

Turning to market forces to accelerate the attainment of Europe's water objectives

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Decades back, the European Union's policy makers have recognised the potential granted by economic incentives and/or disincentives for driving individual and business behaviour toward achieving sustainable development objectives, including protection of healthy environment and efficient use of natural resources. Pursued through a number of statutory acts, the economic policy instruments (EPIs, also called market-based instruments MBIs) permeated environmental (including inland and marine water) legislation. Simultaneously, efforts have been made to detect and remove environmentally harmful subsidies. More recently, the firm commitment to low carbon, resource efficient and socially inclusive growth and economy has become a cornerstone of the EU 2020 Strategy, a part of which is a budgetary-neutral shift of the tax burden away from labour and capital to consumption, property and environment.

Integrated water resource management (IWRM) is a policy field where EPIs, or pledges for their deployment, are widespread, with varying success. The EU Water Policy Review has identified some but insufficient progress in application of the economic principles (e.g. cost recovery, water pricing) and encouraged, cautiously, use of market mechanism (e.g. water right trading scheme) where this represents a value-added improvement. The Review lamented 'insufficient use of economic instruments' (EC 2013, p. 8), limited application of 'incentive and transparent water pricing' (ibid, p. 10), contributing indirectly to increasing magnitude of economic effects of extreme events (such as droughts and floods) (ibid, p. 13). Besides, the Review concluded that 'not putting a price on a scarce resource like water can be regarded as an environmentally-harmful subsidy' (ibid, p.10).

The reasons for the apparent underperformance of EPIs in water management are manifold: First, there is a legal uncertainty (and disagreement) about what constitutes 'water service' according to the Water Framework Directive (WFD, 2000/60/EC), what are the resource and environmental costs and how to estimate them, and under which conditions the overriding public interests hold sway over environmental concerns. Second, the failed attempts to boost greater involvement of public sector in water supply and sanitation services in Italy and, more recently, the public outcry triggered by the proposed Directive on the award of concession contracts (the so-called Directive on concession, COM(2011) 897 final) have demonstrated once again the deeply-rooted divergences in views and beliefs associated with water (service provision).

This paper synthesizes the results of the FP7 EPI-WATER (www.epi-water.eu) project which set off to analyse the benefits, comparative strengths, downsides, and potential side effects of EPIs, applied in water management. EPI-Water has conducted an in-depth review of empirical evidence, experiences and lessons learned from the practical application of economic instruments for water management in Europe and beyond. The review examined 30 EPIs, covering a range of different instruments, which operate under different environmental and socio-economic conditions. Furthermore, EPI-Water conducted an ex ante assessment of five economic instruments (compensation payments for flood storage on agricultural land, nitrate tax, smart water pricing and insurance, water trading and payments for ecosystem services), the application of which was simulated to address four sets of issues (floods, droughts, water quality, or ecosystem services and biodiversity conservation) in five river basins (Tisza, Tagus/Segura, Seine-Normandie, Odense and Pinios). The comparative strengths, downsides, and potential side effects of the instruments were assessed.