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# APPLYING THE HÖGLUND MODEL TO PHOSPHORUS(P) AND NITROGEN(N)

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This paper takes the reader through how the Höglund mechanism of flexible fees might be applied to phosphorus(P) and nitrogen(N), giving the reader enough detail to be able to compare the flexible fees approach with other mechanisms.

A general description of the mechanism, including a short video, is available on our website [www.tssef.se](http://www.tssef.se), and in our White Paper.<sup>1</sup> It is useful to read these first to gain some background.

*The paper starts with a general discussion on the importance of raw materials to the economy and how waste represents a market inefficiency.*

## WASTE REPRESENTS A MARKET FAILURE AND IS A SIGN OF INEFFICIENCIES

### MARKET FAILURE AND EXTERNALIZATION

In today's complex societies and supply chains, costs incurred for the provision of products and services with the extraction, production, supply and disposal of materials are not all born by the firms along the supply chain.

Costs for everything from educating workers, to health care, for roads, railways, and for cleaning up pollution and for refuse disposal are not fully born by the firms. This is called externalization of costs<sup>2</sup>. When society incurs harsh costs for externalization, for example when air pollution causes health care burden, the term "market failure" is used<sup>3</sup>.

Waste in itself actually represents unused resources and are signs that society is not functioning as efficiently as it could.

The failure to effectively internalize harmful externalities in the economic system, pervading almost all aspects of human life, has resulted in an unsustainable lifestyle and a potentially lethal conflict of interests both locally and globally.

**Anders Höglund, TSSEF**

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<sup>1</sup> <http://tssef.se/?p=469>

<sup>2</sup> The question of the environment is viewed, in the traditional economic framework, as being related to the externalization of costs. That is, market economics assumes that a good which is underpriced, is overconsumed. Externalization of cost, in this view, will be corrected by pricing the overconsumed resources which are being used, for example the work of [Lester Thurow](#) and also see [Pigovian taxes](#). Not all economics study accepts this paradigm, and, instead, there is a seven decade old tradition of viewing economic relationships as being based on the scarcity of energy, rather than price, as the central feature of economics.

<sup>3</sup> One definition of market failure is: "A condition that arises when unrestrained operation of markets yields socially undesirable results".

Waste represents business potential given the right conditions.

The Foundation sees these failures as situations where the context within which the firm operates is not effective in ensuring that market forces preserve the environment or health.

Identifying ways to create a context for market forces to operate within, where costs are not externalized, must be the major task of governments. At the least, it befalls government to do everything in their power to introduce monitoring and control mechanisms to curb externalization as they have no mandate to allow degradation of the nation's ecosystem or depletion of resources human, natural, mineral or otherwise.

### **Supply chains are only profitable if the costs of the pollution they create are not factored in.**

The notion of “externalities” has become familiar in environmental circles. It refers to costs imposed by businesses that are not paid for by those businesses. For instance, industrial processes can put pollutants in the air that increase public health costs, but the public, not the polluting businesses, picks up the tab. In this way, businesses privatize profits and publicize costs.

If we take the idea seriously, not just as an accounting phenomenon but as a deep description of current human practices, its implications are positively revolutionary. A recent report <sup>4</sup> commissioned by the United Nations and compiled by The TEEB for Business Coalition concludes that no major industry would be profitable if pollution costs were internalised. The report states: *“No high impact region-sectors generate sufficient profit to cover their environmental impacts”*.

### **Fostering dependence on finite resources is an unsustainable long-term strategy for societal development**

Many long-term visions of business expansion and development of nations take no account of the availability of essential material. For example: according to a study, titled "Metal Stocks and Sustainability,"<sup>5</sup> all of the copper in ore, plus all of the copper currently in use, would be required to bring the world to the level of the developed nations for power transmission, construction and other services and products that depend on copper. The researchers believe scarce metals, such as platinum, risk depletion in this century because there is no suitable substitute for use in devices such as catalytic converters and hydrogen fuel cells. They also found that, for many metals, the average rate of use per person continues to rise. As a result, the report says, even the more plentiful metals may face similar depletion risks in the future.

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<sup>4</sup> NATURAL CAPITAL AT RISK: THE TOP 100 EXTERNALITIES OF BUSINESS, TRUCOST PLC 2013  
[http://www.teebforbusiness.org/js/plugins/filemanager/files/TEEB\\_Final\\_Report\\_v5.pdf](http://www.teebforbusiness.org/js/plugins/filemanager/files/TEEB_Final_Report_v5.pdf)

<sup>5</sup> Proc. Natl. Acad. Sci. USA. By Robert Gordon and Thomas Graedel of Yale University and Marlen Bertram of the Organisation of European Aluminum Refiners

There are energy constraints to growth too. To quote sustainable development expert Richard Heinberg;<sup>6</sup> “The most cursory examination of our current energy mix yields the alarming realization that about 85 percent of our current energy is derived from three primary sources—oil, natural gas, and coal—that are non-renewable, whose price is likely to trend higher (and perhaps very steeply higher) in the years ahead, whose EROEI<sup>7</sup> (net energy yield for energy used for extraction) is declining, and whose environmental impacts are unacceptable.”

Several technological changes we have witnessed over the last decades have been rapid: the spread of mobile phones, the Internet, digital music players. All of these examples are, however, light in terms of materials and energy intensity. Technological infrastructure like transport systems, power generation and waste water purification and handling all take decades to transform. A report sponsored by the United States Government<sup>8</sup>, concludes: “The depreciated value of existing U.S. transportation capital stock is nearly \$2 trillion and would normally require 25 – 30 years to replace.”

Another report, by the Pacific Institute on behalf of Ceres,<sup>9</sup> finds that water stress is rapidly becoming a key strategic risk to commerce. Several business sectors are at risk, including clothing production, food production, metals and mining and electricity production

Material suppliers, like oil companies and metals and mining, have an economic interest in businesses being dependent on their materials. Their mandate is to maximize profits as long as possible until the asset runs out. Conservation, taking depletion into account and minimizing societal dependency risks are not written into the articles of association that govern these organizations. The formation of legal bodies operating under these tenets is accepted practice, the benefits of the creativity and effectiveness these structures unleash is seen as outweighing their downsides.

Given that businesses cannot be expected to act in the interests of the national economy, and that replacement of existing heavy infrastructure would take a long time, and given the scarcity of metals and impending lack of water, governments would be wise to start to:

- steer their country’s economy to be less dependent on finite materials
- ensure the ecosystem can provide water, building material, wood for fuel, etc. in sufficient quantities to supply essential services.

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<sup>6</sup> [http://richardheinberg.com/MuseLetter\\_203\\_March\\_2009.html](http://richardheinberg.com/MuseLetter_203_March_2009.html)

<sup>7</sup> Energy Return on Energy Invested. For a deeper discussion of the relation of EROEI see the article at <http://www.chrismartenson.com/forum/implications-eroei-peak-oil/11020>

<sup>8</sup> Peaking Of World Oil Production: Impacts, Mitigation, & Risk Management, Robert L. Hirsch, SAIC, February 2005

<sup>9</sup> [http://www.pacinst.org/reports/business\\_water\\_climate/full\\_report.pdf](http://www.pacinst.org/reports/business_water_climate/full_report.pdf)



## Phosphorus

This element belongs to the category of recyclable but scarce. Phosphorus is finite and like oil it will peak sooner or later. In his frightening book [Eating Fossil Fuels](#) <sup>10</sup> Dale Allen Pfeiffer shows that conventional agriculture is as oil-addicted as the rest of society. A decline in oil production raises questions about how we will feed ourselves.

In the same way, agriculture is addicted to mined phosphates <sup>11</sup>and would be threatened by a peak in phosphate production. As the U.S. Geological Survey (USGS) wrote in [summary on phosphates](#) (PDF) <sup>12</sup>: There are no substitutes for phosphorus in agriculture.

Fortunately, phosphorus - unlike oil - can be recycled. Responses to a phosphorus peak include re-creating a cycle of nutrients, for example, returning animal (including human) manure to cultivated soil as Asian people have done in the not-so-distant past<sup>13</sup>.

As can be seen in the diagram below, phosphorus enters the supply chain in most countries through import as it is mined in just three main places. Phosphorus is an essential component of fertilizer and is applied in agriculture. Some leaks into the surface water and into rivers and eventually into the sea. Once in the sea it is difficult to recover and return to agriculture. It remains in the supply chain in food until it is excreted as urine and taken care of by sewage treatment plants. Inevitably, phosphorus leaks into the sea stimulating among other things algal blooming. This problem is especially prevalent in the Baltic Sea area, creating problems for the fishing industry and damaging the tourist industry by closing beaches.

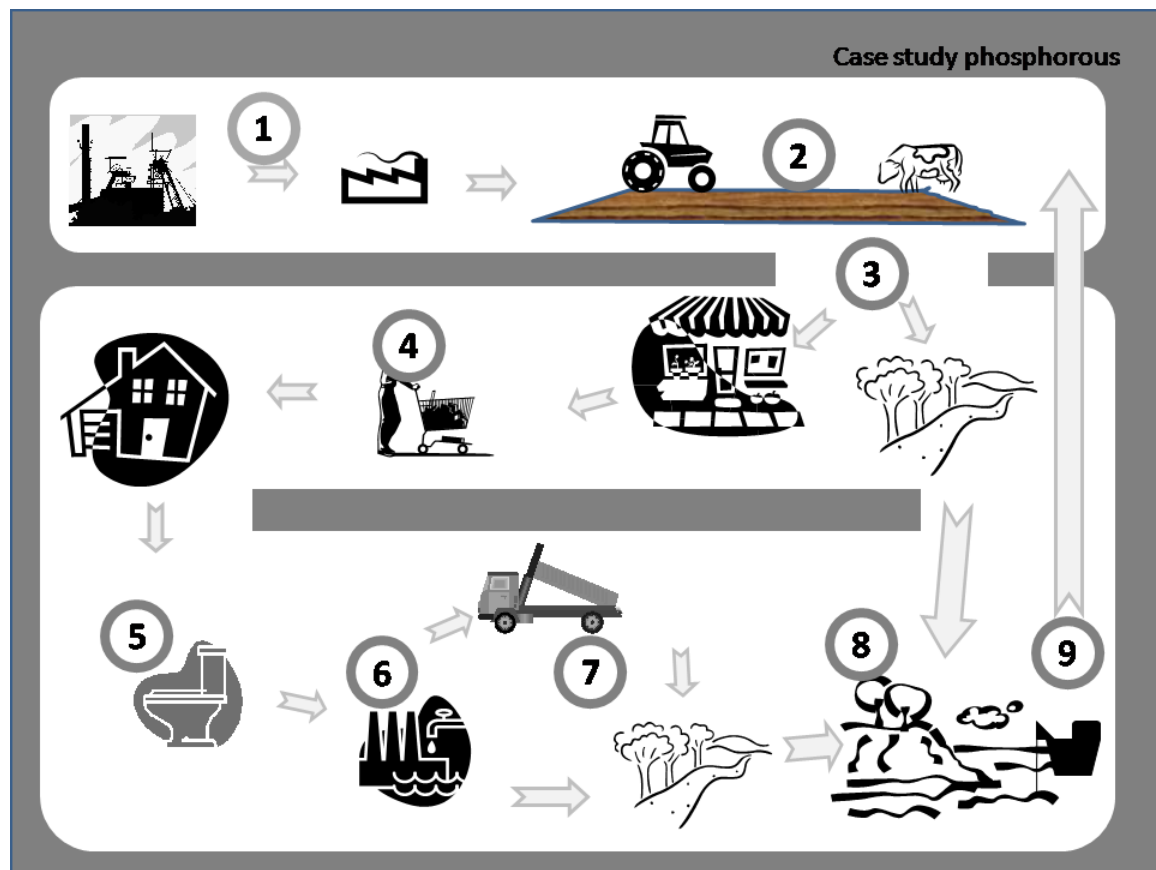
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10 <http://www.amazon.com/Eating-Fossil-Fuels-Coming-Agriculture/dp/0865715653>

11 Abelson, Philip H. "[A Potential Phosphate Crisis.](#)" *Science*. 26 March 1999: Vol. 283. no. 5410, . 2015.

12 [http://minerals.usgs.gov/minerals/pubs/commodity/phosphate\\_rock/phospmcs07.pdf](http://minerals.usgs.gov/minerals/pubs/commodity/phosphate_rock/phospmcs07.pdf)

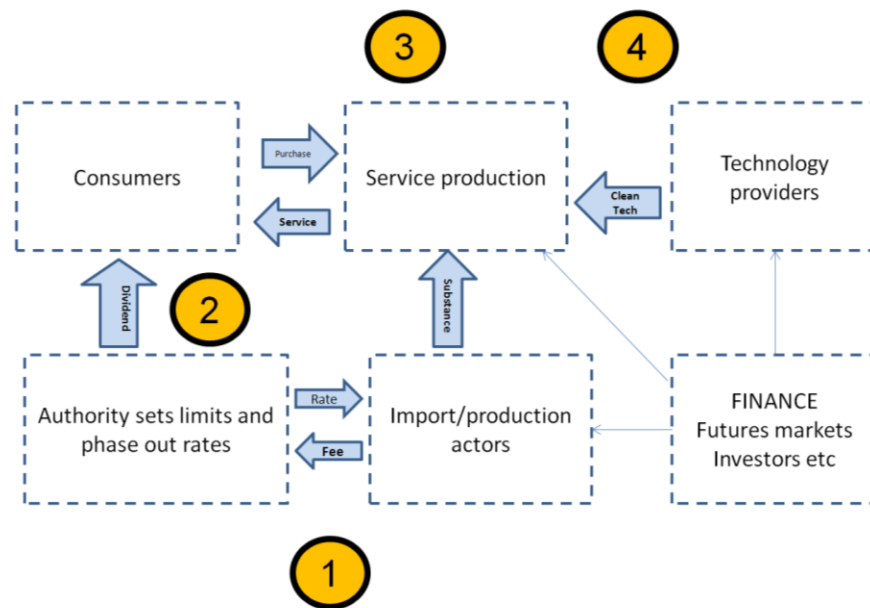
13 F.H. King. [Farmers of Forty Centuries: Organic Farming in China, Korea and Japan](#), Dover Publications, NY, 1911 (ed. 2004)



1. Phosphorus is mined and processed into fertilizer along with other nutrients like potassium and nitrogen.
2. Applied to the fields, it is incorporated into vegetables and sold direct or into animal feed.
3. Phosphorus leaks from agriculture into waterways and is exported to shops as food.
4. Consumers purchase food for consumption.
5. Phosphorus leaves the body mainly as urine.
6. Sewage is processed at water purification plants.
7. Some phosphorus is dumped as waste from purification, some ends up in waterways.
8. Eventually phosphorus travels to the sea
9. Some phosphorus can be recovered from the sea-bed, most remains in the sea

As phosphorus supplies are finite, it would be beneficial to the national economy to encourage recycling - lack of supply will cause food price hikes. It would also reduce damages to waterways and sea ecology.

## An overview of the Höglund mechanism

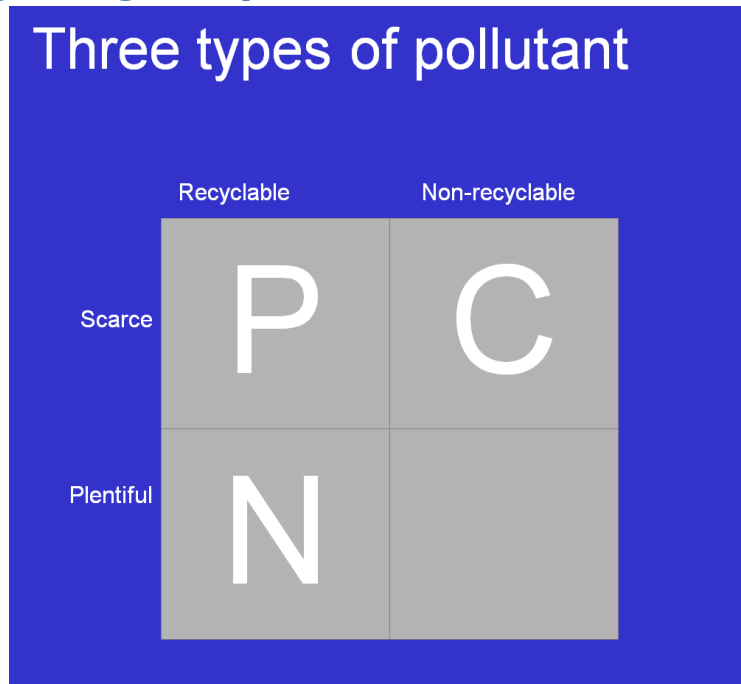


As shown in the diagram above,

1. The authority decides on the fee mechanism and levies a fee. This fee is adjusted depending on how the market reacts. If there is no reduction in pollution, the fee is raised until a change in the right direction occurs.
2. The fee collected is fully or partly returned to the economy as a stimulus dividend to consumers. Consumers are free to spend the money how they wish, but thanks to the fee, products using the polluting element are more expensive.
3. This stimulates producers to purchase alternate, green technologies and services.
4. As these services become competitive, the demand for the pollutant based solution declines, but at a pace that actors invested in the substance can develop alternatives and retain economic stability.



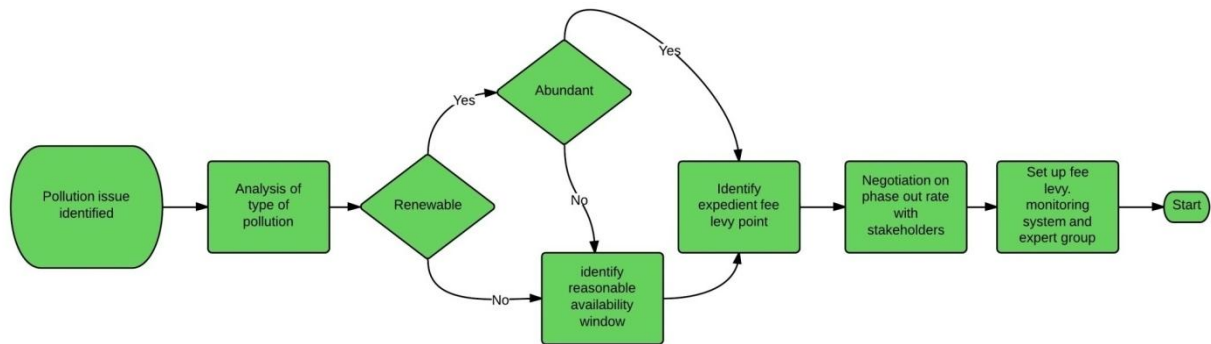
## Understanding the categories of pollutants



Not all pollutants are the same. For the purpose of applying flexible fees, four main classes can be used:

- 1) Non-renewables: examples include fossil fuel and uranium. Once used, the energy is no longer available even if the substance, e.g. carbon, is recyclable.
- 2) Minerals that are recyclable but are handled in a way as to make them practically unrecoverable: examples include phosphorus and platinum
- 3) Elements that are in abundance but cause problems when they accumulate in ecosystems. Examples include nitrogen.
- 4) Not pollutants but where deleterious practices reduce ecosystem services. A good example is clear-felling. Cutting down a tree seldom affects ecosystem services, but clear-felling affects things like soil water retention and soil erosion, causing problems in waterways far from the felling site.

## Using the Höglund mechanism to construct phosphorus fee



The diagram above shows the decision process at the introduction of the mechanism. We will look at the practical application of flex fees through worked examples to illustrate the principles.

Using the Höglund approach we go through the main steps to construct the fee mechanism:

Identify system boundaries:	<p><b>Entry:</b> import of phosphorus in fertilizer and as minerals as well as in food.</p> <p><b>Exit:</b> release from water treatment plants, leakage from agriculture, release from homes not connected to sewer system.</p>
Plan reasonable phase-out of emissions over time:	<p><b>Some of the issues that might inform the decision:</b> small amounts of leakage may be tolerable from a waterway ecology viewpoint. On the other hand, dependency should be cut to protect long term viability of the food industry. The technology for recycling phosphorus is widely available. Based on this a zero emissions target could be achieved in say 30 years, with the aim to reduce emission by half within ten.</p>
Set up fee mechanism:	<p>Initially, a fee charged bimonthly on imports of phosphorus-containing compounds for agricultural use. Imported food contains phosphorus – and so does exported food, factors to consider.</p>
Set up redistribution:	<p><b>Issues for consideration:</b> As food price stability is central to the transformation, redistributing the money via general alleviation of personal taxes could be brought about. More disposable income gives more money to spend on food.</p> <p>The current sewage infrastructure stems from designs of the 1800s. Massive investments are needed to enable phosphorus recycling. Some fee income could be used to stimulate development in this area.</p>

Monitor market behaviour:	<p><b>Things to look for:</b> that the fee is sufficiently high to encourage firms with low abatement costs to change operations. Areas where abatement costs appear prohibitive. Monitoring import of food and other ways for phosphorus to enter the country and affect the competitiveness of home grown food.</p> <p>Making sure food prices do not affect inflation.</p>
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Using this approach we might arrive at the following:

A fee is levied on phosphorus import nationally. This means classes of goods, identified by their commodity codes, that contain phosphorus would be taxed, for example:

- Fertilizers
- Food

As estimates put the availability of phosphorus at 30 years, a 20 year phase-out time might be deemed reasonable.

At the same time, release of phosphorus occurs in human and animal urine. Here a fee might be needed if a market for phosphorus-containing soil additives from urine did not arise.

The authority sets the fee and monitors imports and emissions. It returns the money to taxpayers via a monthly tax rebate, for example. If imports rise or do not fall to any significant extent at the next round the authority raises the fee. This continues until market behaviour shows a decline.

There should also be an increase in sales of, for example, organic food, which should become more competitive. It is important that food prices do not drive inflation. However, with organic food production favoured, and more money in the pockets of consumers we can expect that food prices can remain stable.

Authorities need to monitor emission of phosphorus to waterways and phosphorus burden on waste water treatment.

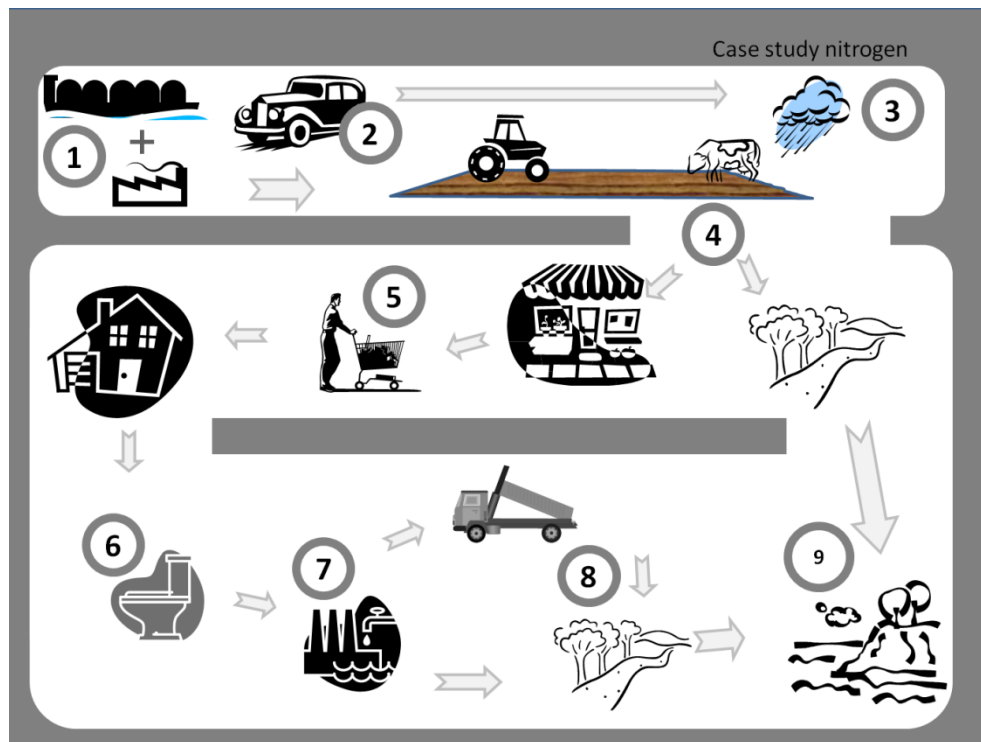
We would hope to see a market for phosphorus-rich products like urine. Entrepreneurs might start to offer urine-separating toilets with special collection facilities. This would be especially interesting if fees on direct release of sewage were increased as indicated earlier.

As the market for recycling develops, there should be a decrease in emissions to water and a decrease in the burden to waste-water. This reduces water treatment costs and should result in lower taxes.

## Using the Höglund mechanism to construct Nitrogen fee

Nitrogen is interesting because it is abundant, is in the air and is brought into the soil by plants and lightening. The main sources of pollution in nature are from industry and combustion engines (possibly around a fourth of all nitrogen pollution) and agriculture (3/4). Like the first two pollutants, nitrogen is an essential element of the living system. Unlike the others it is in abundant supply – presenting new challenges for fee-based regulation.

The diagram below illustrates the flow of nitrogen through our communities.



1. Natural gas is combined with various minerals and nitrogen from the air to create fertilizers for the agricultural industry.
2. Combustion engines and industrial processes combine nitrogen from the air and release nitrogen gasses into the atmosphere.
3. Nitrogen compounds in the air return to earth.
4. Nitrogen in food is transported for sale. Some leaks to watercourses from the fields.
5. Food is consumed and nitrogen exits the body.
6. Nitrogen travels through the sewer system.

7. Water purification plants release some nitrogen to natural watercourses; the rest is dumped where it leaks slowly into groundwater.
8. Nitrogen flows via natural waterways into the sea.
9. In the sea, excess nitrogen contributes to eutrophication.

Identify system boundaries:	<p><b>Entry:</b> N combines in combustion engine and industrial process to form gasses. Also taken from air to create fertilizer. Enters country in food, too.</p> <p><b>Exit:</b> release from water treatment plants, leakage from agriculture, release from vehicles and industrial processes</p>
Plan reasonable phase-out of emissions over time:	<p><b>Some of the issues that might inform the decision:</b> small amounts of leakage may be tolerable from a waterway ecology viewpoint. The technology for recycling is widely available. Based on this, a zero emissions target could be achieved in say 30 years, with the aim to reduce emission by half within ten.</p>
Set up fee mechanism:	<p>Initially, a fee charged annually on all combustion engines and industrial processes that remove nitrogen from the air. Fee could be charged on import of food.</p>
Set up redistribution:	<p><b>Issues for consideration:</b> As food price stability is central to the transformation, redistributing the money via general alleviation of personal taxes could be brought about. More disposable income gives more money to spend on food.</p> <p>The current sewage infrastructure stems from designs of the 1800s. Massive investments are needed to enable nitrogen recycling. Some fee income could be used to stimulate development in this area.</p>
Monitor market behavior:	<p><b>Things to look for:</b> that the fee is sufficiently high to encourage firms with low abatement costs to change operations. Areas where abatement costs appear prohibitive. Monitoring import of food and other ways for nitrogen to enter the country and affect the competitiveness of home grown food.</p> <p>Making sure food prices do not affect inflation.</p>

The mechanism might be applied to nitrogen as follows:

A fee would be place on substances entering the country with high levels of nitrogen in them, these would include

- Fertilisers

- Foods

It would be of interest to explore putting a fee on combustion processes that converted atmospheric nitrogen to NOx. These include

- Combustion engines
- Industrial processes
- Artificial fertilizer production in the country

Import fees could be changed regularly. However, as cars last for many years, the fee would need to be changed every year to cover that year's model range.

Again, monitoring is needed to check imports and to see how emissions directly to waterways respond. There is also a good source of nitrogen in urine, and with fees on imported nitrogen rising, recycling would be encouraged by the price pressure.

Some monitoring of the vehicle industry will be needed to see how quickly technical progress reduces NOx.

### A simulation

It might be helpful to try a thought experiment to see how the nitrogen and phosphorus flexible fee might be introduced in practice.

### Introduce a fee at fertiliser and food import

A suitable point early in the supply chain could be levied on import of fertiliser. At the same time, the amount of food (and thereby nutrients) is large and a similar import tax should be put on food, possibly with the exception of organically labelled food.

Likely effects, Sweden:

Key figures: total sales of food in shops and to public sector is 36 Billion SEK/yr<sup>14</sup>

(food purchase by restaurants and hotels not included)

Total import of chemical fertilisers is 730 000 000 kg<sup>15</sup>

At 2- 20 SEK a kilo the total market value is 1.5 -15 Billion SEK/yr

Note that latrine-based fertilisers introduced in the early 1900's would at today's prices be equivalent to 230kr/kg.

<sup>14</sup> SCB, Statistics Sweden

<sup>15</sup> Jordbruksverket, the Swedish Ministry of agriculture



### **A fee of 100% would raise food prices significantly**

Some estimates put the total cost of fertilisers at 25% of total food costs

For Sweden, estimates by IVL say that a 15-20% increase in bread prices coming from a 100% increase in fertiliser prices would trigger investment in alternatives. This is in line with estimates that put organic food 15-300% more expensive than conventional food that uses artificial fertiliser.

### **A dividend back to the public would mean no net increase in food costs**

An import fee of 100% would not, however in effect make food more expensive if the fee were to be paid back to taxpayers through a general tax dividend. Food costs as percentage of monthly costs would increase, but so would disposable income.

### **Organically-produced food would become more competitive**

Organically produced food would become more price-competitive. Add to this that demand for organic, recycled fertilisers would increase, and technology for capturing nitrogen and phosphorus from waste would become more attractive.

### **Three scenarios indicate how technology might respond**

Scenario possibilities

- 1) Imports continue. The fees are raised but no change in import. This would mean that there was no business case for introducing green technology. Should this happen more government intervention would be needed in investment in technology.
- 2) Already at a 15% gross increase in food prices, investment in green practices accelerates. Approaches include both organic agriculture but also bionutrient recycling. Emissions to watercourses decline, reducing municipal water treatment costs. Many Swedish green tech companies thrive and become more competitive internationally.<sup>16</sup>
- 3) New cheap sources of phosphorus are discovered, making raised fees ineffective. Fee setting moves to fee on agricultural land (to compensate run-off) and toilets (to encourage recycling).<sup>17</sup>

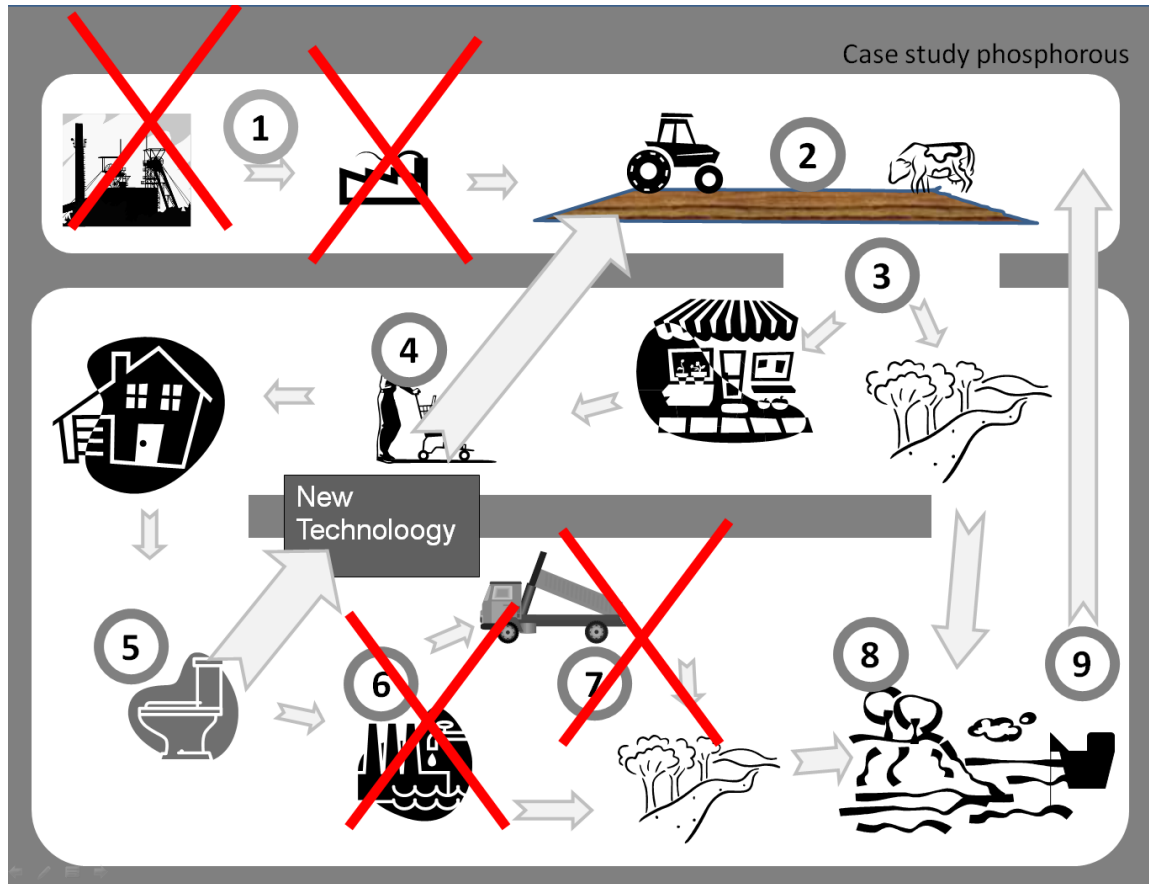
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<sup>16</sup> Of the 1,095,000 tons of N reaching the Baltic(1996 figures), some 11% or 120,000 tons come from Sweden. Together with P emissions, Sweden emits 122,880 tons. This is equivalent to some 16% of all import of chemical fertilizers are released into the Baltic. Half of all emissions are anthropogenic.

<sup>17</sup> A good reference for total emissions burden on Sweden is <http://www.smed.se/wp-content/uploads/2011/10/SMED-56-2011.pdf>

- 4) Fossil fuel price increases drive the cost of fertiliser and food. Having introduced the phase-out strategy, Sweden is well prepared to meet the challenge of nutrient recycling.

### The effect on driving new technology



When the fee on connection to mixing first separate later infrastructure, and import of P and N becomes sufficiently high, investors will invest in new technology.

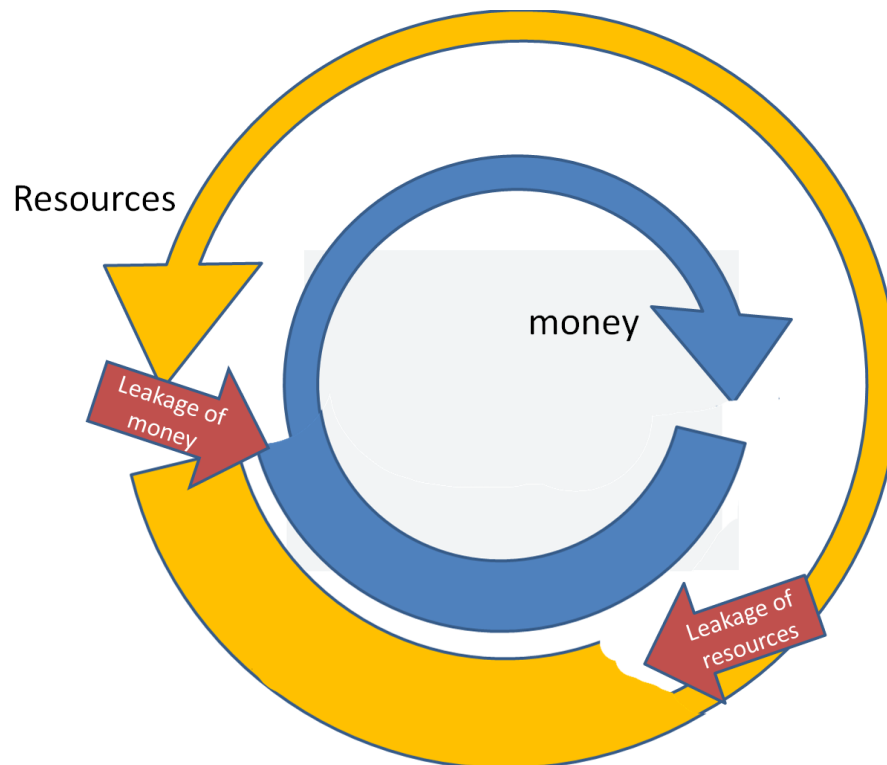
### Several existing green technologies would be favoured

Some thoughts on available technology

- Using computer technology to reduce waste when applying artificial fertilisers
- Domestic urine separation and collection by farmers

- Collecting all biowaste and converting it to compost instead of incinerating it<sup>18</sup>

### The circular economy driven by flex fees



As seen in the diagram above, money is created and then leaks from the national economy. The creation point is when loans arise. Resources are bought and when payments are made abroad for services and or products the money in effect leaks from the nation. To use the examples above, taking the case of Sweden, huge amounts of money pass out of the economy to pay for imports of fuel and fertilizer.

At the same time, we can say that money leaks out of the economy as:

- Nutrients that are not reclaimed but end up for example unrecoverable in the sea or in the case of metals, in inseparable alloys. New supplies of nutrients need to be bought for the next cycle.
- Damage to eco-systems that must be paid by others.

<sup>18</sup> Phosphorous recovery has been investigated as a possibility for Sweden, see the report <http://naturvardsverket.nu/Documents/publikationer/620-5221-7.pdf>

Should eco-system damage not occur, and nutrients not leak, less money would in effect leak out of the economy. Jobs leak out of the economy with money and investment goes with it as well. The Foundation believes we should be striving for something that is closer to economic maturity, where housekeeping with nutrients both biological and mineral ensures no net leakage.

If no leakage occurs, as the result of the barriers to stop leakage of money becoming more effective, the conditions for economic growth improve.

The circular economy recognizes two types of nutrients:

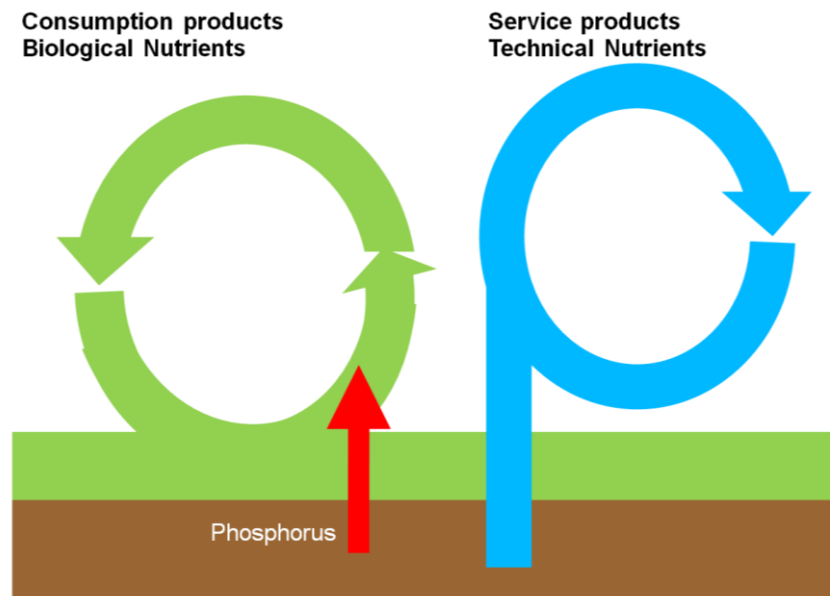
**Biological nutrients**, coming from and returning to the biosphere, and providing products and energy for consumption. Food and biofuel are examples of biological nutrients.

Biological nutrients come from the living layer and return there. Pollution comes from too many or too little being in the wrong place at the wrong time.

**Technical nutrients**, which form the technical infrastructure within which the biological nutrients circulate. The domestic waste water system, made of plastic pipes and metal fittings is an example.

Technical nutrients come mostly from the non-living, sub-surface layer. Once extracted by mining or otherwise they can circulate freely, being kept away from the living layer, where they may poison or otherwise damage eco systems. The investment needed to extract them and refine them to a pure state is huge. Therefore, it makes sense to circulate these elements indefinitely once extracted.

Monetary flows in the opposite direction to biological and technical nutrients as it is used to pay for them.



The aim of the circular economy is to retain and recycle technical nutrients in the economy, to cycle biological nutrients from the economy to the biosphere and back, and to utilize money to facilitate transactions and trade.

The diagram above shows how biological nutrients cycle around from the economic system back to the eco-system and out again. Pollution occurs when nutrients accumulate in the wrong places. Example of this include accumulation of phosphorus in watercourses where eutrophication results. Note that we have added the red arrow to represent phosphorus – which enters the economic system from mineral sources. At first sight it might seem that the phosphorus is something that can circulate indefinitely. In practice, however large quantities wash into the oceans where they are, or have been up to now, irretrievable for practical purposes. This means the practice of mining must continue.

Mineral elements and other technical nutrient components from the non-living layer have no place in eco-systems and should be kept separate from them. Again from the diagram it looks as if iron, for example, once mined can be circulated indefinitely. Whilst true in theory, the practice of combining metals and other materials so they cannot be separated, during manufacture, combined with the practice of waste disposal has meant that large quantities of potentially useful technical nutrients are in landfill unrecoverable for all practical purposes.

By placing flexible fee levying mechanisms at strategic points where substances enter the economy, and raising them sufficiently high at sufficiently frequent intervals, the market gets stimulated to introduce non-emitting alternative approaches.

## **Further clarifications on the Höglund mechanism applied to phosphorus and nitrogen:**

### **The mechanism works to engage market behaviour to reach system behaviour goals**

In this case, reaching independence from mined phosphorus and stimulating recycling are handled by market forces. There is no need for local authorities to enter into expensive end of pipe clean up measures.

### **The mechanism is a form of control engineering, using feedback mechanisms and control signals**

The change to independence is controlled. This makes sure that for example food prices remain stable and that industry has time to change to, for example, recycling. The control mechanism ensures that policy does not nullify investment or create rapid bankruptcies but rather engages the force of the market in a positive way to change at the pace technical development allows. It also creates a market “pull” for innovation.

### **The mechanism is concentrated on ensuring that society functions for the long-term benefit of citizens**

By putting into place the control, feedback and stimulus in appropriate places in the supply chain, the mechanism succeeds in stimulating the change of behaviour to satisfy economic, environmental and social goals.

### **Höglund’s method is potentially popular as it is fair and puts money in people’s pockets**

As people who use the product that pollutes are also the ones who pay increased costs due to fees, and as the fees return to taxpayers, the mechanism can be seen as being fair and positive. Thus, it would be easy politically to introduce it.

## **Import and export**

Many have asked if placing import duties on imported fertilizer or food might affect trade, or even be unfair. The answer is that Swedish nature is very sensitive to acidification and Swedish soils are, with some exceptions, rather poor. It is incumbent upon authorities to protect nature if the conditions are so.

By building up organic agriculture, Swedish food exports will become more competitive as prices in other countries rise due to phosphorus shortages.

Phosphorus balance is very important. The same net amount of phosphorus needs to remain in the country, recycling indefinitely. With outside sources of rock phosphorus limited it is plausible that fees and controls be put in place to ensure the same amount of phosphorus is imported as exported.



## Comparison with Cap and Trade

The following section compares the approach proposed by the Foundation, a form of pollutant control fee, with a form of Cap and Trade proposed by the Swedish Naturvårdsverket.

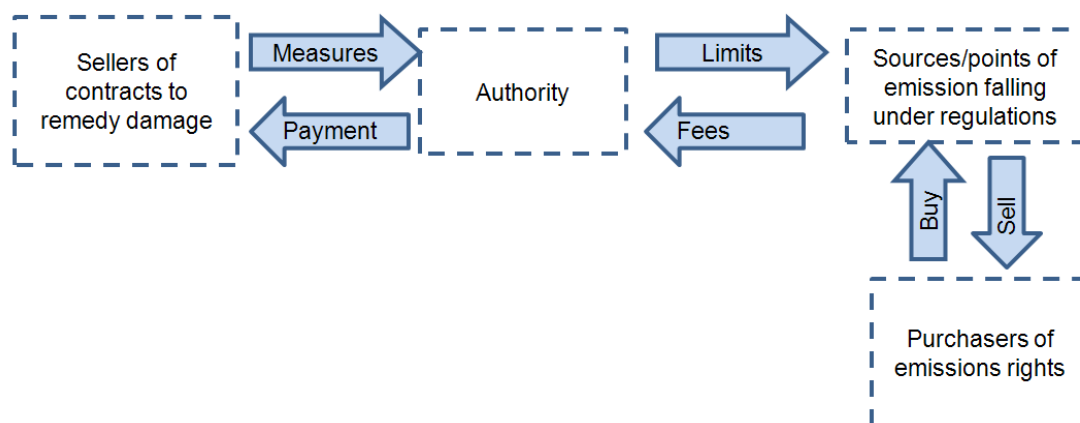
(rapport6345 • mars 2010) This comparison is designed to provide practical insights into how pollution can be priced, based on the following general process:



This analysis was carried out by members of the Board of The Swedish Sustainable Economy Foundation during June- July, 2013 and is entirely based on the Board's perception of the mechanisms and the reading of the report 6345.

Some general conclusions can be drawn about pricing pollution from the exercise:

- 1) If pollution is priced, and a fee is taken, where do the collected fees go? This is just as important for economic impacts of the fee.
- 2) Controlling the pollutant early in its path through the economy is probably cheaper for society as a whole than administering emission permits and controlling their sale.
- 3) Mechanisms that treat classes of pollutants differently are likely to have a higher degree of efficacy.
- 4) Clarity is needed when looking into price mechanisms to understand both the nature of the pollutant (including levels of toxicity) and also the intended effects of the mechanism. For example; Cap and Trade aims to limit emissions. Flexible Control Mechanisms aim to control the pollutant in a way that allows a technological transition whilst retaining economic stability.



The diagram above shows a Cap and Trade mechanism proposed by the Swedish Agency for Nature Protection. (Swedish Naturvårdsverket. rapport6345 • mars 2010). At the centre is a regulating body that on the one hand (the right side of the diagram) places limits on emissions from regulated sources/points and collects fees from the emitters. On the other hand (left) the authority orders remedial clean-up measures from actors, paying them from the fee charged.

Emitters can sell on the rights to emit to other emitters (bottom right).

Cap and Trade exhibits so many differences from flexible fees that comparison can be difficult.

A recent Nordic Council Report <sup>19</sup> compares the Cap and Trade approach with flexible fees. In terms of the market, the Flexible Fee approach assumes that some kind of insurance market will arise to balance the risk of material prices (probably a futures market). This would focus the attention of the market on the rate of change of the fee, opening up to investment in clean tech in new ways.

In terms of economic incentives, Cap and Trade aims to bring polluters in line by charging for emissions. Flexible Emission fees are aimed at ensuring whole supply chains change with the aim of curbing the costs associated with pollution whilst bolstering a clean economy.

The two studies view economic technology differently too. Whilst Cap and Trade relies on adjusting limits every five years, Flexible Fees relies on frequent updates of collected market information, and frequent changes in tariffs. This is only possible with the digital economy, and it is the digital economy, according to Flexible Fees, that enables the economy to be controlled. Does this not call for further investigation into the power of the market place, rather than regulation, to solve pollution?

Firstly, if it were possible to put economic control in place thanks to digital steering of the economy, would policy makers see it as their role to eliminate pollution as quickly as possible? Secondly, Cap and Trade sees all pollutants, for economic purposes, as being similar. Not so for flexible fees, which value the pollutant as a potential resource as well. Does this give us reason to consider working on a classification system for pollutants? Thirdly, the general view of the power of the market place differs: Cap and Trade sees power in allowing those who can reduce pollution as being rewarded by being able to sell the excess capacity. Flexible fees see whole supply chains as being able to adapt in a timely fashion, given sufficient stimulus, which itself can be discovered using the power of the market place

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<sup>19</sup> [\*Two approaches to pricing pollution TN2014:512\*](#),

The main differences in approach can be summarized as follows:

### **Pollution management**

As identified above, pollution in the Flex Fees approach is managed by putting a fee on the pollutant as it enters the economic system. Cap and Trade puts a fee on specific identified points of pollution. *Pollution is seen more as a nuisance to be cleaned up by Cap and Trade. Flex Fees sees pollution in a more subtle way, as congestion in nature of a valuable resource that is not being used to do its job where it should be doing it.*

### **Fee levying**

Fees are levied at the point of entry into the market and raised until pollution stops in the Flex Fees approach. In Cap and Trade they are set by experts and left to work over long periods of time. *Flex Fees are levied upstream so that all pollutant use is regulated, rather than just specific points – this often means that fewer points of fee levy are needed in the flex method and more remittent sources are covered.*

### **Fee redistribution**

In Cap and Trade, authorities purchase remedial works, whereas in Flex Fees, the money collected goes into consumer's pockets for them to spend as they will. More polluting solutions however will be comparatively more expensive. *By redistributing Flex Fees, the market is stimulated to behave in a clean way.*

### **The role of the market**

In Flex Fees the role is to stimulate the market is to stop pollution by providing consumers alternatives. In Cap and Trade the emphasis is on stopping a particular behaviour by making it more expensive and purchasing clean up services. *In Flex Fees the role of the market is to solve the problem, and it is given the financial incentive to do it rather than the punishment for not doing it.*

There is a growing sense of urgency, from the realization that phosphorus supplies may only last 30 years to the recent IPCC report on climate change to the work done by the Stockholm Environmental Institute showing that three planetary boundaries have already been breached. With this sense of urgency, calls are being made for the economic system to better serve the transition to a sustainable economy. Flexible fees aims to provide one such mechanism.