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Contents

Editorial Committee	1
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SYMPOSIUM

The Prime Ministerial Task Group on Emissions Trading John Quiggin	5
The Prime Ministerial Task Group on Emissions Trading Warwick J. McKibbin	13
The Prime Ministerial Task Group on Emissions Trading Alex Robson	19
Reply to McKibbin and Robson John Quiggin	27
Reply to Quiggin and Robson Warwick McKibbin	29
Reply to McKibbin and Quiggin Alex Robson	31

ARGUMENT

Conspicuous Compassion and Wicked Problems Boyd Hunter	35
---	----

REVIEWS

Restoring the Setting Sun Hodaka Morita	55
'The extent of the market' is limited not just by transport but by trust Declan Trott	59
'It is difficult to be an actor but easy to be a spectator' Martin Richardson	63

Editorial Committee

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SYMPOSIUM

The Prime Ministerial Task Group on Emissions Trading

Advocacy and Analysis

John Quiggin¹

The Report of the Prime Ministerial Task Group on Emissions Trading (2007) marks an important step in the development of the climate change debate in Australia. It is particularly notable for the evolution of views on the science of climate change, which reflects a change in the position of the Howard government, if not on the part of all of its members and supporters.

The position of the Intergovernmental Panel on Climate Change (2001, 2007) is supported by all the world's major scientific organisations (Australian Academy of Science et al. 2001). Although the Howard government has officially endorsed the mainstream scientific analysis of climate change, public statements by government ministers have regularly included explicit or coded support for the position referred to by its advocates as 'scepticism' on climate change (MacFarlane 2006, Minchin 2007).

This position entails either an implausibly massive outbreak of scientific incompetence or a deliberate fraud undertaken with the support of most of the world's scientists and scientific organisations. The claim of fraud has recently been presented by Evans (2006), and in the polemical film *The Great Global Warming Swindle*, endorsed by Minchin (2007).

In scientific terms, the 'sceptical' position has long since lost any credibility. But it has received strong public support in Australia from bodies such as the Lavoisier Group, and from a large number of commentators politically aligned with the government (a partial list includes Piers Akerman, Janet Albrechtsen, Andrew Bolt, Miranda Devine, Frank Devine, Jennifer Marohasy, P. P. McGuinness, Christopher Pearson and Alan Wood). Until recently at least, these views were influential in the business sector and in the Commonwealth bureaucracy (Hamilton 2007).

The Task Group report, produced by senior public servants and industry leaders, marks a welcome end to this stage in the debate. The science of global warming is taken as given, and the claims of the 'sceptics' are not even mentioned.

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Nevertheless, the outcome of the inquiry was tightly constrained by the political requirements of the government that commissioned it. Although a slender majority of the members of the committee were business leaders, the process was always going to be dominated by the senior public servants, including the chairman, whose participation reflected the government's need for tight control over the government.

On the one hand, it was virtually inevitable that the Group would recommend some form of emissions-trading scheme. Such an approach had been opposed by the government until just before the announcement of the inquiry. ABARE, the main public research agency in the field, had produced a string of reports supporting the view that technological change (implicitly assumed not to require any price incentive) would deliver more cost-effective reductions in emissions than any market-based approach (Ford et al. 2006, Fisher et al. 2006).

The abandonment of this view represented a return to Australia's (and ABARE's) earlier position in favour of market-based approaches, which was advocated with considerable success in the negotiations leading up to the agreement on the Kyoto Protocol. Although a number of European governments and non-government organisations favoured detailed regulation, Australia and the US successfully pushed for an approach based on tradeable permits.

Despite its rediscovery of the market, however, the government remained resolutely opposed to ratification of the Kyoto Protocol, even though, as the Report notes, Australia had played a significant role in the Kyoto negotiations, and even though, as the Report does not note, Australia had negotiated remarkably favourable emissions targets. Thus, unsurprisingly, the Report refers repeatedly, but mostly non-specifically, to the 'shortcomings' of Kyoto.

More problematically for the Group, the government remained uncomfortable with the idea of quantitative targets for emissions reductions. Since, any system of emissions-permit trading requires specification of the total volume of permits, the constraints under which the Group operated were potentially contradictory. Fortunately, and perhaps not coincidentally, John Howard announced, just before the Group's report was finalised, that he now accepted the general idea of targets.

In these circumstances it is necessary to consider the Report both as advocacy for the Howard government's position and as advice to the government on the best option to take, given its self-imposed political constraints. The Report does a better job on the second of these tasks than on the first.

Advocacy

The most notable section of the Report, considered as advocacy, was its discussion of possible targets for emissions reductions to be achieved by 2020. The most ambitious target currently under discussion is that of the EU — that developed

countries should commit to a reduction of 20 per cent relative to 1990 levels. Such a target for 2020 was also favourably mentioned by then Labor backbencher Peter Garrett in 2005, but without specifying a baseline.

The Report correctly observes that, given that Australia's emissions are currently about 8 per cent above the 1990 level and that the business-as-usual projection is for further growth of about 10 per cent, a cut of 20 per cent, relative to 1990 would require a 38 per cent reduction in emissions relative to business as usual.

By contrast, since the EU as a whole seems likely to meet its Kyoto target of a 6 per cent reduction relative to 1990 by 2012, the difficulty of achieving a further 14 per cent is not great. Moreover, the EU has an emissions-trading market and other necessary structures in place, while Australia has met its target exclusively by once-off measures to limit land clearing

In summary, the suggested target would indeed be ambitious for Australia. However, the Task Group stretches the truth to the limit when it says: "To illustrate the magnitude involved, this is equivalent to, for example, replacing Australia's entire existing fossil fuel-fired electricity generation capacity with electricity from nuclear energy while at the same time removing all existing vehicles from our roads." (p.35)

This claim was stressed in the press conference held to release the report. While literally correct, it is highly misleading. To see the problem, suppose that business-as-usual projections suggest a 100 per cent increase in emissions over some period, and that a proposed alternative target was to keep emissions unchanged. Then the effects of the required policy measures would be 'equivalent', in the sense used by the Task Group, to eliminating all existing use of fossil fuels.

Similarly, the fact that the cuts required to achieve a 20 per cent reduction may be 'equivalent' to drastic measures taken today does not mean that those measures are in fact required.

Among those apparently misled were journalists (Lewis and Shanahan 2007), and, more seriously, the Prime Minister, who had commissioned the report. Referring to the report, Mr Howard stated that 'Mr Garrett's proposal to cut emissions by 20 per cent of 1990 levels by the year 2020 could only be met by replacing every coal-fired and gas-fired power station with a nuclear plant and removing every car, truck and motorbike from the Australian roads.' (Marris 2007) Although the error in this claim was widely noted, and although the members of the Task Group would appear well-placed to advise the Prime Minister of the correct interpretation, it appears that no correction was ever issued.

Kyoto

The other main piece of advocacy in the Report relates to the Kyoto Protocol and the international agreements that are likely to replace or succeed it. The criticisms of Kyoto offered in the Report are familiar (other countries are not meeting their targets, no reductions required from developed countries, and so on) and will not be discussed here.

As with the discussion of the 2020 target, the phrasing of these criticisms, while literally true, gives the misleading impression that Australia is set to meet its Kyoto target (on recent trends, this is unlikely) while nearly everyone else will miss theirs. This dubious claim is made more plausible by tricky language, excluding countries that purchase offsets through the Clean Development Mechanism, established under the Kyoto Protocol to permit developing countries to acquire and sell emissions credits for actions that offset emissions.

More important is the interaction, not discussed in the Report, between Australia's refusal to ratify the Kyoto Protocol and the difficulty we would face in meeting a 20 per cent reduction relative to 1990. As noted above, Australia's Kyoto targets were exceptionally generous.

Given the recommendation not to ratify Kyoto, the Report apparently envisages an international agreement that would not be based on Kyoto, and in which, presumably, the Kyoto targets would play no role. Since most international discussion is focused on the 1990 baseline for developed countries, it seems likely that any such agreement would set targets relative to that baseline, and there is no reason to suppose Australia's negotiating success at Kyoto would be repeated.

Hence, an agreement negotiated without reference to the Kyoto targets seems certain to be less favourable to Australia's interests than one that takes the Kyoto targets for 2012 as a starting point. The obvious way to avoid such an outcome is to ratify Kyoto and push the view that future agreements should take the 2012 Kyoto targets as the baseline.

The Report shows no recognition of any of this, or indeed of the international environment in which agreement will be reached. The Bush Administration, already in lame-duck mode, will be out of office in early 2009, and the EU, China and India have agreed to reach a post-Kyoto agreement by the end of that year. With a newly elected (most probably Democratic) Administration eager to rebuild some of the international capital squandered under Bush, US agreement to a global agreement based on the Kyoto process is quite probable.

Yet the Report is based on the assumption that US resistance to Kyoto, or anything based on Kyoto, will continue indefinitely. As evidence supporting this assumption, the Report quotes a 10-year-old non-binding Senate resolution, playing down more recent and relevant developments.

The Report proposes a leisurely timetable in which Australia would determine its own short-term targets by 2010 and commence trading in 2011 or 2012. The justification is, in essence, that the inaction of the past decade makes it too costly to begin any earlier.

Appealing as this argument may be for domestic consumption, it is far less likely to appear credible in the context of international negotiations where Australia has long been seen as a spoiler. There is every risk that we will find ourselves presented with a *fait accompli* negotiated in our absence. In this context, it is notable that the Task Group fails to discuss the possible adverse consequences to Australia of failing to ratify Kyoto and staying outside the post-Kyoto process.

The possibility of imposing border taxes on imports from industrialised countries which refuse to commit to Kyoto after 2012 has already been raised by the French government. The EU trade commissioner, Peter Mandelson, rejected those calls (Mandelson 2007). However, his reasons for doing so, including the political undesirability of pursuing such penalties while a global consensus on post-2012 climate action is being negotiated, would be greatly weakened by a change in the current US position.

Of course, given a change in the US position, Australia would undoubtedly follow suit. But it would be hard to imagine a weaker position from which to enter negotiations than that being recommended by the Task Group.

Analysis

In considering the analysis of options presented by the Task Group, it is necessary to take as given the assumptions and political constraints discussed above. The most important of these assumptions is that the Kyoto process, including the negotiations scheduled for 2009, will fail to produce an agreement encompassing the major non-ratifying state, the United States, and the most important developing countries, China and India. Associated with this is the political constraint that Australia's strategy should not involve ratification of Kyoto or participation in the associated Clean Development Mechanism.

The first question to be addressed is whether, as was claimed when the AP6 group was established, it would be sufficient to rely on technological progress to achieve reductions in carbon emissions. Not surprisingly, this view, already undermined by the Switkowski report on nuclear power (Commonwealth of Australia 2006), was given short shrift. While the Group noted the benefits that could be gained from well-designed and targeted technology policies, it concluded: 'Given the magnitude of the abatement task facing Australia, it will be critical to rely on broader-based measures that are driven by the market.' (p.41)

Given a primary reliance on market-based measures, the main choice is between carbon taxes, tradeable quota schemes and hybrids, such as those proposed by McKibbin and Wilcoxon (2002). This choice involves trade-offs regarding risk, efficiency and equity, as well as some complex political issues. The Task Group report discusses risk trade-offs associated with price and quantity targets and proposes a hybrid scheme in which a price cap for emissions would be set somewhat above the expected market-clearing price, given the goal for the period in question.

The crucial advantage of a tradeable quota scheme, relative to carbon taxes or price-capped schemes is that it allows for international trade in emissions. Conversely, the main appeal of price-capped hybrid schemes is that they address the concerns of interest groups averse to the risk associated with imposing a substantial price on carbon in the absence of a comprehensive international agreement. The Task Group's advocacy of a hybrid scheme is, therefore, a natural corollary of the assumptions and political constraints already discussed.

Assessment of the risk benefits of a hybrid scheme is difficult in the absence of any quantitative analysis or illustrative targets and quantities. In particular, it is important to distinguish between the technical risk that mitigating emissions will prove more costly than expected, and risk associated with variations in economic growth. In the latter case, a fixed emissions target serves as a countercyclical policy instrument, since the lower the growth in output, the lower the cost of meeting any given target.

Concluding comments

Australia has gone from leader to laggard in the international movement towards the use of internationally coordinated market-based policies to address the global problem of climate change. Having forgone the opportunity to make a significant contribution to shaping global policy agreements, we now run the risk of being forced to adopt policies negotiated in our absence.

Having relied on symbolic gestures and once-off measures for the decade since Kyoto, Australia will incur higher costs in the inevitable move to a global system of emissions trading than if we had moved earlier. Given the constraints under which it operated, the proposals put forward by the Task Group Report represent a reasonable compromise. Even given those constraints, however, the timetable proposed by the group is excessively long. The greater the delay in commencing the adoption of such a system, the greater will be the eventual costs.

By far the best solution to this problem would be to join the existing system created under the Kyoto Protocol, and work within the Kyoto process rather than against it. But of course, this option was ruled out in advance.

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The Prime Ministerial Task Group on Emissions Trading

An Assessment

Warwick J. McKibbin¹

The final report by the Prime Ministerial Task Group on Emissions Trading is a critical turning point in the climate debate in Australia. This report is particularly important for a number of reasons. First, it offers a strategy for climate policy in Australia that moves away from the recent approach of specific subsidies for technology to reduce emissions, and towards a policy of pricing greenhouse-gas emissions so that all greenhouse-gas-reducing technologies are encouraged. More importantly, the Task Group approach offers a new framework for global climate policy to move beyond the approach followed in the Kyoto Protocol.

The broad philosophy of the report is based on the McKibbin-Wilcoxon 'Blueprint' which was outlined in McKibbin and Wilcoxon (1997) and fully developed in McKibbin and Wilcoxon (2002a). The key difference between the approach of the Task Group and the Blueprint in comparison with the Kyoto Protocol is the realisation that aiming for fixed emission-reduction targets, no matter what the cost, is not as viable as an approach that adapts gradually to a combination of clear goals for emission reductions, taking into account the economic and social cost of reducing emissions. Importantly the Task Group approach is from a class of policies known as a price-based approach rather than a quantity-based (or target-based) approach. Setting prices for emissions — and relying on rising longer-term prices, rather than short-term quantitative targets — is argued by many authors to be a more efficient way for tackling climate change than the economic theory of environmental policy design under uncertainty.²

Although the underlying economics of the taskforce report is clear, the proposed implementation of the approach is different from the Blueprint because of political compromises built into the design of the policy. It is important that, to be effective, climate policy have bipartisan support so that the incentives for moving to a lower carbon world are credible. The Task Group report should

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² See Roberts and Spence 1976, Weitzman 1974, Pizer 1997 and McKibbin and Wilcoxon 1997, 2002b and Nordhaus 1993.

form the basis of the policy of both political parties in Australia. To do this requires some movement away from the current proposals in the report towards more credible deep cuts as advocated by the Labor Opposition.

In understanding the Task Group approach, it is useful to compare it to the Blueprint. The approach in the Blueprint is to move away from the philosophy of the Kyoto Protocol of specifying targets and timetables without worrying about costs, to one of setting long-term goals for emissions, with the precise timing of cuts being based on smoothing the costs of emission reduction. Without a mechanism for managing the costs of cutting emissions, the Kyoto approach is subject to problems of lack of commitment. Witness the lack of abatement in most Kyoto-ratifying countries to date. With the Kyoto commitment period, 2008–12, almost upon us, most countries are exceeding their targets for greenhouse-gas emissions by significant amounts because they are unwilling to cut emissions without knowing the costs of doing so. More importantly, major developing countries that will be the major source of growth in greenhouse-gas emissions in future decades are unwilling to take on binding emission-reduction targets. A promise to cut emissions, no matter what it costs, lacks credibility. As countries fail to reach their targets, the global system will ultimately be undermined and the system designed to support the cuts is likely to fail.

Undertaking studies to pick targets in order to minimise costs is important but, in the end, the actual costs of reducing carbon emissions will be determined in the real world, not by computer models which can at best be indicative of the costs. The implemented greenhouse-abatement policy must build in safety valves (that is, mechanisms that limit cost) and flexibility through time so that a least-cost strategy for emission reductions can be found. Under the Blueprint, the key to enhancing credibility of long-term carbon goals is based on the creation of long-term carbon permits equal to the long-term reduction goal (that is, bundles of permits that gradually diminish over time, reflecting the long-term goal of reducing carbon emissions). These long-term permits, once created, should be taken out of the hands of government and issued to key participants, and then traded in a domestic carbon market to set a price of carbon every year into the long-term future.

In the Blueprint, this credibility is achieved by the complete allocation of all long-term permits (reflecting the path of cuts through time such as a Labor-style target) to all households and industry. At set times in the future (five-year steps), a maximum annual carbon price is announced for the next five years as a safety valve against spikes in carbon prices in case there are not enough long-term permits around in any year. The government implements this safety valve by promising to issue as many permits as required by greenhouse-gas emitters at a fixed price. Thus the annual market price is capped at the safety-valve price but it can fall below this price. Note that there is no cap on the long-term carbon

prices but only on carbon prices in the current year. The long-term carbon price is the expected future price of carbon at each year into the future — taking into account the resetting of the safety-valve price every five years.

Under the Task Group approach, some medium-term permits (or, in the taskforce's parlance, a bundle of permits of different duration) are partly handed out, initially to industry, with the rest auctioned by the government. Every five years, a review of emissions is conducted and new bundles of permits of different duration are auctioned. This is argued in the report to be more politically palatable because it gives government a chance to effectively change the target because the science has changed, the international debate has changed or industry has been effective in lobbying for the release of more permits. The problem with this added flexibility, relative to the Blueprint, is that it reduces the credibility of the long-term carbon constraint and therefore increases the uncertainty of the long-term carbon price.

This strategy is not as robust as the Blueprint because, in order to minimise the economic costs through time, there needs to be a rising carbon price signal. The expectation of rising future carbon prices gives strong incentives for investment in carbon-reducing technologies. It is much better to partly tie the hands of future governments by putting the long-term target reduction in the hands of the people, to build a constituency for real carbon abatement. This also addresses the problem of the time consistency of carbon policy where future governments have an incentive to change policy once the private sector has made investment decisions.³ A safety valve takes care of any excessive short-term economic costs. There is no need to have a continuous process of medium-term permits being issued. This policy also undermines the credibility of the medium-term target since there is no guarantee a large quantity of future permits might be issued if industry was effective in lobbying for it.

The second aspect of the Task Group report that is important (coinciding with the Blueprint approach) is the idea that climate policy should be built up at the national level and coordinated across countries, rather than designing policy at the global level and forcing countries to adopt a global framework that may not be perceived to be in their national interest. Implementing policy at the national level but coordinating across countries on key features such as the short-term global carbon price is critical. With a common short-term carbon price (achieved when countries are at the safety-valve price), there is no need to trade carbon permits across countries because the price is already equalized. Thus the market does not deliver the price of emission but it delivers the amount of differentiated abatement across countries at a common price. With a tight enough target path for longer-term emissions, the safety-valve price is likely to

³ See McKibbin and Wilcoxon 2002a.

be the binding constraint on economies and thus the system becomes one of a common carbon price. This is much like a uniform carbon tax but with most of the revenue going to owners of longer-term emission permits and the marginal revenue going to the government for the sale of safety-valve annual permits. This is also known as a 'hybrid' policy of permit trading and carbon taxes.

The third issue that needs to be addressed if the Task Group approach is to be adopted globally is the problem of the existence of current subsidies to greenhouse-intensive activities. In a somewhat dated study, Anderson and McKibbin (2000) found that reducing existing subsidy and tax distortions in world coal markets would reduce greenhouse emissions by more than a fully effective Kyoto target, and raise global GDP in the process. The issue of existing distortions that encourage greenhouse-gas emissions in the Australian context also needed to be addressed as part of the implementation phase of the new Task Group approach to climate policy.

Finally there is the issue of when a permit-trading market could be implemented in Australia. The timeline of the Task Group is to have a prototype in place by 2011 and trading by 2012. This can be done more quickly. The mechanics of setting up the carbon-trading infrastructure has been well understood since the publication of the very good Australian Greenhouse Office working papers (1999) on carbon trading. An effective market could be in place by 2010. It could only be that the politics of Kyoto with a 2012 end date is a complicating factor in when the market would be launched in Australia.

The Task Group report is a valuable document on which to build a better approach than that taken by Kyoto. In implementing the report, the government could improve on the recommendations by making a stronger longer-term commitment to the goal of emissions reduction and thereby generate less long-term price uncertainty. Households should also receive a substantial allocation of longer-term permits: both because it is fair and because widespread ownership of long-term emission permits in superannuation funds and in the balance sheets of major corporations would raise the awareness of the importance of carbon dioxide emissions throughout society.

The Labor Opposition should blend the taskforce ideas around the announced policy of deep cuts by implementing the deep cuts through a Blueprint-style, long-term permit allocation with a safety valve to manage the timing of cuts. If both political parties followed this strategy, there would be convergence on an approach with credible deep carbon cuts but with more short-term flexibility than is possible with precise timetables. The outcome of moving back towards the Blueprint would be bipartisan support for a sensible climate policy. Such a strategy would lead the world and drive the current debate on where global climate policy should be after the Kyoto Protocol.

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The Prime Ministerial Task Group's Report on Emissions Trading

A Solution in Search of a Problem

Alex Robson¹

Introduction

The Prime Ministerial Task Group on Emissions Trading was asked to 'advise on the nature and design of a workable global emissions trading system in which Australia would be able to participate'. In response to the report, the Prime Minister announced on 17 July that a 'cap and trade' system would be introduced in Australia. Whilst details have yet to be announced, reports suggest that the system will cover around 55 per cent of total emissions.

In advocating the policy action of establishing a carbon dioxide (CO₂) emissions-trading system, the report argues that such a system will minimise the costs of achieving any given emissions-reduction target. Even if this is true, however, it does not automatically follow that emissions should be reduced in the first place, let alone by the significant amounts that are being contemplated in various policy circles.

As far as policy is concerned, what matters is not so much the costs to Australia of higher average global surface temperatures, but the costs and benefits of various *policy actions* which are aimed at addressing the possible undesirable effects on Australia of higher average global surface temperatures.² This is a subtle but important distinction. Any policy contemplated by the Australian government should be focused on the net benefits to Australia of that particular policy. Only a full economic cost-benefit analysis of emissions reductions versus alternative policies can shed light on these issues for Australia. No credible economist (or anyone else, for that matter) has demonstrated that there are significantly positive total benefits (let alone significantly positive marginal benefits) to Australia from the policy of reducing our CO₂ emissions. There is a very good reason for this: since Australia's emissions are so small, any benefits (both in total and at the margin) of emissions reductions are likely to be extremely

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² Essex et al. (2006) show that the 'average' temperature of an out-of-equilibrium climate system is not a well-defined physical concept, and that the calculation and widespread use of the simple mean temperature to address global climatological questions is completely arbitrary from a physical point of view. Just as it is possible to define and compute an infinite number of social welfare functions in order to compute a 'social' or 'aggregate' ranking over various policy alternatives in economics, it is also possible to define and compute an infinite number of average global temperature statistics.

small — almost certainly zero. The report therefore constitutes a solution in search of a problem.

Background: Australia is Still a Small, Open Economy

The earth's temperature is determined by a balance of incoming solar radiation ('insolation') energy and outgoing terrestrial infrared radiant energy emitted by the planetary surface and atmosphere. Any gas which partially 'traps' outgoing terrestrial radiation is classified as a greenhouse gas (nitrogen and oxygen, which together make up over 99 per cent of the dry atmosphere, are passive in this respect and are not greenhouse gases). Thus, water vapour is a greenhouse gas (indeed, it is the most important one). The natural 'trapping' of terrestrial long-wave radiation by these stocks of gases leads to surface temperatures some 30° Celsius higher than they would otherwise be in the absence of an atmosphere.³ This is the greenhouse effect.⁴

Greenhouse gases are therefore responsible for providing liveable conditions on earth. In the familiar terminology of economics, the marginal benefits of greenhouse gases are obviously positive over some range. In addition to its 'trapping' properties, carbon dioxide (a naturally occurring greenhouse gas) is vital for photosynthesis and encourages plant, tree and marine growth. Nevertheless, the greenhouse effect may be enhanced by additional man-made greenhouse gases, with possible undesirable effects.

In understanding the relative contribution of these anthropogenic greenhouse gases, it is important to distinguish between stocks and flows. For example, CO₂ cycles naturally through the earth's atmosphere, land mass and oceans. The stock of carbon contained in atmospheric CO₂ is around 730 Gigatonnes of carbon (GtC), and the annual gross flow or exchange of carbon to and from the earth's surface and the atmosphere is estimated at 120 GtC. Between the oceans and the atmosphere the estimated gross flow or exchange is 90 GtC.⁵

In contrast, the annual flow of carbon dioxide into the atmosphere resulting from human activities (fossil-fuel burning and land-use change) is just over 7 GtC.⁶ This is just over 3 per cent of the natural annual gross flows, and less than 1 per cent of the total atmospheric CO₂ stock.

The Shergold Report takes a rather strange view of the desirability of a policy of emissions reductions. A 'cap and trade' system involves setting a cap or a

³ This naïve calculation ignores a number of important factors. See, for example, the discussion in Lindzen (1994).

⁴ Diffuse radiation from clouds can provide an additional indirect component to radiation received at the earth's surface. For example, Mason (2002) estimates that if the constitution of the atmosphere remained as it is now, in the absence of clouds the mean global surface temperature would be 4° Celsius higher than its present value.

⁵ See, for example, Kininmonth (2004), p.130.

⁶ Around 4 GtC of these emissions are taken up again by the land and oceans.

target, but nobody knows for sure what this cap should be, or whether an upper bound even makes good scientific or economic sense for Australia. Indeed, the report admits as much:

The goal of the United Nations Framework Convention on Climate Change, to which Australia is a party, is to achieve 'stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system' (United Nations, 1992). Understanding of the complex environmental, economic and social impacts of climate change is currently not sufficient to identify confidently what this level should be. [Emphasis added] (p.21)

Instead of acknowledging these issues or trying to pin down what an appropriate 'cap' might look like, the Shergold Report takes the following 'risk management' view regarding emissions reductions:

Addressing climate change is a risk management issue on a global scale. While there are costs in acting now, the consequences of inaction are potentially large for many countries. Given the potential for significant costs arising from climate change in the future, a prudent risk management approach suggests that steps to reduce emissions should be undertaken now.

This 'insurance policy' argument was also made by the Prime Minister on 18 July:

A prudent conservative knows we are but temporary stewards of the environment. The Burkean sentiment — that society is a partnership between those who are living, those who are dead, and those who are yet to be born — comes as second nature.

In the face of risk, a prudent conservative takes insurance. We should, in the words of Rupert Murdoch, give the planet the benefit of the doubt given the potential dangers of climate change.⁷

With respect to emissions reductions by Australia, as a matter of science, economics and logic this 'insurance policy' analogy is completely inappropriate and indeed grossly misleading. As far as Australia's CO₂ emissions reductions are concerned, the entire 'risk management' argument simply cannot be sustained. Australia's CO₂ emissions comprise around 1.5 per cent of total global emissions from human activity.⁸ This fact suggests that even if we assume that all of

⁷ See Howard (2007).

⁸ In 2005, Australia's total greenhouse emissions were 559 megatonnes in carbon dioxide equivalent terms: 74.3 per cent of this is carbon dioxide, giving total CO₂ emissions of 415 megatonnes. The ratio of the molecular mass of CO₂ to that of carbon is 3.66419, so this equates to about 113 megatonnes of carbon, or 0.113 GtC. Dividing this by global anthropogenic carbon emissions of just over 7 GtC gives the 1.5 per cent figure. (Prime Ministerial Task Group Report pp. 28, 30)

Australia's emissions currently remain in the atmosphere and add directly to the global stock of CO₂ each year, a policy of completely eliminating our CO₂ emissions would have a negligible effect on the total global atmospheric CO₂ stock. This is true no matter what actions are taken by other countries.

The marginal benefit of a policy action is the change in total economic benefit with respect to a change in that action, holding everything else constant. In many economic problems encountered by policymakers, the marginal benefit of an action is inherently uncertain or may depend on the actions taken by other economic actors. That is simply *not* the case here. The contention that the marginal benefits of a reduction in emissions by Australia are so small as to be negligible, irrespective of the actions taken by other countries, involves very little — if any — uncertainty.

Simply put, as far as the benefits of emissions reductions are concerned, there is no 'risk' for Australia to 'manage'. A policy of emissions reductions is like taking out an 'insurance policy' in which there is never any positive payoff. It is doubtful that Edmund Burke would have regarded such an action as particularly prudent.

Perhaps the best that we can hope for with respect to emissions reductions is an international 'signalling' effect, whereby our emissions reductions generate goodwill and encourage major emitters to take action. But there is little evidence that this signalling effect in international affairs works, particularly when it comes to reducing CO₂ emissions. After all, Australia has, thus far, gone very close to meeting its Kyoto emissions targets, and yet this does not seem to have had any signalling effect on the rest of the world — particularly on European countries, many of which have consistently failed to meet their Kyoto targets, or on China, which is now the largest CO₂ emitter.

The Shergold Report's (rather meagre) discussion of the advantages of cap-and-trade systems over taxes, subsidies and other regulatory measures in situations of uncertainty (and the associated literature beginning with Weitzman (1974)) is therefore completely beside the point. If the total and marginal benefits of emissions reductions for Australia are trivially small in all possible states of the world, it does not matter how such reductions by Australia are ultimately brought about. All policies will be welfare-destroying. There is no tax, subsidy or 'cap' in existence which will equate the marginal benefits of emissions reductions with marginal costs of emissions reductions in any state of the world.

Towards an Optimal Policy for a Small Open Economy

Does it automatically follow that nothing should be done about the possible undesirable effects of global warming? Absolutely not! The Shergold Report and the entire current debate offer us a false choice between reducing CO₂ emissions on the one hand, and doing nothing on the other. But these are not

the only two choices available to us. Different kinds of 'insurance policies' — policies which at least offer the *possibility* of a positive payoff — exist.

Parish (1972), following arguments similar to those made by Coase (1960), points out that welfare improvements can be made by either reducing pollution or mitigating its possible undesirable effects.⁹ Recall that the marginal benefit of an action is defined as the change in total benefits *with respect to a change in that action*. The point here is that there are other actions available which could be taken by Australia to reduce the possible undesirable *effects* of higher average surface temperatures in Australia and climate change more generally, even if we may not be able to do anything about the alleged *causes* of those effects.¹⁰ The marginal benefits to Australia of such appropriately chosen *damage-prevention measures* will likely be positive, at least in some states of the world.

For example, suppose that one of the anticipated adverse effects of higher average global surface temperatures on Australia is a reduction in existing sources of potable water in a major population centre. In this scenario the benefit of any action can be easily measured as the consumption benefits of fresh water. Reducing Australia's CO₂ emissions will have absolutely no effect on these possible benefits — marginal benefits of emissions reductions are always and everywhere zero in this scenario, for reasons discussed earlier. On the other hand, building new dams, desalination plants and so on may have positive benefits (depending on the state of the world that actually eventuates). These (appropriately discounted) expected benefits could then be weighed against expected costs in the usual way.

In the global warming debate these actions often come under the general heading of *adaptation*, but this terminology does not quite encompass the above scenario or what Parish was actually referring to. Adaptation implies that one waits passively until an adverse consequence is observed before acting. But, as the above scenario indicates, damage-prevention measures can take place in anticipation of possible adverse climatic conditions, well before those events actually occur. This is real 'risk management' in action. In contrast to the policy of reducing emissions, these measures may constitute an 'insurance policy' that actually offers the prospect of a positive payout if adverse circumstances occur.

⁹ Parish (1972), p.36. As discussed earlier, CO₂ is vital for the flourishing of life on earth and is not a 'pollutant' in the commonly accepted meaning of that term. Nevertheless, we will use the term for convenience.

¹⁰ The idea that one particular economic activity can 'cause' social costs was completely demolished by Coase (1960). Those individuals whose wellbeing is reduced by pollution could just as easily be said to 'cause' social costs. Indeed, to the extent that polluting activity is also associated with economic benefits, the *absence* of pollution also 'causes' social costs or an absence of benefits. Social costs are exactly that — social. They are not 'caused' by any single party or activity.

Conclusion

The choice between active damage prevention, passive adaptation and emissions reduction (or possibly a combination of all three) should be governed by an assessment of the relative costs and benefits of each particular policy proposal. In all likelihood, the benefits of investment in damage prevention are likely to be much greater than emissions reduction, because Australia is such a small contributor to the global stock of greenhouse gases. Because any adverse economic effects of higher average global surface temperatures on Australia are likely to be localised and seasonal, investment in damage-prevention measures offers a more sensible approach and a more appropriate use of valuable resources than emissions reductions.

To date there seems to be have been very little formal empirical work conducted on the relative costs and benefits of emissions reductions versus damage-prevention measures for Australia, and there has been very little — if any — serious discussion of these issues among economists or policymakers. All attention has been focused on the false dichotomous choice between drastic emissions reductions on the one hand, and doing nothing on the other.

Damage-prevention measures are a more flexible option that can be implemented in a more decentralised fashion, by individuals (via insurance markets and by individuals taking advantage of their knowledge of local conditions and self-insuring) and by state and local governments. In contrast, the policy proposals contained in the Shergold Report (and the recent announcement made by the Prime Minister) envisage the establishment of at least one new federal bureaucracy to monitor individual and aggregate CO₂ emissions and enforce the obligations embodied in each individual emissions permit. Despite all the politically charged fanfare, the policies examined in the report will do absolutely nothing to reduce any future adverse effects of higher average global surface temperatures on Australia.

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Reply to McKibbin and Robson

John Quiggin

Warwick McKibbin makes a number of important points in his contribution. First, given that we have taken no effective action for a decade, the Task Group timeline for setting up an emissions-trading system by 2012 is excessively relaxed. Second, any credible strategy will require deeper cuts in emissions than those currently being considered.

Unsurprisingly in view of his previous contributions to the debate (McKibbin and Wilcoxon 1997, 2002), McKibbin welcomes the Task Group proposal for a 'safety valve' in the form of a cap on the price of emissions. This proposal raises two kinds of questions.

First, in economic terms, does the risk of excessive short-run economic costs from mitigation outweigh the risk of inadequate mitigation (implying either greater damage from climate change or costly adjustment in the future)?

Second, in political terms, is a price-capped system more likely than a purely rights-based system to form the basis of a sustainable global agreement?

As I noted in my assessment of the Working Group, the conditions under which the Group was set up presupposed the hypotheses that the Kyoto process would necessarily fail, and that the economic costs of mitigation should be the primary concern. Under these assumptions, a price-capped approach is optimal. In my view, however, the Kyoto process is the best hope for an agreement and should be pursued.

Alex Robson's piece begins with a description of the greenhouse effect, and on the relative contribution of anthropogenic and natural activity. It ends with the observation that: 'The annual flow of carbon dioxide into the atmosphere resulting from human activities (fossil-fuel burning and land-use change) is just over 7 GtC. This is just over 3 per cent of the natural annual gross flows, and less than 1 per cent of the total atmospheric CO₂ stock.' It is unclear what inference is intended here, but, in view of Robson's previous contributions on the topic (Davidson and Robson 2007), it seems reasonable to interpret this as an attempt to cast doubt on the scientific basis for attributing climate change to CO₂ emissions. If this is the intention, the effort is unsuccessful. Obviously, a net addition equal to 1 per cent of (initial) stocks of atmospheric CO₂ will double the stock in 100 years. A more sophisticated version of this calculation is offered by the IPCC.

In casting doubt on human responsibility for climate change, Robson sets the stage for his main argument which is that, even if humanity as a whole is

responsible for climate change, there is nothing Australia can or should do about it. The central argument is a classic presentation of the case for being a free-rider. Since Australia contributes only 1.5 per cent of emissions, the impact on Australia of any change in our own emissions is small, and therefore we should focus on damage mitigation

The free-rider problem has been studied extensively. The literature yields two central points, neither of which is addressed by Robson. First, when there are many players, the same arguments apply to all, and the free-rider equilibrium is globally suboptimal. Second, free-riding may be deterred if other players punish defectors. In this case, it is necessary to consider both the possibility of directly punishing free-riding through border taxes or indirect punishment in other negotiating forums

Unfortunately, rather than drawing on the large game-theoretic literature that has arisen in relation to this question, Robson frames the analysis in terms of policy choices for a small open economy. Of course, the fact that Australia is small is relevant to free-riding. But in practice, every participant in this process — including relatively large countries, the US and China — is subject to the same logic. As regards openness, this makes free-riding less appealing, not more, since it generates many more opportunities for other parties to punish us for a policy that would rightly be regarded as deserving of such punishment.

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Reply to Quiggin and Robson

Warwick McKibbin

Alex Robson makes a number of important points on the climate change debate: policy needs to be focused on expected costs and expected benefits. I agree completely with this. He claims that no credible economist has demonstrated that there are gains from Australia reducing emissions. The logic of this position is clear in the sense that under perfect certainty Australia is too small to make much difference. However, under uncertainty this statement is misleading because the lack of a clear policy on pricing carbon has meant that critical investment decisions on energy infrastructure have been delayed. This has caused potential economic losses because of the policy uncertainty. Alex could not argue that uncertainty has no economic costs. Otherwise why do insurance markets exist? A clear policy position that enables firms to plan investment and enables risk management — even if climate change does not turn out to be a serious problem — can still have economic benefits. This is why industry has been calling for a clear policy and why they are willing to take on carbon prices (although with a safety valve to control costs). You need to have a clear policy framework with low and controllable costs while you gather more information. This is the approach taken in our research. The point is not whether climate change is true or not — it will be many decades before we can be a little more certain. Given the uncertainty, there needs to be a policy response that lines up expected benefits of taking action with the expected costs. Again the logic that there are no expected benefits of taking action is clearly not true when economic decisions are being distorted by lack of a clear policy framework in Australia. The Task Group approach provides a better framework than we currently have.

The second point as to why an Australian approach to replace the Kyoto strategy is a good idea is that if Australia can design a policy regime that can be implemented in the major emitting countries such as China and India then the gains to Australia are not trivial. This is exactly what the Prime Minister's Task Group approach has the potential to do. It may not eventually be adopted elsewhere but I think the chances are high given the alternatives. If it is not proposed then it will definitely not be adopted.

There is also a problem with the argument that the optimal policy is one in which Australia only adapts. The correct definition of optimal policy is where the marginal cost of mitigation is equal to the marginal cost of adaptation is equal to the expected marginal benefit.¹ The problem is that benefits of mitigation

¹ See McKibbin W. and P. Wilcoxon 2003, 'Climate Policy and Uncertainty: The Role of Adaptation versus Mitigation' in *Living With Climate Change: Proceedings of a National Conference on Climate Change Impacts and Adaptation*, National Academies Forum, Canberra.

undertaken now are only observed many decades hence and adaptation is undertaken at some time in the future. Under uncertainty there will always be an expected gain from some mitigation now and some adaptation later.

John Quiggin also enters the debate on whether the sceptics are correct. This is not a useful debate to have because whether they are correct or not (we can't know that with any certainty) — the existence of manifest uncertainty implies that some policy action is required. Also it seems odd to continue to argue over whether Australia should ratify the Kyoto Protocol when the Kyoto Protocol is in the process of being evolved into something completely different. It demonstrably has not succeeded (where 'success' is defined as changing global emissions) for reasons that many economists have predicted. It focused only on environmental outcomes without enough design features to take into account the trade-off between economic costs and environmental benefits. Or, to put it another way, it did not adequately line up the expected benefits with the expected costs in a world of enormous uncertainty.

Arguing that Australia's targets under Kyoto were exceptionally generous is misleading. It is not the absolute target that is the measure of generosity, but it is the relative ease of meeting that target. Australia was allowed a rise in emissions relative to 1990 but it was nonetheless a significant cut in emissions relative to what otherwise would be the case in the period 2008 to 2012. Contrast that to the fact that Europe had the benefits of a collapse in the UK coal industry, together with the collapse of East Germany, to lead to a much lower baseline emissions profile.

Why ratifying Kyoto or not is currently relevant to moving forward with a new global approach to replace a failed Kyoto approach is completely unclear to me. I am sure John would not argue that being part of the war in Iraq was a good policy because we are in the tent deciding what to do next. His discussion about the global climate debate is also several years out of date. No country is seriously considering border taxes against non-complying countries since most countries inside Kyoto are not close to hitting their targets. The world, and the debate on climate change policy, is rapidly moving on from the Kyoto Protocol arguments of a decade ago.

Reply to McKibbin and Quiggin

Alex Robson

I find little in the contributions of Professors Quiggin and McKibbin that addresses my concerns regarding the benefits (or lack thereof) to Australia of reducing our greenhouse-gas emissions.

Quiggin's chief cavil seems to be with some of the (allegedly) misleading statements made by the Prime Minister and the Task Group regarding the costs of reducing Australia's emissions by 20 per cent (relative to 1990 levels). I do not find Quiggin's remarks on this matter very persuasive. He claims that 'the most ambitious target currently under discussion is that of the EU: that developed countries should commit to a reduction of 20 per cent relative to 1990 levels'. This claim is, however, incorrect. The ALP National Platform¹ states that: 'Labor will cut Australia's greenhouse gas emissions by 60 per cent on year 2000 levels by 2050.'

This is far more ambitious than the EU plan. In 2000, Australia's total emissions were around 550 megatonnes in CO₂ equivalent terms. So Labor's policy translates into a target of 330 megatonnes of emissions by 2050. In the absence of any policy interventions, 'business-as-usual' greenhouse emissions are projected to grow strongly. Indeed, the Australian Greenhouse Office's best-case scenario projects that even with abatement measures in place, total emissions will be around 700 megatonnes by 2020 — more than double Labor's 2050 target. The analysis suggests (but does not predict) that by 2050 total emissions will easily exceed 1000 megatonnes. In other words, achieving Labor's target could be equivalent to eliminating more than 100 per cent of current activities that use fossil fuels! The claims made by the Prime Minister and the Task Group are therefore quite modest.

Professor McKibbin is correct to point out that a policy of emissions abatement at any cost (which is precisely what Labor's policy is) lacks credibility, and that the Prime Ministerial Task Group approach suffers from the same problem.

Unfortunately, the McKibbin-Wilcoxon 'Blueprint' approach is also prone to similar problems. Under the Blueprint, the government will implement a price cap in the short-term permit market 'in case there are not enough long-term permits around in any year'. The government undertakes this resetting of the safety valve every five years. But how will anyone know whether there are 'enough' long-term permits? Nobody even seems to be able to answer that question today. The Blueprint idea seems to be that governments will observe

¹ <http://www.alp.org.au/platform/chapter_09.php#9climate_change> This Platform was adopted at the ALP National Conference on 27–9 April 2007.

movements in the long-term permit price and make a judgment as to whether the price is too high or low. Hopefully, this judgment will be informed by a rigorous cost-benefit analysis that will make some assessment of current costs as reflected in the long-term permit price. But, as my article points out, there has to date been no comprehensive, credible cost-benefit analysis of emissions reductions for Australia. So why should we expect that such an analysis would be done every five years? Given the current state of the policy debate, any commitment to do this is severely lacking in credibility.

ARGUMENT

Conspicuous Compassion and Wicked Problems

The Howard Government's National Emergency in Indigenous Affairs

Boyd Hunter¹

A 'wicked problem' is a term used in the planning literature to characterise a complex multi-dimensional problem. The article argues that Indigenous child abuse is one such problem. Whatever the merits of the recent federal intervention into Northern Territory Indigenous communities, it is unlikely to succeed without both long-term bipartisan commitment of substantial resources and a meaningful process of consultation with Indigenous peoples. If we are to learn from what policies worked (and what did not work), then it is particularly important that a transparent evaluation framework be established before undertaking policy initiatives.

The dramatic press conference of the Prime Minister, John Howard, and the Indigenous Affairs Minister, Mal Brough, on 21 June 2007 produced a front-page headline in the next day's issue of the *NT News*: 'Martial Law — Howard mobilises cops, military as he declares "national emergency" in NT communities' (Adlam & Gartrell 2007).

After intense and heated public debate over the 'national emergency' — and clarification of the more controversial proposals (for example, compulsory health checks were to be less invasive than had been feared) — three Bills were introduced to the federal parliament on 7 August 2007, comprising 480 pages of legislation relating to alcohol restrictions, pornography bans, changes to the permit system and township leasing, and to the quarantining of welfare payments.

The Northern Territory National Emergency Response Bill 2007 provided a legislative framework for:

- alcohol restrictions to stem the instances of family violence and sexual abuse of children;
- computer audits to detect prohibited pornographic material;
- five-year leases to better manage investments to improve living conditions in townships;
- land-tenure changes to enable town camps to become normal suburbs;

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- the appointment of government business managers in Aboriginal townships to manage and implement the emergency measures;
- the removal of customary laws as a mitigating factor for bail and sentencing conditions; and
- better management of community stores to deliver healthier and more affordable food to Indigenous families.

The second piece of legislation, *The Social Security and Other Legislation Amendment (Welfare Payment Reform) Bill 2007*, combined three elements: welfare reform specific to the Northern Territory (NT); welfare reform specific to Cape York; and a broader welfare-reform package announced a little earlier. The government proposed to quarantine various income-support payments and direct Indigenous families to provide basic necessities such as food, clothing and shelter for their children, rather than supporting substance abuse and gambling.

The third and final piece of legislation is the *Families, Community Services and Indigenous Affairs and Other Legislation Amendment (Northern Territory National Emergency Response and Other Measures) Bill 2007*, which amends existing legislation to include the imposition of bans on pornography and changes to the permit system. Rather than the total scrapping of the permit system in all NT Indigenous communities, as had been proposed in the original press conference, the Bill only lifts the requirement for permits to visit Aboriginal land in townships and access roads and airstrips.

These Bills were passed without substantial amendment on 16 August, after a one-day review hearing in the Senate.

Wicked Problems and Indigenous Policy

The 'wicked problem' here does not refer to a moralising condemnation of the inherent evil of the widespread child abuse; rather, it is a term used in the planning literature to characterise a complex multi-dimensional problem. Indigenous policy is one of most complex areas facing governments, as it involves many issues that do not exist for other Australians: a dynamic cultural life; a need to change social norms; unique forms of property rights, such as native title; and the intergenerational transmission of disadvantage, sometimes arising from problematic historical government interventions (such as, the 'stolen generation').

The concept of 'wicked problems' was originally proposed by Rittel and Webber (1973). Ill-defined design and planning problems were called 'wicked' because they are often messy, circular, aggressive and intrinsically complex. Rittel and Webber contrast such problems to the relatively 'tame' problems of mathematics, chess or puzzle-solving. Wicked problems have incomplete, contradictory and changing requirements; and solutions to them are often difficult to recognise as such because of complex interdependencies. The solution

of one aspect of a wicked problem may reveal or create another, even more complex, problem. A wicked problem is likely to be one whose solution requires large groups of individuals to change their mindsets and behaviours.

Conklin (2003) argues that there are four defining characteristics of wicked problems:

1. The problem is not understood until after a solution has been formulated.
2. Stakeholders have radically different world views and different frames for understanding the problem.
3. Constraints and resources for solving the problem change over time.
4. The problem is never solved (completely).

Indigenous policy is easily characterised as a wicked problem. Obviously, mainstream Australian society has a different perspective on the problem from Indigenous stakeholders, who are more likely to emphasise land rights, cultural difference and injustice. One of the main debates for the NT intervention is whether the trade-off between Indigenous rights and socioeconomic status is being taken into account. The existence of this trade-off means Indigenous Australians must 'own' both the problem and solution (Henry 2007). If behavioural and attitudinal change is required, then an adequate process of consultation with Indigenous people is obviously crucial to securing their cooperation. Imposing solutions from above is both profoundly illiberal and unlikely to produce real solutions at all.

Further, the constraints of the problem are changing over time as community dysfunction, sometimes fuelled by excessive alcohol consumption, enters a negative or vicious cycle (see Hunter 2007b for a discussion of a related model of cumulative causation).

Finally, the issues involved are extremely unlikely to be resolved completely as the 'modernisation project' is partially, if not wholly, inconsistent with cultural maintenance.

Context to NT intervention

The immediate rationale for the NT intervention was *Ampe Akelyernemane Meke Mekarle* ('Little Children are Sacred'), the Report of the Northern Territory Board of Inquiry into the Protection of Aboriginal Children from Sexual Abuse, which 'distressed' the Prime Minister and other readers. However, there have been numerous other reports into child abuse, neglect and violence in Indigenous communities written over many years (see, for example, Martin 1988; Memmott et al. 2001). While the rates of child abuse are higher among all disadvantaged groups compared to the Australian average, it is particularly high in Indigenous communities (Australian Institute of Health and Welfare (AIHW) 2006: Table 2.8). Victoria has the highest number of Indigenous child-abuse substantiations

per 1000 children (63.0), followed by the ACT (56.0), South Australia (43.20) and NSW (27.1). The NT had a relatively low rate of Indigenous child-abuse substantiations of 13.7 per 1000 children — only Western Australia (12.2) and Tasmania (5.8) had lower rates. It should be noted that child-abuse data may be particularly prone to measurement error as it involves an inherently difficult and sensitive subject matter. However, it should be noted that under-reporting of child abuse is not confined to either Indigenous communities or the NT — indeed, the ‘Little Children are Sacred’ report specifically rejects the notion that Aboriginal culture is the reason for the under-reporting of abuse (Wild & Anderson 2007: p.58).

Peter Botsman argues that there is a need to put Indigenous child abuse into perspective (2007). Indeed, the fact that substantiated child abuse among non-Indigenous families in Queensland (13.7 per 1000) is as high as that which provoked the NT intervention means that the problem is not confined to Indigenous communities. Given the high level of disadvantage and poverty identified in NT Indigenous communities, the level of substantiated child abuse is relatively low. Obviously, policy needs to address broader issues, rather than simply focusing on Indigenous-specific issues such as permits and land rights.

Some aspects of the intervention were foreshadowed and informed by the Cape York Institute report (CYI 2007) — for example, the focus on quarantining welfare payments for certain behaviour; addressing incentives to work in mainstream jobs; and the reform of the Community Development Employment Projects (CDEP) scheme, the long-standing Indigenous work-for-the-dole program. Nevertheless, the government’s plan differed from the CYI report in crucial ways. The CYI report was based more on ‘ground-up’ theory: it involved substantial collaboration with the Indigenous community and incorporated the direct involvement of community representatives in the proposed Family Responsibility Community (FRC). Another difference was the fact that the quarantining of welfare suggested by the CYI report was not necessarily mandatory.

It became clear in the days following 21 June that there had been no consultations with state and territory governments or local Indigenous community elders. The lack of communication with Indigenous representatives is largely a result of the abolition of ATSIC, as there is no longer any recognised local Indigenous authority for governments to talk to. Even Noel Pearson was given only 15 minutes’ warning of the government’s planned intervention (Pearson 2007).

The public debate that followed involved heated exchanges between the protagonists. In a sense, this is understandable since the intervention was hastily conceived and sketchily outlined: apart from the occasional press release, there was little to tell people what the government’s response actually entailed. Teams

of bureaucrats and army personnel were sent into the NT to scope the issues involved.

The heat of the public debate has scared off many people who may have had positive contributions to make.² Critics of the NT intervention run the risk of being construed as supporting child abuse by default. However, if policy interventions are misconceived and poorly designed, then the possibility of constructing a truly effective long-term response to child abuse may be compromised by restricting public debate to highly committed people and organisations. The following sections outline the main criticisms of the intervention.

War, Shame and Conspicuous Compassion

Since 2000, the government has gradually shifted its rhetoric in Indigenous affairs to focus on a more radical agenda. During the life of the Howard government, the analogy of war has been used routinely to describe complex social issues (Hunter 2006). First, there were the ‘history wars’, as Henry Reynolds, Keith Windschuttle and others fought over the technical detail and interpretation of Australia’s colonial history. This is arguably one manifestation of the ‘culture wars’. Then came the ‘war on terror’, following the events of 11 September 2001. Another alleged battleground is the ‘poverty war’. Given the involvement of the military and the strident language of the protagonists, it is not too much of a stretch to characterise the intervention in the NT as a ‘war on Indigenous child abuse’.

While the analogy of war provides good ‘copy’ for the media, and hence has utility for politicians, it is a singularly inappropriate term for constructing a positive and informed debate about complex social issues. If Indigenous child abuse and community dysfunction are wicked problems, then the oversimplification of the issues diminishes our capacity to construct effective policy options.

If one is serious about Indigenous policy, one needs to attempt to build a long-term consensus rather than construct a heroic-style conflict between competing policies — where one policy is invariably portrayed as a failure and the other as the solution.

Sanders (2007) demonstrates how the language of failure has become increasingly used to describe Indigenous affairs since 2004. The Howard government has used the idea of past policy failure to introduce major new

² There is some anecdotal evidence of this — a colleague recently presented a paper at a conference on ‘Measuring and evaluating Indigenous service delivery’ (held in Alice Springs, 25–26 July 2007). Attendees included federal, state and territory and local government staff, personnel from Indigenous organisations, researchers and others. Despite the direct relationship between the theme of the conference and the ongoing events in the NT, there was barely a mention of the national emergency by any of the speakers (personal communication: David Martin, 6 August 2007).

organisational arrangements in Indigenous affairs: the Aboriginal and Torres Strait Islander Commission (ATSIC) was abolished and its programs were re-assigned to 'mainstream' Commonwealth departments.

Is it possible that the claims that anyone who criticises the earnest attempt to address child abuse is a 'nay-sayer' or, worse, supports child abuse by default, have left people morally conflicted and afraid to contribute to the public debate? The over-simplification of the issues has led to an extremity of language and arguments that militates against a reasoned analysis of evaluation of the policy options.

Helen Hughes' recent book, *Lands of Shame*, makes a direct appeal to the shame that Australians should feel. Shame may not be an entirely inappropriate response to the situation, but potentially it is a debilitating response that can circumscribe public debate.

Hughes' polemical version of history asserts that 'homelands' (which, note, are never defined in the book) are the product of a socialist 'homeland' model conceived by economist Nugget Coombs. She places the main blame for ongoing disadvantage in Indigenous 'homelands' squarely on the shoulders of 'exceptionalist' self-determination policies that were implemented in such areas. This is an inadequate account of history which ignores the fact that Indigenous socioeconomic outcomes were coming from an exceptionally low base in the 1970s. Furthermore, Indigenous disadvantage was (and is) prominent in both remote and non-remote areas. Many of the policy reforms proposed by Hughes resemble the measures incorporated in the federal government's recent 'national emergency' response to child sex abuse (Altman 2007a).

My main criticism of Hughes' analysis is that she has created the space in public debate where the use of hyperbole is acceptable and, indeed, endorsed. I maintain that her earlier use of the word 'apartheid' in describing the permit and land-rights system is inappropriate and categorically wrong (Hughes 2005; Hunter 2007a). If nothing else, the debate over the NT intervention seems to indicate that the vast majority of community residents support the right to control who enters their communal property. When respected academics engage in emotional debates using rhetorical devices, then this sets a public standard whereby exaggeration and categorical errors become legitimated. *The Australian* has published many articles that repeat and expand on the invalid analogy of the 'Australian Apartheid'.

Curiously, the former Minister for Indigenous Affairs, Amanda Vanstone, in a 2005 speech entitled 'Beyond Conspicuous Compassion' (Vanstone 2005), had this to say:

Good intentions are not good enough. Indigenous Australians must be able to expect the same range of opportunities as other Australians. No

more cultural museums that might make some people feel good and leave Indigenous Australians without a viable future. Continuing cultural identity does not require poverty or isolation from mainstream Australian society.

While Vanstone railed against ‘conspicuous compassion’, it is hard to characterise the PM and Brough’s rhetoric as anything other than that. Indeed, Brough stated recently that one ‘wouldn’t have a soul if one did not support the blow-out in spending on the intervention’.

Ironically, it appears that some politicians (not to mention various academics and media outlets) are now competing with one another to be morally righteous and conspicuously compassionate about Indigenous child abuse. Obviously, the public are forced to tolerate the use of rhetorical devices by parliamentarians because politics is a ‘blood sport’, where winning the argument is more important than the substance of the issues involved. However, if the construction of effective policy is the goal, debate must include an array of less moralistic perspectives.

The only way ahead is to acknowledge the complexities of the task at hand and attempt to identify, analyse and address the most relevant issues. All involved need to be open to the possibility that their ideas are wrong, and to submit those ideas for rigorous evaluation and criticism.

Preliminary Evaluations and Criticisms of NT Intervention

The authors of the ‘Little Children Are Sacred’ report have been extremely critical of the legislation. For example, Pat Anderson says that there is no recommendation in their report that coincides with the legislation (Marr & Peatling 2007). Mr Brough responded to this by saying: ‘I was astounded that the report’s authors provided no recommendations designed to immediately secure communities and protect children from abuse.’ This accusation is more than a little unfair since a report to the NT government based on limited terms of reference cannot assume that the Commonwealth might provide additional resources to secure communities.

The other initiatives may have positive effects on community functioning, and possibly even Indigenous disadvantage, but the connections of the initiatives to child abuse have not always been demonstrated definitively. While there is considerable evidence on what needs to be done to respond to Indigenous child abuse — Radio National’s *The Health Report* presented a summary of the evidence-based response to child abuse (Swan 2007) — the overall lack of evidence on which to link various aspects of the intervention to child abuse is a major impediment to constructing effective policy options.

There are many possible criticisms of the legislation. Space constraints limit me to focusing on just a couple. Interested readers are referred to the transcript of the one-day Senate hearing where many of the arguments were rehearsed³ and to Altman and Hinkson (2007) who present robust criticisms of the intervention from more than 30 authors — around half of whom are Indigenous contributors.

Some of the most cogent criticism has come from a former Liberal Minister for Indigenous Affairs, Fred Chaney, in his 2007 Vincent Lingiari Lecture (2007). Indigenous people will be subject to a level of micromanagement that is unprecedented elsewhere in Australian society. Chaney highlights the suspension of the provisions of the *1975 Racial Discrimination Act* and the interference in Indigenous property rights as being of particular concern. He highlights how the lack of meaningful consultation has almost guaranteed that there will be resistance (both passive and active) to the implementation of the policy.

Frank Quinlan, Executive Director of Catholic Social Services Australia, has argued that overseas evidence suggests that no beneficial outcomes flow from financial sanctions unless intensive support programs are also provided. It has also been pointed out, on the basis of evidence from US food-stamp programs, that the new welfare rules would affect only 'a small number' of families (Lane 2007). Yet the fixed costs of such interventions, such as recruiting and training case workers, and point-of-sale machines to read entitlement cards, are high (Blank 2002). Furthermore, the fixed costs of quarantining welfare payments in Australia are likely to be high (relative to the US) because of diseconomies of scale.

Linking child abuse and neglect to the welfare quarantining provisions may also have perverse consequences. Notification of abuse and neglect is often voluntary and it is possible that there will be a decline in reported child abuse and neglect if families are reluctant to suffer the social consequences of welfare/income management — even if the actual incidence of child abuse and neglect is not reduced. This is not a problem in itself, but it may have perverse consequences to the extent that support for families in need is affected.

Few commentators would argue that restricting alcohol consumption is not fundamental to tackling child abuse and dysfunctional Indigenous communities. Nevertheless, the Police Federation of Australia argues that the new liquor controls will make law enforcement difficult because there will be two competing legislative frameworks in place: the Commonwealth's new rules, and the existing Territory legislation (Hall 2007). The Federation also argues that by opening up the permit system in the larger public townships and connecting roads, law enforcement efforts to address the 'rivers of grog' will become more difficult.

³ <www.aph.gov.au/hansard/senate/commtee/S10473.pdf>

Enforcement issues are critically important, as many Indigenous communities already have bans on alcohol consumption. Prohibition is especially difficult to enforce when there are non-Indigenous communities nearby with access to alcohol (that is, there is an incentive for a 'sly grog' market to develop).

Compulsory acquisition leases in townships are a direct intervention into Indigenous property rights. Legitimate questions have been raised about the just-compensation provisions for the compulsory acquisition. The changes to the permit system can also be construed as tampering with Indigenous property rights, as many communities (Oenpelli, for example) rely on the income earned from issuing permits.

As part of the intervention, Mal Brough also announced that all CDEP employment in the NT will be replaced by 'real jobs' (Altman & Hinkson 2007: p.331).⁴ While some commentators question how meaningful the term 'real job' is, the major unresolved issue is where these new jobs might come from and who might finance such positions. Several NT schemes have already closed, with a concomitant loss of governance capacity for administering community-level initiatives. Brough had previously indicated that he wants the state to deliver development directly to Indigenous families and individuals, thus bypassing mediating institutions and representative structures (Altman & Hinkson 2007: p.315). While these policy thrusts are not intrinsically inconsistent, the federal government is likely to have difficulty in developing the organisational capacity to deal directly with Indigenous people and their families — especially given the problems recently experienced in hiring and retaining Indigenous employees (Commonwealth of Australia 2006).

The most substantial criticism of the intervention is that it is an assault on Indigenous choice and, ironically, responsibility. The NT intervention is clearly paternalistic as it imposes a new set of constraints on what Indigenous people can do, both inside the welfare system and elsewhere. The intervention has been promoted on the grounds that it will assist in re-establishing norms in Indigenous communities and hence in enhancing social responsibility. In contradistinction, it has also been argued that depriving people of personal responsibility may not be the best way to increase the capacities and willingness of individuals to exercise this responsibility (Quinlan 2007).

This section has outlined some *ex ante* criticisms and evaluations of the NT intervention, which may or may not turn out to be valid. Given that the intervention is controversial and contestable, it is particularly important to establish a credible and accountable framework for evaluating the resulting outcomes.

⁴ Over the last few years, the CDEP scheme has already been scaled back in non-remote areas.

The Importance of *Ex Post* Evaluations

One of the most disappointing aspects of the NT intervention is that there was virtually no lead time to prepare or think about an evaluation framework. Some *ex ante* planning with Indigenous leaders and relevant bureaucracies would have both lessened the public resistance and facilitated evaluation. It will now be very difficult to evaluate the outcomes of the intervention because no groundwork was laid to establish credible benchmarks for what existed before the policy shift.

In the United States, most major change in policy would start with a strategy for evaluating the social experiment with random assignment (Bloom 2005). Social experiments are regarded with particular suspicion in Indigenous policy because they raise ethical questions about the treatment of the Indigenous population as subjects, rather than as people. The Howard government has clearly indicated a willingness to engage in paternalism with this intervention, but its failure to establish benchmarks or construct control groups means that it will be almost impossible to attribute any changes in outcomes to the intervention. For example, the rate of child abuse and neglect in the NT may go up or down depending upon the level of measurement error both before and after the intervention. Consequently, the NT intervention is unlikely to be held to account and the government can make almost any claim it wants about what happens as a result of its policy.

Given the scale of the intervention, it would not be unreasonable to characterise it as one of the largest social experiments in Australian history — with NT Indigenous communities being the ‘treatment group’. Of course, the ‘experiment’ analogy breaks down when one remembers that there has been no attempt to randomly assign people into control and treatment groups. Another problem for the analogy is that some of the policy initiatives are not entirely confined to the NT. Nevertheless, it is time to consider explicitly adopting a more scientific approach to experiments in Indigenous affairs — especially since it is, arguably, already occurring.

One potentially important advance for the evidence on the development processes facing Indigenous children is the Longitudinal Study of Indigenous Children (LSIC). The 2007 federal budget announced that LSIC would involve around 1,500 babies and children from 11 regional sites. The relatively small sample size may circumscribe the power of the analysis to discern between competing hypotheses. Another concern is that LSIC is not national in scope and hence can be accused of reflecting regional idiosyncrasies. One potentially unfortunate side-effect of the NT intervention is that it may disproportionately affect the level of cooperation of LSIC respondents there vis-à-vis other states and territories (that is, it might induce some measure of non-sampling error).

When LSIC data is eventually collected, it should enhance the findings from the cross-sectional studies of the Western Australian Aboriginal Child Health Survey (WAACHS, see Zubrick et al. 2006). While the proposed LSIC will not be a national study, it shares this limitation with the WAACHS.

Some (Hopefully) Positive Policy Options

Indigenous disadvantage has not arisen suddenly; rather, poor outcomes for Indigenous Australians appear to have accumulated over many generations. While the Howard government and its supporters rightly point to historical factors driving Indigenous disadvantage, their historical focus seems to be rather narrowly confined to the period between the early 1970s and the mid 1990s (for example, Hughes 2005). The quality of data was not really credible before 1981, but Census data seems to indicate that there has been steady, though not spectacular, improvement in certain socioeconomic outcomes since the 1970s (Altman, Biddle & Hunter 2005). This seems like a counterintuitive finding — but those who try to construct a narrative of failure in Indigenous policies do not contest the national statistics on which these results are based; rather, they claim that the failure is mostly manifest in remote outstations and ‘homelands’ (Hughes 2007). Hunter (2007a) argues that this response is inadequate as the geographic definitions used are ill-defined and, in any case, the broad changes in Indigenous wellbeing at the national level are largely reflected when a more disaggregated geography is used. This is not to say that this ‘progress’ is adequate, especially in the presence of substantial macroeconomic growth; rather, that the extreme claims about failure and success should be tempered.

Changes in Indigenous socioeconomic status are unlikely to be achieved without substantial commitment to providing the resources required. The long-run trend in spending on Indigenous affairs has increased over the last 30 years. From the early 1990s, Indigenous-specific expenditure as a percentage of GDP has stabilised at around one-third of one percentage point (Gardiner-Garden & Park 2007). The per-capita measure of Indigenous-specific expenditure is complicated by uncertainty about the exact size of the Indigenous population but, given the substantial undercount of the Indigenous population (Australian Bureau of Statistics (ABS) 2007), it is entirely possible that per-capita spending has actually fallen in the last seven years. Whatever the merits of the current spending levels, it is worth asking whether funding has been spent in the most effective areas.

Indigenous policy debate is challenging at a personal level for all who attempt to engage with it. People from the left of the political spectrum need to acknowledge the existence of incentive effects and the potential for the negative influences of culture. The right will have to accept some role for ‘symbolic’ issues such as Indigenous rights and accept that culture and norms are more

complex than they assume. For example, giving people a choice means having to accept that not everybody will necessarily make the same choices.

It may be naïve to think that one can separate out the politics from the policy, but complex problems need bipartisan and long-term policy options. Positive outcomes are unlikely to be achieved without the cooperation of all parties, who need to change their own (and others') behaviour(s). It should be noted that there are likely to be long lead times in changing behaviour and norms, especially in the presence of intergenerational transmission of disadvantage.

Notwithstanding the apparent lack of evidence for some of the more unique aspects of Indigenous policy, there are some things that we can do to break the 'vicious cycle' of Indigenous disadvantage and child abuse — even if we do not invoke a 'virtuous cycle' immediately. Primary among these would be to address the substance abuse and risky alcohol consumption with supply-side constraints. As argued above, some aspects of the intervention may undermine the efficacy of such policies.

Intervention into the supply of alcohol is only one policy option. Another option would be to consider a policy which operates on the demand for alcohol. If the price of alcohol were increased by raising excise taxes, this would constrain the amount of alcohol consumed in Indigenous communities (that is, if demand is not completely inelastic). This policy has the advantage that it will reduce the consumption of alcohol throughout Australia, rather than focus solely on remote Indigenous communities.⁵ Of course, this may be politically unpalatable, but it is important to recognise that there are many negative externalities arising from alcohol consumption for both individuals and communities throughout Australia (including non-Indigenous communities). Given that the Prime Minister has identified a national emergency, it might be considered an opportunity for a truly national policy.

Learning to drink responsibly is an important element of an Australian youth's education (Brady 2004). Social policies that support the educational process within schools and families will also play a role in addressing the widespread problem of binge drinking.

Policy also needs to facilitate positive child development through funding community infrastructure and supporting families with young children. It is important to note that supporting families does not necessarily entail increasing welfare payments, as these are likely to entail negative incentive effects that work against participation in the mainstream economy (Henry 2007). Daly and Hunter (1999) showed that many (or even most) Indigenous people would earn less than their nominal expected welfare entitlements if they secured work. The

⁵ Macgregor et al. (2004) propose that local Indigenous communities be allowed to set their own alcohol taxes. However, political and constitutional reality may work against any such policy.

likely disincentive effects of welfare payments are likely to have been exacerbated by the growth of generous family payments since the late 1990s. Given that it might be politically difficult to reduce welfare payments, it is necessary to consider the issue of conditionality of welfare payments, not unlike some of the initiatives embodied in the NT intervention. Another approach worth considering is to establish a more positive set of incentives for Indigenous youth to stay at school (Hunter 2003).

Finally, it is hard to deny the historical shortfall in public investment in NT communities, especially in areas of policing and schools (Taylor & Stanley 2005). What is needed now is a sustained effort, community consultation and partnership, effective and appropriate expenditure, and close monitoring by the media of what is being achieved (Altman 2007b). The additional commitment of resources entailed in the NT intervention aimed at ensuring security of communities is laudable, but more is needed. It is a crisis that will now require serious commitment over many years. Governments should not underestimate the magnitude of the task — Jon Altman's estimate of a \$4 billion shortfall in expenditure is extremely conservative as it only focuses on certain aspects of the policy initiatives.

Learned Helplessness and Behavioural Change

Some commentators might be surprised how uncritical many Indigenous community residents have been of the NT intervention, especially in the central desert area. There are at least two possible explanations for this. The first is that some Indigenous people are glad something is finally being done, although they may be sceptical about the efficacy of the plan (Langton 2007). Another possibility is that many Indigenous people are more used to having things done to them than being active participants in mainstream society. This second possibility underscores the major strength and weakness of the NT intervention, which involves substantial constraints on Indigenous choices, especially in the area of property rights and access to citizenship rights embodied in welfare.

Learned helplessness is a psychological condition in which a human being has learned to believe that a situation is helpless (Petersen, Maier & Seligman 1995; Seligman 1975). The theory is that depression results from a perceived lack of control over the events in life, which may result from prior exposure to (actually or apparently) uncontrollable negative events.

Not all people become depressed as a result of being in a situation where they appear not to have control, but the intransigence of Indigenous socioeconomic circumstances is such that it would be surprising if many Indigenous people had not learned to feel helpless. Prolonged exposure to dependence on welfare is likely to be one of the major factors underlying community violence and dysfunction (Hunter 2007b).

The top-down approach has many limitations, especially when it is attempting to change people's behaviour. One of the limitations of military-style interventions is that it perpetuates attitudes of 'learned helplessness' that need to be changed if enduring changes are to be achieved. In a sense, some aspects of the intervention will address the learned helplessness arising from the lack of mainstream employment options. However, by bundling together more controversial measures that alienate Indigenous communities and their property rights, it also risks exacerbating the feelings of alienation and helplessness.

Reprise

In summary, even if one does not disagree with some aspects of the policy focus of the NT intervention, there has been a failure to provide for adequate planning, implementation and evaluation of the initiatives. Wicked problems, in inherently complex domains such as Indigenous policy, require negotiation between stakeholders and vigorous open public debate. In some ways, the public debate has been vigorous, but many commentators have criticised the lack of transparency and openness of the public discussions. This paper emphasises the need for a bipartisan and long-term policy commitment so that substantial progress can be made in addressing Indigenous disadvantage and child abuse. While long-term commitment is essential, a transparent evaluation process is also essential to ensure that any bipartisan policy is based on solid foundations to achieve the desired outcomes.

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REVIEWS

Restoring the Setting Sun

Takatoshi Ito, Hugh Patrick, David E. Weinstein (eds), *Reviving Japan's Economy: Problems and Prescriptions*, MIT Press, 2005

Hodaka Morita¹

With the bursting of its asset and real-estate market bubble in 1990 and 1991, Japan's economy entered into a long period of poor performance. This book develops and recommends policy solutions to return Japan to long-run sustainable economic growth, based on the two-year research project led by professors Takatoshi Ito, Hugh Patrick and David Weinstein. Comprising 11 chapters written by 16 distinguished Japanese and American scholars, it covers a range of important issues including fiscal policy, monetary policy, the financial system, corporate restructuring and financing, the labour market, and international economic relations. Based on thorough analyses of data, institutional details, history, and past research findings, each chapter offers a useful set of policy recommendations in ways that are understandable for non-economists. This book is highly recommended for scholars as well as practitioners who are interested in the revival of the Japanese economy and in learning lessons from its experiences.

Part I of the book analyses macroeconomic policy. A crucial cause of Japan's poor macroeconomic performance has been inadequate aggregate demand necessary to maintain full utilisation of its resources. A key dilemma here, with regard to fiscal policy, is how to increase aggregate demand while curbing government budget deficits. Despite the commonly held view that Japan is on the verge of a government fiscal crisis, Chapter 2 presents a careful empirical analysis that argues that Japan does not face a future fiscal crisis, concluding that Japanese tax rates need not rise above those found in many other high-income countries. Chapter 3 compares the macroeconomic situations and monetary policy responses to the ending of asset price bubbles in Japan in 1991 and in the United States in 2000. It argues convincingly that the eventual deflation might have been prevented if in 1991–94 the Bank of Japan had taken more aggressive action in interest rate cuts, as the Federal Reserve did in 2001–04 in the United States. An important question here is why the Bank of Japan responded erratically, and several possible explanations, including the one based on the conflict between the Bank and the Ministry of Finance, are presented. Chapter 4 provides a comprehensive set of policies for ending Japan's sustained

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deflation, recommending a price-level target and, once that has been achieved, an inflation target.

Part II discusses Japan's financial system. What once was considered to be an extraordinarily large, strong and effective financial system has become one of the weakest among advanced industrial nations. Chapter 5 identifies four basic problems plaguing Japan's banking system: the low level of capitalization; continued support for customers with poor repayment prospects; the excessive size of the banking sector; and the outdated business model. It makes clear that even ending deflation and restoring good economic growth will not be sufficient to create a competitive banking system, and recommends an aggressive policy approach, one that forces the banks to clear up their balance sheets and restructure their loans to distressed borrowers. Chapter 6 provides a careful analysis of government financial institutions and special public corporations. It stresses that, as Japan's economy has matured and the financial system has been deregulated, many government financial institutions have become weak and redundant, and their economic rationales have evaporated. It recommends that some institutions be closed and that the others be transformed into state-owned companies with limited liability and strict budget constraints. Chapter 7 analyses the life-insurance industry, which is in even worse condition than the banking sector and substantially distorted by the presence of the government's postal life-insurance system. It proposes a range of policies to restore the industry's strength.

Part III investigates corporate restructuring and financing, and Part IV discusses Japan's new trade policy. Several studies have found that aggregate productivity growth in Japan slowed substantially in the 1990s, and Chapter 8 identifies this as a main cause of Japan's lost decade. It finds a tendency for industries with lower productivity growth to invest more, and concludes that the Japanese economy has been suffering from a misallocation of resources rather than insufficient investment. Given the problems in the banking sector, Japanese banks are no longer able to play their traditional role of reallocating capital to more productive investment opportunities. It is suggested, however, that government intervention should be limited in order not to crowd out private market restructuring efforts. Chapter 9 analyses Japan's corporate bond market since the late 1990s, when the government's Big Bang policies accelerated its development. It concludes that corporate bond market pricing is working reasonably well because prices and their credit-default swaps are consistent, according to monthly data.

Corporate restructuring has substantial impacts on Japan's labour market, which faces a number of problems, as discussed in Chapter 10. Among other things, it points out that Japanese firms reduced training expenditures during the 1990s in order to save on labour costs, and offers policy recommendations

for Japanese firms to pay increased attention to job training and job satisfaction. Job retraining and mobility support, which will help the economy keep up with a changing industrial structure, are also discussed. Finally, Chapter 11 explains Japan's trade policy motivations and strategy, and strongly recommends that Japan pursue free-trade agreements in a manner complementary to the World Trade Organization. It then identifies obstacles to the formation of free-trade agreements and proposes ways to overcome these issues.

Although the book offers quite a comprehensive coverage of the topic, several important issues for thinking about 'reviving Japan's economy' are still missing, including investment in technological advances and information technology. For example, Jorgenson and Motohashi (2005) found that, although Japanese firms have made substantial investments in information technology since 1995, total factor productivity growth has declined during this period. This finding suggests that Japanese firms have not utilised information technology effectively. Another important issue is the changing nature of Japanese industrial policy. For example, a guiding principle of Japanese industrial policy had been the regulation of so-called excessive competition, and the Japanese government often placed heavy restrictions on entry into industries. In the recent trend of deregulation, how has its entry regulation changed and how has the change affected the competitiveness of Japanese industries?

As pointed out in Chapter 1, Japan's extraordinarily successful post-war economic growth was based significantly on its ability to close the huge gap between the Japanese level of productivity and technology and the world's productivity frontier. Given that Japan had caught up with the West by the mid-1970s, there is now a widespread sense in Japan that it has failed to make the transition from a super-effective manufacturing economy to a high-tech service-oriented economy. How can Japan make this transition successfully? I believe that there are several important issues along this line that remain to be explored in future research. In particular, the nature of technological development differs across 'catching-up' economies and 'caught-up' economies, which suggests that research and development is a key issue to be explored. The changing nature of technological development in turn affects, among other things, the nature of labour markets, the structure of industries, and the education system. What should Japanese governments do, and stop doing, to facilitate such a transition?

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'The extent of the market' is limited not just by transport but by trust

Partha Dasgupta, *Economics: A Very Short Introduction*, Oxford University Press, 2007

Declan Trott¹

Not so long ago, economics had a major image problem. University enrolments were down, and the public impression of an economist was of a heartless, graph-wielding, bean-counter. I am not sure if enrolments are higher today, or if economists are better liked. Yet in the publishing world, it is an undeniable fact that popular economics has become much more, well, popular.²

The professional reaction to this commercial popularity has not been one of uniform gratitude. One must assume a certain amount of jealousy towards the fame and fortune of the lucky first movers. Yet there is also a feeling that some of the best-sellers have trivialised economics, titillating the reader with sex and drugs while neglecting the more important insights of the discipline.

Nobody could accuse Partha Dasgupta of deepening this rut. In this *Very Short Introduction*, he has taken as his theme the original mystery of economics: the nature and causes of the wealth of nations. And he motivates the study not with unadorned GDP statistics but by comparing the lives of two young girls: Becky, who lives in an affluent American suburb, and Desta, the daughter of Ethiopian farmers. Why do two children, born so much alike, live such different lives?

The question is compelling, and presents an opportunity to explore many branches of economics, in a concrete and relevant way. Unfortunately, Dasgupta does not use it consistently. While there are many references to 'Desta's world' and 'Becky's world', these are too often brief appendages to abstract discussions of agents A, B and C and factors X, Y and Z. At times one could be reading a textbook, except there are no problem sets, fewer graphs, and the pictures are in black and white.

This is a great pity, because there is a deep, coherent and insightful argument at the core of the book.

¹ School of Economics, The Australian National University.

² For example, *Freakonomics* by Steves Levitt and Dubner, *The Undercover Economist* by Tim Hartford, *The Wisdom of Crowds* by James Surowiecki, *Sex, Drugs and Economics* by Diane Coyle, *More Sex Is Safer Sex* by Steve Landsberg, *Gittonomics* by Ross Gittens.

One might begin with the proposition: wealth depends on the division of labour, and the division of labour is limited by the extent of the market. But the extent of the market is not limited only by transport and taxes. It is limited also by trust: by the rules and expectations that allow cooperation for mutual gain between people who do not know each other. And these rules and expectations, particularly the expectations, are hard to build but easy to destroy. In the worst case, not just the extent of the market but its very existence is threatened.

The logic for this argument is provided by game theory. Economic life, and indeed social life more generally, depends on trust; not necessarily that people will always do unto others as they would have done unto themselves, but that most people will keep their word most of the time. But even this modest level of trust cannot be gained just by wishing for it. People must believe that the long-run benefits from successful cooperation outweigh the short-term gains from cheating. And they must believe that other people think the same and act accordingly, so that their own trust will not be abused. Both of these beliefs depend crucially on expectations of the future. If prospects for the future become less bright, or if confidence in the other party is reduced, even for trivial or fallacious reasons, the balance may tip from cooperation to conflict very quickly. This has become a cliché in Yugoslavia, Rwanda and Iraq: political uncertainty resurrects dormant divisions and peaceful neighbours become killers.

Less dramatically, such calculations may just restrict the number of people any individual can trust and trade with. The 'community' is a natural boundary: any group which people are born into (and with no easy, voluntary exit) and must deal with repeatedly for their whole lives makes the penalties for cheating higher and more certain. The family is the ultimate example, and such is its strength that it is vitally important in all societies. Yet on their own, families and communities have their limits. They are small, so they limit the division of labour. Becky's father could not trade his services as a lawyer for food and shelter within an economy of four. Their members face the same risks, so insurance is difficult — if there is no rain in Desta's village, all the farmers suffer equally. And saving and investment opportunities are more limited — storing grain is the main option for the lean season, and losses to moisture and vermin make even this problematic. In the longer run, sons are the only effective retirement plan.

Markets, on the other hand, overcome these problems by allowing much larger numbers of people to cooperate. But these large numbers cannot rely on personal ties, so establishing the necessary trust is much more difficult. This may not be a problem in goods markets — Desta's father sells grain on the local market without any problems — but insurance, credit and employment are a different matter, requiring a complicated mechanism of formal law. Man may

'The extent of the market' is limited not just by transport but by trust

have a natural propensity to truck, barter and exchange, but not for banking or wage labour.

While consideration of trust, and its implications for communities, markets, households and firms, is the key content of the book, other subjects are considered. It begins with a brief consideration of the history of economic growth, contains an interlude on the contrasting incentives and institutions in science and technology, and concludes with chapters on sustainability and democratic decision-making. There is little to argue with in these chapters, but they are more abstract and ad hoc, and are linked less tightly to the rest of the book than they might have been.

The *Very Short Introduction* series is advertised as being for 'anyone wanting a stimulating and accessible way into a new subject'. Stimulating, yes. Accessible? I am not so sure. Popular economics is supposedly aimed at the whole literate population, or at least the university-educated, newspaper-reading part of it. Partha Dasgupta seems to equate them with his fellow Cambridge professors and their brightest students. And it is a shame, because the intellectual content of the book, combined with the Becky/Desta device, had the potential for a truly great and accessible introduction to economics.

'It is difficult to be an actor but easy to be a spectator'

Daniel Cohen, *Globalization and its Enemies*, MIT Press, 2006

Martin Richardson¹

A risky title, this one; echoing, as it does, Karl Popper's famous *The Open Society and Its Enemies*. Popper's personal arrogance led to the suggestion that his book should have been titled *The Open Society by One of Its Enemies* and any book with an isomorphic title invites the isomorphic joke. But it's one that cannot be made here at all: while Daniel Cohen's excellent book is not really a cheerleader for globalisation, it certainly cannot be lumped in the 'enemies' camp. Rather, this book takes a surprisingly nuanced view of globalisation — surprising because of both its brevity, which leaves little space for extravagant 'theories of everything', and its foundation in neoclassical economics, which leaves little room for airy speculation. Cohen certainly sees the massive positives of globalisation but is not dazzled by their lustre; indeed, to Cohen, the miracle of globalisation is how poor it is at diffusing prosperity.

This short book covers the origins of global inequality, the failure of serial waves of globalisation to equalise global incomes, the role of culture and religion in explaining income inequality and fertility, the (non-) implications of globalisation for cultural homogeneity, en route to suggesting possible international policies for alleviating global inequality — all in 169 short pages. Written by an economist with one foot in academe and one in the world of journalism, its brevity demands that there are many unsubstantiated claims and rhetorical flourishes and, consequently, it is both an exhilarating and a frustrating read for an academic economist. One might envy the freedom of writing unencumbered by obligations to footnote and reference every thought, but it's not a freedom one would entrust to many. Cohen is an exception, as he has a real eye for the aphorism and bon mot: 'human genius, in all that is unforeseen, is singular in cause' (p.19, reflecting on the role of chance in significant inventions); 'Through the commuter railway or the movies, the suburbs of Paris, Cairo, Mexico, and China all evenly gaze upon the world. It is the world which ignores them' (p.77, on the visibility of today's globalisation); 'colonizers ... brought answers to questions that no one was asking' (p.20, on the inevitable but unintended consequences of globalisation).

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One's views on what constitutes globalisation also colour one's perspective on its inevitability and, to caricature two extremes in this, some see globalisation as an inevitable tsunami triggered by technological shocks and driven by the winds of history, a boon-giver distributing largesse for all; others see it as the deliberate choice of advanced nations, foisted on an unsuspecting world, to shore up capitalism — a vindication of the *Communist Manifesto*.

To the first of these, one cannot sensibly be a 'critic' of globalisation any more than King Canute could be considered a 'critic' of tidal forces; to the latter, globalisation's losers are (deliberately) victims of its winners, a view that finds a slightly more modern expression in the notion of 'unequal exchange', in which poverty for some is the necessary source of wealth for others.

Cohen takes a different perspective, acknowledging that, yes, there are losers in the process of globalisation, but they are 'destroyed by the fact that they are not protected against the perverse effects of industrial society and of urbanization, or against the lifestyle they entail' (p.4). He cites the Spanish conquest of South America through disease, rather than military might, as a useful illustration and parallel (although this particular story has been questioned recently (Stutz, 2006)). He discusses — and rightly rejects — unequal exchange, suggesting instead that 'the drama of the current globalization has an exact opposite cause: the poverty of the poor is gratuitous and useless' (p.163). But a crucial feature of our current globalisation is its exposure and visibility: with a communications revolution at its heart, the whole world indeed gazes upon the successful, so expectations are high and disappointment bitter, a fact of considerable significance to those inclined to believe in the primacy of relative status in determining individuals' welfare. 'It is difficult to be an actor but easy to be a spectator,' writes Cohen (p.6), and perhaps this explains the vociferous divides generated by globalisation today; whatever the case, even past globalisations have failed to 'spread the wealth' because of inappropriate expectations.

Cohen buys what the 'new' economic geographers are selling to explain the evolution of the world economy. He discusses recent moves towards a single-market Europe as 'Smithian', versus the 'Schumpeterian' US — the former driven by the division of labour in an expanded market, the latter by creative destruction — and suggests that comparative advantage has little to tell us in a world of agglomeration and geography. Globalisation, he suggests, is more apparent than real in developed countries as they transform into post-industrial, service economies. I'm a little sceptical of this, given that the geographers' magic bag contains models that will tell you whatever you want to hear, so that every observation confirms something in their analysis. But Cohen is a believer, and suggests that China will someday learn the European lesson that prosperity cannot be generated 'solely on the basis of the international division of labour'

(p.76). No, a country must become 'a "center" in its own right: a place dense with production and consumption' (p.77). While one can draw a very useful lesson from this — that the collapse of trading costs does not flatten the Earth, to use Thomas Friedman's slightly silly metaphor — it will make those familiar with the wrong-headedness of Import Substituting Industrialisation shudder at the policy implications it implicitly endorses.

A short book on such an enormous topic will inevitably include generalisations with which any reader will disagree. This is particularly true for New Zealanders — like myself — reading this sort of book, in part because the colonial history of New Zealand does not fit comfortably with most stories of Western colonisation (in particular, the enthusiasm and success with which Maori initially took to capitalism appears to be a historical oddity) and in part because of New Zealand's success, like that of Australia, as a non-industrial developed nation.

But the weakest part of the book, I think, is in the final substantive chapter as Cohen discusses global policies that might alleviate the imbalances generated by globalisation. It's probably no coincidence that this is also the part of the book in which the big picture is left behind, so the reader is no longer being swept along on waves of glorious language and provocative generalisations but, rather, is invited to engage with the affairs of practical men.

This chapter — entitled 'AIDS and Debt' — addresses two major North-South policy issues: one is the question of pharmaceutical intellectual property (specifically, should the South get cheap access to drugs developed, at considerable expense, in the North?) and the other is the question of sovereign debt relief. In both areas, Cohen attempts to justify, through his economic analysis, positions which I believe can only be supported on compassionate grounds (which is not to trivialise them: on the contrary, such arguments have more resonance with most people than the efficiency rationales of economists). Cohen recognises the standard arguments against price discrimination for medicines (essentially, undermining Northern prices — and thus the incentive to innovate — through parallel imports) and against debt relief (moral hazard) but really comes up with no new rebuttals. He tells us, for example, that debt cancellation does not aggravate the problem of moral hazard: 'It resolves it. It obliges lenders to ask themselves the question that will come at the time of repayment.' (p.156) Well, I suppose lenders refusing further credit is a resolution of sorts. But that hardly seems one that would appeal to either side of the market!

Cohen argues that public opinion has led to changes in policy in both these areas but that alone, surely, is a poor rationale, as it's so easy to vote for the largesse of others (witness Bono's continuous berating of the world's rich taxpayers for their failure to pay more to the world's poor, while moving his own band's publishing arm to the Netherlands from Ireland this year, following

the announcement of a 250,000 cap on tax-free income for Ireland-resident artists). Just as business people favour competition in all industries other than their own, we all are in favour of taxes borne elsewhere.

Ultimately, at least as I read him, Cohen does seem to recognise that the soundest argument for the policies he espouses is a moral one, but he tries to nest this in his economics. This is an unfortunate decision: it is not at all convincing, and there is a real danger that readers might throw out all of his insights in rejecting this obvious failure.

Nevertheless, this small seven-chapter book is an excellent and provocative read and contains within it a quite superb six-chapter book which I would recommend without hesitation to economists and others alike.

References

Stutz, B. 2006, 'Megadeath in Mexico', *Discover* 27(2) (February). Available at <http://www.discover.com/issues/feb-06/features/megadeath-in-mexico/>. Accessed November 2006.