

## PROFESSOR ROSS GARNAUT TRANSCRIPT OF COMMENTS ON THE IMPLICATIONS OF THE FINANCIAL CRISIS FOR CLIMATE CHANGE MITIGATION

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In October 2008, one question is on everyone's mind when we think – I suppose today as much as any time over the last month – about the implementation of global warming mitigation policies. That question is what difference does the unprecedented financial crisis of September and October 2008 make?

I would say first of all in answering this question, that we need to begin by noting that this is not a matter of choosing the environment over the economy or the economy over the environment. I hope I can say that it's reflected in the report, that the issue of climate change is an economic issue. Certainly, climate change is a major environmental issue and if you are just weighing things on their environmental value, there are very big reasons to take them seriously and take action. But separately from the environment issue, it is a big economic issue. Here, the issue is one of short-term economics versus long-term economics, because the economic costs of unmitigated climate change, on the balance of probabilities, will be very, very high.

When we reflect upon the choice between short-term economics and long-term economics, we should think a little bit about how we got into the current financial mess – 'we' being the world. We are here because the world focussed for too long on short-term economics.

Will the financial crisis make mitigation genuinely less urgent, by slowing growth in economic activity and therefore energy use and emissions?

Will it reduce commitment or capacity to sustain economic costs to reduce emissions?

Will it reduce the chances of strong mitigation in major countries and of a global agreement?

My first observation is that the acceleration of economic growth in China and other major developing countries that has made early and strong mitigation more urgent has deep foundations. Those foundations will not be knocked off course by the current financial crisis.

It is still possible of course that the recessionary effects of the financial crisis could interact with weaknesses in social and economic institutions to generate much more severe consequences for growth. Failing those still avoidable outcomes, the "business as usual" trajectory of emissions growth beyond this year and next is likely to much the same as anticipated in my Review.

Something changed in the world in the late 20th and the early 21st century: the beneficent processes of modern economic growth that had brought such richness to the lives of people in a small part of humanity, spread late last century into the populous countries of Asia. That spreading has deep roots and is going to continue.

A pause for a year or two in rapid emissions growth as a result of widespread recession in developed countries and temporarily lower growth in others would provide no more than a little breathing space—which may turn out to have been necessary for attainment of anything like announced mitigation objectives given the points from which we are starting in late 2008.

My second observation is that financial crises, however severe, are short term phenomena. The current crisis, whatever costs it comes to impose on the growth in living standards in many countries, will have run its course before leaders meet in Copenhagen late in 2009 to seek agreement on successor arrangements to those agreed for 2008-2012 in Kyoto in 1997. The crisis will have left a legacy of reduced wealth, incomes and possibly growth prospects, the extent of which will depend on the effectiveness of policy decisions that are still under consideration. But the financial crisis itself will have passed into history.

By contrast, climate change is a long-term structural issue. It is bad policy to allow the approach to important long-term structural issues to be determined by short term cyclical considerations. Moreover, if the financial crisis leaves a legacy of recession – again I’m talking about the world; I think that’s less likely in Australia – it is to be expected that normal patterns of growth will have been re-established by 2013, at the time at which arrangements agreed at Copenhagen are being applied. The period of accelerated growth out of recession, would turn out to be a favourable time to implement policies involving major investment in new technologies, involving considerable structural change.

So the financial crisis does not materially reduce the magnitude or urgency of the mitigation task. Nor does it create a sound reason for delaying mitigation.

There is, however, another question from the financial crisis. Whatever the economic realities, will the post-crisis political environment cause the priority of the mitigation challenge to be downgraded, and therefore delay progress in national policies and international agreement? It may. That will depend on the quality of leadership in many countries. The quality of leadership in Australia will not be irrelevant to the global outcome. But there is no doubt that the period ahead in Australia will be difficult for incomes, and that this will affect willingness to forego some current income for long-term gain, as is required for climate change mitigation.

In Australia, the fall in global economic activity associated with the financial crisis will be responsible for a sharp fall in the terms of trade. The boom in commodity prices associated with exceptional global economic growth in the early twenty-first century up to the third quarter of this year lifted Australia’s terms of trade by two thirds. This raised average Australian incomes by an eighth, and greatly increased revenues of Australian Federal and State Governments. Just through the rest of the world paying us more for doing the same things, we became one-eighth richer.

The modelling that we in our Review did with the Australian Treasury, anticipated that a major part of this improvement in the terms of trade would unwind over a number of years, as global supplies of resource-intensive products rose in response to high prices and profitability. You will see in the modelling results, that this would cause average annual growth in GDP – our output – to 2020 to be substantially above the growth in our income. We’ve been through a period in which the growth in our incomes has been much stronger than the growth of our output. Well, we anticipate in the modelling that over a number of years, our output will grow much more strongly than our income, because the supply increases would bring prices down.

The cost to Australian incomes of the fall in the terms of trade from the high levels of mid-2008, to above historical average levels in a decade’s time, was projected in the analysis in the book, to be substantially above the costs of the most ambitious greenhouse gas mitigation trajectories analysed by the Review. It now looks likely that the return of Australia’s terms of trade to levels that, while historically high, are much lower than mid-2008 levels, will now be compressed into a relatively short period. Much of the fall in the terms of trade from the giddy heights of the third quarter of 2008 will now occur over the next year or so.

During this period, Australian incomes and government budgets will be under great pressure even if, as is possible and with good management likely, Australia avoids the recession that will probably engulf most of the developed world.

This will make Australian participation in the global mitigation effort more dependent than ever on the selection of the most efficient—the lowest cost – mitigation policies and institutions. My Review gives close attention to identification of these policies and institutions, around the central policy of an efficient emissions trading system.

To sum up on the effects of the financial crisis on the prospects for climate change mitigation, I would stress that, climate change is a long-term issue but an urgent issue. It will still be here tomorrow, but our chance of dealing with it may not.