



# In markets we trust? Setting the boundaries of Market-Based Instruments in ecosystem services governance



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## ABSTRACT

A growing tendency to frame environmental problems as a failure to price ecosystem services has coincided with the rise of so-called “Market-Based Instruments” (MBIs). The aim of this introductory article to the special section “In markets we trust? Contrasting views on the performance and legitimacy of Market-Based Instruments in ecosystem services governance” is to promote critical reflection about the nature, scope and limits of MBIs in ecosystem services governance and to provide guidance on where the boundaries for the application of markets ought to be set. First, we examine the role that methodological assumptions and implicit normative positions play in shaping academic perception of the effectiveness and legitimacy of MBIs. Second, we examine MBIs in the broader ideological context and socio-political processes that have favored their development and implementation. Third, we test claims of the literature on MBIs against insights and data from case studies presented in the special section. Fourth, we discuss the scope and limits of markets in ecosystem services governance in the light of biophysical, institutional, and normative boundaries. We end with a summary of concluding remarks from the special section and by identifying critical tasks for the scientific and policy agenda on ecosystem services governance.

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## 1. Introduction

What should be the role and reach of different policy instruments, and in particular the so-called “Market-Based Instruments” (MBIs), in environmental governance? As markets and market values expand into environmental domains that have been traditionally governed by nonmarket norms (Harvey, 2005), some authors point to this question as a critically important missing debate (Gustafsson, 1998; Sandel, 2012; Satz, 2010).

Since the late 1980s, the same institutions (environmental agencies, national governments, and intergovernmental organizations) that steered the first generation of environmental policy regulations, mostly based on standards enforced by the state through “command-and-control” mechanisms, have embraced a “new generation” of environmental policy instruments, usually labeled under the umbrella of “MBIs”. In comparison to so-called “command-and-control” approaches, proponents argue that MBIs are more flexible, cost-effective, and better at rising resources from the private sector (Stavins and Whitehead,

1997). Policy instruments labeled as MBIs include carbon trading schemes, wetland banking, biodiversity offsets and Payments for Ecosystem Services (PES) (Pirard, 2012). One of the distinctive features of this literature is the lack of a consensual definition and therefore a clear delimitation of MBIs.

Indeed, although we use here the term MBIs for the sake of continuity with previous literature, we have argued elsewhere (Muradian and Gómez-Baggethun, 2013) that “MBIs” is a flawed and problematic category due to the confusion that the term “market-based” has induced. It is worthwhile to clarify here that not all the instruments that have been coined as MBIs would fall within a strict (even imperfect) definition of markets, neither all of them share the expectation to influence prices or the cost/benefit calculations of economic agents (an argument that has been used to include subsidies or taxes among MBIs). For the purpose of this paper, we assume that a core characteristic of the instruments labeled as MBIs is the expectation that they can entail economic efficiency gains when attaining environmental goals as compared to so-called “command-and-control” instruments due to their expected higher degree of flexibility.

Although they are inter-related processes, we should not automatically equate the emergence and application of MBIs with markets and market values. In fact, the ascent of market-based approaches in environmental policy and conservation has paradoxically coincided with a

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relative downturn in the international agenda for market liberalization.<sup>1</sup> Hence, if the financial crises started in 2007 put a provisory end to the era of so-called “market triumphalism” (Sandel, 2012), it did not apparently shake the interest on MBIs, since they have kept gaining traction among economists, policy makers, and natural scientists over recent years (Pagiola and Platais, 2007; Engel et al., 2008; Miles and Kapos, 2008; Lockie, 2012; Lapeyre et al., in press).

The rise of MBIs has been nonetheless accompanied by heated debates. Skeptics and critics suggest that MBIs can erode intrinsic motivations for conservation (Bowles, 2008), contribute to undesirable commodification of nature (McAfee, 2012), and promote unequal access to land and resources by privileging those with ability to pay (Martínez-Alier, 2002; Corbera et al., 2007). After years of discussion, it is time to take stock and draw on advances in the recent literature on MBIs and on the evidence from case studies worldwide to appraise the extent to which expectations and fears related to the sue MBIs for ecosystem services governance match observations on the ground.

Such an appraisal is not an easy matter since the outcomes of the assessments depend to a large extent on the “analytical lens” adopted. Within the academic community, views on the virtues and vices of market mechanisms for environmental governance vary greatly across disciplines and the ideological spectrum. Conclusions about the adequacy of a given scheme differ greatly depending on the relative weight given to different appraisal criteria, such as economic efficiency, environmental performance, and distributive justice. Hence, economists, ecologists and political scientists often reach diverging conclusions about the virtues and drawbacks of MBIs. These conclusions may all be internally consistent with the analytical lenses of each school of thought. However, self-referential debates within disciplines or schools hamper the much-needed exchange across epistemic communities in order to promote societal debate on clarifying the boundaries of MBIs in environmental governance.

The special section that we introduce in this paper, “In markets we trust? Contrasting views on the performance and legitimacy of market-based instruments in global environmental governance”, breaks through disciplinary walls and brings together views from economics, political ecology, institutional theory, moral philosophy, and environmental sciences to the same discussion table. In doing so, it shows the many dimensions of MBIs and the issues at stake, involving both advocates and critiques of these instruments. As discussions around the green economy and the new Sustainable Development Goals shape the form that environmental and economic policies will adopt in the coming years, we believe that holding this debate is currently of paramount importance.

The aim of this introductory article to the special section is to promote reflection among academic communities, policy makers and society at large about the nature, scope and limits of different policy instruments, and in particular MBIs, in ecosystem services governance. First, we examine the role of analytical lenses, methodological assumptions, and implicit normative positions in shaping the perception of the effectiveness and legitimacy of MBIs. Second, we examine MBIs in the context of the broader ideological frames and sociopolitical processes that have favored their development and implementation in environmental policy. Third, we test theoretical claims of the literature on MBIs against insights and data from case studies presented in the special section. Fourth, we discuss the scope and limits of MBIs in ecosystem services governance in the light of both technical and normative boundaries to their application. We end up with a summary of concluding remarks and by identifying critical tasks for the scientific and policy agenda on ecosystem services governance.

## 2. The Analytical Lens of Market Environmentalism

The rising influence MBIs is related to a particular way of conceptualizing environmental problems, which also logically condition the associated sets of policy propositions to deal with them. Here, we trace the assumptions and implicit normative positions underlying the case for MBIs.

Philosophers of science have since long discussed the role that systems of values, assumptions and propositions play in defining the way problems are framed and solutions proposed. Building on key contributions in this field (Polanyi, 1946; Schumpeter, 1949; Kuhn, 1962) and discussions about the role of ideological premises and mental models in shaping the environmental science and policy agendas (e.g. Bromley, 1990; Gómez-Baggethun et al., 2010; Spash, 2012) here we attempt to identify the key assumptions (analytical lens) underlying the way problems and solutions are framed by the perspective of so-called market environmentalism, an epistemic community that was decisive in the conceptualization and dissemination of MBIs.

Market environmentalism is referred here as the community of scholars and policy makers that share an approach to environmental governance characterized by the goal to conciliate economic growth, allocation efficiency and environmental conservation (Anderson and Leal, 2001). Core elements in market environmentalism include the establishment of well-defined property rights for ecosystem services, economic valuation of environmental externalities, and the promotion of MBIs for environmental protection (Gómez-Baggethun and Ruiz-Pérez, 2011).

Market environmentalism is embedded in a vision that conceives money and markets as the overarching system of reference defining what is internal and what is external to the mechanism of societal choices. Environmental problems are framed in terms of “externalities”, understood as effects that some agents cause on the wellbeing of others that are not mediated by market transactions. Externalities, which can be negative (e.g. pollution) or positive (e.g. ecosystem services) are seen to derive primarily from “market failures”, amenable to repair through the internalization of social costs into private costs that ultimately should be reflected in prices. Internalization of costs can be done either through state intervention (Sandmo, 2011) or private transactions (Engel et al., 2008). Negative externalities such as pollution can be internalized by obliging economic actors to carry the costs of the external effects produced by their private activity (polluter pays principle) whereas positive externalities can be internalized by paying those who produce them (provider gets principle).

Measurement of externalities through valuation in simulated markets is assumed to facilitate this task, by means of estimating the potential efficiency gains and the distribution of costs and benefits between different social agents. Since the solution of environmental problems is conceived essentially as an issue of influencing production costs and prices, this framework assumes that the solution to environmental problems lies on the technical domain of estimating and enforcing the “right price”. “Optimal” solutions are therefore theoretically possible and “Getting prices right” (ten Brink et al., 2012) or “correcting the economic compass” (UNEP, 2011) is seen as a key means for solving environmental problems. From this perspective, the main contribution of the concept of ecosystem services is that they render visible environmental externalities. The conservation of ecosystems would be ensured as far as the services they provide are acknowledged, measured and incorporated into both private and public decision making or, in the jargon of *The Economics of Ecosystems and Biodiversity*, as far as ecosystem services are *recognized, demonstrated, and captured* (TEEB, 2010).

Market environmentalism adopts efficiency as the core guiding principle for policy design. What matters is the overall ratio between social costs and benefits. Since from its point of view solving environmental externalities by definition leads to efficiency gains, incorporating environmental concerns into economic decision-making can enhance

<sup>1</sup> The Doha Round for the global liberalization of trade is dead and since 2010 most countries have given up liberalization of trade and given priority to bilateral or multilateral treaties (The Economist, 8/9/2012).

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