2. Economic Growth and Wellbeing: Ian Castles' Contribution

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Personal connections and reflections

Ian's path and mine first crossed almost 50 years ago in the early 1960s. I had been seconded from the then Bureau of Census and Statistics to work on some of the Treasury submissions to the Vernon Committee. This committee had been established to advise on the future development of economic policy, following the almost defeat of the Menzies government in 1961. At the time all of Treasury, which then included today's Finance Department, the Tax Head Office, and most of the Statistics Bureau, was located in West Block. Clearly government was smaller then. Now each of these agencies and departments occupy much bigger buildings on their own.

Part of the reason for the increase in the size of the bureaucracy, especially in Canberra, is the increase in the amount of information and the analysis of that information. Perhaps in our discussions we should take time to consider whether all this information and analysis has made government more effective or efficient; or perhaps more pertinently, what changes are needed to ensure that the information contributes to more effective and efficient government?

The small size of government in those days made it easier to know people across different but related agencies. Also, junior officers, such as I then was, could participate in drafting quite important papers, and work almost directly to very senior people. I don't recall that Ian was working on the Treasury submissions for the Vernon Committee, or at least not on the same ones as me, but I think he was asked to comment on the submissions I was engaged upon. I remember at the time taking this as an indication of the very high regard in which Ian was held.

A decade or so later Ian and I first started working directly together when, after the demise of the Whitlam Government, he asked me to join the Income Security Review, which he was chairing, as his deputy. Andrew Podger spoke at some length about the work of this review at a similar function last year, and I will not repeat what he had to say then, especially as, unlike Andrew, I did not stay long with the review but instead returned to Paris.

However, a bit over two years later Ian was instrumental in my decision to return to Australia and to take up a position in PM&C where Ian was a deputy secretary. Shortly after Ian left PM&C to become secretary of the Department of Finance. However, we kept in close touch and I joined Ian three years later as his deputy in Finance in early 1982. In short I believe I owe Ian an enormous debt, as he effectively had a very considerable influence over my career at certain critical points.

All of us who worked with Ian will remember his considerable intellect. Ian was one of the most clear-thinking and logical people I have ever met, with a deep concern for the facts and their proper interpretation. As became even clearer after he left the public service, Ian anguished when facts were distorted or numbers were manipulated in the pursuit of some pre-determined objective, no matter how worthy.

Perhaps equally important during Ian's time as a policy adviser, were his outstanding communication skills, and his ability to engage with ministers. But while Ian was a highly influential public servant, he was in no sense a political public servant. On all the issues on which I worked closely with Ian, I never had any sense that he was committed to achieving a particular policy agenda. Rather he was committed to good policy process where information was properly assessed. What concerned Ian was the misuse of information, and the failure to recognise and address competing objectives. Ian was acutely aware that good policy advice must address the inevitable trade-offs involved, and in this respect the intellectual tradition of economics is or at least should be especially useful.

I believe it was for these reasons that Ian was held in such high regard by governments of both political persuasions. It was also because of these attitudes, combined with his previous experience, that Ian was able to make such an important contribution to the work of the Australian Bureau of Statistics (ABS) as chief statistician.

What I would now like to do is to spend a little time outlining some of the contributions Ian made to our understanding of economic growth and wellbeing. My hope is that this will provide a useful background for our discussions, and accordingly I have grouped my remarks to correspond roughly with the program sessions.

Economic growth – is it important?

A large part of Ian's professional career was spent thinking and writing about economic growth and its measurement. The first significant piece that I am aware of was the Treasury Economic Paper, published in 1973, titled *Economic Growth: Is it Worth Having?*, and I believe that Ian was the principal author.

At that time economic growth was under challenge with concerns about exponential population growth, that the world would run out of non-renewable resources, and that the 'blind pursuit of growth' would cause environmental crises – sound familiar? A widely publicised report, *The Limits to Growth,* had been published a year earlier in 1972 by an organisation called The Club of Rome, and that report concluded that there was an urgent need to bring about a deliberate, controlled end to growth.

I think it is fair to say that Ian's Treasury paper was partly a response, directed to reassessing the objective of economic growth in the light of these changes in attitudes and criticisms. Having regard to our discussions there are a number of key points in the paper that I would like to highlight.

First, as Ian frequently emphasised, economists have never claimed that the measure of GDP covered all aspects of welfare or wellbeing. Nor have they ever urged that economic growth should be pursued for its own sake. Rather the Treasury paper concludes that economic growth 'is best conceived of not as an objective in its own right but as the likely *result* of policies directed to improving the lot of the community without using resources wastefully'. The paper then goes on to argue that the objective of economic and social policies should not be the achievement of any particular statistical rate of economic growth in the longer-run, but rather the efficient use of available resources to establish and maintain those patterns of production and distribution which conform most closely to the preferences of the community.

The Treasury paper suggests that much of the negative debate about economic growth originates in a confusion between economic growth and its statistical indicator – the increase in GDP at constant prices. The paper freely acknowledges that 'The trend in GDP at constant prices is not ... a comprehensive measure of changes in national wellbeing, or in progress (if any) towards the '"good life"'. Furthermore, the Treasury paper then goes on to discuss alternative ways for developing more comprehensive information which can supplement the consideration of wellbeing.

Nevertheless the Treasury paper does contend – correctly in my view – that 'estimates of 'real' GDP, are valuable – indeed essential – for some types of economic analysis'. Most importantly we need these estimates of economic activity if the authorities are to successfully intervene to ensure full employment and low inflation. In addition, the paper 'suggests that some of the objections which are said to be to economic growth are, in fact, objections to the prevailing pattern of growth – that is they are really arguments about priorities'.

While not all things can be valued by a market, in practice we ourselves and our governments do have to take account of such things as personal security, work satisfaction, good health, pleasant surroundings, recreation opportunities and so on when making our decisions. There are costs and benefits in each case, irrespective of whether the values are economic or non-economic, tangible or intangible, social, strategic, aesthetic or even environmental. As the Treasury paper puts it, 'all decisions *imply* a valuation of those effects which are difficult to quantify'. And in a sentence which very much reflects Ian's views, the paper suggests that 'The greater the effort to quantify and to make such judgements explicit, the more rational and consistent will the decision-making process become'.

Finally the Treasury paper concludes by putting forward 'the view that if what economic growth is all about is carefully examined, it seems to constitute the key to achieving many of the things going to make up the national wellbeing'. In this regard it is also of some interest that the OECD much more recently found that cross-country rankings of GDP per capita were generally similar to when GDP is extended to include leisure time, the sharing of income within households, and the effect of income distribution. Indeed, this has led to some to conclude that GDP per capita can serve as a reasonable proxy of overall wellbeing. But I think Ian would perhaps have been more cautious; he might have reminded us that there are other dimensions of wellbeing, and that more work would need to be done to fully establish this conclusion. Indeed the OECD study did not find any strong relation between survey-based data on happiness and life satisfaction and levels of GDP per capita across countries. Instead happiness and life satisfaction may depend more upon one's present living standard relative to the past and relative to one's neighbours.

Equality

I would now like to say a few words about equality, which is one dimension of wellbeing to which Ian contributed a lot both in terms of policy and our understanding.

Ian's approach to equality was perhaps distinctive by today's standards, as he insisted that there are in fact two dimensions to equality – there is both horizontal and vertical equality. Horizontal equity requires that individuals in similar positions be treated consistently in a similar manner, while vertical equity requires that individuals in different positions be treated in a consistently different manner so as to reduce the differences in their positions. There can be tensions between these two dimensions and one dimension is not necessarily more important than the other.

Last year Andrew Podger recalled how the Department of Finance never supported the means testing of family allowances while Ian was head of that Department. Ian had previously led the Income Security Review that persuaded the Fraser Government to adopt the system of family allowances, and he was very aware of that system's antecedents and rationale. I believe that Ian's opposition to means testing stemmed from his view that family allowances were derived from the tax system and should be considered as part of that tax system. In Ian's view income tax should be levied according to capacity to pay, and family allowances were a recognition that families with children had a lower capacity to pay than other taxpayers without children. In effect there would be a reduction in horizontal equity if family allowances, which were an offset to tax in recognition of reduced taxable capacity, were subsequently subject to taxation in the form of a means test.

Ian was also involved in many other policy changes that contributed to greater equity, but time does not permit me to go into detail tonight. I would, however, like to draw your attention to some of Ian's work as the head of the ABS, and how this led to improved understanding of distribution issues. In particular Ian pioneered fiscal incidence studies showing the distributional impact of taxes and government expenditure on household incomes. These studies helped inform policy about the effectiveness of government intervention to reduce the inequality of income distribution. Under Ian's direction the ABS also expanded the range of its social surveys and we now have a much better appreciation of how to interpret income distribution statistics and the variety of possible factors leading to inequality.

For example, in a paper that he wrote comparing the distribution of money incomes in Sweden and Australia, Ian showed that the proportion of aged income units was much higher in Sweden than in Australia at that time. As a consequence, for Sweden to achieve the same relative level of income support per aged person unit as in Australia the aggregate of net cash transfers to the Swedish aged population would need to have been almost twice as great relative to GDP. On the other hand Ian showed that the proportion of 'dependent' units in the working age population was much higher in Australia than in Sweden. Furthermore, 80 per cent of this much smaller dependent population of working age in Sweden were single people, whereas most of the dependent units in Australia were couples with or without children and single parents. This relatively high rate of dependency is probably one of the reasons why income distribution is less equal in Australia than in Sweden, and arguably those who want greater equality in Australia should focus on trying to improve employment participation rather than increasing the amount of welfare transfers.

In short, what Ian effectively did in this paper was to remind us of the sort of information that is relevant if we want to make meaningful international comparisons of welfare expenditure and the amount of income redistribution achieved.

Economic growth and the environment

A large part of Ian's work in his last years was directed towards trying to correct the distortions in much of the advocacy in favour of increased action to combat climate change. Personally I never had any sense that Ian was by conviction a climate change sceptic – that would have been completely out of character; Ian reached his conclusions by examining the evidence, not by conviction.

Indeed, Ian's original Treasury paper on economic growth, to which I referred earlier, clearly accepted some 40 years ago that economic growth has led to increasing pollution that 'could wreak death and destruction on a global scale'. The paper, however, argues that 'Pollution problems are mainly attributable not to economic growth *per se*, but to the economic conditions under which growth has been allowed to take place'. The paper acknowledges that 'the price charged for using environmental resources has been too low – in many cases zero. What is needed, therefore, is to equate the price charged for use of environmental resources with the cost of damage inflicted on society by using them'. In other words society needs to achieve a trade-off between legitimate, but competing objectives, using pricing and based on the best statistical information available.

What I believe upset Ian, however, was that too often the advocates of action to combat climate change did not use the best statistical information available. Instead, their analysis has too often manipulated the statistical evidence to achieve what seems to be a pre-determined conclusion. Ian's work was dedicated to trying to correct these mistakes.

Others here tonight are more qualified than I am to enlarge on Ian's criticisms, but I will try briefly to outline the main points that Ian sought to make.

First, and probably most importantly, Ian thought the projections by the Intergovernmental Panel on Climate Change (IPCC) of future world economic growth were way too high, and therefore their projections of future carbon emissions were correspondingly too high. Ian pointed out on numerous occasions that the IPCC economic projections have been derived by converting national GDPs in nominal values into a common currency using exchange rates. Instead, in line with international statistical practice, which Ian had played a major role in developing, the conversion to a common currency should have been done using estimates of purchasing power parity for different countries.

The use of exchange rates greatly exaggerated the gap between the per capita incomes in the rich countries relative to the developing countries. Thus as Ian pointed out, the IPCC found that in 1990 the relative average incomes in the rich countries were 40 times higher than in Asian developing countries and 12 times higher than the average of developing countries elsewhere. Whereas in fact Ian showed that, using PPPs, average incomes in developing countries are three or four times higher than the IPCC assumed.

Because this initial gap between the developed and developing countries was exaggerated this led the IPCC to project extraordinarily high rates of growth in the developing countries as part of their expected convergence towards the living standards in the rich countries over time. Indeed Ian showed that the IPCC projections reflected increases in per capita output by 2100 for most of the world's population of between 30 and 70 times the 1990 levels – rates of increase that are ridiculously high by any historical standards.

Second, by underestimating the present levels of per capita output in the developing countries the IPCC has grossly under-estimated their present energy efficiency. The high levels of energy consumption implied by the IPCC per each under-valued unit of consumption in the base year leads to further overestimation of future energy consumption in response to further economic growth. Indeed, Ian calculated that the ratio of energy use per unit of GDP in non-OECD countries to that in OECD countries was not the 3.8:1 found when using exchange rates as the conversion factor but instead only 1.2:1 using PPPs. In other words the non-OECD countries are three times more energy efficient relative to the OECD than the IPCC estimates suggest. Furthermore other estimates cited by Ian suggest that energy efficiency has been rapidly improving; thus in China, for example, emissions per unit of output by 2000 were less than half their levels of twenty years before.

As Ian described himself in his presentation to an IPCC expert meeting in Amsterdam in 2003, he was 'someone who is strongly committed to the application of sound scientific method in the social sciences no less than in the natural sciences'. What I think most upset Ian about his experience with the IPCC was the unwillingness to make the corrections that he was asking for, especially when he was led to believe that they would. Furthermore he had previously made the same criticisms of the UNDP's Human Development Index, and the UNDP had changed its procedures in response.

A third principal criticism that Ian had of the work of the IPCC was that instead of referring to their findings as projections, and conditional projections at that, the IPCC readily slipped into referring to these projections as predictions. This shift in language has helped to endow the IPCC findings with an authority that they really don't have; an authority that is further endorsed by the practice of referring all IPCC research to peer groups. In principle, peer-group review of research is most welcome and necessary, but in this case too many of the peer reviews seem to be drawn from the same disciplines as the researchers. Thus these peer reviews were not competent to review the work by Ian and his fellow economists, and appear not to have understood the devastating nature of Ian's criticisms for the overall standing of the IPCC. Instead of carefully responding to Ian and other like criticisms, the IPCC sought to dismiss the critics by labelling them as the 'originators of some disinformation'. I think these manifold faults with the IPCC process led Ian to the sad conclusion that 'the Panel's role in the assessment of the science of climate change has now become subservient to its role in supporting a specific policy agenda'.

Economists and anti-economists

Finally before concluding my remarks tonight I did want to say a few words about Ian's reverence for the intellectual forebears of economics. Ian was a willing biographer and I think it was no accident that much of his writing has provided us with a better appreciation of our intellectual inheritance – especially how our forebears formed their judgements and the nature of the problems they faced.

In the papers for the last session of this meeting you have been provided with copies of pen portraits by Ian describing the early efforts to compile summary statistics, the role of particular pioneers such as Colin Clark and Jevons, the leading people who contributed to the population debate which ran for most of 100 years, and the gradual shift towards a more scientific approach to economic analysis, first in universities in the inter-war years, but after the war led by Sir Roland Wilson in the Treasury. I am sure that Ian was proud of this Australian intellectual tradition, and he certainly played his part in keeping it alive and adding to it further.

Although Ian did not live long into the twenty-first century he was a model for twenty-first century man. Ian had a wide range of interests, a passion for libraries and was very well read. Above all he was committed to the role of economics in particular, and the social sciences more generally in improving policy discussions and analysis. But he fervently believed that this dialogue could be and must be based on a respect for scientific method. I consider myself fortunate to have worked closely with Ian, and I believe he very much provided a role model, both as an intellectual and as a senior adviser to governments.