

## Our research aim

Shaping Sustainable Markets (SSM) is a programme of research and analysis with a practical focus. The programme aims to explore and improve the impact of many kinds of market governance mechanisms on sustainable development. It also analyses the potential of 'innovative' mechanisms that have yet to be implemented – providing new ideas for 'shaping' markets.

A market governance mechanism (MGM) is a set of formal or informal rules consciously designed to change behaviour – of individuals, businesses, organisations or governments – to influence how markets work and their outcomes. Ultimately, the SSM project will inform the future use, design and implementation of MGMs to improve their contribution to sustainable development, as well as proposing the use of new mechanisms.

The main part of this prospectus is divided into two sections. Two annexes provide more detailed information:

- **Section One. A typology of market governance mechanisms.** We have developed a four-part typology of MGMs, as part of improving understanding of them.
- **Section Two. A common framework for analysing MGMs.** This is the underlying structure for all SSM research, helping to ensure good coverage of mechanisms, and to allow comparisons between them.
- **Annexe A. Developing the SSM typology of market governance mechanisms.** This offers more information on other typologies considered in the development of the SSM typology (as featured in Section One).
- **Annexe B. Questions for exploring MGM design and implementation** Explaining the criteria we use for evaluating MGMs in terms of sustainable development. These questions are grouped under effectiveness, efficiency, equity and transparency, as featured in our common framework for analysis (Section Two).

## Section One: A typology of market governance mechanisms

Market governance mechanisms apply to defined economic markets of different kinds and that operate at different levels – global, regional, financial or informal, for instance. MGMs do not apply to any single individual, organisation or government, but only to several of these interacting to form a market.

The SSM research programme has developed a typology of market governance mechanisms, using four broad categories:

1. **economic** – behaviour is primarily affected by changing price incentives, to alter the balance of costs and benefits
2. **regulatory** – certain behaviours are required or prohibited under law
3. **cooperation** – changes to behaviour are made voluntarily and often through partnerships
4. **information** – provision of certain information to alter the behaviour of market participants, particularly consumers and investors, but also producers.

Within these overarching categories, subcategories are useful in profiling MGMs and for further grouping by audience interest. Subcategories are used in the database of mechanisms found on our website:

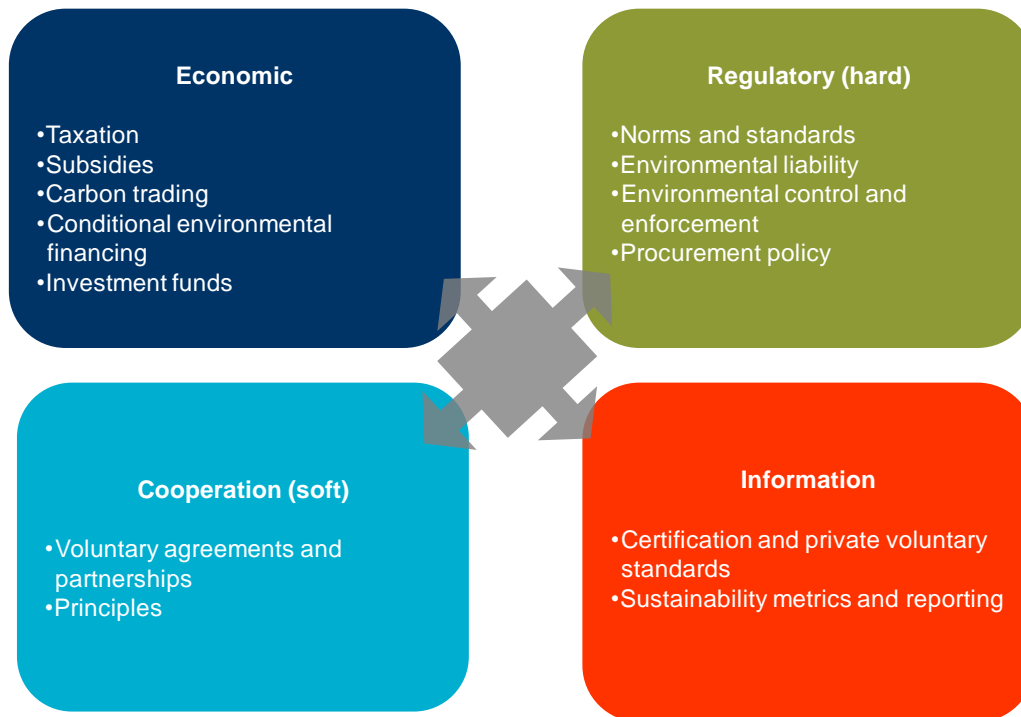
<http://shapingsustainablemarkets.iied.org>. In addition to sector or location, other subcategories include who leads the mechanism, whether it is voluntary or mandatory and the key stakeholders involved.

There are many different MGMs – some well established, and some that have yet to be fully implemented. The sheer variety of mechanisms means that their characteristics, functionality and impact will differ significantly. Despite this, we need a way to assess and compare their effectiveness in contributing to the ‘sustainability’<sup>1</sup> of markets. The typology illustrated in Figure 1 is our suggestion of the best way to convey the complex and expansive landscape of MGMs. The rest of this section summarises each type of MGM, its main characteristics and forms. Annexe A explores other existing typologies and explains how we arrived at the SSM typology.

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<sup>1</sup> By ‘sustainability’ we mean the contribution of markets to sustainable development, rather than their financial sustainability or financial resilience for example.

**Figure 1: The SSM typology of market governance mechanisms**



## 1) Economic MGMs

Economic MGMs are typically market-based instruments that seek to change behaviour through economic incentives such as altering supply and demand, or through financial (i.e. cost) incentives. Financial incentives are usually positive (e.g. payments for environmental services and subsidies) but they can also be negative (e.g. taxes). These MGMs alter the balance of costs and benefits in a way that should promote positive social or environmental outcomes.

**Taxation:** designed to induce consumers and producers to implement more positive behaviour by making behaviour that contributes to environmental or social ‘bads’ more expensive. Taxes can be collected from consumers, businesses or any other organisation.

**Subsidies:** payments to businesses and other organisations to influence production and/or consumption of goods and services, aiming to enhance positive environmental or social outcomes. Subsidies typically serve to influence

levels of production, prices or the costs of factors of production. There are both direct subsidies (grants or credits), and indirect subsidies (e.g. differentiated taxes, tax exemptions, or the provision of goods below market price).

**Carbon trading/ cap and trade:** an administrative approach to controlling pollution by providing economic incentives to reduce it. Carbon trading creates a market for emissions of carbon dioxide, establishing buyers and sellers of permits or credits that permit the release of carbon dioxide. A cap (or limit) is set for maximum permitted emissions for each company. Companies that want to increase their emission allowance must 'trade' – buying credits from those who pollute less. In effect, the buyer is paying a charge for polluting, while the seller is rewarded for having reduced emissions by more than the required amount.

**Conditional environmental financing:** includes payments for environmental services and potential offsets (where there are no formal 'markets' yet).

**Investment funds:** mechanisms for channelling private financial flows to achieve environmental and/or social, rather than solely commercial, returns.

## 2) Regulatory MGMs

Regulatory MGMs are legally binding and set by governments, and include enforceable international agreements. They are known as 'hard' MGMs, in contrast to the 'soft' cooperative or voluntary mechanisms. Regulation promotes behaviour change through the sanction of legal consequences in the event of non-compliance.

**Norms and standards/ command and control:** rules and targets set by public authorities (command), subsequently enforced by compliance procedures (control). These include laws, directives, and technical guidance documents as far as these are legally binding. Norms and standards can be used to implement the 'polluter pays' principle.

**Environmental liability:** makes the agent responsible for environmental damage pay for remedying the damage, and is a way of implementing the polluter pays principle. This form of regulation both provides compensation and is an incentive not to pollute in the first place.

**Environmental control and enforcement:** activities of the public sector to inspect companies or projects for compliance with environmental regulation, laws or standards.

**Procurement policy:** setting and practising procurement policy that promotes positive social and environmental outcomes, or minimises negative social and environmental outcomes. Particularly used in the public sector, procurement policy can alter the role of price signals in the marketplace by leading to purchasing decisions based on criteria other than monetary prices.

### 3) Cooperative MGMs

Cooperative MGMs are defined by their voluntary nature, and therefore regarded as ‘soft’ in comparison to regulation.

**Voluntary agreements and partnerships:** organisations or sectors working together to improve their resource efficiency, performance, and social and environmental conduct beyond the requirements of existing legislation and regulations. These relationships can include collaboration within or between different stakeholder groups – for example, private or public sector firms, NGOs, and civil society. Voluntary agreements will typically emerge from partnerships and will involve an explicit intention to improve social and/or environmental outcomes (typically related to a particular industry and production practice). An example is the International Council for Mining and Metals – a network of 19 companies aiming to ‘strengthen the contribution of mining, minerals and metals to sustainable development’ (see: [www.icmm.com/about-us](http://www.icmm.com/about-us)).

**Principles:** a set of voluntary guidelines or non-legal principles to provide guidance on behavioural choices of various stakeholders in order to promote positive social or environmental outcomes. Principles are cooperative (rather than informational) when they are produced by those who also agree to abide by them, rather than by an external organisation. An example is the International Council for Mining and Metal’s ‘10 Principles for Sustainable Development’ (see [www.icmm.com/our-work/sustainable-development-framework/10-principles](http://www.icmm.com/our-work/sustainable-development-framework/10-principles)), which are subject to independent external assurance.

### 4) Information MGMs

Informational MGMs provide information in the public sphere with the aim of changing behaviour – of consumers, suppliers, investors or producers. These mechanisms aim to persuade, rather than compel, by altering understanding and priorities, and the significance attached to particular environmental and social issues. All other instruments depend partly on information, but information can also be considered as an independent instrument.

**Certification and private voluntary standards:** information for consumers, producers or suppliers about social, economic or environmental standards attained, or aspired to. This can include the adoption of standards for specific methods of production or transport, for example, or can refer to product standards. Certification typically involves a consumer-facing label, but may also be for information to be communicated between businesses.

**Sustainability metrics and reporting:** the process of collecting and assessing information about the environmental and social performance of organisations. 'Sustainability metrics' summarise the reported information into an indicator or set of indicators. 'Sustainability reporting' typically provides a wider information set and may therefore provide more detailed information on organisations' environmental and social practices. SSM is interested in sustainability reporting and metrics carried out externally to a particular organisation or group of organisations. (We will not be analysing sustainability reports provided by individual organisations.)

## Section Two. A common framework for analysing MGMs

Shaping Sustainable Markets (SSM) has developed a framework for analysis that unites our research. This enables us to draw comparisons and lessons between mechanisms. The common framework is particularly important because several different researchers are contributing to the initiative.

We have established the following structure for analysis, for use as far as possible in the discussion of each market governance mechanism (MGM):

1. **Introduction** – including a description of the market failure that the MGM is addressing.
2. **Description of the mechanism** – its aims or claims, and how it is monitored.
3. **Coverage of the mechanism** – where and how widely it is used.
4. **Assessment of existing evidence** (or primary research) on the impact of the mechanism.
5. **Analysis of the mechanism's design and implementation**, in terms of sustainable development.
6. **Conclusions and recommendations** – including identifying any need for future research.

This framework is explained in more detail below. It should be reflected in the structure of each SSM report, as well as forming the basis of six stages in the research process. It may not be possible for every aspect to be considered in detail for every mechanism. This is particularly the case for potential 'innovative' mechanisms that have yet to be implemented.

### **1) Introduction – including a description of the market failure that the MGM is addressing**

What is the market failure or problem that this market government mechanism seeks to address? Which other mechanisms seek to address the same issues, and how? (In brief and to set the mechanism 'context'.) Why is this mechanism of relevance to Shaping Sustainable Markets and sustainable development?

### **2) Description of the mechanism – its aims or claims, and how it is monitored**

The second stage is to explore the stated aims and intentions of a given mechanism or group of mechanisms. This should include the nature of the mechanism (with reference to the SSM four-part typology, as outlined in Section One above), how it aims to bring about behaviour change, and how this is to be measured and monitored (if at all). This step in the analysis should include identification of who is monitoring the impacts of a given mechanism, and particularly whether this is carried out by a third party, and the level of objectivity. Is the mechanism being monitored according to any particular framework of impact assessment? This is important for informing the fourth stage of analysis, on impact (as below). It gives us a sense of the kinds of data that might be available for impact assessment and the types of methodologies employed.

### **3) Coverage of the mechanism – where and how widely it is used**

Stage three explores the extent to which MGMs are being used, to provide information on the proportion of a market employing, or covered by, a given mechanism. It is important to combine this form of analysis with some indication of the effectiveness of mechanisms. Coverage alone gives us no indication of the ‘quality’ or impact of a given mechanism.

Possible questions on coverage of MGMs include the following:

- What is their market coverage (e.g. sales for certification, size of investments for financing)?
- What is their target coverage (e.g. how many people/organisations are included in a scheme)?
- How has their uptake/implementation changed over time? Are there any predictions of future changes in uptake?
- What are the perceived obstacles (e.g. political context) to increasing the coverage of this mechanism?
- What are the drivers of the mechanism’s uptake and implementation (both actual and predicted)? This could include the regulatory context, such as firms seeking to demonstrate commitment to an issue before top-down regulation is enforced. It could relate to market pressures, such as when firms wish to compete in terms of green credentials, reflecting considerable consumer demand.

This analysis should also help us to answer wider, overarching questions. For example, ‘How widely is this group, type or example mechanism being used in the market, in terms of revenue and stakeholder involvement?’ and ‘How does this compare to other groups, types or example mechanisms?’ A second set of



overarching questions concerns how the use of a mechanism has changed over time, and how this compares to the change in use of other mechanisms.

#### 4) Assessment of existing evidence (or primary research) on the impact of the mechanism

The aim of this stage is to collect and analyse existing literature, or to analyse impacts from primary research, on a particular mechanism. Key questions are as follows:

- What measurement frameworks (if any) have been applied to (current and potential) impacts associated with this MGM?
- What current information exists about the impact of the MGM (summary of available of literature)?
  - What impacts does the mechanism have in terms of sustainable development (economic, social and environment)?
  - To what degree do the achieved outcomes correspond to the intended goals of the mechanism?
  - Do the outcomes have a lasting effect on the state of the environment or society?
- Are there clear gaps in the existing literature?
- What are the strengths and weakness of the existing analysis?
- Is there any evident bias or any gaps in impact assessment?
- What is the potential feasibility of filling research gaps?
- Is there a strong and clear need for primary impact assessment by IIED or others (if this has not already been done)?

#### 5) Analysis of the mechanism's design and implementation, in terms of sustainable development

In considering links between the design of MGMs and their ability to contribute to sustainable development, we are interested in answering four questions about each mechanism:

- (i) How **effective** is the design of the MGM in facilitating sustainable development?
- (ii) How **efficiently** are these impacts produced?
- (iii) How **equitably** are the benefits distributed?
- (iv) How **transparently** can these consequences be observed?

A 'good' MGM would therefore be one that is effective, efficient, equitable and transparent.

A key task of the Shaping Sustainable Markets project is to gather, collate, produce where necessary, and analyse evidence on aspects of MGM design and implementation that appear most important in determining sustainable development outcomes. The aim is to develop the series of questions below, by honing, modifying, dropping or adding elements of them. The questions will then be refined into a set of core principles for MGM design, which the evidence suggests are most likely to produce 'good' mechanisms as defined above. This process will be followed gradually, as the SSM project progresses.

Below, we suggest a series of questions for each category, designed to elicit information in areas that we believe *may* be important in determining the ultimate effectiveness, efficiency, equity or transparency of an MGM in terms of sustainable development outcomes. Analyses should therefore be designed, where possible, to answer the following questions on MGM design and implementation in relation to sustainable development. The questions are elaborated in Annexe B.

### **Effectiveness**

- Do the goals of the mechanism cover key environmental or social problems?
- How focused (or broad) is the MGM on achieving specific (or general) sustainable development impacts?
- To what extent is there a clear idea of a 'target market'?
- Is there a clear recognition of market dynamics?
- Is there awareness of and an attempt to track unintended consequences of the MGM?
- In what ways and with what frequency are the desired impacts measured?
- Are the results of the impact measurement used to refine how the MGM functions, and what other approaches are used to enable the mechanism to evolve?
- How is institutional and organisational capacity built over time?
- Does the mechanism function effectively in relation to the wider regulatory and institutional framework?
- Is the MGM responsive to the needs of and pressures faced by different stakeholders?
- Can the mechanism cope with changing conditions?

### **Efficiency**

- How does the cost of implementing the MGM compare to the anticipated (and actual) sustainable development benefits?
- Are implementation and running costs self-financing, and, if not, how are they funded now and are there plans to achieve self-financing in future?

(‘Self-financing’ here means that the mechanism is not reliant on external or donor support, particularly in the long term. Our hypothesis is that only mechanisms that can finance themselves will be ‘sustainable’ in the long term.)

### Equity

- Were all stakeholders able to contribute equitably to the design of the mechanism?
- Are there transparent and regulated procedures for the election of representatives, which ensure an equitable representation of stakeholders?
- Are the benefits and costs of implementation distributed equitably? (For example, are costs of certification proportional to organisation size?)
- Can different groups use the mechanism without (disproportionate) barriers to entry on the basis of gender or ethnic group, for example?

### Transparency

- To what extent is the content of the mechanism transparent and available to all (e.g. in relevant languages)?
- Are the methodology and indicators used to evaluate impacts (including market coverage) publicly available?
- Is information on how the mechanism was developed (e.g. information on the decision-making process) transparent and publicly available?
- Are the costs of implementation of the mechanism publicly available?
- Are stakeholders involved in deciding how information transparency is achieved?
- Are the impacts of the mechanism publicly disclosed?
- Is the impact-assessment mechanism verified by a third party?
- Do the data provided allow for the mechanism to be compared to other mechanisms and to be held to account by a third party?

## 6) Conclusions and recommendations – including identifying any need for future research

Each research process, and each SSM report, should include the following:

- Overall analysis/summary of the impact of the mechanism on sustainable development.
- Overall analysis/summary of the design and implementation of the mechanism in terms of effectiveness, efficiency, equity and transparency.
- Recommendations for future research.

The Foreword of each SSM report will detail what *Shaping Sustainable Markets* seeks to do more broadly, how research on each MGM contributes to this, and how this work will be advanced over time.

## Annexe A. Developing the SSM typology of market governance mechanisms

### Creating a typology

The sheer number and diversity of market governance mechanisms (MGMs) makes their categorisation problematic. Some of the key ways in which mechanisms vary include: their purpose; their design and how they function; who leads them; whether they are mandatory or voluntary; their sectors and geographical regions of operation; and who they seek to target (e.g. consumers, investors or producers). This diversity makes it necessary to organise and simplify the landscape of mechanisms, to help us in conceptualising and understanding MGMs. Inevitably, this process involves some simplification and some loss of detail. However, we think that this is justified by avoiding an excessively complex or unwieldy typology.

For the purposes of Shaping Sustainable Markets (SSM), we are most interested in how the design or operation of a mechanism purports to improve sustainable development outcomes. Mechanisms might function through the provision of information to investors or consumers in the hope they will make more 'sustainable' choices, or through the altering of financial incentives, such as subsidies or taxes, to bring about behaviour change in production and consumption. For this reason we have chosen a typology that focuses on the defining 'functionality' feature of mechanisms. Does a particular mechanism provide information to consumers or producers? Does it alter prices, supply and demand or profitability? Does it incentivise behaviour change through the fear of legal reprisal? Or does it bring about behaviour change through 'softer' mechanisms such as partnerships and working together?

While Section One above presents the typology we have selected for Shaping Sustainable Markets, this annexe explains the rationale for its selection. We recognise that mechanisms may move between categories over time – and that the typology itself may need to evolve. It might also be possible to argue that one mechanism belongs to more than one category, but we have tried to decide upon the positioning of each MGM in relation to its functionality. A brief overview of the most relevant literature follows, to indicate other typologies in use, and upon which we have built.

### An overview of existing literature

Existing publications and reviews of market governance mechanisms tend to focus on one type of mechanism, or mechanisms led by a specific stakeholder.

SSM aims to address this gap, by undertaking an overarching analysis of MGMs – exploring their use, distribution (geographical and sector), market coverage and impact, as a whole. Which mechanisms are working well and under what conditions? How does their design and implementation (according to transparency, efficiency, equity and effectiveness) shape their impact? How can the overall coverage and impact of mechanisms be improved, and according to what principles should MGMs be designed to improve their chances of success?

This overarching analysis drives the need for a neat and simple way to capture a wide number and variety of mechanisms. A simple typology is also vital to inform the structure of the SSM website and an annual publication. However, because existing research on mechanisms tends to focus on one mechanism type, or a small number of mechanisms, there is a dearth of literature on MGMs more widely. This is why we have developed a typology that can work across a large number of diverse mechanisms.

The **Ecosystem Marketplace** (2009a, 2009b) has a suite of research that analyses particular mechanisms, including voluntary carbon markets, forestry carbon markets, watershed payments and biodiversity offsets. This research provides an excellent overview of payments for environmental services schemes (or conditional environmental financing, as we refer to it in our typology) and carbon trading. It provides detail on market size, developing-world impact, the actors involved (market shapers and market service providers) and the likely future direction of the mechanism.

However, the key way in which these mechanisms are categorised is according to their voluntary or mandatory ('compliant') nature, and the geographical regions in which they operate. Compliance markets are those driven by regulation and enforcement; voluntary markets are those driven by ethical and/or business-case motives. Government-mediated markets are also distinguished – these are publicly administered programmes that use public funds to pay private landowners for the stewardship of ecosystem services on their property.

This approach is certainly relevant in considering sustainable development, and the SSM typology includes voluntary/mandatory, and geographical region as subcategories. However, this division alone is too broad to categorise the wide variety of mechanisms we want to explore into a meaningful typology.

A paper by **Jordan et al.** (2003), *Has governance eclipsed government? Patterns of environmental instrument selection and use in eight states and the EU*, discusses 'new' environmental policy instruments (NEPIs) in relation to

governance versus government. It employs a potentially useful typology for these NEPIs, as shown in Box A.1.

**Box A.1: Four types of new environmental policy instruments (NEPIs)**

**Market based instruments (MBIs):** using the market to internalise the cost of polluting activities in a cost-efficient manner. MBIs include eco-taxes, tradable permits, subsidies, and deposit-refund schemes.

**Voluntary agreements (VAs):** agreements between industry and the public authorities on the achievement of environmental objectives. These can be unilateral commitments, public voluntary schemes, or negotiated agreements.

**Ecolabels:** relying on moral persuasion by providing customers with more information about the environmental impact of particular products and services. These can be: externally verified, multi-issue schemes; unverified, self-declaratory schemes; or single-issue schemes.

**Environmental management systems (EMSs):** aiming to encourage industry to behave in a more environmentally responsible manner. Companies are typically required to audit the environmental impact of their activities, establish internal monitoring systems to monitor and reduce impacts, and provide stakeholders with a regular statement on their activities. An example is ISO 14001.

**Table A.1: A typology of instruments by state involvement**

	<b>The state specifies the goal to be achieved</b>	<b>The state does not specify the goals to be achieved</b>
<b>The state specifies how the goal is to be achieved</b>	Regulation (e.g. linking an emission target to the use of a certain type of technology), subsidies	Technology-based regulatory standards (e.g. 'Best available technology' (BAT) for pollution control)
<b>Non-state actors specify how the goal is to be achieved</b>	Most negotiated voluntary agreements (VAs), some market-based instruments (MBIs), some regulation	Environmental management systems (EMSs), most market-based instruments (MBIs), some voluntary agreements (VAs), ecolabels

Source: Jordan *et al.*, 2003

Jordan *et al.* (2003) also employ a simple typology to distinguish between instruments (Table A.1). This is based on the role of state versus non-state actors in setting the goals to be achieved by an instrument, and ‘how’ that goal will be achieved. This typology is well suited to exploring the role of government in shaping mechanisms – which is the main purpose of Jordan *et al.*’s paper. However, the SSM’s set of mechanisms is broader, and requires more disaggregation to enable a categorisation that is both informative and simple.

The **Government of Australia** (2011) employs a three-part typology for its website, *DesignerCarrots – market-based instruments for NRM*. This is based on work by Collins and Scoccimarro (2008), specifically for instruments or mechanisms addressing natural-resource management (Box A.2). This is a simple categorisation and works well for mechanisms related to environmental issues, as well as hinting at the functionality of the mechanism. However, it is too specific for the variety of mechanisms we want to explore within SSM, and does not capture mechanisms rooted in regulation.

**Box A.2: A typology of instruments for natural-resource management**

Price-based MBIs	Quantity-based MBIs	Market friction approaches
<p><b>How</b></p> <p>Influence behaviour by modifying or creating prices for environmental goods and services</p>	<p><b>How</b></p> <p>Influence behaviour by modifying or specifying rights and obligations of using natural resources</p>	<p><b>How</b></p> <p>Influence behaviour by making existing markets work better to achieve environmental outcomes</p>
<p><b>Pros</b></p> <p>Can work as a positive or negative incentive</p>	<p><b>Pros</b></p> <p>Rights and obligations are often tradable</p>	<p><b>Pros</b></p> <p>Enhance information in the marketplace or lower transaction costs within a market</p>
<p><b>Examples</b></p> <p>Conservation tenders, taxes and charges, tax concessions, subsidies and rebates</p>	<p><b>Examples</b></p> <p>Compliance offsets and tradable emissions permits</p>	<p><b>Examples</b></p> <p>Green labelling and web-based water-entitlement exchanges</p>

Source: Collins and Scoccimarro, 2008



**Bayon et al.** (2000) in their report, *Financing Biodiversity Conservation*, employ a typology that categorises mechanisms or tools according to the type of stakeholder that initiated them: international actors, governments, the private sector, or nongovernmental organisations (NGOs). This provides useful information for understanding the particular stakeholders involved in designing and implementing particular mechanisms. For SSM however, the type of initiator is better suited to being a subcategory, rather than the basis for our typology.

**Bayon** (forthcoming) proposes a division of financing mechanisms, based on the types of funds used, as well as their impact on the market (Box A.3). He proposes dividing mechanisms for safeguarding biodiversity into those that are a) regarded as a public good, 2) intended to correct negative externalities, c) stimulate businesses that protect biodiversity and/or use it sustainably. While this is an informative division, it is best suited to financing mechanisms specifically, rather than the broader set of mechanisms explored within SSM.

**Box A.3: A typology of financing mechanisms to safeguard biodiversity**

As public good	Correcting negative externalities	As business
<ul style="list-style-type: none"> <li>• Taxation (national and international)</li> <li>• Grants and subsidies</li> <li>• Loans from multilateral development banks</li> <li>• Debt-related instruments</li> </ul>	<ul style="list-style-type: none"> <li>• Reforming the tax system</li> <li>• Removing damaging subsidies</li> <li>• Environmental fines</li> <li>• Tradable permits and extraction quotas</li> <li>• Deposit-refund schemes</li> <li>• User fees/charges</li> <li>• Joint implementation and carbon sequestration</li> </ul>	<ul style="list-style-type: none"> <li>• Credits and loans to 'green businesses' (including export credits)</li> <li>• Venture capital (equity or quasi-equity) for 'green businesses'</li> <li>• Guarantees for 'green businesses'</li> <li>• Securitisation</li> </ul>

Source: Bayon, forthcoming

In his paper, *Economic Instruments for Sustainable Development*, **Driesen** (2006) divides economic instruments into:

- price-based instruments, which can be negative (e.g. taxes), positive (e.g. subsidies), or mixed incentives (a combination of both)
- tradable environmental rights, which are quantity-based economic incentives (involving setting a cap), as opposed to price-based measures

- informational policy instruments, including right-to-know programmes (for example the disclosure of environment-related information), certification schemes and ecolabelling.

This typology explores only market based instruments – and does not cover the regulatory mechanisms in which we are also interested.

Perhaps the most extensive and comprehensive categorisation of market governance mechanisms is that in *Policy Instruments for Resource Efficiency: Towards sustainable consumption and production* by **GTZ, CSCP and the Wuppertal Institute** (2008). The typology used in this paper (Figure A.1) captures an extremely wide variety of mechanisms or ‘policy instruments’ – something that Shaping Sustainable Markets also seeks to do. These instruments are further categorised according to whether they are hard or soft (on a continuum) and whether they reward/penalise, motivate or support (also on a continuum), as shown in Figure A.2.

**Figure A.1: Typology of policy instruments**



Source: GTZ, CSCP and the Wuppertal Institute, 2008

**Figure A.2: A policy matrix of resource efficiency**



Source: GTZ, CSCP and the Wuppertal Institute, 2008

The typology shown in Figure A.1 appears to be particularly useful for Shaping Sustainable Markets. It covers a large number of mechanisms as well as categorising them in an intuitive way. The categories very quickly and simply indicate the nature and functionality of a particular mechanism. The typologies used in other literature are helpful in informing secondary categories (such as voluntary/mandatory, type of leading stakeholder). These are relevant to SSM but fail to provide a typology able to cover the breadth of mechanisms of concern to us, in a way that is useful and straightforward.

### A typology for Shaping Sustainable Markets

The typology employed by GTZ, CSCP and the Wuppertal Institute (2008) (shown in Figure A.1) is used as the foundation for SSM's typology. The SSM typology includes only four categories, as shown in Figure I.1, and these are detailed in Section One above.

The SSM typology may need to be refined and modified over time. We welcome comments or feedback on the typology. Please contact Emma Blackmore at [emma.blackmore@iied.org](mailto:emma.blackmore@iied.org).

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## Annexe B. Questions for exploring MGM design and implementation

### Introduction

The central aim of Shaping Sustainable Markets (SSM) is to understand the impact of market governance mechanisms on sustainable development. This will improve understanding about the overall progress of attempts to use market governance mechanisms (MGMs) to achieve sustainable development. Ultimately, the project aims to inform the future use, design and implementation of MGMs. A key part of the research is therefore the exploration of the design and implementation of MGMs. This exploration is based on the questions detailed in this annexe, and summarised above in Section Two (point 5).

We believe that the answers to these questions will be important in determining the contribution of market governance mechanisms to sustainable development. However, as our research progresses, we may discover that some of our questions are not relevant in terms of the importance of particular design and implementation features for sustainable development outcomes. In this case, we might modify, remove or add some questions. This annexe seeks to explain our rationale for the use of each question, and we have grouped questions under **effectiveness**, **efficiency**, **equity** and **transparency**.

We recognise that MGMs operate in complex, changing and unpredictable contexts, and that data availability may be a limiting factor in this research. The questions below are nevertheless intended as a guide to understanding effectiveness, efficiency, equity and transparency more broadly. We recognise also that evaluation is inevitably normative and the result of value judgements. This annexe aims to explain the criteria on which we have based our normative judgments (Mickwitz, 2003), and to justify their selection.

### Effectiveness

The questions explored here aim to discover whether market governance mechanisms are being effective in terms of addressing specific sustainable development outcomes. Do they target the 'right' problems? Are the problems addressed by the mechanism too specific or too broad? Does the mechanism involve clear identification of whose behaviour change it aims to induce?

**1) Do the goals of the mechanism cover key environmental or social problems?**

This is simply an analysis of whether the mechanism is addressing an issue important to sustainable development, and that needs addressing. Do the aims and objectives of the mechanism really address the key problems related to sustainable development? If not, there are likely to be unjustifiable costs involved in its design, implementation and adoption, and resources might be better spent elsewhere.

**2) How focused (or broad) is the MGM on achieving specific (or general) sustainable development impacts?**

Mechanisms that address a narrower range of criteria in depth may aim for establishing significant impacts among a smaller group of stakeholders, reflecting a likely trade-off between quality and quantity. As SSI (2010: 26) has argued, 'the actual impacts in any case will depend upon a number of variables beyond actual criteria definition, including, of course, enforcement, capacity and market size'. If a mechanism covers a wide number of issues as well as addressing them in depth, there may be trade-offs in terms of coverage – since there are likely to be increased transactions costs, higher barriers to entry and compliance will be harder to achieve. It may be possible to achieve a 'happy medium' – where a mechanism addresses more than one issue related to sustainable development and covers related issues. This may enable improved overall impact while reducing negative impacts or unintended consequences.

**3) To what extent is there a clear idea of a 'target market'?**

It is essential for any mechanism to reflect clarity about the individuals or organisations whose behaviour change is sought. For payments for environmental services, for example, the target market will be landowners (who receive the payment) and those who make the payment (businesses and governments). For certification, the target will be producers, who obtain certification through altering production to gain market access, and consumers who are able to make more 'sustainable' purchasing decisions by observing a label on a product. Having a clear idea of a target market prevents potential confusion and is likely to allow for improved and more cost-effective targeting of people whose behaviour change is sought.

**4) Is there a clear recognition of market dynamics?**

If a mechanism is designed to alter market dynamics (supply, demand, prices), it needs to reflect a clear vision of current market dynamics. For example, in certification schemes a clear understanding is needed of who will pay the costs of certification, and whether customers are willing and able to pay any associated premiums. We believe that a *market* governance mechanism needs to be designed with market dynamics in mind.

### **5) Is there awareness of and an attempt to track unintended consequences of the MGM?**

Actions can provoke unforeseen and unintended consequences. This is particularly relevant for environmental issues, which are often hard to predict and may involve a delay before impacts emerge. We want to ensure that a gain in one area does not incur a loss elsewhere, including between the environmental, social and governance aspects of sustainable development. This question therefore attempts to highlight the complex trade-offs inherent in the balancing act of sustainability. Due to their very nature, unintended consequences may be impossible to foresee, and difficult to measure, but a recognition that they may occur can aid their identification and tracking – and the adaptation of mechanisms if necessary.

### **6) In what ways and with what frequency are the desired impacts measured?**

Recent research (SSI, 2010; Blackman and Riveria, 2010) has identified a lack of rigorous impact assessment in sustainability certification, among other mechanisms. Where impact assessment has been undertaken, it is often impossible to make comparisons between mechanisms because the indicators and methods are so different. Increased and comparable assessment of impact should enable feedback for positive changes in mechanisms, and eventually to improvements in efficiency and sustainable development outcomes. In particular, the costs and severity of any weaknesses associated with a mechanism may be lessened if problems are identified early on. Recently introduced MGMs should undergo some form of evaluation in the early stages, preferably by a third party.

### **7) Are the results of the impact measurement used to refine how the MGM functions, and what other approaches are used to enable the mechanism to evolve?**

Linked to Question 6, monitoring and evaluation are valuable only if they are used to make improvements. If a market governance mechanism cannot adapt to evident weaknesses in its design and implementation, it is very likely to reduce its effectiveness in terms of sustainable development outcomes.

### **8) How is institutional and organisational capacity built over time?**

MGMs seek to bring about behaviour change – often involving a departure from existing norms and behaviours. But it is important that those using or subject to a mechanism are not adversely affected in ways that undermine other aspects of sustainable development. The mechanism should seek to build the capacity of stakeholders so that they are better able to work with the MGM, and so that the mechanism should be self-sufficient in the longer term (i.e. not reliant on

outside support or donor aid). This is closely related to ideas of ownership and participation. This might involve designing an MGM that takes an incremental approach to achieving its aim. For example, a certification scheme seeking to develop agricultural practices of small producers in the developing world might begin with building their capacities to work towards desired goals rather than presenting insurmountable barriers or standards that exclude small producers or undermine their livelihoods.

### **9) Does the mechanism function effectively in relation to the wider regulatory and institutional framework?**

This question focuses attention on the local, national and international regulatory and institutional context, as this enables or hinders implementation of a mechanism. This is about feasibility and the recognition that MGMs do not operate in a vacuum – their success is inextricably linked to their surroundings. An analysis of key barriers or enablers could be overly broad, but could also be highly valuable in terms of understanding the circumstances under which a mechanism functions, and how its design might be improved. A related aspect of this question is the exploration of how a particular MGM fits with other MGMs. We want to avoid adverse interactions and impacts.

### **10) Is the MGM responsive to the needs of and pressures faced by different stakeholders?**

Evidence suggests that the 'equal application of equal rules may not always be the most effective vehicle for securing maximum sustainable development impact' (SSI, 2010: 30). There may be different priorities in different places and for different people – especially when comparing the developed and developing world. Related to Question 8, this also means that people have differing capacities to act. To avoid perverse sustainable development impacts, a mechanism should address these differing needs as far as possible.

### **11) Can the mechanism cope with changing conditions?**

This question seeks to understand whether a mechanism has been designed to offer a degree of flexibility in response to changing political, economic and social conditions (including technological developments). Without this flexibility, a mechanism may have positive sustainable development outcomes but these may be short-lived if the operating context alters. However, flexibility may conflict with other aspects, such as predictability.

## **Efficiency**

Questions of efficiency aim to explore the costs incurred by a particular mechanism and the benefits it brings about. This gives a sense of whether the mechanism's inputs are worth its sustainable development outcomes. We



recognise the difficulty in measuring this criterion but argue that it has to be a core consideration, and that data should be collected to measure efficiency wherever possible. Another aspect of efficiency is whether a mechanism is financially sustainable.

**1) How does the cost of implementation compare to the anticipated (and actual) sustainable development benefits?**

A mechanism is not efficient if the costs of its design and implementation are greater than the sustainable development benefits it offers. We also want to ensure that benefits are typically public and not private goods. Yet it may be extremely difficult to measure both costs and benefits; environmental benefits in particular may be impossible to value in monetary terms. It is also important to consider here whether the same results could have been achieved with fewer resources – thus freeing resources to be used elsewhere.

**2) Are implementation and running costs self-financing, and, if not, how are they funded now and are there plans to achieve self-financing in future?**

For many mechanisms, particularly those that are market based, long-term financial sustainability is crucial for their survival. Sources of funding may range from donors to producers, consumers, traders, investors and retailers – or funding may involve a combination of these. Where a mechanism is self-financing, it may be better able to survive in the long term.

## **Equity**

Equity is a key tenet of sustainable development – both within today's generation and between current and future generations. Our definition of sustainable development and equity focuses on poverty alleviation and the distributional impacts across firms, income groups and generations (Kasterine and Vanzetti, 2010). The design and use of market governance mechanisms should ensure that poverty is reduced or, at worst, that poverty is not exacerbated.

**1) Were all stakeholders able to contribute equitably to the design of the mechanism?**

Inclusion of affected parties in the design of an MGM can improve its feasibility by increasing its legitimacy and acceptability. Participatory design also increases the potential for anticipating unintended consequences – which may affect only some stakeholders. Participatory processes involve considerable costs and may therefore be impractical beyond a certain point (SSI, 2010). However, there is a moral argument for including all stakeholders in the design (even in limited numbers), particularly those groups that have historically been underrepresented in decision-making and that are likely to be most

disadvantaged when the mechanism is implemented. This relates to the human right to self-determination, which is also ‘a cornerstone of sustainable development itself’ (SSI, 2010: 37).

**2) Are there transparent and regulated procedures for the election of representatives, which ensure an equitable representation of stakeholders?**

For stakeholders to contribute equitably to the design of a mechanism, appropriate procedures are necessary. This question relates to the process by which stakeholders are able to contribute to MGM design (Question 1).

**3) Are the benefits and costs of implementation distributed equitably?**

The costs of implementation of a mechanism should not disadvantage groups that are less able to absorb these costs. From a moral perspective based on equity and fairness, we believe that those responsible for sustainable development ‘bads’ that a mechanism seeks to address should bear the costs of the mechanism (rather than those who are not responsible). As Goulder and Parry (2008) argue, this has implications for fairness and distributive justice and also for political feasibility. For example, polluting businesses should be responsible for paying for carbon permits or the costs of safe waste disposal. Retailers and consumers should have to pay more for ‘sustainable’ products, as part of the process of correcting market failures and incentivising behaviour change among those contributing to environmental and social bads.

**4) Can different groups use the mechanism, without (disproportionate) barriers to entry on the basis of gender or ethnic group, for example?**

The UN Universal Declaration for Human Rights states that human rights apply to all people equally and no distinction should be made in regard to these rights based on race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status. This is the basis of our argument that market governance mechanisms should not be designed to pose barriers to entry based on any of these criteria.

## Transparency

Transparency encapsulates the idea that improved knowledge about the design and implementation of MGMs allows for improved predictability, forward-planning and better feedback and adaptation of a given mechanism.

Transparency can improve participatory decision-making – since it is difficult to influence decision-making without the necessary information – and can improve the accountability of decision-makers to a wider set of stakeholders.

Conversely, imperfect information is a key barrier to efficient markets and can lead to high transaction costs. Improved information allows for smoother

transactions to be made: 'in enhancing the ability of the market to communicate, transparency can promote market efficiency, social welfare and costs internalisation, all core principles of sustainable development' (SSI, 2010).

Transparency also supports the legitimacy of mechanisms and therefore their chances of being politically acceptable and of being implemented. If MGMs are being promoted by certain stakeholders to correct market failures and to bring about behaviour change to improve sustainable development outcomes (and therefore create public goods), there is also a moral case for society to have access to information about the functionality and impacts of a mechanism.

**To what degree are the outcomes of the MGM, as well as the processes used in implementation, observable for outsiders?** We have divided this question of overall transparency into eight more specific questions, under the three headings of informational, participatory and accountability, as listed below.

#### **Informational transparency**

- 1) To what extent is the content of the mechanism transparent and available to all (e.g. in relevant languages)?
- 2) Are the methodology and indicators used to evaluate impacts (including market coverage) publicly available?
- 3) Is information on how the mechanism was developed (e.g. information on the decision-making process) transparent and publicly available?
- 4) Are the costs of implementation of the mechanism publicly available?

#### **Participatory transparency**

- 5) Are stakeholders involved in deciding how information transparency is achieved?

#### **Accountability transparency**

- 6) Are the impacts of the mechanism publicly disclosed?
- 7) Is the impact-assessment mechanism verified by a third party?
- 8) Do the data provided allow for the mechanism to be compared to other mechanisms and to be held to account by a third party?

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