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Thank you very much for inviting me to speak to you this afternoon. It is always good to be back in this city and, given last week's weather, this is a particularly interesting time to be talking about climate change.

I have been asked to talk about climate policy developments in the EU and the UK and their implications for business. I would like to do this however against the background of a key shift in the political context – by which I do not mean President Bush's recent proposal to take us all back to where we were on climate change in 1994.

There are many ways in which climate change is different from any other issue on the global agenda but one of the most striking is the fact that, until now, it has been driven almost exclusively by our growing knowledge of climate science. Knowledge is a rare driver of political action.

This year, experience has joined knowledge as a driver of the politics of climate change. Climate change has generally been seen by most people as something that will affect them in the future. The extraordinary weather events that we have seen all around the world over the past few months have begun to reframe the issue.

For a increasingly large proportion of the population climate change is something they are experiencing now – and, for the most part, it is not a welcome experience. The prospect of level 6 water restrictions in Brisbane or a drought so severe that there would might be no release of water for irrigation in the Murray-Darling basin have underscored the particular vulnerability of Australians to a changing climate that will make this already dry continent even drier.

In Britain we have seen in a year the hottest July, the hottest April, the wettest June, the hottest spring, the hottest autumn, the hottest single month, the hottest twelve month period and probably, the wettest summer since records began. The floods that devastated parts of England in July saw two 1 in 200 year events take place in a single month - in one town a month's rain fell in three hours.

This picture has been repeated around the world – in the United States, in China and India and in Europe where floods, droughts and fires have all been at record levels – the dry spring in Germany so badly affected the barley crop that the price of beer has risen.

Now no reputable scientist would ever attribute a specific weather event to climate change. The southward movement of the jet stream that stole the summer this year in Britain occurs quite regularly and is not related to climate change. But the increased moisture in the atmosphere that meant that a familiar event had very unfamiliar impacts is a consequence of a warmer world.

My point, however, is that the scale and frequency of such unusual, and unwelcome, weather events is such that the public everywhere increasingly believes it is experiencing climate change now. This changing belief changes the politics of climate change. As we have seen all too often, and sadly, on our televisions, climate change is a direct threat to the prosperity and security of ever larger numbers of people. These changing politics of climate change will inevitably change the impact of climate policy on business.

Unfortunately, the political and policy landscape in which business finds itself is going to be no more settled than the weather.

At their Spring Council meeting, and again in the run up to the preparations for this year's G8, Europe's leaders reaffirmed their goal of keeping the eventual rise in global average temperatures to below 2^0C. To put that in perspective, to have an evens chance of meeting this goal, the greenhouse gas concentration would have to stabilise at 450ppm carbon dioxide equivalent. Given that we are currently at 425ppm this is an ambitious goal.

As its part in meeting this goal the EU has a set a legally binding target of reducing its emissions to 20% of their 1990 levels by 2020. It has promised to lift this to 30% if other countries take comparable steps. This is an interim target on the way to the 60 – 80% reductions that they believe will be necessary of the world is to avoid dangerous climate change.

To achieve these targets the EU has set in motion an ambitious strategy which will involve a 20% improvement in energy efficiency, meeting 20% of Europe's primary energy from renewables, using biofuels for 10% of its transport fuel and to build at least 12 carbon capture and storage demonstration plants by 2012.

The commission has also been asked to develop a regulation to require all new fossil fired electricity generation to use carbon sequestration and

storage after 2020. The EU has also launched a cooperative initiative to build a zero emissions coal fired plant in China.

The UK, which is currently forecast to meet more than double its Kyoto requirement by 2010, is bound by the targets in the EU strategy. Furthermore, draft legislation currently before parliament would establish a legally binding target of a 60% reduction in emissions by 2050. It would also mandate the publication of 5 yearly carbon budgets on a 15 year cycle. There would be an independent Climate Change Committee as a statutory body charged with advising on the pathway needed to meet this budget and reporting on performance in meeting it.

This level of ambition reflects the urgency with which Europe's political leaders view the threat posed by climate change. Even so, it may not be sufficiently ambitious to prevent dangerous climate change even if it were shared by other governments. The Stern report's view was that to avoid the worst risks of a changing climate – a potential reduction in global GDP of 5 - 20% - we needed to stabilise greenhouse gas concentrations towards the lower end of the 450 – 550ppm carbon dioxide equivalent.

To do this we would need essentially to render the global energy system carbon neutral by around the middle of the century.

Next month sees the start of a series of meetings that will run through the Bali meeting in December to a crucial meeting in Copenhagen in 2009 that will seek to agree the global regime to tackle climate change beyond the end of the Kyoto Protocol's first commitment period in 2012. At the moment there is little clarity as to the eventual shape or stringency of that agreement – indeed, as to whether there will be an agreement at all.

This means that the current uncertainty about, and volatility of, the future price of carbon will continue for some time to come. This considerably enhances the risk that effective action will be delayed. Faced with really difficult issues politicians everywhere often adopt the P^3P approach – prevaricate, prevaricate, prevaricate, panic.

The danger for business with this approach to climate change is that the cost of coping with it goes up dramatically with time. The later we start taking serious action, the steeper the necessary fall in emissions, the greater the dislocation of business and the higher the cost.

To meet their climate change goals governments basically have four tools. They can set a price on carbon by taxes or cap and trade policies. They can set technical standards. They can provide investment incentives and they can give sermons.

To date, sermons have been by a long way the preferred tool with cap and trade policies second. The sermons have had little effect and the difficulties with cap and trade policies have now been well rehearsed. Getting national, let alone, international agreement on what the caps should is proving to be what might kindly be called a tortuous process. The result has been a carbon price too low and too volatile to make any difference to the long run, high capital investments that will be necessary to render the global energy system carbon neutral.

It turns out that putting a price on carbon is much easier to do in an economic model than it is in the real world.

This means that governments will increasingly need to develop technical standards and to deploy investment incentives if they wish to respond successfully to the challenge of climate change. On the whole this may be much better for business than the current climate policy chaos.

Setting technical standards, provided they are done with a long enough lead time and appropriate supportive policies for adjustment have the considerable advantage of certainty both for the environment and for business. Providing investment incentives to support their adoption encourages rapid take up which will help to drive down costs for newer technologies. Financing those incentives by a relatively low carbon tax – hypothecated to the investments – may breach economists' orthodoxies but has political attractions and again brings a much higher certainty to climate policy.

The business community faces a very uncertain future with respect to climate change as it finds itself caught between the growing urgency of the problem and the reluctance of governments to act effectively. Business would be very unwise to assume that left to itself governments will resolve this dilemma. Contrary to popular suspicion, on an issue such as climate change, businesses are more likely to be policy takers than policy makers. Without a sharper and more thought through message from business to government the current drift will continue. One way or another getting to a carbon neutral energy system is going to cost everyone money. The sooner and smarter the response from

governments the smaller the share of those costs that will fall on business.