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## **PANEL SESSION 3**

### **Invited paper 8**

## **A business perspective of environmental regulation**

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## 8.1 Introduction

My task is to discuss some of the key issues and challenges for business related to environmental regulation. This is an area of growing complexity, and one which affects most of BHP's business activities.

My focus is both domestic and international given that, although BHP has nearly 60 per cent of its assets in Australia, it is located in 70 countries around the world. Environmental regulation also is being developed increasingly through agreements that are international, but which have mounting implications for Australia's long term investment and growth.

## 8.2 Key issues for business

At the outset, I note two points. First, that business recognises the need for sensible and effective environmental regulation. The main issue for business is the way in which environmental regulations are developed and implemented. Of course, we are also concerned with whether or not they are consistent with investment and growth objectives, but we recognise that there sometimes have to be trade-offs between conflicting objectives, both of which may be worthwhile. In those cases what we are concerned to see is that the trade-offs are determined on facts and with full consideration of the costs and benefits.

Secondly, business needs to understand how environmental performance can be a source of competitive advantage. This involves decisions about how to go *beyond* regulatory compliance, and understanding the competitive benefits of doing so.

I want to develop these two key issues regarding environmental regulation by addressing the following two questions:

1. Is the regulatory framework in existence at present and in prospect conducive to both improved environmental outcomes *and* economic growth, and if it is not, what is the least cost approach?
2. Are there advantages for business in achieving higher performance standards than actually required by regulation?

I will try to explore these issues in a little in the time available to me.

### 8.3 The preferred approach

Regarding the first question, in many cases environmental regulation can be compatible with higher economic growth. However, this outcome requires regulations that are soundly based and focussed on clear outcomes, rather than technologies, so as to allow companies the maximum freedom to innovate to achieve the best environmental and commercial outcomes.

In particular, regulation should:

- have clear objectives, be based on sound science and risk management principles, and take full account of costs and benefits;
- be performance based so as to provide maximum flexibility to achieve the aims of that regulation in the most cost effective manner; and
- provide for industry consultation before any new measures are introduced.

Where such a framework is in place, acceptable growth and environmental outcomes are far more likely. Alternatively, where there is a major trade-off the costs can be kept to a minimum.

On the domestic front, we are headed in the right direction. For example, the National Environment Protection Council (NEPC) is working to improve consistency of environmental standards across Australia. This should simplify regulatory procedures, particularly for companies operating in more than one state.

We have also begun to see better coordination at the state and federal levels. The Eastern Gas Pipeline Project (EGPP) is a good example, as it crosses two states. The project required environmental assessment in both New South Wales and Victoria, and under the Commonwealth's foreign investment law. A Joint Government Taskforce was therefore established, and this greatly improved the process. We expect this to be increasingly the norm as the Federal Government and State Governments clarify their roles and responsibilities for environmental assessment.

More generally, the Government's Legislative Instruments Bill sets out a framework for Commonwealth regulatory review. This incorporates a cost benefit approach which in principle is desirable, and we hope that it will work out well in practice.

## 8.4 International environmental agreements

The challenge business now faces is to ensure that the same degree of rigour is applied to the increasing number of international environment agreements that will impact on both domestic and international operations.

The potential costs of ill-considered or poorly specified international agreements for Australia may be highlighted by the global warming debate. The possible implications of human-induced climate change clearly require that the world community, of which business is a part, takes prudent measures to address this issue. Any measures, however, need to pass the tests of rigour, equity and effectiveness.

Modelling by the Australian Bureau of Agriculture and Resource Economics (ABARE) indicates that uniform emission reduction targets (below 1990 levels) would impose much higher costs on Australia than most other Organisation for Economic Cooperation and Development (OECD) countries. The costs are higher because of our heavy reliance on fossil fuels, relatively high economic and population growth rates, and limited fuel substitution possibilities.

ABARE estimates, for example, that Australia's coal output would fall by around 24 per cent relative to business as usual, while production of non-ferrous metals would fall by 60 per cent and iron and steel by over 30 per cent.<sup>1</sup>

A large structural adjustment would also be required. This would have serious impacts across the economy, and especially at a regional level. Welfare losses for an average Australian are estimated at over 22 times that experienced by an average European, and just under six times that for an average American.

In such circumstances, it would be bad policy for government to be party to such an agreement that imposes the burden of international adjustment so inequitably. That is the reason the Australian Government is suggesting that there should be an equitable sharing of the burden by having differentiated reduction targets (as the European Union itself does internally). One reason is that a more equitable approach would increase the chances of real progress being made.

However, differentiation would also make good environmental sense. For example, Australia is a major supplier of energy and energy-intensive commodities internationally, and these industries are highly efficient. Examples

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<sup>1</sup> See ABARE, *The Economic Impact of International Climate Change Policy*, June 1997. The findings relate to a scenario involving reductions in carbon dioxide emissions from fossil fuel combustion to 1990 levels by 2010 and to 10 per cent below 1990 levels by 2020.

include production of clean coal and LNG. Locating these activities in Australia can therefore *reduce* net global greenhouse emissions.

Another major problem with the present proposal is that whatever it does, it will have little overall effect on global emissions. That's because it excludes the non-Annex 1 countries (that is, basically the non-OECD countries), and yet most of the growth in emissions to 2020 is expected to occur in these developing countries.

So what is the appropriate policy for reducing greenhouse gas emissions? Clearly it should involve differentiated targets, on both economic and environmental grounds, and it should involve everyone.

In addition, voluntary initiatives such as the Greenhouse Challenge are important. As an example, BHP's use of coal seam methane to generate electricity is having considerable environmental benefit. Not only does it prevent methane being released into the atmosphere, it also reduces emissions of carbon dioxide from electricity production elsewhere.

I would add that such initiatives will only work where they have widespread community acceptance. This involves recognising local communities as relevant stakeholders, and including them in the process of achieving better environmental outcomes.

## **8.5 Environmental regulation and trade**

Another area of environmental regulation requiring greater rigour and scrutiny relates to market access and trade.

The distinction between environmental regulation and market access is becoming blurred as trade restrictions, product handling, eco-labelling and other requirements become part of the regulatory landscape.

There are two aspects to this issue.

First, international agreements may be used simply as a disguised form of industry protection or promotion. Such actions raise serious concerns from the perspective of national sovereignty, given that many countries are simply unable to afford the levels of environmental amenity that we enjoy and may have different priorities. There is also a danger that environmental regulation could, in reality, be used to protect industry in developed economies.

Secondly, there is an increasing tendency to use trade restrictions to enforce environment agreements. As at February 1997, for example, there were 18 multi-lateral environment agreements (MEAs) containing trade provisions, and

at least some of those raise serious issues in relation to World Trade Organisation rules.

The Basel Convention on Transboundary Movement of Hazardous Wastes is an example. Parties to the convention will meet in October to consider a ban on trade of hazardous wastes, including those destined for recycling, from OECD to non-OECD countries. I note that the Australian Government ratified the convention before its implications were fully understood, and with limited consultation. Hopefully, the Commonwealth's new treaties ratification process will avoid this in future, but there are no guarantees.

The problem with trade restrictions is that they can be extremely costly, and may do little to improve environmental outcomes.

The Minerals Council of Australia is developing a set of principles on trade and environment to address these concerns. The principles seek to strictly limit the use of trade measures. In my view, there is no perfect solution to this problem, but the position adopted by the Minerals Council establishes a reasonable basis for policy development.

In summary, international agreements can be extremely costly for Australia through their impact on trade and investment. In some cases, the regulatory mechanisms are also unlikely to be effective. The Government therefore needs to consider carefully the extent of these costs, and ensure that the burden is shared in an equitable manner.

## **8.6 Is compliance sufficient?**

I would like to turn now to the second question I posed at the start, namely, is compliance sufficient, or should industry aim to achieve performance standards beyond those required by regulation?

My view is that where regulations are not well developed, or do not adequately protect the environment, then we *should* seek to do better. While a higher level of performance will, in most cases, involve increased direct costs, in reality it can also make good commercial sense.

There is a number of reasons for this. One is that a strong environmental record can improve a company's reputation, and this can increase its acceptability to host governments and communities.

Community expectations are particularly important in the resources sector, and may go beyond strict regulatory requirements. It is now standard practice for BHP to consult widely on environmental issues, and community concerns are often taken into account in a project's design.

Another possible reason is that better environmental performance can improve a company's share price. This could happen where a company is recognised as being able to manage complex environmental issues in an effective way. However, I think that further work is needed here before any conclusions can be drawn.

A further suggestion is that environmental regulation may bring its own benefits to companies through driving resource efficiencies. This point has been made by Michael Porter of Harvard University.<sup>2</sup> His analysis is supported by evidence of selected firms (including Dow Chemicals, 3M, Du Pont) and industries (the Dutch flower industry, Scandinavian pulp and paper). It implies that improved environmental performance can be achieved largely in a 'win-win' manner.

However, this analysis draws on selective examples and its conclusions should not be applied universally. Not all firms will be in a position to benefit in the manner described. Environmental innovations may also become increasingly expensive over time where regulations are progressively tightened. It is also unclear why regulation should be required to stimulate commercial innovation which is normally stimulated by competitive cost and market pressures.

So there are some good reasons pushing companies to go beyond compliance levels imposed by regulation, though the Porter point is not as commercially applicable as is sometimes claimed.

## **8.7 Conclusion**

To sum up, I've discussed two main areas. First, environmental regulation can involve significant trade-offs between business and environmental objectives — but it need not. Trade liberalisation, growth and environmental objectives can often be mutually reinforcing so long as policies are carefully considered against appropriate criteria. Where there are trade-offs to be made, the regulations should be based on fact and assessment of the costs and benefits. Formal regulatory processes also do not hold all the answers, and voluntary undertakings can be a valid alternative in many cases.

Secondly, there may also be good reasons for firms to go beyond minimum regulatory requirements. The main advantage is that firms can improve their business prospects, through their reputation at the government and community level.

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<sup>2</sup> See Porter M., 'Green and Competitive: Ending the Stalemate', *Harvard Business Review*, 1995.

