

Letter from America —

On transatlantic vices, or Stern in America

In his latest Letter, Angus looks at the reception of the Stern Report in the USA and finds that it reveals a wide range of differences between the economics professions in America and the UK.

THE STERN REPORT on climate change (henceforth *Stern*) has sparked enormous debate in Britain and in much of the rest of the world, but has had a much smaller impact in the US. Although besieged by paparazzi lurking in the bushes of his Wimbledon house, courted by heads of state and national academies around the world, and decorated by universities with honorary degrees, *Stern* has a limited press in the US. The *New York Times* contained two brief factual reports at the time of publication, an editorial, and occasional discussions in the non-news sections; a search of the archives yields 12 hits in total. The *Wall St Journal*, predictably, was hostile. Congress has shown only sporadic interest in hearings, and, until recently, there has not been much debate among academic economists, whose reaction has been cool, arguing either that *Stern* is wrong, or that it is right, but for the wrong reasons.

The Bush administration's hostility to discussion of climate issues is certainly part of the story. The White House wields a formidable publicity machine that deeply affects both the choice of current topics and the tone in which they are debated. But both houses of Congress are controlled by Democrats, not Republicans, and the Democrats have not highlighted climate change as an issue over which to attack the administration. The leading American voice for action is Al Gore, whose book and film have received wide attention and visibility. (Gore's unwillingness to endorse a carbon tax has been a source of despair to those who would like to see sensible economics contribute to the solution. If the leading Democratic voice on climate change will not endorse a carbon tax, even when he is (to all appearances) not seeking immediate election, it is hard to see the measure ever being seriously debated in the US.) There is

certainly a heightened level of public concern over climate issues, though perhaps less than in Britain. In contrast to British Air, only one of the major US airlines (Delta) offers a carbon offset program. And in a 2006 Gallup Poll, 39 percent of Americans expressed dissatisfaction with the level of effort to preserve the environment, compared with 43 percent in Britain. But the American numbers are identical to those in France, where *Stern* is something of a national hero. So the comparative lack of attention to *Stern* in the US remains something of a mystery. Perhaps the American public, like most American economists, think that *Stern* is wrong.

Constructing a discount rate

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These differences are of long standing and in part reflect the political structures of the two countries. But I also believe that recent developments in macroeconomics have also been important.

The *Journal of Economic Literature* has just published two exceptionally fine reviews of *Stern* by William Nordhaus of Yale and Martin Weitzman of Harvard. They focus, as have many other commentators, on the central role of discounting, and particularly on the claim that it is *Stern's* low discount rates that drive his recommendations for large, prompt, and painful action. With the *Stern* discount rates, the avoidance of future harm, even very far in the future, is worth a substantial sacrifice of consumption now. The

correctness or otherwise of this conclusion is not my topic here, which is the way that the argument is conducted. *Stern* constructs his discount rate from first principles, assuming a rate of time preference that is close to zero; indeed, apart from the possibility of planetary extinction, it is zero. This, together with an assumption about inequality aversion and the extent to which future generations will be richer than we are (itself part of the modelling) provides the discount rate to be applied to projects that ameliorate global warming. (This is a simplification, because climate change cannot be regarded as a marginal project, but it will illustrate my point.) According to much of the American discussion, *Stern's* discount rates cannot be correct because market rates of return are much higher. Or in a related version of the same argument, the *Stern* configuration of discount rate and time preference cannot be right because we do not observe the rates of national saving that such rates would support, a point that has been made by several others, including Kenneth Arrow, perhaps the doyen of American public economics, who says that he was long ago persuaded on this issue by Tjalling Koopmans.

What do we owe to future generations?

Both Nordhaus and Weitzman express their discomfort with *Stern's* taking an explicit ethical position on what the current generation owes to those yet unborn, on the grounds that *Stern* has no right to impose an ethical position on others. Both Arrow and Weitzman believe that a zero rate of pure time preference, while defensible in theory, is typically only so defended by British economists and philosophers, a comment that is clearly not meant to be taken as any recognition of the superiority of British thinking. The paternalism of any such ethical judgment is certainly a concern, and it seems right to want a more democratic discussion and determination of the ethics of climate policy. But a judgment needs to be made on some basis, and Arrow, Weitzman, and Nordhaus argue that we can find at least some of the relevant evidence in markets, revealed by, as Weitzman writes, 'the preferences for present over future utility that people seem to exhibit in their everyday savings and investment behaviour.' Even if the markets do not reveal everything that we need to know about the present and the future, whatever ethical choices we make need to be consistent with market behaviour, because this shows how ordinary people think about these matters. So *Stern's* choices about the ethical parameters are wrong because market rates are higher than those with which he works. An even clearer statement is made by the mostly American (and all non-British) economists (Tom Schelling, Bob Fogel, Douglass North, Vernon Smith, Nancy Stokey, Jagdish Bhagwati, Justin Lin, and Bruno Frey) who signed on to the 'Copenhagen Consensus' statement that climate change was not worth addressing relative to the world's other problems. At the interest rates commonly prevailing in the bond market — and the group used a rate of 5 percent which Stokey, in her account of the process defends as 'a reasonable figure, falling within the

range of various market interest rates' — climate change is not a serious problem.

If zero discounting (with perhaps a touch of paternalism) is the British vice, the refusal to consider ethical questions explicitly but to leave them to the market is surely the American vice. How do the preferences of unborn generations get expressed in the bond market? Do we really want to discriminate across people by their date of birth? And do we really think that saving rates, whether by individuals or governments, are the results of optimal intertemporal planning by individuals, even over their own lives, let alone over those of their unknown descendants who will live as far in the future as King George III and George Washington lived in the past? Are we really entirely comfortable with the essentially arbitrary functional form assumptions that allow us to link risk aversion, intertemporal preferences, and the treatment of rich people versus poor people? The difficulties of matching market behaviour to any coherent normative model have only multiplied in recent years, as indeed is recognized by Weitzman. Whatever it is that is generating market behaviour, it is not the outcome of an infinitely lived and infinitely far-sighted representative agent whose market and moral behaviours are perfectly aligned, and who we can use as some sort of infallible guide to our own decisions and policies. The optimal savings and growth models that used to be taught in development courses as tools of central planning, along with careful explanations of why their solutions cannot be decentralized by the market — remember the transversality conditions? — are now routinely taught in macroeconomics courses as descriptively accurate accounts of the economy. According to some stories, the government does better, correcting our collective missteps, but is it really possible to seriously imagine that an administration that dismissed global warming without economic analysis is nevertheless making optimal provision for future generations? Zero pure time preference, if it is a vice, is surely a minor one. Relying on markets to teach us ethics is very much worse.

Sir Nicholas Stern

Sir Nicholas Stern is to give the RES Annual Public Lecture on

Climate Change, Ethics and the Economics of the Global Deal

in November. Further details are on p.23.