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Experience with Market-Based Environmental Policy Instruments

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Description / Abstract

Environmental policies typically combine the identification of a goal with some means to achieve that goal. This chapter focuses exclusively on the second component, the means – the “instruments” – of environmental policy, and considers, in particular, experience around the world with the relatively new breed of economic-incentive or market-based policy instruments. I define these instruments broadly, and consider them within four categories: charge systems; tradable permits; market friction reductions; and government subsidy reductions. Within charge systems, I consider effluent charges, deposit-refund systems, user charges, insurance premium taxes, sales taxes, administrative charges, and tax differentiation. Within tradeable permit systems, I consider both credit programs and cap-and-trade systems. Under the heading of reducing market frictions, I examine market creation, liability rules, and information programs. Finally, under reducing government subsidies, I review a number of specific examples from around the world. By defining market-based instruments broadly, I cast a large net for this review of applications. As a consequence, the review is extensive. But this should not leave the impression that market-based instruments have replaced, or have come anywhere close to replacing, the conventional, command-and-control approach to environmental protection. Further, even where these approaches have been used in their purest form and with some success, such as in the case of tradeable-permit systems in the United States, they have not always performed as anticipated. In the final part of the chapter, I ask what lessons can be learned from our experiences. In particular, I consider normative lessons for design and implementation, analysis of prospective and adopted systems, and identification of new applications.

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