Market-ish instruments and other strange beasts

A personal wrap-up view

Stefano Pagiola
Environment Department, World Bank

ZEF-CIFOR workshop:
Payments for environmental services
Methods and design in developing and developed countries
Titisee, June 15-18, 2005
What’s in a name?

- **Market-ish instruments**
  - **Market-based instruments**
    - Payments for environmental services
    - Certification of environmentally-friendly activities (joint production)
    - Cap-and-trade
    - ...
  - **Non-market instruments**
    - Command and control
    - ...

Workshop on market-ish instruments
Choosing an instrument

- Understand the objectives (e.g., clean water)
- Understand what is preventing them from being reached (market failure? what kind? policy distortions?)
- Choose instruments appropriately
  - Choice of instrument depends on objective and on context

Do not, do not, do not start from the instrument and decide whether it applies.
Defining Payments for environmental services

Leslie Lipper:
   Any payment aimed at generating an environmental service
   • Very general, not very useful

Sven: PES is
1) a voluntary transaction where
2) a well-defined service (or land use that provides it) is
3) bought by at least one buyer,
4) from at least one seller,
5) in a conditional transaction
   • Descriptive, but includes too much
Defining Payments for environmental services

Modified Sven:
PES is a mechanism by which
1) service user(s) pay
2) service provider(s)
3) to provide a well-defined service (or land use that provides it)
4) in a conditional and
5) voluntary transaction
• Focus on services that bring benefits off-site
  (indirect use value in TEV sense)
• On-site benefits can be captured with very different mechanisms because can control access
• If government/donor is financing, call this ‘supply-side’ PES
Defining Payments for environmental services

PES is a mechanism by which
1) service user(s) pay
2) service provider(s)
3) to provide a well-defined service (or land use that provides it)
4) in a conditional and
5) voluntary transaction

Very little attention

Huge amounts of attention
'Supply-side PES' applications

Tool to make use of given budget more cost-effective
- More bang for conservation buck

But
- No additional financing
- No additional information on value of service
- Only as sustainable as the financing
- If get it wrong, it may stay wrong
- Susceptible to political pressures
Benefits of bringing in service users

- Additional information on value of service
  - No WTP, no PES
  - Instrument that can discriminate between cases where conservation is worth doing and cases where it is not

- Additional financing
  - Current conservation budgets pathetically inadequate - Making their use more efficient important, but doesn’t go very far

- Bring into system a constituency with vested interest in getting it right
  - Help withstand political pressures
  - Adjust to problems
Efficiency of PES programs: Sources of inefficiency

- **'win-win'**: Socially desirable practice adopted
- **'lose-lose'**: Socially undesirable practice adopted
- **Non-incrementality**: Not socially inefficient
- **On-site profits**: Only financially inefficient

**Trade-off**

- Value of environmental services
- **PES**: Efficient

- A: Socially desirable practice adopted
- B: Socially desirable practice not adopted
- C: Socially inefficient
- D: Socially inefficient

Workshop on market-ish instruments
Basing payments on user WTP improves efficiency

Workshop on market-ish instruments

Value of environmental services

Min payment
Max payment

Information rent

No deal!

On-site profits

'twin-win'

'trade-off'

WTP

Min
Max

Max payment

Min payment

WTP

Stefano Pagiola, 2005
When is PES potentially useful?

- When land use choices have a substantial impact on others (i.e., have an \textit{externality})
  - Socially optimal land use differs from privately profitable land use
  - Externality may be a public good, but not always
- Know how land use affects that impact
  - Too often just assume that have positive impacts
- Have institutions that can act as intermediaries between buyers and sellers
  - Technical capacity
  - Trusted by buyers and sellers
Paying providers: issues

- Based on what?
  - Specific action taken (e.g., EU agri-environment prog)
  - Expected outcome of action (e.g., CRP)
  - Monitored outcome of action (e.g., Mexico PSAH)
  - Actual service provision (La Manguera, Costa Rica)

- Setting payment level
  - Flat rate (Costa Rica, Mexico, EU agri-environment)
  - Bidding (US CRP, Australia salinity program)

- Cheapest
- More cost-effective
- More effective
- Best, but difficult and costly
- Lower transaction cost
- More bang for buck
Paying providers: issues

- **Additionality**
  - How important?
    - Very, if have fixed budget
    - Politically/practically, if need to convince users to pay
  - How to achieve?
  - Risk of perverse incentives

- **Avoiding leakage**
  - Conditions on participants
    - Monitoring, enforcement
  - Indirect impacts

- **Permanence**
  - Of contract
  - Of action/impact
  - Need for long-term payment