Identifying the transaction costs of environmental policy making

Transaction costs can be incurred during various phases of environmental policy making, from planning through to enforcement. A recent study has examined what influences these costs and concluded that policy selection and evaluation could benefit from a better understanding of the causes of these transaction costs.

For any form of policy to be efficient its benefits should be greater than its costs. Transaction costs are the indirect costs incurred by all parties involved in creating and using a policy. They are incurred through activities such as information collection, legislation development, hiring and training staff, lobbying, contracting, record keeping, reporting, monitoring, implementation and enforcement etc. Without an understanding of these costs, decision makers may be limited in their assessment of a policy’s past, current or future efficiency.

The study reviewed previous research in this area and identified three major influences on the transaction costs of environmental policy making:

- **The nature of the transaction.** If the transaction involves a specific asset, such as a particular site or a species, then costs are likely to be higher because investments in that transaction cannot easily be transferred to other transactions. The frequency or timing of the transaction is also influential; if there are repeated transactions between the same parties, costs can be reduced by designing a reusable contract. The greater the uncertainty and less observable the policy outcomes, the higher the transaction costs due to the cost of information collection and monitoring and enforcement. For example, the planting of trees is observable, whereas water quality improvement has long lags between action and outcome and is more costly to monitor.

- **The nature of those involved in the transaction.** There is a limitation in people’s ability to foresee the effects of a policy which increases costs. Typically, this can be reduced by employing staff with past policy experience and/or developing policy that builds on existing policy. Policy participants may also be prone to opportunism and motivated by self-interest. If individual participants are gaining excessively from the transaction this will incur costs and a possible way to prevent this is to produce more water-tight contracts and monitor actions closely over time. However, both these preventative actions can also incur costs.

- **Other influences.** The institutional environment, such as existing policy and procedures, can either reduce or create transaction costs. For example, if a new policy is consistent with, or builds upon current policy, then costs may be lower. Additional characteristics of those involved in transactions can be influential, such as trust, general agreement with policy principles and social connectedness.

Having identified the influences, the study reached three main conclusions. Firstly, the causes of transaction costs vary between public and private parties. For example, often the public party or policy administrator bears most of the transaction costs in creating the policy instrument and private parties bear the costs later when they use the instrument.

Secondly, transaction costs vary over time and can be heavily influenced by activities conducted in the initial stages of policy development. For example, costs incurred during policy development may reduce the costs incurred in implementation and ongoing policy use. Therefore transaction costs need to be analysed throughout a policy’s lifetime rather than just at a specific stage. Finally, the cost depends on the policy instrument itself, i.e. whether it is market-based or regulatory. For example, when creating a market-based policy, uncertainty will increase the transaction costs of deciding what should be purchased and ranking these purchases. In regulation, the costs of developing and establishing the policy may be lower, but greater costs may be incurred due to activities such as monitoring and enforcement. In order to inform decision making, greater understanding is needed about the different factors that influence transaction costs across the whole suite of policy instruments.


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Theme(s): Environmental economics