



cc Mr Wilson
Cabinet office
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Treasury Chambers, Parliament Street, SW1P 3AG
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6 October 1989

Rt Hon Christopher Patten MP
Secretary of State for the
Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

Done.
Please ask DOE
when they plan to
reply to ask PM
if they wish to
give an answer
Done. 7/11

Dear Secretary of State,

... I undertook at our meeting on 7 September to let you have some comments in writing on Professor Pearce's report on sustainable development. I attach a note by my officials.

The Report - and some of the material which accompanied its release - conveys the impression that sustainable development is an operational concept. Regrettably, this does not stand up. As parts of the Report honestly admit, there are severe difficulties in the valuation of environmental resources and impacts; often, they cannot even be quantified. This means that laudable-sounding objectives such as measuring sustainable income and taking account of it in decisions are, in practice, unlikely to be achievable in the foreseeable future.

A related point is that the so-called "integration" of environmental concerns into economic decision-making may be much more difficult than the Pearce Report appears to imply. We have to be very careful not to raise false expectations. I fully endorse taking account of environmental concerns; I also endorse making use of market mechanisms wherever these are possible, feasible and consistent with our policy on other issues such as taxation. But far-reaching integration of many aspects of environmental and economic decision making is likely to prove impossible.

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The references to taxation, although in general terms, raise very difficult issues, both practical and political. It is very important not to encourage any assumption that future policy is directed towards the introduction of pollution taxes. For one thing, that simply is not the case at present. And although I should be happy to consider any specific proposals put to me, I have to say that there would need to be very forceful arguments for going down this road to offset its potential disadvantages. For introducing necessarily arbitrary pollution taxes would represent a considerable departure from our taxation policy hitherto. And, of course, to introduce any pollution tax unilaterally would merely disadvantage UK industry vis a vis its overseas competitors, without making any significant difference to the greenhouse effect. I am grateful that you have avoided giving credence to such speculation in your comments on the Report. That said, I agree it would be useful for your officials to do some work on marketable permits and pollution charges.

I understand that you and your officials are currently considering how to take forward Professor Pearce's work, beyond a recognition that the issues raised need to be pursued in the OECD and UN contexts. It will be important that the Treasury and indeed other interested departments are fully involved in this. Before further work is undertaken I should like there to be a thorough discussion between our officials, and then for you and I to agree on any future work programme. And it goes without saying that, if colleagues agree to your proposed White Paper, I should expect the Treasury to be fully involved in that too.

I am copying this letter to the Prime Minister.

Yours sincerely,

Muir Wallace

pp NIGEL LAWSON

(Approved by the Chancellor
and signed in his absence.)

OFFICIALS' COMMENT ON THE PEARCE REPORT

The Pearce report has raised awareness of the need for incorporating environmental factors in economic decision-making. It puts a helpful case for conducting careful analyses of environmental factors and ensuring that they are put in an economic context. It is also a useful review of the available techniques for the monetary estimation of environmental values.

However, the Report's conclusions underplay the substantial practical difficulties in valuing environmental resources and integrating environmental and economic statistics. The text does acknowledge a number of the problems of valuation - for example, those entailed in environmental accounting, such as the arbitrariness of quality standards. But the Report is over-optimistic about problems such as measuring welfare losses due to pollution and depreciation in the natural resource base. Such statistical exercises can absorb considerable amounts of skilled resources, to little practical benefit. A related cause for concern is the wide range of answers likely to be generated in an attempt to value such environmental resources as forests and wetlands - reflecting probably inevitable difficulties with such techniques as contingent valuation. In this regard, the authors note that "much more work is required to adequately explain" the variability between willingness-to-pay and willingness-to-accept valuations. The Report points to our relative ignorance in these areas.

Perhaps inevitably for a report with such a wide sweep, there is little that appears to be operationally useful for policy formulation. This is implicitly recognised in the recommendations, which are mainly for further research.

Turning to the recommendations themselves, the high priority ones for the preparation of statistics are unpromising. "Sustainable income" is an elusive concept, and it is not clear which of various alternative definitions, if any, should be adopted. Yet

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they have radically different implications. "Integrated economy-environment statistics" would be very costly to produce and of doubtful value in practice, given the enormous margins of error to which they would be subject. It is likely to be more productive to focus on major environmental problems (such as global warming and acid rain) case by case, and work through their particular economic linkages.

A second group of recommendations proposes feasibility studies of the use of charges, taxes and marketable permits in selected areas of pollution control. While it might be useful for the Government to do some work on marketable permits and pollution charges, along the lines suggested by Professor Pearce, no encouragement should be given to the presumption that future policy is somehow already directed towards the introduction of pollution taxes.

The remaining recommendations are unlikely to have major economic implications in the short term. Some of these (eg work on how past growth has affected the environment, and on the idea of 'importing sustainability') are for academic research rather than for Government action. Some, such as investigating the effects of the energy and agriculture sectors on the environment, or revising Treasury guidelines, are activities which are in any case in hand to some degree. And some are simply not workable. For example, the recommendation that, for each public expenditure "programme" (not defined) "environment capital in the aggregate" should not be reduced, turns on there being an operational measure of environmental capital. Even if this were the case, which it is not, it is far from clear that this recommendation would be desirable.

To conclude, there is clearly a case for paying more attention to environmental costs and benefits and the Report is helpful in raising awareness of environmental issues and their link with economic decision making. It is a useful contribution to a developing debate. But however theoretically sound many of the Report's arguments may be, it is preferable for Government to

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support work which is likely to generate outcomes which are useful in practice. The most cost-effective approach is likely to be to tackle specific environmental issues on their own merits rather than look for new comprehensive policies based on some overall philosophy of "sustainable development".



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