Reflections on climate change, and the quality of Australian economists

(Article by Saul Eslake, Director of the Productivity Growth Program at the Grattan Institute, published in the business pages of the Melbourne Age *newspaper, and in the online edition of the* Sydney Morning Herald*, on Wednesday 6th July 2011)*

I attended a conference of economists from around the world in Amsterdam last month at which, during one of many discussions about the handling of the Greek sovereign debt crisis, one of the European economists remarked that the world had become a funny place when the Head of the Catholic Church was a German and the Head of the European Central Bank was an Italian.

Australia has become a funny place, too, when the ostensibly left-of-centre major political party advocates reducing Australia's greenhouse gas emissions by using 'price signals' − in the hope that the combination of lower returns from processes which are intensive in their use of fossil fuels and higher prices for goods and services which are similarly intensive will spur the search for less fossil fuel intensive means of producing and distributing goods and services – while the ostensibly right-of-centre party advocates 'direct action', based on the premise that governments actually know the best means of reducing carbon emissions, and will pay people to undertake them.

Economists are, by their training, typically favourably disposed towards 'market-based solutions' to problems. That doesn't mean that economists think markets are perfect, or that they result in socially desirable (as distinct from economically efficient) outcomes, or that government intervention in markets is never justified. There's a fairly wide spectrum of opinion among economists as to the extent to which, and the circumstances under which, government intervention in markets produces benefits that outweigh their costs.

Most economists recognize that markets can 'fail' – for example, because of the inability to put a price on the use of some item whose use has important consequences, or because one side of a transaction has substantially greater information about the product in question than the other. In those circumstances, most economists will support some kind of government intervention in order to procure more socially and/or economically desirable outcomes.

And in those cases, most (though not all) economists will be inclined to favour interventions which work by altering prices upwards (through taxes) or downwards (through subsidies) in order to discourage (or encourage) particular types of economic activity − production or consumption − that the government wants to see less (or more) of, rather than outright prohibition or compulsion.

That's partly because most economists inclined to believe that, given the appropriate price signals (and the potential for profit), firms and individuals are more likely to discover the 'least costly' way of achieving the objectives sought by government intervention, and are less confident in the ability of government agencies, no matter how competent their staff, to arrive at the same outcome at a lower cost than firms or individuals. That won't always be the case – there will always be some situations where 'direct action' is the only means of achieving some objective – but most economists would see that as being a last resort rather than the first choice.

And that's why, as far as I can tell, the overwhelming majority of Australian economists favour a 'market-based' approach to the issue of climate change. Economists are no more qualified than anyone else to judge the extent to which the climate is changing, the extent to which that change is caused by human activities, and the consequences of it continuing to change at recent rates, or under other plausible scenarios. That's the purview of scientists. And scientists, like economists, aren't infallible.

People who aren't scientists (including elected representatives and their advisors) have to make up their own minds as to how much weight to put on what appears to be the 'consensus' of scientific opinion.

That said, the consensus of scientific opinion has for some time strongly suggested that global temperatures have been rising for some time, that human activities (in particular, the burning of fossil fuels) have contributed significantly to that trend, and that if global temperatures continue to increase, there will be unpleasant consequences for humanity, including for Australians.

If one accepts that consensus of scientific opinion (and I acknowledge that not everyone does), there would seem to be a strong case for governments to implement policies aimed at discouraging the use of fossil fuels, and stimulating the search for alternatives.

And, consistent with their training, the overwhelming majority of economists believe that these objectives can be achieved at least cost through measures designed to put a price on carbon, by way of a carbon tax (in which the government sets the price, and 'the market' in effect determines the amount by which emissions are reduced), or an emissions trading system (in which the government determines the amount by which emissions will be reduced, and 'the market' determines the price required to make that happen), and allowing individuals and firms to discover the least costly and most efficient paths towards lower carbon emissions, rather than having governments determine what those paths are and requiring or paying individuals and firms to follow them.

Most economists would be reinforced in that opinion by the recent report by the Productivity Commission, which looked at more than 1,000 different carbon policies across nine countries, and which concluded unequivocally that 'market-based' interventions achieved reductions in carbon emissions at lower cost than interventions based on 'direct action', or (I'd like to think) by an earlier report by the Grattan Institute which came to the same conclusion[1].

Yet according to Opposition Leader Tony Abbott (responding to a question at a conference in Melbourne last Friday), the fact that the overwhelming majority of Australian economists are of this view says 'more about the quality of Australia's economists than it does about the merits of the argument'. In other words, since the overwhelming majority of Australian economists support 'putting a price on carbon' rather than his 'direct action' plan, there's something wrong with them, rather than with his position.

Since he would be similarly hard-pressed to find many Australian economists who support his policy of imposing a tax (though he would no doubt choose to call it something else) on big businesses in order to pay for more generous maternity leave provisions for women working for small businesses, he presumably counts that as additional evidence for his views about the quality of Australian economists.

Yet since Mr Abbott has professed to hold, at some stage or another in the past five years, virtually every position on both climate change and how to respond to it that it's possible to hold, surely it's more likely that his attack on 'the quality of Australian economists' says more about him, and his core beliefs, than it does about Australian economists.

In particular, Mr Abbott has long appeared to have a profound distrust of markets – as befits someone who, early in the development of his political thought, was a disciple of the late BA Santamaria, one of the most anti-market intellectuals in Australian history.

[1] John Daley and Tristan Edis, *Learning the Hard Way: Australia's Policies to Reduce Emissions*, Grattan Institute, Melbourne, April 2011 (www.grattan.edu.au//publications/077_report_energy_learning_the_hard_way.pdf).

Hence, as numerous of his former Howard Government Cabinet colleagues have since disclosed, Mr Abbott has never been particularly enthusiastic about any reforms which entail a greater role for 'market forces' in shaping patterns of resource allocation or economic activity[2].

Unlike Mr Abbott, I'm not going to insult him by saying that makes him wrong, or intellectually inferior in some way. But it does help explain why he thus far hasn't been able to, and probably won't, attract a great deal of support from the overwhelming majority of Australian economists.

(Saul Eslake is a Program Director with the Grattan Institute. However the views expressed here are his own).

[2] Shortly after Mr Abbott was elected as Leader of the Opposition in December 2009, it occurred to me (and I recall remarking to (I think it was) David Uren of *The Australian*), that Australia's major political parties were now both led by people who had a profound distrust of markets, for the first time since Malcolm Fraser and Bill Hayden led the Liberal and Labor Parties, respectively (in the late 1970s and early 1980s). I thought about writing a column along those lines, but Kevin Rudd (who had on occasion displayed a raw hostility towards 'market forces', and not only after the global financial crisis) was politically defenestrated by his Labor colleagues before I could get around to it.