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Via email: [biodiversityreview@hmtreasury.gov.uk](mailto:biodiversityreview@hmtreasury.gov.uk)

5<sup>th</sup> November 2019

Dear Professor Sir Partha,

I am writing in response to your call for evidence as part of your review into the economics of biodiversity. The UK Sustainable Investment and Finance Association (UKSIF) is the trade body representing those in financial services who have a commitment to sustainable and responsible finance. Our 240 members include financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs. They are building a financial system that works for people and planet, managing risks associated with natural capital, and investing in a way that produces positive impacts for the environment and society. In responding to your call for evidence, I will address questions 9, 10, and 16, where we and our members have experience and expertise.

***Question 9 (Economic and Finance Decision Makers): Which sectors of the economy rely most on biodiversity and ecosystem services? How are they affected by biodiversity decline?***

While almost every sector of the economy will be affected by biodiversity loss, some are more at risk than others. The degree of a company's exposure to biodiversity loss depends on the resources it uses, as well as ecosystem services it relies on, such as flood prevention or pollination. Companies operating in the following sectors are regarded by our members as being particularly at risk:

- Construction & building materials
- Electricity generation and supply
- Food & drug retailers
- Food producers & processors
- Forestry & paper
- Leisure and hotels
- Mining
- Oil and gas
- Utilities

A key source of risk arises from overexploitation precipitating a crisis, such as in the Amazon rainforest this year. According to WWF, the rate of deforestation increased 278% between July 2018 and July 2019.<sup>1</sup> Companies, fulfilling consumer demand for products such as cattle products, timber products, palm oil and soy create demand for activities that resulted in a rapid rise in deforestation. These are all exposed to the reputational damage that can arise from being connected with an environmental crisis, as well as risks arising from corrective or punitive policy changes to prevent further deforestation.

UKSIF member Vigeo Eiris' Controversy Risk Assessment Database lists the food sector as being the most exposed to risks arising from deforestation. Out of the 90 deforestation cases Vigeo Eiris identify between 2014 and 2019, 64% were attributed to food companies. Cargill, Golden Agri Resources and Kellogg were all involved in at least 4 controversies regarding deforestation during the last five years, relating to rainforest destruction in Indonesia for palm oil production, draining peatlands for industrial plantations, facilitating fire haze in Indonesia or destruction of biodiversity linked to palm oil sourcing.

***Question 10 (Market and Institutional Failures): What are the main market and institutional failures affecting biodiversity? What is the best evidence (including case examples) that illustrate these failures?***

The main market failure is that biodiversity losses are regarded as financially irrelevant externalities. Companies ignore negative biodiversity impacts that do not incur a cost on their balance sheets in the near future. One of the best case studies to illustrate this is the deforestation taking place in the Amazon. The destruction of biodiversity-rich habitats in the Amazon is taking place because the negative impacts associated with deforestation impose no immediate financial cost on the companies responsible.

These are in fact two market failures, which are central problems in environmental economics. The first is often referred to as the 'tragedy of the commons', which is the problem that environmental harm is usually not borne as a financial cost by the company responsible. The second is often referred to as the 'tragedy of the horizons', which is the problem that negative consequences of environmental harm will only be felt beyond the decision-making time horizons considered by those responsible for the harm.

The best evidence that these market failures exist is the fact that activities that harm biodiversity are economically viable. One of the best examples is in UK agriculture. UK agricultural practices are causing the widespread loss of soil organic matter, which is a finite resource. The Committee on

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<sup>1</sup> [http://wwf.panda.org/wwf\\_news/?352554/The-Amazon-is-burning--business-must-act-now-to-end-deforestation](http://wwf.panda.org/wwf_news/?352554/The-Amazon-is-burning--business-must-act-now-to-end-deforestation)

Climate Change has warned that some of the most profitable arable land in the UK is set to become unprofitable within a generation if UK farmers do not do more to prevent soil erosion.<sup>2</sup> This is a clear example of the tragedy of the horizons. UK farm businesses are viable in the short term despite their unsustainable management of soil resources, since the environmental harm will only produce financially material negative consequences for the farm businesses involved when productive soil is gone many years in the future.

***Question 16 (Fiscal Policy and Regulation): What are strong examples of fiscal and regulatory policy instruments that have simultaneously enhanced biodiversity and supported economic prosperity? What is the best evidence on the impact and effectiveness of these actions? The review is interested in examples at all scales, including regulation, planning, taxation and government spending, including subsidies.***

The UK's Landfill Tax Credits (LTC) scheme has been extremely successful in discouraging waste and promoting biodiversity. The scheme, introduced in 1996 to meet the requirements of the EU's Landfill Directive, aimed to reduce the portion of household waste going to landfill, and to create a source of funding for biodiversity projects. The UK charges a tax on waste that is landfill as a means of discouraging waste from being sent to landfill. Operators of landfill must pay the tax on each tonne of waste they bury. Under the LTC, they may claim a credit if they make a payment to an approved environmental scheme which improves biodiversity in the vicinity of the landfill. Since its introduction in 1996, the scheme has delivered over £1.4 billion to projects restoring river habitats, controlling invasive species, as well as urban biodiversity projects. The scheme not only creates biodiversity benefits for local communities, but it also acts to support investment in recycling infrastructure through a steadily rising tax on waste sent to landfill making recycling a more competitive option.

If you need anything further we would be happy to assist you in your review.

Yours sincerely,

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<sup>2</sup> The Committee on Climate Change. 2015 Progress report to parliament. Available: <https://www.theccc.org.uk/publication/reducing-emissions-and-preparing-for-climate-change-2015-progress-report-to-parliament/>