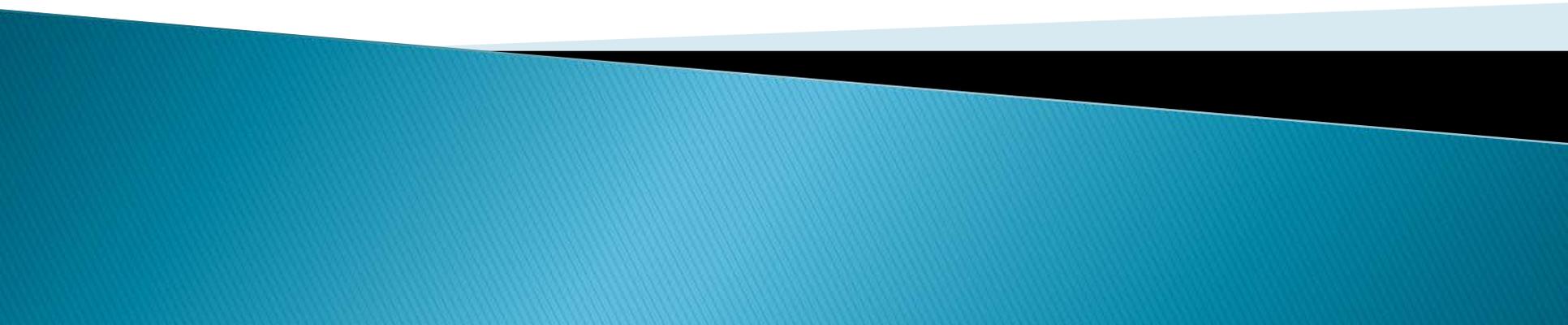


Economic Analysis Versus Business Rent-seeking: the Eclipse of Analysis in Australia

Ross Garnaut
The University of Melbourne
19 June 2015

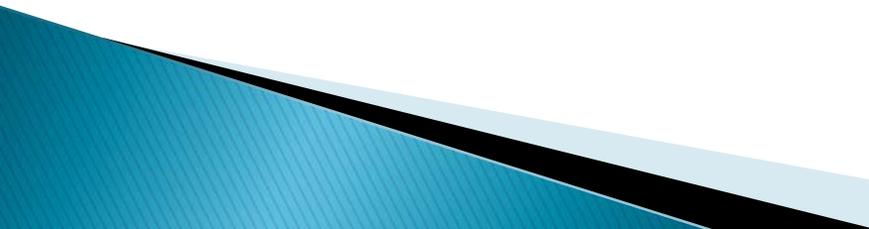
18th Annual Conference on Global Economic Analysis



Economic Analysis Critical to Australian Reform Era 1983–2000

- Long Australian commitment to protection undermined gradually by economic analysis
 - Industries Assistance Commission promoted use of CGE modeling (Impact leading to CoPS)
 - Especially important for rationalizing distributional assertions)
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Reform Era Became Great Australian Complacency 2001 Onwards

- Decline in political culture supported by loss of economists' influence
 - Started but contained in 1990–91 recession.
 - Backlash against “economic rationalism”
 - Short term orientation
 - Acceptance of crude interventions by vested interests and economists' conflicts of interest
- 

Role of Economic Analysis Affected Reform and Economic Performance

- Historically high productivity growth 1990s
 - Historically low productivity growth since early twenty first century
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Garnaut Climate Change Review

- Commissioned by State and Federal Governments 2007 and delivered 2008
 - Independent Review
 - To assess costs and benefits of climate change mitigation
 - Advise on Australian policy
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Optimal Mitigation

- Classic externality requiring tax or regulation to equate private with public benefits (including Hayek)
 - Equate marginal costs of mitigation with benefits of avoided climate change
 - Calculate amount of GHG consistent with avoidance of danger
 - Calculate tax that will generate that level of emissions
 - Or set emissions, auction permits and let market determine price
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A Diabolical Policy Problem

- Uncertainty: favours strong early action economically but deters it politically
 - Costs early decades, benefits start after 3 decades and grow for centuries if not millennia
 - Externalities global not national
 - Challenges concentrated vested interests well organized for political pressure
- 

A Saving Grace

- Unusually large public interest in issue if not in its analysis
 - Therefore issue won't go away despite initial false start
 - Intervention of Pope influential
 - Will leave unto the Pope that which is God's and concentrate on that which is Caesar's
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Some Twists in Costs of Mitigation

- Standard economic parameters and standard CGE for several decades
 - Hard part is estimation of Australia's share of global effort
 - And estimating rate of technological improvement in new low-emissions industries and processes
 - And because stock not flow matters, optimal depletion of a finite resource (Hotelling)
- 

Got Hard Parts Right and Wrong

- ▶ Imposed Hotelling rate of return of 4% seems right for time
 - ▶ But maybe becoming too high with falls in returns
 - ▶ Underestimated technological improvement in some technologies and overestimated in others
 - ▶ If anything, over-estimated costs of mitigation and understated optimal mitigation on both counts
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Determining Fair Shares

- Costs greater for low income developing countries
 - Optimal allocation of effort less demanding for developing countries
 - Modified contraction and convergence did not favour them enough
 - So financial support for developing country mitigation required
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Benefits are costs of climate change avoided

- ▶ Estimated costs of climate change for major impacts
 - ▶ Focussed on median outcomes and gains from strong and moderate mitigation
 - ▶ Benefits difference between climate change costs with and without mitigation
 - ▶ Major later Australian benefits from developing country growth with less climate change
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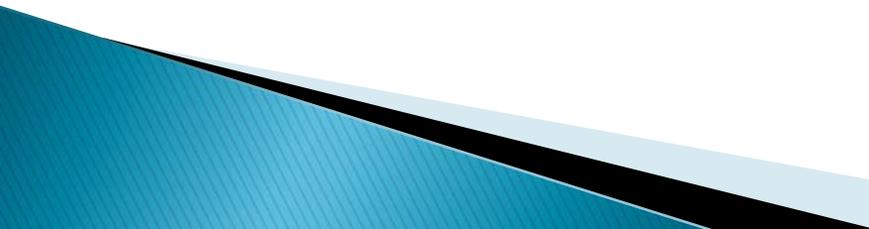
Applications of CoPS CGE Model

- Later integrated with Treasury on costs but not benefits of mitigation
 - International parameters through integration with GTEM
 - Strong detail for emissions-intensive activities and regions
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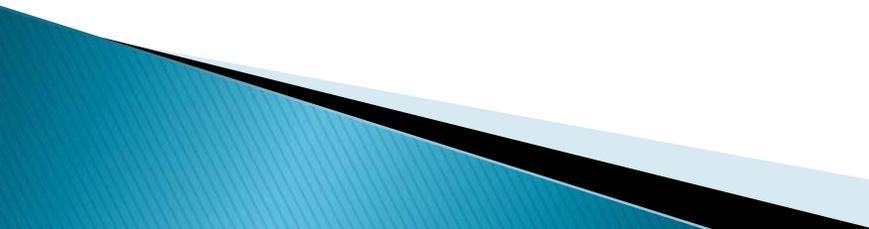
Three Benefits of Climate Change Mitigation not in model

- Insurance against bad departure from the median
 - Effects on “non-economic” values: natural and social heritage, longevity etc
 - Climate Change avoided after 2100
 - Important not to look only at model outcomes: looking under the lamp post
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Discount rate

- Some say normative generally
 - Some say actual rate of return on investment
 - Review said rate of return on investment for investment reduced by mitigation
 - Rate of return on investment also for Hotelling rate
 - Normative rates for comparing utility of income or consumption
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Issues in Choice of Discount Rates

- ▶ Confident that hybrid approach appropriate cf Nordhaus (2013)
 - ▶ Is 4% business return now too high (RBA 18 July 2015)?
 - ▶ Is 2.2% Australian sovereign bond rate now too high?
 - ▶ May have overestimated costs and undervalued benefits of mitigation
 - ▶ Including through excessive costs of low-emissions relative to fossil energy
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Return of Economic Analysis to Influence?

- ▶ Political culture requires change
 - ▶ Economic Society could assess professional quality of policy contributions
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