may have already been decided, and the requirement is then simply to follow expected processes (such as consultation, and possibly public submissions).^{144 145}

¹⁴³ Note also Appendix 1.

¹⁴⁴ For a description of the importance of process, and people's willingness to accept the results if the required processes are followed, see Tyler (2000). Martin and Wilson suggest that a similar view may be held by those implementing laws, with "a legal system which often confuses due process and substantive fairness" (Martin & Wilson, 1997, p. 21). March and Olsen take these points a stage further, suggesting that processes may be followed for symbolic purposes. The aim is to gain acceptance and compliance with decisions (March & Olsen, 1989, pp. 48-50). Whiston (2009) discusses concerns by academic researchers in the UK that unfavourable research is suppressed, poor research supporting the government position is promoted, and the peer review procedure is abused. He also described consultation exercises, "where the topic had already been decided, already cut and dried, and the plan to implement already constructed".

Indications in New Zealand of a political focus on short-term deliberative issues can be seen in the 2009 Sir Ronald Trotter lecture by Stephen Jennings, who said:

“For the last decade or so, New Zealand’s political leaders have sought to retain power by placating and balancing narrow short-term political interest groups through incremental and relatively minor policy adjustments...incremental decisions favouring special interests have tended to take precedence over bold decisions favouring the majority.” (Jennings, 2009)

Former cabinet minister Tim Barnett MP has been quoted as saying, "The frustration in politics is that it's hard to be strategic, as you are living for the next issue and the next day and it's quite media focused and you're always trying to get coverage for what you're saying and what you're doing" (Gates & Williams, 2009). His cabinet colleague, Steve Maharey MP’s valedictory speech in the House on 25 September 2008 made reference to public debate of policy issues, with a the need for, “a dialogue that will lead to real change, instead of [politicians] being forced to watch every word they say or being driven to release the next 3-point plan or new initiative to feed a 24-hour cycle of news and entertainment”. Much earlier, describing the fifty-year period from 1840 in New Zealand, Viscount Bryce wrote:

“Very few were radicals by theory, if indeed one can talk of theory at all among New Zealand politicians. They were occupied by the issues of the hour, and inevitably also by the getting and keeping of office, for the balance of party strength frequently shifted, and a disproportionate amount of time and effort was spent on the incessant game of replacing the Ins by the Outs.” (Bryce, 1929b, pp. 295-296)

March and Olsen also refer to the importance of process and limited concern for outcomes in political deliberation. Information is required to symbolise and signal “decision making propriety”, and intentions are more important than outcomes for legitimacy (March & Olsen, 1989, pp. 48-52).

¹⁴⁵ Processes may be used to give the appearance of dynamic action, as with New Zealand’s Knowledge Wave leadership forum of 19-21 February 2003, or the Job Summit of 27 February 2009.

Proposition 7: The focus in politics is more on the process of policy change than on the determination of desirable policies.

5.3.8 Limited monitoring and policy revision

Governments aim to implement their agendas. Parties in opposition attempt to obstruct governments. One way to do this is to identify problems that can be presented as government's failures and needing urgent attention, thereby drawing political resources away from the planned agenda. Opposition parties may also attempt to get traction for their own agenda items. Monitoring generates attention. Detailed monitoring provides information that can detract from a government's agenda and gives ammunition for opposition parties. Given the limited number of issues on the agenda at any one time (see Proposition 1), such distractions can be costly to governments. It is therefore in a government's interest to allow as little attention as possible to be given to existing policies/laws. Revision of laws will only occur when problems are noticeable enough, and generate sufficient interest by attention groups, to gain traction.

Proposition 8a: A government will attempt to limit monitoring so as to minimise attention given to issues that are not on its agenda.

Proposition 8b: Once a law has been passed, it is unlikely to be evaluated or reconsidered for many years.¹⁴⁶

5.4 Implications

Economics that is based on exogenous preferences inevitably ignores rhetoric, which focuses on persuasion. However, this omission may limit the value of some economic analysis, especially in relation to behaviour in deliberating on indirect or collective policy issues.

¹⁴⁶ This point could be qualified. Changes might occur in the early days after introduction and before the legislation is entrenched if clear flaws are identified quickly or if there is a change of government.

A theoretical “ideal” economic approach to policy making might appear as follows. Begin with an assumption of free, perfect information (a parallel to the zero transaction cost assumption) and then all possible policy alternatives can be considered. Each would have all the costs and benefits identified and measured, and the optimal policy selected using an appropriate decision rule. A policy assessment structure based on this approach has been developed for general use by the Ministry of Economic Development (Regulatory Impact Analysis Unit, 2007a).¹⁴⁷

In other disciplines, a range of concepts are emphasised that could be grouped under the umbrella term of “macro-rhetoric”. In particular, framing, the choice of language and promotion of key terms, and agenda setting and denial are considered by some outside economics to be central components of political and social activity. Hardin’s “street-level epistemology”, along with Mackay’s popular delusions, also suggests that at times viewpoints and ideas can become widely accepted without being strongly justified. Processes whereby groups may be motivated to become active are described by Cobb and Ross, Bryce, Schattschneider and others. These influences are important in the processes of both political law making and the implementation of laws, and so are relevant to the topic of this thesis.

An approach such as that in the Ministry of Economic Development structure is unlikely to mesh well with a political environment based on rhetoric and traction. In such an environment, parties select their preferred policies, after which they operate in a political arena to put their policies into practice. Detailed scrutiny at this late stage would generally be unwelcome, especially where it involves consideration of numerous alternative options (including those of opposition parties).

Consequently, even without consideration of costs of analysis with its associated requirements of information and expertise, an economic approach may not be politically feasible. Economists should therefore be aware of the constraints on policy determination arising from the political process. To quote Simon:

¹⁴⁷ In addition, a 66 point checklist, primarily of legal technical criteria, is provided in guidelines from the Legislation Advisory Committee (2007).

“The dream of thinking everything out before we act, of making certain we have all the facts and know all the consequences, is...the dream of someone with no appreciation of the seamless web of causation, the limits of human thinking, or the scarcity of human attention.” (Simon, 1971, p. 47)

Downs (1957) focused on politics, addressing the issue of choice of policies by parties. However, from either an economics or a political science perspective, there are limitations on the relevance of Downs’ propositions arising from his assumptions of rationality and absence of false information. As has been shown, there are bodies of literature which can be tapped to suggest an alternative approach and to yield alternative propositions.

This chapter indicates some of the possibilities when Downs’ approach is taken together with some of the points in this policy-related literature. The propositions that are presented in Section 5.3 collectively paint an interesting picture of an environment in which people are persuaded to subscribe to particular viewpoints and policy decisions are made. While any theoretical viewpoint is merely describing an analogous structure to the real world, it may be emphasising some aspects which are important.

The picture is one of a limited number of issues commanding attention at any one time, with groups and parties competing to control or influence the agenda. Where an issue has enough attention to gain traction, parties will take a position on that issue. They are less likely to try to promote a new issue, and the media will generally focus on issues which have already achieved traction. Where institutions have been established in relation to an issue, those institutions have an incentive to promote and broaden the issue. Public opinion tends to follow issues that are seen to have wider support or are supported by the current government. It is guided not so much by reasoned debate as by authority, celebrity endorsement and framing, and plausible but flawed arguments may be used when they are persuasive and politically desirable. The political focus tends to be more on agenda setting and denial, competing for public attention and political support on issues, rather than on deliberation on policy options. Governments will not wish to have attention drawn to issues that are not on the agenda, including laws that have been passed, and so monitoring on these matters will not be encouraged.

These alternative propositions build on concepts and findings from a range of literature beyond the normal bounds of economics. Collectively, they suggest that the political process may fail in its function of making laws and monitoring and revising laws. Outcomes may be based more on the result of competing political forces than on a conceptual “ideal” of reasoned evaluation of alternatives.

The implications for policy are important. There are clear possibilities of failure in the policy making process, and errors may not be identified for many years. Consequently it may be productive for analysis to consider two responses. First, recognition of potential limitations in the political process can be the first step towards addressing those limitations. Second, as limitations of the process are also limitations in policy formulation and implementation, resulting constraints on the potential effectiveness of policies should be recognised.

The next chapter considers, as a case study, the parliamentary debate extending over a period of years that resulted in the Property Relationships Act 1976 as passed in 2001.

Chapter 6 Making laws: A policy debate case study

“To retain respect for sausages and laws, one must not watch them in the making.” Otto von Bismark¹⁴⁸

6.1 Introduction

A major function of central government politicians is the introduction and amendment of legislation through the parliamentary process. This includes not only the incumbent government’s legislative agenda, but also private members’ bills introduced by individual MPs. Chapter 2 has indicated that political processes may be important in determining outcomes, and that economics has paid little attention to some aspects of these processes that are considered important. Chapters 3 and 4 suggest that a broader focus for analysis in economics may give additional useful insights, especially with the recent expansion in the range and nature of data available and means of analysing these data. Chapter 5 has presented propositions suggesting the existence of certain characteristics of the policy process which, in the context of this thesis, may affect resulting legislation. A logical next step in an economic perspective on the law would be to consider an example of political debate on an aspect of legislation.

The text of the parliamentary debates, Hansard, is now available electronically and can therefore be compiled into electronically searchable documents. This provides a large, economically accessible and analysable data source. A case study was selected for this chapter, the parliamentary debates in the period from 1998 to 2001 leading to the replacement and extension of the Matrimonial Property Act (1976) by the Property Relationships Act (1976)¹⁴⁹. That serves as a basis for assessing parliamentary debate and the resulting passage of legislation. It is addressing the question of how, and how well, legislation is “produced”. This legislation was chosen because the debate lasted several years, it affects many people, and both main parties had terms in government

¹⁴⁸ Attributed (Waldron, 1999, p. 88).

¹⁴⁹ It seems strange that a major change in legislation, including a new name for the Act, would retain the date of the legislation that was being replaced. Was this an attempt at framing the issue to give a different impression of history?

promoting the legislation and in opposition opposing it. Consequently the issues might have been particularly rigorously considered.

The policy-making process has received little attention in mainstream economics. Several texts have included “policy” in their titles, but then couched their policy discussion simply in the context of mathematically presented economic models.¹⁵⁰ Rather than assuming that all is well, it may be prudent to consider sources which suggest that this dimension is important. For example, Gordon Tullock, taking the “positive”, or “comparative institutional” or “public choice” approach to institutions¹⁵¹, wrote:

“The politician should be best thought of as a businessman. He is in the business of trying to make money by being elected to office instead of trying to make money by selling products to you. He is primarily engaged in making a living by selling policies to people and he changes them just as readily as a businessman does.”
(Tullock, et al., 1983, p. 3)

A Professor of Law at the University of Otago has described Acts of Parliament as, “the product of ad hoc policies rather than sustained rational thought” (Sutton, 2005, p. 98). Also, John Stuart Mill has warned about policy interventions, writing, “the strongest of all the arguments against the interference of the public with purely personal conduct is that when it does interfere, the odds are that it interferes wrongly and in the wrong place” (Mill, 1956, p. 102).¹⁵² He suggests a problem with real world making of policy being unconstrained:

“It is easy for any one to imagine an ideal public which leaves the freedom and choice of individuals in all uncertain matters undisturbed, and only requires them to abstain from modes of conduct which universal experience has condemned. But

¹⁵⁰ For three examples, consider L.S.Friedman (1984), Just, Hueth and Schmitz (1982), and Venieris and Sebold (1977). For a somewhat broader approach, see (Vane & Thompson, 1993).

¹⁵¹ This description of Tullock’s approach is by Ross Parish (Tullock, et al., 1983, p. vii).

¹⁵² This quote continues by distinguishing between social morality and self-regarding conduct. Mill argues that the former affects others, whose expression of self-interest may be justified, but for the latter, others are not affected and it should not concern them.

where has there been seen a public which set any such limit to its censorship? Or when does the public trouble itself about universal experience?" (Mill, 1956, p. 102)

This can be juxtaposed with Tullock's description of the "random behaviour" model of regulation:

"If you begin writing a long list of regulations, a very large part of that list will be things where it is not possible to tell what is the right regulation, either at all, or at least without a great deal of careful study which isn't really worth while. So you produce a long list of regulations, some of which are very sensible, some of which may be silly or perverse; but a very large part of which are simply regulations that have been produced because you have to produce regulations and you have to have some kind of rule, good or bad." (Tullock, et al., 1983, p. 10)

Lippmann (1961, p. 241) draws a connection between people's interest in policy and its perceived impact on them. He suggests that they are likely to give politicians a free hand in matters which are not thought to affect them or their group. This bears some similarity to Tyler's discussion of procedural justice when he says that attitude may be a function of membership or otherwise of the affected group.¹⁵³

These sources seem to indicate that policy debate may not be systematic, and the results of the policy-making process may be flawed. These points are explored in this chapter with the aid of a case study. As the aim is to explore whether the process of parliamentary debate can be expected to result in socially desirable policies, the focus is primarily on the nature of the debate rather than the specific issues discussed. A schedule of the relevant parliamentary debates is included in Appendix 3. Section 2 presents three criteria proposed for an assessment of the debate. Section 3 illustrates the failure of the debate to meet the three criteria, focusing on the broad issue of use of research in the debate, along with three specific issues, human rights, equity, and opting in or opting out, that were given particular attention.

¹⁵³ See p.48 above.

6.2 Criteria

A purely descriptive assessment may be useful, but increased value can be obtained if there are evaluative criteria to apply. Economists have commonly used concepts of market failure when considering market activity, and there is also an ideal for policy under zero costs of analysis and perfect information, whereby all options are considered and evaluated, with the best being selected. Chapters 3 and 4 indicate that standard economic approaches may not consider all the relevant aspects in such a policy process, or the results may not be directly applicable. Chapter 5 has shown that this approach is unlikely to fit the observed process of policy making and the passing of legislation. Therefore, as a first step in the analysis of the parliamentary debate, an attempt was made to identify some suitable criteria on the basis of which a preliminary assessment could be made. They were introduced above at page 10, and are that there should be consideration of:

1. the future environment, as that is where the effects will be felt;
2. the impacts on all the various sub-groups who may be affected; and
3. the effects of behavioural changes by various groups as a consequence of the law change.

These are very basic, and do not rely on a particular theoretical model for their justification. Consequently they may be widely accepted at least as a starting point. A case could be made that each of these are necessary conditions for good policy making. If the future is not considered, then there is no thought for the possible need for or consequences of the policy at the time that it is implemented. Sub-groups may be overlooked if an aggregate approach is taken, or if attention is given only to certain selected groups. In either event, all or some of the distributional implications are overlooked. The third criterion is central to economic thinking and the view that people make choices as to how to behave given their environment.¹⁵⁴

¹⁵⁴ This is encapsulated in the economic concept of equilibrium, being a situation where people's plans are realised. As at equilibrium their expectations are met, they have no incentive to change their behaviour unless something else changes. Outside equilibrium, some people's plans are not met, and so they have an incentive to modify their behaviour. The potential outcomes of policy will not be identified without consideration of these effects. If new or changed legislation is considered as altering people's

More complex or advanced criteria, such as the selection of alternative options for consideration and decision criteria over them, were to be introduced later. However, the initial analysis suggested that these three were already overly ambitious.¹⁵⁵ Consequently later analysis took another direction, looking more carefully at specific aspects of the debate.¹⁵⁶

It was as a result of the early attempts to find literature which might assist in the choice of criteria that this study digressed first into politics and policy process, and from there into media and communication (Birks, 2008), along with further exploration of aspects of rhetoric. These indicated that any expectation by economists that policy decisions are based on logically structured analysis may be ill-founded. This does not mean that these three criteria have no value. If applied as requirements in actual policy debate, they may serve as a check on some of the more extreme distortions that could be achieved

options, some may be constrained from achieving otherwise realisable plans, with the consequence that behaviour may change.

¹⁵⁵ Rodrik is one economist to identify the more haphazard nature of policy making, suggesting that standard economics and political economy approaches “underestimate the roles that serendipity and imperfect knowledge play in policy formulation” (Rodrik, 2007, p. 4). There is a possible alternative explanation that could apply in some cases, namely that policies are chosen and implemented to achieve other objectives. In other words, individual law changes through the political process may occur in isolation, but be part of a broader political agenda. This is suggested in Stairs’ (2006) description of Canada’s involvement in Afghanistan. He argues that it was not based on an assessment and understanding of the situation there, but rather due to relations with NATO and the US. A similar suggestion of relations with other countries has been made about New Zealand’s emissions trading scheme legislation (R. Smith, 2009). Within a country, legislation may be the result of logrolling.

¹⁵⁶ From a conceptual viewpoint, one aspect to consider is the problem of transition in response to a change in the law. Comparative static analysis applied to law compares two alternatives on the assumption that any necessary adjustments have been made. In reality, with relationship property legislation, some individuals and couples will have made decisions and commitments based on one set of rules, and they will then face another. This point was mentioned in the parliamentary debate in terms of those who were in de facto relationships and would then find themselves effectively “married”, but there are also changes for those who are married due to the change in “start time” of the three year period before the full effect of the law would generally apply. This point was hidden in the rhetoric of the debate, where it was stated that the change would just make de facto couples subject to the same rules as married.

through framing issues to favour a particular group or agenda.¹⁵⁷ It may be that the best that can be hoped for in real-world policy formation is the incorporation of some elementary guidelines as a constraint on the making of laws with many “unanticipated reactions”¹⁵⁸.

There was one source which seemed to have some rough similarity to the criteria. In March 2007 the Ministry of Economic Development brought out some new documents on Regulatory Impact Analysis to supersede the previous system of Regulatory Impact Statements. They are *Guidelines on Assessing Policy Options* and *Guidelines on the Regulatory Impact Analysis Requirements* (Regulatory Impact Analysis Unit, 2007a, 2007b). This is a development on the previous approach that emphasised Regulatory Impact Statements, and follows an international trend. From second document (emphasis added):

“In the international context, RIA has taken on a wider meaning, and refers to all of the elements of policy development – **problem definition, setting objectives, considering options...**The **RIA principles** of defining the problem, setting objectives, considering the full range of feasible options, and so on, should be applied from the beginning of the policy development process.” (Regulatory Impact Analysis Unit, 2007b, pp. 3-4)

Also note the following, which, if taken literally, outlines the economic “ideal” where all feasible options are evaluated:

¹⁵⁷ One argument used in the rhetoric of policy debate is that law changes are needed to aid some disadvantaged group. The demonstration of disadvantage for a group requires three steps (Birks, 2009b). First specify the group and comparator(s). Second, choose an indicator(s) with some observed differences between the groups. Third, give a value interpretation of the differences such that the preferred group is considered worse off. Hence suitable framing can provide a desired result. Criteria such as those suggested here would make it harder for politically motivated results to be engineered.

¹⁵⁸ This term, along with its converse, “anticipated reactions”, and the alternative expression with “consequences” in place of “reactions”, seems to be gaining some recognition, if primarily through more casual use. Stairs (2006) and others refer to the “law of unanticipated reactions”. The use of the term “law” should perhaps be seen as a rhetorical device to lend authority to a rather loose concept.

“Appropriate level of RIA analysis

The level of analysis needs to be enough to enable the decision-maker to be confident about which option is best and the impacts this will have. It should be commensurate with the significance/magnitude of the proposal. There are four parts to this:

- identify the range of feasible options (ie the possible options that would meet the public policy objective and solve the problem)
- identify the impacts of each option
- assess the magnitude of each impact
- choose the preferred option.”

(Regulatory Impact Analysis Unit, 2007b, p. 16)

In the section on “*Topics you should cover in your draft RIS or discussion document*”, under “Impacts”, it states:

“All costs and benefits that are likely to be experienced by each affected group should be given consideration... You should ask the following sorts of questions around impacts: Are the costs and benefits attributed to the correct sector (i.e. government, industry, the environment, consumers, society in general)? Are there any additional sectors or sub-sectors that will be affected, and if so, to what extent?”

(Regulatory Impact Analysis Unit, 2007b, p. 29)

In other words, it is expected that a range of options would be assessed, and a disaggregated approach taken to determine the effects of the policies. It could reasonably be assumed that “problem definition” and impacts on “each affected group” would entail a forward-looking assessment as policies will have an impact in the future.

While these documents have applied only from 1 April 2007, Appendix 4 of the second document (Regulatory Impact Analysis Unit, 2007b, pp. 31-33) contains the *Code of Good Regulatory Practice* as endorsed by Cabinet in 1997 and conveying similar sentiments. It could therefore be reasonably concluded that a requirement existed of systematic analysis of policy options and a multidimensional evaluation of

alternatives.¹⁵⁹ Further, this requirement was set by Cabinet, indicating a political interest in such processes. This did not translate into the reality of policy debate, however.

6.3 Consideration of the criteria

With quantitative data, it may be possible to specify a hypothesis and apply a statistical test. Analysis of policy debate may appear more ad hoc, with a range of options being included under umbrella terms such as content analysis (Hsieh & Shannon, 2005), or discourse analysis (Fairclough, 1995; Johnstone, 2001). In this chapter the specific reasoning used is outlined in each section. In relation to the three criteria, while evidence can be presented to demonstrate that a condition has been met, it can be harder to show the failure to meet a condition. One approach is to demonstrate that something else did occur, and that other event is inconsistent with the condition being met. In this case study, there are clear signs that the issues raised by the proposed legislation had not been researched, and so there was little or no evidence on which to base the political decisions. This can be taken as indicative of strong support for a contention that the three criteria were not met.

6.3.1 Consideration of research

There are over 200,000 words in the parliamentary debates between 1998 and 2001 that culminated in the Property (Relationships) Amendment Act being passed. The words, “research” or “researcher” appear 26 times. All but four uses were by ACT or National MPs, and only two references to research findings were made in support of the legislation, both by Margaret Wilson MP¹⁶⁰ ¹⁶¹. Anne Tolley MP used the term ten

¹⁵⁹ In an “ideal” economic world with perfect information and zero costs of analysis, a decision making process should result in the selection of the best of all available options. RIA might be considered as an attempt to specify an operational version of this approach.

¹⁶⁰ A third mention in support of research of a kind was by Keith Locke MP who said, “I did a little bit of research” [29 March 2001, 591, NZPD, 8635].

times, with seven in one speech. Most of the 26 references were pointing to the lack of necessary research. Two examples, Rev Ann Batten MP [5 May 1998, 567, NZPD, 8232] and Anne Tolley MP [29 March 2001, 591, NZPD, 8630], indicate lack of research into the need for the legislation. The absence of research on this matters could perhaps be excused on the basis that politicians are elected representatives who should be in touch with the electorate. Their understanding and preferences could be considered sufficient without further investigation of the feelings of the general public.

More significant are the repeated comments on the lack of research into the possible implications of the legislation. For example, Stephen Franks MP said, “Earlier this year when I asked in the Justice and Electoral Committee whether there had been any research at all on the likely behavioural effects of any of these changes, the department told us ‘No’” [4 May 2000, 583, NZPD, 1944].

Similar concerns were expressed by Marie Hasler MP [31 May 2000, 584, NZPD, 2736], Stephen Franks MP again some months later [21 November 2000, 588, NZPD, 6718], Anne Tolley MP [21 November 2000, 588, NZPD, 6729] and [13 March 2001, 590, NZPD, 8127], and Tony Ryall MP [29 March 2001, 591, NZPD, 8628], who used the term “unintended consequences” as described in Footnote 158. It is notable that, while their comments indicate a lack of research, where their concerns are stated they refer to existing relationships. From an economics perspective, and according to the third criterion above, it is also important to assess the possible impact of the legislation on relationship formation in future.

There were a few occasions in the debates where references apparently point to actual research. For example, Margaret Wilson MP (Associate Minister of Justice):

“An analysis of de facto cases between 1986 and 1990 found that for women the average division of property in opposite-sex de facto relationships that had lasted between 3 years and 10 years ranged from 10 percent to 40 percent. Researchers also indicated that obtaining more than a 20 percent to 30 percent division under the

¹⁶¹ MPs are included in the index by name, plus “MP” and party affiliation.

common law approach is extremely difficult.” [14 November 2000, 588, NZPD, 6517]

While not sourced and there is no information on sample size or further details, this is relevant information on which to determine whether the prevailing outcomes were satisfactory. A second example, included in the same speech, is more problematic. Margaret Wilson MP:

“It is clear that the current law is not equipped to address economic disparities that arise upon the breakdown of a relationship, particularly when there was a non-career partner in that relationship. Research demonstrates that undeniable poverty results for many women, and, sadly, their children, when these relationships break down. The living standards of many women and children are invariably lowered more than those of men when relationships ends [sic]. That is because of the lack of a career option.” [14 November 2000, 588, NZPD, 6517-6518]

There has been controversy about research on outcomes after separation. In particular, one of the most prominent studies showing disadvantage to women (L. Weitzman, 1985)¹⁶² has been discredited (Peterson, 1996). Note also the linking of women and children, and the lack of consideration of repartnering.¹⁶³ Such studies commonly consider circumstances a short period after separation. A US study undertook a more detailed analysis of circumstances after separation, finding that the economic situation

¹⁶² This is probably the basis for Keith Locke MP’s claim, “Studies show that the incomes of women decline by about 30 to 50 percent at the time of separation or divorce” [29 March 2001, 591, NZPD, 8635]. Note also Sue Kedgely MP, “Numerous studies have shown that in the majority of cases after a divorce, women are substantially worse off than men, while in very many cases the financial circumstances of men improve on separation and divorce.” [31 May 2000, 584, NZPD, 2738] In contrast, a Department of Justice study reported a 5 percent fall in income for custodial mothers and a 25 percent fall for non-custodial mothers (Maxwell & Robertson, 1994, p. 42).

¹⁶³ This could be considered as an example of agenda setting and framing. While issues of property, custody and child support are treated separately in law, they are all matters to be dealt with, and affected individuals may see them as an overall package. Similarly the circumstances of women and children are often presented together. Also, in law, it is irrelevant which partner makes the decision that a couple will separate.

of fathers post-separation is far less favourable than the more basic studies indicated (Braver & O'Connell, 1998).

Another study, this time from Australia, was used by opposition MPs¹⁶⁴. Brian Donnelly MP:

“I refer to the Australian research that 75 percent of de facto relationships ended within 4 years. There is not the same degree of presumption of endurance in de facto relationships, whether they be same-sex or heterosexual couples.” [14 November 2000, 588, NZPD, 6526]

Referring to the same statistic, Lynda Scott MP said:

“It is truly ridiculous to impose this regime of Margaret Wilson's on unsuspecting New Zealanders after 3 years. All that we will see is more lawyers' fees, more court time, more Family Court judges, and chaos.” [29 March 2001, 591, NZPD, 8632-8633]

While relevant to the debate, once again this is taking one finding from an overseas study and assuming that it would apply to New Zealand before and after the introduction of the legislation.

In summary, opposition MPs voiced concerns about the lack of research, the very limited amount of research that was used was selectively chosen, its quality was uncertain, and the findings may have been inappropriate for the New Zealand context. Moreover, not only did the politicians not debate the issues in an informed manner, but also the analysis requirements within the public sector were ignored.¹⁶⁵ In this example

¹⁶⁴ The 75 percent statistic from the study was used by Brian Donnelly (NZ First), Richard Worth (National), Anne Tolley (National) (twice), Wayne Mapp (National), Lynda Scott (National) (3 times), and Muriel Newman (ACT). It was not mentioned by MPs speaking in favour of the law change.

¹⁶⁵ Indications of broader institutional problems in law making can be found in an address by Rt Hon Sir Geoffrey Palmer when he was president of the Law Commission:

“Everywhere law reform agencies face serious challenges. The primary one comes down to getting the work implemented. As Justice Kirby of the High Court of Australia recently put it, there is a ‘failure,

at least, although the issue was controversial and hotly debated over a number of years, that did not result in debate based on relevant analysis. In terms of the three initial criteria, the information was not provided for these to be considered in an informed way. It may be that concerns were addressed in a more ad hoc manner.

6.3.2 Informal assessment

While research results were not incorporated into the debate, there may have been less formal forms of analysis. This appeared to be the case on a few occasions. Stephen Franks MP anticipated some possible “unanticipated reactions” from the legislation in a speech [14 November 2000, 588, NZPD, 6534-6535] when he suggested that people will learn to:

- Dump a woman before the baby is born;
- Steer clear of women with children;
- Not rely on formal agreements;
- Hide one’s assets;
- Not worry about putting things in writing (so you can later argue something else);
- Not settle disputes;
- Not save for the long term;
- Prevent an elderly parent from repartnering; and
- If gold-digging, destroy a relationship if you need support (because that is when the legal rights kick in).

On the last day of the debate Anne Tolley MP listed several types of relationship for which the legislation was not designed:

anywhere, to establish a satisfactory link between the institutional law reform body and the lawmakers with the power to convert proposals for legal reform into action?. The problem exists in all countries where there is a Law Commission.” (G. Palmer, 2006, p. 1)

Where the analyses undertaken by Law Commissions are adequate for quality policy recommendations is a separate matter. For a critique of one Law Commission report, see Birks (1998).

“This legislation is designed around first relationships. No account has been taken of the young women who often use relationships as a means of courtship, of the elderly women who often use relationships for companionship, or of the middle-aged New Zealand women who are often in their second or third relationships, and who want to maintain their assets throughout those relationships. This legislation is bad law, and it will be bad for all New Zealand women.” [29 March 2001, 591, NZPD, 8630-8631]

This listing of numerous situations for women that have not been considered suggests that the legislation was narrowly focused. The reality could be more restrictive than she presents. While considering alternative situations, she does not consider the implications for men or children, and she does not raise the question of incentives and behavioural changes.

There were some other concerns and descriptions of possible reactions which could have merited further consideration and modification of the legislation, such as Stephen Franks MP, “uncertainty about the reliability of such agreements will affect the willingness of people to enter into and to continue marriages and de facto relationships” [27 March 2001, 591, NZPD, 8532]. Keith Locke MP:

“In weighing up the issues, I think the select committee rightly suggested that there should be a contracting out regime. That is the best way to protect the weak and vulnerable.” [29 March 2001, 591, NZPD, 8635]

Penny Webster MP : “when this bill goes through, there will be people with young children---like I was---who want to start another relationship but who dare not do that. The idea of living together for a few years then having to split one's property if the relationship does not work will mean those relationships do not get started.” 21 November 2000, 588, NZPD, 6731]

These examples indicate that there was some awareness of the diverse range of situations and effects associated with the legislation. However, they were not central to the debate. Many of these received little more than a brief mention and were not given serious, informed consideration in determining the final product. Even at an informal

level, there is little sign of systematic consideration of the issues as they might affect people in a range of situations in the future.

6.3.3 Historical institutionalism and the Human Rights Act

A dimension overlooked in static analysis is the path of policy and law development over time, with path dependency and future, often unanticipated consequences from earlier decisions. Paul Pierson describes historical institutionalism¹⁶⁶ as, “a range of scholarship that has tried to combine social science concerns with a recognition that social processes must be understood as historical phenomena” (Pierson, 1996, p. 131). This is a particularly telling criticism of static analysis, because it suggests that the present depends not only on current structures, but on the paths taken to get here. He suggests, giving an example of gender policy in the European Union, that a general statement of intent, thought to be “merely hortatory”, can be made to assume greater significance later. In his example, an apparently innocuous agreement to move in a general direction was turned, a few years later, into an obligation to pass legislation.¹⁶⁷

There are some important implications that arise from this perspective. Rather than policy decisions being based on expressions of exogenous preferences, for example, they may be path-dependent, with current preferences being influenced by past decisions made with limited foresight. Pierson also makes a more general statement, “Complex social processes involving a large number of actors always generate elaborate

¹⁶⁶ First mentioned in section 2.4.

¹⁶⁷ The same point was made in New Zealand following the government’s decision to support the Declaration of the Rights of Indigenous Peoples. New Zealand’s first Maori High Court judge, Sir Edward Taihakurei Durie, considered this as the most important development for Maori since the signing of the Treaty of Waitangi in 1840. He is quoted as saying, “Important statements of principle established through international negotiation and acclamation filter into law in time, through both governments and the courts, which look constantly for universal statement of principle in developing policy or deciding cases” (A. Young, 2010). The same article stated, “International declarations are often a first step towards binding conventions”.

feedback loops and significant interaction effects that decision makers cannot hope to comprehend” (ibid, p. 136)¹⁶⁸.

A possible illustration of an unanticipated implication of past decisions is in the parliamentary debates. There were repeated references to the Human Rights Act 1993 to justify equal treatment of marriage, de facto relationships and same-sex relationships. In other words, legislation was passed at one time for certain reasons, and it then used at a later time as a justification for other law changes which may have been neither anticipated nor intended. The legislation was referred to, for example, by Judith Tizard MP and Matt Robson MP on 5 May 1998; Leanne Dalziel MP, Phil Goff MP, and Jeanette Fitzsimons MP on 6 May 1998; by Margaret Wilson MP, Keith Locke MP and Tim Barnett MP on 4 May 2000; by Tim Barnett MP again on 31 May 2000, by Keith Locke MP on 1 June 2000, and by Nandor Tanczos MP on 14 November 2000. Here is an example by Jeanette Fitzsimons MP:

“Tim Barnett has argued that the different treatment of same-sex partnerships is contrary to the Human Rights Act and is clearly discrimination on the grounds of sexual orientation. I think that the select committee should also look at whether the Human Rights Act, which prohibits discrimination on grounds of marital status, is contravened by the different standards for the sharing of property that this legislation proposes for de facto couples as compared with married couples.” [6 May 1998, 567, NZPD, 8282]

The legislation was also alluded to by Belinda Vernon MP (4 May 2000). Richard Prebble MP, , perhaps not entirely coincidentally, was the last to raise the point. It was

¹⁶⁸ Note “unanticipated reactions” above at p.138. Round also describes such phenomena associated with delegated law making (see footnote 5):

“When, in the making of the State-Owned Enterprises Act, reference was first made to Treaty principles, it was accepted by politicians that this was a task to fall to the judges. Politicians opened the floodgates...Mr Prebble describes the consternation in the Beehive, even among well-known constitutional experts, when the Court of Appeal decided in *New Zealand Maori Council v Attorney-General* that section 9 of the State-Owned Enterprises Act was not just the meaningless lip-service which its caring Parliamentary advocates had taken it to be.” (Round, 2000, p. 654)

in the context of proposed different treatment for Maori [21 November 2000, 588, NZPD, 6722].

In the rhetoric of the debate, the Human Rights Act 1993 was used to argue for equal treatment of de facto and married couples, although discrimination as described under part 2 of the Act focuses on employment and other matters, apparently not including relationships. If so, then the passage of one piece of legislation with one intention is used later as a justification for some other, originally unintended purpose. This would then be an illustration of the sort of effect referred to as historical institutionalism by Pearson (1996).

If relationships are to be included, then it may be that the relationships intended to be included under the property relationships legislation would not include all the types of relationship for which the Human Rights Act is relevant on such a possibly broader interpretation. Debate on the scope of the legislation is included in the next subsection, which looks at discussion on the use of the term equity.

6.3.4 Equity

The terms “equity” and “equitable” are used several times in the debate, sometimes together with or in place of “fairness” or “fair”¹⁶⁹. A word search was used to identify instances where these terms appeared, along with a further search for “just”. These searches also picked up related terms, such as “inequitable” and “justice”. Closing speeches by Margaret Wilson MP, Matt Robson MP and Chris Carter MP on the last day of the debates made repeated use of “fair” and related words¹⁷⁰, 24 times by Margaret Wilson MP alone.

The concepts of horizontal and vertical equity are well established in economics. Musgrave, discussing taxation, refers to, “equity in a vertical sense – that is...so as to adjust relative positions... equity in a horizontal sense – that is, to give equal treatment to people in equal positions” (Richard A. Musgrave, 1959, p. 20). Horizontal equity is

¹⁶⁹ Also Brian Donnelly (NZ First): “fairer and more just” [4 May 2000, 583, NZPD, 1940], and Margaret Wilson: “The law will ensure justice and fairness for all” [13 March 2001, 590, NZPD, 8138].

¹⁷⁰ Fairness, unfair, unfairness, fairly, unfairly, and fairer.

the simpler concept, but still faces the classification problem of determining the meaning of “equal” positions. Vertical equity requires an “appropriate” difference in treatment where positions are not equal. The terminology also suggests (but does not require) that diversity is uni-dimensional. In relation to taxation, additional complications arise in the application of the concepts. For example, effort and reward may be important. Should people’s incomes be the sole dimension, or should the effort required to obtain the income be considered relevant? Also, the benefit principle attempts to link the tax contribution to the benefits received from public sector expenditure. For a more detailed outline of equity, see Birks (2007a).

It should not be assumed that politicians understanding of the concepts would coincide with that of economists, and the various terms may be used for rhetorical purposes.¹⁷¹ This is illustrated by the use of “equity” in the objects of the Child Support Act 1991, discussed in Birks (2000c), the ongoing acceptance of which suggests similar issues of interpretation among lawyers.

From 2000, the proposed legislation included same-sex couples under de facto relationships and aimed to treat these and married couples in the same way. All recognised relationships would then be subject to the same legislation. On a horizontal equity criterion, this is to assume that they are all the same (in relation to what are considered to be the relevant characteristics). In other words, relationships should not be distinguished on the basis of whether the couple are married, de facto mixed or same-sex de facto.¹⁷² Diane Yates MP [4 May 2000, 583, NZPD, 1937] and Kevin Campbell MP [4 May 2000, 583, NZPD, 1948] both suggested that, even if the types of

¹⁷¹ Wayne Mapp said of Chris Carter, “He simply applied the rhetoric of equality, without recognising the real injustice that he was prepared to perpetrate” [13 March 2001, 590, NZPD, 8122].

¹⁷² While several MPs questioned the length of relationship required for inclusion under the legislation (three years), Owen Jennings MP (ACT) was one of the few to present a more fundamental challenge:

“It is not a question, as we have just had it described to us, of fairness, or discrimination, or bigotry. It is not a question of our depriving the rights of one group, even a minority in our community. It is about whether we withdraw the preference for the unique relationship of traditional marriage that we have established in a stable civil society. If we withdraw that preference, how far do we go?...It is just too selfish to defend other relationships without our taking a very careful and studied view of the needs of our children.” [4 May 2000, 583, NZPD, 1947-8]

relationship are different, they involve sharing property and so should have the same treatment.

With any grouping, there may be others that should be included which are not, and others which are included but should not be. Examples of both types were mentioned in the debates, with the speakers being opposed to the legislation at the time. The following describe types of relationship which perhaps should be considered in the legislation if treatment is to be equitable, but were omitted. Tim Barnett MP said¹⁷³:

“My first concern is that this legislation has taken so long to emerge, as our society and the nature of relationships in it have moved on. Property is shared in an increasing variety of domestic relationships that are not sexual, not married or de facto. The legislation offers nothing to parents and children, flatmates, or friends buying properties jointly. Although people sharing property in those relationships will remain unprotected, they are covered by the Domestic Violence Act.” [6 May 1998, 567, NZPD, 8270]

Brian Donnelly MP [4 May 2000, 583, NZPD, 1940] similarly argued against the requirement that only sexual relationships would be covered. Lindsay Tisch MP mentioned that the legislation was not considering children from a previous relationship (21 November 2000). Peter Brown MP described a daughter who cared for her mother and got nothing¹⁷⁴, and two sisters who shared a house that one willed to someone else. His point was, “If we are talking about property rights, let us be honest enough to talk

¹⁷³ At that time he was in opposition. By 31 May 2000 he was in government and chairing the select committee that was to consider the Supplementary Order Paper. Although not extended to cover the relationships he described in 1998, he suggested that the issues in the Paper had already been well debated and did not need further select committee consideration. The change of stance, defensive of the bill when in government and critical when in opposition, highlights the adversarial nature of parliamentary politics. The same can be seen in statements by Belinda Vernon, who was in government in 1998 and in opposition in 2000. In government she favoured equal treatment of de facto couples with an opt-out provision [6 May 1998, 567, NZPD, 8275]. In opposition she favoured different treatment, but allowing them to opt-in to the legislation [21 November 2000, 588, NZPD, 6741].

¹⁷⁴ Brian Donnelly (NZ First) described a “familial relationship” as “a relationship whereby one member of the family remains behind to look after a parent and remains in that caring environment”, suggesting that such people should also have some rights to property [14 November 2000, 588, NZPD, 6527].

about property rights for all New Zealanders, and not just the select few who want to have some sort of sexual arrangement” [21 November 2000, 588, NZPD, 6727]. On 27 March 2001 Simon Power MP described children who would lose out to a parent’s new partner if that parent died¹⁷⁵, and the interests of children were also mentioned by Anne Tolley MP on the same day.

Other examples were given of situations covered by the legislation which perhaps should be excluded. Lindsay Tisch MP [21 November 2000, 588, NZPD, 6720] mentioned objectives of convenience and companionship, where people had no wish to share property rights. Katherine Rich MP gave the example of a married man with several de facto partners [27 March 2001, 591, NZPD, 8526-7] and Ken Shirley MP also described "old people who decide to get married for companionship" [29 March 2001, 591, NZPD, 8634].

Vertical equity refers to appropriate different treatment for different circumstances. The proposed legislation not only drew a line to say which relationships would be covered and which excluded, but also specified criteria for different treatment among those included. Prominent among these was the criterion of economic disadvantage. This was based on a concept of a “career asset” possessed by a main income earner and a career sacrifice made by a main caregiver, resulting in post-separation economic disadvantage for the latter. This framing of the issue was widely accepted, especially by women MPs. On this point Lianne Dalziel MP suggested “Sometimes ‘equal’ does not necessarily mean equitable” [6 May 1998, 567, NZPD, 8267]. Chris Fletcher MP [6 May 1998, 567, NZPD, 8280] called for unequal treatment in recognition of “the plight of the custodial parent”. Jeanette Fitzsimons MP [6 May 1998, 567, NZPD, 8281] went so far as to call for equal outcomes after separation.¹⁷⁶

¹⁷⁵ The legislation made provision for a partner to choose whether to follow the terms of a will or the terms that would apply on separation.

¹⁷⁶ This is a telling comment. First, it mentions a presumption that “equal” is synonymous with “equitable”, then it defines equal in relation to outcomes, not, for example, opportunity, or in relation to contribution, or sacrifice, or taking account of personal choices. This has been seen elsewhere in New Zealand politics (Birks, 2004). Selective choice of units of measurement will affect the analysis and can be used as a means of suggesting disadvantage for a particular group (see also Footnote 157). Neil Kirton

Similar points were made by Sue Kedgley MP [31 May 2000, 584, NZPD, 2739], Margaret Wilson MP [14 November 2000, 588, NZPD, 6517-8] and Dianne Yates MP [14 November 2000, 588, NZPD, 6530].¹⁷⁷ In contrast, in the closing stages of the debates Margaret Wilson MP played down the importance of the provision to consider earning disparities and future income when she said, “They are there to account for the exceptional case, not the norm” [27 March 2001, 591, NZPD, 8507].¹⁷⁸

MP observed on the inclusion of de facto relationships that it would “shift the injustice from one group of people to another” [6 May 1998, 567, NZPD, 8277].

¹⁷⁷ In the UK, this position was taken by Baroness Deech (2009), who said, “We expect women to jeopardise their careers by staying at home with their children and then we make their position precarious by providing for easy divorce, regardless of how well they have behaved as homemakers”. She also contended, “Men are permitted, by law, to buy their way out of relationships and fatherhood, regardless of the damage and lasting hurt that they leave behind and which is not thereby lessened”. There is a paradox in this reasoning. If men can buy their way out of a relationship, then women can cash in a cheque as they end a relationship. Also, while men can walk away from their children, women can expect to end a relationship with a partner while maintaining their relationships with their children. The presumption that men choose to leave is also incorrect. Several studies have found that women are more likely than men to be the initiators of separation. From Australia:

“Overall, 23% of men and 25% of women in our sample have separated or divorced from their first marriage. Of these, men report a wife-initiated separation in 35% of cases, a husband-initiated separation in 27%, and a jointly initiated separation in 38% of cases. Women report a wife-initiated separation in 58% of cases, a husband-initiated separation in 17% of cases, and a jointly initiated separation in 25% of cases.” (Hewitt, Western, & Baxter, 2006, p. 1169)

And from the US:

“...the majority of ex-husbands (53%), along with the majority of ex-wives (70%), reported that the wife had wanted the divorce more. (The same pattern held for first talking about divorce and filing for divorce.)” (Amato & Previti, 2003, pp. 620-621)

Also for New Zealand, in Maxwell’s study, both men and women reported that women made about 75 percent of applications to the Family Court, but there may have been response bias (Maxwell & Robertson, 1994, p. 24).

¹⁷⁸ Early indications are that the Court was reluctant to give great weight to economic disparity (Crawshaw, 2009). This finding should be interpreted with care, however. A payment of \$X is a payment from the other party’s allocation, not from the whole property pool. Consequently it results in a recipient’s share that exceeds the other partner’s by twice that amount. A division giving 15 percent (as some have done) would give the claimant almost twice as much as the other party, who would have only 35% of the total.

Implementation problems such as the practicalities of using a lump sum payment to address this issue were described by several opposition MPs.¹⁷⁹ Hence, Katherine Rich MP said:

“...we are asking judges to look at and place a value on the contribution of each party, so that there is a fair split. Once again I support the principle of giving each party a fair deal, but putting a value on future earning capacity, or on the fact that one partner may have forgone income to move to another city, and may have picked up a job that does not pay quite as well as the one he or she left, is not terribly easy to do.” [21 March 2001, 591, NZPD, 8440]

This option for unequal division of relationship property is an attempt to achieve vertical equity in relation to a chosen difference in circumstance. A principle was set, but specific criteria and the practicalities of implementation received little attention.

The choice of factors which can be used to determine what counts as relationship property (such as the “career asset”) and criteria for variations from the basic 50-50 split can have a marked effect on the resulting legislation. A policy process approach might consider this from the perspectives of agenda setting and framing, with the result arising

Moreover, a historical institutionalist approach might lead one to question what broader, currently unanticipated consequences might be observed in the future. The debate on the original Matrimonial Property Act (1976) discussed whether equal sharing was equivalent to a “confiscation of property”, with this being strongly denied by Jim McClay MP. He stressed that it was only property of the “marriage partnership”, not, for example, “formal gifts or investments brought to the marriage by one partner or the other, or achieved by incomes ranging well outside normal family needs” [9 December 1976, 408, NZPD, 4722]. That legislation can change expectations, and not necessarily in a desired way, is illustrated by Simmonds (2002). He described British legislation introduced in 1915 which resulted by 1957 in the entrenched expectation that residential rents would be at a level far below that which markets would require. There was also widespread stigmatisation of landlords as a group, with “Rachmanism” even being listed in dictionaries.

¹⁷⁹ Here lawyers and judges are being required to resolve issues that are essentially economic and hence outside their legal training. It is not easy to forecast an individual’s future economic situation with any certainty. Some National MPs unsuccessfully proposed using spousal maintenance as a more suitable approach. This would have allowed adjustments in response to unanticipated changed circumstances.

from competition between various interests. Mention was made in the debate of groups which had had an important input. Chris Fletcher MP listed the Maori Women's Welfare League, the National Council of Women, the business and professional women's association, the Women's Division Federated Farmers, and Divorce Equity, as well as the Ministry of Women's Affairs [6 May 1998, 567, NZPD, 8280]. She also mentioned collective efforts of “women across the House”¹⁸⁰, and said, “the Ministry of Women’s Affairs has brought strong advocacy to this issue” [6 May 1998, 567, NZPD, 8279].¹⁸¹ On February 29 2000, Dianne Yates MP also gave credit to the Otago Women’s Law Society and the Federation of Business and Professional Women. On the basis of these and other references to the impact of women’s groups, it might be assumed that women’s interests, at least from certain perspectives, were well presented.

There was little mention given of the alternative perspective of a primary income earner, which would have given some alternative ways in which the issues could have been framed. For one example, where the focus was on disparities after separation, what if there had been a change in living standard resulting from entering into the relationship?

¹⁸⁰ Note also the Women’s Electoral Lobby (Preddey, 1998).

¹⁸¹ This raises the question whether (in principle and/or in practice) a Ministry has an advocacy role or one as impartial advisor. The Ministry of Women’s Affairs has claimed that it does not have an advocacy role, but not in terms of the alternative of impartiality (original emphasis): “**We do not act as advocates because we have found that simply advocating for issues is not an effective way for a policy agency to influence others** to achieve outcomes for women” (Ministry of Women's Affairs, 2007, p. 4) Sowell might suggest that it is obliged to become more strident over time to justify its ongoing existence once initial goals are achieved. A similar point might be made on the basis of historical institutionalism (see sections 2.4 and 6.3.3 above). The same MWA publication also claimed to provide high quality, convincing evidence. Such evidence included the claim, “Only 32 percent of parents in households where both parents have equally demanding jobs also equally share housework” (Ministry of Women's Affairs, 2007, p. 6). It sourced the finding to an MSD document, but that document gave a clear qualification to the data:

“Note that the word “housework” was not defined in the questionnaire and therefore it was left to the interpretation of the respondent. Respondents may not have included in their perception of housework all unpaid work related to managing a household. There is a possibility that only tasks traditionally called housework (ie cooking, laundry, cleaning) were included but other tasks such as gardening, finances or car maintenance were excluded. Also the definition of housework may differ for different groups. This should be taken into consideration when interpreting the results of this section.” (Ministry of Social Development, 2006, p. 53)

Should a rise in standard apply for life, as under equal outcomes? In addition, rather than just focussing on income, the payment for effort in paid work, what of the effort required to produce the income? Similarly, if relationships are assumed to involve a balancing of paid and unpaid contributions, why consider only financial aspects after the relationship ends? If one purpose of the relationship was to have and raise children, might there be an expectation of a long-term relationship with those children? Is this what the higher income earner is paying for, and should that be considered at the end of a relationship?¹⁸² Also, how are future circumstances to be assessed? Should this involve potential future earnings only, or might repartnering be relevant? This is not to say that any of these additional perspectives should be considered, or should be the sole criterion. Rather, it is to show that the debate was limited in the perspectives taken, even taking into consideration the critical points raised by opposition MPs.

Equity issues commonly focus essentially on distribution. Efficiency aspects and impact on incentives are also important. Stephen Franks MP listed nine ways in which people should behave as a result of the proposed legislation, as described above on p.144. Such points highlight the fact that people are making choices, and the legislation is merely changing the environment in which those choices will be made. This is considered in the third of the three criteria suggested at the start of this discussion on law making. While little thought was given to such reactions in the parliamentary debate, another aspect of choice was mentioned, that of “merit wants”. Richard Prebble MP said, “We are basically saying to citizens who have no intention of sharing their property that we know better than they do about what is a just thing to do with their property” [6 May 1998, 567, NZPD, 8278]¹⁸³. Stephen Franks MP, “We know already how ready the courts have been to interfere with contractual arrangements, to override them, and to impose their view of what is fair” [4 May 2000, 583, NZPD, 1945].

An economics perspective might suggest that government intervention in the market should only occur if there is “market failure”. By creating legislation to apply to de facto relationships, parliament is choosing to regulate in an area that had not previously

¹⁸² In other words, is the main asset the “career capital”, or the children, and to what extent were each of these a product of the relationship?

¹⁸³ He also said that the law would “confiscate property” from individuals in de facto relationships. Note footnote 178.

been subject to (this form of) regulation.¹⁸⁴ An economics approach to regulation is that it can reduce information (and possibly transaction) costs at the expense of reducing choices, a point made by Lindsay Tisch MP [21 November 2000, 588, NZPD, 6720].

An economist would note the misuse of “equity” and “fairness” in the debate and the importance of imposed views or expectations, but there is a political significance also. J. C. Davies (1962) has described the political importance of violated expectations. As Tyler, points out, “Davies finds that societal dissatisfaction results from violated expectations...This perspective uses the psychological concept of expectancies in that no reference is made to concepts of fairness or deservedness.” (Tyler, 2006, p. 72)¹⁸⁵ In other words, rather than attempting to determine some equity-based justification for an allocation or redistribution, it may simply be enough to generate suitable expectations, or, if existing expectations are suitable, to conform to them whether justified or not. The importance of such expectations is also highlighted in Simmonds (2002), as mentioned in footnote 178. The focus may not be on application of principles, but on rhetoric and manipulating preferences. While the term “equity” was used, it was applied selectively and more as a persuasive tool than a means of analysis of the issues.

6.3.5 Opting in versus opting out

One topic which received significant attention related to the default coverage of the legislation. There was a choice as to whether couples would be automatically included, with an option to exclude themselves, or for some couples not to be covered unless they specifically opted to be subject to the law.

a) Basic issues and economic perspectives

An important determinant of the impact of the legislation was the number of people who would be covered. As legislation sets general rules that apply to all, they may not

¹⁸⁴ The legislation would not be filling a vacuum as the courts had previously considered the matter of property in de facto relationships.

¹⁸⁵ This links in to the “shadow of the law” and the way the law can change expectations. (See Chapter 8.)

suit all possible individual circumstances. Those arguing for the revisions to the legislation are likely to emphasise those who will benefit under the new rules, whereas those arguing against will emphasise situations where the outcome would be undesirable. The proposed option presented for those who might dislike the legislation was that there was the choice not to be subject to it. While married couples would automatically be affected (unless they took steps to be excluded) the same did not apply to de facto couples. For de facto couples, there was some debate on whether they should opt in to the legislation, or be automatically covered and have an opportunity to opt out. The draft (and final) legislation was opt-in, but some MPs opposed this.

From an economics perspective, there are several important aspects that one might wish to see debated. One fundamental implication of extending the legislation to apply to de facto couples with an opt-out provision is that it is changing the default position for the allocation of assets when those relationships end. The presumption seems to be that the man has the greater earning power and more assets, and so the expectation is that, for heterosexual relationships, the law change will result in a reallocation from men to women. From an economic perspective, a regulation is being proposed which will raise the price (on exit) of entering a relationship for men and will lower it for women. This is analogous to the imposition of a price floor for men and a price ceiling for women.¹⁸⁶

Coase described how parties may respond following an allocation of rights in law. There is an additional stage that could be added, in that people may make choices as to whether to put themselves in a position where rights would apply, and under what conditions they would do so (see p.102). Economic theory would suggest that, as an initial response, women will become more willing and men less willing to enter into relationships. In the longer term, non-price responses can be expected to become more apparent, especially among new entrants to the “market” as they have greater flexibility. An analogy could be drawn with rent controls on private rental accommodation. A notable response in that market is a reduction in quality of product due to the restrictions on price. When seen as men supplying partner-services to women at a

¹⁸⁶ Note that this gendered pattern will not universally match reality, but it is the generalised presumption running through the debate, with an acknowledgement that there will be exceptions. Note also that a change in the terms of exit alters bargaining positions (voice) within a relationship.

restricted price, they are the ones who are likely to reduce the quality of services being offered.¹⁸⁷ Conversely, women are likely to increase the quality of the services they offer, or attempt to increase their payments by somehow circumventing the regulations. In this particular market, this could be done by women increasing their earning power. In other words, behavioural and attitudinal changes can be expected. These may have been recognised and understood, but there was no clear consideration of these aspects in the debate.

Economic theory is based on *ceteris paribus* assumptions, and other things can be changing at the same time. Exit from marriage has become easier, and there are even fewer restrictions on exit from de facto relationships. This has an impact on messages given when “signalling” willingness to enter into a relationship (Rowthorn, 2002).¹⁸⁸ Where exit from a relationship is difficult and costly, willingness to enter into a relationship is signalling a high degree of commitment. Where exit from a relationship is easy and results in financial transfers from the other partner, the signal is far less clear. This increases the risk for someone wishing to make a strong commitment, with a general result that they are less likely to enter into a relationship. For people in general, the level of commitment to relationships will fall as ease of exit increases, but the effect will not be equal over partners if there is also a change in the relative prices. Willingness to enter into a relationship will decrease (increase) as the financial costs of exit rise (fall), as will willingness to leave for people once they are in a relationship.¹⁸⁹

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¹⁸⁷ Where relationship property legislation involves a transfer from one partner to the other, the questions could be asked, why does one have to pay the other, and what is being given in return? The equal contribution presumption in law suggests a greater unpaid work contribution by the one making the smaller financial contribution. There are some interesting implications if this is analysed further (Birks, 1994).

¹⁸⁸ Signalling was also indicated by John Tamihere MP when he said that many see pre-nuptial agreements as, “an abrogation of, and an imposition on, their relationships, in that those documents clearly demonstrate that there is an exit policy, and that there should be no commitment to the relationship” [4 May 2000, 583, NZPD, 1940].

¹⁸⁹ This is confounded where the costs or benefits vary with length of relationship. It may be that, where costs of leaving are high, they may be reduced by ending a relationship earlier.

¹⁹⁰ A policy or institutional shift in favour of exit may also have implications for the use of voice (Hirschman, 1970). Improved exit options reduce the relative attraction of voice as an option, but the

In summary, there can be a range of possible reactions to the proposed law change, with repercussions on present and future relationship formation and dissolution. The issue is further complicated when consideration is extended to the possibility that people may form more than one relationship in their lives, and the impact of relationship changes on children.¹⁹¹

Some other economic dimensions relevant for the proposed legislation could include: administration and compliance costs arising from the legislation; transactions costs of entry to and exit from relationships (including costs that one party can unilaterally impose on others); transitional arrangements for those already in relationships (considering also the potentially retrospective impact of the law change if it affects existing relationships); and the distributional effects, which may be different and result in differing responses according to circumstances of individuals (or groups with similar characteristics).

These are only some of the economics-related factors that could possibly be considered in an informed policy debate. There are no doubt numerous other issues that could be identified by psychologists, sociologists and others. Some were mentioned in the parliamentary debates, but their impact on the resulting legislation is less evident.

b) Mention of opting in and out in other debates

The options of opt-in versus opt-out have been considered for other legislation. The economist David Collander (2003b, p. 211) gave the example of savings plans, with much lower participation under opting-in. In a speech which was intended as a critique

improvement may favour one partner over the other in terms of bargaining strength (as in increased payout options on exit). For the other partner, exit is more costly and voice is weakened by the poorer bargaining position. The resulting choice of options is ambiguous. At the institutional culture level, increased exit options may result in “support services” favouring exit, especially if this is linked to further work for the institution.

¹⁹¹ The issue is not purely financial. See Brinig and Allen (2000). Also, expectations of award of sole or shared custody has been found to have an impact on divorce rates in the United States, for example Kuhn and Guidubaldi (1997).

of traditional economics, Michael Cullen MP (2007) made a similar point about KiwiSaver. In these two cases, individuals can make choices on their own. With legislation about relationships, the default option applies unless both parties agree to take the alternative.¹⁹² The “lock-in” effect is therefore likely to be greater.

c) Consideration in this debate

As applied to this legislation, the fundamental issue was one of whether or not the law would automatically apply to de facto relationships of three years or more unless they actively opted out.¹⁹³ There was a side issue in that, while it was said that the aim was to make de facto relationships subject to the same law as married couples, the proposal changed the law for married couples also. Rather than marriages of less than three years being generally considered to be of short duration, the three year period would be considered to have started at the beginning of the relationship, not the date of marriage. Consequently, the full effect of the law might apply before or soon after marriage. This strengthening of the redistributive effects of relationship law was not mentioned.¹⁹⁴

The general lack of research on matters relevant for the proposed legislation has already been mentioned. In its absence, the debate drew on: personal experience and opinion (Penny Webster MP [21 November 2000, 588, NZPD, 6731]; Katherine Rich MP [21 November 2000, 588, NZPD, 6740]); individual cases (Jenny Shipley and Tony Ryall on 21 November 2000, Anne Tolley on 27 March 2001); and generalisations or imagined situations (Chris Fletcher MP [6 May 1998, 567, NZPD, 8279], Tony Ryall MP¹⁹⁵ [29 February 2000, 582, NZPD, 843], Nick Smith MP [21 November 2000, 588, NZPD, 6728], and Lindsay Tisch MP [21 November 2000, 588, NZPD, 6743]). While

¹⁹² Sweden’s joint child custody legislation affects both parents, and that is on a restricted opt-out basis (Singer, 2008).

¹⁹³ Even then, there can be uncertainty as to whether the opting out would be legally recognised at some future date.

¹⁹⁴ There was a proposal put forward by Anne Tolley to change the required period from three to five years. This was in response to the Australian research on the instability of de facto relationships. The amendment was defeated.

¹⁹⁵ While he spoke in favour of an opting out regime at that time, he subsequently changed his position, as indicated in speeches on 21 November 2000 and 29 March 2001.

there was little or no research, Tim Barnett MP [31 May 2000, 584, NZPD, 2741] did indicate that, despite two years of discussion on the point, the debate was still at a rudimentary stage.

The above examples, and others earlier in this chapter, suggest a focus on women by MPs on both sides of the debate. This is strongly indicated elsewhere also, such as Anne Tolley MP [31 May 2000, 584, NZPD, 2740] and Stephen Franks MP [1 June 2000, 584, NZPD, 2756]. This goes against the second criterion for policy debate proposed in Section 6.2, and is consistent with the propositions in Chapter 5. Framing, agenda setting and conventional wisdom have resulted in the belief that women are financially, and hence generally, worse off than men despite evidence to the contrary (Braver & O'Connell, 1998). Schattscheider's perspective would relate this to the issue of groups (original emphasis), "What happens in politics *depends on the way in which people are divided* into factions, parties, groups, classes, etc." (Schattschneider, 1960, p. 62). Traction for these issues required the establishment of gender as an accepted dominant political grouping. Brubaker makes this point very strongly, with groupings shaping perception and interpretation. Hence, "[T]he mere perception of belonging to two distinct groups - that is, social categorization per se - is sufficient to trigger intergroup discrimination favoring the in-group" (Brubaker, 2004, p. 74). Others have also noted the link between perception of groups and differential treatment (Hargreaves-Heap & Varoufakis, 2002; Tyler, 2000).

In summary, the effects of the law will vary according to whether it is specified as opt-in or opt-out. This was recognised by the MPs, with opt-out being supported by those who believed that it would favour women. Debate was based more on examples than on analysis.

6.4 A political explanation?

The information above suggests a failure to meet some basic criteria that economists might consider desirable for policy making. However, the parliamentary debates do demonstrate some aspects of political deliberation. Propositions about policy making in a political context were suggested in Section 5.3. While some of these refer to the

media, public opinion, and other organisations rather than parliamentary debate, there are some propositions for which the information presented here is relevant. For these, the evidence is generally supportive of the propositions to the extent that the observed phenomena are consistent with these propositions. Hence:

Proposition 1: There are a limited number of issues with traction at any one time, and

Proposition 8b: Once a law has been passed, it is unlikely to be evaluated or reconsidered for many years.

In the debates it was stated on several occasions¹⁹⁶ it was time for the existing law to be reconsidered.

Proposition 2: Parties aim to achieve traction on their issues and prevent traction on others.

One form of agenda setting is to put forward amendments to proposed legislation, and agenda denial can be achieved by not responding in debate and voting the amendment down. The following examples illustrate these behaviours.

An amendment to make the legislation come into effect after a three year delay would have prevented it applying to existing de facto relationships. This amendment was proposed by Anne Tolley MP, with four National MPs¹⁹⁷ and Stephen Franks MP speaking in support. With no MPs speaking against the amendment, it was then put to the vote and defeated.

Anne Tolley MP also put forward another amendment such that the legislation would apply to de facto relationships after five years duration rather than three. This was

¹⁹⁶ Phil Goff MP:

“Frankly, it is bizarre that these Bills are being introduced into the House today under urgency. Their provisions implement, largely unchanged, the recommendations of the working party set up in 1988, 10 years ago, by the then Labour Minister of Justice. This Minister has had these Bills sitting on his desk, gathering dust for 7 years.” [26 March 1998, 567, NZPD, 7919]

Tim Barnett MP: “This bill is a signal that after 25 years of matrimonial property law, the renewal and extension of that law are needed.” [14 November 2000, 588, NZPD, 6523]

¹⁹⁷ It was debated on 13 March 2001, and the four National MPs were Wayne Mapp MP, Tony Ryall MP, Alec Neill MP and Phil Heatley MP [13 March 2001, 590, NZPD, 8117-8123].

argued on the basis of the Australian evidence about the instability of de facto relationships. It could also have been argued on the basis that examples used to justify inclusion of de facto relationships in the legislation refer to longer relationships, sometimes ten to twenty years. There were no speeches in reply, and Stephen Franks MP argued against the rushed process and lack of detailed consideration of issues [13 March 2001, 590, NZPD, 8134].¹⁹⁸

Proposition 3: Parties back issues with traction.

Proposition 4a: Parties are more likely to invest in an issue with traction than to generate traction for a new issue.

Both of these propositions are suggested by the widespread focus on the impact of the proposed legislation on women. Government MPs made broad generalisations as if suggested problems for women on average or in particular circumstances applied to all women. Even criticisms by opposition MPs, taking a less aggregated view, still focused on suggested disadvantage for particular groups of women.

Proposition 6a: It is easier to generate traction through celebrity support or framing than through detailed, informed presentation of information.

The lack of research suggests that it is relatively unimportant in the political process.

Proposition 7: The focus in politics is more on the process of policy change than on the determination of desirable policies.

This is suggested by the lack of substance in the debate, rushing the passage of the legislation and operation under urgency, in addition to framing, agenda setting and agenda denial.

¹⁹⁸ Opposition MPs objected to the way debate on this legislation was rushed, with important issues not receiving serious consideration. At the time, there was a Labour-led government. In 2009, and with a national-led government, opposition MPs, many of them in the Labour Party, objected in a very similar way to the rushed debate on the Climate Change Response (Moderated Emissions Trading) Amendment Bill (Moana Mackey MP [24 November 2009, 659, NZPD, 7922]). Rushed passage of legislation may be common. Bill English MP had chaired the committee responsible for the Child Support Act. He referred to rushed debate “to make sure that we put that legislation through as originally framed by Ministers” [21 November 2000, 588, NZPD, 6747], suggesting similar problems with the “ideologically driven” Property Relationships (Amendment) Bill.

Proposition 8a: A government will attempt to limit monitoring so as to minimise attention given to issues that are not on its agenda.

While not directly supported by the information given, it is indicated by the lack of data and research relevant to the policy issues. This suggests that there had been little monitoring of the legislation that was being modified or replaced.¹⁹⁹

As shown in this Chapter, the end result would appear to be a law that was not properly researched, that applies a standard approach to a wide range of different circumstances, and for which discretion is offered to judges with little guidance and much scope for unanticipated consequences and changes in interpretation over time. There is potential for major changes in behaviour in terms of relationship formation and dissolution, lifetime planning, earning and saving patterns, and the upbringing of children, but these issues were not investigated in the parliamentary debates. The implications of the law are linked to other laws (such as on care of children and child support), but these relationships were not investigated in the debates. Given the range of issues on which politicians deliberate, it should hardly be surprising if the debate is not of the highest level. However, the resulting legislation may have been improved had there been consideration in the debate of the three criteria (future environment, sub-groups, and behavioural changes) suggested in this thesis.

While this is just one case study, the debate was spread over a long period, with political parties having time both in government, promoting the changes, and in opposition arguing against them. Unlike the position suggested from economics for policy selection, a limited range of options was discussed, and the debate was poorly informed, with much use of rhetoric more closely fitting the propositions of Chapter 5.

Some of the phenomena identified in this Chapter lend themselves to economic analysis. The parallel between price controls and the extension of the legislation to de facto couples is one illustration of this. This suggests that economics can go part of the way towards specifying the effects of alternative policy interventions, although care is

¹⁹⁹ Two family law examples (award of custody and penalties for obstructing access) of lack of monitoring are included in Birks and Buurman (1997a, 1997b).

needed to avoid Type-A errors. The three basic criteria proposed in Section 6.2 may serve as a simple basic checklist for avoiding some significant weaknesses in debate.

Once laws are passed, and in relation to common law, the next stage relates to implementation through the actions of lawyers, associated professionals and the courts. It is to this area that we now turn.

Chapter 7 The nature of the product/service

In Chapter 1 it was proposed that, from an economics perspective, those working in law could be considered as providing a service. Chapter 3 talked of Type A errors, where theoretical representations and findings may be wrongly applied as if they are accurate descriptions of the real world. It was argued in Chapter 1 that the law and economics literature does not expressly address this issue by considering the law from the perspective of a consumer of the service. While generic economic models of production and markets are standard fare in textbooks (Mankiw, 2007; Stiglitz, 1993), specific characteristics are identified in specialist areas such as the economics of health (McGuire, Henderson, & Mooney, 1988), education (Adnett & Davies, 2002; Belfield, 2000; Johnes, 1993) or land (Balchin, Bull, & Kieve, 1995; Barlowe, 1986). The health economics example is useful because some of the characteristics identified there are also relevant for law. It therefore serves as a useful starting point for considering the characteristics of law as a service. This chapter considers possible characteristics of the law from the perspective of an individual purchaser or consumer of the service. First, some general characteristics are outlined. Then four specific aspects are discussed in more detail. It is in such discussion that the potential value of economic concepts is observed. While theoretical analysis can be undertaken with specific representations and models, individual concepts can also assist in understanding some aspects of observed (or anticipated) behaviour. A concept on its own, like a theory, is only presenting part of the picture, but it can indicate areas of interest and provide a perspective for analysis.

7.1 General characteristics

Economists analyse markets and market failure for goods and services by considering aspects of the nature of the products, how they are produced, whether there is competition, how demand is determined, and so on. Mainstream economics textbooks give us a “Claytons theory of the firm”²⁰⁰, presenting the sort of firm we look at when we are not looking at a firm. This sort of simplification may give a neat and tidy

²⁰⁰ Claytons was a non-alcoholic drink promoted in New Zealand and Australia in the 1980s as “the drink you have when you’re not having a drink”.

structure, but any theoretical approach involves the selection of a limited number of characteristics and the disregard of many others. The aim of this chapter is to look at the law in terms of identifying specific characteristics which may be important for an economics perspective on the operation of the law, taking statute law as given.

Workers in the legal system are collectively providing a service. For example we could consider an output of the Family Court as the resolution of a dispute between the parties. The field of law and economics has focused primarily on the use of economics as an input to legal deliberation, but the characteristics of the law as a service industry also merit some thought. Several of these characteristics overlap with those of health economics. The following characteristics are well accepted in health economics²⁰¹, and can also be expected to apply to legal services:

1. Consumers are infrequent purchasers of the services of the health or legal sectors and often have limited information about what is being purchased.
2. There are principal-agent issues in that people (principals) are buying the expertise of health or legal professionals (agents) and are not fully informed themselves.
3. When someone initially decides to purchase, it is unclear what the end product will be or what the total cost will be.
4. The benefits of an outlay may not even be clear after purchase, as with "credence goods".²⁰²

²⁰¹ See, for example, McGuire, Henderson and Mooney (1988), for discussion of points 1-4 in health.

²⁰² "Credence qualities are those which, although worthwhile, cannot be evaluated in normal use" (Darby & Karni, 1973, pp. 68-69), so the quality is unknown both before and after purchase. This contrasts with "search" qualities of a good or service, which can be discovered through search prior to purchase, and "experience" qualities, which can be identified after purchase (Nelson, 1970). Darby and Karni analyse repair services as their credence good, although the law could also have served as an example and they published in the *Journal of Law and Economics*. Dulleck and Kerschbamer (2006), writing on credence goods in the *Journal of Economic Literature*, do not cover its relevance to the law. There is an indirect connection, however. They state, "Existing institutions address the informational problems associated with markets for diagnosis and treatment. The problem of undertreatment is most famously controlled for by the Hippocratic Oath of a physician and its counterpart in the law." (Dulleck & Kerschbamer, 2006, p. 8). By that they mean that physicians are subject to a legal counterpart to the oath, but the idea has been

Other characteristics can be identified which apply to both health and law, such as:

5. The government does not have full control over its costs, in that services have to be provided in response to demand decisions of others. With health sector spending, some costs could be “capped”. This can result in waiting lists and queuing, and limiting the treatments being funded. Similarly, to some extent public sector legal costs could also be capped, as with provision of judges and courts, and with ceilings on legal aid.
6. Production of the service involves the participation of several service suppliers who are independently appointed, some funded privately and some publicly.

There are additional characteristics which are of particular importance to legal services and which do not all apply to health. Several of these arise from the nature of legal services as a mechanism for addressing disputes between parties (one of which may be the crown). These include:

7. Participation and production may be on the instructions of two or more parties who may not be very cooperative (indeed, they are frequently on opposite sides in an adversarial contest).
8. The decision to purchase can be determined by one party, then requiring outlays by another.
9. While a party has some choice about his or her own counsel, there is relatively little say afforded in the choice of other professionals involved, including the judge.
10. There is limited scope to insure against the costs of legal services²⁰³, and limited redress in most cases of "legal misadventure".

raised that lawyers may require a legal equivalent of the Hippocratic Oath (Economides, 2007; Holroyd et al., 2008).

²⁰³ Although car insurance and professional indemnity insurance policies are examples of policies which may give some cover in specific areas. As one example where this cover may be illusory, McDonald (2009) writes, “Financial advisers are hitting out at insurance firm Lumley for collecting their professional indemnity insurance premiums for years, then refusing to pay up now that angry clients are launching legal claims to recoup their losses”. The company is said to cover 75-80 percent of the professional indemnity insurance market.

11. The outcome can depend on the process. In particular, time taken can have an important impact on costs and benefits to the parties, as with decisions on care of children, or disputes about forthcoming land or property developments where funds are already locked in.
12. Some issues are ongoing, in which case a decision at one time may not permanently resolve the issue. There are several areas where this may apply, but it is readily apparent with care of children disputes, where circumstances can change as children grow. Moreover, decisions at one time may affect options at a later time (i.e. there may be “path dependence”), as when sole care is given to one parent, thus eroding the relationship with the other parent.
13. If we consider the specification of laws as the governmental implementation of policy via the legal sector, then the government does not have full control over outcomes. A parallel can be drawn with other areas of policy. For example monetary policy depends on the response of the trading banks and others.
14. The “shadow of the law” means that the law can affect people without them directly consuming the service. This is because their decisions are made in the knowledge that the law is available to them or to others, and so legal action is a possibility.
15. People make long-term decisions with implications for the future, and they can then be subject to law changes that were not anticipated at the time of the decision.
16. Considering the legal sector as a whole, there is limited monitoring and there is little in the way of formal economic evaluation of the legal system.²⁰⁴ Monitoring and evaluation should ideally also extend to the broader implications, including enforcement issues and incentive and disincentive effects on others.

Collectively, these points indicate that the theoretical conditions for efficient operation of free markets in legal services, as might be argued to occur with perfect

²⁰⁴ One New Zealand attempt to address this problem is Rodney Hide MP’s Regulatory Responsibility Bill and the associated Regulatory Responsibility Task Force (Hide, 2009).

competition²⁰⁵, are unlikely to be met. Application of theory which overlooks characteristics such as these is likely not only to result in conclusions that do not match real world circumstances, but also to detract from or prevent the identification of problems that are occurring. Some specific aspects of particular economic significance will now be considered in more detail.

7.2 Particular concerns

There are numerous issues which could be addressed in this section. They cannot all be covered, so four have been selected. They have been chosen because they are significant, they relate to established economic concepts, and they raise issues of particular interest and relevance to the operation of law. The four areas of concern discussed here are: the principal-agent relationship; production and game theory – the prisoner's dilemma; objectives of the participants; and the nature of costs.

7.2.1 The Principal-Agent Relationship

The first specific characteristic or area of concern is the nature of the relationship between a lawyer and a client, which may differ from that commonly assumed between a consumer and a supplier of a good. There is a common economic problem that arises when a consumer is paying someone to supply a service based on that person's knowledge. Consider, for example, someone in a dispute that could be resolved through the law. The person decides to buy legal services, becoming a lawyer's client. The purchase is essentially of expertise, which means that the client (the principal) is relying on the lawyer (the agent) for information to guide the purchase decision. For this to work well, there are two dimensions to consider. First, is each participant able to convey the right information to the other, and second, do they face incentives to act in some other way? Both these dimensions are important, although attention has focused on the

²⁰⁵ Note also the two questions discussed in Section 3.2.2.a. First, is perfect competition the right ideal? Second, should the comparison be with an unattainable ideal? A more general concept of "failure" might be that the service may not lead to the logical outcome based on perfect information at lowest cost. Deviations from this outcome or costs over this level may be considered to indicate limitations to the effectiveness of the service delivery.

second. To combine the two dimensions, the problem becomes one of whether, when going to a lawyer, the right advice can be expected.

For the first point, on the one hand the client, not being the legal specialist, does not know what legal information is needed, or even what may be available. On the other hand, the lawyer does not know in any detail what the client's wishes (preferences) are. There is partial ignorance on both sides. The required information will only be exchanged if the necessary questions are asked, but neither may be aware of the correct questions to raise. This is important because either conventional assumptions will be made (as provided by framing, or by "street-level epistemology"), or a lot of time could be spent in just identifying the issues.

It is the second point that has received most attention in principal-agent literature, however. Will a lawyer always act in the best interest of the client? This depends on both the motivation of the lawyer and the ability of the client to effectively monitor or supervise the lawyer. Laffont and Martimort (2001) discuss three difficulties, moral hazard, adverse selection and non-verifiability.²⁰⁶ ²⁰⁷ The first two are major problems in the efficiency of insurance coverage, but they also apply here. The third point is potentially highly significant in the law.

Moral hazard is the term used to describe the incentive for people to act inappropriately when they do not face close supervision. People who have insured against accidents may be less concerned about having an accident. This is because many of the costs will be covered by the insurance, but insurance companies cannot closely monitor people's behaviour and prevent them acting imprudently. Similarly, once a lawyer has been

²⁰⁶ Their focus is principally on management-worker relations (Laffont & Martimort, 2001, p. 29), rather than client-lawyer relations.

²⁰⁷ Some years ago Rodell, Professor of Law at Yale, gave a more sceptical view on monitoring lawyers: "It is this fact more than any other – the fact that lawyers can't or won't tell what they are about in ordinary English – that is responsible for the hopelessness of the non-lawyer in trying to cope with or understand the so-called science of law. For the lawyers' trade is a trade built entirely on words. And so long as the lawyers carefully keep to themselves the key to what those words mean, the only way the average man can find out what is going on is to become a lawyer, or at least to study law, himself. All of which makes it very nice – and very secure – for the lawyers." (Rodell, 1939)

engaged, a client does not know if all the work done is necessary, or if the work is done to a satisfactory standard.

Adverse selection in insurance refers to the greater likelihood that insurance cover will be taken out by those requiring payouts than by those who do not. In giving someone insurance cover, the insurance company is agreeing to pay out when specified conditions are met. Those who never get sick may consider health insurance to be of little benefit, whereas those who are frequently ill will find it far more worthwhile. If the insurance company is unable to distinguish between these groups of people, it cannot charge different premiums according to risk. Consequently, the insured will be predominantly those people who are more likely to make claims. In insurance, the insurance company is paying out on claims by a client. In law, the direction of payment is reversed. A client engages a lawyer, and is then under an obligation to pay resulting fees. It may not be known if that lawyer charges inflated fees or if all the work is necessary.²⁰⁸ If such actions are possible, and clients cannot identify them, then those lawyers who use these methods will be able to earn more than those who do not, and are more likely to succeed and prosper.

Non-verifiability refers to the situation where “no third party, and in particular a court of law, can observe [the information]”²⁰⁹ (Laffont & Martimort, 2001, p. 3). This can cause problems for contract design and enforcement. A client could feel dissatisfied with the service received, but is unable to demonstrate failure and then obtain redress.

In practice, there are factors that limit effective competition in the supply of legal advice.²¹⁰ People can choose which lawyer to use. However, purchases of legal services

²⁰⁸ Another term in health economics is “supplier-induced demand” (McGuire, et al., 1988, pp. 160-165). This refers to the ability of the agent to recommend, and hence obtain, work that may not be necessary.

²⁰⁹ The reference to law is worth noting. Frequently courts are required to interpret the information presented, and this can be contentious. Cases may depend on non-verifiable points, and non-verifiable points may be raised and would then prove difficult or impossible to refute. For example, the outcome of a legal case may depend on “non-verifiable” information, such as where motive, intent, or pre-meditation are important.

²¹⁰ There may be other professions involved also. Hence in the Family Court there may be input from counsellors, psychologists, accountants, and actuaries, for example. The field of law and economics has been closely linked to the role of economists as expert witnesses. Similar problems could arise there.

are infrequent and there can be costs involved in transferring from one lawyer to another. There is limited information available about which lawyer would be most suitable.

Some of the available evidence suggests that lawyers may not always try to inform their clients or discover their wishes. For example, some indication of women's experiences with lawyers was provided in a Law Commission consultation paper in 1997. Quotes from submissions include:

“...the often condescending attitude of the young lawyer...Many women feel that they are treated as 'simpletons' and their comments and requests are often ignored...many women feel a decision is often reached in the back room and the woman has no input into the outcome.” (Morris, 1997, p. 1)

When I went to see a lawyer he kept talking in big words that I couldn't understand. I left his office not even knowing what he had said to me. (Morris, 1997, p. 15)

My solicitor told me that my costs would be between \$600-\$2000 initially, but my final account totalled \$25000. (Morris, 1997, p. 15)

These quotes all relate to legal processes, or the way services are delivered. These are important in shaping perceptions of a service. This might be due to inherent concerns about the way someone is treated, or because of the instrumental significance of processes in determining outcomes.²¹¹ In the absence of a reason to expect men's experiences to be systematically different, this sample may reflect the experience of clients in general. There are reasons why lawyers may not act in clients' best interest, and there is evidence in support of this. While principal-agent literature focuses on the principal's limited ability to ensure appropriate behaviour by the agent, there is also the additional problem that each requires information from the other, and their knowledge of the other's requirements may be limited.

²¹¹ Note, “process control has an importance not linked directly or indirectly to decision control: people value having the chance to state their case, irrespective of whether their statement influences the decisions made by the authorities” (Tyler, 2006, p. 116).

7.2.2 Production and game theory – the prisoner's dilemma

A second characteristic or area of concern relates to the adversarial nature of legal activity. The production of the legal service generally requires more than just a trade between a legal professional and a client. There are generally at least two, and sometimes several participants purchasing the service. The purchase of the entire service (such as a dispute resolution in the Family Court) is a joint purchase with other parties. However the parties are in conflict with each other and so they may well be uncooperative. One game-theoretic example of this sort of scenario is known as the prisoners' dilemma.²¹²

To summarise by means of a simple example, assume that two parties in dispute each have the option of being aggressive (uncooperative) or non-aggressive (cooperative). Assume also that the legally decided outcome of the dispute is the same when both parties act in the same way (aggressive or non-aggressive). The preferable strategy for both would therefore be the non-aggressive one as this gives resolution at lower cost. However, there are gains for one party to be aggressive if the other is not. Similarly, if the other party is aggressive, there are losses incurred by the non-aggressive party. There are therefore incentives to each party to be aggressive. So long as one of the parties cannot be trusted not to be aggressive, the end result would be that both are aggressive.

Unless otherwise constrained, legal professionals may well feel pressured to operate aggressively. By acting in this way, they are safeguarding their clients against possible aggressive behaviour from the other party. If a lawyer tries to reduce a client's costs by proposing a conciliatory strategy, this might give the impression that he/she is unwilling to fight, thus increasing the possible gains of an aggressive strategy by the other party. While it is better if all parties are reasonable, there is an incentive for one to be unreasonable.

²¹² The use of game theory for analysing behaviour between litigants is discussed in Baird, Gertner and Picker (1998). Xenophon presents a character, Crito, who described his position, “there are a set of fellows threatening me with lawsuits, not because they have any misdemeanour to allege against me, but simply under the conviction that I will sooner pay a sum of money than be troubled further” (Xenophon & Dakyns, 1897, Book II Chapter IX).

At the same time, communication on these matters between the parties to the dispute is often undertaken indirectly through lawyers. This can lead to less understanding, less trust, and less control by the parties. Disputes can therefore escalate. The parties are acting on the advice of lawyers and rely on this advice being appropriate. Lawyers are paid according to the amount of work done, which might in some cases affect their choice of strategy (as with “supplier-induced demand”).

The prisoner’s dilemma is a simple game, and there will be many other determinants of behaviour in legal disputes. However, as this discussion indicates, the nature of the service, with parties in conflict, a lack of trust, and non-cooperative strategies available, may lend itself to strategies and payoffs consistent with the prisoner’s dilemma.

7.2.3 Objectives of the participating suppliers

A third characteristic or area of concern is the possible objectives of suppliers of legal services. Their behaviour will be influenced by their environment and their objectives. Considerations such as these were used by Niskanen in his discussion of the behaviour of bureaucrats (Niskanen, 1973). It may be possible to take a similar approach here.

Economic theories about people’s behaviour involve specifying their objectives and identifying the constraints they face when trying to meet these objectives. They can consider the available options, selecting the one that performs best in terms of the objectives.

For much of economics, simplifying assumptions are made of profit-maximising firms and utility-maximising consumers. In a competitive market with informed purchasers, economic survival depends on providing value, so such a market with self-interested participants is likely to work quite well. It is a simplified view, however. Few real world markets meet the economic requirements for perfect competition. Objectives can be more complex, and organisations such as firms may not operate in a fully co-ordinated, single-minded fashion. Some economic theories suggest that competitive pressures result in efficiency being widespread in the private sector, and lack of these pressures causes inefficiency in the public sector. However, the two sectors may not be so different, and some of the reasoning may apply in both the public and private sectors.

It would be convenient to be able to assume profit-maximising suppliers competing in a market for homogeneous legal services. However, the market for lawyers' services is not so straight forward. The incentives are more confused and monitoring is difficult, just as in the public sector. In fact, many legal services, such as the operation of the courts, are provided jointly with inputs from both the public and private sectors. Consequently, lawyers may behave in other ways.

We can see some of the possibilities by considering Niskanen's assumptions about the behaviour of bureaucrats. His assumption that they would be budget-maximisers was based on his assessment of their motivation and their environment. He speculated that they may be motivated by "salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau" (Niskanen, 1973, p. 22). Many of these motives could apply equally to lawyers and law practices.²¹³ Some, such as reputation, power and patronage, could be associated with the size and income of the practice, and these may in turn allow them to charge higher fees to clients.

Considering a contrary position, Niskanen speculated about a bureaucrat trying to operate more efficiently. Such behaviour, he suggested, would result in little reward if successful, and risked penalties if things went wrong. Consequently, budget-maximisation would be a more suitable objective. This was contrasted to the situation for a private sector manager, who would supposedly be well-rewarded for efficiency gains (although this is open to question, see Sheeran, 2005). Where lawyers are paid for their time and where the quality of their work is difficult for clients to measure, as suggested for a bureaucrat, rewards are more likely to come from bringing in a large volume of work. Niskanen is not presenting a purely cynical view. He suggests that bureaucrats who wish to do the best job possible would also aim to do more, rather than less. Similarly, a lawyer wishing to make the best case possible for a client may seek to provide a bigger (and more expensive) service.

Niskanen also gives a "survival argument" for budget maximisation in bureaux. This has two aspects in that it considers employees and funders. He suggests that a

²¹³ Posner touches on some of these ideas in relation to the legal sector when he discusses the likelihood of agency costs in administrative agencies (Posner, 2007a, pp. 670-672).

bureaucrat can better please subordinates if able to offer them greater rewards such as job security and promotion prospects. Also, the bureau's sponsor, funding body or "collective organisation" (and a law practice's clients) may have expectations of aggressive pursuit of more activities with their associated higher budgets.

The likelihood of this phenomenon in law was illustrated, at least in part, at a "masterclass" for lawyers in 2008. Many of the speakers were presenting ways in which lawyers could use existing legislation to advocate more effectively for their clients. This involved the use of additional arguments and supporting points, all of which would increase costs and require opposing counsel to respond. If someone were to be cynical, this could be described as a form of "arms race", increasing costs to all protagonists. For Niskanen, in contrast, bureaux are not providing services in an adversarial environment. Such actions in law could also be seen as a genuine attempt to advocate as effectively as possible for the client, and possibly to pre-empt strategies that might be by their opponents. Niskanen's points for bureaucrats may well be more significant in law, therefore.

There is another dimension which gives added weight to a suggestion that lawyers may not act in their clients' best interest. Lawyers are not simply competing against each other in a market place for clients. Their working environment requires regular interaction with other lawyers. Hence their incentives may relate more to their relationship with judges and their fellow lawyers than with clients. They may have one-off interaction with clients, but ongoing working relations with judges and other lawyers.

Clients may come through referral from other lawyers. Work may also depend on decisions by court administrators, as with the appointment of Counsel for the Child, duty solicitors, or allocation of legal aid work, for example. Such work is more likely to arise if a lawyer is on good terms with those making the referrals or decisions. Should a lawyer put a steady source of work at risk in order to better serve a one-off client? In addition, there is professional self-regulation by the Law Society, which may be beneficial or otherwise for clients.

Lawyers have to decide what strategy to advise their clients to follow. Given imperfect information by clients, lawyers have some discretion in this. The issue of "supplier-induced demand" is discussed in literature on health economics, although identification and measurement can be difficult (Labelle, Stoddart, & Rice, 1994), making it difficult to police. The suggestion is that, as the supplier is also the person advising on what should be purchased, there is scope to advise more, or more expensive, actions. Given the added complication with legal services that actions of other parties can also influence the services required, there may well be scope for lawyers to create work for each other while apparently acting to protect their clients.

With possibilities such as these, issues arise of professional ethics and group culture. There may be codes of ethics or behaviour that provide professional constraints on lawyers' behaviour. If so, the problems described above on principal-agent issues may not be so serious. For doctors, there is the Hippocratic oath, although in New Zealand they are not required to swear it.²¹⁴ There is not an equivalent for lawyers.

Cotter and Roper (1996) reported on attitudes to ethics held by legal professionals. In the light of the responses, they speculated on whether the legal profession should be considered a profession or a business. They see the distinction as one between people bound by professional ethics and people allowed a free hand to make money, with many lawyers subscribing to the latter view. As businesses in any industry can have specifications setting out and regulating the nature of their product, the distinction is perhaps more academic than real. Nevertheless, profit-maximising lawyers have to decide what strategy to advise their clients to follow. If they feel unconstrained in their behaviour, they may be misinterpreting their environment, or the constraints are not effectively enforced.

As a general point, lawyers are part of a profession, or a group of professionals, operating together to deliver an overall service. This can lead to a sense of common interest, common culture, and their own "conventional wisdom".²¹⁵ The resulting

²¹⁴ See Dr Richard Worth in the First Reading of the Oaths Modernisation Bill, [17 May 2005, 625, NZPD, 20648-20649]. In the UK there was a debate on the need for a Hippocratic Oath for lawyers, with senior members of the profession as key speakers (Holroyd, et al., 2008). Note also footnote 202.

²¹⁵ See section 3.2.4.b.

culture can then be inward looking and self-reinforcing. Beliefs may differ markedly from the equivalents elsewhere in society. There may be feelings of group identity, and expertise and standards are learned and modified within a working environment. Status in that environment may be important for ongoing earnings and possibilities for promotion. Similarly, they have their internal career scales and self-regulation and disciplinary procedures. Their focus for rewards may be only loosely related to the interests of their clients or the operation of the legal system overall.

7.2.4 The nature of costs

A fourth characteristic or area of concern relates to the effects of legal action on consumers of the service. The performance of the justice system is sometimes assessed solely on whether the “right” decision is reached in the end. For example, Jonathan Krebs, convener of the Law Society’s criminal law committee, said on Radio New Zealand National (emphasis added):

“I think that [the Bain case] shows that **the justice system works**. There is a hierarchy of appeal courts...a new trial has resulted in Mr Bain’s acquittal. That is the way that the justice system works, and yes it does take an awfully long time.”
(Krebs, 2009)

This was a case which had lasted nearly 15 years, for much of which the accused was in prison. He mentions the time, but that is not taken as a failure of the system. Other examples can be found where it is claimed that the law “works” if the end result is considered correct.

According to J K Galbraith, statements such as these should be interpreted with caution if they are made by people in authority. He contends that these people owe their position to a past willingness to expound, and are under an obligation to perpetuate, the “conventional wisdom”:

“The high public official is expected, and is indeed to some extent required, to expound the conventional wisdom. His, in many respects, is the purest case. Before assuming office, he ordinarily commands little attention. But on taking up his position, he is immediately assumed to be gifted with deep insights. He does not,

except in the rarest instances, write his own speeches or articles; and these are planned, drafted and scrupulously examined to ensure their acceptability. The application of any other test, e.g., their effectiveness as a simple description of the economic or political reality, would be regarded as eccentric in the extreme.” (Galbraith, 1999, p. 10)

It would be most unusual for someone in Krebs’ position to say that the law did not work. His comment may be more one of the expected rhetoric rather than a statement of fact. Other examples can be found, including newspaper editorials, emphasising the importance of an issue being “tested in law”, often with little regard for the impact on individuals of the resulting processes.

When asking if the system is working well, economists would be concerned about the nature of costs and benefits of legal services. A common measure of the cost of a good or service is the price paid. Problems might be expected over time. Although not generally explicitly included, the law fits within the category of personal services for which the “cost disease” has been identified. Economies of scale in manufacturing permit significant growth in productivity per worker. This increases the opportunity cost of labour used in other areas, such as personal service.²¹⁶ Baumol writes:

²¹⁶ On the barrier of monetary costs, Dave Smith, former Executive Director of the Legal Services Board, has written:

“I realise that this is simplistic analysis, but would suggest that the market splits up into the following very broad categories:

1. Largish, prosperous corporations with healthy litigation and general legal advice budgets ultimately recoupable from their mass market consumers
2. Upper middle class high earner individuals (say \$200,000 p.a. plus)
3. Lower middle class individuals and one-person shareholder/director companies
4. Poorer individuals on slightly less than the average wage
5. People on the higher level benefits
6. Rock bottom benefit (unemployment etc) recipients

In my view, only categories 1, 2 and 6 can usually face extended civil litigation with any degree of equanimity. The very rich can be self-funding while the very poor can access reasonable quantities of legal aid. Categories 3 – 5 may be capable of maintaining litigation for only short periods before having to settle on unsatisfying terms if their lawyer is not prepared to act *pro bono* or on a success/contingency fee basis of some kind.” (D. Smith, 2001, p. 2)

“...relatively low productivity growth in the personal services is a substantial contributory influence: the services that have been infected by the cost disease are precisely those in which the human touch is crucial, and are thus resistant to labor productivity growth.” (Baumol, 1993, p. 19)²¹⁷

While the direct monetary cost is important, it is not the only type of cost associated with legal action. Other costs include pay foregone due to lawyers' visits and court appearances, and costs of time spent by clients gathering relevant information. These should be noted because reduced legal fees may be achieved by passing on parts of the work to clients.²¹⁸ Fees charged will not then fully describe the resource costs incurred.

When evaluating a service, it can be important to know from what perspective the evaluation is being done. For example, costs and benefits to an individual may be different from costs and benefits to the public sector, or to society as a whole. An approach which might be efficient when evaluated from one perspective may not appear so desirable from another, as with the view expressed by Krebs. In some cases individuals have to pay a high price to prove their innocence. Psychological and other costs to individuals arising from stress and uncertainty could also be considered, as can effects on reputation. These can be significant, and have achieved publicity in some recent criminal cases, but they are hard to measure.²¹⁹ They are related to costs arising

²¹⁷ Baumol sources the concept back to Baumol and Bowen (1966).

²¹⁸ This phenomenon is well recognised in relation to health care, under the label, “cost shifting”. There are parallels also with the distinction between “administrative costs” and “compliance costs” for taxation, with the former being reduced at the expense of the latter (Richard A Musgrave & Musgrave, 1982, pp. 302-303; Sandford, 1981). This could be important in legal cases where costs are awarded, as such costs are likely to be based on lawyers' fees.

²¹⁹ Matthew Oates was tried for killing an intruder who threatened his girlfriend. His case provides an example where personal costs were high, but his trial was presented as a worthwhile test of the law (i.e. an external benefit). Media reports described the situation, “Mr Oates not only had to endure a night of unimaginable terror but also the agony, embarrassment and expense of a murder trial that ended in a hung jury” (“Self-defence must be tested in the courts,” 1997), and “His life has been in turmoil in the year since the incident, and that is an unfortunate cost of a necessary process as the limits of self defence law were again tested, even if the outcome was confirmation of the status quo.” (“Case that had to go to court,” 1997). He had to carry the cost of his defence, estimated at \$45,000 (“Putting a price on the high cost of self defence,” 1997). An editorial in *The Southland Times* concluded, “The present law, as shown in the Oates case, works well enough” (“Sensible result in murder case,” 1997).

from the time required to achieve a resolution, so will be considered here in that context.

British Prime Minister William Gladstone has said (in Parliament on 16 March 1868), “Justice delayed is justice denied”.²²⁰ David Blacktop, a competition and regulatory law specialist, describing the Commerce Act 1986 and the operation of the NZ Commerce Commission, wrote:

“The time and costs associated with court proceedings and regulatory investigations are hugely burdensome and go beyond legal costs to the indirect costs that arise from uncertainty and the management time and resource required. Investigations and litigation distract managers from their focus on core responsibilities: creating dynamic and innovative firms that compete strongly.” (Blacktop, 2009)

On 1 April 2009 Simon Power MP said in a media release on the Disputes Tribunal Bill, “Being tied up in district court dealing with small claims is one of the trouble spots for small businesses - it costs them valuable time and money” (Power, 2009).

Sometimes time costs can work in an individual’s favour, as in this historical English example from the *Poor Law Report of 1834* where the costs would be incurred by those applying the law:

“[T]he overseer...has not unfrequently been obliged to give relief to men who...could have procured work if they had exerted themselves; they threaten to appeal to the magistrate; and, as he lives *fifteen* miles off, the overseers are often induced to yield to their demands, on account of the expense of meeting the claim before him.” (Checkland & Checkland, 1974, pp. 94-95)

Posner, in his widely-read publication, *Economic analysis of law*, takes a restrictive approach to time delays:

²²⁰ Traced at http://hansard.millbanksystems.com/commons/1868/mar/16/adjourned-debate#column_1771 following a reference in Shapiro (2009).

“...court delay is a 'figurative' as distinct from a 'literal' queue. Waiting in line for a table at a restaurant is a literal queue; it imposes an opportunity cost measured by the value of the customer's time while waiting.” (Posner, 2007a, p. 624)

The suggestion is that there are no time costs with figurative queues. This is correct in that time is not taken up by queuing, so there is no opportunity cost in the use of the time, but time delays may not be costless to the parties involved. Posner mentions this, but incompletely. He hints at costs such as those from assets being tied up, restricting options or requiring borrowing in the meantime, or it being harder to plan ahead, given the uncertainty. These costs could be serious, as with foregone investment opportunities or inability to meet current financial obligations. Delays may even affect the outcome, as with interim custody arrangements affecting final custody decisions.²²¹

In addition, delays may arise beyond simply queuing. For example, they may occur due to the time required to gather evidence and make a case. In New Zealand, the point has been made by the New Zealand Law Commission:

“The most crippling effect of delay is not...what goes on in the courthouse. It is the effect on people waiting for court hearings and then decisions. The debilitating and distracting effect of any litigation on the parties and those associated with them cannot be over-estimated.” (J. B. Robertson, 2002, p. 44)²²²

As an additional illustration, Auckland criminal defence lawyer Lorraine Smith said in a radio interview:

“I hear so often my clients saying, ‘Lorraine, if I defend it, and usually they’ve got a pretty a pretty good defence, I’m going to have to come back time and again into court and my boss is getting fed up with me being absent, he’s told me I’m going to lose my job if I have to leave work again, so I may as well bite the bullet and plead guilty even though I didn’t do it.’” (L. Smith, 2009)

²²¹ Even the concept of a final decision in this context could be questioned. A Families Commission report talked of change as, “a day-to-day journey involving the creative management of relationships and behaviours, rather than the achievement of a single point or fixed state that can be predefined and objectively measured” (Handley et al., 2009, p. 34).

²²² Australian High Court judge Ian Callinan has also, “pointed to deficiencies in the adversary system, such as cases taking too long and costing too much money” (Mancuso, 2007).

These costs can be significant. They may affect people's willingness to enter into legal proceedings. Moreover, there is another way in which they can be important. There are opposing parties in legal proceedings. While incurring costs, legal action also imposes costs on the other party or parties. Costs may not be evenly spread over all parties, and the importance of the costs may differ. Hence the law can sometimes be used to one party's advantage even when their position in law is weak. For example, delaying tactics can tie up opponents' resources or prevent them from acting until the matter is resolved.

Some issues, such as care of children, are ongoing. Such issues are poorly suited to legal processes designed to address an issue and make a decision based on circumstances at the time of a hearing. Circumstances change with time. Consider a situation where one parent is not seeing the children. In such a case, delays in getting to court can determine the final outcome. It is hard to see how the law could be said to work well in such cases by using solely a criterion that the last decision was "correct". Time and other costs have an influence on the operation of the law. Their implications should be noted.²²³

7.2.5 More on Posner and queuing

Posner makes an additional point on queuing when he states, "People queue up to buy litigation but not to buy lobsters because judicial time is not rationed by price and lobsters are." (Posner, 2007a, p. 625). This point differs from his distinction between

²²³ There are a range of costs which may be imposed through legal action, and behaviour may be affected as a result of these costs or attempts to avoid them. An accused may be suspended from work, or face social stigma, whether convicted or not. Ogden (2008) describes an example of legal action being brought with indirect costs being the main factor. The case, which was legally hopeless, nevertheless went to court. Consequently, Justice Harrison imposed costs on Clive Bradbury, the lawyer driving the dispute on behalf of his law firm. According to Justice Harrison, "knowing the proceeding was hopeless, [Bradbury & Muir] used the litigation for the ulterior purpose of attempting to force a financial settlement from Westpac...[Bradbury] was declaring his intention to issue proceedings which would disclose confidential information...to extract a financial windfall from the bank by abusing the process of this Court" (Ogden, 2008, p. 7). This illustrates the way that a threat of legal action may be used in bargaining or negotiation, giving an alternative meaning to bargaining "in the shadow of the law" (see Chapter 8).

figurative and literal queues, but it is based on a standard representation of the market. Markets for litigation may not be standard, in which case a Type-A error may arise. For standard markets, queues can be largely eliminated if some of those wanting a good or service can offer a higher price, thereby deterring others from effectively demanding the product.²²⁴ Rather than price-based rationing, there is time-based rationing through queuing (figurative or literal). Posner is justified in suggesting that, in general, reductions in time delays will increase demand. However, he bases his reasoning on the single purchaser model, whereas litigation involves more than one person. Only one of these people needs to express a demand, and others are then obliged to respond. As time delays may even be advantageous for some people, the magnitude of the deterrent effect of queues on demand is therefore not so easy to determine. Environment Minister Nick Smith MP has given an example of this, describing the use of the 1991 Resource Management Act (RMA) for anti-competitive behaviour:

“The RMA has been quite badly abused. I'll give the worst example as the battle between Progressives and Foodstuffs on the new supermarket on the North Shore. It took nearly 20 years with the legal battles. What you had was nothing to do with the environment, but the RMA being used by trade competitors, and it doesn't just occur with big business.” (N. Smith, 2009)

It should also be noted that people cannot currently pay for a judge's time. How much would they buy if they could? Would the supply be the same? If demand increases with fewer delays, would this result in a welfare improvement? Would people want legal services to be handled in the current way if there were other options? Currently the supply of judiciary services and the nature of the product provided by the courts are largely set by government, rather than being based on economic factors. There may be good reasons for government involvement, but an economist would suggest that economic aspects must still be considered to determine an appropriate level and form of provision. These aspects might include consideration of externalities (such as the effect of decisions on the actions of others), equity (given people's differing abilities to pay), judicial independence (so no payment from a party would influence outcomes), and state supervision (appointment of judges, etc.), for example.

²²⁴ In the sense of effective demand being demand backed by money. Some potential consumers are priced out of the market.

Given that the government sets the supply of judicial services, the only conclusion that could be drawn from the existence of queues may be that supply is less than demand at designated levels of court fees. If there are other factors to consider, as described above, we cannot determine whether supply is too low or too high.

Posner also states:

“The main response to the growth in demand has been to add judges and supporting judicial personnel. Such a response is unlikely to have a significant effect on court delay other than in the very short run. By increasing the quality of legal redress, at least to those who value prompt justice, an expansion in the number of judges will induce some people to use the courts who previously had been deterred by the delay.” (Posner, 2007a, p. 625)

The effect on court delay depends on the extent to which demand increases. It should also be noted that cases are not resolved in zero time, so there can be delays in processing because of time required for specialist reports or other preparation, waiting for availability of witnesses, counsel, or other parties, and so forth. Rather than a simple queuing problem, the issue is more one of complex scheduling. Queues are likely to exist under the best of circumstances.

As a specific Family Court example of the relevance of time as a factor determining outcomes, consider the following quote by New Zealand's Principal Family Court Judge, Patrick D. Mahony:

“Young children need routine. Their sense of security is often built around familiarity of environment, familiarity and consistency of caregiving. Those are very important factors for young children. Their bonding is very closely tied to their sense of security.” (Mahony, 1997)

In practice, the Family Court puts great weight on the status quo when considering custody issues. Whichever parent was the "primary caregiver" before separation, or has the children for most nights after separation (if the mother), is therefore greatly favoured on the basis that this would provide continuity for the children. The longer an interim

arrangement lasts, the harder it is to achieve any change. Delays in resolving custody matters therefore favour the parent with effective custody.

This also limits options available if a party is not satisfied with an initial decision. While a decision can be appealed, appropriate remedies at that time may not be the same as appropriate decisions in the first instance.

In summary, as discussed in Chapter 3, theory presents an analogy. The discussion on queues in this subsection illustrates how the specific area of application of theory may be important, and the theory should recognise the characteristics relevant in that application. The time requirements and the effects of delays may depend on the nature of the issues under deliberation. Costs and benefits should be assessed in that context.

7.3 Conclusions

As shown in Chapter 3, theoretical approaches do not represent the real world, but they may provide analogies of the real world. The application of a purely theoretical approach is therefore based on assumptions about that approach's relevance for the problem at hand. There may be a lot of information available about the area of application, only a small proportion of which would be incorporated into a theoretical approach. There is therefore a lot of additional investigation that could be undertaken using this additional information to provide insights beyond or in addition to those resulting from pure theory. This has been recognised in several sub-areas of economics, such as economics applied to health, education and land. The result is an identification of specific characteristics that are important in those areas, consideration of which enhances our understanding.

This chapter takes a similar approach to the law, giving an initial assessment of the nature of legal services. There are numerous distinguishing characteristics of law, many of which are associated with economic concepts and thereby allow existing knowledge to be brought to bear. Individual components may not be unique to law, with some also being common to health care for example. However, collectively they indicate that basic supply and demand analysis will fail to consider some important aspects of the law,

with the danger of Type-A errors. For example, law as a credence good makes market control of quality very difficult, and individuals seldom use the law, so they have little basis for comparison. The presence of opposing parties creates additional complications. In addition, the limited repeat purchase of services and the institutional allocation of work may affect the focus of those working in the law. Sixteen such characteristics are outlined in Section 7.1.

There are many areas which could be investigated in more depth, four of which are covered here. First, the concept of a principal engaging an agent fits the situation where a client uses the services of a lawyer. Consequently, related problems in ensuring appropriate behaviour arise, including those of monitoring and accountability. As was described above, one dimension not commonly addressed is that the relationship between a principal and an agent requires a two-way exchange of information. Neither side may know what information to share, and prior knowledge may be distorted due to prior views as created through means such as macro-rhetoric, including framing and street-level epistemology.

A second area considered the adversarial nature of legal disputes, including those in which one party might be the Crown. This provides a dimension not seen in standard consumption activities because one party's decision on whether or how to participate affects the situation of other parties. The game theory representation of the prisoner's dilemma may give some insights into the results of such interaction, in which case the result may be a heavier and costlier use of legal services with little or no benefit to the consumers.

A third area considered the nature of the market faced by suppliers of legal services. It was argued that demand may be influenced by interactions with others, including fellow lawyers or court staff, with individual clients sometimes being rare or one-time purchasers of their services. This could affect lawyers' behaviour and resulting service provision, and would mean that a simple supply and demand model might overlook significant aspects of the transactions.

The fourth area considered the nature of costs to consumers. It recognised that costs go beyond fees paid for services provided. The concept of cost-shifting may be relevant,

and time may also be significant to a greater or lesser extent depending on the nature of the issues under deliberation. While time delays may be considered as literal or figurative, they do not have to be literal to impose costs. Combining the issue of costs and that of parties in dispute, strategic behaviour is possible, thereby further complicating the representation of a market for legal services. Some of these additional points were discussed in the additional section on queuing.

There is scope for much additional investigation along the lines of this chapter. Particular areas which could be considered include the nature of legal reasoning, including the type of information provided and how it is used, the incorporation of specialist knowledge through the use of “experts”, and mechanisms for ensuring desirable professional behaviour by those working in the legal sector. The material presented here suggests that there are many specific characteristics that can be important, with much potential for “failures” in terms of either increased costs or undesirable or unintended outcomes. One specific concept which usefully illustrates the complex effects of the law has been given the term “the shadow of the law”. This is the subject of the next chapter.

Chapter 8 Shadow of the law

“By the time I had finished my research, I had spoken privately to chief constables who said it was a waste of time arresting criminals; judges who said it was a waste of time sentencing them; and prison governors who said it was a waste of time locking them up. I was confronted with the realisation that **the criminal justice system is rather an effective way of regulating the behaviour of law-abiding citizens, who pick up the deterrent signal and react**; but a strikingly ineffective way of controlling offenders.”

(N. Davies, 2008, p. 38)

8.1 Introduction

As described in Chapter 3 as a general point and in Chapter 7 specifically in relation to the law, it can be valuable to consider specific characteristics of the sector or phenomenon under investigation. This involves more than application of a particular theory, and provides an opportunity to incorporate a wider range of the available information than would be possible when following a particular, prescribed model. In particular, qualitative and cross-disciplinary sources can be brought to bear. When economics is applied, there is a lot of information about the area of application that can be relevant, and this involves investigation beyond the bounds of economics itself. Chapter 4 also emphasises a range of questions that are relevant to the consideration of policy decisions. These include the implications of policies. The costs and effectiveness of laws depend in part on compliance, or, more generally, the way people respond to the laws that are in place. One aspect of this, the shadow of the law, is addressed in this Chapter. It draws on a range of sources, but structured is under an economics-focused series of questions. First, the concept is described, followed by discussion of some debate on its context and importance, including mention of similarities with some economic concepts. This is followed by an investigation of the possible implications of the shadow of the law based on the nature of the signal and some possibly diverse responses that may be observed. In the context of the points in Chapter 3, it could be noted that a theory could be developed to describe each possible response, and there could even be debate on which is the “right” or “best” theory. A key point to draw from

the discussion in this Chapter is that, in the real world, there may be a range of behaviours, and this diversity of responses is also important when considering the effects and desirability of laws.

The concept of the shadow of the law refers to the way laws can affect people's actions even when there is no direct legal involvement.²²⁵ Elster describes this phenomenon, but not the term, when describing what he calls the "disagreement point":

"Consider first how the government can use its legislative powers to shape the disagreement point. If the law determines the outcome when private bargaining fails, it serves as a disagreement point for the latter. The decision that would be made in a court or by an arbitrator, as well as the cost of legal fees, will have to be taken into account by the parties in their private bargaining." (Elster, 1989, p. 88)

Note also (emphasis added):

"What is regulation? Regulation is any law or other government rule that **influences** or controls the way people and businesses behave." (Regulatory Impact Analysis Unit, 2007b, p. 3)

The law does not impact only on those directly involved with the courts. In the parliamentary debates on relationship property legislation, Lindsay Tisch MP said:

"The Law Society has said that it expects that after this legislation has gone through, between 75 and 80 percent of relationship property disputes and litigation will end up in the courts. That is what the Law Society is saying. Its members deal with the current matrimonial property legislation. If we look at the current

²²⁵ A related phenomenon arises where legal decisions in one case have an impact on decisions in other cases, as with the doctrine of precedent (*stare decisis*, or *stare rationibus decidendis*, "let it stand that which has been decided"). With case law:

The decision of a Court has significance beyond the parties involved in the case. Cases are commonly recognised as a statement of the law and the way the law affects individuals...[they establish] a rule of general application. (McDowell & Webb, 2006, p. 317)

With the shadow of the law, the effects can be felt in ways other than through the court.

legislation, we see that only 10 percent of people end up in court.” [21 November 2000, 588, NZPD, 6720]

And, on the same topic, Katherine Rich MP said, “At the moment I understand that about 90 percent of all cases do not make it before a judge, and that most cases are worked out in advance between lawyers and couples” [21 March 2001, 591, NZPD, 8440].

Economic analysis is based on the idea that people react to their environment. The institutional structure, which includes law, affects the constraints that people face and their perceptions of those constraints. Standard microeconomic theory on market failures and regulatory interventions commonly assumes that people are law-abiding, but for some possible brief mention of enforcement issues. The abstract to Heyes (2002) begins:

“Enforcement of any rule or regulation is where ‘the rubber hits the road’. Many economists and policy analysts have been guilty of proposing and promoting legal and regulatory instruments having given scant or no regard to the problems that might surround their implementation.”

This suggests that they are implicitly assuming that people comply with any new law or change in the law, so enforcement is costless. They assume that changes in behaviour, where required by the law, occur without recourse to court action. In other words, there is full compliance in the shadow of the law. There are signs that this oversight is being addressed in some circles, and Heyes’ paper covers some of a rapidly growing body of literature that considers implementation issues.

In law itself, judges are frequently reported as basing their sentencing on whether there is a need to “send a message” to others that certain behaviour is unacceptable. For example, Judge Adeane states (my emphasis), “Having looked around this community and seen this kind of offending touching so much, from public art through to private property around the suburbs where people's homes have been defaced, **a clear message has to be sent out**” (NZPA, 2008). There is an implicit assumption in such decisions that legal decisions affecting some people will alter the behaviour of others without

further recourse to law. The Families Commission commented on the proposed repeal of Section 59 of the Crimes Act²²⁶, removing a defence for the use of force against children, stating, “Repeal will **send a signal** to society that any kind of hitting children is not endorsed by the State” (The Families Commission, 2006). And for a third example, in Parliament on 9 December 2008 at the first reading of the Sentencing (Offences Against Children) Amendment Bill, Dr Richard Worth MP (Associate Minister of Justice) said:

“I accept, of course, that the enactment of this legislation does not of itself resolve lawbreaking, but it does **send a very clear message** to the community as to activity that we abhor and are determined to confront, it does send a **clear signal** to intending offenders, and, of course, it sends a very **clear signal** to the judges to seek, in the exercise of their discretion in imposing sentences, a particular weighting on the issue that is the subject of the bill.” [9 December 2008, 651, NZPD, 674]

Not only is the intent often stated, but there are clear signs that people respond to signals. This can be illustrated by a simple exercise. If people are divided into pairs and asked to decide how to share some counters, say, then in an unconstrained situation many will voluntarily allocate equally. If, instead, they are told that, failing to come to an agreement, an adjudicator will allocate the majority of the counters to a particular, named member of the pair, then the voluntary outcome is likely to be unequal. A difference in observed behaviour occurs while the transactions still appear to be voluntary. The outcomes arise in a different situation, however, because in the second case the allocations occur “in the shadow of” the adjudicator’s ruling. This is a simplified illustration of the effect of bargaining “in the shadow of the law”.

8.2 Debate on the concept

An early approach to the shadow of the law in the context of family law describes the situation as follows:

²²⁶ This section of the Crimes Act 1961 stated, “Domestic discipline---(1) Every parent of a child and, subject to subsection (3), every person in the place of the parent of a child is justified in using force by way of correction towards the child, if the force used is reasonable in the circumstances.” (“The Crimes Act (Reprint as at 1 June 2005),” 1961, Section 59). The section was amended, but not repealed, in 2007.

“Divorcing parents do not bargain over the division of family wealth and custodial prerogatives in a vacuum; they bargain in the shadow of the law. The legal rules governing alimony, child support, marital property, and custody give each parent certain claims based on what each would get if the case went to trial. In other words, the outcome that the law will impose if no agreement is reached gives each parent certain bargaining chips - an endowment of sorts.” (Mnookin & Kornhauser, 1979, p. 968)

The authors suggest, “In negotiations under this regime, neither spouse would ever consent to a division that left him or her worse off than if he or she insisted on going to court” (Mnookin & Kornhauser, 1979, p. 969).²²⁷ It is not stated in their paper, but any assessment should consider the time and money costs of court proceedings²²⁸, uncertainty as to the court ordered outcome, and any possible impact of litigation (or avoidance of litigation) on on-going relations between the parties.²²⁹

Jacob (1992) is critical of Mnookin and Kornhauser, not denying the existence of the shadow of the law, but only suggesting that there can be other factors also at play. He cites a study (Ellickson, 1991) of a small community where custom and social pressure are also important. In that source it is said, “some spheres of life seem to lie entirely beyond the shadow of the law” (Ellickson, 1991, p. 283). Jacob’s own analysis of divorce cases distinguishes broadly two groups of people, those who follow a legalistic approach and those whose approach is relational, or based on the nature of and expectations of the relationship between the parties (some could have characteristics of both).²³⁰ He points out that, where the law was clear (even if only setting a bound), this generally ended discussion:

²²⁷ This is clear if the law or the court is seen as determining the allocation of property rights, as considered by Coase (1960).

²²⁸ As suggested by Elster above.

²²⁹ Ignorance or misinformation, and reliance on or avoidance of established processes, may also affect people’s choices.

²³⁰ Note also “the informal glue that holds a society together” (Ellickson, 1998, p. 541).

“The law may also simply remove some issues from the negotiating table. This is what happened to child support issues for most of the respondents. Although its provisions specify minima, it was almost universally interpreted by both attorneys and clients as mandating a percentage of net pay. Consequently, many of my respondents simply did not deal with support in their negotiations.” (Jacob, 1992, p. 584)

A related point was put forward by Wyatt Creech MP in relation to New Zealand’s Child Support Act (1991) during the parliamentary debates on relationship property:

“When that Act came in...there was an immediate reaction from people who felt that the way things were being divided up was very unfair. But over time people have grown to accept that when they take on parenting they take on a responsibility to provide for children, whether or not they are living with someone. It is this type of change of attitude that the Matrimonial Property Act brought about, and this legislation carries on that tradition...” [6 May 1998, 567, NZPD, 8287]

Note also Keith Locke MP in the same debates:

“There is the problem that many de facto couples find when their relationship breaks up of trying to work out the asset division. It is very hard to work out just on one’s own if no legal provisions exist to assist in this process to make sure that everyone comes out of the situation satisfied.” [4 May 2000, 583, NZPD, 1931]

Frédéric Bastiat (1850) made a similar point in a pamphlet on the law²³¹:

“There is in all of us a strong disposition to believe that anything lawful is also legitimate. This belief is so widespread that many persons have erroneously held that things are just because the law makes them so. Thus, in order to make plunder appear just and sacred to many consciences, it is only necessary for the law to decree and

²³¹ Haffner (2002) also describes acceptance of the law (p.156), along with changes occurring almost unobserved, hidden by the normality of everyday life (pp.6, 91, 113, 127). Historical institutionalism and the process of change with unanticipated reactions may also be relevant.

sanction it. Slavery, restrictions, and monopoly find defenders not only among those who profit from them but also among those who suffer from them.”

Hence it may be reasonable to conclude that laws can shape perceptions.²³² However, while the terms of the legislation may come to be accepted, there may be behaviour changes that arise from the different incentives. In addition, it could be imagined that, if one party was intent on litigation, the other would no longer see the situation as relational, so Jacob’s categorisation may depend on both parties, rather than just one.

From the perspective of this thesis, there are numerous possibilities as to the relative influence of various factors. Therefore, no single theoretical explanation is likely to provide a definitive explanation in all cases. Jacob does not show that the shadow of the law is irrelevant, but just that its significance may be tempered by other influences under some circumstances. A key factor in Ellickson’s example is that there is strong social pressure on both parties to a dispute to resolve matters in other ways and according to other criteria. This lessens the risk of one party defaulting from that convention and having recourse to the court. Similarly for Jacob, where relational factors play a part there are likely to be signals that parties can trust each other. In such cases the shadow effect is less of a threat. Williams (1979) suggests that social controls such as values and morality are superior to the law, but that the law, if heavily relied on, can supersede them.

The sociological dimension could be pursued further²³³. Felstiner, Abel and Sarat (1980) consider disputes as social constructs:

“Studying the emergence and transformation of disputes means studying a social process as it occurs. It means studying the conditions under which injuries are perceived or go unnoticed and how people respond to the experience of injustice and conflict.” (Felstiner, et al., 1980, p. 632)

²³² This is important also in relation to use of an assumption of exogenous preferences in economics.

²³³ And also contrasted to the view that models based on rational behaviour are describing “automatons” (see Footnote 17).

This is an important point, especially in the context of the various components of macro-rhetoric. Perceptions as to what is unjust can be shaped by the law, custom, or by influences such as agenda setting and framing. “The perception of an injury that generates a dispute requires the invocation of a legal or a social norm of acceptable behavior that leads the injured person to feel aggrieved” (Jacob, 1992, p. 567).²³⁴ The factors can also be interrelated. For example, agenda setting may be used in an attempt to change the interpretation of the law, as with pressure for tougher sentencing. Conversely, law changes may be used to try to change perceptions, as with legislation related to smacking children. The shadow of the law, along with numerous other influences, can shape perceptions and expectations, with resulting implications for behaviour. Consequently, laws and law changes should be assessed in this context. Some consideration is given to these issues in the following sections.

The economics literature is not devoid of references to phenomena that have implications for perceptions, outcomes and behaviour elsewhere. Within this broad area, we could consider externalities, announcement effects, indicative planning, the relationship with motivation, and expected penalties. From an economics perspective, the shadow of the law could be considered as an external effect arising from the court decision/signal as described above. Others²³⁵ are affected by the decision besides those participating directly. Shaw described announcement effects as a psychological reaction to a perceived change in the environment. Hence, for example, the effect of a rise in interest rates depends on its impact on expectations. (Shaw, 1973, pp. 19-20). Indicative Planning is an economic phenomenon related to announcement effects, in particular the approach described in the Theory of Demand Expectations (Turner & Collis, 1977, pp. 65-70) in which signals are given through publicised plans. These change perceptions and hence behaviour. Other literature assumes that people base their actions on expected penalties, calculated according to the possible penalty and the probability of it being incurred. This has been referred to as “rational crime” (Cooter & Ulen, 2008, pp. 494-501) and is just one of three alternative models they present. The others are discussed below in Section 8.3.3. The presentation of alternatives is important, because it suggests

²³⁴ Note “consciousness raising” (Sarachild, 1973).

²³⁵ Both those additional people who then change their behaviour, and others who are in turn affected by the changed behaviour.

that one theoretical approach alone may not be a good descriptor of real world behaviour. The expected penalty assumption has also been challenged elsewhere (Chapple, 2007; Torgler, Schaffner, & Macintyre, 2008), with Torgler, et al. discussing literature on the importance of social custom, giving a taxation parallel to the points in Jacob (1992).

8.3 The significance of the concept

This section considers three aspects as follows. First, if the signals being given are correct, then the shadow of the law may result in economical and desirable applications of the law. Second, the signals might be incorrect. For example, the cases being litigated may not be representative, in which case the signals would be distorted, or the signals may not be clear, in which case uncertainty is generated. Third, irrespective of the quality of the signals, people's responses to them may differ. One important dimension to explore is people's willingness to voluntarily comply with the law.

8.3.1 Can be economical if all works well

If the law is intended to send a signal, or is interpreted as sending a signal, then in the ideal situation the signal sent and understood is the correct signal for those receiving it. When the correct signal is given by the law and accepted by potential litigants, outcomes can be achieved without the expense of litigation. On that basis, the shadow of the law is allowing the law to work as intended with lower transaction costs. A proviso could be added that those receiving the signal should then react appropriately.

Such a situation may not be as common as may be thought. If cases vary, and if the signal is blurred due to case-specific details, then the information may be unclear or misread. Alternatively, if cases are handled in the same manner without regard to specific details, then the law may not be providing the intended outcomes in all instances.²³⁶ If people respond to the signals according to different strategies or the

²³⁶ The existence of the shadow of the law has implications when considering whether alternatives to the law are actually independent of the law. They are not necessarily effective substitutes if the existence of one (the law) alters the nature of others.

different theories as described in Cooter and Ulen (see p.198 above), then an additional set of signals are being given which may affect compliance, enforcement costs, outcomes and broader behaviours and attitudes to authority. It is to these possibilities that we now turn.

8.3.2 Can give a distorted signal

Common law or interpretation of statute law may result in others feeling obliged to act in ways that they would not have done otherwise. For a historical example, the *Poor Law Report of 1834* includes descriptions of “allowances” given by parishes as relief for unemployed or those on low wages according to their family circumstances. A Mr Tweedy, reporting from Yorkshire, described the situation at Knaresborough where a particular “rate is allowed, because the magistrates allow it; but in fact, in many cases, it amounts to *more* than a man, when trade is flourishing, could earn” (Checkland & Checkland, 1974, p. 95).

The political implications of (at least politically) undesirable expectations developing as a result of the law are described by Simmonds (2002)²³⁷. He investigated attempts to make rents for accommodation in the UK more economically realistic after decades of controls. Expectations of low cost accommodation had become so entrenched that they caused major political problems.

The concept may also be relevant for Judicial Settlement Conferences in the New Zealand District and High Courts in attempt to reduce costs and time delays. This approach has been used in the UK for the past ten years with some success. Cost savings were not achieved in the UK, however, as the costs are simply realised earlier in preparation for the conferences (Radio New Zealand National, 2009).²³⁸ While this approach may be considered a desirable way to increase the number of cases handled by each judge, it could be an extreme case of negotiating in the shadow of the law unless there is a restriction on judges presiding over both a hearing and a conference. A judge could signal the possible outcome if left to a ruling, leaving the parties little option but

²³⁷ Mentioned above in footnote 178.

²³⁸ The US appears to have had a different experience when arbitration and mediation have been court-ordered, with people being poorly prepared and the process not taken seriously (Krivis, 2007).

to reach an agreement. This would preclude the possibility of an appeal.²³⁹ In any event, the signals given at a conference can be expected to strongly reflect the thinking that would prevail at a hearing.

This raises the question whether the signals being given are the right signals, or are being interpreted correctly.

i) Are representative cases litigated?

If signals are being given from decisions in cases heard in the courts, a first question might be whether those signals are specific to the cases under deliberation or are ones that should be sent to others. Epstein makes this point strongly:

“A common mistake made by judges is to reason from the infrequent cases that come before them to the routine cases their rules will govern...the peculiar method of selecting cases for appellate litigation generates a sample of cases radically different from those that somebody involved in business would see on a daily basis...it is a great mistake for a judge to assume that the rules a court creates only apply to the aberrational cases. The legal rules will also govern the mundane cases that remain within the system, to be resolved without litigation. The judge needs to fear that laying down an ideal rule for this one case in a thousand may unglue the system that works well for the other 999 cases.” (Epstein, 1996, pp. 30-31)

For another angle on this issue, sometimes the process of litigation changes the nature of a case. This was apparent with child custody issues. When serving as Principal Family Court Judge, Patrick Mahony and others suggested that it was conflict between the parties that caused harm to children (Birks, 2001; Haines, 2000). Consequently, under those circumstances shared custody was not a viable option. However, recourse to

²³⁹ In the Family Court in New Zealand, if a judge has presided over a mediation conference, a party can request that the judge not then preside over a hearing on the same matters. However, this safeguard does not apply on all occasions where it might be relevant. Given the relatively informal procedures in the Family Court, judges have been known to give signals to the parties during a hearing in an attempt to resolve matters by consent.

litigation is then seen as a demonstration of conflict, and so court rulings of shared custody were highly unlikely.

This suggests that some of the cases heard may either be inherently different from many of the other situations which may be influenced by the shadow of the law, or become different as a result of the legal action. In either event, the signal may be inappropriate for those other situations.

ii) Do litigated decisions give the desired results?

Even if the cases heard closely resemble situations which do not end up in court, the signals may still be unsuitable. This could arise if legal deliberation produces results which do not send the desired message. There could be several reasons for this. For one possibility, consider litigation between the IRD and individual payers of tax or child support. The sums involved for an individual, while probably significant for them, are small in relation to the costs they may incur through litigation. The outcome of litigation would have a broader relevance for the IRD and the financial implications are much greater. In other words, the benefits to the IRD are internal, whereas many of the benefits from individual litigation are external benefits.²⁴⁰ Posner gives a similar example:

“An interesting question is, when can a judgment be used to bar relitigation of the same issues in a subsequent litigation (**collateral estoppel**, or in a newer phrase, **issue preclusion**), not necessarily with the same party?...To permit A to use the prior judgment [in a suit against B] to bar relitigation of this issue in his suit against C might lead A to invest excessive resources in prevailing on that issue in his suit against B. He might, for example pick as his first defendant (i.e. as B) someone whose stake in the correct determination of the issue was too small to warrant investing significant resources in having it decided in his favour, while A would

²⁴⁰ Downs has suggested, in Proposition 7 (Downs, 1957, p. 297), that politicians may favour producers over consumers. It may be that the same could be said of the law, and for similar reasons. See also the contention that case law is efficient, as outlined in Appendix 4.

spend a great deal, anticipating benefits in subsequent litigation.” (Posner, 2007a, p. 623)

Posner goes on to say, “Cases such as these have given the courts little difficulty” (Posner, 2007a, p. 624), for the reason, given in a footnote, that the later party (here C), does not get “his day in court”. If a precedent has been set, the same can be said in terms of arguing that point of law. The general issue is “resolved”. While it may not cause difficulty for the courts, it can be very significant for the efficiency of the court system in handling such matters (having parallels with “market failure” due to external effects).²⁴¹ One possible counter could be class actions. Another might be to have a “conventional wisdom” against the large organisation or (what is perceived as) more powerful group (e.g. landlords in the UK in the 1960s, perhaps employers). In the absence of class actions, situations such as these are likely to distort the issues that are litigated and the detail with which those issues are considered.

There is an additional reason why incorrect signals may be given. If there are failures in the formulation and implementation of the law, then the signal could be wrong even at that stage. The potential for such failures is indicated by the possibility of group cultures and beliefs being formed among those working in the law. The possibility of these and their implications has been discussed in Chapters 2-5 above. They can be reinforced by limited communication with other groups and the inherent authority vested in people in senior positions in the legal establishment. False perceptions can then spread through a community as a result of the laws and associated decisions. Consequently, distorted signals may be given.

iii) Are clear signals given in decisions?

Sometimes legal decisions can generate uncertainty or false expectations, as indicated by Judge Posner when he said:

²⁴¹ This Posner quote suggests that he is using a court-focused perspective to assess the operation of the court. The approach is worrying as it can conceal significant failures from a broader perspective.

“...often the true grounds of legal decision are concealed rather than illuminated by the characteristic rhetoric of opinions. Indeed, legal education consists primarily of teaching students to dig beneath the rhetorical surface to find those grounds...”
(Posner, 2007a, p. 25)

McDowell and Webb (2006) point out that this can be difficult because, to be relevant for a different case, it is necessary both to determine the rule used in the earlier decision, and then to determine whether this rule applies. As the decision covers not only general aspects of principle but also discussion of the specifics of the case, it is not always clear how these should be disentangled. It should also be noted that criteria for decisions and the resulting outcomes can change over time due to the preferences of judges or changing social pressures as issues gain and lose traction.

For reasons such as these, it should not be assumed that the information that is conveyed and that influences people acting in the shadow of the law is suitable for the circumstances. Distortions can arise at several stages, starting with the laws, and including the cases heard, the decisions made, and uncertainty about the signals. These are important aspects to consider when assessing the effects of legislation and legal decisions.

There is a further dimension to explore. Even if the information is accurate, it cannot be assumed that the effects are desirable. People may react differently to the signals given. To this aspect we now turn.

8.3.3 Does the shadow effect apply equally to all?

If signals are being received, how might people respond? Three approaches can be seen in the literature, in addition to the litigation versus relational distinction described on p.197 above. First, as described above, it may be assumed that there is full compliance with all laws. Second, the law could be considered to specify actions that could be taken at a penalty (commonly taken as the actual penalty, adjusted for the probability of being penalised) for contravention of the law, plus associated costs (these costs are not always

mentioned).²⁴² Third, it may be that there is no common response, with some being more law-abiding than others.²⁴³

The term “shadow of the law” does not appear in the index to Posner’s *Economic analysis of law* (Posner, 2007a)²⁴⁴, nor in Cooter and Ulen (2008). There is no comprehensive analysis of the concept, but some aspects are considered. Hence, they both discuss deterrence, which is linked to the concept. Without the shadow of the law, enforcement costs could be very high.

“In deciding how severely to punish a crime legislators and judges consider the harm it does but also the incentive to commit it. That depends in part on the ease or difficulty of detection. The more difficult the criminal’s deed is to detect, and the easier, therefore, it is for him to get away with his crime, the greater his incentive to

²⁴² See, for example, “Overfishing 'made legal' by fines system” (Churchhouse, 2007).

²⁴³ There is an additional important dimension that is not addressed in this thesis. Obeying the law is considered here in a “first stage”. The laws exist, and people could either obey them, or risk being penalised for contravening them. There is an additional stage after people have been convicted, or after court orders have been made in a dispute. At this stage, the issue is one of compliance with and enforcement of court orders. Will people act as agreed (consent orders), or as ordered? Will sentences (such as community service) be carried out? Can the orders of the court be ignored with impunity? If so, the law could be thought of as having no “teeth”, and therefore compliance is likely to be low.

²⁴⁴ Posner does hint at the concept:

“[T]he judge, and hence the lawyers, cannot ignore the future. The legal ruling will be a precedent influencing the decision of future cases. The judge must therefore consider the probable impact of alternative rulings on the behavior of people engaged in [such] activities...” (Posner, 2007a, p. 26)

However, probably basing his understanding on Coase (1960), he then ignores the shadow of the law to state:

“In [areas such as contracts, and large stretches of property and torts] inefficient rules of law will be nullified by express agreement of the parties, while persistent judicial defiance of economic logic will induce contracting parties to substitute private arbitration for judicial resolution of contract disputes.” (Posner, 2007a, p. 571)

The rules would specify property rights. While private arbitration might then occur, bargaining positions and the final allocation are likely to be influenced by the perceived rules. This would not result in them being nullified. In addition, the shadow of the law is likely to affect outcomes elsewhere, and there are other factors to consider including cost, ignorance (as these are generally not repeat purchases), the advice of lawyers, and rent-seeking by arbitrators.

commit the crime; and the greater the incentive is, the more severe the punishment must be in order to deter its commission.” (Posner, 2007b, pp. 78-79)

Posner is saying that the (potential) criminal is aware of the likelihood of detection and of the penalty, and these affect his (or her?) decision.

“Like the market, the law (especially the common law) uses prices equal to opportunity costs to induce people to maximize efficiency. Where compensatory damages are the remedy for a breach of legal duty, the effect of liability is not to compel compliance with the law but to compel the violator to pay a price equal to the opportunity cost of the violation. If that price is lower than the value he derives from the unlawful act, efficiency is maximized if he commits it, and the legal system in effect encourages him to do so; if higher, efficiency requires that he not commit the act and again the damages remedy provides the correct incentive.” (Posner, 2007a, p. 555)²⁴⁵

The approach where the law is considered as specifying cost of contravention has been referred to as “rational crime” (Cooter & Ulen, 2008, pp. 494-501). This is one theoretical approach, or, as discussed in Chapter 3 above, one analogy, a simplified representation which may give some insights into some observed behaviour. They also describe other models, one of “diminished rationality”, where people act on impulse without due regard for longer-term consequences, and a “civility” model as, “many people obey the law from intrinsic motivation and respect” (Cooter & Ulen, 2008, p. 506).²⁴⁶

²⁴⁵ Posner appears to be equating compensation and opportunity cost, then assuming that this is the correct sum for a desired behaviour change. This may not be correct, if only because there may be less than 100 percent chance of legal action and compensation being ordered. As Oliver (1979) states, it cannot be assumed that compensation equals the optimal incentive (disincentive) sum. The costs (in all forms) of legal action to the parties should also be considered.

²⁴⁶ This has parallels with the discussion on commitment in Subsection 3.2.2.b in that: “Doing one’s civic duty can also create instrumental benefits for the actor, such as improving his reputation” (Cooter & Ulen, 2008, p. 507). It is also asserted that, “People are notoriously susceptible to group pressures, variously described as conformity, herd effects, or social solidarity” (Cooter & Ulen, 2008, p. 507), echoing the points in Section 3.2.4.b.

Differing responses are described in Jacob (1992) as discussed above. They are also considered by Tyler (2006), who considers the importance of perceived legitimacy of the law:

“If people have an experience not characterised by fair procedures, their later compliance with the law will be based less strongly on the legitimacy of legal authorities. Therefore, not experiencing fair procedures undermines legitimacy.” (Tyler, 2006, p. 172)

Just as there are alternative models, so people may have differing views. Specific behaviour types may fit one model more closely than another. Where there is a range of behaviours and these are selected due to differing perceptions or values, the efficiency effects of the shadow of the law will vary. As people are likely to learn over time, certain behaviours may be reinforced, whereas others could fall out of favour.

Similar developments can be seen in consideration of intrinsic versus extrinsic rewards and penalties, with the development of extrinsic systems having an impact on the intrinsic. This is particularly important for the law as it is essentially an extrinsic system. Titmuss’s “gift relationship” blood donor example illustrates the significant, sometimes counter-productive effect of extrinsic rewards (Titmuss, 1970), as do the experiments conducted with students by Gneezy and Rustichini (2000). Ben Kepes gave a New Zealand example:

“I attended a recent meeting where former cabinet minister Ruth Richardson talked about what she calls “regulatory creep”...This loss of focus can be directly attributed to a move from performance to compliance – that is, management and boards move from spending the bulk of their time ensuring corporate performance, to spending their time ensuring compliance with relevant regulations.” (Kepes, 2007)

Don Brash (2009) described similar effects in the UK, “In many ways, this intensive supervision by official agencies made matters worse...[including the effect where] intensive supervision led even some bank directors to suspend their own judgement, and

believe that they were behaving prudently provided they were observing all the official rules.”

Heyes, generalising these points, says, “Frey (1992, 1997) contends that the imposition of external motivation will crowd out intrinsic motivation - self-motivation may be crowded-out or diminished by the use of coercive instruments of enforcement.” (Heyes, 2002, p. 528) This point was also made in relation to the law in an address by Harold Williams, Chairman of the United States Securities and Exchange Commission (Williams, 1979).

An application of this thinking to disputes suggests some interesting implications. The specification of interventions through the court may reduce people’s willingness to reach voluntary agreement, and, perhaps more significantly, result in legally specified requirements overriding any principles or intrinsic motives that might otherwise have guided people’s behaviour. In some cases this is the intent of the law, as when it is designed to change social attitudes and customs. Nevertheless, the processes whereby these effects arise are complex, and there is a danger of unintended consequences.

8.4 Conclusions

This Chapter has emphasised the importance of the shadow of the law when considering the implications of laws and legal decisions. As a result of this phenomenon, there are implications not only for those directly involved in legal decisions, but also for the wider society. This is a result of the signals being given and their effects on behaviour.

There can be problems with the signals being sent. These can arise due to problems with the laws, with the cases heard, with the nature of deliberation, and with the uncertainties in the signal due to varying individual circumstances. There can also be problems with responses to the signals. While individual theories, such as that of “rational crime”, may suggest a particular response to laws, it should not be assumed that this applies, or applies universally. Rather, it could be considered that several theories each have some validity in some circumstances. Collectively, they indicate an array of possible responses. This likelihood of diverse responses complicates the picture because some

responses will be more rewarded than others, with associated signals about the legitimacy and fairness of the legal system.

In summary, the relationship between law and behaviour may be complex. The shadow of the law is important, but its implications are either overlooked or brushed aside through the use of simplistic implicit or explicit assumptions. The signals can be distorted, and actual responses can vary according to individual preferences, values and ethics, and in response to perceptions about institutions. This can make analysis and prediction difficult, and resulting efficiency and equity considerations are often overlooked. The framework presented in this chapter may assist in a systematic consideration of the effects of legal decisions and policies implemented through the law.

Chapter 9 Conclusions

The law is an important component in the organisation of society. Almost all policy making directly or indirectly involves the law. Governments have their legislative agendas, and individual MPs may attempt to affect change through private members' bills. The implementation of law-based policy occurs through the implementation of the law, with varying degrees of compliance and required enforcement. Other policies operate within a legal structure which affects behaviour. Laws also play a part in shaping individual behaviour and interactions with others, as with the resolution of disputes. It is an important part of the institutional structure of a society and merits consideration in economics, or any other any social science concerned with behaviour.

The original intent of this thesis was to explore the law from an economics perspective. This was based on the fact that resources are employed and services delivered by people working in the law. It can be viewed as an economic activity, and so questions could be asked in the same way as they are of numerous other areas of economic activity. There are two dimensions to be considered, namely the political processes of law making, described by a case study in Chapter 6, and the implementation of law, considered in Chapters 7 and 8.

It had been intended that these and additional related topics would form the core of the thesis. However, in the process of investigation, numerous issues arose in relation to the application of economics to this area. Consequently the approach taken is not what might be considered conventional for an economist, and Chapters 2-5 have been included to address these issues. While perhaps not conventional for many economists, there are numerous examples cited in the various chapters of this thesis of books by economists which challenge these standard approaches, and which look at specific details in areas of application.

The differing approach arose because it became apparent at an early stage that some of the issues and perspectives did not fit well within a standard framework. As indicated in Chapter 2, other disciplines looking at related issues present strong criticisms of economics. These criticisms are not entirely justified, but they do demonstrate the

failure of economics to adequately consider some aspects that may be highly relevant. As the Commerce Commission observed, economic theory is useful up to a point, but it may be of limited use when considering individual real world situations. Important aspects may not be considered in the theory, and case-specific details may be central to the decisions. A broader analysis could link to other (especially policy) literature, adjusting the approach to economics accordingly.

Observations such as these resulted in further questioning of economic approaches and quantitative research techniques to the point where a specific assessment of methodology was warranted. The discussion in Chapters 3 and 4 serves several purposes. It investigates some conventions in economists' approaches, identifying and highlighting potential limitations to and misuse of findings. In particular, it can be salutary to recognise theories as analogies, rather than as representations of the real world, and to note that empirical formulations may be restrictive in the information they use, the relationships they can handle, and the questions they address, or fail to include. This discussion indicates additional questions that could be asked to improve the relevance or research results.

In addition, the discussions in Chapters 2-5 illustrate the possibility of group conventions in perspectives on issues. These are important not only when considering the nature of economics, but also as a possible influence on the behaviour of other groups, such as those working in the law. They raise methodological issues that are of relevance beyond economics, and which can be applied to political and legal deliberation. The case for consideration of rhetoric in an analysis of law making and implementation is also strengthened by a demonstration of its importance in economics itself.

In its theoretical perspectives, mainstream economics relies heavily on static analysis, rationality and exogenous preferences. In contrast, the operation of the law is influenced by process and rhetoric. Persuasion, timing and adversarial interaction are important. The general economics view of markets is that competition involves customers facing the options of purchase or non-purchase, the choice being participation or exit. A broader approach could consider an additional option, voice. One mechanism for the expression of voice is through legal processes (although the law can also be used to

enforce exit). The engagement of a lawyer is frequently for the purpose of expressing voice. An analysis based on a theoretical perspective which assumes exit but not voice is unlikely to accurately reflect the operation of the law.

In addition, politicians make laws through political processes, and laws, or their interpretation, also evolve through case law. Literature in these areas refers to rhetoric, agenda setting and denial, framing, process, history and historical institutionalism. These are important influences on the nature of legal services and their impact. They suggest that evolution over time, and the paths followed, may be important. Such historical dimensions are not well handled by static analysis. For reasons such as these, there can be problems with a standard application of economic theory to the analysis of aspects of the law.

If economists and econometricians can adopt, and be persuaded by, methods and ways of thinking without recognising their limitations, then might the same not also apply to other groups and bodies of thought? Might the conclusions drawn be misleading? Flaws in deliberation are relevant both in the application of economics and in the use of deliberation in policymaking and policy implementation, for which the law is a major vehicle.

There is an additional dimension that might distinguish political and legal issues from those faced by people in their daily lives and addressed by theories such as those on consumer behaviour. The perceptions people have on the issues being considered may be different. Lack of direct experience and limited influence can result in people being poorly informed. Those employed in the law have been given the authority to affect outcomes, but are not required to know about the issues being considered. Consequently mechanisms for the spread of understanding, correct or otherwise, are important. This is seen in political processes affecting the agendas, and framing and the importance of language, as in IDFs. Common beliefs can be flawed, as in street-level epistemology, and similar phenomena apply to academic disciplines, professions, and group cultures in general. The news media could also merit attention as they are important participants in shaping and reinforcing perceptions (Birks, 2008), but that is beyond the scope of this thesis.

It is for all these reasons that considerable attention was given to methodological and cross-disciplinary issues in the first half of the thesis. From that foundation, specific aspects of the law could be considered. Consequently the thesis has findings of both a general nature and specific to the law. General findings include the following:

1. There is considerable rhetoric surrounding economics and its quantitative research tools. Although assumptions of exogenous preferences and rational behaviour are common in economic theory, model estimation and evaluation methods, rhetoric is significant among economists. This can be observed, for example in: the choice of perfect competition as an optimal situation and as a basis for comparison with real world outcomes; arguments used in debate on theories (as in point 2 below); and the use of quantitative estimation and the interpretation of results (as in point 3 below).
2. The value of theories is often overstated. Theories should be viewed as analogies, rather than as representations of the real world. In deliberation on accepting or rejecting theories it should be noted that flawed reasoning may be used. Hence, a theory could be treated as giving “the” explanation as a matter of faith. This position can be refuted on the basis that it is a refusal to question the validity of the theory. Alternatively, a theory could be treated as being valid as long as it can give some explanation of a phenomenon. This approach treats *one* possible explanation as if it is *the* explanation. It disregards the way evidence can only show consistency or otherwise, while there may be several alternative explanations that are consistent with the evidence. Thirdly, it could be argued that a theory is acceptable unless a critic can provide a superior alternative (“you can’t beat something with nothing”). This is a rhetorical statement which, if successful, can deflect criticisms. However, the criticisms may show valid flaws or weaknesses in a theory’s explanatory power, and these points should be acknowledged, not ignored. An illustration of the problem arising from partial perspectives is given in the poem about the blind men and the elephant, where each feels a different part of the animal and makes different assumptions about the nature of the whole beast. As an alternative to these three positions, the best understanding may come from a combination of theories, with an awareness of their limitations and recognition that all theories are only analogies of the real world.

3. There are weaknesses in the specification of quantitative relationships, in statistical tests, and in the application of results to real-world issues. For example, at the discretion of a researcher variables in econometrics may be interpreted as either reflecting themselves or being proxies for some other stated variable(s), whereas in practice there is no way of knowing which interpretation may apply in any particular instance. The timing of impacts could be interpreted according to current and lag coefficients without regard for the effects of aggregation over time, although this aggregation can be a major influence on the results. There is also rhetorical power but little actual justification for claims to have “controlled for” influences simply through the addition of variables in an equation. The fallacy of the transposed conditional puts in question standard interpretation of the results of hypothesis tests, and statistical significance alone does not address many of the questions to be considered when making policy decisions. Such questions include the extent of the changes that are possible, costs and benefits of these changes, timing and side effects, distributional impacts, among others. In addition, at a more fundamental level, observation of a relationship does not mean acceptance of the relationship. It may be possible to work with or to change the relationship between variables, although the latter option is commonly assumed away.
4. One way to limit the rhetoric in the application of theory and empirical analysis to understand real world phenomena and to make policy decisions may be to think in terms of errors of types A, B and C. These refer to, respectively, the relevance of theory to the real world, the empirical specification of theoretical relationships, and the step from empirical findings to policy recommendations.
5. The importance of groups should be noted. An academic discipline could be considered as a group, possibly including subgroups, with particular accepted perspectives taken, questions asked, theories, methods of analysis, and conventions on the type of data used. Professions, or those working in particular organisations or institutions, may also have common perspectives and cultures. Membership of a group shapes the behaviour of individual members and the resulting outputs. There may be limited communication and exchange of ideas between groups. This allows alternative perspectives to co-exist over the various groups, and there can be problems understanding the alternative perspectives. Significant differences in perspective between academics specialising in

economics and those in policy analysis/political process was described in Chapter 2. As a general point, academics should note that their analysis of issues commonly involves framing according to particular theories and with the selective use of language, with dominant views probably the result of political forces within disciplines. Similar influences may apply for other groups, including professions such as lawyers, and political parties.

6. Rhetoric can shape views and perceptions at an individual level, but also, and more significantly for policy “macro-rhetoric” can shape opinions on a large scale, possibly contrary to (or with selective use of) the evidence. This has been described in various ways, as in literature on agenda setting and denial, framing, the use of language and ideological-discursive formations, and street-level epistemology. At the individual level, it was recognised long ago by Adam Smith in his lectures on rhetoric, including deliberative eloquence relating to policy debate and judicial eloquence relating to deliberation in the courts. It has received little or no attention in recent economic policy texts. However, these issues are considered important in other disciplines in their analysis of political behaviour and public perceptions. This raises the question whether economists can justifiably overlook them or assume them away, as when exogenous preferences are assumed.
7. Just as a combination of theories and recognition of the limits of theories may be useful within a discipline, the same may apply in cross-disciplinary approaches, synthesising aspects of different disciplines. An illustration of the potential from this approach is the content of Chapter 5 on Downs’ approach to democracy. This was adapted to provide alternative propositions in the presence of agenda setting and other such phenomena. It resulted in the suggestions that there is: political competition to set the policy agenda; a limited number of issues being considered; limited analysis and few policy options; difficulty generating support for new issues; limited public or political debate on the issues; focus on the political processes; heavy use of rhetoric; and limited monitoring. This may result in political activity producing ill-conceived laws and in a poorly informed public.
8. A general conclusion to be drawn from the Chapters 2 to 5 of the thesis is that there is more that can be done in an economic analysis than an application of conventional research methods used by economists. There are assumptions to be

acknowledged and additional questions to consider, such that a broader approach can be productively followed. One perspective on the efficient execution of research might be to consider, at an early stage, what is available in terms of information and prior analysis, including analysis from other disciplines. A novel requirement might be for researchers to justify their disregard for this resource. There are benefits to be gained from going outside a theoretical or technical methodological constraint, and it may be a useful safeguard for those who wish to avoid errors of type A to C. In addition, and most importantly for those concerned with efficient production of research outputs, alternative research approaches are coming available as a result of new technologies and associated information sources. This can increase the efficiency of research and the variety of perspectives and data sources that can be used. These alternatives are relatively novel and have had limited application for economic perspectives on the law, hence the methodological focus chosen for Chapters 6 to 8 of this thesis.

Points specific to law include the following:

1. In Chapter 7 three criteria were specified for an initial analysis of a policy debate. The criteria were that debate should consider: the future environment, as that is where the effects will be felt; the impacts on all the various sub-groups who may be affected; and the effects of behavioural changes by various groups as a consequence of the law change. These policy assessment criteria are potentially very useful for first-stage evaluation and also as criteria to consider for improving general understanding of policy issues and hence possibly developing better policies. The criteria were applied in a content analysis of the extensive debates leading in 2001 to the Property Relationships Act 1976. It was clear that there was very limited research undertaken or otherwise provided on the possible effects of the proposed law changes.
2. There were indications in the parliamentary debate of historical institutionalism, or past decisions being used in unanticipated ways to argue for current changes, and rhetorical use of concepts such as equity. A significant aspect of the legislation was whether it should be on an opt-in or an opt-out basis. Economic

theory and concepts may be helpful in indicating the possible effects of these alternatives, but there was little consideration of them in the debate. Other features, such as the range of relationships to be included and the time delay before couples were affected were raised by opposition MPs, but they failed to generate serious debate.

3. Overall, the analysis demonstrates that lawmaking through a political process may not involve quality debate and detailed investigation of central features that might be considered necessary to produce good laws or policy decisions. Rhetoric may be more important than analysis as a determinant of the resulting legislation. This particular piece of legislation was debated over an extended period of time, with some politicians having periods both in government and opposition, and arguing on both sides of the case. While it is just one case study, the findings may therefore be of wider significance suggesting that, as a result of poor deliberation, laws may be ill-conceived with limited consideration of the substantive issues. The results are also consistent with alternative propositions on political deliberation that are presented in Chapter 5.
4. The application of economics to a particular area cannot be done through generalisation from abstract theoretical representations. As has been shown economics applied to areas such as education, health and land, there may be specific characteristics which must be taken into account. As shown in Chapter 7, there are specific characteristics of law that can be identified when looked at from an economic perspective. Consideration of these may be important if the operation of the law is to be realistically assessed in an economic context.
5. Several criteria seen in other areas of economics can be applied to assist in an understanding of the working of the law. These include credence goods, exit and voice, and principals and agents, to name only a few. Limited information and experience by consumers of the service, along with uncertainties about options and possible outcomes, may be important. Those working in the law may obtain work through a variety of sources, some of which, such as the courts, may be of a repeat nature, whereas others, including some private clients, may be one-off purchases. This may affect their focus and the nature of services provided. There are also specific aspects arising from legal deliberation in an adversarial system.

In particular, a “purchase decision” by one party (that could be the Crown) then results in an obligation to participate by another. The consumption activity is a process, spread over time, with a range of financial and other costs, giving scope for strategies and game-playing by the parties. Some disputes may have payoffs resembling the prisoner’s dilemma, in which case unduly confrontational strategies may be followed. Several possibilities along these lines are identified, with economic concepts being useful in their analysis. This is a potentially fruitful area for further investigation.

6. The assessment of the shadow of the law in Chapter 8 describes a phenomenon which is central to the implementation of laws, their outcomes and the costs of those outcomes. Where the law may be used to determine outcomes, people are making decisions and acting in shadow of the law. This affects their choices. If a law is intended to change behaviour in a specified way, then in the ideal people will voluntarily comply with that law, behaviour will change and there will be no costs of enforcement. In general, this is unlikely to happen. Laws do not generally specify what the outcome would be in every case, and case law similarly may not be definitive due to differing individual circumstances and other reasons. The signals given may not be those intended if the cases heard in court are unrepresentative of those that they influence without hearings. Moreover, uncertainties can result in confused signals. At the next stage, there are several alternative theories on how people may respond to the signals received. Academics may choose to select just one theory, or to debate on which is the “best” theory. However, it would be more realistic to consider the alternatives as indicating that people may respond in different ways, in which case no single theoretical explanation would be meaningful. Some behaviours may be rewarded over others, and these may not be desired in aggregate. For example, if it pays to break the law and risk a fine, individuals may become less law-abiding. While this might be supported under a “rational crime” perspective, it could increase costs of enforcement and reduce the effectiveness of other laws intended to modify behaviour. There are complex issues to consider, and these are important factors in areas where the law might be applied, and in the implementation of policies for which the law is a component.

So, in summary, does the law fail? Market failure is defined in relation to perfect competition. There is no clear optimum state for the law. There is a concept of the law “working well”, meaning that it eventually achieves the right answer. However, that is in relation to existing laws and it disregards the various costs involved. Failures could be perceived in terms of laws that are poorly conceived or designed, incorrect deliberation leading to wrong decisions, unduly costly procedures, and misleading signals being given. In all those regards, there is evidence of failure.

There are two dimensions for response to this existence of failure. First, to some extent improvements can be made. As a first step, this requires an understanding of the nature of the services and their production, including the making of laws through the political process. Economics concepts may be helpful for this, but it should also be noted that this does not mean the promotion of a particular theory as a descriptor of the real world. Errors of types A, B and C can easily arise through a narrow application of theory and standard empirical techniques. By naming these errors, it is possible to frame an analysis to ensure that they are taken into account and the necessary additional questions are asked.

As a second dimension, it may be that the problems cannot be overcome. Some might suggest that “you can’t beat something with nothing”, and so the problems should be ignored. A more prudent conclusion would be that processes are imperfect and expectations of the law should not be too high.

This thesis has just scratched the surface of a large area of potential research. Some areas for further research may be self-evident, but here are a few suggestions. First, some general issues:

1. A broadly based approach to economic issues could be taken as an alternative to, or a supplement to, the more traditional theoretical model/empirical estimation framework. This could involve:
 - i. recognising theory as analogy, along with resulting implications;
 - ii. exploring the limitations of data and of quantitative techniques;
 - iii. consideration of potential errors of types A, B and C;

- iv. considering the efficiency of other approaches to research due to increased availability and reduced costs of a wide range of data and analytical methods; and
 - v. increased use of case studies and on-the-ground investigations.
2. Incorporation of macro-rhetoric into economic assessment of policy, including its implications for estimating values.
 3. Consideration of the roles of groups and the news media in political debate and as a vehicle for macro-rhetoric, including setting agendas, framing issues, street-level epistemology and IDFs.
 4. Further development of the “Downs with traction” approach. This could be in terms of possible propositions, relationship to observed political behaviour, and links to literature on agendas and framing.

Second, some topics on the law:

1. Work on the nature of law as a service could be expanded, especially in terms of the implications of the characteristics of the service.
2. Economics has some useful tools for considering the incentive and disincentive effects of laws, but it is necessary to look at the specifics, and possibly to go beyond theoretical representations.
3. Exit and voice can be considered further. The economist’s view of the market is based on exit, understating the potential importance of voice. Exit may also be a poor means for sending signals if reasons for exit are not conveyed. However, legal avenues for expression of voice are costly, circumscribed, and uncertain as to their effect.
4. The shadow of the law has important implications. This is relevant for assessments involving comparisons of and relationships between legal and other alternative mechanisms. The range of alternative responses and their implications could be explored further. Similarly, consideration of the relationship between intrinsic and extrinsic rewards and controls may provide important insights into desirable organisational and regulatory structures.
5. This thesis has said little on the nature of legal deliberation. Some aspects are discussed briefly in Birks (2000b), but it is a wide and potentially fruitful field. Some relevant topics include:

6. The nature of judicial decisions and the information they contain. It may be that points are illustrative, or legal justifications, rather than drawing on the evidence in a balanced way and clearly signalling the judge's reasons.
7. Judicial activism, or more generally the line between making and interpreting laws. What are the respective roles of elected political representatives and appointed judges? Why is there a demarcation, how is it maintained, and should the demarcation line change?
8. To what extent are judges bound by legal principles if there are conflicting decisions, or if individual decisions are based on a mix of principles and specific aspects of a case? If this gives flexibility in interpretation, what are the implications?
9. What is the nature of legal deliberation? Adam Smith refers to "judicial eloquence" as a form of rhetoric, so are results based on proof or on persuasion? What forms of persuasion are allowed, and how might they work? In particular, how important is "non-verifiability" in legal deliberation?
10. Legal services through the courts are delivered as a team effort, with many different participants. What are the roles of each of these participants? How much influence do they have and to whom are they accountable? How might this play out overall?
11. What are expert witnesses? What is their role? The law is being applied as a means of implementing policies for economic, social, environmental and other objectives. This can give rise to several problems. Hence, if lawyers do not have specialist knowledge of these subject areas, how can they deliberate on these matters? Conversely, if specialist expert witnesses do not understand the forensic aspects of the issues, how can their knowledge be applied?
12. How do lawyers actually behave? Cotter and Roper (1996) found lawyers seeing themselves as a business, not a profession, with implications for their behaviour. There are issues of standards, regulations and controls affecting the behaviour of those working in the law. This may have implications for the nature of the services provided.

As a final closing comment, the thesis has demonstrated that there are limitations in both the making of laws and the operation of the law. Perspectives have been identified which can be informative. The approaches taken can be developed further. They have

already produced valuable results, and there is much scope for further development along these lines. It is hoped that such avenues of enquiry are pursued in the future. Meanwhile, and harking back once again to Socrates, it would be prudent to recognise the limitations of our knowledge and our institutions.

Appendix 1

Politics and process

In comparison to standard economics perspectives, this appendix identifies two sources which suggest alternative ways of looking at policy making.

i) Buchanan

Buchanan questions the legitimacy of any attempt to specify an ideal outcome and emphasises the importance of attention to process when he writes:

“Politics is a process of compromising our differences, and we differ as to desired collective objectives just as we do over baskets of ordinary consumption goods. In a truth-judgment conception of politics, there might be some merit in an attempt to lay down precepts for the good society. Some professional search for quasi-objective standards might be legitimate. In sharp contrast, when we view politics as process, as means through which group differences are reconciled, any attempt to lay down standards becomes effort largely wasted at best and pernicious at worst, even for the man who qualifies himself as expert.” (Buchanan, 1975, p. 1)

From such a perspective it would be difficult to identify desirable or harmful structures and systems, and the significance of concepts such as “market failure” is challenged. Buchanan delves deeper, specifying two approaches to the determination of desirable policies. One is by looking at “existing as well as possible institutions for human choice...in terms of criteria for promoting ‘improvement’, defined largely by potential agreement and independently of advance description” (Buchanan, 1975, pp. 166-167). The second, “involves description of the ‘good society’ independently of either that which exists or of the means through which attainment might be secured” (Buchanan, 1975, p. 167). The second is the more conventional approach in economics. He takes the first approach in *The limits of liberty*, suggesting that pragmatism is not enough to address the problems in society. Instead, he sees the need for “reconstruction of the

basic constitutional order itself” (Buchanan, 1975, p. 167). That is beyond the scope of this thesis.

ii) Goldfinch and Hart

This article presents the following five hypotheses on methods used by political leadership to achieve policy change. Note the link to agenda setting, traction, groups, and rhetoric:

CRISIS, LEADERSHIP, AND POLICY CHANGE

Hypothesis 1: The more dramatically reformist leaders portray current events or issues and serious and acute crises, the higher the likelihood of reform success.

Hypothesis 2: If reform leaders gather together allies to form a cohesive team in support of important changes, prospects of success are enhanced.

Hypothesis 3: If reformers develop and employ strategies targeted at persuading their political environment that the proposed changes are both desirable and inevitable, as well as being practically feasible, they are more likely to be successful.

Hypothesis 4: Successful reformist leaders manage to secure early support of implementing actors for their crisis-response strategy.

Hypothesis 5: The tighter the leadership’s control over the crisis-management process, the higher the likelihood of reform success.

Extracted from (Goldfinch & Hart, 2003, pp. 238-241)

Appendix 2

Data for time regression example in sub-section 4.1.1.a.

Obs. no.	Y	X	Obs. Cont.	Y cont.	X cont.
1	3	3	26	5	4
2	0	2	27	0	3
3	2	5	28	6	3
4	5	1	29	0	1
5	1	3	30	6	5
6	9	6	31	6	6
7	0	6	32	1	1
8	7	1	33	0	3
9	1	1	34	3	5
10	5	5	35	5	2
11	2	2	36	2	3
12	2	2	37	8	5
13	0	4	38	0	4
14	10	6	39	9	5
15	0	1	40	3	3
16	7	6	41	0	1
17	0	6	42	5	4
18	9	3	43	1	1
19	0	1	44	0	1
20	7	6	45	1	1
21	3	3	46	1	1
22	0	1	47	5	4
23	3	2	48	1	1
24	1	1	49	0	3
25	0	1	50	9	6

Appendix 3

Parliamentary debates leading to the Property Relationships Act 1976

At the time these bills were being considered, the stages were:

Introduction and first reading;

Second reading;

Consideration by a select committee and report to House;

Consideration of select committee report to House;

Consideration by a committee of the whole House (committee stage);

Third reading;

Royal assent.

More recently, the second reading takes place after submission of the select committee report.

24 March 1998	De Facto Relationships (Property) Bill Matrimonial Property Amendment Bill	First readings	
26 March 1998	De Facto Relationships (Property) Bill Matrimonial Property Amendment Bill	Second readings	567, NZPD, pp.7916- 7925 Debate adjourned

5 May 1998	De Facto Relationships (Property) Bill Matrimonial Property Amendment Bill	Second readings (cont.)	567, NZPD, pp.8228-8239 Debate interrupted
6 May 1998	De Facto Relationships (Property) Bill Matrimonial Property Amendment Bill	Second readings (cont.)	567, NZPD, pp.8267-8287 Bill referred to Government Administration Committee
29 February 2000	Matrimonial Property Amendment Bill	Consideration of Report of the Government Administration Committee (proposing a Supplementary Order Paper bringing changes into one bill)	582, NZPD, pp.832-844 Bill to proceed
4 May 2000	Matrimonial Property Amendment Bill	Instruction to Committee (to include consideration of de facto and same sex relationships via the forthcoming Supplementary Order Paper)	583, NZPD, pp.1925-1951 Motion agreed
23 May 2000	Matrimonial Property	Questions for Oral	584, NZPD, pp.2432-

	Amendment Bill	Answer: <ul style="list-style-type: none"> • Supplementary Order Paper • Economic Disparity 	2433
24 May 2000	Matrimonial Property Amendment Bill	Questions for Oral Answer: Supplementary Order Paper	584, NZPD, p.2498
31 May 2000	Matrimonial Property Amendment Bill; SOP 25	Referral to Justice and Electoral Committee	584, NZPD, pp.2730-2742 Debate interrupted
1 June 2000	Matrimonial Property Amendment Bill; SOP 25	Referral to Justice and Electoral Committee	584, NZPD, pp.2754-2770 Bill and SOP to be referred, with report back date of 4 September.
23 August 2000	Matrimonial Property Amendment Bill; SOP 25	Procedure	586, NZPD, p.5101 Report date extended to 1 November.
23 August 2000	Matrimonial Property Amendment Bill; SOP 25	Questions for Oral Answer: Matrimonial Property Amendment Bill - Supplementary Order Paper	586, NZPD, p.5113
14 November 2000	Matrimonial Property Amendment Bill	Consideration of Report of Justice and	588, NZPD, pp.6516-6538

		Electoral Committee	Bill to proceed. Name changed to Property (Relationships) Amendment Bill.
21 November 2000	Property (Relationships) Amendment Bill	In Committee	588, NZPD, pp.6705-6759
22 November 2000	Property (Relationships) Amendment Bill	Voting list correction	588, NZPD, pp.6788
13 March 2001	Property (Relationships) Amendment Bill	In Committee	590, NZPD, pp.8117-8171
21 March 2001	Property (Relationships) Amendment Bill	In Committee	591, NZPD, pp.8435-8443
27 March 2001	Property (Relationships) Amendment Bill	In Committee	591, NZPD, pp.8498-8544
29 March 2001	Property (Relationships) Amendment Bill, Administration Amendment Bill, Family Proceedings Amendment Bill (No.2), Family Protection Amendment Bill.	Third Readings	591, NZPD, pp.8625-8640 Bills read.

Appendix 4

The efficiency of the law

Adam Smith contended that common law was more equitable than statute law:

“Whatever, therefore, had been practiced by other judges would obtain authority with them, and be received in time as law. This is the case in England. The sentences of the former cases are greatly regarded, and form what is called the Common Law, which is found to be much more equitable than that which is founded on Statute only, for the same reason as what is founded on practice and experience must be better adapted to particular cases than that which is derived from theory only.” (A. Smith, 1963, p. 169)

Posner has contended, in a qualified way, that common law is efficient:

“What we may call the efficiency theory of the common law is not that *every* common law doctrine and decision is efficient. That would be highly unlikely, given the difficulty of the questions that the law wrestles with and the character of judges’ experience and incentives. The theory is that the common law is best (not perfectly) explained as a system for maximizing the wealth of society. Statutory or constitutional as distinct from common law fields are less likely to promote efficiency...yet even they...are permeated by economic concerns and illuminated by economic analysis.” (Posner, 2007a, p. 25)

The existence of a parallel view of efficient evolution of institutions is described by Pierson and March and Olsen:

“The core arguments of historical institutionalism contrast with a more common view in the social sciences, which, as March and Olsen (1989) observe, assumes (often implicitly) that ‘institutions and behavior...evolve through some form of efficient historical process. An efficient historical process...is one that moves

rapidly to a unique solution, conditional on current environmental conditions, and is independent of the historical path' (pp. 5-6)." (Pierson, 1996, p. 131)

Historical institutionalism is not so clear on the desirability of the evolutionary processes. Parallels may be drawn with economic theory and questioning the beneficial effects of free markets in the real world. Theoretical ideals may not translate well into real world experience.

New Zealand MP Keith Locke presented an alternative view to Smith and Posner, claiming the superiority of statute law for one application at least:

"At present, property division lies in the murky world of case law. It would be a big step forward to have proper legislation, as this legislation promotes, to guide judges, thus leading to more consistency, more justice in the decisions, and cheaper law. Because---and I disagree with Stephen Franks---with a law it will be cheaper. With clear guidelines, parties will tend to reach just settlements either without the law or earlier in the legal process, or through a quicker legal process." [1 June 2000, 584, NZPD, 2757]

One major problem with arguing the efficiency of case law is that case law is partial, addressing only the specified issue(s) from the perspectives presented. This can lead to selective development of case law, especially if there are differences in costs, resources and implications for opposing parties, or if specific issues are selectively tested.

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