



What are Market Based Instruments?

Introduction

Market Based Instruments (MBIs) are tools that use market-like approaches to positively influence the behaviour of people. MBIs can be used to alter market prices, set caps on resource use, improve the way a market works or create a market where one doesn't exist.

Australia is facing a range of complex environmental problems, including declining water quality, salinity, soil erosion and biodiversity loss. MBIs are being tested and implemented across Australia to improve the efficiency and effectiveness of expenditure by governments, industries, landholders and the wider community on natural resource management.

Advantages of MBIs

MBIs can be more cost-effective for delivering environmental outcomes than many traditional methods. They are a positive influencer, encouraging people to address environmental issues, rather than wielding a disincentive approach through regulations and penalties.

MBIs are valuable tools to:

- provide flexibility for participants in adopting better natural resource management practices
- encourage innovation to address environmental issues
- contribute to long-term and self-sustaining solutions
- promote private investment in natural resource management
- address market failures (where markets do not ensure the sustainable management of natural resources,

e.g. landholders may have little incentive to conserve a wetland of significant environmental value)

- allow measurement of progress against regional goals and targets
- support transparency, that is landholders have a clear understanding of assessment and funding processes.

When to use MBIs

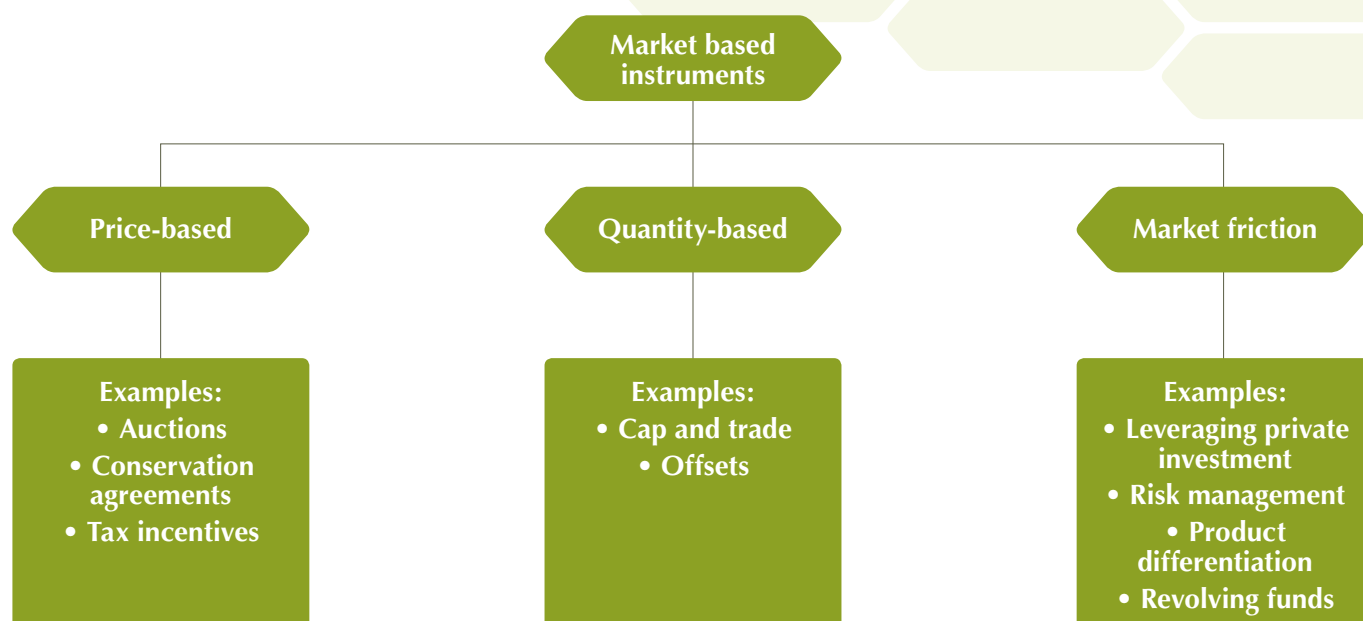
It is best to use MBIs when there are many ways of solving a problem but each solution has a significant difference in costs to individuals and the community. MBIs can reduce compliance costs by encouraging greater change where change is relatively cheap or easy, rather than asking all participants to make the same level of change. It is important to note that MBIs often rely on a regulatory framework to operate effectively.

MBIs are likely to out-perform other instruments when:

- large variations exist in the ability of potential participants to provide the desired outcomes
- there is flexibility in the range of responses that will deliver the desired outcome
- regulatory approaches are difficult to design, implement and administer
- there is scope for innovation in improving natural resource management.

MBIs alone cannot achieve improved environmental outcomes; they are an additional tool for use with a range of other responses.

Types of MBIs



Price-based MBIs directly assign a price to desired environmental outcomes. They allow landholders and industries to respond to the modified market and alter their resource use and/or management practices to achieve financial benefits and improve environmental outcomes.

Examples

- **Auctions for land management tenders:** An auction enables government agencies, catchment authorities and community groups to efficiently fund improved natural resource management by selecting among tenders for the greatest environmental benefits.
- **Conservation agreements:** Many government agencies and non-government organisations across Australia have implemented programs for voluntary, legally-binding agreements with landholders to protect the natural heritage on their land. A range of conservation agreement options are available, varying in terms of permanency, protection and assistance level.
- **Tax incentives:** Tax rebates and deductions provide a further means of encouraging environmentally sensitive practices.

Quantity-based MBIs involve creating a market in the right to undertake an activity with negative environmental consequences (e.g. discharging salt into a river) or to access a scarce resource (e.g. water).

This form of MBI restricts the total level of degradation or resource consumption and then allocates rights to participants who can trade these rights with other participants according to their needs and capabilities.

Quantity-based MBIs are often used where a measurable target is to be achieved, for example a limit on pollution discharge or water usage.

Examples

- **Cap and trade:** This form of instrument involves creating a market to allow the trade of an environmental good or right to discharge a pollutant. Cap and trade promotes a cooperative approach to resource management goals and provides an opportunity for land management outcomes to be cost-effective. Each participant finds a balance between implementing technologies or practices that reduce their resource consumption or pollutant discharge level (such as recycling water or establishing native pasture), and purchasing credits from others who are more able to meet their requirement.

- **Offsets:** A natural resource management offset is an off-site action that counterbalances an environmentally degrading activity on-site. Developers often use offsets as a means of meeting regulatory requirements, and have the option of either undertaking the action themselves or paying another party to do so on their behalf. Offsets provide a useful tool for achieving environmental outcomes at lower cost than on-site mitigation by keeping development costs to a minimum while improving overall environmental standards.

Market friction mechanisms work to improve environmental outcomes by influencing how markets function. This group of MBIs is quite broad, including techniques for reducing risk and uncertainty, encouraging private investment in conservation-related activities and informing consumers about environmentally-sensitive processes involved in supplying a product.

Examples

- **Leveraging private investment:** This technique is based on the recognition that many natural resource management activities may also create commercial benefits attractive to private investors. Agencies can encourage private investment by promoting or providing research outcomes, investment advice or financial assistance, for example.
- **Product differentiation:** Primary producers and other businesses can demonstrate that their product or service has been created in an environmentally sensitive manner. This may generate opportunities for distinguishing a product in the market, potentially providing a commercial premium and/or improved market access.
- **Risk management:** This is a broad term applied to any program or business that assists individuals, companies and communities by providing options for managing the technical and financial risks involved in creating environmental benefits.
- **Revolving funds:** This is a means of conserving private land with particular natural or cultural heritage features that may not otherwise be protected. Properties are purchased and sold to conservation-orientated buyers, usually with some form of binding agreement attached to the title to ensure protection in perpetuity.

Related information

The National Market-Based Instruments Pilot Programme aims to increase Australia's capacity to use MBIs in managing natural resource issues, in particular to address the problems of salinity and water quality.

Eleven projects were carried out under the programme's first round and a further nine have been funded under the second round. See www.napswq.gov.au/mbi/index.html

Other factsheets in this series include:

- Auctions or land management tenders
- Conservation agreements
- Tax incentives
- Cap and trade
- Offsets
- Leveraging private investment
- Revolving funds
- Product differentiation
- Environmental risk management.

For more information on Market Based Instruments please contact

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