



***Address by Ai Group Chief Executive Heather Ridout
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The topic of this Focus Session ***Competitiveness and Economic Development*** goes to the heart of the dilemmas of climate policy: the complexity of tackling climate change while maintaining national competitiveness and without closing off the opportunities for economic growth both for developed and developing countries.

With the possible exception of trade policy, I cannot think of a more difficult and challenging policy area than climate policy. It is difficult for governments of course and it is difficult for the businesses whose responsibilities and interests we represent.

It is difficult not just because of the complex political and political economy challenges it presents. These challenges are often present in policy development. But with climate policy these challenges are compounded by the web of uncertainty that is intrinsic to this particular area.

Uncertainty is everywhere. There is uncertainty over measurement and projections of climate change; over the degree to which the accumulation of greenhouse gases is the cause of climate change; and over how much reducing emissions of greenhouse gases will ameliorate future climate change.

There is uncertainty over how the so-called "free rider" problem can be overcome in developing a concerted global effort to reducing emissions; over the impacts that emission reduction policies may have on the twin issues we are addressing in this session - competitiveness and economic development; and over whether effective policies can be put in place that avoid the hazards of using tariffs and other border adjustments to protect short-term national interests.

And finally, particularly for businesses in developed countries, there is the paralysing uncertainty that is currently hanging over investment decisions and business planning as our governments, individually and collectively, edge towards specific policy responses to climate change.

In many countries, though not in Australia, climate policy is further complicated by being intertwined with concerns over energy security. Australia with its massive proven reserves of coal, uranium and gas and with considerable advantages in geothermal, wind and solar sources, does not have the same overlapping between climate policy and energy security concerns.

Amidst all the complexities and uncertainties of climate policy, there is a need to build a concerted global effort that will fundamentally change the path of economic development away from the emissions intensive route that has been followed to date.

This is of course the same economic development that has brought so much wealth and so many opportunities – most clearly in the developed world. Future economic development promises to further increase wealth and further expand economic and social opportunities – particularly in the developing world.

Notwithstanding the size of this challenge, we have very good reason to believe we can develop low emissions paths to economic development. They will be more expensive than the established pathways but they are certainly within our capabilities and they are less costly than the anticipated costs of not acting.

As big as the technical challenges are, they are overwhelmed by the challenges we face in developing international cooperation. In Australia climate change policy has been described as a “diabolical policy problem”. To paraphrase Professor Ross Garnaut¹:

We face a global problem that requires a global solution. However each country benefits from a national point of view if it does less and leaves more of the task of reducing emissions to other countries. If we all act on this basis “without forethought and cooperation” there will be no resolution.

In the face of this “free rider” problem we are being asked to act with forethought – with an eye to future generations - and in a spirit of international cooperation. There are few precedents on which we can base optimism.

Be that as it may, the cooperative solution that we need to get to, whether at Copenhagen or at some other point in the near future, involves the developed countries taking a lead by committing to reduce emissions and for clear pathways to be established for the major developing country emitters to join in the global effort.

In my country, as in all developed countries, the debate on climate policy is dominated by concerns over international competitiveness. These concerns arise because of the risks that we will be imposing costs that are not imposed in other countries. Importantly it is not the costs themselves that worry us. If these costs were universally applied, the substantial competitiveness concerns would disappear.

For business these concerns range from the threat of an erosion of margins to the threat of carbon leakage where the investment we discourage in our home countries, together with jobs and emissions, shifts to countries that do not impose a price on carbon.

Solutions must be found if developed countries are to build the initial momentum to seriously limit their emissions – and those solutions must work, and be seen to work, long enough for developing countries to be enticed to follow suit. So can these competitiveness concerns be addressed?

My organisation believes they can.

Each country with emissions pricing on its current agenda is developing its own response but they all involve creating transitional arrangements that address the adverse competitiveness impacts of imposing costs domestically that are not reflected in world prices.

In Australia, the government is proposing to introduce an emissions trading scheme to take effect from 2011. It is targeting a reduction in Australian emissions to between 5% and 25% below 2000 levels by 2020 depending on the extent of international action to reduce emissions. Reductions in this range would imply reductions in *per capita* emissions of between 34% and 48% on 1990 levels.

¹ Garnaut Climate Change Review, Draft Report, p. 2.

To insulate trade exposed businesses from a loss of competitiveness, the government has proposed a three-part scheme that my organisation is seeking to strengthen in some critical areas. The scheme as currently proposed involves:

- The adoption of a reduction target that would only intensify as the reach of international cooperation was extended;
- An ongoing, production-linked, free allocation of permits, starting at around 60% of the direct and Scope 2 liabilities of trade exposed businesses (about 27% of all permits). These allocations would be concentrated on the most emissions-intensive trade exposed activities.
- Less emissions-intensive trade exposed businesses would receive free advice on how to reduce energy use and would be able to apply on a competitive basis for capital grants to assist in making investments to reduce direct and Scope 2 emissions.

Importantly, since allocations are based on production and industry average emissions intensities rather than firms' actual emissions, this approach would not undermine the price signal or blunt the incentive to reduce emissions and improve energy use. And vitally, competitiveness would be maintained to the extent that the allocations cover the cost increases.

My organisation does remain concerned with important elements of the proposal and is seeking a strengthening in a number of areas. Our concerns include:

- the vulnerabilities that arise for business from the government's proposal to phase down allocations to emissions intensive businesses regardless of the opportunities for abatement and the extent of international action to address climate change;
- the exposure of particular industries that fall short of the eligibility threshold for permit allocation; and,
- the need to ensure that our domestic policy is able to respond to the full range of possible outcomes at Copenhagen and at subsequent negotiations.

My organisation takes the view that the basic approach – with the modifications we are seeking - will go a long way towards meeting the challenge of managing the transition while building the initial phase of cooperation among developed countries.

Whether it is effective will depend firstly on the extent to which other developed countries make binding commitments in the near term and secondly on the extent to which, over the medium term, developing countries join in the global effort.

In a moment I will turn to the final part of my scene-setting exercise – listing some of the elements in creating the pathways by which developing countries would agree to participate in global action. Before doing so however, I would like to mention an option that is often put forward – that of imposing tariffs on imports from countries that do not impose equivalent carbon constraints.

My organisation is wholeheartedly against such tariffs.

This statement may well attract further discussion but to be brief we see the “green tariff” option as incredibly complex to get right (as anyone familiar with country of origin rules could attest) and inevitably arbitrary in practice.

More importantly, and partly because of the complexity and the arbitrariness, we see it is something that would give rise to substantial abuse – to the detriment of all countries and particularly of the developing countries that we need to engage in climate policies.

For the global trading system, painstakingly built up and already under severe protectionist pressure, the consequences could be dire. As recently argued by a commentator in Australia:²

Applying trade restrictions to countries that are “not doing enough” to reduce emissions would violate WTO law, provoke retaliation, and may well result in a trade war.

I would like to put forward for discussion three alternatives for bringing developing countries on board, without going into great detail on any of them.

The first is technology transfer.

Technological improvements are the key to lowering the costs of shifting to a low-emissions development path. I think there are very strong arguments to suggest that constructive and creative public interventions in technology transfer could be put in place so that as developing countries move towards making binding commitments to reduce emissions, the technological means to do so become more readily available.

A related proposal is the development of sectoral agreements.

These could take a number of different forms, but would involve comparable emissions measures for the bulk of participants in particular, highly-traded industries – including developing countries not yet willing to make binding economy-wide commitments. These measures might variously include:

- Quantitative emissions caps;
- Carbon taxes;
- Emissions intensity targets;
- Baseline-and-credit schemes;
- Best practice regulation; and/or
- Information sharing and technology transfer.

Such sectoral agreements could maintain the relative competitive positions of all participants while protecting developing country industries from the threat of trade retaliation. Global industries employing similar production technologies worldwide would make an easy fit, while more diverse industries might require some assistance to adapt.

Though seen as attractive in principle, there is a lot of head-scratching at how what such agreements would contain in practice and how they might come to fruition. Nevertheless, sectoral agreements are seen as stepping stones to a more comprehensive multilateral response.

Demonstration

As a final element in creating pathways for developing countries, and perhaps at the risk of stating the obvious, how well developed countries manage the transitional difficulties discussed above will have a critical impact on the willingness of developing countries to commit to carbon constraints.

If developed countries can adopt carbon constraints without undermining our own economic success, others will be emboldened to follow suit. Successful management of the transition in the early years of the next decade will be vital.

² Gary Sampson, *Emission policing not on WTO beat*, AFR, 19 September 2009.

Of course the opposite is also true. If we fail to manage the transition, and we undermine the performance of our own national economies, we will deter all comers from pursuing emissions reductions. This will particularly be the case if climate policy drives the relocation of activities from countries that adopt constraints to those that do not.

Conclusion

As business representatives we have very real responsibilities not only to look after the interests of our industries but also, through the advice we provide our governments and through our contributions to public debate, to assist in the development of public policy that is both workable and effective.

In climate policy we face critical choices.

We can hold out and oppose - leaving the heavy lifting to others and hoping to free ride on their efforts;

We can rush in with naïve enthusiasm for the cause brushing aside the real and legitimate concerns of our constituencies; or

We can search for the balance between our immediate and our broader responsibilities and work constructively in developing policies and advising governments to tackle climate change in ways that neither undermine our competitiveness nor deny opportunities for economic development (including through open trade) that are so important for developing countries.

As is often the case the right way is the most difficult certainly in the short term – both for us and for many of the businesses we represent.