CLIMATE CHANGE, CHINA BOOMS AND AUSTRALIA'S GOVERNANCE STRUGGLE IN A CHANGING WORLD

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I am glad of the chance to deliver this oration in honour of Dick and David Hamer, contributors to civilised Victorian and Australian political discourse. Barry Jones once described Dick Hamer as the finest flower of the Victorian Deakinite tradition. That tradition encompassed the ideas that people of goodwill sharing sound knowledge could find the best way through a policy dilemma; and that citizens should be seeking to reconcile competing interests and perspectives, and to strengthen institutions that neutralised extreme views by providing opportunities for sound elements in them to be partially absorbed into the mainstream. Barry Jones had in mind leadership covering a wider field than economic policy, extending into the environment, the arts and humane administration of justice—contrasting sharply with Victorian Governments in times immediately preceding the Hamer years.

These are matters of political culture rather than policy. They have been influential and productive in Victoria and Melbourne, and part of the success of this State and city as civilised polities and communities over more than a hundred years.

I focus mainly on economic issues. Today, sound economic policy embraces the environment. To ignore the environmental impact of policies is as economically irrational as to ignore the effects of allowing demand to exceed the productive capacity of the economy, or to ignore distortions which force investment to shift from highly productive to wasteful activities.

I begin by introducing a few basic ideas about means and ends in economic policy in a democratic polity. This is a bit formal, but hopefully will avoid some misunderstandings and save some time later in this presentation.

It is a recurring challenge of democratic capitalism to reconcile Government by the people, with its necessary concern for equity, with maintenance of the competition in the market place and the incentives for economising behaviour that are necessary for sustained prosperity. And it is a recurring challenge to reconcile the inevitable accumulation of wealth from success in the market economy, and the influence of wealth in the democratic process, with Government by the people. Compromises that are made and political alliances that are struck in meeting one of the recurring challenges can ease or exacerbate the other.

For the outcome of the political process to be conducive to broadly based prosperity and to the preservation of democratic institutions, there must be knowledge of the effects of various policies; education of the democratic polity in that knowledge; restraint in the use of political power to achieve sectional economic objectives; and restraint in the use of economic power in the political process. A successful democratic polity is built around analysis, public education, tolerance and restraint. The presence of these qualities in the polity allows leaders who are concerned to follow some conception of the public interest to appeal to the democratic electorate over the heads of vested interests, which otherwise have a privileged influential place in the policy-making process.

We now know from much experience and analysis quite a lot about the conditions that must be met for a country's economic success.

To the greatest possible extent, goods and services need to be traded and capital allocated through competitive markets.

There are economic efficiency advantages in labour also being traded through competitive markets, although in this case, democratic rights must constrain the treatment of labour as a commodity. The legitimate debates on regulation of labour markets are about the boundaries between what is conducive to good outcomes for economic efficiency and equitable distribution of material economic benefits, and what is necessary to preserve valuable human freedoms in a democratic polity. The best outcomes for efficiency and equity will give the largest possible role to the market subject to securing the essential democratic freedoms, with budget rather than labour market interventions being used to secure equitable distribution.

The prime role of markets does not mean that the role of Government is incidental to economic success. Far from it. Many services that are essential to good economic performance are provided by Governments or not at all. These services have the characteristics of "public goods"—they cannot be provided efficiently through private markets. In addition, there are activities which generate benefits or impose costs on firms other than the parties to market transactions. Efficient economic outcomes require all such external costs to be taxed or discouraged by regulation, and all such external benefits to be subsidised or encouraged by regulation. One special case of intervention to increase economic efficiency is the increase in aggregate demand to maintain full employment for labour and capital in times of "Depression Economics". A second is the internalisation of external environmental costs—now including the important special case of greenhouse gas emissions.

Markets do not generate a distribution of income that bears any relationship to what a society considers to be equitable. It is a legitimate and necessary objective of policy in a democratic country with a market economy to intervene to make the distribution of income and wealth more equitable than would emerge from an unconstrained market. The challenge is to achieve the socially desired modification of the distribution of income with a minimum loss of economic output.

People place different value on the various distributional outcomes from policy intervention. The political process arbitrates among these differences in values. There is room for differences deriving from values about how far and precisely for whom to intervene in market processes to achieve a more equitable distribution.

There is no good reason for differences in values to lead to different views on the extent of intervention that is necessary for the efficient operation of the economy. On intervention for economic efficiency, the useful debate is about the actual effects of different policies.

So one set of interventions is justified by and necessary for effective economic performance. Another set of interventions is justified by and necessary for varying the income distribution from that which would emerge from an unrestrained market economy. Whatever their values, citizens share interests in efficient intervention to improve economic performance, and efficient distribution to achieve specified equity goals at the lowest possible cost.

Many of the dilemmas and contests over public policy arise because the most efficient paths to both equity and efficiency involve judgements about the optimal extent and nature of intervention.

Any intervention confers benefits upon some special business and other interests that are unintended for economic efficiency or equity. The beneficiaries of interventions seek to secure more of these interventions, whether or not more is justified by national economic or equity considerations. Similarly, interventions that are justified on efficiency and equity grounds damage some special interests, which seek to have less of them. Parties and individuals seeking political office undertake to provide more of the interventions that favour the special interests, and less of the interventions that damage them, in return for campaign funds and other support and favours. Special interests have strong incentives to enter the political process directly, to persuade influential elements of the polity or, less reliably, the community at large, that particular interventions are in the national interest or against the national interest on economic efficiency or equity grounds.

So the political process in a democracy is inevitably a contest between groups seeking efficient economic and equity interventions, and others seeking interventions to confer special benefits upon themselves or to avoid or constrain interventions that impose special costs on themselves. The special interests have powerful incentives to obscure the real effects of various interventions. Those seeking greater economic efficiency and equity have an interest in the links between policies and outcomes being well understood—in independent analysis, transparency and public education. The special interests are favoured by ignorance and the fog of politics.

The special interests have a large advantage in the concentration of benefits from particular interventions on a small number of recipients. The sectional beneficiaries of interventions know exactly who they are, and are prepared to invest a proportion of the gains from favourable interventions into securing them. Those seeking to advance the national interest are handicapped by the free rider constraints on collective action. None of the many diffuse beneficiaries of any particular act of good policy will have a strong interest in seeking good information on the effects of policy and persuading others of its merit.

It seems that the special interests have the stronger position in a democratic polity. That explains why good policy for economic efficiency and equity is the exception rather than the rule. It explains Australia's chronic underperformance through most of its history, and the early restoration now of the conditions for underperformance after a brief period of superior outcomes. It explains why correctable flaws in the global financial system were not corrected, and why a global financial crisis has for the time being crippled the greatest and most of the least of the developed capitalist democracies. It explains why our civilisation is at risk from a failure to limit growth in greenhouse gases, despite the science having been clear enough on the balance of probabilities for a considerable time.

Political leaders and parties can associate themselves with national interest objectives, or align themselves with special interests. If they align with special interests, they can catch a ride on the advantage that concentrations of capital have in marketing a distorted perception of the national interest. These opportunities expand with sophisticated modern analysis of opinion and influence.

The vested interests have large advantages, but they don't hold all the cards.

The big card in the hand of the public interest is the community's capacity and tendency to respond to leadership. An able leader's articulation of his or her conception of the national interest can elicit powerful responses, capable of overcoming loyalty to private interests, and of swamping the appeals to perceptions of the national interest that have been distorted by sectional interests. Of course, the human capacity to be led can be used for good or ill; Lincoln in his Inaugural Address referred to leaders' opportunity to speak to the better angels within us, while leaving unspoken the gruesome alternative that was soon to consume the peace of his country. Strong leadership is powerful when used for good or ill. Humanity's capacity to be led is the essential reason why human civilisation achieved its unlikely partial ascent from barbarism over these last ten thousand years, and why civilisation has mostly flourished within the special opportunities of democratic capitalism in modern times.

Within a democratic polity, a leader's opportunity to appeal to a sound conception of the public interest depends on having champions of good policy in an independent centre of the polity. At various times in history and in different countries, the independent centre is stronger or weaker depending on a variety of influences that lie beyond this presentation. The independent centre cannot exist unless there are academic and other centres of policy analysis, media and mass communications that are funded independently of interest groups. Public institutions can play a role in expanding the independent centre, including an independent public service, and public organisations established specifically to undertake transparent independent analysis and public education on policy proposals. On the latter, the Australian Productivity Commission and its role in the analysis of the effects of protection is an outstanding example.

Political parties and leaders always need to be seen as appealing to the national interest. A healthy and productive independent centre of the policy process creates opportunities for leaders to appeal to a genuine national interest, rather than to a perception created by investment in influence by special interests.

The outcome of the struggle between the national interest and special interests determines the prosperity, and in the end the security and longevity of the national community. The prospects for policies in the national interest and for stable outcomes once adopted are shaped by the quality and strength of leadership. Good outcomes are unlikely without effective, strong and clear-headed leadership, drawing support from an informed electorate.

Now for some Australian political and economic history.

The policies through which the economic dimension of the Deakinite tradition was expressed dominated Australian national life through the first eighty years of our Federation. They were subject to much debate in the early years. I recall the creative Australian economist Colin Clark commenting not long before his death in 1989, that his older and overlapping contemporary Alfred Deakin "...was everything that I abhor: an irrigationist, an immigrationist, a protectionist and a prohibitionist". In these days of focus on how women will use their votes in the 2010 election, it is interesting to reflect on how the early female franchise in Australia raised the profile of prohibition, as did the later female vote in the United States in the 1920s. The sense of moderation and tolerance in Deakinite Australian political culture meant that we did not attempt prohibition. Within a less tolerant political culture, the United States tried and failed.

Successful policies always set in train changes that, over time, undermine the foundations for their own success. My own views on the long-term consequences of the Deakinite settlement in Australia are well known; that the approach to reconciling the perspectives and interests of capital and labour in Victoria and then Australia was damaging to Australian development. But the approach was politically successful for an extraordinarily long time. Over time, protection, interventionist industrial relations and heavy reliance on state enterprise in delivering services, however mixed their early effects, changed economic and political behaviour in ways that contributed to substantial declines in Australian economic performance relative to all other developed countries except New Zealand. Once comprehensive intervention by Government in the market economy had been accepted on national interest grounds, the seeking of Government preferment, and investment to influence Government policy, became central to the business of business. By the early 1980s, a major policy reorientation was required which, in turn, needed a sharp break with a political culture that had been distorted grotesquely from its Deakinite origins. Policy change required the elevation of processes that allowed considered concern for the national interest to compete in the political process with union and vested business interests.

From 1983, the Hawke Government implemented fundamentally different and non-Deakinite policies within what could be seen as a restored Deakinite political culture. The new political culture involved a commitment to applying analysis and knowledge to define optimal policies to meet objectives; to communicating on proposed policies and the reasons for them with affected interests and the community, with a view to absorbing legitimate perspectives and to dulling the force of residual opposition to change; to educating the community on the main issues, so as to provide an electoral buffer against the disinformation of sectoral interests; and to avoiding unnecessary surprises and disruption by planning for change to be gradual where this did not defeat the purpose of the policy. Within this changed political culture, a major part was played by the commentary of informed analysts with acknowledged credentials in the media, academia and “think tanks” that were independent of particular business and political interests. To exercise influence, organised business and the trade unions had to frame their pressures on the policy process transparently within a sophisticated conception of the public interest.

So from 1983, there was a comprehensive change in the way in which policy was made in Australia, away from the dominance of discrete rent-seeking pressures from business and its relations with Government, towards transparent analysis and discussion of the national interest in policy. The productivity-enhancing reforms of this period under the Hawke, Keating and early Howard Governments are well known.

By the turn of the millennium, the more flexible Australian economy that had emerged from seventeen years of reform had experienced the longest, and relative to other developed countries the strongest, economic expansion in Australian history. Whereas Australia in the first eight decades of its federation had been the poorest performer in productivity growth and rising living standards of all the countries that are now developed, in the 1990s it was at the top of the productivity growth league. By now, 2010, the more flexible Australian economy has delivered the longest economic expansion without recession not only ever in Australia—that milestone was passed a long time ago—but in any developed country.

It might be expected that the way that restoration of a public interest-focussed political culture and comprehensively changed policy were reflected in greatly enhanced economic performance and prosperity would entrench the new approaches for a considerable period. No doubt success would set in train new changes in political culture and institutions that would themselves one day require dry-docking, when the slow accumulation of barnacles had passed a critical point. But for the time being and for the foreseeable future, the main task would be to extend policy reform within the post-1983 tradition, to the neglected corners of Australian policy.

The expectation that success would entrench the policies and political culture from which it had grown was an unspoken premise of my opening address in 2002, to the first of the Melbourne Institute—The Australian conference series on the Australian economic and social outlook (Garnaut, 2002). The expectation was false. Looking back with embarrassment at my naivety, that lecture more or less marks the dividing line between the era of reform, and the current era—the Great Australian Complacency of the Early Twenty First Century.

There has been no successful major step in productivity-raising reform since the tax changes associated with the introduction of the GST in 2001. Even the GST reform had a large and at the time obscure downside for productivity growth. It was a perfectly understandable downside, arising out of the Federal Opposition's persistent and forceful rejection of the reform. Understandable, but appallingly costly. To win the support of the States, the Commonwealth made the whole of the proceeds of the GST available to the States and Territories. But not to the States and Territories in which the tax was collected. Rather, to win the support of the majority of States and Territories—not Victoria, where Premier Kennett was a believer and supporter and sought no parochial favour, nor New South Wales, where the Coalition Commonwealth Government could afford to sidestep one dissentient Labor voice--the proceeds were to be allocated according to the formulae of the Commonwealth Grants Commission. They were therefore to be allocated within the Commission's arcane formulae on horizontal fiscal equalisation, compounding an impediment to rational financial management, and favouring the smaller States. That was before the China-led resources boom shifted Queensland and Western Australia from the recipient to the donor column of fiscal equalisation. What had been a minor idiosyncrasy became a central part of the Australian fiscal system, profoundly affecting incentives for sound financial management in the Federation. This and the continuing tendency of tied grants from the Commonwealth to turn State into joint powers removed exclusive State and Territory responsibility for all of the main State functions. The blurring of responsibility was a major barrier to improved performance in all of the areas that have turned out to be crucial to the outstanding agenda of productivity-raising reform—transport infrastructure, resources taxation, education and health. In these areas, no-one within the Australian Federal system is unambiguously in charge—and no-one will ever be unambiguously in charge without fundamental reform of Federal fiscal arrangements.

Economic policy since the GST has been characterised by change rather than productivity-raising reform. The use of independent analysis and transparent discussion of policy reform has become rare; when independent studies have been commissioned by Government, they have tended to be sidelined at the decision-making end of policy-making; and the capture of major economic policy decisions by short-term political processes and operatives has become endemic.

Since 2002, there have been some major policy changes with ambiguous or negative effects on Australian productivity and incomes. Australian leadership of an historic Asia Pacific shift from multilateral to preferential trade, led by the US-Australia free trade agreement, is an example. The serious damage to the terms of Australian access to regional agricultural markets is a predictable consequence of the corrosion of multilateral trade. These and other costs of change were obscured from public view by flawed analysis and process at the time when critical decisions were made.

There are some examples of attempts at major reform that had the potential to raise productivity and incomes, but failed comprehensively, and poisoned the soil for further reform for a considerable while. Industrial relations changes under the rubric of work choices, and the Henry Tax Review’s proposals on tax reform and the resources super profits tax are the most important among them. Both proposed reforms contained important flaws, which expanded their vulnerability to fierce attack from and slaughter by sectional interests. We actually need carefully analysed reform of the industrial relations and resources tax systems. The dreadful dilemmas of economic policy in the period ahead, discussed later in this Oration, would be eased by sound reform in these areas. Is there now any chance, after the botched attempts at reform of recent times?

It has been recognised for at least the past decade that weaknesses in the provision of transport and other infrastructure are major drags on Australian economic performance. These matters are constitutionally within the responsibility of the States, but have been rendered joint responsibilities by developments within Federal-State financial relations. Actions to correct weaknesses have been small and piecemeal, without comprehensive, transparent, independent analysis of the range of alternatives. Effective action is held back because no level of Government is unambiguously in charge of the massive sustained effort that is required. Those steps that have been taken have been highly politicised and correspondingly ineffective. The capacity of transport infrastructure has grown less rapidly than the demand for it. In a breathtaking side-stepping of responsibility, the leaderships of both major political parties have turned a failure of leadership on transport infrastructure into what is purported to be a fundamental change in Australian population and immigration policy. The change has large implications for but has been accompanied by no analysis of economic growth and incomes.

Health services are a huge and growing component of the national economy. In Australia, these are funded to a high degree through the public sector. The efficiency with which services are provided is therefore important both to the future Australian standard of living, and to the public finances. Health services warrant close policy focus and received it early in 2010; the productivity-raising consequences of that attention are not yet obvious, and the ambiguity in policy responsibility between Federal and State governments remains a drag on good policy.

Improvements in education and training policy have been properly identified as a potential source of productivity growth, especially by the current Government. Some steps have been taken in the right direction. Sadly, any small contribution from improvements so far in education policy will not affect the national productivity numbers in significant ways for at least a couple of decades.

There has been little substantial reference to productivity growth even of a hortatory or rhetorical kind by Australian Governments over the past decade of stagnating and then declining productivity. A major Prime Ministerial speech on the need for action to promote productivity growth in January 2010 stands out as an exception. Its only steady echo since then—not trivial, but lonely—has been the Minister for Competition Policy and Consumer Affairs' consistent advocacy of competitive markets. Neither leader has referred audibly to the need to correct long-term stagnation in Australian productivity during the current election campaign. The Prime Minister Gillard made welcome reference to the productivity challenge in a National Press Club speech during the current election campaign; that was buried comprehensively by a question from Laurie Oakes about the Prime Minister's ascension to office.

The polls say that there is a considerable chance of a change of Government on August 21. We do not know even whether the Opposition knows that Australia has a longstanding productivity problem, let alone what it would do to resolve it.

Alongside the vacuum on productivity-raising reform, there have been successes in macro-economic policy. Avoiding recession through the United States "tech wreck" of the early years of the century, and more impressively through the Great Crash of 2008 and its aftermath, required astute adjustment of fiscal and monetary policy. While success built on the new institutions and enhanced flexibility from late twentieth century reform, the macro-economic dimensions of the twenty first century interventions were of high quality. In each case, the adjustments were implemented with little regard for opportunities to achieve an additional product through lasting productivity improvements.

How do we reconcile the continued growth of the Australian economy through the first decade of the twenty first century, with the evidence that something has gone wrong with our political culture and economic policy? In truth, it is only the first half of the past two decades of strong economic performance in which productivity-raising reform contributed to Australian prosperity.

The exceptional prosperity of the past two decades can be divided into three parts. Through the 1990s, Australian productivity growth on the back of post-1983 reforms was the highest of the developed countries, after our country had been a chronic underperformer through the first eighty years of the twentieth century. This delivered sustainable increases in living standards.

Productivity growth slowed in the early twenty first century, and soon stopped. To use an economists' term, total factor productivity has actually gone backwards since 2005. However, output, employment and average incomes continued to increase through the early years of the century. Productivity was replaced as the engine of growth by a huge expansion of housing and consumption, supported by increasing bank debt. The banks funded their increased lending by borrowing from foreign wholesale markets to a degree that is unprecedented in Australia or in any other country. The other side of the coin to the housing and consumption boom was the emergence of a current account deficit that was unusual even by high Australian standards. I argued in 2004 and 2005 that this was unsustainable—Australians were spending well above their sustainable means. Sooner or later, some tightening of international credit markets would place constraints on Australian borrowers, even if prudence had not caused earlier adjustment by the borrowers themselves. In the event, what would have been earlier recessionary consequences of the deflating of the housing and consumption boom were avoided by the China-led resources boom.

Jumping forward three years, the collapse of global wholesale markets in the Great Crash of 2008 demonstrated that growth based on debt-funded housing and consumption certainly was not sustainable. The banks survived through the timely provision of an Australian Government guarantee to wholesale borrowing in October 2008—eventually accumulating to today's $157 billion of contingent liabilities. One legacy is moral hazard, with the banks now expecting that they would be bailed out in any future failure of global credit markets, and therefore facing weaker pressures than ever before for prudent management of their liabilities. The moral hazard increases the chances that the guarantee will be called again, in circumstances when it may be more costly to provide than in 2008-10.

Without productivity growth, there can be no reliably sustainable increases in the material standard of living. Neither is there scope for increases in the material standard of living from another debt-financed housing and consumption boom.

Nor is there likely to be additional scope for increased incomes per head from the resources boom. China and the large developing countries are likely to keep growing strongly. However, the expansion of productive capacity in Australia and increasingly in many other countries will, over time, bring down the terms of trade, and reduce the rate of growth of Australian resources investment. The contribution of the resources boom to growth in Australian incomes is likely to be at a peak in 2010.

Australians face hard economic policy choices in the period ahead. Not since the 1930s have Australians faced such tight constraints on growth in living standards, and such high risks of instability and rising unemployment if the constraints are seriously breached.

Meanwhile, the exceptional strength of the resources sector has forced structural change through other parts of the economy that further compounds the difficulties of maintaining economic stability and incomes while sustaining the Australian standard of living.

In the world after the global financial crisis in which our total access to global financial markets is limited, a much higher proportion of the available investment capital is being absorbed by our most capital-intensive sector—the resources sector. This reduces capital available to more labour-intensive activities, in services, manufacturing and agriculture. Standard economics, embodied in what is known as Rybczinski's theorem, tells us that, in these circumstances, real wages may need to decline to maintain full employment. The required decline in real wages is greater the more the capital-intensive resources sector expands. These relationships are affected by taxation arrangements in the resources relative to other sectors.

This "Rybczinski effect" is separate from and compounds the negative effects of strong export growth in the resources sector on the services, rural and manufactures industries through upward pressure on the real exchange rate. This "Gregory Effect" or "Dutch Disease" could create difficulties when the resources sector ceases to be a strong source of growth.

These considerations together suggest that tight constraint on all expenditure is going to be necessary for the foreseeable future. Real wages will need to be constrained tightly if full employment is to be maintained through these tight limits on expenditure. These should be matters of careful analysis and discussion, as a basis for sound policy in the national interest.

In the period ahead, any unnecessary waste or inefficiency in any area of policy probably does not mean a lower rate of growth of living standards. It probably means decline in living standards.

Within this stringent outlook, we must face the probable accumulation of climate change costs, gaining force over time in the absence of effective mitigation The odds can be improved to an extent that most Australians would find acceptable only if we begin now to contribute our proportionate share to an ambitious global mitigation effort.

Climate change mitigation will be cheaper than climate change.

It was a conclusion of the Garnaut Climate Change Review that I presented to Prime Minister Rudd and the State Premiers two years ago, that effective mitigation of the effects of climate change need only deduct one to two tenths of a percentage point per annum from the growth in Australian living standards over the next four decades. After that, the gains from avoided climate change are likely to outweigh additional costs of mitigation.

Without effective mitigation, Australian economic growth would probably be damaged over time by an amount that exceeds the costs of mitigation when appropriate discount rates are applied to future costs and benefits, even if only easily measureable effects this century are taken into account. It is possible that catastrophic outcomes would terminate the era of global and Australian economic growth. Probably, and not with certainty, because the science acknowledges uncertainties in the climate impacts. But the uncertainties encompass the possibility of much worse as well as more benign outcomes. The uncertainties therefore add to the extent and urgency of the mitigation response that is warranted.

The Review discusses in elaborate detail how human scientific, technological, economic and public policy wisdom could break the nexus between economic growth and environmental degradation at manageable short and medium term cost. Australia alone could not solve the problem. But there would be no global solution to the problem without Australia playing its proportionate part. .

The expected future costs of Australia making its proportionate contribution to a strong global mitigation effort have now risen above the levels anticipated in the Review as a result of delays that have already occurred, the uncertainty about climate change policy, and the adoption by Opposition and Government of a number of particularly costly instruments of mitigation. Every year of delay, and every addition to the array of sub-optimal policy interventions, is an additional deduction from a tightly constrained Australian standard of living. The Government speaks of a possibility of considering a shift to less costly and more effective policies during the next Parliament. The Opposition promises unambiguous commitment to costly and less effective policies.

It was never going to be easy. As I said in the Introduction to the Climate Change Review (pxviii), climate change is a diabolical public policy problem. It is harder than any other issue of high importance that has come before our polity in living memory. I noted then, in September 2008, that daily debate in Australia and elsewhere suggests that this issue might be too hard for rational policy making: the issues are too complex; the special interests too numerous, powerful and intense; the time frames within which effects of mitigation become evident too long; and the time frames within which action must be taken too short.

And yet there is a saving grace that may make all the difference (Garnaut, 2008, ppxviii-xix). There is a much stronger base of support for reform and change on this issue than on any other big question of structural change with which the Australian polity has come to grips in recent decades, including trade, tax and public business ownership reform. People in other countries, to varying degrees, seem to share Australian interest in and preparedness to take action on global warming.

The saving grace turns out to be powerful. Despite the abandonment of effective approaches to mitigation by both major parties, and the comprehensive disappearance now for two thirds of a year of leadership on climate change policy from either side of Australian politics, a large majority of Australians wants an Emissions Trading Scheme. When the pollsters tell interviewees honestly that there will be an increase in energy costs and that receipts from sale of permits will cover the cost of price increases for people on low incomes, support rises to higher levels. (Here we need explicitly to reject as unprofessional, the outcomes of surveys of opinion that refer to increases in costs as a result of carbon pricing, but which make no reference to the use of associated increases in Government revenue, for example for adjustments to social security and taxation for low-income families).

There has never been a structural reform issue offering itself so positively to effective political leadership.

Internationally, alongside the diplomatic fiasco at Copenhagen last December, most of the large developing countries committed themselves to strong action to reduce emissions below business-as-usual within the Copenhagen Accord. China matters most, and its commitments under the Copenhagen Accord go further than the Garnaut Climate Change Review assessed as its proportionate share of a strong global mitigation agreement.

True, the structure of the Copenhagen Accord varies greatly from that which Australians, including myself, had in mind. But there is an international agreement, and a potentially important one. Australia stands out for the weakness of its unconditional commitments under that agreement. There is a basis in the Copenhagen Accord for Australia going much further than its unconditional 5 percent, but no signs of Australia doing so.

Worst of all, neither of the major political parties has committed itself to policies that can get us anywhere near even the unconditional commitment to 5 percent reduction from 2000 levels by 2020. The small reductions in emissions that would come from announced policies would be achieved at extremely high cost.

Australia will be called by the international community to meet its 5 percent unconditional target and to do much more.

The Climate Change Review sketched some of the links between climate change and the China-led resources boom (Garnaut, 2008, ppxx-xxi). It was the sustained strong growth of China and other Asian developing countries in the early twenty first century that gave us an opportunity for restoration of much of the superior income levels amongst developed countries that Australians had enjoyed in the early years of our Federation. Much of the expanded export opportunity in the resources boom was in fossil fuels, especially in emissions-intensive coal.

The China-led global resources boom was one half of the cause of Australia's exceptional prosperity of the early twenty first century. It was also the cause of an acceleration in the "business as usual" growth in greenhouse gas emissions, to rates far in excess of the expectations embodied in the climate change projections of the International Panel on Climate Change. "For Australia", the Review noted, "the commitment to the mitigation of climate change can be seen as the reinvestment of a part of the immense gains that have come from accelerated Asian economic growth, in contributing to reduction of an adverse side-effect of that growth". To the rest of the world, much of which is paying for our resources boom with higher import prices, this makes the retarded nature of the Australian response a puzzle, and sometimes a source of resentment

We face great challenges on economic and climate change policy, but find ourselves in a weak position to deal with them. Delayed or inadequate action on climate change would make a hard economic policy problem much harder.

The position on climate change is weak only because of an extraordinary failure of leadership. The failure is a product and represents the nadir of the early twenty first century political culture, in which short-term politics and accession to sectional pressures has held sway over leadership and analysis of the national interest. Those political advisers who turned out to have greatest influence over former Prime Minister Rudd weighed undoubtedly strong resistance from special interest groups, and inchoate reactions from partially informed members of the community, above more fundamental determinants of political success. They played down the unusual reality of majority support for a measure involving major structural change in the economy. More fundamentally, they ignored the crucial respect for and role of leadership in the democratic process. In accepting their advice, Kevin Rudd abdicated the leadership of Australia, and set the scene for the destruction of his Prime Ministership.

More curiously, given the Rudd experience, is the acceptance of similar advice from the same advisers by the new and current Prime Minister, Julia Gillard. The statement on climate change policy on Friday 23 July has precipitated a collapse of political support that is reminiscent of the Rudd abdication. We will learn between now and August 21 whether the 23 July statement was a first or final draft of pre-election climate change policy. We will learn on 21 August whether, first or final draft, that was a second statement of leadership abdication.

The essential elements of climate policy have been much discussed in Australia, are surprisingly well understood, and have widespread support despite the absence of leadership from the major political parties. The required policy also faces strong resistance from special interests. These are circumstances when the polity's characteristic response to leadership could be decisive.

The required climate change policy has two elements. The first is placing an adequate price on greenhouse gas emissions through an Emissions Trading Scheme or a carbon tax—or, as an interim measure, establishing the framework of an Emissions Trading Scheme with a fixed price for emissions permits pending the emergence of a framework for international trade in emissions entitlements. The second is applying a substantial part of the revenue from selling emissions permits or from a carbon tax to support research, development and commercialisation of new low-emissions technologies—to the extent possible, in a technologically neutral way. There is room for further discussion about the details of the two elements of policy, in the process of defining and building support for the way forward. There is no need for further discussion of the central elements of policy.

The required refocussing of economic policy is fundamentally more difficult, because there is no saving grace of community interest and support. It will be rendered more difficult still by any delay or flawed execution of climate change mitigation policy.

The Australian community has been given some indication of the constraint on growth in living standards that will be required for the foreseeable future in the Government's commitment to the 2 percent per annum—roughly zero per capita in real terms—limit on Commonwealth expenditure growth. The commitment is harder still when we recognise some of the realities requiring Government expenditure outside the ways that contribute to the material standard of living—security expenditure in a time of war; the restoration of public debt service payments as a charge on the budget; and the expanding medical and other costs of an ageing population.. The indication of the need for restraint that is provided by the 2 percent limit draws attention to a large gap between what will be necessary for economic stability and acceptably full employment in the period ahead, and community expectations for continuing increases in living standards.

The big lift in Australian living standards over the past two decades—wage and salary increases, and the fairly indiscriminate tax cuts and increased expenditure on services and social security in the early twenty first century—provides scope for adjustment without hardship. But who is ready for such adjustment and restraint?

Through timely economic reform over the last part of the twentieth century, Australia caught the tide of the China-led expansion of opportunity of the early twenty first century. On that full tide we are now afloat.

It is time now to take on the necessary ballast for staying afloat as we move forward into new and more turbulent seas.

Meeting the two large challenges ahead of us requires the restoration of the political culture of the reform period. It requires the rehabilitation of the independent centre of the Australian polity. It requires restoration of the role of transparent, independent authoritative analysis of policy issues, and public education on the results of sound analysis.

The laws of economics cannot be repealed by ignoring them—any more than the laws of gravity, or of climate science.

Independent analysis may discover truly awful choices; better to face them in knowledge, than to choose blindly under pressure from interests that know their sectoral implications.

Good outcomes in the difficult years ahead above all require firm leadership built around clear articulation of the public interest.

Leadership, transparent independent analysis and public education are the means through which sectional interests will be confined appropriately to legitimate supporting roles, rather than being given central roles in formulation of public policy in the national interest.

Leadership is an essential missing ingredient in contemporary public policy.

Omitted, all the voyage of our lives is bound in shallows and in miseries.

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