

POLICY LEARNING IN ACTION: DEVELOPING MARKETS FOR WATERSHED PROTECTION SERVICES AND IMPROVED LIVELIHOODS

International Institute for Environment and Development (IIED)

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1. SUMMARY AND RECOMMENDATIONS

1.1. Summary

1.1.1 Watersheds cover almost half of the developing world land mass and provide services of decreasing quality and quantity despite increasing demand. They are potentially the world's largest asset class after real estate, if markets can be developed around them. As markets for these services emerge from pilot to scale they have the potential to impact on poor people for good or for bad.

1.1.2. ***Policy Learning in Action: Developing Markets for Watershed Protection Services and Improved Livelihoods (Implementation phase)***, is a multi-donor learning initiative that engages in across-country and across-region policy learning in the Caribbean, India, Indonesia, South Africa and two further countries to be finalised.

1.1.3. The ***goal*** is to promote the maintenance of watershed services that support local livelihoods. The ***purpose*** is to increase understanding of the potential role of market mechanisms in promoting the provision of watershed services for improving livelihoods in developing countries.

1.1.4. Implementation follows a complex multi-partner, multi-country 18 month inception phase that ended March 2003.

1.1.5. The evidence and lessons that this focused initiative provides across a few countries will challenge the international debate at a key moment and move it away from simplistic regulatory or market "magic" solutions towards development of market mechanisms implemented by effective institutions delivering sustainable and equitable benefits. The Katoomba Group and key international water policy dialogues linked to the Millennium Development Goals, into which evidence will feed, provide windows of opportunity to use lessons to influence international fora that bring together major donors, private sector, governments and NGOs.

2. LOGICAL FRAMEWORK

Programme name: Policy Learning in Action: Developing Markets for Watershed Protection Services and Improved Livelihoods (Implementation phase)

Country: International – with implementing actions in the Caribbean, India, Indonesia and South Africa, and exploratory actions in two further countries to be finalised

Date of preparation: 1 July 2003
 Date of latest revision: 30 July 2003
 Proposed start date: 1 October 2003
 Proposed end date: 30 September 2006

| Narrative summary | Objectively verifiable indicators | Means of verification | Assumptions |
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| <p>Goal: To promote the maintenance of watershed services that support local livelihoods</p> | <p>Watershed services improve local livelihoods where market mechanisms implemented</p> | <p>Published assessments of changes in livelihoods following introduction of market mechanisms in watersheds</p> | <p>Continued widespread interest in finding innovative mechanisms for promoting improved livelihoods in watersheds</p> |
| <p>Purpose: To increase understanding of the role of market mechanisms in promoting the provision of watershed services to improve livelihoods</p> | <p>1. Lessons from action learning incorporated in plans of government, civil and private organisations</p> <p>2. Plans for shaping markets for watershed services and livelihoods incorporated in policy initiatives and programmes of government, civil and private organisations</p> <p>3. Policy initiatives and programmes reflect hydrological findings on effects of land use on watershed services</p> | <p>Review of the outputs of new analysis and planning of watershed interventions in developing countries</p> <p>Review of new policy initiatives and programmes involving market-based solutions to watershed problems</p> <p>Implementation monitoring records of initiatives to shape markets for watershed services and livelihoods in key countries</p> | <p>Continued interest in developing countries in the role of market-based environmental management</p> <p>Hydrological information allows some generally applicable policy-relevant conclusions to be made, and in a form useable by stakeholders</p> <p>Policy-makers and programme co-ordinators are responsive to recommendations and implement findings</p> |

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| <p>Output 1. Action-learning processes for the development of equitable market mechanisms for watershed services supported in four countries</p> | <p>1.1. Country diagnostics (prepared in the inception phase) utilised and further developed by country learning groups</p> <p>1.2 Programmes of action-learning finalised, co-funded and monitored in four countries.</p> <p>1.3. Country co-funding proposals supported by local donor(s) and implemented</p> <p>1.4. Targeted analysis for country learning groups on key cross-cutting issues prepared</p> <p>1.5. Tools for country learning groups addressing key methodological gaps prepared</p> <p>1.6. Back up and facilitation of country team efforts to reach policy audiences provided</p> | <p>Country learning group reports</p> <p>Programme documents, detailing the process of taking action and learning from that action, from four countries</p> <p>Donor reports and records</p> <p>New policy and programme initiatives from key agencies for watersheds</p> <p>Issue syntheses reports, learning materials and guidance on the use of methodological tools</p> <p>Project monitoring reports</p> | <p>Proposed market mechanisms receive and maintain local political and institutional support, including that of donors</p> <p>Local capacity to facilitate the process of action relating to market mechanisms</p> <p>Continued demand for IIED's contribution to local initiatives</p> |
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| <p>Output 2. Diagnostics, plans and preparedness established in two further countries wishing to adopt market mechanisms for watershed protection</p> | <p>2.1. Two further countries and co-ordinating partners selected</p> <p>2.2. Hydrology evaluated, livelihoods and market-potential assessed</p> <p>2.3. Institutional and capacity needs assessed</p> <p>2.4. Stakeholders engaged and aware of the issues and opportunities for intervention, and the confidence and preparedness to proceed to supporting market development</p> <p>2.5. Options to shape markets developed</p> <p>2.6. Negotiations on options completed, detailed plans made, and the means for institutional support of these plans secured</p> | <p>Criteria for site and co-ordinating partner selection</p> <p>Two diagnostics and practical proposals for action-learning addressing key research questions</p> <p>Initial action-learning reports and dissemination materials</p> <p>New policy initiatives related to market mechanisms for watershed services</p> <p>Project monitoring reports</p> | <p>Sites continue to demonstrate stakeholder demand, reasonable hydrological data and basic prerequisites for market development</p> <p>Interest and demand for action-learning from stakeholders and local partners can be converted into readiness and capability to engage with it</p> |
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| <p>Output 3. Knowledge of market mechanisms improved through networking, development of guidance and dissemination with other countries and institutions</p> | <p>3.1. IIED project manager identified and project management and monitoring system installed and operational</p> <p>3.2. International workshops of country partners and key opinion-formers held, at project initiation, mid-term review and final findings discussion</p> <p>3.3. Working papers and policy briefings on key themes and methods prepared and distributed</p> <p>3.4. Online information and active websites developed</p> <p>3.5. Findings installed in international fora relating to watersheds, markets and livelihoods</p> <p>3.6. Group-to-group exchanges facilitated between country action-learning groups and groups in countries developing diagnostics and plans</p> <p>3.7. Established international network of interested stakeholders and partner institutions with awareness, confidence and preparedness to make effective and equitable intervention to shape market mechanisms</p> <p>3.8. Synthesis report on findings and ways forward with all project components prepared and distributed</p> | <p>Project manager terms of reference and appraisal reports</p> <p>Project management work plan with monitoring milestones</p> <p>International workshop proceedings</p> <p>Group-to-group exchange reports</p> <p>Lists of network participants and records of communications</p> <p>Records of mail outs, internet hits and distribution by hand</p> <p>Records of responses and feedback from target audiences</p> <p>Project synthesis report and monitoring reports</p> | <p>Continued widespread interest in research results and continued existence of forums for dissemination</p> <p>Effective and efficient management, researching, writing, communicating, learning and influencing skills can be mustered amongst the programme partners and in IIED</p> <p>Opportunities for integrating findings in key international and national processes and institutions continue to emerge</p> |
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Activities

Activities for output 1

- 1.1 Supporting the country learning groups in the Caribbean, South Africa, India and Indonesia in their efforts to install the findings from the diagnostics in the planning and practice of key institutions affecting watersheds
- 1.2 Collaborating with country learning groups to finalise 3-year programmes of action-learning, and agreeing them with local partners and DFID country offices
- 1.3 Providing co-funding to country learning groups on the basis of agreed action learning programmes and prerequisites achieved - and monitoring implementation.
- 1.4 Working with country learning groups to develop proposals with local donors and other institutions to provide complementary co-funding and take the work forward
- 1.5 Carrying out targeted analysis on practical challenges shared by several country learning groups in shaping markets for which IIED's inter-country experience can be usefully drawn on
- 1.6 Developing practical tools and preparing tailored guidance on them for country learning groups addressing key methodological gaps in shaping markets
- 1.7 Backing up and facilitating country team efforts to reach key policy audiences

Activities for output 2

- 2.1 Selecting two further countries and co-ordinating partners, in consultation with existing project partners and DFID, on the basis of criteria developed (including the demonstration of stakeholder demand, reasonable hydrological data and basic prerequisites for market development –)
- 2.2 Supporting scoping consultations and network building in these two countries
- 2.3 Working with partners to develop diagnostics in these two countries:
 - Mapping current policies, institutions, incentives and markets influencing watershed land use (including forest and tree use), water use, and watershed-linked livelihoods – and the links, conflicts and synergies between them
 - Initial assessments of economic and hydrological information linked to land uses
 - Stakeholder and institutional analysis
 - Establishment of a learning group on watersheds, livelihoods and markets
 - Planning workshops with specific stakeholder groups and at country level
 - Production of a detailed diagnostic
- 2.4 Facilitating the establishment of country learning groups in these two countries and holding learning events with them
- 2.5 Working with country learning groups to prepare options to shape markets which can be implemented through country institutions and with support from in-country donors where necessary - involving stakeholder engagement, further hydrological evaluation, economic assessment, options development, market design, institutional development, capacity building and monitoring
- 2.6 Supporting negotiation of options to shape markets with stakeholders, and securing the means to take the best bet options forward

Activities for output 3

3.1 Establishing the project manager and his/her terms of reference, and developing the work plan for the project

3.2 Establishing and implementing a project monitoring and evaluation system, with clear milestones for feedback

3.3 Organising international workshops of country partners and key opinion-formers, at project initiation, for mid-term review and final findings discussion

3.4 Building the international network of interested stakeholders and partner institutions focused on developing awareness, confidence and preparedness to make effective and equitable intervention in support of market development

3.5 Producing and disseminating guidance materials – written reports, working papers, policy briefings, learning sheets, online information and other electronic media and curriculum inputs

3.6 Setting up interactive website for project partners, the wider network, and general dissemination and constituency-building

3.7 Arrange and facilitate group-to-group exchanges between country action-learning groups and groups in countries developing diagnostics and plans

3.8 Attending international meetings relating to watersheds-markets and livelihoods

3.9 Preparing and distributing synthesis report on findings and ways forward with all project components

3. PROGRAMME RATIONALE

3.1 Background

3.1.1. Watersheds cover almost half of the developing world land mass and provide services of decreasing quality and quantity despite increasing demand. They are potentially the world's largest asset class after real estate, if markets can be developed around them. As markets for these services emerge from pilot to scale they have the potential to impact on poor people for good or for bad and at scale. This small initiative will generate high profile debate based on concrete evidence on how best to shape the nature of this impact.

3.1.2. The **goal** is to promote the maintenance of watershed services that support local livelihoods. The **purpose** is to increase understanding of the potential role of market mechanisms in promoting the provision of watershed services for improving livelihoods in developing countries.

3.1.3. The International Institute for Environment and Development (IIED) is the coordinating international policy-action civil society organization, and the initiative is implemented with country level partners. DFID India, Indonesia, South Africa and the Caribbean are engaged.

3.1.4. The programme has been prepared during an 18-month inception phase (October 2001 - March 2003), during which key partners in the four focus countries prepared for the **three-year implementation phase** proposed here. Discussions about expansion of the learning to other contrasting locations were also initiated in the inception phase and are ongoing with DFID offices and other partners in China, Vietnam, the Philippines, Ecuador, Mexico and Peru.

3.1.5. During the inception phase scoping work was carried out in South Africa, India, Indonesia and the Caribbean. Country partners shared case study results, diagnostics and provisional workplans at two international workshops, the second held in September 2002.¹ These steadily built up an international network of interested and informed stakeholders. In addition, the current state of environmental services markets (with DFID support focusing on the design and development of markets for watershed protection services in particular) resulted in a review of 61 examples of watershed market development worldwide and an acclaimed book published by IIED.²

3.2 Policy issues

3.2.1. The evidence and lessons that this focused initiative provides across a few countries will challenge the international debate at a key moment and

¹ Draft country diagnostic reports from South Africa, India, Indonesia and the Caribbean are available from IIED and are downloadable from the IIED website www.iied.org.

² "Silver bullet or fools' gold? A global review of markets for forest environmental services and their impacts on the poor" by Landell-Mills, N. and Porras, I.T. 2002, IIED, London. This book reviews all available examples that offer insights into the potential opportunities for such market mechanisms to promote poverty alleviation.

move it away from simplistic regulatory or market “magic” solutions towards development of market mechanisms implemented by effective institutions delivering sustainable and equitable benefits. The Katoomba Group and key international water policy dialogues linked to the Millennium Development Goals, into which evidence will feed, provide windows of opportunity to use lessons to influence a international fora that bring together major donors, private sector, governments and NGOs.

3.2.2. In early 2000 the first Katoomba Group event (Katoomba I) was held. The aim of the Katoomba process is to bring together governmental agencies, experts, private sector, donors, NGOs through a multi-disciplinary gathering of scientific, natural environment, energy and financial markets sectors to design environmental services products and markets. It recommended a first step of reviewing market cases.

3.2.3. As a result DFID, with other donors, brought together its expertise on water, forestry, rural livelihoods and environmental policy and facilitated, in partnership with IIED, the inception work described above. This involved working at country and international levels with both policy makers and market players.

3.2.4. In October 2001 the Katoomba Group (Katoomba IV) met in the City of London with financiers, international investors and other market players to discuss the opportunities for venture capital and project finance for green markets, including for watershed services and prototype funds for salinity credits. However, concern was raised at the conference about whether these emerging markets will positively impact on poor peoples’ livelihoods. This strongly reinforced the need for concrete evidence that would illustrate in practice how such markets can be made to work for the poor.

3.2.5. The implementation phase responds to this policy challenge. It is designed to learn from a focused group of experiences how to shape in practice the public policy, commercial and other drivers of watershed service markets. It will test practical market mechanisms that engage poor people themselves, linking land use managers situated in marginal upland watersheds with downstream water users.

3.2.6. It will rise to the challenge laid down by the UK Government’s December 2000 White Paper *‘Eliminating World Poverty: Making Globalisation Work for the Poor’* which emphasises policies that build on the productive assets of the poor and open up their access to markets.

3.2.7. In contributing to achieving the Millennium Development Goal of ensuring environmental sustainability the work will be aiming at the water target: *To halve, by 2015, the proportion of people without sustainable access to safe drinking water.* Currently, the focus of most water initiatives is on water resource management and utilities, with inadequate attention to sustainable access and management of the sources of that water – the watersheds. This project will install findings in international water policy dialogues to try and address this gap.

3.3. Approach

3.3.1. The inception phase offered insights into the potential opportunities for market mechanisms around watersheds to promote poverty alleviation in both northern and southern countries. The “commodities” involved in such market payments include: watershed protection contracts, watershed leases, water use rights, stream flow reduction licenses, water quality/salinity credits and contaminant removal plantings.

3.3.2. For upstream poor communities potential benefits include increased income, improved diversity of forest-linked livelihoods, and stronger cooperative institutions. In downstream poor communities, benefits might include new mechanisms to ensure improved and sustainable water supplies.

3.3.3. The inception work has started to develop an effective international network - an incipient “policy community” - amongst a wide range of institutions around the world engaging with these issues. IIED will continue to energise and expand this policy community and orient it to action in producing:

- Working papers and policy briefings on key themes
- Group-to-group exchanges facilitated between those in locations at different stages of market-shaping to help create creative solutions to common challenges
- Methods guidance materials and learning events on making market mechanisms for watershed management effective as complements to existing regulatory approaches
- Online information and active websites
- Installation of learning in international dialogue on watershed protection and related themes

3.3.4. The above actions are geared towards generating internationally and locally-active institutions with awareness, confidence and preparedness to make effective intervention in support of equitable watershed market development.

3.3.5. In this phase IIED will enable country-based project partners to pursue agreed priority programmes and to link more effectively with this international network. IIED will support the further development of the learning groups established in the inception phase, with the backing of broader advisory groups, to tackle key challenges at country level identified in the diagnostics that they have prepared.

3.3.6. The “action-learning” approach in developing and carrying forward plans will be continued. The emphasis in each country is as follows:

- *South Africa* – negotiation of the role of incentives and market-based instruments integrated with the development of catchment management institutions and effective water licensing and allocation

approaches.

- *India* – development of understanding of intra and inter-village incentive mechanisms for water and watershed management, and investigation of potential payments between corporate downstream beneficiaries and upland communities, and application in pilot approaches in Himachal and Madhya Pradesh.
- *Indonesia* – creation and facilitation, in the context of wholesale reform of water policy and decentralisation to the district level, of space for directly interactive negotiation of roles for water resource managers and downstream users in catchments in West Lombok and Java.
- *The Caribbean* – formation of a cadre of change agents, experienced through involvement in interventions in pilot sites, who can influence the increasing use of economic instruments and the nature of emerging markets such that they favour livelihoods linked to good watershed management in Grenada, Jamaica, St. Lucia and Trinidad and Tobago.

3.3.7. The action-learning teams have also identified the need for a continued IIED role in preparation of targeted analysis, development of tools and back-up/facilitation in reaching the political audiences needed for this work.

3.3.8. A group of scientific hydrologists has met with the social, economics and forest expertise in IIED to analyse the half truths or myths associated with watershed management and forests, namely, reduced tree cover in catchments reduces precipitation; land cover prevents water flows drying up in the dry season; deforestation intensifies flooding and increases sedimentation of hydroelectric dams. Hydrological data clarifying these are being collected and processed and will provide scientific evidence for different management and market options.

3.3.9. In the four action-learning countries, co-funding and/or contributions in kind, are anticipated from programmes supported by DFID country offices and/or other financial supporters. The level of funding support under this project is conditional on such local “buy-in” – which will be demonstrated within the first year of the project.

3.3.10. In addition, a core of partners in further countries are eager to expand links and seize opportunities. These countries offer contrasting contexts in development of market mechanisms for watershed services from which a great deal can be learned. Engagement of two of these countries in the international work will also be pursued to develop country diagnoses that:

- Assess the hydrological impacts and downstream effects of different land use practices
- Understand the economics and politics of land and water use
- Chart appropriate courses for negotiation through the institutions and fields of policy necessary to develop more efficient, effective and equitable watershed management systems.

4. IMPLEMENTATION

4.1. Timing

The inception phase ended March 2003. This programme will run for 3 years starting 1 October 2003 and ending 30 September 2006.

See **Annex** for Milestones over time.

5. RISKS AND UNDERTAKINGS

5.1. Risk A: Even where the gains from a watershed market are significant, the significant transaction costs involved introduce serious barriers to entry for anyone lacking financial resources, managerial and coordination skills, technical knowledge and political connections.

5.2. Risk B: Moreover, the costs of participating in emerging markets rise the greater is the number of individuals living in a watershed, the weaker is the government's regulatory capacity, the less reliable are the hydrological data, and the less secure are property rights. It is the poorest groups that risk marginalisation in this process. Governments and their civil society supporters have critical roles to play in ensuring markets work for the benefit of all sections of society, not just the most powerful.

5.3. Undertaking: The programme will not directly reduce transaction costs. It will tackle these risks indirectly by raising awareness amongst stakeholders of the transaction costs involved and the possible means to reduce them. It focuses on better understanding of stakeholder roles and responsibilities in managing such risks.

ANNEX

MILESTONES

| MILESTONES | 2003/4 | 2004/5 | 2005/6/7 |
|--|--------|--------|----------|
| Programme start | Oct 03 | | |
| 1 Action-learning in four countries | | | |
| Country work plans developed | Dec 03 | | |
| Prerequisites for country funding met in first country | Jan 03 | | |
| Prerequisites met in second, third and fourth countries | | Oct 04 | |
| Targeting of opinion leaders begins | Nov 03 | | |
| First tools for methodological gaps developed | Jan 04 | | |
| Market design and negotiation underway in first country | Feb 04 | | |
| Cross cutting analyses completed | | | Feb 06 |
| Market design and negotiation completed | | | Jun 06 |
| 2. Diagnostics, plans and preparedness in two further countries | | | |
| Two countries selected | Dec 03 | | |
| Scoping, partner identification & network building completed in two countries | | Aug 04 | |
| Learning groups established | | Aug 04 | |
| Detailed diagnostic produced in two countries | | | Aug 05 |
| Market design and negotiation underway | | | Nov 05 |
| 3. Networking, guidance and dissemination | | | |
| Websites active, from | Oct 03 | | |
| Communications strategy developed | Dec 03 | | |
| International network stimulated and developing new programme material, from | Jan 04 | | |
| Policy briefs and working papers, from | | Apr 04 | |
| Group-to-group exchanges between country action-learning groups and groups in countries | | Jan 05 | Jan 06 |
| Draft synthesis report disseminated | | | Mar 06 |
| Findings installed in international water-related fora, from | | Nov 04 | |
| Findings installed in international forest-related fora (including Katoomba group), from | | Nov 04 | |
| Programme management | | | |
| IIED steering, management & monitoring in place | Oct 03 | | |
| OPRs & international workshops | Jan 03 | Mar 05 | May 06 |
| Independent evaluation of project | | | Jun 06 |
| Programme end | | | Sep 06 |