INVESTING FOR CHANGE NATURAL CAPITAL

RURAL BUSINESS 2030

UNLOCKING INVESTMENT/
UNLOCKING POTENTIAL

WHAT IS NATURAL CAPITAL?

Natural capital is a concept that applies economic thinking to the use of natural resources and the natural environment. By considering the challenges of land use and conservation from an economic perspective it is possible to set out a strong economic case for investing in our natural environment. This bolsters the existing ethical and moral arguments that have dominated conservation in recent decades.

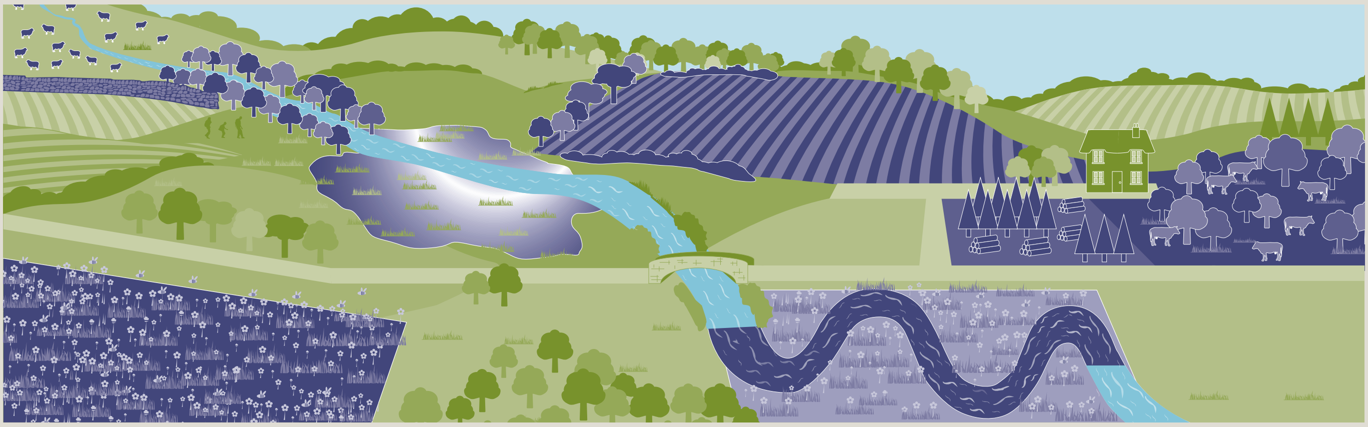
The definition of natural capital extends to all those elements of nature that provide value (directly and indirectly) to people. Natural capital consists of different natural assets such as woods, soils, rivers, land, minerals and oceans. These assets underpin our economies and society by providing us with a wide range of goods and services; such as clean water, food, air and biodiversity. These benefits are often referred to as ecosystem services.

Natural capital assets can be considered as renewable, such as soils and woodland, or non-renewable such as sub-soil assets like minerals. Whether assets are renewable or not affects their management. For instance ensuring assets are not degraded is necessary if they are to continue to provide the relevant benefits. The fact that renewable natural assets have thresholds below which they cease to provide benefits underlines the need for improved management and support. This report focuses on renewable natural capital and considers how, through that framing, government policy and private markets might contribute to an enhanced environment.

RURAL BUSINESS 2030 PROGRAMME

Throughout 2016 the CLA has been holding its Rural Business 2030 programme which concludes with the 2016 Rural Business Conference. As part of this programme the CLA has held a number of seminars, including one on natural capital, which took place on 19 September 2016.

The seminar brought together policymakers, landowners and academics to discuss the future of natural capital and the opportunities for investment in it. This report brings together the discussion, debate and thinking that took place at the seminar and more widely with industry experts and rural businesses.



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CLA

THE CURRENT MARKET PLACE

We need more investment in natural capital

The UK's natural capital underpins our economy and society. It is the foundation upon which rural economies are based and it protects and enhances the lives of all Britons. Our natural capital is finite and under pressure. This pressure will increase further as the climate changes and the UK's population rises[1].

We need to find better ways of managing our natural assets or we risk losing the benefits that we receive. Research undertaken by the UK Government's Natural Capital Committee showed that the state of natural capital is such that many of the benefits we currently receive are at high or very high risk of being lost. These benefits include: clean water; carbon storage; protection from hazards and our wildlife[2]. The recent State of Nature and State of Natural Resources Report (SoNARR) both showed that despite some positive stories the overall pattern is of decline in the vibrancy and diversity of our natural resources and wildlife[3].

There is a positive case for investment

If our governments are to meet their stated objectives for the environment then investing in natural capital is a necessity.

Investing in natural capital is not a budgetary black hole. We know that the benefits of investing in natural capital far exceed the costs[4]. There is a positive case to be made for land managers, business and the state to invest in natural capital assets; at the moment this is poorly understood and difficult to implement.

Valuing our natural capital

➜ The value of **pollination to UK agriculture is £440 million** per year.[5]

➜ At the 2015 official carbon price, the value of the **carbon dioxide locked up in UK woodlands is around £16,000 per hectare**.[6]

➜ Excluding flood and water management benefits and health benefits beside air pollution mitigation, **the total value of UK woodlands is around £270bn**.[7]

➜ Wales' National Parks account for over **half a billion pounds of Wales' Gross Value Added**, representing 1.2% of the Welsh economy.[8]

➜ UK Government figures show that getting 75% of England's rivers, lakes and wetlands healthy would **benefit the economy by £8.5 billion**.[9]

➜ In 2011 the **costs of soil degradation** in England and Wales was valued by Defra between £0.9 billion and £1.4 billion per year – or a **£1.2 billion** central estimate.[10]

➜ England's coastal wetlands have been **valued at £1.5 billion annually** for the benefits they provide as storm buffers and defence from flooding.[11]

Current investment options are limited

Current options for investing in natural capital are limited in scope, scale and ambition.

The most substantial option to support such investment is agri-environment schemes. These schemes are administered through the Common Agricultural Policy (CAP) and joint funded by the European Commission and HM Treasury. Agri-environment schemes have been running in the UK for three decades and are recognised as making a positive contribution to our natural capital and the UK as a whole.

One of the major strengths of agri-environment schemes is that they are now well known by land managers. They are the first option that is considered when looking to improve the natural environment. Having a single point of access for funding is an effective part of the current system.

Natural England's own analysis shows that for every £1 spent on these schemes, £25 is gained in natural capital benefits[12]. Furthermore there is evidence of economic multiplier effects with every £1 that goes to the agreement holder generating £0.26 off-farm in the local economy through direct expenditure and indirect and induced effect[13]. This means that agri-environment schemes support jobs and generate spending in the local economy. The scale of this is thought to be additional annual spending in the economy of between £178 million and £847 million and between 1,800 and 15,000 jobs[14].

Investment options are few and flawed

Despite the positives, agri-environment schemes have a number of major flaws. In practice current schemes are inflexible, subject to regular change and have a very high administrative burden for the state and applicants. Agri-environment schemes are also based on income foregone (which is determined nationally) rather than taking account of the scale of benefit provided.

Fundamentally the design of agri-environment schemes has not created ownership from land managers, who have been disenfranchised by administrative complexity and a system designed to reduce fines from the European Union (known as disallowance). Where authorities have allocated resource and created flexibility there are examples of innovation and substantial gains for nature such as the Moors for the Future and the Welsh Sustainable Management schemes.

Sustainable Management scheme[15] – facilitating flexibility and enabling motivated markets
The scheme offers grants to collaborative groups looking to deliver against three environmental areas. Flexibility is inherent in the design of the scheme as it is for applicants to work with multiple groups across a landscape to create what they think would work for them and their locality; including the budget (within some constraints). The scheme puts the onus and ownership upon applicants and interest to date has been high.

Away from agri-environment schemes investment opportunities are atomised and difficult to access for land managers. There are some positive examples, such as water companies working to improve water quality and highways agencies working with farmers to reduce soil / water runoff; but these examples rely on local enthusiasm and are hard to deliver at large scale.

Fundamentally the demand for environmental benefits is rarely matched up with those who can provide it: land managers.

Where opportunities have presented themselves governments have not sought to support them. For instance, the prospect of delivering net-gains for biodiversity from development using biodiversity offsetting has been ignored. There are also big opportunities for markets particularly around flood risk management, recreation and water quality but governments have not looked to enable these emerging markets through planning, tax or policy.

Due to the presence of barriers and the lack of attractive options, investing in natural capital is too often viewed as a nice to have or as a luxury. This is why there is systemic underinvestment.

Why do members invest in natural capital?

CLA members are investing in natural capital. A new survey shows that to date 52% of CLA members have invested resources, management time, capital and expertise to improve the environment. According to 45% of members, their main motivation for these investments is a sense of stewardship and those in Wales were most likely to have this motivation. Government grants are an important part of current investment decisions as is a desire to improve their natural assets.[16]

In combination the evidence from the survey shows that the current lack of an attractive business case places a ceiling on the scale of future investment. For instance, non-environmental investments are driven by return on investment; being the most significant determinant for 47% of members. For the environment just 6% of CLA members say that an attractive return on investment is their motivation for investing.[17]

Investment is limited by the absence of a attractive business case

The survey suggests that while land managers desire to undertake investment in natural capital, it often doesn't make economic sense to do so.

There is evidence that land managers will diversify from agriculture where there are opportunities that make sense for the business. For example, in 2014/15 61% of farm businesses in England had some diversified activity[18]. In Wales 61% of farm businesses were diversified in 2013/14[19]. The trend is for greater diversification both in terms of the number of farm businesses which are diversifying but also in the types of diversification.

Just two fifths of CLA members say that under the current framework they will look to invest in the environment in the future.

There is an opportunity to increase the number of diverse, resilient rural businesses which are investing in improving natural capital. We cannot rely on landowners' commitment to stewardship alone to deliver the scale of investment that is needed to meet society's greater demand for environment benefits. We must improve the business case for such investment if we – as society – want to see more.

A VISON FOR THE FUTURE

RURAL BUSINESS 2030

A vision for the future

The CLA's vision for investment in natural capital is that by 2030:

- ➜ The role of land based rural businesses in maintaining and enhancing natural capital is recognised and rewarded by society, business and government.
- ➜ Investing in natural capital enhancements is a profitable part of managing a rural business.
- ➜ Society benefits because water quality is high and not deteriorating; flood risks are reduced whilst the impacts of droughts are mitigated; biodiversity in the farmed and non-farmed environment has substantially improved; and the UK's land is a carbon sink.

To achieve this we will look to ensure that landowners and rural businesses have access to a range of tools that allow them to invest in natural capital assets.

What is required to meet the vision

A mixed model for delivering investment in natural capital should be used to deliver the CLA's vision. This involves three distinct areas for improvement which in combination will create the necessary framework. The three elements are:

Government enabling – there is much that Government can do to make investing in natural capital more attractive to rural businesses. Government can enable this investment by removing the regulatory and policy barriers to investing in natural capital. These barriers add costs to and deter from future investment. By improving the coherence of existing and planned policy the Government will improve the efficiency of outcomes that are achieved from public support and open the door to motivated markets.

Public money for public benefits – there are multiple market failures that limit private investment in natural capital. There is a long made and strong argument that the state can and should look to secure these benefits for the population at large. The CLA's view is that for the foreseeable future the public sector should be the primary supporter of investing in natural capital and that this approach should form the foundation for future policy.

Motivated markets – in some areas and for some forms of natural capital assets there are opportunities for private markets to drive investment in natural capital. These markets should be encouraged where they are emerging and new markets should be identified.

How do the three elements work together

Government support should be the foundation for delivering greater investment in natural capital. In some places and for some natural capital assets, investment could be augmented by private markets. To support this, Government can enable better, more efficient and more integrated outcomes by combining Government support with markets as well as by making changes to existing and future policies.

The Welsh Government has already started to create institutions and structures that could facilitate this model with the creation of Natural Resources Wales and the introduction of legislation: the Well-being of Future Generations (Wales) Act and the Environment (Wales) Act. These legislative and institutional arrangements, including Area Statement, Public Service Boards and the State of Natural Resource Report (SoNRR), have great potential and there is much to support; particularly the focus on flexibility and collaboration. However, if these changes are to lead to greater investment in natural capital it is necessary for there to be a commitment to sustained, substantial public sector support. Also needed is a greater emphasis on engaging with and supporting landowners; who are in a position to deliver these bold ambitions.

In England, the Government's new aligned areas for Defra bodies are an opportunity for more effective, integrated local delivery. Government should look to create a brokerage space in which groups of stakeholders – including Government agencies – will be able to come together and present locally determined opportunities for environmental enhancement and restoration. This space, which for the purpose of this paper we have called Local Environment Forums (LEF), should operate from a broadly defined, positive set of local priorities. They should be underpinned by the legislative responsibilities and roles of Government and other agencies but not constrained or defined by these.

At their least ambitious LEFs would be a form of decentralised agri-environment scheme. At their most ambitious, and potentially effective, they would draw together those looking for improvements in natural capital with those able to deliver. By bringing together different groups, different funding streams (private and public) and different priorities it would be possible to implement environmental enhancement schemes which meet the UK Government's principles for the 25 Year Plan for the Environment.

The added value of LEFs will be their ability to look across traditional divisions, sectoral silos and short term horizons to join up schemes and stakeholders which otherwise would not be in contact. Solving this disconnect between beneficiary and provider has the potential to address one of the fundamental reasons for underinvestment in natural capital.

Local Environment Forums could combine motivated markets and public support to deliver bigger and better outcomes while maximising value for money for taxpayers.

Recommendations

Government enabling

- ➜ Codes of practice / standards should be developed for activities that deliver natural capital benefits, such as Natural Flood Management activities. These would create common standards and make it easier for authorities and private groups to deliver natural capital improvements with confidence.
- ➜ The UK and Welsh governments should look to develop investment vehicles (such as bonds) for private investment in natural capital.
- ➜ Government should create shared brokerage spaces for natural capital delivery. This could be achieved through Area Statements in Wales and the proposed Local Environment Forums in England.
- ➜ The biodiversity offsetting impact metric should be mandatory for all planning applications.
- ➜ Governments should facilitate data sharing through initiatives such as Open Data, and continue to release data related to land management so that those with an interest in investing in natural capital can make informed decisions.
- ➜ Conservation Covenants should be revived and taken forward. As part of this Defra, which is leading on this area for the UK, and HMRC should create a form of inheritance tax relief so that land secured by Conservation Covenants is not subject to inheritance tax.
- ➜ Government should introduce capital tax reliefs for flood risk management work even where the works are not supported by grant in aid.
- ➜ The planning system should support improvement in natural capital through permitted development where there are demonstrable benefits such as in ponds, lakes and reservoirs.
- ➜ As an alternative, as part of their engagement with the emerging catchment plans, local authorities should look to support certain natural capital assets through Local Development Orders (LDO).
- ➜ As part of catchment planning specific forms of natural capital improvements should be considered low risk for planning permission and permitting consent. This could be done through local development orders. Examples include the threshold for Environmental Impact Assessment (EIA) for woodland creation and the Environment Agency de-risking these measures, such as ponds and small binds, where there was demonstrable need for such investment.
- ➜ UK and Welsh Governments should look to support proactive environmental advisors who have an integrated remit. This would build on the positive experiences of Catchment Sensitive Farming and Commons Development Officers in England and Wales respectively.

A VISON FOR THE FUTURE

RURAL BUSINESS 2030

Public money for public goods

- The Government commits to create a rolling five year, UK Food, Farming and Environmental Policy (FFEP) that, as well as supporting resilient farming, commits to enhancing natural capital by 2030.

- There should be a formal, ministerial level grouping from across the devolved administrations to agree on the overarching priorities of the FFEP. This would respect the Devolution Settlement while providing multi-annual funding to tackle problems in rural Britain. This is not possible through the Barnett Formula.

- The FFEP should be a cross-Government policy in recognition that delivering for natural capital supports Government's objectives across multiple policy areas.

- The FFEP has the overarching objective of improving the UK's natural capital. Building on the Office of National Statistics (ONS) emerging work around natural capital accounts, the ONS and Natural Capital Committee should be tasked with monitoring the progress of the FFEP. In England, this monitoring role should be extended to the English Government's 25 Year Plan for the Environment which should have the same overarching objective. In Wales, the State of Natural Resource Report (SoNRR) should continue and look to support Area Statements.

- The FFEP should, alongside promoting resilient farming, be structured around payments for ecosystem services Land managers can enter into a contract with the state to deliver an agreed set of ecosystem services, such as water quality, through land management activities. These contracts should focus on outcomes and benefits, not process.

- Government should look at the feasibility of future higher level schemes being administered via reverse auctions, with applications or groups of applicants bidding into a FFEP fund. The fund and related priorities should be suitably devolved.

- The presumption of any future scheme should be that agreements are results-based. This will not be appropriate for every agreement, or all aspects of many agreements, but paying by results is the first step towards creating greater flexibility and ownership of outcomes from land managers.

Motivated markets

- Tenancy agreements could as part of the current 'record of condition' or 'schedule of assets' set out the condition of the natural capital assets subject to the tenancy. The tenancy agreement should also define how these will be assessed at the end of the tenancy and the desired condition. This would support the ongoing maintenance and enhancement of the natural capital assets.

- Landowners should look to put forward investment proposals to possible beneficiaries. This is happening in some areas and should be encouraged potentially under the proposed LEF framework in England and Area Statements in Wales.

- Business led initiatives provide opportunities to contribute to corporate goals and facilitate investment in natural capital. The land based industry should engage with these initiatives and maximise the potential synergies with privately owned land.

- Government and industry should work together to create a carbon code for agriculture; akin to the woodland carbon code. This would enable greater market intervention and provide a standard to support potential Government support.

SUMMARY

RURAL BUSINESS 2030

There is systemic underinvestment in our natural capital. This is due to multiple market failures meaning the business case for individual businesses enhancing the natural world is not robust enough.

If we want to see the level of investment we need, then investing in natural capital assets should not be viewed as a nice to have, but rather as an profitable part of running a land based business.

The CLA proposes a mixed model to deliver greater investment. This model will bring together and amplify public and private funding to deliver substantial investment in natural capital. Taking forward this model and the recommendations in this report will provide the best possible opportunity of delivering the following vision.

Delivering for natural capital brings huge public benefits and there is a demonstrable market failure. The foundation for the model is therefore a UK wide Food, Farming and Environmental Policy (FFEP). As well as supporting resilient farming the FFEP must be based on a contract between the state and land managers to deliver an agreed set of ecosystem services. In some places and for some natural capital assets this funding will be augmented by private markets.

In England, Local Environment Forums (LEFs) can bring the private and public elements together without atomising funding sources and alienating the vast majority of land managers. In Wales, great strides have already been made to facilitate investment in natural resources and this work must continue with landowner engagement and public support.

If we can improve the coherence of existing regulations, create space for flexibility and establish a UK Food Farming and Environmental Policy our natural capital, and the society and economy it underpins, can bloom.

APPENDIX

RURAL BUSINESS 2030

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