

G R E S H A M
COLLEGE

**THE
GREENING
OF
MONEY**

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LECTURE
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I am very grateful to Gresham College, and especially its President, the Lord Mayor, for this opportunity to speak to such a distinguished City audience. I am greatly encouraged to find so many of you here this evening. It shows just how widely it has become recognised that the environment is now a critical business issue.

It is not as if you do not have other matters to occupy you. The levels of bad debt revealed in the recent results from the clearing banks; the current difficulties at Lloyds, in which the environment has played its part; the looming battle to maintain London's pre-eminence as the financial capital of Europe - these are matters of great concern. I have no doubt that some of you will even have given a moment or two's thought to tomorrow's budget.

So, it is all the more remarkable that you have found the time this evening to come to a discussion on the environment. Few people would imagine the City to be a hot-bed of environmental activism. What they forget is that money makes the world go round. And you make the money go round. If we are to protect and enhance our environment, then the money is going to have to go round differently in the future.

But money is not sentimental. And you cannot afford, and in most cases are not allowed, to be sentimental about how you manage money. If money is to go round in greener, more environmentally sustainable ways, then there must be sound, commercial reasons why it should. It is my purpose in addressing the theme, 'The Greening of Money' this evening, to set out what I see as those reasons.

The environment presents the City and the financial community as a whole with two great challenges. First, to manage considerable risks of uncertain proportions. Second, to exploit an opportunity of enormous commercial potential.

This evening, I intend, first of all, to describe the current environmental scene which is an increasingly important part of the context in which all business must operate. I shall then say something about how manufacturers and retailers in Britain are beginning to respond to that context. Finally, I want to draw out in some depth, the risks and opportunities this presents for the financial community.

The environmental scene

I believe, that as this last decade of the Twentieth Century develops, the environment will come to be an increasingly important part of the national and international agenda. Winston Churchill once said, "We ought not to go jogging along improvident, incompetent, waiting for something to turn up, by which I mean waiting for something bad for us to turn up."

In 1948, he was warning against complacency in the face of the then visibly gathering clouds of the Cold War. But his warning is just as apposite today. The threats to the planet are now somewhat different, but they are no less important to the future of mankind. And no less difficult to resolve.

I speak to you in the wake of a sombre and sobering message from the world's scientists. Just over a week ago the Royal Society here, and its US equivalent, the National Academy of Sciences, issued a joint statement. In the 129 years the two bodies have co-existed this was the first time they have taken such a step.

The essence of what they had to say was simple. I quote. "If current predictions of population growth prove accurate and patterns of human activity on the planet remain unchanged, science and technology may not be able to prevent either irreversible degradation of the environment or continued poverty for much of the world".

This message is not wholly new. The doom and gloom merchants of eco-fundamentalism have preached it for years. But it is a new message when it comes from the two most authoritative scientific bodies in the world. I, for one, am not accustomed to hearing scientists and engineers speak in such bleak tones.

The message was all the more powerful coming, as it does, at a moment when the appearance of a hole in the ozone layer over the highly populated Northern latitudes is a very real possibility. Here, indeed, is a vivid example of an environmental problem which has got beyond the abilities of our scientists and technologists to cure.

UNCED

These issues will come sharply into focus in June when the United Nations Conference on the Environment and Development, which has become known as the Earth Summit, takes place in Rio de Janeiro. Britain has taken a leading role in the preparations for this Conference. The Prime Minister was one of the first national leaders to promise to attend in person.

Last week, I announced the United Kingdom's willingness to make available further resources to help tackle global environmental problems, and that we would if possible improve on our current target for reducing our emissions of CO₂, as a sign that we were putting our own house in order.

At Rio, we will be working to make progress in three areas. First, to create new international agreements to deal with immediately urgent problems. The most important, and most difficult, of these agreements will be a convention on climate change. We also hope to agree a convention to protect the planet's great diversity of plant and animal habitats and a declaration on the protection of forests to provide the foundation for a future convention on this increasingly important issue.

Second, we want to agree a comprehensive approach to achieving sustainable development in the 21st Century - Agenda 21. This will, we hope, set out the sensible and practical actions that can be taken by international organisations, national governments, the business community and non-governmental organisations to turn aspirations into achievements.

Third, we are looking to adopt an Earth Charter. The 26 principles agreed at the Stockholm Conference in 1972 have provided a firm basis for the development of international environmental law over the past twenty years. It is now timely that they should be clarified and strengthened to provide an equally durable basis for the next two decades.

Presidency of the European Community

In the second half of the year, we will take over the Presidency of the European Community. Inevitably, in the wake of the UNCED meeting, the environment will be a major theme of our Presidency. Among our priorities will be the agreement of a Fifth Action Programme on the Environment which will set the Community's environmental agenda for much of the rest of the decade; the extension on a Community-wide basis of the concept of Integrated Pollution Control which we in the UK have pioneered; and the establishment of a European Environmental Inspectorate. This new body will be charged with auditing the performance standards of the various national environmental regulatory agencies in order to help create the level playing field that is so important to the business community. It is also quite clear that the negotiations on proposals for European legislation on civil liability, about which I will have more to say later, will be at an important stage.

Implications for Government

Both the Earth Summit and the United Kingdom Presidency come at a time when the underlying level of public concern about the environment is already high. Typically, in most OECD countries, some 80 - 90% of the population say they are 'concerned' or 'very concerned' about the state of the environment. Tracking these polls over some twenty years reveals a very clear pattern. There is, as you would expect, a clear relationship between affluence and public concern for the environment. The wealthier people are, the more concerned they are. But, what the polls also show is that once people become concerned, they remain so despite downturns in the economy or other larger-scale events.

Since 1988, there has been marked change in the nature of public concern. There is now evidence that, where it can, the public is turning its preference for a higher quality environment into a real choice in the real world. We see this in the emergence of the green consumer. Last

year, despite the severity of the recession, over half the population of Britain made a purchase with the specific intent of acquiring some environmental added value. We see it also in the steady rise of membership of environmental bodies. A recent survey found that almost one in five Britons belongs to a local or national environmental body. There are many other such signs, from the increased participation in recycling schemes to the constant presence of 2% or so of the population who wish to vote green at elections.

Thus, public expectations of effective Government action on the environment are now greater than ever. It is widely thought, however much we accomplish, that Government does too little, too late on the environment. This results in relentless political pressure on Government to be seen to be doing more. I can easily see the form these pressures will take in the charged atmosphere after Rio. We will be pressed:-

- to enforce existing legislation more vigorously, to strengthen the regulatory bodies' powers and capabilities and to increase the penalties for breaches of environmental law;
- to introduce new legislation to cover gaps in the regulatory framework;
- to make more use of taxes, charges, levies and other economic instruments to pursue environmental outcomes;
- to set ourselves more demanding environmental targets and to put in place more comprehensive policies for achieving them;
- to further strengthen the machinery of government for developing and implementing environmental policies;
- to integrate the environment much more closely into the development of other policy areas - energy, agriculture and transport in particular - but in due course, into all other areas of policy, including the commanding heights of monetary and fiscal policy;
- and to improve the flow of environmental information into the public domain.

These pressures on Government will, of course, fall equally on the business community. I do not want to expand further on each of these avenues of pressure. But I expect to find an army of proposals marching down them towards me in the coming months.

Let me, rather, to conclude my remarks on the environmental scene, deal in a little more detail with two issues that I think will be of particular importance to business - namely, taxes and trade.

Taxes and Trade

The question of *environmental taxes* is one that I expect to come increasingly to the forefront of the environmental debate. You do not need me to tell you that such taxes, if adopted, would have profound

implications for business. The technical economic arguments for adopting such taxes are well rehearsed. Many environmental goods and services are effectively free goods. As a result they are over exploited. Because there is no market in these goods and services, Government must intervene by putting a price on them, in the form of a tax, in order to encourage their more efficient use.

This is an austere orthodox argument. The public sees it rather more simply. Roughly speaking, in the public mind, pollution is sinful. Sin must be punished. Taxes are punishment. Ergo, tax pollution. Relative to all other forms of taxation, environmental taxes are likely to prove more popular with the public. Hence the popularity, at least in Europe, of some form of carbon or energy tax. When the Advisory Committee on Business and the Environment issued its first report, which dealt mainly with global warming and recycling, it proposed a number of fiscal measures which it saw as essential to achieving our environmental objectives.

These issues are, of course, matters for the Chancellor of the Exchequer and you would not expect me to comment on them, especially not this evening. But we have made our general position on a carbon or energy tax clear. We are not opposed to it in principle, provided such measures are also adopted by our competitors, but there is still a great deal of work to be done before we know exactly what form such a tax might take.

There remain many unanswered questions. For example, if you have a carbon tax do you treat the use of hydrocarbons for chemical feedstock the same as you would treat their use for combustion, even though the former use does not lead directly to the production of carbon dioxide? Or, given the size of the yield of such a tax, how would you maintain fiscal and revenue neutrality?

Work on these, and other, matters is underway. Turning the theory of environmental taxes into practical propositions that will actually deliver the intended environmental, and the anticipated economic, outcomes, is no easy task. This is an area of environmental policy where we should proceed steadily, but with caution.

The environment is maturing as an area of public policy. The management of the global environment has, for the last three years, commanded as many paragraphs in the final communique from the G7 summit as the management of the global economy. A serious effort is now underway in many major countries to integrate the environment with other key policies. Among the most significant, and urgent, of these is trade policy.

I have every hope that we will soon conclude the current GATT round. The environment has not featured very strongly during these negotiations; though, curiously, in seeking to curtail farm subsidies, this

round may have accomplished more for the environment in both North and South than many, more directly environmental, initiatives. I have no doubt, however, that a further round will have the relationship between trade and the environment high on its agenda.

For my part, I am confident that a commitment to high environmental standards and a commitment to free trade are mutually compatible. We have already demonstrated this clearly within the European Community. Indeed, it is rarely remembered, but the bulk of existing Community legislation on the environment was put in place in order to eliminate potential barriers to trade.

What we will be doing in the years ahead is working to ensure that international trade rules encompass legitimate environmental objectives. The business community needs to play a constructive role in contributing to the drawing up of those rules, preferably as a result of a sustained dialogue with Government, the environmental bodies, consumers and others who may be concerned with these issues.

The business response

I have described the environmental scene at some length - in part, in order to give you an impression of the changing environmental agenda as it appears to Government; and, in part, to set out clearly the pressures increasingly bearing down on those companies in which you invest, to whom you lend and which you insure. If they are to succeed in meeting the environmental challenges facing them, it is important that you, too, understand the pressures with which managements will be coping. Ultimately, your success depends on their success. Their failure to meet the growing green regulatory and competitive pressures will eventually show up on your bottom line.

Good environmental management is as much a matter of strenuous attention to detail as it is of heroic major decisions. As John Collins, the Chairman of Shell UK, once put it, "Good management is the sum of small bits". It is also something for every level of responsibility within a company and for companies of all sizes from large to small. Much that needs to be done in terms of management systems, communications flows and motivation to create effective environmental management is almost identical to that which is required for total quality management. There is one important difference, however - few managers face much pressure from their families or neighbours to increase their company's profits. But it is now commonplace for them to find their children, families and friends asking them what they are doing to improve the environment.

I wish that we had more to be proud of when it comes to environmental management. There have been some notable individual efforts by particular companies. But the general picture within Britain is not impressive. The

British Institute of Management carried out a survey of 3,000 of its members last year. What it found was that over half the organisations surveyed did not have statements of their environmental policy.

Sixty-five per cent still had not appointed someone to take specific responsibility for environmental affairs. Less than a quarter had carried out any kind of environmental audit.

This data tells us something uncomfortable about managerial attitudes to the environment. It also says something equally uncomfortable about British attitudes to management. The most recent survey, carried out by the Institute of Directors, confirms the picture. Nearly half the companies polled spent no main board time on environmental issues; less than a quarter had corporate environmental policies in place and less than a fifth had, or were considering carrying out an environmental audit.

What makes this situation even less encouraging is that every leading industrialist I meet tells me that environment is at the top of the corporate agenda and is likely to be a key business issue throughout this decade. There seems to be a large gap between perception and action. Fortunately, a number of initiatives are underway which will help to close this gap.

Environmental management

As many of you will know, the European Commission has been preparing a draft regulation on eco-auditing for some time. A formal proposal will be published shortly. Eco-audit is a somewhat misleading term which means different things to different people. The Community's proposal will establish a set of requirements for sound environmental management. These will include carrying out comprehensive reviews of the environmental impacts of their activities; putting in place improvement programmes and the management and auditing systems necessary to ensure their implementation; publishing regular information on environmental performance and having aspects of the management system and information subject to verification by an independent source.

Another important development is the work of the British Standards Institute in preparing an environmental management standard. This will provide a detailed model of an environmental management system that any organisation can use to develop its own internal management systems. This work is based on the success of the BSI in developing the BS 5750 standard for total quality management. That standard was subsequently adopted as the basis for an international standard, ISO 9000. The BSI environmental management standard, BS 7750 clearly has close links to the quality standard. We hope that it may similarly commend itself to the international market.

A third, very welcome, initiative is being led by the CBI. They have recently launched the Environment Business Forum. This is, in effect, a

club of businesses that have agreed to abide by a charter of environmental management. It is open to all companies in the United Kingdom, whether CBI members or not. A distinctive feature of this initiative is that it will be supported by the CBI nationally and regionally and will be particularly useful to smaller companies. Thus it will be able to act as a forum for the exchange of information and experience between companies.

Two further initiatives are underway. The Business in the Environment Task Team has produced a valuable Executive Guide and a very useful do-it-yourself workbook on environmental management. It is continuing to concentrate its efforts on providing essential support for smaller companies. In addition, the Advisory Committee on Business and the Environment, which Peter Lilley and I established last year, has put in place a working group on environmental management. This, like the Business in the Environment Task Team, is chaired by Sir Anthony Cleaver of IBM. It has been guiding the Government in relation to the other initiatives and is continuing to develop and promote the business case for better environmental management.

Thus, there is no shortage of information and support for those companies seeking to improve their environmental performance. Why then the rather disappointing results revealed in the surveys I mentioned earlier? I suspect that the answer is that, though we have handled the supply-side on environmental management rather well in Britain, we have yet to get the demand-side right.

It seems to me that the people to whom managers, quite rightly, pay most attention are their investors, lenders and insurers.

It is your priorities to which managers respond first. If the environment is low on your list of priorities, it will be low on that of management. The smaller the company, the more dependent it is on the agenda you set. Thus, this striking discrepancy between the large number of environmental management initiatives underway in this country, more than anywhere else, and the relatively low level of adoption of good practise as revealed in the surveys, prompts me to put the question directly to you in the financial community.

Are you getting it right on the environment? Are you playing your full part? Are you putting Britain's managers under the right kind of pressures to improve their environmental performance?

As I said earlier, your fate is bound up with theirs. It is your assets that are at stake if companies fail to manage their environmental risks competently. It is your profits that will be lower if British companies fail to detect and exploit the burgeoning markets for environmental goods and services.

Environment as Risk

Stephan Schmidheiny, the Swiss industrialist and founder of the Business Council for Sustainable Development, made an interesting observation

last year. He said that the financial community could perhaps afford to ignore the environment if its time horizon was just one year. It would be rash to do so if it was looking five years ahead, and it would be dead if it did so when looking ten years ahead. His reasons for making this observation are not hard to discern.

The liabilities which companies face if they fail to pursue high standards of environmental excellence are becoming increasingly clear. Let me give some examples:-

- the problems that can arise in mergers and acquisitions where the takeover target carries hidden costs in the form of contaminated land or obsolete technologies which do not meet current or emerging environmental standards;
- the costs of insurance cover for industrial activities with high environmental risk ratings where the levels of premium and extent of cover are determined by the company's ability to reduce risk;
- the losses which will arise from declining market share if products score badly on environmental performance ratings such as those that will become commonplace as eco-labelling schemes develop.

I am sure that you can all already think of your own examples to fit into these categories. For those companies that fail to keep abreast of these developments, the environment is a threat. Legislation, both within Britain and the Community, requires ever higher standards in response to public pressures. The public feels entitled to benefit from the new technologies available to industry to reduce its harmful impacts. Those companies which fail to plan their future with the environment in mind may well discover that what is at stake is, in Chris Hampson of ICI's phrase, their "licence to operate".

The public increasingly wants to know what is being put into their environment. In response to this demand, our new pollution control measures all carry with them arrangements for better public disclosure of information. You will not need me to remind you that one area in which this will be particularly significant is in the registers of potentially contaminated land that local authorities are now required to draw up. The first of these are likely to be published towards the middle of next year.

There is also increasing public pressure for a clearer definition of who is responsible for liability for environmental damage. This is a subject to chill the heart of most financiers familiar with the 'deep pockets' syndrome so prevalent in the United States. These fears can, of course, be easily exaggerated - we do not have the same litigious approach to life and we are also in the fortunate position of being able to learn from their mistakes. Nevertheless, there are real concerns in this area, which I recognise.

I am in no doubt that the correct assignment of liability for environmental damage has its proper place among the instruments of

environmental policy as a manifestation of the basic principle that the polluter must pay. The European Commission is currently studying this issue. It has no formal proposal on the table at this stage, but it is seeking answers to key questions such as whether the liability should be absolute rather than fault-based, whether it should be joint and several or whether it should be retrospective. The current intention is for the Commission to publish a Green Paper for discussion within the Community. When that paper emerges, my Department will be seeking your views on its contents.

Meanwhile, my Department is developing its thinking on these issues and keeping in touch with the concerns of the various interested parties. We held a seminar last month to discuss these issues with bankers, lawyers, insurers and industrialists. I have asked the Financial Sector Working Group of the ACBE, which is chaired by Derek Wanless of NatWest, to address this question urgently. I am hoping to receive their thoughts by early summer.

I am aware of how vital these issues, and others, are. For instance, the case for lenders to be exempt from liability if they can show due diligence, or the insurance industry's worries that there might be compulsory insurance legislation for environmental risk. We shall be looking for workable solutions in which we are equally as clear about the effects on business costs as we are about the beneficial effects on the environment.

We will also be guided by the need to ensure that any regime for stricter environmental liability provides a practical, as well as legal, level playing field throughout the Community.

As I said at the beginning of this lecture, these environmental risks are both considerable and uncertain. I do not imagine that we will reach a steady state in environmental policy for some time. Thus, in seeking to manage environmental risks, companies are shooting at a moving target. For the financial community, this implies that the boundary between assets and liabilities will remain fluid for some time.

Thus, there will be a premium on developing a capacity to reduce environmental risk across the board and to manage residual risk in a highly disciplined and systematic way. To reduce your exposure, you will need to develop techniques for assessing the capabilities of managements to meet these challenges and to translate those assessments into the signals with respect to share price, cost of capital, and insurance premiums that managers recognise and respond to.

Environment as Opportunity

But, it is not all about risks. There are also great opportunities. One recent estimate put the market for environmental goods and services at £140 billion over the next nine years in the UK alone. It will run to about £850 billion in Europe and over £1,000 billion in the United States. These

figures are, of course, indicative and based on fairly broad definitions. Nevertheless, most estimates now indicate that the European Community will spend 2-3% of the combined GDP of its members on environmental improvements during the nineties.

The UK pollution control and waste management industry is now comparable in size with the pharmaceutical industry, one of Britain's industrial success stories. It is growing at a rate of about 9% a year. Just this proportion of the environmental market will be worth nearly £30 billion by 1995. We expect the overall environmental market to grow at about 6% a year between now and the end of the century.

But despite this success, one distinguished economist has found that our ratio of exports to imports for environmental technology has fallen from 8:1 to 1:1 over the past decade. In other words, we are losing the battle to remain competitive. I am convinced that access to the environmentally sensitive markets of the nineties will be difficult, if not impossible, for those businesses that have not learnt to cope with high environmental standards.

But this is not the best of times for already hard pressed companies to be learning. Yet without a firm foundation of domestic demand I do not see how we will be really effective in competing internationally. It seems to me that there is a part that the financial community could play in developing new products, tailored to financing developments in these growing green markets.

Let me give two examples. For many small and medium sized enterprises, in the current climate, the capital costs of pollution control technologies or new process technologies designed to meet the higher environmental standards being demanded by regulators, customers and consumers are beyond their capacity. Is there room here for innovative leasing arrangements, perhaps put together by financial institutions and the suppliers of such technologies, to help overcome these barriers to both higher environmental standards and the growth of the market? Do we need to develop a kind of GPA style leasing system for pollution control technology?

Secondly, there is no doubt that the single most important area in which we could improve our energy efficiency, and thus reduce our emissions of CO₂, is in the private domestic sector. The vast majority of some 15 million owner occupiers have still not brought their homes up to a comprehensive and fully cost-effective level of energy efficiency. This represents an enormous economic as well as environmental opportunity. Is there no way in which we could put together a consortium, or better still one or two competing consortia, of financial institutions, energy utilities and equipment suppliers to provide a one-stop, quality controlled package of advice, finance and energy efficiency products to householders?

Innovative financing is one of our economic strengths. These skills now need to be applied to development of these growing environmental markets. One clue to the potential is given by the James Capel 'green' portfolio. In the last quarter of last year, their green index of 30 quoted environmentally committed companies had risen 28% on the year compared to the FT 100 index rise of 20%. Their small green index had turned in an even better performance with a 60% rise on the year.

The revolution in inheritance that will flow in the next few years from our national commitment to home ownership will boost these opportunities. The investors of the nineties will be the baby boomers of the sixties, with perhaps £20 billion a year of inherited capital to spend by the end of the decade. Many of these investors will be looking to invest in ways which reflect their own concern for high environmental standards. The challenge to the financial community is to invent the financial goods and services to capture these funds and to channel them in directions that will be both profitable and environmentally friendly. Let me, therefore leave with you with this thought. Are you prepared? Do you, in your own institutions, have in place the systems both to manage the environmental risks and take the market opportunities?

There are encouraging signs that some of you have already started down this road. NatWest among the high street banks, for instance, has received considerable attention for its green efforts.

Less well known, but just as important, is the approach being taken by the Norwich Union. They now require all their Fund Managers to:

- encourage companies to have proper systems for managing environmental performance
- include issues of environmental policy and performance as part of the regular dialogue with company managers on business strategy, and
- maintain up to date records of a company's environmental performance"

These examples are from the biggest and best. What really matters is that this approach becomes part of the culture of the City as a whole. I am certain that if Britain is to retain its financial pre-eminence then this must be so.

If we in Britain are to avoid environmental improvidence and incompetence, then we are going to have to harness the full creative potential of our financial community. I have only skated over the surface of a great many issues this evening. But I hope I have managed to do so in a way that has left you in no doubt that it is your survival and success in the market place that is as much at stake as the quality of our environment.