

“Economics can help solve climate change, but economic rationalism cannot. Its narrow focus on individuals leaves it incapable of offering up effective solutions to multi-faceted environmental problems such as climate change.”

In *Together At Last? Economists & Environmentalists* Richard Denniss argues that economics has the tools available to help deal with climate change and other environmental problems but that the economics required is different from that being currently practised.

What is lacking is not the know-how, but the political will to initiate change and the machinery of government to deliver on that will. If a broad range of economic tools is combined with the political desire to overcome obstacles to change, then effective solutions for environmental problems can be quickly found.

Nevertheless, while economics should play a bigger role in helping us achieve our national objectives, it should play a much smaller role in influencing what those objectives should be.

Finally, the essay argues that we need a new language of economics which might be called Economic Neo-rationalism.

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“The opinions expressed in this essay are personal and do not reflect the views or policies of any political party. The aim of the essay is to illustrate in what way economics can best help to deal with climate change and other environmental problems.” —RICHARD DENNISS

Together At Last?

Economists & Environmentalists

Richard Denniss

THE AUSTRALIAN COLLABORATION

A Consortium of National Community Organisations

Preface

Together at last? Economists & environmentalists forms part of a series of essays being published by the Australian Collaboration on societal and environmental issues facing Australia.

The essay is also one of a sequence of short papers on the economics needed for a sustainable society. Already published is a paper on Behavioural Economics (<http://www.australiancollaboration.com.au/factsheets/index.html>). *Together at last?* will be followed by *Living standards, economic growth and environmental pressure* by economist Dr Steve Hatfield Dodds.

The Australian Collaboration is an association of seven leading national community organisations:

Australian Council of Social Service;
Australian Conservation Foundation;
Australian Consumers' Association;
Australian Council for International Development;
Federation of Ethnic Communities' Councils of Australia;
National Council of Churches in Australia; and
Trust for Young Australians.

The Collaboration carries out research and publishes books and other publications. Its overall aim is to help achieve a sustainable society.

A range of free educational and information resources can also be found on the Collaboration's web site. They include Fact Sheets on societal and environmental issues written and peer reviewed by experienced researchers; Democracy Watch devoted to threats to and ways of enhancing democracy in Australia; and Reference Sources, a listing of key national and international sources of statistical and other information.

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Together At Last: Economists & Environmentalists

Economists and politicians know how to use market mechanisms to protect the environment. The problem in Australia over the past two decades has been that only a very narrow version of economics, referred to throughout this essay as economic rationalism, has been applied to policy problems. As a result, effective policy solutions to environmental problems have been largely overlooked.

Economics can help solve climate change, but economic rationalism cannot. Two decades of economic rationalism have delivered fundamental changes to Australia's banking, communication, energy and transport systems. Similarly, both the role of government and the delivery of government services have been transformed as a result of economic rationalism. But its singular focus on the role of individuals combined with its assumptions of perfect information and the existence of well defined markets leaves economic rationalism incapable of offering up effective solutions to a problem as multifaceted as climate change.

Overall, this essay argues that solving environmental problems is more a political than an economic issue. Emerging social and economic problems can be effectively addressed if policy makers are willing to delve deeper into the economist's bag of tricks. The existence of the economic know-how and the absence of political will is illustrated by the disparity between what Prime Minister John Howard said was needed to tackle climate change soon after he took office and what has subsequently happened.

In 1997, the Prime Minister committed himself to tackling the problem of climate change and announced some significant policy initiatives. He set a two per cent mandatory target for renewable energy; he declared that the Australian car industry would be required to increase the fuel efficiency of its fleet by 15 per cent by 2010; he said that government procurement practices would prioritise environmental attributes; and he announced that Compressed Natural Gas, a low emission transport fuel, would be made available for commercial vehicles in metropolitan areas.

Not only have these commitments not been met, but over the past decade, a range of perverse policies have been introduced that have increased the rate of growth of greenhouse gas emissions. For example, with the introduction of the GST came a reduction in taxes on petrol while a 10 per cent tax was placed on the price of public transport.

The deregulation of the electricity market resulted in a significant increase in the use of brown coal fired electricity (the most greenhouse gas intensive form of electricity generation in Australia).

The abolition in 2001 of indexation of fuel excise resulted in a steady decline in the percentage rate of taxation of fuel. The cost of this measure was estimated to be in excess of \$4.6 billion over the past 6 years.

The result has been that greenhouse gas emissions have risen even faster than Prime Minister Howard predicted they would grow without any action on his part.

SECTION 1:

Expanding economics beyond economic rationalism

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Economics describes itself as the science of the efficient allocation of scarce resources. In order to justify their preferred policy solutions of deregulation and small government, some economists and most politicians, focus on a small selection of the available policy tools designed by economists. Depending on the nature of the problem, economic theory provides strong support for a much wider range of policy solutions. The issue that should be addressed is not which is the best approach to policy overall, but which policy is most appropriate given the specific circumstances of the problem at hand.

Throughout this essay the term 'economic rationalism' (also referred to as economic liberalism in other parts of the world) is used to describe the viewpoint of economists and policy makers who conclude that market forces are almost exclusively preferable to government intervention. While this is also an important conclusion of what is often called 'neoclassical economics', neoclassical economics generally allows for a more nuanced debate about the relative merits of market forces and a wide range of government interventions.

There are many paradigms within economics including institutional economics, post-Keynesian economics and political economy. While all these approaches have the potential to add to the analysis presented in this essay, the distinctions between these schools of thought have been ignored for the sake of brevity of exposition. When the term 'economics' is used it should be interpreted to mean neoclassical economics.

Why economic rationalists just can't cope with the environment

Economics was meant to be easy. Rational people, and rational firms, were supposed to make rational decisions. The rational role for government was

simply to get out of the way and let everyone else get on with solving problems and satisfying the market. From a policy perspective, if there were problems in the delivery of a service, then the government should either privatise it or, if it was already a private market, then simply reduce any 'red tape' and let the rational private individuals get on with satisfying the market.

While simple to describe, there are major limitations to the effectiveness of the economic rationalist approach to policy formulation. Put simply, it cannot cope with complex policy problems of 'market failure' such as where the decisions of individuals impact on other citizens, on people outside of the regulatory jurisdiction, or on future generations. Markets are said to be good at allocating resources only when *all* of the following conditions exist:

There are a large number of buyers for a product;

There are a large number of sellers for a product (i.e. there are no monopolies);

Everyone has free and complete access to information about all products (i.e there is no need for any advertising);

The production or consumption of a product has no external, or spillover, costs that affect other citizens (e.g. no products produce pollution or positively or negatively affect the health of others);

There are no economies of scale (i.e. mass production delivers no benefits); and

There is nothing preventing new competition from emerging (i.e. there are no regulatory restrictions that prevent new firms entering a market such as the monopoly rights previously enjoyed by AWB or the limit of three commercial TV licences).

Unless *all* of the above conditions are met market failure is said to exist and economic theory concludes that under such circumstances there is a

case for government intervention in the failing market to improve efficiency and equity.

It should come as no surprise, therefore, that economic rationalism has enormous difficulties in diagnosing and solving environmental problems that are largely a result of market failure. The real surprise for many is that, after decades of public debate which has assumed that economic rationalism is economics, economics is, and always has been, much more than economic rationalism. Market failures were recognised by economists a long time ago and economists have always proposed a range of solutions for market failures which include the imposition of taxes, government provision of services and varying degrees of regulation. The problem in Australia has been that these policy options have been ignored in recent decades.

The widespread acceptance of economic rationalism has created a structural barrier to the kinds of policy reforms required to address climate change and a range of other environmental problems. As outlined below, however, there is no economic principle which prevents the development of creative and effective solutions to environmental problems. In fact, economists once *expected* that governments would implement exactly those sorts of policies if and when the circumstances demanded them.

The truth about government regulation

Government regulation of business is often derided as 'red tape' and government regulation of consumers is often labeled 'nanny state-ism' despite the reality that there are no markets in Australia that are completely unregulated. For example:

There are laws that prevent farmers spraying poisons on their crops because before the laws existed that is exactly what happened.

There are laws that require car manufacturers to install seat belts, and other laws that require all passengers to wear them, because before those laws seat belts were rarely installed or worn.

There are laws that require all employers to provide a workplace that is safe and free from hazards because without such laws workplaces have been among the most dangerous places in Australia.

There are laws that prevent companies from selling dangerous and defective goods because before such laws companies did exactly that.

The suggestion that there is a choice to be made between ‘regulation’ and ‘free markets’ is as misleading as it is unhelpful. There are a large number of wholly government provided services. Most goods and services fit somewhere between the two extremes. The real question is: ‘What is the appropriate extent and form of regulation for a particular market?’

Industry demands for ‘deregulation’ of a market made through the media are often nothing more than a distraction from private discussions about which forms of regulation will most benefit industry incumbents. For example, the Howard Government’s changes to the industrial relations (IR) system were described as ‘deregulation’ yet they resulted in 1400 pages of new IR legislation. Similarly, the recent ‘deregulation’ of the media industry now allows more media proprietors to purchase additional media assets but still prevents new media companies establishing new television stations or broadcasting news-like content over the internet through the control of broadcasting licences.

Similarly, Qantas has used the threat of international competition to justify reductions in employment, wages and conditions while simultaneously lobbying successfully to prevent increased foreign competition on the routes between Australia and the UK and Australia and the US.

Australian industrialists adopt a pragmatic approach to regulation and government assistance; they are in favour of government policies that are good for them and opposed to policies that they believe will be bad for them. Self interest is a more effective predictive model of an industry’s approach to regulation than the ideological preferences of economic rationalists.

Economics provides a useful framework for analysing better and worse forms of regulation and the circumstances under which they will be most

effective. The analysis of the costs and benefits of alternate courses of action allows economists to provide a good foundation for policy decision making. The problem with economic rationalism is that it is based on the assumption that a small subset of possible policies is always the preferred solution to any problem.

What traditional economics really has to say about the environment

As discussed above, economics is concerned with the allocation of scarce resources. Economists believe that when a resource is scarce its use should be restricted to ensure that it is always used in the most socially useful manner. When circumstances change, and a resource that was once abundant becomes scarce, economic theory makes it clear that either producer or consumer behaviour must adjust to suit the new circumstances. Economic theory also recognises that, in the event that producer or consumer behaviour does not alter to reflect the scarcity of a resource, government intervention may be appropriate. As outlined in the following sections, however, political impediments typically dominate policy solutions that are both economically and environmentally desirable.

The biggest environmental problems in Australia today arise from the fact that, when the laws and practices which dominate the Australian economy were being developed, water, forests, fish, fresh air and the capacity of the atmosphere to absorb carbon dioxide were not considered scarce. In fact, they were rarely considered at all because of their relative abundance. When Europeans first began to colonise Australia it was cleared land, labour and industrial capital that were in short supply and, appropriately, it was the distribution of these resources that attracted the attention of legislators and policy makers. This is no longer the case as natural resources such as water, forests, fish and fresh air have become relatively scarce. Despite this shift in circumstances, the priorities of legislators and policy makers have, recent rhetorical flourishes aside, failed to shift to reflect these changes in relative scarcity. Consider the following examples.

The phrase ‘all the fish in the sea’ was once meant to imply infinite

resources. Now, more fishing vessels than ever are trawling with nets longer than could have been imagined in the 18th Century - yet they are catching less fish than a decade ago. The problem today is not a shortage of fishing boats or fishermen, but of fish. The 'law of the sea' which allows for vessels to take unlimited quantities of fish in the deep ocean made sense when wooden vessels with no refrigeration sailed (literally) the seas. Now that circumstances have changed, laws must change as well. But this is a political problem, not an economic one, as those who are used to catching fish at will (and paying nothing for them) are unwilling to change.

In an era of axes and horse drawn carts the supply of timber was constrained by the number of loggers and not the number of logs. There was no need to prevent the felling of the oldest and largest trees in the forest because they were so big that they could not be hauled out of valleys regardless of how much horse power (literally) could be mustered. Now, two men driving two bulldozers connected by a giant chain can clear more land in a day than 100 men could have once cleared in a week. Economic theory suggests new circumstances require new policies, but those who have grown rich using new technology under the old legal framework are, not surprisingly, reluctant to change.

The problem of climate change arises from a simple, but understandable, oversight on the part of previous generations of legislators. When the industrial revolution began and coal began to replace wood as the main source of fuel, the regulators of the 18th century did not have the foresight to ensure that those who burned fossil fuels were required to pay for the waste disposal services provided by the atmosphere that so rapidly absorbed the carbon dioxide released during combustion. The legislators of the 18th century naively assumed that the amount of carbon dioxide being released was trivial and the capacity of the atmosphere to absorb it was infinite. Because they thought that the atmosphere was not a scarce resource they did not seek to ration it. Today's regulators have no such excuse, but it is politics, not economics, that prevents effective action to address climate change.

The primary cause of these problems is that while technology has evolved

rapidly the regulatory environment has changed slowly, if at all. New regulatory structures need to be introduced to ensure that individuals and companies are valuing resources according to their current scarcity rather than their historic abundance. Ironically, the loudest calls for a new regulatory structure are now coming from the businesses that once suggested that change would be catastrophic for the economy.

Consider the following extract from the recent Switkowski report into the future of nuclear power in Australia. This report, which was both commissioned and warmly received by the Prime Minister, John Howard, states:

To address climate change there needs to be a level playing field for all energygenerating technologies to compete on a comparable whole-of-life basis. In a world of greenhouse gas constraints, greenhouse gas pricing using market based measures would provide the appropriate framework for the market and investors to establish the optimal portfolio of energy producing platforms ... Legislation would be necessary to establish a reliable and efficient regulatory framework... (Switkowski, 2006, p.10).

Switkowski's support for a regulatory framework that would put a price on the costs of pollution from burning coal comes as no surprise. The approach he recommends is entirely consistent with the central proposal of the recently published Stern Report, which states:

Climate change presents a unique challenge for economics: it is the greatest and widest-ranging market failure ever seen (Stern 2006, p i).

Further

The first element of policy is carbon pricing. Greenhouse gases are, in economic terms, an externality: those who produce greenhouse-gas

emissions are bringing about climate change, thereby imposing costs on the world and on future generations, but they do not face the full consequences of their actions themselves.

Putting an appropriate price on carbon - explicitly through tax or trading, or implicitly through regulation - means that people are faced with the full social cost of their actions. This will lead individuals and businesses to switch away from high-carbon goods and services, and to invest in low-carbon alternatives. Economic efficiency points to the advantages of a common global carbon price: emissions reductions will then take place wherever they are cheapest (Stern 2006, p. xviii).

The recommendations of both the Switkowski report and the Stern report are entirely consistent with the requirement of Article 2, Part V, of the Kyoto Protocol which states that signatory countries shall implement:

Progressive reduction or phasing out of market imperfections, fiscal incentives, tax and duty exemptions and subsidies in all greenhouse gas emitting sectors that run counter to the objective of the Convention and application of market instruments (UNFCCC 1997).

Likewise, these recommendations are entirely consistent with traditional economics. Writing soon after World War II, Paul Samuelson, in one of the first modern economics textbooks, states:

...the equilibrium of a closed economy under competition is correct except where there are technological external economies or diseconomies. Under these conditions, since each individual's actions have effects on others which he does not take into account in making his decision, there is a *prima facie* case for intervention. (Samuelson, 1947, p. 208, emphasis in original).

The consensus among economists about what needs to be done to tackle problems of market failure like climate change is as widespread as the consensus among climate scientists over the need for urgent action to reduce carbon dioxide emissions. The economic complexities associated with addressing climate change are not associated with the need, or mechanisms, to reduce greenhouse gas emissions. On the contrary, the economic difficulties associated with climate change are confined almost exclusively to politics and the impacts of the transition from the status quo to a low emission economy.

Any difficulties associated with planning the transition to a low carbon economy and the consequent political difficulties of who should bear the costs of that transition, should be viewed solely in the context of the economic difficulties and distributional costs associated with the expected level of climate change. Whether or not democratic decision making is capable of framing such short term challenges in the context of such a long term consequence is yet to be seen. This is examined in further detail in Section 2.

SECTION 2: The politics of economics

The section above highlights the fact that environmental degradation is caused by the failure of policy makers to implement new regulatory regimes as new problems emerge and resources that were once abundant become increasingly scarce. This section illustrates in what way the failure of the regulatory structures to respond to environmental problems is caused by a lack of political willingness rather than by any shortfall in economic or policy know-how.

Regulatory structures in Australia and in other developed countries can, and do, change rapidly. Recent examples of rapid regulatory responses to emerging problems include:

- The decision to allow embryonic stem cell research in response to pressure from the medical community;
- The provision of regulatory protection to new forms of 'property' such as web addresses in response to businesses who wanted to use the internet for commerce;
- The decision to excise Australian territory from immigration laws in response to increased numbers of applications for asylum;
- The recent decision to reverse Australia's position on the use of nuclear energy and to allow the exportation of uranium to countries which are not signatories to the Nuclear Non- Proliferation Treaty in response to climate change; and
- The decision to ban handguns and heavily restrict the ownership of other firearms following the massacre at Port Arthur.

The interesting question for those interested in understanding the policy

process in Australia, and in turn for those interested in solving a range of environmental problems, is not whether governments are able to adjust to changing circumstances but why governments react to some changes in circumstances and not to others?

Further, why do governments that profess a high level of faith in the efficiency of market prices to solve problems, in areas such as health, education and even the incarceration of prisoners and refugees, refuse to rely on market pricing mechanisms to increase the efficiency of the use of water, energy, transport and timber? If polluters were forced to pay for the damage they cause to others, then their costs would rise, the prices of their products would rise, and consumers would switch to less harmful products. Economic theory suggests that this is the best way to deal with pollutants, but economic rationalists resist such policies in Australia.

Consider the inconsistent approach of the National Farmers Federation (NFF) to the benefits of a market based approach to policy problems. On the one hand;

Free Trade has been a hard sell, but it's the only way forward – especially for NSW and Queensland farmers who are providing the bulk of Australia's high value agricultural exports. There is simply no workable or sustainable alternative to a market-oriented environment (NFF President Peter Corish, 2006).

But on the other:

NFF does not support the inclusion of environmental impact as part of best practice pricing. ... Water pricing must not be used as a policy instrument for delivering environmental outcomes or modifying the behaviour of water users (Peter Corish 2003).

The Federal Government's views on the role of government intervention exhibits a similar degree of inconsistency in relation to the ability of parents to make decisions about what is in the best interest of their children:

We've recognised that there is a concern for young parents who get a very large sum of money and that it may be misused. In some instances there have been concerns that the parent has, in fact, had others use that money on their behalf, not to the benefit of the child. This is erring on the side of being more responsible and ensuring in those cases where we have younger mothers there are safeguards in place to protect the mother and to protect the child. (Mal Brough, Minister for Families, 2006).

However, Health Minister Tony Abbott takes a different approach when explaining why regulation to prevent junk food advertising aimed at children is not required:

The only person responsible for what goes into my mouth is me, and the only people who are responsible for what goes into kids' mouths are the parents. What we really need is more responsible dietary behaviour from parents, from individuals and school canteens. I won't at this point in time, or I suspect down the track, be demanding that they ban ads. (Tony Abbott, 2006)

The Federal Government is willing to be prescriptive and intervene in response to some consumer behaviour yet it cites a preference for 'free markets' and 'individual responsibility' when it chooses not to act. Over 90 per cent of Australians agree that there is too much advertising aimed at children but the Federal Government insists that such concerns are misguided. While a premise of economic rationalism is that individuals know better than governments, when individuals express a preference that is unpalatable to the Government, the Government feels free to say that it knows better than individuals.

A simple way to explain the apparently contradictory approach to the desirability of regulation is to consider which groups benefit from regulation and which groups lose out. There is strong industry opposition to banning junk food advertising presumably because such a ban would likely be as

effective as banning cigarette advertising has been. Alternatively, while there is a perceived political benefit in suggesting that single mothers cannot make good decisions on behalf of their children, there is no industry group that would benefit from arguing against such an insult.

While economic rationalists argue that self interest is what drives a modern economy they are typically silent on community impact of self interested lobbying from large industries which seek to influence the regulatory environment in order to maximize their profit.

There has been little real scrutiny applied to Australian governments' inconsistent approach to the benefits of government intervention. This stems largely from the failure of economists, and other analysts, to incorporate political factors into their analysis of government policy. For example, the coal industry has opposed the introduction of a carbon tax while the renewable energy industry has supported one; to date the coal industry has prevailed. An analysis of relative political influence provides a much simpler explanation for such an outcome than any purely economic analysis could.

The other reason that the inconsistent approach to the role of regulation in Australia has escaped effective scrutiny is the abuse of language inherent in the application of economic rationalism. For example we are told that the Australian car industry needs subsidies to make it internationally competitive. We are also told by the same government that subsidies in the textile industry must be removed to make it internationally competitive.

We are told that we should not ban old growth logging because some people will lose their jobs but we are told by the same governments that unfair dismissal laws must be scrapped because otherwise it is too difficult to sack workers.

We are told that in order to grow the economy Australia must allow mining that destroys Aboriginal heritage yet the same governments criticise Papua New Guinea for wanting to mine near the Kakoda Trail as such activity would destroy Australian heritage.

The real power of economic rationalism has been in the skilful use of language. When the circumstances suit, economic arguments are used to define the scope of problems and when the circumstances do not suit the

alleged 'economic rationalists' rely instead on nationalism, protectionism or common sense. Rather than acknowledging that such selective application of economic rationalism is inconsistent, these double standards are used as evidence that the advocates of economic rationalism are anything but ideologues.

The language of economics is an important political tool. The ability to control the definition of words such as 'efficiency', 'productivity', 'competitiveness', 'growth' and even 'prosperity' provides a substantial rhetorical advantage to incumbent governments.

Those who oppose the policy prescriptions of the economic rationalists are, by definition, opposed to efficiency, growth and prosperity. Rhetorically, but not logically, those who oppose economic rationalism are, by definition, economically irrational.

SECTION 3: Where to from here?

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Language is the armory of the human mind, and at once contains the trophies of its past and the weapons of its future conquests. —SAMUEL TAYLOR COLERIDGE

If names are not correct, language will not be in accordance with the truth of things.
—CONFUCIUS

Wasting natural resources is not efficient. People and products stuck on congested roads are signs of an unproductive transport system. Subsidising polluting industries does not make Australia competitive. Spending billions of dollars on air conditioners to protect ourselves from climate change does not constitute growth. And a society that cannot afford to leave the planet in better condition than it inherited cannot be considered prosperous.

The meaning of words such as growth and efficiency has been narrowed almost beyond recognition, but these words retain their persuasive power. Australians want to live in a society that is improving. They want governments that will enhance their quality of life. They want personal growth and they want more vibrant societies and economies. They take pride in being efficient, productive and internationally competitive. Why would they support policies that deliver decline and inefficiency? Why would they want to be uncompetitive on the world stage?

To economists, producing the same level of output with fewer hours of work is a true sign of efficiency. So is using less energy and water to make a product and having a transport system that allows commuters to get to work quickly while goods can be moved quickly across and between cities. There is nothing inefficient about minimizing the use of natural resources and there is nothing uncompetitive about making polluters pay for the damage they do to the environment.

The broad conclusions of economics are in harmony with the personal reflection of non-economists who express doubt, but struggle to articulate criticism, of the policy prescriptions of economic rationalism. Any successful attempt to reformulate environmental policy in Australia must include a coherent strategy to take back control of the language of hope. Some examples follow.

It is time to reframe the do-gooding desire to increase energy efficiency as the serious task of improving energy productivity. We must ensure that businesses become more productive by increasing their output while reducing their energy use. It is taken for granted that governments have a role to play in increasing labour productivity; it is time that governments were made accountable for their failures to drive energy productivity.

We must ensure that protecting the environment is seen as improving our national competitiveness rather than allowing good environmental policy to be framed as simply an additional cost to our export industries. Australia is a rich country but it uses as much energy to produce each dollar's worth of GDP as developing countries such as China. If Australia could increase its energy productivity to the level of Japan or Germany this would deliver a substantial cost saving to exporters and Australian consumers. In addition to lowering financial costs and greenhouse gasses, the pursuit of such energy productivity would significantly reduce Australia's reliance on imported sources of energy.

The creation and destruction of jobs is inevitable in a market economy. When governments privatise businesses or reduce tariffs we are told that job losses, while unfortunate, are an unavoidable consequence of policies that will improve the overall wellbeing of all Australians. However, calls to end old growth logging or rice farming in deserts are mocked for suggesting such 'job destruction'. It should never be forgotten that the economic rationalists who are so concerned about jobs in logging and mining are the same group who supported the wholesale loss of jobs via the introduction of National Competition Policy in the early 1990s.

Identifying the obstacles

Reclaiming the language of economic debate is a necessary condition for achieving real policy change, but it is not sufficient to ensure that such change will occur. Environmentalists won the debate over the language of sustainability, with few governments or businesses now willing to oppose the need to become 'more sustainable', but this victory over language has been accompanied by policy defeat. Mining companies now publish reports on their growing sustainability to accompany reports on their record extraction of fossil fuels and uranium.

Reclaiming language can help build public support for change. Clearer language can also help clarify policy objectives. But successful outcomes require not just new policy goals, but mechanisms for achieving them.

Australia lacks the political and bureaucratic structure for driving environmental policy reform. State and federal governments have legislation and departments dedicated to protecting 'the environment', but such departments dedicate little or no resources to enforcement. As a society we do not rely on legislation and civic mindedness to protect ourselves from drink drivers; we spend hundreds of millions of dollars paying police to detect such behaviour. Similarly, tax law alone is not expected to ensure compliance, rather, the threat and conduct of tax audits ensures most people take tax law seriously.

When it comes to the environment, however, we simply hope that civic mindedness will prevail.

Enforcement of existing laws would be an improvement on the status quo, but it also would not be sufficient in itself. The biggest environmental problems are not caused by the lack of investigative resources dedicated to preventing illegal land clearing, illegal fishing, illegal waste dumps and the illegal water harvesting. The real problem comes from the structure of the political decision making process that places the environment at the periphery of decisions concerning energy, transport, trade, development and industry assistance.

Ministers for the Environment have a role to play in environmental

policy, but until central agencies such as Prime Minister and Cabinet and Treasury are as concerned with the development of a coherent, government wide, approach to the solution of environmental problems as they currently are in relation to economic problems there is unlikely to be significant policy progress.

In order to achieve greater integration of environmental problems into the policy process it is necessary to identify the major obstacles to such integration. Despite decades of debate, Australia is yet to implement effective reforms to the use of our energy, water, agriculture or transport industries. This failure can be best understood by analyzing the political obstacles to change rather than by redoubling efforts to collect more data on the benefits of reform.

Numerous government inquiries, at all levels of government, have recommended that trucks should be charged for the damage they do to roads; that rail is a more efficient means for inter-city freight transport; that farmers need to pay for the full cost of the water they use and that coal fired power stations need to pay for the damage they cause to the environment. Despite these policies fitting neatly within the economic rationalist world view of 'user pays' they have yet to be implemented.

The trucking industry is opposed to damage based road pricing. This ensures that the costs of roads, and road repairs, are covered by taxpayers in general. The public provision of high quality freeways between cities ensures that road freight is relatively cheap and quick compared to rail freight whereas the cost of building new freight lines is expected to be borne exclusively by the freight users.

Farmers have fought hard to ensure that they do not have to pay for the full opportunity cost of the water that they use. When farm land on city fringes is lost to residential development it is justified on the basis that land is much more valuable to households than it is to farmers. But when the suggestion is made that some farmers should stop using scarce water because it is of higher value to other farmers or to city residents the terms of the debate are shifted towards, equity, history and culture. The only difference is that property developers are better placed to win the

political argument over land use than city residents are in regard to water.

Creating new structures

Policy change will not occur in Australia until the political barriers to change have been overcome. We should not be surprised that power companies are reluctant to pay more for their coal, that farmers are reluctant to pay more for their water or that fisherman and loggers are reluctant to pay more for the fish and logs they harvest. But we should also not let such short term self-interest determine the long run policy settings for Australia.

Addressing climate change and other environmental problems will require substantial changes in Australian society, business and government. The barrier to such changes is not our wit but our political will. The introduction of the GST had a substantial and direct impact on every business and every consumer in Australia. The removal of lead from petrol required the creation of a separate refining, transportation and storage infrastructure for the new form of fuel as well as the redesign of every passenger vehicle sold in Australia. Australian governments know how to change Australia.

Perhaps the best example of such government led change was the introduction of National Competition Policy based on the recommendations of the Hilmer Report. The Hilmer Report provides a unique model for policy change in Australia. Regardless of views about the desirability of the policy changes that resulted from it, there should be no doubt about the effectiveness of the structures that the Hilmer Report recommended in driving such changes.

The Hilmer Report is often wrongly considered by its critics to be the source of economic rationalism. On the contrary, the ideas behind the report had been circulating for nearly two decades. The genius of Fred Hilmer and his Commission was to devise a plan to operationalise those ideas.

It must be remembered that in the 1980s the idea that patients should be seen as customers, that charities should be seen as welfare providers and that services such as prisons could be run in order to make a profit were

anathema to Australian society. There was strong opposition by the public, by the unions, and even from state and local governments to the Hawke/Keating reform agenda of privatization and deregulation. The Hilmer report provided a blueprint for a new set of government structures to ensure that an unpopular reform agenda was implemented despite the wishes of powerful vested interests.

In brief, the Hilmer report identified the major obstacles to change and proposed mechanisms for overcoming them. Some changes were legislative but the most effective mechanisms were structural and financial. State and local governments were bribed into participating, with large grants being made by the Commonwealth to jurisdictions which met specific targets. The National Competition Council was established to both drive the reform agenda and to sanction states which were not meeting their targets. States still receive 'competition payments' from the Commonwealth each year in exchange for their ongoing commitment to the reform process outlined in the Hilmer Report. State Treasurers have become accustomed to receiving these payments from the Commonwealth and are reluctant to risk losing a significant source of revenue in order to accommodate the political considerations of other state ministers who may prefer to drag their feet.

The Hilmer Report succeeded in bringing an ideological preference for the private provision of services into the heart of decision making at all levels of government. While passage of legislation requiring competitive tendering for government service contracts was an important part of this achievement, the provision of large, up front, bribes to participants, combined with ongoing financial sanctions for recalcitrant state governments ensured that the spirit of the reform agenda remains central to government decision making practices.

What Australia needs now is the environmental equivalent of the Hilmer Report. There are already many reports describing the nature of the environmental policy reforms that are needed but they need to be synthesized into a report that goes on to identify the barriers to change, propose the most effective mechanisms for overcoming each obstacle, and set out the new machinery of government needed to initiate and drive such change.

While the political will for such a project would need to be built from scratch, much of the bureaucratic infrastructure is already in place. The Council of Australian Government (COAG), for example, already provides a framework for discussion and decision making by the Prime Minister, the Premiers and the President of the Local Government Association. Similarly, if the battle to reclaim the language of productivity and efficiency can be won, then existing bodies such as the National Competition Council, along with state and federal treasuries, can be charged with the task of ensuring that the efficient use of scarce natural resources is relentlessly pursued. Such a transformation may seem optimistic, but it is important to remember that the Productivity Commission grew out of the ashes of the Industries Assistance Commission.

Finally, it is important to note that while new machinery of government is needed, it must be accompanied by a new political consciousness. Throughout the 1980s and 1990s Australia saw the prominence of economic issues in media and political debate rise exponentially. The nightly news now informs all good citizens of the performance of the Dow Jones, the All Ords and Nikkei stock indexes despite the fact that few people have any idea what they are. But what everyone now understands from all this exposure to stock indexes is that the economy is important. There is no reason that daily water use, energy use and public transport use could not be provided to both politicians and the public to inform their daily decision making. The natural environment will only be truly safe when it has been fully integrated into the public and political consciousness.

With that in mind it is important to recognize that in Australia there is no Minister for the Economy. There is a Treasurer who is primarily responsible for taxing and a Finance Minister who is responsible for spending. There are Industry Ministers, Employment Ministers, Trade Ministers and Agriculture Ministers who would all claim to be centrally concerned with delivering good economic outcomes. In turn, the Prime Minister would see himself as having a central role in delivering a strong economy. The point is that there is no one Minister who speaks for the economy, because all Ministers, including the Environment Minister, see their role as focused on

economic performance. If, as is plain, the environment needs protecting, then policy or politics is failing. Should the environment become as central to decision-making in the next 20 years as the economy became in the last 20 years then it will no longer need lone voices to 'speak on its behalf'.

Setting the right goals

Economics can deliver the solutions to climate change as well as a wide range of other environmental problems. What is lacking is not the know-how, but the political will to initiate change and the machinery of government to deliver on that will. This essay has argued that if the broad conclusions of economic theory are combined with political desire to overcome obstacles to change, then effective solutions for environmental problems can be rapidly implemented.

However, while there is no doubt that economics should play a broader role in the policy formulation process there is also no doubt that economics should play a much less significant role in the setting of national goals. That is, economics should play a bigger role in helping us achieve our national objectives, but it should play a much smaller role in influencing what those objectives should be.

Many Australians would rely on advice from their accountants about how to organize their financial affairs, but there are unlikely to be many who would consult their accountants on how much they should spend on Christmas presents, or which family members should receive the biggest gifts.

The role of economists in a developed democracy should be that of functional, not that of visionary. It is for the Australian people, through the Australian Parliament, to say what it is they want to achieve and it is for economists to propose options, and to compare the alternatives, for achieving such objectives.

Europeans work shorter hours and have longer holidays than Australians and Americans. As a result, they have lower annual incomes. Economic theory provides no foundation for judging such preferences.

Economic theory provides no justification for the pursuit of GDP growth over the pursuit of increased leisure. Indeed, while the 20th century began with most workers having no holidays, no sick pay and no formal weekends, the first 70 years of that century was a steady march towards more leisure. In Australia that march ended, while the Western Europeans, having stuck to their goal, are now averaging over 6 weeks paid leave per year. Australians have been told that the pursuit of leisure was unproductive, inefficient and make us uncompetitive. Such claims are based on the preferences of economic rationalists, not the conclusions of economic theory.

Economic theory views individual preferences as sacrosanct. A foundational premise of economic rationalism is that individuals know better than governments what they want from their lives. Yet when Australians repeatedly state that they want to pay more taxes to fund better health and education and to improve the environment they are told that to pursue such preferences would destroy the economy. According to the economic rationalists, Government knows best after all.

It is ironic that economic rationalists cite the need for Australians to subjugate their personal preferences in pursuit of the collective goal of greater economic growth. But in politics, the presence of irony is no barrier to bad policy. If Australia is to play its part in reducing global warming, as well as solving a wide range of environmental and social problems then it must embrace the full toolbox of economists. In employing those tools, however, it is essential to work around, or through, the political obstacles to change that have halted the work of reform to date. But the greater reliance on economics to solve problems must be separated from the process of identifying which problems need to be solved. In that regard, all citizens views are equal.

A new language of economics – the principles of Economic Neo-Rationalism

We now need a new language of economics which might be called Economic Neo-rationalism. Its principles should be:

- 1) Markets are a powerful force and have the capacity to drive efficiency and innovation.
- 2) Market failure is common and can arise from the existence of externalities, differences in bargaining power, asymmetries in information and the failure of decision makers to consider future generations.
- 3) When significant market failure exists there is an important role for government intervention.
- 4) While government intervention can take many forms, it is the specific circumstances of the specific market, not the general preferences of any group of economists, that should determine the best form of policy response.
- 5) Individual preferences should play an important role in the allocation of resources, but the capacity of government policy, advertising and marketing to effect these preferences should not be ignored by policy makers.
- 6) Individuals are best placed to make value decisions about what is best for them, but the capacity of some people to deceive others into making decisions that are demonstrably bad for them should not be ignored by policy makers.
- 7) Individuals have the capacity to think long term. But policy decisions that improve the wellbeing of today's citizens by imposing costs on future generations, however popular, should be avoided wherever possible.
- 8) Equity is an important goal in and of itself. While individual reward is an important driver of innovation and effort, the notion that greater

inequality can be justified if it is accompanied by faster growth is a moral question best answered democratically, rather than an economic question to be answered by economists.

- 9) Social, cultural and environmental objectives are as important as the pursuit of economic growth. Wealthy countries can afford to pursue a wide range of endeavours, and the role of economists is to assist society in achieving their democratically determined goals.

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