

## **WG1. Natural Resources Development**

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# **Natural Capital and Economic Growth: Policy Lessons from Costa Rica**

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Never before in the history of our countries have we had so much knowledge on our natural environment; or as many institutions oriented towards sustainability and research; so many environmental regulations; so many organizations and professionals, or so many efforts to protect the environment as we have today. Paradoxically enough, however, never before have we had so many and so serious environmental problems.

Something is definitely wrong. What is ironic about all this is that world governments have accepted and preach a sustainability discourse, but little concrete and sustainable progress has been made that reflects any change regarding the plight of environmental destruction. As a rule, we tend to oversimplify our environmental challenges limiting them to climate change. But, in the light of recent data, scientists point to the existence of greater, more severe problems. The loss of biodiversity, the contamination with persistent organic substances and soil degradation and desertification have surpassed all tolerable natural limits, and their restoration or attention calls for both knowledge and resources which are likely not to be available or in existence. Where positive lessons learnt can indeed be applied is in relation to the awareness of the ozone layer depletion, where systematic and globally coordinated actions are yielding results.

The state of the environment is undoubtedly a direct result of the development model, but, in particular, of consumption and production patterns which respond exclusively to economic growth political targets where sustainability continues to be an axiological component without any concrete implications on public policies or actions other than some minor ones, which have no incidence on the need for structural reform.

These production and consumption patterns have focused on an economy based on the use of fossil fuels and on the manufacture of non-returnable, disposable goods. On top of this, we must take into account the fact that the global population (currently of 7 billion) is likely to stabilise around 9 billion, with the added complication that all these people will expect to live the Western model I have earlier alluded to. If countries like China and India continue their current efforts of unstoppable economic growth, in a matter of a few decades there will be no oil, aluminium, timber, paper, iron, or water to meet this demand for resources from a consumerist society which is less than efficient in the manufacturing and recycling of materials.

Global policy challenges are aimed primarily at economic growth, so the structuring of government apparatus has been designed having this purpose in mind. If public economic policy and State institutions are designed in this way, it should therefore come as no surprise that they have not made any considerable progress towards sustainability from Rio '92 to date. I believe beyond any doubt that, if we are to attain our sustainability goals, we must understand the structural reforms necessary to promote and ensure changes in the decision making processes for the formulation of public policies of State agencies and ministries and, above all, the need to incorporate all indirect costs and negative externalities arising from these production and consumption patterns.

The fundamental failure is of a conceptual nature: we consider that environmental problems can be resolved merely through the creation of environmental-style institutions with a sectoral vision. Thus, as a common pattern across our region, over the past ten years we have witnessed the creation of Ministries of the Environment with clear and precise aims and goals, in the belief that these Ministries have the power and coherence required to resolve all identified environmental problems.

Today, some ten or twenty years after the creation of said environmental institutions, we may see that environmental goals have not been reached, for the degradation of the environment is the direct result of the development model previously described, which generates a series of indirect (both environmental and social) costs that go undetected by the market, which is the information benchmark used by politicians in their decision making processes. And only if we are to understand their cross-cutting nature and if we adopt a horizontal approach as an essential aspect of development policy, combined with better national accountability, in which both negative and positive externalities are clearly quantified and internalised, will we be able to create all necessary enabling conditions for substantial, and possibly sustained, progress.

Experience has shown that there are two important aspects to be borne in mind: Firstly, the environmental institutionality has not *per se* achieved environmental goals and aims, for it lacks a cross-cutting focus and scope where it carries out a central policy function where all institutions responsible for the use and management of natural resources (such as those ministries of agriculture, energy, mines, water, fisheries, science and technology) respond in a coordinated and consistent fashion to this governing role. Secondly, markets have been inefficient, as they have failed to reflect the indirect costs associated with the use of natural resources. Thus, productive activities take place in a context of soil erosion, deforestation, lost fisheries...and where the indirect (environmental and social) costs resulting from these production patterns are not taken into account, but rather socialized, by said economic agents.

In effect, still today in our countries we have an additional aggravating factor, as we maintain a subsidy system that clearly goes against the environment. In this sense, we waive taxes and recognise economic incentives to activities which bear a highly negative environmental impact. A clear example of this is the fuel subsidy to the national fishing fleet or the tax exemption afforded to tree logging activities. Through these sorts of subsidies we have favoured economic activities which have proven to be irrational and unsustainable. At a global scale, we see this taking place at a much larger scale in international trade, where certain sectors and markets are protected from the free and fair access on the part of consumers, thus generating environmental impacts in developing countries.

Today, amidst this global context, and with the ever largest and developed global economy, indirect environmental costs may well exceed the direct costs (benefits) of many human activities. Maintaining a form of accountability which does not acknowledge said environmental costs therefore creates market distortions, where we are not told 'the whole truth' about our economic behaviour; a market which misinforms decision makers and economic policy makers and misleads them into taking the wrong path.

To this end, for markets to operate satisfactorily and for economic players to take the right decisions, markets must provide us with comprehensive and accurate information which includes the overall costs of products and services being transacted in the marketplace. In this regard, whenever a country's economic behaviour is measured or assessed, we weigh all activities in the production of goods and in the provision of services; however we do not subtract any environmental and social costs which have been indirectly generated by them.

As long as we do not address these institutional and market deficiencies, all efforts undertaken to revert the high level of deterioration of our natural environment will bear no fruit with the scale and impact so persistently recommended by the scientific community. Thus, today more than ever before, we require the type of political leaders who have the ability to see 'the big picture', to understand the relationship between the economy and environmental services. Given that all major decision makers and public policy makers are economists themselves, we need them to think as ecologists for we can no longer continue to rely on the invisible hand of the market, which has proven to be deaf and blind, nor can we continue to

rely on the creation of fragile environmental institutions amidst an institutional sea marked by dangerous, troubled waters.

In this context, the development of institutional improvement and actions aimed at perfecting the market are as necessary as they are urgent. We cannot wait for the impact of a system of payments for environmental services (PES) to be successful if this is not accompanied by serious and politically viable institutional reforms that focus their attention on the aforementioned problems and failures. I see with greatest concern the development of efforts to implement ESP mechanisms without an understanding of their implicit institutional and economic challenges. In this regard, it is truly important to understand that the ESP constitutes an environmental policy mechanism within a range of other possible options for the implementation of a pre-established environmental policy. In the absence of clear long-term policies that have a vision and are consensus-based, it would be naive to think that a PES system will yield the expected outcomes or those seen elsewhere. PES is therefore a means not an end in itself. The end may be to decrease deforestation and protect biodiversity, and the PES will be the instrument to achieve it.

### **The Institutional Challenge**

As previously noted, a good institutional design in environmental matters is the basis of successful environmental policies and instruments in the long term and at a desired scale (goals must be national and not sub-national, satisfying international commitments and with a vision of sustainability). In its absence, all instruments are mostly unsuccessful and have limited impact. Thus, the institutional framework, the process of institutional evolution, the lessons learnt, the capacity building process, the political clarity in the process of institutional evolution, the resiliency to rectify errors and right the wrongs, the political will and leadership of stakeholders such as those providing social support, all these are *sine qua non* elements which need to be present for economic-environmental policy instruments to be successful.

For the purposes of this publication, it is of utmost importance to highlight that in the absence of designed and structured environmental institutions (ministries), with an operational and environmental management basis anchored on the administration, management, conservation and rational use of renewable natural resources, a country's environmental goals will not be achieved, and the PES will not yield the desired effects. Thus, as a basic rule, Environment Ministries must have direct responsibility for the management, use, utilisation and conservation of forestry resources, biodiversity, water, protected areas and the focus on contamination, or, in the absence thereof, they must have political responsibility for the oversight and management of those decentralised or autonomous agencies in charge of these matters.

All this is part of a higher level, long-term policy that seeks and promotes actions to generate the structural changes required to turn our economies towards low carbon patterns or into green economies. Furthermore, all Ministries of the Environment must also have a clear legal determination to exercise environmental policy leadership, this being understood as the process whereby the Minister of the Environment is the senior public officer who has direct responsibility over the creation of the leadership and the political dialogue that are required to establish and define the sustainable development and environmental policy, thus generating positive dynamics of coordination and conceptual complementarity with those other ministries in charge of public health, transport, energy and mines, agriculture, science and technology, at the very least.

### **The Economic Challenge**

Change towards an economy based on renewable energy sources, a diversified transport system and the production of reusable and recyclable goods is not only imperative but also urgent. This can indeed be done, for we have available to us the financial resources at a global level, and the technological development required for these purposes. However, we must first understand the economic challenge all this represents. As earlier stated, we have serious market failures which do not weigh in the indirect costs of this contemporary productive system where environmental costs and all stimuli and incentives to certain sectors are not taken into consideration, so that the market 'does not tell us the whole truth'.

If the market could indeed tell us 'the actual truth' we would avoid being led so blindly by an accounting system which will ultimately lead to environmental bankruptcy. In this regard, if Marxist societies collapsed because the market did not disclose to them the economic truth, capitalist societies can collapse too if the market fails to tell us the ecological truth. A market economy system which ignores indirect costs in the allocation of values and prices is irrational, inefficient and self-destructive; this has been raised by an endless number of economists and scientists but none with so much political impact as Sir Nicholas Stern when referring to the fossil fuel pricing system, which does not incorporate the global cost of climate change 'the biggest market failure the world has ever seen'.

### **Payment for Environmental Services as a Political Process to Tackle Institutional and Economic Challenges**

In the light of the economic and institutional challenges in a world facing severe problems in the use and rational utilisation of its natural resources, and with major social and wealth distribution challenges, it is our positive experiences and actions which must lead us towards an economic environment that is either green or low in terms of carbon emissions. It is here where we see the great potential of the PES mechanism. To capitalise this, however, we must understand the following rules:

- a) Transfer of experiences must be approached as a capacity-building process, not simply as a convergence of individual efforts.

There are different approaches to value adjudication and to the economic instruments to meet the needs for resources in the sustainable development agenda, depending on the concrete objectives being pursued. There are several stages in the process that is followed to define national policies for resource mobilisation towards the forestry sector, and to the environmental sector in general; however, it becomes evident that many of these stages have a high conceptual and methodological level (for example, economic valuation of environmental goods and services) whilst others refer, rather, to capacity-building for the design and execution of schemes which may be ultimately determined. At an international level, the greatest progress has been made in the first of these two aspects, with implementation experiences being relatively few and/or unknown.

As a result, and given that the case of Costa Rica is based on the experience of several years of public policies linked with the use of diverse economic tools, which has translated into the need to make adjustments in value adjudication and in the charging for and the distribution or redistribution of income, the first methodological element which clearly comes to mind is that the transfer of experiences in this domain must be seen as a process of national capacity-building (this does not necessarily mean an exclusively public view) for the design, implementation and evaluation of policies related to the mobilisation of financial resources. The issue is indeed very complex and, consequently, it must be approached considering its highly complex nature. It is here where, if we take on a critical view, we see how the majority of initiatives, namely the GEF and those of other United Nations agencies, develop PES projects without the necessary capacity-building and public policy improvement.

- b) The Payments for Environmental Services Programme is the result of the accumulation of policy and institutional capacity experiences, and it continues to be the subject of improvement.

In its very conception, the Programme is somewhat more complex than a single economic instrument or mechanism, for apart from the legal definitions which acknowledge at least four generic environmental services, as will be shown below, in practice different modalities have been developed for their recognition and payments, each of which has its own peculiarities. The system is also coupled with credit facilitation actions, mostly for the forestry sector. On the other hand, Costa Rica's experience has focused on the recognition of carbon fixation, and little by little it is dealing with issues relating to water, biodiversity and scenic beauty. Moreover, there are modalities which are beginning to be identified and developed at pilot level (agri-forestry services; agri-forestry and pastoral services; comprehensive farm management, and others), which are all part of what has now been called the 'second generation' of

environmental services in Costa Rica, which pursue the comprehensive management of natural resources (and not merely the recognition of environmental services), as well as the promotion of rural development and the fight against poverty.

The evolution of the system has called for a series of stages of legal, conceptual and operational construction, all of which can be fundamental to achieve the 'maturity' required for the implementation of a programme of payments for environmental services. In other words, we will need to analyse the relevance of pushing stages so that these can be complied with at a faster pace, or else to 'skip' a few. This will depend on the characteristics of each reality.

The assumption underlying this conception refers to the need to have a mechanism in place with the required versatility to adapt to changing environmental, political, cultural and economic circumstances, regardless of the reality.

- c) It must be the result of collective effort, where concerns, strengths and interests of a large number of stakeholders, be they governmental as non-governmental, are taken into account.

Capacity-building processes call for a clear identification of stakeholders in their different roles and responsibilities. The active participation of all relevant stakeholders and sectors (starting with the stages of model design) is key to creating the enabling conditions which will later facilitate implementation of concrete actions, and also to utilising the learning process on the part of the future 'managers' of the various process stages.

On some occasions, and depending on the institutional complexity of each country, the participation of a number of public and private sector actors is required, who must all take part in the creation of a common, single and integral vision of the goals being pursued, with a clear awareness of their individual political, legal and operational responsibilities.

The reconciliation of interests from the very early stages of model design is a central element in order to guarantee the ultimate viability of actions aimed at the implementation of the model itself. The work of consultative teams must be geared mostly towards the provision of technical and methodological tools, to the facilitation of definition processes at a national level, and to the contribution of substantive elements, wherever this might be necessary. The definition of political goals and priorities must always be in the hands of national teams.

- d) Must articulate efforts around a unique vision and strategy (State Policy).

The identification of economic instruments to promote the attainment of environmental, social and economic (sustainable development) goals must be aligned with a State policy which, amongst other things, must guarantee the sustainability of these goals in the long term, across all three dimensions. Consequently, these goals must be clearly linked to the national definitions enshrined in the global and strategic planning instruments of countries (National and Sectoral Development Plans) which, in many cases, must be articulated with policies from other relevant sectors (agricultural policies, competitiveness, social development, etc.), in which interests must be reconciled, as ultimately, decisions must be made over the distribution or redistribution of resources for public investment (which may eventually lead to a competition over public resources), until such time when there are market mechanisms allowing for economic forces to act as regulatory agents in such transactions. As instruments consolidate, the need for public intervention or investment becomes less necessary.

On the other hand, in the light of the necessary articulation amongst national policies, which ultimately pursue national development objectives (the improved standard of living for citizens), articulation is also necessary on two dimensions: a) between national policies and the international agenda and its ramifications (conventions, regional policies, international projects), and b) between that one and national efforts at a private level which are now under way, and which are promoted or, in any case, tolerated, by national policies (pilot valuation, collection and payment or retribution studies and projects, which are in

turn linked back to other efforts in policy areas which may have been initially identified: protected areas, forests, biodiversity, water resources, etc), all this with a view to ensuring the most efficient use of resources and both institutional and financial efforts, all of which involve a cost.

Along these lines, we need to recognise the limited use and validity of various exercises in terms of valuation, such as the collection of and payment for environmental services, whenever they have limited potential to contribute towards the development of national policies and/or mechanisms, among other things, given a) their geographical scope, b) the market characteristics, c) the nature of the environmental service in question, or d) the economic cost of the solution. However, they will continue to always be a significant input as a benchmark for some of the elements that are part of the political decision which might be implemented, although not necessarily sufficient in and by themselves.

- e) The definition of a policy and its correlated funding system must take into account a range of elements which, as a whole, will yield comprehensive outcomes at a legal, political, institutional, cultural, social, economic, and other level.

In line with the above, at the various policy planning levels, elements for analysis must be incorporated that enable an interdisciplinary integration of the inputs required to build this model. Said elements are of a legal, political, economic, institutional, cultural and social nature, and must relate to a specific national reality. The specific identification of said elements will lead to the clarification of roles and expected responsibilities by the various stakeholders within the system, and it is therefore necessary that this should take place at the very early stages of the design process.

- f) Decision-making must be based on an assessment of the status of this topic in each reality (consideration of previous experiences and capacities).

Decisions regarding the orientation of policies and mechanisms for the mobilisation of financial resources towards the sustainable development agenda must not necessarily preface the comprehensive design of a system; rather, it can (and should) be combined (given the learning process being undertaken) so that a) it may facilitate the implementation of concrete actions through the use of existing legal and political spaces and through the adaptation of instruments to the achievement of desired goals, and b) it may complement the model by focusing attention on the missing policies and instruments, which are necessary to fully attain the policy goals.

Without a doubt, the PES and the political implications for its implementation, contribute to political dialogue and to the agreements to be reached with civil society for the transformation of decision making processes in a context marked by a vision of the agricultural landscape which will call for the structural transformations required so that its conservation and rural development goals may be attained. However, the financial mechanism, however novel we may deem it to be, will never achieve its goals and aims if we concurrently leave aside our efforts to improve political management and economic indicators.