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**Market-based instruments for the governance of coastal and marine ecosystem services: An analysis based on the Chinese case**

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# 1 Market-based instruments for the governance of coastal and marine ecosystem services: 2 An analysis based on the Chinese case

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6

## 7 1. Introduction

8 Increasingly, both market-based instruments (MBIs) and the concept of ecosystem services (ESs) have  
9 gained favor in the environmental policy, planning and ecological conservation world (Pirard &  
10 Lapeyre, 2014). ESs are the benefits people obtain from ecosystems, which frames the relationship  
11 between humans and the rest of nature (Costanza et al., 2014; MA, 2005). The close linkages between  
12 human well-being and natural resource management has required better policies and instruments to  
13 enable sustainable governance outcomes. Accordingly, MBIs – a generic term referring to a range of  
14 approaches (e.g., cap and trade schemes, payment schemes, and levies) to address environmental  
15 policy issues in an economically efficient way – have attracted much attention (Muradian et al., 2013;  
16 Pirard & Lapeyre, 2014). These instruments attempt to build supply-demand connections and create  
17 incentives to affect actors' behavior (Boisvert et al., 2013). MBIs mainly support market mechanisms,  
18 such as voluntary transactions between actors, competition for services, and price signals (the EC  
19 Green Paper, European Commission, 2007; Lockie, 2013). Specifically, MBIs internalize the external  
20 costs of an action through taxes, or they create a market for ESs and individual property rights that  
21 favors competition (Dargusch & Griffiths, 2008). By doing so, MBIs seek to solve negative  
22 environmental externalities or even benefit positive externalities, such as inshore overfishing, sewage  
23 discharge into the sea, and utilization of environmentally-friendly tourism products (Engel et al., 2008;  
24 Greiner et al., 2000; Muradian et al., 2010). The main motive underlying MBIs is that they constitute  
25 more flexible responses and cost-effective options, which are superior to traditional regulation for ES  
26 conservation (Bräuer et al., 2006; Davis & Gartside, 2001; Hahn & Stavins, 1992).

27 MBIs have been gradually adopted to serve the governance of coastal and marine ESs. There are  
28 wetland mitigation banks, tradable development rights of flooding zones, eco-labels of fish products,  
29 and payment for ecosystem services (Binet et al., 2013; Filatova, 2014; Froger et al., 2014;  
30 Ressurreição et al., 2012). Coastal and marine ESs play a critical role in sustaining socio-economic  
31 development in coastal regions. However, there is a challenge for coastal and marine governance  
32 worldwide: managing ES complexity in relation to, for instance, ecological uncertainty, bio-physical  
33 dynamics between land and sea, and stakeholders' interests across geographical and institutional  
34 scales (Koch et al., 2009). MBIs have been advocated as being desirable to address this challenge  
35 (Davis & Gartside, 2001). Nowadays, they are considered to be the preferred tools for improving  
36 coastal and marine governance in both developed (e.g., the U.S., and Australia) and developing  
37 countries (e.g., Latin American countries and China; Douvère 2008; Greiner, 2014; Womble & Doyle,  
38 2012; Zhao et al., 2015).

39 Previous studies concerning MBIs have mainly emphasized initiative development in forest  
40 reservation, watershed protection, agriculture, biodiversity, and carbon sequestration (Chobotová,  
41 2013; Hejnowicz et al., 2014; Schomers & Matzdorf, 2013). A strong focus has also been on the  
42 performance evaluation of MBIs by measuring and modeling their benefits and the cost-effectiveness

43 of investment (Connor et al., 2008; Crossman et al., 2011; Bryan et al., 2016). Next to these empirical  
44 experiences, theoretical studies have presented conceptualizations, classifications, and potential  
45 governance modes that may strengthen the application of MBIs (Muradian et al., 2010; Pirard &  
46 Lapeyre, 2014). The governance of MBIs for ESs needs to facilitate economic incentives to influence  
47 actors' behavior and allocate natural resources. This should be in combination with regulations to  
48 draw on different motivations to sustain ESs cost-effectively (Matzdorf et al., 2013). In other words,  
49 the use of MBIs for ESs has required hybrid governance that combines both market and regulatory  
50 elements (Muradian & Gómez-Baggethun, 2013). However, to date, MBIs for ESs in the coastal and  
51 marine field have received limited attention. In particular, an empirical understanding of the required  
52 governance has been lacking. To improve the implementation of MBIs for ESs, it is critical to gain  
53 insights into how existing coastal and marine governance facilitates MBIs in practice.

54 The objective of this paper is to gain theoretical and empirical insights into the utilization of MBIs for  
55 governing coastal and marine ESs. For this purpose, this paper develops an analytical framework to  
56 investigate the governance of MBIs from four distinctive aspects; namely price, regulatory support,  
57 coordination, and spatial consideration (e.g., Boisvert et al., 2013; Muradian & Rival, 2012). The  
58 empirical focus is on experience from China. China has experienced a fast-paced economic  
59 development in the past thirty years. Its complex environmental issues and huge pressures on  
60 ecosystems (e.g., air pollution, biodiversity losses, and depleted fisheries) are among the most severe  
61 of any major country (Liu & Diamond, 2005). China's traditional command-and-control arrangements  
62 have gradually facilitated the evolution of MBIs for ESs to tackle these issues in a more flexible and  
63 effective way. This evolution is visible in China's national coastal and marine governance. Many  
64 national policies have tended to integrate economic incentives, ES valuation, impact assessment, and  
65 spatial allocation. This makes China an interesting case when discussing how MBIs are implemented  
66 in national policies that focus on coastal and marine ESs, and understanding to what extent a market  
67 environment can be created for ESs.

68 The structure of this paper is as follows. Section 2 explains the theoretical relevance of understanding  
69 MBIs for ESs. It also presents an analytical framework formulated around four distinctive governance  
70 aspects of MBIs to guide further empirical investigation. Section 3 introduces the case of China. The  
71 research strategy is explained in Section 4. Results on the governance of the selected MBIs are shown  
72 in Section 5. Subsequently, merits and shortcomings of Chinese coastal and marine governance are  
73 reflected on regarding their relevant to MBIs. Efforts to improve MBIs' utilization in general are  
74 emphasized. The final section presents the main conclusions.

## 75 **2. MBIs for ES governance**

### 76 **2.1 Theoretical relevance of understanding MBIs for ESs**

77 The use of MBIs for ES governance has emerged in recent international discussions and sparked a  
78 broad theoretical debate (Muradian & Gómez-Baggethun, 2013; Tacconi, 2012). Within this debate, it  
79 has been argued that MBIs need to emphasize a typical market feature; namely, the voluntary nature  
80 of the choice for related actors (Engel et al., 2008). MBIs should facilitate freedom of choice for  
81 interactions among related stakeholders (Jack et al., 2008; Tacconi, 2012; Wunder, 2015). This implies  
82 that coastal and marine governance should, for instance, establish negotiation platforms and stimulate  
83 bargaining processes to achieve voluntary agreements on effective allocation of ESs (Filatova, 2014;  
84 Liu & Guo, 2015; Tennent & Lockie, 2013). Reinforcing coordination has also been emphasized in

85 terms of the transaction costs for MBIs. Markets for ESs normally involve considerable transaction  
 86 costs when aligning interrelated actions, such as contract bargains and performance monitoring (Jack  
 87 et al., 2008; Muradian & Rival, 2012). The governance of MBIs seeks to reduce transaction costs by  
 88 building up necessary trust, using regulatory power, providing cost assessment, and stimulating  
 89 competition (Stavins, 2003; Vatn, 2010). For MBIs to be worthwhile, coastal and marine governance  
 90 should keep transaction costs sufficiently low.

91 Moreover, ES valuation has been perceived as an important basis for MBIs. Commoditizing  
 92 ES-related proxies has been promoted and rationalized as a way to integrate ES values into MBIs  
 93 (Nelson et al., 2009). Observable and measurable ecosystem properties and regulatory factors have  
 94 gained favor in valuation to inform costs and benefits in ES transactions (Jack et al., 2008; Tacconi,  
 95 2012). This theoretical discussion implies more instrumental innovations with respect to coastal  
 96 spatial allocation through land/sea uses and economic incentives. Last, but not least, MBIs are  
 97 envisioned to incorporate the idea of dealing with complex causalities of ES issues (e.g., spill-over  
 98 influence, trade-offs and synergies among ESs). MBIs are supposed to reveal cost-effectively causal  
 99 information, internalize multiple costs, and allocate benefits that diverge according to spatial range  
 100 (Corbera et al., 2009; Lockie, 2013; Muradian et al., 2010; Pirard, 2012). MBIs may offer the  
 101 possibility to clarify affected actors, handle impacts that cross land-sea borders, increase co-benefits  
 102 from different ESs, and prescribe offsite measures for compensation.

103 In summary, there is a need to gain a better understanding about market features and ES governance  
 104 complexity. This should be based on empirical studies about MBIs and related governance. Next, an  
 105 analytical framework will be presented to guide further empirical understanding.

106 **2.2 An analytical framework**

107 Against the aforementioned theoretical context, this paper presents an analytical framework. This  
 108 draws on existing qualitative studies about MBIs for ESs which use three perspectives: governance,  
 109 institutions, and ecological economics (e.g., Boisvert et al., 2013; Chang, 2008; Muradian & Rival,  
 110 2012; Schomers & Matzdorf, 2013). These schools of thoughts have suggested four distinctive  
 111 governance aspects of MBIs in relation to coastal and marine ESs. This framework enables a  
 112 structured method to gain insights into the utilization of MBIs. Table 1 presents the four distinctive  
 113 aspects.

114 Table 1 Four distinctive governance aspects of MBIs concerning coastal and marine ESs

Aspects	Specified aspects	Examples
Price	Evaluate specific services	Attach prices to sea foods and wetland forests
	Evaluate ES-related proxies: negative and positive externalities; measurable regulatory elements	Attach prices to pollution and coastal reservation; Land/sea uses, developing rights, permits, and credits
Regulatory support	Assessment rules	Assess land/sea uses, impacts and ecological changes
	Rights and duties	Secure property, permits, and sanction of incompliance
	Transaction rules	Set allowable trading types, forms, scope and total amount, well-defined baselines, and rules on fair distribution
Coordination	Include related actors for voluntary participation	Involve services providers, users, and intermediary agencies

	Coordination methods for making free choices	Arrange meetings, negotiations, platforms, and trading places
	Information sharing and communication	Understand transaction costs, ES social meanings, and agreed measurement and currencies
Spatial consideration	Implementation at the scale where causality occurs	Make offsite allocation between upstream and downstream, and establishment of watershed-based authority
	Address site differences and specification	Set zones, boundaries, and types to differentiate impacts/prices/trading rules

115 2.2.1 Price

116 Generally, MBIs either rely on ESs directly, or on ES-proxies, partially, in regulatory terms, to realize  
 117 commodification. A price could be attached “to different degrees and in different ways...whether for  
 118 market exchange or for direct deals between a limited number of stakeholders, or whatever other  
 119 purpose” (Pirard, 2012). Social and economic values of services have been incorporated into MBIs,  
 120 such as direct fishery losses. Previous studies (e.g. Bräuer et al., 2006; Grafton, 1996; Greiner et al.,  
 121 2000) have provided a considerable evaluation of ES-related proxies for hard-to-commodify ESs,  
 122 including artificial prices for externalities (e.g., upstream pollution), and measurable regulatory  
 123 elements (e.g., land use/cover, fishing quotas, and carbon credits). In this context, land/sea uses have  
 124 played a critical role, as these are assumed to generate desirable ESs, connect ecological functions, ES  
 125 provision, and coastal and marine spatial allocation (Corbera et al., 2009; Schomers & Matzdorf,  
 126 2013).

127 2.2.2 Regulatory support

128 Regulations support markets for ESs in various ways. Generally, they are an important part of MBIs.  
 129 The following three formal regulations normally impose essential preconditions upon which MBIs  
 130 should depend: (1) rules for the assessment of uses, ecological changes and impacts are usually  
 131 formulated by defining, e.g., measurement units and feasible methods; (2) rights and duties are  
 132 required to be clarified (e.g., specify and deliver permits of fishing rights, and guarantee compliance  
 133 with agreements); (3) transaction rules are normally specified, such as defining allowable trading  
 134 types, forms, scope, total amount, and baselines, and fairly distributing financial resource (Boisvert et  
 135 al., 2013; Chang, 2008; Harman & Choy, 2011; Mansfield, 2006). Regulations are prone to cultivate  
 136 and provoke a market-oriented environment. Therefore, the frontier between market and regulation  
 137 tends to be blurred for MBIs used in ES governance (Lambin et al., 2014), including in the coastal and  
 138 marine field.

139 2.2.3 Coordination

140 It is essential that coordination be inherent in the related governance of MBIs and, thereby, play an  
 141 essential role in dealing with coastal and marine ES externalities and interactions among various  
 142 interest groups. Previous studies have noted that MBIs should stimulate voluntary participation of  
 143 service providers, users, and intermediary agencies, and, coordination methods should be in place to  
 144 enable those actors to make free choices within market interactions (Sarker et al., 2008; Scherr &  
 145 Bennett, 2011). Collective meetings, bilateral negotiations, and platforms for learning and trading are  
 146 needed to improve effective ES delivery and long-term transactions (Sarker et al., 2008). Information

147 sharing and communication are also critical components of coordination to smooth MBIs in terms of  
148 supporting ES measurement and exchange currencies, achieving collectively agreed payments, and  
149 capturing ES “social meanings” that determine economic incentives (Aronson et al., 2011; Boisvert et  
150 al., 2013; Muradian, 2013; Muradian & Rival, 2012). Therefore, coordination is generally considered  
151 crucial for negotiating an equitable and efficient scheme regarding ES allocation to facilitate MBIs.

#### 152 2.2.4 Spatial consideration

153 The governance of MBIs for ESs has gradually been featured by spatial consideration on causal issues  
154 (e.g., trade-offs and synergies between ES provision) and site-based specification. First, concerns have  
155 been raised on the implementation scale of MBIs where ES causality occurs (Kemkes et al., 2010).  
156 For example, to deal with offsite externalities, such as the effect of upstream water uses on  
157 downstream uses, Wunder (2015) noted that payments contracts should take a spatial division between  
158 the provision and utilization of ESs into account. Therefore, it is necessary to address the interplay  
159 between ES causality and scales in governance structures; that is, to try to match political boundaries  
160 and jurisdictions with ecological scales (Gómez-Baggethun et al., 2013). Second, when some MBIs  
161 are established on the basis of land/sea use changes, place-based conditions are important for  
162 analyzing ES costs and benefits (Chang, 2008; Harman & Choy, 2011). Specific ecological, economic,  
163 and social conditions in situ determine different measurements of ESs and proxies (zones, types,  
164 prices, and impacts), affecting outcomes of MBIs. Taken together, the spatial nature of MBIs  
165 formulates the way in which cross-border and site-specific issues are dealt with.

### 166 3. Case study: China

#### 167 3.1 The development of MBIs for ESs in China

168 Social and economic development strategies at different historical stages have determined the  
169 characteristics and performance of Chinese environmental governance (Zhang & Zhao, 2007). In the  
170 1970s and early 1980s, China’s environmental protection featured command-and-control methods  
171 under a centrally planned economy. Later, “economic transformation of a market-oriented growth  
172 model and decentralization dynamics” has triggered a change (Carter & Mol, 2013, pp.3). After the  
173 enforcement of the State Environmental Protection Law in 1979, an environmental regulatory system  
174 was formulated with a rapid acceleration of sectoral regulations and standards; starting with marine  
175 environment protection in 1982. A four-tier management system, including national, provincial,  
176 municipal, and county levels, took charge vertically (Carter & Mol, 2013). Meanwhile, simple  
177 economic instruments (e.g., pollution charges) gained popularity, but by no means with a wide range  
178 of influence (Zhang & Zhao, 2007). Since 1992, sustainable development was set down as a basic  
179 national strategy and within which socialist market economy institutions were preliminarily  
180 established (Zhang & Wen, 2008). In this context, MBIs, such as tradable permits of pollution,  
181 subsidies, and environmental fees, have been introduced.

182 Chinese coastal and marine governance has provided space for market-oriented policy to face  
183 ecological degradation, land-source pollution, biodiversity losses, eutrophication risk, coast erosion  
184 and other challenges (SOA, 2014a; Wang, 2006). Particularly in 2002, the Administration of the Use  
185 of Sea Areas created a critical institutional shift from free use to compensatory use of sea areas. This  
186 change marks a milestone in the move towards a market-oriented governance of coastal and marine  
187 public resources. It required coordination among administrative, legal and economic instruments to

188 deal with complex interrelationships of actors (Chen, 2012). Consequently, regulations about, for  
189 example, sea-use permits, trading platform, impact assessment, and sea-use grades, have been  
190 developed to support some market mechanisms (Li, 2006).

### 191 **3.2 Selected MBIs for analysis**

192 Chinese national coastal and marine policies have increasingly emphasized the development of MBIs.  
193 Generally, two types have thrived that directly affect the allocation and protection of coastal and  
194 marine ESs. The first type is property rights trading for access rights of public resources. A typical  
195 instrument is the Bidding and Auction for Sea Use Rights (BASUR). The instrument is applied within  
196 the inland waters or territorial seas of China. It is a market-type exchange whereby users (e.g.,  
197 fishermen and port companies) set a price that they are willing to offer to gain a sea use right, which  
198 allows for an exclusive use of natural resources in certain spatial and temporal scopes. In 2012, the  
199 State Oceanic Administration issued the Notice on the Full Implementation of Market-oriented  
200 Approach to Sell the Use Right of Marine Sand Mining (SOA, 2012). A range of local regulatory  
201 initiatives of trading sea use rights has also been launched within recent years. These aimed to create  
202 incentives of sufficient and efficient sea uses and to increase the value of public marine resources  
203 (ZJOFD, 2013). These efforts have created a market in China that restricts the use of marine ESs and  
204 increases competition and scarcity of access rights to, for instance, marine sand resources, fisheries,  
205 and coastal space for engineering construction.

206 The second type of MBI to have thrived in China is payments for ESs. This aimed to motivate actors  
207 to preserve ESs at low costs through different payment mechanisms. According to the classification  
208 developed by Raes et al. (2016), commonly-used mechanisms in China have included compulsory  
209 payments imposed on private sectors and the internal determination of government payments.  
210 Accordingly, the Charges for Marine Ecological Damage Compensation (CMEDC) and the Subsidies  
211 for Fishery Restoration (SFR) accurately represent the two mechanisms, respectively. CMEDC  
212 requires sea users to pay for ecological damage (e.g., pollution, wetland damage, and species loss)  
213 caused by their activities to compensate the loss of benefit incurred by aquaculture farmers and/or  
214 coastal communities. It attempts to address negative externalities by defining a liability and increasing  
215 the costs to consumers. SFR is a hierarchical payment from the government to the private sector for  
216 carrying out habitat restoration, establishing artificial fish reefs, and boosting fish population. Its focus  
217 is on internalizing positive externalities by encouraging a sustainable provision of fishery to meet  
218 seafood demands. The two instruments have been developed through national policies, such as the  
219 Measures for the State's Loss of Marine Ecological Damage, and the Implementation Guidance on the  
220 Protection of Fishery Resources and Job Transfer Project. These policies have been refined in terms of  
221 local regulations and implemented in coastal governance practice.

222 The development of the two types of MBIs remains an ongoing process and their related governance  
223 shows clear presence of regulatory and market elements. Thus, it is interesting to investigate the  
224 current state of these policy instruments and to analyze the extent to which existing coastal and marine  
225 governance facilitate these instruments from the four distinctive governance aspects of MBIs. BASUR  
226 is used as an example to explore governance of the first type of MBIs. CMEDC and SFR are analyzed  
227 in a bundle as examples to understand the governance of the second type of MBIs.

### 228 **4. Research Strategy for analyzing MBIs in China**

229 This study used a combination of two methods: namely content analysis and semi-structured  
230 interviews. To begin with, existing national policy documents and local pilots on coastal and marine  
231 governance and the two types of MBIs were collected. The national policy documents included  
232 legislations, administrative regulations, statements, program reports, technical guidelines, and  
233 standards (Appendix A). These documents were collected between May and September 2015 from  
234 key official websites, such as the Central Government, the State Oceanic Administration, and the  
235 Ministry of Agriculture. Data about local pilots and initiatives were derived from newspapers and  
236 provincial and municipal government websites to reveal more operational details on each MBI. For  
237 instance, the administrative measures on marine compensation in Shandong province, the bidding for  
238 sustaining marine sand resources in Guangdong province, as well as the implementation of fishery  
239 subsidies in Qingdao city.

240 Next, we interviewed ten key stakeholders to gain insights into the thinking behind the design and  
241 application of each selected MBI in practice. They were either selected according to their position in  
242 the relevant government agencies or their expertise regarding coastal and marine governance  
243 (Appendix B) and whether they were capable of reflecting on the processes, outcomes, developing  
244 trends, and suggestions on the MBIs for ESs. Semi-structured interviews guided questions following  
245 the analytical framework in Section 2.2.

246 Finally, both the policy documents and the interview transcripts were analyzed with the computer  
247 program of Atlas.ti for content analysis. Table 1 was adopted as a preliminary coding scheme to code  
248 all relevant text passages fitting under each distinctive governance aspect. Those text passages were  
249 aggregated and interpreted accordingly. This led to an in-depth understanding of the empirical  
250 implementation of the studied MBIs.

## 251 **5. Results: MBIs for ESs in Chinese coastal and marine governance**

252 After analyzing the data from the case, we summarized the key findings in Table 2. The results are  
253 explained in the remainder of this section.

254

Table 2 Findings on the four distinctive governance aspects of the selected MBIs used in Chinese coastal and marine governance

MBIs	BASUR	CMEDC & SFR
<b>Price</b>		
Evaluate specific services		Losses of natural fisheries and water purification service (CMEDC) Evaluate intangible ESs in pilots of National Marine Nature Reserves
Evaluate ES-related proxies	Sea use rights (inputs for activities or measureable benefits gained from ESs)	Input for ecological conservation and restoration Opportunity costs of alternative uses
<b>Regulatory support</b>		
Assessment rules	Conduct assessment on potential environmental impacts Analyze function and location rationality Evaluate standard price of different sea areas	Integrate compensation in environmental impact assessment Assess direct input and measurable output from ESs as a basic value Assess losses of marine ESs as a theoretical reference for upper limit value
Rights and duties	The State owns the property rights of sea areas Adopt a registration and certificate system for uses The State determines ES supply and maximum tenures of rights  Sanction of noncompliance of both users and government agencies	The State owns the property rights of sea areas Integrate compensation liability with sea use rights (CMEDC) Require collective government finance to stimulate private incentives against common property setting (SFR) Administrative sanctions of noncompliance for government agencies
Transaction rules	Local specification on transaction methods and processes Set allowable transaction for certain use objectives and patterns Determine national qualification thresholds Require collective allocation of payments	Set allowable method and period of compensation, and facilitate an agreed amount of payments (CMEDC) Governments' internal determination of budget amount and project-based allocation (SFR)
<b>Coordination</b>		
Include related actors for voluntary	Users are free to participate but remain rather hierarchically affected	Sea users are obligated to pay, but have free choices of compensatory methods (CMEDC)

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participation	<p>Marine administrative agencies act as both providers and ‘management intermediaries’ with the cooperation among other related government agencies</p> <p>A few third parties exist to organize trading platforms</p> <p>Assessment agencies are involved as ‘assessment intermediaries’</p>	<p>Marine administrative agencies act as both ‘intermediary providers’ and ‘management intermediaries’ (CMEDC)</p> <p>Service providers are voluntary to participate (SFR)</p> <p>Marine administrative agencies play roles of ‘intermediary users’ and ‘management intermediaries’ to assign budgets; beneficiaries do not participate directly (SFR)</p> <p>Limited non-governmental organizations are inclusive</p> <p>Assessment agencies are involved as ‘assessment intermediaries’</p>
Coordination methods for making free choices	<p>Trading platforms</p> <p>Contractual agreements</p> <p>Official documentation and joint meetings</p>	<p>Negotiation on compensatory prices (CMEDC)</p> <p>Less bargaining space for providers in setting top-down payments (SFR)</p> <p>Official documentation and joint meetings</p>
Information sharing and communication	<p>Transparent information on traded areas</p> <p>Explicit transaction costs</p> <p>Unclear socially optimal prices</p>	<p>Transparent information on ecological losses, impact scope, extent, and mitigation measures (CMEDC)</p> <p>Limited understanding of social perceptions of ESs (SFR)</p> <p>Clear transaction costs</p>
<b>Spatial consideration</b>		
Implement at the scale at which causality occurs	<p>Draw on administrative scales and functional zones</p>	<p>Accord with administrative boundaries</p> <p>Address cross-border compensation by higher-level government agencies</p>
Address site differences and specification	<p>Consider place-based geographical, ecological, social, and economic differences to set starting prices</p>	<p>Identify and clarify principle ESs for each geographical unit to take compensatory priority</p>

---

## 257 **5.1 BASUR**

### 258 5.1.1 Price

259 Making sea use rights tradable has been increasingly adopted in China. In 2012, the State Oceanic  
260 Administration issued a policy on fully promoting the instrument of BASUR for marine sand mining  
261 (SOA, 2012). Subsequently, such market-type exchange of rights has been expanded to coastal  
262 aquaculture, reclamation, and engineering construction. The focus of BASUR is on sea uses that are  
263 expected to provide ESs; thereby prices are tied to the proxy. As a planner from the National Oceanic  
264 Technology Center explained: “It is a trade of usufruct rights to natural resources. The value of natural  
265 resources is considerably illustrated by how to produce value, namely, utilization, which finally leads  
266 to sea use rights.” To illustrate the value, payments are usually made in two ways: by attaching prices  
267 to inputs for activities (e.g. infrastructures, environmental costs, and administrative costs); and by  
268 evaluating the measureable benefits from ESs, such as aquaculture output and tourism incomes (SOA,  
269 2013a).

### 270 5.1.2 Regulatory support

271 What guarantees an equitable, open, and standardized market for sea use rights is the regulatory  
272 element as that defines assessment, liability, and transaction processes. First, formal assessment is a  
273 precondition for delivering sea use rights. This includes assessing potential environmental impacts  
274 induced by coastal uses, discussing rationality of function and location, and evaluating standard price  
275 of different sea areas (CNSC, 2014; SOA, 2010). Sea assessment and standard prices are emphasized  
276 by the State to maintain elementary values of public natural resources and to avoid a dramatic shift in  
277 price (SOA, 2013a). This emphasis has been refined locally through a formulation of starting prices  
278 and evaluation schemes for bidding in, for instance, the provinces of Jiangsu, Zhejiang, and Fujian  
279 (SOA, 2008). However, the assessment illustrates less flexibility in performance. As an expert from  
280 the Ocean University of China noted: “Standard price should be dynamic...Current evaluation hardly  
281 captures market changes that may take place rapidly or slowly under the influence of society,  
282 economy, and natural conditions.”

283 Second, BASUR has followed a set of predefined rules on property rights and duties. Access rights to  
284 natural resources are constrained by a registration and certificate system of sea use rights and zoning  
285 (SOA, 2006). According to ecological and social conditions per zone, governments have determined  
286 the supply of ESs, as well as who has access rights (i.e. issue a certificate as the only legitimate  
287 symbol) and for how long (i.e. set a maximum tenure of right for different uses). Such property  
288 settings have created political pressures on exchanges. One example is short tenures of rights gained  
289 by users. As a planner from the National Oceanic Technology Center explained:

290 “Governments are not willing to transfer a long-period use right to a risky or large-scaled production like  
291 fish farming. Rapid economic development normally leads to revoking rights for certain areas for new  
292 economic development. It means the longer tenure possessed by a user, the more costs for compensation  
293 governments have to bear.”

294 BASUR is also conditioned by sanctions for noncompliance of both users and government agencies.  
295 Users who cheat in transactions and change the approved utilization should be fined; government  
296 agencies that fail to conduct supervision should accept penalties (QDHDG, 2015).

297 Finally, the regulatory operation of transactions is central to BASUR. Although there is no national  
298 policy that specifies methods or processes for BASUR, local initiatives have brought this aspect  
299 forward, such as in Gunagxi, Guangdong, and Zhejiang provinces (ZJOFD, 2013; Zhao et al., 2015).  
300 To assure trading efficiency and justice transparency regarding process, results, and information has  
301 been underlined. Allowable transactions for certain use objectives and patterns have also been set  
302 locally to clarify the scope of tradable objects (QDHDG, 2015). At the national level, thresholds have  
303 been qualified on, e.g., spatial resources for reclamation and maintenance of natural coastal lines  
304 (SOA, 2011). This creates a scarcity for certain uses of the sea in markets. Incomes from bidding and  
305 auction are required to be collectively allocated for ecological restoration and climate risk prevention  
306 as a way of fair distribution.

### 307 5.1.3 Coordination

308 The coordination underpinning BASUR is based on users' voluntary participation, diverse  
309 coordinative methods, and information communication. First, users (e.g., individuals, firms, entities)  
310 have free and informed choices about how to engage in a bid or an auction. Although users'  
311 participation is not legally compulsory, users are prone to enter only when a stable relationship with  
312 governments has been developed. This would smooth the subsequent administrative process and  
313 prevents users from undesirable costs. This hierarchical effect is relevant to marine administrative  
314 agencies. These perform as the State's representatives to provide ESs and approve sea use certificate,  
315 as well as 'management intermediaries' for BASUR operation (ZJOFD, 2013). Other related  
316 government agencies are obliged to cooperate with marine sectors. In some local cases, the  
317 operational role can be done by a third party of organizing trading platforms. These can act  
318 independently and without administrative interference (Zhao et al., 2015). BASUR also involves  
319 'assessment intermediaries', since the evaluation of sea uses is quite essential for exchange.  
320 Nevertheless, not only marine assessment agencies, but also those from assessment fields of real  
321 estate, forest, and land uses, are active to participate. Several interviewees argued that, although  
322 experiences have been accumulated, schemes (e.g., a socially organized institute and rules on  
323 overcoming assessment rents) are absent to assure the capacity of assessment and the quality of  
324 results.

325 Second, an array of methods acts to provide bridges to support actors' cooperation. Trading centers for  
326 sea use rights have been established in cities of Nantong, Qingdao, and Lianyungang to connect  
327 supply and demand sides (Li & Liang, 2014; QDHDGO, 2015). Governments (providers) and bidding  
328 winners are coordinated through contractual agreements; this method actually formulates conditional  
329 payments for gaining a legal certificate of access right. Contracts between assessment agencies and  
330 providers or users are different, as they focus on the exchange of technical services, rather than  
331 ES-related proxies. Cooperation among government agencies for intermediation depends on official  
332 documentation and joint meetings. This allows for discussions about spatial allocation, impacts, and  
333 solutions (ZJOFD, 2013). Civil society is also involved through public notices about trading plans and  
334 results. People who are potentially affected could inform of their own concerns for ESs.

335 Information presented in BASUR is partly transparent. Information on traded areas relevant to  
336 location, ecosystem quantity, and starting prices is transparent. Transaction costs associated with an  
337 exchange (e.g., price evaluation, negotiations among intermediaries, and certification enforcement) seem  
338 clear and helpful to reduce information asymmetries. Generally, socially optimal prices of sea use

339 rights have not been identified via transaction processes. As an official from the SOA stated: “A  
340 sea-use project is inclusive of military, transportation and private business information...its openness  
341 cannot be determined by one agency. Outcome of openness is uncertain. No one would like to take a  
342 risk.” The poor information sharing causes a weak perception of tradable rights on sea uses. This  
343 further hinders exchange scales, sufficient frequency of transactions, and the identification of optimal  
344 prices.

#### 345 5.1.4 Spatial consideration

346 Governance of BASUR demonstrates spatial features in terms of matching administrative scales and  
347 functional zones, and taking in situ differences into consideration for starting prices. BASUR takes  
348 place within administrative scales since the use rights are administratively secured. Moreover, use  
349 purposes of traded areas are required to be consistent with marine functional zones, which define, as  
350 an expert from the Ocean University of China explained, “different attributes of marine resources  
351 particularly in territorial water and for which purpose those natural resources can be used.” This  
352 consideration guarantees that activities decided through biddings/auctions are appropriate for a given  
353 spatial area. Also, these ecological attributes, together with geographical, social, and economic  
354 differences, are critical for designing starting prices (SOA, 2013a). Specifically, national delimitation  
355 of sea-use grades and patterns distinguishes place-based values and ecological costs, serving as an  
356 essential foundation for setting starting prices.

## 357 **5.2 CMEDC & SFR**

### 358 5.2.1 Price

359 CMEDC and SFR are the current mainstream of payments for ESs in Chinese coastal and marine  
360 governance. Both payment mechanisms draw on input for ecological restoration (e.g., costs of  
361 infrastructure, monitoring, assessment, and consultation) and the foregone net benefits from ESs (i.e.  
362 opportunity costs). CMEDC brings evaluation forward to specific ESs; namely, prices on losses of  
363 fisheries and water purification service are taken into account (SOA, 2013b). An official from the  
364 National Development and Reform Commission noted that:

365 “Current focus is on the quantity loss of material objects. Actually, values of other services like regulating  
366 services should be dominant in marine compensation. However, who is willing to believe it and pay? A  
367 middle course is thus evaluating tangible or easily-calculated things.”

368 In a recent pilot, more intangible services have been measured and adopted in National Marine Nature  
369 Reserves. This scheme cultivates regulatory rigidity and rich data, in which higher ES prices are  
370 expected to gain great acceptance.

### 371 5.2.2 Regulatory support

372 As mentioned above, CMEDC is about users’ payments for ecological damage caused by their  
373 activities to compensate providers’ losses. SFR is a hierarchical payment from government to  
374 encourage users’ positive activities for ES provision. These two payment mechanisms determine a  
375 strong reliance on regulations. Assessment on ecological losses and payments has been stimulated by  
376 environmental impact assessment (GB/T19485-2014; SOA, 2010). In 2013, the Technical Guidelines  
377 for Assessment of Marine Ecological Damage (Trial) (SOA, 2013b) specified a baseline for  
378 compensation. The value of damaged ESs, however, is only considered as a theoretical reference for

379 upper limit compensation (CCICED, 2008).

380 State-owned property rights of coastal and marine ESs fundamentally affect the two payment  
381 mechanisms. For SFR, people without property are normally short of incentives for ES restoration and  
382 provision. Private incentives need to be stimulated against the context of common property of public  
383 resources. Hence, collective government finance is required to assure the benefits of people who  
384 contribute to ES maintenance or restoration, for example, fishermen and oceanic pasture operators.  
385 For CMEDC, land/sea developers that gained sea use rights normally consume ESs or damage  
386 ecosystems. Sea use rights are helpful to clarify beneficiaries and their liabilities. Thus, the transaction  
387 of sea use rights is a vehicle to impose charges of compensation. Nevertheless, not all utilizations of  
388 coastal and marine space have been clarified in terms of property and this restricts CMEDC (SC,  
389 2013). Eventually, imposing compensation charges and distributing subsidies are typical government  
390 tasks. These activities are associated with administrative sanctions, which have a presence in local  
391 pilots, for instance, the Measures on Administration of Marine Eco-compensation in Shandong  
392 province (SDFD, 2016).

393 CMEDC and SFR draw on different transaction rules. Compensation periods and allowable  
394 compensation methods are specified for CMEDC. Both users and government should agree on the  
395 amount of payment. SFR is more in line with hierarchy. It is a top-down way to determine the total  
396 amount of subsidies. The amount varies depending on financial capacities and the value that  
397 governments attach to ecological conservation (MAO, 2013). SFR is more like a technical-economic  
398 intervention; its application depends on government-planned restoration projects. Outcomes of such  
399 projects tend to be easily monitored and measured.

#### 400 5.2.3 Coordination

401 The two MBIs demonstrate different coordination. The first concern is about the involved actors. For  
402 CMEDC, users are obligated to pay compensation on the demand side, but are free to choose between  
403 cash payment and offsite restoration of a degraded habitat. The official from the National  
404 Development and Reform Commission explained this compulsory participation as follows:

405 “Most beneficiaries still think that ecological services are free to use...If charges of compensation are too  
406 high to be accepted by users, it is thus less likely to make a good use of marine resources...Compulsory  
407 rules of payment are the result of game.”

408 From the supply side, marine administrative agencies act on behalf of the State or fishermen to claim  
409 for compensation (as ‘intermediary providers’ of ESs), and also perform a role of ‘management  
410 intermediaries’ to operate and monitor CMEDC (SOA, 2014b). The planner from the National  
411 Oceanic Technology Center criticized the dual position as follows: “Those agencies are apt to employ  
412 power to control more resources through finance distribution...They have a mandate to immunize  
413 against CMEDC for industrial programs that would greatly enhance economic outputs.” For SFR,  
414 freedom of participation is delegated to providers (e.g. fishermen or contractors of artificial fish reef).  
415 Local governments can be seen as service providers also when they receive the State’s payments for  
416 operating public welfare programs. Marine administrative agencies are ‘intermediary users’ (as  
417 representative of final beneficiaries) to assign a revenue from the demand side and take charge of SFR  
418 operation and supervision (MAO, 2013). In this case, beneficiaries do not participate directly; similar  
419 power-affected distribution, as in CMEDC, also occurs due to the dual position of government

420 agencies. For both CMEDC and SFR, non-governmental organizations are not engaged in transactions  
421 to provide finance or intermediation service. Only assessment agencies are inclusive as independent  
422 third parties to serve ecological monitoring, damage assessment, subsidy standard formulation, and  
423 project evaluation.

424 When focusing on coordination methods, negotiation between users and marine administrative  
425 agencies facilitates an agreed price for CMEDC. By contrast, the top-down payments for SFR allow  
426 for limited bargaining space for ES providers. Coordination mainly takes place between related  
427 government agencies in terms of official documentation and joint meetings for budget distribution.  
428 The planner from the National Oceanic Technology Center criticized this as follows: “Providers  
429 should decide how to use the budget and which ecological project should be launched, since they are  
430 the final beneficiaries. Benefits determined by governments may not satisfy providers’ desire.” This  
431 criticism also reveals an insufficient exchange of information about providers’ perceptions of ESs in  
432 SFR distribution. CMEDC performs better in information sharing to make ecological losses, impact  
433 scope, extent, and compensatory mitigation measures available (SOA, 2013b). Transaction costs seem  
434 clear for both mechanisms, such as revenue arguments within governments, direct negotiation with  
435 users based on assessment, and costs comparison between direct payments and offsite restoration.

#### 436 5.2.4 Spatial consideration

437 Spatial consideration is underlined as a foundation for CMEDC and SFR. Ongoing developments of  
438 both instruments draw on administrative boundaries, rather than a geographical scale of the ecosystem.  
439 Critical ESs for each geographical unit have not been identified and classified to take compensation  
440 priority. Local budgets only support restoration projects that take place within local boundaries.  
441 Payment rules formulated locally have no cross-border sanction to address upstream-downstream  
442 compensation (SDFD, 2016). In this case, a higher-level government agency normally takes charge of  
443 coordination, such as proposing solutions to offsite pollution. Moreover, identifying critical ESs for  
444 each geographical unit is still ongoing to support compensation priorities. The National Principle  
445 Function Zoning (SC, 2015) and the Marine Functional Zoning have built a spatial framework and  
446 laid a foundation for the identification (SOA, 2009). A specific marine ecological zoning has been  
447 planned to fit the scale and pattern of ecosystems better (SOA, 2009).

## 448 **6. Reflection and Discussion**

### 449 **6.1 Advantages and shortcomings of the Chinese governance of MBIs for ESs**

450 This paper sought to gain insights into the utilization of MBIs in China for governing coastal and  
451 marine ESs using an analytical framework with four distinctive aspects. The results show just how  
452 much governance matters for MBIs. Not all of the four aspects are part of the Chinese coastal and  
453 marine policy. The results have illustrated certain advantages of Chinese practice. For example: the  
454 existing governance of MBIs is capable of reducing transaction costs, maintaining natural capital,  
455 stimulating actors’ interactions, and integrating place-based features and ES bundles. Meanwhile,  
456 shortcomings of Chinese coastal and marine governance are also revealed, including the exclusion of  
457 major ES values from price setting, inflexible assessment rules, political pressures on market  
458 coordination, and the administrative scales at which MBIs are operated. In the remainder of this  
459 section, the advantages and shortcomings for each distinctive aspect will be discussed.

460 In China, prices are significantly attached to land/sea uses and inputs, rather than to clearly-defined

461 ESs. This consideration makes evaluation easier and less costly for trading. This advantage has been  
462 widely supported in previous studies (Wunder, 2015). Besides, stakeholders' willingness to pay for  
463 natural resources remains quite weak in China. Given this situation, emphasizing tangible inputs (e.g.,  
464 infrastructures) in sea areas is helpful to identify users and increase their participation; and even  
465 promote compulsory participation. This merit has been illustrated by CMEDC and accords with other  
466 empirical research (Farley & Constanza, 2010). By contrast, the evaluation scope of specific services  
467 is quite narrow for the selected MBIs (only includes natural fisheries provision and water purification  
468 service). Excluding the major values of other ESs in price setting may reduce the environmental  
469 effectiveness of the instruments.

470 Regulations provide a considerable support for the analyzed MBIs in China. First, assessment rules  
471 are helpful to maintain natural capital. Setting standard prices (e.g., the starting price of bidding and  
472 the basic price for compensation) informs stakeholders of basic values of natural capital. It guarantees  
473 a threshold to maintain coastal and marine values in exchanges. Also, the flat-rate prices show  
474 strength in reducing costs that occur in small-scaled transactions (e.g., an exchange of sea use right for  
475 aquaculture). It can lighten the burden that poor users have to bear. Second, property rules and  
476 liability rules (Raes et al., 2016) in China are useful in overcoming free riding and lower transaction  
477 costs. Given the non-excludable attribute of many coastal and marine ESs, access rights to resources  
478 are limited through certificates, or a liability of protection defined by law. Government payments  
479 (SFR) and compulsory charges (CMEDC) are accordingly set. The results reveal the necessity of  
480 hierarchal efforts for ES-related market as many scholars have argued (Kemkes et al., 2010; Wunder,  
481 2015). Meanwhile, hierarchical shortcomings also exist for transactions. For instance, inflexible  
482 assessment rules fail to capture market dynamics, and administrative approval of property can easily  
483 cause political pressures on trading.

484 In China, coordination for implementing MBIs has grown in importance. The use of coordination  
485 methods, the provision of incentives, and a certain level of freedom to make choices are useful to help  
486 reduce transaction costs. The developed trading platforms, joint meetings, and negotiations enable  
487 actors to join market interactions directly. Different degrees of incentives are offered to stimulate  
488 voluntary participation of ES users (in BASUR) and providers (in SFR). These actors' engagement is  
489 crucial to reach agreements and reduce costs (Raes et al., 2016; Tacconi, 2012). Chinese government  
490 has an outstanding position in coordination. Government plays the roles of 'management  
491 intermediaries' and acts as the representative of users and providers by creating links among actors.  
492 Such monopsony situation (i.e., pooling services from providers or funds from users) and the  
493 intermediary role can decrease transaction costs by minimizing the number of involved actors (Raes et  
494 al., 2016; Vatn, 2015). Nevertheless, those settings do not fully create a favorable environment for  
495 actors to have free meetings, form open-market prices, or increase largely voluntary participation. In  
496 some cases, users' participation in a bid depends on their relationships with governments. Essentially,  
497 the multiple roles played by government are likely to create political pressures on MBIs. This is most  
498 obvious in the finance allocation that is subject to power.

499 Regarding the spatial aspect, the two types of MBIs have integrated place-based features and ES  
500 bundles based on spatial zones. Setting starting prices of bids and identifying compensation priorities  
501 considerably rely on the ecosystem functions and attributes of each zone. The assessment of sea areas  
502 and ecological losses in China illustrates a thinking of assessing ES bundles, since an array of ESs is  
503 spatially linked through a certain ecosystem function. Paying for a set of such loosely defined ESs

504 may maximize social benefits (Farley & Costanza, 2010). Additionally, bundling ESs in MBIs may  
505 increase beneficiaries and avoid exclusivity on other services caused by commoditizing a certain  
506 service (Kemkes et al., 2010). However, the implementation of the selected MBIs is at administrative  
507 scales that express little concern for the scale at which ES causality occurs. Findings show that no  
508 specific administrative scale matches upstream-downstream allocation or watershed-based causalities.  
509 Existing rules to address those ecological causalities are rather a hierarchical way to realize  
510 administrative coordination.

511 Overall, as the majority of coastal and marine ESs are common pool or public resources, and as their  
512 property rights belong to the State, Chinese governments promote MBIs in their own way – with  
513 strong reliance on hierarchical support and their past strengths to provide economic incentives.  
514 Consequently, the use of MBIs in Chinese coastal and marine governance only shows part of the four  
515 distinctive governance aspects of MBIs. Based on the above analysis, governance improvements  
516 could be made for a better use of the analyzed MBIs in China.

## 517 **6.2 Efforts for improvement**

518 To improve the implementation of the analyzed MBIs, three important governance efforts could be  
519 made. First, the major value of coastal and marine ESs should be integrated. A comprehensive  
520 assessment system that defines which, and how to identify and evaluate, critical ESs is needed. To  
521 keep a lower level of transaction costs, such an assessment system could be refined step-by-step based  
522 on existing databases and tools (Primmer & Furman, 2012). Moreover, to reveal optimal prices of ESs  
523 in a dynamic market and inform assessment settings, the frequency of transactions should be  
524 increased. This requires broadening the scope of tradable ES-related proxies and imposing explicit  
525 property rules.

526 Enhancing social learning and recognition for the payments for coastal and marine resources is also  
527 worthwhile. Creating better partnership atmosphere and communicating channels to share social,  
528 economic, and ecological information can be recommended so that more awareness and support can  
529 be built for MBIs (Chobotová, 2013). Through this, compulsory participation may gradually convert  
530 into voluntary participation with more willingness of payments. This would increase the  
531 environmental effectiveness and socio-economic efficiency of MBIs (Tacconi, 2012).

532 Last but not least, social and local initiatives on MBIs for ESs should be stimulated to supplement the  
533 hybrid governance in which hierarchy retains a major role. More independent third parties should be  
534 involved and assigned responsibility for operating ES transactions to mitigate political pressures on  
535 markets. Social initiatives on conservation funding need encouragement to change the dominant  
536 position of government funding and improve financial sustainability (Scherr & Bennett, 2011). Local  
537 initiatives on cooperation also require more attention, since they have potentials to bridge across  
538 authorities and overcome sector-by-sector shortages when addressing place-based issues.

## 539 **7. Conclusion**

540 Previous studies on MBIs for ESs and coastal and marine governance have suggested that the  
541 governance of MBIs should integrate ES values by setting prices to ESs or related proxies, as well as  
542 draw on required regulation as an important support. These studies also point to a better coordination  
543 to enable actors to make free choices based on spatial scales at which coastal ES causality occurs.  
544 However, results from the analyses of Chinese practice show different emphases when compared to

545 the general literature about the governance of MBIs for coastal and marine ESs. Chinese policies  
546 largely do not depend on market-oriented ways to determine ES provision, set economic price, or  
547 facilitate free negotiations between supply and demand sides for ES exchange. The understanding of  
548 the role of free choice, and the way in which coastal and marine policies deal with complex ES  
549 interactions, is still limited. By contrast, Chinese MBIs mainly provide economic incentives for ES  
550 maintenance by relying on regulations. The MBIs tend to integrate a certain level of ES valuation and  
551 impact assessment. This contributes to a better understanding of transactions and ES allocations.  
552 Moreover, Chinese coastal and marine governance has a clear focus on improving policy coordination  
553 by reducing transaction costs in a largely non-market environment.

554 Overall, the analytical framework that emphasizes the four distinctive governance features of MBIs  
555 for ESs; namely price, regulatory support, coordination, and spatial consideration, has proven to be  
556 useful to gain insights into the utilization of MBIs for the governance of coastal and marine ESs. The  
557 empirical analysis of, and the general implications for, Chinese practice contribute to the ongoing  
558 discussions about the need to understand MBIs and ES governance complexity better.