

Dr Ken Henry AC Speech – Advancing Australia’s Natural Capital

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**Dr Ken Henry AC – Address to The Fiona Wain Oration
Sydney, 27 May, 2016**

check against delivery

Thank you for that introduction Andrew.

Before I begin I would like to acknowledge the Traditional Owners of the land on which we are meeting. I pay my respects to their Elders, past and present, and the Elders from other communities who may be here today.

It is a pleasure to be here with you this afternoon, and particularly as Sustainable Business Australia celebrates its 25th anniversary of incorporation as a business NGO.

I am honoured to have been asked to speak at this year’s Fiona Wain Oration, commemorating her contribution to business and sustainability. I first encountered Fiona many years ago, when I was working in the Treasury. She had a significant influence on my thinking about the proper role of that organisation in the development of national policy to secure Australia’s environmental assets for the enjoyment of future generations.

Fiona was a person of considerable intelligence, enormous energy and great passion. We miss her greatly.

She led the way in encouraging businesses to consider the role they might play in securing sustainable activity. She was chairing international working groups on sustainability for business leaders way back before it had entered common discourse. As CEO of Sustainable Business Australia she kept Australia at the forefront of that global conversation. Businesses the world over are richer for Fiona’s truly memorable contribution.

I, too, am passionate about conservation. And I have had some opportunity to champion the cause of our endangered species.

I am also passionate about my role at NAB. I joined the board late in 2011 and became Chairman in December last year.

My passion for conservation and my passion for NAB are aligned. That would surprise quite a few people. One of the things I want to do today is explain how those two things can be aligned.

At NAB we have been giving a lot of thought to matters of conduct and culture. We aspire to an organizational culture that it is absolutely customer-centred – continually driving change to improve the customer experience.

That’s what will drive our commercial success. Successful businesses put the customer at the centre of everything they do. Many of our customers are also businesses. We are the largest business bank in Australia. Our business banking customers are looking for a relationship with a bank that understands their business and understands what success for them looks like for them.

Earlier this year I visited Moree where I had the opportunity to talk to some of our customers with farming businesses. I got to see first-hand how important it is for them to have a banking relationship that is more than transactional.

Our customers want a banking partner that helps them realise their aspirations; aspirations they harbour for themselves, for their families, in some cases for future generations, and for their communities.

NAB is Australia's largest agribusiness bank by some margin; we provide financial services to about one in three Australian farmers. We lend money and manage financial risk.

Australian agriculture faces immense challenges, but also extraordinary opportunity. Our farmers operate in the driest inhabited continent on earth and, in many cases, are having to deal with the consequences of past practices that have damaged biodiversity, degraded soils and encouraged the proliferation of weeds and feral animals. Climate change is also threatening the viability of traditional farming practices in many parts of the country.

Yet the Australian population is growing strongly, with a healthy demand for farming produce. And the market potential of the rapidly growing Asian markets to our north, as the number of middle class consumers expands from about 500 million to more than three billion over the next 15 years, can hardly be overstated. Our farmers have an unprecedented opportunity to establish Australia as a reliable supplier of very high quality produce.

All of this is well understood. What is less well appreciated is that Australia's brand as a producer of agricultural produce is tied to the quality of its natural assets. The healthy soil, clean air and water that produces high quality beef and lamb. Or the 'clean and green' products where consumers know they can trace provenance and be assured of quality.

Increasingly, in markets all over the world, consumers are seeking proof of sustainability. The producers and countries with a competitive edge in export markets will be those that can demonstrate sustainable natural capital management. This is especially the case in the high end, quality markets that we should be targeting.

As a bank, we understand that the commercial opportunities available to our agribusiness customers are heavily dependent on the quality of their natural assets.

We know that those who manage their natural capital well – their soil health, water, energy and biodiversity – tend to be more resilient and more productive over time.

When we talk about natural capital we are referring to the stock of living organisms and the biological, physical and chemical systems that support them and the services they provide.

Many of these services are not traded in a market or captured in any system-wide accounting. For that reason, some have termed these services "invisible." Even more concerning is the fact that our ignorance of ecological processes has sometimes had us label natural capital assets as liabilities.

Take for example, the Regent Parrot. Almond farmers have historically seen the Regent Parrot as a pest. And, indeed, research commissioned by Almond Australia found that the Regent Parrot causes \$75/ha/yr worth of damage to almond orchards. However, the research also found that these parrots save up to \$300/ha/year by mopping up the mummy nuts at the end of the season that would otherwise harbour disease.

In other cases we have a more sophisticated understanding of the value of natural capital.

For example, the International Panel for Biodiversity and Ecosystem Services estimated recently that 40% of the world's invertebrate pollinators face extinction. This is of concern because 75% of our global food supply, with a commercial value of \$577 billion a year, is dependent upon the services of pollinators.

More than half of the arable land around the world is moderately or severely affected by soil degradation. The commercial value of the earth's stock of soil is estimated at around \$325 trillion, with the annual cost of soil degradation running at up to \$10 trillion.

These are big numbers, but they relate to only a small part of the system of natural capital that supports agricultural activity, most of which remains invisible.

Today, I want to explain: First, why recognition of natural capital matters; second, why every stakeholder – government, community and businesses like NAB – should factor natural capital into their decision making; third, how natural capital can be incorporated into decision making; and fourth, why this means that we need better data – why support of national environmental accounting frameworks and data sets is fundamental.

Why natural capital matters

Healthy ecosystems underpin prosperous economies and resilient communities.

The more we understand about the linkages between the stock of biodiversity and economic and social outcomes, the better placed we are to invest in improving all three.

The 2016 World Economic Forum Global Risk Survey rates biodiversity loss and ecosystem collapse, water and food crises, extreme weather events and a failure of climate change adaptation and mitigation as major risks facing the world.

Over a longer-term, ten year period, the top four global risks of highest concern to the survey's 750 respondents were environment-related.

The need to address these risks is reflected in the United Nations' new sustainable development goals (SDGs), released in September last year.

Consider the second sustainable development goal: zero hunger.

Achieving food security requires a lot: first, supporting a global agricultural sector in implementing resilient agricultural practices that increase productivity; second, strengthening the capacity for adaptation to extreme weather events and climate change; third, reducing waste in the value chain; fourth, enabling a more nutritious diet; and fifth, supporting producers of all sizes in all countries.

Ambitious, yes. But consider what is at stake here. Already, one in four of the world's children suffers stunted growth. Poor nutrition is responsible for nearly half of all deaths in children under five.

Several SDGs have ambitious targets related to natural capital. For example, SDG goal number 15, commonly referred to as "life on land", sets a target for integrating ecosystem and biodiversity values into national and local planning, development processes, poverty-reduction strategies and accounts by 2020. An example of the implementation of this goal is the US White House memorandum, issued in October last year, directing federal agencies to incorporate the value of natural infrastructure and ecosystem services into their planning, investment and regulatory decisions.

Every stakeholder has a role to play

A local council may have a policy to collect recyclable waste from its households, but it won't work without households and businesses playing their part.

In embedding natural capital into decision-making, in the pursuit of better environmental, commercial and social outcomes, everyone has a role to play.

NAB is prepared to play its part.

As a major Australian bank, NAB is a serious contributor to the Australian economy and to communities right across the nation. We employ over 35,000 people and serve over 10 million customers and over 550,000 shareholders.

We are successful when our customers are successful. So we have good reason to understand how natural capital is impacting our customers' businesses, whether they be not-for-profits, community partners, small or large businesses or government. Our Natural Value Strategy applies right across NAB's business.

In late 2011 we were one of the inaugural signatories to the Natural Capital Declaration (NCD) – a global finance-led initiative working to find ways to identify environmental dependencies in monetary terms.

In 2015, we launched a new asset finance product that offers a 0.7% discount to customers who purchase energy efficient and renewable energy investments. Of the \$70m loaned to date, over 88% of that product has been adopted by our rural customers.

And we are now embedding management of natural capital into our credit risk assessment processes, with the aim of including it in our credit modelling within the next 3-4 years. Our goal is to ensure that natural capital risk is priced like other forms of risk.

This work is being informed by the research we are carrying out with partners like CSIRO, the Australian wine industry, and universities to investigate the links between good management of natural capital assets, financial performance and businesses resilience.

How natural capital can be incorporated into decision making

Leading businesses are already factoring biodiversity and ecosystem impact and dependency into their business strategies.

In surveys of about 5,000 of our agribusiness customers, more than 80% have told us that soil health, water scarcity and energy costs are significant business risks. Biodiversity, minimising run-off and waste are not far behind.

Over three quarters of our agribusiness customers tell us that they have made recent investments in initiatives to improve the sustainability and profitability of their operations.

A couple of examples:

– Sam Violi – a strawberry farmer from Coldstream has led the industry in the adoption of integrated pest management, resulting in substantial reductions in the chemicals applied to his fields. He's won awards for water efficiency and applies organic fertiliser because he sees it as an

investment in his soil health. Critically, his production is competitive, supplying major supermarkets.

– Skybury, of which Ian MacLaughlin is a director, grows coffee, papaya and bananas in Far North Queensland. It has likewise significantly reduced the use of chemicals. Critically, Skybury has implemented numerous strategies to retain sediment, nutrients and water on its farms for productive gain. This is especially important because of their location in the catchment of the Great Barrier Reef.

Many leading farmers are strategically using investments in building natural capital to demonstrate to their stakeholders not only the quality of their produce, but also their management capability.

But what about our cities where most of Australia's population live? With rising population density, urban centres must manage their natural capital as well as, if not better than, regional Australia.

Our urban forest, made up of street trees, parks and gardens is vital infrastructure, providing critical services: cooling our cities, encouraging physical activity, contributing positively to mental health, and helping manage storm flows. Ensuring all residents have immediate access to high quality vegetated spaces is a critical component of modern urban design.

Researchers recently estimated the value of New York's Central Park at \$500Bn. At \$70m/ha/yr, this urban park is the most highly valued ecosystem on the planet.

The city of Melbourne derives its water from a forested water catchment. Were this forest to be damaged, the catchment would erode, the dam would slowly fill with sediments and the city's water source would be polluted. A new filtration plant costing no less than \$1Bn would need to be constructed, not to mention the ongoing maintenance costs.

Now the pipes, pumps and treatment systems that form Melbourne's water supply infrastructure sit on balance sheets. Investments in capital renewal, and the infrastructure's operating costs are managed.

But on what balance sheet do the ecological services of the forested catchment sit? More broadly, on what balance sheet do we record and monitor changes in the value of our stock of pollinators, our soils and our water?

Data for better management

Our poor record of infrastructure planning illustrates the costs of decision-making with inadequate data.

Capital to finance high quality infrastructure projects is readily available. Infrastructure assets are desirable to investors. But how much do we know about the real costs and benefits of major infrastructure projects? Who is taking proper account of the environmental implications of infrastructure planning decisions?

In the area of infrastructure planning, the information gap between where we are and where we need to be is immense. A succession of government-produced Intergenerational Reports, commencing 14 years ago, have alerted Australians to the probability of this continent having to accommodate a population increase of an additional four million people in each of the next four decades. But few of our leaders want to talk about where these people will live, what infrastructure services will be required, and how environmental impacts will be managed. These decisions – about where people will live, what will be built to support their lives, and what happens to the

natural environment as a consequence – should be taken together. This might seem obvious, and I guess it should, but it is a long way removed from the way we have done things in the past: infrastructure build lagging population increase by years, if not decades; and the impact on environmental amenity largely being ignored.

The question we should be asking ourselves turns history on its head: supposing the Australian population is going to grow by two-thirds over the next few decades, in what infrastructure projects, or system of projects, should we be investing in order to protect, even enhance, Australia's natural capital and its environmental amenity more generally?

Now, to answer that sort of question, we need to have some measure of natural capital and some measure of environmental amenity. The work that impresses me most in this area is due to the Wentworth Group of Concerned Scientists in their proposed national accounting framework for environmental assets.

Such a framework would enable the measurement of the health of our environmental assets and the change in their condition over time, using a common index (Econd).

In this framework, the measurement of environmental condition is motivated by an acceptance of responsibility to manage our natural capital in the same way we manage our social, financial, human and built capital. As the Group says, *if you can't measure it, you can't manage it*.

Environmental valuation is gaining momentum.

Frameworks for understanding and accounting for natural capital are not common, but they are not new either. Next generation initiatives are building off a range of foundation tools like the UN's System for Environmental and Economic Accounting – an accounting framework that records the stocks and flows that are relevant to both the environment and the economy, first developed in 1993. Australia was the first country in the world to develop comprehensive national water accounts, in 2010. And with the launch of the Natural Capital Protocol in July this year, we will see momentum build further, as more businesses are supported in measuring and valuing their direct and indirect impacts and dependencies on natural capital.

Conclusion

I said at the beginning that my passions for my role at NAB and for conservation were aligned. Growing the economy and protecting the environment can also be aligned.

As our population grows, degradation of our natural capital becomes ever more expensive; posing significant challenges for our economic prosperity. Turn that around: by investing in building our natural capital, we can enhance business resilience and productivity, and satisfy the aspirations of a growing population.

We need to manage our natural capital with the same diligence that we manage our financial capital. This means accounting for the condition of our environmental assets, including the availability of clean water, the quality of biodiversity and the condition of our soils. And it means an integrated national approach to natural capital management.

But there are significant things that individual businesses can do to contribute to that national challenge. This is one of the messages Fiona Wain would emphasise whenever she had the opportunity.

In that spirit, NAB is working towards integrating natural capital considerations into day-to-day decision making processes and risk assessments.

When I visited the farmers that we partner with in Moree, natural capital was far from an abstract term. I learned that our farmers consider it part of their core business.

We all know that farmers go through dry and wet times. There will be drought. But when the drought breaks:

- if you have invested in your built capital – your pumps will be working,
- if you've invested in your human capital, you'll have staff to operate your machinery and the know-how to run your business commercially,
- and if you've taken care of your natural capital – managed your weeds, your water retention and your soil health – you will be well positioned to take advantage of future commercial opportunities.

Natural capital is not a footnote in a business plan, it is a core asset on the balance sheet. That's true for an individual business; and it is true also for the nation.