Investing in our future: the climate challenge

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Good morning ladies and gentlemen. I'd like to thank LBS for the opportunity to speak to you today.

This conference is about investing in the future of the Middle East. I would like to extend that a little, and talk today about how climate change will change the world economy and what that might mean for the Middle East.

Climate change is, arguably, the greatest challenge we face in the 21st century. The Stern report, for instance, forecasts that by the middle of the century some 200 million people might be permanently displaced 'climate migrants'. This threatens the trend towards increasing global prosperity that has lifted hundreds of millions of people from poverty.

There are doubters and special-interest pleaders, but the overwhelming body of scientific evidence is that we have to act now. I won't rehearse the evidence; others are better qualified.

One small anecdote though: last year in Uganda, the *Daily Monitor* started printing a daily weather map for the first time ever; for the simple reason that the weather was no longer predictable.

carbon revolution

Annual CO_2 emissions globally currently average almost seven tonnes per head. Simply to prevent the world's temperature rising above what is already predicted for 2050, CO_2 emissions need to fall to just two tonnes per head. This is a major reduction – to around India's present level; to half China's level, one sixth of Europe's and one tenth of the US.

The climate is a classic example of "the commons", the public good that is free to everyone. Greenhouse gases are an externality. Our emissions affect other people. And when people do not pay for the consequences of their actions, then as Lord Stern noted "we have market failure".

The solution to market failure is regulation. And by definition, climate change is a supranational issue. We cannot solve this unilaterally or bilaterally. We need international cooperation and leadership, on the part of governments around the world. Which is why the UN's Climate Change Conference in Copenhagen at the end of the year - which will attempt to reach agreement on action to reduce greenhouse gas emissions - is so vitally important.

Gaining agreement, and then acting successfully is far from straightforward. In essence, we are trying to use the power of the market to restrain the output of carbon dioxide.

First, this needs to be informed by international agreement on an effective framework for reducing carbon emissions, backing this up with workable national regulation and factoring the real costs into economies. National and regional regulation needs to be harmonised, so however the debate plays out, it means adopting "the polluter pays" principle in some shape or form, whether that be a cap-and-trade solution or a carbon tax.

If we look at global CO2 emissions historically, we see a straight line graph remorselessly rising from bottom left to top right. But we should not despair.

If we look at developed countries' energy usage, there is clear evidence that we can become more efficient; the US and Europe, for example, use 20-30 per cent less energy to create a dollar of GDP than they did 30 years. In this lies our challenge.

According to a recent report by the McKinsey Global Institute, the two apparently contradictory objectives of stabilising greenhouse gases and maintaining economic growth are not mutually exclusive.

To reconcile the two, carbon productivity – the amount of GDP produced per tonne of carbon emitted – must increase tenfold by 2050, from $740 to $7,300 per tonne of CO_2. McKinsey estimate the costs of this will be manageable – between 0.6 and 1.4 per cent of global GDP by 2030.

This would truly be a "carbon revolution"; a ten-fold increase in productivity equivalent to the ten-fold increase in economic productivity of the industrial revolution – but in a third of the time.

To do this will require a massive shift in patterns of economic development. The actions required will involve five things: improving our energy efficiency from average to best; decarbonizing energy; accelerating new technologies, especially solar; changing consumer behaviour; and preserving the world's largest stores of carbon – notably forests. No one of these levers accounts for more than a quarter of

the productivity opportunity. We will have to act globally, and across the board. A big ask. But the message is fundamentally optimistic: that sustainable growth and the transition to a low carbon economy can be achieved at a reasonable cost.

These changes have serious political implications. As developing countries develop, their carbon intensity increases, for two main reasons. One is the straightforward effect of increased economic activity: more manufacturing, more transportation, more infrastructure. The second is cultural. People's expectations increase: from a bicycle to a car; from rice to meat; and from a fan to aircon.

And we must set this against the historical context, where the most economically developed countries have had decades of free use of the commons and, today, are among the highest per-capita producers of carbon emissions.

I have heard it characterised as the developing countries being invited to join the rich world in time for dessert at an expensive dinner – and then being asked to split the bill.

We cannot ignore the issue. As the former UK Prime Minister, Tony Blair, said at a climate conference earlier this year, "Even if dramatic action is taken in the developed world that has created this problem, over time the same reduction in emissions will have to happen in the developing world, otherwise the gains in one part will be annulled by the losses in the other."

achieving sustainable growth

But we can't do this by asking developing countries to forego the benefits of globalisation and improving living standards. There is no chance of a lasting global solution to climate change that does not take account of the determination of developing countries to raise material standards of living.

It is already proving difficult to persuade the rich world to change its patterns of production and consumption so that it is significantly less carbon intensive. It will be harder still to persuade China or India to sacrifice the economic growth which has lifted hundreds of millions of their people out of poverty.

As well as governments, businesses must step up. At HSBC, we started our journey probably where everyone does. Looking at how to manage and reduce our direct impact on the environment – easier for a bank than for, say, an oil or gas producer.

First, we began to monitor our energy and water usage and waste produced. Then we introduced a programme to reduce waste, and water and energy consumption. Those carbon dioxide emissions that we cannot eliminate, we offset by buying emissions reductions from projects such as wind farms and small scale hydro-electric dams. As a result, since 2005, we have been carbon neutral.

The second phase of our journey was to recognise that, while our direct impact was relatively modest, we also have a responsibility for understanding and managing our indirect impact – the sustainability of the businesses we fund. This is a difficult and sensitive area to deal in, because it requires us to make judgements on how our customers do business.

We have approached this by establishing guidelines which outline how we will, and will not, do business in environmentally sensitive sectors, such as forestry, water, energy, mining and so on.

Where customers are not compliant with our guidelines, our aim is always to work with them to help them move towards more sustainable practices. But we of course retain, and occasionally use, our right to withdraw our support.

We are also active participants in a number of organisations that promote sustainability. So, for example, we were a founding signatory of the Climate Principles for the Finance Sector launched last year.

The next phase of the journey was to recognise that climate change is not simply a business risk to be managed, but a business opportunity to be developed. We can use our competitive strengths to address the challenge of climate change – and write new business.

For banks, this means looking at how we use our expertise in financial markets to create new opportunities. HSBC, for example, is financing renewable energy and we are backing microfinance initiatives.

We've launched a Climate Change Centre of Excellence, and a Climate Change Benchmark Index for institutional investors. In these ways we are harnessing our expertise to develop a sustainable business.

And in January, we helped develop the WEF Taskforce on Low Carbon productivity, a project to collaborate with other companies and governments to devise and promote practical responses to the climate challenge, and to support the creation of a global deal in Copenhagen.

For those parts of the world whose economies are heavily reliant on the production of oil and gas, adapting to the concept of a low-carbon future is a bigger challenge than for most.

As well as the economic challenge of changes in the world's consumption of hydrocarbons, there is the immediate impact of a changing climate. This is an inexact science, but it is likely that the Middle East will become even hotter, and that sea levels will rise. It was interesting earlier this year to see Saudi Arabia pull out of domestic wheat production, in part to conserve non-renewable water supplies.

In terms of their own emissions, although generally low in absolute terms, on a per-capita basis the countries of the Middle East sit at the top of the table, alongside the US and European countries – with Qatar, the UAE, Kuwait and Bahrain in the top-10. This is no surprise; the production of energy is an energy-intensive business and much of the Middle East's industry is based on the easy availability of low-cost petrocarbons.

As a region, the Middle East has considerable resources and, unlike some other developing economies, it has the ability through its reserves and sovereign wealth funds to make investments that essentially convert petrodollars into more sustainable industries. There is a clearly a long-term strategic necessity to diversify away from hydrocarbons as the main source of wealth creation. The well will run dry one day; sooner for some states than others.

The construction in Abu Dhabi of the world's first eco-city, Masdar City, seems to me to be a far-sighted and bold step.

Many of you will have heard of this government-funded, multi-billion dollar project, which aims to build a carbon neutral, zero waste and car-free city with 40,000 residents and creating up to 50,000 jobs concentrated in environmental technologies.

The Masdar Research Institute aims to carve out a niche as a global centre of research, development and commercialisation of new green technologies. In the long-run, it may create business opportunities for the development of technologies that can be deployed everywhere. I find this a fascinating response from a country that has massive energy wealth and reserves, that indicates a desire to invest its wealth rather than to spend it, and to seek to diversify its economic base.

If an eco-city can be successfully built in Abu Dhabi's challenging climate, the possibilities elsewhere in the world are surely endless.

Throughout the region there is now recognition that environmental considerations must now be factored in to energy production and efficiency projects.

Abdullah bin Hamad Al-Attiyah, Qatar's Minister of Energy & Industry, and Chairman of Qatar Petroleum, has said: 'As a major resource holder in a time of rising demand for oil and gas, Qatar is keenly aware of the need to balance the energy security concerns of our customers with the need to preserve the environment.'

Qatar has responded by becoming the first GCC country to join the World Bank's Global Gas Flaring Reduction project, which aims to exercise tight control on gas flaring, in order to reduce CO2 emissions. And it has also embarked on a $70m, 10-year research project with Shell and Imperial College to investigate carbon capture and sequestration technologies.

These projects give me cause for optimism as we look to the future. In the Middle East, as elsewhere, there is understanding that change must come. It is clearly in the self-interest of economies and businesses everywhere to start adjusting to the new realities now.

This generation has important decisions to make that will affect the next. For us to meet the challenge of climate change, we will have to change the way we use energy; we will have to reshape our economies over the next generation.

For countries, for individuals and for businesses, there will be winners and losers. It is our responsibility to start taking action now to maximise the benefits of this change and to mitigate the losses. The Middle East, as the world's energy supplier, will play a pivotal role in determining our collective success.