

# The Australian

---

## Assertions fly thick and fast

- Henry Ergas
- From: **The Australian**
- June 03, 2011 12:00AM

[Recommend](#)

One person recommends this.

[Share](#) 10 **tweeted**

### **ROSS Garnaut's new report released this week starts with an episode of enlightenment.**

"I" the report opens (and suitably so, for the personal pronoun appears to be the professor's closest friend), "was explaining to the Multiparty Climate Change Committee how I had worked out the costs and benefits of reducing emissions.

"The costs come straightaway. The benefits come later. So I needed a way of comparing income now with incomes of young Australians later in their lives and who are not yet born. 'So we had to choose the right discount rate', I said.

"Then I said something that brought back the Prime Minister's attention. 'If we used the sharemarket's discount rate to value the lives of future Australians,' I said, 'and if we knew that doing something would give benefits now but cause the extinction of our species in half a century, the calculations would tell us to do it'."

Triumph! "The smile on the Prime Minister's face became a hearty laugh. 'You've got us there, Ross', she said, as the others were infected by the lift in spirits. 'That's a unanimous decision. We're all against the extinction of the human species'."

Thank God you're here, Professor Garnaut! But had Julia Gillard known any economics, she would have known the claimed demonstration makes no sense.

If an outcome is certain, its consequences should be discounted to the present at the risk-free rate, not at the market rate that has uncertainty built into it.

Moreover, if an action causes certain death, it should be assessed as costing at the very least the entire wealth of the generations affected. It should therefore be treated entirely differently from small or marginal changes in exposure to harm. Thus done properly, the standard analysis works perfectly well. But had Garnaut explained this, he would not have had his story.

And that sets the pace for the economics in this report, in which loose assertions fly thick and fast.

We are told, for example, that so as "to improve the tax system through reducing tax disincentives to work", carbon revenues should be used to substantially increase the income tax's tax-free threshold. But the inevitable consequence would be to raise effective marginal tax rates as the threshold tapers.

Indeed, although this is nowhere noted in the report, Garnaut's proposal would raise effective tax rates in the middle-income bracket by about 5 percentage points, that is by 17 per cent. Such an increase, affecting more than 60 per cent of

taxpayers, would greatly reduce incentives to work and save.

Nor does the looseness end there. In discussing the resources boom, the report says that "for each new mine or gas plant, there must be a cut in jobs and investment in other businesses".

Yet that is only true if we cannot import capital and labour, as we have ever since European settlement: but here too, the vital caveat is not added, presumably for fear of spoiling a good story.

Looseness then reaches Himalayan heights in the discussion of innovation, where the report tells us that at a time of large changes in relative prices and in economic structure, private expenditure on innovation falls short of socially valuable levels by an especially large amount, so the case for public subsidy is especially strong. But this unbacked claim is inconsistent with economic theory and with a mountain of studies starting in the 1930s.

Or consider electricity networks, where the report says that "it is clear from market behaviour" that over-investment has occurred because "the rate of return that is allowed exceeds the network's cost of capital". But economists have developed powerful tests for assessing this precise issue. The report does not apply a single one of these tests to back up its airy claims, nor cite any careful studies that do.

And take the question of comparing "direct action" with market instruments such as emissions permits. Here the report is unequivocal: "Using direct action measures would raise costs much more than carbon pricing". Yet growing research shows that (in the words of leading environmental economist Ian Parry) in the presence of market imperfections, "the superiority on cost-effectiveness grounds of permit systems over technology mandates and performance standards could be overturned".

On a matter of such political sensitivity, it would have behoved the report to at least acknowledge those results; it doesn't. And it would equally have behoved it to treat the comparison between alternative policy instruments as an empirical matter; again, it doesn't.

In fact, to do so would be inconsistent with the report's style, which is to demonise its opponents. They are, it says, "spoiling voices" who live in "isolation from reality".

Unlike Garnaut, they have not "joined Jiang Zemin in reciting the Gettysburg Address with the fruit at the end of a meal"; how could they understand China's actions?

As for their arguments about what Australia should do, they do not reflect a genuinely held alternative view of the public interest: rather, theirs are "narrow interests", while Garnaut speaks for "objective truth" representing the "informed centre that has no sectional interest that leads it to oppose the national interest."

Such claims are the hallmark of a fatal pretence: the pretence of embodying the "general will" that alone can soar above the "will of each". But even putting aside their inherent flaws, these claims of disinterestedness would be more credible were the report not knee-deep in proposed wealth transfers, showering largesse on beneficiaries ranging from the solar industry to the climate scientists who have been Garnaut's vocal supporters.

Yet the best comes towards the end. Here Garnaut paints a glowing picture of 19th-century economist William Stanley Jevons, whose 1865 book *The Coal Question* argued that Britain's dependence on coal meant "the maintenance of Britain's economic position is physically impossible". These words, Garnaut comments, "have a special resonance for Australians, as we face the same choice outlined by Jevons".

But the *The Coal Question* was entirely wrong. Britain did not run out of coal in 1900: indeed, it is unlikely to do so in 2100. Little wonder *The Coal Question* is long forgotten. Could its fate be this report's future?

Recommend

One person recommends this.

Share

0 [tweeted](#)

---

Copyright 2011 News Limited. All times AEST (GMT +10).