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

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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
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
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
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
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
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
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
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
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
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
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
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
Return of Economic Analysis to Influence?

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