

REMARKS BY SECRETARY HENRY M. PAULSON, JR.
MEETING THE CHALLENGE: A PARTNERSHIP ON ENERGY AND THE
ENVIRONMENT

Apr. 3, Beijing, CHINA— Thank you. It is my pleasure to join you here at the Chinese Academy of Sciences. I understand my visit is timely – many of you are also participating in the Chinese Ministry of Science and Technology and the U.S. Environmental Protection Agency discussions on new technology for environmental challenges. Thank you for your work. I believe that workshops like these will help our two countries overcome the energy and environmental challenges of the future.

China has just completed a significant change in its leadership, something that happens every five years. I am here to meet those new leaders so that we can immediately begin work and achieve progress on the critically-important U.S.–China economic relationship. The United States welcomes a stable and prosperous China and wants to continue our efforts and dialogues to meet our shared responsibilities to advance a robust and sustainable world economy.

Benefits of the Strategic Economic Dialogue

The Strategic Economic Dialogue, created by President Bush and President Hu in September of 2006, has allowed both countries to develop long-term, strategic solutions and to address immediate issues of pressing concern in our economic relationship. Through the SED, we make progress on those long-term issues by defining our strategic objectives and laying a course of concrete actions. We solve immediate problems through cooperative engagement. We reduce misunderstandings through dialogue. And perhaps most importantly, at each session of the SED, we review our previous agreements and make sure that progress is being made.

Long-term, structural challenges confront both of our economies. For the United States, the challenge is to save more and spend less. For China, the challenge is to save less and consume more. A deep and more efficient financial sector will help Chinese households earn a higher return on their investments and thus achieve their financial goals without having to save so much of their income. It will give them greater financial security by allowing them to insure against life's many risks, while also reducing their need to save. A more flexible exchange rate is also a powerful tool in redirecting growth to domestic consumption. Although the process of adjustment is not complete, the accelerated pace of appreciation is significant and welcome, and should continue.

The SED also provides a mechanism to address immediate issues. When serious concerns about food and product safety arose last year, our governments quickly initiated consultations to enhance the safety of Chinese food, feed, drug, and medical device exports to the United States. These consultations, in conjunction with the Chinese government's domestic efforts, resulted in two bilateral accords at our last SED meeting, which will enhance cooperation and improve the safety of Chinese exports to the United States. Although these issues are not fully resolved, we now have a process for

developing timely solutions to similar problems as they arise. And the U.S. Department of Health and Human Services is establishing a Food and Drug Administration office in China to strengthen collaboration with Chinese regulators.

Ten Years of Cooperation: Achieving Economic Growth, Energy Security and Environmental Sustainability

Energy and environmental challenges are also part of our overall economic relationship. The United States and China, individually and together, continue to find ways to maintain economic growth while also developing sustainable and secure energy supplies, and protecting and conserving the environment.

At last December's SED meeting, the United States and China announced that we would embark on ten years of cooperation on energy and environmental issues. The cooperation will not replace ongoing United Nations' multilateral climate change negotiations, supported by the Major Economies Process, which includes China and the United States. Through the Major Economies process, we will continue our efforts and will urge every country to reach an agreed outcome by the end of next year that is both environmentally effective and economically sustainable. Successfully confronting the challenge of global climate change will require commitment and leadership by all major economies. Our ten year energy and environment cooperative framework is part of that commitment, as we will focus on shared objectives, including energy security, lower greenhouse gas emissions, clean water, clean air and preservation of wild and beautiful places.

Working together on this ten year framework will challenge our governments, industries, universities, research institutions, academics, thought leaders, and non-governmental organizations to find answers to these and many other questions: How do we reduce dependency on oil and increase energy security? How do we better preserve the natural environment, and prevent greenhouse gas release due to deforestation? How do we meet our energy goals? How do we ensure that our water is clean and safe?

These questions may be answered differently in the United States than in China. Yet, our approaches to finding answers may be similar – to implement proven, effective policies, to educate individuals to make environmentally sound decisions, to ensure that companies follow regulations designed to protect human health. Other solutions will require technological breakthroughs and making existing or new technology affordable by reducing market access barriers.

Our two countries share the challenge of achieving balanced economic growth along with energy security and environmental sustainability. It will take resourcefulness, creativity, determination and a long-term commitment to achieve the results we seek.

Since December, we have been hard at work creating and adding details to this framework, which will require cooperation at the highest levels on climate change, energy security and efficiency, pollution abatement, and natural resource conservation. Only through greater cooperation will we be able to better organize our efforts and target

some of the most pressing issues that the United States and China will face in the coming decade.

We are selecting shared goals, such as reducing dependency on oil. We are defining specific energy targets, such as increasing vehicle fleet fuel efficiency and creating incentives for the development and use of alternative fuels. We are developing action plans for joint projects that will build upon and accelerate existing efforts. These action plans will help each country identify policy solutions to improve implementation of existing regulations and incentives, and challenge us to develop even more innovative approaches and answers.

For example, I was pleased by the announcement by the X Prize Foundation that there will be an X prize for whoever can develop a car that goes 100 miles on a gallon of gas. I want to see American and Chinese scientists and engineers actively engaged in developing that car. I want to see us establish national laboratory systems that will communicate, conduct joint research and share expertise.

This cooperation will likely bring innovations that we cannot even imagine and create new ways to expand our relationship. I often hear from U.S. companies that have Chinese clients ready to buy their technology, but do not sell it for fear that their designs and technology will be stolen. In China, I hear from government officials about the need for U.S. technology to help clean up China's rivers and control pollution from China's many smoke stacks, but that technology can be expensive in part due to tariffs and non-tariff barriers. We have a shared interest in resolving these dilemmas, and we can solve them. Making the air and water clean, improving the health of our people and creating sustainable economic growth, are strong motivations.

Environmental Challenges

The United States knows well that economic development increases opportunity and prosperity, but also that rapid industrial growth often brings serious environmental side effects.

During the late nineteenth and early twentieth centuries, as the United States industrialized, factories and manufacturing plants were built throughout America. As these plants and factories produced goods, they also released chemicals and waste into our environment.

In one example, Ohio's Cuyahoga River – a major tributary into Lake Erie – was so polluted in the 1930's that the river often burst into flames. Pollution was so severe that descriptions from the time declared that the Cuyahoga had "no visible life, not even low forms such as leeches and sludge worms." On June 23, 1969, the Cuyahoga again caught fire, with flames leaping as high as five stories.

China today faces similar and daunting environmental challenges. According to the World Bank, 16 of the world's 20 most polluted cities are in China. Water quality also

has deteriorated. Ninety percent of all rivers show signs of significant pollution, and 62 percent of water is unsuitable for fish. We have followed with great interest the ways you have sought to address the pollution issues surrounding Lake Tai in Jiangsu Province.

In the United States, we address our problems by combining strict laws and regulations with the will and capacity to enforce them. The hazards created by the Cuyahoga River led to the 1972 Federal Water Pollution Control Act. Subsequent efforts to clean the Cuyahoga have been so successful that Lake Erie now has a thriving \$600 million dollar annual fishing industry.

Energy Challenges

Economic activity in China and the United States requires energy; and the energy challenges are as daunting as the environmental challenges.

China's economy is one-sixth the size of the U.S. economy, yet China is in the process of overtaking the United States as the world's largest source of greenhouse gas emissions. China is now the world's largest coal producer and consumer. In 2006, it became the second largest global market for new vehicles, which is one of the key reasons why China is now the world's second largest consumer of oil.

I am not here to tell you what you already know – that achieving economic growth along with energy security and environmental protection is a formidable task. The United States also knows this struggle, and we also continue to search for solutions.

Promoting Energy Security and Protecting the Environment

U.S. economic growth brought substantial environmental impacts, and our government has taken enormous steps to protect our water, land and air. Economic incentives for new cleaner technologies, in addition to strong regulations and enforcement, have been at the core of our success.

The U.S. recognizes the importance of safeguarding the environment through conservation. Through a variety of federal, state and local agencies we conserve, protect and manage natural resources. We also expect private industry and a vibrant non-profit sector to further support these efforts.

I am pleased that China has also recognized the importance of conservation efforts, and applaud China's steps to develop legislation that would more effectively protect natural habitat. It is important that this legislation move forward quickly. I am also encouraged to know that China is adding 2 million hectares of forest per year to increase forest coverage by 6 percent to combat desertification. According to official Chinese projections, by 2010, 16 percent of China's total territory will be natural reserve areas, and 90 percent of typical forest ecosystems and key national wildlife will effectively be protected.

China has established numerous plans and ambitious goals to tackle the energy and environment challenge. With the Tenth Five Year Plan, for 2001 to 2005, China recognized that energy would drive its future economic growth. And in the Eleventh Five Year Plan, for 2006 to 2010, China recognizes that energy and environmental issues must be integrated to promote sustainable economic growth. Aggressive goals have been established to reduce energy consumption per unit of GDP by 20 percent, to reduce total discharge of major pollutants by 10 percent, and to increase overall forest coverage in China from 18.2 to 20 percent.

China has moved towards meeting some of these goals in 2007. China reduced energy consumption over 3 percent per unit of GDP output, and has made progress in reducing water pollution and sulfur dioxide emissions. While I applaud this continued focus and am encouraged by China's progress to date, further results cannot come fast enough.

The Role of Markets

Harnessing market forces can also improve governments' ability to resolve these issues. The 1990 Clean Air Act has demonstrated clearly how market-driven measures can cost-effectively reduce pollution.

The goal of the Clean Air Act was to reduce acid rain by reducing sulfur dioxide, SO₂, and nitrogen oxides, NO_x. Traditional source-by-source limits were set for NO_x. A system of tradable credits – allowing those who could reduce emissions most cheaply to sell excess credits to those whose reductions were more expensive – were set for SO₂.

Studies estimate that the SO₂ market-based trading system will reduce SO₂ emissions by about 50 percent, and that it has reduced the cost of controlling acid rain by up to 80 percent compared to traditional source-by-source regulations. Further, the annual benefits of this market-based trading system are estimated to exceed the program's operating costs by over 40 times.

After a very costly experiment with oil price restrictions, the United States has also learned the lessons of attempting to defy market forces. We learned that markets and consumers are best served when prices are allowed to fluctuate.

In the 1970s, the U.S. attempted various price control regimes. Rather than achieving our intended result, we experienced winter heating oil shortages, supply problems, rationing, and a reduction in domestic oil and gas investment and exploration. In some cases we attempted to control output prices without being able to control input prices, forcing operating losses and large cuts in supply.

China, by setting price controls on fuel, is facing similar consequences today – as can be seen by persistent gasoline and diesel shortages throughout the country. The consequences of these policies also extend to the power sector, where price caps on

electricity and fuel contributed to nationwide power outages during snowstorms this past January and February.

The United States has learned that price controls interfere with the natural equilibrium of markets to match supply and demand, and lead to shortages. And because market forces can never be completely eliminated, price controls often lead to smuggling and corruption.

U.S. Energy and Environment Policy Today

Experience has also taught us that rising energy prices are a strong incentive for consumers to buy more efficient cars and appliances, to insulate homes and buildings and to employ technological advances to reduce energy consumption. This demand for greater efficiency unleashes a wave of market-based innovations.

In the United States, we encourage these innovations and couple them with policies and regulations that encourage and require higher energy efficiency standards. As a result, the consumer benefits, markets continue to evolve and grow, and we come closer to realizing the national good of a cleaner environment.

And these efforts are producing positive results. According to the International Energy Agency, from 2000-2004, as our population increased and our economy grew by nearly 10 percent, U.S. carbon dioxide emissions increased by only 1.7 percent. During the same period, European Union carbon dioxide emissions grew by 5 percent, with lower economic growth. Over the past 35 years, the U.S. has dramatically reduced its energy use per unit of output. Between 1973 and 2006, U.S. total economic production grew from \$4.3 to \$11.4 trillion, a 265 percent increase. Yet the energy used for that production grew by only 32 percent.

U.S. energy and environmental policies continue to evolve, and our efforts are on-going. Since the beginning of the Bush Administration, the United States has spent nearly \$18 billion to research, develop, promote and bring clean and efficient technologies to market. We continue to develop new strategies – President Bush’s “Twenty in Ten” initiative aims to reduce U.S. gasoline consumption by at least 20 percent in ten years through new mandatory fuel economy standards and alternative fuel sources. With the recent signing of the energy bill into law, the President established a mandate for 36 billion gallons of renewable fuel to be provided as transportation fuel, which is five times the amount of renewable fuel consumed in the U.S. transportation sector in 2007.

U.S. – China Cooperation

United States – China energy and environmental cooperation will build on a solid foundation. We already have an agreement to increase industrial energy efficiency, and a joint five-year commitment to promote large scale deployment of alternative fuel technologies for vehicles. We have a memorandum of understanding to combat illegal logging and promote sustainable forest management. In conjunction with the

International Energy Agency, we have also strengthened cooperation on strategic oil reserves. And we have launched efforts to help China develop a nationwide program on sulfur dioxide emissions trading.

In both the United States and China, the private sector is also helping to create the “green” economy. Whether it is the public sector or the private sector, this work is aspirational. We are rethinking transportation systems. We are constructing “green” buildings and “green communities.” And we are developing new methods and technology to power our economies.

Our next steps will be important. Technology must be developed and adopted at a faster pace. Policies and regulations must be developed and refined to create the proper incentives and price signals. U.S. and Chinese institutions need to manage the new demands of energy and environmental issues in innovative ways.

U.S. and Chinese governments and industries have a role to play in reducing greenhouse gases and pollution, increasing energy security and natural resource conservation, and can do a better job of increasing public awareness of the environmental impacts of energy choices.

What can be done right now?

As we establish our ten year energy and environment cooperative framework, my friends in China often ask what can be done about China’s immediate energy and environmental challenges. My answer is that China, given its current economic growth and prosperity, can leapfrog the United States and the rest of the world in deploying and using advanced energy and environmental technology.

Adopting advanced technology will increase China’s energy efficiency and reduce the emissions of greenhouse gases and harmful pollutants. But bringing this technology to China is hindered by the high tariff and non-tariff barriers that China places on environmental goods and services.

For example, there is a water membrane technology available right now. If installed properly, it could help local communities take significant steps towards reducing the pollution entering rivers from power plants. That means that within months, some Chinese citizens could have cleaner water. Yet a tariff of 22 percent on water membranes makes this technology too expensive for many communities.

A high priority should be given to eliminating tariffs and non-tariff barriers on products, goods and services that can improve the health and welfare of the Chinese people.

Advancing a Bilateral Agenda for Sustainable Growth

U.S. and Chinese policy makers will meet for our fourth Strategic Economic Dialogue in June. We will focus on defining a vision for sustainable economic growth. This theme

invokes a transcendent challenge: to sustain economic development while also enhancing energy security and environmental quality – a vision which relies on a strategy of economic openness, especially free trade and open investment policies.

While progress on these issues may be difficult, both our countries gain when we share our capabilities and experiences. We share a commitment to allow our people to prosper and our natural environment to thrive. Our cooperation here is just one powerful step in managing these issues for the future. Thank you.